

## Mutual Fund Managers' Characteristics and Performance, Evidence from Iran

<sup>1</sup>Majid Abbasi and <sup>2</sup>Majid Dadashinasab

<sup>1</sup>M.A. Student of Accounting, Payam-e-Noor University, Behshahr, Mazandaran, Iran

<sup>2</sup>PHD scholar, Department of Management and Human Resource Development Universiti Teknologi Malaysia, Skudai Johor, Malaysia.

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**Abstract:** Mutual Fund is one of the most important mechanisms for indirect investment in financial markets, which provides better conditions in terms of risk and return, especially for amateur investors. This research examined the effects of mutual fund managers' characteristics on the performance of Iranian mutual funds. The research was carried out on all Iranian mutual funds during 2007 to 2011. Generalized Lease Square (GLS) was employed to examine these effects. The results show that fund manager's Age, MBA, Gender, and Tenure significantly influence fund performance.

**Key words:** Mutual funds, Fund Performance, Iran.

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### INTRODUCTION

Mutual fund is basically a company that pools the money from a group of investors (its shareholders) to buy financial securities, building a less risky portfolio than an individual investor would do (Kolosov & Soltanmammedov, 2011). In other words, a mutual fund is a company that invests in a diversified portfolio of securities. People who buy shares of a mutual fund are its owners or shareholders. Their investments provide the money for the mutual fund to buy securities such as stocks and bonds. A mutual fund can make money from its securities in two ways: a security can pay dividends or interest to the fund or a security can rise in value. A fund can also lose money and drop in value. The reduced risk of portfolio comes from the benefits of diversification provided by mutual fund managers for investors. Managers charge small amount of fees for their services and for covering the costs associated with trading securities. However, these charges are smaller than those that individual investors would pay if they tried to build on their own similar portfolio of securities. This is because of the economies of scales in transaction costs (Howells & Bain, 2005, p. 63). Mutual funds today are one of the most studied areas in developed countries due to their efficient and effective role in reducing risk and enhancing return through professional management of funds. These funds boost the incomes of small investors as well as reduce their exposure to unsystematic risks which needs to be taken into consideration for accurate results (Gohar et al., 2011, p. 5583).

#### *1-2-Iranian Mutual Funds:*

Mutual funds in Iran, acting as financial intermediaries, have the potential to convert the investments made by nonprofessional investors from a direct state to an indirect one and, in the wake of such conversion; they will bring about a wide range of benefits and privileges both for capital markets and investors, which include: 1) Promoting indirect investment by individuals in the capital market; 2) Paving the way for quantitative and qualitative growth and sustainable development in the capital market. Mutual funds in Iran are among those financial institutions which have been established in the recent years and are therefore not mentioned in most principal rules and regulations of national economic activities, including the commercial code, companies registration law, civil code and taxation law. They were first presented in the Securities Market Act of Iran, ratified by the Parliament (Pireh, 2011). So, in the new Securities Market Act of I.R.I, the activity of financial intermediaries, including mutual funds, is foreseen and proper conditions are provided to assure the securities market investors about making better use of the existing opportunities. In the article "The Law for Development of New Financial Instruments and Institutions Based on the Overall Policies of the Principle 44 of the Constitution", which was ratified in 2009, mutual funds were defined as follows:

*"A financial institution which invests in the financial resources derived from issuance of units, in its designated area of activity."*

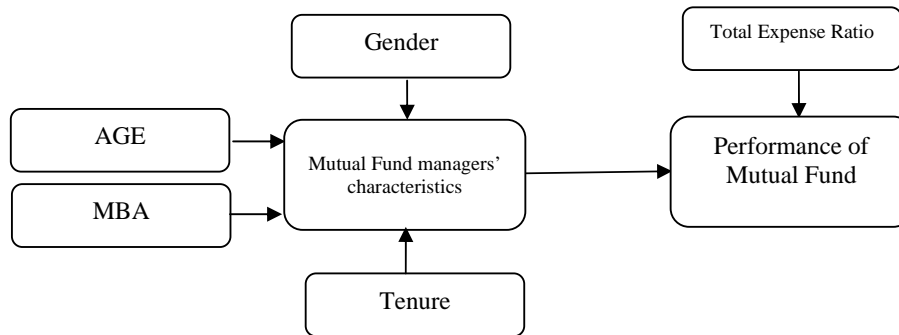
Therefore, mutual fund is a kind of financial institution which pools the people's funds by frequently selling its units and invests the funds in a combination of different types of securities, including stocks, Musharakah Sukuk, short-term instruments of the money market, etc. It is noteworthy that, since trading non-Shariah compatible instruments is not permitted in Iran's capital market, mutual funds can invest only in Shariah compatible instruments. Therefore, in Iran, the structure of mutual funds does not yet include any separate Shariah board (Pireh, 2011).

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**Corresponding Author:** Majid Abbasi, M.A. Student of Accounting, Payam-e-Noor University, Behshahr, Mazandaran, Iran.  
E-mail: [abbasi.majid2010@gmail.com](mailto:abbasi.majid2010@gmail.com)

**2- The Theoretical Framework:**

This research aimed at examining the effects of mutual fund managers' characteristics on performance in the Iranian mutual funds. Figure (1) shows the relationship of variables with each other. As a proxy for Performance of Mutual Fund, the article uses, Total Expense Ratio (TER). The variables of fund manager's characteristics include Age, MBA, Gender, and Tenure.



**Fig. 1:** Conceptual framework of the research.

**3- Literature Review:**

Golec (1996) examined whether a mutual fund manager's characteristics help to explain fund performance, risk, and fees. For 530 mutual funds from 1988-1990, he found that performance (yield and alpha), risk (beta and residual return standard deviation) and fees (expense ratio, management fees, and turnover) were significantly impacted by manager age, tenure, and MBA accreditation. The results demonstrated that younger managers (less than 46 years old) who had managed for a relatively long time, (more than 7 years) with longer tenure, and MBA degrees had the best risk-adjusted performance.

Dellva and Olson (1998) found that funds that large in size (measured by total assets under management) are able to achieve economies of scale and thus lower their expense ratios. Moreover they found negative relation between expense ratio and performance of funds. Similarly, Chevalier and Ellison (1999) examined whether manager age, tenure, and MBA status had any positive correlation to portfolio performance. The data consisted of 492 mutual fund managers from 1988-1994 who had sole responsibility for a growth or growth and income fund. They found that the those managers who attended more selective undergraduate programs with MBA's had higher performance than those who did not; however, the returns achieved were due to a higher systematic risk. In addition, the younger managers outperformed older ones. They believe this distinction may be in part that younger managers must work harder than the old because they can be easily fired and have a long career ahead of them. In addition, younger managers may be more educated and the ones who are phenomenal will exit the industry before they get old.

Dahlquist et al., (2000) in their study found negative relation between performance and fees. They show that high fee fund demonstrate lower performance, calculated using Jensens alpha measure, compared to low fee funds. However, they found that in some cases high fee funds able to perform better than low fee fund before fees are deducted. They conclude that high fees – or expensive management – may generate good performance but not enough to cover the fees. Gottesman and Morey (2006) examined the relation between manager education and mutual fund performance. They specifically examined the average GMAT score for each MBA program and determined that managers who held MBA's from the 30 top ranked schools outperformed those with MBA's from unranked schools and those without MBA's entirely. They used a data set of 518 mutual funds from 2000-2003 in a non-bullish market to contrast Chevalier and Ellison. The latter had been criticized for examining managers during a bull market from 1988-1994 where the younger managers succeeded because they took on more risk generally than the veterans and thus reaped a greater reward.

Recently, Dincer et al., (2010) examined portfolio managers based on three educational factors (CFA, MBA, and experience) and determined their performance while controlling for risk and style methods. A key issue they addressed was that of risk and directly measured it in order to determine if it contributed to manager performance. With a sample of funds from 2005-2007, they determined that returns were not affected by managers having CFA's, MBA's, or experience. However, using two measures of risk they did conclude that those with CFA's reduced portfolio risk while those with MBA's increased it. Furthermore, managerial experience reduced portfolio risk as well.

Finally, Lin et al., (2011) investigated how the characteristics of mutual fund managers influenced their funds' performance. The majority of mutual funds available to Taiwanese investors were actively managed. Apparently, investors would expect the active equity fund managers to provide better performance than passive

managers do. They applied logistic regression, which adopted the performance of Polaris Taiwan Top 50 Tracker Fund (TTT) as the benchmark, in order to examine the relationship between the characteristics of fund managers and fund performance. The results indicated that fund size and the fund manager's gender, seniority and educational background significantly influenced the fund performance. While all other factors are equal, investors can expect higher odds for their fund performance beating TTT if their funds are managed by a female or a senior fund manager or by a manager graduated from domestic public colleges or from overseas colleges.

**3-1- Research Hypotheses:**

In order to evaluate the effects of mutual fund managers' characteristics on the performance of mutual funds, these hypotheses were tested:

- H1: There is a significant relationship between Manager Age and the mutual funds performance.
- H2: There is a significant relationship between Manager MBA and the mutual funds performance.
- H3: There is a significant relationship between Manager Gender and the mutual funds performance.
- H4: There is a significant relationship between Manager Tenure and the mutual funds performance.

**4- Research Methodology:**

To analyze the research hypotheses, independent and dependent variables are analyzed from two different aspects. From one, these variables are tested among various companies and from the other; they are tested in the period of 2007 to 2011. Therefore in this examination, we use panel data methodology.

**4-1- Data Collection Method:**

This study included all the Iranian mutual funds during 2007 to 2011(1st April 2007 to 31st March 2011). In doing so, the main part of data was collected from the respective websites of mutual funds and the remaining data were gathered from financial statements, websites of Securities and Exchange Organization of Iran (SEO), relevant auditing statements and other creditable sources and analysis of stock software's as Dena Sahn and Pars Portfolio (two Iranian software programs).

**4-2- The Empirical Model:**

Multivariate regression analysis is employed to examine the panel data analysis of regression models in the full sample period, from years 2007 to 2011. Panel data analysis allows for the consideration of both cross sectional and time series effect in the sample, and helps in identifying the sources of possibly mingled effects. The panel generalized least square (GLS) estimated equation for analysing panel data is given by the following equation:

$$Y_{it} = \beta_0 + \beta_1 X_{it} + \beta_2 X_{it} + \dots + \beta_n X_{it} + e_{it} \tag{1}$$

Where *i* denotes the firm (cross section dimension) and *t* denotes time (time series dimension). Therefore,  $Y_{it}$  is the dependent variable of pooling *N* cross sectional observations and *T* time series observations, and  $X_{it}$  s are the independent variables pooling *N* cross sectional observations and *T* time series observations.  $\beta_0$  is the constant term or intercept across cross sectional observations, and  $e_{it}$  is the error term.

GLS is the proper estimation method because it effectively standardizes the observations (see, Sulong and Mat nor, 2010; Baltagi, 2001). Given that coefficients may be constant over time, estimating using panel regression becomes more efficient. Besides, panel estimation can be used to examine the sensitivity of the results to alternative specifications (Gujarati, 2003).

**4-3- Research Model:**

Based on the empirical research previously described and the theoretical considerations discussed above, the researchers develop several hypotheses that relate mutual fund managers' characteristics, Age, MBA, Gender and Tenure to performance of mutual funds in Iran. Thus, the regression models can be shown as follows:

$$TER_{it} = \beta_0 + \beta_1 AGE_{it} + \beta_2 MBA_{it} + \beta_3 GENDER_{it} + \beta_4 TENURE_{it} + \beta_5 FUNDSIZE_{it} + \beta_6 FUNDAGE_{it} + e_{it} \tag{2}$$

Where;

TER=Total Expense Ratio, AGE= Manager Age, MBA=Manager MBA, GENDER=Manager Gender, TENURE=Manager Tenure and  $e_{it}$  is the error term.

**4-4- Measurement of Variables:**

**4-4-1-Dependent Variable:**

As a proxy for mutual funds performance, the article uses, like many studies in mutual funds, Total Expense Ratio (TER). The indicator is calculated by dividing total cost of a company by its total assets and presented as a percentage. So, a TER discloses the amount a fund needed to cover all expenses of a portfolio (management fees, performance fees, starting and redemption fees, administration, audit and bank charges and others).

**4-4-2- Independent Variables:**

Manager Age: Years of the chronological Manager Age.

Manager MBA: consists of a dummy variables represent Manager MBA (MBA=1, other=0).

Manager Gender: consists of a dummy variables represent Manager Gender (Male =1, Female =0).

Manager Tenure: Months of a fund manager who manages a particular fund.

**4-4-3- Control Variables:**

This paper also includes two control variables into regression analysis to control for mutual funds characteristics. A set of control variables employed means that this study is quite carefully controlled. According to studies such as Lin et al., (2011) and Kolosov & Soltanmammedov (2011), Mean of monthly fund assets under management (Fund Size) is employed as proxy for mutual funds size effect. Years of the establishment for a fund up to March, 2011 (Fund Age) are included as a control variable to proxy for mutual funds Age.

**RESULTS AND DISCUSSIONS**

**4-5-1- Descriptive Analysis:**

Table (1) provides the descriptive statistics for the independent variables used in the study over the period 2007 to 2011.

**Table 1:** Summary descriptive statistics for the independent variables.

Variable	Mean	Median	Max	Min	Mode	Std. Dev.
Manager Age	47.50	53.00	86.00	26.00	43.00	9.84
Manager MBA	0.56	0.50	1.00	0.00	1.00	0.47
Manager Gender	0.46	0.55	1.00	0.00	1.00	0.43
Manager Tenure	15.41	14.00	32.00	1.00	12.00	7.12

**4-5-1-Empirical Results:**

This paper adopts the generalized least square (GLS) method of estimation instead of the ordinary least square (OLS) to estimate the panel data regression formed. Since a model with random effect displays autocorrelation problem (Gujarati, 2003), this paper estimates the model using panel generalized least square (GLS).Table 3 reports the regression results using generalized least square (GLS) estimation incorporating mutual fund managers’ characteristics on the performance.

**Table 2:** Regression results for GLS estimation.

Independent Variables	Hypotheses	Direct effect	significant
Constant	----	1.685***	(0.005)
Manager Age	H1	0.572***	(0.001)
Manager MBA	H2	0.335***	(0.000)
Manager Gender	H3	0.183**	(0.036)
Manager Tenure	H4	0.644**	(0.022)
Fund Size	----	-0.421***	(0.004)
Fund Age	----	0.759***	(0.002)
R-squared	0.8291	Adjusted R-squared	0.8102
F-statistic	55.874	Prob(F-statistic)	0.0000
Durbin-Watson stat	1.7862	S.E. of regression	2.3059

Note: The asterisks \*\*\*, \*\*, and \* denotes significant at 1 per cent (p<0.01), 5 per cent (p<0.05), and 10 per cent (p<0.1) confidence levels, respectively.

As shown in Table (2), the Manager Age on mutual funds performance, that is H1, is statistically significant and the coefficient is 0.572 on performance. The result supports the predicted hypothesis H1. Result from effect of Manager MBA coefficient on mutual funds performance is positive and statistically significant at 1 per cent level (p<0.01), and thus, the result supports the hypothesis H2. As can be seen, Manager Gender, has a significant positive effect on performance with p<0.05. Thus, the result implies that investors can expect higher performance if their funds are managed by a male. As for the coefficient of Manager Tenure, is 0.644 and significantly positive (p<0.05).The coefficient for Fund size is significantly negative; On the other hand, the coefficient for Fund Age is statistically significant and positively related to performance.

### **5-Conclusion & Discussion:**

The purpose of this study was to analyze the effects of mutual fund managers' characteristics on the performance of Iranian mutual funds and using panel data methodology. The results from the first hypothesis test reveal a positive and meaningful relationship between Manager Age and performance (measured by total expense ratio). This result is in line with the research findings of Golec (1996), Chevalier and Ellison (1999), Lin et al., (2011). The results from the second hypothesis test show a significant relationship between the Manager MBA and mutual funds performance. This result is in line with the findings of Chevalier and Ellison (1999) and Lin et al., (2011) study. The findings from the third hypothesis test of the study shows a positive and meaningful relationship between Manager Gender and performance. This result in contrast with the findings of Lin et al., (2011). Lin et al., (2011) have argued that investors can expect higher odds for their fund with performance superior to TTT if their funds are managed by a female. The findings of the fourth hypothesis test show a positive and meaningful relationship between Manager Tenure and performance. This finding is in line with the findings of Lin et al., (2011).

The time period of this study was five years which may not truly represent the performance of funds. The performance of newly started funds may be over or under estimated due to short time span. Most of the mutual funds in Iran do not have a long history, so there were scarce available data.

### **5-1-Further Research:**

A further study may be carried out which can include more factors on the relationship between managers' characteristics and performance and expand its scope to other mechanisms in Iran in order to gain better understanding and generalize the findings. Future ones could possibly include related variables, like CFA credentials, to determine if these variables, coupled with a manager's institution of education, have any effect on portfolio performance.

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