THE FUND CHARACTERISTICS, FEES, AND EXPENSES STRUCTURE BETWEEN CONVENTIONAL AND ISLAMIC MUTUAL FUND

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ABSTRACT

Shariah principle is notoriously known as the key feature underlying the function of assets management in Islamic financial institutions. The underlined principle highly requires fund managers to consistently manage the fund portfolio in accordance to a legitimate set of rules. As a result, Islamic mutual fund may have distinguishable characteristics, and more importantly, the fund fees and expenses structure. This article studies the fund characteristics, fees, and expenses structure between conventional and Islamic mutual fund. We also describe how the fees, expenses, and return can be explained by fund characteristics accordingly. A dataset comprises 252 open-end mutual funds in Malaysian industry offered within the period 2008 to 2015 is employed to present empirical evidence. Our results describe a significant difference in fees and expenses structure led by Islamic funds. High diversification explains Islamic funds while strong positive growth is associated with the traditional funds, supporting the relation between fees and expenses and fund performance. The declining trend of fees corroborates the idea of a favourable economies of scale contradictory to the rising expenses structure. Nevertheless, Islamic funds present an excessive fees and expenses in offering high and low quality portfolio management.

Keywords: mutual fund, Islamic mutual fund, fund characteristics, fund fees, fund expenses

INTRODUCTION

Shariah compliant asset under management has recorded some devaluation for two consecutive years since 2014 to 56.1 billion dollars in the recent year (2016), as reported by Islamic Financial Services Board (IFSB). With Malaysia remains the second largest funds by domicile after Saudi Arabia, the proportion, 29% of the entire market share seems stagnant at a decelerated growth of assets. While a large number of funds including Islamic mutual fund (IMF) focus on the primary asset class of equities, the underperformance of one stock would likely hurt the overall return as the gain of equities highly depend on the market index. Moreover, the fact that mutual fund is being offered in the market of financial services through professional advices by high-skilled managers insists on competitive price imposed to investors. Thus, a rational investor should often consider by taking into account the trade-off between expected return a fund could deliver and the total costs charged upon the redemption.

The difference in principle embraced by IMF has restricted activities from engaging in investment universally (Abbasi, Hollman, & Murrey, 1989). For instance, entertainment, alcohol, tobacco, and widely most profitable interest based activities are strictly forbidden industries for investing by Shariah law (Abdul Ghafar & Achmad, 2010). This principle is based on the exclusive belief and value system enforces a screening process (Hassan, Abu Nahian, & Ngow, 2010), mainly on business activities, financial, and non-financial criteria in order to meet the Shariah investing compliance. Investment selection would be done to screen out those business organizations that violate the law. Unlike conventional mutual fund (CMF), the investment option of equities available for IMF is relatively limited and undersized in nature. Most often, a permissible share of equities could be made impermissible subject to the supervision of Shariah advisory panel (SAP) under the national guidelines of Shariah Advisory Council (SAC) circulated by the Central Bank of Malaysia (BNM).

In this case, the critical function of SAP in Islamic financial institutions (IFI), particularly fund management, presents the beneficial supplementary monitoring and supervision with additional cost (Mollah & Zaman, 2015; Fikri, Yahya, & Hassan, 2017). More importantly, the continuous improvement in reforming Shariah governance by the introduction of Shariah governance framework (SGF) in Malaysia during 2011 would likely further accelerate the related cost of conformity to regulation gradually. While the board of directors could be merely rubber stamp to ratify and approve management decisions (Hill & Snell, 1988; Gomez-mejia & Wiseman, 1997; Carter, 2001), SAP too, could potentially be emblematic of Shariah compliant investment practice to gravitate

public investor's capital. Consequently, the presence of SAP does not only lead to the complexity practice of Shariah screening investing, but also expand the operating expenditure and increase the total cost for final pricing funds marketed to retail investors as evident in Mansor, Bhatti and Ariff (2015) to cause a lower return performance. Thus, the popularly underperformance IMF coupled with these issues warrant a prompt study to address fees and expenses structure comparison and its relation to performance between both funds.

The rise in compensation rate of manager fees is argued not because of the manager's behaviour alone, but also the increase of firm rents from unit holders and the bargaining power with various stakeholders (Pandher & Currie, 2013). High compensation to managers could be another evidence of agency problem that relates between weak governance and poor performance while denying the shareholder interest (Almazan & Suarez, 2003; Newton, 2015). All fees and charges are specified perspicuously except fund operating expenses that may vary on annual basis. Barber, Odean and Zheng (2005) explain the decline of predetermined fees relative to operating expenses because investors are more sensitive to initial fees than deferred expenses. The complexity nature of operation alluding to the conformity of Shariah governance may influence an indirect proportion of such expenses. Thus, any excessive expense by the need of incorporating some constraints in operation could exacerbate the amount of total cost to the detrimental of shareholders.

This article examines the fund characteristics, fees and expenses structure between CMF and IMF following the effect of Shariah principle embedded and upheld in the investment activities of the latter funds. More specifically, the characteristics of both funds are tested whether they can explain fees, expenses structure, and fund performance differently. Analysis leads to a general finding that IMF sets a higher fees and MER, contrary to a lower EXR, highlighting a different fees and expenses structure. Large economies of scale suggests a downtrend manager fees but expenses appear to expand over the period. The distinctive characteristics attributed to both funds support the interaction between expenses and fund performance. Overall, the option of investing practice in IMF which adhering to Shariah principle exposes unit holders to some additional non-trivial cost, resulting to a more expensive price than regular funds, despite its favourable positive growth and increasing economies of scale every year. This paper sheds light on the current trend of fees and expenses structure in portfolio management while relating the characteristics belonged to both funds and offers a recent empirical evidence in the area of Shariah compliant portfolio management price-setting.

THE MALAYSIAN MUTUAL FUND INDUSTRY

Overview of The Mutual Fund Industry

Malaysia has recorded an early history of establishing mutual fund since 1959 with its first fund management, namely Malayan Unit Trust Limited administered by a group of Australian investors (Norma, Shabri, Salina, Zarinah, & Rosylin, 2010). This was a good effort as the pioneer in alternative equities investment among the neighbouring countries. At this infancy stage, lack of public knowledge and awareness has contributed to unappealing buy and sales activities. By 1960's and 1970's, the industry was dominated by two major players, ASM MARA Unit Trust Management and Asia Unit Trusts Berhad, both owned by Majlis Amanah Rakyat (MARA) (Norma et al., 2010). As more state government sponsored mutual funds were established, a historical milestone boosted up the industry when Permodalan Nasional Berhad (PNB) was introduced in 1979, and thus, launched the first encouraging fund, Sekim Amanah Saham Nasional (ASN) in 1981 (Norma et al., 2010). As a result, public investors begin to have interest by depositing a substantial capitals following an overwhelming response to the government incentive.

The encouraging response continues to have the most rapid growth in 1991 when Amanah Saham Bumiputera (ASB) made its first appearance, specially designed investment for Malay or Bumiputera status citizen to promote savings and encourage their participation in the Malaysian capital market (Mohamed Sharif & Wan Rasyidah, 2011). Since then, a persistent tremendous fund inflows create a massive unit of circulation within the mutual fund industry. Despite the financial crisis which has taken place two times both in 1997 to 1998 and 2007 to 2008 (Rubio, Hassan, & Hesham, 2012), the demand is still potent and appealing, even though distracted by significant outflows due to public uneasiness of the unpredictability future economy. This is because low risk and high diversification features associated in most funds would considerably result in minimum losses. More interestingly, many local banks join the industry by establishing their own sponsored funds and actively promoting the brand through wide marketing, advertisement, and distribution. An increasing number of private funds provide a range of assets focused inside and outside Malaysia, predominantly allotting for more than half of total assets to domestic stock market as illustrated in Table 1. This crucial contribution to Malaysian capital market surges from 12.10% in 2004 to 22.39% in 2017.

Table 1
Overall asset classes of mutual fund as at December 2017

Asset classes (RM billion)	Overall		
	Inside Malaysia	Outside Malaysia	Total
Equities	396.13	98.99	495.12
Fixed income securities	154.37	28.06	182.43
Money market placements	164.14	1.19	165.33
Unit trust funds	27.58	16.36	43.94
Private equities/Unquoted stocks	11.92	8.92	20.84
Others	22.09	9.38	31.47
Total	776.23	162.9	939.13

Adapted from: Securities Commission Malaysia

Islamic Mutual Fund

Due to an increasing strong belief and awareness of majority Muslim investors in Malaysia, IMF presents an alternative practice of investing on the ground of Shariah principle. The embroiled of conventional asset management in impermissible industry, especially the profitable financial sector that comprises widely interest based transactions violates the main underscored principle. Moreover, assurance of a certain predetermined rate of profit offers investors opportunity to maximise the profit in contrary to the risk and profit sharing, inconsistent with harmonisation between god's command and human well-being while relinquishing wealth maximisation objective secondarily. With the presence of SAP on additional board, acquisition and disposal of assets will go first for screening process. Non-compliant assets which exceed 5% are obliged for purification. In addition, profit-making firm is required to purify wealth by paying Islamic tax levy called *zakat* (Lewis, 2010). Thus, Shariah principle has resulted in distinguished characteristics of IMF that penetrated the industry since early 1993 when Tabung Ittikal managed by Arab-Malaysian Unit Trust was launched (Mansor & Bhatti, 2011) followed by many other approved IMF, captivated the industry into an appealing market. Figure 1 shows a sizeable growth attracted by IMF since 2004 with the superior NAV growth in recent year compared to conventional fund.
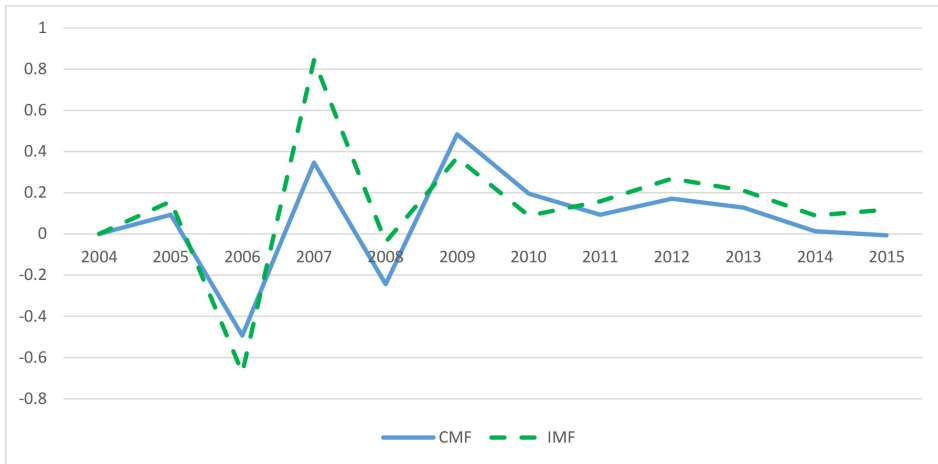
Figure 1. The growth change between CMF and IMF (Source: Securities Commision Malaysia)

The screening process has been varied according to index providers in terms of the ratio and percentage employed. As for Malaysia, the SC has updated the Shariah screening methodology effective November 2013, due to the growing sophistication of the Islamic capital market. The inclusion of new financial ratio is believed to increase the robustness and competitiveness of IMF. Two ratios employed at the cut-off 33% are debt and cash and interest bearing securities using the denominator of total assets while income contribution ratio has been revised to a new two-tier benchmark, 5% and 20% subject to activities or industries. Table 2 exhibits some differences after this reform with attention particularly on quantitative screening criteria.

Consequently, a number of non-compliant activities such as conventional banking, conventional insurance, gambling, liquor-related activities, non-halal food and beverages, and entertainment are limited at 5% of total revenues and profit before tax. SC has compromised, particularly in setting the new two-tier impermissible investment income ratio of 5 to 20%. While the first tier is applied to clearly prohibited activities, the second tier is relevant for the mixed level of income contribution with public interest. Amelioration on the screening process would further restrict the available equities, predominantly blue chip stocks from the investment universe (Ghoul & Karam, 2007), thereby, presumably decreasing the diversification rate (Hayat & Kraeussl, 2011) quantitatively. Trading activities incline to be passive and low in turnover due to the limited number of equities for acquisition. Besides, the portfolio may be affected if a quick disposal has to be performed following the readjustment on Shariah compliant assets list and, in

turn, might jeopardise the state of holding profitable assets. Eventually, a lower risk of securities coupled with lower diversification would likely undermine the expected return. Table 3 reveals the implication of such changes on the number of Shariah compliant securities focusing on stock market.

Table 2
The difference upon the revised Shariah screening methodology

	The preceding screening methodology	The revised screening methodology
1.	Qualitative screening assessment	Qualitative screening assessment is remained unchanged
2.	Income contribution thresholds: 5% 10% 20% 25% subjected to activities and industries	Income contribution thresholds: 5% 20% subjected to activities and industries
3.	No financial ratio screening	Financial ratio screening is introduced at 33%: Debt ratio over total assets Cash and interest bearing securities over total assets

Adapted from: Abdul Ghafar and Achmad (2010)

Table 3
List of shariah compliant securities in Malaysia

Main market of Bursa Malaysia	2010	2011	2012	2013	2014
Consumer products	131	133	125	106	107
Industrial products	273	268	253	194	200
Mining	1	1	1	1	NIL
Construction	48	42	43	36	35
Trading/Services	170	168	178	143	146
Properties	71	77	74	59	67
Plantation	38	39	39	34	37
Technology	104	101	95	71	73
Infrastructure (IPC)	7	7	7	5	4
Finance	3	3	2	2	2
SPAC	NIL	NIL	NIL	2	2
Hotels	NIL	NIL	NIL	NIL	NIL
Closed-end fund	NIL	NIL	NIL	NIL	NIL
Total	846	839	817	653	673

Adapted from: Securities Commission Malaysia

Literature Review and Hypotheses Statement

A large number of academic works, papers, and researches have documented a wide area of interest in relation to portfolio management. Since the introduction of Capital Asset Pricing Model (CAPM), Sharpe (1966) and Jensen (1968) have contributed effective measurements of portfolio performance using the trade-off attributes between return and the given level of risk. Plenty of studies present empirical evidence on portfolio management adopting both prior models and utilising worldwide data. Financial performance is capable at predicting the future performance with the likelihood of yielding a relatively better return. This is partly because investors tend to response to a good performed mutual fund. As a result, a substantial new inflows demonstrated by Hendricks, Patel and Zeckhauser (1993) and Elton, Gruber and Blake (1996) provide more capital to grow in size and favours a large acquisition of equities to fund management.

CMF has been the subject in this area of research since Sharpe (1966) with evidence of outperformance of a few mutual fund within the period of 1954 to 1963. He supports the idea of the best predictor future performance tool using past record, but no assurance could be given to reach a better outcome. The similar positive evidence is also manifested by See and Ruzita (2012) on 69 equity mutual funds in Malaysia from 2005 until 2009. However, outstanding performance is subjected to the high risk associated and the available return to unit holders would depend on total costs. Additionally, strong persistence in returns are recorded by United Kingdom (UK) funds between the year 1991 to 1998 (Otten & Bams, 2002).

On the other hand, Jensen (1968) has positioned a contradictory finding that open-end mutual fund performs on average and not successful in trading activities. Moreover, there is no evidence of superior performance in excess of total costs, thereby supported with later evidence by Carlson (1970), McDonald (1974), Firth (1977), Lehmann and Modest (1987), Cumby and Glen (1990), Malkiel (1995), Cai, Chan and Yamada (1997), and Fletcher and Marshall (2005). Active fund management is not only malfunction to provide excess returns, but exhibit significant inferior performance correspondingly. The Malaysian mutual fund market indicates a similar result by most researchers. Annuar, Shamser and Hua (1997) have documented an underperformance return of 31 funds in Malaysia due to a lower degree of diversification and inconsistent return to risk. Low and Noor Azlan (2005) together with her later work series Low (2007) and Low (2012) have consistently concluded a significant negative overall performance for the period of 1996 to 2004 due to poor investment selection and market timing employing Jensen model. This finding is strengthened further

by Fauziah and Mansor (2007) after the performance of most funds fall below the market and risk-free return. When local funds are compared to global funds based in Malaysia, Abdullah and Abdullah (2009) find their performance is not significantly different. Nevertheless, some of researchers have also discovered a slightly mixed findings in this performance comparison following the work of Abdullah, Hassan and Mohamad (2007), Hesham, Hassan and Yasser (2010), Salina and Saqinah (2012), and Dawood (2013), contending that IMF performs better during bearish or economic depression rather than bullish period.

While IMF has been the subject focus of attention, many other researchers have also approached ethical mutual fund or socially responsible fund (SRF) as well. The identical feature of screening the asset before investment decision resembles the practice in IMF, but this positive screening process highly emphasizes on environmental, social, and governance concerns for a sustainable investment (Renneboog, Horst, & Zhang, 2008). This fund views that ethical or moral attributes are believed to represent a strong force at producing high level of asset stability (Peifer, 2010). Following the findings of CMF performance, SRF has also implied indifference results. Hamilton, Jo and Statman (1993), Gregory, Matatko and Luther (1997), Goldreyer and Diltz (1999), Bauer, Koedijk and Otten (2005), Bauer, Otten and Rad (2006), Izquierdo and Saez (2008), Chang and Witte (2010), Climent and Soriano (2011), and Mollet and Ziegler (2014) are among scholars who compare the fund performance against CMF and record a lower insignificant competitive return due to a lower level of risk association.

Although SRF underperform the domestic benchmarks by -2.2% to -6.5%, Renneboog et al. (2008) assert that the risk-adjusted returns have no statistically difference from CMF, emphasizing on the countries such as France, Sweden, and Japan. Additionally, Blancard and Monjon (2014) alert that investors have to prepare bearing the cost of investment in consequence of selecting the fund with screening process. In contrast, Sauer (1997) holds a special perspective by connecting SRF with social responsibility and arguing the screening process would necessarily have no impact on performance. Thus, investors are not likely to sacrifice negative returns against the matching cost. Besides, majority of the fees according to Luo (2002) can be explained by mark-ups on top of the marginal cost. The screening process feature attributed to IMF leads to the first hypothesis as follows:

H_{01}: There is no difference in fees and expenses structure between CMF and IMF.

On the effect between expenses and fund performance, Malkiel (1995), Dahlquist, Engstrom and Soderlind (2000), Gil-Bazo and Ruiz-Verdú (2008;

2009), and Vidal, Vidal-Garcia, Lean and Gazi (2015) have documented a negative relationship between mutual fund fees and before-fee performance. More recently, the negative association persists on net-fee performance (Robinson & Sensoy, 2013) and return predictability (Vidal et al., 2015). Maximizing fees seems sensible for fund management revenues according to Gil-Bazo and Ruiz-Verdú (2009) by imposing such high expenses under a passive insulation of the board of directors contrarily to better-governed director's function in redesigning and renegotiating a lower or perhaps, a reasonable fees. As for LaPlante (2001), the persistence of high fees charged is acceptable if funds deliver high quality and professional services. It means that the negative elementally relation between expenses and performance could be made positive if the return outcome meets the higher investor's expectations. But, the sort of high quality funds desired may vary among investors apart from their expectation on high return.

As high return is desired, sensitive performance investors are willing to spend a greater expenses without considering its diminishing function on the return (Alexander, Jones, & Nigro, 1998) and wishing that expensive professional services would deliver and translate into an actively portfolio fund management through some leverage on risk, greater skills, and higher expected return as evident by Hu, Chao and Lim (2016). However for Prather, Bertin and Henker (2004), higher cost is associated with overcompensated managers, research activity, marketing, and administration captured by expense ratio. As a result, excessive fees for a standard service would less likely generate a superior return. On the other hand, a low level of management fees is associated with a high risk in the likelihood of illegal, unethical, misconduct, and wrongdoing within internal management (Davis, Payne, & McMahan 2007). This may indicate self-dealing activities to the extent of fund expropriation pursuit due to inadequately compensated managers or abandoned of performance based remuneration, contrary to greater investors protection by Khorana, Servaes and Tufano (2009). Hence, our second hypothesis for examination is:

H_{02}: There is no relationship between fees and expenses and fund performance in CMF and IMF.

Apart from fees and expenses, there are funds that charge the cost of sales and redemption transaction or popularly known as load fees in the literature. Hooks (1996) argue that funds with even higher load fees but low expenses outperform the funds with no load fees at average expenses. On the other hand, Dellva and Olson (1998) contend that front-end load fees reduce risk-adjusted return. Further thought, Droms and Walker (1996) and Abdullah and Chyuan (2006) find no relation between such charges and fund performance. The imposition of load

fees may be onerous as it adds to the list of fees and expenses, but to a small extent, may not have any effect on performance. Thus, the related hypothesis is as follows:

> H_{03}: There is no relationship between load fees and expenses structure, which in turn, leads to absence of relationship with fund performance in CMF and IMF.

In the similar vein, Elton, Gruber, Das and Hlavaka (1993) and Carhart (1997) present a negative relationship between expense ratios, portfolio turnover, and performance in contrary to the evidence of unrelated portfolio turnover by Ippolito (1989) and Droms and Walker (1996). Haslem, Baker and Smith (2008) also find that large size of funds with low expense ratio, low trading activity, and low level of load fees are usually performed very well. In contrast, Grinblatt and Titman (1994) and Wermers (2000) show that high turnover funds dominate a good performance against the index benchmark. In extension, Hooks (1996) and Malhotra and McLeod (1997) support further the positive relation with expense ratio. Mutual fund participants mostly act as uninformed investors that compensate informed market traders to perform some research and investment trading activities. In equilibrium, Ippolito (1989) argue that these fund managers may beat the market at the gross return, but, potentially lose when adjusted for all expenses. Active fund managers do not necessarily generate high return and more specifically, higher sufficiently to offset all the correspondingly high overall fees and expenses. Hence, the next hypothesis in null form is as follows:

> H_{04}: There is no relationship between portfolio turnover and fees and expenses structure, which in turn, leads to absence of relationship with fund performance in CMF and IMF.

The rejection of market imperfections will not imply a better preferable diversified than undiversified portfolio that the former may lead to a higher yield of return and a lower variance than the latter (Markowitz, 1952). Investors benefit the inherent diversification advantage within mutual fund as long as the return-risk combination is positive and matches their tolerance. A possible conjecture for the difference in performance between CMF and IMF is due to a less diversified of the latter funds (Mohamed Sharif & Wan Rasyidah, 2011; Rubio et al., 2012). Similarly, Luther, Matatko and Corner (1992) indicate ethical consideration as the force towards smaller less diversified firms. On the other hand, high diversification in search within limited number of investment would possibly incur a substantially higher cost to derive a lower risk, which in turn, may not necessarily maximise the return. Therefore, the following is the related hypothesis:

H$_{05}$: There is no relationship between diversification and fees and expenses structure, which in turn, leads to absence of relationship with fund performance in CMF and IMF.

Two explanations on dividend yield underlined in Easterbrook (1984) are the financing policies and the ability for cash to dissipate and create new flows. Prior to the negative fund performance, Luther et al. (1992) establish a more positive but weak evidence over performance on risk-adjusted basis because ethical funds tend to choose low dividend yield of assets. Vidal et al. (2015) t-bill yield, default spread and term spread explain the dividend yield factor in predicting the mutual fund return. While there is positive relation of distribution rate on fund performance, this would not have any effect on fees and expenses structure. It takes major insignificant cost to reach high yield of distribution only to persuade the unit holders from exiting the funds. Thus, the next hypothesis is:

H$_{06}$: There is no relationship between distribution rate and fees and expenses structure, which in turn, leads to absence of relationship with fund performance in CMF and IMF.

As far as the fund size is concerned to increase fund performance at the edge of economies of scale, Latzko (1999), Chance and Ferris (1991), McLeod and Malhotra (1994), and Malhotra and McLeod (1997), argue that the growth of funds would reduce the ratio of expenses at a favourable better performance (Geranio & Zanotti, 2005). Thus, the growth of funds in long term will most likely offer a more competitive cost control management while providing the beneficial positive return. However, due to the different growth rate between CMF and IMF, the effect of fund growth is indeterminable at reducing fees and expenses while increasing the return. This study provides the following hypothesis:

H$_{07}$: There is no relationship between fund growth and fees and expenses structure, which in turn, leads to absence of relationship with fund performance in CMF and IMF.

As such, the cost of fund is widely determined, among others, by fund age, fees structure, management style, trend effects and investment objective (LaPlante, 2001). Equities funds with growth objective are major funds offered in the market because they focus widely in stock and equities market characterising with high level of risk. These funds also grow vastly at astounding pace. The two preceding attributes make the funds superior in relation to fund performance. However, high demand and risk tolerance on funds would probably drive the cost further differently between both funds. In general, this study presents the related hypothesis as follows:

H$_{08}$: There is no relationship between equities fund and fees and expenses structure, which in turn, leads to absence of relationship with fund performance in CMF and IMF.

DATA AND EMPIRICAL METHOD

Sample

This paper focuses on the population of open-end mutual fund in Malaysia due to a large accessible data of IMF as reported by Islamic Financial Services Board (IFSB) 2017, the second biggest market for Islamic asset management. The study considers the fund sample between the period 2008 and 2015 to enable as numerous as possible IMF, following an increasing approved funds since 2005. To qualify for consideration in the sample, a fund must be established, at least, in 2007 for the convenience to retrieve the first financial year annual report during 2008. At the end of December 2015, there are 631 total number of approved funds sponsored by 37 fund management companies, from which 433 funds are CMF and 198 funds are IMF. For an equivalent fees and expense ratio comparison, funds are selected from equities and balanced category with objective of income and growth only. Besides, fund performance can be equivalently compared as both fund categories focus on equities as major asset holdings in their portfolio management. Another reason would be their identical fund-specific attributes to represent most of the dominated funds in this industry for an equal treatment of comparison. The sources of data include financial report and financial statement published in annual reports and master prospectuses by fund management. Datastream, Morningstar Asia, Bloomberg, and Fund Supermart support by providing the necessary data. After restricting some funds due to missing reports, the final sample comprises 172 CMF and 80 IMF, representing 39.94% population and generating a strong balanced panel data with 2,016 fund-year observations.

Fees, Expense Ratio and Financial Performance Measures

In this paper, fund-specific characteristics are examined against fees and expense ratio and fund performance. The first measure of fees and expense ratio is the proportion of manager fees on the total expenses. This measure is indispensable because it constitutes a major amount of expenses for compensation, management, and execution of daily operation (Geranio & Zanotti, 2005). The second measure follows with management expense ratio (MER) that has been disclosed by fund management in published reports. It takes into account the total amount of management fees, trustee fees, custodian fees, audit fees, tax agent's fees, and

operating expenses divided by average NAV in a specific year. The third measure is expense ratio (EXR) that has been adopted widely by a number of financial literature, such as Malhotra and McLeod (1997), Latzko (1999), Geranio and Zanotti (2005), and Babalos, Kostakis and Philippas (2009), computed by taking the realized total expenses excluding manager fees divided by total annual NAV.

Meanwhile, our first measure for fund performance is raw return, figured by obtaining the monthly and yearly dividend adjusted net asset value (NAV). By deducting the current month or year of dividend adjusted NAV to the prior month or year, we can generate raw return. The greater return signifies the better performance as a result of appreciation in capital growth. Raw return is written as follows:

$$R_{it} = \frac{NAV_{it} - NAV_{it-1} + DIST_{it}}{NAV_{it-1}} \tag{1}$$

where NAV_{it} refers to net asset value of a particular portfolio for the current year, NAV_{it-1} defines net asset value one period prior to the current year, and $DIST_{it}$ indicates dividend payout for that portfolio at a specific period.

Another different measure for fund performance is Jensen alpha risk-adjusted return based on the work of Jensen (1968) demonstrates the average return of a portfolio given the beta and average market return for a relative comparison. Positive alpha describes an excess return as compared to the market and vice versa. Jensen alpha is expressed as follows:

$$\alpha_{it} = (\bar{r}_{it} - \bar{r}_{ft}) - \beta_{it}(\bar{r}_{mt} - \bar{r}_{ft}) \tag{2}$$

where $\bar{r}_{it}$ is average fund portfolio return, $\bar{r}_{ft}$ defines average risk-free return, $\bar{r}_{mt}$ refers to average market return, and β_{it} signifies beta or systematic risk of a portfolio.

Explanatory variable measures

Fund-specific characteristics variables are load fees (*Loadfees*) that include sales charges and redemption fees, portfolio turnover (*PTR*) proxies for trading activities of management, diversification (*Divers*), income distribution (*Distr*), growth rate (*Growth*), and dummy variable for equities fund (*Eqt*). Control variables are also included, such as fund size (*Size*), fund risk (*Fundrisk*), fund families (*Fundfamilies*), fund age (*Fundage*), and fund type (*Fundtype*) to distinguish between Shariah and non-Shariah compliant funds. Table 4 presents the description for each measure and variable used in the forthcoming empirical model.

Table 4
Description of measures and variables

Measures/variables	Descriptions
Panel A: Fund fees and expenses variables	
Manfees	The yearly amount of manager or management fees divided by total expenses
MER	The total combined of management fees, trustee fees, custodian fees, audit fees, tax agent's fees, and operating expenses charged to a fund divided by its average NAV expressed in percentage
EXR	The total expenses exclude management fees divided by its average NAV
Panel B: Fund performance variables	
Raw return	The difference for annual NAV dividend-adjusted between the current year and the prior divided by base year
Jensen Alpha	Risk-adjusted performance of a fund using expected return associating risk-free return, beta, and excess market return
Panel C: Fund characteristics variables	
Loadfees	The total of sales charges and redemption fees in percentage
PTR	An average sum of acquisitions and disposals to the average value of a fund on daily basis in a year
Divers	Coefficient of determination for fund return
Distr	Rate of income distribution or annual dividend in cent per unit
Growth	The growth of NAV compared to the prior year
Eqt	Dummy variable equals 1 if fund focuses mainly on equities and 0 otherwise
Panel D: Control variables	
Size	Natural log of total assets at the financial end year
Fundrisk	Standard deviation of raw return
Fundfamilies	Total number of funds controlled by parent company
Fundage	The number of age since year of fund inception
Fundtype	Dummy variable of 1 if it is IMF and 0 otherwise

Empirical Model

All hypotheses except the first incorporate all explanatory variables for testing on fees and expense ratio and fund performance using the two models as follows:

$$Fees\ Expenses_{it} = \alpha_0 + \beta_1 Loadfees_{it} + \beta_2 PTR_{it} + \beta_3 Divers_{it} + \beta_4 Distr_{it} + \beta_5 Growth_{it} + \beta_6 Eqt_{it} + \delta_1 CV_{it} + \varepsilon_{it} \tag{3}$$

$$Performance_{it} = \alpha_0 + \beta_1 Loadfees_{it} + \beta_2 PTR_{it} + \beta_3 Divers_{it} + \beta_4 Distr_{it} + \beta_5 Growth_{it} + \beta_6 Eqt_{it} + \delta_1 CV_{it} + \varepsilon_{it} \tag{4}$$

where *Fees Expenses*$_{it}$ is the proxy for fees and expense ratio variables of fund *i* at time *t*, *Performance*$_{it}$ designates the proxy for fund performance variables of fund *i* at time *t*, α_0 refers to a constant, *Loadfees*$_{it}$ appears for the fund sales charges and redemption fees of fund *i* at time *t*, *PTR*$_{it}$ refers to portfolio turnover of fund *i* at time *t*, *Divers*$_{it}$ represents diversification of fund *i* at time *t*, *Distr*$_{it}$ describes income distribution of fund *i* at time *t*, *Growth*$_{it}$ defines growth rate of fund *i* at time *t*, *Eqt*$_{it}$ incorporates the dummy variable of equities fund *i* at time *t*, *CV*$_{it}$ is regarded as control variables of fund *i* at time *t*, and ε_{it} constitutes error term. The sign α, γ, β, and δ are the vectors of coefficient estimation.

Estimation Method

This study primarily aims to provide an evidence on the different of fees and expenses structure designed between CMF and IMF. A simple classical hypothesis *t*-test between two groups examines the difference in mean of fees and expenses between CMF and IMF. The similar test applies to all variables especially on fund characteristics to acknowledge the difference between both funds. Hypothesis examination on fees and expenses structure uses pooled ordinary least square (OLS) regression while investigation of fund characteristics on performance adopts panel data regression to cater a large number of cross-sectional units observed over a large number of time periods. On fund performance, random effect generalized least square model (GLS) fits the estimation following the argument of Mollah and Zaman (2015) that the failure and weakness of alternative fixed effect to deal with time-invariant parameter, such as religion effect. All estimations set for panel-robust standard errors following Huber (1967) and White (1980) adopting Huber-White robust sandwich estimator clustered at fund level to relax the assumption of zero error correlation over time and correct the issue of heteroscedasticity.

Descriptive Statistics

An early treatment of descriptive statistics presents the mean for full sample, CMF sample, IMF sample, and two sample *t*-test for the purpose of mean comparison. Table 5 presents the full descriptive statistics for each variable where we find that for full sample (CMF sample; IMF sample) accordingly, the mean of management fees is 0.7587 (0.7522; 0.7728), MER is 1.72% (1.69%; 1.79%), and EXR is 0.54% (0.56%, 0.50%). Meanwhile, the mean for fund performance measures; raw return is 1.74% (1.80%; 1.64%), and Jensen alpha is 0.0083 (0.0096; 0.0050). *T*-test reveals significant difference in all fees and expenses variables between CMF and IMF. This statistically significant results reject the first hypothesis implying a greater management fees and MER recorded by IMF, but lower compared to its counterpart with attention to EXR. The similar test does

not display any significant difference between both funds for all measures of fund performance.

In explanatory variables, the mean of load fees is 5.7191 (5.7066; 5.7271), portfolio turnover is 90.97% (95.68%; 81.63%), diversification is 49.96% (44.54%; 61.78%), income distribution is 1.92 (2.00; 1.79), growth rate is 3.3206 (0.9318; 8.3960), and equity fund is 0.7976(0.8430, 0.7000). There are significant differences between CMF and IMF in all fund characteristics except for load fees and income distribution. Despite the insignificant difference, both funds are characterized individually and specifically by portfolio turnover, diversification, growth rate, and equities type. IMF can be explained as highly diversified most probably because the portfolio is devoted on systematically low risk of assets surprisingly and contrarily against our conjecture. Moreover, this alternative portfolio features a remarkably higher growth rate.

On the other hand, active trading proxied by portfolio turnover describes CMF that contrarily defines passive portfolio trading of IMF. This conventional portfolio also records a higher number of equities fund than IMF. All control variables appear significantly different between CMF and IMF, which the former entails a larger size of fund, higher in risk, and has a greater number of families, while the latter is favourable with long-established funds after most have converted to Shariah compliant.

Further analysis on the trend of fees and expenses structure summarised in Table 6 finds a substantially downtrend manager fees relative to an increasing MER and EXR over the period. The mean of MER and EXR have surprisingly exceeded the median for almost each sample while on average, management fees remain consistently below the median over the period. This could explain excessive expense ratio and the total overall expenses at the closing year by major number of funds when compared to the total NAV. As the decreasing trend of management fees is beneficial to investors, other expenses may be deferred in both MER and EXR.

We also report the correlation of all explanatory and control variables as presented in Table 7. The sign of correlations are mostly consistent with a number of outstanding literatures such as the well-documented relation between expense ratio and fund size. The coefficients from all bivariate correlations are perceived fundamentally in controlled, free from any symptom of serious multicollinearity. A variation inflation factor (VIF) test will be specified after each estimation for further checking on multicollinearity. Overall, the correlations indicate that the model designed with the fitted parameters seem to capture some of the economic explanation that could support in providing a further explanation between fund-specific characteristics, fees, expenses structure, and fund performance.

Table 5
Descriptive statistics for the sample of mutual funds between 2008 and 2015.

Full Sample Variables	N	Mean	S. D.	Min	Max	Skew	Kurt	CMF sample mean	IMF sample mean	Two-sample t-test
Manfees	2016	0.758690	0.152434	0.431231	0.939911	-0.683813	2.349336	0.752207	0.772758	-2.4274**
MER	2016	1.716503	0.382806	0.590000	2.480000	-0.854737	5.396251	1.686810	1.787719	-3.794***
EXR	2016	0.005384	0.004811	0.000877	0.017749	1.314860	3.739004	0.005575	0.004974	2.612***
Raw	2016	0.017395	0.186819	-0.381565	0.356757	-0.373518	2.912003	0.017973	0.016420	0.159800
Jensen	2016	0.008250	0.173517	-0.347647	0.332797	-0.257987	2.810626	0.009583	0.005025	0.285100
Loadfees	2016	5.719071	0.612646	5	7	0.499917	2.062963	5.706626	5.727080	-1.337700
PTR	2016	0.909722	0.592219	0.180000	2.370000	0.962590	3.162704	0.956766	0.816344	4.446***
Divers	2016	0.499572	0.286391	0.017760	0.923573	-0.203417	1.793097	0.445387	0.617765	-12.56***
Distr	2016	1.920030	2.254370	0	6.980000	0.905432	2.590566	1.999095	1.787795	1.447900
Growth	2016	3.320560	32.81489	-41.78408	89.92879	1.090734	3.828038	0.931785	8.396001	-4.345***
Eqt	2016	0.797619	0.401874	0	1	-1.481522	3.194908	0.843023	0.700000	7.541***
Size	2016	17.84873	1.381151	15.31100	20.43200	0.040105	2.287169	17.91006	17.73103	3.012***
Fundrisk	2016	0.033758	0.012901	0.015960	0.063461	0.704464	2.722185	0.035065	0.030934	5.885***
Fundfamilies	2016	42.48859	32.84293	5	115	2.588473	2.588473	43.18387	40.54531	1.81290*
Fundage	2016	15.02083	7.206942	9	39	2.020783	6.979086	13.97674	16.79062	-5.596***

Note: The first column provides descriptive statistics for full sample based on pooled data across all funds and years. The second and third column present the comparison mean between CMF and IMF sample. The last column reports the t-statistics between two samples. The sign of ***,**, and * indicates significance at 1%, 5%, and 10% respectively explaining an abundantly clear difference between both samples.

Table 6

Mean (median) difference of fund expenses for full sample, CMF sample, and IMF sample.

This table presents the results for mean (median) comparison of fund expenses for full sample, CMF sample, and IMF sample between the period 2008 and 2015. The third column reports the mean (median) value of manager fees, the fourth column reports the mean (median) value of MER, and the last column reports the mean (median) value of EXR.

Year	Fund type	Manager fees		MER		EXR	
		Mean	Median	Mean	Median	Mean	Median
2008	Full sample	0.8475	0.8972	1.6419	1.6600	0.0033	0.0020
	CMF	0.8506	0.9066	1.6090	1.6450	0.0034	0.0020
	IMF	0.8409	0.8800	1.7128	1.6900	0.0032	0.0021
2009	Full sample	0.8304	0.8806	1.6944	1.6900	0.0030	0.0017
	CMF	0.8292	0.8857	1.6678	1.6700	0.0031	0.0017
	IMF	0.8331	0.8752	1.7516	1.7200	0.0028	0.0019
2010	Full sample	0.8206	0.8718	1.7052	1.6850	0.0034	0.0019
	CMF	0.8146	0.8718	1.6867	1.6700	0.0037	0.0019
	IMF	0.8333	0.8742	1.7449	1.7300	0.0030	0.0021
2011	Full sample	0.7504	0.7760	1.7344	1.6900	0.0060	0.0042
	CMF	0.7486	0.7649	1.6979	1.6700	0.0061	0.0038
	IMF	0.7543	0.7846	1.8130	1.7600	0.0058	0.0045
2012	Full sample	0.7268	0.7516	1.7496	1.7000	0.0062	0.0048
	CMF	0.7129	0.7407	1.7256	1.6900	0.0067	0.0049
	IMF	0.7568	0.7725	1.8014	1.7200	0.0055	0.0046
2013	Full sample	0.6964	0.7162	1.7178	1.7100	0.0069	0.0056
	CMF	0.6829	0.6932	1.7016	1.7100	0.0075	0.0057
	IMF	0.7254	0.7378	1.7525	1.7000	0.0058	0.0054
2014	Full sample	0.7010	0.7245	1.7450	1.7000	0.0070	0.0054
	CMF	0.6961	0.7214	1.7277	1.6900	0.0074	0.0054
	IMF	0.7114	0.7306	1.7823	1.7300	0.0063	0.0054
2015	Full sample	0.6964	0.7185	1.7436	1.7000	0.0072	0.0059
	CMF	0.6897	0.7155	1.7398	1.6900	0.0078	0.0060
	IMF	0.7108	0.7249	1.7519	1.7250	0.0063	0.0054

FINDINGS AND DISCUSSION

How Do Fund Characteristics Explain Fees and Expenses Structure?

This study employs Ordinary Least Square (OLS) regression to describe the fund characteristics on fees and expenses structure. Table 8 reports the regression results of fund characteristics on fees and expenses structure. Fees are represented by manager fees while expenses structure are proxied by MER and EXR. Model 1 to 3 encompass the full sample (Panel A), Model 3 to 6 constitute the CMF sample (Panel B), and Model 7 to 9 include IMF sample (Panel C). Each model also incorporates year dummy variable to control for unobserved heterogeneity factors. *F*-statistics display significant model that fits the data sampled and *R*-squared is acceptable across all panels, showing that all models are sensible with good estimators. VIF test confirms no serious multicollinearity as reported in the preceding pairwise correlation.

The results show that the structure of fees and expenses is primarily determined by the proactive fund management in trading securities and managing a portfolio. Interestingly, the active the fund management, the lesser the manager fees incurred. In contrast, both expenses are related positively with PTR. Active managing portfolio demands a huge expenditure but reacts inversely on fees probably because fees are stipulated at fixed on NAV below the maximum allowable rate. The decreasing trend of fees provides another reason that active fund management is mostly financed by the increasing MER and EXR. Highly diversified funds such as IMF thirsts for a substantial amount of fees upon the manager skills in establishing a systematic low risk portfolio. Again, the findings show some mixed results when a more diversified funds are inversely related with EXR. Further, this negative effect remains in IMF on MER contrasting to the positive effect in CMF. While load fees contribute positively to EXR, it is somewhat unsurprising that income distribution paid to unit holders increases EXR. Equities fund demonstrate a lower manager fees, but some evidence show it increases EXR and MER in IMF. The nature imposition of manager fees, MER, and EXR would provide some justifications as to the reason on the different effect of fund characteristics on fees and expenses structure. Fees generally play as fixed expenses whereas EXR acts as variable costs in adapting to the fund management activities. The total cost of MER consists both fees and expenses that could highlight mixed direction of fund-specific characteristics.

On the contrary, fund with a larger growth poses a way to reduce EXR. This is particularly consistent with those of Chance and Ferris (1991), McLeod and Malhotra (1994), Malhotra and McLeod (1997), Tufano and Sevick (1997), and Latzko (1999) on the benefit of economies of scale. Likewise, fund size and fund

age illustrate the similar direction on EXR to support the idea of having the large scale of economies that results in a more sustainable expenditure and competitive pricing. To answer the related hypotheses, we find that manager fees can be explained negatively by PTR and equities fund, but directly by the diversification level. With regard to expenses structure, high PTR, superior income distribution, and equities type of funds are crucial attributes with no difference between CMF and IMF that explain the rising effect on EXR, holding all else constant. A higher growth resembles the effect of economies of scale in controlling and reducing expenses. Both funds can be distinguished based on a number of attributes. For example, load fees increase the total manager fees in CMF whereas it increases EXR in IMF. A highly diversified IMF would decrease significantly the amount of EXR. More importantly, equities funds in IMF do not only elevate EXR, but also the MER.

Does the Price Matter in Paying-Off Good Return?

In examining the second hypothesis, Table 9 presents the regression results of manager fees, fund expenses structure, and fund characteristics on fund performance. Two measures proxy for fund performance are fund raw return (Raw) and fund risk-adjusted return (Jensen). The regression is estimated employing the random effect GLS model applying panel-robust standard errors. Model 1 and 2 estimate the full sample (Panel A), Model 3 and 4 incorporate CMF sample (Panel B), and Model 5 and 6 include IMF sample (Panel C). Both *R*-squared and Wald Chi2 are highly significant and strong for all panels. It indicates good models and a number of estimators that ideally suit the estimation at a remarkably significant rate. VIF test reconfirms the absence of serious multicollinearity issue.

The consensus findings of the present study between fees and expenses structure and fund performance highlight the negative and significant relation between manager fees and fund performance, as well as, EXR and fund performance in line with the previous studies of Malkiel (1995), Hooks (1996), Carhart (1997), Dellva and Olson (1998), Dahlquist et al. (2000), Gil-Bazo and Ruiz-Verdú (2008; 2009), and Vidal et al. (2015). However, the findings also show that MER has no association with fund performance. While fund fees and expenses have a non-trivial effect on shareholder wealth (LaPlante, 2001), this negative relation mirrors the negative effect between fees charged and fund flows in Sirri and Tufano (1998) to reflect the long established economic theory of demand elasticity, particularly on the price of mutual fund services. The absence effect of MER suggests a more reasonable consideration on fees and EXR during investment selection, probably because MER may not capture all expenses realised in EXR as its computation is provided by fund management based on average NAV.

Table 7
Correlation matrix of explanatory variables for the sample mutual funds between 2008 and 2015

	Manfees	MER	EXR	Loadfees	PTR	Divers	Distr	Growth	Eqt	Size	Fundrisk	Fundfamilies	Fundage
Manfees	1.0000												
MER	-0.1117	1.0000											
EXR	0.8349	0.4730	1.0000										
Loadfees	-0.0002	0.0802	0.0824	1.0000									
PTR	-0.2743	0.3468	0.4300	0.0681	1.0000								
Divers	0.2043	0.0592	-0.1233	0.0518	0.0578	1.0000							
Distr	0.0691	-0.0358	-0.0221	0.0958	-0.0198	-0.0976	1.0000						
Growth	0.0566	0.0421	-0.1534	0.0430	0.0812	-0.0067	0.1830	1.0000					
Eqt	-0.0749	-0.0408	0.0615	0.0201	0.0162	-0.0194	-0.0766	-0.0480	1.0000				
Size	0.3951	-0.2623	-0.3490	-0.0471	-0.1009	-0.0734	0.2361	0.1752	0.0883	1.0000			
Fundrisk	0.1781	-0.1150	-0.1372	-0.0063	0.0979	0.2280	0.1237	-0.0191	0.2797	0.1668	1.0000		
Fundfamilies	0.1963	-0.1262	-0.1830	-0.1145	-0.1378	-0.1694	0.0333	0.0351	0.0518	0.5494	0.0215	1.0000	
Fundage	0.0969	0.0205	-0.0654	0.0610	-0.0824	0.2113	0.1738	-0.0021	-0.0016	-0.0533	-0.0337	-0.2215	1.0000

Note: The significant correlation at 1%, 5%, and 10% is boldly highlighted.

Table 8
Ordinary least square (OLS) regression between fund characteristics and management expenses

Variables	Panel A: Full sample			Panel B: CMF sample			Panel C: IMF sample		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Manfees	MER	EXR	Manfees	MER	EXR	Manfees	MER	EXR
Loadfees	0.009*	0.027***	0.000**	0.017***	0.019	0.000	-0.005	0.025	0.001***
	(1.92)	(1.97)	(2.11)	(3.15)	(1.06)	(0.42)	(-0.60)	(1.47)	(3.40)
PTR	-0.062***	0.217***	0.003***	-0.063***	0.257***	0.004***	-0.070***	0.108***	0.003***
	(-10.75)	(14.36)	(17.86)	(-9.76)	(13.57)	(16.38)	(-5.71)	(5.43)	(7.34)
Divers	0.061***	0.094***	-0.001**	0.055***	0.101**	-0.001	0.075***	-0.094**	-0.001**
	(5.31)	(2.68)	(2.05)	(3.59)	(2.14)	(-1.07)	(3.64)	(-2.10)	(-2.40)
Dist	-0.001	0.005*	0.000***	-0.000	0.004	0.000***	-0.003	0.002	0.000*
	(-0.99)	(1.65)	(4.03)	(-0.30)	(1.05)	(2.89)	(-1.44)	(0.32)	(1.91)
Growth	0.000	0.001**	-0.000***	0.000	0.001	-0.000***	-0.000	0.000	-0.000***
	(0.89)	(2.08)	(-8.25)	(1.18)	(1.61)	(-6.26)	(-0.25)	(0.89)	(-4.78)
Eqt	-0.043***	0.006	0.001***	-0.041***	-0.033	0.001***	-0.047***	0.080***	0.001***
	(-6.24)	(0.33)	(5.27)	(-4.65)	(-1.43)	(4.22)	(-4.31)	(3.88)	(2.93)
Size	0.039***	-0.072***	-0.001***	0.036***	-0.073***	-0.001***	0.041***	-0.081***	-0.001***
	(15.78)	(-9.76)	(-12.25)	(11.35)	(-7.35)	(-9.15)	(10.33)	(-9.84)	(-7.56)
Risk	0.004	-0.030***	-0.000**	0.000	-0.023**	-0.000	0.013**	-0.022*	-0.000*
	(1.22)	(-3.48)	(-2.10)	(0.03)	(-2.16)	(-0.84)	(2.23)	(-1.94)	(-1.66)
Families	0.000***	0.001***	-0.000***	0.001***	0.001*	-0.000***	0.000	0.000*	-0.000
	(4.07)	(3.20)	(-2.59)	(4.89)	(1.77)	(-3.50)	(0.05)	(1.91)	(-0.34)
Age	0.002***	0.001	-0.000***	0.002**	0.003	-0.000	0.001***	-0.002***	-0.000***
	(6.13)	(1.44)	(-4.60)	(2.46)	(1.37)	(-1.38)	(3.33)	(-2.94)	(-3.01)
Constant	0.109***	2.580***	0.016***	0.132**	2.549***	0.019***	0.116	3.064***	0.013***
	(2.01)	(14.28)	(9.53)	(2.00)	(11.13)	(7.94)	(1.17)	(14.86)	(4.78)
Year dummy	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Pooled observation	2015	2015	2009	1371	1371	1367	638	640	638
R-squared	0.4131	0.2015	0.4517	0.4135	0.2206	0.4591	0.4289	0.2773	0.4492
F-statistics	91.79	32.77	75.89	62.74	24.02	55.98	36.97	16.41	26.11
P-value	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
VIF	1.74	1.74	1.73	1.82	1.82	1.82	1.77	1.77	1.77

Notes: This table presents the results for OLS regressions of fund characteristics on management expenses as described in Section 3. Three measures of management expenses are manager fees, MER, and EXR explained in Section 3. Panel A presents full sample, Panel B presents CMF sample, and Panel C for IMF sample. Parentheses represent *t*-statistic showing robust standard errors using Huber-White robust sandwich estimator with ***, **, and * indicate significance at 1%, 5%, and 10% respectively.

Table 9
Random effect model regression between fund characteristics and fund performance

Variables	Panel A: Full sample		Panel B: CMF sample		Panel C: IMF sample	
	(1)	(2)	(3)	(4)	(5)	(6)
	Raw	Jensen	Raw	Jensen	Raw	Jensen
Manfees	-0.130***	-0.126***	-0.126***	-0.120***	-0.143***	-0.160**
	(-3.48)	(-3.33)	(-3.05)	(-2.99)	(-2.69)	(-2.37)
MER	0.012	0.011	0.010	0.010	0.014	0.013
	(1.32)	(1.32)	(1.01)	(1.09)	(0.81)	(0.77)
EXR	-4.314***	-4.166***	-3.940***	-3.808***	-4.865***	-5.376***
	(-3.40)	(-3.32)	(-2.91)	(-2.89)	(-2.95)	(-2.77)
Loadfees	0.001	0.002	-0.001	-0.000	0.005	0.006
	(0.46)	(0.48)	(-0.17)	(-0.08)	(0.93)	(1.01)
PTR	0.004	0.005	0.003	0.003	0.003	0.004
	(1.14)	(1.24)	(0.65)	(0.69)	(0.49)	(0.55)
Divers	0.017*	0.042***	0.006	0.037***	0.066***	0.082***
	(1.84)	(4.62)	(0.47)	(3.17)	(3.32)	(3.93)
Dist	-0.008***	-0.008***	-0.009***	-0.009***	-0.006***	-0.006***
	(-8.27)	(-7.80)	(-8.04)	(-7.41)	(-2.63)	(-2.72)
Growth	0.000***	0.000***	0.001***	0.001***	0.000**	0.000**
	(5.70)	(5.66)	(6.08)	(6.03)	(2.38)	(2.17)
Eqt	0.020***	0.020***	0.021***	0.021***	0.015**	0.015**
	(4.34)	(4.42)	(3.41)	(3.36)	(1.97)	(2.02)
Size	-0.005**	-0.004**	-0.005**	-0.004*	-0.006**	-0.005**
	(-2.62)	(-2.51)	(-2.07)	(-1.93)	(-2.20)	(-1.97)
Risk	-0.012***	-0.006**	-0.014***	-0.008**	-0.011	-0.005
	(-4.14)	(-2.18)	(-4.37)	(-2.42)	(-1.57)	(-0.81)
Families	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(4.08)	(3.85)	(3.32)	(2.99)	(3.90)	(3.65)
Age	-0.000	-0.000	0.000	0.000	-0.000	-0.000
	(-1.14)	(-1.20)	(0.23)	(0.17)	(-1.19)	(-1.30)
Constant	-0.114***	-0.144***	-0.089*	-0.127**	-0.153**	-0.163**
	(-2.80)	(-3.64)	(-1.73)	(-2.54)	(-2.22)	(-2.31)
Year dummy	Yes	Yes	Yes	Yes	Yes	Yes
Pooled observation	2009	2009	1367	1367	638	638
R-squared	0.8110	0.7916	0.8029	0.7810	0.8504	0.8362
Wald Chi2	9143.81	8658.64	5249.99	5250.32	4747.45	4424.78
P-value	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
VIF	2.10	2.10	2.23	2.23	2.06	2.06

Notes: This table presents the results for random effect model regressions of fund characteristics on fund performance as described in Section 3. Two measures of fund performance are raw return and Jensen Alpha risk-adjusted return explained in Section 3. Panel A presents full sample, Panel B presents CMF sample, and Panel C for IMF sample. Parentheses represent *t*-statistic showing robust standard errors using Huber-White robust sandwich estimator with ***,**, and * indicate significance at 1%, 5% and 10% respectively.

Table 10
Mean (median) difference of fund performance between high and low quality funds for CMF and IMF sample

	Mean (median) value for high quality funds	Mean (median) value for low quality funds	*p*-value of difference in means	*p*-value of Wilcoxon signed rank test	*n*
Panel A: Manager fees					
CMF	0.7458	0.7598	0.1058	0.0637*	1376
	(0.7725)	(0.7994)	(-1.6184)	(-1.8540)	
IMF	0.7725	0.7741	0.8867	0.5612	640
	(0.7850)	(0.8078)	(-0.1425)	(-0.5810)	
p-value	0.0183**	0.2948			2016
t-test	(-2.3635)	(-1.0483)			
Panel B: MER					
CMF	1.7027	1.6679	0.1365	0.0049***	1376
	(1.6900)	(1.6600)	(1.4900)	(2.8160)	
IMF	1.7997	1.7721	0.1536	0.1032	640
	(1.7400)	(1.7000)	(1.4288)	(1.6290)	
p-value	0.0114**	0.0049***			2016
t-test	(-2.5347)	(-2.8197)			
Panel C: EXR					
CMF	0.0058	0.0056	-0.8135	-0.7630	1376
	(0.0035)	(0.0035)	(0.4161)	(0.4455)	
IMF	0.0051	0.0047	-1.4224	-0.5830	640
	(0.0036)	(0.0037)	(0.1554)	(0.5601)	
p-value	0.2433	0.0141**			2016
t-test	(1.1677)	(2.4591)			

Notes: This table presents the results for mean (median) comparison of fund fees and expenses structure for CMF and IMF sample with paired sample of funds with high and low quality between the period 2008 and 2015. Mean difference is followed by classical hypothesis *t*-test within and between the sample and Wilcoxon signed rank test. Panel A reports the mean (median) value of manager fees, Panel B reports the mean (median) value of MER, and Panel C reports the mean (median) value of EXR. Parentheses for *p*-value represent *t*-statistic with ***,** and * indicate significance at 1%, 5%, and 10% respectively.

We further examine whether a quality fund design a costly fees and expenses structure. Following Berkowitz and Kotowitz (2002), a high quality fund defined as fund which generates positive alpha whereas low quality fund engenders otherwise. We separate between two in a subsample and report each mean and median of fees and expenses for CMF and IMF in Table 10. A simple *t*-test and non-parametric statistical hypothesis test compare the difference in mean for both subsamples classified between CMF and IMF. The findings show that the settings of fees and expenses structure are indistinguishable between high and low quality funds. The cost of fund may be partially determined regardless of the quality. However, in high quality funds, the proportion of manager fees and MER are higher as reported in IMF than CMF, but slightly lower for EXR in low quality funds. Surprisingly, MER is designed greater in IMF even in low quality funds compared to its counterparts. This evidence corroborates expensive cost incurred, and more importantly, excessive expenses in low quality funds that could increase information asymmetry and mislead the shareholders, particularly

those underlined by IMF. Overall, the findings provide a strong evidence to reject the second hypothesis.

To What Extent These Fund-Specific Characteristics Influence Performance Between CMF and IMF?

On fund performance, our findings reveal the fund characteristics, such as PTR and load fees have no significant relation as reported in the previous evidence (see Table 9). A highly diversified with substantial growth funds indicate a positive relationship on performance. We interpret these results as highly diversified funds manage portfolio risk systematically at lowest level possible to sustain a good persistent performance. A higher growth fund also expands the totals assets to favour a more dynamic portfolio. Moreover, equities funds gain benefit from the positive interaction with fund performance, though the effect is weaker or marginally significant in IMF panel contrary to the positive expectation of its higher growth. This would suggest good growth effect in CMF rather than a weaker positive growth effect in IMF. The single most striking finding emerged is the negative relation of income distribution. Thus, the higher income declared might seem appealing to potential investors, but, not a good indicator on enhancing an outstanding fund performance. All the relations of fund-specific characteristics support the negative relation between fees, expenses, and fund performance. Our aim is to investigate any difference of fund characteristics between CMF and IMF in explaining fund performance. CMF demonstrates funds with high impact of growth rate while IMF distinguishes by emphasising a well-diversified portfolio on performance. Overall, each fund-specific characteristic between CMF and IMF influences performance besides the negative association of income distribution, except for the absence effect of load fees and portfolio turnover. In this case, we can reject all the hypotheses five to eight partially on the fund performance relation.

CONCLUSION

This paper is an investigation of the fund characteristics, fees, and expenses structure between CMF and IMF between the period 2008 and 2015. More specifically, it examines how fund-specific characteristics explain fees and expenses settings and fund performance. Fund-specific characteristics proxy are load fees, PTR, diversification degree, income distribution, growth rate, and equities class fund. Shariah principle governs the main portfolio management of IMF underlying the activities that highly motivate this study in comparing the

relevant fund characteristics, fees, and expenses structure against the traditional portfolio management of conventional counterpart.

The main result displays that fees and expenses structure between CMF and IMF is significantly different, predominantly IMF sets a higher manager fees and MER to a relatively lower EXR than its counterpart, despite the plummeting trend of fees at the climbing pace of MER and EXR over the period. Active fund management curbs the fees but tend to increase both expenses structure. Similarly, equities fund resists the fees while increasing EXR at the favourable positive performance. Fund with load fees raises expenses structure as well to obstruct high volume of sales and collect other charges. Although highly diversified fund increases fees, it reaches a better performance most probably due to its capability to reduce EXR. Coinciding with economic theory and our evidence, income distribution and fund growth illuminates the negative interaction between expenses and fund performance. Income distribution multiplies expenses at an inferior fund performance and vice versa for good fund growth. Both funds explain a peculiar individual different characteristic that benefits expenses and fund performance, in which CMF implies a strong growth effect whereas IMF presents a strong and sound diversification. Furthermore, the quality of funds does not seriously matter in the settings of fees and all expenses. This is exacerbated by a higher MER in low quality funds strengthened by an evidence of IMF that outlines enormous fees and MER compared to CMF in high quality funds.

These findings have several implications for investors, funds, and industry in general. Fund-specific characteristics can be the principal foremost reference and guidelines for potential retail investors to get involved in portfolio management on the fundamental knowledge basis of investing. As far as fees and expenses are concerned, investors are supposed to be made well aware and informed about the total real costs incurred explicitly in master prospectus and annual report, so that it could possibly counteract the expected fund performance. Such findings also give knowledge advantages to them in reviewing and evaluating a large number of available funds in the market amongst many other competitors before a critical decision making. Fund management especially banks should understand the fees and expenses structure and justify with reasonable grounds behind the settings in reaching fair quality and pay-off performed funds. Large economies of scale suggests a lower overall investment cost to investors. With unambiguous objectives and the interest of shareholders, fund management will vicariously liable in designing a competitive pricing policy besides controlling operational deferred expenses. If this accountability performed by funds, the industry would probably witness a higher growth and inflows, as many public investors hunt for a truly affordable professional advice on investment at the trade-off between profit

and cost. The industry regulator and policy makers have to constantly improve the regulation and governance framework with regard to ensuring a more highly, timely, and accurately financial report that reflects a representative fund fees and expenses to reduce information asymmetry and promote open market efficiency.

Limitations are not excluded from this study as funds considered in the sample mostly comprise equities and balanced funds only, for an equivalent risk, performance benchmark, fees, and expenses structure comparison. In addition, we emphasize on fund-specific characteristics to explain fees, expenses structure, and fund performance when in fact other factors such as manager skills and management style are not considered. Most importantly, the findings are relevant in the landscape of Malaysian mutual fund industry since the regulation and fund operational may differ from other countries. The rising of expenses in IMF suggests an investigation for future research that possibly enhances our understanding behind the different structure.

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