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1.1 Introduction:

It is viewed from the past that the capital market has always been one of the most important avenue for the investors to invest their savings. However, uncertainty in the security price movements makes it difficult to effectively predict the returns. Uncertainty means that the current as well as the previous prices cannot be used as a measure to predict the future returns. This is in consistent with the practise of the Efficient Market Hypothesis (EMH), which was one of the most acceptable paradigms in the 1970’s (H. Markowitz 1952, William Sharpe 1964, John Linter 1965, Treynor 1965, John Mossin 1966, William Sharpe 1966, Tobin 1958, Hicks 1962, M. Jensen 1968 and Fama & Mcbeth 1973 etc.). The investors often try to guess the expected returns based on past records but this may not be possible (Treynor & Mazuy 1966, Henrikson & Merton 1981, Jensen 1968 & 1969, Narasimhan & Vijayalakshmi 2001, R. Elango 2005, Roy & Ghosh 2012 etc.) without the collection of costly insider trading information. Due to this, the individual investors hardly walk out to invest in the stock markets (Leite & Cortez 2005, Aragon & Ferson 2006, V.L. Sourd 2007, Cuthbertson, Nitzsche & O’sullivan 2010, Shanmughan & Zabiulla 2011, etc.). As a result, different types of financial institutions come into picture in an economy.

The financial system of a country greatly influences its economy. The close relationship between financial structure and economic growth is replicated in the prevailing institutional arrangement, delivery system and intermediation process (Bogle, J. C. 1994, Sadhak 1997, Bansal, L.K. 1996 & 1997 etc.). According to Guerley & Shaw (1955), the role of financial institutions is crucial in recognising the opportunities for savings and real investment in an economy. A certain level of financial prosperity also represents a more mature way of mobilisation of funds – a move from self-financing to direct financing and then to indirect financing. Indirect financing means where financial institutions like banks, insurance companies and other financial companies participate to intervene between savers and borrowers of funds that accelerates the investing activities in the economy (Kaizuka 1987). According to Kaufman (1986) financial institutions ‘are expected to embody the essence of integrity and their entrepreneurial drive is well balanced by a strong sense of fiduciary responsibility and that is why financial regulations have always been a part of economic development’. Sadhak (1997) delicately defines the allocation function of the financial markets: ‘Financial markets
essentially involve the allocation of resources. This can be thought of as the brain of the entire economic system, the locus of central decision making; if they fail, not only will the sectors profit be lower than would otherwise have been, but the performance of the entire economic system may be impaired’.

Thus, the financial institutions are required to play a dominant role of asset management and intermediation and which will subsequently result in the overall macroeconomic development (Markowitz, H. 1952 & 1959, Treynor 1965, Sharpe 1966; Jensen 1968, Treynor & Mazuy 1966; R. Elango 2005; Sadhak 1997; J. Dhar 2005; Abdullah, Hassan & Mohamad 2007; A. Kundu 2009; Bhalla 2005; Roy & Ghosh 2012). The mutual fund is an important investment vehicle, which plays a vital role in an economy by mobilising savings and investing them in the volatile capital market. It establishes a link between saving and the capital market in an economy like India. The functions of mutual funds have both short and long term impact on the savings and capital markets and the national economy. Mutual funds assist the process of financial deepening and intermediation. They mobilise funds in the saving market and act as a complementary to banking; at the same time, they also compete with banks and other financial institutions (Markowitz 1952, Treynor 1965, Sharpe 1966, Jensen 1968, Treynor & Mazuy 1966, A.K. Sengupta 1991, Sadhak 1997, Rao & Ravindran 2001, Narasimham & Vijayalakshmi 2001, Ibrahim 2004, K. Choudhary 2007, S.S. Debasis 2009, Afza & Rauf 2009, Bhalla 2005, Mansor & Bhatti 2011 etc.). Consequently, the stock market activities are also significantly influenced by mutual funds. It may be argued that all the segments of financial market are influenced by the existence and operation of mutual funds. The scope and efficiency of mutual funds are influenced by overall economic fundamentals like interrelationship between the financial and real sector, the nature of development of the savings and capital markets, market structure, institutional arrangements and overall policy regime. The process of liberalisation, deregulation and restructuring of the Indian economy has further created necessity for efficient allocation of resources. In this process of development, mutual fund has emerged as a strong financial intermediary, which plays a crucial role in bringing stability to the financial system and efficiency to the resource allocation process (Markowitz 1952, Treynor 1965, Sharpe 1966, Jensen 1968, Treynor & Mazuy 1966, Fama 1972, Fama., Merton & Millar 1972, A.K. Sengupta 1991, N.P. Tripathy 1996, SEBI MF 1996, Sadhak 1997).
corporate sectors to reserve a certain percentage of public issues for Indian mutual funds.

Financial intermediaries help to transfer the savings to the real sector of the economy through the formation of financial assets. Institutional developments in the financial market influence the saving patterns, particularly in the household sector. The savings pattern of household sectors has been changed in India. The change becomes more clear if it is possible to examine the growth and development of the saving market over a period. India is one of the few countries maintain a steady growth rate in domestic savings. Generally, the healthy growth of savings is supported by the household sector, which has contributed a significantly high percentage to total domestic savings (Markowitz\textsuperscript{79} 1952, Guerley & Shaw\textsuperscript{44} 1955, Treynor\textsuperscript{121} 1965, Sharpe\textsuperscript{109} 1966, Jensen\textsuperscript{61} 1968, Treynor & Mazuy\textsuperscript{122} 1966, Fama\textsuperscript{34} 1972, Kaufman\textsuperscript{167} 1986, Kaizuka\textsuperscript{166} 1987, C.F. Lee & S. Rahaman\textsuperscript{74} 1990, Gupta, O.P.\textsuperscript{159} 1989, A.K. Sengupta\textsuperscript{105} 1991, Laderman & Smith\textsuperscript{169} 1993, L.C. Gupta\textsuperscript{157,158} 1994, SEBI\textsuperscript{180} Monthly Bulletin, RBI Report on Currency & Finance\textsuperscript{175}, AMFI\textsuperscript{129} Monthly report etc). Traditionally, GIC Banks, LIC and PFs are intermediating to mobilise domestic savings to productive uses to the economy. With the growth of capital markets and the emergence of alternative investment vehicles, investors are tended to move towards more liquid, attractive and short-term financial products like units of mutual funds along with shares and debentures. The Indian investors’ generally have lack of knowledge about growing market complexities and investment risks in the capital market along with high inflation rate that have driven the households further towards mutual funds’ investment (Markowitz\textsuperscript{79} 1952, Guerley & Shaw\textsuperscript{44} 1955, Treynor\textsuperscript{121} 1965, Sharpe\textsuperscript{109} 1966, Jensen\textsuperscript{61} 1968, Treynor & Mazuy\textsuperscript{122} 1966, Fama\textsuperscript{34} 1972, Kaufman\textsuperscript{167} 1986, Kaizuka\textsuperscript{166} 1987, C.F. Lee & S. Rahaman\textsuperscript{74} 1990, Gupta, O.P.\textsuperscript{159} 1991, A.K. Sengupta\textsuperscript{105} 1991, Laderman & Smith\textsuperscript{169} 1993, L.C. Gupta\textsuperscript{157,158} 1994, N.P. Tripathy\textsuperscript{124} 1996, SEBI MF\textsuperscript{180} 1996, Sadhak 1997, Narasimham & Vijayalakshmi\textsuperscript{85} 2001, R. Chander\textsuperscript{20} 2002, Bradford, Randy & Smolira\textsuperscript{17} 2003, Ibrahim\textsuperscript{54} 2004, G. Artikis\textsuperscript{9} 2004, R. Chander\textsuperscript{19} 2005, R. Elango\textsuperscript{29} 2005, J. Dhar\textsuperscript{27} 2005, ICSI\textsuperscript{163} Edition 2006, Ferreira, Miguel & Ramos\textsuperscript{35} 2006, K. Choudhary\textsuperscript{22} 2007, Abdullah, Hassan & Mohamad\textsuperscript{28,3} 2007, Kader & Qing\textsuperscript{1} 2007, Vanniarajan, Shajahan & Archana\textsuperscript{125} 2008, S.S. Debasis\textsuperscript{26} 2009, Afza & Rauf\textsuperscript{5} 2009, Bhalla\textsuperscript{133} 2005, Mansor & Bhatt\textsuperscript{78} 2011, Roy & Ghosh\textsuperscript{97,99} &\textsuperscript{100} 2010 \& 2012, SEBI\textsuperscript{180} Monthly Bulletin, RBI Report on Currency & Finance\textsuperscript{175}, AMFI\textsuperscript{129} Monthly report etc.).
1.2 Historical Development / Genesis of Mutual Fund:

The basic idea of pooling money in order to secure the advantages of spreading the magnitude of risk over many securities is not new. The idea of diversifying risks for mutual fund benefit can be traced to the very beginnings of commercial history (Markowitz\textsuperscript{79} 1952, Sharpe\textsuperscript{108} 1964, Treynor\textsuperscript{121} 1965, John Linter\textsuperscript{76} 1965 Sharpe\textsuperscript{109} 1966, Jensen\textsuperscript{61} 1968, Evans & Archer\textsuperscript{31} 1968, Fama\textsuperscript{34} 1972, Amling, Frederic\textsuperscript{128} 1974, M. Jayadev\textsuperscript{60} 1996, Sadhak\textsuperscript{178} 1997, Bansal\textsuperscript{131} 1997, Panawar & Madumath\textsuperscript{86} 2006, K. Choudhary\textsuperscript{22} 2007, Iqbal & Qadeer\textsuperscript{55} 2012). If we look back then it is found that the Egyptians and Phoenicians sale shares in their vessels and merchant Caravans in order to minimise the extent of risks of such foreign voyages (Markowitz\textsuperscript{79} 1959, Sharpe\textsuperscript{108} 1964, Sharpe\textsuperscript{109} 1966, Treynor\textsuperscript{121} 1965, Jensen\textsuperscript{61} 1968, Evans & Archer\textsuperscript{31} 1968, Friend & Blume\textsuperscript{37} 1970, F. Irwin, & Biksher\textsuperscript{150} 1977, F.K.Reilly\textsuperscript{176} 1982, Griffeth Bill\textsuperscript{155} 1995, Thanou\textsuperscript{118} 2008, Roy & Ghosh\textsuperscript{99} 2010). In 1822, King William-I forms the first investment company in the name of “Societe Generale De Belgiaue” in Belgium. The real pioneer in the field, however, is the foreign and colonial Government established in London in 1868 (Markowitz\textsuperscript{79} 1959, F. Irwin., M. Blume & J. Crockett\textsuperscript{151} 1970, F.B. Renwick\textsuperscript{177} 1971, D.E. Horbert\textsuperscript{161} 1973, J.C. Verma\textsuperscript{188} 1992, AMFI\textsuperscript{129} etc). The purpose is to provide the investor of moderate means in the same advantages as the large capitalists, in reducing the extent of risk of investing in foreign and colonial Government stocks by spreading the investment over a number of large stocks. The proposal behind it, does not gain wide acceptance until 1980 to 1890, when several important Scottish companies are formed (Markowitz\textsuperscript{79} 1959, Sharpe\textsuperscript{108} 1964, Sharpe\textsuperscript{109} 1966, Treynor\textsuperscript{121} 1965, Jensen\textsuperscript{61} 1968, Evans & Archer\textsuperscript{31} 1968, John A. Straley\textsuperscript{185} 1967, F. Irwin, M. Blume & J. Crockett\textsuperscript{151} 1970, D.C Corner & D.C. Stafford\textsuperscript{140} 1977, etc).

The canny Scots readily observe the advantages of pooling their investment funds to total a sufficiently large amount so that experienced money managers can be obtained at a relatively low proportionate cost to each unit holder (Markowitz\textsuperscript{79} 1959, Sharpe\textsuperscript{108} 1964, Sharpe\textsuperscript{109} 1966, Treynor\textsuperscript{121} 1965, Jensen\textsuperscript{61} 1968, Evans & Archer\textsuperscript{31} 1968, Friend & Blume\textsuperscript{37} 1970, F. Irwin, & Bicksher\textsuperscript{150} 1977, F.K.Reilly\textsuperscript{82} 1982, William J. Bamoul., S.M. Goldfield L.A. Gordan & M. F. Kohen\textsuperscript{191} 1989, Griffeth Bill\textsuperscript{155} 1995, etc). Through this medium, Scottish and later British investment companies are invested throughout the world. Much of this British and Scottish


In 1920’s, particularly after 1926, a flood of investment companies appear on the American scene. The first mutual fund in the USA, Massachusetts Investors’ Trust, is formed in 1924. Some of these companies are the ‘fixed trust’ type, means the investment management selected a portfolio, which can not be changed for the duration of the trust and the other type of trusts are established primarily as a medium of speculation. Many banking firms form trusts, which are nothing more than a dumping pool for their own unsaleable underwritings. In the same year, three more investment companies namely; Massachusetts Investors Trust, State Street Investment Corporation and United States and foreign securities corporations are established. These funds are primarily close-end and are used to finance industrial growth in the USA after the civil war. However, the crash of stock markets in 1929 led to the demise of these close-end funds. The enactment of securities act, 1993, Investment Company act, 1940, and Investment Advisors Act, 1940 led to the revival and regulation of mutual funds in the USA. After the world war-II, renewed interest in
mutual funds developed as stock market rose. By offering professional management to small and medium-size investors, mutual funds are able to attract more funds and acquire more assets for investment in rising stock markets. As a result, they enhance their assets at a compound annual rate of nearly 18% from 1945 to 1965 in the USA (Markowitz\textsuperscript{79} 1959, Sharpe\textsuperscript{108} 1964, Sharpe\textsuperscript{109} 1966, Treynor\textsuperscript{121} 1965, Jensen\textsuperscript{61} 1968, Evans & Archer\textsuperscript{31} 1968, Friend & Blume\textsuperscript{37} 1970, F. Irwin, & Bicksher\textsuperscript{150} 1977, Lorie James & Brealey Richard\textsuperscript{172} 1978, F.K.Reilly\textsuperscript{82} 1982, John A. Haslem\textsuperscript{160} 1988, William J. Bamoul, S.M. Goldfield L.A. Gordon & M. F. Kohen\textsuperscript{191} 1989, Francis, J. C.\textsuperscript{37} 1993, Laderman & Smith\textsuperscript{169} 1993, John, C. Bogle\textsuperscript{135} 1994, Preeti, Singh\textsuperscript{184} 1995, Griffeth, Bill\textsuperscript{155} 1995, Investment Company Institute\textsuperscript{164} etc.)

Mutual funds reach peak of their rapid growth curve in the late 1960s. In 1965, there are 68 funds with annual sales of $4.4 billion (Investment Company Institute, Annual report USA). The number has increased to 8475 with 375 million-share holders’ account and the fund’s assets under management are expected to be at least $10 trillion by 2010. The secret behind US success story is that their fund managers have developed mutual funds for all economic reasons and for every investment need. It is not only the US; some other countries of the world have also experienced unprecedented growth in this industry. Italy’s mutual fund industry has witnessed a growth of 2000%, Japan’s 600%, UK’s 350% and Germany’s 330% during the 1980s. Countries like Canada, Australia, Ireland, Mexico, Denmark, France and many South American countries too have seen mutual funds recorded enormous growth during this decade (Markowitz\textsuperscript{79} 1959, Sharpe\textsuperscript{108} 1964, Sharpe\textsuperscript{109} 1966, Treynor\textsuperscript{121} 1965, Jensen\textsuperscript{61} 1968, Evans & Archer\textsuperscript{31} 1968, Friend & Blume\textsuperscript{37} 1970, F. Irwin, & Bicksher\textsuperscript{150} 1977, Lorie James & Brealey Richard\textsuperscript{172} 1978, F.K.Reilly\textsuperscript{82} 1982, John A. Haslem\textsuperscript{160} 1988, William J. Bamoul, S.M. Goldfield L.A. Gordon & M. F. Kohen\textsuperscript{191} 1989, Francis, Jack. Clark\textsuperscript{37} 1993, Laderman & Smith\textsuperscript{169} 1993, John, C. Bogle\textsuperscript{135} 1994, Preeti Singh\textsuperscript{184} 1995, Griffeth Bill\textsuperscript{155} 1995, Investment Company Institute\textsuperscript{164} etc).

The journey of mutual fund industry starts in India after the establishment of Unit Trust of India (UTI) in July 1964 by the Government of India with a view to encouraging savings and investment and participation in the income, profits and gains accruing to the corporation from the acquisition, holding, management and disposal of securities (SEBI MF Regulation 1996, RBI Bulletin, GOI Report, UTI annual report, Sadhak\textsuperscript{178} 1997 etc). In 1963, Prime Minister Late Mr. Rajeev Gandhi and Finance Minister Mr. T. T. Krishnamachari initiate the act, makes it clear to the Parliament
that UTI will provide an opportunity for the middle and lower income groups to acquire without much difficulty, property in the form of shares ... This initiation is intended to cater mainly to the needs of the individual investors whose means are small. With this mission, UTI come out its maiden fund an open-end one, in 1964. Although, the growth of mutual fund industry in India is very slow till the end of the 1980s, primarily due to Government controls and over regulation of the financial services industry. Severe entry barriers restrict the growth of the mutual fund industry in terms of number of players, mobilisation of savings and creation of assets. This is the scenario till 1964 – October 1987 when the mutual fund market in India, such as it is, solely controlled by a single institution, namely UTI (SEBI MF Regulation 180 1996, RBI Bulletin 175, GOI Report, UTI annual report 186, SEBI Annual report 180, AMFI Annual Report & AMFI 129, N.P. Tripathy 124 1996, Sadhak 178 1997, L.C. Gupta 157&158 1994). Today, there are four different types of players operating in the Indian market namely UTI, Public sector Mutual Fund, Private sector Mutual Fund and Foreign Mutual Fund. The mutual fund industry has witnessed four interrelated stages of development in terms of entry of players.

1. Phase I – July 1964 – November 1987
2. Phase II – November 1987 – October 1993

Phase - I (Monopoly of UTI):

This period is marked by the operations of a single institution, UTI, which prepares the ground for the future mutual fund industry. The first decade of UTI’s operations (1964-74) is the formative period. The first and still the most popular product launches by UTI is Unit 64. Due to the immense popularity of Unit 64, UTI launched a reinvestment plan in 1966-67. By the end of June 1974, there were six lakh unit holders with UTI. The unit capital totalled Rs. 152 cores and investible funds Rs. 172 cores. The second phase of operations (1974-1984) was one of the consolidation and expansion. In this period, UTI was delinked from RBI. The period was marked by the introduction of open-ended growth funds. Towards the end of the 1980s, winds of change had started blowing in the Indian economy. UTI is one of the few organisations to prepare itself fully to face the emerging challenges. In the following years, it launched all-round diversification programmes through backward and forward integration in order to retain its position as the undisputed market share.

Phase – II, 1987-1993 (Entry of Public Sector Funds):


With the entry of private sector funds in 1993, a new era starts in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 is the year in which the first mutual fund regulations come into being, under which all mutual funds, except UTI are to be registered and governed. The erstwhile Kothari Pioneer is the first private sector mutual fund registered in July 1993. In 1993, SEBI (Mutual Fund) Regulations are substituted by a more comprehensive and revised Mutual Fund regulations in 1996. The industry now functions under the SEBI (Mutual Fund) regulations, 1996. The number of Mutual Fund organisations goes on increasing with many foreign Mutual Funds setting up funds in India and the industry has witnessed several mergers and acquisitions. At the end of January 2003, there are thirty-three (33) Mutual Funds with total assets of Rs. 121805 cores. The UTI with Rs. 44541 cores of assets under management is way ahead of other Mutual Funds (Seema, Vaid187 1994, Sadhak178 1997, L.C. Gupta157&158 1994, L.K. Bansal130 1996, M. Jaydeb165 1998, K.G. Sahadevan, & M.
Phase – IV (Since February 2003):

In February 2003, following the repeal of the UTI Act, 1963, UTI is bifurcated into two separate entities. One is the specified undertaking of the UTI with assets under management of Rs. 29835 cores as at the end of January 2003, representing broadly the assets of US 64 and certain other schemes. The specified undertaking of UTI, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund regulations (Seema, Vaid\textsuperscript{187} 1994, Sadhak\textsuperscript{178} 1997, L.C. Gupta\textsuperscript{157&158} 1994, L.K. Bansal\textsuperscript{130} 1996, M. Jaydeb\textsuperscript{165} 1998, K.G. Sahadevan & M. Thiripalraju\textsuperscript{179} 1997, Elango, R.\textsuperscript{29} 2005, AMFI Quarterly Report\textsuperscript{129}, SEBI Annual Report\textsuperscript{180}, RBI report on Currency & Finance\textsuperscript{175} etc).

The second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund regulations. With the bifurcation of the erstwhile UTI, this had in March 2000 more than Rs. 76000 cores of assets under management and with the setting up a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations and with recent mergers taking place among different private sector funds, the Mutual Fund industry has entered its current phase of consolidation and growth. As at the end of September 2004, there were 29 mutual funds, which manage assets of Rs. 153108 cores under 421 schemes. Similarly, at the end of December 2011, there were 44 mutual fund companies, which manage assets of Rs. 1610052 cores under 1226 schemes (Seema, Vaid\textsuperscript{187} 1994, Sadhak\textsuperscript{178} 1997, L.C. Gupta\textsuperscript{157&158} 1996, L.K. Bansal\textsuperscript{130} 1996, M. Jaydeb\textsuperscript{165} 1998, K.G. Sahadevan & M. Thiripalraju\textsuperscript{179} 1997, Elango, R.\textsuperscript{29} 2005, AMFI Quarterly Report\textsuperscript{129}, SEBI Report\textsuperscript{180}, RBI Bulletin\textsuperscript{175} etc).

(Continue)
Fig. 1.1

GROWTH IN ASSETS UNDER MANAGEMENT

Source: AMFI

Note: Erstwhile UTI is bifurcated into UTI Mutual Fund and the Specified Undertaking of the Unit Trust of India effective from February 2003. The Assets under management of the Specified undertaking of the Unit Trust of India has therefore been excluded from the total assets of the industry as a whole from February 2003 onwards (Source: AMFI annual report).

Table 1.A
Sales as on 31st December 2011 according to Type, Category & schemes wise (in crore)

<table>
<thead>
<tr>
<th>Type</th>
<th>Open Ended</th>
<th>Close Ended</th>
<th>Interval Fund</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Schemes</td>
<td>Rs.</td>
<td>No. of Schemes</td>
<td>Rs.</td>
</tr>
<tr>
<td>Income</td>
<td>221 (205)</td>
<td>125528 (413887)</td>
<td>441 (202)</td>
<td>28676 (37574)</td>
</tr>
<tr>
<td>Growth</td>
<td>300 (299)</td>
<td>9633 (15423)</td>
<td>6 (24)</td>
<td>- (2)</td>
</tr>
<tr>
<td>Balance</td>
<td>29 (31)</td>
<td>902 (2093)</td>
<td>1 (1)</td>
<td>11</td>
</tr>
<tr>
<td>Liquid/ MMMF</td>
<td>55 (51)</td>
<td>1438779 (1712246)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Gilt</td>
<td>39 (36)</td>
<td>907 (1762)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>ELSS</td>
<td>36 (36)</td>
<td>540 (676)</td>
<td>12 (12)</td>
<td>-</td>
</tr>
</tbody>
</table>
Gold ETF & Other ETF & FOF & Total  
| Category      | 12 (10) | 1121 (742) | - | - | - | 12 (10) | 1121 (742) | 21 (16) | 401 (1240) | - | - | - | 21 (16) | 401 (1240) | 19 (16) | 134 (240) | - | - | - | 19 (16) | 134 (240) | 732 (700) | 1577945 (2148308) | 460 (239) | 28687 (37576) | 34 (37) | 3420 (20823) | 1226 (976) | 1610052 (2206707) |

* Figures in parenthesis denote for the previous year  
Source: AMFI Quarterly Report

Table. 1.B AUM as on 31st December 2011 (Type & Category wise in Crore)

<table>
<thead>
<tr>
<th>Category</th>
<th>Open Ended (Rs)</th>
<th>Close Ended (Rs)</th>
<th>Interval (Rs)</th>
<th>Total (Rs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td>167348</td>
<td>123721</td>
<td>7500</td>
<td>298569 (297937)</td>
</tr>
<tr>
<td>Growth</td>
<td>140264</td>
<td>348</td>
<td>-</td>
<td>140612 (181224)</td>
</tr>
<tr>
<td>Balanced</td>
<td>14545</td>
<td>11</td>
<td>-</td>
<td>14556 (19486)</td>
</tr>
<tr>
<td>Liquid/MMMF</td>
<td>120713</td>
<td>-</td>
<td>-</td>
<td>120713 (88681)</td>
</tr>
<tr>
<td>Gilt</td>
<td>3121</td>
<td>-</td>
<td>-</td>
<td>3121 (4103)</td>
</tr>
</tbody>
</table>

AUM as on 31st December 2011 (Type & Category wise in Crore)

<table>
<thead>
<tr>
<th>Category</th>
<th>18426</th>
<th>2204</th>
<th>-</th>
<th>20630 (27011)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ELSS</td>
<td>9153</td>
<td>-</td>
<td>-</td>
<td>9153 (3516)</td>
</tr>
<tr>
<td>Gold ETF</td>
<td>1515</td>
<td>-</td>
<td>-</td>
<td>1515 (1730)</td>
</tr>
<tr>
<td>Other ETF</td>
<td>1533</td>
<td>-</td>
<td>-</td>
<td>2533 (2626)</td>
</tr>
<tr>
<td>Fund of Funds</td>
<td>477618 (505978)</td>
<td>-</td>
<td>-</td>
<td>611402 (626314)</td>
</tr>
</tbody>
</table>

* Figures in parenthesis denote for the previous year  
Source: AMFI Quarterly Report

(Continue)
**Table 1.C**

Sales, Redemption and Asset under Management based on Sponsorship (in Crore)

<table>
<thead>
<tr>
<th>Category</th>
<th>Sales</th>
<th>Redemption</th>
<th>Asset Under Management</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Sponsored</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Joint Ventures-</td>
<td>351514</td>
<td>349200</td>
<td>49448</td>
</tr>
<tr>
<td>Predominantly Indian</td>
<td>(492360)</td>
<td>(493943)</td>
<td>(48890)</td>
</tr>
<tr>
<td>(3)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ii. Joint Ventures-</td>
<td>48469</td>
<td>45829</td>
<td>4582</td>
</tr>
<tr>
<td>Predominantly Foreign</td>
<td>(74300)</td>
<td>(75371)</td>
<td>(2961)</td>
</tr>
<tr>
<td>(1)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>iii. Others (2)</td>
<td>483244</td>
<td>479245</td>
<td>63919</td>
</tr>
<tr>
<td>(663459)</td>
<td>(673984)</td>
<td>(67439)</td>
<td></td>
</tr>
<tr>
<td><strong>Total (i+ii+iii)</strong></td>
<td>883227</td>
<td>874274</td>
<td>117949</td>
</tr>
<tr>
<td></td>
<td>(1230119)</td>
<td>(1243298)</td>
<td>(119290)</td>
</tr>
<tr>
<td><strong>B</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institutions –</td>
<td>27982</td>
<td>874274</td>
<td>117949</td>
</tr>
<tr>
<td>Joint Ventures –</td>
<td>(451455)</td>
<td>(1243298)</td>
<td>(119290)</td>
</tr>
<tr>
<td>Predominantly Indian</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>C</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Sector</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Indian (18)</td>
<td>1888117</td>
<td>1881660</td>
<td>205532</td>
</tr>
<tr>
<td>(2480581)</td>
<td>(2484352)</td>
<td>(222644)</td>
<td></td>
</tr>
<tr>
<td>ii. Foreign (9)</td>
<td>190264</td>
<td>186920</td>
<td>59762</td>
</tr>
<tr>
<td>(214039)</td>
<td>(211308)</td>
<td>(55684)</td>
<td></td>
</tr>
<tr>
<td>iii. Joint Ventures –</td>
<td>1964789</td>
<td>1947305</td>
<td>275414</td>
</tr>
<tr>
<td>Predominantly Indian</td>
<td>(2272198)</td>
<td>(2275988)</td>
<td>(239081)</td>
</tr>
<tr>
<td>(5)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>iv. Joint Ventures –</td>
<td>128466</td>
<td>124611</td>
<td>16828</td>
</tr>
<tr>
<td>Predominantly Foreign</td>
<td>(232112)</td>
<td>(235159)</td>
<td>(19983)</td>
</tr>
<tr>
<td>(5)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total (i+ii+iii+iv)</strong></td>
<td>4171636</td>
<td>4140496</td>
<td>557536</td>
</tr>
<tr>
<td></td>
<td>(5198930)</td>
<td>(5206807)</td>
<td>(537392)</td>
</tr>
<tr>
<td><strong>Grand Total (A+B+C)</strong></td>
<td>5082845</td>
<td>5045927</td>
<td>681708</td>
</tr>
<tr>
<td></td>
<td>(6880504)</td>
<td>(6912668)</td>
<td>(675377)</td>
</tr>
</tbody>
</table>

* Figures in parenthesis denote for the previous year.

Source: AMFI Quarterly Report

1.3 Meaning of Mutual Fund:

Mutual fund, a financial innovation, provides for a novel way of mobilising savings from small investors and allowing them to participate in the equity and other securities of the industrial organisations with lower degree of expected risk (Jensen\(^{61,62}\) 1968 & 1969, Sharpe\(^{108,109,110}\) 1964, 1966 & 1967, M. Ibrahim\(^{54}\) 2005, R. Elango\(^{29}\) 2005, M, Jaydev\(^{60}\) 1996, Bhalla 2005, N.P. Tripathy\(^{124}\) 1996, Tapas Kr Dey\(^{143}\) 2005, Curtis M Arnold\(^{142}\) 2006). According to the Association of Mutual Funds in India (AMFI), “A mutual fund is a trust that pools the savings of a number of investors who share common financial goal”. Anybody with an investible surplus of as little as a few thousand rupees can invest in mutual funds. These investors buy units of a particular mutual fund scheme that has a defined investment objective and
strategy. According to the SEBI Regulations, 1996, “Mutual fund is a fund established in the form of a trust to raise monies through the sale of units to the public or a section of public under one or more schemes for investing in securities, including money market instruments”. A mutual fund is a trust that pools together the savings of a number of investors who share a common financial goal (Sadhak\textsuperscript{178} 1997, Bhalla\textsuperscript{133} 2005, A. Kundu\textsuperscript{73} 2009 etc). They buy units of a fund that best suits their needs. The fund manager then invests this pool of money (called a corpus) in securities ranging from shares to debentures to money market instruments depending on the objective of the schemes. The income earned through this investment and the capital appreciation realised by the schemes are distributed among the investors in proportion to the number of units they own by way of dividend or net asset value (NAV) appreciation. Thus, a mutual fund is the most suitable form of investment for the common person as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost (M, Jaydev\textsuperscript{60} 1996, Bhalla\textsuperscript{133} 2005, N.P. Tripathy\textsuperscript{124} 1996, Tapas, Kr. Dey\textsuperscript{143} 2005, Curtis, M. Arnold\textsuperscript{142} 2006, ICSI\textsuperscript{163} 2006, G.G. Rompotis\textsuperscript{88} 2008 etc).

Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with the objectives as disclosed in offer document (M, Jaydev\textsuperscript{60} 1996, Sadhak\textsuperscript{178} 1997, Bhalla\textsuperscript{133} 2005, N.P. Tripathy\textsuperscript{124} 1996, Tapas, Kr. Dey\textsuperscript{143} 2005, Curtis, M. Arnold\textsuperscript{142} 2006, M.A. Kader & K.Y. Qing\textsuperscript{1} 2007 etc).

Investments in securities are extended across a wide cross-section of industries and sectors and thus, the extent of risk is reduced. Diversification reduces the risk because not all stocks may move in the same time (Markowitz\textsuperscript{79} 1952, Sharpe\textsuperscript{108} 1964, Treynor\textsuperscript{121} 1965, John Linter\textsuperscript{76} 1965 Sharpe\textsuperscript{109} 1966, Jensen\textsuperscript{61} 1968, Evans & Archer\textsuperscript{31} 1968, Fama\textsuperscript{34} 1972, Amling Frederic\textsuperscript{128} 1974, M. Jayadev\textsuperscript{60} 1996, Sadhak\textsuperscript{178} 1997, Bansal\textsuperscript{131} 1997, Panawar & Madumathi\textsuperscript{86} 2006, K. Choudhary\textsuperscript{22} 2007, Iqbal & Qadeer\textsuperscript{55} 2012, Roy & Ghosh\textsuperscript{99} 2010). Mutual fund issues units to the investors in accordance with the quantum of money invested by them. Investors of mutual funds are known as unit holders.

The investors in proportion to their investments share the profit and losses. The mutual funds normally come out with a number of schemes with different investment objectives, which are launched from time to time. A mutual fund is required to be registered with SEBI, which regulates securities markets before it can

1.4 How do Mutual Funds Work?
As per Mutual Fund Fact Book (Published by Investment Company Institute of the United States), “A mutual fund is a financial service organisation that receives money from the unit holders, invest it, earns returns on it, attempts to make it grow and agrees to pay the unit holder cash on demand for the current value of his investment”.

Fig.1.2 Mutual Fund acts as an intermediary

Note: As given In Bansal 1997
It acts as a non depository financial intermediary, mobilising the savings, particularly from the small and household sectors for investment in capital and money market instruments (Bansal 1997). A fund’s portfolio is sometimes referred to as a collection of diversified stocks, bonds or other convertible securities, registered under Securities and Exchange Commission. The investment professionals, who are responsible to construct the fund’s portfolio, invest in different types of securities complying with objective of that particular fund, as specified in the fund’s prospectus.
His objective can be most commonly known as the creation of value and growth or a combination of the two.

Since, the mutual fund managers are responsible to invest the collected monies in stock markets, it is important to examine if they have the stock picking abilities to outguess the market volatility correctly that ultimately generates higher returns with reduced risk. However, there is not much research works done particularly on the strategies and performance of the managers themselves.

1.5 Types of Mutual Fund schemes:


(i) Open-ended scheme: An open-ended mutual fund is a fund with a non-fixed number of outstanding units that stands ready at any time to redeem them on demand. The fund itself buys back the shares surrendered and is ready to sale new shares. Generally, the transaction takes place at the net asset value, which is calculated on a periodical basis. The net asset value of the mutual funds rises or falls because of performance of securities in the portfolio and the stock markets.

(ii) Close-ended scheme: It is the fund where mutual fund management sells a limited number of units and does not stand ready to redeem them. The shares of such mutual funds are traded in the secondary markets. The requirement for listing in lay down to grant liquidity to the investors who have invested with the mutual fund. Therefore, close-ended funds are more like equity shares.

Beside these, mutual fund schemes may also be classified according to their investment objectives. They are as under:

(a) Income schemes: The fund primarily offers fixed income to the investors. Naturally, enough, the main securities in which investments are made by such funds are the fixed income yielding ones like bonds.

(b) Growth schemes: The aim of growth funds is to provide capital appreciation over the medium to long-term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide
different options to the investors like dividend option, capital appreciation etc and the
investors may choose an option depending on their preferences. The growth schemes
are good for investors having a long-term outlook seeking appreciation over a period
of time.

(c) Balanced schemes: These funds cater to both the investment need of the
prospective investors namely fixed income as well as growth orientation. Therefore,
investment targets of these mutual funds are judicious mix of both the fixed income
securities like bonds and debentures and sound equity scripts. In fact, these funds
utilise the concept of balanced investment management.

(d) Money Market Mutual Fund schemes: These funds invest in short-term debt
securities in the money market like certificates of deposits, commercial papers,
Government treasury bills etc. Owing to their large size, the funds normally get a
higher yield on such short-term investments than an individual investor.

(e) Liquid schemes: These funds are also income funds and their aim is to provide
easy liquidity, preservation of capital and moderate income. These schemes invest
exclusively in safer short-term instruments. Returns on those schemes fluctuate much
less compared to other funds. These funds are appropriate for corporate and individual
investors as a means to park their surplus funds for short periods.

(f) Gilt schemes: These funds invest exclusively in Government securities.
Government securities have no default risk. NAVs of these schemes also fluctuate due
to change in interest rates and other economic factors as is the case with income or
debt oriented schemes.

(g) Tax saving schemes: These schemes offer tax rebates to the investors under tax
laws as prescribed from time to time. This is made possible because the Govt. Offers
tax incentive for investment in specified avenues. For example, equity linked saving
schemes and pensions schemes.

(h) Special schemes: This category includes index schemes that attempt to replicate
the performance of particular index such as the BSE, or the NSE or industry specific
schemes. Index fund schemes are ideal for investors who are satisfied with a return
approximately equal to that of an index. Sectoral fund schemes are ideal for investors
who have already decided to invest in particular sector or segment.

(i) Offshore funds: Such funds invest in securities of foreign companies with RBI
permission.
(j) **Hedge funds**: They employ their funds for speculative trading, i.e. for buying shares whose prices are likely to rise and for selling shares whose prices are likely to dip.

(k) **Fund of funds**: They invest only in units of other mutual funds. Such funds do not operate at present in India.

(l) **New Direction funds**: They invest in companies engaged in scientific and technological research such as birth control, anti-pollution, oceanography etc.

### 1.6 Benefits of Investing in Mutual Fund:

The money contributed by the unit holders is invested by the mutual fund manager(s) of the respective schemes in different types of securities depending upon the schemes’ objectives. The income earned through these investments and the capital appreciation realised by the schemes are shared by its unit holders in proportion to the number of units owned by them. It is claimed that investment in mutual fund offers a number of benefits to the investors who willing to invest in securities. Association of mutual funds in India (AMFI) claims that a mutual fund is the most suitable investment for the common man as it offers as opportunity to invest in a diversified, professionally managed basket of portfolios at a relatively minimum cost. The benefits of investing in mutual funds are discussed (Sadhak\(^{178}\) 1997, V.K. Bhalla\(^{133}\) 2005, Tapas Kr Dey\(^{143}\) 2005, SEBI Mutual Fund Regulation\(^{180}\) 1996, AMFI Report\(^{129}\), M. Joydev\(^{165}\) 1998, A.N. Shanbhag\(^{181}\) 1996, Seema Vaid\(^{187}\) 1994, Prasanna Chandra \(^{138}\)1995, Roy & Ghosh\(^{99}\) 2010, Institute of Company Secretary of India\(^{163}\) 2006, E.S. Bolten\(^{136}\) 1973, L.K. Bansal\(^{130}\) 1996 etc) below:

1. **Investment opportunities to all kinds of investors**: The mutual fund companies offer investment facilities to all types of investors. The small as well as the medium type of investors can invest in mutual fund schemes by contributing very little amount of money. Anybody with investible funds of as little as a few hundred rupees can invest in mutual funds.

2. **Professional Management**: Investors avail the services of experienced and skilled professionals who are backed by a dedicated investment research team, which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

3. **Diversification**: Mutual funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. Investors
achieve this diversification through a mutual fund with far less money than one can do on his own.

4. **Convenient Administration**: Investing in mutual fund reduces paper work and helps investors to avoid many problems such as bad deliveries, delayed payments and necessary follow up with brokers and companies. Mutual funds save investors’ time and make investing easy and convenient.

5. **Return Potential**: Over a medium to long-term investment, investors always get higher returns in mutual fund as compared to other avenues of investment. This is already proved by the excellent returns.

6. **Low Cost**: Mutual funds are relatively less expensive way to invest as compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.

7. **Liquidity**: in open-ended schemes, investors can get their money back promptly at net asset value related prices from the mutual fund itself. With close-ended schemes, investors can sell their units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase at net asset value related prices, which some close-ended and interval schemes offer periodically or offer it for redemption to the fund on the date of maturity.

8. **Flexibility**: Through feature such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, investors can systematically plan investment and withdrawal of their funds according to their own needs and convenience.

9. **Choice of schemes**: mutual funds offer a family of schemes to suit varying needs over a lifetime.

10. **Well Regulated**: All mutual funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of mutual funds are regularly monitored by SEBI

1.7 **Risks in Mutual Fund Investment**:


(a). Excessive diversification of portfolio, losing focus on the securities of the key segments.
(b). Too much concentration on blue-chip securities, which are high priced and which do not offer more than average return.
(c). Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission.
(d). Poor planning of investment with minimum returns along with higher risk.
(e). Un-researched forecast in income, profits and Government policies.
(f). Fund managers being unaccountable for poor results.
(g). Failure to identify clearly the risk of the scheme as distinct from risk of the market.

1.8 Kind of Risk:

According to modern portfolio theory (MPT) any investment holds two different kinds of risk,
(a). Market risk  (b). Specific risk

A number of synonyms are used for these two different kinds of risk and they are given below.

<table>
<thead>
<tr>
<th>Market risk (also known as)</th>
<th>Specific Risk (also known as)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Non-diversifiable Risk</td>
<td>1. Diversifiable Risk</td>
</tr>
<tr>
<td>2. Systematic Risk</td>
<td>2. Unsystematic Risk</td>
</tr>
<tr>
<td>3. Non-Controllable Risk</td>
<td>3. Controllable Risk</td>
</tr>
<tr>
<td>4. Beta Risk</td>
<td>4. Unique Risk</td>
</tr>
</tbody>
</table>

These terms may be used interchangeably.

(a). Market Risk:

It arises out of the uncertainty of the whole economy and is, therefore, outside the control of an investor. He cannot avoid such risk. Such risk, are also outside the control of the firms in whose securities the investments are made. They are not specific to any given security and arise due to the following:

1. Purchasing Power Risk: It arises due to the fall in the value of money in an inflationary economy. Thus, due to rise in prices there will be a reduction in the quantity of goods that can be procured with a fixed sum of money.
2. Interest Rate Risk: It arises due to changes in the value of an asset because of changes in interest rates, e.g., when interest rates increase the price of bonds fall and vice-versa.
3. **Security Market Risk:** Stock markets are highly affected due to a number of external factors. A generally depressed economy or a war can send the stock markets crashing. Such a risk arises due to changes in the stock’s price due fluctuations in the stock market.

(b). **Business Risk:**

Such risks are unique to a given security or asset or to a particular company. An investor avoids it by investing in several different kinds of assets or by avoiding a risky project altogether. The components of such risk are,

1. **Business Risk:** It arises due to changes in the firm’s earnings and this in turn may be due to a number of reasons, like rising cost of inputs or fall in sales price or may be due to changes in demand for the firm’s product.

2. **Liquidity Risk:** This arises due to the fact that a security or an asset may not be readily marketable at a short notice. In such a situation, an asset may have to be sold at a distress price in the short run.

3. **Default Risk:** It arises because of firm taking loans may not be able to pay interest or make principal repayments on such debt capital. A firm in financial distress may have a considerable amount of default risk inherent in the bonds issued by it.

1.9 **Mutual Fund Cost:**

There are two broad categories of mutual fund costs, namely (a) Operating expenses (b) Sales charges. The latter can be sub-divided under (i) Front end loads (ii) Back end loads (SEBI Mutual Fund Regulation\textsuperscript{180} 1996, ICSI\textsuperscript{163} 2006, Sadhak\textsuperscript{1997} 1997, Bansal\textsuperscript{130&131} 1996 & 1997, Amling Frederic\textsuperscript{128} 1974 etc). These terms are explained below:

(a) **Operating Expenses:** Costs incurred in operating mutual funds include advisory fees paid to investment managers, custodial fees, audit fees, transfer agent fees, trustee fees, agents’ commission etc. The break-up of these expenses is required to be reported in the schemes offer document. When the operating expenses are divided by the average net asset, the expenses ratio is arrived at. Based on the type of the scheme and the net assets, operating expenses are determined within the limits indicated by SEBI Mutual Fund Regulations, 1996. Expenditure, which is in excess over the specified limits, shall be borne by the Asset Management Company, the Trustees or the Sponsors. Operating expenses are calculated on an annualised basis but are
accrued on a daily basis. Therefore, an investor face expenses prorated for the limit he has invested in the fund.

(b) Sales Charges: These are otherwise called as sales loads and are charged directly to the investors. Mutual funds use the sales loads for payment of agents’ commission and expenses for distribution and marketing. Sales charges have no impact on the performance of the scheme as these are collected from the investor.

(i) Front end load is a onetime fixed fee, which is paid by an investor while he buys into a scheme. Printed load determines the public offer price (POP), which in turn determines how much of the initial investment gets actually invested. Front end loads decrease as the initial investment amounts increase.

(ii) Back end load: This will be a fixed fee redemption load or a contingent deferred sales charge. A redemption load exists permanently and is paid only at the time of redeeming or selling units of a load.

1.10 Regulation of Mutual Fund:

The formation and operations of mutual funds in India is solely guided by the Securities and Exchange Board of India (SEBI) regulations (Mutual Funds), 1993, which come into force on 20 January 1993. The regulations have since been replaced by the SEBI (Mutual Funds) regulations, 1996, through a notification on 9th December 1996. Under the SEBI regulations, every Mutual Fund is required to have an Asset Management Company (AMC) incorporated in the Companies Act, 1956 to manage the funds of the mutual funds. The AMC should be approved by SEBI and should enter into an agreement with the trustees of the mutual fund to formulate schemes, raise funds against units, invest the funds in accrued securities and after meeting the permissible costs as per norms, distribute income to the shareholders of the funds.

1.10.1 SEBI (MUTUAL FUND) Regulations, 1996:

The captioned regulations are notified by SEBI in exercise of its powers conferred by section 30 read with section 11(2c) of SEBI Act, 1992. Some of the important definitions in these regulations are given below:

a. Advertisement includes every form of advertising whether in a publication by display of notices, signs, and labels or by means of circulars, catalogues or other documents, by an exhibition of pictures or photographic films, by way of sound, broadcasting or television or in any other manner.
b. Asset Management Company means a company formed and registered under the Companies Act, 1956 and approved as such by SEBI under Regulations 21(2).

c. Custodian means a person on whom a certificate of registration is granted to carry on the business of custodian securities under the SEBI (Custodian of Securities) Regulations, 1996.

d. Mutual Fund means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of public under one or more schemes for investing in securities including money market instruments.

e. Money Market Mutual Fund means a scheme of a mutual fund set up with the objective of investing exclusively in money market instruments.

f. Money Market Instruments include commercial papers, commercial bills, and treasury bills, Government securities having an unexpired maturity up to one year, call or notice money, certificate of deposit, and any other like instruments as specified by RBI from time to time.

g. Sponsor means any person who, acting alone or in combination with another body corporate establishes a mutual fund.

h. Trustees mean the Board of Trustees or the Trustee Company who hold the property of the mutual fund in trust for the benefit of the unit holders.

i. Unit means the interest of the unit holders in a scheme, which consists of each unit representing one undivided share in the assets of a scheme.

j. Unit Holder means a person holding one or more units in a scheme of a mutual fund.

k. Close-ended scheme means any scheme of a mutual fund in which the period of maturity of scheme is specified.

l. Open-ended scheme means a scheme of a mutual fund, which offers units for sale without specifying any duration for redemption.

1.10.1.1 Registration of Mutual Fund:

Regulation 7 of SEBI (Mutual Fund) Regulations 1996, lays down the following eligibility criteria to be fulfilled by an applicant to get a certificate of registration. In the opinion of SEBI, the applicant should be a fit and proper person. The other criteria are:

(a) The sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions.

The regulations provide that “sound track record” mean the sponsor –
(i) Is carrying on business in financial services for a period of not less than five years; and
(ii) The net worth is positive in all the immediately preceding five years; and
(iii) The net worth in the immediately preceding year is more than the capital contribution of the sponsor in the asset management company; and
(iv) The sponsor has profits after providing for depreciation, interest and tax in three out of the immediately five years, including the fifth year.

(b) In the case of an existing mutual fund, such fund is in the form of a trust and the trust deed is approved by SEBI;
(c) The sponsor has contributed or contributes at least 40% to the net worth of the asset management company. However, any person who holds 40% or more of the net worth of an asset management company shall be deemed to be a sponsor and will be required to fulfil the eligibility criteria specified in these regulations;
(d) The sponsor or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence;
(e) Appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations; appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations;
(f) Appointment of a custodian in order to keep custody of the securities and carry out the custodian activities as may be authorised by the trustees.

Regulation 10 lays down that the registration granted to a mutual fund is subject to the following terms and conditions:
(a) The trustees, the sponsor, the asset management company and the custodian comply with the provisions of these regulations;
(b) The mutual fund to inform SEBI, if any information or particulars previously submitted to SEBI was misleading or false in any material respect;
(c) The mutual fund to inform SEBI, of any material change in the information or particulars previously furnished, which have a bearing on the registration granted by it;
(d) Payment of the prescribed fees.
(e) Payment of service fee for each financial year before 15th April. SEBI may not permit a mutual fund to launch any scheme if it has not paid the service fee.
1.10.1.2 Investment Management Agreement:

According to the SEBI (Mutual Fund) Regulations 1996, the Investment Management Agreement shall contain the following provisions about the duties and responsibilities of the AMC namely:

(i) The AMC appointed by the trustees with the prior approval of SEBI shall be responsible for floating schemes for the mutual fund after approval of the same by the trustees and managing the funds mobilised under various schemes; in accordance with the provisions of the Trust Deed and Regulations.

(ii) The AMC shall not undertake any other business activity other than activities specified therein and management of mutual funds and such other activities as financial services consultancy, exchange of research and analysis on commercial basis as long as these are not in conflict with the fund management activity itself without the prior approval of the trustees and SEBI.

(iii) The AMC shall invest the funds raised under various schemes in accordance with the provisions of the Trust Deed and the regulations.

(iv) The AMC shall not acquire any of the assets out of the scheme property, which involves the assumption of any liability, which is unlimited or which may result in encumbrance of the scheme property in any way.

(v) The AMC shall not take up any activity in contravention of the regulations.

(vi) No loss or damage or expenses incurred by the AMC or officers of AMC or any person delegated by the AMC, shall be met out of the trust property.

(vii) The AMC shall ensure that no offer document of a scheme, key information memorandum, abridged half yearly results and annual results is issued or published without the trustees’ prior approval in writing, and contains any statement or matter extraneous to the Trust Deed or Offer Document scheme particulars approved by the trustees and Board.

(viii) The AMC shall disclose the basis of calculating the repurchase price and NAV of the various schemes of the fund in the scheme particulars and disclose the same to the investors at such intervals as may be specified by the trustees and SEBI.

(ix) The trustees shall have the right to obtain from the AMC all information concerning the operations of the various schemes of the mutual fund managed by the AMC at such intervals and in such a manner as required by the trustees to ensure that the AMC is complying with the provisions of the Trust Deed, and regulations.
(x) The AMC shall submit quarterly report on the functioning of the schemes of the mutual fund to the trustees or at such intervals as may be required by the trustees or SEBI.

(xi) The trustees shall have the power to dismiss the AMC under the specific events only with the approval of SEBI in accordance with the regulations.

1.10.1.3 Code of Conduct:

The trustees shall abide by the code of conduct as specified in the fifth schedule of SEBI (Mutual Fund (Regulations 1996, which contains 10 clauses, namely-

1. Mutual fund schemes should not be organised, operated, managed or the portfolio of securities selected, in the interest of sponsors, directors of AMCs, members of Board of trustees or directors of Trustee Company, associated persons in the interest of special class of unit holders rather than in the interest of all classes of unit holders of the scheme.

2. Trustees and AMCs must ensure the dissemination to all unit holders of adequate, accurate, explicit and timely information fairly presented in a simple language about the investment policies, investment objectives, financial position and general affairs of the scheme.

3. Trustees and AMCs should avoid excessive concentration of business with broking firms, affiliates and also excessive holding of units in a scheme among a few investors.

4. Trustees and AMCs must avoid conflicts of interest in managing the affairs of the schemes and keep the interest of all unit holders paramount in all matters.

5. Trustees and AMCs must ensure scheme wise segregation of bank accounts and securities accounts.

6. Trustees and AMCs shall carry out the business and invest in accordance with the investment objectives stated in the offer documents and take investment decision solely in the interest or unit holders.

7. Trustees and the AMCs shall maintain high standards of integrity and fairness in all their dealings and in the conduct of their business.

8. Trustees and AMC must not use any unethical means to sell; market or induce any investor to buy their schemes.

9. Trustees and the AMC shall render at all times high standard of service; exercise due diligence, ensure proper care and exercise independent professional judgement.
10. The AMC shall not make any exaggerated statement, whether oral or written, either about their qualifications or about capability to render investment management services or their achievements.

1.10.1.4 General Due Diligence by Trustees:

The Trustees shall exercise due diligence according to the SEBI (Mutual Fund) Regulations 1996 as under:

a. The trustees shall be discerning in the appointment of the directors on SEBI of the asset management company.

b. Trustees shall review the desirability of continuance of the asset management company if substantial irregularities are observed in any of the schemes and shall not allow the asset management company to float new schemes.

c. The trustees shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.

d. The trustee shall ensure that all service providers are holding appropriate registrations from SEBI or concerned regulatory authority.

e. The trustees shall arrange for test checks of service contracts.

f. Trustees shall immediately report to SEBI of any special developments in the mutual fund.

1.10.1.5 Specific Due Diligence by Trustees:

The trustees shall exercise specific due diligence as per Mutual Fund Regulations specified by SEBI 1996 as under:

1. Obtain internal audit reports at regular intervals from independent auditors appointed by the trustees.

2. Obtain compliance certificate at regular intervals from the asset management company.

3. Hold meeting of trustee more frequently.

4. Consider the reports of the independent auditor and compliance reports of asset Management Company at the meetings of trustees for appropriate action.

5. Maintain records of the decision of the trustees at their meetings and of the minutes of the meetings.

6. Prescribe and adhere to a code of ethics by the trustees, asset Management Company and its personal.

7. Communicate in writing to the asset management Company of the deficiencies and checking on the rectification of deficiencies.
1.10.1.6 Independent Directors’ Responsibilities:

According to the SEBI (Mutual Fund) Regulations 1996, the independent directors of the trustees or the AMC shall pay specific attention to the following:

1. The investment management agreement and the compensation paid under the said agreement.
2. Service contract with affiliates to identify payments in excess of market rates with outside contractors.
3. Selection of AMCs independent directors.
4. Securities transactions involving affiliates where permissible.
5. Selecting and nominating individuals to fill vacancies of independent directors.
6. Code of ethics to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions.
7. Reasonableness of fees paid to sponsors, AMCs and others for services rendered.
8. Principal underwriting contracts and service contracts with associates of AMC.

1.10.1.7 Inspection and Audit:

The regulations (SEBI Mutual Fund 1996) also incorporate inspection and audit procedures. SEBI can inspect the books of accounts, records, documents, infrastructure system and procedure, or investigate the affairs of the mutual fund, trustees and AMC. SEBI can inspect the books of accounts to ensure that they are maintained as per guidelines, provisions of regulations are complied with and the system and procedures are adequate. SEBI can investigate into complaints of investors or any other persons having a bearing on the activities of the mutual funds, trustees and AMC.

1.10.1.8 Procedure for action in case of default:

The SEBI (Mutual Fund) Regulations 1996 provide detailed provisions and specifies the methods of action in case of default and violation of regulations.

- SEBI may suspended the certificate of a mutual fund in case it contravenes any provision of the regulations, fails to furnish information and periodic returns or comply with the directions of the board, if it indulges in unfair trade practices, or does not co-operate with any inquiry or inspection.
- The certificate of registration can also be cancelled if the mutual fund is guilty of fraud, repeated default or if the price rigging, price-manipulation or the
‘financial condition deteriorates to such an extent that its continuance is not in the interests of unit holders and of the mutual funds’.

- However, the regulations also lay down guidelines about the manner of making the order of cancellation or suspension, effect of suspension or cancellation of certificate of registration, action against intermediaries, adjudication, etc.

1.10.1.9 Investor Protection:

The Association of Mutual Funds in India (AMFI) is formed in August 1995 by the Indian mutual funds with a view to ‘promoting and protecting the interest of mutual funds and their unit holders, increasing public awareness of mutual funds, and serving the investors’ interest by defining and maintaining high ethical and professional standards in the mutual funds industry’. To achieve this goal, AMFI has undertaken investors’ awareness programmes and is working to bring out a comprehensive code of ethics for mutual funds. By the end of December 2011, 44 mutual funds are members of AMFI.

The regulatory structure of mutual fund industry in USA and in India is given below:

![Diagram of Mutual Fund Industry Regulatory Structure]

**Fig. 1.3 indicates regulatory structure of mutual funds in USA.**
**Source: Sadhak 1997**

1.11 Objectives of the Study:

A large number of academic literatures address the topic of mutual fund performance. The literature can be divided into three broad areas. The first area of academic interest is whether fund managers as a group possess any market timing or stock picking or diversification skills. The existing literatures support little evidence about the notion that they exhibit such skills. The second group of academics test the
issue of persistence of performance. This literature generally concludes that fund returns are persistent. Evidence also shows that the returns of mutual funds that performed particularly poorly in the past persist more than the returns of the funds that performed particularly well in the past. The third area of academic interest is whether it is possible to find predictive characteristics explaining performance. A much smaller body of literature attempts to identify the predictive power of fund characteristic. Bulks of the past studies have been conducted on the issue of performance evaluation of mutual funds in developed economics like UK and US. Although, there are a few studies have been done on the performance of mutual funds in the emerging markets like that of Malaysia (Abdullah, Hassan & Mohammad 2007) and India (M. Jaydev 1996).

This study is distinct from other mutual fund related studies, in that it concentrates on the individual scheme and comparative performance evaluation of different types of the open-ended mutual fund schemes in the Indian context. In addition, it brings forward the identification of the strategies and decision-making process of the fund managers as well as the investors who are able to outperform the specific market index. In a nutshell the study would try to focus the following aspects of the mutual fund performance in India:

1. To examine the risk-adjusted performance of the open-ended mutual fund schemes.
2. To make a comparative analysis among the different types of scheme based on risk-adjusted performance.
3. To study the selectivity performance of the open-ended mutual fund schemes.
4. To examine whether the open-ended mutual fund schemes offer superior stock selection performance.
5. To find out the best type of schemes based on selectivity performance.
6. To make a comparative analysis among the different types of mutual schemes based on selectivity performance.
7. To study the market-timing performance of the open-ended mutual fund schemes.
8. To examine whether the open-ended mutual fund schemes offer superior market-timing performance.
9. To find out the best type of schemes according to the market-timing performance.
10. To make a comparative study among the different types of schemes based on market-timing performance.
11. To examine the diversification performance of the open-ended mutual fund schemes.
12. To scrutinise whether the open-ended mutual fund schemes offer superior diversification performance.
13. To find out the best type of schemes based on diversification performance.
14. To make a comparative analysis among the different types of schemes based on diversification performance.
15. To study the overall performance of the open-ended mutual fund schemes based on Fama’s decomposition theory.
16. To observe the selectivity performance of the open-ended mutual fund schemes based on Fama’s model.
17. To study the net-selectivity performance of the open-ended mutual fund schemes based on Fama’s model.
18. To inspect the risk performance of the open-ended mutual fund schemes.
19. To look at the diversification performance of the open-ended mutual fund schemes based on Fama’s model.
20. To make a comparative analysis based on the Fama’s performances variables.

1.12 Significance of the Study:

Mutual funds state that they provide a number of advantages to the investors of investing in themselves. They claim that they generate satisfactory returns on behalf of investors with minimum degree of expected risks. Sometimes, mutual fund provides abnormally higher return to the investors. Mutual fund collects huge amount of money from household sectors and mobilise it to the productive sectors. It acts as a investment vehicle that links between investors to the capital markets. This study has much significance as it examines whether mutual fund managers have provided satisfactory stock selection performance or not. The study also examines whether the mutual fund managers have kept their commitments in respect of market timing and diversification activities. The very basic claim of mutual funds that it’s provide higher returns with minimum degree of expected risks by investing in financial securities. The study deals with this issue based on risk-adjusted criteria. The study also examines the overall performance of the mutual funds. Overall, the study performs as a guide to the investors in planning and effecting their investments with mutual funds. Moreover, this study may help to the mutual fund managers as a guideline about their past performances in respect of market timing, stock selection and diversification.
activities and based on these past activities they would be more responsible in near future.

1.13 Plan of Presentation:

The study is presented in eight chapters. **Chapter I** introduces the concept and origin of mutual fund industry in the world and special attention to India. In this chapter, various types of mutual fund schemes and their advantages of investing in mutual funds by taking into the risk parameter are discussed. This chapter further discusses the regulatory framework of mutual funds and investors’ protection in India. In this chapter, objectives of the study its significance, input data and study period, hypothesis, research methodology and limitations of the study are mentioned. **Chapter II** extensively reviews the existing literature on the subject; bring out the gaps and try to fill up the gaps in the Indian context. **Chapter III** is devoted to examination of risk and return of the open-ended mutual fund schemes. This chapter also evaluates the risk-adjusted performance of the open-ended mutual fund schemes based on universally recognised theoretical models of Sharpe, Treynor and M-M. **Chapter IV** deals with the examination of selectivity performances of the open-ended mutual fund schemes in India. **Chapter V** is devoted to examination of market timing performance of the open-ended mutual fund schemes. **Chapter V** deals with the diversification performance of the open-ended mutual fund schemes. **Chapter VII** examines the different components of investment performance in the light of the universally accepted theoretical model of Fama. **Chapter VIII** presents a summary of conclusions of the study over the preceding chapters.