Mutual funds in india

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Abstract

Mutual Fund companies are financial intermediaries providing financial services to small investors through mobilisation of funds, when the investors invest in a mutual fund they are buying shares or units of the mutual fund and become a shareholder of the fund. Mutual funds are one of the best investments ever created because they are very cost efficient and very easy to invest in. Thus the Rupee is generated in the form of big returns to promote financial excellence. The financial reforms and cut throat competition in the economic environment the mutual fund industry has opened new vistas to interested investors and imparted much needed liquidity to the Indian financial system. This paper studies the classification and growth of mutual funds in India.

Keywords : mutual fund, net asset value, investment ,asset management company

Meaning

Mutual funds are in the form of Trust (usually called Asset Management Company) that manages the pool of money collected from various investors for investment in various classes of assets to achieve certain financial goals. We can say that Mutual Fund is trusts which pool the savings of large number of investors and then reinvests those funds for earning profits and then distribute the dividend among the investors. In return for such services, Asset Management Companies charge small fees. Every Mutual Fund launches different schemes, each with a specific objective. Investors who share the same objectives invests in that particular Scheme. Each Mutual Fund Scheme is managed by a Fund Manager with the help of his team of professionals (One Fund Manager may be managing more than one scheme also).

Mutual Funds usually invest their funds :

The Mutual Funds usually invest their funds in equities, bonds, debentures, call money etc., depending on the objectives and terms of scheme floated by MF. Now a days there are MF which even invest in gold or other asset classes.

Net Asset Value

NAV means Net Asset Value. The investments made by a Mutual Fund are marked to market on daily basis. In other words, we can say that current market value of such investments is calculated on daily basis. NAV is arrived at after deducting all liabilities (except unit capital) of the fund from the realisable value of all assets and dividing by number of units outstanding. Therefore, NAV on a particular day reflects the realisable value that the investor will get for each unit if the scheme is liquidated on that date. This NAV keeps on changing with the changes in the market rates of equity and bond markets. Therefore, the investments in Mutual Funds is not risk free, but a good managed Fund can give you regular and higher returns than when you can get from fixed deposits of a bank etc.

Types of Mutual Fund Schemes

Functional Classification of Mutual Funds are as follows:

1. Open-ended schemes: In case of open-ended schemes, the mutual fund continuously offers to sell and repurchase its units at net asset value (NAV) or NAV-related prices. Unlike close-ended schemes, open-ended ones do not have to be listed on the stock exchange and can also offer repurchase soon after allotment. Investors can enter and exit the scheme any time during the life of the fund. Open-ended schemes do not have a fixed corpus. The corpus of fund increases or decreases, depending on the purchase or redemption of units by investors. There is no fixed redemption period in open-ended schemes, which can be terminated whenever the need arises. The fund offers a redemption price at which the holder can sell units to the fund and exit. Besides, an investor can enter the fund again by buying units from the fund at its offer price. Such funds announce sale and repurchase prices from fund. The time-to-time. UTI's US-64 scheme is an example of such a key feature of open-ended funds is liquidity.

2. Close-ended schemes: Close-ended schemes have a fixed corpus and a stipulated maturity period ranging between 2 to 5 years. Investors can invest in the scheme when it is launched. The scheme remains open for a period not exceeding 45 days. Investors in close-ended schemes can buy units only from the market, once initial subscriptions are over and thereafter the units are listed on the stock exchanges where they can be bought and sold. The fund has no interaction with investors till redemption except for paying dividend/bonus. In order to provide an alternate 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. If an investor sells units directly to the fund, he cannot enter the fund again, as units bought back by the fund cannot be reissued. The close-ended scheme can be converted into an open-ended one. The units can be rolled over by the passing of a resolution by a majority of the unit--holders.

3. Interval scheme: Interval scheme combines the features of open-ended and close-ended schemes. They are open for sale or redemption during predetermined intervals at NAVrelated prices.

Portfolio Classification

Here, classification is on the basis of nature and types of securities and objective of investment.

1. Income funds: The aim of income funds is to provide safety of investments and regular income to investors. Such schemes invest predominantly in income-bearing instruments like bonds, debentures, government securities, and commercial paper. The return as well as the risk are lower in income funds as compared to growth funds.

2. Growth funds: The main objective of growth funds is capital appreciation over the medium-to-long- term. They invest most of the corpus in equity shares with significant growth potential and they offer higher return to investors in the long-term. They assume the risks associated with equity investments. There is no guarantee or assurance of returns. These schemes are usually close-ended and listed on stock exchanges.

3. Balanced funds: The aim of balanced scheme is to provide both capital appreciation and regular income. They divide their investment between equity shares and fixed nicebearing instruments in such a proportion that, the portfolio is balanced. The portfolio of such funds usually comprises of companies with good profit and dividend track records. Their exposure to risk is moderate and they offer a reasonable rate of return.

4. Money market mutual funds: They specialise in investing in short-term money market instruments like treasury bills,and certificate of deposits. The objective of such funds is high liquidity with low rate of return.

Geographical Classification

1. Domestic funds: Funds which mobilise resources from a particular geographical locality like a country or region are domestic funds. The market is limited and confined to the boundaries of a nation in which the fund operates. They can invest only in the securities which are issued and traded in the domestic financial markets.

2. Offshore funds: Offshore funds attract foreign capital for investment in 'the country of the issuing company. They facilitate cross-border fund flow which leads to an increase in foreign currency and foreign exchange reserves. Such mutual funds can invest in securities of foreign companies. They open domestic capital market to international investors. Many mutual funds in India have launched a number of offshore funds, either independently or jointly with foreign investment management companies. The first offshore fund, the India Fund, was launched by Unit Trust of India in July 1986 in collaboration with the US fund manager, Merril Lynch.

Others

1. Sectoral: These funds invest in specific core sectors like energy, telecommunications, IT, construction, transportation, and financial services. Some of these newly opened-up sectors offer good investment potential.

2. Tax saving schemes: Tax-saving schemes are designed on the basis of tax policy with special tax incentives to investors. Mutual funds have introduced a number of taxsaving schemes. These are close--ended schemes and investments are made for ten years, although investors can avail of encashment facilities after 3 years. These schemes contain various options like income, growth or capital application. The latest scheme offered is the Systematic Withdrawal Plan (SWP) which enables investors to reduce their tax incidence on dividends from as high as 30% to as low as 3 to 4%.

3. Equity-linked savings scheme (ELSS): In order to encourage investors to invest in equity market, the government has given tax-concessions through special schemes. Investment in these schemes entitles the investor to claim an income tax rebate, but these schemes carry a lock-in period before the end of which funds cannot be withdrawn. organisational structure of mutual funds in india

Constituents of Mutual Funds

Sponsor: The sponsor is akin to a promoter of a company as he gets the mutual fund registered with Sebi. The sponsor is defined under Sebi regulations as a person who, acting alone or in combination with another body corporate, establishes a mutual fund. The sponsor forms a trust, appoints the board of trustees, and has the right to appoint the asset management company (AMC) or fund manager.

Trustees: The mutual fund can be managed by a board of trustees or a trust company. The board of trustees is governed by the Indian Trust Act whereas a trust company is governed by the Companies Act, 1956. The trustees act as a protector of unit holders' interests. They do not directly manage the portfolio of securities and appoint an AMC (with approval of Sebi) for fund management. If an AMC wishes to float additional or different schemes, it will need to be approved by the trustees.Trustees play a critical role in ensuring full compliance with Sebi's requirements.

Asset Management Company: The AMC is appointed by trustees for managing fund schemes and corpus. An AMC functions under the supervision of its own board of directors and also under the directions of trustees and Sebi. The market regulator has mandated the limit of independent directors to ensure independence in AMC workings.

The major obligations of AMC include: ensuring investments in accordance with the trust deed, providing information to unit holders on matters that substantially affect their interests, adhering to risk management guidelines as given by the Association of Mutual Funds in India and Sebi, timely disclosures to unit holders on sale and repurchase, NAV, portfolio details, etc.

Custodian and depositories: The fund management includes buying and selling of securities in large volumes. Therefore, keeping a track of such transactions is a specialist function. The custodian is appointed by trustees for safekeeping of physical securities while dematerialised securities holdings are held in a depository through a depository participant. The custodian and depositories work under the instructions of the AMC, although under the overall direction of trustees.

Registrar and transfer agents: These are responsible for issuing and redeeming units of the mutual fund as well as providing other related services, such as preparation of transfer documents and updating investor records. A fund can carry out these activities in-house or can outsource them. If it is done internally, the fund may charge the scheme for the service at a competitive market rate.

Performance of mutual funds In india

Mutual Funds in India (1964-2000)

The end of millennium marks 36 years of existence of mutual funds in this country. The ride through these 36 years is not been smooth. Investor opinion is still divided. While some are for mutual funds others are against it. UTI commenced its operations from July 1964 .The impetus for establishing a formal institution came from the desire to increase the propensity of the middle and lower groups to save and to invest. UTI came into existence during a period marked by great political and economic uncertainty in India. With war on the borders and economic turmoil that depressed the financial market, entrepreneurs were hesitant to enter capital market. UTI commenced its operations from July 1964 "with a view to encouraging savings and investment and participation in the income, profits and gains accruing to the Corporation from the acquisition, holding, management and disposal of securities." Different provisions of the UTI Act laid down the structure of management, scope of business, powers and functions of the Trust as well as accounting, disclosures and regulatory requirements for the Trust. The opening up of the asset management business to private sector in 1993 saw international players like

Morgan Stanley, Jardine Fleming, JP Morgan, George Soros and Capital International along with the host of domestic players join the party. But for the equity funds, the period of 1994-96 was one of the worst in the history of Indian Mutual Funds.

1999-2000 Year of the funds

Mutual funds have been around for a long period of time to be precise for 36 yrs but the year 1999 saw immense future potential and developments in this sector. This year signaled the year of resurgence of mutual funds and the regaining of investor confidence in these MF's. This time around all the participants are involved in the revival of the funds the AMC's, the unit holders, the other related parties. However the sole factor that gave lifr to the revival of the funds was the Union Budget. The budget brought about a large number of changes in one stroke. An insight of the Union Budget on mutual funds taxation benefits is provided later. It provided centrestage to the mutual funds, made them more attractive and provides acceptability among the investors. The Union Budget exempted mutual fund dividend given out by equity-oriented schemes from tax, both at the hands of the investor as well as the mutual fund. No longer were the mutual funds interested in selling the concept of mutual funds they wanted to talk business which would mean to increase asset base, and to get asset base and investor base they had to be fully armed with a whole lot of schemes for every investor .So new schemes for new IPO's were inevitable. The quest to attract investors on winning the trust and confidence of the investors under the aegis of the Association of Mutual Funds of India (AMFI) One can say that the industry is moving from infancy to adolescence, the industry is maturing and the investors and funds are frankly and openly discussing difficulties opportunities and compulsions.

Performance of Mutual fund Industry in India from 2000 to 2007

During the period 2000 to july 2007 wealth of mutual fund industry surged by about five fold Touching an all time peak level of 4,86,513 crore as at july end 2007. According to survey by Asocham , mutual fund sector would grow at compound annual rate of 30% in next some years to become 9,50,000 crore industry.

Conclusion

Mutual fund is a collective savings scheme. Mutual funds play an important role in mobilising the savings of small investors and channelising the same for productive ventures in the

India.Indian MFs have emerged as strong financial intermediaries and they play a significant role in bringing stability into the financial system and efficiency in resource allocation. Mutual Funds operations utilized the public money of investors, hence Fund Managers have to use this public money in a proper way and distribute reasonable returns to investors.mutual fund industry is growing but there is more to be done in this area. Most of the growth in the assets under management has come not due to the increased retail participation, but due to the higher corporate investments in liquid schemes of the industry. Sebi must take various steps to make Indian mutual funds more effective.