CHAPTER-I

AN OVERVIEW OF MUTUAL FUND INDUSTRY IN INDIA
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IN INDIA

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1.1 THE FINANCIAL SYSTEM

The term financial system refers to a set of inter-related activities/services, working together to achieve some predetermined purpose or goal. It includes different markets, institutions, instruments, services and mechanisms which influence the generation of savings, investment, capital formation, and growth.

Financial System of any country circumscribes the intermediation of financial instruments or financial products. The financial system is possibly the most important institutional and functional vehicle for economic transformation. Finance is a bridge between the present and the future and whether it is the mobilization of savings or their efficient, effective and equitable allocation for investment, it is the success with which the financial system performs its functions that sets the pace for the achievement of broader national objectives.

According to Robinson, the primary function of the system is "to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth." From the above definition, it may be said that the primary function of the financial system is the mobilisation of savings, their distribution for industrial investment and stimulating capital formation to accelerate the process of economic growth.

The process of savings, finance and investment involves financial institutions, markets, instruments and services. Above all, supervision, control and regulation are equally significant. Thus, financial management is an integral part of the financial system. The concept of financial system is given in Fig.1.1.
1.2 STRUCTURE OF INDIAN FINANCIAL SYSTEM

The Indian financial system comprises specialized and non-specialised financial instruments and financial services, banking and non-banking institutions, and also Mutual Funds and Capital Markets. (See Fig. 1.2).
The effect of economic reforms is clearly visible in figure 1.2 that shows the ratio of capital formation in the private sector to that in the public sector for a decade preceding liberalization and for the period following it. Perhaps the biggest structural change in India’s macro-economy, apart from the rise in the growth rate, is the steep decline in the interest rates. Interest rates have fallen by almost 50% in the period following the reforms, bringing down the corporate cost of capital significantly and increasing the competitiveness of Indian companies in the global marketplace. In this
connection, we remember the words of Shakespeare that “out of this nettle, danger, we pluck this flower, safety”.

The economic development model adopted by India in the post-independence era has been characterized by mixed economy with the public sector playing a dominant role and the activities in private industrial sector control measures emaciated from time to time.

1.3. MUTUAL FUNDS: GLOBAL SCENARIO

Mutual funds are institutions, which pool money from individuals or institutions by issuing ‘units’. The ‘units’ are then invested on the behalf of the investor with predetermined investment objectives and manage the same for a nominal fee. The money is invested across a range of financial instruments: Equity and Debt.

At the very dawn of commercial history, Egyptians and Phoenicians were selling shares in vessels and caravans in order to spread the risk of these perilous ventures. The idea of pooling money dates back to 1822, when groups of people in Belgium established a company to finance investments in national industries under the name of ‘Societe Generale de Belgique’, incorporating the concept of risk sharing. The institution acquired securities from a wide range of companies and practiced the concept of mutual fund for risk diversification. The word ‘mutual’ denoted something to be done collectively by a group of people with the common objective of having mutual faith and understanding among themselves. ‘Fund’ was used in monetary terms, to collect some money from the members for a common objective like earning profits with joint efforts.

In 1822, King William I of Netherlands came up with a close-end fund. In 1860, this phenomenon spread to England. In 1868, the ‘Foreign and Colonial Government Trust of London’ was formed, which was the real pioneer to spread risk of investors over a large number of securities and was considered as the Mecca of modern mutual funds. In 1873, Robert Fleming, established ‘The Scottish American Trust’. Although, many nineteenth century British investment trusts invested in American stocks, the first American investment trust was the close-end Boston
Personal Property Trust created in 1893. In U.K., the accepting houses emerged as a major force in the business of investment management.

Mutual fund in America is basically the concept of Unit Trust of Britain. In U.S.A. mutual funds have come a long way since March 21, 1924 when the first fund, 'Massachusetts Investment Trust' was organised for the professors of Harvard University and offered shares to the public in 1926. But it was Sherman L. Adams, the father of modern mutual fund, who along with Charles Learoyd and Ashton Carr, established a modest portfolio of 45 common stocks worth USD 50,000.

The mutual fund in its present structure is a Twentieth Century phenomenon. Globally there were thousands of funds offering varied schemes with different investment objectives and options. Mutual funds emerged as the most important investment vehicle for household investments in U.S.A. with the basic objective of allowing small investors to partake in the capital market by investing in a wide portfolio of stocks so as to reduce risk. At the end of fourth quarter of 2011, the assets of worldwide mutual funds stood at USD 58.3 trillion, while the assets of equity funds contributed 35% (Exhibited in Fig. 1.3) of the total mutual fund assets.

**FIGURE 1.3**

**COMPOSITION OF WORLDWIDE MUTUAL FUND ASSETS**

The number of worldwide mutual funds stood at 53,150 with equity funds accounting for 42% as shown in the Fig. 1.4.
A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

The fund manager, also known as the fund sponsor or fund management company, trades the fund's investments in accordance with the fund's investment objective. A fund manager must be a registered investment advisor. Funds that are managed by the same fund manager and that have the same brand name are known as a "fund family" or "fund complex".

Mutual funds pass taxable income on to their investors annually. The type of income they earn is unchanged as it passes through to the shareholders. For example, mutual fund distributions of dividend income are reported as dividend income by the investor. There is an exception: net losses incurred by a mutual fund are not distributed or passed through to fund investors.
Mutual funds may invest in many kinds of securities. The types of securities that a particular fund may invest in are set forth in the fund's prospectus, which describes the fund's investment objective, investment approach and permitted investments. The investment objective describes the type of income that the fund seeks. For example, a "capital appreciation" fund generally looks to earn most of its returns from increases in the prices of the securities it holds, rather than from dividend or interest income. The investment approach describes the criteria that the fund manager uses to select investments for the fund.

A mutual fund's investment portfolio is continually monitored by the fund's portfolio manager or managers, who are employed by the fund's manager or sponsor.

1.4. THE INDIAN PANORAMA

The Indian capital market having a long history spanning over a century had passed through the most radical phase. The Indian Capital Market witnessed unprecedented developments and innovations during the eighties and nineties. One such development was the increased role the mutual fund industry played in financial intermediation. Mutual fund, as an institutional device, pools investor's funds for investment in the capital market under the direction of an investment manager. Mutual funds bridge the gap between the supply and demand for funds in the financial market.

In India, the need for the establishment of mutual funds was felt in 1931 and the concept of mutual fund was coined in 1964, by the far-sighted vision of Sri T.T.Krishnamachari, the then finance minister. Taking into consideration the recommendations of the Central Banking Enquiry Committee and Shroff Committee, the Central Government established Unit Trust of India in 1964 through an Act of Parliament, to operate as a financial institution as well as an investment trust by way of launching UTI Unit Scheme 64. The overwhelming response and the vast popularity of UTI Unit Scheme 64 and the 'Mastershare Scheme' in 1986 attracted the attention of banks and other financial institutions to this industry and paved the way for the entry of public sector banks. By the end of 1986-87, UTI had launched 20 schemes mobilizing funds amounting to ₹4,56,500 crores. Since then, the mutual funds have established themselves as an alternative investment vehicle and are now an
integral part of the Indian financial system.

1.5. GROWTH OF MUTUAL FUNDS

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

The formation of Unit Trust of India marked the evolution of the Indian mutual fund industry in the year 1963. The primary objective at that time was to attract the small investors and it was made possible through the collective efforts of the Government of India and the Reserve Bank of India. The history of mutual fund industry in India can be better understood when it is divided into following phases:
1.5.1 First Phase – 1964-87

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

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

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

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

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996.
The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of ₹1,21,805 crores. The Unit Trust of India, with ₹44,541 crores of assets under management, was way ahead of other mutual funds.

1.5.4 Fourth Phase – Since February 2003

In February 2003, following the repeal of the Unit Trust of India Act 1963, UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets worth ₹29,835 crores under its management as at the end of January, 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India, does not come under the purview of the Mutual Fund Regulations. The second is the UTI Mutual Fund, 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 ₹76,000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth.

1.5.5 Phase V. Growth and Consolidation - 2004 Onwards

The industry has also witnessed several mergers and acquisitions recently, examples of which are acquisition of schemes of Alliance Mutual Fund by Birla SunLife, SunF&C Mutual Fund and PNB Mutual Fund byPrincipal Mutual Fund. Simultaneously, more international mutual fund players have entered India like Fidelity, Franklin Templeton Mutual Fund etc. There were 29 funds as at the end of March 2006. This is a continuing phase of growth of the industry through consolidation and entry of new international and private sector players.
The graph indicates the growth of assets over the years.

![Graph showing growth of assets over the years.](image)

**FIGURE 1.5 ASSETS UNDER THE MANAGEMENT OF MUTUAL FUND INDUSTRY**

In 1987, the public sector banks and insurance companies were permitted to set up mutual funds. Accordingly, the LIC and GIC and six public sector banks initiated the setting up of mutual funds, bringing out a new era in the mutual fund industry. The financial sector reforms were introduced in India as an integral part of the economic reforms in the early 1990s with the principal objective of removing structural deficiencies and improving the growth rate of financial markets. Mutual fund reforms were aimed at for the creation of a competitive environment by allowing private sector participation. Since 1991, several mutual funds were set up by private and joint sectors. Many private mutual funds opted for foreign collaboration due to the technical expertise of their counterparts and past track record of success. Based on the recommendations of the Dave panel report in 1991, the Government of India issued new guidelines for setting up mutual funds in public sector, private sector as well as in joint sector on February 14, 1992. On February 19, 1993, the first batch of 12 private sector mutual funds was given "in-principle approval" by the Securities and Exchange Board of India (SEBI). The erstwhile Kotbri Pioneer Mutual fund (now merged with Franklin Templeton) was the first fund established in July 1993 in the private sector.

The SEBI formulated the Mutual Fund Regulations in 1993, establishing a comprehensive regulatory framework for the first time, while the Indian Mutual Fund Industry (IMFI) had already passed through two phases of developments. The first phase was between 1964 and 1987 when the UTI was the only player, managing total
assets of ₹4,564 crores by the end of March 1987. In 1986, the first growth scheme, Master share was launched by UTI and was the first to be listed on stock exchange.

In India, mutual funds as vehicles of mobilization and channels of funds towards the securities market, had shown improvement in total net assets from presently holding total net assets. As on March 31, 2012 through 1275 schemes the mutual funds have been holding total net assets worth ₹6,64,824 crores.

By the end of 1964-65 the total net assets of these funds were valued at ₹25 crores. At the end of March 31, 1993 the total net assets were valued at ₹47,734 crores. On March 31, 2006 the value of the total net assets touched ₹2,31,862 crores indicating a quantum jump in the total net assets. By the year 2012 as has already been pointed out there has been another significant improvement in the value of the total net assets as they recorded a figure of ₹6,64,824 crores. Now it is estimated that mutual funds are set to establish another record in terms of total net assets by bagging a huge chunk of nearly ₹3,05,000 crores of cash reserves from Governments new pension fund and public sector entities.

The mutual fund industry in India had grown several folds in terms of number of schemes, funds raised and investor base over the years. With the growing competition in the market, a regular scientific appraisal of mutual funds is essential for the investors as well as the fund managers. Sector wise domestic savings are presented in Table 1.1.

It can be observed from Table 1.1 and the corresponding Sector wise Domestic Savings presented in Graph 1.2, that the savings of households either excelled or equaled the savings of corporate sector, which indicates the vital role played by mutual funds in pooling the huge chunk from small investors.
**TABLE 1.1**

SECTORWISE DOMESTIC SAVINGS (AT CURRENT PRICES)  
(Billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Household Sector Financial</th>
<th>Physical</th>
<th>Total</th>
<th>Private Corporate Sector</th>
<th>Public Sector</th>
<th>Gross Domestic Savings</th>
<th>Net Domestic Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994-95</td>
<td>1207.33</td>
<td>664.08</td>
<td>1871.42</td>
<td>352.60</td>
<td>242.66</td>
<td>2666.68</td>
<td>1499.19</td>
</tr>
<tr>
<td>1995-96</td>
<td>1057.19</td>
<td>928.66</td>
<td>1985.85</td>
<td>591.53</td>
<td>315.27</td>
<td>2892.65</td>
<td>1766.79</td>
</tr>
<tr>
<td>1996-97</td>
<td>1416.61</td>
<td>829.93</td>
<td>2246.53</td>
<td>625.40</td>
<td>311.94</td>
<td>3183.87</td>
<td>1885.39</td>
</tr>
<tr>
<td>1997-98</td>
<td>1467.77</td>
<td>1373.50</td>
<td>2841.27</td>
<td>660.80</td>
<td>295.83</td>
<td>3797.90</td>
<td>2225.23</td>
</tr>
<tr>
<td>1998-99</td>
<td>1803.65</td>
<td>1717.68</td>
<td>3521.14</td>
<td>691.91</td>
<td>-31.46</td>
<td>4181.59</td>
<td>2544.19</td>
</tr>
<tr>
<td>1999-00</td>
<td>2066.03</td>
<td>2322.48</td>
<td>4388.51</td>
<td>872.34</td>
<td>-92.38</td>
<td>5168.46</td>
<td>3303.74</td>
</tr>
<tr>
<td>2000-01</td>
<td>2152.19</td>
<td>2485.30</td>
<td>4637.50</td>
<td>810.62</td>
<td>-292.66</td>
<td>5455.45</td>
<td>3566.53</td>
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<td>2001-02</td>
<td>2474.75</td>
<td>2978.13</td>
<td>5452.88</td>
<td>769.06</td>
<td>-368.20</td>
<td>5853.75</td>
<td>3965.26</td>
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<tr>
<td>2002-03</td>
<td>2532.55</td>
<td>3109.66</td>
<td>5642.21</td>
<td>992.17</td>
<td>-71.48</td>
<td>6562.29</td>
<td>4100.49</td>
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<td>2003-04</td>
<td>3122.60</td>
<td>3443.27</td>
<td>6565.87</td>
<td>1248.16</td>
<td>363.72</td>
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<td>2004-05</td>
<td>3279.56</td>
<td>4337.29</td>
<td>7616.85</td>
<td>2125.19</td>
<td>744.99</td>
<td>10507.03</td>
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<td>2005-06</td>
<td>4383.31</td>
<td>4306.57</td>
<td>8690.88</td>
<td>2772.08</td>
<td>889.75</td>
<td>13251.51</td>
<td>9874.30</td>
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<tr>
<td>2006-07</td>
<td>4842.56</td>
<td>5101.40</td>
<td>9943.96</td>
<td>3385.84</td>
<td>1579.29</td>
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<td>2007-08</td>
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<td>5381.37</td>
<td>11183.47</td>
<td>4090.23</td>
<td>2489.62</td>
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<td>2008-09</td>
<td>5710.26</td>
<td>5798.46</td>
<td>11508.73</td>
<td>4714.67</td>
<td>542.80</td>
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<tr>
<td>2009-10</td>
<td>8355.58</td>
<td>8034.81</td>
<td>16390.38</td>
<td>5321.36</td>
<td>117.96</td>
<td>21289.70</td>
<td>15259.73</td>
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<td>2010-11</td>
<td>7676.91</td>
<td>9816.20</td>
<td>17493.11</td>
<td>6024.64</td>
<td>1301.55</td>
<td>24819.31</td>
<td>17284.58</td>
</tr>
</tbody>
</table>

Source: Central Statistical Organisation (CSO)

**FIGURE 1.6**

SECTOR WISE DOMESTIC SAVINGS (AT CURRENT PRICES)

- Household Sector
- Private Sector
- Corporate Sector
- Public Sector
- Gross Domestic Savings
- Net Domestic Savings

Source: Table 1.1

The resources mobilized by mutual funds during 1995 – 2012 are incorporated in Table 1.2.
TABLE 1.2
RESOURCE MOBILISATION BY MUTUAL FUNDS IN INDIA

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Sector Mutual Funds</th>
<th>Private Sector Mutual Funds</th>
<th>Total (5+6)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>UTI</td>
<td>Mutual Funds</td>
<td>FI Total (2+3+4)</td>
</tr>
<tr>
<td></td>
<td>Banks</td>
<td>4</td>
<td>5</td>
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<tr>
<td>1995-96</td>
<td>-6314</td>
<td>113</td>
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<td>1996-97</td>
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<td>137</td>
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<tr>
<td>1997-98</td>
<td>2875</td>
<td>237</td>
<td>204</td>
</tr>
<tr>
<td>1998-99</td>
<td>170</td>
<td>-89</td>
<td>547</td>
</tr>
<tr>
<td>1999-00</td>
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<td>296</td>
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<tr>
<td>2000-01</td>
<td>322</td>
<td>249</td>
<td>1273</td>
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<tr>
<td>2001-02</td>
<td>-7284</td>
<td>863</td>
<td>406</td>
</tr>
<tr>
<td>2002-03</td>
<td>-9434</td>
<td>1033</td>
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<td>2003-04</td>
<td>1050</td>
<td>4526</td>
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<tr>
<td>2004-05</td>
<td>-2467</td>
<td>706</td>
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<tr>
<td>2005-06</td>
<td>3424</td>
<td>5365</td>
<td>2112</td>
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<tr>
<td>2006-07</td>
<td>7326</td>
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<td>4226</td>
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<td>2007-08</td>
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<tr>
<td>2011-12</td>
<td>-3179</td>
<td>1054</td>
<td>-3098</td>
</tr>
</tbody>
</table>

Source: UTI and Respective Mutual Funds.

FIGURE 1.7
RESOURCE MOBILISATION BY MUTUAL FUNDS IN INDIA

Source: Table 1.2
1.6 CLASSIFICATION OF MUTUAL FUNDS

Mutual fund schemes are classified on the basis of their structure and investment objective.

1.6.1 By Structure

a) Open ended funds

Investors can buy and sell units of open-ended funds at NAV-related price every day. Open-ended funds do not have a fixed maturity and they are available for subscription every day of the year. Open-ended funds also offer liquidity to investments, as one can sell units whenever there is a need for money.

b) Close-ended funds

These funds have a stipulated maturity period, which may vary from three to 15 years. They are open for subscription only during a specified period. Close ended funds can only be bought by investors buying the period they are up for sale—called the New Fund Offer (NFO) period. Investors can sell them either on the stock exchanges where it is listed or during special buy back periods when the AMC (Asset Management Company) will buy back the units. Investors have the option of investing in the scheme during initial public offer period or buy or sell units of the scheme on the stock exchanges. Some close-ended funds repurchase the units at NAV-related prices periodically to provide an exit route to the investors.

c) Interval Funds

These funds combine the features of both open and close-ended funds. They are open for sale and repurchase at a predetermined period.

1.6.2 By Investment Objective

a) Growth and Dividend Mutual Funds: Funds that make your capital grow over a period of time without giving out profits/dividends to you are called growth funds. In case you received dividends from them, it is called a dividend fund. Obviously, in the latter case, since the profits are paid out from the fund corpus, the NAV of the fund will be less while that of the growth option will be more. They normally invest most
of their corpus in equities, as their objective is to provide capital appreciation over the medium-to-long term. Growth schemes are ideal for investors with risk appetite.

FIGURE 1.8
CLASSIFICATION OF MUTUAL FUNDS

b) Equity Mutual Funds: Funds invest primarily in stocks of companies — in a sense, you own up ending a part of the company when you buy into these. These are meant for long term investments and carry a great deal of risk. Their purpose is capital appreciation over a long period of time. Diversified Equity funds invest in a wide selection of stocks across different companies and market capitalizations so as to reduce the risk for the investor.

c) Income funds

As the name suggests, the aim of these funds is to provide regular and steady income to investors. They generally invest their corpus in fixed income securities like bonds, corporate debentures, and government securities. Income funds are ideal for those looking for capital stability and regular income.
d) Balanced funds

The objective of balanced funds is to provide growth along with regular income. They invest their corpus in both equities and fixed income securities as indicated in the offer documents. Balanced funds are ideal for those looking for income and moderate growth.

e) Money market funds

These funds strive to provide easy liquidity, preservation of capital and modest income. MMFs generally invest the corpus in safer short-term instruments like treasury bills, certificates of deposit, commercial paper and inter-bank call money. Returns on these schemes hinge on the interest rates prevailing in the market. MMFs are ideal for corporate and individual investors looking to park funds for short periods.

f) Other schemes

i. ELSS (equity linked savings schemes) / Tax saving schemes

Tax saving schemes or equity-linked savings schemes offer tax rebates to investors under section 80(C) of the Income Tax Act and also have a lock-in period of 3 years – this means that as an investor, you cannot redeem(sell) your holdings only three years after buying them. They generally have a lock-in period of three years. They are ideal for investors looking to exploit tax deductions as well as growth in investments.

g) Special schemes

These schemes invest only in the industries specified in the offer document. Examples are Infotech funds, FMCG funds, pharma funds, etc. These schemes are meant for aggressive and well-informed investors.

h) Index funds

Index Funds invest their corpus on the specified index such as BSE SENSEX, NSE index, etc. as mentioned in the offer document. They try to mimic the composition of the index in their portfolio. Not only the shares, even their weightage is replicated. Index funds are a passive investment strategy and the fund manager has a limited role to play here. The NAVs of these funds move along with the index they
are trying to mimic safe for a few points here and there. This difference is called tracking error.

i) Sector specific schemes

Sector or Thematic funds invest in a particular sector. There could be a fund investing in only the banking sector. Similarly, there could be thematic funds investing in a particular theme, example, infrastructure. Large-cap mutual funds invest in large market capitalization companies. There is no clear definition of what large capitalization means, many AMCs pick the top 100 companies (based on market cap) on the Sensex and call them large-cap. Similarly, there exist mid-cap and small-cap capitalization companies respectively. Among these, large cap carries the lower risk rate while the small cap carries the most risk. These funds invest only in specified sectors like an industry or a group of industries or various segments like Group shares or initial public offerings.

j) Midcap Funds

After largecap funds come the midcap funds, which invest in stocks belonging to the mid cap segment of the market. Many of these midcaps are said to be the 'emerging bluechips' or 'tomorrow's largecaps'. There can be actively managed or passively managed midcap funds. There are indices such as the CNX Midcap index which tracks the midcap segment of the markets and there are some passively managed index funds investing in the CNX Midcap companies.

k) Hybrid Mutual Funds

i. Monthly Income Plans (MIPs) are plans which invest around 15%-25% in equities and the rest in debt and money market instruments.

ii. Gold Mutual Funds are those that invest in gold as the underlying asset. International Funds invest in companies outside India.

iii. Exchange Traded Funds (ETFs) are those that are traded on the stock exchange on a real time basis.

iv. Socially responsible mutual funds invest in companies that have social, environmental or moral beliefs and promote the same.
v. Fund of Funds do not invest in any companies — instead they put their money into other AMC’s mutual funds.

vi. Real Estate Mutual Funds invest in real estate or lend money to real estate developers.

1.7. ADVANTAGES AND DISADVANTAGES

Mutual funds have advantages compared to direct investing in individual securities. These include:

- Increased diversification
- Daily liquidity
- Professional investment management
- Ability to participate in investments that may be available only to larger investors
- Service and convenience
- Ease of comparison

Disadvantages

- Fees
- Less control over timing of recognition of gains
- Less predictable income
- No opportunity to customize

Every investment has advantages and disadvantages. But it's important to remember that features that matter to one investor may not be important to you. Whether any particular feature is an advantage for you will depend on your unique circumstances. For some investors, mutual funds provide an attractive investment choice because they generally offer the following features:

- Professional Management: Professional money managers research, select, and monitor the performance of the securities the fund purchases. Diversification — Diversification is an investing strategy that can be neatly summed up as "Don't put all your eggs in one basket." Spreading your risk helps you achieve diversification through ownership of mutual funds
rather than through investments across a wide range of companies and industry sectors and can help lower your risk if a company or sector fails.

- **Affordability:** Some mutual funds accommodate investors who don't have a lot of money to invest by setting relatively low monetary amounts for initial purchases, subsequent monthly purchases, or both.

- **Liquidity:** Mutual fund investors can readily redeem their shares at the current NAV — plus any fees and charges assessed on redemption at any time. But mutual funds also have features that some investors might view as disadvantages, such as:

  - **Costs Despite Negative Returns:** Investors must pay sales charges, annual fees, and other expenses (which we'll discuss below) regardless of how the fund performs. And, depending on the timing of their investment, investors may also have to pay taxes on any capital gains distribution they receive: even if the fund went on to perform poorly after they bought shares.

  - **Lack of Control:** Investors typically cannot ascertain the exact makeup of a fund's portfolio at any given time, nor can they directly influence which securities the fund manager buys and sells or the timing of the trade.

  - **Price Uncertainty:** With an individual stock, you can obtain real-time (or close to real-time) pricing information with relative ease by checking financial websites or by calling your broker. You can also monitor how a stock's price changes from hour to hour: or even from second to second. By contrast, with a mutual fund, the price at which you purchase or redeem shares will typically depend on the fund's NAV, which the fund might not calculate until many hours after you've placed your order. In general, mutual funds must calculate their NAV at least once every business day.

### 1.8 SHORTCOMINGS IN THE OPERATION OF MUTUAL FUNDS

The mutual funds have been operating for the last half century. However, for four decades, the industry was still in an emerging stage. Thus, their operations or performance cannot be evaluated easily. Even then one should not lose sight of the fact that the formative years of any institution are very important to evaluate as they could throw light on the pros and cons of the system. Following are some of the shortcomings in the operations of mutual fund⁹.
I. The mutual funds are externally managed. They do not have employees of their own. There is no specific law to supervise the mutual funds in India. There are multiple regulations. While UTI is governed by its own regulations, while the banks are supervised by Reserved Bank of India, the Central Government and Mutual Funds are regulated by the SEBI, apart from other statutory authorities.

II. At present, the investors in India prefer to invest in mutual fund as a substitute for fixed/ time deposits in Banks. About 75% of the investors are not willing to invest in mutual funds unless there is a promise of a minimum return.

III. Sponsorship of mutual funds has a bearing on the integrity and efficiency of fund management which are key to establishing investor's confidence. So far, only public sector sponsorship or ownership by select Corporate Conglomerates have taken care of this need.

IV. Unrestrained fund raising by schemes without adequate supply of scrips can create imbalance in the market to a large extent and exacerbate the distortions. Many small companies did very well last year, by schemes without adequate balance in the market.

V. Mutual funds cannot reap their fullest benefits as they are not allowed to invest in smaller companies. Further, a mutual fund is allowed to hold only a fixed maximum percentage of shares in a particular establishment.

VI. The mutual funds in India are formed as ‘trusts’. As there is no distinction made between sponsors, trustees and fund managers, the trustees play the role of fund managers.

VII. The increase in the number of mutual funds and various schemes has increased the competition. In this context, it has been remarked by a Senior Broker: “mutual funds are too busy trying to race against each other”. As a result, they lose their stabilizing factor in the market.

VIII. While UTI publishes details of the accounts of their investments, mutual funds do not publish any profit and loss Account and balance sheet even after their operation.

IX. The mutual funds have eroded the financial clout of institutions in the stock market for which cross transactions between mutual funds and financial institutions are not only allowing speculators to manipulate price but also
providing cash leading to the distortion of balanced growth of market.

X. As the mutual fund is very poor in standard of efficiency in investor services; such as dispatch of certificates, repurchase and attending to inquiries it leads investors losing interest in the mutual fund.

XI. Transparency is another area in mutual funds which was neglected till recently. Investors have right to know and asset management companies have an obligation to inform where and how their money has been deployed. But investors are often not given the information which is their right.

1.9 MUTUAL FUND COMPANIES IN INDIA

The concept of mutual funds in India dates back to the year 1963. The era between 1963 and 1987 marked the existence of only one mutual fund company in India with ₹ 67 bn assets under management (AUM), by the end of its monopoly era, the Unit Trust of India (UTI). By the end of the 80s decade, a few other mutual fund companies in India took their position in mutual fund market.

The new entrants into mutual fund companies in India were SBI Mutual Fund, Canbank Mutual Fund, Punjab National Bank Mutual Fund, Indian Bank Mutual Fund and Bank of India Mutual Fund.

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

Kothari Pioneer was the first private sector mutual fund company in India which has now merged with Franklin Templeton. Just after ten years with private sector players penetration, the total assets rose to ₹ 1218.05 bn. Today there are 44 mutual fund companies in India.
BENCHMARK MUTUAL FUND

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

1.10 MUTUAL FUND COMPANIES OPERATED BY PUBLIC AND PRIVATE SECTOR BANKS IN INDIA

Bank of Baroda Mutual Fund (BOB Mutual Fund)

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

HDFC Mutual Fund

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

ING Vysya Mutual Fund

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

Prudential ICICI Mutual Fund

The mutual fund of ICICI is a joint venture with Prudential Plc. of America, one of the largest life insurance companies in the U.S.A. Prudential ICICI Mutual Fund was setup on 13th of October, 1993 with two sponsors, Prudential Plc. and ICICI Ltd. The Trustee Company formed is Prudential ICICI Trust Ltd. and the AMC is Prudential ICICI Asset Management Company Limited incorporated on 22nd of June, 1993.
State Bank of India Mutual Fund

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

Kotak Mahindra Mutual Fund

Kotak Mahindra Asset Management Company (KMAMC) is a subsidiary of KMBL. It is presently having more than 10 lakh investors in its various schemes. KMAMC started its operations in December 1998. Kotak Mahindra Mutual Fund offers schemes catering to investors with varying risk - return profiles. It was the first company to launch dedicated gilt scheme investing only in government securities.

Unit Trust of India Mutual Fund

UTI Asset Management Company Private Limited, established on Jan 14, 2003, manages the UTI Mutual Fund with the support of UTI Trustee Company Private Limited. UTI Asset Management Company presently manages a corpus of over ₹ 20,000 crores. The patrons of UTI Mutual Fund are Bank of Baroda (BOB), Punjab National Bank (PNB), State Bank of India (SBI), and Life Insurance Corporation of India (LIC). The schemes of UTI Mutual Fund are Liquid Funds, Income Funds, Asset Management Funds, Index Funds, Equity Funds and Balance Funds.

Canbank Mutual Fund

Canbank Mutual Fund was setup on December 19, 1987 with Canara Bank acting as the sponsor. Canbank Investment Management Services Ltd. incorporated on March 2, 1993 is the AMC. The Corporate Office of the AMC is in Mumbai.
1.11 TERMINOLOGY OF MUTUAL FUND

1.11.1 NET ASSET VALUE OF MUTUAL FUND

Net asset value (NAV) is a term used to describe the value of an entity's assets less the value of its liabilities. The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV).

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 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 ₹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 ₹20 NAV is required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.

Net asset values and other accounting and recordkeeping activities are the result of the process of Fund Accounting, sometimes called securities accounting, investment accounting and/or portfolio accounting. Fund Accounting systems are sophisticated computerized systems used to account for investor capital flows in and out of a fund, purchases and sales of investments and related investment income, gains, losses and operating expenses of the fund. The fund's investments and other assets are valued on a regular schedule such as daily, weekly or monthly, depending on the fund and associated regulatory or sponsor requirements. There is no universal method or basis of valuing assets and liabilities for the purposes of calculating net asset value used throughout the world, and the criteria used for the valuation will depend upon the circumstances, the purposes of the valuation and any regulatory and/or accounting principles that may apply.

At the completion of the valuation process and once all other appropriate accounting entries are posted, the accounting books are 'closed' enabling a variety of information to be calculated and produced including the net asset value per share. Net asset value is most commonly used in the context of open-ended funds. Shares and
interests in such funds are not traded between investors, but are issued by the fund to each new investor and redeemed back to the fund when an investor withdraws. A fund will issue and redeem shares and interests at a price calculated by reference to the NAV of the fund, with the intention that new investors receive a fair proportion of the fund and redeeming investors receive a fair proportion of the fund's value in cash.

In contrast, closed-end funds are traded in the open-market between investors and so the price of shares or interests in a closed-end fund will be whatever the parties agree it to be, which may not correspond to the fund's NAV. Publicly traded shares in such funds generally trade at a price below NAV.

1.11.2 VALUATION OF ASSETS IN OPEN-ENDED FUNDS

The NAV of a collective investment scheme (such as a US mutual fund or a hedge fund) is calculated by reference to the total value of the fund's portfolio (its assets) less its accrued liabilities (money owed to lending banks, fees owed to investment managers and service providers and other liabilities).

The portfolio's assets are generally valued by objective criteria established at the outset of the fund. Where assets are traded on a securities exchange or cleared through a clearing firm, the most common method of valuation is to use the market value of the assets in the portfolio (using, for example, the closing bid price or last traded price). The value of OTC derivatives may be provided by the counterparty to the derivative, who may be trading similar derivatives with other parties. Where, there is no objective method of calculating the value of an asset, the fund manager's own valuation methods, But the fund managers valuation method can be used subject to the condition that the fund director or trustee will ultimately exercise his discretion in deciding the value of an asset.

Turning to operating companies as opposed to investment companies (mutual funds), in determining whether shares in a public company are a cheap or expensive investment, one tool used by investors is a comparison of the company's current market capitalization (being the price at which the market values the company) with its NAV. The NAV may be below the market price for the following reasons:
The NAV describes the company's current asset and liability position. Investors might believe that the company has significant growth prospects, in which case they would be prepared to pay more for the company than its NAV. Also, accounting principles and basis of presentation of amounts in financial statements vary around the globe, further blurring the comparability of companies in various jurisdictions.

The current value of a company's assets likely differ than the historical cost in financial statements used in the NAV calculation.

Certain assets, such as goodwill (which broadly represents a company's ability to make future profits), are not necessarily included on a balance sheet and so will not appear in an NAV calculation.

A company's market value will not always be greater than its NAV. For example, analysts and management estimated that Liberty Media Corporation was trading for 30-50% below its net asset value (or "core asset value") in June 2007. Where a company's market value is lower than its NAV, it may be considered more profitable to wind the company up and sell off its assets individually rather than continue to run it as a going concern.

In contrast to fund valuation, the assets of a company will generally be valued for the purpose of a NAV calculation using the book value, the historical cost or the amortised cost of the company's assets, or an appropriate combination of the three.

1.11.3 Turnover

*Turnover* is a measure of the volume of a fund's securities trading. It is expressed as a percentage of net asset value and is normally annualized. Turnover equals the lesser of a fund's purchases or sales during a given period (of no more than a year) divided by average net assets. If the period is less than a year, the turnover figure is annualized.
1.11.4 EXPENSES AND EXPENSE RATIO

Investors in a mutual fund pay the fund’s expenses. These expenses fall into four categories: distribution charges, operating expenses (which include the management fee and other fund expenses), shareholder transaction fees and securities transaction fees. Some of these expenses reduce the value of an investor’s account; others are paid by the fund and reduce net asset value. Operating expenses are included in a fund’s operating expense ratio, or simply the “expense ratio”.

Annual operating expenses divided by average daily net assets for the same period of time is equal to the Operating Expense Ratio, or simply the expense ratio. The expense ratio highlights how much fund expenses come out of a shareholder’s investment return and allows comparison of different funds. Other fees and charges dilute returns but they are not included in the expense ratio. Assume that a scheme has average weekly net assets of ₹.100 crores. and the scheme incurs ₹.1 crore as annual expenses, then the expense ratio would be 1/100 = 1%. In case this scheme’s expense ratio is comparable to or better than its peers, then this scheme would qualify as a good investment, based on this parameter only.

If this scheme performs well and its AUM increases to ₹.150 crores in the next year whereas its annual expenses increase to ₹.2 crores, then its expense would be 2/150 = 1.33%.

It is not enough to compare a scheme’s expense ratio with peers. The scheme’s expense ratio must be tracked over different time periods. Ideally, as net assets increase, the expense ratio of a scheme should come down.

1.11.5 MANAGEMENT FEE

The management fee is paid to the fund manager or sponsor who organizes the fund, provides the portfolio management or investment advisory services and normally lends its brand name to the fund. The fund manager may also provide other administrative services. The management fee often has breakpoints, which means that it declines as assets (in either the specific fund or in the fund family as a whole) increase. The management fee is paid by the fund and is included in the expense ratio.
If the manager or adviser is waiving fees pursuant to an expense limitation, the 'net' fee is reduced by the amount waived or reimbursed for a fund.

1.12 SEBI GUIDELINES

The Indian mutual fund industry witnessed robust growth and stricter regulation from SEBI since 1996. The mobilisation of funds and the number of players operating in the industry reached new heights as investors started showing more interest in mutual funds. Safeguarding the interests of investors is one of the duties of SEBI. Consequently, SEBI (Mutual Funds) Regulations, 1996 and certain other guidelines have been issued by SEBI that sets uniform standards for all mutual funds in India. Following are the SEBI (Mutual Funds) Regulations

- Securities and Exchange Board of India (Mutual Funds) regulations, 1996, Dated 03-12-1996
- SEBI (Mutual Funds) (Amendment) Regulations, 2006, Dated 12-01-2006

1.13 AMFI CODES AND GUIDELINES

The Indian mutual fund industry witnessed a number of public sector players entering the market in the year 1987. In November 1987, SBI Mutual Fund from the State Bank of India became the first non-UTI mutual fund in India. SBI Mutual Fund was later followed by Canbank Mutual Fund, LIC Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund, GIC Mutual Fund and PNB Mutual Fund. By 2012, the assets under management of the industry increased fourteen times to ₹ 6,58,432 crores. However, HDFC Mutual Fund and ICICI Prudential Mutual funds remained dominant players in the private sector banking space with about 80% market share.

- To define and maintain high professional and ethical standards in all areas of operation of mutual fund industry
• To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.

• To interact with the Securities and Exchange Board of India (SEBI) and to represent to SEBI on all matters concerning the mutual fund industry.

• To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the Mutual Fund Industry.

• To develop a cadre of well trained Agent distributors and to implement a programme of training and certification for all intermediaries and others engaged in the industry.

• To undertake nation wide investor awareness programme so as to promote proper understanding of the concept and working of mutual funds.

• To disseminate information on Mutual Fund Industry and to undertake studies and research directly and/or in association with other bodies.
REFERENCES