3rd International Conference
"Economics and Management-Based on New Technologies"
EMoNT-2013
13-16 June 2013, Vrnjačka Banja, Serbia

INVESTMENT FUNDS IN THE FUNCTION OF STIMULATING ECONOMIC GROWTH AND DEVELOPMENT

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Summary: *Investment funds are one of the generators of economic growth and economic development. They are present in all developed countries of the world, contributing to the establishment of liquidity and macroeconomic stability. For investment funds is often said to have renovated the total financial system of the world. Their function is to encourage savings, the concentration and efficient allocation of capital that is very important for all countries, especially those that are scanty in capital. The future of investment funds industry in Serbia is determined by the further development of capital markets, improvement of legislation, the achievement of macroeconomic and political stability, educating and informing the investing public.*

Keywords: *investment funds, economic growth and development, efficient mobilization and optimal allocation of capital.*

1. INTRODUCTION

Investment funds are financial institutions of collective investment. They perform the function of financial intermediaries who pool resources of individual investors, and then thus associated funds place in different types of assets, thus realizing a number of benefits for individuals like the service of a complete professional portfolio management, reducing investment risk by diversifying the portfolio, reducing transaction costs and the like. In addition to meeting the investment needs of individual investors, investment funds have become in time more able to meet the needs of large institutional investors as well, which clearly indicates their dynamic growth and development. Total global assets managed by the investment funds in late 2011 amounted to 23.8 billion dollars. In the global market of investment funds dominate investment funds from the United States with total assets of 11.6 billion dollars, accounting for 49% of total assets managed by investment funds in the world. In second place are the European Investment Funds which account for about 1/3 of global assets, namely 30%, while the investment funds from the rest of the world account for only 21% of total assets [17]. Today there are numerous types and variations of investment funds in the world. We encounter them under different names and in different forms depending on the development of the financial market of a given country.

2. THE INFLUENCE OF INVESTMENT FUNDS ON ECONOMIC GROWTH AND DEVELOPMENT

Investment funds have been created with the goal directly introducing the small and uninformed investors, through the back door, in the "big world of finance". The main reasons for their popularity among small investors are:

- relatively high return rates (more than the rate of return on fixed-term savings deposits)
- relative safety (thanks to diversification of the portfolio),
- a high degree of liquidity [11].

Investment funds are one of the generators of economic growth and economic development. The investment funds achieved the impact on economic growth and development by performing its basic functions that make them significant for both investors and the economy as a whole, namely:

- *transfer of financial resources from surplus to deficit entities* – the investment funds sell their shares (investment units) to a surplus sector, and then thus raised funds borrow to a deficit sector, i.e. invest in the deficit sector. It is about indirect financing which reduces the cost of connecting the surplus and deficit entities, transaction costs, costs of seeking investment alternatives, information costs, costs of control and the like. Redirection of financial resources from surplus to deficit sector is important both for the sector and for the economy as a whole that is for economic growth and development, because when surplus sector would not lend money to deficit sector, it would have an opportunity cost in the form of missed interest and deficient sector would not have available the means necessary to realize good business ideas that is the investment projects contributing to the development of the economy as a whole. Therefore, if the financial market is underdeveloped and unless the financial intermediaries such as investment funds exist, it is very difficult to transfer funds from entity not seeing the advantage of the investment to the entity observing the benefits. Ultimately the entire economy would be at a loss.
- *efficient mobilization and optimal allocation of financial resources* – the investment funds are considered the most important aspect of collecting the fragmented and dispersed savings of population and its allocation into profitable companies [13]. They, therefore, mobilize financial savings and channel it in the financially the most successful sectors in that way providing their contribution to economic growth and development. "Fresh" capital tends to be allocated to those companies and branches of industry that have high rates of return [6]. Mobilization of financial resources involves the use of the smallest in amount savings as well. Investment funds mobilize the capital of a large number of individuals and place thus collected funds in a portfolio of securities, due to which, in terms of terminology, perhaps more appropriate name for these funds would be "Portfolio Funds". For the allocation of investments in different countries and in different markets, the investment funds are taking into account the long-term potential of GDP growth, macroeconomic stability, potential for further development of the capital market, as well as the potential development of a specific company. Owing to the efficient mobilization and optimal allocation of financial resources it is said for the investment funds that they make financial market more dynamic, bearing in mind the link between the financial and real sector their impact on economic growth and development is more than obvious.
- *reduction of investment risk through portfolio diversification* – the investment funds achieve the intended effects of diversification by investing the collected financial potential in a number of different securities, the yields of which are moving in a different direction. Portfolio diversification is achieved by buying emissions in different industry branches, purchasing emissions in different companies, expanding investment in a larger geographic area, purchasing programs with diversified product lines, time distributed acquisition over different periods, balancing offensive and defensive portfolio securities that is the securities with the value of the beta coefficient of less than 1%, and securities with a beta coefficient of more than 1% [6]. It is important to point out that diversification reduces or even completely eliminates, only unsystematic risk associated with a particular issuer company, while the systematic risk attributable to macroeconomic factors can not be avoided by diversification. In each case, reduction of investment risk through portfolio diversification is evident and also very important for stimulating economic growth and

development, as lower investment risk encourages individual and institutional investors to improve their investment activity.

- *achieving economies of scale effects (reduction of transactions related costs)* – the investment funds in large quantities buy and sell securities. A large amount of trading securities places high discount, even up to 90% of transaction costs in relation to the costs that an individual investor would have [13]. Therefore, thanks to economies of scale that is huge resources and large portfolios, investment funds have lower transaction costs than individual investors. Due to lower trading costs individual investors are opting to invest money in investment funds instead of buying their own securities, which is also important to economic growth and development, because it is assumed that the investment funds will be more successful than individual investors in the allocation of collected resources.
- *attracting foreign capital and encouraging privatization in transition countries* – the investment funds provide easier entry of foreign capital, which is particularly important for the growth and development of countries in transition, which previously have to ensure macroeconomic stability. The establishment of macroeconomic stability, especially price stability is a major factor in attracting foreign investment. Investment funds are also used as one of the main levers of privatization in these countries.

Except by way of performing its core functions, the investment funds, as one of the most important institutions of modern financial systems, generate economic growth and development by:

- *Encouraging savings* - thanks to the numerous benefits they provide to their investors, the investment funds present in many countries a means long-term savings unmatched. Investment funds encourage savings by offering a rate of return higher than interests on term deposits with banks. They also contribute to the savings growth by the efficient allocation that is by channeling it in the most successful financial sectors. Citizen savings is a very important factor in the development of the economy and also a great potential for the improvement of people's living standards. As much as the savings is important, as important is its efficient investment and investment funds are, without a doubt, one of the best financial "conductors" of savings to investments in the financial systems of developed countries [11].
- *strengthening the competitiveness among financial institutions* - investment funds are a significant factor in encouraging competition in the financial sector and increase of the efficiency of financial intermediation. Offering a rate of return higher than the rate of return on fixed-term savings deposits, with relative safety and high liquidity, investment funds in many countries have managed to take over the traditional markets of other financial institutions. Particularly targeted were the banks that tried to defend themselves by emitting specific investment funds in their own arrangement. However, many have realized that according to the slogan "if can not do anything to them, join them" they can find their place in the functions of patrons within the distributive sales organization of the funds [11]. As a result of sound financial competition, the banks are obliged to increase passive and decrease active interest rate. The increase in passive interest rates (the interest rate the bank pays on deposits received) encourages savings and the reduction of active interest rates (the interest rate that banks charge on loans) encourages investment activity without which economic growth and development would be unthinkable.
- *deepening and development of capital markets* - investment funds are a convenient form of the development and efficient functioning of capital markets. A developed capital market offers the possibility of creating new enterprises and allows to the existing ones easier coming to the capital needed for new projects and capital increase. Investment funds can influence on the development of small and medium-sized enterprises, as their founders or co-owners, which has a positive impact on production and employment that is economic growth and development [5].

Thus, the benefit from the development of investment funds is not limited to the surplus and deficit entities, but is reflected in the economy as a whole through higher savings rates, better investment decisions (better allocation of capital), capital market development, the greater degree of competition among financial institutions and attracting foreign capital.

Additionally speaking the development of investment funds affects economic growth, but it depends on it as well. Practice has shown that the development of the investment funds industry coincides with the level of economic development of the country. Also, in countries where the banking sector is the backbone of the financial system, the investment funds develop more slowly (Japan, Germany) [8]. In fact, one of the consequences of the domination of banks i.e. credits as a source of funds in the financial system is neglecting the alternative sources of funding - the issue of equity and debt securities. Therefore, the development of investment funds is made more difficult, as a wide range of financial instruments is an important prerequisite for their development.

3. CURRENT STATUS AND PROSPECTS OF INVESTMENT FUNDS IN SERBIA

Under domestic Law on investment funds, investment funds are collective investment institutions within which they collect and invest funds in various types of assets in order to generate revenue and reduce investment risk. Domestic regulation in the area of operations of the investment funds were adopted at end of 2006, and a few months later (at the beginning of 2007) the first investment fund in our country was founded- Delta Plus Fund. 2007 was the most successful in the history of Belgrade Stock Exchange and therefore very favorable for the emergence and development of the investment funds industry. Unfortunately, the initial enthusiasm was stopped by the current world economic crisis with its far-reaching consequences. The first stock market decline and fall of stock exchange indices followed, and then a sharp decline in the value of investment units in 2008 and 2009, to which investors generally reacted by withdrawing their funding. The appearance of investment funds just before the emergence of the global economic crisis highly slowed their development. Nevertheless, in 2010 and 2011 a slight recovery in investment funds industry was recorded, namely a slight increase in the value of their property. Contribution to the recovery of the investment funds industry was provided by the state as well. For example, at the end of 2009 The Commission for the Securities, in order to encourage the development of investment funds, allowed mutual funds to invest capital abroad (up to 30% of its assets), while the limit for private individuals has increased from 10% to 20% of the capital stock.
In Serbia there are currently 15 investment funds (3 balanced funds, 7 Value growth funds and 5 funds to preserve the value of assets), and the value of their investment units as of 06.04.2013 is shown in the table below:

Table 1: Investment funds in Serbia
[Source: http://www.kamatica.com/investicije/investicioni-fondovi]

Balanced funds	Inv. unit value
Delta Plus	635.93
Triumph Balance	1280.51
ERSTE Euro Balanced 35	1511.21
Value growth funds	
FIMA ProActive	417.48
Ilirika GLOBAL	333.16
Delta Dynamic	318.20
Triumph	497.67
Kombank Invest	631.86
Raiffeisen WORLD	1202.26
Ilirika GOLD	788.37
Funds to maintain the value	
FIMA Novac	1380.73
Ilirika EURO	1299.97
Erste Cash	1408.77
Raiffeisen CASH	1429.14
Erste Euro Cash	1165.32

The highest value of the investment unit has Erste Investment Fund Balanced Euro 35 (1511.21), which belongs to the group of balanced investment funds, and the minimum value of the investment unit has equity fund Delta Dynamic (318.20). Almost 50% of funds are property value growth funds.

However, in the future, attention should be focused on low-risk funds, such as funds to preserve the value of assets and income funds, with the aim of encouraging existing and attract new investors.

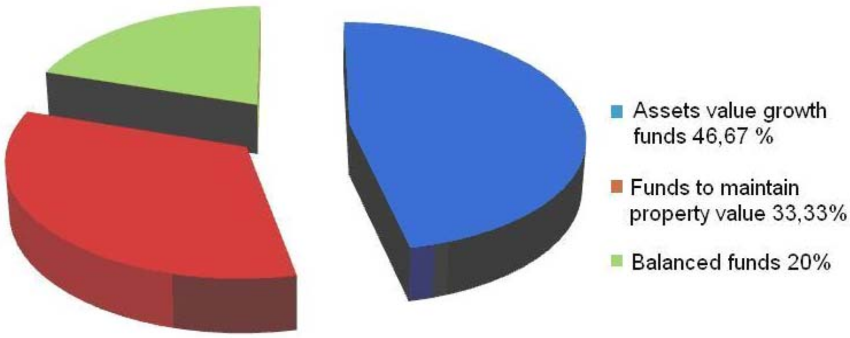

Figure 1: The structure of investment funds in Serbia

It is necessary to emphasize that our country has been the last in the region that passed legislation in the field of investment funds. Hence its lagging regarding development of the sector in relation to neighboring countries (Croatia, Slovenia and Hungary). The number of investment funds in Croatia and Slovenia is about 10 times, and in Hungary even 20 times greater than in Serbia. If we, instead of a number of investment funds in the country and the region, would compare their property we would come to even worse results for Serbia. However, delayed legislation in the area of investment funds is not the only culprit of their modest development. In fact, even if the legal provisions in the country have been made earlier the development of investment funds industry could not have happened much earlier, because for their affirmation it is required:

1) liquid market of securities (in order to successfully resolve the specific issue of liquidity defense and create the appropriate information basis for valuation of its assets, and therefore liabilities), and
2) a sufficiently wide range of different financial instruments (in order to take advantages of the diversification of investments).

The problems will continue to affect the recognition of this form of collective investment are absolutely and relatively high transaction costs, and potential conflicts of interest between the organizers of the fund, as the agent and individual investors as principal [8].

Factors affecting the development and operation of investment funds can be divided into external and internal. The external factors include: 1) savings (as a basis for further investment), 2) economic growth (which attracts not only foreign investors but also the potential founders of new investment funds), 3) financial literacy of the population (citizen education strengthens their confidence in investment funds), 4) legal regulation and 5) fiscal policy (important to create a favorable investment climate). On the other hand the internal factors of the development and operation of investment funds include: 1) portfolio managers, 2) technical analysts, 3) databases and 4) sales network. The sales network is the key to the success of many operations of the investment funds, and one of the solutions for development of the investment funds in Serbia is including banks in distribution sales network that is the synergy of investment funds with banks [13].

For efficient operation of investment funds in Serbia it is necessary that the following conditions are met:

1) strengthening and improving the system of measures aimed at achieving macroeconomic and political stability,
2) wider offer of high-quality equity and debt securities,
3) increase of the level of savings that would stimulate investment opportunities,
4) stable and stimulating tax system (to avoid double taxation and frequent changes in tax rates and the elimination of tax returns earned by investing in investment funds)
5) a better system of educating and informing the general public about the benefits provided by this form of investment,
6) high-quality professional staff that will contribute to the efficiency of investment funds operations,
7) active monitoring the developments in the international financial markets [5].

In addition, Serbia has to reach a certain level of GDP growth to become an interesting area of establishment and functioning of not only domestic but also foreign investment funds.

4. CONCLUSION

Investment funds are institutional investors that withdraw the funds of small individual investors, and place thus withdrawn and pooled funds in different types of assets in order to achieve the maximum possible return for a given level of risk, with respect to the principles of safety, liquidity, and the principle of risk dispersion.

The impact investment funds on economic growth and development is achieved by encouraging savings, efficient mobilization and allocation of optimal capital, deepening and development of capital markets, increasing competition among financial institutions, attracting foreign capital and encouraging privatization in transition economies like ours.

The appearance of investment funds just before the emergence of the global economic crisis highly slowed their development. It is necessary to emphasize that our country has been the last in the region that passed legislation in the field of investment funds. Operation of investment funds in Serbia is defined by the Law on Investment Funds and regulations of the Commission for the Securities, as the regulatory body responsible for the supervision of management companies and investment funds.

In Serbia, in the near future, we should expect an expansion of all types of investment funds. If we look at the European countries which are not members of the European Union we will notice that the Serbian economy is the most developed in the region (Croatia is excluded because it will since July 1, 2013 become a member of the EU). With this in mind it is likely that the bulk of investments of the investment funds in the region will be directed right into the Serbian economy.

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