A STUDY ON MUTUAL FUNDS INVESTMENT AND RISKS IN INDIA

[#1]CH.LAXMN, ***Lecturer in Commerce, Dept of Commerce,***
GOVT JUNIOR COLLEGE ,IBHRAHIMPATNAM, JAGITYAL,TELANGANA.

[#2]CH.RAMULU, ***Lecturer in Commerce, Dept of Commerce,***
SRR GOVT ARTS& SCIENCE COLLEGE, KARIMNAGAR, TELANGANA.

ABSTRACT:
The mutual fund plays a major role in the investment pattern in today's world. Now a day's all are interested to have investment in any forms. And most of the people like to have investment with less risk. Here comes the mutual fund. Because for mutual funds most of the times the investor can invest less amount and also it's less risky. Most of the times it provides with a steady return and no need for market study by the customer itself. The customer just has to invest some amount with some professionals and they can take rest without thinking its loss. Because the professionals most of the times invest the amount in the shares where they expect a steady return. The professionals are always having an eye on the market and they are well versed in this area. So most of the people are attracted towards mutual funds for the less risky nature of it. This paper will give an insight about the mutual funds and its benefits for customers.
Key words: *Diversification, Mutual Fund, Return, Risk, Schemes etc.*

1. INTRODUCTION

The Indian Mutual fund industry has witnessed considerable growth since its inception in 1963. The impressive growth in the Indian Mutual fund industry in recent years can largely be attributed to various factors such as rising household savings, comprehensive regulatory framework, favorable tax policies, and introduction of several new products, investor education campaign and role of distributors. The driving force of mutual fund is the safety of principal guaranteed, plus the added advantage of capital appreciation together with the income earned in the form of interest or dividend people prefer mutual funds to bank deposits , life insurance, chit funds and even bonds, because with little money they can get into the investment game. One can own a string of blue chips like ITC, TISCO, Reliance etc through mutual funds .

Thus mutual funds act as a gateway to enter into big companies hitherto inaccessible to an ordinary investor with his small investment. In financial markets, "expectations" of the investors play a vital role. They influence the price of the securities; the volume traded and determines quite a lot of things in actual practice. These 'expectations' of the investors are influenced by their "perception" and humans generally relate perception to action. We find ample proof for the wide prevalence of such a psychological state among Mutual Fund (MF) investors in India. It is widely believed that MF is a retail product designed to target small investors, salaried people and others who are intimidated by the stock market but, nevertheless, like to reap the benefits of stock market investing. At the retail level, investors are unique and are a highly heterogeneous group. Many products are offered in the mutual fund industry.

This heightens the consumer confusion in his selection of the product. He is confused as to how to sift the grain from the chaff? Unless the MF schemes are tailored to his changing needs, and unless the AMCs understand the fund selection/switching behavior of the investors, survival of funds will be difficult in future. To understand investor's perception and preference a survey has been conducted among 200 mutual fund investors from two different cities. This paper will highlight the factors influencing the fund/scheme selection behavior of Retail Investors. It will also help the mutual fund company to adopt new and innovative marketing techniques. The findings of the study will help the mutual fund companies to improve upon their weak areas regarding the factors that influence investor's decision making as regard to choice of a mutual fund, the facilities or options they expect from a mutual fund.

HISTORY OF MUTUAL FUNDS

The modern mutual fund was first introduced in Belgium in 1822. This form of investment soon spread to Great Britain and France. Mutual funds became popular in the United States in the 1920s and continue to be popular since the 1930s, especially open-end mutual funds. Mutual funds experienced a period of tremendous growth after World War II, especially in the 1980s and 1990s. LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993. The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs.44,541 crores of assets under management was way ahead of other mutual funds. In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs.29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

2. REVIEW OF LITERATURE

A large number of studies have been conducted in India and abroad covering different aspects of Mutual fund.

J.Lilly and DrAnasuya published a research paper “An empirical study of performance evaluation of selected ELSS mutual fund schemes” published on International journal of scientific research (2014) which examined the performance of 49 selected tax saving elss schemes by applying Sharpe ratio, Treynor ratio, Sortino ratio and Jensen’s alpha measure and found out LIC NOMURA MF GROWTH and dividend schemes has the highest return and are risk borne when compared to other schemes.

Lonnie L. Bryant,Hao-Chen liu published a research paper “Mutual fund industry management structure, risk and the impacts to share holders” published on Global finance journal(2011) investigates the effects of a multiple fund management structure on the risk volatility of the funds managed with the help of Sharpe ratio .They found out the impacts that mutual fund management structure has in fund risk volatility using a sample of 1480 funds managed by 407 managers. They also found out that the multiple fund management structure appears to be motivated by the need to achieve economies of scale and reduce cost of the shareholders, fund managers which are driven by strategic reason.

Shanmugham (2000) conducted a survey of individual investors with the objective to find out what information source investor depends on. The results explained that they are economical, sociological and psychological factors which control investment decisions.

Madhusudhan VJambodekar (1996) conducted his study to size-up the direction of mutual funds in investors and to identify factors that influence mutual fund investment decision. The study tells that open-ended scheme is most favored among other things and that income schemes and open-ended schemes are preferred over closed- ended and growth schemes. News papers are used as information source, safety of principal amount and investor services are priority points for investing in mutual funds.

Martin P. and McCann B. (1998) in their book titled “The Investor’s Guide to Fidelity Funds – Winning Strategies for Mutual Fund Investing” have very nicely guided investors regarding issues related with mutual fund investing. They have advised that Investors should focus on sectors of the global economy that have the greatest potential for profit in order to beat the market averages. By combining this approach with the safety provided by mutual funds’ inherent diversification, mutual funds become an investment vehicle with all the advantages of trading individual securities and none of the disadvantages. Like any other investment, it is essential to develop a strategy for selecting which funds to buy and sell – and when. These decisions should not be left to the emotions or to chance.

Gremillion L (2005) in his book “Mutual Fund Industry Handbook – A¬ Compehensive Guide for Investment Professionals” has given detailed information about working of mutual fund industry. It has also mentioned the different type of challenges faced by various professionals connected with this industry. The book has provided a broad and comprehensive sweep of information and knowledge, which will help everybody who has serious interest in the industry.

Tyson E (2007) in his book “Mutual Funds for DUMMIES” (5th edition) has¬ provided practical and profitable techniques of mutual fund investing that investors can put to work now and for many years to come. By proper selection investor can identify good schemes, where fund managers invest in securities as per that match investors’ financial goals. Investors can spend their time doing the activities in life that they enjoy and are best at. Mutual Funds should improve investors’ investment returns as well as their social life. The book helps investors how to avoid mutual fund investing pitfalls and maximizing their chances for success. Whenever any investor wants to buy or sell a mutual fund, the decision needs to fit his overall financial objectives and individual situation.

Jank S (2010) in his Discussion Paper on “Are there disadvantaged clieneles in¬ mutual funds?” has mentioned that mutual fund investors chase past performance, even though performance is not persistent over time. This means that investors buy mutual funds that had a high return in the past. On the other hand, investors are reluctant to withdraw their money from the worst performing funds. This behavior has often been attributed to the irrationality of mutual fund investors. Sophisticated investors rationally chase past performance, because high past performance is a signal for managerial ability. No significant difference was found between investor composition of the worst performing funds and those with average performance.

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Singh B K (2012) in an article "A study on investors' attitude towards mutual¬ funds as an investment option" from International Journal of Research in Management has reiterated the need for spreading the awareness about Mutual Funds among common masses. There is a strong need to make people understand the unique features of investment in Mutual Funds. From the existing investors point of view the benefits provided by mutual funds like return potential and liquidity have been perceived to be most attractive by the invertors' followed by flexibility, transparency and affordability

3. MUTUAL FUND STRUCTURE

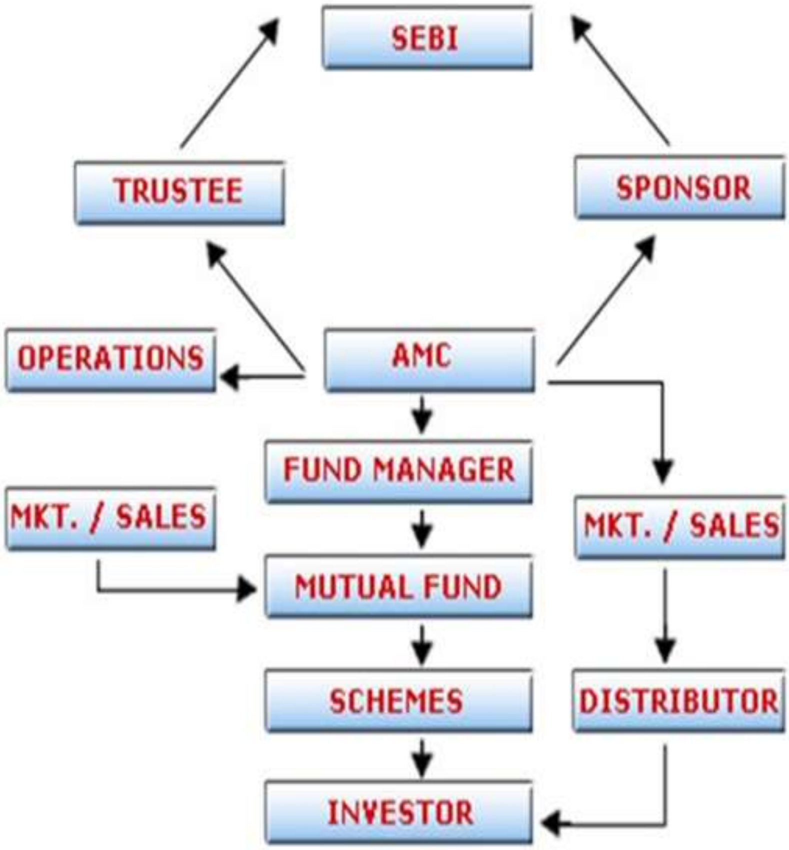


Figure Mutual Fund Structure

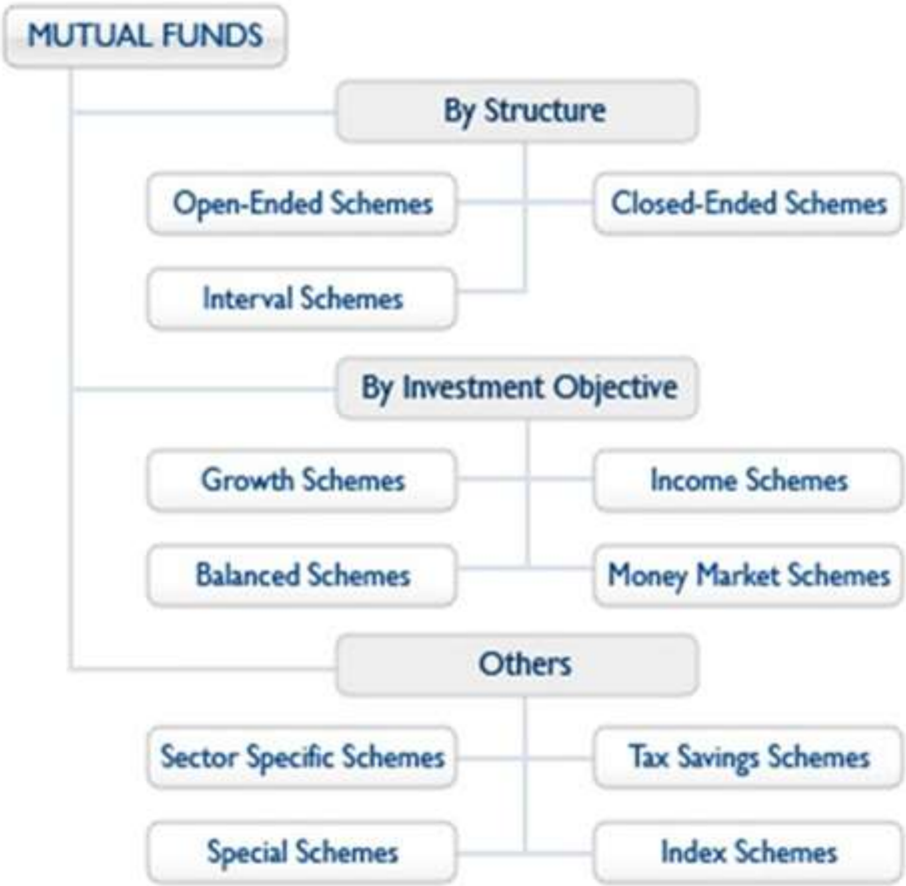
Different parties involved are:

- Sponsor: Sponsor is an entity who in arrangement with other corporate led towards the creation of a Mutual Fund. He needs to comply with the criterion set under Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and must have to throw in at least 40% of the net worth. But the sponsor could never be held accountable for any type of loss as a consequence of scheme operation.
- Trust: Sponsor forms Mutual Fund as a trust as per the provisions of Indian Trusts Act, 1882. Deed is registered under the Indian Registration Act, 1908.
- Trustee: They are accountable to uphold the investor's interests as well as ensure that AMC works as per the guidelines of SEBI. Among the constituent members of the trustee, at least 2/3 are independent directors, since they do not relate to trustee in any form.
- Asset Management Company: AMC is appointed by the Trustee, which requires approval by SEBI to operate as Asset Management Company of Mutual Fund. Such formation too involves 50% independent directors and net worth of at least 10 cr. all the time.
- Registrar or Transfer Agent: AMC assigns Registrar in order to perform functionaries related to application form, redemption requests etc.

4. TYPES OF MUTUAL FUNDS

Savings and investments have evolved over the years, from hidden shelves in cupboards and piggy banks to savings accounts, fixed deposits (FDs) and recurring deposit (RDs) to equities and funds.

Equities have always been a lucrative investment option, but the risk involved has always been a deterrent to many. Besides, there is a lot of research and knowledge required to successfully invest directly in equities and make profits. On the other hand, some people want the security offered by bank deposits and are okay with getting lower returns than equities. Hence, there is a large variety of mutual funds types available that address these specific concerns of investors.



1. OPEN-ENDED MUTUAL FUNDS

You may buy and sell units at any point while investing in open-ended mutual funds. There is no lock-in period or fixed maturity date. Below are four sub-categories of such funds.

Debt or Income Funds

Debt Funds are the least risky type of mutual fund investments, as the corpus is invested in government securities, debentures, and other debt-related instruments. This is a low risk-low return investment and is ideal if you are willing to assume low risks and earn regular income.

Money Market or Liquid Funds

Liquid Funds invest their pooled money in short-term financial instruments. These funds are ideal if you want to park your surplus money in mutual funds that earn better returns than FDs and savings accounts in the short term. This allows you to earn returns in the interim period while awaiting lucrative opportunities.

Equity / Growth Funds

Equities are the highest yielding type of mutual fund. The accumulated corpus is principally invested in equities, thus being a high risk-high return portfolio. This is the ideal investment if you want long-term capital appreciation. Equity funds are further classified as below.

A. Index Scheme

Index funds that invest in indices such as the Nifty or Sensex. These adopt a rather passive investment strategy that performs in tandem with the movements of the indices.

B. Sectoral Scheme

Sectoral Mutual Fund schemes invest in instruments of a particular sector such as pharmaceutical, infrastructure, information technology (IT), and others. Sector funds may also invest in companies with small, medium, or large market capitalization. The risk involved is closely tied to the sector risks.

C. Tax Saving

Also known as Equity Linked Savings Scheme (ELSS), this type of mutual fund has a three-year lock-in period and offers tax benefits. The fund corpus is invested in equity-related instruments and offer long-term capital appreciation. As per Section 80C of the Income Tax (IT) Act, the investments made in ELSS funds are exempt from income tax.

Balanced

Balanced Fund is the perfect mix of equities and fixed income securities as per pre-determined percentage. They enable you to enjoy growth and earn an income at periodic intervals. These funds are suitable for the cautiously aggressive investors.

2. CLOSED ENDED FUNDS

Close-Ended Mutual Funds- have a fixed maturity period. You may invest in these only during the launch or New Fund Offer (NFO) period. Here are two types of close-ended MF schemes:

Capital Protection Funds

Evidently, these funds focus on safeguarding your principal investments and thus invest primarily in high-rated fixed income securities. A marginal component of the corpus is invested in equity. Thus, these funds deliver reasonable returns on your investments.

Fixed Maturity Plans (FMPs)

As the name suggests, these schemes have a fixed maturity period and the corpus is invested in debt instruments that mature with the fund maturity. Such plans earn a fixed interest or coupon. Since FMPs are passively managed, the expenses on these are lower when compared to actively managed schemes.

3. INTERVAL FUNDS

This is a mix of open and closed-ended funds that allow you to invest at pre-defined intervals. These type of funds offer the benefits of both open-ended and close-ended types of funds.

Based on your risk appetite, the period you want to stay invested and the type of returns that you expect, you can choose from the different types of mutual funds. It is recommended you choose funds that deliver stability, growth, and income for maximum benefits. Get ready to start your investment journey with mutual fund investments.

5. INDICATORS OF INVESTMENT RISK

MEASURES	DESCRIPTION	IDEAL RANGE
STANDARD DEVIATION	**Standard Deviation evaluates fund's volatility.** The standard deviation of a Fund **measures this risk by measuring the degree to which the fund fluctuates in relation to its mean return.**	**Sh**ould be near to its mean **return.**
BETA	**A common measure of risk is Beta. It signifies the volatility of the fund in comparison to the benchmark.**	**Beta>1 = high risky** **Beta = 1 = Avg** **Beta<1** = Low Risky
R-SQUARE	R-square connotes the correlation of a fund's **movement to an index. It describes the relation between the fund's volatility and market risk.**	R-square values range between 0 and 1, where 0re presents no correlation and1 represents full correlation.
ALPHA	Alpha is the difference between the returns one **would expect from a fund, given its beta and the re**turn it actually produces. It also measures the **unsystematic risk.**	**Alpha is posi**tive = returns of **stock are better than market returns.** **Alpha** is negative = returns of **stock are worst then market.** **Alph**a is zero = returns are **same as market.**
SHARPE RATIO	**Sharpe Ratio= Fund return in excess of risk free return/ Standard deviation of Fund. Sharpe ratios are ideal for comparing funds that have a mixed asset classes.**	**Higher Sharp**e ratio better funds returns **relative to amount of risk taken.**

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6. RISKS ASSOCIATED WITH MUTUAL FUND

It is well said that Higher the Risk, Higher the Returns. Tolerance for risk varies from oneindividual to another. Hence individual disposition can be

- Conservative
- Aggressive
- Moderate

Following are the techniques which would enable investor to manage the investment risk andattain the financial goals:

- Diversification

Investors must tend to diversify the portfolio i.e. a blend of equity shares, bonds and money market securities would definitely procure more returns rather than investing the entire amount of money into one basket. Moreover, making investments into high growth rate equity along with the high income bonds as well as stable money market would augment returns and moderate risk.

- Systematic Investment Plan

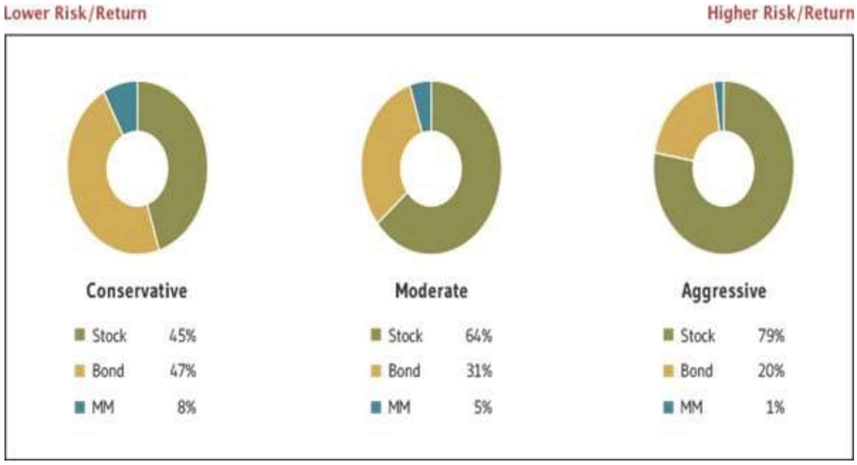

Figure : Risk Return Profile

Unit Holders in order to diminish the risk, can also choose to invest specific amount periodically for some continuous interval. SIP lets investor to invest fixed amount every monthin order to buy additional units at NAV prices.

Consider the following hypothetical example where investor tends to invest Rs. 1000 quarterly:

Table 1 Hypothetical Example (Source: icici)

	Amount Invested (Rs.)	Purchase Price (Rs.)	No. of Units Purchased
Initial Investment	1000	10	100
1	1000	8.20	121.95
2	1000	7.40	135.14
3	1000	6.10	163.93
4	1000	5.40	185.19
5	1000	6.00	166.67
6	1000	8.20	121.95
7	1000	9.25	108.11
8	1000	10.00	100.00
9	1000	11.25	88.89
10	1000	13.40	74.63
11	1000	14.40	69.44
TOTAL	12,000	-	1,435.90

Average unit cost Rs 12,000/1,435.9 = Rs 8.36Average unit price
109.6/12 = Rs 9.13

Unit price at beginning of next quarter Rs 14.90 Market value of investment

1435.9 * 14.90= Rs 21,395/-

The investor liquidates his units and gets back Rs 21,395/-

Using the SIP strategy the investor can reduce his average cost per unit. The investor getsthe advantage of getting more units when the market is turned down.

7. CONCLUSION

Investment in today's era is enveloped with risks like business, credit, default, currency, interest rate, market etc. Mutual Fund allows investor to pool their money with which the investment manager would instigate investments and hence attempt to attain results as per the investor's objectives. Diversification and SIP allows investor to manage the risks. Sponsor, Trust, Trustee, Transfer Agent, Asset Management Company etc. forms key element Mutual Fund structure. Moreover, with the investment in Mutual Fund the investor can avail tax benefits too.

- The mutual funds have emerged as one of the important class of financial intermediaries which cater to the needs of the retail investors
- The major factors influencing the investment decision of retail investors are tax benefits, high return, price and capital appreciation
- Equity based schemes are the most preferred
- Bitter past experience is the major preventing factor while considering investment decisions
- Investors satisfaction with regard to mutual fund investors may be rated to average.

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