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Research Paper

Retail Investors' Take on Mutual Funds and the Regulatory / Fiscal Environment in Which It Operates

Imtiaz Begum. I[1], Dr. B. G. Sathya Prasad[2]

[1]Research Scholar, Dravidian University, Kuppam, Andhra Pradesh, India
[2]Director, G.T. Group of Institution, Bangalore.

Corresponding Author: Imtiaz Begum. I

ABSTRACT

The mutual fund industry arrived in India in 1963 with the inauguration of Unit Trust of India (UTI), at the initiative of the Government of India and the Reserve Bank of India (RBI). India's mutual funds' assets under management had crossed a record INR 20 lakh crores. Investors had been gradually moving from physical assets like gold and real estate to financial investments. Retail investors too, had followed suit. They had been impressed with the affordable opportunities offered by mutual funds. Hence the researcher set out to examine the performance of mutual funds lately. The researcher interacted with 30 retail investors and 30 consultants to collect primary data from them for the purpose. He concluded that goal-driven investment schemes, affordable Systematic Investment Plans, professional management of investors' money, minimisation of trading costs and assured liquidity in designated schemes drove the retail investors towards mutual funds. Retail investors missed Mutual Funds-Linked Retirement Plans and were sore with the government for extending the holding period in case of debt-oriented mutual funds (for qualifying as 'long-term capital asset') to 36 months. The regulator prohibiting distributors from offering investment advice to investors had not gone down well with the retail investors. The researcher asserted that the Mutual Funds-Linked Retirement Plan represented a positive sum game. The country's economy and all the stakeholders associated with the mutual funds industry would benefit from the Plan. Further, distributors being forbidden from offering investment advice were a measure introduced in haste. In the Indian context, this could not be justified fully. The researcher recommended that the measure be reviewed. It made sense to err on the side of caution where there was a grey area. Further, the Securities Transaction Tax (STT) should not be collected during redemption of units under equity schemes of mutual funds -- it amounted to double levy of STT.

Key words: *Designated; Goal-driven; MFLRP; Systematic Investment Plans; RBI; STT; UTI*

1.1 INTRODUCTION

The mutual fund industry arrived in India in 1963 with the inauguration of Unit Trust of India, at the initiative of the Government of India and the Reserve Bank of India. The history of mutual funds in India can be viewed in four distinct phases, namely, the first phase (1964-87), the second phase (1987-93) , the third phase (1993-2003) and the fourth phase (from February 2003, till date).

Mutual fund is a mechanism for pooling money by issuing units to the investors. The money so pooled is invested in securities like stocks in accordance with certain objectives. These objectives are disclosed by the mutual fund concerned in what is called an offer document.

Investments in securities are spread across industries and sectors. This diversifies away the risk because all stocks may not gain in the same proportion all the time. Mutual funds issue units to the investors in proportion to the investment made by them. Investors in mutual funds are called unit-holders. The profits generated or losses incurred are shared by the investors in proportion to their investment. Mutual funds normally come out with a number of schemes. They are launched from time to time and with different investment objectives. A mutual fund is required to be registered with the Securities and Exchange Board of India (SEBI) before it can collect funds from the public. SEBI formulates policies, regulates and supervises mutual funds to protect the interests of the investors. SEBI notified regulations for mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also been issuing guidelines through circulars to mutual funds from time to time to protect the interests of investors. All mutual funds, whether promoted by public sector or private sector entities (including those promoted by foreign entities) are governed by the same set of regulations. There is no distinction in regulatory requirements across mutual funds and all are subject to monitoring and inspection by SEBI.

A mutual fund is constituted as a trust, which boasts of a sponsor, trustees, an Asset Management Company (AMC) and a custodian. The trust is established by one or more sponsors and their role is akin to the role of promoters in a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. The AMC, approved by SEBI, manages the funds by making investments in various types of securities. The custodian, who is required to be registered with SEBI, holds the securities of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance with SEBI regulations by the mutual fund. SEBI regulations require that at least two-thirds of the directors of a trustee company or board of trustees be independent. In other words, they should not be associated with the sponsors. Also, at least 50 percent of the directors of the AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.

India's mutual funds' assets under management crossed a record INR 20 lakh crore, riding on buoyant inflows (Azman, Ridhima, & Jayesh, 2017). Investors have been gradually moving from physical assets like gold and real estate to financial investments. Total assets under management grew three percent sequentially in August to INR 20.6 lakh crore, according to monthly data released by the Association of Mutual Funds in India. Net inflows crossed INR 2.47 lakh crore up to September 2017. That compares with INR 2.83 crore in the whole of 2016. India's mutual fund industry's assets have doubled over the past three years. This is characterised by large inflows into equity and balanced funds, with rising participation from retail and high net worth individual investors, according to an industry watcher. The industry crossed the INR 10 lakh crore mark in August 2014. An independent study published by the Reserve Bank of India has also noted a "distinct increase" in formal channels of savings like mutual funds and life insurance policies since the government scrapped old high-value currency notes in November 2016. Inflows between then and June went up to INR 1.67 lakh crore, compared to INR 9,160 crore in the same period a year ago. Mutual funds are the biggest recipient of the asset allocation rebalancing by Indian savers and it will continue, according to some leading AMCs.

1.2 Statement of the problem

Retail investors have been slowly but steadily moving towards financial assets

in general, from physical assets. Retail investors are apparently impressed with the opportunities offered by mutual funds commensurate with their affordability. Hence it is relevant to examine the performance of the mutual funds lately, in terms of the rewards they have conferred on the retail investors. Since the investors involved are individuals, the regulator should be on its toes all the time. Further, the said retail investors are by and large not familiar with the nitty-gritty of mutual funds. Given that mutual funds have been keeping the retail investors happy, the powers that be should examine how the fiscal carrots can be exploited even more to motivate more and more individuals to invest in securities the mutual funds way.

1.3 Review of literature

1. Investors in debt mutual funds in India have witnessed setbacks lately (Moneycontrol, 2017). While Taurus Mutual Fund's investors in debt funds saw their investment erode owing to a rating downgrade of a paper, investors in many other debt funds generated negative returns owing to a sharp rise in interest rates in the last month. In both the cases, it was the investor that faced the brunt. Bond funds are exposed to credit risk and interest rate risks. Ignoring these two risks and merely running after returns will lead to such adverse consequences, according to a mutual fund distributor. It may be recalled that the value of various fixed income schemes floated by Taurus Mutual funds fell by 7 percent to 12 percent on February 23, 2017 as it held some papers issued by Ballarpur Industries. The latter's papers had been downgraded by a credit rating agency. Over the last month, some ultra-short term bond (USTB) funds too reported negative returns since they were invested in long term papers which witnessed a fall in prices owing to a sudden hike in interest rates in the economy. USTB funds are viewed as relatively safe bets by many investors. In the case of investors in long term bond funds and long term gilt funds, the fall was worse. Contrary to the previous month, during the last calendar year, debt fund investors had realised double digit returns. Consistently falling interest rates, on the back of macro factors like falling inflation or the demonetization-led liquidity in the system, led most investors to treat bond funds like quick money-making contraptions. 10-year benchmark yield moved to 6.516 on December 30, 2016 from 7.732 on January 1, 2016. After scaling a low of 6.183 on December 7, 2016, it moved up to 6.842 on March 2, 2017. If one reviews the one-year return of the bond funds, the picture is rosy for one seeking higher returns. But a look at the last month's returns may lead the investor to rethink.
2. Even as retail investors continue to invest in equity schemes, fund houses are hard put to invest since valuations are higher (Yogita, 2017). The cash component of some equity mutual funds is up to 16 percent of their corpus. Holding high cash balances for longer periods can dent the performance, according to analysts. Most funds with higher levels of cash have lagged their benchmarks, research shows. Equity funds do maintain some cash levels, the levels being governed by market valuations, liquidity needs and fresh purchases. Collectively, the level does not go beyond 6-7 percent. In the short term, cash levels could rise, though. This is because, there may be huge inflows into the fund, or the manager may await suitable investment opportunities. Higher cash balances may come in handy when there is a correction; however, such balances can dent the performance if there is a significant upward movement.
3. An adage has it that almost anybody can enter a good stock at the right time, but only the smart investors can exit at the

right time (Rego, 2017). Although suggested as a long term investment, in certain circumstances, the investor would be better off selling and exiting mutual fund holdings. The following are some such circumstances: Consistent underperformance of the fund, investor's dissatisfaction with the decisions of the fund manager, systemic dent inflicted by key macro changes (RBI may raise interest rates, for example), the goal behind the investment is yet to be met, rebalancing of the portfolio is due, core features of the fund have changed and the fund is attracting a lot of flak from the media.

4. Equity markets will certainly rise and certainly fall, asserts the researcher (Aniruddha, 2017). Most of these movements will be minor in nature, whereas some will be earth-shaking. Undoubtedly, a fair degree of risk aversion follows every such market cycle, with a number of retail investors deserting the "equity ship, only to return and re-commit the blunder. However, winding up mutual fund investments may be unwise for strategic investors. They may miss the gravy train of wealth creation that these products offer. But when one realises that there have been times when even established funds with enviable long term track records have witnessed values drop by 40-50 per cent in bad years, it becomes obvious why a single such event is enough to scare away investors so much that they swear not to return to the mutual fund stable. But they do not realise that they are missing out on opportunity losses in the long term. In 2008, after a sharp sell-off, stocks were available at very attractive valuations but most investors, fearing a further fall in the markets, stayed away unwisely.
5. Indian equity investors, particularly those investing through mutual funds, are allegedly too fickle and too impatient (Sanket, 2016). When the stock market is doing well, equity funds receive heavy inflows. Once the market starts moving south, the enthusiasm wears off. A couple of hiccups is good enough to spoil the show. Inflows terminate or are withdrawn promptly. Research has shown that around 70 percent of mutual fund inflows occur typically when the market is overvalued. A meager 4-5 percent of inflows are witnessed when the market takes a hit. Lately though, a strange phenomenon is becoming noticeable. Over the past year, there has been a paradigm shift in investor attitude towards equity mutual funds. January 2016 marked the twenty-first consecutive month of positive net inflows into equity funds, subdued though the inflows were, compared to previous months. Lump sum investments seem to have lost mojo while SIP investments continue unhindered. The industry has seen a monthly rise of around 200,000 SIPs since March 2015. This is interesting given the shaky, uncertain market environment one has been witnessing over the past few months. In the first eight months of 2015-16, some 35,00,000 new investors participated in mutual funds. Of this, around 27,00,000 invested in equity funds, much like individuals are wont to do. The sustained interest of investors even after the market hit turbulent weather last year seems inexplicable.

1.4 Research gap

The researchers have vetted the issues the retail investors are confronted with, in spite of SEBI being proactive in attending to investor grievances. As one researcher has rightly pointed out, higher valuations are making it difficult for fund house to invest. By default, investors in the country's mutual funds are impatient. Hence products that the fund houses design should ensure that the said idiosyncrasy of the Indian retail investors is not lost sight of. These merits notwithstanding, one does rue the absence of factors that drive the Indian retail investors the mutual funds way, in the

reviewed literature. Nor has the reviewed literature said how the regulatory regime has been performing to protect the interests of the retail investors. Given the relevance of investment in mutual funds to the Indian retail investors, the researchers could have suggested how the fiscal tools could be used more effectively to motivate more and more of retail investors to take the mutual funds route to investment. These gaps are sought to be bridged by the researcher.

1.5 Scope of the present study

The study confines itself to retail investors and consultants based in and around Bangalore.

1.6 Objectives of the study

The objectives of the study are to:

1. Ascertain the factors that lead the retail investors to invest in mutual funds
2. Identify the measures required to fine-tune the regulatory / fiscal regime to ensure that they become more retail investor-friendly

1.7 Hypothesis proposed to be tested

The study proposes to test the following hypotheses:

"Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should be nullified".

1.8 Research design

1.8.1 Research methodology

The study is descriptive in nature and has used the 'fact-finding' survey method

1.8.2 Sources of data

Primary data has been collected from the respondents, viz., 30 retail investors and 30 consultants.

Secondary data has been collected from industry bodies / industry associations including the Association of Mutual Funds in India, RBI and SEBI. In addition, secondary data has been downloaded from the web sites of the RBI, SEBI and the financial press.

1.8.3 Sampling plan

Retail investors: Given the rather limited number of retail investors residing in the vicinity where the researcher lives and the time constraint, purposive or judgement sampling under the non-probability method has been employed. Applying a minimum exposure of five years to investment in mutual funds as the criterion, the researcher selected 30 such investors. This criterion, according to the researcher, is the most appropriate one for the present study. What is important is the typicality and the relevance of the sampling units to the study and not their overall representativeness to the population. Thus it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

Consultants: Given the rather limited number of consultants operating in the vicinity where the researcher lives and the time constraint, purposive or judgement sampling under the non-probability method has been used. Applying a minimum exposure of five years to the mutual funds industry as the criterion, the researcher selected 30 such consultants. This criterion, according to the researcher, is the most appropriate one for the present study. What is important is the typicality and the relevance of the sampling units to the study and not their overall representativeness to the population. Thus it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

1.8.4 Data collection instruments

Interview schedules, specially designed for the purpose, were administered to the respondents for collection of primary data.

1.8.5 Data processing and analysis plan

Non-parametric statistical units were used to test the association between some qualitative characters and conclusions were drawn on the basis of formation of H_o and H_1.

1.8.6 Limitations of the study
Primary data has sometimes been deduced through constant topic-oriented discussions with the respondents. It is possible that a certain degree of subjectivity, even if negligible, has influenced their views.

1.9 Retail investors
In the following paragraphs, the primary data collected from the 30 retail investors is analysed.

1.9.1 Factors that lead the retail investors to invest in mutual funds
In a departure from the past, more and more of retail investors have been investing in mutual funds. Hence the researcher requested the respondents to reveal the factors that led them to invest in mutual funds. Their replies to the query appear in the following Table.

Table-1: Factors that lead the retail investors to invest in mutual funds

Factors	Number of respondents
Can invest modestly and regularly in schemes like SIPs (Systematic Investment Plans)	27
Goal-driven investments are made easier by mutual funds	26
The investment is professionally managed	24
It is possible to minimise trading costs	23
Investment in open-end funds ensures liquidity	22

The factors cited by 27 respondents are that they can invest modestly and regularly in schemes like SIPs (Systematic Investment Plans). Goal-driven investments are made easier by mutual funds, cite 26 respondents. The investment is professionally managed, cite 24 respondents. It is possible to minimise trading costs, cite 23 respondents. Investment in open-end funds ensures liquidity, cite 22 respondents.

1.9.2 Fine-tuning the regulatory / fiscal regime to ensure that they become more retail investor-friendly
Received opinion has it that the regulatory / fiscal regime can be fine-tuned to ensure that they become more retail investor-friendly. Hence, the researcher sought to know from the respondents, the fine-tuning measures required to ensure that the regulatory / fiscal regime becomes more retail investor-friendly. Their replies to the query appear in the following Table.

Table-2: Fine-tuning the regulatory / fiscal regime to ensure that they become more retail investor-friendly

Measures	Number of respondents
Mutual Funds-Linked Retirement Plans (MFLRP) should be introduced	27
Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should be nullified	26
Distributors should not be forbidden from offering investment advice	24

Mutual Funds-Linked Retirement Plans (MFLRP) should be introduced, is the measure suggested by 27 respondents. Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should be nullified, is the measure suggested by 26 respondents. Distributors should not be forbidden from offering investment advice is the measure suggested by 24 respondents.

1.10 Consultants
In the following paragraphs, the primary data collected from the 30 consultants is analysed.

1.10.1 Factors that lead the retail investors to invest in mutual funds
In a departure from the past, more and more of retail investors have been investing in mutual funds. Hence the researcher requested the respondents to reveal the factors that led them to invest in mutual

funds. Their replies to the query appear in the following Table.

Table-3: Factors that lead the retail investors to invest in mutual funds

Factors	Number of respondents
SEBI-induced regulations ensure transparency in all aspects of investment	27
The investment is professionally managed	26
Helps minimise the risk by investing across industries and geographies	26
Retail investors can invest modestly and regularly in schemes like SIPs (Systematic Investment Plans)	25
Investment in open-end funds ensures liquidity	25
Goal-driven investments are made easier by mutual funds	24
On completion of 12 months, the investment qualifies for capital gains and is taxed modestly	24

The factors cited by 27 respondents is that SEBI-induced regulations ensure transparency in all aspects of investment. The investment is professionally managed, cite 26 respondents. Helps minimise the risk by investing across industries and geographies, cite 26 respondents. Helps minimise the risk by investing across industries and geographies, cite 25 respondents. Retail investors can invest modestly and regularly in schemes like SIPs (Systematic Investment Plans), cite 25 respondents. Investment in open-end funds ensures liquidity, cite 25 respondents. Goal-driven investments are made easier by mutual funds, cite 24 respondents. On completion of 12 months, the investment qualifies for capital gains and is taxed modestly, cite 24 respondents.

1.10.2 Fine-tuning the regulatory / fiscal regime to ensure that they become more retail investor-friendly

Received opinion has it that the regulatory / fiscal regime can be fine-tuned to ensure that they become more retail investor-friendly. Hence, the researcher sought to know from the respondents, the fine-tuning measures required to ensure that the regulatory / fiscal regime becomes more retail investor-friendly. Their replies to the query appear in the following Table.

Table-4: Fine-tuning the regulatory / fiscal regime to ensure that they become more retail investor-friendly

Measures	Number of respondents
Mutual Funds-Linked Retirement Plans (MFLRP) should be introduced	27
Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should be nullified	27
Securities Transaction Tax (STT) should not be collected during redemption of units under equity schemes of mutual funds to avoid double levy of STT.	25
Distributors should not be forbidden from offering investment advice	21

Mutual Funds-Linked Retirement Plans (MFLRP) should be introduced, is the measure suggested by 27 respondents. Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should be nullified, is the measure suggested by 27 respondents. Securities Transaction Tax (STT) should not be collected during redemption of units under equity schemes of mutual funds to avoid double levy of STT, is the measure suggested by 25 respondents. Distributors should not be forbidden from offering investment advice is the measure suggested by 21 respondents.

1.11 Summary of findings

In the following paragraphs, a summarised version of the findings arrived at in respect of the three categories of respondents is furnished.

1.12.1 Retail investors

- ✓ The factors cited by 27 respondents are that they can invest modestly and regularly in schemes like SIPs (Systematic Investment Plans). Goal-driven investments are made easier by mutual funds, cite 26 respondents. The investment is professionally managed, cite 24 respondents. It is possible to minimise trading costs, cite 23 respondents. Investment in open-end

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1.12.2 Consultants

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1.12 CONCLUSIONS

Conclusions relate to the hypotheses. They are answers to the research questions.

1.13.1 Hypothesis testing

Hypothesis

As explained, the following is the hypothesis proposed to be tested:

"Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should be nullified".

Hence H_0 and H_1 are as follows:

H_0: Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should not be nullified

H_1: Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months should be nullified

On the basis of the primary data collected from the respondents, vide Tables: 2 and 4, a chi-square test was applied to ascertain the association, if any, between the two variables. The following Table reveals the computation made using MS-Excel:

		Observed Values		
	Category	*Yes*	*No*	*Total*
	Retail investors	26	4	30
	Consultants	27	3	30
	Total	*53*	*7*	*60*
		Expected Values		
	Category	*Agree*	*Disagree*	*Total*
	Retail investors	26.5	3.5	30
	Consultants	26.5	3.5	30
	Total	*53*	*7*	*60*
		Agree	*Disagree*	
2	o-e	-0.5000	0.5000	
		0.5000	-0.5000	
	(o-e)^2	0.2500	0.2500	
		0.2500	0.2500	
	((o-e)^2)/e	0.0094	0.0714	
		0.0094	0.0714	
	CV	*0.0189*	*0.1429*	*0.1617*
	TV			*3.8415*
	p			*0.9969*

The calculated value of χ^2 is *0.1617*, lower than the table value of *3.8415* for an alpha of 0.05 at one degree of freedom. Hence the alternate hypothesis is rejected. p=*0.9969* is the inverse of the one-tailed probability of the chi-squared distribution.

1.13 Researcher's recommendations

1. Mutual funds do provide an opportunity to retail investors to invest in securities which they may not have been able to do on their own. By investing a small sum of money, they can get to part-own even the largest blue-chip. Viewed from this perspective, one has to appreciate the egalitarian approach underlying investment in mutual funds. The retail investor should not be denied the opportunity of part-owing a hugely successful business and enjoy its fruits simply because he / she lacks the requisite financial muscle. In fact, in the advanced economies, the mutual funds route represents the default route the retail investors take to invest in securities, corporate or otherwise. Happily, such a trend is slowly but steadily emerging in India too and that is happy tidings.
2. The country's mutual funds industry, jointly with the regulator SEBI, has been operating schemes like SIP. The latter makes it easier for the retail investor to part-own businesses without feeling the pinch. The not-so-affluent retail investor cannot ask for more – after all, he / she is on a par with his / her affluent peers when it comes to investing in highly coveted securities. It is for the retail investor to grab the opportunity that the country's government and regulator have so generously provided him / her with and enjoy the fruits of such investment.
3. The retail investor is also benefited in another way when he / she takes the mutual funds route to invest: he / she can reduce trading costs and ensure liquidity of his / her investment by investing in designated mutual fund schemes like the open-end schemes.
4. It is time the regulators took serious note of the demand of the retail investors and permitted the introduction of MFLRP. The latter represents a positive sum game and an emerging market economy like India can benefit most from such schemes. It will benefit all the stakeholders associated with the mutual funds industry.
5. Extension of holding period in case of debt oriented mutual funds for qualifying as 'long-term capital asset' to 36 months is the last thing the government and the regulator should have attempted in our country. After all, mutual funds are yet to put down roots in our country. The researcher strongly recommends that the provision be withdrawn immediately. If the provision is fraught with loopholes that are likely to be misused and abused by vested interests, there are better ways of going about it.
6. Distributors being forbidden from offering investment advice is a measure introduced in haste. At least in the Indian scenario, this cannot be justified fully. The researcher suggests that the measure be reviewed in the context of the Indian scenario. After all, it makes sense to err on the side of caution when there is a grey area.
7. Securities Transaction Tax (STT) should not be collected during redemption of units under equity schemes of mutual funds since it amounts to double levy of STT. It is unfortunate that far from encouraging retail investors to actively participate in mutual funds, the government and regulator should bring in such a retrograde regulation.

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