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AN ANALYTICAL APPROACH TO MUTUAL FUNDS INVESTMENT DECISIONS

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Abstract:

At the retail level, investors are unique and are highly heterogeneous, and the mutual fund schemes' selection will also differ depends on their expectations. Hence, investors' expectation is a very important factor in this regard that needs to be analysed by all the investment houses. Hence, the factors that drive the investment decisions of individual investors to meet their expectations by investing money in mutual funds need an in-depth analysis. These driving forces include the preference of investors on mutual fund compared to various available avenues of financial investments, risk attitude of investors, influence of characteristics of instruments of mutual funds on investors, the investment specific attitudes of investors, and influence of qualities of fund management on investors. The success of any mutual fund, a popular means of investment, depends on how effectively an Asset Management Company has been able to understand the level of influence of these factors on the decision of investors to invest in mutual funds. For a substantial growth in the mutual fund market, there must be a high level precision in the design and marketing of the products of mutual funds taking into account these driving forces by the Asset Management Companies. Therefore, there is a need to conduct a detailed study on investments in mutual funds in this direction. A review of available literature also revealed that no detailed study on mutual funds has so far been attempted in this direction; hence the present paper tries an attempt to know the relationship of risk perception of investors, characteristics of mutual funds, investment specific attitude of investors and qualities of fund management with mutual fund investment decision and tries to find out a formula for the same.

Keywords: Mutual Funds, Investors, risk perception of investors, characteristics of mutual funds, investment specific attitude of investors, qualities of fund management and statistical model.

1. Introduction

A Mutual Fund is a trust that pools the savings of a number of small investors, in the form of units, who have a common financial goal. The money, thus collected by them is invested in financial market instruments such as shares, debentures, bonds, money market instruments or some combination of these investments in such a way, as to minimise risk, while ensuring safety and a steady return on investment. In today's highly volatile capital market environment, mutual funds are looked upon as a transparent and low cost investment avenue. The popularity of mutual funds in India as an investment avenue has increased over time and, as a result, new funds with various types of schemes have mushroomed in a very short period. The resource mobilisation of mutual funds has also been growing at a steady pace over the years. In the Indian capital market, the overall growth and development of various products of mutual funds has already proved to be one of the most catalytic instruments in generating momentous investment growth. In India, in spite of the offering of an exciting retail environment for mutual funds by channelising the savings, participation from the investors in retail segment continue to remain at low levels. The analysis of data on the contribution of the amount of investments in mutual funds by various sectors of the economy showed that , participation from the investors in retail segment continue to remain at low levels. It shows thatthe dependence of mutual funds on the corporate sector for investment is pretty high compared to the investments made by the other sectors. Usually the majority of the investors coming under the retail sector in India consist of individual investors. Hence, an attempt to analyse the individual investors' investment in mutual funds has also been made.

2. Statement of the problem

At the retail level, investors are unique and are highly heterogeneous, and the mutual fund schemes' selection will also differ depends on their expectations. Hence, investors' expectation is a very important factor in this regard that needs to be analysed by all the investment houses. Hence, the factors that drive the investment decisions of individual investors to meet their expectations by investing money in mutual funds need an in-depth analysis. These driving forces include the preference of investors on mutual fund compared to various available avenues of financial investments, risk attitude of investors, influence of characteristics of instruments of mutual funds on investors, the investment specific attitudes of investors, and influence of qualities of fund management on investors. The success of any mutual fund, a popular means of investment, depends on how effectively an Asset Management Company has been able to understand the level of influence of these factors on the decision of investors to invest in mutual funds. For a substantial growth in the mutual fund market, there must be a high level precision in the design and marketing of the products of mutual funds taking into account these driving forces by the Asset Management

Companies. Therefore, there is a need to conduct a detailed study on investments in mutual funds in this direction. A review of available literature also revealed that no detailed study on mutual funds has so far been attempted in this direction;hence the present paper tries an attempt to know the relationship of risk perception of investors, characteristics of mutual funds, investment specific attitude of investors and qualities of fund management with mutual fund investment decision and tries to find out a formula for the same.

3. Literature review

Liang, Wang, and Farquhar (2009) developed and empirically tested a model examining the relationship between customer perceptions such as product attributes, benefits, customer satisfaction, trust, commitmentand customer behavior loyalty and financial performance of merchant bank. SEM results indicate that customer perception positively affects financial performance; and customer purchase financial services with dissimilar benefits, all of which come with corresponding attributes, and hence result in different levels of customer satisfaction and behavioral sequence, which is important in reinforcing customer’s trust, commitment, repurchase intentions and corporate financial performance.

Lovric, Kaymak, and Spronk (2008)presented a descriptive modelof individual investor behavior in which investment decisions were seen as interative process of interactions between the investor and investment environment. This model could be used to build stylized representations of individual investors, and further studied using the paradigm of agent-based artificial financial markets.

Hallahan, Faff, and McKenzie (2004) analyzed a large database of psychometrically derived financial Risk Tolerance Scores (RTS) and associated demographic information. They found that people’s self-assessed risk tolerance generally accords with RTS. Furthermore, they found that gender, age, number of dependents, marital status, income, and wealth were significantly related to the RTS. Notably, the relationship between age and risk tolerance exhibits a significant nonlinear structure.

Lenard, Akhter, and Alam (2003) empirically investigated investor attitudes toward mutual fund. Their model, based on investor responses, developed an investor’s risk profile variable. The result indicated that regardless of whether the investors invest in nonemployer plans or in both employer and nonemployer plans, they considered their investment risk, fund performance, investment mix, and the capital base of the fund before switching funds. The model developed in the study can also assist in predicting investors’ switching behavior.

Grable (1997) conducted a study to determine whether the variables gender, age, marital status, occupation, self-employment, income, race, and education could be used individually or in combination to both differentiate levels of investor risk tolerance and also classify individuals into risk-tolerance categories. The Leimberg, Satinsky, LeClair, and Doyle (1993) financial management model was used as the theoretical basis for this study. The model explains the process of how investment managers effectively develop plans to allocate a client's scarce investment resources to meet financial objectives. An empirical model for categorizing investors into risk-tolerance categories using demographic factors was developed and empirically tested using data from the 1992 Survey of Consumer Finances (SCF) (N = 2,626).

4. Objective of the study

To develop a statistical model with 'risk perception of investors', 'investment specific attitude of investors', 'characteristics of mutual funds' and 'qualities of fund management', as explanatory variables for 'mutual fund investment decisions' as the dependent variable.

5. Research Methodology

Both secondary and primary data were collected and used for the study. The secondary data source for the study include books, journals, periodicals, publication of various mutual fund organisations, website of AMFI, website of SEBI, government publications and websites of various mutual fund companies. Primary data required for the study were collected from 900 individual investors in Kerala who have investments in mutual funds. Multi-stage sampling was adopted for selection of respondents for the study. In order to achieve the objectives of the study, a well-structured questionnaire was developed. This was for collecting primary data from individual investors in mutual funds. The questionnaire developed for collecting primary data was administered to 900 individual investors in mutual funds and their responses were collected through filled up questionnaire. The collected data were tabulated and analysed with the help of SPSS. The statistical tools used for analysis include Percentage, Weighted Average Mean, Standard Deviation, Rank, Co-efficient of Variation, Simple Regression Analysis and Multiple Regression Analysis.

6. Discussions

Mutual funds Investment decisions are influenced by risk perception of investors, characteristics of mutual funds, investment specific attitude and qualities of fund management.

(i) Risk perception of investors

Risk perception of investors were studies with 9 statements and the analysis as shown in table 1

Table 1. Risk Perception of Investors

Risk Perception	Mean	Std. Deviation	CV	Rank
A diversified portfolio reduces risk	4.48	0.73	16.36	1
The higher an investments' yield or rate of return, the greater is its associated risk	4.08	0.97	23.84	2
The more familiar an investment, the less risky it is	3.98	0.98	24.67	3
My approach is to be cautious and avoid all risky investment	3.93	1.02	25.95	4
The need to liquidate quickly prohibits me from considering riskier products	3.88	0.92	23.83	5
The more money one has, the more investment risk one can take	3.82	0.9	23.46	6
My broker decides the best investment level for me	3.58	1.22	34.04	7
An investment that involves a great deal of risk isn't really investments, it's gambling	3.36	0.98	29.22	8
The older people take lesser investment risk	3.23	1.26	39.16	9

Source: Field Survey

From the Table 1, it is clear that a diversified portfolio reduces risk is ranked first (Mean Value 4.48) followed by the higher an investments' yield or rate of return, the greater is its associated risk (Mean Value 4.08).

ii) Characteristic of mutual Funds

Table 2. Characteristics of mutual Funds

Characteristics of MFs	Mean	Std. Deviation	CV	Rank
Safety	4.55	0.71	15.72	1
Regular Income	4.42	0.89	20.21	2
Capital Appreciation	4.38	0.66	15.12	3
Liquidity	4.23	0.81	19.06	4
Professional Management	4.18	0.9	21.58	5
Flexibility	4.04	0.84	20.83	6
Diversification Benefits	4.00	0.87	21.7	7
Tax Benefits	3.99	0.88	21.97	8

Source: Field Survey

From the analysis of the data presented in the Table 2, it is understood that the first factor that shapes the preference of the investors in favor of mutual funds was safety followed by regular income, capital appreciation, liquidity, professional management, flexibility, diversification benefits and tax benefits.

iii) Investment Specific attitude

Table3. Investment Specific Attitudes of Investors

No	Factors	Mean	S.D.	Rank
	AWARENESS OF INVESTORS			
a	MFs are useful for small investors	4.52	0.71	1
b	MFs are the cheapest way to equity exposure	4.11	0.8	2
c	MFs investment is like owning any other asset	3.94	0.87	3
	CONFIDENCE OF INVESTORS			
d	MF is one of the best investment tools for one who is unable to track the market and manage his stock investment efficiently	3.95	0.89	1
e	Investing in MFs automatically provides necessary diversification of your investment	3.87	0.85	2
f	MFs give higher return than other investments	3.66	0.91	7
g	Equity MF Schemes are specially designed to cater the retail investors desire to invest stock market.	3.78	0.9	5
h	Bank Sponsored and institution sponsored MFs are more secured than private sector MFs	3.82	0.92	4
i	Trading of MF units on stock exchanges will help the investors in elimination of paper work, execution of transaction would be faster and m more convenient manner	3.85	0.86	3
j	Investing online in MFs is just as safe as investing in MFs offline	3.85	0.86	3
k	In terms of cost saving, the abolition of entry load will be beneficial to the investors in the long run	3.85	0.89	3
l	MFs are for all seasons and one need not wait for the market to go up to buy MFs	3.72	0.94	6
	INVESTMENT HORIZON			
m	The best way to make money is to adopt a long-term strategy	3.86	0.93	1
n	The optimum way of reaping benefits in any market cycle would be through a disciplined, regular and long-term investment approach	3.82	0.92	2
o	Money Market Mutual Funds Gilt funds and Liquid funds are good for investors having short-term investment horizon	3.81	0.92	3
	RISK ATTITUDE			
p	Choice of mutual fund scheme completely depends on investor's risk profile.	3.87	0.9	3
q	The best way to avoid market timing is through regular investing, or the Systematic Investment plan	3.93	0.88	1
r	Diversification through MFs reduces the risk because the stock in the portfolio of the MF may very rarely decline simultaneously or in the same proportion	3.83	0.88	4
s	Those investors with high risk appetite can choose equity MFs for their investments	3.89	0.91	2

	PERSONALISATION OF LOSS			
t	There is no need to concern about short-term fluctuations in the long-term investments.	3.89	0.93	1
u	Investors should try to make sure that their investments keep pace with inflation	3.86	0.87	2
v	If investors' can break even on an investment, they don't feel they have lost money.	3.69	0.93	3
	INVESTMENT CONTROL			
w	Investors should follow their investment closely	3.97	0.9	1
x	The investor, who has control over his investment, can make his own investment decisions without advice from others.	3.9	0.9	2

Source: Field Survey

The analysis of the data presented in Table 3 revealed that awareness of investors is the most influencing factor on investment decisions. Hence, it is suggested that the AMC should take necessary steps to create awareness on investors about the mutual funds which will help to increase the volume of

iv) Quality of Fund Management

Quality of fund management was measured by using statements. Fund quality, fund sponsor quality and investor services are the major determinant of qualities of fund management. First of all, each statement under three categories analyzed. After that correlation between the three main variables analysed. Result is shown in table 4

Table 4 Correlation of Qualities of Fund Management with Sub Dimensions

Sub Dimensions	Correlation
Fund Quality	0.814**
Fund Sponsor Quality	0.689**
Investor Services	0.869**

** Significant at 0.01 levels;

From the Table 4, it is clear that Investor Services (correlation coefficient 0.869) is the most influencing quality of fund management followed by fund quality (correlation coefficient 0.814). So if the AMCs can provide better investor services, they can attract more investments in mutual funds.

From the forgoing analysis, it is clear that the investment decisions of investors is significantly influenced by their risk perceptions, investment specific attitudes, characteristics of mutual funds, and qualities of fund management.

To know the most influencing factors on investment decision, multiple regression analysis was done with investment decision as dependent variable andrisk perception of investors, investment specific attitudes of investors, characteristics of mutual funds and qualities of fund management as independent variables. The result of multiple regression analysis is presented in Table 5.

Table 5. **Relationships betweenRisk Perception of Investors, Characteristics of Mutual Funds,Investment Specific Attitudes of Investors, Qualities of Fund Management and Investment Decisions in Mutual Funds - Results of Regression Analysis**

Independent variables	**Coefficeint**		**Standardized Coefficients (Beta)**	**t**	**Sig.**
	B	**Std. Error**			
Risk Perception of Investors	0.074	0.009	0.792	8.176**	0.000
Characteristics of Mutual Funds	0.041	0.012	0.432	3.393**	0.001
Investment Specific Attitudes of Investors	0.013	0.005	0.381	2.788**	0.005
Qualities of Fund Management	0.019	0.004	0.659	4.995**	0.000
Adjusted R^2 = 0.898					

** Significant at 0.01 per cent level, Source: Field Survey.

Hence the final statistical model with standardized regression coefficient of the significant variables is given below.

$$id = 0.792rpi + 0.432cmf + 0.381isa + 0.659qfm$$

Where ***id*** – Standardised Value of Investment Decisions

rpi – risk perception of investors

cmf- characteristics of mutual funds

isa- investment specific attitudes of investors

qfm– qualities of fund management

The most influencing factors on investment decisions from the equation, by virtue of the coefficient value, and also the significance which is revealed from the analysis is the *risk perception of investors* followed by *qualities of fund management*. As evident from the Table 5 coefficients corresponding to these two dimensions are highly significant at 0.01 levels.

7. Conclusion

It is clear from the forgoing discussion that the mutual fund investment decisions are influenced by risk perception of investors, characteristics of mutual funds, investment specific attitudes of investors and qualities of fund management. Hence, by providing innovative schemes which are suitable to the investors' risk perception and improving the qualities of fund management, creating awareness on mutual funds and educating the investors on the benefits of holding mutual funds on the long run, the AMCs can attract more amounts of investments in mutual funds.

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