UNIT TRUST FUND'S INITIAL SERVICE CHARGE AND ITS DETERMINANTS[*]

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ABSTRACT

This paper examines the variables that might explain the initial service charge (ISC) imposed on unit-holders of Malaysian unit trust funds in the year 1999. By using 39 open-end unit trust funds, customer service and board structure variables are found to have a significant effect in explaining the variations of ISC. Financial performance variables do not seem to have any influence on the level of ISC charged to the unit-holders. Our results also showed that funds which charged higher ISC do not necessarily provide higher returns to investors. Furthermore, there are unit trust funds that are having an initial service charge beyond the maximum 10% level required by the Securities Commissions or did not fulfil the independent directors requirement.

Keywords: open-end unit trust funds, initial service charge, determinants

INTRODUCTION

Initial service charge (ISC) is a fee paid up-front by the unit-holders when they purchase a fund. In the United States (US), it is known as entry fees, sales charge and front-end load. ISC is represented by the spread between the net asset value (NAV) and the selling price of a unit. This charge is to compensate for sales agents and fund's promotion expenses, registration and issuing of prospectus, and other expenses that are not permitted by the trustee to be directly charged to the fund (Siti Zalena, 1995).

The average ISC imposed by the Malaysian unit trust funds in the year 1999 is 6.92%. This is considered high if we were to compare it with the brokerage fees payable for all trades in stocks, ordinary shares, preference shares, and other securities listed and traded on the Bursa Malaysia where the fees are fully negotiated between the broker and his/her client, subject to a maximum of 0.7%

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of the contract value. This issue had been highlighted by Malaysia's Deputy Finance Minister, Datuk Dr. Ng Yen Yen who cited that the high ISC imposed by the players in the industry was among the pull factors to the growth of unit trust industry in Malaysia (*The Edge,* February 22, 2005). Total NAV of Malaysia's unit trust currently only accounted for about 12.84% of Bursa Malaysia's market capitalisation as of June 2005 (Federation of Malaysian Unit Trust Managers, FMUTM), which is still a far cry from the target of 40% set by the FMUTM.

Generally, an expense is only deemed justified if there is value added from the incurring of those charges. In the case of ISC, unit-holders should demand more returns from funds that charge higher ISC. This led to the arguments forwarded by Kihn (1996) that small unit-holders in unit trust funds are willing to pay more in order to gain some comforts provided by the fund managers in the forms of customer services.

This study intends to shed light into the factors that could probably determine the level of ISC. Specifically, it would be interesting to know whether ISC charged to the unit-holders are justified based on the funds' financial performance, i.e. whether high ISC is followed with better financial performance. Similar to Kihn (1996), we also explored the relationship between customer service variables and the level of ISC imposed on the unit-holders of trust funds in Malaysia.

Furthermore, it is known that the Board of Directors' (BOD) fiduciary duty is to protect the unit-holders interest, that is, to ensure the fee structure imposed by the fund managers is justified. This study would at least provide some insights into the level of corporate governance practiced by unit trust funds' BOD where ISC is concerned.

The remaining of this paper is organised as follows: Section two incorporates the literature on ISC (front-end load) and its determinants. Section three provides the description of the data and methodology used in this study. This is followed by an analysis of the results in section four. Section five concludes the study.

THEORETICAL EXPLANATION AND EMPIRICAL EVIDENCE OF INITIAL SERVICE CHARGE

Unit trust or mutual fund[1] expenses (which include the management expenses, manager fees, brokerage commissions and load or sales commissions) have long

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[1] Open-end unit trust funds in Malaysia are similar to open-end mutual funds in the US. The main difference between the two is in their legal structure. A mutual fund is an investment company that issues redeemable shares. This is in contrast to a unit trust, which is not a company, but a trust, which issues units instead of shares.

been a major issue discussed and studied by academicians ever since the classic article by Jensen (1969) was published. Jensen concluded that "after the deduction of fund expenses, the mutual funds performance become inferior as compared to randomly selected widely diversified portfolio. Mutual funds performances are neutral before the deduction of these expenses".

One of the expenses would be sales charge or ISC (if the sales charge is one-off and paid up-front by the investors). Sales charge has been a controversial topic in the US financial press during the 1980s with the introduction of 12b-1 sales charge (annual fees paid by the investors for marketing-related services provided by the mutual funds) by the Securities and Exchange Commission. The proponents of the 12b-1 plan argued that this charge offered an incentive for the selling agents to sell the funds, thus increasing the fund size and bringing economies of scale that could benefit investors. However, further studies by Collins and Mack (1997), Ferris and Chance (1987), and Trzcinka and Zweig (1990) found that funds, which charged 12b-1 fees, tend to have higher overall expenses than other funds. This is in contrast to the views that 12b-1 fees will bring economies of scale to the fund.

Risk and Return

One of the theories used to explain the relationship between ISC and a fund's financial performance variables (risks and returns) is the risk and return trade-off principle. Unit-holders are generally risk averse, assuming all else are constant. They would only pay a higher ISC for a fund that generates higher returns while holding risks constant. On the other hand, unit-holders would only pay a lower ISC for funds that are riskier, but with constant returns. This principle suggests: (1) a positive relationship between the level of ISC and a fund's returns, and (2) a negative relationship between ISC and a fund's risk.

Kihn's (1996) finding is consistent with this principle. He has studied 2,496 mutual funds in the United Kingdom (UK) from the year 1992 to 1993. His finding suggests that a fund's previous and future returns are positively related to its ISC; whereas a fund's risk is negatively and significantly associated with ISC when it is regressed against the financial performance variables. However, the fund's risk becomes insignificant when a full model, which include other explanators such as financial performance variables, customer services, fund characteristics and redemption fees, is executed.

This is in contrast to Ang, Chen and Lin's (1998) study of 1,832 open-end equity funds in the US in the year 1994. They argued that there is no theoretical basis to support the relationship between a fund's performance (returns) and its marketing efforts (proxy by the sales charge). According to them, managers could either

increase sales charge or decrease the initial service charge without affecting the fund's performance. There is no evidence to support returns-enhancing effect from greater marketing intensity through imposing a higher sales charge in the short run (one-year-ahead returns). However, by using five years cumulative returns, there exists a positive and significant relationship between the fund's returns and sales charge for the top 20% performers. This may be due to the willingness of the unit-holders to pay more in order to have the superior performance funds. They further added that sales charge could be a proxy for some unknown qualities in the funds.

In another paper using a similar sample, Ang, Chen and Lin (1999) found that sales charge (load) is negatively related to the fund's 3 months returns but positively and not significantly related to the fund's 12 months returns. They suggest that unit-holders should seek or avoid funds with high sales charge based on their own investment time horizon. If unit-holders have a longer (shorter) investment time horizon, they should seek for funds with a higher (lower) sales charge.

Fund's Switching Dummy and Number of Small Unit Holders

Kihn (1996) found that financial performance variables (risks and returns) are not important determinants of a fund's ISC as compared to a fund's customer service variables. He argued that smaller less-informed-unit-holders would be willing to pay a higher initial service charge in return for a level of comfort that is provided by the fund. He found that a telephone switching dummy is positively related to the fund's ISC. This variable is used as a proxy for small-client services that could benefit the small unit-holders.

The effect of small-client services on unit-holders could be explained by clientele effect. A clientele effect refers to a group of investors who have a preference on a particular company that follows a particular financing policy. These non-performance related variables (customer services and image or popularity of the funds) will attract a group of small unit-holders (less than 5,000 units holding size) based on the level of comfort provided by the fund (Kihn, 1996). Hence, the relationship between the number of small unit-holders (proxy for the popularity of a fund) and a fund's switching dummy with the ISC is expected to be positive.

Board's Size and Fraction of Independent Directors

Relationships between the fund's manager and the independent directors can be explained by the principal-agent model, where an agent (manager) can make decisions that could affect a principal (independent director). Conflict of interests might occur between the agent and the principal (agency problems) when an

agent is tempted to put his/her self-interest ahead of his/her principal. In unit trust funds, a manager tends to increase ISC in order to finance marketing expenses. However, this is in contrast to the independent director's responsibility in safeguarding the interest of unit-holders, which is to ensure that they are not charged with excessive fees. Agency problems could be minimized when the board's size is small and there is a high fraction of independent directors to oversee the charges or fees imposed by fund managers. Tufano and Sevick's (1997) study of 1,587 open-end mutual funds in the US in the year 1992 provides the evidence. Their findings suggest that shareholders fees are lower when the number of BOD is small and have a greater fraction of independent directors[2].

Fund's Size

Economies of scale principle suggests that larger fund will benefit from economies of scale, which would enable the management company to operate at a lower cost than smaller fund. Thus, larger fund might impose ISC that is much lower as compared to the smaller fund. This principle suggests that a fund's size will have a negative relationship with the ISC. A study by Kihn (1996), and Tufano and Sevick (1997) in using the logarithm of total assets as a proxy for fund's size could not find any significant relationship between the fund's size and ISC.

Fund's Age

A fund's age is normally associated to the image and trademark it carries. In general, older funds are quite established. Hence, they could impose a higher ISC on unit-holders. This would mean that there is a positive relationship between a fund's age and ISC. This is in contrast to the negative relationship found between the two variables by Kihn (1996), but consistent with Tufano and Sevick's study (1997).

DATA AND METHODOLOGY

The population of this study consists of all 102 open-end funds (73 private funds and 29 government sponsored funds) in Malaysia in the year 1999. It was identified from the *Malaysian Unit Trust Directory 2000*. Closed-end funds and properties trust funds are not included in this study because there is no ISC for

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[2] In the US, open-end mutual fund's directors are legally empowered to evaluate and approve fees paid to the management company and their affiliates (advisory and distribution fees). In other words, the directors have direct decisions over the establishment of the fund's fees. As required by the Investment Company Act, majority of the independent directors of a fund must approve all advisory and distribution contracts, and thus the associated fees.

these funds. The final sample consists of 23 private funds and 16 government sponsored funds which is 38.24% from the total population of open-end unit trust funds in the year 1999. The sample was selected based on the availability of the fund's month-end NAV per unit in the period 1996 to 2000 and other determining variables in the year 1998 and 1999. The year 1999 was chosen as the study period due to the data availability on most variables.

All the data used in this study is secondary in nature and they were obtained from the FMUTM Library, Malaysian National Library, Universiti Utara Malaysia library, and *Investor's Guide on Malaysian Unit Trust Funds* (Choong, 2001).

Model

This study uses a model developed by Kihn (1996) to explore the determinants of the ISC for the Malaysian unit trust funds. Nevertheless, repurchase fee (exit fee) was excluded from the model due to the fact that all the funds in the sample were not imposed on any repurchase fees as stated in the fund's prospectus. Additional factors other than those mentioned by Kihn have been included to ensure a comprehensive analysis is implemented. Hence, the model could be stated as below:

$$ISC_i = f(PC_i,\ CS_i,\ CHAR_i,\ BOARD_i,\ OWNERSHIP_i)$$

where ISC is a function of

PC	=	performance characteristics (returns, risks and future returns)
CS	=	customer services (switching dummy and the number of small unit-holders)
CHAR	=	fund's characteristics (fund's size and age)
BOARD	=	BOD structure (board's size and fraction of independent directors)
OWNERSHIP	=	share ownership (government sponsored funds or privately-owned funds)

The following two regression models were used to test the relationship between ISC and its determining variables. Equation (1) is solely based on the financial performance criteria (financial model). Equation (2), which is the full model, includes all the determining variables that are likely to explain the ISC.

$$ISC_i = a_0 + \beta_1(R3_i) + \beta_2(SD_i) + \beta_3(FUTR_i) + e_i \tag{1}$$

$$ISC_i = a_0 + \beta_1(R3_i) + \beta_2(SD_i) + \beta_3(FUTR_i)) + \beta_4(DS_i) +$$

$$\beta_5(DGOVERN_i) + \beta_6(UH_i) + \beta_7(SIZE_i) + \beta_8(AGE_i) +$$

$$\beta_9 (BODSIZE_i) + \beta_{10} (INDIR_i) + e_i \qquad\qquad (2)$$

where

ISC_i = The current ISC of the fund for financial year-end 1999 which is the difference between the selling price per unit and the NAV per unit divided by the latter term ([selling price per unit – NAV per unit]/NAV per unit).

R3   = The monthly mean returns over the previous three years. The rate of returns is calculated based on the continuous compounded method as stated below (Jensen, 1968):

$$R_{i,t} \quad = \quad \frac{NAV_{i,t} + D_{i,t}}{NAV_{i,t}}$$

where

$R_{i,t}$ = Monthly continuous compounded rate of returns of the ith unit trust during month t.

$NAV_{i,t}$ = Net asset value for unit trust i at the end of the month t measured by the manager's bid price (repurchase price).

$D_{i,t}$ = Dividend per unit paid by unit trust i during month t.

SD = Monthly standard deviation of returns over the previous three years is use as a proxy for the fund's risk.

$FUTR$ = The fund's one year-future returns. Returns are calculated as the monthly mean returns using the continuous compounded rate of returns such as in R3.

R3, RISK and FUTR are intended to check on the relationship between the fund's financial performance variables and the ISC.

DS   = Switching dummy variable [3] (where '1' is coded if switching facility among funds is available, '0' otherwise).

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[3] Switching among funds is where unit-holders are allowed to sell their units in one trust and purchase another unit trust operated by the same management company. This facility enables

DS is intended to identify the small clientele services on a fund's ISC. We have replaced the telephone switching dummy variable with switching facilities dummy among funds due to the fact that telephone switching facilities are not available in the Malaysian unit trusts.

> DGOVERN = Government dummy variable (where '1' is coded for government – sponsored funds, '0' is coded for private funds).

The government-sponsored funds' dummy is tested due to the fact that they have the objective in increasing the indigenous population's (known as Bumiputera*)* shareholding in corporate sectors under the New Economic Policy (NEP) (succeeded by the National Development Policy in 1991). For a private fund, its main concern is to increase shareholders' wealth without any social consideration. The government's intentional efforts to achieve the public policy goals are expected to have a significant effect on the level of ISC imposed on the unit-holders.

> UH = The number of small unit-holders (having equal or less than 5,000 units) as a percentage of total unit-holders of a fund (the number of small unit-holders of a fund/total unit-holders of a fund).

UH is used as a proxy to check on the popularity of the fund among small unit-holders. This is to examine whether there is a selling pressure effect when a higher ISC is requested by the sales agents. In addition, it is also used to identify the existence of a clientele effect in the unit trust funds, based on the assumption that the group of small unit-holders are influenced easily by the fund's image or goodwill. These unit-holders would purchase a fund with a high ISC without considering the fund's financial performance. Hence, it is expected that the relationship of UH and ISC would be positive.

> SIZE = A fund's total net assets at the financial year-end 1999 in million of ringgit (natural log is taken).

Size is intended to identify whether there is an economy of scale effect on fund's ISC. If this holds true, then large funds would be able to impose lower ISC as compared to the smaller funds.

> AGE = The number of years the fund has been launched up to the year 1999.

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unit-holders to transfer their investment among funds in response to their changing financial needs or market conditions.

AGE is intended to identify whether longer existence funds would be able to collect higher ISC as compared to the newly launch funds.

BODSIZE = Size of the BOD is measured as the number of directors on the board.

INDIR = Fraction of independent directors on the board. Calculated as the number of independent directors[4] as a percentage of total directors on the board.

BODSIZE and INDIR are used to check whether the fund's board structure would have an impact on the ISC imposed on unit-holders.

ANALYSIS OF RESULTS

A summary of the descriptive statistics of the sample is provided in Table 1. On average, ISC in the year 1999 was approximately 6.9% with a maximum and minimum value of 15.6% and 2.3%, respectively. The maximum ISC of 15.6% exceeded the maximum level of 10% stated in the *Guidelines on Unit Trust Funds.* The average company size (SIZE) is RM152 million.

TABLE 1
DESCRIPTIVE STATISTICS ON ALL VARIABLES USED

	N	Mean	Median	Maximum	Minimum	SD	Skewness	Kurtosis
ISC	39	6.903	6.580	15.630	2.300	2.715	1.137	5.017
R3	39	−0.008	−0.009	0.007	−0.022	0.007	0.045	2.862
SD	39	0.102	0.099	0.153	0.041	0.031	0.006	2.313
FUTR	39	0.006	0.005	0.053	−0.040	0.022	−0.108	2.651
SIZE (RM' million)	39	152.000	80.380	500.000	1.100	154.000	0.717	2.167
UH	39	63.331	59.330	99.660	18.640	26.515	0.092	1.529
DS	39	0.744	1.000	1.000	0.000	0.442	−1.116	2.245
BODSIZE	39	5.026	4.000	9.000	3.000	2.300	0.771	2.070
INDIR	39	0.373	0.330	0.560	0.290	0.065	1.266	3.694
AGE	39	12.641	7.000	31.000	3.000	10.348	0.682	1.698
DGOVERN	39	0.410	0.000	1.000	0.000	0.498	0.365	1.133

Most of these companies have been in the market for about 13 years. The average number of small unit-holders as a percentage of total unit-holders as measured by UH is 63.3%; whereas the average board size (BODSIZE) is five individuals. The number of independent directors as a percentage of total directors on the board (INDIR) is 37.3% on the average. The minimum value of 29.0% in INDIR does

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[4] An independent director refers to a person who is free of any relationship that would interfere with his exercise of independent judgement (Securities Commission Malaysia, 1997*).*

not comply to clause 4.4.7. in the *Guidelines on Unit Trust Funds* which required that at least one third of the board should consists of independent directors.

In terms of the fund's average financial performance variables, as measured by R3, SD and FUTR, the average monthly mean returns over the previous three years (R3) is –0.8% with a maximum and minimum return of 0.7% and –2%, respectively. The mean for the funds one-year future returns (FUTR) is 0.6%. There are funds that provide a minimum one-year future return of –4% and a maximum return of 5%. As for the fund's risk, which is represented by SD, the average monthly standard deviation is 10.2%.

Before a cross-sectional analysis is run to determine which variables are likely to explain some of the variations in the ISC, a Pearson correlation matrix is executed to check on multicollinearity problems. This is to ensure that the model used in this study is reliable to explain the variations in the ISC.

Table 2 presents a correlation matrix among the explanatory variables. It is observed that collinearity between LNSIZE and AGE, LNSIZE and UH, UH and AGE is high in the range of 0.757 to –0.868. We chose not to drop these collinear variables to avoid the specification bias problem from omitting of relevant variables that are found significant in previous studies. In addition, variance inflating factors (VIF)[5] estimations on these variables which are less than 10 (Table 3) suggest that multicollinearity problem between the independent variables is not "troublesome" in this study (Gujarati, 1995, p. 339).

TABLE 2
PEARSON CORRELATION MATRIX

	AGE	BODSIZE	FUTR	INDIR	LNSIZE	R3	SD	UH
AGE	1.000	–0.631	0.036	–0.418	–0.785	–0.256	0.179	0.757
BODSIZE	–0.631	1.000	0.048	0.118	0.656	0.378	–0.307	–0.702
FUTR	0.036	0.048	1.000	0.192	–0.008	–0.341	–0.140	0.071
INDIR	–0.418	0.118	0.192	1.000	0.241	–0.166	0.086	–0.071
LNSIZE	**–0.785**	0.656	–0.008	0.241	1.000	0.426	–0.354	–0.868
R3	–0.256	0.378	–0.341	–0.166	0.426	1.000	–0.067	–0.420
SD	0.179	–0.307	–0.140	0.086	–0.354	–0.067	1.000	0.373
UH	**0.757**	–0.702	0.071	–0.071	**–0.868**	–0.420	0.373	1.000

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[5] VIF shows how the variance of an estimator is inflated by the presence of multicollinearity. VIF = $1/(1 – R^2_{x1, x2})$ where $R^2_{x1, x2}$ is the R^2 in the auxiliary regression of x1 on x2 or x2 on x1 (both will give the same r^2 value). As $r^2_{x1, x2}$ approach 1, the VIF approaches infinity. As a rule of thumb, variables with VIF more than 10 (when $r^2_{x,y}$ exceeds 0.90) are deemed as highly collinear and could become troublesome to the regression model.

TABLE 3
VARIANCE INFLATING FACTOR

Independent variables	Correlation coefficient	$R^2_{x1, x2}$	$VIF = 1/(1 - R^2_{x1, x2})$
LNSIZE, AGE	–0.785	0.616	2.60
LNSIZE, UH	–0.868	0.753	4.05
UH, AGE	0.757	0.573	2.34

Note. $R^2_{x1, x2} = R^2_{x2, x1}$

The result for the full model is generated in Table 4. It shows that the explanatory variables could explain 52% of the variations in the ISC. With an F-value of 5.09 and a probability of 0.0003, it is observed that the overall significance of the estimated regression is significantly different from zero implying that collectively the explanatory variables have a significant impact on ISC.

TABLE 4
MULTIVARIATE REGRESSION ANALYSIS OF ISC
AND ITS DETERMINANTS BY USING THE FULL MODEL
AND FINANCIAL MODEL

Variable	Full model		Financial model	
	Coefficient	Probability	Coefficient	Probability
Constant	–1.813	0.84	4.126	0.01^{***}
R3	–17.056	0.78	30.512	0.66
SD	19.940	0.14	27.877	0.06^{*}
FUTR	27.359	0.11	29.109	0.18
LNSIZE	0.216	0.59		
UH	–0.075	0.06^{*}		
DS	–1.887	0.05^{**}		
BODSIZE	0.147	0.48		
INDIR	17.512	0.03^{**}		
AGE	–0.047	0.45		
DGOVERN	4.875	0.01^{***}		
Adjusted R^2	0.518		0.052	
F-statistic	5.09		1.688	
Prob (F-statistic)	0.000310		0.187	

Dependent variable: ISC
***, ** and * significant at $\alpha = 0.01$, $\alpha = 0.05$ and $\alpha = 0.10$

Among the variables, UH, DS, INDIR, and DGOVERN are found to be significant with t-values of –1.991, –2.022, 2.272 and 2.670, respectively. A negative coefficient for UH means that the funds with a high number of small unit-holders are charged with a lower ISC. When the number of small unit-holders increases by 1%, the ISC decreases by 0.075%. This provides evidence to

support Ang, Chen and Lin's (1998) argument that the fund manager could reduce ISC in order to attract more cost sensitive unit-holders to buy the funds.

Another significant variable that has an inverse relationship with the ISC is the fund's switching dummy. As presented in Table 4, DS shows a coefficient of −1.887. This result implies that unit trust companies with funds switching facilities have a lower ISC by 1.887 percentage points as compared to unit trusts funds without such facilities.

A statistically significant INDIR variable has a positive relationship with the ISC. This result suggests that an increase in the fraction of independent directors on the board by 1% would increase ISC by 17.512%. This is not supported by the principle-agent model and in contrast to Tufano and Sevick's (1997) findings who found a negative relationship between ISC and INDIR. One of the possible explanations might be that there is a weakness in the implementation of corporate governance in the Malaysian unit trust industry. It is possible that the fund's independent directors are not providing enough attention to their role in safeguarding the interest of the unit-holders by making sure that unit-holders are not charged with high fees.

DGOVERN, which is a dummy variable, has a positive significant relationship with ISC. This would mean that generally government-sponsored funds have a higher ISC by 4.875% as compared to the private funds. This could be explained by the government effort to improve the chances of success in achieving the public goals as stated by Shamsher and Annuar (1995). By imposing a higher ISC, it means that more intensive marketing (higher sales charge to the sales agents) activities are to be carried out to attract prospective unit-holders to purchase the government-sponsored funds.

As for the remaining variables (R3, SD, FUTR, SIZE, BODSIZE, AGE), none of the coefficient is significantly different from zero. A fund's financial performance variables (R3, SD, FUTR) do not support the risk return trade-off principle. Although FUTR has the expected positive relationship where higher ISC is associated with higher fund's returns, this relationship is not statistically significant in an emerging market such as Malaysia.

With respect to AGE, the relationship between this variable with ISC is in contrast to what was expected. For the Malaysian unit trust funds, longer years of existence do not necessarily mean that they could impose a higher ISC. This is in contrast to the findings reported by Kihn (1996), and Tufano and Sevick (1997) who found that ISC is positively related to the fund's age. The positive and insignificant relationship between SIZE and ISC does not support the view that there exists economy of scale for large funds. This is in agreement to Kihn

(1996), and Tufano and Sevick (1997) studies. As for BODSIZE, although it has a positive relationship with ISC as shown in Tufano and Sevick's findings, this relationship is not statistically significant. This would mean that the level of ISC is not affected by the BODSIZE.

Further analysis was executed to see whether the financial model could provide a better explanation of ISC in Malaysia. A multivariate regression analysis was run and the results are reported in Table 4. The adjusted R^2 decreased to 5% when R3, SD and FUTR are regressed against the dependent variable ISC. The F statistic shows a value of 1.688 with a probability of 0.187. Collectively, none of the variables could explain the variations in ISC. Individually, the monthly standard deviation of returns over the previous three years (SD) is the only variable that has a significant impact on ISC. When SD increases by 1%, the ISC increases by 27.88%. This finding could not be explained by the risk-return trade-off principle that expects a lower ISC for funds that are riskier, and it is in contrast to Kihn's (1996) study which shows a negative relationship between ISC and SD.

CONCLUSION

Two models were employed in this study to identify the explanators that could explain the variations in ISC. By using the full model, UH, DS, INDIR and DGOVERN were identified to have a significant relationship with ISC. When the financial model was employed, SD became the only explanator which is found to have a significant relationship with ISC.

As far as the significance of corporate finance theories to explain the level of ISC and its determinants, the study provides no support for them. BODSIZE and ISC show the expected relationship mentioned in the principle-agent model but it was not significant except for INDIR; whereas for the risk and return trade-off principle, when the financial performance variables are regressed against the ISC, the expected relationship between ISC and SD could not be seen. A higher ISC is observed for funds that are riskier.

Some important implications of this study might be: First, there are funds, which have an ISC higher than 10% of the fund's NAV required by the Securities Commissions (SC). It was also observed that some of the unit trusts did not comply with the at least 1/3 of independent directors in the board, ruling contravening to the *Guidelines on Unit Trust Funds,* issued by the SC. SC would probably needs to double its effort to play a significant role in market monitoring and supervision. Otherwise, its objective to provide a regulatory framework that would protect the interest of the investing public might not be realised.

Second, to the fund managers, it seems that most of their counterparts are employing a cost-cutting strategy to attract the small unit-holders (UH) to purchase into the funds. Lower ISC funds seem to have a higher number of small unit-holders. As mentioned earlier, the study found that fund managers generally do not impose a higher ISC on the switching facilities provided to the unit holders. Instead funds that have these facilities seem to impose a lower ISC.

Third, unit-holders need to be aware of the ISC imposed on them before purchasing a fund. Our findings suggest that funds that are charging higher fees do not necessarily perform better than funds that charge lower fees. In addition, we also found that generally high ISC funds are riskier than the low ISC funds. As for the indigenous (Bumiputera) unit-holders who purchased the government-sponsored funds, they would need to be more critical in choosing these funds with respect to the services and returns provided by the funds. The result of this study shows that the government-sponsored funds generally have a higher ISC as compared to private funds.

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