Chapter 1

Introduction and Research Design
INTRODUCTION

The success story of any economy can only be scripted on the basis of sound financial system of the country. Economic reform process of 1991 had a great impact on the financial system of the country leading to the overall development of the Indian economy. Today, India’s financial system is considered to be sound and stable as compared to many other Asian countries where the financial market is facing many crises. During last one decade or so, role of Indian mutual funds industry as a significant financial service in financial market has really been noteworthy. In fact, Mutual funds have emerged as an important segment of financial market of India, especially as a result of the initiatives taken by the Govt.of India for resolving problems relating to UTI’s US-64 and to liberalize tax liabilities on the incomes earned by the mutual funds. They now play a very significant role in channelizing the saving of millions of individuals into the investment in equity and debt instruments. This research aims at making a critical study of the role performed by mutual funds as a financial service in Indian financial market and the investors’ inclination towards the mutual funds.

INDIAN FINANCIAL SYSTEM

In order to critically examine the role of mutual funds in Indian financial market, we should first of all have a good idea about the Indian financial system. The financial system in India comprises of financial institutions, financial markets, financial instruments and services. Financial market refers to those places where financial assets are created and traded. Financial assets represent a claim for the payment of principal amount some times in future date and for periodic payment of money in the form of interest or dividends. The Reserve Bank of India (RBI) as the main regulator of credit is the apex institution in the financial system. Other important financial institutions are the commercial banks (in the public and private sector), cooperative banks, regional rural banks and development banks. Non-bank financial institutions include finance and leasing companies and other institutions like LIC, GIC, UTI, Mutual funds, Provident Funds, Post Office, Banks etc.. The banking system is, by far, the most dominant segment of the financial sector accounting for over 80 per cent of the funds flowing through the
financial sector. The Indian financial sector reforms aim at improving the productivity and efficiency of the economy. It remained stable, even when other markets in the Asian region were facing a crisis. The opening of the Indian financial market to foreign and private Indian players has resulted in increased competition and better product offerings to consumers. The main function of all these financial institutions is financial intermediation i.e., facilitating the flow of saving from common man to industrial houses. In the initial stages, the role of the intermediary was mostly related to ensure transfer of funds from the lender to the borrower. This service was offered by banks, FIs, brokers, and dealers. However, as the financial system widened along with the developments taking place in the financial markets, the scope of its operations also widened. Some of the important intermediaries operating in the financial markets include investment bankers, underwriters, stock exchanges, registrars, depositaries, custodians, portfolio managers, mutual funds, financial advertisers, financial consultants, primary dealers, satellite dealers, self regulatory organizations, etc.. Financial Markets are mainly classified as Money Market and Capital Market. The term, ‘money market’ is used to denote the financial institutions which deal with the short term borrowing and lending of money. The term, ‘capital market’ is used to mean the institutes which deals with the lending and borrowing of long-term money. Resource mobilization by mutual funds is an important activity in the capital markets. India’s mutual fund and stock market have witnessed phenomenal growth over the last few years. According to a study, mutual funds would be one of the major instruments of wealth creation and wealth saving in the years to come, giving positive results. As India is targeting a GDP growth rate of 9 % in the Eleventh Plan Period, the role of financial sector as well as the role of mutual funds industry in India as an important segment of financial market for resource mobilization in capital market is going to be very significant. The consistency in the performance of mutual funds has been a major factor that has attracted many investors. The mutual fund industry growth is estimated at about 50 per cent, much higher than that of bank fixed deposits which are growing at about 20 per cent.
HISTORY OF THE MUTUAL FUNDS

International Scenario:

Mutual funds really captured the public's attention in the 1980s and '90s when mutual fund investment hit record highs and investors saw incredible returns. However, the idea of pooling assets for investment purposes has been around for a long time. Here we look at the evolution of this investment vehicle, from its beginnings in the Netherlands in the eighteenth century to its present status as a growing, international industry with fund holdings accounting for trillions of dollars in the United States alone.

In the Beginning

Historians are uncertain of the origins of investment funds; some cite the closed-end investment companies launched in the Netherlands in 1822 by King William I as the first mutual funds, while others point to a Dutch merchant named Adriaan van Ketwich whose investment trust created in 1774 may have given the king the idea. Van Ketwich probably theorized that diversification would increase the appeal of investments to smaller investors with minimal capital. The name of van Ketwich's fund, Eendragt Maakt Magt, translates to "unity creates strength". The next wave of near-mutual funds included an investment trust launched in Switzerland in 1849, followed by similar vehicles created in Scotland in the 1880s.

The idea of pooling resources and spreading risk using closed-end investments soon took root in Great Britain and France, making its way to the United States in the 1890s. The Boston Personal Property Trust, formed in 1893, was the first closed-end fund in the U.S. The creation of the Alexander Fund in Philadelphia, Pennsylvania, in 1907 was an important step in the evolution toward what we know as the modern mutual fund. The Alexander Fund featured semi-annual issues and allowed investors to make withdrawals on demand.
The Arrival of the Modern Fund

The creation of the Massachusetts Investors' Trust in Boston, Massachusetts, heralded the arrival of the modern mutual fund in 1924. The fund went public in 1928, eventually spawning the mutual fund firm known today as MFS Investment Management. State Street Investors' Trust was the custodian of the Massachusetts Investors' Trust. Later, State Street Investors started its own fund in 1924 with Richard Paine, Richard Saltonstall and Paul Cabot at the helm. Saltonstall was also affiliated with Scudder, Stevens and Clark, an outfit that would launch the first no-load fund in 1928. A momentous year in the history of the mutual fund, 1928 also saw the launch of the Wellington Fund, which was the first mutual fund to include stocks and bonds, as opposed to direct merchant bank style of investments in business and trade.

Regulation and Expansion

By 1929, there were 19 open-end mutual funds competing with nearly 700 closed-end funds. With the stock market crash of 1929, the dynamic began to change as highly-leveraged closed-end funds were wiped out and small open-end funds managed to survive. Government regulators also began to take notice of the fledgling mutual fund industry. The creation of the Securities and Exchange Commission (SEC), the passage of the Securities Act of 1933 and the enactment of the Securities Exchange Act of 1934 put in place safeguards to protect investors: mutual funds were required to register with the SEC and to provide disclosure in the form of a prospectus. The Investment Company Act of 1940 put in place additional regulations that required more disclosures and sought to minimize conflicts of interest.

The mutual fund industry continued to expand. At the beginning of the 1950s, the number of open-end funds topped 100. In 1954, the financial markets overcame their 1929 peak, and the mutual fund industry began to grow in earnest, adding some 50 new funds over the course of the decade. The 1960s saw the rise of aggressive growth funds, with more than 100 new funds established and billions of dollars in new asset inflows.
Hundreds of new funds were launched throughout the 1960s until the bear market of 1969 cooled the public appetite for mutual funds. Money flowed out of mutual funds as quickly as investors could redeem their shares, but the industry's growth later resumed.

**Recent Developments**

In 1971, William Fouse and John McQuown of Wells Fargo Bank established the first index fund, a concept that John Bogle would use as a foundation on which to build The Vanguard Group, a mutual fund powerhouse renowned for low-cost index funds. The 1970s also saw the rise of the no-load fund. This new way of doing business had an enormous impact on the way mutual funds were sold and would make a major contribution to the industry's success.

With the 1980s and '90s came bull market mania and previously obscure fund managers became superstars; Max Heine, Michael Price and Peter Lynch, the mutual fund industry's top gunslingers, became household names and money poured into the retail investment industry at a stunning pace. More recently, the burst of the tech bubble and a spate of scandals involving big names in the industry took much of the shine off of the industry's reputation. Shady dealings at major fund companies demonstrated that mutual funds aren't always being investments managed by folks who have their shareholders' best interests in mind and who treat all investors equally.

Despite the 2003 mutual fund scandals, the story of the mutual fund is far from over. In fact, the industry is still growing, opening up new markets around the world. The first Korean mutual fund, the Mirae Asset Park Hyun-joo Fund, was launched in Dec 1998. Today there are 20 trillion Korean won (about US$19.32 billion) invested in Korea's funds. In the U.S. alone there are more than 10,000 mutual funds, and if one accounts for all share classes of similar funds, fund holdings are measured in the trillions of dollars. Despite the launch of separate accounts, exchange-traded funds and other competing products, the mutual fund industry remains healthy and fund ownership continues to grow.
INDIAN SCENARIO :

The origin of mutual fund industry in India is with the introduction of the concept of mutual fund by UTI in the year 1963. Though the growth was slow, but it accelerated from the year 1987 when non-UTI players entered the industry.

In the past decade, Indian mutual fund industry had seen a dramatic improvements, both quality wise as well as quantity wise. Before, the monopoly of the market had seen an ending phase, the Assets Under Management (AUM) was Rs. 67bn. The private sector entry to the fund family rose the AUM to Rs. 470 bn in March 1993 and ill April 2004, it reached the height of 1,540 bn.

Putting the AUM of the Indian Mutual Funds Industry into comparison, the total of it is less than the deposits of SBI alone, constitute less than 11% of the total deposits held by the Indian banking industry.

The main reason of its poor growth is that the mutual fund industry in India is new in the country. Large sections of Indian investors are yet to be intellectuated with the concept. Hence, it is the prime responsibility of all mutual fund companies, to market the product correctly abreast of selling.

The mutual fund industry can be broadly put into four phases according to the development of the sector. Each phase is briefly described as under.

Phase 1. 1964-87

Establishment and Growth of Unit Trust of India –

Unit Trust of India enjoyed complete monopoly when it was established in the year 1963 by an act of Parliament. UTI was set up by the Reserve Bank of India and it continued to operate under the regulatory control of the RBI until the two were de-linked in 1978 and the entire control was transferred in the hands of Industrial Development Bank of India (IDBI). UTI
launched its first scheme in 1964, named as Unit Scheme 1964 (US-64), which attracted the largest number of investors in any single investment scheme over the years.

UTI launched more innovative schemes in 1970s and 80s to suit the needs of different investors. It launched ULIP in 1971, six more schemes between 1981-84, Children's Gift Growth Fund and India Fund (India's first offshore fund) in 1986, Master share (India’s first equity diversified scheme) in 1987 and Monthly Income Schemes (offering assured returns) during 1990s. By the end of 1987, UTI's assets under management grew ten times to Rs 6700 crores.

**Phase II---- 1987-1993**

**Entry of Public Sector Funds -**

The Indian mutual fund industry witnessed a number of public sector players entering the market in the year 1991. In November 1991, SBI Mutual Fund from the State Bank of India became the first non-UTI mutual fund in India. SBI Mutual Fund was later followed by Canbank Mutual Fund, LIC Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund, GIC Mutual Fund and PNB Mutual Fund. By 1993, the assets under management of the industry increased seven times to Rs. 47,004 crores. However, UTI remained to be the leader with about 80% market share.

<table>
<thead>
<tr>
<th>AMOUNT MOBILISED &amp; ASSETS UNDER MANAGEMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-93</td>
</tr>
<tr>
<td>UTI</td>
</tr>
<tr>
<td>Public Sector</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Table No: 1.1  
Source: AMFI
Phase III. 1993-96

Emergence of Private Sector Funds –

The permission given to private sector funds including foreign fund management companies (most of them entering through joint ventures with Indian promoters) to enter the mutual fund industry in 1993, provided a wide range of choice to investors and more competition in the industry. Private funds introduced innovative products, investment techniques and investor-servicing technology. By 1994-95, about 11 private sector funds had launched their schemes.

Phase IV ---1996-2004

Growth and SEBI Regulation

The mutual fund industry witnessed robust growth and stricter regulation from the SEBI after the year 1996. The mobilisation of funds and the number of players operating in the industry reached new heights as investors started showing more interest in mutual funds.

Investors’ interests were safeguarded by SEBI and the Government offered tax benefits to the investors in order to encourage them. SEBI (Mutual Funds) Regulations, 1996 was introduced by SEBI that set uniform standards for all mutual funds in India. The Union Budget in 1999 exempted all dividend incomes in the hands of investors from income tax. Various Investor Awareness Programmes were launched during this phase, both by SEBI and AMFI, with an objective to educate investors and make them informed about the mutual fund industry.

In February 2003, the UTI Act was repealed and UTI was stripped of its Special legal status as a trust formed by an Act of Parliament. The primary objective behind this was to bring all mutual fund players on the same level. UTI was re-organised into two parts:

1. The Specified Undertaking,

2. The UTI Mutual Fund

Presently Unit Trust of India operates under the name of UTI Mutual Fund and its past schemes (like US-64, Assured Return Schemes) are being gradually wound up. However, UTI Mutual
Fund is still the largest player in the industry. In 1999, there was a significant growth in mobilisation of funds from investors and assets under management which is supported by the following data:

<table>
<thead>
<tr>
<th>FROM</th>
<th>TO</th>
<th>UTI</th>
<th>PUBLIC SECTOR</th>
<th>PRIVATE SECTOR</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>01-April-99</td>
<td>31-March-2000</td>
<td>11,679</td>
<td>1,732</td>
<td>7,966</td>
<td>21,377</td>
</tr>
<tr>
<td>01-April-01</td>
<td>31-March-02</td>
<td>13,536</td>
<td>4,039</td>
<td>42,173</td>
<td>59,748</td>
</tr>
<tr>
<td>01-April-02</td>
<td>31-March-03</td>
<td>12,413</td>
<td>6,192</td>
<td>74,352</td>
<td>92,957</td>
</tr>
<tr>
<td>01-April-03</td>
<td>31-March-04</td>
<td>4,643</td>
<td>13,613</td>
<td>1,46,267</td>
<td>1,64,523</td>
</tr>
<tr>
<td>01-April-04</td>
<td>31-Jan-05</td>
<td>5,505</td>
<td>22,923</td>
<td>2,20,551</td>
<td>2,48,979</td>
</tr>
<tr>
<td>01-Feb.-05</td>
<td>31-March-06</td>
<td>*</td>
<td>7,259*</td>
<td>58,435</td>
<td>65,694</td>
</tr>
<tr>
<td>01-April-07</td>
<td>31-March-08</td>
<td>-</td>
<td>68,558</td>
<td>5,21,632</td>
<td>5,90,190</td>
</tr>
<tr>
<td>01-April-08</td>
<td>31-March-09</td>
<td>-</td>
<td>1,03,246</td>
<td>7,36,416</td>
<td>8,39,662</td>
</tr>
<tr>
<td>01-April-09</td>
<td>31-March-10</td>
<td>-</td>
<td>1,83,446</td>
<td>9,14,712</td>
<td>10,98,158</td>
</tr>
</tbody>
</table>

Table No: 1.2  
Source: AMFI

Assets under management of mutual funds have soared
USD bn

Figure No: 1.1  
Source: AMFI
Phase V. -----2004 Onwards

Growth and Consolidation –

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

Figure No : 1.2

Source : AMFI
Importance of Mutual Fund

Small investors face a lot of problems in the share market, limited resources, lack of professional advice, lack of information etc. Mutual funds have come as a much needed help to these investors. It is a special type of institutional device or an investment vehicle through which the investors pool their savings which are to be invested under the guidance of a team of experts in wide variety of portfolio’s of Corporate securities in such a way, so as to minimise risk, while ensuring safety and steady return on investment. It forms an important part of the capital market, providing the benefits of a diversified portfolio and expert fund management to a large number, particularly small investors. Now a days, mutual fund is gaining its popularity due to the following reasons :

1. With the emphasis on increase in domestic savings and improvement in deployment of investment through markets, the need and scope for mutual fund operation has increased tremendously. The basic purpose of reforms in the financial sector was to enhance the generation of domestic resources by reducing the dependence on outside funds. This calls for a market based institution which can tap the vast potential of domestic savings and channelize them for profitable investments. Mutual funds are not only best suited for the purpose but also capable of meeting this challenge.

2. An ordinary investor who applies for share in a public issue of any company is not assured of any firm allotment. But mutual funds who subscribe to the capital issue made by companies get firm allotment of shares. Mutual fund latter sell these shares in the same market and to the Promoters of the company at a much higher price. Hence, mutual fund creates the investors confidence.

3. The psyche of the typical Indian investor has been summed up in three words; Yield, Liquidity and Security. The mutual funds, being set up in the public sector, have given the impression of being as safe a conduit for investment as bank deposits. Besides, the assured returns promised by them have investors had great appeal for the typical Indian investor.
4. As mutual funds are managed by professionals, they are considered to have a better knowledge of market behaviours. Besides, they bring a certain competence to their job. They also maximise gains by proper selection and timing of investment.

5. Another important thing is that the dividends and capital gains are reinvested automatically in mutual funds and hence are not frittered away. The automatic reinvestment feature of a mutual fund is a form of forced saving and can make a big difference in the long run.

6. The mutual fund operation provides a reasonable protection to investors. Besides, presently all Schemes of mutual funds provide tax relief under Section 80 L of the Income Tax Act and in addition, some schemes provide tax relief under Section 88 of the Income Tax Act lead to the growth of importance of mutual fund in the minds of the investors.

7. As mutual funds creates awareness among urban and rural middle class people about the benefits of investment in capital market, through profitable and safe avenues, mutual fund could be able to make up a large amount of the surplus funds available with these people.

8. The mutual fund attracts foreign capital flow in the country and secure profitable investment avenues abroad for domestic savings through the opening of off shore funds in various foreign investors. Lastly another notable thing is that mutual funds are controlled and regulated by SEBI and hence are considered safe. Due to all these benefits the importance of mutual fund has been increasing.
Importance of Research on Mutual Funds:

From the above comprehensive information we can understand the importance of Mutual Funds for the investors. They minimize risk, while ensuring safety and steady return on investment. Hubli-Dharwad twin cities are one of the fastest growing cities in Karnataka. They have a lot of potential to grow as many business houses, industries, software companies, banks and financial institutions are coming up and are providing lot of employment opportunities to the people of Hubli-Dharwad and round about. As a result of this, the standard of living and investable surplus income with the people in this area is increasing day by day. People expect high return with less risk, but its very difficult. The more risk we take, the more return we get. Stock market is the only place where we can get returns up to 70%, but the stock market is very fluctuating & the investor has to be very intelligent and has to do a lot of analysis of the stocks before investing in them. A common man will not be having all those expertise of analyzing the stock market and he finds it very risky. Mutual fund is such an financial instrument through which the investor can invest to get a high and steady return with less risk.

There are many financial instruments available for investment like Savings bank, Fixed Deposit, Postal Savings, investing in Gold, investing in Real Estate, Bonds, Debentures, Shares, Mutual Funds, etc. All these instruments carry their own risk and return features. When compared to all the above instruments, Mutual fund is a very good investment option to all the class of investors like lower middle class, upper middle class and rich class, but people are not preferring to invest in Mutual Funds. So this research aims to find out the inclination of investors towards Mutual Funds as compared to other popular investment options available to them.
The research on this topic has never been carried out until now and it is the need of the hour to find out the acceptance level of the Mutual Funds by the investors of Hubli-Dharwad. The same research needs to be carried out in large scale throughout India so as to know why India, despite being a fast-growing economy, is far behind as compared to other developing and developed countries in Mutual Fund Asset Management business. To inculcate perfection and accuracy in the research, my research is limited to Hubli-Dharwad area only.

**Objectives of the Research :**

The following are the main objectives of the research:

- To know the different financial instruments in which the investors of Hubli-Dharwad prefer to invest.
- To find out the awareness of Mutual Funds among the Investors of Hubli-Dharwad.
- To analyze the types of Mutual Funds in which the investors like to invest.
- To find out the different ways through which the investors invest in mutual funds.
- To understand the risk – return behaviour of investors with respect to Mutual Funds.
- To find out the reasons of non-popularity of Mutual Funds among investors in Hubli-Dharwad.
- To understand the risks and drawbacks associated with mutual funds.
- To find out the most popular and best investment instrument according to the investors of Hubli-Dharwad.
- To assess the association between investors awareness of Mutual Funds & different investment instruments like Savings bank A/c, Fixed Deposit A/c, Shares, Real Estate, Postal Savings & Gold/Silver.
Hypothesis of the research:

The following are the hypothesis of the research to assess the association between investors awareness of Mutual Funds & different investment instruments like Savings bank A/c, Fixed Deposit A/c, Shares, Real Estate, Postal Savings & Gold/Silver.

\( H_1 \): There is no significant association between awareness of mutual fund and Savings bank as an investment instrument.

\( H_2 \): There is no significant association between awareness of mutual fund and Fixed deposit as an investment instrument

\( H_3 \): There is no significant association between awareness of mutual fund and Shares as an investment instrument

\( H_4 \): There is no significant association between awareness of mutual fund and Gold/silver as an investment instrument

\( H_5 \): There is no significant association between awareness of mutual fund and Postal savings as an investment instrument

\( H_6 \): There is no significant association between awareness of mutual fund and Real estate as an investment instrument

\( H_7 \): There is no significant association between awareness of mutual fund and Insurance as an investment instrument
Methodology of Research:

The investors’ problems and needs can be best known from the investors themselves. My methodology of study therefore relies primarily on in-depth interviews of investors through structured questionnaires covering a variety of interrelated aspects, such as the investor’s socio-economic and financial position, including income and types of investment held, past experiences, future investment intentions, problems being felt with regard to the investments, etc.

A survey of this kind is a rather difficult exercise, especially because many investors are reluctant to disclose their personal financial data to outsiders. I have tried to overcome this problem by informing the respondents that my objective is wholly focused on promoting the ordinary investors’ interest and strengthening their protection, and that I am a non-profit body and my research is purely for academic purpose.

Collecting of data from a large number of geographically dispersed investors is a stupendous task. The data collected is meaningful, thus its reliability and genuineness is ensured.

Sampling Procedure:

My sampling procedure is designed to overcome the problem due to widespread reluctance to disclose personal income and investments. This was done by a method of purposive sampling. To ensure near-randomness and city wide cross-sectional representation, I have used a highly dispersed network of local respondent investors, drawn mostly from college/university teachers, bank employees, and other professionals. Every completed questionnaire is scrutinised and analysed.

A preliminary version of the questionnaire was developed in English on the basis of insights from in-depth qualitative interviews with experts, mutual fund investors. Besides, personal observation was done where necessarily applicable. A pilot survey was conducted in the cities and the questionnaire was improved in that light. Interviewers were given a letter of introduction from university so that respondents would see that the study was authentic.
telephone number was provided too, in case respondents wanted to verify the identity of the investigators or clarify questions of concern. Several difficulties were encountered during data collection. Few refused to grant interview because, being unfamiliar with such studies, they were suspicious of the interviewers or purpose of the study. Altogether 300 samples were surveyed.

The interviewing work often involved more than one visit to suit the convenience and availability of the respondent. Given the widespread reluctance of respondents to disclose personal financial information, the sample covers only those respondents who were willing to cooperate in the survey by volunteering to provide the information required. Our method of sampling is good enough to give a feel of the entire system by covering the main stream of investors.

Admittedly, the sample does not represent the entire population of Hubli-Dharwad, but only the “universe of investors”. Those below the poverty line or having little voluntary savings for financial investments or no ability to understand investments, like shares and bonds, had to be excluded, because they were irrelevant for the purpose of the present survey.

**Data Collection Approach:**

**Secondary Data:**

Secondary data for this research is collected from different sources like:

1. Business magazines –
   - Business India.
   - Mutual Fund Insight.
   - Investor.
   - Capital Market Chip.
   - Business Today.
   - Outlook Money.
   - Dalaal Street.
   - Value Research
2. Business News papers
   - Economic Times
   - Business Line
   - Business Standard

3. Internet

4. Government Regulatory Institutions
   - Securities Exchange Board of India (SEBI)
   - Association of Mutual Funds of India (AMFI)
   - Reserve Bank of India (RBI)
   - Insurance Regulatory and Development Authority (IRDA)
   - Bombay Stock Exchange (BSE)
   - Bangalore Stock Exchange (BgSE)

5. Financial Institutions
   - HDFC Bank
   - AXIS Bank
   - State Bank of India
   - Canara Bank
   - Syndicate Bank
   - Corporation Bank
   - Karnataka Bank
   - Vijaya Bank
   - ICICI Bank
   - Reliance Money
   - India Bulls Ltd.
   - Karvy Securities Ltd.
   - Geojit Securities Ltd.
   - Motilal Ostwal Pvt. Ltd.
   - Kotak Mahindra Financials Ltd.
   - Stock Holding Corporation of India
Primary data:

Primary data for this research is collected from,

- a. The officials of the above mentioned Financial Institution.
- b. A pilot survey is conducted on the investors in Hubli-Dharwad.
- c. A detailed market research is conducted on the investors in Hubli-Dharwad after designing a comprehensive questionnaire.
- d. By mall intercepting investors in financial institutions.
- e. By personally interviewing the investors in different segments.

Sampling Process:

- **Sampling Unit**: All the Investors and non-Investors in the specified segments like business people, corporate, salaried people, bankers, Govt. Employees, Pensioners, Students, Professionals, etc.
- **Sampling Extent**: Hubli-Dharwad twin cities.
- **Sampling Size**: 300 samples.
- **Sample selection**: A database of the investors is collected from the Financial Institutions and the respondents are selected from the same database for the purpose of survey. Purposive sampling is done to gather responses from different segments of the public so as to analyse the findings and come to a realistic conclusion. The purposive sampling is as follows
  - 20 High School / Primary Teachers
  - 20 Pensioners/Retired people
  - 20 Engineers
• 20 Industrialists
• 20 Transporters
• 20 Students
• 20 University & College Lecturers/Readers/Professors
• 20 Doctors
• 20 Advocates
• 20 Bankers / Finance Professionals
• 20 Self Employed.
• 40 Govt. Employees
• 40 Business men / Traders

The selection of the samples in the above mentioned segments is done randomly. The samples are surveyed based on the questionnaire prepared for them and the responses were recorded for analysis.

**Tools and Techniques used for analysing the data :-**

The following are the tools and techniques used in the research for analysing the primary data collected through sample survey method for getting realistic results.

1. Tables bar diagram and structures are used in explanations to bring out the point more clearly.

2. Tabulation of the primary data was done. On the basis of these tables, trends have come out more visibly.

3. Statistical techniques used in the present study include:

   a) *Percentage Method*: to show the trend of the variable.
b) *Chi-square:* to test the independence of the attributes.

**UTILITY OF THE RESEARCH.:**

This research is useful for the many Mutual Fund companies and Financial Institutions to understand the acceptability of Mutual Funds by the investors. This research helps the mutual fund companies to prepare an action plan to boost the investments in mutual fund schemes especially in tier2 and tier 3 cities of the country. The Mutual Fund companies will come to know about their drawbacks and lacunas so as to improve themselves to gain investors' confidence.

The financial institutions dealing with the Mutual Funds will be able to know the needs and wants of the investors with respect to mutual funds and they can cater the right kind of Mutual Fund to the right kind of Investor thus increasing the business which will lead to huge mobilization of funds from the economy. The funds mobilized through Mutual Funds can be invested in to profitable projects to generate profits and to provide large scale employment opportunities thus leading to overall development or our country.
POTENTIAL FOR MUTUAL FUND IN INDIA

The economic and financial scenario of India prior to 1991 was somehow not optimistic. Indian economy at that time was suffering from low savings, low GDP, high inflation, high unemployment, high rates of interest, low forex reserve, etc.. When India approached IMF for financial assistance in 1991, we were imposed certain conditions on the basis of which the financial assistance was sanctioned to India. These restrictions which we accepted under the pressure from IMF were actually the starting point of economic reforms popularly known as LPG process. The result of the LPG process of 1991 is more clearly visible now. India is now being ranked as one of the fastest growing economy of the world. As the eleventh five year plan is started, we are already targeting a GDP growth of 9%. The saving of the country is now around 29%. Foreign investors are finding Indian market with high potential. India’s forex reserve is around $175 billion. Inflation is also at 5% which is considered good for developing economies. So, Indian economy is really booming today.
Some experts have opined that, the share of the US in world GDP is expected to fall (from 21 per cent to 18 per cent) and that of India to rise (from 6 per cent to 11 per cent in 2025), and hence India will emerge as the third pole in the global economy after the US and China. All these favourable things could have not been possible without the sound financial market. It is the financial market which finances economic development. It is the financial market which channelizes the saving of the people into the investment. Indian financial markets are getting more and more institutionalized. Foreign investors, local institutions and mutual funds are now playing a bigger role. This is the case in developed markets. Mutual Fund is an instrument of investing money. Nowadays, bank rates have fallen down below the inflation rate. Therefore, keeping large amounts of money in bank is not a wise option, as in real terms the value of money decreases over a period of time. One of the options available is to invest the money in stock market. But a common investor is not well informed and competent enough to understand the complexities involved in the price movement of shares in the stock market. This is where mutual funds come to rescue them. The role of mutual funds will increase in the Indian markets also. This means that retail investors will opt for mutual funds. In the US, 35 to 40 per cent of the investments currently come through mutual funds while in India it is very negligible. With the
stock markets reaching to newer heights in 2008 mutual funds could not be far behind. Total assets under management of 30 funds rose by Rs. 1,25,296 crore, or 63 per cent, to Rs. 3,23,601 crore during the calendar year 2011, according to the data published by the Association of Mutual Funds of India (AMFI). Mutual funds saw record resource mobilization as investors lined up to take advantage of the stock market boom. Reliance Mutual Fund — controlled by the Anil Ambani group — has toppled Prudential ICICI MF as the country’s largest private sector fund house, while UTI MF retained its leading position across both public and private sector funds in December 2011.

Market Potential:

The Indian mutual fund industry has traditionally been faced with an unstable asset composition, a small geographically skewed retail investor base, and a relatively insignificant share of household savings. A pervasive issue, and one which SEBI is already attempting to combat, is the mutual fund sales and distribution structures and practices.

The prevailing incentive models in non-proprietary intermediation have imposed three serious threats to mutual funds operating in India. The first is the captive market syndrome where commissioned agents depress both AMC margins and investor returns by demanding high front-end charges and trailing commissions. The second is an escalation in churning practices. The third is distributor disinterest in sales to potential SIP investors. These front-end inefficiencies flow back to AMCs in the form of higher costs, lower profits and erratic investor behaviour.

At one level, this is simply an issue of how the costs involved are shared across the food chain. The customer is unlikely to complain as long as returns on investment match expectations and the actual costs are not transparent. If both product providers and sales and distribution actors are making profits, the only tension is the relative shares each receives.
While economic conditions are buoyant, and general investor savvy is low, these tensions are at worst manageable. However, if general economic conditions sour, or investors demand higher returns, or regulators demand greater transparency in fees and charges, pressure will mount on product providers to lower asset management fees while distributors will seek to make up their losses through escalated charges and/or churning.

With sales incentives skewed heavily towards transactions and investment volumes, it is not surprising that distributors have shown little interest in delivering value added advisory services or in growing the underlying investor base. In this scenario, mutual funds should evaluate alternative sales and distribution arrangements that better protect their long term positions and more effectively insulate them from market fluctuations and tax policy changes.

However, sales and distribution practices are only one of the many reasons for low retail penetration by India's mutual fund sector. Till a few years ago, for example, the incomes of most Indians were at levels too modest for mutual funds to be of active interest. This has rapidly receded into history as India seems set to shoulder its way into a more prosperous future and with average incomes in India rising by nearly 30 per cent from the 2004-05 levels.

Another reason is that smaller retail investors traditionally have been offered a limited range of investment options and most household savings have been channelled into either low yielding bank deposits or to life insurance policies. This has produced what is, for the moment at least, a low risk appetite in the minds of many small investors.

Interest rate subsidies offered by the government as a back door method of selling government paper through various savings schemes offered by India Post have not helped either as they have herded a significant share of household savings in that direction. And finally, the mandatory publicly managed pension and provident funds have consumed over US $50 billion of stable and long-term household savings.

In all of this, the mutual fund industry itself also needs to accept a large part of the responsibility for the inertia as the various mutual fund players are yet to come together to more effectively promote the industry as a whole. As a result, mutual fund investment opportunities have yet to come onto the savings radar of most individuals with incomes in India as nearly 90
percent of them do not know that mutual funds exist. Of those who are aware, over 30 per cent could not recall even a single mutual fund brand. The fact that the mutual fund investor base is small therefore can be pinned substantially to this factor alone.

An important flip side to this analysis is that the existing retail mutual fund investor base represents some 18 per cent of the "aware" population. This suggests that the mutual fund investor base can be grown significantly if a visibility level among the larger audience, where visibility does not exist, is raised. In the mass market context, it is also significant that existing mutual fund investors are heavily influenced by social and familial networks in first being attracted to the mutual fund option.

Hence the underlying size of the investor base can play a key role in attracting new investors. In part, attracting the smaller investor can swing on effectively promoting the systematic investment plan (SIP) approach wherein smaller investors can more easily participate, and in the process spread risks more effectively when doing so. The problem is that the visibility of the SIP investment approach is lower again, with less than half of even the aware population relating to the possibility of investing in this way.

But there are signs that change is in the wind. The mutual fund retail investor base is today at 5.3 million. Life insurers also are experiencing good success with selling ULIPs while equity markets are ramping up with over 4.3 million individual investors. Looked at in this way, the base investor mass of interest to mutual funds already stands at over 10 million, as lying at the bottom of all three investment options is the mutual fund industry's stock in trade - a booming securities market.

Importantly, the potential mass market demand for mutual fund type products outside of this population is not a central issue. At a conservative estimate, an additional 34 million individuals, with the capacity and interest to invest up to US $14 billion annually in mutual fund type products already exists in India. However, over 57 per cent (19.6 million) of this population lives in rural areas.
Therefore, while most of the new demand from existing mutual fund investors will naturally come from middle and higher income earners, most of the potential mass market for mutual funds is likely to be found mainly among the lower and lower middle income groups.

For obvious reasons, this population is unlikely to be of much interest to the existing sales and distribution channels for mutual funds. Most of these potential investors (78 per cent) can instead be reached through the banking and postal networks. On the ground, promotional activities by the mutual fund industry at a bank or postal branch level also may reap rich dividends as three in four of these customers usually visit their bank at least once a month.

In money terms, retail investment flow in mutual funds in the last 12 months stood at US $5.6 billion. Importantly, this result has been achieved with a mutual fund penetration of the active workforce of less than 2 per cent. If the mutual fund industry manages to mobilise the necessary effort to bring the huge number of potential investors for whom mutual fund investments are not yet on the radar, the sky could literally be the limit.

**Indian investors favour mutual funds for investments - Research**

Mutual funds have become the preferred investment option for Indian investors as updated regulations have led to increased transparency in stock markets and asset management companies, according to a report issued recently by Frost & Sullivan, a New York-based market-research firm.

The report concludes that an expanding range of products that cater to different needs, as well as emerging opportunities like global investment funds and real estate funds, will keep the industry buoyant in the years ahead. Frost & Sullivan projects that the Indian asset-management industry will grow by more than 20 percent over the next five years.

The Indian asset management industry is witnessing rapid growth as a result of an economic boom, increase in personal financial assets, entry of foreign asset management companies, favourable stock markets and aggressive marketing by mutual funds. Frost & Sullivan research says “Even though the value of assets under management has risen by 48.22
percent between June 2006 and June 2007, the relatively low penetration rate of mutual funds greatly contributes to industry opportunities’.

According to the study, the Indian asset management industry is still in the nascent stages of growth when compared to developed countries. For example, in the United States, assets managed by mutual funds represented 78.6 percent of the country’s gross domestic product at the end of 2006, whereas in India they accounted for a meager 6.6 percent. This notable difference indicates the enormous market potential in India.

Additionally, retail investors continue to deposit household savings into banks. The huge amount of bank deposits increases growth potential, given that they present the opportunity to convert cash and deposits into mutual funds. In the United States, mutual funds manage about 20 percent of total household financial assets whereas Indian mutual funds only managed 3.6 percent between 2005 and 2006.

Despite the huge potential, the report warns that the rural sector’s limited participation greatly restrains the industry’s growth. Mutual funds remain out of reach for a majority of the population due to poor distribution, lack of investor awareness and limited banking facilities. Moreover, asset management companies reluctantly invest in infrastructure for smaller towns due to the lower margins from rural businesses.

The technological innovations and conveniences offered by the asset management industry cater largely to the urban investors,. Due to the poor penetration of the Internet, mobile phones and ATMs in rural areas, mutual fund investments are not within the easy reach of the rural investor.

**Mutual Funds as a Financial service**

According to the Global Asset Management 2007 Report form Boston Consulting Group, India-managed assets will exceed more than $1 trillion by 2015. This means an annual growth rate of 21% for the next nine years. The Indian mutual funds industry has been growing at a healthy
pace of 16.68 per cent for the past eight years and the trend will move further as has been
emphasized by the report. With the entrance of new fund houses and the introduction of new
funds into the market, investors are now being presented with a broad array of Mutual Fund
choices. The total asset under management of Mutual Fund industry rose by 9.45% from
Rs.309953.04 crores to 339232.46 crores in November, 2006 as published by AMFI. In 1987, its
size was Rs.1,000 crores, which went up to Rs. 4,100 crores in 1991 and subsequently touched a
figure of Rs.72,000 crores in 1998. Since then this figure has been increasing tremendously and
thus revealing the efficiency of growth in the mutual fund industry. It has generally been
observed that as the GDP of a country starts moving up, the share of AUM as a percentage of
household financials assets start to increase. At present, India has a GDP of around $3,000 on a
per capita basis and the AUM as a percentage of household financial assets is under 4%. This is
undoubtedly very low as compared to other countries. As India’s GDP is expected to maintain its
growth rate, households will surely be holding more assets through mutual fund than ever before.
The tremendous growth of Indian Mutual Funds industry is an indicator of the efficient financial
market we are currently having and the trust which investors have on the regulatory
environment. Mutual Funds are essentially investment vehicles where people with similar
investment objective come together to pool their money and then invest accordingly. Each unit
of any scheme represents the proportion of pool owned by the unit holder (investor).
Appreciation or reduction in value of investments is reflected in net asset value (NAV) of the
concerned scheme, which is declared by the fund from time to time. Mutual fund schemes are
managed by respective Asset Management Companies (AMC). Different business groups / financial institutions / banks have sponsored these AMCs, either alone or in collaboration with
reputed international firms. Several international funds like Alliance and Templeton are also
operating independently in India. Many more international Mutual Fund giants are expected to
come into Indian markets in the near future. Mutual Funds invest according to the underlying
investment objective as specified at the time of launching a scheme. So, we have equity funds,
debt funds, gilt funds and many others that cater to the different needs of the investor. The
availability of these options makes them a good option. While equity funds can be as risky as the
stock markets themselves, debt funds offer the kind of security that is aimed for at the time of
making investments. Money market funds offer the liquidity that is desired by big investors who
wish to park surplus funds for very short-term periods. Balance Funds cater to the need of
investors having an appetite for risk greater than that of the debt funds but less than the equity funds. The only pertinent factor here is that the fund has to be selected keeping the risk profile of the investor in mind because the products listed above have different risks associated with them. So, while equity funds are a good bet for a long term, they may not find favour with corporates or High Net-worth Individuals (HNIs) who have short-term needs.

The landscape of the mutual fund industry has undergone significant changes since the establishment of the Unit Trust of India in 1964, which for decades held the monopoly. By the mid 1990s, barriers to entry were gradually dismantled, allowing domestic and foreign private institutions to enter the fray. Assets under management have grown to around USD 65 bn in September 2006 nearly 10% of GDP, quadrupling in value since 1993. At its current growth rate, the sector’s size will double over the next 10 years. With intense competition came the adoption of measures to improve transparency. Restrictions on investment in debt instruments and money markets were loosened. A number of different schemes are now available in the market30, which appeals to investors’ varying investment objectives and constraints. The listing of open-ended schemes allowed investors the flexibility to adjust their fund exposures, while regulations against fund managers’ use of derivatives has been relaxed, allowing them to hedge their positions. Given the rapid growth of the industry in the past 3 years, can the Indian mutual fund industry be characterised as having come of age? Not when seen in the light of the low share of mutual funds in the household sector’s total investment pie. One promising development announced in the Budget in 2006 was the lifting of overseas investment limits by mutual funds to USD 3 bn from USD 2 bn. This will allow domestic fund managers to offer new opportunities in higher-yielding funds, such as those dedicated to emerging markets and alternative investments (e.g. commodities), which are currently not available in the local market. Combined with rising per-capita income, improving awareness of capital market investing and pension fund reforms will make mutual fund investing a viable long-term investment vehicle.
Mutual Fund For Retail Investors

Pure equity new fund offerings (NFOs) collected a whopping Rs 32,309 crore in 2006, almost 33% more than the money raised by Indian corporates through initial and follow-on issues. This is a clear indication that retail investors are increasingly tapping the stock market through the mutual fund route. The mutual fund (MF), as a capital market intermediary, has emerged as new avenue for capital resources. It bridges the gap between retail investors and capital markets. According to Value Research data, the top five equity NFOs were Reliance Equity (Rs. 5,790 crore), SBI Bluechip (Rs. 2,850 crore), Reliance Long Term Equity (Rs. 2,100 crore), UTI Leadership Equity (Rs. 2,080 crore) and Templeton India Equity Income (Rs. 2,030 crore). Close
to 40 NFOs were made in 2006 with average collections of Rs. 950 crore. The top five IPOs of 2006 were made by the following companies — Cairn India (Rs. 5,260 crore), Reliance Petroleum (Rs. 2,700 crore), Bank of Baroda (Rs. 1,633 crore), Parsvnath Developers (Rs. 1,089 crore) and Lanco Infratech (Rs. 1,067 crore). So, it is clearly evident that MF is providing more opportunities for the corporates to raise more funds. It is offering several options in structured forms. The industry is going to play a major role model in the capital markets. According to a study conducted by the Associated Chambers of Commerce and Industry of India, the size of the Mutual Funds industry is expected to be worth Rs. 4 lakh crores by 2010. Mutual Funds would be one of the major instruments of wealth creation and wealth saving in the years to come, giving positive results. The consistency in the performance of mutual funds has been a major factor that has attracted many retail investors. The Indian Mutual Funds industry has been growing at a healthy pace of 16.68 per cent for the past eight years and the trend will move further. According to a study, it has been found out that almost 54 % of people invest for security and certainty while 38 % of the people invest for current spending. Some 53 % of the people prefer long term investment whereas 23% people each prefer medium term and small term investment. All these studies relate to retail investors. Actually, it is the consistence performance of mutual funds which is attracting retail investors towards it. Today, MF equity portfolio is worth around $32 billion, while individual investors own $88 billion. It is the retail investors who have been heavily investing in equities through MFs over the past couple of years. This observation can be made from the fact that close to $17 billion of NFO collections made in the last four years from equity funds. Eventually, money collected on these have made their way to equity market. On an average, MF net investments into equity markets remained at around 50% of that by FIIs in the past three to four years. As retail investor’s investments are typically long-term oriented, they are therefore important for maintaining stability in any equity market. Another very significant development for retail investors in the field of mutual funds is the entry of mutual funds in real estates. For the last three years the real estate sector has been growing at a fast pace of 30-40 %, especially in the metros. But for retail investors, participating in this growth was not easy. By opening the real estate investment for mutual funds, retail investors, who cannot invest directly in real estates (which needs huge investments to start with), are actually allowed to investment in real estates through mutual funds. Retail investors are expected to account for 60% of the industry’s AUM. But this can be possible only if mutual funds in the country manage to enter
into non-urban cities. This becomes more important because this is where savings deposits account for 49% of the total assets. These small towns account for only 30% of their holdings in mutual funds. So, one thing can be said for sure that retail investors are going to participate more and more in mutual funds in the times to come and thereby a lot of financial resources are going to be mobilized to financial market of India.

The Indian mutual fund industry's average assets under management (AAUM) have grown by 19 per cent since June 2008 to touch Rs 6.72 trillion (including fund of funds) in June 2009. AAUM growth followed a key stress point witnessed by the industry during the year in October 2008, largely on account of the contagion effect of the global liquidity and credit crisis. Timely measures to provide liquidity and stimulus by the government and market regulators, coupled with the up-tick in equity markets following the May 2009 elections results played a significant role in helping the industry continue on its growth trajectory.

**Present Scenario**

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The share of debt-oriented funds in industry assets increased to 73 per cent in May 2009 from 66 per cent a year ago. In contrast, the share of equity-oriented funds has reduced to 26 per cent in May 2009 from 33 per cent a year ago, largely owing to mark to market losses in equity funds as the equity markets had been performing weakly for a large part of this period. Fixed income funds, on the other hand, have seen net cash inflows of close to Rs 750 billion, accounting for around 95 per cent of net cash inflows, for year ending May 2009. The fixed income AAUM for the industry stood at Rs 4.84 trillion in May 2009. Bank investment in mutual funds, as per RBI data, topped Rs 1.23 trillion as on June 19, 2009, as compared to less than Rs 100 billion in October 2008.

Retail investor penetration was a topic of great interest during the year with views and initiatives from both the regulators and the market body, Association of Mutual Funds of India (AMFI). The latest Economic Survey for 2008-09 highlighted the scope for expansion of the mutual fund industry since only 7.7 per cent of the total financial savings were allocated to mutual funds in 2007-08. In a recent release, AMFI too had stated that retail investors constituted only 21 per cent (majorly in equity funds) of the mutual fund industry AUM as of March 2009.

CRISIL Fund Services expects increasing investor awareness and proactive steps from the regulator and AMFI towards instilling transparency and good governance practices to enhance investor confidence, thereby aiding increased participation from the retail segment over the medium term.

Future Scenario

During last few years, India’s position as a market having potential for long-term growth has really been noteworthy as the Indian economy is being ranked among the top 10 globally (in terms of GDP), and as the fourth-largest [ in terms of purchasing power parity (PPP)]. Another good thing to note about Indian mutual funds industry is that it has grown at a rapid pace of 16.4% during the last 8 years as compared to global growth rate of 13% during the
same period. However, when it comes to assets under management (AUM) of the global mutual fund (MF) industry, India’s ranks is 25th which is not very satisfactory, rather dismal. With assets of around $76.5 billion (Rs. 3.41 lakh crore) as per AMFI figures at the end of November ’06, India forms just 0.4% of the world’s global MF AUMs. MF assets worldwide stood at $19.41 trillion at the end of the second quarter of 2006. US with $12.4 trillion of MF assets is the topper, followed by Luxembourg ($1.9 trillion), France ($1.6 trillion) and Australia ($723 billion).

Another important criterion which is used by the analysts as parameter to judge the majority of a country’s mutual fund industry is MF assets to GDP (PPP basis) ratio. According to available data, the ratio was 75.2% for US and 34.9% for UK. Even in the emerging economies’ list, India’s numbers were far from encouraging. The figure was 23.1% for Brazil, 26% for Russia, as compared to 1.3% for India. There are few other threats which Indian mutual fund is currently facing. Mutual funds must realize that there are some small saving schemes like NSC and PPF which are still offering high return than debt and income funds. Too much focus is being given to equity and any downswing in equity market would severely dent investor’s confidence. Again, there is a lack of investor education which results in risk-return mismatch for investors investing in mutual funds. However, it can be said, in coming years, mutual fund industry is going to take off to newer heights. The Indian equity market has seen unbelievable rise in the last couple of years. From an index level of 5,590 as at March 31, 2004 to 14,000 during December, 2006, the markets have moved in top gear, at breathtaking speed, tumbling records after records in this unrelenting journey. The prices of gold and real estate have reached to sky high levels not only in India but also throughout the world. And both these traditional investment avenues have been extremely popular with Indian investors. Regulations have also favored these two classes of investments with the Securities and Exchange Board of India introducing norms for gold-traded funds and the government relaxing norms for foreign direct investments in real estate ventures. Retail investors have largely participated through mutual funds and this is clearly evident from the number of equity funds that have been launched in the last couple of years and the record collections they have witnessed. The Reserve Bank of India has relaxed norms for overseas investments thereby opening up more investment avenues. In recent years, SEBI has taken several steps to consolidate the Indian MF industry. There are some changes in guidelines that include standardization of the Funds Portfolios and disclosure of the balance sheet of the fund. Among other changes that are scheduled is reduction in the time taken by AMCs to complete
formalities from 90 to 42 days. Also proposed is the use of unclaimed money for investor education. The present structure of funds is likely to change from the three-tier framework. This is expected to streamline the operations of the funds and will give them more flexibility. Finally, though mutual funds are primarily composed of stocks, there is a slight difference between these two which makes mutual funds more advantageous to the common investors. Diversification is the biggest advantage associated with mutual funds. Diversification is the idea of investing money across many different types of investment avenues. When one investment is not doing well, other might be yielding good profit. Diversification reduces risk significantly. In addition to this, by purchasing mutual funds, one is actually hiring a professional manager at an especially inexpensive price. Now-a-days, a higher portion of investors' savings is now invested in market-linked avenues like mutual funds as compared to earlier times. However, if we compare proportion of people investing in mutual funds in India with that in U.S then we find that in U.S more than 50% people invest in mutual funds whereas in India the proportion is less than 10%. This gives the indication that there is much more untapped potential for growth in this industry in India which must be explored in the coming time. In conclusion, it can be said that despite few problems, the recent changes in the mutual funds industry in India has really favoured its amazing growth and in conclusion it can be said that in times to come mutual funds will continue to be a significant resource mobilizer in the Indian financial market.

India’s regulators have been active in seeking ways to develop the country’s financial markets, and a culture of introducing greater risk management is starting to set in. The main challenge ahead is to strengthen the political will to further ease regulations in the capital markets and the limits prescribed to market participants. India’s economy is expected to benefit enormously from the process of gradual capital market liberalisation. Empirical evidence has shown that emerging market economies that have heralded changes in their financial markets experienced higher growth and investment. India is no exception, with per-capita GDP and domestic investment rising post-liberalisation. Economies which pursued deeper financial market reforms, and whose per-capita incomes were roughly similar to India’s prior to their liberalisation periods, not surprisingly experienced even greater rewards. Drawing from these countries’ experiences, India’s growth potential can experience a sustained pick-up if it stays on the path of reforming its capital markets.
**Review of Literature**

Since 1992, a number of articles and brief essays have been published in financial dailies, periodicals, professional and research journals, explaining the basic concept of Mutual Funds and behaviour of investors on them. They underline the importance of mutual funds in the Indian capital market environment. They touch upon varied aspects like regulation of mutual funds, investor expectations, investor safety, trend in growth and some other critical views on the
performance and functioning of mutual funds schemes. For cases in point, Ippolito (1992) says that fund/scheme selection by investors is based on past performance of the funds and money flows into winning funds more rapidly than they flow out of losing funds. Gupta (1994) made a household investor survey with the objective to provide data on the investor preferences on MFs and other financial assets. The findings of the study were more appropriate, at that time, to the policy makers of mutual funds to design the financial products for the future. Kulshreshta (1994) offers certain guidelines to the investors in selecting the mutual fund schemes. Shankar (1996) points out that the Indian investors do view Mutual Funds as commodity products and AMCs, to capture the market should follow the consumer product distribution model. Jambodekar (1996) conducted a study to assess the awareness of MFs among investors, to identify the information sources influencing the buying decision and the factors influencing the choice of a particular fund. The study reveals among other things that Income Schemes and Open Ended Schemes are more preferred than Growth Schemes and Close Ended Schemes during the then prevalent market conditions. Sikidar and Singh (1996) carried out a survey with an objective to understand the behavioral aspects of the investors of the North Eastern region towards mutual funds investment portfolio. The survey revealed that the salaried and self-employed formed the major investors in mutual fund primarily due to tax concessions. Lynch and Musto (2003) were of opinion that this decade will belong to mutual funds because the ordinary investor does not have the time, experience and patience to take independent investment decisions on his own. Goetzman and Peles (1997) established that there is evidence of investor psychology affecting fund/scheme selection and switching. Sundar (1998) conducted a survey to get an insight into the mutual fund operations of private institutions with special reference to Kothari Pioneer. The survey revealed that agents play a vital role in spreading the Mutual Fund culture; open-end schemes were much preferred then age and income are the two important determinants in the selection of the fund/scheme; brand image and return are the prime considerations while investing in any Mutual Fund. Khorana and Servaes (1999) had experimented that the decision to introduce a new type of fund is affected by a number of variables, including investor demand for the fund’s attributes. Chakarabarti and Rungta (2000) stressed the importance of brand effect in determining the competitive position of the AMCs. Their study reveals that brand image factor, though cannot be easily captured by computable performance measures, influences the investor’s perception and hence his
fund/scheme selection. Shanmugham (2000) conducted a survey of 201 individual investors to study the information sourcing by investors, their perceptions of various investment strategy dimensions and the factors motivating share investment decisions, and reports that among the various factors, psychological and sociological factors dominate the economic factors in investment decisions. In his study “Are Retail Investors Better off Today?” Black (2004) observed that in recent years, investors' attitudes towards the securities industry plummeted, in reaction to both the conflicted research and the mutual fund scandals. He concluded that the most optimistic assessment is that the SEC has plenty of unfinished business to attend to. Keli (2005) is of opinion that Past performance and Fund’s Investment Strategy continued to be the top two drivers in the selection of a new fund manager. Rajeswari and Moorthy (2005) observed that investors demand inter-temporal wealth shifting as they progress through the life cycle. Omar and Frimpong (2006) stressed the importance of life insurance and regarded it as a saving medium, financial investment, or a way of dealing with risks. Alinvi & Babri (2007) are of view that customers’ preferences change on a constant basis, and organizations adjust in order to meet these changes to remain competitive and profitable.

**Literature On Product Innovation And Emerging Issues:**

*Jayanta Kumar Seal* in his paper on “Mutual Funds Industry – An Introduction” deals with the mutual fund industry in India. It tells us as to how from one mutual fund in 1964 we have some 32 mutual funds now offering 4512 schemes and the total assets under management is Rs.556729.71 crore as on 31st October, 2007. Globally, the mutual fund industry grew by 22.47% in 2006. Indian mutual fund industry has grown by 41% in 2006-07 and by 77%
in the last two years. Product innovation is the key to success in the MF industry. The most important innovation is the systematic investment plan where retail investors (mainly salaried) can save and deposit money into mutual fund schemes from their regular salary income. Other new products in the mutual fund industry are Gold ETF, Global Funds, Real Estate Funds etc. The paper expresses the feeling that success of the mutual fund industry depends upon the product innovation, increasing the investor’s education and increasing the overall penetration of mutual funds as a proportion to GDP.

_Tamal Datta Chaudhuri_ in his paper on “**Periodic Variation in Mutual Fund Performance**” gives a brief history of mutual funds in India, and examines the returns distribution of select mutual fund schemes across various Asset Management Companies. The findings show that there is very little to choose between AMCs during the bull period as all funds do well. However, it is during the bear phase that the performance of mutual funds comes under the scanner. In the bear phase the returns pattern across all AMCs and all funds get diffused. It could be because of the redemption pressure and or inability to predict near market corrections. The findings indicate that the investors lose their cool during market downturn and try to exit the market in haste

_Monica Dighe_ in her paper on “**Plain Vanilla to Mixed Flavor in MF Schemes**” traces the growth and change in the flavor of mutual funds equity schemes and highlights the innovative names used by mutual fund equity schemes. Mutual fund route to investing in India began with debt and equity schemes, but with falling interest rates and lower yields on debt schemes, equity schemes have been seeing a lot of interest from the Indian investor. As equity schemes moved from diversified to sector specific schemes, each mutual fund offering was trying to catch the attention of the Indian investor in an already cluttered market and to make a dent in a vast pool of offerings, mutual funds took the route of using innovative names for their schemes

_Soumya Guha Deb, Ashok Banerjee and B B Chakrabarti_ in their paper on “**Market Timing and Stock Selection Ability of Mutual Funds in India An Empirical Investigation**” attempts to evaluate the performance of mutual funds and identify ways of evaluating successful fund managers for stock selection and market timing abilities using both conditional and
unconditional approaches. Stock Selection skills involve micro forecasting of the price movements of the individual stocks relative to the market and identification of the individual stocks that are under or over valued relative to the equities in general. Market timing skills implies assessing correctly the direction of market whether bull or bear and positioning the portfolios accordingly. The paper is a detailed empirical investigation using both TM and HM models. The paper shows that there is ample evidence of good performance in so far as stock selection ability is concerned. The results conclude that fund managers are more inclined towards stock selection than market timing.

_Tamal Datta Chaudhuri and Chandan Ghosh_ in their paper on **“Gold Funds”**, authored jointly, explains the role of gold as a commodity, and hence an area of investment. It explains why gold can be held in the portfolio by an investor. It examines the proposition that investment in gold acts as a hedge against inflation and is an alternative to holding common shares. In this context the growth of gold mutual funds and Exchange Traded Funds (ETFs) are examined and some such schemes launched in India are described. Although gold funds in India do not have a long history, the performance of these funds vis-à-vis other mutual funds are analyzed in this paper.

_S Manjesh Roy_ in his paper on **“Money Market Mutual Funds: A Macro Perspective”** describes how money market offers superior avenues for deployment of bulk short-term funds in terms of risk, return and liquidity. Money Market Mutual Funds make it possible for retail investors to participate in the money market. According to the paper, lack of long-term vision on the part of the mutual fund industry has resulted in low levels of retail penetration. Other structural aspects like lack of awareness, poor infrastructure for fund transfer and regulatory restrictions have also contributed to the poor impact of MMMFs at the macro level. The paper discusses the features and advantages of Money Market Mutual Funds and evaluates their impact in India on household savings, retail penetration and corporate investment.

_B Sujatha_ in her paper on **“Real Estate Mutual Funds in India”**, authored by states that the real estate boom in India has increased the demand for more structured financing and investment schemes. Entry of new investment schemes will bring about the needed liquidity in the market. The paper suggests that long-term sources of funding like pension, insurance and
provident fund must be made available to housing finance companies and developers. A real estate mutual fund (REMF) is the ideal vehicle. The article provides the current SEBI guidelines for REMFs with regard to investment criteria, regulatory safeguards and structure of REMFs. The paper highlights the pros and cons of investing in these funds. It talks about the impact of these funds on the growth of real estate industry giving an outline of the REMFs in operation.

*Steven P Laposa, Pat Alford and Timothy J Trifilo* in their paper on “Global Real Estate Funds Trends and Issues” by emphasizes that global real estate funds are a natural extension of the evolution of real estate in many countries and cities. As the world economy continues to expand over the next decade, the development, construction and operation of commercial real estate assets are likely to become more global, thus creating new, interactive and inter-dependent networks of local, regional and global sources of financing and ownership structures. Emergence, evolution and energy – these three words best describe current global real estate markets and capital flows. There is clearly an emergence of a number of international real estate funds providing opportunities for domestic investors to participate in foreign real estate markets, Growth of equity in relation to the real estate market is yet to emerge in a big way in countries such as India, China and South Korea. If the growth forecast in Asia Pacific public equity markets reaches a comparable benchmark level as Real Estate Investment Trusts (REITs) in the US, then there is a reasonable probability that the Asia Pacific public real estate equity markets will surpass the US REIT in terms of market capitalizations over the next five years, based on recent trends.

*Jayanta Kumar Seal and Joy Chakraborty*, in their paper on “Global Funds: An Exciting Investment Prospect” point out that investments in a global fund can reduce the geographical risk for investors who do not always have to rush into debt when markets fall – especially if their asset allocation profile suggests equity is appropriate. Currency movements should not be a deterrent – investing in the right markets could also provide a currency hedge – particularly where business is increasingly conducted globally.

In a paper sourced from the CFA (*Consumer’s Federation of America*), “Investors’ Mutual Fund Purchase Practices at Odds with those Recommended by Investor Educators – Survey Finds CFA Research Suggests Caution Needed on Internet Disclosures”, discusses
the differences between expert recommendations and actual investor behavior. It suggests that comprehensive review is needed to determine how key educational messages can be delivered more effectively, whether certain messages are simply unrealistic, and how educational materials can better target specific groups of fund investors. To further that goal, CFA plans to distribute the survey report to securities regulators, investor advocates and educators, industry representatives and others in order to promote a broad-based discussion of its implications for mutual fund disclosure requirements, industry information practices and investor education efforts. The paper points out some key discrepancies between expert recommendations and investor’s actual mutual fund purchase performance. Among the key factors for investors selecting a fund are funds’ expenses and its risks including the volatility of its past returns.

Ross M Miller in his paper “Measuring the True Cost of Active Management by Mutual Funds”, shows as to how the true cost for active management actually works. Mutual funds charge investors for the services they provide. However, if the returns of a fund are similar to the returns from passive investment in an index, then a mutual fund should not charge anything extra from customers for the services they provide as they have not been able to generate more than market returns. Thus, it should be investigated as to whether there has been active selection by the fund manager and whether the costs are justified. The paper develops a methodology by which the composition of a fund can be broken down into index components and active components to arrive at a decomposition of total costs. This methodology is then applied to Morningstar rated mutual funds to compute the cost of active management. It has been found that the active expense ratio is around 7%. It has also been found that the active expense ratio is higher for underperformers.

Literature on MF industry with regard to Country Experiences

Richard Heaney, Terry Hallahan, Thomas Josev and Heather Mitchell in their paper on “Time-Changing Alpha? The Case of Australian International Mutual Funds” devises tests for active management and they feel that active management generates stable excess return. The
article argues that this assumption is not appropriate for active management where the emphasis is on identifying profitable trading strategies. This paper models the time-changing nature of Australian international mutual fund alpha using individual fund returns and estimates alpha for mutual fund portfolios that are essentially survivorship-bias-free and focuses on Australian international funds because this sector is growing rapidly and these funds give Australian investors access to international financial markets. International equity-fund data are collected for those Morningstar funds that report their percentage of overseas equity investment in the range 90 to 100%.

*Tamal Datta Chaudhuri* in his paper on “Rating of Mutual Funds – The Danish Experience” states that for a small investor, to make sense out of various types of mutual funds and various AMCs, credit rating of a fund is essential. The paper examines the effectiveness of a new rating methodology of mutual funds in Denmark viz. ATP Rating, and compares it with the performance of the established rating mechanism, Morningstar Rating.

The difference between the two rating methodologies is that while the ATP Rating uses cost as input, Morningstar uses returns as input. While costs are standardized, returns can be volatile. Thus, the rating of a fund can be different based on the two methodologies. Returns behaviour changes during bull and bear runs and also within the runs. Costs, on the other hand, are more or less constant for a fund although they may differ between funds. Thus, ATP Rating can be hypothesized to be more stable than Morningstar. The authors test the above hypothesis with the help of data from the Copenhagen Stock Exchange. The authors derive that funds with higher ratings (i.e. lower costs) have generated better future long-run (ten-year) performance compared to funds with lower ratings. However, the evidence is not conclusive about short-term funds.

*Tamal Datta Chaudhuri* in his paper on “The Chinese Mutual Funds Industry – An Overview” provides an overview of the Chinese Mutual Fund Industry. The rate of growth of this sector has been significant and it has been due to China’s high rate of economic growth and consequent large flow of capital to the financial market, belief among people that mutual fund managers are professionals and can manage funds better and encouragement by the Government
in development of the mutual fund market. Given China’s growing stock market activity, many foreign institutional investors have launched new funds in 2006 and 2007. China Banking Regulatory Commission (CBRC) has permitted local insurers to set up wholly owned asset-management subsidiaries, in addition to securities companies and banks. Moreover, the Government is encouraging companies to provide pension coverage to its employees through voluntary corporate schemes. The Qualified Domestic Institutional Investor (QDII) program of the Government, which will permit Chinese nationals to invest overseas through authorized Chinese asset managers, should help in taking the process of asset management further.

*Martin Carlsson* in his paper on “Performance Differences Across Markets A Study of Mutual Funds” analyses the performance of Swedish-based internationally diversified mutual funds managed by one of the largest commercial banks in the Nordic region using Jensen’s index. The data used is on six international mutual funds floated in Sweden. The portfolio compositions of the funds are described in detail. The results show that there is no empirical evidence which indicates that managers seize superior stock selection skills when investing locally compared with investing on different markets for the selected funds. It is shown that inclusion of emerging markets creates further possibilities for diversification in a portfolio as developed markets tend to have high level of integration and move together.

*Rahul Mukim* in his paper on “How does the Indian Mutual Fund Industry Compare vis-à-vis Global Standards and what should be our Future Expectations From it?” analyses the future expectations from the mutual fund industry in terms of increased investor awareness, product diversity and improvement in penetration and distribution. The paper presents the current scenario of the Indian Mutual Fund Industry, including AUM as a percentage of GDP, penetration of mutual funds and the impediments to the growth of this industry, and makes a comparison of Indian Mutual Fund Industry with global standards in types of products, regulations, risk management techniques and governance. The comparison of the Indian MF industry with respect to global standards shows that India has a lot of catching up to do in terms of penetration, the diversity of products and the risk mitigation techniques used. However, the attitude of the regulator towards investor protection and governance of mutual funds were found to be very close to global standards. The Indian MF industry is possibly at a point of inflection
on the verge of explosive growth. The factors that point towards this are the existence of robust capital markets and the presence of an impartial regulator.

*Navdeep Aggarwal* and *Mohit Gupta* in their article on “Performance of Mutual Funds in India: An Empirical Study” traces the growth path of the global mutual fund industry pointing to the fact that the research on mutual funds has been confined only to a few developed markets, with the US always getting special attention. Although emerging markets such as India have attracted the attention of investors all over the world, they have remained devoid of much systematic research, especially in the area of mutual funds. In an effort to plug this gap, the present study deals with the performance of mutual funds operation in India. MFs offer small investors the opportunity to invest in diversified portfolios and free them to a large extent from the burden to make allocation decisions. It is important to know at what cost these alleged advantages are offered. The paper says that research on mutual funds have proceeded along three lines: (1) Researches dealing with the timing/investment abilities of fund managers and its implications for market efficiency (2) Measurement errors and common factors underlying fund performance, and (3) Fund specific factors that may impact fund performance. Analysis was carried out with the help of Capital Asset Pricing Model (CAPM) and Fama-French Model. In the world of CAPM this study’s findings suggest that mutual funds actually added value and investing in them was worthwhile for investors. However, application of Fama French Model opposes this. This model, which predicts returns on excess market returns, size factor and value factor, suggests that returns earned by mutual funds are actually due to exposure to these factors only and the fund managers do not add any value.