REVIEW OF LITERATURE

In India the interest of individuals in making of investments in financial markets got started from the nationalization of banks (14 banks in 1969 and 6 banks in 1980), merging of private insurance players into Life Insurance Corporation of India (LIC) in 1956 and establishment of Unit Trust of India (UTI) in 1964.

In the financial markets the flow of funds, both inflows and outflows, is largely affected by the individual investor’s expectations. It is the individual investor expectations about the markets, based upon their perceptions about markets, which plays major role in influencing the securities prices (both buy and sell), the numbers of securities traded, the volume of each security traded, etc. It is the investor expectations either due to fear, anxiety, hope, etc. that leads to market transactions.

In theoretical terms of psychology the investor’s expectations are influenced by cognitive dissonance effect and endowment effect. The cognitive dissonance as given by Leon Festinger (in 1957) means ‘having knowledge (cognitive) of presence of inconsistency (dissonance) within consistency (consonance). This will lead to activity oriented towards dissonance reduction’. In other words cognitive dissonance means psychological trend of changing the thoughts and viewpoints in order to justify actions. It is similar to research methodology, sampling theory, type II error where null hypothesis is accepted in spite of it being wrong. While endowment effect as given by Daniel Kahnema (1991) means ‘people are more likely to believe that something they own is better than something that they do not own’.

Normally it is believed that the investor makes always make logical just decisions. But in real life it is not always so. Investors have false impression about their knowledge. Investor belief which is optical illusion has been termed as cognitive illusion by Kahneman and Mark W. Riepe (1998). In other words cognitive illusion means what is believed to be right, is actually wrong.

While it is generally believed that the human beings are rational and they always consider all parameters before making investments. But in financial management there is no such theory which highlights that decision making is influenced by such
rational believes. In real life it is difficult to examine individual investor behavior as it does not follow a consistent path. No such behavioral model has been developed to analysis influence of investors notions on their investment pattern and subsequent return expectations.

Howsoever we can use behavioral theories of human psychology to test investor investment patterns and develop models to determine investor behavior. With this we will try to evaluate individual investor’s behavioral aspects of fund selection techniques and awareness level of mutual funds during the period of July 2010 and Oct. 2011. To the best of my knowledge and believe till date no major study has been undertaken in NCR region of Delhi to understand behavior pattern of individual investors with respect to various investment modes available.

To the best of my knowledge and believe, in the past or in the present work, no study has been done on individual investors in NCR of Delhi. This shall be a first work by an individual on such a subject of studying investment pattern of individual investors with special preference to Mutual Funds.

Mutual Funds attract lot of attention of general investors and encourage academicians and industry practitioner to find conduct study on them to find out how and why investors get attracted to mutual funds. In India very few studies had been as compared to outside India. The literature review of studies done on investor behavior make known such studies can be grouped under two heads - (1) studies relating to investor general financial behavior and (2) studies on investor fund selection behavior.

(1) Studies relating to investor general financial behavior:

Daniel Kahneman and Amos Tversky (1979) in their article on ‘The Prospect Theory – an analysis of decision under risk’ – wrote that human beings are more distressed by the prospective losses than they are happy by equivalent gains. It is generally accepted in the society that loss of Rupee one is twice as painful as the happiness received from gain of Rupee one. Individual’s response to comparable similar situations, where one is in terms of losses and another in terms of gains, is different.

Tversky and Kahneman (1979) in their article published gave an example where they presented similar comparable problems to two groups. One group was presented following problem in terms of gains. In addition to what you own, you have been given
$1000. You are now asked to choose between (i) a sure gain of $500 and (ii) a 50% chance to gain $1,000 and a 50% chance to gain nothing. They also presented the similar problem to another group but in terms of losses. In addition to whatever you own, you have been given $2000. You are now asked to choose between (i) a sure loss of $500 and (ii) a 50% chance to lose $1,000 and 50% chance to lose nothing. In the first group 84% chose (i). In the second group 69% chose (ii). It is the phrasing of the questions differently that made the difference.

Langer (1989) in his book points out that when preferences are based on choices, there is more of ego involvement and attachment to the preferences. This shows bias in selection among preferences.

Robert J. Shiller (1993) in his work came to the conclusion that many investors while making investments do not undertake data analysis. Moreover, many among them also lack in analytical and forecasting skills. Market information is obtained on sector wise indexes. Individual investors who make investments once in a while are more like to base their investment strategy on news and information they get from sources around.

B. Douglas Bernheim and Daniel M. Garrett (2001) states in the article that if a serious campaign is undertaken to promote savings through education and passing of information can have measurable impact on financial behavior of individual investors. Even students when exposed to financial curriculum they accumulated assets highlighting that financial exposure had many of them had reached adulthood.

Gordan J. Alexander, Joanthan D. Jones (1998) in their article stated that only 18.9% of respondents could give an estimate of expenses for their largest Mutual Fund holding. Percentage of respondents who could give approximation of their expenses was much lower. Only 43% of the respondents claimed to know their mutual fund purchase expenses. This shows how much individual investor is ignorant of investment costs and many of them do not use fund investment cost as an investment decision making criteria.

Kent Daniel, David Hirshleifer, Siew Hong Teoh (2002) have in their article categorized different types of cognitive errors that investors make like (1) self-deception – this occurs as people tend to think that they are better than actually they are, (2) heuristic (refers to trial and errors method of learning) simplification – this occurs as people have limited attention, memory and processing capabilities, and (3) disposition effect – people are
prone to sell their likely winning assets too quickly and are likely to hold on to their losing assets for too long.

(2) Studies on investor fund selection behavior;
Investor fund selection Behavior studies can be categorized as foreign studies and Indian studies. **Foreign Studies:**
Ippolito (1993) and Bogle (1998) have stated in their article that selection of a fund by the investors is based on the past performance of the respective fund. The flow of the money in the winning funds is more as compared to the losing funds. Goetzman (1993, 1997) and Grubber (1996) studied the investor ability to select funds. They came to the conclusion that the active fund investors had selection ability. Besides continuous dividend paying stocks were able to have longer time acceptability.
Malhotra and Robert (2000) in their article covering cross sectional differences in the expenses ratios for period 1989 to 1996 determined factors that help investors to select low expenses closed ended fund. They also determined relationship of closed end fund expenses to fund characteristics. They determined that mutual fund investor’s preoccupations make them to simply use fund performance as criteria to select a mutual fund, which may sometime get biased. Ferris and Chance (1987) in their note stated that load of broker incentives should be deducted from payments being made to the mutual fund investors. As it is the investors who use their services in order to determine which of the fund will be most suitable to him to carry out his investment plans.
Lu Zheng (1998) concluded that funds that receive more money subsequently performed better than those that lose money. *On the whole there is no evidence that funds that receive more money subsequently beat the market. This is short lived effect. In any case it is possible to earn positive abnormal returns by using the cash flows information of small funds.*

**Indian Studies:**
Vidhyashankar S. (1990) concluded that mutual funds will emerge as a prominent instrument of savings by the household sector by the turn of this century. While R. K. Bal and B. B. Mishra (1990) said that mutual funds will dominate Indian capital markets. Jhamb Mahendra (1991) also arrived at similar conclusion.
Gupta L.C. (1998) conducted a survey to find out investor preferences. He derived to conclusion that retail investors were withdrawing from mutual funds as their confidence was getting eroded. In fact government regulations were going to reduce corporate management accountability towards shareholders.

John Echeverri – Gent (2004) in his article highlighted that India’s equity markets had experienced dramatic reforms whereby old practices were replaced by institutionalization and computerization of trading system. T+2 rolling settlement introduction prevented periodic system breakdowns. This improved working of mutual funds in India also.

Madhusudan V. Jamboderkar (1996) tried to study mutual funds awareness in investors. They also tried to identify information sources which influence buyer decision. They found that income and open ended schemes are more preferred as compared to close-ended and growth schemes. According to them investors looked for safety of principal, easy liquidity, capital appreciation, etc. in selecting a mutual fund.

Sujit Sikidar and Amrit Pal Singh (1996) conducted a survey to find out investor’s behavior in Mutual fund for North East region. They concluded that investor’s mainly invested in Mutual Fund schemes of SBI, UTI, etc. for obtaining Income Tax relief. Private funds are still not popular.

Tapan K. Panda and Nalini Prava Tripathy (2001) in their stated that government liberalization policy brought in new type of financial instruments like mutual funds, etc. these instruments are expected to increase efficiency, competitiveness, etc. in the market.

Raja Rajan (1997 and 1998) had high lightened segmentation of investors on the basis of their characteristics, investor’s characteristics on the basis of their investment size and the relationship between stage in life cycle of the investors and their investment pattern.

Syama Sunder (1998) conducted a survey to get an insight into the Mutual Funds operations of private institutions with special reference to Kothari Pioneer. The survey had revealed that the awareness about Mutual Fund concept was poor during that time in small cities like Vishakapatnam. He also concluded that agents played a vital role in spreading the Mutual Fund culture, open-end schemes were much preferred, the two important determinants in the selection of fund scheme are age and income and mutual fund prime considerations are brand image and return.
In India NCAER (National Council of applied economic Research) in 1964 organized a first survey of households to understand the attitude towards and motivation for the savings of individuals. During 1996 another NCAER study analyzed the structure of the capital market and presented the views and attitudes of individual shareholders.

In 2000 SEBI-NCAER carried a joint survey to estimate the number of households and the population of individual investors, their economic and demographic profile, portfolio size, and investment preference for equity and other savings instruments. This was a study where data was collected from 3,00,000 well diversified households. Some of the findings of the study are: Households preference for instruments matches their risk perception; Bank Deposit has an appeal across all income class; 43% of the non-investor households (estimated to be around 60 million households) apparently lack awareness about stock markets. Compared with low income groups, the higher income groups have a higher share of investments in Mutual Funds signifying that Mutual Funds have not truly become the investment vehicle for small investors. The number of households owning units of mutual funds is more (9%) than the investor households owning investments in shares and debentures (8%). Nevertheless, the study predicts that in the next two years, i.e., 2000 onwards, the investment of households in Mutual Funds is likely to increase.

Shanmugham (2001) conducted a survey of 201 individual investors to find out how the information sourcing is done by investors, to find out what is their perception towards various investment strategy dimensions and what factors motivate their investment decisions. He also tried to find out psychological and sociological factors dominated economic factors in share investment decisions.

Rajeshwari T.R and Rama Moorthy V.E (2002) studied the financial behavior and factors influencing fund scheme selection of retail investors by conducting Factor Analysis using Principal Component Analysis, to identify the investor's underlying fund scheme selection criteria, so as to group them into specific market segment for designing of the appropriate marketing strategy.

An article by Personal fn (http://www.personalfn.com) for Business India August 2, 2004 with the title, “The Golden Nest Egg”, reported that, investor’s age could be used as a benchmark to determine the nature of the portfolio. The key to financial success is diversification based of professional advice to ensure that retirement is peaceful and without shortage of funds (based on Magazine – Liquid, page number 9, issue 6, August 2010, published by HSBC Bank, Berhad, Malaysia).

A study of Kavitha Ranganathan (2006) reveals that at least 29% of the respondents of Mumbai city used Internet facility to know more about Mutual Funds. While another 29% of respondents prefer to get information like NAV, dividend, bonus, etc. by personally visiting the office. While 30% of the respondents prefer to telephone the office and 12% in the survey have no preferences. The results of the study show that almost equal importance is given to all modes of communication.

Nidhi Walia and Ravi Kiran (2009) concluded that financial markets are constantly becoming more efficient by providing more promising solutions to the investors. Being a part of financial markets, although mutual funds industry is responding very fast by understanding the dynamics of investor’s perception towards rewards, still they are continuously following this race in their endeavor to differentiate their products responding to sudden changes in the economy. Thus, it is high time to understand and analyze investor’s perception and expectations, and unveil some extremely valuable information to support financial decision making of mutual funds. Financial markets are becoming more exhaustive with financial products seeking new innovations and to some extent innovations are also visible in designing mutual funds portfolio but these changes need alignment in accordance with investor’s expectations.

The review of literature reveals that in developed markets a lot of study had been done but developing markets also deserve an extensive research.