

THE DYNAMICS OF INVESTOR KNOWLEDGE IN SMALL CAP MARKETS

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Abstract

Given their impact on the financial markets and the overall health of the economy, mutual funds are significant to the economy. This study's primary goal is to investigate the variables affecting investors' attitudes and levels of expertise. The primary and secondary data obtained from small cap mutual fund investors are the only ones used in this investigation. Primarily, information from respondents who invested in small cap mutual funds and lived in the urban Bangalore district of the state of Karnataka was gathered using a well-designed, self-administered questionnaire survey. Individual, focus group, and survey interviews are among the methods of data collecting that have been used. The technique used to determine this is simple random sampling.

Key Words: Mutual Funds, Economy, Investors, Attitude & Influence

INTRODUCTION

Financial markets allocate resources and provide liquidity for firms and entrepreneurs, which is essential for the proper operation of capitalist economies. Trading financial holdings is made simple for buyers and sellers by the markets. Financial markets design securities as a way to reward investors and lenders who have extra money while also making that money available to those who need it (Ielasi et.al., 2018). Small-cap funds, also known as small-capitalization funds, are mutual equity funds that primarily invest in the stocks of small businesses. Fund managers invest in the stock of small businesses that have displayed encouraging signs of growth and the potential to grow to be very substantial businesses in the future. The fund managers of small cap funds staked the fund money on such stocks because early investors can expect excellent returns (Mirza et.al., 2020).

Mutual funds provide access to a wider range of investments or diversity than an individual investor could afford. There are cost savings associated with group investing. Asset growth is aided by regular contributions from the investor. Funds are more liquid since their volatility is generally lower (Ji et.al., 2021). Return on investment (ROI) is a performance measure used to evaluate the efficiency or profitability of an investment or compare the efficiency of a number of different investments. It tries to directly measure the amount of return on a particular investment, relative to the investment's cost. A common financial metric for assessing the likelihood of profiting from an investment is return on investment (ROI) (Jiang & Verardo, 2018). The researcher is investigating to address the question, "What is the impact of Fund Size & expense ratio on returns of the mutual fund"?

The main objective of the study is to examine the relationship between expense ratio and fund size on performance of small cap mutual funds. Return on investment (ROI) is a performance measure used to evaluate the efficiency or profitability of an investment or compare the efficiency of a number of different investments. It tries to directly measure the amount of return on a particular investment, relative to the investment's cost. A common financial metric for assessing the likelihood of profiting from an investment is return on investment (ROI). A gain or loss from an investment in relation to its cost is compared using this ratio (Galagedera et.al., 2018). Investing choices must be made by fund managers with consideration for the goals of the fund. In keeping with the fund's declared investing strategy, their objective is to maximize returns (jiet.al., 2021).

LITERATURE REVIEW

A popular tool for assessing the relative performance of portfolios is data envelopment analysis (DEA). There has been a lot of study done to understand the role of DEA in the area of evaluating portfolio performance and determining relative rankings. The role of offering attainable benchmarks isn't completely examined in the literature, though.

Most crucially, fund managers can barely be supported in their pursuit of sustainable performance by the DEA-based portfolio performance evaluation methodologies described in the existing literatures (Haigh & Hazelton, 2004). In the years following the financial crisis, bond fund performance has been determined to be superior. Strong past performance, however, cannot be used to forecast future success. Finally, while some funds are capable of market timing, we find that US bond mutual funds tend to have a prevalence of negative market timing (Anghelache & Anghel, 2014). Regression econometric modelling was employed in the study in order to assess the relationship between the performance of a portfolio of financial instruments and the development of the relevant capital market. There are risky assets and a riskless asset in complete markets. It is assumed that both the risk-free and the risky asset are continuously traded throughout time and that there is no friction in the market (Messgan et.al., 2019).

The magnitude of underperformance varies between models, ranging from 32 basis points in the four-factor model with skewness developed by Carhart to two basis points in the three-factor model developed by Fama and French. Additionally, the study reveals that when the skewness component is taken into account during the regression, alpha(s) are merely insignificant for typical mutual funds. Mutual funds have seen tremendous growth on a global scale, and they are essential to economic growth (Cremers et.al., 2019). A mutual fund's average return might differ significantly based on the particular fund, its investing strategy, the state of the market, and other elements. A range of asset classes, such as equities, bonds, and money market instruments, are available for mutual fund investments. The performance of the underlying assets affects the returns. Usually, one can look at a mutual fund's historical performance to find its average return. Different time periods, such one year, three years, five years, and so on, can be used to measure this. One popular statistic for assessing performance over longer time horizons is the average annualized return (Choi et.al., 2020).

The total market value of all the assets that a mutual fund manager for its investors is referred to as the fund size, or assets under management, or AUM. The market value of the fund's holdings in cash, bonds, stocks, and other assets is included in this. The size of the fund may change over time as investors buy or sell shares and as the market and the fund's investments change in value (Li et.al., 2021).

MATERIALS & METHODS

The current study is confined to primary data and secondary data collected from the investors of small cap mutual funds. A well-structured self-administered questionnaire survey was used as the instrument to collect the primary information from the respondents who have invested in the small cap mutual funds residing in the urban Bangalore district of the state Karnataka. The data collection instrument that has been applied includes Survey questionnaire, focus group interviews and individual interviews. Simple Random sampling is the method applied to arrive at the sample size through a Survey questionnaire to collect the data from the investors of small cap mutual funds. A total number of 150 questionnaires were administered to collect the respondents' responses, among which the completed and valid responses resulted were 129. The demographic profile variables involve gender, age, educational status, marital status, monthly income, occupation, type of family, and savings. The demographic variables considered for the studying the perception of mutual fund investors comprise of Gender, Monthly Income, Age, Family Type, and Marital Status. The perception variable involves period of life, objective of investment, term of investment, pattern, risk-bearing attitude.

RESULTS

Investors should take the expense ratio into account when assessing mutual funds because lower ratios typically translate into higher net returns for investors. Over time, high expense ratios have the potential to reduce a mutual fund's overall returns. Investors should search for mutual funds with competitive performance and reasonable expense ratios when comparing them. A mutual fund's expense ratio is a measurement of all operating and management costs, given as a percentage of average net assets in the fund. It stands for the annual fees and costs that investors pay to the fund management firm in order to have the fund's portfolio managed, as well as other operational and administrative costs.

H₀: There is no impact of expense ratio on the performance of mutual fund.

On the predictive variable of fund size, the dependent variable, average return (AR), was regressed. $F(1,8) = 3.75$ significant at 5% level. The independent variable's significant prediction of average return, shows that the study has a significant effect on investors' that confirms that the return of the mutual fund in terms of the performance is influenced by the fund size of the investments.

Table 1: Regression Analysis Summary (Fund Size)

Variable	β	S. E	t - value	p value
Intercept	24.9333	1.70249	14.65	<0.0001**
Fund Size	-2.228	1.161	-1.918	0.0091*
Goodness -of -Fit Indices				
R²				0.315
F Statistic				3.680
p value				0.091
** Significant @ 1 per cent level. Source: Computed from Secondary Data				

Table 1 shows that investments in the mutual fund based on the size, is significantly affects the average return of the fund negative beta coefficient (2.228), t-value (-1.918), statistically significant at 1 per cent. Thus, null hypothesis is rejected and alternative accepted. The R^2 (0.315) depicts that the model explains only by 31.5 per cent variance in average return with constant value 24.93. The predicted model confirms to be fit model satisfying all the assumptions, Normality of residual with chi-square (3.23) with probability (0.198), absence for hetero skedasticity was tested through Breusch-Pagan test and found no auto correlation. The Ramsey RESET test is a widely recognized statistical test that is employed to evaluate the existence of linearity within a regression model. The adequacy of the overall model fit was assessed using the F-Statistic, which determined the relevance of the model in evaluating the impact of the independent variable on the dependent variable. Hence, the obtained Regression equation resulted average return (ar) based on the fund size (fs) as below: $y = 24.93 - 2.228(fs) + \epsilon$

The above equation results that the prediction of average return based on intercept value of 24.93 which will remain constant on the standard error. The beta coefficient of the fund size (ar) is 2.228 with negative direction confirming that every unit of decrease in expense ratio will reflect positively increase in the average return in the investments of the mutual funds.

H_0 : There is no impact of Fund Size on the performance of mutual fund.

On the predictive variable of fund size, the dependent variable, average return (AR), was regressed. $F(1,8) = 3.75$ significant at 5% level. The independent variable's significant prediction of average return, shows that the study has a significant effect on investors' that confirms that the return of the mutual fund in terms of the performance is influenced by the fund size of the investments.

Table 2: Regression Analysis Summary (Fund Size)

Variable	β	S. E	t - value	p value
Intercept	18.74	2.06	9.085	<0.0001**
Fund Size	0.0003	0.0001	1.937	<0.0001*
Goodness -of -Fit Indices				
R²				0.319
F Statistic				3.752
p value				0.08
** Significant @ 1 per cent level. Source: Computed from Secondary Data				

Table 2 shows that investments in the mutual fund based on the size, is significantly affects the average return of the fund beta coefficient (0.003), t-value (9.085), statistically significant at 1 per cent. Thus, null hypothesis is rejected and alternative accepted. The R^2 (0.319) depicts that the model explains only by 31.9 per cent variance in average return with constant value 18.74. The predicted model confirms to be fit model satisfying all the assumptions, Normality of residual with chi-square (2.37) with probability (0.304), absence for hetero skedasticity was tested through Breusch-Pagan test and found no autocorrelation.

The Ramsey RESET test is a widely recognized statistical test that is employed to evaluate the existence of linearity within a regression model. The adequacy of the overall model fit was assessed using the F-Statistic, which determined the relevance of the model in evaluating the impact of the independent variable on the dependent variable. Hence, the obtained Regression equation resulted average return (ar) based on the fund size (fs) as below:

$$y = 18.74 + 0.0003(fs) + \varepsilon$$

The above equation results that the prediction of average return based on intercept value of 18.74 which will remain constant on the standard error. The beta coefficient of the fund size (ar) is 0.0003 with positive direction confirming that every unit of increase in fund size will positively reflect an increase in the average return in the investments of the mutual funds.

CONCLUSION

When assessing mutual funds, investors should take into account both expense ratios and fund size in addition to other elements like the fund's investment strategy, past performance, and the fund manager's experience. It's critical to realize that diversification is a key component of risk management for investments and that past performance does not guarantee future outcomes. Since investors receive a larger portion of the fund's returns, lower expense ratios are typically linked to higher net returns for investors. Fund size has a more complex effect on average returns. Larger funds might have advantages like economies of scale, but they might also have trouble locating lucrative investment opportunities. Two significant variables that can affect the average returns of mutual funds are the expense ratio and fund size.

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