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Does mutual fund advertising provide necessary investment information?

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Abstract

Purpose – Finance theory proposes that consumers require information about the risk-return trade-off credibility information to relieve principal-agent conflict concerns, and transaction cost information – for investment decisions. This paper aims to investigate whether or not such information is present in advertisements for one investment vehicle – mutual funds.

Design/methodology/approach – All advertisements in *Barron's* and *Money* over two years were content-analysed to determine the degree to which mutual fund advertising practice adheres to theories regarding information necessary for optimal investment decisions. Use of techniques known to influence advertisement noting (i.e. advertisement size and colour) and copy readership (i.e. visual size, text length, unique selling proposition/brand-differentiating message, celebrity endorsements, direct or indirect comparisons with competitors, and emotional appeals) was also investigated. Finally, because mutual funds are a financial service, the presence of convenience information (e.g. investment minima, access to agents or account information, and liquidity) was studied.

Findings – Mutual fund advertisements are not providing the information necessary for optimal investment decisions. Mutual funds use techniques known to increase the likelihood that their advertisements are noticed, but they also use techniques known to decrease the readership of their advertisements. Also, they rarely included convenience information.

Research limitations/implications – Mutual fund advertisements attempt the activation of the advertised brand-quality and the long copy-quality heuristic. However, future research must determine whether or not consumers are applying these two heuristics on seeing mutual fund advertisements.

Originality/value – Mutual fund advertising is not serving consumers. Regulators should require all mutual fund advertisements to include an easy-to-read table summarizing necessary investment information to assist consumer decision making.

Keywords Advertising, Transaction costs, Financial management, Rate of return

Paper type Research paper

Mutual funds are one of the most important financial service vehicles for investments. Total mutual fund assets are \$14 trillion. In the USA, more than \$7.4 trillion are

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invested in mutual funds. Over half a trillion dollars are invested in mutual funds in Canada, Argentina, Brazil, Chile, Costa Rica, and Mexico. In Europe, more than \$4.6 trillion are invested in mutual funds (Investment Company Institute, 2004). The mutual fund industry has been one of the fastest growing market sectors in many European economies over the past decade (Jordan and Kaas, 2002). Mutual funds are important financial services in developing countries as well, such as India, Indonesia, and Malaysia (Ramasamy and Yeung, 2003). Due to the risk, the choice of financial services, such as mutual funds, should be a highly involving area of consumer decision making. And in fact, Aldlaigan and Buttle (2001) did find financial service decisions regarding investments to be highly involving. A consumer's financial security, investment portfolio, and retirement dreams often ride on good decision making in this area. To make the best decisions, consumers require certain types of information. Theories from the discipline of finance predict that consumer decision making in regard to selecting a mutual fund would be influenced by considerations of risk-return trade-off, agency issues, and transaction costs.

Mutual funds need the support of investors to survive. Mutual funds use advertisements as a way to communicate with investors. Due to increased competition, advertising for mutual funds has been increasing (Jordan and Kaas, 2002). Jain and Wu (2000) found a strong cause-and-effect relationship between mutual funds advertising and investment decisions. Thus, advertisements provide us with a window into the assumptions made by mutual funds about their investors' decision-making process.

Not much is known about the degree to which actual advertising practices adhere to theories regarding the type of information that investors require to make the best decisions. Prior research has studied the information that financial advisors consider important to know about mutual funds (Ramasamy and Yeung, 2003); the influence on risk-return estimates of the magnitude of numbers in a mutual fund's name, the association of a mutual fund with a well-known vs an unknown investment firm, and the use of emotional appeals (Jordan and Kaas, 2002); and the relationship between mutual fund advertising and investment funds flow (Jain and Wu, 2000); and applied consumer behaviour principles to develop a set of testable propositions in regard to mutual fund advertising (Lichtenstein *et al.*, 1999). However, prior research has rarely considered the information included in actual advertisements for mutual funds. In fact, the advertising practices of the financial services industry are woefully understudied (Albers-Miller and Straughan, 2000). With the recent accounting and mutual fund scandals, the information presented for all types of financial products is under increasing scrutiny (Treanor, 2003; Lewis, 2003). Unfortunately, the type and nature of information available to consumers during their pre-purchase search for financial services is in need of more research (Harrison, 2003).

Therefore, the purpose of the current study is to examine how information in actual mutual fund advertisements aimed at consumers conforms to theories from the discipline of finance regarding the information consumers require when making investment decisions. The current study uses a content analysis of mutual fund advertisements to understand the message that mutual funds are trying to send the investors. As mentioned earlier, financial theory suggests that these messages should indicate that there is a trade-off between risk and return. Also, mutual fund managers could be trying to demonstrate that their mutual fund reduces the principal-agent conflict for investors (Jensen and Meckling, 1976) by providing information pertinent to

agency issues. One might also expect mutual fund advertisements to include transaction cost information to:

- attempt to increase sales to price-sensitive consumers if the loads and management fees to administer a mutual fund are low relative to competing mutual funds; or
- attempt to increase sales to consumers using a price-quality heuristic if the loads and management fees to administer a mutual fund are high relative to competing mutual funds.

As a competing set of hypotheses, this study posits that mutual fund advertisements may not adhere to financial theory regarding the information that consumers require for investment decisions. Instead mutual fund advertisements may use techniques that advertising research has previously found to be effective with other products (e.g. large advertisement sizes, large visuals, convenience appeals, emotional appeals, etc.) The present study will determine if mutual fund advertising practice follows predictions based on financial theory and/or advertising research.

Risk-return trade-off

The dominant paradigm in the theory of finance involves the trade-off between risk and return (Jordan and Kaas, 2002). This paradigm stems from the assumption of risk-averse, rational investors that is used to characterize the utility function of a representative investor. The representative investor is typically assumed to have a monotonic increasing, concave utility of wealth (Huang and Litzenger, 1988; Ingersol, 1987). Such a utility function characterizes an investor who desires higher return but also wants to avoid higher risk. Therefore, in order to induce such an investor to assume greater risk, higher expected return must be present. The capital asset pricing model (CAPM), one of the central theories of finance, posits that the expected return on an asset is a linear function of the systematic risk associated with that asset. Therefore, we should expect mutual fund advertisements to position themselves in the risk-return spectrum. Thus:

- H1.* Mutual fund advertisements will include information on the trade-off between risk and return.

Agency issues

The relationship between the investor and the mutual fund manager can also be modelled as a relationship between the principal (i.e. the investor) and the agent (i.e. the mutual fund manager). The investor entrusts his/her money to the mutual fund for investment. There are regulatory checks on what the mutual funds can or cannot do, but the fact remains that the action and the information of the mutual fund manager is not visible to the investors. This asymmetric information gives rise to agency costs or principal-agent conflict. Principal-agent relationships have been investigated extensively in finance (Arya *et al.*, 2000; Ross, 1973; Holmstrom, 1979; Fama, 1980; Grossman and Hart, 1983). Since mutual fund advertisements are directed at investors, we can reasonably expect that these advertisements will try to extenuate the agency issues. Information that could reassure investors that their money is safe with a particular mutual fund includes stability information (e.g. the fund's age, the number of

years the firm has been selling mutual funds, the mutual fund manager's tenure or reputation), independent or company-sponsored information on past performance, testimonials from consumers, ratings from an independent source (e.g. *Morning Star*), and certification information (Lichtenstein *et al.*, 1999; Ramasamy and Yeung, 2003). Accordingly, our second research hypothesis is:

- H2. Mutual fund advertisements will include credibility information to mitigate agency cost concerns of investors.

Transaction costs

Costs of mutual fund operations (such as loads, i.e. sales commissions, management fees, brokerage costs, etc.) are substantial (Chordia, 1996; Dellva and Olson, 1998; Livingston and O'Neal, 1996, 1998) and should be taken into account by any investor before deciding to entrust his/her money to the mutual fund. In their review of the literature, Ramasamy and Yeung (2003) conclude that transaction costs (i.e. the expense ratio) is often inversely related to the performance of a mutual fund. However, many investors believe you get what you pay for, in other words, the higher a mutual fund's transaction costs the better its performance (Lichtenstein *et al.*, 1999). Thus, regardless of whether consumers consider a mutual fund's transaction costs to be positively or negatively related to return, it appears to be an important piece of information that one would expect advertisements for mutual funds to include.

- H3. Mutual fund advertisements will include information on transaction costs.

Advertising research on appeals and executional factors

Whereas financial theory suggests that consumers seek information on the risk-return trade-off, credibility/agency issues, and transaction costs and, therefore, mutual fund advertisements will include such information; advertising research suggests that mutual fund advertisements will use advertising techniques that have been commonly shown to increase noting and readership.

Copy testing in advertising research has found certain factors that commonly increase the proportion of consumers who notice an advertisement. The size of advertisement has a great influence on whether or not consumers will notice a particular print advertisement or not. Previous research has shown that larger advertisements are more likely to be noticed than smaller ones and that a majority (64.9 per cent) of magazine advertisements are a full page in size or larger (Franke *et al.*, 2004; Grønhaug *et al.*, 1991; Valiente, 1973). Additionally, advertising research has demonstrated that colour print advertisements are more likely to be noticed than black-and-white advertisements (Finn, 1988; Holbrook and Lehmann, 1980; Valiente, 1973). Therefore, if mutual funds are attempting to increase the proportion of consumers who notice their advertisements, one would expect that:

- H4. Mutual fund advertisements will be at least a full page in size and colour.

Larger visuals or illustrations have been found to increase readership of that advertisement (Holbrook and Lehmann, 1980). While increases in visual information appears to be valued by consumers, verbal information tends to be valued more if it is succinct. Text length is a disincentive that has been shown to decrease readership of

print advertisements (Franke *et al.*, 2004; Starch, 1966). A unique-selling proposition (i.e. brand-differentiating message), which indicates the uniqueness of the brand, its attributes or claims, is an important influence on readership as well (Stewart and Koslow, 1989). Holbrook and Lehmann (1980) also demonstrate a relationship between comparisons and readership. Given that financial services, such as mutual funds, are intangible and difficult for the average consumer to grasp, peripheral cues in advertising, such as celebrity endorsements or emotional appeals, should also be important determinants of consumer choice decisions (Harrison, 2003). Holbrook and Lehmann (1980) found that the use of celebrity endorsers and emotional appeals did influence the readership of advertisements for other consumer products. Interestingly, in their experiment, Jordan and Kaas (2002) found that adding emotional appeals to mutual fund advertisement stimuli also lowered perceptions of risk. Therefore:

H5. Mutual fund advertisements will contain large visuals, short text, unique-selling propositions, comparisons, celebrity endorsements, and emotional appeals.

Finally, because mutual funds are a financial service, convenience appeals should be important. Convenience is also an important determinant of consumer choice in service industries (Albers-Miller and Straughan, 2000). In their study of consumers of internet banking financial services, Jun and Cai (2001) found that convenience factors, such as ease of access to one's account and ease of access to and responsiveness of service personnel, were important determinants of consumer satisfaction. Albers-Miller and Straughan (2000) showed that, in print advertisements for banks, demonstrating the convenience of a financial service should help convince business and professional consumers that the financial service is a good value for the money. Lee and Marlowe (2003) found that the most important factor in the choice of checking accounts was convenience, which included access to bank service personnel and account access. Therefore, the current study hypothesizes that:

H6. Mutual fund advertisements will contain convenience appeals.

Method

Content analysis was used to test the hypotheses. Content analysis provides a scientific, quantitative, and generalizable description of an advertisement's content (Kassarjian, 1977). Content analysis of print advertisements has been used in prior research to document the actual advertising practices of the financial services industry (Albers-Miller and Straughan, 2000; Jain and Wu, 2000). To conduct the content analysis, three coders were hired to analyse the mutual fund advertisements included in all the 1999 and 2000 issues of *Barron's* and *Money*. These two publications were chosen because

- they are two of the most widely read investment magazines (Mediamark Research Inc., 2003); and
- they had served as the sample for an earlier study of mutual fund advertising (Jain and Wu, 2000).

Each advertisement was coded for the presence or absence of the information, appeals, and executional factors that either financial theory or advertising research suggested

might be present in mutual fund advertisements. In coding the risk-return trade-off, coders coded whether or not each advertisement explicitly mentioned the risk-return trade-off (e.g. higher returns carry greater risk), risk-adjusted returns, risk mentioned without discussing any specific level of risk, low risk, high risk, increasing risk, decreasing risk, return mentioned without discussing any specific level of return, low return, high return, increasing return, or decreasing return. In coding agency issues, each advertisement was coded as to whether or not credibility information was present to assuage investor's principal-agent conflict concerns. This credibility information included independent information describing the mutual fund's past performance, company-sponsored information describing past performance, information about the firm's stability as indicated by the years in business, information about the firm's stability as indicated by the length of time they had been selling mutual funds, certification information; ratings from an independent source (e.g. *Morning Star*), testimonials from actual consumers, and information highlighting the personal reputation of a mutual fund manager or corporate officer. Each advertisement was coded as to whether or not it included information to establish transaction costs. Transaction cost information included management fees, annual distribution fees (i.e. 12b-1 fees), custodial fees, commission information (e.g. front-load, back-load, no load, or commission-free), or information on the tax implications of the mutual fund investment.

In addition, each advertisement was coded on the variables that advertising research has indicated are important. Size of the advertisement was coded as either less than a full page or a full page or longer. Advertisement colour was coded as either black and white, black and white with one or more colours to highlight important visual or verbal information (e.g. two-colour or three-colour printing), or full-colour (four or more colours). Visual size was coded as no visual present, visual comprises less than a quarter of the advertisement space, visual comprises a quarter to less than half of the advertisement space, visual comprises half to less than three quarters of the advertisement space, or the visual comprises three quarters or more of the advertisement space. Text length was coded as either 50 words or less or more than 50 words, because Starch (1966) found that advertisements with 50 words or less were more than twice as likely to be read as those with more than 50 words. Each advertisement was coded as to whether or not it contained a unique-selling proposition or brand-differentiating message (e.g. "*Unique investment opportunity . . .*," "*The one mutual fund that . . .*," "*An opportunity like no other,*" or "*The only mutual fund with . . .*"). Comparative advertising appeals were coded as no comparison present, an indirect comparison present (i.e. the comparison does not name the brand(s) to which the advertised mutual fund is comparing itself, e.g. "*Better than the leading mutual fund*", "*More than other investments,*" or "*Other investments can't match our . . .*"), or a direct comparison was present (i.e. an explicit comparison of the advertised mutual fund is made to another financial service brand, which is named or shown). Each advertisement was coded as to whether or not a celebrity endorsement was present. Each advertisement was also coded as to whether or not rational appeals were present and whether or not emotional appeals (e.g. warmth, joy, humour, fantasy, guilt, fear, regret, shock, anger, etc.) were present. Convenience appeals were measured by coding whether or not an advertisement stated that the mutual fund required a low investment minimum, the mutual fund's representatives or agents were easy to access, the mutual

fund provides easy access to account information, or the ease of withdrawing money from the advertised mutual fund (i.e. the ease of cashing in the investment or its liquidity).

One of the authors trained the coders with a sample of mutual fund advertisements drawn from issues outside of the sample to familiarize the coders with the coding scheme and instructions. The three coders worked independently of each other and the authors to code the mutual fund advertisements. Coding disagreements were discussed until consensus was reached. Inter-coder agreement ranged from 81 per cent for visual size to 100 per cent for use of celebrity endorsements and size of the advertisement.

Only advertisements for mutual funds themselves were coded. Advertisements for agents who sell investment products including mutual funds were not coded because consumers should look to these advertisements for information about an investment agent's service, not mutual fund products themselves. Advertisements for agents frequently included very little specific information regarding the mutual funds, other than their availability as one of many products sold by the agent.

Results

After duplicates were eliminated, 547 unique mutual fund advertisements were available for analysis. Of these 547 unique mutual fund advertisements, 210 appeared in *Money*, whereas 337 appeared in *Barron's*.

H1 suggests that mutual fund advertisements should include information on the risk-return trade-off. According to the CAPM, the discussion of investment returns should match the discussion of risk. Most forthright would be a discussion of the risk-return trade-off in the advertisement itself. However, the risk-return trade-off itself is explicitly mentioned in only 3.1 per cent of the mutual fund advertisement analysed ($n = 17$). There was no difference in the likelihood that the risk-return trade-off would be explicitly mentioned between *Money* (2.9 per cent of the advertisements) and *Barron's* (3.3 per cent of the advertisements; $\chi^2 = 0.71$, $df = 1$, ns). Similarly, the discussion of risk-adjusted return would also be straightforward. Risk-adjusted return was explicitly discussed in 26.1 per cent of mutual fund advertisements ($n = 143$). Readers of *Money* were more likely to encounter advertisements with statements regarding risk-adjusted returns (31.4 per cent) than were readers of *Barron's* (22.8 per cent; $\chi^2 = 4.933$, $df = 1$, $p = 0.026$).

If the risk-return trade-off or risk-adjusted return is not explicitly mentioned, the CAPM would predict that, if low risk were discussed, then low return should be mentioned. Alternatively, if high returns were discussed, then high risk should be mentioned. If information on risk matches the information on returns, this would constitute an implicit discussion of risk and return. If mutual fund advertisements that do not explicitly discuss the risk-return relationship contain at least an implicit discussion of this relationship as suggested by the CAPM, most mutual fund advertisements should appear on the diagonal of Table I's presentation of results (excluding the first cell of the diagonal which records the number of advertisements that mention neither risk nor return). However, as evident in Table I, mutual fund advertisements with no explicit discussion of the risk-return relationship generally do not follow this pattern of implicitly discussing the relationship. Only 114 advertisements appear on this diagonal; this represents only one-third (29.5 per cent) of the mutual fund advertisements with no explicit discussion of the risk-return

	Not mentioned	Mentioned (but not specific)	Risk		High	Increasing	Decreasing	Total
			Low	High				
<i>Advertisements with an explicit discussion of the risk-return relationship</i>								
Risk-adjusted return								143 (26.1)
Risk-return trade-off								17 (3.1)
Subtotal								160 (29.2)
<i>Advertisements with no explicit discussion of the risk-return relationship</i>								
Return not mentioned	26 (4.8)	17 (3.1)	1 (0.2)	7 (1.3)	2 (0.4)	7 (1.3)		60 (11.0)
Return mentioned, but not specific	3 (0.5)	33 (6.0)	4 (0.7)	19 (3.5)	-	3 (0.5)		62 (11.3)
Low return	1 (0.2)	11 (2.0)	4 (0.7)	1 (0.2)	-	4 (0.7)		21 (3.8)
High return	28 (5.1)	79 (14.4)	2 (0.4)	76 (13.9)	2 (0.4)	10 (1.8)		197 (36.0)
Increasing return	2 (0.4)	21 (3.8)	1 (0.2)	7 (1.3)	1 (0.2)	-		32 (5.9)
Decreasing return	1 (0.2)	13 (2.4)	-	1 (0.2)	-	-		15 (2.7)
Subtotal	61 (11.2)	174 (31.8)	12 (2.2)	111 (20.3)	5 (0.9)	24 (4.4)		387 (70.7)
Total								547 (100)

Notes: Percentages are shown in parentheses. The diagonal is highlighted in italics for the advertisements with no explicit discussion of the risk-return relationship to indicate those advertisements with an implicit acknowledgement of the risk-return relationship

Table I.
Risk-return information
in mutual fund
advertisements

relationship or 20.8 per cent of all the mutual fund advertisements analysed. This does not differ between the two magazines ($\chi^2 = 2.312$, $df = 1$, ns). For *Money*, 25.7 per cent of mutual fund advertisements appear on this diagonal. For *Barron's*, 17.8 per cent of mutual fund advertisements appear on this diagonal. Thus, only half of all mutual fund advertisements in the two magazines discuss the risk-return relationship either explicitly or implicitly.

If only half of all mutual fund advertisements implicitly or explicitly discuss the risk-return relationship, then how do the other advertisements address either risk or return? Of advertisements not discussing return, 43.3 per cent do not mention risk. While not discussing the risk-return trade-off relationship, this is not a clear violation of the risk-return trade-off as epitomized by CAPM, but an omission of information that should be important to investors. However, looking at the proportion of advertisements that do not discuss return, which also do not discuss risk, by the individual magazines turns up some differences; this represents 50 per cent of these advertisements in *Money* but only 36.5 per cent in *Barron's*.

On the other hand, 45.2 per cent of advertisements not mentioning risk claim the advertised mutual funds have a high return, which does violate the risk-return trade-off as characterized by CAPM. By magazine, 20 per cent of mutual funds advertised in *Money* with no mention of risk claim to have a high return, whereas the proportion is 50 per cent in *Barron's*. While many (68.5 per cent) mutual funds advertised as high risk are also advertised as high return, the reverse is not true. Of mutual funds advertised as having high returns, 54.3 per cent either do not mention risk or are not specific about risk. By magazine, 38.8 per cent of mutual funds advertised in *Money* as having high returns either do not mention risk or are not specific about risk, whereas the proportion is 62.3 per cent in *Barron's*. These are clear violations of the risk-return trade-off according to the CAPM.

H2 predicted that mutual fund advertisements should include credibility information to assuage consumers' concerns about the principal-agent conflict. Various kinds of credibility information were counted to determine if a mutual fund advertisement contained information that could assuage consumers' concerns with trusting their money to mutual fund agents. Of the 547 mutual advertisements analysed, 40 per cent contained no credibility information, 40.8 per cent contained one kind, 13.9 per cent contained two kinds, 3.7 per cent contained three kinds, and 1.6 per cent contained four or more kinds of credibility information. No difference was found between the two magazines in the proportion of mutual fund advertisements that did not contain credibility information ($\chi^2 = 2.100$, $df = 1$, ns). In *Money*, 36.2 per cent of mutual fund advertisements do not contain credibility information. The proportion is 42.4 per cent in *Barron's*.

Looking at the kinds of credibility information separately, 2.4 per cent contained independent information describing the mutual fund's past performance, 12.6 per cent contained company-sponsored information describing past performance, 10.8 per cent contained information about the firm's stability as indicated by the years in business, 7.1 per cent contained stability information as indicated by the length of time they had been selling mutual funds, 2.4 per cent contained certification information; 32.7 per cent contained ratings from an independent source (e.g. *Morning Star*), two per cent contained testimonials from actual consumers, and 17.2 per cent relied on the personal

reputation of a mutual fund manager or corporate officer to establish credibility. Significant differences exist between the two magazines for the following kinds of credibility information. Independent information describing the mutual fund's past performance is present in 5.2 per cent of mutual fund advertisements in *Money*, but only 0.6 per cent of mutual fund advertisements in *Barron's* ($\chi^2 = 12.030$, $df = 1$, $p = 0.001$). The length of time a firm had been selling mutual funds is present in 11.0 per cent of mutual fund advertisements in *Money*, but only 4.7 per cent of the mutual fund advertisements in *Barron's* ($\chi^2 = 7.522$, $df = 1$, $p = 0.006$). Certification information is present in 4.3 per cent of mutual fund advertisements in *Money*, but only 1.2 per cent of mutual fund advertisements in *Barron's* ($\chi^2 = 5.355$, $df = 1$, $p = 0.021$). The use of a mutual fund manager's or corporate officer's personal reputation to establish credibility occurs in 12.4 per cent of mutual fund advertisements in *Money*, but 20.2 per cent of mutual fund advertisements in *Barron's* ($\chi^2 = 5.527$, $df = 1$, $p = 0.019$).

Table II presents an analysis of the use of risk and return information by mutual fund advertisements with and without credibility information. Of advertisements with credibility information, 56.4 per cent do not directly mention the risk-return trade-off or risk-adjusted return. In comparison, 92.2 per cent of advertisements without credibility information do not directly mention risk-return trade-off or risk-adjusted return. Advertisements without credibility information were more likely to claim high or increasing return while also claiming low or decreasing risk or not mentioning risk at all. Advertisements without credibility information were more likely to not mention risk or mention it without discussing any specifics about the risks associated with the advertised mutual fund. No significant differences exist between the two magazines in these comparisons ($p > 0.05$).

H3 predicted that mutual fund advertisements should include transaction cost information. This transaction cost information includes management fees, annual distribution fees (i.e. 12b-1 fees), custodial fees, commission information (e.g. front-load, back-load, no load, or commission-free), or information on the tax implications of the mutual fund investment. While many mutual fund advertisements ask readers to write the firm to receive a prospectus, which would include this kind of transaction cost information, fewer than 40 per cent of mutual fund advertisements included any transaction cost information. Information on management fees was included in only 4.4 per cent of the advertisements. Commissions were also infrequently discussed; 69.5 per cent made no mention of commissions. When commissions were mentioned, it was typically to promote the lack of commission fees; 29.8 per cent of advertisements promoted no load mutual funds. Finally, 8.2 per cent of advertisements mentioned tax savings.

When the two magazines were compared on transaction cost information, some significant differences arose. Once again, advertisements in *Money* were more likely to include this information (49.5 per cent) than were advertisements in *Barron's* (33.2 per cent; $\chi^2 = 14.367$, $df = 1$, $p < 0.001$). In terms of specific transaction cost information, mutual funds were more likely to mention information about commissions or load when advertised in *Money* (44.3 per cent) than in *Barron's* (22.0 per cent; $\chi^2 = 30.409$, $df = 1$, $p < 0.001$). However, mutual funds were less likely to include information on management fees when advertised in *Money* (1.4 per cent) than in *Barron's* (6.2 per cent; $\chi^2 = 7.114$, $df = 1$, $p = 0.008$).

Table II.
Number and proportion
of mutual fund
advertisements with and
without credibility
information by
risk-return information

	Risk				Total
	Not mentioned	Mentioned (but not specific)	Low or decreasing	High or increasing	
<i>Mutual fund advertisements with credibility information</i>					
No mention of return	16 (4.9)	2 (0.6)	5 (1.5)	2 (0.6)	23 (7.0)
Mention of return, but not specific	3 (0.9)	18 (5.5)	2 (0.6)	11 (3.4)	37 (11.3)
Low or decreasing return	1 (0.3)	11 (3.4)	5 (1.5)	1 (0.6)	17 (5.2)
High or increasing return	14 (4.3)	43 (13.1)	6 (1.8)	39 (11.9)	108 (32.9)
Sub-total	34 (10.4)	74 (22.6)	18 (5.5)	59 (18.0)	185 (56.4)
Risk-adjusted return					137 (41.8)
Risk-return trade-off					6 (1.8)
Total					328 (100.0)
<i>Mutual fund advertisements without credibility information</i>					
No mention of return	10 (4.6)	15 (6.8)	3 (1.4)	7 (3.2)	37 (16.9)
Mention of return, but not specific	0 (0.0)	15 (6.8)	5 (2.3)	8 (3.7)	25 (11.4)
Low or decreasing return	1 (0.5)	13 (5.9)	3 (1.4)	0 (0.0)	19 (8.7)
High or increasing return	16 (7.3)	57 (26.0)	7 (3.2)	42 (19.2)	121 (55.3)
Sub-total	27 (12.3)	100 (45.7)	18 (8.2)	57 (26.0)	202 (92.2)
Risk-adjusted return					6 (2.7)
Risk-return trade-off					11 (5.0)

Note: Percentages are shown in parentheses

Overall, few advertisements had all three types of information that financial theory maintains is needed for an optimal decision when buying mutual funds. Looking at information on risk-adjusted return or the risk-return trade-off, credibility, and transaction costs together, 11.2 per cent ($n = 61$) had all three types of information. On the other hand, 21.4 per cent ($n = 117$) had none of this information as shown in Table III. Mutual fund advertisements that included information on risk-adjusted return or the risk-return trade-off were more likely to also include transaction cost information when they appeared in *Money* (55.6 per cent) than when advertised in *Barron's* (34.1 per cent; $\chi^2 = 7.414$, $df = 1$, $p = 0.009$). Likewise, mutual fund advertisements that included credibility information were more likely to also include transaction cost information when they appeared in *Money* (49.3 per cent) than when advertised in *Barron's* (28.9 per cent; $\chi^2 = 14.102$, $df = 1$, $p < 0.001$).

The use of some common techniques to increase advertisement noting and readership was also investigated in the sample of mutual fund advertisements. *H4* held that mutual fund advertisements would use large advertisement sizes and colour to increase noting. In regard to advertisement size, mutual fund advertisements more closely resembled advertisements for other products. Almost two-thirds of the mutual fund advertisements (66.1 per cent, $n = 307$) were one full page or larger in size. Of those that were not a full page or larger, 21.0 per cent ($n = 115$) were half a page or larger, whereas 22.9 per cent ($n = 125$) were between a quarter page to almost a half page in size. While mutual fund advertisements were fairly similar to other advertisements in size, most were black and white (75.6 per cent, $n = 369$). Full colour was used in the remaining advertisements. No advertisements used black and white with one or more colours to highlight important visual or verbal information.

Mutual funds advertised in *Barron's* were less likely to use the common techniques of size and colour to increase advertisement noting and readership. Mutual fund advertisements were more likely to be less than a full page in size when they appeared in *Barron's* (51.3 per cent) than in *Money* (31.9 per cent; $\chi^2 = 19.836$, $df = 1$, $p < 0.001$). Due to the newsprint format, colour was not as readily available in *Barron's* (0.6 per cent) as it was in *Money* (77.5 per cent; $\chi^2 = 334.343$, $df = 1$, $p < 0.001$).

H5 predicted that mutual fund advertisements would also use other common techniques and appeals that advertising research has found to increase readership. While common in advertising in general, many of these techniques and appeals

	No risk-adjusted return or trade-off information		Risk-adjusted return or trade-off information		Total
	No transaction cost information	Transaction cost information	No transaction cost information	Transaction cost information	
No credibility information	117 (21.4)	85 (15.5)	8 (1.5)	9 (1.6)	219 (40.0)
Credibility information	124 (22.7)	61 (11.2)	82 (15.0)	61 (11.2)	328 (60.0)
Total	241 (44.1)	146 (26.7)	90 (16.5)	70 (12.8)	547 (100.0)

Note: Percentages are shown in parentheses

Table III. Mutual fund advertisements by risk-return, credibility, and transaction cost information

were much less common in mutual fund advertising. For example, the size of the visuals differed greatly from those used in advertisements for other products. First, 45.5 per cent ($n = 249$) of mutual fund advertisements had no visual. Of advertisements with visuals, many (46.6 per cent, $n = 139$) had visuals less than a quarter of the advertisement's size. Another 25.2 per cent ($n = 75$) had visuals that filled between a quarter and less than half of the advertisement. Visuals that filled between half and three quarters of the advertisement comprised another 25.2 per cent ($n = 75$) of the mutual fund advertisements. Only nine advertisements (1.6 per cent) had visuals that filled more than three quarters of the advertisement. Interestingly, there was no difference between *Money* and *Barron's* in the proportion of advertisements with no visuals or with particular sizes of visuals ($p > 0.05$).

Unlike advertisements for other products, all of the mutual fund advertisements contained more than 50 words of text. Despite the long text, mutual fund advertisements did not use techniques or appeals that increase readership of advertisement text. Few mutual fund advertisements provided consumers with information claiming a unique selling proposition or showing how the advertised mutual fund was better than other mutual funds. A unique selling proposition was present in only 2.7 per cent of advertisements ($n = 15$). Only 1.1 per cent ($n = 6$) used direct comparisons between the advertised mutual fund and another mutual fund. Indirect comparisons, in which a mutual fund claimed it was better on some attribute without naming which mutual fund(s) it outperformed, were used in 8.8 per cent of advertisements ($n = 48$). No advertisements used celebrity endorsements. In regard to the types of appeals present, emotional appeals were present in only 9.1 per cent of advertisements ($n = 50$). Over 90 per cent completely relied on rational appeals. There were some differences between magazines in the use of comparative advertising. All of the mutual fund advertisements with direct comparisons appeared in *Money*. Also, mutual fund advertisements with indirect comparisons were more likely to appear in *Money* (16.2 per cent) than in *Barron's* (4.2 per cent; $\chi^2 = 23.414$, $df = 1$, $p < 0.001$).

As an investment service, *H6* predicted that convenience would be an important selling point for mutual funds (e.g. how convenient it is to buy mutual funds or withdraw money from this type of an investment). However, this was not the case, only 6.9 per cent ($n = 38$) of advertisements stated that a low investment minimum was required to buy the advertised mutual fund. Easy access to representatives or agents was mentioned in 7.7 per cent ($n = 42$) of the advertisements, whereas only one advertisement claimed the firm would provide easy access to account information. Liquidity, or the ease of cashing in the investment, was also rarely mentioned; this information appeared in 0.5 per cent of advertisements ($n = 3$).

Once again, some differences between magazines were apparent. Mutual fund advertisements were more likely to contain information on required minimum investments when they appeared in *Money* (10.5 per cent) than in *Barron's* (4.7 per cent; $\chi^2 = 6.568$, $df = 1$, $p = 0.01$). The one advertisement in our sample that claimed the firm would provide easy access to account information appeared in *Money*. However, information about access to agents was more common when mutual funds were advertised in *Barron's* (11.9 per cent) than in *Money* (1.0 per cent; $\chi^2 = 21.752$, $df = 1$, $p < 0.001$).

Discussion

Mutual funds have become an important vehicle for investment. Choosing an appropriate mutual fund is, thus, a serious activity for many investors. The current study investigated whether or not the information that financial theory maintains is needed by consumers to make optimal investment decisions was in fact included in mutual fund advertisements. This study examined mutual fund advertisements to understand whether the advertisements issued by the mutual funds incorporate the central paradigm in finance, namely the trade-off between risk and expected return, as well as information to establish the degree of principal-agent conflict and transaction costs, which are two other core concepts of finance. This was accomplished by content analysing all the mutual fund advertisements from issues of the popular consumer investment magazines *Money* and *Barron's* over a two-year period. By analysing these advertisements, it is possible to understand what mutual fund managers consider important to communicate to investors.

Interestingly, findings indicate that half of all mutual fund advertisements analysed do not explicitly or implicitly discuss the risk-return trade-off or risk-adjusted returns, 40 per cent include no proof of credibility to assuage consumers' principal-agent conflict concerns, and 60 per cent included no information on transaction costs. Only 11.2 per cent included all three types of information necessary to optimise consumer investment decisions.

The results of the current study of actual advertising practice in the mutual fund industry appear to corroborate Jordan and Kaas' (2002) experimental data in which subjects used an anchor heuristic. With an anchor heuristics, an initial starting value biases forecasts and estimates. Thus, mutual fund advertisers may be encouraging favourably biased risk-return estimates among consumers through the provision of incomplete risk-return information.

The results are also consistent with the work of Jones and Smythe (2003). They examined mutual fund advertisements in *Money* in 1979, 1989, and 1999 using Resnik and Stern's (1977) information content measure. Given that Resnik and Stern developed their measure to count instances of information in consumer packaged goods advertising, it can be difficult to directly compare the results of Jones and Smythe (2003) with the current study's results, which are based on a measure of the information that finance theory claims will optimise investment decisions. However, a close examination of both studies shows that mutual fund advertisements rarely provide transaction cost information, such as management fees, annual distribution fees (i.e. 12b-1 fees), or commission information (e.g. front-load, back-load, no load, or commission-free). In addition, Jones and Smythe found that the inclusion of such information has been decreasing since 1979. Also, it was fairly uncommon for mutual fund advertisements in either study to provide information that helps establish credibility, such as independent information describing the mutual fund's past performance, company-sponsored information describing past performance, the firm's stability as indicated by the years in business, or ratings from an independent source (e.g. *Morning Star*). Unlike transaction cost information, Jones and Smythe found that the inclusion of what the current study calls credibility information has been increasing since 1979.

With regard to almost all the types of information necessary for investors to make optimal investment decisions, the current study found that it was more likely to be

present in *Money* than in *Barron's* when differences were observed between the two magazines. There were some exceptions. The use of a mutual fund manager's or corporate officer's personal reputation to establish credibility was more likely in mutual fund advertisements that appeared in *Barron's* than in *Money*. Also, mutual funds were more likely to include information on management fees when advertised in *Barron's* than in *Money*.

The general trend toward more investment information in *Money* than in *Barron's* may be explained by the readership of each publication. *Money* has a larger, more general, less affluent, readership than *Barron's*. According to the Mediamark Research Inc. report of Spring 2003, approximately 80 per cent of *Money* readers have household incomes of \$40,000 or less with the average household income for all readers at \$73,789. On the other hand, 74 per cent of *Barron's* readers have household incomes of over \$100,000 and the average household income for *Barron's* readers is \$95,720. Whereas 17.5 per cent of *Money* readers are in top management positions in their firms, 44 per cent of *Barron's* readers are in top management and approximately 40 per cent of them work in the financial or banking industries. Thus, it appears that advertisements in *Money* are more likely to be seen by personal investors without the prior investment knowledge and expertise of *Barron's* readers. Prior research has shown that advertisers often do not include as much information in product and service advertisements when consumers have prior knowledge and expertise (Franke *et al.*, 2004). The level of expertise present in *Barron's* readers could also explain the greater prominence of information on management fees and appeals based on the personal reputations of a mutual fund manager or corporate officer.

Although the general lack of risk-return, credibility, or transaction cost information in mutual fund advertising overall can hamper even expert investors' ability to make optimal investment decisions by forcing them to collect additional information from other sources (e.g. a prospectus), the experienced investor is more likely to be aware of these other sources. The danger involves naïve consumers who may be unaware of the type of information that they should seek when making investment decisions and will purchase sub-standard mutual funds lured by promises of high return with low or no risk, unaware of which mutual funds can be most trusted with their money, and/or unaware of the transaction costs, which may be high in comparison to industry averages.

While many mutual fund advertisements are not completely forthright in terms of the information needed for optimal investment decisions, they are also not advertised in manner similar to most consumer products or services. The one exception was that most of the mutual fund advertisements were large (two-thirds were a full-page or larger), which prior research (Franke *et al.*, 2004; Grønhaug *et al.*, 1991; Valiente, 1973) has shown are likely to be noticed more than smaller advertisements. However, this was true more for advertisements in *Money*, in which 68.1 per cent of advertisements were a full page or larger, than for advertisements in *Barron's*, in which 48.7 per cent of advertisements were a full page or larger. Also, where possible, mutual fund advertisements used colour, which prior research has found attracts attention to an advertisement. While colour was rarely used overall, this is partially due to one of the two periodicals investigated (i.e. *Barron's*) being published on newsprint, whereas the other (i.e. *Money*) was printed on glossy magazine stock. Comparing the use of colour between the two periodicals from which advertisements were taken, one can see that

colour was often used where possible. Colour advertisements in *Barron's* tended to be located on the inside or outside cover positions. These were typically the only pages in which colour was available. Thus, whereas 99.4 per cent of advertisements in *Barron's* were black and white, only 22.5 per cent of advertisements were black and white in *Money* because colour was used throughout this glossy stock magazine.

Whereas mutual fund companies did use larger advertisement sizes and colour, where possible, to increase the number of consumers who noticed their advertisements, they rarely used other common advertising techniques such as large advertisement visuals, emotional appeals, or celebrity endorsements, which have long been known through advertising research to increase readership of advertisements (Fletcher and Zeigler, 1978; Holbrook and Lehmann, 1980; Valiente, 1973). Most of the mutual fund advertisements also had many paragraphs of words, including lengthy notes in small print at the bottom, which prior advertising research has repeatedly demonstrated will decrease readership (Fletcher and Winn, 1974; Franke *et al.*, 2004; Holbrook and Lehmann, 1980; Valiente, 1973).

Why are most mutual fund advertisements not providing the information that consumers will need for optimal decision making but using advertising techniques that increase noticing but not reading of the advertisements? Advertising research has found that the presence of lengthy advertisement copy can serve as a heuristic in which consumers, without reading the advertisement, conclude that the brand must be good because the advertiser has so many good things to say about the brand and/or that the advertiser must be honest because the advertisement contains so much text that consumers conclude it must be a full disclosure (Franke *et al.*, 2004; Ogilvy, 1983). Heuristics are rules of thumb used to simplify decision making (Jordan and Kaas, 2002; Lee and Marlowe, 2003). To further support the supposition that consumers are not intended to read the copy, but merely use the long copy as a quality cue, coders for this analysis reported that it took an average of 10 minutes to completely read each mutual fund advertisement. Most consumers would not be willing to spend that much time on a single advertisement. In fact, even when presented with a new advertisement, which they had never seen before, only 40 per cent of consumers spent more than 0.1 s reading the text of advertisement's body copy (Rosbergen *et al.*, 1997).

In addition to using long copy as a quality cue, prior research (Kirmani, 1990; Kirmani and Wright, 1989) has shown that the mere act of advertising can lead consumers to conclude that the brand is high quality. Many consumers will assume that a brand (e.g. a particular mutual fund) that advertises must be successful and, hence, good quality; otherwise, they could not afford the expense of advertising.

While consumers frequently simplify information search and decision making by concluding that advertised brands must be high quality, this heuristic does have some basis in fact. Jain and Wu (2000) found that mutual funds that advertise have higher pre-advertisement performance than the benchmark. Sirri and Tufano (1998) also found that mutual funds with better performance exerted greater marketing effort. Moreover, advertising techniques that consumers know increase the expense of an advertisement (e.g. larger advertisement sizes) are used as further cues with regard to the success and quality of the advertised brand.

Another reason for mutual funds to advertise may have to do with the fact that mutual funds that advertise attract more investment money (Jain and Wu, 2000). This is consistent with the findings of Sirri and Tufano (1998), who found that mutual funds

with higher media exposure get more investment flow. Unfortunately for consumers, Zheng (1999) did not find any evidence that mutual funds receiving more investment money subsequently beat the market.

A necessary corollary of Zheng's finding is that investors cannot systematically predict the performance of mutual funds. Thus, financial research has begun to investigate behavioural factors as an explanation of mutual fund investment flows. Indeed, Goetzmann *et al.* (2000) found behavioural factors to be a strong possible determinant of investment flows to mutual funds. Further evidence of the importance of behavioural factors can be found in Goetzmann and Peles (1997), who found that investors tend to recollect past performance of mutual funds with a positive bias (i.e. they seem to recollect past performance to be at a level which is greater than the actual past performance).

This paper extends the study of behavioural factors by suggesting that mutual fund advertising activates consumer decision-making heuristics that have been documented in the marketing literature. Whereas future research is needed to measure consumer perceptions of mutual funds that advertise vs do not advertise, run larger vs smaller advertisements, and use longer vs shorter advertisement copy; this paper makes some interesting suggestions based on prior research on advertising for other types of products. It suggests that many mutual funds advertise and run large advertisements in well-read consumer investment magazines to attract investment flows by convincing consumers that the mutual funds are successful and good quality through the obvious expense of large advertisements in magazines with high advertisement placement costs. Moreover, they advertise with abundant copy to convince consumers who, although unlikely to read the entire text, will likely perceive the mutual funds to be honest as they conclude that the large amount of information indicates full disclosure and high quality as they conclude that there must be many good things to say about them.

This paper should provide a strong impetus to require all mutual fund advertisements to present specific investment information. Regulatory authorities already place some constraints on the content of mutual fund advertisements. In the USA, the Securities and Exchange Commission (SEC) is the statutory authority. In addition, the National Association of Security Dealers provides mutual fund industry self-regulation guidelines. The regulations of the US are most pertinent to the current study, because the mutual fund advertisements analysed were published in two popular US investment magazines. In the UK, the Financial Services Authority (FSA) is charged with regulating the industry. In Canada, regulation of securities trading is under provincial jurisdiction. Since the Toronto Stock Exchange is the primary securities exchange in Canada and Ontario is the most populous province, the most important regulatory body in Canada is Ontario Securities Commission (OSC).

Regulatory bodies in the USA, the UK, and Canada specify that information presented be truthful and current. For example, SEC regulations provide that all performance data used in an advertisement be of the most current date possible. The NASD also scrutinizes the specific claims that appear in mutual fund advertisements to ensure their truthfulness. Likewise, the FSA requires that information in advertisement be truthful and should not be misleading. Similarly, the OSC requires that no mutual fund advertisement shall be untrue or misleading. Of course, there are regulations that are unique to a particular regulatory authority. For example, the

NASD specifies that all performance information used in an advertisement should be in a prominent text box and the OSC prohibits comparative advertising.

While mutual fund advertisements do not appear to be stating any untruthful or overtly misleading information, they are also not providing the information needed by consumers to optimise their investment decisions. Naïve consumers could conclude that the regulation of mutual fund advertising means that advertisements currently contain information needed for sound investment decisions. This is especially true given the long copy in mutual fund advertisements. Without regulation, consumers would be naturally skeptical. However, limited enforcement of the content of mutual fund advertising by regulatory authorities, such as the SEC, the FSA, or the OSC, could lead to consumers' confidence in the mutual fund advertising as a complete and honest source of information, whereas it is, in fact, an incomplete source of information needed for investment decisions. Therefore, regulatory agencies should require a chart containing risk-return, credibility, and transaction cost information that is simple to use and standardized across all mutual funds advertising. However, there is the danger that even if all the information required for optimal investment decisions is present in mutual fund advertising, consumers may still not read it and may continue to rely on various heuristics (Franke *et al.*, 2004).

Limitations

The regulatory environment is constant for our paper, because all the advertisements examined in our paper comes under the jurisdiction of the SEC and the NASD. It would be reasonable to assume that the advertisements have complied with the regulations since not doing so would be inimical to the interest of the funds. However, there may be differences in the investment information included in mutual fund advertisements that are under the purview of other regulatory authorities. Future research is needed to document the investment information present in mutual fund advertising in other countries.

The results of the current study suggest that mutual fund firms are counting on consumers to apply the copy length-quality and the advertised brand-quality heuristics. Prior research has found that advertised mutual funds attract investment flows. However, future research is needed to test whether or not these heuristics are, in fact, being activated.

It should also be noted that mutual funds do communicate with consumers and financial advisers through other specialised investment magazines, direct mailing and electronic media. The present paper does not analyse communication through these media and, thus, the future research is needed to see if the results are generalizable to these media. The current study analysed mutual fund advertisements for two years (1999 and 2000). It is possible that the results are pertinent only for these years due to changes in mutual fund advertising practice.

A final limitation is that the research that uncovered the use of the copy length-quality and advertised brand-quality heuristics was done with US consumers and US advertisements were analysed in this study. Therefore, the generalizability of the findings may be limited to the US market. Future research is needed to test whether consumers from other countries apply these heuristics or ones unique to their cultures.

Conclusion

In conclusion, most (88.8 per cent) of mutual fund advertisements do not contain all the requisite information on the risk-return trade-off, principal-agent conflict, and transaction costs that consumers need to optimise their investment decisions. While mutual fund advertisements use techniques that advertising research has found to increase the proportion of consumers who notice an advertisement, they do not use appeals or techniques found to increase readership of the information in an advertisement. Instead it appears that mutual funds are being advertised in a way that prior research suggests would increase perceptions of quality, successfulness, and honesty regardless of the accuracy of these perceptions.

Mutual funds managers will likely conclude that the implications of this paper are that mutual fund firms tend to include in their advertisements only information that shows them in a positive light, but in a verbose fashion, and design ads to be noted not read, because consumers tend to apply copy length-quality and advertised brand-quality heuristics. Managers of mutual funds that are currently advertising will likely view the results of this paper, combined with the knowledge that prior research has shown that advertised mutual funds attract more investment flows, to continue their current practices of under-informing consumers. Managers of mutual funds that are not currently advertising will likely join the fray and design their ads in a similar manner. It is incumbent upon regulatory agencies to protect the consumer interest and create a level playing field of required information regarding a mutual fund's risk and return, credibility, and transaction costs.

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