Introduction:

Behavioral Finance, is gaining more importance in today’s uncertain economy. Uncertainty, which breeds fear of the unknown hinders an investor’s ability to make rational decisions. When the markets are buffeted by negative news from around the world and the general consensus is that the worst isn’t over, investors become confused about the course of action they should take. A few decades ago, theoretical and empirical research in finance proceeded as if the human factor in financial decision making did not matter much. Much of the researches in the field of finance centered on Capital Asset Pricing Model, Efficient Market Hypotheses and other theories based on the assumption of rational expectations. During the 1990s, a new field known as behavioural finance began to emerge.

Genesis

The foundations of behavioral finance can be however traced back over 150 years. Behavioural finance adopts an inter-disciplinary approach. It borrows knowledge from psychology to understand the behavior of financial practitioners and their effect on markets. With the stock markets becoming more and more volatile and subsequent melt down of financial market understanding, irrational investor behavior is as important as it had ever been. Empirical evidence that appears to strongly contradict the random walk hypothesis has recently spurred the development of what has come to be known as “Behavioral Finance”.

Indian investors today have to endure a sluggish economy, the steep market declines prompted by deteriorating revenues, alarming reports of scandals ranging from illegal corporate accounting policies like that of Satyam to insider trading to make investment decisions. Stock market’s performance is not simply the result of inherent characteristics but also due to the emotions that are still baffling the analysts. Mutual Fund and Life insurance schemes are retail products designed to target retail investors, salaried people and others who are intimidated by the mysteries of stock market but nevertheless like to reap the benefits of stock market investing. During last one decade or so, role of Indian insurance and mutual fund industry as a significant financial service in financial market has really been noteworthy.
Need for the proposed study

With increasing freedom of choice in the Financial Market, retail investors are constantly looking out for better and better financial products to park their surplus cash. With a number of financial products flooding the economy, each claiming to be the best, the most crucial challenge faced by the investors today is perhaps in the area of taking investment decisions. Keeping large amount of money in bank is not a wise decision as it would give a return lower than the current inflation rate. Tactical investing needs expertise, skill in reading the market signals, as well as the ability to reallocate assets.

Traditional finance theory is based on some fundamental assumptions. Firstly investors make rational decisions. Secondly investors are unbiased in their predictions about future returns of the stock. Thirdly every investor takes careful account of all available information before making an investment decision. However as time went on, academics in both finance and economics started to find anomalies and behaviour that could not be explained by the theories available at the time. Financial economist have now realized that the long held assumptions of traditional finance theory are wrong and found that investors can be irrational and make predictable errors about the return on their investments. Recent researches have shown that the average investor makes decision based on emotion, not logic; most investors buy high on speculation and sell low in panic mode.

A variety of financial securities are created and marketed in order to satisfy the variegated requirements of both the suppliers and the users of the funds. Mutual funds and insurance have emerged as an important segment of financial market of India especially in channelizing the savings of millions of individuals into the investment in equity and debt instruments. Though real estate and gold have in the last few years yielded good returns, they are quite cyclical in nature and overexposure in any of them could be dangerous. The best part about equity investing is that it is liquid, can be sold in parts, is much more manageable and historically returns in the longer term would be much higher than any asset class. However retail investors face a lot of problem in the stock market due to risk factors such as limited resources, lack of professional advice and lack of information and so on.
This empirical study on retail investor’s behavior towards mutual funds and life insurance in Mumbai proposes to study the behavior of investors in the selection of these two investment vehicles in an Indian perspective by making a comparative study. Definition of retail investor is “an individual who has invested in any Mutual Fund / Insurance scheme and does not include institutions.”

**Scope of the study**

The importance of retail investors has been recognized in the development of the country. India being a developing country, expansion and growth of capital market is fast. Mutual fund and Insurance has been widely recognized as popular financial products designed to reach small investors.

The scope of the study would be confined to educated class of investors and would include investors above 18 years of age. The study would also be based on investors residing in the western regions of Mumbai.

**Utility of the study**

From the prior research, it is found that there is persuasive evidence that investors make major systematic errors and there is evidence that psychological biases affect market prices substantially. Furthermore, there are some indications that as a result of mispricing there is substantial misallocation of resources in the economy. Thus, there is some suggestion to the economists to study how regulatory and legal policies can limit the damage caused by imperfect rationality.

The pre-liberalized India had a very poor rate of savings and most of the money earned was spent on consumption rather than accumulation. But in the post-liberalized period, India saw an upsurge in volume of savings. So investment companies are continuously introducing new types of investment opportunities in an effort to mobilize investor’s excess funds. However investment is increasingly considered as a subject falling under behavioral science rather than finance or economics. It is governed more by trends and group behavior rather than rationality and cold calculations. Investors like consumers are also immensely influenced by fashions. Hence designing a general product and expecting a good response would be a futile job.
The future of mutual fund and life insurance industry will be undeniably competitive not only within the industry but also as compared to other financial products that provide many of the same economic functions which is now observed in USA. All this in aggregate heightens the consumer’s confusion in selection of the investment products. Unless the mutual fund and life insurance schemes are tailored to the changing needs and unless investment companies understand the investor’s psychology, survival of the funds will be difficult in future. Investor’s education, standardization of mutual fund advertising, disclosure rules and reporting rules may be helpful for investors to make decisions and also limit their freedom of action.

This study proposes to help the individuals to make a wise decision in investing their savings such as whom to buy from and where to buy. Further this study would help mutual fund and insurance companies to understand the profile of Indian retail investors and their behavioral pattern. By knowing this the companies can improve their products and can adopt strategies to tap unexplored market in a better way.