FACTORS THAT INFLUENCE INVESTMENT DECISION IN INDIAN MUTUAL FUND INDUSTRY

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Abstract

The Mutual Fund industry appears to be on a losing streak. Ever since the Securities and Exchange Board of India (SEBI) banned entry loads-charges collected by fund houses from investors at the time of investment, the number of retail investors in Mutual Funds has been falling consistently. The number of investors dropped by 10 lakh between September 2011 and September 2012. Equity funds have seen the closure of around 19 lakh over a year since September 2011.

Industry players, financial planners and investors' representatives have been trying hard to find a solution to stop the mass migration. However, the industry doesn't seem to have a definite plan to get out of the unstable situation.

The present analysis focuses on the Mutual Fund investment decision function to establish the relevant causal relationship amongst the factors influencing one's decision to invest in the Mutual Funds. The investors were asked to rate fourteen reasons on a five-point scale from highly agree to highly disagree. The assigned marks on these scales are from 5 to 1 respectively. The paper is based upon the results drawn from a survey of 524 respondents. The Mutual Fund investment functions (IF) can be expressed as: IF = F (BE, FS, TP, RI, RFM, PP, LF, CM)

Introduction

Mutual Fund in itself is deemed to be an institutional entity that encompasses the commonly derived and/or schematically accumulated financial goals of the community of investors. The money collected from a plethora of sources is invested by the fund manager in various types of securities depending on their duly specified objectives. A Mutual Fund, therefore, in its rudimentary conceptualization, is a collection of stocks and/or bonds, wherein an investor holds a share, which represents a part of the fund holding thereof.

Review of Literature

Selecting a Mutual Fund which is able to offer high returns with acceptable risks is a complex task. Literature shows that there are a number of factors that determine the performance of Mutual Funds. The purpose of this literature survey is to identify those factors that previous research has found to be important in the purchase of Mutual Funds.

1. Bodla and Garg (2011) evaluated the performance of 24 growth schemes of Mutual Funds. They reveal that most of the schemes have outperformed the market during the study period in terms of return. However,

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the difference in market return and funds return is found insignificant. There exists a moderate positive correlation between risk and return of the sample schemes. A large majority of the schemes have succeeded in earning a risk premium irrespective of the performance measurement model concerned. Most of the schemes have performed better than the market on the basis of risk adjusted return also.

2. Ravindran and Rao (2010) made the performance analysis of 269 open ended Indian Mutual Funds in a beer market. This evaluation was carried out through Treynor ratio, Sharpe's ratio, Jensen measure and Fama measure, the study period being September 1998 to April 2002. The study showed that 58 schemes were able to satisfy investor's expectations based on both premium for systematic risk and total risk.

3. Sarkar and Majundar (2009) made an attempt to make an operational analysis of various Mutual Funds over a period of three years (1996-1999). The results revealed that the income oriented products offered by the public as well as private Mutual Funds organizations were less expensive than the others as these incurred comparatively low cost per rupee of income generated. The results also indicated that the cost effectiveness is favourable towards private-sector Mutual Funds as against their rivals operating in the public sector.

4. Burnett (2007) explained that investors tend to choose funds based on previous performance but stick to these funds despite their poor return. They also reveal that there is only a slight positive relationship, if there is any relationship at all, between previous performance and current returns.

5. Elton and Gruber (1991) suggested that past risk adjusted Mutual Funds performance helps to predict future risk adjusted performance. The Mutual Funds investors make purchase decisions on the basis of past performance.

6. Grinlast and Tilman (1989) found that the investors are influenced by factors other than just return and risk. These are past performance and level of risk associated with the fund, amount of sales change, management fees, fund manager reputation, clarity of accounting statements, recommendations from a financial magazines or newsletter, etc.

Objective of the Study

The present analysis focuses on the Mutual Fund investment decision function to establish the relevant causal relationship amongst the factors influencing one's decision to invest in the Mutual Funds. It confines its objectives to:

1. Examine the Mutual Fund investors decision among the investors.
2. Determine the steps taken by the Mutual Fund industry to encourage the retail investors

Methodology

The study is primarily based upon primary data collected from a structured survey through a questionnaire. The survey was conducted on 524 respondents, in person. The questionnaire comprised of 32 questions. All the variables were measured by response on five point Likert scales, which rated 1 as least important and 5 as most important. The investors' attitude on the nine variables have been analyzed with the help of its mean scores and standard deviation among the retail investors in order to exhibit the importance of the variables involved in decision function. The significant difference of investors regarding their perception on nine variables, the 't' test have been executed.

Analysis of the Survey

The present analysis focuses on the Mutual Fund investment decision function to establish the causal relationship amongst the factors influencing one's decision to invest in the Mutual Funds. The Mutual Fund investment functions (IF) can be expressed as:

IF = F (BE, FS, TP, RI, RFM, PP, LF, CM)

Where

IF	- Mutual Fund invested so far
BE	- Brand equity
FS	- Fund size
TF	- Type of fund
TP	- Type of portfolio and schemes
RI	- Risk involved in the Mutual Fund
RFM	- Reputation of fund manager
PP	- Past performance of the fund
LF	- Liquidity factors
C	- Current market conditions

Brand Equity

Fund families like UTI, SBI, Reliance, Birla Sunlife, etc. have high brand equity and the funds of such families were most likely to have greater investors' confidence. In the present study, the investors were asked to rate on a five-point scale the brand equity of the fund family as the discriminate of their investment on Mutual Funds.

Fund Size

Fund size may be small, medium or large. It must be ascertained that a larger fund size would mean a higher amount of fund being invested and therefore a higher degree of involvement by the fund family. It would therefore mean one of the most profitable investment decisions that could be undertaken. In the present study, the investors were asked to rate the fund size as the discriminate of their investment on Mutual Funds on five point scale.

Type of Fund

A Mutual Fund may be a growth of fund, dividend fund, tax saving fund, etc. and therefore, their impact on the Mutual Funds investment decision is largely related to their respective functional intents. In the present study, the investors were asked to rate the type of fund as the discriminate of their investment on Mutual Funds at five point scale.

Type of Portfolio and Schemes

The type of portfolio could be mixed, equity, debt, etc. which makes a sizeable impact on investment decision on Mutual Fund. It helps the investors to assess their utmost need to invest in either the mixed fund or equity fund or likewise. In the present study, the importance of the type of portfolio and the schemes in the investment on Mutual Fund have been measured on a five-point scale.

Risk Involved in Mutual Funds

A high risk involved in a particular Mutual Fund would generally mean a low investment in it, though with same quick mathematical calculations, even the major and minor limits of the risk may be ascertained. In the present study, the investors were asked to rate the importance of risk involved in Mutual Funds in the investment on Mutual Funds on a five-point scale.

Reputation of Fund Managers

A fund manager is a high authority in ascertaining an investor's financial roadmap. The reputation of the fund manager also plays a key role in determining the level and extent of profitable investment one could make in Mutual Funds. Fund managers with a high market reputation who are likely to make profitable investment decisions and upon whom an investor can rely for undertaking a high-risk investment initiative can attract more funds. The importance of the fund manager in the investment on Mutual Funds among the investors is also rated on a five-point scale.

Past Performance of the Funds

Good past performance of the fund is a reflection of its ingenuity and a high investor's confidence in it. Past performance is generally undertaken through ascertaining the annualized returns for the previous five years and comparing it to benchmarks like NSE, BSE, etc. In the present study, the importance of past performance of funds in the investment on Mutual Funds among the investors is rated on a five-point scale.

Liquidity Factors

Liquidity factors have their own relevance especially when the investor wishes to rotate the profits for various investments for maintaining one's financial obligations. A liquidity factor simply denotes their pace of convertibility into cash which therefore serves as a major discriminant of the Mutual Fund investment. In the present study, the importance of liquidity factor in investment in Mutual Funds is measured on a five-point scale.

Current Market Conditions

An eagle's eye in the current market conditions also helps investors to make a better investment decision. The knowledge as to how the share market, the real estate market, etc. was performing also helps investors in making their relative decisions. The investors were asked to rate the importance of current market conditions in investing on Mutual Funds on a five-point scale.

After collecting these data, the investors attitude on the nine variables have been analyzed with the help of its mean scores and standard deviation among the retail investors in order to exhibit the importance of the variables involved in decision function. The significant difference among the two group of investors regarding their perception on nine variables, the 't' test have been executed. The results are given in Table 1.

Table 1
Investors' Attitude on Decision Variables
One-Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
Brand equity	524	2.14	.906	.040
Fund size	524	2.67	.889	.039
Type of fund	524	2.75	.904	.039
Type of portfolio/scheme	524	2.92	1.117	.049
Risk involved in Mutual Funds	524	2.74	.982	.043
Reputation of fund managers	524	2.91	.805	.035
Past performance of the fund	524	2.83	1.108	.048
Liquidity factors	524	3.03	1.028	.045
Current market conditions	524	2.02	.917	.040

One-Sample Test

	Test Value = 0					
					95% Confidence Interval	
	t	Df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Brand equity	54.084	523	.000	2.141	2.06	2.22
Fund size	68.857	523	.000	2.674	2.60	2.75
Type of fund	69.745	523	.000	2.754	2.68	2.83
Type of portfolio/scheme	59.770	523	.000	2.916	2.82	3.01
Risk involved in Mutual Funds	63.859	523	.000	2.740	2.66	2.82
Reputation of fund managers	82.840	523	.000	2.914	2.85	2.98
Past performance of the fund	58.409	523	.000	2.828	2.73	2.92
Liquidity factors	67.448	523	.000	3.029	2.94	3.12
Current market conditions	50.501	523	.000	2.023	1.94	2.10

*Significant at five percent level.

The important decision variables among the retail investors were liquidity factors, type of portfolio/scheme and reputation of fund managers, since their respective mean scores were 3.029, 2.916 and 2.9144 respectively. Regarding the importance given on the decision variables, the investors have been identified in the case of brand equity, family size, type of portfolio/scheme, risk involved in Mutual Fund, reputation of fund manager and liquidity factors since their respective 't' statistics was significant at five per cent level.

Various steps have been taken by the Mutual Fund industry to encourage the retail investors in their investment decision

1. Improving Awareness

In a country, where 55 per cent of domestic savings go into bank fixed deposits, the Mutual Fund industry sees a huge scope for growth. The Association of Mutual Funds in India (Amfi) has initiated a programme under which each fund house needs to organise at least five investor awareness programmes every month.

2. Focus on SIPs

After the ban on entry loads, fund houses have shifted their focus to systematic investment plans.

3. Goal-based Products

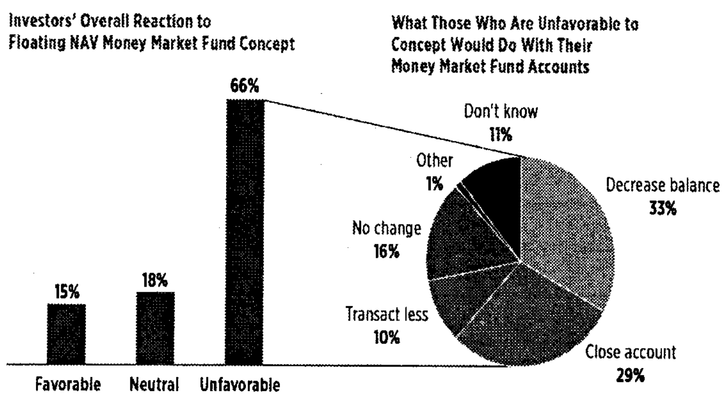
Goal-based savings products – be it pension plans, child plans or retirement plans – the insurance industry has succeeded in selling such schemes more aggressively than Mutual Funds. Mutual funds have been selling more return-based plans and there is a need for more goal-based plans to ensure long-term investments. There is certainly a shift towards such products.

4. Battle with FDs

Fund houses have realized that they need to have more products in the fixed-income category to attract risk-averse investors who have so far preferred bank fixed deposits. They are now launching more capital-protection-oriented funds, monthly income plans and fixed maturity plans.

5. Caveat Emptor

Notwithstanding all the efforts by Mutual Fund players, the industry needs to address the issue of incentivising financial planners in order to push the sales of Mutual Funds.



Source: Harris Interactive / T Rowe Price

Conclusion

Two-thirds of retail investors surveyed found the idea of a floating NAV money market fund unfavorable. Among those who found the concept unfavorable, 72 percent indicated that they would use the product less, and that their most likely response would be to close their money market fund accounts (29 percent), decrease their money market fund balances (33 percent), or execute fewer money market fund transactions (10 percent). A third survey, conducted among both retail and institutional shareholders by Fidelity Investments, found much the same result. This survey found that institutional investors overwhelmingly (78 percent) disliked the idea of a floating NAV product and would use money market funds less or not at all (69 percent of 78 percent) if faced with the prospect of a floating NAV. Retail investors also disliked the floating NAV concept. Forty percent of the retail investors surveyed disfavored the floating NAV concept; however, when informed of the adverse tax consequences, the percent disfavoring jumped to over sixty percent. In short, there is good reason, backed by data, to believe that investors do not want and will likely reject a floating NAV money market fund.

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