CHAPTER: 2

MUTUAL FUNDS
INTRODUCTION AND CONCEPT

Mutual Fund is an important Financial Service Sector Segment in the emerging economies which directs the actual savings of the people into productive sectors. It is actually a Trust or Investment Company which pools together the savings of a number of investors, invest them in shares, bonds and other long term and short term securities. It earns income through dividend, interest and capital appreciation from these investments. At the end of a definite period, the extra income earned through these investments is distributed to the actual contributors of the fund.

The Securities and Exchange Board of India (Mutual Funds) Regulations, 1993 defines a Mutual Fund as "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". These mutual funds are referred to as 'Unit Trust' in U.K. and 'Investment Companies' in U.S.A. Encyclopedia Britannica defines a Mutual Fund as "Mutual Funds- also called Unit Trust or Open Ended Trust - a company that invests the fund of its subscribers in diversified securities and in turn issues units representing shares in those holdings. They make continuous offering of new shares at Net Asset Value and redeem the shares on demand at Net Asset Value determined daily by the market value of the securities they hold. Thomson Dictionary of Banking defines a Unit Trust as "a method of investment by which money subscribed by many people is pooled in a fund, the investment and management of which is subject to the strict legal provision of a trust deed. The fund is invested in securities on behalf of subscribers by a management company. The management company and the trust who must be independent of each other are parties to the trust deed which defines their respective responsibilities towards the subscribers, to the trust fund and details the rules for the operation of the trust.

As we compare this particular investment option with mere shares, bonds and other investment areas, the possibilities and potentialities of
Mutual Funds as an investment option cannot express in comprehensive terms. What a Mutual Fund is better understood by the functions it performs and role it plays. It is a non-depository financial intermediary. Mutual Funds are mobiliser of savings, particularly from the small and household sectors, for investment in stock and money market. Basically, these institutions are professional fund managers, managing funds of individuals and institutions that may not have such high degree of expertise or may not have time sufficient to cope with complexities of different investment avenues, legal provisions associated therewith and unpredictable fluctuations of capital markets. Mutual funds, thus, provide an alternative to the investors who instead of making direct investments in shares or bonds through public issues or through secondary market, subscribe to the corpus of mutual funds. Investor can reap all the benefits of good investing through mutual funds like enjoying growth in scripts in which he could not have otherwise instead, holding a balanced and well-diversified portfolio, better returns due to specialized and professional management of funds etc. Mutual funds mobilize funds by selling their own shares also known as units. When an investor owns shares in mutual funds he owns a proportional share of their securities portfolio. In other words, share of a mutual fund actually represent a part share in many securities that it has purchased. Mutual Fund share certificate combines the convenience and satisfaction of owing shares in many industries. Thus mutual funds are investment intermediaries which pool investors’ funds to acquire individual investments and pass on the returns there of to fund investors. Besides investment business, mutual funds may also undertake if permitted, under writing and other merchant banking activities.

**IMPORTANCE OF MUTUAL FUNDS**

The Mutual fund industry has grown at a phenomenal rate in the recent past. One can witness a revolution in the mutual fund industry in view of its importance to the investors in general and the country’s economy at large. The following are some of the important advantages of mutual funds.
(a) Offering Wide Portfolio Investment

It is one of the important advantages of mutual funds over other investment avenues is that a mutual fund diversifies its risk by investing on a large variety of shares and bonds which cannot be done by small and medium investors. This is in accordance with the maxim 'Not to lay all eggs in one basket'. If a small investor invests in a select few shares, some may even sink without a trace never to rise again. Even though it is very difficult for a small investor to keep his investment diversified with his limited resources, it is possible for a mutual fund as they possess a pool of savings from different investors. With this large resource, they are in a position to have a balanced portfolio with low risk as compared with a single investor. Thus a mutual fund can play the investment game with more courage.

(b) Rendering Expertise Investment Service at low cost

The securities market always has a complex nature. So it is very difficult for a common investor to do all these works by himself. In such a situation, he is forced to go for a professional portfolio manager. Nowadays these individual portfolio managers charge a hefty management fee. When we compare these fees with the return on investment, it is a huge amount and is not affordable to a small investor who wants to keep his hard earned money in the capital market. Here arises the importance of mutual funds. In a mutual fund, the management of the fund is generally assigned to professionals who are well trained and have adequate experience in the field of investment. The investment decisions of these professionals are always backed by informed judgment and experience. Thus investments are assured of quality services in their best interest. Thus the intermediation fee is very less in mutual funds as compared to individual portfolio management fee.
(c) Providing better returns

The policy of funds from a large number of customers enables the funds to have large funds at its disposal. Due to these large funds, mutual funds are able to buy cheaper and able to sell dearer than the small and medium investors. Thus they are able to provide better market rates for the investment and charge lower rates of brokerage. So mutual funds are able to provide better yields to their customers, i.e., mutual funds enjoy the economies of large scale and can reduce the cost of capital market participation. Because of these advantages, mutual funds can produce a good return to the investors by way of dividends and capital appreciation. A study shows that during the calendar year 2004, while banks provide an interest rate of 6% for its deposits, the BSE Sensex gives a return of average 11%. During the same period, equity funds on an average gave a return of 24%.

(d) Mutual Funds Offer Tax Benefits

Some mutual funds avail the benefit of tax concessions to its investors other than a good earning for their investment. Other than many tax benefit schemes, according to the new section 80C introduced in the Union Budget 2005-'06, we can invest a maximum of Rs.1,00,000 in investment options like Equity-linked Savings Schemes, Infrastructure Bonds, Unit linked Insurance Plans etc. and the entire sum can be deducted from one's taxable income. Besides equity oriented schemes are exempted from the long term capital gain tax. Both these points attract more investors nowadays to these mutual funds.

(e) Providing Greater Affordability and Liquidity

Greater affordability is one of the important features of mutual funds. With his limited resources, one can get into the investment game and can reap good return. Mutual funds always provide an attractive and cost effective alternative to direct purchase of shares to a common
investor. Here with his limited resources, he can even own a string of blue chips. Other than affordability, mutual funds provide liquidity for its members. Units can be sold to the fund at any time at the Net Asset Value and thus quick access to liquid cash is assured. Most mutual fund houses offer the facility of converting mutual fund units into liquid cash within a period of 48hrs. Besides, sponsoring banks of many mutual funds are always ready to provide loan facility against the unit certificates.

(f) Providing Research Service
Every mutual fund conducts an in-depth study and carry out research on corporate securities. It is because a mutual fund should be able to command vast resources. They made investments purely on the basis of a thorough research. Since research involves a lot of time, efforts and expenditure an individual investor cannot take up this work. So by investing in a mutual fund, the investor gets the benefit of the research done by the fund.

(g) Flexibility in Investing Different Schemes
Some mutual funds have permitted the investors to switch over their units from one scheme to another. This is actually a great help for the investors. It is because of the fact that, the performance of a fund is always unpredictable. It is always depends on the scripts which is backed by the investment. The investment climate may be some times good for one fund and bad for the other. So an intelligent investor can switch over his units in one fund to another depending up on the performance of the funds. One cannot find such flexibility in any other investments.
(h) **Channelising Savings for Investment**

Mutual Funds acts as a vehicle which channelises the savings of the people in a country to the capital market by offering various schemes suitable to the various classes of investors according to their capacity to invest. This type of an investment option always helps an economy by activating the capital market. An active capital market always represents the financial health of an economy. In the absence of mutual funds these schemes would have remained idle. Thus the whole economy benefits by mutual funds due to the cost efficient optimum use of scarce financial resources in the economy for its speedy development.

(i) **Simplified Record Keeping**

An investor with just an investment in 1000 shares or so in 3 or 4 companies has to keep proper records of dividend payments, bonus issues, price movements, purchase or sale instructions, brokerage and other related items. It is a tedious task and consumes a lot of time. One may even forget to record the rights issues. Thus record keeping is the biggest problem for small and medium investors. Here the mutual fund offers a single investment source facility. ie, a single buy order of 100 units from a mutual fund is equivalent to invest in more than 100 companies. Thus in this case, the investor has to keep a record of only one deal with the mutual fund. Even if he does not keep a record, the mutual fund sends statements very often to investors. Thus by investing in Mutual funds, the record keeping work is also passed on to the fund.

(j) **Supporting Capital Market**

Mutual Funds play a vital role in the development of the capital market. It makes the capital market active by means of providing a source of demand for capital market instruments. In other words, the
savings of the people are directed towards investments in capital markets through these mutual funds. Because of this active presence of mutual funds in the capital market, it remains stable even when foreign investors and speculators exit and reenter the markets occasionally to reap the benefit of a fluctuated market. Thus it is rendering an excellent support to the capital market and helping in the process of institutionalization of the market.

(k) Acting as Substitute for Initial Public Offerings (IPOs)

In most of the cases, investors are not able to get allotments in IPOs of companies because they are often oversubscribed many times. Moreover, they have to apply for a minimum of 500 shares which is very difficult particularly for small investors. But in mutual funds, allotment is more or less guaranteed. Mutual funds are also guaranteed a certain percentage of IPOs by companies.

During the end of 2004 and the beginning of 2005, which witnessed a boom in the Initial Public Offerings of new mutual fund schemes, lead by a rapid growth in the capital market segment forced the authorities to change the term Initial Public Offerings (IPOs) which is also used for launching new mutual fund schemes in to NFO (New Fund Offer) This was because of the fact that a common investor may be confused with the launch of a new fund with the actual Initial Public Offering of a company.

(l) Helps to Reduce Marketing Cost of Initial Public Offering (IPO) of a Company

Cost of marketing a new capital issue is always a main factor taken into consider by the issue manager in case of large public offerings of big companies. In such a case if they allot a major share of the initial public offerings to the mutual funds, they can save a big portion of
such expenses. Thus mutual funds help to reduce the marketing cost of the new issues.

(m) Keeping the Money Market Active
An individual investor cannot have any access to money market instruments since the minimum amount of investment in it is considerably big. On the other hand, mutual funds keep the money market active by investing money on the money market instruments. Infact the availability of more money market instruments itself is a good sign for a developed money market which is very essential for the successful functioning of the central bank in a country

(n) Allocation of Trigger Facility with Selected Funds
Triggers are the options provided to the unit holders as part of a systematic withdrawal plan to enable automatic redemption on the happening of the desired events. These triggers may be;

Value trigger:
In this case, the redemption will be triggered when the investment in the fund reaches a value that the investor has defined. For example, if some one has invested Rs.50,000 with a mutual fund and has set the trigger at Rs.75,000, the mutual fund will automatically redeem when the repurchase value reaches RS. 75,000.

Downside Trigger:
This is a type of value trigger. This is based on the stop loss concept. For example, if an investor invests Rs.50,000, he can specify a value trigger of Rs.45,000. In case of depreciation in NAV, as and when his investment value reaches Rs.45,000 or lower, the trigger will be fired.

The Date Trigger:
In these cases, the investor opts to redeem on a date specified by him. For example, he may want to redeem his investment on a specific date such as the date of his retirement etc.
Triggers at Transaction Level:
An investor may carry out two separate investment transactions with the fund at two different times. He could specify separate triggers for each of his transactions and these triggers could be of different types.

Index-based Trigger:
The equity schemes can avail a new trigger based on NSE Nifty or BSE Sensex values. An investor has to specify the index value on reaching of which the investments should be redeemed or switched.

(o) Protecting Investors from Fraud
Nowadays mutual fund industry is highly regulated. These regulations protect investors from the clutches of fraud and malpractices. As mutual fund industry has a good growth potential in India, the regulator, SEBI has taken special initiative in protecting the interest of small investors. This is evident from the recent guidelines put forward by SEBI regarding the investment limit of corporates in the total corpus of a fund, regulation of FII (Foreign Institutional Investors) in the participation of investments etc.

Thus mutual funds provide stability to share prices, safety to investors and resources to prospective entrepreneurs.

INVESTMENT OPPORTUNITIES AVAILABLE IN INDIA
The investment scenario in India has changed dramatically in the last decade by keeping pace with the trends of globalization. With an increased awareness about new investment avenues, and with an ambition to gain maximum returns, many people are looking for new investment options other than the ones our traditional banking system offers. Nowadays the trend of finding new investment avenues reached from mere 'Bank Deposit' to 'Commodity Future Market'. It is very interesting to go through different investment options available in India from the traditional investment option bank deposits.
Bank Deposits

It is one of the oldest and common investment option available to investors. The 'interest' on investment in bank deposit depends on the period of investment and type of accounts viz fixed, recurring, saving and current. Nowadays banks offer interest for fixed deposits (FDs) a maximum near to 6.5%. It is considered as the risk free return which is not enough to accommodate the inflation rate of currency. The low returns and long lock-in periods make this investment option unattractive.

But FDs offer two unique benefits which still remain unmatched. One is assurance of returns over the tenure of the investment. Perhaps it offers the best risk adjusted return on an investment, with the exception of small saving schemes. Second is greater liquidity. Some banks offer the benefit of writing cheques against fixed deposits. Investors can also avail of finance through loans against their FDs. Lastly, an FD allows an investor to plan out his cash flows because it is stable and assured. Lower interest rate is the price the investor is willing to pay for certainty and assurance.

Shares

It is one of the best investment opportunities in a growing economy. That is evident from the recent trends in the Indian stock market. If one economy is growing, the industries playing in it have a good growth prospect and present good results. The performance of most of the Indian companies has improved in the recent years compared to previous years. This was driven by improved margins, low interest costs and improved asset utilizations. Accelerated sales and strong net profit growth on the back of improved operating margins and falling interest burden have propelled this. The recent trend of heavy inflows from Foreign Institutional Investors (FIIs) has also improved the health of Indian stock market. The current bullrun in the Indian equities market has raised many questions in the minds of investors. But if one tracks the BSE Sensex movement along with its Earning
Per Share (EPS), the rise in the Sensex is in line with the sharp growth in the EPS of 30 BSE Sensex companies.

There is no cause for worry regarding equity investors as long as the market movements are in line with the economic and company fundamentals. There are a few basic guidelines that a small investor can follow in order to ensure that risk in the investing process is reduced. Before investing one should evaluate the company: the nature of the business, growth rate, potential, management credibility and track record, dividend history, its position in the industry and make the right comparison concerning on performance and trend. Anyway an investor needs to be done a bit of subjective and objective homework before taking an investment decision.

The basic investment approach in shares is to ‘buy stocks at a fair discount to its intrinsic value and sell at well-defined price points. There are different approaches to finding under valued stocks. For instance, an investor might have to take contrarian calls to find ‘value’ in areas ignored by the investing community. It could in the form of finding companies in out-of-favour sectors or through disparity on peer-group valuation. Thus the selection of shares can do in different ways based on the risk-taking appetite of investors.

It is advisable to be extra cautious of investing in stocks. Because it may show a sudden fluctuation some times as a result of sensitive backgrounds which may not be related to company’s fundamentals. So the investor should think twice before making an investment decision and not get swayed by the hype created by the market buoyancy. If one is not a full time investor, leave it to the experts.

**Debt Market**

This fixed interest and less variable return instrument is also a popular investment avenue these days. This option is attractive to those who are risk averse and are happy with assured modest fixed income or interest income,
and certainty of income. But the debt market is not so developed in India for many reasons. Firstly Government and semi-Government bodies being largest issuers of debt, the interest rates on debt are controlled historically by the Government for long, the interest rates on fixed deposit of companies and P.S.Us were also fixed by the RBI, at ceiling levels. Secondly these interest rates were kept low to facilitate Government funding at cheaper cost. But a variety of new debt instruments are issued by corporates since the entry into capital market was freed in May 1992. Secured premium notes, fully convertible preference shares, premium notes, fully convertible and partly convertible debentures, convertible preference shares, discount bonds, zero coupon bonds, flexibonds, floating rate bonds etc. are some of the examples of debt instruments in Indian market. Since March 1998, these instruments are to be compulsorily credit rated.

Real Estate

The real estate industry has much influence on the economy of a developing country. The performance of this sector in the last five years has proved a landmark period, emphasizing the role that real estate industry can play in catalyzing economic growth. The real estate industry has direct linkages with core industries like cement, steel etc. It also has a multiplier effect on sectors like retail, hospitality, infrastructure, tourism etc. Thus better real estate assets can be leveraged for developing the entire economy. According to the Tenth Five Year Plan there is a gap of 30 million units between demand and supply for housing. Bridging this gap will require an investment of Rs.1,75,000 crore. 19 million homes are needed in urban centres and the rest in rural India.

One may argue that the recent boom in real estate is helping solve the problem but the demand still far outstrips supply. The immediate requirement is to create an environment that establishes real estate industry as a sound investment option. Once this happens, more funds will automatically flow in. Some of the ground work in this regard has already been done. Home loan
rates are reduced to an extent from the last five years. An FDI policy in this regard still needs a fine tuning. Besides these facts, the real estate sector requires a professional outlook and a more systematic way of conducting its affairs. One of the biggest hindrances to invest in this sector is lack of professionals and lack of transparency in real estate development.

Table 2.1

AVERAGE RETURNS ON INVESTMENT OF REAL ESTATE IN VARIOUS CITIES

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<th>2005</th>
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<td>22.21</td>
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<td>Chennai</td>
<td>11.54</td>
<td>14.34</td>
<td>14.50</td>
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</tbody>
</table>

<table>
<thead>
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<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
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</thead>
<tbody>
<tr>
<td>Bangalore</td>
<td>6.69</td>
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<tr>
<td>Mumbai</td>
<td>7.45</td>
<td>3.87</td>
<td>4.95</td>
<td>10.31</td>
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</tbody>
</table>

Source: Outlook, 7 November 2005

Pension Plans

It is good news that the life expectancy of an average Indian has increased. It also implies the need to accumulate more for retirement. A person, who starts earning at age 24 and plans to retire at 60, will need to save around 25% of his earnings every year in order to maintain the same life style after retirement if the life expectancy is 70-75 years. In this context, the importance of Pension Schemes arises. This is especially true if one is not in government service nor part of the Employee Provident Fund Organisation schemes and are therefore, not eligible to pension or provident fund benefits.

3 The Government of India launched a New Pension System (NPS) on January 1, 2004 While this scheme is initially open only to new Central
Government Employees, it will soon be made available to the public at large. The scheme is based on a number of important principles and its features make it somewhat different from other retirement and long-term saving schemes in India. Before one start saving for retirement, it will be useful to evaluate the current pension plans against some standard benchmark features.

A pension plan is a tax efficient way of ensuring steady source of income after retirement. Till last year, pension premium of up to Rs.10,000 a year was fully deductable from the taxable income of a person, making pension plans the most efficient way of saving tax. Budget 2005 has removed pension plans from Section 80 CCC and put them under the omnibus Section 80 CCE. That means the premium paid for a pension plan will be part of the Rs.1 lakh saving limit under the new section.

All life insurance companies, even banks offer pension policies and any adult can buy one. Pension usually begins when the policy holder is at least 50 (which is known as the vesting age). On maturity, the policy holder can choose an option among several options available. The policy holder also has option to take 25% of the corpus as a lumpsum on maturity. The balance is invested in an annuity to earn monthly income for the pensioner. Though interest rates have come down drastically in the past few years, investors can now have a slice of the stock market pie through unit-linked products. Most insurers have unit-linked pension plans that invest some part of the corpus in equities. Investors can also switch from a debt plan to a balanced plan, and vice versa. One or two such switches in a year are not charged. More than two switches usually carry a 1-2 percent charge.

**Equity Derivative Market**

Though the equity derivatives market in India is not so developed by international standards, interest in this market is increasing. These instruments give rise to many opportunities as well as challenges because there are many complications and that is why many retail investors shy away
from this market. These are primarily a tool to use short-term expectations about a stock or an index to trade.

To start trading on the derivative market, the client has to make an initial deposit with the broker. The amount can vary from Rs.15,000 to Rs. 50,000 depending on the size of the positions the investor wishes to take and the instrument (future/option) he is interested in. The amount also varies from broker to broker. In the derivatives market, the market lot for every scrip is prescribed, corresponding to a minimum contract size of 2 lakh. A derivative investor can deal only in multiples of the prescribed market lot. The market lot varies for every stock (eg. from 100 shares per contract for Infosys to 3300 shares for one contract of Tata Motors). The market lot determines the margins or the premium to be paid to enter into a derivative contract. Even though the value of the contract size is high an investor does not have to shell out the entire amount as an investment.

Commodity Future Market

When the commodity exchanges were launched in the country a few years back under the banner of National Commodities and Derivatives Exchange (NCDEX) and Multi Commodity Exchange (MCX), these had attracted attention of investors who were already involved in futures trading in the stock market. Both these commodity exchanges are now doing well and have become well established. Other than these two having a nationwide footprint, there are more than 20 commodity exchanges working regionally. All these exchanges are regulated by the Forward Markets Commission, which comes under the ministry of Consumer Affairs and public Distribution.

The exchanges facilitate buying and selling of a number of agri-commodities, ranging from pulses, grams, sugar, metals and bullion. Even crude oil is now traded on the commodity exchanges. Investors wishing to invest in commodities can do so through brokers registered with these exchanges. Commodities can be bought on the spot as well as in the future.
market. One can trade in the future market without actually holding tones of grains or metals. Just like equity shares or bonds, the spot purchases are credited to the investor's demat account. He can ask his broker to buy cotton or gold for a specific amount or he can sell the same in the future market.

Though commodity prices are less volatile than stocks, these investment come with an inherent market risk. In the equity market, the market value of shares depends on the future performance of the company. In the commodity market, prices are driven by demand and supply. Also prices of precious metals like gold and silver rise when the US dollar is falling. Another thing is that commodity futures are not long term investments that one can buy and forget. They require monitoring on a daily, even hourly basis.

An investor can invest in commodities in many ways. They can buy shares in companies that produce commodities, service or supply inputs to those companies. They can also buy commodity futures directly on commodity exchanges.

**Commercial Paper**

A commercial paper is a short-term negotiable money market instrument. It has the character of an unsecured promissory note. Banking or non-banking companies can issue this for raising their short term debt. Commercial papers are always sold at a discount from their face value and redeemed at their face value. This 15 year old instrument, which allows corporates to meet their working capital requirements directly from the market as an alternative to bank loans has really come a long way since inception. When the instrument was launched, only firms with a minimum tangible networth of Rs.10 crore were allowed to raise funds through this instrument and that too for a period of 3 to 6 months. Nowadays the regulators have made this instrument more flexible as they have lowered the minimum tangible networth requirement to Rs.4 crore and the period of maturity could range from 15 days to one year.
There are many reasons we can raise for such a huge interest in this paper. The one among them is that the market has picked up with the entry of Mutual funds as an investor class these days. The Mutual fund houses made great exposures to this sector as they feel it as an instrument with safe play. The regulator of Mutual funds, the SEBI has restricted investments by mutual funds in unlisted papers to 10% of their investments and CPs, though unlisted, are excluded from this list. Those MFs, specially debt schemes, that are already exhausted their 10% limit are now putting their money into CPs.

Besides, even the insurance sector has also started investing in CPs. The reduction of stamp duty is also another factor for the growth of this sector. Data reveals that among the CP issuers, the share of manufacturing companies has fallen from 82% in 2000-’01 to 56% in 2002-’03 and then to 34% in 2003-’04. However, the issuances by lease and hire purchase firms and financial institutions have gone up. Two of the big issuers now are IDBI and the country’s largest mortgage bank HDFC. Corporates like L&T too have taken the CP route to raise debt.

Investment in Gold

Possessing the good old gold spells an emotional and financial investment in India, which is what makes it the world’s most gold consuming country in the world, according to the World Gold Council (WGC). The lure of gold emanates from the Indian tradition of passing the ‘wealth’ to the next generation. Be it in a daughter’s wedding or on other festivities as gifts. Most famous temples, in fact have idols of gold – that add a touch of ‘purity and piety’ to this revered precious metal.

India in fact, is the world’s largest consumer of gold and accounts for 20% of the global gold off-take annually. An estimated 13,000 tonnes of gold rests in India, which is about 9% of the global cumulative production. People generally hold gold by either buying gold bars, coins or jewelry.4

Gold offers several advantages. First, gold is the perfect hedge against investments in other assets like equities and property. If the economy
gets hurt for some reason, gold prices are likely to rise even as other investments will see a huge decline. Therefore if one holds equities as a predominant investment class, then holding a bit of gold may be a good idea.

While finding it as a good investment option, it is a promising investment particularly for medium-term investors who want to hold it for at least three years and also want a hedge against their other investments. Data reveals that it is a good option for long-term investors also. A weakening US dollar had driven gold prices to multi-year heights recently. However, gold prices have risen steadily over the last few months. Gold is any way a safe investment haven even if there is any political destabilization. Even if international tensions arise, gold will remain steady or may rise. Gold offers the perfect hedge against environmental risk also.

**Art & Antiquities**

Investment in art and antiquities emerged as a good investment avenue these days. Indian art market has started entering in the world of stock market. Share prices of auction houses are shooting up. If the share price of one of the Indian auction house Osian's was Rs.10 to 30 in 2000, it has shot up to Rs.360 recently. Works by the progressive artists, that could not fetch anything more than $5000 a decade ago, are now going for record figures. The recent incident in which the well known artist M.F. Husain signed a deal with industrialist S. Srivastav, selling 125 oil paintings from ‘Our Planet Called Earth’ series at a price of 100 crores is the best example for that. The cultural variances and rich heritage of India extends scope for this sector. Experts identifies the factors that affected the change in the last decade are a changing mindset, new perceived value in Indian modern and contemporary art post-independence, increasing price transparency, more historical data, liquidity in the market, more art galleries and auction houses.
Public Provident Fund (PPF)
The Public Provident Fund (PPF) scheme is a statutory scheme of the Central Government framed under the provisions of the Public Provident Fund Act, 1968. The account can be opened in any branch of the State Bank of India and its subsidiaries. It can also be opened in any Head Post Office or in any authorized P.O. or in certain branches of some nationalized banks. Those having General Provident Fund or Employees Provident Fund can also open a PPF account. Only one account can be opened in one name either in the Head Post Office or in the State Bank or the nationalized banks. The subscription can be deposited in a lumpsum or in convenient instalments. Not more than 12 instalments can be deposited in a year and more than one instalment can be deposited in a month. But it is not necessary to subscribe every month of the year and the amount of subscription can also be varied to suit the convenience of the subscribers. The PPF deposits can be made in monthly instalments and carry a compounded return of 8%. It has a maturity period of 15 years. For the financial year 2005-06, the maximum limit of one person can invest in PPF is Rs.70,000. Under this investment option, one withdrawal per financial year can be made any time after 5 years from the end of the year in which the subscription is made. Withdrawal is limited to 50% of the balance at the end of the fourth year. It is not transferable, but has nomination facility. A subscriber can also take a loan from the fund in case of need. The first loan can be taken in the third year from the year of opening the account. The amount of loan is restricted to 25% of the balance repayable either in lumpsum or in convenient instalments of not more than 36. Subsequent loan can be taken when the earlier loan with the interest has been fully repaid.

While changes are expected in this scheme, there is a likelihood of new rule being applicable only for new investments made after the change. Many investors have been afraid that the new rules, if applicable to existing investments will make the entire scheme unviable and one will have to wait till some actual changes is made to know that exact result. But several
investment advisors are asking their clients to at least ensure that the current year's level is exhausted.

**National Savings Certificates**
Here the return is 8% with the payout every six months. There is no limit for the investment here and the amount is available as a deduction under Section 80C. Investors can use this route to fill in a part of their debt portfolio which does not require immediate liquidity and earn good returns in the process.

There are also various postal deposits that are present and these can be used by investors as per their need. They currently offer rates that are slightly higher than the rates on similar deposits with banks. However this difference in rates could narrow significantly in case there is an upward movement in the interest rates in the economy and the banks are forced to raise the rates on their deposits.

**Post Office Monthly Income Plan**
This is another useful instrument and it remains an attractive option even after the recent removal of the 10% bonus on maturity. What is useful about this product is its ability to provide monthly cash inflows. This is unlike a fixed deposit where the interest is paid out at the time of maturity and not during the term of the deposit.

It also scores over Monthly Income Plan (MIP) of mutual funds in terms of predictability of cash flows. Dividends declared by mutual fund MIPs typically tend to vary, moreover, many mutual funds also devote a certain proportion of the fund's assets to equity. While this gives a kick to the returns when the markets are doing well, it can also drag down returns in the event of a down turn. Considering the returns in pure debt funds, the interest on post office MIP is still very attractive. Moreover like the other plans offered through the post office, these deposits come with zero credit risk. However, MIPs from mutual funds do have a more efficient tax structure. A dividend
distribution tax of twelve and a half percent is deducted and the dividend amount thereafter is free of tax in the hands of the investor. The Post Office MIP, therefore is suited for investors looking for monthly cash flows, predictable returns and zero risk. The disadvantage however is that the interest paid out on these deposits is taxable. The initial investment made too does not qualify for Section 80C benefits. The current rate on these deposits is 8%. The maturity period for a post office MIP is 6 years. Premature closure after one year but before three years becomes at a discount of 2%. 1% is deducted if premature closure is made after three years.

Kisan Vikas Patra

This is perhaps one of the most under-rated investment options. This offers no tax benefits. The initial investment amount does not qualify for any tax benefits, and the interest accruing on the investment, too is taxable. KVP is so structured as to double the investment amount. Over time, with the decline in interest rates, the time period required to double the investment has increased. Currently, it takes 8 years and 7 months to double one's investment through KVPs. This, works out to a compounded annual interest rate of 8.4%. On a simple interest basis, the return works out to almost 11.6%.

Senior citizens and those with income below the minimum level for tax purposes will find KVPs the most profitable since no tax needs to be paid on the interest. In this respect, it also compares favourably with the Senior Citizens Scheme. The SCS in comparison gives a simple interest at the rate of 9% p.a. Also, SCS normally requires the money to be kept for at least five years. Pre-mature closure before 2 years however attracts a penalty of 1.5% while closure between 2 to 5 years attracts a penalty of 1% of deposit. Importantly, there is enough liquidity built into the KVP instrument. The patras can be pledged as security in a bank. Moreover premature encashment can be done any time after two and half years.
ADVANTAGES OF MUTUAL FUNDS OVER INDIVIDUAL COMPANY SHARES

The investment logic in a share and a mutual fund unit is more or less same. Investment in equity share represents investment in a particular company alone. The market value of a share is quoted in a stock exchange according to its demand. Just like shares, the price of units of a fund is also quoted in the market. This price is governed basically by the value of the underlying investments held by that fund. i.e., investment on a unit of a Fund represents investment in the part of shares of a large number of companies. This gives an idea how safe the units are. If a particular company fails, the shareholders of that company are affected very much whereas the unit holders of that company are able to withstand that risk by means of their profitable holdings in other companies shares.

(a) Diversification

It is a basic principle of mutual fund concept. It is according to the maxim "don't keep all your eggs in one basket". By investing in many companies, the mutual funds can protect themselves from unexpected drop in value of some shares. The small investor cannot achieve wide diversification on his own because of many reasons, mainly the quantity of resource he can put forward. Mutual funds on the other hand, pool funds of lakhs of investors thus can participate in a large basket of shares of many different companies. Majority of people consider diversification as the major strength of mutual funds.

(b) Expertise Supervision

Making investments is not a full time assignment of investors. So they can hardly have a professional attitude towards their investment. When investor buys mutual fund schemes, an essential benefit one acquires is expert management of the money he puts in the fund. The professional fund managers who supervise fund's portfolio take desirable decision viz., what scripts are to be bought, what
investments are to be sold and more appropriate decision as to the timings of such buy and sell. They have extensive research facilities at their disposal, can spend full time to investigate and can give the fund a constant supervision. The performance of mutual fund schemes, of course, depends on the quality of fund managers employed.

(c) Liquidity of Investment
A distinct advantage of a mutual fund over other investments is that there is always a market for its units. In case of open ended schemes, where the mutual fund itself buys back the units from the investors. There is a simple process to be undertaken by the investor. They have to fill up the withdrawal slip that is given to them by the mutual fund and submit it to the fund. Depending up on the time at which this is submitted to the fund, the investor will see his units redeemed at the prevailing rate applicable. It is according to the NAV(Net Asset Value) of the units of a scheme. Since the fund itself is buying back the units there is little to worry in terms of there not being enough buyers for the units when the investors goes to sell his units. The money is then returned to the investor.

(d) Reduced Risks
Risk in investment is as to recovery of the principal amount and as to return on it. Mutual fund investments on both fronts provide a comfortable situation for investors. The expert supervision, diversification and liquidity of units ensured in mutual funds minimize the risks. Investors are no longer expected to come to grief by falling prey misleading and motivating ‘headline’ leads and tips, if they invest in mutual funds.
(e) Safety of investments
Besides depending on the expert supervision of funds managers, regulating agency in a country (like SEBI) had formed to keep a watch on the securities market to avoid malpractices. Mutual funds have to broadly follow the laid down provisions for their regulation. SEBI acts as a watch dog and attempts whole heartedly to safeguard investor interests.

(f) Tax Shelter
Depending on the schemes of mutual funds, tax shelter is also available. Other than many tax benefit schemes available with different schemes, according to the new section 80C introduced in the Union Budget 2005-'06, one can invest a maximum of Rs.1,00,000 in investment options like Equity-linked Savings Schemes and the entire sum can be deducted from his taxable income. Besides equity oriented schemes are exempted from the long term capital gain tax.

(g) Minimize Operating Costs
Mutual funds having large investible funds at their disposal and it results the advantage of 'Economies of Large Scale'. Because of this the brokerage fee or trading commission may be reduced substantially. It helps to reduce fund's operating cost and obviously increases the income available for investors.

(h) Option to Reinvest Dividends
Every mutual fund has two options available with it. i.e. 'income plan' and 'growth plan'. In the growth plan, the dividend earned by the units in each dividend declaration will be added to the primary investment. Thus one can reinvest the dividend earned in the fund itself.

Investing in securities through mutual fund has many advantages over organizing a personal portfolio. Many find it as the first
stage of step into the capital market. It provides the facility to laymen who are not aware of the capital market and reap the vast and wide benefits out of it. When we compare mutual fund units with mere share, it has a lower risk than shares and more safe.

ADVANTAGES OF MUTUAL FUNDS OVER REAL ESTATE

(a) Affordability
Real Estate has traditionally been a sound investment option. But it remains limited to only a few as the amount of money required for investing in real estate directly is very high. The minimum amount of money required to start a mutual fund investment is quite small. Most of the newly launched funds have a minimum investment requirement of Rs.5,000. However, there are several other existing schemes present in the market where the minimum investment requirement goes to as low a figure as Rs. 2,000. Thus, investors have the choice to kick off their investment with low figures depending upon their convenience.

(b) Liquidity
If an investor directly invest in a real estate property, buying and selling proves a complex and time consuming process. This type of a risk is not present in mutual funds as the process of transforming units into liquid cash is possible within 48 hours with out any hindrances.

(c) Professional Management
There are many risk factors attached with real estate business such as risks related to documentations, title of property, legal aspects etc. Those who are not well versed in these matters will find difficulty in dealing with the property. So professionalism is a must for doing business in this sector. If one invests money in mutual fund, the actual
management of the fund transferred to the fund manager. He is a professional in the field of fund management and works for the investors.

(d) Tax Advantages

In India, the stamp duty and other property taxes are higher compared to other nations. Thus the cost of transferring property from one party to another finds a costly process and it will eat away the major portion of profit earned in the deal. But in mutual funds, any amount of dividend that the investor received will not form a taxable income of that party. In case of equity oriented schemes, the tax aspect is more favourable for the investor. If the holding of is for a period of more than 12 months then there is no long capital gains tax to be paid by the investor.

This chapter mainly deals with the explanation of the concept of mutual funds and its importance as an investment avenue. The concept of mutual fund can be described as 'risk reducing mechanism by diversification' in the investment world. This has a due importance in the current investment scenario of capital market boom because even those who are not knowing how to deal in the field of capital market like a small investor can reap the benefit of the capital market developments through mutual funds. As the experts are managing the mutual funds with a large resource, the risk related to the investment is also reduced to a greater extend in the mutual fund investment. This chapter evaluate different other investment opportunities available in India like Bank F.D., Shares, Debt Market, Real Estate, Pension Plans, Equity Derivative Market, Commodity Future Market, Commercial Paper, Investment in Gold, Art & Antiquities, PPF, NSC, Post Office MIP and Kisan Vikas Patra. A special comparison of mutual funds with individual company shares and real estate is also made in this chapter.
REFERENCE