CHAPTER-1: INTRODUCTION

1.1 INTRODUCTION

Mutual funds play a crucial role in the economic development of the respective countries. The dynamic involvement of mutual funds in the development of economics can be seen by their dominant presence in the money and capital markets all over the world. Their presence is, however, comparatively stronger in the economically advanced countries.

The role of the mutual funds in the form of financial mediator, by way of resource mobilization, allocation of resources, and development of capital markets and growth of corporate sector is very noticeable. Mutual funds also play an important role in the stock market by way of ensuring stability as supplier of large resources and through steady absorption of floating stocks.

The Indian capital market has been increasing tremendously during last few years. With the economic reforms, reforms of industrial policy, reforms of public sector and reforms of financial sector, the economy has been opened up and many developments have been taking place in the Indian money market and capital market. In order to assist the small investors, mutual fund industry has come to occupy an important place. The mutual fund attracts foreign capital flow in the country and secures profitable investment avenues abroad for domestic savings through the opening of off shore funds in various foreign investors. Another notable thing is that mutual funds are controlled and regulated by SEBI and hence are considered safe. Due to all these advantages the importance of mutual fund has been increasing.

As mutual fund has entered into the Indian Capital market, growing profitable enough to attract competitors into this cherished territory encouraging competition among all the mutual fund operators, there is need to take some strategy to bring more confidence among investors for which mutual fund would be able to project the image successfully.

The twenty-first century unfolds unprecedented growth for the Indian economy along with employment opportunities, increase in non-refundable income and scope for higher savings. It set a worthy cycle with more money in the market and financial institutions offering a wide range of investment schemes designed to meet the individual’s specific
need. Beside, spread of information and education too has created awareness not only of the avenues for savings and earnings, but also the necessity for a secure future is surrounded by uncertainty. It cannot be denied that with the sensex climbing up with every day, the market has expanded rapidly; from a limited option like fixed deposits, units in Unit Trust of India (UTI) to a host of plans to choose from including on-line trading facilities by anyone. Though term deposits in banks and post office remains a risk free scheme, the return on such investment is relatively low, especially with modest interest rate. The other means, with a degree of risk in investment are many: debentures, stocks, mutual funds, derivatives like forwards, options, futures, swaps and so on. Among all these, mutual funds have gained investors’ acceptance and confidence.

1.2 CONCEPT OF MUTUAL FUND:

A Mutual Fund is a common pool of money into which investors place their contributions that are to be invested in accordance with a stated objective. The ownership of the fund is thus joint or “mutual”; the fund belongs to all investors. A single investor’s ownership of the fund is in the same proportion as the amount of the contribution made by him or her hears to the total amount of the fund.

Mutual Fund is a fund established in the form of a trust by a sponsor to raise money by the trustee through the sale of units to the public under one or more schemes for investing in securities in accordance with the SEBI regulations. Mutual Funds are trusts, which accept savings from investors and invest the same in diversified financial instruments in terms of objectives set out in the trusts deed with the view to reduce the risk and maximize the income and capital appreciation for distribution for the members A Mutual Fund is a corporation and the fund manager’s interest is to professionally manage the funds provided by the investors and provide a return on them after deducting reasonable management fees.

SEBI (Mutual Funds) Regulations 1993, define Mutual Fund as follows “a fund established in the form of a trust by a sponsor to raise monies by the trustees through the
sale of units to the public under one or more schemes for investing in securities in accordance with these regulations”.

According to Frank Reilly, “Mutual Funds is considered as financial intermediaries which bring a wide variety of securities with in the reach of the most modest investors”.

1.3 OBJECTIVES OF MUTUAL FUNDS
Most people have neither the time nor interest to research and select individual stocks and bonds for their investment portfolios, and that's how mutual funds comes in. Mutual funds can invest in a variety of bonds, stocks and other assets, giving you heterogeneity, which means a fall in value in any one stock or bond won't significantly hurt your overall return. A handful of well-chosen mutual funds or index funds can offer a diversified portfolio that allows the individual investor to spend his or her time on other quests. Lots of mutual funds are available that can satisfy the objectives of different types of investors.
A mutual fund acts as a diversified, relatively stable investment vehicle that allows casual investors to profit from market action without requiring constant oversight and management on their part.

➤ Diversification Of Assets
Investors are often advised that they shouldn't "put all their eggs in one basket." Investors who have too high of a percentage of their assets in one or two stocks can be severely affected if one of the companies goes belly-up. Most financial experts say investors should have at least 15 stocks in their portfolios. It takes a lot of time and effort to keep up with that many companies. On the other hand, mutual funds hold a number of stocks, which gives investors instant diversification and protects them from a sharp decline in any one holding.

➤ Exploring Growth Funds
Some mutual fund investors are looking for rapid growth in the value of their funds. Stocks have offered the best long-term returns compared to any asset class, though it can
be an up-and-down ride. Stock funds that are labeled "growth" typically invest in companies with clear prediction, while "value" funds target stocks that seem inexpensive compared with the company's earnings.

- **Evaluating The Benefits Of ETFs**
  Exchange-traded funds, or ETFs, have become attractive investment opportunities for many individuals due to the numerous benefits they offer. Thanks to a highly unlike grouping of assets, ETFs are considered a relatively stable form of investment, and are linked to every major index today. Compared to mutual funds, ETFs typically feature a lower expense ratio, making them more reasonable for investors.

- **Identifying Steady Income Opportunities**
  Other fund investors care more about receiving income from their investments. Numerous stock funds invest in companies with high dividend payouts. Funds invested in bonds also can provide steady income, as can funds that invest in real estate investment trusts, or REITs. All these income-focused funds pass the yields along to their investors, usually on a monthly or quarterly basis. Earnings of 3 percent to 7 percent are often available with income-oriented mutual funds.

- **Gaining International Exposure**
  Some large international firms offer their shares on U.S. markets, but others don't. For example, individual investors can have a tough time getting access to shares in the fast-growing market of China. But international-focused mutual funds have an easier time investing in these shares. Exposure to overseas stocks and mutual funds may add much-needed diversification and open the door to additional beneficial opportunities.

- **Benefitting From Low Fees**
  Stock picking can be expensive thanks to broker commissions, but many "no-load" mutual funds are available that don't charge investors anything. Many other funds charge investors less than 1 percent a year for operational fees.
Investors looking for especially inexpensive funds might consider index funds, which charge fees as least as 0.1 percent per year. In 2018, Fidelity even introduced zero-fee index funds. These funds usually hold every bond or stock in a given asset class, which offers incredible diversification at a low cost.

1.4 CHARACTERISTICS OF MUTUAL FUNDS

The specific characteristics of Indian Mutual Fund Schemes, can be narrated as listed below.

➤ Assured of minimum returns:
In general mutual funds do not assure any minimum returns to their investors. However, Indian Mutual Fund Schemes launched during 1987 to 1990 assured specific returns till 1991, when the SEBI and Union Ministry of Finance order the mutual funds not to assure minimum returns. Recently, SEBI has formulated a policy that, mutual funds with a track record of five years will be allowed to offer fixed returns not exceeding one year period.

➤ Multiple Options:
Most of the mutual fund schemes are offering different options to the investors under one scheme. For example, a growth oriented scheme may offer option of either regular income or re-investment of income. Under the regular income plan, dividend shall be distributed to investors and under the second dividend will be reinvested and total amount shall be paid at time of redemption.

➤ Lock in Period:
Mutual Fund Schemes offer documents that contain a clause of lock-in period ranging from one year to three years. Till the completion of the minimum period the investors are to trade neither the units on the stock exchange nor to avail themselves of repurchase facility.

➤ Liquidity:
Generally open-ended funds offer the facility of repurchase and the close ended are traded at stock exchange offering repurchase after a minimum lock in period of two to
three years. Mutual funds also have a facility to mortgage at banks to obtain loan and can be transferred in favour of any individual.

- **Incentives to early subscribers:**
Most of the close-ended mutual fund schemes are offering incentives to encourage early subscription to investors. This is more often in the tax planning schemes. For instance, if the scheme is open for a period of three months, the investor may be allowed a deduction from the amount to be invested at a certain specified rate, if the subscriptions were during the specified time limits.

1.5 HISTORY OF MUTUAL FUND IN INDIA

- **1964**  
  - Unit Trust of India, single MF entity in India

- **1987-1993**  
  - Eight new funds established by banks, LIC and GIC  
  - Total number of schemes up to 167

- **1988**  
  - Assets under management (AUM) grows to Rs. 6,700 Cr.

- **1993**  
  - AUM shoots up to Rs 61,000 crore.  
  - Private and foreign sector players enter the industry  
  - Kothari Pioneer Mutual Fund first entrant.

- **1996**  
  - SEBI formulates Mutual Fund Regulation, a comprehensive regulatory framework

- **2014**  
  - 45 mutual fund organisation  
  - AUM nearly Rs 10 lakh crore.

**Figure-1.1 : History of mutual fund**
By the end of 1988, UTI had total assets worth Rs 6,700 crore. Soon after, eight funds were established by banks, LIC and GIC between 1987 and 1993. The total number of
schemes went up to 167 and total money invested – measured by Assets under Management (AUM) – shot up to over Rs 61,000 crore.

In 1993, private and foreign players entered the industry, marking the third phase. The first entrant was Kothari Pioneer Mutual fund, which launched in association with a foreign fund.

The Securities and Exchange Board of India (SEBI) formulated the Mutual Fund Regulation in 1996, which, for the first time, established a comprehensive regulatory framework for the mutual fund industry. Since then, several mutual funds have been set up by the private and joint sectors.

Currently there are around 45 mutual fund organizations in India together handling assets worth nearly Rs 10 lakh crore. Today, the Indian mutual fund industry has opened up many exciting investment opportunities for investors. As a result, we have started witnessing the phenomenon of savings now being entrusted to the funds rather than in banks alone. Mutual Funds are now perhaps one of the most sought-after investment options for most investors.

As financial markets become more sophisticated and complex, investors need a financial intermediary who can provide the required knowledge and professional expertise on taking informed decisions. Mutual funds act as this intermediary.

1.6 THE MUTUAL FUND INDUSTRY IN INDIA:

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India (UTI) at the initiative of the Reserve Bank of India (RBI) and the Government of India. The objective then was to attract small investors and introduce them to market investments. Since then, the history of mutual funds in India can be broadly divided into six distinct phases.

➢ Phase I (1964-87): Growth Of UTI:

In 1963, UTI was established by an Act of Parliament. As it was the only entity offering mutual funds in India, it had a monopoly. Operationally, UTI was set up by the Reserve Bank of India (RBI), but was later delinked from the RBI. The first scheme, and for long one of the largest launched by UTI, was Unit Scheme 1964. Later in the 1970s and 80s,
UTI started innovating and offering different schemes to suit the needs of different classes of investors. Unit Linked Insurance Plan (ULIP) was launched in 1971. The first Indian offshore fund, India Fund was launched in August 1986. In absolute terms, the investible funds corpus of UTI was about Rs 600 crores in 1984. By 1987-88, the assets under management (AUM) of UTI had grown 10 times to Rs 6,700 crores.

➢ Phase II (1987-93): Entry of Public Sector Funds:
The year 1987 marked the entry of other public sector mutual funds. With the opening up of the economy, many public sector banks and institutions were allowed to establish mutual funds. The State Bank of India established the first non-UTI Mutual Fund, SBI Mutual Fund in November 1987. This was followed by Canbank Mutual Fund, LIC Mutual Fund, Indian Bank Mutual Fund, Bank of India Mutual Fund, GIC Mutual Fund and PNB Mutual Fund. From 1987-88 to 1992-93, the AUM increased from Rs 6,700 crores to Rs 47,004 crores, nearly seven times. During this period, investors showed a marked interest in mutual funds, allocating a larger part of their savings to investments in the funds.

➢ Phase III (1993-96): Emergence of Private Funds:
A new era in the mutual fund industry began in 1993 with the permission granted for the entry of private sector funds. This gave the Indian investors a broader choice of 'fund families' and increasing competition to the existing public sector funds. Quite significantly foreign fund management companies were also allowed to operate mutual funds, most of them coming into India through their joint ventures with Indian promoters. The private funds have brought in with them latest product innovations, investment management techniques and investor-servicing technologies. During the year 1993-94, five private sector fund houses launched their schemes followed by six others in 1994-95.

➢ Phase IV (1996-99): Growth And SEBI Regulation:
Since 1996, the mutual fund industry scaled newer heights in terms of mobilization of funds and number of players. Deregulation and liberalization of the Indian economy had
introduced competition and provided impetus to the growth of the industry. A comprehensive set of regulations for all mutual funds operating in India was introduced with SEBI (Mutual Fund) Regulations, 1996. These regulations set uniform standards for all funds. Erstwhile UTI voluntarily adopted SEBI guidelines for its new schemes. Similarly, the budget of the Union government in 1999 took a big step in exempting all mutual fund dividends from income tax in the hands of the investors. During this phase, both SEBI and Association of Mutual Funds of India (AMFI) launched Investor Awareness Programme aimed at educating the investors about investing through MFs.

➢ Phase V (1999-2004): Emergence of a Large and Uniform Industry:
The year 1999 marked the beginning of a new phase in the history of the mutual fund industry in India, a phase of significant growth in terms of both amount mobilized from investors and assets under management. In February 2003, the UTI Act was repealed. UTI no longer has a special legal status as a trust established by an act of Parliament. Instead it has adopted the same structure as any other fund in India - a trust and an AMC. UTI Mutual Fund is the present name of the erstwhile Unit Trust of India (UTI). While UTI functioned under a separate law of the Indian Parliament earlier, UTI Mutual Fund is now under the SEBI's (Mutual Funds) Regulations, 1996 like all other mutual funds in India. The emergence of a uniform industry with the same structure, operations and regulations make it easier for distributors and investors to deal with any fund house. Between 1999 and 2005 the size of the industry has doubled in terms of AUM which have gone from above Rs 68,000 crores to over Rs 1,50,000 crores.

➢ Phase VI (From 2004 Onwards): Consolidation and Growth:
The industry has lately witnessed a spate of mergers and acquisitions, most recent ones being the acquisition of schemes of Allianz Mutual Fund by Birla Sun Life, PNB Mutual Fund by Principal, among others. At the same time, more international players continue to enter India including Fidelity, one of the largest funds in the world.
1.7 STRUCTURE OF MUTUAL FUNDS IN INDIA

We have seen many aspects of mutual funds, whether it was about their performance, portfolio, how to choose them and how to compare them. In this post, we will see the structure of mutual funds in India. Mutual funds in India are regulated by the Securities and Exchange Board of India (SEBI). As running of a mutual fund involves managing of investors’ money, SEBI prescribes a complete set of guidelines for operating the mutual fund (MF) through the “SEBI MF regulations 1996”. These regulations designate that a mutual fund must be a three-tired structure consisting of:

1. A Sponsor
2. A Trustee
3. An asset management company (AMC)

While the above-mentioned play the most vital roles in creating and running a fund house, registrar and transfer agent (RTA), the custodian, the auditors and the fund accountants play an important supporting role in helping the smooth functioning of the mutual fund.

SPONSOR –

The Sponsor, is the main body that establishes the Mutual Funds. The Sponsor can be correlated to a promoter of a company. The duty of the sponsor involves appointing the trustees with the consent of SEBI and setting up an Asset Management Company under the Companies Act 1956 while making the trust registered with SEBI. As the Sponsors play the most vital role in the functioning of a mutual fund, SEBI has a set of stringent guidelines for the eligibility of a sponsor. Some of them are as follows: the sponsor should have a good track record of conducting business in the financial services field for not less than 5-7 years. A Sponsor also needs to have made profits in at least 3 of the 5 years including the latest year.

During the same period, it is also essential that the sponsor has had a positive net value. It should be contributing at least of 40 percent net worth of the AMC. It is also important that the sponsor has a good track record of fairness and integrity in all its transactions. For example, ICICI Bank and Prudential Plc are sponsors for ICICI Mutual Fund. For
TRUSTEE –
In the structure of mutual funds, the foremost role of a trustee is to secure that the interest of the unit holders is shielded while making sure that the mutual fund complies with all the regulations of SEBI. Either, the sponsor should select four trustees or establish a trustee company with at least four independent directors. Additionally, at least two-thirds of the trustees or the directors should be independent not associated with the sponsor in any way.
Some of the important responsibilities of the trustees involve entering into an investment management contract with the AMC to define its functioning. Trustees are also accountable for ensuring that the AMC has all the necessary procedures, processes, and systems in place while ensuring that all the key persons such as the CIO, CEO, the fund
managers and the analysts are selected after the due care. All the schemes launched by the AMC have to be approved by the trustees before launch. The trustees also review all the transactions of the AMC on a quarterly basis whilst filing reports to SEBI, generally on a half yearly basis.

**ASSET MANAGEMENT COMPANY (AMC)**

AMC’s are the investment manager of the trust. They take care of the everyday operation of the mutual fund and managing the investor’s money as well. The AMC is appointed either by the Sponsor or the Trustee after getting the approval of SEBI. The Asset Management Company consists of the Chief Investment Officer, analytics, and the fund managers, who are together responsible for managing the different schemes started. The compliance officer makes sure compliance of all the actions of the AMC are in line with SEBIs laws and regulations. For example; Axis AMC is the Asset Management Company for Axis Mutual Fund.

**CUSTODIAN**

He has the custody of the all the shares and numerous other securities purchased by the AMC. The custodian is responsible for safe custody of all the securities. The custodian is accountable for managing the investment account of the mutual fund.

**REGISTRAR AND TRANSFER AGENT (RTA)**

It maintains and updates all the investor’s records. The primary function is investor servicing through its office and many other branches. Its functions involve processing of investor application, purchase and redemption transaction history by investors in different fund schemes and plans.

**AUDITORS**

The auditors are responsible for the auditing of the AMC’s accounts while assuring that the accounts of schemes are maintained autonomously from that of AMC. The fund accountants are liable for calculating the NAV of the schemes based on the information about the assets and liabilities of every scheme.


**BOTTOM LINE –**

Therefore we can note that the mutual funds in India are a well-regulated entity with a clearly defined structure including several components whose roles and responsibilities are correctly defined under the purview of SEBI. The advantage of such a structure, especially the trust form, assures that nobody, other than the AMC or the sponsor can mishandle your money. In the case of a fund house closing down, your money is certainly returned to you. In other cases, where a fund house does not want to operate the business, it sells its business to another AMC and investors are given a choice to exit or to stay with the new AMC. Thus, while your money does undergo any market risks, there is no risk of losing money to the AMCs.

**1.8 AMFI - ASSOCIATION OF MUTUAL FUNDS IN INDIA**

AMFI stands for Association of Mutual Funds in India. AMFI India is actually an association of SEBI registered Mutual Funds in India and is well known for “AMFI NAV” facility it provides. It was incorporated on August 22, 1995, as a non-profit organisation. The AMFI "locate distributor" services available on the AMFI website (amfiindia.com) is used to locate certified Mutual Fund distributors within a certain area. Other services provided include- AMFI NAV, circulars, newsletters, updates and other data related to the Mutual Funds industry. Also, many years ago, it used to conduct an exam for distributor certification called "AMFI exam".

**1.8.1 ROLE OF AMFI IN INDIA**

The Association of Mutual Funds in India was set up to maintain overall standards in the Mutual Fund industry. Firstly, AMFI is entrusted to maintain and define the ethical and professional standard in all operational areas of the industry. Secondly, it also recommends the code of conduct and best practices for all its members, those engaged in activities of Mutual Funds including agencies involved or connected with them. Since as a body it represents Mutual Funds, the Association of Mutual Funds in India also makes representation to SEBI, the Government, RBI and other bodies on matters related to the Mutual Fund industry. It also undertakes the activity of getting a training and certification
program in place for all intermediaries and those engaged in the Mutual Fund industry. Over the years, the Association of Mutual Funds in India has also worked towards getting an investor awareness program on mutual funds. It additionally takes research and studies directly or indirectly and disseminates information on the Mutual Fund industry. AMFI has a lot of committees to ensure it progresses on each of its objectives. Some of the prominent committees are:

a. Committee on Valuation
b. Committee on Operations & Compliance
c. Committee on Registration of Certified Distributors
d. Committee on Financial Literacy

1.8.2 OBJECTIVES OF AMFI

- Outlines ethical and uniform professional standards in every mutual fund operation under the association
- Encourages members and investors to maintain ethical business practices and regulations
- Gets AMCs, agents, distributors, advisories and other bodies involved in the capital market or financial service fields to comply with their guidelines
- Networks with SEBI and comply with their mutual fund regulations
- Represents the Finance Ministry, RBI, and SEBI on everything related to the industry
- Spreads awareness across the country on safe mutual fund investments
- Distributes information on Mutual Fund Sector and conduct research and workshops on various funds
- Keeps a check on Code of Conduct of everyone included and take disciplinary action in case of rule violations
- Investors can approach AMFI to air their grievances and register complaints against a fund manager or a fund house.
- Safeguards the interest of investors and asset management companies
1.9 THE 4 A’s CONTRIBUTING TO THE GROWTH OF THE INDIAN MUTUAL FUND INDUSTRY

Mutual fund industry in India is set to reach new heights in the coming years. Over the last decade, the total assets managed by mutual fund houses rose by 70%. Let's look at the major factors influencing this spurt of growth.

It’s a common notion that Indian households ‘save’ much compared to their counterparts in other parts of the world. Despite this, Indian investment in mutual funds have been minimal as compared to other avenues for investment. Of late however, we are seeing a change with the changing demographic profile of the Indian population. With new products being launched, coupled with financial awareness and literacy initiatives by the industry and the regulator, investors are beginning to recognise mutual funds as a tool for attaining financial goals rather than as mere investment means. Among the multiple factors, there are four that are heavily influencing investors to fall in love with mutual funds.

1.9.1 ACCESSIBILITY

Emerging distribution channels based on online and mobile platform are expected to gain further prominence in mutual fund industry. Mobile technology is acting as an enabler in reaching out to investors in far and distant places. Gone are the days when investors travelled to the nearest mutual fund house office to fill up forms and submit photocopies of PAN and other documents. With eKYC soon to become a reality, investors will no longer need to visit offices to submit documents. Then why should they visit offices to buy or sell mutual funds?

Though the mutual fund houses were quick to offer online (web-based) transaction services, the idea of extending these services through mobile applications has gained momentum only recently. A number of mutual fund houses have already launched mobile applications to enable their investors to ‘buy’ mutual funds from the convenience of their office or home. Along with mutual fund houses, third party mutual fund distributors like ‘funds India’ have also come up with intuitive mobile applications.
Along with the basic features required for mutual fund transactions, such apps will be equipped with effective tools. These tools help to identify the risk appetite and investment objectives of investors, thus guiding them to suitable funds.

1.9.2 AFFORDABILITY
As per a study by KPMG, a lion’s portion of mutual fund participation is restricted to the top five cities in India viz. Mumbai, Delhi, Bangalore, Chennai and Kolkata. This is mainly because of the high concentration of HNIs in these cities. However, it is estimated that the disposable income of the Indian youth will increase threefold by 2020. This will pave way for higher participation in mutual funds from tier II and III cities too. And as it is always, the cost of investing and maintaining the mutual fund is relatively less compared to other investment options like equity or commodity trading. These points, along with many other positive factors related to job and income scenario will boost the mutual fund industry in the coming years.

Figure 1.3: 4A’s for Mutual fund growth
Source:www.cafemutual.com

1.9.3 AWARENESS
If we compare the mutual fund penetration in India to other parts of the world, we get a very weak correlation with GDP. In India, the AUM to GDP ratio stands at 7 to 8% as compared to a global average of 37%, according to a PwC-CII report. Mutual fund
participation will largely depend on increasing investor awareness at grassroots level. In its effort to increase investor awareness, the industry and the Securities and Exchange Board of India (SEBI) have launched several initiatives. These include awareness programmes and campaigns to propagate financial education to various investor segments, including potential investors. Hopefully, the collective efforts of regulators and mutual fund houses towards awareness programmes will yield good results in the coming years. Indian mutual fund house’s effort to reach out more into tier II and III cities will also yield more results in the coming years. Some mutual fund houses are even providing higher commission to their agents for the business brought in from these cities.

1.9.4 AVAILABILITY

With the number of mutual fund houses, the number of fund offerings with different composition and investment objective are plenty. Investors have a large choice to select from, whatever be their objective — be it building up their wealth, pension corpus or fixed income.

Mutual fund houses are offering a handful of SIP options, which cater to a different investor behavior. Currently, SIP is possible for a fixed amount/units. Some fund houses have deployed advanced logarithms to work towards investor profitability (SIP sure, smart SIP, etc.)

Out of these 4 A’s, the latter three can be achieved by mutual fund houses and regulators through product innovation and awareness programmes. However, to implement the first one - accessibility- mutual fund houses may need to partner with technology providers. Technology providers with mobility expertise can help mutual fund houses to launch their products through mobile applications. With India’s youth embracing mobility at an unprecedented rate, providing additional channels through mobile is a key and inevitable strategy.
1.10 OPPORTUNITIES OF MUTUAL FUNDS

The current macro-economic environment, despite concerns around rising inflation and expected slow down in the economic growth rate, presents a unique set of opportunities for fuelling the growth of the mutual fund industry.

➢ **High Cost Of Business In Tier I Cities**

The high cost of doing business in Tier I metro cities, primarily due to high cost of real estate have forced corporate houses, especially multi nationals who have off shored their back office operations to India, to look at the economically more viable Tier II cities. This would eventually result in the creation of the income effect in these cities and towns. Higher income generally results in higher saving potential and these savings could then be channelised to mutual funds.

➢ **Interest Rate Scenario In India**

Traditionally, mutual funds were looked upon by retail investors primarily as an option to direct equity investing. However, in the wake of a correction in equity markets and the north bound movement in interest rates, fixed maturity plans offered by mutual funds, which are akin to fixed deposits have caught fancy with the retail investors.

➢ **Development Of Commodity Exchanges**

The relatively quick development of two commodity exchanges in India, the Multi Commodity Exchange of India Limited and the National Commodity and Derivatives Exchange Limited, may prove to be a blessing for the mutual fund industry. The two exchanges are clocking record turnovers in commodities like gold and silver and provide an advanced commodity trading platform for institutions and investors. A vigilant regulator in the form of the Forward Markets Commission keeps a very close watch on the commodity market thereby building investor confidence. Commodity funds which are quite popular in the mature markets may just be able to make a debut in India. The Summit takes a look at the state of preparedness of the industry and the regulator to introduce commodity funds in India.
The Real Estate Boom

With the liberalisation of Foreign Direct Investment rules in real estate by the Reserve Bank of India, the sector has seen an influx of foreign funds which has lifted the real estate prices to dizzying heights. The traditionally closed construction sector is now in the public eye and this will lead to a more transparent real estate market. Real estate has always been one of the preferred investment avenues for the Indian investor. And what better way for the smaller investors to participate in this boom than to have a real estate mutual fund. However, a real estate mutual fund would come with its own set of challenges. SEBI on its part would be keen to ensure that all relevant regulations are in place before real estate mutual funds kick-off as this being a sensitive area any negative event could have a severe impact on investor confidence. The Summit would provide an insight on key areas such as valuation, declaration of net asset value and accounting, on which discussions have been initiated by the working committee on real estate mutual funds.

The Opportunity To Go Global

It’s been a good year for India. Indians have made headlines globally from making big ticket international acquisitions to earning global awards for the most consistent fund performances. The India growth story was known to all; but now its time to make way for the global Indian. The Reserve Bank of India has also added the right ingredients to further spice it up for the mutual fund industry. Indian investors are now allowed to invest upto USD 100,000 abroad. Its time to go global! But opportunities always come with challenges. The steps have been initiated but there’s a long way to go. Fund managers having proven their mettle locally would be ready to take on further challenges. But the risks are manifold. The retail investor ultimately has to be convinced about the opportunities available in the more mature global markets and the time’s just right to make a beginning. With a strong regulatory framework, clear guidelines and the talent to back it up, the Indian mutual fund industry is in a position to cater to the new breed of investors who are keen to diversify their risks.
1.11 DIFFERENT TYPES OF MUTUAL FUNDS

There are different types of mutual funds which plays an important role in capital market and are classified in following ways:

1.11.1 MUTUAL FUNDS BASED ON FUND SCHEME:

There are two key kinds of mutual funds on the basis of the constitution of the fund. This basically affects when investors can buy fund units and sell them.

- Close-Ended Schemes:

These schemes have fixed maturity periods. Investors can buy into these funds during the period when these funds are open in the initial issue. Once that window closes, such schemes cannot issue new units except in case of bonus or rights issues. After that period, you can only buy or sell already-issued units of the scheme on the stock exchanges where they are listed. The market price of the units could vary from the NAV of the scheme due to demand and supply factors, investors' expectations and other market factors.

- Open-Ended Schemes:

These funds, unlike close-ended schemes, do not have a fixed maturity period. Investors can buy or sell units at NAV-related prices from and to the mutual fund, on any business day. This means, the fund can issue units whenever it wants. These schemes have unlimited capitalization, do not have a fixed maturity date, there is no cap on the amount you can buy from the fund and the total capital can keep growing. These funds are not generally listed on any exchange. Open-ended schemes are preferred for their liquidity. Such funds can issue and redeem units any time during the life of a scheme. Hence, unit capital of open-ended funds can fluctuate on a daily basis.

The advantages of open-ended funds over close-ended are as follows:

Investors can exit any time they want. The issuing company directly takes the responsibility of providing an entry and an exit. This provides ready liquidity to the investors and avoids reliance on transfer deeds, signature verifications and bad deliveries. Investors can entry any time they want. Thus, an open-ended fund allows one to enter the fund at any time and even to invest at regular intervals.
1.11.2 MUTUAL FUNDS BASED ON ASSETS INVESTED IN:

There three kinds of mutual funds based on the assets invested in. These are as follows:

- **Equity Funds:**
  These are funds that invest only in stocks. As a result, they are usually considered high risk, high return funds. Most growth funds – the ones that promise high returns over a long-term – are equity funds. These funds have less tax liability in the long-run as compared to debt funds. Equity funds can be further classified into types based on the investment objective into index funds, sector funds, tax-saving schemes and so on. We shall go through these in detail later.

- **Hybrid Funds:**
  These are funds which invest in both equities as well as debt instruments. For this reason, they are less risky than equity funds, but more than debt funds. Similarly, they are likely to give you higher returns than debt funds, but lower than equity funds. As a result, they are often called ‘balanced funds’.

- **Debt Funds:**
  These funds invest in debt-market instruments like bonds, government securities, debentures and so on. These are called debt instruments because they are a kind of borrowing mechanism for companies, banks as well as the government. Simply put, you give them money, which the company returns with interest over a period of time. After which, it matures. Since the interest payments are fixed as well as the return of the principle amount, debt instruments are considered low-risk, low-return financial assets. For the same reason, debt funds are relatively safer. They are usually preferred for the regular interest payments. Debt funds are further classified on the basis of the maturity period of the underlying assets – long-term and short-term. Some debt funds invest in just a single type of debt instrument. Gilt funds are an example of such a fund.
1.11.3 MUTUAL FUNDS BASED ON INVESTMENT OBJECTIVE:

Every investor has a different reason for investing in financial instruments. Some do so for making profits and increasing wealth, while some others do so for a regular secondary source of income. Some others invest in mutual funds for a bit of both. Keeping these requirements in mind, there are three key kinds of mutual funds based on the investment objective.

- **Growth Funds:**
  These are schemes that promise capital returns in the long-term. They usually invest in equities. As a result, growth funds are usually high risk schemes. This is because the values of assets are subject to lot of fluctuations. Also, unlike fixed-income schemes, growth funds usually pay lower dividends. They may also prefer to reinvest the dividend money into increasing the assets under management.
- **Balanced Funds:**
  As the name suggests, these schemes try to strike a balance between risk and return. They do so by investing in both equities and debt instruments. As a result, they are a kind of hybrid fund. Their risk is lower than equity or growth funds, but higher than debt or fixed-income funds.

- **Fixed-Income Funds:**
  These are schemes that promise regular income for a period of time. For this reason, fixed-income funds are usually a kind of debt fund. This makes fixed-income funds low-risk schemes, which are unlikely to give you a large amount of profit in the long-run. They pay higher dividends than growth funds. As with debt funds, they may be further classified on the basis of the specific assets invested in or on the basis of maturity.

**1.11.4 SOME SPECIAL FUNDS:**
These are funds which invest in a specific kind of assets. They may be a kind of equity or debt fund.

- **Index Schemes:**
  Indices serve as a benchmark to measure the performance of the market as a whole. Indices are also formed to monitor performance of companies in a specific sector. Every index is formed of stock participants. The value of the index has a direct relation to the value of the stocks. However, you cannot invest in an index directly. It is merely an arbitrary number. So, to earn as much returns as the index, investors prefer to invest in an Index fund. The fund invests in the index stock participants in the same proportion as the index.
  For example, if a stock had a weightage of 10% in an index, the scheme will also invest 10% of its funds in the stock. Thus, it recreates the index to help the investors earn money. Such schemes are generally passive funds as the managers need not research much for asset allocation. As a result, the fees are lower. They are also a kind of equity fund.
- **Real Estate Funds:**
  These are not a sector-specific fund which invests in realty company shares. Instead, these funds invest directly in real estate. This may be by buying property or funding real estate developers.
  That said, they can also buy shares of housing finance companies or their securitized assets. Risk depends on where the fund is investing the money.

- **Gilt Funds:**
  These schemes primarily invest in government securities. Government debt is usually credit-risk free. Hence, the investor usually does not have to worry about credit risk.

- **Interval Schemes:**
  These schemes combine the features of open-ended and closed-ended schemes. They may be traded on the stock exchange or may be open for sale or redemption during predetermined intervals at NAV based prices.

- **Sector Funds:**
  These are a kind of equity scheme restrict their investing to one or more pre-defined sectors, e.g. technology sector.
  Since they depend upon the performance of select sectors only, these schemes are inherently more risky than general schemes. They are best suited for informed investors, who wish to bet on a single sector.

- **Tax-Saving Schemes:**
  Investors are now encouraged to invest in the equity markets through the Equity Linked Savings Scheme (ELSS) by offering them a tax rebate. When you invest in such schemes, your total taxable income falls. However, there is a limit of Rs 1 lakh for tax purposes. The crutch is that the units purchased cannot be redeemed, sold or transferred for a period of three years.
However, in comparison with other tax-saving financial instruments like Public Provident Funds (PPF) and Employee Provident Funds (EPF), ELSS funds have the lowest lock-in period. An example of ELSS scheme is the Kotak ELSS scheme.

- **Money Market Schemes:**
  These schemes – a kind of debt fund – invest in short-term instruments such as commercial paper (CP), certificates of deposit (CD), treasury bills (T-Bill) and overnight money (Call).
  The schemes are the least volatile of all the types of schemes because of the short-term maturities of the money-market instruments. These schemes have become popular with institutional investors and high-net worth individuals having short-term surplus funds.

1.12 **ADVANTAGES OF MUTUAL FUNDS**

<table>
<thead>
<tr>
<th>Advantages of Mutual Funds</th>
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<tbody>
<tr>
<td>Liquidity</td>
</tr>
<tr>
<td>Diversification</td>
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<td>Expert Management</td>
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<td>Less cost for bulk transactions</td>
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<tr>
<td>Cost-efficiency</td>
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<td>Automated payments</td>
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<td>Suit your financial goals</td>
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<td>Quick &amp; painless process</td>
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<td>Tax-efficiency</td>
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<td>Invest in smaller denominations</td>
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<td>Safety</td>
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<td>Systematic or one-time investment</td>
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**Figure 1.5: Advantages of mutual funds**
**Source:** www.cleartax.com

- **Liquidity**
  Unless you opt for close-ended mutual funds, it is relatively easier to buy and exit a scheme. You can sell your units at any point (when the market is high). Do keep an eye
on surprises like exit load or pre-exit penalty. Remember, mutual fund transactions happen only once a day after the fund house releases that day’s NAV.

- **Diversification**

Mutual funds have their own share of risks as their performance is based on the market movement. Hence, the fund manager always invests in more than one asset class (equities, debts, money market instruments etc.) to spread the risks. It is called diversification. This way, when one asset class doesn’t perform, the other can compensate with higher returns to avoid the loss for investors.

- **Expert Management**

Mutual fund is favoured because it doesn’t require the investors to do the research and asset allocation. A fund manager takes care of it all and makes decisions on what to do with your investment. He/she decides whether to invest in equities or debt. He/she also decide on whether to hold them or not and for how long.

Your fund manager’s reputation in fund management should be an important criterion for you to choose a mutual fund for this reason. The expense ratio (which cannot be more than 1.05% of the AUM guidelines as per SEBI) includes the fee of the manager too.

- **Less Cost For Bulk Transactions**

You must have noticed how price drops with increased volume, when you buy any product. For instance, if a 100g toothpaste costs Rs. 10, you might get a 500g pack for, say, Rs. 40. The same logic applies to mutual fund units as well. If you buy multiple units at a time, the processing fees and other commission charges will be less compared to when you buy one unit.

- **Invest In Smaller Denominations**

By investing in smaller denominations (SIP), you get exposure to the entire stock (or any other asset class). This reduces the average transactional expenses – you benefit from the market lows and highs. Regular (monthly or quarterly) investments as opposed to lumpsum investments give you the benefit of rupee-cost averaging.
➢ **Suit Your Financial Goals**

There are several types of mutual funds available in India catering to investors from all walks of life. No matter what your income is, you must make it a habit to set aside some amount (however small) towards investments. It is easy to find a mutual fund that matches your income, expenditures, investment goals and risk appetite.

➢ **Cost-Efficiency**

You have the option to pick zero-load mutual funds with less expense ratios. You can check the expense ratio of different mutual funds and choose one that fits in your budget and financial goals. Expense ratio is the fee for managing your fund. It is a useful tool to assess a mutual fund’s performance.

➢ **Quick & Painless Process**

You can start with one mutual fund and slowly diversify. These days it is easier to identify and handpick fund(s) most suitable for you. Maintaining and regulating the funds too will take no extra effort from your side. The fund manager with the help of his team of will decide when, where and how to invest. In short, their job is to consistently beat the benchmark and deliver you maximum returns.

➢ **Tax-Efficiency**

You can invest up to Rs. 1.5 lakhs in tax-saving mutual funds mentioned under 80C tax deductions. ELSS is an example for that. Though a 10% Long Term Capital Gains (LTCG) is applicable for returns in excess of Rs 1 Lakh after one year, they have consistently delivered higher returns than other tax-saving instruments like FD in the recent years.

➢ **Automated Payments**

It is common to forget or delay SIPs or prompt lumpsum investments due to any given reason. You can opt for paperless automation with your fund house or agent. Timely email and SMS notifications help to counter this kind of negligence.
➢ **Safety**
There is a general notion that mutual funds are not as safe as bank products. This is a myth as fund houses are strictly under the purview of statutory government bodies like SEBI and AMFI. One can easily verify the credentials of the fund house and the asset manager from SEBI. They also have an impartial grievance redressal platform that work in the interest of investors.

➢ **Systematic Or One-Time Investment**
You can plan your mutual fund investment as per your budget and convenience. For instance, starting an SIP (Systematic Investment Plan) on a monthly or quarterly basis suits investors with less money. On the other hand, if you have surplus amount, go for a one-time lump sum investment.

### 1.13 DISADVANTAGES OF MUTUAL FUNDS
Like many investments, mutual funds offer advantages and disadvantages, which are important for you to consider and understand before you decide to buy. Here we explore some of the drawbacks of mutual funds.

➢ **Fluctuating returns**
Mutual funds are like many other investments without a guaranteed return. There is always the possibility that the value of your mutual fund will depreciate. Unlike fixed-income products, such as bonds and Treasury bills, mutual funds experience price fluctuations along with the stocks that make up the fund. When deciding on a particular fund to buy, you need to research the risks involved - just because a professional manager is looking after the fund, that doesn't mean the performance will be stellar.

Another important thing to know is that mutual funds are not guaranteed by the U.S. government, so in the case of dissolution, you won't get anything back. This is especially important for investors in money market funds. Unlike a bank deposit, a mutual fund will not be FDIC insured.
➢ **Diversification**
Although diversification is one of the keys to successful investing, many mutual fund investors tend to over diversify. The idea of diversification is to reduce the risks associated with holding a single security; over diversification (also known as diversification) occurs when investors acquire many funds that are highly related and so don't get the risk reducing benefits of diversification. To read more on this subject, see this article.

At the other extreme, just because you own mutual funds doesn't mean you are automatically diversified. For example, a fund that invests only in a particular industry or region is still relatively risky.

➢ **Cash, Cash And More Cash**
As you know already, mutual funds pool money from thousands of investors, so everyday investors are putting money into the fund as well as withdrawing investments. To maintain liquidity and the capacity to accommodate withdrawals, funds typically have to keep a large portion of their portfolio as cash. Having ample cash is great for liquidity, but money sitting around as cash is not working for you and thus is not very advantageous.

➢ **Costs**
Mutual funds provide investors with professional management; however, it comes at a cost. Funds will typically have a range of different fees that reduce the overall payout. In mutual funds the fees are classified into two categories: shareholder fees and annual fund-operating fees.

The shareholder fees, in the forms of loads and redemption fees, are paid directly by shareholders purchasing or selling the funds. The annual fund operating fees are charged as an annual percentage - usually ranging from 1-3%. These fees are assessed to mutual fund investors regardless of the performance of the fund. As you can imagine, in years when the fund doesn't make money these fees only magnify losses.
Misleading Advertisements
The misleading advertisements of different funds can guide investors down the wrong path. Some funds may be incorrectly labelled as growth funds, while others are classified as small-cap or income. The SEC (Securities and Exchange Commission) requires funds to have at least 80% of assets in the particular type of investment implied in their names. The remaining assets are under the discretion solely of the fund manager.

The different categories that qualify for the required 80% of the assets, however, may be vague and wide-ranging. A fund can therefore manipulate prospective investors by using names that are attractive and misleading. Instead of labelling itself a small cap, a fund may be sold under the heading growth fund. Or, the "Congo High-Tech Fund" could be sold with the title "International High-Tech Fund".

Evaluating Funds
Another disadvantage of mutual funds is the difficulty they pose for investors interested in researching and evaluating the different funds. Unlike stocks, mutual funds do not offer investors the opportunity to compare the P/E ratio, sales growth, earnings per share, etc. A mutual fund’s net asset value gives investors the total value of the fund's portfolio less liabilities, but how do you know if one fund is better than another?

Furthermore, advertisements, rankings and ratings issued by fund companies only describe past performance. Always note that mutual fund descriptions/advertisements always include the tagline "past results are not indicative of future returns". Be sure not to pick funds only because they have performed well in the past - yesterday's big winners may be today's big losers.

1.14 REASONS TO INVEST IN MUTUAL FUNDS
Investing in mutual funds offers a multitude of benefits. Let’s have a look:

- PROFESSIONAL INVESTMENT MANAGEMENT:

When you invest in a mutual fund, your money is managed by professional experts. This is one of the primary benefits of investing in mutual funds. Being full-time, high-level investment professionals, a good investment manager is more resourceful and capable of monitoring the companies the mutual fund has invested in, rather than individual
The managers have real-time access to crucial market information and are able to execute trades on the largest and most cost-effective scale. Simply put, they have the know-how to trade in the markets that retail investors may not possess.

➢ **LOW INVESTMENT THRESHOLD**
A mutual fund enables you to participate in a diversified portfolio for as little as Rs 5000, and sometimes even lesser. And with a no-load fund, you pay little or no sales charges to own them. For example, some bonds and fixed deposits have a minimum investment amount of Rs 25,000. Instead, you can give your money to a mutual fund, which will in turn invest in the bonds and fixed deposits. This could be done for as little as Rs 1000.

➢ **CONVENIENCE**
Investing in mutual funds has its own convenience. You save up on additional paperwork that comes with every transaction, the amount of energy you invest in researching for the stocks, as well as actual market-monitoring and conduction of transactions. With a mutual fund, you don’t have to do any of that. Simply go online or place an order with your broker to buy a mutual fund. Another big advantage is that you can move your funds easily from one fund to another, within a mutual fund family. This allows you to easily rebalance your portfolio to respond to significant fund management or economic changes.

![Figure 1.6: Professional Investment Management](source:www.kotaksecurities.com)
LIQUIDITY:
In open-ended schemes, you can get your money back at any point in time at the prevailing NAV (Net Asset Value) from the Mutual Fund itself. This makes mutual fund investments highly liquid. Compare that with a fixed deposit or a bond which may have a fixed investment duration.

VARIETY
While investing in mutual funds, you are spoilt for choice. You have a number of mutual fund schemes to choose from, which may invest in a whole range of industries and sectors, different kinds of assets, and so on. You can find a mutual fund that matches just about any investment strategy you select. There are funds that focus on blue-chip stocks, technology stocks, bonds, or a mix of stocks and bonds. In fact, the greatest challenge can be sorting through the variety and picking the best for you.

TRANSPARENCY
SEBI regulations for mutual funds have made the industry very transparent. You can track the investments that have been made on your behalf to know the sectors and stocks being invested in. In addition to this, you get regular information on the value of your investment. Mutual funds are mandated to publish the details of their portfolio regularly.

1.15 THINKS TO BE KEPT IN MIND WHILE CHOOSING MUTUAL FUND
Money is precious. It is hard-earned. You can’t just put your money in an investment vehicle or mutual fund without some research. H

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<tr>
<th>CHOOSING MUTUAL FUNDS</th>
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<tbody>
<tr>
<td>Meet diversification targets</td>
</tr>
<tr>
<td>Match the scheme's risk with your profile</td>
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<tr>
<td>Know your fund manager</td>
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<td>Check for past Performance</td>
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Figure 1.7: Points to be kept in mind while choosing mutual funds
➢ PAST PERFORMANCE:
History is important. Before investing, check the historic performance of the mutual fund scheme, the asset manager’s investment decisions, fund returns and so on. While the past performance is not an indicator of the future, it could help you figure out what to expect in the future. You can understand the investment philosophies of the fund and the kind of returns it is offering to investors over a period of time. It would also make sense to check out the two-year and one-year returns for consistency. Statistics such as how the fund had performed in the bull and bear markets of the immediate past would help you understand the strength of a fund. Tracking the fund's performance in the bear market is particularly important because the true test of a portfolio is often revealed in how little it falls during a bearish phase.

➢ MATCH THE SCHEME'S RISK WITH YOUR PROFILE:
Even though a mutual fund diversifies its portfolio to reduce risk, they may eventually invest in a single type of asset. The risk of the fund varies with the kind of assets it is invested in. For this reason, check if the mutual fund fits your risk profile and investment horizon. For example, certain sector-specific schemes come with a high-risk, high-return tag. Such plans are suspect to crashes in case the industry or sector loses the market's fancy. If the investor is risk-averse, he could instead opt for a debt scheme with little risk. However, if you are a long-term investor, who doesn’t mind risk, you could go ahead with the sector-specific mutual fund scheme. For this reason, most investors prefer balanced schemes, which invest in a combination of equities and debts. They are less risky than pure equity or growth funds, which are likely to give greater returns, but more risky than pure debt plans.

➢ DIVERSIFICATION
While choosing a mutual fund, one should always consider factors like the extent of diversification that a mutual fund offers to your portfolio. A mutual fund can offer diversification either by investing in multiple assets, or by balancing your overall portfolio.
For example, suppose your portfolio contains 70% exposure to stocks from different industries, then it makes sense to invest the 30% in a debt fund to balance the portfolio. Similarly, if your portfolio has a lot of exposure to a particular sector like IT, then avoid investing in a mutual fund that also invests in IT. This way, you can balance your exposure to a similar kind of risk.

➢ KNOW YOUR FUND MANAGER:
The success of a fund, to a great extent, depends on the fund manager. Some of the most successful funds are run by the same managers. It would be sensible to always ask about the fund manager before investing as well as knowing about changes in the fund manager's strategy or any other significant developments that an AMC may have undergone.

For instance, if the portfolio manager, who generated the fund's successful performance, is no longer managing that particular fund, you may do well to wait and analyze the pros and cons of investing in that fund.

➢ READ THE FINE PRINT:
The prospectus says a lot about the fund. Reading the fund's prospectus is a must to learn about its investment strategy and the risk that it is prone to. Funds with higher rates of return may carry a higher element of risk. Hence, it is of utmost importance that an investor always chooses a particular scheme after considering his financial goals and weighs them against the mutual fund’s risk.

That said, remember that all funds carry some level of risk. Just because a fund invests in government or corporate bonds does not mean that it does not have any risk.

➢ COSTS:
A fund with high costs must perform better than a low-cost fund to generate returns for you. Even small differences in fees can translate into large differences in returns over a period of time.

So, ensure the costs and returns tally. There is no point in spending extra if it is delivering the same kind of returns like a low-cost fund.
PATIENCE:
Finally, an investor must not enter and exit mutual funds as and when the market turns. Market cycles are natural. Be patient. Like stocks, mutual funds too pay off only if you have the patience to wait. This applies for both buying and selling. Don’t pick a fund simply because it has shown a spurt in value in the current rally. Ensure its returns are consistent. Similarly, don’t sell off a mutual fund just because it is not performing well due to poor market conditions. However, it makes little sense to hold on to a fund that lags behind the market year after year.

1.16 TAX ASPECTS OF MUTUAL FUND SCHEMES
Wherever life may take you, you will always have to pay taxes – even on your investments.
Let’s look at the taxation aspects of a mutual fund:

Figure 1.8: How mutual funds are Taxed?
Source: www.kotaksecurities.com
➢ **Tax-Savings:**
The government has been trying to encourage retail investment in equities. For this reason, the government came up with the ELSS or Equity-Linked Savings Schemes. The amount you invest in ELSS schemes reduces your total income as per Section 80C of the Income Tax Act. For example, if you earn Rs 4 lakh per annum, of which you invest Rs 50,000 in ELSS schemes, your total taxable income comes down to Rs 3.5 lakh. However, the government has limited the total amount of investment eligible for tax-saving through ELSS to Rs 1.5 lakh. You also don’t pay any tax while redeeming ELSS funds.

➢ **Dividend Income:**
Mutual fund dividends are tax-free for investors. However, mutual funds are taxed for distributing dividends. This is mainly applicable to debt mutual funds, not equity funds.

➢ **Securities Transaction Tax:**
This is the tax you pay for selling assets in the securities market. A STT of 0.001% is eligible when you sell your equity schemes and exchange traded funds.

➢ **Capital Gains:**
The profit you make when you sell a financial asset at a higher rate is called capital gains. When you sell an asset within a short period, the capital gained is called short-term capital gains. If you hold your asset for a longer time, the profit you make on selling it is called long-term capital gains.

➢ **Equity Funds:**
The holding period for equity funds is 1 year or 12 months. If you sell your fund before this period, you will be taxed 15%. If you hold it for a year or more, you will not have to pay any tax.
➢ Debt Funds:
The holding period for debt funds has been increased to 36 months or 3 years in the Union Budget for FY2014-15. This means, if you sell your debt fund within 36 months, you will have to pay the short-term capital gains tax – the same as your income tax slab rate. If you hold your fund for at least 3 years, you have to pay a long-term capital gains tax of 20% for debt funds. This, however, comes with indexation benefits.

➢ Indexation:
This is the process of adjusting your income by taking into account inflation. This is done using an inflation index. This helps reduce your taxable income.

You first adjust your proceeds from sale using indexation. Then, you calculate your capital gains by a simple subtraction.

This is the formula to adjust your income through indexation:

\[
\text{Indexed Proceeds} = \frac{\text{CPI for current year}}{\text{CPI for year of investment}} \times \text{Purchase Price}
\]

Figure 1.9: Indexation Formula
Source: www.kotaksecurities.com

For example, you invested Rs 10,000 in a debt mutual fund in 2010-11, when the inflation index was 711. You sold the fund for Rs 15,000 in 2014-15. At this time, the index figure was 1025. So you adjust your purchase price of Rs 10,000 through indexation to Rs 14,416.315. So, your after-indexation capital gain is Rs 583.68. You will then have to pay 20% of this amount as tax. This comes to Rs 116.73. Had you not adjusted using indexation, your net capital gains would have been Rs 5,000. 20% of this would have amounted to Rs 1,000. Needless to say, you have saved much on tax.
1.17 THE NEXT PHASE OF MUTUAL FUND GROWTH

Over the last 10 years, the mutual funds industry has grown sixfold. The next phase of growth will need new ideas. Industry CEOs discuss some of these ideas. The mutual fund industry is witnessing an unprecedented pace of growth with total assets under management increasing sixfold to Rs20 trillion in a matter of 10 years. Given the market scope, there is an exciting buzz in the industry about the future. Last week at the Cafemutual Confluence 2017, the question of accelerating incremental growth was addressed by some of the industry’s chief executive officers (CEOs). Cafemutual.com caters to mutual fund industry stakeholders with information about the industry. A panel of six CEOs gave radical ideas on how to add investors at an even faster pace.

The industry currently has several stakeholders: asset managers, distributors, advisers, investors and the regulator. Although the objective should largely be around asset managers providing suitable choices and investors seeking performance, there are smaller debates which crop up. Some of the ideas talked about in the conference were an attempt to iron out such debates to enable faster growth.

➢ No AMC sales team

Every asset manager has an internal sales team. While the institutional sales have largely been direct, retail sale has depended more on distributors. Over the last 4-5 years, however, with direct plan options, the asset management companies (AMCs) are also seeking retail investors directly. AMCs do not have to pay distributor commission on direct plans. They also save on the costs of servicing distributors. This helps investors too as distributor commissions are part of the total expense ratio charged to them. Without it, direct plan returns are higher than those of corresponding regular plans. However, this has created some friction between distributors and AMCs. According to a senior executive with a domestic asset manager, not authorised to speak to media, “Distributors don’t like low expense direct plans. Retail investors do come through distributors but AMCs also want direct clients.”

At the Cafemutual event, Sunil Subramaniam, chief executive officer, Sundaram Asset Management Co. Ltd, spoke about changing the perception. “It should not be ‘them versus us’, rather ‘us plus them’. We can do away with the AMC sales force completely.
and rely on distribution networks to reach investors. It can help save costs and focus on launching products that deliver what is promised,” he said.

An aggressive internal sales team may push for launching too many products, which aren't always relevant for long-term investing. On the other hand, the cost argument might favour direct plans for large-sized asset managers. Some asset managers now also have dedicated service to direct investors.

➢ **Technology can take over**

Bring in technologies, like robo-advisors, and one can talk of doing away with internal sales teams, especially for smaller asset managers. This threat is real and impacts not only AMC sales teams but also distributors who haven’t adapted to change. Large distributors and clients, in any case, call for meetings with fund managers. The salespersons may have a small role in acquiring those transactions. Kailash Kulkarni, chief executive officer, L&T Investment Management Ltd, said embracing technology is inevitable: “With technology, each distributor can deliver service to 500 families rather than just 100.” Kulkarni said his company has undertaken a project to teach women in villages to use feature phones, which can in turn be used to buy mutual fund units.

➢ **Make experience important**

Fixed deposit investors don’t know what to expect from market-linked mutual funds. To ease in new investors, Saurabh Nanavati, chief executive officer, Invesco Asset Management (India) Pvt. Ltd, said one should be able to experience the product before buying, alluding to free samples of FMCG products. “Along with investor awareness, we can...give free units to every new unique PAN that gets registered. These investors can then see the benefits of investing though mutual funds. New (distributors) can be given some of these new unique PAN folio holders as investors who need help and advice with future decisions.” Experience is also dictated by expectations. Many times too much focus on the market environment can create unattainable return expectations. Kalpen Parekh, president DSP Blackrock Investment Management Ltd, said, “In the last 20 years, I have always seen emphasis on market trends. Mutual funds need to be presented not just as market-linked products, rather as concepts and solutions towards a goal.”
Some of this is already getting done at industry level and by individual asset managers. However, measuring the efficacy of this strategy in adding new investors is not an easy task.

- **Unity of action**

A combined effort by all the asset managers might see a faster pace of growth in assets and investor folios, some CEOs believe. Ashutosh Bishnoi, chief executive officer, Mahindra Asset Management Co. Pvt. Ltd, said that AMCs too need take risks and reach out further into the interiors of the country. This is being done to an extent. Internal distribution channels, through affiliated banks and non-banking finance companies, are being leveraged for better sales. Nilesh Shah, managing director, Kotak Asset Management Co. Ltd, talked of a collective vision: “Our vision can be to make each Aadhaar holder an investor, but the vision communicated to the government has to be that all Aadhaar holders need to be turned into income tax paying mutual fund investors. The caste system in MFs where some funds are Brahmins and others are Shudras needs to stop...start small then implement on large scale. Distributors too need to unite on one forum.”

It has happened that schemes that are perceived to be of better pedigree (or Brahmin) are more sought than others with comparable or even better returns but a lesser brand foothold. Practically speaking, asset management is not about having similar products on similar platforms. Each asset manager will come with its own processes, product ideas and distribution channel. Ultimately the investor will choose those which offer better in performance, service and overall experience. An industry which offers relatively easy entry for managers and distributors, is unlikely to see any major joint effort being undertaken on too many fronts.

### 1.18 CHALLENGES OF MUTUAL FUNDS

- **Growth Versus Governance**

A right mix The Indian Mutual Fund industry has held its ground in the midst of adversities in the capital markets thanks to the strong regulatory framework in place. An increasing responsibility is being placed on the Trustees to ensure that the operations of
the funds are managed to the full benefit of the unit holders. As the number of players in the market increases, competition may force fund houses to comply not only with the laid down regulations and concentrate more on growth but endeavor in creating excellence in governance as well. In this challenging environment, the debate of growth versus governance is surely set to assume greater significance.

➢ Regulations - What More Is Needed?
As the industry moves on from its nascence to adolescence, it is joint responsibility of the industry players, the regulators and also the investors to ensure that it further transits to maturity as smoothly as possible. A strong regulatory platform is a key challenge in any business environment, more so in the Indian context at this point on the growth curve of the industry. While we do have a strong regulatory platform in place, more can be done based on the experience of mature markets like the US and UK, where investor protection has assumed top priority. The industry is well governed with a spate of reactive regulations and it's now time to introduce more proactive, growth enhancing regulations.

➢ Administration And Distribution
No discussion on mutual funds can be complete without touching upon the aspect of distribution. A lot has been spoken about the need to increase penetration of mutual funds in Tier II and Tier III cities. Rural participation in mutual funds continues to be poor. Such poor penetration has much to do with lack of investor awareness, inefficiencies in fund transfer mechanisms, presence of safer substitutes and cost of establishing presence in smaller areas. Fund houses cannot fight this battle single handedly. They need adequate support in terms of banking infrastructure, distribution services and technological solutions to ensure a sustainable cost-benefit model of growth. Even in terms of the transfer agency function, the choice of players was very limited which too sometimes places a constraint in terms of ensuring administered growth. However, with more players entering the business, watch out this space for more action.
**Investor Education- A Thrust On Financial Planning**

The efforts taken by the industry and AMFI towards investor education are definitely showing results. The media is also making a fair share of its contribution. Today, we have news channels, running dedicated shows for mutual funds, wherein fundamentals of investing in mutual funds are explained and queries of investors are answered by experts. However, the fact remains that in our country mutual funds are sold rather than bought. And this trend has been observed uniformly across all classes of investors and for all kinds of products. This is where professional help is required. The economic boom in our country has led to the emergence of a very strong Small and Medium Enterprise (SME) sector. Banks and financial institutions are also vying for a stake in wooing this niche business segment. However, the focus of SMEs has primarily been in the manufacturing sector. The services sector could also be accredited with this status. This would help professionalise financial planning in our country as is the trend in mature markets like the USA. The Certified Financial Planner accreditation can now be acquired in India. With the right kind of assistance from the banking sector, we could have an army of entrepreneurs willing to take up financial planning as a very profitable business option and this could go a long way not only in ensuring professional education and guidance to the investors but also in improving the long term financial health of investors.

**The Technological Backbone**

Fund houses have introduced interesting technological innovations such as transacting through the internet, net asset value updates on mobile phones, unit balance alerts via SMS messages, transacting through ATM cards etc. However, these innovations currently cater to the already pampered urban class of investors. The internet revolution in our country is yet to penetrate to the grass root levels. The per capita usage of internet in our country is still very low compared not only to the developed countries but also as compared to our developing peers. Mobile telephony comparatively has grown exponentially. Herein lies another important challenge for the industry. It is very important to strike the right balance while choosing to invest in technological advancements. As mentioned earlier, the industry is now at a stage where to progress to the next level of growth, it needs more support from other sectors in the economy. A few
fund houses with deep pockets may be able to make necessary investments in the required technology. But for the long term benefit of all the players in the industry, it is indeed necessary to join hands with other sectors of the economy such as banking and telecommunications.

➢ Diminishing Talent Pool

Print media these days has dedicated space to capture resource movements between companies, especially in the financial services sector. The acute shortage of talented resources is slowly but surely showing its impact. The pool of talented people is diminishing and staff costs are soaring. The key challenge is to find a permanent solution to tide over this acute shortage. One possible solution could be for the industry through AMFI to tie up with universities and colleges to offer programmes dedicated to the financial services industry in general and the mutual fund industry in particular, which would cover various critical aspects of the financial services industry ranging from fund management, research, analysis, treasury, operations and accounting. Aspirants acquiring accreditation in these courses could then be directly channelised into the various subsets of the financial services industry. This could ensure a continuous steady supply of talented resources to the industry.
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44
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