INTRODUCTION

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1.1. Introduction

The success of an investment activity depends on the knowledge and ability of investors to invest the right amount, in the right type of investment, and at the right time. A well-planned investment alone can ensure regular income, capital appreciation and can meet the financial requirements of the investors. An investor has to use his discretion in appropriate decision making for the selection of investment avenues, which is an art acquired by learning and practical experience. Those investors with lack of knowledge and expertise about the operation of the financial market may lose their money while investing in financial securities. So, they need professional advice for the selection of the right type of investment; otherwise, due to fear of losing their hard-earned savings, they will never come forward to invest their funds in the financial market.

The role of savings and investments has been given paramount importance in promoting economic growth of India since Independence. With the advent of Liberalisation, Privatisation and Globalisation, the Indian economy has been opened up and many developments have been taking place, especially in capital and money markets. The revolution in the development of communication technology has become so advanced and that also helped to link the issuers of financial instruments with the investors in the global financial market without any difficulty. All these developments lead to economic growth and the dynamics of economic growth provide various opportunities not only in the Indian market but also in the global market for investors to invest their savings in different attractive avenues of investments with various features matching with their financial goals. The selection of an appropriate type of investment among the various investment avenues is predominantly determined by the financial goal of the investors. Now-a-days, interest rates on bank deposits
are falling down therefore; keeping big deposits in banks is not a wise investment option, as in real terms the value of money is also decreasing over a period of time. In this situation one of the best options available to investors is to invest their money in the stock market. But, the main concern for investors is optimum allocation of available funds among different avenues of investments. It is also a complex task for investors to find an appropriate investment avenue, which satisfies their objectives of investments, to minimise their chance of risk in future and at the same time, ensures a reasonable level of growth and income on their investment. In the investment arena, financial markets are constantly becoming more efficient by providing more promising solutions to the investors. In the financial market, among all investment options available for investment, securities are considered to be the most challenging as well as rewarding to the investors. Moreover, usually different securities carry different risk-return profiles and normally securities having higher risk carry higher return and vice-versa. As far as common investors are concerned, they are not well informed and competent enough to understand the complexities involved in the movement of the stock market. Due to the peculiar nature of the marketable securities and the market, investments in securities require considerable knowledge, skill and expertise of the investors and carry the risk of loss if the right type of security is not selected and the investment decision is not taken at the right time. Hence, investment in stock market is a highly complicated one to the common man. In this situation, mutual funds became a most appropriate investment avenue for individual investors as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. In India, mutual fund industry also provides reasonable options for the common man to invest their savings in the capital market. In 1993, with the entry of the private sector in mutual funds, the Indian mutual fund industry has actually started a new era in investment by offering a wider choice of funds. In the economy, mutual fund industry
forms part of an organised financial system which is easily accessible to individual investors and now it plays a very significant role in channelising the savings of millions of investors.

1.2. Mutual Fund – A Financial Instrument

A Mutual Fund is a trust that pools the savings of a number of small investors, in the form of units, who have a common financial goal. The money, thus collected by them is invested in financial market instruments such as shares, debentures, bonds, money market instruments or some combination of these investments in such a way, as to minimise risk, while ensuring safety and a steady return on investment. A fund is “mutual” as all of its returns, minus its expenses, are shared by the investors of the fund. The Securities Exchange Board of India has defined a mutual fund as “a fund established in the form of a Trust to raise money through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments or gold or gold related instruments or real estate assets.” A mutual fund will have a Fund Manager who is responsible for investing the pooled money into specific securities. Mutual fund schemes are managed by respective Asset Management Companies (AMC). When one invests in a mutual fund, the investor is buying a portion called unit of the mutual fund and becomes an owner of the fund. The income earned through these investments and capital appreciation realised are shared by its unit holders in proportion to the number of units held by them. The appreciation or reduction in value of investments in the fund is reflected in Net Asset Value (NAV) of the concerned scheme, which is declared by the fund manager from time to time. Mutual funds are considered a good route to invest and earn returns with reasonable safety. Mutual fund companies offer investors the advantages of portfolio diversification and professional management at a relatively low cost.
1.3. Statement of the Problem

In India, it is the household sector which occupies a position of dominance over the other institutional sectors like private corporate sector and public sector in terms of generating savings. If there is higher mobilization of household savings, it means higher availability of resources in the economy for growth and development. Particularly, savings in financial assets by households are more important from the resource mobilisation point of view, because of their liquidity characteristics compared to physical savings which can be more easily translated into investments.

In today’s highly volatile capital market environment, mutual funds are looked upon as a transparent and low cost investment avenue. The popularity of mutual funds in India as an investment avenue has increased over time and, as a result, new funds with various types of schemes have mushroomed in a very short period. The resource mobilisation of mutual funds has also been growing at a steady pace over the years. In the Indian capital market, the overall growth and development of various products of mutual funds has already proved to be one of the most catalytic instruments in generating momentous investment growth. In India, in spite of the offering of an exciting retail environment for mutual funds by channelising the savings, participation from the investors in retail segment continue to remain at low levels. As on 31st March 2010, the participation from the retail segment has been only 26.6 per cent and at the end of 31st March 2009 it was only 21.3 per cent. The analysis of data on the contribution of the amount of investments in mutual funds by various sectors of the economy showed that as on 31st March 2010 the corporate sector contributed 51 per cent, banks/financial institutions contributed 3 per cent, Foreign Institutional Investors contributed 19 per cent, and High Net worth Individuals contributed one per cent of their total amount of
investments. It shows that the dependence of mutual funds on the corporate sector for investment is pretty high compared to the investments made by the other sectors. Usually the majority of the investors coming under the retail sector in India consist of individual investors. Hence, an attempt to analyse the individual investors’ investment in mutual funds has also been made.

Traditionally India enjoys a very high saving rate. It was approximately 34 per cent in financial year ending 31st March 2011 of which household savings in financial assets were around 11.8 per cent. The survey conducted by National Council of Applied Economic Research (NCAER) in 2008 revealed that although Indians have a positive attitude towards increased savings, around 65 percent of savings are with banks or post office deposits and cash at home, 23 per cent are invested in real estate and gold, and only 12 per cent is channelised towards financial Instruments. According to the data available in Karvy Private Wealth Reports, it is revealed that out of the total amount of investments in financial assets, only 3.34 per cent and 3.38 percent cent were made in mutual funds respectively in the financial years ending 31st March 2011 and 31st March 2012 by the individual investors in India. It shows that increase in investments in mutual funds between these two years was only 0.04 per cent. But in developed markets, investments in mutual funds constitute a significant proportion of one’s portfolio of investments. Mutual funds play a key role in achieving both the long-term and short-term goals of savings of U.S. households. It represented a significant component of many financial holdings of U.S. households in 2011. In the U. S. A. altogether, 52.3 million households, or 44 per cent of all U.S. households, owned mutual funds in 2011.

Unfortunately, in India it is a fact that most of the investors are not interested in mutual funds. Those who are investing, they are investing only very small amounts. But what is important to be noted here is that
when compared to other financial instruments, investments in mutual funds are safer and also yields more returns on the investment portfolio. Moreover as an investment avenue mutual fund is available for those investors who are not willing to take any exposure directly in the security market. It also helps such investors to build their wealth over a period of time. At the retail level, investors are unique and are highly heterogeneous, and the mutual fund schemes’ selection will also differ depends on their expectations. Hence, investors’ expectation is a very important factor in this regard that needs to be analysed by all the investment houses. Hence, the factors that drive the investment decisions of individual investors to meet their expectations by investing money in mutual funds need an in-depth analysis. These driving forces include the preference of investors on mutual fund compared to various available avenues of financial investments, risk attitude of investors, influence of characteristics of instruments of mutual funds on investors, the investment specific attitudes of investors, and influence of qualities of fund management on investors. The success of any mutual fund, a popular means of investment, depends on how effectively an Asset Management Company has been able to understand the level of influence of these factors on the decision of investors to invest in mutual funds. For a substantial growth in the mutual fund market, there must be a high level precision in the design and marketing of the products of mutual funds taking into account these driving forces by the Asset Management Companies. Therefore, there is a need to conduct a detailed study on investments in mutual funds in this direction. A review of available literature also revealed that no detailed study on mutual funds has so far been attempted in this direction; hence the present study on Driving Forces of Investment Decisions in Mutual Funds is undertaken.
1.4. Objectives of the study

The present study entitled Driving Forces of Investment Decisions in Mutual Funds is undertaken with the following specific objectives.

1) To ascertain the preference of mutual fund investors in respect of various investment avenues.

2) To establish the influence of risk perception of investors on investment decisions.

3) To examine the influence of characteristics of mutual funds on investment decisions.

4) To study the influence of investment specific attitude of investors on investment decisions.

5) To analyse the relationship between qualities of fund management and investment decisions.

6) To develop a statistical model with ‘risk perception of investors’, ‘investment specific attitude of investors’, ‘characteristics of mutual funds’ and ‘qualities of fund management’, as explanatory variables for ‘mutual fund investment decisions’ as the dependent variable.

1.5. Hypotheses

The following hypotheses are formulated for the study.

H1. There exists significant association between selected demographic variables of investors such as gender, age and income and their preferences for various avenues of investments.

H2. There exists a positive relationship between risk perception of investors and investment decisions.
H3. There exists a positive relationship between characteristics of mutual funds and investment decisions.

H4. There exists a positive relationship between the investment specific attitudes of investors and investment decisions.

H5. There exists a positive relationship between qualities of fund management and investment decisions.

1.6. Definitions of Concepts

1.6.1. Investment Decision

In financial literature the concept ‘investment decision’ generally means the determination made by investors as to where, when, how, and how much funds will be invested on various avenues of financial products/instruments with the objective of generating income or appreciation in value in the future.

In the present study, operationally, the concept ‘investment decision’ is defined as the amount of investments made by individual investors in mutual funds. The investment decision of individual investors is studied here based on the percentage of amount of investments made by them in mutual funds out of their total amount of investments in financial assets.

1.6.2. Risk Perception of Investors

Risk is an inherent feature of all types of financial investments. The risk perception of investors is an important factor that influences the investment decisions. The concept ‘risk perception’ means the way in which investors view the risk of financial assets, based on their concerns and experience, but not necessarily on objective data.

Investment decision of individual investors in financial asset is usually affected by their risk perception. Hence, in the present study based on the review of literature and discussions with experts in the field a
number of factors influencing the risk perception of investors were identified. These factors include unpredictability of returns, knowledge about the financial assets, chance for incurring loss, diversification of portfolios, and dependence on professional investment advice. The concept ‘risk perception of individual investors’ is operationally defined here as their beliefs, feelings, concerns, experiences and judgments about these factors. In order to measure the risk perception of individual investors, statements were developed based on these factors and the opinions of the respondents were measured on a five point rating scale.

1.6.3. Characteristics of Mutual Funds

Characteristics mean features of something that is typical of them and easy to recognise. Mutual Fund as a financial asset it has its own characteristics. From the review of characteristics of financial assets with specific emphasis on mutual funds eight characteristics peculiar to the mutual funds were identified.

Operationally, in the present study, the characteristics of mutual funds such as safety of investment, regular income, capital appreciation, professional management, flexibility, diversification benefits, and tax benefits are included. The investment decision of individual investors in mutual funds is influenced by these characteristics. Since all the individual investors are not giving equal importance to these characteristics at the time of investment decisions, the respondents were asked to mark their preference on each of these characteristics on a five point rating scale.

1.6.4. Investment Specific Attitudes of Investors

Investment specific attitude of investors means the requirements and beliefs of investors regarding the risk to the principal amount of investment, risk to return potential and other factors. From the available review of literature, it is learned that there are five investment specific attitudes of investors on mutual fund investment decisions. These are confidence of investors, risk attitude of investors, investment horizon of
investors, personalisation of loss, and investment control. Awareness of investors, about mutual funds as an investment avenue, is also an important factor which affects the investment decisions in mutual funds.

Hence, in the present study investment specific attitude of investors is operationally defined as how these factors viz., ‘confidence of investors’, ‘risk attitude of investors’, ‘investment horizon of investors’, ‘personalisation of loss’, ‘investment control’ and ‘awareness of investors’, influence them while investing funds in mutual funds. Based on review of literate and discussions with experts in the field separate statements were developed on a five point rating scale to measure each of these factors.

1.6.5. Qualities of Fund Management

Qualities of Fund Management mean the inherent or distinguishing characteristics of professional management of mutual funds.

Based on the review of earlier studies and opinion of experts in the field ‘fund quality’, ‘fund sponsor quality’, and ‘investor services’ provided to the investors by the Asset Management Companies are considered as the qualities of fund management. In the present study, the concept ‘qualities of fund management’ is operationally defined by incorporating all these factors. Separate statements were developed to measure each of these factors. While assessing these factors by the individual investors at the time of investments in mutual funds, they are usually not giving equal importance to all of the factors. Hence, the respondents were asked to mark their responses on each of these statements on a five point rating scale depending upon the importance they are given.

1.6.6. Driving Forces

In the present study the usage ‘driving forces’ mean the factors that influence the investment decisions of individual investors in mutual funds. The factors, analysed include ‘risk perception of investors’, ‘investment specific attitude of investors’, ‘characteristics of mutual funds’ and
‘qualities of fund management’. Hence, here, the usage driving forces of investment decisions in mutual funds include these factors. These driving forces such as ‘risk perception of investors’, ‘investment specific attitude of investors’, ‘characteristics of mutual funds’ and ‘qualities of fund management’ are the explanatory/independent variables used in the study for explaining mutual fund investment decisions as the dependent variable.

1.7 Research Methodology

The present study is descriptive and explanatory in nature. Both secondary and primary data were collected and used for the study.

1.7.1. Secondary data source

The secondary data source for the study includes books, journals, periodicals, publication of various mutual fund organisations, website of AMFI, website of SEBI, government publications and websites of various mutual fund companies.

1.7.2. Primary data source

Primary data required for the study were collected from 900 individual investors in Kerala who have investments in mutual funds.

1.7.3. Sampling Design

Multi-stage sampling was adopted for selection of respondents for the study. In the first stage, the state of Kerala was divided into three regions namely Southern, Central and Northern regions. Southern Region consists of Thiruvananthapuram, Kollam, Pathanamthitta and Alappuzha revenue districts of the state. The Central Region includes Kottayam, Idukki, Eranakulam and Thrissur revenue districts of Kerala. Northern Region of the state covers Palakkad, Malappuram, Kozhikode, Wayanad, Kannur and Kasargod revenue districts. In the second stage, Thiruvananthapuram district
from the Southern Region, Ernakulam district from the Central Region and Kozhikode district from the Northern Region were selected for the study. These districts were selected based on judging criteria on the presumption that there are more individual investors in mutual funds in these districts and also by giving due consideration to geographical location. The features of these districts are Thiruvanathapram district the state capital, Ernakulam district the industrial capital and Kozhikode district the trade capital of the state. In the third stage, 300 mutual fund investors each from these three districts were selected by using convenient sampling method subject to the fulfillment of the inclusion criteria such as gender, income, age, education, occupation and area of residence. Thus, the total sample size of the study comes to 900 individual investors in mutual funds.

1.7.4. Instrument used for collecting primary data

In order to achieve the objectives of the study, a well structured questionnaire was developed. This was for collecting primary data from individual investors in mutual funds. The questionnaire was finalised after conducting a pilot study among 50 individual investors in mutual funds in Ernakulam district. On the basis of the experience from the pilot study, some of the questions were refined with a view to ensuring the correctness of the responses and included in the final questionnaire. A number of experts/consultants in the mutual fund industry have been consulted and their suggestions were incorporated while finalising the questionnaire to ensure the content validity of the instrument.

An assessment of the reliability of the scale of measurement used for measuring the variables is necessary because reliability refers to the degree of dependability, consistency or stability of a scale of measurement. In the present study, the reliability of the scale of measurements used was
assessed by using Cronbach Alpha coefficient, which was above the minimum acceptable level, 0.845 thereby confirmed the reliability of the scale of measurement.

The questionnaire developed for collecting primary data was administered to 900 individual investors in mutual funds and their responses were collected through filled up questionnaire.

1.7.5. Tools used for Analysis of Data

The collected data were tabulated and analysed with the help of SPSS. The statistical tools used for analysis include Compounded Annual Growth Rate, Percentage, Weighted Average Mean, Standard Deviation, Co-efficient of Variation, Chi-square test, Friedman Repeated Measures on Rank, Wilcox on Signed Rank Test, ANOVA, Simple Regression Analysis and Multiple Regression Analysis.

1.8. Chapter scheme

The Thesis is presented in seven chapters:

Chapter 1 - Introduction

Chapter 2 - Review of Literature

Chapter 3 - Mutual Funds in India - An Overview

Chapter 4 - Preference of Investment Avenues and Risk Perception of Investors

Chapter 5 - Characteristics of Mutual Funds and Investment Specific Attitudes of Investors on Investment Decisions

Chapter 6 - Qualities of Fund Management and Investment Decisions

Chapter 7 - Summary of Findings, Suggestions and Conclusion.
1.9. Limitations of the study

The major limitation of the present study is that it does not cover the entire mutual fund investors in Kerala. Convenience sampling technique has been used because the identification of mutual fund investors was a main problem. Further, the inherent limitations associated with the responses generated from memory might have affected the present study to a certain extent. However, maximum care was exercised to counter check the responses through observation and cross questions to counter verify the validity of the responses. This study has not been conducted over an extended period of time having both ups and downs of stock market conditions which is a significant influence on investors, buying pattern and preference.