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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INTRODUCTION

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 invested by the fund manager in different types of securities depending upon the objective of the scheme. These could range from shares to debentures to money market instruments. The income earned through these investments and the capital appreciation realized by the scheme 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 portfolio at a relatively low cost. The small savings of all the investors are put together to increase the buying power and hire a professional manager to invest and monitor the money. Each Mutual Fund scheme has a defined investment objective and strategy. The flow chart below describes broadly the working of a mutual fund.

ROLE OF MUTUAL FUND IN THE FINANCIAL MARKET

The brief review in the preceding section of financial system and structural changes in the market suggests that Indian mutual funds have emerged as strong financial intermediaries and are playing a very important role in bringing stability to the financial system and efficiency to recourse allocation. Mutual funds have opened new vistas to investors and imparted much – need liquidity to the system.Mutual funds are the fastest growing institutions in the household saving sector. Growing complications and risk in the stock market, rising tax rates and increasing inflation have pushed household towards mutual funds. The active involvement of mutual funds in promoting economic development can be seen not only in terms of their participation in the saving market but also in their dominant presence in the money and capital market. A developed financial market is critical to overall development and mutual funds play an active role in promoting a healthy capital market. We have also noted that Indianinvestors have moved towards more liquid, growth-oriented tradable instrument like share / debentures, and units ofmutual funds. This shift in asset holding pattern of investors has been significantly influenced by the ‘equity’ and ‘unit’ culture.Mutual funds in India have emerged as a critical institutional linkage among various financial segments like saving, capital market and the corporate sector.

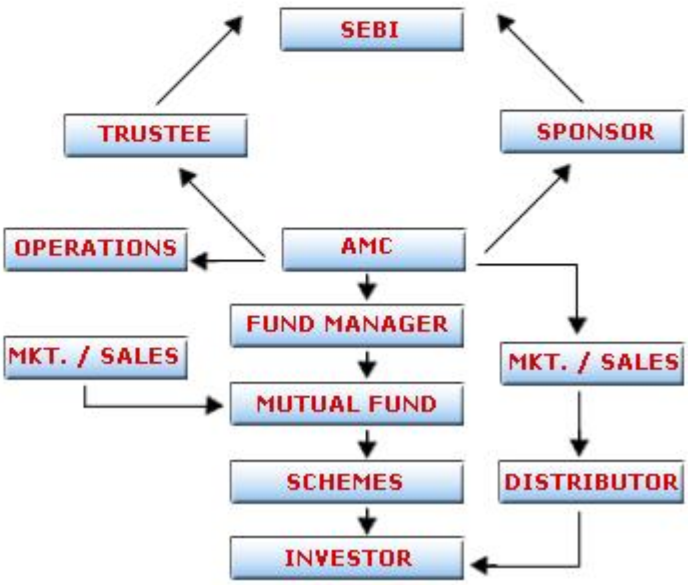
OBJECTIVES OF THE STUDY

MAIN OBJECTIVE-:

The main objective of the project research report is to study all the elements factors which influence the mutual fund market expansion in India in the term of technological economic and legal environment.

- To understand the awareness of mutual fund products among investors
- To study the factors that decides the personal finance pattern of investors.
- To find out the correlation between age of the investors and presence of mutual funds in their investments.
- To find out if the subject of the investors have a significant association with their investment in mutual funds.

MUTUAL FUND STRUCTURE



THE STRUCTURE OF MUTUAL FUND CONSISTS OF THE FOLLOWING:-

SPONSOR

Sponsor is the person who acting alone or in combination with another body corporate establishes a mutual fund. Sponsor must contribute at least 40% of the net worth of the Investment Managed and meet the eligibility criteria prescribed under the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.The Sponsor is not responsible or liable for any loss or shortfall resulting from the operation of the Schemes beyond the initial contribution made by it towards setting up of the Mutual Fund.

Trust

The Mutual Fund is constituted as a trust in accordance with the provisions of the Indian Trusts Act, 1882 by the Sponsor. The trust deed is registered under the Indian Registration Act, 1908.

Trustee

Trustee is usually a company (corporate body) or a Board of Trustees (body of individuals). The main responsibility of the Trustee is to safeguard the interest of the unit holders and inter alia ensure that the AMC functions in the interest of investors and in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, the provisions of the Trust Deed and the Offer Documents of the respective Schemes. At least 2/3rd directors of the Trustee are independent directors who are not associated with the Sponsor in any manner.

Asset Management Company (AMC)

AMCs manage the investment portfolios of the schemes. An AMC's income comes from the management fees it charged to the schemes. The management fee is calculated as a percentage of net assets managed. Some countries provide for performance based management fees as well.

In order to earn the management fee, any AMC has employ people and bear all the establishment costs that are related to its activity, such as for premises, furniture, computers and other assets, software development, communication costs etc. these are to be met out of the management fee earned. Expenses such as on trustee fee, marketing etc. can be directly borne by the mutual fund scheme. However, in some cases, competition in the marketplace could force an AMC to bear some of these costs, which would otherwise have been born by investors in the schemes.

Distributors

Distributors earn a commission for bringing investors into the schemes of a MF. This commission is an expense for the scheme, although there are occasions when an AMC chooses to bear the cost, wholly or partly.

Registrar and Transfer Agent

The AMC if so authorized by the Trust Deed appoints the Registrar and Transfer Agent to the Mutual Fund. The Registrar processes the application form, redemption requests and dispatches account statements to the unit holders. The Registrar and Transfer agent also handles communications with investors and updates investor records.

ONLINE MUTUAL FUND TRADING

The innovation the industry saw was in the field of distribution to make it more easily accessible to an ever increasing number of investors across the country. For the first time in India the mutual fund start using the automated trading, clearing and settlement system of stock exchanges for sale and repurchase of open-ended de-materialized mutual fund units.Systematic Investment Plan (SIP) and Systematic Withdrawal Plan (SWP) were options introduced which have come in very handy for the investor to maximize their returns from their investments. SIP ensures that there is a regular investment that the investor makes on specified dates making his purchases to spread out reducing the effect of the short term volatility of markets. SWP was designed to ensure that investors who wanted a regular income or cash flow from their investments were able to do so with a pre-defined automated form. Today the SW facility has come in handy for the investors to reduce their taxes.Instead of going through the hassles of filling up a repurchase request form, sending it to the investor service centre and then waiting for Cheque to be delivered to them, all they need to do is to simply bank the cheques with them and save time and effort.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) REGULATIONS, 1996

The fast growing industry is regulated by Securities and Exchange Board of India (SEBI) since inception of SEBI as a statutory body. SEBI initially formulated "SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) REGULATIONS, 1993" providing detailed procedure for establishment, registration, constitution, management of trustees, asset management company, about schemes/products to be designed, about investment of funds collected, general obligation of MFs, about inspection, audit etc. based on experience gained and feedback received from the market SEBI revised the guidelines of 1993 and issued fresh guidelines in 1996 titled "SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) REGULATIONS, 1996". The said regulations as amended from time to time are in force even today.The SEBI mutual fund regulations contain ten chapters and twelve schedules.

TYPES OF MUTUAL FUNDS/ SCHEMES

Funds are generally distinguished from each other by their investment objectives and types of securities they invest in. currently, mutual funds in India are allowed to invest either in equity or debt or a combination of these two. While moves are on to float funds that invest in gold or real estate etc, as of date, mutual funds are not permitted to currently hold physical assets.

Thus, a fund can invest in shares or debt instruments of a gold mining company, but cannot buy gold itself. Here the funds are classified on the basis of the investment objective where objective reflects the purpose for which the investor is investing his money. By law each mutual fund must declare an investment objective which tells an investor what the fund concentrates on and allows the investor to integrate a particular fund with his or her own needs. The main objective of any investor is to generate returns and the portfolio for any investor varies.

Investors can have one particular objective or can have a mix of various objectives. On the basis of objective and asset allocation mutual funds can be categorized as follows.

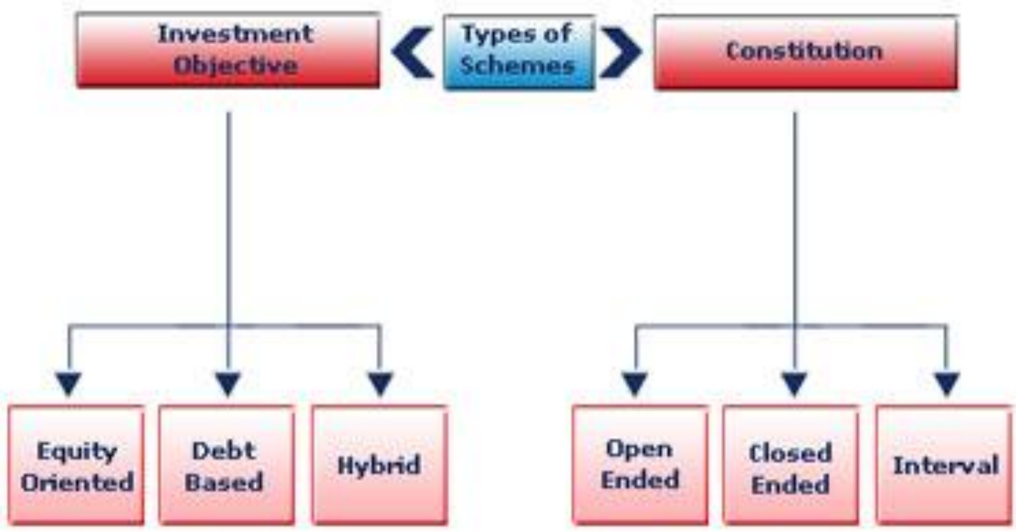


Diagram showing the Types of Schemes

1) Investment Objective:-

Schemes can be classified by way of their stated investment objective such as Growth Fund, Balanced Fund, and Income Fund etc.

a. Equity Oriented Schemes

These schemes, also commonly called Growth Schemes, seek to invest a majority of their funds in equities and a small portion in money market instruments. Such schemes have the potential to deliver superior returns over the long term. However, because they invest in equities, these schemes are exposed to fluctuations in value especially in the short term.

Equity schemes are hence not suitable for investors seeking regular income or needing to use their investments in the short-term. They are ideal for investors who have a long-term investment horizon. The NAV prices of equity fund fluctuates with market value of the underlying stock which are influenced by external factors such as social, political as well as economic.HDFC Growth Fund, HDFC Long Term Advantage Fund (formerly HDFC Tax Plan 2000) and HDFC Index Fund are examples of equity schemes.

b. Debt Based Schemes

These schemes, also commonly called Income Schemes, invest in debt securities such as corporate bonds, debentures and government securities. The prices of these schemes tend to be more stable compared with equity schemes and most of the returns to the investors are generated through dividends or steady capital appreciation. These schemes are ideal for conservative investors or those not in a position to take higher equity risks, such as retired individuals. However, as compared to the money market schemes they do have a higher price fluctuation risk and compared to a Gilt fund they have a higher credit risk.

c. Hybrid Schemes

These schemes are commonly known as balanced schemes. These schemes invest in both equities as well as debt. By investing in a mix of this nature, balanced schemes seek to attain the objective of income and moderate capital appreciation and are ideal for investors with a conservative, long-term orientation. HDFC Balanced Fund and HDFC Children’s Gift Fund are examples of hybrid schemes

2)Constitution:-

Schemes can be classified as Closed-ended or Open-ended depending upon whether they give the investor the option to redeem at any time (open-ended) or whether the investor has to wait till maturity of the scheme.

I. Open ended Schemes

The units offered by these schemes are available for sale and repurchase on any business day at NAV based prices. Hence, the unit capital of the schemes keeps changing each day. Such schemes thus offer very high liquidity to investors and are becoming increasingly popular in India. Please note that an open-ended fund is NOT obliged to keep selling/issuing new units at all times, and may stop issuing further subscription to new investors. On the other hand, an open-ended fund rarely denies to its investor the facility to redeem existing units.

II. Closed ended Schemes

The unit capital of a close-ended product is fixed as it makes a one-time sale of fixed number of units. These schemes are launched with an initial public offer (IPO) with a stated maturity period after which the units are fully redeemed at NAV linked prices. In the interim, investors can buy or sell units on the stock exchanges where they are listed. Unlike open-ended schemes, the unit capital in closed-ended schemes usually remains unchanged. After an initial closed period, the scheme may offer direct repurchase facility to the investors. Closed-ended schemes are usually more illiquid as compared to open-ended schemes and hence trade at a discount to the NAV. This discount tends towards the NAV closer to the maturity date of the scheme.

III. Interval Schemes

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

New Development In The Ways Of Mutual Funds' Investments

I. Systematic Switching Plan

The unit holder may set up a Systematic Switching plan on a monthly, quarterly, semi-annual or annual basis to exchange a fixed number of units or amount in one scheme to another scheme within the Fund Family or one plan / option to another. The redemption or investment will be at the applicable NAV for the respective scheme as specified in the offer document.

II. Systematic Investment Plan

Systematic Investment Plan is available for planned and regular investments, under this plan unit holders can benefit by investing specified rupee amounts periodically for a continuous period. This concept is called Rupee Cost Averaging. This program allows Unit holders to save a fixed amount of rupees every month / quarter by purchasing additional units of the scheme(s). Rupee cost averaging does not guarantee a profit or protect against a loss. Rupee cost averaging can smooth out the market's ups and downs and reduce the risk of investing in volatile markets.

For as little as Rs. 250 each month for 12 months or Rs. 500 every month for 6 months, you can purchase mutual fund units and avoid larger minimum investment amounts of over Rs.1,000. Fixed amounts can be invested in Mutual Funds each month using funds drawn automatically from your saving account regularly.Investing in Systematic Investment Plan (SIP) offer the benefit of "Rupee-cost averaging", i.e., by purchasing Mutual Fund units over a period of time, you automatically buy more units when price are low and fewer units when prices are high, resulting in lower "per unit acquiring cost" as a result of averaging.Understanding SIP – How does cost averaging benefit you? (Taking an example of few schemes of Prudential ICICI mutual fund)Many investors think that they should invest only when an opportunity to invest – like an IPO (Initial Public Offering) – is available.

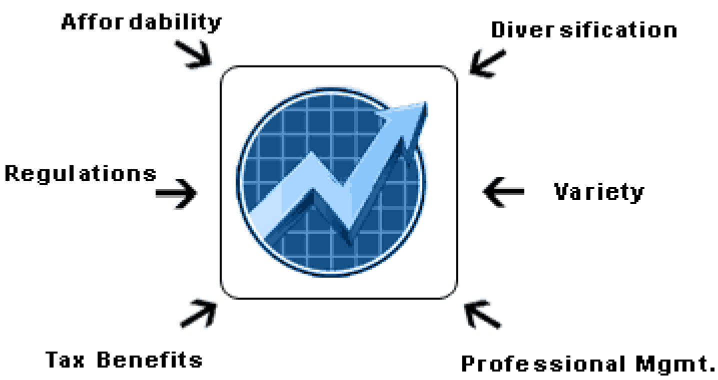
However, when doing this, one runs the risk of mistiming the market. For example, many times investors are attracted by the price in the market only to subsequently find out that they had invested at a peak. Sometimes investors buy when they think the market has bottomed out only to find the prices falling further. SIP through cost averaging helps you avoid the risk of mistiming by spreading your risk.

III. Systematic Withdrawal Plan

Systematic Withdrawal Plan (SWP) lets you automatically a prearranged amount of your mutual fund holding each month. SWPs are an ideal way to supplement your monthly cash flow, meet minimum withdrawal requirements, or move assets between the funds.SWPs is a no-change service. When you set up your SWP, cash proceeds from each redemption (minimum balance maintained @ 25% of holding at any given point of time) are given to you in the form of post-dated cheque (six monthly cheque at par, which enables you to get the funds loaded).

Benefits of Mutual Funds

There are numerous benefits of investing in mutual funds and one of the key reasons for its phenomenal success in the developed markets like US and UK is the range of benefits they offer, which are unmatched by most other investment avenues. We have explained the key benefits in this section. The benefits have been broadly split into universal benefits, applicable to all schemes and benefits applicable specifically to open-ended schemes.



Universal Benefits

Affordability

- A mutual fund invests in a portfolio of assets, i.e. bonds, shares, etc. depending upon the investment objective of the scheme. An investor can buy in to a portfolio of equities, which would otherwise be extremely expensive. Each unit holder thus gets an exposure to such portfolios with an investment as modest as Rs.500/-. This amount today would get you less than quarter of an Infosys share! Thus it would be affordable for an investor to build a portfolio of investments through a mutual fund rather than investing directly in the stock market

Diversification

The nuclear weapon in your arsenal for your fight against risk. It simply means that you must spread your investment across different securities (stocks, bonds, money market instruments, real estate, fixed deposits etc.) and different sectors (auto, textile, information technology etc.). This kind of a diversification may add to the stability of your returns, for example during one period of time equities might underperforms but bonds and money market instruments might do well enough to offset the effect of a slump in the equity markets. Similarly the information technology sector might be faring poorly but the auto and textile sectors might do well and may protect your principal investment as well as help you meet your return objectives.

Variety

- Mutual funds offer a tremendous variety of schemes. This variety is beneficial in two ways: first, it offers different types of schemes to investors with different needs and risk appetites; secondly, it offers an opportunity to an investor to invest sums across a variety of schemes, both debt and equity. For example, an investor can invest his money in a Growth Fund (equity scheme) and Income Fund (debt scheme) depending on his risk appetite and thus create a balanced portfolio easily or simply just buy a Balanced Scheme.

Professional Management

Qualified investment professionals who seek to maximize returns and minimize risk monitor investor's money. When you buy in to a mutual fund, you are handing your money to an investment professional that has experience in making investment decisions. It is the Fund Manager's job to (a) find the best securities for the fund, given the fund's stated investment objectives; and (b) keep track of investments and changes in market conditions and adjust the mix of the portfolio, as and when required.

Tax Benefits

- Any income distributed after March 31, 2002 will be subject to tax in the assessment of all Unit holders. However, as a measure of concession to Unit holders of open-ended equity-oriented funds, income distributions for the year ending March 31, 2003, will be taxed at a concessional rate of 10.5%.

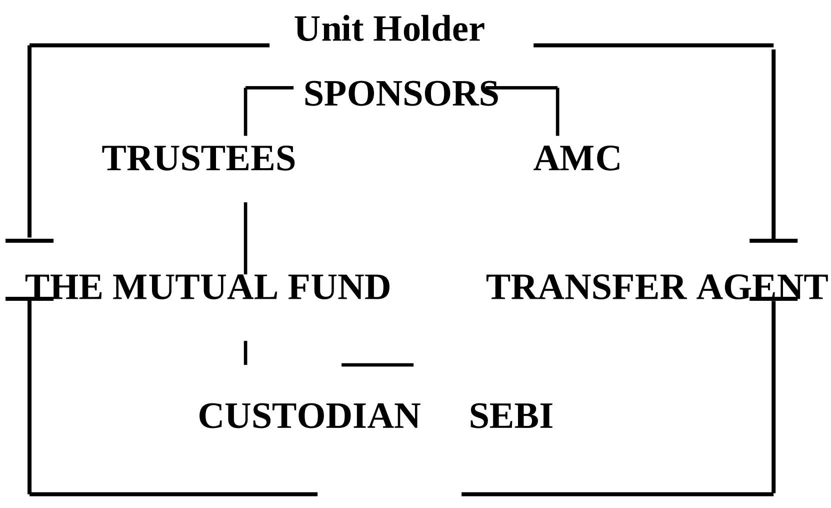
- In case of Individuals and Hindu Undivided Families a deduction upto Rs. 9,000 from the Total Income will be admissible in respect of income from investments specified in Section 80L, including income from Units of the Mutual Fund. Units of the schemes are not subject to Wealth-Tax and Gift-Tax.

Regulations

Securities Exchange Board of India ("SEBI"), the mutual funds regulator has clearly defined rules, which govern mutual funds. These rules relate to the formation, administration and management of mutual funds and also prescribe disclosure and accounting requirements. Such a high level of regulation seeks to protect the interest of investors

Organization of a Mutual Fund

The mutual fund is formed as trust in India. Mutual fund in India has a 3- tier structure of Sponsor- Trustee- AMC. Sponsor is the promoter of fund. It creates the AMC and Trustee Company and appoints the Boards of both these companies with SEBI approval. The trustees appoint the Asset Management Company (AMC) to manage the investors' money. The AMC is the business face of the mutual fund. The AMC gets fee for managing the funds. The trustees make sure that the funds are managed according to the investors' objective. The investor's funds and the investments are held by custodian. Registrar and Transfer agent manage the sell and repurchase of units and keep the unit holder accounts.



Distribution of Mutual fund

The mutual fund is formed as a trust in India and supervised by the Board of Trustees. The trustees appoint the asset management company (AMC) to manage the investors' money. The AMC gets a fee for managing the funds according to the stated objective of the investors. Since the fees, which includes investment management fees, custodian fees, registrar fess, trustees fees, marketing and distribution expenses, operating expenses, audit fees, cost of mandatory advertising expenses etc. charged by the AMC is very less (2.5 % of NAV) so it does not have the direct distribution of mutual fund schemes.

An asset management company has generally four types of distribution channels. These are as below

National Distributors

Banking Channels

Corporate

Investment Financial advisors (IFA)

Asset Management Company

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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