

Factors Influencing The Growth of Mutual Funds Companies in the Pakistan Stock Exchange

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Abstract

Mutual fund industry plays a vital and an essential role in optimum allocation, capitalization, and utilization of limited resources of small individual investors. This research is conducted in order to investigate and analyze various factor that attribute to growth of mutual fund in Pakistan. Further, in this research secondary data from 2018 to 2022 of 8 different companies is used and Management Fee, Size, Turnover ratio and expense ratio as independent variables and growth as dependent variable. For purpose of data analysis, Hausman test is used to find appropriate model, regression analysis is used to check contribution of variables on dependent variable and correlation is used. The results showed that management fee and expenses play a vital role in growth of mutual funds, whereas management fee affects positively and expense affects negatively on growth. Further, all analysis is performed by E-views software.

Keywords: *Mutual Funds, Growth, Management Fee, Expense Ratio, Assets Turnover.*

Introduction

This research is to investigate and study thoroughly the mutual funds industry in Pakistan and to analyze determinants of its growth. In this research they are investigating and study the determinants of mutual fund growth in Pakistan. Mutual funds now a day's play one of the most essential roles in capital and money market for small and individual investors. This study explains that how the mutual fund is growing in Pakistan and the determinants of its growth in Pakistan (al 2019). A mutual fund offers investors access to full-time, professional money managers who have the expertise, experience and resources to actively buy, sell, and monitor investments. If one investment decreases in value, another investment in the portfolio may increase. For many people, it would be more costly to purchase directly all of the individual securities held by a single mutual fund. Buying shares in a mutual fund is an easy way to diversify your investments across many securities, which is just another way of saying that you will not have all your eggs in one basket.

The first modern American mutual fund opened in 1924, yet it was only in the 1990, that mutual funds became mainstream investments, as the number of households owning them nearly tripled during that decade, with recent surveys showing that over 88% of all investors in the US participates in mutual funds.

Around the same time, the Asset Management Companies Rules, 1995 had been notified which allowed private and foreign firms to launch open-end mutual funds. Mutual Funds Association of Pakistan (MUFAP) was formed in 1996 when a group of investment advisors managing eight closed-end mutual funds. The first open-end mutual fund was introduced in 1962 and closed-end mutual funds from 1966. While the first one open-end mutual fund was launched in 1997, it was not before 2002 that this area started to really pick up pace when several other players entered the industry (Khan 2020). Mutual fund represents a professionally-managed collective investment vehicle which pools money from investors for the sake of investment in securities (FINK, 2008). It can also be defined as asset management companies that pools money from small individual investors and invest the money received in stocks, bonds and other types of money market or combination of these securities. Generally, mutual funds are mostly suited to the demands of the small individual investors considering the knowledge of the investors, capital and certain other factors. However mutual funds are becoming equally important to large investors and companies.

Mutual funds are legally separate entities but their assets, investments and management are run by different companies known as Asset Management Company. In the provision of law and asset management company is separate from the Mutual fund that it manages. In Pakistan for an asset Management Company to manage a fund it needs to obtain license from security and exchange commission of Pakistan (SECP). One license can be used either for management one type of fund or for more than one type of fund. A Management Company charges management fee against the services that it provides to a fund. All the mutual funds are required to be listed and its securities are traded on Karachi Stock Exchange (Kaur J., 2021). In economies such as Pakistan in which the investors do not have much of the knowledge of capital and risk aptitude for direct investment in capital market, mutual funds play an important and essential role for investment of capital (Pareek 2019).

Problem Statement

This study has analyzed the determinants of Mutual Fund Growth in Pakistan in listed on Pakistan stock exchange taking growth as dependent variable and management fee, expense ratio, asset turn over, size of mutual funds as independent variables.

Research Objective

To find the impact of mutual funds on the asset management companies registered in Pakistan Stock Exchange.

Research Question

Is there any impact of mutual funds on Asset Management Companies registered in Pakistan Exchange?

Significance of the Study

Purpose of this study is to analyze the relationship between mutual funds and asset management companies; this will help businesses to allocate their resources in best way to increase their profitability. As previous studies, have done on the determinants of mutual fund growth in Pakistan in developed countries but this study has taken the businesses less developed or developing countries to analyze this relationship like Pakistan. It will also help to show whether the mutual funds has really some influence on asset management companies in developing countries or not. Previous studies have used variables of mutual funds including management fee, expense ratio, asset turn over and size of mutual fund and this study has used same variables as independent and donation made by business is a dependent variable.

Limitations of Study

This study is limited to only Pakistan stock exchange and only top eight companies are taken that are listed with stock market. Further this study doesn't contain other data of non-listed companies.

Literature Review

The relationship between the net assets and return of mutual fund studied the performance of mutual fund. According to him increase in net asset of a mutual fund should lead to increase in performance of mutual fund i.e., it should lead to growth in return (Wahba 2022). According to him increase in net asset of a mutual fund should lead to increase in performance of mutual fund i.e., it should lead to growth in return. The performance of mutual funds with respect to the size of mutual fund, he studied the operating effectiveness of funds. From his research, he found that the small size mutual funds would operate more effectively than large size mutual funds.

The relationship of return of mutual funds to the investors with respect to risk adjusted factor, they suggested that investors were paid higher return for taking higher risk and lower return for exposing themselves to lower risk. The relationship between the expenses of mutual funds and performance, according to him investor tended to invest in mutual funds which had low expenses. He also advised the investors to invest in such funds. The fund sets policies for fee charging. According to them governance with smaller board and larger proportion of independent directors usually would charge lower fees and vice versa (Alvi 2020).

Management remuneration as an obstacle towards the growth of mutual funds. According to them a mutual fund with lower management fee keeping all the other factors constant would be subject to more growth than a fund with higher management fee. Hence, they argued by lowering the management fee mutual fund could be grown in a rapid phase (Seal 2022). The growth of mutual fund was resisted by advisory fee which is quite high. They also argued that the growth of mutual fund could have been enhanced by decreasing the redemption expense that provides the greatest benefits to the unit holders. Therefore, according to them if managers wanted to carry out their duties, they would need to focus on reducing the redemption expenses (Freeman 2008, Hussain, Shah et al. 2023).

According to (Golec 2003) managers of asset management companies earned their remuneration based the balance of assets they manage and hence they were more concerned with the growth of total assets under their management rather than on the benefit of unit holders. The consistent performance and greater size of mutual funds would lead to better performance while higher transaction cost would determinants the performance of mutual funds. Studied the performance of mutual funds based on three factors namely, consistency in performance of mutual funds, size of mutual funds and transaction cost (Hussain, Shah et al. 2023).

Management remuneration as an obstacle towards the growth of mutual funds. According to them a mutual fund with lower management fee keeping all the other factors constant would be subject to more growth than a fund with higher management fee. Hence, they argued by lowering the management fee mutual fund could be grown in a rapid phase. Argued that the economic development situation of a country would play an essential, significant and vital role for growth of mutual funds (Nazir 2010, Wattanatorn 2020) concluded that one of the most important factors that would govern the performance and growth of mutual fund was the asset management company. According to him investors mostly took into consideration the history of asset Management Company before investing in any fund. According to them a good asset management company could change the performance of a poorly operating fund. The determinants of mutual fund growth while focusing on equity funds in Pakistan. The focus of this study was to determinants of mutual fund growth in Pakistan. (Abbasi 2005)discussed the performance of mutual funds with respect to economies of scale. According to them economies of scale mostly affected the transaction funds. Cost

and also the management remuneration which in turn led to higher return. Considering the current status and importance of mutual fund industry in Pakistan and the interest and stake of investors there is a desperate need to study, analyze and investigate the fundamental factors that lead to growth of mutual fund in Pakistan. As per the mutual fund association of Pakistan (MUFAP), mutual funds might not option to provide ultimate security to investors from overall market failure risk.

Theoretical Framework

The following figure 1 shows the theoretical framework of the study, in which Growth of mutual funds is dependent upon Asset Turnover, Management Fee, Expense Ratio and Size of Mutual Fund.

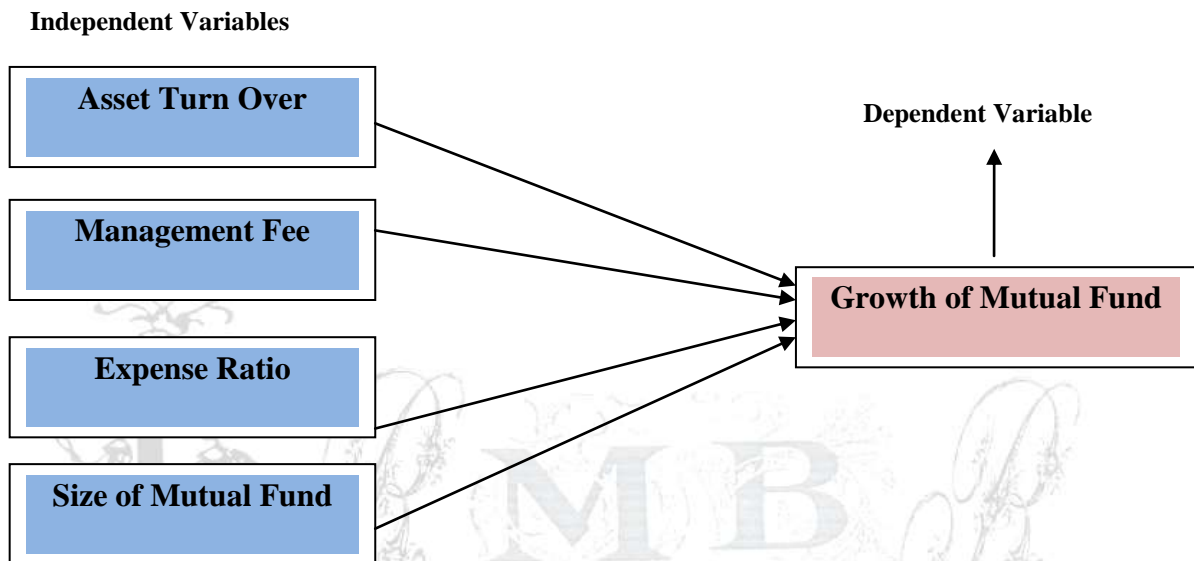


Figure No 1: Theoretical Framework

Research Methodology

As our research relates with positivism philosophy, the researchers usually work on observable data to produce credible knowledge. To achieve that, they explore the existing theories and develop hypo research work. Once the hypo research work is confirmed, they will strengthen the credibility of the existing theories and vice versa, if the hypo research work is rejected, the existing theories will once again be challenged and improved to be a better one which can suit the real work. Therefore, positivist studies are mostly done by using quantitative approach and with the results generated from the approach, statistical analysis is then produced positivism result then other philosophies as it mainly employs mathematical formulas in generating result which restrict the ability of researchers to produce subjective analysis and interpretation. We find that positivism philosophy is more suitable than other to generate the conclusion.

The data of top asset management companies are collected from the website of PSX stock, having the period of 2013 to 2022 after adjusting holidays where the market does not exhibit any specific change. The regression is run on the basis of observations calculating the betas of market premium. The top five asset management is selected on the basis of market.

This paper involves multi stages sampling technique from Pakistan stock exchange, choosing 8 top rating asset management company's one country wide financial intuition which is at high in Pakistan inventory trade, taken their data from 2013 to 2022. This paper shows the taken outcome form Pakistan stock

alternate as a populace and sample measurement indicates the asset management sector which goes extra precisely on high five companies.

Sampling

The sampling technique used in this study is random sampling and sampling size is 10 years of secondary data is used. The annual reports on which the research is substantially based will be use for the periods from 2013 to 2022. The data will be used in analyzing the relationship between independent variables and dependent factor. Company names are:

- Nafa Investment Limited
- MCB Management Asset Limited
- Nit Investment Limited
- Habib Asset Management Limited
- Alfalah Investment Limited
- Pak Oman Investment Limited
- Js Investment Limited
- 786 Investment Limited

Data Analysis and Results

Table no.1 shows Hausman test results indicating that whether random effect model is appropriate or fixed effect model is appropriate based on Chi-square statistic it suggests that fixed effect model is appropriate for regression analysis as prob value is less than 0.05 that is 0.0008 hence null hypo research work of Hausman test is rejected that is random effect is appropriate. Based on this table results it is now confirmed that we can use fixed model for regression and correlation analysis.

Table No.1: Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Period random	18.832401	4	0.0008

The above table no.2 of regression analysis shows that independent variable size and turnover insignificant as prob value is greater than 0.05 that is 0.7337 and 0.8145 as well as t-statistic are less than ± 1.96 that are -0.3416 and -0.2355 respectively. Hence it indicates that growth of mutual funds company is insignificantly and negatively affected by size and turnover.

Table No. 2: Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.295348	0.41246	3.140545	0.0025
FEE	0.192341	0.075563	2.545427	0.0133
EXPENSE	-0.112809	0.053209	-2.120109	0.0378
TURNOVER	-0.18738	0.795503	-0.235549	0.8145
SIZE	-1.33E-10	3.88E-10	-0.341641	0.7337

On the other hand, expense ratio is negatively and significantly affecting the growth of mutual fund companies in Pakistan as prob value is less than 0.05 that is 0.0378 and t-statistic is -2.120109 which shows individual significance of expense ratio and indicate that if mutual funds increase their expenses by 1% it will decrease their growth by -11%. Whereas, management fee is also significantly and positively affecting mutual funds growth as prob value is less than 0.05 that is 0.0133 and t-statistic is 2.545 showing that

management fee is significantly affecting growth also it indicates that if mutual fund companies increase its fee for asset managers who manages assets will increase their growth by 19%. Hence it is suggested that more expenses will decline growth and more management fees may motivate employees which ultimately helpful for companies for their growth. The regression model is also good fit at f-statistic is 2.7 and prob value of f-statistic is 0.003.

The table no 3 shows the of correlation analysis that growth and management fee are insignificantly correlated as sig value is greater than 0.05, whereas, growth and expenses are significantly and negatively correlated at 95% significance level. The above table further explains that growth is insignificantly correlated with turnover and size at 95% significance level.

Table No.3: Correlation Analysis

		GROWTH	Fee	Expense	Turnover	Size
GROWTH	Pearson Correlation	1	.176	-.238*	.160	-.203
	Sig. (2-tailed)		.118	.034	.156	.071
Fee	Pearson Correlation	.176	1	.388**	.257*	.017
	Sig. (2-tailed)	.118		.000	.021	.879
Expense	Pearson Correlation	-.238*	.388**	1	.008	.560**
	Sig. (2-tailed)	.034	.000		.947	.000
Turnover	Pearson Correlation	.160	.257*	.008	1	-.168
	Sig. (2-tailed)	.156	.021	.947		.136
Size	Pearson Correlation	-.203	.017	.560**	-.168	1
	Sig. (2-tailed)	.071	.879	.000	.136	

Further Management fee significantly correlated with Expense and turnover as sig value is less than 0.05 and it is insignificantly correlated with size of firm. Whereas, Expense ratio of mutual funds is significant correlated with size, management fees and growth and insignificant correlation with turnover. The turnover ratio is also significant correlated with expense and insignificant correlated with other variables. The size of mutual funds is only significantly correlated with expense and insignificant relationship with all other variables.

Conclusion and Recommendations

This study was to identify growth determinants of mutual funds companies in Pakistan and based on this research we have research on this conclusion that mutual fund companies in Pakistan are affected with management fees positively which means the more we pay to our asset managers the best results they can give to companies therefore it is recommended the for better performance it is important to provide time by time monetary incentives to encourage and motivate them to increase firm performance. Whereas, if firms increase their other expenses, they slow down the growth of company as in Pakistan it is still not a well-established area for Pakistan. The study found that other independent variables which are size and turnover ratio do not affect the performance of these firms in Pakistan therefore it is important to focus on human resource to improve performance of mutual funds industry rather than other expenses. Further, the study conducted to identify the growth determinants of mutual fund companies in Pakistan has significant theoretical and practical implications for the financial industry in the country. One of the key theoretical findings of the study is the positive correlation between management fees and the performance of mutual fund companies. This challenges the conventional belief that lower fees are always better for investors. It opens up discussions in the field of finance about the value of skilled asset management and the potential trade-offs between fees and performance. This finding suggests that investors in Pakistan may benefit from paying higher management fees if it results in better financial results for mutual fund companies. Furthermore, the study recommends providing monetary incentives to asset managers as a means to

encourage and motivate them to increase firm performance. This aligns with theories of agency and motivation in organizational behavior.

Theoretical and Practical Implications

The practical implication here is that mutual fund companies in Pakistan should design effective incentive structures for their asset managers to ensure that their interests are aligned with the company's growth objectives. This approach could lead to improved performance and outcomes for both the companies and their investors. On the practical side, the study highlights the importance of cost management within mutual fund companies. It suggests that increasing other expenses can have a detrimental effect on a company's growth. In an industry like asset management, where efficiency is crucial, companies should regularly monitor and control their expenses. Conducting regular expense audits and streamlining operations can be practical steps to enhance efficiency and reduce costs, ultimately contributing to better growth prospects.

Moreover, the study indicates that size and turnover ratio do not significantly affect the performance of mutual fund companies in Pakistan. This finding challenges the assumption that larger companies or higher turnover automatically led to better financial performance. For practical purposes, mutual fund companies operating in Pakistan should reconsider their market strategies. Instead of focusing solely on expansion and growth in terms of size, they should prioritize enhancing their asset management capabilities and differentiating themselves in the market.

This could involve investing in skilled human resources, implementing unique investment strategies, and emphasizing the value of expertise to potential investors. In conclusion, the study's theoretical implications challenge conventional wisdom in the finance industry, particularly regarding management fees and the significance of size and turnover. The practical implications offer guidance to mutual fund companies in Pakistan, emphasizing the importance of aligning employee incentives, efficient cost management, and a focus on building strong asset management capabilities to foster growth and competitiveness in the market.

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