Chapter: 1
OVERVIEW OF MUTUAL FUND INDUSTRY IN INDIA

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1.1 INTRODUCTION:

The Indian financial system based on four basic components like Financial Market, Financial Institutions, Financial Service, Financial Instruments. All are play important role for smooth activities for the transfer of the funds and allocation of the funds. The main aim of the Indian financial system is that providing the efficiently services to the capital market. The Indian capital market has been increasing tremendously during the second generation reforms. The first generation reforms started in 1991 the concept of LPG. (Liberalization, privatization, Globalization)

Then after 1997 second generation reforms was started, still the it’s going on, its include reforms of industrial investment, reforms of fiscal policy, reforms of ex-imp policy, reforms of public sector, reforms of financial sector, reforms of foreign investment through the institutional investors, reforms banking sectors. The economic development model adopted by India in the post independence era has been characterized by mixed economy with the public sector playing a dominating role and the activities in private industrial sector control measures emaciated form time to time. The last two decades have been a phenomenal expansion in the geographical coverage and the financial spread of our financial system.

The spared of the banking system has been a major factor in promoting financial intermediation in the economy and in the growth of financial savings with progressive liberalization of economic policies, there has been a rapid growth of capital market, money market and financial services industry including merchant banking, leasing and venture capital, leasing, hire purchasing. Consistent with the growth of financial sector and second generation reforms its need to fruition of the financial sector. Its also need to providing the efficient service to the investor mostly if the investors are supply small amount, in that point of view the mutual fund play vital for better service to the small investors. The main vision for the analysis for this study is to scrutinize the performance of five star rated mutual funds, given the weight of risk, return, and assets under management, net assets value, book value and price earnings ratio.
1.2 WHAT IS A MUTUAL FUND?

Mutual fund is the pool of the money, based on the trust who invests the savings of a number of investors who shares a common financial goal, like the capital appreciation and dividend earning. The money thus collect is then invested in capital market instruments such as shares, debenture, and foreign market. Investors invest money and get the units as per the unit value which we called as NAV (net assets value). Mutual fund is the most suitable investment for the common man as it offers an opportunity to invest in diversified portfolio management, good research team, professionally managed Indian stock as well as the foreign market, the main aim of the fund manager is to taking the scrip that have under value and future will rising, then fund manager sell out the stock. Fund manager concentration on risk – return trade off, where minimize the risk and maximize the return through diversification of the portfolio. The most common features of the mutual fund unit are low cost. The below I mention the how the transactions will done or working with mutual fund

1.3 GROWTH OF MUTUAL FUND INDUSTRY:

The history of mutual funds dates support to 19th century when it was introduced in Europe, in particular, Great Britain. Robert Fleming set up in 1868 the first investment trust called Foreign and colonial investment trust which promised to manage the finances of the moneyed classes of Scotland by scattering the investment over a number of different stocks. This investment trust and other investment trusts which were afterward set up in Britain and the U.S., resembled today’s close – ended mutual funds. The first mutual fund in the U.S., Massachusetts investor’s trust, was set up in March 1924. This was the open – ended mutual fund.

The stock market crash in 1929, the Great Depression, and the outbreak of the Second World War slackened the pace of growth of the mutual fund industry. Innovations in products and services increased the popularity of mutual funds in the 1950s and 1960s. The first international stock mutual fund was introduced in the US in 1940. In 1976, the first tax – exempt municipal bond funds emerged and in 1979, the first money market mutual funds
were created. The latest additions are the international bond fund in 1986 arm funds in 1990. This industry witnessed substantial growth in the eighties and nineties when there was a significant increase in the number of mutual funds, schemes, assets, and shareholders. In the US the mutual fund industry registered s ten – fold growth the eighties. Since 1996, mutual fund assets have exceeds bank deposits. The mutual fund industry and the banking industry virtually rival each other in size.

A Mutual fund is type of Investment Company that gathers assets form investors and collectively invests in stocks, bonds, or money market instruments. The investment company concepts date to Europe in the late 1700s, according to K. Geert Rouwenhost in the Origins Mutual Funds, when “a Dutch Merchant and Broker Invited subscriptions from investor with limited means.” The materialization of “investment Pooling“ in England in the 1800s brought the concept closer to U.S. shores. The enactment of two British Laws, the Joint Stock Companies Acts of 1862 and 1867, permitted investors to share in the profits of an investment enterprise, and limited investor liability to the amount of investment capital devoted to the enterprise.

May be more outstandingly, the British fund model established a direct link with U.S. Securities markets, serving finance the development of the post – Civil War U.S. economy. The Scottish American Investment Trust, Formed on February1, 1873 by fund pioneer Robert Fleming, invested in the economic potential of the United States, Chiefly through American railroad bonds. Many other trusts followed that not only targeted investment in America, but led to the introduction of the fund investing concept on U.S. shores in the late 1800 and early 1900s.

Nov. 1925. All these funds were open – ended having redemption feature. Similarly, they had almost all the features of a good modern Mutual Funds – like sound investment policies and restrictions, open end ness, self – liquidating features, a publicized portfolio, simple capital structure, excellent and professional fund management and diversification etc……..and hence they are the honored grand – parents of today’s funds. Prior to these
funds all the initial investment companies were closed – ended companies. Therefore, it can be said that although the basic concept of diversification and professional fund management, were picked by U.S.A. from England Investment Companies “The Mutual Fund is an American Creation.”

Because of their exclusive feature, open – ended Mutual Funds rapidly became very popular. By 1929, there were 19 open – ended Mutual Funds in USA with total assets of $ 140 millions. But the 1929 Stock Market crash followed by great depression of 1930 ravaged the U.S. Financial Market as well as the Mutual Fund Industry. This necessitated stricter regulation for mutual funds and for Financial Sectors. Hence, to protect the interest of the common investors, U.S. Government passed various Acts, such a Securities Act 1933, Securities Exchange Act 1934 and the Investment Companies Act 1940. A committee called the National Committee of Investment Company (Now, Investment Company Institute), was also formed to co – operate with the Federal Regulatory Agency and to keep informed of trends in Mutual Fund Legislation.

As a result of these measure, the Mutual Fund Industry began to develop speedily and the total net assets of the Mutual Funds Industry increased form $ 448 million in 1940 to $ 2.5 billion in 1950. The number of shareholder’s accounts increased from 296000, to more than one Million during 1940 – 1951. “As a result of renewed interest in Mutual Fund Industry they grew at 18% annual compound rate reaching peak of their rapid growth curve in the late 1960s.”

**1.4 WORLDWIDE ROLE OF MUTUAL FUND**

![Graph showing Mutual Fund Industry growth from 2005 to 2007]

- **2007**: 26.20 crores
- **2006**: 21.82 crores
- **2005**: 17.77 crores
1.5 ORGANIZATION STRUCTURE OF MUTUAL FUNDS

Mutual funds have organization structure as per the Security Exchange Board of India guideline, Security Exchange Board of India specified authority and responsibility of Trustee and Asset Management Companies. The objectives is to controlling, to promoted, to regulate, to protected the investors right and efficient trading of units. Operation of Mutual fund start with investors save their money on mutual fund, than Mutual Fund manager handling the funds and strategic investment on scrip. As per the objectives of particular scheme manager selected scrips. Unit value will become high when fund manager investment policy generate the return on capital market. Unit return depends on fund return and efficient capital market. Also affects international capital market, liquidity and at last economic policy. Below the graph indicates how the process was going on to investors to earn returns. Mutual fund manager having high responsibility inside of return and how to minimize the risk. When fund provided high return with high risk, investors attract to invest more fund for same scheme.
The Mutual fund organization as per the SEBI formation and necessary formation is needed for sooth activities of the companies and achieved the desire objectives. Transfer agent and custodian play role for dematerialization of the fund and unit holders hold the account statement, but custody of the unit is on particular Asset Management Company. Custodian holds all the fund units on dematerialization form. Sponsor had decided the responsibility of custodian when investor to purchase the fund and to sell the unit. Application forms, transaction slip and other requests received by transfer agent, middle men between investors and Assts Management Companies.

1.6 ORIGIN OF MUTUAL FUND IN INDIA

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1.7 GROWTH OF MUTUAL FUNDS IN INDIA

By the year 1970, the industry had 361 Funds with combined total assets of 47.6 billion dollars in 10.7 million shareholder’s account. However, from 1970 and onwards rising interest rates, stock market stagnation, inflation and investors some other reservations about the profitability of Mutual Funds, Adversely affected the growth of mutual funds. Hence Mutual Funds realized the need to introduce new types of Mutual Funds, which were in tune with changing requirements and interests of the investors. The 1970’s saw a new kind of fund innovation; Funds with no sales commissions called “ no load “ funds. The largest and most successful no load family of funds is the Vanguard Funds, created by John Bogle in 1977.

In the series of new product, the First Money Market Mutual Fund (MMMF) i.e. The Reserve Fund” was started in November 1971. This new concept signaled a dramatic change in Mutual Fund Industry. Most importantly, it attracted new small and individual investors to mutual fund concept and sparked a surge of creativity in the industry.
1.8 TYPES OF MUTUAL FUNDS

Wide variety of Mutual Fund Schemes exists to cater to the needs such as financial position, risk tolerance and return expectations etc. The table below gives an overview into the existing types of schemes in the Industry.

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<thead>
<tr>
<th>By Structure</th>
<th>Open Ended Funds</th>
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<th>Other Schemes</th>
<th>Tax Saving Funds</th>
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<td>Special Funds</td>
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<td>Index Funds</td>
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<td>Sector Specific Funds</td>
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1.9 ADVANTAGES OF MUTUAL FUNDS

Mutual funds have designed to provide maximum benefits to investors, and fund manager have research team to achieve schemes objective. Assets Management Company has different type of sector funds, which need to proper planning for strategic investment and to achieve the market return.

Portfolio Diversification

Mutual Funds invest in a well-diversified portfolio of securities which enables investor to hold a diversified investment portfolio (whether the amount of investment is big or small).
**Professional Management**

Fund manager undergoes through various research works and has better investment management skills which ensure higher returns to the investor than what he can manage on his own.

**Less Risk**

Investors acquire a diversified portfolio of securities even with a small investment in a Mutual Fund. The risk in a diversified portfolio is lesser than investing in merely 2 or 3 securities.

**Low Transaction Costs**

Due to the economies of scale (benefits of larger volumes), mutual funds pay lesser transaction costs. These benefits are passed on to the investors.

**Liquidity**

An investor may not be able to sell some of the shares held by him very easily and quickly, whereas units of a mutual fund are far more liquid.

**Choice of Schemes**

Mutual funds provide investors with various schemes with different investment objectives. Investors have the option of investing in a scheme having a correlation between its investment objectives and their own financial goals. These schemes further have different plans/options.

**Transparency**

Funds provide investors with updated information pertaining to the markets and the schemes. All material facts are disclosed to investors as required by the regulator.
**Flexibility**

Investors also benefit from the convenience and flexibility offered by Mutual Funds. Investors can switch their holdings from a debt scheme to an equity scheme and vice-versa. Option of systematic (at regular intervals) investment and withdrawal is also offered to the investors in most open-end schemes.

**Safety**

Mutual Fund industry is part of a well-regulated investment environment where the interests of the investors are protected by the regulator. All funds are registered with SEBI and complete transparency is forced.

**1.10 DISADVANTAGES OF MUTUAL FUNS**

The mutual fund not just advantage of investor but also has disadvantages for the funds. The fund manager not always made profits but might creates loss for not properly managed. The fund have own strategy for investment to hold, to sell, to purchase unit at particular time period.

**Costs Control Not in the Hands of an Investor**

Investor has to pay investment management fees and fund distribution costs as a percentage of the value of his investments (as long as he holds the units), irrespective of the performance of the fund.

**No Customized Portfolios**

The portfolio of securities in which a fund invests is a decision taken by the fund manager. Investors have no right to interfere in the decision making process of a fund manager, which some investors find as a constraint in achieving their financial objectives.
Difficulty in Selecting a Suitable Fund Scheme

Many investors find it difficult to select one option from the plethora of funds/schemes/plans available. For this, they may have to take advice from financial planners in order to invest in the right fund to achieve their objectives.

1.11 MUTUAL FUND & CAPITAL MARKET

Indian Institute of Capital Market (IICM) aims to educate and develop professionals for the securities industry in India and other developing countries, other objectives like to function on a centre for creating investors awareness through research & turning and to provide specialized consultancy related to the securities industry.

Capital market play vital role for the growth of Mutual fund in India, capital market divided into the two parts one is the primary market and another is secondary market, primary market concern with issue management, as per the mutual fund concern the primary called as the NFO New Fund Offer, all the AMC (Assets Management Company) are issuing all the funds all the way through the NFO, Every NFO came with particularly investment objectives, style of investment and allocation of the funds all that thing depend on the fund manager style of investment. The other portion of the capital market is secondary market, as we have a discussion with reference with mutual fund secondary market means when the market bull stage the investors sole the units. Opposite when the bear stage the investor buy or some of the investor time wait for sale.

1.12 Role of SEBI

A index fund scheme’ means a mutual fund scheme that invests in securities in the same proportion as an index of securities;” A mutual fund may lend and borrow securities in accordance with the framework relating to short selling and securities lending and borrowing specified by the Board.”A mutual fund may enter into short selling transactions on a recognized stock exchange, subject to the framework relating to short selling and securities lending and borrowing specified by the Board.” “Provided that in case of an index
fund scheme, the investment and advisory fees shall not exceed three fourths of one percent (0.75%) of the weekly average net assets.

“Provided further that in case of an index fund scheme, the total expenses of the scheme including the investment and advisory fees shall not exceed one and one half percent (1.5%) of the weekly average net assets.” Every mutual fund shall buy and sell securities on the basis of deliveries and shall in all cases of purchases, take delivery of relevant securities and in all cases of sale, deliver the securities: Provided that a mutual fund may engage in short selling of securities in accordance with the framework relating to short selling and securities lending and borrowing specified by the Board: Provided further that a mutual fund may enter into derivatives transactions in a recognized stock exchange, subject to the framework specified by the Board.”

### 1.13 Role of AMFI

**(Association Mutual Fund in India)**

The Association of Mutual Funds in India (AMFI) is dedicated to 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 working group on Best Practices for sales and marketing of Mutual Funds under the Chairmanship of Shri B. G. Daga, Former Executive Director of Unit Trust of India with Shri Vivek Reddy of Pioneer ITI, Shri Alok Vajpeyi of DSP Merrill Lynch, Shri Nikhil Khattau of Sun F & C and Shri Chandrashekhar Sathe, Formerly of Kotak Mahindra Mutual Fund has suggested formulation of guidelines and code of conduct for intermediaries and this work has been ably done by a sub-group consisting of Shri B. G. Daga and Shri Vivek Reddy.
Following are Assets Management Companies under India

<table>
<thead>
<tr>
<th>Name of the Asset Management Company</th>
<th>Website</th>
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<tbody>
<tr>
<td>AEGON Asset Management Company Pvt. Ltd.</td>
<td>N/A</td>
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<tr>
<td>AIG Global Asset Management Company (India) Pvt. Ltd.</td>
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<tr>
<td>Axis Asset Management Company Ltd.</td>
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<td>Baroda Pioneer Asset Management Company Limited</td>
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<td>Benchmark Asset Management Company Pvt. Ltd.</td>
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<td>Bharti AXA Investment Managers Private Limited</td>
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<td>Escorts Asset Management Limited</td>
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<td>FIL Fund Management Private Limited</td>
<td>fidelity.co.in</td>
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<td>Quantum Asset Management Co. Private Ltd.</td>
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### 1.14 Tax Planning and Mutual Fund

Investors in India opt for the tax-saving mutual fund schemes for the simple reason that it helps them to save money. The tax-saving mutual funds or the equity-linked savings schemes (ELSS) receive certain tax exemptions under Section 88 of the Income Tax Act. That is one of the reasons why the investors in India add the tax-saving mutual fund schemes to their portfolio. The tax-saving mutual fund schemes are one of the important types of mutual funds in India that investors can option for. There are several companies in India that offer – tax – saving mutual fund schemes in the country.

### 1.15 NISM (National Institute of Securities Market)

NISM has the sub – part of national stock exchange. National stock exchange established one branch who handling the activities which have been related with the capital market and security market. Here the national institute market has six constitutes of securities markets

1) Investors  
2) Regulation  
3) Intermediaries  
4) Opinion Market  
5) Knowledge Generate  
6) Issuer
NISM organized six types of school which are as under

1. School of certificate of Intermediaries (SCI)
2. School of Regulatory Studies and Supervision (SRSS)
3. School of Corporate Governance (SCG)
4. School of Investors Education & Financial Literacy (SIEFL)
5. School of Securities Education (SSE)
6. School of Securities Information and Research (SSIR)

**1.16 NICM (National Institute of Capital Market)**

National Institution of Capital Market also sub division of National Stock Exchange, NSE have seven Subsidiaries, which included necessary for growth of capital market. Institute provided education which related with capital market transaction. Seminar and workshop related with transparency for trading activities develop technology on trading and doing market research.

**1.17 SEBI Guideline of Mutual Fund**

SEBI Regulation Act 1996

Establishment of a Mutual Fund:

In India mutual fund play the role as investment with trust, some of the formalities laid down by the SEBI to be establishment for setting up a mutual fund. As the part of trustee sponsor the mutual fund, under the Indian Trust Act, 1882, under the trustee company are represented by a board of directors. Board of Directors is appoints the AMC and custodians. The board of trustees made relevant agreement with AMC and custodian. The launch of each scheme involves inviting the public to invest in it, through an offer documents.
Depending on the particular objective of scheme, it may open for further sale and repurchase of units, again in accordance with the particular of the scheme, the scheme may be wound up after the particular time period.

1. The sponsor has to register the mutual fund with SEBI

2. To be eligible to be a sponsor, the body corporate should have a sound track record and a general reputation of fairness and integrity in all his business transactions.

   **Means of Sound Track Records**

   ➔ The body corporate being in the financial services business for at least five years

   ➔ Having a positive net worth in the five years immediately preceding the application of registration.

   ➔ Net worth in the immediately preceding year more than its contribution to the capital of the AMC.

   ➔ Earning a profit in the three out of the five preceding years, including the fifth year.

3. The sponsor should hold at least 40% of the net worth of the AMC.

4. A party which is not eligible to be a sponsor shall not hold 40% or more of the net worth of the AMC.

5. The sponsor has to appoint the trustees, the AMC and the custodian.

6. The trust deed and the appointment of the trustees have to be approved by SEBI.

7. An AMC or its officers or employees can not be appointed as trustees of the mutual fund.
8. At least two thirds of the business should be independent of the sponsor.

9. Only an independent trustee can be appointed as a trustee of more than one mutual fund, such appointment can be made only with the prior approval of the fund of which the person is already acting as a trustees.

**LAUNCHING OF A SCHEMES**

Before its launch, a scheme has to be approved by the trustees and a copy of its offer documents filed with the SEBI.

1. Every application form for units of a scheme is to be accompanied by a memorandum containing key information about the scheme.

2. The offer document needs to contain adequate information to enable the investors to make informed investments decisions.

3. All advertisements for a scheme have to be submitted to SEBI within seven days from the issue date.

4. The advertisements for a scheme have to disclose its investment objective.

5. The offer documents and advertisements should not contain any misleading information or any incorrect statement or opinion.

6. The initial offering period for any mutual fund schemes should not exceed 45 days, the only exception being the equity linked saving schemes.

7. No advertisements can contain information whose accuracy is dependent on assumption.
8. An advertisement cannot carry a comparison between two schemes unless the schemes are comparable and all the relevant information about the schemes is given.

9. All advertisements need to carry the name of the sponsor, the trustees, the AMC of the fund.

10. All advertisements need to disclose the risk factors.

11. All advertisements shall clarify that investment in mutual funds is subject to market risk and the achievement of the fund’s objectives can not be assured.

12. When a scheme is open for subscription, no advertisement can be issued stating that the scheme has been subscribed or over subscription.

1.18 Recent Trend of Mutual Fund

India is at the first stage of a revolution that has already peaked in the U.S. The U.S. boasts of an Asset base that is much higher than its bank deposits. In India, mutual fund assets are not even 10% of the bank deposits, but this trend is beginning to change. Recent figures indicate that in the first quarter of the current fiscal year mutual fund assets went up by 115% whereas bank deposits rose by only 17%. (Source: Thinktank, the Financial Express September, 99) This is forcing a large number of banks to adopt the concept of narrow banking wherein the deposits are kept in Gilts and some other assets which improves liquidity and reduces risk. The basic fact lies that banks cannot be ignored and they will not close down completely. Their role as intermediaries cannot be ignored. It is just that Mutual Funds are going to change the way banks do business in the future.
**Comparison of investment in Banks V/S Mutual Funds**

<table>
<thead>
<tr>
<th>PARTICULAR</th>
<th>BANKS</th>
<th>MUTUAL FUNDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Returns</td>
<td>Low</td>
<td>Better</td>
</tr>
<tr>
<td>Administrative exp.</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Risk</td>
<td>Low</td>
<td>Moderate</td>
</tr>
<tr>
<td>Investment options</td>
<td>Less</td>
<td>More</td>
</tr>
<tr>
<td>Network</td>
<td>High penetration</td>
<td>Low but improving</td>
</tr>
<tr>
<td>Liquidity</td>
<td>At a cost</td>
<td>Better</td>
</tr>
<tr>
<td>Quality of assets</td>
<td>Not transparent</td>
<td>Transparent</td>
</tr>
<tr>
<td>Interest calculation</td>
<td>Minimum balance between 10th. &amp; 30th. Of every month</td>
<td>Everyday</td>
</tr>
<tr>
<td>Guarantee</td>
<td>Maximum Rs.1 lakh on deposits</td>
<td>None</td>
</tr>
</tbody>
</table>

**1.19 Conclusion**

The Indian economy is second largest economy in the world, but on 2008 and first quart of 2009 was international financial liquidity and global fund crisis. USA economy affect by sub-prime crisis that creates problem of international financial market, commodity market and foreign exchange market. But Indian economy less affects due to fast moving for consumer durable, growth of capital expenditure projects and service sector, Indian government easily attract foreign investors. Foreign Institutional Investors invest on Indian capital market, it is continuous growing.


Reference:


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