

PERFORMANCE EVALUATION OF MUTUAL FUNDS: AN ANALYSIS OF RISK & RETURN

(I) Introduction

A mutual fund is an investment company that creates a bridge between individual investors or retail investors & corporate giants. Mutual funds provide a investment options for retail investors or individual investors those who are not aware about stock market still they want to invest their funds in stock market with a small amount of money. A mutual fund is a pure intermediary which performs basic function of buying & selling security on behalf of its investors or unit holders. Mutual funds mobilize saving from a large number investors & invest these funds in share and other securities mutual funds are sine qua non for the development of the capital markets & the creation of the equity cult in an economy..

1.1 Evolution of Mutual Funds

The inception of Unit Trust of India marked the evolution of the Indian mutual fund industry in the year 1963. The basic objective at that time was to attract the small investors or retail investors for investment and it was made possible through the collective efforts of the Government of India and the Reserve Bank of India. The history of mutual fund industry in India can be better understood divided into following stages:

Stage 1. Establishment and Growth of Unit Trust of India - 1964-87

Unit Trust of India enjoyed complete monopoly when it was established in the year 1963 by an act of Parliament. UTI was set up by the Reserve Bank of India and it continued to operate under the regulatory control of the RBI until the two were de-linked in 1978 and the entire control was transferred in the hands of Industrial Development Bank of India (IDBI). UTI launched its first scheme in 1964, named as Unit Scheme 1964 (US-64), which attracted the largest number of investors in any single investment scheme over the years.

UTI launched more innovative schemes in 1970s and 80s to suit the needs of different investors. It launched ULIP in 1971, six more schemes between 1981-84, Children's Gift Growth Fund and India Fund (India's first offshore fund) in 1986, Master share (India's first equity diversified scheme) in 1987 and Monthly Income Schemes (offering assured returns) during 1990s. By the end of 1987, UTI's assets under management grew ten times to Rs 6700 crores.

Stage II. Entry of Public Sector Funds - 1987-1993

The Indian mutual fund industry witnessed a number of public sector players entering the market in the year 1987. In November 1987, SBI Mutual Fund from the State Bank of India became the first non-UTI mutual fund in India. SBI Mutual Fund was later followed by Canbank Mutual Fund, LIC Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund, GIC Mutual Fund and PNB Mutual Fund. By 1993, the assets under management of the industry increased seven times to Rs. 47,004 crores. However, UTI remained to be the leader with about 80% market share.

Stage III. Emergence of Private Sector Funds - 1993-96

The permission given to private sector funds including foreign fund management companies (most of them entering through joint ventures with Indian promoters) to enter the mutual fund industry in 1993, provided a wide range of choice to investors and more competition in the industry. Private funds introduced innovative products, investment techniques and investor-servicing technology. By 1994-95, about 11 private sector funds had launched their schemes.

Stage IV. Growth and SEBI Regulation - 1996-2004

The mutual fund industry witnessed robust growth and stricter regulation from the SEBI after the year 1996. The mobilizations of funds and the number of players operating in the industry reached new heights as investors started showing more interest in mutual funds.

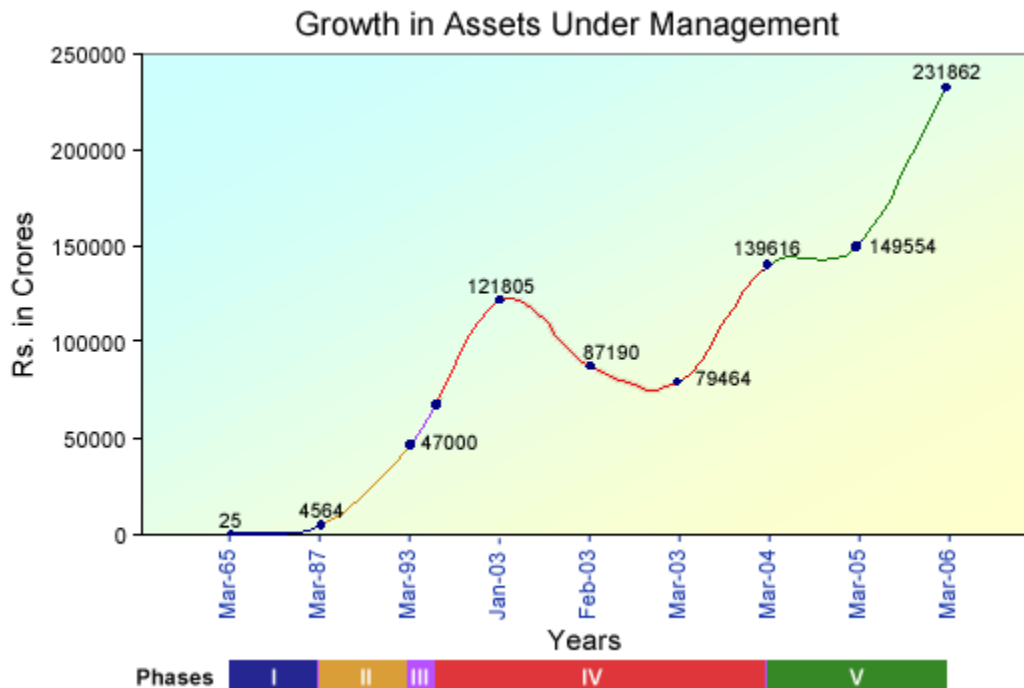
Investors' interests were safeguarded by SEBI and the Government offered tax benefits to the investors in order to encourage them. SEBI (Mutual Funds) Regulations, 1996 was introduced by SEBI that set uniform standards for all mutual funds in India. The Union Budget in 1999 exempted all dividend incomes in the hands of investors from income tax. Various Investor Awareness Programmes were launched during this stage, both by SEBI and AMFI, with an objective to educate investors and make them informed about the mutual fund industry.

In February 2003, the UTI Act was repealed and UTI was stripped of its Special legal status as a trust formed by an Act of Parliament. The primary objective behind this was to bring all mutual fund players on the same level. UTI was re-organized into two parts: 1. The Specified Undertaking, 2. The UTI Mutual Fund

Presently Unit Trust of India operates under the name of UTI Mutual Fund and its past schemes (like US-64, Assured Return Schemes) are being gradually wound up. However, UTI Mutual Fund is still the largest player in the industry. In 1999, there was a significant growth in mobilizations of funds from investors and assets under management

Stage V. Growth and Consolidation - 2004 Onwards

The industry has also witnessed several mergers and acquisitions recently, examples of which are acquisition of schemes of Alliance Mutual Fund by Birla Sun Life, Sun F&C Mutual Fund and PNB Mutual Fund by Principal Mutual Fund. Simultaneously, more international mutual fund players have entered India like Fidelity, Franklin Templeton Mutual Fund etc. There were 29 funds as at the end of March 2006. This is a continuing stage of growth of the industry through consolidation and entry of new international and private sector players.



(Source: <http://www.appuonline.com/mf/knowledge/industry.html>)

(II) Importance of the study:

The present study can be grate helpful to research agencies, academicians, mutual funds investors, business school students, mutual funds companies etc. The study focuses on the present & future scenario in the mutual funds industry, which is concern with the rapidly changes in the capital market with respect to the investors preference. An attempt is made for the cope up with the problems facing by the investors that earn a handsome return with the minimum level of risk. For testing the performance of various mutual funds schemes I have take 50 schemes from different investment companies according to risk & return criteria.

(III) Objectives of the study:

The primary objective of the present study entitled “*Performance evaluation of mutual funds*” to understand the mutual fund industry & its impact on the retail investors on one hand and its risk & return on the other.

To be specific following are the main objective of the present research study.

- To examine the performance of selected mutual funds
- To predict the trends for investment of selected mutual funds for future
- To study the risk-return preference of investors.
- To study the purpose of buying mutual funds.

(IV) Research methodology:

This will be a descriptive research wherein the source for the data will be both primary as well as secondary. There has been very limited published data and information with regard to this study.

Hence the study will try to understand the investment pattern among the investors & also focus on the performance on mutual funds. This study will cover different stages of investors. Fifty mutual funds schemes having different investment opportunities both from the public & private sector were selected for the purpose of measuring the performance and also testing the risk-return abilities of the Indian fund managers.

Primary data:

A detailed questionnaire will be prepared and administered on investors. In few selected cities in the state of Gujarat namely Ahmedabad, vadodara, Surat, Rajkot and anaad

The sample of the survey would be 450 mutual funds investors spread across the above cities. The non probabilistic convenience sampling method will be used for the study.

Secondary Data:

The information collected from the various mutual funds brochures of the company as well from similar research project conducted elsewhere. Annual reports, journals, magazines and books will be referred for this study. Search will also be made from various websites.

Research tools:

This is a survey type of research; the major tools will be a questionnaire, opinionaire, observations. The data collected will be analyzed and interpreted by using appropriate statistical tools.

Performance evaluation models will be used for the analysis purpose. Mutual funds schemes would be measuring with the help of following models.

- Capital asset pricing Model
- Rate of return model
- Sharpe model
- Treynor model
- Jenson model

Plan of the study:

The first chapter of study “introduction” discusses the general introduction of the study, research & reviews the literature already available on the subject. Second chapter discuss about the concept meaning, definition, history, classification, types, needs, importance & regulatory & statutory framework for Indian mutual fund industry. Third chapter is related to objectives & research methodology of the study. Fourth chapter is concern with the examine performance of the mutual fund schemes & to estimate the future trend of various mutual fund schemes. Fifth chapter evaluates measuring the performance with respect to risk & return criteria with the help of various models. Sixth chapter deals with the risk-return preference of the investor & purpose of buying mutual funds. Last chapter sum up the summary of the main findings conclusion & offers suggestions to mutual fund investors as well as companies.

Literature Review:

Mutual funds have already attracted the attention of world wide investors and academicians but most of the existing research available is on either accelerating the return on funds or comparing it with benchmark fund schemes. Few studies are available that focus on investor's objective and considering risk associated with the mutual funds investors that some of are as following:

Investors are generally more careful while making investment decision and presence of rationality in every investor demands higher return at minimum level risk but when markets are efficient it is not possible to gain abnormal returns. Risk is generally, associated with various applications differently but in common it means negative connotation such as harm or loss or some undesirable action. Risk expressed by Kaplan and Garrick (1981) demonstrates that risk involves a factor of uncertainty and potential loss that might be incurred.

Sahadevan and Thiripalraju, in their research paper titled "Mutual Funds – Data Interpretations And Analysis" (1997), analyzed the performance of private sector funds they compiled and analyzed the monthly average return and standard deviation of 10-selected private sector funds. The investigation reveals that in terms of the rate of return, 5 funds viz., Alliance 95, ICICI Power, Kothari Prima, Kothari Pioneer Blue Chip and Morgan Stanley Growth Fund out performed the market, during the period of comparison. The analysis also shows that, by and large, performance of a fund is not closely associated with its size.

Gupta & Sehgal, in their research paper "Investment Performance of Mutual Funds: The Indian Experience" (1998), tried to find out the investment performance of 80 schemes managed by 25 mutual funds, 15 in private sector and 10 in public sector for the time period of June 1992-1996. The study has examined the performance in terms of fund diversification and consistency of performance. The paper concludes that mutual fund industry's portfolio diversification has performed well. But it supported the consistency of performance.

Bijan Roy, ET. al., conducted an empirical study on conditional performance of Indian mutual funds. This paper uses a technique called conditional performance evaluation on a sample of eighty-nine Indian mutual fund schemes .This paper measures the performance of various mutual funds with both unconditional and conditional form of CAPM, Treynor- Mazuy model and Henriksson-Merton model. The effect of incorporating lagged information variables into the evaluation of mutual fund managers' performance is examined in the Indian context. The results suggest that the use of conditioning lagged information variables improves the performance of mutual fund schemes, causing alphas to shift towards right and reducing the number of negative timing coefficients

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