India is among the world’s most efficient financial markets in the terms of technology, regulation and systems. It also has one of the highest savings rate in the world—the gross household savings rate, which was averaged 19% of GDP between 1996-97 and 1999-2000, increased to about 23% in 2003-04 and has been growing ever since.\textsuperscript{1} Further, over the last few years, India’s investment rate, which was earlier less than the savings rate, has now surpassed it. From, 2001-02 to 2004-05, the savings rate was the higher than the investment rate. However, from the fiscal year 2005-06, the trend reversed and the investment rate has outperformed the savings rate.\textsuperscript{2} Among the six Asian countries, the savings and investment rates have been very high in Bhutan, followed by China and then India. India’s savings and investment rates however have shown acceleration in recent years among select major Asian countries and emerging markets. During the last few years, savings of the country was around 23%, which was one of the highest in the world.

The Liberalization, Privatization and Globalization (LPG) process initiated on 24\textsuperscript{th} July, 1991, has brought in a lot of changes in various aspects of the financial market. Presently the Indian financial market, which has witnessed considerable maturity, has been providing ample opportunities for investment to the savers of money. All this has led India gradually to be converted from a country of savers to a nation of investors. The household sector is the major saver in India and contributes to the bulk of the total savings that flow into financial assets which may take any of the forms of currency, deposits with banks and companies, PF, Insurance and corporate shares, bonds, etc.

There are various options available for these savings to be invested. Such investment leads to capital formation, which further gives an impetus to development of industries, production and consumption. It is in this sense that savings, when invested, act as a driver for the growth of a country. There are a number of mediators, in the form of an institutional arrangement, which mobilize the ‘savings’ towards ‘investment.’ Through banks, money and capital markets the funds are mobilized from its ‘savers’ to its ‘users’ The financial system helps the process of institutionalization of these savings for promoting investment and production in the
economy. The financial intermediaries play a crucial role in the process in the stock and capital markets in India. Among others, the importance of mutual funds as important intermediary is to be appreciated in this context.

Savings, when pooled into a financial product, becomes an investment. Mere saving is meaningless unless it is invested, because money has time value. The purchasing power of money deteriorates as the time elapses. Therefore, everybody desires to have hedge against ever rising inflation and hence his/her money to grow day by day. The purchasing power of money, say in other words, the value of money, today is more than the same amount of money at a future date. Hence, money must grow. Money must fetch more money in future. Then and then only one could hedge oneself against inflation. One works for eight hours but one’s money works for twenty-four hours. It is in this sense that investing money is actually making money or growing money as the time elapses. It is achieved only through appropriate investment at appropriate time. However this calls for up-to-date knowledge of share market and skill to make ‘right investment decision’ at ‘right time’ and to act upon such decisions with certain degree of confidence and risk. Many a times, quick decisions are utterly required to enter the market to make profitable investment and sometimes to escape from being trapped into market catastrophe. All this calls for expertise in investment.

Truly speaking, investment is the exchange of money or cash for a future claim on money or the purchase of a security of a promise to pay at a later date along with a regular income as in the case of a share, debenture and bond etc. However, the return on investment depends upon a number of factors and there is a close nexus between the ‘expected return’ and ‘risk-zone.’ The investor expecting the highest return on investment has invariably to assume the highest degree of risk. In the present dynamic global environment, exploring investment avenues are of great relevance. Investment skills developed by experience and spadework carried out to arrive at conclusions. The success of an investment activity depends on the knowledge and ability of investors to invest the right amount, in the right type of investment, at the right time. Particularly for small investors who are in a very large number requires such an institutional arrangement that provides them investment expertise and benefits of diversified portfolio so that they should reap the benefits of share market and other profitable investment avenues.
Mutual fund is such an intermediary which pools the savings of a number of
investors who shares common financial goals such as capital appreciation and
dividend earning and invests it on behalf of them in various investment avenues. The
money thus collected is invested in capital market instruments namely shares,
debenture and foreign market. Investors invest money and get the units as per the unit
value which is called as Net Assets Value. For a common man, mutual fund is the
most suitable investment as it offers an opportunity to invest in diversified portfolio
management under the supervision of Fund Managers, who possess expertise in
investment.

Undoubtedly, an individual can invest in various instruments such as equity,
debentures and bonds etc. on his own. However, due to constraints on time and skill,
their investment may turn unrewarding. Further, they may not afford to maintain the
substantial diversified portfolio, which is utterly required to minimize the risk and to
generate expected returns. However, their investment could be much better if invested
through Mutual Funds, which have emerged as professional financial intermediaries
bridging the ‘time’ and ‘skill’ constraints. Mutual Funds, through their well trained
Fund Managers, maintain and track a diversified portfolio on continual basis with
lower costs. In India, mutual funds play a crucial role in the economic development
of the country. As financial intermediary, the role played by mutual funds by way of
resource mobilization, allocation of resources, and development of capital markets
and growth of corporate sector is quite eye-catching. The key characteristics of Indian
Mutual Fund industry have been focused on in this chapter along with its evolution.

3.1: MUTUAL FUND: THE CONCEPT

Mutual fund is an important financial intermediary that strives to meet twin
objectives of mobilizing savings from the surplus pool and generate expected rates of
return through participation in industrial growth of an economy. A mutual fund is a
professionally managed type of collective investment scheme that pools money from
many investors and invests it in shares, debentures, bonds, short-term money market
instruments and other securities. On behalf of the investors (i.e. unit holders) the Fund
Manager of a mutual fund invests the money in stocks, bonds etc. and books profit by
selling them at appropriate time.

A mutual fund acts as the connecting bridge or a financial intermediary that
allows a group of investors to pool their savings together with a predetermined
investment objective. The appointed fund manager invests the pooled money into
specific corporate securities on behalf of the investors participating in the scheme. The profit booked by the mutual funds is distributed among the investors, who are known as unit-holders, in proportion of their holdings. The investors thus can purchase corporate securities (stocks and bonds) with much lower trading costs than if they tried to do it on their own. The investors get the advantage of diversification by minimizing risk and maximizing returns. The mutual funds are regarded as one of the best available investment avenues as they are cost-effective and easy to invest in.

In short, a mutual fund is type of Investment Company that gathers savings from investors and collectively invests in stocks, bonds or money market instruments.

3.1.1: MUTUAL FUND DEFINED

In a common parlance a mutual fund may be understood as a corporation, trust or partnership, which manages the collected money with the help of professional expertise. However, the term ‘Mutual Fund’ has been defined as follows.

(1) The SEBI Mutual Fund Regulations, 1993:

‘Mutual fund is a fund established in the form of a trust by a sponsor, to raise money by the trustees through sale of units to the public, under one or more schemes, for investing in securities in accordance with the regulations’

(2) A. John Halin

‘A mutual fund is almost like a cooperative society of investors. That is why the word ‘mutual’ is used. It collects money from investors by issuing mutual fund units, invests it in securities, and divides whatever dividend or interest is received among its members.’

In short, a mutual fund is----

- an intermediary through with savings can be invested in corporate securities
- an indirect mode of investing in corporate securities
- a collective investment vehicle

3.1.2: ORGANISATIONAL STRUCTURE OF MUTUAL FUND IN INDIA

The organization of mutual funds is dictated by Securities and Exchanges Board of India (Mutual Fund) Regulation, 1996, except Unit Trust of India. UTI is governed by Government of India UTI Act, 1963. Bank sponsored mutual funds supervised by RBI. However, this does not overlap with SEBI’s supervision.
Mutual Funds in India follow a 3-tier structure, inclusive of Sponsor, Trustees and Asset Management Company. Their role in operating the mutual fund has been briefed as follows.

**First Tier: Sponsor:** Behind establishment of a mutual fund the sponsor plays a role of an initiator. Sponsor is an individual or a group of individuals or a body corporate who think of starting a mutual fund. He is akin to the promoter of the fund. But the sponsor is not a Trust and hence it is not a Mutual Fund. The sponsor has to fulfill certain eligibility criteria as laid down under Chapter-II of Clause 7 of above-said Regulation.

The sponsor approaches the Securities and Exchange Board of India (SEBI), which is the market regulator and also the regulator for mutual funds. The sponsor has to contribute at least 40% of the net worth of the Asset Management Company and must possess sound financial track record over five years and the net worth in the immediate preceding year more than the capital contribution in AMC. He performs the following functions.

- Gets the Fund registered with SEBI
- He forms the Trust on getting clearance from SEBI
- He appoints the Board of Trustees, Asset Management Company (AMC) and Custodian through Trustees as per the rules laid down under Chapter-II, Clause-7 (a), (b), and (c) of Regulations

**Second Tier: Public Trust:** The sponsor creates a Public Trust as per the provisions laid down under Indian Trusts Act, 1882. Conceptually, the Trusts bear no legal identity in India and cannot enter into contracts. Trustees are the people authorized to act on behalf of the Trust. Trust Deed is executed by the sponsor in favour of trustees and stamped and registered with SEBI. Two third of trustees are independent and not associated with the sponsors. Once the Trust is created, it is registered with SEBI after which this trust is known as the mutual fund. Trustees may be seen as the internal regulators of a mutual fund. The Trust performs the following functions.

- Holds the unit holders’ money in fiduciary capacity i.e. it invest money on behalf of the unit holders
- Trustees appoint Asset Management Company to manage the portfolio of securities
• Trust does not manage money but its job is to see whether the money is being managed as per stated objectives

**Third Tier: Asset Management Company (AMC):** Trustees appoint the Asset Management Company (AMC) to manage investor’s money. The AMC charges a fee for the services provided which is ultimately borne by the investors as it is deducted from the money collected from them. AMC must have a minimum net worth of Rs. 10 crores at all times and cannot act as Trustees for any other mutual fund. Further, at least 50% of AMC’s directors should be independent of Trustees and Sponsors. The AMC functions the following functions.

• To manage money of investors on a day-to-day basis
• To prepare the Offer Document (OD), the legal document on which the investors rely upon for investing in the mutual fund scheme
• To appoint intermediaries like Independent Financial Advisors (IFAs), banks and distributors at national and regional levels
• To float new schemes (known as New Fund Offer or NFO) under the name of Trust manage these schemes by buying and selling securities
• To function under the supervision of it’s Board of Directors and under the direction of the Trustees and SEBI

**Other Functionaries:** The organizational chain further includes Custodians, Registrar and Transfer Agents and Distributors. To carry on the operations of a Mutual Fund, the following functionaries play an important role, as explained here below.

**Custodian:** Mutual Funds have a Custodian appointed by the Board of Trustees. Custodians carry out custodial services for various schemes of a mutual fund. The Custodians provide the following services.

(i) They provide safe keeping of physical securities,
(ii) They keep a tab on the corporate actions like issue of rights and bonus, and declaration of dividends by the companies in which the fund has invested money,
(iii) On behalf of mutual funds, the custodians participate in a clearing and settlement system through approved depository companies especially in case of dematerialized securities.

HDFC Bank, SHICL, Citi Bank and Deutsche Bank proved custodial services to mutual funds.
Registrar and Transfer Agents (RTA): The Registrar and Transfer Agent (RTA) is a record keeper of the fund. All the New Fund Offer (NFO) forms and Redemption forms go to the RTA’s office where the information is converted from physical to electronic form. RTA performs the following functions.

(i) to issue and redeem units of a Mutual Fund
(ii) to keep and update investors’ records
(iii) to keep the record as regards how many units will the investor get, at what price, what is the applicable NAV, what is the entry load, how much money will he get in case of redemption, exit loads, folio number, etc.

CAMS and Karvy act as Registrar and Transfer Agents for mutual funds now. M/S MN Dastoor and Company, IIT Corporate Services, Computeronics, MCS Software Solution Ltd., PCS Industries Ltd., Tata Share Registry were previously providing RTA services, however now they have discontinued it.

Distributors: Mutual Funds solicit the services of distributors/agents to send their products (i.e. MF schemes) across the length and breadth of the country. AMC appoints the distributors. Sponsors may also act as distributor with proper disclosures. Usually, the banks, non-banking financial institutions, corporate and even individuals can act as distribution channel. Their main task is (i) to reach to the prospective investors and (ii) to convince the prospective investors about the features of the MF scheme and distribute them the MF schemes.

![Organizational Structure of a Mutual Fund](image)

**Figure: Organizational Structure of a Mutual Fund**

3.1.3: WORKING OF MUTUAL FUND

It is important here to understand how a Mutual Fund works. In a very simple manner the working of a mutual fund can be understood as follows.

- The AMC designs a new scheme of mutual fund, which clearly and precisely mention its objectives, type (open or close-ended), time-frame, entry and exit load etc.
The scheme is launched in the market and its units (they are like shares) are offered to the public. The units are offered by issuing New Fund Offer (NFO), which is like a prospectus issued for collecting subscription from intended investors. The offer document is a legal document and it is the investor’s obligation to read NFO carefully before investing. The NFO contains all the material information that the investor would require to make an informed decision. It contains the risk factors, dividend policy, investment objective, expenses expected to be incurred by the proposed scheme, fund manager’s experience, historical performance of other schemes of the fund and a lot of other vital information. The unit holder is like a shareholder.

The money so collected, which is known as ‘Corpus’, is invested in corporate securities, money market instruments etc. as per the investment objectives stated in NFO. Generally MFs invest in a wide range of securities in different industries with an aim of reducing the risk and maximizing the returns. Here, the portfolio is constructed in the light of the objectives of the fund. For example, Growth/Equity Funds will invest in equities, Income/Debt Funds will invest in debt instruments, Sector Specific Funds will invest in specific sector like Petroleum, Pharma, Automobile, FMCG etc. Index Fund will invest in Sensex or Nifty etc., Gold ETF will invest in gold and Fun of Funds (FOF) will invest in other mutual funds.

The expert Fund Manager is employed to manage the funds. He carries out the specific task of purchasing and selling corporate securities at the appropriate time in the market. The success or failure of the fund depends upon the knowledge and professional skill of Fund Manager.

After the annual accounts are audited, the MFs ascertain the income earned by them and distribute at least 90 percent of their income by way of dividends to the unit holders. There is also an arrangement of reinvesting the dividend in MF units.

After the duration of MF scheme is over, MFs sell the securities pertaining to the scheme and redeems the units by paying the unit holders their capital with capital gains, in proportion to their holdings.

The unit holders, who want to withdraw from the scheme, get back money as per the Net Asset Value (NAV) on the date of withdrawal. Likewise, the new investors may enter the MF scheme by purchasing its units at the Net Asset Value (NAV) on the date of entry.
The operation of a mutual fund is governed, controlled and supported by Trust, AMC, SEBI, Fund Manager etc. It is explained in diagrammatic form as follows.

![Diagram: Functioning of a Mutual Fund](image)

3.1.4: WHO CAN INVEST IN MUTUAL FUND?

Basically, the mutual funds were evolved to attract the savings of small/retail investors. However, the following entities such as Banks and Non-Banking Financial Institutions (NBFIs), Insurance Corporations/Companies, Provident Funds, Trusts, Foreign Institutional Investors (FIIs) registered with SEBI, Corporate, Retail Investors (i.e. Individuals), Non-Residents Indians (NRIs) and Overseas Corporate Bodies can invest in mutual funds. However, foreign citizens are not allowed to invest in Indian mutual funds.

3.1.5: ENTRY AND EXIT OF INVESTORS IN MUTUAL FUND

Mutual fund is comparatively a new avenue for investors in India hence it is imperative to know as to how an investor can enter in and exit from a MF scheme.

(I) Entering a Mutual Fund: The mutual funds generally come in two packages—Open-ended and Close-ended funds. The investor can enter into any or both of these schemes. However, the mode of entering in these schemes differs.

**Entering into an Open-ended Mutual Fund:** The investor can enter in open-ended mutual fund at the beginning through New Fund Offer at price of Rs. 10/- per unit or at any time thereafter at the prevailing Net Asset Value.

**Entering into a Close-ended Mutual Fund:** In a close-ended mutual fund, an investor can enter only at the time the scheme is launched and not afterwards.

**Entry Modes:** There are following two options for entering into a mutual fund scheme.

(i) **Lumpsum:** i.e one time investment in the scheme.
(ii) **Systematic Investment Plan (SIP):** Investing every month. A stipulated amount automatically goes out of their savings account into a scheme of their choice.

(II) **Exiting from a Mutual Fund**

*Exiting from an Open-ended Mutual Fund:* The investor can exit from an open-ended mutual fund at any time as per rules.

*Exit Modes:*

(i) **Lumpsum withdrawal** i.e. the investor can withdraw all money at one time

(ii) **Partial withdrawal** i.e. the investor can partially withdraw his/her money from MF scheme. It is known as Systematic Withdrawal Plan (SWP). The investor can withdraw some money regularly over a period of time.

*Exiting from a Close-ended Mutual Fund:* An investor cannot exit from MF scheme till the term of the scheme comes to an end.

**3.1.6: PROS AND CONS OF INVESTING IN MUTUAL FUND**

No investment avenue is risk-free and only returns-generating. Every investment avenue carries certain degree of risk. Hence, many a times, it may happen that the investor derives benefits and at the same time foregoes the same that would have been derived in other most profitable avenue. It would, therefore, be like remaining under wrong impression to regard mutual fund investment is always fruit giving. As it happens in all other types of investment avenues, there are certain *pros* and *cons* of investing in mutual funds.

(I) **Benefits of investing in Mutual Funds**

Mutual funds as an investment option have become very attractive for retail investors who are interested in the financial markets but do not have the time, expertise and experience in good stock picking. The problems faced by small investors in the share market have been offset by the emergence of mutual funds. It has now become a common and reliable investment in India. The popularity of mutual funds has increased because it derives the following benefits.

1. **Professionally Managed:** Mutual funds are always managed by professionals who have expertise and experience in investing funds. They are well qualified and remain constantly in touch with the market. Long-term planning of investment is evolved by fund managers.

2. **Benefits of Diversification:** There are limitations on an individual to hold more number of stocks and in large quantity. However, by investing in a mutual fund scheme an investor can avail the opportunity to hold wide spectrum of securities.
3. Reduced Transaction Costs: The mutual funds buy and sell the securities in large quantity, which helps reduce the transaction cost per unit-holder.

4. Liquidity: A major service offered by mutual funds is liquidity. Mutual funds allow their investors to liquidate their holdings as and when they want. Only the close-ended MFs have lock-in period, during which the investor cannot exit. However, the investor can sell his units in stock market if the MF is listed on bourses.

5. Small Amount Required: Compared to other investment avenues like gold, real estate and even stocks which calls for large amount to invest in, the investment in mutual fund can be started with a little amount at hand. One can start investing in a mutual fund just by Rs. 2000/- or as little amount as Rs. 100/-per month under SIP.

6. Risk-Spread: The risk in investment is spread over a large number of unit holders.

7. Transparency: The organizational structure of a Mutual Fund and its regulation is such that all information including risk factors, charges, expense ratio and NAV is disclosed periodically, in the form of a Bulletin, web-pages and SMS services. Further, the information on the performance of the mutual funds, schemes, fund managers etc. is disseminated.

8. Wider Choice: There are around 45 MF houses and thousands of MF schemes launched by wholly government undertaking like UTI, public sector bank sponsored, privates sector, foreign players etc. The investors can choose any of the MF scheme as per their requirement and convenience. Mutual funds provide ‘funds for all reasons and all seasons’

9. Reinvestment Facility: The investors are given two options about dividend. They may either withdraw dividend or reinvest it in the scheme. This automatic reinvestment of dividends may enhance the capital gains

10. More Flexibility: Mutual funds offer flexibility in respect of entry in and exit from the fund through different modes as well as withdrawal of dividend or its reinvestment.

11. Well Regulated: Mutual funds are regulated by different regulators such as SEBI, RBI, Company Law Board, Ministry of Finance, Office of Public Trust etc. hence the investors regard mutual funds as the safe conduit for their savings.

(II) Disadvantages of investing in Mutual Funds

Though there are many motives which may magnetize the investors towards mutual funds, there are some limitations which may drive them away from investing.
in mutual funds. The following may be regarded disadvantages or limitations for a mutual fund investor.

1. **Slithering from objectives:** One of the important parameters in the selection of fund is alignment of the risk profiles of investor and fund. The objective of the fund says a lot about how the fund plans to invest. Non-compliance of the stated investment objectives may drive the investors away from mutual funds.

2. **Cost control not in the hands of investors:** Investor has to pay the fund distribution cost (entry and exit loads) and investment management fees as a percentage of the value of the holdings as long as holding continues, irrespective of performance of the fund.

3. **Difficulty in choosing the right fund:** There is a plethora of thousands of schemes issued by a number of Mutual Fund houses from public and private sectors, with varying objectives and degree of risk. This state of affair just enhances the confusion of investors, especially the beginners.

4. **Personal tax situation ignored:** The Fund Managers do not consider the personal tax situation of an investor. For example, when a Fund manager sells a security after 12 months, the Capital Gain Tax is triggered. This affects how profitable the investor is from such a sale. It might have been more advantageous for the investor to defer the liability of Capital Gain Tax.

5. **Gain or loss, dependent upon Fund Managers’ vigor and action:** Generally mutual funds are accepted as an indirect mode of investing in share market, which is bother-less as the responsibility of investment decision making is budged to Fund Manager. His expertise, dynamism, alertness, rational decision making, skill of swinging with market trend etc. all determine the destiny of the fund itself and of investors. The genuine investor might suffer at a loss for the professional malfunctioning of Fund Managers.

**3.2: REGULATORS OF MUTUAL FUND**

Investment market, like other markets, depends upon credibility and fairness. It is crystal-clear that lack of adequate regulations can lead to manipulations and market abuses, which endanger the market-integrity and damage investor’s confidence. Hence, a sound regulatory framework is expected to provide transparency, maintain market-integrity, fairness and ensure investor protection. The very existence of a regulatory body improves the confidence of market participants and investors. Obviously, the better regulation leads to better participation of

*Ph.D. Thesis*
investors. Mutual funds are subject to strict regulation and supervision by various regulators in general and SEBI in particular. These are as follows.

(1) **The Securities and Exchange Board of India (SEBI):** The Securities and Exchange Board of India (SEBI), formed in 1992 as the apex body to regulate Indian capital market, had come out its first Mutual Fund Regulations in 1993. A major task of SEBI is to provide assurance that it is safe to undertake transactions in corporate securities. It was empowered adequately and assigned the responsibility to (a) protect the interests of investors in securities, (b) promote the development of securities market, and (c) regulate the securities market.

SEBI’s regulatory jurisdiction extends over corporate in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with Securities Market. All market intermediaries are registered and regulated by SEBI. By virtue of this, Mutual Funds, being intermediaries, are registered and regulated by SEBI. The Mutual Funds Department is responsible for the regulation of mutual funds that operate in the securities market.

SEBI has issued guidelines to govern mutual fund operations, their investments, income-expense accounting and disclosures for investor protection, among others. SEBI has stressed on market discipline through enhanced transparency and disclosure requirements.

SEBI has expressed the need for creation and compliance mechanism for mutual fund industry in the guidelines issued under Mutual Fund Regulations of 1993. These regulations were revised and enlarged subsequently in 1996. With the SEBI (Mutual Fund) Regulations, all mutual funds have been brought under a common regulatory framework to ensure greater degree of transparency in their operations and adherence to a common structure. These regulations spell out numerous restrictions.
and requirements designed to protect the interests of investors, and ensure that each mutual fund scheme is managed and operated in the best interest of its unit holders.

(2) **Reserve Bank of India (RBI):** RBI plays dual supervisory role in regulating mutual funds. RBI and SEBI both jointly regulate the bank-sponsored mutual funds such as SBI Mutual Fund, Bank of India Mutual Fund etc. SEBI regulates the market related and investor related aspects, while RBI regulates the issues relating to ownership of AMC, fund mergers, capital adequacy for assured returns etc. Money Market Mutual Fund (MMMF) guidelines were formulated in 1995 and banking institutions and private sector were allowed to set up money market mutual fund.

(3) **Ministry of Finance (MoF):** Truly speaking, it is an indirect but strong regulator of mutual fund industry. Ministry of Finance supervises both RBI and SEBI. MoF plays the role of appellate authority for disputes regarding SEBI guidelines.

(4) **Company Law Board (CLB):** Company Law Board is the apex regulatory authority under Indian Companies Act, 1956. CLB is a body especially constituted by Central Government for carrying out judicial proceedings with respect to company affairs. It has legal standing of a civil court, and may call for inspection of documents and enforce attendance.

Department of Company Affairs (DCA) carries the overall responsibility of formulating and modifying regulations relating to companies.

Registrar of Company (ROC) ensures the Asset Management Company (AMC) or Trustee Company, as the case may be, is in compliance with all relevant provisions of Companies Act. All AMC’s accounts and records are filed with ROC, which acts as a watchdog.

(5) **Office of Public Trust:** The office of Public Trust regulates the operations Board of Trustees or the Trustee Company. The Board of Trustees is accountable to the Office of Public Trust, which reports to Charity Commissioner.

(6) **Self-Regulatory Organizations (SROs):** Self-regulatory organizations (SROs) are organizations, which group market participants and have been granted some powers to regulate their own members. For example a Stock Exchange regulates its members under overall supervision of SEBI. Generally, SROs regulate admissions of members, set code of conduct to be observed by members, frames rules and by-laws etc.

There is such an organization formed by all mutual funds named as Association of Mutual Funds of India (AMFI), which regulates the membership and frames rules and by-laws to be followed by all member mutual funds.
3.3: ROLE OF AMFI

The Association of Mutual Funds in India is an SRO (Self-Regulatory Organization) incorporated on August, 22, 1995, by various mutual funds. As of March, 2013, all mutual funds in operation are its members.

AMFI’s vision is ‘Developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.’

AMFI undertakes investor education and training of agent distributors. AMFI works through different committees such as Committee on Valuation, Committee on Certification Programme for Intermediaries and Employees, Committee on Best Practices, Committee on RBI Related Matters, Committee on Risk Management System for Mutual Funds, Committee on Registration of AMFI Certified Distributors, Committee on AMFI Taking the Role Self-Regulatory Organization (SRO) etc.

Mutual funds investing solely in equity compare their performance with various equity indices like Sensex, Nifty, BSE-PSU and BSE-Teck etc. For the benefit of mutual funds investing in debt and money market instruments, AMFI came out with the Mutual Fund Benchmark Indices in March, 2002. All these indices have as their base, the prices as on 31st March, 2003. These indices are ---Crisil Composite Bond Fund Index, Crisil MIP Blended Index, Crisil Balanced Fund Index, Crisil Liquid Fund Index, I-Sec i-BEX and I-Sec Composite Index etc.

AMFI publishes certain industry relevant data in its year books, annual reports and quarterly updates, data in the year book and quarterly updates includes latest regulatory information, industry statistics like sales during the period, new schemes launched, gross and net inflow and outflow of funds into the industry, total assets under management of various categories of schemes based on ownership (UTI, Bank-sponsored and Private etc.) and investment objectives (Income, Growth and Balanced etc.) It also gives the total assets under management by each individual AMC to endure fairness to investors and to avoid unfair competition and trade practices among various AMCs.

3.4: STRUCTURE, CATEGORIES AND TYPES OF MUTUAL FUNDS

While over-viewing the mutual fund industry, it would here be imperative to understand the structure, categories and types of mutual funds.
3.4.1: STRUCTURE OF MUTUAL FUNDS

Mutual funds come in two packages namely open-ended and close-ended. An open ended scheme allows the investor to enter and exit at his convenience, anytime (except under certain conditions) whereas a close ended scheme restricts the freedom of entry and exit. Whenever a new fund is launched by an AMC, it is known as New Fund Offer (NFO). Units are offered to investors at the par value of Rs. 10/unit. The structure of mutual funds has been briefly discussed hereunder.

Open-Ended and Close-Ended Mutual Funds: In case of open ended schemes, investors can buy the units even after the NFO period is over. Thus, when the fund sells units, the investor buys the units from the fund and when the investor wishes to redeem the units, the fund repurchases the units from the investor. This can be done even after the NFO has closed. The buy / sell of units takes place at the Net Asset Value (NAV) declared by the fund. The freedom to invest after the NFO period is over is not there in close ended schemes. Investors have to invest only during the NFO period; i.e. as long as the NFO is on or the scheme is open for subscription. Once the NFO closes, new investors cannot enter, nor can existing investors exit, till the term of the scheme comes to an end. However, in order to provide entry and exit option, close ended mutual funds list their schemes on stock exchanges. This provides an opportunity for investors to buy and sell the units from each other. This is just like buying / selling shares on the stock exchange. This is done through a stock broker. The outstanding units of the fund do not increase in this case since the fund is itself not selling any units. Sometimes, close ended funds also offer ‘buy-back of fund shares / units”, thus offering another avenue for investors to exit the fund. Therefore, regulations drafted in India permit investors in close ended funds to exit even before the term is over. Open-ended funds have ‘fixed corpus and fixed maturity’, while close-ended funds have ‘variable corpus and no fixed maturity.’ In India, open-ended mutual funds are more popular.

3.4.2: MUTUAL FUND CATEGORIES

Mutual funds are available in following categories.

- **Equity / Growth Funds**: These funds essentially invest the investor’s money in equity shares of companies, which is a risky avenue.
• **Debt/Bond Funds:** These funds are funds which invest money in debt instruments such as short and long term bonds, government securities, treasury-bills, corporate paper, commercial paper, call money etc.

• **Hybrid/ Balanced Fund:** These funds invest the unit holders’ money in both equity and debt in a certain proportion as described in the scheme.

• **Money Market Fund:** These funds invest the investors’ money in money market instruments, which have maturities not exceeding one year. They are also known as liquid funds.

**3.4.3: MUTUAL FUND PRODUCT VARIETY**

Over the years, Indian Mutual Fund industry has evolved a number of mutual fund schemes compatible to investors of different categories, falling in either of the above mentioned categories.

(I) **PRODUCT VARIETY UNDER EQUITY FUNDS**

(a) **Growth Funds:** This is an aggressive investing type of fund. These funds mainly invest in equity stocks of companies, which are expected to perform better than market. The primary objective of such funds is to seek long-term capital appreciation (i.e. growth of capital). These funds are suitable to the investors desiring their capital to grow.

(b) **Mid-Cap Funds:** These funds invest in mid-sized companies, which grow at a faster rate than large companies do.

(c) **Value Funds:** These are value investing funds. Investment of these funds is mainly in equity stocks whose current valuation does not reflect some underlying value proposition.

(d) **Equity Income Funds:** The portfolio of these funds is focused primarily on dividend yields.

(e) **Index Funds:** Index funds are portfolio of securities, which have been specially designed to represent the characteristics and attributes of a chosen target index.

(f) **Exchange Traded Funds (ETFs):** These funds provide exposure to a selected index be it equity or debt. ETFs have a number of advantages over traditional open-ended index funds as they can be bought and sold on the Stock Exchange at prices that are usually close to the actual intra-day NAV of the scheme. ETFs were first launched in USA in 1993.
(g) **Sector Funds/ Segment Specific Funds:** These funds invest mainly in specific sector stocks. These funds concentrate in particular industry, such as Technology, Telecommunication, FMCG, Petroleum, Automobile etc.

(h) **Large Cap, Mid Cap and Small Cap Funds:** This is another variety of mutual funds. The Large Cap Funds invest only in blue chip companies and the Mid-Cap Funds invest in the shares of the companies with capitalization in medium range, while the Small-Cap Funds invest in the shares of the companies with low market capitalization.

(i) **Equity Linked Savings Schemes (ELSS):** These funds invest in equity and equity related instruments with an objective to produce long-term appreciation. The only difference between an Equity Fund and ELSS is that the latter has a 3-year lock-in period and tax-benefit like other tax saving products such as PPF, NSC etc.

(II) **PRODUCT VARIETY UNDER BOND/ DEBT/ INCOME FUNDS**

(a) **Corporate Bond Fund:** These funds invest in bonds issued by companies. The objective of these funds is to produce higher levels of income. Triple A (AAA) rated bonds are generally preferred for investment.

(b) **Gilt Schemes:** These funds invest money in securities issued by Government of India and/or the State Governments. The portfolio of G-Sec is free of credit risk (i.e. the risk of default by the issuer). The only risk associated with this fund is interest rate risk.

(c) **Floating Rate Scheme:** Floating rate funds are very popular abroad, which have entered in Indian mutual fund industry in the recent past. These funds provide a hedge to investors against volatile interest rates. These funds primarily make investments in floating rate debt instruments, popularly known as ‘floaters’ (i.e. securities whose interest rates get reset at periodic intervals)

(d) **Liquid Funds:** These funds invest in ultra short term instruments which have maturity below 91 days. These are favourite funds of corporate as they invest predominantly in these funds for their ‘Treasury Management.’ Some investors prefer these funds as a substitute for savings bank deposits.

(III) **PRODUCT VARIETY UNDER BALANCED/HYBRID FUNDS**

(a) **Balanced Funds:** These funds invest in equities and debts in a certain proportion. Balanced funds have objectives of payment of current income, moderate capital appreciation and preservation of capital. Generally NAV of balanced funds move in
narrower range and is not volatile as that of equity funds. These funds perform better than equity funds in bearish phase but lag behind in bullish phase.

(b) **Asset Allocation Funds:** These funds invest in a variety of securities in different asset classes. The purpose of these funds is to provide investors with truly diversified holdings and consistent returns while sparing the investors the trouble of having to accomplish asset allocation at different market conditions. Composition of asset classes may be stable or variable as per the strategy of the fund. Asset allocation plan may range from very ‘conservative’ (i.e. less proportion of equity) to very ‘aggressive’ (i.e. more proportion of equity)

(iv) **OTHER FUNDS**

(a) **Commodity Funds:** Specialized funds may invest in a single commodity or a commodity group such as edible oil or grains while diversified commodity funds spread their assets over many commodities. These funds also invest in precious metals.

(b) **Real Estate Funds:** Specialized real estate funds invest in real estate directly or may fund real estate developers or lend them or buy shares of housing finance companies.

It can be understood here that mutual funds are available for all reasons and all seasons. While a large number of mutual fund products with varied ‘risk-return-liquidity’ profiles are available in the market, the investor has to be selective in choosing the schemes that are most suitable to his/her current and future needs.

3.5: **CUSTOMER SERVICES PROVIDED BY MUTUAL FUND**

Generally, the mutual funds provide the following specific services to investors as their valued customers.

(1) **Variety of Products:** Mutual funds provide a wide range of variety of investment products to their investors.

(2) **Variety of Options:** Different options are provided to mutual fund investors such as growth option, income option, dividend option, dividend re-investment option etc.

(3) **Systematic Investment Plan (SIP):** This is a facility of investing a fixed amount every month or any frequency for a pre-decided period of time usually six months to one year through post-dated cheques at applicable NAV-related prices. This facility helps the investors to average out their cost of investments over a period of 6 months or a year and thus overcome the short term fluctuations in the market.
(4) **Systematic Withdrawal Plan (SWP):** This is a mirror image of SIP, under which the facility of withdrawing a fixed amount periodically from mutual fund investment is provided.

(5) **Switch Facility:** This is a unique facility of switching units between growth plan, dividend plan and any other plan and options within the plan under a scheme, at applicable NAV based prices. Besides, the unit holders under a scheme may exchange their units for units of the other schemes(s).

(6) **Gift Facility:** The unit holders can write to AMC/Registrar requesting for the gift form to gift the units (by way of transfer of units to donee), to the extent provided in the regulations.

(7) **Facility of On-line Dealing:** On-line mutual fund bazaar is available on Internet. Mutual funds provide a wide range of services on net. The on-line facility of buying, switching and redeeming units is provided to investors.

(8) **Up-to-date Information:** Mutual funds provide up-to-date information about all its transactions, NAV and other mandatory disclosures on net. This helps to ensure transparency and reliability. Performance of the fund is communicated continuously through bulletins/ factsheets and also posted on webpages.

(9) **Accessibility:** Mutual fund units are available through a variety of sources such as agents, brokers, distributors, select banks and post offices and directly from the fund. Many of mutual funds can be bought on-line. In recent times a few mutual funds have made units available through ATM.

(10) **DeMat Facility:** Mutual fund units can be held in DeMat form.

(11) **Investor Education:** Mutual funds take efforts to educate investors in their financial planning.

### 3.6: THE EVOLUTION AND HISTORY OF MUTUAL FUNDS

The origin of mutual fund can be traced back to Europe where William-I established a society in Belgium for collective investment. Comparatively, for Indians the idea of mutual fund as collective investment vehicle is a latest phenomenon. The evolution and history of mutual fund has been studied at global/world level as well as in India.

#### 3.6.1: THE GLOBAL SCENARIO

The basic idea of pooling money dates back to 1822, when groups of people in Belgium established a company to provide finance to industries of national
importance, under the name of ‘Societe Generale de Belgique.’ It was this first ever known effort that laid down the concept of risk sharing.

In 1822, King William-I of Netherlands came up with a close-end fund. In 1860, this phenomenon spread to England and resultantly, the Foreign and Colonial Government Trust of London was formed in 1868, which was the real pioneer to spread risk of investors over a large number of securities. In 1873, Robert Fleming, established ‘The Scottish American Trust’. However, though, British Investment Trusts invested in American stocks, the first American Investment Trust was the close-end Boston Personal Property Trust, which was created in 1893. Mutual fund in America is basically the concept of Unit Trust of Britain. In America, the first fund, ‘Massachusetts Investment Trust’ was established on March 21, 1924 for the professors of Harvard University and offered shares to the public in 1926. Sherman L. Adams is regarded as the father of modern mutual fund, who along with Charles Learoyd and Ashton Carr established a modest portfolio of 45 common stocks worth $ 50,000.3 The first mutual fund set up in Canada in 1932 was the Canadian Investment Fund followed by Commonwealth International Corporation Limited and Corporate Investors Limited.

By 1930’s, 920 mutual funds were formed in U.S.A. and most of them were close-ended even though the crash of stock markets in 1929 had led to the demise of many funds. However, the American mutual fund industry was revived with the enactment of Securities Act in 1933, the Investment Company Act in 1940 and Investment Advisors’ Act in 1940. In the next decade the favourable effects of these measures were seen as the value of securities owned by American Mutual Funds shot up to $ 2.5 billion at the end of 1950.4

Though, the mutual fund industry in Japan dates back to 1937 an investment trust modeled on the unit-trusts of United Kingdom was actually established only in 1941. In Japan, mutual funds are known as Investment Trusts; however they are different from the investment trusts operating in U.K. With the prime objective of meeting the changing requirement of government policy, The Japanese Investment Trusts were established, under the Securities Investment Law of 1951, bearing three most important characteristics of contractual nature, open-end and flexibility.

The individuals and institutional investors became extremely sensitive to the true value of money because of increasing inflation and interest rates during 1990’s. Since the beginning of 1990, investors have poured over half a trillion dollars into
stock and bond mutual funds. In 1990, American mutual fund industry was comprised of 2,362 mutual funds with over 3.96 crore investors holding $570.8 billions of assets. Further, by the end of 1994 in U.S.A., mutual funds had become the second largest financial institution after the banking sector holding assets worth USD 2161.4 billion. In 1995, U.K. equity income category had the highest number of account holders (11, 86, 365).\(^5\)

Further, the directives issued in December 1995 by European Community, under the name ‘Undertakings for Collective Investment in Transferable Securities’ aimed at coordinating regulations and administrative provisions relating to mutual fund, established the common regulatory scheme for investment policies, public disclosure, structure of organization, and regulations to encourage the growth of mutual funds all over the globe. Resultantly, Hong Kong, Thailand, Singapore and Korea got the momentum for development of mutual fund industry. The mutual fund in its present structure is a 20\(^{th}\) century phenomenon. Now mutual fund is omnipresent all over the globe. As on today, globally there are thousands of mutual funds, which offer wide-ranging schemes with different investment objectives and options. At the end of March, 2011, the number of mutual funds stood 19,799 having assets under management of 13,513,324 million USD. The following table throws light on growth and development in number of Mutual Funds and Assets under Management in the world upto 2011.

**Table: 3.6.1 (A)**

<table>
<thead>
<tr>
<th>Continent</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas* (Of which United States)</td>
<td>13763 (7974)</td>
<td>14475 (8118)</td>
<td>15459 (8026)</td>
<td>16459 (8022)</td>
<td>16953 (7684)</td>
<td>18018 (7580)</td>
<td>19799 (7637)</td>
</tr>
<tr>
<td>Europe** (Of which United Kingdom)</td>
<td>30060 (1680)</td>
<td>33151 (1903)</td>
<td>35210 (2057)</td>
<td>36780 (2371)</td>
<td>34899 (2266)</td>
<td>35292 (2204)</td>
<td>35713 (1941)</td>
</tr>
<tr>
<td>Asia &amp; Pacific*** (Of which India)</td>
<td>12427 (445)</td>
<td>13479 (468)</td>
<td>14847 (555)</td>
<td>14909 (551)</td>
<td>14795 (590)</td>
<td>15265 (658)</td>
<td>16198 (680)</td>
</tr>
<tr>
<td>Africa (South Africa)</td>
<td>617</td>
<td>750</td>
<td>831</td>
<td>884</td>
<td>904</td>
<td>943</td>
<td>947</td>
</tr>
<tr>
<td>World Total</td>
<td>56867</td>
<td>61855</td>
<td>66347</td>
<td>69032</td>
<td>67551</td>
<td>69518</td>
<td>72657</td>
</tr>
</tbody>
</table>

*Inclusive of Argentina, Brazil, Canada, Chile, Costa Rica, Mexico, Trinidad & Tobago & United States
**Inclusive of Austria, Belgium, Bulgaria, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey & United Kingdom.
***Inclusive of Australia, China, Hong Kong, India, Japan, Rep. of Korea, New Zealand, Pakistan, Philippines & Taiwan

Source: 2012 Investment Company Fact Book-Table 61 Data Section-7, pp 194
### Table: 3.6.1. (B)

**Worldwide Assets under Management (Year End Figures)**

(In Million of USD)

<table>
<thead>
<tr>
<th>Continent</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas*</td>
<td>9750205</td>
<td>11470489</td>
<td>13423089</td>
<td>10581988</td>
<td>12585776</td>
<td>13586843</td>
<td>13513324</td>
</tr>
<tr>
<td>(Of which United States)</td>
<td>(8891108)</td>
<td>(10397935)</td>
<td>(12001463)</td>
<td>(9603649)</td>
<td>(11120153)</td>
<td>(11820650)</td>
<td>(11621595)</td>
</tr>
<tr>
<td>Europe**</td>
<td>6002310</td>
<td>7803877</td>
<td>8934861</td>
<td>6231116</td>
<td>7545535</td>
<td>7903389</td>
<td>7220298</td>
</tr>
<tr>
<td>(Of which United Kingdom)</td>
<td>(547092)</td>
<td>(755163)</td>
<td>(897460)</td>
<td>(504681)</td>
<td>(729141)</td>
<td>(854413)</td>
<td>(816537)</td>
</tr>
<tr>
<td>Asia &amp; Pacific***</td>
<td>1939251</td>
<td>2456492</td>
<td>3678325</td>
<td>2037536</td>
<td>2715234</td>
<td>3067323</td>
<td>2921277</td>
</tr>
<tr>
<td>(Of which India)</td>
<td>(40546)</td>
<td>(58219)</td>
<td>(108582)</td>
<td>(62805)</td>
<td>(130284)</td>
<td>(111421)</td>
<td>(87519)</td>
</tr>
<tr>
<td>Africa</td>
<td>65594</td>
<td>78026</td>
<td>95221</td>
<td>69417</td>
<td>106261</td>
<td>141615</td>
<td>124976</td>
</tr>
<tr>
<td>(South Africa)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Total</td>
<td>17757360</td>
<td>21880884</td>
<td>26131496</td>
<td>18920057</td>
<td>22952806</td>
<td>24699170</td>
<td>23779874</td>
</tr>
</tbody>
</table>

*Inclusive of Argentina, Brazil, Canada, Chile, Costa Rica, Mexico, Trinidad & Tobago & United States

**Inclusive of Austria, Belgium, Bulgaria, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey & United Kingdom.

***Inclusive of Australia, China, Hong Kong, India, Japan, Rep. of Korea, New Zealand, Pakistan, Philippines & Taiwan

Source: 2012 Investment Company Fact Book-Table 60 Data Section-7, pp 193

### 3.6.1. (B): Worldwide Assets under Management as on 31/03/2012

**3.6.2: INDIAN SCENARIO**

In India, the concept of mutual fund was actually coined in 1964, by the then visionary Finance Minister Hon’ble T.T.Krishnamachari. Based on the recommendations of the Central Banking Enquiry Committee and Shroff Committee, the Government of India established Unit Trust of India in 1964 by passing the special Act in Parliament (i.e. Unit Trust of India Act, 1963) , to operate as a financial
institution as well as an investment trust by way of launching US 64 on 1st July, 1964. Its primary objective was to provide investors from middle and lower income groups with a route to invest in the equity market. It was also meant to encourage household savings. US-64 was the first ever mutual fund scheme launched in Indian market, which mobilized the savings of Rs. 246.7 million. SBI Mutual Fund became the second mutual fund in the Indian market when it was launched in 1987, till then UTI enjoyed a monopoly in India. By then US-64 had grown to Rs. 32.69 billion and overall asset base of UTI was Rs. 67.38 billion with 25 different schemes.

3.6.3: DIFFERENT PHASES OF GROWTH AND DEVELOPMENT OF MUTUAL FUND INDUSTRY IN INDIA

As mentioned above, the Indian mutual fund industry has evolved from a single player monopoly in 1964 to a fast growing competitive market on the back of a strong regulatory framework. The primary objective at that time was to attract the small investors and it was made possible through the collective efforts of the Government of India and the Reserve Bank of India. The history of mutual funds in India can be broadly divided into four distinct phases.

First Phase: 1964-1987 (Establishment and Monopoly of UTI)

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. Unit Trust of India enjoyed complete monopoly till 1987. The first scheme launched by UTI was Unit Scheme 1964, which attracted the largest number of investors in any single investment scheme over the years. In 1966, Reinvestment Plan was introduced under the same scheme to provide capital appreciation.

Further in 1970s and 80s, UTI launched more innovative schemes to suit the needs of different investors class. Unit-Linked Insurance Plan (ULIP) was introduced in 1971 to provide life/accidental insurance coverage besides regular income and six more schemes were introduced between 1981-84, Children's Gift Growth Fund and India Fund (India's first offshore fund) in 1986, Master Share (India's first equity diversified scheme) in 1987 and Monthly Income Schemes (offering assured returns) during 1990s. UTI introduced series of investment schemes with varied objectives for different strata of investing public based on their risk-return-liquidity profile. By the
end of 1987, UTI's assets under management grew ten times to Rs 6700 crores.

**Second Phase: 1987-1993 (Entry of Public Sector Mutual Funds)**

The second phase indicated the entrance of non-UTI, public sector mutual funds in the market. The SBI Mutual Funds was the first in the list (June 1987) and was followed by many others like Canbank Mutual Fund, Punjab National Bank Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund, Bank of Baroda Mutual Fund, LIC and GIC.

Liberalization was the turning point to the industry as private players were allowed to participate in the industry for the first time. In 1993-94, Morgan Stanley, Kothari Pioneer Mutual Fund, and Taurus Mutual Fund launched their maiden schemes. The industry, since then, has grown manifold. The good performance of the economy coupled with the low interest rates on bank deposits and tax concessions, contributed to the growth of the mutual funds. By the end of 1993, the Indian mutual fund industry held assets worth Rs. 47,004 crore under its management.

**Table 3.6.3**

<table>
<thead>
<tr>
<th>Fund Mobilization and AUM in the Second Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
</tr>
<tr>
<td>UTI</td>
</tr>
<tr>
<td>Public Sector</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

*Source: www.amfinidia.com*

**Third Phase: 1993-2003 (Emergence of Private Sector Mutual Funds)**

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. The permission was granted to foreign management companies which entered in Indian mutual fund industry through joint venture mode. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed SEBI (Mutual Funds) Regulations. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993. The private mutual funds introduced a variety of innovative products, investment techniques and investor-servicing technology. By 1994-95, about 11 private sector funds had launched their various schemes in Indian market.

In order to promote the confidence among investors, all mutual funds in India evolved self-regulation under the aegis of the Association of Mutual Funds of India (AMFI) which was incorporated on August 22, 1995 as a non-profit organization.
Fourth Phase: SEBI Regulation and Growth of Mutual Fund during 1996-2004

Further, the 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996. The mutual fund industry witnessed vigorous growth and stricter regulation from the SEBI especially after 1996. SEBI set uniform standards for all mutual funds in India. The feeling that investors' interests were well safeguarded by SEBI and tax benefits offered by government of India to mutual fund investors encouraged many people towards mutual funds. As investors started showing more interest in mutual funds, the number of players operating in the industry and fund mobilization by them reached new heights.

The number of mutual fund houses went on increasing, with many Foreign Mutual Funds setting up funds in India and also the industry witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs.44,541 crores of assets under management was way ahead of other mutual funds.

AMFI as the voluntary association of Indian mutual funds and SEBI as the regulator of mutual funds jointly implemented various ‘Investor Awareness Programmes’ during this phase with an intention to educate investors and make them informed about the mutual fund industry. Further, in February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. The primary objective behind this was to bring all mutual fund players on the same level. As a result of this, UTI was reorganized into two parts: (1) The Specified Undertaking, and (2) The UTI Mutual Fund. Presently Unit Trust of India operates under the name of UTI Mutual Fund and its past schemes (like US-64, Assured Return Schemes) are being gradually wound up. Despite this, the fact is that UTI Mutual Fund is still the largest player in Indian mutual fund industry.

The Specified Undertaking of the Unit Trust of India with assets under management of Rs. 29,835 crores as at the end of January 2003, representing broadly, the assets of US-64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, 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. 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 to provide an optimal environment for investors.
Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs.76,000 crores of assets under management and with the setting up of 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 funds, which manage assets of Rs.153108 crores under 421 schemes.

Table: 3.6.3. (A)

<table>
<thead>
<tr>
<th>Period</th>
<th>Mutual Funds (Rs. In Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>UTI</td>
</tr>
<tr>
<td>1/04/1998</td>
<td>31/03/1999</td>
</tr>
<tr>
<td>1/04/1999</td>
<td>31/03/2000</td>
</tr>
<tr>
<td>1/04/2000</td>
<td>31/04/2001</td>
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<tr>
<td>1/04/2001</td>
<td>31/03/2002</td>
</tr>
<tr>
<td>1/04/2002</td>
<td>31/03/2003</td>
</tr>
<tr>
<td>1/04/2003</td>
<td>31/03/2004</td>
</tr>
</tbody>
</table>

Source: www.amfinidia.com & indiainfoline.com

Fifth Phase: Growth and Consolidation - 2004 Onwards

The industry touched Rs. two trillion in September 2005. The growth rate of the industry scaled up, as the next milestone of Rs. three trillion was reached in August 2006. The industry has also witnessed several mergers and acquisitions recently, examples of which are acquisition of schemes of Alliance Mutual Fund by Birla Sun Life, Sun F&C Mutual Fund and PNB Mutual Fund by Principal Mutual Fund. Simultaneously, more international mutual fund players have entered India like Fidelity, Franklin Templeton Mutual Fund etc. There were 29 funds as at the end of March 2006. This is a continuing phase of growth of the industry through consolidation and entry of new international and private sector players.

Table: 3.6.3. (B)

<table>
<thead>
<tr>
<th>Period</th>
<th>Mutual Funds (Rs. In Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>UTI</td>
</tr>
<tr>
<td>1/02/2004</td>
<td>31/03/2005</td>
</tr>
<tr>
<td>1/04/2005</td>
<td>31/03/2006</td>
</tr>
<tr>
<td>1/04/2006</td>
<td>31/03/2007</td>
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<tr>
<td>1/04/2007</td>
<td>31/03/2008</td>
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<td>1/04/2008</td>
<td>31/03/2009</td>
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<td>1/04/2009</td>
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<td>1/04/2011</td>
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</tr>
<tr>
<td>1/04/2012</td>
<td>31/03/2013</td>
</tr>
</tbody>
</table>

Source: www.amfinidia.com & indiainfoline.com
3.6.4: SPECTACULAR GROWTH OF INDIAN MUTUAL FUND INDUSTRY SINCE INCEPTION (1963-64 to 2011-2012)

The following table exhibits the growth of Indian mutual fund industry since its inception in 1963 till end-March, 2012, in terms of number of schemes launched in the market and the assets under management.

(I) ASSETS UNDER MANAGEMENT:

The Assets under Management (AUM) is a typical term used in the world of mutual funds. It is regarded as one of the important parameters to measure the performance of the industry. It is the core part, though not an ultimate part, of the performance of MF industry as to how many assets (in INR) are under the management of the mutual fund houses. Indian Mutual Fund industry is different from others in the world as regards its phase of development. In India, in the initial years there was only one mutual fund operating in the market that is UTI. Thereafter it was made open to Public Sector institutions in 1987 and to private sector in 1993. This unique feature of its development has hampered its growth in terms of AUM. The following table exhibits the growth in AUM of Indian MF industry since inception till FY 2012.

Table: 3.6.4.
Growth of Indian Mutual Fund Industry (In terms of AUM) since inception (1963-64 to 2011-2012) (Rs. In Crores)

<table>
<thead>
<tr>
<th>Year (1964-65)</th>
<th>AUM</th>
<th>Year (1966-67)</th>
<th>AUM</th>
<th>Year (1967-68)</th>
<th>AUM</th>
<th>Year (1968-69)</th>
<th>AUM</th>
<th>Year (1969-70)</th>
<th>AUM</th>
<th>Year (1970-71)</th>
<th>AUM</th>
<th>Year (1971-72)</th>
<th>AUM</th>
<th>Year (1972-73)</th>
<th>AUM</th>
<th>Year (1973-74)</th>
<th>AUM</th>
<th>Year (1974-75)</th>
<th>AUM</th>
<th>Year (1975-76)</th>
<th>AUM</th>
</tr>
</thead>
</table>

Source: www.amfiindia.com

As exhibited in above table, it can be understood that mutual funds have been taking firm roots as an investment vehicle to reap the benefits of securities market. Indian mutual fund industry has traversed a long since 1964 with a single player (UTI) and with AUM of just Rs.25 in 1964 crores to AUM of Rs.611402 crores in 2012. It is undoubtedly an excellent improvement in mutual fund industry of India. It is obvious that mutual fund industry in India has grown several folds since beginning
till date in terms of MF houses, number of schemes, resource mobilization and above all the investor base.

(II) ‘AUM’ AS PERCENTAGE OF ‘GDP’

It is an usual practice that the performance of mutual funds is measured in terms of ‘resource mobilisation as a percentage of gross domestic products (GDP)’. In the above table it is seen as to how resource mobilization by Indian mutual fund industry has increased over the number years. However, if the resources mobilized by Indian MF industry as percentage to gross domestic products is compared with other countries of the world, it unveils the following fact.

When this parameter of performance (i.e. resource mobilisation as a percentage of GDP) is applied, it is found how meagre the percentage of resources have been mobilised over last 48 years.

(III) GEOGRAPHICAL SPREAD OF INDIAN MUTUAL FUND INDUSTRY

SEBI has made it mandatory for Mutual Funds to disclose its geographical spread every quarter. From the above information, it can be understood that mutual funds have reached only to the investors living in big/metropolitan cities. As more number of literate investors with well understanding and awareness about investment
avenues are available in metros, mutual funds have concentrated more on those cities for distribution of MF products. Further, in next 10 cities mutual funds reach was up to 14 percent as on 31st March, 2012, and in next 20 cities it was 7 percent. However, in next 75 cities, which are comparatively very small cities or towns its reach was just 5 percent, and in very small places. Especially in rural parts its reach was just 3 percent. In this connection, SEBI has recently taken steps to enhance the distribution network of mutual funds in untapped or poorly tapped areas. SEBI has allowed the retired teachers, bank officers, govt, and semi-govt. servants to act as an authorized distributors as per its current notifications.

3.6.5: TRENDS IN RESOURCE MOBILIZATION OF INDIAN MUTUAL FUND INDUSTRY

As mentioned above, resource mobilisation is one of the important prime objectives of mutual funds. Mutual funds, as financial intermediary, are expected to mobilize maximum savings of the society towards productive channels through securities market. In the beginning the velocity of mobilizing resources by mutual fund industry was very slow evidently because of dominance of single player (UTI). However, since 1987 and again since 1993 the resource mobilisation by mutual fund industry got momentum. However, as yet the Indian mutual fund industry has not attained maturity the funds had to redeemed due to several reasons. This has been exhibited in the following tables. For this purpose, the period from FY 2002-2003 to 2011-2012 has been considered.

Table: 3.6.5. (A): Resource Mobilisation by Mutual Funds (All Mutual Funds) (Rs. Billion)

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Gross Resource Mobilisation*</th>
<th>Redemption</th>
<th>Net Resource Mobilisation</th>
<th>Net Amount as % of Gross Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-03</td>
<td>3147.06</td>
<td>3105.10</td>
<td>41.96</td>
<td>1.33</td>
</tr>
<tr>
<td>2003-04</td>
<td>5901.90</td>
<td>5433.81</td>
<td>468.09</td>
<td>7.93</td>
</tr>
<tr>
<td>2004-05</td>
<td>8397.08</td>
<td>8375.08</td>
<td>22.00</td>
<td>0.26</td>
</tr>
<tr>
<td>2005-06</td>
<td>10981.49</td>
<td>10453.70</td>
<td>527.79</td>
<td>4.81</td>
</tr>
<tr>
<td>2006-07</td>
<td>19384.93</td>
<td>18445.08</td>
<td>939.85</td>
<td>4.85</td>
</tr>
<tr>
<td>2007-08</td>
<td>44643.77</td>
<td>43105.75</td>
<td>1538.02</td>
<td>3.45</td>
</tr>
<tr>
<td>2008-09</td>
<td>54263.54</td>
<td>54546.50</td>
<td>(282.96)</td>
<td>-0.0052</td>
</tr>
<tr>
<td>2009-10</td>
<td>100190.23</td>
<td>99359.43</td>
<td>830.80</td>
<td>0.83</td>
</tr>
<tr>
<td>2010-11</td>
<td>88595.15</td>
<td>89089.21</td>
<td>(494.06)</td>
<td>-0.5577</td>
</tr>
<tr>
<td>2011-12</td>
<td>68196.79</td>
<td>68417.03</td>
<td>(220.24)</td>
<td>-0.3230</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>403701.5</strong></td>
<td><strong>400330.7</strong></td>
<td><strong>3370.80</strong></td>
<td><strong>22.57</strong></td>
</tr>
<tr>
<td><strong>Mean</strong></td>
<td><strong>40370.154</strong></td>
<td><strong>40038.069</strong></td>
<td><strong>337.08</strong></td>
<td><strong>2.257</strong></td>
</tr>
<tr>
<td><strong>S.D.</strong></td>
<td><strong>36193.415</strong></td>
<td><strong>36294.849</strong></td>
<td><strong>639.019</strong></td>
<td><strong>2.86</strong></td>
</tr>
<tr>
<td><strong>C.V. (%)</strong></td>
<td>89.65</td>
<td>90.65</td>
<td>189.55</td>
<td>126.72</td>
</tr>
</tbody>
</table>

*Inclusive of UTI, Public Sector and Private Sector Mutual Funds
It can be understood from the above graph that in 8 consecutive years from 2002-2003 to 2009-10 the gross mobilization of funds have neen increased, however, in recent two years it has slid down. On an average , in the last decade Indian MF industry has mobilised the resources of Rs. 40, 370 crores.

3.6.5.(A): REDEMPTIONS

The mutual funds redeem the investment to unit holders with accumulated returns as and when demanded, the liquidity being the crux. However, the increased redemptions reduce ‘the net resources mobilized’ and resultantly ‘AUM.’ The redemptions of Indian MF industry during FY 2002-03 to 2011-12 were as follows.

Table: 3.6.5. (B)
Redeemptions by Mutual Funds during FY 2002-03 to 2011-12
(Rs. In Billion)

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>UTI</th>
<th>Public Sector</th>
<th>Private Sector</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-03</td>
<td>164.96#</td>
<td>267.30</td>
<td>2668.64</td>
<td>3100.90</td>
</tr>
<tr>
<td>2003-04</td>
<td>213.96</td>
<td>298.81</td>
<td>4921.04</td>
<td>5433.81</td>
</tr>
<tr>
<td>2004-05</td>
<td>493.78#</td>
<td>592.16#</td>
<td>7288.63</td>
<td>8374.57</td>
</tr>
<tr>
<td>2005-06</td>
<td>427.96</td>
<td>1308.47</td>
<td>8717.26</td>
<td>10453.69</td>
</tr>
<tr>
<td>2006-07</td>
<td>1203.81</td>
<td>2032.93</td>
<td>15208.38</td>
<td>18445.12</td>
</tr>
<tr>
<td>2007-08</td>
<td>3276.78</td>
<td>3354.48</td>
<td>36474.49</td>
<td>43105.75</td>
</tr>
<tr>
<td>2008-09</td>
<td>4267.90</td>
<td>7010.92</td>
<td>43267.68</td>
<td>54546.50</td>
</tr>
<tr>
<td>2009-10</td>
<td>8661.98</td>
<td>14261.89</td>
<td>76435.55</td>
<td>99359.42</td>
</tr>
<tr>
<td>2010-11</td>
<td>8004.94</td>
<td>11662.88</td>
<td>69421.40</td>
<td>89089.21</td>
</tr>
<tr>
<td>2011-12</td>
<td>5256.37</td>
<td>6168.77</td>
<td>56991.89</td>
<td>68417.02</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>31313.7</strong></td>
<td><strong>46366.45</strong></td>
<td><strong>321395</strong></td>
<td><strong>400326</strong></td>
</tr>
<tr>
<td><strong>Mean</strong></td>
<td>3914.21</td>
<td>5151.83</td>
<td>32139.496</td>
<td>40032.599</td>
</tr>
<tr>
<td><strong>S.D.</strong></td>
<td>3268.91</td>
<td>5062.33</td>
<td>28234.25</td>
<td>36295.37</td>
</tr>
<tr>
<td><strong>C.V. (%)</strong></td>
<td>83.51</td>
<td>98.26</td>
<td>87.85</td>
<td>90.66</td>
</tr>
</tbody>
</table>

# Redemptions are more than gross funds mobilisation
It can be understood that during 2002-03 to 2011-12 the redemtions have increased year after year. Hence even though the gross resources have been increased during study period, the net resources have not increased. The net resources mobilization by MF industry during FY 2002-03 to 2011-12 were as follows.

The data relating to net resources mobilized by Indian mutual fund presented in table 3.7.5. (A) here above reveals that net resource mobilization has dropped considerably to INR 22 billion in the year 2004-05 from INR 468.09 billion in preceding year. The position was further worsened in FY 2008-09, when net resource mobilization was INR -282.96 billion. This simply meant that redemptions were more than the gross resources mobilised during that financial year. It was quite high (INR 1538.02 billion) in preceding year i.e FY 2007-08. In FY 2009-10 it rose to INR 830.8 billion. But the last two years it continuously felt down. It was INR -494.06 billion in FY 2010-11 and INR -220.24 billion in FY 2011-12. It may be regarded as slight improvement over the preceding year.
There are now three groups of mutual funds namely UTI MF, Public Sector MF and Private Sector MF. The following table throws light on percentage of resources mobilized by these different groups of mutual funds during the period under study.

Table: 3.6.5. (D)
Percentage of Resources Mobilized by different groups of Mutual Funds during 2002-03 to 2011-12

<table>
<thead>
<tr>
<th>Mutual Fund Groups</th>
<th>Percentage to Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross</td>
</tr>
<tr>
<td>UTI MF</td>
<td>7.92</td>
</tr>
<tr>
<td>Public Sector MF</td>
<td>11.72</td>
</tr>
<tr>
<td>Private Sector MF</td>
<td>80.36</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Computed from data in Table 3.6.5 (C)
The total gross resources mobilised by Private Sector Mutual Funds during the period of last ten years (2002-03 to 2011-12) are 80.36%, which is ten times that of UTI. The resource contribution of Public Sector Mutual Funds accounted for 11.72 percent. The same is the case of net resources mobilised. Ninety percent of net resources were mobilised alone by Private Sector, while Public Sector could mobilise 9.70 percent net resources and UTI mobilised just 0.28 percent of net resources. The same is statistically corroborated in Table3.6.5. (F)

**Hypothesis: 1:** There is consistent growth in resource mobilization of Mutual Funds in India

In order to support the first above-mentioned hypothesis of the study the attempt has been made to find answer to two questions; one is whether there is consistent growth in resource mobilized by Indian Mutual Fund industry, second is whether resource mobilization by UTI, Public Sector MF and Private Sector MF differ significantly during study period. For that the following two null hypotheses (1a & 1b) are tested. Sub-hypothesis -1a is tested by using simple statistical tool of Coefficient of Variance (Descriptive Statistics) while one-way ANNOVA test is applied to test sub-hypothesis-1b.

(1a): ‘There is no consistent growth in resource mobilization by Mutual Funds in India during 2002-03 to 2011-12’

**Table 3.6.5. (E)**

Gross Source Mobilization by Mutual Funds in India

(Period covered: 2002-03 to 2011-12, N=10)

<table>
<thead>
<tr>
<th>Mutual Fund</th>
<th>Total Resource Mobilization</th>
<th>Mean Value</th>
<th>Standard Deviation</th>
<th>Coefficient of Variance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UTI Mutual Fund</td>
<td>31973.3</td>
<td>3197.33</td>
<td>3259.47</td>
<td>101.94</td>
</tr>
<tr>
<td>Public Sector Mutual Funds</td>
<td>47295</td>
<td>4729.50</td>
<td>4980.38</td>
<td>105.30</td>
</tr>
<tr>
<td>Private Sector Mutual Funds</td>
<td>324435</td>
<td>32443.46</td>
<td>28139.62</td>
<td>86.73</td>
</tr>
<tr>
<td>All Mutual Funds</td>
<td>403701.5</td>
<td>40370.15</td>
<td>36193.42</td>
<td>89.65</td>
</tr>
</tbody>
</table>

*Source: Based on Table No. 3.6.5 (A) & 3.6.5 (C)*

The first sub-hypothesis that there is no consistent growth in resource mobilization by Mutual Funds in India during study period is rejected. Consideration of values of Coefficient of Variance (C.V.) leads to interpret that there has been...
consistent growth in resources mobilized by Mutual Funds in India during study period. Among three segments of Indian Mutual Fund industry, Private Sector Mutual Funds have more consistently mobilized the resources.

(1b): ‘There is no significant difference between resources mobilized by UTI, Public Sector and Private Sector Mutual Funds during 2002-03 to 2011-12.’

This sub-hypothesis is tested by applying one-way ANNOVA test and the results are presented in Table 3.6.5 (F)

<table>
<thead>
<tr>
<th>Source of Variation</th>
<th>Sum of Squares</th>
<th>DoF</th>
<th>Mean Square</th>
<th>‘F’ Statistic</th>
<th>Critical Value (At 0.05)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treatment</td>
<td>554454.2</td>
<td>2</td>
<td>277227.1</td>
<td>3.014</td>
<td>3.39</td>
</tr>
<tr>
<td>Error</td>
<td>2482789</td>
<td>27</td>
<td>91955.14</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>3037243</td>
<td>29</td>
<td>369182.24</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\[ F_{a,k-1,n-k} = F_{0.05} = 3.014 \]

Since \( F < F_{a,k-1,n-k} \), \( H_0 \) is accepted i.e. difference in not significant. It may be accepted here that resources mobilized by three segments of Indian Mutual Fund industry namely UTI MF, Public Sector MF and Private Sector MF during 2002-03 to 2011-12 do not differ significantly.

The first hypothesis of the study stated as – ‘There is consistent growth in resource mobilization of Mutual Funds in India’ is partially accepted on the grounds that Mutual Funds in India have mobilized gross resources consistently during the study period though segment-wise it differs.

3.7: PARTICIPATION OF RETAIL INVESTORS IN MUTUAL FUNDS

Even though the Mutual Funds are meant for retail investors and they are provided with abundant growth opportunities, it is a fact that the participation of retail investors in mutual funds have continued to remain at deplorably low levels. It is the corporate sector that has invested more in mutual fund schemes. Hence, the investor contribution to mutual funds remained skewed towards the corporate sector. Volatile market conditions sound a note of caution for Mutual Fund industry, as high dependence on the corporate sector may result in the fund houses being prone to unexpected redemption pressures.
Table 3.7 (A)
Investor Contribution as on March 31, 2012

<table>
<thead>
<tr>
<th>Investors</th>
<th>% of contribution to MF schemes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td>51</td>
</tr>
<tr>
<td>Retail Investors</td>
<td>26</td>
</tr>
<tr>
<td>Banks and Financial Institutes (FIs)</td>
<td>19</td>
</tr>
<tr>
<td>Foreign Institutional Investors (FIIs)</td>
<td>03</td>
</tr>
<tr>
<td>High Networth Investors (HNWIs)</td>
<td>01</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: AMFI

Graph 3.7 (A)
Investor Contribution as of March 31, 2012

It means that the impressive growth in AUM of mutual funds was predominantly driven by corporate sector.

Table 3.7 (B)
Assets under Management Under Various Investor Segments

<table>
<thead>
<tr>
<th>Investor Segment</th>
<th>AUM (In Rs. Billion)</th>
<th>2011</th>
<th>2012</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>%</td>
<td>Amount</td>
<td>%</td>
</tr>
<tr>
<td>Corporates</td>
<td>3015.71</td>
<td>50.92</td>
<td>117.69</td>
<td>50.99</td>
</tr>
<tr>
<td>Retail Investors</td>
<td>1260.32</td>
<td>21.28</td>
<td>1626.49</td>
<td>26.60</td>
</tr>
<tr>
<td>Banks and Financial Institutes</td>
<td>273.00</td>
<td>4.61</td>
<td>180.07</td>
<td>2.95</td>
</tr>
<tr>
<td>Foreign Institutional Investors</td>
<td>69.31</td>
<td>1.17</td>
<td>50.73</td>
<td>0.83</td>
</tr>
<tr>
<td>High Networth Investors (HNWIs)</td>
<td>1304.16</td>
<td>22.02</td>
<td>1139.04</td>
<td>18.63</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>5922.50</strong></td>
<td><strong>100.00</strong></td>
<td><strong>6114.02</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: AMFI

Graph 3.7 (B)
Assets under Management Under Various Investor Segments
3.8: ISSUES OF CONCERN OF INDIAN MUTUAL FUND INDUSTRY

There are a number of stumbling blocks in the way of progress of Indian mutual fund industry. Some of them are discussed hereunder based on the data presented hereinabove.

(1) Heavy redemptions and decline in AUM: Undoubtedly, Indian Mutual Fund industry has evolved from a single-player monopoly in 1964, into a high-growth and competitive market due to the support of favorable economic and demographic factors. However, after several years of persistent growth, the industry witnessed consistent declines of 6.3% and 5.1% in its AUM during financial year 2011 and 2012 respectively. Behind this, one of the reasons could be the changes in regulatory guidelines such as ban on entry load, stringent KYC norms, guidelines on transaction charges, tightening valuation and advertisement norms, which were introduced in a short span of time thus giving less time to the industry to adjust in the new environment.

(2) Underpenetrated population: Further, the penetration of mutual funds in India, as measured by the AUM/GDP ratio, remains low at 4.7% as compared to 77.0% in US, 41.1% in Europe and 33.6% in the UK. Further, mutual funds also constituted only 3.3% of household financial savings in FY 2010, which further contracted to 1.2% and 1.1% in FY 2011 and FY2012 respectively due to large redemptions and capital losses.9

As per National Council of Applied Economic Research’s (Published in 2008) around 65 percent of savings in India are with Banks or Post Office deposits and cash at home, while 23 percent are invested in real estate and gold and only 12 percent is channelized towards financial instruments. This manifests that there is a tremendous opportunity for growth of mutual funds. At the same time it however indicates that penetration level of mutual funds in the smaller towns is lagging behind that of urban cities.

(3) Low geographical reach: The geographical reach of mutual fund products is another important issue. The concentration of mutual funds to a few major cities and the low reach to small cities and rural parts has been another vital concern for the mutual fund industry of India. There are very limited distribution channels and limited investor servicing available beyond top 20 cities. As seen above, top 5 cities have contributed approximately 71 percent of the total AUM of the mutual fund sector. Out
of this, only Mumbai itself has contributed about 42.1 percent. Lack of incentives for distributors to expand in small cities has resulted in mutual funds becoming an investment product in the hands of urban Indians.\(^{10}\)

Progressively rising level of disposable income in the Tier 2 and Tier 3 cities have shown the latent potential for investments in mutual funds. Investors in these cities are gradually awakening to other potential investment areas like equity and mutual funds, apart from the traditional bank fixed deposits, national savings certificates, gold, silver and real estate. However, the unique diversity of Indian culture implies that different models are required to be explored and executed in order to penetrate in smaller towns and cities.

(4) **Insufficiency and inefficiency of distribution network:** The strong and efficient network of mutual fund distributors is lacking in India. The distribution channels are powerful only in metros and other big cities. The Tier-II and Tier-III cities and villages have not yet been covered by efficient distribution network. The inaccessibility of mutual funds in smaller towns and cities is one of the major concerns of Indian mutual fund industry.

(5) **Heavy reliance on institutional sales:** The corporate bodies are the major buyers of mutual fund products. Truly speaking, mutual funds are meant for small/retail investors. However, the participation of retail investors in mutual funds was 26.60 percent in FY 2012 and that of corporate was 50.99 percent. This simply means that the savings of small investors are being diverted to other channels.

(6) **High distribution cost:** High cost of distribution of mutual funds especially in Tier-2 and Tier-3 cities has eroded the profit margins of AMCs. Prompting the distributors for technology-based distribution would help increase reach to smaller towns and cities on one hand and curb costs on another. The man power hiring cost is also more, which is inevitable to attract and retain the required talent. Further, ensuing from the restriction on entry loads, cost of sales and marketing has spiraled, as AMCs are now forced to pay out of their own pockets.

It is assumed that as the size of the corpus (AUMs) increases, the cost incurred on managing the fund will come down, being shared by a number of investors and thus the expense ratios will get ironed out. However, this premise has been rendered faulty in the more recent scenario, where increase in assets under management has actually seen the rise of expense ratios.
(7) **Low financial literacy level:** The low level of financial literacy of retail investors has further hampered the reach of mutual funds to the large chunk of the society. This is the major problem except top 5 and next 10 cities. Investors in metros are well familiar with mutual funds. They regard it as one of the profitable investment avenues. However, the people in smaller towns and cities still have some inhibitions about investing their savings in mutual funds. The people in rural area mostly look for such an investment avenue, which has simple terms and conditions and a small amount to initiate investment with. Recently, most of Mutual Fund houses have been conducting Investor Awareness Programmes, in order to spread financial literacy. To bring the small investors in the net of mutual funds, it is essential to evolve innovative products compatible to their risk appetite. Further, use of various mobile applications and on-line services can facilitate the spread of investor awareness.

3.9: **STEPS RECENTLY TAKEN FOR SUSTAINABLE GROWTH OF MUTUAL FUND INDUSTRY**

For re-energizing the Indian mutual fund industry and restoring its momentum of high growth, SEBI, the regulator, has adopted the following measures.

(1) **Change in structure of Total Expense Ratio:** AMCs are allowed to charge an additional Total Expense Ratio (TER) up to 30 bps, IF 30% of their net sales or 15% of their AUM (whichever is higher) originates beyond the top 15 cities. If the inflow from beyond the top 15 cities is less that 30% of net sales or 15% of AUM, the proportionate amount will be allowed as additional TER. While this step may reduce investors returns in the short-term it may give AMCs more scope to incentivize distributor to expand their geographical reach/ SEBI has also decided that AMCs should not bear the service tax (12.36%) payable on investment and advisory fees, instead, it can be charged in addition to the TER. This more it in line with the SEBIs attempt to bring the mutual fund sector at par with other sectors. In short-term, investors, returns may be affected due to this more but investors are likely to gain in the long-term as AUM increases.11

Further, SEBI has also mandated a single expense structure under a single plan to eliminate differential treatment between retail and institutional investors. However, to promote direct investment and to be fair to direct investors, a separate plan for direct investments with a lower expense ratio and a separate net asset value (NAV) has been proposed. One of the outcomes of this step could be less distributors’ commissions as many institutional clients who are major investors and are well-
informed may prefer the direct route. But on the other hand, retail investors who need help to select the most suitable scheme and complete requisite paperwork would still invest through a distributor.  

(2) **Relaxation in mandatory requirement:** In order to help AMCs widen their customer base in Tier-IV to Tier VI cities, SEBI has also relaxed the mandatory requirement of a PAN Card or Bank A/C for cash investments of up to INR 20,000 per financial year. Further, the regulator’s recommendations to include equity mutual fund schemes under the Rajiv Gandhi Equity Savings Schemes (RGESS) that offers tax brakes to small investors could help AMCs attract new investors in capital markets.

(3) **Stimulation of distribution network:** In another step to stimulate the distribution network, SEBI has proposed to simplify the distributors registration process and widen the distributor by including postal agents, retired officials from govt. banks, retired teachers and other similar professionals (such as bank correspondents) for the distributions of simple products. Agents, retired officers and recommending the inclusion of equity schemes MF products under REGSS could help strengthen the last-mile connectivity in MF distributor.

(4) **Attempts to enhance financial literacy:** Low customer awareness and financial literacy are one of the biggest road blocks in channelizing household savings into mutual funds. In a bid to enhance customer awareness, SEBI has mandated AMCs to set aside at least 2 bps of their daily net assets annually for the investors education campaign. AMCs should also make disclosures regarding the investor education and awareness initiatives undertaken.

(5) **Enhancing transparency:** To further strengthen the regulatory frame work and to make it increasingly transpired SEBI has asked AMCs to upload monthly portfolio disclosures and half-yearly financial results on their websites, inclusive of grows inflow, net inflow, average AUM and distributor-wise gross inflow on their websites.

No doubt, through its recent initiatives and announcements, SEBI has given a much needed boost to the mutual fund sector but the industry is waiting for a long term initiative by the regulator that will put this sector amongst the most preferred instrument of investment.

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