CHAPTER: 1:
INTRODUCTION
1.1 Introduction:
Before 1947 there was no strong financial system existing in the country. During the period of 1947 to 1948 it was anarchy in the operating financial mechanism in the country, due to lack of participation of financial intermediaries and institutions in the financial operating system in the country. The industrial and business sector was not able to fulfill their financial requirement that’s why industrial growth was very poor. The primary capital market was very inactive and introvert. The unorganized and private players play a vital role for maintaining the liquidity in the country. In short the chaotic circumstances raised in the economic system of the country. Some serious attention was drawn towards the financial system in India at the time of planning phase. Most of the economist recommended for the adoption of the mixed economy theorem. The planner of Indian economy tries to adopt the balanced economy, which has beneficial for socio economic and political areas. The existing government was started establishing various financial institutions for fulfilling the requirement for industries and agricultures; it also started nationalized financial institution for providing the finance without any interruption. This was the first step of economic reforms in Indian financial system.

The era begins in the year of 1948 were the nationalization of financial institutions started. Large financial institutions like banks & insurance companies were nationalized to avoid the loopholes in the economy. During the 1960’s public were mostly aware about the saving, investments and consumptions. They
were familiarized with the financial system. Establishment of UTI in 1964 was the creating a benchmark in Indian financial system, the main objective of UTI is to collect the fund from small investors and general public, those funds directly transfer to the corporate giants and industries. UTI is one of the largest and oldest mutual funds in the country. Later on the other private sector companies and financial institutions adopted this mechanism and started to mobilize fund through the concept of mutual fund.

During the 1970’s a lots of structural changes had been occurred in the financial system. Financial system was developing very fast, establishments of development banks play a vital role in the economy. The government has established MRTP act in 1970 for the monitoring & regulating the newly established financial system. The really was continued in the year of 1980’s many more financial institutions like NABARD (1982), EXIM Bank (1982), NHB (1988), etc were established with the support of government during this time period.

The major policy of Indian economy had changed from 1990 onward. The era has begun with the economic reform called as liberalization, privatization and Globalization (LPG Policy). The basic theme behind the LPG policy is to create new opportunities and open a door for global players, the result of LPG policy was spread the Indian economy become a competitive and growing economy in the world. The continuous reforms undertaken with respect to financial sector, trade areas and industrial sector aimed to become a more efficient and prominent economy among the world. During this time period the central
government has decided to allow the foreign investment among the specialized sectors. The purpose behind this policy was that active participation of the foreign players in the Indian economy.

A remarkable development in the reorientation of the Indian financial system in the post 1991 years was reflected in the structural growth of mutual fund industries. Later in the year 1993, in the wake of policies of liberalization and globalization, the government also permitted the private sector to enter into the mutual funds business. As a result, the industry has now become more competitive. At present the industry has four different types of categories, UTI, mutual funds sponsored by public sector banks, mutual fund sponsored by financial institutions and mutual funds sponsored by the private sector.

The 1993 rules and regulations related to mutual fund operation has been revised and amended on the basis of general recommendations of the Mutual Funds 2000 Report prepared by SEBI. The amendment strongly concern with the governance of mutual fund operation and increases the accountability and responsibility of the trustees in supervising the functions of the asset management company. As per revised regulation, the prior permission has been taken from the investor and unit holder for changes in fundamental attributes of a mutual fund schemes. The revised rules and regulation emphasizes on the mandatory disclosers of portfolio composition, transaction with the asset management, sponsors, and trustees, personnel of asset management company and fund manager by the mutual fund scheme. The revised terms of the regulation has been drawn in favour of the investor’s protection. From the 1993
onward the new era has started in the Indian mutual fund sector with the private players like J. P. Morgan, Capital international and Morgan Stanley. During this time period the first time mutual fund rules and regulation came into existence. SEBI (Security exchange board of India) was imposed a mandatory requirement for all mutual fund schemes exist in India have to be registered under the SEBI’s guidelines. SEBI has also introduces a various governing body to protect the interest of investors against the fraud and malpractices in mutual fund operation.

Up to the end 2008, the number of players in the mutual fund industry increased with 46 fund houses operating in the country.

The mutual fund industry plays a vital role in the world economy and also contributes higher values towards gross domestic products and net national products of any nation’s economy. The main reasons behind the success stories of the mutual fund are earning capabilities, volume base growth, products and services offered and of course also international players provides the huge contribute to the growth of the industry. Today the mutual fund industry offers a variety of products and schemes from the various areas of financial instruments.

Mutual funds are emerging as the back bone of the India capital market and as the vehicles for institutionalization of security investments for the relatively small investors. Mutual funds companies operate within the rigorous and comprehensive framework prescribed by SEBI to promote the sound and healthy growth of mutual fund industry, consistent with the investors’ requirements. The reorganization of the UTI recently, has added a new dimension to growing the
significance of mutual funds as a highly vibrant component of Indian financial system.

India economy stood among the fastest growing economy in the world. The huge potential market is also opened for the mutual fund industry; this would accelerate the growth of the industry. Generally Indian economy called as a saving economy, 80% of population has saved more than 35% of GDP rate. The present saving shell channelized in the mutual fund industry as it offers a variety of investment avenues. In India there is a huge scope for mutual fund sector in tire I and Tire II cities. Further scope is open from agriculture sector and other allied sectors for mutual fund players from the rural areas. It is predicted that mutual fund sector would grow at a rate of 30% to 35% in next five years, and it will reach 300 Billion USD by 2015.

As it can be noticeable, there is huge and potential growth in the mutual fund sector. The mutual fund industry is very sound and growth oriented in the next future based on the continuous developmental activities in this sector.

**1.2 Mutual funds – A conceptual framework:**

This part contained discussion about the various aspects of mutual funds and it’s also focuses on the theatrical perspective of mutual funds. This part divided into two sections. Section 1 discuss about the conceptual frame work of mutual funds while section 2 concern with the theoretical aspects of the mutual funds.

**1.2(A) Mutual fund: The Concept:**

A mutual fund is a big professionally managed investment organization that combines the money of many individuals’ investors having different kinds of
investment objectives. It invest this money in a wide range of securities and individuals investors share its income and expenses, its profits and losses, its capital appreciation and growth in proportion to their share holding. In other words, a mutual fund is a type of an investment avenues, which mobilizes saving of individuals and institutions and channelized these saving in corporate securities to provide investors steady stream of return and capital appreciation.

For the purpose of achieving the common financial goals a trust of mutual fund collect the fund from small number of investors. The money which has collected from the retail investors is invested in various money market and capital instrument such as equity share, bond, debenture and other liquid securities. The income generated from the investment distributed among the shareholder or unit holders as a return on the investment, so the mutual fund provide to opportunities for the retail investors to invest their money in diversified and well constructed professionally managed portfolio at relatively low cost. The below charts describe the general mechanism of mutual fund operation.

(Figure: 1.1: Mutual fund operation flow chart)

(Source: http://finance.indiamart.com/india_business_information/mutual_funds_concept.html)
Investors are investing a small part of money in the mutual fund with the advice of the fund manager, now fund manager invest their fund into the various kind of securities. Securities are generates the return as per the mutual fund schemes and generated return would be passed back to the investors.

When we are talking about Indian mutual funds industries, it’s wholly control and managed by Securities and Exchange board of India Mutual Funds Regulations 1996. It is a prime and apex governing body for monitoring the various investment avenues. They are also concern with the investor’s protection with respect to the available financial options.

The detailed definition of mutual fund is a kind of trust which manages the pool of resources collected from the various retail investors and it is also managed by professional team of fund managers with charging a small amount of fees. The overall investment made by the mutual fund in bonds, equities and other call money market instruments etc., based on terms of each schemes floated by the mutual fund. The value of present investment calculated on day to day basis and the same value reflected in the NAV declared by the funds by time to time.

This NAV can change due to change in the value of bond and equity market, therefore the investment in mutual fund is quite risky; but professional fund managers continuous make alteration in the portfolio time to time and generates higher return as compare to the other financial asserts and fixed assets.
1.2(A) (A) classification of Mutual funds:

Most of the mutual funds are classified into three different classes (I) Portfolio classification of Mutual funds (II) Functional classification of mutual funds (III) Geographical classification of Mutual funds

(I) Portfolio classification of Mutual funds:

In this category different variety of securities which comprise the portfolio. Funds are designed with the help of risk and return profile of different type of investors. It means the objectives of the funds differ as per the schemes. The various numbers of schemes under the head of portfolio classification are Income funds, balanced funds, growth funds, gilt Fund, money market funds, index funds, tax saving funds, systematic withdrawal plans, and sector funds. Now, various schemes are briefly discuss mentioned above. Income fund is a type of a mutual fund or unit trust that seeks steady, constant and high income instead of increase in value of net assets by investing in securities that gives higher return. Another is a balanced funds generally it able to produce the constant return and capital gain with a minimizing the risk components, the balance fund portfolio comprised the equity stock, preferred stock and other liquid debt securities. Sometimes the balance fund is also called as a hybrid fund because of investors have satisfied their financial objectives from the single mutual fund scheme. In general balance fund is more suitable when investors wants to stable growth and constant return for their financial needs. Capital appreciation in the stock value through the increase in the price of securities is called as a Growth fund. They
focus on companies that are experiencing significant earnings or revenue growth, rather than company that payout dividend.

Gilt funds stick to high quality-low risk debt, mainly government securities. Gilt fund differ from the other debt securities, it’s associated with the comparative low level of risk but generate a higher return. Money market funds are highly liquid and safe funds. This fund consists of cash and cash equivalent high rated debt issue. A money market fund's purpose is to provide investors with a safe place to invest easily accessible cash-equivalent assets characterized as a low-risk, low-return investment.

An inactive portfolio of mutual fund focuses on the key performance of a specific index like BSE 30, Nifty 50 and S&P 500 etc., generally index fund portfolio have a less expanses and transaction as compare to the actively managed portfolio funds. In India tax saving funds are more attractive under these category, because investors are availed the tax advantage under section 88 of The Income tax act 1961. This type of portfolio is also called as equity linked saving schemes. In India tax saving fund usually have a three years maximum lock in period as per SEBI's guidelines. The constant amount of payout to the unit holders at specific intervals like monthly, quarterly, semi annually and annually, known as a systematic withdrawal plan in tax saving fund. The next type of fund is sector fund; the portfolio of the sector fund is concern with individual and specific sector. The money of the retail investors are directly invested in the specific sector’s stock. These type of funds focuses on specific sector or segment of the economy such as banking, FMCG, energy, technology, real estate, health care, power,
pharmaceuticals and infrastructure etc., the theme behind these kind of portfolio is to permit the investors to invest their money in growth potential sectors of the economy. Sectorial mutual funds are also called as thematic funds.

(II) Functional classification of mutual funds:
According the functionality mutual funds are classified into two different categories open-ended funds and close-ended funds. Further description regarding to the in open-ended funds, there is no limit to the size of funds. Investors can invest as and when they like. The purchase price decides on the basis of Net Asset Value (NAV). NAV is the market value of the funds assets divided by the number of outstanding share/units of the funds. Open-ended funds are most popular investment avenues among the various classes of investors. Now close-ended funds are fixed in size as regards the corpus of the fund and the number of the shares. In close-ended funds, no fresh units or shares are created after the original offer of the scheme expires. The shares or units of these funds are not redeemable at their NAV during their life as are in case of open-ended funds. The share or units are traded in the secondary market on the recognized stock exchanges at market price that may be above or below their NAV.

(III) Geographical classification of Mutual funds:
A mutual fund that operates within a country’s boundaries by mobilizing saving of its citizens within the country are called domestic mutual funds, on the other hands, funds those are meant for subscription form foreigners or from a country’s citizens outside its shores are known as a offshore mutual funds.
1.2(B) Mutual fund: A Mechanism:

Securities exchanges board of India is described the mechanism to establish the mutual fund organization. Various parties involved to establish a mutual fund organization. A mutual fund can be constituted either as an entity or as a trust. In India, it is mandatory to have a three tier structure of Sponsor-Trustee-Asset Management Company. Custodians and transfer agents or register are also involved to establish a mutual fund company. They are also subsidiary part of a mutual fund company for smooth operation purpose. The diagram below illustrates the organizational set up of a mutual fund company.

(Figure: 1.2: Organization structure of a mutual fund company)

![Organization structure of a mutual fund company](http://finance.indiamart.com/india_business_information/mutual_funds_organization.html)

The person or group of persons acting individually or jointly with another corporate organization to establish a mutual fund is called a Sponsor or sponsors of mutual fund. The sponsor or sponsors or group of persons establishes the mutual fund and registers the same with SEBI. Sponsor appoints the Trustees, custodians and the AMC with prior approval of SEBI and in accordance with
SEBI Regulations. Sponsor must have a 5-year track record of business interest in the financial markets. Sponsor must have been profit making in at least 3 of the above 5 years.

The 40% of contribution provided by the sponsor of total net worth investment for matching the initial eligibility criteria, which have mentioned in the SEBI (Mutual fund) regulation 1996. The person or group of persons acting as a sponsor is not accountable for any loss occurs before its initial contribution for setting up a mutual fund.

As per the provision of the Indian trust act 1882, mutual fund called as a trust which has established by the sponsor. As per prescribe format given in the India registration act 1908, the mutual fund trust must have to prepare the deed and also registered under the provision of this act.

A company and body of individuals consider as a trustee and board of trustees. The general roles and responsibility of the trustees is to protect the interest of the mutual fund holders and the functions of the asset management companies are also concentrating on the safety of the unit holders which has prescribed by SEBI Regulation 1996. As per the rules and regulation the minimum 2/3 appointed directors are not connected with the sponsor in any subject manner and also called as independent director.

Asset Management company act as a investment manager of the mutual fund and it has appointed by the trustees. First prior approval taken from the SEBI for act as a investment manger for AMC of mutual fund. AMC appointed more then 50% of the individual directors who are not connected with the sponsor. All the
AMC who act as investment banker must have hold the minimum Rs. 10 Crores of net worth at any point of time.

The Asset Management Company can appoint the registrar and transfer agent for any mutual fund as prescribe in the trust deed. The primary roles and responsibility of transfer agents and registrar to communicate with investors or unit holders and regularly dispatches the account statements to respective unit holders, also maintain the updated track records for any mutual fund schemes.

A Custodian is an agent, bank, trust company, or other organization which holds and safeguards an individual's, mutual funds, or investment company's assets for them.

By investing in various mutual funds schemes low income investor or middle income investors are getting the extra benefits compared to the other investment vehicles. Investment Variety and fund spread in to different industries. Capital appreciation without having to watch the upward or downward performance curves of different scripts. Investors are also availed the advantage of professional management to manage their investment. Fund manger constructs the portfolio with their level best of skills and also diversified the constructed portfolio in the small time duration for generating the handsome returns. To save the interest of the unit holders from fraud and malpractices Mutual fund organization must have to follows the certain rules and regulation which is framed by the central government. Mutual funds are highly liquid assets, any time you can easily converted into cash. Funds are also having some extra advantages like low cost, transparency, flexibility, tax benefits, well regulated,
convenience etc. Every coin has a two side let us discuss about the drawbacks of the mutual funds. Risk component always associated with any financial assets. If the whole stock market declines it is obvious that the entire value of the mutual fund portfolio is also decline even though it’s a balance fund or portfolio. Most of the funds collected administrative expanses as fees to cover their regular operating expanse that means those who are interested to invest their money in mutual fund are paying a higher fees and commissions. During the typical year, most actively managed mutual funds are transacted very frequently the burden taxes are higher then the passive funds. Management risk is always associated with the mutual fund operation. Investors are depended on the fund manager’s decisions. One wrong decision may raise a huge potential loss for investors.

1.3 Importance of the study:

In India 70% to 80% investors are belongs from the low or middle income groups. Majority of the investors are preferred to invest their funds in to low level of risk with secure returns. Mutual funds are the most favorable investment vehicles among these groups. It is interesting and important to study the performance of the various mutual fund schemes with the different expectation of individual investors who belongs from the above groups. Mutual funds represent that range of pre-packed products that enable us to implement investor’s future financial plans.

This study tries to investigate various available risk-return combinations for investment purpose. It is also concerns with those investors are already investing
their money in the mutual funds, who wants to hold their current investment for long time horizon as per the risk-return analysis.

Mutual funds enable to focus on the core future planning needs, without frittering away our time doing elaborate chores that can be efficiently outsourced. The present study can be of great help to research agencies, academicians, mutual funds investors, business school students, mutual funds companies etc. The study focuses on the present & future scenario in the mutual funds industry, which is concern with the rapid changes in the capital market with respect to the investor’s preference. An attempt is made to cope up with the problems facing by the investors that earn handsome return with the minimum level of risk. For testing the performance of various mutual fund schemes I have take 51 schemes from different investment companies according to risk & return criteria.

1.4 Plan of the study:

There are seven chapters in the thesis. After this first chapter of introduction, second chapter is on industry overview. The basic objective behind this chapter is to provide a general aspect and overview of the mutual fund industry in which the study was undertaken. Third chapter about the literature review related to the topic of the study. Forth chapter contained the research part based on the secondary data and it’s also concern with the performance evaluation of various mutual fund schemes. Fifth chapter represents the finding based on the primary research as well as secondary research. Sixth chapter is associated with the conclusion part and last part of the thesis chapter seven is about the recommendations and suggestions.