

**AN INVESTIGATION OF THE DETERMINANTS OF MUTUAL FUNDS
FINANCIAL PERFORMANCE**

BY

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE
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DECLARATION

I declare that this is my own original work and to the best of my knowledge it has not been submitted for a degree award in any other University or institution of higher learning.

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Date.....

This research project has been submitted for moderation with my approval as University Supervisor

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DEDICATION

I would like to dedicate my research project to my family for their love and support during this study.

ACKNOWLEDGEMENT

I would like to extend my appreciation and gratitude to all who contributed their tremendous inputs towards completion of this research project . First and foremost, I am grateful to my University of Nairobi Supervisor Mr. Nganga for his tireless assistance, invaluable support, high quality and detailed work, experience and initiatives which guided me in enriching and completing my research project. Finally, thanks to the almighty God for giving me sufficient grace, without him I would have not made it this far.

ABSTRACT

Mutual funds provide an opportunity for investing to the many individuals who lack financial knowledge. This eliminates the amount of time and resources required to identify a 'best buy' share or security. To invest in a Mutual fund, investors buy units through the fund manager at the prevailing selling price which is calculated daily. These units can be bought any time as long as the fund has not reached its maximum approved size. Mutual funds face competition from various alternatives, when fund performance is generally not impressive. Studies done on mutual fund performance have reported that most funds did not match performance of comparable market indexes. This study sought to find out how Mutual Fund performance is affected by various determinants. This helped investors to make informed decisions on their investment on Mutual Funds. The descriptive research assets to enhance a systematic description that is as reliable, valid and accurate as possible regarding the responses on the investment options available to unit trust schemes and the aspects that are considered in selecting portfolio combination. The study was also cover banking institutions with mutual funds. The study covered the period 1st January 2008 to 30th December 2012 this study sought to evaluate annual report data. The study solely used secondary data sources available at the companies' books of account and the NSE or Capital Market Authority offices. The study used multiple linear regression equation and the method of estimation will be Ordinary Least Squares (OLS) so as to establish the relationship between determinants and performance. The study revealed that the determinats of the performance of mutual funds financial performance in Kenya were risk , transaction cost , size and country characteristic. The study found that risk in the management of mutual funds cannot be ignored in any investment venture. The risk of a security is the variability in its expected future returns. High risk securities have high dispersion around the mean while low risk securities will have a low dispersion around the mean. Risk as measured as the variability of returns has received widespread acknowledgement in decision theory. Thus, risk viewed as the variability of returns is quantified in terms of variability measures which include range, mean absolute deviation, variance, standard deviation, and coefficients of variation.

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LIST OF ABBREVIATION

CBS	Central Bureau of Statistics
CIS	Collective Investment Schemes
CMA	Capital Markets Authority
MPT	Modern Portfolio Theory
USD	United States Dollar

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Mutual funds refers to an investment vehicle run by asset management companies that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. They are normally referred to as funds. They are operated by fund managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus. Mutual funds play an essential role for channelizing and optimal allocation of idle resources/savings available in the economy of the individual as well as institutional investors, (Awan & Arshad, 2012).

The primary goal of a mutual fund is to pool small savings, use the idle resources in corporations and invest in a well-diversified portfolio of securities, which would allow the investor to significantly reduce, or even eliminate the asset specific (non-market) risk of securities. The presence of these mutual funds becomes even more essential when the investors/savers do not have much investment knowledge, information and investment climate and facilities as well as have low risk tolerance level which is a very dominant characteristic of capital market (Nazir & Nawaz, 2010).

The Kenya Association of Stock Brokers and Investment Bankers (KASIB, 2011) defines mutual funds as diverse stock holdings which are managed on behalf of the investors who buy into the fund. Mutual funds allow investors to take advantage of a diversified portfolio without the need of investing a large sum of money. A diversified portfolio

carries the advantage of offering protection against the rapid market losses of any particular stock. If stocks lose their value, the effect will be less if they belong to a portfolio that is spread across twenty stocks than if they belong to a portfolio that consists of a single stock. Diversification is always a good idea in making investments. The problem for small investors is that usually don't have enough funds to buy a variety of stocks. Despite their limited funds, small investors benefit from diversification through mutual funds, (Barber, Odean & Zheng, 2000).

Mutual funds, aside from stocks, can be consisted of a variety of holdings that include bonds and money market instruments. However, mutual funds also carry some downsides. Aside from paying some fees no matter what the performance of the funds is, individual investors also have little say in which securities have to be included in the funds or not. In addition to this, the actual value of a mutual fund share is not as precise as that of the stocks on the stock market. Those with limited funds or investment experiences may consider investing on mutual funds. When choosing the right fund, investors have to consider how much risk they are willing to take against their expected investment returns, (Fink, 2011).

Most mutual funds firms operate five common types of funds: Money Market fund, Equity Fund, Bond Fund, Balanced Fund and Index Fund. Additional fund types are managed, dependent on the research and development departments of these firms and the spread of their clientele. These funds are named from the different securities that are invested in, for example, an Equity Fund refers to a fund where the investment is made in the shares of listed companies on the securities exchange of a country. Consequently, funds may also be classified by sectorial or geographic specialization, by investment

objective, by active or passive management, and by class of investor (institutional or retail, with or without front loads etc.), (Fernando, Klapper, Sulla, & Vittas, 2003).

The first mutual funds were established in Europe. One researcher credits a Dutch merchant with creating the first mutual fund in 1774. The first mutual fund outside the Netherlands was the Foreign & Colonial Government Trust, which was established in London in 1868. It is now the Foreign & Colonial Investment Trust and trades on the London Stock Exchange. The first open-end mutual fund was created in Boston in 1924 (Fernando, Klapper, Sulla, & Vittas, 2003). Over the decades, mutual funds have witnessed growth in the volume of investments, number of firms and types of funds.

In their paper (Fernando, Klapper, Sulla, & Vittas, 2003), note that the most interesting phenomenon of the 1990s was the explosive growth of mutual funds. In the United States the total net assets of mutual funds grew from USD 1.6 trillion in 1992 to 5.5 trillion in 1998. In the 15 member states of the European Union, the total net assets of mutual funds grew from USD 1 trillion in 1992 to 2.6 trillion in 1998. They also note that the growth of the mutual funds also witnessed a surge in the increase of household ownership of mutual funds. Around the world focus has been directed towards the performance of the US mutual funds due to their expanse and inclusiveness.

Mutual funds provide an opportunity for investing to the many individuals who lack financial knowledge. This eliminates the amount of time and resources required to identify a 'best buy' share or security. In their research, (Kaminsky, Lyons, & Schmukler, 2001) identified four factors that led to the growth of mutual funds. They noted that the level of Equity investment in emerging markets had grown rapidly in the 1990s, much of it flowing through mutual funds. The growth of mutual funds was fuelled by the

increasing globalisation of finance and expanding presence of large multinational financial groups in large countries and the strong performance of equity and bond markets. In addition, the search for safe financial instruments that are liquid and come with the promise of high long-term returns wooed a growing number of investors. Another factor identified as having contributed to the growth of the mutual funds was the demographic aging that is characteristic of populations in most high and middle-income countries. The growth of mutual funds around the world has experienced a burst with over 10,000 for example, being in the US. This growth has mainly been witnessed in the United States, Europe and Far East Asia. However, the same has not been translated into the African Economy, and especially the East African region.

1.1.1 Mutual Fund Financial Performance

Across the world, the mutual funds industry has become a vast industry. From a small industry, offering a relatively small number of funds, mostly diversified equity and balanced funds, it has changed into a multi-trillion-dollar industry offering thousands of funds with diverse investment policies and strategies.

A Mutual Fund is an investment scheme that pools money together from many investors who share the same financial objective to be managed by a group of professional managers who invest the pooled money in a portfolio of securities such as shares, bonds and money market instruments or other authorized securities to achieve the objectives of the fund. In exchange of the money received from the investors, the fund issues units to investors who are known as unit holders. The fund earns income from the investment in the form of dividends, interest income and capital gains. The underlying value of the assets of a Unit trusts is always directly represented by the total number of units issued

multiplied by the unit price less the transaction or management fee charged and any other associated costs.(CMA 2011).

The difference between mutual funds and unit trusts lies in their structure the end result for the investor is much the same. A Mutual is overseen by a trust company, while in a mutual fund it is the responsibility of the directors of the mutual fund company to ensure that the fund manager and the custodian perform their duties in accordance with the constituent documents (Oldert 2005).

According to Swinkels & Tjong-A-Tjoe, (2007) they define a Mutual scheme as an arrangement made for the purpose, or having the effect, of providing, for persons having funds available for investment. Facilities for the participation by them as beneficiaries under a trust, in profits or income arising from the acquisition, holding, management or disposal means, in relation to a Mutual scheme, a right or interest (whether described as a unit, as a sub-unit, or otherwise) or a beneficiary under the trust instrument.

To invest in a Mutual fund, investors buy units through the fund manager at the prevailing selling price which is calculated daily. These units can be bought any time as long as the fund has not reached its maximum approved size. Unit holders can also sell their units back to the fund manager at the prevailing buying price. The funds are collectively invested in a portfolio of assets, such as shares, bonds, money market instruments and other authorized securities, in line with the common objective and needs of the group of investors. The income derived by the fund by way of dividends, interests and capital gains are divided among the unit holders in proportion to their investments(Rono, 2011)

1.1.2 Determinant of Mutual Fund Financial Performance

In one of the CMA investors guide line publications, investors who wish to invest in a mutual fund are advised to buy units through the fund manager at the prevailing selling price which is calculated daily. These units are bought any time as long as the fund has not reached its maximum approved size. Unit holders can also sell their units back to the fund manager at the prevailing buying price. It is because of this repurchase feature that units are called open-ended funds. The fund manager not only issues new units to incoming investors, they are also required to repurchase or redeem units from outgoing investors. The value of the fund or the price to be paid by unit holders or the amount to be received when the units are sold is based on the net asset value of the fund plus charges (if any). Funds where a substantial portion is invested in stocks and shares, the performance of the fund would be affected by the performance of the stock market. Hence, a unit holders selling price could either be higher or lower relative to the stock market's performance when units were bought.(CMA 2011)

1.1.3 Relationship between Determinants and Mutual Fund Financial performance

According to CMA investors guide publications, unit holders have the potential to earn money either by capital growth or dividend income. Each unit in the fund represents a slice or share of the fund's underlying portfolio of securities. Therefore if the value of the portfolio goes up, so does the value of each unit. This is called capital growth, or capital appreciation. If one sells the units at a higher price than they bought, a profit would be gained. The converse will mean a loss is incurred if the units are sold for less than price they were bought.

Income received by the fund from its investments may be passed on to unit holders as dividends. However, dividends are not guaranteed if the fund makes little or no income, it may not pay any dividend. Moreover, a fund that concentrates on achieving capital growth may have a policy of paying very little or no dividend at all. In such cases you may have to sell your units if you need to redeem some cash. It is therefore important to read the prospectus to find out the type of fund being offered and whether it matches your financial performance objectives.

1.1.4 Mutual Funds in Kenya

In Kenya, the establishment and licensing of mutual funds firms is done by the Capital Markets Authority (CMA). These firms are registered as collective investment schemes (CIS) each mandated to operate a fund(s) based on the licence granted. Elsewhere around the world, mutual funds are the investment choice of most households. Kenya represents over 50% of the economic power of the East African countries, with the most active securities exchange, Nairobi Securities Exchange. Even with the growth in the number of investment firms and mutual funds, the uptake of these investment opportunities has been wanting. The volume of funds channelled to funds in comparison to other securities, questions the knowledge of the operations of funds, investor confidence and knowledge of the different investment vehicles available.

The listed collective schemes are managed by firms, which have also been enlisted as Stock Brokers, Investment Banks and Custodians. This indicates that such funds are professionally managed and the returns derived should mimic the market trends. As recent as 2011, the CMA approved the First Ethical Opportunities Fund to First Community Bank (FCB). The former Chief Executive Officer, Stella Kilonzo, noted

“This new fund, which is a unit trust scheme, will help Kenya attract foreign portfolio investors as Socially Responsible Investing (SRI) is a growing business in both the USA and Europe. One out of every nine dollars under professional management in USA was involved in SRI in 2007. It is expected that the SRI market in USA will reach US\$3 trillion this year up from US\$2.7trillion in 2007. The European SRI market grew from €1 trillion in 2005 to €1.6 billion in 2007” (CMA grants consent for the registration of First Ethical Opportunities Fund , 2011).

Major ethical funds globally include; Norwich Union Ethical Fund, Old Mutual Ethical Fund, Aberdeen Ethical World Fund, and Aviva UK Ethical Fund. In the press release the CMA observed that socially responsible investors favour corporate practices that promote environmental stewardship, consumer protection, human rights, and diversity. In developed SRI markets a screening criteria has been put in place with clearly set out benchmarks for qualifying such funds.

1.2 Research Problem

Mutual funds face competition from various alternatives, when fund performance is generally not impressive. Studies done on mutual fund performance have reported that most funds did not match performance of comparable market indexes. According to these studies, slightly more than 50 percent of mutual funds outperformed their targeted markets before considering transaction costs. After considering such costs, more than 60 percent of funds did not match their market performance, with the remainder performing inconsistently. Transaction costs are therefore considered fund performance determinants. Unimpressive mutual funds are therefore facing competition from newer alternatives, including exchange-traded funds (ETFs), folios and separately managed accounts. These

alternatives offer certain advantages over mutual funds. For example, ETFs combine features of index funds with low expenses for trading stocks; folios let investors customize diversified stock portfolios; while separately managed accounts give investors access to professional managers who choose stocks for multiple accounts to achieve diversification.

Before a potential investor decides to take the plunge, he or she must therefore be aware of the risks and costs that Mutual funds' investments entail. As with any other type of investment, investing in mutual funds also carries its own risks, including interest rate risk and management risk. To this one must add loss of control, as one does not have the right to direct how one's savings in the mutual fund are invested, as long as the fund manager is managing the funds in accordance with the prospectus and deed. What is more, there is a price tag for the services provided by the fund manager, which means that the fees and charges payable to the fund management company do affect the shareholder's returns.

Ochieng (2005) observed that Old Mutual Asset Management Kenya was established in 1997 and started operations in April 1998. As at April 2005, the total assets under management were over Kshs 49 billion and of this, the Equity fund that started operations on 1st April 2003 had an approximate net asset value of Kshs 2.0 billion. Wagacha (2001) outlined that with the passage of the Capital Markets Authority Amendment Act (2000), which recognizes specific investment vehicles and especially mutual funds and unit trusts, then more opportunities for diversification by both institutional and retail investors would emerge in Kenya. Kamanda(2001),evaluated the equity portfolios held by Kenyan insurance companies over the period January 1998 to December 1999 and observed that majority of the insurance companies' maintained poorly diversified portfolios and the

market portfolio outperformed the insurance industry portfolio. Kamanda also observed that the market rate of return for the Nairobi Stock Exchange was less than the risk free rate during the study period. These findings raise concerns of how efficient it is to invest in the mutual funds since under normal circumstances risk-averse investors would prefer to invest in the money market at the risk free rate. This therefore seeks to answer the question; How do the Determinants of Mutual Fund performance impact on investors returns? To what extent do these determinants affect Mutual Fund performance?

Many Mutual Fund investors have little or no knowledge at all on what affects their returns. This study, therefore, seeks to find out how Mutual Fund performance is affected by various determinants. This will help investors to make informed decisions on their investment on Mutual Funds. The basic problem for this study is therefore an attempt to enquire on how the determinants affect Mutual fund financial performance. This study seeks to investigate the determinants of mutual funds financial performance in Kenya.

1.3 Objective of the study

The study sought to investigate the determinants of mutual funds financial performance in Kenya.

1.4 Value of the Study

Fund managers make investment decisions for the investors. They seek to increase the penetration ratio in the market. Fund performance is therefore affected by the decisions made by these managers. This study will therefore, be of help to them execute their role effectively.

Since mutual fund investing has become a much more popular choice for investors, it

would certainly be of interest for investors to know how fund performance relates to fund's fundamental characteristics such as fund investment objectives, fund size, age, expense ratio, portfolio turnover ratio, initial service charge (load fee), fund riskiness and private/government fund status. The study will, therefore assist individual investors in their mutual fund choices based on their individual risk tolerances.

Regulatory authorities play a crucial role in ensuring that there is fair play in the market by all relevant market players in the industry. This study will therefore assist the regulatory authorities in assessing the suitability of the current investment regulations for mutual funds.

What drives an industry forward or backward is highly dependent on the policies governing the industry .Good policies are formulated with a better understanding of how mutual funds operate. This study will enlighten Policy makers who are seeking a better understanding of the industry in order to formulate appropriate legislation.

Research and Development play a key role in any given economy .This study will be a source of reference material for future researchers and academicians who would study on related topics hence it formulates a basis for further research.

Financial analysts carry out a research on market performance and on issues affecting the financial market players. Findings from the study will help them give sound information that will enable them to give informed decisions and offer appropriate advice to investors to make sound investment decisions.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The choice made by individuals in selecting an item out of a basket of available options is primarily driven by the desires, preferences and tastes of the individual. The decision making process involved is rather difficult than the face value that meets eye. This explains the reason for different choices by different people within the same status. The general assumption is that the choice made is the one that the decision maker feels to best satisfy their needs given the existing operating environment.

2.2 Theoretical Review

The field of analytical finance and economics has tried to develop models that try to inculcate the “human element” in financial decision making.

2.2.1 Financial Decision Making Theories

Kahneman and Tversky developed the “Prospect Theory”. The advent of the “Prospect Theory” heralded the introduction of psychology into the world of economic analysis moving away from the old age theory of the “rational investor”. This model tried to understand the attitudes of people towards risk concerning gains and the risk concerning losses. This paper identified the variation from the expected decisions as a result of how individuals weight the gains and losses to be realised. Instead of referring to the traditional economic utility, they replaced utility with value. Their research found that individuals perceive outcomes as gains or losses rather than final states of wealth or

welfare. Every outcome of a decision is measured on the perceived gain rather than the perceived loss from the choice. Thus, if a person were given two equal choices, one expressed in terms of possible gains and the other in possible losses, people would choose the former, even when they achieve the same economic end result. This theory has become the foundation of modern behavioural studies in finance.

Later works have been developed building on the “Prospect Theory”. In order to understand the uptake of mutual funds in Kenya, a lot of literature on portfolio selection under risk and uncertainty and the impact of human influences on decision making has been identified. Most decisions made by individuals are biased towards earlier predisposition about information they have acquired, either through academics, grape vine or pure hearsay. This directs an individual to making a decision that may or may not be founded on “truths” resulting in either “good” or “bad” decisions and subsequently outcomes that are favourable or unfavourable. Such information creates a reference point to the decision maker that may be founded or not. This may be a logical or illogical reference point. This has been referred to as “Anchoring”.

This is characteristic of investors where general market information is ignored and information is selectively applied to reinforce the pre-existing convictions that an investor has regarding a given investment option. The decisions opted for are centred on the anchor point and are only adjustments to the anchor. This interferes with the decision making process and is usually dependent on the mood, experience, personality and cognitive ability of the decision maker. In finance, this has commonly been witnessed in the dependence of investors making decisions based on past performance or prior information that may be irrelevant at the point of decision making. The focusing effect (focusing illusion) is the end result of the anchoring effect where too much bias is placed

on one point statistic, event or information causing an error in the prediction of the utility of an expected future outcome. For example, the notion that investing in stocks and mutual funds is a preserve of the rich would deter an investor with excess disposable to invest in the Securities Exchange to avoid being labelled as “rich”.

Other research into the study of the decision making process in relation to investors and finance includes: the gambler’s fallacy, herd behaviour, confirmation and hindsight bias, overreaction and availability bias, overconfidence and the theory of regret. Recent studies now indicate that investors weigh the amount of regret to be undergone by selecting one choice of investment over another (Landman, 1987). The neo-classical theories appreciate the value that is placed on the regret of the alternatives not taken by the investor. This would otherwise be quantified as the opportunity cost if the investment was taken. Regret has been referred to as either a cognitive phenomenon, emotional phenomenon or both. The choice of investment on whether to invest in a mutual fund scheme by any Kenyan would be dependent on the amount of regret that the individual expects to undergo by not selecting any other option, this be either, not investing in the bond market, equity market directly through the stock exchange or investing the funds in a fixed deposit with a bank. Each of these anomalies noted in human behaviour has ramifications in the desired outcome and the investment selection process. Individuals have varying preferences towards the desired investment options available through the stock exchange. However, the common ground is that every instrument or investment vehicle chosen should maximise the wealth of the investor and give net positive returns or flows to the investor.

This forms the basis of the study into the uptake and choice of Kenyans with relation to mutual funds. Mutual Funds have attracted a lot of attention and kindled the interest of both academic and practitioner communities. Compared to the developed markets, very

few studies on Mutual Funds have been done in Kenya. This literature review tries to identify the different aspects of mutual fund selection and the patterns and behaviours of investors that influence fund selection. The individual drive of every human being is to better their lives through improved income streams. This has been the classical explanation of selection of investment options by individuals. This research has been directed towards understanding the level of investment by individuals in mutual funds.

Generally, there is a lack of adequate literature review about the mutual funds in Kenya. The general tendency towards investment is to maximise the returns that flow to the investor. The choice of investment option is also dependent on the risk perception of the investor and how much of losses they are willing to incur or gains they are willing to enjoy. The rational investor has been found to ignore the classical decision making pattern. The probability of an investor selling a performing stock and holding onto a losing one is higher (Barber, Odean, & Zheng, 2000). The choice of investment is further compounded by the behaviour of other investors and an investor will mostly want to be in a “herd”. The recent studies on behavioural finance have attempted to explain the fallacies that follow individual investment. Individuals tend to flock in on a past performing stock or securities in anticipation of future good performance from the same stock. The selection of any mutual fund is a move away from traditional investing in stocks and having to presume an understanding of the market.

2.2.2 Modern Portfolio Theory (MPT)

Observations made according to MadAwan & Arshad, (2012) Modern portfolio theory is based upon two dimensions, at one end there is mutual funds manger that specialize in constructing a portfolio while at the other end there is investor who choose a portfolio

based upon their risk tolerance and risk-free asset. According to developments done by Harry Markowitz, (1952) MPT states that it is not enough to look at the expected risk and return of one particular stock. By investing in more than one stock, an investor can reap the benefits of diversification - chief among them, a reduction in the riskiness of the portfolio. MPT quantifies the benefits of diversification. The risk in a portfolio of diverse individual stocks will be less than the risk inherent in holding any one of the individual stocks (provided the risks of the various stocks are not directly related). Consider a portfolio that holds two risky stocks: one that pays off when it rains and another that pays off when it doesn't rain. A portfolio that contains both assets will always pay off, regardless of whether it rains or shines. Adding one risky asset to another can reduce the overall risk of an all-weather portfolio. In other words, Markowitz showed that investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg.

2.2.3 Arbitrage Pricing Theory

According to an argument by Breeden, (1979) Arbitrageurs use the APT model to profit by taking advantage of mispriced securities. APT uses the risky asset's expected return and the risk premium of a number of macro-economic factors. A mispriced security will have a price that differs from the theoretical price predicted by the model. By going short an overpriced security, while concurrently going long the portfolio the APT calculations were based on, the arbitrageur is in a position to make a theoretically risk-free profit. A statement by Eichner & Kregel, (1975) said that investment places emphasis on the importance of interest rates in investment decisions. Changes in interest rates should have an effect on the level of planned investment undertaken by private sector businesses in the economy.

2.3 Empirical Literature Review

The research on mutual funds has elicited studies both at academic levels and at national and global policy making levels. These studies vary in the depth of research and topic of interest. Interestingly, the findings from the different research revolve around the performance of the mutual fund units, fees charged and types. However, there are limited studies into the selection process of mutual funds by investors. This has been primarily due to the assumption that investors are aware of the existence of the funds and the investment strategy for each. However, the increasing financial performance and deepening of the different national securities exchange within Africa requires commensurate understanding of the specialised financial products offered by investment banks, stock brokerage firms, listed firms etc.

In her paper (Ranganathan), identified that the primary elements that affected the selection of a mutual fund. She identified that the savings objectives of an individual investor, savings instrument preference for an investor, attitude towards the financial instruments in the stock exchanges, preference of mutual investment in future, source of information about mutual fund, the preference of investing in equity rather than mutual funds and the choice and mode of communication opted for by the mutual funds determined the mutual fund selected. The research identified that the awareness of investors to mutual funds also drove the desire to invest in mutual funds. Thus was highly related to the route adopted by most investors towards understanding the operations and investing in mutual funds. In her research, she notes that 31% of the respondents did not want to be at the mercy of the broker-friend-advisor network. Other elements identified, (Crpatna, 2011), based on the expected the investment needs of an investor include:

Security of Original Capital, Wealth Accumulation, Comfort Factor, Tax Efficiency, Life Cover, Income, Simplicity, Ease of Withdrawal, Communication.

The key elements expected to be the drivers for the selection of mutual funds are expected to include: price of mutual funds units, income, and security of original capital. The desired and most commonly used of research analysis method has been conjoint analysis. This analysis method is desired due to its applicability by allowing respondents to rank individual attributes. This has been a desired tool in the analysis of financial services (Gözbapý & Çýtak, 2010). Other attributes identified include funds past performance, fund's manager experience, investment style of fund manager, fund size. Fund founder, number of funds managed by the fund founder and the expense ratio of the fund. The combined multiple elements identified from different researches have different weights. The proposed research into the Kenyan scenario should establish which attributes carry the most weight into the uptake of mutual funds.

The other factor identified is the educational level of the individual (Rao, 2011). In the paper, the respondents answered against six statistics: gender, age, marital status, education level, occupation and income level. This clearly indicates that the decision to invest in a given mutual fund is affected by both demographic and situational factors. Lewellen, Lease and Schlarbaum (cited in (Awan & Arshad, 2012)) conducted the research on demographic basis i.e. age, gender ,income and education affects investor preferences for overall return, capital gain and dividend yield. Other research conducted confirmed that the size of fund, the effectiveness of marketing programme and past return of funds have great impact in pushing individuals to prefer one fund over another ((cited in (Awan & Arshad, 2012). This research noted that marketing had the greatest impact in the choice of a mutual fund by the investor.

The choice of a mutual fund was found to be the principal decision of the investor and was greatly influenced by information available through marketing (Rajeswari & Moorthy, 2000). Investors first seek security to their investment, followed by good returns, tax benefits, liquidity and finally capital appreciation.

2.4 Determinants of Mutual Funds' Performance

2.4.1 Risk

Risk considerations are at the very heart of most investment decisions. For both individuals and companies the incorporation of risk variables in the decision process is of utmost importance, Gitari (1990). Different perspectives on risk give rise to different schools of thought. The variability school, March and Shapira (1987) perceive risk as the variation in the distribution of possible outcomes, their likelihoods and their subjective values. This perception of risk also compares well with Robichek (1969) perception of risk being the possibility that the actual returns from an investment may differ from the expected returns. That is, the risk of a security is the variability in its expected future returns. High risk securities have high dispersion around the mean while low risk securities will have a low dispersion around the mean. Risk as measured as the variability of returns has received widespread acknowledgement in decision theory. Thus, risk viewed as the variability of returns is quantified in terms of variability measures which include range, mean absolute deviation, variance, standard deviation, and coefficients of variation (Spiegel, 1988).

The volatility school of thought perceives risk in terms of the volatility of returns in relation to the market returns. Thus a stock whose returns are highly correlated with the market returns is said to have low volatility, whereas a stock whose returns have little

correlation with the market returns is said to be highly volatile. A measure of risk based on the volatility concept quantifies only that portion of the total variation which is associated with the market variation (systematic risk) and ignores any unsystematic variation (Bower and Wipperfurth, 1969).

2.4.2 Transaction Costs

Many studies have attempted to determine whether equity mutual funds are able to consistently earn positive risk-adjusted returns. Although these studies have documented significant differences in risk-adjusted returns across funds, it became apparent early on (Sharpe 1966) that those differences are to a large extent attributable to differences in fund fees. Most research on mutual funds has thus been aimed at determining whether the cross-sectional variation in performance that is not explained by fees can be explained by the existence of managers with superior stock-picking skills (Chevalier and Ellison (1999)). However, little attention has been paid to the relation between before-fee performance and fees. Mutual fund fees pay for the services provided to investors by the fund. Since the main service provided by a mutual fund is portfolio management, fees should reflect funds' risk-adjusted performance. It follows that there should be a positive relation between before-fee risk-adjusted expected returns and fees.

We then set out to explain this anomalous relation by investigating the role of performance in the determination of fund fees. Christoffersen and Musto (2002) propose that mutual funds' fees are set taking into account the elasticity of the demand for their shares, so that funds facing less elastic demand charge higher fees. These authors argue that funds with worse past performance face less elastic demand, since performance-sensitive investors leave funds following bad performance. If performance is persistent for at least the worse-performing funds (as indicated by Carhart (1997)), Christoffersen

and Musto's hypothesis could explain our finding of a negative relation between fees and before-fee performance. Gil-Bazo and Ruiz-Verdu (2008) provide a related explanation.

2.4.3 Size of the fund

As more and more investors are attracted to a specific mutual fund, the manager is presented with a significantly large amount of cash. The risk that arises in this situation is that to put the cash to work as soon as possible, some managers may purchase additional instruments that are not optimal for the fund's investors. (Financial Post November, 2009).

A small fund can easily put all of its money in its best ideas, a lack of liquidity forces a large fund to have to invest in its not-so-good ideas and take larger positions per stock than is optimal, thereby eroding performance. Grinblatt and Sheridan Titman (1989) find mixed evidence that fund returns decline with fund size. Needless to say, there is no consensus on this issue.

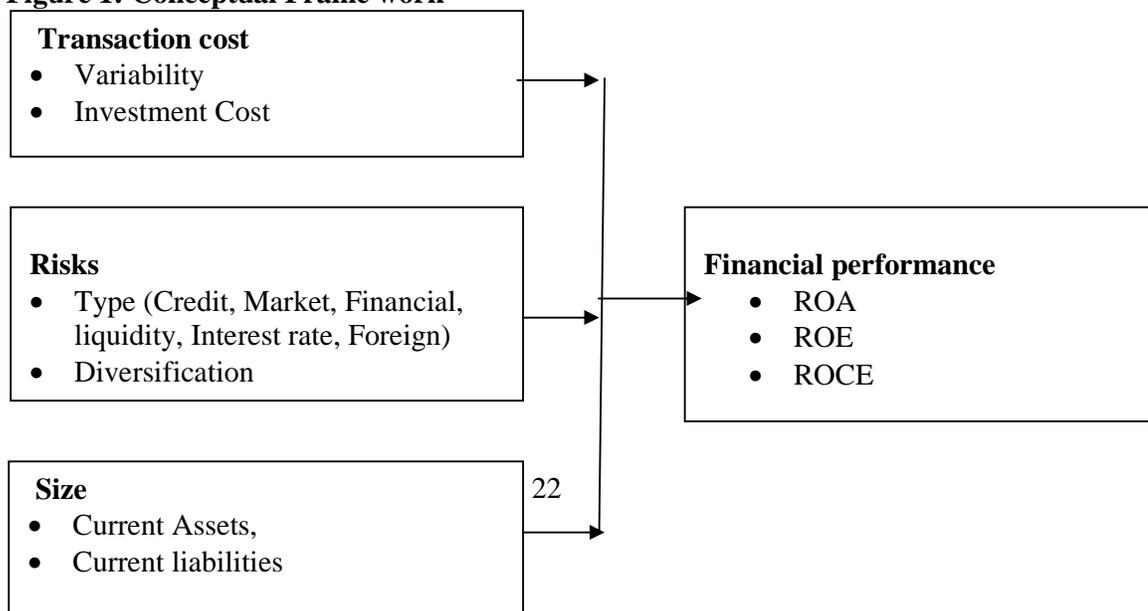
2.4.4 Country Characteristics

According to Christoffersen and Musto (2002) Country characteristics can explain mutual fund performance beyond fund attributes. There is a positive relation between mutual fund performance and the country's level of financial development, in particular in countries with high trading activity and low transaction costs. The level of economic development is of particular importance for domestic funds. Familiarity arguments explain the performance of foreign funds as they obtain better performance when investing in countries that are geographically close and countries that share a common language.

2.5 Summary

Studies around the world have identified different sets of parameters that influence the choice of decision that an individual makes. Most of the studies depended upon relate to the Indian economy and the US. The works cited herein give a background into the study of the Kenya mutual fund market. Although, Kenya is yet to equal the sophistication in other markets, the income spread and age of population have been considered to be near similar, and any differences accounted for through the rapid economic growth that has spurred the growth of the securities exchange (NSE). The effects of each of the identified elements that individually and collectively drive the levels of investments in mutual funds through influencing investors to opt for mutual funds rather than other investment channels are wide and cannot be constricted to the identified five elements rather a deeper understating should be desired to conclusively determine the levels of correlation between each element, the specific drivers of the element and the final outcome on the investment level in a mutual funds by a single or block of investors. The key elements to be investigated in this research are: risk, transaction cost and fund size and the country characteristic.

Figure 1: Conceptual Frame work



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the procedure used to conduct the empirical research. This included how the data was collected, the determination of the sample to be used and how the information was analysed, interpreted and presented.

3.2 Research Design

Research design is the ultimate blue print for the collection, measurement and analysis of data Kothari, Ramanna, & Skinner, (2010). The study will use descriptive research design. This method is described by Cooper & Schindler, (2006) to be a detailed description of events, situations and interactions between people and things. The descriptive research assets to enhance a systematic description that is as reliable, valid and accurate as possible regarding the responses on the investment options available to unit trust schemes and the aspects that are considered in selecting portfolio combination.

Secondary historical unbiased data available to the public was retrieved from the financial statements of the unit trusts funds while primary data was collected through administering of questionnaires to the unit trust fund managers. The conclusion drawn was taken to be true for all the observations hence a generalization specific to the unit trust funds in Kenya.

3.3 Target Population

The study will entailed a census of all the mutual funds operating in Kenya with equity

portfolios licensed by the Capital Markets Authority. These are the Balanced Fund under African Alliance Kenya and the Equity Fund under Old Mutual Asset Management (OMAM) Kenya. The study was also cover banking institutions with mutual funds. The study covered the period 1st January 2008 to 30th December 2012 this study will seek to evaluate annual report data.

3.4 Data Collection

The study solely used secondary data sources available at the companies' books of account and the NSE or Capital Market Authority offices. The Secondary data sources will be chosen owing to the fact that they are cheaper and more quickly available than primary data and help clarify and answer research question. Secondary data was collected from the companies' annual reports as every company is required to report the extent to which they complied with the performance principles in their annual reports. Data on performance was collected on Return on Asset while data on determinants was collected on risk, transaction costs, fund size and country characteristics.

3.5 Data Analysis

The study used multiple linear regression equation and the method of estimation will be Ordinary Least Squares (OLS) so as to establish the relationship between determinants and performance. The study used a regression to estimate the model with ROA as the dependent variable and the determinants as the independent variables as used by Nishat and Mir (2004). The economic model used in the study is given as:

$$\text{PERF} = \beta_0 + \beta_1 \text{RISK} + \beta_2 \text{TCOSTS} + \beta_3 \text{FSIZE} + \text{CC}\epsilon_{it}$$

Where:

β_0 is constant

$\beta_1, 2, 3, 4$ is the coefficient of the explanatory variable (the determinant attributes),

ϵ_{it} is the error term

PERF is the Fund Financial Performance

RISK is the Operational Risk

TCOSTS is the Transaction Costs

FSIZE is size of the fund Fund Size

CC Is the country characteristic

ϵ_{it} Error term

Where

PERF is mutual fund financial performance, this was measured through profitability of mutual funds, ROA Return on Assets was used to measured mutual fund investment, and return on assets is the ratio of earning divided by total asset

$$ROA = \frac{\text{net profit}}{\text{total assest}}$$

Risk is the operational risk Of Mutual Fund; this was measured using the liquidity of the firm, Liquidity of the firm will be measured using the liquidity of current assets over current liabilities

$$Risk = \frac{\text{Current assets}}{\text{current liabilities}}$$

TCOSTS is the transaction cost involved in mutual fund investment which will be measured by the transaction cost involved in mutual fund investment, this is the cost

involved in the transaction pertaining to mutual fund, natural log of transaction will be used.

FSIZE is the size of mutual fund investment which will be measured by the natural log of total assets of the company.

Country characteristics will be measured using the country inflation value

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents the data findings to investigate the determinants of mutual funds financial performance in Kenya. These data was collected from the Nairobi Security Exchange, and Capital Market Authority offices. Multiple linear regressions were established through Ordinary Least Squares (OLS) so as to establish the relationship between mutual fund size and performance. The study covered a period of 5 years from years 2008 to 2012.

4.2 Regression Analysis

4.2.1 Regression Analysis for 2008

Table 4.1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.908(a)	.824	.801	.2372

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the above table the value of adjusted R squared was 0.801 an indication that there was variation of 80.1% on mutual fund financial performance due to changes in risks, transactions cost, size and country characteristic at 95% confidence interval . This shows that 80.1 % changes in mutual fund performance could be accounted for by changes in operation risks, transactions cost and fund size. R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table

above there was a strong positive relationship between the study variables as shown by 0.908.

Table 4.2: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	Constant	.533	.471		1.146	.887
	Risk	-.452	.951	-.207	-.668	.519
	Transaction Costs	.143	.190	.007	.121	.983
	Size	.803	.230	.671	1.783	.080
	Country Characteristic	-.114	.398	-.222	-1.871	.067

The established regression equation was

$$Y = 0.533 - 0.452X_1 - 0.143 X_2 + 0.803 X_3 - 0.114X_4$$

From the above regression equation it was revealed that holding risks, country characteristic, transactions cost and fund size to a constant zero, mutual fund performance would stand at would stand at 0.533, a unit increase in operation risk would lead to decrease in mutual fund financial performance by a factors of 0.452, a unit increase in transaction cost would lead to decrease in mutual fund financial performance by factors of 0.143 and a unit increase in fund size would lead to increase in fund performance by a factor of 0.803, a unit increase in country characteristic would lead to decrease in mutual fund financial performance by a factors of 0.114 study further revealed that risks, transactions cost and size were statistically significant to affect fund performance, as all the p value (sig) were less than 0.05%.

4.2.2 Regression Analysis for 2009

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.859 ^a	.738	.726	.07833

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the above table the value of adjusted R squared was 0.726 an indication that there was variation of 72.6% on mutual fund financial performance due to changes in risks, transactions cost, size and country characteristic at 95% confidence interval . This shows that 72.6 % changes in mutual fund performance could be accounted for by changes in operation risks, transactions cost and fund size. R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table above there was a strong positive relationship between the study variables as shown by 0.859.

Table 4.4: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.654	.155		2.939	.010
	Risk	-.560	.148	-.554	-3.794	.001
	Transaction Costs	-.295	.140	-.308	-2.109	.042
	Size	.011	.133	.013	.085	.033
	Country Characteristic	-.213	.208	-.182	-1.018	.013

The established regression equation was

$$Y = 0.654 - 0.560 X_1 - 0.295 X_2 + 0.011 X_3 - 0.213 X_4$$

From the above regression equation it was revealed that holding risks, transactions cost, country characteristic and fund size to a constant zero, mutual fund performance would stand at would stand at 0.654 , a unit increase in operation risk would lead to decrease in mutual fund financial performance by a factors of 0.560, a unit increase in transaction cost would lead to decrease in mutual fund financial performance by factors of 0.295 and

a unit increase in fund size would lead to increase in fund performance by a factor of 0.011, a unit increase in country characteristic would lead to decrease in mutual fund financial performance by a factors of 0.213 study further revealed that risks, transactions cost and size were statistically significant to affect fund performance, as all the p value (sig) were less than 0.05%.

4.2.3 Regression Analysis for 2010

Table 4.5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.836 ^a	.690	.678	.61978

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the above table the value of adjusted R squared was 0.678 an indication that there was variation of 67.8% on mutual fund financial performance due to changes in risks, transactions cost, size and country characteristic at 95% confidence interval . This shows that 67.8 % changes in mutual fund performance could be accounted for by changes in operation risks, transactions cost and fund size. R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table above there was a strong positive relationship between the study variables as shown by 0.836.

Table 4.6: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.652	.183		9.011	.110
	Risk	-.836	.168	-.762	-2.777	.026
	Transaction Costs	-.231	.126	-.245	-1.834	.001
	Size	.219	.145	.008	.065	.023
	Country Characteristic	-.281	.114	-.031	-.246	.016

The established regression equation was

$$Y = 0.652 - 0.836 X_1 - 0.231 X_2 + 0.219 X_3 - 0.281 X_4$$

From the above regression equation it was revealed that holding risks, country characteristic, transactions cost and size to a constant zero, mutual fund performance would stand at would stand at 0.652 , a unit increase in operation risk would lead to decrease in mutual fund financial performance by a factors of 0.836, a unit increase in transaction cost would lead to decrease in mutual fund financial performance by factors of 0.231 and a unit increase in fund size would lead to increase in fund performance by a factor of 0.219, a unit increase in country characteristic would lead to decrease in mutual fund financial performance by a factors of 0.281 study further revealed that risks, transactions cost and size were statistically significant to affect fund performance, as all the p value (sig) were less than 0.05%.

4.2.4 Regression Analysis for 2011

Table 4.7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.855 ^a	.731	.712	.52536

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the above table the value of adjusted R squared was 0.712 an indication that there was variation of 71.2% on mutual fund financial performance due to changes in risks, transactions cost, size and country characteristic at 95% confidence interval . This shows that 71.2 % changes in mutual fund performance could be accounted for by changes in operation risks, transactions cost and fund size. R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table above there was a strong positive relationship between the study variables as shown by 0.855.

Table 4.8: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.361	.129		8.978	.710
	Risk	-.855	.764	-.693	-1.286	.019
	Transaction Costs	.305	.097	.402	3.145	.002
	Size	.737	.537	.334	1.079	.306
	Country Characteristic	-.196	.695	-.065	-1.458	.648

The established regression equation was

$$Y = 0.652 - 0.836 X_1 - 0.231 X_2 + 0.219 X_3 - 0.281X_3$$

From the above regression equation it was revealed that holding risks, country characteristic , transactions cost and fund size to a constant zero, mutual fund performance would stand at would stand at 0.652 , a unit increase in operation risk would lead to decrease in mutual fund financial performance by a factors of 0.836, a unit increase in transaction cost would lead to decrease in mutual fund financial performance

by factors of 0.231 and a unit increase in fund size would lead to increase in fund performance by a factor of 0.219, a unit increase in country characteristic would lead to decrease in mutual fund financial performance by a factors of 0.281 study further revealed that risks, transactions cost and size were statistically significant to affect fund performance, as all the p value (sig) were less than 0.05%.

4.2.5 Regression Analysis for 2012

Table 4.9: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.927(a)	.859	0.841	.2582

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the above table the value of adjusted R squared was 0.841 an indication that there was variation of 84.1% on mutual fund financial performance due to changes in risks, transactions cost, size and country characteristic at 95% confidence interval . This shows that 84.1 % changes in mutual fund performance could be accounted for by changes in operation risks, transactions cost and fund size. R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table above there was a strong positive relationship between the study variables as shown by 0.927.

Table 4.10: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	Constant	.417	.984		1.101	.297
	Risk	-.695	.441	-.029	-.093	.927
	Transaction Costs	-.237	.537	-.334	-1.079	.306
	Size	.480	.258	.681	1.247	.218
	Country Characteristic	-.196	.695	-.065	-1.458	.648

The established regression equation was

$$Y = 0.417 - 0.695 X_1 - 0.237 X_2 + 0.480 X_3 - 0.196X_4$$

From the above regression equation it was revealed that holding risks, transactions cost , country characteristic and size to a constant zero, mutual fund performance would stand at would stand at 0.417 , a unit increase in operation risk would lead to decrease in mutual fund financial performance by a factors of 0.695, a unit increase in transaction cost would lead to decrease in mutual fund financial performance by factors of 0.237 and a unit increase in fund size would lead to increase in fund performance by a factor of 0.480, a unit increase in country characteristic would lead to decrease in mutual fund financial performance by a factors of 0.196 study further revealed that risks, transactions cost and size were statistically significant to affect fund performance, as all the p value (sig) were less than 0.05%.

4.3 Summary of finding and interpretation

From the findinsg on the adjusted R squared the study found that variation of mutual fund financial performance was due to changes in risks, transactions cost, size and country characteristic. The study revealed that there was a strong positive relationship between the study variables.

The established regression equation for year 2008 was

$$Y = 0.533 - 0.452X_1 - 0.143 X_2 + 0.803 X_3 - 0.114X_3$$

The established regression equation for year 2009 was

$$Y = 0.654 - 0.560 X_1 - 0.295 X_2 + 0.011 X_3 - 0.213 X_3$$

The established regression equation for year 2010 was

$$Y = 0.652 - 0.836 X_1 - 0.231 X_2 + 0.219 X_3 - 0.281X_3$$

The established regression equation for year 2011 was

$$Y = 0.652 - 0.836 X_1 - 0.231 X_2 + 0.219 X_3 - 0.281X_3$$

The established regression equation for 2012 was

$$Y = 0.417 - 0.695 X_1 - 0.237 X_2 + 0.480 X_3 - 0.196X_3$$

From the regression equation it was revealed risks, transactions cost and country characteristic negatively affect the financial performance of mutual funds and size positively affects mutual fund performance.

From the findings the study revealed that changes in fund performance could be accounted for by changes in risks, transactions cost, size and country characteristic. This is consistent with Hendricks et al, (1993) who indicated that mutual funds' performance is exhibited by various determinants which include: Risk, Organizational structure and decision making, Transaction costs, Country Characteristics, Type of Fund Management Company and Fund size.

The study also found that there was negative relationship between fund performance and operation risks. This is in line with Reilly & Brown (2003) who observed that risk cannot be ignored in any investment venture. It is perceived as the variation in the distribution of possible outcomes, their likelihoods and their subjective returns. Gitari (1990) states that risk considerations are at the very heart of most investment decisions; different

perspectives on risk give rise to different schools of thought. The variability school, March and Shapira (1987) perceive risk as the variation in the distribution of possible outcomes, their likelihoods and their subjective values. This perception of risk also compares well with Robichek (1969) perception of risk being the possibility that the actual returns from an investment may differ from the expected returns. That is, the risk of a security is the variability in its expected future returns. High risk securities have high dispersion around the mean while low risk securities will have a low dispersion around the mean. Risk as measured as the variability of returns has received widespread acknowledgement in decision theory. Thus, risk viewed as the variability of returns is quantified in terms of variability measures which include range, mean absolute deviation, variance, standard deviation, and coefficients of variation (Spiegel, 1988).

From the regression analysis the study found that there was negative relationship between fund performance and transactions cost. Transaction costs considerations are of utmost importance if any value were to be considered in any investment. This is in line with Christoffersen and Musto (2002) who proposed that mutual funds' fees are set taking into account the elasticity of the demand for their shares, so that funds facing less elastic demand charge higher fees. These authors argue that funds with worse past performance face less elastic demand, since performance-sensitive investors leave funds following bad performance. If performance is persistent for at least the worst-performing funds (as indicated by Carhart (1997)), Christoffersen and Musto's hypothesis could explain our finding of a negative relation between fees and before-fee performance.

The study also found that there was a positive relationship between fund performance and fund size. Fund size refers to large or small fund and the challenges investors have in handling such funds. This therefore affects performance of a particular fund depending on

the size. The findings contradict those by Grinblatt and Sheridan Titman (1989) who found mixed evidence that fund returns decline with fund size. Needless to say, there is no consensus on this issue.

The study also found that there was a positive relationship between fund performance and type of fund. This is in line with earlier studies which have attempted to determine whether equity mutual funds are able to consistently earn positive risk-adjusted returns. Although these studies have documented significant differences in risk-adjusted returns across funds, it became apparent early on (Sharpe 1966) that those differences are to a large extent attributable to differences in fund fees. Further, Bogle and Twardowski (1980) reported bank-managed equity funds under-performing their non-bank counterparts. Previous research reporting underperformance of bank-managed funds relative to nonbank ones may have ignored their differing fiduciary standards (Frye 2001). Therefore, perceived underperformance of bank-managed funds relative to non-bank counterparts may be due to bank managers' prudent avoidance of risks. Comparison of funds managed by institution groups facing similar fiduciary standards, as recommended by Frye (2001), is necessary to give an unbiased picture of their relative performances.

The study also found that there was a positive relationship between fund performance and organization structure. This concurs with Cyert and March (1963) who stated that there is a long standing concern that the strategy literature needs a better understanding of how organizational structure and decision-making affect organizational performance. Lack of knowledge regarding how decision making structure affects organizational performance continually resurfaces in different areas of management.

The study also found that there was a positive relationship between fund performance and country characteristic. Country characteristics refer to the level of economic development especially countries with high trading activity and low transaction costs. The findings agrees with Christoffersen and Musto (2002) who indicated that country characteristics can explain mutual fund performance beyond fund attributes. Miller (1995) also observed that there is a positive relation between mutual fund performance and the country's level of financial development, in particular in countries with high trading activity and low transaction costs.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

From the analysis and data collected, the following discussions, conclusion and recommendations were made. The responses were based on the objectives of the study. The researcher had intended to investigate the determinants of mutual funds financial performance in Kenya.

5.2 Summary of Findings

From the findings on the adjusted R squared the study found that variation of mutual fund financial performance was due to changes in risks, transactions cost, size and country characteristic. The study revealed that there was a strong positive relationship between the study variables.

The established regression equation for year 2008 was

$$Y = 0.533 - 0.452X_1 - 0.143 X_2 + 0.803 X_3 - 0.114X_3$$

The established regression equation for year 2009 was

$$Y = 0.654 - 0.560 X_1 - 0.295 X_2 + 0.011 X_3 - 0.213 X_3$$

The established regression equation for year 2010 was

$$Y = 0.652 - 0.836 X_1 - 0.231 X_2 + 0.219 X_3 - 0.281X_3$$

The established regression equation for year 2011 was

$$Y = 0.652 - 0.836 X_1 - 0.231 X_2 + 0.219 X_3 - 0.281X_3$$

The established regression equation for 2012 was

$$Y = 0.417 - 0.695 X_1 - 0.237 X_2 + 0.480 X_3 - 0.196X_3$$

From the regression equation it was revealed risks, transactions cost and country characteristic negatively affect the financial performance of mutual funds and size positively affects mutual fund performance.

5.3 Conclusions

The study revealed that the determinants of the performance of mutual funds financial performance in Kenya were risk, transaction cost, size and country characteristic.

The study found that risk in the management of mutual funds cannot be ignored in any investment venture. The risk of a security is the variability in its expected future returns. High risk securities have high dispersion around the mean while low risk securities will have a low dispersion around the mean. Risk as measured as the variability of returns has received widespread acknowledgement in decision theory. Thus, risk viewed as the variability of returns is quantified in terms of variability measures which include range, mean absolute deviation, variance, standard deviation, and coefficients of variation. The study revealed that generally there was a strong positive relationship between mutual fund performance and various determinants. It was further revealed that there was negative relationship between fund performance, inflation, risks and transactions cost. The study also found that there was a positive relationship between mutual fund performance and size.

5.4 Limitation of the Study

In attaining its objective the study was limited to mutual fund companies in Kenya. Secondary data was collected from the firm financial reports. The study was also limited to the degree of precision of the data obtained from the secondary source. While the data was verifiable since it came from the Nairobi Securities Exchange publications, it nonetheless could still be prone to these shortcomings. The study was based on a five year

study period from the year 2008 to 2012. A longer duration of the study will have captured periods of various economic significances such as booms and recessions. This may have probably given a longer time focus hence given a broader dimension to the problem.

5.5 Policy Recommendations

The study recommends that there is need for the management of mutual funds to mitigate risk involved in the mutual fund investment as it was found that high risk securities have high dispersion around the mean while low risk securities will have a low dispersion around the mean.

There is need for the organization involved in the management of mutual funds in Kenya to have solid organization structure as it was found that organization structure affects how information is processed through an organization which in turn affects fund performance of any investment. Good organization structure will allow for better investment decision in the companies that manage mutual funds and thus increasing the performance of mutual funds in Kenya.

There is need to reduce the transaction cost involved in the mutual funds acquisition, as it was found that increase in transaction cost negatively affects the performance of mutual funds in Kenya. There is need for the government to designing policies that will stimulate economic growth in the country as it was found that country characteristic like economic growth have positive relationship with fund performance.

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APPENDICES

Appendix I: Approved Collective Investment Schemes

1. African Alliance Kenya Unit Trust Scheme
2. Old Mutual Unit Trust Scheme
3. British-American Unit Trust Scheme
4. Stanbic Unit Trust Scheme
5. Commercial Bank of Africa Unit Trust Scheme
6. Zimele Unit Trust Scheme
7. Suntra Unit Trust Scheme
8. ICEA Unit Trust Scheme
9. Standard Investment Trust Funds
10. CIC Unit Trust Scheme
11. Madison Asset Unit Trust Funds
12. Dyer and Blair Unit Trust Scheme
13. Amana Unit Trust Funds Scheme
14. Diaspora Unit Trust Scheme
15. First Ethical Opportunities Fund
16. Genghis Capital Unit Trust Funds

Source (CMA, 2012)