RELATIONSHIP BETWEEN INVESTMENT PORTFOLIO CHOICE AND PROFITABILITY OF INVESTMENT COMPANIES LISTED IN THE NAIROBI SECURITIES EXCHANGE

BY

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DECLARATION

This research project is my original work and has not been presented for a degree in any other university or any other award.

Sign…………………………………   Date……………………….
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This research project has been submitted for examination with my approval as the university supervisor.

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Mr. F. S. Ndede
Chairman, Department of Accounting and Finance
School of Business.

DEDICATION

To the almighty God for seeing me through, to my family for the support they accorded to me. To my supervisor for guiding and directing me.

ACKNOWLEDGEMENT

My special thanks goes to my family for their continuous encouragement, to my supervisor Mr.Theuri for the guidance and direction, to my lecturers and classmates through out this course for their constant assistance whenever requested.

TABLE OF CONTENT

LIST OF TABLES

LIST OF FIGURES

ABSTRACT

The portfolio choice problem and the optimum allocation of resources under multiple investment options is not a new topic in the economics literature. Investment is driven by three basic needs: income, capital preservation and capital appreciation. In most emerging markets financial liberalization has been accompanied by sharp fluctuations in key macro and micro prices together with increasing uncertainty. Investment is the sacrifice of current consumption for future consumption whose objective is to increase future wealth. The sacrifice of current consumption takes place at present with certainty and the investor expects desired level of wealth at the end of his investment horizon. This study sought to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities exchange. The research design employed in this study was descriptive research design inform of a survey. The population of interest in this study comprised of the four companies listed as Investment Companies at the Nairobi Securities Exchange (NSE, 2012). The study employed a stratified random sampling to select 49 senior and middle level managers who are in-charge of the different lines of investments engaged by their organization from each firm`s finance and investments division. The study had a sample of 49 respondents. Questionnaire was designed to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange. The researcher used structured questionnaires as the main data collection instrument. Pilot testing was conducted to establish the validity of the research instrument. The content analysis was used to analyze the respondents' views about the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis. Data was presented using tables, and pie charts to make them reader friendly.

The study found that investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg, investment managers strategy is to invest in various assets which can generate optimal returns while keeping risks at its minimal. The study also concludes that investment projects which tend to promise both high returns and a high risk are not attractive for most institutional investors.Institutional investors maintain a conservative investment style, trying to combine the highest return with the lowest risk level in the investment portfolio, there exist a relationship between the returns of a portfolio and the returns of a single asset, investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment. The study further concludes that revealed that risk assessment of the investment opportunities has an effects on performance, during investment emphasis should be put 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 and regarding liquidity the study concludes that investment institutions utilize their exposure and resources to develop detailed economic analysis and market area studies, liquidity preference affects the performance of investment companies, and finally that there is a great need for investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment,

CHAPTER ONE

INTRODUCTION

1.1: Background of the Study

An investment is the current commitment of resources for a period of time in the expectation of receiving future resources that will compensate the investor for the time the resources are committed, the expected rate of inflation and the risk (uncertainty of future payments). Companies invest because of the desire to pass money from the present into the future. Institutions investors anticipate future cash needs, and expect that their earnings in the future will not meet those needs. Another motivation is the desire to increase wealth, which requires risk taking as the return to investment in future is not guaranteed.

The investment return is a measure of the growth in wealth resulting from that investment. This growth measure is expressed in percentage terms to make it comparable across large and small investors. In a study conducted by Murumba, (2012), findings shows that return is a major factor and has a direct link as the final measure of an investment. The higher the return the more investors would make a decision to invest in a particular security says for example.

The effects of uncertainty, risk and volatility on the investment performance of developing countries have been of particular interest in the recent economics literature especially given the declining fixed capital formation rates in major developing countries during the 1990s (UNCTAD, 2003). In this respect, the empirical work so far suggests a general consensus regarding their negative effects on private investment performance in both developed and developing countries. Nevertheless, there are relatively few empirical studies exploring the

channels through which uncertainty and risk affect investment. In particular, the interactions among fixed investment, uncertainty, and portfolio choice remain an unexplored field of research. The absence of empirical work on the portfolio choice and its impact on performance for investment firms is particularly surprising given the increasing integration of international goods and capital markets and the widening gap between the real and financial sector transactions.

The portfolio choice problem and the optimum allocation of resources under multiple investment options is not a new topic in the economics literature. Grube (2012), for example, already pointed out the substitutability of real and financial assets in portfolio balances. Accordingly, depending on the respective rates of returns investors decide how to allocate their portfolios between real and financial investments. Tornell (2010), argued that given the uncertain environment in developing countries, real sector firms may prefer to invest in more liquid reversible assets in the financial sectors that also offer comparable or higher rates of return on their investments rather than on irreversible fixed assets.

Jonava Inc (2009), argues that performance measurement begins with portfolio valuations and transactions translated into a rate of return. For large companies, connecting market products to contribution margin in order to achieve portfolio excellence can be elusive. Balancing performance expectations and resource allocation across multiple business units requires clearly defined portfolio management processes within business units at the corporate level. Maximum profitability requires portfolio executives to prioritize and execute innovation strategically.

1.1.1: Investment Portfolio

Investment is driven by three basic needs: income, capital preservation and capital appreciation. For income, investments can be made in the hope of providing future income. Usually investors want income to begin in the immediate future. For capital preservation, investments are made to preserve capital, or the original value. These are generally conservative investments. The investor wants the money set aside with the assurance that the funds will be available, with no risk of loss of purchasing power, at a future point in time. Because the investor wants to preserve the real value of the invested capital, the nominal value of the investment should increase at a pace consistent with inflation trends.

For capital appreciation, investments are made so that funds will appreciate, or grow in value, to meet a future need. The aim is to have the value of the invested money grow at a faster rate than inflation so there is a positive return after the effects of taxes and inflation. Typically, investments made for capital appreciation include some risk exposure to get the desired return. Optimal investment implies that on profit margins, the firm must be indifferent between investing today and transferring those resources to tomorrow, as long as appropriate discount rate is identified to discount the payoff in the next period (Trygve, 2006).

In most emerging markets financial liberalization has been accompanied by sharp fluctuations in key macro and micro prices together with increasing uncertainty. Consumption volatility, for example, has increased in emerging markets during the 1990s

(Kose et al., 2003). Likewise, capital flows to developing countries during the 1990s compared to late 70s and 80s are found to be 'high, rising and unpredictable" (Gabriele et al., 2000). The existing evidence also shows an increase in the volatility of stock markets as well as sales and earnings of firms in both developed and developing country markets for the last three decades (Comin and Mulani, 2006).

Capital flows can have significantly negative effects on investment in tradable goods sectors through changing relative prices, which partly explain the decreasing business savings and employment contraction in these sectors (Frenkel and Ros, 2006). In addition, excess volatility in exchange rates raises inflation uncertainty and encourages financial investments by real sector firms (Felix, 1998; UNCTAD, 2006).

1.1.2: Profitability of Portfolio Companies

Several financial profitability measures have been adopted in financial statements analysis and long term planning (Ross, Westerfield, Jafee, & Jordan, (2008). Organizations are held accountable by measuring performance measurement; such become the consequences for performance, (Ross, Westerfield, Jafee, & Jordan, 2008). Managers need these to improve performance as well as value judgement from customers and citizens. In this study several financial ratios have been adopted. Return on Assets (ROA), a measure of profitability which divides the net income by the amount of its assets. ROA measures how well a fund is doing. It indicates how well the fund's assets have been invested used to generate optimal returns. In their study Kosmidou, Pasiouras, & Tsaklanganos, (2007) points out; the ROA has emerged

as key ratio for the evaluation of profitability and has become the most common measure of profitability in the literature.

ROA provides useful information about profitability, however the investors (unit holders) care more about how much the fund is earning on their investment, an amount that is measured by the return on equity (ROE), the net income per dollar of capital.

According to an indication by Willie and Hopkins, (1997) that the ultimate measure of the strength of any financial institution is not its asset size, the number of branches, or the pervasiveness of its electronics rather the true measure is its return on unit holders (ROE). Hence ROE is the preferred method of measuring profitability. Thus, on review of the financial performance measures of funds, ROA and ROE will be considered as a general measure of funds profitability.

1.1.3: Relationship between Portfolio Choice and Profitability

The performance of the firm can be measured by its financial results, i.e., by its size of earnings riskiness and profitability are two major factors which jointly determine the value of the concern, (Pi and Timme, 1993). Financial decisions which increase risks will decrease the value of the firm and on the other hand, financial decisions which increase the profitability will increase value of the firm. Risk and profitability are two essential ingredients of a business concern. There has been a considerable debate about the ultimate objective of firm performance, whether it is profit maximization or wealth maximization (Pi and Timme, 1993). It is observed that while considering the firm performance, the profit and wealth maximization are linked and are effected by one-another.

The financial performance of a corporation is of vital interest to many different groups and individuals. Lenders are concerned with the corporation's ability to repay loans as well as whether it is abiding by loan contracts. Purchasing agents for other companies are concerned with its viability as a supplier of goods or services for its products. Potential investors are interested in determining the financial strength of a company as an element in assessing the company's value. In addition to these external analysts, managers within the corporation are also concerned with analyzing its financial performance. These internal analysts compare the actual performance of the company and its divisions and lines of business with plans, budgets, or objectives; they also compare the company's performance with that of current and potential competition (Scott, 2007). The primary sources of information these analysts use to evaluate firm's performance are its financial statements. Performance assessment via financial statement analysis is based on past data and conditions from which it may be difficult to extrapolate future expectations. Any decision to be made as a result of such performance assessment can affect only the future as the past is gone, or sunk.

While past performance is interesting, many managers and analysts are more interested in what will happen in the future. The past performance of a company, as shown in its financial statements, may be used to help predict future performance (Pi and Timme, 1993). When analyzing financial statements, one must keep in mind the purpose of the analysis. Since different analysts are interested in different aspects of a corporation's performance, no single analytical technique or type of analysis is appropriate for all situations.

1.1.4: Investment Companies in Kenya

In Kenya, the establishment and licensing of Investment Companies is done by the Capital Markets Authority (CMA). These firms are registered as collective investment schemes (CIS) each mandated to operate investment based on the license granted.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, the uptake of these investment opportunities has been wanting. The volume of funds channeled 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 investment companies, in Kenya there are four investment companies listed in the Nairobi Securities Exchange. This indicates that such investments are professionally managed and the returns derived should mimic the market trends. The Investment companies listed at NSE are City Trust, Olympia capital holdings, Centum Investments and Trans Century.

1.2: Statement of the Problem

Making portfolio choice is one of the major policy issues in an investment company. Investing in a portfolio provides an attractive option to Investment Company as it provides maximization of returns and minimization of risks when compared to investing in segregated securities hence the need to make an intelligent portfolio choice (Karan ja, 2007).How to choose and invest for maximum returns is certainly a major concern among investors at NSE.

Despite major incentives at the NSE for instance the expansion of the scope of foreign investment, introduction of incentives for capital markets by government, setting up of tax free capital funds, removal of capital gains tax and licensing of dealing firms to improve market liquidity favoring investments (NSE annual report, 2001).Kenyans have been wary of investing through them challenging the premise that improved market performance should attract new investments. The only entrants into these investment channels are corporates and high net worth individuals (CMA annual report, 2011).

Studies done in Kenya includes , Bowa (2001) who did a study to determine the risk minimizing portfolio at the NSE, Ngene (2002) did an empirical investigation into portfolio performance measures by pension fund managers and the challenges they face in portfolio management in Kenya, Sallah (2005) did a study on the portfolio returns using different portfolio management styles at the NSE, Obusubiri (2006) conducted study on corporate social responsibility & portfolio performance at the NSE and Karanja (2007) conducted a study on factor influencing investment company portfolio choice, to the researcher knowledge no known local study has sought to determine the impact of investment portfolio choice on performance of investment companies, this study seeks to fill the existing researcher gap by conducting a study to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi securities exchange.

1.3: Objective of the study

The main objective of the study was to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange.

1.3.1: Specific Objective

i. To identify how investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange

ii. To find out how expected returns influences profitability of investment companies listed in the Nairobi Securities Exchange

iii. To find out how risk influences profitability of investment companies listed in the Nairobi Securities Exchange

iv. To find out how liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange

1.4: Research questions

The study sought to answer the following research questions

i. How do investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange?

ii. How does expected returns influences profitability of investment companies listed in the Nairobi Securities Exchange?

iii. To what extent does risk influences profitability of investment companies listed in the Nairobi Securities Exchange?

iv.   How does liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange?

1.5: Significance of the Study

Investment Companies Managers make investment decisions for the investors. They seek to increase the penetration ratio in the market. Firm Financial performance is therefore affected by the decisions made by these managers. This study will therefore, be of help to them execute their role effectively and have the right investment portfolio for their firm

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 investment firms. What drives an industry forward or backward is highly dependent on the policies governing the industry. 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.

1.6: Scope of the Study

This study was done on the four investment companies listed at the NSE. The study covered how the investment managers make their portfolio choices and the impact of these choices on the firm`s performance. The fieldwork was undertaken from August 2013 up to mid-September 2013. The study sought to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange.

1.7: Limitation of the Study

Some of the respondents approached were reluctant in giving information fearing that the information sought would be used to intimidate them or print a negative image about them or the investment companies. Some respondents even turned down the request to fill questionnaires. The study handled the problem by carrying an introduction letter from the University and assuring them that the information they give would be treated confidentially and would be used purely for academic purposes.

Since most of the managers operated on tight schedules; they did not complete the questionnaire in good time and this overstretched the data collection period. To mitigate this limitation, the study made use of networking to persuade targeted respondents to fill up and return the questionnaires.

The researcher also encountered problems in eliciting information from the respondents as the information required was subject to areas of feelings, emotions, attitudes and perceptions, which could not be accurately quantified and/or verified objectively.

CHAPTER TWO

LITERATURE REVIEW

2.1: Introduction

This chapter has three sections: theoretical framework, empirical studies and performance from the literature review .Theories and empirical studies on portfolio have been reviewed in this section. Theories and empirical studies questioning performance have been reviewed too.

2.2: Theoretical Review

Investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment. The study was guided by the modern portfolio theory, expected utility theory and Financial Intermediation Theory which tries to show the relationship between the returns of a portfolio and the returns of a single asset through a linear combination of many independent macro-economic variables.

2.2.1: Modern Portfolio Theory

Balancing risk and returns is a cornerstone of modern portfolio theory. Markowitz's (1952) seminal work derived measures for calculating expected returns and expected risk of a portfolio. He presented variance as a meaningful measure of risk, and created a method of calculating the overall portfolio risk – taking into account the imperfect correlation of price movements between assets. Variance is a statistical measure of how widely disbursed a set of probability outcomes are around its mean value. When combining multiple assets that are less than perfectly correlated, the combined variance of the portfolio reduces. Markowitz's work into calculating these measures at a portfolio level allows today's investors to quantify the relationship between risk and return rather than relying on the investor's best guess.

Markowitz makes a number of important assumptions (Reilly & Brown, 2009, pp. 182-183): Each asset has a set of probable outcomes which can be thought of as a probability distribution. Investors aim to maximize their single period utility of wealth. Investors are risk averse – that is, they have diminishing marginal utility of wealth. Investors can estimate risk based on the variability of returns. Investors only base their investment decisions on the first and second moments of the distribution – expected return and variance. For any given level of risk (or variance), the investor prefers a higher expected return. Similarly, for any given expected return, the investor prefers a lower level of risk.

2.2.2: Expected Utility Theory (EUT)

It makes sense that the explanations in human and social psychology would help in advancing our understanding of stock market behavior. The latest research has made great strides in explaining the persistence of anomalies by adopting a psychological perspective. In psychology literature reveals that individuals have limited information processing capabilities, exhibit systematic bias in processing information, are prone to making mistakes, and often tend to rely on the opinion of others. Rabin and Thaler (2001) discusses the explanation of risk aversion in the EUT is not plausible by providing examples of how the theory can be wrong and misleading. They call for a better model of describing choice under uncertainty. It is now agreed that the failure of EUT is based on the fact that the psychological principles governing decisions were not fully recognized and as a consequence it wasn't successful.

2.2.3: Financial Intermediation Theory

Intermediaries provide services: this is clear because intermediaries issue "secondary" financial assets to buy "primary" financial assets. If an intermediary provided no services, investors who buy the secondary securities issued by the intermediary might as well purchase the primary securities directly and save the intermediary's costs. To explain the sorts of services that intermediaries offer, it is useful to categorize them in terms of a simplified balance sheet. Asset services are those provided to the issuers of the assets held by an intermediary, e.g., to bank borrowers. An intermediary that provides asset services is distinguished by its atypical asset portfolio. Relative to an intermediary that provides no asset services, it will concentrate its portfolio in assets that it has a comparative advantage in holding (Allen, 1998).

The existence of financial intermediaries needs to be justified in economic terms because in the financial world, the financing of firms (and governments) by households occurs via financial markets in a frictionless manner - there are no transactions costs - which leaves no role for financial intermediaries. There are no transactions costs and there exists a full set of contingent markets in which all can participate. Credit markets also being perfect, individuals do not face credit rationing. Allocation of resources is Pareto optimal and there is no role for intermediaries to add value. In addition, (employing Modigliani-Miller), financial structure is irrelevant as in a world such as that described; households can construct portfolios which offset the actions of an intermediary and intermediation cannot add any value (Fama, 1980). As noted by Allen and Santomero (1998) the traditional theory of financial intermediation is focused on the real-world market features of transactions costs and asymmetric information.

These are central to the activity of banks and insurance companies. The idea of transactions costs, first developed in the context of the theory of the firm by Coase (1937), was introduced as a key form of friction in financial markets by Gurley and Shaw (1960). Economies of scale which benefit intermediaries result from indivisibilities and non-convexities in transactions technology which restrict diversification and risk sharing under direct financing. Examples include fixed costs of evaluating assets, and declining average trading costs which mean intermediaries may diversify more cheaply than individuals. The "liquidity insurance" banks provide to depositors and borrowers whereby deposits can be cashed on demand while banks' assets are mainly long-term and illiquid.

2.3: Empirical Review

Effective organizational decision-making is the primary responsibility and the raison of management (Dearlove, 1998). According to Drucker (1979): Executives do many things in addition to making decisions. But only executives make decisions. The first managerial skill is, therefore, the making of effective decisions (Drucker, 1979 p2) Furthermore, of all the decisions that business executives must make, none is more challenging than choosing among alternative capital investment opportunities (Hertz, 1964). Here executives must decide to invest some fixed amount today in exchange for an uncertain stream of future payoffs. Each investment decision often involves complexity and uncertainty. Complexity is reflected, in part, by the number of alternative courses of action from which the decision-maker can choose. Uncertainty is inherent in all decision-making but particularly pertinent to the investment decision-maker where the implications of their decisions are often very

significant for the organization. Moreover, executives are usually trying to fulfill multiple objectives in their investment decisions and therefore have to make trade-offs between expected return and riskiness. Perhaps it is not surprising given this that entrepreneurs, on average, have nine failures for each major success (Pike and Neale, 1996).

Since risk is essentially a mathematical construct, not an emotional one, the ability to properly understand and assess risk is critical (Pablo, 1997) .The role of risk and uncertainty in decision-making is a topic that has increasingly attracted the attention of both practitioners and scholars. However, as indicated in the preceding quotes, managers hold widely divergent views on the handling of risk and uncertainty in business situations, with some taking a more analytical approach, whereas others appear to operate on a more intuitive basis. Similarly, researchers have historically developed explanations of how decisions are made under risk and uncertainty from a variety of theoretical perspectives, resulting in a fragmented and often contradictory body of literature on the subject (Pablo, 1997). Lipshitz and Strauss (1997) observed that decision-makers conceptualize risk and uncertainty differently and that this affects method of coping that decision-makers use to cope with risk and uncertainty.

It is accepted almost universally in the investment decision-making literature that risk and uncertainty are inherent in all investment decision-making (Bailey et al., 1999; Morgan and Henrion, 1990) and hence receive considerable attention in the academic investment decision-making literature (Atrill, 2000). This prominence is well deserved. Ubiquitous in realistic settings, risk and uncertainty constitute a major obstacle to effective capital investment decision-making (Simpson et al., 2000). However, despite this prominence, there

is much confusion in the academic investment decision-making literature over the definitions of risk and uncertainty (Lipshitz and Strauss, 1997).

2.3.1: Investment Assets and Profitability

To achieve diversification, the investment managers strategy is to invest in various assets which can generate optimal returns while keeping risks at its minimal. The main asset to be considered in this research are; cash, bonds, equities, property, offshore investment, money market, government securities. In their research Gregory & Whittaker, (2007) observes that invetsment managers search for suitable properties is conducted in an inefficient marketplace where data limitations on risk and return analysis can present fundamental problems to the management of the investment . Also in the property portfolio the switching of investment s among assets is complicated by high transfer costs which need to be considered in the setting of policy. In an investment illustration Cass & Stiglitz, (2011) investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg.

2.3.2: Expected Returns and Profitability

Investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment. Roll & Ross, (2012) using Arbitrage pricing theory predicts a relationship between the returns of a portfolio and the returns of a single asset through a linear combination of many independent macro-economic variables. An asset pricing model based on the idea that an asset's returns can be predicted using the relationship between that same asset and many common risk factors. Most institutional investors maintain a conservative investment style, trying to combine the highest return with the lowest risk

level in the investment portfolio. In practical terms this results in the selection of market areas which fit the criteria of the investment policy. Thus investment projects which tend to promise both high returns and a high risk are not attractive for most institutional investors, particularly as the success or failure of the management policy is expressed by the performance of the investment .

In a study conducted by Murumba, (2012), findings shows that return is a major factor and has a direct link as the final measure of an investment. The higher the return the more investors would make a decision to invest in a particular security says for example. According to their study Shukla & Van Inwegen,(1995) hypothesized that local knowledge and contacts lead to superior returns for local investment managers relative to foreign manager. They examined the effectiveness of UK open end investment managers (foreigners) investing in the US relative to US open end investment managers (locals) investing in the US. Control for differential tax treatment, investment expenses, investment objectives, and currency risk, they found that UK mutual investment s that invested in the US performed worse than US domestic funds. And they drew conclusions that information/relationship disadvantages and fund size contribute to this poor performance.

Research done by Malkiel, (2012) on investor's preferences for stock mutual funds, analysis showed that investors weighted past performance more than fee structure. The wealthier and the knowledgeable investors are more biased towards load while selecting the mutual funds. But the authors are of the point of view that past performance is not only the guarantee of future return. There are other factors that effects on decision making, but investors make

cognitive errors while selecting funds.The basic nortion underlying the methods of performance evaluation is that the returns on managed portfolios can be judged relative to those 'naively selected' or 'benchmark portfolios with similar levels of risk. Investors tend to refer to past performance in the market while making investment decision. Empirical studies have shown that funds which performs well or poorly in the previous year tend to continue performing well or poorly in the following year or period, and that investors' timing performance is negatively related to fund performance, (Tony Chieh-Tse Hou, 2012).

2.3.3: Risks and Profitability

In a risk study analysis by Murumba, (2012), the study reveals that in making investment decisions of investment managers of investment companies risk was one of the major factors that influences decision making. This therefore means that how risky or less risky securities are will determine the decision of investment managers. However, it does not translate to the riskier the investment, the higher or the more the returns it can generate.

According to Gregory, Matatko, & Luther, (1997) analyses 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. An examines the benefits of international portfolio diversification for U.K. unit trusts by Fletcher, (2006) reveals that significant increases in performance in moving from a domestic strategy to an international strategy that includes either global industry or country equity portfolios, even in the presence of short selling restrictions. Further findings indicated also significant diversification benefits using U.K. unit trusts with international equity objectives.

By Considering a portfolio that holds two risky stocks: one that pays off when it rains and another that pays off when it doesn't rain. Sharpe, (1963) shows that 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. According to Hendricks, Patel, & Zeckhauser, (2012) in their research found that, investment in mutual funds is somewhat not very much risky as investment in stock market. Mutual fund schemes are designed for smaller investors.

With the use of Sharpe's index, Kinyeki, (2011) measures and tests the performance of unit trust firms as compared to that of the stock market. The findings were that unit trusts portfolio underperformed the stock market. Therefore, this clearly demonstrates that stock market had superior risk adjusted returns as compared to the unit trusts portfolio. According to a study conducted by Gruber, (2012) shows that a fall in interest rates should decrease the cost of investment relative to the potential yield and as result planned capital investment projects on the margin may become worthwhile. A firm will only invest if the discounted yield exceeds the cost of the project. During investment emphasis should be put 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, (Malkiel, 2012)

2.3.4: Liquidity of the Firm and Profitability

Investment institutions will utilize their exposure and resources to develop detailed economic analysis and market area studies, with financial projections incorporated into their operating budgets and property management programmes. A study done by Michuku, (2012) finds that

there exist needs among investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment portfolio.

2.3.5: Financial Performance Measure

Several financial profitability measures have been adopted in financial statements analysis and long term planning Ross, Westerfield, Jafee, & Jordan, (2008). Organizations are held accountable by measuring performance measurement; such become the consequences for performance Ross, Westerfield, Jafee, & Jordan, (2008). Managers need these to improve performance as well as value judgement from customers and citizens.

In this study several financial ratios have been adopted. Return on Equity (ROA), a measure of profitability which divides the net income by the amount of its assets. ROA measures how well a fund is doing. It indicates how well the fund's assets have been invested used to generate optimal returns. In their study Kosmidou, Pasiouras, & Tsaklanganos, (2007) points out; the ROA has emerged as key ratio for the evaluation of profitability and has become the most common measure of profitability in the literature. ROA provides useful information about profitability, however the investors (unit holders) care more about how much the fund is earning on their investment, an amount that is measured by the return on equity (ROE), the net income per dollar of capital.

According to an indication by Willie and Hopkins, (1997) that the ultimate measure of the strength of any financial institution is not its asset size, the number of branches, or the pervasiveness of its electronics rather the true measure is its return on unit holders (ROE). Hence ROE is the preferred method of measuring profitability. Thus, on review of the

financial performance measures of funds, ROA and ROE will be considered as a general measure of funds profitability.

A strong debate continues over the methodology of measuring and comparing returns. As early as 1970, Friend, Blume, and Crockett warned about using a benchmark that effectively tricks the alpha calculation by over (under) weighting small-firm returns. During the same time period, Carlson (1977) further warned about drawing conclusions that were specific to the time period, type of fund, or choice of benchmark and stressed the importance of factors such as benchmark selection, survivability, portfolio composition, and non-CAPM return-generating factors when measuring fund performance.

2.4: Conceptual Framework

Independent Variables   **Dependent Variable**
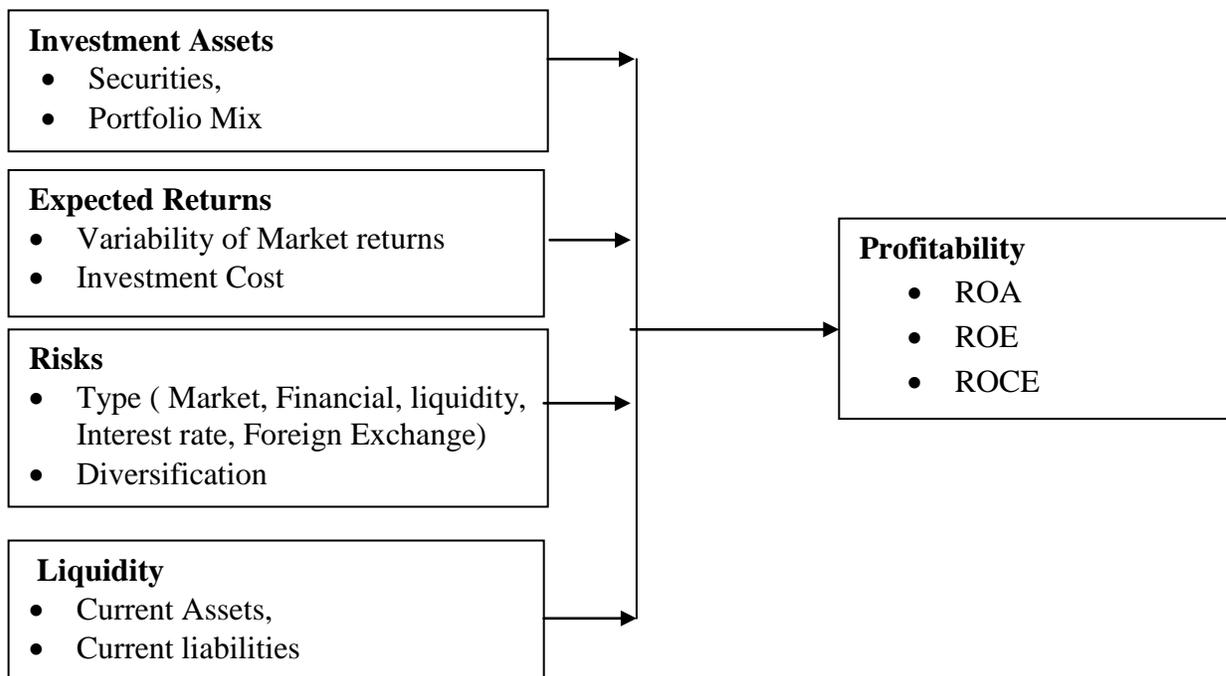
Figure 2.1: Conceptual Frame work

Source, Author (2013)

2.5: Research Gap

Elton, Gruber and Blake (1995) found that bond funds underperformed the returns predicted by a relative pricing model that they developed by the amount of expenses, on average. They note that there is no evidence that managers, on average, can provide superior returns on the portfolios they manage, even if they provide their services free of cost and Milonas (1995) examined the performance of 36 mutual funds operating in the Greek financial market over the period 1990-1993. He concluded that the equity mutual funds achieved returns higher than those of the General Index of the Athens Stock Exchange (GIASE), while they undertook lower risk.

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. This study seeks to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1: Introduction

This chapter provides the methodology of the study. It gives the specific procedures that were followed in undertaking the study. The research design, population, sampling design, data collection methods and data analysis are described in this chapter

3.2: Research Design

The research design to be employed in this study was descriptive research design inform of a survey. The major purpose of descriptive research design is to describe the state of affairs as it is at present. According to Mugenda and Mugenda (1999), a descriptive research is a process of collecting data in order to answer questions concerning the status of the subjects in the study. The primary use of descriptive statistics is to describe information or data using numbers (create number of pictures of the information). The characteristics of groups of numbers representing information or data are called descriptive statistics (Kay, 1997).

According to Mugenda and Mugenda (1999), this type of research attempts to describe such things as possible behavior, attitudes, values and characteristics. These descriptions of a descriptive research matched with the purpose of this study, as its intention of this study is to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange. The advantage or the purpose of using descriptive research design in this study is to ensure the in depth description of the state of affairs.

3.3: Target Population

Target population in statistics is the specific population about which information is desired. According to Ngechu (2004), a population is a well-defined or set of people, services, elements, and events, group of things or households that are being investigated. The population of interest of this study were senior and middle level employees in finance and investment departments of the four investment companies listed at the NSE. There are 97 senior and middle level employees working in these four investment companies listed at the NSE. The populations were categorized as illustrated below.

Table 3.1: Population Distribution

Level Of Management	Frequency	Percent
Senior management	23	23.7
Middle level management	74	76.3
Total	97	100

Source: Human Resource Departments, 2013

3.4 Sampling and Sampling Technique

This is used when it's not possible to study the entire population. In this case the researcher was not in a position to study the whole population since the population of interest to the researcher was large so the researcher chose a sample. A total of 49 respondents were involved in the study. This sample is 50% of the entire population and was representative as it was drawn from the relevant departments. Hainmueller (2007) offers that a large sample size reduces sampling variability and also reduces the probability of biases. In order to select appropriate sample size the study employed stratified random sampling technique. As defined by Mugenda and Mugenda (1999), any meaningful study, 10-20% of the sample is

adequate. This method was the most suitable for this study because the population will be divided into strata.

Table 3.2: Sample size table

Level Of Management	Frequency	Proportion	Sample Size
Senior management	23	50 %	12
Middle level management	74	50 %	37
Total	97	50 %	49

3.5: Data Collection Procedure

Data collection is the most crucial part in gathering the required information with a view of achieving the research objective stated. The researcher acknowledges the various options available as data collection methods or research instruments, each with its advantages and disadvantages. In order to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange self-administered questionnaires was distributed among sampled respondents. Questionnaire was designed to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange. This was made easier to get adequate and accurate information necessary for the research.

The researcher used structured questionnaires as the main data collection instrument. The questionnaires had both open and close-ended questions. The close-ended questions provided more structured responses to facilitate tangible recommendations. The open-ended questions provided additional information that may not have been captured in the close-ended questions.

3.5.1: Pilot Test

Validity may be defined as the ability of a test to measure what it purports to measure. Validation of the research instrument was done by use of a pilot study. Prior to the actual study, pilot test of the measures was conducted against prospective sample population. The subject to be approached during piloting was marked so that they could not be applied in the final study. The wording of items was carefully modified based on the pilot test outcomes and reviewed. Pre-testing the questionnaire was of great significance in this survey. The questions re-examined to ensure that they are not ambiguous, confusing, or potentially offensive to the respondents leading to biased responses. This enhanced in increasing validity of the research instruments.

3.6: Data Analysis and Presentation

Before processing the responses, the completed questionnaires were edited for completeness and consistency. A content analysis and descriptive analysis was employed. The content analysis was used to analyze the respondents' views about the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange. The data was then coded to enable the responses to be grouped into various categories. Descriptive statistics such as means and standard deviation were used to help in data analysis. Tables and other graphical presentations as appropriate were used to present the data collected for ease of understanding and analysis. Inferential statistics regression was done to establish the relationship between investment portfolio choice and profitability of investment companies listed in the Nairobi Securities Exchange. Data was presented using tables, and pie charts to make them reader friendly.

DATA ANALYSIS AND INTERPRETATIONS

4.1: Introduction

This chapter discusses the interpretation and presentation of the findings obtained from the field. The chapter presents the background information of the respondents, findings of the analysis based on the objectives of the study. Descriptive and inferential statistics have been used to discuss the findings of the study. The study targeted a sample size of 49 respondents from which 45 filled in and returned the questionnaires making a response rate of 90 %. This response rate was satisfactory to make conclusions for the study. The response rate was representative. According to Mugenda and Mugenda (1999), a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. Based on the assertion, the response rate was considered to excellent.

4.2:Respondents Information
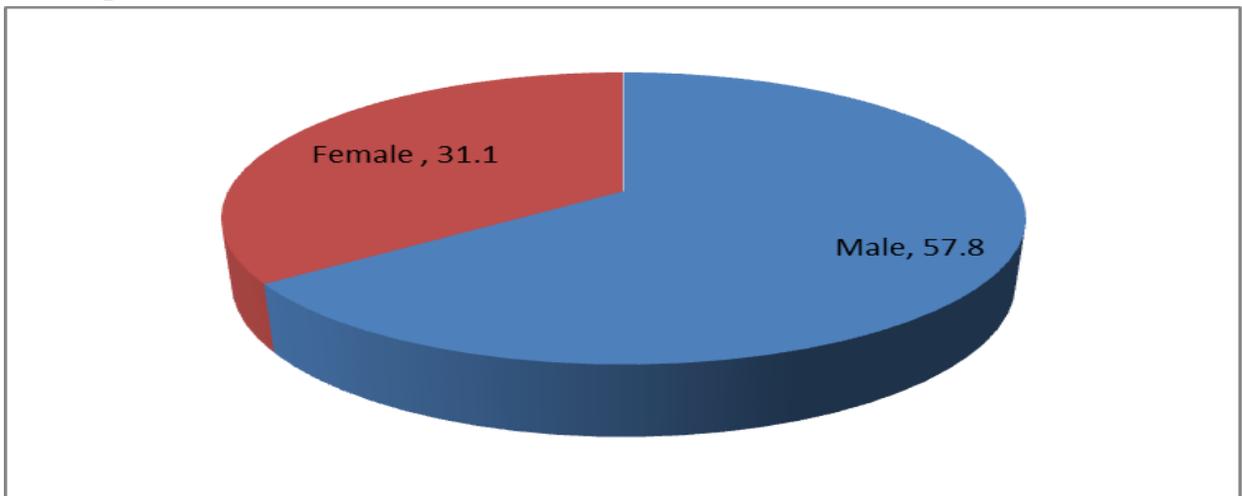
Figure 4.2: Gender of the respondent

The study sought to determine the gender of the respondent and therefore requested the respondent to indicate their gender. The study found that majority of the respondent as shown by 57.8% were males whereas 31.1% of the respondent were females, this is an indication that both genders were involved in this study and thus the finding of the study did not suffer from gender bias.
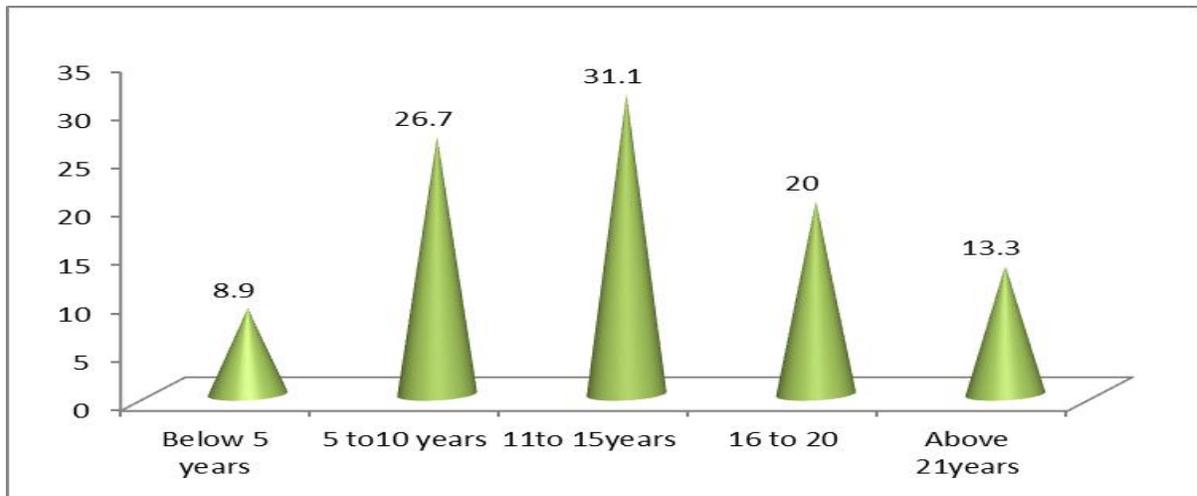
Figure 4.3: Years of service in the organisation

The study requested respondent to indicate the number of years they had served for. From the findings the study established that 31.1 % of the respondents had served for a period of above 12 years 26.7 % of the respondent indicated that they had served for a period raging between 5 to 10 years , 20% of the respondents had served for a period ranging between 16 to 20 years, 13.3% of the respondents indicated to have served for a period of a above 21 years ,whereas 8.9% of the respondents indicated to have served for a period of less than 5 years , this indicates that majority of the respondents had served for a considerable period which implies that most of the respondents had vast knowledge which could be relied upon by this study.
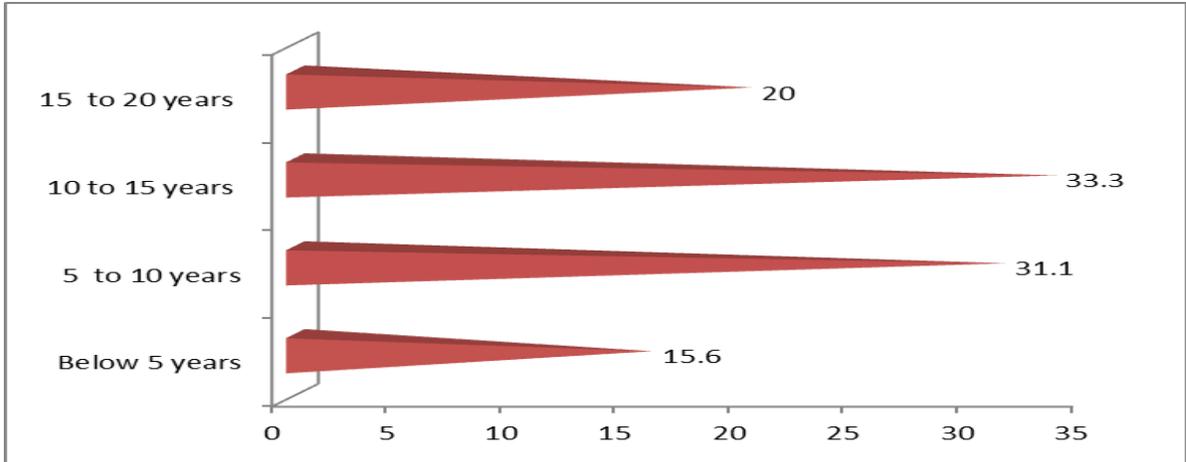
Figure 4.4: Length of time worked in the current position

The study sought to establish how long the respondent had been worked in the current work position, from the findings 33.3% of the respondents indicated that they had been working in the same positions for a period of raging between 10 to 15 years, 31.1% indicated 5 to 10 years, 20 % of the respondents indicated 15 to 20 years, whereas 15.6% of the respondents indicated for a duration not exceeding 5 years. This implies that at least half of the population held the same positions in the last 5 years.
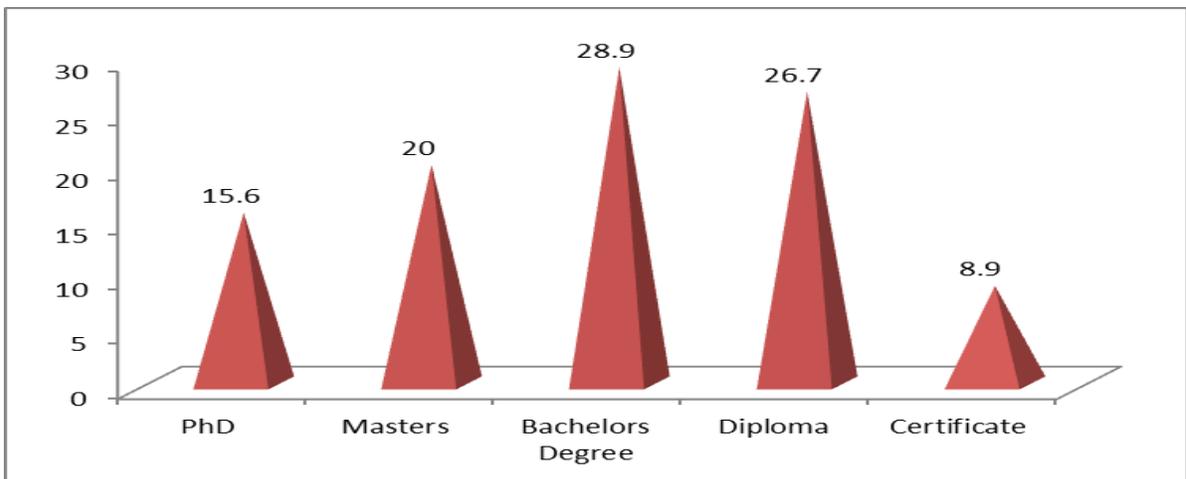
Figure 4.5: Level of Education

The study requested the respondent to indicate their highest level of education. from the findings, 28.9% of the respondent indicated their highest level as bachelor's degree, 26.7% of the respondent indicated their highest level of education as diploma, 20% of the respondents indicated their highest level of education as masters , 15.6% of the respondents indicated PhD whereas 8..9 % of the respondents indicated their highest level of education as certificates , this is an indication that most of the respondents focused in this study had degree certificates as their highest levels of education.

4.3:Investment Assets and Profitability
Table 4.3: Effects of investment assets on profitability of investment companies

	Frequency	**Percentage**
Yes	**30**	66.7
No	15	33.3
Total	45	100

The study sought establish whether assets affects profitability of investment companies listed in the Nairobi Securities Exchange, from the finding 66.7% of the respondent agreed to the statement, whereas 33.3% of the respondents were of contrary opinion. This implies that assets affects profitability of investment companies listed in the Nairobi Securities Exchange

Table 4.4: Extent to which investment assets affects profitability of investment companies

	Frequency	**Percentage**
Very great extent	**15**	33.3
Great extent	20	44.4
Moderate extent	10	22.2
Total	**45**	**100**

The study sought to determine the extent to which investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange, from the findings 44.4% of the respondents indicated to a great extent 33.3% of the respondents indicated to a very great extent, whereas 22.2% of the respondents indicated to moderate extent, this implies that investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange to a great extent.

Table 4.5: Investment assets and profitability of investment companies

statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Mean	Std Deviation
Investment managers strategy is to invest in various assets which can generate optimal returns while keeping risks at its minimal	6	34	5	0	0	1.98	0.32
invetsment managers search for suitable properties in an inefficient marketplace where data limitations on risk and return analysis can present fundamental problems to the management of the investment	4	36	5	0	0	2.02	0.34
investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg	7	35	3	0	0	1.91	0.33
Asset allocation and long term strategy that meets the future liability of the company	7	32	6	0	0	1.98	0.29

The study sought to determine the respondent's level of agreement with the above statements relating to investment assets and profitability of investment companies listed in the Nairobi

Securities Exchange, from the findings majority of the respondents agreed that investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg as shown by a mean of 1.91, investment managers strategy is to invest in various assets which can generate optimal returns while keeping risks at its minimal, Asset allocation and long term strategy that meets the future liability of the company as shown by a mean of 1.98 in each case and finally that invetsment managers search for suitable properties in an inefficient marketplace where data limitations on risk and return analysis can present fundamental problems to the management of the investment as shown by a mean of 2.02 the above findings concures with the findings by Gregory & Whittaker, (2007) observes that invetsment managers search for suitable properties is conducted in an inefficient marketplace where data limitations on risk and return analysis can present fundamental problems to the management of the investment. The study established that Choosing between equities or fixed income, as well as making investment choices, affects the ability to achieve investment objectives. It is extremely important to consider market conditions that are expected to persist over the coming months or years and the influence of economic policy.

4.4:Return and Profitability
Table 4.6: Influence of returns on profitability of investment companies

	Frequency	**Percentage**
Yes	**34**	75.6
No	11	24.4
Total	**45**	**100**

The study sought to determine whether returns influences profitability of investment companies listed in the Nairobi Securities Exchange from the finding 75.6 % of the respondent agreed to the statement, whereas 24.4% of the respondents were of contrary opinion. This implies that returns influences profitability of investment companies listed in the Nairobi Securities Exchange.

Table 4.7: Extent to which return influences profitability of investment companies

	Frequency	Percentage
Very great extent	**10**	22.2
Great extent	27	60.0
Moderate extent	8	17.8
Total	**45**	**100**

The study sought to determine the extent to which investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange, from the findings 60% of the respondents indicated to a great extent, 22.2 % of the respondents indicated to a very great extent, whereas 17.8% of the respondents indicated to moderate extent, this implies that investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange to a great extent.

Table 4.8: Relating influence of returns on profitability of investment companies

Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Mean	Std deviation
Investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment	13	26	6	0	0	1.84	0.24
There exist a relationship between the returns of a portfolio and the returns of a single asset	12	29	4	0	0	1.82	0.27
institutional investors maintain a conservative investment style, trying to combine the highest return with the lowest risk level in the investment portfolio	9	35	1	0	0	1.82	0.33
investment projects which tend to promise both high returns and a high risk are not attractive for most institutional investors	14	26	5	0	0	1.80	0.25
Return is a major factor and has a direct link as the final measure of an investment, the higher the return the more investors would make a decision to invest in a particular security says	11	28	3	3	0	1.96	0.25

The study sought to determine the respondent's level of agreement or disagreement with the above statements relating to influence of returns on profitability of investment companies listed in the NSE, from the findings, the study established that majority of the respondents' agreed that, investment projects which tend to promise both high returns and a high risk are not attractive for most institutional investors as shown by a mean of 1.80, institutional

investors maintain a conservative investment style, trying to combine the highest return with the lowest risk level in the investment portfolio, There exist a relationship between the returns of a portfolio and the returns of a single asset, as shown by a mean of 1.82 in each case, Investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment, as shown by a mean of 1.84 and finally that Return is a major factor and has a direct link as the final measure of an investment, the higher the return the more investors would make a decision to invest in a particular security says as shown by a mean of 1.96 ,all the cases were supported by a low mean which implies that respondents were of similar opinion.

The study established that daily returns affects the profitability of the company in that if company that cannot pay its creditors on time and continues not to honor its obligations to the suppliers of credit, services and goods could result in losses on account of non-availability of supplies and lead to possible sickness or insolvency. Also, the inability to meet the short term liabilities could affect the company's operations and in many cases it may affect its reputation as well. Lack of cash or liquid assets on hand may force a company to miss the incentives given by the suppliers of credit, services, and goods as well. Loss of such incentives may result in higher cost of goods which in turn affects the profitability of the business.

4.5:Risk and Profitability

Table 4.9: Influence of risk on profitability of investment companies

	Frequency	**Percentage**
Yes	**29**	64.4
No	16	35.6
Total	45	100

The study sought to establish whether risk influences profitability of investment companies listed in the Nairobi Securities Exchange, from the findings, the study revealed that majority of the respondents agreed with the statement as shown by a mean of 64.4% whereas 35.6% o9f the respondents were of contrary opinion this implies that risk influences profitability of investment companies listed in the Nairobi Securities Exchange,

Table 4.10: Extent to which risk influences profitability of investment companies

	Frequency	**Percentage**
Very great extent	**13**	28.9
Great extent	29	64.4
Moderate extent	3	6.7
Total	**45**	**100**

The study sought to determine the extent to which risk influences profitability of investment companies listed in the Nairobi Securities Exchange, from the findings 64.4% of the respondents indicated to a great extent, 28.9 % of the respondents indicated to a very great extent, whereas 6.7% of the respondents indicated to moderate extent, this implies that risk influences profitability of investment companies listed in the Nairobi Securities Exchange a great extent.

Table 4.11: Influence of risk on profitability of investment companies

Statements	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Mean	Std deviation
In making investment decisions of investment managers of investment companies risk is one of the major factors that influences decision making	13	26	6	0	0	1.84	0.24
investment in mutual funds is somewhat not very much risky as investment in stock market	12	29	4	0	0	1.82	0.27
During investment emphasis should be put on the importance of interest rates in investment decisions	6	39	0	0	0	1.87	0.38
A firm will only invest if the discounted yield exceeds the cost of the project	15	25	5	0	0	1.78	0.24
Changes in interest rates should have an effect on the level of planned investment undertaken by private sector businesses in the economy	9	33	3	0	0	1.87	0.31
Risk assessment of the investment opportunities has an effects on performance	14	28	3	0	0	1.76	0.27

The study sought to determine the level at which the respondents agreed or disagreed with the above statements relating to influence of risk on profitability of investment companies listed in the Nairobi Securities Exchange, from the findings the study established that,

majority of the respondents agreed that Risk assessment of the investment opportunities has an effects on performance as shown by a bean of 1.76, a firm will only invest if the discounted yield exceeds the cost of the project as shown by a mean of 1.78 investment in mutual funds is somewhat not very much risky as investment in stock market as shown by a mean of 1.82, In making investment decisions of investment managers of investment companies risk is one of the major factors that influences decision making as shown by a mean of 1.84, During investment emphasis should be put 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 as shown by a mean of 1.87 in each case, the above findings concurs with the findings in another study conducted by conducted by Gruber, (2012) shows that a fall in interest rates should decrease the cost of investment relative to the potential yield and as result planned capital investment projects on the margin may become worthwhile. The study revealed that risk influences profitability of investment companies listed in the Nairobi Securities Exchange to a great extent.

4.6:Liquidity and Profitability
Table 4.12: Effects of liquidity on the profitability of investment companies

	Frequency	**Percentage**
Yes	**32**	71.1
No	13	28.9
Total	**45**	**100**

The study sought to establish whether liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange, from the findings, the study revealed

that majority of the respondents agreed with the statement as shown by a mean of 71.1% whereas 28.9% of the respondents were of contrary opinion this implies that liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange

Table 4.13: Extent to which liquidity affect the profitability of investment companies

	Frequency	**Percentage**
Very great extent	**12**	26.7
Great extent	25	55.6
Moderate extent	8	17.8
Total	**45**	**100**

The study sought to determine the extent to which liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange, from the findings 55.6% of the respondents indicated to a great extent, 26.7 % of the respondents indicated to a very great extent, whereas 17.8% of the respondents indicated to moderate extent, this implies that liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange to a great extent.

Table 4.14: Effects of liquidity on profitability of investment companies

Statement	Strongly Agree	Agree	Neutral	Disagree	Strongly	Mean	Std deviation
investment institutions will utilize their exposure and resources to develop detailed economic analysis and market area studies	7	33	5	0	0	1.96	0.31

There is a great need for investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment portfolio	8	30	4	3	0	2.04	0.27
Liquidity preference affects the performance of investment companies	7	32	6	0	0	1.98	0.29

The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to effects of liquidity on profitability of investment companies listed in the Nairobi Securities Exchange, from the from the finding majority of the respondents agreed that; investment institutions will utilize their exposure and resources to develop detailed economic analysis and market area studies as shown by a mean of 1.96, Liquidity preference affects the performance of investment companies as shown by a mean of 1.98, and finally that there is a great need for investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment portfolio as shown by amen of 2.04, the above findings concurs with the argument by Michuku, (2012) finds that there exist needs among investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment portfolio. The study also revealed that Liquidity risk also tends to compound other risks i.e. If a trading organization has a position in an illiquid asset, its limited ability to liquidate that position at short notice will compound its market risk it is therefore important liquidity risk has to be managed in addition to market, credit and other risks.

4.7: Regression Analysis

In this study, a multiple regression analysis was conducted to test the influence among predictor variables. The research used statistical package for social sciences (SPSS V 20) to code, enter and compute the measurements of the multiple regressions.

Table 4.15 : Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.924(a)	.854	.829	0.89628

Source, Researcher (2013)

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable. Adjusted R^2 tells us how changes in profitability varied with return, risk, and liquidity of the fund and investment assets. According to the findings in table above, the value of adjusted R^2 is 0.829. This implies that, there was a variation of 82.9% on profitability due to changes in expected return, risk, liquidity of the fund and investment assets at 95% confidence level R is the correlation coefficient which shows that there was a strong correlation between the study variable as shown by the correlation coefficient of 0.924.

Table 4.16: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.744	4	0.936	3.307	.007(a)
	Residual	11.32	40	0.283		
	Total	15.064	44			

Source, Researcher (2013)

From the ANOVA statistics in table above, the processed data, which is the population parameters, had a significance level of 0.007 which shows that the data is ideal for making a conclusion on the population's parameter as the value of significance (p-value) is less than 5%. The calculated F was greater than the critical value (2.015<3.307) an indication that expected returns, risk, liquidity of the fund and investment assets were significantly influencing profitability of investment firm in Kenya. The significance value was less than 0.05 an indication that the model was statistically significant.

Table 4.17: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.621	.109		.055	.037
	Expected Returns	.145	.141	.024	.075	.042
	Risk	-.035	.290	-.003	-.011	.012
	Liquidity	.143	.190	.007	.021	.013
	Investment assets	.517	.162	.355	1.429	.023

Source, Author (2013)

From the data in the above table the established regression equation was

$$Y = 0.621 + 0.145 \ X_1 - 0.035 \ X_2 + 0.143 X_3 + 0.517 \ X_4$$

Y is the dependent variable representing the profitability of investment companies.

X_1 represented the expected returns X_2 represented the risk,X_3 the liquidity of the fund and X_4 the investment assets were the dependent variables investment managers considered in their portfolio choices.

From the above regression model, holding expected returns, risk, liquidity of the fund and investment assets to constant zero profitability would be at 0.621. It was established that a

unit increase in expected returns would cause an increase profitability of the investment company by a factor of 0.145.

However there was a negative relationship with risk in that a unit increase in risk would lead to decrease in profitability of the company by a factor of 0.035.

A unit increase in liquidity of the fund would cause an increase in profitability by a factor of 0.143 and similarly a unit increase in investment assets would cause an increase in profitability of the firms by a factor of 0.517.

All the coefficients were found to be statistically significant at 95% confidence level with risk factor being the most significant at 0.012.

CHAPTER FIVE

SUMMARY OF FINDINGS CONCLUSION 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. This study therefore sought to determine how investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange,to find out how returns influences profitability of investment companies listed in the Nairobi Securities Exchange, to find out how risk influences profitability of investment companies listed in the Nairobi Securities Exchange, to find out how liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange,

5.2:Summary of the findings

The study sought to established that assets affects profitability of investment companies listed in the Nairobi Securities Exchange to a great extent, further the research revealed that investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg, investment managers strategy is to invest in various assets which can generate optimal returns while keeping risks at its minimal, Asset allocation and long term strategy that meets the future liability of the company and finally that investment managers search for suitable properties in an inefficient marketplace where data limitations on risk and return analysis can present fundamental problems to the management of the investment.

The study determined that returns influences profitability of investment companies listed in the Nairobi Securities Exchange to a great extent. From the analysis it was also revealed that, investment projects which tend to promise both high returns and a high risk are not attractive for most institutional investors, institutional investors maintain a conservative investment style, trying to combine the highest return with the lowest risk level in the investment portfolio, there exist a relationship between the returns of a portfolio and the returns of a single asset, investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment.

The study established that risk influences profitability of investment companies listed in the Nairobi Securities Exchange a great extent. The study also revealed that Risk assessment of the investment opportunities has an effect on performance; a firm will only invest if the discounted yield exceeds the cost of the project. Investment in mutual funds is somewhat not very much risky as investment in stock market and in making investment decisions of investment managers of investment companies risk is one of the major factors that influences decision making. During investment emphasis should be put 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.

The study determined that liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange to a great extent.The study further revealed that; investment institutions utilize their exposure and resources to develop detailed economic analysis and market area studies, liquidity preference affects the performance of investment companies,

and finally that there is a great need for investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment,

5.3:Conclusions

From the analysis and summary the research concludes that investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg. Investment managers strategy is to invest in various assets which can generate optimal returns while keeping risks at its minimal, the study also concludes that investment projects which tend to promise both high returns and a high risk are not attractive for most institutional investors since they maintain a conservative investment style through trying to combine the highest return with the lowest risk level in the investment portfolio.There exist a relationship between the returns of a portfolio and the returns of a single asset, investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment, the study further revealed that risk assessment of the investment opportunities has an effect on performance, during investment emphasis should be put 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 And regarding liquidity the study concludes that investment institutions utilize their exposure and resources to develop detailed economic analysis and market area studies, liquidity preference affects the performance of investment companies, and finally that there is a great need for investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment.

5.4:Recommendations

The study recommends that companies should have a well-maintained portfolio in order to achieve success, companies should also determine an asset allocation that best conforms to company's investment goals and strategies. The portfolio should meet the expected future needs for capital. Investment companies Investors should be very clear about their investment objectives when considering switching funds, because their investment horizon can be directly affected.

Investment companies should consider their cash flow situation and set aside money for emergencies tying up their funds in investments. It may also be wise to invest in more liquid assets if you have a short-term goal, it is vital for investment companies to diversify their portfolio by investing across markets, sectors or geographical regions to reduce risk.

It is extremely important for every company to recognize potential risks they face and prepare effective strategies to deal with them and prepare contingency plans shows how to handle risks as they occur, Investors should also consider investing across different asset classes such as stocks, bonds or mixed-assets to further diversify their portfolios.

There is need for the management of investment companies to have solid organization structure, organization structure will influence their investment portfolio choice which impact on their financial performance. Good organization structure will allow for better investment decision in the companies that manage their investment and thus increasing the performance of their companies in Kenya.

5.5:Suggestions for Further Research

A study can be designed to find out the impact of country economic growth on performance of investment companies in Kenya. This will give an indication on the effects of country economic growth on performance of investment companies in Kenya.

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APPENDICES

Appendix I: Questionnaire

Section A: General information

1. Please indicate your gender.

   Male   [   ]   Female   [   ]

2. How long have you worked in the organization?

   Below 2 years [ ]   2-6 years [ ]   7-10 years [ ] Above 10 years [ ]

3. How long have you worked in the current position?

   Below 5 years   [ ]   5-10 years   [ ]   10-15 years   [ ]   15-20 years [ ]

4. Please indicate your highest level of education:

   Phd   [ ]   Masters [ ]   Bachelors [ ]   Diploma [ ]   Certificate [ ]

5. To what category does you firm belong to**?**

   Agricultural   [ ]   Commercial and services   [ ]

   Telecommunication and technology   [ ]   Automobiles and accessories [ ]

   Banking   [ ]   Insurance   [ ]

   Investment   [ ]   Manufacturing and allied   [ ]

   Construction and allied   [ ]   Energy and petroleum   [ ]

Section B: Investment Assets and Profitability

6. Does investment assets affects profitability of investment companies listed in the Nairobi

   Securities Exchange?

   Yes   [ ]   No   [ ]

7. To what extent does investment assets affects profitability of investment companies listed in the Nairobi Securities Exchange?

    To a very great extent   [ ]

    To a great extent   [ ]

    To a moderate extent   [ ]

    To a little extent   [ ]

    To no extent   [ ]

8. To what extent do you agree with the following statement relating to investment assets and profitability of investment companies listed in the Nairobi Securities Exchange?

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Investment managers strategy is to invest in various assets which can generate optimal returns while keeping risks at its minimal					
invetsment managers search for suitable properties in an inefficient marketplace where data limitations on risk and return analysis can present fundamental problems to the management of the investment					
investment is not just about picking stocks, but about choosing the right combination of stocks among which to distribute one's nest egg					
Asset allocation and long term strategy that meets the future liability of the company					

9. How does an investment asset affects profitability of investment companies listed in the Nairobi Securities Exchange?

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Section C: Return and profitability

10. Does returns influences profitability of investment companies listed in the Nairobi Securities Exchange?

    Yes   [ ]   No   [ ]

11. To what extent does return influences profitability of investment companies listed in the Nairobi Securities Exchange?

    To a very great extent   [ ]

    To a great extent   [ ]

    To a moderate extent   [ ]

    To a little extent   [ ]

    To no extent   [ ]

12. What is you level of agreement on statement relating influence of returns on profitability of investment companies listed in the Nairobi Securities Exchange?

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree

Investor looks forward to getting good return for their investment as a compensation or reward for taking a risk in an investment				
There exist a relationship between the returns of a portfolio and the returns of a single asset				
institutional investors maintain a conservative investment style, trying to combine the highest return with the lowest risk level in the investment portfolio				
investment projects which tend to promise both high returns and a high risk are not attractive for most institutional investors				
Return is a major factor and has a direct link as the final measure of an investment, the higher the return the more investors would make a decision to invest in a particular security says				

13. How else does returns influences profitability of investment companies listed in the Nairobi Securities Exchange?

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Section D: Risk and Profitability

14. Does risk influences profitability of investment companies listed in the Nairobi Securities

Exchange?

Yes   [ ]   No   [ ]

15. To what extent does risk influences profitability of investment companies listed in the

Nairobi Securities Exchange

To a very great extent   [ ]

To a great extent   [ ]

To a moderate extent   [ ]

To a little extent   [ ]

To no extent   [ ]

16. What is you level of agreement on statement relating to influence of risk on profitability

of investment companies listed in the Nairobi Securities Exchange

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
In making investment decisions of investment managers of investment companies risk is one of the major factors that influences decision making					
investment in mutual funds is somewhat not very much risky as investment in stock market					

During investment emphasis should be put on the importance of interest rates in investment decisions					
A firm will only invest if the discounted yield exceeds the cost of the project					
Changes in interest rates should have an effect on the level of planned investment undertaken by private sector businesses in the economy					
Risk assessment of the investment opportunities has an effects on performance					

17. How does risk influences profitability of investment companies listed in the Nairobi Securities Exchange?

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Section E: Liquidity and Profitability

18. Does liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange?

    Yes   [ ]   No   [ ]

19. To what extent does liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange?

    To a very great extent   [ ]

    To a great extent   [ ]

To a moderate extent   [ ]

To a little extent   [ ]

To no extent   [ ]

20. What is you level of agreement on the following statement relating to effects of liquidity on profitability of investment companies listed in the Nairobi Securities Exchange?

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
investment institutions will utilize their exposure and resources to develop detailed economic analysis and market area studies					
investors for real investment trusts because they considered offering more liquid investment vehicles that formed part of a well-diversified investment portfolio					
Liquidity preference affects the performance of investment companies					

21. How does liquidity affect the profitability of investment companies listed in the Nairobi Securities Exchange?

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Thank you

Appendix II: Nse Listed Companies.

AGRICULTURAL	COMMERCIAL AND SERVICES	INSURANCE
Eaagads Ltd Ord 1.25 AIMS*	Express Kenya Ltd Ord 5.00 AIMS	British-American Investments Co.(Kenya)Ltd Ord 0.10
Kakuzi Ltd Ord.*5.00	Hutchings Biemer Ltd Ord 5.00 (suspended)	CFC Insurance Holdings Ltd ord.1.00
Kapchorua Tea Co. Ltd Ord Ord 5.00 AIMS	Kenya Airways Ltd Ord 5.00	Jubilee Holdings Ltd Ord 5.00
The Limuru Tea Co. Ltd Ord 20.00 AIMS	Longhorn Kenya Ltd Ord 1.00 AIMS	Kenya Re Insurance Corporation Ltd Ord 2.50
Rea Vipingo Plantations Ltd Ord 5.00	Nation Media Group Ltd Ord. 2.50	Pan Africa Insurance Holdings Ltd Ord 5.00
Sasini Ltd Ord 1.00	Scangroup Ltd Ord 1.00	
Williamson Tea Kenya Ltd Ord 5.00 AIMS	Standard Group Ltd Ord 5.00	**INVESTMENT**
	TPS Eastern Africa Ltd Ord 1.00	Centum Investment Co Ltd Ord 0.50
AUTOMOBILES & ACCESSORIES	Uchumi Supermarket Ltd Ord 5.00	City Trust Ltd Ord 5.00 AIMS
Car & General (K) Ltd Ord 5.00		Olympia Capital Holdings Ltd Ord 5.00
CMC Holdings Ltd Ord 0.50 (suspended)*	**CONSTRUCTION & ALLIED**	Trans-Century Ltd Ord 0.50 AIMS
Marshalls (E.A.) Ltd Ord 5.00	Athi River Mining Ord 5.00	
Sameer Africa Ltd Ord 5.00	Bamburi Cement Ltd Ord 5.00	**MANUFACTURING & ALLIED**
	Crown Berger Kenya Ltd Ord 5.00	A.Baumann & Co Ltd Ord 5.00 AIMS (Suspended)
BANKING	E.A.Cables Ltd Ord 0.50	B.O.C Kenya Ltd Ord 5.00
Barclays Bank of Kenya Ltd Ord 0.50	E.A.Portland Cement Co. Ltd Ord 5.00	British American Tobacco Kenya Ltd Ord 10.00
CFC Stanbic of Kenya Holdings Ltd ord.5.00		Carbacid Investments Ltd Ord 5.00
Diamond Trust Bank Kenya Ltd Ord 4.00	**ENERGY & PETROLEUM**	East African Breweries Ltd Ord 2.00
Equity Bank Ltd Ord 0.50	KenGen Co. Ltd Ord. 2.50	Eveready East Africa Ltd Ord.1.00
Housing Finance Co. Kenya Ltd Ord 5.00	KenolKobil Ltd Ord 0.05	Kenya Orchards Ltd Ord 5.00 AIMS
Kenya Commercial Bank Ltd Ord 1.00	Kenya Power & Lighting Co Ltd Ord 2.50	Mumias Sugar Co. Ltd Ord 2.00
National Bank of Kenya Ltd Ord 5.00	Total Kenya Ltd Ord 5.00	Unga Group Ltd Ord 5.00
NIC Bank Ltd Ord 5.00		
Standard Chartered Bank Kenya Ltd Ord 5.00		**TELECOMMUNICATION & TECHNOLOGY**
The Co-operative Bank of Kenya Ltd Ord 1.00		AccessKenya Group Ltd Ord. 1.00
		Safaricom Ltd Ord 0.05

Source: CMA Annual Report 2012