CHAPTER 1

INTRODUCTION

The financial system of a country deeply influences its economic growth and development. India has emerged as one of the top most economies in the world due to its transforming and liberalizing financial system. A huge amount of changes that are taking place at the institutional as well as regulatory front of this system has provided an impetus to the wide range of opportunities to the emerging market like India.

In this situation, the regulatory bodies and intermediaries are going to play a crucial role in helping out the channelization of the savings of the individuals into real investments for the economic development of the country. The savings, which represent the surplus of income over expenditures, can be induced in the financial and economic development of a country through mobilization of funds. This can take place through direct as well as indirect financing. The mobilization of funds through indirect financing is done with the help of financial intermediaries like banks, insurance companies, finance companies and nowadays through mutual funds also. These intermediaries are a very strong link between money savers and borrowers. Hence, the success of the liberalized financial system of the country is very much dependent on the growth and penetration of the products of these financial intermediaries in the financial markets.

The financial markets are the place where the investment avenues are made available to the individual as well as to the institutional investors. Mutual funds being one of the most important investment avenue available in the market for the investors who not only want to take the risk of the stock market but also want to play safe with the help of the professionals.

Mutual fund is the money pooled by a large number of investors which is managed by the professional managers. These managers use their professional investment management skills to invest these funds in various financial instruments like shares, debentures etc. In India, the stock and mutual funds only account for 4.9% of personal financial assets which suggests that investors in this country have a tendency to avoid risk assets. This also indicates that there is huge potential for growth in investments into mutual funds and other risk assets in India by
individual investors. It is also seen that the market potential of mutual fund industry has broadened because of the growth of new middle class retail investors which not only include wealthy but also middle segment investors.

Mutual funds are a form of financial intermediary which are expected to play an important role in enhancing savings and investments in developing countries like India. This is also because it provides multiple benefits to the investors of expert opinion, diversification of funds, convenient purchase and sale of securities. In addition to it, the mutual funds enable the common or retail investor to have the taste of equity investment through professional management of the portfolios. Thus, it serves the dual purpose of providing investment avenue for the small investors on one hand and creating a source of fund for the economic development of the country on the other.

1.1 RATIONALE OF THE STUDY
The growth and success of the mutual fund industry is largely dependent on the investment strategies and professional skills of the fund managers which will bring about a substantial amount of increase in the returns of various mutual fund schemes. It is also dependent on the professional skills of the investment advisors in the mutual fund market, who act as a link between investors and mutual fund. They guide them to choose between the plethora of schemes according to their risk appetite. The present environment of dynamic and turbulent capital market along with the economic liberalization has resulted into extreme competition in the mutual fund market, which makes the role of fund managers and investment advisors very crucial to establish mutual funds as an important financial intermediary in the investment market.

The relevance of the role of investment advisors and fund managers is of vital importance for all the agencies associated with the mutual fund industry i.e. the investors, the capital market and the policy makers at the industry. The academicians and researchers are also interested in the subject because mutual funds play a very important function in the economic development of the country. In addition to this, the fund managers practicing in the industry as well as the investment advisors guiding the investors are also interested in knowing the technique to
improve their professional skills so that they are able to establish themselves in this highly competitive market.

It is seen that it has been more than 20 years since the mutual fund industry of India has opened up for new players. The objective was to expand the business by widening and deepening the market for its products. Though, the regulatory regime kept pace with the changing environment and the assets under management (AUM) of the industry grew from 470 billion INR in 1993 to 1396 billion INR in 2004 and to 8252 billion INR in 2014, i.e. grown at a Compound Annual Growth Rate (CAGR) of 15 percent from FY07 to FY13, the growth performance in the recent years has been rather subdued [49]. Industry also recorded an asset under management (AUM) of INR 8800 trillion in May 2014 with the highest AUM recorded in August 2013 as INR 9580 billion. The industry witnessed a decline in AUM in December 2013, although the AUM of equity funds increased by 4.5 percent on account of rising stock prices.[48] This shows that the growth of the industry will continue to be attributed to external factors such as volatility and performance of capital markets and macroeconomic factors such as GDP growth, inflation and interest rates. The graph given below represents the above data:

![Growth in AUM of Indian mutual fund industry from March 1993 to March 2014](www.pwc.in)

**Figure1.1:** Growth in AUM of Indian mutual fund industry from March 1993 to March 2014

Source: www.pwc.in

With the changing demographic profile of the Indian population along with launch of new products, the financial awareness and literacy initiatives for investors have also improved both
by the industry and the regulator. However, the main point of contact for the investors are investment advisors and distributors and hence, the onus of expansion of the market falls on them. The investment advisors have to guide the investors about using mutual funds as a financial tool rather than as a mere investment to fulfill their financial needs.

It is seen that the industry has grown to a great extent but it is yet to take away significant mind share as well as market share from other traditional investment products. Financial literacy is one of the most important factors impeding the growth of this financial product especially in the smaller cities & towns. Investors should be made aware of their financial goals and the means to achieve the same. While all fund houses and regulatory bodies are making genuine efforts at investor’s education, the products of the industry are still far away from the minds of the investors. It emphasizes that the industry should assess the opportunity and create new paths for changing the present status with an objective to attain next level of growth for the industry. This can take place by designing and positioning appropriate and relevant products and also creating proper architecture for their sales and distribution. This relates to exploring additional and different channels of distribution as well as augmenting the existing distribution structure.

This requires not only educating the investors but also enhancing the knowledge of the points of contact of the investors in the distribution channel. This is important because even if their ability to invest directly exists, the investors are largely reliant on the distribution channel or distributors. It is also seen that the number of AMFI registration numbers (ARNs) has declined from around 82,015 as on 31 March 2011 to 58,167 as on 31 December 2013. This shows that the industry needs to analyze this trend and come with a solution of the above problem.

Moreover, the distributors and the investment advisors need to be well equipped so that the investors are able to receive quality advisory services from them. This could be done by providing the investment advisors with some analytical and risk assessment tools so that they are able to render quality advisory services. Thus, increasing the mutual fund penetration will largely depend on increasing investors’ awareness as well as their confidence in the advice given by the investment advisors.
This proves that it is of crucial importance to know the perception and professional skills of investment advisors about the various mutual fund schemes present in the Indian mutual fund industry so that we can judge their efficiency in guiding the investors. This is also significant in the present scenario of the industry in which the investors have to select the appropriate funds according to their needs, from the plethora of schemes present in the market. Hence, it is imperative to know not only the perception of the investment advisors but also their selection criteria. We have to find out that whether the perception of the advisors is based on technical and fundamental analyses or it is based merely on their biases. This will highlight the professional skills present in the investment advisors and will also help the policy makers in framing suitable training programs for them for the welfare of the industry.

We know that the selection criteria of the investment advisors is based on certain combination of attributes present in the various mutual fund schemes such as past performance, expense ratio, asset size, investment style, risk status etc. Hence, it is also important to understand the most appropriate combination of attributes which should be present in a mutual fund scheme so that it is promoted by the advisors. It will also help the mutual fund companies to design new schemes accordingly so that they are successful in the market.

In the recent past, SEBI has tried to improve the investment climate by drawing a line between advisors and distributors by announcing a new series of regulations governing the investment advisors. This was aimed at distinguishing the advisors who will provide financial advice to the investors for a fee but will not be entitled to charge commission from the AMC for directing investors toward a particular scheme. This regulation was designed to ensure that the advisory services will not be motivated by the distributors’ commission earned from the AMCs leading to conflict of interest. Hence, the financial advisors will look at the interest of the investor without being inclined to favor any particular product. It will also give an impetus to the poor growth of mutual fund industry as it will enhance the trust of investors towards the advisors.

However, this concept can only be successful if the investors see value in terms of returns and advice from the financial advisor and if the advice given by them is really based on certain technical and fundamental analyses of various mutual fund schemes.
In the present scenario of approximately 44 AMCs operating in the market offering a wide range of products, it provides a number of options to the Indian investors to invest in mutual funds. In such a situation, selecting from these innumerable options an investor will have to seek the professional help of a financial advisor and thus, these advisors will have to gain relevance as a competent navigator to sail through their investors from this complexity. To establish this channel as a relevant model, we have to explore their efficiency and ability to judge the various mutual fund schemes as well as their criteria i.e. the attributes which they keep in their mind to advice a particular scheme for investment.

The role of fund managers is also very crucial, in this context, as they are the force behind developing new and innovative products in the mutual fund industry with intent to attract more and more investors towards it. With the increased competition in the market, the mutual fund companies have to keep a constant track on the performance of their fund managers in terms of innovations as well as returns from the schemes. They have to appraise the top performing schemes of their fund houses to find out that the superior performance is merely because of the market movements or it is the skill and professional experience of the fund manager which has given an extra edge to the investors. Thus, it emphasizes that the fund managers will have to prove their skills to be a part of the business on a long term basis. The regulatory bodies can also play a crucial role in finding out the quality of funds present in the market. They can ensure whether the schemes are adhering to their objectives and fulfilling the promises made to their investors or not. Thus, by measuring the performance of the top performing mutual funds, the investors can also be motivated to invest in these financial products by making them aware about the advantages of these funds.

The above discussion can be concluded with some critical issues, which need to be addressed for the growth and sustained development of the mutual fund industry in India. Firstly, we have to judge the professional competency and selection criteria of the investment advisors, who are the main guiding force behind the investors’ decisions to invest in the mutual fund industry. Secondly, the attributes governing the investment criteria of these advisors, are also important and hence they should be analyzed. It will be helpful for the fund houses to design new mutual
fund schemes as well as it will enable them to predict the success of the mutual fund schemes according to the attributes present in them.

Another area of research, which is of crucial importance, is to analyze the performance of mutual fund managers. This will enable us to know that whether the outstanding results of top performing schemes are merely due to market movements or they are due to the skills of these fund managers.

In addition to this, the corrective measures, suggested in the study, for the regulators and policy makers, will increase the professional skills of investment advisors and fund managers. These measures will eventually enhance the confidence of investors towards the mutual fund products, which will increase the penetration of these products in the market.

1.2 ORGANISATION OF THE STUDY

The study is organized as follows. In chapter 2, an overview of the Indian mutual fund industry has been provided. This chapter deals with the conceptual framework for mutual funds, their advantages, types, history i.e. origin and growth, phases of mutual fund industry in India, its regulatory framework and the recent trends of the industry.

Chapter 3 discusses the review of past literature both in terms of concept and statistical techniques to be used in the study. In depth literature review regarding attributes of mutual funds and perception has been provided in the same chapter. Objectives of the study have also been provided in chapter 3 only.

In chapter 4, research methodology has been discussed. This gives the details of data, population, sample, sampling frame, data collection, tools, techniques and methodologies used for the study.

Description of the statistical techniques used has also been provided in this chapter.

Analysis of secondary data for studying the performance of mutual funds as well as that of primary data for studying the investors’ behavior along with their interpretation has been presented in chapter 5. Chapter 6 provides the research findings or the conclusions of the study.

In chapter 7, suggestions, limitations of the study and some scope for further research has been presented.