Role of Strategic Investment Approaches on Efficient Performance of Real Estate firms in Kenya

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Abstract

Resources like time, organizational efforts and materials require efficient management in order to achieve greater outputs. Every organization need to reduce waste in these resources to the minimum possible so as to produce high quality services and products. The real estate industry has been evolving overtime from the traditional conventional bricks and mortar industry to be more dynamic and operational, focusing on access and outcomes rather than ownership. Investors who do not develop creative and cost-effective strategies of accessing operational experience and innovation are likely to have diminishing returns on their investments. This paper illustrates how efficiency in operations is influenced by how investors select a combination of their investment portfolio. The study reviews and analyses the concept of operational efficiency of real estate investment firms in Nairobi county and suggests ways in which it can be improved in future through strategic decision making. This article sought to establish the effect of strategic investment approaches on efficient performance of real estate investment firms in Kenya, the study period being 2018-2022. Strategic investment approaches were the independent variable and efficient performance the dependent variable thus analyzing the relationship between the two variables. Theoretical literature links strategic investment approaches to investment performance both positively and negatively with some scholars stating that there is a positive relationship between the two while other scholars contradicting. Correlational survey design and census sampling method were used to draw 231 registered real estate investment firms in Kenya's capital city of Nairobi. Primary data was gathered using structured questionnaires to collect data from 231 operations managers and analyzed by regression analysis. The findings of the study indicated that strategic investment approaches is positively correlated to efficient performance at ($p<0.05$) and R^2 of 60.3% indicating that 60.3% change in efficient performance is caused by strategic investment approaches while 39.7% will be explained by other factors. The study revealed that strategic investment approaches is a strong driver of operational efficiency thus recommends that the firm's strategic intelligence teams should proactively integrate strategic innovation and move away from the old ways of creating and managing real estate.

Keywords: Vacancy rate, Inputs, Outputs, Innovation, Portfolio

Introduction

Efficiency is achieved when the right combination of people, process, and technology merge to enhance the productivity and value of a business operation, with a focus on limiting the cost of routine operations. Due to the capital intensive nature of real estate investments, corporate managers have the responsibility of ensuring efficient and effective use of limited resources in order to maximize output to shareholders who expect return on their investments in the form of rent. According to Karakozova, (2015), real property constitutes nearly one-half of the wealth in the world, and thus, in terms of value, represents the most significant investment class. Efficiency will be measured using activity ratios in this case rental yield and occupancy rate which are relevant from the management's perspective and highlights the level of competence & effectiveness in management and asset utilization. Occupancy rate and rental yield are fundamental measures for real estate units in regards to responsibility of revenue managers to quantify the profitability of the firm's investments and to identify the most appropriate solutions for maximizing the income. (Hoesli and MacGregor, 2015).

Commercial real estate investment transactions in the United States have fell by 8%, the greatest reduction since 2010. According to Real Capital Analytics, a total of $375.6 billion in real estate transactions more than $10 million were executed in the United States in 2017, an 8 percent decrease from the previous year and the second consecutive year of dropping investment. In Kenya, the objective of providing decent housing was included in the first National Development Plan of 1964 to 1970, all through to the ninth National Development Plan of 2002 to 2008. Housing is a backbone of Kenya's real estate sector, which contributed approximately 5.3 percent of gross domestic product (GDP) in the third quarter of 2020.

Championed by the government's Big 4 Agenda, which established the Affordable Housing Programme (AHP), activities by both the private sector and government have increased to resolve the housing deficit that stands at two million. Despite several interventions that help to cushion developers, the incoming supply of housing units stands at approximately 50,000 housing units a year with only two percent of this being for the low income market against an annual demand of 250,000 units (Kenya National Bureau of Statistics, (2020). This paper reviews the issues surrounding the operational efficiency of investment firms and the role of strategic investment approaches in affecting efficient performance.

Strategic investment approaches

Theoretical literature links real estate investment strategies to investment performance both positively and negatively (Cerutti, E. et al. (2017). Strategic investment approaches are the guidelines, procedures and policies that investors employ in building an efficient real estate portfolio meaning that the investor's risk-return trade-off is determined by real estate investment strategy adopted. An investor therefore should plan his investment strategically before making any real estate investment decisions (Lakonishok, Shleifer, and Vishny, (1994).). Fama & French (1992) further argues that investment strategies adopted at market levels, organizational or industry levels should guide investors in selecting and constructing most efficient investment portfolios. Real estate investment strategy is the decision made by the investors or the top level management concerning the amount of funds that can be utilized or deployed in real estate investment opportunities (Fama & French, (1992).

Price of houses in Nairobi have been increasing over the years making it impossible to acquire rental houses since investors usually want to recoup their investment outlays quickly by charging the tenants extremely high rents. This make accessibility of housing a problem, which in turn leads to the middle income earners occupying the houses meant for the low-income earners. It is because of this that many houses in the high end residential areas are left unoccupied. In turn, landlords charge discretionary rents, making access to proper housing increasing difficulty (Vuluka & Gachanja, (2014). The slump in the 2018-2022 real estate returns was attributable to a slowdown in demand for property amid the growing supply, evidenced by the 3.0% points decline in the residential sector occupancy rates and the 0.4% points decline in occupancy rates in the retail space on account of increased supply of mall space recording a growth of 4.8% in Nairobi to 6.5million square feet in 2018 from 6.2million square feet in 2017 (Cytton report, (2020).

There is a significant decline in supply of low to middle income housing in Kenya since 2017 according to Cytton report, (2020) and this sector is undersupplied because margins remain extremely thin. Unfortunately, there is an oversupply of high-end, expensive properties which are mostly vacant in places such as Kilimani, Lavington, Westlands and Kileleshwa. Developers and estate agents should focus on providing rentals for the middle-income earners. Affordable rentals will continue to rise in places such as Ruaka, Lower Kabete, Roysambu and other locations further away from the city Centre. The global economy is witnessing changes from the coronavirus pandemic. The economy is getting weaker which means investors could end up buying because of a drop in real estate prices. Small and medium-sized businesses might have to lay off staff to stay afloat which will affect their financial capacity (Cytton report, (2020).

Strategic investment approaches and efficient performance

Investment strategies is the determination made by the investors, in case of an individual investment or management where a corporation is involved, as to how, when, where, and how much capital will be spent on investment opportunities (Millington, (2008). These decisions are usually supported by decision tools, literacy being one of the necessity, that would help achieve a satisfactory return after performing an investment analysis using the fundamental and technical analyses. The decision to invest is usually followed by research to determine the costs and returns for various options available. Property managers continue to create asset portfolios in sectors which are oversupplied and mostly vacant as they abandon sectors like low to medium income housing which is undersupplied. Therefore, they fail to invest resources in efficient ways that produce output, the result being tied up capital in projects that turn into white elephants since most of them remain unoccupied as investors expect return on their investments in the form of rent.

Ensynch operational efficiency illustrates the usefulness of the ratio analysis The various activity ratios measure this kind of operational efficiency. Activity ratios include those ratios, which highlight upon to activity and operational efficiency of the business firm (Murugan, (2008). Modern portfolio theory, often referred to today and pioneered by Harry Markowitz in 1959, employs asset allocation models. The theory makes assumptions that all preferences regarding the investment decision are based on financial outcomes alone. So, if some factor besides the financial outcome has an influence on the decision the result will deviate from the model's predictions (French, (2001).

Most common form of real estate investment strategies includes the buy and hold strategy, development strategies and own and operate strategies. Others include flipping strategy commonly known as buy low sell high. The decision on whether to invest or not to invest in real estate is determined by factors such as real estate prices, mortgage interest rates, access to financing, disposable income of investors and risk of investors. A Buy and hold investment strategy is a real estate investment strategy where a real estate investor holds real estate for long-term, even if there are short-term market fluctuations. This strategy is not a passive strategy since an investor actively selects the securities to invest (Stavros &Andreas, (1997).

The vacation rental market is another strategy and it has been very strong recently. Investing in short term rentals is a great rental strategy if you choose the right market at the right time. There is also single family home which is usually used with the traditional long term rental strategy; you invest in a normal house and rent it out to a tenant. Development strategy is where the investor constructs on property or land for sale or for rental purposes. The buyer opts to develop the real estate property instead of renting it out or buying and holding for speculation. Cerutti, E. et al. (2017) state that investors should definitely be aware of what costs they can include in their tax deductions. In order to structure your real estate portfolio between growth and income, you will want to make sure the cash flow generated by your properties is positive (Cerutti, Dagher, and Dell'Ariccia, (2017).

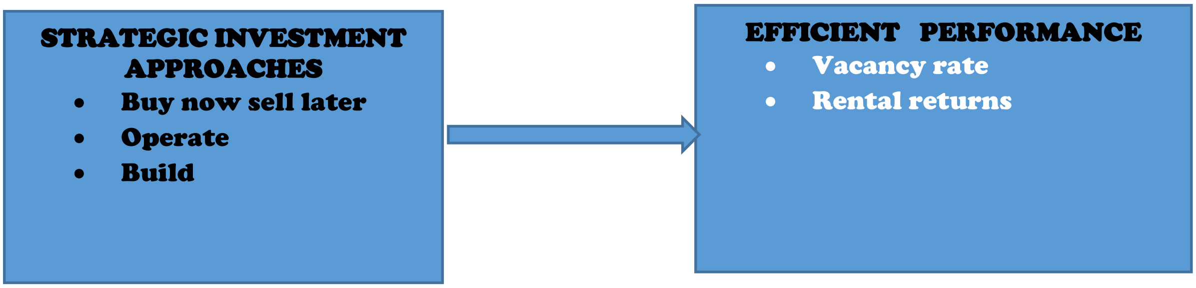
Operational efficiency refers to the profitable, efficient and judicious use of resources financial available to an organization in perfect consonance with clearly laid-down financial policies relating to the operation. In order to examine the efficiency and profitableness in making use of resources as well as the wisdom and farsightedness in observing the financial policies laid down in this regard, certain ratios are being used and they are collectively called as Activity Ratios or Performance Ratios. It is significant to note that these ratios are always expressed as turnover. All ratios coming into this category are calculated with reference to sales or cost of sales and are expressed in number of times, i.e., rate of turning over or rotation (Gupta, (2001).

Results on the effect of strategic investment approaches on efficient performance

This paper sampled 231 investment firms in Nairobi, Kenya, collecting data from the operations managers by use of structured questionnaires. The information gathered was examined using descriptive statistics to quantify dispersion and central tendency and hierarchical multiple regression analysis in cases when means and averages were not available and to determine the link between the dependent variable being strategic investment approaches and dependent variable being efficient performance.

Figure 1.1 Relationship between strategic investment approaches and efficient performance

Independent variable **Dependent**
variable



Source: Adapted from Mbogo, (2016)

To meet the study objective, modifications were made to the conceptual framework from Mbogo, (2016) who used a descriptive study approach to examine the effect of real estate investment strategies on financial performance of investment groups in Kenya and investigating the strategies of 284 licensed real estate brokers. As a result, they were relevant to how we conducted our investigation. Property investment plans were used to describe a collection of issues and considerations in Mbogo, 2016. The rebuilt framework shows strategic investment approaches as the independent variable that impacted efficient performance, the dependent variable and was predicted to modify the connection between the independent and the dependent variables. The study established the effect of strategic investment approaches on efficient performance of real estate investment firms in Kenya using multiply regression analysis and the regression model below was developed to guide the analysis.

$$\boldsymbol{Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \beta_3 X_{3i}} + \in \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (i)$$

Where:
Y = Efficient performance (Dependent variable)
X_1= Buy now sell later approach (Independent variable)
X_2= Operate approach (Independent variable)
X_3= Build approach (Independent variable)
$\in$ = Error term
i = Unit of analysis

The study findings indicated that the dependent variable efficient performance is positively correlated to strategic investment approaches at ($p<0.05$). Social scientists confirm that probabilities below 0.05 is indicative of genuine effect meaning that there is less than 0.05 chance that the correlation co-efficient happened by chance in a sample of 231 firms. This indicated a positively significant correlation between strategic investment methods and efficiency in real estate investment firms in Nairobi Kenya. This means that any change in strategic investment approaches causes a similar change in efficient performance.

Correlation analysis indicates relationships between variables whereas regression analysis identifies the impact of independent variable on the dependent variable. Co-efficient of determination(R^2) is a superior measure compared to correlation coefficient(r) as it indicates the amount of variability in one variable that is explained by the other. In this case, the results gave $R^2=0.603$ indicating that strategic investment approaches accounts for 60.3% variability in efficient performance. This means that 60.3% change in efficient performance is caused by strategic investment approaches while 39.7% will be explained by other factors. It is therefore clear that strategic investment approaches cause an increase or decrease in efficient performance hence to increase efficiency in performance, firms need to have strategic investment approaches.

Discussion

The results of this study are consistent with the findings by Mbogo (2016) who in her study on the effect of real estate investment strategies on financial performance of investment groups in Kenya concluded that investment strategies adopted by investment groups greatly affect their performance. Gallimore, (2004), identified investment strategies as one of the driving factors in performance among other factors. In the same regard, the study revealed that there was a significant inter-relationship between the strategic investment methods and efficiency of investment firms.

Real estate firms’ strategic and operational intelligence need to be open to innovations in real estate investments and customize service delivery when they operate their premises, introduce new and innovative products that matches the clientele needs hence their satisfaction. In addition, it gives firms a competitive edge within the broad real estate industry. Academicians need to understand the broad scope of current emerging product innovation orientation construct in the real estate industry as it is a driver of financial performance growth hence efficient performance. The government should regulate flooded real estate ventures so that the risk is spread across available opportunities and returns also increased. It also needs to focus on real estate effects on monetary policies through in-depth trend analysis.

Conclusion

Efficient performance is positively and significantly correlated to strategic investment approaches meaning that a change in one causes a similar change in the other respectively. It is therefore evident that a firm's efficiency is affected by the investment approaches taken by its investment managers. Modern financial theory assumes that a company's sole goal should be to maximize the wealth of its owners therefore managers should create value for both the company and society by transferring resources from low- to high-productivity property sectors since real estate is a high capital intensive investment. Firms should take on projects with a positive Net Present Value (NPV), where the current value of cash inflows exceeds the present value of cash outflows in order to maximize shareholder wealth.

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