CHAPTER 2

AN OVERVIEW OF MUTUAL FUND INDUSTRY

2.1 CONCEPT OF MUTUAL FUND

According to AMFI, the apex regulatory body for registered mutual fund companies, it is the money pooled in by a large number of investors what makes up a Mutual Fund. This money is then managed by a professionally skilled manager, who uses his investment management skills to invest it in various financial instruments. An investor owns units, which basically represent the portion of the fund he/she holds, based on the amount invested by him/her. Therefore, an investor can also be known as a unit holder. The increase in value of the investments along with other incomes earned from it is then passed on to the investors/unit holders in proportion with the number of units owned after deducting applicable expenses, load and taxes. [19] [76]

Fig.2.1 Mutual Fund operation flow chart

Source: (http://portal.amfiindia.com/images)

The above figure demonstrates the operational flowchart of the mutual funds. As appeared in the above figure, the investors purchase units of a specific Mutual Fund that has a characterized target and methodology. The cash gathered in this way, is then put by the manager of the funds in diverse sorts of securities. These could be diversified in shares, debentures or money market instruments, contingent on the fund’s expressed targets. The returns earned through these investments and the capital appreciation realized by the scheme, are shared by its investors in
proportion to the quantity of units possessed by them. The value of each unit is depicted as NAV (Net asset value). NAV is the market value of each unit of a fund or the cost at which investors can purchase or offer units every day. The NAV is ascertained day by day which represents the market value of the shares, debentures and securities held by a fund on a particular day. Thus, a Mutual Fund is the most suitable investment for those investors who don’t have much time to study and research investments themselves, as it provides a way to have a diversified portfolio of securities which is managed by professionals at quite a minimum cost. [107]

2.2 ADVANTAGES OF INVESTING IN A MUTUAL FUND

The advantages of investing in a Mutual Fund are:[19] [107]

(i) Professional Management:
The investors get the administrations of experienced and gifted experts who are having the support of an educated venture exploration group which investigates the execution of organizations and chooses suitable securities as per the targets of the plan.

(ii) Diversification:
Mutual funds put fund resources into various organizations over a wide cross area of commercial ventures and divisions. This expansion decreases the risk as it is extremely uncommon that all securities decline at the same time and to the same extent. This widening of investments can be accomplished through a mutual fund with a little measure of cash than the sum invested if we do all alone.

(iii) Convenient Administration:
Mutual funds help in saving the time of investors and also make the process of investment easy and convenient for them by reducing the official and administrative requirements. It helps to avoid many other different issues for example bad deliveries, deferred payments and unnecessary follow up with agents and organizations.

(iv) Return Potential:
Mutual funds can possibly give a higher return than other investment avenues as they put in resources in a diversified group of selected securities, over a medium to long period of time.
(v) Low Cost:
Mutual Funds are generally less costly form of investment compared to specifically putting investment in the stock markets because the advantages of economies of scale in brokerage, custodial and many other expenses result into lower overall expenses for investors.

(vi) Liquidity:
Liquidity is an additional point of interest possessed by the mutual fund schemes. The units can be sold by the investors directly to the mutual fund companies at its NAV, in case of open-ended schemes, in a brief span of time. Moreover, in case of close-ended schemes, the units can be sold on a stock exchange at the ongoing market price or repurchased through mutual fund companies at NAV related costs. This is offered by few close-ended and interval schemes to the investors at intermittent intervals.

(vii) Transparency:
It is the right of the investor to get continuous information on the estimation of his investment in addition to disclosure on the specific investments made by the fund manager of the scheme in which he has invested. Not only this, the proportion of investment in each class of assets and the financial manager’s investment procedure and point of view is also disclosed by the mutual fund company.

(viii) Flexibility:
The features such as Systematic Investment Plans (SIP), Systematic Withdrawal Plans (SWP), give provisions to the investors to methodically contribute or pull money as indicated by their needs and comfort.

(ix) Choice of Schemes:
Mutual Funds offer a number of schemes to coordinate with the changing needs of the investors. Thus, the investor can select from the options available, according to his objective of investment like growth of funds, tax-relief, liquidity and safety, regular income etc.
(x) Well Regulated:

Each and every mutual fund is registered with SEBI and does the business according to the stringent rules and norms formulated for the benefit of the investors. SEBI keeps a check on the operations of mutual funds regularly.

2.3 TYPES OF MUTUAL FUND SCHEMES

A number of Mutual Fund schemes are present that cater to the needs of the investors depending on their age, financial background, risk tolerance ability and expected returns. The mutual funds can be classified into various types depending on their structure, investment goal and some other criteria.[107]

2.3.1 CLASSIFICATION BY STRUCTURE

(i) Open-Ended Schemes

These do not have a fixed maturity. The key element is liquidity. The units can be purchased or sold easily at Net Asset Value (NAV) related prices any time by the investor.

(ii) Close-Ended Schemes

Schemes that have a designated period of maturity (which can range from 2 to 15 years) are called close ended schemes. The investor can put their money in these schemes at the time of the initial issue and after that its units can be purchased or sold on the stock exchanges at which they are listed. The market price at the stock exchange could differ from the scheme’s NAV due to the demand and supply situation, desires of unit holders’ and other conditions related to market. One of the attributes of the close-ended schemes is that they are by and large exchanged at a value lower to NAV; however it is seen that as they are close to maturity period, the rebate goes down.

There is an extra choice of selling back units to the mutual fund company with the help of occasional repurchase at NAV related costs in some of the close-ended schemes. SEBI Regulations guarantee that no less than one of the two exit routes are available to the investor under the close ended schemes.
(iii) Interval Schemes
These consolidate the attributes of both the open-ended and close-ended schemes. They have the option to be sold or purchased on the stock exchange or may be available for sale or redemption during pre-designated intervals prices related to NAV.

2.3.2 CLASSIFICATION BY INVESTMENT OBJECTIVE
(i) Growth Schemes
The goal of this plan is to provide increase of capital over a period of medium to long term. These schemes mostly invest a huge amount of their funds in equity shares and hence, they are not disturbed by short term losses in their fund value as they have the hope for future gains. These schemes are not for investors who are looking for returns on a regular basis or want to recover their cash back in the short term. Hence, they are perfect for investors who are in most active period of earning in their life in which they want to seek good returns on a long term basis.

(ii) Income Schemes
The prime objective of this type of scheme is to give consistent and regular income to investors. These schemes by and large put resources into fixed income securities such as bonds and corporate debentures. However, these schemes have a restricted scope for capital appreciation. They are appropriate for individuals who are retired and those with a need for stability of their capital as well as regular income. These are also fit for investors who need consistent income at regular intervals to make their income sufficient.

(iii) Balanced Schemes
These schemes have the components of both growth and income schemes as they occasionally divide a portion of the income and capital gains earned by them. They put resources in both shares and fixed income securities in the same ratio as shown in their offer documents. In a bullish stock market, the NAV of these schemes may not usually maintain their returns and similarly, it may not go down in the same pace when the market is bearish. Hence, they are appropriate for those investors who are investing to get a combination of income and moderate growth in their investments.
(iv) Money Market / Liquid Schemes

The principle aim of these schemes is to ensure high liquidity, preservation of capital and moderate income to its investors. These schemes by and large put resources in secure, short term instruments for example treasury bills, certificates of deposit, commercial paper and interbank call money.

However, returns on these schemes may go up and down as it depends on the interest rates prevailing in the market. These schemes are appropriate for institutional as well as individual investors as an approach to invest their investible funds for brief time periods, during which they are waiting for a more suitable investment avenue.

(v) Tax Saving Schemes (Equity Linked Saving Scheme - ELSS)

These schemes provide tax gains to the investors under tax laws which are revised from time to time. These schemes also give refunds in taxes to its investors under the Income Tax Act, Section 88 in India. They enhance investments for long term in equity shares through mutual funds. These schemes are appropriate for the investors who are interested in tax relief investment avenues.

(vi) Gilt Fund Schemes

Gilt funds are the mutual fund schemes inclined exclusively to investments in government securities. Government securities incorporate central government as well as state government securities and treasury bills. These funds promise the investors for safety of their investments made in government securities and provide better returns than that which they gain from direct investments in these securities through investing in a group of government securities which yield different rate of returns. The first gilt fund in India was set up in December 1998. Gilt funds can be both for a short term and a long term period. Investors can select between the available options depending on their own investment objective. These are ideal for those investors who are risk-averse in nature and at the same time, want reasonable returns on their money.
2.3.3 OTHER SCHEMES

(i) Index Fund Schemes:

This category includes schemes that attempt to repeat the execution of a particular index such as the BSE Sensex, the NSE 50 (NIFTY). Index fund schemes are perfect for investors who are contended with a return approximately equal to that of an index.

(ii) Sectoral Fund Schemes:

These kinds of schemes invest in particular divisions such as Technology, Infrastructure, Banking, Pharma etc. They are ideal for investors who have made up their mind to invest in a specific division or segment.

(iii) Fixed Maturity Plans (FMPs):

Fixed Maturity Plans (FMPs) are passively managed plans marketed by mutual funds and are close ended with a definite time period, that may range between one month to three/five years. These plans are mostly investing in debt- instruments like bonds and certificate of deposits, while few may have a nominal amount invested in equity shares. The aim of such a scheme is to generate stable returns over a fixed-maturity period and safeguard the investor against market deviations. FMPs are typically passively managed fixed income schemes with the fund manager investing into avenues with maturities corresponding with the maturity of the plan. They also provide protection against interest rate movements along with tax reliefs.

(iv) Exchange Traded Funds

Exchange Traded Funds are basically index funds that are enlisted and traded on exchanges like equity stocks. These are open ended funds that track the changes in an index like an index fund, but trades just like the shares of an individual company on an exchange. Dissimilar to the equity of an organization, every unit of an ETF represents a portfolio of shares. Internationally, ETFs have come up with a completely innovative choice of investment opportunities to retail and corporate investors. ETFs empower investors to effortlessly invest in the capital market as well as in particular areas, on a constant premise and at a lower expense than numerous different types of investment options.
An ETF is a group of shares that gives an image of the constitution of an index, like S&P stocks CNX Nifty, BSE Sensex, CNX Bank Index, CNX PSU Bank Index etc. The ETF’s trading worth is based on the net asset value of the group of shares held by it. They additionally experience changes in their costs for the entire duration of the day as they are purchased and sold on the stock exchange. Accordingly, it can be contrasted with an equity share that can be purchased or sold on ongoing premise amid the business hours. The first ETF in India, Benchmark Nifty Bees, opened for buying on December 12, 2001 and listed on the NSE on January 8, 2002.

(v) Capital Protection Oriented Schemes
Capital Protection Oriented Schemes are schemes having the main aim to ensure the protection of the capital by making investments in highly secured fixed income investment options and an optional goal to produce capital increase by putting resources into stock/stock oriented options. In this way, they give their investors the advantages of not only debt but also equity. The first Capital Protection Oriented Fund in India, Franklin Templeton Capital Protection Oriented Fund which was opened for subscription on October 31, 2006.

(vi) Gold Exchange Traded Funds
Gold Exchange Traded Funds provide investors a new, cost-efficient and secure approach to have a track on estimation of gold and access the gold market. Gold ETFs are designed to offer investors a way to take part in the gold bullion market by exchanging units on the Stock Exchange, without taking physical possession of gold. These Gold ETFs are extensively liquid in nature as they can be purchased and sold at any point of time during the business hours. In addition to it, they are marketable as well; investors can do the trading of the units of these GETF as a normal share. The first Gold ETF in India, Benchmark GETF, was opened for subscription on February 15, 2007 and listed on the NSE on April 17, 2007.

(vii) Quantitative Funds
A quantitative fund is an investment fund that chooses investment options in the light of quantitative investigation. The managers of such funds build computer based models which are supported by investing formulas taking into account historical data of price-to-earnings, price-to-book, financials of the organization and other industry parameters observed in the past 10-15
years, to find out if or not the investment option is attractive. In a pure quantitative fund, the final decision to purchase or sell is made with the help of the model. However, there is a mid way where the fund manager uses his own judgment in addition to a quantitative model. The first Quant based Mutual Fund Scheme in India, Lotus Agile Fund opened for subscription on October 25, 2007.

(viii) Funds Investing Abroad
After the Indian economy was liberalized, permission was granted to the mutual funds to invest in foreign securities/ American Depository Receipts (ADRs) / Global Depository Receipts (GDRs). Few of these schemes have totally devoted their funds for investment abroad while others invest a part of it in foreign securities and the remaining part in domestic securities. It is seen that because these funds are very unpredictable as compared to the investments made in domestic funds, they are suitable for investors who are ready to take risk as well as want exposure to international market. These funds invest their money in a diversified portfolio which ensures higher return as compared to the domestic market.

(ix) Fund of Funds (FOFs)
Fund of Funds are plans that put their resources into other mutual fund schemes. Its portfolio is not composed of shares but rather it is made up of units of other mutual funds which are selected to serve a specific aim. The investors of these funds get a wide diversification of resources and asset allocation by investing in only one scheme. The first FOF was launched by Franklin Templeton Mutual Fund on October 17, 2003. Fund of Funds can be Sector specific e.g. Real Estate FOFs, Theme specific e.g. Equity FOFs, Objective specific e.g. Life Stages FOFs or Style specific e.g. Aggressive/ Cautious FOFs etc.

2.4 ORGANISATION OF MUTUAL FUNDS
The SEBI MF Regulations, 1996 controls the Mutual Funds in India. Under its directives, mutual fund works as a Public Trust under the Indian Trusts Act, 1882. In accordance with the provisions of the Indian Trust Act, 1882 it is mandatory that each mutual fund shall be constituted in the form of a trust. Initially, SEBI Guidelines, 1992, set down in clear terms the foundation norms for mutual funds. It designated a three level frame work for managing the
functions of mutual funds and the three levels were the sponsoring company, the trustees and the asset management company (AMC). These three components were again included in SEBI Regulations, 1996 for the administration of mutual funds. In addition to these three two more important components of mutual funds are custodians and transfer agents. [107]

![Fig. 2.2 Organization of Mutual Fund (Source: potal.amfiindia.com)](image)

The figure given above shows the relationship of the different constituents of mutual funds in a pictorial form.

(i) THE FUND SPONSOR

According to SEBI regulations sponsor is an individual who either himself or in association with any other organization sets up a mutual fund. Sponsor establishes a mutual fund to gain returns by doing fund administration through its allied company which acts as a fund manager of the money invested in the mutual fund. Largely, a sponsor is similar to a promoter of a company. Sponsors’ perform the activities like setting up a Public Trust under Indian Trust Act, 1882 (the mutual fund), appointment of trustees to manage the trust with the approval of SEBI, establishing an Asset Management Company under Companies Act, 1956 (the Investment Manager) and also registering the trust with SEBI. According to the eligibility criteria laid down by SEBI, not less than 40% of the net worth must be contributed by the sponsor of the Asset Management Company as well as it should have a sound reputation of not less than five years in the area of financial services. Sponsors can be Indian corporate, banks or financial institutions, foreign companies or a joint venture between two organizations.
(ii) TRUSTEES
The fund sponsor executes the trust deed for the trustees with the help of which the main body of the mutual fund i.e. the trust is created under the provisions of Indian Trust Act, 1882. Trustees do the administration of the trust and are responsible towards the investors in the mutual funds. They are the main protector of the unit-holders and thus, guard their funds and assets. Trustees can be constituted in either of the following two ways - Board of Trustees or a Trustee Company. The provisions of Indian Trust Act, 1882, govern board of trustees or the Trustee Company. A trustee company is also subject to provisions of Companies Act, 1956. There must be no less than four members in the board of trustee out of which at least two third must be having independent charge. It is the duty of the trustee that the AMC has proper systems and procedures in place. Trustees guarantee that the other fund constituents are appointed and due diligence is practiced by the AMC in their appointments.

(iii) ASSET MANAGEMENT COMPANY (AMC)
The AMC is the functional unit of the mutual fund. In other words, the Asset Management Company (AMC) is the fund administrator of the Trust. The sponsor or the trustees as so authorized by the trust deed, appoints the AMC as the “Investment Manager” of the trust (Mutual Fund) via an agreement called as ‘Investment Management Agreement’. An asset management company (AMC) is registered as a company under the Companies Act, 1956. The AMC performs under the supervision of Trustees and is involved in primarily three activities of portfolio management, investment analysis and financial administration. Hence, the directors of AMC should be expert in the field of finance. The mutual fund or the trust pays a small fee to the AMC for management of its fund. According to SEBI’s regulation, an AMC should have a net worth of at least Rs. 10 crores at any point of time and a company can act as an AMC of one mutual fund only. Also, at least 50 percent of the board members of an AMC have to be independent. The chairman of the AMC should also be an independent person.
In addition to the above mentioned three constituents, another two important constituents of mutual funds are custodians and transfer agents. They are discussed below.
(iv) CUSTODIAN
The custodians are responsible to keep the securities safe. Though the securities are purchased and held in the name of trustees, they are kept with the custodians. The securities, which are in material form, are kept under the guardianship of the custodian whereas the securities, which are in “De-Materialized” form, are kept with a Depository participant, who acts on the instructions given by the custodian. This demonstrates that the custodian acts as a very important back office operator. They make it sure that the delivery of the securities, which are purchased, has been received properly as well as they are accurately transferred in the name of the mutual fund. They similarly guarantee that funds are paid out by the mutual fund, when securities are bought. It is the responsibility of the custodians to keep the investment account of the mutual fund. They also collect and account for the dividends and interests receivable on mutual fund investments. It is thus, their duty to ensure that the timely resolution of the discrepancies and failures regarding delivery and acceptance of securities is done.

(v) TRANSFER AGENT
The transfer agents bear the responsibility to create and maintain investor records in numbered account called folios and service them regularly. As we know that a mutual fund manages money of many unit-holders spread across cities and towns of the country. In such a situation, providing service to the investor becomes important as well as challenging. This would essentially include processing investors’ application, recording investors’ details, sending them statements of their accounts and other reports on a regular basis. It also includes processing dividend payouts, making changes in investor details and keeping investor records updated by adding details of new investors and by removing details of the investors, who withdrew their funds from the mutual funds. It is very impractical and costly for any mutual fund to have a very large workforce spread all over India for this purpose. In place of that, they use entities called as Registrars and transfer agents, which usually provide these services to many mutual funds. This enables to impart quality services across all locations and keeps the costs lower for the unit-holders.
2.5 REGULATION

2.5.1 SEBI

Securities and Exchange Board of India (SEBI) is the primary regulator of mutual funds in India. SEBI is also the apex regulator of capital markets. The regulation of capital market intermediaries and the issuance and trading of capital market instruments is under the purview of SEBI. As the regulator of Indian capital market, SEBI came out with its first mutual fund regulations in 1993 that were revised subsequently in 1996. These regulations result in more transparency in their operations along with providing a common framework for the same. Apart from SEBI, mutual funds follow the regulations of other regulators in a limited manner.

2.5.2 RBI

RBI acts as regulator of sponsors of bank-sponsored mutual funds, especially in the case of funds offering guaranteed/assured returns. No mutual fund is allowed to bring out a guaranteed returns scheme without taking approval from RBI. Moreover, banks can also act as custodians and distributors of mutual funds and in that case their functioning comes under the purview of RBI. The regulator of the government securities and money markets in India is RBI. Since mutual funds may invest in these securities, they are required to follow the RBI Regulations as may be applicable on these instruments.

2.5.3 ASSOCIATION OF MUTUAL FUNDS IN INDIA (AMFI)

AMFI is the apex body of all the registered asset management companies (AMC). It was incorporated on August 22, 1995 as a non-profit organization. All the AMCs that have launched mutual fund schemes are member of this organization. The main aim of AMFI is to protect investor’s interest by defining and maintaining high ethical and professional standards in the mutual fund industry. It suggests the best business norms and practices for its members. AMFI represents the various matters of the mutual fund industry to regulators and policy makers as SEBI, RBI and Government of India. It also conducts various awareness programs to create the understanding and knowledge of mutual funds amongst investors.
2.5.4 STOCK EXCHANGE

It is mandatory for closed-ended funds to list their units on a stock exchange. In such a case, the listings are subject to the listing regulation of stock exchanges. Mutual funds have to sign the listing agreement with the stock exchange and abide by its provisions, which primarily deal with periodic notifications and disclosure of information that may impact the trading of listed units.

2.5.5 INDIAN TRUSTS ACT, 1882

As we know that mutual funds are formed and registered as a public trusts under the Indian trusts Act, 1882, they have to follow the provisions of this act.

2.5.6 COMPANIES ACT, 1956

Asset Management Company and Trustee Company are subjected to the provisions of the Companies Act, 1956.

2.5.7 MINISTRY OF FINANCE (MOF)

The ministry of finance is the supervisor of both the RBI and the SEBI. The MoF is also the appellate authority under SEBI regulations. Aggrieved parties can make appeals to the MoF on the SEBI rulings relating to mutual funds.

2.6 FREQUENTLY USED KEY TERMS

A few frequently used terms are explained here below:

2.6.1 NET ASSET VALUE (NAV)

Net Asset Value is the market value of the assets of the scheme minus its liabilities. The per unit NAV is the net asset value of the scheme divided by the number of units outstanding on the valuation date.

2.6.2 SALE PRICE

It is the price you pay when you invest in a scheme. Also called Offer Price. It may include a sales load.

2.6.3 REPURCHASE PRICE

It is the price at which units, under open-ended schemes, are repurchased by the Mutual Fund. Such prices are related to the NAV of the scheme.
2.6.4 REDEMPTION PRICE
It is the price at which close-ended schemes redeem their units on maturity. Such prices are also NAV related.

2.6.5 SALES LOAD
It is a charge collected by a scheme when it sells the units. These schemes are also called, ‘Front-end’ load schemes. However, the schemes that do not charge a load are called ‘No Load’ schemes.

2.6.6 REPURCHASE OR ‘BACK-END’ LOAD
It is a charge levied and collected by a mutual fund scheme when it purchases back the units from its unit holders.

2.6.7 EXPENSE RATIO
It is a measure which determines the costs an investment company incurs to operate a mutual fund. An expense ratio is determined through an annual calculation, where a fund's operating expenses are divided by the average rupee value of its assets under management. Operating expenses are taken out of a fund's assets and lower the return to a fund's investors.

2.6.8 ASSETS UNDER MANAGEMENT
Assets under Management are the sum total value of all the investments which are being managed by the fund currently.

2.7 GLOBAL HISTORY AND SCENARIO OF THE INDUSTRY
The origin of mutual funds on the global front is uncertain but some historians cite the launch of close-ended investment companies, in Netherlands in 1822 by King William I, as the first mutual funds. However, some other historians point out that Andnaan Van Ketwich, a Dutch merchant created the first investment trust in 1774 and this gave the idea to the king. Ketwich was the person who conceived the idea of diversification of investments and according to him this would appeal the small investors who actually want to invest small capital and gain maximum returns. The name that Ketwich gave to his fund was Eendragt Madkt Magt which translates to “Unity Creates Strength”. The next wave of avenues close to mutual funds was the investment trusts launched in Switzerland in 1849. This was followed by same type created in Scotland in the 1880s.[72]
This idea started penetrating in the investment scenario of Great Britain and France in the 1890s and soon it made its way in United States. The Boston Personal Property Trust was the first closed ended fund which was established in United States in 1893. The Alexander Fund in Philadelphia in 1907 was the most important step in the evolution of modern mutual fund in the global market. This fund was issued semiannually in the market and had the feature of withdrawals on demand by the investors.

2.7.1 ARRIVAL OF THE MODERN FUND

The inception of the Massachusetts Investors’ Trust in Boston, Massachusetts, lead to the arrival of the modern mutual fund in 1924. This fund went public and it resulted in the formation of MFS investment management, a mutual fund firm. The mutual fund saw an impetus with the launch of Wellington Fund in 1928, the first fund in the world to include stocks and bonds. In 1929, 19 open ended mutual funds started competing with nearly 700 closed ended funds and with the stock market crash the open-ended funds survived while the closed-ended funds were thrashed out.


The mutual fund industry continued to expand regularly. The numbers of open ended funds were 100 at the beginning of 1950s adding some 50 new funds over the course of the decade. A large number of new funds were launched during the period of 1959-1969 until the bear market of 1969 which settled down the demand of mutual funds. Money started flowing out of the mutual funds but the industry soon restored the growth in the next decade. In the 1980s and 90’s the bull market mania was prevalent and this resulted in the gain for the fund managers who were up till now unknown in the industry. Recently the global market has faced a number of scandals and the burst of technology bubble which involved big names of the industry. These incidents resulted in the downward movement in the growth of the mutual fund industry and also reflected a gloomy picture of the same in the eyes of the investors.

However, the industry is still on its growth path and has overcome all the crises. As at the end of March 2008, in the US alone there were 8,064 mutual funds with total assets of about US$ 11.734 trillion (Rs.470 lakh crores). It is seen that only in the U.S. there are more than 10,000
mutual funds, with fund holdings measured in trillions of dollars. This shows that inspite of a number of competing products launched in the market, the global mutual fund industry continues to proceed on its growth path. It is also seen that the growth of mutual fund industry in the US has played an extremely important role in its economy. This trend has also spread to a significant number of countries around the world.

2.8 PHASES OF MUTUAL FUND INDUSTRY IN INDIA

Here we are going to take a look on how fund investing has changed to a large extent in the last 50 years in India. The period of investing in mutual funds between 1980s and early 1990s can be marked as gloomy period for the industry. The funds were bought and sold as a replica of debt instruments with no information about the underlying risks or characteristics of the fund. The first phase of Indian mutual fund industry started with the inception of the first Indian fund house i.e. Unit Trust of India (UTI) in 1964. It became very popular amongst small and medium class investors. UTI provided quasi-debt schemes to these investors till 1990s which gave them assured returns and confidence of government security. The Unit scheme 64 of UTI was very popular amongst investors for the combined features of dividend and ever increasing repurchase prices exhibited by it. Then there was UTI-monthly income plan also with guaranteed returns of 13-15 percent having features of long term endowment, which was very appealing to the investors who wanted to save their money for some long term goals like child’s education or marriage. The success of UTI as a secured income scheme with assured returns were mainly due to some of the advantages attached with the scheme like lack of daily NAV disclosures, easy inter-scheme transfer of funds and monopoly of the fund house.

The second phase of the mutual fund industry began with the entry of first public sector mutual fund in the scene between 1985 and 1993. SBI replicated the UTI model to introduce the first bank sponsored fund in 1987 as Magnum Rising Income Scheme series. Many other public sector banks – Bank of India, Canara Bank and Indian Bank joined SBI to introduce many equity funds between 1985 and 1993. However, these funds were not able to provide any extra edge to the investors except their promise of returns. The funds were neither disclosing their investment strategies nor their NAVs. The investors used to buy units on the previously declared NAVs. The portfolios of the schemes were only declared in the annual reports of UTI. The success of UTI
and other public sector fund houses during this phase can be confirmed by the huge amount of assets of about Rs.62,000 crore gathered by them by the end of 1993. This could be achieved by attracting the attention of retail investors towards their schemes.

The third phase of mutual fund industry in India started with the entry of private sector houses that gave a jolt in the steady growth of the public sector players. The first private sector house in India- Kothari Pioneer Mutual Fund, launched its maiden fund – the 3 years closed ended Kothari Pioneer Blue Chip Fund in 1993 after getting registered. Kothari Pioneer created its investors base through developing innovations in their working i.e. sale and purchase of units on actual NAVs, less time in processing and simple statements of accounts to the investors.

The IPO boom was also seen in this phase between 1993-1994. The public sector as well as private sector fund houses were gaining in short term period putting their stakes in IPOs. Thus, this period also witnessed the entry of a number of private sector players in the industry like Apple finance, Birla group and 20th century finance. However, the IPO bubble of 1994 busted with a crash in the stock market and resulted in the distraction of the retail investors from this industry. This created a cumbersome path for new entrants in the mutual fund market. They had to fight their way out in the public sector dominated market. They started an era of open-ended funds in which the transparency and disclosures were increased to the retail investors as well as the funds were professionally managed by experienced fund managers. In the mean time, SEBI came out with its mutual fund regulations by 1996. These regulations covered almost every aspect of mutual fund operations – from the structure of asset management company (AMC) to the processes which involved disclosures, costs, accounting and valuation norms. Thus, the industry started functioning under the SEBI (Mutual fund) Regulations 1996.[76]

This also gave an impetus to the number of mutual fund houses operating in the industry. There were 33 mutual funds with total assets of Rs. 121,805 cr. by the end of January 2003. The unit trust of India was leading amongst them with total assets under management of Rs. 44,541 cr.

The fourth phase started with repeal of Unit Trust of India Act 1963 in February 2003 by which UTI was divided into two separate entities, one was the specified undertaking of the UTI with assets under management of Rs. 29,835 crores and the other was UTI Mutual Fund sponsored by SBI, PNB, BOB and LIC, which functions under the Mutual Fund Regulations. This phase also witnessed mergers among various private sector funds, and hence the mutual fund industry
entered the current phase of consolidation and growth.

![Growth in AUM in the four phases of Indian mutual fund industry](image)

**Fig. 2.3** Growth in AUM in the four phases of Indian mutual fund industry

Source: [www.amfiindia.com](http://www.amfiindia.com)

As the fund industry witnessed a large number of shakeouts its loopholes were plugged by the regulations made by SEBI and hence, the last ten years have been very uneventful for the industry. However, still the retail penetration is not enough in the industry which needs to be taken care of.

### 2.9 RECENT TRENDS OF THE MUTUAL FUND INDUSTRY IN INDIA

#### 2.9.1 GROWTH IN AUM IN LAST ONE YEAR

The graph given below shows the growth of assets under management of Indian mutual fund industry during the last one year. The graph represents 26% growth in AUM from July 2014.
2.9.2 AUM / GDP RATIO

The AUM/GDP ratio is one of the best indicators of how much of the yearly income in a given country is being invested into mutual funds.

The graph given below shows that the mutual fund penetration in India is low as compared to global and peer benchmarks. The AUM to GDP ratio in India stands at 7 to 8% as compared to a global average of 37%. Even the South America, Africa, Asia and the Middle East (SAAME) economy of Brazil, considered a peer emerging economy, is significantly ahead, with an AUM to GDP ratio of 45% (Source – AMFI, ICI Fact Book 2013). The AUM/GDP ratio stands at approx. 6.99%, for India as a whole. When this ratio is calculated for the top ten districts, the ratio is 29.52% -slightly lower than the world average. However, the rest of India represents a dismal picture with the AUM/GDP ratio standing at 1.82%. This skewed organization of AUM in India is its single biggest challenge and its biggest opportunity at the same time.[9]
The analysis of the above graph shows that the AUM/GDP ratio is skewed to the tier I cities of India which clearly indicates that there is an opportunity to expand the horizon of the mutual fund industry in tier II and tier III cities. This can be achieved by increasing the distribution network in these areas. Thus, the critical issue for fund houses is the availability of quality distribution infrastructure to distribute their products in smaller cities. It indicates that fund houses should concentrate on areas like increasing their branches, relationship managers and sales service staff in these locations so that the sales volume, coming from these geographies, can be enhanced.[29] [50]

2.9.3 COMPOSITION OF INVESTORS’ HOLDING
The pie-charts given below show the composition i.e. percentage of different schemes held by individuals and institutions in the mutual fund industry in July 2015.
The above charts show that individuals which include HNIs or individuals investing Rs.5 lakhs or above invest mainly in equity oriented schemes. These schemes include both equity and balanced funds. Around 59% of individual investors’ assets are invested in equity oriented schemes.

Institutional investors include domestic and foreign institutions and banks. About 90% of their investments are in liquid/money market schemes and debt oriented schemes. This indicates a clear demarcation in the mutual fund market of India. The individual investments are inclined towards equity oriented schemes while institutional investments are inclined towards liquid and debt-oriented schemes.

These data can be represented in a different way showing the investor categories in the different types of schemes in the Indian mutual fund industry.
2.9.4 INVESTOR CATEGORIES ACROSS SCHEME TYPES

The figures given below shows the domination of institutional investors in debt-oriented and liquid schemes.

![Figure 2.7: Investor Categories Across Scheme Types](image)

**Fig 2.7 Investor Categories Across Scheme Types**

**Source:** [www.amfiindia.com](http://www.amfiindia.com)

The liquid schemes are having 93% investments by institutional investors only. At the same time, 62% investments in debt-oriented schemes and 64% investments in ETFs and FoFs are also by institutional investors.

Individual investors are dominating the equity oriented schemes to a very large extent as investments in these schemes are more than 80% by these investors.

This reiterates that individual investors are inclined towards equity oriented schemes as they want to taste the fluctuations of stock market but with a safety quotient attached to it.

This also confirms that for the individual investors, the Indian asset management industry is virtually synonymous with equity mutual funds and thus, there is an opportunity for fund managers to widen the offering and to bring on board alternative products relevant to the Indian market.

As a result, looking at the present scenario of Indian mutual fund industry, the two-pronged approach of increasing awareness of investors as well as investment advisors and access to innovative financial products and services will go a long way in increasing the penetration of mutual funds in the country.