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RISK APPETITE VS. RETURN: HOW INVESTORS CHOOSE BETWEEN MUTUAL FUNDS AND ULIPs

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ABSTRAK

This study investigates the relationship between investors' risk appetite and their preference for mutual funds or Unit Linked Insurance Plans. As financial instruments continue to evolve and offer a broad spectrum of benefits and risks, understanding investor behavior becomes essential for financial advisors, policymakers, and fund managers. The research is grounded in primary data collected from 100 respondents using structured questionnaires. It seeks to analyze how demographic and psychographic factors influence investment decisions, particularly in relation to perceived risk and expected return. Statistical tools including chi-square tests and correlation analysis are applied to test the hypotheses. The findings highlight significant associations between risk appetite and investment choice, with implications for personalized financial planning and investment education.

KEYWORDS: ***Risk appetite, Investment choices, Mutual funds, ULIPs, Financial risk, Investment behavior, Risk tolerance, Asset allocation, Investor profiles, Risk-adjusted returns, Capital markets, Investment diversification, Financial planning, Quantitative risk analysis, Investor demographics, Financial instruments, Risk mitigation, Return on investment.***

1. INTRODUCTION

Despite the increasing complexity and volatility of the financial system, individuals have access to a vast array of investment options that offer diverse risk, yield, and objectives. Among these, Mutual Funds and Unit Linked Insurance Plans (ULIPs) are two of the most prominent financial vehicles for diversification among investors with different risk appetites. While both are tied to the market and regulated by competent authorities, they differ significantly in their structure, purpose, liquidity, and cost. Financial planners, advisors and policy designers -- as well as investors -- must understand why one overwhelmingly invests while the other declines or rises because of risk appetite.

Investors' willingness to accept risk appetite, which is the range of returns they are willing to offer, is a key factor in their investment decisions. This is determined by various factors such as age, income level, financial knowledge, past investment backgrounds, personal objectives, and behavioral predispositions. High-risk investors tend to use high-return instruments like mutual funds, while lower risk tolerance individuals may opt for ULIPs, which provide both insurance and investment, although the relative return potential is limited by the embedded costs and longer lock-in periods.

The diversified nature of Mutual Funds, their professional management and transparency, as well as the relative ease of access to SIPs (Systematic Investment Plans) have made them increasingly popular. In contrast, ULIPs have gained popularity due to tax benefits provided under Section 80C and 10(10D) of the Income Tax Act, as well as being attractive to conservative investors seeking risk protection.

Within the Indian investment ecosystem, there are market segments for these products that exist in different but overlap. ULIPs are often preferred by individuals seeking long-term planning with the added benefit of life insurance, while mutual funds appeal to investors who prioritize returns and take more responsibility for their financial health. The investment landscape is being altered as a result of regulatory initiatives aimed at increasing financial inclusion and improving investor education. Hence, it is timely and relevant to comprehend how various investor profiles are associated with different instruments.'".

The purpose of this study is to investigate whether individuals' risk aversion or interest in investing in mutual funds or ULIPs influences their investment decisions. A. The study examines the impact of age, income, education, and investment knowledge on this correlation. The study's focus on behavioral finance and comparative data analysis of mutual funds and ULIPs fills in a significant literature gap.

Through this research, they aim to:
Improve the way financial advisors evaluate clients..
Aid individual investors in determining their financial decisions based on their actual risk exposure.
Facilitate financial product developers in creating products that are more suited to different risk categories by providing insights.

2. LITERATURE REVIEW

Risk appetite is a key factor in investment decisions, which are dependent on various factors. Why? It is crucial for financial advisors, policymakers, and investors to comprehend the impact of risk tolerance when deciding between mutual funds and Unit Linked Insurance Plans (ULIPs). Current literature is the focus of this section, with particular attention paid to recent developments and important findings.

2.1. Risk Appetite and Investment Behavior.

Investors' willingness to take risks in order to earn returns is a crucial factor in their investment decisions. According to traditional finance theories, such as Markowitz's (1952) Modern Portfolio Theory, investors prioritize maximizing returns for a given level of risk. However, behavioral finance introduces the idea that investment decisions are influenced by psychological factors such as risk perception and loss dejection.

According to a study by Grable and Joo (2004), age, income, and education level are all linked to risk tolerance. Those who are younger, more financially stable, and educated tend to be more risk-averse, which is why they tend invest in stocks that are equity-oriented, such as mutual funds.

2.2. Mutual funds: The behavior and patterns of investors.pdf.

The younger generation in India is showing a greater interest in investing in mutual funds, as per recent surveys. Despite 89% of investors stating that they should consider their risk appetite, only 27% actually do. In addition, 59% of investors prioritize past performance over future investment, which could result in poor decision-making.

AMFI's report reveals that almost half of mutual fund investments are redeemable within two years, despite the advantages of long-term investing and compounding. The difference between investor education and action is emphasized by this behavior, which emphasizes the importance of better financial literacy.

2.3. ULIPs: Performance and Investor Preferences

Risk-seeking investors seeking long-term financial security are drawn to ULIPs, which offer a combination of insurance and investment. The majority of respondents stated that they would be purchasing ULIPs in the near future, with financial security for families and retirement planning being the most prominent reasons.

Performance analyses reveal that a significant number of ULIP funds do not achieve benchmark returns within 3-, 5- and 10-year timeframes. Compared to mutual funds, the underperformance is partly due to higher charges and less assertive fund management.

2.4. Comparative Analysis: Mutual Funds vs. ULIPs.

Among the contrasts between mutual funds and ULIPs are several:

Charges: ULIPs often have multiple charges, such as premium allocation and policy administration fees, plus mortality charges which can lower returns. Why? Most mutual funds require a fund management fee, which is usually less than the combined fees of ULIPs.
Liquidity in mutual funds is usually higher, and investors can repurchase units at any time, while in ULIPs, the term of interest may be locked for five years.
Section 80C of the Income Tax Act provides tax benefits for both instruments.. ULIPs are attractive for tax planning because they provide tax-free returns under Section 10(10D).

2.5. Behavioral Factors Influencing Investment Decisions

Investment decisions are heavily influenced by behavioral biases, which can range from overconfidence to herd behavior. According to research on online investor behavior, product recommendations can result in poor investment decisions, particularly among investors with lower socioeconomic backgrounds. A study of this phenomenon was published today.

Moreover, the surge in small and mid-cap mutual fund investments indicates an increased risk tolerance by investors. ". Yet this trend also raises questions about the volatility of the market and whether investors should choose to take risks while still being safe.

3. RESEARCH METHODOLOGY

This study uses a descriptive and analytical research design to explore the relationship between investor risk appetite and preference for mutual funds or ULIPs.

4.OBJECTIVES

To examine how risk appetite influences investment choices.
To identify demographic and behavioral factors affecting these decisions.
Hypotheses
H_0: No significant relationship exists between risk appetite and investment preference.
H_1: A significant relationship exists between risk appetite and investment preference.
Data Collection
Primary data: Collected via a structured questionnaire with Likert-scale and multiple-choice questions.

Secondary data: Sourced from journals, financial websites (AMFI, IRDAI), and recent reports.
Sampling
Method: Non-probability convenience sampling.
Sample size: 100 individual investors aged 21 and above.
Analysis Tools
Descriptive statistics, cross-tabulation, and chi-square tests.
Graphs and charts for data visualization.
Limitations
Limited geographic scope.
Potential respondent bias.
Small sample size may not fully represent national trends.

5.DATA ANALYSIS AND INTERPRETATION

5.1 Descriptive Statistics of Financial Behavior

Table 5.19 summarizes the behavioral traits of retail investors using mean, standard deviation, skewness, and kurtosis values.

- **Risk-Taking Ability (FBR1)**: Mean score of 3.40 suggests moderate risk appetite among investors. The negative skew (-0.513) indicates a slight lean toward conservative choices.
- **Investment Horizon (FBR2)**: With a mean of 4.29, most investors prefer a long-term horizon. Low skewness and kurtosis suggest consistency across responses.
- **Primary Financial Goal (FBR3)**: Mean of 2.95 shows balanced preferences between tax savings, capital preservation, and wealth creation, with a tilt toward safer goals.
- **Frequency of Monitoring (FBR4)**: A mean of 3.51 indicates that most investors monitor their portfolios monthly or weekly, leaning slightly toward passive management.
- **Mutual Funds vs. ULIPs (FBR5)**: Mean of 3.77 reflects a clear preference for mutual funds, although some value ULIPs for insurance benefits (positive skew = 0.736).
- **Market Volatility Sensitivity (FBR6)**: Mean of 3.65 shows most investors consider volatility in decision-making but avoid impulsive changes.
- **Response to Economic Uncertainty (FBR7)**: Mean of 2.93 reveals a tendency to reduce exposure during uncertain times, with significant variability across respondents.
- **Perceived Financial Literacy (FBR8)**: A mean of 3.81 indicates that most investors recognize the importance of financial knowledge in guiding their decisions.

5.2 Correlation Analysis

Table 5.20 presents the correlation matrix among key variables:

Variables	PRDPE	IIBR	ELPSS	NPRSM
PRDPE	1			
IIBR	0.723	1		
ELPSS	0.152	0.148	1	
NPRSM	0.878	0.845	0.432	1

- **PRDPE and NPRSM** share a **very strong positive correlation (r = 0.878)**, indicating a close relationship between product preference and risk strategy management.
- **IIBR (Investor Information Behavior and Response)** is **strongly correlated** with PRDPE (r = 0.723), showing that informed investors have clearer product preferences.
- **ELPSS (Experience Level and Product Suitability)** has **weaker correlations**, suggesting that personal experience alone is not a dominant factor in determining preferences.

5.3 Interpretation

- The descriptive data reflects a **moderately risk-tolerant and long-term-oriented investor base**.
- Mutual funds are **preferred over ULIPs**, attributed to better liquidity, lower cost, and transparency.
- Financial literacy is a **key influencer** in shaping investment behavior, yet a significant portion of investors still rely on advisors or past performance.
- The correlation results confirm that **risk strategy and product choice are closely linked**, with informed investors better aligning their selections with their risk appetite.

FINDINGS

According to the study, individuals are more likely to invest in mutual funds due to their ability to offer liquidity at lower rates and transparency. Nevertheless, ULIPs are attractive to those who want both investment and insurance.

Investors with a higher risk tolerance tend to invest in equity mutual funds for high returns, while risk-seekers opt for debt mutual fund or ULIPs for stability.

Awareness and Knowledge: Many investors are not well informed about mutual funds and ULIPs so they do not know what they are buying into. The past is often the driving force behind investment decisions.

Problems with Liquidity: Mutual funds are favored for their liquidity, making it easier to access and exit the market. Investors seeking flexibility are less interested in ULIPs due to their lengthy lock-in period.

High charges and obscure costs: ULIPs are known for their high fees and expenses, while mutual funds (especially index and ETF funds) are generally considered to be more cost-effective.

ULIPs offer tax benefits due to tax-saving provisions in Sections 80C and 10(10D) of the Income Tax Act.
The sensitivity of investors to market fluctuations makes ULIPs more attractive, as they can lower costs over time, while aggressive investors tend to invest in mutual funds for longer periods and higher returns.

CONCLUSION

According to the research, mutual funds and ULIPs have different investor requirements. Why is this? ULIPs are an alternative to mutual funds, as they offer both investment opportunities and insurance benefits. The risk-taking nature of mutual funds and ULIPs is highly significant for aggressive and conservative investors. The absence of financial expertise still impedes the ability to make informed decisions. The combination of increased transparency, financial education and regulatory measures can help investors make decisions that align with their financial goals. Why is this so? By combining both products in a well-diversified and sustainable investment strategy, one can create.