CONCEPTUAL ASPECTS OF MUTUAL INVESTMENT FUNDS DEVELOPMENT: REVIEW OF INFLUENCING FACTORS

Sultonboyeva Munira Bakhodirovna

Banking and Finance Academy of the Republic of Uzbekistan (BFA), Tashkent, UZBEKISTAN.

tadqiqotchi@gmail.com

ABSTRACT

This paper reviews the practical situation on activities of mutual investment funds in selected countries. In addition, in order to find main factors, which has been, studied the review of empirical literature has been conducted. Review has shown that there are vast variety of factors such as managers' education, managers' tenure, fund's turnover ratio, fund governance mechanisms, fund expenses, marketing efforts, size of funds, electronic technology, level of independence of mutual funds, prudence of investors, asset prices, information asymmetry, corporate information disclosure which can influence on mutual funds' performance.

Keywords: mutual funds, investment funds, bond funds, literature review

INTRODUCTION

Explosive growth of mutual funds is considered as one of the most interesting financial phenomena for last decade. Before world-financial-crisis in the United States total net assets of mutual funds was growing on average close to 20 percent annual rate. This trend was true for most of other countries in the world.

We can guess that one of the main factors of the global growth of mutual funds was due to strong globalization trends in financial sector and increasing the participation of large multinational financial groups in a most of countries. Beside of it the strong performance of equity and bond markets also has played its vital role. Another factor, which has been mentioned in most recent papers, is the demographic aging in most high and middle-income countries, which forces population of those countries to look for financial instruments that are safe and liquid but also promise high long-term returns.

In most of markets, where there is a visibility of equity market performance definitely helped contribute to the increase of the popularity of mutual fund products.

From the economic and financial theory, it is well known that mutual funds offer investors the advantages of portfolio diversification and professional management at low cost. These advantages are particularly important in the case of equity funds where both diversification and professional management have the potential to add value. The significant advantage for bond and money market mutual funds is transactional efficiency through professional management. There should be kept another stimulating factor for the development of bond and money market funds, such as tax incentives and regulatory factors provided by governments and local authorities.

The remaining interest as a very effective alternative tool for investors to mutual investment funds and vast variety of factors, which can influence its activity and performance it has been decided to conduct a review of main aspects of this issue.

Leena and Luna International, Chikusei, Japan.
(株) リナアンドルナインターナショナル, 筑西市,日本
ISSN: 2186-845X ISSN: 2186-8441 Print
www.ajmse. leena-luna.co.jp

REVIEW OF MUTUAL INVESTMENT FUNDS DEVELOPMENT BY COUNTRIES

The United States and Europe

The first open-end mutual fund was created in Boston in 1924. Mutual funds of both the closed and open-end varieties experienced turbulent growth in the 1920s. Mismanagement, fraud the stock market crash of 1929 became the main barrier in their further development. There was very small growth between 1930 and 1970.

Economic growth of 1990s stimulated the new interest on mutual funds. Thus most of researchers started focusing on issues and on the factors that explain the performance of mutual funds.

Study by Otten and Schweitzer (1998) that compared the US and European mutual fund industries found that the European mutual fund industry is lagging the American industry with regard to capital market importance, total assets and average fund size.

Fixed income mutual funds has been more preferred by European investors. In Europe itself, main players in mutual fund markets were large domestic groups, mostly banks, which caused the lower level of competition.

As mutual funds are financial institutions that serve the needs of households, their growth is likely to be determined by a number of factors. First and foremost is the level of income and wealth of the residents of a country. Conceptual aspect behind this idea is that investing in mutual funds is similar to purchasing life insurance and/or saving for retirement. Thus, it is a luxury good with a positive income elasticity of demand. However, in macroeconomic scale the relationship between per capita income and aggregate holdings of mutual fund assets is not always positive.

In the United States and France, because of obtrusion of tight restrictions on the interest rate that banks could pay on retail deposits money market mutual funds faced its growth.

In the end, mutual funds became competitive if to compare with banks through offering market-related returns and lower spreads than traditional bank deposits, in the same time ensuring the liquidity and ease of access.

Subdued inflation, rising equity prices, low and stable interest rates, demand for financial assets increased the demand for mutual funds (Reid 2000). Additional stimulus was provided by the expanded retirement savings plan.

Australia

The situation in countries with underdeveloped mutual fund industries, mainly in developing countries and emerging markets was not similar to what was happening in developed markets, even if to compare those counties with each other. Anglo-American countries were leading in the level of the development of securities markets and had the strong established common law traditions. Even among them countries like Australia, New Zealand and South Africa were in a position with relatively underdeveloped mutual fund industries with total assets around 10 percent of GDP. However, in all three countries mutual funds experienced considerable growth during the 1990s.

The main factors for such case can be considered the presence of a well-developed contractual savings industry in South Africa and the continuing credibility of tax-financed universal pensions in Australia and New Zealand. For example if to pay attention on reported Australian statistics it shows very large increase of mutual funds' performance, while the reason can be the inclusion of the compulsory pension funds.

Japan

In East Asia, the experience of Japan is worth noting. Since the collapse of the Tokyo stock market in 1990, the mutual fund industry has stagnated. Total assets under management declined in relation to GDP from 9 to 8 percent. However, later despite of rigid restrictions on bank deposit rates in Japan levels of development of mutual investment fund continued. It can be assumed that even in the absence of regulatory distortions, money market mutual funds, once invented, mutual funds tend to grow to meet the demand from sophisticated investors, as they need a convenient and trustworthy place to allocate their liquid investment balances. Noteworthy is the fact that Japan is the case country where money market mutual funds have a significant share of over 25 percent of the mutual fund sector but their total assets are not large in relation to national income.

Brazil

Despite of existence of the well developed equity markets the equity funds in Brazil and Chile, like in most middle-income countries, where far behind the level of developed countries. We can try to explain it through the simultaneous impact of several factors such as: low level of confidence in the integrity of local markets; low risk tolerance of investors; and use of overseas mutual funds by wealthier and more sophisticated investors.

If to compare with other middle-income countries, Brazil has the most developed mutual fund sector. In most other developing countries, mutual fund assets are close to, or lower than, 5 percent of GDP, while for many years this indicator for Brazil kept to be more than 5 percent.

Case of Brazil is also worth to be studied because of the well development of bond funds, similar to several countries of Continental European, such as Austria, France and Italy where government bond markets are large. From the economic theory, it is well known that bond funds have chance to further development in case of existence of large government, sufficient development of corporate and mortgage bond markets.

REVIEW OF EMPIRICAL LITERATURE ON MUTUAL INVESTMENT FUNDS

Impact of various factors on performance of mutual funds

The research literature on mutual funds is vast and covers a number of aspects.

Several recent papers study the influence of management structure, which includes management by teams and side by-side management. It has been shown that this factor is an important determinant of mutual fund performance. Chevalier and Ellison (1999) show the effect of the level of education of the mutual funds manager and fund performance. Golec (1996) studies the relationship between manager tenure and performance. Khorana, Servaes, and Wedge (2007) found that managerial ownership affects performance. Some of the recent papers in this direction are Baer, Kempf, and Ruenzi (2011), Cici, Gibson, and Moussawi (2010), and Deuskar, Pollet, Wang, and Zheng (2012). There are several studies on the relationship between the fund characteristics and performance. Wermers (2000) finds that a fund's turnover ratio has a positive effect on fund performance, while its expense ratio has a negative impact. It has been found that greater fund inflows erode fund performance (Chen et al., 2004; Pastor and Stambaugh, 2010). Another factor, which impact on fund performance is a fund governance mechanisms and the presence of the advisory contract (Khorana et al., 2007; Chen, Goldstein, and Jiang, 2008; Deli, 2002; Elton, Gruber, and Blake, 2003; Massa and Patgiri, 2009)

There are evidences that the relationship between mutual fund expenses and performance is also strong. Usually very high expense rations is normal for funds that are heavily

ISSN: 2186-845X ISSN: 2186-8441 Print
www.ajmse. leena-luna.co.jp

underperforming. On the contrary, successful funds instead of raising their fees try to benefit from the increased size of their funds (Elton Et al. 1996, Carhart 1997). James et al. (1999) assumes that actively managed equity funds charge higher fees than index tracking funds or bond and money market funds, reflecting the higher costs of employing investment management staff to achieve diversification and strategy.

In setting fees, the role of fund governance cannot be underestimated. Smaller board funds and funds with more independent directors likely to charge lower fees (Tufano and Sevick 1997). Larger and more mature funds as well as no-load funds have lower expense ratios (Malhotra and McLeod 1997). Sirri and Tufano (1997) found the positive correlation between high performance and marketing effort and between performance and fees. Allocation strategies seem to have its own impact on fund fees, as aggressive growth funds tend to charge higher entry and exit fees to discourage redemptions. This happens due to the fact that they hold more of the smaller, less liquid stocks (Chordia 1996).

Scale and scope economies is an important feature of mutual funds and especially fund complexes. Large overheads, such as record keeping, communication and marketing, although adverse price impact and managerial diseconomies of scale place a limit on the efficient size of funds (Baumol et al. 1990, Sirri and Tufano 1993, Collins and Mack 1997, James et al. 1999). However, despite the basic academic advice offered to investors to prefer low expense index funds, actively managed funds continue to be popular (Gruber 1996). In practice, less than 10 percent of total mutual fund assets are index-tracking funds.

Transaction costs in most studies has not been considered when the main focus was given to performance based on mutual funds returns. A single index model in explaining mutual funds returns was put into the doubt (Fama and French, 1996; Cahart, 1997; Chen et all, 2000).

Sirri and Tufano (1998) based on their research insure that investors in equity portfolios are sensitive to entry commissions. It has been found that funds with significant capital gain distributions and heavily-taxed dividends are less attractive to investors than funds with similar pretax returns and lower tax charges (Bergstresser and Poterba, 2002). The study was based on investigation of the impact of unrealized gains as well as recent capital gain distributions on inflows. As regards questions of microeconomic efficiency, the prevailing view is and the standard advice for investors is to invest in low expense index funds (Malkiel 1995, Bogle 1999).

In our subjective opinion, the most important factor, which is considered that, can be implied in any countries growth of mutual funds is the advent of electronic technology and the concomitant large reduction in the cost of operating a large number of accounts and an even larger volume of transactions.

Issues of independence of mutual funds

According to Tate (2000) even in the US, the real independence of directors in mutual funds is under the question. In India for mutual fund companies, it is required for at least 50% directors to be independent. There is still a knowledge gap on the questions whether they really remain independent.

Massa (2003) finds a negative relation between performance and the degree of product differentiation in the mutual fund families, whereas Chen et al. (2004) show that fund performance, controlling for its own size, does not deteriorate with size of the fund family it belongs to. Gaspar, Massa and Matos (2006) find evidence that mutual fund families may cross subsidise the performance of a favoured fund while Chen and Chen (2009) and Cici et al. (2010) find that mutual fund families that have both mutual funds and hedge funds, favour hedge funds over the mutual funds.

Asset Prices

Finally, there is research, which shows the effect of institutional investment on the dynamics of asset prices.

Badrinath, Gay and Kale (1989) and Del Guercio (1996) found that institutional investors give their preference for bigger, low-risk, and low leverage firms due to prudence. Evidence shows that asset prices has been affected because of this preference. Theory and empirical evidence was provided by Badrinath, Kale, and Noe (1995) on impact of prudence, which results in the returns on portfolios with high institutional interest leading the returns on the portfolio of low institutional interest stocks.

Empirical results provided by Sias (1997), Boehmer, and Kelly (2009) and Cohen and Frazzini (2008) support the series of hypotheses which claim that ownership by institutional investors affects other aspects of financial markets such as liquidity and return predictability. Mutual investment funds in developing markets can face the capacity constraints, which can be seen in behavior of investors, who seek to invest in only 10 percent of companies out of overall number of listed companies.

Information

From the theory, it is know that information asymmetry refers to inequalities between the information held by market participants, which can affect investors' decision-making.

Studies conducted in China and in other countries have coinciding results, claiming that company's earnings management is closely related to its information environment. Both Dye (1988) and Trueman and Titman (1988) find that information asymmetry between shareholders and management is a necessary condition for the existence of earnings management.

Yang (2005) studied the relationship between information disclosure and earnings management through implementation of a client–agency model. His findings suggest that information forecasts can decrease the information asymmetry between managers and owners. According to results, managers should face an additional cost for their deliberate forecasting of inaccurate information, so that managers' information forecasts can reduce the possibility of earnings management.

Xia and Lu (2005) use listed companies' condemned announcements as a proxy for information disclosure and their results indicate that the degree of earnings management and the quality of information disclosure have a negative relationship. This implies that listed companies may lower information disclosure quality to conceal their earnings management.

Fang and Hong (2007) made their conclusions where they state that the quality of corporate disclosure has an effect on analysts' behavior. Thus it comes the logical conclusion that that the information asymmetry between investors and listed companies leads to management speculation.

Dai, Kong and Wang (2013) investigates how information asymmetry and mutual fund ownership affect listed companies' earnings management. They found that reducing information asymmetry improves firms' earnings management behavior.

CONCLUSION

Leena and Luna International, Chikusei, Japan.
(株) リナアンドルナインターナショナル, 筑西市,日本
ISSN: 2186-845X ISSN: 2186-8441 Print
www.ajmse. leena-luna.co.jp

In general, review of literature on mutual funds show that mutual investment funds are developed in countries, which have better developed, and more stable capital markets. This is due to liquidity and profitability of investable securities, investors' confidence in market integrity and overall higher amount of supply of securities, which are attractive for investing. It is clear that equity funds dominate in Anglo-American countries and bond funds in most of Continental Europe and in middle-income countries. Equity funds are significantly smaller in countries with higher market volatility and weaker accounting standards, this can lead to conclusion that in developed countries, investors are more concerned with market microstructure. Opposite to this in developing countries, macroeconomic factor seems to be the most significant. In developing countries, there is a strong relationship between bond fund development and high levels of GDP per capita, also strong relationship between bond fund development and low levels of interest rates. However, in both developed and developing countries, lower country risk and higher investor confidence leads to greater fund development.

In addition, it is clear that there should be developed microeconomic, macroeconomic and institutional infrastructure for maximization of positive effects from establishing the mutual funds.

Review has shown that there are vast variety of factors such as managers' education, managers' tenure, fund's turnover ratio, fund governance mechanisms, fund expenses, marketing efforts, size of funds, electronic technology, level of independence of mutual funds, prudence of investors, asset prices, information asymmetry, corporate information disclosure which can influence on mutual funds' performance. Knowing these factors and their relationship with mutual funds' performance has a practical benefit in decision making both for managers of mutual investment funds and investors. Additionally, these factors can be used for further researches devoted on studying the mutual investment funds activities during the selection of variables to test through quantitative and qualitative methods.

REFERENCES

[1] Badrinath, S. G., Gay, G. D., & Kale, J. R. (1989). Patterns of institutional investments, prudence, and the managerial 'safety net' hypothesis. *Journal of Risk and Insurance, 56,* 605-629.

[2] Badrinath, S. G., Kale, J. R., & Noe, T. H. (1995). Of shepherds, sheep, and the cross-autocorrelations in equity returns. *Review of Financial Studies, 8,* 401-430.

[3] Baer, M., Kempf, A., & Ruenzi, S. (2011). Is a team different from the sum of its parts? Evidence from mutual fund managers. *Review of Finance, 15*, 359e396.

[4] Baumol, W. J., Stephen, M. G., Lili, A. G., & Michale, F. K. (1990). *The economics of mutual fund markets: Competition versus Regulation.* Boston, MA: Kluwer Academic Publishers.

[5] Bergstresser, D., & Poterba J. (2002). Do after-tax returns affect mutual fund inflows? *Journal of Financial Economics 63*, 381-414.

[6] Boehmer, E., & Kelley, E. (2009). Institutional investors and the informational efficiency of prices. *Review of Financial Studies, 22*, 3563-3594.

[7] Bogle, J. (1999). *Common sense on mutual funds: New imperatives for the intelligent investor*. New York: John Wiley and Sons, Inc.

[8] Carhart, M. (1997). On persistence in mutual fund performance. *Journal of Finance, 56*, 57-82.

[9] Chen, H.L, Jegadeesh, N., & Wermers, R. (2000). The value of active mutual fund management: An examination of the stockholdings and trades of fund managers. *Journal of Financial and Quantitative Analysis, 35* (3), 343-368.

[10] Chen, J., Hong, H., Huang, M., & Kubik, J. D. (2004). Does fund size erode mutual fund performance? The role of liquidity and organization. *American Economic Review, 94*, 1276-1302.

[11] Chen, Q., Goldstein, I., & Jiang, W. (2008). Director ownership in the U.S. mutual fund industry. *Journal of Finance, 63*, 2629-2677.

[12] Chevalier, J., & Ellison, G. (1999). Are some mutual fund managers better than others? Cross-sectional patterns in behavior and performance. *Journal of Finance, 54*, 875-899.

[13] Chordia, T. (1996). The structure of mutual fund charges. *Journal of Financial Economics, 41*, 3-39.

[14] Cici, G., Gibson, S., & Moussawi, R. (2010). Mutual fund performance when parent firms simultaneously manage hedge funds. *Journal of Financial Intermediation, 19*, 169-187.

[15] Cohen, L., & Frazzini, A. (2008). Economic links and predictable returns. *Journal of Finance, 63*, 1977-2011.

[16] Collins, S., & Philip, M. (1997). The optimal amount of assets under management in the mutual fund industry. *Financial Analyst Journal*, 67-73.

[17] Dai, Y., Kong, D., & Wang, L. (2013). Information asymmetry, mutual funds and earnings management: Evidence from China. *China Journal of Accounting Research, 6*, 187–209.

[18] Del, G. D. (1996). The distorting effect of the prudent man law on institutional equity investments. *Journal of Financial Economics, 40*, 31-62.

[19] Deli, D. N. (2002). Mutual fund advisory contracts: an empirical investigation. *Journal of Finance, 57*, 109-133.

[20] Deuskar, P., Pollet, J. M., Wang, Z. J., & Zheng, L. (2012). The good, the bad or the expensive? Which mutual fund managers join hedge funds? *Review of Financial Studies, 24*, 3009-3024.

[21] Dye, R.A. (1988). Earnings management in an overlapping generations' model. *Journal of Accounting Research, 26*, 195–235.

[22] Elton, E.J, Gruber M., & Blake C. (1996). The persistence of risk-adjusted mutual fund performance. *Journal of Business, 69*(2), 133-157.

Leena and Luna International, Chikusei, Japan.
(株) リナアンドルナインターナショナル, 筑西市,日本
ISSN: 2186-845X ISSN: 2186-8441 Print
www.ajmse. leena-luna.co.jp

[23] Elton, E.J., Gruber, M.J., & Blake, C.R. (2003). Incentive fees and mutual funds. *Journal of Finance, 58*, 779-804.

[24] Fama, E.F., & French, K.R. (1996). Multifactor explanations of asset pricing anomalies. *Journal of Finance, 51* (1), 55-84

[25] Fang, J.X., & Hong, J.Q., (2007). Listed firms' information disclosure quality and securities analysts' earnings forecasts. Securities *Market Herald, 3*, 25–30.

[26] Gaspar, J.M., Massa, M., & Matos, P. (2006). Favoritism in mutual fund families? Evidence on strategic cross-fund subsidization. *Journal of Finance, 61*, 73-104.

[27] Golec, H.J. (1996). The effects of mutual fund managers' characteristics on their portfolio performance, risk, and fees. *Financial Services Review, 5*, 133-148.

[28] Gruber, M. J. (1996). Another puzzle: The growth of actively managed mutual funds. *Journal of Finance, 51*(3), 783-810.

[29] James, E., Gary, F., James, S., & Dimitri, V. (1999). Mutual funds and institutional investments: What is the most efficient way to set up individual accounts in a social security system? *World Bank Policy Research Paper, 2099*.

[30] Khorana, A., Servaes, H., & Wedge, L. (2007). Portfolio manager ownership and fund performance: an empirical analysis. *Journal of Financial Economics, 40*, 403-427.

[31] Malhotra, D.K., & Robert, M. L. (1997). An empirical analysis of mutual fund expenses. *Journal of Financial Research, 20*(2), 175-190.

[32] Malkiel, B. G. (1995). Returns from investing in equity mutual funds 1971 to 1991. *Journal of Finance, 50*(2), 549-572.

[33] Massa, M. (2003). How do family strategies affect fund performance? When performance maximization is not the only game in town. *Journal of Financial Economics, 67*, 249-304.

[34] Massa, M., & Patgiri, R. (2009). Incentives and mutual fund performance: Higher performance or just higher risk taking? *Review of Financial Studies, 22*, 1777-1815.

[35] Otten, R., & Mark, S. (1998). *A comparison between the European and the U.S. mutual fund industry*. Maastricht: Limburg Institute of Financial Economics, Maastricht University.

[36] Pastor, L., & Stambaugh, R. (2010). On the size of the active management industry. USA: University of Chicago.

[37] Reid, B. (2000). The 1990s: A decade of expansion and change in the U.S. mutual fund industry. *Investment Company Institute Perspective, 6*(3).

[38] Sias, R. (1997). The sensitivity of individual and institutional investors' expectations to changing market conditions: Evidence from closed-end funds. *Review of Quantitative Finance and Accounting, 8*, 245-269.

[39] Sirri, E. R., & Peter, T. (1993). Competition and change in the mutual fund industry. In Samuel B. Hayes III (Ed), *Financial services: Perspectives and challenges*. Boston, MA: Harvard Business School Press.

[40] Sirri, E. R., & Peter, T. (1997). *Costly search and mutual fund flows*. USA: Wiley publications.

[41] Trueman, B., & Titman, S. (1988). An explanation for accounting income smoothing. *Journal of Accounting Research, 26*, 127–139.

[42] Tufano, P., & Matthew, S. (1997). Board structure and fee-setting in the US mutual fund industry. *Journal of Financial Economics, 46*, 321-55.

[43] Wermers, R. (2000). Mutual fund performance: An empirical decomposition into stock-picking talent, style, transaction costs and expenses. *Journal of Finance, 55*, 1655-1695.

[44] Xia, L.J., & Lu, X.N. (2005). On the relationship between earnings management and information disclosure quality of listed firms. *Contemporary Economy and Management, 10,* 145–150.

[45] Yang, D.M. (2005). The disclosure of information forecasts and earnings management. *Chinese Journal of Management Science 7*, 108–112.

Leena and Luna International, Chikusei, Japan.
(株) リナアンドルナインターナショナル, 筑西市,日本
ISSN: 2186-845X ISSN: 2186-8441 Print
www.ajmse. leena-luna.co.jp