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A Study on Mutual Funds Investments and its Long Term Impact

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Abstract: Investment and saving in a portfolio can take different forms. An investor can either invest directly in shares and Securities, or can invest through an investment or portfolio management company, also referred to as a mutual fund. An investment company is a financial intermediary that collects money from investors and invests in various securities or their behalf.

As a saving and investment instrument mutual fund can be defined as a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested by the fund manager on behalf of the investors in different types of securities. The income earned through these investments and the capital appreciated realized by the scheme are shared by its unit holders in proportion to the number of units owned by them.

The basic objective sought to be achieved by Mutual Fund is to provide an opportunity for lower income groups to acquire without much difficulty financial assets. They cater mainly to the needs of the individual investor whose means are small and to manage investors portfolio in a manner that provides a regular income, growth, safety, liquidity and diversification opportunities

RISK FACTORS OF MUTUAL FUNDS and it's Long term Impact

1. **The Risk-Return Trade-Off:**

The most important relationship to understand is the risk-return trade-off. Higher the risk greater the returns / loss and lower the risk lesser the returns/loss. Hence it is up to you, the investor to decide how much risk you are willing to take. In order to do this you must first be aware of the different types of risks involved with your investment decision.

2. **Market Risk:**

Sometimes prices and yields of all securities rise and fall. Broad outside influences affecting the market in general lead to this. This is true, may it be big corporations or smaller mid-sized companies. This is known as Market Risk. A Systematic Investment Plan ("SIP") that works on the concept of Rupee Cost Averaging ("RCA") might help mitigate this risk.

3. **Credit Risk:**

The debt servicing ability (may it be interest payments or repayment of principal) of a company through its cash flows determines the Credit Risk faced by you. This credit risk is measured by independent rating agencies like CRISIL who rate companies and their paper. A 'AAA' rating is considered the safest whereas a 'D' rating is considered poor credit quality. A well-diversified portfolio might help mitigate this risk.

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4. **Inflation Risk:**

Things you hear people talk about: "Rs. 100 today is worth more than Rs. 100 tomorrow." "Remember the time when a bus ride coasted 50 paisa?" "Mehangai Ka Jamana Hai." The root cause, Inflation. Inflation is the loss of purchasing power over time. A lot of times people make conservative investment decisions to protect their capital but end up with a sum of money that can buy less than what the principal could at the time of the investment. This happen when inflation grows faster than the return on your investment. A well-diversified portfolio with some investment in equities might help mitigate this risk.

5. **Interest Rate Risk:**

In a free market economy interest rates are difficult if not impossible to predict. Changes in interest rates affect the prices of bonds as well as equities. If interest rates rise the prices of bonds fall and vice versa. Equity might be negatively affected as well in a rising interest rate environment. A well-diversified portfolio might help mitigate this risk.

6. **Political / Government Policy Risk:**

Changes in government policy and political decision can change the investment Environment. They can create a favorable environment for investment or vice versa.

ADVANTAGES OF MUTUAL FUNDS AND IT'S IMPACT

If mutual funds are emerging as the favorite investment vehicle, it is because of the many advantages they have over other forms and the avenues of investing, particularly for the investor who has limited resources available in terms of capital and the ability to carry out detailed research and market monitoring. The following are the major advantages offered by mutual funds to all investors:

1. Portfolio Diversification:

Each investor in the fund is a part owner of all the fund’s assets, thus enabling him to hold a diversified investment portfolio even with a small amount of investment that would otherwise require big capital.

2. Professional Management:

Even if an investor has a big amount of capital available to him, he benefits from the professional management skills brought in by the fund in the management of the investor’s portfolio. The investment management skills, along with the needed research into available investment options, ensure a much better return than what an investor can manage on his own. Few investors have the skill and resources of their own to succeed in today’s fast moving, global and sophisticated markets.

3. Reduction/Diversification Of Risk:

When an investor invests directly, all the risk of potential loss is his own, whether he places a deposit with a company or a bank, or he buys a share or debenture on his own or in any other from. While investing in the pool of funds with investors, the potential losses are also shared with other investors. The risk reduction is one of the most important benefits of a collective investment vehicle like the mutual fund.

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4. Reduction Of Transaction Costs:

What is true of risk as also true of the transaction costs. The investor bears all the costs of investing such as brokerage or custody of securities. When going through a fund, he has the benefit of economies of scale; the funds pay lesser costs because of larger volumes, a benefit passed on to its investors.

5. Liquidity:

Often, investors hold shares or bonds they cannot directly, easily and quickly sell. When they invest in the units of a fund, they can generally cash their investments any time, by selling their units to the fund if open-ended, or selling them in the market if the fund is close-end. Liquidity of investment is clearly a big benefit.

6. Convenience And Flexibility:

Mutual fund management companies offer many investor services that a direct market investor cannot get. Investors can easily transfer their holding from one scheme to the other; get updated market information and so on.

A Sudy on Mutual Fund with Porters 5 Forces

Introduction

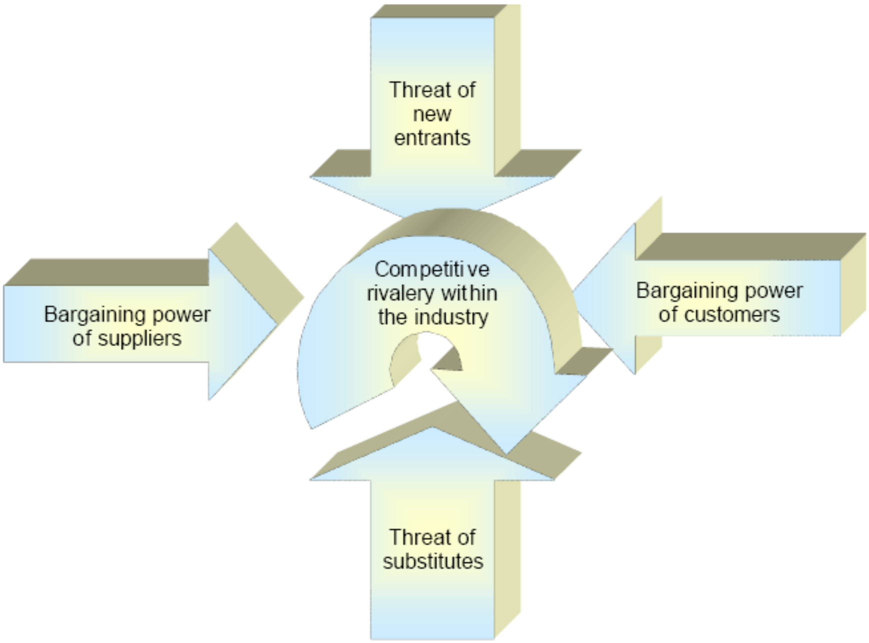
The model of the Five Competitive Forces was developed by Michael E. Porter in his book Competitive Strategy: Techniques for Analyzing Industries and Competitors" in 1980. Since that time it has become an important tool for analyzing an organizations industry structure in strategic processes. Porter's model is based on the insight that a corporate strategy should meet the opportunities and threats in the organizations external environment. Especially, competitive strategy should base on and understanding of industry structures and the way they change. Porter has identified five competitive forces that shape every industry and every market.

These forces determine the intensity of competition and hence the profitability and attractiveness of an industry.

The objective of corporate strategy should be to modify these competitive forces in a way that improves the position of the organization. Porter's model supports analysis of the driving forces in an industry. Based on the information derived from the Five Forces Analysis, management can decide how to influence or to exploit particular characteristics of their industry.

2 The Five Competitive Forces

The Five Competitive Forces are typically described as follows:



2.1 Bargaining Power of Suppliers

The term 'suppliers' comprises all sources for inputs that are needed in order to provide goods or services. Supplier bargaining power is likely to be high when:

- The market is dominated by a few large suppliers rather than a fragmented source of supply,
- There are no substitutes for the particular input,
- The suppliers customers are fragmented, so their bargaining power is low,
- The switching costs from one supplier to another are high,
- There is the possibility of the supplier integrating forwards in order to obtain higher prices and margins. This threat is especially high when
- The buying industry has a higher profitability than the supplying industry,
- Forward integration provides economies of scale for the supplier,

This may not be applicable for service industry.

Threat new entrants

Bargaining power of buyer

2.2 Bargaining Power of Customers

Similarly, the bargaining power of customers determines how much customers can impose pressure on margins and volumes. Customers bargaining power is likely to be high when

- They buy large volumes, there is a concentration of buyers,
- The supplying industry comprises a large number of small operators
- The supplying industry operates with high fixed costs, The product is undifferentiated and can be replaces by substitutes,
- Switching to an alternative product is relatively simple and is not related to high costs,
- Customers have low margins and are price sensitive,
- Customers could produce the product themselves,

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- The product is not of strategically importance for the customer,
- The customer knows about the product costs.
- There is the possibility for the customer integrating backwards.

Bargaining power of buyer in Mutual fund: -

Now a day competition is increasing in the each and every sector, and as a competition in the market increase the bargaining power of the buyer will get increase. So buyers bargaining power is high.

- ❖ Market is highly segmented.
- ❖ Buyers in this industry are very return oriented and it switches easily.
- ❖ The switching cost of buyer over brand or close substitute products: The mutual fund industry has the uniqueness of providing investment, which does have any substitute. Thus the switching cost has no place. As far as the substitute products are concerned they are providing the service of having and tax benefits but still they lag in the risk coverage factor.
- ❖ If buyers buy MF then switching cost becomes high. High switching cost creates buyers lock in and makes a buyer's bargaining power.
- ❖ Buyers have a strong competitive force when they are able to exercise bargaining leverage over premium, service or other terms of sale.

Bargaining power of Suppliers: -

- ❖ Product designer tend to have less leverage to bargain over cost and other terms of sale when the company they are supplying a major customer.
- ❖ Suppliers bargaining power increase if reduced administrative cost and also reduced claim procedure time.
- ❖ Some of the schemes are tax exempted so that suppliers bargaining power increases.
- ❖ Suppliers then have a big incentive to protect and enhance their customer's competitiveness via reasonable premium, better service and on going advances in the technology of the item supplied.
- ❖ Supplier's ability to integrate forward: the private players can integrate forward to increase the volumes of business by providing customized and tailor-made policies whereas existing players whereas lack on this point.
- ❖ Brand identity: there is certainty among the minds of people in relation to existence and payment of claims from the existing players whereas the solvency of private players is not certain.

Threat from Substitutes

2.4 Threat of Substitutes

A threat from substitutes exists if there are alternative products with lower prices of better performance parameters for the same purpose. They could potentially attract a significant proportion of market volume and hence reduce the potential sales volume for existing players. This category also relates to complementary products. Similarly to the threat of new entrants, the treat of substitutes is determined by factors like

- Brand loyalty of customers,
- Close customer relationships,
- Switching costs for customers,

- The relative price for performance of substitutes,
- Current trends.

Threat new entrants in Mutual fund: -

The future of mutual fund market scenario will be marked by the active presence of many national players, beside several Indian players, bank based MF non bank based MF etc. As far as this industry is concerned there would be fewer entries due to more specialized firm with lower expenses ratios and better capitalization.

- ❖ Threat of entry is determine by the entry barriers which act to prevents firms from entering the industry. In MF industry entry barriers is moderate so that it becomes profitable, it attracts new entrants, thereby increasing the number of competitors.
- ❖ The Indian market is highly brand oriented, it is difficult to introduce new brand. The acceptability of new brand is also very low.
- ❖ The capital requirement in sector is high, which attract more companies to invest in.
- ❖ Tax exemption structure makes the industry attractive.
- ❖ High level of competition in MF industry become giant player came into the market.
- ❖ Profit in MF industry act as a magnet to firms outside the industry motivating potential entrants to commit the resources needed to hurdle entry barriers.
- ❖ But again due to potential market, private giants and international player try to enter in to the market in the large scale with their proper homework with customized and products too. An Indian private are well – developed and has capacity to face challenges, foreign companies foresee good prospects for new business by alliances and partnership with domestic outfits .
- ❖ Registration: Every AMC is required to obtain a certificate of registration from the controller of mutual fund i.e. SEBI. The registration is required to be renewed after a period of three years.
- ❖ Economies of scale: Economies of scale is difficult to find in the initial stage of entry into the market because of experience as evidence by the theory of experience curve.
- ❖ Legislation or government action: special permission is required from the government to enter in the insurance sector. With the tariff advisory committee to control the rates, rules and regulation, and with the control of SEBI and the government's attitude to serve to the needs of the people with social objectives, the multinationals may face breathing and developmental problems.

2.3 Threat of New Entrants

The competition in an industry will be the higher, the easier it is for other companies to enter this industry. In such a situation, new entrants could change major determinants of the market environment (e.g. market shares, prices, customer loyalty) at any time. There s always a latent pressure for reaction and adjustment for existing players in this industry. The threat of new entries will depend on the extent to which there are barriers to entry. These are typically

- Economies of scale (minimum size requirements for profitable operations),
- High initial investments and fixed costs,
- Cost advantages of existing players due to experience curve effects of operation with
- Fully depreciated assets,
- Brand loyalty of customers

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- Protected intellectual property like patents, licenses etc,
- Scarcity of important resources, e.g. qualified expert staff
- Access to raw materials is controlled by existing players,
- Distribution channels are controlled by existing players,
- Existing players have close customer relations, e.g. from long-term service contracts,
- High switching costs for customers
- Legislation and government action

Threat from Substitutes in MF industry:-

MF sector can be featured in three factors. They are saving, investment and tax benefit. SAVING: As far as saving are concerned, Existences of a large number are saving through PPF, EPF. Most of customer saving their money in bank, post deposit. Many customers invest their money in share market, purchase Gold & Silver also. The substitute products for the industry are as follow:

Investment Instruments and Types-

Instrument	Issuer	Tenure (Years)	Rate of Returns	Tax Benefits	Safety	Liquidity
PPF	GOI	15	8.5%	u/s 80 C	High	Moderate
NSC	GOI	9	8.5%	u/s 80 C	High	Low
MIS	GOI	9	8.5%	No	High	Low
Senior citizen Scheme	GOI	5	9%	No	High	Low
Post Office Deposits	GOI	1,2,3…	4.5%	No	High	Low
Post Office SB A/c	GOI	Open Ended	4.5%	No	High	Low
GOI Bonds	GOI	8	8.5%	No	High	Low
Govt Securities	GOI	2-30 Yrs	7-8%	No	High	Low
Bank Deposits	Banks	14 Days - 15Yrs	9%	No	High	Low
Infra Bond	Fish	3-10 Yrs	8%	u/s 80 C	High	Low
Corporate Bonds	Companies	3-10 Yrs	8%	No	Moderate	Low
T. Bills	GOI	91- 364 days	Discount Rats	No	High	Low
Certificate of Deposits	Banks	91- 364 days	Discount Rats	No	High	Low
Comm. Papers	Companies	91- 364 days	Discount Rats	No	Moderate	Low
ELSS	MFs	3-10 Yrs	Market Linked	u/s 80 C	Moderate	Low
Life Insurance products	LI companies	Close Ended	6-7%	Yes	Moderate	Low

Traditional Policies	**Insurance Comp**	**Close Ended**	**6-7%**	**u/s 80 C, 10 (10d)**	**High**	**Moderate**
ULIPS	**Insurance Comp**	**3-30 Yrs**	**Market Linked**	**u/s 80 C, 10 (10d)**	**Moderate-High**	**Moderate**

- Term deposits in bank (5.25-8 %)
- Investment in government securities. (4-5%)
- Money market investment (for corporate)
- Capital market (around 13% p.a. for developing country like India)
- There is threat of increasing market potential of Direct investment in market, Ulips, NSC, Government debenture etc.
- For investment, there is close substitute of the products is ULIP by life insurance companies. Tax Benefits: There are various substitute of this feature of MF. Some of the substitute, which provides tax benefit, is: • PPF • NSE • Post Office deposits • Investment in life insurance • Other Tax saving instruments. Thus these are the substitute of the mutual fund industry. But the core competency of this sector is the investment management.

2.5 Competitive Rivalry between Existing Players

- This force describes the intensity of competition between existing players (companies) in an industry. High competitive pressure results in pressure on service cost, prices, margins, and hence, on profitability for every single company in the industry. Competition between existing players is likely to be high when
- There are many players of about the same size asset and ,
- Players have similar strategies
- There is not much differentiation between players and their products, hence, there is
- much price competition
- Low market growth rates (growth of a particular company is possible only at the expense of a competitor),
- Barriers for exit are high (e.g. expensive and highly specialized equipment). Rivalry among the exiting player: As a result of competitive conditions will prevail in which entry of companies buyers will exercise control.

Mutual Fund Sector-

- There is cut- thought competitions among rivals in mutual fund industry.
- There are mainly 15 players based as a different AMCs in India with the various schemes available in India.
- The mutual fund sector is showing high market growth rate as a saving and investment instrument. Which enables the asset management companies to achieve its own market growth through the growth in market place? As per the study conducted by the monitor group, the size of the Indian mutual fund market is expecting annual growth rate by 15% every year as new investor's base.

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- All the asset management companies deal in identical policies, as service levels offered are similar. Hence, where there is no product differentiation service and after sales service become an important area..
- Ministry of finance controls all the mutual funds by SEBI guidelines that are in the industry at present. Hence, there are less chances of exit.
- All players have computerized systems and use of management information system (MIS). Although they are planning to implement software developed by CMC for fulfilling the MIS requirements across various levels of offices. Private players will make extensive use of MIS as well as will have more or less a paperless office.

Conclusion

Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal and invest it in capital market instruments such as shares, debentures and other securities. The income earned and capital appreciation thus realized is shared by its unit holders in proportion to the number of units owned by them. Thus, it offers to common man an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

A competent fund manager should analyze investor behavior and understand their needs and expectations, to gear up the performance to meet investor requirements. Therefore, in this current scenario it is very important to identify needs of mutual funds investors, their preference for mutual funds schemes and its performance evaluation

- One should diversify the investments between a few funds (the actual number depends entirely on the amount of investment). This strategy ensures that the portfolio is not dependent on the performance of one single fund. However, one needs to avoid over-diversification as that would achieve nothing.

  Investor can also plan like one mutual fund of diversified equity plan, second mutual fund of balanced type and third one you can plan of debt type etc. In this manner the money will get diversified, risk is reduced and the investor will get excellent profit.
- Some schemes are launched because they are easy avenues to capture management fees and increase the fund house's asset base. These schemes are usually just clones of existing schemes, but with new peppy names flaunted to attract investors.

  Investors have to make self-analysis of one’s needs, risk-bearing capacity, and expected returns so as to develop a prudent investment ideology. Investors have to be aware of the mutual fund regulations, the channeling of money, objectives of schemes, besides ensuring better diversification of investment so that they can have good returns on their investment in mutual funds

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