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“A STUDY ON MUTUAL FUNDS IN INDIA”

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A STUDY ON MUTUAL FUNDS IN INDIA

ABSTRACT

This paper focus on the entire journey of mutual fund industry in India. Its origin, its fall and rise through out all these years and tried to predict what the future may hold for the Mutual Fund Investors in the long run. A mutual fund, also called an investment company, is an investment vehicle which pools the money of many investors. The fund's manager uses the money collected to purchase securities such as stocks and bonds. The securities purchased are referred to as the fund's portfolio. Restrictions on competing products may have acted as a catalyst for the development of money market and (short-term) bond funds. This study was conducted to analyze and compare the performance of different types of mutual funds in India and concluded that equity funds outperform income funds. This study further concludes that equity fund managers possess significant market timing ability and institutions funds managers are able to time their investments, but brokers operated funds did not show market timing ability. Further, it has been found empirically that fund managers are able to time their investments with the conditions in the market, and possesses significant timing ability.

Key words:
Mutual Fund Industry, India, Equity Fund, Money Market

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INTRODUCTION

A mutual fund is a managed group of owned securities of several corporations. These corporations receive dividends on the shares that they hold and realize capital gains or losses on their securities traded. Investors purchase shares in the mutual fund as if it was an individual security. After paying operating costs, the earnings (dividends, capital gains or loses) of the mutual fund are distributed to the investors, in proportion to the amount of money invested. Investors hope that a loss on one holding will be made up by a gain on another. Heeding the adage "Don't put all your eggs in one basket" the holders of mutual fund shares are able collectively to gain the advantage by diversifying their investments, which might be beyond their financial means individually. A mutual fund may be either an open-end or a closed-end fund. An open-end mutual fund does not have a set number of shares; it may be considered as a fluid capital stock. The number of shares changes as investors buys or sell their shares. Investors are able to buy and sell their shares of the company at any time for a market price.

HISTORY OF MUTUAL FUNDS

The modern mutual fund was first introduced in Belgium in 1822. This form of investment soon spread to Great Britain and France. Mutual funds became popular in the United States in the 1920s and continue to be popular since the 1930s, especially open-end mutual funds. Mutual funds experienced a period of tremendous growth after World War II, especially in the 1980s and 1990s. LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. 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 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. 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.

MUTUAL FUND PROSPECTUS

The prospectus is a legal document that includes information about the mutual fund. In this document you will find information about the terms of the offer, the issuer, and its objectives. In the aftermath of the 1929 stock market crash the federal government in the Securities Act of 1933 required security companies to publish a prospectus. At first glance a prospectus may seem overwhelming. The information in the prospectus is usually lengthy, packed with tables and graphs, and written in technical and legal language. This document is provided to help you make an informed investment decision before you invest in a mutual fund. **To gain the essential information you need, pay close attention the following key sections:** ***Investment Objective*****: A** short statement of the fund's investment objectives. Some funds intend to achieve short-term growth while others might focus on long-term stability. ***Investment Strategy:*** Exactly how the fund plans to accomplish the objectives. This section describes the types of assets that the fund purchases. ***Fees and Expenses:*** Although mutual funds aim to make money for their investors, their ultimate goal, just like any other business, is to make money for themselves. In order to do so, funds charge their shareholders a variety of fees and expenses, all of which must be documented in the prospectus. A table at the front of every prospectus contains a breakdown of the different fees and expenses, along with a hypothetical projection of how the fees would impact a $10,000 investment over a 10-year period. This enables you to compare fees and expenses across mutual funds. ***Account Information*****:** This section contains very basic information about how to buy and sell shares and other account-related information. In addition to telling you how to get your money into the fund, the prospectus will also tell you how to take it out of the fund. The prospectus will inform you which redemption methods are available to you.***Risks:*** The level of risk that the fund takes and the risks that are associated with the specific investments made by the fund are one of the most important sections in the prospectus.***Performance:*** Information about the fund's performance over the last 10 years is included. Investors should be aware that past performance is not necessarily an indicator of future results. As important is how well the fund has traditionally performed compared to an index, such as the S&P 500. A fund's performance is also related to the fund's volatility, dividend payments, and turnover.***Management***: The names the managers and some additional information about their experience and qualifications is reported. It can be helpful to know whether or not they have managed other funds in the past and their success or failure in order to get a sense of their past strategies and results.

MUTUAL FUND SHARE CLASSES

Morning Star is a generally accepted authority on divides most stocks into classes or types. The use eight type designations: ***Distressed, Hard Asset, Cyclical, Speculative Growth, Aggressive Growth, Classic Growth, Slow Growth and High Yield***. Each designation defines a broad category of investment characteristics. Stocks are assigned to a type based on objective financial criteria and Morning Star's proprietary algorithm, so stocks of the same type have similar economic fundamentals. ***Classes/Types Are:*** ***Distressed:*** These companies are having serious operating problems. This could mean declining cash flow, negative earnings, high debt, or some combination of these. Such "turnaround" stocks tend to be highly risky but also harbor some intriguing investments. ***Hard Asset:*** These companies' main businesses revolve around the ownership or exploitation of hard assets like real estate, metals, timber, etc. Such companies typically sport a low correlation with the overall stock market and investors have traditionally looked to them for inflation hedges.***Cyclical:*** Cyclical companies core businesses can be expected to fluctuate in line with the overall economy. In a booming economy such companies will look excellent; in a recession, their growth stalls, and they might even lose money. ***Speculative Growth:*** Don't expect consistency from speculative growth-companies. At best their profits are spotty. At worst they lose money. In fact, many companies never make it beyond speculative growth, going instead to bankruptcy court. That's why they're speculative. But current profitability isn't what makes speculative-growth companies interesting. It's future profits. Hopefully, a speculative-growth company will eventually blossom into a world-class company. ***Aggressive Growth***: Aggressive-growth companies show a bit more maturity than their speculative-growth counterparts: They post rapid growth in profits, not just in sales-a sign of more staying power. At this point, it's time to make some money. ***Classic Growth***: These firms are in their prime and have little left to prove. The best classic growers have blossomed into money machines, churning out steady growth, high returns on capital, positive free cash flows, and rising dividends. The catch is, their growth is nowhere near that of the aggressive-growth group. ***Slow Growth and High Yield:*** The growth of these companies is a fading memory. Having run out of attractive investment opportunities, most of them pay out the bulk of their earnings in dividends expects - high payout ratios - rather than plow the profits back into their businesses.

PROFESSIONAL MANAGEMENT & RANKING OF MUTUAL FUNDS

Professional management :Mutual funds use professional managers to make the decisions regarding which companies' securities should be bought and sold. The managers of the mutual fund decide how the pooled funds will be invested. Investment opportunities are abundant and complex. Fund managers are expected to know what is available, the risks and gains possible, the cost of acquiring and selling the investments, and the laws and regulations in the industry.

Ranking :Funds are ranked based upon their performance as a whole and performance against their peers by such companies as Morningstar which has an industry recognized rating system for mutual funds. They have a one-to-five star system in which five stars is the best. Usually the higher the rank, the higher the quality of the fund. For example Morningstar rates mutual funds from 1 to 5 stars based on how well they've performed (after adjusting for risk and accounting for sales charges) in comparison to similar funds. Within each Morningstar Category, the top 10% of funds receive 5 stars and the bottoms 10% receive 1 star. Funds are rated for up to three time periods: three-, five- and 10- years and these ratings are combined to produce an overall rating. Funds with less than three years of history are not rated. Ratings are objective, based entirely on a mathematical evaluation of past performance. The ratings are a useful tool for identifying funds worthy of further research, but should not be considered signals to buy or sell.

MUTUAL FUND ANNUAL REPORT

Every year mutual funds send each investor an Annual Report. The Annual Report includes a list of the fund's financial statements, a list of the fund's securities, and explanations from the fund's management as to why the fund performed as it did for the previous year.

CONCLUSION:

With the structural liberalization policies no doubt Indian economy is likely to return to a high grow path in few years. Hence mutual fund organizations are needed to upgrade their skills and technology. Success of mutual fund however would bright depending upon the implementation of suggestions. With regard to the Mutual Fund investor we are of the view that the investor needs to adopt two crucial skills for successful investing i.e. a sense of timing and investment discipline both need to be adopted at the same time.

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