A Study on Changes in Equity Funds Due to Categorization of Mutual Funds and Their Impact on Investors' Behavior

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Abstract

Securities Exchange Board of India (SEBI), the regulator of the Indian capital markets, is constantly bringing in changes to improve investor experience in the capital markets. One such development is the October 6, 2017 announcement on the categorization of mutual funds to remove clutter in the industry and to make it more understandable to ordinary investors. The categorization caused a huge impact on the existing schemes and influenced investors to make necessary adjustments to their existing investments in mutual funds. The study used both primary and secondary data to analyze the impact of the changes on investors and their consequent behavior. The study was conducted as a descriptive and exploratory study. The study found that most mutual fund investors were aware of the changes and understood the changes and their impact. There were 11 mutual fund schemes, which had an impact on their attributes because of the categorization announcement of SEBI.

Keywords : **Categorization, mid cap, large cap, mutual fund schemes, small cap**

JEL Classification: G11, G18, G19

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A mutual fund is a type of financial intermediary that pools the funds of investors who seek the same general investment objective and invests them in a number of different types of financial instruments, for example, equity shares, bonds, and money market instruments. These pooled funds provide thousands of investors with proportional ownership of diversified portfolios managed by professional investment managers.

The mutual fund industry has enjoyed substantial growth in terms of assets under management as well as the investors' accounts. Of many reasons that contributed to the growth of the mutual fund industry, the fundamental one is the increasing complexity of modern investments. The number of securities available for investment has increased substantially. The varied and interrelated forces influence the prices of securities, and the technical and analytical study of securities' value made it difficult for men of small means and limited knowledge to make sound and profitable investment decisions. In such a situation, mutual funds offer several advantages to the investors over direct investing. They are professional investment management, risk reduction through diversification, convenience, availability of alternate portfolio objectives and products, unit holders' account administration and services ensuring liquidity of investment, lower transaction and other costs, regulatory protection, relatively higher returns than other financial instruments vis-à-vis their risks, etc.

However, despite this sharp growth, the industry remains a maze for the investor given the large number of schemes (280 open-ended equity schemes) and absence of standardization in the offerings. To bring in uniformity

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and avoid duplication, the market regulator, SEBI introduced a new system of fund classification on October 6, 2017.

Before this announcement, there were not any standard definitions of mutual fund categories. Mutual funds were free to determine a scheme's characteristics and investment strategy while seeking approval from SEBI to launch a fund within a broad framework. As a result, mutual fund companies came up with their own names, definitions, and methodologies of categorizing funds. For example, Flexi cap Emerging Blue-chip, etc. In addition, the mutual funds companies launched multiple schemes with similar strategies, and themselves decided on what stocks qualified as large cap, midcap, and small cap. Hence, there was no uniformity across the asset management companies (AMCs). Further, there was no set definition for the percentage of stocks of a particular market a fund could hold. For example, some large cap funds invested 50% in mid and small caps stocks, but were still categorized as large cap funds. Non-standard or ad hoc category definitions and the large number of schemes made it difficult for advisors and investors to meaningfully evaluate and compare funds and select a suitable one for investment.

SEBI's latest circular on categorization and rationalization of mutual fund schemes proposed three new rules. One, all AMCs are henceforth required to classify their open-end schemes into just five categories - equity, debt, hybrid, solution-oriented schemes, and others (only index funds and fund-of-funds). Two, they should further classify their schemes into SEBI-approved types. It has provided a readymade list of 10 types of equity funds, 16 types of debt funds, 6 types of hybrid funds, and 2 solution-based products. No AMC can run more than one scheme under each type. Three, to ensure truth in labeling, SEBI has asked all AMCs to ensure that their schemes stick to mandates defined by it. For instance, it defines a large-cap fund as one which invests a minimum 80% in the top 100 stocks by market capitalization. A focused fund cannot own more than 30 stocks. These guidelines would result in a rationalization of funds across categories.

Due of these guidelines, AMCs had to categorize their funds into defined sections and seek approval from the regulator prior to December 15, 2017. AMCs, particularly those running multiple funds with similar mandates, either needed to make changes to the investment strategies or merge them with other existing funds within a maximum period of three months, that is, by March 2018. Due to the complications involved in the process of change, SEBI extended the deadline to June 2018. AMCs were also required to communicate any changes in fund attributes, mergers, etc. to investors within a stipulated period and typically, in case of significant changes in attributes, exit options would be provided to investors. Further, any significant changes in the investment strategy might also result in a fund becoming unsuitable for investors' portfolios based on the investment horizon, risk appetite, or desired portfolio mix. Thus, the circular not only affected the investors' investment patterns (behavior) but also impacted the AMCs.

Since the nature of funds is changing due to the new mandate, the present study was conducted to analyze the changes and its impact on investors. Further, the study tries to understand the perceptions of investors towards categorization of mutual funds and gives suggestions on how to increase the knowledge level of investors.

The Table 1 shows how asset under management has been growing in the Indian mutual fund sector over the last 10 years from 2009 to 2019. There has been almost a five-fold growth. Indian mutual funds offered over 1200 mutual fund schemes across 42 AMCs. Each scheme had a direct plan and a normal plan, and each plan had a dividend option and a growth option. Moreover, the larger AMCs would have multiple equity schemes with different names, but the same structure. This made the choice tough for the mutual fund investor.

Table 1. Growth in Asset Under Management

Date	Asset Under Management (₹)
June 30 , 2009	5.83 Trillion
June 30 , 2014	9.75 Trillion
June 30 , 2019	24.25 Trillion

Review of Literature

(1) Investors' Perceptions : Kaur and Kaushik (2016) conducted a study to understand the determinants of investment behavior of investors towards mutual funds. Based on the theory of planned behavior, the study examined the effect of awareness, attitude (perception for outcome), and socioeconomic conditions of an investor on his/her investment behavior towards mutual funds with the logit model. The results were based on 450 valid responses obtained from a primary survey conducted in Delhi-NCR. The research showed that investment behavior could be explained with awareness, perception, and socioeconomic characteristics of individual investors. Better awareness related to various aspects of mutual funds had a positive effect on investment in mutual funds. Contrary to belief, risk perception for mutual funds had no effect on investment decisions.

Kumar and Kasilingam (2017) found the investors' perception about the process of mergers. This study also tried to find the influence of profile of investors on their perception about the process of mergers. This study was based on primary data collected from 513 equity investors in Chennai and Puducherry. The statistical tools of simple mean, cluster analysis, discriminant analysis, chi-square test, correspondence analysis, ANOVA, post-hoc analysis, and canonical correlation were adopted to analyze the data. This study found that the equity investors felt that SEBI was effectively controlling the process of M&As.

Kotishwar and Khan (2012) analyzed mutual fund investments in relation to investors' behavior. Investors' opinion and perceptions were studied pertaining to various issues. The issues considered were: type of mutual fund scheme, main objective behind investing in mutual fund scheme, role of financial advisors and brokers, and investors' opinion relating to factors that attracted them to invest in mutual funds, sources of information for investors, deficiencies in the services provided by mutual fund managers, challenges before the Indian mutual fund industry, etc.

Saha and Dey (2011) analyzed the factors affecting investors' perception of mutual fund investments. The study focused on measuring investors' expectations and their preferences. It also attempted to gauge the factors that they took into consideration before making any investment in mutual funds as well as the awareness level among individual investors regarding mutual fund investments. A sample survey was conducted in Kolkata during the period from November 2008 to January 2009. A sample of 100 individual mutual fund investors was approached through a pre-tested questionnaire. The individual investors included people who had invested in mutual funds and had some knowledge about the basic terminologies involved with mutual funds. An attempt was made to identify the factors perceived to be important by investors before investing in any mutual fund.

(2) Factors Affecting Performance of Funds : Yadav, Sudhakar, and Kumar (2016) attempted to conduct an empirical study of the performance of equity oriented open-ended growth mutual fund schemes in India. For the purpose of the study, 80 mutual schemes were selected which were active during the period from June 2005 to June 2015. The study analyzed through regression, the performance of the schemes on the basis of returns and macroeconomic variables on the performance of the funds. The various macroeconomic variables which were studied were CPI, gold prices, oil prices, exchange rate, foreign exchange reserves, and interest rates. The study also concluded that some of the fund attributes and macroeconomic factors affected the performance of the mutual funds.

Vijayakumar and Muruganandan (2012) examined the relationship between fund performance and fund characteristics. The fund performance was measured by fund return and its determinants were measured by standard deviation, fund size, turnover ratio, income ratio, and expense ratio. The study employed panel data analysis and observed that fund performance was positively influenced by its volatility, size, and expenses ratio, and was negatively related with turnover ratio. The study also found no evidence of income ratio relating to fund performance. Overall, the study observed that fund managers were generally not aggressive to new information in the market.

Benson, Tang, and Tutticci (2008) examined the relevance of fund specific and family variables in the determination of money flows to Australian investment funds. Existing literature established the relevance of past period returns to individual fund flows. The results showed that family characteristics were also relevant to flows. Investors in individual funds were sensitive to family size, family age, and product proliferation. The reported relations showed that investors recognized that a fund was an embedded member of the family where fund-level and family-strategies were important for investment decisions.

(3) Response of Asset Allocation to Fund Performance and Market Conditions : Karoui and Meier (2010) analyzed the response of the asset allocation process to fund performance and broad market conditions as well as the market determinants of fund flows for hybrid funds. Using a large sample of hybrid funds, the findings revealed that managers increased their stock allocation and reduced their bond allocation subsequent to periods of outperformance; that the stock allocation was positively correlated with past stock returns and negatively correlated with bond returns. For the bond allocation, the study documented a negative correlation with lagged stock and bond returns. In addition, fund flows reacted favorably to an increase in stock and bond returns, while high-stock fund flows exhibited a higher sensitivity to stock returns.

(4) Guidelines for Investment Service Provider : Puustinen, Kuusela, and Rintamäki (2012) collected data from 95 individuals and network analysis were used to reveal and identify 747 linkages among 33 content-analyzed goals as reasons for investing in individual stocks, mutual funds, and/or voluntary pension plans. The results suggested that consumers' goals associated with investments were: (a) besides economic, functional, emotional, and symbolic ; and (b) were influenced by the type of investment product under evaluation rather than being independent of the investment alternatives. The article presented guidelines for investment service providers on: (a) how to provide facilities that support consumers' investment-related goals; and (b) how to encourage consumers to take an active role in customizing and personalizing their investment practices when using these facilities. While economic, functional, emotional, and symbolic goals are well established in consumer research literature, these elements contributed to a novel understanding of the drivers underlying investment in general and the differences in distinct product categories in particular.

(5) Performance Across the Business Cycle : Badrinath and Gubellini (2012) analyzed mutual fund performance across the business cycle by disaggregating funds into different investment objectives to determine which funds possessed this cyclical performance and which did not. The study employed a conditional asset-pricing model that better captured variations in the pricing kernel in different economic states. The empirical model was adjusted for time-variation in both risk (beta) and performance (alpha). The study specified economic states using an ex-ante measure, the expected market risk premium. In a comparison of active mutual funds with passive counterparts, it was found that both the stocks held by the small-cap managers as well as their stewardship of the portfolio contributed to that performance.

(6) Response of Fund Categories Towards Hazard Functions Depending on the Investment Objective : Bu and Lacey (2009) examined the determinants of U.S. mutual fund terminations and provided estimates of mutual fund hazard functions. The study found that mutual fund termination correlated with a variety of fund specific variables as well as with market variables such as the S&P 500 index, and the short-term interest rate. The study also found that the different fund categories exhibited distinct hazard functions depending on the fund's investment objectives.

(7) Speed of Adjustment of a Fund's Stock Holding Level : Calvet, Campbell, and Sodini (2009) studied the dynamics of the portfolio of individual households between 1999 and 2002 in Sweden. Wealthy, educated investors with better-diversified portfolios were found to rebalance more actively. Some evidence was found that households rebalanced towards a greater risky share as they became richer. Households were more likely to fully sell directly held stocks if those stocks performed well, and were more likely to exit direct stockholding if their stock portfolios had performed well. These relationships were much weaker for mutual funds, a pattern that was consistent with previous research on the disposition effect among direct stockholders and performance sensitivity among mutual fund investors.

Objectives of the Study

- To determine the impact of new stock classification on 30 equity funds recommended by Geojit.
- To study investors' perception towards the categorization of funds.

Research Design

(1) Statement of the Problem : Lack of knowledge and awareness of investors regarding the changes that have happened in funds due to categorization and rationalization of mutual funds due to the SEBI announcement on October 6, 2017 could affect their investments in mutual funds. Being aware of the changes and doing nothing about it can also have a negative impact on investors' investments.

(2) Scope of the Study : The scope of the first study is reasonably broader and includes evaluation of attributes (type of scheme, objective, strategy, asset allocation of each fund). For this, the study has only considered one fund for each category on the basis of convenient sampling. These are funds with corpus value above ₹ 200 crore (Cr) and those that have empaneled with Geojit. The second study is confined to portfolio movement of 30 recommended equity funds of Geojit, and for the third study, the questionnaire was only sent to the investors of Ernakulum region. The study availed data pertaining to five months from November 2017 to May 2018.

(3) Methodology : Exploratory and descriptive research methods were adopted. The objective of the collection of data from the questionnaire was to accurately describe basic information about the perception of investors regarding categorization. The research can be considered exploratory since it helps us to understand the impact of categorization on investors and fund managers' behavior.

(4) Sampling Technique : The study was based on convenience sampling technique which relies on data collection from investors who are easily available to participate in the study. The researchers' accessibility to mutual fund investors has been considered as the cause of convenience. The sample size selected for the survey in this research was 104 respondents.

(5) Data Collection : The study was supported by both primary as well as secondary data. The changes in fund attributes were examined through secondary data, which were collected from the records of Association of Mutual Funds of India, Value research website, Morningstar website, Mutual cafe website; other data based websites, company websites, journals, magazines, and other authenticated published data. To examine investors' awareness and perception towards change and their behavior aligned along with it, primary data were collected through a structured questionnaire prepared for this purpose. To elicit information, the questionnaire was sent to some existing customers of Geojit and to other investors. Out of this, 104 investors responded and the response rate was 52%.

Analysis and Results

Impact of New Classification on 30 Recommended Equity Funds of Geojit : In the circular issued by SEBI for Equity Schemes vide no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017, it was decided to define large cap, midcap, and small cap as follows :

- Large Cap: 1st -100th company in terms of full market capitalization.
- Mid Cap: 101st - 250th company in terms of full market capitalization.
- Small Cap: 251st company onwards in terms of full market capitalization.

The market cap cut-offs for large, mid, and small are now based on the average capitalizations of the BSE 500, BSE Midcap, and BSE Small cap indices. Therefore, the cut-offs for each market capitalization segment were adjusted to account for market movements. This ensured that a large-cap fund that began taking too much mid-cap exposure was moved into a different category, or a diversified fund that continuously stepped up mid-cap exposure was compared to mid-cap funds and so on.

Furthermore, SEBI has also directed mutual funds to adopt to the list of stocks prepared and published by AMFI in this regard. This list would be uploaded on the AMFI website and it will be updated every six months based on the data as of in the end of June and December of each year. Subsequent to any updation in the list, mutual funds would have to rebalance their portfolios (if required) in line with the updated list within a period of one month.

Prior to this amendment, commonly accepted classifications of companies based on the market capitalization in the Indian stock market were as depicted in the Table 2.

Table 2. Old Categorization

Market Capitalization	Classification
Less than ₹ 5000 Cr	Small Cap
Between ₹ 5000Cr and ₹ 20000Cr	Mid Cap
Greater than ₹ 20000Cr	Large Cap

The Table 2 presents the categorization of mutual fund schemes before the SEBI announcement on October 6, 2017. SEBI's October 6, 2017 circular defined large, mid, and small caps as follows:

- Large Cap: 1st-100th company in terms of full market capitalization.
- Mid Cap: 101st -250th company in terms of full market capitalization.
- Small Cap: 251st company onwards in terms of full market capitalization.

Due to the new classification of stocks based on market capitalization, 31 companies shifted their category from large cap to mid-cap and 112 midcap companies moved to small cap. In order to study the impact of these shifted stocks on the 30 recommended equity funds, the movement of their shares for the past seven months starting from November 2017 after SEBI's announcement have been examined and analyzed. The outcomes of the analysis are denoted as follows: constant (no movement), upward movement (purchase), downward movement (sell), and exit in Table 3.

As can be seen from the Table 3, not all stocks moved for each mutual fund scheme. A portion of the stock portfolio changed. Of the 2,538 stocks covered by the 30 mutual fund schemes, 69 stocks exhibited constant movement, 171 stocks showed upward movement, 67 stocks had downward movement, and 71 stocks exited from the fund.

Table 3. Portfolio Movement After Categorization

			Movement in Portfolio Stocks				
Funds	Total Number of Stocks	Stocks that Changed	Constant		Upward Movement	Downward Movement	Exit
		From Large Cap to Mid-Cap	From Mid-Cap to Small Cap				
Aditya Birla SL Equity Fund (G)	90	7	7	5	8	1	0
Aditya Birla SL Frontline Equity Fund (G)	96	9	3	3	3	4	2
Aditya Birla SL Tax Relief '96 (ELSS U/S 80C of IT ACT) (D)	55	6	4	2	8	0	0
Axis Long Term Equity Fund (G)	106	3	5	1	3	2	2
BNP Paribas Large Cap Fund (G)	66	4	3	0	2	2	3
Canara Rob Emerg Equities Fund-Reg (G)	94	10	15	2	13	3	7
DSPBR Equity Opportunities Fund-Reg (G)	111	11	11	2	13	4	3
DSPBR Focus Fund-Reg (G)	38	1	1	0	0	0	2
DSPBR Tax Saver Fund-Reg (G)	103	9	13	3	7	3	8
Franklin India Bluechip Fund (G)	49	3	0	1	1	1	0
Franklin India Equity Advantage Fund (G)	67	6	6	2	8	0	2
Franklin India Smaller Cos Fund (G)	83	19	1	7	8	5	0
HDFC Hybrid Equity Fund (G)	35	1	4	2	2	1	0
HDFC Mid-Cap Opportunities Fund (G)	99	8	25	6	11	8	8
ICICI Pru Bluechip Fund (G)	81	4	0	0	1	2	1
ICICI Pru Equity & Debt Fund (G)	150	4	2	0	2	2	2
ICICI Pru Value Discovery Fund (G)	56	2	7	3	2	3	1
Invesco India Growth Opp Fund (G)	54	5	3	0	7	0	1
Kotak Bluechip Fund (D)	78	6	7	2	4	3	4
Kotak Emerging Equity Scheme (G)	86	9	13	0	17	4	1
Kotak Standard Multicap Fund (G)	81	3	6	5	3	0	1
L&T Hybrid Equity Fund-Reg (G)	150	4	5	1	5	2	1
L&T Large and Midcap Fund-Reg (G)	78	6	3	1	5	3	0
L&T Midcap Fund-Reg (G)	101	8	13	2	16	1	2
Reliance Large Cap Fund (G)	80	4	1	0	3	1	1
SBI BlueChip Fund-Reg (G)	87	6	6	7	1	0	4
SBI Equity Hybrid Fund-Reg (D)	150	3	6	2	2	2	3
SBI Magnum Midcap Fund-Reg (G)	72	9	15	8	6	4	6
Tata Equity P/E Fund (G)	72	2	9	2	5	0	4
UTI Equity Fund-Reg (D)	70	7	6	0	5	6	2
TOTAL	**2538**			**69**	**171**	**67**	**71**

It is observed from the Table 4 that out of total 104 respondents, 71 respondents invested in mutual funds and 33 respondents were non-investors. These 33 non-investors belonged to the 20-30 years age group. The majority of the investors were from the 20-30 years age group. Out of 71 investors, 49% belonged to the new investor category, 35% belonged to frequent investors category, and 16% belonged to prominent investors.

Table 4. Consolidated Data of all Respondents in Each Age Group and in Each Investor Category

Age Group and Investors' Category	No	Yes	Grand Total
20-30 years	**33**	**25**	**58**
A frequent investor		4	4
A new investor		19	19
A prominent investor		2	2
Not an investor	33	33	
30-40 years		**17**	**17**
A frequent investor		7	7
A new investor		10	10
40-60 years		**21**	**21**
A frequent investor		10	10
A new investor		4	4
A prominent investor		7	7
Above 60 years		**8**	**8**
A frequent investor		4	4
A new investor		2	2
A prominent investor		2	2
Grand Total	**33**	**71**	**104**

The Table 5 shows the mutual fund companies, which are known as asset management companies (AMCs). The investors made their investments in funds of these AMCs and hence, it can be inferred that these are the renowned and popular AMCs which offer good performing funds in the mutual fund industry.

The Table 6 reveals that out of 71 investors, 38% had partial knowledge about mutual funds,32% were only aware of the scheme in which they had invested, 27% were fully aware, and 3% were totally ignorant investors with respect to mutual funds.

Table 5. Investments Made in Mutual Fund Companies

ADITYA BIRLA	AXIS	BNP PARIBAS	CANARA ROBECO	
INVESCO	KOTAK	L&T	MIRAE	MOTILAL OSWAL
DSP BLACKROCK	FRANKLIN	HDFC	HSBC	ICICI
RELIANCE	SBI	SUNDARAM	TATA	UTI

Table 6. Level of Awareness About Mutual Fund Schemes

Response	Number of Responses
Totally ignorant	2
Partial knowledge of mutual funds	27
Aware only of any specific scheme in which you invested	23
Fully aware	19

Table 7. Sources of Information About Mutual Funds

Sources		Number of Responses
1.	Consultants and financial planners	5
2.	Consultants and financial planners, TV channels, Internet, newspapers & magazines	4
3.	Consultants and financial planners, TV channels, Internet, newspapers & magazines, others	1
4.	Stock brokers	14
5.	Stock brokers, consultants, and financial planners	2
6.	Stock brokers, consultants and financial planners, TV channels, Internet , newspapers & magazines	6
7.	Stock brokers, consultants and financial planners, TV channels, Internet, newspapers & magazines, others	5
8.	Stock brokers, TV channels, Internet, newspapers & magazines	8
9.	TV channels, Internet, newspapers & magazines	24
10.	TV channels, Internet, newspapers & magazines, others	2
Grand Total		**71**

Table 8. Level of Awareness of the Categorization and Rationalization of Mutual Funds Notified by SEBI

Response	Number of Responses	Percentage of Responses (%)
Yes	56	79
No	15	21

From the Table 7, it is understood that the major sources of information for mutual funds were TV channels, Internet, newspapers and magazines, and others, followed by stockbrokers and consultants & financial planners.

The Table 8 shows that out of 71 investors, 79% were aware and 21% were not aware of categorization of mutual funds.

From the Table 9, one can understand that out of 15 investors, 60% lacked knowledge, 27% were not bothered, and 13% found difficulty in understanding what was happening in the industry.

It is evident from the Table 10 that out of 56 investors who were aware of categorization, 22 investors and 26 investors felt that categorization of mutual funds was a necessity and they gave rank 5 and rank 4, respectively ; 6 investors *neither agreed* nor *disagreed* with the statement ; 2 investors who *disagreed* with the statement gave rank 1. Hence, we can conclude that the majority of the investors considered categorization as a necessity.

Table 9. Reasons for Lack of Awareness

Response	Number of Responses	Percentage of Responses
Lack of knowledge	9	60
Not bothered	4	27
Difficult to understand	2	130
Others	0	

Table 10. Level of Agreement on the Necessity of Mutual Fund Categorization

Response	*Strongly Disagree*	*Disagree*	*Neither Disagree nor Agree*	*Agree*	*Strongly Agree*
Rank	1	2	3	4	5
No of Responses for each rank	2	0	6	26	22

Table 11. Categorization Meaningful to Investors

Response	Number of Responses
1. All of the above	30
2. Ease in comparing mutual funds schemes offered by different AMCs	8
3. Ease in comparing mutual funds schemes offered by different AMCs, enhanced transparency due to adherence to fund mandate	4
4. Ease in comparing mutual funds schemes offered by different AMCs, enhanced transparency due to adherence to fund mandate, simplification of choices, fewer options -less confusion	2
5. Ease in comparing mutual funds schemes offered by different AMCs, enhanced transparency due to adherence to fund mandate, simplification of choices, fewer options - less confusion, all of the above	2
6. Enhanced transparency due to adherence to fund mandate	2
7. Enhanced transparency due to adherence to fund mandate, simplification of choices, fewer options - less confusion	4
8. Simplification of choices, fewer options-less confusion	4
Grand Total	**56**

Table 12. Impact of Re-categorization on Investors

Response	Number of Responses
1. Change in investment strategies	10
2. Change in investment strategies, redemption of investments	2
3. Needed a review and re-plan of the portfolio	9
4. Needed a review and re-plan of the portfolio, change in investment strategies	2
5. Needed a review and re-plan of the portfolio, redemption /switching of units from the scheme in case of merger	2
6. Needed a review and re-plan of the portfolio, redemption /switching of units from the scheme in case of merger, change in investment strategies	4
7. No impact	18
8. Redemption /switching of units from the scheme in case of merger	6
9. Redemption /switching of units from the scheme in case of merger, change in investment strategies	1
10. Redemption of investments	2
Grand Total	**56**

According to Table 11, out of 56 investors, 30 investors chose all of the options, which means that most of the investors who were aware of categorization knew what it actually meant, that is, they were aware of the benefits and reasons for its implementation.

It is evident from the Table 12 that out of 56 investors who were aware of categorization, all investors except for 18 investors got affected due to re-categorization. The maximum impact has been change in their investment strategies followed by review and redesign of portfolios.

The Table 13 shows that out of 56 investors who were aware of categorization, 54% realigned their portfolios ; whereas, 46% did not realign their portfolios.

Some of the common reasons given by investors for not realigning their portfolios according to Table 14 were lack of time, not knowing how to do it, need to review, does not affect as the investors were only going to invest after change, lack of support or help from the stock brokers, no major issue found which needs to be corrected, and portfolio was already categorized.

Table 13. Portfolio Realigned Post Categorization

Response	Number of Responses	Percentage of Responses (%)
Yes	30	54
No	26	46

Table 14. Reason for Not Aligning Portfolio

Response	
Does not affect me as I am investing only after the change	Not knowing how to do it
Needed to review	I didn't find a major issue which needs to be corrected
Portfolio was already categorized	No time
No time	No impact
Didn't know	Stock brokers did not help in it
Absence of time	Don't know how to do it
Not required	Stock brokers didn't initiate
Geojit being my stock broker could have dropped an email asking whether I would like to realign my portfolio. They only bothered to ask about getting a new mutual fund (new business).	Not interested in wasting time

Table 15. Initiation of Realignment of Portfolio

Response	Number of Responses	Percentage of Responses (%)
Realignment done by AMC and accepted by investor	12	40
Realignment done by AMC and further changes made by investor	12	40
Initiated by me	6	20

Table 16. Opinion on the Positive Impact of Categorization

Response	*Strongly Disagree*	*Disagree*	*Neither Disagree nor Agree*	*Agree*	*Strongly Agree*
Rank	1	2	3	4	5
No of Responses for each rank	0	8	26	12	10

The Table 15 indicates that out of 30 investors who realigned their portfolios, 40% made changes to the portfolio realigned by AMCs ; for another 40%, it was done by AMCs ; and 20% initiated the changes.

The Table 16 shows that out of 56 investors who were aware of categorization, the majority, that is, 26 investors *neither agreed* nor *disagreed* with the view that categorization had a positive impact on their returns. If a fund has changed its nature, whatever pattern it had set in the past (with respect to return, risk, volatility, alpha, and beta) will not be valid going forward. It will take few years to have enough real data to correctly compare the funds in the category. Due to category wise restrictions, there is a possibility that the funds which were previously performing well are reporting bad.

The Table 17 shows that out of 56 investors who were aware of categorization, mostly investors got to know about changes in fund attributes, new classes, mergers, and fund exit through AMCs and through stock brokers. The Internet is also considered as a source of information by investors who do not execute their financial market transactions through stockbrokers.

Table 17. Sources of Information About Changes in Funds

Sources	No of Responses
1. Through AMC	12
2. Through AMC, through Internet	6
3. Through AMC, through stock brokers	12
4. Through AMC, through stock brokers, through Internet	2
5. Through AMC, through stock brokers, through Internet, others	1
6. Through Internet	11
7. Through Internet, others	2
8. Through stock brokers	8
9. Through stock brokers, through Internet	2
Grand Total	**56**

Table 18. Opinion on SEBI's Efforts on Categorization

Response	*Strongly Disagree*	*Disagree*	*Neither Disagree nor Agree*	*Agree*	*Strongly Agree*
Rank	1	2	3	4	5
No of Responses for each rank	0	2	6	32	16

Table 19. Reasons for Investing in Mutual Funds

Response	No of Responses
1. No knowledge about how and where to invest	13
2. No knowledge about how and where to invest, others	1
3. No satisfactory return on investment when compared with other investment instruments.	3
4. No satisfactory return on investment when compared with other investment instruments, others	1
5. No satisfactory return on investment when compared with other investment instruments., risky investment instrument	1
6. Others	11
7. Risky investment instrument	2
8. Risky investment instrument, no knowledge about how and where to invest, others	1
Grand Total	**33**

The Table 18 shows that out of 56 investors who were aware of categorization, 32 investors *agreed* and 16 investors *strongly agreed* that categorization was a step in the right direction. They gave rank 4 and rank 5, respectively ; 6 investors gave rank 3, which means that they *neither agreed* nor *disagreed* with the statement.

It is seen from the Table 19 that 13 respondents had no knowledge about how and where to invest, 3 respondents said they got no satisfactory return on investment when compared to other investment instruments, 2 respondents said that it was a risky investment instrument, and 11 said that there were other reasons for not investing.

Findings

In order to comply with the norms laid out in the new equity category, the 11 funds in the study made few changes

Table 20. Changes in Funds

Funds	Category Change	Increase or Decrease in Large Cap/Mid Cap/Small Cap
ABSL Focused Equity Fund	Large cap to focused fund	Increase in large cap
Decrease in mid & small cap		
HDFC Growth Opportunities Fund	Large cap to large & midcap	Decrease in large cap
Increase in midcap		
Kotak India Eq Contra Fund	Large cap to contra or value fund	Increase in large cap
ABSL Small Cap Fund	Small & midcap to small cap	Increase in small cap
Decrease in midcap		
DSP Black Rock Mid Cap Fund	Small & mid to midcap	Decrease in large & small cap
Increase in midcap		
Invesco India Multicap Fund	Small & mid to multi cap	Increase in large & small cap
Decrease in midcap		
DSP Black Rock Small Cap Fund	Mid cap to small cap	Increase in small cap
Decrease in midcap		
IDFC Multi Cap Fund	Mid cap to multi cap	Decrease in mid & small cap
Increase in large cap		
IDFC Sterling Value Fund	Mid cap to value fund	Increase in large & small cap
Decrease in midcap		
LIC MF Large & Mid Cap Fund	Mid cap to large & midcap	Increase in large & midcap
Decrease in small cap		
SBI Focused Equity Fund	Mid cap to focused fund	Increase in large & small cap
		Decrease in midcap

in their attributes. The Table 20 gives a glimpse of category changes in the mutual fund schemes and the direction of the movement of large, mid, and small cap in each mutual fund scheme. Increase in large cap happened in 7 mutual fund schemes, while decrease in large cap happened only in 2 schemes. Increase in mid cap happened in 2 schemes, while decrease in mid cap happened in 7 schemes. Increase in small cap happened in 5 schemes, while decrease in small cap happened in 4 schemes.

(1) Impact of Changes in Categorization on Investor Behavior : A changed asset allocation can be contrary to the investment plans of investors. Hence, there is a need to alter the investment strategy.

A change in category can alter the risk profile of the scheme, for example, if the scheme moves from a large-cap to large-and mid-cap, the risk or volatility of the scheme increases. Therefore, an investor needs to understand his/her risk tolerance and has to act accordingly (either hold or look for other alternatives).

A change in category will also have an influence on returns and hence, investors need to adequately invest. For example, investment in high-risk midcap fund gives higher return when compared to large cap funds.

A change in investment style can influence the performance of the fund, which can be positive or negative. Therefore, investors can either hold (in case of profit) or exit (in case of loss) after 6 months.

Hence, it is imperative for investors to review their mutual fund portfolios and check if the reclassified schemes in their portfolios are aligned to their investment goals and risk-return expectations.

As per the new mandate on equity stock classification, if the stock in the portfolio has changed its category either from large cap to mid-cap or from mid-cap to small cap, the fund manager cannot hold the stock on his/her liberty in order to increase the return. On shifting the category, the holding of the stocks gets affected. Out of the 378 stocks of all 30 recommended funds that changed their category, 171 stocks showed upward movement (purchase), 67 stocks showed downward movement (sell), 71 stocks exited, and 69 stocks remained constant. These movements in stocks are made to meet the minimum investment requirement for each category fund. Thus, it can be concluded that every fund in the study has rebalanced its portfolio in effect to the new classification of stocks.

The study reveals that out of 71 mutual fund investors, 56 investors were aware of categorization, and out of this 56, 30 investors knew what it actually meant, that is, benefits and reasons for its implementation. The study also found that almost all except 18 investors were affected due to the categorization. It was noticed that only 30 investors realigned their portfolios in order to keep their investments in line with their goals. It was observed that for most of the investors, the portfolio realignment was done by AMCs and it was not their initiative. Some of the common reasons for not realigning their portfolios are lack of time, not knowing how to do it, need to review, does not affect as the investor was only going to invest after change, lack of support or help from the stock brokers, no major issue found which needs to be corrected, portfolio was already categorized, etc.

The study also shows that though investors support categorization as a necessity and agreed that it is the right step in the right direction, they neither disagreed nor agreed with the view that it will have a positive impact on returns.

(2) Recommendations to Relevant Parties in the Mutual Fund Industry : Websites like Morning star, Value research etc. can present investors with a tabulated form of representation of major fund attributes providing the actual data or picture before the SEBI classification and the data on an ongoing basis after the categorization (shown along with old and new fund names if any) in order to guide them in aligning their portfolios. This comparison should be run and reflected at least for the next 3 years or for a period until the risk - return characteristics of funds stabilize in their new categories.

The fund manager has to rebalance the fund portfolio if the fund deviates from the list of stocks published by Association of Mutual Funds (AMFI) every six months and should keep the investors informed whenever these changes take place through AMCs.

There is a need for active support and involvement of the Association of Mutual Funds in India (AMFI) and stockbrokers to build awareness on the changes due to categorization and its impact on fund portfolio among investors. Further, investment advisors can also stand as financial intermediaries who provide them with the required knowledge and professional expertise for realigning their portfolios.

Conclusion and Research Implications

Categorization of schemes may lead to short-term turbulence for both investors and fund houses while adjusting to the new mandate. In the end, this move will have a growth effect for the industry as a whole. With more and more investors preferring investment in mutual funds, this initiative is a step in the right direction. Investors who can handle these changes should devote time required to make them. As for those who do not understand the changes, it would be prudent to get professional advice.

The research has brought out an initial feel of the categorization and rationalization of mutual funds based on SEBI announcement on October 6, 2017. The study has clearly brought out its immediate impact on the investors and their response to it.

Limitations of the Study and Scope for Future Research

The analysis conducted was limited to the availability of data. Though the effective date of change of some funds was considered to be in May and June 2018, the change was already in process starting from November 2017. The fund will only adjust slowly to the changes in asset allocation. Therefore, the analysis has been done only to this extent (for 7 months) and the effect of change is seen only for this period.

There is ample scope to further explore this topic with a larger time horizon and with more schemes. It is important to explore and find if the provision of information required by investors has improved over the period.

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