CHAPTER 3
CONCEPTUAL AND STRUCTURAL FRAMEWORK OF MUTUAL FUNDS

3.1 Introduction
3.2 Conceptual Background of Mutual Funds
3.3 Return on Mutual Funds
3.4 Mutual Funds as a Service
3.5 Advantages of Mutual Funds
3.6 Disadvantages of Mutual Funds
3.7 Risks Associated with Mutual Funds
3.8 Structure of Mutual Fund in India
3.9 Regulations of Mutual Funds
3.10 The Association of Mutual Funds in India
3.11 Products
3.12 Benchmarking a Fund
3.13 Fees Associated with Mutual Funds
3.14 Distribution in the Mutual Fund Industry
3.15 Conclusion
CHAPTER 3
CONCEPTUAL AND STRUCTURAL FRAMEWORK OF MUTUAL FUNDS

3.1 Introduction

Mutual funds have opened new avenues to millions of small investors as the other investment avenues that are available in our system are very complicated and requires understanding. An average investor is generally clueless as to how the stock market functions and the risks associated with it can endanger the hard-earned money. The other options that are available are the bank rates but the bank rates have fallen down and are generally below the inflation rate. When the bank rates fall down, the value of money also decreases over a period of time which in turn affects the returns of the investor. This is where Mutual Funds come into picture because returns in the mutual funds are generally better than any other option in any other avenue over a reasonable period of time. Mutual funds make savings and investing simple, accessible, and affordable. Mutual funds are an alternative to investing directly. So in order to understand the concept of mutual funds the researcher has attempted in this chapter to provide an overview of the basics of mutual fund, the products that are available and the major transformation and structural changes witnessed in the last two decades.
3.2 Conceptual Background of Mutual Funds

A Mutual Fund is a professionally managed investment vehicle which allows a group of investors to pool their money together with a clear common financial objective - to make money. It consists of an extensive collection of stocks and/or bonds, which is managed by a professional or group of professionals called fund managers. Each investor holds shares, which forms a portion of the holdings. The mutual fund was created for those investors who feel investing their money by themselves to be too risky or just not savvy enough, but who still want to take benefit of the share market.

The Security and Exchange Board of India (Mutual Funds) Regulations, 1996 defines a mutual fund as a “a fund established in the form of a trust to raise money through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments." Thus mutual fund is a special type of institution that pools the savings of a number of investors who share a common financial goal and invests them in a well-diversified portfolio to obtain optimum return on investments.

3.3 Return on Mutual Funds

An investor in mutual fund earns return from two sources:

- Income from dividend paid by the mutual fund.
• Capital gains arising out of selling the units at a price higher than the acquisition price.

The figure given below shows the working pattern of mutual funds and the parties directly and indirectly associated with it.

Figure 3.1

Working of Mutual Funds

The working pattern of the fund is very simple. First Mutual funds are designed to meet the needs of large, medium and small investors with the objective of either growing its assets (capital gains) and/or generating income (dividends) for its investors. These investors buy units of a particular mutual fund scheme that has a defined investment objective and strategy. The money thus collected is managed by professional fund managers who in turn invest them in diversified securities. Each fund is divided into a small fraction called
“units” of equal value. Each unit holder is allocated units in the proportion to the size of his investment. Thus, every investor, whether big or small, will have a stake in the fund and can enjoy the wide portfolio of the investment held by the fund. Their investments provide the money for a mutual fund to buy securities such as stocks and bonds. Distributions in the form of capital gains (short-term and long-term) and dividends may be passed on (paid) to 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. The income thus earned through these investments and the capital appreciation realized by the schemes is shared by its unit holders in proportion to the number of units owned by them. Like all other investments, investing in mutual funds involves risk. While risk cannot be eliminated, skillful management can minimize the risk.

Thus it can be said that a mutual fund is the most suitable investment for the common person as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost and they are becoming popular among the savings community in our economy especially with the middle and small income segments.
3.4 Mutual Funds as a Service

Mutual fund services have been undergoing a sea change in the Indian market place. Since mutual funds have greater characteristics of being a service rather than a product, mutual funds can also be viewed from a different dimension called service. The reason is mutual funds primarily sell service to the investors such as the service of organizing the funds, pooling of resources, and managing assets and investments of the investors. Services offered by mutual funds vary across funds. Some mutual funds are more investor friendly than others, and offer information at regular intervals. For instance, some funds disclose the expense ratios, an important criterion for fund selection, once a year, some disclose it once every 3 months, while a few disclose it every month.

The most important service offered by mutual funds is (PMS) - Portfolio management service which is a type of professional service offered by portfolio managers to their client to help them in managing their money in less time. Portfolio managers manage the stocks, bonds, and mutual funds of clients considering their personal investment goals and risk preferences. In addition to money, the portfolio managers manage the portfolio of stocks, bonds, and mutual funds. Easy and convenient portfolio management, in the form of specialist investment knowledge, while at the same time taking care of administrative issues.
The other services provided by the mutual funds are:

1. Portfolio diversification
2. Marketability
3. Redemption of units within 24-48 hours
4. Switching between accounts/plans and options
5. Toll-free telephone numbers
6. Check-writing privileges
7. Automatic investment programs
8. Demat form of holding mutual funds
9. Buying/Selling and Redeeming units through net
10. Reporting performance to the investors through monthly fund fact sheets
11. Communication of financials
12. Easy accessibility through distributors, ATM and Post offices

3.5 Advantages of Mutual Funds

Mutual funds offer several advantages that make them a powerful and convenient wealth creation vehicle. Thus mutual funds act as a gateway to enter into big companies hitherto inaccessible to an ordinary investor with his small investment. More specifically, some of the important advantages of mutual funds are listed below in the Figure:
1. Well regulated

Mutual funds are regulated by securities and Exchange Board of India (SEBI). The rules and regulations framed and enforced by SEBI protect the interests of the investors. Regulations for mutual funds have made the industry very transparent.
2. **Well diversified**

A crucial element in investing is asset allocation. It plays a very big part in the success of any portfolio. However, small investors do not have enough money to properly allocate their assets. By pooling funds with others, the investor enjoys the benefit from greater diversification. Mutual funds invest in a broad range of securities. This limits investment risk by reducing the effect of a possible decline in the value of any one security. Mutual fund unit-holders can benefit from diversification techniques usually available only to investors wealthy enough to buy significant positions in a wide variety of securities.

3. **Choice of schemes**

Mutual funds provide investors with various schemes with different investment objectives. Investors have the option of investing in a scheme having a correlation between its investment objectives and their own financial goals. These schemes further have different plans/options. The availability of these options makes them a good option. While equity funds can be as risky like the stock markets themselves, debt funds offer the kind of security that is generally aimed at the time of making investments. Money market funds offer the liquidity that is desired by big investors who wish to park surplus funds for very short-term periods.

4. **Professional management**

The investment decisions in a Mutual Fund are made by professionally qualified managers with sound experience. Fund manager carries out extensive
research work and has better investment management skills which ensure higher returns to the investor than what he can manage on his own. The transaction costs are low because they deal in large volumes. The earnings of the fund are distributed to the investor after deducting the expenses. A mutual fund investor can enjoy the benefits of high return from investment in shares and other instruments, and at the same time reduce the risk associated with it to a minimum. Two components of returns are capital appreciation and revenue income.

5. **Less risk**

Investors acquire a diversified portfolio of securities even with a small investment in a mutual fund. The risk in a diversified portfolio is lesser than investing in merely 2 or 3 securities.

6. **Low transaction costs**

Due to the economies of scale (benefits of larger volumes), mutual funds pay lesser transaction costs. These benefits are passed on to the investors.

7. **Liquidity**

An investor may not be able to sell some of the shares held by him very easily and quickly, whereas units of a mutual fund are far more liquid.

### 3.6 Disadvantages of Mutual Funds

Some of the important disadvantages of mutual funds are listed below:
1. **Cost Control is not in the hands of an investor**

   Investor has to pay investment management fees and fund distribution costs as a percentage of the value of his investments (as long as he holds the units), irrespective of the performance of the fund.

2. **No customized portfolios**

   The portfolio of securities in which a fund invests is a decision taken by the fund manager. Investors have no right to interfere in the decision making process of a fund manager, which some investors find as a constraint in achieving their financial objectives.

3. **Difficulty in selecting a suitable fund scheme**

   Many investors find it difficult to select one option from the plethora of funds/schemes/plans available. For this, they may have to take advice from financial planners in order to invest in the right fund to achieve their objectives.

3.7 **Risks associated with mutual funds**

   Like any business, mutual funds have risks and costs associated with returns. As a shareholder, the risks of a fund directly have an impact on the shareholder’s return. Risk refers to the possibility of loosing money (both principal and any earnings) or failure to make money on an investment. A fund's investment objective and its holdings are influential factors in determining how risky a fund is. Generally speaking, risk and potential return are related. This is the risk/return trade-off. Following is a glossary of some risks to consider when investing in mutual funds.
- **Country risk**: The possibility of political events (War, Terrorism, etc.), financial problems (rising inflation, government default), or natural disasters (an earthquake, a poor harvest) will weaken a country's economy and cause investments in that country to decline.

- **Income risk**: The possibility that a fixed-income fund's dividends will decline as a result of falling overall interest rates.
- **Industry risk**: The possibility that a group of stocks in a single industry will decline in price due to developments in that industry.

- **Inflation risk**: The possibility that increases in the cost of living will reduce or eliminate a fund's real inflation-adjusted returns.

- **Fund manager risk**: The possibility that an actively managed mutual fund's investment adviser will fail to execute the fund's investment strategy effectively resulting in the failure of stated objectives.

- **Market risk**: The possibility that stock fund or bond fund prices overall will decline over short or even extended periods. Stock and bond markets tend to move in cycles, with periods when prices rise and other periods when prices fall.

- **Principal risk**: The possibility that an investment will go down in value, or "lose money," from the original or invested amount.

### 3.8 Structure of Mutual Funds in India

The mutual fund industry is a young industry where there are frequent changes in the rules of the game and there are constant shifts and upheavals. The mutual fund is structured around a fairly simple concept, the mitigation of risk through the spreading of investments across multiple entities, which is achieved by the pooling of a number of small investments into a large bucket. The structure of mutual funds in India is regulated by SEBI (Mutual Fund) Regulations, 1996. These regulations require a fund to be established in the form of a trust under the Indian Trust Act 1882. A mutual fund operates
through a four-tier structure. The following figure gives us a fair idea about the structure of the mutual fund industry in our country.

Figure 3.4
Structure of Mutual Funds in India

1. **Sponsor**

SEBI regulations define sponsor as any person who either itself or in association with another body corporate establishes a mutual fund. In simple words, a sponsor is an entity that sets up the mutual fund. Sponsor does the following important activities:

- Sponsor creates a Public Trust under the Indian Trust Act, 1882.
- Sponsor appoints trustees to manage the trust with the approval of SEBI.
- Sponsor creates an Asset Management Company under the Companies Act, 1956.
2. **Trust/trustee**

The Trustees manage a trust. Trustees can be formed in either of the following two ways:

- **Board of Trustees** (Governed by the provisions of Indian Trust Act, 1882), and
- **Trustee Company** (Governed by the provisions of Indian Trust Act, 1882 and Companies Act, 1956)

The sponsor with prior approval of SEBI appoints trustees. There should be at least four members in the board of trustees. At least 2/3rd of the trustees should be independent. Trustee of one mutual fund cannot be trustee of another mutual fund, unless he is an independent trustee in both cases and has the approval of both the boards. The trustees are appointed by executing and registering a trust deed.

Functions of trustees:

- Trustees ensure that the activities of the mutual fund are in accordance with SEBI (Mutual Fund) regulations, 1996.
- Trustees ensure that the AMC has proper systems and procedures in place.
- Trustees ensure that all the other fund constituents are formed and that proper due diligence is exercised by the AMC in the appointment of constituents and business associates.
- All schemes floated by the AMC have to be approved by the trustees.
- Trustees review and ensure that the net worth of the AMC is as per the SEBI stipulated norms.
- Trustees furnish to SEBI, on a half yearly basis, a report on the activities of AMC.

3. **Asset Management Company (AMC)**

An asset management company is a company registered under the Companies Act, 1956. Sponsor creates the asset management company and this is the entity, which manages the funds of the mutual fund (trust). The mutual fund pays a small fee to the AMC for management of its fund. The AMC acts under the supervision of trustees and is subject to the regulations of SEBI too. At present there are 33 AMC’s in India. When an AMC acts as an Investment Manager to a mutual fund, then it becomes very important to see that such an AMC focuses just on its core business. It also becomes very important for the regulator to ensure that the activities of AMC’s are not in conflict with each other.

4. **Custodian**

The most important asset of any mutual fund is portfolio. Hence it becomes very important to keep safe the securities. This responsibility of keeping safe the securities, which are in the material form, are kept in safe custody with custodian. Custodian performs a very important back office
operation. They ensure that delivery has been taken of the securities, which are bought, and that they are transferred in the name of mutual fund. They keep the investment account of the mutual fund. They collect and account for the dividends and interest receivables on mutual fund investments. They also keep track of various corporate actions like bonus issue, right issue, and stock split, buy back offers, open offers etc.

3.9 Regulations of Mutual Funds

Mutual Funds in India are regulated by SEBI (Securities and Exchange Board of India). All the mutual funds in India are regulated by SEBI. SEBI has framed the SEBI (Mutual Funds) Regulations, 1996, (hereinafter referred to as SEBI Regulations) which provides the scope of the regulations of mutual fund in India.

SEBI has the following broad guidelines pertaining to mutual funds:

1) Mutual Funds should be formed as a Trust under Indian Trust Act and should be operated by Asset Management Companies (AMC’s).

2) Mutual Funds are required to set up a board of trustees and trustee companies. They should also have their board of directors.

3) The net worth of the AMCs should be at least Rs.5 crore.

4) AMCs and Trustees of a mutual fund should be two separate and distinct legal entities.

5) The AMC or any of its companies cannot act as managers for any other fund.

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98 Source: SEBI Guidelines
6) AMCs have to get the approval of SEBI for its Memorandum and Articles of Association.

7) All mutual fund schemes should be registered with SEBI.

8) Mutual funds should distribute minimum of 90 percent of their profits among the investors.

SEBI regulations provide for the following points:

- The structure and formation of mutual funds.
- Appointment of key functionaries.
- Operations of mutual fund.
- Rights and obligations of functionaries and investors.
- The restriction imposed on investment.
- The compliance to be fulfilled and the penalties imposed on non-fulfilment of the same.

3.10 The Association of Mutual Funds in India

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

AMFI is an apex body of all Asset Management Companies (AMC) which has been registered with SEBI. Till date all the AMCs that have launched mutual fund schemes are its members. It functions under the supervision and guidelines of its board of directors.
Association of Mutual Funds India has brought down the Indian mutual fund industry to a professional and healthy market with ethical lines enhancing and maintaining standards. It follows the principle of both protecting and promoting the interests of mutual funds as well as their unit holders. Some of the important objectives of AMFI are:

- To maintain a high professional and ethical standard in all areas of operation of the industry.

- To interact with SEBI and work according to SEBI’s guidelines in the mutual fund industry.

- To represent the Government of India, the Reserve Bank of India and other related bodies on matters relating to the mutual fund industry.

- To recommend and promote the top class business practices and code of conduct for the different parties associated with the mutual fund industry.

- To develop a team of well qualified and trained agent distributors.

- To conduct awareness programme for investors in order to promote proper understanding of the concept and working of mutual funds.

- To undertake studies and research either directly or in association with other bodies.
3.11 Products

Mutual funds offer a family of schemes to suit the various needs of investors. Firstly, funds are usually classified as close-ended or open-ended. The distinction depends upon whether they give the investors the option to redeem and buy units at any time from the fund itself (open-ended) or whether the investors have to wait for a given maturity period before they can redeem their units to the fund (close-ended).

Funds can also be grouped in terms of whether they collect from investors any charges at the time of entry or exit or both, thus reducing the investible amount or the redemption proceeds. Funds that make these charges are classified as load funds, and funds that do not make any of these charges are termed no-load funds.

Finally, funds can also be classified as being tax-exempt or non-exempt, depending on whether they invest in securities that give tax-exempt returns or not. Let us observe the following figure to understand the classification of mutual funds.
Under each broad classification, we may then distinguish between several types of funds on the basis of the nature of their portfolios, meaning whether they invest in equities or fixed income securities or some combination of both. Every type of fund has a unique risk-profile that is determined by its portfolio, for which reason funds are often separated into more or less risk-bearing. Now let us have a look at the classification of mutual funds.
1) **By Structure**

   a. **Open-ended fund/scheme**

   Open-ended schemes usually do not have a fixed maturity period and are available for subscription and redemption on an ongoing basis. The units can be bought and sold any time during the life of the scheme at NAV related prices which are declared on a daily basis. The key feature of open-end schemes is liquidity.

   b. **Close-ended fund/scheme**

   Close-ended mutual fund schemes have a stipulated maturity period wherein the investor can invest directly in the scheme at the time of the initial issue and thereafter units of the scheme can be bought or sold on the stock exchanges where the scheme is listed. The market price at the stock exchange could vary from the scheme’s NAV on account of demand and supply situation, unit holders’ expectations and other market factors. Usually a characteristic of close-ended schemes is that they are generally traded at a discount to NAV; but closer to maturity, the discount narrows.

2) **By Investment Objective**

   On the basis of investment objective, a scheme can also be classified as growth scheme, income scheme, or balanced scheme etc., the schemes can be
open-ended or close-ended schemes as described earlier. The schemes can be
classified mainly as follows:

Some of the important types are given below:

a. **Equity-oriented scheme**

   Equity funds provide medium to long term capital appreciation and also
   provide higher returns than other funds. Such schemes normally invest a major
   part of their corpus in equities. Such funds have comparatively high risks.
   These schemes provide different options to the investors like dividend option,
   capital appreciation, etc. and the investors may choose an option depending on
   their preferences. Some of the Equity schemes are:

   - Aggressive Growth Funds
   - Growth Funds
   - Speciality Funds
   - Sector Funds
   - Foreign Securities Funds
   - Mid-Cap or Small-Cap Funds
   - Option Income Funds
   - Diversified Equity Funds
   - Equity Index Funds
   - Value Funds
   - Equity Income or Dividend Yield Funds
b. Debt-oriented scheme

Income funds invest in medium to long-term debt instruments issued by private companies, banks, financial institutions, governments and other entities belonging to various sectors. The objective of these funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes. Although debt securities are generally less risky than equities, they are subject to credit risk by the issuer at the time of interest or principal payment. Some of the Debt schemes are:

- Diversified Debt
- Focused Debt Funds
- High Yield Debt funds
- Assured Return Funds
- Fixed Term Plan Series

c. Balanced fund

Balanced fund is a type of mutual fund that buys a combination of common stock, preferred stock, bonds, and short-term bonds, to provide both income and capital appreciation while avoiding excessive risk.

Balanced funds provide investors with an option of single mutual fund
that combines both growth and income objectives, by investing in both stocks (for growth) and bonds (for income). Such diversified holdings ensure that these funds will manage downturns in the stock market without too much of a loss. But on the flip side, balanced funds will usually increase less than an all-stock fund during a bull market. These funds are appropriate for investors looking for moderate growth.

d. Money market or liquid fund

These funds are also income funds and their aim is to provide easy liquidity, preservation of capital and moderate income. These schemes invest exclusively in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money, government securities, etc. Returns on these schemes fluctuate much less compared to other funds. These funds are appropriate for corporate and individual investors as a means to park their surplus funds for short periods.

e. Gilt fund

Also known as Government Securities in India, Gilt Funds invest in government papers (named dated securities) having medium to long term maturity period. Issued by the Government of India, these investments have little credit risk and provide safety of principal to the investors. However, like all debt funds, gilt funds too are exposed to interest rate risk. Interest rates and
prices of debt securities are inversely related and any change in the interest rates results in a change in the NAV of debt/gilt funds in an opposite direction.

f. Index fund

Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc. These schemes invest in the securities in the same weightage comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as "tracking error" in technical terms. Necessary disclosures in this regard are made in the offer document of the mutual fund scheme. There are also exchange traded index funds launched by the mutual funds which are traded on the stock exchanges.

g. Load funds/No-load funds

Mutual Funds incur various expenses on marketing, distribution, advertising, portfolio churning, fund manager's salary etc. Many funds recover these expenses from the investors in the form of entry load, exit load, deferred load etc. These funds are known as Load Funds. All those funds that do not charge any of the above mentioned loads are known as No-load Funds.

3) Special Schemes

The special schemes are given below:
➤ **Industry specific schemes**

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

➤ **Index schemes**

Index Funds attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE 50

➤ **Sectoral schemes**

Sectoral Funds are those, which invest exclusively in a specified industry or a group of industries or various segments such as 'A' Group shares or initial public offerings.

4) **Other schemes**

**Tax-exempt funds /Non-Tax-exempt funds**

Funds that invest in securities free from tax are known as Tax-exempt Funds. All open-ended equity oriented funds are exempt from distribution tax (tax for distributing income to investors). Long term capital gains and dividend income in the hands of investors are tax-free.

Funds that invest in taxable securities are known as Non-Tax-exempt Funds. In India, all funds, except open-ended equity oriented funds are liable to pay tax on distribution income. Profits arising out of sale of units by an
investor within 12 months of purchase are categorized as short-term capital gains, which are taxable. Sale of units of an equity oriented fund is subject to Securities Transaction Tax (STT). STT is deducted from the redemption proceeds to an investor.

3.12 Benchmarking a Fund

All mutual funds schemes have different objectives and therefore their performance also varies. Schemes are usually benchmarked against commonly followed market indexes like the BSE Sensex, Nifty, BSE 200, CNX 500. The relevant index can be chosen after taking into consideration the asset class of the scheme. The fund's performance can be tracked against the benchmark index. For example BSE Sensex can be used as a benchmark for an equity scheme.

3.13 Fees associated with Mutual Funds

All mutual funds in India charge a fee from the investors. These fees have been enumerated as under:

1. Load- This is charged at the time of purchasing shares in various mutual funds and is charged as a percentage of the first investment made. It is usually recognized as a kind of sales commission.

2. Management and Expense fees- This fee is charged by the mutual fund in order to manage the investments, that is, the money collected from various investors. This fee is given to the fund manager to carry out the
management procedures in investments. The management and expense fee is charged as a percentage of the fund's assets on a yearly basis.

3. Redemption fees- The redemption fee is charged while selling the shares in a mutual fund.

4. Back end loads- The back end loads are charged while withdrawing the money from the fund. This fee is charged in order to bring down the frequency of money withdrawal from the funds.

The mutual funds have distinct revenue streams and expenses. The following table reflects the AMC’s recurring expenses.

Table 3.1

AMC’s Recurring Expenses

<table>
<thead>
<tr>
<th>Sr.No.</th>
<th>Expense</th>
<th>Percent of weekly Net Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Fund management fees</td>
<td>1.25</td>
</tr>
<tr>
<td>2.</td>
<td>Marketing/Selling Expenses</td>
<td>0.80</td>
</tr>
<tr>
<td>3.</td>
<td>Audit Fees</td>
<td>0.15</td>
</tr>
<tr>
<td>4.</td>
<td>Registrar Fees</td>
<td>0.12</td>
</tr>
<tr>
<td>5.</td>
<td>Trustee Fees</td>
<td>0.11</td>
</tr>
<tr>
<td>6.</td>
<td>Custodian Fees</td>
<td>0.07</td>
</tr>
<tr>
<td>7.</td>
<td>Total Recurring Exp.</td>
<td>2.50</td>
</tr>
</tbody>
</table>

Source: www.personalfn.com
At is evident from table 3.1, the expenses of the AMC typically comprise of fund management expenses, marketing fees and audit fees among other expenses. The recurring expenses are indicative and the actual expense could be different. There are well-defined expenses and guidelines formulated by SEBI. These guidelines set limits as to what the AMC can charge the fund at a particular net asset level.

3.14 Distribution in the Mutual Fund Industry

A mutual fund distributor is an entity responsible for marketing and selling the shares of a mutual fund company. These mutual fund distributors are also known as underwriters for the fund. The distributor is responsible for the following:

- Creating prospectus for the mutual fund
- Develop extensive marketing campaigns (television, internet, magazine)
- Sell the shares directly to the public
- Provide a wholesale market to reach a larger number of investors

Fund houses are reporting an influx of distributors. Numbers are set to rule the world of mutual fund distribution in more ways than one. Not only are the assets under advice by intermediaries are expected to rise exponentially, but the number of distributors is also set to soar in tandem.
The tally of distributors registered with AMFI, the association formed by mutual funds, has touched 1, 00,000\(^{99}\).

In India, AMC’s work with five distinct distribution channels, they are direct, banking, retail, corporate and individual financial advisor. The following figure gives us an idea about the distribution structure of Indian mutual funds.

**Figure 3.6**

*Distribution Structure of Indian Mutual Funds.*

\(^{99}\) Source AMFI website
❖ The Banking channel

Banks have a large customer base and the public, private and foreign banks have entered into an agreement with various fund companies for providing distribution and servicing. This channel of distribution is believed to be the most vital distribution channel for fund companies as there are many advantages like long time relationship with the customers etc.

❖ The Retail channel

The retail channel which is also called as the distribution companies sell the schemes of several fund houses simultaneously and brokerage is paid by the AMC whose funds they sell. The retail channel offers the benefits of specialist knowledge and established client contact and, therefore private fund houses are generally prefer this channel.

❖ The Corporate channel

Corporates can either invest directly in mutual funds, or through an intermediary such as a distribution house or a bank. Corporates in general exhibit varying degrees of awareness of mutual fund products. The Corporate
Channel includes a variety of institutions that invest in shares on the company's name. These are businesses, trusts, and even state and local governments.

- **Individual Financial advisors- Distributors/Agents**

  An agent acts as an interface between the customer and the fund house. There is a unique system in place in India, wherein several sub-brokers are working under one main broker. The huge network of sub-brokers, thus ensure larger market penetration and geographic coverage. In order to be an agent or a sub-broker an individual should clear the test for certification conducted by AMFI. As per AMFI, as at the end of December 2007, the number of candidates who successfully cleared the test across 79 cities conducted by AMFI stood at 1, 14,004.

### 3.15 Conclusion

This chapter gives us conceptual clarity about the mutual funds and their benefits. The present chapter gives us also a clear idea about the regulatory framework, structure, products and the distribution channels that are available in the country. The regulatory framework is very comprehensive and matches with the best in terms of standards, practices and procedures. It is also observed that there is a wide innovation in the different categories of mutual funds in India. Thus it can be concluded that all this has resulted in healthy growth of the industry and the regulatory framework is very comprehensive and matches with the best in terms of standards, practices and procedures.