



Alternative Investment and Firm's Financial Performance in Nigeria

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ABSTRACT

The study examined the effect of alternative investment on firm's financial performance in Nigeria. The qualitative (descriptive) method of research was adopted by deeply discussing the meaning, types of alternative investment, advantages, disadvantages, theoretical and empirical reviews of alternative investment in Nigeria. It was recommended that the Securities and Exchange Commission should create a means by which alternative investments can be regulated to curb fraudulent practices.

INTRODUCTION

A financial asset that does not fit within the traditional asset classes of stocks, bonds, and cash is known as an alternative investment. Private equity, venture capital, hedge funds, managed futures, and collectibles like artwork and antiques are examples of alternative investments. Alternative investments could include commodities and real estate.

Alternative investments can have a mixed impact on firm performance, depending on the specific investment and the firm's characteristics. Firm's performance refers to how well a company is doing in achieving its goals and objectives. The performance of a firm can be measured in various ways, including financial performance, market performance and operational performance (Adu and Ajigbotoso, 2024).

Alternative stock markets have faced up to several difficulties in their expansion such as the decrease in the liquidity and volatility of stocks (Mortazian, 2021). Thus, firms seek other forms of financing such as access to credit bank channels, access to other forms of non-traditional alternative financing such as venture capital, private equity funds, funds to funds, real estate, cypto-currency, crowd funding, business angels (Rupeika-Apoga and Danovi, 2015). Entrepreneurs distrust to use a new source of financing that could jeopardize the control of their company, higher transparency in the information that may affect the value of the firm; the assumption of excessive direct or indirect economic costs; fraud, illiquidity, low financial returns, etc. (Palacín-Sánchez and Pérez-López, 2016).

LITERATURE REVIEW

Alternative investments often have unique characteristics such as illiquidity, high minimum investment requirements, and limited access, which can make them suitable for investors with specific investment goals, risk tolerance, and time horizon. In relation to the concept of stewardship, the philosophy of stewardship emphasizes the importance of establishing organizations that provide employees and other stakeholders with a sense of independence and assurance. More attention is paid to management roles or employee ranks in order to ensure that investors' profits are maximized (Sipos, 2020).

METHODOLOGY

Types of Alternative Investments

Hedge funds are private, pooled investment funds that use a variety of risky and varied investing strategies in an effort to generate large returns. They have the ability to invest participants' funds in a wide range of assets, including currencies, startups, publicly listed stocks, and derivatives. Usually set up as private investment partnerships, hedge funds have a general partner who oversees the portfolio and makes investment choices. The fund's selected mandate is the only thing that truly restricts that person's options. (Elinga and Faust, 2010).

The goal of private equity funds, which are pooled investment entities, is to purchase majority shares in both private and public businesses. They actively manage the businesses in their portfolio and contribute both financial and

intellectual capital. The objective of a private equity fund's acquisition of a business is often to restructure the enterprise and supply funds to spur expansion. When the fund sells off its stake, either by selling it to another business or by going public with an initial public offering (IPO), it makes money. (Fung, Hsieh, and Tsatsaronis, 2000).

Venture Capital Funds: In return for equity, venture capital funds lend money to potential entrepreneurs. They might actively participate in management and provide the required knowledge, much like private equity firms. But compared to private equity funds, venture capital investors typically hold their investments for a longer period of time. They collaborate with the portfolio firm, track its growth, and release investment rounds when specific goals are reached. After a merger, acquisition, or initial public offering, they withdraw their investment (Adu, 2024).

Fund of Funds: A fund of funds functions similarly to a hedge fund, but instead of investing in individual stocks, bonds, or other assets, it makes investments in other hedge funds. Because hedge funds usually have high minimum investment requirements, this strategy can increase investors' access (Adu, 2021).

Natural Resources: Farmland, forests, and commodities are examples of natural resources. Purchasing barrels of gasoline or trainloads of iron ore to manufacture other goods is what large corporations mean when they invest in commodities. Derivatives such as futures and options allow ordinary individuals to invest in commodities. Purchasing farmland and forests provides alternative investors with revenue streams that are dependent on the prices of agricultural commodities, wood, and tree sales (Giralt, and González, 2015).

Since many Americans already own homes, they are already invested in real estate, making it the most accessible alternative investment. Buying real estate or funds that invest in real estate is known as real estate investing. While real estate assets like apartment buildings or shopping malls produce consistent rental revenue, real estate investors expect their value to increase over time (Adu, 2023).

Crypto-Currencies: Crypto-currencies are a newer form of alternative investment that have gained popularity in recent years. They are decentralized digital assets that use cryptography to secure transactions and control the creation of new units. While they can be highly volatile and speculative, some investors believe they offer significant growth potential (Adu, 2024).

Alternative Investment Benefits: Poor correlation the fact that alternative investments have little link to conventional asset classes is one of their biggest benefits. Commodities, for instance, may be doing well when the stock market is struggling (Park, 2015).

Diversification: Adding alternatives to a portfolio can increase diversification because of their poor correlation to the stock or bond markets (Adu, 2023). **Reduced volatility:** Alternative investments may be less affected by market volatility since they are less exposed to the overall market (Adu, 2021).

Hedges against inflation: Certain alternatives, like gold, oil, or real estate, can be useful in mitigating the danger of inflation. Additionally, commodity futures and options can be utilized as a hedge against price fluctuations (Adu,

2024). Potentially larger returns: Alternative investments have the potential to yield larger returns because they carry a greater degree of risk (Mortazian, 2021).

RESULTS AND DISCUSSION

Risks of Alternative Investments

Absence of regulation: Alternative assets are not regulated as not all of them are SEC-registered. Nonetheless, the SEC may examine their procedures because they are subject to the Dodd-Frank Act. **Lack of transparency:** There are very few, if any, public regulatory filings because the SEC does not oversee the majority of alternatives. For investors, this leads to a lack of information.

Low liquidity: Buying or selling these investments may be challenging because a large number of alternatives are not listed on a public exchange. Lockups are a common feature of hedge funds and private equity funds that bind investors to a specific investment period during which redemptions are not permitted.

Difficult to value: It could be difficult to assess the worth of alternative investments when there is no market price. Depending on the appraiser, valuations might differ significantly and are more subject to subjectivity.

(Adu, 2021). **High minimum investments:** Because alternatives are not designed with the typical investor in mind, they may have unreasonably high minimum investment requirements.

Increased risk: The possibility of large gains is accompanied by increased risk. Risky tactics like short selling or trading intricate derivatives may be a part of many alternative investment strategies.

The process of purchasing alternative assets involves more difficulties than sticking to conventional asset classes. The risk is proportionate to the potential for more diversity and larger returns, which can be enticing. It will be necessary to conduct thorough study and due diligence before considering alternative options. Access to alternative assets may be restricted for non-accredited investors. However, a lot of alternative investing mutual funds and exchange-traded funds (ETFs) are accessible these days, even though many of them are expensive (Wang, Lin, and Luo, 2019).

These funds may be safer options for unaccredited investors because they are publicly traded securities that are subject to SEC registration and regulation. You can find available funds and exchange-traded funds (ETFs) using resources like Morningstar, but the ideal way to invest in alternatives is to collaborate closely with a financial advisor who can recommend the finest options to help you reach your objectives (Adu and Williams, 2023).

Alternative investments can have a mixed impact on firm performance, depending on the specific investment and the firm's characteristics. Here are some factors to consider

Diversification: Alternative investments can provide diversification benefits to a firm's portfolio, which can help to reduce overall risk and improve performance. However, the degree of diversification and the specific alternative investment chosen can affect the firm's performance. **Return expectations:** Alternative investments may offer higher returns than traditional investments, but they may also come with higher fees and greater risks. Firms that invest in

alternative investments need to carefully consider the potential returns and risks of each investment and weigh these against the expected costs (Adu, 2024).

Firm size and complexity: Firms with larger portfolios and more complex investment strategies may be better equipped to invest in alternative assets than smaller or less complex firms. Smaller firms may not have the resources or expertise to properly evaluate and manage alternative investments, while larger firms may be better able to leverage their resources and expertise to take advantage of these investments (Adu, 2021).

Regulatory environment: The regulatory environment for alternative investments can vary by jurisdiction and investment type. Firms that operate in jurisdictions with more stringent regulations may face greater barriers to investing in alternative assets, while firms that operate in jurisdictions with more lenient regulations may be able to take advantage of a wider range of alternative investments (Cumming, Dai, and Johan, 2013).

Theoretical Review

There are several theories that can be used to analyze alternative investments. Here are a few:

Modern Portfolio Theory (MPT): MPT is a widely-used theory in finance that suggests that investors can minimize risk and maximize returns by constructing a diversified portfolio of assets. MPT assumes that investors are rational and risk-averse, and it uses statistical techniques to measure the risk and return of a portfolio.

Behavioral Finance Theory: This theory takes into account the fact that investors are not always rational and may make investment decisions based on emotions, biases, and cognitive errors. Behavioral finance theory suggests that investors can make better investment decisions by understanding their own biases and emotions and by following a disciplined investment strategy.

Market Efficiency Theory: This theory suggests that markets are efficient and that asset prices reflect all available information. Proponents of market efficiency theory argue that it is difficult to beat the market consistently by using alternative investments because market prices already incorporate all available information.

The under-pinning Theory for alternative investment and firms' performance is Alternative Investment Theory: This theory specifically focuses on analyzing alternative investments and suggests that these investments can provide diversification benefits and higher returns than traditional investments. Alternative investment theory often involves analyzing historical performance data, understanding the investment strategy and risk profile of the investment, and assessing the skill and experience of the investment manager.

Alternative investment theory is a set of principles that guide the analysis and investment decision-making process for alternative investments. Alternative investments refer to assets that are not typically found in traditional investment portfolios, such as real estate, private equity, hedge funds, commodities, and collectibles.

Alternative investment theory suggests that alternative investments can provide diversification benefits and higher returns than traditional investments. However, alternative investments can also be riskier and more complex than

traditional investments, and they may require a higher level of due diligence and analysis.

Key Principles of Alternative Investment Theory

Understanding the Investment Strategy: Alternative investments often involve unique investment strategies that may not be well-understood by the general public. To effectively analyze an alternative investment, it is important to have a thorough understanding of the investment strategy and the risks associated with it.

Analyzing Historical Performance: Historical performance data can provide valuable insights into an alternative investment's risk and return profile. However, it is important to be cautious when interpreting historical performance data, as past performance does not necessarily indicate future results.

Assessing the Investment Manager: The skill and experience of the investment manager can have a significant impact on the success of an alternative investment. When analyzing an alternative investment, it is important to assess the investment manager's track record, investment philosophy, and experience in the relevant industry.

Evaluating Risk: Alternative investments can be riskier than traditional investments, and it is important to evaluate the potential risks associated with an investment before making a decision. Some common risks associated with alternative investments include liquidity risk, market risk, and operational risk.

Developing a Diversified Portfolio: Alternative investments can provide diversification benefits by adding assets that are not correlated with traditional investments. To effectively diversify a portfolio, it is important to select alternative investments that have low correlation with existing investments.

Empirical Review

Early research on hedge funds in emerging economies, such as Peltomäki (2008), described how these funds adapted to shifting legal and economic circumstances in these regions and demonstrated how local expertise gained through a local presence significantly enhances hedge fund performance. Elinga and Faust (2010) shown that hedge funds outperform mutual funds and that, in contrast to US funds, style impacts of emerging markets and geographic specialization help hedge funds perform better (Park, 2015).

Hedge fund regulation has an impact on fund structure and performance, according to a number of empirical studies published in journals such as *Financial Management*, *European Financial Management*, the *Journal of Corporate Finance*, and the *Journal of Empirical Legal Studies*. In particular, limitations on the location of important service providers and wrapper distributions are typically linked to poorer performance, lower fund flows, less sensitive fund flows in comparison to previous performance, and more frequent misreporting of monthly returns. Future studies will probably show how managed assets have changed over time and how the lines separating hedge funds from other asset management companies have become hazier.

Parallels across various fund kinds are demonstrated by scholarly study, and these parallels seem to be expanding recently in regards to fund fees and other aspects of fund structure and governance. Depending on whether the fund is focused on emerging markets or not, pay for performance sensitivity has been

demonstrated to influence fund risk taking (Yang and Hou, 2016). Additionally, Islamic funds typically have different fee structures than other fund types.

Summary

The field of alternative investments in emerging markets has experienced rapid growth in research and a notable increase in scholarly interest. Angel investment, fund-to-fund, hedging, venture capital, and private equity have all seen significant growth. Interest in sectors like hedge funds and private debt has increased, but it has decreased considerably. For alternative investments in emerging nations, a variety of research areas related to information asymmetries and agency costs, governance and monitoring, and legal and economic constraints are particularly significant. Significant dataset gaps also frequently result in inconsistent findings and discrepancies between studies.

Among the study's highlights are several significant and inventive studies that will motivate future researchers to lead the charge in transforming alternative investment research to improve knowledge of the various levels, structure, governance, and performance of alternative investments in emerging economies for the benefit of other businesses, scholars, practitioners, and policymakers.

CONCLUSIONS AND RECOMMENDATIONS

Alternative investments are majorly carried out by institutions or high-net-worth individuals accredited by the Securities and Exchange Commission (SEC) because most alternative investments are not traded on public markets, and they are typically unregulated by the SEC.

From the study, the following suggestions were made: the Securities and Exchange Commission should create a means by which alternative investments can be regulated to curb fraudulent practices: the government should find means of formalizing most of the alternative securities or instruments so that they can be traded publicly: the government should create price ranges within which alternative instruments can be bought and sold to avoid unethical practices.

FURTHER STUDY

This study still has limitations so that further research is still needed on the topic of "Investment and Firm's Financial Performance in Alternative Nigeria".

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