THE VALUE CHAIN OF A COLLECTIVE INVESTMENT SCHEME AND THE IMPACT THEREOF ON THE INDIVIDUAL INVESTOR

by

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DECLARATION

Student number: 0502-013-1

I declare that ***THE VALUE CHAIN OF A COLLECTIVE INVESTMENT SCHEME AND THE IMPACT THEREOF ON THE INDIVIDUAL INVESTOR*** is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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A B WALTERS DATE

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EXECUTIVE SUMMARY

Collective investments have become a very popular investment vehicle in South Africa because it is, among other things, transparent, liquid and easily accessible. Growing investor knowledge, good market returns and its suitability for diversification, which minimizes risk, also contributes to its popularity. A value chain that adds value to the investor has developed around the collective investment scheme. The role players in this chain include the investment manager, the management company and financial intermediaries. The growth in this part of the collective investment industry has been so dynamic that regulation and the introduction of various new intermediary layers are constantly affecting the value chain and the value added for the investor. Research was conducted to assess the impact of the value chain on the behaviour of the individual investor and the effect this has on wealth creation. The literary review established that the environment surrounding this dynamic and interdependent value chain is well-regulated and that costs and investor behaviour could have a significant impact on investment returns. The empirical study revealed that the average individual investor recognizes the impact of the value chain on his investment, but perceives himself as being knowledgeable enough to avert ineffectiveness in the chain by ensuring desired investment returns through good investment decisions. Over-diversification and irresponsible switching between funds by the investor can, however, destroy value and negate the effect of long-term returns.

Key terms:

Collective investment scheme; unit trust; mutual fund; portfolio theory; diversification; value chain; management company; investment manager; financial intermediary; individual investor; investor behaviour

CONTENTS

LIST OF ABBREVIATIONS

ACI	-	Association of Collective Investments
AFMA	-	Australian Financial Markets Association
ALSI	-	All Share Index
BBA	-	British Bankers Association
CAPM	-	Capital Asset Pricing Model
CFA	-	Chartered Financial Analyst
CIS	-	Collective Investment Scheme
CISCA	-	Collective Investment Schemes Control Act
CPIX	-	Consumer Price Index (Excluding interest rates and mortgage bonds)
DJIA	-	Dow Jones Industrial Average
EFFAS	-	European Federation of Financial Analysts Association
EMH	-	Efficient Market Hypothesis
ETF	-	Exchange Traded Fund
EU	-	European Union
FAISA	-	Financial Advisory and Intermediary Services Act
FICA	-	Financial Intelligence Centre Act
FMI	-	Financial Market Intermediary
FSB	-	Financial Services Board
ICI	-	Investment Companies Institute
IIAC	-	Investment Industry Association of Canada

IMA	-	Investment Management Association
IOSCO	-	International Organization of Securities Commissions
JSDA	-	Japan Securities Dealers Association
JSE	-	Johannesburg Stock Exchange
LISP	-	Linked Investment Service Provider
MPT	-	Modern Portfolio Theory
NYSE	-	New York Stock Exchange
OEIC	-	Open-Ended Investment Company
QAIB	-	Quantitative Analysis of Investor Behaviour
SAGE	-	South African Growth Equity
SEC	-	Security and Exchange Commission
SISA	-	Savings Institute of South Africa
SML	-	Security Market Line
SP500	-	Standard & Poor's Top 500 Index
TER	-	Total Expense Ratio
UCITS	-	Undertakings for Collective Investment in Transferable Securities
ZKA	-	Zentraler Kreditausschuss

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

Why do investors invest? The two main motivations for investors investing are firstly to save – in other words, the desire to pass money from the present to the future in anticipation of future cash needs, and secondly to increase wealth or simply put, to make money grow (Goetzmann, 1997). As there is a trade-off for the investor between these two motivations, the investor needs to assess the inherent risk of losing money against the expected returns of the investment. Bogle (1998, p. 3) puts this into perspective when he says: *"But the reality of investing, as I see it, is that an extra percentage point of standard deviation (a rough proxy indeed for the elusive concept of risk) is meaningless, while an extra percentage point of long-term return is priceless."*

Investment theory explains the way in which investors specify and measure risk and return. Broadly, investors are faced by systematic and unsystematic risk, which they deal with by constructing portfolios invested in various asset classes in order to reduce risk (Marx, et al. 2003). Markowitz (1952) realised, however, that it was not enough to look at the expected risk and return of one stock. By investing in more than one stock, an investor could reap the benefits of

diversification -- chief among them, a reduction in the risk level of the portfolio (McClure, 2006). Harry Markowitz, a Nobel laureate developed the *Modern Portfolio Theory (MPT)* in the early 1950's. The Modern Portfolio Theory is defined as a

> Set of concepts aimed at building a most efficient collection (portfolio) of different types of assets, based on the observation that although investors want high returns they dislike high risk (likelihood of the deviation of an actual return from the anticipated return). It suggests that the risk of a particular investment comprising a portfolio should be assessed on the basis of how its value varies in comparison with the market value of the entire portfolio, and not in isolation. And that a diversified portfolio of investments is efficient if it yields highest possible return for a given level of risk or incurs the lowest level of risk for a given amount of return (BusinessDictionary.com, 2007).

Investment theory was further refined by the introduction of the concept of the risk-free asset by researchers such as Sharpe (1963), Lintner (1965) and Mossin (1966). Essentially, their argument is that investors are not rewarded for bearing unsystematic risk that can be diversified. The principle of diversifying a portfolio is fully entrenched in the theory of collective investments (unit trusts). In order to ensure that unit trusts are sufficiently diversified, unit trust managers are required

not to invest more than 5% of the assets of the fund in one particular security (Marx, et al. 2003).

A Collective Investment Scheme (CIS) is a regulated pooled investment fund where the underlying investors own units in a shared portfolio. The full definition of a collective investment scheme as defined in the Collective Investment Schemes Control Act (CISCA) is:

> *"Collective investment scheme"* means a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which –
>
> *(a)* two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and
>
> *(b)* the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed, but not a collective investment scheme authorized by any other Act (2002).

The most common type of collective investment scheme in South Africa is a unit trust, although the Collective Investment Schemes Control Act of 2002 makes provision for various types of collective investment schemes such as Open-Ended Investment Companies (OEIC's), Exchange Traded Funds (ETF's), participatory bonds and others (Oldert, 2006). In the United States of America, the biggest investment market by far, these funds are known as mutual funds. Elsewhere in the world, such as the United Kingdom, they are still referred to as unit trusts. These funds are all per definition and for the purposes of this dissertation *Collective Investment Schemes (CIS).* The terms c*ollective investment schemes, unit trusts* and *mutual funds* will be used indiscriminately throughout this dissertation as the context of the particular passage calls for.

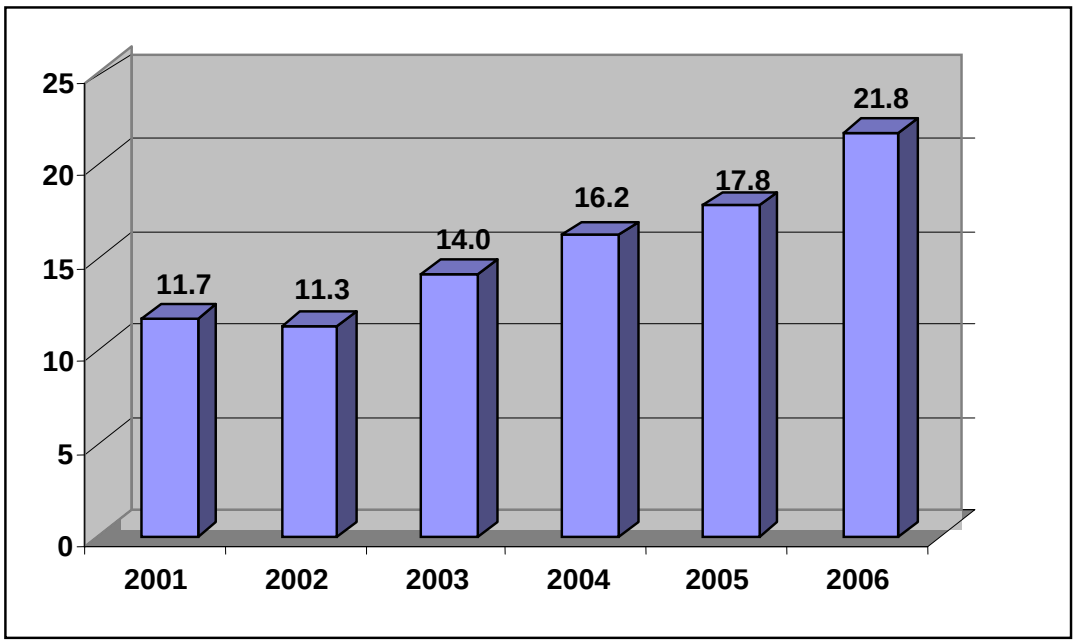
A value chain has developed around the collective investment scheme through value added by portfolio managers, management companies, and financial advisors and brokers. This value chain, as originally developed by Porter (1985), creates value for the individual investor. The value created is enhanced through the effectiveness of the value chain.

Investments in collective investment schemes have seen a worldwide growth phenomenon during the latter part of the 20th century that continued into the new millennium. The latest Investment Company Institute (ICI) Survey of 61,506 funds in 34 countries shows that net cash flow into collective investment schemes during 2006 ($1,299 billion) was four times more than that of 2003

($317 billion) (Investment Company Institute, 2006a). The graph below (Figure 1-1) shows the worldwide growth in mutual fund assets during the first part of this millennium.

FIGURE 1-1

Worldwide mutual fund asset growth 2001 – 2006 ($'trillion)



Source: Adapted from Investment Company Institute (2007a)

Table 1-1 below shows the relative sizes of the mutual fund industries worldwide. 50% of the world mutual fund market is in the United States. The South African collective investment market is, however, still very small in relation to other industries worldwide. Interestingly enough, the biggest markets outside the United States are those in Luxembourg and France which, when combined, are bigger than half the size of the whole European unit trust market.

TABLE 1-1

Global investments in collective investment funds

	2001 US$ bn	2006 US$ bn
World	11,654	21,765
United States	6,975	10,414
Europe	3,168	7,744
Asia and Pacific	1,039	2,457
Africa (South Africa)	15	78

Source: Investment Company Institute (2007a)

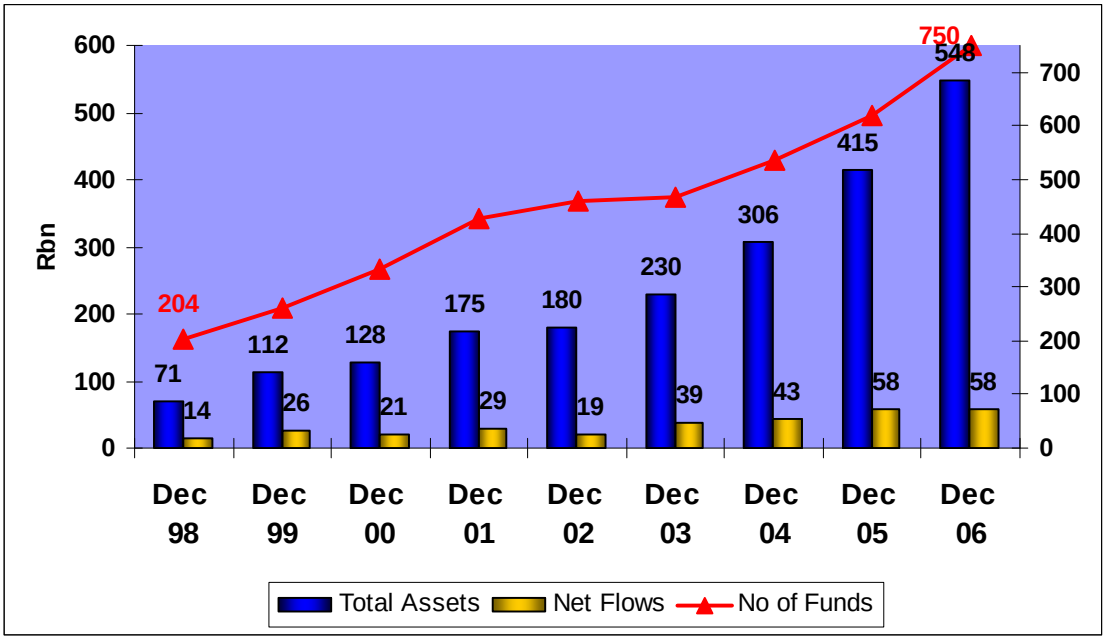
The collective investment industry in South Africa started in 1965 with the introduction of the first unit trust, the South African Growth Equity fund (SAGE). The fund was created with the objective to give the man in the street access to the stock exchange without actually investing directly. The original unit trusts mainly gave access to equities on the security exchange. As the success of this new investment vehicle grew, access was also given to other asset classes such as property, capital and money markets, as well as several kinds of financial instruments such as derivatives, etc.

Gradual awareness of the benefits of collective investments as an investment vehicle has led to more and more individuals as well as institutions in South Africa taking note of and starting to invest in it. This growth has culminated in an industry in South Africa today (December 2006) that has R546,656 million assets

under management that are invested in 750 funds managed by 34 management companies for 1,945,148 investors. The total of all the equity holdings under management in the industry constitutes 4.42% of the market capitalisation of the Johannesburg Stock Exchange (JSE) (Association of Collective Investments, 2006a).

FIGURE 1-2

Growth of the collective investment industry in South Africa



Source: Association of Collective Investments (2007a)

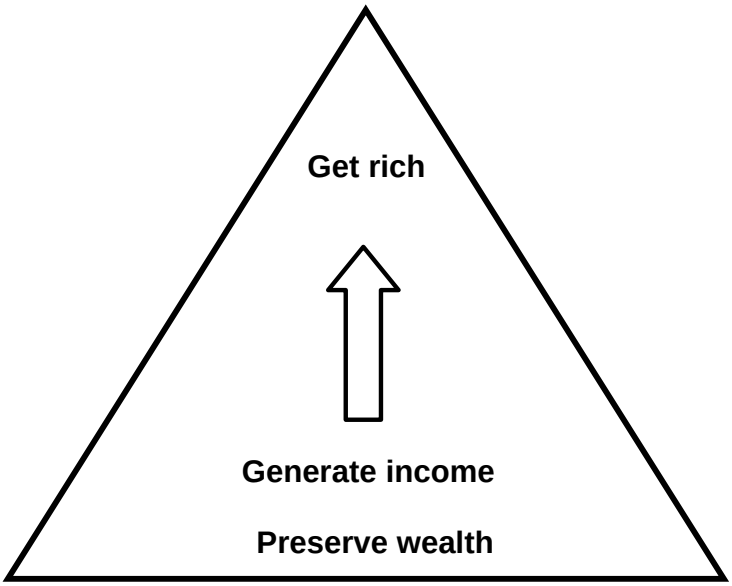
The growth of the South African collective investment industry over the recent past is shown in Figure 1-2 above. The annual compound growth of 29,1% per annum of industry assets over the last 8 years is equally shared between net

inflows and market growth. It therefore confirms the growth in its popularity amongst the South African investment community.

What then are the main drivers behind an individual investor's behaviour? Maslow (1954) and Herzberg (1966) describes the needs of a human being as being in the form of a pyramid where the basic need for food and shelter first needs to be satisfied before the need for personal achievement, etc., can get attention. Shefrin and Statman (2000) also describe an average individual investor as first having basic needs, such as preserving wealth, before he wants to 'get rich'. Figure 1-3 below shows a pyramid depicting the typical individual investor's behaviour character.

FIGURE 1-3

Behaviour pyramid of the individual investor



Source: Adapted from Nofsinger (2005)

The investor therefore invests in an investment vehicle to satisfy a specific need. This basic need is for wealth creation and preservation. A definition for "investment" according to Reilly and Brown (2003, p. 5) is "…the current commitment of funds for a period of time in order to derive future payments that will compensate the investor for (1) the time the funds are committed, (2) the expected rate of inflation, and (3) the uncertainty of the future payments".

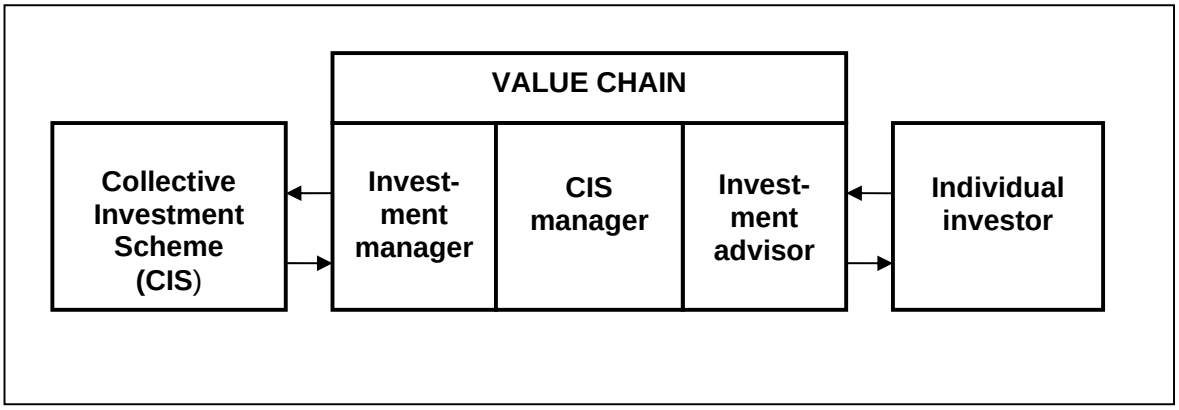
In order to satisfy these needs, the investor is dependent on an investment vehicle that should amongst other things be able to maximise the investor's investable income apportionment, asset class (securities, bonds, property, etc.), allocation and risk/ return attribution. A Collective Investment Scheme (CIS) is such an investment vehicle. The CIS is linked to the individual investor by way of a value chain. This value chain consists roughly of the following three main elements:

- An Investment Adviser who analyses the investor's investment need based on the investor's specific risk/ return profile and links it to an acceptable solution;
- A Collective Investment Scheme Manager who, through a regulated process, creates and administers the pooled structure;
- An Investment Manager who manages the underlying assets of the scheme as per pre-determined investment mandate.

These three main elements are linked to form the value chain of a collective investment scheme as depicted in Figure 1-4 below:

FIGURE 1-4

The value chain for a collective investment scheme



Source: Own design (2006)

1.2 PROBLEM STATEMENT

The popularity of Collective Investment Schemes as an investment vehicle in South Africa today lies in the fact that an individual investor can satisfy his investment needs through a value chain that has a dynamic interdependence and that ensures value added for the individual investor.

In this dissertation the value chain of a collective investment scheme will be identified and evaluated, and the role it plays in adding value for the individual investor will be determined. Although there are sound arguments to be made both for and against the effectiveness of the individual links in the value chain of a CIS, e.g. *"Unit trusts are managed by highly qualified investment managers, specialists whose full-time job is to make investment decisions"* (Prinsloo, 2005, p. 20), *"Trust me, I'm a broker"* (Harris, 2005, p. 10) and *Fees are the worm in your returns"* (Clayton, 2005), the value chain as a whole was taken into account to determine the satisfaction of the needs of the individual investor. In this regard the research also includes a study of the perceptions individual investors in South Africa have on the value added by this value chain. The following research questions were addressed in order to reach a satisfactory conclusion:

How is value created for an individual investor through a collective investment scheme value chain?

Investment theory principles such as the Modern Portfolio Theory and Mutual Fund Theory are used to explain value creation for the individual investor through diversification of his portfolio. In order to unlock this value, a feasible value chain should exist. A number of role players in this value chain contribute to the creation of value for the individual investor. These role players have an interdependent relationship among themselves as role players, as well as with the investor and CIS on the alternative ends of the chain. This leads to the

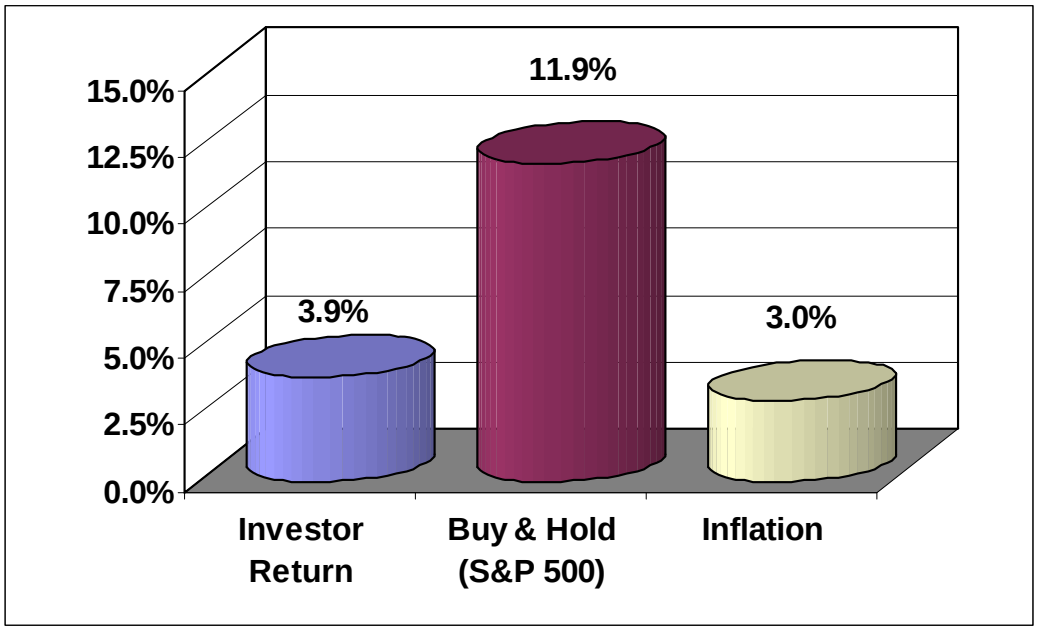
hypothesis that the value chain as a whole is responsible for creating value and satisfying needs for the individual investor. These theoretical aspects of the problem statement are addressed in Chapter 2 of this dissertation.

What is the value created, and can it be quantified?

A study of investor behaviour over a 20-year period between 1986 and 2005 has shown that mutual fund portfolios earned 11.9% on average per year while investors' own portfolios earned only 3.9% per annum. This left 77% of possible earnings on the table (Dalbar, Inc., 2006).

FIGURE 1-5

Returns for 20 years (1986 – 2005) on mutual fund investments



Source: Dalbar, Inc. (2006)

This was ascribed to investor behaviour such as fear, greed, risk aversion, etc. This study would suggest that an individual investor is prone to behaviour that does not affect maximum returns, for example switching in and out of funds for the wrong reasons. Nofsinger (2005) suggested that a number of psychological biases affected the individual investor's investment decision making. Some of these biases were related to overconfidence, pride and regret, mental accounting, etc.

Simple arithmetic would suggest that the collective investment scheme value chain had a huge role to play in this earning loss differential. The earnings loss referred to above was 8.0% (11.9% - 3.9%). To what extent did the value chain add to this differential? Stafford Thomas (2006, p. 86) argues that it cost less to manage your own portfolio than to opt for collective investments. He stated in an article in *The Financial Mail* that an individual investor of an equity portfolio managed by himself would have earned 9.7% on average against a collective investment portfolio that would have earned only 6,6% after costs. Over a 10 year period, the individual who has managed his own portfolio would have had a 152% net capital gain, whereas the investment in the collective investment portfolio would have had only a 90% capital gain. It is therefore clear that cost is a major factor in quantifying the value added by the value chain. In Chapter 2 a brief look at all the types of costs that exist within this value chain is taken.

What are the perceived needs of the individual investor and how is it satisfied through the value chain?

In the end it is the investor whose investment need satisfaction needs to be addressed. Although investment returns can be quantified, it may differ considerably from investor to investor, depending on their individual risk profile and investment portfolio. Each investor also has a different perception of what they expect from an investment. Much of these expectations are non-monetary based. Examples of these are client service, peace of mind, simplicity, etc. The behavioural aspects therefore also play a major part in the individual investor's investment decisions. People tend to be more emotional than logical about investment decisions. According to Nofsinger (2005), complex financial decisions are often made on the basis of the investor's emotions and feelings at that particular time. This may then indeed suggest that *"Investors can be their own worst enemy"* (Du Preez, 2005). The empirical part of this study consists of an evaluation of individual investors in South Africa that indicates their perception of wealth created by the value chain. The results thereof are discussed in Chapter 4.

How does the South African collective investment industry compare with the global mutual fund industry in terms of the behaviour of the individual investor?

The South African economy is generally regarded as an emerging market by the international investment community. The individual investor in South Africa can therefore be regarded as relatively immature in the investment behaviour arena. Earlier in this chapter a comparison of Figure 1-1 and Figure 1-2 showed that the collective investment industry in South Africa grew at a much faster rate (25.65% p.a.) during the past 5 years than the worldwide mutual fund industry (13.25% p.a.). This is a significant difference and could be ascribed to many factors. Indicating her perception of the South African investor, Di Turpin, the chief executive of the Association of Collective Investments (ACI), recently stated in an ACI news release (October 18, 2007): “It appears that the effects of the sub-prime fallout offshore have not had a major effect on South African investor behaviour, probably as they had been anticipating a market correction for a while and have been investing accordingly.” The results of the empirical study discussed in Chapter 4 will also endeavour to look at the South African investor in context with the global mutual fund investor.

1.3 RESEARCH OBJECTIVES

The research objectives of this dissertation are to address the problem statement and try to answer the research questions as stated in the previous section. This has been done by first exploring the theory behind the investment portfolio, and specifically the collective investment portfolio, to establish the value that it adds to the value chain. This was done by means of a literature review that researches

and compares various popular models of investment theory, illustrates the dynamics of collective investments, and investigates the impact of intermediaries on investment decisions.

Secondly, the research problem has been addressed by determining the individual investor's perception of the value created by the value chain and his likely behaviour. This was researched by way of a quantitative study that took the form of questionnaires sent to a representative sample of current investors in collective investments in South Africa. The well-diversified sample was asked to complete the questionnaire that was mailed to them electronically. The questionnaires were directed to determine the investor's knowledge of the investment environment in general, specifically focusing on the value chain and his view of value added by the value chain.

As already stated in the previous section, South Africa is still relatively young in the investment behaviour arena and there isn't currently much data available in this area. This research has been done to gather more data focused on the South African collective investment industry environment and to try to understand the behaviour of the individual investor in South Africa.

In summary the research objectives are:

- to understand how value is created for an individual investor through a collective investment scheme value chain;
- to try and quantify the value created by a value chain and determine the impact of costs on it;
- to determine if and how the individual investor's need is satisfied through the value chain, and
- to ascertain if there is a difference in investment behaviour between the South African individual investor and the average global individual investor.

1.4 AN OVERVIEW OF THE COLLECTIVE INVESTMENT INDUSTRY IN SOUTH AFRICA

Collective investments schemes have become an increasingly popular investment vehicle as shown by the sheer growth of the industry worldwide as alluded to in the Section 1.1. Table 1-2 below shows the growth of collective investments in South Africa during the past 20 years. According to this table, the assets of the industry grew by an average of 33% per annum. As shown in Section 1.3, the growth in South Africa nearly doubles that of the global mutual fund industry. There can be no doubt that collective investments have become a popular investment vehicle in South Africa. Reasonable grounds to explore some of the rationale behind this amazing growth therefore do exist.

TABLE 1-2

Summary of the South African collective investment industry growth

	Year end 31 March				
	2005	2000	1995	1990	1985
Number of management companies	26	30	22	18	7
Number of Funds	551	273	82	33	13
Assets under management (R'm)	319,414	117,334	25,630	7,623	1,150
Unit holders ('000)	2,318	2,271	1,648	601	249

Source: Association of Collective Investments (2005)

Table 1-2 above shows a strong growth in assets under management (33% per annum) and number of funds (21% per annum). Although there are also significant growth in the number of management companies (7% per annum) and number of unit holders (12% per annum), the growth seemed to have stabilized over the last 5 to 10 years. A more detailed analysis of the Table 1-2 shows some interesting trends. Table 1-3 below shows a more detailed analysis of the data above. The purpose of this analysis is to show the actual growth areas in the industry and the resulting impact it had on the value chain in more detail. This would indicate that an interactive dynamic that adjusts to environment change exists in the value chain.

TABLE 1-3

Analysis of the South African collective investment industry growth

Average	2005	2000	1995	1990	1985
Funds per manager	21	9	4	2	2
Unit holders per manager	89,000	76,000	75,000	33,000	35,000
Value of assets managed per manager (R'm)	12,285	3,911	1,165	424	164
Value of assets per fund (R'm)	580	430	313	231	88
Unit holders per fund	4,207	8,319	20,097	18,212	19,153
Value of assets per unit holder (R'm)	138	51	16	13	5

Source: Derived from Table 1-2

Table 1-3 above shows that there was a significant increase in the number of funds on each management company's platform, especially over the last 5 years. This is also true of the value of assets under management per management company, showing a strong correlation between growth in funds and growth in assets. The increase in the number of funds indicates an increase in the number of options available for investors. Although assets and the number of funds have increased dramatically, the number of unit holders has not increased by that much. There was, in fact, an increase in the average value of each fund, but a

decrease in the number of unit holders per fund. This indicates a significant increase in the value of assets per unit holder. This can be ascribed to '*bulking'.*

Bulking in this context means the gathering of individual investor assets through product packaging and a fund selection platform by an intermediary, and investing in bulk in collective investment schemes with management companies. This creates fee bargaining power for the bulking entity or intermediary, but not necessarily for the individual investor. The investor benefits by having access to a switching facility between different management companies, thereby increasing investing options and diversification considerably. Typical examples of these bulking entities that effectively extend the value chain are linked investment service providers (LISPs), broker funds or third party funds, and institutional funds that serve as underlying assets for pension fund schemes and life company funds.

These entities have had a major impact on the value chain during the past 5 to 10 years as can be derived from Table 1-3 above. They have direct access to the individual investor and can therefore influence their decision making, effectively controlling the flow of assets in the industry. This has transformed the traditional value chain in South Africa, and it is worthwhile to take cognisance of their role and how they fit into the value chain, and to evaluate their impact on the traditional value chain. The roles of these intermediaries and the additional intermediary layer are discussed and evaluated in Chapters 2 and 4.

On the other side of the value chain, it seems that the individual investor has become more 'investment wise' through the general awareness created in newspapers, financial magazines and other publications. The most important of these are probably the publication of fund performances and the consequent commentary on that. As already referred to at the beginning of Section 1.2 above, the individual investor is informed of and gets opinions on a wide range of 'unit trust'-related topics such as investment profiles and strategies, cost vs. return, etc. This has had an impact on the individual investor's perception of 'value added' and influenced his decision making and therefore his behaviour. The research results discussed in Chapter 4 looks at the level of knowledge and awareness of the individual investor.

On their website *(http://www.aci.co.za)* the Association of Collective Investments (ACI) lists the benefits of Collective Investments as:

- Spreading risk;
- Ease and accessibility;
- Value for money;
- Protection;
- Flexibility, and
- Good returns (2006b).

These features of collective investments have developed over the years and are entrenched in the Collective Investment Schemes Control Act of 2002 (CISCA). The growth in this part of the financial services industry has been so dynamic that the collective investment scheme value chain is constantly being affected by various interventions by the regulator (Deregulation of fees – 1998; Financial Advisory and Intermediary Services Act (FAISA) – 2002; Financial Intelligence Centre Act (FICA) – 2001; and the said CISCA in 2002). Chapter 2 takes a more comprehensive look at the development of the collective investment industry in South Africa and the role the regulators played in defining the industry.

1.5 DELIMITATIONS OF SCOPE AND KEY ASSUMPTIONS

The research in this dissertation is focused on the current South African investor. Although extensive research has been done to compare and evaluate international trends, the conclusions are meant to mainly reflect the South African situation.

As described in Section 1.1, the term "*Collective investment*" also refers to the terms "*Mutual fund*" and "*Unit trust*". Where any of these terms are used it means the same in the context of this dissertation. The use of the individual terminology will differ throughout this dissertation, mainly for reference purposes in the context of the particular section in which it is used.

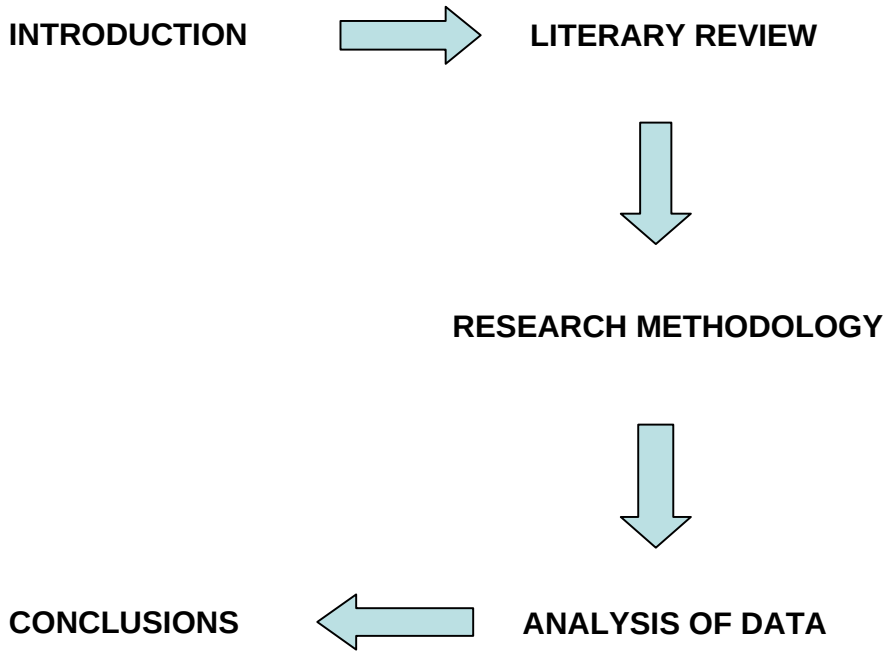
The scope of the dissertation is to determine the impact of the value chain on the individual investor in South Africa. This may lead to the expectation of detailed research on investment strategies, the impact of linked investment service providers (LISPs) and other intermediaries, investor behaviour analysis, etc. This dissertation acknowledges the important impact that they have on the value chain and that they may well warrant a separate research each. However, it does not pretend to express the full knowledge base on these entities. Their impact is only addressed in so far as it affects the whole value chain hypothesis and its perceived effect on the South African investor.

The sample used to research investor behaviour and perceptions were drawn from the investor database of one management company. This has been done for practical reasons. It is assumed, as discussed in Chapter 3, that this sample should reflect the view of the average individual South African investor. The results as discussed in Chapter 4 have been conclusive enough to justify this assumption.

1.6 OUTLINE

FIGURE 1-6

Outline of the research methodology



Source: Welman et al. (2005)

CHAPTER 1: INTRODUCTION

Chapter 1 gives an overview of the collective investment growth phenomenon internationally and in South Africa. This phenomenon is narrowed down to the value chain of a collective investment scheme. The problem statement revolves around the effectiveness of the value chain to add value for the individual investor. The research objectives are discussed and an overview of

the South African collective investment environment is given. The outline of the dissertation is given and major limitations are addressed.

CHAPTER 2: VALUE CHAIN OF A COLLECTIVE INVESTMENT SCHEME

The theory of investment is discussed with specific focus on the Capital Asset Price Model (CAPM), diversification and the Modern Portfolio Theory (MPT). This illustrates the value of a diversified portfolio for an investor. Furthermore, the theory of mutual fund (collective investment fund) investment and how it adds value as an investment vehicle is discussed. The principle of the value chain as formulated by Michael Porter and developed to other business areas is discussed. Intermediaries have an important role in the value chain. Their role in the effective functioning of the value chain is discussed. As already referred to earlier in this chapter, mutual funds/ unit trusts have had enormous international success as an investment vehicle. This phenomenon, as well as the role of the value chain in its success, is discussed in this chapter. Not only internationally, but also in South Africa, the collective investment industry has experienced extraordinary growth. It is discussed in this chapter with reference to the research that has been done so far in this chapter.

CHAPTER 3: RESEARCH METHODOLOGY

Chapter 3 describes how data was gathered from a diverse selection of individual investors to establish their investment knowledge, as well as their

perception of the value chain and the factors impacting their investment decisions. The method used to reduce the database to a manageable sample is discussed. The research was done by way of questionnaires that were mailed electronically and the responses were captured in a workable format. The problems encountered during the data gathering process and the ethical issues that had to be addressed are also documented.

CHAPTER 4: RESEARCH RESULTS

All the data gathered are analysed in Chapter 4. Detailed findings of investor knowledge, perceptions and investment behaviour patterns are given. The results are compared with similar research as well as actual investment pattern data. Gaps are identified and analysed.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

Chapter 5 concludes the findings and summarises the results. An evaluation is done of the present situation and existing perceptions. Future scenarios of what can be expected from the investor of tomorrow and how the industry could fulfil his needs are also given.

1.7 CONCLUSION

Chapter 1 laid the foundation of the dissertation. It introduced the value chain of a collective investment scheme and identified the research problem. Questions were asked to help understand how a value chain can add value to the individual investor. The collective investment industry in South Africa was introduced in order to put the investor that was researched in this dissertation in context. The rest of Chapter 1 outlined the research process that will be followed and described the chapters of the dissertation that will follow.

CHAPTER 2

VALUE CHAIN OF A COLLECTIVE INVESTMENT SCHEME

2.1 INTRODUCTION

To understand the role of the value chain of a collective investment scheme, one needs to understand the underlying elements that contribute to the effectiveness of the value chain. This chapter starts off with a theoretical background of the basic investment portfolio. Thereafter follows a discussion on the theory of mutual funds, the value chain theory and the various role players in the value chain. The impact of the value chain of collective investments internationally is then explored, and the chapter ends off with the South African experience.

2.2 THE THEORY OF INVESTMENT

The theory of investment was explored by economic theorists such as Keynes (1936) and Hayek (1941), who focused on the employment of capital and investment from a firm's point of view. Strictly speaking, investment is the *change* in capital stock during a period. One of the earliest investment theories, however, came from Irving Fisher in his *"Nature of Capital and Income"* (1906) and his later work *"Theory of Interest"* (1930). In his theory, although simplistic and open to a number of assumptions, he developed a basic investment frontier.

This investment frontier indicates the optimum return for an investment over certain time periods, and would form the basis of the more popular investment frontier models we have today.

Investment decisions as explored by the economists mentioned above concerns the decision to construct a new plant, replace machinery, etc., mostly from a production point of view. To be able to finance such an undertaking or to take advantage of any other investment opportunity, a firm needs cash. The firm can borrow from the bank or borrow publicly by issuing securities.

Securities are basically promises of future payment and they come in many forms. The most common securities are bonds and shares. Bonds are promised repayments of loans at a fixed rate of interest over time. A share is a fraction of ownership in a company and a claim to dividends. Most of these securities can be traded on a secondary market. Financial securities are characterized by the fact that they represent economic claims against future benefit, and that they have two important features, risk and return.

In this section we will concentrate further on the financial decision from the point of view of the individual investor who trades in these securities. An individual investor is free to buy and sell financial assets. Most of the time this investor holds a portfolio consisting of a number of various types of securities.

According to Goetzmann (1997), the following basic question should first be answered in order to determine what an individual investor's portfolio should look like: "*What rate of return will investors demand to hold a risky security in their portfolio*?" As mentioned in Chapter 1, the two main motivations for investors investing are to save and to increase wealth. Since there is a trade-off between these two motivations, the investor needs to assess the inherent risk of not losing any money against the expected return of the investment. The rate of return measures the growth in wealth and is expressed as a percentage over a specific time period.

One of the greatest allies for an investor seeking investment returns is time. This is because of what's known as the "eighth wonder of the world" -- compounding. Compounding can make your money grow substantially over a relatively short period of time. It refers to the growth of an investment from reinvesting any money that is earned. So, your investment not only earns a return based on the original amount you invested, but also on any return already paid.

Over a 68 year period from 1926 to 1995, a dollar invested in the SP500 grew to $889. Over the same period, a dollar invested in corporate bonds grew to $40 (Goetzmann, 1997). Although the returns of the corporate bonds were much lower, the risk of achieving the expected return over any period in this time was much lower, as the return curve was flatter, though fairly straight. The SP500

yielded a far higher return, but may have yielded a negative return at any time within that period. The return curve would therefore be much more erratic. This puts the investor in front of the classical trade-off of risk vs. return. The higher the risk the investor is prepared to take, the higher the return that he can expect from the investment will be. The margin an investor earns as the result of investing in a more risky investment, is called the risk premium.

Each investor has a certain risk appetite or risk tolerance. Both refer to the same behaviour, which indicates how much risk an investor is prepared to take for an expected return. To give the investor a broad risk - return profile within one portfolio, the portfolio manager needs to make capital allocation decisions which would determine how much of the overall portfolio is going to be invested in low-risk, low-return investments vs. risky, high-return investments.

Bodie, et al. (1999, p. 148) describes the investment process as consisting of two broad tasks. One task is security and market analysis, from which the risk and expected return attributes of the entire set of possible investment vehicles are assessed. The second task is the formation of an optimal portfolio of assets. This latter task is referred to as *portfolio theory,* which plays an integral part in the construction of a collective investment portfolio and on which this dissertation is based.

The father of modern portfolio theory (MPT) was Harry Markowitz. One of the most important and influential economic theories dealing with finance and investment was developed by him and published under the title "Portfolio Selection" in the 1952 *Journal of Finance*. MPT says it is not enough to look at the expected risk and return of one particular stock. By investing in more than one stock, an investor can reap the benefits of diversification - chief among them, a reduction in the riskiness of the portfolio.

Markowitz (1959) also proposed that investors expect to be compensated for taking additional risks, and that an infinite number of ‘efficient’ portfolios exist along a curve defined by three variables: standard deviation, correlation coefficient and return. The efficient frontier curve consists of portfolios with the maximum return for a given level of risk, or the minimum risk for a given level of return.

Sharpe (1981, p. 144), however, believes that the market itself is the most efficient portfolio. Every investor is assumed to have the same information, and to analyze and process it in the same way. Investors are assumed to be concerned only with risk and return. The market consists of a large number of rational, profit-seeking, risk-averting investors who compete freely with each other in estimating the future value of individual stocks. Any changes affecting a stock are quickly incorporated in its value.

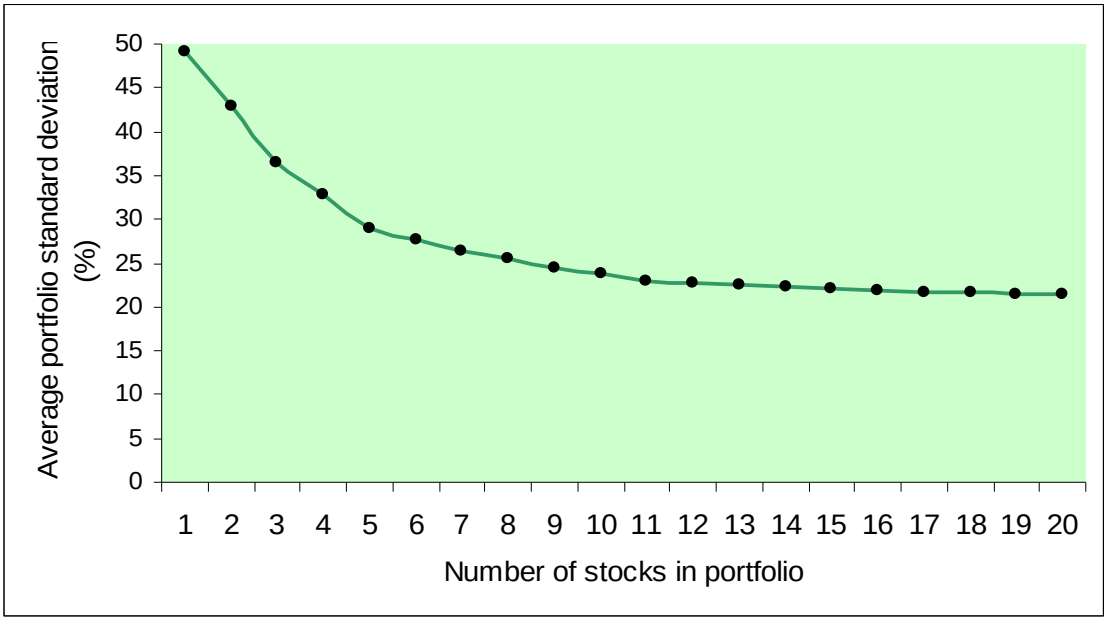
When is a market efficient? According to Elton & Gruber (1995, p. 406), a market is efficient when security prices fully reflect all available information. The Efficient Market Hypothesis (EMH) was first defined by Fama (1970). According to this hypothesis, the prices of shares on the stock market are the best available estimates of their real value because of the highly efficient pricing mechanism inherent in the stock market (Ross, 2002, p. 52). For the individual investor this would mean that he is better off by owning a proportionate slice of every financial asset available.

An efficient way to manage risk in a portfolio is therefore by way of diversification. To eliminate firm (or security) specific risk, the number of individual stocks in a portfolio could be increased. This will result in a much lower impact on a portfolio if one (out of 20) stocks should under perform vs. one alone or one out of two.

Figure 2–1 below shows the decrease in risk (measured in standard deviation) as the number of stocks increases. This was an empirical study done by Statman (1987) in which he used data of stocks listed on the New York Stock Exchange (NYSE). His findings show that the ultimate number of stocks to negate risk in a portfolio is about 20.

FIGURE 2–1

Portfolio diversification of stocks on the NYSE

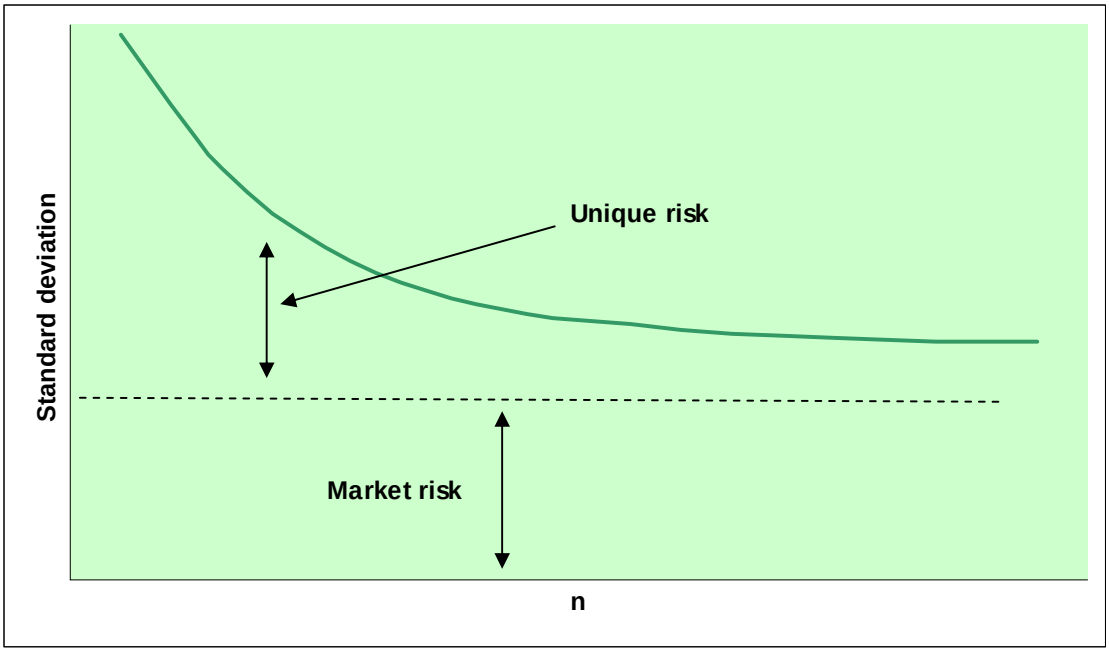


Source: Statman (1987)

It is, however, important to note that regardless of the number of stocks in your portfolio, risk cannot be completely eliminated. The risk that remains after extensive diversification is called market risk as indicated in Figure 2-2 below.

FIGURE 2–2

Portfolio risk: Market risk vs. unique risk



Source: Bodie, et al. (1999)

The total security risk of the portfolio can therefore be expressed as the sum of the unique risk, otherwise known as diversifiable risk, and market risk, otherwise known as non-diversifiable risk

The Capital Asset Pricing Model (CAPM), which is now a centerpiece of modern financial economics, was developed through articles by Sharpe (1963), Lintner (1965) and Mossin (1966). This model gives us a precise prediction of the relationship that we should observe between the risk of an asset and its expected return. This relationship serves two vital functions. Firstly, it provides a benchmark rate of return for evaluating possible investments. Secondly, the

model helps us to make an educated guess as to the expected return on assets that have not yet been traded in the marketplace. The CAPM is therefore a set of predictions concerning equilibrium between the expected returns on risky assets.

According to Gitman (1985, p. 403), the CAPM links the relevant risk and returns for all assets. The mathematical equation of the CAPM is given as:

$\boldsymbol{k_j = R_F + b_j \times (k_m - R_F)}$, where:

k_j = the required (expected) return on asset *j*

R_F = the rate of return required on a risk-free asset

b_j = the beta coefficient or index of non-diversifiable risk for asset *j*

k_m = the required rate of return on the market portfolio of assets that can be seen as the average rate of return on all assets

Goetzmann (1997) argues that the CAPM theory can only be true if its assumptions are true. Amongst a long list of assumptions, the CAPM assume that the global market is in equilibrium and each investor holds a value-weighted portion of the world wealth portfolio. In the past 20 years, the legitimacy of the CAPM could not be verified or refuted. The spirit of CAPM seems, however, to be correct as it has had a profound impact on the investment world.

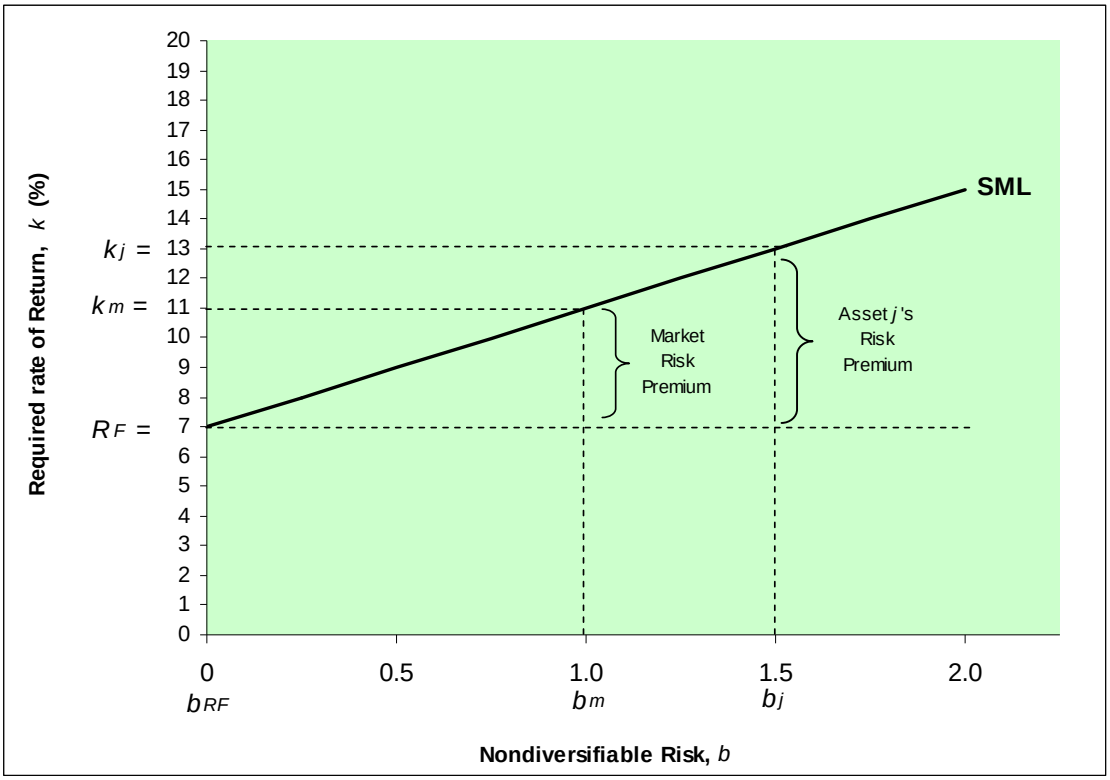
Reilly and Brown (2003, p. 211) recognize that Markowitz's model is based on several assumptions and summarize it as follows: "a single asset or portfolio of assets is considered to be efficient if no other asset or portfolio of assets offers

higher expected return with the same (or lower) risk, or lower risk with the same (or higher) expected return." Although the CAPM will not fully withstand empirical tests, it is widely used because of the insight it offers and because its accuracy suffices for many important applications.

When the CAPM is depicted graphically, it is called the *security market line (SML)*. This line is shown in Figure 2-3 below.

FIGURE 2–3

The security market line (SML)



Source: Gitman (1985)

From the above Figure 2-3 it can be derived that all investors will hold a portfolio along the security market line. Elton & Gruber (1995, p. 294) argue that the CAPM is based on an objectionable set of assumptions, but it does an amazingly good job of describing prices in the capital market. The only portfolio of risky assets an investor will own under the CAPM assumptions, is the market portfolio. However, each investor can construct his unique optimum portfolio by combining a market fund with a riskless asset (the two mutual fund theorem).

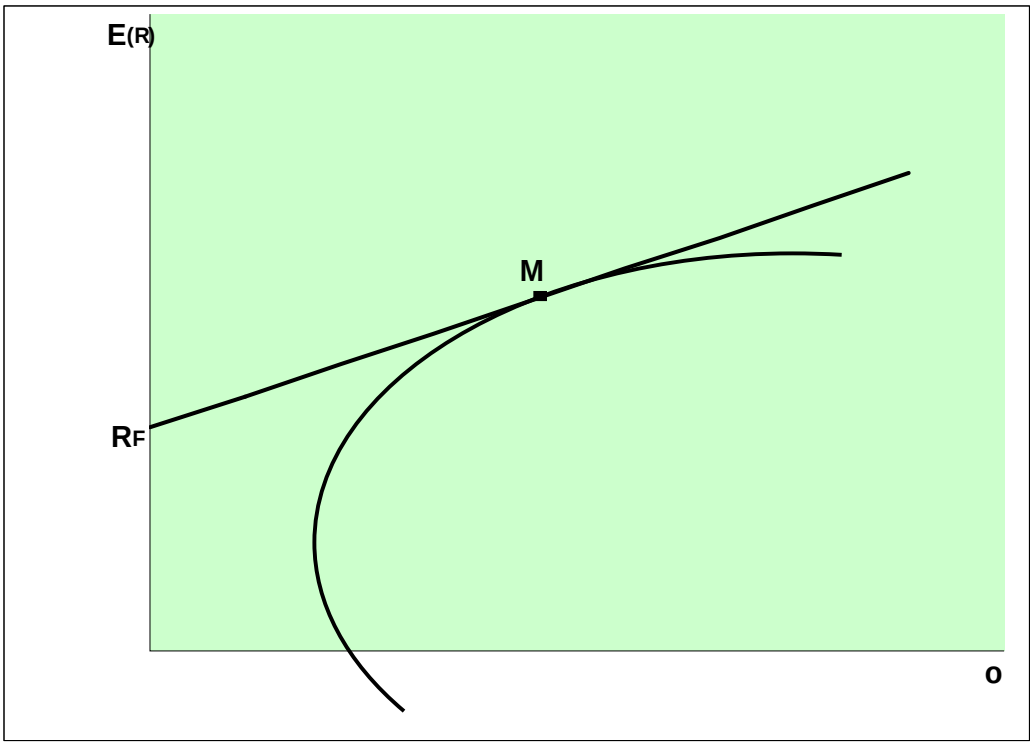
The mutual fund theorem generally relates to the principle that investors follow a passive strategy of investing in a market index portfolio that is efficient. According to Bodie, et al. (1999, p. 254), portfolio selection can be separated into two components, namely the creation of mutual funds by professional managers, and the investor's allocation of his complete portfolio between the mutual fund and risk-free assets.

The two mutual fund theorem stems from the two-fund separation theorem, which states that investors who hold a number of risky assets and a riskless security should all hold the same mutual fund of risky assets. An investor's risk aversion affects only the proportions of wealth that he invests in the risky mutual fund and the riskless security. The allocation of wealth across the different risky assets does not depend on the investor's preferences. Cass and Stiglitz (1970), and Merton (1973) are perhaps the most prominent works on this fundamental result.

Thus all investors will hold a portfolio along a curve called the *'efficient frontier'*. Figure 2-4 below illustrates the efficient frontier:

FIGURE 2-4

The efficient frontier



Source: Gitman (1985)

Malkiel (1973) argued that, based on fundamental as well as technical analysis, it is impossible to outperform the market consistently on an efficient basis. He suggests that price movements are totally random and that investors should adopt a buy-and-hold strategy. However, this strategy ignores the risk associated with continuous investment in the market. There will always be a

correlation between risk and return. The *Dow Theory,* for example, seeks to move into risk-free treasuries when a bear market is signaled, significantly reducing the risk associated with that portfolio.

2.3 MUTUAL FUND INVESTMENT

The principle of the mutual fund exposes the individual to the same risk profile as the other investors in the fund. The mutual fund is invested in a wide range of securities or assets. Smith (2007) argues that the common consensus is that a well-balanced portfolio with approximately 20 to 30 stocks diversifies away the maximum amount of market risk. Because a single mutual fund often contains five times that number of stocks, does that mean that one fund is enough? If not, how many mutual funds are optimal for your portfolio?

One can argue that equity investors buy a broad index fund and let time do its work. Investors seeking exposure to both stocks and bonds can get their desired asset allocation through the purchase of a single balanced fund. On the other hand, the argument against a single mutual fund (McWhinney, 2006a) proposes that a single fund would fail to provide adequate exposure to international investments. The argument here is that a global fund provides a little bit of everything, but not enough of anything. Added to this should be a large-cap domestic fund and a small-cap domestic fund. Two international funds, one from

the developed markets and the second in emerging markets, as well as a fixed-income fund, should bring the desired count to 6 funds.

A *style box* is a graphical representation of a mutual fund's characteristics. The domestic equity style box, designed to assist in the evaluation of securities, is the best-known and most popular type of style box (McWhinney, 2006b).

FIGURE 2–5

The Morningstar Style Box ™

Source: McWhinney (2006b)

The vertical axis of the style box is divided into three categories that are based on the market cap. The horizontal axis is also divided into three categories based on valuation. An investor does not need a fund in all the stock and bond categories. A few funds can be chosen that best fit an investor's asset-allocation and risk-return requirements.

Smith (2007) argues further that, while mutual funds are popular and attractive investments because they provide exposure to a number of stocks in a single investment vehicle, too much of a good thing can be a bad idea. Although there are hundreds of mutual fund providers offering thousands of funds, there is no magic number for the "right" number of mutual funds in a portfolio.

Investopedia (2005) also says owning a mutual fund that invests in 100 companies doesn't necessarily mean that you are at optimum diversification either. Many mutual fund holders also suffer from being over-diversified. Some funds, especially the larger ones, have so many assets (i.e. cash to invest) that they have to hold literally hundreds of stocks and, consequently, so does the investor. In some cases this makes it nearly impossible for the fund to outperform indexes – the whole reason for investing in the fund and paying the fund manager a management fee.

Diversification is like ice cream: most people would agree that both diversification and ice cream are "good" things. This doesn't mean you can't have too much of a good thing. Eat too much ice cream and you'll end up with a stomach ache.

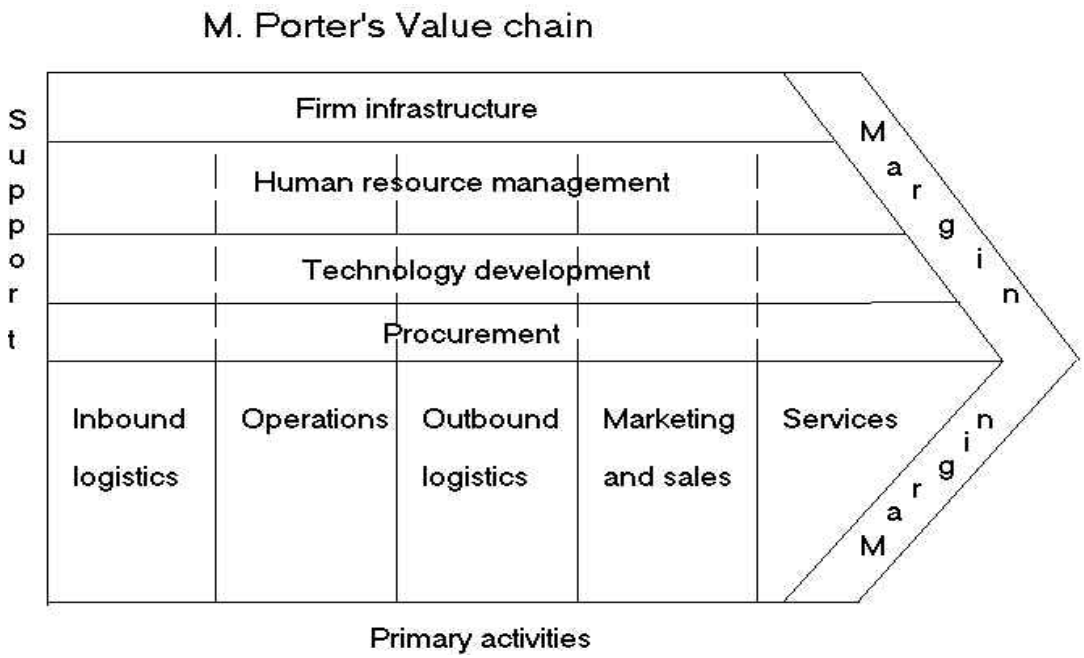
The common consensus is that a well-balanced portfolio with approximately 20 stocks diversifies away the maximum amount of market risk. Owning additional stocks takes away the potential of big gainers, significantly impacting your

bottom line, as is the case with large mutual funds investing in hundreds of stocks. According to Investopedia (2005), Warren Buffett said: "wide diversification is only required when investors do not understand what they are doing".

This dissertation not only explores the value of a diversified portfolio, but also the value chain linked to a collective investment scheme. The value chain is a systematic approach to examining the development competitive advantage. It was created by Porter (1985). The chain consists of a series of activities that create and build value. They culminate in the total value delivered by an organisation.

FIGURE 2-6

Porter's value chain



Source: Porter (1985)

The model was initially created to support Michael Porter's views on creating a competitive advantage within an organisation. The model helps to categorize and analyze specific value-adding activities in the organisation. The costs and value drivers are identified for each value activity. The ultimate goal is to maximize value creation while minimizing costs.

This concept has been extended beyond individual organisations. It can apply to whole supply chains and distribution networks. The delivery of a mix of products and services to the end customer will mobilize different economic actors, each managing its own value chain. Porter termed the larger interconnected system of value chains a 'value system'.

The principle of the value chain in capturing the value generated along the chain has led to the focus on the supply area of the chain and the term 'supply chain'. The supply chain is primarily associated with physical activities that have to occur to meet the requirements of the customers. On the other hand, the value chain encompasses a much more complex set of tangible physical and non-tangible factors.

Morecroft and Sterman (1994) define a value chain as "a framework for thinking about how a company can build and sustain a unique advantage over its competitors that will ensure long term profitability and survival". Walters and Lancaster (2000) define a value chain as "a business system which creates user

satisfaction (that is value) and realises the objectives of other member stakeholders". Due to the linear connotation of a 'chain', the value chain has also been referred to as a 'value net' and is defined by Otton (2007) as "a non-linear web of units (both hard and soft systems factors) which assist contemporary value and supply chains to operate".

A business ecosystem refers to a business operating in an environment that closely resembles a biological 'ecosystem' (Moore, 1996). Each business has a role to play, each has their place in the ecosystem 'hierarchy', and the actions of each business directly relate to and impact on other businesses. For example, movements in price, additions to services, new products, removal of products, increases in efficiency and the introduction of technology all have an effect on a market and on natural competitors.

Therefore it is relevant to apply these general principles of the value chain theory to the collective investment industry. As an industry that can claim uniqueness through its own regulatory framework, the following two characteristics of the value-chain concept is nurtured as being essential to the growth and existence of the industry:

The first important characteristic of the value chain is the concept of a *competitive advantage*. A central tenet of value chain analysis, identification and chain 'thinking' is the search for competitive advantage. As Porter (1985)

explains: “A firm is said to have competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors…and when these other firms are unable to duplicate the benefits of this strategy.”

The primary aim of applying a ‘chains approach’ is the search for a competitive advantage. The development of a better understanding of the environment in which a business operates (and with whom it operates) can lead it to operate more effectively and efficiently. In this instance the collective investment industry can be seen as a firm that gains its competitive advantage through the unique chain that is created through the act and deeds of the primary investment vehicles. The individual management companies can also compete amongst each other by creating efficiency along their own specific value chain.

The second important characteristic is the concept of *interdependence*. A concept that refers to business becoming more open in their relationships – moving from a position where a supplier or customer may be viewed almost as a competitor for profit margins to a philosophy where benefits can be shared between interdependent business partners. In the ideal chain-based relationship, partners work together to extract maximum efficiency and effectiveness from their supply chain (thus forming a value chain) and increase their collective competitive advantage.

Although from an agricultural perspective, Boehlje, et al. (1999) see interdependence emerging in a three-phase sequence, capturing efficiencies and controlling costs, reducing risks (quality, quantity, legal and governance) and responding to consumer demands for attributes. All three of these benefits are captured in the manifest of the ACI that is appointed by the regulator to govern the collective investment industry. This naturally encompasses all the other role players in the industry as referred to in this paper, i.e. portfolio managers, regulators, distribution networks and the individual investor.

Each mutual fund has a specified investment policy which is described in the fund's prospectus or mandate (Bodie, et al.1999, p. 106). For example, money market funds hold short–term, low-risk money market instruments such as bank acceptances, treasury bills and certificates of deposits, while bond portfolios will hold mostly government bonds and other mortgage-backed securities. Management companies manage a 'family' of mutual funds under one umbrella. This makes it easy for the investor to allocate assets across market sectors and to switch assets across funds while still benefiting from centralized record keeping. Some of the more important basic fund types are money market funds, fixed income funds, equity funds, asset allocation funds, index funds and specialized sector funds.

Investment company performance has been one of the most widely studied topics in all of finance. According to Reilly and Brown (2003, p. 1095) there are

two primary reasons for this: (1) these funds reflect the performance of professional money managers; (2) fund data have been available for a long time. When Sharpe (1966) first evaluated the overall performances of mutual funds, he found that only 32 percent of the funds outperformed the DJIA (Dow Jones Industrial Average). Comparing ranks of funds between the first and second halves of the sample period led Sharpe to conclude that past performance was not the best predictor of future performance. He also concluded that the average mutual fund manager selected a portfolio at least as good as the DJIA, but after deducting the operating costs of the fund, most achieved net returns below those of the DJIA. Similar studies were done by Jensen (1968), Lehmann & Modest (1987), and Grinblatt & Titman (1993), all concerning the performances of mutual funds vs. relevant benchmarks.

Mutual fund managers inform potential investors about their intended investment strategy in the fund's prospectus. Malkiel (1995) and Bogle (1998) found in earlier studies that the more aggressive the investment objectives of the funds were, the more the risk and returns increased and the more the likelihood was to outperform a benchmark. However, traditional fund objective categories fell out of favour because a fund's actual holdings may not necessarily represent the objective classification.

Subsequently the overall performance of mutual funds became measured through investment styles and performance persistence. Studies in this regard

were performed by Brown and Goetzmann (1995) and Carhart (1997). These types of performance studies are of significance for the investor because it puts performance into perspective and, according to Reilly and Brown (2003, p. 1098), it helps the portfolio manager to add value for the investor in a mutual fund.

The portfolio manager determines your risk-return preferences and develops a portfolio that is consistent with them. He diversifies your portfolio to eliminate unsystematic risk, and maintains your portfolio diversification and desired risk class while allowing flexibility. He also attempts to achieve risk-adjusted performance that is superior to aggregate market performance, and administers the account, keep records, provide information and reinvest dividends.

Elton and Gruber (1995, p. 665) agree that a mutual fund provides a reasonable alternative for a small investor. However, they also ask if there are characteristics of mutual funds that are associated with superior performance. Apart from the sales charges (load vs. no-load funds), there are also other variables to consider. This includes turnover, ratio of expenses to assets and fund size. They could all have adverse effects on the alpha return of a fund.

Bogle (1999, p. 205) describes the task of investment as follows: *"The central task of investing is to realize the highest possible portion of the return earned in the financial asset class in which you invest – recognizing, and accepting, that*

that portion will be less than 100 percent." Hereby he urges investors to recognize the importance of the cost of investing and the impact it has on the return of a portfolio.

Bogle further promotes the principle of simplicity and recommends individual investors to rely on ordinary human virtues such as common sense, thrift, realistic expectations, patience and perseverance. He then gives the following rules for an individual investor to help make intelligent fund selections. Select low-cost funds, consider carefully the added cost of advice, do not overrate past fund performance, use past performance to determine consistency and risk, beware of stars, beware of asset size, don't own too many funds, and buy your fund portfolio – and hold it.

This brings us to another important link in the value chain, the financial market intermediary (FMI). Mamaysky and Spiegel (2001) explored the fact that FMIs acted on behalf of their investors and the potential impact it may have on trading styles and asset prices. The fact that mutual funds outnumber traded securities (at least in the US market) creates new investment families that offer a varied set of potential trading strategies. This implies that new funds added to individual portfolios do not necessarily reduce volatility. However, the FMI is not endowed with its own utility function, but only acts on orders from the individual investor.

Bednarczyk and Eichler (2002), however, disagree with Mamaysky and Spiegel, and argue that a principal agency conflict exists between the investor and the mutual fund manager. They argue that both are aiming to maximize individual wealth, which does not lead to discrepancies in investment strategies. It is in the fund manager's interest to maximize fund size which, in turn, negatively impact fund returns. They suggest that the maximum fund size could be in the region of $1.6bn - $2.0bn.

Another area where the fund manager may negatively impact investor expectations is performance fees. This is to distinguish between so-called "beta-grazers" who look to increase fund sizes as described above and so increase fixed fee income. "Alpha-hunters", on the other hand, look for outperformance and expects to be paid for it. The individual investor may not agree with excessive fees and the investment manager may take undue risk to attain that outperformance (Harris, 2007, p. 82).

Spatt (2006), Chief Economist of the US Securities and Exchange Commission's (SEC) Office of Economic Analysis, also found the existence of the conflict as described above. However, they also found that existing regulation requires an adviser not to deviate from an investor's reasonable expectation about a fund's risk profile. There are also enough risk and return information made available to the investor to help mitigate this conflict.

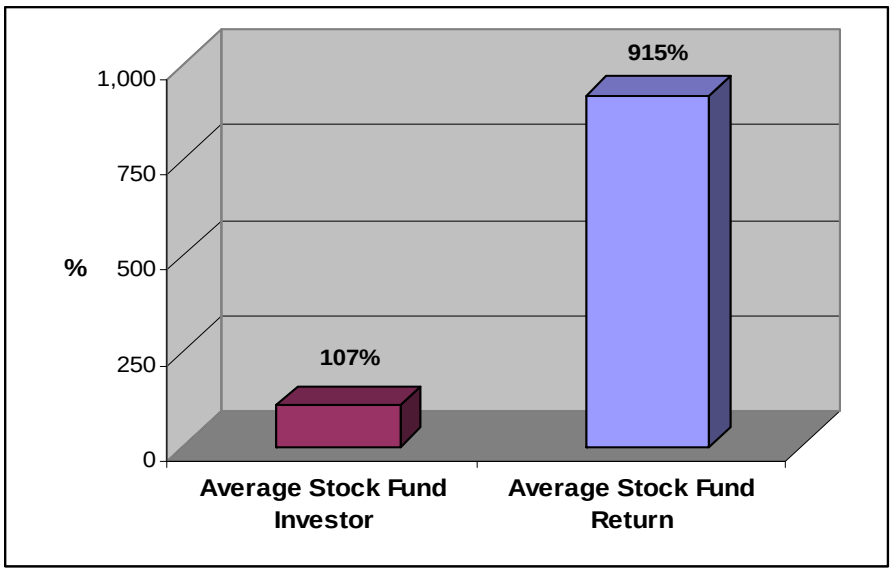
The competition in the mutual fund industry is strong, however, with over 600 organizations offering mutual funds in the United States. Three quarters of the assets are invested in funds with costs that are below average and returns (over a 10 year period) that are above average (Investment Company Institute, 2006b).

It therefore concludes that, over time, investor behaviour determines the patterns of mutual fund investment and, consequently, investment strategy and market pricing. What is it then that influences investor behaviour? Abbey (2007) simply says *"A happy investor is a successful one."* He says further that how investors behave has a far bigger impact on success than how markets behave. He refers to the Dalbar studies in the US which found that investors lost up to 77% of the available return in the market due to switching in and out of funds.

In Figure 2-7 below, the bar graph named "Average Stock Fund Investor" with a value of 107% relates to the actual returns the individual investor earned on his own portfolio over the 20 year period. The bar graph named "Average Stock Fund Return" with a value of 915% relates to return that are actually available in the market without switching from fund to fund.

FIGURE 2-7

Cumulative effect of 20 years return on Stock Fund investments



Source: Dalbar, Inc. (2005)

In its research, Dalbar, Inc. (2005) states some factors influencing investor behaviour. Investors typically invest when markets rise and then disinvest when markets starts falling. By effectively entering late and realising losses, the investor does not receive the benefit from long-term investment by riding the lows and highs. Although up to 90% of people may be optimistic at a certain time, the law of averages states that 50% of those will be wrong. Thus very few people will expect the inevitable when it actually occurs.

Funds or managers that achieve exceptional returns over a short period are perceived to be a pattern that does not actually exist. People say they will start to save later for various reasons, while actually missing a good market growth

period. When people are afraid to lose capital they keep their savings in cash. The reality is, however, that in a low-interest environment they can lose more income by being in a taxable low-return investment than a non-taxable average-return investment.

People get more distressed by the prospect of losing than they get excited by that of winning. They will therefore rather cash in on investments that have done well than on investments that made losses. People also tend to pick themselves a reference point such as the price at which they invested, thereby ignoring the intrinsic value of the investment. They have preconceived ideas and will search for the 10% confirmation of their view whilst ignoring any views that contradict theirs.

2.4 INTERNATIONAL TRENDS

It is generally recognized that the first closed-end investment company was formed in 1822 by King William I of the Netherlands. Thereafter an investment trust was launched in 1849 in Switzerland, followed by similar vehicles in Scotland in 1880. This blew over to the United States in the 1890's. The first (open-ended) mutual fund as we know it today was the Massachusetts Investor's Trust established in Boston in 1924.

The worldwide distribution of collective investment funds are shown in Table 2-1 below:

TABLE 2-1

Worldwide distribution of mutual funds

	Number of funds	Assets ($ million)
Europe	32,800	7,744,204
Americas	14,477	11,486,171
Asia Pacific	13,479	2,456,511
Africa	750	78,026
World	**61,506**	**21,764,912**

Source: Investment Company Institute (2007a)

The United States mutual fund industry ($10,413,617 million) alone makes up 50% of the world's total investments in collective investment schemes. It is therefore significant to concentrate on the United States mutual fund industry to determine worldwide trends in the industry. The other countries having significant collective investment industries in terms of assets under management are Luxembourg ($2,188,278 million), France ($1,769,258 million), Australia ($864,254 million) and the United Kingdom ($786,501 million).

Despite conflicting evidence on the nature and effect of the relationship between the intermediary and the investor as shown earlier in this chapter, the role of the value chain was essential in effecting this asset build-up. Evidence of this was the mere creation of collective investment schemes. One of the main reasons for the development of collective investment schemes was to give affordable access to the investment market for the 'man in the street'. As Woodard (2007) put it: *"Mutual funds are one of the best investments ever created because they are very cost efficient and very easy to invest in."* Woodard further explains that a mutual fund is simply a financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The fund manager is responsible for investing the pooled money into specific securities. Investors can therefore acquire stocks or bonds with much lower trading costs than if they tried to do it on their own. The biggest advantage to mutual funds is diversification.

Another reason to recognize the intermediary in the creation of wealth for the individual investor is to look at the development of collective investments up to now. This would indicate that the intermediary (value chain) listened to the needs of the investor and provided him with products to suit his personal needs through a range of economic cycles, investment classes, cost structures, life cycles, etc. A quick look at the development of collective investments over the years confirms this fact. After the initial closed-ended type of investment trusts, the open-ended schemes developed to give access to a broader base of investors.

Because of the obvious benefits of diversification, the financial advisor started to make a study of the offerings in the market and provided the investor with a broader spectrum of investment options relating to his client's specific risk profile. Nowadays the advisor is regulated, ensuring sound advice in the client's best interest. The International Organization of Securities Commission (IOSCO) issued a consultation report in February 2007 entitled "*Market Intermediary Management of Conflicts that Arise in Securities Offerings"*. This report acknowledges the existence of conflict between intermediary offerings and best interest of clients. It stated a wide range of issues concerning potential conflict areas/situations and invited its members to comment.

The reaction was overwhelming and included the Investment Industry Association of Canada (IIAC), Japan Securities Dealers Association (JSDA), British Bankers Association (BBA), Australian Financial Markets Association (AFMA), European Federation of Financial Analysts Association (EFFAS), Zentraler Kreditausschuss (ZKA), etc. These comments indicated that considerable progress has been made with regulating the intermediary environment in investment management in these countries.

As the effect of costs on the investor's return became apparent, no-load and index-type funds were introduced. Access to new classes was also given, e.g. money market funds and hedge funds. The major growth area is currently in Exchange Traded Funds (ETFs). According to Bogle (2006), the growth of ETFs

is an *entrepreneur's* dream come true. They offer the excitement of a new idea, massive publicity, and the marketing flexibility of the fund industry's asset gatherers to focus on whatever sectors are hot and whatever strategies have paid off in the recent past, all the better to attract the capital of performance-hungry investors. Not only do ETFs generate soaring assets and soaring fees to the managers, but active trading in ETF shares also generates heavy sales commissions for brokers.

In recent years, the flood of assets into ETFs has approached a stampede. ETFs have grown to be a huge part — $340 billion of the $900 billion index mutual fund asset base — a 38 percent share, up from just 9 percent as 2000 began and only 3 percent a decade ago. Lydon (2007) predicts an even more exciting outlook for ETFs, predicting the worldwide expansion of ETFs to emerging markets, the retirement market and the inevitable bear market.

In Europe the Collective Investment scene has been dominated by UCITS (Undertakings for Collective Investment in Transferable Securities). UCITS are a set of European Union directives that aim to allow collective investment schemes to operate freely throughout the EU on the basis of a single authorisation from one member state. A collective investment fund may apply for UCITS status in order to allow EU-wide marketing. The concept is to create a single market in transferable securities across the EU. With a larger market, the economies of

scale will reduce costs for investment managers, which can be passed on to consumers.

2.5 THE COLLECTIVE INVESTMENT INDUSTRY IN SOUTH AFRICA

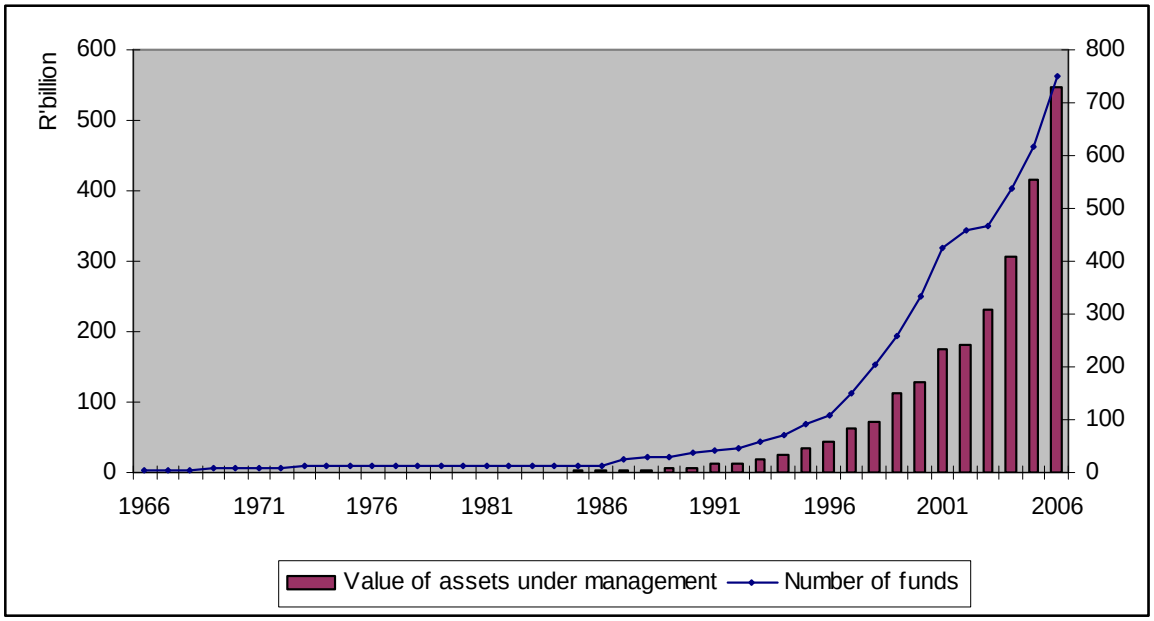
From the humble beginnings in 1965 when the Sage Fund was launched on 14 June 1965 and the National Growth Fund was launched on 15 October 1965, the CIS industry in South Africa has grown to a massive savings industry, ending June 2006 with 679 funds in existence and the total CIS industry size standing at R455.3bn. If you take into account that “only” R3 million was under management at the end of 1965, the assets within the industry grew by 34.26% per annum over more than 40 years.

From 1965 until June 2006, the CIS industry has received a net inflow of R314.6bn. Strip this out of the R455.3bn; the CIS industry has created R140.7bn of wealth over the years, which represents an annual growth of 30.42%. Over this same period, the JSE All Share Index achieved a return of 27.9% with headline inflation increasing with 10.36% per year over this period (Association of Collective Investments, 2006c).

FIGURE 2-8

Growth of the South African collective investment industry

(1966-2006)



Source: Adapted from Association of Collective Investments (2006a)

The growth in the industry was slow over the first 20 odd years because the stock market was a mysterious and unknown entity for the man in the street, and people generally regarded the stock market as a risky investment environment. The financial environment in South Africa at that stage was dominated by the life insurance industry and the banking sector. Access to the JSE was perceived to be limited to the big institutions and the very rich. The only known means for the general public to invest was through traditional financial products such as life annuities and bank deposits. Due to the conservative culture that existed then,

the prospect of unit trusts as a saving vehicle was looked upon with much apprehension.

Unfortunately, the market crashed in May 1969 and the scars it left took long to heal. The stock market took nearly 10 years to recover to the same levels. This, of course, did not help to lure investors and the industry went into hibernation. Lessons were however learnt, amongst them the fact that unit trusts should still be considered a long-term investment, and that investment decisions should be made responsibly. The importance of investor education therefore became more important to the industry.

By 1987, however, the number of funds more than doubled as the JSE followed renewed heights in overseas markets. In the same year, however, there was another market crash, but the effect on unit trust investors was far less than in 1969, as most of them have already built up a balanced portfolio by then, and were prepared to give the markets a chance to recover.

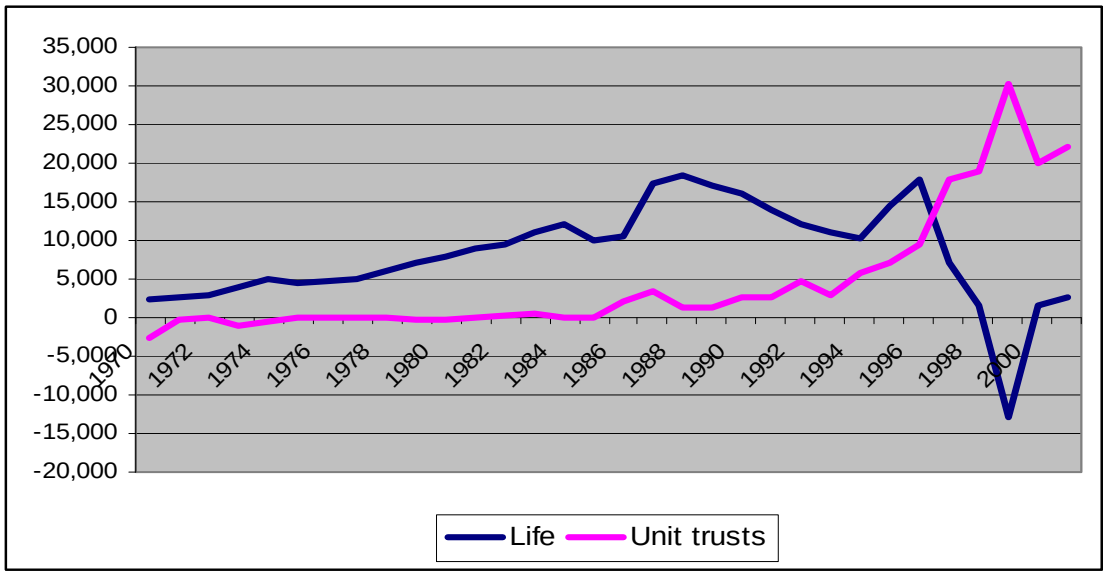
The 90's were characterized by the proliferation of funds, and by the end of 1999 there were already 271 funds against the 31 funds that existed in 1989. The main reason given for this explosion is that the consumer became more sophisticated. Knowledgeable investors wanted to narrow their asset allocation to specialist sectors such as IT, resources, etc. Management companies obliged by differentiating their product range. Asset managers also wanted to limit their

exposure to underperforming sectors (such as mining at that stage) and preferred mandates that focused on financial and industrial shares.

The range of collective investments made available during the 90's includes money market funds, gilt funds, specialist equity funds, international funds and funds of funds. Other significant developments that impacted the industry during the latter part of the 90's were the advent of managed prudential funds, the relaxation of exchange control and the deregulation of fees (Oldert, 2006).

FIGURE 2-9

Net flows into unit trusts and life industry



Source: Adapted from HSBC (2002)

This sudden explosion of funds and inflows into the unit trust industry is highlighted in Figure 2-9 above. Towards the end of the nineties, it became clear

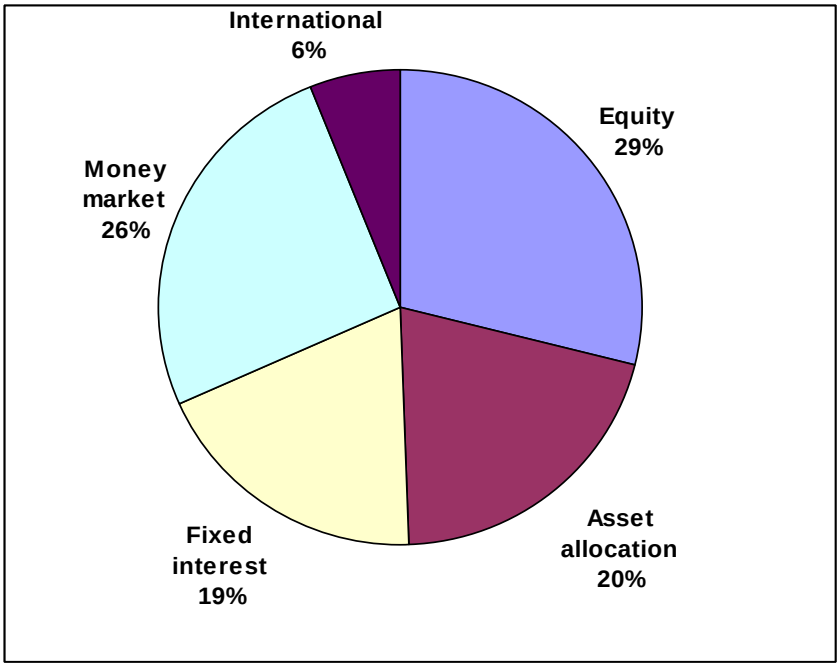
that household savings were more directed towards discretionary savings such as unit trusts, at the cost of contractual savings that Life companies traditionally offered.

Currently (at the end of 2006) the industry has a total of R546bn assets under management. The total equity holdings in unit trusts represent 4.42% of the market capitalization of the JSE. Although relatively small against the rest of the world as shown in Table 2-1 in a previous section, it is growing in importance in the SA financial services industry.

The principle of spreading risks and diversifying assets as alluded to in the previous section is depicted in Figure 2-10 below. This indicates that the investor has well and truly adapted to the principles of diversifying risks and is taking a long-term view on investments.

FIGURE 2-10

Asset class spread in the South African collective investment industry: December 2006



Source: Adapted from Association of Collective Investments (2006a)

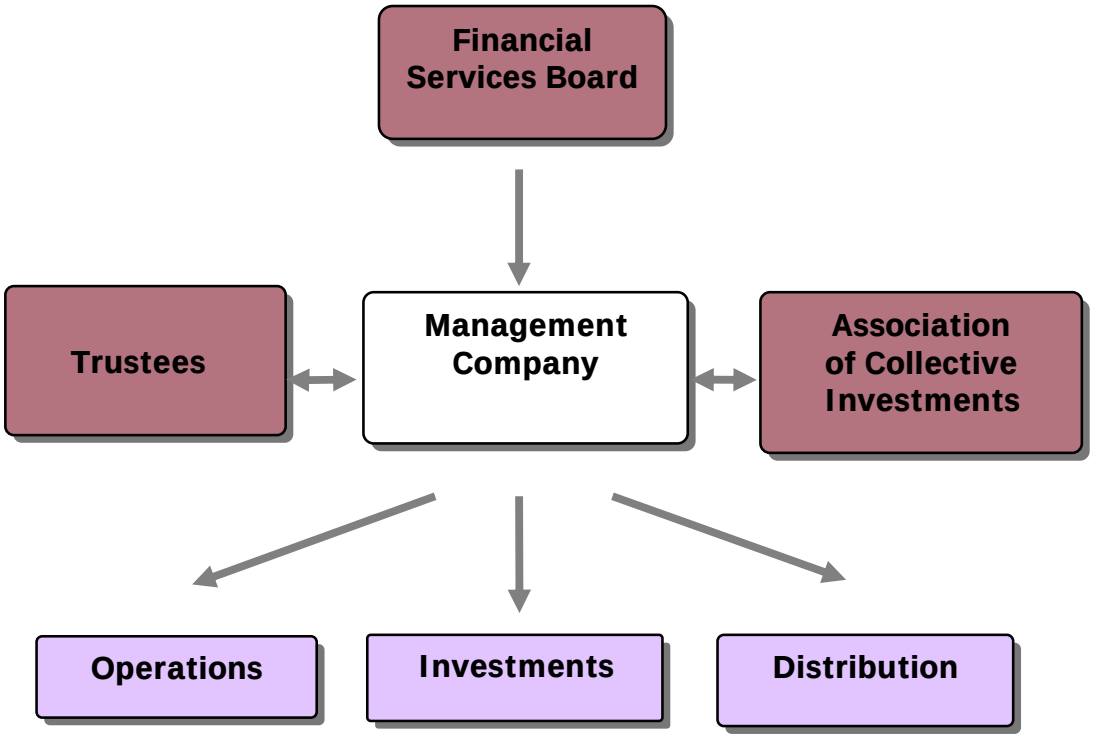
The collective investment industry is widely perceived as being one of the better regulated industries in the financial sector. One of the big milestones of the industry was the introduction of the Collective Investment Schemes Control Act (CISCA) in 2002. This act replaced the Unit Trust Control Act of 1947 and was designed to accommodate a whole range of collective investment schemes and to bring South Africa in line with best practice elsewhere in the world.

This act, together with the Financial Advisory and Intermediary Services Act (FAIS), also of 2002, and the Financial Intelligence Centre Act of 2001,

underlines the commitment of the regulators to put the South African collective investment industry alongside similar industries in the United Kingdom, United States and Australia as far as at least legislation is concerned.

FIGURE 2-11

Structure of a management company



Source: Adapted from Oldert (2006)

The Financial Services Board (FSB), a sub section of the Department of Finance, is responsible for initializing, implementing and governing the various acts controlling the industry. What makes the Collective Investment Schemes Control Act (CISCA) a unique act, is that the act makes provision for an industry

association to co-govern the industry together with the regulator. In some cases, such as the code of advertising, governance was delegated in full to the association.

The Association of Collective Investments (ACI) is a statutory body appointed by the FSB and representing the whole industry. The ACI sees to it that the Collective Investment Schemes Control Act is adhered to through Regulations and Standards, and acts with the regulators as spokesperson for the industry. The ACI is also responsible for the reputation of the industry and can rightly claim that the industry is one of the more transparent industries in the financial services sector. The ACI is made up of member companies and works under the following mandate:

“Association of Collective Investments represents the collective interests of South African management companies, registered foreign collective investment schemes and their investors. The primary aim of the Association is to facilitate the development and growth of the industry, through its dealings with the authorities and regular communication with the media and investing public. Working on behalf of its members, the Association acts as the custodian of codes of practice and standards throughout the industry, and is the forum for identifying and fulfilling common goals” (Association of Collective Investments, 2006b).

The trustee is another mandatory player in the regulatory environment and is responsible for the custody of the assets of the scheme, as well as the daily transfer of units between the manager and the scheme. They fulfill more of an executive role to see that the individual's assets are protected. Any irregularities and breaches should be reported.

The Management Company ("Manager") is amongst others responsible for the set up of the deed and investment mandate, acquiring approval from the regulator, and the appointment of the portfolio manager and trustee. It should further ensure legal and regulatory compliance, administer the fund and unit holder accounts, and market and distribute the funds. There are currently 34 Management Companies in South Africa, managing 750 collective investment funds.

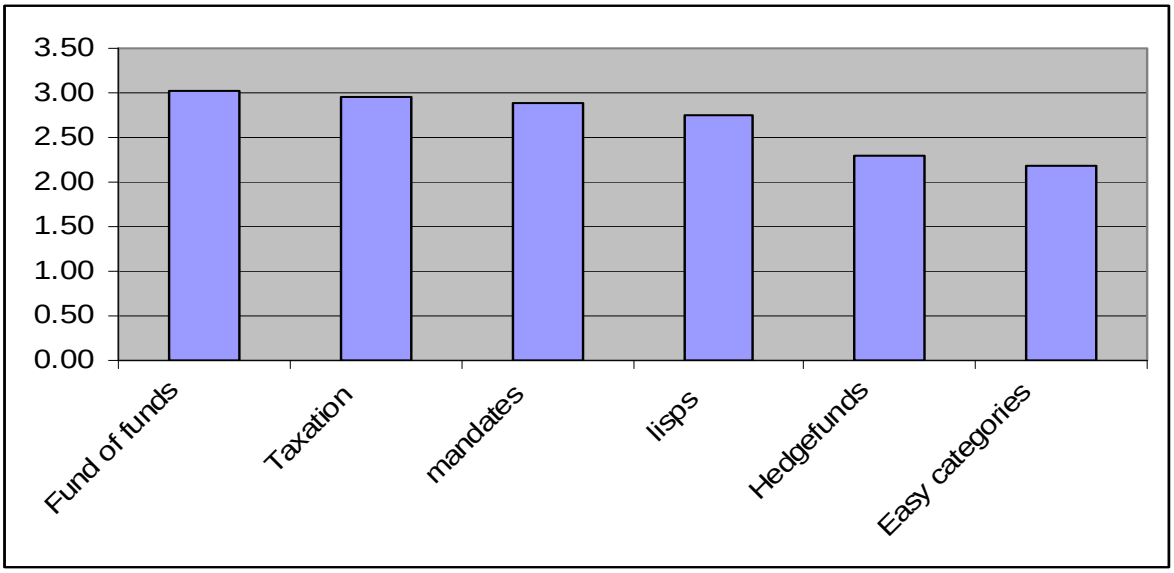
The portfolio manager is the person who actually unlocks the value for the individual investor by using the pooled investment to structure a portfolio of assets within the framework of the deed (also know as the mandate). They distinguish themselves from each other by the instruments used within the portfolio, being it stock selection, asset class weight or any other portfolio management tool available to them. Their job is complicated by volatile market conditions, expectations of the investor and regulatory restrictions. Investment managers are highly skilled, and normally have Chartered Financial Analyst

(CFA) qualifications. They make use of extensive research departments and statistical models to make their decisions.

There are traditionally two main types of investment advisers, the independent broker and the tied agent. The independent broker is self-employed and may present any company's product for which he is registered. He earns commission from his client for advice given. This commission can be earned up front or on a recurring basis. The tied agent earns commission on the same basis as the broker, but may normally only present the products of the organization (such as a life company) he is employed by.

FIGURE 2-12

Intermediary survey: Understanding collective investment concepts



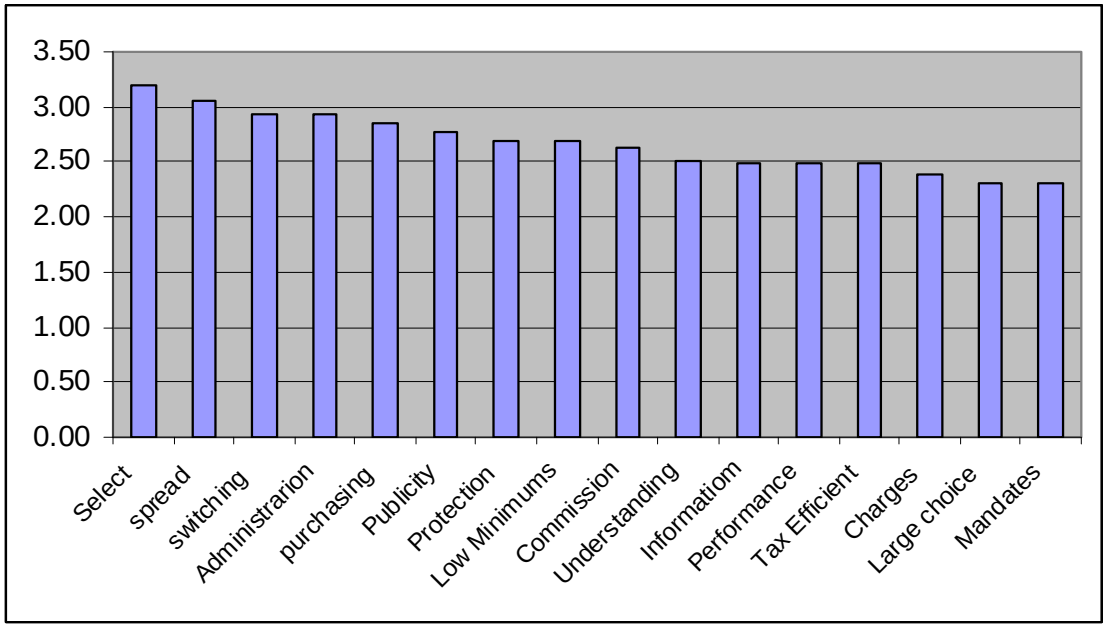
Source: Wigram (2006)

Figure 2-12 above indicates the amount of knowledge the Intermediary himself perceive to have on each of the areas. The scale is out of a maximum point of 4. The tied agent or broker was traditionally the only access the individual investor had to collective investment schemes other than going directly to the manager. The intermediary sold mainly life products and did not have enough investment knowledge to sell more than the basic general unit trust product.

The intermediary has suddenly found himself in a changing environment where investment knowledge is necessary. There are also other role-players in the value chain, e.g. LISPs, which means less commission. Furthermore, the FAIS Act has put a new discipline on them with regard to advice. This means that they are leveraging the one thing they do have control over, and that is the client.

FIGURE 2-13

Intermediary survey: Advantages of collective investments



Source: Wigram (2006)

Figure 2-13 above indicates the perceived advantages of collective investments by intermediaries. The scale is out of a maximum of 4.

Linked Investment Service Providers (LISPs) have mainly been established to provide an administration platform through which an investor can access multiple investment houses through one platform. This gave the investor the ability to diversify his portfolio and change it at will. LISPs have initially taken over a huge portion of the market due to the fact that they sell solutions to clients via intermediaries. Lately, however, the intermediary has realized that the LISP takes a huge margin and start up their own broker funds.

Multi-managers are also a fairly recent addition to the value chain. They give the same diversity to the investor as the LISP, but already on Portfolio Management Level. A Multi-Manager can use existing collective investment schemes from different asset managers and package them into a fund of funds. A fund of funds is in itself recognized as a collective investment scheme. A multi-manager can also use various asset managers to invest and put together a segregated portfolio that is packaged in a collective investment scheme, giving an investor access to the diversified option. This option can, however, be more expensive due to the layers involved, but they do bring a special skill to the fray.

Investment brokers have recently come on to the market. They have combined two functions of the value chain, i.e. portfolio management and distribution. They put together a generic suite of funds (defensive, moderate and aggressive) by using existing funds or fund managers. They normally register these funds under an existing manager's license, which are referred to as Third Party Funds or White Labels. Because they already have the client base, they administer their client accounts through LISP platforms. This doesn't necessarily reduce the value chain, but simplifies the cost structure for the investor ("all-in fee").

The life insurance industry has for a while now recognized the benefits of Collective Investment Schemes as underlying building blocks of life portfolios. This gives the policy holder flexibility of choice and insight into his own investment. This facility is still not available on a number of the older generation

policies. Pension funds (especially smaller ones) that do not have access to a segregated portfolio due to their size, find that collective investments is an attractive alternative. Because of the fee load on top of the policy, the fee in the underlying funds tends to be very low. These are also sizeable investments that acquire very little administration from the Manager.

As a result of the dynamic nature of the industry, which is fuelled by influences from elsewhere in the 'global village', the local collective investment industry needs to constantly review its ever growing role in the South African financial services environment. One of the challenges facing the industry today is hedge funds. The industry and regulators need to find a way to recognize hedge funds under the collective investment schemes umbrella. Already in existence worldwide, the financial sector is calling for regulation of these types of funds in South Africa.

Another challenge is third party funds (broker/ white label funds). The industry has allowed investment managers to launch their own funds on the license of an existing management company. These 'investment managers' include brokerages that have a client base, but not necessarily the skills to manage a fund effectively and prudently. South Africa has a unique economy and much needs to be done to introduce our huge entry level market to collective investments as a savings vehicle. Due to the extremely low margins, it is difficult to get these projects up and running.

As a result of the lengthening of the ‘food chain’ and subsequent margin squeezes that were experienced, the industry has introduced the TER to encourage transparency. The Total Expense Ratio or TER of a portfolio is a measure of the fund’s assets that have been sacrificed as payment for services rendered in the management of the fund, expressed as a percentage of the daily average value of the portfolio, usually calculated over a period of a financial year. TERs enable investors to evaluate their portfolios by quantifying the costs incurred in the management of the fund in a single number so that the impact of these costs on returns is clearer (Association of Collective Investments, 2007b).

2.6 CONCLUSION

Over the last century, numerous investment theories have been developed around the management of risk in an individual investment portfolio because the concept of risk has been recognised as being one of the major impacts on investment returns. Central to these is the Capital Asset Pricing Model (CAPM) and derivatives thereof. All of these models recognize that portfolio risk can be mitigated through diversification.

The mutual fund provided the ideal vehicle for the ‘man in the street’, giving him access to the investment market at an acceptable cost. Diversification came as part of the package, and even further diversification became possible through various portfolio strategies. However, mutual fund theorists debate the optimal

portfolio strategy, the effect of fund sizes and movement between portfolios on investment returns, and the role of the intermediary.

It was shown that the value chain through intermediation has been instrumental in creating wealth for the individual investor. However, much of that wealth was destroyed through the behaviour of the individual investor, which has been widely studied. There are some characteristics of ‘human’ nature that consistently affect investment decisions, however irrational they might be.

The United States mutual fund market is by far the single biggest mutual fund market in the world, although Europe also has a well developed and substantial collective investment fund market. In relation to this, South Africa is very small. As with the rest of the world, South Africa’s collective investment industry has also grown and adapted to the investor’s specific needs.

The research that has been done later on in this dissertation was aimed to determine whether the view and experience of the individual investor in South Africa agrees with what has been found in literature studies worldwide.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 INTRODUCTION

The purpose of this chapter is to describe the research methodology used and to expand on the issues encountered in the process of data collection. It was important to make sure that the data collected was relevant and comprehensive enough to give substance to the hypothesis.

To start off, various research methodologies were evaluated, after which a specific methodology was chosen. A description of the research methodology used is given, why it was chosen and how it was applied. As a particular database was used for the sampling, it was important to justify this database as being a fair replication of a larger universe pertaining to this particular dissertation. This chapter explains how the data was managed to eventually get to a suitable sampling. To put the data received in context and to test the results against perceptions, various forms of additional data were obtained to ensure the relevancy of all outcomes. Finally, during the process of obtaining the data, some ethical issues needed to be considered pertaining to this particular database. These issues are addressed later in this chapter.

3.2 RESEARCH METHOD USED

Research is a process that involves obtaining scientific knowledge by means of various objective methods and procedures (Welman, et al., 2007, p. 2). There are two main research methodologies, quantitative and qualitative. Quantitative methodologies concern controlling the situation and using remote, empirical and inferential methods. Qualitative methodologies concern unstructured interviewing and detailed observation processes.

Quantitative research evaluates a reliable and objective set of data. The database used for this study represents these elements, which was one of the reasons why this methodology was chosen. Qualitative research, however, rely on subjective data gathered through interviews, observations, etc. This would have been a very cumbersome process, which would have resulted in an opinionated view of a few that wouldn't necessarily have reflected the large population that has been researched. The law of numbers that dictates a quantitative sample gave sufficient empirical evidence to substantiate the findings in this dissertation.

The research method that was chosen is based on the research process as first described by Wellman, Kruger & Mitchell (2007). This section will continue to describe the actual research process.

3.2.1 The aim of this research is to identify the existence and analyze the effectiveness of the value chain of a collective investment scheme, and to determine whether it has an impact, and if so, the extent thereof on an individual investor in South Africa today.

3.2.2 The research problem is formulated in Chapter 1 as:

"The popularity of Collective Investment Schemes as an investment vehicle in South Africa today lies in the fact that an individual investor can satisfy his investment needs through a value chain that has a dynamic interdependence and that ensures value added for the individual investor."

From the problem statement it can be derived that the following areas needed to be researched:

- Collective investment schemes – unit trusts
- Individual investor in South Africa
- Investment needs
- Investment knowledge
- Value chain – interdependence
- Value chain – value adding

3.2.3 To find data on the areas identified in 3.2.2, an appropriate sampling had to be found from a population that were made up of individual investors in South Africa that owned unit trusts. The database that was decided on was the client register of the Sanlam Collective Investments Management Company.

The main reason for choosing this database was that the database was a fair reflection of the population that was going to be studied, i.e. individual investors in South Africa that own unit trusts (the statement that the database is a fair reflection is discussed in further detail in the justification following this section).

Furthermore, a significant number of the client database has internet access, which made the collection of data a lot more effective. Permission was given by the Sanlam Collective Investments Management to mine the database of nearly 300,000 individual investor records.

The systematic sampling method was first used to select a population from the database and then narrow it down to a population that simulated the required profile. This was done through a process of the elimination of data subjects that did not fit the desired population profile. The final selection was made by way of a systematic sampling process. The details

of this process (and actual numbers) are relayed in a following section on 'data management'.

3.2.4 The integrity of the research is crucial. It is therefore important to confirm the validity of the data. The fact that the database used comes from one management company (Sanlam Collective Investments in this case), can raise the question whether this is a true sample of the average South African investor, given the fact that with Sanlam Group's historical background, the database can be perceived as too homogenous in terms of language, etc.

It can further be argued that there is not enough diversification in the database to include a significant portion of current investor behaviour as opposed to historical investor behaviour. These issues are addressed in full in the following section on 'justification'.

3.2.5 The questionnaire was designed to encompass all the major areas that were probed in the first part of this dissertation, with specific reference to the value chain and its major elements. The following areas (and questions pertaining to them) were covered. Care was also taken to interlink the questions to ensure continuity and to back up responses. The term 'unit trust' was used throughout the questionnaire, as it was a more

recognizable term for the sample, and the term ‘collective investment’ may have confused some.

General awareness of unit trusts

Q: Why has the investor decided to invest in unit trusts?

Q: How was the investor made aware of unit trusts?

Q: Which benefits of unit trusts appeals to the investor?

Investor knowledge

Q: How does the investor monitor the growth of his unit trust?

Q: What type of growth expectations does an investor have for his unit trust?

Q: Is the investor aware of the Collective Investment Schemes Control Act?

Q: Does the investor know what it costs to invest in unit trusts?

Management company

Q: How actively did the investor interact with the management company?

Q: With how many other management companies does the investor have investments?

Industry

Q: What does the investor think of the various financial sectors in terms of regulation?

Q: Why did unit trusts become more popular during the past 10 years?

The value chain

Q: Which part of the value chain, if not the whole, is most important for the investor?

Q: How much is the investor prepared to pay for a unit trust investment?

Q: Is the investor generally satisfied with his unit trust investment?

Investment Manager

Q: Does the growth of his Unit Trust investment actually meet the investor's expectations?

Q: Does the investor compare relative unit trust performances?

Q: Would an investor be prepared to pay more for additional investment management services?

Intermediary

Q: Does the investor manage his unit trust investments actively?

Q: What is the investor's view on investment advice?

Q: Would an investor be prepared to pay more for additional investment advisory services?

Biographical details

Q: Age

Q: Gender

Q: Language

3.2.6 The data collection took place by way of survey questionnaires that obtained information on biographical details, behaviour, opinions and attitudes.

The details of this questionnaire are discussed under ‘data management’ and an example of it is attached to this dissertation as annexure A.

The questionnaire was electronically mailed to the predefined sampling and responses were sent back to a central electronic mail address. Some of the responses were also faxed and mailed to a given address. Details of the response rate, etc., are given in a following section on data management.

3.2.7 The data analysis was done by capturing all the responses on a MS Excel spreadsheet and converting it into statistical data. Due to the nature of each different question, the statistical outcomes were interpreted individually per question. It should, however, be noted that the final sample remained the same and biographical profiles are analysed in the

beginning of Chapter 4. The rest of the analysis is also presented in Chapter 4. The presentation of the results differs from question to question, depending on suitability.

3.3 JUSTIFICATION

In describing the research method used in Section 3.2 above, the areas that needed to be covered in a questionnaire to help address the research problem were listed (3.2.2) and reasons were given why the particular database was chosen (3.2.3). The validation of the data is important for research integrity. Therefore the aim is to justify the database as a true reflection of the universe that was researched. The following three areas support this statement:

3.3.1 Similarities with Industry Data

The composition of the main investment asset classes of the Sanlam Collective Investments database from which the sample was taken, have been compared to that of the South African Collective Investment industry as a whole (excluding institutional business). The following table (Table 3-1) shows that the similarity between the composition of the assets classes of the Sanlam Collective Investments database and that of the whole industry is significant.

TABLE 3-1

Comparison between industry and Sanlam assets under management

	Value of assets under management			
	Industry		Sanlam	
	R'bn	%	R'bn	%
Equity	115.4	29	4.8	27
Asset allocation	89.1	22	2.9	16
Fixed Interest	183.7	46	9.5	53
Property	15.1	4	0.6	3
TOTAL	403.3	100	7.8	100

Source: Association of Collective Investments (2006a)

3.3.2 Number of investors

The industry has 1,945,148 investor accounts in total according to the ACI statistics of 31 December 2006. Sanlam Collective Investments had 243,550 active investor accounts on that date. This constitutes 12.5% of the industry, which is a significant portion, given that there are 34 management companies in total. On average, a management company will therefore constitute 3% of the total.

3.3.3 Diversification

63% of the respondents indicated that they have invested with other management companies as well. The average broker or financial adviser has access to most of the products available in the industry. As 62% of the respondents indicated that they have a broker or adviser, one can assume that most of the respondents has access to diversified products. The 63% above seems to confirm this.

It can therefore be assumed with reasonable justification that the Sanlam Collective Investment database is a true reflection of the universe that was researched.

3.4 DATA MANAGEMENT

3.4.1 Sampling

The first step after deciding upon the database as described in 3.2.3 above, was to extract a 'universe' from the database to narrow it down from 243,550 records to a manageable size. This was done by requesting the database managers to extract the data using the following criteria:

Include only the records that have an e-mail address attached to it.

Exclude all the records that have indicators that they are wholesale investors, such as Linked Service Providers (LISPs) and other investment managers.

Exclude all the investors that were invested in institutional funds (set up specifically for bulked investments and mainly used by life companies, investment managers etc.).

Exclude all the records that have indicators that they are a broker or a financial adviser (who have invested for their own account).

The result was 36,744 records that were imported into an Excel-spreadsheet. The following data fields were extracted:

FUND	INVESTOR CODE	NAME	E-MAIL ADDRESS	PHYSICAL ADDRESS	UNIT HOLDING	LANGU AGE	AGENT CODE

The data was then sorted in an effort to take out all possible anomalies and to reduce the extracted database to a manageable sampling.

Due to the fact that the data extraction was set up to display a data row for each variant, a single e-mail address had numerous data rows. For example, a single e-mail address may have had different investor codes (a family), various funds and even more than one agent code. The first sorting action was done to reduce the database to a single row per e-mail address. This didn't affect the quality of the sampling at

all, and made the database more manageable for data collection purposes.

The next step was to refine the data by taking out data that may have possibly affected the quality of the responses. That included all non-individuals (trusts, companies, etc.), e-mail addresses relating to Sanlam employees, and international postal and e-mail addresses.

Investors that only invested in the money market fund and not in any other unit trust fund, have also been excluded for the reason that such investors may only be invested for cash management purposes (the same as a bank deposit or current account), and might therefore not have experienced the full value of a unit trust investment as contemplated in this dissertation.

The sampling that was left contained 12,869 records. As this was still too big a number to send out (taking costs considerations into account), 5,000 records were randomly extracted to use as a sampling.

The random sample was extracted in a way that would take out any logical order (e.g. names or addresses alphabetically). The data was sorted according to number of units held. Any specific order that could have been derived from unit holding (such as total value of

investments per investor) was negated by the fact that (a) the number of units used in this sample only pertains to one particular fund (randomly chosen when multiple addresses were eliminated) and not the investor's whole portfolio, and (b) the value of a particular unit differs from fund to fund and therefore number of units do not relate to value of investment when comparing different funds.

3.4.2 Data collection

E-mails were sent to 5,000 investors as per random sample as described above. A message accompanied the questionnaire in which the reason for the questionnaire was explained and confidentiality was promised. An example of the message, together with an example of the questionnaire, is attached as annexure A.

In the end 228 responses were received. This relates to a response rate of 4.56%. This response rate seemed to be acceptable, due to the fact that the normal response rate for this kind of survey as done by the organization that assisted with this survey, involving a similar kind of selection universe, was between 2% and 4%.

At a 90% confidence level, the result of 228 responses from a selection universe of 5,000 constitutes an error level of 5.3%. An acceptable

error level for this kind of research is normally between 3% and 6% (CustomInsight, 2004). The University of Florida (1994) also indicates that a sample size of 200 - 500 is adequate to support mathematical deductions.

Of the 228 responses, all but 6 were returned electronically. These 6 responses were faxed after the respondent indicated problems with the electronic link. Some other responses related to ethical issues and are discussed in a following section. All the responses were imported electronically into an Excel spreadsheet in the following format for each question:

TABLE 3-2

Example of electronic data import

Title: Reasons for investing in Unit Trusts										
Analysis: As part of my personal financial and retirement plan										
	Base		Demographics							
		No reply	<34 years	35-49 years	50-64 years	65+ years	Male	Female	English / Other	Afri-kaans
	228	1	33	95	82	16	155	72	86	141
Mean	3.41	4	3.31	3.26	3.58	3.53	3.47	3.26	3.47	3.36
Standard Error	0.05	0	0.12	0.09	0.07	0.13	0.06	0.1	0.08	0.07
No reply	19	-	4	9	5	1	12	7	7	12
	8.3%	-	12.1%	9.5%	6.1%	6.3%	7.7%	9.7%	8.1%	8.5%
Strongly Agree	109	1	12	40	48	8	78	30	44	64
	47.8%	100%	36.4%	42.1%	58.5%	50.0%	50.3%	41.7%	51.2%	45.4%
Agree	83	-	14	34	27	7	57	26	29	54
	36.4%	-	42.4%	35.8%	32.9%	43.8%	36.8%	36.1%	33.7%	38.3%
Disagree	10	-	3	6	1	-	5	5	5	5
	4.4%	-	9.1%	6.3%	1.2%	-	3.2%	6.9%	5.8%	3.5%
Strongly Disagree	7	-	-	6	1	-	3	4	1	6
	3.1%	-	-	6.3%	1.2%	-	1.9%	5.6%	1.2%	4.3%

Source: Response data from own research

The response data was used to compile the research results as shown in Chapter 4.

3.5 ETHICAL ISSUES

The biggest ethical issue was the confidentiality of the database, and several questions were received in this regard. Some of the investors were querying the fact that permission was given to access their personal detail, and also queried Sanlam Collective Investments' intentions with the questionnaires.

It was explained to them that permission was given by the management of Sanlam Collective Investments to access their database. It was only the intention to use the summary of results for this dissertation and that none of the personal data would ever be disclosed. No comebacks were received on the replies and it was generally felt that the respondents had positive intentions when completing and submitting their questionnaires.

3.6 CONCLUSION

The research process was done scientifically and enough assurances were gathered to verify a believable set of data that would assist in reaching viable conclusions with regard to the problem statement. Although it is a very important part of the dissertation, the research part only assists in the ultimate outcome of the problem statement.

CHAPTER 4

RESEARCH RESULTS

4.1 INTRODUCTION

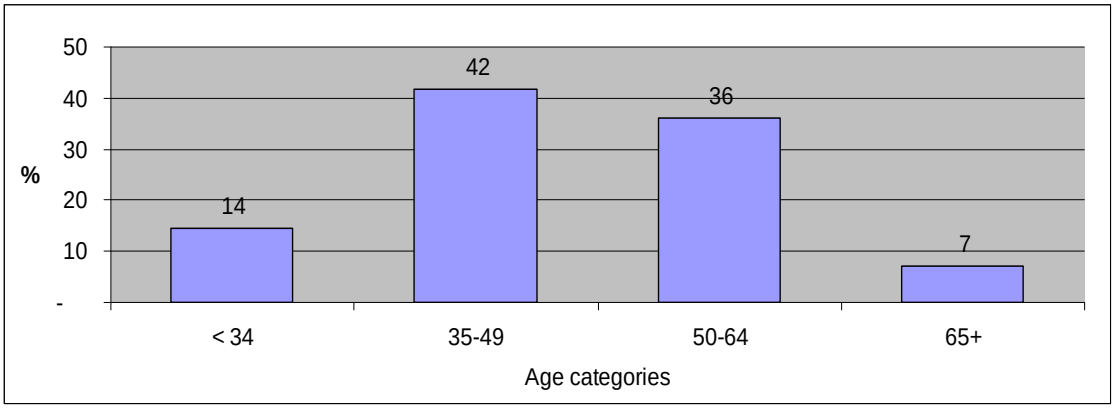
The data gathered as described in Chapter 3 is analyzed in this chapter. The purpose of this chapter is to present the reader with statistical evidence of assumptions made in this dissertation as well as through analysis, to identify trends to support deductions made in this dissertation. The profile of the respondents will first be looked at, after which the responses will be analyzed in detail in the context of this dissertation.

4.2 PROFILE OF RESPONDENTS

The total sample is 228 respondents coming from the Sanlam Collective Investments Management Company client database. These clients each have at least 1 Sanlam Collective Investment (unit trust) product. Here are the main profiles:

FIGURE 4-1

Age profile of respondents



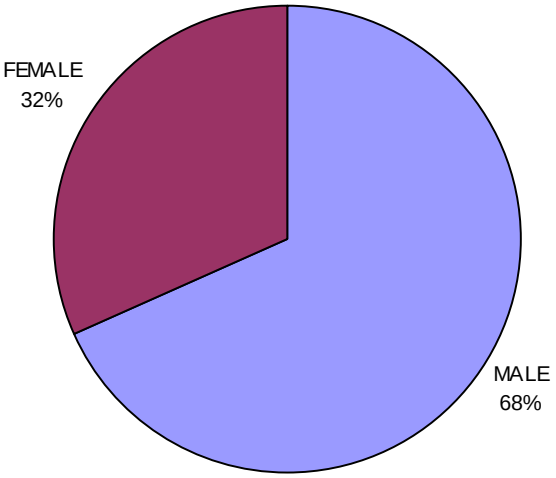
People's investment habits change as they go through different life stages. This is also clear from the information above. Nearly 80% of the investors that responded are in the age groups between 35 and 64. Investors in the age group below 35 are mostly starting with their careers and spend most of their available earnings on the acquisition of houses, cars, etc., and starting families. Those who are older than 64 on the other hand are very risk averse, and tie up most of their savings in stable/ risk free products such as those that life companies and pension funds provide.

The Research Fundamentals study by the Investment Company Institute (2007b, p. 4) in the United States shows a similar pattern. Taken from a much larger sample universe, the study shows that 18% of the investors are below the age of 35 and 16% of the investors are above the age of 65. The categories between 35 and 64 are also evenly spread. It is, however, significant to note that more mutual

fund investors in the United States older than 65 are still active in the savings market than in South Africa.

FIGURE 4-2

Gender profile of respondents



The gender profile of respondents also provides us with significant findings. The fact that two thirds of the respondents are male could reflect on the fact that the male is historically still the dominant saver in the family. However, the number of female investors is also significant, showing a clear trend of an increase in the female propensity to save as independent income earner.

4.3 ANALYSIS OF RESPONSES RECEIVED

The research sample totals 228 respondents. Not all of the respondents answered all the questions or selected all the propositions in each question. At

some of the questions some of the respondents may have selected against the various propositions. For that reason all the graphic depictions below, where applicable, show the results as a percentage of the sample total (228).

TABLE 4-1

Reasons why an individual investor saves

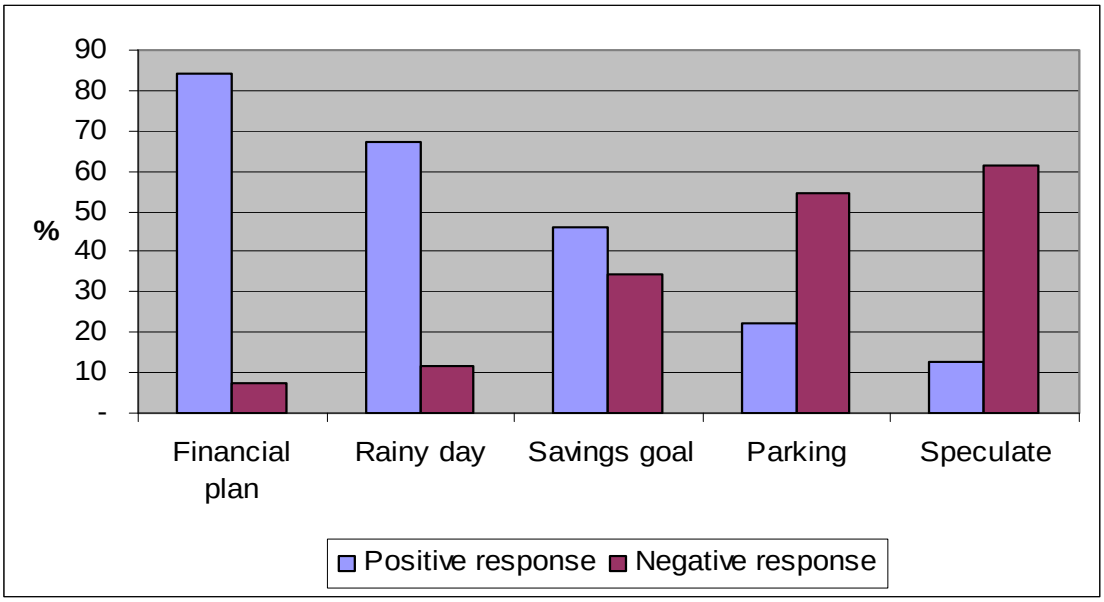
	Strongly agree	Agree	Disagree	Strongly disagree
As part of a personal financial and retirement plan	109	83	10	7
To add to savings (for a rainy day)	67	86	20	6
For a specific savings goal (e.g. children's education, holiday, etc.)	50	55	47	31
To temporarily park surplus funds (short term)	17	34	63	61
To speculate	5	24	51	89

The individual investor saves for a number of reasons. According to the South African Savings Institute (SISA), this should be a two-pronged approach for each investor: *prevent* financial stress situations and *provide* for retirement. Collective investments are only one of several savings vehicles (e.g. bank savings, pension/ provident funds, stokvels/ credit unions, etc.) through which an individual investor can save (South African Savings Institute, 2007). The sample was asked why they were investing in unit trusts as a savings vehicle to

determine where it fits into their personal financial management framework. The results are shown in Table 4-1 above. To simplify the discussion of the outcome, the “strongly agree” and “agree” statements are combined and compared with the combined “disagree” and “strongly disagree” statements. The results are shown in Figure 4-3 below.

FIGURE 4-3

Reasons why an individual investor saves



The majority (84%) of the respondents reacted positively to unit trusts being seen as part of their personal financial and retirement plan. This supports the hypothesis of this dissertation; that the collective investment value chain adds value to the individual investor’s investment needs. It also indicates the other specific areas of the investment need that is satisfied. 67% of the respondents

use unit trusts for ‘rainy day’ savings and nearly 50% of the respondents have committed to a savings goal.

Although it is a very low percentage, 13% - 22% of respondents still like to manage their unit trust investment actively through speculating and parking funds. Unit trusts as a savings vehicle therefore provides for a need over the whole savings/ investment spectrum, but are preferred to provide liquidity or as a short- to medium-term solution for the personal financial plan of the individual investor.

TABLE 4-2

Awareness creation of collective investments

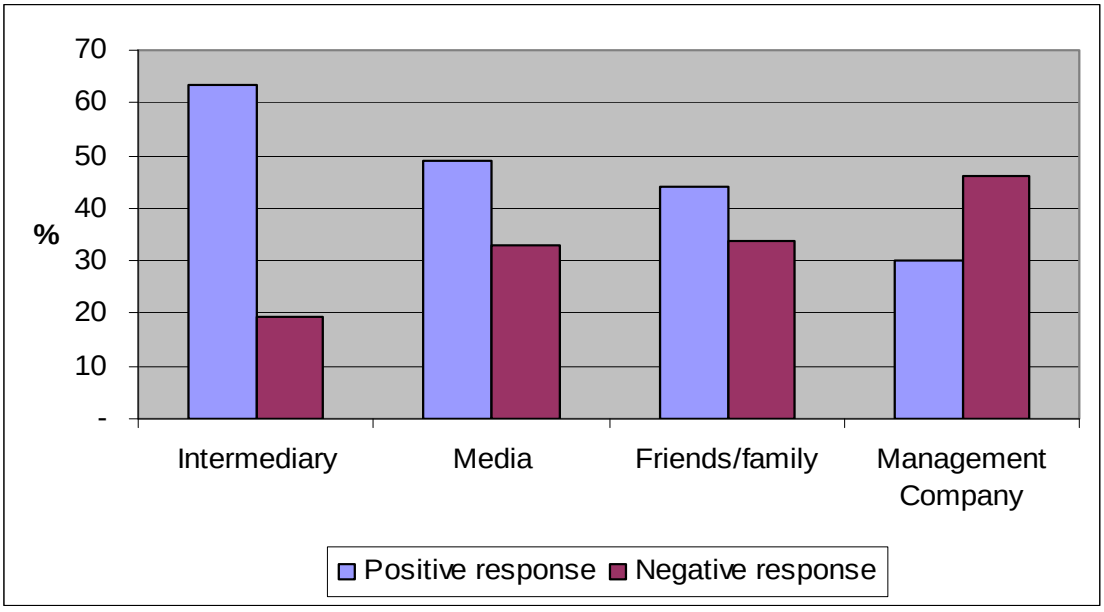
	Strongly agree	Agree	Disagree	Strongly disagree
An intermediary (financial adviser/ broker, etc.)	65	80	22	22
The media (newspapers, TV, etc.)	50	62	47	28
Friends, family, colleagues	34	66	46	31
A unit trust management company	16	53	63	42

In the beginning of the dissertation it is shown that collective investments have experienced strong growth during the recent past. One of the reasons stated was the awareness created of collective investments. This was tested with the sample to determine how effective collective investments are promoted as a savings

vehicle and through which channels it is best communicated. The results are shown in Table 4-2 above. As with Figure 4-3 above, the statements were combined to simplify the discussion of the outcome and the results are shown in Figure 4-4 below.

FIGURE 4-4

Awareness creation of collective investments



The financial adviser/ broker still seem to be the best communication channel according to 64% of the respondents. The media is also a relative important awareness creator (nearly 50%), but a higher percentage would have been expected here, seeing that nearly as many (44%) of the respondents indicated that they heard about unit trusts by word of mouth (family and friends). The unit trust management company on the other hand received an overall negative response of 46% vs. 30% positive, which is relevant because it is the duty of the

manager to promote and educate on unit trusts. Financial advisers themselves, however, indicated in the Wigram intermediary survey (2006) that they receive most of their information from financial magazines (87%), followed by newsletters from the unit trust management companies (71%), which indicate that management companies make use of intermediaries through which they contact the client. Also apparent from the Wigram survey is that intermediaries indicated low responses for general media (TV, radio) as information source (55%), which collaborates with the individual investor findings in this survey.

TABLE 4-3

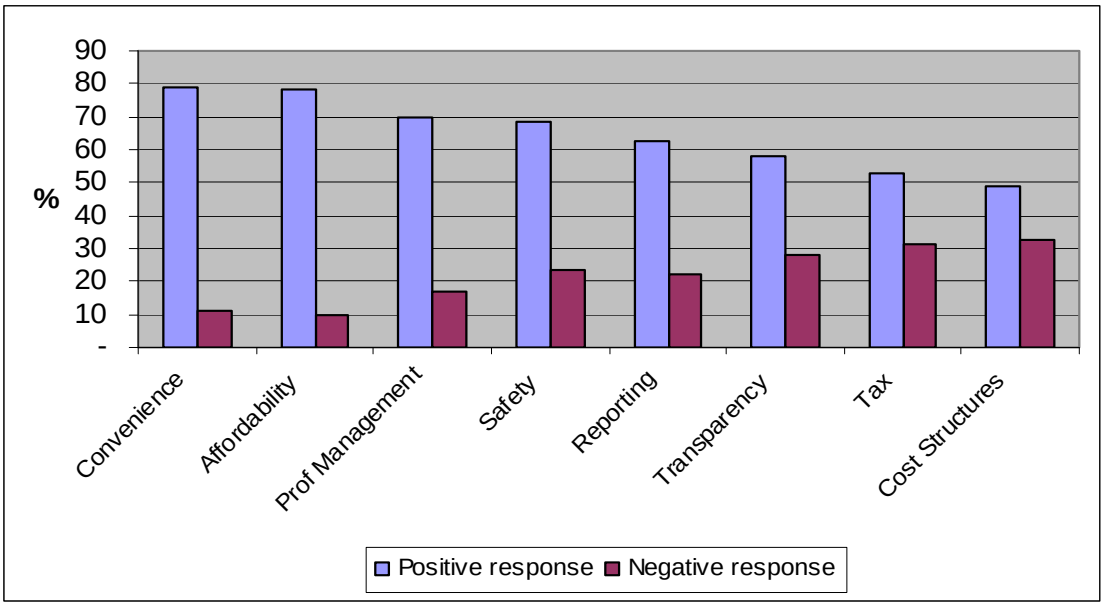
Benefits of collective investments

	Strongly agree	Agree	Disagree	Strongly disagree
Convenience and liquidity	76	104	21	5
Affordability	57	121	15	7
Professional management	30	129	28	10
Safety of investment	41	115	45	9
Reporting on performance	36	107	35	15
Transparency	25	107	46	18
Tax effectiveness	27	93	58	14
Competitive cost structures	14	97	55	20

The problem statement of this dissertation revolves around the value added to an individual investor through the collective investment value chain. The sample was asked to indicate which benefits of unit trusts appealed to them and what enticed them to invest in unit trusts. These benefits are listed by the Association of Collective Investments on their website to promote unit trusts. The results are shown in Table 4-3 above. The positive responses were combined and showed together with the combined negative responses in Figure 4-5 below.

FIGURE 4-5

Benefits of collective investments



If one should revisit the statement made by Woodard (2007) in Chapter 2 of this dissertation, *"Mutual funds are one of the best investments ever created because they are very cost efficient and very easy to invest in",* it is clear that the majority of respondents agreed with him. The majority of the respondents, 79% and 78%

respectively, indicated that ‘convenience’ and ‘affordability’ were the two most acceptable benefits listed. As with the two top-rated benefits (encapsulating the essence of unit trust investments), it is significant that the other benefits are also paired and ranked accordingly by the respondents themselves!

‘Professional management’ (70%) and ‘safety’ (68%) are the second highest grouping. These benefits relate to the trust put in the portfolio manager to safeguard the individual investor’s personal savings and to give execution to the investor’s personal financial plan referred to in Table 4-1 above. That is the reason why most of the investment managers make a promise to investors similar to that of Vanguard (2007) *“to manage your investments with prudence, a long-term perspective, and the goal of providing returns that are consistently better than those of competitors”.*

The next group is ‘reporting’ (63%) and ‘transparency’ (58%), which are actually regulatory requirements and are enforced by the Financial Services Board (FSB) and Association of Collective Investments (ACI) to ensure a safe investment environment for the industry. The last group, ‘tax’ (52%) and ‘cost structures’ (49%), is the lowest ranked, most probably because they are the most difficult aspects of collective investments to understand. In total the positive responses outweighs the negative responses by far (by more than 40% on average).

TABLE 4-4

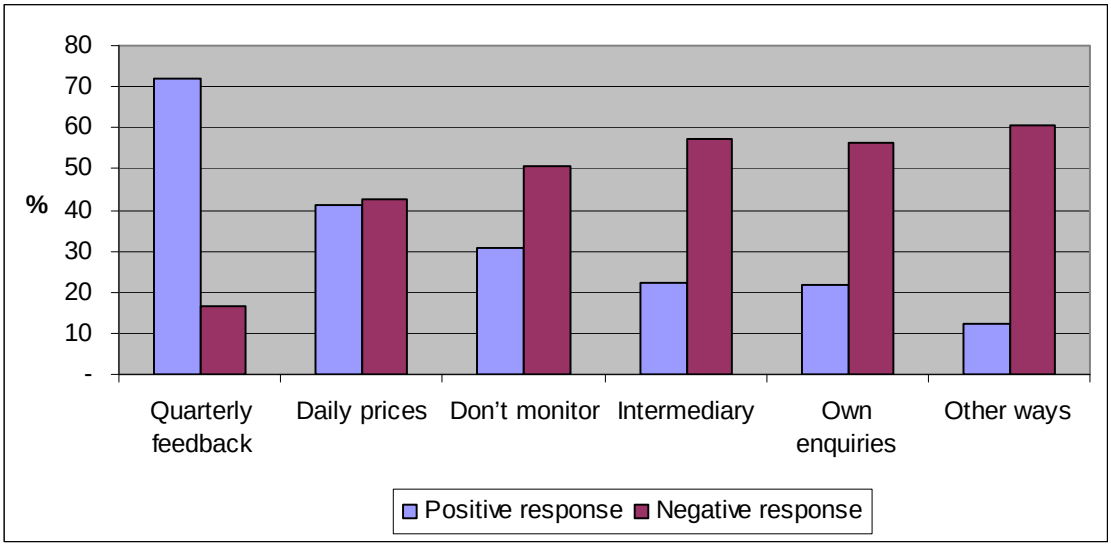
Growth monitoring of collective investments

	Strongly agree	Agree	Disagree	Strongly disagree
Quarterly feedback from the management company	61	103	23	15
Daily price updates in newspapers, the internet, etc.	45	49	67	30
I don't really monitor the growth on a regular basis	24	46	50	65
Regular feedback from my financial adviser/ broker	15	36	62	69
I have to make my own enquiries through the call centre, etc.	19	31	72	56
Other ways not mentioned above	7	21	73	65

Some of the questions were directed to determine what impact the investor's own actions (or lack of) have on the value added to the value chain. To determine whether investors monitor their investments actively and if so, how they obtain the information to do so, the sample was asked to indicate their personal involvement. The results are shown in Table 4-4. The combined positive- vs. negative-response scenario was also used to interpret the results as shown in Figure 4-6 below.

FIGURE 4-6

Growth monitoring of collective investments



72% of the respondents rely on the management company's quarterly feedback to monitor their investments, which could indicate a fairly passive management style. Against that only 41% of the respondents refer to daily updates by the newspapers and internet, etc. 50% of the respondents implied that they do monitor their investment growth regularly. According to the respondents the intermediary has a small role to play (22%) in updating the investor with his funds' growth information and as many of the investors have to make their own enquiries. It is therefore not conclusive how active investors monitor their fund performances. It is, however, clear that it provides the intermediary with the opportunity to be more actively involved in his clients' investments. The role of the intermediary is further investigated later on in the study.

TABLE 4-5

Growth expectancy of collective investments

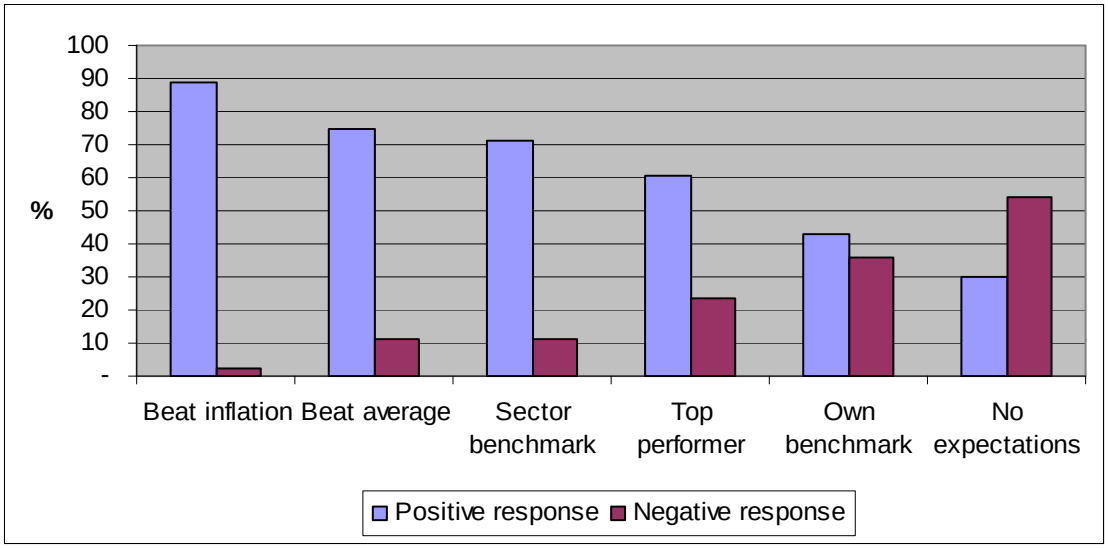
	Strongly agree	Agree	Disagree	Strongly disagree
Beat inflation	156	47	4	2
Beat the average of all the funds in its category	71	99	24	1
Beat the sector benchmark (e.g. ALSI for the general equity fund)	61	101	22	3
Be the top performing fund in its category	51	87	49	5
Achieve a benchmark or target set by myself	30	68	68	14
I don't have expectations as long as it grows	18	51	74	50

As has been established up to now, the individual investor is mainly invested in unit trusts for its convenience and affordability. Also determined through this questionnaire is that the individual investor mostly uses this investment vehicle to form part of a comprehensive individual financial plan. It is now perhaps pertinent to determine what kind of returns an investor expects from this investment vehicle as this would contribute to the perceived value added in the end for the investor. The sample was asked to indicate their growth expectations (if any) for their unit trust investments. In evaluating the replies it could be determined what the sample's knowledge on growth expectations was and whether it was realistic. Table 4-5 above shows the results.

An immediate observation is that nearly 70% of respondents felt strongly that their investment should at least beat inflation, which is a fair expectation. The same can be said for their expectation that their investment should beat the average of all the funds in the category or beat the sector benchmark. It is, however, interesting to note that more than 60% of respondents expected their fund to be the top performer in its category. A more detailed interpretation follows after Figure 4-7 below, combining the positive and negative responses.

FIGURE 4-7

Growth expectancy of collective investments



Nearly all the respondents (89%) want their investment to beat inflation. They also want their investment to beat the average of all the funds in the industry (71%) and beat the sector benchmark (75%), which is a reasonable expectation.

However, 61% of respondents want their investment to be the top-performing fund, which may not be a realistic expectation.

The December 2006 Unit Trusts Survey (Lambrechts, 2006, p. 43) shows that there were 53 General Equity funds with a performance history of at least 12 months. The CPIX inflation index for the 12 month period ending December 2006 was 5.0% according to Statistics SA. The worst performing fund in the category (30.53%) still managed to beat inflation comfortably. The average of the category was only 36.93%, which 23 of the 53 funds managed to beat. Only 5 of the 53 funds outperformed the sector benchmark (the ALSI). This meant that all the respondents should have been more than satisfied with the fact that their fund beat inflation. A selected few, however, would have been able to able to beat the sector benchmark. In the context of the general outperformance of the class, not many would have been dissatisfied with the returns, even though it didn't outperform the benchmark.

Interestingly enough, 43% of the respondents indicated that they have set their own benchmarks, which could also include any of the above. A significant portion of the respondents (30%) do not have specific expectations, 'as long as it grows'. This does not necessarily indicate an ignorant view towards unit trusts, but could add to the findings of previous statements that indicate that they see a unit trust investment as a long-term growth vehicle.

TABLE 4-6

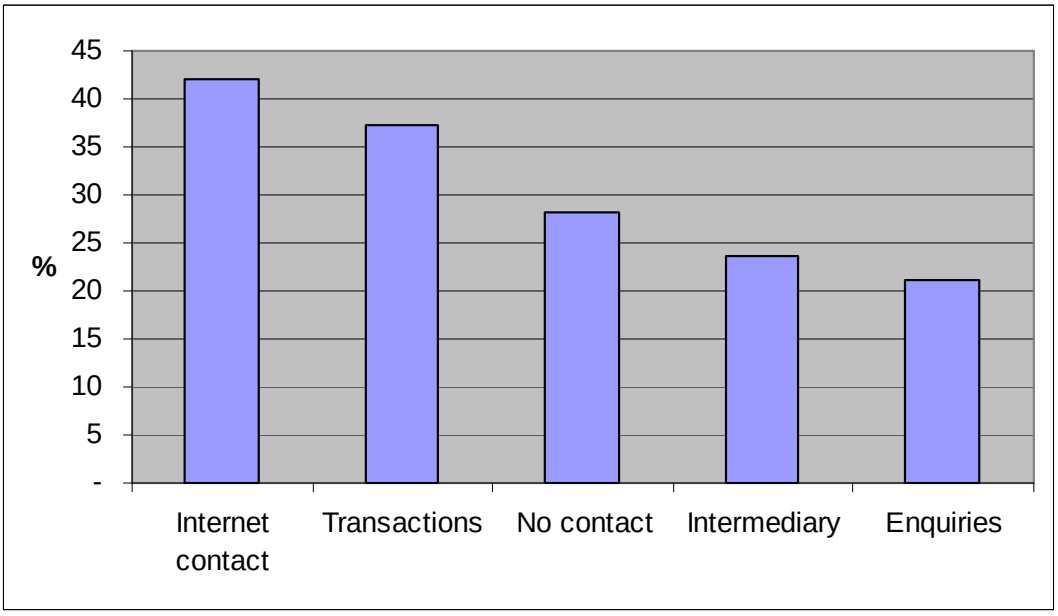
Contact with management company

Internet contact	96
To repurchase, switch or make an additional investment etc.	85
No contact	64
Contact via your financial adviser/ broker	54
To make a general enquiry through the call centre	48

The reason for this question was to determine the extent of the investors' relationship with the management company and to ascertain whether regular contact is important to the investor. Table 4-6 above shows the results. To illustrate the results, the chart below (Figure 4-8) was used.

FIGURE 4-8

Contact with management company



True to modern day trends, most of the investors (42%) have contact via internet. Together with enquiries (22%), internet contact is the only other voluntary means of contact by the individual investor. Significantly so, a fairly large number of respondents (28%) indicated that they haven't had any contact with the management company within the past 24 months. The results also indicate that 37% of investors did some or other transaction with their unit trusts during the past 24 months. This can be seen as 'forced' interaction.

In the context of the value chain and the results shown in Table 4-2, the management company does not have such a direct or even an indirect (through the intermediary – 23%) impact on the investor. This does not take away from the

importance of the management company as a role player in the value chain. It shows that the individual investor may not recognize the importance. The following results could shed more light on this statement.

TABLE 4-7

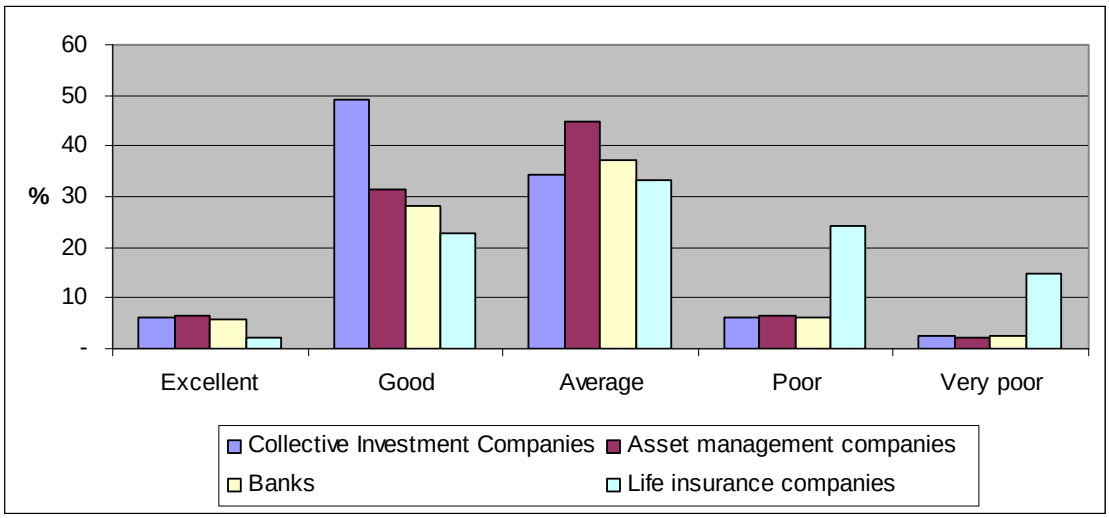
Regulation and transparency of financial services

	Excellent	Good	Average	Poor	Very poor
Unit trust companies	14	112	78	14	6
Asset management companies	15	72	102	15	5
Banks	13	64	85	46	14
Life insurance companies	5	52	76	55	34

Table 4-7 above shows the results of a question that was directed to determine how the collective investment industry rates as an investor-friendly industry against the other major financial sector industries. To best illustrate these results, a composite bar chart is used in Figure 4-9 below.

FIGURE 4-9

Regulation and transparency of financial services



The first observation to be made is that none of the industries were rated near "excellent". Less than 7% of the respondents rated any of the industries as "excellent". The next significant result is that most of the respondents rated unit trust companies as "good" (49%), with the other financial services industries being rated some distance behind (23%-31%). All of the industries were rated as "average" by more than a third of the respondents. Apart from the life insurance industry, none of the other industries received a "poor" rating from more than 7% of the respondents or a "very poor" rating from more than 3% of the respondents. 24% of the respondents gave the life insurance industry a "poor" rating, while 15% of the respondents gave them a "very poor" rating.

It hasn't been ascertained whether the respondents in this sample have products with any or all of the other financial service providers. There can therefore be a

bias toward unit trust products. Given the nature of the sample, however, it can be assumed that most of them have some products with the other industries as well.

TABLE 4-8

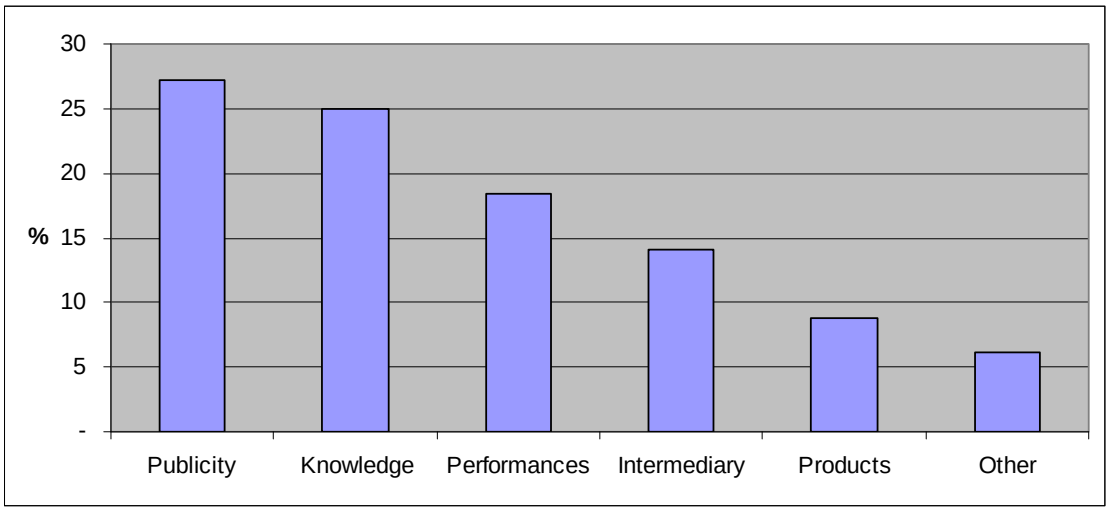
Collective investment awareness

More publicity	62
Improved investor knowledge	57
Better fund performances	42
Financial advisors'/ brokers' knowledge improved	32
More products available	20
Other	14

The general awareness of collective investments as a savings vehicle was tested earlier in this chapter. While that question focused on *who* created awareness, this question focused on *what* created the awareness. The results in Table 4-8 above are best illustrated in Figure 4-10 below.

FIGURE 4-10

Collective investment awareness



As in many industries, publicity seems to be the biggest reason greater awareness was created (27%). The investor also recognizes improvement in his own knowledge (25%), which could also have been the result of general awareness. However, these results contradict the results to the second question where the intermediary was given the recognition by the respondents of being the highest contributor to unit trust awareness, as specifically opposed to the media. If the respondents interpreted the question correctly, it would mean that according to the respondents, intermediaries made them aware of unit trusts, but wasn't the reason that they eventually invested. According to the results in Figure 4-10, the investor gained more knowledge through the media and decided on that information to invest.

TABLE 4-9

Value added by value chain

	Strongly agree	Agree	Disagree	Strongly disagree
The investment decision (by yourself or your financial adviser/ broker)	61	104	17	5
Investment products and service from the management company	13	100	43	11
The management of the underlying assets by the portfolio manager	36	98	23	13
A value chain involving all of the above	52	97	27	10

This question was formulated to get directly to the core of the problem statement, and that is to determine if the value chain adds value, and in which area in particular. The results are shown in Table 4-9 above. The question was structured in such a way that each of the major links in the value chain was represented by each of the statements above:

Investment decision – involving the intermediary

Investment products – involving the management company

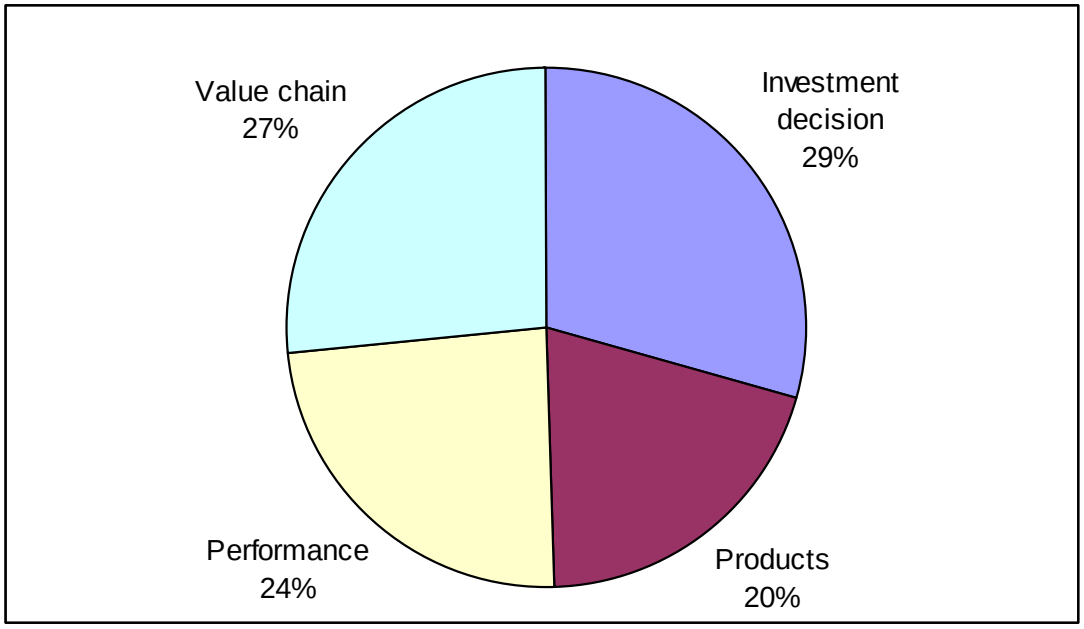
Underlying asset management – involving the asset manager

Value chain – involving all of the above

As the results are predominantly positive (80/20), values for ‘strongly agree’ and ‘agree’ were added and displayed in the form of a pie-chart comparison in Figure 4-11 below.

FIGURE 4-11

Value added by value chain



All of the areas are perceived to be more or less equally important. There is a gap between the investment decision and products, but not too significant. The investor hereby recognized each role player as well as the value chain as a whole.

The problem statement formulated in Chapter 1 states*: "The popularity of Collective Investment Schemes as an investment vehicle in South Africa today lies in the fact that an individual investor can satisfy his investment needs through a value chain that has a dynamic interdependence and that ensures value added for the individual investor."*

This statement is basically proven through the result illustrated in Figure 4-11.

More than 80% of the sample answered this question. Of the respondents that answered the question, 88% were positive with regard to their own investment decision, 80% were positive with regard to the whole value chain, 72% were positive with regard to the portfolio manager, and 60% were positive with regard to the products.

The differences between the results in terms of the investor's perception of his (and/ or his advisor's) own decision-making ability as opposed to the actual value added by the portfolio managers and the intrinsic value of the product are explored in more detail later on in this chapter.

TABLE 4-10

Growth expectation

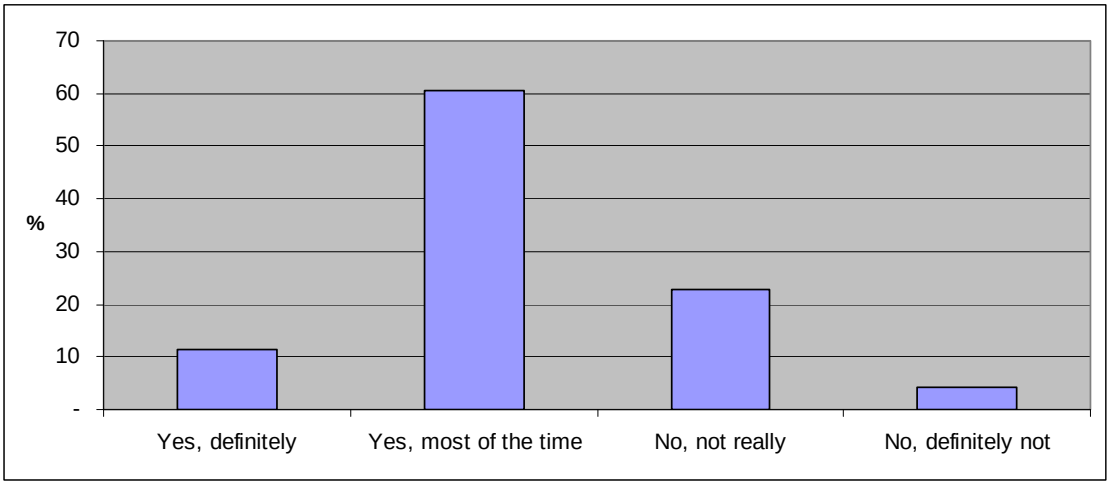
.	
Yes, definitely	26
Yes, most of the time	138
No, not really	52
No, definitely not	10

In the introduction of this dissertation it was stated that investors basically invest to *save* money and to make money *grow*. In order to satisfy his investment needs, the investor needs to have a realistic growth expectation of his investment vehicle in trade-off with the risk attached to such an investment. The sample was

asked to indicate to what extent unit trusts as an investment satisfy their growth expectation. The results are shown in Table 4-10 above. For illustration purposes, Figure 4-12 below shows the results by way of a bar chart.

FIGURE 4-12

Growth expectation



The combined total of the positive replies are 72%. The respondents who are extremely positive (11%) either have a fairly low growth expectation, or have enjoyed recent investment performances that would have satisfied most investors. The 61% that are satisfied with their growth most of the time typically recognize market fluctuations and temporary underperformances. This is a very positive result for unit trust as an investment vehicle. It should, however, be taken into account that the survey was done in a fairly rapidly growing equity market with strong growth performances.

A fairly high number (27%) of respondents in total are not satisfied with their growth experience. This can be for a number of reasons, including simply too high a growth expectation, wrong investment decision, or a combination of having too high a growth expectation for a specific investment decision. This would then also put a spotlight on the investment adviser (or lack of investment advice) that should ensure the matching of the investor and product profiles, etc. The 4% who are extremely unsatisfied should probably not be invested in this vehicle.

TABLE 4-11

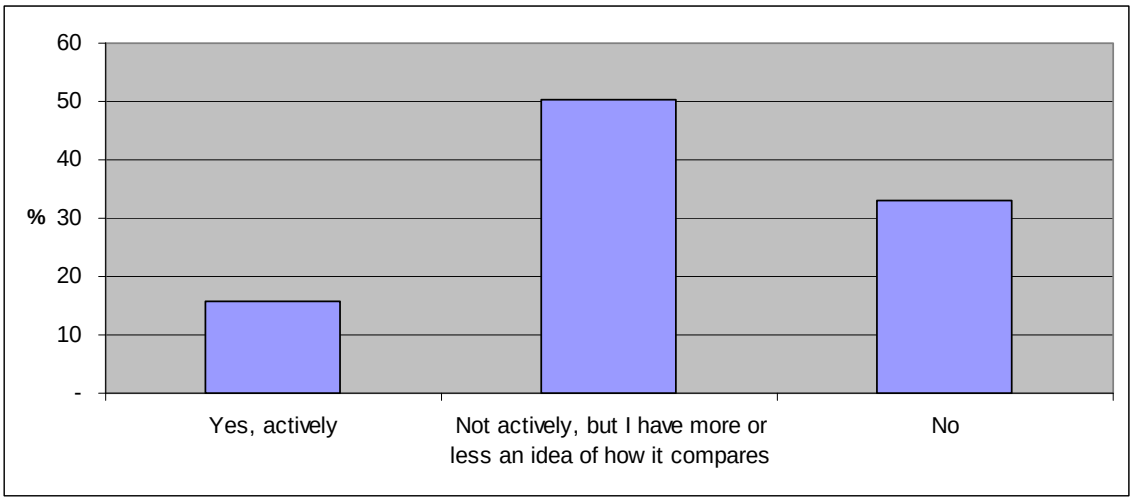
Relative fund performance comparison

Yes, actively	36
Not actively, but I have more or less an idea of how it compares	115
No	75

To expand on the previous result, the sample was asked to indicate whether they monitor the performance of their own portfolios by actively comparing it to relative performances of other funds and managers. This was meant to determine whether the investor has a good understanding of what his growth expectations should be. The results are shown in Table 4-11 above and illustrated in Figure 4-13 below.

FIGURE 4-13

Relative fund performance comparison



The majority of respondents (83%) indicated that they do not actively follow relative fund performances. 50% indicated that they do have some knowledge, while 33% indicated that they have no knowledge. The 33% result in this statement could be related to the 27% of the previous statement which indicates dissatisfaction that could indicate some degree of ignorance on the investor's part.

The impact of investor behaviour, i.e. the individual investor's perception, expectations and actions/ reactions to actual outcomes that would determine investor satisfaction cannot be overstated. As seen in the above two statements, as well as other statements in this chapter, the effectiveness of the value chain is a function of a number of inputs, not the least being investor behaviour.

In an effort to provide a framework to explain investor behaviour, Wydeveld (1999) found that expected returns and subsequent outcomes, risk preferences and the change thereof, and personal confidence, including pride, fear and regret, mostly determine investor behaviour. Gillespie (2006) also concluded that investment return is far more dependent on investor behaviour than on fund performance.

TABLE 4-12

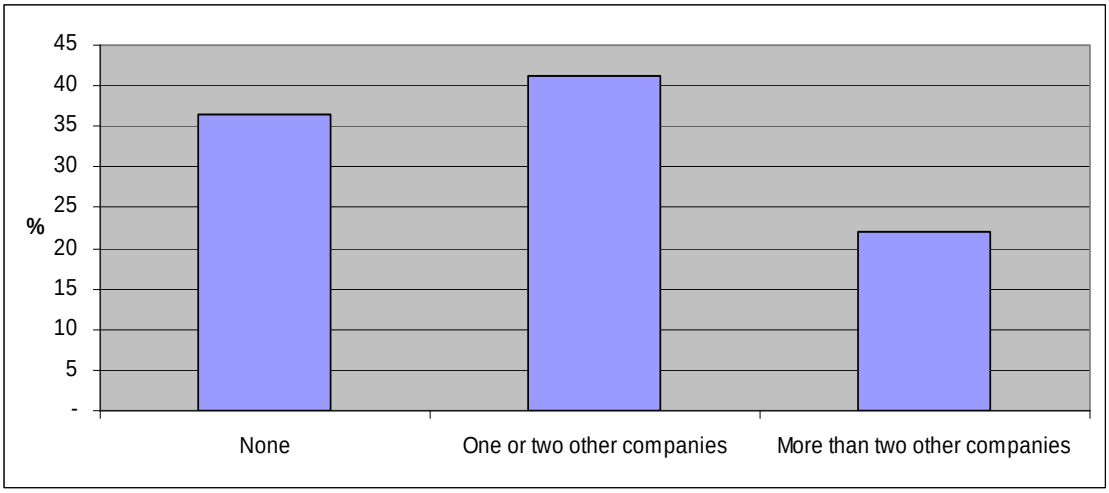
Investments with other management companies

None	83
One or two other companies	94
More than two other companies	50

As was widely argued in Chapter 2, there is no ideal number of mutual funds in a portfolio, although 6 was mentioned as an adequate number. This would cater for all types of asset class exposure. As is the modern trend with multi-manager funds, an investor may opt for more than one or two managers to even further diversify his portfolio. For this purpose the respondents were asked to indicate if they had unit trust investments with other management companies as well. The results are shown in Table 4-12 above and are illustrated in Figure 4-14 below.

FIGURE 4-14

Investments with other management companies



36% of the respondents seem to be content with one manager, while 41% have some diversification, and 22% of the respondents are even more diversified. Despite the fact that the sample was taken from one management company's database, more than 60% of the sample is diversified. This would seem to indicate that investors take note of fund performances and particularly consistent performances by specific managers. In December 2006 there were 34 management companies managing 750 various funds. This does not, however, reflect the true diversification of the fund universe. Among the 750 funds are 250 funds managed by 80 various 'third party' fund managers who have their own management style and are only associated with a management company for regulatory purposes (Association of Collective Investments, 2006a).

TABLE 4-13

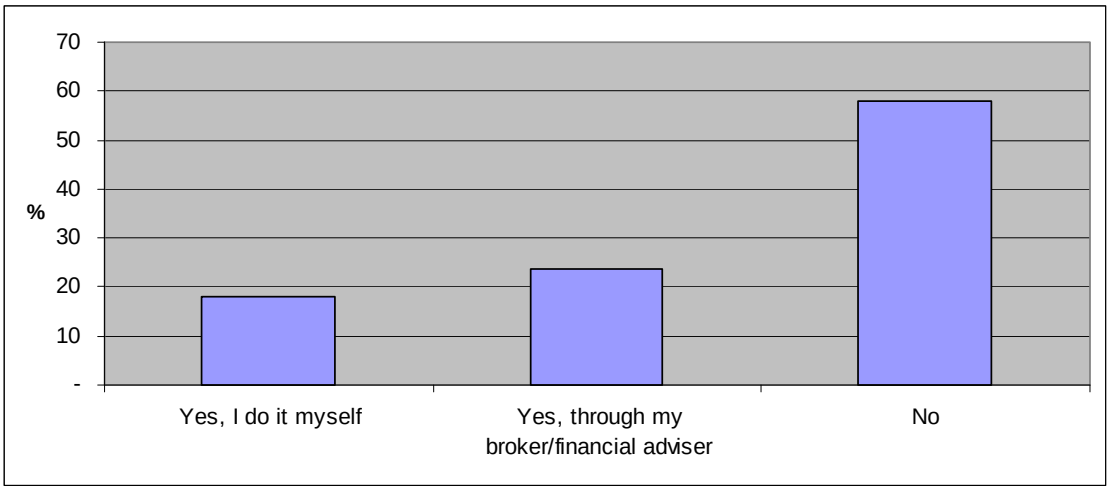
Switching between funds

Yes, I do it myself	41
Yes, through my broker/ financial adviser	54
No	132

As it has now been proved by various studies by Dalbar, Inc. (2003), an investor is responsible for dilution in the performance of his own portfolio by switching between funds to chase after short-term superior performance and getting the market timing wrong. Over a period of 19 years the investors in the Dalbar study lost nearly 10% to the market index and performed even lower than inflation. The sample was asked to indicate whether they switched between funds regularly and to what extent intermediaries assisted them. The results are shown in Table 4-13 above and illustrated in Figure 4-15 below.

FIGURE 4-15

Switching between funds



Slightly more than half (58%) of the respondents indicated that they do not actively switch their portfolios, while slightly less than half (42%) indicated that the do actively switch between portfolios. Actual data on unit trusts (Association of Collective Investments, 2006a) shows that for the calendar year 2006 there was a cash flow of R435bn into unit trusts of which only R58bn was net new inflows. This means 87% of the cash flow is because of churning. This also means that the average asset base of R481bn for 2006 was turned over nearly once in one year. This is considerably higher than the results in Figure 4-15 would indicate, but the sample above does not include wholesale (bulked) investors who transact on a daily basis. The fact that investors tend to use advisors more than doing it themselves may indicate that financial advisers have an active role to play with regard to switching, which will be explored in the next statement.

TABLE 4-14

Importance of financial advice

I have a financial adviser/ broker and I am happy to pay a fee for investment advice	84
I have a financial adviser/ broker but I do not feel they add value to my investment decisions	57
I do not have a financial adviser/ broker but I am prepared to pay a fee for investment advice	23
I do not have a financial adviser/ broker because I do not feel they add value to my investment decisions	63

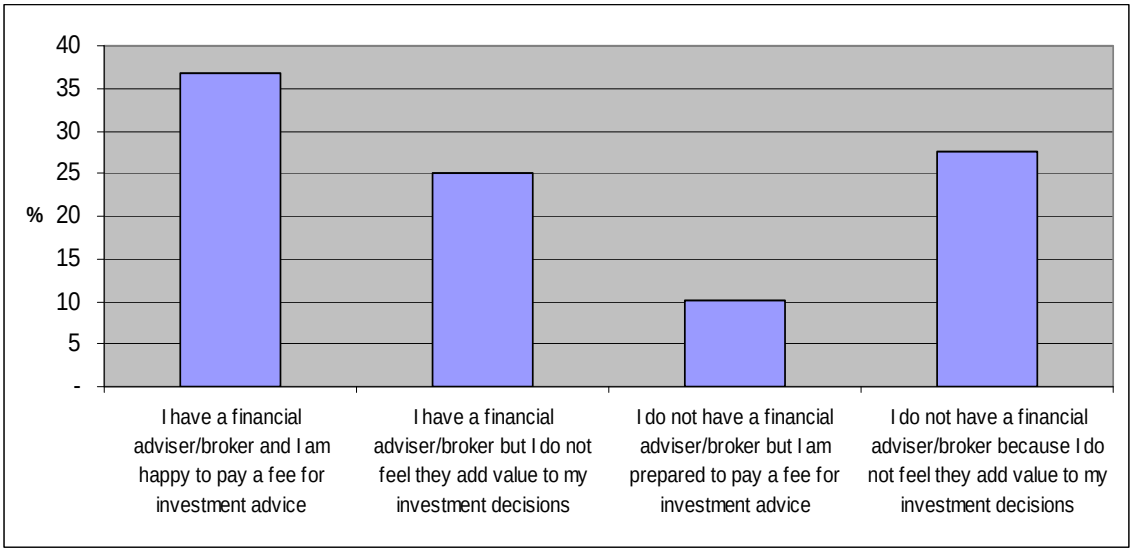
As determined in the previous statement and others in this chapter, the financial advisor has a role to play in the decision-making process of the individual investor and the value chain as a whole. The importance of this role is underpinned in the efforts of the various industry associations worldwide to help advisors to align their goals with those of their client, the investor. The ACI recommended that advisers themselves invested in unit trusts and thereby improve their knowledge (Association of Collective Investments, 2003). They believe the adviser can serve his client better by having a first-hand experience of the investment environment. The IMA investigated the cost and quality of advice (Investment Management Association, 2004). The IMA found that investors have specific preferences in the way they want to pay fees for advice, depending on the quality. The ICI suggested ways to ensure the alignment of the

interests of advisers and investors (Investment Company Institute, 2007c). This included the alignment of fee and remuneration structures.

To determine the extent of the importance of investment advice, the respondents were asked to indicate their relationship with an advisor or broker and their experience thereof. The reason for asking this question was also to ascertain the effectiveness of the intermediated part of the value chain and the investor's willingness to pay for investment advice. The results are shown in Table 4-14 above and illustrated in Figure 4-16 below:

FIGURE 4-16

Importance of financial advice



The response to this question was varied. Most of the respondents (62%) have a financial adviser/ broker. 37% of them are happy to pay fees for investment advice, whereas 25% of them do not feel the adviser/ broker adds any value.

38% of the respondents do not have a financial adviser or broker. 28% of them state their reason as not feeling they add value. Another 10% are, however, prepared to pay for advice.

Assuming then due to these discrepancies in the results that a number of investors have a financial adviser/ broker for other reasons than advice, the results above should be interpreted differently. The percentage of investors who are happy to pay for advice (regardless of having an advisor or not) are 47%. In total 53% of respondents do not feel that financial advisers/ brokers add value to investment decisions. There is therefore no clear indication of investor preference regarding the role of the intermediary with regard to advice.

In the context of the problem statement of this dissertation, the inconclusiveness of this result can place a question mark on the role of the intermediary in the value chain. Together with the results of some of the other statements in this chapter, it can be concluded that the role of intermediary in this context should be more clearly defined.

TABLE 4-15

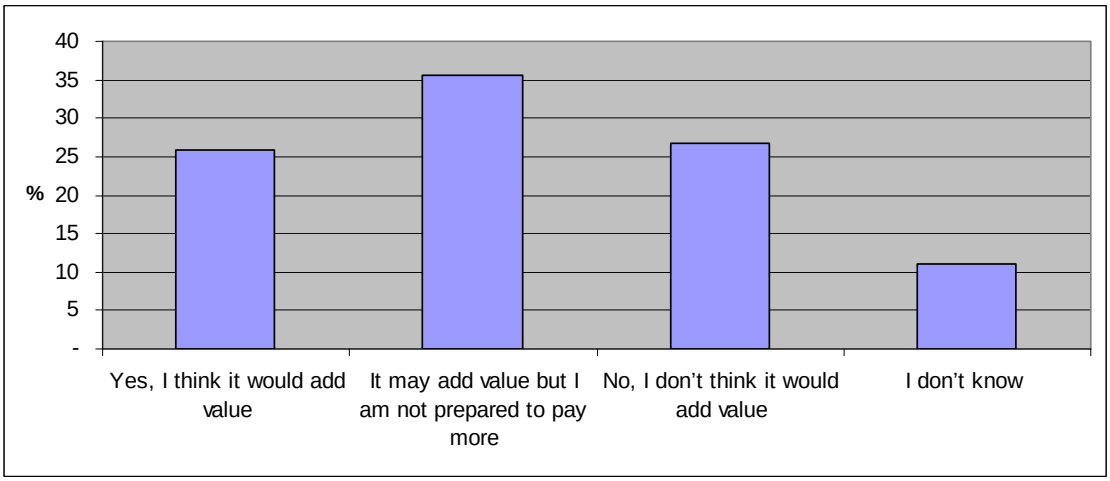
Investing on linked platforms

Yes, I think it would add value	59
It may add value but I am not prepared to pay more	81
No, I don't think it would add value	61
I don't know	25

The next two statements were made to determine whether the individual investor is prepared to expand his current investment options. The first one indicates a willingness to create diversity by way of investing through a Linked Investment Service Provider (LISP) at an extra cost. The results are displayed in Table 4-15 above and illustrated in Figure 4-17 below:

FIGURE 4-17

Investing on linked platforms



In total 62% of the respondents will consider investing on a linked platform, but only 26% of the respondents are willing to pay more for this service. 27% are of the opinion that it would not add value. This indicates that the investor is weary of lengthening the value chain that would result in additional cost, but not necessarily add value.

The reality is that during the 2006 calendar year, 43% of the cash flows into the South African unit trust industry came through the linked investment channels (Association of Collective Investments, 2006a). As this investment channel is not researched in this dissertation, the reasons for this cannot be established for certain. For example, this phenomenon can be explained as a solution that provides diversity to the investor, but at an extra cost. It is not only a direct layer cost, but also causes dilution in portfolio value creation.

TABLE 4-16

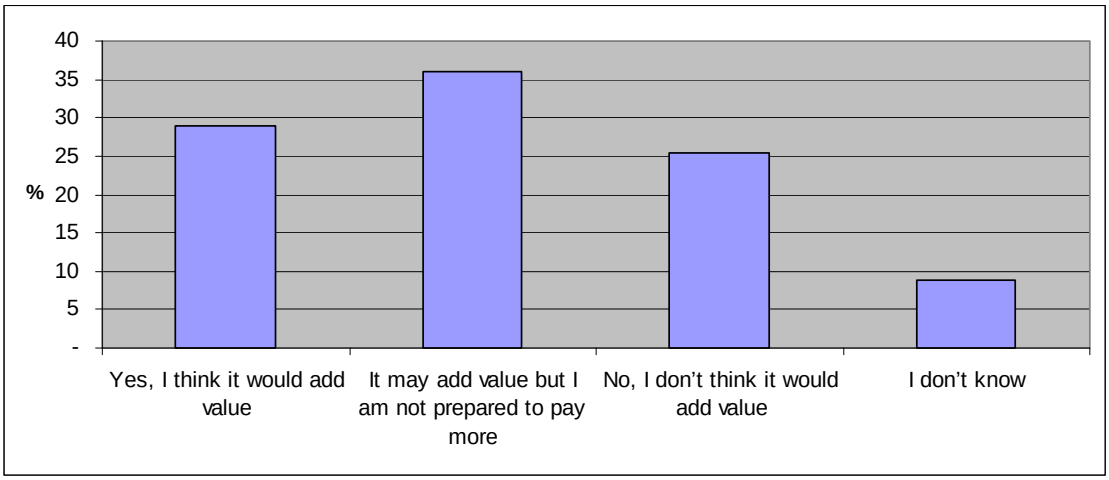
Investing in funds of funds

Yes, I think it would add value	66
It may add value but I am not prepared to pay more	82
No, I don’t think it would add value	58
I don’t know	20

This question relates to the previous question, but instead of the investor having own investment discretion, the investment decision is taken by an investment multi-manager by way of a fund-of-fund structure. Other than a LISP, which is an investment platform, a fund of funds is a recognized CIS fund that invests in a number of other CIS funds to create portfolio diversity as well as diversity by means of asset managers. The results are shown in Table 4-16 above and illustrated in Figure 4-18 below:

FIGURE 4-18

Investing in funds of funds



The results of this question correlate very closely to that of the previous question. This would indicate that the respondents are wary of the extra cost layer, regardless of where the investment decision lies. It would seem from both sets of results that the additional cost is too much of a determining factor. At 31 December 2006, 15% of the total assets under management were wrapped into

funds of funds, confirming this view (Association of Collective Investments, 2006a).

TABLE 4-17

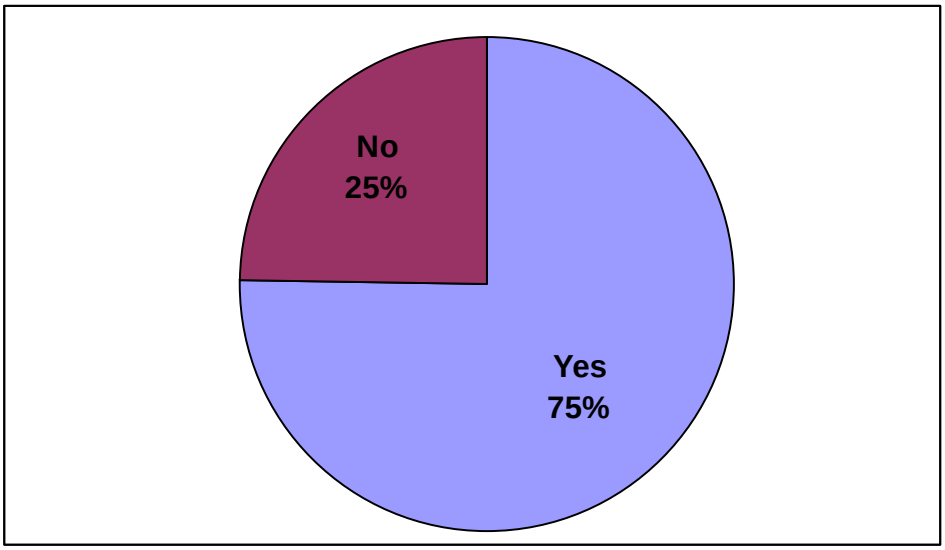
Awareness of collective investment regulation

Yes	171
No	56

To determine the role of the regulators on the value chain, the respondents were simply asked to indicate if they were aware of legislation and regulation controlling collective investment schemes. The results are shown in Table 4-17 and Figure 4-19 below illustrates the results by way of a pie chart.

FIGURE 4-19

Awareness of collective investment regulation



The majority of respondents (75%) are aware of the regulation protecting them. This is a positive result, and even more than one would have expected. This, however, does not indicate the measure of knowledge pertaining to the legislation. Amongst numerous regulatory requirements that ensure the protection of the investor, a statutory obligation towards investor education is also built in.

TABLE 4-18

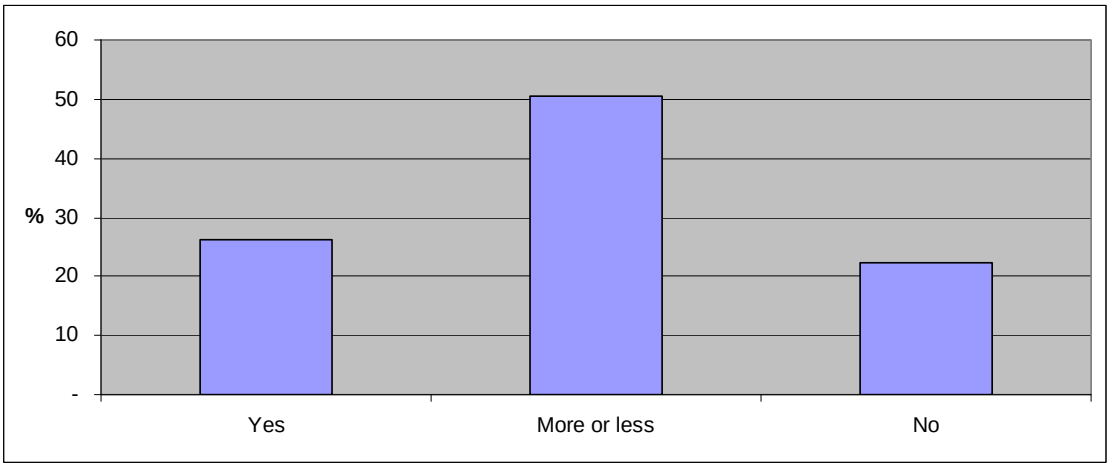
Knowledge of the cost to invest in collective investments

Yes	60
More or less	115
No	51

Adding to the issue of investor education and knowledge, the sample was asked to indicate their knowledge of what it costs to invest in unit trusts, which were presumably a major consideration with the results displayed in Tables 4-15 and 4-16. The results are displayed in Table 4-18 and illustrated in Figure 4-20 below.

FIGURE 4-20

Knowledge of the cost to invest in collective investments



There is a near perfect normal distribution to this response. In total more than 77% indicated that they know enough about the costs, while (significantly) more than 22% of the respondents do not know what they are paying for their investment. As illustrated in Chapter 2, costs can have a huge impact on returns for the investor. The investor sample admits that the collective investment value chain does add value, but it can also be a hungry chain. A typical cost structure for an individual investor in South Africa who buys into a rand-denominated international fund of funds through an intermediary and a linked product platform could amount to:

Upfront costs - 5% (commission and investment costs)

Annual management fees: LISP – 0.75%

Manager – 1.25%

Underlying investment – 1%

Total – 3% (Oldert, 2006)

This is a fairly expensive investment in any terms, and with proper knowledge such an investment should have been carefully considered by any investor. For this reason and as part of their obligation to education and transparency, the ACI has recently introduced Total Expense Ratios (TER). TER gives the investor an indication of all the underlying costs pertaining to an investment (including compulsory audit fees, trustee fees, etc.). The TER is reported and should be publicized alongside all the other required reporting standards.

TABLE 4-19

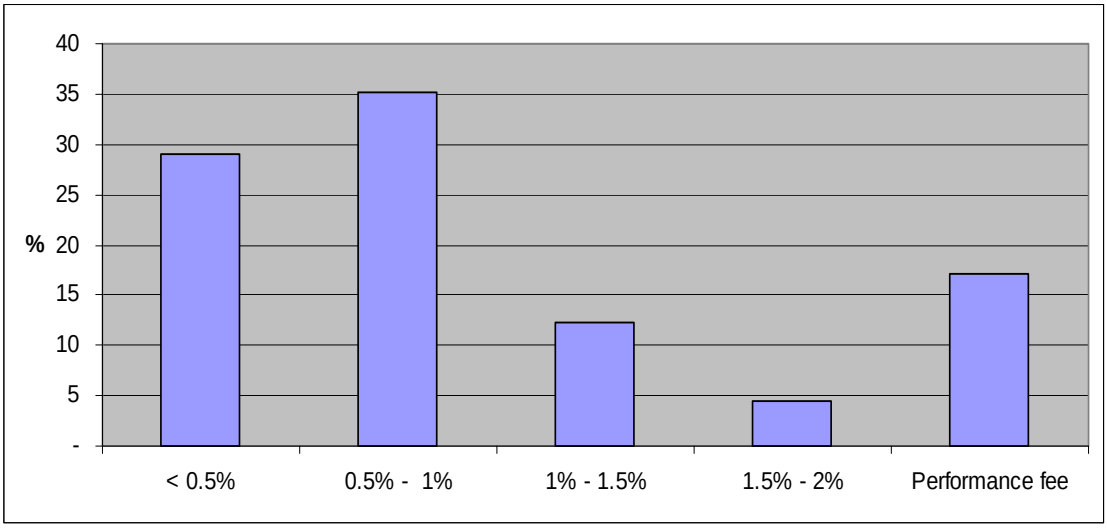
Fees investors are prepared to pay

Less than 0.5% of total fund value annually	66
Between 0.5% and 1 % of total fund value annually	80
Between 1% and 1.5% of total fund value annually	28
Between 1.5% and 2% of total fund value annually	10
A fixed minimum fee plus a performance fee totalling 3+% of fund value annually	39

What then is the investor prepared to pay, taking into account all the benefits that the value chain gives him? The sample was asked to respond to exactly this question, and the results are shown in Table 4-19 above and illustrated in Figure 4-21 below.

FIGURE 4-21

Fees investors are prepared to pay



Although 29% of the respondents indicated that they do not want to pay more than 0.5% (the lowest option given) per annum on the asset value of his investment, 35% realise that there should be a cost involved for participating in the value chain and they are prepared to pay up to 1% per annum. In reality most of the retail funds' fees are currently more than 1%. The respondents who indicated that they are prepared to pay more than 1% are probably relating to the fees they are paying currently. A fairly low percentage (17%) indicated that they would like to pay a performance fee. In other words, pay a higher percentage if the fund outperforms the set benchmark and a lower fee if the fund underperforms. This is fairly new to the market, and although the idea sounds appealing, there is a lot of debate going on around the fairness of this fee type.

In the USA the mutual funds are under pressure regarding costs for some time now. The average annual fee for equity funds for 2006 was under 0.9% (Investment Company Institute, 2007d). Another interesting finding of the US mutual fund market regarding costs is that 90% of the assets invested in their industry are invested with funds that charge below average costs.

TABLE 4-20

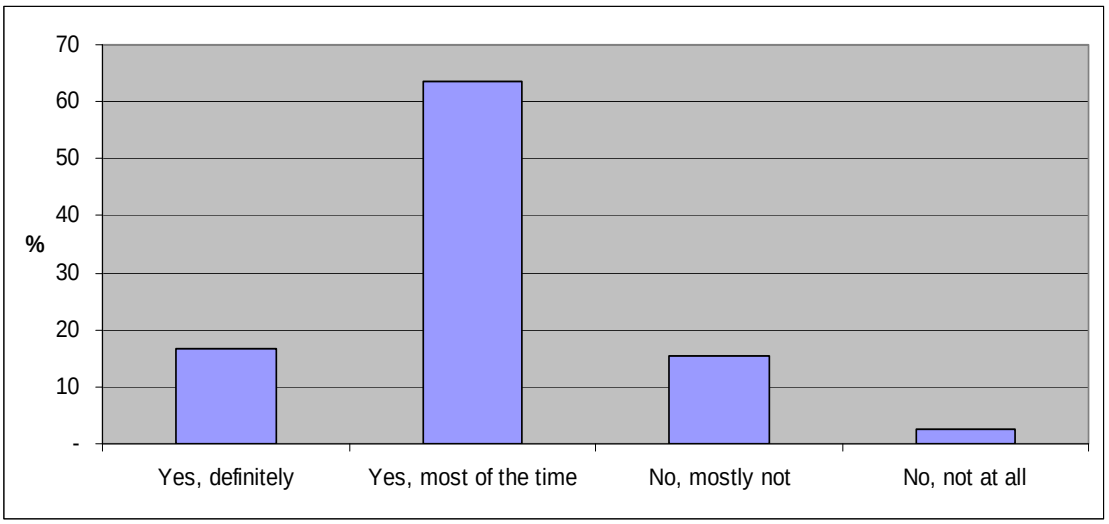
Satisfaction with unit trust investment

Yes, definitely	38
Yes, most of the time	145
No, mostly not	35
No, not at all	6

To finish the questionnaire, the sample was asked whether they were generally happy with their investment in unit trusts. This was an all-encompassing question and would reflect the general mood, attitude or sentiment towards unit trusts as a value adding investment vehicle. The results are displayed in Table 4-20 above and illustrated in Figure 4-22 below.

FIGURE-22

Satisfaction with unit trust investment



Only 18% of the respondents responded negatively to this question. More than 80% of the respondents indicated that they were generally satisfied with their investment.

4.4 CONCLUSION

The 20 questions were designed to give substance to the hypothesis "*The popularity of Collective Investment Schemes as an investment vehicle in South Africa today lies in the fact that an individual investor can satisfy his investment needs through a value chain that has a dynamic interdependence and that ensures value added for the individual investor."*

Individual investors in South Africa use collective investments as part of their overall financial planning and more specifically the short- to medium-term savings portion. They find collective investment to be a convenient and affordable investment vehicle. They tend not to actively monitor the investment performance of their investment, but expect a lot from their return in terms of outperformance. They don't really have much contact with collective investment management companies, but they do admit that the collective investment industry is the best regulated and most transparent industry in the South African financial services sector. They recognize the value of the individual role players of the value chain as well as the interaction of the value chain as a whole. They do, however, feel that their own investment decision plays a slightly more important role. Collective investments in general satisfy their growth expectation most of the time, but they don't necessarily know how it compares with other funds or benchmarks. They are fairly diversified in terms of having funds with various managers.

They do not admit to switching funds regularly, but this is contrary as to what industry statistics tend to suggest. Their dependency on the intermediary and their reliance on his advice are inconclusive. They are not really interested in diversifying their portfolio more by using linked investment platforms or funds of funds. They claim to have an idea of the costs involved in investing in collective investments, but they want to pay less than they currently do for their investment. All in all they are fairly satisfied with their investment.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION

John Bogle, founder of the Vanguard group and well respected ‘guru’ of Mutual Funds in America, addressing the National Investment Companies Service Association in Florida on 20 February 2007, referred to 5 dreams he has for redesigning the fund industry.

1. The Dream of a Fair Share for Shareholders

    In his first dream Bogle urges investors to put pressure on the industry by choosing low-cost solutions and thereby forcing high-cost firms to conform.

2. The Dream of Serving Investors for a Lifetime

    His second dream is to design an industry that will serve investors for a lifetime. Mutual funds (Collective Investments) should become a central element in the country’s overall retirement system. This includes proposals and designs to help accomplish “cradle-to-grave” retirement security.

3. A Dream of Long-Term Investment Horizons

His third dream is that investment managers turn back the clock, reverting to the traditional focus on long-term investment strategies.

4. A Dream that We Serve Long-Term Investors

His fourth dream is to serve long-term investors. The industry should return to its roots in providing broadly diversified mutual funds (collective investments) – not narrowly-defined products – that can be bought and held “forever.”

5. The Dream of Putting Fund Investors in the Driver’s Seat

His fifth dream is putting the investors in the driver’s seat of fund governance. Investors should have an active role in fund governance and ensure that the best interest of the unit holders is always taken into account.

These visionary statements are important in the context of this dissertation, not only because of John Bogle’s vast experience and influence on the industry, but also due to the fact that it embraces the essence of the findings of this dissertation. This final chapter will summarize the findings of the research done for this dissertation in terms of the hypothesis and objectives.

5.2 CONCLUSION FROM RESEARCH

Early economists explored the principle of optimizing investments from a firm's point of view. These principles were carried forward to the security investment market where optimum investment frontiers are still explored today. The search for these frontiers is guided by the risk vs. return trade-off, which differs from individual to individual depending on specific investment needs. To give the investor a broad risk-return profile, a portfolio of securities in various asset classes is compiled for the individual investor.

Modern Portfolio theory states that the diversification of securities reduces the portfolio risk. A number of portfolios can be created on an efficient frontier of portfolios, depending on the risk-return level. In an efficient market where security prices reflect all the information, a portion of all available securities should maximize diversification. This is, however, not necessary, as studies have shown that a maximum of 20 stocks in a portfolio should minimize the risk of a portfolio in terms of diversification.

Mutual funds provide the diversification an investor needs in one portfolio. An investor can, however, increase his exposure to all sections of the market by investing in a diversified number of mutual funds. Investment in mutual funds, however, poses its own set of challenges. Apart from having to choose from a

range of mutual funds, each with its own investment policy, an investor also has a choice of a number of investment managers. Factors like performance and costs can play a role in the investor's choice, but ultimately the investor needs to have an investment portfolio that suits his risk profile.

The value chain as developed by Michael Porter, consists of a series of activities that create and build value. A value chain is not only limited to a firm, but can be extended to supply chains and distribution networks that are interconnected to form a value system. Two key principles relating to value chains are competitive advantage and interdependence. These principles are encompassed in the chain that creates value for an individual investor through a Collective Investment Scheme.

The main role players in this value chain are portfolio managers, management companies and financial advisers. These role players are responsible to create value for the investor by managing a unitized portfolio for the investor, according to a specified investment policy within the rules and guidelines as required by the relevant regulators. A specific investment portfolio is linked to the investor by a financial adviser through the evaluation of the investor's needs and risk profile.

The concept of creating value through a value chain has grown from the original as proposed by Porter. One of the biggest adaptations was the supply chain that

benefited most production companies. Another variation is the value profit chain that is mostly utilized by service companies or customer service divisions. Nowadays, the term global value chain refers to managing the processes of a global company. On the financial services front, the most common form of value chains are the automated payment systems and clearing houses between banks, businesses and customers. The investment and insurance industries all have their value chain linking the customer to the product. The collective investment scheme value chain is just an extension of this concept.

The results of the study done for this dissertation indicate that investors see investments in collective schemes as part of their financial plan, not only for growth, but also for its other features, such as liquidity. Investors seem to be positive about the benefits and growth of CIS in general, indicating convenience and affordability as the main benefits. The study also confirms that investors recognized the role of other role players in the value chain, such as the intermediary, management company and portfolio manager. The investors acknowledge that a value chain comprising of all these role players exists and adds value. Similar surveys done by the Investment Management Association (IMA) in the United Kingdom and the Investment Company Institute (ICI) in the United States support these results.

The study shows, however, that value is destroyed through careless switching of funds by investors and through costs charged through the value chain. The

investor's role in this is not conclusive, as the research found that far less investors indicated their participation in active switching than the actual churning taking place according to industry statistics. Studies done by the Dalbar Institute clearly indicate the value destroyed for the average investor in mutual funds due to switching. In terms of the extra layers in the value chain, the individual investor is generally not prepared to pay more, and is therefore fairly cost sensitive. In fact, investors feel that they are paying too much at the moment, and are very much aware of costs. This sentiment is shared by investors in the United Kingdom and the United States according to studies done by the IMA and ICI respectively.

Overall, the study shows that more than 80% of investors were generally satisfied with their investment in collective investments, and that their needs are satisfied through the value chain. They do, however, attach different benefit values to collective investments, and have various degrees of growth expectations, cost limitations, etc. This confirms the diverse nature of investor needs and behaviour. Capon, et al. (1996) found that investors claim that they consider many non-performance-related variables. However, most investors appear to be naive, having little knowledge of the investment strategies or financial details of their investments.

5.3 IMPLICATIONS AND RECOMMENDATIONS

The research has shown that a feasible value chain exists for a collective investment scheme, the same as for all other industries trying to maximize benefit and minimize cost. The principle of diversifying through mutual fund investment alone cannot create value for the individual investor. In some cases value can even be destroyed by investing irresponsibly. To fully optimize the benefits of a diversified investment portfolio, an investor will need advice from a financial advisor to ensure that the investor's risk-return profile matches that of the investment vehicle. The investor needs to access the investment portfolio at a reasonable cost, and should expect diligent reporting on his investment. The investment portfolio should also be managed in a way that adheres to the prescribed investment policy, but still strives for maximum returns within that mandate.

The research still indicated some ignorance from the investor with regard to communication, performance monitoring and the role of the intermediary. Although the interest of the investor is protected, it would seem that there might still be a gap between the specific investment need of the investor and the solution offered. As this solution should preferably be a longer term solution, investor behaviour as influenced by a number of short-term external factors may result in the ultimate goals not being reached. Globally, the investment environment has become as complex as it has become diverse. As John Bogle

states in the beginning of the chapter, the industry should turn back the clock and focus again on the long-term nature of an investment strategy.

Some recent trends in the South African industry have seen the growth of the institutional investor market in the collective investment industry. This is due to life offices and pension funds using collective investment funds as underlying investments, and at the same time giving the investors investment choice. This may lead to a long-term association of investors with specific funds or managers which they can extend to all their investment needs. Managed correctly, these institutions may add value by ensuring stability in the investor's portfolio.

Although there has been some pressure on the industry to lower costs recently, there hasn't been significant cost reduction in the industry. In the research, the investors also indicated that they prefer to pay less for fees than what they currently do. The average fees are well above their expectations. The extension of the intermediary layer has lead to additional cost layers, but no real pressure has come from investors yet, partly due to the fairly high growth experienced in the market that reduces the effect of the cost on the returns to the investors.

The average South African individual investor joined the migration to Collective Investments, having a good idea of why they do not want to invest in traditional life products anymore, but they are still conservative in nature and careful enough to adhere to the long-term nature of a CIS investment. They are,

however, very much prone to investor psychology and could start behaving irrationally on a larger scale. Montier (2002) says that investors make mistakes in a predictable fashion, and that they do not act as rationally as investment models want them to do. Rothchild (1997, p. 36) gives a list of investment ‘tips’ that he accumulated from well-known people in the industry. Most of these ‘tips’ contradict each other, e.g. “Never sell too soon.” vs. “It’s never too soon to sell.” This confirms that each investor has his own reasons for investing, his own risk profile, etc. The industry should recognize this, and all the role players, regulators, product providers, intermediary layers, etc. should nurture this through investor education, etc. They should not force speculative chasing after top returns, profits, etc.

Although presumably following international trends with regard to investing patterns, the *“investment psychology of the South African investor”* could be researched further. The principles of behavioural finance and investment behaviour are well established. The average investor in the USA is well researched through the Dalbar Institute, the ICI, etc. In South Africa, more research can be done on a similar basis to compare the average South African investor with that of other countries, and to give an indication of the reaction of the average South African investor to major market impacts, etc. This could help intermediaries and product providers to pre-empt possible irrational decisions by investors.

The individual investor recognizes the value chain and the value it adds. As long as they can experience the value added and is fairly charged for it, they will accept it. The investor is, however, becoming more and more cost sensitive. There is already a trend of value adders that currently lengthen the chain and charges the investor more for services that he does not necessarily care for. This could dilute the effectiveness of the chain, and the industry should endeavour to return to the basic value chain before the investor doesn't recognize it anymore and opt for other routes. Hence "*the increasing impact of additional role players on the CIS value chain"* should be researched further.

Financial reporters in South Africa has given much exposure in the past few years to the value added or destroyed by the increasing number of intermediary layers to the cost chain. The South African regulators have introduced the FAIS act to protect the individual investor from irresponsible advice. The industry (ACI) has also responded by introducing TER to help with transparency of all the costs. However, there still seems to be individual justification for each intermediate intervention and the cost associated with it. This should, however, be researched within the whole value chain and compared with the effectiveness of the simple value chain as featured in this dissertation.

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ANNEXURE A

Dear investor

I am a post graduate student at UNISA busy with a dissertation for a Masters degree. The dissertation, amongst other things, studies your views, as individual investor, on unit trust investments. I have obtained permission to approach you as a member of Sanlam Collective Investments' client data base. I will appreciate it if you would just spare a few minutes of your time to complete the attached electronic questionnaire. Your feedback is anonymous and will form part of an electronic dataset that will be treated confidentially. I thank you in advance for your willingness to participate.

To complete the questionnaire, simply click on the link below. If the link does not work, copy and paste it in the address line of your Internet browser. Then click on "Go". The questionnaire will appear. Once you have completed the questionnaire, click on the "submit" button.

Link to questionnaire:
http://www.sanlam.co.za/snap/surveys/snsanlamsci_eng_.htm

Please complete the questionnaire by **Friday, 10 November 2006.**

Should you have any enquiries, you are welcome to contact me on (021) 950 2106 or at andriesw@sci.sanlam.com

Best regards

Andries Walters

Investor questionnaire

Simply click on the appropriate block to indicate your answer

Instruction for Question 1 to Question 5:
Please indicate to what extent the options underneath each statement apply to you.

Q1 I have decided to invest in unit trusts ....

	Strongly Agree	*Agree*	*Disagree*	*Strongly Disagree*
As part of my personal financial and retirement plan	❑	❑	❑	❑
For a specific savings goal (e.g. children's education, holiday, etc.)	❑	❑	❑	❑
To add to my savings (for a rainy day)	❑	❑	❑	❑
To temporarily park surplus funds (short term)	❑	❑	❑	❑
To speculate	❑	❑	❑	❑

Q2 I was made aware of unit trusts as a savings vehicle via ...

	Strongly Agree	*Agree*	*Disagree*	*Strongly Disagree*
The media (newspapers, TV, etc.)	❑	❑	❑	❑
A Unit Trust Management Company	❑	❑	❑	❑
An intermediary (financial adviser/ broker, etc.)	❑	❑	❑	❑
Friends, family, colleagues	❑	❑	❑	❑

Q3 The following benefits of unit trusts appeal to me:

	Strongly Agree	*Agree*	*Disagree*	*Strongly Disagree*
Safety of investment	❑	❑	❑	❑
Reporting on performance	❑	❑	❑	❑
Transparency	❑	❑	❑	❑
Affordability	❑	❑	❑	❑
Tax Effectiveness	❑	❑	❑	❑
Professional Management	❑	❑	❑	❑
Competitive Cost Structures	❑	❑	❑	❑
Convenience and Liquidity	❑	❑	❑	❑

Q4 I monitor the growth of my investment in unit trusts via ...

	Strongly Agree	*Agree*	*Disagree*	*Strongly Disagree*
Daily price updates in newspapers, the internet, etc.	❑	❑	❑	❑
Quarterly feedback from the Management Company	❑	❑	❑	❑
Regular feedback from my financial adviser/broker	❑	❑	❑	❑
I have to make my own enquiries through the call centre etc.	❑	❑	❑	❑
Other ways not mentioned above	❑	❑	❑	❑
I don't really monitor the growth on a regular basis	❑	❑	❑	❑

Q5 I expect the following type of growth from my unit trust investment; it must ...

	Strongly Agree	*Agree*	*Disagree*	*Strongly Disagree*
Beat inflation	❑	❑	❑	❑
Beat the average of all the funds in its category	❑	❑	❑	❑
Be the top performing fund in its category	❑	❑	❑	❑
Beat the sector benchmark (e.g. ALSI for the general equity fund)	❑	❑	❑	❑
Achieve a benchmark or target set by myself	❑	❑	❑	❑
I don't have expectations as long as it grows	❑	❑	❑	❑

Q6 Did you have contact during the past 24 months with Sanlam Collective Investments for any of the following reasons? (Tick all the applicable options)

- ❑ To repurchase, switch or make an additional investment etc.
- ❑ To make a general enquiry through the call centre
- ❑ Internet contact
- ❑ Contact via your financial adviser/broker
- ❑ No contact

Q7 How do you rate the following financial sectors in terms of regulation and transparency?

	Excellent	*Good*	*Average*	*Poor*	*Very poor*
Banks	❑	❑	❑	❑	❑
Life insurance companies	❑	❑	❑	❑	❑
Unit trust companies	❑	❑	❑	❑	❑
Asset management companies	❑	❑	❑	❑	❑

Q8 What do you think is the <u>single</u> biggest reason why the individual investor became more aware of and started investing more in Unit Trusts during the past 10 years?

- ❑ More publicity
- ❑ Better fund performances
- ❑ More products available
- ❑ Improved investor knowledge
- ❑ Financial advisors/brokers' knowledge improved
- ❑ Other

Q9 The value added to your unit trust investment portfolio is effectively the result of the following:

	Strongly agree	*Agree*	*Disagree*	*Strongly disagree*
The investments decision (by yourself or your financial adviser/broker)	❑	❑	❑	❑
Investment products and service from the Management Company	❑	❑	❑	❑
The management of the underlying assets by the portfolio manager	❑	❑	❑	❑
A value chain involving all of the above	❑	❑	❑	❑

Q10 Does the actual growth of your unit trust investment currently meet your expectations?

- ❑ Yes, definitely
- ❑ Yes, most of the time
- ❑ No, not really
- ❑ No, definitely not

Q11 Do you follow the relative performances of the funds of the various unit trust companies and compare your funds' returns to them? (e.g. Plexcrown ratings, etc.)

- ❑ Yes, actively
- ❑ Not actively, but I have more or less an idea of how it compares
- ❑ No

Q12 With how many other unit trust companies (i.e. besides Sanlam Collective Investments) do you have unit trust investments?

- ❑ None
- ❑ One or two other companies
- ❑ More than two other companies

Q13 Do you manage your unit trust investments actively by switching as changes in the market / your own circumstances demands etc?

- ❑ Yes, I do it myself
- ❑ Yes, through my broker/financial adviser
- ❑ No

Q14 Which of the following statements best describes your view on the importance of investment advice?

- ❑ I have a financial adviser/broker and I am happy to pay a fee for investment advice
- ❑ I have a financial adviser/broker but I do not feel they add value to my investment decisions
- ❑ I do not have a financial adviser/broker but I am prepared to pay a fee for investment advice
- ❑ I do not have a financial adviser/broker because I do not feel they add value to my investment decisions

Q15 Would you consider investing (at an extra cost) through one service provider that gives you access to all the funds in the industry but you still have to decide in which funds to invest?

- ❑ Yes, I think it would add value
- ❑ It may add value but I am not prepared to pay more
- ❑ No, I don't think it would add value
- ❑ I don't know

Q16 Would you consider investing (at an extra cost) in a unit trust product like a fund of funds that gives you access to all the funds in the industry but the investment decisions are made on your behalf by the investment manager?

- ❑ Yes, I think it would add value
- ❑ It may add value but I am not prepared to pay more
- ❑ No, I don't think it would add value
- ❑ I don't know

Q17 Are you aware that there is an act specifically for the regulation of Unit Trusts and to protect your interests as an investor?

- ❑ Yes
- ❑ No

Q18 Do you know what the costs are to invest in unit trusts?

- ❑ Yes
- ❑ More or less
- ❑ No

Q19 What are you prepared to pay for a unit trust investment that meets your needs on a consistent basis?

- ❑ Less than 0.5% of total fund value annually
- ❑ Between 0.5% - 1 % of total fund value annually
- ❑ Between 1% - 1.5% of total fund value annually
- ❑ Between 1.5% - 2% of total fund value annually
- ❑ A fixed minimum fee plus a performance fee totaling 3+% of fund value annually

Q20 Taking everything into account, are you satisfied with your unit trust investment?

- ❑ Yes, definitely
- ❑ Yes, most of the time
- ❑ No, mostly not
- ❑ No, not at all

Please indicate the following:

Q24 Your age:

- ❑ Younger than 25 years
- ❑ 25-34 years
- ❑ 35-49 years
- ❑ 50-64 years
- ❑ 65+ years

Q25 Your gender:

- ❑ Male
- ❑ Female

Q26 Your language:

- ❑ English
- ❑ Afrikaans
- ❑ Other

Thank you for taking the time to complete this questionnaire