CHAPTER II

REVIEW OF RELATED LITERATURE

2.1. Literature Review

2.1.1. Ari Supangat (1997)

A research dealing with mutual fund has already been done in a thesis written by Ari Supangat. The thesis aims to know and value the performance of mutual fund as a whole in Indonesia. The thesis focuses on observing and analyzing the profitable prospect of mutual fund compared with other investment vehicles.

Variables that are used to measure the performance of mutual fund in the thesis are Mutual Fund Value, Jakarta Composite Index, 12 month Deposit Interest Rate, 3 month Deposit Interest Rate, and Bank Indonesia's Certificate. Beside these variables, the writer uses some benchmark; they are return per sub period, risk per sub period (*standard deviation*), and risk-less profit (*Sharpe measure*) (Supangat, 1997).

The research in this thesis concludes that the performance of mutual fund is higher than another investment vehicles as a whole. From the calculation, the thesis states that the return of mutual fund with 3.495261% on average is higher than other investment vehicles at amount 2.79282% on average.

2.1.2. Agus Sugiarto (2003)

Many articles discuss about the problem of mutual fund. Two of them are articles written by Agus Sugiarto; an officer and senior researcher of Bank Indonesia. In his first article he explores the significant role of mutual fund in Indonesia. Since the latest three years the mutual fund has grown rapidly and becomes a potential investment in financial sector in Indonesia. This article describes the relationship among mutual fund, saving accounts and long term financing in Indonesia. Mutual fund becomes an alternative financing source beside banking to finance economic projects in long term. With its characteristic as long term investment, mutual fund can play its role to finance long term projects in sector real (Sugiarto, 2003c).

The second article that Sugiarto wrote deals with the existence of mutual fund in Indonesia. In this article he discusses the supportive role of banking to market mutual fund products. He argues that the rapid growth of mutual fund in Indonesia is actually supported by banking industry with its larger branches. Banking sector marketed Rp. 58 quintillion of mutual products from total sales of mutual fund Rp. 68.35 quintillion until June 2003. This amount indicates that 85% of total sales of mutual fund at the time were sold through distributive support of banking sector.

By referring to its role in marketing mutual fund products, banking sector should consider prudential aspect in doing its function as

agent of sales for mutual fund products. Sugiarto (2003b) suggests a prudential operation for banks that market mutual fund products in order for the banking parties to pay attention to the image of banks itself based on banking's original function. Bank must give a clear explanation and transparence service to the investors who buy mutual fund products, to educate investors. Investors should know that the mutual fund products are differed from the deposit that is included in blanket guarantee by the government. Bank must inform to the investors about the risks and advantages in the same time, when they buy mutual fund products. Investors should know that the rate of return of mutual fund is based on market mechanism (market risk). The prudential action should be taken by the banks that serve as sales agent of mutual fund in order to avoid reputation risk and legal risk caused by investors' claim and to provide transparency and clear information.

2.1.3.. Leora Klapper, Víctor Sulla and Dimitri Vittas (2002)

Internationally, many articles and journals discuss mutual fund. A paper written by World Bank's officials describes the development of mutual funds around the world. The paper states that with few exceptions, mainly in Asia, mutual funds grew explosively in most countries around the world during the 1990s. Equity funds predominate in Anglo-American countries and bond funds in most of Continental Europe and in middle-

income countries. Capital market development (reflecting investor confidence in market integrity, liquidity and efficiency) and financial system orientation are found to be the main determinants of mutual fund development. Restrictions on competing products may have acted as a catalyst for the development of money market and (short-term) bond funds.

This paper uses aggregate data on total fund assets from a cross section of 40 developed, developing and transition countries to study the structure and growth pattern of mutual funds in different countries and analyze the determinants of mutual fund growth. The data cover the period 1992-1998 and are collected from various of sources. Some are primary, such as mutual fund industry associations and capital market regulatory authorities, while others are secondary, such as the European Federation of Investment Funds and Companies (FEFSI), the Investment Company Institute (ICI) of the United States, the Organization of Economic Co-operation and Development (OECD), and Goldman Sachs Investment Research.

During the 1990s, mutual funds grew explosively in most countries and regions around the world in high-income countries, mutual fund assets expanded from 10 to 24 percent of GDP over this period and in middle-income countries they first grew from 4 to 8 percent but then fell back to 4 percent of GDP after the East Asian crisis. This reversal was

mostly caused by the experience of Asian countries. A total of 16 countries had mutual fund sectors with net assets exceeding 20 percent of GDP in 1998, and 11 of these countries were from Continental Europe.

In general, the paper finds that mutual funds are more advanced in countries with better developed and more stable capital markets. This reflects investor confidence in market integrity, liquidity and profitability and a greater supply of investable securities. It also finds that equity funds dominate in Anglo-American countries while bond funds dominate in most of Continental Europe and in middle-income countries. In developed countries, investors are concerned with market microstructure; for example, equity funds are significantly smaller in countries with higher market volatility and weaker accounting standards. In comparison, in developing countries macroeconomic factor appears most important; for example, bond fund development in developing countries is significantly related to higher GDP per capita and lower interest rates. However, in both developed and developing countries, lower country risk and higher investor confidence leads to greater fund development. In addition, restrictions on competing savings products may have acted as a catalyst for the development of money market and (short-term) bond funds.

2.1.4. Ajay Khorana, Henri Servaes and Peter Tufano (2003)

This paper studies the mutual fund industry in 55 countries around the world and tests various hypotheses why the fund industry would be preferred by investors over two alternative asset management choices: "do-it-yourself" options where the investors purchase primary assets and "opaque financial institution" options, such as banking or insurance investments. In terms of law and economics literature, it is found that the mutual fund industry is larger in countries with stronger rules, laws, and regulations, specifically where mutual fund investors' rights are better protected. Meanwhile, the industry is smaller in countries where barriers to entry are higher, measured by the time and cost required to set up a new fund. The mutual fund sector is smaller when banks face restrictions when entering the securities business. The fund industry is larger in countries with a wealthier and more educated population. Finally, the fund industry is larger in countries in which defined contribution pension plans are more prevalent. These results indicate that laws and regulation, supply-side, and demand-side factors all affect the size of the mutual fund industry.

This paper focuses on the mutual fund industry around the world. It documented the development of the mutual fund sector relative to other ways in which households invest in financial assets. Its sample consists of 55 countries with total mutual fund assets of $11.7 trillion at the end of

2001, held in over 55,000 funds. For the median country, the industry comprises 8.8% of GDP and 4.3% of all primary securities. However, there is substantial cross-country variation in the development of the fund industry. Luxembourg and Ireland are the countries with the largest industry relative to the size of the economy. Both countries have engaged in domicile competition. Luxembourg has benefited tremendously from its stringent bank secrecy laws whereas a favorable tax treatment of fund management companies is responsible for the significant growth of Ireland.

For the remaining countries, a combination of demand side, supply side, and legal and regulatory factors help explain why the fund industry is larger in some countries than in others. The results corroborate the findings from the law and economics literature that countries' rules and norms affect financial development. In particular, strong legal and regulatory factors have a positive impact on the size of the mutual fund industry, especially fund industry regulations addressing the process approving fund starts, mandating fee and performance disclosures, and handling conflicts of interest between the fund management company and fund shareholders. Failure to enforce insider trading laws has a positive effect on the size of the equity fund industry, perhaps because fund investors are less confident of trading on their own against better-informed insiders.

Not all regulations and restrictions enhance the growth of the fund industry. Specifically, it is found that the fund sector is smaller when there are restrictions placed on banks when considering entry into the securities business, and when it is more costly and time-consuming to set up a fund.

On the demand side, investor wealth and education have a positive impact on industry size, but only for equity funds. In addition, the fund sector is larger in countries where a greater proportion of pension funds are of the defined contribution type.

The paper acknowledges, these results are imperfect and cannot be interpreted without caution. Its conclusions lay out working hypotheses rather than put issues to rest. For example, its finding that some types of regulation - typically regulations that protect fund shareholder rights - lead to a larger fund industry needs substantial additional study, probably in the form of detailed country-level analysis. Regulators are writing standards in the European Union and elsewhere to establish the appropriate forms of protection for fund investors. With literally trillions of dollars or Euros of wealth entrusted to the fund industry, non-partisan scholarship should inform this debate.