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An analysis of Mutual funds as financial intermediation and its contributions

Dr. R. Narmadha
Assistant Professor in Commerce, Govt. First Grade College, HSR Layout, Bangalore

Abstract: Economic development of a country depends on both autonomous investment and induced investment. The Former relates to the investments made by government in public utility works, undertaken to improve the general welfare. Whereas the later deals with private investments, undertaken with profit motive. The corporate sector of a country will be in constant demand of finance for varied purposes such as initiating of new projects, expanding the existing one, diversification of the business, modernization of present working process etc., Despite the fact, retained earnings helps in meeting some part of these requirements, major proportion of funds flows from well established and functioning financial system of a country. It is this financial system of a country, which establishes link between those who have got excess of money and those who requires it. Financial system facilitates the capital formation of a country. Savings from the household sector of the economy, whereas investments are made by the corporate sector. Hence a proper mechanism which ensures, accumulation of savings from households and supplying it to those who invest, needs to be established enabling the utilization of idle funds and enhancing their value and contributing to economic growth and development in general. Therefore, creating an environment, where borrowers and lenders are easily accessible to each other, is a vital requisite. Though this situation seems to be an ideal financial system, having direct access between lenders and borrowers may not be possible due to asymmetric information. Hence, the role financial intermediaries becomes predominant, which pool funds from various sources and facilitates its investment in diversified financial assets. Mutual funds performs these functions very effectively. A mutual fund is a collective investment instrument arrangement. In India, three entities constitutes a mutual fund: the sponsor, the trust and the asset management company. The sponsor promotes the mutual fund. The mutual fund is organized as a trust. Mutual funds have recorded a very impressive growth in India. This paper attempts to depict the different facets of mutual funds from the investors' perspective.

Key words: Savings, Investment, Financial intermediation, Economic development.

INTRODUCTION

The mutual fund sector in India was founded in 1963 when the Government of India launched the Unit Trust of India. The first move toward millennials occurred in 1964, when UTI created the first mutual fund plan in India, with public sector firms such as Punjab National Bank, SBI, Indian Bank and Bank of Baroda participating in the scheme, which was valued at Rs 6,700 crores by the end of 1988. After a tremendous heyday in the mutual fund business in India, the industry collaborated to build a portal for the private sector, and by 1993, India had burgeoned in the Mutual fund Industry. According to data, the Indian mutual fund sector had Rs 31.43 trillion in assets under administration as of March 2021, representing a 41% increase in fiscal 2021. Assets Under Management (AUM) in the mutual fund industry was worth Rs 33.67 trillion as of June 30, 2021. The bond funds were the most appealing in fiscal 2021, with net inflows of Rs 3,299 crore. Credit risk funds had the largest net outflows of Rs 28.923 crore.

A mutual fund is a type of financial intermediary that pools the funds of investors who seek the same general investment objective and invests them in a number of different types of financial claims. These pooled funds provide thousands of investors with proportional ownership of diversified portfolios managed by professional investment managers.

The popularity of the mutual funds has increased because of the advantages it has provided over and above the other investment avenues. Some of the advantages are:

1. Portfolio Diversification- Each investor is a part owner of the entire funds asset thus enabling him to hold a diversified portfolio with a small capital that he

has invested. The investor enjoys the benefits of diversification.

2. Professional Management- The financial professionals, who are able to select the right stocks at the right time manage the mutual funds. The investment management skills, along with the needed research into available investment options, ensure a much better return than what an average investor can manage on his own.

3. Risk Diversification - The risk of the investor is reduced as he is investing in the pool of funds with the other investors.

4. Low Transaction Costs- The transaction cost that the investor would have incurred for possessing the same portfolio would have been much higher than what he incurs by investing in a mutual fund. When the investor invests in a stock, he bears all the cost of brokerage and custody. But the in case of a mutual fund, the investor enjoys economies of scale.

5. Liquidity - The units of the mutual fund can be sold very easily. In case of an open-ended mutual fund the units can be surrendered to the mutual fund itself and in case of closed ended mutual fund it can be sold in the stock market to generate cash whenever required. Liquidity is a big benefit that is availed by the mutual fund investors.

6. Convenience and flexibility - Mutual fund management companies offer many investor services that a direct market investor cannot get. Investors can easily transfer their holdings from one scheme to another; get updated market information and so on.

7. Transparency - Mutual Funds have to disclose their holdings, investment pattern and necessary information before all investors under a regulated framework.

8. Well-Regulated- the regulations in the mutual fund has been changing over period of time. At present the disclosure norms have become too tight for the mutual fund companies. They have to adhere to the guidelines laid down by the Securities Exchange Board of India. The SEBl guidelines lay a lot of emphasis on the investor protection.

REVIEW OF LITERATURE

Sadak (1997) studied the industry as a whole with the objective of disclosing some facts of marketing of the Mutual Fund schemes in the future. The study intended to emanate from Indian Mutual Funds as important financial intermediaries and asset allocates. He critically examined the recent growth and performance of Mutual Funds in India, while identifying the constraints in their development. He observed that marketing is one of the most critical areas of MF operations due to distinctive nature of products and consumers. He observed that efficiency of investment management directly influences marketing operation, whereas the efficient management of investment depends on several factors, including securities selection, resource allocation, investment research, and timing. He found that Mutual Fund in India has been wrongly promoted as an alternative to equity investing, thus creating very high expectations in the minds of the investors. In a falling market, their expectations have been belied. He found that the introduction and implementation of new regulatory norms have contributed in some measures to market sluggishness as market was initially not able to respond to the regulatory objectives. The absence of product diversification and a confused market situation has been made worse by the absence of an innovative marketing network for Mutual Funds. In the light of these findings, he suggested some corrective measures for the sustained growth of the industry. For undertaking a well-designed and comprehensive program of investor education, positive media support is also required. The product range offered by MFs needs to be redesigned keeping in view the short-term, medium term and long-term changes in the savings and investment markets. The success of Mutual Fund depends to a great extent on institutionalized efforts. Indian Mutual Funds should shift from fund-based marketing to scheme-based marketing to reach specific target groups.

SEBI-NCAER survey (2000) was carried out to estimate the number of households, the population of individual investors, their economic and demographic profile, portfolio size and investment preference for equity as well as other savings instruments. Data was collected from three lakhs geographically dispersed rural and urban households. Findings of the survey are: the investors' choice of investment instruments matched the risk perceived by them. Bank Deposit was the most preferred investment avenue across all income class; 43% of the non-investor households (estimated around 60 million households) apparently lack awareness about stock markets; and a relative comparison shows that the higher income group has a greater share of investments in mutual funds compared with low income groups, suggesting that mutual funds have not truly become investment vehicle for small investors'. Nevertheless, the study predicts that in the next two years the investment of households in mutual funds is likely to increase.

Narasimhan and Vijayalakshmi (2001) have conducted an empirical evaluation of diversification and timing performance of mutual funds in India. They have shown that the mutual fund managers have failed to invest in the top performing stocks of the period. The study found that Life Insurance Corporation was the most preferred avenue to invest and people in general were risk averse and wanted to invest in safe assets.

Lynch and Musto (2003), in the paper titled "How investors interpret past fund returns" have empirically tested the assumptions that 1. Past returns do not reflect future performance and 2. Bad performers change their strategy and perform at a better rate than their current performance levels. The authors developed a model to test the assumptions and empirically proved that the relationship between past and future performance is also convex and money management strategies of bad performers are extremely successful than the good performers in the context of institutional investors.

Research Gap:
In an economy, financial sector plays an important role. The strength of the financial sector influences the survival, growth and development of different sectors of the economy. Resource mobilization and deployment depends on both the institution mechanism and the capital market operation. The emerging investment scenario clearly reveals that there is a trend of changing of preference of investors towards new savings instruments. The Mutual Fund industry because of its simplicity of operation and wider reach of the investors' class plays a significant role, not only in mobilizing idle resources but also by encouraging saving habits and channelizing these resources into the productive sector of the economy. A healthy Mutual Fund industry will lead to a healthy development of the economy. A detailed study focused on understanding the different facets of mutual fund is needed as earlier research have not concentrated on the same.

Objectives of the study:
1. To understand the meaning and functioning of Mutual Funds in India
2. To explore the advantages and superiority of Mutual Funds in India.
3. To define the influencing factors of the investors in choosing Mutual funds over other investment options.

RESEARCH METHODOLOGY

Data Type: The present study is based on primary data which was collected using questionnaire method.
Sample Size: The sample size of the study is 220 investors from Bangalore city, Karnataka, India. However, only 207 respondents have selected due to not sufficiency of data in few questionnaires for data analysis.
Primary Data: Method of Questionnaire has been used to procure data from investors who are interested in mutual funds scheme and other investment options.
Locale of the study: Bangalore city, Karnataka, India.
Data Analysis: The hypotheses were formulated and then analyzed with the help of statistical techniques of Chi-Square test for relationship using IBM SPSS software version 20. Both hypotheses were tested with 95 percent confidence level i.e. at 5 percent significant level.

DATA ANALYSIS AND INTERPRETATION

Table 1-Frequency distribution of respondents on the basis of their annual Income

Annual Income	Number of respondents	Percentage	Cumulative Percentage
Below 3,00,000	91	44	44
3,00,001 to 5,00,000	65	31	75
5,00,000-8,00,000	23	11	86
Above 8,00,000	28	14	100

Source: Primary Data.

Analysis:

As it is evident from the above table, that majority of the respondents have responded that their annual income is less than 3,00,000. The beauty of mutual funds is one can start investing in them with a mere Rs.100 through systematic investment plans. Hence it provides a good investment opportunity for those who look for some safe source of passive income options.

Table 2-Frequency distribution of respondents on the basis of potential savings of the respondents

Annual Savings	Number of respondents	Percentage	Cumulative Percentage
Less than 20%	37	18	18
20% to 30%	134	65	83
30 % to 50%	28	13	96
More than 50%	8	4	100

Source: Primary Data

Analysis:

Majority of the respondents were falling under the bracket of 20 to 30% savings. This is the normal savings capacity of an average middle class Indian. After meeting their requirements, people will generally be able to save around 30% of their income and they look forward to investment this savings in some safe source of earning passive income and Mutual Funds have turned out to be an attractive destination for those type of potential investors.

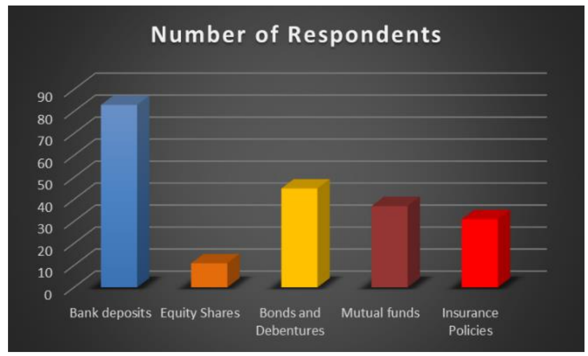
Table 3-Preferred Investment source by the Respondents

Investment Options	Number of Respondents	Percentage
Bank deposits	29	14
Equity Shares	18	9
Bonds and Debentures	32	15
Mutual funds	114	55
Insurance Policies	14	7
Total	207	100

Source: Primary Data

Analysis:

It was astonishing to know that majority of the respondents have given their first preference to Mutual funds as their first priority investment option. Respondents were asked to indicate their investment preference in their rank order. 114 respondents out of 207 have indicated that Mutual Funds is their first priority option. Since Asset Management Company manages the funds and relatively less risk associated with Mutual funds has made it a prioritized investment option. There are multiple government rules and SEBI regulations guiding the functioning of Mutual Funds.



Mutual funds are the institutions which gives an opportunity to the small investors to invest their savings in the capital markets. The small investors normally do not have the experience, time or the resources to reach up to the capital markets all by themselves. So, they depend on the investment to be made through the intermediaries in the capital market and seek for their professional knowledge. Thus, the role of Mutual Fund Institutions evolved which is a corporate body that attracts and helps the small investors to invest in money market, debt market and capital market instruments namely the shares and debentures. It is a link between the public and the capital market. Further, under a mutual fund an agreement is entered into between three parties namely, the Sponsors, Trustee and the Asset Liability Management Company (AMC).

SUGGESTION

- Mutual Fund companies should provide efficient customer care services to tap the potential investors.
- The mutual fund companies must ensure proper connectivity with the investors through effective technical support and adopt simple methods of technology for the convenience of the investors especially the small investors.

- The mutual fund companies must ensure adequate infrastructure facility to enhance the satisfaction level of the investors.
- The mutual fund companies must primarily work towards achieving the concept of social mutual fund.

CONCLUSION

Mutual fund industry in today's financial scenario shows good progress due to Governmental support such as tax concessions and exemption and also by receiving preferential treatment in the hands of the government. Further, investors have started to make investment in mutual funds since it ensures good returns, quick liquidity and safety. It is thus, time for the mutual funds to act as mutual friends by creating a good understanding with the investors by providing adequate interpretation of the various schemes, being well-organized and by providing quick services to its investors. If these measures are ensured then, there is no doubt about an optimistic future for mutual funds in India.

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