CHAPTER – III

THEORETICAL CONCEPT OF MUTUAL FUND

3.1. INTRODUCTION

As defined by the association of mutual funds in India AMFI, an apex body of all registered asset management companies “mutual fund is a trust that pools the savings of a number of investors who share a common financial goal. Anybody with an investible surplus can invest in mutual fund units according to their stated investment objective and strategy”. According to Securities and Exchange Board of India (SEBI) Regulations 1996 “mutual fund means a fund established in the form of a trust to raise money through the sale of its units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments”. As defined by the mutual fund book of investment company institute of the U.S. “A mutual funds is a financial service organization that receives money from shareholders, invests it, earns returns on it, attempts to make it grow and agrees to pay the shareholder for the current value of his investment”.

Mutual fund is a special type of institution that acts as an investment conduit. It is a professionally managed investment organization that pools money of individual investors having similar investment objectives. Money thus collected is invested by the fund manager in different types of securities such as shares, debentures, and money market instruments depending upon objectives of the scheme. Income earned and capital appreciations thus realized by schemes are shared to its unit holders in proportion to the
number of units owned by them. Therefore, mutual fund is an investment institution, which assembles savings of individuals, institutions, invests and conducts these savings in corporate securities. Thus it endows the individual investors, with an opportunity to invest in a diversified, professionally managed portfolios at a relatively low cost.

Mutual funds mobilize savings, particularly from small household sectors, for investment in the capital and in the money market. Basically, these institutions professionally manage funds of individuals and institutions that have no such high degree of expertise and sufficient time to deal with the complexities of different investment avenues, legal provisions associated and impulse and vicissitude of financial markets.

Figure 3.1. Mechanics of Mutual Fund Operations

Collection of Small Savings

Depositing public

Mutual Fund Company

Payment of Returns Income

Deposit/Savings

Deployment of Savings

Open-Ended

Close-Ended

Income Fund

Growth Fund

Bond Fund

Sectoral Fund

Gift Fund

Income and Capital Gains Generation
3.2. HISTORY OF MUTUAL FUND IN INDIA

Mutual Fund Industry was started in India (1963) with the formation of Unit Trust of India (UTI), at the initiative of the government of India and Reserve Bank of India (RBI). The history of mutual funds in India can broadly be divided into four distinct phases.

3.2.1. First Phase: the Monolithic Phase (1964-87)

Unit Trust of India was established in 1963 by an Act of Parliament. It was set up by RBI and was functioned under the regulatory and administrative control of RBI. In 1978, UTI was delinked from RBI. Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in the place of RBI. The first scheme launched by UTI was Unit Scheme 1964 (US-64), which attracted the largest number of investors in any single investment scheme over years. UTI launched more innovative schemes in 1970s and 1980s to suit the needs of different investors. It launched ULIP in 1971, six more schemes between 1981 and 1984, children’s gift growth fund and India fund (India’s first offshore fund) in 1986, master share (India’s first equity diversified scheme) in 1987 and monthly income scheme (offering assured returns) during 1990s. By the end of 1987, UTI’s assets under management grew ten times to Rs.6700 crores.

3.2.2. Second Phase: 1987-1993 Entry of the Public Sector Funds

Indian capital market had undergone an unprecedented transformation over 100 years history by the end of 1987. This year marked the entry of non-UTI, the public sector mutual funds set up by the public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI mutual fund was the
first non-UTI mutual fund established in June 1987 followed by Canara Bank mutual fund (Dec. 1987), Punjab National Bank mutual funds (Aug. 1989), Indian Bank mutual funds (Nov. 1989), Bank of India (June 1990), and Bank of Baroda mutual funds (Oct. 1992). LIC established its mutual funds in June 1989 while GIC had set up its mutual funds in December 1990. At the end of 1993, mutual funds industry had assets under management of Rs.47,004 crores. From 1987-88 to 1992-93, fund industry was expanded nearly seven times in terms of asset under management. However, UTI remained to be the leader with about 80 percent market share.

3.2.3. Third Phase: 1993-2003 (Entry of the Private Sector Funds)

A new era in the mutual fund industry began with the permission granted for entry of the private sector funds in 1993, giving Indian investors a wider choice of fund families and increasing competition for the existing public sector funds. Also, 1993 was the year in which the first mutual fund regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari’ Pioneer (now merged with Franklin Templeton) was the first private sector mutual funds registered in July 1993. The 1993 SEBI (mutual fund) regulations were substituted by a more comprehensive and revised mutual funds regulations in 1996. Industry now functions under SEBI (mutual fund) regulations 1996. Number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs.1,21,805 crores. UTI with Rs.44,541 crores of assets under management was way ahead of other mutual funds.
3.2.4. Fourth Phase : Since February 2003

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the specified undertaking of UTI with assets under management of Rs.29,835 crores as at the end of January 2003, representing broadly, assets of US - 64 scheme, assured returns and certain other schemes. The specified undertaking of UTI, functioning under an administrator and under rules framed by the government of India and does not come-under the purview of the mutual fund regulations. The second is UTI mutual funds, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the mutual funds regulations. In 2007, mutual funds were permitted to introduce gold exchange funds and also the guidelines for ‘capital protection oriented scheme’ were notified by SEBI. As on 31 March 2010, the total AUM is Rs.6,14,545.98 crores.

3.3. MUTUAL FUNDS AND TAXATION

An important factor that significantly influences the mutual fund operation in India is taxation. In an economy of deficit financing, the government encourage savings in household and in corporate sector and announces certain tax incentives for saving scheme. Mutual funds have certain tax benefits both from fund and investor’s point of view.

3.3.1. Tax Benefit for Fund

As per Income Tax Act 1961, any income of a notified mutual fund set up by a public sector bank or a public financial institution is fully exempted from tax. According to section 10(33) of Income Tax Act, tax exemption was given to income received on
units of UTI and mutual funds. This measure will definitely boost investments in units of UTI and mutual funds and thereby improve the development of the capital market. Big investors paying tax on dividend income at the rate of 30% will be really benefited by this measure. Small investors exempted from payment of tax will stand to lose as UTI and mutual funds will now pay smaller dividend to their investors in view of tax imposed on distributed income at 10%

3.3.2. Tax Benefit for Investors

Mutual fund is tax friendly for an individual investor, resulting in large inflows into the capital markets through mutual funds. Finance bill has made income [i.e. dividends] received from all mutual funds tax free in the hands of investors. Investors need not pay any tax on dividend received from mutual funds, effective from April 1, 1999 [i.e., Assessment year (2000-2001) for investors], it does not matter what kind of mutual funds scheme they were invested in. Dividend whether received from equity, equity and debt, or a debt scheme all will be tax-free for the investor.

3.3.3. Tax Benefits for Eligible Institutions

Investment in mutual fund units by religious or charitable trust is an eligible investment under section 11(5) of Income Tax Act. Eligible institutions such as those covered under sections 12, 10(21), 10(23) or 10(23c) of Income Tax Act 1961, which invest in units, would qualify for tax exemption in respect of income and corpus under the applicable sections of Income Tax Act 1961.
3.3.4. Benefits Under Wealth Tax

Investment in mutual funds would be treated at par with investment entitled to exemptions within the overall limit of Rs. 5,00,000 Lakh referred in section 5(1A) of Wealth Tax Act, 1957.

3.3.5. Benefits Under Gift Tax

No tax shall be charged on gifts of mutual fund units provided that the aggregate value of gifts made during the year does not exceed Rs.30,000. Further, gift made to a relative who is dependent on the unit holder for support and maintenance on the occasion of marriage of relative is exempted, provided the value of gift is upto Rs.100000 for each such relative.

3.4. MUTUAL FUND COMPANIES IN INDIA

3.4.1. ABN AMRO Mutual Fund

ABN AMRO mutual fund was set up on April 15, 2004 with ABN AMRO Trustee (India) Pvt. Ltd. as the Trustee Company. AMC, ABN AMRO Asset Management (India) Ltd. was incorporated on November 4, 2003. Deutsche Bank A G is the custodian of ABN AMRO mutual fund.

3.4.2. Birla Sun Life Mutual Fund

Birla Sun Life mutual fund is the joint venture of Aditya Birla group and Sun life financial. Sun life financial is a global organization evolved in 1871 and is being represented in Canada, U.S.A, Philippines, Japan, Indonesia and Bermuda apart from
India. Birla sun life mutual fund follows a conservative long-term approach to investment. Recently, it crossed a AUM of Rs.10,000 crores.

3.4.3. Bank of Baroda Mutual Fund

Bank of Baroda mutual fund or BOB mutual fund was set up on October 30, 1992 under the sponsorship of BOB. BOB asset management company limited is AMC of BOB mutual fund and was incorporated on November 5, 1992. Deutsche Bank AG is the custodian.

3.4.4. HDFC Mutual Fund

HDFC mutual fund was set up on June 30, 2000 with two sponsors namely housing development finance corporation limited and standard life investments limited.

3.4.5. HSBC Mutual Fund

HSBC mutual fund was set up on May 27, 2002 with HSBC securities and capital market (India) private limited as the sponsor. Board of Trustees, HSBC mutual fund acts as the trustee company of HSBC mutual fund.

3.4.6. ING VYSYA Mutual Fund

ING Vysya mutual fund was set up on February 11, 1999 with the same named Trustee Company. It is a joint venture of Vysya and ING. AMC, ING investment management (India) private limited was incorporated on April 6, 1998.
3.4.7. Prudential ICICI Mutual Fund

Mutual fund of ICICI is a joint venture with prudential PLC of America, one of the largest life insurance companies in U.S.A. Prudential ICICI mutual fund was set up on October 13, 1993 with two sponsors, Prudential PLC, and ICICI Ltd. The Trustee Company formed its prudential ICICI Asset Management Company limited incorporated on June 22, 1993.

3.4.8. Sahara Mutual Fund

Sahara mutual fund was set up on July 18, 1996 with Sahara India financial corporation Ltd. as the sponsor. Sahara asset management company private limited incorporated on August 31, 1995 works as AMC of Sahara mutual fund. The paid-up capital of AMC stands at Rs.25.8 crores.

3.4.9. State Bank of India mutual fund

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

3.4.10. TATA Mutual Fund

Tata Mutual Fund (TMF) is a trust under the Indian Trust Act, 1882. Sponsors for Tata Mutual Fund are Tata Sons Ltd., and Tata Investment Corporation Ltd. The
investment manager is Tata asset management Ltd. and Tata Trustee Company Pvt. Ltd. Tata asset management Ltd. is one of the fastest growing mutual fund in the country with more than Rs.7,703 crores (as on April 30, 2005) of AUM.

3.4.11. Kotak Mahindra Asset Management Company

Kotak Mahindra Asset Management Company (KMAMC) is a subsidiary of Kotak Mahindra Bank Limited. It is presently having more than 1,99,818 investors in its various schemes. KMAMC started its operations in December 1998. Kotak mahindra mutual fund offers schemes catering to investors with varying risks-returns profiles. It was the first company to launch dedicated gilt schemes investing only in the government securities.

3.4.12. Unit Trust of India Mutual Fund

UTI asset management company private limited was established in January 14, 2003 and it managed UTI mutual fund with the support of UTI trustee company private limited. UTI asset management company presently manages a corpus of over Rs.20,000 crores. Sponsors of UTI mutual fund are BOB, Punjab National Bank (PNB), State Bank of India (SBI) and Life Insurance Corporation of India (LIC). Schemes of UTI mutual fund are liquid funds, income funds, asset management funds, index funds, equity funds and balance funds.

3.4.13. Reliance Mutual Fund

Reliance Mutual Fund (RMF) was established as trust under Indian Trust Act, 1882. It was registered on June 30, 1995 as Reliance capital mutual fund, which was
changed on March 11, 2004. Reliance mutual fund was formed for launching various schemes under which, units are issued to the public with a view to contribute to the capital market and to provide investors the opportunities to make investments in diversified securities.

3.4.14. Standard Chartered Mutual Fund

Standard chartered mutual fund was set up on March 13, 2000 sponsored by standard chartered bank. Standard Chartered Trustee Company Pvt. Ltd. is AMC, which was incorporated with SEBI on December 20, 1999.

3.4.15. Franklin Templeton Mutual Fund

The group, Franklin Templeton Investments is a California (U.S.A) based company with a global AUM of US$ 409.2 billion (as of April 30, 2005). It is one of the largest financial services group in the world. Investors can buy or sell the mutual fund through their financial advisor or through mail or through their website. They have open-end diversified equity schemes, open-end sector equity schemes, open-end hybrid schemes, open-end tax saving schemes, open-end income and liquid schemes, close-end income schemes and open and fund of funds schemes to offer.

3.4.16. Morgan Stanley Mutual Fund

Morgan Stanley is a worldwide and leading financial services company in the market in securities, investment management and credit services. Morgan Stanley investment management (MSIM) was established in the year 1975. It provides customized asset management services and products to governments, corporations,
pension funds and non-profit organizations. Its services are also extended to high net worth individuals and retail investors. In India, it is known as Morgan Stanley Investment Management private limited (MSIM India) and its AMC is Morgan Stanley Mutual Fund (MSMF). This is the first close-end diversified equity scheme serving the needs of Indian retail investors focusing on a long-term capital appreciation.

3.4.17. Escorts Mutual Fund

Escorts mutual fund was set up on April 15, 1996 with Escorts finance limited as its sponsor. Trustee company is Escorts investment trust limited. Its AMC was incorporated on December 1, 1995 with the name Escorts Asset Management Limited.

3.4.18. Alliance Capital Mutual Fund

Alliance Capital Mutual Fund was set up on December 30, 1994 with Alliance Capital Management Corporation of Delaware (U.S.A) as sponsor. Trustee is ACAM trust company Pvt. Ltd. and AMC, Alliance Capital Asset Management India private limited with the corporate office in Mumbai.

3.4.19. Benchmark Mutual Fund

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

Can Bank Mutual Fund was set up on December 19, 1987 with Canara bank acting as the sponsor. Can bank investment management services Ltd. incorporated on March 2, 1993 is AMC. Corporate office of AMC is in Mumbai.

3.4.21. Chola Mutual Fund

Chola Mutual Fund under the sponsorship of Cholamandalam Investment & Finance Company Ltd. was set up on January 3, 1997. Cholamandalam Trustee Co. Ltd. is Trustee Company and AMC is Cholamandalam AMC Limited.

3.4.22. LIC Mutual Fund

Life Insurance Corporation of India set up LIC mutual fund on June 19, 1989. It contributed Rs.2 crores towards the corpus fund. LIC mutual fund was constituted as a trust in accordance with the provisions of the Indian Trust Act 1882. Company started its business on April 29, 1994. Trustee of LIC mutual fund have appointed Jeevan Bima Sahayog Asset Management Company Ltd. as investment manager for mutual fund.

3.4.23. GIC mutual fund

General Insurance Corporation of India (GIC), sponsored by Government of India and the four Public Sector General Insurance Companies, viz. National Insurance Co. Ltd (NIC), the New India Assurance Co. Ltd. (NIA), the Oriental Insurance Co. Ltd (OIC) and United India Insurance Co. Ltd (UII) and is constituted as a trust in accordance with provisions of Indian Trust Act, 1882.
3.5. DIFFERENT MUTUAL FUND PRODUCTS/SCHEMES

Investment companies or investment trusts obtain funds from a large number of investors through sale of units. Investors have option of choosing from a wide variety of schemes in mutual fund, depending upon their requirements. Mutual funds adopt different strategies to achieve these objectives and accordingly offer different schemes of investments. A detailed classification of mutual funds is discussed below.

3.5.1. Open-Ended Scheme

Open-end fund is a mutual fund, which continuously issues new shares or units to meet the demand of investors. At the same time, it redeems shares for those who want to sell. Fund manager buys and sells units constantly on demand by investors. Under this scheme, the capitalization of fund will constantly change, as it is always open for investors to sell or buy their share units. Scheme provides an excellent liquidity facility to investors, although units of such scheme are not listed. No intermediaries are required. Open-ended scheme has no maturity period. There is a certainty in repurchase price, which takes place in accordance with the declared NAV.

3.5.2. Close-Ended Scheme

Close-ended funds have a fixed maturity period. The first time investments are made when close-end scheme is kept open for a limited period. Once closed the units are listed on a stock exchange. Investors can buy and sell their units only through stock exchanges. Demand and supply factors influence prices of units. The investor’s expectation also affects units prices. Market price will not be the same as the net asset value. Sometimes mutual funds with features of close-ended and open-ended schemes are
launched, known as interval funds. They are listed in the stock exchange or available for repurchase during specific periods at the net asset value or related prices.

3.5.3. Interval Scheme

It is a kind of a close-ended scheme with a peculiar feature that it remains open during a particular part of the year for the benefit of investors, either to off-load their holdings or to undertake purchase of units at NAV. Under SEBI regulations, every mutual fund is free to launch any or both types of schemes, including interval scheme.

3.5.4. Income Fund Scheme

Scheme that is tailored to suit needs of investors who are particular about regular returns is known as ‘income fund scheme’. This scheme offers the maximum current income, whereby the income earned by units is distributed periodically. Such funds are offered in two forms. The first scheme earns a target constant income at relatively low risk, while the second scheme offers the maximum possible income. This obviously implies that the higher expected returns come with higher potential risks of investment.

3.5.5. Growth Fund Scheme

It is a mutual fund scheme that offers the advantage of capital appreciation of the underlying investment. For such funds, investment is made in growth-oriented securities that are capable of appreciating in the long run. Growth funds are also known as nest eggs or long haul investment. In proportion to such capital appreciation, amount of risks to be assumed would be far greater. These schemes are not for investors seeking regular income or needing their money back in the short-term.
3.5.6. Conservative Fund Scheme

A scheme that aims at providing a reasonable rate of return, protecting the value of investment and achieving capital appreciation, is designated as conservative fund scheme. These are also known as middle of the road funds, such funds offer a blend of all these features. Further, these funds divide their portfolio in common stocks and bonds in such a way to achieve the desired objectives.

3.5.7. Equity Fund Scheme

A kind of mutual fund whose strength is derived from equity-based investments is called ‘equity fund scheme’. They carry a high degree of risk. These funds do well in periods of favorable capital market trends. The objective is to generate potentially superior returns by taking on higher risk. As these funds invest in stocks, returns do fluctuate thereby posing higher risk. Therefore, these funds are not for risk average investors.

3.5.8. Bond Fund Scheme

It is a type of mutual fund whose strength is derived from bond-based investments. Portfolio of such funds comprises of bonds, debentures, government securities, commercial papers and other money market instruments. These funds are relatively low-risks-low-returns schemes. This types of fund carriers the advantage of securing steady income. However, such funds have little or no chance of capital appreciation, and carry low risks. A variant of this type of fund is called ‘liquid funds, which specializes in investing in the short-term money market instruments. This focus on liquidity delivers twin features of lower risks and low returns.
3.5.9. Balanced Fund Scheme

A scheme of mutual fund that has a blend of debt and equity in portfolio of investments is referred to as a ‘balanced fund scheme’. These types of fund provide both growth and income by periodically distributing a part of income and capital gains they earn. They invest in both shares and fixed income securities in the proportion indicated in their offer documents. In a rising stock markets, NAV of these schemes will normally keep space, or fall equally when the market falls. Portfolio of such funds will often be shifted between debt and equity, depending upon the prevailing market trends.

3.5.10. Sectoral Fund Scheme

Sector funds are those with the objective to invest only in the equity of those companies existing in a specified sector, as laid down in fund’s offer document. When managers of mutual funds invest the amount collected from a wide variety of small investors directly in various specific sector of economy such funds are called ‘sectoral mutual fund’. The specialized sectors may include gold and silver, real estate, specific industry such as oil and gas companies and offshore investment.

3.5.11. Fund-of-Fund Scheme

There are funds to funds, where funds of one mutual are invested in units of the other mutual fund. There are number of funds that direct investment into a specified sector of economy. This makes diversified and yet intensive investment of funds possible.
3.5.12. Leverage-Fund Scheme

Funds that are created out of investments, not only with the amount mobilized from the small savers but also from the fund managers, who borrow money from the capital market, are known as ‘leverage fund scheme’. Fund managers pass on benefits of leverage to the mutual fund investors. To operate such schemes, there must be provisions available. Normally leverage funds use short sale, whereby the management controlling fund avails of advantage of declining markets to realize gains in portfolio. Options, especially call options are used by leverage funds.

3.5.13. Global/International Funds Scheme

An international fund invests only outside the native country. Global funds invest anywhere around the world. These funds are either riskier or safer than domestic investments. They do tend to be more volatile and have unique country and political risks. But, on the flip side, they can, as part of a well-balanced portfolio, actually reduce risk by increasing diversification. Although the world’s economies are becoming more inter-related, it is likely that another economy somewhere is outperforming the economy of home country.

3.5.14. Specialty Fund Scheme

This classification of mutual funds is more of an all-encompassing category that consists of funds that have proved to be popular but does not necessarily belong to categories described so far. This type of mutual fund forgoes broad diversification to concentrate on a certain segment of economy.
3.5.15. Gilt Funds Scheme

These funds seek to generate returns through investment in gilts. Under this scheme, funds are invested only in the central and the state government securities and have response/reverse repo in such securities and not in equity or corporate debt securities. A portion of the corpus is invested in the call money market. Government securities carry zero credit risks or default risks. Their prices are, however, influenced only by movement in interest rates in the financial system.

3.5.16. Tax Savings Schemes

Tax savings schemes offer tax rebates to investors under specific provisions of the income tax Act 1961. These are growth-oriented schemes and invest primarily in equities, like an equity scheme, they largely suit investors having a higher risk appetite and aim to generate capital appreciation over medium to long term. Income is also periodically distributed, depending upon surplus. Broad investment pattern of scheme includes investment in equities, cumulative convertible preference shares and fully convertible debentures and bonds to the extent of 80 – 100 percent and the rest in money market instruments.

3.5.17. Index-Fund Scheme

These funds are also known as growth funds, but they are linked to a specific index of share prices. It means that funds mobilized under such scheme are invested principally in securities of companies whose securities are included in the index concerned and in the same weightage. Index scheme replicate performance of a particular index such as BSE senses or S&P CNX Nifty. Portfolio of these schemes consist only of
those stocks that represent the index and the weightage assigned to each stock is aligned to the stock weightage in the index. Hence, returns from these funds are more or less similar to those generated by index.

3.5.18. Money Market Fund (MMF)

Money market fund is a mutual fund, which invests in money market securities like Treasury Bills and commercial papers for a period of less than 91 days. The aim of money market mutual funds is to provide easy liquidity preservation of capital and moderate income. These funds are ideal for corporate and individual investors looking for moderate returns on their surplus funds.

3.5.19. Regional Funds

Regional funds make it easier to focus on a specific area of the world. An advantage of these funds is that they make it easier to buy stock in foreign countries, which is otherwise difficult and expensive. For sector funds, investors have to accept high risk of loss, which occurs if the region goes into a bad recession.

3.5.20. Socially Responsible Funds

Socially responsible funds are also called ethical funds. They invest only in companies that meet the criteria of certain guidelines or beliefs. Most socially responsible funds are invested in industries such as tobacco, alcoholic, beverages, weapons or nuclear power. The idea is to get a competitive performance by maintaining a healthy conscience.
3.6. MUTUAL FUNDS IN INDIA

Mutual fund industry in India made its debut by setting the largest public sector mutual fund in the world, namely, Unit Trust of India (UTI). It was set up in the year 1964 by a special Act of Parliament. The first unit scheme offered was the US-64. A host of other fund schemes were subsequently introduced by UTI. The basic objective behind setting up of the trust was to mobilize small savings and to allow channeling of those savings into productive sectors of the economy, so as to accelerate the industrial and the economic development of the country.

Monopoly of UTI ended in the year 1987, when the Government of India permitted commercial banks in the public sector to set up subsidiaries operating as trusts to perform functions of mutual funds by amending the Banking Regulation Act, SBI set up the first mutual fund, which was followed by Canara bank. Later, many large financial institutions under government’s control also came out with mutual fund subsidiaries. Recently, with the beginning of the economic reforms and liberalization of economy based on recommendations of the Abil Hussain Committee, foreign companies were also permitted to start mutual funds in India. Government introduced a number of regulatory measures, through various agencies such as SEBI for the purpose of allowing growth of mutual funds industry in an orderly fashion for benefit of investors, especially the small investors.

An important feature of mutual funds industry in India is a mutual fund set up by a public sector bank or a financial institution or that authorized by SEBI is exempted from tax under section 10(23D) provided it distributes 90 percent of its profits.
Mutual fund industry grow faster in the coming years. Because of the tax exemption benefits on dividend received from mutual funds, soon investors shift their funds from banks mutual funds particularly in a growing market situation. Indian banks face stiff competition from mutual funds for investors’ savings in the immediate future.

Mutual funds provide detailed information on performance of various schemes including latest NAV and fund comparisons. AMC insurers, advisors and financial planner’s distributors and brokers, treasuries and trusts and banks find it particularly useful to subscribe to various publications like MFI explorer, newsletters, event updates and articles on personal finance to meet their business needs.

3.7. TOP PERFORMING MUTUAL FUNDS

This report contains list of funds, presented in descending order of performance. User can pick the time period based on which top performing funds can be assessed. Table 3.1. Exhibits top performance of mutual fund in India.
Table 3.1

Top Performing Mutual fund

<table>
<thead>
<tr>
<th>Fund Name</th>
<th>Category</th>
<th>AUM (₹ in cr)</th>
<th>1W%</th>
<th>1M%</th>
<th>3M%</th>
<th>6M%</th>
<th>1Y%</th>
<th>3Y%</th>
<th>5Y%</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI Small and Midcap Fund</td>
<td>Equity-Diversified</td>
<td>713.96</td>
<td>0.19</td>
<td>0.32</td>
<td>3.83</td>
<td>9.80</td>
<td>27.17</td>
<td>38.58</td>
<td>22.06</td>
</tr>
<tr>
<td>SBI Pharma Fund</td>
<td>Equity Sector</td>
<td>861.97</td>
<td>0.38</td>
<td>-5.80</td>
<td>-1.69</td>
<td>4.51</td>
<td>24.63</td>
<td>35.95</td>
<td>26.53</td>
</tr>
<tr>
<td>Sundaram Select Micro Cap Services V</td>
<td>Equity-Diversified</td>
<td>168.83</td>
<td>1.68</td>
<td>1.66</td>
<td>5.89</td>
<td>11.69</td>
<td>23.43</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Birla Sunlife MNC Fund</td>
<td>Equity Sector</td>
<td>2704.37</td>
<td>0.09</td>
<td>-2.38</td>
<td>-1.67</td>
<td>1.05</td>
<td>21.92</td>
<td>31.85</td>
<td>22.68</td>
</tr>
<tr>
<td>Motilal Oswal Most Focused Midcap 30 Fund</td>
<td>Equity-Diversified</td>
<td>816.20</td>
<td>-0.10</td>
<td>-2.43</td>
<td>-2.15</td>
<td>1.00</td>
<td>21.53</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DSP Black Rock Micro Cap Fund</td>
<td>Equity-Diversified</td>
<td>2191.27</td>
<td>1.54</td>
<td>0.85</td>
<td>4.38</td>
<td>7.76</td>
<td>21.31</td>
<td>34.95</td>
<td>20.51</td>
</tr>
<tr>
<td>Escorts High yield Equity Plan</td>
<td>Equity-Diversified</td>
<td>3.25</td>
<td>1.23</td>
<td>2.63</td>
<td>6.87</td>
<td>4.67</td>
<td>20.10</td>
<td>24.73</td>
<td>11.87</td>
</tr>
<tr>
<td>Sundaram Select Micro Cap Series IV</td>
<td>Equity-Diversified</td>
<td>45.87</td>
<td>1.21</td>
<td>-0.33</td>
<td>1.38</td>
<td>8.24</td>
<td>19.97</td>
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</tr>
<tr>
<td>Sundaram Select Micro Cap-Series III</td>
<td>Equity-Diversified</td>
<td>60.97</td>
<td>1.22</td>
<td>-0.32</td>
<td>1.33</td>
<td>8.08</td>
<td>19.86</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sundaram Select Micro Cap Series I</td>
<td>Equity-Diversified</td>
<td>110.39</td>
<td>1.21</td>
<td>-0.33</td>
<td>1.36</td>
<td>7.96</td>
<td>19.51</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 3.1. shows that SBI small and midcap fund is performing good as it occupies the first place of the top ten performing mutual funds in India.

3.8. PRIVATE SECTOR MUTUAL FUND

Private sector mutual funds are facing severe redemption pressure when compared with UTI mutual fund and other public sector funds. While the former witnessed a net outflow of Rs.822.5 crores, UTI mutual funds and other public sector funds together have received a net inflow of almost Rs.500 crores in July, 2009 according to latest data available with SEBI. Some of the leading private sector funds include Franklin Templeton, HDFC MF, Prudential ICICI MF, Birla sun life MF, Reliance MF, Standard Chartered MF, DSP Merrill Lynch MF and HSBC MF. Table 3.2. shows the leading Mutual Fund Companies and the change in their market value.

Table 3.2

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Company Name</th>
<th>Change in Market Value (Rs. in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>HDFC Bank Ltd.,</td>
<td>1257.7445</td>
</tr>
<tr>
<td>2.</td>
<td>Tata Motors Ltd.,</td>
<td>1205.8506</td>
</tr>
<tr>
<td>3.</td>
<td>Reliance Industries Ltd.,</td>
<td>770.8436</td>
</tr>
<tr>
<td>4.</td>
<td>Tata Motros-DVR-A-ORDY</td>
<td>632.7182</td>
</tr>
<tr>
<td>5.</td>
<td>IDFC Bank Ltd.</td>
<td>612.7182</td>
</tr>
<tr>
<td>6.</td>
<td>Kotak Mahindra Bank Ltd.,</td>
<td>466.1623</td>
</tr>
<tr>
<td>7.</td>
<td>ICIC Bank Ltd.,</td>
<td>405.3072</td>
</tr>
<tr>
<td>8.</td>
<td>Cipla Ltd.,</td>
<td>385.9426</td>
</tr>
<tr>
<td>9.</td>
<td>Ultra Tech Cement Ltd.,</td>
<td>295.8861</td>
</tr>
<tr>
<td>10.</td>
<td>Bajaj Fin Serve Ltd.,</td>
<td>287.146</td>
</tr>
</tbody>
</table>

3.9. ASSET MANAGEMENT COMPANY (AMC)

The investment manager of a mutual fund is technically known as AMC and is appointed by the sponsor or the trustee. AMC manages affairs of mutual fund. It is responsible for operating all the schemes of fund, and act as AMC of only one mutual fund. Only activities which are in nature of management and advisory services to offshore funds, pension fund, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on commercial basis are undertaken by AMC. With the permission of SEBI, it can also operate as an underwriter.

- **SEBI Requirement of AMC**

  SEBI requires AMC to possess the following attributes to ensure its efficient management.

- **Track Record**

  AMC should have a sound track record, good net worth, dividend paying capacity and profitability with a net worth of at least Rs.100 crores.

- **Reputation**

  AMC should have a general reputation of fairness in transaction.

- **Expertise**

  Directors of AMC should have an expert knowledge of the relevant fields like portfolio management, investment analysis and financial administration.
• Operational Autonomy

Operational autonomy shall only be provided to directors of whom at least 50 percent should have no association with sponsor or trusts, its chairman being an independent person.

• Contribution

Minimum contribution by sponsor should be 40 percent of its net worth so as to ensure stake of sponsors in AMC.

• Functions of AMC

Many a time, an AMC carries out its functions through outside agencies that are appointed for this purpose. However, the functions remain the same as outlined below.

• Registrars and Transfer Agents

Registrars and transfer agents who are appointed by AMC carry out the following functions:

i. Receiving and processing the application forms of investors.

ii. Issuing unit certificates.

iii. Sending refund orders.

iv. Giving approval for all transfers of units and maintaining all such records.

v. Repurchasing units and redemption of units.

vi. Issuing dividend or income warrants.
These intermediaries are paid compensation for their services by AMC. In India almost all AMCs engage such agents.

- **Fund Accountants**

  Fund accountants are appointed by AMC. They are in charge of maintaining proper books of accounts relating to fund transaction and management. Functions performed by these agencies are:

  i. Computing NAV per unit of the scheme on a weekly basis.
  
  ii. Maintaining books and records.
  
  iii. Monitoring compliance with schemes, investment limitations as well as regulations of SEBI, monitoring others.
  
  iv. Preparing and distributing reports on scheme for unit holders and SEBI, and monitoring the performance of mutual funds custodians and other service providers.

- **Lead Managers**

  Lead managers carry out the following functions:

  i. Selecting and coordinating activities of intermediaries such as advertising agency, printers, collection centers and marketing services.

  ii. Carrying out extensive campaigns about scheme, and acting as marketing associates to attract investors.

  iii. Assisting AMC to approach potential investors through meetings, exhibitions, contacts, advertising, publicity and sales promotion.
• **Investment Advisors**

Investment advisors carry out the following functions:

i. Carrying out market and security analysis.

ii. Advising AMC to design its investment strategies on a continuous basis.

They are paid for their professional advice regarding funds investment on the average weekly value of funds net assets. Majority of Indian mutual funds have their own market analysis who design their investment strategies.

• **Legal Advisors**

Legal advisors are appointed to offer legal guidance about planning and execution of different schemes. A group of advocates and solicitors are appointed as legal advisors. Their fee is in no way associated with net assets of fund, but is paid to them as decided.

• **Auditors**

An auditor is required to be appointed by AMC, and must undertake independent inspection and verification of its accounting activities.

• **Underwriters**

In recent times, mutual funds also undertake activities of underwriting issues. Such activities generate an additional source of income for mutual funds. Prior approval from SEBI is necessary for undertaking this activity.
3.9.1. Work Mechanism of AMC

Work Mechanism of AMC revolves around the investment functions. AMC carries out a specialized investment function by designing strategies. Work mechanism of AMC is described below.

- **Creating Fund Manager**

  A fund manager is responsible for managing funds of AMC. Fund manager should desirably be an independent agency, as is practiced in USA. But, according to practices in India, a single fund manager handles many schemes simultaneously. The basic function of a fund manager is to decide the rate, time, kind and quantum of securities to be bought or sold. It is the fund manager who ensures the success of fund schemes.

  In case of bank-sponsored funds, committees created for that purpose handle investment exercise. For instance, ‘Investment Committee’, which is a broad-based committee with nominees of sponsor, decides the primary market investment. ‘Market Operation Committee’ handles assignment of disinvestment and interactions with the secondary market.

- **Research and Planning**

  Research and planning cell of AMC undertakes research activities relating to securities as well as prospective investors. Results of the study are analyzed to draft future policy governing investment management. It is also possible that the research work is assigned to an independent outside agency.
• **Creating Dealers**

Dealers having a deep understanding of stock market operations created by AMC to execute sale and purchase transactions in the capital or the money market. It is possible that this job is assigned to a separate marketing division of AMC. Dealers should comply with all formalities of sale and purchase through brokers, appointed by Board of Directors of AMC. Board lays down guidelines for allocation of business to different brokers.

• **Portfolio Management Process in Mutual Funds**

Portfolio management process of mutual fund involves four basic steps.

- Setting investment goal.
- Identification of specific securities.
- Portfolio designing.
- Portfolio revision.

• **Setting Investment Goal**

The first and foremost task of managing portfolio of mutual fund is to identify and set goal for proposed scheme. Goal is set keeping in mind considerations such as protection of investors, nature of scheme, risks and returns, market conditions, regulatory norms, and size of issue.

• **Identifying Specific Securities**

Once goal to be accomplished by the proposed scheme is identified, efforts are made to analyze and to identify the right security where funds are required to be invested. For this purpose, security analysis is carried out from company’s point of
view, industry and economy. For this purpose of analysis, fund manager considers strengths and weaknesses of some of the sample securities.

- **Portfolio Designing**

Portfolio designing involves making an ideal mix of debt and equity securities of corporate and government. It is concerned with decisions regarding type of securities to be bought, the quantum and the timing of issue. Portfolio designing is carried out on the basis of research and analysis of stock markets. Based on their results, the long-term and the short-term investment strategies are worked out.

Fund manager makes efforts at building portfolio that consists of a well-diversified portfolio of securities so as to reduce significantly the unsystematic risk. For this purpose, the expected returns on individual security and portfolio as a whole, is associated with market or systematic risk. Design will consider ways and means by which liquid resources in scheme could be invested in money market instruments like government securities, commercial papers, certificates of deposits and treasury bills.

While designing portfolio, regulations are to be followed. For instance, as per SEBI, mutual funds:

i. Are prohibited from making investments in unlisted securities.

ii. Cannot own more than ten percent of any company’s paid up capital carrying voting rights.

iii. Can make investments in other schemes of the same mutual fund upto five percent of NAV.

iv. Can make investment only in transferable securities in money or capital market.
• Portfolio Revision

Build-up of portfolio needs to be periodically reviewed keeping in mind the risks-returns characteristics of all securities under the changing circumstances. Revision of portfolio has to be undertaken in the context of the dynamic investment world.

3.10. OPERATIONAL EFFICIENCY OF MUTUAL FUNDS

Operational efficiency of mutual funds are described below:

3.10.1. Net Return

Operational efficiency of a mutual fund is the best judged as its ability to earn investors better and safe returns. Returns take the form of appreciation in value of investment made in mutual funds and dividend or interest received on such investment. There are some expenses that are always incurred while earning such returns. Expenses are incurred as part of efforts made at protecting the interest of investors, compliance with the regulatory framework of SEBI. Expenses include trusteeship fee, management fee, administrative expenses, fund accounting fee, custodian fee and initial charges. Net return is computed by taking into consideration gross returns and the expenses.

3.10.2. Net Asset Value (NAV)

NAV is another parameter used to measure the operational efficiency of mutual funds. Intrinsic value of a unit under a particular scheme is referred to as NAV of scheme. Value gives an idea of the amount obtained by the unit holder on its sale to mutual fund company. NAV of a unit is calculated as follows:-
NAV per unit $= \frac{TMV - CL}{SU}$

where,

- $TMV = \text{Total market value of investment portfolio}$
- $CL = \text{Current liabilities}$
- $SU = \text{Number of outstanding units in that scheme}$

### 3.10.3 Load

Initial expenses that are incurred by a mutual fund in relation to a scheme operated by it, is referred to as load of scheme. According to SEBI guidelines, a certain percentage of load is borne by the respective scheme. In such a case, the load borne by the scheme will reduce the amount available for investment by the fund manager. On account of the perceived advantages of the ‘load schemes’, they are gaining popularity.

### 3.10.4. Disclosures

A highly transparent nature of mutual fund is said to operate to benefit of mutual fund itself, in addition to serving needs of investors. Mutual funds are supposed to follow certain norms to ensure adequate and ample disclosure of their operations. Operational efficiency of mutual funds is disclosed through half yearly results and annual reports, where all statistical information relating to all schemes in operation is disclosed.
3.10.5. Voting Right to Investors

A part of ensuring greater operational efficiency, mutual funds are obligated to obtain the prior permission of investors of the scheme whenever fund managers intend to bring changes in the basic features of schemes. Investors are granted voting rights when such matters are put up in a meeting of unit holders by AMC.

3.10.6. Investors Protection

Fund managers who protect interest of investors should follow certain safeguards. Towards this end, a greater order of transparency is adopted by fund managers. Unit certificates are to be issued to investors within six weeks from the date of closure of subscription list. Units submitted for transfer should be executed within 30 days. Dividend warrants against the scheme are to be dispatched within 42 days of declaration of dividend.

3.11. SUMMARY

Historical background of mutual fund in India, the different phases of its development, types of products offered through mutual funds and also work mechanism of mutual funds are discussed.


