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THE INDIAN MUTUAL FUND INDUSTRY: A STUDY WITH SPECIAL REFERENCE TO GROWTH SCHEMES

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The Indian Mutual Fund Industry: A Study with Special Reference to Growth Schemes

Bhupender Kumar

Abstract – The Indian Mutual Fund Industry is more than four-decade-old and is a fast growing industry in the financial sector. Mutual Fund schemes have become the most preferred investment avenue in the recent past. Considering the high returns, liquidity, safety, professional management and comparative low risk, investor's prefer the Mutual Fund route for their investment planning. The present research is on determining the factors affecting the performance of Mutual Fund equity schemes. The Mutual Fund Industry in India has crossed the landmark figure of Asset Under Management (AUM) of Rs 4,00,000 Crores by the end of June, 2007 (as per AMFI) and has been continuously increasing. A year ago, during June, 2006 the AUM was approximately Rs 2,63,949 crores and the AUM has shown a growth of 41% during this period. The Mutual Fund industry had grown by mere 2.1% during the year 1992 to 1998 (Fernando Deepthi, Klapper Leora, Sulla Victor, Vittas Dimitri, May 2003). From a mere growth of 2.1% in a period of 5 years, the Indian Mutual Fund Industry is growing at a rate of 41% per annum over the years (As per Association of Mutual Funds of India (AMFI) Quarterly update - Issue IV (Jan - Mar 2007)). The Mutual Funds have the ability to grow 35% to 40% for the next 2 to 3 years (Financial Express dated 19th June, 2008). The growth in the AUM has been due to the favourable stock market prices and more investors have been pumping their money in the Mutual Fund Industry.

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INTRODUCTION

Investment is a commitment of funds in real assets or financial assets. Investment involves risk and gain. In the present dynamic global environment, exploring investment avenues are of great relevance. Investment skills developed over a period of time are considerably influenced by experience and spadework carried out to arrive at conclusions. 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, at the right time. Real assets, being tangible material things, are less liquid than financial assets. Compared to financial assets, returns on real assets are more difficult to measure accurately due to the absence of broad, ready, and active market. Financial assets available to individual investors are manifold, having different concomitant benefits to choose from. All financial investments are risky but the degree of risk and return differ from each other. An investor has to use his discretion, which is an art acquired by learning and practical experience. The knowledge of financial investment and the art of its management are the basic requirements for a successful investor. The pre-requisite for a successful Chapter I 2 investment also lies in its liquidity, apart from risk and return on investment. Liquidity through easy marketability of investments demands the existence of a well-organized Government regulated financial system.

SIGNIFICANCE OF THE STUDY

The role of the mutual funds in the form of financial intermediation, by way of resource mobilization, allocation of resources, and development of capital markets and growth of corporate sector is very conspicuous. Mutual funds also play an important role in the stock market by way of ensuring stability as supplier of large resources and through steady absorption of floating stocks. Mutual funds are well known for their benefits in the following forms to its investors: Professional expertise in buying and selling of units;

- Professional management of securities transactions;
- Opportunity to hold wide spectrum of securities;
- Long-term planning by fund managers;
- Safety of funds;
- Spreading of risk;
- Freedom from stress and emotional involvement;

- Automatic reinvestment of dividends and capital gains;
- Dissemination of information on the performance of the mutual
- Funds, schemes, fund managers and, Investor protection.

OBJECTIVES OF THE STUDY

This research work is undertaken with the following objectives: To appraise the performance of mutual fund industry in India underϖ the regulated environment. To study the relationship between the performance of market indexϖ with that of the growth schemes. To evaluate the performance of growth schemes using Sharpe,ϖ Treynor, Jensen and Eugene Fama's measures of portfolio evaluation. To study the factors influencing choice of investment in mutualϖ funds by the fund managers. To study the attitude of investors and brokers towards investmentϖ in mutual funds.

HYPOTHESES

Based on the above objectives, the following hypotheses were set:

Hypothesis 1: There is no significant difference among the performance evaluation tools as suggested by Sharpe, Treynor and Jensen.

Hypothesis 2: Index returns and scheme returns are not significantly related.

Hypothesis 3: Past performance of the scheme does not have any significant relationship with that of current performance.

Hypothesis 4: Investment decisions are not significantly influenced by the profile of investors.

Hypothesis 5: Profile of investors does not have any significant impact on the criteria of selecting mutual fund scheme.

Hypothesis 6: There is no domination of attitudinal difference between the opinions of investors towards investment in mutual funds.

Hypothesis 7: There is no significant difference between the opinions of investors, brokers and fund managers with regard to the factors influencing the choice of mutual fund and scheme.

REVIEW OF PREVIOUS STUDIES

A large number of studies on the growth and financial performance of mutual funds have been carried out during the past, in the developed and developing countries. Brief reviews of the following research works reveal the wealth of contributions towards the performance evaluation of mutual fund, market timing and stock selection abilities of fund managers. The pioneering work on the mutual funds in U.S.A. was done by Friend, et al., (1962) in Wharton School of Finance and Commerce for the period 1953 to 1958.

Friend, et al., (1962) made an extensive and systematic study of¬ 152 mutual funds found that mutual fund schemes earned an average annual return of 12.4 percent, while their composite benchmark earned a return of 12.6 percent. Their alpha was negative with 20 basis points. Overall results did not suggest widespread inefficiency in the industry. Comparison of fund returns with turnover and expense categories did not reveal a strong relationship.

Treynor (1965) used 'characteristic line' for relating expected rate of return of a fund to the rate of return of a suitable market average. He coined a fund performance measure taking investment risk into account. Further, to deal with a portfolio, 'portfolio-possibility line' was used to relate expected return to the portfolio owner's risk preference.

The most prominent study by Sharpe, William F (1966) developed¬ a composite measure of return and risk. He evaluated 34 open-end mutual funds for the period 1944-63. Reward to variability ratio for each scheme was significantly less than DJIA and ranged from 0.43 to 0.78.

Smith and Tito (1969) examined the inter-relationships between the three widely used composite measures of investment performance and suggested a fourth alternative, identifying some aspects of differentiation in the process. While ranking the funds on the basis of ex-post performance, alternative measures produced little differences. However, conclusions differed widely when performance were compared with the market. In view of this, they suggested modified Jensen's measure based on estimating equation and slope coefficient.

Klemosky (1973) analysed investment performance of 40 funds based on quarterly returns during the period 1966-71. He acknowledged that, biases in Sharpe, Treynor, and Jensen's measures, could be removed by using mean absolute deviation and semi-standard deviation as risk surrogates compared to the composite measures derived from the CAPM.

Gupta (1974) evaluated the performance of mutual fund industry for the period 1962-71 using Sharpe, Treynor, and Jensen models. All the funds covered under the study outperformed the market irrespective of the choice of market index. The results indicated that all the three models provided identical results. All the mutual fund subgroups outperformed the market using DJIA while income and balanced groups underperformed S&P 500. Return per unit of risk varied with the level of volatility assumed and he concluded that, funds with higher volatility exhibited superior performance.

Vidhyashankar S (1990) identified a shift from bank or company deposits to mutual funds due to its superiority by way of ensuring a healthy and orderly development of capital market with adequate investor protection through SEBI interference. The study identified that mutual funds in the Indian capital market have a bright future as one of the predominant instruments of savings by the end of the century.

Bansal L K (1991) identified that mutual fund like other financialꝏ institutions is a potential intermediary between the prospective investor and the capital market. Mutual fund, as an investment agency was preferred since 1985-86 due to the benefits of liquidity, safety and reasonable appreciation assured by the industry. The schemes with assured returns showed tremendous progress. Majority of the funds floated by commercial banks gave an impression that the responsibility of funds laid with the respective banks and their investment was secured.

Gupta L C (1992) attempted a household survey of investors with the objective of identifying investors' preferences for mutual funds so as to help policy makers and mutual funds in designing mutual fund products and in shaping the mutual fund industry.

Krishnamurthi S (1997) identified mutual funds as an ideal investment vehicle for small and medium investors with limited resources, to reap the benefits of investing in blue chip shares through firm allotment in primary market, avoid dud shares, access to price sensitive information and spread risk along with the benefits of professional fund management.

JENSEN MEASURE

The Sharpe and Treynor models provide measures for ranking the relative performance of various portfolios on a risk-adjusted basis. Jensen developed a measure of absolute performance on a risk-adjusted basis, with equilibrium average return on a portfolio as the benchmark. Scheme's Expected Return= Risk free return + (Beta ¥ Risk Premium) Jensen Alpha is the gap between the scheme's expected return and its actual returns. To assess the extent of diversification, Jensen performance measure (1968) has to be compared with Sharpe Differential Return (1966). If a portfolio is well diversified, the quantum of differential return of the two measures will be the same.

SHARPE'S DIFFERENTIAL RETURN

Sharpe's Differential Return measures the ability of the fund manager in terms of both security selection and diversification of portfolio. The difference between the expected return and actual return of the portfolio is the differential return. Differential returns are computed by applying the following equation.

Sharpe's Expected Return = [Risk-free return + (Excess of market return over risk-free return ¥ standard deviation of scheme) / standard deviation of market]

COMPOSITE RISK –RETURN ANALYSIS

A composite risk-return analysis of sample schemes during the eight year period ofstudy and their ranking based on Sharpe, Treynor and Jensen measures is of utmost importance to identify the scheme that perform well in terms of actual return, total risk, systematic risk and return in excess of expectations based on market conditions.

RISK ANALYSIS

An analysis of the scheme's risk in comparison with that of the benchmark index risk is of paramount importance to identify the schemes which are riskier than the market and the impact of the market on the mutual fund scheme. Sharpe considers the total variance explained by the market index in terms of systematic risk and the unexplained other wiseresidual variance in terms of unsystematic risk.

CONCLUSION

During the eight years of study period, the IMFI had shown a good progress in terms of number of private sector Indian mutual funds, number of schemes launched, funds mobilized and assets under management. There had been a good number of schemes been launched particularly in close-end type with income objective. The hallmark of any mutual fund is to outperform the market both in rising and falling markets besides ensuring benefits of diversification. Of the sample schemes, Cangrowth Plus Scheme, Franklin India Bluechip scheme, Franklin India Prima Scheme, HDFC Capital Builder Scheme and SBI Magnum Multiplier Plus scheme outperformed the market in terms of absolute returns and Sharpe index. While Only SBI Magnum Multiplier Plus scheme outperformed market in terms of Treynor index and also had positive Jensen alpha. All the three risk-adjusted performance measures showed significant agreement in ranking the sample schemes. Of the sample schemes studied, SBI Magnum Multiplier Plus Scheme topped the list in all the three portfolio performance models. All the sample schemes (except LIC MF Equity Scheme) ensured positive returns due to stock selection skills of fund managers. The variance explained by the market was high in the case of SBI Magnum Multiplier Plus scheme. The market performance had a significant positive influence on scheme performance in case of all the schemes covered under the study. The present NAV is positively significantly correlated with that of its past NAV but the impact got reduced as the time lag increased.

SUGGESTIONS

The analysis of the sample investors' opinion shows that majority were moderately satisfied with the performance, investment opportunities and services offered by the Indian mutual funds industry. However, the sample mutual fund schemes were also not performing upto their expectations and does not provide adequate returns commensurate with the risk involved. Hence, for the better future of the Indian Mutual Fund Industry the following suggestions are made:

It is absolutely necessary to harness the savings of the nation especially from rural and semi-urban areas into financial assets and the units of mutual funds should certainly become one such asset that can attract these savings through a wide spread and efficient network of operations.

Mutual funds should build confidence in the existing unit holders as well as the public not covered so far. Mutual funds have to prove as an ideal investment vehicle for retail investors by way of assuring better returns in relation to the risk involved and by way of better customer services.

Mutual funds as institutional investors have to ensure professional market analysis, optimum diversification of portfolio, minimizing of risk and optimizing of return.

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