CHAPTER – 2
REVIEW LITERATURE

This chapter devoted to the review of literature available on the topic under study. The selection of the topic for the study has been undertaken after a brief review of literature available on the subject. The purpose of referring the research paper, project reports, articles and working paper was also to derive supporting evidence for some of the finding of the study. An attempt was made to refer some of the national as well as international journals and project reports. A few names may be mentioned here in:

- World development report
- Journal of financial performance
- The intelligent investors, Mumbai
- Chartered accountant, ICAI, New Delhi
- Chartered secretary, ICAI, New Delhi
- Vikalpa, The journal for decision makers, IIM, Ahmedabad
- Management review, IIM, Bangalore

In literature various researchers have used profitability and growth as measurement of performance. Profitability has been used as measure of performance by Gort (1962), Rumelt
One of the financial indicators that give the utmost satisfaction to the investors is return that is generated by their investment but at the same time they are worried about the risk that is associated with their investment. Hence, it turns out to be very significant and vital for the financial managers to analysis and identified the risk and return associated with the investment.

According to Erich L. Kohlar “It is a general term applied to a part or to all of the conduct of activities of an organization over a period of time; often with reference to Past or Projected costs efficiency management responsibility or accountability or the like.” (1)

Robert Albanese “Performance is used to mean the efforts extended to achieve the targets efficiently and effectively the achievement of targets involves the integrated use of human, financial and natural resources.”

2.1 Research on mutual funds in India: A review

There are some Indian studies which viewed UTI as a development financial institution and critically examined the role of UTI in providing industrial finance to the corporate
sector and others. However, they have not attempted to evaluate the performance of UTI schemes in terms of returns and risk. Hence, these studies cannot be considered as research work on the Indian mutual funds.

Since 1986, a number of articles and brief essays have been published in financial dailies, periodicals, and a few in the professional and research journals. The available literature can be divided into five categories;

- Informative and descriptive,
- Regulatory issues,
- Valuation and pricing,
- Managerial aspects, and
- Performance evaluation.

A brief review of the literature is presented here.

- A number of academics, professionals, and journalists have written articles explaining the basic concept of mutual funds, their characteristics and reviewed the trends in the growth of mutual funds. They also emphasised the importance of mutual funds in the development of the capital market in India. A few under this category are: Sudeep Ghosh, Madan Gopal, Vidyashanker, Batra, Sunil Garoida, Sarkar, Agrawal, and Sadhak. Verma’s book on mutual funds covers the
conceptual and regulatory aspects of the Indian mutual funds with some informational data and guidelines to the investors in selection of mutual funds.

Gupta made a household investor survey in April 1992. The main objective of the survey is to provide data on the investor preferences on mutual funds and other financial assets. The findings of the study are more appropriate to the policy makers and mutual funds to design the financial products for the future.

Seema Vaid’s study covers conceptual and the regulatory framework, review of the growth of mutual funds, and primary information about mutual fund schemes. Kulashreshta offers certain guidelines to the investors in selecting the mutual fund schemes.

- In 1987, when the public sector banks entered the mutual fund sector there were no regulations at all. Later guidelines were issued by RBI and the government of India. A few articles highlighted the importance and issues for the regulation of mutual funds. Among them the notable are: Barua, Narayan Bhatt, Bhanu, and Bhatt. Finally, in 1993, SEBI framed regulations for mutual funds.
• Computation of the Net Asset Value (NAV) and the pricing of mutual fund units are very important as there were no guidelines at all. A few articles published in the financial dailies highlighted the importance of uniform valuation of investment. Jayadev also critically analysed the desperate practices of mutual funds in the valuation of investments. In January 1996, SEBI committee report of valuation and pricing was released which suggests norms for the valuation and pricing. However, empirical works on relationship between NAV, repurchase price and market price, and reasons for close-ended fund discounts are yet to be attempted in the Indian context.

• A few articles touched upon certain aspects of portfolio management and other issues involved in the management of mutual funds. The notable among them are Sengupta, Lal and Sharma and Saha and Murthy.

• Some empirical work in this area can be termed as research, as they have some methodology and conclusions. Barua and others (1991), made a pioneering attempt to evaluate the performance of ‘master share’ scheme of UTI from the investor point of view. They employed the capital asset pricing model (CAPM), and computed the risk of the ‘master share’ scheme (for the period 1987-1991). The risk adjusted performance is measured by using Sharpe, Jensen and Treynor ratios. Here the bench-mark selected is the ‘economic times
ordinary share price index'. The study concludes that, 'master share' has performed better in systematic risk, but not in terms of total risk. Sharad Shukla (1991) evaluated the performance of 'canshare' and 'master share' by employing the Sharpe, Jensen and Treynor ratios for the period January 1988 to June 1991. He concludes that the 'master share' has performed better than the 'canshare'.

Ajay Shah and Susan Thomas studied the performance evaluation of 11 mutual fund schemes, on the basis of market price data. The weekly returns were computed for these schemes since their commencement to April 1994. Jensen and Sharpe measures were used to evaluate the superior performance of the schemes. They concluded that except UGC 2000 of UTI, none of the schemes earned superior returns than the market in general. The risk of these schemes is very high and funds might be inadequately diversified.

Jaideep and Sudip Majumdar (1994) evaluated the performance of five growth oriented schemes for the period February 1991 to August 1993. They have employed the CAPM and Jensen measure to evaluate the performance. They have also evaluated the boom period performance of the scheme during the first quarter of 1992 by employing Jensen model. They conclude
that the selected mutual fund schemes have not offered superior returns during the study period than the market in general. However, they concluded that in the boom period the funds performed well. Kaura and Jayadev (1995) evaluated the performance of five growth oriented schemes in the year 1993-94, by employing the Sharpe, Treynor and Jensen measures. According to them, 'Mastergain 91', 'Canbonus' and 'IndSagar' have performed better than the market in terms of systematic but not in terms of total risk. However, the methodology would have been more appropriate had the study period were longer.

All the above studies attempted to evaluate the performance of a few growth or equity-oriented schemes in terms of risk and return. The popular of CAPM and the measures based on that were experimented in these studies.

A few articles also appeared in the financial dailies (The economic times, Financial express, Business standard) and the periodicals (Dalal street, Business today, etc.) about the evaluation of mutual fund schemes by comparing the changes in NAV and market price between the changes in stock market indices. However, these analyses were purely for a short period and ignored the concept of risk.
From the above review, it can be stated that research covering large number of funds for a long-term, has not yet commenced. There are some important areas where research is necessary.

2.2 Research on mutual funds in the US

In the US, the mutual funds (MFs) have a long history of more than 50 years. The advanced research on MF performance evaluation contributed a lot to the wealth of knowledge, a brief review of which follows.

The pioneering work on the US mutual funds was done by Wharton School of finance and commerce (1962) for the period 1953 to 1958. The study examined the issues relating to investment policy, portfolio turnover rate, performance and impact of MFs trading activity on the stock markets. The study concludes that, on an average, the funds had not performed well than the composite markets from which they select their securities. There was no persistent relationship between the annual portfolio turnover rates and the performance. Further, the funds' net purchases have significantly affected the price movement of individual stocks and, to a lesser extent, the price movements of the markets.
Friend and Vickers (1965) evaluated the performance of mutual funds against the randomly constructed portfolios. The study concludes that MFs on the whole have not performed superior to random portfolios.

Sharpe (1966) study concludes that out of 34 funds selected, 19 had outperformed the bench-mark in terms of total risk. Treynor (1966) evaluated the performance of MF managers in terms of their ability in market timing. The evidence on 57 MFs shows that, none of the fund managers has outguessed the market. Jensen (1968) evaluated the ability of the fund managers in selecting the undervalued securities. He concludes that for the sample of 115 MFs, the fund managers were not able to forecast security prices well enough to recover research expenses and fees. Friend, Blume and Crockeet (1970) compared the performance of 86 MFs with random portfolios. The study concludes that, MFs did worse than the randomly selected portfolios in terms of total risk. Further, the funds with high turnover seem to outperform the funds with low turnover and the fund size has no impact on the performance.

Risk adjusted performance evaluation is also made by Carlson (1970) and SEC study (1971). The broad conclusions arrived by
them are, that some of the funds had outperformed the benchmarks, but there was no consistency in performance.

John Mcdonald (1974) examined the relationship between the stated fund objectives and their risks and return attributes. The study concludes that, on an average the fund managers appeared to keep their portfolios within the stated risk.

Norman E. Mains (1977) applied neutral risk adjusted performance measure and concludes that approximately 66% of the funds (out of 75) had larger net returns adjusted for systematic risk. Kelmosky (1977) concludes that past risk adjusted performance is not a good guide to future performance.

To conclude, the literature survey reveals that, on an average, MF managers are not able to offer higher returns than the unmanaged portfolios. Further, their ability in stock selection and market timing is also poor. The recent works indicate that fund managers are able to earn higher returns, but they offset the expenses. Further, in the short period fund managers are able to offer the superior returns. The implication of these studies is that the markets are reasonable efficient.
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- William F. Sharpe, op. cit.

- Jack L. Treynor, op. cit.

- Michael C. Jensen, op. cit.


• Seema Vaid, mutual funds operations in India.