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A Comparative Study of Investor Preferences With Reference to Debt And Equity while Constructing A Portfolio In Mumbai Region.

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Abstract: *Any nation's productive capacity mainly depends on the capital formation. Good savings rate coupled with good capital mobilization are the key macro-economic variables, which play a significant role in economic growth. A nation's savings and investment propensities also play a key role in achieving dynamic stability in the capital market. Per Capita Income in India has been on the rise since all of the last decade. With growth in the PCI, savings and investment in the country too has shown a northbound movement. India's GDP has increased almost three times over the past decade. This growth in the size of economy has been complimented by a dramatic 8 fold increase in the market capitalization of Indian Companies. However, despite such positive environment, the development of capital market has been uneven and its penetration has been limited.*

In today's highly competitive environment, different kinds of investment avenues or options are available to the investors. All investment modes have their own advantages & disadvantages. An investor tries to keep a balance between the benefits and shortcomings of different investment modes before investing in them. In this paper, an attempt is made to study the various investment options preferred by the investors of Mumbai, and the study also tried to analyze the investor's preferences particularly towards investment in equity and debt funds when other investment avenues are also available in the market.

Keywords: *Investors, Debt Fund, Equity Fund, GDP, Capital Market*

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I. INTRODUCTION

In today's highly competitive financial environment, the emergence of different investment optionsleads to more confusion of investors when it comes to investing. Many questions are raised in investor's mind like:

- Which Investment will give us maximum returns?
- What could be the right mix of debt and equity in our portfolio?
- Is the investment safe?
- How quickly one can liquidate the investments?

Portfolio building or portfolio construction for an investor is an exercise of perfectly mixing togetherdifferentasset classes to obtain maximum returns with minimum risk. All investments are subject to risk. E.g.Investments in bonds are subject to interest rate, credit, and inflation risk investing in the stocks of companies in emerging markets is more risky than investing in stocks of companies in developed markets. SME's stock fluctuation is more than large cap companies. So one needs to understand the beneficial proportion of both equity and debt in Portfolio.

By including asset categories with investment returns that fluctuate under different market conditions within a portfolio, an investor can protect against significant losses. Historically, the returns of the three major asset categories have not moved up and down at the same time. If one asset category is not doing well other may do well. By investing in more than one asset category, investors will reduce the risk of losing money and portfolio's overall investment returns will have a smoother ride. By not using the full investment opportunity investors are ignoring a range of opportunities across the capital structure that have a legitimate role to play in a well-constructed portfolio.

The purpose of this research is to examine how investors classify their investment portfolio, what factors they consider while deciding the desirable combination of debt and equity? Do they prefer only equity for investment? Or do they prefer 100% debt instruments for Investment? Do they correlate Debt and Equity?

This study helps to understand the Investors preferences for Equity and Debt instruments and build an optimum portfolio mix as per the investor risk appetite. The study is confined to Mumbai region.

Theoretical Background

Out of debt and equity, investing in equity is highly risky, it is kind of high risk and high returns. So when it comes to invest in equity, investor's needs to separate the speculation from investment.Speculation is a process where one puts the money hastily or being greedy. Investment should be a long term process, so one needs to be very careful when it's come to investing. Investments in equity can be done directly by buying shares of companies or through mutual funds. There are various benefits as well as risks associated with both these routes and it is up to the individual to make up his mind.

Risks involved in Equity market:

- **Macro-economic risks:** Share prices are sensitive to the developments in the economy, such as a change in interest rates, value of currency, inflation rate, government policies, tax rates, and central bank policies.
- **Liquidity risks:** The liquidity of a stock is a function of its trading volume. A constriction in the volume of securities could affect the investor's ability to transact. Investments in small-cap or unlisted stocks are more prone to such risks. The inability to sell securities due to a lack of volumes could lead to substantial losses for investors. Prices of mid- and small-cap stocks often fluctuate more than those of large-company stocks.
- **Non-diversification risks:** A portfolio aims at eliminating or minimizing internal, or company-specific, risks through diversification.

Debt is a route that most people know and have the necessary experience of. There is a wide range of debt instruments that are present from bank fixed deposits to company fixed deposits and even bonds and debentures whose issues come in the market. Debt operates on a simple principle of giving a fixed % of return to investors at the end of the tenure. The good part for the investor is that the risk in the investment is very less. But on the other hand, the returns are limited to the interest as a percentage of the total amount. This is a trade-off that the investor takes for the purpose of the investment.

Risks involved in Debt market:

Investments in bonds are subject to interest rate, credit, and inflation risk.

Interest-Rate Risk: Fixed income securities such as bonds, debentures and money market instruments face interest-rate risk. Generally, when interest rates rise, prices of existing fixed income securities fall and when interest rates drop, prices of fixed income securities increase.For example: If a Rs. 100 par value security offers 9% rate of return, and the prevailing rate of interest increases from 9% to 10%, the values of the security will fall below Rs. 100 because it offers a lower rate of return(9%) compared to the market return(10%). The extent of fall or rise in the prices depends on the existing coupon rate, time to maturity of the security and the quantum of increase or decrease in the interest rates.

Credit Risk: In simple terms this means that the issuer of a debenture/bond or a money market instrument may default on interest payment or in paying back the principal amount on maturity.

Liquidity Risk: This refers to the ease with which a security can be sold at or near to its market value. Liquidity risk can be measured by the difference between the buy price (bid price) and the sell price (offer price) quoted by a dealer. Larger the difference, greater is the Liquidity Risk.

Another factor relevant here is whether the instrument is traded on a regular basis or not.

II. LITERATURE REVIEW

Review of Literature provides a critical summary of research already done on the relevant topic. It provides researchers a bird's view on the problem in hand, stresses the need for the new study, and demonstrates how it will contribute to existing evidence. The primary purpose of literature is to gain a broad background available related to problems in conducting research. Thus it facilitates selecting a problem and its purpose, developing a framework and formulating a lesson plan. In brief, review of relevant literature is an analysis and synthesis of research sources to generate a picture of what is known about a particular situation and to expose the knowledge gaps that exist in the situation.

To locate the unsearched areas in the current research, the literature already available and relevant to the problem is reviewed.The literature available is broken down into following topics and is presented below:

a) Investor's awareness and preferences towards debt and equity funds.
b) Risk-Return profile of investors.

A. Investor's awareness and preferences towards debt and equity funds.

1. In the book, "Money Lessons for a Lifetime: Stories, Observations and Tips on Living a Prosperous Life", Gim Jorgensen, said:"If you want to fine-tune your asset allocation, you might select one of the following long-term portfolios:

- Relatively conservative, income-oriented, in or near retirement. Put 45 percent of your assets in stocks, 35 percent in bonds, and 20 percent in cash or short-term saving accounts.

- A moderate approach for the middle-of-the-roaders between the ages of 45 and 65. Put 60 percent in stocks, 35 percent in bonds, and 5 percent in cash.
- An aggressive approach for those under age 45. For a growth oriented portfolio with little or no income, put 85 percent in stocks, 10 percent in bonds, and 5 percent in cash.
- A more aggressive approach for those under age 35. Put 95 percent in stocks and 5 percent in bonds."

2. "A study of investor behavior on investment avenues" in Mumbai was undertaken by Brahmabhatt, P.S Raghu Kumari, and Dr. ShamiraMalekar. In this study they analyzed the investor behavior and their preferences. The objectives for their study were to understand about various investment avenues available in the market, to understand the pattern of investors while making the investments, & to find out the factors that investors consider before investing. Through their study it was revealed that people like to invest in stock market. The percentage of income they make as investment depend on their annual income.
3. "A Study on Preferred Investment Avenues among SalariedPeople With Reference To Pune, India"The research was conducted by Sonali Patil and Dr.KalpanaNandawar.The paper was issued on (Sep.-Oct. 2014) .The present study is an attempt to throw a light on Investment behavior of salaried employees of Pune, India.
4. "A Study of Customers' Preference towards Investment in Equity Shares andMutual Funds"

The research was conducted by Manoj Kumar. The paper was released on April 2013. The major focus of the paper is related to customer's preference with respect to:

- To know the investors" preference towards various investment alternatives
- To know Customers preference towards investment between shares and mutual fund.
- To find out most important attribute for investment consideration.
- To find out objectives of investment.

5. "A Study on People's Preferences in Investment Behavior". The paper was published by N. Geetha& Dr. M. Ramesh in November 2011.The main focus of the study was:

- To study the factor that influence investment behavior of the people.
- To study the attitude of the respondents towards different investment choices.
- This study examined on people's choice in investment avenues of Kurumbalur

6. International Journal of Management Research and Business strategy has published Research paper on 3rd July,2015 On "Investors Preferences towards Equity". This research is done by Satyanarayana, N B C Sidhu and S Harish Rao.This research paper talks about Investors that makes an investment in Equity considering the high returns irrespective of risk.The study is undertaken to understand Equity market and to find out the new opportunities to attract the investors towards the Equities according to their risk preferences. The study is conducted to understand the functioning of Equities in India Equity market.

7. A research paper by Malcolm baker et al in 2007 on "Investor Sentiment inthe Stock Market"tries to study the role of investor's sentiments in investing money in various financial instruments.

8. Kenneth French et al in paper "Investor Diversification & International Equity Market", tries to findestimates of International equity holdings of investors in U.S,Japan,and Britain.This study found out that more than 98% of the equity portfolio of Japanese investors is held domestically, 94% of U.S and 82% of Britain.This research paper basically focus on investor's preferences and behavior,their investment patterns.This research paper also International Asset Ownership pattern

This paper reviews our research into the investment decisions involved in constructing a diversified portfolio.

9. A study conducted by MeenakshiChaturvedi and ShrutiKharediscusses about saving pattern and investment preferences of individual household in India. The objectives of the study were to study the saving pattern of the individual household in India, to analyze the Investment preferences of individual household in India, to study relation of saving pattern and investment preferences to social, economic, educational and occupational background of the individual household & to give suggestions for evolving better investor awareness and educational programs. It is concluded from the study that Majority of the respondent (79.6%) stated that they had a high degree of awareness about bank deposits as investment avenues.

10. A study on investment avenues with particular reference to mutual fund by Dr. G. Santhiyavalli M. Usharani in 2012 focuses on the following things.

- To study the socio-economic profile of selected individual investors.
- To assess their saving objectives.
- To identify the preferred savings avenue of the respondents.
- To identify their preferred mutual scheme.

It has been seen that there are strong theoretical and empirical explanations for various investments tools, definitions of various investment tools, awareness, perception and attitude of people towards various investment options etc. However there is dearth of literature on investors preferences towards debt and equity staying in Mumbai.

B. Risk-Return profile of investors and Factors Affecting the Investors preferences towards debt and equity:

1. SumanChakraborty and Sabat Kumar Digal (2011) found in their research work, demographic factors like age, occupation and income level of investors have significant impact on savings. It was found that female investors tend to save more in a disciplined way than the male investors. Paper attempts to explore whether dichotomy of the popular believes that men are more pro-risk than women. It was observed that women are risk averse indeed but save more than the male counterparts as the income level rises.
2. Kabra, et al (2010), in their research found that investors' age and gender plays a significant role in deciding the risk taking ability of investors.
3. Manish Mittal and R. K. Vyas (2007) in their study found that gender plays a key role in deciding where to invest. They further found that men prefer Equities as their first choice and women prefer post office deposits as their first choice. The investor in the age group 18-25choose Equities for investing and above 45 years choose Derivatives. Less income group prefers investment in debt instruments and high income group prefers Derivatives as a preferred investment choice.
4. Verma (2008), studied the impact of demographics and individual’s personality on investment preferences among Indian investors and found that mutual funds were most popular amongst professionals, students and the self-employed. Retired people displayed their risk aversion by not investing in mutual funds and equity shares. It was also found that higher the education, higher was the level of understanding of investment complexities. Graduates and above in qualification preferred to invest in equity shares as well as mutual funds.
5. Gupta and Jain (2008) in their research work based on an all-India survey of 1463 households found the preferences of investors towards investment in shares, in various types of mutual fund schemes, gold fund, bank fixed deposits and government savings schemes. The study found that the investors’ investment attitude towards various investment types is based on their income, age, risk appetite, quality of market regulation etc.

From the review of literature it can be inferred that various studies on investment pattern and preferences provide only glimpses of investment pattern of investors across India. None of the studies are limited to Mumbai and finding the factors affecting the investor’s preferences and risk appetite of people living in Mumbai city. Hence the present research is an effort in that direction.

Objectives of the study

- To know the investors preferences towards equity or debt instruments
- To explore risk appetite of the respondent.
- To understand the factors considered by investors while constructing Investment portfolio.

III. RESEARCH METHODOLOGY

Type of Data

Primary Data

We have collected Primary Data from sample population.Our Research is completely based on first-hand information collected by individuals.The Method we used for Data Collection is Questionnaire.

Research Design

Descriptive Research Design

Descriptive research is used to find answers to the questions of who, what, when, where, and how with respect to a particular research problem; a descriptive study cannot conclusively ascertain answers to why. The present paper attempt is made to discuss the investor’s preferences towards Debt and Equity instruments.Descriptive research shows How Investors Investment avenues differ from person to person and what factors influences investment decision using variables such as Income level, Risk appetite,Objective of Investment, Age etc.

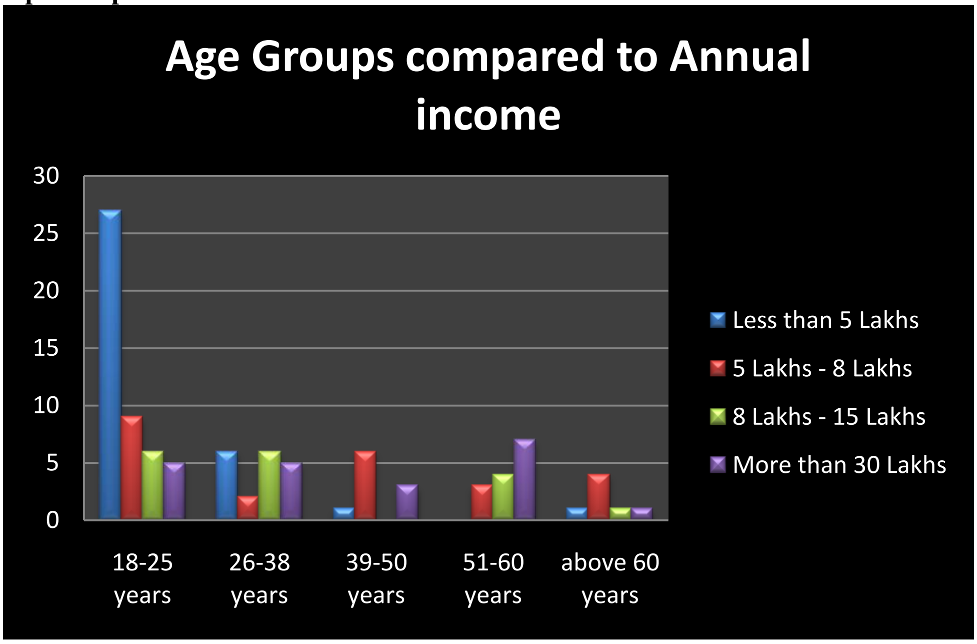
Sampling Methodology

Convenience sampling is the purest form of probability sampling. Each member of the population has an equal and known chance of being selected. When there are very large populations, it is often difficult or impossible to identify every member of the population, so the pool of available subjects becomes biased.

In our Research,We have taken Sample size of 100 random Males & Females in the Mumbai region irrespective of age.We have randomly selected 100 individuals and collected information with the help of Questionnaire.

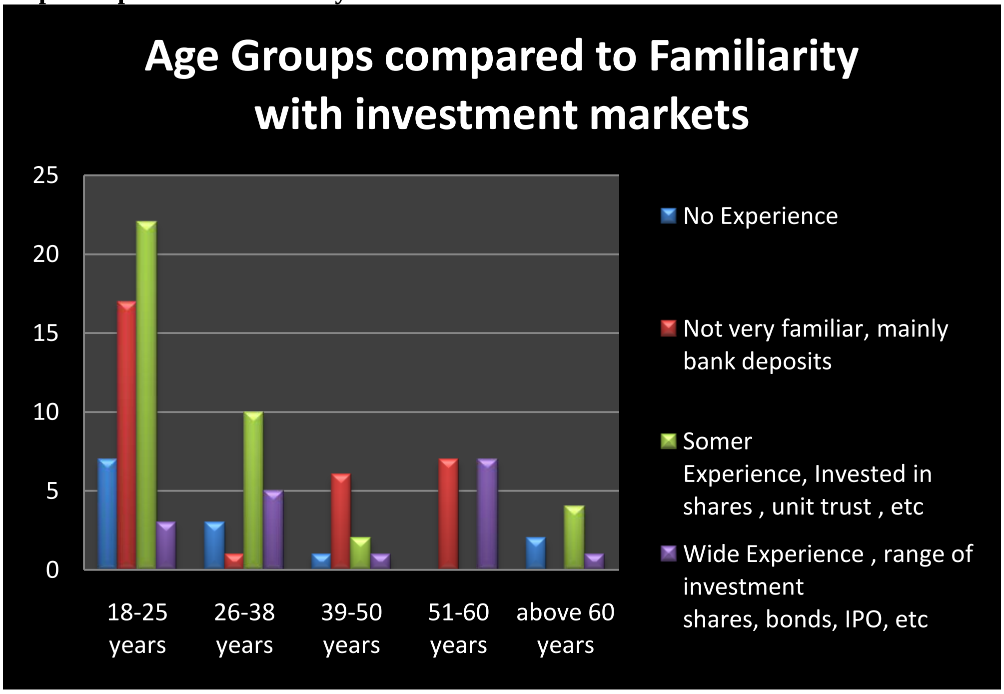
IV. Data Analysis

1. Age Groups Compared to Annual income



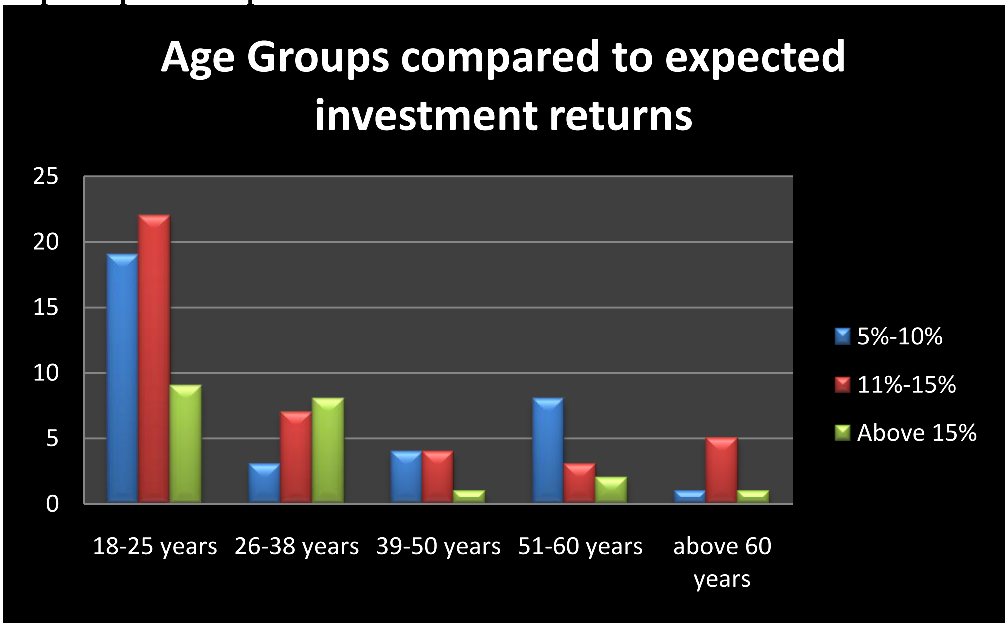
It can be inferred from above that people with age group 18-25 has less than 5 lakh of annual income and people with age group above 50 has more annual income with age group 51-60 having annual income of more than 30 lakhs.

2. Age Groups compared to Familiarity with investment markets



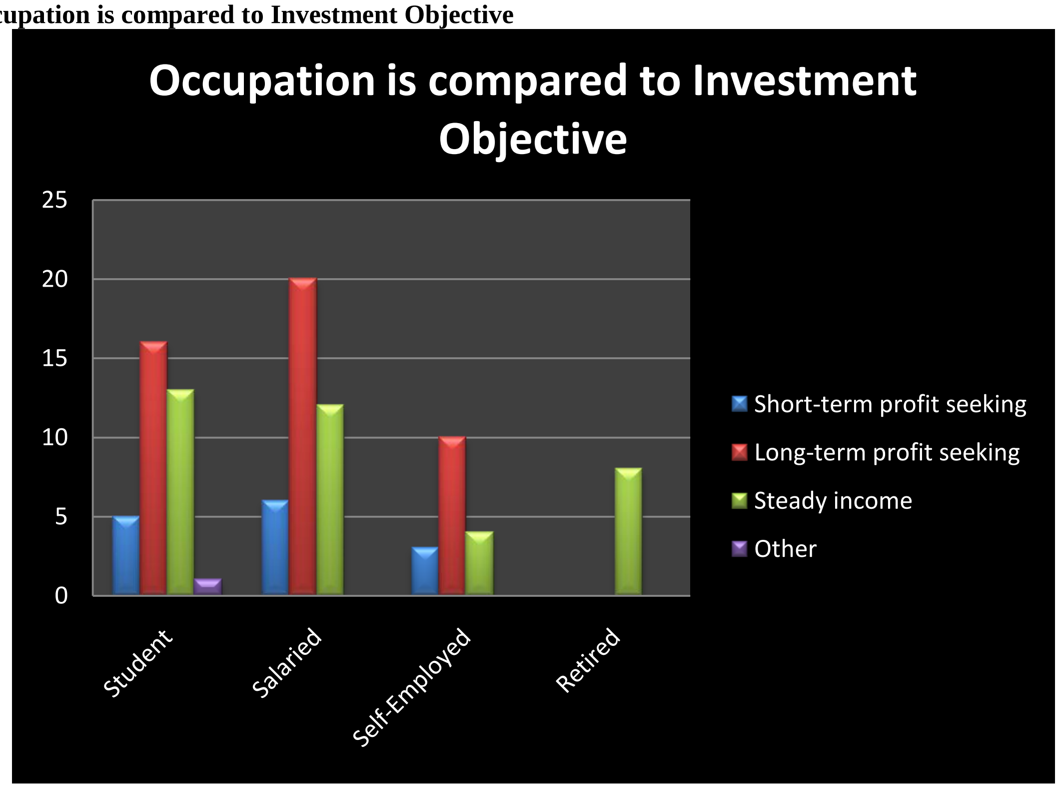
It can be inferred from above that age group 18-25 has some experience in investment market but not wide range of experience in investment market. Age group 51-60 is most experience having wide range of experience in shares, bonds, ipo, etc.

3. Age Groups compared to expected investment returns



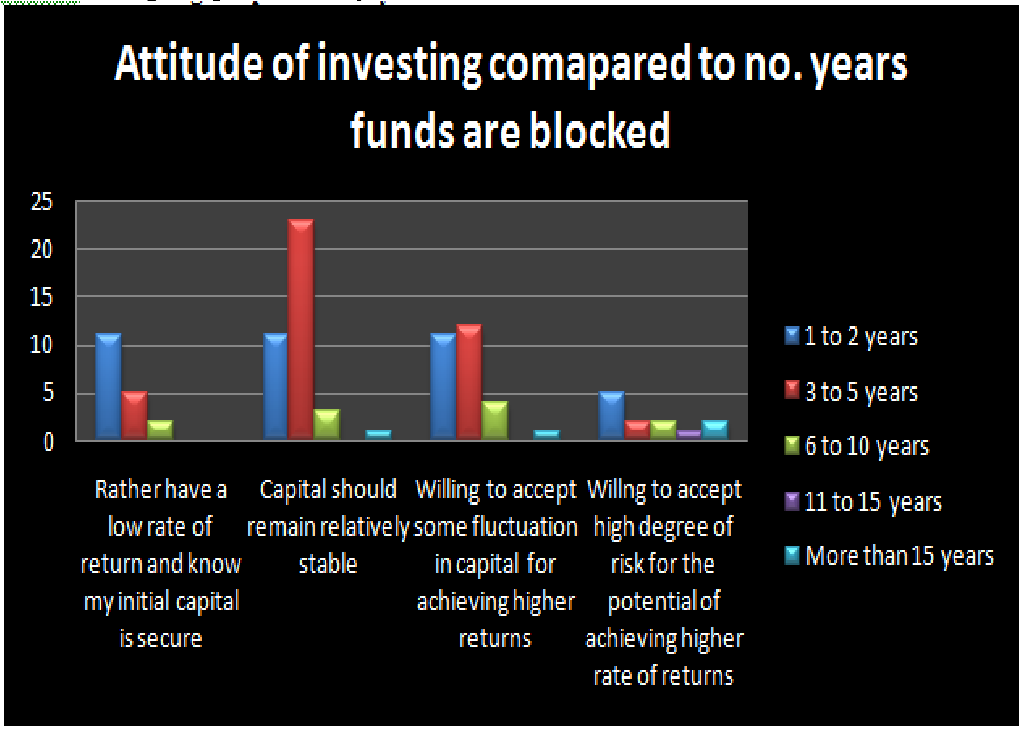
Most of the people in age group 18-25 are expecting return on investment of about 11-15% and closely followed by 5-10%.
People in age group of 26-38 are more risk takers and have expected return of more than 15%.
People in age group of 51-60 are least risk takers and want to preserve their capital and have expected return of 5-10%.

4. Occupation is compared to Investment Objective



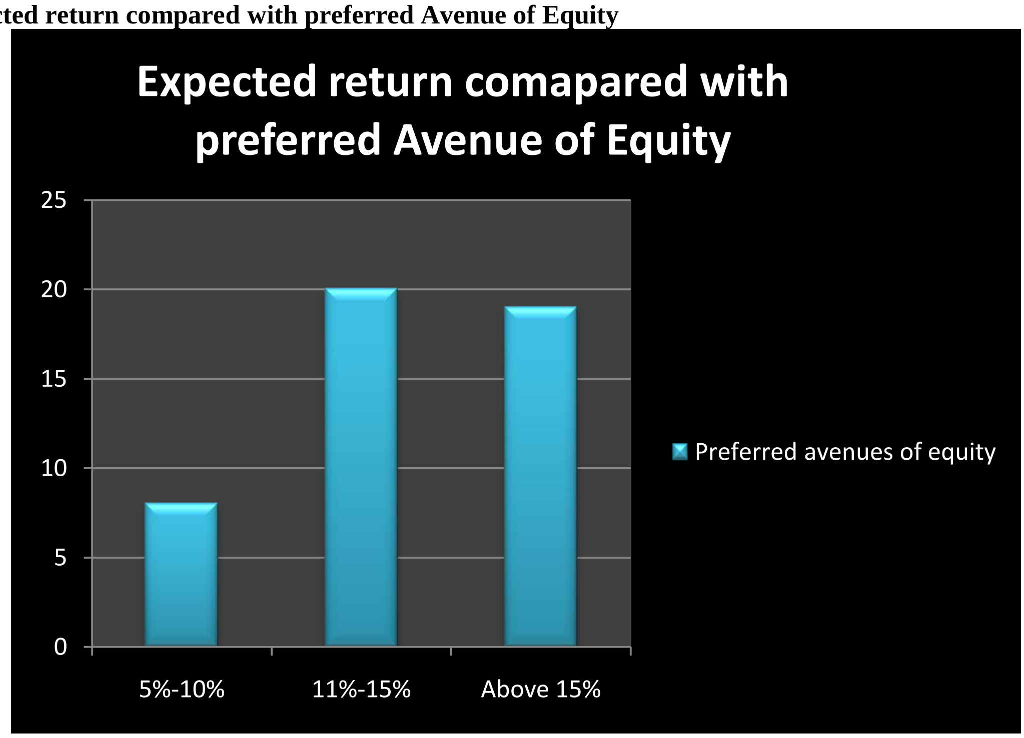
Retired people would prefer steady income than taking risk in short and long term. They are risk averse.
And in all other categories long term profit is most preferred since they don't look much at short term gains and would like to see their capital grow in long term.

5.Attitude of investing compared to no. years funds are blocked



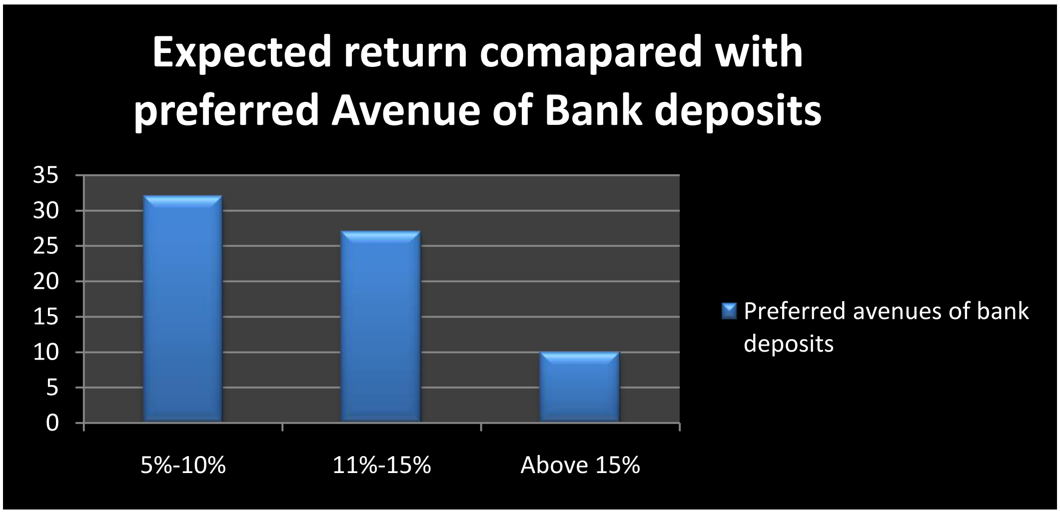
People who want their capital to remain stable is willing to block their money for 3-5 yrs.
People who are willing to take high risk for high return are willing to block their capital for shorter period of 1-2 yrs.People who want their capital to grow steadily are willing to give their funds for 3-5 years.

6.Expected return compared with preferred Avenue of Equity



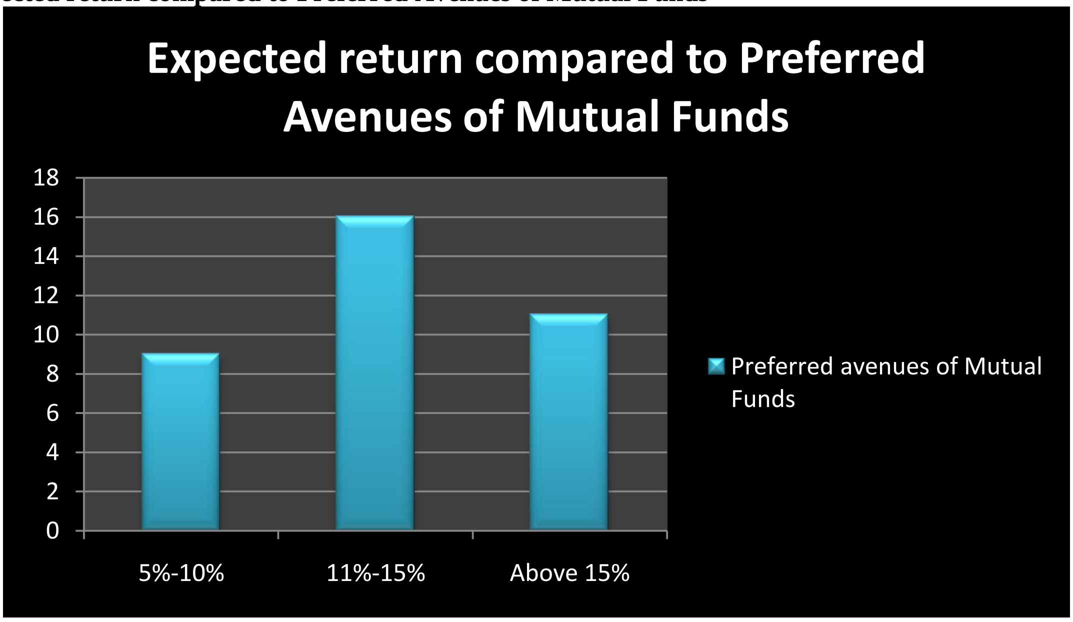
People who invest in equity expect that their return will be above 11% and in some cases above 15%.Or people who want higher return are tending to invest in equity.

7.Expected return compared with preferred Avenue of Bank deposits



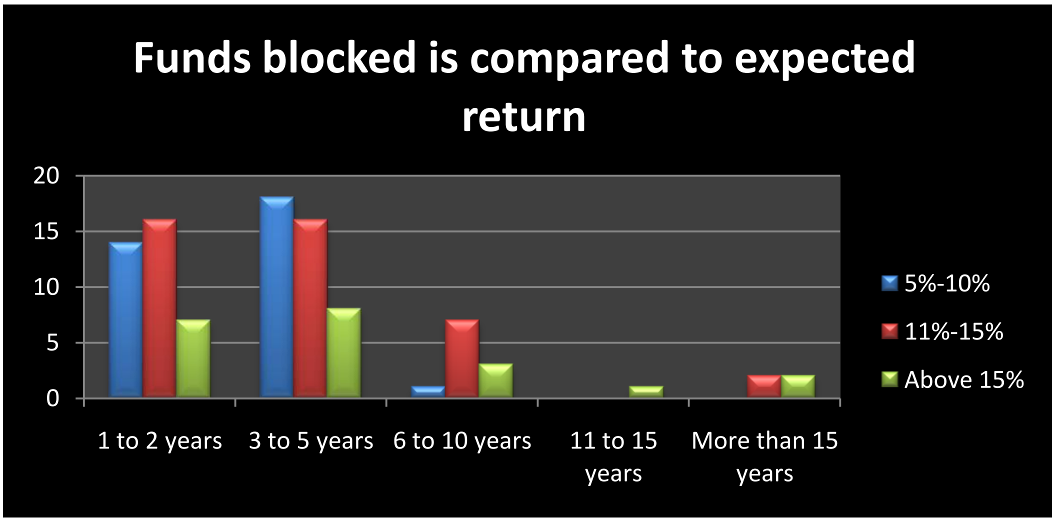
People who have expected return of 5-10 % is most likely to invest in bank deposit for safer and assured returns.

8.Expected return compared to Preferred Avenues of Mutual Funds



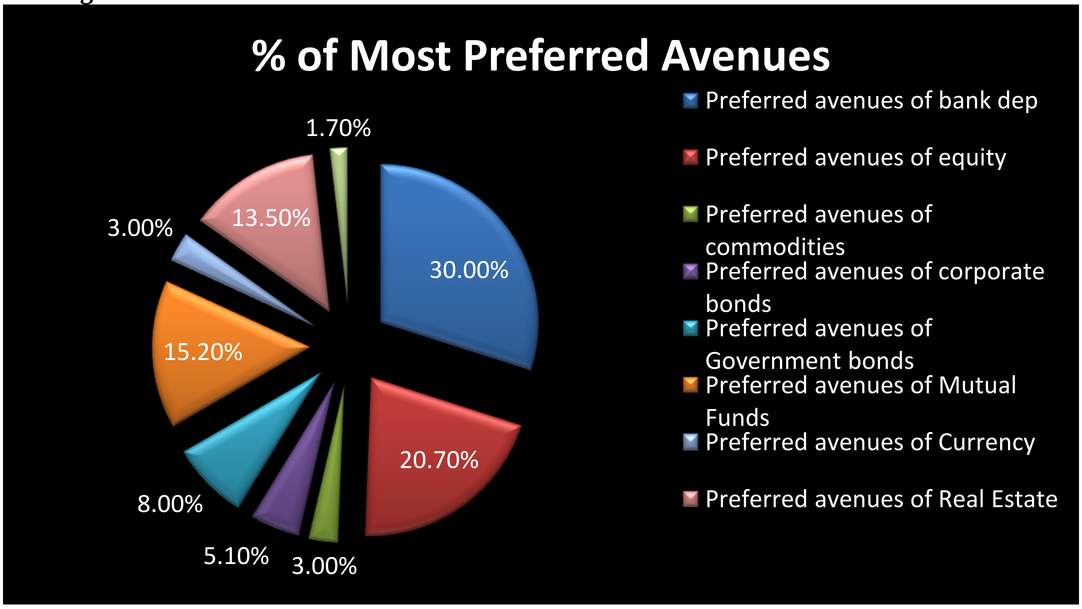
People who are expect steady return of 11-15% invest in mutual funds for higher returns at not much risk.

9. Funds blocked is compared to expected return



People are willing to block their money for more than 15yrs expects more than 15% returns
People are willing to block their money for 1-2 yrs their expected return is below 15%

10. Percentage of Most Preferred Avenues



Bank Deposits and Equity investment are most preferred avenues of investment by the people.
They are followed by mutual funds and real estate. Artifacts is least preferred avenue for investment by the sample size.

Chi - Square Test

Chi - Square test is a non-parametric test of statistical significance for bi-variant tabularanalysis. A non-parametric test, like chi square, is a rough estimate of confidence. Chi-square is used most frequently to test the statistical significance of results reported in bi-variant tables.

Analysis of chi-square

1) **H0:** Age is independent the way people distribute their investment in debt and equity
H1: Age is dependent the way people distribute their investment in debt and equity
Chi square calculated = 69.819
Chi square table value = 88.250
As chi square table > chi square calculated,
Accept Null Hypothesis.
Hence, Age is independent towards the way respondents invest in debt or equity.
Distribution of investment in debt and equity does not depend on age but we can still see that from age 18-25 more people invest in equity than in debt.

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	69.819[a]	68	.416
Likelihood Ratio	70.346	68	.399
Linear-by-Linear Association	.364	1	.547
N of Valid Cases	100		

2) H0: Expected Return is independent the way people distribute their investment in debt and equity
H1: Expected Return is dependent the way people distribute their investment in debt and equity
Chi square calculated = 54.961
Chi square table value = 48.602
As chi square table < chi square calculated,
Reject Null Hypothesis.

Hence, Expected Return is dependent towards the way respondents invest in debt or equity.This is because the higher the return people want they invest more in equity market than debt market. As we can see in the graph if they want a return of 15% they prefer to invest in equity market than debt market.

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	54.961[a]	34	.013
Likelihood Ratio	60.394	34	.004
Linear-by-Linear Association	14.031	1	.000
N of Valid Cases	97		

3) H0: Attitude towards investing in Debt and equity on the basis of risk is independent
H1: Attitude towards investing in Debt and equity on the basis of risk is dependent
Chi square calculated = 63.344
Chi square table value = 68.669
As chi square table > chi square calculated,
Accept Null Hypothesis.

Hence, the attitude towards investing in debt or equity is independent of risk.
This is because 30% of respondent wants the capital to be stable in equity market and 70% in debt market. Respondent believe that they would rather have low rate of return and know that their capital is secure.

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	63.344[a]	51	.115
Likelihood Ratio	71.417	51	.031
Linear-by-Linear Association	7.501	1	.006
N of Valid Cases	98		

Findings:

Every investor invests either in Equity or Debt instruments or in both with the purpose generating higher returns with low risk.Optimum level of distribution of Debt and Equity in an investment portfolio can be maintained by considering the following factors
Deciding between Debt vs. Equity
• Investment objectives - The investor's objective could be to generate more income or create more wealth. Investors looking to generate income through their investments should invest in debt fund because it provides more certainty of return.
• Investment duration –If investors are ready for long term investments, equities is a good option. For short term duration like 5 years or less than 5 years debt fund are better.
• Returns expected –Current research study shows that investors choose an asset class (Debt or Equity) with unrealistic expectations. Returns from either or both asset classes comes with varying degrees of risk and uncertainty. On a long-term basis, average returns for debt are in the region of 9% and equity in the region of 16%.

• Risks involved- Risks involved should be defined in line with the investment objective and returns expected. Investments in debt are usually less risky and a long term investment in debt provides usually 8-10% returns. On the other hand investments in equity are risky. There is risk of capital loss also in equity investments. However, if one stays invested in equity for long time, good returns are expected. In general, if one needs to decide where to invest, the decision is based on 9% certain return or 16% return but no uncertainty.

V. CONCLUSION

Investment Management has become one of the key elements of many individuals,firms, and corporates. Decision to choose between Debt and Equity is one of the difficult jobs further.The current study found not only the Investor behavior that affects the investment decision but also other factors like Income,Occupation,Age,Marital Status has similar influence on investors during constructing investment portfolio.It seem to be people mostly prefer Bank Deposit is secured form of Investment but Equity, on the other hand, is an essential asset class for the long-term growth of savings with returns that beat inflation. Equity funds typically invest in stocks of companies and have proven in the past to provide inflation beating return over the long term.Only the people having high risk taking ability prefer Equity as an investment option. Debt mutual funds are normally lower in risk and they invest in financial instruments which yield a fixed income e.g. government bonds, company debentures, commercial paper and company fixed deposits. However this does not imply a guaranteed return but a certain fixed income. Debts funds provide tax benefits and hence they are more attractive than FDsPeople preferring Debt instruments are risk averse & their main objective of investment is to get steady income.

VI. LIMITATIONS

- The research is restricted to Mumbai and not India
- The study has been conducted to analyze only some factors affecting investment behavior of investors.
- The sample size may not truly represent the behavior of the population.
- This study is for a particular time frame and hence the results might differ with the change in government policies, stock market scams, deflation, market expectations-bull and bear, etc. because the speculation will differ, sentiments might change thus affecting the investors' behavior towards equity market.

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