

Mutual Funds

Lecture-2

2.1 History and Growth of Mutual Fund Industry

Growth of Mutual Fund

The Mutual Fund industry in India started in 1963 with the formation of Unit Trust of India at the initiative of the Government of India and Reserve Bank. The primary objective at that time was to attract small investors and it was made possible through the collective efforts of the Government of India and Reserve Bank of India. The history of Mutual Fund in India can be divided into five Phases.

Phase I: Establishment and growth of Unit trust of India 1964-1987

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and it continued to operate under the regulatory control of the RBI until the two were delinked in 1978 and the entire control was transferred in the hands of Industrial Development Bank of India. (IDBI). UTI launched its first scheme in 1964 named as Unit Scheme 1964 (US-64) which attracted the largest number of investors in any single investment scheme over the years. UTI launched more innovative schemes in 1970's and 80's to suit the need of different investors. By the end of 1987, UTI had launched 20 schemes mobilizing net resources amounting to Rs.4564.0 crores. For these 23 long years up to 1964-87, UTI enjoyed complete monopoly.

Phase II: Entry of public sector Funds (1987-1993)

It was in 1986 that the Government of India amended banking regulations and allowed commercial banks in the public sector to set up Mutual Funds. This led to promotion of "SBI Mutual Fund" by State Bank of India in July 1987 followed by Canara Bank, Indian Bank, Bank of Baroda, Bank of India, Punjab National Bank, and GIC Mutual Fund.

The Government of India further granted permission to Insurance corporations in the public sector to float Mutual Funds. The year 1987 marked the entry of non - UTI, public sector Mutual Fund set up by public sector bank, Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). The period of 1987 – 1993 can be termed as the period of public sector Mutual Funds. From a single player in 1985, the number increased to 8 players in 1993.

Phase III: Emergence of private sector funds (1993 – 1996)

The permission was given to the private sector funds including foreign funds management companies (most of them entering through joint venture with Indian promoter) to enter the Mutual Fund industry in 1993. With the entry of private sector funds in 1993, a new era started in Indian Mutual Fund industry, giving the Indian investors a wider choice of fund and therefore giving rise to more competition in the industry. Private funds introduced innovative products, investment techniques and investors servicing technology.

Phase IV: Growth and SEBI Regulation (1996 – 2004)

The Mutual Fund industry witnessed robust growth and strict regulations from SEBI after 1996. The mobilization of funds and the number of players operating in the industry reached new heights as investors started showing more interest in Mutual Funds. Investors' interests were safe guarded by SEBI and the government offered tax benefit to the investors. In order to encourage them, SEBI (Mutual Funds) Regulations 1996 was introduced by SEBI that set uniform standards.

Phase V: Growth and Consolidation (2004 onwards)

The industry witnessed several mergers and acquisition. Recent examples of which are acquisition of schemes of Alliance Mutual Fund by Birla Sun Life, etc. Simultaneously more international Mutual Fund players entered India like Fidelity, Franklin Templeton Mutual Fund etc. Active participation of the retail investor will further boost the Mutual Fund industry in India. Today the industry is pre – dominantly urban and to some extent semi – urban. Mutual Fund industry must tap the huge untapped potential in the country.

2.2 Types of Mutual Fund Schemes

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

Based on Structure:

1. Open-ended Funds

An open-ended fund is one that is available for subscription all through the year. These do not have a fixed maturity. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices. The key feature of open-end schemes is liquidity.

2. Closed-ended Funds

A closed-ended fund has a stipulated maturity period which generally ranges from three to fifteen years. The fund is open for subscription only during a specified period. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where they are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the Mutual Fund through periodic repurchase at NAV related prices.

3. Interval Funds

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

Based on Investment Objective:

• Growth Funds

The aim of growth funds is to provide capital appreciation over medium to long- term. Such schemes normally invest a majority of their corpus in equities. Growth schemes are ideal for investors having a long-term outlook seeking growth over a period of time.

• Income Funds

The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures and Government securities. Income Funds are ideal for capital stability and regular income.

- **Balanced Funds**

The aim of balanced funds is to provide both growth and regular income. Such schemes periodically distribute a part of their earning and invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are ideal for investors looking for a combination of income and moderate growth.

- **Money Market Funds**

The aim of money market funds is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money.

Others:

- **Tax Saving Schemes**

These schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues.

- **Sector Specific**

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

- **Index Funds**

Index Funds attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE.

- **Exchange Traded Funds**

Exchange Traded Funds, (ETF) just like their index fund counterparts, also track indexes. The difference is that the stocks of individual companies that comprise a given index are bundled into an equity-like investment vehicle that is traded on an exchange, exactly like a stock. Because they are traded on an exchange and share many of the attributes of individual equities, ETFs can also be shorted and offer underlying options as an investment opportunity.