# MUTUAL FUNDS IN INDIA — AN OVERVIEW

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Introduction</td>
</tr>
<tr>
<td>3.2</td>
<td>Mutual Funds - The Concept</td>
</tr>
<tr>
<td>3.3</td>
<td>Structure of Mutual Funds in India</td>
</tr>
<tr>
<td>3.4</td>
<td>Benefits of Investments in Mutual Funds</td>
</tr>
<tr>
<td>3.5</td>
<td>Classification of Mutual Funds</td>
</tr>
<tr>
<td>3.6</td>
<td>History and Growth of Mutual Fund Industry</td>
</tr>
<tr>
<td>3.7</td>
<td>Recent Trends in Mutual Fund Marketing</td>
</tr>
</tbody>
</table>
3.1. Introduction

In India, as a result of the governmental policy of liberalization in industrial and financial sector, there are lots of investment alternatives available to common investors. These new instruments are expected to impart greater competitiveness, flexibility and efficiency to the financial sector.

The major investment avenues available in India are classified into marketable and non-marketable investment avenues. The non-marketable financial assets (bank deposits, post office schemes, company deposits, life insurance and public provident funds) are such financial assets which give moderately high return but cannot be traded in the market. The marketable financial assets are bonds, debentures, money market instruments, financial derivatives like swaps, options, futures, stocks (Equity and preference share) and mutual funds. Today, the non financial investments like real estate and precious objects like gold, silver, precious stones and art objects are also considered as investment avenues.

An investor with investable surplus can invest in the investment avenues available in the financial market. He however needs to invest carefully and work out various investments options. He then decides on how to make best of his investment in terms of monetary benefits.

The stock market provides higher returns than any of the investment options available in the financial market. A prudent investor can earn a lot from the stock market operations. But there is a chance of high risk and uncertainty. As we know, higher the return, higher will be the risk. Those investors with lack of knowledge and expertise may lose their money while investing in financial assets, especially in securities. This is where mutual funds come into picture.
Chapter 3

As household sector’s share is much larger in the country’s savings, it is all the more important to show a right path for their savings. Mutual fund is a retail financial instrument, service or product designed to target small investors, salaried people, household sectors and others who are intimidated by the mysteries of stock market but, nevertheless, like to reap the benefit of stock market investing.

Mutual Funds are the ideal investment vehicles for today’s complex and modern financial scenario. A typical individual is not likely to have the knowledge, skill, inclination and time to keep track of and understand the cause and implications of the price changes and trends. Mutual Funds are the financial intermediaries who act for individuals with their expertise in managing money. A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money collected is invested by fund managers in different type of securities. These could range from shares to debentures to money market instruments, depending upon the scheme’s stated objectives. The income earned through these investments and capital appreciations realised by these schemes are shared by its unit holders in proportion to the number of units owned by them. Thus Mutual Fund is the most suitable investment for a common man as it offers an opportunity to invest in a diversified professionally managed basket of securities at a relatively low cost.

3.2. Mutual Funds- The Concept

A mutual fund is a company, corporation, trust, partnership that combines the asset of its unit holders into one common investment account for the purpose of providing diversification and professional management.

The Encyclopedia Britannica defines a mutual fund as “Mutual Fund also called Unit Trust or Open-Ended Trust- a company that invest the fund of its subscribers in diversified securities and in turn issues unit
representing shares in those holding. They make continuous offering of new shares at net asset value and redeem the shares on demand at NAV determined by market value of the securities they hold. The SEBI (Mutual Fund) Regulations, 1993 defines a Mutual Fund as, “a fund established in the form of a trust by a sponsor, to raise money by the trustees through the sale of units to public under one or more schemes, for investing in accordance with these regulations.

From the definitions of mutual fund stated above and similar definitions, it is revealed that a mutual fund is an investment company or a trust that pools the resources of a large number of its’ shareholders and invest on behalf of them in diversified portfolios to attain the objectives of the investors which in return achieve income or growth or both. Thus mutual funds become a major investment vehicle for mobilization of savings particularly from small and household sectors for the investment in security market. At present the importance of mutual funds in India has been increasing in the capital market by expanding the investors’ base.

On a close examination of the meaning and definitions of mutual funds, the following features can be identified:

1) It is established as a fund in the form of trust having professional management

2) It is established by a sponsor

3) It is created to raise funds through sale of units of various schemes

4) It has common investing group and having, diversified investment opportunities

5) It has pooling of collective sharing of profit earned.

6) It has having efficient portfolio management and portfolio contraction as per the objectives of individual MF scheme.
The mutual fund operation flow chart is drawn below:

![Concept of Mutual Fund](image)

Many investors with common financial objectives pool their money

Investors on a proportionate basis, get mutual fund units for the sum contributed to the pool

The money collected from investors is invested into shares, debentures and other securities by the fund manager

The fund manager realizes gains or losses, and collects dividend or interest income

Any capital gains or losses from such investments are passed on to the investors in proportion of the number of units held by them

Source: Retrieved from www.appuonline.com

**Figure 3.1. The Mutual Fund Operation Flow Chart**

### 3.3. Structure of Mutual Funds in India

SEBI contemplated a four-tier system for managing the affairs of mutual funds. The four constituents were the sponsoring company, trustees, the custodians and the Asset Management Company. The details of these constituents are as follows:

1. **Sponsor** - The Company which sets up the mutual fund is called the sponsor. It is this agency which of its owner or in collaboration with other body corporate comply the formalities of establishing a mutual fund. The SEBI has laid down certain criteria to be met by the
sponsor. These criteria mainly deal with adequate experience of five years, good past track record, net worth etc.

(2) **Board of Trustees** - Trustees are people with long experience and good integrity in their respective fields. A company is appointed as a trusty to manage the Mutual Funds. To ensure fair dealings, Mutual Fund regulation requires that one cannot be trusty or a director of a trusty company in more than one mutual fund. Trustees are to appoint Asset Management Company to float the schemes. Trustees carry the crucial responsibility of safeguarding the interest of investors. For this purpose, they monitor the operations of different schemes. They have wide ranging power and they can even dismiss Asset Management Company with the approval of the SEBI.

(3) **Asset Management Company (AMC)** - The AMC actually manages the funds of various schemes. The AMC employs a large number of professional to make investments, carry out research and do agent and investor serving. In fact, the success of any MF depends upon the efficiency of this AMC. The AMC submits a quarterly report on the functioning of the mutual fund to the trustees who will guide and control the AMC.

(4) **Custodian** - The mutual fund shall use the services of a custodian registered with SEBI for safe custody of the securities. The custodian should not be linked with the AMC. Custodian shall be responsible to collect and receive all income, dividends, interest rights, capitalization of reserved etc. relating to securities belonging to be mutual fund. He shall maintain proper records and hold securities of the mutual fund scheme-wise.
The structure of a mutual fund in India presented in the following diagram.


**Figure 3.2 Structure of a Mutual Fund**

### 3.4. Benefits of Investments in Mutual Funds

The investment in mutual fund provides many benefits to investors. Mutual fund helps small investors to enter into capital market with minimum investment. The benefits available to investors are:
(1). **Affordability** - mutual funds allow investors to start with small investments. For example, if an investor wants to buy a portfolio of blue chips of moderate size, he/she should at least have a few lakhs of rupees. A mutual fund gives the investor the same portfolio for meager investments of Rs 1000-5000. A mutual fund can do that because it collects money from many people and it have a large corpus.

(2). **Professional Management** - The major advantage of investing in a mutual fund is that an investor gets a professional money manager for a small fee. The investor can leave the investment decisions to the professional manager and only have to monitor the performance of the fund at regular intervals.

(3). **Diversification** - Considered the essential tool in risk management, make it possible for investors to diversify its portfolio because of large corpus. However, a small investor cannot have a well-diversified portfolio because it calls for large investment. Mutual Funds help the investors to diversify his risk.

(4). **Convenience** - Mutual funds offer tailor-made solutions like systematic investment plans and systematic withdrawal plans to investors, which is very convenient to investors. Investors do not have to worry about the investment decisions or they do not have deal with brokerage or depository, etc. for buying or selling of securities. Mutual funds also offer specialized schemes like retirement plans, children’s plan, and industry specific schemes etc. to suit the personal preference of investors. These schemes also help small investors with asset allocation of their corpus. It also saves a lot of paper work.
(5). **Cost Effectiveness** - A small investor will find that a mutual fund route is a cost effective method. AMC fee is normally 2.5% and they also save a lot of transactions costs as they get concession from brokerages. Also, they get the service of a financial professional for a very small fee. If they were to seek a financial advisors’ help directly, they may end up pay more. Also the size of the corpus should be large to get the service of investment experts, who offer portfolio management.

(6). **Liquidity** - Investors can liquidate their investments anytime they want. Most mutual funds dispatch checks for redemption proceeds within two or three working days. Investors also do not have to pay any penal interest in most cases. However some schemes charge exit load.

(7). **Tax breaks** - Investors don’t have to pay any taxes on dividends issued by mutual funds. They also have the advantage of capital gains taxation. Tax –saving schemes and pension schemes give them the added advantage of benefits under sec.88, investments up to Rs 100000 in them qualify for rebate.

(8). **Transparency** - Mutual funds offer daily NAV of schemes, which help to monitor investors investments on a regular basis. They also send quarterly newsletters, which give details of the portfolio, performance of schemes against various benchmarks,etc. They are also well regulated and SEBI monitors their actions closely.

(9). **Innovative schemes to suit unique needs of different investors** - There are schemes that offer international diversification to reduce the geographical risk. There are derivatives funds which adopt various derivative strategies to gain from the either side movement of the market. Capital protection funds offer a unique feature of capital protection coupled with market linked returns.
3.5. Classification of Mutual Funds

3.5.1. General Classification of Mutual Funds

Generally, mutual funds can be classified into three namely open end funds and closed end funds.

3.5.1.1. Open-end Funds

Funds that can sell and purchase units at any point of time are classified as Open-end Funds. The fund size (corpus) of an open-end fund is variable (keeps changing) because of continuous selling (to investors) and repurchases (from the investors) by the fund. An open-end fund is not required to keep selling new units to the investors at all times but is required to always repurchase, when an investor wants to sell his units. The NAV of an open-end fund is calculated every day.

3.5.1.2. Closed-end Funds

Funds that can sell a fixed number of units only during the New Fund Offer (NFO) period are known as Closed-end Funds. The corpus of a Closed-end Fund remains unchanged at all times. After the closure of the offer, buying and redemption of units by the investors directly from the Funds is not allowed. However, to protect the interests of the investors, SEBI provides investors with two avenues to liquidate their positions:

1. Closed-end Funds are listed on the stock exchanges where investors can buy/sell units from/to each other. The trading is generally done at a discount to the NAV of the scheme. The NAV of a closed-end fund is computed on a weekly basis (updated every Thursday).

2. Closed-end Funds may also offer "buy-back of units" to the unit holders. In this case, the corpus of the Fund and its outstanding units do get changed.
3.5.1.3. Interval Funds

Interval funds combine the features of open-ended and close-ended schemes. They are open for sale or redemption during pre-determined intervals at NAV related prices.

3.5.2. Broad Mutual Fund Types

A wide variety of mutual fund schemes exists to cater to the needs such as financial position, risk tolerances, return expectations etc.

The Following are the broad classification of mutual funds.

3.5.2.1. Equity Funds

Equity funds are considered to be the more risky funds as compared to other fund types, but they also provide higher returns than other funds. It is advisable that an investor looking to invest in an equity fund should invest for long term i.e. for three years or more. There are different types of equity funds each falling into different risk bracket. In the order of decreasing risk level, there are following types of equity funds:

(a) **Aggressive Growth Funds** - In Aggressive Growth Funds, fund managers aspire for maximum capital appreciation and invest in less researched shares of a speculative nature. Because of these speculative investments Aggressive Growth Funds become more volatile and thus, are prone to higher risk than other equity funds.

(b) **Growth Funds** - Growth Funds also invest for capital appreciation (with time horizon of 3 to 5 years) but they are different from Aggressive Growth Funds in the sense that they invest in companies that are expected to outperform the market in the future. Without entirely adopting speculative strategies, Growth Funds invest in those companies that are expected to post above average earnings in the future.
(c) **Specialty Funds** - Specialty Funds have stated criteria for investments and their portfolio comprises of only those companies that meet their criteria. Criteria for some specialty funds could be to invest/not to invest in particular regions/companies. Specialty funds are concentrated and thus, are comparatively riskier than diversified funds. The following are the types of specialty funds:

(i) **Sector Funds** - Specialty Funds have stated criteria for investments and their portfolio comprises of only those companies that meet their criteria. Criteria for some speciality funds could be to invest/not to invest in particular regions/companies. Specialty funds are concentrated and thus, are comparatively riskier than diversified funds.

(ii) **Foreign Securities Funds** - Foreign Securities Equity Funds have the option to invest in one or more foreign companies. Foreign securities funds achieve international diversification and hence they are less risky than sector funds. However, foreign securities funds are exposed to foreign exchange rate risk and country risk.

(iii) **Mid-Cap or Small-Cap Funds** - Funds that invest in companies having lower market capitalization than large capitalization companies are called Mid-Cap or Small-Cap Funds. Market capitalization of Mid-Cap companies is less than that of big, blue chip companies (less than ₹ 2500 crores but more than ₹ 500 crores) and Small-Cap companies have market capitalization of less than ₹ 500 crores. Market Capitalization of a company can be calculated by multiplying the market price of the company's share by the total number of its outstanding shares in the market. The shares of Mid-Cap or Small-Cap Companies are not as liquid as of Large-Cap Companies which
gives rise to volatility in share prices of these companies and consequently, investment gets risky.

(iv) **Option Income Funds** - While not yet available in India, Option Income Funds write options on a large fraction of their portfolio. Proper use of options can help to reduce volatility, which is otherwise considered as a risky instrument. These funds invest in big, high dividend yielding companies, and then sell options against their stock positions, which generate stable income for investors.

(d) **Diversified Equity Funds** - Except for a small portion of investment in liquid money market, diversified equity funds invest mainly in equities without any concentration on a particular sector(s). These funds are well diversified and reduce sector-specific or company-specific risk. However, like all other funds, diversified equity funds too are exposed to equity market risk. One prominent type of diversified equity fund in India is Equity Linked Savings Schemes (ELSS). As per the mandate, a minimum of 90% of investments by ELSS should be in equities at all times. ELSS investors are eligible to claim deduction from taxable income (up to ₹ 1 lakh) at the time of filing the income tax return. ELSS usually has a lock-in period, and in case of any redemption by the investor before the expiry of the lock-in period makes him liable to pay income tax on such income(s) for which he may have received any tax exemption(s) in the past.

(e) **Equity Index Funds** - Equity Index Funds have the objective to match the performance of a specific stock market index. The portfolio of these funds comprises of the same companies that form the index and is constituted in the same proportion as the index. Equity index funds that follow broad indices like S &P CNX Nifty, Sensex) are less risky than equity index funds that follow narrow
sectoral indices like BSE BANKEX or CNX Bank Index etc. Narrow indices are less diversified and therefore, more risky.

(f) **Value Funds** - Value Funds invest in those companies that have sound fundamentals and whose share prices are currently under-valued. The portfolio of these funds comprises of shares that are trading at a low Price to Earning Ratio (Market Price per Share / Earning per Share) and a low Market to Book Value (Fundamental Value) Ratio. Value Funds may select companies from diversified sectors and are exposed to lower risk level as compared to growth funds or specialty funds. Value stocks are generally from cyclical industries such as cement, steel, sugar etc. which make them volatile in the short-term. Therefore, it is advisable to invest in Value funds with a long-term time horizon as risk in the long term, to a large extent, is reduced.

(g) **Equity Income or Dividend Yield Funds** - The objective of Equity Income or Dividend Yield Equity Funds is to generate high recurring income and steady capital appreciation for investors by investing in those companies which issue high dividends (such as Power or Utility companies whose share prices fluctuate comparatively lesser than other companies' share prices). Equity Income or Dividend Yield Equity Funds are generally exposed to the lowest risk level as compared to other equity funds.

### 3.5.2.2. Debt/Income Funds

Funds that invest in medium to long-term debt instruments issued by private companies, banks, financial institutions, governments and other entities belonging to various sectors (like infrastructure companies etc.), are known as Debt/Income Funds. Debt funds are low risk profile funds that seek to generate fixed current income (and not capital appreciation) to investors. In order to ensure a regular income to investors, debt (or income)
funds distribute a large fraction of their surplus to investors. Although debt
securities are generally less risky than equities, they are subject to credit
risk (risk of default) by the issuer at the time of interest or principal
payment. To minimize the risk of default, debt funds usually invest in
securities from issuers who are rated by credit rating agencies and are
considered to be of "Investment Grade". Debt funds that target high returns
are more risky. Based on different investment objectives, there can be the
following types of debt funds:

(a) **Diversified Debt Funds** - Debt funds that invest in all securities
issued by entities belonging to all sectors of the market are known as
diversified debt funds. The best feature of diversified debt funds is
that investments are properly diversified into all sectors which results
in risk reduction. Any loss incurred, on account of default by a debt
issuer, is shared by all investors which further reduces risk for an
individual investor.

(b) **Focused Debt Funds** - Debt funds that invest in all securities issued
by entities belonging to all sectors of the market are known as
diversified debt funds. The best feature of diversified debt funds is
that investments are properly diversified into all sectors which results
in risk reduction. Any loss incurred, on account of default by a debt
issuer, is shared by all investors which further reduces risk for an
individual investor.

(c) **High Yield Debt funds** - We now understand that risk of default is
present in all debt funds, and therefore, debt funds generally try to
minimize the risk of default by investing in securities issued by only
those borrowers who are considered to be of "investment grade". But,
High Yield Debt Funds adopt a different strategy and prefer
securities issued by those issuers who are considered to be of "below
investment grade". The motive behind adopting this sort of risky
strategy is to earn higher interest returns from these issuers. These funds are more volatile and bear higher default risk, although they may earn higher returns for investors at times.

(d) Assured Return Funds - Although it is not necessary that a fund will meet its objectives or provide assured returns to investors, there can be funds that come with a lock-in period and offer assurance of annual returns to investors during the lock-in period. Any shortfall in returns is suffered by the sponsors or the Asset Management Companies (AMCs). These funds are generally debt funds and provide investors with a low-risk investment opportunity. However, the security of investments depends upon the net worth of the guarantor (whose name is specified in advance on the offer document). To safeguard the interests of investors, SEBI permits only those funds to offer assured return schemes whose sponsors have adequate net-worth to guarantee returns in the future. In the past, UTI had offered assured return schemes (i.e. Monthly Income Plans of UTI) that assured specified returns to investors in the future. UTI was not able to fulfill its promises and faced large shortfalls in returns. Eventually, the government had to intervene and took over UTI's payment obligations on itself. Currently, no AMC in India offers assured return schemes to investors, though possible.

(e) Fixed Term Plan Series - Fixed Term Plan Series usually are closed-end schemes having short term maturity period (of less than one year) that offer a series of plans and issue units to investors at regular intervals. Unlike closed-end funds, fixed term plans are not listed on the exchanges. Fixed term plan series usually invest in debt/income schemes and target short-term investors. The objective of fixed term plan schemes is to gratify investors by generating some expected returns in a short period.
3.5.2.3. Gilt Funds

Also known as Government Securities in India, Gilt Funds invest in government papers (named dated securities) having medium to long term maturity period. Issued by the Government of India, these investments have little credit risk (risk of default) and provide safety of principal to the investors. However, like all debt funds, gilt funds too are exposed to interest rate risk. Interest rates and prices of debt securities are inversely related and any change in the interest rates results in a change in the NAV of debt/gilt funds in an opposite direction.

3.5.2.4. Money Market/Liquid Funds

Money market / liquid funds invest in short-term (maturing within one year) interest bearing debt instruments. These securities are highly liquid and provide safety of investment, thus making money market / liquid funds the safest investment option when compared with other mutual fund types. However, even money market / liquid funds are exposed to the interest rate risk. The typical investment options for liquid funds include Treasury Bills (issued by governments), Commercial papers (issued by companies) and Certificates of Deposit (issued by banks).

3.5.2.5. Hybrid Funds

As the name suggests, hybrid funds are those funds whose portfolio includes a blend of equities, debts and money market securities. Hybrid funds have an equal proportion of debt and equity in their portfolio. There are following types of hybrid funds in India:

(a) **Balanced Funds** - The portfolio of balanced funds include assets like debt securities, convertible securities, and equity and preference shares held in a relatively equal proportion. The objectives of balanced funds are to reward investors with a regular income, moderate capital appreciation and at the same time minimizing the risk of capital
erosion. Balanced funds are appropriate for conservative investors having a long term investment horizon.

(b) **Growth-and-Income Funds** - Funds that combine features of growth funds and income funds are known as Growth-and-Income Funds. These funds invest in companies having potential for capital appreciation and those known for issuing high dividends. The level of risks involved in these funds is lower than growth funds and higher than income funds.

(c) **Asset Allocation Funds** - Mutual funds may invest in financial assets like equity, debt, money market or non-financial (physical) assets like real estate, commodities etc. Asset allocation funds adopt a variable asset allocation strategy that allows fund managers to switch over from one asset class to another at any time depending upon their outlook for specific markets. In other words, fund managers may switch over to equity if they expect equity market to provide good returns and switch over to debt if they expect debt market to provide better returns. It should be noted that switching over from one asset class to another is a decision taken by the fund manager on the basis of his own judgment and understanding of specific markets, and therefore, the success of these funds depends upon the skill of a fund manager in anticipating market trends.

### 3.5.2.6. Commodity Funds

Those funds that focus on investing in different commodities like metals, food grains, crude oil etc. or commodity companies or commodity futures contracts are termed as Commodity Funds. A commodity fund that invests in a single commodity or a group of commodities is a specialized commodity fund and a commodity fund that invests in all available commodities is a diversified commodity fund and bears less risk than a specialized commodity fund.
3.5.2.7. Real Estate Funds

Funds that invest directly in real estate or lend to real estate developers or invest in shares/securitized assets of housing finance companies, are known as Specialized Real Estate Funds. The objective of these funds may be to generate regular income for investors or capital appreciation.

3.5.2.8. Exchange Traded Funds (ETFs)

Exchange Traded Funds provide investors with combined benefits of a closed-end and an open-end mutual fund. Exchange Traded Funds follow stock market indices and are traded on stock exchanges like a single stock at index linked prices. The biggest advantage offered by these funds is that they offer diversification, flexibility of holding a single share (tradable at index linked prices) at the same time. Recently introduced in India, these funds are quite popular abroad.

3.5.2.9. Funds of Funds

Mutual funds that do not invest in financial or physical assets, but do invest in other mutual fund schemes offered by different AMCs, are known as Fund of Funds. Fund of Funds maintain a portfolio comprising of units of other mutual fund schemes, just like conventional mutual funds maintain a portfolio comprising of equity/debt/money market instruments or non financial assets. Fund of Funds provide investors with an added advantage of diversifying into different mutual fund schemes with even a small amount of investment, which further helps in diversification of risks. However, the expenses of Fund of Funds are quite high on account of compounding expenses of investments into different mutual fund schemes. The chart below gives an overview into the existing type of schemes in the industry.

"Precious Metals Fund" and Gold Funds (that invest in gold, gold futures or shares of gold mines) are common examples of commodity funds.
Figure 3.3. Broad Mutual Fund Types

Equity Funds
- Aggressive Growth Funds
- Growth Funds
- Equity Income or Dividend Yield Funds
- Diversified Equity Funds (ELSS)
- Equity Index Funds
- Value Funds
- Speciality Funds

Money Market/Liquid Funds
- Balanced Funds
- Growth- and - Income Funds
- Asset Allocation Funds

Hybrid Funds

Debt/Income Funds
- Diversified Debt Funds
- Focused Debt Funds
- High Yield Debt Funds
- Assured Return Funds
- Fixed Term Plan Series

Gift Funds
- Commodity Funds
- Real Estate Funds
- Exchange Traded Funds (ETFs)
- Fund of Funds

Others

Courtesy: www.appuonline.com
Chapter 3

3.6. History and Growth of Mutual Fund Industry

At the dawn of commercial history, Egyptians and Phoenicians sold shares in vessels and caravans in order to spread the risk of their perilous ventures. At the same lines the idea of mutual fund had its formal origin in Belgium, Societe’ Generale’ de Belgique ‘in 1822 as an investment company to finance investments in national industries with the modern concept of mutual funds goes to the ‘Foreign and Colonial Government Trust of London established in 1868. The first open-ended mutual fund was created in Boston in 1924. Thereafter a large number of close-ended mutual funds were formed in the U.S.A. in 1930s’ followed by many countries, both open and close-ended type were popular. In fact, mutual fund gained a general popularity only after the Second World War. Between 1930 and 1970 mutual funds grew relatively little, although there was an upsurge of interest in equity funds during the stock market boom of the early and mid 1960s’. However, this reversed in the 1970s following the first oil crisis and poor performance of equity markets. The collapse of International Overseas Services, a fraudulent fund management group, in the late 1960s’ contributed to the loss of investor confidence in mutual funds.

A major product innovation occurred in the 1970s with the launching of money market mutual funds. They achieved high levels of development in U.S.A. and other countries with rigid restrictions on bank deposit rates. Money market mutual funds tend to grow to meet the demand from sophisticated investors who need a convenient place for parking their liquid investment balances. Growth of equity and bond funds resumed in the early 1980s as macroeconomic performance and equity markets started to improve. But growth did not become explosive until the early 1990s. Investors started to change their financial asset allocation very drastically after 1990. The global growth of mutual funds was fuelled by the increasing globalization of finance and expanding the presence of large multinational financial groups in a large number of countries and by the strong performance of equity and bond markets throughout most of the 1990s’. Today, globally, there are thousands of mutual funds with different investment objectives and they collectively manage almost as much as or more money as compared to banks.

The Table 3.1 shows the world wide mutual fund net assets and number of schemes for the period of 2008-2012.
Table 3.1 World Wide Net Assets and Number of Mutual Funds for the period 2008-2012

<table>
<thead>
<tr>
<th>Year (ending 31st March)</th>
<th>Countries</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>10,581,988</td>
<td>16,459</td>
<td>6,231,116</td>
<td>36,322</td>
<td>2,037,536</td>
<td>14,909</td>
<td>69,417</td>
<td>884</td>
<td>18,920,057</td>
<td>68,574</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>12,585,776</td>
<td>16,953</td>
<td>7,545,535</td>
<td>34,899</td>
<td>2,715,234</td>
<td>14,795</td>
<td>106,261</td>
<td>904</td>
<td>22,952,806</td>
<td>67,551</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>13,586,843</td>
<td>18,018</td>
<td>7,903,389</td>
<td>35,292</td>
<td>3,067,323</td>
<td>15,265</td>
<td>141,615</td>
<td>943</td>
<td>24,699,170</td>
<td>69,518</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>13,524,360</td>
<td>19,799</td>
<td>7,220,298</td>
<td>35,713</td>
<td>2,921,276</td>
<td>16,198</td>
<td>124,976</td>
<td>947</td>
<td>23,790,910</td>
<td>72,657</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>14,808,328</td>
<td>20,911</td>
<td>7,902,217</td>
<td>34,649</td>
<td>3,196,428</td>
<td>16,934</td>
<td>138,283</td>
<td>964</td>
<td>26,045,256</td>
<td>73,458</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAGR</td>
<td>0.088</td>
<td>0.062</td>
<td>0.061</td>
<td>-0.012</td>
<td>0.119</td>
<td>0.032</td>
<td>0.188</td>
<td>0.022</td>
<td>0.083</td>
<td>0.017</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Note: The figures in the years ending 31st March 2011 and 2012 are provisional because they are Net assets of the fourth and third quarter of the respective years.
3.6.1. History of Mutual Fund Industry in India

The mutual fund industry in India started in 1963 with the formation of the Unit Trust of India, at the initiative of the Government of India and the Reserve Bank. The history of mutual funds in India can be broadly divided into four distinct phases, as follows:

3.6.1.1. First Phase-1964-87

The Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and Administrative control of RBI.

<table>
<thead>
<tr>
<th>Year (ending 31st March)</th>
<th>Net Assets (₹ In crores)</th>
<th>Annual increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1964</td>
<td>24.67</td>
<td></td>
</tr>
<tr>
<td>1965</td>
<td>25.94</td>
<td>5.15</td>
</tr>
<tr>
<td>1966</td>
<td>33.86</td>
<td>30.53</td>
</tr>
<tr>
<td>1967</td>
<td>48.7</td>
<td>43.83</td>
</tr>
<tr>
<td>1968</td>
<td>65.4</td>
<td>34.29</td>
</tr>
<tr>
<td>1969</td>
<td>88.3</td>
<td>35.02</td>
</tr>
<tr>
<td>1970</td>
<td>105.14</td>
<td>19.07</td>
</tr>
<tr>
<td>1971</td>
<td>119.26</td>
<td>13.43</td>
</tr>
<tr>
<td>1972</td>
<td>141.96</td>
<td>19.03</td>
</tr>
<tr>
<td>1973</td>
<td>172.09</td>
<td>21.22</td>
</tr>
<tr>
<td>1974</td>
<td>172.09</td>
<td>0.00</td>
</tr>
<tr>
<td>1975</td>
<td>169.96</td>
<td>-1.24</td>
</tr>
<tr>
<td>1976</td>
<td>176.66</td>
<td>3.94</td>
</tr>
<tr>
<td>1977</td>
<td>279.91</td>
<td>58.45</td>
</tr>
<tr>
<td>1978</td>
<td>393.7</td>
<td>40.65</td>
</tr>
<tr>
<td>1979</td>
<td>455.3</td>
<td>15.65</td>
</tr>
<tr>
<td>1980</td>
<td>513.97</td>
<td>12.89</td>
</tr>
<tr>
<td>1981</td>
<td>679.24</td>
<td>32.16</td>
</tr>
<tr>
<td>1982</td>
<td>870.24</td>
<td>28.12</td>
</tr>
<tr>
<td>1983</td>
<td>1261.33</td>
<td>44.94</td>
</tr>
<tr>
<td>1984</td>
<td>2209.61</td>
<td>75.18</td>
</tr>
<tr>
<td>1985</td>
<td>3218.34</td>
<td>45.65</td>
</tr>
<tr>
<td>1986</td>
<td>4563.68</td>
<td>41.80</td>
</tr>
</tbody>
</table>

CAGR 0.268

Source: Data compiled from UTI Fact Book
3.6.1.2. Second Phase-1987-1993 (entry of public sector funds)

In 1978 the UTI was de-linked from RBI and IDBI took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had ₹ 6,700 crore of AUM.

1987 marked the entry of non-UTI, Public Sector mutual funds set up by the Public Sector Banks and Life Insurance Corporation of India (LIC) and GIC. SBI Mutual fund established in June 1987 followed by Can Bank Mutual Fund (Dec.87), Punjab National Bank Mutual Fund (Nov.87), Indian Bank Mutual Fund (Nov.89), Bank of India (June.90), Bank of Baroda MF (Oct.92). LIC established its Mutual Fund in June ‘89 while GIC had setup its Mutual Fund in Dec.’90.

At the end of 1993, the Mutual Fund Industry had AUM of ₹ 47,733 crores. The following table shows the Net assets for the period of 1987-1993.

<table>
<thead>
<tr>
<th>Year (ending 31st March)</th>
<th>UTI Amount</th>
<th>Annual increase</th>
<th>Others Amount</th>
<th>Annual increase</th>
<th>Total Amount</th>
<th>Annual increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>4563.68</td>
<td></td>
<td></td>
<td></td>
<td>4563.68</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>6738.81</td>
<td>47.66</td>
<td>132</td>
<td>-8.70</td>
<td>6870.81</td>
<td>50.55</td>
</tr>
<tr>
<td>1989</td>
<td>11834.65</td>
<td>75.62</td>
<td>1621</td>
<td>245.54</td>
<td>13455.65</td>
<td>95.84</td>
</tr>
<tr>
<td>1990</td>
<td>17650.92</td>
<td>49.15</td>
<td>1480</td>
<td>20.61</td>
<td>19130.92</td>
<td>42.18</td>
</tr>
<tr>
<td>1991</td>
<td>21376.48</td>
<td>21.11</td>
<td>1784.99</td>
<td>245.54</td>
<td>23161.47</td>
<td>21.07</td>
</tr>
<tr>
<td>1992</td>
<td>31805.69</td>
<td>48.79</td>
<td>6167.78</td>
<td>41.97</td>
<td>37973.47</td>
<td>63.95</td>
</tr>
<tr>
<td>1993</td>
<td>38976.81</td>
<td>22.55</td>
<td>8756.61</td>
<td>1128.03</td>
<td>47733.5</td>
<td>25.70</td>
</tr>
</tbody>
</table>

CAGR 0.430 1.314 0.479

Source: Data compiled from Mutual Fund Year Book 2000

3.6.1.3 Third Phase-1993-2003 (entry of private sector funds)

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the First Mutual Fund
Regulation came into being, under which all mutual funds, except UTI were registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The SEBI (Mutual Fund) Regulations 1993 were substituted by more comprehensive and revised mutual fund Regulations in 1996.

The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also by the end of January 2003, there were 33 mutual funds with total assets of ₹ 1, 21, 805 crores. The UTI with ₹ 44, 541 crores were way ahead of other mutual funds. In 2003, UTI was bifurcated into two namely Specified Undertakings of UTI and UTI mutual fund Ltd. after the UTI 64 scam. The Following table shows the net assets of mutual fund industry for the period of 1994-2003

Table 3.4 Net Assets of Mutual Fund Industry in India (1994 – 2003)

<table>
<thead>
<tr>
<th>Year (ending 31st March)</th>
<th>UTI</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Annual increase</td>
<td>Amount</td>
</tr>
<tr>
<td>1994</td>
<td>51708.88</td>
<td>10721.17</td>
<td>62430.05</td>
</tr>
<tr>
<td>1995</td>
<td>59618.64</td>
<td>-15.30</td>
<td>12786.92</td>
</tr>
<tr>
<td>1996</td>
<td>61528.39</td>
<td>-3.20</td>
<td>13065.92</td>
</tr>
<tr>
<td>1997</td>
<td>59341.26</td>
<td>-3.55</td>
<td>10856.15</td>
</tr>
<tr>
<td>1998</td>
<td>47611.69</td>
<td>-19.77</td>
<td>11306.53</td>
</tr>
<tr>
<td>1999</td>
<td>56010.15</td>
<td>17.64</td>
<td>14613.35</td>
</tr>
<tr>
<td>2000</td>
<td>68524</td>
<td>22.34</td>
<td>34928.98</td>
</tr>
<tr>
<td>2001</td>
<td>58017</td>
<td>-15.33</td>
<td>32570</td>
</tr>
<tr>
<td>2002</td>
<td>51434</td>
<td>-11.35</td>
<td>49160</td>
</tr>
<tr>
<td>2003</td>
<td>13516</td>
<td>-73.72</td>
<td>65948</td>
</tr>
<tr>
<td>CAGR</td>
<td>-0.139</td>
<td>0.224</td>
<td>0.027</td>
</tr>
</tbody>
</table>

Source: Data compiled from Mutual Fund Year Book 2000 and AMFI monthly

Note: In 2003 UTI bifurcated into two. So the total asset ₹ 29835 crores for the period April 2002-January 2003 is therefore excluded from the data.
3.6.1.3 Forth Phase - Since February 2003

Basically, for a period of 2-3 years, UTI distributed more dividends to the unit holders of US-64 than the return earned from the investment in the scheme. Thus UTI crisis began. The reasons for UTI crisis were (1) for open ended scheme that US-64 is, its prices were not linked to the NAV and so, the real worth of the portfolio was never known to the investors. (2) With the huge amount collecting through the said scheme, UTI in several hundred stocks. Tracking these stocks is certainly not an easy job and the performance of US-64 goes on to show that while size does not matter, too much can be a bit problem. (3) the problem of inter scheme transfer holdings, which is has been a common practice in UTI, it involves carrying dead investments for years without making any provision for them.(4) centralization of decision making. The chairman acted as fund manager. The poor fund management was the main reason for UTI crisis and (5) lack of disclosure details.

To overcome this type of crisis in future, a reform package was adopted. In February 2003, following the repeal of the Unit Trust of India Act 1963, UTI bifurcated into two separate entities. One is the Specified Undertakings of Unit Trust of India with an AUM of ₹ 29,835 crore as at the end of January 2003, representing broadly, the assets of US-64 scheme, assured return and certain other schemes. The Specified Undertaking of UTI, functioning under an administrator and under the rules framed by the Government of India and does not come under the preview of the MF Regulations.

The second is the UTI Mutual Fund Ltd. Sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the MF Regulations. With the bifurcation of erstwhile UTI which had in March 2000 more than ₹ 76000 crores of AUM and with setting up of UTI MF, conforming to SEBI (MF) Regulations, and recent mergers taking place
among different private sector MFs, the mutual fund industry has entered its current phase of consolidation and growth. The following table shows the net assets of mutual fund industry for the period of 2003-2012.

### Table 3.5 Net Assets of Mutual Fund Industry in India (2004 – 2012)

<table>
<thead>
<tr>
<th>Year (ending 31st March)</th>
<th>UTI Amount</th>
<th>Annual Increase</th>
<th>Others Amount</th>
<th>Annual Increase</th>
<th>Total Amount</th>
<th>Annual Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>20617</td>
<td>0.60</td>
<td>118999</td>
<td>8.29</td>
<td>139616</td>
<td>7.15</td>
</tr>
<tr>
<td>2005</td>
<td>20740</td>
<td>42.33</td>
<td>202343</td>
<td>57.03</td>
<td>231862</td>
<td>54.99</td>
</tr>
<tr>
<td>2006</td>
<td>37613</td>
<td>27.42</td>
<td>321484</td>
<td>58.88</td>
<td>359097</td>
<td>54.88</td>
</tr>
<tr>
<td>2007</td>
<td>48983</td>
<td>30.23</td>
<td>489525</td>
<td>52.27</td>
<td>538508</td>
<td>49.96</td>
</tr>
<tr>
<td>2008</td>
<td>48754</td>
<td>-0.47</td>
<td>444531</td>
<td>-9.19</td>
<td>493285</td>
<td>-8.40</td>
</tr>
<tr>
<td>2009</td>
<td>80218</td>
<td>64.54</td>
<td>667307</td>
<td>50.11</td>
<td>747525</td>
<td>51.54</td>
</tr>
<tr>
<td>2010</td>
<td>67189</td>
<td>-16.24</td>
<td>633349</td>
<td>-5.09</td>
<td>700538</td>
<td>-6.29</td>
</tr>
<tr>
<td>2011</td>
<td>58922</td>
<td>-12.30</td>
<td>605870</td>
<td>-4.34</td>
<td>664792</td>
<td>-5.10</td>
</tr>
<tr>
<td><strong>CAGR</strong></td>
<td><strong>0.140</strong></td>
<td></td>
<td><strong>0.226</strong></td>
<td></td>
<td><strong>0.215</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: Data compiled from AMFI monthly

### 3.6.2 Growth of Mutual Fund Industry

As the indicator of any economy is GDP, it is worthwhile to measure the per cent of growth with GDP. In developed markets such as the US, the AUM of mutual fund are more than 60 per cent of the GDP as compared to a little above 8 per cent in India. Even in other emerging markets it is a lot higher. Brazil for example has a ratio of 39 per cent. This difference indicates the enormous market potential in India. AUM as a percentage of bank deposits at 25 per cent. The mutual fund penetration has risen from as low as 0.4 per cent in the fiscal year 2005 to the 4.8 per cent currently.

Mutual Funds are a popular investment tool for investors because it offers a convenient and cost-effective way to invest in the financial markets. Mutual fund industry in India came with the concept of Mutual Fund in the year 1963 at the initiative of the Government of India and
Reserve Bank of India. The growth was slow initially but it accelerated from the year 1987 when non-UTI players entered the industry. The industry witnessed a compounded annual growth rate of 31.25 per cent from March 2003 to March 2011. The figure for March 2011 is the quarterly average for the first calendar quarter as the regulator stopped providing monthly average asset under management (AAUM) from September 2010 onwards.

The Indian mutual fund industry continues to find it tough to attract money from investors in the country’s interiors. Despite consistent efforts to spread awareness about mutual funds as a financial product for investment, the industry has little to rejoice, as close to three-fourths of its assets still come from the country’s five major cities.

Mumbai, Delhi, Bangalore, Chennai and Kolkata collectively contributed a little over 73 per cent of the assets under management (AUM) of fund houses during the December quarter. Interestingly, compared to the September quarter, this was a decline of around 150 basis points. The next 10 cities, including Ahmedabad, Pune, Hyderabad, Baroda and Jaipur, reported a marginal rise of 23 basis points, contributing 13.2 per cent of AUM. Contribution from the next 75 cities, too, declined during the period, a clear blow for the fund houses struggling to increase penetration. Though industry officials admit there is huge untapped money in India, they have failed to route this into mutual funds. Based on the overall folio number as on March 31, 2012, the penetration of mutual fund products, at less than four per cent, continues to be poor. As on March 31, 2012 there were 44 fund players managing assets worth ₹6.64 lakh crore.

The growth of mutual fund industry is no longer centered on the major metros, it is moving out to the second line of metros which include
Kochi as well. According to a study conducted by SEBI, around 13.7 per cent of the urban households and 3.8 per cent of the rural households in Kerala are owning mutual fund units. The chief officials of all mutual fund houses recognize the growth potential of industry in Kerala. As on 31.3. 2013 the Average AUM from the state of Kerala was approximately ₹ 6,050 crores.

3.7. Recent Trends in Mutual Fund Marketing

During recent years, some innovative activities are taking place in the Indian mutual fund industry. Some of the recent developments in the Indian mutual fund industry are:

1. The measures taken up to improve marketing include widening the product basket, enlarging the chain of product placement and improved disclosure of the product.

2. The offer document/ statement of additional information have become more structured and contain information relating to service and management.

3. The use of technology for communication selling and servicing has also improved the marketing of mutual funds.

4. Investors’ protection is now ensured better than earlier times.

5. Mutual fund can be purchased through selected ATMs.

6. Recently, SEBI has permitted trading of MF units on recognised stock exchanges. While trading through the stock exchange, the investor would get to know about the validity of his order and the value at which the units would get credited/ redeemed to his account by the end of the day. Whereas, while investing through MF distributor or directly with the MF, the investor gets information of the subscription and redemption details only in the form of direct communication from the MF/ AMC. Thus, by trading through the stock exchange, the investor would be able to optimize
his investment decisions due to the reduced time lag in the movement of funds. This transparency in knowing the status of order till completion helps in reducing disputes. Further, the investor would able to get a single view of his portfolio across multiple assets like securities, MF units etc.

7. Entry load is abolished.

8. Introduction of training and self-regulations for marketing personnel and the programmes for investors’ education, both initiated by AMFI.

9. SEBI’s Marketing Code for mutual funds, which has made mutual funds marketing a more regulated and disciplined activity, more alert to the investors’ right and expectations.

The Indian mutual fund industry is also facing many problems. Currently there are 43 players with lots of different schemes. There are mergers and acquisitions are there with different fund houses, even with different schemes. Besides that, there are schemes with different sub-schemes with different plans and options. One of the major problems in the industry is that ordinary investors are not at all knowledgeable for understanding these details. The agents/ fund houses are not willing to explain the details.

Through overcoming these limitations and by introducing innovative schemes, Indian mutual fund industry can capture the market.

...etc....