CHAPTER 1

Introduction

1.1 Background of the Study

The mutual fund (MF) is considered as the most successful recent financial innovation (Khorana, Servaes and Tufano, 2005). The MF schemes are increasingly gaining importance world over as an investment avenue. Hence, MF industry is experiencing the spectacular growth and has approximately tripled its size of net assets from $9.6 trillion in 1998 to $26 trillion in 2007\(^1\), corresponding to an annual growth rate of 12.38 %. This growth in the net assets is accompanied by exponential growth in the number of MF companies (MFCs) and schemes being offered by them.

Over the last decade, Indian MF industry has emerged as the fastest growing segment of the Indian financial markets. The CAGR\(^2\) in the total net assets of MFCs was 34.72 % from 2000 to 2007\(^3\). This growth in the net assets has been coupled with competition amongst MFCs as they have to vie with each other to attract the existing and

\(^2\) CAGR stands for ‘Compounded Annual Growth Rate’
prospective investors towards their schemes. As a result, MFCs have been spending heavily on marketing (development, launch, promotion, distribution and maintenance) of their new and existing schemes. The successful marketing of MF schemes requires a clear understanding of the investment behaviour of MF investors. Yet, the MF marketers have only a naïve understanding of above relationship.

The current state of knowledge about the investor behaviour is still at the nascent stages and moreover, inadequate when applied to understand the buying decision process of MF investors. The fundamental normative model of investment behaviour considers risk and return, as only crucial variables impacting the investors’ buying behaviour. Further, the model assumes investors as rational. However, this has not been the case and humans are shown to be irrational at times (Shefrin, 2000). Literature in behavioral finance suggests that investor behavior is “predictably irrational” (Ariley, 2008). Further, there is adequate evidence in the literature suggesting non-economic motives influencing the behaviour of investors (Nagy and Obenberger, 1994). Hence, normative model of investment behavior has only limited applicability for the MF marketers (Capon, Fitzsimons and Prince, 1996) and regulators. Therefore a model that captures the essence of traditional finance, behavioral finance and consumer behavior is likely
to provide more insight into the buying decision process of MF investors. This has more relevance in the current context as today, shopping for financial instrument has become increasingly like shopping for any other consumer items (Wilcox, 2003).

The existing research in consumer behaviour provides some useful insights into the buying decision process of consumers. Research in consumer behaviour suggests that consumers with varying degrees of prior knowledge (Hansen, 2005; Howard and Sheth, 1969; Radecki and Jaccard, 1995; Raju, Lonial and Mangold, 1995), perceived risk (Bauer, 1960; Conchar et al., 2004) and involvement (Richins and Bloch, 1986) engages in qualitatively different types of choice process. In spite of the above findings, few studies have explained how consumer knowledge, perceived purchase risk and involvement combine to impact buying behaviour. Further, in spite of the importance of these constructs in shaping buying behaviour (Engel et al., 1968; Howard and Sheth, 1969), few studies have investigated their role in shaping the investment behaviour of individual investors thereby severely limiting the existing literature on ‘financial goods buying behaviour’. Moreover the findings of any study conducted in respect of tangible goods and services cannot be generalized for intangible financial goods, particularly, MF schemes.
Literature suggests considerable differences between tangible goods, intangible goods and services (Hill, 1999). MF schemes are intangible financial good (Lin and Lee, 2004) having characteristics which are different from tangible goods and services. First, buyers of the MF schemes have to predict about the unknown realization of the market outcomes at the time of purchase (Strassl, 1986), as the value of investment is the right of ownership of subsequent benefits. This is due to the fact that MF is a high credence product (Brady and Bourdeau, 2005). Second, the buyer may have to go through a complex decision making process due to the available information about the MF schemes which, though abundant, is not quite organized and comprehensible. Third, the motives for investing in MF schemes may be primarily to increase the current and future monetary returns, which are different from that of the other intangible goods and services which are primarily purchased for some consumption/functional purpose or to fulfill fantasies and satisfy emotion and vanity.

In this thesis, therefore, a new comprehensive model of investment behaviour is proposed to explain the impact of MF investor’s perceived purchase risk, subjective knowledge, and purchase decision involvement on their investment behaviour specifically, information search and information processing behaviour. The proposed model is
tested empirically using the data collected through a survey wherein a pretested structured questionnaire was administered to the 268 MF investors.

The study has been divided into four parts. In the first part the impact of MF investors’ perceived purchase risk on their investment behaviour is empirically investigated. In the second part the impact of mutual fund investor’s types of knowledge (i.e. objective knowledge and subjective knowledge) on their investment behaviour is empirically investigated. Third part empirically investigates the impact of purchase decision involvement on the investment behaviour of MF investors. Finally, in the fourth part a new comprehensive model on the investment behaviour of MF investor is proposed, and empirically validated to explain the combined role of MF investor’s perceived purchase risk, MF investors’ knowledge and investors’ purchase involvement on their investment behaviour.

Key research issues investigated in the first part of the study are:
(a) How the level of perceived purchase risk impacts the width of information search by MF investors?
(b) How the level of perceived purchase risk impacts the depth of information search by MF investors?
(c) How the level of perceived purchase risk impacts the width of information processing by MF investors?
(d) How the level of perceived purchase risk impacts the depth of information processing by MF investors?

Key research issues investigated in the second part of the study are:
(a) How the types of knowledge (OK and SK) of MF investors impact the width of information search behaviour?
(b) How the types of knowledge (OK and SK) of MF investors impact the depth of information search behaviour?
(c) How the types of knowledge (OK and SK) of MF investors impact the width of information processing behaviour?
(d) How the types of knowledge (OK and SK) of MF investors impact the depth of information processing behaviour?

Key research issues investigated in the third part of the study are:
(a) How the level of purchase decision involvement impacts the width of information search by MF investors?
(b) How the level of purchase decision involvement impacts the depth of information search by MF investors?
(c) How the level of purchase decision involvement impacts the width of information processing by MF investors?
(d) How the level of purchase decision involvement impacts the depth of information processing by MF investors?

In the fourth part of the study, a comprehensive model of the investment behaviour of MF investor is proposed based on the review of related literature to explain how MF investors’ perceived purchase risk, investors’ subjective knowledge and investors’ purchase decision involvement (PDI) combines to impact the investment behaviour specifically information search and processing behaviour. The model suggests that; (a) MF investors subjective knowledge (SK) negatively impact MF investors perceived purchase risk (PPR) associated with MF; (b) MF investors SK positively impact purchase decision involvement (PDI); (c) MF investors PPR negatively impact PDI; (d) MF investors PDI positively impact their depth of information search and information processing behaviour; (e) MF investors depth of information search positively impacts their depth of information processing.

1.2 Methodology, Statistical Techniques and Data Sources

Apart from the descriptive statistics, the study used various parametric statistics to arrive at the results. The parametric statistics used in this study are; independent sample t-test, bivariate regression
analysis, multivariate regression analysis, exploratory factor analysis (EFA) and structural equation modeling (SEM).

The data for the study was collected, using the survey method. The convenience sampling method was used due to non-availability of data base of the target group. MF investors, who invested in any MF scheme within one month period, were considered as eligible for the sample frame of the study. This was done to measure the respondents’ perceived purchase risk, knowledge and purchase decision involvement as close to the time of purchase. The pretested structured questionnaire was used to collect the data from the 350 MF investors in the Jammu Region (J&K), India. The total usable responses were 268 (76.57 % of the sample size) which forms the basis for the study.

1.3 Plan of the Study

The study spreads over to seven chapters including this chapter. The second chapter is divided into four sections. In section I the concept, benefits & types of MF schemes are discussed. Section II traces the historical evolution and growth of MF industry, including the development pertaining to MF industry in Unites Kingdom, United States and India. Section III provides the future outlook of the MF
industry including the outlook of MF Industry in India. Finally, summary of the chapter is presented in the Section IV.

The third chapter analyzes the impact of MF investors’ perceived purchase risk (PPR) on their investment behaviour particularly, information search and information processing behaviour. The empirical study conducted on the data collected through survey on the individual MF investor suggests that significant difference exist in the width and depth of information search and information processing by high PPR mutual fund investors and low PPR mutual fund investors. Specifically, study finds that (a) during information search high PPR mutual fund investors use less number of information sources and they rely more on personal formal source of information like sales agent rather than impersonal source (e.g. financial portal); and (b) during information processing, high PPR mutual fund investors use less number of attributes information to compare MF schemes and engage in less depth of information processing in comparison to low PPR mutual fund investors. Based on the above findings, we conclude that MF investors’ high level of PPR impedes active information search and processing by them and motivates them to depend more on distribution channels for investment advice during investment in MF schemes. We suggest that the behaviour of high PPR mutual fund investors might explain for the
‘distribution centric’ nature of MF industry in India. The implications of the findings that are relevant for the marketers and policy makers are also discussed in this chapter. Finally, the chapter discusses the limitations of this research and possible scope of future research in this area.

The fourth chapter of the thesis investigates how MF investors’ objective knowledge and subjective knowledge impact their investment behaviour. Contrary to the popular belief that objective knowledge (i.e. what is actually stored in memory) and subjective knowledge (i.e. what individual perceive they know) differently impact information search and information processing behaviour, this study suggests no significant difference in the impact of objective knowledge (OK) and subjective knowledge (SK) on the width and depth of information search and information processing behaviour of MF investors. The study suggests that OK and SK significantly positively impact the width and depth of information search and information processing behaviour. However, no significant difference exists in the way they impact the behaviour. The possible explanation put forward is that even though MF investors may suffer from self deception (i.e. pseudo expertise) and report high knowledge (i.e. high SK), the impact of SK on actual investment behaviour is not significantly different from that of OK.
implications of the findings are also discussed in this chapter. Finally, the chapter discusses the limitations of this research and possible scope of future research in this area.

The fifth chapter analyzes the impact of MF investors’ purchase decision involvement (PDI) on their investment behaviour. The empirical study suggests that the level of PDI significantly predicts the investment behaviour of MF investors. Further, the results suggest significant difference in the width and depth of information search and information processing by low PDI mutual investors and high PDI mutual fund investors. Specifically, it is found that (a) during information search low PDI mutual fund investors are likely to use less number of information source to collect information, rely less on source providing detailed information related to MF schemes (for example financial portal etc.) and perceive banks as more credible source of investment advice in comparison to high PDI MF investors; and (b) during information processing low PDI mutual fund investors are likely to use information on less number of attributes to compare MF schemes, do not process MF schemes related attribute information in details in comparison to high PDI mutual fund investors. The implications of the findings are also discussed in this chapter. Finally, the chapter discusses
the limitations of this research and possible scope of future research in this area.

In the sixth chapter, a comprehensive model on the investment behaviour of MF investor is proposed based on the review of related literature to explain how MF investors’ perceived purchase risk (PPR), investors’ subjective knowledge (SK) and purchase decision involvement (PDI) combines to impact the investment behaviour specifically information search and processing behaviour. The model suggests that (a) MF investors subjective knowledge (SK) negatively impact MF investors perceived purchase risk (PPR); (b) MF investors SK positively impact purchase decision involvement (PDI); (c) MF investors PPR negatively impact PDI; (d) MF investors PDI positively impact their depth of information search and information processing behaviour; (e) MF investors depth of information search positively impacts their depth of information processing. The proposed model is empirically validated by studying the investment behaviour of a sample of 268 MF investors. The results of the structural equation modeling analysis significantly supported the hypothesized relationship of the model. The overall model was also found to adequately fit the data using conventional goodness-of-fit measures. In evaluating a hypothesized model, it is important to compare its fit to competing models
We estimated the following alternative models; (a) knowledge mediates the influence of perceived purchase risk and purchase decision involvement on investment behaviour (referred to as Alternative 1), whereby perceived purchase risk and purchase decision involvement only directly influenced the subjective knowledge which subsequently influenced investment behaviour; (b) perceived purchase risk mediates the influence of subjective knowledge and purchase decision involvement on investment behaviour (referred to as Alternative 2), whereby subjective knowledge and purchase decision involvement only directly influenced the perceived purchase risk which subsequently influenced investment behaviour. The difference in Chi-square ($\chi^2$) and Akaike Information Criterion (AIC) between the hypothesized model and each alternative model was found significant. The other fit statistics for the alternative models were also poorer than the hypothesized model. The implications of the findings, as are relevant for the MF marketers and policy makers, are also discussed in this chapter. Finally, the chapter discusses the limitations of this research and possible scope of future research in this area.

Seventh, chapter summarizes the findings of the study and discusses the policy implications emanating from the thesis. First,
findings of the thesis are reviewed with a view to further thinking in this area. Second, the implications of the study for MFCs are discussed. Third, the policy implications for the regulation of MF industry are discussed. Finally, the limitations and direction of future research emanating from the thesis is discussed.