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Factors Affecting Investment in Mutual Funds

Varun Sagar Singal[1] and Dr. Rishi Manrai[2]

[1] UG Student, Symbiosis Center for Management Studies, NOIDA
[2] Assistant Professor, Symbiosis Center for Management Studies, NOIDA

E-mail: varun.sagar2019@scmsnoida.ac.in
rishi.manrai@scmsnoida.ac.in

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Abstract

Mutual funds act as a medium for retail investors to invest their savings in the professional funds management system, irrespective of the sum invested. It enables masses to enter the Indian Financial Market with much more ease. Indian Mutual Funds industry is growing rapidly which is reflected with the growth in assets under management under various AMC's year on year. Investment in mutual funds is less risky when compared to investment in equities market. Less risk combined with moderate returns and professional management act as a magnet for the risk averse investors to invest their savings in the financial markets.

This project aims at finding out the factors affecting investment decision on mutual funds and the impact of behavioral factors on an investor. This project also aims at finding about the factors that prevent the people to invest in mutual funds. The findings will help mutual fund companies to identify the areas required for improvement and can also improve their marketing strategies. It will help the MF companies to create new and innovative product according to the orientation of investors.

Investor perception cites a significant impact on the investment decision making process. It is important to understand few basic factors such as level of awareness and impact of date of inception *of the fund which play a significant role in guiding the investment decision making process of a retail investor.*

Keywords: *Mutual Fund Performance, Investment, Risk-returns, Factors Affecting, Behavior*

INTRODUCTION

Capital markets have arisen to be at the Centre stage of the Indian financial system from a miniscule impact it had upon the financial markets a decade earlier. Capital market in India has also witnessed a significant increase in institutional setup and development. Institutions have evolved and developed in the form of a diversified structure of mutual funds.

A mutual fund is a special purpose institutional setup established specifically for investment purposes and it acts as an investment conduit. Its primary function is to pool and gather resources (savings) from small investors, build a bigger corpus of large resources and invest them into a well-diversified portfolio of sound investments. It aims to maximize returns as much as possible while keeping the quantum of risk associated with equities low.

Despite being available in the market less than 10% of Indian households have invested in mutual funds. A recent report on Mutual Fund Investments in India published by research and analytics firm, Boston Analytics, suggests investors are holding back from putting their money into mutual funds due to their perceived high risk and a lack of information on how mutual funds work. Close to 40% of those who live in metros and Tier I cities considered such investments to be very risky, whereas 33% of those in Tier II cities said they did not know how or where to invest in such assets.

Mutual funds issue units (securities) to unit holders (investors) in accordance with the amount of money invested by them. The distribution of profit/loss among unit holders takes place in proportion to their investments. The setup of mutual funds is of a "trust" consisting of

- *Trustees:* The trustees of a mutual fund hold its property for the benefit of the unit holders.
- *Sponsor:* The trust is established by a sponsor who is like the promoter of a company.
- *Asset management company:* The asset management company is responsible for making investment into securities.
- *Custodian:* The custodian is responsible for holding the securities of various schemes of the fund in its supreme custody.

The trustees are persons usually holding the general power of superintendence and direction over the asset management company. They are vested with the powers to oversee the compliance and performance of all guidelines, rules and regulations laid down by SEBI (securities exchange board of India) by the mutual fund. Mutual funds as an investment vehicle offers a variety/range of services to marginal/small investors who are limited by their resources and are unable to manage and build a vibrant investment portfolio caused by mainly due to miniscule funds, lack of professional experience and expertise, etc. Mutual funds have many advantages for marginal investors which include convenience, lower risk, expert management, economies of scale.

Lower Risk

Investments in mutual funds are expose investors to a much less risk than they will face while investing individually in securities market. Lower risk is mainly because of diversification of investment portfolio. Diversification of portfolio significantly reduces the risk of poor returns/dividends and depreciation of capital. Since diversification is a function of the size of investible funds as well as market information and supervision facilities available to the investors, relatively small investors with limited capital can obtain better diversification by purchasing units of mutual funds than what they could do by direct purchase of securities in the securities market.

Convenience

Mutual funds make it convenient for small savers to mobilize their savings and convert them into securities. It has two broad dimensions *divisibility* and *maturity.* Mutual funds are able to offer securities in varying sizes after adjusting their denominations that suit the individual saver. Primary securities of higher denominations are converted into indirect securities of lower amounts/denominations. Minimum required investment in mutual funds can be as low as thousand rupees as compared to individual securities exchange wherein a minimum of six to seven thousand are required. Flexibility is easier to achieve. Mutual funds on the other hand are the manufacturers of liquidity in the financial market.

Expert Management

Mutual funds have an aforesaid benefit of specialized and experienced management combined with ever continuing supervision. These features are not present at the end of any individual investor. The importance of this service provided by the mutual funds should be viewed in the context of complexities involved in the selection and supervision of securities such as specialized knowledge, training, ability, aptitude, time and inclination.

Economies of Scale

Mutual funds are able to achieve economies of scale as they are continually engaged in the business of buying and selling securities and this phenomenon has a great impact upon the performance of the fund with respect to risk and returns. They are able to transfer funds from lenders to borrowers at a lowest cost.

There are also some disadvantages of mutual funds.

No Guarantees

No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money.

Fees and Commissions

All funds charge administrative fees to cover their day-to-day expenses. Some funds also charge sales commissions or “loads” to compensate brokers, financial consultants, or financial planners. Even if you don’t use a broker or other financial adviser, you will pay a sales commission if you buy shares in a Load Fund.

Taxes

During a typical year, most actively managed mutual funds sell anywhere from 20 to 70 percent of the securities in their portfolios. If your fund makes a profit on its sales, you will pay taxes on the income you receive, even if you reinvest the money you made.

Management Risk

When you invest in a mutual fund, you depend on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as you had hoped, you might not make as much money on your investment as you expected. Of course, if you invest in Index Funds, you forego management risk, because these funds do not employ managers

As per guidelines laid down by SEBI, an asset management company is free to design various schemes to best suit the needs of investors. Mutual fund companies operating in India currently offer more than 400 different options for investors to choose from.

Structurally mutual funds consist of *open ended* and *close ended schemes*. An open-ended scheme has perpetual existence and investors are free to buy and sell units at any time.an individual investor can buy and sell units on daily basis. All the prices are linked to NAV [Net Asset Value]. The process of dis-investment can be initiated after a short lock in period. Liquidity is instant as the fund announces sale and purchase daily. However, they are not listed on the exchange. A close-ended scheme is the one in which the subscription remains only for a specified period. After the end of the specified period the entire fund is dis-invested and the corpus is distributed to the unit holders. After this process the scheme doesn't exist.

From the point of view of product mutual funds can be classified as *equity funds, bond funds, hybrid funds, money market funds.* Equity funds are funds that specifically and only invest into equity shares of a company. It can be further classified into 8 categories *growth funds, mid-cap funds, value funds, income funds, index funds, exchange traded funds [ETF], sector funds, equity linked savings scheme [ELSS].* Growth funds main objective is capital appreciation and they invest in shares of a company which is expected to fare better than the market. Mid-cap funds are also known as value-oriented funds and they only invest in shares of mid-sized companies as they give higher returns than large cap companies. Value funds invest with the motive of value investing and they seek securities with the most promising potential for growth. Equity income funds objective is to provide a major portion of the return as income. Index funds represent attributes of a chosen target index. ETFs are a fund that closely tracks the performance of an index and can be bought and sold directly on the stock exchanges. It is usually a passively managed fund. Sector specific funds are those funds that invest only in shares if a specific sector. ELSS alike schemes invest in equity for long term capital gains with a three-year minimum lock in period and tax benefit under section 88 if income tax act.

Debt funds concentrate their investments in debt securities. Interest earned as returns from investment is the principal source of income. The net asset value of these funds is directly influenced by changes in interest rates. Further debt funds can be categorized into *corporate bond funds, gilt schemes, floating rate scheme, bond index funds.* Corporate bond funds invest in bonds issued by companies so as to earn high income. Corporate bond funds can further be classified into *high grade bond funds* and *high yield bond funds.* Funds which invest in only AAA rated bonds are known as high grade bond funds and funds which invest in high yield instruments are known as high yield bond funds. Gilt funds are those schemes which only invest in government securities (G-sec). an investment in gilt schemes is usually free of credit risk but interest rate risk prevails. G-sec funds also offer capital appreciation to some extent. Floating rate funds are schemes which primarily invest in floating rate debt instruments. These schemes facilitate a hedge against volatile interest rates. Bond index funds primarily invests in instruments comprising of the underlying bond index in the same proportion so as to replicate the return on the same.

Hybrid funds have a dual categoric composition of shares and bond funds. Hybrid funds can be sub classified into *balanced funds* and *asset allocation fund*. Balanced funds invest in a portfolio of securities consisting of both shares and bonds. They offer investors with present income combined with constant returns and moderate growth with a much lower interest. NAV of balanced funds move in a narrow range and are less volatile. They are bound to perform better in bearish market but give lesser returns in a bullish market. Asset allocation fund invest their corpus into different asset classes to diversify their holdings and give consistent returns. Both conservative and aggressive funds can be seen in securities market.

Money market mutual or liquid schemes are those funds which invest in short term highly liquid instruments. They offer investors stability, liquidity and a short investment horizon.

Based on options and plans mutual funds can be classified into *growth/ dividend/ reinvestment plan, systematic investment plan (SIP), systematic withdrawal plan, switching option and gifts*.

Under the growth option the dividend and income are not declared. These parameters are ascertained through appreciation or depreciation in the NAV of the investment. Number of units remain constant and their value varies with the value of the portfolio of the scheme. Under the dividend option investors are bound to receive a dividend on their investment. Investors/unit holders also have an underlying option to reinvest their earnings/dividends from investment without any load charge. SIP is a plan in which investors can choose to invest a fixed amount after a fixed interval for a pre-fixed period at the prevailing price of the asset/NAV. It helps investors to average out the cost of investment over the period and making it possible for investors to overcome short term fluctuations in the market.

Moreover, there are two strategies to accomplish it, i.e. *dollar cost method and value averaging*. Dollar cost averaging eliminates the market timing decision that is get in at the bottom and get out at the top for a fat profit. Value averaging is an aggressive form of dollar cost of averaging suitable to investors with high risk appetite. Under the systematic withdrawal plan an individual investor can withdraw a pre-fixed amount at fixed intervals. Switch is a facility provided to the unit holders under the scheme which allows them to transit between plans applicable on NAV based prices. Gift is also a facility provided to the unit holders of a certain fund as provided by the mutual fund regulation.

MUTUAL FUNDS IN INDIA

The concept of mutual funds in India dates to the year 1963. The era between 1963 and 1987 marked the existence of only one mutual fund company in India with Rs. 67 bn assets under management (AUM), by the end of its monopoly era, the Unit Trust of India (UTI). By the end of the 80s decade, few other mutual fund companies in India took their position in mutual fund market. The new entries of mutual fund companies in India were SBI Mutual Fund, canara bank Mutual Fund, Punjab National Bank Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund. The succeeding decade showed a new horizon in Indian mutual fund industry. By the end of 1993, the total AUM of the industry was Rs. 470.04 bn. The private sector funds started penetrating the fund families. In the same year the first Mutual Fund Regulations came into existence with re-registering all mutual funds except UTI. The regulations were further given a revised shape in 1996.Kothari Pioneer was the first private sector mutual fund company in India which has now merged with Franklin Templeton. Just after ten years with private sector player's penetration, the total assets rose up to Rs. 1218.05 bn. Today there are 33 mutual fund companies in India.

REVIEW OF LITERATURE AND PROPOSED RESEARCH MODEL

The purpose of this literature survey is to identify the factors that previous research has found to be important in the performance of mutual funds. These factors are then used in the design of the questionnaire used for data collection.

Many studies have been conducted in India and abroad covering different aspects of Mutual fund. J. Lilly and Dr. Anasuya published a research paper "An empirical study of performance evaluation of selected ELSS mutual fund schemes" published on International journal of scientific research (2014) which examined the performance of 49 selected tax saving ELSS schemes by applying Sharpe ratio, Treynor ratio, Sortino ratio and Jensen's alpha measure and found out LIC NOMURA MF GROWTH and dividend schemes has the highest return and are risk borne when compared to other schemes. Lonnie L. Bryant, Hao-Chen liu published a research paper "Mutual fund industry management structure, risk and the impacts to shareholders" published on Global finance journal (2011) investigates the effects of a multiple fund management structure on the risk volatility of the funds managed with the help of Sharpe ratio. They found out the impacts that mutual fund management structure has in fund risk volatility using a sample of 1480 funds managed by 407 managers. They also found out that the multiple fund management structure appears to be motivated by the need to achieve economies of scale and reduce cost of the shareholders, fund managers which are driven by strategic reason.

Factors Affecting Investment in Mutual Funds

Shanmugham (2000) conducted a survey of individual investors with the objective to find out what information source investor depends on. The results explained that they are economical, sociological and psychological factors which control investment decisions. Madhusudhan V Jambodekar (1996) conducted his study to size-up the direction of mutual funds in investors and to identify factors that influence mutual fund investment decision. The study tells that open-ended scheme is most favored among other things and that income schemes and open-ended schemes are preferred over closed-ended and growth schemes. Newspapers are used as information source; safety of principal amount and investor services are priority points for investing in mutual funds. Some literature seems to find that there is only a slight positive relationship or no relationship at all between previous performance and current returns (Blake et al., 1993; Bogle, 1992; Brown and Goetzman, 1995; Brown et al., 1992). Others seem to be more conclusive about the relationship (Grin blatt and Titman, 1992; Hendricks et al., 1993). Goetzman and Ibbotson (1994) go as far as to show that a two- year performance is predictive of performance over the successive two years. It is no surprise then that prior returns are the most important source of new money flows into mutual funds (Carhart, 1997; Gruber, 1996; Ippolito, 1992). Even though funds are supposed to warn customers that previous returns do not guarantee future performance, a survey of 298 affluent investors found performance track record to be one of the four most important criteria for mutual fund selection (Capon et al., 1994).

On the question of why poorly performing funds still survive, Harless and Peterson (1998) explain that investors tend to choose funds based on previous performance but stick to these funds despite their poor returns.

Research Hypothesis

Based on extensive literature review the following hypotheses have been framed:

- **H_{01}:** There is a significant relationship between investment behaviour of an investor and fundamental factors affecting investment in mutual funds.
- **H_{02}:** There is a significant relationship between investment behavior of an investor and investor perception about the fund.

METHODOLOGY

Research Design and Research Method

Both exploratory as well as descriptive research designs were used in the study. Literature review, interview and focus group discussion methods of exploratory research design are used to generate and purify the pool of adoption items. Survey method of descriptive design is used to obtain the primary data with respect to investment in mutual funds. A self-administered structured questionnaire is used as survey instrument for primary data collection.

Survey Location and Target Population

The survey has been carried out in the SDMC region of Delhi. Individuals both males and females who have invested once in their life in mutual funds market are considered as target respondents for the survey.

Sampling Technique and Sampling Distribution

Proportionate quota sampling technique is used for the study. There are 104 wards under SDMC. For each of the 104 wards quotas are decided based on wards population in proportion to the total population of SDMC. A sample consisting of 226 citizens is used for the study.

Questionnaire Design

A two-stage research was designed to develop the questionnaire. Initially, a pool of attributes in probable seven factors influencing adoption of e-government services was formed based on the literature review. In the second stage, the initial pool of items was refined using the qualitative techniques of focus groups and in-depth interviews with investors.

Table 1: Constructs and Items of the Study

Constructs	*Items*
Past Performance [PP]	I consider before investing
Return [R]	I consider before investing
Risk [RI]	I consider before investing
Systematic Investment Plan [SIP]	I will prefer
Risk Diversification [RD]	I consider before investing
Liquidity [L]	I consider before investing
Professional Management [PM]	I consider before investing
Volatility [V]	I consider before investing
Experience of the fund manager [EFM]	I consider before investing
Investment [I]	I will continue
Date of Inception [DOI]	I consider before investing
Type [T]	It will impact
Debt to Equity balance [DE]	I consider before investing
Awareness [AW]	I am aware about various schemes and types

Based on the respondents' feedback, unclear words and sentences were revised and the placements of certain questions were also changed.

DATA ANALYSIS

Sample Profile

Out of 226 respondents surveyed 50.9% were males and 48.7% were females. 42% of the respondents are up to 25 years old, 29.2% of the population is between 26-35 years, 14.6% of the respondents were between 36-45 years and 15.2% were above 45 years. Majority of the investors invest up-to Rs. 100000 (68.6%). 23% investors invest between Rs. 100000-Rs. 250000 annually. Only 8.4% of the investors invest more than Rs.250000 in mutual funds.

Validity and Reliability

The items of the questionnaire were developed based on extant literature review, thus ensuring the content validity. The questionnaire was also pilot tested with a panel of investors, after which necessary changes were made to improve the content as well as clarity of the questionnaire. Then, a sample of respondents distinct from those included in the pilot test was asked to pre-test the questionnaire.

Table 2: KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		.915
Bartlett's Test of Sphericity	Approx. Chi-Square	1269.776
	df	78
	Sig.	.000

Here, KMO = 0.915 which indicates that the sample is adequate, and we may proceed with the Factor Analysis. Bartlett's Test of Sphericity Taking a 78% level of Significance, $\alpha = 0.05$ The p-value (Sig.) of .000 < 0.05, therefore the Factor Analysis is valid. As $p < \alpha$, we therefore reject the null hypothesis H0 and accept the alternate hypothesis (H1) that there may be statistically significant interrelationship between variable. The Kaiser-Meyer Olkin (KMO) and Bartlett's Test measure of sampling adequacy was used to examine the appropriateness of Factor Analysis. The approximate of Chi-square is 1269.776 with 0.915 degrees of freedom, which is significant at 0.05 Level of significance.

Model Testing

The hypothesis testing was concluded with 13 independent variables PP, R, RI, SIP, RD, L, PM, V, EFM, DOI, T, DE, AW and 1 dependent variable I.

Multiple regression analysis was used for hypothesis testing. First, we tested for regression assumptions. There was no autocorrelation as

Table 3: Variance and Eigen Values

Factors	*Total*	*% of Variance*	*Cumulative %*
1	6.065	46.652	46.652
2	1.166	8.969	55.621
3	.830	6.383	62.004
4	.778	5.982	67.986
5	.678	5.212	73.198
6	.601	4.623	77.821
7	.557	4.281	82.102
8	.517	3.975	86.077
9	.462	3.556	89.632
10	.392	3.018	92.651
11	.339	2.608	95.259
12	.333	2.561	97.820
13	.283	2.180	100.000

Table 4: Factor Loadings

Factor	*Factor Loading*	
	1	*2*
Professional mgmt. of fund (PM)	.809	
Experience of fund manager (EFM)	.807	
Risk (RI)	.700	
Diversification (RD)	.699	
Past performance of fund (PP)	.641	
Return (R)	.638	
Liquidity (L)	.585	
Volatility (V)	.579	
Sip (SIP)	.559	
Type (T)	.551	
Date of inception (DOI)		.825
Debt to equity balance (D/E)		.763
Awareness about various funds (AW)		.613

Table 5: Regression Result

Model	*R*	*R Square*	*Adjusted R Square*	*Std. Error of the Estimate*	*Durbin-Watson*
1	.836[a]	.704	.699	.79462	1.912

Table 6: Corellations

PP	*R*	*RI*	*SIP*	*RD*	*L*	*PM*	*V*	*EMF*	*DOI*	*T*	*DE*	*AW*	
PP	1	.480	.450	.385	.473	.378	.505	.422	.526	.295	.435	.412	.379
R		1	.564	.494	.523	.494	.465	.512	.448	.407	.530	.378	.357
RI			1	.417	.646	.389	.512	.426	.462	.315	.481	.355	.301
SIP				1	.332	.381	.347	.464	.417	.244	.478	.309	.309
RD					1	.514	.544	.407	.519	.340	.540	.414	.379
L						1	.429	.473	.441	.312	.441	.408	.253
PM							1	.421	.647	.204	.495	.302	.330
V								1	.436	.342	.430	.333	.352
EFM									1	.189	.471	.349	.294
DOI										1	.439	.528	.319
T											1	.446	.502
DE												1	.444
AW													1

the Durbin Watson statistic was 1.912 which is greater than 1. Correlation analysis was also done with the model constructs. The results reported in Table 6 show that correlation between all constructs was below 0.90, which is the threshold for significant correlation and that multicollinearity is not present.

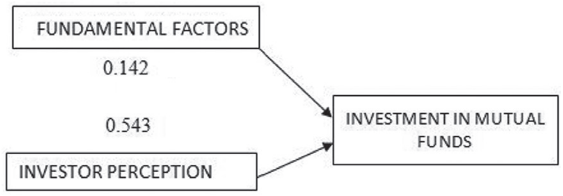

Figure 1

RESULTS

The model explains 55.6% variance in factors affecting investment in mutual funds. Fundamental factors such as past performance, experience of the fund manager, risk, return, diversification play a vey vital role in the decision-making process of an investor. Liquidity and volatility have a very minuscule impact on the investment in mutual funds by in large considering retail investors. Investors seek to take investment advice as they are risk averse and lack in depth knowledge about funds and its management.

Investors analyze past performing (NAV) of the fund before purchasing units in the fund. Retail investors' gathers information about the performance of various mutual funds mainly from brokers, financial consultants, financial institutions, internet, TV channels and magazines/newspapers respectively. The primary source of knowledge about mutual funds as an investment option is from sales representatives to most of the retail investor followed by internet, newspaper/journals, television and from friends /relatives.

Table 7

Variables		*Beta*	*t*	*Sig.*
	F1	.142	2.227	.027
	F2	.543	8.532	.000

Perception about certain factors lead the investor to invest into certain fund. The investor duly considers the date of inception of the fund and takes note of the time span and investor confidence to ensure security of its investment in mutual funds.

The investor can perceive extreme exposure of the fund to debt or equity according to its own personal bias and without proper knowledge and experience this can lead them to buy lesser performing funds. Mutual funds are gaining popularity. Even though the total money invested is small, but the number of investors is large, and they would like to invest more in these in future. Most of the investors invest once in a year, some invest once in six months and some on monthly basis investors with investment pattern as very rare are least. This infers that almost all investors follow a regular investment pattern. The level of satisfaction of investors regarding mutual fund based on risk exposure is average and that of overall experience is also average. Most of the investors accept the fact that investing in mutual fund will lead to economic development.

Factors which prevent investors from investing in mutual fund is mostly bitter experience and difficulty in selection of schemes to some extent is another preventing factor. Tax benefit, return potential, liquidity, low cost and transparency are the major factors that motivate a retail investor to invest in mutual fund. Economies of scale are also a motivating factor to a certain extent.

CONCLUSION

The study integrates constructs from the factors affecting investment in mutual funds into an insightful investment model [IM] for adoption. The results indicate that the fundamental factors and investor perception play a very vital role in the investment decision making process.

Research Implications

This project is limited to the study of certain selected factors and its effect on retail investors in their investment on mutual funds, analyzing retail investor's perception towards the mutual fund industry and the study is limited to New Delhi. Sample size of the study was limited to 226 only which may not represent the whole market. The study has not been conducted over an extended period considering both market ups and downs. The market state has a significant influence on the buying patterns and preferences of investors. The study cannot capture such situations. The study is limited to the investors of New Delhi only. Therefore, the inferences cannot be generalized.

Implications for Practice

The mutual fund product designers should craft strategies to introduce innovative products to improve the scope of the mutual funds market the makers of the fund who decide the various aspects of the scheme should innovate products in order to make a scheme that suits the investor need the most. The mutual funds should disclose the names of fund managers on the fund document itself. The scope of the mutual funds needs to be increased and more and more people should be able to enroll themselves in the schemes. Mutual funds should carry out confidence building measures to convince investors to invest in mutual funds.

The retail investors may be divided into various groups so that right product shall be served to the right customer the investors ae divided into various categories. Not all investors like to take risk and there are some retail investors who prefer to take risk while some investors want security or post-retirement benefits, etc. The funds should make schemes which could suit to investor needs. The right product should be able to reach the right investor.

To increase the loyalty and trust among the investors, proper information and knowledge should be provided to them.

Proper information dissemination should take place from the funds so as to build confidence among investors and build loyalty. Financial consultants must ensure transparency and responsibility and they should be capable of catering the needs of the retail investors as well as marketing the mutual fund products the financial consultants should give more weightage to customer needs and emotions rather than convince investors to invest in a scheme which offers them a higher commission.

Proper investor education should be undertaken. Mutual fund companies as well as mutual fund authority of India should ramp up its efforts to educate the investor and undertake measures on war footing to increase financial literacy among citizens. Government should also promote and encourage investments in mutual funds as they stabilize the securities market Government should also increase tax deductions in order to increase investment from people.

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