AN ANALYTICAL STUDY ON INVESTORS' AWARENESS AND PERCEPTION TOWARDS THE HEDGE FUNDS IN GUJARAT

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Abstract

Hedge Funds in India are among relatively new investment opportunities. In spite of tall claims that Hedge Funds have been demystified, the fact remains that a big segment of the investment community is not aware of the risk return permutations of this asset. The Monetary Policy of 2007-08 gave a never-before opportunity to Hedge Funds- Access to the Indian HNI's and Institutional investor's share of Portfolio Pie. According to analysts at Singapore's fund research house Eurekahedge, Indian Hedge Fund Index returned over 5% in the first eight months of 2010 vis-à-vis 2% gains by benchmark Sensex in the same period. In modern times, without market research and without understanding the investors' needs & desire, it becomes difficult to sell the investment products. Financial institutions have realized this fact and begin to find out the needs of investors and tried to satisfy them. An attempt is made here to identify the awareness and perception of the investors' towards hedge funds as an investment avenue with special reference to Gujarat state.

1. Key Words

Hedge Funds, Private Placements, High Net worth Individuals, Fund Managers.

2. Introduction

India, fast growing emerging financial market, is very keen for new investment propositions, particularly investment in hedge funds. Presence of systematic institutional framework for hedging, regulatory factors, good information disclosure standards, a well-developed capital market, liberalized stable economy, rapid economic and social reforms, democratic set-up, better return on capital have rather favored India score over other competing nations as a superior place for investment in hedge funds. Investment in hedge funds is becoming more attractive investment avenue for sophisticated investors, high net worth individuals (HNI) or families and big institutions. They are class of investors who believe in the finance mantra – "high risk, and higher return". Investment in India focused hedge funds - for those with an appetite for risks, most willing to take risks in anticipation of explosive reward. This study investigates the investors' awareness level about hedge funds as an investment avenue and their perception towards the factors challenging the growth of hedge funds as an investment opportunity.

3. Literature Review

The study on hedge fund has been undertaken for example by Gavin Cassar and Joseph Gerakos (2011), Richard W. Sias and David A. Whidbee (2010), Tom Nohel, Z. Jay Wang and Lu Zheng (2010), David J. Brophy, Paige P. Ouimet and Clemens Sialm (2009), John M. Griffin and Jin Xu (2009), Benjamin J. Haskin, Joseph G. Davis and Jocelyn C. Flynn (2009), Vikas Agarwal and Narayan Y. Naik(2004), Duen-Li Kao (2002) and Simon Firth and Alix Prentice (2002).

Gavin Cassar and **Joseph Gerakos (2011)** investigated the extent to which hedge fund managers smooth self-reported returns. In contrast to prior research on the "anomalous" properties of hedge fund returns, authors observe the mechanisms used to price the fund's investment positions and report the fund's performance to investors, thereby allowing us to differentiate between asset illiquidity and misreporting-based explanations. The researchers found that funds using less verifiable pricing sources and funds that provide managers with greater discretion in pricing investment positions are more likely to have returns consistent with intentional smoothing. Traditional controls, however, such as removing the manager from the setting and reporting of the fund's net asset value and the use of reputable auditors and administrators, are not associated with lower levels of smoothing. At the end the researcher reported that with respect to asset illiquidity versus misreporting, investment style and portfolio characteristics explain 14.0–24.3% of the variation in our smoothing measures, and pricing controls explain an additional 4.1–8.8%, suggesting that asset illiquidity is the major factor driving the anomalous properties of self-reported hedge fund returns. **Richard W. Sias and David A. Whidbee (2010)** attempted to examines the relation between insider (officers and directors) transactions and trading between institutional and individual investors to better understand what motivates insiders to trade, the role of institutional investors in providing liquidity to insiders, and how insiders' perception of mispricing is related to net demand by individual investors versus institutional investors. Researchers found that is a strong

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inverse relation between insider trading and institutional demand the same quarter and over the previous year and suggested a combination of factors contribute to this relation. First, institutional investors are more likely to provide the liquidity necessary for insiders to trade. Second, insiders are more likely to buy low valuation and low lag return stocks while institutions are attracted to the opposite security characteristics. At the end the researchers concluded that insider trading is inversely related to demand by institutional investors (and positively related to demand by individual investors) in the same quarter and over the previous year. Institutional investors providing liquidity to insiders and institutions' and insiders' attraction to opposite security characteristics account for most of these relations. **Tom Nohel, Z. Jay Wang and Lu Zheng(2010)** attempted to examine situations where the same fund manager simultaneously manages mutual funds and hedge funds. Researchers refer to this as side-by-side management. They have documented 344 such cases involving 693 mutual funds and 538 hedge funds. Proponents of this practice argue that it is essential to hire and retain star performers. Detractors argue that the temptation for abuse is high, and the practice should be banned. Analysis based on various performance metrics showed that side-by-side mutual fund managers significantly outperform peer funds, consistent with this privilege being granted primarily to star performers. Interestingly, side-by-side hedge fund managers are at best on par with their style category peers, casting further doubt on the idea that conflicts of interest undermine mutual fund investors. **David J. Brophy, Paige P. Ouimet and Clemens Sialm (2009)** discussed Security structures, Characteristics of PIPE(private investments in public equity) securities, Characteristics of PIPE companies, Stock price performance, Short-term stock price performance, Long-term stock price performance, Determinants of stock price performance, Additional measures of long-term performance, Short interest of PIPE companies and Performance of hedge funds that invest in PIPEs In his research paper titled research paper titled "**"Hedge Funds as Investors of Last Resort?".** This paper discusses the role of hedge funds in private placements. At the end the researcher found that investments by hedge funds are associated with significantly negative long run performance of the underlying equity, even after controlling for the security type. **John M. Griffin** and **Jin Xu(2009)** sheds some light on hedge funds in the equity market by examining their trading intensity, their relative weights compared to the market and mutual funds, and the types of securities they hold. Researchers have also examined the ability of hedge fund and mutual fund aggregate holdings, changes in holdings, and large position bets to predict the cross section of future stock returns. Hedge fund stock picking, sector selection, and average style are compared relative to mutual funds. Finally, they have examined differences in ability within the hedge fund industry. Decomposing returns into three components, authors found that hedge funds are better than mutual funds at stock picking by only 1.32% per year on a value-weighted basis, and this result is insignificant on an equal-weighted basis or with price-to-sales benchmarks. Hedge funds exhibit no ability to time sectors or pick better stock styles. Surprisingly, we find only weak evidence of differential ability between hedge funds. Overall, our study raises serious questions about the perceived superior skill of hedge fund managers. **Benjamin J. Haskin, Joseph G. Davis and Jocelyn C. Flynn (2009)** seek to examine regulatory and compliance issues for hedge funds valuing complex assets. Within the context of hedge fund valuation, the paper provides a general overview of: the regulatory background of hedge funds and the central role valuation plays in the operation and regulation of such funds; relevant cases brought by the SEC; and a discussion of valuation best practices. Hedge funds are not ''unregulated.'' There is a body of law and accounting standards that applies to hedge fund valuation. Nevertheless, hedge fund valuation standards are evolving in this era of heightened regulatory scrutiny. The common concepts that have emerged from valuation best practices will likely provide the underpinning for any regulatory initiatives regarding hedge fund valuation. **Vikas Agarwal and Narayan Y. Naik (2004)** attempted to characterize the systematic risk exposure of hedge funds using buy-and hold and option based strategies. Results showed that a large number of equity- oriented hedge fund strategies exhibits payoffs resembling a short position in a put option on the market index and therefore bear a left tailed risk. At the end researchers concluded that with the systematic risk exposure of hedge funds, recent performance appears significantly better than long run performance. **Duen-Li Kao (2002)** empirically examined whether the alphas of hedge funds and those of long-only portfolios present different distributions and are derived from different risk factors. The researchers discussed adjusted for return volatility differences, hedge funds seem to offer more consistent alphas for potential transfer to either equity or bond asset classes than do long-only portfolios- even under extreme market conditions. Potential explanations for the findings include lack of data reliability and differences between hedge funds and actively managed long-only funds in compensation, investment constraints, and structures. Factors related to market index returns do not adequately detect hedge funds' risk postures beyond a fund's

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exposure to the market-directional risk of standard asset classes. Risk factors derived from asset prices in financial markets do provide timely and systematic descriptions of the risks underlying trading strategies used by hedge funds. The multifactor style-risk analysis can effectively monitor a hedge fund's exposure to systematic versus idiosyncratic risks and volatility-risk factors over time. **Hung-Gay Fung, Xiaoqing Eleanor Xu, Jot Yau (2002)** examined the performance of 115 global equity-based hedge funds with reference to their target geographical markets in the seven-year period 1994-2000. Several results are noteworthy. First, global hedge fund managers do not show positive market-timing ability but do demonstrate superior security-selection ability; the Jensen's alphas we found, before and after controlling for market timing, are sizable and positive. Second, incentive fees and leverage both have a significant positive impact on a hedge fund's risk-adjusted return (as demonstrated by Sharpe ratios and Jensen's alphas) but not on a fund's "selectivity index" (i.e., its performance after controlling for market-timing effects). Third, incentive fees can lower the hedge fund's up-market and down-market systematic risk. Fourth, the size of a hedge fund is consistently related to its return performance. Finally, contrary to the general perception, leverage does not significantly affect the systematic risk of hedge funds. **Simon Firth and Alix Prentice (2002)** discussed important issues related to hedge funds in his paper **titled "Legal and regulatory protections for hedge fund investors".** A common perception is that, as investors in hedge funds are afforded a lesser level of legal and regulatory protections than investors in regulated products, there is a deficiency in the degree of transparency and disclosure afforded to them. This paper examines from a largely UK perspective whether that is, in practice, the case.

4. Research objective:

- ✓ To analyze the awareness level about Hedge Funds as an investment avenue among the investor community of Gujarat
- ✓ To study the investor's perception towards the benefits of investing into hedge funds
- ✓ To study the investor's perception towards the factors that challenges the growth of Hedge Funds

5. Hypothesis of the study

- ✓ There is no association between the Age of the investors and the Awareness for the Hedge Funds.
- ✓ There is no association between the Education of the investors and the Awareness of the Hedge Funds.
- ✓ Investors' give equal ratings to the advantages associated with hedge funds.
- ✓ Investors give equal ratings to the factors that challenge the growth of Hedge Funds in India.

6. Methodology

This is an analytical study based on the primary data collected through scientifically developed questionnaire. The questionnaire has been personally administered on sample size of 246, chosen on a convenient basis from the cities of Gujarat state. A literature review was undertaken to identify what parameters to consider in research. It outlines the previous research with respect to customer satisfaction, awareness in the industry. Second, in-depth interviews were held with customers to establish the evaluation criteria and the factors which result in customer satisfaction. Third, a questionnaire was constructed and piloted. Questionnaire was prepared keeping in mind the various outcomes possible. Care was taken to minimize the possibility of wrong interpretation and biased views. The five-point likert scale was used to analyze the different variables and their relationship. For the analysis of data statistical methods are applied with the aid of SPSS (Statistical Package for Social Science) software, version 16.0 and excel. Sample size was determined using following formula.

$$n = \frac{z^2 pq}{d^2}$$

Here Z = 1.96, p = 0.20, q = 0.80, d = 0.05,

$$n = \frac{(1.96)^2(0.20)(0.80)}{(0.05)^2}$$

n = 245.8624 ≈ 246

7. Sample

The population comprised investors as defined in similar studied in literature. A convenience sampling procedure was used on a sample of 246 respondents. The population of this study was investors of major cities of Gujarat.

Table-1
Characterstics of the sample

	Category	Frequency
Age	18-23	46
	24-29	63
	30-35	49
	35-40	41
	40+	47
	Total	246
Monthly Income	10,000-20,000	58
	20,001-30,000	73
	30,001-40,000	41
	40,000+	74
	Total	246
Occupation	Student	33

	Professional	109
	Businessman	27
	Housewife	17
	Govt. employee	32
	Others	28
	Total	246
Education Level	Undergraduate	8
	Graduate	78
	Postgraduate	160
	Total	246
Gender	Male	183
	Female	63
	Total	246

8. Findings and Analysis

1. Hedge funds are same as Mutual Funds was not believed by majority of the investors.
2. Looking at the various **Advantages** of Hedge Funds, investors rated highly for the advantage of **Potential to adopt various Tactics & Strategies,** wherein investors responded between BELEVE and STRONGLY BELIEVE.
3. Looking at the various Challenges that hamper the Growth of Hedge Funds in India, challenges namely SEBI Regulations, Lack of awareness about Hedge Funds, Misperceptions about Hedge Funds, Lack of standard Hedge Fund Indices in India and Lack of transparency and secretive nature of Hedge Funds were highly rated by the investors.
4. Out of the respondents who were AWARE about the Hedge Funds, **62.3%** believed that Hedge Funds are **NOT better option** than Mutual Funds.
5. Out of the total 61 respondents, who were AWARE about Hedge Funds, **39** respondents, i.e. **63.9%** respondents agreed to invest in Hedge Funds, if they were an Accredited Investors.
6. **34.4%** respondents would invest about 10 to 20% of their total value of the portfolio in Hedge Funds, followed by 20 to 30% of their portfolio by other **16.4%** respondents.
7. **42.6%** of the respondents would like to be stay invested in Hedge Funds for **1 to 3 years**
8. **26.2%** respondents expected 30 to 40% returns per annum from the investment they have made in Hedge Funds.
9. From those who were not AWARE about Hedge Funds, majority of them were eager to know about it and found the concept interesting.
10. Considering the Advantages of Hedge Funds investors highly believed that the "Potential of Hedge Funds to adopt various Tactics and Strategies" by its managers as one of the factors reflecting the advantages of Hedge Funds.
11. Major challenges that hamper the growth of Hedge Funds were challenges like: SEBI Regulations, Lack of awareness, Misperceptions and Lack of Transparency and Secretive nature of Hedge Funds.

9. Hypothesis testing:

1. Awareness towards hedge funds and Age Cross tabulation:

Table-2

Are you aware about hedge funds? * Age

	Age					Total
	18-23	**24-29**	**30-34**	**35-40**	**40+**	
Aware	8	26	12	4	11	61
	17.4 %	41.3 %	24.5 %	9.8 %	23.4 %	24.8 %
Not Aware	38	37	37	37	36	185
	82.6 %	58.7 %	75.5 %	90.2 %	76.6 %	75.2 %
Total	46	63	49	41	47	246
	100 %	100 %	100 %	100 %	100 %	100 %

Table-3

Chi-Square Test

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	15.546	4	0.004
Likelihood Ratio	15.737	4	0.003
Linear-by-Linear Association	1.372	1	0.241
N of Valid Cases	246		
a. = 0 cells (.0%) have expected count less than 5. The minimum expected count is 10.17			

It can be inferred from the above table that there is **a Strong association** between the Age of the investors and the Awareness for the Hedge Funds. The Asymptotic Significant value is 0.004, which is **less** than 0.05; this means that the $H_{0\ is}$ rejected.

2. Awareness towards hedge funds and Education

Table-4

Cross tabulation

Are you aware about hedge funds? * Education

		Education			Total
		UG	**Grad**	**PG**	
Are you aware about Hedge Fund?	**YES**	2	17	42	**61**
		25.0%	21.8%	26.3%	**24.8%**
	NO	6	61	118	**185**
		75.0%	78.2%	73.8%	**75.2%**
		8	78	160	**246**
		100%	100%	100%	**100%**

Table-5

Chi-Square Test

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	.558(a)	2	.756
Likelihood Ratio	.567	2	.753
Linear-by-Linear Association	.384	1	.535
N of Valid Cases	246		
a 1 cells (16.7%) have expected count less than 5. The minimum expected count is 1.98.			

It can be inferred from the above table that there is **NO association** between the Education of the investors and the Awareness for the Hedge Funds. The Asymptotic Significant value is 0.756, which is **more** than 0.05; this means that the $\mathbf{H_0}$ **is not rejected.**

Table-6

3. **Investors' give equal ratings to the advantages associated with hedge funds.**

Advantages	**Sig. 2-tailed**		**0.05**
Potential for positive returns	*0.027*	<	0.05
Potential to adopt various Tactics & Strategies	*0.199*	>	0.05
Minimum volatility risk	*0.000*	<	0.05
Enhance portfolio efficiency and diversification	*0.000*	<	0.05
Alignment of manager goals with investors' goals	*0.001*	<	0.05
Investment in all possible avenues	*0.000*	<	0.05
Provide liquidity to the market	*0.000*	<	0.05

Most of all the investors give different weightage to the different advantages associated with hedge funds.

Table-7

4. **Investors give equal ratings to the factors that challenge the growth of Hedge Funds in India.**

Prospective Advancement of HEDGE FUNDS	**Sig. 2 tailed**		**0.05**
SEBI providing a Registered & Regulated platform to HEDGE FUNDS	*0.139*	>	0.05
HEDGE FUNDS Companies will Increase in Size and Offerings	*0.008*	<	0.05
Greater Increase in the Number of HEDGE FUNDS playing in the market	*0.009*	<	0.05
Reduced HEDGE FUNDS Fees and Cost, against higher returns	*0.000*	<	0.05
More Powerful & Reliable Indices providing the accurate data	*0.210*	>	0.05
Improved Transparency in terms of Capital Structure, Strategies adopted	*0.282*	>	0.05
Enhanced investor's Liquidity & Willingness to invest In HEDGE FUND	*0.788*	>	0.05
Increase in the level of Awareness about HEDGE FUNDS in public	*0.013*	<	0.05

From the above test it can be seen that the null hypothesis is rejected and alternate hypothesis is not rejected for 4 factors while means that the majority of the Investors' responded that they are neutral about the following factors that are the prospects of Hedge Funds in India namely hedge funds Companies will Increase in Size and Offerings, Greater Increase in the Number of hedge funds playing in the market**,** Reduced hedge funds Fees and Cost, against higher returns and Increase in the level of Awareness about hedge funds in public. They believe and strongly believed about the following factors that are the prospects of Hedge Funds in India namely, SEBI providing a Registered & Regulated platform to hedge funds, More Powerful & Reliable Indices providing the accurate data**,** Improved Transparency in terms of Capital Structure, Strategies adopted and Enhanced investor's Liquidity & Willingness to invest In hedge fund.

10. Limitations of research

The present study is based on a moderate sample size and areas covered are major cities of Gujarat state therefore the results of this study cannot be generalized. The total sample size was 246 useable questionnaires, after disaggregation into the demographic categories, a few of subgroups were small in number. For example, the sample is skewed to a particular gender with 75 Percent of the respondents being male. Future researcher could make several extensions of the current study.

11. Future Aspects & Contribution of Study.

As mentioned above the research is just a small step in understanding the constructs of Investor's awareness and their perception. The causal relationships between the two have not been investigated. Future research could examine a wider respondent base across the States of India with more diversified sample in the research. Future researchers could use quota sampling across the different income groups, gender and age categories. Hedge fund is such as a wide area of research that no single study can cover different dimensions related to it. Even primary surveys for studying the perceptions of investors towards hedge funds time to time is not a regular feature in India, Hence there is much potential of research on a bigger scale covering wider area.

12. Conclusions

The awareness level regarding hedge funds is very less in area covered for study. The investors are not aware of the advantage that they can get by investing in hedge funds nor are they aware of the basic functioning of hedge funds. Investors in Gujarat prefer to invest in government securities and fixed deposits of nationalize banks were they can have complete safety of their funds though they get less returns. The investors willing to take risk invest in equity markets, land, gold etc. Access to financial consultant for the management of the funds is costly so very few investors prefer to have their own financial consultant for the management of their funds. Investors generally see the past performance of the funds for investing their money in it which is not the right way to analyze the funds portfolio.

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