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MUTUAL FUNDS IN INDIA: AN OVERVIEW

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ABSTRACT

Mutual funds have been around for a long period of time, to be precise for 47 years of its existence in India. The Indian mutual fund industry is one of the fastest growing sectors in the Indian capital and financial markets. The mutual fund industry in India has seen dramatic improvements in quantity as well as quality of product and service offerings in recent years and still has to travel a very long prosperous journey to achieve new heights. Mutual fund is more suitable investment for the common man, as it offers an opportunity to invest in a diversified, professionally managed portfolio at a relatively low cost. Each Mutual fund schemes has a defined investment objective and strategy. In February 2003, the UTI Act was repealed and UTI was stripped of its Special legal status as a trust formed by an Act of Parliament The growth path of Mutual Fund Investment India is attributed to the high saving pattern in India. This is a healthy status of the MFs industry in India when compared to Japan, France and China. Private sector Asset Management Companies (AMCs) account for majority of mutual fund sales in India (around 84% on March 31, 2008).

Keywords: Mutual funds, Portfolio, AMCs, SEBI, Diversified, ELSS, NAV, AUM.

INTRODUCTION

A mutual fund is nothing more than a collection of stocks and/or bonds. Mutual fund as a company that brings together a group of people and invests their money in stocks, bonds, and other securities. Each investor owns shares, which represent a portion of the holdings of the fund. The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. It is registered with SEBI and functions under the Mutual Fund Regulations. Conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth. A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

Portfolio managers evaluate their portfolio performance and identify the sources of strength and weakness. The evaluation of the portfolio provides a feed back about the performance to evolve

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a better management strategy. Even through evaluation of portfolio performance is considered to be the last stage of investment process, the managed portfolios are commonly known as mutual funds. Various managed portfolios are prevalent in the capital market. Their relative merits of return and risk criteria have to be evaluated.

Mutual funds have become extremely popular over the last 20 years. What was once just another obscure financial instrument is now a part of our daily lives. In fact, to many people, investing means buying mutual funds. After all, its common knowledge that investing in mutual funds is (or at least should be) better than simply letting your cash waste away in a savings account, but, for most people, that's where the understanding of funds ends. It doesn't help that mutual fund sales people speak a strange language that is interspersed with jargon that many investors don't understand.

Originally, mutual funds were heralded as a way for the little guy to get a piece of the market. Instead of spending all your free time buried in the financial pages of the Wall Street Journal, all you had to do was buy a mutual fund and you'd be set on your way to financial freedom. As you might have guessed, it's not that easy. Mutual funds are an excellent idea in theory, but, in reality, they haven't always delivered. Not all mutual funds are created equal, and investing in mutual isn't as easy as throwing your money at the first salesperson who solicits your business.

The paper explains the basics of mutual funds and hopefully clears up some of the issues around them. It aims to evaluate the emerging scenario of mutual funds in India and an out look for future. The study is based on secondary data and it draws some suggestions.

Mutual Fund Concept:

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments ruches shares, debentures and other securities. The income earned through these investments and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common an as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. The flow chart below describes broadly the working of a mutual fund:

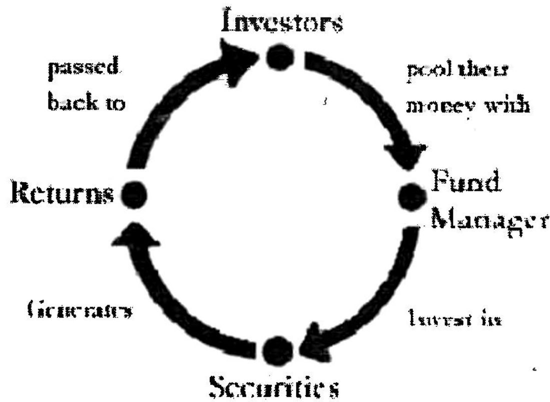
A mutual fund is nothing more than a collection of stocks and/or bonds. Mutual fund as company that brings together a group of people and invests their money in stocks, bonds, and other securities. Each investor owns shares, which represent a portion of, the holdings of the funds. We can make money from a mutual fund in three ways:

1) Income is earned from dividends on stocks and interest on bonds. A fund pays out nearly all of the income it receives over the year to fund owners in the form of a distribution.

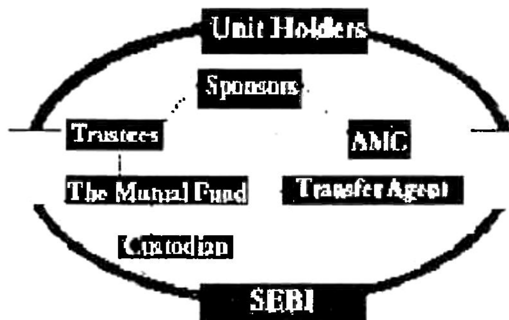
2) If the fund sells securities that have increased in price, the fund has a capital gain. Most funds also pass on these gains to investors in a distribution.

3) If fund holdings increase in price but are not sold by the fund manager, the fund's shares increase in price. You can then sell your mutual fund shares for a profit.

Funds will also usually give you a choice either to receive a check for distributions of reinvest the earnings and get more shares, securities at a relatively low cost. The flowchart-1 describes broadly the working of mutual funds. The chart throws light on rationale of mutual funds. They receive money from many investors, pool them and then purchase securities. The individual investors receive the benefits of professional management and diversified portfolio at relatively low cost with much convenience.



There are many entities involved and the chart-2 illustrates the organizational set up of a mutual fund. Basically, Mutual funds are trusts that are formed to mobilize the savings from the people and pool them together to invest within the securities markets. The main advantage of mutual funds is that it is professionally managed. And the general idea is for investors to contribute small amounts into units in the various schemes, which in turn is deployed in the various markets. This way, any investor who is not in a position to directly invest in the markets can take advantage of this route.



The term mutual fund is the common name for what is classified as an open-end investment company. Being open-ended means that, at the end of every day, the fund issues new shares to investors and buys back shares from investors wishing to leave the fund. Mutual funds must be structured as corporations or trusts, such as business trusts, and any corporation or trust will be classified as an investment company if it issues securities and primarily invests in non-government securities.

Types of mutual fund /schemes:

Open-ended Fund/ Scheme-An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices, which are declared on a daily basis. The key feature of open-end schemes is liquidity.

Close-ended Fund/ Scheme-A close-ended fund or scheme has a stipulated maturity period e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.

Growth / Equity Oriented Scheme-The aim of growth funds is to provide capital appreciation over the medium to long- term. Such schemes normally invest a major part of their corpus in equities. Such funds have comparatively high risks. These schemes provide different options to the investors like dividend option, capital appreciation, etc. and the investors may choose an option depending on their preferences. The investors must indicate the option in the application form. The mutual funds also allow the investors to change the options at a later date. Growth schemes are good for investors having a long-term outlook seeking appreciation over a period of time.

Income / Debt Oriented Scheme-The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures, Government securities and money market instruments. Such funds are less risky compared to equity schemes. These funds are not affected because of fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAVs of such funds are affected because of change in interest rates in the country. If the interest rates fall, NAVs of such funds are likely to increase in the short run and vice versa. However, long term investors may not bother about these fluctuations.

Balanced Fund-The aim of balanced funds is to provide both growth and regular income as such schemes invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are appropriate for investors looking for moderate growth. They generally invest 40-60% in equity and debt instruments. These funds are also affected because of fluctuations in share prices in the stock markets. However, NAVs of such funds are likely to be less volatile compared to pure equity funds.

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

Gilt Fund-These funds invest exclusively in government securities. Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as are the case with income or debt oriented schemes.

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

Income funds- These funds are named appropriately: their purpose is to provide current income on a steady basis. When referring to mutual funds, the terms "fixed-income," "bond," and "income" are synonymous. These terms denote funds that invest primarily in government and corporate debt. While fund holdings may appreciate in value, the primary objective of these funds is to provide a steady cash flow to investors. As such, the audience for these funds consists of conservative investors and retirees.

Equity Linked Saving Schemes ELSS-This is equity linked saving schemes. It is a kind of diversified mutual fund in which fund manager invest in varies companies from varies industry so risk factor is low. Also in India there is a tax benefit in investing ELSS, These funds have a lock in period of three years but the return is better and plus you will get tax benefits.

Bond funds-These funds are likely to pay higher returns than certificates of deposit and money market investments, but bond funds aren't without risk. Because there are many different types of bonds, bond funds can vary dramatically depending on where they invest. For example, a fund specializing

in high-yield junk bonds is much more risky than a fund that invests in government securities. Furthermore, nearly all bond funds are subject to interest rate risk, which means that if rates go up the value of the fund goes down.

Sector funds-These funds are targeted at specific sectors of the economy such as financial, technology, health, etc. Sector funds are extremely volatile. There is a greater possibility of big gains, but you have to accept that your sector may tank.

Regional funds -These funds make it easier to focus on a specific area of the world.
International mutual funds-International mutual funds are those funds that invest in non-domestic securities markets throughout the world.

The terms that are generally used in mutual fund industry and need to understand are as follows -
The Net Asset Value: This is per share amount of total fund's value. To calculate the NAV first add current market values of all assets and divide it by the number of shares. In stocks prices change in every second but NAV is calculated in a daily basis
Sale Price: The price you pay when you invest in a scheme? Also called Offer Price. It may include a sales load that call sale price.

Repurchase Price: The price at which units under open-ended schemes are repurchased by the Mutual Fund. Such prices are NAV related.
Redemption Price: The price at which close-ended schemes redeem their units on maturity. Such prices are NAV related.
Sales Load: A charge collected by a scheme when it sells the units. Also called, 'Front-end' load. Schemes that do not charge a load are called 'No Load' schemes.

Advantages of Mutual Funds:

The advantages of investing in Mutual Funds are the professional expertise they employ coupled with the variations offered on the basis of asset classification and the diversification of the chosen portfolio aimed at optimizing the risk for the required return. The benefits that can be accrued from Mutual Funds are as under.
•**Professional Management** - The primary advantage of funds (at least theoretically) is the professional management of your money. Investors purchase funds because they do not have the time or the expertise to manage their own portfolios. A mutual fund is a relatively inexpensive way for a small investor to get a full-time manager to make and monitor.
•**Diversification** - By owning shares in a mutual fund instead of owning individual stocks or bonds, your risk is spread out. The idea behind diversification is to invest in a large number of assets so that a loss in any particular investment is minimized by gains in others. Large mutual funds typically own

hundreds of different stocks in many different industries. It wouldn't be possible for an investor to build this kind of a portfolio with a small amount of money.

•**Liquidity** - Just like an individual stock, a mutual fund allows you to request that your shares be converted into cash at any time.
•**Simplicity** - Buying a mutual fund is easy! Pretty well any bank has its own line of mutual funds, and the minimum investment is small. Most companies also have automatic purchase plans whereby as little as $100 can be invested on a monthly basis transactions.
•**Costs** - Mutual funds don't exist solely to make your life easier - all funds are in it for a profit. The mutual fund industry is masterful at burying costs under layers of jargon. These costs are so complicated that in this tutorial we have devoted an entire section to the subject
•**Dilution** - It's possible to have too much diversification. Because funds have smallholdings in so many different companies, high returns from a few investments often don't make much difference on the overall return. Dilution is also the result of a successful fund getting too big. When money pours into funds that have had strong success, the manager often has trouble finding a good investment for all the new money.
•**Taxes** - When making decisions about money, fund managers don't consider your personal tax situation. For example, when a fund manager sells a security, a capital-gains taxis triggered, which affects how profitable the individual is from the sale. It might have been more advantageous for the individual to defer the capital gains liability
• **Choice of Schemes**-Mutual funds offer a family of schemes to suits your varying needs over a life time.

UTI is the oldest of Indian mutual funds, having entered the arena with the launch of the Unit Scheme - 64 in 1964, hence the alphanumeric name. It was only in 1998 that other public sector banks were allowed to enter into the segment which was followed by a whole range of Asset Management companies including almost all the leading international portfolio managers including Merrill Lynch, Templeton, and Prudential among others.

Mutual Fund Industry in India: The Evolution

The formation of Unit Trust of India marked the evolution of the Indian mutual fund industry in the year 1963. The primary objective at that time was to attract the small investors and it was made possible through the collective efforts of the Government of India and the Reserve Bank of India. The history of mutual fund industry in India can be better understood divided into following phases. The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. The history of mutual funds in India can be broadly divided into four distinct phases:

Phase- 1. Establishment and Growth of Unit Trust of India - 1964-87

An Act of Parliament established Unit Trust of India (UTI) on 1963. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve

Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. UTI launched more innovative schemes in 1970s and 80s to suit the needs of different investors. It launched ULIP in 1971, six more schemes between 1981-84, 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 Schemes (offering assured returns) during 1990s. By the end of 1987, UTI's assets under management grew ten times to Rs 6700 crores.

Phase II. Entry of Public Sector Funds - 1987-1993

1987 marked the entry of non- UTI, public sector mutual funds set up by 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 1987followedby Can bank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct92). LIC established its mutual fund in June 1989 while GIC had set up itsmutualfundinDecember1990. At the end of 1993, the mutual fund industry had assets under management of Rs.47, 004 Crore.

Phase III. Emergence of Private Sector Funds - 1993-96

The permission given to private sector funds including foreign fund management companies (most of them entering through joint ventures with Indian promoters) to enter the mutual fund industry in 1993 provided a wide range of choice to investors and more competition in the industry. Private funds introduced innovative products, investment techniques and investor-servicing technology. By 1994-95, about 11 private sector funds had launched their schemes.

Phase IV. Growth and SEBI Regulation - 1996-2004

Since 1996 the mutual fund industry in India saw and tighter regulation and higher growth . It scaled new heights in terms of mobilisation of funds and the number of players. Investors' interests were safeguarded by SEBI and the Government offered tax benefits to the investors in order to encourage them. SEBI (Mutual Funds) Regulations, 1996 was introduced by SEBI that set uniform standards for all mutual funds in India. The Union Budget in 1999 exempted all dividend incomes in the hands of investors from income tax. Various Investor Awareness Programmes were launched during this phase, both by SEBI and AMFI, with an objective to educate investors and make them informed about the mutual fund industry.

In February 2003, the UTI Act was repealed and UTI was stripped of its Special legal status as a trust formed by an Act of Parliament. The primary objective behind this was to bring all mutual fund players on the same level. UTI was re-organized into two parts: 1. The Specified Undertaking, 2. The UTI Mutual Fund. Presently, Unit Trust of India operates under the name of UTI Mutual Fund and its past schemes (like US-64, Assured Return Schemes) are being gradually wound up. However, UTI Mutual Fund is still the largest player in the industry. In 1999, there was a significant growth in

mobilisation of funds from investors and assets under management, which is supported by the following

GROSS FUND MOBILISATION (RS. CRORES)

FROM	TO	UTI	PUBLIC SECTOR	PRIVATE SECTOR	TOTAL
01April, 98	31March, 99	11,679	1,732	7,966	21,377
01April, 99	31March, 00	13,536	4,039	42,173	59,748
01April, 00	31March, 01	12,413	6,192	74,352	92,957
01April, 01	31March, 02	4,643	13,613	1,46,267	1,64,523
01April, 02	31Jan, 03	5,505	22,923	2,20,551	2,48,979
01Feb., 03	31March, 03	*	7,259*	58,435	65,694
01April, 03	31March, 04	-	68,558	5,21,632	5,90,190
01April, 04	31March, 05	-	1,03,246	7,36,416	8,39,662
01April, 05	31March, 06	-	1,83,446	9,14,712	10,98,158

ASSETS UNDER MANAGEMENT (RS. CRORES)

AS ON	UTI	PUBLIC SECTOR	PRIVATE SECTOR	TOTAL
31March, 99	53,320	8,292	6,860	68,472

Phase V. Growth and Consolidation - 2004 Onwards

The industry has also witnessed several mergers and acquisitions recently, examples of which are acquisition of schemes of Alliance Mutual Fund by Birla Sun Life, Sun F&C Mutual Fund and PNB Mutual Fund by Principal Mutual Fund. Simultaneously, more international mutual fund players have entered India like Fidelity, Franklin Templeton Mutual Fund etc. The Assets under Mutual Funds Management as on June 30, 2007 stood at Rs.4,00,842 crore as against Rs.2,65,534 crore as at the end of the previous year, registering the increase of 51% over the year. There are 41 fund houses in India rose 284% to a record high of Rs. 935.6 crore as at the end of March 2010. This is a continuing phase of growth of the industry through consolidation and entry of new international and private sector players.

Potential of Indian Mutual Funds Industry:

The Indian mutual funds industry has been experiencing a rapid growth due to infrastructure development, personal financial assets getting augmented and increased foreign participation. The risk appetite of the middle class investors has been increasing, income has been going up, investors being made aware of the potential of the mutual fund industry – all these have been making India a preferred Mutual Fund investment destination when compared to other investment vehicles like Fixed Deposits (FDs) and postal savings. The diversified portfolio is another reason for the investors to get

allured by the Mutual Fund Investment India. The growth path of Mutual Fund Investment India is attributed to the high saving pattern in India. This is a healthy status of the MF industry in India when compared to Japan, France and China. The Mutual fund sector in India though has huge potential, yet the limited participation of the rural sector will always act as a deterrent factor. The other hurdles in this regard are lack of awareness, inferior distribution channel and limited banking services in the rural regions. The best instrument of investing money nowadays is the mutual fund. Investing in a stock market has become risky these days due to the high volatility in the market.

How to invest in Mutual Fund:

Step One –Identify the investment needs

One's financial goals will vary, based on his/her age, lifestyle, financial independence, family commitments, and level of income and expenses and many other factors. Therefore, the first step is to assess one's needs .One can begin by defining his/her investment objectives and needs which could be regular income, buying a home or finance a wedding or educate your children or a combination of all these needs, the quantum of risk you are willing to take and your cash flow requirements.

Step Two-Choose the right Mutual Fund

The important thing is to choose right mutual fund scheme, which suits the requirements. The offer document of the scheme tells its objectives and provide supplementary details like the track record of other schemes, managed by the same Fund Manager. Some factors to evaluate before choosing a particular Mutual Fund are the track record of the performance of the fund over the last few years in relation to the appropriate yardstick and similar funds in the same category. Other factors could be the portfolio allocation, the dividend yield and the degree of transparency as reflected in the frequency and quality of their communications.

Step Three –Select the ideal mix of Schemes

Investing in just one Mutual Fund scheme may not meet all investment needs. One may consider investing in a combination of scheme to achieve the specific goals.

Step Four –Invest regularly

The best approach is to invest a fixed amount at specific intervals, say every month. By investing a fixed sum each month, you buy fewer units when the price is higher and more units when the price is low, thus bringing down your average cost per unit. This is called rupee cost averaging and do investors all over the world follow a disciplined investment strategy. One can also avail the systematic investment plan facility offered by many open-end funds.

Step Five- Start early

It is desirable to start investing early and stick to a regular investment plan. If one starts now, he/she will make more than if he/she waits and invests later. The power of compounding lets one earn income and the money multiplies at a compounded rate of return.

Step Six- The final step

Mutual Funds are suitable for every kind of investor- whether starting a career or retiring, conservative or risk taking, growth oriented or income seeking.

Conclusion and Suggestions:

The buzzword Mutual Funds is taking off with new dimensions in this millennium. Portfolio manager needs to invest in a manner so that both the parties are at a win-win situation at the end of transactions. In India mutual funds has revolutionized the functioning of the financial and capital market. E business has not only increased the ease of transactions, but also reduced time and cost of those transactions. Sustainable growth is possible by integrating innovation with ethical business practices and care for business environment. The common man must be encouraged to indulge in mutual fund trading / investing activities. As the majority of the Indian population resides in villages where the literacy as well as awareness level is low and the infrastructure needed for business/trade is inadequate, the authority should take proper initiation and move forward in the direction for creating 'virtual trade centers' to provide marketing services of various innovative funds to the larger masses of people at low costs. With a view to providing greater opportunity for investment overseas, the aggregate ceiling of for overseas investment by mutual funds registered with the SEBI has been enhanced from $5 billion to $7bilion effective from April 3, 2008. The Indian mutual funds retail market, which at present is growing at a CAGR of around 30%, is estimated to reach US$ 300 Billion by 2015.Income and growth MF schemes made up for the bulk Assets Under Management (AUM) in India. Diversification of investment holdings reduces the risk tremendously. Nowadays, keeping large amounts of money in bank is not a wise option, as in real terms the value of money decreases over a period of time. One of the options is to invest the money in stock market. But a common investor is not informed and competent enough to understand the intricacies of stock market. This is where mutual funds come to the rescue. The issues concerning to Governance and disclosure rules need to be given far more focus for effective monitoring system to curb the existing unethical practices. Government, RBI and SEBI initiatives will take the Mutual Fund industry forward to compete in global business environment.

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