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A Study of Mutual Funds in India

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Abstract

Mutual Fund is a mechanism of pooling together the savings of a large number of small investors for collective investment with the common objective of providing attractive yields and capital appreciation, safety of holdings and liquidity as the primary parameters. The money thus collected is then invested in capital market instruments such as shares, bonds, money market instruments and/or other securities. The proposed study to describe the concept, history, types and mutual fund asset class in India. In the conclusion mainly there are three types of mutual funds are available in India which are Open-ended funds, Close-ended funds and Interval funds. On the basis of Asset Class Mutual Funds, mutual funds are Equity funds, Debt mutual funds, Hybrid mutual funds, Solution-oriented mutual funds and Other mutual funds and on the basis of investment goals mutual funds can be classifies as growth mutual funds, Tax-saving mutual Funds (ELSS), Liquidity-based mutual funds, Capital protection mutual funds, Fixed-maturity mutual funds and Pension mutual Funds

Introduction

The rising inflation rate has made investing an essential part of wealth creation. It helps us achieve our financial goals and secure our financial future. Exploring investment opportunities is quite relevant in the present day situation. In today's scenario economic environment has turned out to be quite critical, sensitive and dynamic in nature. An investment turns out to be good only when you have made an investment in the right type of security and at the right time. Returns on these securities provide is dependent on multiple factors to name few-risk associated with the security, duration of investment, investors' behaviour, government policies etc. Investor should understand his/her risk appetite before investing into any kind of security. Mutual funds are treated as a vehicle of investment, which is suitable for the all-age groups of investors who want to take good return from their investment and are ready to bear risk.

Review of Literature

Zaheeruddin, Sivakumar & Reddy (2013) analyzed the performance of three mutual funds from the financial services sector. They considered HDFC Mutual Fund, Birla Sunlife Mutual Fund and ICICI Prudential Mutual Fund for the purpose during the period July 2009 to April 2012 .They concluded that ICICI Prudential Mutual Fund performed better under Sharpe, Treynor and Jensen measures than HDFC and Birla Sunlife Mutual Fund.

Jain (2012) made a study of 45 equity based mutual fund schemes offered by 2 public sector companies and 2 private sector companies in India during the period April 1997 to April 2012 on the basis of risk-return analysis. The study concluded 25 that the private sector mutual funds performed better than the public sector mutual funds during the study period.

Joshi (2010) analyzed the various issues on risk management in mutual funds and suggested methods of effective risk management in mutual funds.

Saini.et.al (2011), has outlined that mostly the investors have positive approach towards investing in mutual funds. In order to maintain their confidence in mutual funds they should be provided with timely information relating to different trends in the mutual fund industry. For achieving heights in the financial sector, the mutual fund companies should formulate the strategies in such a way that helps in fulfilling the investors' expectations.

Agarwal (2007), examine there has been a tremendous growth in the mutual fund industry in India, attracting large investments not only from the domestic investments but also from the foreign investors. Increasing number of Asset based Management Companies providing opportunity to the investors in the form of safety, hedging and arbitrage. With the growing middle-class household families with limited risk bearing capacity, it provides better returns than any other long-term securities. India's high rate of savings and a rapid-liberalizing economy is expected to elevate the mutual fund sector to new hikes.

Shanmugham (2000), conducted a survey of 201 individual investors to study the information sourcing by investors, their perceptions of various investment strategy dimensions and the factors motivating share investment decisions, and reports that among the various factors, psychological and sociological factors dominate the economic factors in investment decisions. In his study "Are Retail Investors Better off Today?" Black (2004) observed that in recent years, investors' attitudes towards the securities industry plummeted, in reaction to both the conflicted research and the mutual fund scandals. He concluded that the most optimistic assessment is that the SEC has plenty of unfinished business to attend to.

Lynch and Musto(2003) were of the opinion that this decade will belong to mutual funds because the ordinary investor does not have the time, experience and patience to take independent investment decision on his own.

SatyaSwaroop (2009) evaluated the performance of 23 equity based mutual funds during the period April 1996 to March 2009. He used the Sharpe ratio, Treynor ratio and Jensen measure in his study and concluded that in the public sector UTI mutual fund schemes and in the private sector Franklin Templeton schemes outperformed the market.

Pathak (2008) mentioned that the number of different types of mutual fund schemes has increased from 394 in 2000-01 to 788 in 2006-07 and concluded that the mutual fund industry is slowly catching the fancy of retail investors in India.

Sankaran (2008) studied the growth and future prospects of mutual fund industry in India. The study also examined the regulatory framework of mutual funds in India and pointed out that regulations should be strengthened for ensuring better service to the investors.

Objectives

The proposed study to describe the concept, history, types and mutual fund asset class in India.

Research Methodology

This study is based on secondary data and data have been collected from the Books, Journals, magazines, news papers, shodhganga, shodh gangotri various libraries and bank has also been visited to collect the data and to develop an overview of the paper regarding the mutual funds in India.

Discussion and Results

Concept of Mutual Funds

Mutual Fund is a mechanism of pooling together the savings of a large number of small investors for collective investment with the common objective of providing attractive yields and capital appreciation, safety of holdings and liquidity as the primary parameters. The money thus collected is then invested in capital market instruments such as shares, bonds, money market instruments and/or other securities. The income earned on these investments and capital appreciation is shared among its unit holders in the proportion of the number of units held by them.

Mutual funds are dynamic financial institutions which play a pivotal role in an economic growth and development. They mobilize the savings of small investors and invest it in the stock market. Mutual fund is a basket of securities, which contain variety of financial products in various combinations, optimising the risk appetite and return expectation of the investors. The various combination of financial securities individually is called portfolio's. These portfolio's are being managed by a fund manager, who's role is to continuously analyse the market risk and expected returns. So that positive returns can be provided to the investors.

Types of Investment Options

1. **FIXED DEPOSITS:** They considered as the safest investment option available to the investors. An investor can park their idle money in fixed deposits and can earn interest on it. It promotes habit of savings among individuals. Its act as a boon for the risk averse investors. The rate of interest to be paid on the deposits is pre decided by the banks.
2. **BONDS:** A bond is a debt instrument which reflects a loan given by an investor to a company or the government. Bonds carry a fixed rate of interest which issuer of the bond will pay to the investors of the instrument.
3. **STOCKS:** They are considered as a growth oriented investments. Although stocks yield high returns to the investors but the risk associated with the securities is also high. Returns are highly volatile in nature and depends on market conditions.
4. **REAL ESTATE INVESTMENT:** It involves the purchase, sale, management or rental of real estate for the purpose of earning profit. Real estate investment is considered very attractive source of investment in India. These investments are highly illiquid in nature and require large sum of money. Duration and market conditions also play a significant role in investment decision making.
5. **MUTUAL FUND INVESTMENT:** Mutual funds are considered as a safe investment option through which an investor can diversify their investment in multiple stocks with minimal risk. They are considered a good option for the prudent investors who have low risk appetite.
6. **GOLD:** From decades gold has been considered as the person's first choice for investment. It is considered as the safest of all and provide liquidity to the investors as well. Not only individual, government bodies , banks, financial intermediaries show their confidence in the gold for the purpose of investment.

History of Mutual Funds

The concept of mutual fund is not new to us. We can trace out its origin back from the 18th century in Egypt. Another origin of mutual fund was identified in the year 1822, when Netherlands' King William established "societe generale de belique", at Brussells. The purpose behind such mechanism was to provide hassle free foreign loans to government. The foundation of modern concept of mutual funds industry known to us was laid in London in the year 1868, followed by the United States of America and other European countries in the early 20th century.

In India mutual funds initiated in the year 1964, with the establishment of Unit Trust of India. UTI was governed under Unit Trust of India Act, 1963. In the year 1964 UTI launched its Unit Scheme. Gradually mutual funds started becoming popular and gained momentum in early 1980's. in the year 1987, government opened the mutual fund sector for the insurance companies like Life Insurance company, General Insurance company and six other public sector banks. In 1993 SEBI legalized this system and formed mutual fund framework to run and govern the Indian mutual sector.

Overall journey of Indian mutual fund industry can be classified into five phases:

- **Phase of Inception (1964-87):** The first phase noticed the emergence of the Unit Trust of India (UTI). It started off as collaboration between the Reserve bank of India and the Government of India, though the latter was soon delinked from the day to day functioning of the Unit Trust of India by an act of parliament. UTI launched Unit Insurance Linked Plan in the year 1971. In 1978, RBI separated from UTI and all the administrative functioning was taken care by Industrial Development Bank of India (IDBI). The collaborative efforts of UTI and IDBI led to shaping up of the Indian mutual fund sector. This helped in gearing up Indian financial sector and Indian economy as a whole.
- **Entry of Public Sector (1987-1993):** Due to their continuous efforts, government gradually allowed Indian public sector banks to enter the Indian mutual fund sector. State

Bank of India (SBI) made itself the first non UTI Asset Management fund provider in India. SBI's success encouraged other banks and insurance giants like Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC) to enter the mutual fund market with their respective offerings.

- **Entry Private Sector Phase (1993-1996):** It is considered a path breaking period for the Indian economy. India underwent major reforms under the efficient leadership of Dr. Man Mohan Singh (Finance Minister of India). Indian economy got liberalised under LPG model. The reforms gave open path way to private firm in the mutual fund sector. The reforms lured various multinational firms and private companies towards Indian mutual funds industry. To name few leading AMC's in private sectors were:
  - ICICI Prudential
  - HDFC Mutual Fund
  - Kotak Mahindra Mutual Fund
- **Phase of Consolidation (February 2003 – April 2014):** In 2003, the Unit Trust of India split into two separate entities- the UTI Mutual Fund and the Specified Undertaking of the Unit Trust of India (SUUTI). This bifurcation and numerous mergers among different private sector entities led the mutual fund industry to take a step towards the phase of consolidation. In 2009, the world was hit by the global economic recession. The recession made the investors hesitant in investing in mutual funds. No investments in were made for two years in mutual fund which gradually led to abolition of entry load by SBI.
- **Phase of Steady Development and Growth (Since May 2014):** To bring more transparency and security among the various mutual fund stakeholders, SEBI took various measures in September 2012. With this, the Indian mutual fund sector was reorganized with the various initiatives taken by SEBI. With the arrival of new government in centre, there was increase in mutual fund investment. With efforts of SEBI, mutual fund players, and government, other agencies, investors started shifting their savings from gold, land, bonds, and silver to mutual fund. Compared to global level, still the Indian mutual fund market is very small. There are enormous opportunities available in Indian mutual fund markets. With the efforts from government and AMFI, the Indian mutual fund market is going in right directions.

Indian mutual fund industry has witnessed a decent growth rate, but when we compare it with the developed nations we can say that there is lot of scope and tremendous opportunity lying ahead.

Types of Mutual Funds

Structure of Mutual Funds

Based on the ease of investment, mutual funds can be:

- **Open-ended funds:** Such funds do not limit when or how many units can be purchased. Investors can enter or exit throughout the year at the current net asset value. Open-ended funds are ideal for investors seeking liquidity.
- **Close-ended funds:** These funds have a pre-decided unit capital amount and also allow purchase only during a specified period. Here, redemption is bound by the maturity date. However, to facilitate liquidity, schemes trade on stock exchanges.
- **Interval funds:** A cross between open-ended and close-ended funds, interval mutual funds permit transactions at specific periods. Investors can choose to purchase or redeem their units when the trading window opens up.

Mutual Fund Asset Class

Depending on the assets they invest in, mutual funds are categorized under:

- **Equity funds:** Equity funds invest money in company shares, and their returns depend on how the stock market performs. Though these funds can give high returns, they are also considered risky. They can be categorized further based on their features, like Large-Cap Funds, Mid-Cap Funds, Small-Cap Funds, Focused Funds, or ELSS, among others. Invest in equity funds if you have a long-term horizon and a high-risk appetite.

- **Debt funds:** Debt funds invest money into fixed-income securities such as corporate bonds, government securities, and treasury bills. Debt funds can offer stability and a regular income with relatively minimum risk. These schemes can be split further into categories based on duration, like low-duration funds, liquid funds, overnight funds, credit risk funds, gilt funds, among others.
- **Hybrid funds:** Hybrid funds invest in both debt and equity instruments so as to balance out debt and equity. The ratio of investment can be fixed or varied, depending on the fund house. The broad types of hybrid funds are balanced or aggressive funds. There are multi asset allocation funds which invest in at least 3 asset classes.
- **Solution-oriented funds:** These mutual fund schemes are for specific goals like building funds for children's education or marriage, or for your own retirement. They come with a lock-in period of at least five years.
- **Other funds:** Index funds invest based on certain stock indices and fund of funds are categorized under this head.

Mutual Funds based on Investment Goals

You can also choose a fund based on your financial objective:

- **Growth funds:** Funds that invest primarily in high-performing stocks with the aim of capital appreciation are considered growth funds. These funds can be an attractive option for investors seeking high returns over a long period.
- **Tax-saving Funds (ELSS):** Equity-linked saving schemes are mutual funds that invest mostly in company securities. However, they qualify for tax deductions under Section 80C of the Income Tax Act. They have a minimum investment horizon of three years.
- **Liquidity-based funds:** Some funds can be categorized based on how liquid the investments are. Ultra-short-term and liquid funds, are ideal for short-term goals, while schemes like retirement funds have longer lock-in periods.
- **Capital protection funds:** These funds invest partially in fixed income instruments and the rest into equities. This could ensure capital protection, i.e., minimal loss, if any. However, returns are taxable.
- **Fixed-maturity funds (FMF):** These funds route money into debt market instruments, which have either the same or a similar maturity period as the fund itself. For instance, a three-year FMF will invest in securities with a maturity of three years or lower.
- **Pension Funds:** Pension funds invest with the idea of providing regular returns after a long period of investment. They are usually hybrid funds that give low but have potential to provide steady returns in future.

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