An Analysis of the Different Types of Systematic Plans of Mutual Fund Investments in India

Dr. Soheli Ghose
Assistant Professor
Department of Commerce
St. Xavier's College
Kolkata, West Bengal, India

Abstract

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized is shared by the unit holders in the proportion to the number of units owned by them. Thus a mutual fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified professionally managed basket of securities at a relatively low cost. Of all investing institutions, Mutual Funds have grown at the fastest rate due to their operational flexibility and because they provide better returns to the investors and serve as a sophisticated market-clearing agent. There are various strategies of investing in Mutual Funds through Systematic Investment Plans, Systematic Withdrawal Plans and Systematic Transfer Plans.

This paper analyses the growth of these plans in the last decade. It also highlights the advantages and problems of investing through such plans. The data is secondary and has been collected through various websites and journals. The inference of this study is that these plans have grown astronomically over the last decade with Systematic Investment Plans surpassing the other two. This is primarily due to the ease of transactions provided by the above plans. Most of the young investors today are aware of investing in various financial market instruments including mutual funds thereby they are starting to invest early in their lives. Thus this study would help potential investors in understanding appropriate investment avenues to optimize their investment objectives.

Keywords

Mutual Funds, Portfolio Diver-sification, Systematic Investment Plans,Systematic Transfer Plans, and Systematic Withdrawal Plans.

Introduction

In the recent years Mutual Funds have become an extremely popular investment avenue. With the last Union Budget encouraging the investors to enter the financial mark-ets, Mutual Fund schemes (Tax Saving Variety) have become the comparatively safer investment to consider in the financial markets. A Mutual Fund is a trust the pools in the small savings of middle class salaried people with a common inve-stment objective. The money thus collected is known as the Corpus of the fund and is invested in various companies in a diversified manner. The risks of investment are thereby reduced to a large extent through the diversification of the portfolio. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public. The essence of a Mutual Fund is the diversified portfolio of investment, which diversifies the risk by spreading out the investor's money across available or different types of investments.

Literature Review

In their study **Guha Deb and Banerjee (2009)** used Value at Risk approach (VaR) as a single risk measure summarizing all sources of downward risk. They attempted to highlight the importance of VaR as a measure of 'downside risk' for Indian equity Mutual Funds. **Roy andDeb(2003)** used the Treynor-Mazuy model and Henriksson-Merton model to measure the Conditional Performance of Indian Mutual Funds**. Ferson and Schadt (1996)** advocated a technique called conditional performance evaluation measuring the performance with both unconditional and conditional form of - CAPM, TreynorMazuy model and Henriksson-Merton model. Several recent studies have empirically tested the persistence in fund performance like **Volkman and Wohar (1994)),** but didn't tho-roughly investigate other syste-matic factors affecting future fund per-formance. Similar to previous studies, **Wohar (1995**) investigated the persistence between past and future fund performance using an empirical model that controls for these systematic factors. **Khorana, Servaes, Wedge (2006)** studiedthe level of portfolio manager ownership in the funds they manage and examined whether higher ownership affects improved future performance.

Objectives and Methodology

1. To understand the concept of Systematic Investment Plans.
2. To understand the concept of Systematic Withdrawal Plans
3. To understand the concept of Systematic Transfer Plans.
4. To compare the above plans for possible advantages and problems in the context of investments.

Research Methodology

The paper is exploratory in nature mainly focusing on understanding the conceptual commonalities and differences of these plans. The data is secondary and has been collected from various websites and journals. In India the investors are still not savvy with various forms of investment plans thus this comparative study would help them in understanding the investment avenues better.

Comparative Analysis of Systematic Investment, Withdrawal and Transfer Plans

Understanding Systematic Investment Plans

Systematic investment plan as the name suggest allows a user to build an investment portfolio with a small systematic investment at regular intervals. The investor can choose his or her preferred mode of investment as monthly, quarterly or annually and invest the funds according to his or her convenience. Users of systematic investment plans can choose from various investment vehicles to invest their money including stocks, mutual funds, ETFs and even gold funds. Amount can be invested in any investment vehicle. e.g. Fixed Deposit, debt fund, stocks, mutual fund, real estate, ETF(gold, oil), commodities ETF. People do SIP, if they are confident of long-term prospects of underlying and don't want to lose from short-term fluctuations.

Advantages of investing using a systematic investment approach

1. Investment discipline: The one basic rules of investing is to always maintain a focused and dedicated approach towards investment A large number of people enter the investment markets with a lot of enthusiasm but fail to maintain a monthly investment towards building a regular investment corpus. Investing in a systematic investment plan allows users to maintain a monthly investment scheme which is far easier to maintain in the long run rather than investing a lump sum amount each year. Investing in systematic investment plans must be considered by all investors who are yet to attain an investment discipline

allowing them the convenience to invest a pre-determined short sum every month towards their future.

2. Rupee cost averaging: Rupee cost averaging, also commonly known as RCA is one of the very significant reasons why investing in a systematic investment plan must be considered by almost every investor. Investors investing a fixed amount of money every month towards any investment vehicle allow them to purchase more units or stocks when the price of the investment is lower. This reduces the average cost of purchasing of the financial asset over time.
   Considering a long term investment approach, rupee cost averaging can even out any market ups and downs in the long term, allowing the investor to gain maximum benefits ion his or her investments over time.
3. Power of compounding: One of the basic rules of being a successful investor is to start early. Since all investment and returns are based on the power of compounding, an investor starting out early can earn much higher returns than a one starting out late even with a slightly higher corpus. Since a systematic investment plan do not seek a large amount of investment and users can start investing with a low sum each month depending on their financial condition, it allows them to start investing much early in life.
4. Investment convenience: A systematic investment plan as the name suggests is systematic in nature allowing the investor the advantage of investing small amount of money each month without any hassles. The investor can send a onetime instruction to his or her bank to allow auto debit of the investment amount each month from his or her savings bank account allowing systematic investments without worrying about missing out on any monthly investment.

Disadvantages of Systematic Investment Plans

1. If price of underlying (investment vehicle) doubles in first month and don't move much after that, then the investor won't have handsome returns.
2. If the investor have significant amount of cash to begin with, then it doesn't make much sense to do SIP and keep the rest of amount as cash in initial period.
3. SIP averages out short-term fluctuation and gives returns similar to long-term growth of underlying. Bad part is, the investor invest the same amount

at market highs and lows. It would be better, if the investor could invest more at lows and less at highs.

Precautions to be Taken while Investing through SIPs

The past five years of lacklustre performance have led to a spate of SIP cancellations. It is time to refresh the investor knowledge about SIP fundamentals.

1. An SIP is not a product or a fund. It is simply an investment process. Instead of basing investment decisions on expectations of how the market will behave, SIPs facilitate a disciplined participation in the market through ups and downs. Since a fixed amount is invested across time, SIPs enable a reduction in average cost. Therefore, the returns from an SIP are not likely to be different from those of the mutual fund in which the investment is made. Many investors believe that if they invest through SIPs, they will earn better returns. That is not true. The returns will depend on how the fund has performed at all times.
2. The benefit of this option has to be measured across cycles. If the investors invest via an SIP as the NAVs are moving up, then while computing the investors' return, the investor will value all the investors' SIPs at the current NAV, which would be higher than the investors' cost of acquisition.

Figure 1.1: Comparison of Sip and one time Lump Sum Investment

Month	NAV	Mr. SIP investor		Mr. One Time Investor	
		Amount Invested	Units Accumulated	Amount Invested	Units Accumulated
1	10	5000	500.00	30000	3000
2	11	5000	454.55	0	0
3	9	5000	555.56	0	0
4	8	5000	625.00	0	0
5	8	5000	625.00	0	0
6	11	5000	454.55	0	0
Total units accumulated		3214.65		3000	
Value of investment (Rs.)		35361.11		33000	
Avg. price / unit		9.332		10	

Source:*www.moneycontrol.com*

However, in a falling market, all the investors' SIPs will be valued at the lower NAV, and hence, will look bad. The returns are measured on the basis of where the investors stand today, and that will bias the investors' gain or loss. If the investor persist across cycles, the investors' investment in both the equity and SIPs will look good.

3. There is no point in comparing lump-sum investments and SIPs. They are two completely different ideas, and the latter will typically beat SIPs. When the investor invests a lump sum amount, a larger chunk of the money works for a longer period of time. On the other hand, a SIP is a slow model, where the investors build the investors' wealth with each instalment.

   Had the investor invested Rs 10,000 per month in the Sensex since its inception in 1979—406 months in all— the investor would have about Rs 1.6 crore today. A lump-sum investment of the same amount, Rs 4.06 lakh at that time would be worth over Rs 8 crore today. If the investor have a lump sum handy, the investor are better off not trying to go for an SIP unless the investor think the market is falling and the investors want to invest at lower levels.
4. SIPs are not about smart market timing; they simply allow the investor to invest regularly. If the investors are a salaried person with a regular income and monthly saving, SIPs are just the thing for the investor.
5. When the investor cancel the investors' SIP, the investor need to find a way to deploy the money the investor are saving. Even if the investors keep it idle in the bank, seeking a safe investment option, the investors have made a significant asset allocation decision.

Cancelling a SIP in a down market amounts to under weighing equity in a bear market. If the investor choose to come back when the market moves up again, the investor are invariably coming in at a higher NAV, and lose the benefit of having invested at the bottom.

The investors' money moves with the market in a SIP, and when the investor leave and join at will, the investor indulge in trying to time the market. When this attempt converts into buying at peaks and selling at the bottom, there is no money to be made.

6 An SIP in a debt fund is not a great idea, especially when the investor wants to invest a lump sum. A debt fund earns steady and regular interest income. The lesser the investor participate, the lesser the investor earn. In equity, the market cycles may modify the investors' benefits in the short term, but with a debt fund, holding a lump sum to invest, and then choosing a SIP is clearly inefficient. If the investor has the money, put it to work. A SIP in equity will be subject to market volatility but will do well in the long run, just like any other equity investment. To cancel a SIP in a falling market is to take the timing call that the investor will not participate in a falling market.

Understanding Systematic Withdrawal Plans

Systematic Withdrawal Plan as the name suggests offers investors a choice of withdrawing a fixed sum of money systematically each month on a fixed date from his or her investment corpus. Financially a systematic withdrawal plan is the exact opposite to a systematic invest-ment plan where the investor invests a fixed amount of money each month in his or her investment corpus. The amount of money to be withdrawn and the frequency of the withdrawal are fixed by the investor depending on his or her preferred choice. The investor can seek withdrawal of money monthly, quarterly or ann-ually depending on his or her individual financial need. An SWP (Systematic Withdrawal Plan) allows an investor to withdraw designated sum of money and units from the fund account at pre-defined regular intervals. It allows the investor a certain level of independence from market instability and helps in avoiding market timing. The investor can reinvest the redeemed cash in another portfolio or use it as a source of regular income. It is suitable for retirees who are looking for a fixed flow of income. SWP help investors who require liquidity as it permits them to access their money precisely when they need it to meet their objectives.

Opting for a systematic withdrawal plan (SWP) reduces the risk of irregular cash flow. Even when the scheme is making losses, it will pay the amount opted for by the investor by digging into the principal, if needed. With a systematic with-drawal plan, an investor's money will co-ntinue to grow as long as the investment is performing at a rate that is higher than the rate of withdrawal. As the long term capital gains from

equity mutual funds are exempt in case of holding beyond a year, you end up paying no tax on the withdrawals. Inflation Protection: Most of the fixed income instru-ments do not offer inflation beating returns. So, though the principal may be secure, the income might fall short of needs in future. Here again SWP scores in terms of generating returns to keep up with inflation especially if you opt for an equity fund. The only drawback in the SWP is that it will at some point eat into your capital. But judicious mix of investment instruments will ensure that your primary goal of income generation will be met without you running out of money in times of need. So the conclusion is that SWP is a noteworthy strategy to use for generation of regular income in various scenarios. Let us try and understand the working mechanism of a systematic withdrawal plan using a simple illustration.

Let us assume Mr. A has 10,000 mutual fund units as part of his investment portfolio. Let us assume that the net asset value of the each mutual fund unit is Rs. 20. This makes the total investment of Mr. A to be Rs. 2 Lakhs. Now let us assume Mr. A wants a monthly income of Rs. 5000 each month and adopts a systematic withdrawal plant to that effect. For the first month Mr. A withdraws Rs. 5000 his invest-ment would get depleted by 250 units (since 5000/20 NAV is 250). Now with each subsequent month while Mr. A would withdraw a fixed amount of Rs. 5000, the NAV of the mutual fund units would also increase as per market dynamics. Let us assume that NAV of the units held by Mr. A now increase in value to reach Rs. 20.15 per unit. The number of units required for a Rs. 5000 withdrawal would hence reduce to 248.14 units. Now effecti-vely Mr. A withdrew Rs. 10,000 in total from his overall investment corpus of Rs. 2 Lakhs. His balance should be Rs. 1,90,000 but is effectively Rs. 191462.4 making for effectively better earning with a systematic withdrawal scheme in place.

Advantages of Systematic With-drawal Plans: They have a number of intrinsic benefits including tax bene-fits, fixed income and a customized cash flow each month.

Tax Advantage

- In case of investing in debt mutual funds, a systematic wi-thdrawal plan scheme would effective reduce the overall tax liability of the individual investor compared to a dividend scheme. While dividends paid out by mutual funds

are not liable for any tax, mutual fund companies pass on the dividend distribution tax they are charged to the investor. The DDT rate charged by mutual fund houses to the investors ranges from 12.5% in case of balanced and debt funds to 25% in case of liquid or money market funds. In case the investor opts for a systematic withdrawal plan, the profit earned from ale of units at each withdrawal is taxable but treated as long term capital gain taxed at a flat rate of 10% without indexation or at 20% with indexation benefits. Thus sys-tematic withdrawal plans are more cost effective when it comes to tax liability compared to a divided pay out scheme.

Fixed Income

- Systematic withdrawal plans are an effective financial tool for those investors seeking a fixed monthly income from their investment corpus. This can be an effective tool for elderly or senior citizens allowing them the comfort of getting a fixed amount each month from their investment rather than relying on dividends which can vary each month as per market dynamics and functioning of the fund in question.

Disadvantages

1. One cannot run an SIP and SWP in the same fund.
2. Inflation is likely to increase the monthly withdrawal amount each year to meet expenses.
3. There will be fluctuations in the inflation rate as well as the portfolio return which can considerably impact the port-folio.
4. Since an SWP is nothing but redemption of units from the scheme, the tax treatment of each withdrawal will be the same as in the case of full withdrawal of equity and debt funds. Hence, for units where the period of holding has not crossed 12 months for equity funds, there might be a short term capital gains tax.

Understanding Systematic Transfer Plans

Investors who want to invest lump sum money in schemes with stable returns and ensure small exposure to equity schemes in order to avail of the potential for higher growth through equities opt for STP. Investors can use Systematic Transfer Plan (STP) as a defence mechanism in volatile market. STP is essentially transferring in-vestment from one asset or asset type into another asset or asset type.

The transfer happens gradually over a period. A fixed STP is where investors take out a fixed sum from one investment to another. A capital appreciation STP is where investors take the profit part out of one investment and invest in the other.

Disadvantages

1. STP is a possibly the second best investment strategy after SIP. It is one of the best risk mitigation strategies of the market. All risk mitigation strategies cap the loss but also reduce returns when market is bullish.
2. Investors need to follow it with discipline. STP, just like SIP, benefits only when followed properly. Breaking STP because of short term market movement or interest rate movement will only harm the investment in long term.
3. The investor needs to understand the assets and the stages they are in. For example, it would be unwise to transfer money from debt to equity when the market is closer to peak value. Similarly, it would be counter-productive to transfer money from equity to debt when the market is close to bottom.

Depending upon the investors risk appetite and objectives, he should carefully consider the above discussed methods of investing. If the investor monitors his investment a little he can easily gain a lot by deciding when to buy and sell the funds. To ease the burden of constant monitoring, the investor can choose any of the above mentioned plans.

Conclusion

The Indian Mutual Fund Industry, though still in its early stages is growing at an astronomical pace. The growth in the number of young market savvy investors has helped in this development to a large extent. Though the rural areas have not been tapped completely, there is a huge scope for market penetration. With advanced technology and growing investor awareness the mutual fund industry will surely continue its great run in years to come. However investors should always take proper caution before investing in mutual fund schemes as they are subject to market fluctuations. SEBI and other Government regulatory agencies have made the investment scenario extremely transparent, competitive and investor friendly. Thus a well regulated financial market will further help in consolidating the investors' faith in mutual funds. In the Global scenario, Indian Mutual Funds are at a very nascent stage. However India is

one of the fastest growing economies in the world and this growth phase will obviously help the overall financial markets, thereby mutual funds.

Most of the young investors today are aware of the pros and cons of investing in various financial market instruments including mutual funds thereby they are starting to invest early in their lives. Investors should foray into this lucrative avenue of investing and see their money multiply in no time.

Limitations of the Study

1. The data is limited to the Indian Context and thus could be enhanced further.
2. More empirical analysis can be conducted.
3. The study only considers the retail investors.

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