A Model for Investigating the Effects of Power Sources on Mutual Fund Performance and Financial Reporting Quality

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ABSTRACT

In order to try, research, and study to accurately identify the factors that determine managerial performance, researchers have paid particular attention to specific and influential factors such as power sources, characteristics, skills, and behavior of managers. This study aimed to investigate the relationships of investment manager power sources with mutual fund performance and financial reporting quality. Accordingly, the authors tried to improve the quality of financial reports and offered suggestions about mutual fund rankings to help investors make the best decisions. We also look at which power source is most effective in mutual fund performance and reporting quality. To this end, the data from 120 investors and experts working in 66 mutual funds in 2020 were collected using the questionnaire method. The obtained data were then analyzed using structural equation modeling. Manager power influenced both mutual fund performance and financial reporting quality. In addition, mutual fund performance mediated the relationship between manager power and financial reporting quality.

Keywords:

Power Sources, Mutual Fund Performance, Financial Reporting Quality.

1. Introduction

An organization's ability to achieve its desired goals relies on the performance of its managers, which in turn is greatly influenced by the sources of power used by the managers. Today, increasing population growth and rising public demands for easy access to public services have led to the expansion of government organizations. This has enormously complicated the responsibilities of managers of these organizations. The crucial role of manager performance, which itself depends heavily on manager power sources, in accelerating the development of society on the one hand and meeting the general needs of individuals, on the other hand, highlights the importance of the selection of competent managers (Lari Dashtbayaz et al., 2018).

For years, various banks and credit institutions, as depository institutions, have been the main entities attracting monetary deposits from people. However, in recent decades, many investment funds and companies have started competing with these depository entities, although under the title of non-depository institutions. Mutual funds have recently entered this competition as open-ended investment institutions (Eslami Bidgoli et al., 2005).

In mutual funds, managers control and handle all affairs, investors provide managers with financial resources, and managers decide how to use these resources. Therefore, owners are always concerned about managers' performance in using resources effectively and creating higher value. Accordingly, proper manager performance evaluation can increase investor trust in mutual funds (Vadiei, 2012). Performance evaluation is a critical issue in the management of mutual funds. Performance evaluation reveals how an investment manager can create a balance between returns and acceptable risk.

Managers need to have the power to manage various affairs in a group or organization. Moreover, to maximize their power, managers must increase the dependence of others on themselves. For example, managers can increase the reliance of a senior official on themselves by improving their business-related knowledge and skills because the senior official is inevitably more dependent on a manager for he/she finds no reasonable alternative (Robbins, 1998).

Financial reporting is one of the most essential products of accounting systems that primarily aims to provide users with necessary information about performance evaluation and corporate profitability to help them make the best economic decisions. Obtaining and processing accurate information can considerably affect the investment decisions of shareholders. It should also be noted that the mechanism people choose to collect such data is of great importance (Mehrani et al., 2014).

The present study aimed to investigate the relationships of power sources of investment managers with mutual fund performance and financial reporting quality. Accordingly, the authors tried to improve the quality of financial reports and offered suggestions about mutual fund rankings to help investors make the best decisions.

2. Research literature and background

2.1 Power

Scholars have proposed several classifications of leadership or supervisory power (Strong, 1999); however, French and Raven (1959) seem to have offered the most popular classification of sources of power (Kim, 2004). Power can be defined as the ability of a group to affect or control the behavior or attitude of members of another group. According to French and Raven (1959), the most essential sources of power include coercive power, reward power, legitimate power, expert power, and referent power (Rahim, 1988).

2.2 Mutual fund performance evaluation

Performance evaluation occurs in two stages: assessing the desirability of performance and measuring the stability of performance. To do this, the portfolio risk level must be estimated over a specific period (Christidis, 2010).

2.3 Financial reporting quality

Financial reporting quality is essential primarily because of the widespread belief that high-quality information results in more significant judgments and decisions. In other words, high-quality financial reporting information is more useful than low-quality information when making important decisions (Nikbakht and Ebrahimi, 2012).

2.4 Research background

Hartner (2021) argued that power is a fundamental issue in organizations, which is exercised by organizations and their supervisors. The path analysis results showed that the perceived coercive power of the organization and supervisors is positively associated with employees' inner resignations. In addition, the perceived legitimate power of the organization and supervisors was positively related to the contextual performance of employees and negatively related to their inner resignations. Finally, supervisors' reward power was found to reinforce the relationship between the organization's legitimate power and employees' inner resignation.

In their study, Bahar et al. (2021) introduced reward power as a decisive factor motivating students. Teachers use coercive and legitimate power to modify students' disciplinary behavior.

Hofmann et al. (2017) found that coercive power creates an unfriendly atmosphere and increases compulsory obedience, while legitimate power creates a friendly environment and encourages rational trust and voluntary cooperation. Unexpectedly, legitimate power negatively affects unfriendly atmospheres and positively influences compulsory obedience.

In the study of Mihai Tasian et al. (2016), employees believed that their leaders have high levels of referent and expert power, low levels of reward and coercive power, and a moderate level of legitimate power. They concluded that referent and expert power are well established in the organization, but managers must devise plans to increase levels of reward power in the future.

Maheen (2021) examined the beating capacity of assets with active management during the market recession, and observed that the Indian Mutual Fund cooperates with the market with active management and does not have the ability to beat the market.

According to Wan Ismail et al. (2021), conditional conservatism has been prevalent during the corporate governance reforms, and the results are inclusive even after performing extensive specification tests. They observed that after the corporate governance reforms, the financial statements of Malaysian companies have become more reliable for investment decisions.

Namakavarani et al. (2021) found significant positive relationships between the audit committee and the qualitative characteristics of financial information in high-level political positions, as well as between financial knowledge and the quality of financial information. They also suggested that political economy theories can help researchers carry out comprehensive studies in the future.

In their study on financial reporting quality, Van Beest et al. (2009) successfully devised a valid and reliable method for evaluating the quality of financial statements. By complying with the FASB and the IASB (2008) request to make quality characteristics operationally measurable, they developed a measurement tool that improves the evaluation of financial reporting information.

Falah Shams et al. (2021) conducted a quantitative study to investigate the effects of power sources on mutual fund performance and financial reporting quality. They concluded that manager power affects mutual fund performance and financial reporting quality. They also observed that the variable of corporate performance mediates the relationship between manager power and financial reporting quality.

The findings of a study carried out by Bagher Salimi et al. (2014) indicated that the type of power influences stress levels. In addition, a significant relationship was found between manager power bases (including formal power and personal power) and employee stress levels. All components of formal power were positively related to job stress, while dimensions of personal power negatively affected job stress. In other words, higher use of formal power (including legitimate, coercive, and reward power) increased job stress in subordinates. In comparison, higher use of personal power reduced perceived job stress levels in employees.

3. Research hypotheses

3.1 Main hypotheses

1) Manager power predicts mutual fund performance.
2) Mutual fund performance predicts financial reporting quality.
3) Manager power predicts financial reporting quality.
4) Mutual fund performance mediates the relationship between manager power and financial reporting quality.

3.2 Sub-hypotheses

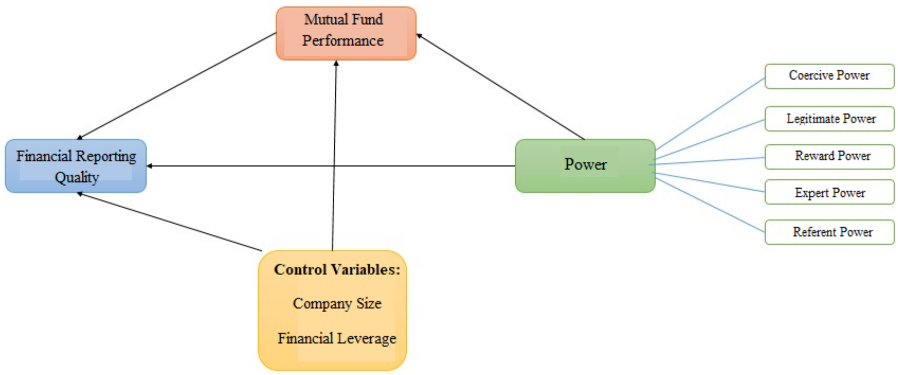
1) Coercive power predicts mutual fund performance.

2) Coercive power predicts financial reporting quality.
3) Mutual fund performance mediates the relationship between coercive power and financial reporting quality.
4) Reward power predicts mutual fund performance.
5) Reward power predicts financial reporting quality.
6) Mutual fund performance mediates the relationship between reward power and financial reporting quality.
7) Legitimate power predicts mutual fund performance.
8) Legitimate power predicts financial reporting quality.
9) Mutual fund performance mediates the relationship between legitimate power and financial reporting quality.
10) Expert power predicts mutual fund performance.
11) Expert power predicts financial reporting quality.
12) Mutual fund performance mediates the relationship between expert power and financial reporting quality.
13) Referent power predicts mutual fund performance.
14) Referent power predicts financial reporting quality.
15) Mutual fund performance mediates the relationship between referent power and financial reporting quality.

4. Methodology

The study population consisted of all experts and investors of mutual funds, of whom 120 individuals working in 66 mutual funds in 2020 were selected as the study sample. The data were collected using Rahim Leader Power Inventory, Van Beest's Standard Financial Reporting Quality Scale, and the researcher-made Mutual Fund Performance Evaluation Questionnaire. Finally, given the small size of the study population, the final sample was determined after excluding funds with different fiscal year ending (because their financial statements were not available during the study period) and removing the funds that not complete, and submitting the questionnaires.

This descriptive cross-sectional applied survey was carried out using an inductive research approach. The data were collected using the desk and field (questionnaire) methods (Hafeznia, 2008).



Conceptual research model

4.1 Research variables

The research variables were divided into the dependent and independent categories:

A. Dependent variables

The two dependent variables included mutual fund performance and financial reporting quality. Two separate models were designed to investigate the effects of the independent variable (power resources) on each of these dependent variables.

Mutual fund performance

The researcher-made Mutual Fund Performance Evaluation Questionnaire was used to measure mutual fund performance in structural equation modeling. Exploratory factor analysis was used to determine the constructs of this questionnaire. To this end, Kaiser-Meyer-Olkin (KMO) was used to assess the adequacy of the data for conducting factor analysis, and Bartlett's Test of Sphericity was conducted to examine the correlation between items of each construct.

Table 1: Bartlett's p-value

KMO	Bartlett's p-value	
0.758	$\chi 2$	9085.535
	df	4560
	Level of significance	0.000

The obtained KMO value was 0. 758 (> 0.7), and Bartlett's p-value was 0.000; thus, the data are suitable for conducting exploratory factor analysis.

Financial Reporting Quality (FRQ)

Financial reporting quality was assessed using Van Beest's (2018) Standard Financial Reporting Quality Scale. Several researchers have confirmed the psychometric properties of this 22-item questionnaire. The items are scored on a five-point Likert scale to measure observations or perceptions.

B. Independent variables

Power sources

Rahim Leader Power Inventory (RLPI) was used to measure manager power. The psychometric properties of this scale have been confirmed in several studies (Lam, 1997; Rahim and Magner, 1996; Hess and Wagner, 1999). Rahim and Magner (1996) confirmed the validity of the model by analyzing three national samples (1474 people) and two foreign samples (978 people). Several other studies (e.g., Rahim et al. (1994)) support the structural validity of this model (Rahim, 2014). The items are scored on a five-point Likert scale to measure subordinates' observations or perceptions of bases of manager power. Higher scores indicate greater managerial power (Rahim, 2014).

4.2 Validity and reliability assessment

The validity and reliability of the research tools were assessed using Waltz and Bausell's Content Validity Index and reliability coefficient, respectively.

Table 2: validity & reliability

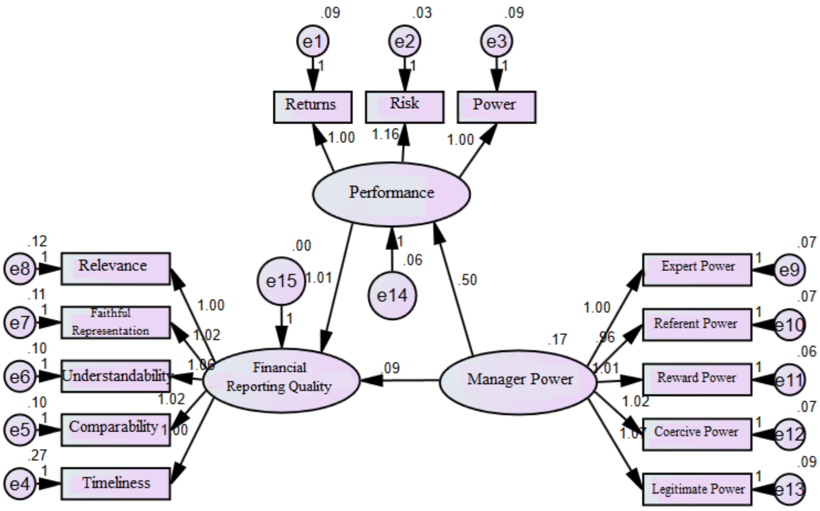
Dimension	Item(s)	Cronbach's alpha (validity)	Cronbach's alpha (reliability)
Relevance	4	0.754	0.841
Faithful representation	5	0.802	0.854
Understandability	5	0.753	0.798
Comparability	6	0.741	0.754
Timeliness	2	0.725	0.715
Financial reporting quality	22	0.782	0.814
Return	5	0.795	0.758
Risk	15	0.712	0.831
Manager ability	5	0.703	0.765
Mutual fund performance	25	0.798	0.803
Expert power	7	0.745	0.901
Referent power	7	0.725	0.896
Reward power	7	0.746	0.858
Coercive power	7	0.782	0.799
Legitimate power	7	0.725	0.813
Manager power	35	0.795	0.874

5. Results

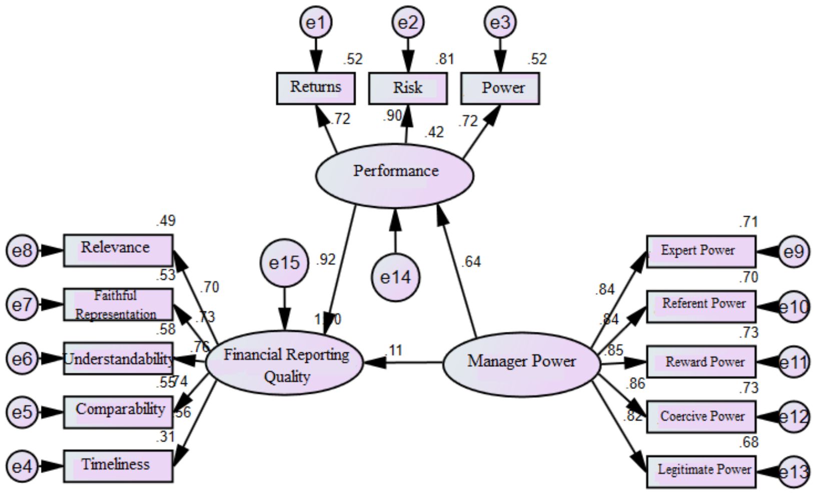
The research hypotheses were tested after confirming the goodness of fit of the conceptual research model.

5.1 Measurement and structural models

In this section, the goodness of fit of the conceptual research model was assessed to ensure that the model fits the data well. To this end, the measurement and structural research models were assessed and analyzed.



Mode1 1: Non-standardized regression coefficients of the research model



Mode1 2: Standardized regression coefficients of the research model

According to the above model, the standardized regression coefficients of the effects of manager power and performance on financial reporting quality were 0.11 and 0.92, respectively. Therefore, the effect of performance on financial reporting quality is greater than the impact of manager power on this variable. Accordingly, performance may mediate the relationship between manager power and financial reporting quality; hence, the Sobel test was carried out to confirm the mediating role of performance in this relationship. Moreover, the effect of manager power on performance was calculated as 0.64.

As shown in the above table, all regression coefficients are significant.

Table 3: Regression coefficients and significance levels of research variables

Path			Coefficient	Standard error	Critical value	Level of significance
Performance	→	Manager power	0.497	0.045	10.929	0.000
Financial reporting quality	→	Manager power	0.094	0.042	2.249	0.025
Financial reporting quality	→	Performance	1.009	0.078	12.984	0.000

(P < 0.01***)

Table 4: Goodness of fit indicators

Indicator	*χ2*	*CMIN/DF*	*CFI*	*NFI*	*RMSEA*	*GFI*
Value	67.569	1.056	0.990	0.975	0.013	0.971

CFI and NFI compare the fit of the proposed model to that of the independent model (the null model). The obtained CFI (0.990) and NFI (0.975) values were both greater than 0.9, indicating that the model fits the data well.

The root mean square error approximation (RMSEA) represents the difference between the mean observed residual correlation/covariance of the sample and the estimated population covariance. According to Lohlin, RMSEA values < 0.08 indicate a good fit.

GFI is used to measure the proportion of variance accounted for by the estimated population covariance (Range: 0-1). The calculated GFI value is 0.971 (> 0.90); thus, the research model has a good fit.

In this section, the Sobel test was used to confirm the mediating role of performance in the relationship between manager power and financial reporting quality.

In the Sobel test, the significance level was 0.000 (< 0.05); therefore, the mediating effect of performance in the relationship between manager power and financial reporting quality was confirmed at a 95% confidence level.

Table 5: Sobel test

Path			Coefficient	Standard error
Performance	→	Manager power	0.497	0.045
Financial reporting quality	→	Performance	1.009	0.078
Sobel statistic		8.399		
Level of significance		0.000		

5.2 A summary of research findings

Hypothesis	Result	Direction
Main hypothesis 1: Manager power predicts mutual fund performance.	Confirmed	Direct
Main hypothesis 2: Mutual fund performance predicts financial reporting quality.	Confirmed	Direct
Main hypothesis 3: Manager power predicts financial reporting quality.	Confirmed	Direct
Main hypothesis 4: Mutual fund performance mediates the relationship between Manager power and financial reporting quality.	Confirmed	Direct
Sub-hypothesis 1: Coercive power predicts mutual fund performance.	Confirmed	Direct
Sub-hypothesis 2: Coercive power predicts financial reporting quality.	Confirmed	Direct
Sub-hypothesis 3: Mutual fund performance mediates the relationship between coercive power and financial reporting quality.	Confirmed	Direct
Sub-hypothesis 4: Reward power predicts mutual fund performance.	Confirmed	Direct
Sub-hypothesis 5: Reward power predicts financial reporting quality.	Rejected	-----
Sub-hypothesis 6: Mutual fund performance mediates the relationship between reward power and financial reporting quality.	Confirmed	Direct
Sub-hypothesis 7: Legitimate power predicts mutual fund performance.	Confirmed	Direct
Sub-hypothesis 8: Legitimate power predicts financial reporting quality.	Confirmed	Direct
Sub-hypothesis 9: Mutual fund performance mediates the relationship between legitimate power and financial reporting quality.	Confirmed	Direct
Sub-hypothesis 10: Expert power predicts mutual fund performance.	Confirmed	Direct

Hypothesis	Result	Direction
Sub-hypothesis 11: Expert power predicts financial reporting quality.	Rejected	-----
Sub-hypothesis 12: Mutual fund performance mediates the relationship between expert power and financial reporting quality.	Confirmed	Direct
Sub-hypothesis 13: Referent power predicts mutual fund performance.	Confirmed	Direct
Sub-hypothesis 14: Referent power predicts financial reporting quality.	Rejected	-----
Sub-hypothesis 15: Mutual fund performance mediates the relationship between referent power and financial reporting quality.	Confirmed	Direct

6. Discussion and Conclusions

All the four main hypotheses were confirmed; therefore, the variable of manager power affects mutual fund performance and financial reporting quality.

Sub-hypotheses 1 to 3 were all confirmed, indicating that managers have used coercive power to influence mutual fund performance. Some managers may have been appointed to their position because of their close relations with senior officials; therefore, they may have used coercive power to maintain their position because of their lack of expertise and lack of authority. Proper mutual fund portfolio management requires high concentration and accuracy. Accordingly, any coercive behavior may disturb the concentration of investment experts, result in hasty and irrational decisions, reduce mutual fund returns, and decrease asset value; however, investors believe that coercive power improves mutual fund performance. This can be attributed to the fact that investors answered the questions in 2020 when the stock prices of many companies listed on the Tehran Stock Exchange increased sharply due to high inflation, severe sanctions, and the COVID-19 pandemic. In general, the stock market was growing very fast; hence, the investors assumed that all mutual funds had performed very well. Therefore, they answered the questions with a very optimistic view about the performance of mutual funds.Furthermore, due to the repulsive behavior of these managers, other employees tend to disclose their performance and provide relevant financial statements to all users. This leads to the release of quality financial statements and reports. In line with the present results, Bagher Salimi et al. (2014), Azizi et al. (2011), Hartner (2021), and Pourghaz and Mohammadi (2011) found positive relationships between coercive power and sports abilities, job stress, inner resignation, and independence-seeking behavior in employees. However, inconsistent with the present findings, Mollahosseini and Kahnooji (2009) and Falah Shams et al. (2021) found that coercive power has a negative relationship with employee commitment and no significant relationship with mutual fund performance. Therefore, it can be concluded that coercive power is only effective on some occasions.

Sub-hypotheses 4 to 6 assessed the variable of reward power. In this regard, it can be stated that despite the soaring national inflation rate and the ability of professional managers to earn substantial profits from their personal portfolios, employees of these funds receive poor rewards. This is mainly due to the small commission fee of mutual funds for financial institutions. In addition, investment experts and managers also receive very small rewards compared to their heavy responsibilities; therefore, they are not much concerned with the performance of the funds. However, due to their unique position and relationships, they have access to information about the allocation of funds (e.g., the purchase and sale of securities). They can use this type of information to optimize their personal stock portfolios. Moreover, it should be noted again that the participants (investors) answered the questions in 2020 when the stock prices of many companies listed on the Tehran Stock Exchange increased sharply; therefore, they answered the questions with a very optimistic view about the performance of mutual funds and assumed that all mutual funds had performed very well. No significant relationship was found between reward power and financial reporting quality. This reveals the inefficiency of the reward system, especially since the financial unit was directly deprived of the resource allocation reward. Bagher Salimi et al. (2014), Mollahosseini and Kahnooji (2009), Pourghaz and Mohammadi (2011), Kumar et al. (2021), and Bahar et al. (2021) found that reward power affects stress, commitment, tolerance of ambiguity, risk-taking ability, achievement orientation, and internal control of employees, greater trust in leaders, and high learning motivation in students. In addition, in line with the present results, Yukl and Falbe (1991) observed that middle managers are more likely to use reward power than other organizational managers. Finally, these findings contrast with the results of Falah Shams et al. (2021).

The results of testing sub-hypotheses 7 to 9 should be interpreted with regard to the definition of legitimate power. In this regard, the respondents (including mutual fund experts and investors) believed that managers with important organizational positions possess great legitimate power. According to the participants, legitimate power influences mutual fund performance and financial reporting quality, because they believe that legitimate power is the main source of other sources of power (e.g., coercive and reward power). On the other hand, due to Iran’s stock market boom at the beginning of 2020 and the production of up-to-date statistics in mutual funds, investors (the participants) assumed that the performance of investment funds and the quality of financial reporting were very high; thus, they answered the questions very optimistically. Inconsistent with these findings, Falah Shams et al. (2021) observed that legitimate power has no significant impact on mutual fund performance and financial reporting quality. The results align with the findings of Mollahosseini and Kahnooji (2009) and Hartner (2021) regarding the negative relationships of legitimate power with employee commitment and inner resignation. Moreover, consistent with these findings, Kumar et al. (2021), Hofmann et al. (2017), Bahar et al. (2021), Nikmaram et al. (2018), Bagher Salimi et al. (2014), and Pourghaz and Mohammadi (2011) observed direct associations between legitimate power and variables of trust in leaders, rational trust, voluntary collaboration, modification of disciplinary behavior in students, conflict management styles, job stress, creativity, and tolerance of ambiguity. Yukl and Falbe (1991) argued that this source of power is among the most important reasons for compliance with the requests of bosses and colleagues.

Sub-hypotheses 10 to 12 assessed the variable of expert power. Managers who use their expertise substantially improve the performance of their mutual funds. In other words, these individuals do not change financial statements because they believe that they should disclose and report the actual performance of mutual funds. Managers with great expertise spend their time and energy where they need to. They do not manipulate financial reports, and therefore financial reporting quality is not related to the expertise (expert power) of investment managers. Having expertise does not only mean holding academic degrees because managers with high academic degrees do not necessarily deliver good performance. Expert managers can appropriately allocate and select among different resources and are able to maintain a balance between returns and risk. They can also take advantage of market fluctuations to create value for shareholders. In line with these results, Kumar et al. (2021), Savolainen (2021), Hernandez et al. (2020), Mollahosseini and Kahnooji (2009), and Pourghaz and Mohammadi (2011) observed direct relationships between expert power and variables of trust in leaders, opinion leaders’ power, subordinate satisfaction, commitment, creativity, and tolerance of ambiguity. However, Bagher Salimi et al. (2014) observed that expert power is negatively associated with employee stress. Yukl and Falbe (1991) concluded that expert power is among the major reasons for compliance with the requests of bosses and colleagues. These results are consistent with the findings of Falah Shams et al. (2021).

Sub-hypotheses 13 to 15 examined the variable of referent power. There was a significant relationship between referent power and mutual fund performance. This is probably due to the fact that in Iran, information rent is a crucially important investment factor. In addition, investment and mutual fund experts and investors believe that many managers have been appointed to their position in financial institutions and companies because of their close relations with senior officials or political figures. Therefore, the high referent power of these managers improves mutual fund performance. However, no significant relationship was observed between referent power and financial reporting quality. In this study, all of the rejected hypotheses examined the variable of financial reporting quality; therefore, it seems that investors are unsure about companies' provision of quality information. For example, due to the imposition of heavy sanctions against Iran, many Iranian export companies are offering massive discounts in order to sell their products on global markets. Since these discounts are not clearly mentioned in financial statements, investors are skeptical about the accuracy of financial statements and reports released by these companies. In other studies, Hernandez et al. (2020), Mollahosseini and Kahnooji (2009), Nikmaram et al. (2018), Azizi et al. (2011), and Pourghaz and Mohammadi (2011) concluded that referent power positively influences subordinate satisfaction, conflict management styles, employee commitment, creativity, achievement orientation, satisfaction, and sports abilities.On the other hand, Bagher Salimi et al. (2014) observed a negative link between referent power and employee stress. Yukl and Falbe (1991) introduced referent power as a major reason for compliance with the requests of colleagues and bosses. Unlike the present results, Falah Shams et al. (2021) argued that managers with high referent power are unable to create value for shareholders because of their limited expertise.

6.1. Suggestions

- Given the significant effects of the manager on fund performance and financial reporting quality (main hypotheses 1-4), investors are suggested to identify and analyze fund managers’ sources of power when making investment decisions.
- Given the results of testing main hypotheses 1-4, authorities of Tehran Stock Exchange are suggested to rank mutual and investment funds by considering managers’ various sources of power, based on their knowledge, experience, relationships, teamwork, allocation and selection abilities, and the ability to create a balance between risk and returns.
- Considering the results of testing sub-hypotheses 1-3 and sub-hypotheses 7-9, experts and investors are suggested to evaluate portfolio performance when performing fundamental analysis of investment funds.
- Regarding the significant effects of reward and legitimate power on mutual fund performance (sub-hypotheses 4-9), authorities are suggested to determine fund managers' reward and commission fee based on their funds' performance and returns.
- Considering the high importance of legitimate power (sub-hypotheses 7-9), flexible laws and regulations must be enacted in order to enable managers to cope with different political and economic situations.
- Given the results of testing sub-hypotheses 10-12, authorities are suggested to recruit investment managers based on their expertise and qualifications.
- According to the results of testing sub-hypotheses 13-15, referent power was found to have no significant effect on financial reporting quality. Since managers with high referent power cannot improve fund returns and are unable to create value for investors in thriving markets, relevant authorities are suggested to temporarily dismiss these managers during market booms.

6.2. Suggestions for future studies

- Given the positive relationship between manager power and financial reporting quality, researchers are suggested to identify factors affecting manager power and rank these factors using the hierarchical analysis process (AHP) in future studies.
- Researchers are suggested to design a causal model of factors affecting manager power using the fuzzy Dematel technique.
- Managers with high reward, expert, and referent power were unable to positively influence financial reporting quality; therefore, researchers are suggested to determine the impact of financial manager power sources on financial reporting quality.
- Finally, researchers can carry out similar studies in other industries (e.g., the banking industry) to further examine other aspects of manager power.

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