INTRODUCTION

1.1 ECONOMIC DEVELOPMENT AND INDIAN FINANCIAL SYSTEM

The economic development of a nation is reflected by the progress of the various economic units broadly classified into corporate sector, government unit and household sector. While these entities carry out their activities, they get placed in a surplus/deficit balanced budgetary situation.

The corporate need funds for investment in new projects, for expansion/Diversification/modernization, etc. The retained earnings meet some part of these requirements, but for the rest they depend on the financial system. On the other hand, a government, which always faces a deficit budget needs huge amount of funds for public expenditure to finance its developmental activities. Along with these two economic units, the household sector also requires funds for varied purposes. However, the surplus of the household sector is more than the other units.

It is observed that, at any given point of time, some units will be having idle funds, while a few others would need them. The volume of funds required by the corporates for investment and the government expenditure is very large when compared to the household requirements. And if funds are not provided for these activities, economic progress will suffer a setback. On the other hand, there are surplus budget units, which have excess funds in the form of savings.

The mere act of savings will, however; not guarantee economic progress. This is because different groups usually carry out savings and investments where savings come from household sector and investments are made by corporate sector. Hence, there should be a mechanism to ensure that savings flow from those who save to those who invest. Thus, this process would enable the utilization of excess idle funds, thereby enhancing their value.

A financial system enables such a transfer of funds from savers to the borrowers. It represents a channel through which savings are mobilized from the surplus units and routed to the deficit units. The role of the financial system can be broadly classified into the following functions:

1. Savings Function: Mobilizes savings to provide a potentially profitable and low risk outlet.
2. Policy Function: Ensures smooth flow of funds from savings to investments in order to stabilize the economy.
3. Credit Function: After mobilizing the savings and laying down the necessary policies for the transfer of these funds, the credit function of the financial system will ensure that these savings transform into the necessary credit for investment and spending purposes. Complexities arise while performing these functions, especially when the requirements of the savers and the borrowers do not match. The main consideration of the savers is with regard to safety of funds, returns and liquidity. On the other hand, the needs of the borrowers will be relatively diversified. Their concerns are the availability of funds and cost of funds. The varied requirements of the lenders and the borrowers will lead to mismatch in periods- lending period may differ from the needs of the borrower. Similarly, the risk exposure and the corresponding returns may not suit the lender. These factors led to the need to develop the financial system in such a way that it matches the requirements of the borrowers and lenders.

Proper allocation of funds is essential for the transactions to take place in the financial system for the development of the economy. And to enable proper allocation of resources, various financial markets are being developed and various financial instruments were born. Over a period of time, these developments have made the operations of the financial system complex. Specialized services were offered in these markets with newer and better instruments. And this further enhanced the necessity of specialized intermediaries to perform the various financial transactions.

Another feature of the financial system is the manner in which the flow of funds takes place. In an environment where the borrowers and lenders are easily accessible to each other, the financial system will be in dis-intermediation stage, i.e no intermediary is involved. And also there is an intermediation stage where a few specialized intermediaries enable the transfer of funds. Now a day the financial requirements are so varied and large that the system generally operates through both the intermediation and disintermediation mechanisms. Irrespective of how the transfer of funds takes place, it is the central bank of the country along with the government, which generally regulates the financial system by regulating the markets, instruments and players operating in it.

With the recent changes in the financial system and with the broadening of its operations, the impact on the same is tremendous. This enhances the need for a closer examination of the network between the various financial markets, intermediaries and the financial assets available in these markets.
The financial markets that are present today have come a long way from the informal to well-developed formal markets. Depending on the different requirements, various sub-markets have developed.

The main segments of the organized financial markets are as follows:

**Money Market:** The money market is a wholesale debt market for low risk, highly liquid, short-term instruments. Funds are available in this market for periods ranging from a single day up to a year. Government banks and financial institutions mostly dominate the market. The other participants in the market are corporate, FIIs, Mutual funds and individuals. RBI is the principal regulator of the money market.

**Capital Market:** The capital market is aimed at financing the long-term investments. The transactions taking place in this market will be for a period over a year. Corporates, Banks, financial institutions, individuals, mutual funds and FIIs dominate the market. SEBI is the regulator of this market.

**Forex Market:** The forex market deals with the multi-currency requirements, which are met by the exchange of the currencies. Depending on the exchange rate applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated markets across the globe. The market provides funds for both short term and long term needs. Banks, Corporates, forex dealers are the main players in this market. RBI regulates the market.

**Credit Market:** Credit market is a place where banks, FIIs and NBFCs provide short, medium and long term loans to corporate and individuals.

The financial system can further be distinguished by the primary and secondary market. The primary market is a place for the fresh issue of securities. Corporates, banks, FIIs and government can issue new securities and raise funds for investment purposes. The securities issued in the primary market are transacted in the secondary market. The secondary market transactions take place in the stock market. The secondary market helps in undertaking maturity intermediation by bringing together savers and users with conflicting maturity targets.

Though there are various markets present in the financial system, the ease with which the transfer of funds takes place depends on the level of efficiency present in the financial markets.
A market is considered to be perfect if it has the following characteristics:

- All players in the markets are price takers.
- No significant regulations on the transfer of funds.
- Very low/insignificant transaction costs.

The first situation will be possible when all the players in the market have all the information relating to the security and the market price of the security reflects all available information. The flow of funds within the market and between the markets should not be restricted by government regulations. There should be free flow of funds from one market to the other. Finally the transaction costs will depend on the trading and the settlement process. Transparency in the trading mechanism and shorter settlement periods are critical for low transaction costs. However, most of the financial markets still have some components of imperfection and are yet to be fully developed. The imperfections present in the markets may have an adverse impact on the players of these markets. Further, as the financial markets are interlinked, the factors affecting one market may have a direct or indirect impact on the others also.

1.2 FINANCIAL INTERMEDIARIES

Financial Intermediaries are firms that provide services and products that customers may not be able to get more efficiently by themselves in financial markets. The presence of financial intermediaries has a lot of advantages for the financial system. The financial intermediaries pool funds from various sources and invest in broadly diversified portfolio of financial assets. The size economies of scale help in reduction of transaction costs, monitoring costs etc. The confidentiality of the borrowers is kept intact. The financial institutions perform a signaling function for the investing community.

The various financial intermediaries are as under:

**Commercial Banks**

Commercial banks comprising public sector banks, foreign banks and private sector banks represent the most important financial intermediary in the Indian financial system. The largest commercial bank is SBI set up in 1955. In 1969, the fourteen largest privately owned commercial banks were nationalized. The banking sector has seen a lot of changes in its structure and control, which has resulted in wider geographic coverage and deeper penetration in rural areas, higher mobilization
of deposits, reallocation of bank credit to priority activities and operational autonomy for bank management. In the recent times a lot of private banks and foreign banks have emerged.

**Developmental Financial Institutions**

Since independence a number of developmental financial institutions have been set up to primarily cater to long term financing needs of the industrial sector. An elaborate structure of financial institutions consisting of all India term lending institutions like IDBI, ICICI, SIDBI, Sector specific financial institutions (TFCI, IRFC, PFC, IDFC, NHB) and state level institutions like state financial corporations, state industrial and development corporations has come into being. The financial institutions have been fairly responsive to the growing varied long-term capital needs.

**Insurance Companies**

India in the recent past had only two insurance companies i.e., LIC and GIC, with the insurance sector opening up, both in the life and non-life business a lot of private players like Bajaj Allianz, ICICI Prudential, etc. have come into the existence. IRDA is the regulatory authority for the Insurance Companies. Government has allowed foreign participation upto 49% in Insurance sector.

**Other Public Sector Financial Institutions**

There are a variety of other public sectors financial institutions like Post Office Savings Bank, National Bank for Agriculture and Rural Development, State Cooperative Banks, etc.

**Non-Banking Financial Companies**

From the mid-eighties many non-banking financial companies have come into being in the public sector as well as in the private sector. Some of the well known ones are SBI capital markets, Kotak Mahindra Finance, Sundaram Finance, Cholamandalam Financial, etc. Non-Banking Financial Corporation's engage in variety of activities like fund based and fee based. The principal fund based activities are leasing, hire purchase and bill discounting, etc.

**Mutual Funds**

A mutual fund is a collective investment instrument arrangement. In India three entities are central to a mutual fund: the sponsor, the trust and the asset management company. The sponsor promotes the mutual fund which will be organized by the trust. It is an umbrella organization, which floats various schemes in
which the investment public can participate. Mutual Funds have recorded a very
impressive growth in India. The AMC is the operational face of the Mutual fund
which structures mutual fund products, markets them and mobilizes funds, manages
funds and services the investors. The Indian AMC’s have been banks owned, financial
institutions owned, private sector owned, FIIs owned and joint collaboration of the
Indian and the foreign collaborators.

Other Organizations

Other organizations are Merchant Bankers, Venture Capital Firms and
Information services, etc. Merchant Bankers, Venture Capitalists are coming in a big
way looking into the sound fundamentals of the Indian Economy. The current growth
of GDP at a rate of around 7-8 % is bringing in a lot of venture capitalist investment.
There are many private equity firms that are also investing in the Indian stock Market.

1.3 FINANCIAL INNOVATIONS

In the present days, the emerging economic environment is recognized as the
era of service economy, where all-round efforts are being made by the Government to
quench the financial hunger of the industrial sector. But the financial need of the
organization varies from the unit to unit where the features of capital market vary
from country to country. The competition has been accepted as the hall mark of the
new globalization environment. The era of financial disintermediation and
government interference in the financial sector is slowly disappearing in most of the
developed and developing countries of the world. The admission of the FIIs and the
permission given to financial market players, like pension fund, provident fund,
insurance fund and other dedicated funds, are slowly changing the colour of the
capital market. The spirit of the competition among the financial market players
encouraging more and more customized financial innovations wherein MF industry is
not an exception.

During the 80s and 90s, while the world economy has witnessed various types
of financial innovations, the MF industry as an active player in the financial market
has also undergone qualitative and quantitative transformation. The withdrawal of the
government from the market and absence of any protection from the regulator agency
for different type of risk associated with direct investment in the capital market has
forced many investors to route their funds to the capital market via the MF. During
the recent days the newspapers are full of advertisement provided by both the public sector and private sector MFs offering different types of innovative products to the investors. From Capital markets, many MF organizations have also ventured into money market and derivate market segments. They have accepted the investors as the king of the business.

A close look at the functioning of the MF industry in India brings out some important observations.

- The MF industry has not properly tapped the full-saving potential of the public. In spite of increasing purchasing power, there has not been any significant increase in the fund mobilization by MFs. This may be partly due to absence of effective marketing strategy by the MF players.
- Market safety and liquidity for MF schemes have been found to be preferred by a majority of the investor’s community. The individual investors are becoming more and choosier because of wide choice of instruments available in the capital market.
- Majority of the investors prefer more and more traditional financial savings instruments like bank and postal deposits, and insurance policies, due to their safety and assured return. Even though there is slow shift of savings from physical assets to financial assets, but the MF industry has not been able to fully capitalize this trend.

There has been a significant increase in the number of players and instruments available in the MF market. However, in majority of the cases the features of different instruments are found to be more or less similar. As a result of which, there is a mere switching of customers from one MF to another without any addition of new customers from the traditional instruments to the MF products.

1.4 **RECENT CHANGES IN THE INDIAN FINANCIAL MARKET**

The Indian Financial System has market a lot changes in these past years. This is evident from the emergence of a wide array of financial institutions to provide a variety of services like significant expansion of the network of commercial banks and operations of the financial institutions has taken place. The financial system has moved from the stage of intermediation to the stage of disintermediation. The
remarkable growth in the primary and the secondary segments of the capital is a glaring example of that.

There are evidences of compositional changes in the household savings between physical and financial assets. The share of financial savings to total savings, which was only 28.1 percent during 1970-71, went up to 39.4 percent in 1980-81. The above share has gone up sharply to 56.8 percent in the year 1990-91 following high economic growth and expansion of the banking network in the decade of facilitating financial deepening. The share of financial savings to total savings went up to 59.1 percent in 1998-99. The household savings consists of currency deposit, shares and debentures, claim on government, insurance funds, etc.

In the recent years Indian Banking has moved into several territories. With the opening up of the insurance sector, several banks have started subsidiaries and undertaken joint ventures to enter into insurance sector. Most of the commercial banks have started offering their customers remote banking services through automated teller machines and several have started offering electronic banking facilities as well. Other schemes provided by banks include electronic fund transfer, bill payment and custodial services.

The Indian capital market has also experienced a process of structural transformation with operations conducted to standards equivalent to those in the developed markets. It was opened up for investment to FIIs in 1992 and Indian Companies were allowed to raise resources abroad through Global Depository Receipts, American Depository Receipts, Foreign currency convertible Bonds, etc., the primary and secondary segments of capital market have expanded rapidly, with greater institutionalization and wider participation of individual investors accompanying this growth. There has been emergence of new instruments like Futures, options in the capital markets to reduce the risk associated with the investment. Both the cash segment and the derivatives segment are both growing. The number of companies listed in India stands at 9871 with a market capitalization of over 3 million dollars.

The increasing volatility of the market has also motivated the investors to invest in another relatively safe vehicle of investment i.e., mutual funds. The mutual funds industry is growing at a much faster pace. A lot of variants to
standard mutual funds have come like exchange traded funds, gold exchange traded funds, etc.

The breakup of various schemes is given in the table below

**Table: 1.1 Sales Figure for the month of March 2013**

<table>
<thead>
<tr>
<th>Type of Scheme</th>
<th>Sales as on September, 2010 (in Rs. Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income/Debt Oriented Schemes</td>
<td>396788</td>
</tr>
<tr>
<td>Growth/Equity Oriented Schemes</td>
<td>172652</td>
</tr>
<tr>
<td>Balanced Schemes</td>
<td>16629</td>
</tr>
<tr>
<td>Exchange Traded Funds</td>
<td>13124</td>
</tr>
<tr>
<td>Fund of Funds investing overseas</td>
<td>702494</td>
</tr>
<tr>
<td>Gilt</td>
<td>8074</td>
</tr>
</tbody>
</table>

Source: Association of Mutual Funds of India

Currently the mutual fund industry has 41 players with more than 300 schemes. The assets under management are more than Rs. 1,00,000 crore.

The assets under management various categories on mutual funds are given below

**Table: 1.2 Assets Under Management Figure for the month of March 2013**

<table>
<thead>
<tr>
<th>Category</th>
<th>Assets under Management (In Rs Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporates</td>
<td>323107</td>
</tr>
<tr>
<td>Banks/FIs</td>
<td>18696</td>
</tr>
<tr>
<td>FIIs</td>
<td>5652</td>
</tr>
<tr>
<td>High Net worth Individuals</td>
<td>194063</td>
</tr>
<tr>
<td>Retail</td>
<td>160975</td>
</tr>
<tr>
<td>Total</td>
<td>702493</td>
</tr>
</tbody>
</table>

Source: Association of Mutual Funds of India

In light of the changes in the financial system structure mutual funds have emerged as the collective investment vehicle that are mobilizing huge amount of funds from the retail investors and providing an impetus to the capital market. In this context the mutual fund as a concept and its structure needs to be understood which has been dealt in the subsequent actions.
1.5 MUTUAL FUND – CONCEPT AND CLASSIFICATION

Mutual Funds have become one of the largest financial intermediaries in the leading world economies, currently controlling about 7 trillion dollars in the assets in US, over 3 trillion Euros in assets in Europe (Investment Company Institute, 2002) end in India it stands at Rs 30,000 crores. Currently investors can choose from thousands of funds offering a wide range of investment profiles, from relatively safe short-term debt instruments to relatively risky stocks and derivatives.

A mutual fund is a type of financial intermediary that pools the funds of investors who seek the same general investment objective and invests them in a number of different types of financial claims. These pooled funds provide thousands of investors with proportional ownership of diversified portfolios managed by professional investment managers.

There has been a great debate about the history or the origin of the mutual funds. It is said that the concept of the mutual fund is more than one and half century old. In 1822, King Williams of the Netherlands formed “SocieteGenerale de Belique”, at Brussels, which appears to be the first Mutual fund. It was intended to facilitate small investments in foreign government loans, which then, offered more security and returns than the home industry. But the concept of mutual fund flourished as an industry in UK and USA. The very first investment trust, Foreign & Colonial, launched its scheme in the year 1868. By the year 1900, there were more than 100 investment trusts. The origin of mutual funds in the USA was marked during the second half of the 19th century. Boston Personal Property Trust was the pioneer in USA to launch the first mutual fund in the year 1893. But the credit of the ideas of mutual funds that is prevalent in the present market goes to W. Wallace Alexander who launched the Alexander Fund established in Philadelphia in 1907. In India the concept came in around the year 1964 when UTI launched the first mutual fund scheme i.e. US – 64.

The popularity of the mutual funds has increased because of the advantages it has provided over and above the other investment avenues. Some of the advantages are listed as follows:
1. **Portfolio Diversification** – Each investor is a part owner of the entire funds asset thus enabling him to hold a diversified portfolio with a small capital that he has invested. The investor enjoys the benefits of diversification.

2. **Professional Management** – The financial professionals who are able to select the right stocks at the right time manage the mutual funds. The investment management skills, along with the needed research into available investment options, ensure a much better return than what an average investor can manage on his own.

3. **Risk Diversification** – The risk of the investor is reduced as he is investing in the pool of funds with the other investors.

4. **Low Transaction Costs** – The transaction cost that the investor would have incurred for possessing the same portfolio would have been much higher than what he incurs by investing in a mutual fund. When the investor invests in a stock, he bears all the cost of brokerage and custody. But the in case of a mutual fund, the investor enjoys economies of scale.

5. **Liquidity** – The units of the mutual fund can be sold very easily. In case of an open ended mutual fund the units can be surrendered to the mutual fund itself and in case of closed ended mutual fund it can be sold in the stock market to generate cash whenever required. Liquidity is a big benefit that is availed by the mutual fund investors.

6. **Convenience and flexibility** – Mutual fund management companies offer many investor services that a direct market investor cannot get. Investors can easily transfer their holdings from one scheme to another; get updated market information and so on.

7. **Transparency** – Mutual Funds have to disclose their holdings, investment pattern and necessary information before all investors under a regulated framework.

8. **Well Regulated** – The regulations in the Mutual Fund has been changing over period of time. At present the disclosure norms have become too tight for the mutual fund companies. They have to adhere to the guidelines laid down by the Securities Exchange Board of India. The SEBI guidelines lay a lot of emphasis on the investor protection.
The mutual funds provide a variety of products available to suit the investor’s objectives. Generally they can be classified under three broad classifications. Firstly, funds are usually classified in terms of their constitution as open-ended and close ended. The distinction depends upon whether they give the investors the option to redeem and buy units at any time. From the fund itself (open ended) or whether the investors have to wait for a given maturity before they can redeem their units to the fund (close ended).

Funds can also be grouped in terms whether they collect from the investors any charges at the time of entry or exit or both, thus reducing the investible amount of the redemption proceeds. Funds that make these charges are classified as load funds and funds that do not make any of these changes are termed as no-load funds. Finally, funds can also be classified as being tax-exempt or non tax exempt, depending on whether they invest in securities that give tax exempt returns or not. All mutual funds would be either closed-end or open-end and either load or no load.

These general forms of classifications are as follows:

- **Broad fund types by nature of investments**
  
  Mutual funds may invest in equities, bonds or other fixed income securities, or short-term money market securities. So we have Equity fund, Bond fund and Money Market funds as presented in **Annexure-I**. All of them invest in financial assets. But there are funds that invest in physical assets. For example, we may have Gold or precious metals fund or real estate funds.

- **Broad fund types by investment objectives**
  
  Investors have different investment objectives as per their individual requirement. Investment in Income funds helps to generate regular income with less capital appreciation. Investment in Balanced funds consists of investment in debt instruments, convertible securities and preference and equity shares. By investing in a mix of this nature, they seek to attain the objectives of income, moderate capital appreciation and preservation of capital.

- **Broad fund types by Risk Profile**
  
  The nature of a fund’s portfolio and its investment objective imply different levels of risk undertaken. Funds are therefore often grouped
in the order of the risk. The classification of mutual funds on basis of risk in the ascending order is given in the following list.

1. Money Market Funds – Lowest risk
2. Gilt Funds
3. Debt Funds/Income Funds
   3.1 Diversified Debt Funds
   3.2 Focused Debt Funds
   3.3 High Yield Debt Funds
4. Hybrid Funds – Quasi Equity/Quasi Debt
   4.1 Balanced Funds
   4.2 Growth Funds
   4.3 Asset Allocation Funds
5. Equity Funds
   5.1 Aggressive Growth Funds
   5.2 Growth Funds
   5.3 Speciality Funds
      5.3.1 Sector Funds
      5.3.2 Off Shore Funds
      5.3.3 Small Cap Equity Funds
      5.3.4 Option Income Funds
      5.3.5 Fund of Funds
   5.4 Diversified Equity Funds
      5.4.1 Equity Linked Savings Scheme
   5.5 Equity Index Funds and Exchange Traded Funds
   5.6 Value Funds
   5.7 Equity Income Funds
6. Commodity Funds
7. Real Estate Funds

The Mutual Funds have a unique structure not shared with other entities such as companies or firms in the Indian Financial system. The main model of the Indian Mutual fund industry has been borrowed from both the UK and US models, with the UK model having a greater influence. A mutual fund in USA is typically externally managed. It is not an operating company with
employees in the traditional sense. Instead a fund assembles services from third parties to carry out its business activities i.e., investing in securities. It consists of the share holders, the board of director (oversees the fund activities), investment advisor (manages fund’s portfolio), principal underwriter (sells funds), custodian (holds assets), independent public accountant (certifies financial statement) and transfer agent (maintains records)( Please refer figure in annexure IV). In UK, there are investment trusts and unit trust. A unit trust is a fund of money, which is divided into units. Each unit accurately reflects the underlying investments. Unit trusts are open-ended created by trust deed. They have trustees who safeguard the unit holder’s interest and hold assets on behalf of the investors. Investment trusts on the other hand are public limited companies traded on the stock market and incorporated under the company law. The investors are shareholders that enjoy the same rights and privileges as any other shareholder in any company. They own the company and it is up to them to choose the directors.

India has adopted the model of unit trust form UK, where the trustee has to play a vital role in protecting the interest of the investor. Unlike in UK they have separate set of guidelines for investment trust as well as unit trust; here one regulator controls both the type of structures. A mutual fund is allowed to launch both open ended and close ended schemes.

A mutual fund in India is constituted in the form of a public trust created under the Indian Trust Act, 1882. The fund sponsor acts as the settler of the trust, contributing to its initial capital and appoints a trustee to hold the assets of the trust for the benefit of the unit-holders, who are the beneficiaries of the trust. The fund then invites the unit holders to contribute money in the common pool, by subscribing to unit issued under various schemes established by the trust as evidence of their beneficial interest in the fund.

In the following paragraphs the structure of the mutual fund in India as laid down by SEBI (Mutual Fund) Regulations, 1996 is discussed briefly:

1. **The Fund Sponsor:** Sponsor is defined under the SEBI regulations as any persons who acting alone or in combination with another body corporate, establishes a mutual fund. The sponsor is the promoter of the mutual fund as it gets the mutual fund registered under SEBI. The sponsor will form a
trust or a board of trustees. Then the sponsor, either directly or indirectly with the help of the trustees, appoints the asset management company and the custodian. All these appointments are made as per the regulations of SEBI. The sponsor contributes at least 40 percent of the net worth of the AMC and should have a sound financial track record for over five years prior to registration.

2. **Trustees:** The trust structure of the mutual funds has been borrowed from UK. The regulation offers the sponsor to form a trust company or a board of trustees. In India almost all mutual funds follow the trustee company model. A Company is formed and the sole duty is to function as a trustee. Every fund house must have at least four trustees from which three fourth of the trustees should be independent. In theory, the sponsor identifies the member of the board of the Trustee Company but for all practical purposes, it is taken up by the AMC. The trustees are bestowed with a lot of powers and the actions taken by it are deemed to be the action of the mutual fund. The primary duties of the trustees are appointment of the directors of the asset management company, obtain periodic reports about operations from the asset management company, monitor security dealings of key personnel of the asset management company, review contracts, file periodic reports with the regulator and protect the investor’s interest. The trustees meet for six (or more) times in a year to deliberate on these matters.

3. **Asset Management Company:** The role of an asset management company is to act as the investment manager of the trust under the board of supervision and the direction of the trustee. The AMC should be approved of and registered with SEBI as an AMC. The trustees can terminate the AMC in case they find the AMC to be engaged in any fraudulent activities with prior permission of the board and the unit holders. The AMC of a mutual fund must have a net worth of at least Rs 10 crore at all times. Directors of the AMC should be professionally qualified and should be persons of high moral standing. The rules prevent the AMC from acting as trustee in some other mutual fund. The duties of the AMC are investing funds as per the regulations, submitting periodic reports to the trustees,
making payments as per the jobs provided, floating new schemes with the prior approval of the trustees and SEBI, etc.

The above three are the primary constituents of the mutual fund. The other funds constituents are:

1. **Custodian and Depository:** Mutual funds are in the business of buying and selling large number of securities in terms of physical delivery and eventual safe keeping is therefore a specialized activity. The custodian is appointed by the board of trustees for safe keeping of the securities or participating in the clearing system through depository companies on behalf of the mutual funds.

2. **Bankers:** A fund’s activities involve dealing with money on a continuous basis primarily with respect to buying and selling units, paying for investments made, receiving the proceeds on sale of investments and discharging its obligations towards operating expenses. A fund’s bankers play a crucial role with respect to its financial dealings by holding its bank accounts and providing with remittance services.

3. **Transfer agents:** Transfer agents are responsible for issuing and redeeming units of the mutual fund and provide other related services such as preparation of transfer documents, updating investor records.

4. **Distributors:** Mutual funds operate as collective investment vehicles, on the principle of accumulating funds from a large number of investors and then investing on a big scale. For a fund to sell units across Wide retail base of individual investors, an established network of distribution agents is essential. The mutual funds operate through a network of individual small brokers to large banks that act as distributors.
1.6 RELEVANCE OF THE STUDY

The emerging investment scenario clearly reveals that there is a trend of changing of preference of investors towards new savings instruments. During 80s and 90s different types of savings and investment schemes have been introduced and have been adopted. It is observed that during such period the investing public has changed the shift from traditional to new debt and equity based schemes. As per the survey findings of L.C.Gupta (Gupta;1993) in his two studies during mid-1990 and mid-1992, the most memorable change in the investment behavior of the people were shifting towards mutual funds, units and moderately continuing shift towards shares, debentures from traditionally adopted savings instruments like NSCs, LIC policies, Bank and Postal deposits, etc.

In a free market economy, financial sector plays an important role. The strength of the financial sector influences the survival, growth and development of different sector of the economy. Research mobilization and deployment depends on both the institution mechanism and the capital market operation.

The MF industry because of its simplicity of operation and wider reach of the investors class plays a significant role, not only in mobilizing idle resources by encouraging savings habits, but also channelizes these resources into the productive sector of the economy. A healthy MF industry will lead to a healthy development of the economy. Successive financial scams in India have demoralized confidence of both the investing population and investing players. The revival of the economy depends largely on the health and vitality of the financial marketers.

The present study is relevant from other angle also.

1. The savings rate influences the capital market flow to the productive sector. A high rate of savings depends on availability of adequate safety and liquid investment proposals. MFs can play an important role to provide towards increasing the rate of savings by providing adequate number of safe investment proposals.

2. In a competitive marketing environment, where a large number of MF companies are competing with themselves, it is essential that they adopt proper marketing strategies which not only expand and diversify their investor’s base also sustain their confidence.
3. Innovation is the secret for the success of any player in the free market economy wherein MF’s are not an exception. There is a need to find out how and what type of innovations have been brought about by the existing MF players in the areas of products, process and management style.

4. The role of the MF industry varies from economy to economy. In highly developed market, where the investors are educated and knowledgeable, their savings may directly be channeled to the capital market, or may be routed indirectly by MFs. However, in an underdeveloped economy, with a limited number of investment avenues, either in money market or capital market, the MFs may have to play a more important role. In an economy like Gujarat, where the masses actively prefer equity, it is pertinent to examine the role of the MFs in mobilizing and deploying the savings.

5. Mobilization and investment pattern of MFs changes from time to time depending on the conditions of the market, guidelines of the regulatory bodies, nature of competition and the domestic and global situations. Some of the studies, which have been referred earlier, were conducted during 90s. A lot of changes have taken place in the operating environment of the MFs. The entry of FIIs flooded by private players and foreign institution, the listing of schemes in stock market, the disclosure norms announced by SEBI, etc., have completely changed the rules of the game. In this backdrop, it is essential to study how the MFs awareness and adoption to cope the emerging challenges of the industry.

The present study is of both explorative as well as descriptive. Accordingly at the planning stage, specific objectives were setup to provide the basis of inquiry. In the light of those objectives, the scope of the study, the methodology of data collection, sample design and tools of analysis were decided.

1.7 OBJECTIVES AND METHODOLOGY

The present study is undertaken with the following specific objectives:

1. To study the evolution and growth of the MF industry in India.

2. To study the underlying reasons for investor’s preference towards mutual funds over other investment instruments.

3. To study the relationship of various demographic variables on investors’ perception towards mutual funds.
4. To study and rank the factors responsible for the selection of mutual funds as an investment option.

5. To know the experience of the people who have invested in Mutual Funds.

6. To know the preferred source of information used by investors for analyzing performance of investment.

The present study attempts to evaluate the effect of various demographic variables on investor’s perception towards mutual funds. For this purpose, individual mutual funds investors have been selected. The study has explored the theoretical aspects of perception and the emerging trend of the mutual fund industry as a whole. The individual investor’s perception has been confined to the Ahmedabad, Baroda, Jamnagar, Rajkot and Surendranagar districts only.

This study is based on both primary and secondary data sources. The secondary data have been collected from different published records of different institutions. Specifically, information about the MF’s has been collected from different publications of the government of India, RBI, SEBI, AMFI, MF Organizations and other financial journals and periodicals. The reports on different studies related to MFs conducted by different research institutions and individual scholars have also been referred to collect the relevant data. For studying the perception of investors has been administered of structured questionnaire of the respondents.

500 respondents have been selected for this study from Ahmedabad, Baroda, Jamnagar, Rajkot and Surendranagar districts only. From the total population of the investors of different schemes including the MF schemes, different segments are taken into consideration.

The data collected from primary and secondary sources is subjected to statistical treatments. Simple statistical tools like percentages, ratios, Mean, Cross Tabulation, Graphs, Chi-Square Tests and Factor Analysis have been used. The chi square test has been adopted to examine the association between the demographic variables with the awareness and adoption of the MF schemes and organizations.
1.8 LIMITATIONS

The present study is mainly based on data collected through the administration of a questionnaire. The general limitations of the validity of the responses of the investors are subject to their interest in giving responses. As far as possible, care was taken to spend more time with the investors, so that the responses are given with some thought based on their experience with the Mutual Funds.

1.9 WORK FLOW

Work flow of the present study is driven by its objectives. An introduction is presented in the first chapter while the existing literature available is reviewed in the second chapter. The third chapter is devoted for a full length presentation of the Mutual Fund Industry with special reference to India. The fourth chapter of the research is dedicated to the research methodology being adopted in the study wherein sample size, sampling frame, hypothesis statement has been kept. The fifth chapter focuses on the application of various statistical tests like cross tabulation, factor analysis and simple ratio’s and percentages for the study. The sixth chapter is on the summary and suggestions after the study. Various Mutual Fund Schemes of different Asset Management Companies are preserved in Annexure-I, while Annexure-II is the Questionnaire used in the study, followed by bibliographical references.