Chapter 1
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The Mutual Fund Industry in India is more than four-decade-old with an average annual growth rate of above 40% for the past few years. The Asset Under Management (AUM) has posted a 41 percent increase over the year (As per Association of Mutual Funds of India (AMFI) Quarterly update - Issue IV (Jan - Mar 2007). The Mutual Funds have ability to grow 35% to 40% for the next 2 to 3 years (Financial Express dated 19th June, 2008). The Mutual Fund industry is regarded as one of the fastest growing segment of the Indian Economy. It is likely to grow at an average annual growth rate of 40 to 45% in the near future. There is a lot of potential for the Mutual Fund Industry to grow in the future. Along with the growth of the Industry, the competition in the industry is ever increasing on a regular basis. Apart from this there are lots of challenges being faced by the Mutual Fund, the Asset Management Companies and the Fund Managers.

The Mutual Funds have become extremely popular in the last 15 years after the liberalization of the economy and the private sector being allowed to enter the Mutual Fund industry in India during the year 1993. A new eternity started in the Mutual Fund Industry, with the entry of private sector Mutual Funds in the year 1993. During the olden days Mutual Fund was an instrument where
an investor would like to invest. Today, it has become the part of our daily life. We recognize a Mutual Fund as a Financial Institution where we invest our money to get rewarding returns, together with the option of Liquidity. The Mutual Fund Industry has crossed the 4 Lacs Crores of AUM by the end of June 2007. The Mutual Fund Industry has crossed the landmark of more than 2.99 Crores folio's as at the end of March, 2007 as per the statistic provided on SEBI website.

Background to the Study

The biggest challenge to the Fund Manager today is the performance of the Mutual Fund Schemes. **The main genesis of the performance of the Mutual Fund Scheme is to maximize the returns and minimize the risk involved in investing in securities.** Investors are also very keen in evaluating the performance of their portfolio.

Today the Investor is confused where to invest, which fund to invest, whether his capital is safe. We see many sites like www.crisil.com, www.myiris.com, www.mutualfundsindia.com, www.valueresearchonline.com etc which does the performance evaluations of various Mutual Fund schemes and publish their ranking of the schemes in various segments. However, the true crux of performance evaluation of Mutual Fund schemes is very difficult and may require further studies to evaluate.
The CRISIL Composite Performance Ranking (CPR) is the most accepted ranking by the Fund Houses, Distributors and the Investors. The performance criterion covers the risks versus the returns and also the assessment of the portfolio. The CRISIL Risk adjusted Return Ranking is also a new ranking system assigned by CRISIL for Mutual Fund Schemes. We can see the shift of the industry from the ranking on the mere performance to the risk adjusted performance of the schemes. Because of the increasing complexity of the Mutual Funds market it may be useful to introduce a rating systems, like the Morning star's one, based on peer group comparison for the Italian Funds (Casarin, Lazzarin and Domenico, 2002)

In India, the growth of Mutual Funds started in the third phase with the entry of private sector funds in the year 1993. SEBI introduced the Mutual Fund Regulations in 1996. By the end of January, 2003 there were 33 Mutual Fund with the total Asset Under Management of Rs 1,21,805 Crores. In February 2003, the Unit Trust of India act was repealed by the Government of India and the total Asset Under Management went down drastically to Rs 87,190 Crores. The Mutual Fund saw a new beginning and has reached approximately Rs 5,45,000.00 Crores till date. Considering the same, the Indian Mutual Fund Sector is about a decade old unlike the Mutual Funds in the developed countries. Mutual Funds are more advanced in countries with better-developed capital markets and market based financial systems.
Objective of the Study

The Objective of the research is to give a direction to the Fund Managers to align their schemes from a low-performing scheme to a high-performing scheme. The other objective of the research is to give a direction to the Investors for investing in a potential high-performing scheme.

Reasons For Selecting the Present Problem

Extensive research have been done till date on the performance of the Mutual Fund Schemes. Studies have been conducted on the performance evaluation of the Mutual Fund Schemes. Most of this research has been confined by taking one factor at a time. At present, the Fund Managers are more interested to know the various factors, which will increase the returns of the Mutual Fund Schemes and decrease their portfolio risk. The Investor is more interested to know whether to keep going in the same scheme or look for a better performing scheme.

It appears that performance and performance measurement has been overdone on the Mutual Fund Schemes. Through this research, attempt is being made to find out the underlying reasons for high or low performance. As mentioned by Akio Morita, 'Curiosity is the key to Creativity'.
Research Gap

The limitation of the earlier studies is that they focuses on individual factors and interpret the meaning and significance of each factor. Being univariate, it provides a partial view of the performance of the Mutual Fund, with one aspect at a time. The same will be useful to the experts and not to the common investor. The investor would like to have a single measure by which he would be able to classify the schemes into high performing or a low performing scheme. The investor would like to have a single score to have an idea of the future performance of the scheme and take a decision on his investment in the scheme.

At the same time, the single score will facilitate the Fund Manager to improve future performance and take corrective steps, if any, to enhance the performance of the scheme. As mentioned by Jack Welch, 'Control your own destiny or someone else will'.

The present study is an attempt to develop a single score of the performance of Mutual Fund scheme. As mentioned by Peter Drucker, 'The best way to predict the future is to create it'. The Discriminant Analysis will be used to analyze this Research Gap and come out with a single score.
Key Steps Undertaken in the Research

The following were the key steps undertaken by the Researcher.

- Identification of the problem and the research work by which this research gap could be filed.

- Collection of the related literature available on the performance measurement and the performance of Mutual Fund schemes.

- Designing the research design to fill the research gap.

- Collection of the secondary data viz the NAV of the Open Ended Equity Schemes.

- Analysis of the secondary data as collected above.

- Designing the questionnaire for collection of the primary data for the research.

- Collection of the primary data
Analysis of the primary data as collected by the questionnaire for the research. The Factor Analysis was used to analyse the primary data and come out with the four core factors affecting the performance of Open Ended Equity Mutual Fund Scheme.

Synchronize the primary data and secondary data to come out with the research analysis.

Analysis of the primary and the secondary data after synchronization and come out with the research analysis. The Discriminant Analysis was used to come out with the final research analysis.

Finally to provide the summary and conclusions of the final research analysis.

Earlier Studies On the Topic

A similar type of study was made of 33 Greek Mutual Fund by Pendaraki K, Doumpos M and Zopounidis C, 2003. The model developed in this study using the UTADIS (UTilities Additives DIScriminantes) was of major support to the Mutual Fund Managers and the Investors.
Unlike the above study, it is proposed to use the Discriminant Analysis as the statistical tool instead of the UTADIS. Discriminant Analysis is the widely used statistical tool as compared to the UTADIS. The above study was specific only to the Greek Mutual Fund Industry and cannot be applied to the Indian Mutual Fund Industry mainly due to the reason that Greece is a part of European Union, which consists of developed economies and India is an emerging economy. Issues related to Market efficiency, Microstructure etc are dissimilar with respect to the operating environment of the Fund Managers.

Earlier studies, were done with emphasis on secondary data, whereas in the present study, secondary as well as primary data are considered. The study on Indian Mutual Funds, can be further extended to international levels like the South East Asian countries like Malaysia, Philippines, Thailand, Vietnam, Indonesia and other countries which there are emerging Mutual Fund markets.

**The Origin of Mutual Funds in India**

It was during the year 1963, Shri T T Krishnammachari, popularly known as TTK who was the Minister for Economic and Defence Coordination had seen the news of the formation of the unit trust of Pakistan. He had then written to the Prime Minister, Shri Jawaharlal Nehru urging the need for such an institution for the country. Shri Jawaharlal Nehru forwarded the letter to Shri
Morarji Desai, Ministry for Finance, which in turn was forwarded to Shri P C Battacharya, Governor, Reserve Bank of India. Thus, the stone started rolling for the formation of Unit Trust of India. In September, 1963 Shri T T Krishnamachari, took over as Finance Minister after the resignation of Shri Morarji Desai, the then Finance Ministry. Shri T T Krishnamachari, the then Finance Minister then introduced the bill of formation of Unit Trust of India on 4th December, 1963. The Lok Sabha after discussing for two days passed the Bill on 5th December, 1963. It was presented to the Rajya Sabha on 12th December, 1963 and on the same day it was passed. The Bill received President's assent on 30th December, 1963 and became the Unit Trust of India Act, 1963 (Act 52 of 1963). The Unit Trust of India was born on 1st February, 1964.

**The Concept of Mutual Funds in India**

In India the Mutual Fund is a Trust that pools the savings of the investors who have a common financial goal. The money is collected from the investors and then invested in the capital market. The investments are in the form of equity shares, debentures, Government Securities, Treasury Bills etc. The profit and the income earned through these investments are shared by the investors in the ratio of the number of units held by them. A Mutual Fund offers a whole lot of benefits to the Investors like professional management, diversification of the portfolio, safety, liquidity and cost benefit.
Figure 1: Organisation of the Mutual Fund in India

The Mutual Fund structures in the developed markets are different than those of the Mutual Funds in India.

In the USA, the Mutual Funds are set up as an investment company. The Investment Company may be a corporation or a partnership or any other legal entity. All these legal entities are known as Mutual Funds. The Investment Company appoints the Management Company, which is either close end Management Company or an open-end management company. The open-end Management Company is technically called as the "Mutual Fund" in the USA.
Mutual Funds in the UK, have two alternative structures. Open-end funds are in the form of Unit Trust while the close end funds are in the form of corporate entities called as Investment Trust. There are separate regulatory mechanisms for both the entities. The Securities and Investment board regulates the Unit Trust. Since the Investment trusts are structured as companies, the provisions of the Companies Act are applicable to them.

**Structure Of Mutual Funds in India**

The Indian Mutual Fund organisation is in the form of a Trust. A Mutual Fund is a Trust, which pools the savings of the Investors and then investment in the Capital Market. The structures of the Indian Mutual Funds are governed by the SEBI (Mutual Fund) Regulations, 1996. Accordingly, the Mutual Funds have a three-tier structure of Sponsor-Trustee-Asset Management Company. The sponsors form the Trustee Company and the Asset Management Company. The sponsor is the promoter of the Mutual Fund. The Trustee Company is the Trustee of the Mutual Fund and the Asset Management Company manages the assets of the Mutual Fund.
Figure 2: Structure of Indian Mutual Fund Industry

The Advantages of Investing in a Mutual Fund

A Study was conducted by Rajeshwari T R and Moorthy V E Rama for the factors influencing the Mutual Fund / Schemes selection by the Retail Investors. It was widely felt that the Mutual Fund was a retail product designed for the small investors, salaried people and others who are intimidated by the Stock Market but wanted to reap the benefit of investing in the Stock Market. The conclusion of the research was very interesting. The survey findings must have been very useful for the AMC in the product designing and marketing.
As per the findings of the survey, Bank Deposits were the most preferred investment vehicle, whereas the Mutual Fund was in the 4th ranking. The connotation has changed and Mutual Fund has become the most preferred investment vehicle. Growth was the most preferred scheme followed by the Income and Balanced schemes. The investors look for safety first, followed by good returns, tax benefits, liquidity and capital appreciation. It further reveals that the scheme selection decision was their own.

However, the benefits of investing in Mutual Funds are as follows:

- Diversification of Portfolio
- Professional Management
- Safety / Diversification Of Risk
- Liquidity
- Reduction of Transaction Costs
- Convenient Administration
- Return Potential
- Low Costs
- Transparency
- Flexibility
- Affordability
- Choice of Schemes
- Well Regulated
The Disadvantages of Investing in a Mutual Fund

Compared to the advantages of investing in Mutual Fund Schemes, there are very few disadvantages of investing in a Mutual Fund Scheme, which are given below:

- Not A Tailor Made Portfolio
- No Cost Control

Types Of Mutual Funds Schemes

There are various types of Mutual Fund schemes for the Investor to select as per his requirement. Wide variety of Mutual Fund Schemes exists to cater to the needs such as financial position, risk tolerance and returns expectations etc. Mutual Fund schemes may be classified on the basis of its structure and its investment objective.

By Structure

- Open-Ended Funds
- Closed-Ended Funds
- Interval Funds
By Investment Objective

Growth Funds
Income Funds
Balanced Funds
Money Market Funds
Gold Exchange Traded Fund
Other Schemes

Tax Saving Schemes

Special Schemes

- Industry Specific Schemes
- Index Schemes
- Sectoral Schemes

Various Phases of the Mutual Funds in India

The Mutual Funds in India can be classified into four distinct phases, which have are as follows:

The First Phase [1964-1987]

The first phase of Mutual Fund started with the set up of Unit Trust of India. Unit Trust of India started functioning in year 1964 and the Regulatory and administrative control of the same was with Reserve Bank of India. UTI came
into existence during the period when there was great political and uncertainty in India. The financial markets were in depressed conditions and entrepreneurs were very reluctant to enter the capital market. The existing companies found it difficult to run the companies due to want of capital, Investors were not responding to the new issues. It was the idea of the then Finance Minister, T T Krishnamachari to set up the Unit Trust which would collect the savings of individuals or institutions and in turn will help the corporate with the capital collected by Unit Trust. This lead to the formation of the Unit Trust of India as an intermediary that would mobilize the retail savings and invest these savings in the capital market. By the end of the year 1988, UTI was having an AUM of Rs 6700 Crores. During the initial period, the concept was very new to the Investors. Moreover, the investors knew only the Share market and the debt market.

**The Second Phase [1987-1993]**

In 1987 the Public Sector were allowed entry into the Mutual Fund Industry. The Public Sector Banks, Life Insurance Corporation and General Insurance Companies entered the Mutual Fund Industry with SBI Mutual Fund being the first Mutual Fund launched by State Bank of India. PNB Mutual Fund, Indian Bank Mutual Fund, Bank of India and Bank of Baroda Mutual Fund followed soon. The period 1987 to 1993 was termed as the period of public sector Mutual Funds. The number of the players increased to 8 in 1993. By the end
of the year 1993, the Mutual Fund Industry had an AUM of Rs 47000 Crores plus.

The Third Phase [1993-2003]

In the year 1993 the Mutual Fund Industry was opened to Private Sector, leading to a new era of Mutual Fund Industry. At this juncture, the Investor had the choice of investing in Unit Trust of India, the Public Sector Mutual Fund and the Private Sector Mutual Fund. In 1993 the Mutual Fund Regulations came into existence, which covered all the Mutual Fund except Unit Trust of India. The Mutual Fund now comes under the purview of SEBI (Mutual Fund) Regulations, 1996 that was formed as a revised regulation of the earlier. By opening the industry to Private sector, we could see many international players like Jarding Fleming, Morgan Stanley and others entering the Indian Mutual Fund Industry.

The Fourth Phase [2003 Onwards]

On 1st February, 2003, following the Unit Trust of India Repeal Act, the Unit Trust of India was bifurcated into 2 entities viz UTI Mutual Fund and the Specified Undertaking of the Unit Trust of India (SUUTI). All NAV based schemes came under the purview of UTI Mutual Fund and all the assured returns schemes came under the purview of the Specified Undertaking of the
Unit Trust of India. UTI Mutual Fund came under the purview of SEBI and the SUUTI came under the functioning under an Administrator. UTI Mutual Fund was a Mutual Fund like any other Mutual Fund.

(The phases of the Indian Mutual Fund Industry have been taken from the official site of Association of Mutual Funds of India - AMFI)

The Unit Trust of India has a glorious past, which was considered as the most safe and high yielding investment vehicle by the Investors. As regards to the Investors base, UTI Mutual Fund still has the largest investor base of approximately 8 billion investors, which is the highest investor by a Mutual Fund. Many investors still continue to hold their holding in UTI Schemes even after the 1999 bail out and the 2001 crisis, wherein the US64 was bailed out by the Government of India. As explained by the 'Endowment Effect' by Thaler Kahneman and Knetsch (1992) that "People are more likely to believe that something they own is better than something they do not own". This is evident by the above in the Mutual Fund Industry.

The fourth phase started a new era in the Mutual Fund Industry. All Mutual Funds came under the purview of SEBI including UTI Mutual Fund. Investor had the choice to select from the Public Sector and Private Sector Mutual Funds. The Mutual Fund became more regulated due to the SEBI Mutual Funds Regulation, 1996 and with continuous refining in the subsequent years
by SEBI. There was transparency, wherein the investor was aware what was happening to the investors’ investment.

The Growth of the Mutual Fund Industry

The Mutual Fund in India is more than 40 years old. As the Mutual Fund Industry was made open to the private sector in the year 1993 we could see many private sector entering the Mutual Fund Industry. There was a revolution in the Mutual Fund Industry with the entry of private sector players in the market. The industry started becoming more and more competitive. By the end of year 1998 the industry saw a great potential and development in the Mutual Fund Sector. The year 1999-2000 was called the 'Year of the Funds'. The Investor started knowing the concept of Mutual Funds and benefit of investing in a Mutual Fund. Moreover, many Mutual Funds were performing better and passing on the benefits to the investors. This started a revival in the Mutual Fund Industry and the investors were regaining their confidence in the Mutual Funds.

The main reason for the revival of the Mutual Fund Industry was the Union Budget. The Union Budget had given the taxation benefits to the Mutual Fund Industry. As per the Union Budget, the dividend of the equity-oriented schemes of the Mutual Fund was exempted from tax in the hands of the Investors as well as for the Mutual Fund. The Mutual Funds were in a
position to give better returns to the investors. More and more schemes were being launched by the Mutual Funds, thus, attracting the Investors. The Association of Mutual Funds in India (AMFI) was incorporated on 22nd August, 1995 as a non-profit organisation. AMFI was the apex body for all the registered Asset Management Companies. The Mutual Funds started regularizing themselves and started the best practices as mentioned by AMFI. At present, the industry is very well developed and is well regulated. This has increased the Investor's confidence. The industry is growing with thousands of Crores on a monthly basis.

During the year 1990, the Mutual Funds found it very difficult to attract investor and mobilize funds. During these years, the Government papers were with a yield of 14% and the Bank deposits hovering around 12%, due to this, debt instruments were gaining popularity as compared to Equity. Mutual Funds were finding it very difficult to give such high yields from debt schemes. Performance of most of the Mutual Fund performance was not upto the mark for many years due to which the Investors confidence in Mutual Fund was low. Moreover, the stock market conditions were also not encouraging for the investors to invest in the Mutual Funds.

From 1998-99 onwards, the Mutual Fund Industry registered significant growth. The stock markets were blooming. The Indian economic conditions were bright and also the Finance Ministry had given certain tax concessions
to the Mutual Fund Industry. These helped the Mutual Funds to regain the Investors confidence and thus started mobilizing huge funds by the Mutual Funds. The entry of major corporate's like the Tata's, Birla's, Reliance, SBI during the year 1995-1996 gave a revival to the Mutual Fund Industry.

**AUM History and Graph**

Asset Under Management (AUM) is the estimate of the money involved in the investments done by the Mutual Funds. AUM is the total asset managed by the Mutual Funds under various schemes.

Placed below is the AUM History and Graph of the Mutual Fund Industry from the year of inception till June 2007.
The Unit Trust of India (UTI) went into crisis during the year 2002 and had to be restructured. Many Investor again lost their confidence in Mutual Funds seeing the flagship of UTI viz US64 in the red. With the timely intervention of the Government and restructuring of UTI, the lost faith was again recovered upto certain extent, however the investors had already felt the burns of US64.

The Mutual Fund industry has grown manifold. As per the data from the Mutual Funds and compiled by SEBI, the following has been observed:
The Asset Under Management has grown to Rs 3,28,745.49 Crores as on 31\textsuperscript{st} March, 2007 as against Rs 2,31,862 Crores as on 31\textsuperscript{st} March, 2006 which shows an increase of 41% in the Asset Under Management. This is the highest growth in the financial sector. Accordingly, the investor base has also increased as on 31\textsuperscript{st} March, 2007 as compared to 31\textsuperscript{st} March, 2006. It is likely that there may be more than one folio of an investor whereas the actual number of the Investors would be less. The total Asset Under Management (AUM) was Rs 3,28,745.49 Crores as on 31\textsuperscript{st} March, 2007. Out of the total number of 2.99 Crores folio's approximately 2.88 Crores of the folio's are individual investors accounts accounting for 96.45 % of the total number of investors account and contributed 42.36% amounting to Rs 1,39,210.91 Crores of the total net assets of the Mutual Fund Industry. The corporates and Institutions form only 1.67% of the total number of investors accounts and contribute nearly 49.94% amounting to Rs 1,64,175.43 Crores of the total net assets of the Mutual Fund Industry. The NRI's/ OCB/ FII constitute a very small 1.87% of the total number of Investors and account approximately 7.71% amounting to Rs 25,359.15 Crores of the total net assets.

A further analysis of the Private Sector versus the Public Sector Mutual Funds shows that investors are gradually moving towards the Private Sector Mutual Funds due to various reasons. There has been a shift of more than 2% of the AUM from the Public Sector Mutual Funds to the Private Sector Mutual Funds.
Future Growth of the Mutual Fund Industry

Mutual Fund Investor is more keen to know the growth of the Mutual Fund Industry. It would be very keen and interesting to know that the Mutual Fund Industry is likely to grow with 30% CAGR and the MF size is likely to be Rs 9.50 Lakh Crores by 2010.

The Associated Chambers of Commerce and Industry of India (ASSOCHAM) had given a press release on 1st October, 2007 stating that the Mutual Fund is likely to grow at 30% CAGR in the next 3 years to reach the level Rs 9.50 Lakh Crores by 2010 from the Rs 4.67 Lakh Crores in July 2007 with the contribution from Private, Public and Joint sector Mutual Funds staying around 70%, 20% and 10% respectively.

ASSOCHAM highlighted that in view of the growing awakening and certainties prevailing in the MF Industry, its market penetration would increase more than double by 2010 and now gradually Mutual Funds are becoming the most preferred savings instruments for urban and rural people. These findings were brought out by ASSOCHAM in their paper on ‘MF Growth Pattern’.

ASSOCHAM comparing the Indian Mutual Fund Industry with the Mutual Fund Industry of the United States has revealed that despite that the fact that the
Indian Mutual Fund Industry growing at a substantially higher rate in the last 3 years, it is still 100 times behind the US Mutual Fund Industry. The US Mutual Fund Industry is at an expected size of over US $ 12 trillion whereas the Indian Mutual Fund Industry is only at Rs 4.67 Lakhs Crores and the market penetration is at 4% of the total Indian population as compared to 49% in the US and 20% in the United Kingdom. The Mutual Fund Industry manages nearly 700 schemes in India, whereas the US Mutual Fund manages more than 12000 Mutual Fund schemes. This shows that there is a lot of potential for the Indian Mutual Fund industry to grow. Also it can be observed that, the Indian Mutual Fund industry requires lot of penetration in the Indian population and especially in the rural India. Specific schemes suiting the Indian Rural population is required to penetrate in the rural populations, this will enable to increase the rural penetration and bring in new schemes.

The retail investors are diverting much of the savings volumes towards the Mutual Funds. It is because of this reason and the supportive favourable conditions that the Mutual Fund Industry will grow and touch the estimated levels as mentioned above of Rs 9.50 Lakhs Crores by 2010.

At present the private sector Mutual Fund players are estimated to manage 82% of the total Mutual Fund Industry, which is likely, to fall to nearly 70% as estimated by ASSOCHAM. The public sector is likely to grow to 20% as
compared to the present level of less than 10% and that of the joint sector to 10% as compared to the present level of around 8%.

As per ASSOCHAM the emerging trend would be the commodity funds, which shall invest in commodities such as metals, food grains, and crude oil. We have already seen the move towards this trend with more and more funds coming out with the Gold fund, which has captured substantial size of Investor base in their recent New Fund offer. It may take some time for the Investor to understand these products and invest in such funds. As highlighted earlier the real estate fund is in the pipeline, however the same has been kept on hold due to various other issues.

ASSOCHAM has further mentioned that, as the Indian Market and the Investor mature, financial advice, product diversification and multi distribution channels will become critical for the long-term success. Increasing the Investor awareness will help to propel grow of the Indian Mutual Fund industry. However, Investors have to be made aware against the common mistake of comparing the returns of the debt-oriented scheme and the fixed income products without considering the attendant risks.

In the United States, half of the households own their investments in Mutual Funds. In India, Mutual Fund penetration is very low as mentioned above. The Indian Mutual Fund Industry is fast catching with the advanced markets in
terms of product offering. Also efforts are being made to reach cities other than metros by the Mutual Fund Industry.

**An Overview of the performance of Mutual Fund Industry in India**

The industry has seen new innovative product to suit the Investors needs and garner new customers, as well as the Fund Management has become very conscious about the performance of their schemes. The investor now a days are very well aware about the products available in the market. They are the well-informed investor, unlike the olden days where the agents and distributors could take them to a ride. The distributors, the Registrars and transfer agents have come under the purview of SEBI and have become more mature and responsible. Many new players have entered the Mutual Fund Industry and few of them have merged with others. It may be pertinent to note that the Mutual Fund Industry has an intense impact on the financial markets.

The savings rate is estimated at 32.4%, which is the highest in the world. This saving has to be channelised into the Mutual Fund Industry for the industry to grow manifolds. There are 32 Mutual Funds in India whereas there are more than 800 Mutual Funds in the United States. There is a very big scope for the industry to expand in the future. Moreover, there is very little reach to the rural areas as most of the Mutual Funds are catering to the needs
of urban clients, where the business potential is too high as compared to the rural areas.

The Fund performance has improved very much, many of the Fund houses are able to give returns more than the market returns. The funds collections by the Fund houses have increased manifold. We can see that even a single scheme of the Mutual Fund was able to collect approximately Rs 5000 Crores in a single new fund offer viz the Reliance Equity Fund of the Reliance Mutual Fund during March 2006. This collection of approximately Rs 5000 Crores in a single fund is much more than few of the Mutual Fund houses put together. During the recent years, the Mutual Funds have played a vital role in the capital market and mobilizing huge funds.

As per the Annual Data for the period April 2006 to March 2007 given by AMFI, the performance of the Mutual Fund Industry is marvelous. There were 414 new schemes launched by the fund houses and these schemes mobilized Rs 1,40,298 Crores approximately double the collections made by the Mutual Fund Industry in the previous year.

The Mutual Fund Industry mobilized a total fund of Rs 19,38,592 Crores during the year representing an increase of 77% than the previous year. The previous year collection was Rs 10,98,158 Crores. Equally the redemption’s were also on a higher side at Rs 18,44,512 Crores which was 76% higher
then the previous year. The previous year's redemption was 10,45,382 Crores, thus, giving a net inflow of Rs 94,080 Crores. During the previous year the net inflow was Rs 52,776 Crores. The Asset under management thus stood at 3,26,388 Crores as on 31\textsuperscript{st} March, 2007 as compared to Rs 2,31,862 Crores as on 31\textsuperscript{st} March, 2006. We can clearly see that the AUM of the Mutual Fund Industry as grown by 41% over the years. This gives us the idea how the industry is growing very fast as compared to the other industry.

**Recent Trends In the Mutual Fund Industry**

The recent trend in the Mutual Fund Industry is the aggressive expansion of the Foreign owned and Private Mutual Fund companies. The nationalized banks and the smaller private sector players have declined in the industry.

Many nationalized banks ventured into the Mutual Fund business during the early nineties and performed very well during the initial period. During the subsequent period the performance of these funds was not good. Similarly, the experience of the private sector Mutual Funds was also not different. The foreign owned companies are comparatively very much financially strong. The foreign companies have invested in the Indian Mutual Fund industry considering the long horizon. The have entered the market to stay and reap the benefits of investing in the Indian Market. The major benefits of these foreign owned companies are bringing in innovative products, excellent
customer service etc. The Mutual Fund Industry has been forced by these foreign owned Mutual Funds to upgrade themselves and maintain the industry standard.

The Mutual Fund Industry has an immense impact on the Financial Markets. Till recently the UTI Mutual Fund, which was carved out of Unit Trust of India, was a dominant player in the Financial Markets. The private sector Mutual Funds are now the dominant players with the Reliance Mutual Fund leading the race with the Numero Uno position with Rs 59,857 crores of AUM, followed by the ICICI Prudential Mutual Fund with Rs 43613 crores of AUM.

The Fund Managers have gained expertise in their stock selection criteria and have forced to award better returns to the investors. By rewarding for their performance, the industry has moved towards the risk reward system and has become more transparent. The Fund performances have improved drastically.

The Investors have been richly rewarded by high returns with the outstanding performance in the Mutual Fund during the year 2005. The Sabrawal effect, which are able to hear about the SBI Mutual Fund. Earlier the Mutual Funds focus mainly on the high-capitalized securities in the bourses, whereas Mr Sandip Sabrawal changed is focussed towards the Small and Mid Cap segment. These helped the SBI to offer high returns to the Investors. The
Mutual Funds have shifted their focus on diversified sectors like FMCG, Petro, Banking, software and others. This has necessitated the need of various index like the BSE Sectorial Index like the Bankex, AUTO, FMCG etc.

Earlier, the old notional was to keep the money in the saving accounts in the Banks. This saving's was able to earn at least some interest to the Investor. However, recently the Investors have realized that the interest received by the investor was on the lowest outstanding amount in the bank. They realized that their funds were not earning the highest returns as per their ideology. This made the Investors to look for a better greener pasteur and thus found that the Mutual Fund is the best suitable options available with them.

The era has changed in the Financial Sector. The Mutual Funds are competing with Banks for the retails Investors savings and Corporate Funds. Mutual Funds are marketing their products aggressively giving the benefit of investing in Mutual Funds over the banks. The Investors too have become very much aware and are able to understand the benefit of investing in Mutual Funds. Investors are realizing that keeping their funds in saving accounts is as good as locking their funds with very minimal returns. The fund mobilization by Mutual Funds indicates that funds are flowing into Mutual Funds in a very big way and the same trend is likely to continue in the future.
The services offered by the Mutual Funds to the Investors have improved drastically. Earlier, after investing the investor had to wait for 10 to 15 days to either get the Certificate or the Statement of Accounts. The scenario has changed; nowadays the investor gets his Statement of Accounts on the third day itself. If the Investor has access to Internet, he is able to view the Statement of Account on line and take a print out instantly. Most of the Mutual Funds mail the Statement of Account to the investor, in case he has provided his email ID in the application form. The Mobile phone has become the latest gazette to the Investor. If the investor provides his mobile phone on the application form, he gets the information of the units allotted and the rate at which he has invested through an SMS. This all has brought in a revolution in the Mutual Fund Industry. These services are have not yet been upgraded in the banks, which as a very long pathway to progress.

The Mutual Funds have realized the potential of Internet and as mentioned above have equipped themselves to offer better performance to the Investor. The scenario and focus has changed to an Investor centric approach. Internet has become the easiest way for the buy-sell transactions of the Mutual Funds. Many Mutual Funds have already offered this service to the Investors. This has helped the Investor for an easy access to his Investments and it has become less time consuming for the investor to invest and redeem in Mutual Funds. In future, the trend of Internet investment and redemption in Mutual Fund will be common and in a massive way.
Of the total AUM of the Mutual Fund Industry, 32 percent of the investment is in the growth funds of the Mutual Funds. This forms the major category after the income funds where the investment is around 38 percent of the AUM. Three years down the line during June, 2004 the equity schemes had an exposure of approximately 14 % of the total AUM of the Mutual Fund Industry. That time too, the income schemes had a major exposure of more than 42 % of the AUM. Considering the high returns offered by the Equity Schemes and added to this the jump in the Stock Markets, the investors have diverted from a Debt scheme towards the Equity schemes. Therefore we can see that in a span of 3 years the AUM in Equity Funds has increased more than double as compared to the AUM three years ago. Most of the Investors are interested in the returns offered by the Open Ended Equity Schemes. More over, there is more potential in the Equity Funds for the Fund Manager to reap higher returns. Whenever, the investor check the returns given by a Fund House, he considers the returns offered by Equity scheme of the Fund House. This gives a per se idea about the performance of the Fund House.

Considering the above, the research was undertaken to determine the factors affecting the performance of Indian Mutual Fund Industry (Open Ended Equity Schemes).
Future Scenario

After over four decades the Investors are of a divided opinion about Mutual Fund Industry. With only one scheme of the Unit Trust of India in 1964, we find more than 500 schemes for the Investors to invest in the Mutual Fund Industry. Inspite of the tough competition and losing the market share, the UTI is still recognized as the market leader. Some investors are for and some are against investing in Mutual Fund Industry. However, the Mutual Fund Industry will stay here and we can see many more new Mutual Funds entering the industry with the influx of the AUM. During the year 1999, the industry saw a good potential in this segment. There after the industry is growing at a tremendous rate.

We are at present in the fourth phase of the Mutual Fund Industry. The fourth phase started with the end of Unit Trust of India and the beginning of UTI Mutual Fund. The Asset Under Management has grown at an annual rate of 40% plus over the last four year except during the year 2005 where the growth rate was only 7% approximately. The Asset Under Management will continue to grow in the future at an annual growth rate of 30 to 35% over the next few years. Considering the facts that Mutual Funds give more returns and the income from Mutual Fund is tax-free, added to this the various advantages of investing in Mutual Funds, Investors have shifted their assets from banks and other institutions to Mutual Funds. Few of the public and
private sector players have either closed their shop or have been taken over by other Mutual Funds.

There would be large offering from various asset management companies in the future. SEBI has already approved Mutual Funds to trade in Derivatives and Commodity Market. UTI Mutual Fund is shortly launching the Gold Fund and other Mutual Funds are likely to launch such types of schemes shortly. Gold being very dear to the household segment, is likely to attract more investors from the household segment. These would attract more investors and garner good amount in the future.

Also the reality fund which is a real estate fund is awaiting approval from SEBI. However due to various reasons like valuation of the assets on daily basis and practical difficulties, the approval is awaited. However, Investors who would like to benefit from rising price of real estate would be benefited by investing in this scheme. Moreover, small Investors would not be able to invest in big projects, this would enable such investors to invest in big projects with small investments and rip the benefit of the rising real estate prices.

The Mutual Fund Industry is maturing and the Investors are also very well aware about investing in Mutual Fund Schemes. The AUM of the Mutual Fund Industry will continue to grow at an annual rate of about 35 to 40% over the next few years. Going by a moving average of three months, the industry
is very much likely to grow at a rate of 35% to 40% in the next few years. The investors are also shifting their base to Mutual Fund Industry over their earlier traditional style of investing in the banks. The mobilizations of savings have shifted their focus from Banks to Mutual Funds.

In the next few years to come the weaker one's will merge down with the stronger one or the stronger one will takeover the small players. However, in the Mutual Fund Industry has only very few mergers or takeover as there are very few players in this Industry. The IL&FS Mutual Fund was taken over by UTI Mutual Fund. The Alliance Capital Mutual Fund was merged with Birla Sunlife Mutual Fund and the GIC Mutual Fund was merged with ICICI Prudential Mutual Fund. Three years down the line, there were 35 Mutual Funds in the industry, which has come down to 32 players in the Mutual Fund Industry. There is scope for other players to enter the industry. Already UTI Bank Limited has applied to SEBI to set up an Asset Management Company, UBL AMC. Others may follow shortly for setting up their Asset Management Company.

**Challenges Ahead of the Indian Mutual Fund Industry**

The Challenges to a Mutual Fund is manifold. Firstly there are challenges to the Mutual Fund House, secondly to the Fund Managers and lastly to the Asset Management Companies managing the assets of the Mutual Funds.
Challenges to the Mutual Fund

There is a tough competition going on in the Mutual Fund Industry. Each of them trying to compete the leadership position. The UTI Mutual Fund, which was the market leader with the largest AUM, has moved on to the second position with Prudential ICICI leading the Industry. Same patterns have been observed at the subsequent positions in the industry. Courtesy to Association of Mutual Fund of India (AMFI), which gives the AUM of all the Mutual Funds on a Monthly basis on its web site. This has enabled a healthy competition in the Fund houses and others are aware about the AUMs of the Fund Houses and the Industry. The greatest challenge, to the Mutual Fund is to get more retail participation so that they can sustain in the long run.

Challenge to the Fund Manager

Today, the biggest challenge to the Fund Manager is the performance of the scheme. There are tough competitions in the Mutual Fund Industry, with each of the Mutual Funds giving comparison of the performance of their schemes in the respective segment. Moreover, the CRISIL CPR ranking has become one of the parameter of the performance of the scheme. This has increased the competition among the Fund Managers, which ensures that his scheme ranks the top in the ranking. Thus each Fund Manager is trying his
level best to ensure that their scheme come out to be the topper in the CRISIL ranking. This level of competition has ensured that the Fund Manager performs at the optimal level. Recent Studies (Hendricks et al, 1994, Brown and Goetzman, 1995) have found evidence supporting the idea that past performance is related to future performance. Mr N Sethuram, the Chief Investment officers said that the unexpected exits by the Investor from the scheme have also been a challenge to the Fund Manager. The challenge before the fund manager is intense research and sound risk management techniques to help identify suitable stocks.

**Challenge to the Asset Management Company**

The Asset Management Companies manage the assets of the Mutual Funds. These AMC get Management Fees for managing the assets of the Mutual Funds. There are prescribed limits beyond which the AMC cannot charge the management fees to the scheme. However, even though there are outer limits for charging the fees, there are no lower limits. Fund Managers have to ensure that the performance of their schemes is the best, to ensure that their scheme performance are not impacted, they negotiate with the AMC to lower the Management Fees. Liquid Funds and Money Market Funds cannot afford to give higher fees, as it will have a bigger impact on the returns of the schemes. The similar thing lies with the debt schemes. Due to increase in competitions, Fund Managers are lowering the management fees due to
which the incomes of the AMC's are coming down. Incase the AUM is larger, the AMC can afford to charge lower Management fees, however the same cannot be the case of smaller Mutual Funds.

It has been found that actively managed mutual funds have to attain a minimum fund size before they achieve returns sufficient to cover their cost. It is comparatively easy for the Fund Manager to increase the returns of the schemes, if the size of the scheme is reasonable. It was also found that there are diminishing marginal returns to information activities and that the marginal returns becomes negative when a Mutual Fund exceeds its optimal size (Indro, Jian, Michael, Lee, 1999).

**Challenges to the Marketing Managers.**

The Mutual Fund Industry has become so competitive that the first question the Investor would like to know is what are the returns of the scheme and the service that is provided by the Mutual Fund. The Investor is primarily interested to know what will be the returns, when he invests the money in the scheme. It is very difficult for the marketing team to convince the Investor to invest in the scheme unless the Marketing Manager shows the positive side of the scheme to the Investor. Unlike the olden days, today the Investor is fully aware about the Market and Mutual Fund concepts. Moreover, there are many Mutual Funds selling the same type of the product, with added features.
The Marketing Manager has to highlight those features that make his product different from the other product available in the Market. Thus the Marketing Manager cannot lose even a single opportunity to market the product to the investors. The biggest challenge before the investing community is to educate investors and make chartered accountants take on more seriously the role of financial advisors says Mr T. P. Raman, Managing Director, Sundaram Newton Asset Management

Summary

At the end of the year 1965, the Unit Trust of India which was the only Mutual Fund at that time had an AUM of approximately Rs 25 crores. In the year 1988, one year after the public sector was allowed entry to the Mutual Fund Industry, the AUM was Rs 6700 Crores. By the end of 1993, the total AUM was Rs 47,004 Crores. Prior to the split of the Unit Trust of India, the total AUM was Rs 1,21,805 crores. The figures dipped immediately to Rs 87,190 crores after the split of UTI. At the end of June, 2006 the AUM was Rs 2,65,535 crores. After the split of UTI, the AUM of the Mutual Fund is growing at an annual rate of 50% plus except during the year 2004-2005. In the past three months, the AUM has grown at a rate of 14% on an average. It is obvious, that if the same trend continues, the growth of Mutual Fund Industry is expected to grow manifold.
The challenges as envisaged above are interlinked to each other functions. The Marketing Manager can market the product only when his product tops the other product available in the market viz in the form of returns and ranking. The Fund Manager in turn looks at the AMC to reduce the Management fees and the Marketing team for more inflow, so that they have sufficient amount of AUM to manage the scheme and in turn reduce the AMC fees. The AMC looks at the Fund Manager, so that the performance of the scheme increases and also the Marketing team gets good business so that they get sufficient Management fees.

The present study is to determine the factors which will increase the returns on the Mutual Funds schemes and lower the risk which will in turn decrease the per unit risk. The per unit risk can be expressed as under:

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\text{Per unit risk} = \frac{\text{Returns}}{\text{Risk}}
\]

* The main objective of the study is to evaluate the performance of the Indian Mutual Fund schemes viz the returns and risk which gives the per unit of risk.
* To study the determinant factors affecting the returns of Mutual Fund schemes (Performance of Mutual Fund).
To develop a single score of overall performance of the Mutual Fund Scheme.

The study is aimed at the three dimensional study of the performance evaluation of Mutual Fund Schemes viz from the actual performance of the schemes, from the Investors point of view and from the Fund Managers point of view.