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Mutual Fund In India: A Financial Service In Capital Market

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ABSTRACT

The Indian capital market has been increasing tremendously during last few years. With the reforms of economy, reforms of industrial policy, reforms of public sector and reforms of financial sector, the economy has been opened up and many developments have been taking place in the Indian money market and capital market. In order to help the small investors, mutual fund industry has come to occupy an important place. The main objective of this paper is to examine the importance and growth of mutual funds and evaluate the operations of mutual funds and suggest some measures to make it a successful scheme in India.

INTRODUCTION

According to Shakespeare 'out of this nettle, danger, we pluck this flower, safety'. The economic development model adopted by India in the post-independence era has been characterized by mixed economy with the public sector playing a dominating role and the activities in private industrial sector control measures emaciated from time to time. The industrial policy resolution was introduced by the government in the 1948, immediately after the independence. This outlined the approach to industrial growth and development. The industrial policy statement of 1980 focussed attention on the need for promoting competition in the domestic market, technological upgradation and modernisation. A number of policy and procedural changes were introduced in 1985 and 1986, aimed at increasing productivity, reducing costs, improving quality, opening domestic market to increase competition and making free the public sector from constraints. Overall, in the seventh plan period (1985-86 to 1989-90), Indian industries grew by an impressive average annual rate of 8.5 percent. The last two decades have seen a phenomenal expansion in the geographical coverage and financial spread of our financial system. The spread of the banking system has been a major factor in promoting financial intermediation in the economy and in the growth of financial savings. With progressive liberalization of economic policies, there has been a rapid growth of capital market, money market and financial services industry including merchant banking, leasing and venture capital. Consistent with this evolution of the financial sector,

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the mutual fund industry has also come to occupy an important place.

Origin

Mutual funds go back to the times of the Egyptians and Phonenicians when they sold shares in caravans and vessels to spread the risk of these ventures. The foreign and colonial government Trust of London of 1868 is considered to be the fore-runner of the modern concept of mutual funds. The USA is, however, considered to be the mecca of modern mutual funds. By the early - 1930s quite a large number of close - ended mutual funds were in operation in the U.S.A. Much latter in 1954, the committee on finance for the private sector recommended mobilisation of savings of the middle class investors through unit trusts. Finally in July 1964, the concept took root in India when Unit Trust of India was set up with the twin objective of mobilising household savings and investing the funds in the capital market for industrial growth. Household sector accounted for about 80 percent of nation's savings and only about one third of such savings was available to the corporate sector, It was felt that UTI could be an effective vehicle for channelising progressively larger shares of household savings to productive investments in the corporate sector. The process of economic liberalization in the eighties not only brought in dramatic changes in the environment for Indian industries, Corporate sector and the capital market but also led to the emergence of demand for newer financial services such as issue management, corporate counselling, capital restructuring and loan syndication. After two decades of UTI monopoly, recently some other public sector organisations like LIC (1989), GIC (1991), SBI (1987), Can Bank (1987), Indian Bank (1990), Bank of India (1990), Punjab National Bank (1990) have been permitted to set up mutual funds. Mr. M.R. Mayya the Executive Director of Bombay Stock Exchange opined recently that the decade of nineties will belong to mutual funds because the ordinary investor does not have the time, experience and patience to take independent investment decisions on his own.

Importance of Mutual Fund

Small investors face a lot of problems in the sharemarket, limited resources, lack of professional advice, lack of information etc. Mutual funds have come as a much needed help to these investors. It is a special type of institutional device or an investment vehicle through which the investors pool their savings which are to be invested under the guidance of a team of experts in wide variety of portfolio's of Corporate securities in such a way, so as to minimise risk, while ensuring safety and steady return on investment. It forms an important part of the capital market, providing the benefits of a diversified portfolio and expert fund management to a large number, particularly small investors. Now a days, mutual fund is gaining its popularity due to the following reasons :

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

2. An ordinary investor who applies for share in a public issue of any company is not assured of any firm allotment. But mutual funds who subscribe to the capital issue made by companies get firm allotment of shares. Mutual fund latter sell these shares in the same market and to the Promoters of the company at a much higher price. Hence, mutual fund creates the investors confidence.

3. The phyche of the typical Indian investor has been summed up by Mr. S.A. Dave, Chairman of UTI, in three words; Yield, Liquidity and Security. The mutual funds, being set up in the public sector, have given the impression of being as safe a conduit for investment as bank deposits. Besides, the assured returns promised by them have investors had great appeal for the typical Indian investor.

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

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

6. The mutual fund operation provides a reasonable protection to investors. Besides, presently all Schemes of mutual funds provide tax relief under Section 80 L of the Income Tax Act and in addition, some schemes provide tax relief under Section 88 of the Income Tax Act lead to the growth of importance of mutual fund in the minds of the investors.

7. As mutual funds creates awareness among urban and rural middle class people about the benefits of investment in capital market, through profitable and safe avenues, mutual fund could be able to make up a large amount of the surplus funds available with these people.

8. The mutual fund attracts foreign capital flow in the country and secure profitable investment avenues abroad for domestic savings through the opening of off shore funds in various foreign investors. Lastly another notable thing is that mutual funds are controlled and regulated by S E B I and hence are considered safe. Due to all these benefits the importance of mutual fund has been increasing.

Schemes of Mutual Fund

Within a short span of four to five years mutual fund operation has become an integral part of the Indian financial scene and is poised for rapid growth in the near future. Today, there are eight mutual funds operating various schemes tailored to meet the diversified needs of savers. UTI has been able to register phenomenal growth in the mid eighties. Now there are 121 mutual fund schemes are launched in India including UTI's scheme attracting over Rs. 45,000 Crores from more than 3 Crore investor's accounts Out of this closed-end scheme are offered by mutual fund of India to issue shares for a limited period which are traded like any other security as the period and target amounts are definite under such security as the period and target amounts are definite under such schemes. Besides open-end schemes are lunched by mutual fund under which unlimited shares are issued by investors but these shares are not traded by any stock exchange. However, liquidity is provided by this scheme to the investors. In addition to this off shore mutual funds have been launched by foreign banks, some Indian banks, like SBI, Canara Bank etc, and UTI to facilitate movement of capital from cash-rich countries to potentially high growth economics. Mutual funds established by leading public sector banks since 1987-SBIMF, Can Bank, Ind Bank, PNBMF and BOIMF, emerged since 1987-SBIMFo, as major players by offering bond like products with assurance of higher yields. The latest schemes of BOI mutual fund goes to the extent of allowing each individual investor to choose the date for receiving the income. Besides the bank mutual funds have also floated a few open-ended schemes, pure growth schemes and tax saving schemes. The LIC, GIC mutual funds offer insurance linked product providing various types of life and general insurance benefits to the investors. Also the income growth oriented schemes are operated by mutual fund to cater to an investor's needs for regular incomes and hence, it distributes dividend at intervals.

Growth Trend of Mutual Fund

Opening of the mutual fund industry to the public sector banks and insurance companies, led to the launching of more and more of new schemes. The mutual fund industry in India has grown fast in the recent period. The performance is encouraging especially because the emphasis in India has been on individual investors rather in contrast to advanced countries where mutual funds depend largely on institutional investors, In general, it appears that the mutual fund in India have given a good account of themselves so far. UTI's annual sale of units crossed Rs.1000 crores mark in 1986 to 87, 2000 crores mark in 1987-88 and reached Rs.5500 crores mark in 1989 to 90. During 1990 to 91 on account of decline of corporate interest,, sales declined to Rs.4100 crores though individual sales increased over its preceeding year. LICMF has concentrated on funds which includes life and accident cover. GICMF provide home insurance policy. The bank sponsored mutual fund floated regular income, growth and tax incentives schemes. Together the eight mutual fund service more than 15 million investors with UTI alone holds for 13 million unit holding accounts. Magnum Regular Income Scheme 1987 assured a return of 12 percent but gave 20 percent dividend in 1993, UTI record 26 percent dividend for 1992 to 93 under the unit 1964 scheme. Magnum Tax saving scheme 1988 to 89 did not promise any return but declared 14 percent dividend in 1993 and recorded a capital appreciation of 15 percent in the first year. Equity oriented scheme have earned attractive returns. Especially since early 1991 there has been a steady increase in the number of equity oriented growth funds. With the boom of June 1990 and then again 1991 due to the implementation of new economic policies towards structure of change the price of securities in stock market appreciated considerably. The high rate of growth in equity price led to a high rate of appreciation in the net asset value of the equity oriented funds for which investors started changing their preferences from fixed income funds to growth oriented or unfixed income funds. That is why more equity oriented mutual funds were launched in 1991. Master share provide a respective dividend of 18 per cent in 1993, Can share earned a dividend of 15 percent in 1993. In general the Unit Trust of India which manages over 28,000 crore under various schemes has for its service an excellent reputation.

Short Commings in Operation of Mutual Fund

The mutual fund has been operating for the last five to six years. Thus, it is too early to evaluate its operations. However one should not lose sight to the fact that the formation years of any institution is very important to evaluate as they could be able to know the good or bad systems get evolved around this time. Following are some of the shortcomings in operation of mutual fund.

1. The mutual funds are externally managed. They do not have employees of their own. Also there is no specific law to supervise the mutual funds in India. There are multiple regulations. While UTI is governed by its own regulations, the banks are supervised by Reserved Bank of India, the Central Government and insurance company mutual regulations funds are regulated by Central Government

2. At present, the investors in India prefer to invest in mutual fund as a substitute of fixed deposits in Banks, About 75 percent of the investors are not willing to invest in mutual funds unless there was a promise of a minimum return,

3. 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 organisations had taken care of this need.

4. Unrestrained fund rising by schemes without adequate supply of scrips can create severe imbalance in the market and exacerbate the distortions

5. Many small companies did very well last year, by schemes without adequate imbalance in the market but mutual funds can not reap their benefits because they are not allowed to invest in smaller companies. Not only this, a mutual fund is allowed to hold only a fixed maximum percentage of shares in a particular industry.

6. The mutual fund in India are formed as trusts. As there is no distinction made between sponsors, trustees and fund managers, the trustees play the roll of fund managers.
7. The increase in the number of mutual funds and various schemes have increased competition. Hence it has been remarked by Senior Broker "mutual funds are too busy trying to race against each other". As a result they lose their stabilising factor in the market.
8. While UTI publishes details of accounts their investments but mutual funds have not published any profit and loss Account and balance sheet even after its operation.
9. The mutual fund have eroded the financial clout of institution in the stock market for which cross transaction between mutual funds and financial institutions are not only allowing speculators to manipulate price but also providing cash leading to the distortion of balanced growth of market.
10. As the mutual fund is very poor in standard of efficiency in investors service; such as despatch of certificates, repurchase and attending to inquiries lead to the detoriation of interest of the investors towards mutual fund.
11. 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. But investors are deprived of getting the information.

Future Outlook and Suggestion

As mutual fund has entered into the Indian Capital market, growing profitable enough to attract competitors into this cherished territory encouraging competition among all the mutual fund operators, there is need to take some strategy to bring more confidence among investors for which mutual fund would be able to project the image successfully. The followings are some of the suggestions. As there is no comprehensive law to regulate the mutual fund in India, uniform coordinated regulations by a single agency would be formed which would provide the shelter to the investors. Secondly, as the investors are not willing to invest in mutual fund unless a minimum return is assured, it is very essential to create in the mind of the investors that mutual funds are market instruments and associated with market risk hence mutual fund could not offer guaranteed income. Thirdly, all the mutual funds are operated in the public sector. Hence private sector may be allowed to float mutual funds, intensifying competition in this industry. Fourthly, due to operations of many mutual fund, there will be need for appropriate guidelines for self-regulation in respect of publicity/advertisement and inter-scheme transactions within each mutual fund. Fifthly, the growth of mutual fund tends to increase the shareholdings in good companies, give rise the fear of destabilising among industrial group, hence introduction of nonvoting shares and lowering the debt-equity ratio help to remove these apprehension. Sixthly, as there is no distinction between trustees, sponsors and fund managers, it is necessary to regulate frame work for a clear demarcation between the role of constituents, such as shelter, trustee and fund manager to protect the interest of the small investors. Seventhly, steps should be taken for funds to make fair and truthful disclosures of information to the investors, so that subscribers know what risk they are taking by investing in fund. Eighthly, infrastructure bottlenecks will have to be removed and banking and postal systems will have to be taken place for growth of mutual funds. Ninethly, mutual funds need to take advantage of modern technology like computer and tele-communications to render service to the investors. Lastly, mutual funds are made by investors and investors interest ought to be paramount by setting standard of behaviours and efficiency through self-regularisations and professionalism.

Conclusion

With the structural liberalisation policies no doubt Indian economy is likely to return to a high grow path in few years. Hence mutual fund organisations are needed to upgrade their skills and technology. Success of mutual fund however would bright depending upon the implementation of suggestions.

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