CHAPTER 1

INTRODUCTION

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CHAPTER I
INTRODUCTION

1.1 Introduction to Mutual Funds

The financial system is a set of institutional arrangements through which financial surpluses available in the economy are mobilized. A financial system, which is inherently strong, functionally diverse and displays efficiency and flexibility, is critical in creating a market-driven, productive and competitive economy. A mature financial system has to gear up and undergo varied and comprehensive changes in order to achieve rapid economic development.

The financial sector reforms in India in the early nineties has resulted in explosive growth of the economy, opening up of the Indian financial market to foreign and private Indian players, large inflow of Foreign Institutional Investors, increased competition and better product offerings to consumers. One of the major developments of this decade has been the take-off of mutual funds. Mutual funds have emerged as a strong financial intermediary and are the fastest growing segment of the financial services sector in India. It aims at promoting a diversified, efficient and competitive financial sector increasing the return on investment and promoting and accelerating the growth of the economy. It is a medium of investment suitable to the small investors, who are not able to invest in stock market directly.
Mutual funds now play a very significant role in channelising the savings of millions of individuals. The mutual fund industry in India over the years has seen dramatic improvements in terms of quantity as well as quality of product and service offerings in recent years. The tremendous growth of Indian Mutual Funds industry is an indicator of India’s efficient financial market and the trust which investors have on the regulatory environment. Millions of investors rely on mutual funds as their primary investments because they offer a convenient, cost-effective and easy way to invest in the financial markets. The Securities Exchange Board of India (SEBI) regulates this fast growing industry and it is the representative body of all mutual funds in the country.

Every mutual fund has a goal - either growing its assets (capital gains) and/or generating income (dividends) for its investors. Distribution in the form of capital gains (short-term and long-term) and dividends may be passed on (paid) to the shareholders as income or reinvested to purchase more shares.

A mutual fund is valued daily and reports a price known as a Net Asset Value (NAV) per share. In its simplest form, a NAV is the total value of all the securities held in a fund divided by the total number of shares owned by its shareholders. As the price of the NAV increases or decreases, the shareholder's value will increase or decrease.
1.2 Historical Perspective of Mutual Funds

Tracing the history of mutual funds, worldwide, the mutual fund - unit trust as it is referred in some parts of the world, has a long and successful history.

1) The Beginning

The origin of investment fund has been cited by some historians as the close-ended investment companies launched in the Netherlands in 1822 by King William I as the first mutual funds, while some researchers point to a Dutch merchant named Adriaan van Ketwich whose investment trust was created in 1774. It is also believed that Van Ketwich developed the idea that diversification would increase the appeal of investments to smaller investors with minimal capital.

The next company “The Foreign and Colonial Government Trust”, formed in London in 1868, resembled a mutual fund. It promised the investors, modest returns by spreading the investment over a number of different stocks. They sold a fixed number of shares, the price of which was determined by supply and demand.

The idea of pooling resources and spreading risk using close-ended investments soon took root in Great Britain and France, making its way to the United States in the 1890s. The Boston Personal Property Trust, formed in 1893, was the first close-ended fund in the U.S. The creation of the Alexander

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1 McWhinney James E., A Brief History of the Mutual Fund, Investopedia.

Fund in Philadelphia, Pennsylvania, in 1907 was an important step in the evolution towards what we know as the modern mutual fund.

**2) The Arrival of the Modern Fund**

The Massachusetts Investors' Trust\(^3\) which was launched in Boston in 1924 is believed to be the first modern mutual fund. The fund went public in 1928; eventually it was named as Mutual Funds Investment Management. State Street Investors' Trust was the custodian of Massachusetts Investors' Trust and later, State Street Investors started its own fund in 1924 with Richard Paine. The year 1928 can be called as a momentous year in the history of mutual funds, which also saw the launch of the Wellington Fund, which was the first mutual fund to include stocks and bonds, as opposed to direct merchant bank style of investments in business and trade.

There were 19 open-ended mutual funds by the end of 1929 competing with nearly 700 close-ended funds. With the stock market crash of 1929, the dynamics began to change as highly-leveraged close-ended funds were wiped out and small open-ended funds managed to survive.

**1.3 Regulation and Expansion**

The industry began growing at a rapid pace opening up new markets around the world. The different regulators across the world also began to take notice of the exploding mutual fund industry. The creation of the Securities and Exchange Commission (SEC), the passing of the Securities Act of 1933 and the

\(^3\) McWhinney James E., A Brief History of the Mutual Fund, Investopedia.

The enactment of the Securities Exchange Act of 1934 put in place safeguards to protect investors. Mutual funds were required to register with the SEC and to provide disclosure in the form of a prospectus. The Investment Company Act of 1940 put in place additional regulations that required more disclosures and sought to minimize grievances of investors of different categories.

The mutual fund industry expanded aggressively and by 1950s, the number of open-ended funds topped 100. In 1954, the financial markets overcame their 1929 peak, and the mutual fund industry began to grow in earnest, adding some 50 new funds over the course of the decade. The 1960s saw the rise of aggressive growth funds, with more than 100 new funds established and billions of dollars in new asset inflows.

Hundreds of new funds were launched throughout the 1960s until the bear market of 1969 cooled the public appetite for mutual funds. Money flowed out of mutual funds as quickly as investors could redeem their shares, but the industry's growth later resumed.

Thus the global growth of mutual funds was fuelled by the increasing globalisation of finance and the investor's requirement of financial instruments that are safe and liquid but also promise high long-term returns. The industry has made significant strides in terms of its variety, sophistication and regulation.

The complexion and size of the mutual fund industry dramatically changed across the world as new products and services were added. The

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5 McWhinney James E., A Brief History of the Mutual Fund, Investopedia.
number of mutual funds worldwide has grown rapidly and most of the mutual funds are based in the United States, UK, Japan and France.

1.4 Current Global Scenario of Mutual Funds

The global economic environment was conducive and this led to the explosive growth of mutual funds in most countries particularly since 1980’s. This growth can be attributed to the strong emergence of the market economy which depends more on the growth led by the stock market. Mutual funds found increasing acceptance in the developed countries when compared to the developing countries in the early and mid 90’s but gradually it found its place even in the developing countries because of its advantages. Gradually the number of mutual funds increased significantly world wide and many developed countries started designing country specific funds to match the trend prevailing in other developed countries. The following table gives us the figures of total number of funds for all the countries for the period 2002-2007. The year 2007 has been divided into four quarters for a clear understanding.

Table 1.1 and graph 1.1 shows that the number of mutual funds worldwide stood at 66,350 at the end of the fourth quarter of 2007. By type of fund, 41 percent were equity funds, 20 percent were bond funds, 21 percent were balanced/mixed funds, and 5 percent were money market funds. It is evident from these figures that equity funds are the most popular funds worldwide and next in line is the balanced funds. Infact table 1.1 shows that the total number of money market funds during the year 2002 stood at 4,394 which decreased to 3,480 during the year 2007.
### Table 1.1
Total Number of Funds World Wide for the period 2002-2007

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Details</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Equity</td>
<td>22,974</td>
<td>22,688</td>
<td>22,362</td>
<td>23,264</td>
<td>25,698</td>
<td>26,950</td>
</tr>
<tr>
<td>2.</td>
<td>Bond</td>
<td>11,619</td>
<td>11,886</td>
<td>13,309</td>
<td>13,231</td>
<td>13,571</td>
<td>13,446</td>
</tr>
<tr>
<td>4.</td>
<td>Balanced/Mixed</td>
<td>11,228</td>
<td>11,465</td>
<td>11,603</td>
<td>11,393</td>
<td>12,530</td>
<td>13,963</td>
</tr>
<tr>
<td>5.</td>
<td>Other</td>
<td>1,310</td>
<td>1,578</td>
<td>1,997</td>
<td>3,317</td>
<td>4,116</td>
<td>5,613</td>
</tr>
</tbody>
</table>

**Total All Countries** | 53,996 | 54,569 | 54,982 | 56,868 | 61,855 | 66,350

**Source:** National Mutual Fund Associations and European Fund and Asset Management Association (EFAMA)
Now let us observe the following graph that shows the mutual fund assets by region.

**Graph 1.2**

*Worldwide Mutual Fund Assets by Region, 2007*

Graph 1.2 shows that by region, 51 percent of worldwide assets were in America in the fourth quarter of 2007, 34 percent were in Europe and 14 percent in Africa and Asia/Pacific. Mutual fund assets worldwide increased 1.6 percent to $26.20 trillion at the end of the fourth quarter of 2007. For the year as a whole, assets grew at a rate of 20.1 percent. Net cash flow to all funds worldwide stood at $383 billion in the fourth quarter of 2007, an increase of $316 billion in the third quarter of 2007. On an annual basis, net cash flow to all funds was $1.54 trillion in 2007, an increase of 18.5 percent from 2006. It is evident from the above tables that the mutual funds have grown tremendously and in developed countries like the U.S.A there are funds to satisfy everybody’s requirement.

1.5 Evolution of Mutual Fund Industry in India

The mutual fund revolution that was sweeping the other countries bypassed India also. 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.

UTI commenced its operations from July 1964 in order to encourage savings and investment. Different provisions of the UTI Act laid down the
structure of management, scope of business, powers and functions of the trust as well as accounting, disclosures and regulatory requirements for the trust. Even though the growth of the mutual fund industry was very slow in the beginning, it accelerated when the public sector and private sector mutual funds entered the market after the year 1987.

The mobilization of funds and the number of players operating in the industry reached new heights as investors started showing more interest in mutual funds. Investors' interests were safeguarded by SEBI and the Government offers tax benefits to the investors in order to encourage them. SEBI also introduced SEBI (Mutual Funds) Regulations, 1996 and set uniform standards for all mutual funds in India. The Union Budget in 1999 exempted all dividend incomes in the hands of investors from income tax. Various Investor Awareness Programs were launched during this phase, both by SEBI and AMFI, with an objective to educate investors and make them informed about the mutual fund industry.

In February 2003, the UTI Act was repealed and UTI was stripped of its special legal status as a trust formed by an Act of Parliament. The primary objective behind this was to bring all mutual fund players on the same level. UTI was re-organised into two parts:

The Specified Undertaking and the UTI Mutual Fund

The industry also witnessed several mergers and acquisitions. Some of them are: acquisition of schemes of Alliance Mutual Fund by Birla Sun Life,
Sun F&C Mutual Fund and PNB Mutual Fund by Principal Mutual Fund. Simultaneously, more international mutual fund players have entered India like Fidelity, Franklin Templeton Mutual Fund etc. There were 32 funds as on December 2007. This is a continuing phase of growth of the industry through consolidation and entry of new international and private sector players and Mutual funds in India are increasingly becoming a preferred investment option with growing risk appetite, rising income, and increasing awareness compared to other investment vehicles like fixed deposits and postal savings that are considered safe but give comparatively low returns.

The following table shows a brief synopsis of the history of mutual funds in India.

### Table 1.2

**Synopsis of the History of Mutual Funds in India**

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Year</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1963</td>
<td>Launch of India’s first mutual fund – UTI</td>
</tr>
<tr>
<td>2</td>
<td>1964</td>
<td>Launch of US-64</td>
</tr>
<tr>
<td>3</td>
<td>1986</td>
<td>Launch of UTI Master share</td>
</tr>
<tr>
<td>4</td>
<td>1987</td>
<td>In 1987 the Mutual Fund Industry was opened to other Public Sector Banks &amp; Financial Institutions. 7 such funds commenced.</td>
</tr>
<tr>
<td>5</td>
<td>1993</td>
<td>In 1993 Securities and Exchange Board of India notified ‘Mutual Fund Regulations’.</td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td>Private Sector players were permitted to enter the Mutual fund industry.</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>Morgan Stanley is the first foreign player</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>SEBI's mutual fund regulations comes into effect</td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>India's first index fund - UTI Master Index Fund launched</td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>First Take over happens – Zurich Mutual fund takes over 20th century Asset Management company</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>The Assets under Management crosses Rs. 1,00,000 crore</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>US 64 scam leads to UTI overhaul</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>UTI bifurcation comes under SEBI preview</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>In 2003 the UTI Act was repealed, it marked the end of assured returns schemes, UTI mutual fund came into being.</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>Securities transaction costs introduced</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>The industry’s AUM crosses 2,00,000 crore</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>The industry’s AUM crosses 3,00,000 crore</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>Mutual funds launch Gold ETFs that will invest in overseas securities</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>The industry’s AUM crosses 5,00,000 crore</td>
<td></td>
</tr>
</tbody>
</table>

1.6 Geneses of the Problem

The Indian Mutual Fund Industry is one of the fastest growing segments of the Indian economy. During the last ten year period the industry has grown at nearly 22\(^8\) percent CAGR. India ranks 19th\(^9\) and is one of the fastest growing, among the countries of the world. But when compared with the United States of America, the AUM in the US is more than 200\(^{10}\) times than the Indian counterpart. In the product offering too, the Indian fund industry is not close to the US. Even though the total net assets of mutual fund has grown by 366.85\(^{11}\) percent in India between 1998-2005 as compared to 85.22 percent growth worldwide, the total net assets of mutual funds during the same period is very less as compared to other developed countries.

From the above discussion it is evident that the Indian mutual fund industry is still in an evolutionary phase. The Indian fund industry has to scale new heights to narrow the gap with the other developed countries. On an average even if it is able to reach at least 20 per cent levels of a country like Brazil without taking in to consideration the US or the UK Indian mutual funds will be able to secure a better position world-wide.

To achieve this, focused advertising, better customer service, newer distribution channels, consistent returns, new product offerings catering to the needs of the investment community and asset manager specialization is

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\(^8\) The Evolution of India’s Mutual Fund Industry, XXII IIFA Conference Montreal, Canada October 6 – 9, 2008

\(^9\) The Evolution of India’s Mutual Fund Industry, XXII IIFA Conference Montreal, Canada October 6 – 9, 2008


important at this point of time. As the industry moves from the growth to the maturity phase, competition has become fierce. To stand out from the clutter, a strong brand image has to be developed by the fund managers. The distribution channels in India also have to improve substantially as the funds have so far not been able to reach the smaller towns. Besides, mutual funds can survive only if they satisfy the expectations of the investors so it is important on the part of the fund managers and mutual fund product designers to combine various elements of liquidity, return and security in making mutual fund products the best possible alternative for the small investors in the Indian market.

The industry is also plagued by scarce technological infrastructure and needs to collaborate with other sectors of the economy such as banking and telecommunications. The mutual fund industry also faces some major challenges in terms of manpower crunch, diminishing talent pool of fund managers, pressure of consolidation, innovation and product differentiation as increasing responsibility is being placed on the trustees to ensure that the funds are managed to the full benefit of the unit holders.

From the above discussion it is very obvious that India’s 32 member mutual fund industry is struggling to reshape the fault lines in the industry and to reshape the market dynamics. It is essential to make this Industry the strongest and the most preferred instrument in Indian capital market for the coming years. In this context the researcher has made an attempt to study the performance of Indian mutual industry to find out whether the factors discussed above has been achieved already by this industry or whether there is still a long
way to go for the industry. A sincere attempt has also been made by the researcher to evaluate the performance of ICICI Prudential mutual fund, Franklin Templeton mutual fund and HDFC Mutual fund for the period 2002-2007. This study therefore may prove to be highly interesting and aims at generating fresh ideas about the fund industry.

1.7 Scope of the Study

The focus of this study is to examine and evaluate the Indian mutual fund industry. An attempt has been made to examine the steady growth of the industry, the innovations and the development that has taken place in India. An in-depth analysis of the performance of Franklin Templeton, HDFC and ICICI Prudential mutual funds has been carried out in this study for five-year period starting from Jan. 2002 to December 2007. This study consists of a detailed examination about the sample companies’ products, descriptions and various charts and tables that depict the performance of the companies. The idea behind performance evaluation of these companies is to find out the risk adjusted return levels at which they are delivered in comparison to their benchmark indices. A study of these companies will also give an actual insight in to the performance of these companies.

The analysis of investor preferences has also been carried out considering all-important factors such as their perceptions, behaviour, preferences among mutual fund organisations and preferences among scheme types etc with regard to ICICI Prudential mutual funds, HDFC mutual funds and Franklin Templeton mutual funds.
Similarly, the analysis of distributors has also been carried out in order to find out the role played by them in influencing an investor's investment decision. This aspect is especially very important in order to find out the strategies used by the distributors, which affects the investor's choice of mutual fund organisation.

Based on the analysis, inferences have been drawn and suggestions have been made for the benefit of both the industry players as well as the investors. The study aims at presenting suggestions not only for the functional improvement of the fund industry but also to create awareness about the conceptual and technical aspects of the mutual funds. Thus it can be said that the present study is interesting and relevant to all the parties associated with the fund industry like the policy makers, the fund managers, distributors and the investors and help them to rectify their respective areas of weaknesses.

1.8 Objectives of the Study

Against this background, the following objectives have been framed by the researcher:

1. To study the organisation, management and regulation of mutual funds in India.

This objective focuses on the basic understanding of the concepts, structure, management, regulation and working pattern of Indian mutual funds. This objective is important from the researcher's point of view because conceptual awareness, overall understanding and the knowledge of various
regulations in effect is required for a subject of this nature before the actual research work is carried out.

2. **To study the services offered by mutual funds.**

   Mutual fund services have been undergoing a sea change in the Indian market place and the asset management companies are finding their niche in delivering unique products and service offerings. An attempt has been made to list out the benefits and the services offered by the mutual funds to the unit holders because information about the products and services offered by the mutual fund companies gives a glossary about the queries that exists in the minds of individual investors.

3. **To examine the growth and development of Indian mutual funds in terms of resource mobilisation and assets under management.**

   The present study attempts to provide an in-sight in to the industry. It discusses in detail the growth and development of the Indian mutual fund industry in terms of resource mobilization and assets under management since the inception of UTI, the first mutual fund of the country. The challenges faced by the industry will also be analysed to highlight the areas where improvement is required.
4. To understand the inception, growth and performance of Franklin Templeton, HDFC and ICICI Prudential Asset management companies.

Since this research mainly focuses on Franklin Templeton, HDFC and ICICI Prudential Asset management companies, it is necessary to first understand the background, the products offered and the working pattern of these companies. The sample schemes of these companies taken up for the purpose of the study will be analysed next in terms of CAGR returns in comparison against their benchmarks for the period 2002-2007. This aspect of the study will help the researcher to understand the performance of these schemes without considering risk factor.

5. To evaluate the performance of the sample schemes of Franklin Templeton, HDFC and ICICI Prudential mutual funds and to measure the risk/volatility in order to arrive at the appropriate risk-adjusted rate of return using W.F. Sharpe’s method.

This is an important objective of the study from the researcher’s point of view since the hypothesis is drawn based on this objective. In order to test the hypothetical statement an attempt is made by the researcher to evaluate the performance of the sample schemes by using the Sharpe ratio which measures the excess return per unit of total risk. Sharpe ratio represents the trade off between risks and returns. The main advantage of the Sharpe ratio is that it brings different schemes on an even level, and it helps the researcher to find
out whether the excess returns earned are due to smart investment decisions, or due to excess risk undertaken by the fund manager.

The following aspects of the study will also be examined by the researcher.

1. To identify the preferred investment avenues among individual investors.
2. To identify the investment objectives of the investors.
3. To find out the investors risk perceptions of mutual funds.
4. To identify the product qualities that affects the selection of mutual funds and specific schemes.
5. To identify the most popular mutual fund among the three selected companies from both the distributors and investors perception.
6. To identify scheme preferences of investors among the three selected companies.
7. To find out the investors image of the three companies chosen for the study.
8. To find out whether the investors are satisfied with the performance of the three mutual fund companies selected for the purpose of the study.
9. To assess the influence of distributors in fund / scheme selection of the investors.
10. To identify investor related services offered by the distributors.
11. To find out whether the distributors recommend the funds chosen for the purpose of the study to the investors.

12. To ascertain investor preferences of schemes and funds from the distributor.

13. To find out whether the funds chosen for the purpose of the study are better performers than other private, public and foreign players.

14. To ascertain the views of the mutual fund investors and distributors about the current and the future state of mutual fund industry.

15. To highlight the challenges faced by the Indian mutual funds.

16. To offer suggestions to rectify the weak lines of the system.

17. To offer appropriate suggestions and recommendations based on the findings of the study.

1.9 Research Design/Methodology

Research design is highly essential as it is the blueprint for collection, measurement and analysis of data in order to obtain answers to research questions. The present study is both descriptive and analytical. The research design of this study has been classified into four subsections they are:

1. Research hypotheses of the study

2. Sampling size, composition and procedure

3. Method of data collection

4. Technique of analysis
1. **Research Hypotheses of the Study**

Keeping in mind the objectives of the study, the researcher has framed the following hypotheses.

1) **THE SHARPE RATIOS OF THE SAMPLE SCHEMES HAVE OUTPERFORMED THE SHARPE RATIOS OF THEIR RESPECTIVE BENCHMARKS.**

2) **THE INDIVIDUAL INVESTOR’S SELECTION OF MUTUAL FUNDS IS BASED ON HIS PERCEPTION ABOUT THE FUNDS IN TERMS OF BRAND IMAGE.**

2. **Sampling Size, Composition and Procedure**

   (i) **Mutual fund companies**

   For the purpose of the study the non-probability method of purposive or judgement sampling has been chosen and three big and active players in the market were selected. They are Franklin Templeton, HDFC and ICICI Prudential Mutual Funds. The procedure adopted in selection of schemes is described below:

   Based on the judgement sampling, the following procedure has been adopted in selection of schemes:
Even though the selection of sample schemes was based on judgement sampling, the researcher would like to present the reason behind this selection of the sample. First, before deciding on the title of the study the researcher did an extensive research to find out some of the best performing companies. For this the researcher had to depend on the secondary sources namely reports like SEBI Bulletin, SEBI’s Hand book of statistics, mutual fund updates, leading mutual fund magazines like Mutual Fund Insight, Outlook Money, Dalal Street, Capital Market and Internet sites like Value Research online, Mutualfundindia.com etc. Based on the researcher’s perception and understanding of the toppers and laggards at that point of time these sample companies were selected. The total number of schemes including options of these sample companies as on December 31, 2007 is as follows:

- ICICI Prudential AMC – 374
- HDFC AMC – 287
- Franklin Templeton AMC – 213

The sample schemes selected for the purpose of the study is shown below in the following figure.
As mentioned earlier, the emphasis of the study is to specifically examine the performance of the above companies. Taking into consideration the limitations in a research and since it is practically not possible to examine all the schemes of these companies the researcher first classified all the schemes as equity, debt, and balanced. The next step was to filter the schemes which had no common parameters to form a basis of comparison among the three companies. Next, four debt funds, four equity funds and one balanced fund from each of the category along with their plans and options for each of the company was selected. Only growth options are considered in this study.
The objective-wise classification was made to facilitate peer group comparison. The selection criterion of the schemes is based on common parameters which can be used to compare the same class of the schemes across different companies. But from a broader perspective comparison of the parameters based on all categories is not possible because the objectives of the schemes may be common between one scheme and another say for example monthly income plan of one company and another company but the period or the sub clauses differ which leads to inappropriate comparison. So the researcher has selected the above schemes and has attempted to analyse the scheme performance and if any common factor is diagnosed across the companies the said parameter will be used for comparison.

As regards the analysis, the performance of the schemes will be measured by observing the risk-adjusted rates of return they are able to earn during the duration of the test period (five years) using the Sharpe’s performance measure in order to arrive at a conclusion. This reward to variability ratio measures the excess return per unit of total risk (Standard Deviation).

(ii) **Mutual fund individual investors and distributors**

As investors respond differently to fund performance across fund types, it is important for a study of this nature to find out the perceptions of investors also. Besides the perceptions of the distributor’s who are responsible in influencing the investor’s decision making will also be examined in this study. Therefore by using the random sampling method, the pre-tested questionnaires
were administered on individual mutual fund investors and AMFI registered mutual fund distributors.

As regards the sample size, the main sample in the survey covered 50 distributors geographically spread across Mumbai city and 125 educated individual investors. In the case of investors, they were screened and the inclusion was purely based on their knowledge about mutual funds. This was necessary, because the questionnaire presumed awareness of some basic terminology about mutual funds. The investors sample also covered a wide range of income groups, age groups and occupation groups. The personal income and investments of investors were not enquired in the questionnaires because of the confidential nature of information. This careful selection of sample is not only due to the time and financial constraints but also to pick up only the investors who have invested in these three companies. The criterion that was kept in mind during the process of selection was - the investor should have invested at any point of time in all the above three sample companies or at least a minimum of two.

The survey was based on direct personal interviews with the investors using the interview schedule method. The survey was conducted during the period December 2007 to January 2008. The questionnaires had both open-ended and close-ended questions. The following figure shows the sample size of both the mutual fund investors and the distributors.
Thus from the above figure it can be observed that out of 125 mutual fund investors, 101 were male investors and 24 were female investors. The distributor sample covered 43 male distributors and 7 female distributors.

3. Method of Data Collection

The data for this study is gathered both from the primary and secondary sources. Generally, data can be collected in different ways for the subject of study. One method is to observe subjects on certain parameters, which is called observation studies and the other method is the questionnaire method. The researcher has selected the second method in this study.
1. Primary data collection

The survey method was used for primary data collection in this study. Two surveys were conducted for which two sets of questionnaires were prepared. One set for the mutual fund individual investor and the second one for the mutual fund distributor. The unit of observation and analysis of survey was only among individual investors whose definition is “An individual who has currently invested in any mutual funds and this does not include institutional investors” and in case of distributors, AMFI registered distributors.

The questionnaires had both open-ended and close-ended questions. Both the questionnaires were partially overlapping and administered by different means for accuracy. Both the sets of questionnaires were then pre-tested. The pre-tested questionnaires were then administered on the sample. The methodology for both the surveys was similar. They were based on direct personal interviews with distributors and investors using the interview schedule method. The survey was conducted during the period December 2007 to January 2008.

Some of the objectives of the survey were:

- To identify and understand the perceptions, behaviour, preferences among mutual fund organisations and preference among scheme types etc with regard to ICICI Prudential mutual funds, HDFC mutual funds and Franklin Templeton mutual funds.

- To identify and understand the distributor’s perceptions, strategies and the influence they have on the investor’s decision making which
also enables us to understand the distributor’s views on investor’s perception regarding the sample companies and their performance chosen for the purpose of the study.

2. Secondary data collection

Since the primary objective of the study is to evaluate the performance of the sample schemes for the period January 2002 to December 2007 of selected mutual funds, the CAGR returns along with the index value of the benchmark indices were obtained from the following sources:

3. Annual Reports and offer documents of Various Mutual Funds

4. SEBI’s Handbook of Statistics

5. AMFI updates.

6. Monthly fact sheets of ICICI Prudential mutual fund, HDFC and Templeton AMC’s.

7. Internet sites
   - www.nse.india.com
   - www.mutualfundsindia.com
   - www.amfi.com
   - www.bseindia.com
   - www.sebi.gov.in.com
   - www.icicibank.com
   - www.icicipruamc.com
   - www.hdfcmutualfund.com
Further, the finance journals, magazines, newspapers, market reports, fund fact sheets and the annual reports of other mutual fund companies were also scrutinised. The data thus collected will be analysed with the help of statistical tools.

4. **Technique of Analysis**

The performance of the funds will be measured by observing the rates of return they are able to earn during the duration of the test period (**five years**) using the **Sharpe's Ratio method of performance evaluation**. This method utilizes a risk-adjusted return measurement and it is considered to be the most popular technique to measure portfolio performance. Sharpe Ratio is computed
using the formulae:

Sharpe ratio of the mutual fund scheme = \( \frac{(R_p - R_f)}{SD_p} \)

The benchmark comparison is = \( \frac{(R_m - R_f)}{SD_m} \)

- Where \( R_p \) is the average return of the mutual fund scheme portfolio
- Where \( R_m \) is the average return of the benchmark portfolio
- \( R_f \) is the average risk free rate
- \( SD_p, SD_m \) is the standard deviation of the portfolio.

The investors and the distributors’ responses will be analysed using statistical methods.

1.10 Chapterization

The researcher has organized the research study into the following chapters:

Chapter 1: Introduction

This chapter traces the history of mutual funds where the beginning and arrival of modern mutual funds are reviewed. It also provides factual background about the evolution of Indian mutual fund industry. This is followed by the geneses of the problem and the scope of the study. Next the objective of the study and the research methodology that includes sample size, composition, procedure and the sources of data collection are highlighted.

Chapter 2: Review of Literature

The researcher has made an attempt to review the literature that is available in the form of journals, reference books, periodicals, published
reports, news papers and magazines. For this purpose, the review is divided into two broad sections such as review of literature on mutual funds in India and review of literature on mutual funds in other countries followed by concluding remarks.

Chapter 3: Conceptual and Structural Framework of Mutual Funds

This chapter attempts to examine the conceptual background, regulation and structure of mutual funds. First the concept of mutual fund is introduced and then the constitution and management of mutual funds is discussed in detail. It provides in a detailed yet precise format of the products offered by the fund industry. The facilities and the services they offer are also discussed. In short the aim of this chapter is to get a good understanding about mutual funds in India.

Chapter 4: Overview of Indian Mutual Fund Industry

This chapter highlights the growth and the important developments that have taken place in the Indian mutual fund industry since the launch of UTI, India’s first mutual fund. It also describes the pertinent changes that have taken place in the recent past in the fund management industry in India. The challenges faced by the industry are also presented in this chapter. The aim of this chapter is to gain insight into the fund management industry.
Chapter 5, 6, 7: Profile of ICICI Prudential Asset Management Company, HDFC Asset Management Company and Franklin Templeton Asset Management (India) Pvt. Ltd.

The main focus of this study is to understand and examine the profile of ICICI Prudential Asset Management Company, HDFC Asset Management Company and Franklin Templeton Asset Management (India) Pvt. Ltd. For this purpose, the researcher has made sincere attempt to understand the inception, functioning, products offered and the performance of the above companies. The researcher has also selected the growth options of four debt schemes, four equity schemes and on balanced scheme from each company specifically with common parameters and has tried to examine the performance of these schemes in terms of CAGR returns in comparison to their benchmark returns from the period 2002-2007. A study of these organizations will help the researcher not only to understand the different schemes, their performances and other relevant aspects that will give the researcher a broad idea behind the success of these companies and the facts that has made this success possible.

Chapter 8: Performance Evaluation of Sample Schemes using Sharpe Ratios

An attempt is made in this chapter to evaluate the performance of the sample schemes of the selected companies by using the Sharpe ratio which measures the excess return per unit of total risk. Sharpe ratio represents the trade off between risks and returns. The risk free return and the standard
deviation computed are used to arrive at the Sharpe Ratio. The main advantage of the Sharpe ratio is it helps the researcher to find out whether the excess returns earned are due to smart investment decisions, or due to excess risk undertaken by the fund manager.

Chapter 9: Comparison of Mutual Fund Sample Schemes based on Sharpe Ratio

The researcher has attempted to further extend the investigation in this chapter by classifying the schemes which aims at grouping funds with comparable investment objectives using the results of Sharpe ratios. Peer comparison is also done in this chapter to get meaningful results. The key objective of this chapter is to facilitate a transparent comparison of schemes.

Chapter 10: Comparison of ICICI Prudential Asset Management Company, HDFC Asset Management Company and Franklin Templeton Asset Management (India) Pvt. Ltd. based on Investors Response

This chapter is devoted to compare the mutual fund organisations based on the observations made from the survey conducted on the mutual fund investors to identify and understand their perceptions, behaviour and preferences among the above mutual fund organisations. The results of the survey will serve as a benchmark for the fund managers to focus more on the areas of their weakness and understand more about the perceptions of the investors and design products accordingly.
Chapter 11: Comparison of ICICI Prudential Asset Management Company, HDFC Asset Management Company and Franklin Templeton Asset Management (India) Pvt. Ltd. based on Distributors Response

This chapter presents the observations made from the mutual fund distributor’s survey. The analysis of distributors has been carried out in order to find out the role played by them in influencing an investor’s investment decision. This aspect of study is very important in order to find out the strategies used by the distributors, which affects the investor’s choice of mutual fund organisation. So the researcher has attempted in this chapter to compare the sample mutual fund companies based on distributor’s response.

Chapter 12: Conclusions and Findings

On the basis of the observations made, this chapter summarises the major findings of the study along with the conclusions. The observations thus made are further divided in to general and specific conclusions and findings.

Chapter 13: Suggestions and Recommendations

On the basis of the conclusions and findings, the researcher has offered suggestions and recommendations that are necessary for the healthy growth of the mutual fund industry in India.
1.11 Limitations of the study

The major limitations of the study are as follows:

1. Secondary data was collected only from the investors and distributors residing in Mumbai region. Due to geographical constraints the investors and the distributors from other parts of the country could not be covered.

2. Another major limitation of the study is there are other popular performance measures for evaluating the performance of mutual funds but only one technique has been used in this study to evaluate the schemes selected for the purpose of the study.

3. Another limitation of the study is the sample size of the mutual fund companies. Only three big companies have been selected for the purpose of the study due to the general limitations of a research work like for e.g. time, availability of resources, period of study and geographical limitations. The underlying assumption here is by examining the profile of these three companies, an understanding of the industry in general is attained.

4. Since it is very difficult to evaluate all the schemes of the sample companies, only few schemes have been selected for the purpose of the study.
1.12 Conclusion

The Indian Mutual fund industry has started opening up many exciting investment opportunities for Indian investors. The industry has started witnessing the phenomenon of savings now being entrusted to the funds rather than in banks alone. The scenario is changing slowly and mutual funds have now become one of the most appropriate investment vehicles for most investors. As financial markets have become more sophisticated and complex, there is more scope for research. Keeping in mind the above factors and the objectives of the study, the following chapters will try to examine various aspects such as the regulation, overview of the industry and the profile of the sample companies chosen for the purpose of the study.