CHAPTER - 1

MUTUAL FUND INDUSTRY IN INDIA
The term ‘investment’ refers to the sacrifice of certain present value for an uncertain future reward. The regularity of income to be received, the safety and negotiability of specific investments or combination of investments are the important considerations in any investment. Individuals make investments with the primary motive of preserving and improving the purchasing power.

Investments can be broadly categorized into real investments and financial investments. Real investment refers to an activity in which mere exchange of assets takes place without creating any liability on the part of supplier/owner. On the other hand, financial investment refers to an activity in which a liability is created on the part of supplier. In the present study, the term ‘investment’ is used to mean financial investment, which has the following objectives.

**Objectives of Financial Investment:**

1. To maximise the value of money
2. To channelise the surplus funds into profitable earnings
3. To earn regular income
4. To enjoy the benefits of capital appreciation and

5. To get tax rebate.

**Investment Avenues:**

In order to realise the investment objectives, investors keep their savings in any one or a combination of investment channels which suits their attitude towards risk. The following are some of the investment avenues:

1. Bank deposits
2. Small saving schemes
3. Company deposits
4. Social security deposits/funds
5. Equity shares, preference shares and debentures and
6. Mutual funds.

**Bank deposits**

Commercial bank deposits include (a). Demand deposits, (b). Term deposits, (c). Recurring deposits, (d). Saving deposits account, and (e). Home safe account.

Demand deposits or current deposits are suitable to businessmen who have number of transactions every day. The
depositor can withdraw from this account any number of times. He pays service charges to the bank and he is not paid any interest on this account. Term deposits otherwise called as fixed deposits are deposited for fixed period of time, which can not be withdrawn before the expiry of the period. The rate of interest varies according to the period of investment. The longer the period, the higher will be the rate of interest. Recurring deposits suit the salaried class people who are unable to save the bulk sum at a stretch. These deposits aim at regular savings by the public generally in monthly investments for the agreed period. As the principal and interest are payable on maturity, the interest is compounded. Saving deposits encourages and mobilise the small savings of the people. Rate interest paid on these deposits is low as compared to that on fixed deposits. Home safe account is provided to the depositor in the form of a safe to keep it at home and put his small savings in it. At regular intervals, the amount saved in the safe is credited to the depositor’s bank account.

Small saving schemes:

There are various small saving schemes offered by National savings organisation. These schemes include National
Saving Certificates, Indira Vikas Patra, Kisan Vikas Patra, Rahat Patra, Public Provident Fund, National Saving Schemes etc. These investments are administered through selected post offices and banks. It imposes no restriction on the withdrawals, unlike in a commercial bank. Withdrawals from the account are made by cheque. The post office recurring deposit covers free life insurance cover. In the event of death of the depositor after a minimum period of two years of deposit, the nominee will get the full maturity value of the account, only when the account still exist and no withdrawals have been made in between.

**Company deposits:**

Companies are permitted to borrow money from the public by way of fixed deposits. These deposits are unsecured and also not insured. Further, they are subjected to the regulations of Government. Though deposits yield high rate of interest, they have no tax exemption and thus are considered risky.

**Social security deposits:**

Social security funds include savings in insurance, pension and provident funds.
Equity shares, Preference shares, Debentures:

Equity shares are issued by companies to the public through a prospectus. After the public issue, they are listed on the stock exchanges. Well managed and profit making companies reward their shareholders through dividends, bonus issues, right issues etc. However, investment in equity shares is risky because no fixed/minimum return is assured on them. The return on these securities varies with the profits of the company. The holders of these shares are called residual owners because they get dividend after servicing debt capital, after paying taxes to the Government and after servicing preference capital. However, the advantage of investing in equity shares is that, the holders of these shares are likely to receive a large part of profit. Risk taking investor prefers such shares.

Preference shares have priority over equity shares with regard to dividend or capital or both. The holders of preference shares get fixed rate of dividend every year. But these shares are not popular among the investing public.

Debentures are low risky securities as a fixed interest is assured on them irrespective of the company’s profits. The
debenture holder is paid back his amount before the preference and equity shareholders. Companies can issue debentures either as secured non-convertable or as convertable debentures.

**Mutual Funds:**

According to SEBI (Mutual Funds) Regulations 1993:

"Mutual Fund means a fund established in the form of a trust by a sponsor to raise money by the trustees through the sale of units to the public under one or more schemes for inviting in securities in accordance with these regulations".

The functions of the mutual fund can be understood with the help of Exhibit 1.1

![Diagram of Mutual Funds](Exhibit 1.1)
The basic objective of any mutual fund is to provide a vehicle for the investors to avail of the benefits of investment in the capital market and money market. A mutual fund motivates small and big investors to entrust their savings to it so that these are professionally employed for ensuring good returns. Mutual fund comes to the rescue of those investors who does not have proper knowledge of selecting a good portfolio. It can mobilise more number of small savings. Thus, at micro level investor is benefited as he can have a well developed portfolio of his investment. At macro level the economy as such is also benefited by mutual funds, which can mobilise larger volumes of funds and thereby extends financial assistance required for industrial development.

Special Features of Mutual Funds:

Investors generally prefer to build their portfolios according to their own ability, knowledge and experience. Mutual funds comes to the rescue of those people who do not excel at stock market due to certain mistakes they commit viz., lack of sound investment strategies, untimely decisions of
investing or disinvesting etc. Mutual funds today have become better option as compared to a number of other small savings instruments. The following are the special features of mutual funds that encourage and initiate investors to opt for mutual funds thus increasing its popularity.

1. **Liquidity of investment:**

   A distinct feature of mutual funds over other investments is that there is always a market for its units. Open-ended schemes of mutual funds provide liquidity by extending the facility of buy-back of units from investors at NAV. Investors in Close-ended schemes also have sufficient liquidity for their investments as they are listed on stock exchanges and can be sold in market at the prevailing rates. Further, mutual fund units can be pledged or mortgaged with commercial banks or financial institutions to obtain a loan as per the rules and regulations of the banks or financial institutions.

2. **Diversification of portfolio:**

   Funds pooled from large number of investors ensure that the corpus of a mutual fund is very large. This facilitates the
mutual fund to invest in companies belonging to different industrial sectors and thereby reduce the risk.

3. Expertise of professional management:

This is the main characteristic that attract the small investors who lack sufficient knowledge and expertise to build a portfolio on their own and also cannot afford or do not have access to, higher caliber and expensive investment advisor. Every mutual fund establishes a separate Asset Management Company consisting of professionals/experts to manage the funds mobilised.

4. Reduced risk:

Risks that are generally involved in investments like, recovery of principal amount, return on it, etc. can be minimised with the expert supervision, liquidity of units and diversification of portfolio ensured in mutual funds.

5. Meets the diversified needs of various investors:

Mutual funds provide different schemes to the investors. Investors may or may not prefer regular dividends. For those who does not want regular dividends, mutual fund continuously reinvest their dividends and provide them growth schemes and
for those who want dividends, mutual funds distribute dividends under the regular income schemes.

6. **Economies of scale:**

   Mutual funds have large corpus, which enables the fund to buy at a lower rate and sell at a higher rate than the individual investors do. Bulk purchase or sale of securities enables the mutual funds to pay lower brokerage charges and other floatation costs.

7. **Tax shelter:**

   In India, a tax rebate upto 20% of investment is available for equity-linked schemes of mutual funds under section 88. Further, the 1999 budget has made the mutual fund investor exempt from paying the tax on the returns of Mutual Funds under section 10(33) of the Income Tax Act.

**Genesis and Growth of Mutual Fund Industry:**

The origin of mutual funds can be traced to Belgium, where ‘Society Generate de Belgium’, was established in 1882 as an investment company to finance investment in national industries with high associated risks. The concept of mutual
funds has been spread to England and America in 1868 and 1924 respectively. In India, the mutual fund concept took root only in 1960s. Sensing the need for more active mobilisation of household savings to provide financial assistance to industries, the mutual fund business was started by UTI under the Unit Trust of India Act, 1964. US-64 was the first scheme to be launched by UTI with RBI, LIC, SBI, other banks and financial institutions as its contributors and trustees. Upto 1987, the UTI was the sole offeror of mutual fund schemes. The monolithic structure of mutual fund industry came to an end in 1987 when Government of India, by amending Banking Regulation Act enabled commercial banks in public sector to set up subsidiaries operating as trust to perform the functions of mutual funds. Even the investment institutions like LIC, GIC also entered the mutual fund industry in the same year. In 1993, private sector banks also entered the mutual funds making the industry more competitive. Besides this, foreign players also entered the mutual fund industry increasing the expectations of investors. With the institutionalisation of the capital market the mutual fund industry is gaining momentum.
In India, mutual funds have been playing a very important role in channelising savings into the capital market. The data available on investible funds generated by mutual fund industry in India reveals that it could as a whole generate investible funds to the tune of Rs.73,406 crores out of which UTI alone could generate Rs.58,432 crores (79.60%); Public Sector Banks Sponsored Mutual Funds could generate Rs.12,517 crores (17.00%); Private Sector Mutual Funds could generate Rs.1,654 crores (2.30%) and Mutual Funds Sponsored by Foreign Institutions could generate only Rs.803 crores (1.10%).

The mutual fund industry has grown to the size of 35 Asset Management Companies (AMCs), which run 384 schemes with a total asset base of Rs.1069.29 billion in September, 2002. The size of Mutual Fund Industry in India can better be understood with the help of the data presented in the following table:
### Table – 1.1

**Market size of Mutual Fund Industry**  
(In billion rupees)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Sep'02</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit Trust of India</td>
<td>442.55</td>
</tr>
<tr>
<td>Sponsored by state-owned banks(5)</td>
<td>45.29</td>
</tr>
<tr>
<td>Sponsored by other state-owned institutions(4)</td>
<td>51.96</td>
</tr>
<tr>
<td>Private Sector</td>
<td></td>
</tr>
<tr>
<td>1. Indian (7)</td>
<td>67.33</td>
</tr>
<tr>
<td>2. Joint ventures: Predominantly Indian (8)</td>
<td>153.35</td>
</tr>
<tr>
<td>3. Joint Ventures: Predominantly Foreign (10)</td>
<td>308.81</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td>1,069.29</td>
</tr>
</tbody>
</table>

**Source:** Business World, 18th Nov. 2002, Vol. 22 Issue 25 P. No. 44

The growing market size of mutual fund industry as depicted in the above table can be attributed to several advantages that the mutual funds offer to its investors. The following are some of the benefits offered by mutual funds.
UTI - Unit Trust of India  
SSOB - Sponsored by state-owned banks  
SSOI - Sponsored by other state-owned institutions  
PS - Public Sector  
Indian  
Joint Ventures: Predominantly Indian  
Joint Ventures: Predominantly Foreign  

Fig 1.1
Share of various institutions in Mutual Fund Industry

<table>
<thead>
<tr>
<th>Institution</th>
<th>Indian</th>
<th>Joint Ventures: Predominantly Indian</th>
<th>Joint Ventures: Predominantly Foreign</th>
</tr>
</thead>
<tbody>
<tr>
<td>UTI</td>
<td></td>
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<tr>
<td>SSOB</td>
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<td>PS</td>
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</tbody>
</table>

Joint Ventures: Predominantly Indian

Joint Ventures: Predominantly Foreign

SSOB

SSOI

UTI
Benefits of Mutual Funds:

The funds mobilised by the mutual funds, largely from small investors, are invested in corporate securities. Thus, they provide an opportunity to the investors to indirectly own the corporate securities, which give them a number of benefits. They are:

1. Mutual funds provide small and moderate investors, an opportunity that is enjoyed by large, rich investors with regard to realisation of high and secured rate of return on their savings by spreading the investments over a large number of different kinds of stocks.

2. It facilitates the small investors to have the benefit of professional management, which in turn benefits them to earn a relatively higher rate of return than what their independent investment would earn.

3. Risk of loss due to ill-informed and misinformed purchase/sale is also reduced by mutual funds since the managers of these funds have better access to information.

4. It also satisfies the diversified needs of those investors who do not have enough time, knowledge, expertise, experience and
resources for directly accessing profitable avenues in capital and money markets.

5. Mutual funds also render certain services like investment consultancy, judicious investment decisions, professional management of portfolio etc., at affordable costs.

6. As the savings and investments are pooled, mutual funds enjoy the benefits of economies of scale of operations.

7. Mutual funds also assure greater liquidity to its investors through its open-ended schemes, which provide the facility of buy-back of units from investors at a price fixed by them.

8. The tax-saving schemes of mutual funds provide some tax benefits to its shareholders.

To sum up, it can be rightly said that informed investment, safety of funds, dispersal of risk, a reasonably satisfactory yield, tax advantages etc., are the hallmarks of mutual funds.

**Organisation and Structure of Mutual Funds:**

The organisation of Mutual Funds includes five key players.

They are:

1) The sponsor
2) The Board of Trustees or Trust Company

3) The Asset Management Company

4) The Custodian and

Sponsor:

Sponsor is the organisation, which establishes the mutual fund. The sponsor has to follow the rules and regulations laid down by SEBI in order to promote the mutual fund business. The sponsor of mutual fund should be eligible for which it should be a Registered company, Scheduled Bank or all India or State Level Financial Institutions of good track record, positive net worth, good management, fair dealings and integrity.

In India, the SBI Mutual Fund is sponsored by SBI capital market, Canbank Mutual Fund by Can Bank Financial Services Limited, a subsidiary of Canara Bank, 20th Century Mutual Fund by 20th Century Finance Corporation.

Asset Management Company (AMC):

AMC manages the funds of the various schemes by employing large number of professionals for investment and research. It looks after the business of mutual fund under the supervision and guidance of the trustee. The AMC should be a
private or public limited company, which may or may not be listed. The AMC may be a new or an existing company, carrying on the business of merchant banking, venture capital, leasing or any other financial services. The sponsoring company should have a 40 percent stake in the paid-up equity of the AMC. Public issue, NRIs or foreign equity participation as permitted by the RBI can bring in the rest. The minimum net worth of AMC should be at least Rs. 5 crores. The AMC should not invest funds in any company under any of its schemes managed by it for which it has provided any financial service. The AMC should prepare its Memorandum and Articles of Association to get the approval of the SEBI. AMC is authorised to do business, if the following conditions of SEBI are fulfilled.

i. If the AMC is an already existing company, it should have a sound track record, general reputation and fairness in all its business transactions;

ii. The directors of AMC should be persons of high repute having at least 10 years of professional experience in portfolio management, investment analysis, and in financial administration;
iii. At least half of the Board of AMC should be independent directors not connected with the sponsoring organisation.

iv. The AMC should at all times have a minimum net worth of Rs. 5 crore.

SEBI is authorised to withdraw the grant given to AMC if its functioning is not in the interest of investors. Within three months of such withdrawal by SEBI, the board of trustees of a mutual fund may appoint another AMC or liquidate the mutual fund as may be necessary.

**Trustee:**

Trustees are people with high experience who carry the responsibility of safeguarding the interests of investors by constantly reviewing the operations of the schemes. Trustees can demand required information from AMC as and when needed. They have to submit a half-yearly report to the SEBI and an annual report to the investors. At least half of the Board of Trustees should be independent members not connected with the sponsoring organisation or any of its subsidiary.
**Custodian:**

Every mutual fund shall have a custodian who is not in any way associated with the Asset Management Company. The custodians carries activity of safe keeping of the securities or participate in any clearing system on be half of the mutual fund to effect deliveries of the securities. The approval of any agency as custodian would depend up on its track record, experience, quality of services, computerisation and other infrastructural facilities.

Every mutual fund proposed by a sponsor has to be set up as a trust under the Indian Trust Act, 1882. All mutual funds have to be registered with the SEBI. The sponsors, the Board of Trustees, the Asset Management Company and the Custodian should maintain good and healthy relations in order to reduce conflict of interests, and to safeguard the interest of the investors.
Structure of Mutual Fund Industry in India

Exhibit 1.2