CHAPTER 1

INTRODUCTION
INTRODUCTION

Mutual funds have become an overly attractive investment media in the capital market for both corporate and retail investors. They are very cost beneficial, simple and do not require an investor to figure out which securities to invest into. Investors’ want the ‘best brains’ to look after their money. The exclusivity of the fund manager lies in providing guaranteed superior returns year after year. (Shanmugham R., 2011)

During the last few decades, the global financial scenario has witnessed several significant developments, one of which is the initiation of new and innovative financial services. The phenomenal growth of the global capital market is an interesting phenomenon and has been accompanied by the advent of the ‘equity cult’ among the household sector. The household sector, which constitutes the surplus funds, despite having disposable income tends to be psychologically ‘risk neutral’ or averse. Therefore institutional shields have been created whose role is to act as intermediaries between the people who have the ability and propensity to save (the household sector) and those (the corporate sector) who require money and must borrow. This is the historical necessity, which has given rise to the concept of “Mutual Funds”.

Mutual fund is an American concept and the terms ‘Investment Trust’. ‘Investment Company’, ‘Mutual Fund’ etc, are being used interchangeably in American literature. Investment Company as defined in the US Investment Company Act of 1940 is "any issuer that is or holds out as being engaged primarily or proposes to engage primarily in the business of investing, reinvesting or trading in securities is engaged or proposes to engage into the business of issuing face amount of certificate of the installment type or has been engaged in such business and has any such certificates outstanding, is engaged or proposes to engage in the business investing, reinvesting, owing, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40 percent of the value of such issuer’s total assets (exclusive of Government securities and cash items) on an unconsidered basis”.

In British literature, mutual fund has not been defined. However, it is considered a synonym of investment trust of the USA. Similarly, in India also mutual fund and investment trust are used as interchangeable terms.
In the Indian context a mutual fund is a corporation trust or partnership that combines the assets of all its shareholders or partners into one common investment account for the purpose of providing diversification and professional management. This combining or “pooling” allows thousands of investors to share, according to their amount of investment, the performance of the fund that is managed with what is presumed to be expertise. By means of the many stocks, bonds or other financial instruments in the fund’s portfolio the investor gains access to a wide range of securities. Managers of mutual funds also provide a variety of services not otherwise available to small investors. (Bhole L. M.,1993)

Taking the ‘pool’ of money and investing it in the securities of a wide range of companies, industries and government enterprises, managers of mutual funds decide when to buy, sell or hold the securities in order to achieve the objective of the fund. The individual investor should know what the objectives of the mutual funds are, in which he or she is considering investing and on the basis of these objectives, determine which fund is suitable for his or her own needs.

Different scholars have defined mutual fund differently. Some of the definitions are given as follows:

According to Micheal H.B. “A mutual fund is professionally managed investment company that combines the money of many people whose goals are similar, and invests this money in a wide variety of securities.”

According to Sambammurthy B. “Mutual funds as corporations which pool funds and reduce risk of diversification.”

“Mutual funds are financial intermediaries which bring a wide variety of securities within the reach of the most modest of investors.”

According to Kulshreshtha C.M. “Mutual fund as financial intermediaries which pool the savings of numerous individuals and invest the money thus raised in a diversified portfolio of securities, including equity, bonds, debentures and other instruments, thus spreading and reducing risk.”

According to Vinayakam “A mutual fund is an indirect investment made by the public by pooling its resources. The fund comprises equal units / shares / certificates and
the public invests its saving in their depending on the quantum of resources available with individuals.”

According to Franks R.K. “Mutual fund as a pool of funds belonging to many individuals that is used to acquire a collection of individual investments such as stocks, bonds and other publicity traded securities.”

The above-mentioned definitions reveal the following:

1. Mutual funds gather scattered small savings into common funds of sizeable amount.
2. Funds collected by mutual funds are invested in securities of different companies.
3. Mutual funds employ experts for professional portfolio management.
4. Due to diversified portfolio, the risk is spread out and a stable return for an investor becomes possible.
5. The earnings of mutual funds are distributed amongst the investors after deducting the management costs.
6. Small investors can benefit from stocks/securities which are beyond reach.

Thus, mutual fund is an excellent investment vehicle, which provides the benefit of diversification, professional management and liquidity and provides opportunities to the public for investing their savings, depending on the quantum of resources available.

The flow chart below describes broadly the working of a mutual fund.

**MUTUAL FUND OPERATION FLOW CHART**

![Mutual Fund Operation Flow Chart](source: www.amfiindia.com)

Figure 1.1
1.1 CHARACTERISTICS OF MUTUAL FUNDS:

Some significant characteristics of mutual funds, which are universal in nature irrespective of the type of fund, are discussed below. (Jeol, 1988)

(i) Mobilization of Funds: Mutual funds mobilize small investors’ saving by launching schemes designed to conform to their investment preferences. Thus scattered savings are garnered into a common fund of sizeable amount and invested in a number of securities. Thus the small investors are made participants in the prosperity of a large number of companies.

(ii) Managed by Experts: Mutual funds employ experts in investment and portfolio management to manage the funds, professional managers can easily tackle the purchase and sale without giving pain of paperwork to the individual investors.

(iii) Diversification of Risks: The investible resources of mutual funds are invested in the scrip of a number of companies so as to ensure the diversification of the portfolio, resulting in reduction in the magnitude of risk.

(iv) Sharing Returns with Investors: The returns earned on the numerous scrip that make up the portfolio of mutual funds are distributed among the investors after the management cost have been met. The return earned depends on the value of the underlying portfolio and on the various scrip that makes up the portfolio.

1.2 ADVANTAGES OF INVESTING IN MUTUAL FUNDS:

In several ways, mutual funds are unique among the many investment vehicles available, other investment alternatives have one or more of the following advantages, and few, if any possess the many advantages of mutual funds. (Anjaria, et.al., 2001)

(i) Convenience: Mutual funds free the investors from the time consuming mechanics involved in the direct purchase of single securities in an individual portfolio. They do not have to constantly monitor the stock market trends and switch securities, which would have been necessary had they invested directly in the market.
(ii) Liquidity: Mutual funds are liquid investments as there are provisions for redemption of the shares of these funds. They are buy back arrangements under which the mutual funds institutions offers to buy the shares of the investor at specific prices which they announce after regular intervals. Some mutual fund shares are also listed on the stock exchange and can be sold off by the investors at the prevailing market price. So investments in mutual funds provide the investors the benefit of liquidity. Many companies launched mutual fund with the objective of liquidity e.g. Principal Cash Management Fund launched on October 25, 2000 by Principal PNB, Reliance MF launched Reliance Liquid Fund on November 16, 2004, SBI MF launched SBI Magnum Insta Cash Fund, similarly UTI MF launched UTI Liquid Fund on June 2003 and Pru ICICI MF launched Pru ICICI Liquid Plan on 31 March 2002.

(iii) Professional Management: Most people do not have the time or experience to choose and manage their own investments. Those who want to manage their own investments have a variety of problems such as inside trading, fluctuations in the stock market, paper work involved in purchasing and disposing of securities. It would be difficult for investors to individually get such help. Professional managers are in a position to tackle these problems better than individual investors. Highly skilled managers who have a sound knowledge of the market and wide experience in investment manage mutual funds. Example Fund Manager of UTI. manages majority of the fund of UTI Mutual Fund i.e. (UTI Liquid Fund, UTI Money Market Fund, UTI Floating Rate Fund, UTI G-sec Short-term Plan, UTI G-sec Investment Plan, UTI Monthly Income Scheme etc). Fund manager of HDFC Mutual Funds (HDFC Growth Fund, HDFC Capital Builder Fund, HDFC Index Fund, HDFC Children’s Gift Fund, HDFC Balanced Fund, HDFC Tax Plan 2000, HDFC Tax Saver). Similarly SBI Fund Manager manages SBI Mutual Fund i.e. (SBI Magnum Balanced Fund, Magnum Index Fund, Magnum Equity Fund, Magnum Multiplies Plus 1995, Magnum Global Fund, Magnum Tax Gain Scheme 1995).

(iv) Risk and Return: Individual investors have to face company – related risks (unsystematic risks) and market – related risks (systematic risks). The former arise from wrong selection of investments, non-performance of the company,
inadequate monitoring of performance etc. Market related risks arise from the volatilizing of the market due to economic and political factors. This risk can be dispersed and reduced through the diversification of portfolios. Appropriate portfolio diversification may not be possible for a small investor due to shortage of funds, but through investment in mutual fund, the investor’s portfolio automatically gets diversified. Mutual funds generally fetch higher returns than the low risk and fixed interest bearing securities. Example Principal PNB launched Principal Govt. Securities Fund on August 23, 2001 with the objective of low risk and high return. Similarly SBI MF launched SBI Magnum Balanced Fund, UTI MF launched UTI Gilt Advantage Fund January 2002, Reliance MF launched Reliance Gilt Securities Fund 10th July 2003, Pru ICICI MF launched Pru ICICI Advisor series.

(v) Low Cost: Mutual funds are a relatively less expensive way to invest compared to directly investing in the capital market. This is because the brokerage, custodial and other fees are less in comparison to other investible instruments.

(vi) Return Potential: Over a medium to long-term, mutual funds have the potential to provide higher returns as they invest in a diversified basket of selected securities. Example-By investing Rs.10,000 in Sunder Growth Fund in May 1997 it gave a return of Rs.79,450 in August 2006.

(vii) Flexibility: Mutual Fund is also more flexible instrument compared to other investible instrument. It provides the benefit of regular investment plans, regular withdrawal plans and dividend reinvestment plan through which the investor can systematically invest or withdraw funds according to his/her needs and convenience.

(viii) Affordability: Investors individually may lack sufficient funds to invest in high-grade stocks. A mutual fund because of its large corpus allows even a small investor to take the benefit of its investment strategy through less investment. Example like minimum investment Rs. 250 per month an investor can invest in SBI Magnum Children Benefit Plan, Magnum Equity Fund, Magnum Balanced Fund and Magnum Multi Plus Fund. Through minimum investment of Rs.500 per month investment in UTI Equity Tax
Saving Plan is done. Similarly minimum investment of Rs.5, 000 p.a. and with no entry on exit load investment in Birla Index Fund is done.

(ix) Freedom from responsibility: As there are fund managers to manage it helps to reduce the responsibility of the investors. Investors are not bothered to do the paper work and to take decision. They escape the responsibility of investing the saving by handling over their investible funds to a mutual fund. Fund Manager takes decision on their behalf. Example Peozarkar D. manager, takes decision of UTI Children’s Career Plan, UTI Balanced Fund, UTI Mahila Unit Scheme etc. Similarly Jain P. manages HDFC Equity Plan, HDFC Top 200 Fund, HDFC Core and Satellite Fund, HDFC Prudence Fund. SBI Magnum Children’s Benefit Plan, Magnum Income Plus Fund, Magnum Monthly Income Plan are managed by Kenarkose B.

(x) Transparency: An investor gets regular information on the value of investment in addition to disclosure on the specific investments made by his scheme. It also discloses fund manager’s strategy and outlook.

(xi) Switching: Many mutual funds allow investors to switch from one fund to another. Investors can switch from growth to income funds and vice-versa, and accordingly, their objective from capital gains to income and vice-versa.

(xii) Diversification: Mutual funds invest in a number of companies across a broad cross section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. Example Reliance Floating Rate Fund invests in a portfolio comprising Floating Rate Debt Securities, Money Market Instruments and Fixed Rate Debt Instruments. Similarly SBI Magnum NRI Investment Fund has a diversified portfolio comprising corporate debentures and bonds, government securities, equity, cash and call money market, debentures. Birla Income Plus a diversified income fund of corporate debt, securities debt, PSU/bonds, government bonds and money market instruments. HDFC Floating Rate Income Fund a diversified fund comprising of floating rate debt/money market instruments and fixed rate debt.

(xiii) Choice of Schemes: Mutual funds offer a family of schemes to suit the investor varying needs over a lifetime. Like equity/growth schemes, income/debt oriented schemes, balanced scheme, money market/liquid
schemes, gilt fund, index fund, specialized schemes, sector specific schemes, tax saving schemes etc.

(xiv) Well regulated: All mutual funds are registered with SEBI and they function within the provisions of strict regulation designed to protect the interests of investors. The operations of mutual funds are regularly monitored by SEBI.

1.3 PROBLEMS FACED BY MUTUAL FUNDS:

(i) Poor investor’s education: One of the drawbacks of mutual fund industry is that it still lacks investor’s education. Despite efforts by many fund houses they failed to improve the investor’s education. For example Templeton Mutual Fund hold investor’s campus regularly but the result was not satisfactory. Investor education is an ongoing effort and will eventually bring its rewards but in long run. (Business Standard fund Manager, 2004)

(ii) No proper disclosure: Full disclosure of the portfolio in its annual report is not done by the mutual funds. There were also instances in which investment is more than 10 percent of paid up capital of many company. For example – UTI did not follow some of the investment restrictions prescribed by SEBI, UTI invested more than 10 percent of paid up capital of many companies. UTI also was not making full disclosures of its portfolio in its balance sheet in accordance with SEBI Regulations.

(iii) More emphasis towards institutional/corporate investor: Institutional/corporate investor’s money account 60 percent of the mutual investible fund. Thus mutual fund pays more emphasis towards the accumulation of the fund from the corporate/institutional investor. Since retail investors invest smaller amount of money, the cost of serving them is invariably higher than the institution. The entry of institutional money helps to improve the expense ratio. Another reason for the institutional preference is that the time expended on getting Rs. 1 lakh out of a retail investor is far greater than getting a few crore out of an institution.

(iv) Consolidation/ Mergers have negative effect also: In order to gain economies of scale and to serve investors better consolidation was the new step. Though consolidation has its positive aspects, which can serve the investors in a more efficient manner, but it has its negative sides also. When two fund houses are merged, it also leads to merging of their schemes, which have similar
investment objective. This implies that a loss-making scheme may adversely affect a scheme that is doing well. And thus investors of the stronger fund house may have to face losses due to consolidation with the poorly performing schemes of the other fund house. Example UTI Mutual Fund, which is India’s largest mutual fund, joined the league by acquiring IL & FS Mutual Fund. Principal Mutual Fund took over PNB Mutual Fund and IDBI Mutual Fund.

(v) Misleading names: Mutual Fund players are also indulging themselves in the name game for sometime now. For example HDFC Mutual Fund launched Relief Bond Fund, which mislead investment as the ‘Relief Bond’ usually associated with ‘RBI Relief Bonds’, that offer tax benefits and also guarantees return of capital. Similarly ING Vysya launched two schemes High Liquidity Fund and High Interest Fund, which represent misleading names. However, SEBI quick response put an end to these misleading name games. SEBI has said that names of schemes should not mislead the market or encourage it to believe that fund managers will deliver guaranteed returns.

(vi) Misleading the investor: Distributors share a part of their distribution commission with brokers and retail investors as an incentive. This leads to promoting/selling schemes for wrong reasons and may end up misleading the investor.

(vii) Inside Trading: Inside trading is also an unethical practice followed by mutual fund. Under this fund’s entire holding are disposed at an unpublished price. Example Samir Arora, Star fund manager of Alliance Capital decided to part ways to set up a mutual fund on his own. SEBI imposed a ban on Samir Arora activities as he did not make disclosures and sometimes even made wrongful disclosures, when some of Alliance’s holdings in certain stocks breached limits and these needed to be intimated to the respective companies and he was also accused of disposing of his fund’s entire holdings in Digital Global Soft based on unpublished price.

(viii) Many Mutual Fund houses launched new schemes praising them as IPO: The word initial public offering is usually associated with a company. In recent times, many mutual fund houses launched new schemes praising them as IPOs which led investors to believe that those were similar to stock IPOs. Many schemes, which were launched as IPOs, fell below the so-called at par
value of Rs.10. For instance, accordingly to a report by the Economic Times, dated May 24, 2005, many new mutual fund schemes’ NAV fell below Rs.10, post-launch. It included schemes like Franklin India – Flexi Cap, Principal –Focused Advantage and LIC Mutual Fund –Opportunities Fund.

(ix) Banks still dominate: The biggest hindrance to the growth of the industry lies in its ability to attract the saving of the public. Public have greater confidence in public sector. Investors turned their attention to the public issue, thus inflow into mutual funds have slowed down. Inflow into both equity and debt funds have dropped drastically with average weekly inflows down by almost 50 percent.

(x) Share switching: Another area of long-term concern is share switching. SEBI has not, so far, found a full proof way to prevent mutual funds from switching securities between schemes. Example Prudential ICICI mutual fund made switching famous. Switching securities between schemes without their investors knowing it is more widespread than one is led to investors. Since funds declare their scheme-wise assets only at the end of the month, there is a lot of scope for switching around investments from one scheme to another depending on which scheme the fund wants to show a higher NAV.

(xi) Late Trading: One of the biggest ills that the mutual fund industry is facing is late trading. Under this preferential treatment is given to large investors by offering them backdated net asset value. According to an earlier study done by Business Standard in 2004 all income funds recorded daily gains of more than 0.5 per cent at least six times. For example Birla Income Plus – Six times, HDFC Income Fund – Eight times, Prudential Income Fund – Seven times, Templeton Income Fund – Seven times medium and long-term gilt funds exhibited at least double that figure.

In order to protect the investors, SEBI issued new guidelines. SEBI’s decision is to set a cut-off time for trade in Mutual Fund Schemes. The new guidelines issued by SEBI state that in case of local cheque applications received after 8 p.m. the NAV of the next business day would be applicable, while in case of outstation exchequer/DP line NAV of the day on which the instrument is credited would be taken into consideration.

(xii) Inappropriate market timing: One of the frauds committed by the mutual fund industry is in appropriate market timing. It is the use of ultra short-term
traders that remove profits from longer-term unit holder. For example, Alliance came under a cloud as some of its senior management officials were allegedly indulging in market-timing.

(xii) High promotional Expenses: Cutthroat competition among the various mutual funds to mobilize the saving of the masses necessitates heavy promotional expenses. An estimated Rs.1.5 crore is being spent on the promotion of every scheme launched by mutual funds in India. These expenses are likely to increase as new players enter the industry.

(xiv) Crisis of confidence: One of the major challenges facing the industry is the lack of investors’ confidence. Due to the bad performance of UTI – flagship US-64 there is a crisis of investors’ confidence.

(xv) High management cost: Mutual funds have to incur substantial expenses to manage the investible funds collected from investors. These include the salaries of the professional experts employed to manage its portfolio. The management costs of the fund are deducted from the total returns earned on the funds portfolio and only the balance is distributed among the investors. This reduces the returns that would have otherwise been available to the investors had they managed their portfolios themselves.

(xvi) Poor reach: Retail investors are not familiar enough with mutual funds. This is due to the improper distribution network and channels. That’s why mutual funds are not top priority of retail investors. The reach of the mutual finds industry in India is very limited. It can be expanded by including public sector banks and post offices that can double up as collection centers.

1.4 **FACTORS ATTRIBUTED TO THE GROWTH OF THE MUTUAL FUND:**

(i) Consolidation: Consolidation in the industry has just started. Consolidation is taking place of two-type, one that takes place between two different fund houses and the other that belong to mergers of schemes from the same fund house. HDFC Mutual Fund acquired Zurich India, Sundaram Mutual Fund acquired Newton Investment Management. UTI Mutual Fund which is India’s largest mutual fund, joined the league by acquiring IL and FS Mutual Fund, Can Bank Mutual Fund took over GIC Mutual Fund. The Sahara Group house takes over First India Mutual Fund. Principal Mutual Fund,
which earlier acquired Sun F & C Mutual, took over PNB Mutual Fund and IDBI Mutual Fund.

(ii) Technology: The technology wave has changed the operation of the mutual fund. It has bought flexibility and convenience to investors. It has also widened the reach of mutual fund. Advantages of technology wave include lower distribution cost through on line transaction, more customized and personal advice to customer.

(iii) Deeper penetration into the country: Mutual fund industries are now focusing to mobilize the saving of the semi-urban and rural investors. The growth of the industry thus depends on the strong and well-spread intermediary chain. The Intermediaries Advisory Committee constituted by Canbank Mutual Fund attempts to provide a platform for the intermediaries. It can further be expanded by including Public Sector Banks (PSBs) and Post Offices that can double up as collection centers. If they are allowed to sell mutual fund schemes, the reach can be widely expanded.

(iv) Tax incentives: Tax benefit given to investor of mutual fund also helped for the spurt growth of the industry. Dividend is tax free in the hands of the investors. Some of the schemes, which provide tax benefit, are HDFC Tax Saver launched in December 1995, Pru ICICI Tax Plan Scheme launched in May 1999, Birla Equity Plan launched in February 1999, HDFC Tax Saving Fund launched on December 2004 and SBI Magnum Tax Gain Scheme launched in 1993.

(v) Booming Stock Market: One of the major reasons behind the spurt growth of mutual fund industry is the booming stock market. The stock market gained 18 percent in the last one year and 90 percent in the last three years.

(vi) Product innovation: With the product innovation a variety of funds are available for the investors. For instance, today, many funds offer innovative features like same day redemption in liquid funds, institutional plans which will reduce the overall cost of investment and bonus units instead of dividend, Birla Sun Life AMC launched its dividend yield fund early on, and recently Tata Mutual fund and Principal Punjab National Bank AMC have also launched their own versions of dividend yield funds. In October 2000, Principal Mutual Fund launched India’s first Asset Allocation program the ‘Future Goal Series’. Another innovative fund launched recently is the
lifestyle fund. Kotak Mahindra Mutual Fund launched Kotak Lifestyle Fund. Global Advantage Fund is another modern scheme to hit the mutual fund scheme. Kotak Mutual Fund has launched the Kotak Global India Fund. In order to provide risk-free returns to investors, Benchmark Mutual Fund launched new fund called the Equity Arbitrary Fund. Another very innovative fund is the T.I.G.E.R. (The Infrastructure Growth and Economic Reforms) fund being launched by DSP Merrill Lynch India. The scheme basically focuses on Power, Oil and Gas, Telecom Banking and Finance, Pharmaceuticals, Media, Fertilizers, Travel and Tourism, Cement, Engineering, Metals and Auto sectors. Some of the other innovative products that are gaining in popularity are Exchange Traded Funds (ETFs). Prudential – ICICI and Benchmark have both launched their own ETFs called SPICE (in association with BSE) and BEES, respectively. UTI launched its own ETF called SUNDERS.

1.5 TYPES OF MUTUAL FUND SCHEMES

1.5.1 BY SCHEME TYPE:

1.5.1.1 Open-ended Funds:

In US, UK and many other countries only open-ended funds are called mutual funds. An open ended fund is characterized by -

- Unlimited capitalization
- No predetermined date of redemption
- Sale and purchase of units at current net asset value (NAV)
- No restriction on entry and exit
- Purchase of units directly from the funds
- Sale of units directly to the funds.

The first open-ended fund, the Massachusetts Investors Trust (MIT) was established in the U.S. in 1924. The fund, which operates even today, paved the way for modern day open-ended funds.

The open-ended funds survived the 1929 Crash and emerged as the winners in the years to come. According to Donald Christenson, ‘the real reason that the open ended trust of the time survived to become a model for a period of reforms and rebirths was the tradition of conservative investment policy followed by these trusts.
From then on it was the open-ended funds, which ruled the mutual fund industry in the US and the world at large.

The main reason behind the growth of open-ended schemes was its high liquidity and it churned out healthy return. As they have no fixed maturity period so investors can easily buy and sell it at NAV. Open-ended schemes launched various innovative schemes, which suits the investors. It was also able to attract many retail investors.

1.5.1.2 Close-ended funds:
A close-ended fund is characterized by -

- Constant capitalization
- Predetermined date of redemption
- Predetermined date of closing subscription
- Frequent lock-in period
- Purchase and sale of units at the traded prices at the stock exchange.

The shares of a close-ended fund are listed on stock exchange or traded in the OTC market. A diversified close-ended fund invests in assets different stocks and bonds while a non-diversified one puts larger funds into a particular investment.

Close-ended funds are basically of two types, stock and bond funds, the latter being more popular. In 1996, about 70 percent of the assets of close-ended funds were in bond funds.

- Close-ended funds can be further classified as domestic and international. There are stock and bond funds under both categories.
- A uniform practice is followed while calculating the NAV. It is calculated on a daily, weekly or other basis of different funds. Since the stock prices depend on the demand of the investors the trading prices of a fund may exceed the NAV, or may be sold at a discount. Other than being under the purview of federal laws and the SEC, close-ended funds must comply with the requirements of the exchange in which they are listed.

Investors are giving more preference to open-ended schemes. The boom in the assets of open-end funds was caused by the poor-performance of many public sector close-ended schemes as well as of fund managers and the failure of guaranteed returned schemes. These factors resulted in an outflow of funds from the close-ended schemes. Another reason for the growth of open-end schemes was that aggressive private sector mutual funds played a large part in enhancing the popularity of open
ended schemes by launching several innovative and sector funds. Investors also opted for IT, entertainment and technology funds. But for the last two years it's investible fund increased because of innovative schemes launched by closed ended mutual funds.

In India close-ended schemes are less popular but in U.S. they are highly popular. Though close-ended funds are not called mutual funds in the US, they play a role in the fund industry. They are successfully competing with the open-ended funds and offer similar benefits to investors.

1.5.2 BY INVESTMENT TYPE:

1.5.2.1 Income /Debt Funds:

Income schemes seek to provide low-risk, regular and steady income to risk-averse investors, on a monthly, quarterly, or yearly basis, in the form of interest or dividend. Income schemes can be open-ended or close-ended. The dividend is usually paid at the close of the accounting year. In cases where returns are assured, post-dated cheques are sent in advance. The tenure of close-ended income schemes can be five to seven years. An income scheme can be a deferred income scheme, which does not distribute any income during the initial two or three years, but pays higher income subsequently or a growing income scheme, under which income increases with the passage of time. There are income schemes offering the cumulative option and recurring investment option. Income schemes invest predominantly in low risk debt instruments and in the securities of companies with records of regular dividend payment, which provide them with a regular flow of income.

Income fund has provided very good post-tax returns on year-to-year basis. Even historically, it is found that some of the income funds have generated superior returns at relatively low level of risks. On an average income funds have posted returns over 10 percent over one-year horizon.

The income fund that are performing well include HDFC MIP Long Term, UTI MIS- Advantage Fund, DSPML Saving Plus Aggressive, Birla MIPII, HSBC MIP Savings, LIC MF MIP, FT India MIP, ICICI Pru MIP.

1.5.2.2 Growth / Equity Oriented Funds:

The aim of growth funds is to provide capital appreciation over the medium to long-term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options
to the investors like dividend option, capital appreciation, etc., and the investors may choose an option depending on their preference. The investors must indicate the option in the application form. Mutual funds also allow investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.

There has been encouraging collection by growth funds of domestic mutual funds. The main reason behind the increase of growth schemes was that it managed risk quite effectively through diversification by restricting its exposure in a single sector.

Among the growth funds, Magnum Global has emerged as the best performing on the risk–adjusted return basis. Among the other fund with impressive performances are Magnum Contra, Sundram PNB Paribas Growth, Reliance Growth, UTI Infrastructure, HDFC Equity, Reliance Vision, Magnum Multiplier Plus, ICICI Pru Dynamic, DSPML Equity Fund.

### 1.5.2.3 Balanced Funds:

Balanced funds are an important variant of income and growth funds. Also called total return funds they divide their portfolio into debt and equity. These funds have the capacity to withstand market pressure. Since they function on the basis of assumption that the equity and debt markets move in opposite directions, they are able to perform in any market situation. A part of the portfolio is invested in securities with higher risk and the probability of higher returns, and the rest in low risk debt instruments. Despite their several positive features, balanced fund have not been able to make much of a dent in the Indian market.

Magnum Balanced ranks first amongst the Balanced Funds. The fund’s ability to give good returns goes to the fund manager’s strategy of consistent portfolio re-balancing, good stock selection and high quality of bond holdings. Some of the best performing funds from these categories are HDFC Prudence, Kotak Balance, Tata Balance, Escort Balance, Can Balance II, Birla Sunlife’95, Principal Child Benefit, ICICI Pru Advisor-Aggressive and ICICI–Pru Balanced.

### 1.5.2.4 Liquid / Money Market Funds:

Money market mutual funds (MMMFs) also known as cash funds, first appeared in the U.S. in 1972. They steadily increased their assets and by the early 1990 about 30 percent of the total assets of the US mutual funds were in MMMFs. However, they suffered a setback in 1994. The portfolio of MMMFs consists of
short-term debt instruments such as treasury notes, commercial papers, certificates of deposits and the call money market. They are able to provide better returns than short-term bank deposits. MMMFs are best suited for investors who want maximum returns for short-term investments with a minimum of risk.

The reason behind the growth of liquid/MMF is because of investors are looking at a shorter time horizon for their investments by switching to short-term plans, which typically invest in securities with maturities of less than a year. This helps them to guard against any further downside risk in NAVs arising from a firming up of interest rate.

LIC MF Liquid leads in the liquid fund category. Other best performing money market mutual fund/liquid funds are HDFC Cash Management Saving Plus Retail, HDFC Cash Management Saving, Can Liquid Retail, UTI MMMF, Liquid Benchmark ETS, HDFC Liquid, UTI Liquid Cash Regular and DBS Chola Liquid. The fund’s portfolio comprises of highly rated debt papers.

1.5.2.5 Gilt Funds:

The primary objective of the gilt funds is to invest in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rate and other economic factors as in the case with income and debt oriented schemes.

Among the gilt fund – Birla Gilt Plus Liquid is the winner. The next two top performing funds are Kotak Gilt Saving and Reliance Gilt Long Term.

1.5.2.6 ELSS Funds:

Tax planning schemes in India are popularly known as equity linked saving schemes (ELSS) because they are formulated under ELSS 92, a notification of the Ministry of Finance. The notification which was issued in the Ministry Gazette on 28th December 1992, stipulates the tenure of such schemes, the tax benefits accruing to investors, the investments to be made repurchase etc. Under Section 88 of the Income Tax Act 1961, investors (individual and HUF) are entitled to tax rebate in ELSS fund. They can take long-term calls on stock and market conditions without having to worry about redemption pressure as the money is locked in for three years and provide good returns. Some of the ELSS have exceptional performance in past and cater to equity investor with good performances. The industry offer tax benefits under various sections of Income Tax Act for e.g. dividend income is free in the hands of the investor while capital gains are taxed after providing for cost inflation,
indexation. Hitherto, the benefit under section 54EA / EB were applicable to take benefit of the tax provisions for capital gain but have now been removed.

In the equity – ELSS category, Magnum Tax Gain is the top-ranked fund. The other impressive equity – ELSS Funds are ICICI Pru Tax Plan, Principal Tax Savings, Sundaram Paribas Tax Saver, HDFC Long Term Advantage Fund-Dividend, Birla Equity Plan, ING Vysya Tax Saving, Can Equity Tax Saver, Principal Tax Saver.

1.6 RECESSION
A period of general economic decline; typically defined as a decline in GDP for two or more consecutive quarters. A recession is typically accompanied by a drop in the stock market, an increase in unemployment, and a decline in the housing market.

Recession is a normal (albeit unpleasant) part of the business cycle; however, one-time crisis events can often trigger the onset of a recession. The global recession of 2008-2009 brought a great amount of attention to the risky investment strategies used by many large financial institutions, along with the truly global nature of the financial system. As a result of such a wide-spread global recession, the economies of virtually all the world's developed and developing nations suffered extreme set-backs and numerous government policies were implemented to help prevent a similar future financial crisis.

A significant decline in activity across the economy, lasting longer than a few months. It is visible in industrial production, employment, real income and wholesale-retail trade. The technical indicator of a recession is two consecutive quarters of negative economic growth as measured by a country's gross domestic product (GDP); although the National Bureau of Economic Research (NBER) does not necessarily need to see this occur to call a recession.

A recession generally lasts from six to 18 months, and interest rates usually fall in during these months to stimulate the economy by offering cheap rates at which to borrow money.

1.7 CAUSES OF RECESSION
- Many factors contribute to an economy's fall into a recession, but the major cause is inflation. Inflation refers to a general rise in the prices of goods and services over a period of time. The higher the rate of inflation, the smaller the
percentage of goods and services that can be purchased with the same amount of money.

- Apart, high interest rates are also a cause of recession. That's because it limits liquidity, or the amount of money available to invest.

- Economic recessions are caused by a decline in GDP growth, which is itself caused by a slowdown in manufacturing orders, falling housing prices and sales, and a drop-off in business investment. The result of this slowdown is falling employment, and rising unemployment, which causes a slowdown in retail sales. This creates a downward spiral in manufacturing and increased layoffs.

**Cause of 2008 Recession**

Irrational exuberance in the housing market led many people to buy houses they couldn't afford, because everyone thought housing prices could only go up. In 2006, the bubble burst as housing prices started to decline. This caught many homeowners off guard, who had taken loans with little money down. As they realized they would lose money by selling the house for less than their mortgage, they foreclosed. An escalating foreclosure rate panicked many banks and hedge funds, who had bought mortgage-backed securities on the secondary market and now realized they were facing huge losses.

By August 2007, banks became afraid to lend to each other because they didn't want these toxic loans as collateral. This led to the $700 billion bailout, and bankruptcies or government nationalization of Bear Stearns, AIG, Fannie Mae, Freddie Mac, IndyMac Bank, and Washington Mutual. By December 2008, employment was declining faster than in the 2001 recession. In 2009, the government launched the economic stimulus plan. It was designed to spend $185 billion in 2009. And in fact, it halted a four-quarter decline in GDP by Q3 of that year, thus ending the recession. However, unemployment continued to rise to 10%, and many business leaders still expected a W-shaped recession by the end of 2010. High unemployment rates still persisted into 2011.

**1.8 PERFORMANCE APPRAISAL OF MUTUAL FUNDS IN INDIA**

The performance of mutual funds with regard to mobilization of saving has been examined so as to shed light on the basic role of the mutual funds assigned to play for the income development as new financial institutions.
1.8.1 RESOURCE MOBILISED BY MUTUAL FUNDS:
Since mutual funds are essentially financial intermediaries which mobilize resources from a large number of investors for channelizing them in a variety of investment avenues, their corpus must be large and contributed by a number of small investors. This, therefore, serves as a parameter for performance evaluation.

1.8.2 NET RESOURCE MOBILISED BY MUTUAL FUNDS:
The funds mobilized by the mutual funds from 1970-71 to 2009-10 have been presented in table below:

<table>
<thead>
<tr>
<th>Year</th>
<th>UTI</th>
<th>Bank-sponsored mutual funds</th>
<th>FI-sponsored mutual funds</th>
<th>Private sector mutual funds</th>
<th>Total (2 to 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>18</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>18</td>
</tr>
<tr>
<td>1971-72</td>
<td>15</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>15</td>
</tr>
<tr>
<td>1972-73</td>
<td>23</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>23</td>
</tr>
<tr>
<td>1973-74</td>
<td>31</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>31</td>
</tr>
<tr>
<td>1974-75</td>
<td>17</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>17</td>
</tr>
<tr>
<td>1975-76</td>
<td>29</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>29</td>
</tr>
<tr>
<td>1976-77</td>
<td>35</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>35</td>
</tr>
<tr>
<td>1977-78</td>
<td>73</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>73</td>
</tr>
<tr>
<td>1978-79</td>
<td>102</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>102</td>
</tr>
<tr>
<td>1979-80</td>
<td>58</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>58</td>
</tr>
<tr>
<td>1980-81</td>
<td>52</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>52</td>
</tr>
<tr>
<td>1981-82</td>
<td>157</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>157</td>
</tr>
<tr>
<td>1982-83</td>
<td>167</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>167</td>
</tr>
<tr>
<td>1983-84</td>
<td>330</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>330</td>
</tr>
<tr>
<td>1984-85</td>
<td>756</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>756</td>
</tr>
<tr>
<td>1985-86</td>
<td>892</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>892</td>
</tr>
<tr>
<td>1986-87</td>
<td>1261</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1261</td>
</tr>
<tr>
<td>1987-88</td>
<td>2059</td>
<td>250</td>
<td>-</td>
<td>-</td>
<td>2309</td>
</tr>
<tr>
<td>1988-89</td>
<td>3855</td>
<td>320</td>
<td>-</td>
<td>-</td>
<td>4175</td>
</tr>
<tr>
<td>1989-90</td>
<td>5584</td>
<td>889</td>
<td>315</td>
<td>-</td>
<td>6788</td>
</tr>
<tr>
<td>1990-91</td>
<td>4553</td>
<td>2352</td>
<td>604</td>
<td>-</td>
<td>7509</td>
</tr>
<tr>
<td>1991-92</td>
<td>8685</td>
<td>2140</td>
<td>428</td>
<td>-</td>
<td>11253</td>
</tr>
<tr>
<td>1992-93</td>
<td>11057</td>
<td>1204</td>
<td>760</td>
<td>-</td>
<td>13021</td>
</tr>
<tr>
<td>1993-94</td>
<td>9297</td>
<td>148</td>
<td>238</td>
<td>1560</td>
<td>11243</td>
</tr>
<tr>
<td>1994-95</td>
<td>8611</td>
<td>766</td>
<td>576</td>
<td>1322</td>
<td>11275</td>
</tr>
<tr>
<td>Year</td>
<td>UTI</td>
<td>Bank-sponsored mutual funds</td>
<td>FI-sponsored mutual funds</td>
<td>Private sector mutual funds</td>
<td>Total</td>
</tr>
<tr>
<td>----------</td>
<td>----------</td>
<td>-----------------------------</td>
<td>---------------------------</td>
<td>----------------------------</td>
<td>----------</td>
</tr>
<tr>
<td>1995-96</td>
<td>-6314</td>
<td>113</td>
<td>235</td>
<td>133</td>
<td>-5833</td>
</tr>
<tr>
<td>1996-97</td>
<td>-3043</td>
<td>7</td>
<td>137</td>
<td>864</td>
<td>-2035</td>
</tr>
<tr>
<td>1997-98</td>
<td>2875</td>
<td>237</td>
<td>204</td>
<td>749</td>
<td>4065</td>
</tr>
<tr>
<td>1998-99</td>
<td>170</td>
<td>-89</td>
<td>547</td>
<td>2067</td>
<td>2695</td>
</tr>
<tr>
<td>1999-00</td>
<td>4548</td>
<td>336</td>
<td>296</td>
<td>16938</td>
<td>22118</td>
</tr>
<tr>
<td>2000-01</td>
<td>322</td>
<td>249</td>
<td>1273</td>
<td>9292</td>
<td>11136</td>
</tr>
<tr>
<td>2001-02</td>
<td>-7284</td>
<td>863</td>
<td>406</td>
<td>16134</td>
<td>10119</td>
</tr>
<tr>
<td>2002-03</td>
<td>-9434</td>
<td>1033</td>
<td>861</td>
<td>12122</td>
<td>4582</td>
</tr>
<tr>
<td>2003-04</td>
<td>1050</td>
<td>4526</td>
<td>787</td>
<td>41510</td>
<td>47873</td>
</tr>
<tr>
<td>2004-05</td>
<td>-2467</td>
<td>706</td>
<td>-3384</td>
<td>7933</td>
<td>2788</td>
</tr>
<tr>
<td>2005-06</td>
<td>3424</td>
<td>5365</td>
<td>2112</td>
<td>41581</td>
<td>52482</td>
</tr>
<tr>
<td>2006-07</td>
<td>7326</td>
<td>3033</td>
<td>4226</td>
<td>79477</td>
<td>94063</td>
</tr>
<tr>
<td>2007-08</td>
<td>10678</td>
<td>7597</td>
<td>2178</td>
<td>128032</td>
<td>148485</td>
</tr>
<tr>
<td>2008-09</td>
<td>-3659</td>
<td>4489</td>
<td>5954</td>
<td>-31425</td>
<td>-24641</td>
</tr>
<tr>
<td>2009-10</td>
<td>15653</td>
<td>9855</td>
<td>4871</td>
<td>48166</td>
<td>78545</td>
</tr>
</tbody>
</table>

**Note:**
1. Data for 2009-10 are provisional.
3. Data for UTI for 2003-04 relates to UTI Mutual Fund for the period from February 01, 2003 to March 31, 2004, being the first year in operation after the bifurcation of the erstwhile UTI into UTI Mutual Fund and Specified Undertaking of the Unit Trust of India. Subsequent annual data (from 2004-05 onwards) pertain to UTI Mutual Fund only.


**Figure 1.2**

![Net Resource Mobilised](chart.png)

- **UTI**
- **Bank-sponsored mutual funds**
- **FI-sponsored mutual funds**
- **Private sector mutual funds**
- **Total**

- **Rs Crore**
- **2002-03 to 2009-10**
• Net resource mobilized by UTI funds in the FY 2007-08, 2008-09 & 2009-10 was Rs 10678, (Rs -3659) & Rs 15653 crores respectively thus showing strong negative impact of recession on UTI funds during recession.
• Net resource mobilized by Bank sponsored Mutual Funds in the FY 2007-08, 2008-09 & 2009-10 was Rs 7597, Rs 4489 & Rs 9855 crores respectively thus showing adverse impact of recession on Bank sponsored Mutual Funds during recession.
• Net resource mobilized by Private Sector Mutual Funds in the FY 2007-08, 2008-09 & 2009-10 was Rs 128032, (Rs -31425) & Rs 48166 crores respectively thus showing negative impact of recession on Private sector Mutual Funds during recession. Net resource mobilized by private sector mutual fund was negative for the first time in the year 2008-09 since its inception in the FY 1993-94.
• Net resource mobilized by FI sponsored Mutual Funds in the FY 2007-08, 2008-09 & 2009-10 was Rs 2178, Rs 5954 & Rs 4871 crores respectively. It shows these funds were not impacted in a negative way by recession.
• Overall net resource mobilized by Mutual Funds in the FY 2007-08, 2008-09 & 2009-10 was Rs 148485, (Rs-24641) & Rs 78545 crores respectively. It shows how badly was the Indian Mutual Fund market in India was hit by recession.

We thus observe that the impact of recession was adverse on overall Mutual Fund industry in India. Hence, it becomes imperative to analyse the performance of Mutual Fund Industry in India during recession as significant proportion of Indian masses are directly or indirectly effected by Mutual Fund industry in India and this leads to the need of this research.

1.9 NEED AND JUSTIFICATION OF THE STUDY

It is important to know whether mutual funds perform, when it matters to investors the most, i.e. in recessions, when investors’ marginal utility of wealth is particularly high.

Mutual funds of certain investment categories such as balanced/income and growth/income funds promise to provide relatively stable returns over time and can be expected to exhibit more time variation of their risk exposures as a result of the ability to change their relatively high debt/equity ratio. The question remains whether they manage to fulfill their promises.
During recession times, everybody is in doubt whether this is the right time for investment or not. Investing in stock market is not easy during recession times. As a stock market investor, one needs to have a lot of knowledge both theoretical and practical to survive in the present day stock-trading sessions to make some money in the bargain. However, there are a few exceptional people, who have this stock market acumen and are ready to play the game with high stakes. These people are not only knowledgeable but are also supported by a few reliable information channels, which gives them creditable information regarding a particular stock or company. Depending on these helpful resources and combining the same with their own study of stock market, these people take decisions whether to invest or not at a particular point of time during trading sessions. A better option for a common man, who does not have much knowledge and access to different kinds of credible information resources, is to invest through mutual funds. Sensing the financial potential of people, who have money but no stock market knowledge, a few investing companies created mutual funds. These funds help people who have money and want to have a share in the stock market profits, but no knowledge of stock trading.

As mentioned above, considering that Mutual Funds are meant for common man who have money to invest in market but not much stock market knowledge it becomes essential to investigate how the performance of the mutual funds have been affected due to recession, and whether the investment patterns or behaviour of investors has been affected due to changes (if any) in mutual fund performances. To answer these research questions the objectives of this study were framed.

1.10 OBJECTIVE OF THE STUDY

The primary objective of the present study is to appraise the performance of Mutual Funds in India, in the light of the role they are expected to play as a significant constituent of the Indian Financial system. For this following are the specific objectives of this study

- To find out the impact of recession on performance of various categories of Mutual Funds in India
- To find out the investment / saving pattern of various categories of investors.
- To find out the behavior of the investors of Mutual Fund under the impact of recession.