

## Investment Perception and Selection Behaviour Towards Mutual Fund

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### **Abstract**

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. Anybody with an investible surplus of as little as a few hundred rupees can invest in Mutual Funds. These investors buy units of a particular Mutual Fund scheme that has a defined investment objective and strategy. The money thus collected is then invested by the fund manager in different types of securities. These could range from shares to debentures to money market instruments, depending upon the scheme's stated objectives. The income earned through these investments and the capital appreciation realized by the scheme is shared by its unit in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low-cost.

*Key words:* Mutual funds, portfolio, money market instruments and SEBI

### **Introduction**

A mutual fund is trust that pools the savings of a number of investors who shares a common financial goal. Mutual funds offer benefits of supervision and management, diversification, taxation low operating cost higher return to the investors. In the era of New Financial Order across the world there are dominant evidences regarding the great degree of proliferation in the management of funds around the world. Every rational investor is always on the toes to maximize the returns on their funds for a given level of risk. It is widely understood that diversified funds risk. It is widely understood that diversified funds intend to reduce market risk to a greater extent. In today's scenario a common man with some disposable income can get only 3% to 4% in a bank's savings account or 8% to 9% in fixed deposits. Investors, who have hitherto been investing in these assured returns products, are searching for better returns as the requirements are increasing day by day. People normally have three main objectives:

- Safety
- Return and
- Liquidity

They like their investment to be absolutely safe, while it generates handsome returns and provides

high liquidity. But unfortunately it's difficult to achieve all the three simultaneously. One objective often trades – off against another. For example, if you want high returns you may have to take some risk or if you want high liquidity you may have to compromise on returns. There are many different kinds of investments to choose from. Each kind of investment differs from the others in objectives and benefits. Some differ by how much they can be expected to earn. They also differ in relative volatility—how much their value changes compared to the market as a whole. Each investment option has some risk associated with it and a corresponding financial return.

As the investors are available a number of investment options, this makes very difficult for them to decide where to invest, which can fulfill their investment objectives. All the retail investors are not so informed and skilled, so that they can make decision regarding their investment which gives them desired results. For investment in different options they require the assistance of the professionals so that they do not land in a situation which makes their investment unfruitful.

As each individual have different investment objective and different requirements. Each investor has different risk profile and also has different disposable income. Before investing his money investor must know his risk profile and investment objective. So in this way investors can be categorized into different categories based on their investment objectives, disposable income and requirements in future. We have categorized the investors into various categories based on their

- Life Cycle Stage
- Wealth Cycle Stage

Now for develop the portfolios for these different investor categories, we are required to analyze the various investment options based on the various factors like

- Return
- Risk
- Liquidity

Analyzing the various investment options requires the assessing the investment options using different methods for example stocks can be assessed by using Compounded Annual Growth Rate, bonds can be analyzed using Yield to Maturity Model. Once we have calculated, return, risk and liquidity associated with each of the investment options, I can easily develop the portfolios for the different investor categories which can fulfill their requirements. Portfolio development mainly involves finding how much proportion of the disposable income should be invested into different investment options so that it can give required return at required time with the lowest possible risk. We have analyzed various investment options like:-

- Bank Deposits

- Post Office Schemes
- Insurance
- Money Market Instruments
- Long-term Debt Instruments
- Mutual Funds
- Equity Shares

Our main objective is to relate mutual fund investment perception and selection to behavioral factors. That varies across our sample of investors. We begin by using each sample investor's record of Common stock holdings and trading to estimate a set of variables that proxy for the behaviors evident in each investor's common stock portfolio. Recognizing that behavioral factors are Unlikely to be the only determinant of mutual fund choices, we also construct controls for other Drivers of mutual fund decisions suggested by the mutual fund and behavioral finance literatures. We use these variables in a variety of tests across individual investors and then across types of mutual funds.

### **Objectives of the Study**

The specific objective of the study is as under:-

- 1 To study the meaning, organization, working and growth of mutual funds in India.
- 2 To depict the present & future potential of mutual funds.
- 3 To find out the various factor affecting the behavior of selection towards mutual funds.

### **The Concept of Mutual Funds**

Mutual funds are institutions that collect money from several sources - individuals or institutions by issuing 'units', invest them on their behalf with predetermined investment objectives and manage the same all for a fee. They invest the money across a range of financial instruments falling into two broad categories – equity and debt. Individual people and instructions no doubt, can and do invest in equity and debt instruments by themselves but this requires time and skill on both of which there are constraints. Mutual funds emerged as professional financial intermediaries bridging the time and skill constraint. They have a team of skilled people who identify the right stocks and debt instruments and construct a portfolio that promises to deliver the best possible 'constrained' returns at the minimum possible cost. In effect, it involves outsourcing the management of money.

More explicitly, the benefits of investing in equities and debt instruments are supposedly much better if done through mutual funds. This is because of the following reasons: Firstly, fund managers are more skilled. They are trained to identify the best investment options and to assess the portfolio on a continual basis.

Secondly, they are able to invest in a diversified portfolio consisting of 15-20 different stocks or bonds or a combination of them. For an individual such diversification reduces the risk but can demand a lot of effort and cost. Each purchase or sale invests a cost in terms of brokerage or transactional charges such as demat account fees in India.

The need to possibly sell 'poor' stocks bonds and buy 'good' stocks' bonds demands constant tracking of news and performance of each company they have invested in. Mutual funds are able to maintain and track a diversified portfolio on a constant basis with lesser costs. This is because of the pecuniary economies that they enjoy when it comes to trading and other transaction costs.

Thirdly, funds also provide good liquidity. An investor can sell her/his mutual fund investments and receive payment on the same day with minimal transaction costs as compared to dealing with individual securities, this totals to superior portfolio returns with minimal cost and better liquidity. This can be represented with the following flow chart: In India one can gain additional benefit by investing through mutual funds tax savings. Investment in certain types of funds such as Equity Linked Tax. Savings Schemes (ELSS) allows for certain amount of income tax benefits.

### **AMFI the Mutual Funds Industry in India**

The beginning of mutual funds in India was laid by the enactment of the Unit Trust of India (UTI) Act in 1963. The objective was to provide investors from the middle and lower income groups with a route to invest in the equity market. It was also meant to encourage savings. UTI brought out its first fund, Unit Scheme (US) 64 in 1964. It called an amount of Rs.246.7 millions. UTI remained a monopoly in the mutual fund industry till 1987. By then US 64 had grown to Rs.32.69 billion and the overall asset base of UTI was RS.67.38 billion with 25 different schemes.

In 1987 other public sector banks were allowed to offer mutual funds. The State Bank of India (SBI) set up the SBI Mutual Fund and Canara Bank Mutual Fund. Other public sector banks such as Bank of India, Punjab National Bank, And Indian Bank entered the fray by 1990. Two public sector insurance companies - Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC) also started their own mutual fund companies. But during this period only public sector companies were permitted to enter the mutual fund market. The collective assets under management continued to grow and by the end of 1993 it was Rs.470 billion with UTI alone

accounting for RS.390 billion>' There were 44.7 million investors in mutual funds". 1992-93 saw the beginning of economic reforms in India. The reforms aimed at reducing government control over the economy and allowing for greater play for the private sector besides others. In keeping with this direction the private sector was allowed to enter the mutual fund industry in 1993. In keeping with this direction the private sector was allowed to enter the mutual fund industry in 1993.

In the same year the first mutual fund regulations 1993 SEBI (mutual fund) Regulations came into being. This was later substituted by a more comprehensive set of regulations - SEBI (mutual fund) Regulations 1996. However, UTI did not come under these regulations and continued to be governed under the UTI Act of 1963. By 2003 the total assets under management (AUM) had increased to Rs.1, 218 billion with 33 mutual fund families and 401 funds. UTI alone accounted for Rs.445 billion of the total AUM.

In 2003 the public sector UTI, which had faced serious problems in the late 90's and again during 2002, was split into two entities. One was the specified undertaking of UTI which managed US 64, assured return schemes and others which totaled to Rs.298.4 billion and the other was UTI Mutual Fund Ltd.

The latter came under the regulations of SEBI. Since 2003 the mutual fund industry has also seen a spate of mergers. Hence this period was marked by consolidation. By March 2007 the total AUM excluding UTI touched Rs.3, 591 billion showing a phenomenal growth of 47 percent year-on-year since 2003". During this period only Russia and China did better than India with AUM growth rates of 97 percent and 67 percent, respectively".

### **Organization of Mutual Funds in India**

Mutual Funds are one form of Collective Investment Vehicles (CIV's) in India. The other forms being Collective Investment Schemes (CIS's) and Venture Capital Funds (VCF's). The organization of mutual funds in India (excepting for Unit Trust of India)<sup>2</sup> is dictated by the Securities and Exchange Board of India - SEBI (Mutual Funds) Regulations, 1996, (henceforth termed as 'regulations'). Bank-owned mutual funds are also supervised by the Reserve Bank of India (RBI). This does not overlap with SEBI's supervision. Besides, the Indian Companies Act of 1956 and Indian Trust Act of 1882 also govern funds.

The SEBI regulations stipulate a three tier structure. The constituents of a Mutual fund include the Sponsors, the Mutual Fund, the Trustees and the Asset Management Company (AMC). The Sponsor as an individual or along with another corporate body initiates the process by approaching the SEBI for registration of a mutual fund. There are certain eligibility criteria which the sponsor has to fulfill.

Broadly speaking it requires a sound financial track record over the past five years, a sound reputation with respect to integrity and a minimum of 40 percent stake in the AMC by the sponsor.

The Mutual fund is itself set up in the form of a trust under the Indian Trust act of 1882. The instrument of the trust is executed by the sponsor in favor of trustees and is registered under the Indian Registration Act, 1908. The investor subscribes to the 'units' of the fund and, the collected funds/assets are held by the trustee for the benefit of the investor. The Sponsor then appoints the Trustees, AMC and Custodian. A Trustee holds the fiduciary responsibility of protecting the interest of the investor. The trustees themselves are to be of impeccable personal credentials. Two thirds of them have to be independent persons and should not be associated with the sponsors in any manner'. No employee of the AMC is to be a part of the Trustee.

The Trustee has the duty of ensuring that the AMC carries out its activities in accordance with the regulations and prevent conflict of interest between the investors and the AMC. The trustee could be either a group of individuals or a Trust Company. Most funds prefer a board of trustees. The AMC consists of the fund managers who manage the investments. Regulations are laid down with regard to their eligibility and obligations. The AMC takes decisions with respect to investment/sales, computing asset values, declaring dividend and providing investor information, regularity. An AMC cannot act for any other fund. The AMC for Tata mutual fund is Tata Asset Management Ltd. In addition to the above three principal constituents there is the custodian predominant duties includes stock keeping of securities and settlement between funds. A custodian can service more than one fund but not a fund promoted by a sponsor who has 50 percent stake or more in the custodian.

Apart from these there are the depositories, transfer agents and distributors who complete the organizational chain for mutual funds in India.

### **Parties to Mutual fund:-**

SEBI (Security Exchange Board of India):- SEBI formulated the Mutual fund (regulation) 1993, which for the first time established a comprehensive regulatory framework for the mutual fund industry.

### *Sponsors:-*

The sponsor is the company which sets up the mutual fund. Sponsor means anybody corporate who acting alone or in combination with another body corporate established a mutual fund after initiating and completing the formalities. As an example, State Bank of India is Sponsor of SBI Mutual Fund.

*Trustees:-*

The management of the mutual fund is subject to the control of the board of trustees of the fund. They are the eminent persons who have wide experience in investment matters finance, administration, etc. They guide the operations of the fund. The trustees carry the crucial responsibility to see that AMC always act in the best interest of the investors. As an example, SBI MUTUAL FUND Trustee company private ltd. Is TRUSTEE of SBI Mutual Fund?

*Asset Management Company:-*

The mutual fund will be operated by separately established asset management companies (AMC).It manages the funds of the various schemes. It plays a key role in running the mutual fund and it operates under the supervision and guidance of the Trustees. It is entrusted with the specific task of mobilizing funds under the scheme. As an example SBI Fund Managements pvt. Ltd., (A Joint venture between SBI & SGAM) is AMC.

*Custodian:-*

A Custodian is a person carrying on the activities of the safekeeping of the securities or participating in any clearing system on behalf of the clients to effect deliveries of the securities.

*Transfer Agents:-*

A transfer agent is employed by a mutual fund to conduct recordkeeping and related functions. Transfer agents maintain records of shareholder accounts, calculate and disburse dividends, and prepare and mail shareholder account statements, federal income tax information and other shareholder notices.

**Mutual Funds**

Mutual funds are generally categorized according to their investment objectives. Some mutual funds focus on stocks, others on bonds, money market instruments or other securities. Some mutual funds invest primarily in Canada, others invest internationally, and some specialize in countries or specific industries. Some mutual funds will invest in only low-risk investments, while others may hold much riskier securities. If you decide to become a mutual fund investor, choosing funds whose investment objectives and risk profile are right for you will be one of your most important decisions.

## **Types of Mutual Funds**

A mutual fund, say, Tata Mutual Fund, can have several 'funds' [called 'schemes' in India) under its management. These different funds can be categorized by structure,

An 'Open end' fund is available for purchase or redemption on continuous basis at the day's closing Net Asset Value (NAV). This gives liquidity to investments. A 'Close end' fund is open for investment only during the Initial Public Offer (IPO) after which the investment is locked in until the maturity date which could be between 3-7yrs. The investor can, however, sell or buy the shares of the funds on the stock exchange where the shares are listed.

Interval funds combine the characteristics of both 'open end' funds. They Can be bought or redeemed by the investor at predetermined times, say once in six or twelve months.

'Income' funds aim at providing regular income to investors. They generally invest a major portion of their assets in fixed income earning instruments such as government securities, corporate bonds and money market instruments. Their returns are determined by fluctuations in interest rates. A 'Balanced fund' tries to provide both capital appreciation and regular Income. They invest in both equities and fixed income securities. They specify the maximum equity exposure in the prospectus and is normally 60 percent; of late other types of balanced funds such as "Asset Allocation funds and 'Arbitrage funds' have also emerged. Asset allocation funds, such as the Franklin Templeton (FT) PIE ratio fund, allocate funds to equity or debt depending on the dynamic situation. They tend to increase exposure to equity during a market downturn and move out during market peaks. The FT PIE ratio fund uses the market PIE ratio to determine the degree of equity exposure.

Arbitrage funds are funds that try to capitalize on the arbitrage opportunities that arise out of pricing mismatch of stocks in the equity and derivative (Futures and options) segments of the stock market (Value Research Inc). They invest predominantly in equities 'Money Marker. Funds invest only in short term debt such as call money, treasury bills and commercial paper. In the case of these funds the Net Asset Value is simply the interest accrued on these investments on a daily basis. Their NAV does not fall below the initial investment value, unlike bond funds which are marked to market.

Tax saving funds give an investor tax benefits under section 80 C of the Income Tax Act. Such funds also termed as Equity Linked Saving Schemes (ELSS), have a lock in period of three years. By investing in such funds a person can avail of a maximum of rupees one hundred thousand in tax deductions. ELSSs are normally diversified equity funds. Index funds invest in securities of a particular index such as the Bombay Stock Exchange (BSE) sensex in the same proportion. They provide returns which are close to that of the benchmark index with similar risks as well. It is a passive investment approach with lower costs. Sector specific funds focus their investments on specific sectors which the fund manager feels would do well. For instance, Franklin FMCG fund



invests only in shares of companies that produce fast moving consumer goods. Exchange Traded Fund's (ETF) are relatively a new concept in India. Such funds are essentially index funds that are listed and traded on the stock markets. There are also commodities ETFs such as Reliance hold ETF.

*Money Market Funds:*

Invest in short-term (less than one year to maturity) corporate and government debt securities such as treasury bills, bankers acceptances and corporate notes. Some money market funds specialize in Canadian or US money market instruments or invest only in treasury bills. These are generally very low-risk funds offering low returns.

*Fixed Income Funds:*

Invest in debt securities like bonds, debentures and mortgages that pay regular interest, or in corporate preferred shares that pay regular dividends. The goal, typically, is to provide investors with a regular income stream with low risk. Fund values will go up and down to some extent, particularly in response to changes in prevailing interest rates.

*Growth or Equity Funds*

Invest primarily in common shares (equities) of Canadian or foreign companies, but may hold other assets as well. The goal is typically long-term growth because the value of the assets held increases over time. Some growth funds focus on large 'blue-chip' companies, while others invest in smaller or riskier companies. Performance will be affected by the success or failure of specific investments and by the performance of the stock markets generally

*Global and Foreign Funds:*

May be fixed income, growth or balanced funds that invest in foreign securities. These funds can offer investor international diversification and exposure to foreign companies, but are subject to risks associated with investing in foreign countries and foreign currencies. What are the potential advantages of investing in mutual funds?

**There are many reasons why people invest in mutual funds:**

*Diversification:* Investing in a number of different securities helps reduce the risk of investing. When you buy a mutual fund, you are buying an interest in a portfolio of Dozens of different securities, giving you instant diversification, at least within the type of securities held in the fund.

*Affordability:* With many mutual funds, you can begin buying units with a relatively small amount of money. Some mutual funds also let you buy more units on a regular basis with even smaller installments.

*Professional Management:* Mutual funds are managed by professionals who are experienced in investing money and who have the skills and resources to Research many different investment opportunities.

*Liquidity:* Units or shares of mutual funds can be redeemed at any time.

*Flexibility:* Many mutual fund companies administer several different mutual funds (e.g., money market, fixed-income, growth, balanced and international funds) and allow you to switch between funds within their ‘fund family’ at little or no charge. This can enable you to change the balance of your portfolio as your personal needs or market conditions change.

*Performance Monitoring:* The value of most mutual funds is reported daily in the financial press and on many internet sites, allowing you to continually monitor the performance of your investment.

**Conclusion**

Mutual funds play an increasingly important role in financial intermediation. As of yearend 1992, the U.S. mutual funds industry had more than \$1.5 trillion under management in 3000+ funds. The popularity of mutual funds traditionally is attributed to the fact that they are professionally managed, small investors can achieve diversification generally available only to large investors, and that investors can take advantage of lower transaction costs, primarily in brokerage commissions.

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