CHAPTER – I
INTRODUCTION AND DESIGN OF THE STUDY

1.0 INTRODUCTION

Many investors want to diversify their holdings in order to limit their exposure to risk. However, most of the individual investors cannot afford the fees and commissions necessary to take large positions in a number of individual securities. Fortunately, they can take advantage of mutual funds.

Investors are blessed with different investment avenues which are made available for them to make their investments. Mutual fund is one such avenue which offers good investment opportunity for the investors. Like all investments, they also carry certain risks. The investors should compare the risks and expected yields after adjustment of tax on various instruments while taking investment decisions. Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities, debt instruments and other investment avenues in accordance with objectives as disclosed in offer document.

Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unit holders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives that are launched from time to time. In India an Asset Management Company dealing with mutual fund is required to be registered with
Securities and Exchange Board of India (SEBI) that regulates securities markets before it start collecting funds from the public.

1.1 HISTORY OF MUTUAL FUNDS IN INDIA

Unit Trust of India was the first mutual fund to set up India during the year 1963. In early 1990s, Government allowed public sector banks and institutions to set up mutual funds. In the year 1992, Securities and Exchange Board of India (SEBI) Act was passed. The objectives of SEBI are – to protect the interest of investors in securities and to promote the development of and to regulate the securities market.

As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI notified regulations for the mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines to the mutual funds from time to time to protect the interests of investors.

All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspection by SEBI.

1.1.1 SET UP OF MUTUAL FUND

A mutual fund is set up in the form of a trust, which has sponsor, trustees, Asset Management Company (AMC) and custodian. The trust is established by a sponsor or more than one sponsor who is like promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. Asset Management Company (AMC) approved by SEBI manages the funds by making
investments in various types of securities. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund.

SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.

1.1. 2 ADVANTAGES OF MUTUAL FUNDS

1. **Diversification.** Mutual funds spread their holdings across a number of investment vehicles, which reduces the effect any single security or class of securities that will have on the portfolio. Because mutual funds can contain hundreds or thousands of securities, where investors aren’t likely to be fazed if one of the security do not do well.

2. **Expert Management.** Many investors lack the financial know-how to manage their own portfolio. However, non-index mutual funds are managed by professionals who dedicate their careers to helping investors receive the best risk-return trade-off according to their objectives.

3. **Liquidity.** Mutual funds, unlike some of the individual investments they may hold, can be traded daily. Though not as liquid as stocks, which can be traded intraday, buy and sell orders are filled after market close.

4. **Convenience.** If one invests on his own, he should ideally spend time researching securities. He should also have to purchase a huge range of securities to acquire holdings comparable to most mutual funds. Then, he needs to monitor all those securities. Choosing a mutual fund is ideal for people who do not have the time to micromanage their portfolios.
5. **Reinvestment of Income.** Another benefit of mutual funds is that they allow the investor to reinvest his dividends in additional funds units. In effect, this allows him to take advantage of the opportunity to grow his portfolio without paying regular transaction fees for purchasing additional mutual fund units.

6. **Range of Investment Options and Objectives.** There are funds for the highly aggressive investor, the risk averse, and the middle-of-the-road investor – for example, emerging markets funds, investment-grade bond funds, and balanced funds, respectively. There are also life cycle funds to ramp down risk as one is nearing his retirement. There are funds with a buy-and-hold philosophy and others that are in and out of holdings almost daily. No matter his investing style, there is bound to be a perfect fund to match it.

### 1.1.3 DISADVANTAGES OF MUTUAL FUNDS

Although mutual funds can be beneficial in many ways, they are not for everyone.

1. **No Control over Portfolio.** If one invests in a fund, he gives up all control of his portfolio to the mutual fund money managers who run it.

2. **Capital Gains.** Anytime one sells stock, he is taxed on his gains. However, in a mutual fund, he is taxed when the fund distributes gains it made from selling individual holdings – even if he has not sold his shares. If the fund has high turnover, or sells holdings often, capital gains distributions could be an annual event.

3. **Fees and Expenses.** Some mutual funds may assess a sales charge on all purchases, also known as a “load” – this is what it costs to get into the fund. In addition to that, all mutual funds charge annual expenses, which are conveniently expressed as an annual expense ratio – this is basically the cost of doing business. The expense ratio is expressed as a percentage, and is what one pays annually as a portion of his account value. The average for managed funds is around 1.5%. 
Alternatively, index funds charge much lower expenses (0.25% on average) because they are not actively managed. Since the expense ratio will eat directly into gains on an annual basis, one should closely compare expense ratios for different funds they are considering.

4. **Over-diversification.** Although there are many benefits of diversification, there are pitfalls of being over-diversified. Think of it like a sliding scale: The more securities you hold, the less likely you are to feel their individual returns on your overall portfolio. What this means is that though risk will be reduced, so too will be the potential for gains. This may be an understood trade-off with diversification.

5. **Cash Drag.** Mutual funds need to maintain assets in cash to satisfy investor redemptions and to maintain liquidity for purchases. However, investors still pay to have funds sitting in cash because annual expenses are assessed on all fund assets, regardless of whether they’re invested or not.

### 1.1.4 NET ASSET VALUE (NAV)

The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV). Mutual funds invest the money collected from the investors in securities markets. In simple words, Net Asset Value is the market value of the securities held by the scheme. Since market value of securities changes every day, NAV of a scheme also varies on day-to-day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. For example, if the market value of securities of a mutual fund scheme is Rs 200 lakhs and the mutual fund has issued 10 lakhs units of Rs. 10 each to the investors, then the NAV per unit of the fund is Rs.20. NAV is required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.
1.1.5 TYPES OF MUTUAL FUND SCHEMES

Mutual fund schemes may be classified according to maturity period and according to the investment objective.

1.1.6 SCHEMES ACCORDING TO MATURITY PERIOD

A mutual fund scheme can be classified into open-ended scheme or close-ended scheme depending on its maturity period.

1.1.6.1 OPEN-ENDED FUND/ SCHEME

An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices which are declared on a daily basis. The key feature of open-end scheme is liquidity.

1.1.6.2 CLOSE-ENDED FUND/ SCHEME

A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.

1.1.7 SCHEMES ACCORDING TO INVESTMENT OBJECTIVE

A scheme can also be classified as growth scheme, income scheme, or balanced scheme considering its investment objective. Such schemes may be open-
ended or close-ended schemes as described earlier. Such schemes may be classified mainly as follows:

1.1.7.1 GROWTH / EQUITY ORIENTED SCHEME

The aim of growth fund is to provide capital appreciation over the medium to long-term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.

1.1.7.2 INCOME / DEBT ORIENTED SCHEME

The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes. These funds are not affected because of fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAVs of such funds are affected because of change in interest rates in the country. If the interest rates fall, NAVs of such funds are likely to increase in the short run and vice-versa. However, long term investors may not bother about these fluctuations.

1.1.7.3 BALANCED FUND

The aim of balanced funds is to provide both growth and regular income as such schemes invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are appropriate for investors looking for moderate growth. They generally invest 40-60% in equity and debt instruments.
These funds are also affected because of fluctuations in share prices in the stock markets. However, NAVs of such funds are likely to be less volatile compared to pure equity funds.

### 1.1.7.4 MONEY MARKET OR LIQUID FUND

These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much less compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

### 1.1.7.5 GILT FUND

These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt oriented schemes.

### 1.1.7.6 INDEX FUNDS

Index Funds replicate the portfolio of a particular index such as the BSE Sensitivity index, S&P NSE 50 index (Nifty), etc. These schemes invest in the securities in the same weightage comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error" in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme. There are also exchange traded index funds launched by the mutual funds which are traded on the stock exchanges.
1.1.7.7 SECTOR SPECIFIC FUNDS/SCHEMES

These are the funds/schemes which invest in the securities of only those sectors or industries as specified in the offer documents. e.g. Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks, etc. The returns in these funds are dependent on the performance of the respective sectors/industries. While these funds may give higher returns, they are more risky compared to diversified funds. Investors need to keep a watch on the performance of those sectors/industries and must exit at an appropriate time. They may also seek advice of an expert.

1.1.7.8 TAX SAVING SCHEMES

These schemes offer tax rebates to the investors under specific provisions of the Income Tax Act, 1961 as the Government offers tax incentives for investment in specified avenues. e.g. Equity Linked Savings Schemes (ELSS). Pension schemes launched by the mutual funds also offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities. Their growth opportunities and risks associated are like any equity-oriented scheme.

1.1.7.9 FUND OF FUNDS (FOF) SCHEME

A scheme that invests primarily in other schemes of the same mutual fund or other mutual funds is known as a FoF scheme. An FoF scheme enables the investors to achieve greater diversification through one scheme. It spreads risks across a greater universe.

1.1.7.10 LOAD OR NO-LOAD FUND

A Load Fund is one that charges a percentage of NAV for entry or exit. That is, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses. Suppose the NAV per unit is Rs.10. If the entry as well as exit load charged is 1%, then the investors...
who buy would be required to pay Rs.10.10 and those who offer their units for repurchase to the mutual fund will get only Rs.9.90 per unit. The investors should take the loads into consideration while making investment as these affect their yields/returns. However, the investors should also consider the performance track record and service standards of the mutual fund which are more important. Efficient funds may give higher returns in spite of loads.

A no-load fund is one that does not charge for entry or exit. It means the investors can enter the fund/scheme at NAV and no additional charges are payable on purchase or sale of units.

1.1.8 PERFORMANCE OF A MUTUAL FUND SCHEME

The performance of a scheme is reflected in its Net Asset Value (NAV) which is disclosed on a daily basis in case of open-ended schemes and on weekly basis in case of close-ended schemes. The NAVs of mutual funds are required to be published in newspapers. The NAVs are also available on the websites of mutual funds. All mutual funds are also required to put their NAVs on the website of Association of Mutual Funds in India (AMFI), i.e., www.amfiindia.com and thus the investors can access NAVs of all mutual funds at one place.

The mutual funds are also required to publish their performance in the form of half-yearly results which also include their returns/yields over a period of time i.e. last six months, 1 year, 3 years, 5 years and since inception of schemes. Investors can also look into other details like percentage of expenses of total assets as these have an affect on the yield and other useful information in the same half-yearly format.

The mutual funds are also required to send annual report or abridged annual report to the unit holders at the end of the year.
Various studies on mutual fund schemes including yields of different schemes are being published by the financial newspapers on a weekly basis. Apart from these, many research agencies also publish research reports on performance of mutual funds including the ranking of various schemes in terms of their performance. Investors should study these reports and keep themselves informed about the performance of various schemes of different mutual funds.

Investors can compare the performance of their schemes with those of other mutual funds under the same category. They can also compare the performance of equity oriented schemes with the benchmarks like BSE Sensitivity Index, S&P CNX Nifty, etc.

On the basis of performance of the mutual funds, the investors should decide when to enter or exit from a mutual fund scheme.

1.2 STATEMENT OF THE PROBLEM

Now-a-days the savings habit of the middle class people has been transformed into making investments. There are many investment avenues at the disposal of the retail investors. Mutual fund is one of such investment avenue and it is considered to be less risky when compared with the other avenues. There are various mutual fund schemes available for the investors. The retail investors are yet to get financial literacy. Under these circumstances it is deemed to be appropriate to understand how the investors prefer or select the mutual fund schemes. Since Namakkal District is one of the fastest growing districts in Tamil Nadu in terms of agriculture and industrial development, the investment attitude is growing. In this context, the following questions have been probed in the present study:

1. Which of the savings avenues is mostly preferred by the investors?
2. What is the current attitude of investors towards financial instruments?
3. Which of the mutual fund schemes is preferred by the investors?
4. Whether the fund related qualities and fund sponsor qualities have influenced the mutual fund scheme selection?
5. Whether the mutual fund scheme selection is influenced by investor related services? and
6. What is the relationship between socio-economic variables of investors and their perception towards mutual funds?

1.3 NEED FOR THE STUDY

Mutual fund is considered to be one of the safest investment avenues. However, the investors are required to possess financial literacy and awareness of mutual fund concepts. When compared with the developed countries, the financial literacy of Indian retail investors is less. The attitude of investing in mutual funds is increasing. Without understanding the concepts of mutual funds, making investment in mutual funds could not be fruitful. Mutual fund companies are growing day-by-day and they are introducing variety of schemes to attract all types of investors. Thus the investors are at the cross roads in selection of the best mutual fund or its scheme. Hence, it is felt that an exclusive study is needed to analyze the investors’ preference towards mutual funds in Namakkal District.
1.4 OBJECTIVES OF THE STUDY

The present study is undertaken with the specific objective of analyzing the investors’ preference towards mutual funds with special reference to Namakkal District. In this regard, the following objectives have been framed:

1. To examine the investors’ preference towards savings avenue.
2. To assess the investors’ attitude towards financial instruments.
3. To analyze the investors’ preference towards mutual fund schemes.
4. To study the influence of fund related schemes and fund sponsor qualities on scheme selection.
5. To evaluate the influence of investor related services on scheme selection.
6. To understand the relationship between socio-economic variables and investors’ perception towards mutual funds and
7. To offer suitable suggestions for selection of best mutual fund schemes.

1.5 SCOPE OF THE STUDY

In the present study an attempt has been made to analyze the investors’ preference towards mutual funds in Namakkal District. In this regard, investors’ preference on savings avenues, their attitude towards financial instruments and their preference towards mutual fund schemes have been analyzed. The degree of influence of fund related qualities, fund sponsor qualities and investor related services on selection of mutual fund scheme is also studied. The present study extends its scope to examine the association between socio-economic variables of the investors and their preference towards mutual funds.

1.6 RESEARCH METHODOLOGY

The methodology or design of the research can be taken as the skeleton of the study. It provides overall picture of the analyses to be made in the study. The research methodology comprises the step-by-step process of the study. It enables the
researcher to conduct the research smoothly. It describes the source from which data is required for the study that is conducted and the tools used for collecting the data. The size of sample and technique used for selection of samples are also included in the research methodology. It also includes the statistical tools used for data analysis.

RESEARCH DESIGN

Since the research study involves collection of data pertaining to investors’ characteristics, the researcher has opted for descriptive research design.

1.6.1 DATA SOURCE

The data required for a research study can be obtained both from the primary and secondary sources. The primary data is the data obtained by the researcher himself with the specific objective of the study. On the other hand, the secondary data is a data obtained by others for some other purposes. The secondary data may or may not be suitable for the objectives of the study. The present study is mainly dependent on the primary data. The secondary data obtained from books and journals is also used in this study.

1.6.2 COLLECTION OF DATA

The data required for the study is obtained through questionnaire method. In this regard, a structured questionnaire is designed by the researcher with due care to include all the relevant questions. The questionnaire is administered to the sample respondents. They were asked to fill the questionnaire with complete responses and return the same. The researcher has taken much care to avoid incomplete and incorrect data. The data so obtained were re-grouped and tabulated wherever necessary. The data as obtained above were put through the statistical analysis for drawing a valid conclusion.
1.6.3 SAMPLE SIZE

The sample size refers to the number of samples drawn from the population for the study. Though there is no specific criterion for determining the size of sample, it is to be taken into account that the sample should represent all the sections of the population. The size of sample for the present study is determined to be 300 respondents.

1.6.4 SAMPLING TECHNIQUE

In order to increase the accuracy of results, the researcher has gone for systematic sampling which is one among the probability sampling technique. The respondents are met at the intervals specified and the primary data is collected from them.

1.6.5 TOOLS OF ANALYSIS

In the present study, the data obtained from the primary sources have been analyzed by employing the statistical tools like percentage analysis, Garrett ranking, chi square test, analysis of variance (ANOVA), t test, weighted average score analysis, multiple regression and factor analysis.

1.6.6 FRAMEWORK OF ANALYSIS

The socio-economic variables of the investors like sex, gender, academic qualification, marital status, occupation, annual income, annual savings and objectives of savings have been analyzed using percentage analysis. The investors’ preference towards savings avenues has been analyzed by employing Garrett Ranking method. Chi square test was used to analyze the relationship between objective of savings and investors’ current attitude towards financial instruments. Investors’ preference towards mutual fund and other savings avenue is analyzed with percentage analysis. Weighted average score analysis and percentage analysis are used to analyze the preference of mutual fund schemes. The reason for preference of investment in
mutual fund is also analyzed using weighted score analysis. The association between mutual fund schemes preferred and fund related qualities, fund sponsor qualities and investor related services has been analyzed by performing analysis of variance. The relationship between socio-economic variables and perception of investors towards mutual fund has been analyzed by employing t test and analysis of variance.

1.7 LIMITATIONS OF THE STUDY

The present study has been undertaken subject to the following limitations:

1. Since the study is mainly concerned with the primary data obtained from the sample respondents, their preference could change from time-to-time.
2. The study is undertaken in Namakkal District only and hence, while generalizing the results to other districts, care should be taken.

1.8 CHAPTER SCHEME

The structure of the thesis has been designed with five chapters as described below:

The first chapter deals with the introduction and design of the study. It includes introduction, statement of the problem, need for the study, objectives of the study, scope of the study, research methodology, limitations of the study and chapter scheme.

The second chapter presents review of literature. In this chapter the literature relating to the current research problem has been reviewed.

An overview of investment avenues and mutual funds has been discussed in the third chapter. It contains the various investment avenues available for the
investors. It also includes the details regarding the geographical area chosen for conducting the research study.

The fourth chapter comprises the analysis and interpretation of data. It includes the analysis of socio-economic variables of the investors, their preference towards savings avenues, attitude of investors towards financial instruments, investors’ preference towards mutual fund schemes, the relationship between mutual fund schemes and fund related qualities, fund sponsor qualities and investor related services and the relationship between socio-economic variables and perception towards mutual funds.

The fifth chapter recapitulates the summary of findings, suggestions, conclusion, future directions for the research and societal benefits of the study.