CHAPTER - 1
INTRODUCTION

“Never depend on single income. Make investment to create a second source.”

- Warren Buffet

1.1 Introduction

Financial markets perform the basic function of mobilising the funds needed by corporate entities. Investments are assets held by an individual or an enterprise for earning income by way of dividends, interest, and rentals or for capital appreciation, or for other benefits. Investment is an attempt to carefully plan, evaluate and allocate funds to various investment outlets that offer safety of principal and excepted returns over a long time of period. According to Fisher and Jordan an investment is a “Commitment of funds made in the expectation of some positive rate of return in future. If the investment is properly undertaken the return will be commensurate with the risk the investor assumes.”

An investor can invest directly in securities or indirectly through financial intermediary. The number of investors participating in the financial markets has risen due to the availability and introduction of new financial products. Normally retail investors trade with small amount of investment when compared to the institutional investors. Emergence of new financial products in the market often leads to confusion and complexities for financially unsophisticated investors at the time of making investment decisions. Investors are provided with numerous savings and investment avenues such as bank deposits, provident fund, insurance schemes, mutual funds, equity shares, debentures, commodities and gold. Mutual fund acts as a popular investment tool for middle and high income group of individual investors as it offers a convenient and cost-effective way to invest in the financial markets. A mutual fund is a trust that pools the savings of number of investors who share a common financial goal and invest their savings in capital market and money market securities. It plays an important role in mobilising the household savings for deployment in capital market. Mutual fund
also brings the benefit of diversification and money management to the individual investors by providing an opportunity for financial success that was once available only to a select few. It acts as a professional intermediary between the investors and the capital markets.

The mutual fund concept was introduced in India with the setting up of UTI in 1963. The Unit Trust of India (UTI) is the India’s first mutual fund organisation which commenced its operation from July 1964. The objectives of mutual funds are to provide continuous liquidity and higher yields with high degree of safety to investors. Based on these objectives, different types of mutual fund schemes have been evolved. Currently the industry has 1861 schemes comprising 357 equity schemes, 1251 income schemes, 25 balanced schemes, 53 liquid/money market schemes, 4 infrastructure debt funds, 45 gilt schemes, 51 ELSS equity schemes, 14 gold ETF schemes, 31 other ETF’s schemes and 30 fund of fund investing schemes(AMFI monthly report, December 2014).

Net resources mobilised by mutual funds during 2012-2013 was Rs.749.38 billion (RBI report September 2014). Based on the maturity period, Mutual fund schemes can be classified into open-ended and closed-ended schemes. Investors who do not have time or professional knowledge prefer to invest in mutual fund schemes as the fund houses are professionally managed. Mutual funds allow investors to systematically invest in equities and debt markets through Systematic Investment Plan which allows investors to take exposure with a fixed amount regularly for a longer period of time. This helps the investors to benefit from cost averaging and to build a large corpus to meet future commitments. This feature attracts more middle income groups to deal with mutual funds.

Many of the retail investors are not having adequate knowledge for informed investment decision. They are not aware of risk profile of the investment type (Ministry of Corporate affairs -Under the aegis of Investor Education and Protection Fund). To take a wise investment decision, the investors should have right information, planning and ability to assess the investment. Keeping this in
mind, the study focuses on three aspects, namely the level of financial literacy of investors, personality traits of individual investors and fund qualities which influence the investment decision of retail investors.

**Mutual fund**

Mutual fund is a financial intermediary that pools the savings of the investors for collective investment in a diversified portfolio of securities. A fund is ‘mutual’ as all of its returns, minus its expenses, are shared by the fund’s investors. Anybody with an investible surplus of as little as a few hundred rupees can invest in mutual funds. These investors buy units of a particular mutual fund scheme that has a defined investment objective and strategy. The money thus collected is then invested by the fund manager in different types of securities. These could range from shares to debentures to money market instruments, depending upon the scheme’s stated objectives. The income earned through these investments and the capital appreciation realised by the scheme are shared by its unit in proportion to the number of units owned by them. Thus a mutual fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

A diagrammatic representation of mutual fund concept is given below

![Figure 1- Concept of mutual funds](Source: AMFI website)
The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 defines a mutual fund as a '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'.

According to the above definition, a mutual fund in India can raise resources through sale of units to the public. It can be set up in the form of a Trust under the Indian Trust Act. The definition has been further extended by allowing mutual funds to diversify their activities in the following areas:

- Portfolio management services
- Management of offshore funds
- Providing advice to offshore funds
- Management of pension or provident funds
- Management of venture capital funds
- Management of money market funds
- Management of real estate fund

A mutual fund serves as a link between the investor and the securities market by mobilising savings from the investors and investing them in the securities market to generate returns. Thus, a mutual fund is akin to portfolio management services (PMS). Although, both are conceptually same, they are different from each other. Portfolio management services are offered to high net worth individuals; taking into account their risk profile, their investments are managed separately. In the case of mutual funds, savings of small investors are pooled under a scheme and the returns are distributed in the same proportion in which the investments are made by the investors/unit-holders.

Mutual fund is a collective savings scheme. Mutual funds play an important role in mobilising the savings of small investors and channelising the same for productive ventures in the Indian economy. The mutual funds normally
come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

**Table-1**

**Assets under management as on 30\(^{th}\) June 2014- Category and type wise**

<table>
<thead>
<tr>
<th>Category</th>
<th>Open ended</th>
<th>Closed ended</th>
<th>Interval fund</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open ended scheme</td>
<td>294792</td>
<td>173927</td>
<td>10263</td>
<td>478982</td>
</tr>
<tr>
<td>Infrastructure debt fund</td>
<td>-</td>
<td>1091</td>
<td>-</td>
<td>1091</td>
</tr>
<tr>
<td>Equity</td>
<td>204979</td>
<td>5817</td>
<td>-</td>
<td>210794</td>
</tr>
<tr>
<td>Balanced</td>
<td>15896</td>
<td>18</td>
<td>-</td>
<td>15914</td>
</tr>
<tr>
<td>Liquid / money market</td>
<td>215995</td>
<td>-</td>
<td>-</td>
<td>215995</td>
</tr>
<tr>
<td>Gilt</td>
<td>5492</td>
<td>-</td>
<td>-</td>
<td>5492</td>
</tr>
<tr>
<td>ELSS – equity</td>
<td>27538</td>
<td>2692</td>
<td>-</td>
<td>30230</td>
</tr>
<tr>
<td>Gold ETF</td>
<td>7943</td>
<td>-</td>
<td>-</td>
<td>7943</td>
</tr>
<tr>
<td>Other ETFS</td>
<td>5048</td>
<td>-</td>
<td>-</td>
<td>5048</td>
</tr>
<tr>
<td>Fund of fund investing Overseas</td>
<td>3266</td>
<td>-</td>
<td>-</td>
<td>3226</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>780907</strong></td>
<td><strong>183545</strong></td>
<td><strong>10263</strong></td>
<td><strong>974715</strong></td>
</tr>
</tbody>
</table>

**Source: AMFI website**

Table 1 explains that the total of income scheme Rs.4,78,982 crores includes open ended schemes of Rs. 2,94,792 crores, closed ended schemes of Rs. 1,73,927 crores and interval fund of Rs.10263 crores. The assets under management includes infrastructure debt bond with closed ended schemes of Rs. 1091crores. The total of equity includes open ended schemes of Rs.2,04,979
crores and closed ended schemes of Rs.5,817 crores. Balanced fund includes Rs.15,896 crores open ended schemes and Rs. 18 crores closed ended schemes. The following funds are having only open ended schemes such as liquid/money market (Rs.2,15,995 crores), Gilt-edged (Rs. 5,492 crores), Gold ETFs (Rs.7,943 crores), other ETFs Rs. 5,048 crores and fund of fund investing (Rs. 3,266 crores)

**Organization structure of Mutual Funds**

![Figure 2- Organisation structure of mutual funds](image)

**Source: AMFI website**

The organisation structure of the mutual fund is given below.

(i) **Sponsor** - SEBI regulations define Sponsor as any person who either itself or in association with another body corporate establishes a mutual fund.

(ii) **Trustee** - The trust is created through a document called the trust deed which is executed by the fund sponsor in favour of the trustees. Trustees manage the trust and are responsible to the investors in the mutual funds.

(iii) **Asset Management Company (AMC)** - The Asset Management Company (AMC) is the investment Manager of the Trust.

(iv) **Registrar and Transfer Agent** - The AMC if so authorized by the Trust Deed appoints the Registrar and Transfer Agent to the Mutual Fund. The Registrar processes the application form; redemption requests and dispatches account statements to the unit.
History of mutual funds in India

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. The history of mutual funds in India can be broadly divided into four distinct phases

First Phase - 1964-1987

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India.

Second Phase - 1987-1993 (Entry of Public Sector Funds)

1987 marked the entry of non-UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987.

Third Phase - 1993-2003 (Entry of Private Sector Funds)

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores.

Fourth Phase - since February 2003

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs. 29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes.
Types of mutual fund schemes

A) Schemes according to structure wise

(i) Open-ended funds/schemes

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.

(ii) Close-Ended Schemes

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 the launch of the scheme.
(iii) Interval Schemes

These combine the features of open-ended and close-ended schemes. They may be traded on the stock exchange or may be open for sale or redemption during pre-determined intervals at NAV related prices.

(B) Schemes according to investment objective

(i) Growth / Equity Oriented Scheme

The aim of growth funds 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.

(ii) 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.

(iii) 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.

(iv) 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.
C) Other schemes

(i) 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.

(ii) Index Funds

Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty). These schemes invest in the securities in the same weightage comprising of an index.

(iii) 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. The returns in these funds are dependent on the performance of the respective sectors/industries.

(iv) 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. Example 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.

(v) 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. FoF scheme enables the investors to achieve greater diversification through one scheme. It spreads risks across a greater universe.
(vi) Exchange Traded Funds (ETF)

ETFs are a phenomenon which imparts a lot of liquidity to an existing market. They are passively Managed Funds tracking and investing in the stocks of a particular benchmark index. ETFs offer the best features of an open- and close end funds. They represent units of beneficial interest in Unit Investment Trusts that hold the component stocks of the representative index. As the name suggests they are listed and traded on an exchange like a common stock - the biggest advantage.

1.2 Statement of the Problem

“Save prudently …….Invest even more wisely” – A statement from “A first step to investing - A beginner’s guide” by Ministry of Corporate affairs (Under the aegis of Investor Education and Protection Fund)

Mutual fund provides liquidity, diversification and professional management for the fund invested. The retail investors select mutual fund as one of the best suitable investment avenues for their surplus amount. According to SEBI report 2014, there are 44 fund houses with 1638 schemes comprising 1,178 debt-oriented schemes, 363 equity-oriented schemes, 30 balanced funds, 40 exchange traded funds and 27 fund of funds investing schemes to suit the investors growing financial needs. The investor without basic financial knowledge and awareness about mutual fund characteristics struggles to take a wise investment decision.

Financial knowledge is considered as one of the imperative factors for any investment decision. CRISIL Mutual Fund Year Book April 2013 states that the investors in the country with low financial literacy rate faces difficulty in selecting the suitable funds. The Master Card worldwide financial literacy index survey 2012 also pointed out that India ranks 20th place in financial literacy among 25 countries across Asia-Pacific, Middle East and Africa. As investment decision is positively related with financial literacy, an effort has been made to know the level of financial literacy and its influence towards mutual fund selection.

Each investor is unique in his character, knowledge and ability to tolerate risk. Retail investors differ in financial planning, their needs and expectation
about their investment. Investment size and choice of investment decisions depend on their personal characteristics and their risk attitude towards investment avenues. Retail individual investors fall under highly distinctive clusters. To select a suitable mutual fund scheme, the investors have to consider the qualities of the fund such as performance report, risk and return aspect, past track records, load structure, portfolio constituents and transparency factors.

Under this background, the following research questions are raised:

1. Why do people save and invest and where do they invest?
2. Are the respondents financially literate and how their literacy level influences the mutual fund selection?
3. Does the personality of the investors influence their investment decision?
4. Do the fund qualities influence investors towards mutual fund selection?
5. Is there any significant association between financial literacy, personality type and fund qualities in mutual fund selection?

1.3 Objectives of the study

To find answers to the above questions the following objectives were framed:

1. To understand the investment objectives and preferred investment avenues of individual investors.
2. To assess the level of financial literacy of the respondents and their awareness regarding mutual fund.
3. To analyse the influence of personality traits and risk tolerance level in mutual fund selection.
4. To study the influence of fund-related qualities in the selection of mutual fund by investors.
5. To identify the determinants of mutual fund selection by individual investors.
1.3.1 Hypotheses

Based on the objectives, the following null hypotheses were tested:

1. $H_0$: Personal variables of the individual investors do not have an impact on their savings and investment pattern.

2. $H_0$: Financial literacy does not have any significant impact on the selection of mutual fund schemes.

3. $H_0$: There is no association between personality traits of the individual investors and their attitude towards investment channels.

4. $H_0$: Fund-related qualities do not influence the individual investor's mutual fund selection.

5. $H_0$: There is no association between, financial literacy, personality of the investors and mutual fund qualities in mutual fund selection.

1.4 Scope of the study

The study mainly concentrates on individual investors of Coimbatore district and their attitude towards mutual funds. The NCAER HOUSEHOLD SURVEY REPORT JULY 2O11 highlights that Coimbatore stands 17th place among 54 cities with 1.17 per cent of total investors. The study covers three aspects, namely level of financial literacy, personality traits of individual investors and fund qualities which determine the mutual fund selection by retail investors. The purpose of the study is to understand the mutual fund selection by retail investors. Their investment objectives, personality characteristic, their mutual fund conceptual awareness level and influence of mutual fund qualities among individual investors are the focal points of the study. The unit of observation and analysis of survey is only individual investors in any of the mutual fund schemes. The fund performance and appraisal of fund houses are beyond the purview of the study.
1.5 Limitations of the study

1. The sample selected from each taluks was restricted to 100, which results in 720 valid samples; it may not adequately represent the national market. Hence the findings cannot be generalised.

2. The results are based on the information collected from the respondents. So there may be a chance of bias.

3. The mutual fund investors have also invested in different investment channels namely government securities, bank deposit, provident fund/PPF, insurance scheme, mutual funds, share/debentures, commodities (gold) and real estates. So their personality traits may affect the research findings.

1.6 Scheme of presentation

The study is divided into five chapters:

- **Chapter one** deals with a background of the study, statement of the problem, objectives of the study, hypotheses, scope of the study, concepts used in the study and limitations of the study.

- **Chapter two** provides the review of literature on financial literacy and awareness level of mutual fund investors, personality traits and risk tolerance level of investors and factors influencing mutual fund selection of investors.

- **Chapter three** explains the research methodology adopted for the study.

- **Chapter four** focuses on the analysis and interpretation of data. The results are presented under the three major headings namely financial literacy and mutual fund conceptual awareness level, personality trait and fund qualities that influences the retail investor in mutual fund selection.

- **Chapter five** highlights the summary of findings and conclusion, implications of the current study and the areas for future research.