# ROLE OF MUTUAL FUND IN INDIA

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## ABSTRACT

Mutual fund in Indian context is a challengeable phenomenon. It has attained commanding heights in the financial scenario of India. The main focus of this study is, on the factors influencing the respondents on their choice of Mutual Fund Company. The most important factors consider before investing in the mutual fund are objective of the scheme, past performance of a research team, services provided by the company etc. The best way of surviving and prospering in the competitive environment is through providing prompt, relevant and efficient information about Asset under Management, Net Asset Value and information about the scheme.

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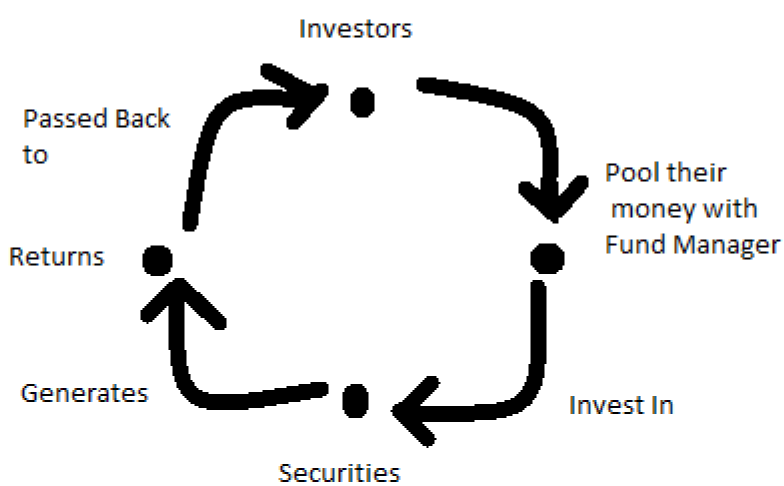
## MEANING OF MUTUAL FUNDS

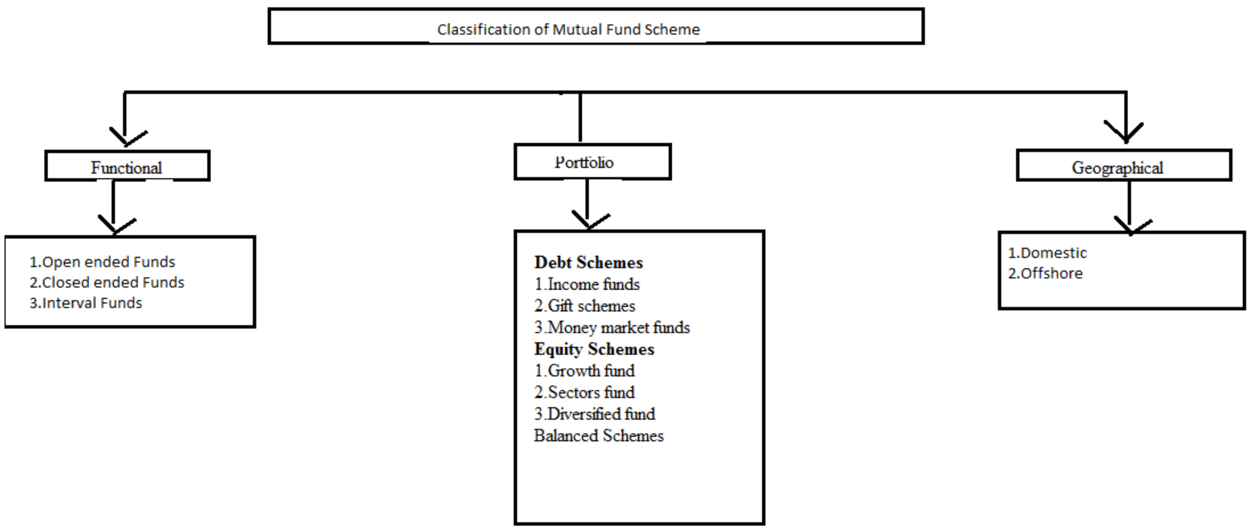
A Mutual Fund is an investment vehicle for investors who pool their savings for investing in diversified portfolio of securities with the aim of attractive yields and appreciations in their value. As per Mutual Fund Book, published by Investment Company Institute of the U.S.," A Mutual Fund is a financial service organization that receives money from shareholders, invests it, earns return on it, attempts to make it grow and agrees to pay the shareholder cash on demand for the current value of investment." The investment managers of the funds manage these savings in such a way that the risk is minimized and steady return is ensured.

### CONCEPT OF MUTUAL FUNDS

The concept of 'mutual fund' is a new feather in the cap of Indian capital market but not to international capital markets. The formal origin of mutual funds can be traced to Belgium where Society General was established in 1822 as an investment company to finance investments in national industries with high associated risk. In England, the Foreign and Colonial Government Trust was established in 1868to spread risks for investors over a large number of securities. The concept of mutual funds spread to U.S.A.in the beginning of the 20$^{th}$ century and three investment companies were started in 1924.

**<u>Mutual Fund Operation Flow Chart</u>**






**(i)Functional Classification**

Functional classification, based on basic characteristics of the mutual fund schemes opened for public subscription, can be grouped into:

- Open-ended funds
- Close-ended funds
- Interval funds
- **Open-ended** funds continuously offer new shares for sale and always stand ready to buy securities at any time. The capitalization of the funds is constantly changing as investors buy and sell their shares directly with thefund.US-64, CanClgr and Franklin Blue Chip are examples of such funds.
- **Closed-ended** mutual funds are open for subscription only once and can be redeemed only after a fixed investment period. These funds have a fixed number of shares that can be owned by the investing public.
- **Interval Funds** are the variations of the above stated two concepts. Thus, some funds are close-ended for the first couple of years and become open-ended after some time-some funds allow fresh subscriptions and redemptions as fixed intervals every year in order to reduce the hassles of daily entry and exist, yet providing reasonable liquidity.

**(II)Portfolio Classification**

Mutual funds can be categorized according to the type of instruments in which the funds have been invested. As such, different funds are designed to meet the diverse nations of savers.

- **Income funds-**The objectives of such funds is to generate income and distribute regular return to investors. In such schemes the fund are invested in safe and income earning instruments like public-deposits, bonds, debentures etc.
- **GILT schemes-**Such schemes are also called income schemes but they concentrate mainly on long term government securities.
- **Money-market funds-**Such funds invest in highly liquid and safe securities like commercial papers, certificatesof deposits, banker acceptances, treasury bills etc. Money is not invested in capital market instruments like shares, debentures or bonds.
- **Growth funds-** Growth schemes aim at generating long term capital appreciation for its investors. The funds are invested inequities with high growth potentials, of course, such securities involve risk also. Liquidity of investment is secondary tothem; they want to accumulate wealth for future needs.
- **Diversified Funds** have investment portfolios spread across industries and companies. Choice of stock is the discretion of the fund managers. Can equity diversified fund of Canada Bank is the example of such funds.
- **Sector Funds** deploy funds in stock of a particular business sector or industry, like information technology, fast moving consumer goods. The degree of diversification of risk is very limited in this type of fund, making it extremely risky.
- **Balanced funds-**Balanced funds combine bonds and/or preferred stocks with the ownership of common stock, usually at some pre-determined percentage relationship. Several balanced funds keep one-half in bonds and preferred stocks. Balanced portfolios are more conservative than common stock funds and they generally do not have significant price movement either up or down.
- **Other schemes-** Within each of the above categories, there can be further variants of the funds. For instances, debt funds may be diversified debt funds, focused debt funds and high yield debt funds.

- **Index funds** track key market indices like BSE SENSEX or NSE Nifty. Thus, an index fund tracking the SENSEX will invest only in the SENSEX stocks. The performance of the fund is directly related to the performances of the index, except the tracking error, which is due to the management fees and transaction costs, charged to unit-holders.
- **Taxation Funds** are designed to providetax exemption benefits to the investors, whether in the domestic or foreign markets.

**(III)Geographical Classification**

Mutual funds can also be grouped according to geographical boundaries of their operations, as domestic mutual funds, off – shore funds and overseas funds.

- **Domestic Funds** are open for mobilizing savings of the nationals within the country. These funds may be of various kinds, as outlined above under the portfolio and functional groups.
- **Off-shore Funds** represent mutual funds with investments source abroad. Thus, subscription to these funds is mobilized from international financial markets for investment in the economies and capital market instruments of specific country.

## TYPES OF MUTUAL FUNDS

There are a number of mutual funds to suit the needs and preferences of investor.The choice of the fund is linked to the demand of the investor. Does he expect a stable low earnings, capital appreciation, etc? The objectives of earning helps in deciding the type of funds where investment is made. To achieve the differing objectives of the investors, mutual funds adopt different strategies and accordingly offer different schemes of investment.

**The various mutual funds may be classified under five abroad categories:**

1. **According to Ownership**
2. **According to the Scheme of Operation**
3. **According to Portfolio**
4. **According to Location**
5. **Others.**

**A.** ***According to Ownership***

According to ownership, mutual funds in India may be classified as

- Public Sector Mutual Funds
- Private Sector Mutual Funds

1. **Public Sector Mutual Funds**

Unit Trust of India has been functioning in the arena of Mutual Fund business in India since 1963-64. However, it was only after 23 years, in 1987 that second fund was established in India by the State Bank of India. Although UTI was functioning

Successfully, it was found inadequate to meet the requirements of small and medium household sectors.

2. **Private Sector Mutual Funds**

Seeing the success and growth of Mutual Funds in the Indian capital market, the Government of India allowed the private sector corporate to join the Mutual Fund Industry on February 14, 1992. Since then, a number of private sector companies have approached SEBI for permission to set up private mutual funds. SEBI Regulations, 1996 provide guidelines for registration, management and schemes of Mutual Funds.

**B. According to Scheme of Operation**

The most important classification of mutual funds is on the basis of the scheme of their operations as all types of mutual funds fall under this classification. According to the scheme of operations, the mutual funds could be divided into three categories, i.e. **open ended funds, close ended funds and the interval funds.**

**(i) Open-Ended Schemes**

**(ii)** Open ended scheme means of mutual funds which offers units for sale without specifying any duration for redemption. These schemes do not have a fixed maturity and entry to the fund is always open to investors who can subscribe it at any time. Similarly, the investors have an option to get their holdings redeemed at any time. The fun redeems the units/shares at periodically announced rates.

**(iii) Close-Ended Schemes**

A close ended scheme means any scheme of mutual fund in which the period of maturity of the scheme is specified. Unlike open ended funds, the corpus of close ended scheme is fixed and an investor can subscribe directly to the scheme only at the time of initial issue. The price in the secondary market is determined on the basis of demand and supply and hence could be different from the net assets value.

**(iv) Interval Schemes**

An interval scheme of mutual fund which is kept open for a specific interval and after that it operates as a close scheme. Thus, it combines the feature of both open ended as well as close ended schemes. Interval schemes have been permitted by the SEBI in recent years only. The units of the scheme are also traded in the stock exchanges.

**C. According to Portfolio**

Mutual Funds can be classified according to portfolio according to portfolio or the objectives of the fund. Some of these funds are discussed as follows:

**(i) Income Funds**

These funds aim at providing maximum current return to the investors. The investments are made in stocks yielding higher returns and capital appreciations of small importance. Such funds distribute the income earned by them periodically amongst the investors.

**(ii) Growth Funds**

These funds aim at providing capital appreciation in the value of investment. Such funds invest in growth oriented securities have a potential appreciate in long run. However, the risk involved in such funds is higher than the income funds.

**(iii) Stock/Equity Fund**

These funds mainly invest in shares of the companies. The investments may vary from 'blue chip' companies to newly established companies.

They undertake risk associated with investment in equity shares of companies. A special type of equity fund is known as 'indexfund'.

**(iv) Bond Funds**

These funds employee their resources in bonds. These investments ensure fixed and regular income. Sometimes bonds are available in the market at lower than face value, the net income on these bonds goes higher because interest will be received on the face value of the bond. Bond funds ensure regular income to the investors.

**(v) Specialised Funds**

These funds invest in a particular type of securities. The funds may specialisein securities of companies dealing in a particular product, firms in a particular industry or of certain producing securities.

**D. According to Location**

Mutual fund can also be classified on the basis of location from where they mobilize funds, as;

**(i) Domestic Funds**

These are the funds which mobilise savings of people within the country where investments are made. Domestic funds can further be sub divided on the basis of scheme of operation.

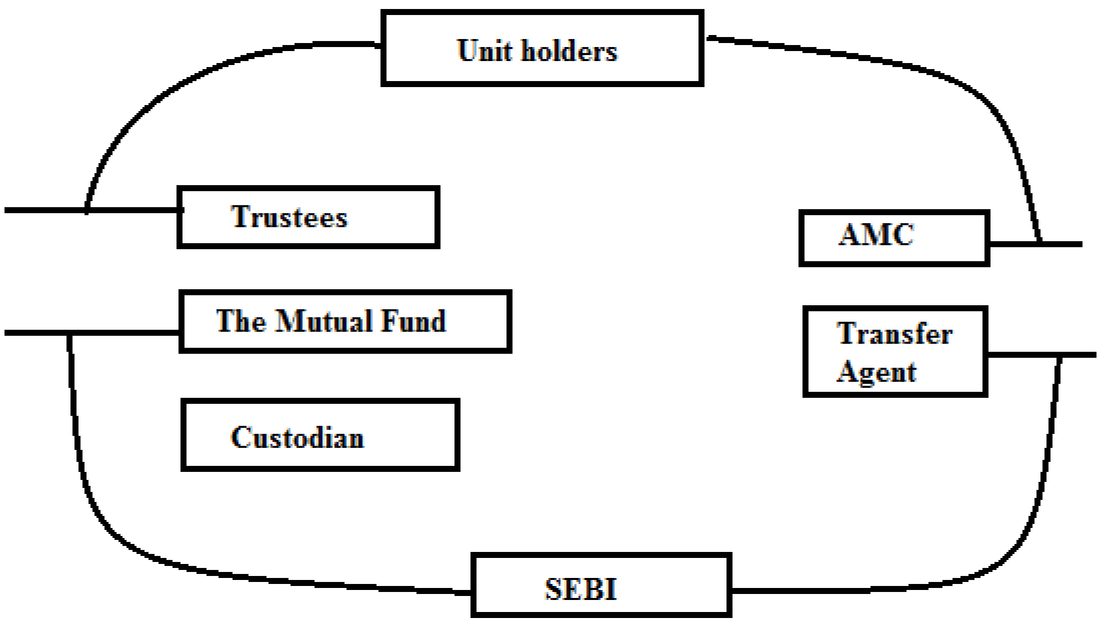
**(ii) Off-shore Funds**

Off shore mutual funds are those which raise or mobilise funds in countries other than where investments are to be made. These funds attract foreign savings for investment in India.

**E. OtherTypes of Mutual Funds**

In addition to the above mentioned mutual funds, there can be some other types of mutual funds also, such as, 'Loan Funds' and 'Non Loan Funds' based upon the expenses to be charged.

## ORGANIZATION OF A MUTUAL FUND




## ADVANTAGES OF MUTUAL FUNDS

A Mutual Fund is a special type institution which acts as investment intermediary and channelizes the savings of large number of people of the corporate securities in such a way that investors get steady returns, capital appreciation and a low risk. Mutual funds are becoming very popular worldwide because of the following important advantage:

**(i) Diversification**

A large number of investors have smallsavings with them. They can at the most buy shares of one or two companies. When small savings are pooled and entrusted to mutual funds then these can be used to buy shares of many different companies.

**(ii) Reduced Risk**

A mutual funds invest in large number of companies and are managed professionally, the risk factor of the investors reduced. Small investors, on the other hand, may not be in position to minimize such risk.

**(iii) Tax Advantage**

There are certain schemes of mutual funds which provide tax advantage under the Income Tax Act. Thus the tax liability of an investor is also reduced when he invests in these schemes of mutual funds.

**(iv) Flexibility**

Mutual Funds provide flexible investments plans to its subscribers such as, regular investment plans, regular withdrawal plans and dividend reinvestment plans, etc.

**(v) Higher Returns**

Mutual funds are expected to provide higher returns to the investors as compared to direct investment because of professional management.

## MUTUAL FUNDS IN INDIA

Mutual Funds were first started in England during 19th century. These funds could not succeed due to highly speculative nature. Mutual funds started in during USA 1900 but they picked up only after 1924 when a number of such funds were started. After World War IImutual funds expanded rapidly up savings In India first mutual fund was started in 1964when Unit Trust of India was established to mop up savings of small investors and channelize them into productive avenues. UTI brought out a number of schemes beneficial to every category of investors. There are schemes for those who prefer safe steady returns and those who prefer high growth. UTI has brought schemes for non resident Indians too for mopping their resources. The Government of India has amended Banking Regulation Act in 1987 to enable commercial banks to launch mutual funds to mop up savings of every section of society. Canada banks formed can bank Mutual Fund with the objectives of housing investmentexpertiseunder a single roof with the objectives of housing investment expertise under a single roof for the benefit of investors. It started two close ended schemes Canstock and Canshare in 1987.

## EVOLUTION OF MUTUAL FUND SCHEMES

There are broadly two aspects on the basis of which any scheme of mutual fund may be evaluated by an investor:

A. Quantitative Aspect
B. Qualitative Aspect

**A. Quantitative Aspect**

The investor would like to invest his hard earned money in such schemes of mutual funds where he can expect appreciation in the value of his investments in the long-run. Investors can not speculate and earn profits by sale or purchase of mutual fund units in the short run. A mutual fund may be evaluated by an investor on the following parameters in the long run:

**(1) Appreciation in the value of investments.**

A mutual fund that ensures higher total return on investments is likely to be considered by the investors. Return includes any income received by way of dividend plus capital appreciation. A return can be calculated as follows:

Capital appreciation + dividend **/** Net asset value in the beginning

**(2) Income ratio**

Income ratio indicates the earning potential of the scheme of mutual fund. It can be calculated as follows:

Net investment income / Average net asset

Greater the ratio better is the mutual fund scheme.

**(3) Expense ratio**

How effectively the scheme is being managed is indicated by the expense ratio. It is calculated as under:

= Total expenses / Average net assets

Expense ratio is very much affected by the size of the scheme. Larger is the scheme, lesser e the will be cost of operating the scheme. But if the size of scheme reduces, it will increase the per unit cost of operating a scheme. A lower expense ratio indicates the efficiency with which the scheme is being managed.

**B. Qualitative Aspect**

Second aspect that is taken into consideration while evaluating a mutual fund is qualitative in nature. An investor takes into consideration the following qualitative aspects:

(i) Track record of the sponsoring authority i.e. who is the sponsor of the mutual fund scheme.
(ii) The promptness with which response given to investor.
(iii) Location of collection centers.
(iv) Timely redemption of units.
(v) Timely dispatch of units certificates or account statement.
(vi) Efficiency with which a request for the change of address is met.
(vii) Convenience/time taken in switching over to other schemes.
(viii) Timely receipt of dividends etc.
(ix) Adequacy of the infrastructure.
(x) Time taken for redressal of grievances, or complaints of the investors looked into.

Thus, qualitative aspects are mostly focused on the quality of service provided before and after the sale of units of mutual fund scheme. Schemes may not turn out to be successful because of the infrastructure or back up facility or due to indifferent attitude of the sponsors towards investors.

## CONCLUSION

A mutual fund is the ideal investment vehicle for today's complex and modern financial scenario of India. Markets for equity shares, bonds and other fixes income instruments, real estate, derivatives and other assets have become mature and information driven. Today each and every person is fully aware of every kind of investment proposal in Indian economy. Everybody wants to invest money, which entitled of low risk, high returns and easy redemption. In my opinion before investing in mutual funds, one should be fully aware of each and everything.

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