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INVESTORS PURCHASING PREFERENCES ON INVESTMENT IN INDIAN MUTUAL FUNDS MARKET

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INTRODUCTION

Investment decisions are taken within the framework provided by a complex of financial institutions and intermediaries, which together comprise the capital market. It has a vital role in promoting efficiency and growth. It intermediates the flow of funds from those who want to save a part of their income, from those who want to invest in productive assets. It is this market, which provides the mechanism for channeling current savings into investment, into productive facilities, that is, for allocating the country's capital resources among alternative uses. In effect, the capital market provides an economy's link with the future, since current decisions, regarding the allocation of capital resources, are major determining factors of tomorrow's output. The crucial role played by the capital market, in shaping the pattern and growth of real output, imparts a social significance to individual investments and portfolio decisions. The efficiency of intermediation depends on the width, depth and diversity of the capital market. Till about two decades ago, a large part of household savings was either invested directly in physical assets, or put in bank deposits and government small savings schemes. It is only since the late eighties that the equity market has started to play a role in this intermediation process.

The Capital Market in India, based on the strong foundation of the 8th five-year plan, has witnessed phenomenal growth in recent years. The encouraging trends in the economy, especially on the industrial front and the process of liberalization of the recent past, have spurred the growth of the capital market.

In India, the Mutual Funds industry has been monopolized by the Unit Trust of India ever since 1963. Now, the commercial banks, like the State Bank of India, Canara Bank, Indian Bank, Bank of India and the Punjab National Bank, have entered into the field. To add to the list are the Life Insurance Company of India and the private sector banks and financial institutions. These institutions have successfully launched a variety of schemes to meet the diverse needs of millions of small investors. Unit Trust of India has the country's largest corpus accounting for nearly 10 percent of the country's stock market captialisation. Next comes the State Bank of India Mutual fund.

In order to meet the challenges of the emerging competitive environment, financial corporations reoriented their strategies to bring about innovations in their products and diversified their activities both fund-based and non-fund based. As a result of this, Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI) and Industrial Development Bank of India (IDBI) launched mutual fund schemes to tap more and more savings of households and set up asset management company to manage these schemes.

There are mutual funds with investments sources abroad called 'off-shore funds'. They have been established for attracting NRI investments to the capital market in India. The India Fund Unit Scheme 1986 traded in the London Stock Exchange and the India Fund Unit Scheme 1988 traded in the New York Exchange were floated by the Unit Trust of India and the India Magnum Fund was floated by the State Bank of India.

Besides the above, the Life Insurance Company and the General Insurance Company have also entered into the market. Again, many private organizations have entered into the field. Most of the schemes have declared a dividend ranging between 13.5 percent and 17 percent. In most of the cases it is around 14 percent only.

The recent trend in the mutual fund industry is to go for tie-up arrangements with foreign collaborators. We find Tata tying up with Klein Worth Benson; General Insurance Corporation with George Soros; Credit Capital with Lazard Brothers; Kothari with Pioneer; Industrial Credit and Investment Corporation of India with JP Morgan; 20th century with Morgan; State Bank of India with General Electric Capital and so on. Of course, these tie-ups would bring in new perspective, systems and technology and this very foreign tag may add credit to the institution.

The private sector, which entered the arena in 1993, is concentrating on the primary market. It is so because, investments in new shares fetch appreciation from 30 to 1500 percent in a very short period. Promoters too give preferential treatment to mutual funds because it reduces their marketing cost. Again, they go for fund participation in a venture ever before its goes to public. They see potential for immense appreciation in unlisted securities, which intend to go to public with a short period of one year.

In India, mutual funds have been preferred as an avenue for investment by the household savers only from 1990s. On the whole, the mutual fund industry is able to mobilize 8 percent of the gross domestic household savings in the country. It is a good going, indeed.

Mutual Funds

A mutual fund is a special type of investment institution, which acts as an investment conduit. It pools the funds of the investors and invests large funds into well-diversified portfolio. It employs fund managers and investment consultants for maximizing returns on investments. These institutions are popularly known as mutual funds.

Mutual funds are generally used for open-ended investment schemes being set up by banks or financial and other institutions, which raise funds from public through issue of stocks or units. Holders are assured of a fixed percentage of return on their investment. The units so issued are also eligible for redemption at a later date. The funds collected are invested in stock exchange securities or money market operations.

Mutual Fund – A Globally Proven Investment

Worldwide, the mutual fund, or unit trust, as it is called in some parts of the world, has a long and successful history. The popularity of the mutual fund has increased, manifold. In developed financial markets, like United States, mutual funds have almost over taken bank deposits and total assets of insurance funds. In United States alone there are over 5,000 Mutual funds with total assets of over US$ 7000 billion. A mutual fund is formed by the coming together of a number of investors who hand over their surplus funds to a professional organization to manage their funds. A mutual fund is basically a risk reduction tool.

Types of Mutual funds

- **Equity Fund:** Mutual funds invest only in equity shares of companies and undertake risks associated with equity shares.
- **Growth Funds:** Mutual funds invest their funds in growth securities, which assure capital appreciation in long run.
- **Income fund:** Mutual funds invest in such securities, which yield high return on investments
- **Real Estate funds:** These are closed-ended mutual funds with investment in real estate and properties.
- **Offshore Funds:** Such mutual funds invest in securities of foreign companies and such investments require RBI permission.
- **Open-Ended Schemes:** Mutual funds may have open-ended schemes under which an investor is free to join the fund or withdraw from the fund at any time after an initial lock in period. It announces purchase and repurchases prices from time to time. Unit Trust of India's 1964 unit scheme is an example of such fund.
- **Close-Ended Schemes:** Such mutual funds do not issue shares or units or repurchase or redeem on a periodic basis. Units of such schemes can be redeemed only on termination or through dealing in secondary market. Canshare, Canstock, Cangrowth, SBI Magnum etc., are examples of such mutual fund.
- **Leverage Fund:** Also known as borrowed funds are used to increase the size of value of portfolio and benefit to members by gains arising out of excess of gains over cost of borrowed funds. Such mutual funds invest in risky investment and speculative trading.
- **Hedge Funds:** Mutual funds which employ their funds by speculative trading, i.e., buying shares whose prices are likely to rise and selling shares whose prices are likely to dip, are called hedge funds.
- **Growth and Income Funds:** These include balance funds, total return funds and equity income funds. These are highly interest sensitive. Portfolio consists of common stocks to the extent only to offer a degree of capital appreciation and only to offset against consumer rising prices Aggressive

- **Growth Funds:** Aims at capital growth. It is characterized by high turnover, investment in risk taking new companies, risk taking approach, capital appreciation, etc.,
- **Speciality Funds:** It may take the form of sectoral funds, index funds, option income funds, leverage funds, metal funds etc.,
- **Asset Allocation Funds:** These funds depend upon the asset classes to be included in their portfolio. Such funds include common stocks, foreign stocks, precious metals, real estate stocks, bonds, money market instruments, foreign currencies and other mutual fund units.
- **International Funds:** These include global funds, which invest in securities of both domestic and other countries; international funds that invest in securities of companies domiciled outside the country; regional funds that invest in countries of a specific region and funds that are country specific.
- **Tax-Exempt Fund:** These funds invest their funds in such investments, which receive tax benefits and/or enjoy exclusive tax-free treatment.
- **Dual Purpose Fund:** Income growths are two objectives which are achieved by offering half of the amount of funds to those investors who expect regular income and half of those who wish growth or appreciation. The funds thus received are pooled together and used for investment. Any income derived from the portfolio goes to the investor who holds income shares. The investors who hold growth shares receive no income. Instead, they receive capital gains arising from the sale of investments of total portfolio.
- **Funds of funds:** Mutual funds, which invest only in units of other mutual fund, are called fund of funds.
- **New direction funds:** These funds invest in companies engaged in scientific and technological research in fields such as birth control, anti-pollution, oceanography, etc.,

NEED AND IMPORTANCE OF THE STUDY

The New Economic Policy (NEP) of structural adjustment and stabilization program was given a big thrust in India in June 1991. The financial system reforms have received special attention as a part of this policy because of the perceived interdependent relationship between the real and the financial sectors of the modern economy. Immediately after the announcement of the New Economic Policy, the government had appointed a high level committee of financial system to examine all aspects relating to the structure, organization, functions and procedures of the financial system. The committee submitted its main report in November 1991. Since then, the authorities have introduced a large number of changes or reforms in the Indian financial sector in the light of the said report.

Measures introduced in the Indian economy by the Government through devaluation, deregulation, delicensing, globalization, mutual fund market reforms and free pricing have further increased the interest in stock market. A number of new investors and significant fresh funds have been induced into the mutual fund industry, In addition, Government is also keen to attract foreign investment into Indian mutual fund industry through various schemes-membership, number of listed companies, investors population, new institutions and instruments.

What have been noticed, particularly, during the last 2 to 3 years are – Economic liberalizing policy of the Government for the corporate sector, Free pricing, Invitation to foreign institutional investors to make investment in the corporate sector, Direct foreign investment in industries, Emergence of new institutions and Financial instruments.

It is a place for trading in money and short-term financial assets that are as liquid as money. It provides a platform for short-term surplus funds of lenders or investors and short-term requirements of borrowers. The instruments can be traded at low cost and are highly liquid. Mutual fund activities in India were limited to only money markets but are now developing into a various market. In recent years, new instruments such as 182 days treasury bills, certificate of deposits and commercial paper have been introduced. Inter bank call money transactions still form the major part of the mutual fund market. The market is highly volatile. Treasury bills and certificate of deposits are now widely used but use of commercial paper has not picked up because of its high money market rate. The above argument profoundly forces the researcher to study the implications of financial sector reforms especially on the Indian capital market. It is also important to study how the economic reforms flourish the mutual fund industry and help the investors to possess the awareness and transparency.

REVIEW OF THE LITERATURE

Customary Measures of Measurement Standard Deviation Markowitz (1952) suggested the use of standard deviation as a measure of risk. This metric measures the dispersion of returns from a central average value. The metric has distributional properties that allow inferences to be drawn. The greater the standard deviation, the greater is the fund's volatility.

The Sharpe Index The Sharpe ratio is a risk-adjusted measure developed by the Nobel Laureate William Sharpe. Markowitz (2009), the founder of Modern Portfolio Theory (MPT) , suggested that investors choose optimum portfolios on the basis of their expected return and risk characteristics. As noted above, the overall risk of a portfolio is measured by the standard deviation of its returns. Sharpe used this concept to build a "reward to variability" ratio which has become known as the Sharpe Index. The metric is calculated using standard deviation and excess return (i.e. return above a risk free investment) to determine reward per unit of risk. The higher the Sharpe ratio, the better is the fund's historical risk-adjusted performance. In theory, any portfolio with a Sharpe index greater than one is performing better than the market benchmark.

Lensen's Alpha (2012) Jensen's Alpha is also a reward to risk measure. However, it uses a different concept of risk. This measure's framework is taken from the capital asset pricing model (CAPM). In this model, among the assumptions, it is taken that every investor holds a diversified portfolio. This allows investors to diversify away some of their investment risk, leaving them exposed only to 'systematic' or non-diversifiable market-related risk. Jensen's Alpha uses only systematic risk for scaling a portfolio's return. Alpha measures the deviation of a portfolio's retum from its eqUilibrium level, defined as the deviation of return from the risk., adjusted expectation for that portfolio's return. For ranking purposes, the higher the alpha, the better is the performance. The fund beats the market, on a systematic risk adjusted basis, if Jensen's Alpha is greater than zero, and vice versa.

Treynor Index (2012) A third performance measure is the Treynor index. This is calculated in the same manner as the Sharpe index, using excess returns on the fund, but the excess return on the fund is scaled by the beta of the fund, as opposed to the funds' standard deviation of returns.

Of these three traditional measures, the regression-based Jensen's Alpha is most commonly used in academic research. It provides a measure of whether a manager beats the market, as well as suggesting the magnitude of over/under performance (cited in FMRC Report, 2003 prepared for the Australian Securities & Investment Commission, Sydney)

The path breaking works of Sharpe (2006), Treynor (2007), Treynor and Mazuy (2008), Jensen (1968), Fama (2009), Merton (2010), Henriksson and Merton (2011), Henriksson (2012), and those of other researchers are widely acknowledged and used botll by academics and practitioners in performance evaluation of managed portfolios. The later studies have made several refinements, up-gradation, and extension of earlier works in terms of methodology, coverage and estimation.

STATEMENT OF THE PROBLEM

In 1991, the Indian government initiated a comprehensive market-oriented reform program. At the core of the program was a phased deregulation of the financial sector, along with reforms of trade and industrial policies. Important elements of the financial liberalization program were a lifting of several interest rate ceilings in both credit and bond markets, an easing of requirements that had made it mandatory for banks to hold a part of their portfolio in non-interest-bearing reserves and low-yielding government securities, a partial dismantling of barriers to enter into the banking sector and greater freedom given to banks to close unviable branches in rural and semi-urban areas. Along with the liberalization measures was a move to introduce a regulatory mechanism that could ensure the safety and solvency of the financial sector in the deregulated environment. Hence, this study is focused on analyzing the implications of financial sector reforms on mutual funds and the influence of latest developments on the behaviour of investors.

OBJECTIVES OF THE STUDY

1. To study the various factors of characteristic features of select Public and Private sector mutual funds and its influence on the investment preference and behaviour of investors.
2. To identify the role of different industries and source of information about awareness of public and private sector mutual funds in increasing the investments in mutual funds.
3. To offer suggestions and recommendations to investors and mutual fund organization for better investment options.

METHODOLOGY

Pilot Study and Pre-Testing

A preliminary investigation was undertaken by contacting 75 investors of mutual funds to identify the important variables regarding characteristic features of mutual funds, instrument and the changes, return of investments and the latest developments in the mutual fund industry. The purpose of the pilot study is to test the quality of the items in the questionnaire and to confirm the feasibility of the study.

Sample Size

In order to obtain different perceptions of investors of public and private sector mutual funds, totally 746 well framed questionnaires are circulated in different parts of Chennai city on a random basis. Out of 746, only 719 are returned. Among 719 questionnaires it is found that 700 as suitable for primary data analysis. Out of 700, it is found that 375 are investors of public sector and 325 are from selected private sector mutual funds. The top five private and public sector mutual funds are considered for the study. Since the population is unknown, a Simple Random Sampling procedure is adopted to obtain better statistical results to reflect the characteristic features of the population. The efficient estimated process satisfying Crammer-Rao's Inequality to justify the sample size representing the unknown population is used.

Data Analysis

The sources of data are primary as well as secondary. The data collected from the investors survey constitute primary and information gathered through books, journals, magazines, reports, dairies consists of secondary. The data collected from both the sources is scrutinized, edited and tabulated. The data is analyzed using statistical package for social sciences (SPSS) and other computer packages.

FINDINGS

1. A maximum of 33 percent of investors are in the age group 26 to 40 followed by the investors in the age group >55 with 30 percent, 20 percent in the age group 41-55 and 17 percent in the age group < 25 .
2. It is clear that 65% of the investors are males and 35% are females. This, profoundly, states that males are more enthusiastic than females in mutual funds investment
3. It is found that most of the investors are having good education background. 31 percent of the investors are graduates and 20% are post graduates and 20% are professionals, 24 percent are diploma holders and a minimum of 5 percent are educated up to school level. This shows that the educated investors are able to analyze the advantages and disadvantages of investment in mutual funds and they also concede that they are able to get transparent information through television and magazines regarding mutual funds in India.
4. In public sector mutual funds, the reduction of extra cost explains that the public sector mutual fund investments are risk free with transparent growth. Simple extra

cost made the public sector mutual funds to announce innovative schemes and to perform well in the market

5. It is found that there is no significant difference in the opinion of public and private sector mutual fund investors about the characteristics of mutual funds. In fact, both the investors have identified the indispensability of the risk free and maximum returns..
6. It is concluded that the private sector mutual investors in Chennai classified the characteristics of mutual funds into 8 major factors namely capital appreciation, purposive investment, safe service, extra cost, risk free, transparent growth, innovative schemes and good performance
7. In the case of public sector mutual funds, capital appreciation has positive relationship with purposive investment, sales service, extra cost, risk free, innovative schemes and good performance
8. The private sector mutual fund investors feel that their investment yields better returns when there is no extra cost and risk. They expect good returns as well as safety of their capital with prompt service of private sector mutual funds
9. It is concluded that the investors agree that the public sector mutual fund schemes give high return with less risk. They felt that public sector mutual funds are useful to invest during NFO and taxation periods.
10. The private sector mutual fund investors in the age group less than 25 possess less awareness than other investors due to their investment experience. Other investors are highly aware of the factors of private sector mutual fund.

SUGGESTIONS

In the light of the findings, the following suggestions are offered to increase the mutual fund penetration among the individual investors.

Investor Awareness

Investor awareness is the prerequisite for achieving transformational growth of mutual funds. This requires planning, financing and executing initiatives aimed at increasing financial literacy and enhancing investor education across the entire country through collaborative efforts of SEBI, AMFI, AMCs, Confederation ofIndian Industry (CIl), Ministry of Finance and the media.

The Investor Awareness Programs should be so designed and planned with a long term perspective of at least 5 years to get the desired benefits. A "Mutual Fund Education Fund" with contribution from all stake holders can be created for financing investor awareness programs.

To create greater awareness of mutual funds among potential investors, SEBI/ AMFI must make efforts to have the concept of financial planning and mutual funds in partiCUlar introduced at high school and college levels, sponsor research programs and undertake publicity seminars/conferences at the regional level and in regional languages. Knowledge of financial products is ingrained in school and college curriculum in countries like UK, US and France.

AMCs with support of AMFI and National Institute of Securities Management (NISM) should roll out customer awareness campaigns and provide infrastructure, content and speakers for running campaigns on a pan-India basis . . Effective and meaningful mass media campaigns in multiple vernaculars using television, hoardings, flyers and street plays can be used to reach the masses. The infrastructure of The India Post' and Public Sector Banks both of which have a major presence in semi urban and rural areas can be used to promote these programs in these areas. Investor associations, self help groups and other affinity groups can be identified to facilitate investor workshops in cities and towns across the country.

There should be closer coordination between AMFI, mutual funds and the media to promote investor education in India. Media especially Television plays a definitive role in shaping the decision of investors. A media friendly environment needs to be developed to promote the healthy exchange of views and news. Improved and sustained communication with investors educates and creates a bond between investors and AMCs which will be of benefit to the Industry. The medium of communication should be simplified (region specific, language specific etc) to accommodate even rural investors

Attractive Product Offering

The market success of any product, particularly a financial product, depends largely on its acceptance by consumers, in this case investors. Asset management companies need to introduce a new range of offerings in the market in order to attract investments. AMCs through AMFI should conduct a nationwide survey of customer needs across various investment objectives, frequency and quantum of contribution to design product variants that have features that meet customer needs.

In order to make Mutual Funds more acceptable to the retail investor, the mutual fund industry has to offer comprehensive life cycle financial planning. These would include products catering to specific life cycle needs like buying a house, funding college admission, marriage of children, retirement etc., India does not have the kind of social security developed nations have. So, institutional structure for savings needs to be provided. If one looks at the US market, in 1981 Ronald Regan brought in 401(k) in a big way which led to the manifold growth of the mutual fund industry. Pension fund products and insurance linked products are great vehicles to foster the growth of the mutual fund industry considering the demographics of the country.

Product innovations by AMCs should be driven around simple products that have features of capital protection with returns that are higher than traditional products. This can attract and retain risk adverse investors as also first time investors of mutual funds.

Since the focus is on retail penetration beyond the metros and other Tier I cities , products that appeal to low income groups , commodity related, crop related and agriculture oriented fund products may be conceptualized and developed keeping in mind the specific segment needs.

Investible surplus of investors should be allowed to be invested any time in ongoing schemes with a flexible Systematic Investment Plan (SIP) option. SIPs can be used to revolutionize the market just as the "sachets" did for the FMCG industry and "pre-paid" did for the telecom industry. These small value products are endowed with the potency to rip open the market potential.

Since products of mutual funds 90mpete with other investment avenues like bank deposits, small savings, provident fund etc., where the returns are more or less assured, assured return schemes should be permitted, subject to the conditions laid down by SEBI. Hence in addition to the capital protection funds that have been introduced assured return funds should be re introduced.

The identification of market segments that rely differentially on various information sources and employ various selection criteria is consistent with hub and spoke model mutual funds (master-feeder funds) which have been introduced in the US and this can be introduced in India.

Distribution

AMCs should focus on giving training to distributors of mutual funds to enhance their marketing and advisory capabilities so that they can win the trust and confidence of customers. Advisory capabilities can be enhanced by having financial planning modules in their course materials.

Today the contribution of direct channel to investments in MFs is low and it is more or less a 'distributor driven model'. IFAs are the hardest to be hit by the new Regulation of banning entry load. Yet, ironically they are still the most preferred investment routes amongst retail investors. IFAs comer a small part of the distribution pie in big cities, but their function takes on tremendous importance when one looks at Tier II and Tier III cities. IFAs can be paid fees instead of commissions and they can be brought under the rolls of the AMCs or distribution houses by way of paying a retainer and fixing minimum business to be executed with time targets. Employees of Public sector banks, Regional Rural Banks, Cooperative Banks can be trained to market mutual fund products to retail investors in semi urban and rural areas.

Provision of Conducive Environment for Serious Ames

The eligibility norms for setting up mutual fund houses should be looked into to allow only serious players to enter/remain in the market. The minimum net worth of AMCs can be increased from the existing Rs. 10 crores to Rs. 50 crores. Regulations should be formulated to encourage and support more serious players in the market, who help bring in more investor awareness and sale of mutual funds.

Leveraging Technology

Personal computers, mobiles,. sophisticated hardware and software, as also advances in information and communication technology are enablers that can be harnessed effectively to increase retail mutual fund penetration in India and to also increase the profitability of the industry. Fund houses need to assign an increased budget for investment in technology, which will help them streamline their distribution. networks and increase efficiencies in their business. Net asset value updates on mobile phones, unit balance alerts via SMS messages, transacting through ATM cards etc are some of the ways to promote mutual fund service and attract customers.

Boost Investor Confidence in Mutual Funds

More information on mutual fund performance through independent third party research is required so that investors can make informed decisions about which schemes to invest in. Currently, value research's portal on the web in India does a good job of rating MF schemes but we need more such web portals which can scientifically measure MF performance. In US there is a vibrant industry that thrives on independent scientific performance measurement tools and it needs to be developed in India as well, with a focus on developing the correct benchmarks for comparing MF performance. For more quality performance measurement of MFs in India, AMFI would need to train increasing number of professionals through tie-ups with business schools to introduce such courses in the curriculum. AMFI can also introduce certifications on scientific methods of performance measurement and can develop a research division which will keep monitoring MF performance from time to time and develop benchmarks. Fund managers should be made accountable to unit holders. This can be done by organizing Annual General Meetings of unit holders where performance of the fund would be reviewed.

Rating should be made mandatory for all fund houses and all schemes. It should be made mandatory for all promotional materials of schemes to carry the ratings of fund houses as well as those of the schemes. Adequate protection against failures of schemes where retail participation is more can be provided by creating a protection fund by instituting an insurance scheme akin to the insurance schemes of bank deposits. This will increase investor confidence.

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