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Asset Allocation Based Investment Strategy to Improve Profitability and Sustainability of the SMEs

Subiakto Soekarno^a, Sylviana Maya Damayanti^{a*}

^a*School of Business and Management, Institut Teknologi Bandung, Jl. Ganesha No 10 Bandung, 40132, Indonesia*

Abstract

SMEs usually have a volatile revenue and income stream. In order to reduce the operational risk, SMEs allocates high cash position as a buffer during difficult situation. This paper aims to increase earning from this cash position through asset allocation strategy. Asset Allocation Investment Strategy is a strategy that allocates investment among several different investment classes in certain proportions and rebalanced periodically. By keeping the same proportion in these different investment class, SMEs are forced to apply the simplified investment principle which is many time difficult to apply in reality because of market sentiment.

The author forms three portfolios consisting of stock mutual fund, bond mutual fund and money market in certain proportion into conservative, moderate and aggressive portfolio. The proportions are kept in balance through rebalancing process. Three rebalancing process are applied, which is quarterly, semi-annually, and annually. The return performance of all portfolios combined with these three rebalancing processes then will be compared each other and against the IHSG (Indonesian Stock Market Index) performance.

The research result shows that Asset Allocation Strategy with Periodically Rebalancing gives better return compared to IHSG index performance. Aggressive Portfolio with quarterly rebalancing gives superior result compared to all other portfolios. When SMEs use this strategy for profit generated from their business, SMEs can improve their profit and sustainability significantly.

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Keywords: SMEs Profitability; SMEs Sustainability; Asset Allocation

* Subiakto Soekarno. Tel.: +62-22-2531923 ext: 306; fax: +62-22-2504249

* Sylviana Maya Damayanti. Tel.: +62-22-2531923 ext: 314; fax: +62-22-2504249

E-mail address: subiakto@sbm-itb.ac.id; sylvianamaya@sbm-itb.ac.id.

1. Background

Entrepreneurs usually face volatility in their SMEs. Volatility in revenues, earnings, and cash flows. This paper are trying to see whether the earnings generated from the SMEs business can be enhanced certain specific investment strategy. Specifically this paper is examining the Asset Allocation Investment Strategy. It is widely known that succesful investing is not determined from how good we are looking for the best asset but it is from how we allocate asset consistently. Asset Allocation Investment Strategy is a strategy that allocates investment among several different investment classes in certain proportions and rebalanced periodically. By keeping the same proportion in these different investment classes, SMEs are forced to apply the “buy-low sell-high” principle which is many time difficult to apply in reality because of market sentiment.

The author forms three portfolios consisting of stock mutual fund, bond mutual fund and money market in certain proportion into conservative, moderate and aggressive portfolio. The proportions are kept in balance through rebalancing process. Three rebalancing process are applied, which is quarterly, semi-annually, and annually. After finding the best way how we are going to allocate asset, then authors will try to apply the suggested strategy into selected SMEs to enhanced business returns.

Problem Identification

There are four questions to be answered in this research as follows:

- a. Does asset allocation strategy give better risk adjusted return compared to that of IDX?
- b. Does rebalancing process in asset allocation strategy affect risk adjusted return of portfolio?
- c. Which does rebalancing process give the best risk adjusted return performance?
- d. How the asset allocation strategy can be applied to enhance returns of SMEs?

2. Theoretical Foundation

2.1. Asset Allocation

Asset allocation is an investment strategy that aims to balance risk and reward by apportioning a portfolio's assets according to an individual's goals, risk tolerance and investment horizon (Bodie, Kane and Marcus, 2009). Asset allocation provides the foundation for diversifying a portfolio. Generally, investors diversify their holdings by spreading assets among companies, industries, and countries. However, asset allocation suggests that investors should also diversify their securities across a minimum of three asset classes: stocks, bonds, and liquid instruments like Treasury Bills and money market securities (Mittra, Sahu and Crane, 2007).

2.2. Rebalancing Process

One effective way of guarding against risk creep and maintaining a consistent investment strategy is to regularly rebalance the portfolio. This simply means periodically shifting money among the various asset classes to keep the portfolio diversification in line with the desired asset allocation strategy (Mittra, Sahu, and Crane, 2007). Rebalancing is the process of selling portions of your portfolio that have increased significantly, and using those funds to purchase additional units of assets that have declined slightly or increased at a lesser rate.

2.3. Risk Tolerance Profile

One of the factors that should also beware by the investor is the risk tolerance profile of the portfolio. There are three basic categorized of portfolio risk profile which are conservative portfolio, moderate portfolio, and aggressive portfolio. These three categorized of portfolios are also could determine the types of investor based on their risk tolerance profile. The author would take the Merrill Lynch risk tolerance profile because Merrill Lynch is already regarded as one of the world's premier providers of wealth management, trusted advisor, and superior execution (Campbell and Viceira, 2002).

2.4. Rate of return

In process of calculating risk adjusted return, the author also uses some source to get theoretical

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