

Chapter 3

**LITERATURE REVIEW**

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### **INDEX**

<b>Sr No</b>	<b>Topic</b>	<b>Page No</b>
3	<b>LITERATURE REVIEW</b>	
3.1	Introduction	58
3.2	Base of Literature Review	58
3.3	Objectives of the Literature Review	58
3.4	Order of Literature Review	59
3.4.1	Literature related to Indian Mutual Funds.	59
3.4.2	Review of Literature on Mutual Funds in other countries	84
3.5	Major Findings of the Review of Literature	94

### **3.1 Introduction**

A critical literature review within a specific field or interest of research is one of the most essential activities in the process of the research. The purpose is to gain an insight of knowledge and ideas that have been established on the topic. This chapter will draw from such a pool of professionally shared knowledge and will undoubtedly contribute further to the traditional understandings in this field.

In this chapter, the available literature on the different aspects of this study and the host of facts that has contributed to the phenomenal growth of the industry is reviewed.

### **3.2 Base of Literature Review**

Literature review is carried out in two sections, the first being review of the research on mutual funds in India and second is the review of the research on mutual funds in other countries.

For literature review, available books on the subject are reviewed. Also the mutual fund research papers, surveys, research by Mutual Fund Companies are also reviewed.

### **3.3 Objectives of the Literature Review**

1. To get the conceptual awareness about the mutual funds in India and in other countries.
2. To understand the research work carried out by the researchers
3. To understand the investors response to mutual funds investment

4. To get insight of Index Funds
5. To understand researchers' perceptions about Index Funds.

### **3.4 Order of Literature Review**

The order of the literature review is carried on in two parts. The first part includes the review of literature related to Indian mutual funds while the second part related with the review of literature related to the mutual funds in other countries.

#### **3.4.1. Literature related to Indian Mutual Funds.**

The number of researches in India is comparatively less in India with respect to Mutual funds and Index Mutual Funds is low as compared to other developed nations. A number of articles and brief studies have been published in the financial dailies, periodicals, professional and research journals, explaining the basic concept of mutual funds, index mutual funds and highlighted their importance in Indian capital market environment.

They touch upon varied aspects like Regulation of Mutual Funds, Investors expectations, Investors response, evaluation of Index mutual funds, trends in mutual funds industry.

The literature review begins with the literature available in India in this aspect of the study.

**Dr. Sadhak H<sup>38</sup>** has explained in detail the growth of Indian mutual fund industry over a period of time. He has explained very neatly the benefits of

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<sup>38</sup>Sadhak H., Mutual Funds in India-Marketing Strategies and Investment Practices, new Delhi, Response Books, 2003.

the mutual funds and their benefits as well as risk involved in the investment in them Further, he has explained the recent changes in the regulations, practices, investment management, and strategies of marketing, various products of mutual funds, selling and distribution as well as services delivery systems. The book has suggested various ways of improvements in the strategic as well as operational practices of mutual funds are suggested keeping in mind the mechanisms used by the fund managers in developed economies. These include --

1. Measures to improve operational efficiency
2. Strict norms for the supervision of the mutual fund industry by the regulatory body.
3. Higher and strict standards of disclosure and managerial accountability
4. Ways for minimising risks by better planning so that the business cycles and liquidity planning is managed in a better way.
5. Strategies for product development, market expansion and improvement in service standards

Further in the context of extreme market volatility the book discussed the self regulatory organisation, corporate governance and related fiduciary responsibilities in mutual funds. Thus the book provides fund managers and investors a thorough analysis of mutual funds.

**Seema Vaid** <sup>39</sup> has discussed in details the conceptual and regulatory framework and the growth of mutual funds in India. The entire book is very comprehensive and it explains the technical terms and concepts in a very simple manner.

Further all the regulations and other aspects related to the regulatory framework have been covered extensively in the book. It also deals with the different types of schemes, classifications of the mutual fund schemes. The features and their importance and usefulness for the investors have been dealt with by this author in a precise manner. Another important feature of this book is that the growth of mutual funds in India has been examined by the author very critically. Thus this book is a guideline for researchers and readers interested in this area of study

**Venkatapath Raju** <sup>40</sup> has authored a book which explains in detail about the description about different types of products of mutual funds with their investment objectives. The book also tries to match the objectives of the mutual fund schemes with the investors' expectations from such schemes. The author has tried to match the expectations of the investors' expectations with the objectives of the mutual fund schemes so that the investors get a proper scheme for investment. A detailed explanation of various types of mutual funds schemes explains the benefits and limitations so that the investor can select the proper scheme. The book also attempts to provide information to assist to investor to assess their risk-return profile and accordingly choose the right product. One unique thing about the book is that it analyses the factors which motivates the mutual fund investors to take their investment decisions.

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<sup>39</sup>Vaid Seema, Mutual Fund Operations in India, Varanasi, Rishi Publications, 1994.

<sup>40</sup>Raju Venkatapathi, Mutual Funds in India-Investors' perceptions, new Delhi, Quality Publishing Company, 2000.

**Amithabh Gupta** <sup>41</sup> has evaluated in details about the comparative performance of the mutual funds schemes in his book. For the comparison purpose he has selected the period of five years. The period is from 1<sup>st</sup> April 1994 to 31<sup>st</sup> March 1999. The author has explained with examples the abilities of Indian mutual fund managers to time the market and to beat the market. The author has explained that the structural changes which took place in the Indian mutual fund industry have changed the investment pattern of the investment. The book explains the regulatory and structural changes in the industry from the period 1987 to 2001. The book was written with one more objective of evaluating some milestone mutual fund schemes. For instance it has explained the investor's response and reactions on the crisis which was raised after the collapse of US-64 scheme of UTI. The book touches various aspects of this collapse which has long lasting effects on the investors' psychology. The author has pointed out that investors take the decisions which are governed mainly by the emotions of the investors.

The book also examines the regulatory frame work of mutual funds also. It describes the growth of mutual fund industry in India and it also attempts to test the market timing ability of fund managers. The book attempts to find whether the risk-return characteristics of mutual fund schemes are in conformity with their stated objectives, whether the Indian mutual funds have been able to achieve benefits of repurchases exceeding sales.

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<sup>41</sup>Gupta Amitabh, A Study of Investment Management , New Delhi, Anmol Publications, 2002.

**L. C. Gupta**<sup>42</sup> carried out the survey of the small investors in April 1992. The major respondents of his survey were the household investors. The objective of his survey was to create the data base of information showing the preferences of the investors for various investment options including mutual fund investments. He observed that small investors are more worried about their principal amount invested than returns on the same. He further observed that investors are not ready to take risk beyond a certain limit even it may create the opportunity for better returns. The findings of the study provide a clear picture of the perceptions of the investors and their preferences for different savings instruments with emphasis of safety, risk and returns.

**Vivek Bhalla**<sup>43</sup> explained the topics related to the areas of investment environment in his book. He has unfolded the topics in to related chapters covering specific areas of alternative investment outlets for funds, security analysis, portfolio analysis and management, financial derivatives and international financial flows. The book is in very lucid language and it describes techniques, vehicles and strategies for planning, implementing and overseeing the optimal allocation of the funds of an investor or an institution in the changing environment. The book is useful for the investors and the financial experts who are already aware of the basic terminologies and concepts of mutual fund investments.

**Mr. Raju and Sahadevan**<sup>44</sup> have contributed by studying the operating expenses of the mutual funds in India. They studied the mutual fund

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<sup>42</sup>Gupta LC, Mutual Funds and Assets Preference Household Investors Survey, New Delhi, Society for Capital Market Research and Development, 1994.

<sup>43</sup> Bhalla V.K., Investment Management-Security Analysis and Portfolio Management, new Delhi, S.Chand and Co Publishers, 2005

<sup>44</sup> Sahadevan and Raju, MT, Mutual Funds, Data Interpretation and Analysis, new Delhi, Prentice Hall of India Pvt Ltd, 1996

expenses and other related aspects which are generally covered in annual reports of the mutual funds without going into the details of financial performance evaluation of the funds. The book has presented the different forms of expense incurred by a fund and how the expenses are shown in the company annual reports. This book is useful for the students and scholars having interest in accounting and the management areas.

**S. Sankaran**<sup>45</sup> has described in detail working of mutual funds for the retail investors. The book also describes the significance of mutual funds as suitable investment avenue which takes care of varied needs of investors. The book is very useful for the new investors as it gives insights into how mutual funds work the types of mutual funds and their investment strategies and portfolio compositions. The book also deals with the regulatory and legal structure and the operating expenses of the mutual funds in a comprehensive manner.

**Rachna Baid**<sup>46</sup> has authored a book on mutual funds, their products, and various services provided by the mutual fund companies. The book is logically divided into various chapters as below

- Concept of mutual funds
- Role of mutual funds
- Organization of mutual funds,
- Accounting and valuation
- Investment management
- Development of model portfolios and the unit holders' protection.

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<sup>45</sup>Sundar Sankaran, Indian Mutual Funds Handbook, new Delhi, Vision Books, 2003.

<sup>46</sup>Baid Rachna, Mutual Funds Products and Services, New Delhi, Taxman Publications(P)Ltd, 2007.

The book covers the overall information about the mutual fund working..

**Amit Singh Sisodiya** <sup>47</sup> has focused the journey of the mutual fund industry development in India. The book has highlighted the milestones in the development of the mutual fund industry in the country. It has also explained various phases of the industry over four decades of existence and how increased deregulation paved the way for a healthy competition which benefited both the investors and the industry players. This book is a very good attempt to offer incisive insights into the Indian mutual fund industry.

**Amit Singh Sisodiya, Azala Reddy & Feroz Zaheer** <sup>48</sup> have authored a book on the development phases of mutual fund industry and the emergence of the mutual fund industry as a major force in Indian financial market. The authors observed that with the total AUM increasing from Rs. 1,01,565 crores in January 2000 to Rs.1,75,918 crores by the year 2005, the industry growth has been very rapid and outstanding. According to the authors, the vibrant development in the economy backed by the booming stock market is the major reasons behind such a radical development of the mutual fund industry.

**Shishir Kumar** <sup>49</sup> has explained the need for a strong network for distribution and model for the mutual fund industry in India. He has also explained the work of mutual fund to capture the huge untapped market in the country.

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<sup>47</sup> Sisodiya Amit Singh, Mutual Fund Industry in India-An Introduction, ICFAI university press

<sup>48</sup>Sisodiya Amit Singh, Reddy Aala Santosh & Zaheer Feroz, "On a Growth Trail", Mutual Fund Industry in India –An Introduction, ICFAI University press

<sup>49</sup>Kumar Shishir and Sisodiya Singh, "Evolving Distribution Models.", Mutual Fund Industry in India-An introduction, ICFAI university press

The author observed that the intensifying competition and the need to attain economies of scale are forcing industry players to increase their reach in non-metro cities and small towns, where the potential is high but penetration is low.

This has resulted in fund houses exploring innovative distribution channels like Depository and Distributor models along with the traditional ones like collection centre model. Further increasing commodization and growing need of the customers are forcing players to shift to solution-based models from the product-based ones.

**Abhinav Jain**<sup>50</sup> has focused in his book on the long run effects of the changes in the economic conditions on the capital market and mutual fund industry. He has also explained the importance of consolidation phase in the overall economy. The book also talks about the effects of mergers and takeovers in the mutual fund industry and its effects on the investment environment. Many small players in the industry are being taken over by the big mutual fund companies while some foreign players are also pulling out of the country. All these events have favorable as well as adverse effect on the economic environment of the country. The book is useful for the study of macro parameters of the mutual fund industry and the concerned factors.

**Sharad Jutur and Rajesh**<sup>51</sup> have focused on the introduction of Gold Exchange Traded Funds in India emerged in a new era in the market for gold. It is observed that historically gold has been the best hedge against

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<sup>50</sup>Jain Abhivan “The Consolidation Spree”, Mutual Fund Industry in India-An introduction, ICFAI university press

<sup>51</sup> Rajeshwer and Jutur Sharat,”Gold Exchange Traded Funds-Enter India”, Mutual Fund Industry in India-An introduction, ICFAI university press(publication division)

inflation. As mentioned in the book, the purchasing power of the gold has remained unchanged since the ancient age. In the investment field, gold has always enjoyed always a unique status. It is considered as one of the best investment options and it is most liquid form of asset.

Units of the Gold ETFs are expected to get better returns than the physical gold as they can be traded in the stock market and their liquidity is per the liquidity of the equity shares. The author feels that gold ETFs are going to open a new dimension in the industry in coming years.

**Naidu Kumarswamy G and Sravana Kumar B**<sup>52</sup> have concentrated their study on gold Exchange Traded Funds. They have explained that the investment in gold ETF is cheaper and simpler way of investment in gold than the traditional purchase of gold. The gold ETFs are like the trading in stock market which gives the benefit of the real time value of the gold. Further they can be used for speculation also in the short term. Gold ETFs are very much liquid in nature and the investors can liquidate it fully or partly as per his need. It also eliminates the maintenance cost. However the researchers point it out that the investors should be well aware about the transactions and other regulations related to gold ETFs.

**Amit Sisodiya and Y. Bala Bharathi,**<sup>53</sup> concentrated on a new type of the fund called as Arbitrage Funds. As explained in the study, Arbitrage funds exploit the differences of stock prices between the cash segment and derivative segment of the market. Hence makes possible for the investors to benefit from such opportunities at lower costs than the stock

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<sup>52</sup>Kumarswamy Naidu G And Sravana Kumar B,” The Gold ETFs-The Nifty-Gritty,” Mutual Fund Industry in India-An introduction, ICFAI university press

<sup>53</sup>Sisodiya Amit Singh and Bala Bharati Y.”Arbitrage Funds in India: Leveraging the Derivatives Markets”, Mutual Fund Industry in India-An Introduction, ICFAI University press

market investors. The idea of arbitrage funds is growing slowly in India as compared to other developing economies. The idea is that stock prices in cash/spot market always differ from those in the derivatives market. The arbitrageur simultaneously purchase and sell the underlying security to gain risk-free profits from the transactions. Arbitrage funds are effectively & efficiently developed from the market fluctuations to provide market neutral returns.

**Bansal Manish**<sup>54</sup>, details an eight-step strategy for the Indian mutual fund industry so as to achieve greater penetration and hence fuel its growth. Some of the major recommendations of the article are-

- Migrate from ‘industry to ‘opportunity zone’.
- Revisit mutual funds’ core competence
- Rebuild investors’ confidence
- Manage risks through derivatives
- Treat investors like customers

**Madhusudan and Jambodekar V**<sup>55</sup> studied the marketing strategies of mutual fund companies to get the business from the prospective investors. They also carried on a survey to find out the awareness amongst the common investors regarding mutual fund investments. They tried to find out the factors and the information sources which influence the buying decision of the mutual fund investors. The study concluded that that Income Schemes and Open Ended Schemes are more preferred than Growth Schemes and Close Ended Schemes. Investors give preference to

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<sup>54</sup>Bansal Manish, “Mutual Funds-Eight Steps to Nirvana”, Mutual Fund Industry in India-An Introduction, ICFAI University press.

<sup>55</sup> Madhusudan Jambodekar V,,” Marketing Strategies of Mutual Funds-Current Practices and Future Directions”, Working paper, UTI-IIMB Centre for Capital markets Education and Research, Bangalore 1996

the liquidity of their investments. Hence they prefer open ended schemes over close ended schemes. The study also found out that newspapers and Magazines are the most preferred source of information for the investors for taking their investment decisions.

**Jaideep Sarkar and Sudip Majumdar**<sup>56</sup> studied the performance of mutual fund schemes. They selected five growth oriented schemes for the period February 1991 to August 1993. They used the technique of CAPM for measuring to evaluate the performance of these schemes. They evaluated the boom period performance of these schemes also. Their conclusions include that the mutual fund schemes have not delivered better returns during the study period than the market in common.

**Raychaudhuri Arjun**<sup>57</sup> studied the mutual fund performance in India from the year 2001 to the year 2004. The study measured the performance of the mutual funds and concluded that there is wide gap between the predictions and the actual performance of the mutual fund schemes. The author has used various tests from the literature to study the persistence in the mutual fund market. Based on the outcomes of the study the author has concluded that the predictions for the longer term are more accurate than that of the short term period. He has concluded that the investors should apply his own judgment along with the predictions given by the mutual fund scheme while taking buying decisions.

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<sup>56</sup>Sarkar Jaideep and Majumdar Sudip," Performance Evaluation of Mutual Funds in India", NMIS Management Review, Vol. VI, No 2, July-Dec 1994, pp 64-78

<sup>57</sup>Raychaudhuri Arjun," Persistence in the Indian Mutual Fund Market, "The ICAI Journal of Financial Economics, Vol III, Issue 1, 2005, pp 6-25

**Barua**<sup>58</sup> concentrated on a specific scheme of the mutual fund namely MasterShare. The scheme was launched by the UTI AMC. The author has studied the scheme from the investors' point of view. He has used the CAPM technique by relating the relative risk and returns of the investment in MasterShare. He used the benchmark of Economic Times Ordinary Share Price Index. He pointed out the importance and issues for the regulation of mutual funds in 1993 by SEBI. According to the author these rules which are framed regulations for mutual funds would have long run effects on mutual fund industry in India.

**Susan Thomas and Ajay Shah**<sup>59</sup> studied the performance of the selected mutual fund schemes. They selected 11 mutual fund schemes and studied the performance evaluation of these schemes on the basis of market price data. They computed returns for these schemes on weekly basis since their inception. All the schemes were evaluated by using Sharpe measures. They have concluded with specific conclusions like they have mentioned that except UGS 2000 of UTI, none of the schemes earned superior returns that the market in general. They further mentioned that risk of these schemes was very high and funds were not adequately diversified.

**Sujit Sikidar and Amrit Pal Singh**<sup>60</sup> conducted a survey with an objective of understanding the behavioral aspects of the investors of the mutual funds. They selected the geographical area of the North Eastern region for their study. The survey concluded that the salaried and self employed were the major investors in mutual fund primarily due to tax

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<sup>58</sup>Barua Samir K,"A Regulatory Framework for Mutual Funds, "Economic and Political Weekly, May 25,1991,pp 55-59

<sup>59</sup>Shah Ajay and Susan Thomas," Performance Evaluation of Professional Portfolio management in India", A paper by CMIE, April 1994

<sup>60</sup>Sujit Sikidar and Amrit Pal Singh ,"Financial Services: Investment in Equity and Mutual Funds-A behavioral Study "Management of Financial Services, new Delhi, Deep and Deep Publications,1996

concessions. UTI and SBI schemes were popular in that part of the nation and other funds had not proved to be very popular during the time when survey was done.

**Syama Sunder**<sup>61</sup> carried out the survey to study to growth prospects of mutual funds and investors perceptions with special reference to Kothari Pioneer mutual funds. The study concluded that the awareness about Mutual Fund concept was very low during time in small cities. The main conclusions of the study include

- Agents play a vital role in developing the mutual fund culture
- Open ended schemes were much preferred over the closed ended schemes
- Age and income are the two important factors which determine the selection of the fund schemes
- Investors consider the brand image and returns of the mutual fund schemes while taking the buying decisions

**Kaura and Jayadev**<sup>62</sup> carried out the study of evaluation of the performance of five growth oriented schemes in the year 1993-1994. They used the techniques of sharpe, Treynor and Jensen measures. Out of the five mutual fund schemes studied by the researchers, MasterGain-91, Can-

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<sup>61</sup> Sunder Syama ,”Growth Prospects of Mutual Funds and Investor perception with special reference to Kothari Pioneer Mutual Fund, Project Report, Sri Srinivas, Andhra University, 1998.

<sup>62</sup>Kaura and JayaDev,” Performance of Growth Oriented Mutual Funds :An evaluation”, The ICFAI Journal of Applied Finance, Vol 1,No1, January 1995, pp 1-14

Bonus schemes performed better than other schemes and market in terms of SIPs.

**Shukla Sharad, Kulraj J and Vikraman Shaji**<sup>63</sup> studied in their articles whether there is any relationship between the past performance of a particular mutual fund scheme and its future performance. They conducted this evaluation of mutual funds schemes by comparing the changes in NAVs. However these analyses were purely for short period and ignored the concept of risk. These articles were published in financial dailies like Financial Express, Economic Times, Business Standard and the periodicals like Dalal Street, etc.

**Jayant Sarkar**<sup>64</sup> evaluated financial performance of five close-ended growth funds to find out whether there is relationship between the lock-in of funds and performance of the schemes. However he concluded that there is no any direct relationship between these two factors as the performance of the selected schemes was below average and fund possessed high risk as well.

**Gupta and Sehgal**<sup>65</sup> studied the mutual fund schemes' performance over a four year period from the year 1992 to the year 1996. This study is very much useful because when it comes to performance evaluation, there are different techniques of evaluation and the authors have selected the method of benchmark comparison and the sample schemes selected for the purpose of study. Both the researchers studied 80 mutual fund schemes in their

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<sup>63</sup> Shukla, Sharad "Mutual Funds" Past Performance is no indicator of the Future", The Economic Times June 1<sup>st</sup>, 1992.

<sup>64</sup> Sarkar Jaideep, "Performance Evaluation of Mutual Funds in India", NMIS Management Review, Vol. VI, No 2, July-Dec 1994, pp 64-78

<sup>65</sup> Gupta O.P. and Sehgal, "Investment Performance of Mutual Funds- The Indian Experience", "Indian Capital Market", Tata McGraw Hill Publishing Company 1997.

research process. They concluded that mutual fund industry performed well during the period of the study. The performance was well evaluated in terms of benchmark comparison, performance from one period to the next period during the process of the study.

**Sondhi<sup>66</sup>** has examined the financial results of the selected equity oriented mutual fund schemes. He has concentrated on the size of the mutual fund scheme vis-a-vis its financial result. The method and technique used in the study are very much systematic and the results of the study are also displayed very logically and in a systematic manner.

**Jayadev M<sup>67</sup>** carried on the study for comparison of the performance of the selected mutual fund schemes. He selected around 62 mutual fund schemes from different AMCs and he studied the performance of the funds for the period from the year 1987 to the year 1995. He concluded that very few funds were able to outperform the market index for the period of the study. He has also pointed out that the schemes which are labeled as the diversified schemes are not always diversified in real sense. He has concluded that the mutual fund industry should develop a better transparent product for the retail investors.

**Dave S A<sup>68</sup>** has explained the performance of mutual fund industry and has reviewed the performance of individual funds. According to the researcher the mutual fund industry performance has not been very satisfactory in spite of the improved fundamentals. The researcher has concentrated on the wrong investments and agency. According to him the

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<sup>66</sup> Sondhi, H,2004,Financial Performance of Indian Mutual Funds, IIT ,New Delhi

<sup>67</sup> Jaydev m, "Mutual Fund Performance: An Analysis of Monthly Returns, "Finance India Vol.X, No 1, march 1996,pp 73-84

<sup>68</sup>Dave S.A.-"The Challenges of the Mutual Fund Industry", Tata McGraw Hill Publishing company Ltd., New Delhi, 1998,pp 15-17

Indian economy has shown good performance. The GDP growth rate has been very good, the savings rate has increased and the corporate earnings have improved during the period of study. He feels that the mutual fund industry must try to restore its image as early as possible by individual and collective acts to restore the faith of investors in the mutual fund industry.

**Susan T.**<sup>69</sup> has tried to evaluate the performance of Indian mutual funds for a specific period of time. The study deals with the evaluation of the fund managers' ability to beat the benchmark index. Thus the paper has compared the active investment with the passive investment. A fund manager who beats the benchmark index consistently is referred as the manager adding the value to investors' funds. She has used the Jensen's measure and Sharpe ratio to evaluate the performance of the selected mutual funds. The paper has studied the performance of funds mainly during the year 1994-95.

**Kulkarni Vivek**<sup>70</sup> answered the basic questions related to the performance evaluation. In his article related to the topic of evaluation of mutual fund schemes he explained following things-

- The framework for good performance evaluation
- Methodology of CRISIL's risk measurement
- Influence of fund management fees in a performance evaluation

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<sup>69</sup>Thomas Susan, "Performance evaluation of Indian Funds", Tata McGRaw Hill Publishing Company Ltd., New Delhi, 1998, pp 23-31

<sup>70</sup> Kulkarni Vivek, "Fund Evaluation at CRISIL", Tata McGraw hill Publishing Company Ltd, New Delhi, 1998, pp 33-35

- Norms for comparison with benchmark index.

According to him, the benchmark must facilitate a fair comparison in a risk return framework. He also strongly pointed out that the fund managers do not have access to liquid and cheap sources of funds. Some of the other factors according to him which are very important are the services that the investor gets the repurchase facility and redemption schemes.

**Hudson Julie**,<sup>71</sup> has provided the idea about selection of benchmark, using Sharpe measure for evaluation of portfolio performance. He has also explained the method of calculating of tracking error. The researcher has concluded that the progress of mutual fund industry in India is a fairly good and has established good reporting standard.

**Chakrabarti and Harsha Rung**<sup>72</sup> studied in-depth the creditability of mutual fund schemes with focus on private sector equity funds. The inference of the study revealed that there is no one to one correspondence between performance by return and performance risk-adjusted returns. The authors have studied the risk-return characteristics of selected major equity based private mutual funds companies.

**Gupta Amitab**<sup>73</sup> has studied the investment management of the mutual fund companies in India. He has evaluated the schemes with related to BSE Sensex index to find out whether the schemes have been able to beat the index. The researcher author examined whether the returns were

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<sup>71</sup>Hudson Julie,” Issues in Performance Evaluation”, Tata McGraw Hill Publishing Company Ltd, new Delhi,1998 pp37-43

<sup>72</sup> Chakrabarti and Harsha Rung “Mutual Funds Industry in India. An in-depth look into the problems of creditability, risk and brand” The ICFAI Journal of Applied Science, volume 6 April 2000.

<sup>73</sup>Amitab Gupta” Mutual Funds in India: A study of Investment Management” Finance India Vol,XV No 2, June 2001,pp 631-637

commensurate with the risk undertaken by the fund managers and evaluated market timing abilities of the fund managers. The results of the study indicated that around 38 schemes (nearly 52%) earned higher returns in comparison to the market return while the remaining 35 schemes (48%) generated lower returns than that of the market. Thus the author points it out that it possible for the individual fund managers to beat the market index.

**Narasimhan M S and Vijayalakshmi S<sup>7475</sup>**, studied the performance of around 75 mutual fund schemes on two aspects. The first aspect considered for the study is of diversification level by the fund scheme and the second is about the timing ability of the fund managers. The fund schemes selected for the study were from different AMCs. The study then compared the average returns, standard deviation and co-efficient of variation of these stocks, it is found that in almost all cases the risk level is high compared to the returns. The study pointed out that the diversification of most of the mutual fund schemes selected for the study was almost same. It indicates that almost all the schemes offer the same level of diversification. Thus an investor investing any of the diversified schemes get almost same benefits of diversification. The difference in the returns by the different schemes is because of the timing abilities of the fund managers. Thus the crucial point for the selection of the scheme for the investment is the fund manager's ability to time the market. However, barring few exceptions, as pointed out in the study, time the market is very difficult activity for the managers particularly in the long run.

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<sup>75</sup>M S Narasimhan and Vijayalakshmi S, "Performance Analysis of Mutual Funds in India" *Finance India* Vol XV No 1, March 2001, pp 155-174

**Tarun M. S., Bodla B.S. and Mehta Sushil Kumar**<sup>76</sup> studied the performance of 54 listed schemes of mutual funds on the basis of weekly data of NAVs. For this purpose, besides risk and return analysis, the risk adjusted performance measurements have been employed. The study has included schemes from various sectors and the measure of risk was calculated. The study pointed out that there is a considerable low level of risk which is associated with the selected schemes, irrespective of the sector concerned.

**Biswasdeep Mishra**<sup>77</sup> tried to compare the timing and selectivity skills of mutual funds. In his research article he has tried to test to non-stationary of mutual fund betas and finds out the cause of non-stationary beta. The study concluded that the selected mutual fund schemes had no timing ability, even though at individual level some fund managers had timing abilities. They have concluded that it is very difficult for an individual manager to time the market consistently over a longer duration of time.

**Ramesh Chander**<sup>78</sup> explained the process of performance of mutual funds in India. He has suggested using Sharpe, Treynor and Jensen for better evaluation. The paper examined the portfolio management practices of mutual fund managers with respect to construction of the portfolios, portfolio evaluation and disclosure of the policies and practices to the investors. This study is useful for the students of the mutual fund filed as well for the portfolio managers as it covers all important areas of constructing a portfolio management.

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<sup>76</sup>Taran MS,Bodla B S and Mehta Sushil Kumar” Performance Evaluation of Listed Schemes of Mutual funds” Management Researcher, Vol VIII, No 1 & 2 July –December 2001,pp 38-66

<sup>77</sup> Biswasdeep Mishra-“Selectivity and Timing Skills of Mutual Funds in India : An empirical Analysis “, The ICFAI Journal of Applied Finance, Volume 8,No 5,Sept 2002,pp 5-16

<sup>78</sup>Ramesh Chandra ,”Performance Appraisal of Mutual Funds in India” Excel Books, New Delhi, 2002, pp 79-110

**Social Audit Committee**<sup>79</sup> has given its report on the study of mutual fund schemes and their performance. This committee was constituted by UTI in 1984 under the chairmanship of Justice M.H.Kania who is the former Chief Justice of India. The social audit committee evaluated the performance of UTI from various dimensions, such as return on investments of the investors, investor services and satisfaction of employees and agents of UTI. The main findings of the committee report are as follows :

- From the investors' point of view, UTI is regarded as progressive institution in financial sector. The institute is managing the funds most efficiently with low expense ratio. However, some of the investors have deteriorated their investment amount. Further, UTI doesn't have enough transparency in respect of its investments, particularly the US 64. The scheme has not disclosed the NAV details to the common investors which crated chaos amongst them.
- Unit Scheme 64 (US64) and various other monthly Income schemes have consistently yielded more than interest rate on bank deposits. The Mastershare Scheme has higher return that the BSE SENSEX during 1988 to 1991. However, after 1992 the performance was poor.

The committee concluded that the research covering large number of funds for a long-term, has not yet developed in our country.

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<sup>79</sup> Report of the Social Audit Committee, Unit Trust of India, Report published in 1998

**Value Research India Pvt Ltd**<sup>80</sup> carried a survey during the period June, 2000 to December, 2001. The agency studied the performance of the selected mutual fund schemes. The mutual fund schemes were examined and the study concluded that out of 85 schemes 15 schemes gave negative returns. Out of these 15 schemes 13 were growth schemes. Very important observation of this study is that one of the income schemes has delivered returns above 20 percent. The risk adjusted returns of these schemes outperformed the index even in bear phase. The study concluded that overall Indian mutual funds are safe on the whole for investment purpose however the investors should study their present portfolio and asset allocation before adding any new mutual fund investment in their portfolios.

**Fernandes Kshama**<sup>81</sup>, tried to evaluate the process and developments of index funds implementation in India. In this working paper, tracking error of index funds in India is measured by the author. He has pointed out that it is possible for many of the index fund managers in India to lower the tracking error by applying professional management. He has also pointed out that many of the index fund managers are deviating from the basic principles of index investment which is dangerous for the investors.

**Ranganathan Kavitha**<sup>82</sup> has focused on a very critical aspect of the investment by the small investors. She has studied about the behavioral finance. The author has pointed out that it is difficult to predict the behavior of a small investor during a particular economic situation. She

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<sup>80</sup> Value Research India Pvt Ltd, "Mutual Fund Survey-2000-2001," New Delhi, 2001

<sup>81</sup> Fernandes Kshama, "Evaluating Index Funds Implementation in India," Working Paper, <http://www.nseindia.com/content/research/paper66.pdf>

<sup>82</sup> Ranganathan Kavitha, "A Study of Fund Selection Behavior of Individual Investors Towards Mutual Funds-with Reference to Mumbai City", Indian Institute of Capital Market ,9<sup>th</sup> Capital Market Conference Paper, 2006.

has pointed out that investors do read and observe the views of the experts in the financial sector before taking the investment decision, however it cannot be assured that they will behave in the same manner at the time of taking final decision of the investments. The author has studied to examine the behavior related aspects of the fund selection of individual investors towards mutual funds, in the city of Mumbai. This study is useful for the academicians as well as for the practitioners as it gives new dimensions to understand the psychology of the mutual fund investors.

**Bijan Roy**<sup>83</sup> carried on a study using a new technique called as conditional performance evaluation. The study was conducted for 89 schemes of various mutual fund companies. The technique of conditional performance evaluation refers to the evaluation of the scheme under various conditions. The conditions include the existence of normal conditions in stock market over a longer period of time. The study has pointed out that this technique gives better platform for evaluation.

**Sehgal Sanjay and Manoj Jhanwar**<sup>84</sup> focused their study on the aspect of the performance of the mutual fund schemes in the short term. The authors concluded that it is very difficult to predict the performance of the mutual fund schemes in the short run. It is found in the study that there is no evidence confirms persistence using monthly data. Using daily data it has been observed by the researchers that for fund schemes sorted on prior period four factor abnormal returns.

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<sup>83</sup> Roy Bijan Saiket Sovan Deb," The conditional performance of Indian mutual funds: an empirical study", Working paper, <http://papers.ssrn.com/so13/papers.cfm/abstract>

<sup>84</sup> Sehgal Sanjay and Manoj Jhanwar," Short-Term Persistence in Mutual Funds Performance: Evidence from India",10<sup>th</sup> Capital markets Conference, Indian Institute of Capital markets, [www.ssrn.com](http://www.ssrn.com)

**Panwas Sharad and Madumathi R**<sup>85</sup> studied in their study using sample of public sector sponsored and private sector sponsored mutual funds. The study was carried on for the period of the year 2002 to 2005. They selected the funds of varied net assets to investigate the differences in characteristics of assets held, portfolio diversification and variable effects of diversification on investment performance. The study found that public sector sponsored funds do not differ significantly from private-sector sponsored funds in terms of average returns percent. However there was a significant difference between public sector sponsored mutual funds and private sector sponsored mutual funds in terms of average standard deviation & average variance.

**Ferruz Luis and Ortiz Cristina**<sup>86</sup> have concentrated on a different aspect of the mutual fund management. They have tried to study whether the classification of the mutual funds really bifurcate the investment pattern and investment related risk. They have also pointed out that the mutual fund industry has undergone spectacular growth in recent years. This has made it very essential to study this aspect both from the angle of the industry and from the angle of the investors as well.

**Prof. Athma Prashanta, Kumar K. Raj**<sup>87</sup> explained the comparison of Exchange-Traded Fund (ETF) and Index Funds in their study. They have strongly pointed it out that there are innovative products and have good combination of many of the other investment options in mutual fund and stock market. The authors have tried to explain in a lucid language the

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<sup>85</sup>Panwas Sharad and Madhumathi R,” Characteristics and performance evaluation of selected mutual funds in India” Indian Institute of Capital Markets, 9<sup>th</sup> Capital markets’ Conference Paper,2006.

<sup>86</sup>Ferruz Luis and Ortiz Cristina-,”Does Mutual Fund Management in India Correspond to its investment objective classification?”,[www.ssrn.com](http://www.ssrn.com)

<sup>87</sup> Prof Athma Prashanat, Kumar K Raj – ETF vis-à-vis index funds: An evaluation.” Dept of Commerce , University College for Women, Osmania University, Koti, Hyderabad.,Year 2009

usefulness of the ETFs as well as index funds for the common investors who are not aware of the market terminologies and market workings. The study covers the trends and progress of ETFs and Index Funds in India and to evaluate the performance of ETFs vis-à-vis Index Funds in India. The study is based on the data and covering the period of five years from 2005 to 2009 for the purpose of evaluating performance of select ETFs and Index Funds in India. The authors have collected the data since inception of the funds for the purpose of analyzing trends and progress of ETFs and Index funds in India. The parameters for evaluating the performance are NAVs of the respective funds, Risk, Return, Expenses Ratio, Tracking Errors of the index funds, Reward to Variability and Differential Return. The statistical tools like Standard Deviation, Beta, Alpha, R-squared and Sharpe Ratio are used for data analysis. It is concluded that ETFs have given a good opportunity for the small investors in terms of diversified portfolio with a small amount of money; low expense ratio, reduced tracking error, lower risk and volatility as compared to Index Funds. The ETFs can become a best investment alternative, provided, awareness is created among the investors.

**Dr Ram Sahebrao Zaware<sup>88</sup>** concentrated on comparative study of selected diversified and sectoral mutual funds for the period of year 1995 to year 2000. He has explained how some mutual fund schemes delivered good returns to the investors during this period. He further pointed out that though the performance of selective mutual funds was attractive, overall performance of mutual funds schemes was poor.

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<sup>88</sup> Dr Ram Zaware-“ A study of performance of diversified mutual funds” year 2000.

**S. N. Rao**<sup>89</sup> has compared the performance of Indian mutual funds in bullish market with the performance in bearish market. He has explained how the funds performed in bearish market. He has used the concepts of Treynor's ratio, Sharpe ratio, relative performance index, risk-return analysis, Sharpe's measure, Jensen's measure, and Fama's measure. The book has evaluated in total 269 open-ended mutual fund schemes for computing these ratios and for evaluation purpose. The author has also studied how these funds succeeded / failed to beat the benchmark index of the funds by computing relative performance index. Then after excluding funds whose returns are less than risk-free returns, 58 schemes are finally used for further analysis. The results of performance measures suggest that most of mutual fund schemes in the sample of 58 were able to satisfy investor's expectations by giving excess returns over expected returns based on both premium for systematic risk and total risk

**The General Accounting Office**<sup>90</sup> published the report in the year 2000. The office has expressed in the report that the disclosures of the mutual fund schemes should be more clear and transparent. The report further points out that the disclosures by the mutual fund companies are not sufficient for the retail investors to understand the exact amount of fees he has to pay for the investment in mutual funds. The report points out that unless there is transparency in the workings and disclosure of the mutual fund schemes, it is difficult to gain the confidence of the small investors.

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<sup>89</sup> S.Narayan Rao "Evaluation of Indian Mutual Funds in Bearish Market" Year 2002, The Management Accountant

<sup>90</sup>The General Accounting Office – "Mutual Fund Expenses & Investors" Behavior " Paper published in 2000

**Kshama Fernandes**<sup>91</sup> has evaluated the process of implementation of index fund in India. The researcher has mainly studied the tracking errors of the index funds in India. He has pointed out that it is possible for the index funds in India to reduce their tracking errors and has suggested many ways to reduce the tracking error. He has also pointed out that due to the pressure of beating the benchmark index performance, some of the index fund managers deviate from the basic rules of index investing which is not the right thing for the investors.

### **3.4.2. Review of Literature on Mutual Funds in other countries**

In other countries, mutual funds have a long history in terms of number years of its existence. The advanced research of mutual fund performance evaluation has contributed a lot to the wealth of knowledge.. A brief review of the same is as below

**Sharpe W.F.**<sup>92</sup> has done the remarkable work in the area of developing a tool for the measurement of the performance of the mutual funds. He developed a tool which consisted a measurement of relationship between risk and return. This tool then became popular and is known as Sharpe's ratio that considers both risk and return. He evaluated the performance of 34 open ended mutual funds during the period 1944-63 by the measures developed by him. He concluded that the average mutual fund performance was very much inferior to an investment in the Benchmark. It was also revealed in his study that good performance should always be associated with low expenses ratio and only low relationship was discovered between fund size and performance.

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<sup>91</sup> Kshama Fernandes –Evaluation of Index Fund Implementation in India. Year 2003

<sup>92</sup> Sharpe.William F., “Mutual Fund Performance “Journal of Business ,39,1966,119-138

Sharpe classified for the first time, the mutual fund schemes as below which is characteristics-based style analysis

- Value Funds
- Growth Funds
- Small-cap Funds
- Large Cap Funds
- Income Funds etc,

This classification is based on portfolio's and benchmark's current and / or historical holdings and its security weights and is considered to be the most powerful and comprehensive approach.

Sharpe also analyzed returns-based style analysis which is a statistical technique. The approach is based on multi-index model which suggests that a portfolio's return is related linearly to the return on a series of factors

**Treynor J. L. and Mazuy K. K**<sup>93</sup> developed a model that tested the mutual funds success while predicting the returns. They also tested this model on 57 open ended funds during the ten year period and found no statistical proof that investment manager of 57 funds were not able to guess market movements in advance. This study expresses that an investor in mutual funds was totally dependent on fluctuations in the general market. The study revealed that the improvement in the rate of return was due to the fund managers' ability to identify under priced shares in the market.

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<sup>93</sup> Treynor J L and Mazuy K ,”Can mutual funds outguess the market?”Harvard Business Review, 44,1966,pp 131-13

**Jensen M. C**<sup>94</sup> tried to co-relate the extra-returns of some mutual funds scheme over the market returns and their capacity to predict the stock prices. He used the technique of CAPM for his analysis and developed his own model. In this model the excess returns of the fund were regressed upon the excess returns of the market to estimate the characteristic line of regression. He concluded that for the sample of 115 mutual funds, the fund managers were not able to forecast security prices well enough.

**E Fama**<sup>95</sup> developed a methodology for evaluating investment performance of managed portfolios. He argued that the observed return of a fund could be due to ability of fund managers to pick up the best securities at a given level of risk. He suggested that the overall performance of managed portfolios could be broken down into several components. Some portion of this return could also arise due to the prediction of general market price movements. Fama suggested that return on portfolio could be subdivided into two parts namely. The return for security selection and return for bearing risk. The model developed by him used the concepts from modern theories of portfolio selection and capital market equilibrium with those of traditional concepts of what constitute good portfolio management

**McDonal J. G**<sup>96</sup>. examined the performance of the mutual fund schemes based on the objectives of the schemes. He also evaluated performance in terms of Sharpe and Treynor's index as also in terms of Jensen's alpha.

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<sup>94</sup> Jensen M.C., "The performance of Mutual Funds in the period 1945-1964" Journal of Finance, Vol 23, No 2, 1968 pp 389-416.

<sup>95</sup> E Fama, "Efficient Capital market". A review of theory and empirical work" Journal of Finance , Vol 25, No 5, 1970

<sup>96</sup> McDonald J.C., "Objectives and Performance of Mutual Funds: 1960-67", Journal of Financial and Quantitative Analysis , June 1974, pp 311-333

The study revealed that 54 percent of the funds had positive alphas. Mean alpha for the sample was found to be 0.052.

**Kon S.F.**<sup>97</sup> conducted the study to evaluate the performance of selected equity funds. He selected the sample size of 37 equity funds and period for the evaluation was 1960 to 1976. His analysis revealed that the overall funds performance is impressive but very few managers succeeded in beating the market. He further observed that the funds which could beat the market were mostly the thematic funds or the sectoral funds which carry higher risk for the investors. Thus an ordinary equity fund is either at par or lowers in performance as compared with the benchmark index of the market.

**Henriksson R. D**<sup>98</sup> examined in his study the ability of the individual fund managers to time the market. He took a sample of around 115 open ended mutual fund schemes. His study concluded that the individual fund managers were not able to time the market most of the times. His study was based on the performance of the funds and fund managers during the period of the year 1968 to the year 1980.

**Chang EC and Lewellen W**<sup>99</sup> tried to examine the timing ability of the fund managers by studying the 67 mutual funds' performance for the period 1971 to 1979. They also checked whether the fund managers possess the ability to select the right stocks for adding in portfolio. The

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<sup>97</sup> Kon S.F."The Market Timing Performance of Mutual Funds Managers", Journal of Business, July 1983,pp323-347

<sup>98</sup>Henriksson R.D., "Market Timings and Mutual Funds Performance :An Empirical Investigation", Journal of Business, January 1984 pp 73-96.

<sup>99</sup>Chang, E C and Lewellen W. (1984)"Market Timings and Mutual Fund Investment Performance" Journal of Business, January 1984 pp57-72.

study concluded that the most of the fund managers are not able to outperform a passive investment strategy.

**Blake, Elton and Gruber**<sup>100</sup> studied the samples of bond funds – one sample designed to eliminate survivorship bias and a second much larger sample using linear and nonlinear models. The authors find no evidence of predictability using past performance to predict future performance for their unbiased sample.

**Malkeil**<sup>101</sup> studied the performance of the equity funds for the period from the year 1971 to the year 1991. He concluded that the equity funds can deliver better results than the market returns in the long run also provided the fund is well diversified and fund managers are active enough. In short, he favoured the non-index funds over the index funds. His study utilized a unique data set including returns from all equity mutual funds existing each year.

**Jain and Wu**<sup>102</sup> conducted a different type of study in which they selected 294 mutual funds for which the mutual fund companies conducted advertisement campaign in the magazines. The authors observed that the performance of these mutual fund schemes was significantly higher as compared to the benchmark index. Thus they pointed out that funds having better performance only are projected by the mutual fund companies in their advertisements. However, at the same time nobody assures about their future performance.

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<sup>100</sup> Blake, Elton and Gruber-“The Performance of Bond Mutual Funds”, Journal of Business,1993.

<sup>101</sup> Malkiel,”Returns from Investing in Equity Mutual Funds 1971 to 1991”Journal of Finance 1995.

<sup>102</sup> Jain and Wu,” Truth in Mutual Fund Advertising: Evidence on future performance and fund flows”, Journal of Finance , year 2000

**Wermers**<sup>103</sup> used a new data base to perform a comprehensive analysis of the mutual fund industry. They found that funds hold stocks that outperform the market their net returns underperformed by one percent. Thus funds pick stock well enough to cover their costs Also high- turnover funds beat the Index Fund on net return basis

**Zheng**<sup>104</sup> studied whether the funds which receive regular cash inflows deliver better returns than the funds which don't receive regular cash inflows. He checked the argument that some fund managers succeed because they have sufficient balance of cash regularly to invest in various stocks. However he concluded that the result of this fact remains for the short run and in the long run size of the assets (cash) hold by the fund have no relation with its performance. In the aggregate there is no significant evidence that funds that receive more money subsequently beat the market.

**Satman**<sup>105</sup> tried to study the social responsibility of the mutual fund companies in total. He tried to separate facts from beliefs because he feels that conversations about socially responsible investing are difficult because they combine facts with beliefs. This study is totally new and unique one and very few other researchers have studied this aspect.

**Chalmers, Edelen and Kadlec**<sup>106</sup> estimated trading costs for a sample of equity mutual funds and found that these costs average 0.78 percent of fund assets per year. They also found that the cross-sectional variation in trading costs is greater than that implied by turnover and trading costs have more

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<sup>103</sup> Wermers," Mutual Fund Performance: An empirical decomposition into stock-picking talent, style, transaction costs and expenses ", Journal of Finance, year 2000

<sup>104</sup> Zheng,"Is Money Smart?" A study of mutual fund investors' and fund selection ability", Journal of Finance,1999

<sup>105</sup> Statman,"Socially Responsible Mutual Funds", Financial Analysts Journal year 2000

<sup>106</sup> Chalmers, Eden and Kadlec," Mutual Fund Trading Costs," Rodney L White Center for Financial Research Working Papers,1999.

explanatory for fund returns and they concluded by saying that turnover is an important factor in assessing mutual fund trading costs.

**Brad M. Barber and Zheng**<sup>107</sup> have studied the behavior of the common investors in US mutual funds. They point out that for many investors, mutual funds are the investment vehicle of choice and this is increasing also. They point out that from 1991 to 1999 in the U.S., the value of corporate equities held by mutual funds increased almost ten times. In contrast, direct ownership of common stock increased only three times during the same period. Thus the common investors are taking more interest in the investment in mutual funds rather than investing in direct equity. This study is very much useful for the US as well as for the other countries as during the period of the year 1991 to 1999 many other emerging markets were developing in a rapid way.

**Hendricks, Patel, and Zeckhauser**<sup>108</sup> studied whether it is rational for investors to chase performance when purchasing mutual funds. They point it out that depends on the degree to which past fund performance can predict future fund returns and on the costs associated with chasing performance. Empirically, there is said that the past performance is useful to predict the future but there is no concrete evidence to prove the same.

**Martingale**<sup>109</sup> studied the totally different aspect of the mutual fund investment. He pointed out that Mutual fund managers may have a conflict of interest because of the way they are paid. In particular, mutual fund managers are encouraged to make risky investments are not in the interests

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<sup>107</sup> Brad M. Barber and Zheng. The Behavior of Mutual Fund Investors (Year 1999) School of Business Administration, University of Michigan,

<sup>108</sup> Hendricks, Patel, and Zeckhauser-“Is chasing mutual funds’ performance rational?” ,paper published in the Financial Analyst ,year 1997.

<sup>109</sup> Martingale ,”Do mutual fund managers have an inherent conflict of interest?

of unit holders, and to over-concentrate their holdings. Mutual fund investors, on the other hand, would tend to benefit from less risky investments, and greater diversification. This article has explored this conflict of interest and its implications for investors who buy actively managed mutual funds. The researcher has pointed out that many mutual fund investors choose funds that have better than average five or ten year performance numbers. The author concludes that on the other hand, underperforming funds see money flow out of the fund at a much slower rate. Overall, the rate of inflow to a successful fund is much higher than the outflow from an unsuccessful one.

**William A Birdthistle**<sup>110</sup> has focused on the of the most dynamic and complex new investment vehicles on the market today -the exchange-traded fund (ETF) He points out that the majority of that expansion has occurred in just the two years i.e. 2006 to 2008, largely as a consequence of recent difficulties in the mutual fund industry. With the introduction of ETF, there will be changes in the overall investment pattern of the mutual funds of all the mutual fund companies. The article argues that the mutual fund industry and its recent speed have contributed to the emergence of ETFs.

**Richard Loth**<sup>111</sup> has studied the difference between an index mutual fund and an exchange-traded fund (ETF). He points it out that the though the basic concept of both types of the funds is same, they differ from each other in their working style. Both the types of funds have their own

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<sup>110</sup> William A Bird Thistle ,” The Fortunes and Foibles of Exchange-Traded Funds: A Positive Market Response to the Problems of Mutual Funds –Jan 2008

<sup>111</sup> Richard Loth- Index Mutual Fund Or ETF: Which Is Right For You? (Year 2010)

benefits and the investors should be aware of his exact need before investing in any of them. Both the funds are managed passively, i.e., they are tied to a market index but an index mutual uses indexing and the latter uses a human element to make investment decisions.

**Michael Jensen**<sup>112</sup> developed a risk-adjusted measure of portfolio performance (Jensen's alpha) that estimates how much a manager's forecasting ability contributes to fund's returns. As indicated by Jensen, the performance of the individual fund manager should be evaluated on his ability to give better returns than the market returns.

**William Reichenstein**<sup>113</sup> carried out an analysis of the flow of investments into and out of mutual funds demonstrated a direct relationship between Morningstar Rating changes and investor reactions. He points out that the ratings by the rating agency should be taken as guidelines by the investors. He has explained the fact with examples how a change in the rating of a particular mutual fund scheme results in either inflow or outflow of funds into or out of that scheme. He further points out that the STARS should not have direct impact on investors' confidence because Morningstar itself largely avoids making performance predictions.

**Zakri Y.Bello**<sup>114</sup> conducted his study in the year 2005 wherein he tried to differentiate between a fund which is socially responsible and a normal

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<sup>112</sup> Risk –adjusted measure of portfolio performance (Year 1967)

<sup>113</sup>William Reichenstein, Multi-criteria Methodology of Mutual Fund Portfolio -Year 2001

<sup>114</sup>Zakri Y.Bello “Socially responsible stock mutual funds “-Year 2005

mutual fund scheme. The study found that socially responsible funds do not differ significantly from an ordinary mutual fund in terms of any of the major features.

**Michael Jensen's**<sup>115</sup> analysis of mutual fund performance found that the average mutual funds produced disappointing returns. A report on the performance of 57 mutual funds and their sensitivity to market fluctuations. At the end he concluded that perhaps no investor, professional or amateur, can outguess the market.

**Patricia and Rolf**<sup>116</sup> carried on a different study to analyze the performance of the mutual fund schemes. He conducted a test to see the consistency in performance of active fund managers and concluded that the best one can hope from selecting an investment manager strictly on the basis of past results is a 50-50 chance of success – about the same odds as a flip of a coin. He concludes that an individual fund manager cannot be superior to a passive way of investment in the long run provided the index is constructed scientifically and has a broad base.

**Cunningham and Fender**<sup>117</sup> studied the debate of passive and active management processes. They studied to compare the benefits of both the ways of investment strategies and found that only a very few money managers have outperformed the after-tax S & P index in US. They demonstrated that low cost funds outperform high cost funds on both an absolute and risk-adjusted basis. They concluded with the fact that mutual

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<sup>115</sup>Michael Jensen-“Does Past Performance persists over time (Year 1992)

<sup>116</sup>Patricia and Rolf -Consistency in returns of mutual funds (1983)

<sup>117</sup> Cunningham and Fender -Passive &Active Management of Mutual Funds

fund managers as a family do not create superior net returns compared to the index through their active fund management process. Thus the authors express strongly their opinion in favour of index funds.

**EDWARD WYATT**<sup>118</sup> has criticized the basic concept of Index funds. The author indicates that it is doomed to lag behind the performance of the hottest mutual funds while the market is going up, they also fail to attract great cheers when their funds sink no lower than the market during a downturn. He points out that no one asks index funds for impassioned reviews of their favorite stocks, nor do shareholders flock to their presentations at mutual fund confabs, breathlessly waiting for a chance to tell them how they have guaranteed returns to the investors. Thus he concludes that index fund is a very ‘boring’ way of investment.

**Joshua Kennon**<sup>119</sup> has expressed that Index Funds are better instrument of investment particularly for those who do not have the idea about the investment in mutual funds. He further points it out that investors should be aware of technical concepts like competitive advantage of various corporations, differentiate an income statement and balance sheets, discounted cash flows if they want to invest in non-index mutual funds. The reason behind the same, as pointed out the author, is that there is availability of very large number of schemes of mutual funds and the investor who is not well versed with the technicalities as mentioned above may get confused and may select a wrong mutual fund scheme. He further points is out that the index fund is a cost effective way to acquire various

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<sup>118</sup> EDWARD WYATT -“Are Index Funds Great Literature?” April 2001

<sup>119</sup>Joshua Kennon -“Beginner’s Strategy: Investing in Low-Cost Index Funds”-2005

stocks while avoiding the hundreds of dollars in brokerage commissions that would otherwise result.

### **3.5 Major Findings of the Review of Literature**

Following are the major findings of the review of literature

#### **1) Steady development of the Mutual Fund Industry**

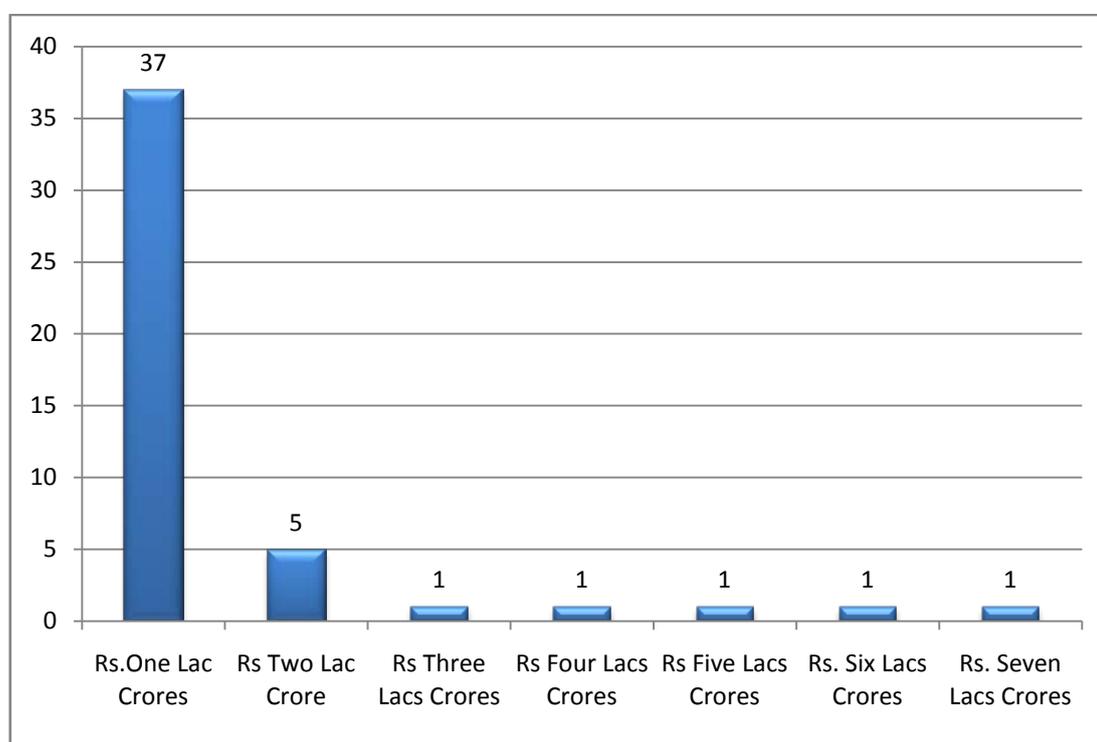
The review observed that mutual funds Industry in India and other countries is growing steadily. The mutual funds in India has grown in terms of number of funds, number schemes, resources mobilized, range of products being offered to the investors and service offerings in recent years. Following are the major milestones in the development process of AUM (Assets Under Management) are as below<sup>120</sup>

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<sup>120</sup> [www.amfiindia.com](http://www.amfiindia.com)

**Table 5 - Increase in AUM of Indian Mutual Fund Industry**

Mutual Fund AUM firstly reached at	In Year	No. of Years required
Rs. One Lac Crores	2000	37
Rs Two Lac Crore	2005	5
Rs Three Lacs Crores	2006	1
Rs Four Lacs Crores	2007	1
Rs Five Lacs Crores	2007	1
Rs. Six Lacs Crores	2008	1
Rs. Seven Lacs Crores	2009	1



**Figure 5 -Increase in AUM of Indian Mutual Fund Industry**

Above chart explains that almost 37 years were required for first One Lac Crore AUM while second One Lac Crore were achieved in next 5 years. However for all next incremental AUM of Rs One Lac

Crore were achieved in one year each. This shows the momentum in AUM rise

**2) Performance of the Mutual Fund Schemes**

Various researchers have studied the performance of mutual fund schemes. The basic observation of all the researchers is that mutual fund performance in the short run is disappointing in many cases. However in the long run they have given handsome returns. Proper selection of investment strategy has been the major reason behind the success of the mutual fund schemes.

**3) Investors' response to Mutual Fund Investment**

Investors, particularly in other countries have been very much familiar with the mutual funds investment. Various researches indicate that there has been a steady growth in the both number of investors as well as AUM of mutual funds. However in India, the growth of the mutual fund industry has been very slow in the initial periods of the inception but then there was sharp growth in the industry.

**4) Fund Managers' ability to time the market**

A lot of work has been carried out for studying the fund managers' abilities to time the market. The main observations in this regard are that in the short span many of the fund managers were able to time the market and outperform the same. However, in the long run hardly few of them were able to beat the market. Thus, very few fund managers have the ability to beat the market over the long term. Research shows that even the good fund managers are finding it difficult to beat the market.

**5) Slow Development of Index Funds**

Another major finding is that the development of the index funds has been very slow as compared to other types of mutual funds. The growth of the other types of mutual funds has been impressive in terms of the number of investors as well as size of the asset under management. Many of the researchers also have criticized the workings of index funds on account of the lower returns and higher tracking errors.

**6) Reduction in expenses & transaction costs**

Overall transactions costs have drastically reduced for the mutual fund investors over a period of time. The entry load of all types of the mutual funds has been abolished in India since August 2009<sup>121</sup> and investors are not required to pay any charges in form of entry load when they buy the mutual funds. Another point is that the time span for the NFOs (New Fund Offers) has been reduced to 15 days from 45 days. Thus the funds of investors in new funds are getting blocked for a comparatively shorter period of time than before. As a result there has been reduction in overall expenses and costs of the mutual funds.

**7) Working in ‘Comfort Zone’**

Mutual fund industry is concentrating on the urban part of the country and middle upper class of the society. They have not been able to reach the rural or sub-urban parts of the country. As a result, the mutual fund investment has remained restricted to the selective part of the country. The analysis done by AMFI has reflected that 5

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<sup>121</sup> SEBI Circular No SEBI/IMD/Cir No 4/168230/09 dated 30<sup>th</sup> June 2009.

top cities in India is contributing almost 71% of the total AUM (Assets Under Management) of entire Mutual Fund Investment. The details of city-wise investment for these top 5 cities is as below<sup>122</sup>

<b>City Name</b>	<b>Contribution in total AUM (As on 31<sup>st</sup> March 2012)</b>
Mumbai	42%
New Delhi	13%
Banglore	6%
Chennai	5%
Kolkata	5%
Total	71%

**8) Rebuilding investors' confidence**

Some of the mutual fund companies are slowly losing the number of folios as well as assets under management. The basic reason behind the same is that many investors are losing their confidence in these mutual funds companies. These mutual fund companies should try hard to regain investors' confidence.

**9) Passive investment**

In case of index mutual funds, the fund manager is expected to be passive in his investment approach and has to mimic the benchmark index. However on reviewing the literature, it is observed that many of the index fund managers bypass this principle. Though sometimes it may result in profits, it is against the basic assumption of index mutual funds.

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<sup>122</sup> AMFI Report on “ City-wise Investment in Mutual Funds “ dated 27<sup>th</sup> July 2012

### **3.6 Scope for further analysis.**

A large number of performance evaluation studies have been undertaken for actively managed funds. However, despite the significant growth in the value of assets being indexed across the world, empirical research evaluating the performance of index funds is scarce. This is evidenced by the researcher at time of reviewing the available literature also. On reviewing the available literature in the research area, the researcher is of opinion that following is scope of the further study

#### **a) Analysis of performance of index funds**

As pointed out earlier, comparatively lesser study has been carried out as regards to evaluation of performance of index funds, a research work is required in this area. The new area of research should focus on comparison of performance of index funds with performance of selected diversified mutual funds schemes. The basic reason of the same is to find it out whether all diversified funds have outperformed the index mutual funds.

#### **b) Composition of various index funds**

Index Funds are of various types. The researcher intends to study the composition of various types of index funds and their relative performance over a period of time. The study will point out which types of index funds have been better in performance.

#### **c) Response of investors to index mutual funds**

There is scope to study the response of the mutual fund investors to the various index funds' schemes as compared to other mutual funds' schemes. The researcher intends to study the awareness

amongst the investors as regards to index funds and the probable reasons of lower investments in index mutual funds by the common investors.

**d) Response of Mutual Fund Advisors**

Mutual Fund Advisors play the important role in the entire process of the mutual fund industry. There is scope to study and analyse their opinion about the Index Funds and probable reasons of low participation by the retail investors in Index Funds.