

A CRITICAL ANALYSIS OF INVESTMENT OPTIONS IN NIGERIA

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Abstract

Investment is the giving up of today's consumption for tomorrow's benefit. It usually take the form of an income flow and or capital gain. Often individuals are left with surplus capital to their immediate requirement but faced with the challenge of decision on what to invest. Thus, this article examines the various investment options available to Nigerian investors in the present day economy. The study revealed money market, stock market, and real estate as the major windows of investing capital in Nigeria. The study also showed that security of capital, security of income, liquidity, and manageability are the basic qualities of any ideal investment. Money market revealed an average return of 6.27% using the savings account return for 2002-2006. The stock market ordinary shares indicated an average return of 61.11% and real estate residential property had 13.89% for the same period. The study recommended that small investors should consider money market, medium investors should explore the stock market and high investors should go into real estate because this require huge capital.

Introduction

Investment is the giving up of a capital sum now in exchange for benefits to be recovered in the future, (Enever and Isaac, 1994). It is the forgoing of a capital sum in return for a regular income over a period of time (Richmond, 1994). Also Olusegun (2003) sees it as the use of an indirect process to obtain a higher output and thus defines it, as any economic activity designed to increase, improve or maintain the productive quality of the existing capital. Contributing, Ogbuefi (2002) defines it, as parting with present capital in return for future income. The common feature in all of the above definitions is the postponement or suspension of consumption for tomorrow's benefit. Therefore, investment could be said to be the postponement of today's consumption in anticipation of tomorrow's benefit or reward.

A person who has capital surplus to his immediate requirements may retain this for future contingencies. However, a better alternative would be to put his capital to work by investing it and enjoying a return of income, probably on an annual basis. Investment usually takes the form of an income flow and or capital gain. The primary purpose of an investment is the future income of profit. Investments have varying dimensions depending on the nature, quality, and area of investment. To appreciate the quantity or quality of returns or profit realized from an investment, it depends on the real value rather than nominal value of the return. In essence, the return from an investment should be profited on a plane of time in order to give credibility to the quantum of the return. The main reason of time value of money is predicated on the interest and exchange rates differentials, inflationary tendency, changes in specific and general market trend, etc (Ogbuefi, 2002). The above factors give cradle to the emphasis on real value than normal value.

An investor may make a conscious choice between investing his capital in real property or alternatively in stock or money market. Even in real property, he could choose between purchasing a property for occupation of his business or renting a similar property, owned by someone else so that he can invest his capital elsewhere. The choice of what to invest or not to invest most often than not is usually detected by the mood of the economy. Some analysts have also identified a correlation between the depth and breadth of an investor's purse and how he allocates funds to any of these investment options. This is due among others, to the volume of funding required to participate in each investment options and do the returns expectation. This study therefore, is designed to examine the various investment options available to an investor in Nigeria with their implications. Also discovered are, the qualities of ideal investment, the various investment options and analysis, and their average annual return of the various investment options in Nigeria.

Qualities of Ideal Investment

The final choice of a potential investor should be that investment with features which make it nearest to his ideal investment. Enever and Isaac (1994), Richmond (1994), Nwanekezie (1996), Johnson (2000), Ogbuefi (2002), Olusegun (2003), and Udo (2003) have identified the following qualities of an ideal development:

i. Security of Capital

This is the ability of an investment to retain the original value of the capital outlay. It is concerned about the present and future stability of the capital so committed and the protection against the ravages of monetary inflation. An investor may, at some future date, want to transfer his investment back into cash at short notice. It is essential that the investment can be sold for, or converted to cash at any particular time.

The greater the chances of being able to get the original money back at any point in time, the greater the willingness to invest. If the chances of getting the original money back are slight, then investment will be considered insecure. Thus, the vast majority of investors will only wish to place their money in an investment if there is a strong probability that they will be able to recoup their capital at any point in time the need arises.

ii. Security of Income

This refers to the security of income in relation to purchasing power. The income generated from any investment should be able to meet the market price even in the face of inflation or dwindling economy. It is concerned with the probability of getting future returns in terms of immediate profits, future growth in income levels, and long term capital appreciation.

In investing his money, an investor is giving up the immediate use of that money and is allowing its use to pass to some other party. In return, for giving the use of his money to another, he requires payment of an interest, the income which his money earns. Coupled with the certainty that adequate interest will be paid it will also be the investor's wish to receive regular payment of interest. The investment should be able to produce income as at when expected and regularly.

iii. Liquidity

The ease with which capital resources of a particular investment can be converted into cash is referred to as liquidity. The facility of converting an asset into cash is determined by its ratio of conversion, that is cash obtained, divided by market value. Liquidity depends on the cost of transfer, the size of the investment, marketability, and the extent to which it can be divided into smaller units.

Marketability describes the reserve of potential buyers for an investment and the speed and ease with which they may be contracted in marketing this investment, the cost of transfer should be minimal, not higher than those associated with the alternative investment. The investment should also be divisible to ease its liquidity. For instance an investor may wish to withdraw part of his money, but not the entire sum. If so, it will be a great advantage if he is able to sell only part of the building.

Investment in banks and building societies may be easily and cheaply converted into cash, whereas conversion of those in land and property will prove to be more costly and time-consuming. Real property investments are not generally considered to be liquid and are often not marketable compared with some other investment alternatives. However, whenever the real property is sold, it will attract a high capital than the original capital invested, because of its ability to appreciate in value.

iv. Manageability

This is the minimum inconvenience and expense in management. Investment may vary in the amount of inconvenience and cost of obtaining the income. The amount of income the investment produces should be enough to satisfy the investor after expenses and management.

The manageability of an investment is the extent to which it requires monitoring and periodic change. Generally, real property investment requires much more management than other forms of investment. Every investment has a direct or indirect cost for management built into it when it does not require direct management by the investor.

Investment Options in Nigeria

This is the entire range of alternative opportunities open to a potential investor—that is all the options a potential investor has in committing his resources. Richmond (1994) have identified four investment options namely, banks and building societies, stocks and shares, unit trusts, and real property. Millington (1982) and Nwanekezie (1996) have listed bank deposit, public stocks and bonds, corporate stock and shares, and property as investment options available to an investor in investment market.

However, the list would not be appropriate in Nigeria since investment like unit trusts identified by Richmond (1994) is barely known and available to Nigerian investors. Also public stocks and bonds, corporate stock and shares identified by Millington (1982) and Nwanekezie (1996) can be grouped into one and called stock market. Banks and building societies can also be called money market.

Therefore, this paper shall adopt the following as investment options in Nigeria. This classification was supported by Uzoigwe (2006). These include:

Money Market

This refers to investment in banks and building societies—whether they are savings or fixed interest account. Investment in the deposit account of a bank will compare favourably with the ideal investment since invested capital is quickly and cheaply recouped if required (Richmond, 1994). Building societies have many of the desirable qualities attributable to investments with the banks. Both capital and income are secure, and the building society attempts to cater for a wide range of investors.

Nwanekezie (1996) viewed bank deposit as the most un-imaginative way of investing money, since it is a very dominant investment venture. This is more true now, that interest rate for bank deposit is truly 2 – 2 ½% in commercial banks in Nigeria. The low interest rate of bank deposit could be as a result of the little or risk involved in it. Money market investments are highly liquid, almost 100%, but their capital is inflation prone, as they are usually easily affected by changing rate of inflation in the economy. They tend to fluctuate at regular interval with inflation and exchange rate.

Investment in money market does not require huge capital, with as little as N1, 000 or less, an individual can have bank savings account, money market can not be described as a lucrative investment, though it does not require huge capital. This is because, the capital committed is not safe as one requirement in characteristic of ideal investment.

Stock Market

If stocks and shares are purchased, a small part of a company is in fact purchased; the size and part owned being represented by the relationship between the shareholding bought and the total number of issued shares in the company (Millington, 1982). Stocks could be classified into public stocks and bonds which are issued by the government and public agencies when they want to raise money for development purposes, and corporate stocks and shares which are made up of share capital, loan capital and convertible stocks which are the major means through which companies raise money.

Richmond (1994) list types of stocks and shares to include fixed-interest securities, ordinary shares or equities, preference share, and debenture stocks or bonds. Bonds are special kinds of promissory notes, nicely printed on gilt edged paper, issued in N1, 000 or other denominations to be readily marketable for resale (Ifediora, 2004). A bond is a security promising to pay the holder a certain number of naira or other units of money in interest every 6 months for a number of years until it matures. Ordinarily, payments for interest and principal must be made on time, regardless of whether the company has been making earnings or not. Common stock holders share in profits and in control of business decisions, but must also share in losses. There is a more risky venture because they cannot receive any dividend until the fixed charges owed to the bondholder are paid off.

As an alternative to investment in money market, an investor may consider stock market. The greatest advantage about investment in stock market is that, they are very easily marketable. A telephone call giving instructions to a bank manager or stock-broker is all that is needed, and providing the quoted price at which a sale or purchase can be made is satisfactory, the transaction can be rapidly completed. Stock market has good capital appreciation especially, when the share was brought in a good company. They do not require huge capital outlay as in real estate and could be

required as medium size investment. This is because to buy a minimum share in a company, it may require from N10, 000 at least and above (Nwanekezie, 1996).

The nominal rate of interest, or dividend, from an investment in stock market is the annual return to the investor in respect of every N100 face value of the stock. Where stock is selling at its face value that is at par the nominal rate of interest and actual rate of interest, or yield, are the same. For example, a stock is fixed at 4.5% that is N4.50 interest will be received each year for each N100 face value of the stock held. If the stock is selling at N100 for each N100 face value, an investor will receive N4.50 interest each year for every N100 invested which gives a yield of 4.50%. but assume now that N100 face value of 4.50% stock is selling at N55, or below par. Each N55 of capital actually invested would be earning N4.50 interest annually

$$\therefore \text{Yield} = \frac{4.5}{55} \times \frac{100}{1} = 8.18\%$$

Therefore, the actual rate of interest is 8.18% while the nominal rate of interest remains 4.5%.

Now, assume that N100 face value of 4.5% stock is selling at N125 or above par.

$$\text{The yield would be} = \frac{4.5}{125} \times \frac{100}{1} = 3.6\%$$

Thus, the actual rate of interest is 3.6% while the nominal rate of interest would remain 4.5%.

Real Estate

This refers to land and improvements and the rights to own or use them (Harwood, 1980). Real property as an investment is made up of interest and rights on land which can be compared with stocks and shares. Property generally is a profitable investment option and they are considered as much secured because they appreciate in value faster than the inflation rate (Nwanekezie, 1996). In stock market, there is no problem of management for the investor, but with most types of real property, however, some management is involved. Apart from this factor, a landowner will incur cost such as the agreeing of new rental levels and may incur legal and surveyors fee in disputes with tenants over various matters affecting the property. He will, require the yield to compensate for this cost and risk. Where, in addition to being costly, management is troublesome, the investor will require a higher yield to compensate for this.

Transaction in landed property takes fairly lengthy process and the costs of transfer are higher. This makes the liquidity of real property are higher. This makes the liquidity of real property very low compare to other forms of investment such as stock, which can be sold with a mere phone call to a stock-broker. Legislation also impinges on many types of investment but its effects, direct or indirect, on real property are frequently of major significance.

Planning Acts:- Restrict the uses to which a property can be put. Unlike other types of investments, real property investment requires huge capital outlay. Even the smallest investment in land will require a considerable amount of money for its purchase. Real property is not easily divisible into smaller units, and this indivisibility results in property being unattainable as an investment medium for the small investor, except for his own occupation, or through acquiring shares in property companies, property bonds or other indirect means.

The income generated or the capital gain achieved from an investment can be measured by converting it to a percentage of the capital outlay (Enever and Isaac 1994). This percentage is normally calculated on an annual basis and is referred to as the rate of interest or discount rate. A capital gain can be described in terms of an annual discount rate by calculating the rate of compound interest required to achieve a certain capital gain over a given period of time. The return on property investment, a property purchased for letting is the rental income and or capital appreciation. If it is acquired for occupation, the return will be in the form of savings in rental outgoing and capital appreciation.

The rate of return in a particular investment is determined by the forces of supply and demand within the market, and is evaluated by investors and their advisers by comparing returns from various investments. There are, however, certain underlying economic influences on the rate of return, and these include inflation, taxation, and liquidity of the investment, the costs of transfer, and the cost and

trouble of management. In times inflation, the investors will require to be compensated for any erosion of his capital and income. The rate of return required from the investment will also be affected by the incidence of taxation as of differentials between types of investment, classes of investor and between the types return such as income or capital gain. Capitalization rate or initial yield of an investment is derived by dividing the initial income by the market value and expressing it as a percentage. This initial yield is represented by the equation:

$$\text{Capitalization rate or yield} = \frac{\text{Income (Net rent)} \times 100}{\text{Capital value}} \quad 1$$

Table 1:
Average Annual Return of the Various Investments Options in Nigeria

Year	Money Market (Saving Account) %	Stock Market (Ordinary Shares)%	Real Property (Residential)%	Commercial %
2002	4.50	76.04	12.14	5.60
2003	3.20	59.64	11.56	7.01
2004	2.85	86.25	10.40	6.68
2005	2.55	39.64	17.01	9.17
2006	2.50	43.98	18.25	8.00
Mean	6.27	61.11	13.87	7.29

(Source: Field Survey, by the writers, 2009).

The data on the above table indicates that investment in ordinary shares are higher in return than those in real property and money market. The risk associated with investment in ordinary shares is also higher than that of investment in residential property. This confirms that property investment (with lower risk) is relatively more secure than investment in ordinary shares. In addition, as expected, the higher risk in ordinary share investment is accompanied with higher returns. The mean rate of return of investment in saving account of 6.27% may be misleading since, the most recent trends of the return is something lower as obtain in 2006 which is 2.5%. This low return could be attributed to the low or no risk associated with the investment.

Conclusion

The study dealt deeply into the assessment of investment option in Nigeria. It indicates that money market, stock market, and real property are the classes of investment available to a potential investor in the country. The stock market shows a higher rate of return, with higher risk and higher liquidity ratio. The real property proved to be a secured investment with low return, low risk and low liquidity. On the other, the money market with the lowest return would not be said to be the best investment, since, its capital is highly unsafe in the face of inflation and has poor capital appreciation compared to the other two options.

Generally, real property has a better capital appreciation compare to others. It holds a bright opportunity for investors in Nigeria, though it is generally capital intensive. Thus it could be recommended to investors that have enough capital. Medium size investors should consider the stock market, while the small investor would find opportunities in the money market.

Recommendations

Based on the analysis, the following are hereby suggested:

1. The income generated from any investment should be able to meet the market price even in the face of inflation or dwindling economy.
2. In the cost of marketing investments, the cost of transfer should be minimal, not higher than those associated with the alternative investment.
3. The investment should also be divisible to ease its liquidity.

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