INVESTIGATING THE VIABILITY OF UNIT TRUST BUSINESS IN ZIMBABWE

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Abstract

This paper uses a case study methodology to investigate the viability of unit trust business in Zimbabwe during the period from 2000 to 2005. The research revealed that unit trust companies at least managed to break even during the period under study except in 2004. However, factors which worked against unit trust business viability in Zimbabwe during the period under study include among others the restrictive regulatory framework, harsh operating economic environment, trustee inefficiency, low volume of funds under management, poor asset and liability management strategy, high levels of withdrawals and low confidence levels in unit trust companies. It can be concluded that unit trust business has good potential in Zimbabwe. The fact that unit trust funds' returns have been consistently outperforming both inflation and stock market growth shows a great potential for unit trust business in Zimbabwe. The author therefore recommends that policies, which are geared towards boosting unit trusts' funds under management, should be intensified, in order to promote long-term viability of unit trust business in Zimbabwe.

Keywords: Zimbabwe, Unit Trusts, Viability, Funds Under Management, Profitability

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1. Introduction

Unit trusts are a popular investment vehicle in the present day world financial markets as they represent a significant proportion of personal financial assets Sellon (2004). The developments in Zimbabwe seem to confirm the above research findings by Sellon (2004). According to Reserve Bank of Zimbabwe (RBZ, 2001), financial market deregulation allowed more participants in the provision of unit trust products in Zimbabwe. The number of unit trusts providing companies in Zimbabwe had gone up to 6 by 1997, namely First Mutual, Old Mutual, Tetrad, Kingdom, Syfrets and Fidelity unit trusts Zimbabwe Association of Unit Trusts (ZAUT, 2001). ZAUT (2005) report revealed that unit trust business reached its peak in terms of profitability and number of market participants in year 2003. The report further revealed that the number of unit trust companies in Zimbabwe had gone up to 13 by end of 2003 namely Old Mutual, First Mutual, Zimnat, GP2, Goal bold, Sunshine, African Banking Corporation (ABC), Syfrets, Fidelity, Barbican, Fins real, Kingdom and Tetrad. According to the RBZ (2004), 6 unit trust companies collapsed due to viability problems and failure to adhere to regulatory framework provisions. These include First Mutual, GP2, Sunshine, Goal bold, Intermarket and Barbican unit trusts.

Unit trusts worldwide have been proven to be having the capacity to mobilise meaningful resources even from the marginalised sectors of the economy African Development Bank (ADB, 2004). Like any other business, unit trust business need to be viable in order to remain vibrant in resource mobilisation aspect, argued Brookey (1999). Increasing costs associated with doing unit trust business in Zimbabwe exacerbated by a four-digit (1193.5%) year on year inflation, dwindling savings, shrinking purchasing power, foreign currency shortages and high nominal but negative real interest rates, makes it difficult for unit trust business to survive, Bankers' Association of Zimbabwe (BAZ, 2005). It is against this background that the researcher wants to investigate the viability of unit trust business in Zimbabwe given the prevailing harsh macro economic environment during period 2000 to 2005.

Strategic resources allocation is going to be made easy through the adoption of this research's recommendations. The research will benefit the unit trust business policymakers in coming up with their strategic business models meant to revitalise unit trust business in Zimbabwe. It is the researcher's belief that this research will provide a useful input in unit trust business strategy formulation, implementation and review process. Section 2 looks at unit trust business viability in Zimbabwe. Section 3 reviews major theoretical and empirical underpinnings of unit trust business viability. Section 4 looks at the presentation and analysis of results of the study. Section 5 concludes the study.

2. Unit trust business viability in Zimbabwe

The developments in Zimbabwe seem to confirm the above research findings by Sellon (2004). Return from unit trust funds on average had managed to consistently beat both inflation and Zimbabwe Stock Exchange Industrial Index (Comarton Survey, 2001-2005). The potential of unit trusts attracted new players in year 2001, namely Zimnat and Barbican unit trusts. Fins real, GP2, Sunshine and Goal bold were then launched in year 2002, further confirming the popularity of unit trusts not only in Zimbabwe but the world over, (ZAUT, 2005).

Muringari (2004) pointed out that poor macro economic environment that prevailed during the period under study was not suitable for unit trust business viability. The hyper inflationary environment, which recorded 1193.5% year on year and 28% month on month in May 2005, reduces income's purchasing power hence effectively reducing amount of savings on the part of investors. Reducing savings indirectly lower unit trust business viability and profitability (ZAUT, 2004). Muringari (2004) further pointed out that reduced savings was one of the reasons attributable to the collapse of some unit trust companies in year 2004.

According to ZAUT (2004), the fixed foreign exchange rate system had been causing some negative effects on the viability of unit trust business in Zimbabwe. The policy created foreign currency shortages in the official market thus negatively impacting on companies which uses imported unit trust systems. This has further constrained unit trust business operations and viability in Zimbabwe, (Old Mutual Unit Trusts Report, 2005). Delays to pay systems maintenance fees has created poor business relationships as the system vendors deliberately take long period to sort out a minor unit trusts system problem hence negatively impacting on quality of service delivery ZAUT (2004).

According to the RBZ (2005), foreign currency shortages have made it extremely difficult to send staff members to other countries to study modern ways of administering unit trusts. A greater portion of unit trust business profit goes towards payment of system maintenance fees as the local currency continues to depreciate against other currencies hence affecting profitability and viability of unit trust business in Zimbabwe, (Syfrets Unit Trusts Report, 2004). In addition, the report pointed out that stringent regulatory framework further pull down profitability and potential of unit trust business in Zimbabwe. High interest rate regime work against unit trust business viability as it increases interest rate exposure Zimbabwe National Chamber of Commerce (ZNCC, 2004).

3. Review of related literature

Nicoll (2005) described unit trusts viability as a situation where the return of unit trusts outweighs both inflation and stock exchange performance. Woodlin (2003) added that such a scenario can easily be achieved if unit trusts portfolio is properly diversified and actively managed. However, Lambrechts (1999) pointed out that unit trust viability has to be assessed in terms of its contribution to the overall profitability of the company and shareholder value point of view. Chiplin and Wriht (1998) supported this view and even further noted that tools such as the BCG Matrix Model must be used to assess if unit trusts in any country are viable.

According to Phillip (2000), unit trusts viability can also be analysed from the view of changes in units in issue or new business growth. An unprecedented increase in units in issue or new investments is an indicator of unit trusts viability. An increase in units in issue will obviously boost funds under management and enable unit trusts funds enjoy advantages associated with economies of scale (Phillip, 2000). Unit trusts viability can also be measured by assessing business volumes lost by banks and pension funds to unit trusts, argued Sellon (2004). The more business is lost to unit trusts by pension funds and banks, the more viable unit trusts products according to Sellon (2004).

Two approaches that explain unit trusts viability include the risk-return and cost-income approach (Jean, 1996). Risk-Return theory focuses on unit trusts from investors' point of view. According to Jean (1996), unit trusts can only be viable if return offered justifies the risk taken. This theory is also known as the opportunity cost theory on unit trusts viability. Jean (1996) further noted that unit trusts viability has to be analysed in the context of how much return could have been made if money had been invested elsewhere. However, the theory was criticised by John (2000) who cited theory's lack of imagination on the point of view unit trusts viability should be analysed. According to John (2000), any theory on this subject matter which fails to note that profitability and cash flow implications are core issues surrounding unit trust business viability in any country should be dismissed. Cost-Income theory states that unit trusts can only be viable as a business unit if cash inflows are greater than cash outflows. Jean (1996) further noted that unit trusts like any other business can only become viable if it does not face any cash flow problems. According to John (2000), the cost-income theory only stated but fell short of articulating the actual implications of negative cash flows on unit trusts viability.

Allen (1993) argued that active fund management strategy is the pillar for unit trusts viability management. In active fund management strategy, fund managers look for shares of companies they believe offer strong earnings growth potential.

Investment strategy focuses on shares with strong earnings, growth prospects, health cash flows and shares showing a positive relative strength. Unit trusts shares are continuously monitored to justify their inclusion in the portfolio and will be sold if they do not meet the selection criteria. Allen (1993) argued that the traditional 4Ps of marketing (product, place, price and promotion) are very crucial in designing the best marketing strategy to ensure unit trust business viability. Supportive unit trusts distribution channels, low cost strategy and heavy promotion of unit trust products are essential ingredients in achieving and sustaining unit trust business viability, argued Allen (1993).

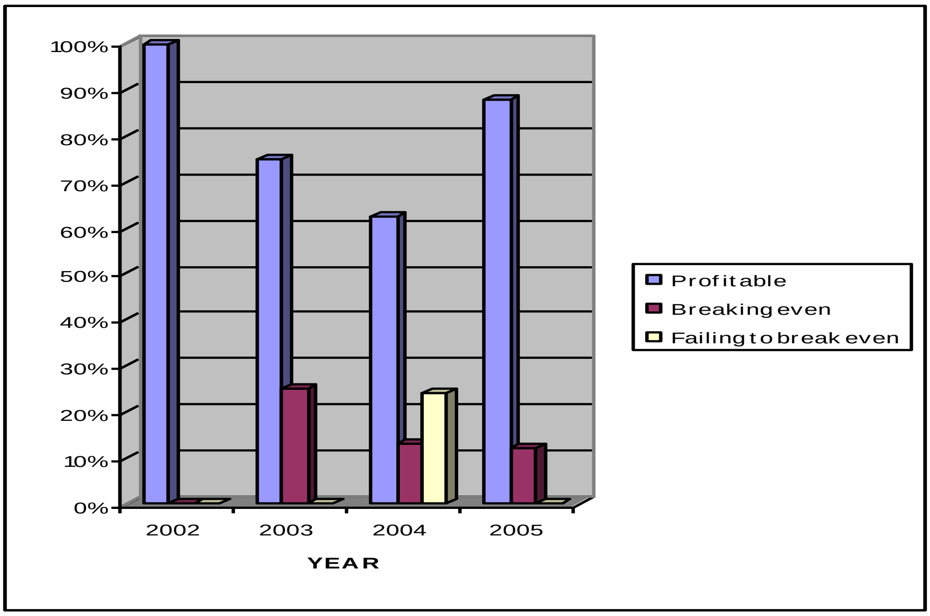
4. Analytical framework of viability of unit trust business in Zimbabwe

Three tools were used to critically analyse unit trust business viability in Zimbabwe, namely profitability, break even and cash flow analysis. The findings regarding these analyses are now considered in detail.

a) Profitability and breakeven analysis

Figure 1 below is a bar graph which shows percentage of profitable and unprofitable unit trust companies during the period 2002 to 2005.

Figure 1. Unit trusts profitability analysis in Zimbabwe (from 2002 to 2005)



Source: Zimbabwe Association of Unit Trusts (2006)

Seventy five percent (75%) of unit trust companies were at least profitable and 25 percent managed to break even in 2003. Undoubtedly, these statistics were inevitable as competition intensified, characterized by new players which were intending to establish themselves by engaging in rigorous marketing efforts. Marketing expenditure levels surged across all unit trust companies as the fight for market share control intensified in 2003.

Figure 1 also revealed that, 63 percent of unit trust companies were profitable whilst 13 percent managed to break even in 2004. On the other hand, 24 four percent failed to break even during the same year. The general decline in profitability levels in 2004 is attributable to the December 2003 monetary policy which tightened the liquidity provision policy to banks. The policy had produced some negative ripple effects as it led to the collapse of a number of asset management companies such as Barbican, First Mutual, ENG Capital, Fins real, GP2, First Factoring, Imperial, Sunshine and Goal bold only just to mention a few. The financial crisis of 2004 forced many unit trust investors to channel their money to traditional banks which they perceived as secure, ZAUT (2006). This greatly reduced general profitability levels in 2004. According to ZAUT (2006), eighty eight percent of unit trust companies were profitable in 2005 whilst the remainder managed to break even during the same year.

(b) Cash flow analysis

Banks in Zimbabwe lost a significant amount of business to unit trusts in the year 2002 and 2003 whilst the trend was opposite in the year 2004. According to Comarton survey (2004), Old Mutual unit trusts was the biggest beneficiary of investors pulling out their money from banks in favour of unit trusts, followed by Kingdom, Syfrets, Tetrad, Datvest, Zimnat and Merchant Bank of Central Africa

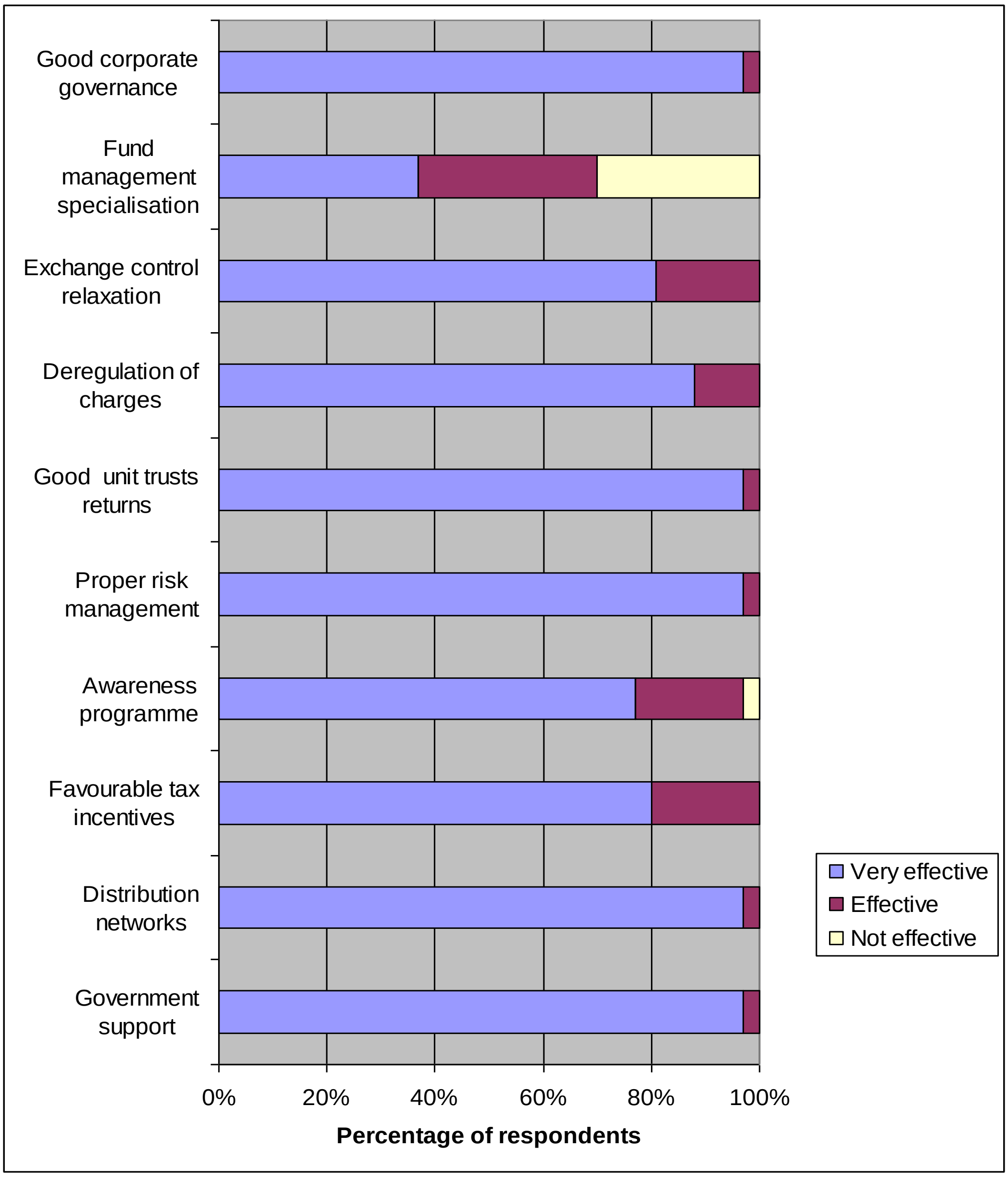
(MBCA). Comarton Survey (2005) revealed that strategic alliance was behind the increased investments from banks into unit trusts. For example the strategic alliance between Old Mutual unit trusts and Central African Building Society (CABS), Kingdom unit trusts and Kingdom Bank, Syfrets unit trusts and Zimbank, Datvest unit trusts and Interfin Merchant Bank.

Whilst all other unit trust companies were losing business to unit trust funds, Old Mutual in 2004 actually experienced the highest amount of new business injection from banks by approximately 26 percent because of high investor confidence in the company. According to RBZ (2004), the year 2004 was characterised by large amounts of funds withdrawals from unit trusts to traditional banks due to panic by investors as Barbican, First Mutual, GP2, Fins real and Goal bold unit trust companies were placed under curatorship.

c) Critical success factors for unit trust business viability in Zimbabwe

According to ZAUT (2006), there are ten critical success factors for unit trust business viability in Zimbabwe, namely good corporate governance, fund management specialisation, exchange control relaxation, deregulation of charges, good unit trusts returns, proper risk management, awareness programme, favourable tax incentives, distribution networks and government support (see Figure 2).

Figure 2. Analysis of effectiveness of strategies to promote unit trusts viability in Zimbabwe

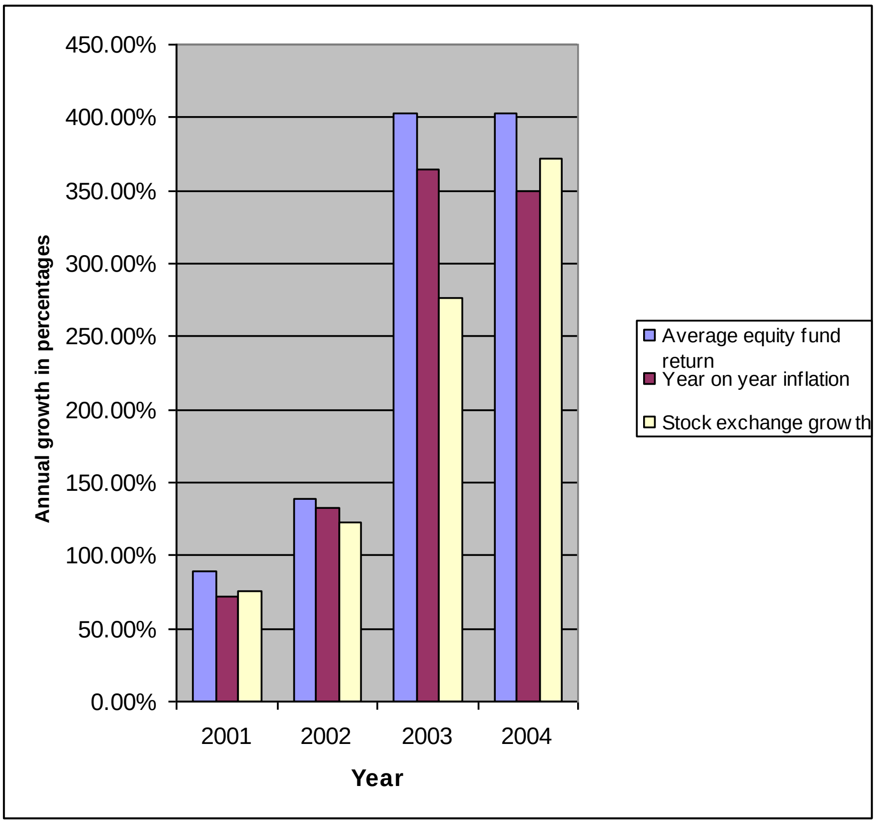


Source: Zimbabwe Association of Unit Trusts (2006)

d) Unit trust funds performance in Zimbabwe

The research compared unit trust funds return versus inflation and Zimbabwe Stock Exchange growth from year 2001 up to 2004. The study revealed that unit trusts have been performing consistently above both inflation and Zimbabwe Stock Exchange during the period under study (see Figure 3).

Figure 3. Unit trust funds return versus inflation and Zimbabwe Stock Exchange growth.



Source: Zimbabwe Association of Unit Trusts (2006)

The research revealed that superior stock selection, good diversification strategy and proper asset and liability management strategy were behind the impressive performance of unit trust funds in Zimbabwe during the period under study.

5. Conclusion

It can be concluded that unit trust business in Zimbabwe has been profitable but viable to a lesser extent during the period under study. Positive profit levels recorded by all unit trust companies during the period under study were inadequate to enable unit trust business expansion and infrastructural development. The research confirmed that government support is a chief factor in the growth, success and viability of unit trusts in Zimbabwe and this corroborates with empirical research findings by Syapouty (2004). The research also revealed that there is a positive correlation between cash inflow into unit trust funds and profitability levels thus confirming empirical research findings by Woodlin (2003). It can therefore be concluded that net cash inflow into unit trust funds is one of the chief factors necessary for unit trust business profitability and viability in Zimbabwe.

Research findings on the importance of proper risk management in ensuring unit trust business viability mirrors that of Jorion (2003). The latter found out that increase in the sophistication of risk analysis by better educated and more experienced managers in Singapore further added impetus to unit trust business viability. Kainja (1998)'s research findings to a larger extent confirmed those of the current research particularly on the critical success factors for unit trusts in South Africa.

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