CHAPTER 1
INTRODUCTION

A mutual fund is an investment vehicle that pools the monies of several investors, and collectively invests this amount in either the equity market or the debt market, or both, depending upon the fund’s objective. This means one can access either the equity or the debt market, or both, without investing directly in equity or debt.

As given by Bansal, a mutual fund is a financial service organization that receives money from shareholders, invests it, earns return on it, makes it grow, and agrees to pay the shareholder cash on demand for the current value of his investment. It acts as a non-depository financial intermediary, mobilizing the savings, particularly from the small and household sectors for investment in capital and money markets. (Bansal, 1997)

A mutual fund means a fund established in the form of a trust by a sponsor to raise money by the trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with the regulations. (SEBI, 1993). The income earned through these investments and the capital appreciations realized 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. The rapid growth of mutual funds indicates the need for a deeper look into the performance of the mutual funds taking into account the expectations from the investor and the capital market. (Jayadev, 1998)

Mutual fund as an institutional investor plays a vital role in causing the stock market to function on sound and healthy lines. From the capital markets point of view mutual funds are influencing the stock market in terms of stability and volatility. (Jayadev, 1998)

Most mutual funds adopt investment styles that cluster around a broad market benchmark, few funds take extreme positions away from the index but those who do are more likely to favour growth stocks and past winners. The bias towards glamour and the tendency of poorly performing value funds to shift styles may reflect agency and behavioral considerations. After adjusting for style there is evidence that growth managers on average outperform value managers, though a funds factor loadings and its portfolio characteristics generally yield similar conclusions about its style and approach using portfolio characteristics predict fund return better. (Chan, Chen, Lakonishok, 2002)

Over the past 30 years numerous studies have examined whether or not mutual funds successfully time the market, these studies have focused exclusively on market returns: Do mutual funds capitalize of superior information by increasing market exposure before market upswings or by decreasing market exposure before downturns? Although market returns are difficult to predict market volatility is predictable because it persists: high volatility is often followed by high volatility and low by low. (Busse, 1999) When managers adjust portfolio weights in response to information that is not reflected in conditional models, the portfolio weights are conditionally correlated with future returns given the public information. In such
cases the alpha is a time-varying function of the conditional covariance between the managers weights and future returns, given the public information. (Christopherson, Ferson, and Glassman, 1998)

For the strategy used to predict the market fund managers who attempt to time the market might use publically available information. (Person and Schadt., 1996). When a fund receives large inflow of cash, it might not immediately invest the cash in stock market. As the new cash earns a return that is not highly correlated with the stock market the systematic risk of the fund could decline if cash flows are positively correlated with volatility then even when fund managers are not actively timing volatility the reductions in systematic risks during periods of high volatility could give the appearance of volatility timings. (Ferson and Warther, 1996)

In the case of mutual funds, a fund’s stated objective (such as, growth, income, or balanced) historically served as a limited form of product differentiation. However these descriptions are generally too vague to be very informative. (Chan, Chen, Lakonishok, 2002)

A different style classification procedure that is widely used in the investment management industry is the procedure which regresses a funds return on the returns to cash and a variety of equity classes. The regression coefficients are constrained to be non negative and sum to one, so they can be interpreted as portfolio weights. The model thus yield the funds effective asset mix. (Sharpe, 1992)

Competitive advantage grows fundamentally out of the value a firm is able to create for its buyer that exceeds the firms cost of creating it. (Poter, 1985) The investor sentiment can represent trading on noise rather than trading on news or trading explained by popular models. (Fisher (1986) and Shiller, 1984)

With a very few exceptions, mainly in Asia, mutual funds grew explosively in most countries around the world during 1990s. One of the major determinants for this overall progress was identified as the tremendous development of the capital markets and the way they were oriented. (Klapper et al, 2003)

**HISTORY OF MUTUAL FUNDS**

Mutual fund concept roots back to the sixties when reacting to the needs of more active mobilization of household savings the Reserve bank of India was entrusted to create a special institution to serve as a channel to these resources to the Indian capital market. Thus Unit Trust of India was started in 1964 with a view to encouraging savings and investments and participation in the income, profits and gains accruing to the corporations from the acquisition, holding, management, and disposal of securities. (Sadhak, 2003) Till 1987 the UTI, popularly known as US 64, was the only mutual fund with a huge fund of Rs 6700 crore. The fund industry witnessed an unprecedented level of growth with the entry of mutual funds sponsored by nationalized banks and insurance companies in 1987 (Sahadevan & Thiripalraju, 1997)

For the mutual fund industry a brand new era began in 1993 with the entry of the private sector players. The new private sector funds had distinctive advantages over others in the sense that Sadhak (1997): Most of them were jointly floated by the
Indian and foreign asset management organizations and thus, facilitating access to the latest technology and foreign fund managers strategy. They were better able to attract the best managerial talents from the public sector, already available infrastructural inputs by the public sector made their setting up much easier.

**First Phase (1964-1987)**
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. (AMFI, 2001)

The table indicates the growth of assets over the years
Table 1.1 Asset Under Management – AMC – Wise as on 31st March, 2004 (Rs. in crores)

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Name of the Asset Management Company</th>
<th>Asset under Management (Rs. in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>BANK SPONSORED</td>
<td></td>
</tr>
<tr>
<td></td>
<td>BOB Asset Management Co. Ltd.</td>
<td>429</td>
</tr>
<tr>
<td></td>
<td>Canbank Investment Management Services Ltd.</td>
<td>1416</td>
</tr>
<tr>
<td></td>
<td>SBI Funds Management Ltd.</td>
<td>5320</td>
</tr>
<tr>
<td></td>
<td>UTI Asset Management Company Pvt. Ltd</td>
<td>19073</td>
</tr>
<tr>
<td></td>
<td><strong>Total A</strong></td>
<td><strong>26238</strong></td>
</tr>
<tr>
<td>B</td>
<td>INSTITUTIONS</td>
<td></td>
</tr>
<tr>
<td></td>
<td>GIC Asset Management Co. Ltd.</td>
<td>209</td>
</tr>
<tr>
<td></td>
<td>IL &amp; FS Asset Management Co. Ltd.</td>
<td>1761</td>
</tr>
<tr>
<td></td>
<td>Jeevan Bima Sahayog Asset Management Co. Ltd.</td>
<td>5096</td>
</tr>
<tr>
<td></td>
<td><strong>Total B</strong></td>
<td><strong>7066</strong></td>
</tr>
<tr>
<td>C1</td>
<td>PRIVATE SECTOR</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Benchmark Asset Management Co. Pvt. Ltd</td>
<td>78</td>
</tr>
<tr>
<td></td>
<td>Cholamandalam Asset Management Co. Ltd</td>
<td>1139</td>
</tr>
<tr>
<td></td>
<td>Escorts Asset Management Ltd.</td>
<td>140</td>
</tr>
<tr>
<td></td>
<td>JM Capital Management Pvt. Ltd.</td>
<td>4212</td>
</tr>
<tr>
<td></td>
<td>Kotak Mahindra Asset Management Co. Ltd.</td>
<td>5567</td>
</tr>
<tr>
<td></td>
<td>Reliance Capital Asset Management Co. Pvt. Ltd.</td>
<td>10806</td>
</tr>
<tr>
<td></td>
<td>Sahara Asset Management Co. Pvt Ltd.</td>
<td>415</td>
</tr>
<tr>
<td></td>
<td>Sundaram Asset Management Company Ltd.</td>
<td>2005</td>
</tr>
<tr>
<td></td>
<td>Tata Asset Management Private Ltd.</td>
<td>5211</td>
</tr>
<tr>
<td></td>
<td><strong>Total C1</strong></td>
<td><strong>29573</strong></td>
</tr>
<tr>
<td>C2</td>
<td>JOINT VENTURES PREDOMINANTLY INDIAN</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Birla Sunlife Asset Management Co. Ltd.</td>
<td>9720</td>
</tr>
<tr>
<td></td>
<td>Credit Capital Asset Management Co. Ltd.</td>
<td>140</td>
</tr>
<tr>
<td></td>
<td>DSP Merill Lynch Fund Managers Ltd.</td>
<td>6201</td>
</tr>
<tr>
<td></td>
<td>HDFC Asset Management Co. Ltd.</td>
<td>15778</td>
</tr>
<tr>
<td></td>
<td><strong>Total C2</strong></td>
<td><strong>31839</strong></td>
</tr>
<tr>
<td>C3</td>
<td>JOINT VENTURES – PREDOMINANTLY FOREIGN</td>
<td></td>
</tr>
</tbody>
</table>


Alliance Capital Asset Management (India) Pvt. Ltd. 2462
Deutsche Asset Management (India) Pvt. Ltd. 2391
Franklin Templeton Asset Management (India) Pvt. Ltd. 17085
HSBC Asset Management (India) Private Ltd. 5625
ING Investment Management (India) Pvt. Ltd. 1495
Morgan Stanley Investment Management Pvt. Ltd. 1963
Prudential ICICI Asset Management Co. Ltd. 15181
Principal Asset Management Co. Pvt. Ltd. 4638
Standard Chartered Asset Management Co. Pvt. Ltd. 9362

Total C3 59302
Total (C1 + C2 + C3) 120714
Total (A + B + C) 154018


It should be noted that there are certain factors such as the volatility of the market; extent of regulations and the size and the extent of the governments involvement that distinguish the mutual funds in the emerging markets from their counterparts in established financial markets. (Ramasamy and Yeung, 2003)

PUBLIC SECTOR MUTUAL FUNDS

State Bank of India Mutual Fund
State Bank of India Mutual Fund is the first Bank sponsored Mutual Fund to launch offshore fund, the India Magnum Fund with a corpus of Rs. 225 cr. approximately. Today it is the largest Bank sponsored Mutual Fund in India. They have already launched 35 Schemes out of which 15 have already yielded handsome returns to investors. State Bank of India Mutual Fund has more than Rs. 5,500 Crores as AUM. Now it has an investor base of over 8 Lakhs spread over 18 schemes.

Unit Trust of India Mutual Fund
UTI Asset Management Company Private Limited, established in Jan 14, 2003, manages the UTI Mutual Fund with the support of UTI Trustee Company Private Limited. UTI Asset Management Company presently manages a corpus of over Rs.20000 Crore. The sponsors of UTI Mutual Fund are Bank of Baroda (BOB), Punjab National Bank (PNB), State Bank of India (SBI), and Life Insurance Corporation of India (LIC). The schemes of UTI Mutual Fund are Liquid Funds, Income Funds, Asset Management Funds, Index Funds, Equity Funds and Balance Funds.

Bank of Baroda Mutual Fund (BOB Mutual Fund)
Bank of Baroda Mutual Fund or BOB Mutual Fund was setup on October 30, 1992 under the sponsorship of Bank of Baroda. BOB Asset Management Company Limited is the AMC of BOB Mutual Fund and was incorporated on November 5, 1992. Deutsche Bank AG is the custodian.

Canbank Mutual Fund
Canbank Mutual Fund was setup on December 19, 1987 with Canara Bank acting as the sponsor. Canbank Investment Management Services Ltd. incorporated on March 2, 1993 is the AMC. The Corporate Office of the AMC is in Mumbai.
LIC Mutual Fund
Life Insurance Corporation of India set up LIC Mutual Fund on 19th June 1989. It contributed Rs. 2 Crores towards the corpus of the Fund. LIC Mutual Fund was constituted as a Trust in accordance with the provisions of the Indian Trust Act, 1882. The Company started its business on 29th April 1994. The Trustees of LIC Mutual Fund have appointed Jeevan Bima Sahayog Asset Management Company Ltd as the Investment Managers for LIC Mutual Fund.

GIC Mutual Fund
GIC Mutual Fund, sponsored by General Insurance Corporation of India (GIC), a Government of India undertaking and the four Public Sector General Insurance Companies, viz. National Insurance Co. Ltd (NIC), The New India Assurance Co. Ltd. (NIA), The Oriental Insurance Co. Ltd (OIC) and United India Insurance Co. Ltd. (UII) and is constituted as a Trust in accordance with the provisions of the Indian Trusts Act, 1882.

PRIVATE SECTOR MUTUAL FUNDS
ABN AMRO Mutual Fund
ABN AMRO Mutual Fund was setup on April 15, 2004 with ABN AMRO Trustee (India) Pvt. Ltd. as the Trustee Company. The AMC, ABN AMRO Asset Management (India) Ltd. was incorporated on November 4, 2003. Deutsche Bank A G is the custodian of ABN AMRO Mutual Fund.

Birla Sun Life Mutual Fund
Birla Sun Life Mutual Fund is the joint venture of Aditya Birla Group and Sun Life Financial. Sun Life Financial is a global organisation and is being represented in Canada, the US, the Philippines, Japan, Indonesia and Bermuda apart from India. Birla Sun Life Mutual Fund follows a conservative long-term approach to investment. Recently it crossed AUM of Rs. 10,000 crores.

HDFC Mutual Fund
HDFC Mutual Fund was setup on June 30, 2000 with two sponsors namely Housing Development Finance Corporation Limited and Standard Life Investments Limited.

HSBC Mutual Fund
HSBC Mutual Fund was setup on May 27, 2002 with HSBC Securities and Capital Markets (India) Private Limited as the sponsor. Board of Trustees, HSBC Mutual Fund acts as the Trustee Company of HSBC Mutual Fund.

ING Vysya Mutual Fund
ING Vysya Mutual Fund was setup on February 11, 1999 with the same named Trustee Company. It is a joint venture of Vysya and ING. The AMC, ING Investment Management (India) Pvt. Ltd. was incorporated on April 6, 1998.

Prudential ICICI Mutual Fund
The mutual fund of ICICI is a joint venture with Prudential Plc. of America, one of the largest life insurance companies in the USA. Prudential ICICI Mutual Fund was setup on 13th of October, 1993 with two sponsors, Prudential Plc. and ICICI Ltd. The Trustee Company formed is Prudential ICICI Trust Ltd. and the AMC is Prudential ICICI Asset Management Company Limited incorporated on 22nd of June, 1993.
Sahara Mutual Fund
Sahara Mutual Fund was set up on July 18, 1996 with Sahara India Financial Corporation Ltd. as the sponsor. Sahara Asset Management Company Private Limited incorporated on August 31, 1995 works as the AMC of Sahara Mutual Fund. The paid-up capital of the AMC stands at Rs 25.8 crore.

Tata Mutual Fund
Tata Mutual Fund (TMF) is a Trust under the Indian Trust Act, 1882. The sponsors for Tata Mutual Fund are Tata Sons Ltd., and Tata Investment Corporation Ltd. The investment manager is Tata Asset Management Limited and its Tata Trustee Company Pvt. Limited. Tata Asset Management Limited's is one of the fastest in the country with more than Rs. 7,703 crores (as on April 30, 2005) of AUM.

Kotak Mahindra Mutual Fund
Kotak Mahindra Asset Management Company (KMAMC) is a subsidiary of KMBL. It is presently having more than 1,99,818 investors in its various schemes. KMAMC started its operations in December 1998. Kotak Mahindra Mutual Fund offers schemes catering to investors with varying risk - return profiles. It was the first company to launch dedicated gilt scheme investing only in government securities.

Reliance Mutual Fund
Reliance Mutual Fund (RMF) was established as trust under Indian Trusts Act, 1882. The sponsor of RMF is Reliance Capital Limited and Reliance Capital Trustee Co. Limited is the Trustee. It was registered on June 30, 1995 as Reliance Capital Mutual Fund which was changed on March 11, 2004. Reliance Mutual Fund was formed for launching of various schemes under which units are issued to the Public with a view to contribute to the capital market and to provide investors the opportunities to make investments in diversified Securities

Standard Chartered Mutual Fund
Standard Chartered Mutual Fund was set up on March 13, 2000 sponsored by Standard Chartered Bank. The Trustee is Standard Chartered Trustee Company Pvt. Ltd. Standard Chartered Asset Management Company Pvt. Ltd. is the AMC which was incorporated with SEBI on December 20, 1999.

Franklin Templeton India Mutual Fund
The group, Franklin Templeton Investments is a California (USA) based company with a global AUM of US$ 409.2 bn. (as of April 30, 2005). It is one of the largest financial services groups in the world. Investors can buy or sell the Mutual Fund through their financial advisor or through mail or through their website. They have Open end Diversified Equity schemes, Open end Sector Equity schemes, Open end Hybrid schemes, Open end Tax Saving schemes, Open end Income and Liquid schemes, Closed end Income schemes and Open end Fund of Funds schemes to offer.

Morgan Stanley Mutual Fund India
Morgan Stanley is a worldwide financial services company and its leading in the market in securities, investment management and credit services. Morgan Stanley Investment Management (MISM) was established in the year 1975. It provides customized asset management services and products to governments, corporations, pension funds and non-profit organisations. Its services are also extended to high net worth individuals and retail investors. In India it is known as Morgan Stanley Investment Management Private Limited
(MSIM India) and its AMC is Morgan Stanley Mutual Fund (MSMF). This is the first close end diversified equity scheme serving the needs of Indian retail investors focusing on a long-term capital appreciation.

**Escorts Mutual Fund**
Escorts Mutual Fund was setup on April 15, 1996 with Escorts Finance Limited as its sponsor. The Trustee Company is Escorts Investment Trust Limited. Its AMC was incorporated on December 1, 1995 with the name Escorts Asset Management Limited.

**Alliance Capital Mutual Fund**
Alliance Capital Mutual Fund was setup on December 30, 1994 with Alliance Capital Management Corp. of Delaware (USA) as sponsors. The Trustee is ACAM Trust Company Pvt. Ltd. and AMC, the Alliance Capital Asset Management India (Pvt) Ltd. with the corporate office in Mumbai.

**Benchmark Mutual Fund**
Benchmark Mutual Fund was setup on June 12, 2001 with Niche Financial Services Pvt. Ltd. as the sponsor and Benchmark Trustee Company Pvt. Ltd. as the Trustee Company. Incorporated on October 16, 2000 and headquartered in Mumbai, Benchmark Asset Management Company Pvt. Ltd. is the AMC.

**Chola Mutual Fund**
Chola Mutual Fund under the sponsorship of Cholamandalam Investment & Finance Company Ltd. was setup on January 3, 1997. Cholamandalam Trustee Co. Ltd. is the Trustee Company and AMC is Cholamandalam AMC Limited.

There are several benefits of privately run mutual funds. Lack of pressure from investors to perform and maintain profitability. At a private company managers have the ability to stick to their nitting because there is less pressure to follow whatever is the hot asset at that time. The biggest difference between public and private funds is that a return on capital is much less important at private funds. Specifically, private funds are primarily looking to pay their employees, not create excess returns to equity holders of their company. (Business Today, May 22-June 6, 1996)

Baks (2003) show that 50% of a funds performance can be attributed to the performance of its fund manager. Ding & Wermers (2005) further claim that the managers who are more experienced and who are responsible for larger funds out perform their less experienced counter part which makes it clear that the manager characteristics play an important role in explaining the portfolio performance of the mutual fund. Kaminsky, Lyons and Schukler (2004) addressed the factors which caused the difference in the fund managers strategy across crisis and non-crisis periods.

**ORGANISATION & MANAGEMENT OF MUTUAL FUND**

The concept of mutual funds in India dates back to the year 1963. The era between 1963 and 1987 marked the existence of only one mutual fund company in India with Rs. 67bn assets under management (AUM), by the end of its monopoly era, the Unit Trust of India (UTI). By the end of the 80s decade, few other mutual fund companies in India took their position in mutual fund market.
The new entries of mutual fund companies in India were SBI Mutual Fund, Canbank Mutual Fund, Punjab National Bank Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund.

The succeeding decade showed a new horizon in Indian mutual fund industry. By the end of 1993, the total AUM of the industry was Rs. 470.04 bn. The private sector funds started penetrating the fund families. In the same year the first Mutual Fund Regulations came into existence with re-registering all mutual funds except UTI. The regulations were further given a revised shape in 1996.

Kothari Pioneer was the first private sector mutual fund company in India which has now merged with Franklin Templeton. Just after ten years with private sector players’ penetration, the total assets rose up to Rs. 1218.05 bn. Today there are 33 mutual fund companies in India. Seema Vaid’s (1994) study covers conceptual and the regulatory framework review of the growth of mutual funds and primary information about mutual fund schemes.

**Mergers and Restructuring of Mutual Funds**

Some of the private sector mutual funds have gone for mergers and restructuring with the objectives of increasing the competitive skill, increasing the network of AMC, to promote operational synergies and efficiency. When SEBI prescribed that the net worth of the AMC must be Rs. 10 crores. HB AMC (worth Rs. 5.25 crores) merged into Credit Capital AMC (worth Rs. 5 crore). Zurich India Mutual Fund took over first the 20th Century Mutual Fund and then the ITC Threadneedle Mutual Fund in a two phase merger. Some of the cases of take over of mutual funds are: Apple Mutual Fund by Birla Mutual Fund, some schemes of Indbank Mutual Fund by Tata Mutual Fund and some schemes of BOI Mutual Fund by Taurus Mutual Fund.

Prudential Corporation took over 55% shares of ICICI AMC and the name was changed to Prudential ICICI AMC. Management structure of ICICI AMC was changed. Hence, it can be said that consumers are confused about where their money are invested at present.

Some of the commercial banks launched assured return mutual fund schemes such as Double Square Plus, Festival Bonanza (all BOI Mutual Fund), Canstar (Canbank Mutual Fund), Ind Jyoti (Indian Bank Mutual Fund), Magnum Triple Plus (SBI Mutual Fund). Contrary to expectations, these schemes failed and could not earn the income to provide assured return to the unitholders. Consequently, the sponsors and AMC of these schemes had to meet the shortfall in order to honour the commitment to the unitholders. SEBI in its Regulations, 1996 has provided that the mutual funds need not launch the assured return scheme unless the return is guaranteed by the Sponsor/AMC.

UTI was established in 1963 as a statutory and first mutual fund in India. It has a monopoly till 1987. It has launched several schemes so far. The first scheme of the UTI, the US-64, has been the most talked about and the most popular scheme. US-64 was a unique scheme and was outlined in the UTI Act itself. It also emerged as the longest tenure mutual fund scheme in India and ended in 2002.

**Mutual Fund structure in the USA**

In the USA, mutual funds are setup as investment companies, which may be thought of as “the fund sponsors”. An investment company may be a corporation partnership or a unit of investment trust. For our purposes, all these legal entities may be broadly understood as mutual funds. The investment company in turn appoints a management company, which
may be either a close end management company or an open end management company. Only open end management companies are technically called “mutual funds” in the USA.

The constituents of mutual Funds in the USA are the Management Company, Underwriter, Management group of Custodian. The Management Company is the Indian Equivalent of an AMC. Underwriter of a fund is the distributor or the marketing company that sells the shares to brokers or to the public. A Management Group is a family of management companies owned by a group of people or a Corporation. Custodian is the entity that holds the fund’s assets on behalf of the management Company.

**Mutual Fund structure in the UK**

In UK, mutual funds have two alternative structures. Open ended funds are in the form of Unit Trusts while Close ended funds are in the form of corporate entities although called Investment trusts. Separate regulatory mechanisms exist for both types of entities. Unit Trusts are regulated by the Securities and Investment Board. They must also be authorized by the relevant Self regulatory organization. Investment trusts are structured as companies Act are applicable to them.

- The money market fund segment has a total corpus of $ 1.48 trillion in the US against a corpus of $100 million in India.
- Out of the 10 mutual funds worldwide, eight are bank sponsored. Only Fidelity and Capital are non-bank mutual funds in this group.
- In the US the total number of schemes is higher than that of the listed companies while in India we have just 277 schemes.
- Internationally, mutual funds are allowed to go short. In India fund managers do not have such leeway.
- In US about 9.7 million household will manage their assets on-line by the year 2003, such a facility is not yet of avail in India.
- On-line trading is a great idea to reduce management expenses from the current 2% of total assets to about 0.75% of the total assets.
- 72% of the core customer base of mutual funds in the top 50 broking firms in the US is expected to trade on-line by 2003.

Internationally, on-line investing continues its meteoric rise. Many have debated about the success of e-commerce and its breakthroughs, but it is true that this aspect of technology could and will change the way financial sectors function. However, mutual funds cannot be left far behind. They have realized the potential of the internet and are equipping themselves to perform better.

In fact in countries like USA, mutual funds buy-sell transactions have already begun on the net, while in India the Net is used as a source of Information. Such changes could facilitate easy access, lower intermediation costs and better services for all. A research agency that specializes in internet technology estimates that over the next four years Mutual Fund Assets traded on-line will grow ten folds from $128 billion to $1227 billion; whereas equity assets traded on-line will increase during the period from the period from $246 billion to $1561 billion. This will increase the share of mutual funds from 34% to 40% during the period. Such increases in volume are expected to bring large in the way Mutual funds conduct their business.
**Structure of Mutual Funds in India**

Like other countries, India has a legal framework within which mutual funds must be constituted. Unlike in the UK, where two distinct ‘trust’ and ‘Corporate’ structures are followed with separate regulations, in India, open ended and close ended funds operate under the same regulatory structure, and are constituted along one unique structure, and are constituted along one unique structure as unit trusts. A Mutual Fund in India is allowed to issue open-ended and close end schemes under a common legal structure. Therefore a mutual fund may have general differential schemes (open and close end). Under it i.e. under the Unit Trust, at any point of time.

The structure which is required to be followed by Mutual Funds in India is laid down under SEBI (Mutual Fund) regulations, 1996. Following are the fund constituents and other fund constituents:

**Fund Constituents**
- The Fund Sponsor
- Mutual Funds as trusts
- Trustees

**Other Fund Constituents**
- Custodian and Depositories
- Bankers
- Transfer Agents
- Distributors or Agents or Brokers

On an ongoing basis, SEBI expects the Trustees to play a critical role in ensuring full compliance with SEBI’s requirements and protecting the interest of Investors. Accordingly, SEBI has specified the obligation of trustees as regards the compliance function, and categorized them as General Due Diligence and Specific Due Diligence.

With the increase in mutual fund players in India, a need for mutual fund association in India was generated to function as a non-profit organisation. Association of Mutual Funds in India (AMFI) was incorporated on 22nd August, 1995.

AMFI is an apex body of all Asset Management Companies (AMC) which has been registered with SEBI. Till date all the AMCs that have launched mutual fund schemes are its members. It functions under the supervision and guidelines of its Board of Directors.

Association of Mutual Funds India has brought down the Indian Mutual Fund Industry to a professional and healthy market with ethical lines enhancing and maintaining standards. It follows the principle of both protecting and promoting the interests of mutual funds as well as their unit holders. (LICI Dairy, 1995)

**MUTUAL FUND-ADVANTAGES**

Professional management

In case of equities, most of the people have neither the skill to find good stocks that suit their risk and returns profile nor the time to track their investments—but still want the returns that can be had from equities. That’s where mutual funds come in.

When investors invest in mutual funds, it is the fund manager who will take care of public investments. A fund manager is an investment specialist, who brings to the table an in-depth understanding of the financial markets. By virtue of being in the
market, the fund manager is ideally placed to research various investment options, and invest accordingly on behalf of the investors.1

Small investments
Today, if any investor wants to buy government securities, he would have to invest a minimum amount of Rs 25,000. Much the same is the case if you want to build a decent-sized portfolio of shares of blue-chips. Now, that might be too large an amount for many small investors.
A mutual fund, however, gives an investor the ownership of the same investment pie— at an outlay of Rs 1,000-5,000. That’s because a mutual fund pools the monies of several investors, and invests the resultant large sum in a number of securities. So, on a small outlay, a small investor gets to participate in the investment prospects of a number of securities.

Diversified portfolio
One of the oft-mentioned tenets of portfolio management is diversification. In other words, don’t put all your eggs in one basket. The rationale for this is that even if one picks in your portfolio turns bad, the others can check the erosion in the portfolio value.
Take a simple—even if extreme— example. Say, one has Rs 10,000 invested in one stock, Reliance. Now, for some reason, the stock drops 50 per cent. The value of his investment will halve to Rs 5,000. Now, say he had invested the same amount in a mutual fund, which had parked 10 per cent of its corpus in the Reliance stock. Assuming prices of other stocks in its portfolio stay the same, the depreciation in the fund’s portfolio— and hence, your investment—will be 5 per cent. That’s one of the merits of diversification.

Liquidity
An investor is free to take his money out of open-ended mutual funds whenever he wants, no questions asked. Most open-ended funds mail their redemption proceeds, which are linked to the fund’s prevailing NAV (net asset value), within three to five working days of your putting in your request.

Tax breaks
Last but not the least, mutual funds offer significant tax advantages. Dividends distributed by them are tax-free in the hands of the investor.
They also give you the advantages of capital gains taxation. If you hold units beyond one year, you get the benefits of indexation. Simply put, indexation benefits increase your purchase cost by a certain portion, depending upon the yearly cost-inflation index (which is calculated to account for rising inflation), thereby reducing the gap between your actual purchase costs and selling price. This reduces your tax liability.
What are more, tax-saving schemes and pension schemes gives the added advantage of benefits under Section 88. One can avail of a 20 per cent tax exemption on an investment of up to Rs 10,000 in the scheme in a year.

Convenient Administration
Investing in a Mutual fund reduces paperwork and helps you avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual funds save your time and make investing easy and convenient.
Your own just one security rather than many, yet enjoy the benefits of a diversified portfolio and a wide range of services. Fund managers decide what securities to trade collect the interest payments and see that your dividends on portfolio securities are received and your rights exercised. It also uses the services of a high quality custodian and registrar in order to make sure that your convenience remains at the top of our mind.

**Flexibility**

Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, you can systematically invest or withdraw funds according to your needs and convenience.

**Personal Service**

One call puts you in touch with a specialist who can provide you with information you can use to make your own investment choices. They will provide you personal assistance in buying and selling your fund units, provide fund information and answer questions about your account status. For example, Prudential ICICI has implemented an interactive voice response system in order to ensure customers service.

**Transparency**

The investors get regular information on the value of their investment in addition to the disclosure on the specific investments made by the mutual fund scheme, the proportion invested in each class of assets and the fund manager’s investment strategy and outlook.

**Return Potential**

Over a medium to long-term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

**Proper Regulation**

All mutual funds are registered with SEBI and they function within the provisions of strict rules and regulations designed to protect the interests of the investors. The operations of the Mutual Funds are regularly monitored by SEBI.

**MUTUAL FUND - DISADVANTAGES**

*No assured returns and no protection of capital*

If an individual is planning to go with a mutual fund, his mantra should be: mutual funds do not offer assured returns and carry risk. For instance, unlike bank deposits, your investment in a mutual fund can fall in value. In addition, mutual funds are not insured or guaranteed by any government body (unlike a bank deposit, where up to Rs 1 lakh per bank is insured by the Deposit and Credit Insurance Corporation, a subsidiary of the Reserve Bank of India). There are strict norms for any fund that assures returns and it is now compulsory for funds to establish that they have resources to back such assurances. This is because most closed-end funds that assured returns in the early-nineties failed to stick to their assurances made at the time of launch, resulting in losses to investors.

*Restrictive gains*

Diversification helps, if risk minimization is the prime objective. However, the lack of investment focus also means less gains than if one had invested directly in a single security.
In our earlier example, say, Reliance appreciated 50 per cent. A direct investment in the stock would appreciate by 50 per cent. But the investment in the mutual fund, which had invested 10 per cent of its corpus in Reliance, will see only a 5 per cent appreciation.

Entry and Exit Costs
Mutual funds are a victim of their own success. When a large body like a fund invests in shares, the concentrated buying or selling often results in adverse price movements i.e. at the time of buying, the fund ends up paying a higher price and while selling it realizes a lower price. This problem is especially severe in emerging markets like India, where, excluding a few stocks even the stocks in the Sensex are not liquid, let alone stocks in NSE 50 or the Crisil 500. So, there is simply no way that a fund can beat the Sensex or any other index, if it blindly invests in the same stocks as those in the Sensex and in the same proportion. For obvious reasons, this problem is even more severe for funds investing in small capitalization stocks. However, given the large size of the debt market, excluding UTI, most debt funds do not face this problem.

Wait times before investment
It takes time for a mutual fund to invest money. Unfortunately, most mutual funds receive money when markets are in a boom phase and investors are willing to try out mutual funds. Since it is difficult to invest all funds in one day, there is some money waiting to be invested. Further, there may be a time lag before investment opportunities are identified. This ensures that the fund under performs the index. For open-ended, there is the added problem of perpetually keeping some money in liquid assets to meet redemptions.

Fund Management costs
The costs of the fund management process are deducted from the funds. This includes marketing and initial costs deducted at the time of entry itself, called “load”. Then there is the annual asset management fee and expenses, together called the expense ratio. Usually, the former is not counted while measuring performance, while the later is. A standard 2% expense ratio means that, everything else being equal, the fund manager under performs the benchmark index by an equal amount.

Cost of Churn
The portfolio of a fund does not remain constant. The extent to which the portfolio changes is a function of the style of the individual fund manager i.e. whether he is a buy or hold type manager or one who aggressively churns the funds. It is also dependant on the volatility of the fund size i.e. whether the fund constantly receives fresh subscriptions and redemptions. Such portfolio changes have associated costs of brokerage, custody fees, registration fees etc. which lowers the portfolio return commensurately.

Inflation Risk
Sometimes referred to as “Loss of Purchasing Power.” Whenever inflation sprints forward faster than the earnings on your investment, you run the risk that you’ll actually be able to buy less, not more. Inflation risk also occurs when prices rise faster than your returns.
Credit Risk
In short, how stable is the company or entity to which you lend your money when you invest? How certain are you that it will be able to pay the interest you are promised, or repay your principal when the investment matures?

Interest Rate Risk
Changing interest rates affect both equities and bonds in many ways. Investors are reminded that “predicted” which way rates will go is rarely successful. A diversified portfolio can help in offsetting these changes.

Mutual Fund - Advantages of Net
India has around 1.6 million net users who are potential investors in mutual funds and this could just be the beginning. The Internet users are going to increase dramatically and mutual funds are going to be the best beneficiary, with smaller administrative costs more funds would be mobilized. A fund manager must be ready to tackle the volatility and will have to maintain sufficient amount of investments which are high liquidity and low yielding investments to honor redemption.

Some of basic changes that have taken place since the advent of the Net:
1. Lower Costs
Distribution of funds will fall in the online trading regime by 2003. Mutual funds could bring down their administrative costs to 0.75% if trading is done on-line. As per SEBI regulations, bond funds can charge a maximum of 2.25% and equity funds can charge 2.5% as administrative fees. Therefore if the administrative costs are low, the benefits are passed down and hence Mutual Funds are able to attract more investors and increase their asset base.

2. Better Advice
Mutual funds could provide better advice to their investors through the Net rather than through the traditional investment routes where there is an additional channel to deal with the brokers. Direct dealing with the fund could help the investor with their financial planning.

3. Net based advertisement
There will be more sites involved in ads and promotion of mutual funds. In the US sites like AOL offer detailed research and financial details about the functioning of different funds and their performance statistics.

4. Net Savvy
In India, brokers could get more Net savvy than investors and could help the investors with the knowledge gained from Net.

5. New investors would prefer online
Mutual funds can target investors who are young individuals and who are Net savvy, since servicing them would be easier on the Net.

CLASSIFICATION OF FUNDS
Many people tend to wrongly equate mutual fund investing with equity investing. Fact is, equity is just one of the various asset classes mutual funds invest in. They also invest in debt instruments such as bonds, debentures, commercial paper and government securities.

Every scheme is bound by the investment objectives outlined by it in its prospectus, which determine the classes of securities it can invest in. Based on the asset classes, broadly speaking, the following types of mutual funds currently operate in the country.
1. EQUITY FUNDS

The highest rung on the mutual fund risk ladder, such funds invest only in stocks. Most equity funds are general in nature, and can invest in the entire basket of stocks available in the market. There are also ‘specialized’ equity funds, such as index funds and sector funds, which invest only in specific categories of stocks. As explained now, such funds invest only in stocks, the riskiest of asset classes. With share prices fluctuating daily, such funds show volatile performance, even losses. However, these funds can yield great capital appreciation as, historically, equities have outperformed all asset classes. At present, there are four types of equity funds available in the market. In the increasing order of risk, these are:

(i) INDEX FUNDS

These funds track a key stock market index, like the BSE (Bombay Stock Exchange) Sensex or the NSE (National Stock Exchange) S&P CNX Nifty. Hence, their portfolio mirrors the index they track, both in terms of composition and the individual stock weightages. For instance, an index fund that tracks the Sensex will invest only in the Sensex stocks. The idea is to replicate the performance of the benchmarked index to near accuracy. Index funds don’t need fund managers, as there is no stock selection involved. Investing through index funds is a passive investment strategy, as a fund’s performance will invariably mimic the index concerned, barring a minor "tracking error". Usually, there’s a difference between the total returns given by a stock index and those given by index funds benchmarked to it. Termed as tracking error, it arises because the index fund charges management fees, marketing expenses and transaction costs (impact cost and brokerage) to its unit holders. So, if the Sensex appreciates 10 per cent during a particular period while an index fund mirroring the Sensex rises 9 per cent, the fund is said to have a tracking error of 1 per cent.

To illustrate with an example, assume you invested Rs 1,000 in an index fund based on the Sensex on 1 April 2007, when the index was launched (base: 100). In August, when the Sensex was at 3.457, your investment would be worth Rs 34,570, which works out to an annualised return of 17.2 per cent. A tracking error of 1 per cent would bring down your annualised return to 16.2 per cent. Obviously, the lower the tracking error, the better the index funds.

(ii) DIVERSIFIED FUNDS

Such funds have the mandate to invest in the entire universe of stocks. Although by definition, such funds are meant to have a diversified portfolio (spread across industries and companies), the stock selection is entirely the prerogative of the fund manager.

This discretionary power in the hands of the fund manager can work both ways for an equity fund. On the one hand, astute stock-picking by a fund manager can enable the fund to deliver market-beating returns; on the other hand, if the fund manager’s picks languish, the returns will be far lower.

The crux of the matter is that your returns from a diversified fund depend a lot on the fund manager’s capabilities to make the right investment decisions. On your part, watch out for the extent of diversification prescribed and practised by your fund manager. Understand that a portfolio concentrated in a few sectors or companies is a high risk, high return proposition. If you don’t want to take on a high degree of risk, stick to funds that are diversified not just in name but also in appearance.
(iii) TAX-SAVING FUNDS

Also known as ELSS or equity-linked savings schemes, these funds offer benefits under Section 88 of the Income-Tax Act. So, on an investment of up to Rs 10,000 a year in an ELSS, you can claim a tax exemption of 20 per cent from your taxable income. You can invest more than Rs 10,000, but you won’t get the Section 88 benefits for the amount in excess of Rs 10,000. The only drawback to ELSS is that you are locked into the scheme for three years.

In terms of investment profile, tax-saving funds are like diversified funds. The one difference is that because of the three year lock-in clause, tax-saving funds get more time to reap the benefits from their stock picks, unlike plain diversified funds, whose portfolios sometimes tend to get dictated by redemption compulsions.

(iv) SECTOR FUNDS

The riskiest among equity funds, sector funds invest only in stocks of a specific industry, say IT or FMCG. A sector fund’s NAV will zoom if the sector performs well; however, if the sector languishes, the scheme’s NAV too will stay depressed. Barring a few defensive, evergreen sectors like FMCG and Pharmacy, most other industries alternate between periods of strong growth and bouts of slowdowns. The way to make money from sector funds is to catch this cycles—get in when the sector is poised for an upswing and exit before it slips back. Therefore, unless you understand a sector well enough to make such calls, and get them right, avoid sector funds.

2. DEBT FUNDS

Debt funds invest only in debt instruments, and are a good option for investors averse to taking on the risk associated with equities. Here too, there are specialized schemes, namely liquid funds and gilt funds. While the equity funds invest predominantly in money market instruments, gilt funds do so in securities issued by the central and state governments. Such funds attempt to generate a steady income while preserving investors’ capital. Therefore, they invest exclusively in fixed-income instruments securities like bonds, debentures, Government of India securities, and money market instruments such as certificates of deposit (CD), commercial paper (CP) and call money. There are basically three types of debt funds.

a) INCOME FUNDS

By definition, such funds can invest in the entire gamut of debt instruments. Most income funds park a major part of their corpus in corporate bonds and debentures, as the returns there are the higher than those available on government-backed paper. But there is also the risk of default—a company could fail to service its debt obligations.

b) GILT FUNDS

They invest only in government securities and T-bills—instruments on which repayment of principal and periodic payment of interest is assured by the government. So, unlike income funds, they don’t face the specter of default on their investments. This element of safety is why, in normal market conditions, gilt funds tend to give marginally lower returns than income funds.

c) LIQUID FUNDS

They invest in money market instruments (duration of up to one year) such as treasury bills, call money, CPs and CDs. Among debt funds, liquid funds are the
least volatile. They are ideal for investors seeking low-risk investment avenues to park their short-term surpluses.

THE ‘RISK’ IN DEBT FUNDS
Although debt funds invest in fixed-income instruments, it doesn’t follow that they are risk-free. Sure, debt funds are insulated from the vagaries of the stock market, and so don’t show the same degree of volatility in their performance as equity funds. Still, they face some inherent risk, namely credit risk, interest rate risk and liquidity risk.

1. INTEREST RATE RISK
This is common to all three types of debt funds, and is the prime reason why the NAVs of debt funds don’t show a steady, consistent rise. Interest rate risk arises as a result of the inverse relationship between interest rates and prices of debt securities. Prices of debt securities react to changes in investor perceptions on interest rates in the economy and on the prevalent demand and supply for debt paper. If interest rates rise, prices of existing debt securities fall to realign themselves with the new market yield. This, in turn, brings down the NAV of a debt fund. On the other hand, if interest rates fall, existing debt securities become more precious, and rise in value, in line with the new market yield. This pushes up the NAVs of debt funds.

2. CREDIT RISK
This throws light on the quality of debt instruments a fund holds. In the case of debt instruments, safety of principal and timely payment of interest is paramount. There is no credit risk attached with government paper, but that is not the case with debt securities issued by companies. The ability of a company to meet its obligations on the debt securities issued by it is determined by the credit rating given to its debt paper. The higher the credit rating of the instrument, the lower is the chance of the issuer defaulting on the underlying commitments, and vice-versa. A higher-rated debt paper is also normally much more liquid than lower-rated paper. Credit risk is not an issue with gilt funds and liquid funds. Gilt funds invest only in government paper, which are safe. Liquid funds too make a bulk of their investments in avenues that promise a high degree of safety. For income funds, however, credit risk is real, as they invest primarily in corporate paper.

3. LIQUIDITY RISK
This refers to the ease with which a security can be sold in the market. While there is brisk trading in government securities and money market instruments, corporate securities aren’t actively traded. More so, when you go down the rating scale—there is little demand for low-rated debt paper. As with credit risk, gilt funds and liquid risk don’t face any liquidity risk. That’s not the case with income funds, though. An income fund that has a big exposure to low-rated debt instruments could find it difficult to raise money when faced with large redemptions.

TYPES OF MUTUAL FUNDS ON THE BASIS OF STOCK MARKETS

**Domestic Equity Funds** - These mutual funds mainly focus on stocks offered by different U.S. companies. With this type of fund there is a wide range of offerings that takes into consideration the size of the company, the stability of the company, growth and the potential value of the company.

**Global/International Funds** - Global or International mutual funds mainly allow the investor to include foreign equities into their investments. Although deemed slightly
riskier their values do tend to go up when domestic equities drop, offering a balance to the investor’s portfolio.

**Sector Funds** - sector funds give the investor a way to focus on specific parts of the business world. For example, niches like real estate, precious metals or financials. If an investor is able to tolerate an amount of risk, they may end up benefiting from investing in this way. Particularly if the investor knows something about that market segment.

**Fixed Income Funds** - fixed income mutual funds tend to be less volatile. This is the right fund for an investor who is looking for income. Fixed mutual funds for the most part are made up of bonds, CD’s and money market funds. Yes, they do fluctuate with interest rates, still are a sound investment for someone looking for an income generating portfolio.

**Hybrid Funds** - Hybrid mutual funds are generally made up of different investment sectors in one mutual fund. For example, a usual mix may be the pairing of equities with bonds or blue chip stocks with riskier ones.

**Index Funds** - Index mutual funds imitate the selections and amounts of specified market indexes like the S&P 500. They are generally unmanaged keeping costs down.

**Enhanced Index Funds** - Enhanced index funds are actively managed funds applying a portion of their resources to outperform their benchmark indices.

**Asset Allocation Funds** - Asset allocation funds target investors who want a single product solution. They are designed to invest across the primary asset classes including equities, fixed income securities and money market. Each fund is allocated among different asset classes according to their risk tolerances.

**Conservative Allocation Funds** - Conservative allocation mutual funds are usually for investors with a minimum five-year investment timeframe.

**TYPES OF MUTUAL FUND SCHEMES BY STRUCTURE**

1. **OPEN ENDED SCHEMES**

Open-ended or open mutual funds are much more common than closed-ended funds and meet the true definition of a mutual fund – a financial intermediary that allows a group of investors to pool their money together to meet an investment objective– to make money! An individual or team of professional money managers manage the pooled assets and choose investments, which create the fund’s portfolio. They are established by a fund sponsor, usually a mutual fund company, and valued by the fund company or an outside agent. This means that the fund’s portfolio is valued at "fair market" value, which is the closing market value for listed public securities. An open-ended fund can be freely sold and repurchased by investors.

Open funds sell and redeem shares at any time directly to shareholders. To make an investment, you purchase a number of shares through a representative, or if you have an account with the investment firm, you can buy online, or send a check. The price you pay per share will be based on the fund’s net asset value as determined by the mutual fund company. Open funds have no time duration, and can be purchased or redeemed at any time, but not on the stock market.

An open fund issues and redeems shares on demand, whenever investors put money into the fund or take it out. Since this happens routinely every day, total assets of the fund grow and shrink as money flows in and out daily. The more investors buy a fund, the more shares there will be. There’s no limit to the number of shares the fund can issue. Nor is the value of each individual share affected by the number outstanding, because net asset value is determined solely by the change in prices of the stocks or
bonds the fund owns, not the size of the fund itself. Some open-ended funds charge an entry load (i.e., a sales charge), usually a percentage of the net asset value, which is deducted from the amount invested.

Advantages
Open funds are much more flexible and provide instant liquidity as funds sell shares daily. You will generally get a redemption (sell) request processed promptly, and receive your proceeds by check in 3-4 days. A majority of open mutual funds also allow transferring among various funds of the same “family” without charging any fees.

Open funds range in risk depending on their investment strategies and objectives, but still provide flexibility and the benefit of diversified investments, allowing your assets to be allocated among many different types of holdings. Diversifying your investment is key because your assets are not impacted by the fluctuation price of only one stock. If a stock in the fund drops in value, it may not impact your total investment as another holding in the fund may be up. But, if you have all of your assets in that one stock, and it takes a dive, you’re likely to feel a more considerable loss.

Risks
Risk depends on the quality and the kind of portfolio you invest in. One unique risk to open funds is that they may be subject to inflows at one time or sudden redemptions, which lead to a spurt or a fall in the portfolio value, thus affecting your returns. Also, some funds invest in certain sectors or industries in which the value of the in the portfolio can fluctuate due to various market forces, thus affecting the returns of the fund.

2. CLOSED-ENDED SCHEMES
Close-ended or closed mutual funds are really financial securities that are traded on the stock market. Similar to a company, a closed-ended fund issues a fixed number of shares in an initial public offering, which trade on an exchange. Share prices are determined not by the total net asset value (NAV), but by investor demand. A sponsor, either a mutual fund company or investment dealer, will raise funds through a process commonly known as underwriting to create a fund with specific investment objectives. The fund retains an investment manager to manage the fund assets in the manner specified.

Unlike standard mutual funds, you cannot simply mail a check and buy closed fund shares at the calculated net asset value price. Shares are purchased in the open market similar to stocks. Information regarding prices and net asset values are listed on stock exchanges; however, liquidity is very poor. The time to buy closed funds is immediately after they are issued. Often the share price drops below the net asset value, thus selling at a discount. A minimum investment of as much as $5000 may apply, and unlike the more common open funds discussed below, there is typically a five-year commitment.

Advantages
The prospect of buying closed funds at a discount makes them appealing to experienced investors. The discount is the difference between the market price of the closed-end fund and its total net asset value. As the stocks in the fund increase in value, the discount usually decreases and becomes a premium instead. Savvy investors search for closed-end funds with solid returns that are trading at large discounts and then bet that the gap between the discount and the underlying asset value will close. So one advantage to closed-end funds is that you can still enjoy the benefits of professional investment
management and a diversified portfolio of high quality stocks, with the ability to buy at a
discount.

**Risks**
Investing in closed-end funds is more appropriate for seasoned investors. Depending on
their investment objective and underlying portfolio, closed-ended funds can be fairly
volatile, and their value can fluctuate drastically. Shares can trade at a hefty discount and
deprive you from realizing the true value of your shares. Since there is no liquidity,
investors must buy a fund with a strong portfolio, when units are trading at a good
discount and the stock market is in position to rise.

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

**BY INVESTMENT OBJECTIVE**

1. **GROWTH SCHEMES**
A mutual fund’s aim is to achieve capital appreciation by investing in growth stocks.
They focus on companies that are experiencing significant earnings or revenue growth,
rather than companies that pay out dividends. The hope is that these rapidly growing
companies will continue to increase in value, thereby allowing the fund to reap the
benefits of large capital gains. In general, growth funds are more volatile than other
types of funds, rising more than other funds in bull markets and falling more in bear
markets.
The lack of affordable credit for the financially excluded (people on low incomes in
deprived areas) has long been a source of concern for Government, and community-
focused organizations. Although DWP offers budgeting and crisis loans through the
Social Fund, this lack of affordable credit often means that financially excluded people
turn to high cost doorstep lenders and even illegal loan sharks which can result in
spiraling debt problems.
The Chancellor’s Pre-Budget Report, published in December 2004 outlined measures to
promote financial inclusion one of which was to set up a Growth Fund of £36 million to
increase the availability of affordable personal loans via third sector (not-for-profit)
lenders such as credit unions and community development finance institutions.

Given its key role in the wider Financial Inclusion agenda and experience in dealing
with third sector lenders, HM Treasury invited DWP to administer the Growth Fund.
Third sector lenders were invited to bid to deliver the Growth Fund (affordable lending)
service within deprived areas throughout England, Scotland and Wales. The bids were
evaluated during April and May 2006 and rollout of the service has now begun. You
can see the organizations offering the affordable lending service, or find answers to
frequently asked questions.

2. **INCOME SCHEMES**
Income funds are for the investor who seeks current income for a variety of reasons and
needs. The underlying assets of the Enterprise income funds range from high-yield
corporate bonds to tax-exempt municipal bonds to government bonds. Keep in mind
that successful, long-term investing is a mix of many ingredients — chief among them
diversification. By investing in a well-thought-out portfolio of investments among the
different asset classes, you may reduce your overall investment risk. It is unlikely that
you can achieve your long-term goals by focusing on only one fund or one type of fund.
We recommend that, in addition to Income funds, you evaluate and consider investment opportunities from among the other funds to create a balanced, diversified portfolio. Please remember diversification does not assure a profit nor protect you against a loss in declining markets. A professional financial advisor can be an invaluable help in this regard.

If one of your investment goals is to generate income with more relative stability than an investment in a stock fund, bond funds can be a wise choice. Bond funds generally produce higher income than money market funds, although they are less stable, and they can be a good way to balance the volatility of a stock portfolio. But keep in mind that bond funds generally focus less on growth of capital than stock funds.

3. BALANCED SCHEMES

As the name suggests, balanced funds have an exposure to both equity and debt instruments. They invest in a pre-determined proportion in equity and debt—normally 60:40 in favour of equity. On the risk ladder, they fall somewhere between equity and debt funds, depending on the fund’s debt-equity split—the higher the equity holding, the higher the risk.

Therefore, they are a good option for investors who would like greater returns than from pure debt, and are willing to take on a little more risk in the process.

4 MONEY MARKET SCHEMES

Aiming for protection, money market funds are considered the safest place to invest money in mutual funds. They do not provide much potential for income or growth. However, they do seek to generate a small amount of return by loaning money on a short-term basis, anywhere from one day to up to a year. These loans are considered low-risk because they are such short-term. On the other hand, they are also typically the class of fund that earns the least for investors. Money market funds charge low interest rates for the loans, thus earning you small amounts on your investment. Money market funds try to maintain a consistent share price of $1 by paying out all of the earnings to shareholders and by avoiding securities that can rise and fall in price (so there are no capital gains to distribute).

There is a choice of varieties of money market funds:

- **Taxable:** These are simply called "money market funds" if offered by a mutual fund company; or "money market accounts" if offered by a bank. Both make short-term loans, but those offered by a bank are FDIC insured. Those offered by mutual funds are insured by the private insurer, SIPC (Securities Investors Protection Corporation).

- **Government:** These funds only make loans to national governments or agencies of those governments. Earnings are free from federal taxation.

- **Municipal:** These funds only make loans to various state and local governments and their agencies. The income from these funds is free from federal taxation, and any portion of the income that comes from the state in which you live is also free from state taxation. You can also find money market funds that make loans only within a particular state, so you can find a money market fund for your own state and generally be free from all taxation.

5. OTHER SCHEMES

**Tax Saving Schemes**

These schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues. Investments made in Equity Linked Savings Schemes (ELSS) and Pension
Schemes are allowed as deduction u/s 88 of the Income Tax Act, 1961. The Act also provides opportunities to investors to save capital gains u/s 54EA and 54EB by investing in mutual funds.

SPECIAL SCHEMES

1. INDUSTRY SPECIFIC SCHEMES
   Industry Specific schemes invest only in the industries specified in the offer document. The investment of these funds is limited to specific industries like InfoTech, FMCG, and Pharmaceuticals etc.

2. INDEX SCHEMES
   Index schemes attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE 50 Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc. These schemes invest in the securities in the same weightage comprising of an index. NAV’s of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error" in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme.

3. SECTOR SPECIFIC SCHEMES
   Sectoral schemes are those which invest exclusively in a specified sector. This could be an industry or a group of industries or various segments such as ‘A’ Group shares or initial public offerings. These are the funds/schemes which invest in the securities of only those sectors or industries as specified in the offer documents. e.g. Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks, etc. The returns in these funds are dependent on the performance of the respective sectors/industries. While these funds may give higher returns, they are more risky compared to diversified funds. Investors need to keep a watch on the performance of those sectors/industries and must exit at an appropriate time. They may also seek advice of an expert.

SPECIALIZED FUNDS

Real Estate Mutual Funds (REMFs)
The new and added flavor in the mutual fund market in the real estate mutual funds which are governed by the SEBI guidelines and regulations and include investment in debt and equity based securities. The REMFs offer a good investment opportunity for the growth in the fast paced worked of continuous investment. The real estate is booming and in at a great pace of development. It is expected to grow at about 3 times in usual by the year 2010 which come to about Rs. 7000 crores. One of the major plus points of the REMFs in India is the fact that in yields here are higher than elsewhere. Also various other sectors like IT, ITES, health, banking, insurance etc. have shown growth in the present time. Since the lifestyle and luxurious segment of the country is at a booming pace the investments in these types of mutual funds are on the rise.

However, the major issues in these types of funds would be the high transaction costs involved and the length involved in obtain clearances from the authorities. There is also then the problem of lack of transparency and information. These problems must be solved before the REMFs loose out on the market. There is buoyancy in housing sector and the REMFs coming up will surely help the markets and investors a lot. The NAVS of such funds are declared on a daily basis and all the funds are close ended.
Thus to institutionalized the real estate sector it is essential that proper care must be taken for these funds taking into account the norms of the country, various companies like Omaxe, Paravnath, Mahindra Life space, Prime urban estate developers etc. have come to capture the market.

SEBI very recently declared that REMFs will be invested in the real estate assets. This declaration was given out very recently in April 2008. No mutual fund will invest in an asset of real estate which was owned by an AMC during the period of last five years or in which the sponsor or its associates hold tenancy. A large number of specialized funds are in existence abroad. They offer specific needs of specific categories of people like pensioners, windows etc. There are also funds for investments in securities of specified areas. For instance, Japan Fund, South Korean Fund etc. In fact, these funds open the door for foreign investors to invest on the domestic securities of these countries.

Again, certain funds may be confined to one particular sector or industry like fertilizer automobiles, petroleum etc. These funds carry high risk taking investors who prefer this type of fund. Of course, in such, the rewards may be erratic. The best example of the petroleum industry funds in USA.

Caps Defined

- **Large Cap**
  Stocks with market capitalization of at least the last stock of S&P CNX Nifty Index. (Colgate Palmolive India – Mkt Cap Rs. 3300 Cr. *)

- **Mid Cap**
  Stocks with market capitalization lower than the last stock in the S&P CNX Nifty Index and above 10% of the market capitalization of the last stock in the S&P CNX Nifty Index (Mkt Cap between Rs 330 Cr and Rs. 3300 Cr)

- **Small Cap**
  Stock with market capitalization lower than 10% of the market capitalization of the last stock in the S&P CNX Nifty Index. (Mkt Cap below Rs 330 Cr.)

The Schemes would be benchmarked against the BSE 100 Index.

In **India the Mutual Fund schemes the trustee company and the management company are organised and supervised principally under the following laws/regulations:**

- The SEBI MF regulations or, the SEBI CIS regulations, as the case may be issued under the securities.
- The Companies Act, 1956
- The Indian Trusts Act, 1882
- The Indian Registration Act, 1908
- Guidelines issued by The Reserve Bank of India (RBI) in respect of Non Banking Financial Companies.
- The Foreign Exchange Management Act, 1999

**REGULATORY FRAMEWORK OF MUTUAL FUND IN INDIA**

**SEBI (Mutual Funds) Regulation Act, 1996**

Mutual funds function under the SEBI. The main postulates of this regulation are:

1) The board of trustees enters into the relevant agreements with the AMC and the custodian.
2) A fund can launch one or more schemes.
3) The launch of each scheme involves inviting the public to invert it, through an offer document.
4) The offer remains open for specific time period, after which the AMC starts managing the corpus in accordance with the investment objectives mentioned in the offer document. Depending upon the particulars after scheme, it may subsequently open for further sale and repurchase of units.
5) Depending upon the particulars of scheme, the scheme may be wound up after passage of specific period of time.

The formalities laid down by SEBI regulations have to be fulfilled for setting up a mutual fund in India. The organization structure of a mutual fund is as under:

1) The sponsor sets up the mutual fund as a trust under the Indian Trust Act, 1882.
2) Then it appoints the board of trustees, or alternatively the trustee company, represented by a board of directors.
3) It also appoints the asset management company (AMC) and the custodian.

Role of SEBI to Regulate and control mutual funds in India
The importance of regulation lies in controlling monopoly power, nurturing competition and protecting consumer interest. SEBI is regulator for the entire family of mutual funds, which are becoming an important part of Indian Financial System. It regulates the entry of new mutual funds in the industry and the investment in which mutual funds can invest and investing FIIs.

All mutual funds whether promoted by public sector or private sector organizations including those promoted by foreign entities are governed by SEBI’s Regulations. There is no distinction in regulatory requirements for the mutual funds and all are subject to monitoring and inspections by SEBI.

Broad Guidelines Issued by SEBI for Mutual Funds in India
The net worth of the AMC’s should be at least 5 crores. AMC’s and trustees of mutual fund should be two separate and distinct legal entities. The AMC have to get the approval of SEBI for its articles and memorandum of association. All mutual fund schemes should be registered with SEBI. Mutual funds should be distributing 90% of their profits among the investors. In the middle of 2000, SEBI streamlined mutual fund industry with the following regulators:

The total time taken for completion of formalities for new mutual fund schemes is to be reduced from 90 days to 42 days. Any unclaimed money lying with the funds is to be used for investor education and balance sheets of AMC have to be disclosed.

Other Regulatory Aspects
The asset management company shall not launch a scheme unless the trustees approve such scheme and a copy of the offer document has been filled with the board. Every mutual fund along with the offer document shall pay a fee. The offer document shall contain certain disclosures which are adequate in order to enable the investors to make informal investment decision including the disclosure on maximum investments proposed to be made by the scheme in the listed securities of the group of companies of the sponsor. A close ended scheme shall be fully redeemed at the end of the maturity period.

SEBI has also framed rules regarding advertisement, investment objectives and valuation policies. Moreover, the general obligations, role of auditors, procedure for action in case of default and restriction on investments has been put forth to streamline and regulate the mutual fund industry, so as to maintain a more customer savvy approach, and also enhance the investor protection.
Rights of Mutual Fund Investors
As per SEBI regulation on mutual funds the under noted rights are available to a mutual fund holder:

a) An investor is entitled to receive statements of accounts in 6 weeks from the date of request for the unit certificates.
b) He also has a right to receive information about investment policies, objectives, financial position and general affairs of the schemes.
c) He is eligible to receive dividend within 42 days of declaration and the proceeds within 10 days of redemption for repurchase.
d) The Trustees are bound to disclose to the unit holders that could adversely impact investments.
e) With prior SEBI approval 75% of the unit holders can terminate the AMC of the fund.
f) They can also pass the resolution to wind the scheme.
g) An investor can also send complaints to SEBI who will take up the matter with the concerned mutual fund institution and follow them up till the issue is solved.

POLICY AND GOVERNMENT REGULATIONS FOR MUTUAL FUNDS
First quarter review of Annual Statement on Monetary Policy for the year 2006-07
RBI has left CRR and the Bank Rate unchanged. Its GDP growth forecast for FY07 is unchanged at 7.5-8%. The inflation target for FY07 is unchanged at 5.0-5.5%.

MUTUAL FUNDS IN INDIA (1964-2007): Historical Perspective
The end of millennium marked 43 years of existence of mutual funds in this country. The ride through these 43 years is not been smooth. Investor opinion is still divided. While some are for mutual funds others are against it.

UTI commenced its operations from July 1964. The impetus for establishing a formal institution came from the desire to increase the propensity of the middle and lower groups to save and to invest. UTI came into existence during a period marked by great political and economic uncertainty in India. With war on the borders and economic turmoil that depressed the financial market, entrepreneurs were hesitant to enter capital market. The already existing companies found it difficult to raise fresh capital, as investors did not respond adequately to new issues. Earnest efforts were required to canalize savings of the community into productive uses in order to speed up the process of industrial growth.

UTI commenced its operations from July 1964 with a view to encouraging savings and investment and participation in the income, profits, and gains accruing to the Corporation from the acquisition, holding, management and disposal of securities. Different provisions of the UTI Act laid down the structure of management, scope of business, powers and functions of the Trust as well as accounting, disclosures and regulatory requirements for the Trust. The period 1986-1993 can be termed as the period of public sector mutual funds (PMFs). From one player in 1985 the number increased to 8 in 1993. The party did not last long, when the private sector made its debut in 1993-94, the stock market was booming.

The opening up of the asset management business to private sector in 1993 saw international players like Morgan Stanley, Jardine Fleming, JP Morgan, George Soros and Capital International along with the host of domestic players joins the party. But for the equity funds, the period of 1994-96 was one of the worst in the history of Indian Mutual Funds.
By December 2004, the Indian mutual fund industry reached Rs 1, 50,537 crores. It is estimated that by 2010 March-end, the total assets of all scheduled commercial banks should be Rs 40, 90,000 crores. The annual composite rate of growth is expected 13.4% during the rest of the decade. In the last 5 years we have seen annual growth rate of 9%. According to the current growth rate, by year 2010, mutual fund assets will be double.

Table 1.2: Growth trends of banks in India

<table>
<thead>
<tr>
<th>Aggregate deposits of Scheduled Com Banks in India (Rs.Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Month/Year</strong></td>
</tr>
<tr>
<td>Deposits</td>
</tr>
<tr>
<td>Change in % over last yr</td>
</tr>
</tbody>
</table>

Source – RBI

Table 1.3: Growth trends of MF AMU’s in India

<table>
<thead>
<tr>
<th>Mutual Fund AUM’s Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Month/Year</strong></td>
</tr>
<tr>
<td>MF AUM's</td>
</tr>
<tr>
<td>Change in % over last yr</td>
</tr>
</tbody>
</table>

Source – AMFI

Some facts for the growth of mutual funds in India

- 100% growth in the last 6 years.
- Number of foreign AMC’s is in the queue to enter the Indian markets like Fidelity Investments, US based, with over US$1 trillion assets under management worldwide.
- Our saving rate is over 23%, highest in the world. Only channel sing these savings in mutual funds sector is required.
- We have approximately 29 mutual funds which is much less than US having more than 800. There is a big scope for expansion.
- 'B' and 'C' class cities are growing rapidly. Today most of the mutual funds are concentrating on the 'A' class cities. Soon they will find scope in the growing cities.
- Mutual fund can penetrate rural like the Indian insurance industry with simple and limited products.
- SEBI allowing the MF’s to launch commodity mutual funds.
- Emphasis on better corporate governance.
- Trying to curb the late trading practices.
- Introduction of Financial Planners who can provide need based advice.
Highlights:

- Reverse Repo Rate increased by 25bps to 6.0 per cent and Repo Rate to 7.0 per cent.
- Bank Rate and Cash Reserve Ratio kept unchanged.
- GDP growth projection for 2006-07 retained at 7.5-8.0 per cent.
- Containing inflation within 5.0-5.5 per cent for 2006-07 warrants appropriate priority in policy responses.
- Money supply, deposit and credit growth above the indicative projections, warranting caution.
- Appropriate liquidity to be maintained to meet legitimate credit requirements, consistent with price and financial stability.

Domestic Developments:

- Real GDP growth during January-March 2006 is placed at 9.4 per cent as against 8.6 per cent in the corresponding quarter a year ago and real GDP growth for the year 2005-06 is revised to 8.4 per cent from 8.1 per cent.
- Inflation, measured by variations in the wholesale price index (WPI) on a year-on-year basis, raised from 4.1 per cent at end-March 2006 to 4.7 per cent as on July 8, 2006.
- The average international price of the Indian crude basket increased from US $ 60.1 per barrel in January-March, 2006 to US $ 67.3 per barrel in April-June, 2006 and further to US $ 71.4 per barrel in July 2006 (up to July 21).
- During 2006-07 so far, there has been a reversal of the phenomenon of consumer prices lagging wholesale prices, indicative of the increase in food prices which constitute a relatively larger share in the consumer price basket.
- On a year-on-year basis, money supply (M3) growth at 18.8 per cent by July 7, 2006 was higher than 13.8 per cent, net of conversion, a year ago and above the projected trajectory of 15.0 per cent indicated in the Annual Policy Statement for 2006-07.
- The year-on-year increase in aggregate deposits at 20.7 per cent (Rs.3, 72,977 crore) was significantly higher than 14.9 per cent (Rs.2, 34,020 crore), net of conversion, a year ago.
- On a year-on-year basis, the increase in non-food bank credit was 32.9 per cent (Rs.3, 71,993 crore) on top of an increase of 31.0 per cent (Rs.2, 60,164 crore), net of conversion of a non-bank into a bank, a year ago.
- The overhang of liquidity in the system, as reflected in the liquidity adjustment facility (LAF), the market stabilisation scheme (MSS) and the Central Government's cash balances with the Reserve Bank which, put together, averaged Rs.65,174 crore during January-March, 2006 stood at Rs.91,231 crore as on July 20, 2006.
- Reflecting the easy conditions at the short end of the market spectrum, interest rates in the call, market repo and collateralised borrowing and lending obligations (CBLO) segments of the money market eased while gilt prices declined in the secondary market for government securities.
- Banks increased their deposit rates by about 25-100 basis points across various maturities between March 2006 and July 2006. A majority of public sector banks adjusted their deposit rates up to three year maturity upwards by 25 to 50 basis points, while keeping the range of 6.00-7.25 per cent unchanged for deposits of over three years over the same period. The adjustments in deposit rates made by some private sector and foreign banks were somewhat higher, up to 100 basis points, particularly for deposit rates of over one year maturity.
• Exclusive of LAF operations, banks' investments in Government and other approved securities declined by Rs.1,328 crore during 2006-07 up to July 7, as compared with an increase of Rs.12,397 crore a year ago.
• Gross market borrowings of the Central Government at Rs.69,533 crore (Rs.60,282 crore a year ago) during 2006-07 so far (up to July 17, 2006) constituted 38.2 per cent of the budget estimates while net market borrowings at Rs.34,572 crore (Rs.39,234 crore a year ago) constituted 30.4 per cent of the budget estimates.

External Developments:
• Export growth in US dollar terms moderated to 16.9 per cent during April-June, 2006 from 35.4 per cent a year ago. Merchandise import also decelerated to 17.7 per cent from 45.4 per cent.
• While petroleum, oil and lubricants (POL) import growth rose sharply to 39.0 per cent from 31.0 per cent reflecting the steep rise in international crude oil prices, non-oil imports posted a relatively modest growth of 9.6 per cent as compared with 51.7 per cent a year ago.
• India's foreign exchange reserves increased by US $ 11.0 billion over their end-March, 2006 level to US $ 162.7 billion as on July 14, 2006.
• The exchange rate of the rupee depreciated by 4.7 per cent against the US dollar, by 8.4 per cent against euro, by 10.2 per cent against pound sterling and by 5.1 per cent against Japanese yen during 2006-07 so far (up to July 21, 2006). Orderly conditions have prevailed in the domestic foreign exchange market during the period.

Global Developments:
• According to the World Economic Outlook of the International Monetary Fund (IMF) released in April 2006, global growth is expected to pick up from 4.8 per cent in 2005 to 4.9 per cent in 2006 before easing to 4.7 per cent in 2007.
• In major industrial countries, inflation appears to be on the upswing mainly on account of oil price increases. In addition, risks loom large in the form of lagged second order effects of oil price increases, geopolitical tensions, the probability of disruptive adjustment of current account imbalances and the cooling global housing market.
• A large number of central banks have raised their official interest rates, inter alia: the US Federal Reserve, the European Central Bank, the Bank of Japan, the Bank of Canada, the Reserve Bank of Australia, the People's Bank of China, the Bank of Korea and the Banco Central de Chile. Some central banks have kept their policy rates steady as for instance, the Bank of England, the Bank Negara Malaysia, the Bank of Thailand and the Monetary Authority of Singapore. A few central banks have also eased monetary policy such as the Banco de Mexico, the Bank Indonesia and the Banco Central do Brazil.
• Global imbalances, emanating mainly from the twin deficits of the US and reflected in misalignment of major currencies, have continued to widen during 2006 in an environment of rising interest rates worldwide and prospects of contraction of liquidity in the global financial markets.

Overall Assessment:
• There are several positive factors in domestic developments during 2006-07 so far, inter alia: reasonably robust corporate performance, pick-up in investment activity, strong demand for bank credit, growth in new order books, increase in
capacity utilization, ample liquidity, stabilization of inflation since mid-June and strong export growth.

- Some developments in the first quarter of 2006-07 do suggest the need to remain on guard against the emerging risks: incomplete catch-up of domestic POL product prices with the possible permanent component of international prices; growth in non-food bank credit and monetary aggregates higher than the projections; and contrasting liquidity conditions in the Government securities market vis-à-vis money markets.

- While the prospects for growth in the world economy in 2006 are considered bright in the near-term as reflected in indicators of business confidence and unemployment in major economies, downside risks to the economic outlook internationally continue in the form of large fiscal deficits, low household savings and low investment in some large economies; unprecedented and growing current account imbalances; narrowing or closing in of output gaps in many economies; record highs in oil prices accompanied by uncertainties about their future evolution; the outlook for inflation firming up; the hardening of international interest rates along with the direction of movement in setting monetary policy; and re-pricing of risks by financial markets, in particular, in emerging market economies.

**Role of Mutual Funds in the Financial System in India**

Capital markets in India are in the process of maturing. The markets witnessed many structural changes in the years gone by primarily due to the market regulators pro-active approach to the changes in the global scenario as well as to meet the needs of the domestic investors. The RBI has carried out major reforms in the Indian financial markets in the last few years primarily by reducing Cash Reserve Ratio by 4% over 3 years and the bank rate by 5% over 5 years. The interest rates in the country are at record lows and have led to an increase in the credit flow to the commercial sector. The market capitalization of both the bond and equity has increased over the years. Strong economic fundamentals will cherish the growth of financial market, especially mutual funds in the coming years.

Indian national savings have risen over the last two decades from 19% to 23.5% of national income with household savings rising sharply from 14% to 22% and corporate savings from 1.5% to 4%. Though saving rate is on a high, investments are not made prudently. Major chunk of Indian savings are put in physical assets rather than in financial assets. Real estate and Gold form a considerable amount of physical assets. A look at the financial savings shows that considerable amount is retained in the form of currency or deposited in the bank which is the low income generating option. Looking at the high savings rate of the Indians it can be clearly judged there is going to be considerable demand for advice to help individuals channelize the savings into investments which generate high growth. Household are steadily graduating to higher income brackets. By 2007, approximately 22% (4.4 crore) households had an average income of more than Rs 1,45,000 per annum, ($3,150) compared with under 7% in 1995. Equally important, the number of household falling in the low income category has shrunk by a whopping 33% to 5.9 crore (59 million) and had fallen to 4 crore (20% of total by 2007). According to Goldman Sachs India has the potential to raise its US Dollar income per capita in 2050 to 35 times the current levels.

The increasing standard of living of people would increase the amount of savings in their hands thereby urging them to create more wealth and hence the role of fund managers and mutual fund industry is very vital in the development of Indian economy.

With the regulatory bodies pro-active approach to give boost to the Indian mutual fund industry and the investor awareness programmes would also go to help Indian mutual fund industry to play an active role in the financial system in India.
The mania of mutual funds is fast catching up in India the reasons are varied...be it the rising income levels in the middle class employees or increased awareness of the use of mutual funds as an investment instrument apart from safe bank deposits and other government saving avenues.

Over the past 10 years the Indian mutual fund industry has been one of the fastest growing sector in the Indian capital and financial markets. From 1991-2003 the compounded annual growth rate for the industries assets under management averaged around 20%. The rapid growth has led to considerable changes in regulation, the structure of funds available and the composition of net assets across various industry segments as well as in the portfolio of investment fund.

India is at the stage of a revolution that has already peaked in the US, where the asset base of the mutual fund is much higher than the bank deposits. In India only about 8% of the households have invested in the mutual funds, which is much less than 52% in US and 35% in UK. In India mutual fund assets are not even 10% of the bank deposits but this trend in beginning to change.

**COMPARISON BETWEEN PUBLIC AND PRIVATE SECTOR INSTITUTIONS**

On the basis of the earlier studies comparison between the Public Sector & Private Sector Mutual Funds has been done basically on the parameters given here under, it transpired that private sector mutual funds score over the public sector mutual funds and that is why in the recent years the flow of funds has become more towards private sector mutual funds rather than on the public sector mutual funds.

- Fund Size
- NAV
- Liquidity Provider
- Sale Price
- Availability
- Portfolio Disclosure

There are several benefits of privately run mutual funds. One is the lack of pressure from investors to perform and maintain profitability. Imagine running a mutual fund focused on an out-of-favor asset class at a publically traded mutual fund. Assets and profitability go out the door when the hot money leaves, and the manager is left with a choice of style drift or possibly losing their job. At a private company, managers have the ability to stick to their knitting because there is less pressure to follow whatever is the hot asset at the time.

The biggest difference between public and private funds is that a return on capital is much less important at private funds. Specifically, private funds are primarily looking to pay their employees, not create excess returns to equity holders of their company.

Based upon the studies made by Jain, Jain and Dhar (2002-03); Shaineesh and Mohan (2001), Rich, Michael (2000), Colgate, Alexander (1998) and Mittal (2006 and 2008), the following issues need to be addressed before the public sector institutions implement adequate strategies to match with private sector institutions. The issues relating to internal Communication, Political dynamics, Organizational structured reward systems have to be suitably addressed.

Moreover, the lack of leadership and executive involvement, together with Misinterpretation that technology is the solution and Lack of knowledge and training have to be taken care of. Similarly the point of Inadequate or no change management methodologies, Weak follow through after technology implementation, Lack of will to accommodate the other party together with Mutual trust have to be imbibed in the staff public sector. The study also revealed that the factors regarding Lack of mutual respect, Lack of emotional bonding, Poor customer service, Ineffective management support, Hostility and lack of support, resources and skills, Lack of knowledge and marketing
skills, Overemphasis on sales, Indifferent attitude towards customers, Narrow view of the external environment, Poor and inadequate marketing intelligence, Little internal sharing of marketing intelligence, and Inadequate understanding and support from senior management has to be of paramount importance for public sector institutions to implement to come up to the desired level of customer savvy approach.

The study into the relationship marketing implementation in public sector institution also identified managerial, human resource, cultural, comprehension, communication, strategic resource and operational forces impeding the process of relationship marketing, its up-take and the viability of the implementation of its resulting recommendations. The above issues tell that senior leadership makes trade offs with critical resources when determining what level of customer relationship they can afford to sustain. They advocate the core group of analytical experts that can drive the customer analysis and establish business rules. Integrators can work across the organizational boundaries. Cross functional teams support rapid deployment strategies. Analytics and customer relationships must be everyone’s’ top of mind. Appropriate RM skill sets must be evaluated and respective training made available. RM efforts must be quantified and measured. Marketing and technology must be interlinked from the strategic position.

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One relationship marketing (RM) key success factor is human resources. Too often employees are asked to take on RM initiative in addition to their activities. Their roles should be redefined. Training is critical from both the business and technical perspective. Sometimes people are trained in how to use relationship marketing enabling tool well in advance of its implementation. This is usually the result of delays. By the time the enabling technology is available people have lost their knowledge and momentum, requiring training.

The organization must ensure that it has employees trained in state of the art marketing and technology methodologies. Risks in testing and implementing these new methods and impact on the customer relationships must be assessed. The businesses have a common problem. Their customer relationships are very successful and teat very success created a bond with the customer held on to so dearly that any change in the interaction could lead to dissatisfaction and ultimately a lost customer. Organizations must achieve a realistic and workable balance between customer relationships and their human resource capacity. Cooperation across the company is critical so the question is how difficult is it to implement and maintain a RM mindset within the organization culture. Organization structures have a certain level of bureaucracy in order to operate successfully. The people working within such as employees, and with such as value chain members, have learnt how to behave and operate within the structure are most likely comfortable with it, and being human beings will have varying levels of resistance to change. For all intents and purposes it is probably the right structure for the respective business.
The major differences between both of the above are based on the parameters of trust, bonding, communication, empathy, reciprocity, culture and customer satisfaction. The studies reveal that there exist a wide perceptual difference among the customer of private and public sector organization regarding the relationship marketing philosophy. The gap is very high depicting that public sector organizations are quite ineffective in regards to implementing relationship marketing which has led to great deal of dissatisfaction among customers. On a whole the public sector need to work very hard to administer relationship marketing approach. The poor implementation also reveals poor customer satisfaction, poor culture, less score on reciprocity and empathy dimensions.

On the basis of the survey done for the purpose of comparing the performance of the private and public sector mutual fund companies the study revealed that the private sector mutual fund companies score over the public sector mutual fund companies. The phase of 1987-93 marked the entry of public sector starting their asset management business. But post privatization in ‘93, private players have managed to beat the rest in the performance game.

As observed with the performance ratings of both the private and public mutual fund companies it can be concluded that the performance of the private mutual funds is better than the Public Mutual Fund companies. Even among the public sector funds, it was SBI, which bagged all the accolades. SBI goes neck to neck with respect to Private Mutual Fund companies in terms of performance. However, the rest of the Public Mutual Fund companies lack behind.

The reason that can be attributed to good performance of the Private Mutual Fund companies can be their efficient management, flattened organizational structure (narrow span of control and fewer levels of management.), less pressure from the investors side, more autonomy in terms managerial decisions.

1. The study reveals that the fund size in private sector mutual funds are flexible while the fund size in case of public sector mutual funds are not that flexible.
2. The NAV is daily calculated by the private sector and public sector mutual funds mutual fund by using the understated formula

\[
\text{NAV} = \frac{\text{Value of Securities} - \text{Liabilities}}{\text{No. of Units Outstanding}}
\]

But the liabilities and costs in the case of public sector mutual funds are more than that of the private sector mutual funds and hence the more customer satisfactory performance is depicted in the NAV of the private sector funds as compared to public sector funds. Similarly the return from a mutual fund of private sector is more than the return from the public sector mutual funds.

The return from a mutual fund consists of the following:

- Periodic dividends in cash (Generally Annual)
- Distribution of Capital Gains and
- Increase (Change) in NAV over the period.

Annual percentage return from a mutual fund is calculated as :

\[
\text{Return} = \frac{\text{Div} + \text{CG} + (\text{NAV}_1 - \text{NAV}_0)}{\text{NAV}_0} \times 100
\]

On the basis of the above calculated the performance of the private sector mutual funds is better as compared & that of private sector mutual funds as in NAV₀ and
NAV₁ are less in the case of public sector mutual fund than that of private sector mutual funds.

3. Liquidity provider in the case of the private sector is from the fund itself, while in the case of public sector mutual funds it is generally based on the basis of stock market performance.

4. Sale price in the case of public sector funds is at NAV plus load but in the case of public sector funds it a significant premium/discount NAV.

5. Availability for private sector funds is much more as compared to the availability of mutual funds by public sector as the private sector players are functioning round the clock and their services are more customer friendly and more customer oriented than that of public sector mutual funds.

6. Portfolio Disclosure is much more transparent and hence more responsive attitude is adopted by the private sector mutual funds than that of public sector mutual funds. While the private sector funds may disclose the information on daily/real time basis in public sector mutual fund may provide it on monthly basis.

Table 1.4: Trends in Transactions on Stock Exchanges by Mutual Funds (since January 2000)

<table>
<thead>
<tr>
<th>Equity (Rs. in crores)</th>
<th>Debt (Rs. in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross Purchase</td>
</tr>
<tr>
<td>Jan 2000-March 2000</td>
<td>1170.54</td>
</tr>
<tr>
<td>April 2000-March 2001</td>
<td>17375.78</td>
</tr>
<tr>
<td>April 2001-March 2002</td>
<td>12098.11</td>
</tr>
<tr>
<td>April 2002-March 2003</td>
<td>14520.89</td>
</tr>
<tr>
<td>April 2003-March 2004</td>
<td>36663.58</td>
</tr>
<tr>
<td>April 2004-March 2005</td>
<td>45045.25</td>
</tr>
<tr>
<td>April 2005-March 2006</td>
<td>10435.90</td>
</tr>
<tr>
<td>April 2006</td>
<td>12752.47</td>
</tr>
<tr>
<td>May 2006</td>
<td>18345.43</td>
</tr>
<tr>
<td>June 2006</td>
<td>7843.52</td>
</tr>
<tr>
<td>July 2006</td>
<td>7552.18</td>
</tr>
<tr>
<td>August 2006</td>
<td>8851.58</td>
</tr>
<tr>
<td>September 2006</td>
<td>10345.23</td>
</tr>
<tr>
<td>October 2006</td>
<td>9944.46</td>
</tr>
<tr>
<td>November 2006</td>
<td>12675.21</td>
</tr>
<tr>
<td>December 2006</td>
<td>13181.43</td>
</tr>
<tr>
<td>January 2007</td>
<td>11643.60</td>
</tr>
<tr>
<td>February 2007</td>
<td>12697.09</td>
</tr>
<tr>
<td>March 2007 (upto 8th)</td>
<td>3362.40</td>
</tr>
<tr>
<td>Total (April’06-March’07)</td>
<td>129194.60</td>
</tr>
</tbody>
</table>

Source: www.sebi.gov.in
Table 1.5: Trends in Transactions on Stock Exchanges by Mutual Funds March 2007

<table>
<thead>
<tr>
<th>Transaction Date</th>
<th>Gross Purchase</th>
<th>Gross Sales</th>
<th>Net Purchase/Sales</th>
<th>Gross Purchase</th>
<th>Gross Sales</th>
<th>Net Purchase/Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.03.07</td>
<td>767.80</td>
<td>796.92</td>
<td>-29.12</td>
<td>845.18</td>
<td>411.54</td>
<td>433.64</td>
</tr>
<tr>
<td>02.03.07</td>
<td>442.45</td>
<td>567.57</td>
<td>-125.32</td>
<td>238.24</td>
<td>272.74</td>
<td>-34.50</td>
</tr>
<tr>
<td>05.03.07</td>
<td>707.38</td>
<td>541.24</td>
<td>166.14</td>
<td>981.15</td>
<td>591.73</td>
<td>389.42</td>
</tr>
<tr>
<td>06.03.07</td>
<td>528.54</td>
<td>460.10</td>
<td>68.44</td>
<td>1148.53</td>
<td>243.93</td>
<td>904.60</td>
</tr>
<tr>
<td>07.03.07</td>
<td>338.20</td>
<td>717.76</td>
<td>-379.56</td>
<td>690.76</td>
<td>282.95</td>
<td>407.81</td>
</tr>
<tr>
<td>08.03.07</td>
<td>578.23</td>
<td>617.99</td>
<td>-39.76</td>
<td>533.50</td>
<td>502.33</td>
<td>31.17</td>
</tr>
<tr>
<td>Total</td>
<td>3362.40</td>
<td>3701.58</td>
<td>-339.18</td>
<td>4437.36</td>
<td>2305.22</td>
<td>2132.14</td>
</tr>
</tbody>
</table>

Table 1.6: Top 10 Open Ended- Equity & Debt-Funds -Period (Jan 1, 2006-Dec 6, 2006)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Scheme Name</th>
<th>Date</th>
<th>NAV (Rs.)</th>
<th>% Return as on NAV date</th>
<th>Type of Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>JM Balanced- Dividend</td>
<td>Dec 6,2006</td>
<td>17.65</td>
<td>45.83</td>
<td>Private</td>
</tr>
<tr>
<td>2</td>
<td>JM Balanced- Growth</td>
<td>Dec 6,2006</td>
<td>23.23</td>
<td>45.79</td>
<td>Private</td>
</tr>
<tr>
<td>3</td>
<td>PRINCIPAL Child Benefit- Career Builder Plan</td>
<td>Dec 6,2006</td>
<td>54.09</td>
<td>43.37</td>
<td>Private</td>
</tr>
<tr>
<td>4</td>
<td>PRINCIPAL Child Benefit- Future Guard Plan</td>
<td>Dec 6,2006</td>
<td>53.38</td>
<td>43.31</td>
<td>Private</td>
</tr>
<tr>
<td>5</td>
<td>Can Balanced II</td>
<td>Dec 6,2006</td>
<td>38.02</td>
<td>42.43</td>
<td>Public</td>
</tr>
<tr>
<td>6</td>
<td>Tata Balanced Fund- Growth</td>
<td>Dec 6,2006</td>
<td>49.39</td>
<td>40.49</td>
<td>Private</td>
</tr>
<tr>
<td>7</td>
<td>Tata Balanced Fund- Dividend</td>
<td>Dec 6,2006</td>
<td>36.54</td>
<td>40.47</td>
<td>Private</td>
</tr>
<tr>
<td>8</td>
<td>SBI Magnum Balanced Fund-Growth</td>
<td>Dec 6,2006</td>
<td>35.96</td>
<td>39.63</td>
<td>Public</td>
</tr>
<tr>
<td>9</td>
<td>SBI Magnum Balanced Fund-Dividend</td>
<td>Dec 6,2006</td>
<td>26.25</td>
<td>39.61</td>
<td>Public</td>
</tr>
</tbody>
</table>

Source: www.valueresearchonline.com

Table 1.7: Top 10 Open Ended- Debt-Funds -Period (Jan 1, 2006-Dec 6, 2006)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Scheme Name</th>
<th>Date</th>
<th>NAV (Rs.)</th>
<th>% Return as on NAV date</th>
<th>Type of Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>LIC MF Unit Linked Insurance Scheme</td>
<td>Dec 6,2006</td>
<td>12.82</td>
<td>38.11</td>
<td>Public</td>
</tr>
<tr>
<td>2</td>
<td>Templeton India Children Asset Gift Plan- Growth</td>
<td>Dec 6,2006</td>
<td>30.31</td>
<td>35.19</td>
<td>Private</td>
</tr>
<tr>
<td>3</td>
<td>Templeton India Children Asset Gift Plan- Dividend</td>
<td>Dec 6,2006</td>
<td>30.31</td>
<td>35.19</td>
<td>Private</td>
</tr>
<tr>
<td>4</td>
<td>Escorts Income Bond- Dividend</td>
<td>Dec 6,2006</td>
<td>17.04</td>
<td>25.96</td>
<td>Private</td>
</tr>
<tr>
<td>5</td>
<td>Escorts Income Bond- Growth</td>
<td>Dec 6,2006</td>
<td>20.19</td>
<td>25.95</td>
<td>Private</td>
</tr>
</tbody>
</table>
### Table 1.8: Top 10 Open Ended Equity Funds - Period (Jan 1, 2006-Dec 6, 2006)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Scheme Name</th>
<th>Date</th>
<th>NAV (Rs.)</th>
<th>% Return as on NAV date</th>
<th>Type of Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Sundaram BNP Paribas Select Midcap-Dividend</td>
<td>Dec 6,2006</td>
<td>18.01</td>
<td>72.16</td>
<td>Private</td>
</tr>
<tr>
<td>2</td>
<td>Sundaram BNP Paribas Select Midcap-Growth</td>
<td>Dec 6,2006</td>
<td>90.71</td>
<td>71.81</td>
<td>Private</td>
</tr>
<tr>
<td>3</td>
<td>UTI Thematic Infrastructure Fund- Growth</td>
<td>Dec 6,2006</td>
<td>28.62</td>
<td>71.74</td>
<td>Public</td>
</tr>
<tr>
<td>4</td>
<td>UTI Thematic Infrastructure Fund- Dividend</td>
<td>Dec 6,2006</td>
<td>20.92</td>
<td>71.57</td>
<td>Public</td>
</tr>
<tr>
<td>5</td>
<td>Tata Infrastructure Fund- Dividend</td>
<td>Dec 6,2006</td>
<td>21.84</td>
<td>70.29</td>
<td>Private</td>
</tr>
<tr>
<td>6</td>
<td>Prudential ICICI Infrastructure Fund- Growth</td>
<td>Dec 6,2006</td>
<td>18.57</td>
<td>70.24</td>
<td>Private</td>
</tr>
<tr>
<td>7</td>
<td>Tata Infrastructure Fund- Growth</td>
<td>Dec 6,2006</td>
<td>24.33</td>
<td>70.22</td>
<td>Private</td>
</tr>
<tr>
<td>8</td>
<td>Prudential ICICI Infrastructure Fund-Dividend</td>
<td>Dec 6,2006</td>
<td>16.09</td>
<td>70.13</td>
<td>Private</td>
</tr>
<tr>
<td>9</td>
<td>SBI Magnum Global Fund 94- Dividend</td>
<td>Dec 6,2006</td>
<td>34.44</td>
<td>68.65</td>
<td>Public</td>
</tr>
<tr>
<td>10</td>
<td>SBI Magnum Global Fund 94- Growth</td>
<td>Dec 6,2006</td>
<td>44.08</td>
<td>68.53</td>
<td>Public</td>
</tr>
</tbody>
</table>

Source: [www.valueresearchonline.com](http://www.valueresearchonline.com)

As per the rating given by the value research on the basis of the % Return on the NAV between the period from Jan –Dec 2006 for Debt funds, Equity funds and Debt -Equity funds, among the top 10 ranks, mutual funds offered by the Private funds scored better than those by the Public funds. Except the UTI, SBI, Canara Bank and LIC no public fund was able to fetch any rank in the first 10 positions. Also, all the top 3 ranks under all the three categories are headed by the private mutual funds.

Clearly, the private funds companies are doing fairly well than the public funds companies giving a higher rate of return to their mutual fund holders.

Hence the private sector mutual funds have an edge over the public sector mutual funds.