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PROBLEMS AND PROSPECTS OF MUTUAL FUNDS – AN EMPIRICAL ANALYSIS

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Abstract

The mutual fund industry in India has come of age. We find enormous expansion in the size of mutual funds and the private sector has especially shown galloping growth. With unmatched advances in the information technology front, increased role of institutional investors in the stock market and SEBI still in its infancy, the mutual fund managers have gained unchecked powers. Ensuring the safety of small investors is the need of the hour. The present study was undertaken to know the perceptions of small investors who are the most exploited lot in the Indian capital market by the tall claims of mutual fund managers as dependable guardians of small investors on the one hand and the role of regulators on the other. This paper has examined the problems faced by the investors of mutual funds, factors discouraging investment in mutual funds, opinion of respondents, the measures for the development of mutual funds and the level of fulfillment of the objectives of the investors. It offers concrete suggestions for the elimination of the problems of the mutual fund investors.

Introduction

'Put your money in trust, not trust in money**"** entices the small investors, who generally lack expertise to invest on their own in the securities market and prefer some kind of collective investment vehicle which can pool their marginal resources, invest in securities and distribute the returns therefrom among them on co-operative principles. The investors benefit in terms of reduced risk, and higher returns arising from professional expertise of fund managers employed by such investment vehicle. This was the original appeal of mutual funds (MFs), which offer a path far simpler and safer to stock market than the traditional call-a-broker-and-buy-securities route. This caught the fancy of small investors leading to proliferation of MFs. In developed financial markets, MFs have overtaken bank deposits and total assets of insurance funds. In USA, the number of MFs far exceeds the number of listed securities.

In USA, every second household has entrusted some savings to these ubiquitous money pools. In fact, retail investors have more money parked in mutual funds than in banks. By comparison, small investors in India have been lukewarm in their acceptance of mutual funds. They have nine times more money in bank deposits than in mutual funds. According to a SEBI-NCAER survey, just 11.8 million households-13.7 per cent urban and 3.8 per cent rural- have invested in mutual funds in 2000-01.That was four years ago, and the number of available schemes has roughly doubled since, but even that has not done much to move small investors from bank deposits to funds.

Many financial experts believe, however, that this trend is now set for a decisive shift. Returns from safe bank deposits average 5 per cent, and from the artificially propped up, assured-returns post office schemes like PPE, NSC and other post office deposits slightly higher. Going by the broad direction of the on-going financial reforms, these props will go sooner than later. The interest rates on these schemes will be aligned with rates current in the economy, and the generous tax breaks that make real returns higher will slowly go. The risk-averse small investor still clings to the hope that this may never happen, but the writing is on the wall.

The other option for the investor till not so long ago was company deposits that offered 4-6 percentage points higher interest than current bank deposits, depending on their safety ratings. He preferred these over mutual funds because these were ' fixed-income instruments'. In other words, he sought safety in the promise that he would get 'x' sum of money after 'y' years, even if in many cases, the sanctity of that promise was questionable. History bears witness to the hundreds of cases of companies defaulting on their deposits.

Mercifully for the investor, these options have dried up. And now, he must look at mutual funds to give himself a chance of creating a portfolio that consistently beats inflation. If not by design, then by default, he will have done himself a good turn. And he will discover over time that a carefully constructed, diversified portfolio of mutual funds not only keeps his risk exposure in check, but also gives him a shot at returns that he could only have dreamt of in his 'fixed returns' days.

The year 2005 has been a bumper year for the equity market. Money poured into the markets both from domestic and foreign investors. The Indian mutual fund industry also saw its Assets Under Management (AUM) grow from Rs.1, 51,879 crores in January'05 to Rs. 1,75,898 crores in July'05, representing a growth of over 16%.

Objectives of the Study

The present study was undertaken to know the perception of small investors, who are the most exploited lot in the Indian capital market by the tall claims of mutual fund managers. The main objectives of the study are:

1. To examine the problems faced by mutual fund investors.
2. To ascertain the usefulness of the proposed measures for the promotion of mutual fund industry.

Methodology

The study was confined to the four big cities of Tamil Nadu Viz.,Chennai, Coimbatore, Trichy and Madurai. The study was based on primary data. Interview schedule was the main tool for collecting the primary data. The sample size of the study was 300 respondents, comprising 75 respondents from each of the four cities. Judgment sampling method was adopted in the selection of investors.

Analysis and Interpretation of Data

The collected data have been analyzed and presented in the following heads.

Problems Faced by the Investors in Mutual Funds

The investors in mutual funds have been facing some problems from the time of investment to the redemption period. In order to analyse the difficulties faced by the respondents, they were asked to state their opinion on the occurrence of these problems faced by them.

From Table-1, it could be observed that more than one-third of the respondents had never faced any kind of difficulty with the mutual funds. Around one-fourth of the respondents had faced these difficulties rarely. Around 15 per cent of the respondents had often faced difficulties.

Factors Discouraging Investments in Mutual Funds

There are several factors which influence the investment decision of an investor. At the same time, there do exist certain negative factors and forces that discourage investments in mutual funds in India.

The study is aimed at analysing the relative level of the different discouraging factors. It is evident from Table 2 that fear of fraud is the most discouraging factor which occupies the first position with the mean score of 4.26 points on a five point scale. It shows that the investors are not aware of mutual funds. Next on the ladder comes an equally damaging and discouraging factor, namely, lack of investor education with a mean score of 4.08. Lack of professionalism in management of funds, portfolio manipulation, reckless management of funds, non-compliance with the objectives of the schemes and poor grievance handling mechanism are the other discouraging factors with mean score values exceeding 3.50 points, indicating the very high discouraging effects caused by them. The remaining factors are somewhat less severe, but still with a high level of discouraging effect, their mean score ranging between 2.96 to 3.5. Appropriate measures should be taken by the Government, SEBI and other related agencies to weed out these discouraging factors and create a climate for the conducive growth of mutual fund industry in the country.

Opinion of Respondents on the Measures for the Development of Mutual Funds

A list of measures have been framed by the researcher which will promote the growth of mutual fund industry in our country. In order to know to what extent these measures are considered useful by the mutual fund investors in the promotion of mutual founds in India, the respondents were asked to indicate their perceived level of utility of these measures.

An analysis of Table 3 reveals that the measures such as assured returns schemes, investors' education through seminars and conference, rating of mutual fund schemes and granting more powers to SEBI have been very well perceived to be useful in improving the mutual funds in India with mean scores of 2.56,2.52,2.46 and 2.44 respectively.

However, measures such as self regulatory organization, market research, pass book system for open-ended schemes, internet trading and mutual fund units selling through post offices have not been predicted to contribute towards the development of mutual funds with their mean scores being merely 2.10,2.04,2.02,1.94 and 1.70 respectively.

The overall average score for all these fourteen measures comes to 2.20 on a 3 point scale which shows that majority of the respondents on the whole have favourable opinion on the usefulness of these measures for the development of mutual fund industry in India.

Level of Fulfillment of Investors' Objectives

From Table 4, it can be seen that more than half of the respondents numbering 170 (56.67%) have stated that their objective of investing in mutual funds were reasonably fulfilled. Respondents numbering 60 (20%) have stated that they were disappointed in the fulfillment of their objectives. 8.33 per cent of the respondents stated that they were very much disappointed. 20 respondents were of the opinion that the returns on investment had exceeded their expectations.

Suggestions

1. Investor education is the need of the hour. SEBI, AMFI and Mutual Funds should organize well defined and comprehensive investor education/ awareness programmes by arranging seminars, conferences and training programmes, publicity through media like newspaper, magazine, T.V., radio and publishing and distributing books, pamphlets and brochures nation wide, particularly among rural investors.

2. Investor are disquieted at the alarming regularity with which some of the mutual funds are bending the rules and regulations. The SEBI and AMFI should plug the loop holes, and tighten regulations. A specialist fraud prevention unit may be developed in order to detect financial crimes more effectively and formalizing inter-agency co-operations in this front. Introduction of professional corporate trustees may be contemplated. If possible, a separate legislation may be enacted.
3. It is suggested to introduce mutual fund ratings that are designed to provide investors, intermediaries and fund sponsors/ AMCs with an independent opinion on the performance and risks associated with various mutual fund schemes.
4. Penal provision should be enhanced considerably as a deterrent for the defaulters. A separate Ombudsman Scheme should be initiated for redressing the grievances of mutual fund investors effectively. Each mutual fund should be required to establish investor grievance cell of its own.
5. 'Up dates' information about the fund and schemes should be dispatched to the investors at least once in a month.
6. Insider trading should be effectively prevented in the functioning of mutual funds.

Conclusion

The mutual fund industry in India is still in an embryonic stage. The whole system merits in-depth examination and follow up action. Ensuring the safety of investment of small investors against ideas and fancies of professional fund managers has become the need of the hour. The findings of this study, as discussed above, may prove to be of use for streamlining the working of mutual funds through its regulatory bodies like SEBI etc., so as to check the exploitation and help small investors to regain confidence in them as superior channel of investment. Mutual funds too can earmark and try to improve upon their weak areas regarding the problems faced by the investors. As seen, the enormous growth of mutual fund industry, if controlled effectively, could be channelised for achieving better economic growth.

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Table 1
Respondents Views about Problems Faced

S.No	Difficulties	Often	%	Occasionally	%	Rarely	%	Never	%	Total	%
1	Unit Certificate issue in time	48	16	72	24	78	26	102	34	300	100
2	Dividend payment in time	42	14	30	10	96	32	132	44	300	100
3	Annual Report	36	12	66	22	90	30	108	36	300	100
4	Transfer of units	42	14	60	20	66	22	132	44	300	100

Source : Primary data

Table - 2
Respondents views on the level of influence of the factors discouraging investments in mutual funds

S.No	Factors Discouraging Investment	Total Score	Mean Score	Rank
1	Lack of Transparency	1026	3.42	8
2	Poor Timing of Investment	1002	3.34	11
3	Conflict of Personal Interest of the fund manager	990	3.30	12
4	Reckless Management of funds	1080	3.60	5
5	Portfolio Manipulation	1110	3.70	4
6	Fear of frauds	1278	4.26	1
7	Lack of professionalism in Management of Funds	1146	3.82	3
8	Discourteous Service	948	3.16	14
9	Poor Regulatory Mechanism	1014	3.38	10
10	Non – Compliance of the objectives of the schemes	1068	3.56	6
11	High loading charges	984	3.28	13
12	Poor Accounting standards as to valuation	942	3.14	15
13	Lack of innovative products	888	2.96	17
14	Lack of adequate research infrastructure	912	3.04	16
15	Lack of invest of education	1224	4.08	2
16	Poor after sales service	1020	3.40	9
17	Poor grievance handling mechanism	1050	3.50	7

Source : Primary data

Table – 3
Usefulness of Measures in the Development of Mutual Funds

S.No	Measures	Total Score	Mean Score	Rank
1	Appointment of Ompudsman for supervising mutual funds	642	2.14	8
2	Granting more powers to SEBI	732	2.44	4
3	Mutual funds allowed to operate in derivatives	636	2.12	9
4	Self regulatory organization	630	2.10	10
5	Mutual fund units selling through post offices	510	1.70	14
6	Rating of mutual fund scheme	738	2.46	3
7	Internet trading	582	1.94	13
8	Investor's production fund	726	2.42	5
9	Investor education through seminars, Conference etc.	756	2.52	2
10	Pass book system for open ended scheme	606	2.02	12
11	Assured return schemes	768	2.56	1
12	Enhancement of accounting and disclosure standards	648	2.16	7
13	Switch over facilities	666	2.22	6
14	Market research	612	2.04	11

Source : Primary data

Table - 4
Respondents views on the level of fulfilment of objectives

S.No	Fulfillment of objectives	Number of respondents	% of Total
1	Exceeded	20	6.67
2	Reasonable	170	56.67
3	Disappointed	60	20.00
4	Very much disappointed	25	8.33
5	No opinion	25	8.33
TOTAL		300	100.00

Source : Primary data