CHAPTER - 1

AN OVERVIEW OF MUTUAL FUNDS

1. AN OVERVIEW OF MUTUAL FUNDS

1.1. Introduction

1.1.1. The words Savings and Investment are mutually inclusive since if one has the savings with him then only he can invest. The savings are of no value if it does not generate any growth and wealth for future requirements. The savings need to be invested efficiently and for that golden rule is GILT, where G stands for growth, I stand for inflation, L for liquidity and T for taxation. An efficient investment must cater for the appropriate growth, beat the inflation and take into consideration the applicable taxes while selecting the investment opportunity. The future needs and aspirations of an individual are of paramount importance while selecting the appropriate financial product. Money invested in the right instrument, at the right time and for the right tenure will mean financial success. Investment is an art and a science and the key to successful investment is focused and effective investment planning.

1.1.2. Investment has different meanings in finance[1] and economics. In economics, investment is related to savings and deferring consumption. In finance, investment is putting money into something with the expectation of gain, usually over a longer term. This may or may not be backed by research and analysis. Most or all forms of investment involve some form of risk, such as investment in equities, property, and even fixed interest securities which are subject to inflation risk.

1.1.3. In contrast putting money into something with a hope of short-term gain, with or without thorough analysis, is gambling or speculation. This category would include most forms of derivatives, which incorporate a risk element. It would also include purchase of a company share in the hope of a short-term gain without any intention of holding it for the long term. Under the efficient market hypothesis, all investments with equal risk should have the same expected rate of return, that is to say there is a trade-off between

risk and expected return. But that does not prevent one from investing in risky assets over the long term in the hope of benefiting from this trade-off.

1.1.4. Financial planning has become more complex with the abundant and complex opportunities available for investment, the tax concession offered by the government, varied needs of individuals depending upon the objective, lifestyle, age, income, family size etc. Therefore careful planning is warranted and one can take the services of expert financial planners for taking the final decision for the investments.

1.2. Various Investment Options.

Every person wants to safe guard his money against inflation, taxation and has an aim that it grows. But then one needs to select the right financial product. The purpose of investment may vary from person to person, depending upon his requirements, viz. short term and long term investment for future requirements, growth, children education / marriage, buy white goods, property etc. There are abundant opportunities and avenues open for the investors to meet his needs. However, careful selection of appropriate avenue needs careful study and the individual may seek the advice of the financial advisor.

Investment Options.[2]

- Fixed deposits – Banks, Companies and FMP
- Post Office Saving Instruments
- Stock Market
- Precious Metals -Gold and Silver
- Real Estate
- ULIP
- Antique
- Bonds
- Mutual funds

1.2.1. Fixed Deposits (FD)

Fixed Deposit (FD) is a financial instrument where an investment is made for a fixed period of time resulting in a fixed rate of interest in return. This is best suited for investors with a low risk and who want to invest a large sum of money to earn a fixed rate of interest.

Types of Fixed Deposits

There are three types of Fixed Deposits

a) Bank Fixed Deposits
b) Company Fixed Deposits
c) Fixed Maturity Plans

(a) Bank Fixed Deposits

These are kind of fixed deposits which are made with a bank. The tenure can vary from 15, 30, 45 days to 3, 6 months, 1year, and 5 years to 10 years and varies from bank to bank. The minimum deposit amount and the rate of interest will also vary from bank to bank. These are considered as safe investments as they are insured up to 1.0 Lakhs under the Deposit Insurance and Credit Guarantee Scheme of India and provide an assured rate of return. Investors also have the flexibility to take the interest income as a lump sum amount on its maturity or may opt for monthly or quarterly or annual interest options. One point to remember is the interest income earned on fixed deposit is taxable. Ideally there are no charges/expenses charged for fixed deposits, however premature withdrawal will attract a charge. It is also possible to get loans up to 75-90% of the deposit amount.

In order to invest in a bank FD, one has to open a FD account with the bank, nationalized, private or co-operative and make the deposit.

One must not forget the dynamics of investing in fixed deposits and that variables like tax and inflation affect real returns. The interest earned on fixed deposits of all types of banks, corporates etc is added to the income of the assesses. Thus taxes would be at the rate Nil /10% /20% /30%, depending on the applicable individual tax slab. Further surcharge and education cess would also be applicable. In a financial year, up to Rs 10,000 of interest is exempt from TDS under Sec 80 TTA[3]. The resident individuals can file Form 15G or 15H to claim exemption from TDS if the gross income for the year is not in taxable slab. These underlying hidden costs can virtually erode all the returns you earn from them. Even with the interest rate of 10 %, one is not sure to get the positive return considering the inflation and the taxes to be paid on the maturity amount. With the present scenario the return can be negative in the tax bracket of 20 %. (Interest earned Rs 10 – inflation Rs 8.82 and –Tax Rs 2 = - 0.18). In the long run, fixed deposits usually return less than stocks and more than savings accounts. However, fixed deposits tend to be very safe, especially at nationalized banks.

b) Company Fixed Deposit

These are kind of fixed deposits which are made with a company / Financial Institutions / Non Banking Financial Institutions (NBFC). The minimum deposit amount and rate of interest varies from company to company depending upon the amount and the period of investment. Investment in Company Fixed Deposit is unsecured than Bank Fixed Deposit because if the company defaults, the investor cannot sell his documents and recover the investment amount. Also the sum invested is not insured. The benefits of investing in Company Fixed Deposits is that one gets higher interest rate as against Bank fixed deposit and no income tax is deducted at source if the interest income is up to Rs 10,000 in one financial year. The Crisil rating of the Company needs to be looked into while making a fixed deposit of the Company.

c) Fixed Maturity Plan

This kind of investment is similar to fixed deposit in terms of tenure but varies in terms of assured returns. This is a kind of mutual fund scheme offered by mutual fund companies providing an indication of the returns an investor can expect but do not give assured returns. These are closed ended schemes, which mean that an investor can only enter them when they are launched and exit them when their pre-stated term is over. One can exit them earlier, but generally after paying an exit load that is high enough to be a serious discouragement. One has the option to get the dividend quarterly / half yearly or annually and also has the option for growth. The dividend is tax free in the hands of investors since the tax is deducted by Mutual Fund companies. However, for the Growth option, the individual may claim capital gain tax exemption for the maturity amount for that financial period.

1.2.2. Post Office Savings Instruments

Small savings schemes are designed to provide safe and attractive investment options to the public and at the same time it mobilises resources for development projects of the Government. These schemes are operated through about 1.54 lakh post offices throughout the country. These schemes are Public Provident Fund (PPF), National Savings Certificate (NSC), Kisan Vikas Patra (KVP), Deposit schemes like Fixed Deposit, Recurring deposit and Retirement Benefit schemes etc. Deposit Schemes for Retiring Employees are operated through selected branches of public sector banks. Interest rate of 8.4% per annum is payable monthly w.e.f. 01-04-2013. These schemes are also operated through about 8000 branches of public sector banks in addition to the post offices

a) Savings account

The Bank and Post Offices saving accounts are the primary savings product that anyone can open. However it provides low returns of 4 to 5 per cent only. The amount in this

account makes sense only if the credit balance is sufficient to cover needs that are supposed to arise in a short period, since it offers highest liquidity. One can withdraw the funds required at any given point of time through multiple modes i.e. direct withdrawal from bank, through ATMs and also with the enhancement in banking facilities like net banking, one can transfer the required funds via electronic mode too. There is one more favourite and most popular scheme know as recurring deposit where in the investor invests the pre- determined amount at the regular interval and at the end gets the maturity lump sum amount.

Some of banks have devised new method of attracting the customers with a facility to have a flexible fixed deposit in the Savings Account. The investor may earn an interest of as high as 7-8 % in the Savings Account by opting for a period of 3 /6/ 9/12 months after maintaining the mandatory minimum balance in the account say Rs 10000/- at the discretion of the Bank. The fixed deposit is created after the amount exceeds the minimum value of Rs 10,000/ and the FD breaks if the withdrawal amount exceeds the balance. There is no penalty for breaking the FD, but minimum balance of Rs 10,000 is to be maintained by the account holder else he is liable to pay penalty.

b) Kisan Vikas Patra (KVP)

Kisan Vikas Patra is a saving scheme that was announced by the Government of India which doubles the money invested in eight years and seven months. The Directorate of Small Savings Government of India, sells these saving bonds through all Post Offices in the country so that the scheme can be accessed by citizens from all over the country. A KVP can be encashed after two and a half years from the date of issue at the value it has been bought along with the interest accrued for the period. The revenue mobilized by this scheme will be used by the Government of India in welfare schemes for farmers. Any individual of Indian Nationality can invest in Kisan Vikas Patra (KVP) and save their money and earn interest. However, Kisan Vikas Patra is not for business entities such as a company or institutions. NRIs or HUF are also not eligible to invest in KVP.

c) National Savings Certificate (NSC)

The investments in NSC are eligible under section 80 C of Income Tax Act. The Annual Interest income also qualifies for tax rebate under section 80 C of income tax act, as it is deemed to be reinvested. Here the individuals and minor through guardian are eligible to invest. The period of investment is generally 5 years. The interest income is taxable but not deducted at source.

(i) NSC VIII Issue

This scheme is specially designed for Government employees, Businessmen and other salaried classes who are Income Tax assesses. There is no maximum limit for investment and tax is not deducted at source. Individual can obtain loan on this certificate. Investment up to Rs. 1,00,000/- per annum qualifies for IT Rebate under section 80 C of IT Act. The rate of interest is 8.50 %. NSC of Rs.100/- purchased on or after 1.4.2012 shall get Rs 151.62 after 5 years.

(ii) NSC IX Issue

In this NSC IX issue, the difference is only in the interest rate and the time period as compared NSC VIII. The rate of interest is 8.80%. and the time period is 10 years. On maturity a certificate of Rs.100/- purchased on or after 1.4.2012 shall earn Rs 236.60 after 10 years.

d) Post Office Time Deposit

These deposit schemes are for a period of 1 year, 2 year, 3 year and 5 year. The interest earned is 8.20 %, 8.30 %, 8.40 % and 8.50 % respectively. Interest is payable annually but compounded quarterly. Minimum amount of deposit is Rs 200/- and in multiples of Rs 200/- thereafter. There is no maximum limit for investment amount. Interest income is taxable. However, the time deposit of more than 5 Yrs qualifies for Income tax rebate under Sec 80C. The Premature closure facility is available with a penalty.

e) Senior Citizen Savings Schemes

The Government is sympathetic towards senior citizens considering their age and resources. They offer interest of 9.2% per annum from the date of deposit on quarterly basis w.e.f. 01-04-2013. Minimum deposit is Rs 1000 and multiples thereof can be invested. There is a Maximum limit of 15 lakhs and maturity period is 5 years and can be extended for a further period of 3 years. Age limit is 60 years or more, and 55 years or more but less than 60 years for those who have retired under a Voluntary Retirement Scheme or a Special Voluntary Retirement Scheme on the date of opening of the account and investment is made within three months from the date of retirement. There is no age limit for the retired personnel of Defence services provided they fulfill other specified conditions. TDS is deducted at source on interest, if the interest amount is more than Rs 10,000/- per annum. Investment up to Rs 1,00,000/- per annum qualifies for Income Tax Rebate under section 80C of IT Act. Interest can be automatically credited to savings account provided both the accounts stand in the same post office. Premature closure is allowed after one year on deduction of 1.5% of the deposit and after 2 years on deduction of 1%. No withdrawal permitted before the expiry of a period of 5 years from the date of opening of the account. Non-resident Indians (NRIs) and Hindu Undivided Family (HUF) are not eligible to open an account.

f) Post office monthly income scheme (MIS)

The interest rate of 8.4% per annum is payable monthly w.e.f. 01-04-2013 and the maturity period is 5 years. There is no Bonus on Maturity w.e.f. 01.12.2011 and no tax deduction at source (TDS). However there is no tax rebate applicable. Minimum investment amount is Rs.1500/- or in multiple thereafter. Maximum amount is Rs. 4.50 lakhs in a single account and Rs. 9 lakhs in a joint account is permitted. The facility for auto credit of monthly interest to saving account is available, if accounts are at the same post office. Account can be opened by an individual, two/three adults jointly, and a minor through a guardian. Non-Resident Indian / HUF cannot open an Account. Minors have a

separate limit of investment of Rs. 3 lakhs and the same is not clubbed with the limit of guardian. Facility of premature closure of account after 1 year but on or before 3 years is allowed at 2.00% discount. Deduction charges of 1% if account is closed prematurely at any time after three years. This scheme is suitable for retired employees/ senior citizens and for those who need regular monthly income.

g) Public Provident Fund (PPF)

Public Provident Fund (PPF) is a statutory scheme by the Central Government of India. It is one of the instruments suitable for long term investment. PPF scheme is for a period of 15 years and can be extended further for a period of 3 years each time. The interest rate is announced annually in the Budget and is of the order of 8.7%[4]. The minimum investment required in a PPF account is Rs 500 per year and the maximum investment amount is Rs 1,50,000 per year. One can take a loan on the PPF account after completion of the third year opening of the account. Partial withdrawal is also applicable after 4 year's completion of account opening. Any individual who is a native of India can open a PPF account. If one is salaried or business person you can open a PPF account. Even one can open PPF account in the name of minor children. Opening of PPF account is voluntary and not mandatory. A salaried person can also open a PPF account apart from the existing PF account from a long term investment perspective. The PPF contribution of up to Rs. 1,50,000/- qualifies for rebate under Sec 80 C of Income Tax Act.

1.2.3. Stock Market

Stock Market is one of the interesting investment options. This is the investment option which offers a very high rate of return coupled with maximum risk. There are many factors which affects a stock price fluctuation so it is extremely difficult to predict the future share prices, because the stock market runs on probability. Based on information and analysis, future share prices are predicted but the probability of the share prices reaching the target price is always a 50:50 chance. As there are many factors which affect

the share prices of a company and this price target is predicted based on certain assumptions, if the assumptions become incorrect, the chances of the share reaching the target price decreases. Considering the probability involved in a stock market, one should be careful before you park money with any company. One must have a clear idea of the stock one wants to purchase. Pick a stock based on your investment objective, risk appetite and the fundamental parameters of the stock. One should take a note of additional points that liquidity of the stock, volumes of shares traded on a daily basis and the volatility of the share, the difference between the highest price and lowest price for the day before investing in the stock.

1.2.4. Precious Metals

a) Gold

The shining yellow metal is one of the most popular investment options. It is considered as a safe haven against all national, political and cultural crises. Millions of people, financial institutions and governments globally, invest in gold as a store of value. Traditionally gold has been considered as the most favored currency of the world's population, based on Gold Standards. The value of gold is negatively correlated to shares. When the economy is not stable, the price of gold appreciates. Gold returns are also linked to the performance of Indian Rupee v/s the US Dollar, since gold prices in international markets are quoted in US$. The positive of investing in gold is it improves the consistency of the investments. A majority of the financial planners recommends around 15- 20% allocation of the total portfolio to Gold.

Investment in gold can be made in two forms – a) Physical form and b) Non Physical form. Investment in physical gold is in form of Coins / Bars in addition to the jewellery, which every Indian household have. Whereas Non physical form of investment is in the form of Gold Exchange Traded Fund (ETF). It is financial product designed to give an opportunity to the investors to invest in gold without taking the physical custody of the

yellow metal. Most of the banks are selling gold coins / bars where one can invest. Many banks and few private organizations also provide the option of gold loans. In fact, gold is just as risky as any other commodity. However, for all practical purposes in the Indian context, gold is quite safe. It is riskier than fixed deposits but safer than stocks.

The benefits are that it is a safe investment and protects against inflation and is a good diversification tool. Although it does not provide dividend or interest but some reputed Gold sellers are offering gold deposit schemes with interest of the order of 5 % and return of equivalent gold of same purity at the end of the maturity. Safe custody of gold needs to be addressed if it is in physical form.

a) Silver

Silver considered as a poor man's gold is one of the attractive investment option. Normally Gold is preferred over Silver by all investors. The silver market is much smaller in value than the gold market. Silver is a better investment in a bull market. Price of silver is driven by speculation and supply and demand. Silver price is significantly volatile. This is because of lower market liquidity, and demand fluctuations between industrial and store value. Investment of silver is a good option. Silver often tracks the gold price due to store value demands. Investment in silver can be made in the form of jewellery or silver coins or bars.

1.2.5. Real Estate

Real Estate refers to investment in immovable properties which includes land, buildings, flats etc. Investing in real estate involves the purchase of real estate and selling it for

profit. Basically investment in real estate involves a substantial investment and for a long period of time. Majority of the investors invest in real estate in the form of buying a house. But real estate investment is beyond this and the objective behind the investment is to make profits. Before making a real estate investment, the investor should evaluate the risk and investment amount. The different types of real estate investments are as follows –

a) Rental

The aim of this form of investment is to rent out property to a tenant and earn a continuous stream of rent from the tenant. The value of the property also increases over a period of time. The risk in this form of investment is the owner of the property has to find out a tenant and also needs to pay for the maintenance expenses and taxes.

b) **Trading**

Basically traders in real estate make a quick profit by buying properties for a short term and sell them at a profit. Traders look out for buying undervalued properties and sell them at a profit.

c) **Long Term Investment**

There is a certain group of investors who invest in real estate basically a plot of land from a long term perspective. The objective is over a period of time the value of the property will rise and the owner will make profit by selling it. The biggest flaw in this investment is that the money gets blocked for an indefinite period.

1.2.6. Unit Linked Insurance Plans (ULIPs)

Unit Linked Insurance Plans, popularly known as "ULIPs" is an investment cum insurance option provided by Insurance Companies. It is a single contract comprising of insurance cover with an investment benefit. The insurance company allots units to the ULIP investors and the net asset value (NAV) is calculated and declared on a daily basis. An investment in ULIP is divided into two parts:-

a) Life Cover Premium and b) Investment

Certain portion of ULIP goes for life cover and the remaining portion goes for investment. Most of the investors of ULIP do not understand the terms or jargon mentioned in the life insurance contract. There are many instances where insurance agents do not explain the jargon to the investors. In some cases, the investor is not interested to understand the jargon as they are not bothered. As an investor one should know and understand all the terms used by insurance companies before investing in insurance product. The financial advisers advise two things insurance and investment. However both should never be combined and one should opt separately for pure insurance and investment through stock market or mutual funds.

1.2.7. Antiques

Majority of the investors do not consider buying antiques as an investment. Investing in antique is quite difficult for an average investor. Antiques are extremely vulnerable to fluctuations in public demand, so they are considered high-risk, speculative investments. There are instances where a painting was sold at an exorbitant price. Antiques have always been good investment. In many categories it has outperformed the stock market, but like any investment one can make mistakes without good knowledge. Investing in antiques can be profitable with the added advantage that you can enjoy their beauty while

you own them, unlike stocks. In the medium to long term, most good quality art and antiques do appreciate in value.

1.2.8. Bonds

Bonds and debentures are other lucrative investment options available. Bonds which get listed on the secondary market offer dual benefit. Firstly, fixed interest income in form of coupon rates and secondly, capital appreciation if any, since bond value can appreciate based on prevailing market conditions and interest rates. There are different categories of bonds like tax-free bonds where interest income from the same is exempted from tax. Such bonds offer 7 per cent to 9 per cent per annum tax free returns; one can consider investing in the same for regular income payouts. Section 54 EC also provides an investment opportunity in bonds for saving capital gains made through sale of property. However, interest on such bonds is quite low - approximately 6 per cent. Bonds are fixed income instruments which are issued for the purpose of raising capital. Both private entities, such as companies, financial institutions, and the central or state government and other government institutions use this instrument as a means of collecting funds. Bonds issued by the Government carry the lowest level of risk but could deliver fair returns.

Bonds in general, are less risky than stocks but more risky than fixed deposits or savings account deposits. Bonds issued by the government - Central and State are for all practical purposes risk free. Bonds issued by private corporations carry some risk of default like not paying coupon payments or principal on time. This risk is known as credit risk. The rating agencies such as CRISIL and ICRA issue credit ratings for bonds. AAA grade bonds are the safest and anything below BBB grade bonds are non-investment grade.

The benefits are many like Capital Preservation since at maturity you get your principal back and the regular Income of Interest is paid on regular basis and can complement your income. The Tax Exemption on some bonds is available. As a small investor, one should invest in bonds mainly for tax benefits and should avoid investing in bonds below AAA

rating. There are bonds like infrastructure bonds, National Highways Authority India (NHAI) bonds, Rural Electrification Corporation (REC) Bonds etc.

Considering the risk and return of the above investment options, investors seek that investment option which will offer a balance between risk and return. Mutual funds help the investors achieve fairly good returns with lesser amount of risk than directly investing in stock market.

1.3. INTRODUCTION TO MUTUAL FUNDS

1.3.1. 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 realised is shared by its unit holders in proportion to the number of units owned by them. Investors of mutual funds are known as unit-holders. The funds are invested in securities in accordance with the objectives as disclosed in the offer document. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. The investment in securities is spread across a wide cross section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction, in the same proportion and at the same time. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

1.3.2. Investors prefer Mutual Funds for several reasons. Buying shares from the market requires spending time to find out the performance of the company, whose share is being purchased, evaluating the track record of promoters, the history of the company, dividends declared and bonus issue. A common investor finds it time consuming to do research before investing in the shares. They, therefore, prefer to invest in mutual funds as the analysis and research is done by the professional fund management team of the

mutual funds. Another reason why investors prefer mutual funds is that they get the benefit of diversification. An investor with small investible surplus, as low as Rs 500, can invest in mutual fund and get the benefit of diversification in various stocks and bonds. Thus 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.

1.3.3. Advantages of Investing in Mutual fund:

- **Professional Management**

Mutual Funds provide the services of experienced and skilled professionals, backed by a dedicated investment research team that analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

- **Diversification**

Mutual Funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. One achieves this diversification through a Mutual Fund with far less money than one can do on their own.

- **Convenient Administration**

Investing in a Mutual Fund reduces paperwork and helps you avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual Funds save your time and make investing easy and convenient.

- **Return Potential**

Over a medium to long-term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

- **Low Costs**

Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.

- **Liquidity**

The units can be sold on a stock exchange at the prevailing market price or the investor can avail of the facility of direct repurchase at NAV related prices by the Mutual Fund.

- **Transparency**

Investor gets regular information on the value of his investment in addition to disclosure on the specific investments made by the scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

- **Flexibility**

Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, one can systematically invest or withdraw funds according to his needs and convenience.

- **Affordability**

Investors individually may lack sufficient funds to invest in high-grade stocks. A mutual fund because of its large corpus allows even a small investor to take the benefit of its investment strategy.

- **Choice of Schemes**

Mutual Funds offer a family of schemes to suit investor's varying needs over a lifetime.

- **Well Regulated**

All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI.

1.4. History of Mutual funds

1.4.1. Historical Background : USA[5]

1.4.1.1. The collecting together of the individual assets for investment purposes has been around for a long time. Historians are uncertain of the origins of investment funds, some cite the closed-end investment companies launched in the Netherlands in 1822 by King William - I as the first mutual funds, while others point to a Dutch merchant named Adrian van Keswick whose investment trust created in 1774, may have given the king the idea. Keswick probably theorised that diversification would increase the appeal of investments to smaller investors with minimal capital. The name of Keswick's fund, Eendragt Maakt Magt, translates to "unity creates strength". The next wave of near-mutual funds included an investment trust launched in Switzerland in 1849, followed by similar funds created in Scotland in the 1880's.

1.4.1.2. The idea of pooling resources and spreading risk, using closed-end investments soon took root in Great Britain and France, making its way to the United States in the 1890s. The Boston Personal Property Trust, formed in 1893, was the first closed-end fund in the U.S. The creation of the Alexander Fund in Philadelphia in 1907 was an important step in the evolution toward what we know as the modern mutual fund. The Alexander Fund featured semi-annual issues and allowed investors to make withdrawals on demand.

1.4.1.3. The creation of the Massachusetts Investors' Trust in Boston, Massachusetts, heralded the arrival of the modern mutual fund in 1924. The fund went public in 1928, eventually spawning the mutual fund firm known today as MFS Investment Management. State Street Investors' Trust was the custodian of the Massachusetts Investors' Trust. Later, State Street Investors started its own fund in 1924 with Richard Paine, Richard Saltonstall and Paul Cabot at the helm. Saltonstall was also affiliated with Scudder, Stevens and Clark, an outfit that would launch the first no-load fund in 1928. A momentous year in the history of the mutual fund, 1928 also saw the launch of the

Wellington Fund, which was the first mutual fund to include stocks and bonds, as opposed to direct merchant bank style of investments in business and trade.

1.4.1.4. By 1929, there were 19 open-ended mutual funds competing with nearly 700 closed-end funds. With the stock market crash of 1929, things began to change as highly-leveraged closed-end funds were wiped out and small open-end funds managed to survive. Mutual funds became popular in the United States in the 1920s and continue to be popular since the 1930s, especially open-ended mutual funds. Mutual funds experienced a period of tremendous growth after World War II, especially in the 1980s and 1990s

1.4.1.5. Government regulators also began to take notice of the nascent mutual fund industry. The creation of the Securities and Exchange Commission (SEC), the passage of the Securities Act of 1933 and the enactment of the Securities Exchange Act of 1934 put in place safeguards to protect investors: mutual funds were required to register with the Securities and Exchange Commission (SEC), and to provide disclosure in the form of a prospectus. The Investment Company Act of 1940 put in place additional regulations that required more disclosures and sought to minimize conflicts of interest. The mutual fund industry continued to expand. At the beginning of the 1950s, the number of open-end funds topped 100. In 1954, the financial markets overcame their 1929 peak, and the mutual fund industry began to grow in earnest, adding some 50 new funds over the course of the decade. The 1960s saw the rise of aggressive growth funds, with more than 100 new funds established and billions of Dollars in the new asset inflows. Hundreds of new funds were launched throughout the 1960s until the bear market of 1969 cooled the public appetite for mutual funds. Money flowed out of mutual funds as quickly as investors could redeem their shares, but the industry's growth later resumed.

1.4.1.6. In 1971, William Fouse and John McQuown of Wells Fargo Bank established the first index fund, a concept that John Bogle would use as a foundation on which to build The Vanguard Group, a mutual fund powerhouse renowned for low-cost index

funds. The 1970s also saw the rise of the no-load fund. This new way of doing business had an enormous impact on the way mutual funds were sold and would make a major contribution to the industry's success.

1.4.1.7. With the 1980s and '90s came bull market mania and previously obscure fund managers became superstars; Max Heine, Michael Price and Peter Lynch, the mutual fund industry's top notch MF companies, became household names and money poured into the retail investment industry at a stunning pace. More recently, the burst of the tech bubble and a spate of scandals involving big names in the industry took much of the shine off of the industry's reputation. Shady dealings at major fund companies demonstrated that mutual funds aren't always benign investments managed by folks who have their shareholders' best interests in mind.

1.4.1.8. Despite the 2003 mutual fund scandals and the global financial crisis of 2008-2009, the story of the mutual fund is far from over. In fact, the industry is still growing. In the U.S. alone there are more than 10,000 mutual funds, and if one accounts for all share classes of similar funds, fund holdings are measured in the trillions of dollars. Despite the launch of separate accounts, exchange-traded funds and other competing products, the mutual fund industry remains healthy and fund ownership continues to grow.

1.4.1.9. In the United States, mutual funds must be registered with the Securities and Exchange Commission, overseen by a board of directors (or board of trustees if organized as a trust rather than a corporation or partnership) and managed by a registered investment adviser. Mutual funds are not taxed on their income and profits if they comply with certain requirements under the U.S. Internal Revenue Code.

1.4.1.10. Mutual funds have both advantages and disadvantages compared to direct investing in individual securities. They have a long history in the United States. Today they play an important role in household finances, most notably in retirement planning.

There are 3 types of U.S. mutual funds: open-end, unit investment trust, and closed-end. The most common type, the open-end fund, must be willing to buy back shares from investors every business day. Exchange traded funds (or "ETFs" for short) are open-end funds or unit investment trusts that trade on an exchange. Open-end funds are most common, but exchange-traded funds have been gaining in popularity.

1.4.1.11. Mutual funds are generally classified by their principal investments. The five main categories of funds are debt funds, balanced funds, stock or equity funds, index funds and MIP funds. Funds may also be categorized as open or closed ended. Investors in a mutual fund pay the fund's expenses, which reduce the fund's returns. There is controversy about the level of these expenses. A single mutual fund may give investors a choice of different combinations of expenses, which may include sales commissions or loads by offering several different types of share classes.

1.4.2. Historical Background : Europe[6]

1.4.2.1. The Foreign and Colonial Government Trust (F&C) was set up in 1868 to provide the investor of moderate means with the same advantages as the large capitalists in diminishing the risk, by spreading the investment over a number of stocks. Although times were very different then, the reasons for investing, and the kinds of investors, were not so very different from today. The late 19th and early 20th centuries were periods of rapid industrialisation in Britain, with substantial fortunes being accumulated by entrepreneurs, and this new wealth needed to be invested. However, it was not only the very wealthy who had some savings to invest. The booming economy had created new opportunities in education and employment and it was also a period of increasing social mobility, which allowed a much wider variety of people the chance to prosper.

1.4.2.2. It so happened that this increased supply of British investment capital coincided with a massive demand for development capital from that period's own emerging markets – North and South America, in particular, as well as Asia. Money was required to pay for

some ambitious infrastructure projects – namely railroads, gas and electricity – and to lend to pioneer settlers. With wealth to invest and domestic interest rates low, overseas opportunities in developing countries were extremely attractive to British investors.

1.4.2.3. In order to attract the investors globally, investment trusts were created. The idea was pooling the savings together, the smaller subscriber could invest in the same way as wealthier counterparts and thus investment became available to the wider middle classes.

1.4.2.4. The men who invented the first investment trust had clear objectives: that the shares should be available to all kinds of investors and that the risk should be diversified. The Scottish American Investment Company (SAINTS) back in 1873 had original investors that included an optician, a plasterer and a fish curer. When the Edinburgh American Land Mortgage Company Limited was launched in 1878 (later taken over by British Assets) small shareholders were deliberately targeted. The list of British Assets' 46 founding shareholders in 1897 reflected ownership of more than half of the initial investors were professionals, the remainder were categorised into manufacturing, trade, farming and mining .

1.4.2.5. In order to minimize the risk, the F&C initially invested in 18 bonds issued by various governments and companies in countries as diverse as the USA, Austria, Chile, Spain, Turkey and Egypt. Individually, any of these investments may have been considered risky, but the overall spread of investments actually helped to diversify this risk.

1.4.2.6. Another attractive feature of some of these early investment trusts was their two tiered structure – which enabled them to offer different classes of shares or debentures that carried different levels of risk or return to match the individual investor's needs. For example, the trusts from which the Alliance Trust originated, when consolidated in 1888, issued £30,000 of riskier equity capital to wealthy merchants and £165,000 of safer debentures, into which many local solicitors put common people's money.

1.4.2.7. Nevertheless, ordinary people were still taking something of a gamble – with little information about the portfolio; early subscribers relied quite heavily on the reputation and integrity of the founding directors. Records show that the fact that Robert Fleming's original trust, which was based in Dundee, consisted of a board backed by "four of the best men in town" was vital to its success, attracting much local support.

1.4.2.8. The Scots formed the Straits Mortgage and Trust Company Ltd, in Edinburgh back in 1909. This partly reflected the booming industries in which Scotland excelled: heavy engineering, shipbuilding, fishing, whaling and textiles, giving them the means to invest. In particular, it was a golden age for Dundee – the American Civil War and associated demand for tenting and sandbags drove its burgeoning jute industry. Indeed, Robert Fleming's first investment trust and the major investment trust management group, Alliance, both owe their origins to the jute barons of Dundee.

1.4.2.9. Scottish lawyers and professional advisers were in a strong position to advise their clients on the new investment trust and many of the early investment trusts were set up by people from Edinburgh and Dundee. The early investment trust industry was very much concentrated north of the border. This is a feature which – although less marked – is still evident even today. The maturity of many investment trusts is testimony of the solidarity of the original idea and their core workings remain the same to this day. Although the types of investments they select have altered somewhat over the years, in both scope and location, they continue to offer advantages to modest and substantial investors alike.

1.4.3. Historical Background : India[7]

1.4.3.1. 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 the Reserve bank of India. The primary objective was to attract the small investors and was made possible by collective

efforts. The History of Mutual Fund in India can be broadly divided in to four distinct phases.

1.4.3.2. First Phase : 1964 – 1987

Unit trust of India (UTI) was established in 1963 by an Act of Parliament. 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.

1.4.3.3. Second Phase : 1987 – 1993 (Entry of Public Sector Funds)

The year 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 1987 followed by Can-Bank Mutual Fund (Dec 87) and Punjab National Bank Mutual Fund (Aug 89). At the end of 1993, the mutual fund industry had assets under management of Rs 47,004 Crores.

1.4.3.4. Third Phase : 1993 – 2003 (Entry Of Private Sector Fund)

1.4.3.4.1. With the entry of Private Sector funds in 1993, a new era started in the Mutual Fund Industry, giving the Indian investors a wider choice of fund families. Also 1993 was the year in which the first Mutual Fund Regulation came into being, under which all mutual funds except UTI were to be registered. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993. The 1993 SEBI (Mutual Fund) regulations were substituted by a more comprehensive and revised Mutual fund Regulation in 1996.

1.4.3.4.2. The mobilisation of funds and the number of players operating in the industry reached new heights as investors started showing more interest in the mutual fund. The industry witnessed a robust growth. The investor's 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.

1.4.3.5. Fourth Phase : Since February 2003

1.4.3.5.1. 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 the Unit Trust of India with assets under management of Rs 29,835 Crores as at the end of January 2003, representing broadly, the assets of US 64 scheme. The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under Mutual Fund Regulations. With recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidations and growth.

1.5. Organisation of Mutual Funds in India[8]

1.5.1. Mutual funds have a typical organization in which five key constituents are involved. They are

- Sponsors - the Board of Trustees (BOT)
- Asset Management Company (AMC)
- Custodian
- Registrar & Transfer Agents
- Unit holders.

1.5. 2. Sponsors - the Board of Trustees (BOT)

First tier is the Sponsor who thinks of starting a mutual fund. He approaches SEBI who is the regulator of Mutual Funds. SEBI checks the financial experience, integrity and net worth of the sponsor. If SEBI is convinced then the sponsor can create a Public Trust as per Indian Trusts Act, 1882. After the Trust is created, it is registered with SEBI and then the trust is known as a Mutual Fund. As Trusts have no legal identity, they cannot enter into contracts and hence contracts are registered in the names of trustees. The role of Trustee is not to manage the money but to see whether the money is being managed as per stated objectives. They act as internal regulators of a Mutual Fund.

1.5. 3. Asset Management Company

The AMC conducts the necessary research and based on it, manages the fund or portfolio. It is responsible for floating, managing and redeeming the schemes. The role of Asset Management Company (the third tier) is to manage the investor's money. It charges a certain percentage as fee for managing the money which is deducted from the amount collected from the investor. The Asset Management Company has to be approved by SEBI and it functions under the supervision of its Board of Directors and also under the direction of Trustees and SEBI. The AMC floats new schemes of mutual funds and manages these schemes by buying and selling securities as per the regulations of SEBI. In case of a new scheme, the AMC submits a draft offer document to SEBI for approval. After SEBI's approval it becomes an offer document. The Offer document is the legal document on the basis of which investors invest their money.

1.5.4. Custodian

The custodian is responsible for co-ordination with brokers, the actual transfer and storage of stocks and handling the property of the trust. The main role of a custodian is to keep the physical securities in safety. It also has to record the dividends declared, the rights and bonus issue of shares of companies in which the fund has invested. The Board

of Trustees appoints the Custodian. In case of dematerialized securities, the custodian participates in the clearing and settlement system through approved depository companies. At the instructions of the AMC and under the overall direction and responsibility of the Trustees, the custodian takes the deliveries and receipts of the units of mutual funds.

1.5. 5. Registrars and Transfer Agents

The important role of maintaining investor's records is done by Registrars and Transfer Agents. The data regarding new fund offers and redemption forms go to RTA's office where the information is converted from physical to electronic form. The RTA records the NAV at which the investor will get the units of mutual funds, redemption amount, folio number, dividend etc which the investor is entitled to receive.

1.5. 6. The Rights of Investors

- The investments made by investors are held by the trust in fiduciary capacity. The investors of mutual funds are mutual, proportional and beneficial owners of the scheme's assets.
- The investors have a right to receive dividend within 30 days of declaration of the dividend.
- The AMC of a mutual fund must dispatch the redemption proceeds within 10 working days of the request of redemption. If the AMC fails to do so then it has to pay interest at 15%.
- Investors can inspect documents like trust deed, annual reports, offer documents etc and obtain information from trustees.
- Investors can terminate an AMC or wind up a scheme of the mutual fund if 75% of the investors pass a resolution to that effect.
- Investors have a right to receive information regarding any changes in the fundamental attributes of the scheme.

- For grievance redressal , the investor can approach the investor relations officer. If he is not satisfied then he can approach the investor grievance cell of SEBI.

- Mutual Fund industry today, with about 45 players and more than five hundred schemes, is one of the most preferred investment avenues in India. However, with a plethora of schemes to choose from, the retail investor faces problems in selecting funds. Factors such as investment strategy and management style are qualitative, but the funds record is an important indicator too. Though past performance alone cannot be indicative of future performance, it is, frankly, the only quantitative way to judge how good a fund is at present. Therefore, there is a need to correctly assess the past performance of different mutual funds.

1.5.7. Regulations

The Mutual Fund Regulations are made with the view that a particular scheme does not invest more than a certain percentage of their NAV in a single stock. Following are the regulations:

- No Fund taking into account all its schemes can hold more than 10% of the company's paid up capital.
- No particular scheme can invest more than 10% of its NAV in a single company.
- Aggregate inter scheme investment should not exceed 5% of the NAV of the mutual fund.
- No scheme can invest in unlisted securities issued by its sponsor or its group of entities.
- In case of listed entities belonging to sponsor group, the scheme can invest maximum 25% of its net assets in these securities.
- A scheme cannot invest more than 10% of its NAV in unrated paper of a single issuer and the total investment in unrated papers cannot exceed 25% of its NAV.

- A scheme cannot invest more than 15% of its NAV in rated debt instruments of a single issuer. This limit may be raised to 20% with prior approval of Trustees.

1.5.8. Industry Association

AMFI (Association of Mutual Funds in India) is the industry association for mutual funds in India and it was incorporated in the year 1995. The main objectives of AMFI are:

- To promote the interests of mutual fund houses, investors and interact with regulators like SEBI, RBI, Government agencies etc.
- To maintain ethical and professional standards in the industry and to promote best business practices.
- To undertake investor awareness programmes and to spread knowledge about the concept and working of mutual funds among the common man.
- To conduct training of distributors and certification of all intermediaries engaged in the industry.

1.6. Types of Mutual funds[9]

1.6.1. Equity funds:

These funds invest a maximum part of their corpus into equity holdings. The structure of the fund may vary differently for different schemes and the fund manager's outlook on different stocks. Equity Funds are those funds which have at least 65% of their assets invested in Indian equity market. They can be classified on the basis of market capitalisation namely Large cap funds, Midcap Funds or Small Cap Funds.

The Equity Funds are also sub-classified depending upon their investment objective, as follows:

- Diversified Equity Funds
- Large, Mid and Small-Cap Funds
- Sector Specific Funds
- Tax Savings Funds (ELSS)

Equity investments are meant for a longer time horizon, thus Equity funds rank high on the risk-return matrix.

1.6.2. Debt funds:

Debt funds are funds that invest in fixed income securities like bonds and treasury bills. The objective of these Funds is to invest in debt papers issued by Government authorities, private companies, banks and financial institutions. Debt funds are preferred by those who do not wish to invest in highly volatile equity market. These funds provide steady but low income as compared to equity. By investing in debt instruments, these funds ensure low risk and stability of income to the investors. Debt funds are further classified as:-

(a) Debt Long term Funds: Long-term debt funds that have a maturity longer than a year. These bonds and loans generally carry a higher interest rate than short term bonds. These funds are suitable for those investors who would like to stay invested for a period more than 1 year.

(b) Debt Short term Funds: Short-term debt fund has a maturity of one year or less. This usually carries a relatively low interest rate. Investors who would like to invest for a period less than one year prefer debt short term funds.

1.6.3. Balanced Funds:

The aim of balanced funds is to provide both growth and regular income. Such schemes periodically distribute a part of their earnings and invest both in equities and fixed income securities in the proportion indicated in their offer documents. In a rising stock market, the NAV of these schemes may not normally keep pace, or fall equally when the market falls. These are ideal for investors looking for a combination of income and moderate growth.

1.6.4. Index Funds:

Index Funds attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE 50. Index funds are those funds which invest in shares of major indices like Nifty 50 which is a broad based index comprising of 50 shares. There are other indices like CNX Midcap 100 or S&P CNX 500 which have a large number of shares of companies. The main objective of Index funds is to invest in stocks comprising the Nifty and in the same proportion as they are in the index. Index funds are passively managed funds as the fund manager does not have to do any research and stock selection but passively invest in the stocks of the index.

1.6.5. Monthly Income Plan (MIP) Funds :

MIP Funds are hybrid funds; i.e. they invest in debt as well as equities. Investors who want a regular income stream invest in these schemes. The objective of these schemes is to provide regular income to the investor by paying dividends. Investment in the debt portion provides for the monthly income whereas investment in the equities provides for the extra return which is helpful in minimizing the impact of inflation. MIPs invest maximum of their total corpus in debt instruments while they take minimum exposure in

equities. It gets benefit of both equity and debt market. These schemes rank slightly high on the risk-return matrix when compared with other debt schemes.

Mutual fund schemes may be further classified on the basis of its structure and its investment objective.

1.6.6. By Structure

- **Open end Funds**

An open-end fund is one that is available for subscription all throughout the year. These do not have a fixed maturity. Investors can conveniently buy and sell units at Net Asset Value ("NAV") related prices. Thus open Ended Funds are those in which the investors can enter and exit anytime whereas the close ended funds restrict the freedom to enter and exit the fund. When a new scheme or fund offer is made by the AMC then it is called New Fund Offer. Units of the fund are offered at Rs 10 per unit. In case of Open ended funds, the investor can enter or buy and exit or sell the units of the mutual fund at the prevailing NAV. The key feature of open-end schemes is liquidity.

- **Closed–end Funds**

A closed-end fund has a stipulated maturity period which generally ranges from 3 to 15 years. The fund is open for subscription only during a specified period. 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 they 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.

- **Interval Funds**

Interval funds combine the features of open-ended and close-ended schemes. They are open for sale or redemption during pre-determined interval at NAV related prices.

1.6.7. By Investment Objective

- **Growth Funds**

The aim of growth funds is to provide capital appreciation over the medium to long term. Such schemes normally invest a majority of their corpus in equities. It has been proved that returns from stocks, have outperformed most other kind of investments held over the long term. Growth schemes are ideal for investors having a long term outlook seeking growth over a period of time.

- **Income Funds**

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 and Government securities. Income Funds are ideal for capital stability and regular income.

- **Money Market Funds**

The aim of money market funds is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money. Returns on these schemes may fluctuate depending upon the interest rates prevailing in the market. These are ideal for Corporate and individual investors as a means to park their surplus funds for short periods.

1.6.8. Other Schemes

1.6.8.1. Tax Saving Schemes

These schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues. ELSS or Equity Linked Tax Saving Schemes are funds where the investor gets tax benefit of Rs 1 lakh under Sec 80C of the Income Tax Act if he keeps his investment for a minimum period of 3 years. Thus ELSS serves the dual purpose of tax planning and investment.

1.6.8.2. Special Schemes

- **Industry Specific Schemes**

Industry Specific Schemes invest only in the industries specified in the offer document. The investment of these funds is limited to specific industries like InfoTech, FMCG, and Pharmaceuticals etc.

- **Sectoral Schemes**

Sectoral Funds are those which invest exclusively in a specified sector. This could be an industry or a group of industries or various segments such as 'A' Group shares or initial public offerings. Sectoral funds invest in shares belonging to a particular sector like Pharma sector, IT sector, Banking sector. These funds are risky as they invest in shares of only one particular sector. Mutual Fund Regulations do not permit funds to invest over 1% of their NAV in a single company. This is to ensure diversification and avoid undue risk. However there is relaxation in the regulation in case of sectoral and index funds.

- **Diversified Large Cap Funds**

Diversified Large Cap Funds are those funds which invest in the top 100 or 200 stocks with highest market capitalization. These stocks have good financial position, strong management and globally competitive business. Therefore this fund is considered safe and stable.

- **Mid Cap Funds**

These funds invest in stocks belonging to **the mid** capitalisation segment of the market. These shares are mainly of companies who are emerging blue chip companies or tomorrow's large cap companies.

- **Fund of Funds**

These funds invest in units of other mutual funds which the fund manager feels will give high returns. They do not invest directly in shares. The performance of such funds depends on the judgment of the fund managers.

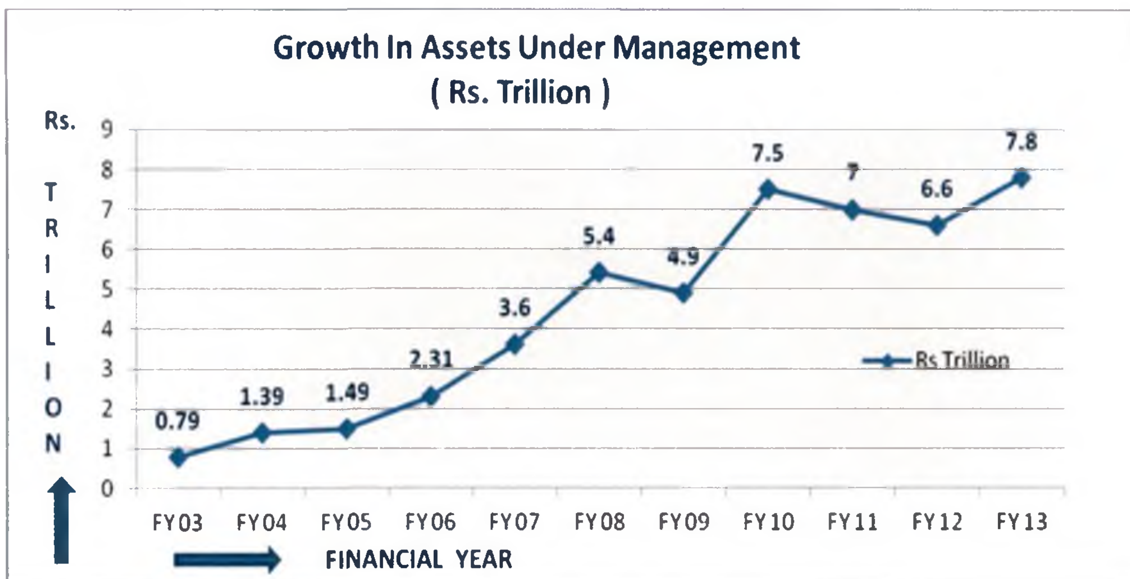
- **Exchange Traded Funds**[10]

These are mutual fund units which the investor buys directly from the stock exchange as against the normal practice of buying the units from the distributor or AMC. The Exchange Traded Funds are relatively new in India. They are relatively cheaper than other mutual funds as the expense ratio is lower for ETFs than other mutual funds. The AMC of a mutual fund issues units to the Authorised Participants (APs) who then provide two way quotes for the ETFs on the stock exchange. The investor buys and sells the ETFs at the available quotes anytime on the stock market. There are Exchange traded funds on several asset classes like Gold, Silver, and Nifty etc.

1.7. Present Scenario of Mutual fund Industry

1.7.1. From a single-player monopoly in 1964, the Indian mutual fund industry has evolved into a high-growth and competitive market on the back of favourable economic and demographic factors. As of August 2012, 44 asset management companies (AMCs) were operating in India with assets under management (AUM) of INR 6.4 trillion[11]. However, after several years of persistent growth, the industry witnessed consistent declines of 6.3 percent and 5.1 percent in its AUM during FY11 and FY12, respectively. One of the reasons could be the changes in regulatory guidelines – example: ban on entry load, stringent KYC norms, guidelines on transaction charges, tightening valuation and advertisement norms - which were introduced in a short span of time thus giving less time to the industry to adjust to the new environment.

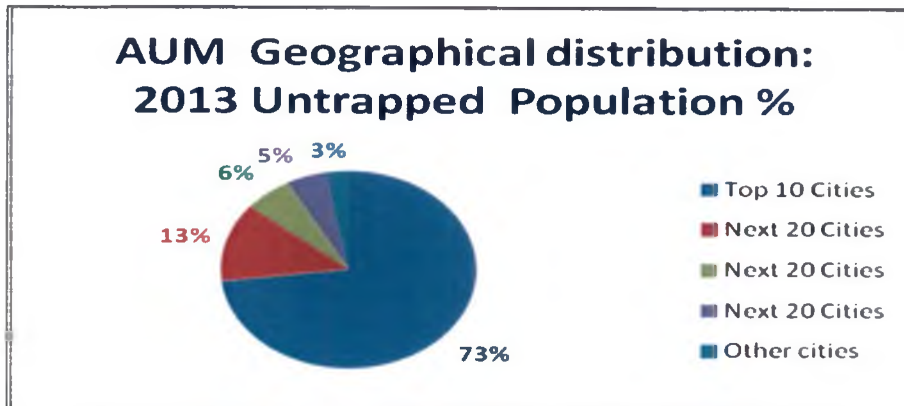
1.7.2. Graph No. 1.1: The Graph : Growth in Assets Under Management.(AUM)



Source: www.amfiindia.com

1.7.3. Mutual funds are an under tapped market in India

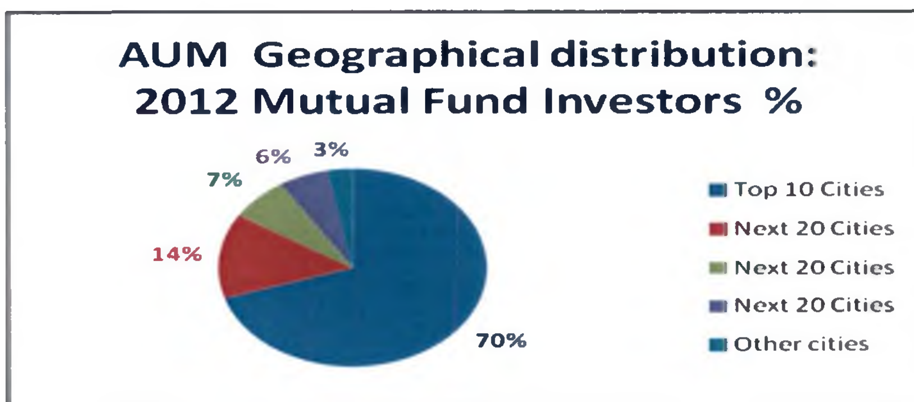
Graph No. 1.2 : World Scenario : Mutual Fund Contribution:



Source: World Bank, Financial Access Survey; 2013 data

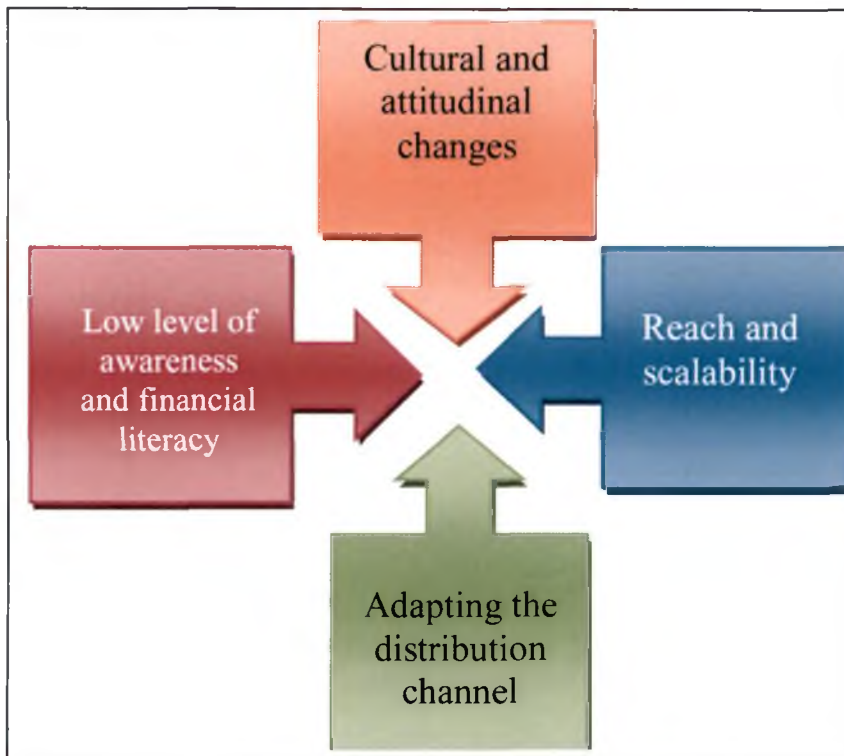
1.7.3.1. Mutual funds are being available in the market for over four decades now with assets under management equaling Rs 7.8 trillion as of March, 2013 vis-a-vis 15 trillion in the USA. Less than 20% of Indian households have invested in mutual funds. A recent report on Mutual Funds Investments in India published by research and analytics firm, Boston Analytics, suggests investors are holding back from putting their money in mutual funds due to their perceived high risk and a lack of information on how mutual funds work.

Graph No. 1.3 : Mutual Fund Investors in India in Tier I, II, III Cities



Source: World Bank, Financial Access Survey; 2013 data

Graph No 1.4 : Challenges of an under-penetrated market



Source : CII Mutual Fund Summit 2013

1.7.3.2. There is very low and under-penetrated Mutual Fund market in India[12]. Although it shows huge opportunities for market players to sell their products, there are multiple road blocks to tap the potential opportunities. Some basic challenges arise due to very low levels of awareness and financial literacy. Even if the ability to invest exists, these savings are not directed into mutual fund products because of the slow capital market growth, lack of awareness of mutual funds being a low-cost investment vehicle and the returns they can generate. There is also the cultural and behavioral change which prevents savings from being streamlined into investment products, diverted from gold or property. Indians still feel that gold and property is a less risky alternative as compared to investment in the stock markets. The investors are not aware of low risk characteristic of Mutual funds. A cultural & attitude change is required so that people are convinced to invest in the capital markets.

1.8. MUTUAL FUNDS AND TAXATION

1.8.1. Introduction

1.8.1.1. India is a savings dominated market but people invest largely in guaranteed return products such as bank fixed deposits. Reserve Bank of India data shows that Indians have parked almost 50% of their savings in bank deposits, while less than 5% of assets have gone into market-linked investment avenues such as mutual funds. Despite improvement in best practices and transparency, most investors are unaware about the benefits of investing through mutual funds especially after considering the return after the tax deduction. An attempt has been made to understand the tax pattern in India concerning the Mutual Funds.

1.8.1.2. There has been a struggle between the Government and the Tax payers – Govt. to impose the taxes to generate the revenue and the Tax payers to reduce the taxes by tax planning or tax avoidance. Governments' intention is to increase revenue so that the tax payer can be given better infrastructure and facilities. However, the Govt. is also considerate to inculcate the tax payer to resort to savings by way of offering certain tax exemptions offers in schemes and also collaterally use that money for development / infrastructural projects.

1.8.1.3. Let us first understand the categories of Mutual fund investment avenues. They are classified as Equity Oriented schemes where the investment is made in the shares of various companies. There are Debt oriented schemes where the money is invested in Govt. Bonds / securities, fixed deposits of banks as well as the Companies. Lastly, the Liquid funds/money markets which is ideal for investors looking to utilise their surplus funds in short term instruments while awaiting better options and also earn reasonable interest.

1.8.2. Types of Taxes on Mutual funds

a) Income Tax on Dividends in the hands of investor

b) Dividend Distribution Tax (DDT) on dividend distributed by company.

c) Security Transaction Tax (STT) on equity mutual funds.

d) Income Tax on capital appreciation.

- Long term capital gains tax and

- Short term capital gains tax

The Taxes enumerated above are applicable to specific schemes only and not to all types of fund in general as misunderstood generally. The details are given in subsequent paragraphs.

1.8.3. APPLICABLE TAX RATES YEAR A.Y. 2014-15 ON M.F. SCHEMES

1.8.3.1. Income Tax on Dividends in the hands of investor

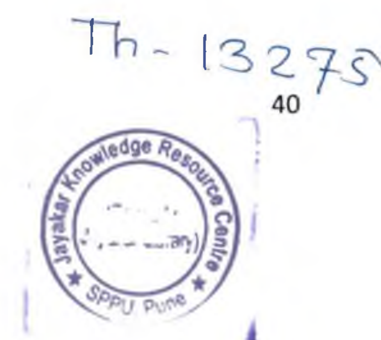
Dividend Income received from units of mutual funds registered with the Securities and Exchange Board of India is exempt in the hands of the unit holder.

Table No. 1.1: Income Tax on Dividend

PRODUCT	INDIVIDUAL/HUF	DOMESTIC CO.	NRI
ALL MUTUAL FUNDS SCHEMES	NIL	NIL	NIL

As per existing tax provisions, income from dividends is tax free in the hands of the investor. The Dividend Distribution Tax is payable by the Scheme and the Dividend is free of Tax in the hands of the Investors.

Th- 13275



1.8.3.2. Dividend Distribution Tax (DDT)[13] on dividend distributed by company.

The Dividend Distribution Tax is levied by the Government of India on companies who distribute the dividend. Income Tax Sec 115-O was introduced by Finance Act, 1997 and materially altered the taxation of income distribution by companies and the companies to pay the tax to the government. Prior to its introduction, entire amount of dividends paid by a company to its shareholders was taxed in the hands of the shareholders.

Table No 1.2. : Dividend Distribution Tax (Payable By the Scheme)

TAX ON DIVIDEND DISTRIBUTED INCOME (PAYABLE BY THE SCHEME) RATES APPLICABLE FROM 1st June 2013 and for 2014-15			
PRODUCT	INDIVIDUAL/HUF	DOMESTIC CO.	NRI
Equity Oriented Schemes	NIL	NIL	NIL
Other-than Equity Oriented Schemes	25%+ 10% Surcharge + 3% Cess =28.325 %	30%+ 10% Surcharge + 3% Cess = 33.99 %	25%+ 10% Surcharge + 3% Cess = 28.325 %

1.8.3.3. Securities Transaction Tax (STT) on equity mutual funds.

Securities transaction tax (STT) is a tax payable on equity oriented mutual fund schemes at the time of redemption / switch to the other schemes/ sale of units. Mutual Fund Company would also have to pay securities transaction tax wherever applicable on the securities sold as per following table.

Table No. 1.3 : Security Transaction Tax	**Tax. Rates**	**Payable By**
Purchase of units of equity oriented mutual fund (delivery based) on recognized stock exchange	0.1%	Purchaser
Sale of units of equity oriented mutual fund (delivery based) on recognized stock exchange	0.001%	Seller

1.8.3.4. Capital Gains Taxation

Capital Gains Tax is a type of tax levied on capital gains incurred by individuals and corporations. Capital gains are the profits that an investor realises when he or she sells the capital asset for a price that is higher than the purchase price. Capital gains taxes are only triggered when an asset is realized and not while it is held by an investor.

Table No. 1.4 : LONG TERM CAPITAL GAINS TAX

PRODUCT	INDIVIDUAL/HUF	DOMESTIC CO.	NRI
EQUITY ORIENTED SCHEMES	NIL	NIL	NIL
OTHER THAN EQUITY ORIENTED SCHEMES	20% with indexation + 10% Surcharge + 3% Cess = 22.66%	20% with indexation + 10% Surcharge + 3% Cess = 22.66%	20% with indexation + 10% Surcharge + 3% Cess = 22.66%

Table No 1.5 : SHORT TERM CAPITAL GAINS TAX

PRODUCT	INDIVIDUAL/HUF	DOMESTIC CO.	NRI
EQUITY ORIENTED SHEMES	15% + 10% Surcharge + 3%Cess = 16.995%	15% + 10% Surcharge + 3%Cess = 16.995%	15% + 10% Surcharge + 3%Cess = 16.995%
OTHER THAN EQUITY ORINTED SCHEMES	30%+ 10% Surcharge +3% Cess = 33.99 %	30%+ 10% Surcharge+ 3% Cess = 33.99 %	30%+ 10% Surcharge +3% Cess = 33.99 %

1.9. ECONOMIC RECESSION AND ITS IMPACT ON INDIAN MUTUAL FUND INDUSTRY

1.9.1. Introduction

1.9.1.1. In the age of globalization, one cannot remain isolated from the fluctuations of world economy. The effect of financial crisis of USA and Europe severely affected the Indian economy and the third world. The sub–prime crisis, the bankruptcy of Lehman Brothers USA and worldwide economic slowdown of the advanced countries which started around mid-2007 led to the spread of economic crisis across the globe.

1.9.1.2. A recession is a decline in a country's Gross Domestic Product (GDP)[14] growth. A recession is also preceded by several quarters of slowing down. An economy, which grows over a period of time, tends to slow down the growth as a part of the normal economic cycle. An economy typically expands for 6-10 years and tends to go into a recession for about six months to two years. One cannot predict correctly as to when the recession will strike, but it comes as a Tsunami. The actual recession period was December 2007 to July 2009 i.e. 19 months, but the effect had precursor of 6 months prior to December 2007 and the post impact of 6 months.

1.9.2. Causes of Recession:

1.9.2.1. A recession is cyclic and normally takes place when consumers lose confidence in the growth of the economy and spend less. This leads to a decreased demand for goods and services, which in turn leads to a decrease in production, lay-offs and a sharp rise in unemployment. Investors spend less as they fear stocks values will fall and thus stock markets fall on negative sentiment. The effect was felt due to following parameters, singularly or collectively.

- Layoffs and unemployment,
- Decline in the housing market,

- Fall of Rupee Vs Dollar,
- Increased crude oil prices,
- Fall in export,
- FII pull outs etc.

1.9.3. **Effect on India**

1.9.3.1. The Indian economy[15] has shown negative impact due to the recent global financial meltdown. Though the public sector in India, including nationalized banks could somehow insulate the negative effects of globalization, as we are also part of the globalization strategy of neo-liberalization, there is a limit to our ability to resist global recession. The impact of the crisis was significantly different for the Indian economy as opposed to the western developed nation. The GDP fall was very drastic.[16]

Table No 1.6 : Economic Growth : Year 2006 - 2010

YEAR	GROWTH %
2006-2007	9.6
2007-2008	9.3
2008-2009	6.8
2009-2010	8.0

1.9.3.2. In 2006-07 the GDP growth rate was 9.6% which became 9.3% in 2007-08 and due to the impact of global financial crisis, the growth rate of Indian economy declined to 6.8 % in 2008-2009. On 8 Jan 2008, the BSE Sensex stood at 20,873 and by the end Oct 2008 it dropped to 9044, a drastic fall of 26 %.

1.9.4. Impact on Indian Financial Market:

1.9.4.1. The impact of the financial crisis has been deeper in India than what was estimated by our policy makers though it is less severe than in other emerging market economies. The extent of impact has been restricted due to several reasons such as Indian financial sector particularly our banks have no direct exposure to non performing assets of the banks of USA and Europe.

1.9.4.2. Share Market - A recession is typically accompanied by a fall in the securities market. More number of people have sold the shares in the Indian share market than they bought in recession period. This has added to the fall of Sensex to lower points. Foreign investors have pulled out from stock markets leading to heavy losses in stocks and mutual funds. Stock broking houses were laying-off people. Due to uncertainty many people kept away from share market.

Graph No. 1.5 : Sensex : 2007-2013

Source: www.bseindia.com/indices/indexarchivedata.aspx

1.9.5. Impact on retail Investors – The volatile environment in the market due to increase in inflation and unfavorable changes in the market took heavy toll on the retail investors. Many people, preferred to keep money in banks rather than investing the same in securities and mutual funds. The NAV of mutual Funds dropped drastically. The index fund was the most affected Mutual fund. Mutual Funds although less risky than shares also suffered due to volatility of market. However, the Hybrid funds like Monthly Income Funds survived due to diversity of portfolio.

1.10. Importance of Mutual Fund

1.10.1. Small investors face a lot of problems in the share market, limited resources, lack of professional advice, lack of information etc. Mutual funds have come as a much needed help to these investors. It is a special type of institutional device or an investment vehicle through which the investors pool their savings which are to be invested under the guidance of a team of experts in wide variety of portfolio of corporate securities in such a way, so as to minimize risk, while ensuring safety and steady return on investment.

1.10.2. It forms an important part of the capital market, providing the benefits of a diversified portfolio and expert fund management to a large number, particularly small investors. Now days, mutual fund is gaining its popularity due to the following reasons:

- With the emphasis on increase in domestic savings and improvement in deployment of investment through markets, the need and scope for mutual fund operation has increased tremendously. The basic purpose of reforms in the financial sector was to enhance the generation of domestic resources by reducing the dependence on outside funds. This calls for a market based institution which can tap the vast potential of domestic savings and channelize them for profitable investments. Mutual funds are not only best suited for the purpose but also capable of meeting this challenge.

- An ordinary investor who applies for share in a public issue of any company is not assured of any firm allotment. But mutual funds who subscribe to the capital issue made by companies get firm allotment of shares. Mutual fund later sells these shares in the same market or to the Promoters of the company at a much higher price.

- The psyche of the typical Indian investor has been summed up by Mr. S.A. Dave[17], Chairman of UTI, in three words; Yield, Liquidity and Security. The mutual funds have given the impression of being as safe a conduit for investment as bank deposits.

- As mutual funds are managed by professionals, they are considered to have a better knowledge of market behaviours. Besides, they bring about a certain level of competence to their job. They also maximise gains by proper selection and timing of investment.

- Another important thing is that the dividends and capital gains may be reinvested automatically in mutual funds and hence are not fritted away. The automatic reinvestment feature of a mutual fund is a form of forced saving and can make a big difference in the long run.

- The mutual fund operation provides reasonable tax free returns to investors. The mutual fund dividend is tax free in the hands of investors. The growth option of mutual funds gives indexation benefit under the long term capital gain section of the Income Tax Act.

- As mutual funds create awareness among the middle class people about the benefits of investment in capital market, they could be able to make up a large amount of the surplus funds available with these people.

- The mutual funds attract foreign capital flow in the country and secure profitable investment avenues abroad for domestic savings through the opening of off shore funds

in various foreign countries. Lastly another notable thing is that mutual funds are controlled and regulated by SEBI and hence are considered safe. Due to all these benefits the importance of mutual fund has been increasing.

1.11. Need for the Present Study

The mutual fund industry manifests huge opportunity for growth and further penetration in rural areas, and this can be achieved over time, with support from technology. The key lies in strengthening distribution networks and enhancing levels of investor education to increase its presence in rural areas. The mutual fund industry should emulate some best practices from other industries and sectors to transit to the next level of growth.

The Mutual funds offer professional management, liquidity, diversification, multiple choice, tax benefits, low cost, affordability and transparency. In order to reap maximum benefits from mutual funds, investor needs to diversify across different categories of funds. However, selecting a right fund for investment can be challenging task for the investor.

Monthly Income Plan (MIP) funds are mutual funds that provide an optimal combination of equity and debt. These funds invest a majority of their portfolio (at least 70% in debt and the rest in equities) and are ideal for an investment horizon of greater than three years. CRISIL's analysis reveals that MIPs have given better tax adjusted returns than three year Fixed Deposits. MIP funds are suitable for those investors who do not want to take greater risk but want stability of income and preservation of their investment.

Considering the above merits and demerits of mutual funds, the researcher decided to conduct an in depth research into various aspects of these funds. In order to survey the existing literature on mutual funds and for identification of gaps in existing research, the researcher conducted a comprehensive review of available literature on the subject.

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