

INVESTORS' PERCEPTIONS OF MUTUAL FUND RISKS AN EMPIRICAL STUDY

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Abstract

The Mutual Fund Industry is a fast growing sector of the Indian Financial Markets. They have become major vehicle for mobilization of savings, especially from the small and household savers for investment in the capital market. Mutual Funds entered the Indian Capital Market in 1964 with a view to provide the retail investors the benefit of diversification of risk, assured returns, and professional management. Every type of investment, including Mutual Funds, involves risk. Risk refers to the possibility that investors will lose money (both principal and any earnings) or fail to make money on an investment. A Fund's investment objective and its holdings are influential factors in determining how risky a fund is. Reading the prospectus will help the investors to understand the risks associated with that particular Fund. The study aimed to understand and analyze investor's perceptions of such risks and expectations, and unveil some extremely valuable information to support financial decision making of Mutual Funds. The detailed analysis revealed that investors perceive risk as under performance, risks in Mutual Fund investments are medium and the returns on Fund investments are not so satisfactory.

Introduction

The Mutual Fund Industry is a fast growing sector of the Indian Financial Markets. They have become major vehicle for mobilization of savings, especially from the small and household savers for investment in the capital market. Mutual Funds entered the Indian Capital Market in 1964 with a view to provide the retail investors the benefit of diversification of risk, assured returns, and professional management. Since then they have grown phenomenally in terms of number, size of operation, investor base and scope. Being a part of financial markets although Mutual Funds industry is responding very fast by understanding the dynamics of investor's perceptions towards rewards, still they are continuously following this race in their endeavor to differentiate their products responding to sudden changes in the economy. Every type of investment, including Mutual Funds, involves risk. Risk refers to the possibility that investors

will lose money (both principal and any earnings) or fail to make money on an investment. A Fund's investment objective and its holdings are influential factors in determining how risky a fund is. Reading the prospectus will help the investors to understand the risks associated with that particular Fund. Thus, it is time to understand and analyze investor's perceptions of such risks and expectations, and unveil some extremely valuable information to support financial decision making of Mutual Funds.

Review of Literature

A number of studies have been made on the working of Mutual Fund industry. Many of them are general topics like study of operations, growth and development of Mutual Funds, perceptual views of investors on Mutual Funds.

In this sequence, Nalini Prava Tripathy (2006)¹ in her empirical study "Market Timing Abilities and Mutual Fund Performance- An Empirical Investigation into Equity Linked Saving Schemes" evaluated the market timing abilities of Indian Fund managers of thirty-one tax planning schemes in India over the period December, 1995 to January, 2004 by using Jensen and Mazuy Model and Henriksson and Merton model. The study indicates that the Fund managers have not been successful in reaping returns in excess of the market; rather they are timing the market in the wrong direction. P. Hnaumantha Rao

and Vijay KR. Mishra (2007)² in their article "Mutual Fund: A Resource Mobiliser in Financial Market" made a critical study of the role performed by Mutual Funds as a financial service in Indian Financial Market. Gajendra Sidana and Debashis Acharya (2007)³ in their article "Classifying Mutual Funds in India: Some Results from Clustering" made an attempt to classify hundred Mutual Funds employing cluster analysis and using a host of criteria like the 1 year annualized return, 3 year annualized return, 5 year annualized return, alpha, beta, R-squared, Sharpe's ratio, mean and standard deviation etc. S.K

Miglani (2007)⁴ in his study made an attempt to understand the Mutual Fund industry and its implications on the common investors on one hand and its returns and performance on the other. An analysis was made on the perceptual views of investors in "Investment Decision

Making: An empirical study of perceptual View of Investors" by Yesh Pal Davar and Suveera Gill (2007)⁵. The results of this study suggest that investor's preferences are supposedly related to the actual performance of investments and the same is taken into account while forming an opinion about making future investment decision. In their study entitled "A study on Investors perception towards Mutual Fund investments", S. Sudalaimuthu and P. Senthil Kumar (2008)⁶ was concentrated on highlighting the investor awareness and preference in Mutual Fund schemes, factor that influences the investor in selecting Mutual Fund scheme, the level of satisfaction on the investment of Mutual Fund, problems faced by Mutual Fund investors and the investment objectives, preference among Fund types(balanced, growth, dividend etc.). An Empirical Study of "Indian Individual Investors' Behaviour" by Syed. Tabassum Sultana (2010)⁷ was an attempt to know the profile of the investors and also to know their characteristics so as to know their preference with respect to their investments. The study also tried to unravel the influence of demographic factors like gender and age on risk tolerance level of the investors.

Need for the Study

In general, investments in Funds are risky, because they are exposed to economic forces or factors, which the future is uncertain. By its very nature, risk concerns the uncertain future. If investors know what happened to a Fund's returns in the past, they can predict the likely range of Fund's returns in future. The greater is this range, the more risky are Fund's prospects. Thus, investors and their advisors need more information to help them assess the risks of Mutual Funds.

Ignorance of Law is no excuse. Investors must ultimately be responsible for understanding or making predictions about the regulations and risks associated with the major market sectors, as well as the extent to which sectors are likely to move with one another. Much of this information is common to many Funds and can be most efficiently provided to investors by third parties, such as financial planners and database providers. But, most of the investors are not aware of the complete information about the risks. Various studies were made on the Mutual Funds, but the research on the investors' perceptions towards risk disclosures of

Mutual Funds was scanty. Hence, it is necessary to find out how the companies are providing information about the investments to the investors, whether that information is sufficient to educate the investors regarding the risks of Funds; and how for the investors are benefited.

Objectives of the Study

The primary objective of the present study is to analyze the investors' perceptions of the Mutual Fund Risks. The following are the specific objectives of the study

- 1) To study the investors' perceptions of risk;
- 2) To study the investors' perceptions of Mutual Fund risks: and
- 3) To study the investors' satisfaction over return on Mutual Funds.

Hypothesis

The following are the hypotheses set for the study

- i. H_0 : The age of the investors and their perception of risk are independent
- ii. H_0 : The marital status of the investors and their opinion on risks associated with Mutual Funds are independent and
- iii. H_0 : The annual income of the investors and their opinion on risks associated with Mutual Funds are independent.

Methodology

Database - The present study was conducted by gathering both Primary and Secondary data. The primary data was collected through a questionnaire and the Secondary data was collected from Journals, Books, Magazines, News Papers, and websites of various statutory and non-statutory organizations such as Association of Mutual Funds in India, Securities and Exchange Board of India.

Sample size - A survey was undertaken through questionnaires for the purpose of studying the above objectives. Investors who invested in Mutual Funds constitute the universe of the study. The Survey was conducted among 555 geographically dispersed investors spread over 12 urban and semi-urban areas in four districts of Rayalaseema region of Andhra Pradesh in India.

Period of the Study - The survey was conducted for the period of six months i.e. from September 2010 to November 2010.

Tools of analysis - The data drawn from various sources are analyzed with the help of statistical tools and techniques such as percentages and Chi- square tests.

$$\text{Chi-square } (\chi^2) = \sum \frac{(\text{Observed frequency} - \text{Expected Frequency})^2}{\text{Expected Frequency}}$$

Results and Discussion

Table 1 shows the demographics of the sample respondent investors. 90.09 per cent of the respondents were male, 39.64 per cent of the respondents were in the age group of 40-50years, 79.28 per cent of the respondents were married, 55.86 per cent of the respondents were employees and 55.86 per cent of the respondents were earning less than Rs.100000 per annum.

Perceptions of Mutual Fund Risks

Generally speaking, risk and potential return are related. This is the risk/return trade-off. Higher risks are usually taken with the expectation of higher returns at the cost of increased volatility. While a Fund with higher risk has the potential for higher return, it also has the greater potential for losses or negative returns. The investors' perceptions of risk were shown in **Table 2**. Majority of the investors (52.25 per cent) believe Risk as under performance (low returns) which indicates the curiosity of the investors to earn income.

Testing of Hypothesis I

From the particulars mentioned in **Table 3**, the first hypothesis was tested (Values were shown below in **Table 3**) and obtained the values as under-

H₀: The age of the investors and their perception of risk are independent.

Calculated Value = 108.29 and Table Value 7.815 ((for 3 df, at 5 per cent level of significance). Since the calculated value of Chi-square is greater than the table value of Chi-square for 3 df at five per cent level of significance, the H₀ is rejected. The biggest risk of investing in a Mutual

Fund is underperformance. When an investor decides to invest in a particular Fund, he typically expects to get the return that the benchmark of the asset provides. Keeping this in mind, the investors were asked to express their opinion on risks associated with Mutual Funds and the values were depicted in **Table 4**. Majority of the investors (56.58 per cent) felt that the risks associated with Mutual Funds are medium. Interestingly, majority of the un-married investors (63.48 per cent) felt that the risks in Funds are very low. In contrast to this, most of the married investors (65 per cent) opined that the risks are medium. Majority of the investors whose age is more than 50 years (63.33 per cent) opined that risk refers to both loss of principal and as well as income. All the investors whose income is above Rs. 6 lakhs felt that the risks in Mutual Funds are low. Majority of the investors whose income is less than Rs. 1 lakh said that the risks in Mutual Funds are medium.

Testing of Hypothesis II

From the particulars mentioned in **Table 5**, the second hypothesis was tested (Values were shown below in **Table 5**) and obtained the values as under:

H₀: The marital status of the investors and their opinion on risks associated with Mutual Funds are independent.

Calculated Value = 16.5691 and Table Value 5.991 ((for 2 df, at 5 per cent level of significance). Since the calculated value of Chi-square is greater than the table value of Chi-square for 2 df at five per cent level of significance, the H₀ is rejected.

Testing of Hypothesis III

From the particulars mentioned in **Table 6**, the third hypothesis was tested (Values were shown below in **Table 6**) and obtained the values as under

H₀: The annual income of the investors and their opinion on risks associated with Mutual Funds are independent.

Calculated Value = 116.19 and Table Value 9.488 ((for 4 df, at 5 per cent level of significance). Since the calculated value of Chi-square is greater than the table value of Chi-square for 4 df at five per cent level of significance, the H₀ is rejected.

The most disappointing finding is that 53.15 per cent of the Fund investors are just satisfied with respect to the returns which in fact reveal their dissatisfaction over the Funds’ performance.

Table 1 – Demographics of the sample respondents

Particulars	Number of respondents	Percentage to total
Gender		
Male	500	90.09
Female	55	9.91
Total	555	100.00
Age		
Below 40 years	215	38.74
40-50 years	220	39.64
50-60 years	60	10.81
Above 60 years	60	10.81
Total	555	100.00
Marital status		
Unmarried	115	20.72
Married	440	79.28
Total	555	100.00
Occupation		
Employee	310	55.86
Business	130	23.42
Others	115	20.72
Total	555	100.00
Annual income		
Less than Rs.100000	310	55.86
Rs.100001 to Rs. 300000	195	35.14
Rs.300001 to Rs.600000	35	6.31
Rs.600001 to Rs.1000000	10	1.8
Above Rs.1000000	5	0.9
Total	555	100.00

Source: Survey report

Table 2 - Investors' Perceptions of risk

	Number of respondents	Percentage to total
Under performance (Returns)	290	52.25
Loss of principal amount	112	20.18
Loss of principal and return	153	27.57
Total	555	100.00

Source: Survey report

Table 3 - Age-wise Investors' Perceptions of Risk

Age	Under performance	Loss of Principal amount	Loss of Principal amount and Return	Total
Less than 40 years	158 (011)	37 (012)	20 (013)	215
40-50 years	104 (021)	42 (022)	74 (023)	220
50-60 years	16 (031)	23 (032)	21 (033)	60
More than 60 years	12 (041)	10 (042)	38 (043)	60
Total	290	112	153	555

Source: Survey Report

Values in parentheses represent the observed values.

Calculated Value	108.29
Table Value	7.815
Degree of freedom	3

Table 4 - Investors' Opinion on Risks Associated With Mutual Funds

Degree of risks in Mutual Funds	Number of respondents	Percentage to Total
High	136	24.50
Medium	314	56.58
Low	105	18.92
Total	555	100.00

Source: Survey Report

Table 5 - Marital status-wise Opinion on Risks Associated with Mutual Funds

Marital status	High	Medium	Low	Total
Un married	24 (011)	18 (012)	73 (013)	115
Married	112 (021)	286 (022)	32 (023)	440
Total	136	314	105	555

Source: Survey Report

Values in parentheses represent the observed values.

Calculated Value	16.5691
Table Value	5.991
Degree of freedom	4

Table 6 - Annual Income-wise Opinion on Risks Associated with Mutual Funds

Income level	High	Medium	Low	Total
Less than Rs. 1,00,000	83 (011)	204 (012)	23 (013)	310
Rs. 1,00,000 to Rs. 3,00,000	39 (021)	101 (022)	55 (023)	195
Rs. 3,00,000 to Rs. 6,00,000	14 (031)	9 (032)	12 (033)	35
Rs. 6,00,000 to 10,00,000	0 (041)	0 (042)	10 (043)	10
Above Rs. 10,00,000	0 (051)	0 (052)	5 (053)	5
Total	136	314	105	555

Source: Survey Report

Values in parenthesis represent the observed values.

Calculated Value	116.19
Table Value	9.488
Degree of freedom	4

Table 7 - Investors' Satisfaction over Return on Mutual Funds

Particulars	Highly Satisfied	Moderately Satisfied	Satisfied	Not Satisfied
Return	15	143	295	102

Source: Survey Report

Findings of the Study

- Most of the investors opined that risk is under performance (52.25 per cent)
- 56.58 per cent of the investors felt that the risks in Mutual Funds are medium (56.58 per cent).
- Most of the unmarried investors stated that the risks in Mutual Funds are low (63.48 per cent).
- In contrast to unmarried investors, 65 per cent of married investors said that the risks in Mutual Funds are medium.
- Majority of the investors whose age is more than 60 years (63.33 per cent) opined that risk refers to both loss of principal and as well as income.
- All the investors whose annual income is above Rs. 6 lakhs felt that the risks in Mutual Funds are low.
- Majority of the investors whose annual income is less than Rs. 1 lakh said that the risks in Mutual Funds are medium.
- Most of the investors were just satisfied with respect to the return on Funds.

Suggestions

- As majority of the respondent investors are much more anxious with the prior information pertaining to risks in investing, the Mutual Fund companies (MFCs) have to think about higher levels of disclosures in this regard.
- As majority of the investors feel the risk as under performance, Mutual Fund companies may work hard to offer the returns as expected by them.
- The MFCs may concentrate on mobilizing the resources from the investors whose annual income exceeds Rs. 6 lakhs as they feel that the risks in Mutual Funds are low.

- MFCs may concentrate on unmarried investors for their resource mobilization.
- As every investment involves risk, the MFCs may try to educate the investors about risks by conducting awareness programmes.
- The Fund Managers should precisely concentrate on portfolio construction so as to generate more returns.
- The MFCs may try to mobilise the funds from the people other than employees opening information centers in different areas of the country.

Conclusion

The present study endeavored to throw a light on the investors' perceptions of Mutual Fund risks. Understanding the requirements of investors by the Mutual Fund Companies has become necessary to accelerate the required pace of growth. A detailed analysis of risk perceptions of the investors was made in this study. Survey findings of this study have got significant implications that can be adopted by the Fund companies either by adding to the existing practices or by replacing.

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