CHAPTER - 3
INVESTMENT AND MUTUAL FUND – AN OVERVIEW

Investment scenario – an overview:

With rapidly changing economic equation, the emerging economies like China, India, Singapore, Malaysia, Russia, Brazil etc are all set to steal the focus of investors from USA & Europe. No wonder that these new economic powers are growing very fast and tables will be shifted sooner than later. America used to "drive the bus" in global economic terms; now other areas of the world are getting more attention. USA is suffering from economic recession and Federal Reserve is confused on whether to increase the interest rates and keep inflation under check or to reduce the rates and help economy grow. Though the impact of the sub-prime crisis and housings market slow-down on the US economic system may have been restrained up to now, economic indicators are indicating that the economy will slow down. Business and consumer confidence appear to be damping in both the US and Euro zone, and leading indicators are too in a negative trend. Till the credit situation clears up, investors will remain edgy allowing high risk credit assets still vulnerable to a further sell-off. Where to invest amongst these emerging economies is a tough call to take. On one side China has a history of delivering continuous 9%+ growth rate per year. On the other side, India is much less trade and export-oriented than China and has poor infrastructure which is being developed. As a result, India banks more on the domestic consumer for overall growth and job creation. That also makes it harder to attract productivity-enhancing foreign direct investment but this insulates India from recession in global markets. In this situation, the safest way for a retail investor to benefit from this growth is by investing in Global Emerging Economy Funds offered
by many mutual fund companies. However, if one wants to invest directly in stock markets then one need to be extra cautious because even though these countries are growing fast and will continue to grow, there are many stocks that won’t give good returns and some may even result in complete loss of capital. Also, any company or firm irrespective of its size, which aspires to be a global player cannot for long ignore India and China as they are to become high growth emerging economies. India has a vast potential for foreign investment and foreign players find it their next investment destination. India is an investment goldmine for long-term growth. While short term profits may be churned out from time to time but they are not of a penny’s worth in the longer run. Investing in Gold is also great option of saving your money in view of decreasing value of USD, whenever US investors get jittery about prospect of US economy they turn to gold as a safe haven. Hence gold might have room for higher levels from where they are today. It is an opportunity for the investors’ to invest money in gold by buying it physically or by buying gold funds offered by many financial institutes.

Globalization and Foreign Direct Investment form an integral part of all the developed as well as developing economies. In fact, the growth of the underdeveloped economies is also dependant on these key factors. These components equip any nation with new skills, new items and provide smooth access to markets and technology. Today, every nation across the globe is looking for foreign and overseas investors. Whether it's India or China, everyone wants foreign investments. According to recent trends, India is only second to China in the league of favorite investment destinations. In the report issued by Department of Industrial
Policy and Promotion, the fund inflow to India reached US$ 27.3 billion in the period 2008-09, considered from the month of April 2008 to the month of March 2009.

Investment is the sacrifice of certain present value for the uncertain future reward. It entails arriving at numerous decisions such as type, mix, amount, timing, grade etc. of investment and disinvestments. Further, such decision-making has not only to be continuous but rational too. Broadly speaking, an investment decision is a tradeoff between risk and return. All investment choices are made at points of time in accordance with the personal investment ends and in contemplation of an uncertain future.

Financial institutions receive daily requests for guidance from a wide range of potential savers and investors. These include:

- Those who receive a relatively large sum of money by way of redundancy or early retirement pension;
- Those who inherit large sums of money and other assets
- Those who win large sums of money from the National Lottery or Premium Savings Bonds;
- Smaller investors who have purchased shares issued by former public corporations as part of the government’s privatization programme or from an Employee Share Option scheme;
- People who wish to set aside regular or occasional sums of money to build up funds for future purchases, which may be long term, e.g. saving for a house, or short term, e.g. saving for a holiday.
There is a wide choice of financial institutions that offer products and services to savers and investors. A.D. Bain divides these into three categories:

- **Banks, building societies and National Savings**, which generally provide capital guaranteed savings and investment accounts offering ready access to funds and a rate of interest;

- **Life assurance and pension funds**, the former providing savings and financial protection in the event of early death, the latter doing the same in the event of lengthy survival. These institutions are differentiated from the first group in that early surrender or lapse of investments may result in suffering a capital loss or having funds ‘locked in’.

- **Unit trusts, investment trusts and stocks and shares**. The capital value of these assets can change on daily basis. Their value can rise or fall.

Traditionally, each set of financial institutions had a highly defined role in the provision of personal savings and investment products and services. This was partly due to their respective specializations and expertise, but also due to government controls, often implemented as part of monetary policy. These demarcations have broken down since 1980, with institutions making inroads into the markets of their competitors. Most of the retail and mortgage banks and all of the large building societies now provide a full range of services, often with specialist subsidiary and associated companies.
For these reasons, many customers now approach a single financial institution to meet a whole array of financial needs instead of having to go to different organizations for each need. Some financial products and services are regulated by the Financial Services Act 1986. Generally, these are products that can involve capital risk or whose performance is subject to market conditions. Although anyone can give factual information to customers on these products, investment advice relating to whether a customer should or should not invest in them requires the adviser to be licensed under the Act.

**Investment:**

Investment is the sacrifice of certain present value for the uncertain future reward. Investment would imply the employment of funds with the objective of realizing additional income or growth in value of investment at a future date. It entails arriving at numerous decisions such as type, mix, grade etc. “Investment” or “investing”, like “Value” is a word of many interpretations. There are basically two concepts of investment:

i) **Economic Investment:**

The term economic investment has a rather precise meaning in the literature of economic theory. Typically it includes net additions to the capital stock of society. By ‘capital stock of society’ is meant those goods, which are used in the production of other goods.

ii) **Financial Investment**

Financial investment means an exchange of financial claims-stocks and bonds, real estate etc.
Types of Investment:

Financial Instruments:

i) Equities:
Equities are a type of security that represents the ownership in a company. Equities are traded (bought and sold) in stock markets. Alternatively, they can be purchased via the Initial Public Offering (IPO) route, i.e. directly from the company. Investing in equities is a good long-term investment option as the returns on equities over a long time horizon are generally higher than most other investment avenues. However, along with the possibility of greater returns comes greater risk.

ii) Mutual funds:
A mutual fund allows a group of people to pool their money together and have it professionally managed, in keeping with a predetermined investment objective. This investment avenue is popular because of its cost-efficiency, risk-diversification, professional management and sound regulation. Investor can invest as little as Rs. 1,000 per month in a mutual fund. There are various general and thematic mutual funds to choose from and the risk and return possibilities vary accordingly.

iii) Bonds:
Bonds are fixed income instruments which are issued for the purpose of raising capital. Both private entities, such as companies, financial institutions, and the central or state government and other government institutions use this instrument as
a means of garnering funds. Bonds issued by the Government carry the lowest level of risk but could deliver fair returns.

**iv) Deposits**

Investing in bank or post-office deposits is a very common way of securing surplus funds. These instruments are at the low end of the risk-return spectrum.

**v) Cash equivalents:**

These are relatively safe and highly liquid investment options. Treasury bills and money market funds are cash equivalents.

**Non-financial Instruments**

**i) Real estate**

With the ever-increasing cost of land, real estate has come up as a profitable investment proposition.

**ii) Gold**

The 'yellow metal' is a preferred investment option, particularly when markets are volatile. Today, beyond physical gold, a number of products which derive their value from the price of gold are available for investment. These include gold futures and gold exchange traded funds.
Investment Policy:

The government or the investor before proceeding into investment formulates the policy for the systematic functioning. The various policies are:

i) Investing funds:

The entire investment procedure revolves around the availability of investible funds. The fund may be generated through savings or from borrowings. If the funds are borrowed, the investor has to be extra careful in the selection of investment alternatives. The return should be higher than the interest he pays. Mutual funds invest their owners’ money in securities.

ii) Objectives:

The objectives are framed on the premises of the required rate of return, need for regularity of income, risk perception and the need for liquidity. The risk taker’s objective is to earn high rate of return in the form of capital appreciation, whereas the primary objective of the risk averse is the safety of the principal.

iii) Knowledge:

The knowledge about the investment alternatives and markets plays a key role in the policy formulation. The investment alternatives range from security to real estate. The risk and return associated with investment alternatives differ from each other. Investment in equity is high yielding but has more risk than the fixed income securities. The tax sheltered schemes offer tax benefits to the investors.
Security Analysis:

After formulating the investment policy, the securities to be bought have to be scrutinized through the market, industry and company analysis.

i) Market analysis:
The stock market mirrors the general economic scenario. The growth in gross domestic product and inflation are reflected in the stock prices. The recession in the economy results in a bear market. The stock prices may be fluctuating in the short run but in the long run they more in trends i.e. either upwards or downwards. The investor can fix his entry and exit points through technical analysis.

ii) Industry analysis:
The industries that contribute to the output of the major segments of the economy vary in their growth rates and their overall contribution to economic activity. Some industries grow faster than the GDP and are expected to continue in their growth. The economic significance and the growth potential of the industry have to be analysed.

iii) Company analysis:
The purpose of company analysis is to help the investors to make better decisions. The company’s earnings, profitability, operating efficiency, capital structure and management have to be screened. These factors have direct bearing on the stock prices and the return of the investors. Appreciation of the stock value is a function of the performance of the company. Company with high product market share is able to create wealth to the investors in the form of capital appreciation.
Features of an Investment Programme

In choosing specific investments, investors will need definite ideas regarding features, which their portfolios should possess. These features should be consistent with the investors’ general objectives and in addition should afford them all the incidental conveniences and advantages, which are possible under the circumstances. The following are the suggested features as the ingredients from which many successful investors’ compound their selection policies.

i) Safety of Principal

The safety sought in investment is not absolute or complete; it rather implies protection against loss under reasonably likely conditions or variations. It calls for careful review of economic and industry trends before deciding types and/or timing of investments. Thus, it recognizes that errors are unavoidable for which extensive diversification is suggested as an antidote.

Adequate diversification means assortment of investment commitments in different ways. Those who are not familiar with the aggressive-defensive approach nevertheless often carry out the theory of hedging against inflation-deflation. Diversification may be geographical, wherever possible, because regional or local storms, floods, droughts, etc. can cause extensive real estate damage. Vertical and horizontal diversification can also be opted for the same. Vertical diversification occurs when securities of various companies engaged in different phases of production from raw material to finished goods are held in the portfolio. On the other hand, horizontal diversification is the holding by an investor in various companies all of which carry an activity in the same stage of production.
ii) Adequate Liquidity and Collateral Value

An investment is a liquid asset if it can be converted into cash without delay at full market value in any quantity. For an investment to be liquid, it must be reversible or marketable. The difference between reversibility and marketability is that reversibility is the process whereby the transaction is reversed or terminated while marketability involves the sale of the investment in the market for cash. To meet emergencies, every investor must have a sound portfolio to be sure of the additional funds, which may be needed for the business opportunities. Whether money raising is to be done by sale or by borrowing it will be easier if the portfolio contains a planned proportion of high-grade and readily saleable investment.

iii) Stability of Income

Stability of income must be looked at in different ways just as was security of principal. An investor must consider stability of monetary income and stability of purchasing power of income. However, emphasis upon income stability may not always be consistent with other investment principles. If monetary income stability is stressed, capital growth and diversification will be limited.

iv) Capital growth

Capital appreciation has today become an important principle. Recognising the connection between corporation and industry growth and very large capital appreciation, investors and their advisers constantly are seeking “growth stocks”. It is exceedingly difficult to make a successful choice. The ideas “growth stock” is the right issue in the right industry, bought at the right time.
v) Tax Benefits

To plan an investment programme without regard to one’s tax status may be costly to the investor. There are really two problems involved here, one concerned with the amount of income paid by the investment and the other with the burden of income taxes upon that income. When investors’ incomes are small, they are anxious to have maximum cash returns on their investments, and are prone to take excessive risks. On the other hand, investors who are not pressed for cash income often find that income taxes deplete certain types of investment incomes less than others, thus affecting their choices.

vi) Purchasing power stability

Since an investment nearly always involves the commitment of current funds with the objective of receiving greater amounts of future funds, the investor should consider the purchasing power of the future fund. For maintaining purchasing power stability, investors should carefully study (1) the degree of price level inflation they expect, (2) the possibilities of gain and loss in the investment available to them, and (3) the limitations imposed by personal and family considerations.

vii) Concealability

To be safe from social disorders, government confiscation, or unacceptable levels of taxation, property must be concealable and leave no record of income received from its use or sale. Gold and precious stones have long been esteemed for these purposes because they combine high value with small bulk and are readily transferable.
Motives for Saving and Investing

The famous economist John Maynard Keynes, writing in 1936, identified three reasons for saving:

- Precautionary – saving for a rainy day
- Transaction – saving to buy something in the future
- Speculative – Moving out of money and into non-money assets in anticipation of a financial return.

More recently, the monetarist Milton Friedman proposed his portfolio theory as to why people hold different financial assets. This suggests that people will satisfy the cash demands before considering any other assets. They will then fulfill their needs for highly liquid accounts (Those that can be quickly converted into cash, such as current and deposit accounts), then less liquid but potentially high return assets.

The motive for saving or investing has an effect on responses to changes and market conditions. For example, in a period of high inflation: Those saving for a specific future purchase will probably spend now and withdraw savings, if necessary borrowing the differences between price and savings balance, in fear that the price of the purchase will increase in the future. Those saving for a rainy day will save more, as they perceive that the value of their savings is no longer adequate in real terms for the purpose intended.
Factors Affecting Customer Choice

When saving and investing, customers are driven by various stimuli. These vary according to personal need and preference, as well as factors such as averseness to risk.

The following factors usually drive customer demand for funding products offered by financial institutions:

Rate of interest

Potential for capital growth

Risk of capital loss

Convenience

Liquidity requirements (the perceived need to be able to convert the asset back into cash)

Simplicity – the ease with which the customer can understand the product or service

Tax efficiency – some products are tax free such as Tessa’s, and Peps

Risk, Time and Return:

Requirements of different investors

Different investors have different risk and time preferences. A person with only Rs.500 to invest will not wish to take much risk, and will probably require the money to be readily available to meet any sudden bills. This investor will have entirely different requirements to an investor with an existing portfolio of about Rs.2,00,000
who has just won Rs.5,000 on the National Lottery. This latter investor will have a much greater willingness to accept a high risk, long-term investment in the hope of a higher return.

**Kinds of risk**

In considering economic and political factors, investors commonly identify five kinds of hazards to which their investments are exposed. They are:

**i) Business and Financial Risk**

Business risk and financial risk are actually two separate types of risks, but since they are interrelated it would be wise to discuss them together. Business risk, which is sometimes called operating risk, is the risk associated with the normal day-to-day operations of the firm. Financial risk is created by the use of fixed cost securities (that is, debt and preference shares). Looking at the two categories in a sources and uses context, business risk represents the chance of loss and the variability of return created by a firm's uses of funds. Financial risk is the chance of loss and charges and taxes.

**ii) Purchasing Power Risk**

Whenever investors desire to preserve their economic position over time, they utilize investment outlets whose values vary with the price level. They select investments whose market values change with consumer prices, which compensates them for cost of living increase. If they do not, they will find that their total wealth has been diminished. Inflation is an economic cripper that destroys the economic power of
investors over goods and services. In essence, investors have to be concerned with
the command that their invested money has over goods and services on a continuing
basis. In fact, we have been living with increasing consumer prices for many years.

iii) Market Risk
This hazard arises from the fact that market prices and collateral values of securities
and real property may vary substantially, even when their earning power does not
change. The causes of these price uncertainties are varied. At times many markets
are simply thin- that is, buyers and sellers appear only intermittently. More
commonly, investment prices vary because investors vacillate in their preference for
different forms of investment, or simply because they sometimes have money to
invest and sometimes do not have it. But once the equity has developed a particular
price pattern, it does not change this pattern quickly. The causes of changes in
market price are usually beyond the control of the corporation. An unexpected war
or the end of one, an election year, political activity, illness or death of a president,
speculative activity in the market, the outflow of bullion – all are tremendous
psychological factors in the market. The irrationality in the securities markets may
cause losses unrelated to the basic risks. These losses are the result of changes in
the general tenor of the market and are called market risks.

The market risk in equity shares is much greater than it is in bonds. Equity shares
value and prices are related in some fashion to earnings. Current and prospective
dividends, which are made possible by earnings, theoretically, should be capitalized
at a rate that will provide yields to compensate for the basic risks.
iv) Interest Rate Risk

A major source of risk to the holders of high quality bonds is changes in interest rates, commonly referred to as interest rate risk. These high-quality bonds are not subjected to either substantial business risk or financial risk. Consequently, they are referred to as high-quality bonds; their prices are determined mainly by the prevailing level of interest rate in the market. As a result, if interest rates fall, the prices of these bonds will rise, and vice versa.

Interest rate risk affects all investors in high quality bonds regardless of whether the investors hold short-term or long-term bonds. Changes in interest rate have the greatest impact on the market price of long-term bonds, since the longer the period before the bond matures, the greater the effect of a change in interest rates. On the other hand, changes in interest rates will not have much of an impact on the market price of short-term bonds, but the interest income on short-term bonds portfolio may fluctuate markedly from period to period, as interest rates change. Consequently, changes in interest rates affect investors in long-term as well as in short-term bonds.

v) Social or Regulatory Risk

The social or regulatory risk arises where an otherwise profitable investment is impaired as a result of adverse legislation, harsh regulatory climate, or in extreme instance nationalization by a socialistic government. The profits of industrial companies may be reduced by price controls, and rent controls may largely destroy the value of rental property held for income or as a price-level hedge. The social risk is really political and thus unpredictable, but under a system of representative
government based on increasing government intervention in business affairs, no industry can expect to remain exempt from it.

Other Risks:
Other types of risk, particularly those associated with investment in foreign securities, are the monetary value risk and the political environment risk. The investor who buys foreign government bonds or securities of foreign corporations often in an attempt to gain a slightly higher yield than obtained on domestic issues, runs the calculated risk of a change in the foreign government and reputation of outstanding debt, nationalization of business, or the desire but inability of the foreign government or corporation to handle its indebtedness. The investor should weigh carefully the possibility of the additional risks associated with foreign investments against the expected return, either in the form of interest or dividends or capital gains, when investing in foreign securities rather than domestic securities.

Link between risk, time and return:
Generally speaking, the greater the risk and time involved, the greater the potential return if all goes well.

Investment – longer term: low to high risk/reward:
Investment has a higher risk and longer timescale than saving, and the return can come in the form of income, or capital gain, or a mixture of the two. When we come to consider portfolio planning we will see that nobody should invest until he has adequate savings to meet any unforeseen financial emergency. One form of
investment is equities because in the long-term, say five years or more, the capital value of equities and their dividends should grow as the economy grows.

**Capital Markets:**

The capital market provides the resources needed by medium and large-scale industries for investment purposes while the money market provides resources for working capital needs. As such while money market deals in short-term sources of funds, capital market deals in long-term sources of funds. Thus, the capital market functions as an institutional mechanism to channel long-term funds from those who save to those who need them for productive purposes. It serves as a medium to bring together entrepreneurs, initiating activity involving huge financial resources and savers, individuals or institutions, seeking outlets for investment.

**Structure of the Capital Market:**

The capital market consists of the primary markets and the secondary markets and there is a close link between them. The primary market creates long-term instruments through which corporate entities borrow from the capital market. But Secondary market is the one which provides liquidity and marketability to these Instruments. These markets interact. If the secondary market active and buoyant it enables the corporate entities to enter the new issue market or the primary market and raise funds through the market that more instruments are available in the secondary market for the purpose of improved activities in the market.
Primary Market

To meet the financial requirements of their projects companies raises capital through issue of securities in the primary market. The Capital Issue-Control Act, 1947, controlled capital issues of the companies. Pricing of the issues was determined by the Controller of Capital Issues. The main purpose of control on capital issue was to prevent the diversion of investible resources to non-essential projects. Though the necessity of retaining some sort of control on issue of capital to meet the above purpose still exists, the CCI was abolished in 1992 as the practice of Government control over capital issues as well as overpricing of issues has lost its relevance in the changed circumstances.

Investors

The major categories of investors in primary markets for government securities are:

1. Commercial banks
2. Financial institutions (FIs)
3. Large corporate bodies
4. Reserve Bank of India
5. Foreign Institutional Investors

The Commercial banks are compulsive investors in government securities due to SLR maintenance with RBI, while nationalized banks prefer long-dated securities which normally have higher interest rates; the foreign banks prefer short-dated securities in order to minimize the depreciation in their investments.
The financial institutions and large corporate bodies prefer long-dated securities as they have large long-term surplus. This also helps them to match their long-term liabilities with such loan maturities. Government securities and bonds are preferred by them as they are totally risk-free.

The Reserve Bank of India is a major investor in government securities. Such investments are by default as RBI takes over the unsubscribe portion of any issue of government loan. It is in fact, a market maker of government securities. Such market making is carried out through RBI's open market operations and switch deals with the sole purpose of managing the issue of government borrowings and facilitate the commercial banks to maintain their portfolio in such a way that they do not suffer any loss. These operations are discussed below under the section secondary market.

**Investments in Government Securities**

The FII’s have been permitted to invest in dated securities within the framework of guidelines on debt instruments for 100 % debt funds, subject to an annual cap on such investment within the overall limit of external commercial borrowings.

- FII’s are allowed to invest in dated securities of all maturities of both Central and State Governments and in treasury bills both in primary and secondary markets.
- FIIls are allowed to set-up 100% debt funds.
- Interest earned debt instruments are taxed at 20%.
The secondary market in government securities was a few years back quiet narrow and dominated by a few institutions and commercial banks. However, in early 90’s the market has turned fairly active with various trading banks and some brokers quoting two-way prices, which has imparted liquidity to this money market instrument.

The secondary market for securities is akin to the call market with major business being concentrated than in Mumbai. RBI approved brokers are permitted to transact business in securities with banks, institutions and RBI transactions are effected in spot as well as in futures for outright sale/purchase as well as for the ‘ready forwards’.

**Success in Investment:**

Success in most things is relative, and not less so in the field of investment.

Success in investment means earning the highest possible return with the constraints imposed by the investors’ personal circumstances – age, family needs, liquidity requirements, tax position and acceptability of risk. If possible, performance should be measured against alternative investments, or combinations of investments, available to the investor within those constraints.

Genuine success also means winning the battle against inflation, against the fall in the real value of savings and capital. To be successful investor, one should strive to
achieve not less than the rate of return consistent with the risk assumed. But is this success? If markets are efficient, abnormal returns are not likely to be achieved, and so the best one can hope for a return consistent with the level of risk assumed. The trick is to assess the level of risk we wish to assume and make certain that the collection of assets we buy fulfills our risk expectations. As a reward for assuming this level of risk, we will receive the returns that are consistent with it. If, however, we believe that we do better than the level of return warranted by the level of risk assumed, then success must be measured in these terms. But care must be exercised here. Merely realizing higher returns does not indicate success in this sense.

We are really talking about outperforming the average of the participant in the market for assets. And if we realize higher return we must be certain that we are not assuming higher risks consistent with those returns in order to measure our success. Thus we are left with two definitions of success.

- Success is achieving the rate of return warranted by the level of risk assumed. Investors expect returns proportional to the risk assumed.

- Success is achieving a rate of return in excess of warranted by the level of risk assumed. Investors expect abnormal returns for the risk assumed.

- To be successful under the first definition, an investor must have a rational approach to portfolio construction and management. Reasonably efficient diversification is the key. To be successful under the second definition, an investor must have at least one of the following i.e., superior analytical skill, superior forecasting ability, Inside information, dumb luck.
Mutual Fund – An Overview

Introduction:

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

In the dynamic Indian capital market, mutual fund industry has become a core area of research in recent years. Hence, customized products and close monitoring of funds are essential for fund managers to construct a most preferred fund in Indian capital market for the coming years. Investors do not hold mutual funds to achieve higher performance but, to relieve them from the burden of managing a well – diversified portfolio themselves.

One school of thought (Nalini Prava Tripathy, 2007) argues that investors invest in mutual funds because funds are pooled and professionally managed while another school of thought (VK Bhalla, 2005) believes that investors do not have thorough knowledge about the investments in mutual funds on account of inadequate information about Capital markets, are time constrained to do research, high research cost etc. Investments in constrained situations could result in selecting an inappropriate fund that does not meet the investment objective. This is evidenced by
the recent growth in the retail investor segment with these investors being more active in Initial Public Offer and New Fund Offer as compared to investments by High Networth Individuals and Qualified Institutional Bidders.

Retail investors perhaps prefer the mutual fund investments for long term capital appreciation and potential possibility for tax advantages because investments are of longer time horizon. Some would like to participate in the NFO and some would like to enter in the established existing fund but a million dollar question, “Whether enter at cheaper NAV or Premium NAV?” has been unanswered for a long time. The basic tenet emphasizes that the performance of a portfolio cannot be measured by NAV and apparently the performance is determined by the stocks involved in the fund. On universal ground, the typical selection would be based on the return and risk profile of the portfolio.

The mutual fund market has essentially three categories of participants, ie. the issuers of securities, investors in securities and the intermediaries. The issuers are the borrowers or deficit savers, who issue securities to raise funds. The investors, who are surplus savers, deploy their savings by subscribing to these securities. The intermediaries are the agents who match the needs of users and suppliers of funds for a commission. These intermediaries pack and unpack securities to help both the issuers and investors to achieve their respective goals. There are a large variety and a number of intermediaries providing various services in the Indian mutual fund market.
This process of mobilisation of resources is carried out under the supervision and overview of the regulators. The regulators develop fair market practices and regulate the conduct of issuers of securities and the intermediaries. They are also in charge of protecting the interests of the investors. The regulator ensures a high service standard from the intermediaries and supply of quality securities and non-manipulated demand for them in the market.

**Origin of Mutual fund:**

Mutual funds go back to the times of the Egyptians and Phoenicians’ when they sold shares in caravans and vessels to spread the risk of these ventures. The foreign and colonial government Trust of London of 1868 is considered to be the fore-runner of the modern concept of mutual funds. The USA is, however, considered to be the mecca of modern mutual funds. By the early-1930s quite a large number of close-ended mutual funds were in operation in the U.S.A. Much later in 1954, the committee on finance for the private sector recommended mobilisation of savings of the middle class investors through unit trusts. Finally in July 1964, the concept took root in India when Unit Trust of India was set up with the twin objective of mobilising household savings and investing the funds in the capital market for industrial growth. Household sector accounted for about 80 percent of nation’s savings and only about one third of such savings was available to the corporate sector; it was felt that UTI could be an effective vehicle for channelising progressively larger shares of household savings to productive investments in the corporate sector. The process of economic liberalization in the eighties not only brought in dramatic changes in the environment for Indian industries, corporate sector and the capital market but also led to the emergence of demand for newer financial services such as issue
management, corporate counseling, capital restructuring and loan syndication. After two decades of UTI monopoly, recently some other public sector organisations like LIC (1989), GIC (1991), SBI (1987), Can Bank (1987), Indian Bank (1990), Bank of India (1990), Punjab National Bank (1990) have been permitted to set up mutual funds. Mr. M.R. Mayya the Executive Director of Bombay Stock Exchange opined recently that the decade of nineties will belong to mutual funds because the ordinary investor does not have the time, experience and patience to take independent investment decisions on his own.

**Importance of Mutual Fund:**

Small investors face a lot of problems in the share market, limited resources, lack of professional advice, lack of information etc. Mutual funds have come as a much needed help to these investors. It is a special type of institutional device or an investment vehicle through which the investors pool their savings which are to be invested under the guidance of a team of experts in wide variety of portfolios of corporate securities in such a way, so as to minimise risk, while ensuring safety and steady return on investment. It forms an important part of the capital market, providing the benefits of a diversified portfolio and expert fund management to a large number, particularly small investors. Now days, mutual fund is gaining its popularity due to the following reasons:

- With the emphasis on increase in domestic savings and improvement in deployment of investment through markets, the need and scope for mutual fund operation has increased tremendously. The basic purpose of reforms in the financial sector was to enhance the generation of domestic mutual fund in
India. This calls for a market based institution which can tap the vast potential of domestic savings and channelize them for profitable investments. Mutual funds are not only best suited for the purpose but also capable of meeting this challenge.

- An ordinary investor who applies for share in a public issue of any company is not assured of any firm allotment. But mutual funds who subscribe to the capital issue made by companies get firm allotment of shares. Mutual fund latter sell these shares in the same market and to the Promoters of the company at a much higher price. Hence, mutual fund creates the investors confidence.

- The psyche of the typical Indian investor has been summed up by Mr. S.A. Dave, Chairman of UTI, in three words; Yield, Liquidity and Security. The mutual funds, being set up in the public sector, have given the impression of being as safe a conduit for investment as bank deposits. Besides, the assured returns promised by them have investors had great appeal for the typical Indian investor.

- As mutual funds are managed by professionals, they are considered to have a better knowledge of market behaviours. Besides, they bring a certain competence to their job. They also maximise gains by proper selection and timing of investment.
• Another important thing is that the dividends and capital gains are reinvested automatically in mutual funds and hence are not frittered away. The automatic reinvestment feature of a mutual fund is a form of forced saving and can make a big difference in the long run.

• The mutual fund operation provides a reasonable protection to investors. Besides, presently all Schemes of mutual funds provide tax relief under Section 80 L of the Income Tax Act lead to the growth of importance of mutual fund in the minds of the investors.

• As mutual funds creates awareness among urban and rural middle class People about the benefits of investment in capital market, through profitable and safe avenues, mutual fund could be able to make up a large amount of the surplus funds available with these people.

• The mutual fund attracts foreign capital flow in the country and secures profitable investment avenues abroad for domestic savings through the opening of off shore funds in various foreign investors. Lastly another notable thing is that mutual funds are controlled and regulated by SEBI and hence are considered safe. Due to all these benefits the importance of mutual fund has been increasing.
**Mutual funds in India:**

A mutual fund is set up in the form of a trust, which has Sponsor, Trustees, Asset Management Company (AMC) and Custodian. The trust is established by a sponsor or more than one sponsor who is like promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. Asset Management Company (AMC) approved by SEBI manages the funds by making investments in various types of securities. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund.

SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.

In India, during the past decade, there has been a significant growth in the investment (as indicated by AUM) in mutual funds (Figure-1). This growth can be attributed to an apparent stabilization in the stock markets rendering mutual funds more attractive to investors.
As on June 2010 (AMFI Monthly report), there are 39 Asset Management companies in India manage 832 arrays of schemes. Out of 39 AMC’s, 6 are Public sector and 33 are Private sector. Out of 33 Private sectors AMC’s, 16 are Indian origin, 5 are Foreign, 5 are predominantly Indian Joint ventures, and 7 are predominantly foreign joint ventures. During May 2010 (SEBI Bulletin-June’10 Issue), mutual funds liquidated Rs. 62,960 crore from investors (of which Rs. 12,325 crore were redeemed by private sector mutual funds and Rs. 50,634 crore were redeemed by public sector mutual funds) as compared to Rs. 1,85,955 crore mobilized during April 2010. During 2010-11, so far, mutual funds mobilized Rs.1,22,996 crore from investors compared to Rs. 83,080 crore in 2009-10. The market value of asset under management stood Rs. 7,43,116 crore as on May 31, 2010 as compared to Rs. 8,08,541 crore as on April 30, 2010, indicating a decrease of 8.1 percent.
Market regulator Security Exchange Board of India (SEBI) continuously monitors mutual fund industry in order ensure transparency in the system as well as investors protection. This facilitates high amount of investors’ participation in mutual funds. It also plays valuable role in investors’ awareness and encourages all categories of investors. In order to bring enhanced participation, time to time it maneuver’s the policy related issues. As a bench mark, on August 2009, it abolished the entry load structure and investors’ do not have to incur any investment cost, thus, the earning potential would be approximately around 2.25% to 2.75% depending on the style and investment objective of the fund on the first day of investment.

MILESTONES OF INDIAN MUTUAL FUND INDUSTRY

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank. The mutual fund industry started in India in a small way with the UTI Act creating what was effectively a small savings division within the RBI. Over a period of 25 years this grew fairly successfully and gave investors a good return, and therefore in 1989, as the next logical step, public sector banks and financial institutions were allowed to float mutual funds and their success emboldened the government to allow the private sector to foray into this area.

The initial years of the industry also saw the emerging years of the Indian equity market, when a number of mistakes were made and hence the mutual fund schemes, which invested in lesser-known stocks and at very high levels, became loss leaders for retail investors. From those days to today the retail investor, for
whom the mutual fund is actually intended, has not yet returned to the industry in a big way. But to be fair, the industry too has focused on bringing in the large investor, so that it can create a significant base corpus, which can make the retail investor feel more secure. The history of mutual funds in India can be broadly divided into four distinct phases.

First Phase – 1964-87:
Unit Trust of India (UTI) was established on 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs.6,700 crores of assets under management.

Second Phase – 1987-1993 (Entry of Public Sector Funds):
1987 marked the entry of non-UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. At the end of 1993, the mutual fund industry had assets under management of Rs.47,004 crores.
Third Phase – 1993-2003 (Entry of Private Sector Funds):

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993. The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996. The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs.44, 541 crores of assets under management was way ahead of other mutual funds.

Fourth Phase – since February 2003:

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs.29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations. The
second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs.76,000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth. As at the end of September, 2004, there were 29 funds, which manage assets of Rs.153108 crores under 421 schemes.

Dependence of mutual fund markets

Three main sets of entities depend on mutual fund market. While the corporate and Governments raise resources from the mutual fund market to meet their needs of investment and/or discharge some obligations, the households invest their savings in the securities. During 2003-04, corporate sector and Government together raised a total amount of Rs. 2,67,660 crore from the mutual fund market, while the household sector invested Rs.22,554 crore of their financial savings through the mutual fund market. The Central Government and the State Governments nowadays finance about two third and one third of their fiscal deficits respectively, through borrowings from the mutual fund market. The corporate sector finances about one third of its external finance requirements through the mutual fund market.

Corporate Sector:

The early 1990s witnessed the emergence of mutual fund market as a major source of finance for trade and industry. However, according to CMIE data, the share of mutual fund market based instrument in resources raised externally increased to
53.2% in 1993-94, but declined thereafter to -18% in 2002-03. This causes more concern when the share of external finance in the corporate finance declined from 74% in 1996-97 to 38% in 2002-03. The mutual fund market has virtually collapsed as a source of industrial finance as its share in industrial finance has declined from 1.9% of GDP at current prices during 1992-93 to 1996-97 to a meager 0.2% during 1997-98 to 2001-02. Similarly, the share of equity capital in the external finance of corporate declined from 20.5% during 1992-97 to 12.8% during 1997-2001.

**Governments:**
Along with the increase in the fiscal deficits of the Government, the dependence on market borrowings to finance fiscal deficits has increased over the years. The State Governments and the Central Government financed about 14% and 18% respectively of their fiscal deficit through market borrowing during 1990-91. In percentage term, dependence of the State Governments on market borrowings did not increase much till 2000-01. However, their dependence on market borrowings had been increasing since then to reach 28% during 2002-03 and 32% during 2003-04. In case of Central Government, it increased to 72% by 2002-03 and then declined to 65% during 2003-04.

**Households:**
Household sector accounted for 86.5% of gross domestic savings during 2003-04; 46.8% of their savings were in financial assets. The share of financial savings of the household sector in securities (mutual funds, debentures, public sector bonds, units of UTI and other Mutual Funds and Government securities) was estimated to have gone down from 22.9% in 1991-92 to 5.4% in 2003-04.
Features of mutual funds:

i) Affordability:
Mutual funds allow the investor to start with small investments. For example, if an investor wants to buy a portfolio of blue chips of modest size, he should at least have a few lakhs of rupees. A mutual fund gives you the same portfolio for meager investment of Rs 1,000-5,000. A mutual fund can do that because it collects money from many people and it has a large corpus.

ii) Professional management:
The major advantage of investing in a mutual fund is that investor gets a professional money manager for a small fee. Investor can leave the investment decisions to him and only have to monitor the performance of the fund at regular intervals.

iii) Diversification:
Considered the essential tool in risk management, mutual funds make it possible for even small investors to diversify their portfolio. A mutual fund can effectively diversify its portfolio because of the large corpus. However, a small investor cannot have a well-diversified portfolio because it calls for large investment.

iv) Convenience:
Mutual funds offer tailor-made solutions like systematic investment plans and systematic withdrawal plans to investors, which is very convenient to investors. Investors also do not have to worry about the investment decisions or they do not have to deal with their brokerage or depository, etc. for buying or selling of securities.
Mutual funds also offer specialized schemes like retirement plan, children's plan, industry specific schemes, etc. to suit personal preference of investors. These schemes also help small investors with asset allocation of their corpus. It also saves a lot of paper work.

v) Cost effectiveness:

A small investor will find that a mutual fund route is a cost effective method. AMC fee is normally 2.5% and they also save a lot of transaction costs as they get concession from brokerages. Also, they get the service of a financial professional for a very small fee. If they were to seek a financial advisor's help directly, they may end up pay more. Also, the size of the corpus should be large to get the service of investment experts, who offer portfolio management.

vi) Liquidity:

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

vii) Tax breaks:

Investors do not have to pay any taxes on dividends issued by mutual funds. They also have the advantage of capital gains taxation. Tax-saving schemes and pension schemes give investors the added advantage of benefits.
viii) Transparency:
Mutual funds offer daily NAVs of schemes, which help investors to monitor their investments on a regular basis. They also send quarterly newsletters, which give details of the portfolio, performance of schemes against various benchmarks, etc. They are also well regulated and SEBI monitors their actions closely.

MUTUAL FUND SETUP:

A mutual fund is set up in the form of a trust, which has sponsor, trustees, asset management company (AMC) and custodian. The trust is established by a sponsor or more than one sponsor who is like promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. Asset Management Company (AMC) approved by SEBI manages the funds by making investments in various types of securities. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund.

SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.
The flow chart below describes broadly the working of a mutual fund:

Figure: 3.2

Working of a Mutual fund
Organisation of a mutual fund:

There are many entities involved and the diagram below illustrates the organisational set up of a mutual fund:

Figure:3.3

Organisation of a Mutual fund

- Unit Holders
- Sponsors
- Trustees
- The Mutual
- Custodian
- SEBI
- AMC
- Transfer Agent
Advantages of mutual funds:

Professional Management:

The primary advantage of funds is the professional management of money. Investors purchase funds because they do not have the time or the expertise to manage their own portfolios. A mutual fund is a relatively inexpensive way for a small investor to get a full-time manager to make and monitor investments.

Diversification:

By owning shares in a mutual fund instead of owning individual stocks or bonds, the risk is spread out. The idea behind diversification is to invest in a large number of assets so that a loss in any particular investment is minimized by gains in others. In other words, the more stocks and bonds you own, the less any one of them can hurt you. Large mutual funds typically own hundreds of different stocks in many different industries. It wouldn't be possible for an investor to build this kind of a portfolio with a small amount of money.

Economies of Scale:

Mutual fund buys and sells large amounts of securities at a time, its transaction costs are lower than what an individual would pay for securities transactions.
Less Risk:

Investors acquire a diversified portfolio of securities even with a small investment in a Mutual Fund. The risk in a diversified portfolio is lesser than investing in merely 2 or 3 securities

Low Transaction Cost:

Due to the economies of scale (benefits of larger volumes), mutual funds pay lesser transaction costs. These benefits are passed on to the investors.

Choice of Schemes:

Mutual funds provide investors with various schemes with different investment objectives. Investors have the option of investing in a scheme having a correlation between its investment objectives and their own financial goals. These schemes further have different plans/options

Transparency:

Funds provide investors with updated information pertaining to the markets and the schemes. All material facts are disclosed to investors as required by the regulator.

Flexibility:

Investors also benefit from the convenience and flexibility offered by Mutual Funds. Investors can switch their holdings from a debt scheme to an equity scheme and vice-versa. Option of systematic (at regular intervals) investment and withdrawal is also offered to the investors in most open-end schemes.
Safety:

Mutual Fund industry is part of a well-regulated investment environment where the interests of the investors are protected by the regulator. All funds are registered with SEBI and complete transparency is forced.

Liquidity:

An investor may not be able to sell some of the shares held by him very easily and quickly, whereas units of a mutual fund are far more liquid.

Bottlenecks in Mutual Funds:

Costs:

Creating, distributing, and running a mutual fund is an expensive proposition. Expenses such as manager’s salary to the investors’ statements cost money are passed on to the investors. Since fees vary widely from fund to fund, failing to pay attention to the fees can have negative long-term consequences.

Dilution:

It's possible to have too much diversification. Because funds have small holdings in so many different companies, high returns from a few investments often don't make much difference on the overall return. Dilution is also the result of a successful fund getting too big. When money pours into funds that have had strong success, the manager often has trouble finding a good investment for all the new money.
**Taxes:**

When a fund manager sells a security, a capital-gains tax is triggered. Investors who are concerned about the impact of taxes need to keep those concerns in mind when investing in mutual funds. Taxes can be mitigated by investing in tax-sensitive funds.

**No Customized Portfolios:**

The portfolio of securities in which a fund invests is a decision taken by the fund manager. Investors have no right to interfere in the decision making process of a fund manager, which some investors find as a constraint in achieving their financial objectives.

**Difficulty in Selecting a Suitable Fund Scheme**

Many investors find it difficult to select one option from the plethora of funds/schemes available. For this, they may have to take advice from financial planners in order to invest in the right fund to achieve their objectives.

**SEBI guidelines governing mutual funds:**

Market watchdog Securities and Exchange Board of India (SEBI) is strengthening the mutual fund distribution system to prevent possible cases of mis-selling by banks and national distributors. Recently, the Association of Mutual Funds in India (AMFI) had sent a strict warning to national distributors like HSBC, NJ India Invest, HDFC Bank and Kotak Mahindra Bank who were actively engaged in this sector. SEBI is working along with the National Institute of Securities Markets (NISM) to formulate the guidelines. The working group committee will also include representatives from banks and national distributors. SEBI had asked fund houses to disclose all
complaints received by them on their respective websites and in their annual reports by 30 June 2010 in order to increase transparency. SEBI has now proposed that the risk appetite, investment objective and affordability of the customer should match with the product. Besides, national distributors and banks will have to seek an acknowledgement document from the clients before a client invests in a scheme. The acknowledgement document will contain the customer category and a statement of fee earned from a particular product. The market regulator has also suggested recording the calls of all relationship managers with the customers for auditing and has also proposed periodic auditing and compliance of these new norms. Securities and Exchange Board of India has been vested with wide ranging statutory power to oversee the constitution and working of mutual funds. These guidelines include

- All mutual funds shall be authorised for business by the Securities and Exchange Board of India and operated only by separate asset management companies.
- Mutual funds cannot invest more than 10 per cent of the total net assets of a scheme in the short-term deposits of a single bank.
- The asset management companies (AMCs) shall not be permitted to charge any investment and advisory fees for parking of funds in short-term deposits of banks in case of liquid and debt-oriented schemes.
- Mutual funds can invest only in transferable securities either in the money market or in the capital market.
- No mutual fund will be promoted to do option trading, short selling or carrying forward of transactions in securities.
• Investment under all the schemes cannot exceed 25 percent of funds in the shares and debentures of a single company.

• Investments in rated debt instruments of a single issuer have been limited to 15 percent of the net asset value of the scheme. Securities and Exchange Board of India will grant registration to only those mutual funds which can conduct their business smoothly and efficiently. Parameters for deciding this will include a track record of sponsors, a minimum experience of 5 years in the relevant field of financial services, integrity in business transactions and financial business.

• The minimum net worth of such an Asset Management Company is stipulated as Rs.5 crores, of which the minimum contribution of the sponsor should be 40 percent.

• The mutual funds should have a custodian, not associated in any way with the asset management company and registered with the Board.

• The minimum amount to be raised with each closed ended scheme should be Rs.20 crores and for the open scheme Rs.50 crores.

• In case of low subscription, the entire amount has to be refunded within 6 weeks from the date of closure of the scheme; otherwise an interest at 15 percent per annum from the date of expiry of 6 weeks has to be paid.

• Mutual funds will have to maintain books of accounts, expenses and make appropriation of expenses among the individual schemes, fix limit for the expenses of the Asset Management Company that can be charged to the mutual funds, provide for depreciation and bad debts.

• Mutual funds have to publish scheme wise annual reports, furnish annual statement of accounts, furnish six monthly unaudited accounts, quarterly
statements of movements and net assets value and quarterly portfolio statements to Securities and Exchange Board of India.

- Mutual funds should ensure adequate disclosure to the investors. The Securities and Exchange Board of India also restricted mutual funds from making assurances or claims that could mislead the public.
- In case of violations of the provisions of the Securities and Exchange Board of India Act, 1992, Securities and Exchange Board of India can withdraw authorization to any Asset Management Company.

**RBI guidelines:**

Mutual funds should be constituted as a trust under the Indian Trust Act and atleast tow outside trustees should be appointed.

Mutual funds should have a full time executive for the day-to-day management.

There must be an arm’s length relationship between the mutual fund and the sponsor Banks.

`A clear statement of objective and policies for the funds must be laid down and published. Bank sponsored mutual funds cannot invest in finance companies.

Mutual funds are not to undertake direct or indirect lending, underwriting, bills discounting and money market operations.
Figure No: 3.4

TYPES OF MUTUAL FUND SCHEMES

Types of Funds

Capitalisation

Open-Ended Schemes

Close-Ended Schemes

Investments

Growth Funds

Growth & Income Funds

Fixed-Income Funds

Balanced/Equity In.Funds

Money Market Funds

Specialty / Sector Funds
CLASSIFICATION ACCORDING TO CAPITALISATION

Open-Ended Schemes:

These funds are sold at the NAV based prices, generally calculated on every business day. These schemes have unlimited capitalization, open-ended schemes do not have a fixed maturity - i.e. there is no cap on the amount you can buy from the fund and the unit capital can keep growing. These funds are not generally listed on any exchange.

Open-ended funds are bringing in a revival of the mutual fund industry owing to increased liquidity, transparency and performance in the new open-ended funds promoted by the private sector and foreign players. Open-ended funds score over close-ended ones on several counts. Some of these are listed below:

Any time exit option:

The issuing company directly takes the responsibility of providing an entry and an exit. This provides ready liquidity to the investors and avoids reliance on transfer deeds, signature verifications and bad deliveries.
**Tax advantage:**

Though Budget 2004 proposals envisage a tax rate of 20.91% (Corporate investors) and 13.06875% (Non-Corporate investors) on dividend distribution made by the Debt funds, the funds continue to remain attractive investment vehicles. In equity plans there is no distribution tax.

**Any time entry option:**

An open-ended fund allows one to enter the fund at any time and even to invest at regular intervals (a systematic investment plan).

**Close-ended Schemes:**

A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.
Classification according to Investment Objectives:

Mutual funds have specific investment objectives such as growth of capital, safety of principal, current income or tax-exempt income. In general mutual funds fall into three general categories:

- Equity Funds invest in shares or equity of companies.
- Fixed-Income funds invest in government or corporate securities that offer fixed rates of return.
- Balanced Funds invest in a combination of both stocks and bonds.

Growth Funds:

These funds seek to provide growth of capital with secondary emphasis on dividend. They invest in shares with a potential for growth and capital appreciation. Because they invest in well-established companies where the company itself and the industry in which it operates are thought to have good long-term growth potential, growth funds provide low current income. Growth funds generally incur higher risks than income funds in an effort to secure more pronounced growth.

These funds may invest in a broad range of industries or concentrate on one or more industry sectors. Growth funds are suitable for investors who can afford to assume the risk of potential loss in value of their investment in the hope of achieving substantial and rapid gains. They are not suitable for investors who must conserve their principal or who must maximize current income.
Growth and Income Funds

Growth and income funds seek long-term growth of capital as well as current income. The investment strategies used to reach these goals vary among funds. Some invest in a dual portfolio consisting of growth stocks and income stocks, or a combination of growth stocks, stocks paying high dividends, preferred stocks, convertible securities or fixed-income securities such as corporate bonds and money market instruments. Others may invest in growth stocks and earn current income by selling covered call options on their portfolio stocks.

Growth and income funds have low to moderate stability of principal and moderate potential for current income and growth. They are suitable for investors who can assume some risk to achieve growth of capital but who also want to maintain a moderate level of current income.

Fixed-Income Funds:

The goal of fixed income funds is to provide current income consistent with the preservation of capital. These funds invest in corporate bonds or government-backed mortgage securities that have a fixed rate of return. Within the fixed-income category, funds vary greatly in their stability of principal and in their dividend yields. High-yield funds, which seek to maximize yield by investing in lower-rated bonds of longer maturities, entail less stability of principal than fixed-income funds that invest in higher-rated but lower-yielding securities.

Some fixed-income funds seek to minimize risk by investing exclusively in securities whose timely payment of interest and principal is backed by the full faith and credit of the Indian Government. Fixed-income funds are suitable for investors who want to
maximize current income and who can assume a degree of capital risk in order to do so.

**Balanced Fund:**

The Balanced fund aims to provide both growth and income. These funds invest in both shares and fixed income securities in the proportion indicated in their offer documents. Ideal for investors who are looking for a combination of income and moderate growth.

**Money Market Funds/Liquid Funds**

For the cautious investor, these funds provide a very high stability of principal while seeking a moderate to high current income. They invest in highly liquid, virtually risk-free, short-term debt securities of agencies of the Indian Government, banks and corporations and Treasury Bills. Because of their short-term investments, money market mutual funds are able to keep a virtually constant unit price; only the yield fluctuates.

Therefore, they are an attractive alternative to bank accounts. With yields that are generally competitive with - and usually higher than -- yields on bank savings account, they offer several advantages. Money can be withdrawn any time without penalty. Although not insured, money market funds invest only in highly liquid, short-term, top-rated money market instruments.

Money market funds are suitable for investors who want high stability of principal and current income with immediate liquidity.
**Specialty/Sector Funds:**

These funds invest in securities of a specific industry or sector of the economy such as health care, technology, leisure, utilities or precious metals. The funds enable investors to diversify holdings among many companies within an industry, a more conservative approach than investing directly in one particular company.

Sector funds offer the opportunity for sharp capital gains in cases where the fund's industry is "in favor" but also entail the risk of capital losses when the industry is out of favor. While sector funds restrict holdings to a particular industry, other specialty funds such as index funds give investors a broadly diversified portfolio and attempt to mirror the performance of various market averages.

Index funds generally buy shares in all the companies composing the BSE SENSEX or NSE Nifty or other broad stock market indices. They are not suitable for investors who must conserve their principal or maximize current income.

**Other types of Mutual Fund Schemes:**

**Tax Savings Scheme:**

These schemes offer tax rebates to the investors under specific provisions of the Income Tax Act, 1961 as the Government offers tax incentives for investment in specified avenues. E.g. Equity Linked Savings Schemes (ELSS). Pension schemes launched by the mutual funds also offer tax benefits. These schemes are growth oriented and invest pre-dominantly in equities. Their growth opportunities and risks associated are like any equity-oriented scheme.
**Fund of Fund Scheme:**

A scheme that invests primarily in other schemes of the same mutual fund or other mutual funds is known as a FOF scheme. An FOF scheme enables the investors to achieve greater diversification through one scheme. It spreads risks across a greater universe.

**Load or Non-Load Fund:**

A Load Fund is one that charges a percentage of NAV for entry or exit. That is, each time one buys or sells units in the fund, a charge will be payable. This charge is used by the mutual fund for marketing and distribution expenses. Suppose the NAV per unit is Rs.10. If the entry as well as exit load charged is 1%, then the investors who buy would be required to pay Rs.10.10 and those who offer their units for repurchase to the mutual fund will get only Rs.9.90 per unit. The investors should take the loads into consideration while making investment as these affect their yields/returns. However, the investors should also consider the performance track record and service standards of the mutual fund, which are more important. Efficient funds may give higher returns in spite of loads.

A no-load fund is one that does not charge for entry or exit. It means the investors can enter the fund/scheme at NAV and no additional charges are payable on purchase or sale of units.
**Meaning of Midcap funds:**

Mid cap funds are those mutual funds, which invest in small / medium sized companies. As there is no standard definition classifying companies as small or medium, each mutual fund has its own classification for small and medium sized companies. Generally, companies with a market capitalization of up to Rs 500 crore are classified as small. Those companies that have a market capitalization between Rs 500 crore and Rs 1,000 crore are classified as medium sized. Big investors like mutual funds and Foreign Institutional Investors are increasingly investing in mid caps nowadays because the price of large caps has increased substantially. Small / midsized companies tend to be under researched thus they present an opportunity to invest in a company that is yet to be identified by the market. Such companies offer higher growth potential going forward and therefore an opportunity to benefit from higher than average valuations. Mid cap companies are looked upon as wealth creators and have the potential to join the league of large cap companies. Such companies are nimble, flexible and can adapt to the changes faster. One of the challenges that fund managers of mid cap funds face is to identifying such companies. But mid cap funds are very volatile and tend to fall like a pack of cards in bad times. So, caution should be exercised while investing in mid cap mutual funds. Mid cap funds are a good option in case the investor wants to add some diversity to his portfolio

**Performance Evaluation of Mutual Funds:**

Any meaningful evaluation of performance will necessarily have to measure total return per unit of risk or the ability to earn superior returns for a given risk class.
There are various statistical techniques to measure this factor. One of the technique estimates the realized portfolio returns in excess of the risk free return, as a multiple of the factor of the portfolio. The factor of portfolio, in turn, measures the systematic or undiversifiable risk of the portfolio, the relation to the market index.

Mutual funds sell their shares to public and redeem them to current net asset value (NAV) which is calculated as under:

\[
\text{NAV of MF} = \frac{\text{Total market value of all MF holdings} - \text{All MF liabilities}}{\text{No. of MF units or shares}}
\]

The net asset value of a mutual fund scheme is basically the per unit market value of all the assets of the scheme. NAV also includes dividends, interest accruals and reduction of liabilities and expenses, besides market value of investments.

**Presentation of accounts:**

Mutual funds, should prepare scheme wise balance sheet as per Annexure IA and IB of Eleventh Schedule of SEBI (Mutual Funds) Regulations 1996. As per regulation 54, every mutual fund or asset management company shall prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and funds.
The balance sheet shall give scheme wise particulars of its assets and liabilities and shall contain particulars as per Eleventh Schedule. It should also disclose accounting policies relating to valuation of investments and other important items. Under each type of investment, the aggregate carrying value and market value of non-performing investments shall be disclosed. It should also indicate the extent of provision made in revenue account for the depreciation/loss in the value of non-performing investments. It shall also disclose per unit Net Asset Value (NAV) as at the end of accounting year. Previous year figures should also be given against each item.

It should also indicate the appropriation of surplus by way of transfer to reserves and dividend distributed. It should also contain -

- Provision for aggregate value of doubtful deposits, debts and outstanding and accrued income.
- Profit or loss in sale and redemption of investment may be shown on a net basis.
- Custodian and registrar fees.
- Total income and expenditure expressed as a percentage of average net assets, calculated on a weekly basis.

Scheme wise balance sheet normally contains the information under following groups

Asset side - Investments, Deposits, Other Current Assets, Fixed Assets, Deferred revenue expenditure

Liability side - Unit capital, Reserves and surpluses, Loans, Current liabilities,
Accounting Policies of mutual fund schemes:

Accounting policies of mutual fund schemes are somewhat different from those of an industrial concern. Ninth schedule to SEBI (Mutual Fund) Regulations 1996 deal with accounting policies and standards to be adopted by a mutual fund.

The accounting policies generally cover the following areas -

**Basis of Accounting:**
The mutual fund maintains its books of account on an accrual basis.

**Portfolio Valuation:**
Investment is stated at market/fair value at the balance sheet date/date of determination. In valuing the scheme's investments;

(i) Securities listed on a recognized stock exchange are valued at the last quoted price on the principal exchange on which the security is traded.

(ii) Money market instruments are valued at fair value as determined in good faith by Asset Management Company (AMC)

**Securities Transactions:**
Investment securities transactions are accounted for on a trade date basis. The scheme uses the average cost method for determining the realized gain or loss on sale of investments.

**Investment Income:**
Dividend and interest income are recorded on an accrual basis.
Deferred Revenue Expenditure:
Initial issue costs comprise those costs directly associated with the issue of units of the scheme and include brokerage/incentive fees on issue of units, advertising and marketing costs, registrar fees and expenses and printing and dispatch cost, which are being amortized over a period of ten financial years.

Dividend Equalization Reserve:
The net distributable income relating to units issued/repurchased is transferred from/to Dividend Equalization Reserve for Dividend Plan for determining the net surplus/deficit transferred to/from Unit Premium Reserve.

Unit Premium Reserve:
Upon issue and redemption of units, the net premium or discount to face value of units is adjusted against the Unit Premium Reserve of the Scheme, after an appropriate portion of the issue proceeds and redemption payout is credited or debited respectively to the Dividend Equalization Reserve.

The Unit Premium Reserve is available for dividend distribution except to the extent it is presented by unrealized net appreciation in value of investments and deferred revenue expenditure.

Agent’s Commission:
Agents commission expenses are not considered as distribution charges.

Annual Report of Mutual Fund:
According to Regulation 54 of SEBI regulations, every mutual fund of the asset management company shall prepare in respect of each financial year an annual
report and annual statement of accounts for all schemes and fund as specified in Eleventh Schedule.

An annual report should contain the following:

- report of the board of trustees on the operations
- balance sheet
- revenue account
- auditor’s report
- Brief statement of board of trustees on liabilities and responsibilities of the trustees, objective of investments, basis and policy of investments and comments of the trustees on performance of scheme.
- A statement to the effect that "the price and redemption value of the units, and income from them, can go up as well as down with the fluctuation in the market value of its underlying investments."
- Statement giving relevant perspective historical per unit statistics.
- Statement to the effect that "on written request, present and prospective unit holder/investors can obtain copy of the trust deed, the annual report at a price and the text of relevant scheme."

As per Regulation (57), every mutual fund is responsible to forward a copy of annual report and other information containing details of investments and deposits held by the fund so that the entire scheme wise portfolio of the fund is disclosed to SEBI within six months from the date of closure of the financial year. The reports required to be submitted to SEBI are as specified in Regulation (58) above
Mutual Fund investors should go through the annual report, its contents and auditor’s report carefully. They should also keep a track of NAV and investment portfolio.

Risk Factors:

- Mutual Funds and securities investments are subject to market risks and there can be no assurance that the objectives of the schemes will be achieved.
- As with any investment in securities, the NAVs of the Units issued under the Schemes can go up or down depending on the factors and forces affecting capital markets.
- Past performance of the Sponsor / Investment Manager / Mutual Fund does not indicate the future performance of the Schemes and may not necessarily provide a basis of comparison with other investments.
- The name of the Schemes do not in any manner, indicate either the quality of the Schemes or its future prospects or returns.
- The Sponsors are not responsible for any loss resulting from the operation of the Schemes beyond the initial contribution of Rs.1,00,000 towards setting up the Mutual Fund.
- The Mutual Fund schemes are not guaranteeing or assuring any returns. The Mutual fund schemes are also not assuring that it will make monthly/Quarterly dividend distributions, though it has every intention of doing so. All dividend distributions are subject to the investment performance of the scheme.
- The liquidity of the Scheme's investments is inherently restricted by trading volumes and settlement periods. In the event of an inordinately large number of redemptions or of a restructuring of the Scheme's investment portfolio, there may be delays in the redemption of units.
• Changes in Government Policy in general and changes in tax benefits applicable to mutual funds may impact the returns to investors in the respective Schemes.

• The NAV’s may be affected by changes in the general market conditions, factors and forces affecting capital market in particular, level of interest rates, various market related factors, settlement periods and transfer procedures.

Causes for Fund Failure:

Excessive diversification of portfolio:
The total risk attached with the fund has two fold namely market related and firm specific risks. It is universally accepted principle that the firm specific risk could be offset by simple diversification i.e. by increasing the asset base of various sectors. Some times on account of vast diversification leads to procurement of poor performers in turn breaks the return in the future. If this trend continues it might cause to failure of the fund and within the short period of time the scheme will be redeemed.

High turnover of portfolio may lead to huge payment of brokerage / commission:
Sometimes on account of vast diversification we may tend to purchase the securities in smaller proportion, which attracts high brokerage as well as Securities transaction tax leads to reduction in scheme’s Net Asset Value.
Poor investment planning:

The investment objective as well as the asset allocation pattern of a customised scheme has been structured according the investor’s investment objective. Nevertheless, the scheme fails to fulfill the expectations of the investors. This could be because of poor research with respect to macro economic variables.

Poor use of forecasts such as income, profitability, interpretation of Government policies etc.

Tailor-made products will not be much appreciated by the investors, which lead the fund houses to devise a scheme that would squarely meet the expectations of the investors. The high research cost associated with understanding the fundamentals of the organisation as well as understanding the macro economic variables perhaps restricts the diversification in turn enhances the risk associated with the fund. The information sought by the scheme may be inadequate to understand the investor’s profile.

MAJOR DETERMINANTS - MARKET TIMING AND STOCK SELECTION

There are two dimensions of capital market i.e. time and investing. The first begins with savings and when saved, the money is invested. Similarly, if the investments are held for longer periods, the long-run benefits of investing will be realized. Generally, investments are made in markets. The motivation of all participants in financial markets is to earn a return as least commensurate with the level of risk assumed. But it should be noted that markets are not efficient as they were once thought to be. So efficient markets are those in which the expected return from investing commensurate with the risks assumed and no more or no less. But
Indian stock markets cannot be considered efficient in a strong sense as there are many instances of inside information leading to abnormal gains.

In the past decade, significant changes have taken place in the investment climate in India. Portfolio management is becoming a rapidly growing area serving a broad array of investors both individual and institutional with investment portfolio ranging in asset size from thousands to crores of rupees. Ideally, an individual's portfolio should be tailor made to fit one's individual needs. The shifting of assets between stocks and a money fund in an effort to avoid or minimise loses when prices are expected to fall.

Conservative trend following, Market Timing or Dynamic Allocation is an investment strategy with the primary goal of investing in the markets when the upward trend is strong and to be out of the market, in the safety of a money market account, when the market trend is weak. Market Timing is designed to reduce investor risk, anxiety, and overall volatility while increasing liquidity and portfolio returns. The adversaries of Market Timing declare that because some of the biggest market days come just after the end of a market decline, the Market Timing strategy will most likely miss out on these biggest up days. However, studies have shown that that even if all of these days are missed, which is unlikely, the overall investor return still benefits more by missing the bulk of the worst days.

Fund Switching is an investment strategy where by the mutual fund investor monitors the different market areas or sectors in an attempt to be in the strongest
funds of the market or sector at any given time. In theory, the Fund Switching investor would always be 100% invested at all times. While this risk exposure is the same as the buy-and-hold investor's, the overall risk is considered less by allowing exposure to only the strongest market areas and eliminating the weakest. While both Market Timing and Funds Switching have their advantages, together they make an investment formula that yields superior returns and safety.

**Recent trends in mutual fund industry:**

Today there are plenty of investment avenues open. Some of them include banks deposits, bonds, stocks, mutual fund investments and corporate debentures. Investors may invest money in banks, bonds and corporate debentures where the risk is low and so are the returns. On the contrary, stocks of companies have high risk but the returns are also proportionately high.

The recent trends since last year clearly suggest that the average investors have lost money in equities. People have now started opting for portfolio managers who have the expertise in stock markets. There are many institutions in India which provide wealth management services. An average investor has found refuge with the mutual funds.

There have been a lot of changes in the mutual fund industry in past few years. More number of multinational companies has bought their professional expertise to manage funds worldwide. In the past few months there has been consolidation going on in the mutual fund industry. Mutual funds in India now offer a wide range of schemes to choose.
The most important trend in the mutual fund industry is the aggressive expansion of the foreign owned mutual fund companies and the decline of the companies floated by nationalized banks and smaller private sector players.

Mutual funds are turned to be the most preferred choice worldwide for both small and big investors due to their numerous advantages. It's all about long term financial planning. These benefits mainly include diversification, professional management, potential of returns, efficiency and easy to use.

Mutual fund investments carry low risk because of their diversified nature. It is important to understand the benefits of mutual funds before investing the money you really care about.

The size of Indian mutual fund industry has grown in recent few years. India can now boast of having dominance in this industry. The total Asset Under Management popularly known as AUM has increased from Rs.1,01,565 crores in January 2000 to Rs.5,67,601.98 crores in April 2008.

According to the Association of Mutual Funds in India, the growth of mutual fund industry has been exceptional. This industry has indeed come a very long way with only 34 players in the market and more than 480 schemes.

One of the major factors contributing to the growth of this industry has been the booming stock market with an optimistic domestic economy. Second most important
The reason for this growth is a favorable regulatory regime which has been enforced by SEBI. This regulatory board has improved the market surveillance to protect the investor's interest.

NAV is directly proportionately to the bearish trends of the market. Top mutual funds also suffer because of the fluctuations in the market. The pooled money is invested in shares, debentures and treasury bills and thus has high risk involved.

Indian mutual funds however reveal this multi-dimensional avenue and all the intricacies in a highly fashionable manner. It provides a lot of scope to understand the scenario and make some thoughtful investments for decent returns.

**Future of Mutual Funds:**

Future of mutual funds industry seems to be bright in view of the improved performance of fund managers and increasing confidence of investors in working the funds as also the benefits of investing in funds. Further, with economy picking up, mutual funds industry is expected to grow at a good pace. It is also expected that money moving into the lap of mutual funds from banks as open-ended funds offers same convenience, higher rate of returns, variety of schemes, better performance, transparency, after sales customer service and genuine retail investor interest will drive the industry’s growth. Technology and new distribution channels would increase the reach even as investors move funds out from traditional investment channels.
Despite the slow down in the growth of mutual fund industry during 1999-2000, the growth potential of the industry is beyond doubt. As the chairman of Housing Development Finance Corporation, Deepak Parekh stated recently that ‘we have only scratched the surface’. Equity funds in the United States account for nearly 65% of the total equity market capitalisation of Rs.8,50,000 crores in March 31, 2000. Indian mutual funds are expecting a pickup in equity investments in near future with blue chip shares looking attractively valued after the recent decline.

Besides, the 40 percent average growth of the mutual fund industry during the last two years compares favorably with the much more sedate growth in bank deposits of 16-18 percent recorded in the last five years. Mutual funds will continue to grow as they are getting accepted as a saving vehicle. Large pools of savings are outside the purview of the industry at present, for example, bank deposits, pension funds, etc. These will certainly provide a source for big growth for the industry.

Prospects of mutual funds industry are likely to brighten further in view of the important reforms on the anvil. With the Securities and Exchange Board of India proposing a corporate structure on the lines of funds in United States, the existing trustee structure will be modified to introduce professional trustee companies. The underlying objective is to bring greater democracy in mutual fund administration and give the unit holders the right to change the trustees, if they fail to perform their job.

More flexibility to the asset management companies is also likely so that it can charge expenses, which are directly attributable to a particular scheme. Investors will have access to the balance sheets of Asset Management Companies though the
balance sheets of most Asset Management Companies, which are subsidiaries of public listed companies, are already available. But most foreign mutual funds are not bound to disclose their Asset Management Company operations separately and this provision would help investors understand their operations better.

In the interest of the unit holders, mutual funds are now required to follow minimum international standards, for trading by their employees so that there is no conflict of interest between the transactions of employees and the mutual funds and there is no front running and insider trading. The code is likely to be finalised soon in consultation with the Association of Mutual funds in India.

Besides the above points, mutual fund industry is having a good prospect in our country. It is likely to show a good progress in the coming years due to a variety of factors like

- The Securities and Exchange Board of India is extending its full support for the promotion of the mutual fund industry directly as well as indirectly. For instance, it has allowed the promoters of a company to retain percent holding. It has raised the minimum subscription amount to Rs.5,000 for an individual investor for direct investment. It has introduced the proportionate allotment scheme. These factors stand in the way of small investors from entering into the capital market directly and they favor only big investors. So, a small investor has to necessarily seek the services of mutual fund industry with his meager savings.
• Moreover, ever since the disbanding of the Controller of Capital Issues Office, many companies have entered into the market with a petty premium on their shares. Naturally, the small investors find them out of their reach, and hence, they have to seek the blessings of the mutual fund industry. One can easily subscribe to mutual fund shares at par with one’s little investment.

• In recent times, the interest rates on bank deposits have been declining. The household savers are looking for alternative avenues, which could bring higher returns. The return on the mutual fund schemes compare favorably with the returns on bank deposits.

• The trend of rising profit earning ratio, the entry of large domestic institutional investors, the opening of the market to the foreign investors etc., would make stock market inaccessible to the small investors. Hence, they have to necessarily go for the mutual fund industry.

• Mutual funds provide a wider range of products so as to meet the diverse needs of the investing public. The investors have a good choice to meet their different expectations like security, growth and liquidity.

• The Government has also given the necessary impetus by providing tax concessions and tax exemptions. When the mutual funds industry is receiving a preferential treatment at the hands of the Government, it is bound to grow in future.
The Department of Company Affairs has agreed to amend the Companies Act to grant voting rights in companies, in favor of mutual funds.

Again mutual funds have been permitted to underwrite share also.

All these factors would go a long way in making mutual funds an increasingly popular, lucrative and cost efficient vehicle for investment. The advent of mutual funds has augured well for genuine and good entrepreneurs too. The promoters suffered grievously during 1987 and early 1988 due to the failure of their new issues. Now ‘mutual funds’ are able to cycle the saver’s resources productively for equity capital in the industry and thus, new entrepreneurs are guaranteed of success in their new issues.

If mutual funds ensure good returns, quick liquidity and safety of funds may create a good rapport with the investors; their future will be very bright. They act as a via media between bank deposit and share, in the sense, it involves a higher risk than a bank deposit and hence a better return, but lower risk than a share and hence more safety. Hence, soon it would become an ideal vehicle for investment in India. It is time for the mutual funds to act as ‘mutual friends’ by creating a good rapport with the investors by rendering efficient and prompt service. No doubt, there is a bright future for mutual funds in India.

Suggestions to make mutual funds effective:

In order to render the existing mutual funds more effective and purposeful, the following steps should be taken:
There should be a comprehensive legislation to control the operations of the mutual funds including the Unit Trust of India. At present, mutual funds are subject to guidelines laid down by the Securities and Exchange Board of India, Reserve Bank of India and Government of India. Some of the guidelines are contradictory, leading to confusion among the mutual fund managers. Further, the guidelines governing the Unit Trust of India are different. It is therefore, necessary that the Government should come out with a single comprehensive legislation, which will, uniformly be applicable to public sector and private sector mutual funds and the Unit Trust of India.

So far, mutual funds in India confined themselves to urban areas, leaving vast saving potential in rural areas untapped. By penetrating in rural areas and introducing savings schemes tailored to the diverse preferences of the rural community and by educating them about the benefits of the schemes, mutual funds can raise burgeoning resources which can gainfully be employed for the national development.

Rendering their operations more transparent and providing better services can restore investors’ confidence in mutual funds.

While it is fine to advertise good performance of a particular scheme by a fund in order to attract more investments, the times are fast approaching when an honest view based approach would compel a mutual fund to advise investors on ‘sell’ or ‘switch’ between schemes, as emphatically as it would advise on the purchase. So as to attract investors, it is, therefore, advisable to mutual
funds to offer this sort of counseling which will certainly make a mutual fund different from other institutions.