Chapter 1

INTRODUCTION

1.1 Introduction

The pace of economic development of any country is greatly influenced by capital formation, as it is the kingpin of economic advancement. The most important source of capital formation is the capital market which pools the capital resources of the country. It is the source from which finance flows to grease the wheels of business enterprises.

In a situation where savings are made by millions of households across the country, who do not venture to set up and manage enterprises but would want to be partners of economic development, the capital market gives an outlet for their savings. On the other hand, there are entrepreneurs who wish to set up projects which are beyond their individual financial capacity. Hence there is a mismatch between a large pool of savings supplied by the household savers and their entrepreneur users. The capital market is a bridge that matches these supplies of savings with demands for investments. Healthy, efficient and transparent functioning of capital market is, therefore, imperative for the protection of investor interest that would ensure growing mobilisation of resources for growth (Nayak, 1994, p.149).

Capital market, however, is a complex place fraught with risks which a small investor cannot afford to take. There are innumerable factors which constantly influence the behaviour of the capital market. To emerge as a winner in the market, one needs deep understanding of the dynamics of the market, the industry, and the domestic and global economy. But an average investor, in his ordinary course of business, is not equipped with a clear perception of all these factors. Further, he is also handicapped by
the investible resources at his disposal that are too small to achieve the optimum diversification of risk, which alone can give higher investment return. The risk diversification, which a pool of savings of large number of investors can achieve, cannot be attained by an individual investor. Besides, the transaction costs of large number of small investments are also substantially higher than that of large investments. Apart from that, the capital market may not be accessible to millions of small savers.

Though the changing scenario in the capital market throws open a host of new avenues and opportunities to the investing community at large, it has been recognised that “direct participation in capital market is a full-time vocation and not one suited for occasional dabbling by the workingman” (Shankar, 1999, p.12). The experience of small and marginal savers and investors in the capital market, particularly stock market, is not always lucrative and lustrous. Due to the ignorance and incorrect understanding of the intricacies involved in the market and its behavior, a large number of small and marginal investors suffer losses. Bitter experiences loom large in the minds of such investors and they are virtually driven out of the market. This is because, the real world of investing is full of political, economic and social and other forces that they do not understand sufficiently to permit them to predict anything with absolute certainty. In such an ever-changing, uncertain world of investing, decision-making on investment becomes a hard nut to crack. Here comes the need and relevance of an intermediary like Mutual Fund.

The Mutual Fund, thus, is a product of necessity. The constraints on the banking sector to tap the fruits of the capital market and the reluctance of the investors to take direct plunge into the complex and erratic capital market operation required an intermediary and Mutual Funds filled this gap admirably Mutual Funds, thus, serve as a link between the saving public and the capital markets. By the very nature of their activities and by virtue of being knowledgeable and informed investors, they influence the stock markets and play an active role in promoting good corporate governance, investor-protection and the health of capital markets. Mutual Funds have imparted the much needed liquidity into the financial system and challenged the hitherto dominant role of banking and financial institutions in the capital market (Anjaria and Anjaria, 2001, p.4).
A Mutual Fund is an institution that mobilises financial resources of the community, particularly from the household sector and allocates and directs these scarce resources from the idle to the productive sectors for increase of Gross National Product and the growth of the economy in general. The basic objective of this institution is to assist the investors, particularly the small investors to reap the benefits of capital market investments. The concept of Mutual Fund may be discerned in any joint venture or partnership. In the financial market, a Mutual Fund implies a pool of funds belonging to many individuals that is used to acquire a collection of individual investments such as shares, bonds and other publicly traded securities commonly called capital market or money market instruments (Dhar, 1994, p.675). Thus it is a common pool of money into which investors place their contribution that are to be invested in accordance with a stated objective. The ownership of the Fund is joint or mutual; the Fund belongs to all investors. A single investor’s ownership of the Fund is in the same proportion as the amount of the contribution made by him bears to the total amount of the Fund.

“The Mutual Fund is a form of collective investment that is useful in spreading risks and optimising returns. It brings a wide variety of securities within the reach of the modest of investors, and thus enables persons to achieve diversification instantly with a single investment” (Strong, 1994, p.103). Hence Mutual Funds can be said to be the matchmaker bringing together people’s savings on the one hand and investment opportunities offered by various instruments on the other.

Brigham and Weston (1997, p.36) hold that “Mutual Funds are corporations which accept dollars from savers and then use these dollars to buy stocks, long term bonds and short term debt instruments issued by business or government units. These corporations pool funds and thus reduce risk by diversification”.

In the most concise manner a Mutual Fund is a professionally managed investment company that combines the money of many people whose goals are similar, and invest this money in a wide variety of securities (Hirch, 1987). The Securities and Exchange Board of India which regulates the functioning of Mutual Funds in India defines Mutual Fund as under “Mutual Fund means a Fund established in the form of a trust by a sponsor to raise monies by the Trustees through the sale of units to the public
under one or more schemes for investing in securities in accordance with these regulations”. (Sec. 2(m) – SEBI (MF) regulations – 1993. Varma, 1996, p.1373).

In India, it will be more appropriate to define Mutual Funds as Trusts because all except Mutual Funds promoted by the Unit Trust of India have been organised and set up under Indian Trust Act 1882, with functions basically the same i.e, to accept savings from the investors and invest the same as per the objectives incorporated in the text of the Trust Deed to manage diversified portfolio for the Investors.

A Mutual Fund uses the money collected from the investors to buy those assets which are specifically permitted by its stated investment objectives. Thus, an Equity Fund would buy mainly equity assets – ordinary shares, preference shares, warrants etc. A Bond Fund would mainly buy debt instruments such as debentures, bonds or government securities. When an investor subscribes to a Mutual Fund, he or she buys a part of the assets or pool of Funds that are outstanding at that time. It is not different from buying shares of a joint stock company, in which case the purchase makes the investor a part owner of the company and its assets. In fact, in the USA a Mutual Fund is constituted as an investment company and an investor “buys into the Fund”, meaning he buys the shares of the Fund. In India, a Mutual Fund is constituted as a Trust and the investor subscribes to the “units” issued by the Fund. However, whether the investor gets fund shares or units is only a question of legal matter.

Since each unit holder is a part owner of a Mutual Fund, it becomes necessary to establish the value of his part, i.e., each unit or share that an investor holds needs to be assigned a value. Since the units held by an investor evidence the ownership of the Fund’s assets, the value of the net assets of the Fund when divided by the total number of units issued by the Mutual Funds gives the value of one unit. This is generally called the Net Asset Value (NAV) of one unit or one share. The value of an investor’s part ownership is thus determined by the NAV of the number of units held. The investment value can go up or down, depending on the market value of the Fund’s assets.

The Mutual Fund operation is simple. A large group of investors- small, medium or large—entrust their savings to the Mutual Fund. The corpus of the Fund thus becomes sizable. The amount is then invested in a wide variety of portfolios of securities in such a way as to minimise risk, while ensuring safety and steady returns and managed by a
team of investment specialists backed by critical evaluations and supportive data. The resulting earnings are distributed amongst the unit holders.

The primary objective of all Mutual Funds is to provide better returns to investors by minimising the risk associated with capital market investment. Naturally the degree of risk associated with the expected returns and associated benefits differ. All Mutual Funds aim at achieving one or more of the following (Sadak, 2003, p.95).

- Providing a steady flow of income.
- Providing high capital appreciation
- Providing capital appreciation with income.
- Providing income or capital appreciation with tax benefits.

The present study aims to evaluate the performance of Asset Management Companies (AMCs) in terms of expenses, incomes, net assets and corpus and their efficiency in portfolio management in terms of return, risk, market out-performance and portfolio diversification.

1.2 Statement of the Problem

The Mutual Fund industry has been in operation in India since 1964 and it occupies a pivotal place in Indian Capital Market for mobilising small savings and channelising it in the field of investment. This industry has grown substantially in terms of size and operations over the years and currently the industry has 29 AMCs across the sectors operating more than 600 schemes between various categories and assets under management to the tune of over Rs 2,31,000 crores.

In spite of the tremendous growth and expansion that the Mutual Fund industry in India has achieved in terms of size and growth over the four decades of its existence, a general feeling that prevailed in the financial community is that the Fund Industry did not

1 Note:- The Association of Mutual Funds in India (AMFI) has classified all the AMCs in India into six different Industry Sectors – viz-UTI, Bank Sponsored, Institution-Sponsored, Indian Private Sector, Predominantly Indian Joint Ventures, and Predominantly Foreign Joint Ventures. AMFI has also classified the various Mutual Funds operated by these AMCs in to four broad categories – Equity, Balanced, Debt and Liquid & Money Market Funds.

2 (AMFI UPDATE, March 2006, p.12)
fare well in the Indian Capital Market in the recent past particularly during the initial years of the post-regulation era. Several unfavourable developments, the market witnessed during these years are corroborative of this general belief in the market. In terms of mobilisation of funds the market witnessed violent fluctuations and the total mobilisation registered even negative growth in some years. The free entry of private sector Funds and the resulting competition in the field led to many structural weaknesses in the financial spectra. Many newly introduced innovative and novel schemes such as Money Market and Assured Return Schemes failed to takeoff and fulfil their commitments. Market witnessed loss of investor confidence and several Funds were forced to close down or compelled to adopt management changes due to mergers and takeovers.

Many socio-political factors like the uncertain political climate along with economic maladies like stock market and other financial scams might have led to a lack lustre in trading, leading to doldrums in the market scenario. Anyhow, continuing weak demand for securities during the latter part of the 1990s and the early part of the new millennium pushed the capital market into a predominantly bearish phase despite good economic fundamentals, though of late the market has, however, come out of the clutches of the pessimistic grip that prevailed more than half a decade and now continues in the upbeat mood till date.

The factors mentioned above that hindered the market are macro-economic in character that affect the capital market in a wider perspective. But researchers have identified certain specific causes which have significant bearing on the working of the capital market particularly Mutual Funds. These factors affect the working and efficacy of Mutual Funds in general and AMCs in particular and they are listed below.

1. AMCs use poor investment alternatives (Varma, 1996).
2. AMCs provide poor investment service.
3. Many Mutual Funds (AMCs) being staffed from the parent organisation are not having investment analysts with research capabilities (Avadhani, 1997).
4. Technology used for servicing of investors and for portfolio management and investment decision making is poor and the methods used are antiquated.
5. Risk diversification does not take place either in the hands of the portfolio managers or the small investors who invest a majority of their funds in a few assets (Gupta and Sehgal, 1998).

6. Too frequent turn over activity leads to superfluous diversification and cause portfolio's value squandered in brokerage commission.

7. Superfluous diversification reduces portfolio returns

8. Search for hot securities does not result into pay more than average return (Rao and Venkateswaralu, 1998).

9. Whether or not the fund managers exhibit the market timing abilities also is a matter of serious concern in the Mutual Fund industry (Shah and Thomas, 1994).

10. Loss of confidence of small investors is a serious problem ailing the Indian Mutual Fund industry (Gupta and Sehgal, 1998).

Clearly the investing public are searching for answers to many of these questions but there exists a vacuum of information essentially to be filled in. The impact of these issues on the working of the AMCs and their efficiency in portfolio management has to be gauged in depth and probed in detail and evaluated. But the fact that remains is that, despite the existence of Mutual Fund Industry for over four decades with its vast network, enormous mobilised resources and a large number of schemes and accounts, there has been no comprehensive study to evaluate the investment performance of AMCs (Gupta and Sehgal, 1998). Elaborate and in-depth studies have not been conducted to assess and evaluate the performance of fund managers from different angles such as financial, managerial, technical, Investor service, research and development and the like. Their market timing ability, their visualising calibre of the market tendencies and exercising selectivity of securities also have not been tested for validity.

The generally accepted belief is that Mutual Funds are able to outperform because of their expertise and professionalism. It is also believed that the performance of the schemes depend on the capability and efficiency of the AMCs. However, the
various studies in this area give different findings and the evidence on the evaluation of performance is not conclusive too. Not only that, none of these studies considered the impact of sector and category on the performance of Funds. As the factors affecting performance of AMCs are macro-economic too, it is felt that the sectors to which AMCs belong and the categories of schemes they operate may have significant impact on the performance of AMCs or Funds. Hence the present study is conducted concentrating on the sector-wise and category-wise evaluation of AMCs and Funds. Earlier researchers in this field also accentuate the necessity of vigorous research in this area.

1.3 Review of Literature

Review of Literature has been presented in two sections. In the first section, a brief outline of the major studies in this area in the Indian context is presented. In the second section, a brief sketch of the relevant studies in the western markets is given.

1.3.1 Studies in the Indian Market

The Indian finance literature presents only a very few cases of evaluation of the performance of the Mutual Funds. Studies highlighting the performance of the AMCs also seldom exist. However, the following are the important works available in this area.

Barua and Varma [1991] made an attempt to evaluate Mastershare scheme of UTI using the data of 1987-90. They came to the conclusion that Mastershare scheme has outperformed the market in terms of NAV. Further, they commented that Mastershare scheme benefited large investors rather than small investors, which is against the declared objectives of the UTI.

Shukla (1991) evaluated Mastershare of UTI and Canshare of Canbank Mutual Fund using the data for the period between 1989-91 and concluded that Mastershare and Canshare have outperformed the Market.

Lal and Sharma (1991) made a close look at the performance of Mutual Funds and focuses on the grey areas. It suggests a comprehensive legislation to check the creeping distortions and for ensuring the healthy growth.

Jhamb (1991) examines the overwhelming role of UTI, Canara Bank and Bank of India in the Mutual Fund industry and points out that Mutual Fund arena is the only greenfield area which contains potential for substantial appreciation. Because of their
immense financial clout the Mutual Fund promoters operate with an added advantage of acquiring big chunks of growth-oriented new shares at the time of initial issue and the designated MF schemes get an instant boost in the net asset value of these schemes.

Dave (1992) opines that the growth of Mutual Funds in future will depend on the growth of household savings, buoyancy of capital market, number of instruments and penetration of Mutual Funds in the rural areas. It is pointed out in this study that investment in securities has doubled during the previous decade while investor population remained at 1 percent as against 20-25% in developed countries.

Bansal and Gupta (1992) highlight the importance of fund management as the Mutual Funds manage the resources pooled from the public to meet their diverse needs of returns in the form of dividend or capital appreciation. They suggest that profit distribution should be more liberal.

Lal and Sharma (1992) explain the meaning and salient features of Mutual Fund and discuss the various types of Mutual Funds as well as the genesis and growth of Mutual Fund in the domestic market. Their work also contains an overview of the Indian domestic funds and offshore funds, underlining their importance for the Indian Economy.

Chander and Mahajan (1992) found that the most important factors that the investors consider in the choice of a Mutual Fund are the strong possibilities of capital appreciation and the past record of the Mutual Fund Organisation. Pure equity schemes are the most preferred and the Regular income schemes are the least preferred ones as per their study.

Saha and Murthy (1993) present a brief overview of the changing needs of the Indian households as reflected in their pattern of investments in shares and debentures over the years and its linkage with the growth of Mutual Funds and their performance. In order to provide a framework for managing the Mutual Funds in Indian context an empirical test of the important valuation models such as PER (price-earning ratio)model, BVM(Book value model) DDM (Dividend-Discount Model) for Modi Rubber Ltd. has been conducted in the study.

Francis (1993) has pointed out that portfolio performance analysis of Mutual Funds suggests that investors could expect higher rates of return and less risk if they invested their funds by selecting securities randomly.
Subramanian (1993) points out that awareness about the concept of Mutual Fund among the general public is very little. However, people who are aware of it consider them safer than Shares of new companies but riskier than bank deposits. While choosing a scheme investors look for return, safety and promoters’ reputation and customer service, in this order.

Kulshreshtha (1994) attempts an objective and critical evaluation of the state of Indian Mutual Fund Industry bringing out the fundamental strengths and the likely pitfalls for the investor. It highlights both the opportunities and the risks that the Mutual Funds offer and how to safeguard against the risks involved. It presents an in-depth analysis of the types of Mutual Fund Schemes and explains how Indian Mutual Funds are regulated; what are the grey areas to watch out for; why is it vital to study the investment pattern of Mutual Fund Schemes; how to evaluate a Mutual Fund’s Management by looking at its cost and similar areas associated with Mutual Funds.

Nayak (1994) in his article brings out the role of Mutual Fund as a vehicle that enable millions of small and large savers spread across the country as well as internationally to participate and derive the benefits of capital market growth. He cites it as an alternative vehicle of intermediation between suppliers and users of investible resources.

Shah and Thomas (1994) evaluated eleven growth schemes taking four from UTI, six from Canbank Mutual Fund and one from Indian Bank Mutual Fund and they observed that all the schemes selected have under-performed except UGS-2000 scheme of UTI. They also verified the market timing abilities of Fund Managers with the help of Henrikson-Merton technique and found only UGS-5000 scheme has displayed some faint market timing abilities.

Dhar (1994) deals with an analytical review of the performance of Mutual Funds. An analysis of growth of NAVs of pure growth schemes vis-à-vis that of equity indices for the period 1988 to 1992 has been presented. The paper indicates that performance of Mutual Funds is below the aggregate market performance if the BSE Indices are taken as proxies for aggregate markets.

Kaura and Jayadev (1995) evaluated five schemes of Indian Mutual Funds, two from UTI, one each from Can Bank MF, Ind. Bank MF and SBI MF. They concluded that
of the two schemes selected from UTI, one has outperformed the market while the others have underperformed.

Jayadev (1996) evaluated two growth schemes, one from UTI and another from SBI Mutual Fund using data for the period from June 1992 to March 1994 and concluded that the scheme selected from UTI has outperformed the market.

Nalini (1996) conducted a study to examine the impact of Mutual Funds on the deposit mobilisation of Commercial Banks in Kerala and also to review the growth of Mutual Funds and to analyse the major factors that influence the investors in adopting Mutual Fund Schemes. The study reveals that impact of Mutual Funds on bank deposits is not significant. The major objective behind investing in Mutual Fund is to earn high yield in the form of capital appreciation and/or high dividend/interest. Mutual Funds are considered as a better investment option than bank deposits due to its high yields, the study points out.

Fredman and Wiles (1997) make a detailed presentation that provides investors with the background and tools necessary to analyse Mutual Funds and to make better choices on an ongoing basis which lead to improved results.

Pandey (1998) examines the issues related to optimal investment and risk management policies appropriate to Minimum Assured Return Schemes. The paper also examines the economics of such schemes from the point of view of sponsor/investment manager and argues that the structure of such schemes requires an alternative regulatory framework and warrants a close examination by the sponsor, industry and the regulator (SEBI).

Purchure and Uma (1998) found that there is a large gap between the perception of the investment theorists and the Fund Managers. The first part of this paper formulates a Markowitz model for solving the portfolios that are efficient in a return-risk-liquidity scene. The second part of the paper derives a general version of the CAPM (Capital Assets Pricing Model) which is consistent with the empirical findings of an intercept greater than the risk-free interest rate and a slope lesser than the market excess return.

Gupta and Sehgal (1998) evaluated the investment performance of eighty Mutual Fund schemes over a period of 4 years from 1992 to 1996. Results reported in this study
indicates that Mutual Fund industry has performed reasonably well for the Indian Market, but the fund portfolios do not seem to be well diversified. This study also indicates that a positive risk-return relationship emerges for the Indian Market when standard deviation is used as a measure of risk.

Rao and Venkateswaralu (1998) examined the performance of UTI during 1964 to 1994 using the traditional and modern measures. Their conclusion is that the performance of UTI is mixed. When measured against the measures of Treynor, Sharpe and Jensen they found out-performance only in some of the schemes like US-64 and ULIP in open-ended category and Master Share in the close-ended category.

Thiripalraju and Patil (1998) evaluated 21 tax saving schemes of Indian Mutual Funds using Fama's Investment performance measures. Their conclusion is that Indian Fund Managers basically lack both the micro and macro forecasting abilities.

Thripathy and Sahu (1998) evaluated 17 Indian Mutual Fund schemes with one year data using the measures of Treynor, Sharpe, Jensen and Fama and suggested that the performance analysis should lead to adjustment of portfolios and accentuated the necessity of rigorous equity research by institutions.

Shankar (1999) in his article briefly traces the history of Mutual Funds and gives a behind-the-scene look at the operations on Custody, Fund Accountability, Unit holder Accounting and Customer Services.

Sarma and Prudvi Raj (2001) present a contemporary debate on Mutual Funds in Indian context from past experience and suggest tips to choose a more promising fund for a retail investor. They suggest to choose a leader in the industry (Fund Manager) and then choose Fund managed by them with moderate size of assets concentrating on limited number of holdings.

Turan, Bodhla and Mehta (2001) analysed the performance of as many as 54 listed schemes of UTI and the public and private sectors. The analysis has been done on the basis of the weekly data on NAVs from March 1995 to June 1998. The result of the study points out that Mutual Funds do not seem to have lived upto the expectations of the investors.
Sadhak (2003) in a structured study on Mutual Funds in the context of the national economy and capital market lucidly explains the characteristics of Mutual Funds and the benefits and risks of investing in them, describing the recent changes in the regulatory practices, marketing strategies, investment management, products distribution and service delivery systems. In addition, keeping in mind the mechanisms used by Fund Managers in developed capital markets several improvements in the strategic and operational practices of Mutual Funds such as introduction of managerial accountability, planning for risk minimisation and the like have been suggested in this work.

Sahadevan and Thiripalraju (2004) make some analysis to compare the size and growth in investment, income and expenses pattern across various Funds using data on Mutual Funds from 1964 to 1995. In this work, data and analysis of various aspects of Mutual Funds such as the profile of the public and private sector Funds, the investment pattern of the industry as a whole and of private and public sector Funds separately and the portfolio structure of individual Mutual Funds have been presented. They also present a comparison of source-wise income and expenses of all private and public sector funds individually and collectively for the period from 1991 to 1995.

Purdy (2004) argues that Mutual Funds have a positive role to play in the country’s savings revolution though in India currently they may be haemorrhaging assets at times.

1.3.2 Studies in the Western Markets

The Studies aimed at evaluating Mutual Funds in western markets considered mainly the abilities of the fund managers relating to selection of securities. Important studies among them are the following:

The literature on testing for timing ability began with Treynor and Mazuy (1966). Their conclusion was that investment managers have no ability to outguess the market.

Fama (1972) has suggested a somewhat finer breakdowns of performance. Subdividing the returns on portfolio into returns from security selection,(selectivity) and return from bearing risk(Risk) he offers a technique for knowing what has gone wrong and what kind of remedial activity is needed.
Firth (1977) studied 360 Mutual Funds of UK for the period from 1967 to 1974 and concluded that the Mutual Fund industries’ performance matches the market after providing for the adjustment for risk.

Fabozzi and Francis (1979) evaluated 85 Mutual Funds for the period between 1965 and 1971. Their study mainly focused on the changes taking place in systematic risk for Bull and Bear Markets. The result suggests that Mutual Fund Managers have not outguessed the markets.

Chang and Lewellen (1984) studied 67 Mutual Funds between 1971 and 1979 using the Henriksson-Merton method. Their conclusion is that neither skillful market timing nor clever security selection abilities are evident in abundance in observed Mutual Fund return data.

Henriksson (1984) evaluated 116 open-ended Mutual Funds for a period of 12 years from 1968 to 1980 using Henriksson-Merton technique. No evidence was found in the study that forecasters are more successful in their market timing activity with respect to predicting larger changes in the value of market portfolio.

Jagannadhan and Karajozyk (1986) demonstrated the possibility to create artificial market timing by investing in option like securities. By taking 56 years’ data using Henriksson-Merton technique they concluded that if Mutual Funds invest in less option like securities, then one would find average measured timing performance to be negative.

Cumby and Glen (1990) studied the performance of 15 internationally diversified Mutual Funds using the Jensen’s Measure. All the 15 Funds showed negative values for Jensen’s coefficient indicating perverse market timing by Fund Managers.

Huang and Wei (2001) present a simple rational model to highlight the effect of investors’ participation costs on the response of Mutual Fund flows to past Fund performance. They show that Mutual Funds with lower participation costs have a higher flow sensitivity to medium performance and a lower flow sensitivity to high performance than their higher-cost peers.
Ting (2002) analyses the relation between Mutual Fund flows and Stock Market returns and the empirical result indicates that Mutual Fund flows are affected by Stock Market returns but Stock Market returns are not affected by Mutual Fund returns.

Sjotrom (2003) in an academic study that looked at the Funds in the ‘growth’, ‘value’ ‘small’ and 'large' categories found that Funds that had changed their names over the years reviewed, attracted 22% more money than other Funds of a similar size and investment strategy that didn’t change their names.

Bogle (2004) addresses some vital emerging issues that have come to light in the Mutual Fund field such as the Mutual Fund fees, relationship between fund fees and fees paid by pension funds, the appropriate structure of Mutual Fund governance and the like.

Cremers, Maenhout and Weinbaun (2005) using a unique database on the ownership stakes and compensation of Equity Mutual Fund Directors investigate whether the Directors’ incentive structure is related to Fund performance. They found in their work that the governance plays an economically substantial and statistically significant role. The ownership stakes of both independent and non-independent Directors matter for Fund performance.

Zheng, Nanda and Wang (2005) examined the diversified domestic equity funds from 1993 to 2000 to see how the transition to a multiple class structure affects the fund cash flows, investor clientele, performance and expenses. It is found that the switching from a single A class to a multiple-class fund increases the overall fund cash inflow initially by an estimated 12%, but switching to multi-structure hurts overall fund performance.

Jensen (2006) in a survey of American Funds claim that though one would think that Mutual Funds provide benefits to shareholders by hiring ‘expert’ stock pickers, the sad truth of the matter is that the vast majority - approximately 80% - of Mutual Funds underperform the average return of the stock market. It is revealed in this study that the majority of the Funds fall short because of the fees they charge on the investors known as ‘sales loads’ or ‘purchase loads’.

Josh and Wright (2006) found in the survey they conducted that the Mutual Fund Investors focus primarily on fees, historical performance and risk when purchasing Funds.
and around two-thirds of investors do not consult fund prospects or shareholder reports in making their purchase decisions.

1.4 Objectives of the study

The primary objective of this study is to make a comprehensive and in-depth analysis and evaluation of the Asset Management Companies, their financial, managerial and technical performance with a view to bring to light their managerial, financial and technical strengths, weaknesses.

The study inter-alia attempts to probe into the efficiency of the Fund Managers (AMCs) in portfolio management, by analysing and evaluating the investment performance of the schemes operated by the AMCs during the fourth phase (Current Phase) of its development in the Indian Financial Market and the other propositions related to it. ³

The overall objective of the study is to enquire into the working of the AMCs and operations of the schemes they manage with a view to evaluate the performance of the AMCs and assess the efficiency of performance of the schemes they operate. Also, to throw some light on the various aspects of the wide spectrum of Fund industry internally and globally.

To put in more specific terms, the objectives of this study are:

1. to evaluate the financial performance of the AMCs by analysing expenses, incomes, net assets and corpus and examine their structural composition and behaviour pattern, industry sector-wise and Fund category-wise.

2. to analyse and evaluate the role of individual items of expenses and income on the overall incomes and net assets of the AMCs on the basis of industry sectors and Fund categories.

³ As per AMFI, Indian Fund Industry has passed through four phases and now is in its fourth phase since 1996.
3. to examine whether various sectors of AMCs are able to generate income commensurate with the expenses they incur, corpus they posses and net assets they hold.

4. to ascertain whether various sectors of AMCs are able to generate net assets, commensurate with the expenses they incur, income they produce and corpus they hold.

5. to assess and evaluate the investment performance of various AMCs across the sectors and between categories in terms of Risk, Return, Portfolio diversification and Market Timing Abilities.

6. to examine whether the schemes operated by the AMCs outperform the market

1.5 Hypotheses

The following hypotheses pertaining to the AMCs and their performance in the Indian Mutual Fund Industry have been formulated, based on the objectives of the study:

1. There are sector-wise and category-wise differences in the overall structure and composition and behaviour patterns in the expenses, incomes, net assets and corpus of Mutual Funds.

2. The incomes of AMCs are independent of the net assets, corpus and expenses.

3. The performance of AMCs in terms of net assets is independent of the corpus, income and expenses.

4. There are sector-wise and category-wise difference in the performance of AMCs.

5. There are sector-wise and category-wise differences in the risk perception and risk characteristics of Mutual Fund schemes.

6. Fund return is a function of their risk.

7. Mutual Fund schemes outperform the market.

8. The performance of similar schemes of different Funds and different schemes of same Fund are different.

9. Mutual Fund performance depends on diversification and market timing.
1.6 Methodology

Description regarding the nature of the study, collection of data, tools of analysis, method of processing data and the scheme of analysis have been presented in methodology.

1.6.1 Nature of the Study

The study is analytical and descriptive using secondary data available from published sources. The expenses, income, net assets and corpus of the AMCs as well as the NAVs of the schemes operated by them over the study period are analysed using various tools of analysis and the structural compositions, behaviour patterns and the interrelationships among variables have been described highlighting their notable features. A brief description regarding the origin and growth of Mutual Funds and the current scenario of the global and Indian industry also have been presented in the study.

1.6.2 Collection of Data

Consolidated data pertaining to the expenses, income, net assets and corpus of the Funds operated by the AMCs across the industry sectors, and between the various Fund categories, have been collected for a period of five years from 1996 to 2000 through a complete enumeration mode, from various published sources such as AMFI records, Company websites and Annual Reports of Assets Management Companies.

Data pertaining to the average monthly NAVs of 190 schemes are collected for a period of 36 months from September 2002 to August 2005 on a purposive sampling basis from a total of 581 schemes that existed in August 2005. Only those schemes which have a continuous NAV history of 36 months as on the cutoff date have been included in the sample as per the standard method followed internationally. NAV details have been collected primarily from Mutual Fund Insight (various issues) AMC websites, Annual Reports of Asset Management Companies and other journals and periodicals. The data collected thus have been classified and cross-classified on the basis of industry sectors, Fund categories, period and individual items of expenses, income, corpus and net assets. Monthly NAVs also have been classified on the basis of industry sector of AMCs and Fund categories for analysis purposes. Monthly averages of the BSE 30-share Sensex of 36 months corresponding to the period of monthly NAVs are
collected from BSE records and used in computation of Beta, R-square and Portfolio Alpha. In order to work out the risk-adjusted measures such as Sharpe and Treynor ratios and Portfolio Alpha, the annual rate of interest on fixed deposits in Nationalised Banks have been used.

1.6.3 Tools of Analysis

Analysis of the performance of AMCs has been conducted using the important financial ratios and other relevant statistical tools. In particular, the tools employed are:

1. **Ratio Analysis:** Various Financial ratios that bring out the structural composition and inter-relationships between the variables namely, Expense ratios, Income ratios, and Trend ratios have been employed in analyses of expenses, income, corpus and net assets.

2. **Standard Deviation:** For risk analysis of the schemes across the sectors and between categories, Standard Deviation is applied.

3. **Beta Co-efficient:** In order to measure the sensitivity of the Funds to fluctuations in the market index and thereby to assess the market risk of the schemes the Beta is worked out (Sharpe, Alexander and Bailey, 1996, p.929).

4. **Sharpe and Treynor Ratios and Portfolio Alpha:** For evaluating the performance of schemes, Sharpe Ratio, Treynor Ratio and Portfolio Alpha have been applied (Sharpe, Alexander and Bailey, 1996, p.929).

5. **R-square:** This statistic indicates how much of fund’s fluctuations are attributable to movements in the overall market. It is also used to gauge the degree of diversification resorted to by Fund managers (Strong, 1994, p.48).

6. **ANOVA:** In order to test the statistical significance of various ratios and percentages ANOVA (both one-way and two-way) is applied wherever appropriate, at 5% level of significance.

7. **χ² test (chi-square):** In order to test the association or dependency relationship between variables, χ² test is applied wherever appropriate.
8. **Multiple Regression Analysis**: In order to ascertain whether the AMCs produce income commensurate with the incurrence of expenses, net assets and corpus and net assets commensurate with the expenses, income and corpus, multiple regression model is applied to predict the income and net assets (statpages.org).

### 1.6.4 Processing of Data

Processing of data has been done using computer programmes, both off-line and on-line. Computations of ratios pertaining to expense analysis, income analysis, corpus and net assets analysis and the various ratios in respect of NAV analysis such as Standard Deviations, Beta, Sharpe and Treynor Ratios, Portfolio Alpha and R-square have been made using Microsoft Excel. The average monthly percentage returns computed from the average monthly NAVs of the 190 schemes pertaining to 36 months have been utilised in computation of the various ratios in respect of NAV analysis. For the computation of variance ratios, Chi-square and Multiple Regression values, an online programme - the Interactive Statistical Pages Project is used.  

### 1.6.5 Analytical Framework

Comparative analysis and evaluation of all the AMCs belonging to the various industry sectors such as UTI, Bank-Sponsored, Institution-Sponsored, Indian Private Sector, Predominantly Indian Joint Ventures and Predominantly Foreign Joint Ventures have been made in this study. Aggregates of expenses, income, net assets and corpus of the AMCs, classified on the basis of Industry sectors, as well as various Fund categories such as Equity Funds, Balanced Funds, Debt Funds, and Liquid and Money Market Funds have been put to a multi-pronged analysis to bring out their structural composition, behaviour pattern, and other characteristic features that throw light on the overall performance of the Fund Industry. In order to test the various hypotheses

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4 statpages.org - developed by John. C. Pezzullo (jc12345@gamail.com), which represents an ongoing effort to develop and disseminate statistical analyses software in the form of web pages, which contain within it all the programming needed to perform a particular computation, is made use of.
developed in the study, ANOVA (both one-way and two-way) as well as Chi-square test have been applied wherever appropriate. The significance of the variations in the structure and composition of expenses, income, net assets and corpus as well as variations in the expense-income and income-net assets relationships across the sectors and between categories have been tested using ANOVA. The variations in the different measures of Fund performance also have been tested for statistical validity using ANOVA. The variations, if any, between the actual income/net assets and the predicted income/net assets have been tested for validity using $\chi^2$ test.

1.7 Limitations of the Study

As the scope of the study is restricted to analysing the expenses, income, corpus and net assets and NAVs sector-wise and category-wise, no attempt is made to go in to the analysis of individual AMCs. Analysis of Scheme NAVs also is done in a macro-setting. Hence, individual schemes are not considered. The period of study is from 1996 onwards. While the data for analysis of expenses, income, net assets and corpus pertain to 1996-2000 period, the data for analysis of NAVs do not pertain to this period, as there were only a few schemes with continuous NAV history of more than 36 months during the initial years of the post-regulation period. The limitations inherent in the use of secondary data are operative in this study too.

1.8 Organisation of the Study

The present study is presented in six chapters. Chapter 1 is the introductory one which introduces the problem, presents the need and importance of the study, its objectives, the hypotheses, methodology adopted including collection of data, tools used for analysis, processing of data, and the framework of analysis. A brief outline of the limitations of the study also has been included in this chapter.

Chapter 2 deals with the genesis and growth of Mutual Funds and an overview of global scenario. It deals with the historical background and the theoretical concepts and related aspects of the Mutual Funds. It details the different types and categories of Funds, the structural composition and constituents of the Fund Industry, the tools and techniques used to evaluate the Funds and AMCs in a broad manner and a broad outline and overview of the global picture.
Chapter 3 contains a detailed picture of the Mutual Fund industry in India with regard to its various aspects till 2006. The overall growth of Mutual Fund industry over the period has been dealt with in this chapter. It also gives a clear picture of the Profile of the AMC in India during the post regulation period.

Chapter 4 presents the detailed analysis of the expenses, income, net assets and corpus of the AMCs across the sectors and between categories. It is divided into 3 Sections – A, B & C. Section A deals with the detailed analysis of expenses. Section B presents the analysis of income and Section C presents the analysis of net assets and corpus, over the period of study.

Chapter 5 is devoted to the analysis of the Scheme NAVs, in respect of 190 schemes over the study period, to evaluate the efficiency of Fund Managers in portfolio management.

The sixth and final chapter presents a summary of the findings and inference and some suggestions based on the findings of the study.