Chapter – 2

Development of Mutual Funds Industry in India

(a) Financial System of India.
(b) Capital Market in India.
CHAPTER – 2

Development Mutual Funds Industry In India

An InDepth Study Of The Financial Performance Of Unit Trust Of India
Contents

2.1 Introduction.

2.2 Concept.

2.3 Origin of the Fund.

2.4 Types of Funds.

2.5 Importance.

2.6 Organisation of the Fund.

2.7 Facilities Available to Investors.

2.8 Fund Unit Vs Share

2.9 Mutual Fund 2000.

2.10 Commercial Banks & Mutual Funds.

2.11 Mutual Funds Abroad.

2.12 Mutual Funds in India.

2.13 Reason for Slow Growth.

2.14 Future of Mutual Funds

2.15 Guidelines for Mutual Funds

2.16 Conclusion.

2.17 References.
2.1 Introduction

Saving from an important part of the economy of our nation. With savings invested in various options available to the people, the money acts as the driver for growth of the country. Indian financial scene too presents multiple avenues to the investors. Though certainly not the best or deepest of markets in the world, it has ignited the growth rate in mutual fund industry to provide reasonable options for an ordinary man to invest his savings.

Investment goals vary from person to person. While somebody wants security, others might give more weightage to returns alone. Somebody else might wants to plan for his child's education while somebody might be saving for the proverbial rainy day or even for life after retirement. With objectives defying any range, it is obvious that the products required will vary as well.

Though still at a nascent stage, Indian Mutual fund Industry offers a plethora of schemes and serves broadly all types of investors. The range of products includes equity funds, debts, liquid, gilt and balanced funds. There are also funds meant exclusively for young and old, small and large investors. Moreover the set up of a legal structure, which has
enough teeth to safeguard investors' interest, ensures that the investors are not cheated out of their hard-earned money.

The history of Mutual Funds in India is not very old. It started with the establishment of the Unit Trust of India in the year 1964. However, the real take-off started when public sector banks entered into this area in the year 1987. Today India occupies the 10th position in the World. But the total fund raised from the capital market is just 7% of household savings and individual investors still do not form a large percentage of mutual fund resources. Experience of other countries shows that with the development of the capital market more household savings are channeled into the secondary market through institutions like mutual funds. This is quite visible from the growing popularity of mutual funds in India.

According to a study prepared by Prof. G. Setha, UTI Institute of capital Markets in August, 1999. The economic rationale for the existence of mutual fund product has been based on three agreements.

♦ A mutual fund can offer efficient diversification benefits which small investors cannot obtain with their limited investments.

♦ Mutual Funds can reduce expenses of portfolio management due to the presence of overall economies of scale.
Mutual fund managers can bring their professional expertise and full-time commitment to enhance portfolio performance.

The Indian mutual fund industry has come of age since the inception of Unit Trust of India, the first mutual fund, in 1964.

The industry at present has 38 players both in the public as well as private sector offering about 259 schemes and with a corpus of U.S. $24 billion by the end of March 1998. These schemes have been classified into growth, income-growth and tax-savings on the basis of their objectives.

The mutual funds collect small and scattered savings of investors and invest on their behalf in money and capital markets. The evaluation of fund performance is, therefore an extremely important issue. The fund managers, because of their sound information base and superior forecasting skills are expected to out-perform simple buy, and hold strategies like the market index. Superior performance can be attributed to stock selection skills and market timing coupled with luck.

All in all, benefits provided by them out across the boundaries of investor category and thus create for them, a Universal appeal.
2.2 Concept

Once decided to invest in the stock market, Mutual Funds are an easy way to own stocks without worrying about choosing individual stocks. But it is important to understand mutual funds. It is not complicated. A dictionary definition of a mutual fund might go something like this: a single portfolio of stocks, bonds and/or cash managed by an investment company on behalf of many investors.

A Mutual Fund is a trust that pools the savings of number of investors who share a common financial goal. The money thus collected is invested by the fund manager in different types of securities depending upon the objective of the scheme. These could range from shares to debenture to money market instruments. The income earned through these, investment and the capital appreciation realised by the scheme is shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed portfolio at a relatively low cost. The small savings of all the investors are put together to increase the buying power and hire a professional manager to invest and monitor the money. Anybody with an investible surplus of as little as a few thousand rupees
can invest in Mutual Funds. Each Mutual Fund scheme has a defined investment objective and strategy.

Mutual Fund is essentially a mechanism of pooling together the savings of a large number of small investor for collective investment, with an avowed objective of attractive yields and capital appreciation, holding the safety and liquidity as prime parameters.

The investment company is responsible for the management of the fund, and it sells shares in the fund to individual investors. When we invest in a mutual fund, we become a part owner of a large investment portfolio, along with all the other shareholders of the fund. When we purchase the units, the fund manager invests the same along with the money contributed by the other investors. Every day, the fund manager counts up the value of all the fund’s holdings, figures out the number of units purchased by shareholders/investors, and then calculates the Net Asset Value (NAV) of the mutual fund, the price of a single unit of the fund on that day.

Mutual funds put the pooled money of small investors in company’s stocks, government securities, bonds etc. Any downtrend in stock prices would have ripple effect on earnings of mutual funds’ investment.
Similarly any rates cut announced by the government on securities or bank deposits etc., will also do the same. Hence, the aspects of:

2. Government regulation of funds, and
3. Effective management by professional fund managers have an important role to play in deciding the fate of mutual fund industry in India.

The mutual fund industry is a fast growing sector of the Indian capital and financial markets. Starting with UTI, which was established in 1964, the industry over the years has grown to cross Rs. 100,000 crores of assets under management with about 400 different types of schemes covering all the assets classes—equity, debentures, Government securities and money market instruments. The industry consists of different segments, UTI with its unique structure and position stands apart with assets accounting for nearly two-thirds of the whole industry. The banks sponsored mutual funds established since 1987 as well as the financial institutions’ sponsored mutual funds since 1989 are the other segments followed by those funds set up from 1994 by private sector, joint sector predominantly Indian and Joint Sector predominantly foreign.
Table 2.1
Net assets of the Indian Mutual Funds Industry (Rs. Crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>UTI</th>
<th>Other Mutual Funds</th>
<th>Total</th>
<th>Year on year Growth Rate (%)</th>
<th>Net Accretion to Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>17650.92</td>
<td>1480.00</td>
<td>19130.92</td>
<td>42.18</td>
<td>5675.27</td>
</tr>
<tr>
<td>1991</td>
<td>21376.48</td>
<td>1784.99</td>
<td>23161.47</td>
<td>21.07</td>
<td>4030.55</td>
</tr>
<tr>
<td>1992</td>
<td>31805.69</td>
<td>6167.78</td>
<td>37973.47</td>
<td>63.75</td>
<td>14812.00</td>
</tr>
<tr>
<td>1993</td>
<td>38976.81</td>
<td>8756.69</td>
<td>47733.50</td>
<td>25.70</td>
<td>6760.03</td>
</tr>
<tr>
<td>1994</td>
<td>51708.88</td>
<td>10721.17</td>
<td>62430.05</td>
<td>30.79</td>
<td>14696.55</td>
</tr>
<tr>
<td>1995</td>
<td>59618.64</td>
<td>13348.58</td>
<td>72967.17</td>
<td>16.88</td>
<td>10537.12</td>
</tr>
<tr>
<td>1996</td>
<td>61528.39</td>
<td>12786.92</td>
<td>74315.31</td>
<td>1.85</td>
<td>1348.14</td>
</tr>
<tr>
<td>1997</td>
<td>59341.26</td>
<td>10856.15</td>
<td>70197.41</td>
<td>-5.54</td>
<td>-4117.90</td>
</tr>
<tr>
<td>1998</td>
<td>47611.69</td>
<td>11306.53</td>
<td>58918.22</td>
<td>-16.07</td>
<td>-11279.19</td>
</tr>
<tr>
<td>1999</td>
<td>56010.15</td>
<td>14613.35</td>
<td>70623.50</td>
<td>19.87</td>
<td>11705.28</td>
</tr>
<tr>
<td>2000</td>
<td>68524.00</td>
<td>34928.98</td>
<td>103452.98</td>
<td>46.49</td>
<td>32829.48</td>
</tr>
</tbody>
</table>

[Source : Mutual Fund Year book 2000]

Figures for UTI over the period 1964 – 1995 are investible funds (at cost) and include net assets of off-shore funds and venture capital schemes.

- Net assets of the mutual fund industry have grown over the period 1996 – 2000 from Rs. 74315 crore to Rs. 103,452 crores.
- Number of schemes has grown from 168 in 1996 to 326 in 2000.
- The UTI manages 66.2 % of net assets and the remaining 33.8 % is managed by other mutual fund.
Joint-Venture (pre-dominantly foreign) funds have witnessed the highest growth in net assets during 1996–2000 and account for 40% of the non-UTI net assets at the end of March 2000.

- 54.36% of the industry’s assets are in equity securities 32.28% in bonds and debentures of the corporate sector 10.5% in government securities and 2.6% in money market securities.


- Realised income of mutual funds as a proportion of net assets have gone up from 12.07% in 1996 to 18.94% in 2000.

- 54.18% of realised income is from profit on sale of investments which has replaced interest income as the dominant source of income for the industry. Interest income was 58.16% of total income in 1996.

- Significant reductions in expenses have been achieved by the mutual fund industry during 1996-2000. Expenses of mutual fund funds (other than UTI) have reduced from 11.05 of net assets in 1996. to 3.65% in 2000. UTI’s expenses were 2.56 of net assets in 2000.

- Operating expenses of mutual funds were 1.35% of net assets in 2000, management fees averaging 65 basis points on net asset of the industry.
Table 2.2

Corpus and schemes of Indian Mutual Fund Industry.

<table>
<thead>
<tr>
<th>Year</th>
<th>UTI</th>
<th>Other MFs.</th>
<th>Total</th>
<th>Year on Year Growth Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>43945.84</td>
<td>11229.14</td>
<td>55174.98</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>46713.30</td>
<td>10637.83</td>
<td>57351.13</td>
<td>3.94</td>
</tr>
<tr>
<td>1998</td>
<td>49518.07</td>
<td>10545.94</td>
<td>60064.01</td>
<td>4.73</td>
</tr>
<tr>
<td>1999</td>
<td>51717.71</td>
<td>11815.89</td>
<td>63533.60</td>
<td>5.78</td>
</tr>
<tr>
<td>2000</td>
<td>56789.73</td>
<td>23322.18</td>
<td>80111.91</td>
<td>26.09</td>
</tr>
</tbody>
</table>
Chart – 1

Corpus and Schemes of India Mutual Funds Industry

![Bar chart showing the corpus and schemes of India Mutual Funds Industry from 1996 to 2000. The chart includes data for UTI, Other MFs, and Total.]
Table 2.3

Scheme of Fund Industry. [Number of Schemes]

<table>
<thead>
<tr>
<th>Year</th>
<th>UTI</th>
<th>Other MFs.</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>54</td>
<td>114</td>
<td>168</td>
</tr>
<tr>
<td>1997</td>
<td>65</td>
<td>131</td>
<td>196</td>
</tr>
<tr>
<td>1998</td>
<td>76</td>
<td>159</td>
<td>235</td>
</tr>
<tr>
<td>1999</td>
<td>87</td>
<td>187</td>
<td>274</td>
</tr>
<tr>
<td>2000</td>
<td>87</td>
<td>239</td>
<td>326</td>
</tr>
</tbody>
</table>
Chapter - 2 Development Of Mutual Funds Industry In India

Chart – 2

Number of Schemes of Fund Industry

An Indepth Study Of The Financial Performance Of Unit Trust Of India
2.3 Origin of Mutual Fund

The Mutual Fund concept has been in vogue in the Western World since long. Its origin dates back to the very dawn of commercial industry. It is said that the Egyptians and the Phoenicians sold their shares in vessels and caravans with a view to spread the risk attached with these risky ventures.

The Mutual Fund originated in Britain in the 19th Century and the real credit of introducing the modern concept of Mutual Fund goes to the Foreign and Colonial Government Trust of India established in 1868. It developed in the U.S. in the late 19th and early 20th Century in principle money centres of North East followed by many countries in Europe, the Far East and Latin America. The term Mutual Fund being an American concept is also known as ‘Investment Trust’, ‘Investment Company’ and ‘Money Fund’. These funds were basically close-ended and used to finance growth in the U.S.A. after the Civil War. The crash of stock markets in 1929 led to the demise of these Close-ended funds. But later in the 30s, there was again a rise in the popularity of the fund. The enactment of Securities Act of 1933, Investment Company Act of 1940 and Investment Advisors Act 1940 led to the revival and regulation of Mutual Funds in the U.S.A. IN 1940, U.S. had about 65 funds; but by
1990 the number had exceeded 3000. In the year 1965, there were only 2%, 3% of U.S. households who owned fund shares. By 1990, about one fourth of all U.S. households had invested in Mutual Funds. In 1965, U.S. Mutual Fund. In annual sales were $4.4 billion, whereas, in 1990, its monthly sales was twice the previous level. The U.S. Mutual Funds managers have many other countries, such as, Italy, Japan, U.K., Germany, Canada, Australia, Mexico and of course India witnessed the growth of Mutual Fund Industry.

The need for establishing unit type of investing institutions was felt as early as 1931 when the Indian Central Banking Equiry Committee submitted its report. It was observed that “an immeasurable benefit to India is bound to grow from the establishment and proper working of Unit Trust and the assistance which they will give to the investors in the creation of intermediate securities which do no exist now, in providing a channel for investment in industrial and other fields where the primary investors would be too scared or too ignorant.” The Mutual Fund in India was launched first by the Unit Scheme 1964. It is an open-ended actual fund and enjoyed a monopoly position in the public sector until 1987. It also enjoyed unique tax benefits, such as exemption from income tax of its entire TDS, that is, if the annual income is more than
Rs. 10,000. After the Amendment to the Banking Regulation were allowed to set up Mutual Funds with prior approval of the RBI and the Government. Since then, SBI, Canara Bank, Punjab National Bank and some other Nationalized Banks have set up their own Mutual Funds.

Mutual fund industry, as it is a part and parcel of the economy will be moving with the movement in the Indian economy. Figure 2.1 depicts that how over the year mutual funds industry in India grew and the assets being management by it. This clearly brings out the importance of this investment channel in the Indian economy figure 2.1 depicts that how over the years mutual funds industry in Indian grew and the assets being managed by it. This clearly brings out the importance of this investment channel in the Indian economy. Noticeably, at times when share index had been doing well, even then mutual funds.

Conclusion: The entry of the commercial banks and private corporate sector have shown good potentiality for their growth in addition to a large number unlisted schemes operated by about 25 companies.
### Figure 3.

**Mutual Funds Swelling Corpuses**

| Series 1 |  
|----------|---
| 1964-69  | 65  
| 1969-74  | 172  
| 1974-79  | 402  
| 1979-86  | 1261  
| 1986-87  | 4563.68  
| 1987-88  | 738.81  
| 1988-89  | 13455.65  
| 1989-90  | 19110.92  
| 1990-91  | 23030.45  
| 1991-92  | 37480.2  
| 1992-93  | 46988.02  
| 1993-94  | 61301.21  
| 1994-95  | 75050.21  
| 1995-96  | 81026.52  
| 1996-97  | 80539.0  
| 1997-98  | 68984  
| 1998-99  | 68472  
| 1999-00  | 107946.1  
| 2000-01  | 90587  
| 2001     | 101821.8  

[Source: SEBI and AMFI as quoted in BT. Jan, 2002, P.69.]
Maintained their overall position in the Indian capital market. Figure 2 shows that in the year 1992-93, the assets under fund management were Rs. 46988.02 crores. But after the private sector mutual funds were allowed to enter the Indian market assets under fund management grew to Rs. 61301.21 crores in 1993-94 and touched the figure of Rs. 107946.10 crores in 1999-00. After falling back to Rs. 90587 crores in 2000-01 mutual funds industry withered the onslaught and managed to maintain assets under their management to Rs. 101821.8 crores which ultimately settled at Rs. 100594.0 crores by the end of March, 2002.

Table – 2.4 depicts that the mutual funds are the first choice of individual investors in all the mutual fund sectors i.e. Private, Public and UTI, the majority investors as against corporate bodies, both Indian and overseas and Institutional Investors. On overall basis, the individual investors.

(2.44) crores are the maximum as compare to other categories. This paints out to the fact that small investors still prefer to depend upon the expertise of mutual fund professional managers for booking after their capital market investment.
### Table 2.4

**Mutual Funds Investors Pattern (in percentages)**

<table>
<thead>
<tr>
<th>Item</th>
<th>Individual</th>
<th>Corporate &amp; Institutions</th>
<th>NR is, OCBs, &amp; Fills</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Sector</td>
<td>96.70</td>
<td>0.89</td>
<td>3.11</td>
<td>100</td>
</tr>
<tr>
<td>Public Sector</td>
<td>97.95</td>
<td>0.41</td>
<td>1.64</td>
<td>100</td>
</tr>
<tr>
<td>UTI</td>
<td>98.37</td>
<td>0.47</td>
<td>1.16</td>
<td>100</td>
</tr>
<tr>
<td>Overall Average</td>
<td>98.04</td>
<td>1.46</td>
<td>0.56</td>
<td>100</td>
</tr>
<tr>
<td>Investors (crores)</td>
<td>(2.44)</td>
<td>(0.41)</td>
<td>(0.23)</td>
<td>(3.08)</td>
</tr>
</tbody>
</table>

[Source : SEBI as quoted in financial Express (P-1) dated Aug.13, 2002]
Table 2.5

Mutual Funds close - ended scheme

<table>
<thead>
<tr>
<th>Year</th>
<th>UTI</th>
<th>Other Mutual Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>39</td>
<td>93</td>
</tr>
<tr>
<td>1997</td>
<td>47</td>
<td>107</td>
</tr>
<tr>
<td>1998</td>
<td>54</td>
<td>113</td>
</tr>
<tr>
<td>1999</td>
<td>60</td>
<td>117</td>
</tr>
<tr>
<td>2000</td>
<td>56</td>
<td>93</td>
</tr>
</tbody>
</table>

[Source : SEBI as quoted in financial Express (P-1) dated Aug.13, 2002]
Chapter - 2 Development Of Mutual Funds Industry In India

Chart - 4
Number of Close – Ended Schemes.

![Chart - 4](image-url)
Table 2.6

Number of Open – Ended Scheme

<table>
<thead>
<tr>
<th>Year</th>
<th>UTI</th>
<th>Other Mutual Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>15</td>
<td>21</td>
</tr>
<tr>
<td>1997</td>
<td>18</td>
<td>24</td>
</tr>
<tr>
<td>1998</td>
<td>22</td>
<td>46</td>
</tr>
<tr>
<td>1999</td>
<td>27</td>
<td>70</td>
</tr>
<tr>
<td>2000</td>
<td>31</td>
<td>146</td>
</tr>
</tbody>
</table>

[Source : SEBI as quoted in financial Express (P-1) dated Aug.13, 2002]
Chart – 5

Number of Open – Ended Schemes.
### Number of Scheme Across Fund categories

**Table 2.7**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>UTI</td>
<td>OMFs</td>
<td>Total</td>
<td>UTI</td>
<td>OMFs</td>
</tr>
<tr>
<td><strong>Equity Funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pure Equity Funds</td>
<td>11</td>
<td>27</td>
<td>38</td>
<td>12</td>
<td>30</td>
</tr>
<tr>
<td>Sectoral Funds</td>
<td>0</td>
<td>4</td>
<td>4</td>
<td>01</td>
<td>06</td>
</tr>
<tr>
<td>Tax Saving Funds</td>
<td>6</td>
<td>28</td>
<td>34</td>
<td>6</td>
<td>40</td>
</tr>
<tr>
<td>Index Funds</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(Balance Funds Pre-dominantly</td>
<td>1</td>
<td>8</td>
<td>9</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>equity)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Debt Equity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pure Debt. Funds</td>
<td>26</td>
<td>10</td>
<td>36</td>
<td>34</td>
<td>22</td>
</tr>
<tr>
<td>Gift Funds</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Sectoral Fund</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(Balance Funds Predebt)</td>
<td>9</td>
<td>14</td>
<td>23</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>money mkt. Of liquid fund</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

[Source: SEBI as quoted in financial Express (P-1) dated Aug.13, 2002]
2.4 Types of Funds

Today, when each industry has variety of products, it is not possible for the Mutual Funds Industry to stay away from the clutches of competition. No doubt, it is said that the variety of Mutual Funds has been made on the basis of the different needs and requirement of the people. But it is equally true that customer satisfaction is thought about in times of competition. It can be also said that the Mutual Fund Industry diversifies its services by providing different types of products in the market.

The mutual fund people basically divide their universe between open-ended and close-ended funds. Both the funds are pools of investors' money and are both managed by professionals to maximise diversification within a set strategy. The basic difference lies in the ownership structure of the funds.
OPEN-END FUND:

An open-end fund issues and redeems share on demand, that is, the investor can anytime put money into the fund or take it out. This happens routinely everyday and the total assets of the fund grow and shrink as money flows in and out. This means the more investors buy the Vanguard 500 Index fund, for instance, the more shares there will be. There is no limit to the number of shares the fund can issue. Neither the value of each individual share is affected by the number outstanding, since net assets value (NAV) is determined solely by the change in prices of the stocks or bonds, the fund owns, nor the size of the fund itself. The unit scheme (1964) of the Unit Trust of India is an example of an open-end fund.
CLOSED-END FUND:

A closed-end fund is a different animal. Like a company, it issues a set number of shares in an initial public offering (IPO) and which is open for subscription only during a specified times-period. These funds trade on exchange that is the units are bought or sold on the stock exchange where they are listed. In order to provide an exit route for investors, some close-ended funds give an option of selling back the units to the Mutual Fund through periodic selling at NAV related prices. The SEBI Regulations stipulates repurchase at least one of the two exit routes is provided to the investor. Investing in closed-end funds can be very confusing for the investors who are just beginners. Most investors who buy closed-end funds look for those with solid returns that are trading at large discounts. At the time of redemption, the entire investment pertaining to a closed-end scheme is liquidated and the proceeds are distributed among the unit holders.

INTERVAL FUND:

Another type of fund based on its structure is Interval Fund. Not being much prominent in the market, such funds have the combined features of open-ended and close-end schemes. They are open for sale or redemption during pre-determined intervals at NAV related prices.
In a nutshell the open-ended funds have a perpetual existence and their corpus is ever-changing depending upon the entry and exit of members. Those who are novice in the market should not get into close-ended funds. For them, the best is the open-ended fund.

There are various other modes and methods to distinguish the types of fund dealt with in the market. The remaining funds have been classified according to its yield and investment pattern as such which is shown in fig 6.

❖ **INCOME FUND**:

The aim of income funds is to provide regular and steady income to investors. Such funds employ their fund in high yielding common stock. There are two basic group within this fund:

(a) Those that stress constant income at relatively low risk and those.

(b) That attempt to achieve the maximum income possible even with the use of leverage.

Such schemes generally invest in fixed income securities such as bonds, corporate debentures and government securities. Funds are ideal for capital stability and regular income.
❖ **GROWTH FUND:**

The aim of growth funds is to provide capital appreciation over the medium to long term. They do not offer fixed regular returns. The investment by such funds are predominantly made in equities of high growth companies. It has been proved that returns from stocks, have out performed most mother kind of investment held over the long term. Growth schemes are ideal for investors having a long-term outlook seeking growth over a period of time.

❖ **BALANCED FUND:**

The aim of balanced funds is to provide both growth and regular income. In fact, this fund is also known as “income-cum-growth” fund. Such schemes periodically distribute a part of their earning and invest both in equities and fixed income securities in the proportion indicated in their offer documents. In a rising stock market, the NAV of these scheme may not normally keep pace, or fall equally when the market falls. These are ideal for investors looking for a combination of income and moderate growth.
♦ **MONEY MARKET FUND:**

The aim of money market funds is to provide easy liquidity, preservation of capital and moderate income. These schemes are basically open-ended funds. They generally invest in safer short term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money. Returns on these schemes may fluctuate depending upon the interest rates prevailing in the market. These are ideal for corporate and individual investors as a means to park their surplus funds for short periods.

❖ **TAXATION FUND:**

A taxation fund is basically a growth oriented fund, but the exception is that it offers tax rebates to the investors under specific provisions of the Indian Income Tax Laws, as the Government offers tax incentives for investment in specified avenues. Investment made in Equity Linked Savings Scheme (ELSS) and Pension Scheme are allowed as deduction U/S 88 of the Income Tax Act. 1961. The Act also provides opportunities to investors to save capital gains U/S 54EA and 54 EB by investing in Mutual Funds. The tax Saving Magnum of SBI capital Market Limited is the best example for the domestic type.
Table 2.9

Net Assets: Industry segment—wise

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UTI</td>
<td>61528.39</td>
<td>59341.26</td>
<td>47644.69</td>
<td>56010.15</td>
<td>68524.00</td>
<td>21.77</td>
</tr>
<tr>
<td>Other Mutual Funds</td>
<td>12786.92</td>
<td>10856.15</td>
<td>11306.56</td>
<td>14613.65</td>
<td>34928.98</td>
<td>22.260</td>
</tr>
</tbody>
</table>

❖ All data's presented in these tables have been calculated from the audited unabridged annual reports of Mutual Funds.

Table 2.10

Percentage Composition of Net Assets.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>OMFs</td>
<td>17.21</td>
<td>15.47</td>
<td>19.19</td>
<td>20.69</td>
<td>33.76</td>
</tr>
<tr>
<td>UTI</td>
<td>82.76</td>
<td>84.53</td>
<td>80.81</td>
<td>79.31</td>
<td>66.24</td>
</tr>
</tbody>
</table>

Source: Audited Unabridged Annual Reports of MFs.
Table 2.11
Corpus: Industry Segment Wise

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UTI</td>
<td>43945.84</td>
<td>46713.30</td>
<td>49518.07</td>
<td>51717.71</td>
<td>56789.73</td>
</tr>
<tr>
<td>Other MFs.</td>
<td>11229.14</td>
<td>10637.83</td>
<td>10545.94</td>
<td>11815.89</td>
<td>66.24</td>
</tr>
</tbody>
</table>

Source: Audited Unabridged Annual Reports of MFs.

Table 2.12
Number of Schemes - Across Industry Segments

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UTI</td>
<td>54</td>
<td>65</td>
<td>76</td>
<td>87</td>
<td>87</td>
</tr>
<tr>
<td>Total OMFs.</td>
<td>114</td>
<td>131</td>
<td>159</td>
<td>187</td>
<td>239</td>
</tr>
</tbody>
</table>

Source: Audited Unabridged Annual Reports of MFs.
Table 2.13

Net Assets : Open ended and close ended Funds.

(1) Close ended funds

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UTI</td>
<td>33164.49</td>
<td>30011.96</td>
<td>25976.07</td>
<td>32799.40</td>
<td>36640.36</td>
</tr>
<tr>
<td>OMFs.</td>
<td>11333.56</td>
<td>9433.84</td>
<td>8046.01</td>
<td>8648.45</td>
<td>8501.59</td>
</tr>
<tr>
<td>(% Total Assets of UTI)</td>
<td>59.88</td>
<td>56.19</td>
<td>57.74</td>
<td>58.69</td>
<td>43.64</td>
</tr>
</tbody>
</table>

Source : Audited Unabridged Annual Reports of MFs.
Closed Ended Funds
## (2) Open Ended Funds

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UTI</td>
<td>28363.89</td>
<td>29329.30</td>
<td>21635.62</td>
<td>23210.74</td>
<td>31883.64</td>
</tr>
<tr>
<td>Total OMFs.</td>
<td>1453.36</td>
<td>1422.31</td>
<td>3260.53</td>
<td>5964.90</td>
<td>26427.39</td>
</tr>
<tr>
<td>(% Total Net Assets)</td>
<td>40.12</td>
<td>43.81</td>
<td>42.26</td>
<td>41.31</td>
<td>56.36</td>
</tr>
</tbody>
</table>

Source: Audited Unabridged Annual Reports of Mutual Funds.
SPECIALIZED FUND:

These funds offer special schemes so as to meet the specific needs of specific categories. Some of the schemes are Industry Specific Schemes, Index Schemes and Sectoral Schemes.

OFF SHORE FUND:

These are mutual funds with investments source abroad. The subscription to these funds is mobilised from international financial markets for investment in the economic and capital market of specific countries.

CONCLUSION:

The only withdrawable conclusion is that the Indian Financial System provides varied products in order to suit the requirements of the public of India. Yet wide recognition is what is required.

2.5. Importance:

The mutual fund industry today is an important participant of the financial institutions leading towards the economic development of any country. In general, the mutual funds are important to the public and the
country’s economy at large. Such funds functions as financial intermediaries mobilising the savings of those who have surplus income and channelising the same in those avenues where there is demand for funds. Mutual funds reduces risks of their bond holders by evolving schemes suitable to the preferences of the saver looking for either income or capital gains. They provide their investors the combined benefits of low risk, steady return, high liquidity, minimum paper work and capital appreciation through diversification and expert management. The mutual funds develop the expertise by setting up a professionally – managed structure which would look after the needs of the investing public.

Investors of all categories could choose to invest on their own in multiple options, but opt for mutual funds for the sole reason that all benefits come in a package.

The importance of mutual funds can be listed as below.

1. **CHANNELISING SAVINGS FOR INVESTMENT**

The mutual funds act as a vehicle in galvanising the savings of the people by offering various schemes suitable to the various classes of customers for the development of the economy as a whole. Such funds are investment vehicles where people with similar investment objectives
come and invest accordingly. The mutual funds then invest the collected fund according to the investment objectives specified at the time of launching a scheme. Equity funds, debt funds, gift funds and many others are available to cater the different needs of the investors. The availability of these options are beneficial to the investors as well as the economy as a whole.

❖ COMMENTS:

Hence, it can be concluded that the mutual funds industry provides a pathway to the small savers to combine together and opt for any one or two types of mutual funds and cater themselves with constant returns on that small amount of savings.

2. DIVERSIFICATION AND WIDE PORTFOLIO INVESTMENT

Savers of moderate means in the under-developed regions are generally reluctant to invest in corporate securities because of their lack of adequate knowledge about complicated investment affairs. The savings of such investors represents a part of the funds’ entire portfolio diversified in terms of securities, units, industries and geographical regions. The risk undergone by the fund is diversified by investing in
large variety of shares and bonds which is not possible job of small and medium investors. By investing in mutual funds investors are assured of low risks, steady return, liquidity and capital appreciation. Such is possible through diversification, because all stocks do not move in the same direction at the same time. The mutual funds take upon themselves the problems which confront the small savers and helps mobilise their savings and promote thrift.

❖ COMMENTS:

It is clear from the above discussion that after burning their fingers in stock exchange operations, the small savers are to find the mutual funds as a boon for them. They can now enjoy the wide portfolio of investment held by the mutual funds.

3 POTENTIAL OF BETTER RETURNS:

Returns on the mutual funds are generally better than any other option in any other avenue over a reasonable period of time. People can pick their investment horizon and put in the chosen fund for the duration. Equity funds can out perform most other investment over long periods by placing long-term calls on fundamentally good stocks. The debt funds too shall out perform other options such as banks. Though they are affected by the interest rate risk in general, the returns generated are
more as they pick securities with different duration that have different yields and so are able to increase the overall returns from the portfolio. The pooling of the funds from a large number of customers enables the mutual fund companies to have large funds at its disposal. These large funds enables the fund companies to buy cheaper and sell dearer shares than the small and medium investors. The fund companies are able to predict better market rates and lower rates of brokerage. Playing the role of financial intermediaries, mutual funds provide a convenient and effective link between savings and investments. On one hand, they help the investing community by offering a share of corporate growth, on the other they have a salutary impact on the stock market.

The transaction costs of large investment are definitely lower than that of small investments. In fact, all the profits of a mutual fund are passed on to the investors by way of dividends and hence capital appreciation. The expenses pertaining to a particular scheme alone are charged to the respective scheme. The funds have blended caution with aggression and analysis with intuition converting market opportunities into lucrative returns for the investors. Most of the mutual funds so far floated have given a dividend at the rate ranging between 12 % p.a. to 17 % p.a. providing a fair good yield.
Hence, specifically one can avail of benefits of better returns with added benefits of any time liquidity by investing in open-ended debt funds at lower risks-companies sometimes do assure of high returns, but get bust in course of time leading to distraught investors as well as pending cases in the company Law Board. Therefore, for those who are not adopted to understanding the stock market, the task of generating superior returns at similar levels of risk, mutual fund can prove to be the best opt.

4. AVAILABILITY OF EXPERTISED INVESTMENT SERVICE AT LOW COST:

The risk of default by any company that one has chosen to invest in can be minimized by investing in mutual funds as the fund managers' analysis of the companies' financials more minutely than an individual can do. Such managers are employed professionals of the fund companies. These managers hold expertise and years of work experience as backup. The investment decisions of these managers are always backed by informed judgment and intensive research. Due to the complex nature of the securities market, a single investor cannot work all by himself. The professionals manage the maturity of their portfolio by investing in instruments of varied maturity profiles. Since there is no
penalty on pre-mature withdrawal, as in the cases of fixed deposits, debt funds provide enough liquidity. Moreover, mutual funds are better placed to absorb the fluctuations in the prices of the securities as a result of interest rate variation and one can benefit from any such price movement.

❖ COMMENTS:

It can be figured out from the above discussion that investing into the mutual funds means to put the investors’ botheration, onto the fund manager’s shoulder.

5. CONDUCTS RESEARCH FOR INVESTORS’ BENEFIT:

As prominent from the heading, the funds have to carry out research works. Infact, the whole network and the dealing of the shares require proper before - hand research work to be conducted. With the vast field of an availability of the information systems, the conducting of research and the in depth study of the corporate securities should become an easy task for the funds. Each fund maintains a large research team which constantly analyses the companies and the industries and recommends the fund to buy-sell a particular share. Since research involves a lot of
time, effort and expenditure, an individual investor cannot take upon such a work. Hence, by investing in a mutual fund, the investor get the additional benefit of the research done by the fund.

Comment:

If viewed from the number of benefits' side, the comparable number provided by the fund can attract good amount of customers. The investor are sure to benefit of the money invested by them in the fund. What counts the most are the services provided by the funds.

6. POST TAX BENEFITS:

Mutual funds also provide tax benefits to its customers. Apart from liquidity, these funds provide very good post-tax returns on year-to-year basis. Even historically, it is found that some of the debt funds have generated superior returns at relatively low level of risks. On an average debt funds have posted returns over 10 percent over one-year horizon. The best performing funds have given returns over/around 14 percent in the last one-year period. The mutual funds themselves are totally exempted from tax on all income on their investment. But the other companies have top pay taxes and they can declare dividends only from the profit maintained after payment of tax. But, mutual funds do not deduct tax at source (TDS) from dividends received and finally payable,
proving to be a boon to the investors. The mutual funds are charged with a dividend distribution tax on dividend paid out at 10% (plus a surcharge of 10%), the net income is still tax free in the heads of investors and is generally much more than all other avenues, on a post tax basis.

❖ COMMENT:

In a nutshell, it can be said that these funds have delivered more than what one expects of debt avenues, such as, bank fixed deposits.

7. AVAILABILITY OF FLEXIBLE INVESTMENT SCHEDULE:

For any sort of business to be carried out, it is very important for the firm or the industry as a while to provide attention to consumer satisfaction and their tastes and preferences. For the above reasons, certain mutual funds permit their investors to exchange their units from one scheme to another. Such mutual funds provide wide span of flexibility with features such as regular investment plans, regular withdrawal plans and dividends reinvestment plans enabling systematic investment or withdrawal of funds. The smallest or the dividend earned gets reinvested. For example, the Income Units can be exchanged for
Growth Units depending upon the performance of the funds. Such a flexibility may not be enjoyed in other investment.

❖ COMMENT:

From the above paragraph, one can derive that the mutual funds acts as those vehicles which provides pathways to those investors not having the stability of mind. Those investors not having the capacity to carry risk and uncertainty, find such types of mutual funds as a boon on them.

8. HIGHER RATE OF AFFORDABILITY AND LIQUIDITY:

Mutual Funds offer a relatively less expensive way to invest when compared to other avenues such as capital market operations. The fee in terms of brokerages, custodial fees and other management fees are substantially lower than other options and are directly linked to the performance of the scheme. It is affordable for small investors to participate into the investment business through the mutual funds. These small investors may not even be in a position to think of being able to be a part of number of investment.

Fixed deposits with companies or in banks are usually not withdrawn premature, because there is a penalty clause attached to it, whereas, the
investors can withdraw or redeem money at the Net Asset Value (NAV) related prices in the open-end schemes. In closed-end schemes, the units can be transacted at the prevailing market price on a stock exchange. Mutual funds also provide the facility of direct repurchase at the Net Asset Value (known as Premium) or less than the Net Asset Value (Known as Discount) depending on the expected future trend of the Net Asset Value, which in turn is linked to general market conditions. Bullish markets may result in schemes trading at premium, while in bearish markets the funds usually trade at Discount. This means that the money can be withdrawn at any time, without much reduction in yield. Such types of funds provide quick and easy access to liquid cash. On the other hand, the branches of the sponsoring bank are always ready to provide loan facility against the unit certificates.

9. **SIMPLIFIED RECORD KEEPING:**

Unlike the company fixed deposits, where there is little control with the investment being considered as unsecured debt from the legal point of view, the mutual fund industry is very well regulated. All investments have to be accounted for, decisions judiciously taken. SEBI acts as true watchdog in this case and can impose penalties on the AMCs at fault.
The regulations designed to protect the investors' interest are also important and implemented effectively.

On the other side of the coin an investor with just an investment in 500 shares or such in about 3 to 4 companies, need keep proper records of dividend payments, bonus issues, price movements, purchase or sale instruction, brokerage and other related items. For so many investors as a whole, keeping records of minute details all by themselves is a tedious and a time consuming job. With not much practice, such investors may even forget to maintain records sometimes. Mistakes conducted on such levels may also lead to the forfeiture of their savings by the company.

❖ COMMENT:

The investors of Mutual Funds are exempted from the burden of maintaining plenty records. All they have to do is to maintain record of one deal with the mutual fund.

10. SUPPORTS CAPITAL MARKET:

The Mutual funds play an important role in supporting the development of the capital market. The overall functioning of a capital market is based on the liquid money available to it by various means. The mutual funds are one of the means. Here, the entire job of mutual funds can be
understood. These funds pool money from their investor, invest them into the capital market, earn dividend and speculative profits and after deducting their surplus, distribute the remaining to their investors. When foreign investors and speculators exit and re-enter the markets, mutual fund keep the market stable and liquid. In the absence of mutual funds, the prices of shares would be subject to wide price fluctuation due to the exit and re-entry of speculators into the market.

❖ COMMENTS:

The mutual funds, thus, render an excellent support to the capital market and help in the process of institutionalizations of the market. The current scene of the capital market would have been much different from what it is today, in the absence of the mutual funds. The mutual funds provide oxygen for the existence of the capital market.

11. PROMOTES INDUSTRIAL DEVELOPMENT:

The capital market comprises of the equity issued by the corporate companies for creating capital fund. It is very important that these companies are avail of funds, since these are the one which lead to the economic development of a country by industrial advancement and
agricultural development. The industries are assured of their capital requirement by the sole existence of the mutual funds. They are provided financial resources at market rates.

❖ COMMENTS:
The Mutual funds have great hands behind the economic development of a country.

12 ACTS AS SUBSTITUTE FOR INITIAL PUBLIC OFFERINGS (IPOs):
Many-a-times, investors are unable to get allotment in IPOs of companies, because they are often over subscribed. Moreover, a minimum of 500 shares have to be applied for, which may be unsuitable to small investors. But, incase of mutual funds, allotment is more-or-less confirmed. This is easy, since, Mutual Funds are guaranteed a certain percentage of IPOs by companies. Hence, by participating in Mutual Funds, investors are able to get the satisfaction of participating in various companies.
❖ COMMENTS:

The Mutual funds in such, provide services to the corporate companies and the public.

13. REDUCES THE MARKETING COST OF NEW ISSUES:

When a company plan to issue their shares in the market, they have to undertake major expenses. But after the happening of the Mutual Funds, the companies before-hand allot a major share of the Initial Public Offering to the Funds. In the whole process, the company offering the IPOs save a lot by reduced marketing expenses. This on the other reduce the overall cost of marketing the new issues.

❖ COMMENTS:

Viz-a-viz, the Mutual Funds also have a big head behind the cost minimization.

14. KEEPS THE MONEY MARKET ACTIVE:

An individual investors cannot have any access to money markets instruments, since the minimum amount of investment stipulated is out of his reach. On the other hand, Mutual Funds keep the money market active by investing money in the money market instruments. Infact, the
availability of more money market instruments itself is a good sign for a
developed money market which is very essential for the successful
functioning of the central bank in a country.

❖ COMMENTS:
The important job of keeping the money market active is done by
mutual fund. Hence, they have great contribution towards the economic
development of a country.

2.6 Organisation of The Fund:
While discussing the organization of the mutual funds in India, it is
important to clarify certain terms to be dealt with:

❖ Sponsoring Institution:
The company which sets up the Mutual Fund is called the sponsor. The
SEBI has laid down certain criteria to be met by the sponsor. These
criteria mainly deal with adequate experience, good past track record,
net worth and many other factors.

❖ Trustees:
Trustees are people with lone experience and good integrity in their
respective fields. They carry the crucial responsibility of safeguarding
the interest of investors. For this purpose, they monitor the operation of the different schemes. They have wide ranging powers and they can even dismiss Asset Management Companies (AMCs) with the approval of the SEBI.

❖ **Asset Management Company (AMC)**

The AMC actually manages the funds of various schemes. The AMC employs a large number of professionals to make investments, carry out research and to do the agent and investors servicing. Infact, the success of any mutual fund depends upon the efficiency of this AMC. The AMC submits a quarterly report on the functioning of mutual fund to the trustees who will guide and control the AMC.

UTI was set up as corporation under an Act of Parliament in 1964. Indian banks when permitted to operate mutual funds were asked to create trusts to run these funds, for example, The SBI launched SBI mutual fund and Cahara Bank launched CanBank Mutual Fund to carry out the mutual fund business. A trust observes unlimited liability and has to work on behalf of its trustees. The Indian Banks operating mutual funds had made a convincing plea before the government to allow their funds to constitute them as 'Asset Management Companies.' The Department of company Affairs, Ministry of Law, Justice and Company
Affairs has issued guidelines in respect registration of Asset Management Companies (AMCs) in consultation with securities and Exchange Board of India (SEBI). Thus, a mutual fund can be constituted either as a corporate entity or as trust.

The SEBI holds the responsibility of authorizing and supervising the mutual funds except in the case of pure Money Market Mutual Funds and off shore Mutual Funds. These funds are governed by the regulations of RBI and Ministry of Finance.

There are many components of the organisation of Mutual Funds. But the Mutual Funds in India takes services from basically four outside agencies:

- **Registrars and Transfer Agents**: These people receive and process the application form of investors.

- **Advertiser**: These people help Mutual Funds organizes to prepare a media plan for marketing.

- **Legal Advisor**: Provides professional advice on the Fund’s investments.

- **Custodian**: Holds securities, receives and delivers securities, collects income/interest/dividends on the securities and holds and processes cash.
In India the remaining work is organized in house by employing officer and are paid salaries. The SEBI has issued detailed guidelines for the establishment and operation of Mutual Funds in India.

2.7 FACILITIES AVAILABLE TO INVESTORS:

While conducting a business operation, it is very important to keep in view the facilities available to the beneficiaries of the risk bearers. The
investors in the fund, though may be holding small units, are the risk takers, since they put their hard earned savings into the fund. On that behalf, they ought to enjoy certain facilities as such:

❖ **Repurchase Facilities:**

The units of close-end schemes had to be compulsorily listed in recognized stock exchanges. Such units can be sold or bought at market prices. But, the units of open-ended schemes are not to be listed and hence they were to be bought only from the fund. The fund reserves the right to buy back such units from the investors and the process in termed as repurchase facility. The price fixed for the purpose is termed as repurchase price. The repurchase facility is available in both the schemes in order to provide liquidity to investors.

❖ **Reissue Facilities:**

In the case of open-ended schemes, units can be bought only from the fund and not in the open market. The units bought from the investors are reissued to those who are interested in purchasing them. The price fixed for the purpose is known as re-issue price.
Roll over facilities:
The facility is available in the case of the close-ended fund schemes. During redemption, the investor, are given an option to reinvest their entire investment all over again for another term. An investor can overcome an adverse market condition prevailing at the time of redemption by resorting to the Roll Over Facility. For sure, if the investor is to enjoy the withdrawal of his money during the hike season, he may have to think over his decision on both the paths.

Lateral Shifting Facilities:
Certain Mutual Funds allow the investors to shift from one scheme to another on the basis of the Net Asset Value with a view to providing total flexibility in their operation. This is done without any discount on the fund and without any additional charges. The privilege provided to the investors is known as lateral shifting.

2.8 Fund Unit Vs. Share:
A fund unit can be termed as one holding in the Mutual Funds, whereas, a share is termed as one holding of equity of a particular company.
To make it clear that holding a fund unit of Mutual Fund represents an investment in the parts of shares of a large number of companies. On the other hand, investment on equity share represent investment in a particular company alone. It is of course very near from the explanation that investing in fund unit is safer than in share equity. Lets say for example, if Mr. X invests Rs. 1000/- in purchasing 100 shares of the company A and his friend Mr. Y. invests the same in Mutual Funds. Mr. X needs to base on the performance of the company. A for its annual returns, Whereas, Mr. Y need not worry at least about the performances of any of the companies. His money is in safe hands speculating the best of the market.

Both, the prices of the units of a fund as well as those of share are quoted in the market. This price is governed basically by the value of the underlying investments held by the fund.

The investment on equity shares can be used as a tool by speculators and investment the stock market enthusiasts with a view to gain abnormal profits. These people play investment games in the stock market on the basis of daily movement of prices. But, Mutual Funds cannot be invested for such purposes and they are not at all concerned with the daily ebbs and flows of the market.
Conclusion:

It can be summarized, that the Mutual Funds is not the right investment vehicle for speculators. In fact, they are suitable only to genuine investors whereas shares are suitable to both the genuine investors and the speculators.

2.9 Mutual Funds 2000

During April 1996, the Mutual Funds Department of SEBI released an exhaustive study on the mutual fund industry known as “Mutual Fund 2000”. The study suggested several reforms as such:

- It has been proposed that mutual funds should broaden their areas of investment. Accordingly, there is a proposal to set up mutual funds to invest in quilt edged securities or real estate.

- There is a proposal to do away with the restrictions of a maximum industry exposure of 15% for a mutual fund schemes. Earlier the restriction applied to all Mutual Fund Scheme except those which are designed to invest in a particular industry.
At present, a mutual fund can hold at a maximum of only 5% of the equity of a company. It has been proposed to increase the limit to 10%. Similarly, it is proposed to remove the existing maximum limit of 10% of a mutual fund investment (equity and debt) in a single company.

All closed-end mutual funds should get used within 6 months from the date of allotment, unless they offer a continuous repurchase facility to their clients.

It has been proposed that close-end mutual fund schemes, which offer, monthly income or schemes, which are targeted at any certain categories of investors, like women, need not get listed.

The existing requirements of minimum initial corpus for both open-end and closed-end schemes is likely to be removed.

Further, the requirement of refunding subscription in case of collection falling below 60% of the target collection is sought to be removed.

There is a proposal to extend the lock-in period of 60 days before redemption in the case open-end schemes to six (6) months.
For the purpose of meeting the redemption requests along, it has been suggested that Mutual Funds be permitted to borrow upto 10% their net assets for a maximum period of three (3) months only.

2.10 Commercial Bank & Mutual Funds:

In order to provide wider choice to small investors, the Government of India amended the Banking Regulation Act in 1987 to permit commercial banks to launch Mutual Funds in India and hence breaking the monopoly of the UTI. The State Bank of India (SBI) was the first bank to launch a mutual fund named SBI mutual fund, in July, 1987. The second bank was the Canara Bank which established its subsidiary CanBank Mutual Fund in 1987 to carry out the mutual fund business. The reasons behind the need for the banks to enter the mutual fund industry are such:

❖ Competition:

Due to many other financial intermediaries entering into the financial market and providing attractive returns, the banks remain unattractive. Hence, to remain into the market the banks had to adopt the upcoming scheme to maintain its customers.
❖ Diversified Reaches:
The massive branch expansion programme of banks and its growing deposit mobilizations has been due to its having branches in the rural and urban sectors. Hence, mutual funds backed by a bank is to be in a better position to tap the savings effectively and vigorously for the capital market.

❖ Public Confidence:
The Indian Investors, specifically small and medium ones, are not much easy to work with the private financial intermediaries. Whereas, in matters concerning the banks as intermediaries, the investors come forward to invest their savings. The bank being an old and gold concept holds public confidence of the Indians.

❖ Green Signal:
The banks have received a green signal from the Government to enter the Mutual Funds industry and reap the maximum benefits. And Ofcourse, any one provided such a change would not miss it.
❖ Varied Products:

The banks provide wider range of products and services through Mutual Funds by introducing innovative schemes and extend their professionalism to the mutual funds industry. The banks itself being a financial institution, has the capacity to provide the best of services to the public.

❖ Wide Experience:

The merchant banks being old ventures have wide range of experience in the capital market. They have obtained superior managerial skills and abilities and hence, managing a mutual fund may not be a difficult job for them. They also hold the forecasting ability as a whole.

❖ Widen Customer Choice:

Units 1987, the UTI held the monopoly of Mutual Funds in Indian which was first challenged by the SBI. This pushed the Indian Mutual Fund industry into competition. The competition is always to improve customer service and widen customer choice.

❖ Dis-Intermediation Period:

During the 80s, the Indian Economy witnessed the operation of intermediation and dis-intermediation. The disintermediation process
could be easily controlled by commercial banks through mutual funds. The process of dis-intermediation of time deposits into mutual funds would benefit the capital market because it would provide a sustainable domestic source of demand.

❖ **Network:**

The commercial banks received easy entry in the mutual funds market and was an easy approach for them due to their intense network. Their branches were spread and are spread throughout the country. The banks can also provide the best of services to its investors to its varied branches and network. Hence, the commercial banks have entered into the mutual fund market without any hesitancy.

❖ **Increased Profits:**

The profit earning ability of the banks has been very much affected due to too many restrictions on their leading policies. It is very important for any venture undertaken, to earn some reasonable profits in order to keep itself adhere to the business. They have been compelled to seek some other alternative, to increase their profits, by means of diversifying their activities. The Mutual Funds offered an excellent outlet for diversification.
Conclusion:

In spite of the fact that other than the UTI, the others in India have sprung only recently, yet have performed well through a variety of schemes. Some of the mutual fund schemes like Master Share, Master Gain of UTI, Can share and Canstar of Canbank Mutual Fund have had runaway successes in the matter of public support and subscription. This has enhanced the interest of investors in Mutual Fund Schemes, thereby enabling them to mobilize huge amounts running into thousand of crores from the public. The mutual funds have now become dominant players in the Indian Stock Markets.

2.11 Mutual Funds Abroad:

The basic idea of mutual funds originated in Great Britain during the 19th century and have been growing at an unprecedented pace throughout the world. In the U.S.A. investors become interested in mutual funds around 1900, but was less active until 1924 when three mutual funds that are, Massachusetts Investors Trust, State Street Investment Corporations; and U.S. and Foreign Securities Corporations were organized. In the U.S.A. mutual funds have been labeled as the "bank deposits of 1990's".
Mutual funds have changed the American financial landscape by offering a menu of investment choice and some companies like Fidelity Investment, Vanguard and Merrill Lynch are very popular among them. The stock market crash of 1929 and the subsequent depression left among all forms of investment, severe difficulties. Many mutual funds failed, and to regulate their operations and protect the interest of the investors, investment Company Act was passed in 1940. Since 1940, there has been a rapid growth in the mutual funds industry, much of which can be attributed to the economy of the country after World War II. Assets of the mutual funds increased tremendously to $ 980 billion at the end of 1989. In 1990, about one-fourth of the households invested in mutual funds and the number of funds had increased more than 3000.

According to a study, the mutual funds industry was expected to have $ 2 trillion in assets by 1995-96 and touch $ 3 trillion by the year 2000. But, in 1993 the assets value touched the $ 2 trillion mark. This industry has an annual growth of about 20 to 25 percent.

The funds in U.K. has already crossed the 100 mark by the end of 1987. The top 25 funds in terms of performance came from Japan and the Far East Growth Sectors. Some of them have doubled their money within a
period of a year. In Australia, three funds have been very successful. The Mutual Funds are growing in size and importance in countries like Hong Kong, Singapore, Philippines, Thailand and South Korea.

2.12 Mutual Funds in India:

Created with the aim of tapping the savings of the small men and to deploy the funds for productive purposes, UTI was established during 1963, under the Unit Trust of India Act. The UTI seeks to garner savings by way of sale of units to the public, each of which confers on the buyer an equal right in the beneficial ownership of the assets of the Trust. It launched myriad of schemes to cater to varying notions of savings.

Until 1986, UTI held the monopoly of mutual funds in India. With a view to provide wider choice to small investors, the Government of India amended the Banking Regulation Act in 1987 to permit commercial banks to launch mutual funds in India. This was made possible under the Governments' scheme of financial liberalizations, and was put into action since June 1987. The first bank to launch a mutual fund was the State Bank of India (SBI), to launch 'SBI mutual Fund' in July 1987. The launching of its first "Magnum Regular Income Scheme 1987" was received enthusiastically by the investors. Another
scheme, “Magnum Monthly Income Scheme”, was introduced in June 1989. In 1990, it launched “Magnum Tax Savings Scheme” extending Section 80cc benefits and “Magnum Regular” income with 12% minimum assured rate of return per annum.

The next major entrant was Canara Bank which established its subsidiary CanBank Mutual Fund in 1987. It introduced Vancigo, Cangilt, Can 80cc, Can Growth, Can Double, Can Star and Can Triple. Each has its own different features.

During 1989-90 three more banks, Union Bank, Bank of India and Punjab National Bank set up their own mutual funds.


IDBI floated an off shore mutual fund in 1991, managed by a subsidiary set up in the joint sector, i.e. “Fidelity International” – the world’s largest privately managed investment company. The domestic mutual funds are managed by the Investment Management Company Limited
(ITMCO) constituted by IDBI. ITMCO launched ‘Call 1-Unit ’97, “Deposit 1 Units ’97 and ‘Child 1 Unit’97.’

The IFCI launched a mutual fund scheme in 1993 and managed by one of the corporation’s subsidiaries, the risk capital and Technology Finance Corporation Ltd.

The private sector which entered the areas in 1993 is concentrating on the primary market. Promoter too give preferential treatment to mutual funds because it reduces their marketing cost. They go for fund – participation in a venture even before it goes public. They see potential for immense appreciation in unlisted securities which intend to go to public with a short period of one year.

2.13 Reasons For Slow Growth:

While analyzing an industry, it is important to keep a view on its growth with passage of time. When we give a look at the mutual funds industry. One can find that it has been through hard times. Most of the funds have not been able to through collect the targeted amount from small investors. Investors tend to keep out of the new issue mutual funds and they prefer to buy units from secondary market even by paying a
brokerage fee of 3 %. The problems faced by the mutual funds industry during its growth are such:

❖ **Disparity Between NAV And Listed Price:**

The incongruity between the NAV and the listed prices puts the investors in a dilemma. In spite that NAV seems to be good, the listed prices are awfully poor. In practice, almost all the mutual fund schemes are deeply discounted to their NAV by as much as 30 to 40 percent. Hence the investors are unable to dispose off their units in the market and leads to no liquidity at all.

❖ **No Uniformity In The Calculation Of NAV:**

There is no standard formula for the calculations of the NAV. Different companies apply different formula and use different method leading to varied results. Fruitful comparison of one fund with another is not possible at all. Hence small investors cannot form a concrete opinion on the performance of different funds.

❖ **Lack Of Transparency:**

Under a regulatory framework, mutual funds have to disclose their holdings, investment pattern and all the information that can be considered as material, before all investors. But Mutual Funds in India
are not providing the same. Unfortunately, most of the funds are not able to send even quarterly report to their members. It is very important for the funds to overcome this weakness for a successful future.

❖ Poor Investor Servicing:
Due to recurring transfer problems and non-receipt of dividend in time, people are hesitant to touch the mutual fund script and hence the funds are in loss of investor confidence. The industry suffers of deteriorated after sales services provided to the investors. In case of a company, it is obligatory to convene the meeting of the company. It is obligatory to convene the meeting of the shareholders and place before them important matters of discussion. But no such meeting, are being conducted.

❖ Too Much Dependence On Outside Agencies:
Research - driven funds assure good returns to its members, but relying on borrowed research leads to expensive dealings. Such can lead to expenses beyond the 3 % stipulated by the SEBI. Apart from the expense, business rules say that one should not rely on borrowed research for self development.
❖ Investor's Psychology:
Before conducting a venture it is important to check the psychology of the users of the product. Investors often compare units with that of share and expect a high listing price. They do not understand the low risk capacity of the units. Mutual funds are for those who have the patience to wait for a long period for their returns on investment, which is lacking in India and hence making them unpopular.

❖ Absence Of Qualified Sales Force:
Efficient management of a fund requires expertised knowledge in portfolio management and skills in execution. Without professional agents and intermediaries it cannot be managed efficiently. Unfortunately such professionals are rate in funds and present in deals related to share and stock. The industry, hence suffers.

❖ Other Reasons:
Few funds which have not performed well have actually demoralized the investing public. The listing of close-ended funds on the stock exchanges had compelled the medium and small investors to go back to the stock market and face the hassles and headaches of its dealings. Most of the investors are not aware of the mutual fund industry and the varied products offered by it.
Short-Comings of Mutual Funds:

1) The Mutual Funds have been assuring minimum guaranteed return to investors under various schemes without explaining the risk factor associated with their investment portfolio. Thus they misguide the investors by giving an impression that their savings are as safe as bank deposits.

2) Mutual Funds do not function independently of the commercial banks which sponsor them. Their funds are often diverted for use either by the mother bank or its financial services subsidiary.

3) Advertising war and misrepresentation in advertisement.

4) There is a lack of uniform regulator framework for all mutual funds. UTI is operating under its own statute. Not only this it is enjoyed more tax incentives and exemptions as compared to all other Mutual funds.

5) Problems of inter-schemes transfers e.g. Children growth fund to US -'65

2.14 Future of Mutual Funds:

Compared to USA and UK, the mutual funds culture of India is still in its infancy. In USA, where capital formation is high and investment literacy is considerable, there are as many as 1600 Mutual Funds,
whereas in India, where illiteracy is high and capital formation low, there are only few mutual funds, which can be counted on the fingertips. This clearly indicates the vast scope for more mutual funds is India. The factors, due to provide a good progress to the Mutual Funds industry are:

❖ The SEBI is lending its full support for the promotion of the mutual fund industry directly as well as indirectly. It has also introduced the proportionate allotment scheme.

❖ Ever since the disbanding of the controller of Capital Issues Office, many companies have entered into the market with a petty premium on their shares. Hence, the small investors find them out of their reach and they have to seek the blessings of the mutual funds.

❖ Recently the interest rates on bank deposits have been declining leading the household savers to search for alternatives. The return on the mutual fund schemes compares favourably with the returns on bank deposits.

❖ The trend of rising PE ratio, the entry of large domestic institutional investors, the openings of the market to the foreign investors, etc. would make stock market inaccessible to the small investors.

❖ Mutual funds provide a wider range of products so as to meet the diverse needs of the investing public.
❖ The Government has also given the necessary impetus by providing tax concessions and tax exemptions. When the mutual fund industry is receiving a preferential treatment at the hands of the Government, it is bound to grow in future.

❖ The Department of Company Affairs has agreed to amend the Companies Act to grant voting rights in companies for mutual funds.

❖ Mutual funds have been permitted to underwrite shares also.

❖ The Union Budget 1999-2000 contains many measures to encourage the mutual fund industry. These includes:

- a three year dividend tax exemption for all income from UTI and equity dominated open-ended mutual funds; and

- a full income tax exemption for all income from the UTI and other mutual funds in the hands of the investors.

⇒ Conclusion:

The future of mutual funds industry seems to be bright in view of improved performance of fund managers and increasing confidence of investors in working the funds as also benefits of investing in funds. With the yet developing economy of our country, the mutual funds industry is expected to grow at a good pace. Technology and new
distribution channels would increase reach even as investors move funds out from traditional investment channels.

2.15 Guidelines For Mutual Funds (Issued On 14th February, 1992)

Mutual funds have become a major vehicle for mobilisation of savings particularly from the small and household sectors for investment in the stock market. In view of their growing importance in the capital market, their expanding investors base and the decision to allow mutual funds to be set up in the joint and private sectors, it has become necessary to evolve a comprehensive set of prudential guidelines for the all round development and regulations of mutual funds and for ensuring investor protection. These guidelines are laid down below:

❖ Scope:

1. These guidelines shall be applicable to all mutual funds which invest primarily in the capital market and also partly in money market instrument subject to the following.

   (a) Money market mutual funds that would invest exclusively in money market instruments be regulated by the RBI on the basis of specified guidelines to be laid down by the RBI. However, money
market schemes of other mutual funds would be regulated by the securities and Exchange Board of India. These regulations will be in conformity with the guidelines to be issued by the Reserve Bank for Money market. Mutual Funds investing exclusively in money market instruments.

(b) Off shore funds which have non-resident investors and are regulated by the provisions of the countries where these are registered shall be outside the previews of these guidelines. These funds shall continue to be governed by the rules and procedures laid down for the purpose of approving and monitoring their performance by the Department of Economic Affairs, Ministry of Finance and the Government or RBI’s directives on this subject.

(c) Mutual funds with special characteristics, e.g. funds dealing with assets other than securities, may be specifically exempted by the Government from the purview of these guidelines.

2. Existing mutual funds should conform to these guidelines within a period of six months from the date of issue of these guidelines.
2.16. Conclusions:

Mutual Funds have proved to be an attractive investment for many investors, the world over since they give them a mixture of liquidity, return and safety in accordance with their performance. Further, the investor gets these benefits without having a direct invest in a large number of scrips. Only by investing in one fund he gets the benefits of a diversified portfolio which is handled by specialists. The interest of various investors are generally protected through mutual funds. As individual investors they may not be hold much about in companies.
whose shares they hold but by being part of institutional investors like mutual funds, their bargaining power is enhanced.

The future of mutual funds industry seems to be bright in view of improved performance of fund managers and increasing confidence of investors in working the funds as also benefits of investing in working the funds as also benefits of investing in funds. With the yet developing economy of our country the mutual funds industry is expected to grow at a good-pace Technology and new distribution channels would increase reach even as investors more funds out from traditional investment channels.

The overall conclusion that can be drawn is that India is a developing country and the mutual funds industry is expected yet to rise to a great extend.

Mutual funds offer several benefits that are unmatched by other investment options. Due to the low key investor awareness, the inflow under the industry is yet to over take the inflows of banks. Rising inflation, falling interest rates and a volatile equity market make a deadly cocktail for the investor for whom mutual funds offer a route out of the impasse.
Yet it is expected that with the support of the efficient managers the industry will see the heights in near future.

2.15 References:

1. Jorden and Natarajan, Financial Market and Services
2. Shrivastave, R. M., Essentials of Business Finance
3. Avadhani, V. A., Investment Management
5. Economic times dated 16th Dec. 02
6. Articles by the Mutual Fund Research Team.
   Dated 21st & 22nd August, 2001


15. Joshi, Navenchandra., : Mutual Funds and the Public Financial Express, Nov. 27,1990


Chapter – 2

(A) Development Financial of System in India.
Chapter 2 Development Financial System In India

Content

2.18 Introduction

2.19 The Mode of Operation of Financial System
   ❖ Financial Assets
   ❖ Financial intermediaries
   ❖ Financial Markets

2.20 Financial Rate of Return

2.21 Recent Trends

2.22 Financial Instruments
   ❖ Creditorship Securities
   ❖ Ownership Securities

2.23 Conclusions

2.24 References
2.18 Introduction

Beginning from 1991, India’s financial system took a radically new turn towards the “Market Model”. This envisaged an increased role for the capital market, along with a fundamental restructuring of banks and financial institutions. Such restructuring has been rather slow. The bulk of the banking system and major financial institutions are still largely owned and controlled by the Government.

Enhancing the stock market’s role was supposed to eliminate political interference and patronage but such markets can develop only if the saver – investor feels that he is reasonable protected from market and corporate abuses. The sad thing in that this has not happened.

The most significant contributions to the debate on restructuring of the financial sector in India have come from the two Narsimham committees of 1991 and 1998 and the RBI’s recent discussion paper entitled “Harmonising the role and operations of Development of Financial Institution and Banks.”

The purely “harmonising” questions have to be weighted against the fundamentally important “developmental” questions. As the issues involved are of great importance to the whole economy, the Board of Governors of the society for Capital Market Research and Development
decided, in September 1998, to hold a high level national seminar. The idea received ready support from many organizations. The seminar turned out to be a highly meaningful and thought provoking exercise.

Financial system, which operator through financial market and institutions is a set of institutional arrangements through which financial surplus in the economy are mobilized from surplus units and allocated in deficit units. Stock markets are a part of a financial systems like money, forex market, which play a very important role for raising of capital and matching of those who want capital (borrowers) with those who have it (lenders). Industries require more funds for their operation and growth, so they seek more external finance, which comes from stock market. Countries endowed with rich natural resources, require funds for the industries to start with and naturally, need financial development.

Financial markets and institutions may develop to meet the needs of one set of industries, but then facilitate the growth of another younger group of industries. The financial development typically measured by the level of credit and the size of the stock market may predict economic growth simply because financial markets anticipate future growth. Stock market capitalizes the present value of growth opportunities while financial
institutions lend more if they think sectors will grow. Thus, financial development may simply be leading indicator rather than a casual factor.

In a market economy, the financial system performs a number of functions influencing the efficiency of the economy as a whole. The main function is to accept the excess of surplus units and lend it to deficient units that wish to borrow.

The development of economy of an country depends upon the existence of a well organized financial system. It is the financial system which supplies the necessary financial inputs for the production of goods and services which in turn promote the well being and standard of living of the people of country.

**Chart. 9**

Financial System

- Financial market
- Financial Institutions
- Assets
- UTI, IRBI, LIC & GIC etc.

(Money and Monetary assets)

The responsibility of the financial system is to mobilize the saving in the form of money and monetary assets and invest them to productive
venture. Thus the financial system provides the intermediation between savers and investors and promotes faster economic development as shown in chart-9.

In short we can say that saving mobilization and promotion of investment are functions of the stock and capital markets which are a part of the organized financial system in India.

2.19 The Mode of Operation of Financial System

1. Arrangement of Liquidity:

The term "liquidity" is used to refer to cash money and nearness to cash or which can be converted into cash readily without loss. Money and monetary assets are traded in the financial system. Thus provision of liquidity is one of the functions of financial system hence all the activities in a financial system are related to liquidity.

While cash creations is the function of the RBI, credit creation is done by banks and claims on money or monetary assets are dealt in by financial institutions, including the RBI, banks and term leading institutions. But again let me tell you these institutions are all a part of the financial system. RBI has to shoulder the responsibility of developing a sound financial system by strengthening the institutional structure and by promoting savings and investment in the country as
RBI is the leader of the financial system and has to control the money supply.

2 Transformation of Saving Into Investment

The financial system as shown in chart 2.1.2 is geared to the mobilization of savings and channelisation of these savings into productive activities. Through appropriate differentials in the rate of return and other incentives funds flow from less productive to more productive activities. These flows of funds are facilitated by the efficient functioning of the financial incentives to attract savings and make them available for more productive ventures. Thus the financial system facilitates the transformation of saving into investment and consumption. The financial intermediaries have to play a dominate role in this activity.
Chart 10

Mobilization of Savings and Promotion of Investment

National Savings and Flow of Investment

Sectors (Savings/Investment)

Household  Foreign  Business  Government
Sector  Sector  Sector  Sector
(S > I)  (S > I)  (I > S)  (I > S)

MARKETS

Primary  All Markets  Primary  Stock
Market  New Issues  & Secondary Markets  & Capital  Market

S : Savings
I : Investment

An understanding of the financial system required an understanding of the following concepts.

(a) Financial Assets.
(b) Financial Intermediaries.
"A Financial asset is one which is used for production or consumption or for further creation of assets."

From the definition we could understand that Financial assets will generate or earn or create income in future. For instance, ‘A’ buys equity shares and naturally these shares are financial assets as they earn income in future. It is interesting to note that the objective of investment decides the nature of the assets i.e. physical or financial. For instance if a building is bought for residence purpose, it becomes a physical asset. If the same is bought for hiring, it becomes a financial asset.

Financial assets can be classified into two categories

1. Marketable assets.
2. Non-marketable assets.

Marketable assets are the assets which can be easily transferred from one person to another without much difficulty say - shares of listed...
companies, Government securities, Bonds of Public Sector undertakings etc.

Where as the non-marketable securities are not easily transferable e.g. Bank deposits, Provident Funds, Pension Funds, National Savings Certificates, Insurance Policies etc.

Chart 11

Financial Assets

Marketable Assets ➔ Shares ➔ Government Securities ➔ Bonds ➔ M.F. Units ➔ UTI Units ➔ Bearer Debenture

Non-marketable Assets ➔ Bank Deposits ➔ LIC Scheme ➔ Coy Deposits ➔ P. O. Certificates ➔ Provident Fund

b. Financial Intermediaries

Financial intermediaries perform the intermediation function etc. they bring the users of funds and the suppliers of funds together. Many of them issues financial claims against themselves and use cash proceeds to purchase the financial assets of others. The Units Trust of India and Mutual funds, belong to this category. Most financial institutions
Chapter 3: Development Financial System in India

underwrite issues of capital by non-government public limited companies in addition to directly subscribing private placement.

The Financial Institutions engaged in intermediary activities include the Industrial Development of India, Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India, UTI, LIC and General and Investment Corporation. Two institutions which have broadened financial services activities in India deserve a special mention. They are the credit Rating Information Services of India Ltd. (CRISIL) and the Stock Holding Corporation of India Ltd. (SHCIL).

CRISIL was set up jointly by ICICI, UTI, LIC, GIC and Asian Development Bank as the first credit rating agency in the country. It started operation in January, 1988 and has rated 101 debt instrument upon March 31, 1990. These instruments aggregated to a value of Rs. 3093.4 Crores. Out of these, rating for 48 instruments covering a debt volume of Rs. 1887.6 Crores have been accepted by the concerned companies and are in use. CRISIL rating provide a guide to investors as to the risk of timely payment of interest and principal on a particular debt instruments. It provides ratings for debentures, fixed deposits, short term instrument and preference shares on receipt of request from a company. Rating relate to a specific instrument and not to the company.
as a whole. They are based on factors like industry risk, market position and operating efficiency of the company, track record of management, planning and control, system, accounting, quality and financial flexibility, profitability and financial position of the company and its liquidity management. CRISIL ratings are expected to improve the marketability of debt instruments of the company and consequently its fund-raising capability.

The SHCIL was sponsored by IDBI, IFCI, ICICI, UTI, LIC, GIC and IRBI to introduce a book entry system for the transfer of share and other types of scrips replacing the present system that involves voluminous paper work. The Corporation commenced its operations in August 1988. SHCIL received delivery instructions for purchase and sale of securities of Rs. 349 Crores in 1989 as against Rs. 110 Crores in the previous year. Commencing its operations to GIC, LIC mutual fund and New India Assurance Company Limited. The Corporation started its depository in Mumbai. This has a capacity to store about 78 lacs securities. Computerisation of operation is well on way and electronic transfer of scrips through a Central Securities Depository (CDS) is shortly to be taken up.
Financial intermediaries refers to all kinds of financial institutions and investing institutions which facilitate financial transactions in financial markets or in other world all kinds of organizations, which intermediate and facilitate financial transactions of both individual and corporate customers. Financial intermediaries may also be classified into two.

1. Capital Market Intermediaries:

These intermediaries mainly provide long term funds to individuals and corporate customer. They consist of term lending institutions like Financial Institution and Investing Institutions Like L.I.C. as shown in the Chart 12.
Chart 12

Segments of Capital Market

Apex Body

IDBI

IFCI

LIC

New Issue

Initial Issues

ICICI

UTI

Market

Further Trading

Banks

GIC

Securities

SFCS

Brokers

Market

Development Agencies

PFs

Financial Companies

Investment companies

Brokers

Direct Borrowing

From Banks

From Public Deposits

Others
2. Money Market Intermediaries:

Money market intermediaries supply only short term funds to individual and corporate customers. They consist of commercial banks, co-operative banks etc. as shown in the Chart 13

Chart 13

A Segments of Money Market

(C) Financial Market:

Financial market can be referred to as those centres and arrangements which facilitate buying and selling of financial assets, claims and services.
Wherever a financial transaction takes place, it is deemed to have taken place in the financial market, as there is no specific place or location to indicate a financial market.

Securities markets can be seen as Primary and Secondary. The primary market or the new issue market is an informal forum with national and even international boundaries. Anybody who has funds and the inclination to invest in securities would be considered a part of this market. Individuals, trusts, banks, mutual funds, financial institution, pension funds and for that matter any entity can participate in such as market. Companies enter this market with initial and subsequent issues of capital. They are required to follow the guideline prescribed by the controller of capital Issues (CCI) from time to time unless they are expressly exempted from doing so.

It is rightly said that the investments in Mutual Funds decline sharply. But the performance of the Stock Exchange of Mumbai (BSE) is reported to be positive for the financial year ended March 31, 2001. The total income of the exchange has increased by Rs. 136.68 Crores, which is a marginal increase over the last year’s income of Rs. 127.70 Crores. However, the investment in mutual funds as such has declined. The value of investments made by BSE in mutual Funds has declined from
Rs. 530.51 Crores (1999 – 2000) to Rs. 44.12 Crores (2000-2002). The investment by the exchange in the balanced schemes has declined from Rs. 63.90 Crores to Rs. 23.67 Crores, whereas that in the equity schemes has declined from Rs. 15.35 Crores to Rs. 9.19 Crores. Investments in the the debt schemes have also eroded during the year to a paltry Rs. 11.25 Crores from Rs. 451.25 Crores.

In a recent development of the Association of Mutual Funds in India (AMFI) has defended the mutual funds industry against certain allegation made on them following their bad performance. The Apex body has stood up for them saying that their poor bad performance is due to the bad performance of the markets. The NAVs of the schemes have fluctuated owing to the fluctuation in the market value of the assets they have invested in.

❖ Importance of Stock Market Development:

The stock market development indicators help in assessing financial sector needs, which should prove helpful to have quantifiable methods of measuring whether capital market development project are successful or not. The comprehensive view of financial sector reform incorporate the broad set of financial intermediaries, stock market, as well as other components of stock markets. Thus constructing measures of the level
of stock market development is a precondition for a comprehensive empirical evaluation of how the financial sector as a conglomeration of intermediaries and markets influence economic development. How the stock market developments alter the capital financial decisions of firms?

Empirical evidence suggests that financial services mobilizing savings, managing risk, allocating resources, and facilitating transaction importantly influence and are importantly influenced by economic development. A larger literature demonstrates the financial crisis widespread bank failures, stock market collapses, etc. an impede and even reverse economic advances. In light of these observation and experience, the world Bank in the 1980s began devoting an increasing amount of effort.

❖ Improving the financial systems of countries in an attempt to stimulate economic development.
❖ Coping with financial crisis that threaten economic prosperity.

Through out this period the World Bank Programs focused on core financial themes – loosening interest rate controls, reducing Government involvement in credit allocation, and rationalizing the taxation of financial intermediaries as well as on managing
banking failures, rehabilitating insolvent banks, and training bank managers and supervisors.

It is often argued that stock market effect economic activity through liquidity. Many high return projects require long-term commitment of capital. Investors, however, are generally reluctant to relinquish control of their savings for long periods. Without liquid market or other financial arrangements that promote liquidity therefore less investment may occur in high run projects. In this context, stock markets may arise to provide liquidity saver have liquid assets like equities while firms have permanent use of capital raised by issuing equities specifically, liquid stock markets reduce the downside risk and costs of investing in projects that do not pay off for a long time. With a liquid equity market, the initial investors do not lose access to their savings for duration of the investment project because they can quickly and confidently save their stake in the company.

Some companies would use the primary market by using their “in house” skill but most of them would employ brokers, broking and underwriting firms, issue managers, lead managers for planning and monitoring the new issue. New guidelines issued by the Securities & Exchange Board of India (SEBI) now require the compulsory
appointments of a registered merchant banker as issue manager where the amount of the capital issue exceeds Rs. 50 lacs.

Secondary markets as shown in chart No. 14 also known as Stock Exchanges are set up under the Securities contracts (Regulation) Act, 1956. They are known as recognized exchanges and operate precincts that possess networks of communication, automatic information scans, and other mechanized systems. In India, we have recognized stock Exchanges at Mumbai, Calcutta, Madrass, Delhi, Bangalore, Hyderabad, Kanpur, Indore, Ahmedabad, Cochin, Jaipur, Ludhianna, among others.

One of the most important service institutions of crucial importance in a modern economy is the Stock Exchange. It is one of the hallmarks and facilitators of entrepreneurial progress. This means that it is no longer possible to confine the forms of industrial organizations to proprietorships or even partnerships. Indian Stock Exchange are yet not very modern, but, all the players and the policy makers are on the learning curve and we would like to believe that there has been much progress (see verma, 1988 Barua 1992).

The volume of business transacted at the floor is often too inadequate. Consequently, enormous deals take place outside the floor and during off-business hours: They are known as "Kerb" deals. In view of the vast
flows of transactions and as astronomical increase in equity-holdings, demand are being made for multiple exchanges to replace the erstwhile conventions of “One-State-One-Exchange.”

The small investors, is unfairly handicapped almost invariably. Moreover, the existing recognized stock exchanges work only for limited hours and even it they organize odd lot sessions their business, by and large, remains centred on the “market lots.” The demand for an over-the-counter market has been keenly felt and the Government of India approved the creation of an OTC market in August 1989. This would help in introducing a multi-tiered market in the country.

The regulatory mechanisms is also under a thorough overhaul. The securities and Exchange Board of India (SEBI) is now to take over the responsibilities of monitoring and controlling the stock market operations, new capital issues, working of mutual-funds and merchant banking subsidiaries of banks. The capital market developments may take it to a new era of self discipline, Unitary Control and progressive automation.
Table : 2.13

Spread Of Unit Cult Through Stock Exchange

<table>
<thead>
<tr>
<th>Operation of inter connected S.E. Centres</th>
<th>Registered Brokers</th>
<th>10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered Sub-Brokers centers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Terminal located :-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) NSE</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td>(b) BSE</td>
<td>250</td>
<td></td>
</tr>
<tr>
<td>Inter-Connected Stock Exchange Centres</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Other Stock Exchange (including OTC)</td>
<td>20</td>
<td>1000</td>
</tr>
<tr>
<td>Registered Brokers/ Sub-brokers online network services</td>
<td>20,000</td>
<td></td>
</tr>
</tbody>
</table>

❖ Review of Literature

The stock market are linked to economic growth, providing financial services to the economy. It can lower the cost of mobilizing savings and can facilitate investment in most productive activities. A well functioning stock market has effect on economic development through raising the savings and the quantity and quality of the investments. It also ensures take over mechanism that past investments is most profitably utilised. The stock market liquidity means the ability to trade equity easily is important for growth. Specifically, although many profitable investments require the long run commitment of capital, savers do not like to relinquish control of their savings for long period.
Hence, liquid equity markets ease this tension by providing an asset to savers that they can quickly and inexpensively sell. Simultaneously firms have permanent access to capital raised through equity issues. Liquid stock markets can increase incentives to get information about firms and improve corporate governance. Finally, through stock markets worldwide the international risk sharing by all those integrated stock markets can improve resource allocation, which in turn accelerate the rate of economic growth.

To begin with, let us discuss the findings of major studies/literatures in this area. Past literature like Joseph A. Schumpeter (1911) Emphasizes the positive influence of development of a country’s financial sector on the level and the rate of growth of its per capital income. The argument essentially is that the services of the financial sector provides of reallocating capital to the highest value use without substantial risk of loss through moral hazards, adverse selection of transaction cost are an essential catalyst of economic growth.

A good number of studies have been carried out in relation to firm financing structure and stock market development. The shortage of long-term capital was believed to be a major constraint on industrialisation since banks supply only short-term loans in India. In this scenario, the
sate promoted DFIs often supported by the World Bank were expected to make up for the absence of an efficient capital market. In this context, many are of the opinion that one of the reasons for post-war success of Japanese and German growth and productivity is the difference in their institution set up for financing industry (Zysman 1983, Dore 1985, Dimsdale and Prevezer 1994). In these economics, large firms and banks have a close financial links because of stock markets are relatively small and illiquid. Hence firms reportedly take a long-term view of corporate success. In sharp contrast to this set up, firms in the US and UK have arms-length relations with banks.

In development economics, stock markets do not receive adequate attention, as it is a recent phenomenon in the LDCs. Singh and Hamind (1992) and Singh (1995) analyzing corporate financing pattern of top 50 (100) private corporate firms, found that on an average equity capital finances about 40 per cent of corporate investment growth in these economies, Cobham and Subramaniam (1995) by using Mayer’s methodology conclude that a much limited role for equity financing corporate growth in India. Singh (1992), argued that the real test for capital market in developing economies is its effect on saving, investment and growth. The important question is whether the development stock markets in these economies has led to increase in
aggregate savings or whether it simply represents the substitution of one from of saving, e.g. bank savings or government bonds for another purchase of corporate share in stock market. It should market. It could be the stock market, which is useful for a more efficient allocation of these savings or to better corporate or to better corporate performance as a result as a result of stock markets.

It is seen that what does capital market growth mean for domestic saving rate, corporate investment rate and output growth. What proportion of physical investment is financed by internal resources?

Makoto Nagaishi (1999) in his findings stated that Indian stock market development from 1980s onward has not played any pivotal role so far as the domestic savings mobilization is concerned. If there is further deregulation of the stock market to attract more foreign portfolio inflows into India, there seems to be no way to avoid similar problems at Mexico, Korea and Thailand, such as more volatile movement of domestic stock prices and unstable BoP positions. Bank credit to the commercial sector has no positive correlation with indicators of stock market development.
In another research paper Singh (1997 & 1999) and Nagraj (1996) have provided a benchmark for opposition in Indian stock market development.

While confirming Singh’s view, Nagraj (1996) said that in India the huge increase in stock market financing activity is not associated with either rise in aggregate domestic savings (CDS) or equally significantly with an increase in the proportion of financial savings. This seems the enormous stock market activity in the 1980s basically involved portfolio substitution by households and institutions from bank deposits towards stock market instruments. The increase in external finance available with the corporate sector through the capital market to have replaced in a greater extent their funds during this decade, which could be due to a decline in corporate profitability.

Shah & Thomas (1987) found that at a fundamental level, the banking system and the stock market compete in two dimensions maximize their quality of processing and to minimize the transaction costs that they impose upon households. In both these contexts, the stock market is more efficient than banking system and it plays a key role, strongly assist reforms in banking system through competition between them. They further added that efficient stock market would contribute to long-
term growth in the real economy through efficient allocation of scarce savings and improving utilization of funds. Moreover, foreign capital inflows must have positive impact from the real economy via lowering the cost of capital and the assets effect.

In principle greater reliance on external finance subjects firms to a constant scrutiny of capital market. If the share of external finance increases it will give boost to corporate investment rate, which is desirable for many rapidly industrialising economies as Singh and Hamid noted in countries like South Korea.

A comprehensive study on performance of corporate sector, 1996-97 (Dash) indicates that there is a scope for expanding equity capital and reducing dependence on capital based on loans and borrowings. A study based on balance sheets analysis of 7295 companies for 1996-97 showed that at macro level (public and private limited companies) equity capital accounted for about 11 per cent, reserves and surplus accounted for about 26 per cent while borrowing/loan accounted 44 per cent of the total assets of the companies.
The classification of financial markets in India is shown in Chart 14

Chart 14

Financial Markets

Organised

- Reserve Bank of India
- Banks Financial Institutions
- Inter Bank Market
- Money Market Stock and capital
- Bullion Market

Unorganised

- Indigenous Bankers
- Money Lenders
- Pawn Brokers
- Traders
- Landlord etc.

2. Unorganised Market:

In these markets there are a number of money lenders, indigenous bankers, traders etc. who lend money to the public. As shown in chart 15 there are also private finance companies, chit Fund, Nidhis and host of other unincorporated bodies whose activities are not amendable to the Financial discipline of RBI, main drawback of these type of market is the regulations concerning their financial dealings are still inadequate and their financial instrument have not been standardized.
3. Organised Markets:

In the organized markets, there are standardized rules and regulations governing their financial dealings. There is also a high degree of institutionalization and instrumentalisation. These markets are subject to strict supervision and control by the RBI or other regulatory bodies like the Registrar of Company Law Board (CLB).

These organized market can further classified into two. They are:

i. Capital Market

ii. Money Market.
Further classifications are shown in Chart 15

Char 15

Classification of Organised Market

Organised Market

Capital Market

Industrial Securities Market

Government Securities Market

Long term Loans Market

Primary Market

Secondary Market (stock Exchanges)

- Term Loan Market
- Market for Mortgages
- Market for Financial Guarantees

Money Market

- Call Money Market
- Commercial Bill Market
- Treasury Bill Market
- Market for Short Market

Capital Market:

The capital market is a market for financial assets which have a long or indefinite maturity but mainly it deals with long term securities which have a maturity period of above one year. This topic will be explained in detail, in the next Chapter.
Money Market:

Money market is a market for dealing with financial assets and securities which have a maturity period of up to one year. In a nutshell, one can say that "It is a market for purely short term funds."

2.20 Financial Rate of Return:

Most households in India still prefer to invest in physical assets like land, building, gold, silver, etc. But, studies have shown that investment in financial assets like equities in the capital market fetches more return than investments on gold. It is imperative that one should have some basic knowledge about the rate of return on financial assets also.

The return on Government securities and bonds are comparatively less than one corporate securities due to lower risk involved there in. The government and the RBI determine the interest in the government securities. Thus the interest rates are administered and controlled.

The interest rate structure for bank deposits and bank credits is also determined by the RBI. Normally, interest rate on preference shares is fixed by the government. Unfortunately in India, the administered interest rate policy of the government fails to perform the role of allocating scarce resources between alternative uses.
Reference may be made to the relevant recommendations of the Chakravarthy Committee to review the working of the monetary policy (RBI-1985). This report highlighted the need to bring the interest rates nearer to the free market rates and to fix them at levels of positive return in real terms adjusted for inflation. Debentures are the corporate debt just as deposits are but while debenture are mostly secured, deposits are not. Some of the debentures are convertible into equity shares, called convertible debentures. The interest rates offered on them are lower than on non-convertible debentures. The interest rates on debentures are allowed to be fixed by the companies depending on the free market forces.

2.21 Recent Trends:

With a view to bring the interest rates nearer to the free market rates, the Government has taken the following steps.

1. The interest rates on company deposits are freed.

2. The interest rates on 364 days, Treasury Bills are determined by auctions and they are expected to reflect the free market rates.

3. The coupon rates on government loans have been revised upwards so as to be market oriented.

4. The interest rates on debentures are allowed to be fixed by companies depending upon the market oriented.
5. The maximum rates of interest payable on bank deposits (fixed) are freed for deposits of above one year.

Thus, all attempts are being taken to adopt a realistic interest rate policy so as to give positive return in real term adjusted for inflation. The proper functioning of any financial system requires a good interest rate structure.

2.22 Financial Instrument:

Financial instruments refer to those documents which represent financial claims on assets. As discussed earlier, financial assets refers to a claim to the repayment of a certain sum of money at the end of a specified period together with interest or dividend. Examples: Bill of Exchange, Promissory Note, Treasury Bill, Government Bond, Deposit receipt, Shares, Debentures etc. The innovative instruments introduced in India have been discussed later in this Chapter. Financial Instrument can also be called financial securities.

Financial assets or instruments can be classified in a variety of ways. We will classify the into creditorship and ownership securities on the basis of the nature of the buyers commitment. The description will then be split into public and private issues differentiating the two major forms of issuance.
❖ Creditorship Securities:

Debt instrument furnish an evidence of indebtedness of the issuer to the buyer. Periodic payments on such instruments are generally mandatory and all of them provide for the eventual repayment at maturity of the principal amount. Securities may also be sold at a price below the eventual repayment at maturity of the Principal amount. Securities may also be sold at a price and the sale price constituting the interest. The interest amount in rupees measured as a percent of the par value of a debt instrument is known as nominal coupon rate of interest. e.g. Rs. 28/- payable per year on a debenture whose face/par value is Rs. 200/- yield a coupon of 14 percent per annum.

Debt instrument can be issued by public bodies and governments and also by private business firms.

Classification are shown in Chart 16

Chart 16

Financial Instruments

- Creditorship securities
  - Public Debt
  - Private Debt
  - Special Instruments

- Ownership Securities
  - Indirect Instruments debt Instruments
  - Direct Equities Equities
❖ Public Debt Instruments:

Government issues debt instruments for long and short periods. They are rates the best in terms of quality and are risk free. A common term used to designate them is "gilt-edged securities". The 182 days treasury bills issued by the Government of India are examples of short term instruments and 11.5 percent loan 2009 (V issue) of the Government of India, an example of long term instruments. State Government of India, an example of long term instruments. State Governments and local bodies also issues series of loans and bonds. Banks, issuance, pension and provident funds, and several other organizations buy government debt in compliance with their statutory obligations. Such debt instruments are usually over subscribed.

❖ Private Debt Instrument:

They are issued by private business firms which are incorporated as companies under the companies Act. 1956. Generally these instruments are secured by a mortgage on the fixed assets of a company. Unsecured or naked debentures are now of theoretical importance. A very popular variety of such debentures is "convertible" whereby either the whole or a part of, the par value of a debenture is convertible usually automatically on the expiry of a stipulated period after issue. The terms of conversion are stated in advance. They may be a series of conversions
and while the terms of the first conversions are left to the discretion of the controller of capital Issues with or without a ceilings as to premium on conversion.

Some selected Indian Companies can now raise short term funds by issuing a debt instrument known as commercial paper (CP). The Reserve Bank of India have issued detailed guidelines in January, 1990 in this regard. They are contained in “Non Banking Companies (Acceptance of Deposits through the Commercial Paper) Directives, 1989”. The eligibility for entering into the Commercial Paper market is based on transparent norm which companies themselves can readily assess. The condition were relaxed in April 1990.

Companies have been permitted to issue Commercial Paper since January, 1990 and the amount outstanding as on August 24, 1990 was Rs. 188.00 Crores in respect of 18 Companies.

❖ **Special Debt Instrument** :

With a view to mop up resources and innovating the spectrum of debt-instruments, two new debt instrument deserve a special mention viz. Public Sectors Undertakings (PSU), Bond (long term), and certificates of Deposits (Short term).
The Public Sector Undertakings bonds are issued to the generally public and financial institutions by Public Sector Undertakings, usually, with tax incentives. Out of the total public sector undertakings, bonds issued in 1998-99, issues aggregating Rs. 2,657 Crores were tax free bonds with a coupon rate of 9.0 % per annum and Rs. 912 Crores were taxable interest bonds with a coupon rate of 13.0 percent per annum. It is interesting to note that a large proportion of Public Sector Undertaking bonds is privately placed with banks, their subsidiaries and financial institutions, for example, Public Sector Undertakings floated 14 bond issues for Rs. 1266 Crores in 1988-89 of which Rs. 100 Crores were for public subscription and the rest were privately placed. Certificates of Deposits (CDs) were introduced in June, 1989. Commercial banks can now issue CDs within a ceiling equal to 2 % of their fortnightly average outstanding aggregate deposit (as against the earlier ceiling at 1 %). On this basis, the banking system could issue CDs worth Rs. 3017 Crores, during the year 1989-90. The outstanding amount of CDs issued by 37 banks as July 13, 1990 was of the order of Rs. 2000 Crores. The maturity of 3 month at the short end and one year at the long end were generally popular with investors. Interest rates for maturities of 3 months ranged between 9.0 percent and 16.33 percent.
Ownership Securities:
These instruments are called "equities" because investor in them get a right to a share of residual profits. Equity investments may be acquired indirectly directly or even through a hybrid instrument known as preference shares. They are discussed in this order.

Indirect Equities:
The investor acquires special instrument of institutions who take buy-sell decisions for him. Such institutions are Unit trust or mutual funds. An individual who buys units gets a dividend from the income of the trust/mutual fund after meeting all expenses of management. The units can be only bought from and sold to the institutions (in the case of the UTI) at sale and repurchase prices announced from time to time (on a daily basis). In The cash of other mutual funds like the Can share or even the UTI’s Master share, sales and purchases can be affected though secondary markets. The objective of trusts and mutual funds is to use their professional expertise in port folio construction and pass on the benefits to the small investor who cannot repeat such a performance if left along to subscribe to equity shares directly.
Direct Equities:

The investor subscribes directly to the equity issues placed on the market by new companies or by existing companies. If she/he is already a shareholder of an existing company which enters the capital market for additional issues of equity shares, such an investors would get a pro rata right to subscribe, on a pre-emptive basis, to the new issues. Such offering are known as “right shares”. Established companies reward their shareholder in the from of “bonus shares” as well. They are given out of the accumulated reserves and shareholders have note to pay any cash consideration as happened in the case of “right shares”. For example, a company may announce a bonus issue on a one for one basis. This amounts to a 100 % bonus issues. (or loosely stock dividend) so that the number of shares held by a shareholder after the bonus would be doubled. The chances of an increase in the potential dividend income become very bright and this would happen unless the company, impose a proportionate cut in future dividends. Thus a shareholder who held 100 shares of Rs. 10/- each in a company got a dividend income of Rs. 200/- the dividend announced being 20 %. His shareholding after a 100 % bonus now increases to 200. Now if the company maintaining the same rate of dividends as last year viz. 20 % the dividend income of the shareholder would go up to Rs. 400. He will, of course, get only Rs. 200 even after the bonus if the company prunes the dividend to 10 %.
A less popular instrument is called ‘Preference Share’. It is neither full debt nor full equity and is therefore, recognized as a “hybrid Security”. Such a shareholder would have certain preference over equity shareholder. They may relate to dividends, redemption, participation, and conversion etc. The most common is with regard to dividends which, when not paid for any particular year, get accumulated and no equity dividend would be payable in future until such accumulated and no equity dividend are cleared. The dividend rate on these shares is less than the one on equity shares.

One can get an idea of growth in issues of various kinds of instrument by public limited companies in the non-government sector from Table 14.
Table 14

New Capital Issues by Non-Government Public Limited Companies

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity Shares</th>
<th>Preference Shares</th>
<th>Debentures</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Issues</td>
<td>Amount (Rs.Crs.)</td>
<td>No. of Issues</td>
</tr>
<tr>
<td>April -</td>
<td>758</td>
<td>898.4</td>
<td>9</td>
</tr>
<tr>
<td>March</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1985-86</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>424</td>
<td>1007.5</td>
<td>3</td>
</tr>
<tr>
<td>1986-87</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>174</td>
<td>1104.0</td>
<td>5</td>
</tr>
<tr>
<td>1987-88</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>256</td>
<td>1029.2</td>
<td>6</td>
</tr>
<tr>
<td>1988-89</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>267</td>
<td>1206.2</td>
<td>4</td>
</tr>
<tr>
<td>1989-90</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: RBI report on currency and finance, 1989-90 Vol. I Table IX-2 P.302
Graph 17 – A

Equity Shares Graph
Graph 17- B

Preference Shares Graph
Graph 17- C

Debentures Graph
2.23 Conclusions:

An important point that needs to be kept in mind is that a non-transparent markets can never become a nation wide market. How has NSE been able to bring about so much of liquidity? "In terms of the value of trades, only 38% originate from Mumbai City, the rest of the country contributes towards the remaining 62%. The NSE has been able to bring the liquidity that was latent all over the country into a single order book and build a huge liquidity. The same development will take place in the debt and the derivatives markets. We should not consider the derivatives markets to be dangerous. In fact it is believed that this would reduce the risks of the cash market. Whatever people may say, derivatives bring relative stability in prices in the cash market. The earlier we enter the derivatives markets, the better it would be for us. We are fortunate to have some technological advantages. Many of the derivatives markets, to begin with, were essentially floor markets. People took huge positions on the trading floor and the clearing-house or the clearing corporation responsible for settlement did not know the exposure the players were taking.

Luckily we are having an automated trading system, entirely screen based on a real time basis, and as a result, we would be able to know precisely the exposure each party is taking. At least two major Stock
exchanges have developed a soft-ware where by any body who takes a larger exposure than his due is automatically disqualified from trading. All these safety – values are available and can be applied even in the derivatives markets. And the risks of the derivatives market, which some of the foreign markets faced have been eliminated. We in India financial system is not ready for derivatives.

The stock market crash of the last one year and the busting of the tech dream has left many casualties in the mutual fund industry with just about all mutual funds, especially those that focused on technology to fall sharply.

The mutual funds industry however says it is the stock markets and not the fund managers that are to blame. According to A. P. Kurian chairman AMFI, “The tech funds under – performed as the assets eroded and stock market fell. We feel that all such issues ought to be addressed by the proper forum which is the SEBI.”

They also insist that investors need to realize that stock market investments have their own inherent risks. Ajay Kakkar, mutual fund industry analyst claimed, “The investors should be educated and told that a stock that got him a huge return may also burn a hole in his pocket.
2.24 References


3 Indian’s Financial Markets & Institutions Edited by L.C. Gupta.


Chapter 1: Development Financial System in India


11 Ritter, R.J., The long run performance of initial Public Offerings.”

12 Reilly, Frank K, “New Issues Revisited Financial Management,
   1977, Volume 6, No. 4: pp. 28-42.
Chapter – 2 (B)

Capital Market in India
Chapter - 2 (h) Capital Market In India

Content

2.25 Introduction.
2.26 What is capital market?
2.27 Structure of market.
2.28 Household Investors’ survey
2.29 Categories of capital market
2.30 Institutional structure of capital market
2.31 Importance of capital market
2.32 Weakness of capital market
2.33 Reference

An Indepth Study Of The Financial Performance Of Unit Trust Of India
2.25 Introduction:

Capital market in India has grown significantly though there were many ups and downs. In the last decade, Indian Capital Market has shown a spectacular growth. Effective and safe investment in the capital market depends on how the investors go about in choosing a particular security. In order to safeguard from the perils of the stock market, an investor should possess knowledge of market mechanisms, company performance, its policies and the regulatory bodies that are monitoring the capital market in India.

2.26 What is Capital Market?

Capital market essentially involves the allocation of resources. They can be thought of as the brain of the entire economic system, the central locus of the decision making, if they fail, not only will be sector’s profit be lower than they would otherwise have been but, the performance of the entire economic system may be impaired (Stigliz, E.J. 1993). Capital Market in India has grown significantly though there have been many ups and downs.
Capital market refers to the transactions involving procurement and supply of long term funds, which take place among individuals and institutions (Tulsian P.C. 2002).

Capital market constitutes (a) Raising of Capital by issue of new shares, (b) Raising of borrowing by issue of new debentures (c) Raising of long-term borrowings by Indian & foreign banks financial institutions (Ghosh, P.K. 1998).

Capital Market is a wide term used to comprise all operations in the New issues and Stock market. New issues made by the companies constitute the primary market, while trading in the existing securities relate to the secondary market.

In the last decade the Indian Capital Market has shown a spectacular growth. The investor’s population is estimated to have increased from two million to around fifty million. (Santhi Swarup K., Amika Verma, 1998).

India has become the second top nation in the world in terms of listed companies, which demonstrated the fund seeker’s ability to lure investors. By the end of March 1999, there were twenty – two stock exchanges in India. There were little over nine thousand listed companies.
whose aggregated paid up capital was Rs. 1,748 billion and market capitalization was Rs. 6,396 billion (Bhalla, V.K., 1999).

The year 1997 could rightly be perceived as one of the worst years for the primary market. The number of offers that tapped the market for subscription were at a pitiable figure of 128 through which, the corporate sector mobilized Rs. 5,032 Crores compared with 1445 issues in the year 1995 through which an amount of Rs. 14,557 Crores was raided. In 1996, 1183 issues were made raising as much as Rs. 12,410 Crores (Banerjee, S.K. 1999). To make a rewarding investment one should be thorough with the nature of the business, the market share of the company, its profitability, dividend policies, efficiency of the management, share price movement, functioning of stock exchange and various intermediaries. In practice investors face several problem in the stock market, which pose a threat to their investment desire. This is evidenced by the fact that in 1997-’98 alone, Securities Exchange Board of India (SEBI) received 1,59,670 complaints from various investors against different mal-practice perpetrated by different groups (SEBI – Annual Report 1998). Many of the grievances reported by investors relate to market manipulation, issue of fake securities, manipulation through insider trading and to other routine matters like non – receipt of refund to safeguard from the perils of
the stock market and to make an effective and safe investment investors should possess knowledge of market mechanisms, company’s performance and its policies as well as the regulatory bodies that are monitoring the capital market in India.

2.27 Structure of The Market:

There are various sub-markets in the capital market in India. The structure has undergone vast in recent years. New instruments and new institutions have emerged on the scene.

The sub – markets are as follows:

4. Mutual funds scheme and UTI schemes, etc.

So far as the individual investors are concerned, the market for corporate securities and mutual fund schemes are more relevant. They satisfy the requirements of investors namely income, appreciation of capital, safety, liquidity and hedge against inflation.
Chapter – 2 (b) Capital Market In India

Chart No. 18

Capital Markets Structure

Marketable Securities
- M. Securities
  (It is transferable and hence are traded on stock exchange)
- Govt.
- Corporate
- P.S.U.
- U.T.I.
- Bank
- Deposits
- Loan and
- Post Office
- Bonds
- Mutual
- Deposit
- with
- advances
- Certificates
- Funds
- companies
- of Banks
- and
- financial
- Institutions

Non Marketable Securities
- (These are not transferable and hence are not traded on stock exchanges.)
- Deposits
- Loan and
- Post Office
- Bonds
- Mutual
- Deposit
- with
- advances
- Certificates
- Funds
- companies
- of Banks
- and
- financial
- Institutions

New Issues Market Players – Original
- Promoters & Directors
- Associates & Friends
- Collaborators
- Employees
- FIs and Banks
- FIs
- OCBs
- NRIs
- Public

Stock Market Intermediaries
- Brokers
- Jobbers
- Dealers
- Badla Financial
- Arbitraguers

New Issues Market Players – For issues
- Merchant Bankers
- Collecting Bankers
- Registars
- Brokers
- Underwriters
- Advertising Agencies
- Printers
- Solicitors
- Sub-Broker
- Sub-Underwriters
- Mailing Agents
2.28 Household Investors’ Survey:

According to the Household Investors’ survey, 1999; conducted by society for capital market Research and Development, Delhi, October 1999. The salient findings are as shown in table 2.15.
Table 2.15

Capital Markets Mobilisation and Household Sectors Gross Saving. (Rs.crore)

<table>
<thead>
<tr>
<th>No.</th>
<th>Year</th>
<th>Public &amp; Right Issues of Shares and bonds</th>
<th>Mutual Funds net Sales</th>
<th>Total Mobilisation</th>
<th>Household sector's Gross savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1994-95</td>
<td>27,632</td>
<td>11,275</td>
<td>38,907</td>
<td>2,00,632</td>
</tr>
<tr>
<td>2</td>
<td>1995-96</td>
<td>20,804</td>
<td>-5,833</td>
<td>14,971</td>
<td>2,12,402</td>
</tr>
<tr>
<td>3</td>
<td>1996-97</td>
<td>14,276</td>
<td>-1,981</td>
<td>12,295</td>
<td>2,64,655</td>
</tr>
<tr>
<td>4</td>
<td>1997-98</td>
<td>4,570</td>
<td>3,305</td>
<td>7,875</td>
<td>2,86,231</td>
</tr>
<tr>
<td>5</td>
<td>1998-99</td>
<td>5,586</td>
<td>-905</td>
<td>4,636</td>
<td>3,00,000</td>
</tr>
</tbody>
</table>

Source: RBI Currency and the Finance Reports and the Govt. of India, Economics Survey and SEBI’s Annual Report for Various Years.

* Other Than treasury bonds.

Note: The Mutual funds net sales were negative (−) in several years.

1) Number of Share-holder has almost stopped growing after 1995.
2) More Shareholders want to reduce their exposure to equity than to increase it.

3) A majority of investors report unsatisfactory experience of equity investing.

4) 80% respondents show little / no confidence in company management.

5) 55% respondents show little/no confidence in SEBI.

6) Only 6% respondents intend to buy private company bonds.

7) Only 15% respondents intend to buy private company bonds.

8) 24% bond holders report defaults of undue delay or non-payment of interest and or redemption money.

9) 80% investors regard DFI (Development Finance Institution) bonds safe and 45% intend to invest in them.

10) Most preferred savings instruments are government savings schemes and bank fixed deposits.
2.29 Categories of Capital Market

The various categories of capital market are shown in Chart 19

Chart 19

Types of Capital Market

Capital Market

Organised Capital Market  Unorganised Capital Market

Primary Market  Secondary Market

[ Primary Market refers to an arrangement which facilitates the procurement of long-term finance by the new issue of shares and debentures]

New Issue of shares and Debenture

Public Issues

Issues House

Private Placement

Right Issues

[It facilitates the purchase and sales of those shares & debentures which have already issued by the company in the primary market.]
In respect of corporate securities, leaving aside new issues market, the structure of the secondary market has undergone some changes which are depicted in the Chart given below:

It contains selective presentation of marketable and non-market table securities and those, which are the issues of the securities, the players and intermediaries in the markets – both the primary and secondary markets are also set out as given in Chart No. 19.
Indian Capital Market Landmarks and Developments During A Decade:

1. Amendment to Banking Regulation Act in 1983 permitted banks to undertake non-banking functions like merchant banks and mutual funds who started operations in the capital market through their subsidiaries.

2. Entry of public sector banks though their mutual funds in a big way since 1987 for channeling small savings into the capital market.

3. Setting up of the SEBI by the government in 1988 to oversee capital market.

4. Establishment of SHCIL by All India Financial Institutions (FIs) introducing a new concept of depository functions and book keeping for stock market dealings.

5. Belling of credit rating agencies, namely CRISIL, UCRA, CARE etc., during 1988 to 1993 popularising the credit rating function by companies issuing debt instruments.

6. Introducing a new tire to the capital market structure OTCEI was set up in 1989 – started operations in 1992.
2.30 Institutional Structure in Capital Market:

Development and investment Institutions:

Functionally, there are two types of financial institutions in the Indian Capital Market, namely, developmental institution and investment institutions. In the former category, there are institutions of all India stature, namely, IDBI, IFCI, ICICI and IRBI and stock level stature, namely, state Finance and Development Corporations. In the category of investment institutions, there are all India bodies like UTI, LIC, GIC etc. and State-level bodies like the State Industrial Corporations (SIICs) and State Industrial Investment Corporations. The all-India bodies provide finance, entrepreneurial guidance, training and technical guidance etc., to the all-India projects and regional projects of medium and large size. They lend at concessional terms for the development of no-industry districts and backward regions. Among the all – India bodies, IDBI is the leader of financial institutions. But in 1988, the SEBI was set up as the developmental and regulatory body of the securities industry in India.

* Functions:

The State – level bodies provide finance and entrepreneurial guidance to State-level, small and medium entrepreneurs and infrastructure and
industrial growth in the respective states. Some of them have set up industrial estates and undertake joint ventures with the private sector and promote industries in their respective state. Besides giving loan and advances to industrial units, they invest in their debentures and equity shares, provide the seed capital for new and small entrepreneurs, underwrite and various other instruments in the capital market or subscribe to new issues or buy or sell these instruments in the secondary market, etc. A number of mutual funds have also become players in the market since 1987.

Of the major players in the market, namely, the investment institutions like LIC, GIC and UTI, the bulk of the activity is generated by the UTI by its mobilization of savings from the public through its various schemes, referred to below. It has today investible fund to the tune of about Rs. 60,000 Crores and its actively participates in trading in the market and in subscribing to new issues of shares, debentures etc.

A detailed write up of the activities and functions of UTI is provided below:

* UTI and Its Objective:
The Unit Trust of India (UTI) was set up in 1964 with a major contribution from the RBI under the UTI Act, 1964. Subsequently, with the passing of ownership of UTI to Government in 1976, the IDBI became its shareholder along with the LIC, SBI and other Financial Institutions. Its activities namely, the scheme. It operates to mobilise saving and its investments, are all governed by the Act. It has originally a paid-up capital of Rs. 5 Crores and it was the only Unit Trust or Mutual Fund in the public sector allowed to operate in India. It was accorded special treatment income tax assessment and tax deductions. Not only is its investment income-tax free but its dividend payments are also tax-exempt up to certain limits in the hands of the investors.

Its main objectives are to mobilize savings particularly from the low and middle income groups, to channelize these savings into productive investment and to provide an assured income to savers. It provides the savers with expert investment service, portfolio management and assured income. The risk averting savers would not normally invest in stock and capital market. They are afraid to so due to lack of expertise and easy access. The UTI provides expert management of their fund, steady income and liquidity for their investment through repurchase. The UTI mobilizes the savings though the sale of its units and operates a number
of scheme with varied characteristics to suit the requirements of savers and investors. These characteristics include income, capital appreciation, liquidity through repurchase, an elements of insurance etc.

* Functions of UTI:

The activities of UTI include a wide variety of service to the corporate world as well as investors. It can underwrite new issues, make direct subscription to public issues or private placements, keep deposited with banks and companies and operate in the money market by subscribing to Treasury Bills, Commercial Bills, etc. It can also partake in the inter bank market as lender or borrower of short term funds. It can borrow from the RBI or the Government in case of need.

The Units of UTI are denominations of Rs. 10 or 100, through which it mobilizes funds from the household and business sectors. It can also sell units to foreign individual and institutions. For example, NRIs are eligible to invest in the units without prior permission of the RBI on a non-repatriation basis. The UTI has a net work of agents all over India to sell units and service the Units-holders. It has arrangements with some banks to operate its schemes.
Investment pattern:

The normal pattern of investment of its funds is broadly as follows although it may vary year to year.
### Chart No 21

**Investment Pattern of the Fund.**

<table>
<thead>
<tr>
<th>Investment Pattern</th>
<th>% of total investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>40.8</td>
</tr>
<tr>
<td>Debentures &amp; preference shares</td>
<td>21.4</td>
</tr>
<tr>
<td>Advance deposits for under written shares debentures</td>
<td>1.5</td>
</tr>
<tr>
<td>Term Loans</td>
<td>7.9</td>
</tr>
<tr>
<td>Government Securities</td>
<td>15.6</td>
</tr>
<tr>
<td>Money market instruments</td>
<td>5.9</td>
</tr>
<tr>
<td>Deposits with companies</td>
<td>0.9</td>
</tr>
<tr>
<td>Deposits with banks</td>
<td>6.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

It will be seen from the above Chart No 21 that the bulk of its funds into the corporate sector in the form of loans, deposits, debentures, equity etc. Barring about 27.5% with banks and a government securities and money market instrument rest is invested in high yielding corporate instruments.

Two unit schemes viz, India Fund and India Growth Fund were floated in foreign countries to mobilize foreign funds for since 1986. These two off-
shore funds were operated since 1986. The first one was India Fund floated in July, 1986 in association with the Merrill Lynch and collected $75 million. These shares were quoted in London. The second fund, namely, India Growth Fund, was launched in July 1988 and mobilized $60 million. These shares were quoted in New York. These two funds have been doing well in their performance with the result that a number of other off shore funds were floated by the Grindlays Bank, SBI, Caps, Can Bank and others. Besides, the UTI has also launched two Venture Capital Funds in 1989 and 1990 respectively for the promotion of green field companies and new venture having a high - risk components.

* Schemes Offered by the UTI :

1. Unit Scheme 1964, It is a perpectual scheme, each Unit with a face value of Rs. 10 transferable and repurchased by the UTI. Dividend income from the UTI qualifies for deduction of income tax under Section 80L of the Income Tax Act and eligible for Wealth Tax exemption up to Rs. 5 lacs. Reinvestment facility as an alternative to dividend distributions is available.

2. Unit – Lined Insurance Plan (ULIP) 1971 : Scheme of 10 years and 15 year periods are available both with life insurance and accident insurance. The target amount is a maximum of Rs. 60,000 and the
age limit is 55 years. The life coverage is secured from LIC by the contributions of UTI. The contributions of the insured are payable yearly or half yearly.

3. Capital Gains Unit Scheme (CGUS) : Investment in part or in full of the capital gains due to sale of any long – term capital assets in the capital gains units scheme would qualify for exemption from capital gains tax under Section 54A of the income – tax Act. This investment is to be made within six month of the date of the sale of capital assets and there is no maximum limit. This is to be held for a minimum period of three years. Dividend income along with others is exempt under Section 80 L of Income – Tax Act upto Rs. 13,000 and from the Wealth Tax upto Rs. 5 lacs.

4. Children’s Gift Growth Plan : Unit with a face value of Rs. 10 are gifted to a minor child under this scheme, maturing at the age of 21 by the child. Gift upto Rs. 20,000 are exempt gift tax, at that time and Rs. 30,000 now.

5. Various close – ended scheme : Such scheme as monthly income unit scheme, growing income unit scheme etc. were started in various yearly since 1982 for meeting the varying needs of investors.

6. Mater Share floated for Indian investors and Indian Fund and India Growth Fund etc. for foreign investors : The Mutual Fund Subsidiary
Unit Scheme (Master Shares) 1986 are quoted on the stock exchanges and are treated as shares. A third off-shore fund was initiated in 1989-90 with the help of a Japanese securities firm and ADB, in addition to the two, referred to above.

Recently UTI has set up its own bank (UTI Bank) and some subsidiaries to serve its investors.

The first three schemes are the most popular of all and account for 70 percent of the total inventible funds of the UTI. The second venture capital fund which is managed by the Technology Development and Information Company of India Ltd. was set up in March 1990 with a contribution of Rs. 35 Crores from the UTI and contributions from other financial Institutions. This fund like the earlier one helps the financial of greenfield venture from new entrepreneurs to promote industrial growth.

2.31 Importance of Capital Market

Absence of capital market acts as deterrent factor to capital formations and economic growth. Resources would remain idle if finances are not funneled through capital market. The importance of capital market can be briefly summarized as follows:
1. It provides an avenue for investors, particularly the household sector, to invest in financial assets, which are more productive than physical assets.

2. It provides incentives to saving and facilitates capital formation by offering suitable rates of interest as the price of capital.

3. It facilitates increase in production and productivity in the economy and thus enhanced the economic welfare of the society. Thus it facilities "The movement of stream of command over capital to the point of highest yield? towards those who can apply them productively and profitably to enhance the national income in the aggregate.

4. The capital market serves as an important source for the productive use of the economy’s savings. It mobilizes the savings of the people for further investment and thus avoids their wastage in unproductive uses.

5. A healthy capital market consisting of expert intermediaries promotes stability in values of securities representing capital funds.

6. Moreover, it serves as an important link between those who save and those who aspire to invest these savings.

7. The operations of different institutions in the capital market induce economic growth. They give quantitative and qualitative directions.
2.33 References:


8. SEBI – Annual Reports - 1998


