Unit-5. Mutual Funds

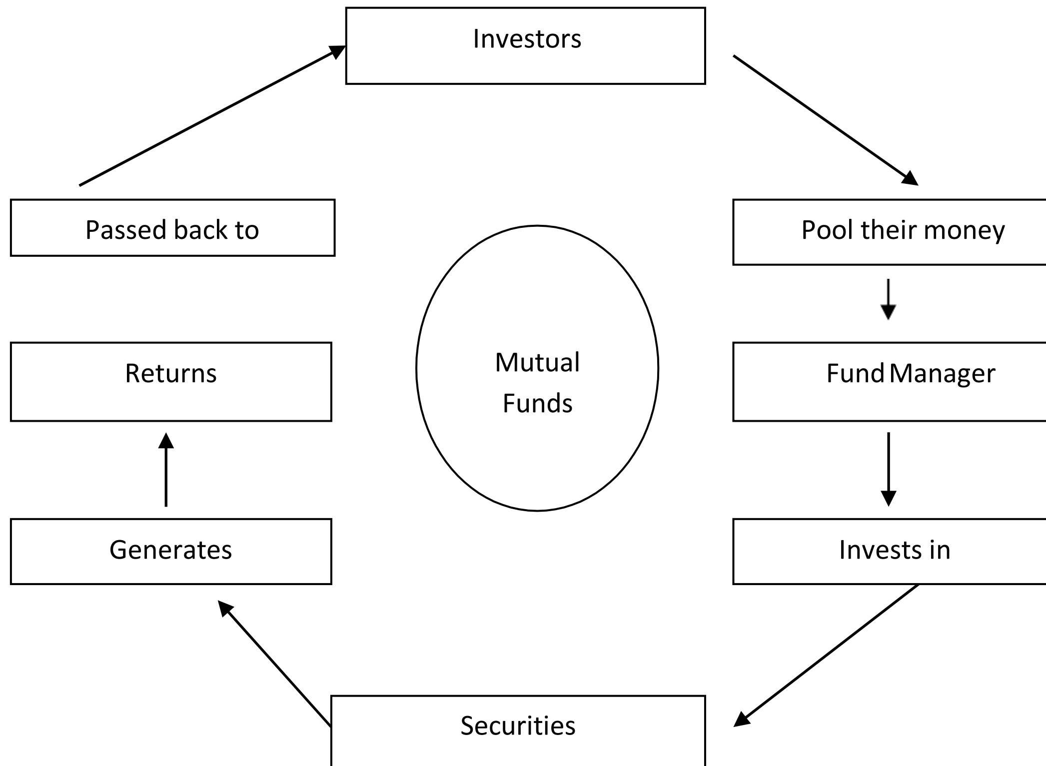
MEANING AND SCOPE OF MUTUAL FUND

The "Fund" is constituted under statutes for the mutual benefit of unknown small investors The organization which floats the Fund, pools the small savings of general public, manages the pooled funds by investing in quality securities and pays return to investors and pays back the principal after the lapse of stipulated time period stated in Fund Certificate. It cannot be said that return will be constant on investment of savers. It depends upon the movement and behaviour of stock market. If there is boom in stock market, returns will be high and vice-a-versa in case of depression in the economy and in stock market. If the stock market is volatile, returns will also oscillating and investment will also be in trouble. But shrewd Fund managers shift the securities quickly to better yielding securities, so that investment of small investors are protected and certain return is assured.

Simply put, money pooled by large number of investors is what makes up a mutual fund. This money is then managed by a professional fund manager, who uses his investment management skills to invest it in various financial instruments.

Mutual Fund is defined by Securities and Exchange Board of India (Mutual Funds) Regulations, 1993 as "a fund established in the form of a trust by a sponsor, to raise monies by the trustees through the sale of units to the public, under one or more schemes, for investing in securities in accordance with these regulations." Thus, a Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

The flow chart below describes broadly the working of a mutual fund.



Scope

MFs cover wide range of activities. They being the managers of public funds, that too of small investors, by and large, cannot operate arbitrarily. Though they provide funds for development of the economy, they cannot stretch their operations beyond unmanageable limits They should maintain strict financial discipline. They should always look for quality investments If they feel that the portfolio they hold is volatile or all on a sudden exposed to unmanageable risk, they should liquidate such scrips and invest in solid securities. The scope of their operation is restricted to the funds they hold. They should have good spread to possess ready liquidity. Good financial analysts who continuously study the capital market can be good market operators. Dealing in stock market itself is a risky activity. Mutual Funds, while operating in this risk market should better understand their strengths in transacting and managing others' funds. Scope here refers to as how far the MFS can stretch their operations.

The limiting factors are:

(i) The size of the fund that they can collect.
(ii) Maintaining total fund to investment ratio
(iii) The market behaviour of the scrips they hold
(iv) Their strength in taking calculated risk to hold certain category of securities
(v) Their balancing capacity to have diversified mix of scrips in their basket(i.e., high yielding, low yielding but safe and medium or average yielding securities.
(vi) The capacity of fund managers to hold liquid assets to meet the investors' claimson time
(vii) Clean and transparent operations
(viii) Courage to handle the situation in times of turbulence.

The Evolution of Mutual Funds In India

The origin of the Indian mutual fund industry can be traced back to 1964 when the Indian government, with a view to augment small savings within the country and to channelize these savings to the capital markets, set up the Unit Trust of India ("UTI"). The UTI was setup under a specific statute, the Unit Trust of India Act, 1963. The Unit Trust of India launched its first open-ended equity scheme called Unit 64 in the year 1964, which turned out to be one of the most popular mutual fund schemes in the country. In 1987, the government permitted other public sector banks and insurance companies to promote mutual fund schemes. Pursuant to this relaxation, six public sector banks and two insurance companies i.e, Life Insurance Corporation of India and General Insurance Corporation of India launched mutual fund schemes in the country. Subsequently, in 1993, the Securities and Exchange Board of India ("SEBI") introduced The Securities and Exchange Board of India (Mutual Funds) Regulations, 1993, which paved way for the entry of private sector players in the mutual fund industry.

The evolution/ history of Indian mutual fund industry is broadly divided into four phases:

First Phase-1964-1987

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up 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. At the end of 1988 UTI had Rs. 6,700 crores of assets under management.

Second Phase - 1987-1993 (Entry of Public Sector Funds)

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 Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. At the end of 1993, the mutual fund industry had assets under management of Rs. 47,004 crores.

Third Phase-1993-2003 (Entry of Private Sector Funds)

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. 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 Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996. The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs. 44,541 crores of assets under management was way ahead of other mutual funds.

Fourth Phase - since February 2003

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, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs. 76,000 of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations. And with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth.

FEATURES OF MUTUAL FUNDS

- **Mobilisation of Savings**
  Mutual funds mobilizes funds by selling its shares popularly known as units. This in turn encourages the household savings and investment.

- **Provides Investment Avenue**
  Mutual funds provides investment avenues for small and retail investors who does not have the expertise of investing in equity market.

- **Diversification in Investment**
  Mutual fund invest the funds collected from retail investors in securities of different industries. This diversification leads to reduction in the risk associated with investment

- **Professional Management**
  Panel of experts who possesses professional knowledge manages mutual funds. This leads to professional and profitable management of mutual funds.

- **Reduces Risk**
  Mutual funds reduces the risk associated with investment by going for better liquidity of units, professional management and diversification.

- **Better Liquidity**
  Mutual fund units can be sold/liquidated easily as they possess ready market.

- **Provides Tax Benefits**
  Investing in many schemes of Mutual funds provides tax exemptions under section 80C of Income tax act

STRUCTURE/ INSTITUTIONAL FRAMEWORK OF MUTUAL FUND

A mutual fund is set up in the form of a trust, which has sponsor, trustees, asset management company ("AMC") and a custodian. The trust is established by a sponsor or more than one sponsor who is like a promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit-holders. The AMC, approved by SEBI, manages the funds by making investments in various types of securities. The custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are vested with the general power of superintendence and direction over AMC. They

monitor the performance and compliance of SEBI Regulations by them mutual fund.

A typical mutual fund structure in India can be graphically represented as follows:

1. **Sponsor**

   Sponsor of a mutual fund is akin to the promoter of a company as he gets the fund registered with SEBI. Under SEBI regulations, sponsor is defined as any person who acting alone or in combination with another body corporate establishes the mutual fund. Sponsor can be Indian companies, banks or financial institutions, foreign entities or a joint venture between two entities. As Reliance mutual fund has been sponsored fully by an Indian entity. Whereas, funds like Fidelity mutual fund and JP Morgan mutual fund are sponsored fully by foreign entities. ICICI Prudential mutual fund has been set up as a joint venture between ICICI Bank and Prudential plc. Both sponsors have contributed to the capital of the Asset Management Company of ICICI Prudential.

   SEBI has laid down the eligibility criteria for sponsor as it should have a sound track record and at least five years experience in the financial services industry. SEBI ensures that sponsor should have professional competence, financial soundness and general reputation offairness and integrity in business transactions. At least 40 percent of the capital of AMC has to be contributed by the sponsor. Also, they identify and appoint the trustees and Asset Management Company. Sponsors are also free to get incorporated an AMC as well as to appoint a board of trustees. They, either directly or acting through trustees, will appoint a custodian to hold the fund assets. To submit trust deed and draft of memorandum and articles of association of AMC to SEBI is also a duty of sponsor. After the mutual fund is registered, sponsors technically take a backseat.

2. **Trustees**

   Under the Indian trust act 1882, a sponsor creates mutual fund trust, which is the main body in creation of mutual funds. Trustees may be appointed as an individual or as a trustee company with the prior approval of SEBI. As defined under the SEBI regulations, 1996,trustees mean board of trustees or Trustee Company who hold the property of mutual fund forth benefit of the unit holders. A Trustee acts as the protectors of the unit holders interests and is the primary guardians of the unit holders' funds and assets. Sponsor

executes and registers a trust deed in favour of trustees. There must be at least 4 members in the board of trustees and least two third of them need to be independent. For example, HDFC Trustee Company Limited is the Trustee of HDFC Mutual Fund vide the Trust deed dated June 8, 2000. It has five board members, of whom three are independent. To ensure fair dealings, mutual fund regulations require that trustee of one mutual fund cannot be a trustee of another one, unless he is an independent trustee in both the cases, and has approval of both the boards, AMC, its directors or employees shall not act as trustees of any mutual fund. Trustees must be the person with experience in financial services and every trustee should be a person of integrity, ability and standing. SEBI has also defined the rights and obligations of trustees. Under their rights, trustees appoint AMC with the prior approval of SEBI. They approve each of the schemes floated by AMC in consultation with the sponsors. They have the right to obtain from the AMC, such information as they consider necessary to fulfill their obligations.

Trustees can even dismiss AMC with the approval of the SEBI and in accordance with the regulations. Under their obligations, trustees must ensure that the transactions of mutual funds are in accordance with the trust deed and its activities are in compliance with SEBI regulations. They must ensure that AMC has all the procedures and systems in place, and that all the fund constituents are appointed. Also, they must ensure due diligence on the part of AMC in the appointment of business associates and constituents. Trustees must furnish to SEBI, on half yearly basis a report on the activities of the AMC.

3. Asset Management Company (AMC)

Asset Management Company is the body engaged to run the show of a mutual fund. The sponsor or trustees appoint AMC to manage the affairs of the mutual fund to ensure efficient management. SEBI desires that AMC must have a sound track record in terms of net worth, dividend paying capacity, profitability, general reputation and fairness in transactions AMC is involved in basically three activities as portfolio management, investment analysis and financial administration. Therefore, the directors of AMC should be expert in these fields. SEBI's regulation for AMC requires that it should have a net worth of at least Rs. 10 crore at all times and that a company can act as an AMC of one mutual fund only. Also, at least 50percent of the members of the board of an AMC have to be independent and these can be the director of another AMC also. Its chairman should be an independent person. AMCs can

not in any business other than that of financial advisory and investment management. Its memorandum and articles of association have to be approved by the SEBI. Statutory disclosures regarding AMCs operations should be periodically submitted to SEBI. Prior approval of the trustees is required, before a person is appointed as a director on the board of AMC. An AMC cannot invest in its schemes until it is disclosed in the offer document. Moreover in such investments, AMC will not be eligible for fees also. The appointment of an AMC can be terminated by the majority of trustees or by 75 percent of unit holders. Example: HDFC Asset Management Company Lad was approved by SEBI vide its letter dated June 30, 2000 to act as an Asset Management Company of the HDFC mutual fund. In terms of investment management agreement, the trustee appointed this AMC. HDFC holds 60 percent of the capital and Standard Life Investments holds remaining 40 percent of the capital of the AMC. Its board has 12 members of whom 6 are independent. Apart from three constituents discussed above, Custodians and transfer agents are another two important constituents of mutual funds. These have been discussed below.

4. Custodian

SEBI requires that each mutual fund shall have a custodian who is independent and registered with it. SEBI regulations provide for the appointment of a custodian by trustees of the mutual fund who are responsible for carrying on the activities of safe keeping of securities and participating in any clearing system on behalf of mutual fund. Custodian is not permitted to act as a custodian of more than one mutual fund without the prior approval of SEBI. They should be independent of the sponsors. As for example, ICICI Bank is a sponsor of ICICI Prudential Mutual fund. It is also a custodian bank. But it cannot offer its services to ICICI Prudential Mutual fund, because it is a sponsor of this fund. The appointment of any agency as custodian depends upon its track record, quality of services, experience, transparency, computerization and other infrastructure facilities. Custodians primarily perform securities settlement functions However, some also offer fund accounting and valuation services. The responsibilities of custodian include delivering and accepting securities and cash, to complete transactions made in the investment portfolio of mutual funds. Custodians also track and keep payouts and corporate actions such as bonus, rights, offer for sale, buy back offers, dividends, interest and redemption on the securities held by the fund. They also look after that the discrepancies and failure must be timely resolved.

5. Transfer Agent

Registrar and transfer (R&T) agents are responsible for creating and maintaining investor records kept in numbered account called folios and servicing them. They accept and process investor transactions and also operate investor service centre (ISCs) which acts as an official points for accepting investor transactions with a fund. As for example, Computer Age Management Services (CAMS) is the R&T agent for HDFC mutual fund. R&T Functions include issuing and redeeming the units and updating the unit capital account. R&T perform creating, maintaining and updating the investors' records and enabling their transactions such as redemption, purchase and switches. Banking the payment instruments such as drafts and cheques given by investors and notifying the AMC is also done by them. R&T send statutory and periodic information to investors and process payouts to investors in the form of dividends and redemptions.

MUTUAL FUND SCHEMES/CLASSIFICATION OF MUTUAL FUNDS/TYPES OF MUTUAL FUNDS

Depending upon the requirement/expectations of the investors a tailored made. Scheme may be provided by the mutual funds to investors.

Types of Mutual Funds Schemes in India

1. **Classification on the basis of Operations/Structure**

   a.Open ended Scheme: In an open-ended mutual fund there are no limits on the total size of the corpus (Fund raised). Investors are permitted to enter (Buy) and exit (Sell) the open ended mutual fund at any point of time at net asset value (NAV). These schemes are opened throughout the year with no definite closing period. It provides, excellent liquidity, although the units are not listed. Axis Triple Advantage Fund, Birla Sun Life Basic Industries Fund, IDBI India Top 100 Equity Fund, L&T Contra Fund, Taurus Tax Shield, Templeton Floating Rate Income Fund, UTI-G-Sec Fund are some of the open ended mutual funds.

Characteristics

- Accepts funds from investors on continuous basis.
- Repurchase facility available.
- No listing in stock exchange.
- Better liquidity due to continuous repurchase.
- Sale and purchase based on NAV of the units.

b.Close ended Schemes: Here the duration and amount to be raised from the fund a pre-fixed schemes are opened for specific time period. Once the subscription reaches the determined level, the entry of investors is closed. After the expiry of the fixed period, the entire corpus is disinvested and the proceeds are distributed to the various unit holders in proportion to their holding. Investors can transact (buy or sell) the units of the scheme on the stock exchanges where they are listed. The market price at the stock exchanges could vary from the net asset value (NAV) of the scheme on account of demand and supply situation, expectations of unit holder and other market factors. Canara Robeco Equity Tax Saver-93, DSP Merrill Lynch Tax Saver Fund, Tata Life Sciences and Technology Fund, JM Arbitrage Advantage Fund, Kotak Gold ETF are some of the close ended funds in India.

Characteristics

- Schemes are opened only for short duration.
- Corpus normally does not change, throughout the year.
- Normally these schemes are listed in stock exchanges.
- Liquidity is available to investors at the time of redemption.
- Market price may be below or above par.

c.Interval Schemes: Basically it is a close ended scheme with a peculiar feature that every year for a specified period (interval) it is made open. Prior to and after such interval the schemes operates as closed ended schemes. During the said

period, mutual fund is ready to buy or sell the units directly from or to the investor. Reliance interval fund, Taurus quarterly interval fund-series 1, ICICI-Pru's Interval Fund II are some of the intervals funds in India.

2. **Classification by Investment Objectives**

a.Income Schemes: To maximize the current income is the objective of this scheme. Periodical income distribution is the feature. Investment in low risk securities is made in these schemes. Predominantly funds are invested in debt instruments. Scheme offers maximum current income, where by the income earned by units is distributed to unit holders periodically. Some of the examples of Indian income mutual funds are IDFC Capital Protection Oriented Fund, Kotak Hybrid Fixed Term Plan, Reliance Fixed Horizon Fund, SBI Capital Protection Oriented Fund etc.

b. Growth Schemes: To achieve capital appreciation is the objective of this scheme. Investment is made in growth oriented securities like equity shares. They concentrate mainly on long run gains i.e., capital appreciation. They do not offer regular income and they aim at capital appreciation in the long run.BNP PARIBAS Equity Fund, Canara Robeco equities, DWS Investment Opportunity Fund, Fidelity Equity Fund, HSBC Dynamic Fund, Quantum Long-Term Equity Fund are some examples of growth mutual funds in India.

c.Balanced Schemes: To provide current income as well as capital appreciation is the objective. Investment in Equity and Fixed income securities as per the offer document. HDFC Balanced Fund, UTI Balanced Fund, Tata Balanced Funds are some of the examples of these funds in India.

3. Classification by Nature of Investment:

(a) Equity fund: These funds invest a maximum part of their corpus into equities holdings. The structure of the fund may vary different for different schemes and the fund manager's outlook on different stocks. The Equity Funds are sub-classified depending upon their investment objective, as follows:

- Diversified Equity Funds
- Mid-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.

(b) Debt funds: The objective of these Funds is to invest in debt papers. Government authorities, private companies, banks and financial institutions are some of the major issuers of debt papers. By investing in debt instruments, these funds ensure low risk and provide stable income to the investors. Debt funds are further classified as:

- **Gilt Funds:**
  Invest their corpus in securities issued by Government, popularly known as Government of India debt papers. These Funds carry zero Default risk but are associated with Interest Rate risk. These schemes are safer as they invest in papers backed by Government.

- **Income Funds:**
  Invest a major portion into various debt instruments such as bonds, corporate debentures and Government securities.

- **MIPs (monthly Income Plan):**
  Invests 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 scheme ranks slightly high o on the risk-return matrix when compared with other debt schemes.

- **Short Term Plans (STPs):**
  Meant for investment horizon for three to six months. These funds primarily invest in short term papers like Certificate of Deposits (CDs) and Commercial Papers (CPs). Some portion of the corpus is also invested in corporate debentures.

- **Liquid Funds:**
  Also known as Money Market Schemes, These funds provides easy liquidity and preservation of capital. These schemes invest in short-term instruments like Treasury Bills, inter-bank call money market, CPs and CDs. These funds are meant for short-term cash management of corporate houses and are meant for an investment horizon of 1day to 3 months. These schemes rank low on risk-return matrix and are considered to be the safest amongst all categories of mutual funds.

(c)Balanced funds: As the name suggest they, are a mix of both equity and debt funds. They invest in both equities and fixed income securities, which are in line with pre-defined investment objective of the scheme. These schemes aim to provide investors with the best of both the worlds. Equity part provides growth and the debt part provides stability in returns.

(4) Classification by Geography

(a) Domestic Mutual Fund Schemes: Schemes launched with a view to mobilize savings of the citizens of the country.

(b) Off Shore Schemes: Mutual fund schemes launched with a view to mobilize the savings of the foreign countries for the investments in local markets. The aim is normally long term capital growth by investing in local equities.

(5) Other Classification:

(a) Tax Saving Schemes: These schemes provide tax incentives to Individual tax Payers under section 80C of Income Tax Act. By investing in these scheme the taxpayer can reduce his tax liability. These funds have minimum lock in period of three years.

(b) Sector Funds: These funds Invest the funds in securities (equity shares) of certain sector of the economy like, IT, Pharma, Automobile etc. The risk is confined to one particular sector.

(c) Index Funds: These funds invest the money in equity shares of those companies which are part of indices such as Sensex, Nifty, etc. The objective is to match the performance of the stock market by tracking an index that represents the overall market.

(d) Money Market Funds: Investment of these funds is in securities of short-term nature, which generally means securities of less than one-year maturity. The major advantages are the Liquidity and safety.

(e) Exchange Traded Fund (ETF): An exchange traded fund is an open ended fund that tracks an index like an index fund, but trades like a stock on an exchange just like the shares of an individual company. Unlike the share of a company, each unit of an ETF represents a portfolio of stocks. Therefore, these funds are similar to a unit of an open-ended mutual fund but with a big difference. The difference between an ETF and an open-ended mutual fund is that the units of an ETF trade on an exchange and therefore, the investor can trade in it during market hours and the units can be sold short or margined just like shares. Another difference is the type of management. Mutual funds

employ an active management strategy wherein the fund manager chooses portfolio of stocks and manages them in an endeavour to outperform the fund's benchmark.

(f) Fund of Fund (FOF): A Fund of Fund invests in other funds. Its portfolio is not made up of securities but of other mutual funds, selected to serve a given investment objective. A fund of funds allows investors to achieve a broad diversification and an appropriate asset allocation with investments in a variety of fund categories all wrapped up into one fund. However, if the fund of funds carries an operating expense, investors may have to bear double for expense that is already included in the expense figures of the underlying funds. Some fund of funds may invest in other mutual funds, not necessarily from the same fund house. These are called 'Multi-Manager Fund'. Prudential ICICI was the first to introduce FoFs in India in November2003 (SEBI Annual Report 2003-04 and Bhole, 2005) [18]. Birla Sun Life Asset Allocation Fund, Fidelity Multi Manager Cash Fund, ICICI Prudential Advisor Series, Quantum Equity Fund of Funds are some of their examples in India.

(g) Gold Exchange Traded Funds: Gold ETFs are exchange traded funds that are mea to track closely the price of physical gold. Each unit of the ETF lets the investor own 1 gm of gold without physically owning it. Thus investing in a gold ETF provides the benefit of liquidity and marketability which are a limitation of owning physical gold. Gold ETF is highly liquid because these can be traded at any time during market hours. Some of the Gold Exchange Traded Funds in India are Axis Mutual Fund-Axis Gold ETF. Gold Benchmark Exchange Traded Scheme, Birla Sun Life Gold ETF, HDFC Gold Exchange Traded Fund, ICICI Prudential Gold Exchange Traded Fund, KOTAK Gold ETF, Quantum Gold Fund .

SEBI REGULATIONS ON MUTUAL FUNDS

The Securities and Exchange Board of India (SEBI) as the regulator of Indian capital market had come out with its first mutual fund regulations in 1993. The need for creation and compliance mechanism for mechanism for mutual fund industry was expressed by SEBI in these guidelines. These regulations were revised and enlarged subsequently in 1996. These regulations were amended regularly. The latest amendment was made in January 2014. The crux of these regulation is that Interest of Unit holders is supreme. With SEBI regulations, all mutual funds have been brought under a common regulatory framework to ensure greater degree of transparency in their operations and adherence to a common structure. This act spells out numerous restrictions and requirements designed to protect the interests of the investors, and ensure that each mutual fund scheme is managed and operated in the best interest of its unit holders.

1. Legal character of mutual funds in India

It is useful to understand the legal composition of a mutual fund. A mutual fund is a legal entity. In India it is organized in form of a trust. The SEBI (Mutual Fund) Regulations, define a mutual fund as a fund established in the form of a trust by a sponsor, to raise monies by the trustees, through the sale of units to the public under one or more schemes for investing in securities in accordance with these regulations. This imposes three limitations on a mutual fund and determines its basic legal character. First, it allows the mutual fund to raise resources through sale of units to the public. Second, it permits the mutual fund to invest only in securities prescribes in the SEBI (MF) Regulations. This implies that mutual funds cannot invest in property or a real estate or in any other assets, as the securities prescribed in the regulations are only shares, debentures and equity-linked instruments. Third, it requires the mutual fund to be set up in the form of a trust under the Indian Trust Act. In the context of Indian mutual funds, it needs to be mentioned that the Indian Trust Act was enacted in 1882, essentially to govern private trusts and charitable institutions. A trust is defined as an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner for the benefit of another. The person who creates the trust is called the author of the trust. The person for whose benefit the trust is created is a beneficiary.

2. The Structure

The SEBI Mutual Fund Regulations have defined the structure of a mutual fund and segregated the various constituents into separate legal entities. The mutual funds are set up as trusts are to be managed by a separate asset management companies (AMCs). The custody of the assets is to be with a custodian, which is independent of the sponsors and the AMCs. Arms length relationships have been sought to be built into the various constituents of a mutual fund, primarily through the requirement that two third of the trustees and also 50% of the board of directors of the AMC must be independent and not associated or affiliated to the sponsor. Various documentation viz. trust deed, investment management agreement, which are to be executed, delineate the responsibilities of the asset management companies and the trustees.

3. Independent Custodian

Regulation 25 of the SEBI (MF) Regulations requires that mutual funds should have a custodian who is not in any way associated with the AMC. Further, the regulations require that the custodian is not the sponsor or trustee of any mutual fund and that the custodian or its directors will not be in any way be directly or indirectly affiliated or associated with any AMC.

The custodian cannot act as a sponsor or trustee of neither any mutual fund nor it can act as a custodian of more than one mutual fund without the prior approval of SEBI. The underlying purpose of these regulations is to ensure that the custodian meets the test of independence along with the mutual fund so as to prevent any conflicts of interests.

4. Registration of mutual funds

All mutual funds are required to register with the Securities and Exchange Board of India. Registration is intended to provide adequate and accurate disclosure of material facts concerning the mutual fund. SEBI regulations have laid down an eligibility criteria u/s 7, for the purpose of grant of a certificate of registration with a view to ensure that players have a sound track record and general reputation of fairness and integrity in all their business transactions.

Regulation 20(e) states that the AMC shall have a minimum net worth of Rs.10 crores This is to serve both as an entry barrier as well as to enable the AMC to provide for its own infrastructure such as office space, personnel and systems independent of the sponsor. Any shortfall in the net worth would have to be made up by the sponsor immediately. The initial contribution to the net worth should be in the form of cash and all assets should be held in the name of the AMC. This is necessary to bring about a complete arms length relationship with the sponsor and its affiliates. In case the AMC wants to carry out other fund management businesses, it should satisfy the capital adequacy requirement for each such business independently.

5. Governance of mutual funds

Mutual fund schemes are repositories of trust and of investor's hard earned money. The task of providing protection to them is a difficult one. Mutual funds are unique in a way as that they are organized and operated by people whose primary loyalty and pecuniary interest lies outside the enterprise. Consequently the very structure of mutual funds has inherent conflicts of interest, creating great potential for abuse. The existing SEBI Regulations have tried to address the issue, through separation of various entities which constitute a mutual fund-sponsor, trustees asset management companies and custodian, and also requiring that 2/3rd of the trustees and half of the board of directors of AMC must be independent of sponsor or its affiliates. The beneficial owners of the trust, i.e. the unit holders have also been given a role, as their approval is required by the fund/ AMC to enable it to bring about certain changes in the fund or to wind up a scheme. The SEBI regulations have made it mandatory that the trustees shall obtain the consent of the unit holders in important matters. The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of the unit holders, shall be carried out unless it is made known to the unit holders and the unit holders are given an

option to exit at the prevailing Net Asset Value without any exit load. The unit holders have a right to terminate the asset management company. The appointment of an asset management company can be terminated by majority of the trustees or by 75% of the unit holders of the scheme. Any change in the appointment of the asset management company shall be subject to prior approval of SEBI and the unit holders.

6. Operations of mutual funds

This section will show the regulatory provisions pertaining to the operations of the mutual fund and their implications on unit holders protection. The SEBI regulations relating to operations are as follows:

(a) Business of the Asset Management Company: Regulation 23 of the SEBI regulations provides that AMC shall not undertake any business activity other than management of the mutual funds and such other activities as financial services consultancy. exchange of research and analysis on commercial basis as long as these are not in conflict with the fund management activity itself, without prior approval of the trustees and SEBI.

(b) Disclosure Requirements: Mutual funds are required to disclose to SEBI regular. comprehensive disclosures of their operations. In addition, each fund must provide unit holders with annual report along with a statement on portfolio holdings, and it must furnish unit holders and prospective investors with an up-to-date prospectus. The prospectus contains full disclosures on the fund's management, investment objectives, purchase redemption procedures and other business practices, including load charges, if any. It is often criticized that big investors trade to the disadvantage of small investors. Mutual funds shall disclose large unit holdings in the scheme, which are over 25% of the NAV. The offer document discloses the constitution of the mutual fund including the details regarding the sponsor, the trustees, the AMC, the custodian and the responsibilities and functions of each constituent of the mutual fund; the detailed investment objective of the scheme and the investment pattern likely to be followed by the AMC, the risk profile of the investments; and risk factors. The offer documents also contains other information pertaining to the redemption of units, the tax benefits available to unit holders, the principles of valuation of investments, the method of calculation of NAV, frequency and mode of distribution of income, the duration of the scheme, the detailed breakup of the expenses that will be incurred for the management of the scheme and the extent to which expenses are loaded on the scheme. Mutual funds are further required to disclose full portfolio of their schemes every half year, either by sending a complete statement of scheme portfolio or by publishing it by way of an advertisement in one English daily circulating in the whole of India and in a newspaper published in the languages of the region where the head office of the mutual fund is situated.

(c)Advertisements: Mutual funds must adhere to specific rules regarding the sale, distribution and advertising of mutual funds, Advertisements or sales literature must be carefully worded and explained. The advertisement for each scheme shall disclose investment objective for each scheme. The offer document and advertisement materials shall not be misleading or contain any statement or opinion, which is incorrect or false. These steps ensure that potential investors are aware of the benefits as well as the potential risks involved in mutual fund investing. With a view to ensure that an asset management company may not in promoting its schemes use untrue and misleading information or withhold important facts from investors SEBI has prescribed an advertisement code. Advertisements in respect of every scheme shall be in conformity with the Advertisement Code.

(d) AMFI Certification For Agents: Mutual funds are advised to ensure that their agents distributors do not indulge in any kind of malpractice or unethical practice while selling/marketing mutual fund units. SEBI has prescribed a detailed code of conduct for mutual fund intermediaries i.e. agents and distributors. With a view to implement this code of conduct effectively the AMFI certification examination was made mandatory for all distributors and agents of mutual funds. All promotional material must contain an express warning note to the fact that risk is connected with the investment and returns to date are not a guarantee of future return. Mutual funds cannot provide guaranteed return, unless such returns are fully guaranteed by the sponsor or the asset management company. When guaranteed by the sponsor or the AMC a statement indicating the name of the person who will guarantee the return, is made in the offer document; or the manner in which the guarantee to be met has been stated in the offer document.

(e) Investment Restrictions: Investments by mutual funds are subject to investment restrictions. These restrictions are essentially prudential investment norms, most of which are universally followed by mutual funds to ensure portfolio risk diversification. For example, investment in equity shares or equity related instruments of a single company are restricted to 10% of the NAV of a scheme.

(f) Daily Pricing: In open-ended schemes unit holders are always free to vote with their rupees by not buying a product if the fees are too high or vote with their feet by redeeming the units if they are unhappy over the performance of schemes. Mutual funds are required to update the NAV of the scheme and the sale/repurchase prices of their schemes on the AMFI website on a daily basis in case of open-ended schemes. Price determination of units is not an arbitrary process. SEBI has prescribed the accounting and valuation norms. While determining the prices of the units, the mutual fund shall ensure that the repurchase price is not lower than 93% of the NAV and the sale price is not higher than 107% of the NAV. Provided that the difference between the repurchase price and the sale price of the unit shall not exceed 75% calculated on the sale price.

(g) Borrowings By Mutual Funds: "Mutual funds cannot borrow except as a measure of last resort" Since leveraging has risks attached to it, mutual funds can borrow only to meet the temporary liquidity needs for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders. Provided that the mutual fund shall not borrow more than 20% of the net asset of the scheme and the duration of such a borrowing shall not exceed a period of six months. The trustees are required to ensure that borrowing is used as a measure of last resort and determine whether the mutual fund could borrow should be disclosed in the scheme's offer document.

(h) Reporting Requirement: Every mutual fund has to appoint compliance officer. The compliance officer ensures the compliance of the mutual fund schemes with SEBI regulations. It receives circulars notifications from SEBI and puts the same to the respective department for necessary action. The officer receives relevant information from various departments/officers of the trust, compiles the same into standard formats and submits to SEBI/AMFI etc. he vets the offer document to ensure the offer document discloses all the information as required by SEBI. This helps SEBI to do continuous offsite inspection.

(i) Risk Management System In Mutual Funds: Recognizing the need to establish a minimum level of risk management system conforming to international standards, AMFI formed committee for studying the present system of risk management and proposing ways and means of strengthening the same. They have made certain recommendations to ensure a minimum standard of due diligence or risk management system for all the mutual funds in various areas of their operations like fund management, operations, customer service, marketing and distribution, disaster recovery and business contingency, etc. the report has been submitted to SEBI and has been adopted as the regulatory framework for risk management in the Indian mutual fund industry.

7. Grievance mechanism: Mutual funds need to specify in the offer document the name of contact person whom unit holders may approach in case of any query, complaints or grievances. The names of the directors of Asset Management Company and trustees are also given in the offer documents; and they can also be approached. Historical information about the investor's complaints and redressal form A part of the offer document. Investors can also approach SEBI for redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with them till the matter is resolved.

FACTORS CONTRIBUTING FOR THE GROWTH OF MUTUAL FUNDS IN INDIA

A few factors have contributed for the growth of mutual fund industry in India during the past two decades.

1. **Better Returns**
   The first and foremost reason is delivering of substantial returns by equity and debt-oriented funds. Different periods of outstanding performance aided by strong bull runs in the late 1990 which saw the stock prices shooting through the roof, as well as the current bullish fervour which has helped equity-oriented funds deliver substantial returns. Debt funds too have been benefited by the soft bias in the interest rates. The volatility in the bond prices has also helped debt-oriented funds deliver handsome returns.

2. **Changes in Investment environment**
   Significant changes in the investment environment such as increased competition, on going reforms which allow mutual funds to invest abroad as well as in derivative instruments helped for growth of the industry.

3. **Competition and Efficiency**
   Unlike monopoly of UTI in the past, mutual fund industry now-a-days has been backed by FIIs and domestic market. Early in the reforms process, it is recognized that greater competition and innovation would be required so that the public received better financial services. It is true that some steps have been taken to increase competition between financial intermediaries both within and across categories. Banks and financial institutions have been allowed to enter each other territories. Fields like mutual funds, leasing and merchant banking have been thrown open to the banks and their subsidiaries. The private sector has been allowed into fields like banking and mutual funds.

4. **Transparency**
   The transparency in operations and disclosure practices related to the NAV, stock selection strategies, portfolio churning costs, rationale for expense charges and investment related risks also fueled the growth of the industry.

5. **Regulation**
   Stringent regulatory environment of the SEBI, investor awareness programmes offered by the AMFI, entry of foreign players with strong financial and research capabilities, potential entry of employee pension and provident funds and a slew of innovative schemes to cater to the different needs have attracted the investors.

6. **Standardization of operations**
   Mutual fund operations like maintenance of investment accounts and the scheme accounts by outsourcing is restricted. Marketing strategies in consultation with marketing advisors have been established by the AMCs. The SEBI regulations with respect to offer documents, NAV computation, NAV reporting, valuation of investments, accounting standards, performance reports etc., have tended to create a certain level of homogenization of the Indian mutual fund products.

7. **Technology**
   Majority of the mutual funds have their own websites providing basic information relating to the schemes and enable purchase and redemption of units online for clients in select locations.
   Most significant influence of technology is seen in servicing investors through agencies. The advantages of technology resulted in lower distribution costs through online transactions, more customized and personal advice customers and reaching out to the growing young and net-savvy population of India.

8. **Product Innovation**
   The tailor-made innovative schemes launched by the mutual fund houses have given investors option to choose funds which choose his investment needs. Schemes with systematic investment plan, automatic redemption plan, linking current accounts to money market mutual funds, cheque writing facility etc. are attempts to create homogeneity. Products such as Index funds, International funds, Ethical funds, Sectoral funds, Exchange traded funds, Pension funds. Children funds, Reality funds have galvanized the industry growth.

ADVANTAGES OF MUTUAL FUNDS

The advantages of investing in a Mutual Fund are:

- **Diversification:** The best mutual funds design their portfolios so individual investments will react differently to the same economic conditions.
  For example: economic conditions like a rise in interest rates may cause certain securities in a diversified portfolio to decrease in value. Other securities in the

portfolio will respond to the same economic conditions by increasing in value. When a portfolio is balanced in this way, the value of the overall portfolio should gradually increase over time, even if some securities lose value.

- **Professional Management:** Most mutual funds pay topflight professionals to manage their investments. These managers decide what securities the fund will buy and sell, when to buy or sell etc.

- Performs as Substitute for Initial Public Offerings (IPOs): As MFs areassured certain per cent of allotment in IPOs, small investors who are unableto apply for IPOs can enjoy the benefit of IPO through MF.

- Marketing cost of new shares can be reduced by MFs.

- MFs keep money market active by investing money on the money market instruments and strengthen money market operations. Thus, MFs provide stability to share prices, safety to investors and resources to business.

- **Supports Capital Market:** MFs channelize private funds to the capital market and make this market active through sustained supply of funds. They also provide valuable liquidity to capital market and make the market stable.

- **Regulatory oversight:** Mutual funds are subject to many government regulations that protect investors from fraud.

- **Liquidity:** It's easy to get your money out of a mutual fund. Write a cheque, make a call, and you've got the cash.

- **Convenience:** You can usually buy mutual fund shares by mail, phone, or over the Internet.

- **Low cost:** Mutual fund expenses are often no more than 1.5 per cent of your investment. Expenses for Index Funds are less than that, because index funds are not actively managed. Instead, they automatically buy stock in companies that are listed on a specific index.

- **Transparency:** There is very little scope for malpractice as it is regulated by SEBI.

- **Flexibility:** The funds can be easily shifted to different categories or from one MF to another.

- **Choice of Schemes:** Each MF company will have number of products. Most of the funds provide variety of schemes depending on the individual requirement of the investors.

- **Tax benefits:** Most of the MFs have tax saver schemes covered by IT Act.

- **Well regulated:** Security Exchange Board of India (SEBI) fully controls MF operations through its regulations.

DRAWBACKS OF MUTUAL FUNDS

- **No Guarantees:** No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money.

- **Fees and Commissions:** All funds charge administrative fees to cover their day-to day expenses. Some funds also charge sales commissions or "loads "to compensate brokers, financial consultants, or financial planners. Even if investor don't use a broker or other financial adviser, they will have to pay a sales commission in a Load Fund.

- **Taxes:** During a typical year, most actively managed mutual funds sell any where from 20 to 70 percent of the securities in their portfolios. If fund makes a profit on its sales, investors will have to pay taxes on the income received.

- **Management Risk:** When investment is done in a mutual fund, investor depend on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as investor had hoped, they might not make as much money on investment as you expected. Of course, if investor invest in Index Funds, they forego management risk, because these funds do not employ managers. The various schemes of different MFs constitute the product-mix. These plans and types will change the market. Product will be designed by

professionals appointed by MFs, introduced in the market and gradually popularized after correcting the imbalances in the scheme.

- Sponsorship of mutual funds has a bearing on the integrity and efficiency of fund management which are key to establishing investor's confidence. So far, only public sector sponsorship or ownership of mutual fund organizations had taken care of this need.

- The increase in the number of mutual funds and various schemes have increased competition. Hence it has been remarked by Senior Broke mutual funds are too busy trying to race against each other". As a result they lose their stabilizing factor in the market.

- Transparency is another area in mutual fund which was neglected till recently, Investors have right to know and asset management companies have an obligation to inform where and how his money has been deployed.

THE ASSOCIATION OF MUTUAL FUNDS IN INDIA (AMFI)

The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders AMFI, the association of SEBI registered mutual funds in India of all the registered Asset Management Companies, was incorporated on August 22, 1995, a non-profit organisation. As of now, all the Asset Management Companies that are registered with SEBI, are its members.

Objectives of AMFI

- To define and maintain high professional and ethical standards in all areas of operation of mutual fund Industry,

- To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.

- To interact with the Securities and Exchange Board of India (SEBI) and to represent to SEBI on all matters concerning the mutual fund industry.

- To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the Mutual Fund Industry. To develop a cadre of well trained Agent distributors and to implement a programme of training and certification for all intermediaries and others engaged in the industry.

- To undertake nation wide investor awareness programme so as to promote proper understanding of the concept and working of mutual funds.

- To disseminate information on Mutual Fund Industry and to undertake studies and research directly and/or in association with other bodies.

- To take regulate conduct of distributors including disciplinary actions (cancellation of ARN) for violations of Code of Conduct.

- To protect the interest of investors/unit holders

The Sponsorers of AMFI

Sponsoring Banks:

- SBI Fund Management Ltd.
- BOB Asset Management Co. Ltd.
- Canbank Investment Management Services Ltd.
- UTI Asset Management Company Pvt. Ltd.

Institutions

- GIC Asset Management Co.Ltd.
- Jeevan Bima Sahayog Asset Management Co.Ltd.

Private Sector (Indian)

- BenchMark Asset management Co.Pvt.Ltd.
- Cholamandalam Asset Management Co.Ltd.
- Credit Capital Asset Management Co.Ltd.
- Escorts Asset Management Ltd.
- JM Financial Mutual Fund.
- Kotak Mahindra Asset Management Co.Ltd.
- Reliance Capital Asset Management Ltd.
- Sahara Asset Management Co.Pvt.Ltd.
- Sundaram Asset Management Company Ltd.
- Tata Asset Management Private Ltd.

Predominantly India Joint Ventures

- Birla Sun Life Asset Management Co.Ltd.
- DSP Merrill Lynch Fund Managers Ltd.
- HDFC Asset Management Company Ltd.

Predominantly Foreign Joint Ventures

- ABN AMRO Asset Management (I) Ltd.
- Alliance Capital Asset Management (India) Pvt.Ltd.
- Deutsche Asset Management (India) Pvt.Ltd.
- Fidelity Fund Management Private Ltd.
- Franklin Templeton Asset Mgmt. (India) Pvt.Ltd.
- HSBC Asset Management (India) Private Ltd.
- ING Investment Management (India) Pvt.Ltd.
- Morgan Stanley Investment Management Pvt.Ltd.
- Principal Asset Management Co.Pvt.Ltd.
- Prudential ICICI Asset Management Co.Ltd.
- Standard Chartered Asset Mgmt.Co.Pvt.Ltd.

MARKETING OF MUTUAL FUNDS

Marketing a product or service involves various aspects. Of them important ones are: (1)Products offered for sale, (2) Price fixing for range of products offered for sale, (3) Promotion through different channels, (iv) Customer care, (v) Marketing research etc. All these important aspects are discussed in the following paragraphs,

1.Mutual Fund Products

MF product includes mainly corporate (i) securities, viz., Equity shares and Debentures, (ii) Government sponsored loan bonds for carrying out specific infrastructural and other projects and (iii) other approved securities such as money market instruments like Treasury Bills, Commercial Papers etc. Each MF will design its own marketing plan for its products. However, the elements of marketing mix are helpful in developing a good marketing plan. The products cited above are sold to the investors with different schemes.

i. Closed-End Mutual Funds
ii. Open-End Mutual Fund
iii. Large Cap Funds
iv. Mid Cap Funds
v. Equity Mutual Funds
vi. Balanced Fund
vii. Growth Funds
viii. No-Load Mutual Funds
ix. Exchange Traded Funds
x. Value Funds
xi. Money Market Mutual Funds
xii. International Mutual Funds xit. Regional Mutual Funds
xiv. Sector Mutual Funds
xv. Index Funds
xvi. Fund of Funds

2. Price Fixing

MF certificates will have the face value. The price is governed basically by the value of the underlying investments held by that fund. Whenever MFs sell the certificates, the price of the unit may have load or no-load concept. But in case resale of units, Net Asset Value (NPA) will be price for that unit.NAV is the market price of each unit of a particular scheme in relating to all the assets of the scheme. NAV exhibits the intrinsic value of the unit and also indicates the performance of that scheme.

NAV is computed by adopting the following formula.

$$NAV = \frac{\text{Market Value of the Investment}}{\text{Scheme Size}} \times \text{Value of Each Unit}$$

Pricing of any scheme of any MF is based on the size of fund of that scheme. Incase of re issue or repurchase ruling NAV is the price on the day of purchase. NAV is published in news papers and periodicals every week.

3. Promotion

There is a keen competition to sell MF products. There are different schemes for different purposes. MFs will adopt advertising (Audio-Visuals, Print media),personal selling, tele-marketing, network marketing, publicity, seminars etc., to launch and to continuously promote the schemes and plans of different MFs. To position the scheme of a MF, the promotion activity in that segment should be aggressive till such time the brand is created for that MF. As MFs are mainly catering the small savers, promotion policy has to be formulated to bring this class of investors into scheme in a big way.

4.Customer Service

This is a vital aspect in a financial product. As MFs have to compete with financial product like stocks, shares, bank deposits, loan bonds etc. Customer care needs attention on priority basis. It is essential here to categorize the customers to position the MF products in the market Without customer satisfaction MF products cannot gain the market. Customers can be classified as (i) overt consumer (consumers are fully satisfied), (ii) covert consumer (consumer is satisfied with service but inhibits to express satisfaction), (iii) consumer in dilemma (unable to make up his mind on the overall rating of the product based on his past experiences), (iv) Dissatisfied customer, (v) Dissatisfied and disturbs other potential customers by spreading "bad word of mouth." Of these five categories of customers, the last three are the ones who really disturbs the market for product or service. Therefore, service organizations should develop promotion strategies to sell the financial products to these customers. MFs normally open their "customer care service" centers in metros, big cities and even in large towns to service their clients. Both promotion and maintenance of MF schemes and plans is essential. Because MFs can garner a major portion of national savings, particularly from small investors, if they render quality service on sale and after services like periodical reminders to the customers about the maturity of their holdings, or assisting them in conversion process from one plan to another or continuously informing about the market behaviour of their holding, etc., will develop confidence in the unit holders and feel that they are really saved from the business hazards of MFs. Continuous servicing the customers by MFS is very essential. Still MF market is not developed in India.

Small savers, who cannot directly enter the security market with their meager savings, are the major customers of MFs. It is the duty of MFS to provide quality service to small savers to develop the MF market. It is only the quality service that can convert the dissatisfied, disturbing customers to become satisfied owners of MF plans.

5. Marketing Research

Marketing research at a juncture where MFs are not developed in the country to the expected level has gained momentum. The potential for developing MF market is being high, every MF operator involved in developing products, plans and schemes which cater to the needs of small investors. Diverting small savings investment from long-term low-yielding rigidly operated financial instruments such as NSCS, postal savings schemes, term deposit schemes of banks etc., to better-yielding, easily shift able MF products is a tough task. Still the people have not developed flair for investment in MFs. Therefore research in MF operations to identify the weak areas of operational mechanism including the defects in MF plans, inactive sales promotion aspects, regional disparities in positioning the MF plans, defective prioritization of plans in the regions where the plans are promoted etc. Research should also be conducted to assess the savings level of people in different regions, potentiality for developing MF market, the altitude of people in new regions to purchase MF products etc.

6. Strategic Marketing Plan: MFs being service-oriented activity, they have to develop a marketing plan which is innovative to capture and sustain the market. They have to adapt one of the following strategies to develop an effective marketing plan.(1) Growth through existing products in existing markets.(ii) Growth through existing products in new markets.(i) Growth through new products in existing markets.(iv) Growth through tapping new markets through new products. These four strategies help the marketers to develop a specific strategic plan for MFS products. This plan helps the planner and the strategist to evaluate strengths/weaknesses in relation to marketing opportunities in the environment. A strategic marketing plan for MF product can be prepared adapting the following procedure:

a. Situational Analysis: Whenever a strategy is to be adapted to improve the market situation for the existing product or to introduce a new product, the MF should make a situational analysis. This means, as far is the scheme is considered, it should be analyzed as to how the scheme is moving in the market. This is actually a problem identification process. For example, "UTI Master Growth"-A scheme of Unit Trust of India, is a slow moving product in UTIs portfolio. Now, the Fund managers want to reposition it to make it a fast moving product in the market. In order to develop a strategy, UTI has to make a situational analysis as to why it is moving slowly in the market. Situational analysis gives information on market demand, market environment and performance. It enlightens the Fund on its capabilities and limitations. The marketing mix of this product is thoroughly reviewed to find out the weakness in the mix.

b. Marketing Objectives and Strategies: Marketing strategies are to be closely allied with Fund objective. The marketing objectives translate the corporate strategy. In our example of "UTI Master Growth", the Fund objective is to increase the sale of UTI-MG "no-load" which means reducing commission to agents by 2 per cent to enhance profitability. This Fund strategy will now be the marketing objective and marketing strategy will be selling 'no-load unit to enhance sales. Selling cost will be reduced by bringing down percentage of Commission to agents by 2 per cent as they were paid high per cent to sell loaded units.

c. Segmentation and Target Market: In a new MF, segmentation enables the company to identify potential target markets. In a running concern, management reassesses the choice of target markets and modifies them, if necessary. The Fund may also reconsider segmentation strategy. It has to ascertain sales forecast in its target markets.

d. Marketing-mix: A distinctive marketing-mix is now prepared to satisfy target market demand and attain marketing objective for each target market. Marketing-mix and its implementation constitute the bulk of company's marketing efforts. Fund will have the best integration of product, price, promotion and distribution strategies.

Net Asset Value (NAV)

The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV), Mutual funds invest the money collected from investors in securities markets. In simple words, NAV is the market value of the securities held by the scheme. Since market value of securities changes every day. NAV of a scheme also varies on day to day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. For example, if the market value of securities of a mutual fund scheme is INR 200 lakh and the mutual fund has issued 10 lakh units of INR 10 each to the investors, then the NAV per unit of the fund is INR 20 (i.e.200 lakh/10 lakh). NAV is required to be disclosed by the mutual funds on a daily basis.

NAV or "net asset value" is the per-unit market value of all the securities held by the mutual fund portfolio. It indicates the price of each share in a particular fund. NAV is calculated by deducting the liabilities and expenses from total assets divided by the number of units outstanding.

Net Asset Value represents the market value per share for a particular mutual fund. It is calculated by deducting the liabilities from total asset value divided by the number of shares. One needs to gather the market value of a portfolio and divide it by the total current fund unit number to determine the price of each fund unit.

Most of the time, the unit cost of mutual funds begin with Rs. 10 and increase as the asset under the funds grow. Going by this rule, the more popular a mutual fund is, the higher is its NAV.

The net value of an asset is most commonly used in case of open-end funds. With these investments, the interest and shares do not get traded between shareholders. NAV helps determine which investment one might choose to withdraw or keep in their investment portfolio by providing a reference value.

Calculation of NAV.

The net value of an asset = (Total asset-total liabilities)/ total outstanding shares

However, it is crucial to input the correct qualifying items under assets and liabilities to get an accurate net value of assets.

Assets

The section of mutual funds includes the cumulative market value of a particular fund's investments, receivables, cash, cash equivalents and other accrued income. This market value is calculated at the end of each day, based on the closing price of the various securities included in the fund's portfolio. These funds may include a percentage of capital in the form of liquid assets and cash as well as other items like interest payments, dividends, etc. The sun of all these assets mentioned above or their variants falls under the category of assets.

Liabilities

The liabilities section, while computing net asset value mutual funds include outstanding payments, money owed to the lenders, and other fees and charges that are owed to associated entities.

Apart from these, mutual funds may also have foreign liabilities which can include shares for non-residents, payment pending to foreign conglomerates and various sale proceeds that are yet to be ousted. Liabilities can also include various accrued expenses including utilities, staff salaries, operating expenses, distribution, management expenses, etc.

Thus, for net asset value calculation for mutual funds, the quantum of the above mentioned liabilities and assets as of the end of a particular day are taken into account.

The Role of NAV in the Performance of a Mutual Fund

Most investors believe the net value of an asset is the same as its stock price. Thus, they tend to think that funds with a lower net asset value are cheaper and consequently better investments. However, the net asset value calculation does not correlate with the fund's performance. Just because a fund has a lower net value does not make it a comprehensive investment.

The net value of an asset merely illustrates how the underlying assets have performed in the previous years. Therefore, investors should not make it a deciding parameter while choosing funds to invest in. They should check the returns from their investments to make an informed decision.

Thus, the net value of an asset is useful when it comes to understanding how a fund performs every day. It does not indicate how lucrative a fund is. Therefore, investors should check the current cost of funds and its historical performance before choosing to invest in it.

Types of Mutual Fund Returns

Mutual funds are professionally managed by experts responsible for allocating assets to generate capital gains or profits for their investors. The amount of return generated is dependent on the mutual fund's performance. Different types of returns are often considered while assessing a mutual fund

1. Absolute Returns: Absolute Returns or Point-to-Point returns indicates the increase or decrease in investment, in terms of percentage. The time taken for this change is not accounted for. The absolute returns method of calculating returns is used for mutual funds with a tenure less than 1 year. If the period is more than one year, the investor has to calculate annualized returns.

Example of Absolute Return calculation:

Suppose the current market value of the investment is Rs. 4, 00,000 and the amount originally invested was Rs. 2, 50,000. In this case, the absolute return would be-[(4,00,000-2, 50,000)/2, 50,000]=60%.

2. Annualised Return: As the term implies, annualised returns measure the amount of growth in the value of your investment on an annual basis. For instance, let's say that you made an investment of Rs. 1 lakh in a MF scheme. In a span of three years, your investment has grown to Rs.1.4 lakh. In this case, your absolute return is 40%, but your annualised return is 11.9% because of the compounding effect.

3. Total Return : It refers to the actual returns you have accrued from the investment. It includes dividends as well as capital gains. For instance, let's say that you made an investment of Rs. 1 lakh in a MF scheme, and the NAV was Rs.20. Since you made purchases worth Rs. 1 lakh and the NAV is Rs.20, it means that you purchased 5,000 units. After a year, the NAV of the MF scheme increases to Rs.22, and the value of your units will be Rs.1.1 lakh (5,000 units x Rs.22 per unit), which means your capital gains shall be Rs.10,000. Now, in case the scheme declared dividends of Rs.2 per unit over the course of the year, the overall dividend paid to the investor shall be Rs.10,000 (5,000 units x Rs.2 per unit). Therefore, your overall accrued return shall be

Rs.10,000 + Rs.10,000 (dividend + capital gains) = Rs.20,000, which makes your overall return=20%.

4. Trailing Return: It is the annualised return over a particular trailing period which ends today. For instance, if the NAV of a MF scheme today is Rs. 100, and it was. let's say, Rs.60 three years ago. The formula to calculate trailing return in a Microsoft Excel sheet is (Today's NAV/NAV at the beginning of the trailing period) ^ (1/Trailing Period) -1. Therefore, your three-year trailing return will be 18.6%. In case the scheme's NAV five years ago was Rs.50, the five-year trailing return shall be 14.9%

5. Point to Point Return: It is the annualised return recorded between two points of time. All you need to calculate point to point returns is the start date and the closing date of a mutual fund scheme.

6. Annual Return: As the term suggests, annual return essentially refers to the return earned from a scheme between the 1st of January and the 31st of December of a particular year. For instance, in case a scheme's NAV on the 1st of January is Rs.100 and on the 31st of December is Rs.110, your annual return shall be 10%.

7. Rolling Returns: They refer to a scheme's annualised returns over a particular period of time. Rolling returns periods can be daily, weekly or monthly and shall be used until the last day of the duration in comparison with the benchmark of the scheme (for instance, Nifty, CNX-Midcap, CNX-500, BSE-200, BSE-Midcap, etc.) or fund category (for instance, midcap funds, large cap funds, balanced funds, diversified equity funds, etc.)

Dividend Plans of Mutual Fund

Mutual Funds offer multiple options for investing in verities of schemes based on investor's needs. Investors who prefer getting regular income have the dividend option. While investors who want to stay invested for long horizons have the growth and dividend reinvestment option. Though both growth and dividend reinvestment sound similar, they are actually different.

1.Dividend payment plan: In this type of plan, dividends are paid out of the distributable surplus of the funds. Here dividends declared are actually paid out to the investors. Some key features of dividend plans are:

- As per SEBI regulations, dividends are to be paid out from the accumulated profits of the scheme.
- There is no assurance about dividend pay-out rate or timing of dividend payments.
- The dividend paid to investors is adjusted from the scheme NAV. Therefore, investor will see a drop in NAV (ex-dividend NAV) of scheme after receipt of dividend.

2. Dividend Reinvestment plan: Under dividend reinvest plan, the dividend declared is used to buy additional units to the investors. The dividend reinvestment option is quite different. Dividends that would otherwise be paid out to investors in the fund are used to purchase more shares in the fund. Again, cash is not paid out to the investor when dividends are paid on the stocks in the fund. Instead, cash is automatically used by the fund's administrators to buy more fund units on behalf of the investors and transfer them to individual investors accounts In a dividend re-investment option, the unit balance goes up but at the same time the NAV falls by the amount of dividend declared.

3. Growth Plan: These schemes are appropriate for investors who are looking for capital appreciation in the long run. The growth option on a mutual fund means that an investor in the fund will not receive any dividends that may be paid out by the stocks in the mutual fund. Some shares pay regular dividends, but by selecting a growth option, the mutual fund holder is allowing the fund company to reinvest the money it would otherwise payout to the investor in the form of a dividend. This money increases the net asset value (NAV) of the mutual fund.

The growth option is not a good one for the investor who wishes to receive regular cash payouts from their investments. However, it's a way to maximize the fund's NAV and, upon the sale of the mutual funds, realize a higher capital gain on the same number of shares they originally purchased. This is because all dividends that would have been paid out have been used by the fund company to invest in more stocks and grow clients' money. In this case, the investor does not receive more shares, but their shares of the fund increase in value.

MUTUAL FUND EVALUATION MEASURES

The important measures of performance of mutual fund portfolio are derived independently by **Sharpe, Jensen and Treynor**. All these three ratios are based on the assumption that

(1) All investors are averse to risk, and are single period expected utility of terminal wealth maximizers.

(2) All investors have identical decision horizons and homogeneous expectations regarding investment opportunities.

(3) All investors are able to choose among portfolios solely on the basis of expected returns and variance of returns.

(4) All trans-actions costs and taxes are zero.

(5) All assets are infinitely divisible.

Sharpe Ratio

A ratio developed by Nobel Laureate William F. Sharpe to measure risk-adjusted performance. It is calculated by subtracting the risk-free rate from the rate of return for portfolio and dividing the result by the standard deviation of the portfolio returns. The Sharpe ratio tells us whether the returns of a portfolio are due to smart investment decisions or a result of excess risk. This measurement is very useful because although one portfolio or fund can reap higher returns than its peers, it is only a good investment if those higher returns do not come with too much additional risk. The greater a portfolio's Sharpe ratio, the better its risk adjusted performance has been. One approach is to calculate portfolio's return in excess of the risk free return and divide the excess return by the portfolio's standard deviation. This risk adjusted return is called 'Sharpe Ratio". This ratio measures reward to variability. A fund with higher Sharpe ratio in relation to another is preferable as it indicates that the fund has higher risk premium for every unit of standard deviation risk. Because Sharpe ratio adjusts return to the total portfolio risk, the implicit assumption of the Sharpe measure is that the portfolio will not be combined with any other risky portfolios.

$$\text{Sharpe Ratio} = \frac{\text{Average return of portfolio} - \text{Average risk free return}}{\text{Standard deviation of portfolio}}$$

The Sharpe ratio is used to characterize how well the return of an asset compensates the investor for the risk taken. When comparing two assets each with the expected return E[R] against the same benchmark with return Rf, the asset with the higher Sharpe ratio gives more return for the same risk. Investors are often advised to pick investments with high Sharpe ratios. However like any mathematical model it relies on the data being correct. Pyramid schemes with a long duration of operation would typically provide a high Sharpe ratio when derived from reported returns but the inputs are false. When examining the investment performance of assets with smoothing of returns (such as With profits funds) the Sharpe ratio should be derived from the performance of the underlying assets rather than the fund returns. The Sharpe ratio has as its principal advantage that it is directly computable from any observed series of returns without need for additional information surrounding the source of profitability. Unfortunately, some authors are carelessly drawn to refer to the ratio as giving the level of 'risk adjusted returns' when the ratio gives only the volatility of adjusted returns when interpreted properly. Other ratios such as the Bias ratio (finance) have recently been introduced into the literature to handle cases where the observed volatility may be an especially poor proxy for the risk inherent in a time-series of observed returns.

Treynor Ratio

A ratio developed by Jack Treynor that measures returns earned in excess of that which could have been earned on a riskless investment per each unit of market risk. The Treynor ratio is a measurement of the returns earned in excess of that which could have been earned on a riskless investment (i.e. Treasury Bill) (per each unit of market risk assumed). The Treynor ratio (sometimes called reward-to-volatility ratio) relates excess return over the risk-free rate to the additional risk taken; however systematic risk instead of total risk is used. The higher the Treynor ratio, the better the performance. The Treynor measure adjusts excess return for systematic risk. It is computed by dividing a portfolio's excess return by its beta as shown in equation. This ratio indicates return per unit of systematic risk, it is a valid performance criterion when one wishes to evaluation a portfolio in combination with the benchmark portfolio and other actively managed portfolios.

$$\text{Treynor Ratio} = \frac{\text{Average return of portfolio - Average risk free return}}{\text{Beta of portfolio}}$$

$$Treynor\ Ratio = \frac{r_p - r_f}{\beta_p}$$

Treynor ratio (T) does not quantify the value added, if any, of active portfolio management. It is a ranking criterion only. A ranking of portfolios based on the Treynor Ratio is only useful if the portfolios under consideration are sub-portfolios of a broader, fully diversified portfolio. If this is not the case, portfolios with identical systematic risk, but different total risk, will be rated the same. But the portfolio with a higher total risk is less diversified and therefore has a higher unsystematic risk which is not priced in the market.

Jensen Ratio

Like the previous performance measures discussed, the Jensen measure is also based on CAPM. Named after its creator, Michael C. Jensen. The Jensen measure is also suitable for evaluating a portfolio's performance in combination with other portfolios because it is based on systematic risk rather than total risk. The Jensen measure or alpha is usually very close to zero. A positive alpha means that return tends to be higher than expected given the beta statistic. Conversely, a negative alpha indicates that the fund is an under performer. Alpha measures the value-added of the portfolio given its level of systematic risk.

$$JR = \frac{\alpha}{\beta} = \frac{\text{Alpha}}{\text{Beta}}$$

Alpha is a coefficient that is proportional to the excess return of a portfolio over its required return, or its expected return, for its expected risk as measured by its beta. Hence, alpha is determined by the fundamental values of the companies in the portfolio in contrast to beta, which measures the portfolio's return due to its volatility.

Jensen's Alpha = Rp – Rf + [β * (rm – rf)]

Jensen's Alpha = Total Portfolio Return - Risk-Free Rate - [Portfolio Beta x (Market Return - Risk-Free Rate)]