CHAPTER 4

INVESTMENT IN MUTUAL FUNDS

4.1 Investments in shares v/s mutual funds

A mutual fund is simply a financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual funds are one of the best investments ever created because they are very cost efficient and very easy to invest in. By pooling money together in a mutual fund, the investors can purchase stocks or bonds with much lower trading costs than if they tried to do it on their own. But the biggest advantage of mutual funds is diversification.

The money collected is invested in different types of securities by the fund manager depending upon the objective of the scheme. The income earned through these investments and the capital appreciation realised by the scheme are shared by its unitholders in proportion to the number of units owned by them (pro-rata).

The combined holdings, the mutual fund owns, are known as its portfolio. The income earned through these investments and the capital appreciation realised are shared by its unitholders in proportion to the number of units owned by them. The flow diagram below describes broadly the working of a mutual fund:

Diagram 4.1

**Mutual Fund Operation Flow Process**

A mutual fund is an ideal investment vehicle for today's complex and modern financial scenario. The markets for equity shares, bonds and other instruments, real estate,
derivatives and other assets have become mature and information driven. The price changes in these assets are driven by global events occurring in different countries.

The mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing the funds in securities in accordance with objectives as disclosed in the offer document. Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. The mutual fund issues units to the investors in accordance with quantum of money invested by them. The investors of mutual funds are known as unitholders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund in India is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets, before it can collect funds from the public.

If one is quite knowledgeable about investing, have enough money to purchase shares of companies in different industries to allow for diversification, and have time to research stocks, then may be investing in individual shares is a good starting point.

On the other hand If one has limited knowledge about investing, have a small amount of money that one can invest regularly, and is not comfortable with the ups and downs of individual shares, then mutual funds may be a better fit.

Some common mistakes, mutual fund investors make and should avoid:

1. Failing to have a good understanding of the objectives, policies and risks of the funds the investors buy. This can lead to unsuitable investments and unexpected losses.

2. Investing in the wrong funds even though they may be in the right categories. Losers will tend to exhibit either high costs, excessive sales charges or poor management.

3. Using the rear-view mirror approach of buying volatile funds that were top performers over the most recent year or quarter.

4. Failing to follow a consistent long-term view of buy- and-hold investing.
4.1.1 Working of Mutual funds

When we invest in a mutual fund, we purchase a certain number of units of the fund. The fund manager buys and sells the investments in the securities markets to maximise returns for the investors within the investment guidelines of a scheme outlined in the prospectus.

The fund's value and the value of the units can go up or down on a day to day basis. Some funds will fluctuate more than others and we would like to consider this factor when we choose a fund.

Many factors influence how the mutual fund performs, including the value of the underlying investments, changes in interest rates and other economic trends, even the buy/sell process.

When we purchase units in a mutual fund, we pay certain fees and expenses usually deducted directly from our investment. We should understand these fees, well for both buying and selling the units.

4.1.2 Benefits of investing in mutual funds

The investment in Mutual funds have several benefits, including:

1. Professional Money Management

The Professional fund managers have the qualifications, training and experience to manage investments effectively. Investing in mutual funds has the benefit of the expertise of professionals who have the resources to thoroughly research potential investments, churn the portfolio and balance the risk-return trade-off. They monitor the market and the economic trends and then take a conscious investment decision on the basis of their analysis.

2. Risk Diversification

Diversification is a key to intelligent investing. Because of the economies of scale provided by mutual funds, even a small investment is diversified. When the money is invested in a mutual fund, the holding always represents an array of shares, bonds and/or other investments and this diversified investment portfolio helps in reducing the level of risks.
3. **Flexibility**

The Mutual funds are considered as flexible investments as the investor has a variety of plans to choose from - income or growth plan, dividend or re-investment plan, Systematic Investment Plan or Systematic Withdrawal Plan, Children Benefit Plan or Tax Saving Plan. They offer multiple schemes / options to allow investors to switch easily between various schemes. This flexibility gives the investor a convenient way to change the mix of his portfolio over time, quite easily as compared to changing shares portfolio.

4. **Convenience**

The investments in Mutual funds are simple to buy and sell. When one buys mutual funds, one gains the benefit of diversification without having to research and track numerous individual investments. They give detailed reports to review mutual funds’ performance through the quarterly disclosure reports. The facilities of periodic purchase/ withdrawals and re-investment are available to investors. Each investor is issued units electronically, receives an account statement which is non transferable. Hence, he does not have to worry about theft of the physical certificates or loss in transit.

5. **Long-Term Growth**

The Mutual funds have more long term growth potential than short term investment vehicles such as savings accounts and money market funds.

6. **Reduction in Costs**

The Mutual funds have a large pool of money that they have to invest. So they are often involved in buying and selling of large amounts of securities that will cost much lower than when we invest on our own.

The fund expenses are often no more than 1.5% of the investment expenses. For Index Funds the expenses are less than that, because index funds are not actively managed. Instead, they automatically buy stock in companies that are listed on a specific index like BSE.

7. **Liquidity**

A mutual fund investor can sell off the investments and get the current market value of the investments based on NAV, in a short time. With open-ended mutual funds, one can
re redeem all or part of the units any time. Such liquidity makes mutual funds much more attractive than illiquid instruments such as fixed deposits and bonds.

8. Transparency

The Mutual funds are very transparent. All mutual fund schemes disclose their NAV daily and full portfolio quarterly. They give detailed information about investments, the proportion in which the investments have been made in different asset categories, fund manager's investment strategy and objective of the scheme. This level of transparency where the investor himself sees the underlying assets bought with his money, is unmatched by any other financial instrument.

9. Well Regulated

The Securities and Exchange Board of India (SEBI), the mutual fund’s regulator has clearly defined rules which govern all mutual funds in India. These regulations relate to the formation, administration and management of mutual funds and also prescribe disclosure and accounting requirements. Such a high level of regulation seeks to protect the investors from misuse of their money. This regulatory control and check are not available in such detail in case of other investments.

10. Choice of Schemes

The Mutual funds investment offer a tremendous variety of schemes. It is beneficial in two ways: first, it offers different types of schemes to investors with different needs and risk appetites; secondly, it offers a chance to an investor to invest sums across a variety of schemes, both debt and equity.

4.1.3 Drawbacks of mutual funds

The Mutual fund investments have their own following drawbacks, however may not be for everyone:

No Guarantees

In the mutual fund investment, no investment is risk free. If the stock market falls, the value of mutual fund units go down as well, no matter how balanced the portfolio is. Anyone who invests through a mutual fund runs the risk of losing money.
Fees and Commissions

All mutual funds charge administrative fee to cover their day-to-day expenses. Some funds also charge sales commissions or “loads” to compensate the brokers, financial consultant, or financial planners. Even if one doesn’t use a broker or other financial adviser one will pay a sales commission if one buys units in a Load fund.

Management Risk

When one invests in a mutual fund one depends on the fund manager to make the right decisions regarding the fund’s portfolio. If the manager does not perform as well as we had hoped, we might not make as much money on our investments as expected. Of course, if we invest in Index Funds, we forego management risk because these funds are passively managed.

4.2 Types of Mutual Fund Schemes

The Mutual Funds offer a wide variety of schemes to the investors according to the objectives of the scheme, appetite of the investors, extent of diversification, financial position, risk tolerance and returns expectations. The following broad types of schemes are offered by the Mutual Funds:

Table 4.1: Types of Mutual Fund Schemes

<table>
<thead>
<tr>
<th>BROAD TYPE</th>
<th>MAJOR FEATURES</th>
</tr>
</thead>
<tbody>
<tr>
<td>By Structure:</td>
<td></td>
</tr>
<tr>
<td>Open-ended schemes</td>
<td>Schemes open throughout the year. Sale and repurchase of units on a daily basis at NAV</td>
</tr>
<tr>
<td>Close-ended schemes</td>
<td>Schemes open for subscription for a specific period only. Repurchase permitted at NAV, after the lock in period, if any</td>
</tr>
<tr>
<td>Interval schemes</td>
<td>Schemes that combine the features of open-ended and close-ended schemes, making the fund open for sale or redemption during predetermined intervals.</td>
</tr>
<tr>
<td>By Investment Objective:</td>
<td></td>
</tr>
<tr>
<td>Growth schemes</td>
<td>Aim is to achieve capital appreciation by investing in equity shares of companies that are experiencing significant earnings or revenue</td>
</tr>
</tbody>
</table>
growth. In general, growth funds are more volatile than other types of funds.

<table>
<thead>
<tr>
<th>Schemes</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income schemes</td>
<td>Schemes that primarily concentrate on investment in bonds with an objective of earning regular income and providing regular dividend to the investors.</td>
</tr>
<tr>
<td>Balanced schemes</td>
<td>Schemes use a combination of strategies, typically including some level of investment in bonds, to stay more conservative when it comes to risk and also invest in equity shares to aim for some growth.</td>
</tr>
</tbody>
</table>
| Money market schemes            | Schemes that invest in short term money market instruments, entail the least risk, as well as lower rates of return. Money market units are liquid and redeemable at any time. These schemes exclusively invest in money market instruments. These funds are open ended, transacting in short term debt instruments, like Treasury Bills, Government Securities, call money, commercial paper, certificate of deposits. The investment in such securities is for a shorter tenure, so volume of investment is big. Such funds serve two important purposes:-  
1. Providing access of money market benefits to ordinary investors.  
2. Acting as a balancing instrument for stabilizing volatile interest rates. |
| Other Schemes:                  |             |
| Tax saving schemes              | Schemes that offer to the investors rebates in taxes under the Income Tax Act 1961. Usually have a three year lock in period. The fund |
manager of the Tax Saving Funds in India invests the money in instruments that are related to equity. The dividends of Tax Saving schemes in India are tax free.

| Index funds | Funds which maintain investments in companies that are part of major stock indices, such as the BSE or NSE. The assets of an index fund are managed, to closely approximate the performance of a particular published index. An index fund manager makes fewer trades and thus the funds generally have lower trading expenses. |
| Sector specific schemes | Schemes that invest solely in companies that operate in a particular industry or sector of the economy. Because the holdings of this type of scheme are in the same industry, there is an inherent lack of diversification associated with these schemes. |
| Gilt edged schemes | Schemes which invest their pooled money in Government securities and generally provide a fixed rate of return. |

4.3 Performance Measurement and Evaluation of Mutual Fund Schemes

The mutual fund investments are considered to be less risky investment avenues as compared to direct investments in stock markets. All mutual fund schemes provide market related returns. The performance of mutual funds can be evaluated with resources mobilized by mutual funds over a period, net inflow or outflow of funds and trading of mutual fund units in the market.

4.3.1 Net Asset Value (NAV) of a scheme

The performance of a particular scheme of a mutual fund is denoted by the Net Asset Value (NAV). The mutual funds invest the money collected from the investors in securities markets. In simple words, Net Asset Value is the market value of the securities held by the scheme. Since the market value of securities changes every day, NAV of a scheme also varies on day to day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. For example, if the market value of securities of a mutual fund scheme is Rs 200 lakhs and the mutual fund has issued 10 lakhs units of Rs. 10 each to the investors, then the NAV per unit of the fund is Rs.20. The NAV is
required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.

**NAV of a mutual fund unit is calculated as:**

**Calculation of NAV**

| Market value of investments + Receivables + other accrued Income + Other Assets - Accrued expenses - other payables - other liabilities | NAV= No. of units outstanding as on NAV date |

The NAV is calculated once in a day by marking the balance sheet of the scheme to the market. First, the total market value of all the stocks held is computed. The total of the market value is added to the scheme's cash and equivalent holdings. The Liabilities (including accrued expenses) are subtracted. The result is total net assets. Dividing the total assets by the number of units outstanding, give the NAV per unit.

The proper performance measurement of mutual fund schemes involve recognition of both, the return and the riskiness of the investments. The central issue in performance measurement is both a measurement of risk with return. Benchmarking and peer group analysis of mutual fund schemes help the investors to understand the performance in more meaningful terms. The investors should monitor the performance of their mutual fund schemes on a regular basis.

**4.3.2 The concept of return**

The performance in the context of the mutual funds, is to compare the expected return with the actual return. Therefore, the performance measurement exercise needs to begin by carefully understanding the objectives of the fund and then comparing the actual performance against these objectives. The most vital statistic in measuring the performance of a mutual fund is the rate of return.

**4.3.3 The concept of risk**

The risk is the key dimension of the performance measurement and a decisive factor in determining a fund manager's skills. One cannot make a judgment about how skilful a fund manager is in a particular period by looking at return only.
Risk in a generic sense is the possibility of loss, damage, or harm. For investment purposes a more specific definition of risk has to be given. It refers to variability in the expected return.

For a mutual fund, the following factors cause variability of the investment performance:

- The kind of securities in the portfolio. e.g., small cap stocks may be more volatile than large cap stocks.
- The degree of diversification. e.g., a portfolio of only 5 stocks may be more volatile than a portfolio comprising of 15 stocks.
- The extent to which the portfolio manager times the market. e.g., an index fund tends to be less volatile than an aggressive growth fund.

4.3.4 Standard deviation

Standard deviation is a measure of dispersion in return. It quantifies the degree to which returns fluctuate around their average. A higher value of standard deviation means higher risk. The standard deviation is used probably more than any other measure to describe the risk of a security (or portfolio of securities). It’s not just a financial tool though.

**Standard Deviation for Mutual Funds**- When used to measure the volatility of the performance of a security or a portfolio of securities, standard deviation is generally calculated for monthly returns over a specific time period usually, 36 months. And, because most people think about returns on an annual and not on monthly basis, the resulting number is then modified to produce an annualized standard deviation.

Though standard deviation measures volatility on both the upside and the downside, it’s a good proxy for measuring the risk of loss with any security. One of the strengths of standard deviation is that is can be used across the board for any type of portfolio with any type of security. The calculation is the same for a portfolio of bonds as it is for a portfolio of growth stocks.

4.3.5 Performance evaluation

After measuring the performance, next important step is to evaluate it against some suitable benchmark to address more important issues like how the reassured return measures up to the similar investment opportunities. Performance evaluation will also enable the fund's sponsor and the asset management committee to determine if the fund manager has enhanced the fund's value beyond what could be obtained from a passive indexed strategy. The performance evaluation involves benchmarking and peer group analysis.
4.4 Selecting a Mutual Fund

Selection Parameters

The objective: First of all, the investment goal of the investor must match the investment objective of a mutual fund scheme. It is necessary, as it would affect one’s prospective returns. For example, a scheme that invests heavily in equity shares is not suited for a conservative investor.

The risk capacity and capability: Those investors with no risk tolerance should go for debt schemes, as these are relatively safer. Aggressive investors can go for equity related schemes.

Fund Manager’s and scheme’s track record: It is essential that the mutual fund has an excellent track record. It should also be professional and maintain high transparency in operations. The performance of the scheme must be seen against relevant market benchmarks and its competitors.

Cost factor: Though the AMC fee is regulated, one should look at the expense ratio of the fund before investing. A higher entry load or exit load also will eat into the returns. A higher expense ratio can lower the returns.

Purchasing Mutual Funds

Purchasing during NFO: The units can be bought at par during the NFO. However, it is not always advantageous to buy mutual fund units during NFO. One can always wait and see the performance before investing in it.

Purchasing existing mutual fund units: One can buy units of an open-end scheme anytime at NAV-related price. Most mutual funds charge an entry load.

Selling Mutual Funds

Ideally, one should sell the units when the target profit has been met. The other reason could be requirement of money to meet urgent needs. Any major changes in the objective of the fund or a sharp rise in expenses could also be valid reasons to redeem units. One must learn booking periodical profits when the NAV is attractive.

Income from Mutual Funds: The Options

The Mutual funds distribute their income as dividend. An investor has the option of receiving the dividend or opting for the dividend re-investment. If an investor needs the income, he can opt for dividend payout option. However, if he does not need the money, he can opt for
dividend re-investment. Another choice before him is the growth or cumulative option. Here the income generated from sale of securities or capital appreciation is automatically re-invested.

**Speedy Investment, Redemption and Dividend**

Due to the Electronic Clearing Services (ECS), the mutual fund investor has the option of automatic credit of dividends and redemptions into the bank account. This saves a lot of paperwork, for both the investor and the fund. He can also instruct his bank to automatically withdraw a certain sum from his bank account towards systematic investment plan. Alternatively, he can also directly receive systematic withdrawal proceeds in his bank account.

**4.5 Superior Disclosure by Fund Houses**

The need for more comprehensive and superior disclosure by fund houses cannot be undermined. It helps investors understand the various funds on offer and help them in making informed investment decisions in their quest for achieving long-term investment goals. The Mutual Funds must consider the following:

1. **Investment objectives must be concrete and conclusive**

   The scheme’s objectives must be concrete and conclusive like an equity fund has an investment objective to achieve capital appreciation from a portfolio that is invested predominantly in equity and equity related instruments to generate long-term growth of capital.

   The mutual fund must communicate to investors in no uncertain terms, as categorically as possible the mutual fund's investment objective and the strategy to achieve the same.

2. **Offer document/KIM must be comprehensive**

   The Offer Document and the Key Information Memorandum (KIM) should be comprehensive and reveal everything significant from a fund management perspective.

   Every fund house has a responsibility towards the investor to fulfill this responsibility, it must furnish the investor all the relevant information that he will need to make an informed investment decision. Apart from the legal and compliance related issues, the investor would really like to see the following in OD/KIM:

   I. The fund's investment mandate
II. The investment style (growth, value, and blend)

III. Top down or bottom up investment method

IV. Likely investment pattern (large caps, mid caps and their likely allocations)

V. Asset allocation

VI. The team-based or fund-manager-led investment approach

VII. Fund’s distinctive features from comparable investments in the market

VIII. Proposal to keep its expenses to the minimum

The fund house must use the OD/KIM to communicate everything about the fund that the investor must know.

3. Complete portfolio disclosure

For investors to 'interpret' the fund manager's investment strategy and ensure that he is abiding by the investment mandate, it is important that they access the fund's complete portfolio. This involves having access to entire portfolio disclosure.

In the best interests of the investor, the Mutual Fund must declare the entire portfolio of all its schemes in a timely and consistent format for ease of comparison. All the stocks and sectors must be displayed in a manner to facilitate research and analysis so that investors can take an objective decision as to whether the fund manager is managing the money as promised.

4. Complete disclosure of relevant ratios

The Mutual Fund must provide updated ratios/statistics like Expense Ratios and Portfolio Turnover Ratios to help investors make more informed investment decisions and these ratios must give a detailed explanation of how they were calculated.

4.5.1 Launching the schemes of Mutual Funds

Each scheme announced by the Asset Management Company should be approved by the Trustees and the SEBI. The AMC shall forward to the SEBI, in draft, the particulars of the scheme, prospectus, letter of offer and material relevant to the scheme. After scrutinizing, the SEBI may require AMC to carry out modifications as it deems fit in the proposed scheme. The AMC may announce the scheme, if no suggestions are received from SEBI within 21 days from the date of receipt of the documents. The letter of offer and other advertising materials for every scheme shall be in conformity with the provisions of Schedule V of the Regulation, it is provided in the said Schedule that no letter of offer or brochure or any
advertisement material shall be issued unless it is approved by the Board. All the marketing and publicity brochures for each scheme shall properly disclose the investment objectives, the method and periodicity of valuation of investments, the exact method and periodicity of sales, purchases and other details considered by SEBI to be essential for the protection of mutual fund scheme investors. The letter of offer or brochure or advertisement shall not be misleading or contain any statements or opinions which are incorrect or false.

**Diagram 4.2: Mutual Fund Investing: A Step-By-Step Approach**

**Mutual fund**
Check whether its portfolio objectives match with your risk-return-Liquidity objectives

Contact nearest branch of the fund or agent or a distributor company or download the application form

Obtain and read prospectus. Complete application form and enclose cheque/draft in favour of the respective scheme and hand it over to the nearest collection centre of the fund, Registrar's office, corporate office or other designated offices by the fund or agent/distributor company or submit online

Receive confirmation and save for reference

Track performance

Hold on or add to the investments

Redeem or switchover to another scheme. Fill up the redemption form, which is sent normally along with the account statement, submit it to the collection centre of the fund/corporate office/registrar's office

4.6 Mutual Fund Industry in India

The origin of mutual fund industry in India was with the introduction of the concept of mutual fund by Unit Trust of India in the year 1963. Though the growth was slow, but it accelerated from the year 1987 when non-UTI players entered the industry. The Indian mutual fund industry can be broadly put into the following four phases according to the development of the sector:

First Phase (1964-1987)

The Unit Trust of India (UTI) was established in 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 RBI. The first scheme launched by UTI was Unit Scheme 1964 (US-64). The other notable and popular schemes launched by UTI were Unit Linked Insurance Plan (ULIP), Monthly Income Scheme (MIS), Children Gift Growth Fund (CGGF) during this phase.

Second Phase (1987-1993) Entry of Public Sector Funds


Third Phase-(1993-2003) Entry of Private Sector Funds

In the third phase, 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 mutual fund (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 started functioning 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 witnessed several mergers and acquisitions.
Fourth Phase- since February 2003

This phase had bitter experience for UTI. It was bifurcated into two separate entities. The first specified undertaking of the Unit Trust of India with AUMs of Rs.29, 835 crores (as on January 2003). It functions under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations, governed by SEBI. The second is the UTI Mutual Fund Ltd, jointly 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 AUMs 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.

In the year 1992, Securities and Exchange Board of India (SEBI) Act was passed with the objectives to protect the interests of investors in securities and to promote the development of and to regulate the securities market.

As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interests of the investors. SEBI notified the regulations for the mutual funds in 1993. The regulations were fully revised in 1996 and have been amended thereafter from time to time. The SEBI has also issued guidelines to the mutual funds periodically to protect the interests of investors.

All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI. The risks associated with the schemes launched by the mutual funds sponsored by these entities are of similar type.

4.6.1. Structure of Mutual funds in India

The SEBI (Mutual Funds) Regulations, 1993, later replaced by SEBI (Mutual Funds) Regulations, 1996 prescribe the legal structure of mutual funds in India.

A typical MF in India has the following constituents:

**Fund Sponsor:** A 'sponsor' is any person who, acting alone or in combination with another body corporate, establishes a MF. The sponsor of a fund is like the promoter of a company. In accordance with SEBI Regulations, the sponsor forms a trust and
appoints a Board of Trustees and also generally appoints an Assets Management Company (AMC) as fund manager. The sponsor also appoints a custodian to hold the fund assets. The sponsor must contribute at least 40% of the networth of the AMC and possess a sound financial track record over five years prior to the registration.

**Mutual Fund:** A MF in India is constituted in the form of a trust under the Indian Trusts Act, 1882. The fund invites investors to contribute their money in the common pool by subscribing to 'units' issued by various schemes established by the trust. The assets of the trust are held by the trustee for the benefit of unitholders who are the beneficiaries of the trust. Under the Indian Trusts Act, the trust or the fund has no independent legal capacity, it is the trustee(s) who have the legal capacity.

**Trustees:** The MF or trust can either be managed by the Board of Trustees, which is a body of individuals or by a Trust Company which is a corporate body. Most of the funds in India are managed by Board of Trustees. The trustees being the primary guardians of the unitholders funds and assets, a trustee has to be a person of high repute and integrity. The trustees, however, do not directly manage the portfolio of securities. It is managed by the AMC as per the defined objectives, in accordance with Trust Deed and SEBI (Mutual Funds) Regulations.

**Asset Management Company:** The AMC, which is appointed by the sponsor or the trustees and approved by SEBI, acts like the investment manager of the trust. The AMC functions under the supervision of its own Board of Directors and also under the direction of the trustees and SEBI. AMC, in the name of the trust, floats and manages the different investment schemes as per the SEBI regulations and as per the investment management agreement signed with the Trustees.

Apart from these, the MF has some other fund constituents, such as custodians and depositories, banks, transfer agents and distributors. The custodian is appointed for a safe keeping of securities and participating in the clearing system through approved depository. The bankers handle the financial dealings of the fund. Transfer agents are responsible for issue and redemption of units of a MF. The AMC appoints distributors or brokers who sell units on behalf of the Fund, and also serve as investment advisors. Besides brokers, independent individuals are also appointed as agents for the purpose of selling fund schemes to investors. The regulations require an arm length relationship between the fund sponsors, trustees, custodians and AMC.
Diagram 4.3: Structure of Mutual Funds in India

**Sponsor**
- Akin to the promoter of the company
- Establishes the fund
- Gets it registered with SEBI
- Forms a trust and appoints board of trustees

**Trustees**
- Hold assets on behalf of the unitholders in the trust
- Appoint Asset Management Company and ensure that all the activities of the AMC are in accordance with the SEBI regulations
- Appoint the custodian of the fund

**Custodian**
- Holds the fund's securities in safekeeping
- Settles securities transactions for the fund
- Collects interests and dividends paid on securities and
- Records information on stock splits and other corporate actions regulations

**Asset Management Company**
- Floats schemes and manages them in accordance with the SEBI Regulations

**Distributors/Agents**
- Sell units on behalf of the fund

**Registrar and transfer agent**
- Maintains records of unitholders, accounts and transactions
- Disburses and receives funds from unitholder transactions, prepares and distributes account statements and tax information, handles unitholders communication, and
- Provide unitholders transaction Services

**Banker**
- Facilitates financial transactions
- Provides remittance facilities

4.7 Regulation & Registration of Mutual Funds in India

The primary authority for regulating MFs in India is Securities and exchange Board of India (SEBI) which requires all MFs to be registered with it. The SEBI (Mutual Funds) Regulations, 1996 has outlined the broad framework of authorization process and selection criteria. Accordingly, the authorization process is granted in two steps. The first step includes approval and eligibility of each of the constituents of the mutual fund viz. sponsors, trustees, asset management company (AMC) and custodian. For this purpose the interested parties are required to submit necessary informations only in prescribed formats. The second step involves formal authorization of the mutual fund for business. For this purpose the sponsor or the AMC is required to apply to SEBI in an application form for authorization along with an application fee specified.

The authorization shall be granted subject to conditions and payment of authorization fee specified by SEBI. The SEBI advises an applicant within 10 to 15 working days of receipt of the letter/ application form regarding status of his application.

The sponsor/s and each of the sponsoring entities, must have a sound trackrecord as evidenced by (a) Audited balance sheet and profit and loss account for last five years; (b) A positive networth and consistent record of profitability and a good financial standing during the last five years; (c) Good credit record with banks and financial institutions; (d) General reputation in the market (e) Good organization and management and (f) Fairness in business transactions. The sponsor/s should have at least a 40% stake in the paid-up equity of the AMC. The AMC will be authorized by SEBI on the basis of the criteria indicated in the guidelines.

4.8 Performance of Mutual Funds in India

The concept of the performance of mutual funds in India has to be started from the day the concept of mutual fund took birth in India when in 1963 Unit Trust of India invited investors or rather to those who believed in saving their money with Unit Trust of India, a Public sector financial institution.

For a long period of 30 years it was without a single second player. Though the year 1988 saw some new mutual fund companies, but UTI remained in a monopoly position for a very long time.
The performance of mutual funds in India in the initial phase was not even closer to satisfactory level. People rarely understood the concept of taking their savings to the equity shares through stock exchange and the pace of investing was very slow. But about more than 2 crore unitholders were accustomed with guaranteed high returns by the beginning of liberalization of the industry in year 1992. This good track record of UTI became marketing tool for new entrants. The expectations of investors touched the sky in profitability factor.

The Net Asset Value (NAV) of mutual funds in India declined when stock prices started falling in the year 1992. Those days, the market regulations did not allow portfolio shifts into alternative investments. There were rather no choices apart from holding the cash or to further continue investing in shares.

The performance of mutual funds in India suffered qualitatively. The 1992 stock market scandal, the losses by disinvestments and of course the lack of transparent rules rocked confidence among the investors. The supervisory authority adopted a set of measures to create a transparent and competitive environment in mutual funds. Some of them were like relaxing investment restrictions into the market, introduction of open-ended funds, and paving the gateway for mutual funds to launch pension schemes. The measure was taken to make mutual funds the key instrument for long-term saving.

As long as mutual fund companies perform with lower risks and higher profitability within a short span of time, more and more people are inclined to invest until and unless they are fully educated with the dos and don’ts of mutual funds. The succeeding decade showed a new horizon in Indian mutual fund industry. 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.

4.9 Recent trends in Mutual Fund Industry in India

The most important trend in the mutual fund industry is the aggressive expansion of the foreign owned mutual fund companies, decline of the companies floated by nationalized banks and smaller private sector players. Many nationalized banks got into the mutual fund business in the early nineties and got off to a good start due to the stock market boom prevailing then. These banks did not really understood the mutual fund business and they just viewed it as another kind of banking activity. Few hired specialized staff and generally chose to transfer staff from the parent organizations. The performance of most of the schemes
floated by these funds was not good. Some schemes had offered guaranteed returns and their parent organizations had to bail out these AMCs by paying large amounts of money as the difference between the guaranteed and actual returns. The service levels were also very bad. Most of these AMCs have not been able to retain staff, float new schemes etc.

The experience of some of the AMCs floated by private sector Indian companies was also very similar. They quickly realized that the AMC business is a business, which makes money in the long term and requires deep-pocketed support in the intermediate years. Some have sold out to foreign owned companies, some have merged with others and there is general restructuring going on.

The mutual funds can be credited with introducing many new practices such as new product innovation, sharp improvement in service standards and disclosure, usage of technology, broker education and support etc. In fact, many aggressive players in the industry like Reliance Mutual Fund, HDFC Mutual Fund have forced the industry to upgrade itself and service levels of organizations. The UTI has also improved dramatically in the last few years in response to the competition provided by other Mutual fund houses.

4.10 Average Assets Under Management (AAUMs) of Mutual funds in India

The Average Assets Under Management (AAUMs) are the average amount of assets held during a period. For practical purposes, these are calculated by taking the sum of assets at the beginning of a period and assets at the end of the period and then dividing the sum by 2. This gives AAUMs for a particular year. The Table 4.2 gives AAUMs (Average Assets Under Management) of 40 mutual funds for the five year period 2008-09 to 2012-13.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Mutual Fund Name</th>
<th>2008-09</th>
<th>2009-10</th>
<th>% age change</th>
<th>2010-11</th>
<th>% age change</th>
<th>2011-12</th>
<th>% age change</th>
<th>2012-13</th>
<th>% age change</th>
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<td>2</td>
<td>Baroda Pioneer Mutual Fund</td>
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<td>BNP Paribas Mutual Fund</td>
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<td>No</td>
<td>Fund Name</td>
<td>Total Assets (INR)</td>
<td>Growth Amount (INR)</td>
<td>Growth (%)</td>
<td>NAV Per Unit (INR)</td>
<td>NAV Per Unit Change (%)</td>
<td>AUM (INR)</td>
<td>AUM Change (%)</td>
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<td>N/A</td>
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<td>HDFC Mutual Fund</td>
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<td>AUM 2</td>
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<td>Mirae Asset Mutual Fund</td>
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<td>Morgan Stanley Mutual Fund</td>
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<td>PRINCIPAL Mutual Fund</td>
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<td>Quantum Mutual Fund</td>
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<td>37</td>
<td>Tata Mutual Fund</td>
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<td>Tata Mutual Fund</td>
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<td>851599703</td>
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<td>3103</td>
<td>278268752</td>
<td>-1311</td>
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</table>

**Total** | 584851535 | 851599703 | 3117 | 562372554 | 3103 | 278268752 | -1311 | 301753301 | 1511

The analysis of AAUMs of 2009-10 over 2008-09 shows that there is an increase in the AAUMs for most of the mutual funds and the increase ranges from 8% to 1668%. The highest increase of 1668% is in case of Baroda Pioneer mutual fund followed by Taurus mutual fund to the tune of 383%. Comparing the AAUMs between 2009-10 and 2010-11, most of the mutual funds have shown decrease between -3% to -58%. However, Peerless mutual fund showed an increase of 3291% in the second year of its launch and L & T mutual fund, also launched in 2009-10 showed an increase of 513% in the AAUMs. The comparison of AAUMs between 2010-11 and 2011-12 show that almost all the mutual funds have shown a decline in their AAUMs, but three new mutual funds recorded an increase in their AAUMs namely BNP Paribas mutual fund showing an increase of 108%, IDBI mutual fund 94% and Peerless mutual fund 30%. All these three newly launched mutual funds with their aggressive marketing might be the reason for their positive increase in AAUMs. The analysis of AAUMs for 2012-13 shows that 29 out of 40 mutual funds have shown an increase in their AAUMs over 2011-12. This increase is highest in case of IIFL mutual fund to the tune of 682%, in the 2nd year and its existence.

The overall analysis shows that the AAUMs Rs.58,48,51,535/- (in crores) in 2008-09 have increased to Rs.85,15,99,703/- (in crores) in 2009-10. However, at the end of 2013 these are Rs.30,17,53,301/- (in crores) showing a decrease of 48% as compared to AAUMs of 2008-09.

4.10.1 Assets Under Management (AUMs) of Mutual Funds

The mutual fund industry offers diversification of investment instruments alongwith funds getting invested in a large number of companies. The mutual fund schemes broadly are categorized into debt-oriented, income schemes, growth schemes, balanced and money market schemes. Each category of the schemes has unique investment objectives. The investors invest in the different kind of schemes in view of their financial goals and risk appetite. Assets Under Management (AUMs) denote the market value of assets that a mutual fund manages on behalf of investors. These are looked at as a measure of success against competition and consists of growth/decline due to both capital appreciation/losses and new money inflows/outflows. In a mutual fund, AUMs are not constant and may vary due to redemptions, withdrawals and new sales.
### Table 4.3: Assets Under Management (AUMs) - Category wise from 2008 to 2013

<table>
<thead>
<tr>
<th>Types of Schemes</th>
<th>AUM (Rs. In Crores)</th>
<th>As on 31/03/2009</th>
<th>As on 31/03/2010</th>
<th>% age change</th>
<th>As on 31/03/2011</th>
<th>As on 31/03/2012</th>
<th>% age change</th>
<th>As on 31/03/2013</th>
<th>% age change</th>
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<td>Liquid/Money Market</td>
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<td>90058.83</td>
<td>75752.81</td>
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<td>5966.93</td>
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<td>Debt Oriented</td>
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<td>37</td>
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<td>291067.74</td>
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<td>396787.81</td>
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<td>Equity Oriented</td>
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<td>ETFs(other than Gold)</td>
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</tbody>
</table>

**Source:** [http://www.amfiindia.com/AUMFolioDataReport.aspx](http://www.amfiindia.com/AUMFolioDataReport.aspx)

The analysis of AUMs of Mutual Funds in the five year period from 2008-09 to 2012-13 show that the money market schemes have shown an increase of 16% in 2013 as compared to 2012. The same had declined by 19% in 2010 as compared to 2009. The highest growth in AUMs is in Gilt funds to the tune of 121% in 2013 over 2012 compared to decrease of 72% in 2010 in relation to 2009. When debt funds are looked into, they show an increase of 36% in 2013 in comparison to 2012. In 2010 also these funds had shown an increase of 37% over 2009. The equity oriented schemes show an increase of 45% in 2010 over 2009. However from 2011 to 2013 the AUMs under equity oriented schemes have decreased. The balanced funds show an increase of 26% in 2010 over 2009, increase of 11% in 2011 over 2010 and decrease of 6% in 2012 over 2011. Gold ETF category fund is one category which is showing regular increase in AUMs from 2009-20013, highest being of 177% in 2011 over 2010. The ETF (other than gold) have also seen an increase of 163% in 2011 over 2010. However, the growth is negative to the tune of 8% in 2013 as compared to 2012.

In totality, the AUMs in all categories have shown an increase in 2013 over 2012. Gilt schemes have shown highest increase followed by Debt oriented funds in the five year period from 2009-2013.
This Chapter discusses the concept, structure, features, growth and phases of mutual fund industry in India. The benefits of investing in mutual funds have been detailed in this chapter. It also includes the types of mutual fund schemes and the concept of NAV, used for the performance, measurement and evaluations. This chapter also includes the history of mutual funds in India and also the structure and regulations of mutual funds, specified by SEBI. One table shows the AAUMs of mutual funds in the five year period from 2008-13 and the second table shows the category wise AUMs of mutual funds during the five year period from 2008-13. The role of SEBI, is also explained alongwith its regulations including the advertisement code for the working of mutual funds in India.