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CONTENTS

Mutual Funds & Other Financial Instruments: A Study of Customer Behaviour with special reference to Udaipur

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Abstract

In a rapidly changing economy mutual funds industry is changing dramatically. In this context it is essential to re-examine the customer behaviour & perceptions towards its effect on Indian financial instruments. This research paper has identified some of the critical issues to be addressed. Growth of Indian mutual fund industry was remarkable during the last consecutive years especially after economic reforms started in India in 1991.

In this Paper an attempt has been made to study the impact of various financial instruments on investors with special regard to Udaipur city. The present exploratory study was conducted with an objective to analyze the current status of mutual funds. Customer's perception & behaviour towards mutual fund and other investment avenues are various and can be simultaneously positive and negative. Mutual fund companies are not putting enough efforts for customer services and which may discourage investment and savings particularly in mutual funds. Positive effects include mutual funds are doing well in urban areas bur still their reach to rural areas is very poor. This paper also describes briefly various factors affecting investments in various avenues.

This paper is completely a conceptual one whose basic information comes from various secondary sources like research articles in journals, books & websites. The Monetary & fiscal reforms in India has witnessed a marvellous growth but these reforms have some significant and some reverse effects Indian Economy & Common Man are some of the major findings of the study.

Key Words: Mutual fund, investment, financial instruments, fiscal policy, reforms

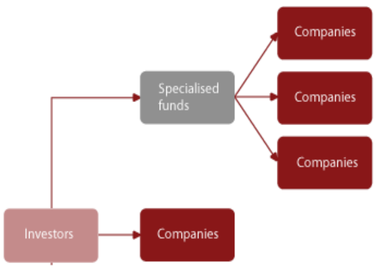
1. Introduction

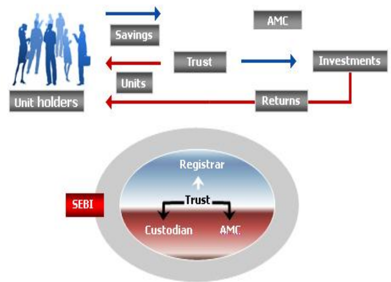
A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The Money thus collected is then invested in Capital Market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized is shared by its unit holders 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 opportunities to invest in a diversified, professionally managed basket of securities at a relatively low cost.

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 market before it can collects funds from the public.

A Mutual Fund is set up in the form of a trust, which has sponsor, trustee, asset Management Company and custodian. The trustee of the mutual fund holds its property for the benefit of the unit holders. Asset Management Company approved by SEBI manages the funds by making investments in various types of securities.

The performance of particular schemes of a mutual fund is denoted by net asset value (NAV). Net asset value is the market value of the securities held by the schemes, since market value of securities change every day, NAV of schemes also varies on day-to-day basis.





2. Research Methodology

Objectives

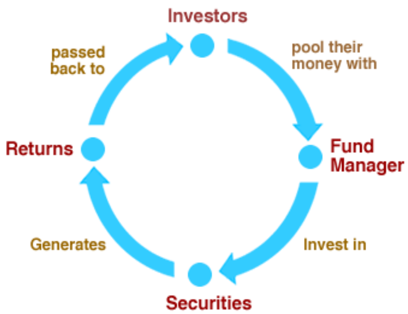
- To Study Mutual Funds & its benefits & disadvantages
- To Study different Mutual funds & Regulatory authority of Mutual Funds
- To study Different investment avenues & Preferences Pattern
- To provide Suggestions to Mutual Fund industry

3. Mutual Funds: Benefits & Disadvantages

3.1 Benefits

- **Variety**: Mutual funds can be an excellent vehicle to carry out a well-conceived investment plan. Once an investor has a disciplined, well thought out strategy, there are many choices available in the mutual fund universe to execute the investment plan with reasonable costs.
- **Diversification:** Mutual funds can provide a high degree of security of principal and income through diversification of securities. Few individuals could afford to buy as many different types of stocks as the typical mutual fund holds.
- **Professional Investment Management**: The purchase of shares in a mutual fund allows an investor to hire top notch investment management expertise, thus freeing the investor from the responsibility of managing the portfolio of securities on a day-to-day basis.
- **Liquidity**: Most mutual funds "maintain a market" their own shares. Such funds are referred to as "open-end" investment companies. This means that the mutual fund company has obligated itself to buy back its shares from investors. An investor can require the fund to redeem its shares at any time. This requirement provides the purchaser of fund shares with a high degree of liquidity.
- **Low Cost**: Several large discount brokerage firms have created "fund supermarkets" where an investor can have a wide mix of funds, from hundreds of separate fund groups, all in one brokerage account. This makes it easy for an investor to put together a diversified portfolio of funds from different fund families, with top-notch management and low costs.
- **Convenience & Flexibility:** Under the "family of funds" concept, a company will

sponsor a number of funds with different investment objectives and underlying assets. The investor can decide to switch assets back and forth from one fund to another.



3.2 Mutual Funds: Disadvantages

- **High Load**- Purchasing shares from many mutual funds involve payment of a sales charge, commonly called a "load." This charge covers the cost of marketing the fund through brokerage firms and certain other fees. Sales charges can be as high as 8.5% of the original investment, but this is very unusual.
- **Reduced Returns:** Annual management fees and administrative charges can reduce the overall return on the investment. Management fees can range from 0.5% to 3% or more of the value of the investment. Administrative charges may be imposed in addition to management fees and frequently cost from $5 to $25 annually per account.
- **No Personal Involvement:** While professional management relieves the investor of certain obligations and responsibilities; it also eliminates his personal involvement in the management of the fund. The purchaser of a mutual fund cannot control the selection of specific assets or the timing of purchases and sales.

4. Mutual Funds: Different Types

✓ **4.1 Schemes according to Maturity Period:**

A mutual fund scheme can be classified into open – ended scheme or close – ended scheme depending on its maturity period.

- **Open-ended Fund / Scheme**

An open – ended fund or scheme is one that is available for subscription and purchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices which are declared on a daily basis. The key feature of open-end schemes is liquidity.

- **Close-Ended Fund / Scheme**

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 launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed.

✓ **4.2 Schemes according to Investment Objectives:**

A scheme can also be classified as growth scheme, income scheme, balanced scheme considering its investment objective. Such schemes may be open-ended or close-ended schemes as described earlier. Such schemes may be classified mainly as follows:

- **Growth / Equity Oriented Scheme:**

The aim of growth fund is to provide capital appreciation over the medium of long-term. Such schemes normally invest in a major part of their corpus in equities. Such funds have comparatively high risks.

- **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. Such funds are less risky compared to equity schemes.

- **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.

- **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.

- **Gilt Fund**

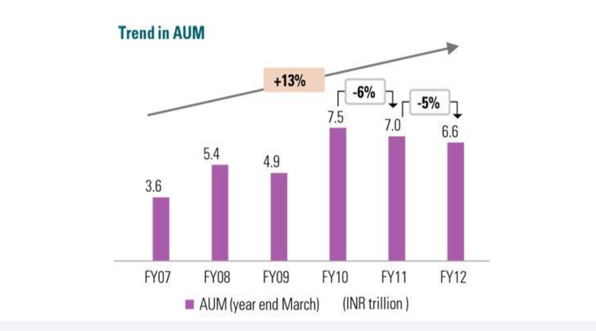
These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as in the case with income or debt oriented schemes.

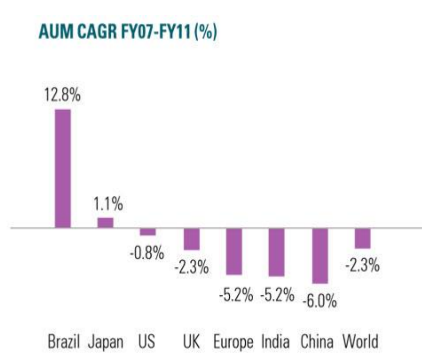
- **Index Funds**

Index funds replicate the portfolio of a particular index such as the BSE Sensitive index, S & PNSE 50 index (Nifty), etc. These schemes invest in the securities in the same weight age comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index.

5. Mutual Fund: Industry Scenario in India

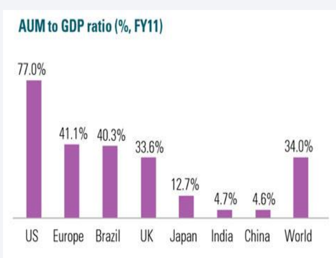
From a single-player monopoly in 1964, the Indian mutual fund industry has evolved into a high-growth and competitive market on the back of favorable economic and demographic factors. As of August 2012, 44 asset management companies (AMCs) were operating in India with assets under management (AUM) of INR 6.4 trillion. However, after several years of persistent growth, the industry witnessed consistent declines of 6.3 percent and 5.1 percent in its AUM during FY11 and FY12, respectively[1]. One of the reasons could be the changes in regulatory guidelines-example ban on entry load, stringent KYC norms, guidelines on transaction charges, tightening valuation and advertisement norms - which were introduced in a short span of time thus giving less time to the industry to adjust n the new environment.





Source various monthly publications of Association of Mutual Funds of India (AMFI); ICI Fact book 2012
Note: based on GDP and AUM as of December 2011

Further the penetration of mutual funds in India (as measured by the AUM/GDP ratio) remains low at 4.7 percent as compared to 77.0 percent in the US, 41.1 percent in Europe and 33.6 percent in the UK. Mutual funds also constituted only 3.3 percent of households' financial savings in FY10, which further contracted to -1.2 percent and -1.1 percent in FY11 and FY12, respectively, due to large redemption and capital losses[2]



6. Mutual Funds: Challenges & Measures by SEBI

- ✓ Challenges have led the Securities and Exchange Board of India (SEBI) to adopt certain measures to re-energize the mutual fund industry with an objective to restore sustainable high growth for the sector.
- ✓ To start with, AMCs are allowed to charge an additional total expense ratio (TER) up to 30 bps, if 30 percent of their net sales or 15 percent of their AUM (whichever is higher) originates beyond the top 15 cities. If inflow from beyond the top 15 cities is less than 30 percent of net sales or 15 percent of AUM, the proportionate amount will be allowed as additional TER. While this step may reduce investors' returns in the short term it may give AMCs more scope to incentivize distributors to expand their geographical reach. SEBI has also decided that AMCs should not bear the service tax (12.36 percent) payable on investment and advisory fees; instead, it can be charged in addition to the TER. This move is in line with the SEBI's attempt to bring the mutual fund sector at par with other sectors.
- ✓ In short-term, investors' returns may be affected due to this move but investors are bound to gain in the long-term as AUM increases.
- ✓ In order to help AMCs widen their customer base in tier-IV to tier-VI cities, SEBI has also relaxed the mandatory requirement of a permanent account number (PAN) card or bank account for cash investments of up to INR 20,000 per financial year. Further, the regulator's recommendation to include equity mutual fund schemes under the Rajiv Gandhi Equity Savings Scheme (RGESS) that offers tax breaks to small investors could help AMCs attract new investors in capital markets[4]
- ✓ In another step to stimulate the distribution network, SEBI has proposed to simplify the distributors' registration

process and widen the distributor by including postal agents, retired officials from government, banks, retired teachers and other similar professionals (such as bank correspondents) for the distribution of simple products. Although this could help AMCs expand their footprint, they will need to be cautious of the increased risk of mis-selling schemes due to lack of knowledge on investors part. SEBI has introduced various levels of certification and registration depending on products and services offered, but a mechanism to monitor compliance by the individuals must be identified.

- ✓ SEBI has also mandated a single expense structure under a single plan to eliminate differential treatment between retail and institutional investors. However, to promote direct investment and to be fair to direct investors, a separate plan for direct investments with a lower expense ratio and a separate net asset value (NAV) has been proposed. One of the outcomes of this step could be less distributors' commissions as many institutional clients who are major investors and are well-informed may prefer the direct route. But on the other hand, retail investors who need help to select the most suitable scheme and complete requisite paperwork would still invest through a distributor[4]
- ✓ Low customer awareness and financial literacy are one of the biggest roadblocks in channelizing household savings into mutual funds. In a bid to enhance customer awareness, SEBI has mandated AMCs to set aside at least 2 bps of their daily net assets annually for the investor education campaign. AMCs should also make disclosures regarding the investor education and awareness initiatives undertaken[5]
- ✓ To further strengthen the regulatory framework and to make it increasingly transparent, SEBI has asked AMCs to upload monthly portfolio disclosures and half-yearly financial results on their websites. It has also mandated AMCs to report additional annual disclosures such as gross inflow, net inflow, average AUM, and distributor-wise gross inflow on their websites. The regulator has also asked its panel to study regulatory provisions in some of the international jurisdictions (such as the US and the UK) to propose ways to increase inflow to mutual funds. The report is expected to be released in the next three to four months[5]
- ✓ SEBI has announced various measures to increase the penetration and improve the distribution network, increasingly liberal TER with fungibility was expected. Currently, equity mutual funds can charge a maximum of 2.5 percent as TER, of which 1.25 percent may be allocated as fund management fees/charges and other expenses (such as marketing, distribution and operations) each. Any expense above 2.5 percent has to be borne by the AMC. Initially, SEBI proposed the removal of sub-limits on expenses, giving AMCs the freedom to allocate the 2.5 percent TER the way they wanted to. This could have helped AMCs to incentivize distributors more effectively and attract them to sell mutual funds more actively, which was hampered after the ban on entry loads.

To summarize, enhancing TER (up to 30 bps) and charging service tax separately are expected to help fund houses improve their reach and energize the distribution network.

Although investors' returns will likely be compromised in the short term, enhanced presence and a rejuvenated distribution network are likely to be beneficial for investors in the long term. Relaxing KYC norms for small investors, widening the distributor network to include postal agents and retired officials, and recommending the inclusion of equity scheme mutual fund products under RGESS could help strengthen the last-mile connectivity in mutual fund distribution.

Sources

1. Various monthly publications of Association of Mutual Funds of India

(AMFI)

2. RBI Annual Report FY12
3. AUM by geography, AMFI, March 2012
4. Steps to re-energize Mutual Fund Industry, SEBI. September 2012
5. Steps to re-energize Mutual Fund Industry, SEBI. September 2012
6. Press Release, SEBI Board meeting, August 2012

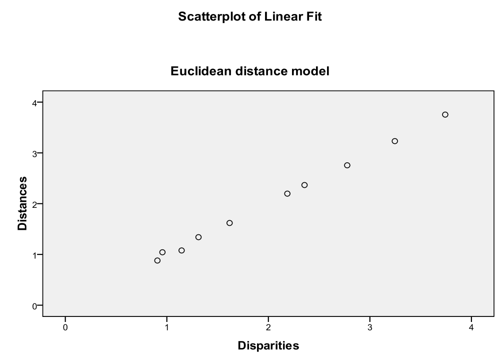
7. Mutual Funds: Selling Channels

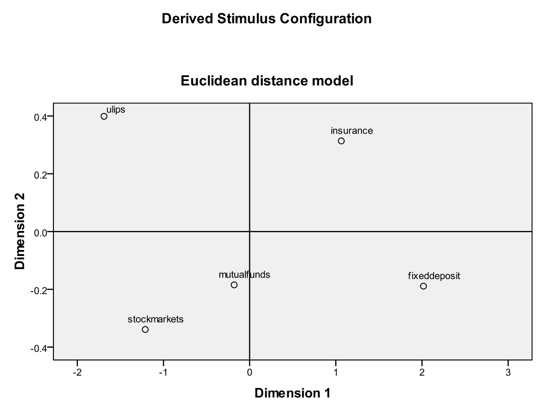
- Mutual Fund Company
- National Distributors (NDs) & Intermediaries
- Banks
- Individual Financial Advisors (IFAs)
- Internet

8. Data Analysis & Interpretation

Statistical Tools Used: The main statistical tool used for the collection and analysis of the data in this project are

- Questionnaire
- Scatter Charts (Using Excel)
- SPSS

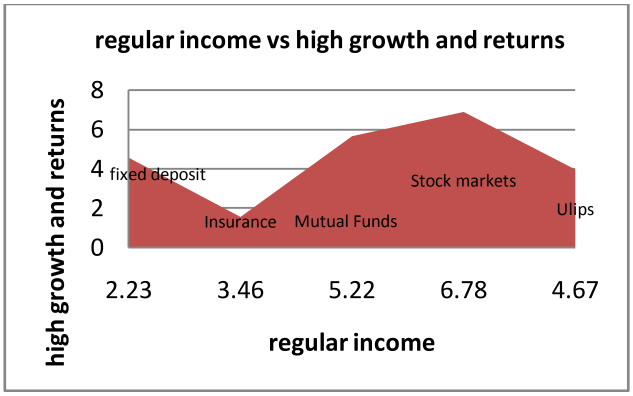




From the above report we can see the perception of various financial instruments in the customer's point of view. The ***options of stock market and fixed deposit are very far which shows that they are not competing with each other***.

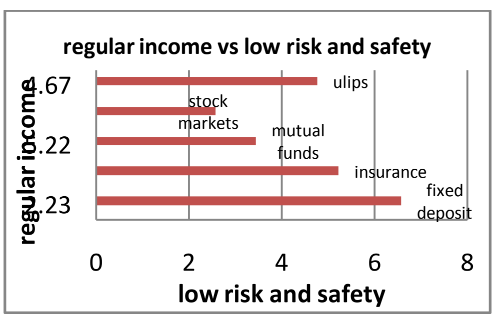
The three financial products ***mutual funds, Ulips and insurance are at equal distances to each other because they are a bit similar in their nature of investments***. Ulips is a combination of both insurance and mutual fund and hence they are similar but not completely equal.

Stock market and mutual fund are a bit closer to each other as they invest in the shares of various companies. Hence customers perceive them to be a bit similar.



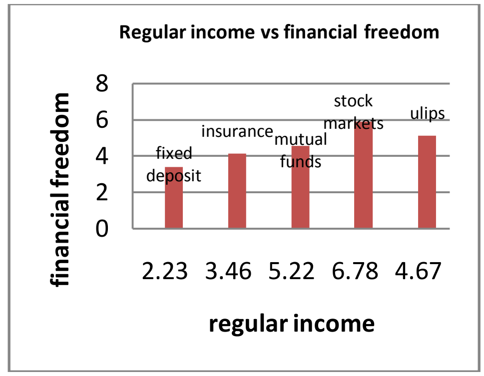
8.1 Regular Income vs. High Growth and Returns:

Stock markets are perceived to be giving high returns and regular income while fixed deposit is low on both the factors. Insurance is perceived to have very low growth in terms of investments. Ulips and mutual funds are perceived as same.



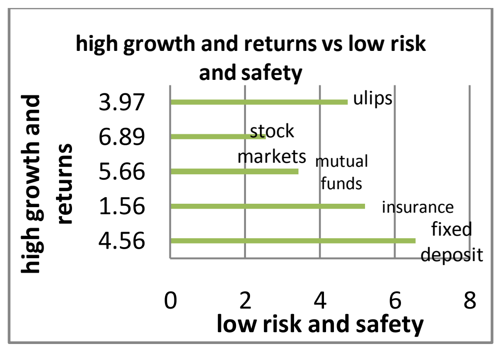
8.2 Regular Income vs. Low Risk and Safety:

Stock markets give high regular income but the safety of the investment is very low. ***Fixed deposits are perceived as very safe but have very low income***. Hence those people who want high returns can invest in stock markets but should be willing to take the risk. Mutual funds are perceived to give regular income and at the same time the risk involved is less.



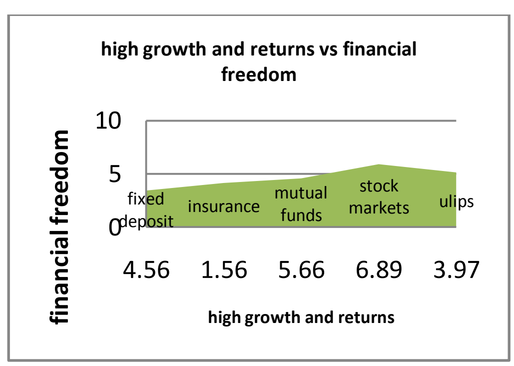
8.3 Regular Income vs. Financial Freedom:

Stock markets are perceived to have high income and financial freedom. It is followed by mutual funds which are almost similar to ulips.



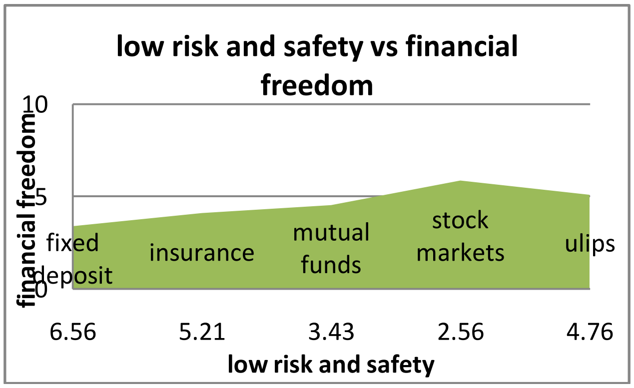
8.4 High Growth and Returns vs. Low Risk and Safety:

Mutual funds are perceived to have more risk compared to ulips insurance and fixed deposit while they are less risky than stock markets. The growth and returns in mutual funds are also high.



8.5 High Growth and Returns vs. Financial Freedom:

Mutual funds have good growth and returns after stock markets while ***Ulips are perceived to have higher financial freedom*** because they invest in both mutual funds and insurance.



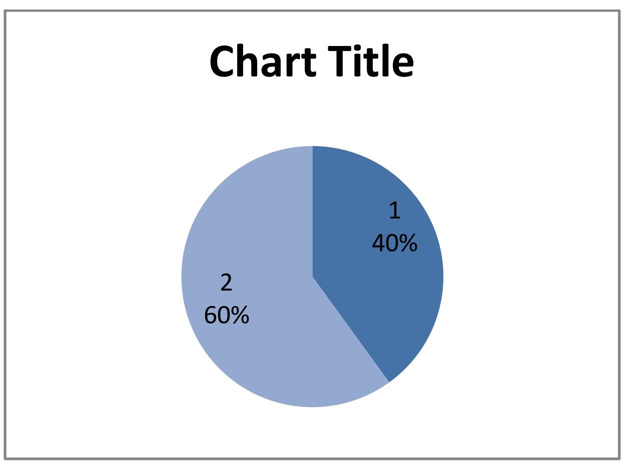
8.6 Low Risk and Safety vs. Financial Freedom:

Stock markets are perceived to be having lowest safety but high freedom of investment which is followed by mutual funds. Ulips and insurance are perceived to have higher safety to mutual funds.

9. Data Analysis & Interpretation

9.1 Fixed Deposits give you regular income

	1	2	3	4	5	6	7	
Strongly Disagree	○	○	○	○	○	○	○	Strongly Agree

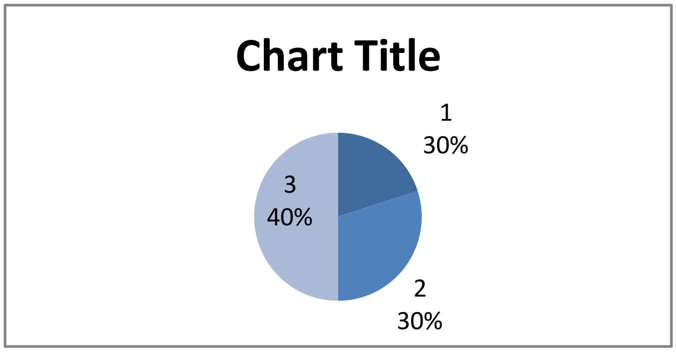


Interpretation: Sample of 30 investors 60% says that fixed deposit give regular income i.e. 18 & 40% says no i.e. 12

9.2 Fixed Deposits give you high growth and returns

	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree

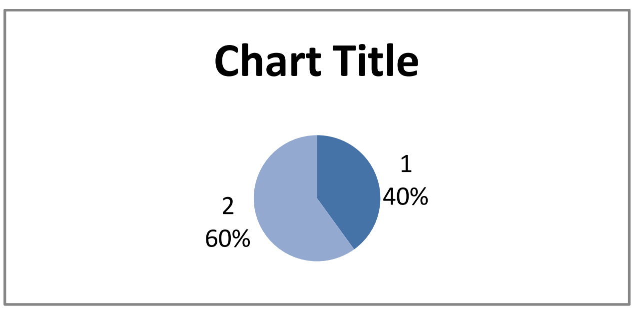
Interpretation: 30% says that fixed deposit give high growth i.e. 9 30 % says low income i.e. 9 & 40 % says medium income i.e. 12



9.3 Insurance gives you regular income

	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree

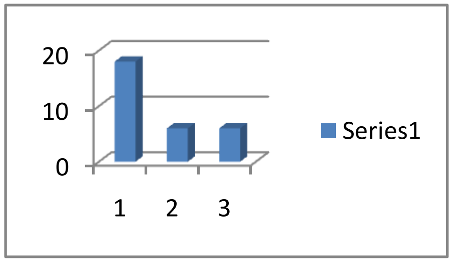
Interpretation: 40 % says insurance gives regular income 60% says that insurance gives income after certain period of time

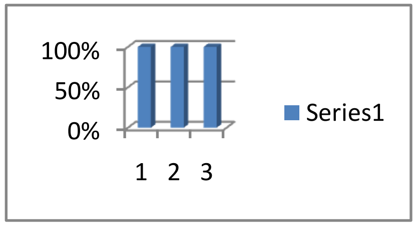


9.4 Insurance gives you high growth and returns

	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree

Interpretation: 60% say insurance gives high growth and return i.e. 18-20 % say insurance gives low return i.e. 6 20 % says insurance give medium return i.e. 6

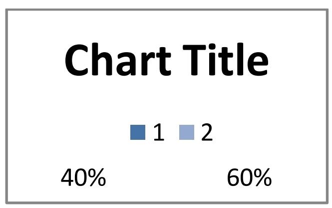




9.5 Mutual funds give you regular income

	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree

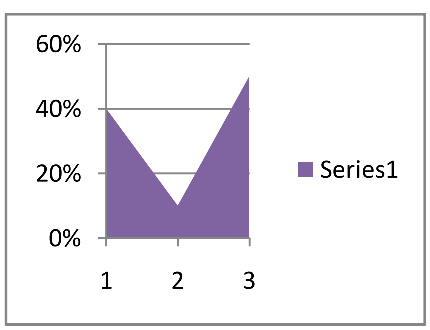
Interpretation: 60% says yes & 40% says no



9.6 Mutual funds give you high growth and returns

	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree

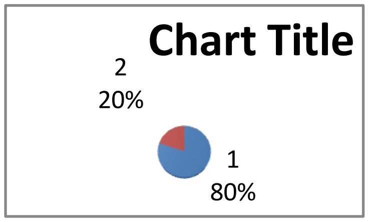
Interpretation: 40 % says that mutual fund give high growth10% says low growth50% says medium growth



9.7 Mutual funds give you low risk and safety of investment

	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree

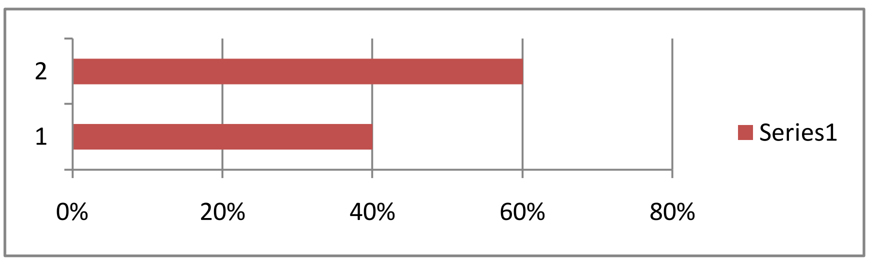
Interpretation: 80 % says mutual fund give low risk 20 % says mutual fund give high risk



9.8 ULIPs give you regular income

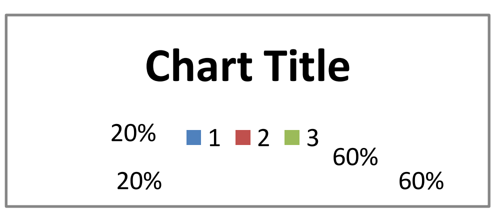
	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree

Interpretation: 40% say ULIPs give regular income 60 % says no



9.9 ULIPs give you growth (Return)

	1	2	3	4	5	6	7	
Strongly Disagree								Strongly Agree



Interpretation: 20% say Ulips give high growth 20% says low growth & 60% says medium growth

10. Conclusion & Suggestions

- The ahp results show that those customers who want high returns should invest in stock markets and mutual funds.
- Most of the customers are not aware of mutual funds. Hence their awareness levels must be increased.
- Most of the Customers with income below 15000 rupees per month do not have a pan card. Hence they must be educated to get a pan card issued to fulfil the KYC guidelines.
- The company can have a tie-up with pan card brokers so that those customers who are willing to invest in mutual funds, but do not have pan cards are also considered as potential customers.
- The SPSS results show that customers perceive mutual funds as somewhat similar to stock markets and hence consider mutual funds to be as risky as stock markets. But because of factors like expert guidance, diversified investments, mutual funds are less risky. Hence customers must be educated on this issue.
- Also customers perceive ULPS to be similar to mutual funds and have greater financial freedom and less risk. Hence proper discrimination must be done to avoid mutual funds from being clubbed with ULPS.
- The relationship managers take around six months to get completely acquainted with the customers, IFA's, brokers etc. The people deal directly with the relationship manager and remember him as a person rather than an employee. All the queries are sent to him personally. So when the relationship manager is transferred within a short span of six months to one year, it becomes difficult for the intermediaries to communicate with the company through a new person. All the queries are sent to the old relationship manager and it becomes difficult for him to handle those queries which are not under his supervision. Hence relationship managers should not be transferred in short intervals.
- The net AUM of government Mutual Fund Company, it shows that SBI is a top player in the industry. The main reason for this is that customers feel SBI is safe as it is backed up by State Bank of India. Hence the brand image of SBI should be properly used to improve the investors' confidence.
- The service level of some of the mutual fund is perceived to be lower to other top funds like Reliance, HDFC etc. Hence care must be taken to provide standard service to all customers.
- Many customers have complained regarding delays and miss happenings in transactions like redemption, registration etc. Hence these problems must be reduced as far as possible.
- The televisions in the state owned banks can be used for displaying advertisements of Mutual funds so that it increases the awareness.
- Most of the IFA's felt that the tax gain scheme is saturated completely as it has around 5000 cr. Hence the amount cannot be invested in any big companies as there is a limit for every company. Hence it is better to stop the tax gain scheme and launch a new scheme in its place.
- Most of the IFA's have complained about the low brokerages given to them compared to other mutual fund companies. Hence the brokerages should be increased to compete with other top performing funds.
- The returns in most of the mutual funds are very low(highest is 26% for contra

fund) compared to other company funds like Reliance and HDFC which have funds giving more than 30% returns. Hence the performance of the funds must be increased.

- Most of the intermediaries are not aware of most of the funds in SBI; hence the relationship managers must make regular visits to them and inform them about various funds and their benefits.
- Most of the intermediaries felt that the application forms and promotional materials used are not that satisfactory compared to other competitors.

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    2. Business Today
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