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A STUDY ON MUTUAL FUND AND RISKS INVOLVED IN IT

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Abstract – Mutual funds are increasingly finding greater acceptance among investors, when it comes to planning their finance. Like any other investment, mutual fund investing also has a lot of risk involved. Though the funds are managed by professionals and fund house have adequate risk management policies in place, so it is said that- Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with the objectives as disclosed in offer document. Investment in securities is spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unit holders.

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INTRODUCTION

Mutual fund is a retail product designed to target small investors, salaried people and others who are intimidated by the mysteries of stock market but, nevertheless like to reap the benefits of stock market investing.

Mutual fund is a fund established in the form of a trust by a sponsor to raise money by the trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with the regulations. Thus a mutual fund collects money from the investors, issues certificates to them known as units and invest the collected money in securities so as to achieve mutual benefits in terms of capital appreciation in such securities. It is a non –depository financial intermediary, which acts as an important vehicle for bringing wealth holders and deficit units together indirectly.

As different investment avenues are available to investors. Mutual funds also offer good investment opportunities to the investors. Like all investments, they also carry certain risks. The investors should compare the risk and expected yields after adjustment of tax on various instruments while taking investment decision. The investors may seek advice from expert and consultants including agents and distributors of mutual fund schemes while making investment decisions. As mutual fund can fit well into either your long term or short term investment strategy, but the success of your plan depend on the type of fund you choose. As all funds invest in securities market, it is crucial to maintain realistic expectations about the performance of those markets and choose funds best suited to your needs.

The mutual fund is a trust registered under the Indian trust act. It is initiated by a sponsor. A sponsor is a person who acts alone or with a corporate to establish a mutual fund. The sponsor then appoints an AMC to manage the investment marketing, accounting and other functions pertaining to the fund.

So it is quoted that a mutual fund is an investment company that buys a portfolio of securities selected by a professional investment advisor to meet a specified financial goal. Investors buy fund shares, which represent proportionate ownership in all the funds securities. There is no limit on the number of shares issued by a mutual fund.

A mutual fund is referred to as an “open end” fund for two main reasons: (1) it is required to redeem (or buy back) outstanding shares at any time, at their current net asset value, which is the total market value of the fund’s investment portfolio, minus its liabilities and divided by the number of shares outstanding; and (2) virtually all mutual funds continuously offer their shares to the public.

The conclusion states that “Mutual fund is nothing more than a collection of stocks and/or bonds. You can think of a mutual fund as a company that brings together a group of people and invests their money in stocks, bonds, and other securities. Each investor owns shares, which represent a portion of the holdings of the fund.

REVIEW OF RELATED LITERATURE

Triynor and Mazuy (2012) conducted a study whether Mutual Fund Managers can outguess the market, i.e. can they anticipate successfully the major turns in the stock market or not implying thereby that they adjust the composition of their portfolios according to the expected rise or fall in the stock market. Being one of the market practices which undertake the market condition to be in consideration. The results suggested that an investor in Mutual Funds is solely dependent on general market fluctuations. It would not be better to say that a fund manager can provide the investor with a better rate of return that is higher in both the bad times and good times. Study concluded with the fact that ability to identify underpriced industries and to outguess the movements in the market is a major component to consider.

Riepe, James S., (2011) studied a comparison being done between the consumer goods and mutual funds (a product) with their marketing procedure. In this, some of the techniques used to market mutual funds are not so different from those used in distributing consumer goods, have been explained. Stating that an important difference between a mutual fund and a typical consumer product is that the benefits accruing to the buyer are variable. The survey also compared characteristics of customers who buy funds sold directly to investors with those who buy from a salesperson. Concluded that virtually all providers of goods and services want to deliver good quality. Mutual fund managers are no different. In contrast, mutual fund managers cannot make any promises about the future performance of the investment. But a predict about the future on the basis of past performances.

Admati. Anat R. and Peleiderer Paul, (2010) in this article they compare two methods for a monopolist to sell information. This paper explores different strategies for selling information to traders in a financial market. One method involves the sale of information directly, and another selling method – which we call indirect. In this study they try to find the optimal strategy for selling information indirectly, and compare direct and indirect sale of information.

Ansari (2013) in his article singled out the various innovative schemes of mutual funds which are responsible for mobilizing huge funds from the small savers and argued for a separate legislation for mutual funds as in the case of UTI. In his opinion the operating mutual funds have successfully launched various innovative schemes tailored to the diversified saving and investment motives and have managed to mobilize massive funds from the savers, particularly the smaller over. However, he alleged that in-spite of the valuable services being rendered by mutual funds; their working is not free from certain short comings. Therefore, he suggest that to overcome them there should also be a separate regulatory body as the SEBI is already overburdened with many other functions, as such it may not effectively supervise the working of each mutual fund.

Capon Noel, Fitzsimons, Gavan J. and Weingarten Rick, (2012) in this study the characteristics which differentiate affluent investors from typical investors used as the basis for strategic action. Profiling research has repeatedly found that an affluent consumer differs from typical consumers on managerially interesting dimensions. Through a co-operative arrangement with several financial advisory firms, survey was administered to 298 affluent investors (with Liquid assets of over $ 1 million). Findings conclude, although past performance and level of risk (safety) were rated the two most important factors in aggregate.

Rich Forting and James Jordan-Wagner (2009) found no relationship between manager tenure and performance. They found a significant negative relationship between manager tenure and turnover and positive relationship between manager tenure and Mutual fund size. The investigation overtakes a sample of 800 equity and Bond Mutual funds in 10 investment categories. The result demonstrate the investors should look beyond manager tenure and consider other investment variable affecting performance, such as consistency of return, investment objective, turnover, expense ratio of fund size.

Nanda Vikram, Narayanan, M.P and Warther. Vincert A., (2010). They develop a model of the mutual fund industry in which the management fees and loads charged by actively managed open-end funds and average fund returns are determined endogenously in a competitive market setting. Showing that heterogeneity in managerial skills at investing and minimizing costs, and the existence of investors with differing Liquidity and marketing needs gives rise to a variety of open-end fund structures that differ in the average return delivered to investors. In equilibrium, funds that constrain Liquidity withdrawals may have to charge Lower fees and share some profits in the form of higher investor returns when there is relative scarcity of investors with low liquidity needs.

OBJECTIVES OF THE STUDY

Without objectives the position of business organization will be like a directionless ship moving without a compass and which cannot reach its destination with any amount of confidence. So it’s important to be studied.

1. To study the concept of Mutual Funds.

2. To study the risks involved in mutual funds.

RISK INVOLVED IN MUTUAL FUND

It may be interpreted that under Mutual Fund there is greater amount of risk involved in the subject matter;

even if the disclaimer statement(s) are not too lengthier. In fact, these disclaimers, directly or indirectly, give a clear message that investors should be informed, take adequate care and beware of the inherent risks before investing in the mutual fund. Now the issue is what those Risks are?

Investor Psychology Risk: The investor psychology is such that most of the investors be it Mutual Fund Investors or Direct Capital Market Investors, behave like reactionaries. e.g. they enter the market when the share prices starts rising and they get panicky & exit as soon as share prices starts falling. Therefore, whether it is shares of company or mutual fund unit investors, investors resort to sell their investments when market starts looking down. Because of this, there will be more than normal demand on Mutual Fund manager to redeem the units. To honor the redemption demands of the exiting unit holders during the worst market times, Mutual Funds are forced to sell more stocks at the prevailing low prices. As a result of this, along with the redeeming unit holders, all the other unit holders who have invested in the fund suffer. This means, irrespective of one being a long-term buy and hold investor or not, he suffers because of investing in Mutual Fund.

Choice Risks: All the experts recommend different schemes/ funds. Naturally, all of them cannot be and will not be right. Investors are also advised to stay invested for long-term to reap good returns. These experts also suggest different funds at different times. Of course, to be in the well-being fund, one needs to move from fund to fund intermittently. In an attempt to stay invested for a long-term and to be in the well-doing fund, the investor, whether educated and informed, will have to be satisfied with disappointment.

Cost Risks: Mutual Funds charge huge fees that they can get away with and that too in the most confusing manner possible. The fund managers never intend to make their costs clear to their clients. It would not be painful for the investors to pay for the expenses and costs of the funds when they derive satisfactory returns. But, the irony is that investors have to pay for the sales charges, annual fees and many other expenses irrespective of how the fund has performed.

Prediction Risks: Nobody can predict the capital market perfectly and can always find good investments. Similarly, the fund manager's predictions of future actions and outcomes are of necessity subject to error.

Jargon Risks: The newsletters and other documents that are distributed to the investors do report so much and that too in such a language filled with technical jargons that it will not be very easy for an investor to understand and follow the report.

Competition Risks: Return is ultimate measure of job performance for any investment, be it in a mutual fund or otherwise. Performance is the matter of comparison and the evaluation is intended to measure how the fund has performed vis-à-vis its past performance, peers and market. At present, Mutual Funds are required to report their performance including returns on a quarterly basis. Therefore, to prove that the fund is performing well, managers focus on quarterly returns. Buying & Selling of stocks at the end of quarter will be done to report better quarterly returns and to make fund’s holdings look better based on recent market action. In this process, where the competition is not really productive, fund managers incur expenses & losses that are naturally passed on to the unit holders.

Risk of Redemption Restrictions: Whether informed in writing or not, normally the liquidity of schemes investments may be restricted by the trading volumes settlement period and transfer procedures.

Management Change Risks: It is not uncommon for a Mutual Fund to have changes in its management. The change in the funds management may affect the achievement of the objectives of the fund. The fund company may, for various reasons, replace a fund manager or may be the fund managers himself resigning from his job for any reason. This change will be significant since the fund manager controls the fund investments.

Judgment Risks: Investors may not know more than the fund manager about the investment strategy and whatever judgment the investor makes will not be full proof.

Forward Pricing Risks: The prices of a Mutual Fund do not change during the day. Order placed up to a cut off time of 3:00 p.m. get that day's Net Asset Value (NAV) and orders placed after 3:00 p.m. receive the next day's NAV. This is called the rule of forward pricing. This system assures a level playing field for investors. No investor is supposed to have the benefit of post 3:00 p.m. information prior to making an investment decision.

Breakpoint Risks: Mutual Fund charge loads such as front end & back end. Few Mutual Fund charge front end sales load which will charge lower sales loads for larger investments. The investment level required to obtain a reduced sales load are known as breakpoints. These breakpoints lure investors to invest huge funds to avail the discounts on volumes and end up losing focus on his planned diversification for his Mutual Fund investments.

Risks of Blind Diversification: It may happen that a fund is heavily committed to a particular area of the economy at any given time. This is called blind diversification risk and any investor would like to invest in Mutual Fund that concentrate in asset classes that he himself has not invested at his own.

Risks of changes in the Regulatory Norms: Mutual Funds are constantly regulated by SEBI and investors are subject to risk of the changes in the norms for the Mutual Funds.

Besides the above risks, Mutual Funds will also have the common risks that any investment has. In fact, risk is present in every decision made with regard to the investments in capital markets. Following is the list of some common risks involved while investing in the capital markets and particularly in the mutual funds:

Country Risk : This risk arises from the possibility that political events such as war, national elections etc. and financial problems such as rising inflation or natural disasters such as an earthquake, a poor harvest etc. will weaken a country's economy and cause investments in that country to decline.

Credit Risk: This is a risk that arises from the possibility that a bond issuer will fail to repay interest and principal in a timely manner. This risk is also called as default risk.

Currency Risk: This risk arises from the possibility that returns could be reduced for Indians investing in foreign securities because of a rise in the value of the Indian rupee against dollar, euro or yen etc. This is also known as Exchange Rate Risk.

Industry Risk: This risk arises from the possibility that a group of stocks in a single industry will decline in price due to developments in that industry.

Manager Risk: This risk arises from the possibility that an actively managed mutual fund's investment adviser will fail to execute the fund's investment strategy effectively, resulting in the failure of the stated objectives.

Market Risk: This risk arises from the possibility that stock fund or bond fund prices overall will decline over short or even extended periods.

Principal Risk: This risk arises from the possibility that an investment will go down in value, or lose money from the original or invested amount.

DATA ANALYSIS

Responses obtained from the returned questionnaires were separately coded and entered on the computer terminal for use in computer tabulations, keeping in context with the objectives of the study. The data was analyzed using SPSS version 17.0 for windows throughout the study to show relationships between various variables. It was further suitably analyzed by chi-square test, one way – ANOVA and Multi-Dimensional Scaling (MDS) method. However, ranks comparison was also done for analyzing the surveyed information.

Data was edited at the spot as respondents were personally interviewed in order to assure that they are complete, consistent and according to the instructions.

Both simple and cross tabulation were done in the present study to find the effect of various personal factor on the marketing, in content with the objective of the study.

RESEARCH METHODOLOGY

In research methodology, exploratory research questions have been asked during the survey and research have been verified in the context of fourteen sample based mutual fund companies. An exploratory survey identifies the important process and result variables in marketing practices decisions. The survey has been conducted using questionnaires. Data obtained cover variables of marketing decision-making relating to different schemes offered by mutual-fund companies. Present research work is exploratory cum descriptive in nature. Researcher has contacted a number of marketing executives of mutual fund companies, marketing experts, Amfi advisors (qualified) and brokers, who had practical experience with the problem and contributed new ideas for solving the problem. Before conducting this study, the Researcher has been in contact with the Investors including Mutual fund Investors and those who invest in Banks, post offices etc. Rough problems of marketing were discussed along with them to reach the real concept of this study.

SAMPLE DESIGN

The objective of most marketing research projects is to obtain information about the characteristics or parameters of a population. A population is the aggregate of all the elements that share some common set of characteristics and that comprise the universe for the purpose of the marketing research problem. A sample, on the other hand is a subgroup of the population selected for participation in the study.

In most of the research studies, the amount of work is always limited by two constraints – time and resources. With these limitations, the sample has been drawn so that it may be representative of the entire universe. Therefore, the fourteen mutual fund companies have been selected for deep study. All the concerned head offices, regional offices and branches are sample population of this study. Convenience sampling method was followed. The researcher has chosen regional offices and head offices of every mutual fund company. All types of branches like urban, semi-urban etc. have been included in research sample. The researcher has chosen investors who are investing in the mutual fund for the last two or three years, also from urban and semi-urban areas. This has been done in view of time and financial resources available with the researcher.

SAMPLING TECHNIQUE

Two techniques have been used for the selection of the sample:-

(a) For the selection of the Mutual Fund Companies and their corresponding Branches, Stratified Quota Sampling was used for the selection of the Funds.

(b) For the selection of the respondents- Convenience Sampling was used.

DATA COLLECTION

Data were collected from the primary and secondary sources.

COLLECTION OF SECONDARY DATA

Secondary data have been taken for the purpose of general understanding of marketing practices in Mutual fund companies. The main sources of secondary data are:

(i) Reserve Bank of India Bulletins.

(ii) Securities Exchange Board of India Bulletins.

(iii) Associations of Mutual Funds of India Bulletins.

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