International Journal of Research in Advent Technology, Vol.7, No.3, March 2019
E-ISSN: 2321-9637
Available online at www.ijrat.org

Financial Performance Evaluation Of Tax Saving Mutual Funds In India

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Abstract: The financial services in India have undergone revolutionary changes and had become more sophisticated, in response to the varied needs of the economy. Investment in mutual funds has helped in garnering the investible funds of investors in a significant way. The retail investors turn to mutual funds to reap the advantages of less risk and high returns. The deep spikes in the Indian stock market, credit market, and rupee depreciation have created negative impact on the returns of equity mutual funds. The ordinary salaried investors may not be aware of the challenges involved and the required tools to select the appropriate tax saving mutual fund scheme for his investment. The present study aims at analyzing the performance of Open Ended Equity linked savings schemes (ELSS) tax saving mutual funds from January 2008 to December 2013 as the study period.

Keywords : Mutual fund, Investment, ELSS

1. INTRODUCTION

The Gross financial savings to the total percentage of GDP stands at ten percent (RBI , 2013) . Assets under management as a percentage of GDP is less than seven per cent in India as compared to eighty three per cent in the US, sixty one per cent in France and thirty seven per cent in Brazil (PWC, 2013). There is a need to channelize the financial savings of households in to equity investments and build financial assets in the Indian capital market. Mutual funds is considered as the most suitable investment for the common man as it offers a opportunity to invest in a diversified professionally managed securities at a relatively low cost. It allows the retail investors to beat inflation, derive capital appreciation and receive higher returns. In this way mutual fund industry contributes to the process of financial intermediation and also provide depth to the market. Mutual funds entered the Indian capital market in 1964 with a view to provide the retail investors the benefit of diversification of risk, assured returns, and professional management. Since then they have grown phenomenally in terms of number, size of operations, investor base and scope. In India, the mutual fund industry came into being with the establishment of Unit Trust of India in 1964. Public sector banks and financial institutions began to establish mutual funds in 1987. The private sector and foreign institutions were allowed to set up mutual funds in 1993. In March 1965 the AUM was INR 25 crore. As on 31st December 2013 the AUM was INR 882322 crore with 45 mutual fund houses and 2512 schemes promoted under the category of equity, debt, hybrid and gold (SEBI Annual report 2013). Over the past decade mutual funds have been the fast growing institutions in the world as they manage the risk management tools through diversification (Reily & Brown ,2003). In India Tax Saving Mutual funds (TSMFs) are otherwise known as Equity Linked Savings Scheme (ELSS). Tax saving scheme is among the popular mutual fund schemes which has been attracting investors to save taxes under Sec 80C of the Income Tax Act with an investment limit if Rs 150000. ELSS launched by mutual funds are open-ended schemes having a lock-in period of three years. An ELSS is an Mutual fund scheme which is similar to any diversified equity mutual fund scheme that routes investments into the equity markets

2. REVIEW OF LITERATURE

Treynor (1965) used characteristic line for relating expected rate of return of a fund to the rate of return of a suitable market average. The researcher coined a fund performance measure taking investment risk into account

Sharpe,William F (1966) The result of the study clearly reveals that good performance is associated with low expense ratio only and not with size.

Treynor and Mazuy (1966) evaluated the performance of 57 fund managers in terms of their market timing capabilities and found that, fund managers had not successfully outguessed the market.

Jensen (1968) developed a composite portfolio evaluation technique concerning risk-adjusted returns.

Sarkar A K (1991) examined mutual fund evaluation methodology and pointed out that Sharpe and Treynor performance measures ranked mutual funds alike inspite of their differences in terms of risk.

Gupta and Sehgal (1998) The study revealed the existence of inadequate portfolio diversification and consistency in performance among the sample schemes.

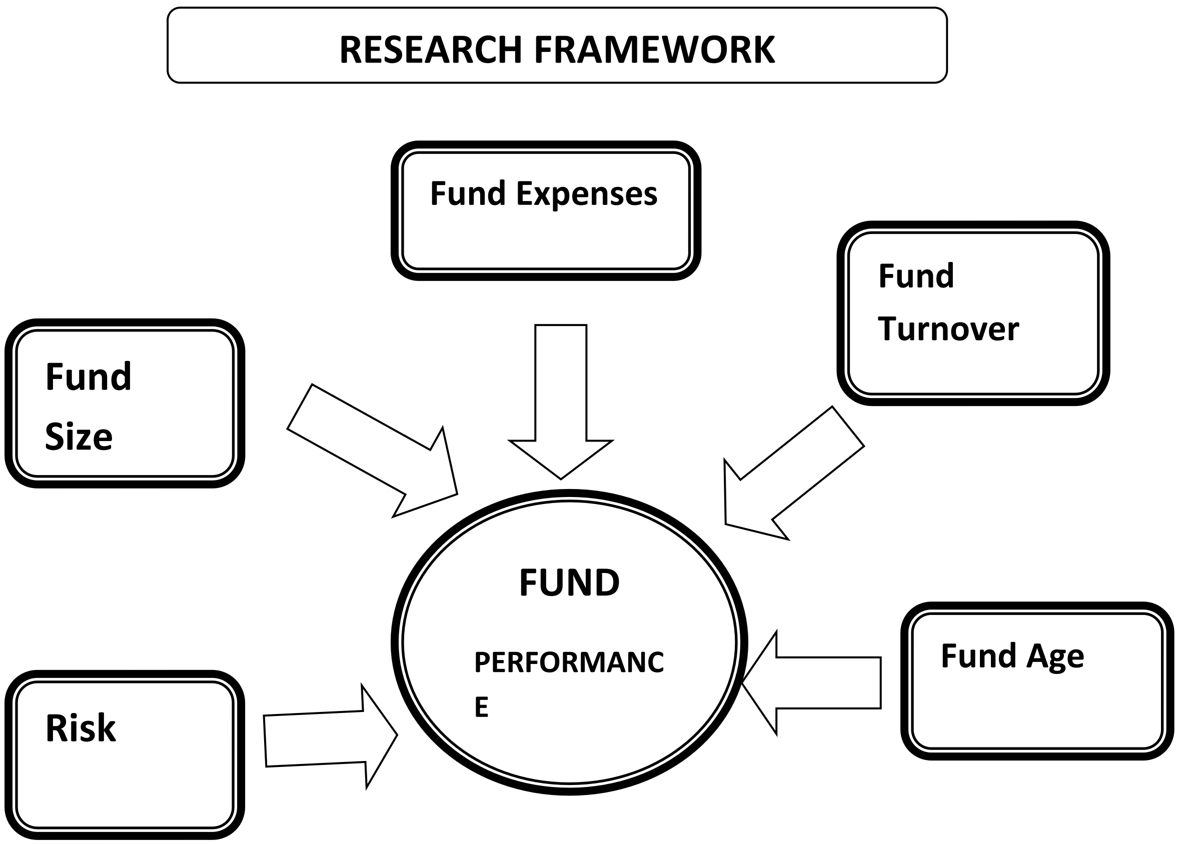
Saha, Tapas Rajan (2003) The study concluded that, the efficiency of the fund managers was the key in the success of mutual funds and so the AMCs had to ensure more professional outlook for better results.

Madumita Chakraborty, Jain.P.K and Vinay Kallianpur (2008) The study concludes that majority of the equity funds included in the sample have outperformed the benchmark

Amporn soongswang and Yosawee santdontree (2011) The study concludes that open-ended equity mutual funds significantly out performed the market and it persisted for three year period of investment.

Gaps in the Literature

The survey of literature points to the fact that only few of these studies have comprehensively attempted to focus on the performance of mutual fund schemes offered by the various Global Asset Management Companies. The fund characteristics like Risk, Fund size, Management expense ratio, Turnover ratio and Fund age were evaluated for fund performance with reference to Malaysian equity mutual funds (Young Pui See & Ruzita Joseph,2012). A closer scrutiny of these literature shows that no study so far has been done highlighting the fund characteristics and it's impact on fund performance with reference to TSMFs in India . Indeed, this gap in the available literature on the subject provides the rationale for undertaking the proposed study. The researcher examines the fund characteristics that affect fund performance by studying 36 TSMF schemes over the period of six years. The research framework were constructed upon the following fund characteristics namely Fund risk, Fund size, Fund expenses, Fund Turnover and Fund Age. These variables are considered as independent variable and Fund performance is stated as dependent variable. The hypothesis were tested using regression analysis to see whether Fund risk, Fund size, Fund expenses, Fund Turnover and Fund Age have significant relationship with fund performance.



3. OBJECTIVES OF THE STUDY

The study was undertaken with the following objectives,

1. To study the growth and development of Tax saving Mutual Funds in the Indian Mutual fund industry.
2. To compare the financial performance of Tax saving mutual funds with respect to their benchmark indices.
3. To study the Fund attributes, selection of sector investment and equity stock investment among Tax saving mutual funds.
4. To assess persistent performance among Tax saving mutual funds using Treynor, Sharpe and Jensen measures.
5. To analyze the contribution of fund risk, fund size, fund expense, fund turnover and fund age in the performance of Tax saving mutual funds.

4. HYPOTHESIS OF THE STUDY

The present study is undertaken to test the following hypotheses,

1. There is no significant relationship between TSMF returns and their respective benchmark indices.
2. There is no significant relations between Fund risk, Fund size, Fund expenses, Fund turnover, Fund age and TSMF returns.

5. LIMITATIONS OF THE STUDY

The following are the limitations of the present study.

(1) The study has covered only TSMFs from Mutual Funds Companies

(2) This study has analyzed only Open Ended and Growth based Equity Funds.

(3) The study period is restricted to the period of six years from 2008 to 2013.

6. METHODOLOGY OF THE STUDY

The present study is an attempt to analyze the performance of Open Ended Equity linked savings scheme (ELSS) of tax saving mutual funds in India during the period of 1st January 2008 to 31st December 2013. As on 31 December 2013, Indian Mutual Funds Industry had 45 players in the market. For evaluating the performance of sample Mutual Funds, Net Asset Value (NAV) was used. RBI Treasury Bill yield were taken as a risk free rate for evaluating the persistence performance of mutual funds. The tools used for examining the performance of mutual funds are daily NAV and market returns, Sharpe ratio, Treynor ratio, Jensen ratio. t-test and Regression analysis is used to find the degree of relation and significance between interdependent variables that affect the financial performance of the fund. Statistical package for social science (SPSS) was used to analyze the data.

7. MAJOR FINDINGS

1. Findings pertaining to objective 1 - Analysis of Growth and Development of Tax Saving Mutual funds in Indian Mutual fund Industry.
   The study shows that the amount of TSMFs have increased from Rs 2347 millions to Rs 23460 millions with a CAGR of 19 percent during the period of 13 years. The financial performance of TSMFs based on NAV for the period of 2008 to 2013 shows that the average returns of NAV is highest under Quantum tax-saving mutual fund followed by ICICI Pru Tax Plan and HDFC Tax Saver fund. The Average Co-efficient variation of returns is lowest for HDFC Tax Saver Fund, Franklin India Tax Shield, ICICI Pru Tax Plan and HDFC Long Term Advantage Fund indicating consistent performance.
2. Findings pertaining to objective 2 - Analysis of Financial performance of Tax Saving Mutual Funds with respect to their Benchmark Indices
   It is found that Rs 10000 invested among the TSMFs during the study period of 2008 to 2013 shows that 61 percent of the TSMFs have contributed positive returns and 39 percent shows negative returns. The study shows that only 21 TSMFs have outperformed against their respective benchmark portfolio indices and 15 TSMFs have under performed their respective benchmark indices. The t- values calculated for this study indicate that the majority of the TSMFs returns were not significantly different from their respective benchmark portfolio.
3. Findings pertaining to objective 3 - Analysis of Fund Attributes, Sector and Stock selection among the Tax Saving Mutual Funds
   The study indicates that 38 percent of the TSMFs invested on an average of 40 to 50 stocks under their fund. It is found that the average P/E ratio among Tax saving mutual funds for the study period of 2008 to 2013 ranks that Axis Long Term equity fund with the highest of 24.63 times The average P/B ratio of TSMFs for the study period 2008 to 2013 shows that Escorts tax ranks the lowest average of 2.42 times The fund managers of the TSMFs concentrated their equity investment in the Banks – Private sector category with fifty percent. The concentration of equity investment among fund managers for the study period 2008 to 2013 shows that 24% of the TSMFs invested their company holdings in Reliance Industries Ltd followed by ICICI Bank Ltd and Infosys Ltd
4. Findings pertaining to objective 4 - Analysis of Performance Persistence among the Tax Saving Mutual Funds.
   The Average Standard deviation of the TSMFs ranges from 1.63 to 0.85 during the study period from 2008 to 2013. It is found that 81% of the TSMFs shows positive beta and 19% of the fund shows negative beta. It is found that 66% of the funds shows positive Sharpe value, 6% of the funds shows low Sharpe value and 6% of the fund shows negative Sharpe value. Among the thirty six tax saving mutual funds , 33% of the funds shows positive Treynor value, 8.33% of the funds shows low Treynor value and 58.3% of the fund shows negative Treynor value. Among the thirty six TSMFs, 39% of the funds show positive Jensen value. The Top persistent performers with same ranking under Sharpe, Treynor and Jensen measures are Axis Long Term Equity fund, ICICI Pru Tax Plan, Religare Invesco Tax Plan, Reliance Tax Saver, Principal Tax Saving fund, DSP BR Tax Saver fund, Quantum Tax Saving fund and HDFC Tax Saver fund.
5. Findings pertaining to objective 4 - Analysis of Fund Risk, Fund Size, Fund Expenses, Fund Turnover and Fund Age in the Performance of Tax Saving Mutual Funds
   The Liner Multiple Regression analysis results clearly shows that all the 36 TSMFs shows that Fund risk, Fund size, Fund expenses , Fund turnover and Fund Age characteristics significantly affecting the NAV performance of the fund. The hypothesis results shows that Risk beta and Risk standard deviation is the most important independent variables affecting the performance of the fund and the least variable affecting the performance of the fund is the fund age. Similar results were found in the study of Fund characteristics and fund performance (Yong Pui See and Ruzita Jusoh, 2012)
6. Finding for 6th objective (To study the following factors affecting the performance of tax saving mutual funds :fund size, fund risk, expense ratio, fund turnover and fund age).
   The hypotheses were tested by using regression analysis to test the significant relationship between the fund variables and performance. It is found that all the hypotheses were rejected and concludes that the fund variables have significant impact on the performance of TSMFs.

8. SUGESSTIONS

The analytical study suggest that investors can invest in TSMF schemes to earn higher returns on long term basis based on NAV performance of the fund. Investors can choose the TSMF's based on the fund manger investments in top sectors of the economy that includes Bank – Private& Public and IT – Software.. Fund attributes like the number of equity stocks, P/E ratio, P/B ratio values need to be evaluated before selecting the TSMF. The NAV returns of the fund can be compared with the respective benchmark indices to identify persistent performers of the fund. It is suggested that investors analyze the risk-adjusted measures like Sharpe, Treynor and Jensen measures to evaluate the performance of the TSMFs and the stock picking abilities of the fund managers. It is suggested that the Investors compare their respective TSMFs with their peer categories. Identical ranks on all three risk-adjusted measures would signify that there is high consistency in terms of the performance of the fund. Investors should consider past performance and consistency of TSMF'S as an important factor for investment.

9. CONCLUSION

Indian Mutual Funds have emerged as strong financial intermediaries in bringing stability into the Indian financial system and Global Securities market. Majority of the TSMF schemes have shown positive NAV returns during the study period. The study revealed that the majority of the TSMF fund schemes returns were not significantly different from their respective benchmark portfolio It was noted that Fund managers invest their majority of asset allocation investment in sectors like Banks and IT sector. The study concludes that consistent performance of TSMF's were from Indian private and Joint venture type of Mutual Fund organization. The findings of the study have shown that a conceptual framework of fund characteristics affects the performance of the TSMF's in India. The results of this study are prone to various limitations and hence paving the way for future scope of study. The research framework on evaluating TSMF's will educate and empower retail investors to take informed decisions on investments related to TSMF schemes.

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