MUTUAL FUNDS AND BANKING: INDIA AND GLOBAL EXPERIENCE

by

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EXECUTIVE SUMMARY

Even though the first mutual fund in the country is more than 40 yrs old, the mutual fund industry is still nascent one. Most of the mutual funds are about 10 years old. As percentages of the savings of the household sector; they manage only about 3%. This shows, however, a great potential that the industry has. This slow growth by the mutual funds is a surprising one when one collects that, just over a decade back, the industry in one year, was managing as high as 8-9% of financial savings of the household sector. Also during the last 15 years, interest rates on safe banking instruments have been coming down. The number of mutual funds has grown but their penetration in household sector has not increased commensurately. This calls for an explanation on further research. Unfortunately the area of mutual funds has been a highly under researched one. The relative yields of long term instruments, their riskiness, comparative performance etc are areas of research where not enough attention has been paid by the researchers. The reason may be that industry is a nascent one and a decade is not sufficiently long period for drawing meaningful conclusions. The period chosen for this study is when public mutual funds have already been set up and private sector funds entered and global mutual funds are just entering. The external environments are common to both. The public sector mutual funds have the legacy and performance and advantage of distribution network, but now they are facing the adverse market situation. The private sector mutual funds entered perhaps at a wrong time but have a freedom to recruit talent at the market price and started with the best available talent in the financial sector. This set up allowed good competitive environments for fund managers. There is a good reason to deviate from the long term study of other countries because the returns on the equity investment outperforms returns on the risk free instruments. Only a good research can help us to know whether this is also an appropriate time for India.

Mutual fund industry is an important financial intermediary that strives to meet the twin objectives of mobilizing the savings from the surplus pool and generate expected rates of returns through participation in industrial growth of the economy. The growth on success of mutual fund industry depends upon sound financial management policies and the investment practices it pursues to bring about the value addition to the financial assets it manages. The subject assumes greater significance in view of present turbulent market environment as well as the economic scenario of liberalization, globalization leading to a more intense competitive environment. Of late, Indian mutual funds have attracted every investor's attention and have become one of the best options for retail investors primarily because MF on the one hand diversifies the portfolio by investing in various asset classes and minimizes the risk, and at the other hand maximizes the opportunities and is affordable by all. MF provides liquidity as well as tax benefits to the investors. The investor gets regular information on the value of his investments and in that way the transparency is maintained. Moreover, mutual funds are subject to several regulations that protect investor confidence and above all they are professionally managed.

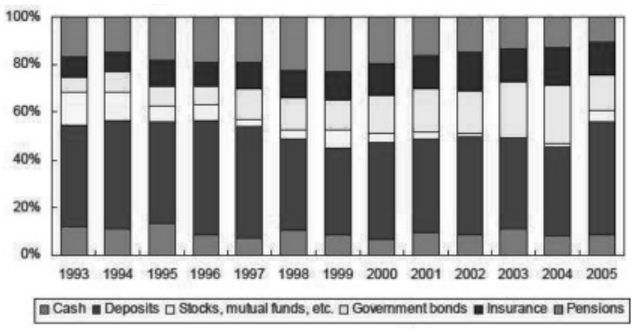
Perspectives

Mutual fund companies in India are influencing the retail investors to invest their surplus funds with or without complete understanding to the mutual funds. It also explores the factors influencing the retail investor to invest in mutual fund schemes. It also seeks to understand the role of SEBI in safeguarding the interest of retail investor in mutual funds. It also identifies the key factor that influences the customer preference for a particular mutual fund. One of the objectives of the present study was to evaluate the financial performance of various mutual fund schemes on different parameters. Performance of mutual fund schemes has been evaluated by using risk to standard deviation, sharp ratio Treynor Index. From the study it was found that, the majority of sample funds have experienced high returns and lower variability on the returns as compared to market portfolios. Earlier, every mutual fund offering resembled the other and this was one reason why the investors were a bit slow in embracing the mutual fund option. Now the time has changed and fund houses have come out with a host of new products that eye investor's wallet. Indian mutual fund industry has been growing at a healthy pace of 16.68% for the past 8 years and the trend will move further. The size of mutual fund industry is expected to be worth 4 lakh crores by 2010 from its current level of over 2 lakh crores and in future investors would prefer mutual funds for their investment destination rather than choosing their funds from stock market. It also says that mutual funds should be one of the major instruments of wealth creation. Overall,it provides a snapshot of challenges that lie ahead.

INTRODUCTION

The mutual fund industry is among the most successful recent financial innovations. Over the past few decades, the mutual fund industry, both in the US and elsewhere, has exploded. While the US continues to be the largest market in terms of number of Funds and assets under management, investors and researchers are generally unaware that US domiciled funds accounted for only 15% of the number of funds available globally and 60% of the world's fund assets. They are also not aware that the nation which is home to the second largest fund industry (measured by fund assets) is Luxembourg, with 6.5% of world mutual fund assets. Similarly, France and Korea offer the second largest number of mutual funds available worldwide (13% of the world total for each country). In aggregate, as of 2005 the global mutual fund increased to doubling those managed in 1998 ($9.6m)

The growth of the mutual fund industry in the US mutual fund industry has played an extremely important role in the economy. This trend has spread to a significant number of countries around the world. Mutual funds industry controls a sizeable stake of corporate equity and plays a fundamental role in the determination of the stock prices. As a result, investors are increasingly concerned about fund selection and demanding detailed mutual fund information and investment advice.



Note: The horizontal axis shows the fiscal year ending March

Source: Nomura Institute of Capital Markets Research based on materials from the Reserve Bank of India

Figure 1: Household financial assets

Establishing a business base in the BR1Cs[1] economies has become a key business theme for the world's financial institutions, and this has increasingly shined a spotlight on the future growth potential of India's mutual fund industry. Stocks and mutual funds only account for 4.9% of personal financial assets in India, suggesting that India's individual investors have a tendency to avoid risk assets (Figure 1). This could also be interpreted, however, as an indication of the huge potential in India for growth in investments by individuals into mutual funds and other risk assets. India has recently seen a rapid decline in the number of its extremely poor, along with an increase in its wealthy and middle-income segments, with the latter referred to as the "new middle class." In India, the owners of mutual funds include not only the wealthy but also regular retail investors, and because of this growth in the middle- class should further broaden the market of potential mutual fund investors. In this paper, we first provide an overview of the assets managed by India's mutual fund industry, both now and in the past, and of the legal framework for mutual funds, and then discuss the current situation and recent trends in financial products, sales channels and asset management companies.

Institutional portfolios manage an ever-increasing part of investors' savings. Although they offer small investors the opportunity to invest in diversified portfolios and frees them to a large extent from the burden to make allocation decisions, it is important to know what cost these alleged advantages are offered. Performance measurement tries to tackle this issue: Are funds which are actively managed by professional managers able to achieve higher returns than passively managed funds, or do the former merely incur additional transaction costs, thus lowering returns? Related to this topic is the question: Is it possible to identify managers who consistently beat either their benchmarks or their peers and so on? These very questions have always attracted researchers on mutual funds and have lead to the formation of huge body of studies on mutual funds.

[1] *BRICs, an acronym for Brazil, Russia, India, and China, has caught on rapidly as a term to refer to those four emerging markets ever since Goldman Sachs' Indian strategist, Roopa Purushothaman, used the term in his 2003 report entitled, "Dreaming with BRICs, the Path to 2050."*

Financial intermediaries like mutual funds are expected to play an important role in accelerating saving-investment process in a developing country like India. This is so on account of their unique characteristics in providing to the investors the benefits of the expert management, diversification, continuous as well as convenient purchase and sale of securities and so on. Such services cannot be arranged by investors, on their own. The equity mutual funds provide benefits of the equity investment to the small/common investors by providing balance/sound portfolio and technical knowledge of the market. Clearly, they hold promise of becoming an important investment vehicle for the small investors on one hand and source of funds for economic development on the other.

The growth and success of mutual fund industry depends upon sound financial management policies and investment practices it pursues to bring about value addition to the corpus of the mutual funds. The subject assumes greater significance now than ever before in view of the present dynamic and turbulent capital market environment as well as economic scenario of liberalization and globalization leading to more intense competition.

The experience of the industrially advanced countries where such institutions occupy an important position among the financial intermediaries in the industrial market is an apt illustration of their relevance in the scheme of things.

The subject is vital for all the agencies connected with the mutual funds industry, i.e., the investors, the practicing fund managers, the capital market, the policy-makers at the centre and industry level as well as researchers and the academicians as mutual funds are engaged in all important functions of economic value addition.

In India, mutual fund industry is rather nascent (started in the year 1964) compared to developed countries like the USA, UK, Netherlands and Japan. The first mutual fund was set up in Netherlands in 1822. Soon thereafter, the investment trusts began their operations in UK. There were 90 investment trusts in UK in 1914 (Stropp, 1988). In the USA, the first mutual fund (the Boston personal party trust) was established in the year 1893. Since early 20th century, mutual fund industry has traveled a long way and has seen wide fluctuations and volatility of capital market globally. In spite of such volatility, mutual funds have been a popular investment avenue in these developing countries.

In India, mutual fund activities began in 1963 with the establishment of Unit Trust of India (UTI) by an act of Parliament. The objective of setting up[UTI was "... to provide for the establishment of corporation with the view to encouraging savings and investment and participation in the income, profits and gains accruing to the corporation from acquisition, holding, management and disposal of securities" (UTI Act, 1963). Series of schemes were floated by UTI between 1964 and 1968 with varied objectives.

In September 1986, UTI floated India's first equity mutual fund scheme, namely, "Mastershare-86". During 1986 to 1994, eight public sector undertakings and banks sponsored asset management companies. These were SBI mutual fund, CanBank mutual fund, Indbank mutual fund, BoI[2] mutual fund, BoB[3] mutual fund, PNB mutual fund, GIC and LIC mutual funds.

Since 1992, the government allowed setting up of asset management companies by private enterprises. That led to the establishment of asset management companies during 1993-94 by reputed private sector enterprises, viz., Indian Corporate, Foreign and Joint venture companies. Since then mutual funds have become popular investment avenues in India. The popularity can be gauged from the fact that Indian mutual fund industry has grown significantly in terms of assets under management (up from Rs. 246.7 millions in the year 1965 to over Rs. 1006 billions at the end of 31st march, 2002), range of products and number of investors. The pure equity scheme accounts for Rs. 138520 millions (2002) assets under their management. Presently, the assets under their management exceed Rs. 1500 billions (September, 2004).

Equity mutual hinds predominantly invest in company stocks. These funds are usually growth funds. High risk-high return is a typical characteristic of these funds. The investors having expectations of high return prefer to invest in these mutual Funds. These individuals are expected to possess appetite for higher risks. The extent to which mutual funds will succeed to their main function of mobilizing savings of the investors and making them available for industrial growth, inter-alia, will depend on their financial performance. Financial management of resources/funds in terms of profitability constitutes, by far, the most important element of their financial performance. What are their rates of return'? Are their profits/returns adequate? What rates of return do they provide to investors, given their risk level? Do the fund managers manage investment portfolio well in terms of selection of securities? Are the\ able to predict the appropriate timings of buying and selling securities'? The present study is a modest attempt to provide answers to these and other important aspects related to financial management of equity mutual funds operating in India.

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[2] *Bank of India.*

[3] *Bank of Baroda.*

In case of banking, prescription of minimum capital has been a key element of international banking regulation. The 1998 Capital Accord prescribed, for the first time, minimum capital of 8% of risk weighted assets for all international banks. This was followed up in 1996 by prescribing capital for interest rate risk. The revised capital accord company known as Basel-II norms has proposed capital requirement for operational risk as well. Though these norms accord as much importance to regulatory review and market discipline as to minimum capital, the required level of regulatory capital is the focal point in almost all discussions, which assess the potential impact on Basel-IL Even the motivation for banks to adopt advanced approaches to risk management emanated largely form the possibility that these methods would reduce capital requirements. Basel-II norms permit banks to use internally developed risk measurement models for risk assessment and to compute capital requirements, provided they convince the regulatory authority about accuracy and suitability of such models. While stipulation of minimum capital by regulatory authorities would force banks with promoters or through a further issue of equity for other "good" banks, bulk of capital would accrue essentially through plough back of profits. Moreover, if well capitalized banks assume lower risk, capital in its turn would impact profitability profile.

Current Status of Mutual Fund Industry: Outlook for Next Two Years

The mutual fund business in India is passing through one of its crucial phases of growth. Though the mutual funds operation started with the setting up of UTI in 1963, the small scale operation of the industry had solitarily been vested with UTI till 1987 when the government permitted nationalized banks to set up mutual funds. During the initial phase of the development of the mutual funds in India between 1964 and 1986, UTI alone managed the show with five open-end schemes, two offshore funds and one closed end scheme. The second phase between 1987 and 1992 has witnessed the broadening of the base industry by entry of commercial banks and public sector financial institutions. In 1987, the SBI set up the first bank sponsored mutual fund followed by Canara Bank in the same year. Subsequently other public sector banks and insurance companies have joined the race. The post 1992 period is the most crucial phase which has witnessed the opening up of the industry for private mutual fund operations. During this period, all India financial institutions including ICICI and IDBI launched their mutual funds. By the entry of powerful Indian industrial houses like Tatas and Blrlas to mutual funds has taken its number to 22 by the end of 1995.

Combined with the entry of private mutual funds, the shift in focus from the individual to the institutional investors has led to the surge in mutual fund operations during the last three years. This unprecedented growth necessitated the Securities and Exchange Board of India (SEBI) to frame guidelines for mutual funds in 1993. By March 1995, the total number of mutual funds registered with SEBI including UTI was 21 with an aggregate of 178 schemes. The funds mobilized through new capital issues by the private and public sector mutual funds and UTI which accounted for only 2.3% of gross capital formation of the country in 1981-82, rose to 16.3% in 1991-92 and 17.1% in 1992-93 and slightly come down to the previous year's level in 1993-94.

The entry of private sector mutual funds imparted competitive efficiency in the industry and helped investors to choose from schemes with different maturity periods and offering different risk-return trade-offs. However, as far as the mobilization of savings is concerned, UTI retains majority share by mobilizing more than 80% of the total funds raised. The total subscription to the schemes of mutual funds amounted to Rs 3783.7 crores in 1988-89 has increased to 13017.8 crores in 1992-93. Due to an overall slump in market conditions, the resources mobilized by the private as well as public mutual funds has fallen to Rs 11405.9 crores in 1993-94 and further to Rs 11342 crores in 1994-95. Though the entry of private mutual funds is considered to be a significant development, the impact of it was felt only in 1993-94. They had collected an amount of Rs 1551 crores as compared to Rs 397 cores by the public sector mutual funds including UTI. During 1994-95 their collection stood at par with the private funds with the former netting Rs 13334 crores and the later Rs 1327 cores.

UTI is still able to garner more than 75% of total amount mobilized in the industry. Its share has increased to 81% in 1989-90 to 84% in 1992-93 and fallen only to 76% in 1994-95 even when the number of mutual funds increased from 8 to 22. The entry of private sector funds has mainly affected the public sector mutual funds sponsored by banks and Fls.

One of the important dimensions of the growth of mutual funds is that many small funds have come into operation. A bigger fund always has the advantage of economies of scale which provides more flexibility to fund managers and low average expenditure. These explicit benefits have led many small funds to merger in the US.

Mobilization of Savings by Mutual Funds in India[4]

(In Rs core)

	Public sector banks and FIs	Sponsored by UTI	Subtotal	Private MFs	Grand total
1987-88	250.3	1767.6	2017.9	0	2017.9
1988-89	319.3	3464	3783.3	0	3783.3
1989-90	1214.3	5490.9	6705.2	0	6705.2
1990-91	2779.5	3198.8	5978.3	0	5978.3
1991-92	2731.5	8685.4	11416.9	0	11416.9
1992-93	1960.8	11057	13017.8	0	13017.8
1993-94	396.5	9458	9854.5	1551.4	11405.9
1994-95	1334.2	8681	10015.2	1326.8	11342
1995-96	1335	7586.5	8921.5	1123.5	10045
1996-97	1500	5466.8	6966.8	1354.8	8321.6
1997-98	1243.5	9587.5	10831	1564.4	12395.4
1998-99	1958.5	10354.8	12313.3	1657	13970.3
1999-2000	900.9	16554.8	17455.7	1458.8	18914.5
2000-01	665.7	11368.5	12034.2	1645.8	13680
2001-02	1165.8	16980.1	18145.9	2100.5	20246.4
2002-03	1468.5	19786.5	21255	2546.5	23801.5
2003-04	1600	25554.2	27154.2	2534.5	29688.7
2004-05	1546.8	26543.5	28090.3	3125.4	31215.7
2005-06	2198.8	30012.5	32211.3	3214.5	35425.8
2006-07	15235	31255.2	46490.2	3812.5	50302.7
2007-08	18643.8	33542.6	52186.4	3463.5	55649.9
2008-09	20054.5	36005.2	56059.7	3945.5	60005.2

Data for UTI are net sales with premium for the period July-June 1987-88 and 1988-89 data represent net sales value.

Mutual Fund Industry at a Glance Capital at the Year

Public Sector MFs	*Capital at the year end 1994-95 (Rs Crore)*	*Schemes Managed*	*Unit Holding Accounts (IN lakh)*
UTI	45268.55	58	480
SBI	2458.32	15	29
Canbank	2322.23	16	15
LIC	1332.03	19	10
GIC	1318.09	10	8
BOI	663.08	5	6
Indbank	618.7	12	6
PNB	448.45	7	3
IDBI	200	1	1
BoB	37.84	1	0
Total	54667.29	144	558

[4]*RBI Report on Currency and Finance.*

Public Sector MFs	*Capital at the year end 1994-95 (Rs Crore)*	*Schemes Managed*	*Unit Holding Accounts (IN lakh)*
Morgan Stanley	910.87	1	15
Kothari Pioneer	504.54	4	5
Taurus	280.34	2	4
ICICI	249.48	2	2
CRB	229.25	1	0.5
JM	225	3	0.11
Birla	162.45	1	1
20th Century	113.81	2	1
Apple	103.6	2	1
Alliance Capital	68.22	1	0.2
Shriram	14.48	1	0.05
Total	2862.04	20	29.86
Grand Total	57529.33	164	587.86

The size of mutual fund industry has grown enormously over the last few years. The fund has grown from 13456 crores in 1988-89 to Rs 61032.92 crores in 1993-94 and further to Rs 74711 crores at the end of June 1995. The table shows that

UTI holds more than 80% of the investible funds. The UTI's fund size has touched Rs 61000 cores mark compared to 10926 cores mark and Rs 2786 cores respectively of the other public sector mutual funds and private sector funds by the end of June 1995.

(Rs Crore)

	93-94	*92-93*	*91-92*	*90-91*	*1989-90*	*1988-89*
UTI	51709	38977	31806	21377	15892	11835
Other Public Sector MFs	9323.92	8011.21	5672.08	1188.89	1480	1621
Total	61032.92	46988.21	37478.08	22565.89	17372	13456

Source: UTI Institute of Capital Markets, *Mutual Funds in India-Fact book 1995*

In order to judge the status of the industry in its right perspective, one may evaluate it based on the following issues:

(a) Do MFs are still capable of offering itself as a sensible and profitable investment channel to the public?
(b) Is it true that the Indian MI's have failed to keep up the investor expectations?
(c) Do the MF operations and regulators play their respective roles for the healthy growth of the industry?

On an average, MFs in India historically delivered a yield of 4-8 per cent points above bank fixed deposits. But in India, MFs are not recognized as long term investment and saving vehicles which can't be used to make quick returns. Investors maintain a distorted perception that MFs give high returns which are not commensurate with the risk involved.

A comparison of performance of top 10 growth funds based on their NAV with market index (Sensex) over one year period from April 94 to March 95 showed that many of them had performed not better than the index.

Performance of top 10 Close-ended Schemes

	Unit Capital as at the end 1994-95 (Rs Crore)	*Net Asset Value*		*Performance*	
		1994	1995	over	1 year
Mastergain 92	4278.06	18.65	14.61	-21.66	(-20.54)
SBI Magnum 91	9.84	15.47	14.48	-6.4	(-13.71)
Multiplier Plus 93					
Morgan Stanley Growth Funds	910.87	9.02	9.03	0.11	(-13.71)
Mastershare Plus 91	910	27.47	20.85	-24.1	(-20.54)
Mastershare 1986	758.43	189	143.66	-23.99	(-20.54)
Canstar CG	667.51	20.4	18.46	-9.51	(-13.71)
BOI Double Square Plus 90	480.92	308.16	277.68	-9.89	(-13.71)
Can Premium	414.5	17268.93	16428.52	-4.87	(-13.71)
Master Growth 93	408.6	21.36	15.97	-25.23	(-20.54)
UGS	346.52	40.75	33.35	-18.16	(-20.54)

The expectations of investors are hammered down to a great extent by the poor investor services rendered by the operators. Not only the private sector MI's but the public sector Mutual Funds equally dampened the expectations of the investors. The cases of Canstar and Magnum Triple Plus respectively of Canbank and SBI mutual funds which have failed to keep up their promises are more than sufficient to demotivate the investors. In such cases of breach of trust and of contract, it is highly essential that SEBI takes stern action in order to save the confidence of thousands of investors.

As far as regulation of MF is concerned, one of the positive developments is that SEBI has tightened its grip over the fund operators. However, as long as undue delay in taking decisions and lack of proper enforcement of rules exist; building investor confidence will remain a myth. Perhaps the damage

to investor would have been reduced had SEBI intervened timely in many occasions; the most important among them being the ridiculous failure of Morgan Stanley Growth Fund which has proved to be a clear case of the violation of advertisement code.

Future Outlook

The recent past has given nothing to be proud of with mutual funds in India. The investors who have depended on professional fund managers with the hope of performing better than they would have on their own had bitter experience. Investors lost confidence in MFs for many reasons including fall in NAV even below face value in many cases, lack of liquidity due to thin trading in secondary market, poor investor services and unkept promises. The mutual fund business operators can no more take the investors for a ride. The recent experience of many mutual funds shows that the knowledgeable investors are not ready to tolerate the inefficient fund managers any more. This is evident from the fact that many of them failed to collect even the targeted amount despite the offering of wide variety of schemes with attractive promises. As more and more mutual funds enter, their survival would depend on performance.

Nevertheless, the emerging scenario of capital market is such that the mutual funds become one of the important segments of the financial system. The post liberalization period has been marked as the beginning of institutionalization of Indian capital market. To the extent of individual investor participation is limited, the mutual funds' participation in primary market is bound to increase. Simultaneously, the individual investors will be forced to opt the mutual fund route for investment. This combined with the SEBI's imposition of minimum investment of Rs 5000 on individual investors works well in favour of mutual funds. In addition to this the loss of charm in the primary markets favors the growth of mutual funds in the coming years. The multiplicity of applications for and high premiums on primary issues keep the common investors aloof not found to be that encouraging. The mutual funds have to grab this opportunity and change the negative perception of the investors about them.

The investor awareness is the need of the day and hence every mutual fund has to take concerted efforts to enlighten the investors. This calls for the active support and involvement of the Association of Mutual Funds in India (AMFI) to educate the investors so as to make them assess mutual fund investment in its right perspective. It's equally important that the mutual funds ensure decent investor servicing. This is the high time for all mutual funds to learn lesson from the experience of Mastergain 92 which was ultimately suspended from trading on BSE. To conclude, no one can deny the fact that funds offer a sensible and profitable investment channel to those who don't have wherewithal and expertise to make direct benefit from capital market. Therefore, any attempt to promote the mutual funds should first ensure that every investor is fairly treated and his interest be well protected.

Sustaining Factors for Growth of Mutual Funds in India

The number of retail investor investing in the market has risen considerably which was once occupied by the selected investors. Although mutual fund investing is a blooming concept in a country like India, the economic, social and environmental factors had an impeding effect on the growth of the mutual funds, in a short span of time. The main factor attributed to the mutual Fund growth is the introduction of various schemes by many fund houses and in particular by the banks. In today's environment banks are the main participatory resource for the mutual fund schemes. According to the market sources, 70% of the products of the mutual funds are through banks. Another reason is the marketing strategy adopted by many fund houses, in order to lure the customers. Such marketing strategies have been in the form of' aggressive campaigning. In addition to these factors, another factor which helped the growth of the mutual funds has been the creation of tailored schemes to suit the requirements of the retail investors. Retail investors are the people who are "Relishing the small share of a big pizza", by investing their hard-earned money in the mutual funds.

Legal Framework for Mutual Funds

The regulation of mutual funds in India is set forth in the SEBI (Mutual Fund) Regulations. The mutual funds defined in these regulations are modeled after the UK's Unit Trust, and are contractual plans. The legal framework for India's mutual funds, as described below, is built around the concept of a sponsor, a mutual fund, a board of trustees, and an asset management company.

The sponsor establishes the mutual fund, board of trustees, and asset Management Company. SEBI regulations require that a sponsor own at least a 40% share of an asset management company and have a track record of at least five years in the financial industry.

The concept of a mutual fund under SEBI regulations, unlike that in Europe and the US, does not mean an individual fund offered as a product to final investors. Such individual funds are referred to as schemes in India. A mutual fund is defined as a fund established in the form of a trust. and with a trust

deed. It is therefore a pass- through vehicle that does not make decisions or have the status of a juridical person.

In fact, the typical use of the term mutual fund in India is similar to what is known as a fund family in the US; the group of schemes managed by UTI is called the UTI Mutual Fund.

The board of trustees has the authority to make all decisions related to the mutual fund, and is governed by both SEBI regulations and the Indian Trusts Act. Many of these mutual funds take the form of a trustee company, in which case the 1956 Companies Act applies. The Board of Trustees shoulders all of a mutual fund's liabilities, retains oversight over the asset management company, and has the role of protecting the rights and interests of the final investors. Specifically, the Board of Trustees (1) names the asset management company (prior approval from the SEBI is required). (2) approves the schemes (individual mutual funds) set by the asset management company, (3) concludes an investment management agreement with the asset management company to entrust management of the assets, (4) submits to the SEBI a semi-annual mutual fund activity report and a sworn statement that the asset management company managed the scheme independent of its other activities, and (5) names a custodian. Two-thirds of the trustees must be independent of the sponsor.

The asset management company, upon approval from the Board of "trustees and the SEBI, establishes and manages a scheme under the mutual fund. At least half of the asset management company's board of directors must not be an associate of, or associated in any manner with, the sponsor or the trustees. The asset-management company must maintain at all times a net worth of Rs 100 million.

Management Fee

The maximum fees that can be charged by India's mutual funds are regulated by the SEBI. The maximum sales fee on mutual funds is 6%. In actual practice, however, there are a number of equity funds, for example, that charge a sales fee of 2.25% for investments below a certain amount,[5] and offer a declining scale of sales fees as the amount of investment increases. Many funds do not charge any redemption fees although there are some funds that charge a fairly high fee for redemptions within a short timeframe. The minimum initial investment for many equity funds is set at Rs 5000. The maximum management fee, meanwhile, is 1.25% for amounts up to Rs 1 billion, and 1.00% for amounts greater than that. There is also a maximum for the total of management Fees and various other ongoing expenses[6] related to fund management, which starts at 2.5% on amounts up to Rs 1 billion, and then declines as the amount of assets invested increases, down to 1.75% for amounts over Rs 7 billion. Many equity funds set their total fees at between 2.25% and 2.5%. The maximum total fees for bond funds are set 0.25 percentage points lower (Figure 8). Although these fees are paid for out of customer assets. SEBI regulations prohibit the use of customer assets for payment of fees related to fund accounting.

Distribution Channels

The primary distribution channels for mutual funds in India are (1) banks (approximately 80), (2) national and regional distributors (approximately 3000), and (3) independent financial advisers (approximately 40,000).

Banks are one of the primary distribution channels for mutual funds, given their access to a nationwide network of branches. Independent financial advisers (IFAs) do not belong to any particular financial institution, and many of them apparently work out of private offices to serve a local and familiar clientele. Many IFAs in India started out as either sales agent for the state-run insurance company or as employees of a securities firm. To that extent, they have a similar presence to that of IFAs in the UK. Compared with the banks and the national and regional distributors, IFAs are more likely to use a fee schedule based on the amount of assets, and therefore appear to be the preferred route for attracting funds from longer term investors, particularly by the traditional domestically capitalized asset management companies. One large domestically capitalized asset management company, for example, gives desk space, as well as access to company resources such as PCs and fax machines, to its top- selling IFAs.

One factor that sets India's mutual fund sales channels apart is that national and regional distributors, who specialize in the sale of financial products (particularly mutual funds), have a share of the market. Both are considered non-banking financial companies under the 1956 Companies Act, and thus are in principle unable to take deposits or make loans.[7] These distributors had various origins. Some, for example, used to

[5] *This is often set at between Rs 10 and Rs 25 million*

[6] *Ongoing expenses related to fund management include expenses related to trustees, custodians, transfer agents, marketing, printing and delivery, and legal services.*

[7] *Nevertheless, some of the leading national distributors also perform brokerage duties as stock exchange members and also engage in deposit taking and lending within the limited scope allowed by regulations.*

be a securities firm or bank and then began specializing in the sale of financial products, while others started out as a division within a leading financial institution. The difference between a national distributor and a regional distributor is that, as the name implies, the former operates on a nationwide basis, while the latter targets only a specific region. Some of the leading national distributors, such as Birla Sunlife Distribution Co. Ltd, Bajaj Capital Ltd, and IL&FS Investmart, have name recognition equal to that of India's leading domestic banks. In addition, India's post offices have also begun selling mutual funds in some cases. India Post, which runs India's largest domestic bank, the Post Office Savings Bank. began selling mutual funds in January 2001, and currently distributes mutual funds for UTI, ICICI Prudential, and SBI. Although no official data exists, mutual fund sales by the post office are said to be on a very small scale. Some view the post office's nationwide network as having substantial sales potential, however, and this makes it a sales channel that may bear watching in the future. The rough division of labor among sales channels appears to be that the banks and the national distributors target wealthy and corporate clients, while the regional distributors, IFAs, and India Post primarily target regular retail investors. Guidance from the SEBI in 2003 requires that personnel who sell mutual funds in India pass the AMFI Mutual Fund Advisors Module and receive a registration number from the AMFI.[8] This requirement has been helpful in improving the knowledge and skills of personnel working in all of the above sales channels, and of IFAs, in particular. As of the end of 2006, 53,308 individuals had passed the AMFI's sales personal test and have been given a registration number.[9]

Efficiency of Mutual Funds

The efficiency of mutual funds should be judged by the following factors: The test of efficiency or a good mutual fund shall comprise of evaluation of a mutual fund on its:

1. *Stability* – whether a mutual fund is stable or not so far as its schemes are concerned.
2. *Liquidity* – whether the schemes offer liquidity by way of their listing on stock exchange.
3. *Growth* – whether the mutual funds offer increase in net asset value, consistent growth in dividend and capital appreciation.
4. *Credibility of issuer* – previous track record of the issuer.
5. *Returns* – Assured or otherwise.
6. *Management approach*-Risk – taking, portfolio, diversification, returns maximization, bonus, etc.

Banking in a Global Marketplace

The Indian banking system will have to deal with mind-boggling paradigm shifts in a complex global environment in the years ahead. With yet another year of high economic growth, the Indian economy continues on a sustained upwards trajectory. The GDP growth has averaged 8% over the past four years and is determined by three key macroeconomic factors.

1. Changing demographic profile- 60% of India's population is expected to be below the age of 40 years by 2015
2. Structural change in the GDP- with over 60% of the contribution coming from the service sector, the higher contribution from services, coupled with high growth in the industry sector and improved performance of the agriculture sector are de-risking India's economic model and building a strong foundation for continued growth.
3. Booming capital market and increased employment opportunities are resulting in higher disposable incomes, higher consumption and greater appetite for risk. The development of the debt market and the role of financial intermediaries in routing national savings to fund the massive requirements of the infrastructure segment will play a critical role in sustaining the growth momentum.
4. The sustained economic growth provides banks with significant business opportunities, rapid growth driven by player strategy choices. Some banks have aggressively focused on pure growth to create size and mass, others have focused on the quality of growth. These widely divergent strategic approaches are likely to establish leadership position for the future.
5. While growth brings greater opportunities, it also creates significant new challenges for the Indian banking system. Challenges have the potential to fundamentally change the structure of the Indian financial service industry, particularly banking, with specific reference to three key impact areas:
   a. Capital management challenge
   b. Managing the convergence of financial services
   c. Mastering the challenge of liabilities

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[8]*Other tests administered by the AMFI include the AMFI Mutual Funds Basic Module, a test of basic mutual fund knowledge that can be taken by anyone. All of these tests were first given in 1999.*

[9]*According to Cerulli Associates, however, only approximately 10,000 individuals are employed full time giving advice on financial products.*

Management of Capital

In many ways for banks, capital is not just a source of funds but an enabler for growth. A study of the advances growth vis-à-vis the capital adequacy reflects a requirement for larger infusions of capital at shorter time frequencies in order to sustain the growth momentum (growth matrix). Indian Banks Association (IBA) estimates that the collective capital requirement of public sector banks alone is likely to be around 1.5 lakh crores over the next 2 years. The total capital requirements for the banking system will be over 2 lakh crores. This higher requirement of capital is driven by:

(a) *High business growth*-Credit flow from the banking system is expected to grow at more than 20 %.
(b) Growth in risk weighted assets exceeding internal capital generation
(c) Structural issues like liquidity reserve requirement, which in the case of Indian banks is 32.5% (the comparable regulatory requirement for Chinese banks is 11%).
(d) Regulation is a bottleneck as incremental resources flow into the reserve requirements, rather than being put to productive use through growth and credit.
(e) Implementation of BASEL II norms has resulted in additional capital requirements to cover operational risks under pillar I and residual risk under pillar 2.
(f) The success of the Indian banks in raising capital in the global markets is expected to be driven by a larger Indian growth story and may potentially require a structural change in the share holding pattern

Motivation of the Study

The study is motivated by the fact that, in mutual fund industry, there is increase in investor sophistication and wealth and power have led to a significant influence, on the growth of mutual funds market. Investors are demanding better levels of services, transparency in prices, and more product variety. The pace of change is very rapid resulting in steep increase in Volumes. The increased level of competition is putting pressures on prices, therefore, new products are launched and newer distribution techniques are being explored. With the rising demand for mutual funds, fund companies and distribution companies developed new outlets for selling mutual funds and expanded traditional sales channels. A large number of mergers, acquisitions and takeovers have been reported in the Indian mutual fund industry in the recent past. The mergers and takeovers in the mutual funds industry in India occurred both at the level of individual schemes as well as at the level of asset management companies.

Objectives of the Study

The following major objectives were set for the study:

(a) Regulations concerning mutual funds sales practices at the bank counters-comparison between India and developed markets such as UK.
(b) To identify the investor related issues for banks which are present in both the segments
(c) To identify comparative performance benchmarks of fund house that is owned wholly or partly by commercial banks and those that are owned outside of banks.
(d) To analyze the growth of bank owned asset management companies from the erstwhile assured returns scheme to market determined return schemes and also the lessons the banks have learned in the process.

Hypothesis

Our hypothesis regarding the effects of the mutual funds on the informativeness of earnings of Chinese publically listed firms is as follows: H 1 a: Fund involvement decreases the informativeness of earnings of Chinese listed companies.

H2b: Compared to non-bank affiliated ones, bank affiliated mutual funds increase the informativeness of earnings of Chinese public companies.

Hlc: Compared to joint equity bank affiliated ones; state owned bank-affiliated mutual funds lower the informativeness of earnings.

To examine the effect of mutual funds on agency problems due to the separation of ownership from management, on the other hand, we look at the effects of fund involvement on the level of executive compensation.

Following our analysis our hypothesis on the role of mutual funds in influencing executive compensation in Chinese public companies are as follows:

H2a: Fund involvement decreases the compensation package of the Chinese listed companies.

H2b: Compared to non-bank affiliated ones, bank affiliated mutual funds lower the executive compensation in Chinese publically listed companies.

H2c:Compared to joint-equity bank affiliated ones, state owned bank affiliated mutual funds increase the executive compensation in Chinese publically listed companies.

Rationale for the Present Study

The above two sections presented detailed literature review on performance measure of mutual funds. This section briefly

covers the rationale for the present study. The literature review has revealed that performance measures of mutual funds include rate of return, benchmark comparison risk-adjusted returns, stock selectivity abilities and market timing skills of the fund managers.

There have been many studies in the USA, UK and India showing performance of mutual fund portfolios. Various studies on performance evaluation of mutual funds in USA have analyzed fund performance for the period ranging from 9 to 25 years. Whereas in case of studies in India, the maximum sample period is four years by Gupta and Sehgal (1997), the performance of equity mutual fund is better captured when analyzed over a longer period as has been the case of studies abroad.

It seems that none of the studies on performance of Indian mutual funds have analyzed the effect of factors such as category (open-ended or closed-ended), size (small, medium and large) and the ownership pattern (private or public mutual funds) on their financial performance, except the study of Gupta and Sehgal (1997), who have analyzed the performance of open ended and closed ended funds.

This forms the rationale for the present study on financial performance evaluation of equity mutual funds operating in India during the period, 1993-2002.

Significance of the Study

The impressive growth of mutual funds in India has attracted the attention of Indian researchers, individuals and institutional investors during past ten years. A number of empirical studies have been conducted to examine the growth, competition, performance and regulation of mutual funds in India. The Indian mutual fund industry is currently in the phase of consolidation and growth stage of the product life cycle.

The Indian mutual fund industry is no exception and the competition would intensify in the coming years as it happened in other industries. Hence, it's appropriate, relevant and topical to focus our attention as to how the Indian mutual industry would emerge in the coming few years to ascertain what kind of products (mutual fund schemes) would be able to win the investor's confidence and survive in the market place. One way of achieving the above objective is to research into the investment styles adopted by the portfolio managers, as these facilitate some kind of product differentiation resulting in different performance levels. Further, style analysis aids performance evaluation of portfolio manager's contribution in terms of active return and active risk.

Despite the impressive growth of mutual fund industry in India over the last ten years, till date, there is no empirical study which researched the nature of relationships that exists between the investment styles and performance of mutual funds in the Indian context. Thus this study is topical and proposes to bridge the gap.

The study would also help the existing and prospective mutual fund companies, institutional and individual investors, researchers and policy makers to get an idea of the nature of relationship between the investment styles and performance of mutual funds in the Indian context, which will have broader implications for (1) Developing competitive strategies, (2) Becoming more investor oriented; (3) Developing appropriate policies conducive to the healthy growth of Indian mutual funds, etc, From an academic perspective, the goal of identifying superior fund managers is interesting as it encourages development and application of new models and theories, thus making significant contribution to the body of knowledge of investment management.

Organization of the Study

The present study is organized in the five chapters. The first chapter serves as introduction, chapter two reviews the theoretical and empirical research on mutual funds, chapter three discusses research design and provides the details of the sample used for the study and presents the results of the investigation. The last chapter serves as the concluding chapter and discusses the implications of the study.

Proposed Methodology

Building upon the review of the received literature and the evolution of the regulatory framework for banks in India since 1992-93, the study would undertake an exploration of the Inter-linkages between capital and risk for Indian public sector banks with a view to examining the implementations on the banking system of changes in the regulatory framework (more specifically, those aspects of this frame work impinging on capital adequacy).

Hypothesis: Given the above objectives, the major hypotheses of the study are as follows.

HI: Appraise Investment performance of mutual funds with risk adjustment, the theoretical parameters as suggested by Sharpe, Treynor and Jensen

H2: The financial performance of funds is likely to vary size wise

H3: The financial performance of funds is likely to vary ownership wise.

Data and Methodology

Sample:

Domestic banks: HDFC, ICICI, AXIS, SBI.

Foreign banks: UBS, Barclays, HSBC, ABN Amro.

Domestic Mutual Funds: HDFC, Kotak Mahindra Mutual fund, SBI, UTI, Reliance

Global mutual funds: DSP Merrillynch, Franklin Templeton, HSBC, FIDELITY.

To test the above objectives, the period was taken from June 2005 to December 2008 and used the weekly return data of equity mutual funds and their relevant benchmarks over the above said period. The return data of the mutual funds is taken from the Alpha database of CMIE. I also used popular websites for obtaining information about disclosed benchmarks for the funds in our sample. The week end values of the benchmarks were obtained from the PROWESS database of CMIE and were used to calculate the weekly returns from the benchmark.

Data Sources

The main data sources are the mutual annual reports of the various Mutual Funds, the offer document of various Mutual Fund schemes, and the NAVs and repurchase prices announced by the funds from time to time. Data on market prices are collected from "*The Economic Times*" and the monthly economic reviews published by the Center for Monitoring Indian Economy (CMIE). The data of BSE National Index are collected from the index values published by The Stock Exchange, Mumbai till December 1994 and afterwards as available in '*The Economic Times*'. In addition to this, popular investment periodicals, such as Dalal Street and Capital Market have also been referred. Informational data are also collected from the various issues of RBI Bulletin and RBI reports on Currency and Finance. No primary data have been collected; however, interviews were conducted with the executives of Mutual Funds. During the interview, inquiries were made about the investment decision and organizational problems.

Literature Review

As highlighted above, the following main hypothesis were presented and tested to Identify comparative performance benchmarks of fund houses that are owned wholly or partly by commercial Banks and those that are owned outside of Banks. In view of the large investor base as well as financial assets under their management, a great deal of interest has been generated amongst the Investors, fund managers, analysts and academicians to get an insight In to the various aspects of investment management practices which affect the financial performance of mutual fund portfolio. Various studies conducted In this regard do not show consensus regarding any particular measure of performance suitable as well as applicable to all mutual funds. Other performance measures include comparison of rate of return of NAV with the risk free return and bench mark comparison, Performance in terms of risk adjusted rate of return (Treynor and Sharpes Indices). Vast literature is available in developed countries like the USA and UK on these performance measures. The relevance of all these studies has been considered vital from the perspective of the investors as well as the fund managers. This section provides a brief discussion of the theoretical literature on compensation structures in the mutual fund industry. The presentation here is meant to be indicative of the work that has been done in this area and not as a survey of the field.

Broadly speaking, there are two branches to the literature on mutual fund compensation. On the one hand are the papers that take a partial equilibrium approach and examine the reaction of the managers to *a ceteris paribus* change the fee structure, on the other hand are the papers that adopt a "full" equilibrium approach, solving for compensation structures as part of equilibrium. Papers falling into the first group include Davanzo and Nesbit [3], Ferguson and Lestikow [4], Goetzmann, Ingersol and Ross [7], Grinblatt and Titman [8] Grinold and Rudd [9] and Kritzman [12]. Those falling into the second group include Heinkel and Stoughton [10], Huddart [11], and Lynch and Musto [15]. Finally there is the recent paper of Admati and Pfeiderer [1] which combines aspects of both approaches. We discuss some of these papers in more detail below. Of the first category of papers, a comprehensive analysis is carried out in Grinblatt and Titman

[8]. Grinblatt and Titman assume that managers can risklessly capture the value of any implicit in their payoff structure by hedging in their personal portfolios. This enables the use of results from option pricing theory in characterizing the optimal. Among the other things, Grinblatt and Titman show that for certain classes of portfolio strategies, adverse risk-sharing incentives are avoided when the penalties for poor performance outweigh the rewards for good performance.

Heinkel and Stoughton [10] aim to explain the predominance of fraction of funds fee arrangement in the asset-management industry (including but not only, mutual funds). They employ a two period model with heterogeneous types of managers, in which moral hazard is also present. Under some assumptions, the authors show that the optimal initial set of contracts features a smaller performance based fee in the first period than in a first best contract. They suggest that this reduced emphasis on the performance component in the first period is analogous to the lack of a performance-based fee in many parts of the asset management industry.

Huddart [11] builds on the Heinkel-Stoughton model by dropping the assumption that managers are risk-neutral and by introducing fund managers. He examines the problem in which the investor must decide which fund to invest in under managers. However Huddart does show that the adoption of a performance fee can mitigate undesirable reputation effects and results in investors being se-ante better off. Lynch and Musto [11] builds on the Heinkel-Stoughton model by dropping the assumption that managers are risk neutral and by introducing competing fund managers. He examines the problem in which the investor must decide which fund to invest in under the assumption that fees is exogenously fixed at some proportion of assets under management. However, Huddart does show that the adoption of a performance fee can mitigate undesirable reputation effects and result in investors being ex-ante better off.

Lynch and Musto [15] aim to explain the fee structure commonly found in mutual funds and hedge funds. They employ a moral hazard model in which the manager's effort is observable by the investor, but is not contractible (i.e., can't be used as legal evidence).the manager commits to an effort level; observing this the investor then decides on the amount in which different fee structures predominate.

Admati and Pfeiderer [1] consider a scenario where the fund manger has superior information to the investor and faces a fulcrum fee structure. Their aim is to examine whether there are any condition under which the manger would pick the investor's most desired portfolio (i.e., the portfolio that the investor would have chosen had he been possessed of the same information as the manger). There are superficial similarities between this question and the motivating paper, but there are some fundamental differences in the analyses. First, the issues studied by Admati and Pfeiderer are the desirability of benchmarking within a fulcrum fee structure; they do not, for instance, consider incentive fee structures. We, on the other hand, take benchmarking as a given, and compare the effects of different fee structures on equilibrium payoffs. Second, Admati and Pfeiderer are not explicitly concerned with determining equilibrium fee structures and portfolio allocations. Thus for instance, they take the amount invested with the manager as exogenous; they also compute the investor's most desired portfolio by using gross returns rather than returns net of the manager's fee. Finally, the presence of asymmetric information is central to the Admati Pfeiderer paper while our paper, as mentioned above, involves a symmetric information setting. The empirical literature on the impact of different fee structures on fund performance and equilibrium risk levels is somewhat limited. Baumol, et al [2] and Lakonishok, Shleifer, and Vishny [13] have each documented the prevailing payoff structures and the extent of variation in these structures. There have also been direct economic studies of the performance issue, including Golec [5], and Lin [6]. All three of these studies find that fulcrum fee are typically used only by large (well-capitalized) firms, and, more importantly that funds with fulcrum fees on average outperform those without such fees. However, while Golec [5] finds a significant performance differential, Lin [14] does not.

Relevance of Historical Performance of Mutual Funds

Historical performance of a mutual fund is one of the major indicators of its likely performance in future. The study provides various learning Issues for more effective ways of managing the mutual fund portfolios in future. Following studies support the hypothesis that historical performance is one of the major indicators of likely future performance.

Nancy (1985) has stated that study of the past performance is helpful in forecasting. Study of the past performance unveils some or all factors that influence the level of financial returns. The study of these factors may help in improving the ability and accuracy of forecasting future returns.

According to Haslem(1988), the past performance is the most important aspect of the mutual fund because it is the basis to estimate how well the future would perform in future.

According to Firth (1977), unit trust performance In the UK has used returns as the sole yardstick, of evaluation. The financial performance of unit trusts in UK during the period 1965-1975 was evaluated using the equation R1= D1 + (P1 – PO)/P0.

Gupta (1981) analyzed rate of return on equities in India for the first time. The study, covering the period 1960 to 1976 is considered as the most comprehensive work in this field. The study examined the trend of variability of rate of return over different time span and also traced the trends of rate of return of specific scrips . The study has been a major contribution in the field and has been regarded as the bench mark on the rate of return on equities for the specified time span. It laid the basis of rate of return concept in performance evaluation. It provided useful concepts for adjustment of dividend, bonus and rights.

Bench mark comparison is an important performance measure as it indicates to what extent the fund managers were able to produce better performance of managed portfolio compared to the market or index portfolios.

Radcliff (1994) had concluded in his work that to receive greater average yearly returns, the investor must accept greater variability in returns, i.e. they should have higher risk tolerance level. According to Hudson (1997), where ever performance evaluation is implemented, there will always be two key ingredients. a) a measure of risk b) a measure of return over a given time horizon. Proper evaluation and comparison is possible only if the reporting standards are of high quality and there are well based standards for calculating NAVs. There should be reasonable level of transparency in operations.

According to Arnaud (1985) bench mark comparison (i.e. comparison of fund performance with market or index portfolio in terms of returns)is the third level of performance, which indicates how well or worse the managed portfolio has performed, vis-à-vis the bench mark portfolio. CAPM approach of portfolio performance covered takes into account the market return while computing required rate of return on the managed portfolios of equity mutual funds.

Jensons (1968) study on mutual fund performance of 115 funds over a period spanning from 1945 to 1964, confirmed the efficient market hypothesis. His analysis has shown that the performance of expense - adjusted fund returns was markedly lower than those randomly chosen portfolios of similar risk category. These results were in synchronization with the findings of Treynor (1965) and Sharpe (1966). Performance of professionally managed funds also was not any the better than the performance of risk-adjusted index portfolio, which also indicated that managers of these funds did not appear to possess private information. Thus, the results of the early studies prevailed as general conclusions in the erstwhile literature.

McDonald (1974) had evaluated performance in terms of Sharpe and Treynor's index as also in terms of Jensen's alpha. T he study revealed that 54% of the funds had positive alphas. Mean alpha for the sample was found to be 0.0562. Statistical significance was not reported in the study.

Overview of the Mutual Fund Industry

1. **Assets under Management:** As of the end of March 2007, India's mutual funds have assets under management of 3.3 trillion rupees. India's market for mutual funds has generated substantial growth in assets under management over the past 10 years, but this growth has been particularly impressive over the past two years, in FY 2005 and FY 2006.
   A detailed breakdown of the fund inflows over the past two fiscal years shows particularly strong inflows into equity funds, an indication that investors in India see strong growth potential for India's domestic firms. Most of the money flowing into equity funds is from individual investors and appears to include both funds owned by the wealthy which tend to invest via growing private banking channels and funds from regular retail investors, who are growing in number in step with growth in the middle class.
2. **Ownership of mutual fund shares:** One notable characteristic of India's mutual fund market is the high percentage of shares owned by corporations. According to the Association of Mutual Funds in India (AMFI), individual investors held slightly under 50% of mutual fund assets, and corporations held slightly over 50%, as of the end of March 2007. This high percentage of corporate ownership can be traced back to tax reforms instituted in 1999 that lowered the tax rate on dividend and interest income from mutual funds, and made that rate lower than the corporate tax rate levied on income from securities held directly by corporations.
   Although there is no official data regarding the type investor in each asset class, the typical pattern seems to be that individual investors primarily invest in equity funds while corporate investors favor funds, particularly short-term money market products that provide a way for corporations to invest surplus cash.

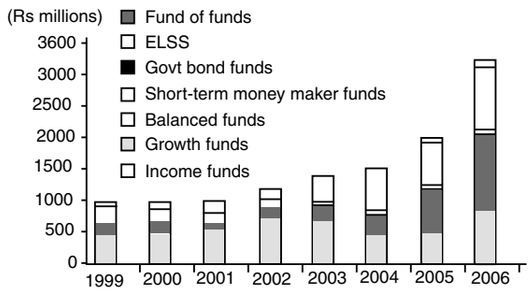
Ownership of Mutual Funds (as of end-March 2007)

	Ownership Share (%)	*Asset amount* (%)
Individuals	96.09	42.83
Non-resident Indians	1.66	495
Foreign Institutional Investors	1.21	1.21
Corporations, domestic Institutional investors	2.24	*51.01*
Total	100	100

Growth of Mutual Funds in India (Assets Under Management) (in Rs Crores)

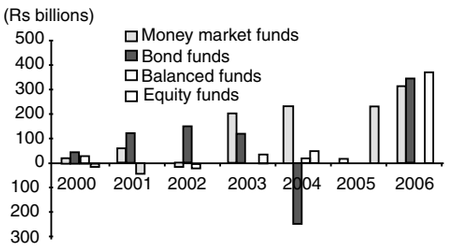
category	*97-98*	*98-99*	*99-2000*	*00-01*	*2001-02*	*2002-2003*	*2003-04*	*2004-05*
1. UT1 57554	53320	76547	58017	51434	13516			
Growth %		-7.36	43.56	-24.21	-11.35	-73.72		
% of total	83.43	77.87	67.74	64.05	51.13	13.44		
2. Bank Sponsored	4872	5481	7842	3333	3970	4491	28085	29103
Growth %		12.5	43.08	-57.5	19.11	13.12	525.36	3.62
% of total	7.06	7.06	8	6.94	3.68	3.95	4.46	20.12
3. Institutions	2472	2811	3570	3507	4234	5935	6539	3010
Growth %		13.71	27	-1.76	20.73	40.17	10.18	53.97
% of total	3.58	4.11	3.16	3.87	4.21	5.9	4.68	2.01
4. Private sector	4086	6860	25046	25730	40956	55522	85107	117487
(a+b+c)								
growth %	67.89	265.1	2.73	59.18	35.56	53.28	38	
% of total	5.92	6	10	22	28.4	40.7	55.1	61
(a) Indian	1031	1016	2331	3370	5177	10180	3633	30750
Growth %								
% of total	1.49	1.48	2	3.72	5	10	2.6	20.55
(b) JV-Predominantly	1583	3040	9724	8620	15502	15459	33143	30885
Indian								
Growth %		92	219	-11	80	-0.28	114	7
% of total	2.3	4	9	10	15.5	15.4	24	21
(c) 1V-predominantly	1472	2804	12991	13740	20277	29883	48331	55852
Foreign								
Growth %		91	363	6	48	47	62	16
% of total	2.13	4	12	15	20	30	35	38
Total (1+2+3+4)	68984	68472	113005	90587	100594	100594	139616	149600
Growth %		-0.74	65	-20	11		39	7
Total	100	100	100	100	100	100	~ 100	100

Assets under management in India's mutual funds market



Source: Nomura Institute of Capital Markets Research based on materials from the Association of Mutual Funds in India.

Money inflows by type of fund



Note: The outflow of money from bond funds in 2004 was sparked by rate hike in the US

Source: Nomura Institute of Capital Markets Research based on materials from Cerulli Associates

3. **The history of mutual funds:** The development of India's mutual fund can be separated into four distinct phases. The first phase was from 1964 until 1987. In 1963, India's central bank, the Reserve bank of India (RBI), established the Unit Trust of India (UTI), control of which was passed from RBI to the Development Bank of India

in 1978. The first fund created by the UTI was the Unit Scheme 1964, which had managed assets at the end of 1988 totaling Rs 67 billion.

The second phase was from 1987 until 1993. The first non-UTI fund was SBI Mutual Fund, which was established by the State Bank of India in June 1987. This was followed by several other funds introduced by public sector banks and insurance companies. As of the end of 1993, India's mutual fund industry had assets under management of Rs 470 billion.

The third phase was from 1993 until 2003. The SEBI introduced a comprehensive set of regulations governing mutual funds, known as SEBI (Mutual Fund) Regulation 1993, to regulate, and require the registration of all non-UTI funds. These regulations were completely overhauled in 1996. and now it's the SEBI (mutual fund) Regulation 1996 that regulates mutual funds. Since 1993, private sector asset management companies have been actively involved in the mutual fund industry. The first private-sector fund to be registered was Kothari Pioneer in July 1993, a fund that has since merged with Franklin Templeton. The number of asset management companies has continued to grow; while there have also been a number of mergers and acquisitions in the sector. As of the end of January 2003, India's mutual fund industry had 33 asset management companies managing assets totaling Rs 1.218 trillion, and the largest of these was UTI, with assets of Rs 445.4 billion.

The fourth phase began in 2003. The Unit Trust of India Act 1963 was repealed in February 2003, resulting in UTI being split into two different entities. The first was the Specified Undertaking of the Unit Trust of India, which was made up of UTl's flagship fund Unit Scheme 1964 and closed-end funds, and managed assets as of the end of January 2003 totaling Rs 298.3 billion. The other entity was UTI Mutual Fund, the major shareholders of which were four public-sector financial institutions, including the State Bank of India. These funds were registered with the SEBI and subject to SEB[‘s mutual fund regulations. This split up of UTI, along with mergers and acquisitions within India's mutual fund industry propelled the industry into a new era of growth and restructuring. Mutual funds in India have thus had a fairly long history, although it was probably not until private-sector asset management companies began to participate in the 1990s that it began to take shape as a single industry.

A. The various investor related issues are as follows:

1. Issues related to providing correct information regarding the investment scenario to the investors
2. Issues related to corporate governance: Banks need to follow a standard set of procedure regarding the investors
3. Issues related to strengthening the Examination and Approval, Registration, Foreign Exchange and Taxation Administration of Foreign Invested Enterprises.

The working of a free market economy rests primarily on the assumption that the information available to all economic agents in the economy are complete and perfect. Thus, the transmission of information or communication network among the economic agents assumes vital significance. No market that lacks communication can operate effectively, for without it there is ignorance and misunderstanding. Hence, to increase the efficiency of the market mechanism. the communication link up has to be developed and constantly updated over time.

The liberalization of the Indian economy in general and the spur in capital market activity (with increase in volume of trade and larger number of participants) in particular, calls for some introspection in this context. The growth in information technology has hastened the globalization of financial markets. It has broken down barriers of time and place and made worldwide instantaneous transmission of information and instructions, common place. This represents a risk of greater volatility in market prices as more major players make their money by taking positions quickly before the market moves to their disadvantage. In addition, the variety of choice, the opportunities for hedging and diversification and the case of mobilization and transfer of capital have led to a significant widening of market for equity.

The Importance of Guidelines and Standards

Disclosure standards are among the most important of all investment standards because they not only protect investors, but also promote high professional standards of practice within investment institutions. If disclosure of investment management practices is mandatory, they are more likely to conform to high professional standards and investors are less likely to be exposed to unexpected disappointments. Disclosure standards are not only important in their own right but have a potent effect on the development of other types of standards of practice. If disclosures furnish prospective clients with an adequate, accurate and comparable description of major professional management practices internally performed by the institution, the institution has a commercially strong incentive to engage in high standards of practice, than if the disclosures were not otherwise made, the reason being that if investors select institutions and investment programs on the basis of disclosures, institutions will compete for clients

by offering programs supported by high professional practices.

Disclosure standards also offer direct benefits. As noted either, more and better information would presumably be able to make better or more suitable choices among available institutions and programs. Moreover, the regulation of business conduct by setting high standards of disclosure is much more compatible with the ethics of the free market system than those imposed through direct government control and supervision. Laws and government regulation on insider trading, antifraud provisions, etc. enable a free capital market to allocate resources efficiently among alternatives available, which is the essence of the free market system.

This philosophy is not fully appreciated by everyone. While some investment *institutions believe in "caveat emptor" (let the buyer beware), that is the* investor has the exclusive responsibility to investigate and gather information on which to base an investment decision, others, like government officials believe that as an institution the government is in a better position to protect interests of investors by direct mandatory controls on operations of institution, investment advisors and programs. The reality is, however, far from both. Information is costly and it is quite implausible that the single investor would be able to monitor and gather all relevant information and process them optimally to take the best decision. The government, as an agency is definitely at an advantage in terms of bearing cost of information but whether it acts as a scrupulously fair and benevolent institution in transmitting the information to society is as much, a matter of faith, rather than truth. A mixture of these different and competing philosophies is evident in our pluralistic society. Nevertheless, disclosures standards can be effective both in promoting high standards of practice in promoting investors interests.

ISSUES IN MARKETING OF MUTUAL FUNDS

Product

Financial products especially whose performance depends on the behavior of the market are quite different than any ordinary consumer product and, therefore, the marketing of them are also subtly different. A marketing manager of a typical consumer product could convince the prospective consumer by claiming identifiable and measurable consistency of performance in respect of attributes of the product like mutual funds, however professional and expert one is, can't make promises about future performance of the product performance. The fund managers have to convince the investor only through their past performance and assurances about their professional expertise. It is quite difficult job than a marketing manager of a consumer product has to perform. What then the prospective investor expect when they send substantial amount of their hard earned money to the faceless fund managers? What then these fund managers sell? They offer the hope of achieving desired returns on their investment. They offer professional investment services, which otherwise, investors would have to invest on their own. They are in the business of creating the conviction in the mind of the investors that they are better equipped with the specialized skills to invest their money. And the last but not the least, they offer good quality of services-this includes simple procedural formalities, timely and appropriately reporting of performance and timely remittance of returns on their investment. Thus, it is the reputation of integrity and good quality of services, the fund managers have to sell along with the investment characteristics of their products.

Investors

The mutual funds are basically aimed at small customers who do not ordinarily know the intricacies of the market. By 1995, India had 150 million people in middle and upper class. It is this class and its widely untapped potential that the fund managers had to tap in the last phase of the century. Assuming at every 5 persons one person earns and saves, and if the fund manager could extract Rs 5000 per annum from his disposable income, one could generate Rs 15000 crores. For this one has to focus on the consumption pattern, lifestyle, demographic and cultural traits, media, habits, etc. of various subclasses of the investors and exploit the saving. In India there is dearth of detailed research on investor's base. The latest publicly available study is as old as of 1990-91 (Gupta-1991). He lamented confusing state of the Indian investors on finding that the debentures are perceived as risky as equity shares and in contrast the mutual fund schemes are perceived as safe as bank deposits. He also found that investors always give higher preference to liquidity, procedural simplicity and tax saving features of the financial product. The corporate theory asserts that mutual funds are more suitable for the general public to invest than to invest directly in financial market on their own; but he surprisingly found that equity ownership was throughout higher than units ownership in mutual funds in all income classes. It suggested that mutual funds have not so far successfully aimed themselves at lower income class. Alternatively, it indicated that the mutual funds are more oriented towards upper income class than common man-might be due to their preference for higher volumes or their appeal for tax saving. These empirical findings may be less relevant in 1996 but not totally irrelevant. It still helps

the fund managers to peep into the intrinsic financial needs and attitudes of more than 30 million investors class.

Market and Market Players

The fund managers have to broaden their vision about the market and the potential of the market they have to cater to. Their targets and achievements and, therefore, their marketing strategies would then depend upon whom they consider the market and its potential. The Mutual fund industry's share in 1993-94 was at the most 9% vis-à-vis 14% for currency, 37% for bank deposits, 25% for insurance, provident and pension funds of gross financial savings of the year.

The fund managers will have to market their products aggressively to increase their share not only in terms of gross financial savings but they should also look up to the personal disposable income of the economy as the size of the market, to grow in developing economy. They need to estimate the size and growth of the markets and its potential. It estimates that by 2011the market size indicated by personal disposable income, gross domestic saving and gross financial savings would be approximately Rs 14.49 lakhs crores, Rs 3.06 lakh crores respectively.

Market Players

Analysis of the shares of various market players is an essential and the vital marketing exercise. So far as the mutual fund industry interse, is concerned, UTI is the oldest player leading with 75% shares. What is more important for the fund mangers is to compete with their substitutes and complimentors who take away the major share of total funds available in the economy. They are not only consumption in financial avenues like, currency, banks and corporate deposits, insurance, provident and pension funds, shares and debentures etc., but also in physical assets. By 2011, bank deposits, insurance, provident funds and pension funds and currency holding would be the likely competitors with collectively 65% share of total Rs 4 lakh crores.

Market Segmentation

Different segment of markets have different equations of their risk return parity, on the basis of which they take investment decisions. This parity depends on the differential preference for various investment attributes of financial products. Different attributes, an investor expect in a financial product are: liquidity, capital appreciation, safety of principal tax treatment, dividend or interest income, regulatory restrictions, time period for treatment, hedge against inflation, etc.

Retail Segment

This segment characterizes large number of participants but low individual volumes. It consists of Hindu Undivided Families and firms. It may be further sub divided into: (i) salaried class, (ii) retired people, (iii) Businessmen and firms having occasional surpluses, (iv) HUFs for long term investment purpose. Similarly the investment preference for urban and rural prospects would differ and, therefore, the strategies for taping this segment would differ on the basis of differential life style, value and ethics, social environment, media habits and nature of work. Broadly, this class requires security of the principal, liquidity and regular income more than capital appreciation. It lacks specialized investment skill in financial markets and highly susceptible to mob behavior. The marketing strategy involving indirect selling through agency network and creating awareness through appropriate media would be more effective in this segment.

Institutional Segment

This segment has less number of participants and large individual volumes. It consists of banks, Public sector units, financial institutions, foreign institutional investors, insurance corporations, provident and pension funds. This class normally looks for more professional investment skills of the fund managers and expects a structured product than a ready made product. The tax features and regulatory restrictions are the vital considerations of their investment decisions. Each class of participants provides a niche to the managers in this segment.

Trusts

This is highly regulated but high volumes segment. It consists of various types of trusts, namely charitable trusts, religious trusts, etc. Its basic investment need would be safety of the principal, regular income and hedge against the inflation rather than liquidity and capital appreciation. This class offers vast potential to fund managers, if the regulators relax guidelines and allow the trusts to invest freely in mutual funds. Alternatively, the fund managers many also design a product confirming all the restrictions on investment imposed by the regulators. In this case, the trust instead of directly investing in the permitted financial product, invest in the funds having similar portfolio but selected and managed by the specialized fund managers. This course is likely to generate more returns to the beneficiaries.

Non-Resident Indians

This segment consists of most risk sensitive participant, at times referred to as "fair weather friends". They need the

highest cover against political and exchange risk. They also hold a strategic importance as they bring in crucial foreign exchange. The marketing to this segment requires special kind of products for groups of foreign countries depending upon the provisions of tax treaties.

Corporates

The investment need of this segment is to park their occasional surplus that earns more return than what they have to pay on account of holding them. Alternatively, they also get surplus funds due to seasonality of business, which are getting due for payment within a year or a quarter or even a month. It offers a vast potential to specialized money market managers. Given the relaxation in regulatory guidelines, the funds managers are expected to design the product suitable to this segment, at least to compete with bank deposits with more than 46 days. . Thus, each segment and sub-segment having their own risk-return preferences forms niches in the market. The Indian fund managers are required to analyze in detail the intrinsic needs of the prospectus and design variety of suitable products for them. Not only is that, the products also required to market through appropriately differential marketing strategies.

Product Innovations

The wide range of products is required to cater to the multiple risk-return preferences of various classes of investors. The Indian mutual fund industry is yet to see exclusively government treasury funds, high-yield funds, metal funds, option income funds, etc. The investors in India have highly restricted options and, therefore, the saving of the economy is diverted to other government or quasi-government avenues. The regulators are responsible for not allowing the mutual funds to invest freely in the market and to that extent the fund managers are unable to produce variety of products. Still the regulator doesn't intend that the mutual funds compete with bank deposits with less than 46 days. There are still ceiling limits on investment which restricts mutual funds to earn competitive returns in thin and shallow Indian stock market, trusts, insurance and provident funds etc. They are still not allowed to invest freely in mutual funds. For smaller funds catering to particular niche may not be possible with existing minimum resource mobilization requirements. The fund managers can still innovate variety of products targeting the trusts, corporate, banks, Fls, rural investors to broaden their share of market.

It's the need of the day to provide freedom and level playing field to the mutual fund industry for competing with existing financial products with government patronage, by offering varieties of diversified products with different classes of investors.

Advertising and Sales Promotion

Mutual funds require higher promotion and advertising expenses than any consumer product offering measurable performance. It's interesting to find that they are not even half percent of the funds mobilized during a particular year.

In US, the fund passes selling costs on the investors in the form of "load". It used to charge 8.5% front load charges on purchase of shares in the fund. Later on with increase in the popularity of the funds, it started offering schemes with back-end load with progressive decrease with increase in holding period.

Different kinds of advertising and sales promotion exercises are required to serve the needs of different classes of investors. Here also, the regulators need to relax two restrictions. Firstly, removal of the five percent surcharge over financial advertisement which makes the financial products costlier. Secondly, removal of regulating the management fees on the size of fund. Though the restriction on the management fees is warranted but it should not be linked with size of the fund but on the basis of performance of the fund, as prevalent in US. This will provide due incentives to the fund managers to perform better and rewards to the better performing fund managers. The Brand-equity in Indian mutual fund industry is conspicuous by its absence. Except UTI, no other funds have been able to create its brand-equity apparently because of its late entry and infancy of industry itself. The fund managers will have to strive hard to show consistency in performance and services and sharpen their efforts enough to have not only the overall strong brand image but also the different brands for each niche. It would be easier to impress upon the investors now in this virtually faceless industry.

Quality of Service

This industry primarily sells quality of services. It's this attribute along with procedural simplicity the fund gradually builds its brand and the class of loyal investors. The quality of services is broadly categorized as: (i) timely services after the sale of the shares, and (ii) continuous reporting of funds performance. The fund managers must give their attention and evaluate their performance on each front. They may also consider an option of conducting the service audit for controlling and improving the quality of service.

B. The Need for Regulation and regulatory environment in India

The prevalence of risk associated with investment activity, necessitates regulation of the financial market in general, and the activities of investment management firms in particular. Regulatory measures, whatever their form and structure, are designed to attain the twin objective of correcting market failures and protecting investors from potential loss. The principles of regulations are based on the following premises:

- To correct identified market imperfections and failures in order to improve the market and enhance competition;
- To increase the benefit to investors from economies of scale; and
- To improve the confidence of the investors in the market by introducing minimum standards of quality.

Regulatory measures can be broadly classified into five categories:

- Imposing capital requirement for investment management firms
- Monitoring and auditing the operations of investment management finns
- Disclosure and rating of management firms
- Providing insurance and
- Setting up minimum standards for investment management firms

Effective regulation should take into account both the cost of regulation and value addition. Two types of costs are usually associated with any regulatory measure: direct and indirect. The direct cost is the cost of administration and implementation, while the indirect cost is the cost of welfare due to restrictions on competition. It is essential that any regulation is formulated only after taking into account the total cost and implicit benefits. This is more so in a developing country and emerging market like India, where regulatory expenditure is and additional burden on the public exchequer and expenses are incurred at the cost of development expenditure. Moreover, in an emerging and semi-efficient market like India, investors are exposed to greater volatility and risks. Therefore, in order to be effective, regulation should be able to protect the investors' interest and the direct benefits must be more than the indirect benefits and cost of regulation.

Mutual Funds are regulated by SEBI through the Guidelines for Mutual Funds issued in 1993. The public sector banks floating mutual funds are governed by both RBI and SEBI. Some of the major regulatory provisions of SEBI Guidelines, 1993 are as under:

(a) The fund is to be managed by Asset Management Company (AMC) having not less than Rs 5 crore net worth. A sponsor will have to contribute at least 40% of capital of AMC. At least 50% of the Board of the AMC and the Board of trustees of the fund should be independent directors not connected with the sponsoring organisation.

(b) The fund is required to raise at least Rs 20 crores and Rs 50 crores for each close ended and open ended scheme respectively. Minimum subscription limit is 60% of the offered amount.

(c) 90% of the income generated should be distributed to the unit holders. Expenses charged to the fund should not be more than 3% of the average NAV on an ongoing basis. The management fees to AMC should not be more than 1.25% of weekly averages NAV, if net assets are less than Rs 100 crores, otherwise, 1% of weekly average NAV.

(d) A scheme of mutual fund can not invest more than 5% of its corpus in a single company's share. The mutual fund as a whole can't invest more than 10% of its corpus in any one company's securities (shares and debentures) and more than 15% of its fund in any one industry (except industry based schemes). Inter-scheme transfer must be at market prices. The funds will not invest in debt instruments with a rating below investment grade. The funds will not indulge in carry forward or badla transactions; they should always deal on delivery basis.

(e) The major tax provisions for mutual funds areas under:

  – The fund will have to deduct the tax at source for the payment of more than Rs 10000 to the unit holder @20% for domestic companies; 15% for residents; and 20% for NRIs. Dividend income from mutual fund up to Rs 13000 is allowed as deduction from gross total income for individuals and Hindu Undivided Family.
  – The Foreign Institutional Investors are taxed either at concessional rate under Tax Treaties or 20% on dividend income, 30% on short term capital gain and 10% on long term capital gains.

Regulating Market Risks in Banks: A Comparison of Alternate Regulatory Regimes

The introduction of the Basel Accord marks an important watershed in establishing capital standards among banks across the globe. Prior to 1992, uniform minimum capital standards were applied to all banks, regardless of any differences in the level of their investment risk. The task of limiting banks' portfolio risks and ensuring capital adequacy was left to regulatory monitoring and supervision and to some degree to market pressures.

The Basel Accord represented the first step in linking bank capital standards to credit risk exposures and to that extent a movement away from a subjective judgment of capital requirements and towards a more objective rule based approach. However, the growing disenchantment with the Capital Adequacy Ratio (CAR), have led regulators to search for feasible alternate possibilities to regulate market risk in banks. Three alternative approaches have been discussed in the literature.

The first of the approach to market risk capital standards is the Building Block Approach (BBA). The BBA consists of a single model to be applied to all banks. This approach is characterized by a "building Block" framework, a framework it shares with the 1998 Basel Accord credit capital standards. Two regulatory frameworks, those of Capital Credit Adequacy Directive (CAD) of European Union and of the Basel Standardized Measures (BSM), incorporate this approach. Under this approach, capital charges are determined for each of the four major market risk categories (interest rate, exchange rate, equity and commodities) and are then aggregated. Different procedures are used for each category to determine the category's respective capital charge. It is a set of rules that assigns risk charges to specific instruments and crudely accounts for selected portfolio effects on banks' risk exposures. Interest rate and exchange rate risks dominate the market risks for most banks' trading departments. Under the building block approach debt securities incur a specific and a market risk capital charge. The specific risk-charge is intended to cover changes in the value of the debt positions that owe to change in the general level of (risk free) interest rates. Equity positions are subject to both a specific risk and a market risk capital charge. Equity capital charges are determined on a notional market basis and are then aggregated across markets at current exchange rates with no offsets permitted for hedging or diversification among markets. Finally, commodity capital charges are essentially 15% of the net position in each commodity. Some additional capital charges are also assessed for basis risk and interest risk.

The second approach is the internal models Approach (AMA), whereby capital charges would be based on market risk estimates from banks' internal risk measurement models. The bank would use its proprietary risk measurement model to estimate its trading risk exposure which when multiplied by a certain scaling factor as a measure of regulator's conservatism, would become the basis for the regulatory capital charge for market risk.

The third and largest proposal is the Pre-commitment Approach (PA). Under this approach each bank pre-commits to a maximum loss exposure over a designated horizon. The maximum loss commitment becomes the bank's market risk capital charge. If the bank incurs trading losses in excess of its capital commitment, it is subject to penalties which may include fines, a capital surcharge in future period or other regulatory disciplinary measures.

Persistent from the point of view of the Indian scenario, are the Internal Models Approach and to a lesser extent, the pre-commitment Approach, which are taken up for discussion. What is a brief description of the two approaches followed by an examination of the likelihood of the use of these models in the Indian context?

Importantly, these models are not designed to measure the longer-horizon exposure that is the intended basis of regulatory capital requirements. Simply stated, longer horizon risk exposure depends not simply on a bank's initial risk exposure but also on its risk management strategy and the risk control system that a bank has in place. Risks need to be measured and managed on daily basis. However, the longer the horizon, the less important will be the initial risk exposure and the more important will be management's risk objectives and the bank's risk management system. The internal models' proposal sets the capital requirement at some multiple of the model risk-risk estimate for an initial portfolio composition. This risk measure places undue emphasis on the initial portfolio at the expense of ignoring the importance of the bank's risk management objectives and the efficiency of its risk control systems.

Regulation and Investor Protection in India

Securities regulation in India is in the process of evolution and can't be identified either with the UK or the US type of regulation. In India, under the present framework, the regulation of all participants in the securities market (with the exception of issuers of capital) is the responsibility of SEBI.

As the prime regulator of capital market activities in India, SEBI's basic objective is to protect the interest of investors. This objective has been stated in the preamble of the Securities and Exchange Board of India Act 1991, thus... "to protect the interest of the investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto". Accordingly, all capital market activities, including those of mutual funds, are covered under the above objectives so far as investor protection is concerned.

The SEBI regulations of 1993 were the first attempt to bring mutual funds under a regulatory framework and to give directions to their functioning. However, as noted earlier, new

regulations were passed in 1996 and these have many similarities with the Investment Companies Act 1940 of the US as far as mutual fund regulation and investor interests are concerned. The regulatory and supervisory powers of SEBI also stand strengthened by the securities law (Amendment) Ordinance, 1995 which empowers SEBI to impose penalties for violation of its regulations. Under this amendment SEBI is also allowed to file complaints in courts without prior approval of the central government. SEBI has thus emerged as an autonomous and powerful regulator of mutual fund in India. The 1996 regulation lays down many measures to protect mutual funds investors. Some of the measures are briefly discussed below.

SEBI has incorporated several provisions to screen mutual funds at the entry level, similar to the provisions for a fit and proper test in the UK. Every mutual fund shall be registered with SEBI and the registration will be granted on the fulfillment of certain conditions laid down in the regulations for efficient and orderly conduct of the affairs of a mutual fund. The regulation further stipulate that the sponsor must have a sound track record and experience in the relevant field of financial services for a minimum period of five years, professional competence, financial soundness and a general reputation for fairness and integrity in all business transactions.

SEBI has laid down conditions for the appointment of trustees and has specified their obligations as well as detailed guidelines on the trust deed. The AMC is to be approved by SEBI. SEBI has also laid down terms and conditions for the approval of the AMC, one of the conditions of approval being that the AMC has a net worth of not less than Rs 10 crores. The directors of the AMC are to be persons having adequate professional experience in finance and financial services-related fields. The key personnel of the AMC should not have been working for any AMC or mutual fund or any intermediary whose registration has been suspended or cancelled at any time by the board. Mutual funds may have a custodian who is to be approved by SEBI, and one of the preconditions for approval is a sound track record, general reputation and fairness of transactions.

SEBI has laid down several provisions for pre-launch and post-launch disclosures to ensure that investors can take informed decisions on the basis of factual information supplied by a mutual fund.

No new schemes can be launched by any mutual fund unless the same has been approved by the trustees and a copy of document has been filed with the board. SEBI has also stipulated that the AMC should stipulate the minimum amount it seeks to raise under scheme and the extent of oversubscription to be retained. There are clear regulatory provisions regarding the listing of close-ended schemes, refunds, transfer and sending of unit certificates to investors. In addition it has been stipulated that the names of the trustees of the mutual fund and the director of the AMC should be disclosed in the prospectus of the fund. The investment objectives and strategy, as well as the appropriate percentage share of investment to be made in various instruments are also to be disclosed. No guarantee of returns can be given unless they are fully guaranteed by the sponsors or the AMC and a statement indicating the manner of guarantees is to be made in the offer document.

Corporate Governance in Mutual Funds

Corporate governance is seen by many as a combination of corporate ethics, corporate transparency as well as corporate accountability. The fundamental objective of corporate governance is the enhancement of shareholders' wealth, the approach and instruments are quite different. The US, the country with the maximum degree of social respect for corporate governance and the responsibilities it entails, adopts a soft approach so as to minimize the conflict between the owners and the manager. This includes giving financial incentives (stock options). Stock exchanges (through listing conditions) play an important role in imparting transparency and accountability to the activities of the corporate managers. In order to instill transparency, insider-trading has been made illegal and disclosure norms have been made an essential part of corporate governance in the US. The approach is thus basically market oriented.

In Germany, on the other hand, corporate governance is implemented through interactions and consensus between the management and supervisory boards.

Banks play an important role in the market because of their role as holders of company stocks and providers of long-term finance. The banks are run by "supervisory and management boards. While the supervisory board is responsible for the company's accounts, major capital expenditure, strategic acquisitions and closures, dividends and most importantly, appointments to the management board, the management board is responsible for the company.

In Japan, the basic approach centers around the concept of obligation to the company, country and family. It is implemented through cross-holding and networking among group companies, and there is less focus on the boards. Corporate governance in Japan is more concerned about all-out appreciation of the value of the Yen, the promotion of the entrepreneurial and innovative talents of the people for the

development of the society, and the best means of making them accountable.

Financial institutions play a pivotal role in promoting and sustaining the growth and development of the economy. We have already mentioned the recent trends towards disintermediation and the fact that the leading role of the banks is being overtaken by other financial institutions, like mutual funds, pension funds, insurance and investment banking, broking houses. The focus is on financing led by the capital market instead of bank finance. The shareholders of financial institutions are large in number than those of manufacturing companies. Financial institutions, in addition to enhancing the shareholders value to increase the wealth of the depositor investors, who are the core of their business activities. Moreover, the activities of a financial institution are having a wider spread and a failure of any kind of institutions is a collapse in the entire economy. Therefore, corporate governance is more important for such institutions, not only in the interest of the shareholders, investors/depositors and other stock holders, but also in the greater interest of the national economy.

The economic influence of Mutual Funds can be seen from the fact that about 30% of the investors fall within the income group that has a monthly income of up to Rs 10,000. The existence of large number of unit holders, with a very high percentage belonging to the low and medium income groups, speaks of efficiency, transparency and accountability in fund management.

Indian Mutual Funds are regulated by SEBI whose regulation is quite comprehensive and qualitatively superior to those of many other countries. Thus, they have an implicit bias towards the SEC Regulations. Many of the prescriptions of the Kumar Mangalam Committee for establishing the practice of corporate governance in India are already reflected in the SEBI Regulations, i.e., the responsibility of the trustee/board of directors of AMC, norms for disclosure, formation of an audit committee, etc. apart from these. the guidelines on accounting policy, advertisement, investment restrictions, frequency of disclosure, formation of a valuation committee, and so on, are aimed at protecting the investors and providing checks and balances for managers. These measures have an explicit as well as implicit bearing on corporate governance.

Mutual funds are expected to enhance the wealth of the investors by investing the money they have mobilized. It is the prudence and appropriateness of the investment and asset allocation strategies which influence the returns from the money invested in mutual funds. Therefore, the AMC and trustees must see to it that appropriate investment strategies are developed and implemented to ensure safety and growth. Corporate governance plays an important role in keeping the fund manager alert and diligent about protecting the interest of the investors. Responsible corporate governance in a mutual fund ensures that the right type of strategy or a combination of strategies is developed before the funds of any schemes are invested. Keeping in view the declared objectives of the fund (short term, medium term and long term). The basic pre-requisite for responsible corporate governance in the context of mutual funds is ability, responsibility, accountability and transparency.

The various regulatory measures initiated by SEBI have undoubtedly put in place a well-defined corporate governance mechanism for Indian Mutual Funds. Many, of course, term it as 'policing by the regulator'. However, the basic thrust of Indian regulation is regulation through control, similar to the model adopted by the US and unlike the UK model of regulation through SROs. Apart from the nature of regulation, it must be admitted that SEBI has laid the foundation of a well-conceived corporate governance mechanism, which needs to be implemented in the true spirit by the entities involved in the management and supervision of the funds. The mutual funds are the managers while the investors are the true owners, who have placed their faith in the management of the funds. Therefore, the managers must be sensitive to the considerations and vulnerability of the investors. It is true that SEBI is there to monitor the regulations, but their real implementations also requires the active participation of the investors, owners and the other stake holders like registrars, bankers and brokers. The active involvement of these entities would not only eliminate the scope of diversion of the fund managers objectives and functions as per the goal of the funds, but would also help the managers/supervisors achieve the fund's objective and create value for it.

The US

As we know, mutual funds in the US are regulated by SEC, a government body. The cornerstone of regulation of mutual funds in the US is the Investment Company Act, 1940, and the subsequent amendments. The basic thrust of the system is that it relies primarily on statutory (legislative) measures rather than SROs. However, SROs play a secondary role by trying to impart fairness to the market and protecting the interest of the investors. According to Paul A. Leder (1995), the underlying philosophy of regulation in the US consists of the following elements.

- The regulations are broadly against misstatement and misrepresentation, and there are statutory provisions for punishment for fraud.

- The regulations are aimed at further disclosure of information to enable the investors to take informed decisions regarding investments.
- Fair dealing is compulsory for all the market participants to combat insider trading and to ensure fairness for all investors.
- The US model relies heavily on statutory control, investigation and enforcement of the securities law.

The UK

The essence of the UK model is self-regulation of the market participants, overseen by the SROs, while the regulation of the market is within the jurisdiction of the police and the relevant government departments. The interest of the investors is protected through control of the activities of market intermediaries like investment trusts, unit trusts, etc.

Financial services in the UK are regulated through the Financial Services Act (FSA) of 1986. The act contains a combination of legislative (statutory) and self-regulatory mechanism. According to it, the regulatory authorities lies with the Securities and Investment Board (SIB), which has framed the rules and regulations for conducting investment business, but the primary responsibility of implementing these regulations and supervising the market participants has been delegated to SROs. The SROs are certified and supervised by the SIB.

From the investor point of view, the basic objective of the regulatory framework should be the protection of investor from default risk. This can be done by offering guarantee on payment of principal amount. It is not possible, in the alternative, laying down of the capital adequacy norms which facilitates the reduction of default risk. But the current regulations do are silent about this. The diversification of investments also reduces the quantum of default risk. Restrictions are imposed on investments (regulation 41) may facilitate diversification. However, it depends upon the ability of the fund manager. Therefore, it is suggested that capital adequacy norms should be prescribed to protect the investor. As alternatives to capital adequacy, insurance protection for investors or establishment of compensation fund is also suggested.

While granting the permission to AMC, SEBI should also consider individuals behind AMC and their experience in financial services and portfolio management. This facilitates professional supervision of the funds.

The regulations on expenses, both managerial remuneration and initial expenses are too flexible. Therefore, these regulations are to be further strengthened, which would increase the surplus available for distribution and returns to the investors. Regarding investment restrictions, SEBI should insist on rating the investments, such as private placed debentures, securitized debt and other unquoted debt instrument. This would improve the quality of investment and minimize the risk to the investor.

SEBI regulations should improve the transparency in the areas of portfolio disclosure, reporting of expenses, and commission paid on dealings.

For institutions in the financial sector, the concept of self-regulation is more popular in the UK and the US. For example, the objectives of Investment Management Regulatory Organisation (IMRO) and Personal Investment Authority (PIA) (both belong to UK) are more attentive to investor protection. They also articulate the formulation of standardized procedures and practices for investment business. Such type of framework is suitable to India also, and MFs should come forward for development of such an organization, instead of the present umbrella regulation provided by the SEBI. In this direction, a welcome feature is that the Association for Mutual fund in India (AMFI) has been formed, but so far, it has not laid down any steps for self regulation.

Developmental Role of Regulator

SEBI has introduced a broad spectrum of policies to promote healthy regulations in the mutual funds industry and to protect the investors' interest. However, not much is known about the official assessment made by SEBI while taking regulatory initiatives. It is not known whether SEBI has conducted any analysis regarding vital issues, like the cost-return relationship of mutual fund investing, risk management practices, funds management strategies, corporate governance, service delivery and the investors' perception regarding the funds and regulators. In the US, SEC frequently conducts in-depth studies in the interest of both the investors and industry. SEBI can consider similar steps to remove certain regulatory and operational weaknesses.

The recent norms in India and globalization offer tremendous opportunities to Indian Mutual Funds. While liberalization by itself doesn't guarantee growth, institutionalization of liberalization, achieved through changes in the managerial mind set, can definitely produce the desired results. The Indian mutual funds industry can emerge as one of the strongest players in the global capital market by absorbing investment technology and modifying managerial practices in the regional context, while thinking and acting with the global vision.

Transparency is essential for corporate governance and portfolio disclosure is an important means of keeping the investors informed about the way their moneys are being used to create financial assets. Therefore, SEBI has made it mandatory for mutual funds to disclose the entire portfolio of any scheme. It has stipulated that all mutual funds shall, before the expiry of the month from the case of each half year (that is 31st March and 30th September); send to all unit-holders a complete statement of the scheme portfolio. However, a statement need not be sent to the unit-holders if the information is published in the form of an advertisement in an English daily of national circulation and in a regional language newspaper which is in circulation where the Head Office of the mutual fund is located.

LEGAL STRUCTURE

Mutual Fund Structure in the USA

In the USA, Mutual funds are set up as investment companies, which may be thought of as "the fund sponsors". An investment company may be a corporation, partnership or a unit investment trust. For our purpose, all these legal entities may be broadly understood as mutual funds. The investment company in turn appoints a management company which may be either a closed end management company or an open end management company. Only open-end management companies are technically called "mutual funds" in USA.

The constituents of mutual funds in the USA are the Management Company, Underwriter, Management group and custodian. The management company is the Indian equivalent of an AMC. Underwriter of a fund is the distributor or the marketing company that sells the shares to brokers or to brokers or to the public. A Management Group is a family of management companies owned by a group of people or a corporation. Custodian is the entity that holds the fund's assets on behalf of the Management Company. All mutual funds irrespective of their structure, including all of the constituents described above are regulated by the Securities Exchange Commission.

Mutual Fund Structure in the UK

In the UK mutual funds have two alternative structures. Open-ends are in the form of Unit Trusts, while closed-ends are in the form of corporate entities. Unit Trusts are regulated by the Securities and Investment Board. They must also be authorized by the relevant "Sell'-regulatory Organizations". Investment Trusts are structured as companies and provisions of the Companies Act are applicable to them.

Mutual Fund Structure in India

Like other countries, India has a legal framework within which mutual funds must be constituted. Unlike in the UK, where two distinct-'trust' and 'corporate'-are allowed with separate regulations depending on their nature-open or closed end. In India, open end and closed end funds are constituted along one unique structure-as unit trusts. A mutual fund in India is allowed to issue open-end and closed-end schemes under a common legal structure. Therefore, a mutual fund may have several different schemes (open-ended and closed ended) under it i.e., under one unit trust at any point of time. However, like the USA, all the funds and their open end and closed end schemes are governed by the same regulations and the regulatory body, the SEBI. The structure that is required to be followed by mutual funds in India is laid down under SEBI (Mutual Fund) Regulations, 1996.

Guidelines for Banks Sponsoring Mutual Funds

Some public sector banks have set up mutual funds and a few are in the process of doing so. It is considered necessary to issue guidelines on certain important aspects as indicated below:

Every mutual fund should be constituted as a trust under the Indian Trust Act and the sponsoring bank should appoint a board of trustees to manage it. The board of trustees should have at least two outsider trustees, who are the persons of ability and integrity and have proven capacity in dealing with problems related to investment and investor protection. The overall super inheritance, direction, control and management of affairs and business of the fund should vest in the board of trustees.

The day today management of the scheme under the fund should be looked after by a full time executive trustee who should not be concurrently discharging any other responsibility in the concerned bank. If the management of the mutual fund has been assigned to the bank subsidiary, the full time Executive Trustee should not be holding any other position. An arm's length relationship should be maintained between sponsor bank and the board of trustees who manage the Mutual fund and care should be that in putting through the transactions, there is no clash of interest between the sponsor bank and the beneficiaries under the schemes of its mutual fund. In case, the management of the mutual fund has been entrusted to a subsidiary of the bank, similar care should be exercised by the latter to avoid any clash of interest between itself and the beneficiaries under the scheme of the mutual fund.

The sponsor bank's contribution to the corpus of fund should be a minimum of Rs 25 lakhs or such higher amount as may be specified by the Reserve Bank. The corpus may be converted at a later date into subscription to any of the schemes of the fund with approval to board of the trustees of the fund. In addition to the contribution to the corpus, the sponsor bank should contribute and maintain in each of the fund's schemes by way of its stake an amount equivalent to 1% of the total amount outstanding. This stipulation will not, however apply to special schemes wherein the sponsor bank can't participate. Banks should obtain Reserve Bank's prior approval before announcing any scheme of a mutual fund irrespective of whether it is identical or not to any of the earlier schemes approved by the Reserve Bank. The investment objectives and policies of the mutual fund should be laid down in the trust deed and every scheme to be launched by fund must be in accordance with such broad objectives and policies and the rules and regulations framed in connection therewith. The mutual fund should make a clear statement of investment objectives of the fund and its investment policies, besides the terms and conditions of the scheme.

The mutual funds should invariably take delivery of scrips purchased and in the case of scrips sold, give delivery thereof to the purchaser. The scrips should be got transferred in the funds name. In no event should a mutual fund make a short sale/purchase of securities or carry over the transactions from one settlement period to the next settlement period. The mutual fund should not make investment in any other Unit Trust, Mutual Fund or similar other collective investment schemes. The fund should not also invest in the shares, etc. of investment companies/corporations.

Mutual Funds should maintain separate accounts of each schemes launched by it, segregating the assets under each scheme. No switching of assets between the schemes should take place, except with the prior approval of the board of trustees and at the prevailing market rates. The board of trustees of mutual funds should prepare an annual statement of accounts in respect of each of the schemes which should contain inter alia statements of assets and liabilities and income and expenditure accounts, duly audited by qualified auditors. Further an abridged version of the annual accounts, together with the report of the auditors and the board of trustees, should be published for the information of subscribers to the concerned scheme.

The board of trustees of mutual funds should disclose the net asset value (NAV) of each of the schemes and the method of valuation for the benefit of the concerned subscribers. Sponsor banks should furnish to the reserve bank in duplicate the following reports on a regular basis:

(a) A half yearly report indicating the performance of the mutual fund as a whole as well as each scheme thereof.
(b) Audited annual statement of accounts, together with the reports if auditors and report of the board of trustees.
(c) Scheme wise details of investment portfolio since the previous annual report and industry wise exposure.

The above guidelines are applicable to all schemes of mutual funds of banks or their subsidiaries including those already set up. If existing scheme under a mutual fund is not in accordance with any of the guidelines, the bank concerned should inform RBI the nature of variations and the action taken/proposed to be taken for compliance with the guidelines.

Banks are required to obtain the Reserve Bank's prior approval before announcing any scheme for a mutual fund as informed in July 1989 irrespective of whether it is identical or not to any of the earlier schemes approved by the Reserve Bank. As the banks and their mutual funds have gained some experience in the formation of schemes since the issue of the guidelines, it has now been decided to relax the requirements of prior authorization of the Reserve Bank for individual schemes of the bank's mutual funds. Accordingly, henceforth the banks do not require RBI's approval for the close ended pure growth schemes which do not carry any minimum guaranteed yield or minimum guaranteed capital appreciation and which don't have a maturity period exceeding 10 years. However, the banks should formulate such schemes with due care and diligence and requisite research, taking into account inter alia the past performance of the mutual funds and overall market conditions and the trends. They should also furnish details of the scheme and its sales literature to the Reserve Bank of India while announcing a scheme to the public and also intimate to the Reserve Bank the amount collected under the scheme within 30 days from the date on which the subscription for the scheme closes. These instructions don't override any regulations and guidelines of SEBI currently in force or which may be issued from time to time relevant to this matter and it will be incumbent on the banks' mutual funds to comply with them fully.

All schemes other than the ones mentioned above, will continue to require RBI's prior authorization as specified in the guidelines issued by RBI in 1989.

RBI as Supervisor of Bank Owned Mutual Funds

The first non-UTI mutual funds were started by public sector banks. Banks come under the regulatory jurisdiction of the RBI. Therefore, the operation of bank owned mutual funds were governed by guidelines issued by the Reserve Bank of

India. Subsequently, it has been clarified that all mutual funds, being primarily capital market players, come under the regulatory umbrella of SEBI. It is generally understood that all market related and investor related activities of the funds are to be supervised by SEBI, while any issues concerning the ownership of AMCs by banks fall under the regulatory ambit of the RBI. For example, if banks as fund sponsors have offered assured return schemes, RBI would have to review the capital adequacy and financial implications of the guaranteeing bank. Any fund mergers of bank-sponsored funds with others will also involve RBI approvals. However, the RBI no longer issues guidelines on bank-owned funds' operations.

Sales Practices Norms for Mutual Funds

Just as fund distributors have to follow certain desirable sales practices, the mutual funds themselves have a collective responsibility to follow good practices in the interest of the investors. SEBI and AMFI have been consciously working on evolving some guidelines on the subject. Such guidelines are summarized below:

SEBI's Advertising Code: SEBI's advertising code lays down guidelines to be followed by funds while advertising their schemes. Recently, AMFI and SEBI have jointly developed a detailed uniform set of standards for advertising.

AMFI/SEBI guidelines lay emphasis on fund performance reporting. While reporting the performance of their schemes in advertisements, funds are expected to provide a complete perspective to the investor. The guidelines include uniform practices for computation of yields so that investors can meaningfully and correctly compare the yields given by different funds. Some key points of SEBI guidelines are given below:

- The code protects investors from misleading advertising by specifying norms for computing returns, management capability and comparisons that may be contained in advertisements.
- The code classifies advertisements into two categories: one that contains basic information regarding an existing scheme, and the other that contains information on a scheme's performance.

  It further enumerates the items that may be included in each category of advertisement.
  The following is a list of important items relevant to performance advertisements:

- The dividends declared or paid shall be mentioned in rupees per unit along with the face value of each unit of that scheme and the prevailing NAV at the time of declaration of the dividend.
- Only compounded annualized yields can be advertised if the scheme has been in existence for more than one year.
- All performance calculations shall be based only on NAV and the payouts to the unit holders. The calculation of results should assume that all payouts during the period have been re-invested in the units of scheme at the then prevailing NAV.
- Annualized yields when used must be shown for last 1 year, 3 years, 5 years and since launch of the scheme. For funds in existence for less than one year, performance may be advertised in terms of total returns and such returns should not be annualized. However, in case of schemes/cash and liquid plans, performance can be advertised by simple annualization of yields if performance figure is available for at least 30 days provided it doesn't give any unrealistic or misleading picture of performance/future performance of the scheme.

Technology and Regulations

Mutual funds and other types of investment companies have recognized and capitalized upon the tremendous opportunities provided by technology. Funds world over sell their units to a rapidly growing market, and are anxious to use new systems to locate and communicate with potential investors. Many funds in India too have successfully adapted electronic media into their operations and communications strategies. Technology has permitted more funds to reach out to more investors faster, and more cost-effectively, than ever before. The government and SEBI now have to respond to the promise of technology by introducing the laws to accommodate new ideas that are consistent with investor protection and are friendly to the industry as well.

Thus, SEBI and the government have to continue to be responsive to the new technology-drives ideas. While some of recent growth in industry may be attributed to the increased use of technology by mutual funds and investors, not all mutual fund outfits and investors have embraced technology to the same extent. However, the market will ultimately prove the worth of technology. While many mutual funds could realize significant cost saving by delivering all of their required disclosure document electronically, many investors are not able to willing to receive them in format. Thus, a system of pure electronic communication seems some distance away.

Regulations of Mutual Funds in USA

The mutual fund industry in the US is highly regulated one. Four principal securities laws govern mutual funds.

Stringently Regulated Business

The investment company act of 1940 regulated the structure and operation of mutual funds and other investment companies. Among other things, the 1940 Act requires mutual funds to maintain detailed books and records, safeguard their portfolio securities, and file semi-annual reports with the US Securities and Exchange Commission (SEC).

The Securities Act of 1933 requires federal registration of all public offerings of securities, including mutual fund shares. The 1933 Act also requires that all prospective investors receive a current prospectus describing the fund.

The Securities Exchange Act of 1934 regulates broker-dealers, including mutual fund principal underwriters and others who sell mutual fund shares and requires them to register with SEC. Among other things, the 1934 Act requires registered broker dealers to maintain extensive books and records, segregate customer securities in adequate custodial accounts and file detailed financial reports with SEC.

The Investment Advisers Act of 1940 requires federal registration of all investment advisers to mutual funds. The Advisers Act contains various anti - fraud provisions and requires fund advisers to meet record keeping, reporting and other requirements.

In UK, there is another variety of mutual funds, which are not available to the retail market, e.g., private investment partnership and unauthorized unit trusts. These funds are available only to immediate customers and market counter parties. Intermediate customers include public authorities, listed companies, other companies and partnerships. Market counter parties include central banks and other regulated firms. This variant of mutual funds is not considered in the ongoing discussion.

Growth of Mutual Funds in USA/UK/India

The concept of mutual funds in India is about four decades long but in developed countries like USA and UK mutual fund activities began in early 20th Century.

Mutual fund activities have witnessed wide fluctuations and volatility of capital market since the beginning in USA and UK as well in India in the recent past.

USA Experience

In early 1920s, many types of financial institutions were formed in USA, offering Americans more investment opportunities. Several companies in USA located in New York, Boston and Philadelphia tried to meet investors' need. Soon bankers, brokers and investment counselors joined the mutual funds. Shortly after the first mutual fund, Massachusetts Investor's Trust was organized in Boston in 1924, the USA witnessed the stock market crash in 1929 (Mutual Fund, 2004, ICFAI). Despite the setback, many of the efficiently managed investment companies maintained their pattern of growth and service, and the industry grew dramatically over the years.

In 1940, Investment companies' Act was promulgated giving birth to National Committee of Investment companies to co-operate with Security and Exchange Commission (SEC) in formulating rules and regulation, and stay informed of State and federal legislation affecting mutual funds. In 1941, it took responsibility of public education, in liaison with the SEC and monitoring legislations affecting mutual funds as well as exerting a strong influence to maintain high industry standard.

Number of mutual funds grew from 68 in 1940 to 400 in early 1970s, their assets grew from US$448 million in 1940 to US$50 billion in early 1970 (i.e., assets grew more than 100 times in 30 years). Shareholders accounts grew from 296000 in 1940 to 1 million in 1951.

In early 1970, money market mutual fund (MMMF) emerged in American capital market. This let to the small investors participate in the high short-term interest rate of money market that previously were available only to major institutions and wealthy. The major contribution was addition of many new accounts to mutual funds. 30 % of the mutual fund investors say that their first mutual fund was a MMMF. MMMF sparked a surge of creativity in the mutual fund industry. What followed was a series of mutual funds i.e., Municipal Bond Funds in 1976, Income/Option Funds in 1977, Government Income and Ginnie Mae funds in early, especially or sector funds throughout the decade.

In 1989, there were 2917 mutual funds with assets worth US$982 billion. By 1994, there were 5357 mutual funds with funds with asset base of more than US$2.3 trillion (Fiorini, 1995), registering a growth rate of 83.6% during the period 1989 to 1994. In terms of assets under management, the growth rate has been 134% during the same period. Currently (2004) mutual fund assets are more than US$9 trillion (Mutual Funds, ICFAI, 2004). The industry continued to grow and prosper despite the market Volatility providing investment diversification and professional management to around 15 million individual investors through more than 8000 investment schemes.

UK Experience

Mutual fund investment in the UK was primarily through Investment Trust (close-ended funds) during initial period.

Investment trusts were the joint stock companies formed under the UK Companies Act (Arnaud, 1985). Capital issue in one time and remains unchanged though the same can be increased with the consent of the shareholders. Unit Trusts are open-ended funds in the UK. Unit trusts can accept unlimited funds from the investors, issue units and reinvest the funds in capital market instruments. Unit trusts are constituted by a deed of Trust. Every Unit Trust is legally obliged to have separate trustees to act as an independent arbitrator and safeguard the assets on behalf of the number of investors, who subscribe to the fund. There are primarily three types of funds namely Capital Trusts, which aim to provide capital appreciation, General Trusts, which aim to provide capital appreciation and reasonable periodic income, and Income Trusts, which aim to provide high income.

In the UK, mutual fund activities were started in the second half of 19th century. The first investment company set up in the UK was Scottish-America Investment Company in London in 1860 (Mutual Fund, ICFAI, 2004). During early 1900, there were 58investment trusts in existence in the UK. When 1st world war broke, London and New York Stock Exchanges closed for a few months. The UK Trust exchanged most of their American holdings for Government bonds. This was done by the UK government to secure loan from USA against government securities held by the Investment Trusts. Investment trusts weathered the war years in good style. The post-war period was difficult. Inflation was high. This period saw the beginning of a shift from fixed interest investment securities into increasing proportion of equity. This was done to offset the impact of inflation and taxation as higher proportion of equity investment brings about high returns.

Late 1920s were characterized by the vast increase in financial and business activities. This accelerated renewed growth in the number investment trusts. The growth was slower as compared to USA. The number doubled after the war. Some funds were caught by the unexpected length and depth of the bear market of USA. Recovery was slow. It was a time for patience and a gradual rebuilding which continued until the outbreak of the Second World War. During the Second World War, New York market was relatively stronger than London Market. Because of exchange control and market forces, the UK Investment Trusts reduced their overseas investments, which fell from 50% to 10% of the total funds. The money so realized was used to repay loans or to invest in equities at bargain basement levels in the UK. By 1943, the Trusts were able to report an appreciation in the value of its investments since 1930. War time years were a period of inactivity enforced by the absence of many directors and employees. Jobs became complicated by the requirements of keeping two sets of books. Precaution proved wise, as many officers suffered from bombing, fires, etc., but continuity was maintained. By then, investment Trusts started showing resilience. The period from 1950 to 1960 was the period of recovery, i.e., recovery from devastating war and long depression of 1930, recovery of industry all round the world, low inflation rate, low rate of interest for long term borrowing, etc. Finance Act 1965 was a major setback for Investment Trusts. Favorable tax legislation in finance Act 1972 and strength of equity market gave birth to a sudden explosion of investment trusts. The period from 1976 to 1978 was a depressing period due to high interest rate and high inflation. The period from 1979 to 1982 was a period of favorable government practices. The budget of 1980 exempted investment trusts to pay Capital gains tax made within their funds. Thereafter, there was accelerated renewed growth in mutual fund activities. The period 1990-1995 saw the mutual funds assets growing from £ 54.22 billion in 1992 to £ 110.17 billion. The asset base increased to £387.15 billion as at the end of 2001 (Mutual Funds, ICFAI, 2004).

Indian Experience

Mutual fund concept was unknown in India until the establishment of UTI by an act of parliament in 1963 with the main objective of encouraging savings and investments and participation in income, profits and gains accruing to the corporations from the acquisition, holding, management and disposal of securities.

UTI launched the first open ended investment scheme, Unit Scheme 1964 on 1st July 1964. The investment objective was to provide regular income to the investors. In 1966, Reinvestment Plan was launched under the same scheme to provide capital appreciation. Unit Linked Insurance Plan (ULIP) was introduced in 1971 to provide life/accidental coverage besides regular income. Thereafter, UTI introduced series of investment schemes with varied objectives for different investing public based on their risk, return, liquidity profile. The credit of first equity growth fund goes to Unit Trust of India with the launch of seven year close-ended fund called "Mastershare" in September 1986 under its subsidiary UTI Mutual Fund, 1986. The fund's main objective was capital growth-cum-income. The fund collected Rs 1500 million at that time. The mutual fund activity in India, in true sense, may be said to have begun in 1986. State Bank of India and Canara Bank floated its subsidiaries namely SBI mutual fund and Canbank Mutual Fund in the year 1986 and 1987 respectively. Canbank Mutual Fund launched its first seven-year growth fund "Canshare" in January 1988. The fund collected Rs 170 million. SBI launched its first growth fund magnum multiplier in October 1990. In September

1990, Indbank Mutual Fund introduced a tax saving growth scheme called "Ind 88 A". From the year 1991 onwards a series of growth funds, income funds, Income plus growth funds, and tax saving growth/income funds were floated by asset management companies in public sector. At the end of June 1992, the asset under the management of mutual funds was Rs 43 billion, contributed by 35 million Unit holding accounts.

During 1992, the collection was Rs 23.36 billion by public sector mutual funds and Rs 71.71 billion by UTI. In 1993-94 the mutual fund industry was thrown open to the private sector. During 1994-95, private sector collected 9.16 billion rupees, public sector mutual funds collected Rs 3.96 billion and UTI collected Rs 130.01 billion. In 1995-96 UTI collected Rs 59.92 billion whereas there was net outflow of Rs 988.1 millions in the case of public sector mutual funds. Private sector mutual funds could only collect Rs 831.2 millions. Funds under management were more than Rs 700 billion at the end of the year June 1997 and unit holding accounts over 40 millions. From the year 1997-2000, the assets under management grew from Rs 700 billion to Rs 1034 billion and during the period 2000-2004 the asset under management of mutual fund industry have steadily increased from Rs 1043 billion to more than Rs 1500 billion. However, the unit holding accounts decreased from 50 million to estimated 20 million indicating that common investors seem to have gone away from the investment radar of mutual funds. The study attempts to ascertain the reasons for such a shift.

(C) Benchmark Comparison

Although the sample equity funds failed to generate returns higher than the risk free returns during the period (1997-2007) of this study, benchmark comparison revealed contrary picture of financial performance of sample equity mutual funds. Benchmark comparison has been one of the measures of performance of equity funds. For a passive investor, investment in market portfolio is better option if the market portfolio produces better performance than the managed portfolio. In the event, the investors would not want to park their investment with the fund managers.

The study revealed that the sample equity mutual funds, in general, have performed far superior to the market portfolio, i.e. BSE 100 index during the entire period of the study. In terms of number of funds, two-thirds (61%) of the sample equity funds have posted better performance compared to benchmark portfolio (BSE 100 index). It is further observed that the average monthly returns on a sample equity funds have been 0.44% compared to 0.14% for the benchmark portfolio during the period of the study.

Further analysis was carried out to find out whether the difference in performance in terms of benchmark comparison may be due to the type of fund (open-ended or closed-ended), size or ownership pattern. The findings of the study eloquently proved that different groups of the sample mutual funds have produced differential performance in terms of benchmark comparison.

The performance of open-ended, small sized and private sector sample equity funds have shown better performance. An overall poor performance of large size sample equity funds irrespective of the ownership class indicated that large sized funds are likely to perform poorly irrespective of the ownership class. This leads to the conclusion that there may be an optimal size of managed portfolio, which may produce better performance.

Comparing the performance during two sub periods, the data reveal that during sub,-period 2, the performance of the sample equity funds (tnean monthly return, 0.58 %) was far better than the benchmark portfolio(mean monthly returns 0.29%) was better than the equity mutual funds(mean monthly returns 0.15%) during sub-period 1. It has been observed that performance during sub-period 1 has been unsatisfactory for the equity mutual funds for various reasons. The period characteristic with host of factors related to the mutual funds operations particularly during sub-period 1 (1993-1998) of the present study. The illustrative list of these factors may be underlined as follows:

- The mutual fund industry was new and perhaps experiencing the learning curve.
- The ambiguities related to investment norms abounded the investors as well as the fund managers.
- Lack of education to equity investors leading to higher than required expectations of return by them
- Equity investment avenues of above standard quality may have been limited
- The investors were assured minimum returns on the equity schemes, which was perhaps the most immature decision of the fund managers
- Lack of transparency and responsiveness towards the dynamic needs of the investors.
- There seems no research backed stock selection process.
- The stock market in India may not have been efficient leading to unsustainable rise in the equity values due to disproportionately higher speculative position in the market.
- It was a regime of high interest rates and equity investors expected even higher returns on their investment in the equity funds.

- The PSU mutual funds miserably failed to chum out continuous better performance due to inherent weakness of investment decision process.
- The private sector mutual funds were new and needed some time before showing performance.

Treynor's Ratio

Jack Treynor (1965) conceived an index of portfolio performance measure called as reward to volatility ratio, based on systematic risk defined in equation. He assumes that the investor can eliminate unsystematic risk by holding a diversified portfolio. Hence, his performance measure denoted as Tp is the excess return over the risk free rate per unit of systematic risk, in other words it indicates risk premium per unit of systematic risk.

$$Tp = \text{Risk Premium/Systematic Risk Index}$$

$$= (rp - rf)Bp$$

Where Tp = Treynor's ratio, rp = portfolio return, rf = risk free return and Bp = Beta coefficient for portfolio. As the market beta is 1, Treynor's index "hp for benchmark portfolio is (rm-rf) where rm= market return. If Tp of the mutual fund schemes is greater than (rm-rf) then the scheme has out performed the market.

The major limitation of the Treynor's Index is that it can be applied to the schemes with positive betas during the bull phase of the market. The result will mislead if applied during bear phase of the market to the schemes with negative betas. The second limitation is that it ignores the reward for unsystematic or unique risk.

Sharpe's Ratio

William F. Sharpe (1966) devised an Index of portfolio performance measure, referred to as reward to variability ratio denoted by Sp defined in equation 9. He assumes that a small investor invests in the mutual fund and doesn't hold any portfolio to eliminate unsystematic risk and hence demands a premium for the total risk.

$$Sp = \text{Risk premium/Total Risk}$$

$$= (rp - rf)/SD$$

Where, Sp = Sharpe's ratio, rp = portfolio return, rf = risk free return, and SD=standard deviation of the portfolio returns. The Sp of the mutual fund scheme is greater than that of the market portfolio; the fund has out performed the market.

The superiority of the Sharpe's ratio over the Treynor's ratio is that it consists of the point whether investors are reasonably rewarded for the total risk in comparison to the market. A mutual fund scheme with a relatively large unique risk may outperform the market in Treynor's index and may underperform the market in Sharpe's ratio. A mutual fund scheme with large Treynor ratio and low Sharpe's ratio can be concluded to have relatively larger unique risk. Thus the two indices rank the schemes differently.

The major limitation of the Sharpe's ratio is that it is based on the Capital Market Line (CML). The major limitation of the capital market line is that only the efficient portfolios can be plotted on the CML but not inefficient. Hence we assume that a managed portfolio (mutual Fund scheme) is an efficient portfolio.

Sharpe Measure

Sharpe (1963) suggested that it is possible to consider the return for each security to be represented by the following equation:

$$Rp = a + b*rm + e$$

Where rp = expected return, a = intercept, b = beta coefficient, rm = expected market return, e = error term with zero mean and constant deviation.

Sharpe noted that the variance explained by the index could be referred as the systematic risk and the unexplained variance is called residual or unsystematic risk. Sharpe suggests that systematic risk and unsystematic risk for a security can be qualified as:

Systematic risk = b^2x Var (rm)

Unsystematic risk (Unique risk) = Var (ri) – b^2 xVar (rm)

Where, var (ri) = Variance of mutual fund return scheme, Var (rm) = Variance of market return, b=beta coefficient of the scheme. A well diversified fund is expected to have lower unsystematic risk.

Jensen's Measure

Sharpe and Treynor ratio rely on ranking of portfolio in comparison to the market portfolio. They are unable to answer question like: Has fund given more than/less than/equal to expected returns? Hence there is a need for better performance measure.

Michael C. Jensen (1968) has given different dimension and confined his attention to the problem of evaluating a fund manager's ability of providing higher returns to the investors. He measures the performance as the excess return provided by the portfolio over the expected (CAPM) returns. The

performance measure denoted by Jp is defined in the following equation. He assumes that the investor expects at least CAPM returns.

$$Jp = \text{Portfolio. Return} - \text{CAPM.Retunrs}$$

$$= rp - \{rf + bp(rm - rf)\}$$

Where Jp = Jensen's measure for portfolio, rp = portfolio return, rf = risk free return, and bp = beta coefficient of the portfolio. A positive value of the Jp would indicate that the scheme has provided a higher return over the CAPM return and lies above Security Market Line (SML) and a negative value would indicate that it has provided a lower than expected returns and lies below SML. The Jensen's model assumes that the portfolio is fully invested and is subjected to the limitations of CAPM.

Fama's Measure

Jenson's measure computes excess returns over expected returns based on premium for systematic risk. Eugene Fama (1972) goes ahead, he suggests to measure fund performance in terms of excess returns over expected returns based on premium for total risk. In other words the excess returns are computed based on Capital Market Line (CML).

Fama breaks down the observed return into four components:

(i) Risk Free return rf
(ii) Compensation for systematic risk
$b(rm - rf)$
(iii) Compensation for inadequate diversification
$(rm - rf)\ \{(sp/sm) - (b)\}$
(iv) Net superior returns due to selectivity
$(rp - rf)(sp/sm)(rm - rt)$

The second and third measures indicate the impact of diversification and market risk. By altering systematic and unique risk, portfolio can be reshuffled to get the desired return. Fama says the portfolio performance can be judged by the net superior returns due to selectivity. His performance measure denoted by Fp is defined in the following equation.

$$Fp = \text{Portfolio return} - \text{Risk free returns} - \text{returns due to all risks}$$

$$= (rp - rf) - (sp/sm)(rm - rf)$$

Where Fp = Fama's measure for portfolio, rp = portfolio return, rf = risk tree return, sp=standard deviation of the portfolio returns & sm = standard deviation of the market returns.

A positive value for Fp indicates that the fund earned returns less than expected returns and lies below CML. The purpose of performance evaluation is that it should be in a position to identify the mistakes and suggest a direction for the correction. A comparison of Sharpe's and Treynor's ratios will help the fund managers to correct their actions from risk angle and comparison of Jensen's and Fama's measure will help from return angle.

Performance Measurement

The performance of mutual funds receives a great deal of attention from both practitioners and academicians. With an aggregate investment of over $11 trillion worldwide and over $20 billion in India, the investing public's interest in identifying successful fund managers is understandable. From an academic perspective, the goal of identifying superior fund managers is interesting as it encourages development and application of new models and theories. The idea behind the performance evaluation is to find the returns provided by the individual schemes and the risk levels at which they are delivered in comparison with the market and the risk free rates. It is also our aim to identify the outperformers. The objective of the study is to evaluate the performance of Indian Mutual Fund Schemes in a bear market using:

- Relative performance index
- Risk return analysis
- Treynor's ratio
- Sharpe's ratio
- Sharpe's measure
- Jensen's measure
- Fama's measure

Performance in terms of rate of return: Absolute Measure of performance

Performance in terms of growth of net asset value per unit is commonly applied measure of performance of mutual funds. According to Firth (1977), the growth of NAV is measured in terms of rate of return over a period of evaluation using the following equation:

$$R1 = \{D1 + (P1 - Po)\}/Po$$

Where,

R1 = Return during period 1

P1 = value of the fund at the end of period 1

Po = value of the fund at the end of period P1

Rate of return on equities held by equity mutual fund have a direct bearing on the fund performance. The study of Gupta (1981) presented a detailed and well-based estimate of "portfolio" rate of return on equities. This pioneering study

in the Indian context has been a major contribution in the field and is regarded as the benchmark on the rate of return on equities for the specified time. He laid the basis of rate of return concept in performance evaluation. Jain (1982) evaluated performance of Unit Trust of India (UTI) during 1964-65 to 1979-80, including the profitability aspects of Unit Scheme 1964, Unit Scheme 1971 and Unit Scheme 1976. He concluded that its real rate of return have low indicating overall poor performance of UTI schemes. There has been no significant increase in the profitability over the years.

1. **Performance in terms of benchmark comparison:** benchmark comparison is important performance measure as it indicates the extent the fund managers were able to produce better performance of managed portfolio compared to the market of index portfolio.
   According to Arnaud (1985) benchmark comparison (i.e., comparison of fund performance with market or index portfolio in terms of returns) is 3rd level of performance, which indicates how well or worse the managed portfolio has performed vis-à-vis the benchmark portfolio.
   Haslem (1988) evaluated fund performance by comparing the fund return with the return on market portfolio with the comparable risk. The fund's systemic risk, beta coefficient, is used to compare portfolio risk relative to the market risk. Beta is a measure of risk of the fund's portfolio relative to the risk of the market portfolio.
2. **Performance in terms of risk-adjusted rate of return: relative measure of performance:** portfolio performance without reckoning the risk exposure do not provide fair and true picture. Various studies in the past have not only examined performance in terms of rate of return but also evaluated portfolio performance in terms of risk-adjusted rate of return (Treynor and Sharpe's indices).
   Equity mutual funds assume higher risks compared to gifts, bonds or other government securities. Hence, they are expected to produce returns not only higher than the returns offered by the gifts bonds or other government securities but also high enough to match the risk of a given equity fund. Treynor and Sharpe's indices offer such a measure of performance. Treynor (1965) and Sharpe (1966) have provided the conceptual framework of relative measure of performance of equity mutual funds. While Treynor used systemic risk, Sharpe used total risk to evaluate the mutual fund performance.
   Higher value of Treynor's index indicates better performance of portfolio and vice-versa. The Treynor's measure of portfolio performance is a relative measure that ranks the funds in terms of risk (market risk) and return. The index is also termed as reward to Volatility ratio.
   Higher value of Sharpe's index indicates better performance of portfolio and vice-versa. Sharpe's measure of portfolio performance is also relative measure that ranks the funds in terms of risk (total risk) and return. The ratio is also termed as reward to variability ratio.
   McDonald (1974) had evaluated performance in terms of Sharpe and Treynor's index, as also in terms of Jenson's alpha. Mean alpha for the sample was found to be 0.052. Statistical significance was not reported in his study.

Fama (1972) advocated yet another measure of portfolio performance. Fama suggested that overall portfolio performance has two components. First, performance due to stock selection ability (realized return minus expected portfolio return) of the fund manager and second. performance expected portfolio return-risk assumed by the fund manager.

He further broke selectivity into two fine components, i.e., net asset selectivity and diversification. Higher portfolio return may be consequence of higher portfolio risk resulting from low diversification of equity mutual fund. Apart from rate of return, Firth (1977) has also suggested Capital Asset Pricing Model as another measure of fund performance. The performance model used in the study was based on the generally accepted premise that increased expected returns are associated with higher level of' risk. This model can evaluate risk-return performance.

Kon (1983), evaluated performance in terms of selectivity and timing parameters over a period, January 1960 to June 1976. The sample was 37 funds. The study concluded that individually few funds have shown positive selectivity and timing skills but collectively mutual funds failed to perform satisfactorily.

In the literature we find the following most used risk-adjusted Performance measures based on ex-post returns in the perspective capital Asset Pricing Model

- Sharpe's measure (Sharpe, 1966)
- Treynor's measure (Treynor, 1965)
- Jenson's Alpha (Jenson, 1968)

However, the above three measures are derived from capital market theory and the CAPM and are, therefore, dependent upon the assumptions involved with this theory. For example, if the Treasury bill rate is not a satisfactory proxy for the risk-free rate, or if the investors can't borrow and lend at the risk-free rate, this will have an impact upon these measures of performance.

Fama (1972) suggested fund performance in terms of excess returns over expected returns based on premium for total risk. In other words, the excess returns are computed based on capital market line (CML). Henriksson (1984) evaluated performance in terms of market timing abilities with samples of 116 open-ended investment schemes during the period, February 1968- June 1980. The empirical results obtained indicated satisfactory timing skills of the fund managers.

Chang, et al. (1984) tested stock selectivity abilities and market timing abilities of 67 mutual funds over a performance period January 1971 to December 1979. They used parametric statistical tool to test the presence of either of the two skills in the mutual funds. They concluded that the fund managers are unable to outperform a passive investment strategy. In order to overcome the limitations associated with the above traditional risk-adjusted performance measures, Ferson and Warther (1996) developed a conditional model in which the excess returns to the portfolio are related to three explanatory variables: the standard market portfolio, an interactive term that is the product of the returns to the benchmark market index and the legged dividend yield and an interactive term that is the product of the benchmark market index and the legged T-bill rate.

Fund Performance-related Studies in the Indian Context

Barua and Verma (1991) provided empirical evidence of equity mutual fund performance in India. They studied the investment performance of India's first 7-year closed-end equity mutual fund, Master share. They concluded that the fund performed satisfactorily for large investors in terms of rate of return. Vaid (1994) looked at the performance in terms of the ability of the mutual fund to attract more investors and higher fund mobilization. It shows the popularity of the mutual funds as it is perceived to pay superior returns to the investors. She concluded that even for equity oriented funds, investment is more in fixed income securities rather than in equities, which is distortion.

Sarkar and Majumdar (1995) evaluated financial performance of five closed ended growth funds for the period February 1991 to August 1993 and concluded that the performance was below average in terms of alpha values (all negative and statistically not significant) and funds possessed high risk. No reference was provided about the timing parameters in their study.

Jaydev (1996) evaluated performance of two schemes during the period June 1992 to March 1994 in terms of returns/ benchmark comparison, diversification, selectivity and market timing skills. He concluded that the schemes failed to perform better than the market portfolio. Diversification was unsatisfactory. The performance didn't show any sign of selectivity and timing skills of the fund managers.

Sahadevan and Raju (1996) focused on data presentation on expenses and other related aspects, which are generally covered in annual reports of the mutual funds without going into the details of financial performance evaluation of the funds.

Gupta and Sehgal (1997) evaluated mutual fund performance over a four year period 1992-96. The sample consisted of 80 mutual fund schemes. They concluded that the mutual fund industry performed well during the period of study. Performance was evaluated in terms of benchmark comparison, performance from one period to next and their risk-return characteristics.

Mishra (2001) evaluated performance from April 1992 to December 1996. The sample size was 24 public sector sponsored mutual funds. The performance was evaluated in terms of rate of return, Treynor's Sharpe's and Jenson's measures of performance. The study also addressed beta's inability issues. The study concluded dismal performance of PSU mutual funds in India, in general, during the period 1992-96.

Singh and Meera (2001) in their book presented a framework for conducting critical appraisal of mutual fund performance in the Indian context, reviewed the performance of UTl and private and money market mutual funds.

Narayan and Ravindran (2003) studied the performance of Indian mutual funds in a bear market using relative performance index, risk-return analysis, Treynor's ratio and measures of Sharpe, Jenson and Fama.

Sadhak (2003) in his book suggested several improvements in the strategic and operational practices of mutual funds keeping in mind the mechanism used by fund managers in developed countries.

Sondhi (2004) studied the financial performance evaluation of equity-oriented mutual funds on the basis of type, size and ownership of mutual funds using the measures of absolute rate of returns, comparisons with benchmarks (BSE 100) and the return on 364 days T-bills and risk adjusted performance measures (Sharpe, Treynor, Jensen, Alpha and Fama).

Performance in Terms of Benchmark Comparison

Benchmark comparison is important performance measure as it indicates the extent the fund managers were able to

produce better performance of managed portfolio, compared to the market or index portfolios. According to Arnaud (1985) benchmark comparison (i.e. comparison of fund performance with market or index portfolio in terms of returns) is 3rd level of performance, which indicates how well or worse the managed portfolio has performed vis-à-vis the benchmark portfolio.

Haslem (1988) evaluated fund performance by comparing the fund return with the return on market portfolio with the comparable risk. The funds systemic risk, beta coefficient, is used to compare portfolio risk relative to the market risk. Beta is a measure of the risk of fund portfolio relative to the risk of market portfolio.

Fund Brokers' Sales Practices in USA

National Association of securities Dealers (NASD) is a self regulatory organization, which has prescribed mandatory sales practices for its members under NASD Rule 2830, which applies to securities of companies registered under the investment Company Act, 1940. Here we list some relevant practices governed by Rule 2830.

- NASD prescribes a cap on sales and distribution expenses. The cap is a percentage of sale prices for funds without an asset based sales charges (load), and a percentage of total new sales in case of funds with an asset based sales charge (load).
- A broker is not allowed to describe a fund as "no load" if there is a front end or deferred load.
- A broker is prohibited from recommending or implying that purchase of units before the ex-dividend date may be advantageous.
- The rule also provides for refund of the distributor's commission received from a fund if the investor redeems units within seven days of transaction
- Distributors are prohibited from using commissions as a basis for recommending investments in specific funds.
- Preferred pricing to specific categories if investors with respect to purchase of units, as compared to the public offer price, is prohibited.
- The rule also includes other ethical norms of conduct of distributors vis-à-vis the investor and the fund, or between distributors.

We can gauge from the above that mutual fund sales practices are closely regulated in the US. The criticality of such regulation can't be over emphasized with regard to investor protection. It is, therefore, conceivable that in the years to come SEBI's involvement in the streamlining and regulating of sales practices in the Indian mutual fund industry will be further enhanced either directly or working through AMFI or an association of distributors.

(D) Indian Banking Industry

The Demand for regulatory capital would be directly related to specific stipulations from the regulator and risks faced by the banks or more accurately the perceived risks faced by the banks. As banks get freedom to develop internal models for risk measurement, the demand for regulatory capital would increasingly become bank specific. As regards supply of capital only those banks that face a short fall of capital would need to raise capital from external sources. But for other banks supply of capital would be endogenous; it would be augmented by profits. Current and past profitability would determine the level of capital currently available to a bank. On the other hand, level of capital available to a bank would impact the risks bank is able to assume within the stipulations prescribed by regulatory authorities about minimum capital requirements. The level of risk assumed would impact the pattern of profits realized by a bank. Thus, profitability and capital will have a simultaneous relationship. This paper makes an attempt to study the nature of such relationships between profitability and regulatory capital for commercial banks in India.

The increased emphasis on capital regulation has raised a number of inter-related questions: Is focusing on capital an efficient way of regulating banks? What is the best way to structure capital regulation? The present study is examining the bank responses and the cost associated with these responses to capital requirements. The discussion draws heavily on international experiences, which serves as useful backdrop for the work on capital adequacy and understanding of banks responses to capital regulation, may be helpful in designing regulations that better satisfies regulator's objectives. One traditional objective of capital regulation has been to reduce bank failures and promote bank's stability.

A bank may increase its capital ratios as measured under the regulatory standards without reducing either the probability the bank will fail or the losses to the depositors and the depositing insurance agency in the event of bank failure. This general category of response will be referred to as cosmetic changes in the capital ratios. One way for a bank to make cosmetic improvement would be to reduce total assets so as to improve upon its capital to asset ratio while increase in portfolio risk by increasing the proportion of risky assets. The purpose of economic capital is primarily to limit the probability of bank failure and secondarily to finance bank activities. In other words, economic capital is concerned merely with the private cost of bank failures. Regulator capital

factors into consideration the public cost of bank failure so that regulatory capital is likely to require banks to maintain more capital than they would otherwise hold according to their internal capital allocation systems. Internationally, banks have responded to the regulations by reducing the risk exposure and increasing the capital. Banks reduce the risk exposure via loan sells and perhaps by refusing to make new loans. Further, banks issue new equity to help meet the regulatory guidelines even though these issues often reduce the price of existing shares predicted by some theories. In evaluating the capital position, the banks must consider the static cost associated with any capital, gain, the dynamic cost associated with adjusting it. Banks regulators have long considered the maintenance of adequate capital as an important element for maintaining safety and soundness of individual banks. The regulatory pressure on banks to maintain capital is asymmetric. Regulators will protest capital ratios that are too low, but they often have little objection about capital ratios that are too high. Market forces could, however, potentially impose varying cost on shareholders, based on both the level of banks capital and changes in the capital structure.

Indian banking in Indian has traditionally been one of the most stringently regulated sectors. The RBI is the apex body responsible for issuing rules and guidelines governing banking operations in India. Based on ownership, banks are classified as:

- Public Sector Banks (SBI and Associates; 19 other nationalized banks);
- Private sector banks (18 banks including ICICI Bank); and
- Foreign banks including CITI bank.

Other types include banking co-operatives and regional rural banks. In terms of assets and operations, the State Bank of India is the largest bank in India, followed by ICICI Bank. Banking regulations in India underwent a series of reforms after the economic liberalization policy of the government of India, which came into being after 1999 balance of payment crisis. In 1991, the GOI had to devalue rupee against the US dollar by 18% in 3 days. Following the recommendations of the International Monetary Fund to correct its fiscal and monetary imbalance, the GOI initiated wide scale reforms. Among these were the 1993 guidelines for the establishment of private sector banks, which permitted several non-banking companies including ICICI Limited, to set up their own banking subsidiaries. Later in 1998, the RBI recommendations on the harmonization of the Role and Operations of Development Financial Institutions and Banks paved the way for universal banking in India.

Although industry level competition increased with the entry of private sector, the GOI continued its protectionist policy in not allowing foreign banks to expand their operations beyond certain prescribed limits. FDI in Indian banks was also capped at levels between 10% and 26%.

Regulatory reforms were also aimed at changing banking habits in India. For example, the banking public financial institution and Negotiable Instrument Laws (amendment) Act in 1988 provided for penalties for the dishonor of cheques, thus promoting their use as a substitute for cash. In 1999, RBI issued guidelines for the issue of debit cards and smart cards, thus promoting electronic payment channels. For the new age private banks who could not replicate the distribution reach of the public sector banks in terms of branches, because of both financial resources constraints and time compression diseconomies, the RBI guidelines for internet banking of 2001 were a boon. Private Banks began promoting internet banking, phone banking and ATMs as convenient banking channels. Investment by private banks in technical structural assets helped them reduce the disparity in comparison with nationalized banks in terms of geographical reach. Meanwhile the corporate scope of banking companies, which in the early 1980s was restricted to retail and corporate banking, began expanding with initial forays into mutual funds. Banks were able to exploit the relational capacity that they had nurtured in terms of their customer base. The insurance Regulatory and Development Authority (IRDA) Act of 1999 paved the way for private sector entry into the life and non-life insurance market. However, foreign owned banks in India were only allowed to take up corporate agencies via bancassurance alliance for cross-selling insurance products to existing customers.

Deregulation of the financial sector started in the late 1980s and increased in the 1990s, leading to broadening of corporate scope of financial firms. Banks began operating in the six segments: if retail banking, corporate banking, investment • banking, asset management, life insurance and general insurance. This industry convergence may be seen as a result of both institutional level changes as well as continuous morphing of the organizational form by the banks.

Whereas the institutional changes of the 1950s-70s were aimed at nationalizing key financial sectors such as banking, insurance and asset management (the Unit Trust of India being the only mutual fund company in operation until 1987), deregulating and the subsequent entry of private firms into these sectors led to an increase in competitive activity. The relatively fast pace of charge meant that the incumbent firms found themselves facing environmental uncertainty. In times of uncertainty, incidence of isomorphic behavior is expected,

motivated both by requirements of industry regulators (coercive isomorphism) as well as a mimetic response to actions taken by perceived industry leaders (mimetic isomorphism). The pattern of entry by commercial banks into the fields of mutual funds, life insurance, general insurance, as well as in development of operational resources such as service through internet banking, phone banking and ATMs suggest mimesis in the strategic banks.

While institutional theory offers us an explanation for why banks' strategy to expand their business-scope was similar, it doesn't clarify why the leading firms took the strategic decisions they did. The following analysis seeks to elaborate the role of IC endowment and firm histories on the two largest banks' IC development and exploitation strategies.

Sales Practices

In the previous section, we discussed various distribution channels that are used by mutual funds in India. We also saw that new distribution channels have gradually been opening up in India, following global trends. Now we turn to a brief discussion of how mutual fund distributors work in practice. Note that while distribution channels now used in India may be the same as used elsewhere, the distribution methods or what is called "sales practices" differ from country to country. The term sales practices usually cover all methods by which funds and their distributors market the mutual fund schemes to investors. The sales practices cover areas such as distributor commission, before sales and after sales services from funds/ distributors to investors, advertising of schemes, ethical code of conduct, desirable marketing practices and distributor's responsibility vis-à-vis the investors.

Sales practices usually arise from convention but may also be mandated by regulators. It's therefore important for both fund distributors and the employees to understand the sales practices prevalent in Indian mutual fund market.

Professional Selling Practices

Members shall not use any unethical means to sell market or induce any investor to buy their products and schemes. Members shall not make any exaggerated statement regarding performance of any product or scheme. Members shall endeavor to ensure that all times investors are provided with true and adequate information without any misleading or exaggerated claims to investors about their capability to render certain services or their achievements in regard to services rendered to other clients.

- Investors are made aware of attendant risks in members' schemes before any investment decision is made by the investors.
- Copies of prospectus, memoranda and related literature are made available to investors on request.
- Adequate steps are taken for fair allotment of mutual fund units and refund of application moneys without delay and within the prescribed time limit and
- Complaints from investors are fairly and expeditiously dealt with.

Members in all their communications to investors and selling agents shall

- Not present a mutual fund scheme as if it were a new share issue.
- Not create unrealistic expectations.
- Not guarantee returns except as stated in the offer document of the schemes approved by SEBI and in such case, the members shall ensure that adequate resources will be made available and maintained to meet the guaranteed returns.
- Convey in clear terms the market risk and the investment risks of any scheme being offered by the members.
- Not induce investors by offering benefits which are extraneous to the scheme.
- Not misrepresent either by stating information in a manner calculated to mislead or by omitting to state information which is material to making an informed investment decision.

Reporting Practices

- Members shall follow comparable and standardized valuation policies in accordance with the SEBI Mutual Fund Regulations.
- Members shall follow uniform performance reporting on the basis of total returns.
- Members shall ensure scheme wise segregation of cash and securities accounts.

Sales Practices in Indian Mutual Fund Market

(A) Distribution Commission: As discussed in the previous section, Distributors (whether individuals or distribution companies) are compensated by funds through commissions.

- *Commission Rates:* In India there are no rules prescribed for governing the minimum or maximum commission payable by a fund to its distributor. Each fund has discretion to decide the commission structure for its distributors. As a result, commission structure and rates vary from fund house to fund house and from scheme to scheme. Thus, UTIMF pays commission to agent at a basic rate plus an incentive that depends on the Volume of business. Most fund houses pay upfront commissions

for mobilization of funds, and pay trail commission to their distributors in order to encourage the retention of the investors. The commission rates for equity schemes range from 1.5% to 2.5% and for debt funds between 0.25% to 1.25%. Higher commissions are paid in case of investments that are made with the purpose of taking tax benefits. since investors are required to lock in their funds for longer periods.

- *SEBI Regulations:* SEBI doesn't prescribe the minimum or the maximum amount of commission payable by a fund to the distributors. However, under SEBI (MF) Regulations, 1996:
  - *All* Initial Issue expenses including brokerage paid distributors are limited to 6% of the resources raised under the scheme.
  - In addition, SEBI regulated open ended funds are authorized to charge the investor's "entry and exit" loads to cover the fund distribution expenses. These loads shouldn't exceed the percentage specified in the scheme's offer document. In case the distributor's commission paid by the fund results in overall distribution expenses exceeding the rate specified in the offer document, excess distribution expenses are to be borne by the AMC; i.e., the excess can't be passed on to the unit holders.
  - A no-load fund, charging no entry or exit loads, is authorized to charge the schemes with the commissions paid to distributors as part of the regular marketing and management expenses allowed by the SEBI. SEBI puts a cap on the total expenses (including commissions) that can be charged to a commission each year. Any excess over allowable expenses is required to be borne by the AMC
  - Distributors can claim commissions on investments made through them by their clients. However, they are not entitled to commissions made on their own investments.
- *Market Practice:* Some funds pay the entire commission upfront to the distributors (i.e., at the time of sale of units), while others pay a part of it upfront and the balance in phases. The latter practice is known as "Trail Commission". Some funds follow the practice of not paying the balance to the distributor if the investor exits the scheme before a specified period. or stop paying the commission after the investor exits. Distributors are well-advised to educate the investors who have come to expect such rebates from distributors of all financial products. The distributors themselves must realize that they provide useful processing and advisory services to the investors, and have to incur cost in the process that need to be covered from well deserved commissions received from the funds and desist from rebating commissions.
- *Distributors Obligations:* distributors are well advised to follow the practices of honesty and transparency in explaining the commission structure to the investors, whose trust will build a long tern relationship.

(B) Sales Practices-Norms for mutual Funds

Just as fund distributors have to follow certain desirable sale practices, the mutual funds themselves have a collective responsibility to follow good practices in the interest of the investors. SEBI and AMFI have been consciously working on evolving some guidelines on the subject. Such guidelines are summarized below:

(a) While reporting the performance of their schemes in advertisements, funds are expected to provide a complete perspective to the investors. The guidelines include uniform practices for computation of yields so that investors can meaningfully and correctly compare the yields given by different funds.
Some key points of SEBI guidelines are given below:
  - The code classifies advertisements into two categories- one that contains basic information regarding an existing scheme, and the other that contains information on a scheme's performance.
  - The dividends declared or paid shall be mentioned in rupees per unit along with the face value of each unit of that scheme and the prevailing NAV at the time of declaration of dividend.
  - Annualized yields when used must be shown for last 1 year, 3 years, 5 years and since launch of the scheme. For funds in existence for less than one year, performance may be advertized in terms of total returns and such returns should not be annualized.

We can gauze from the above that the mutual fund sales practices are closely regulated in the US. The criticality of such regulation can't be over emphasized with regard to investor protection. It is therefore conceivable that in the years to come SEBI's involvement in the streamlining and regulating of sales practices in the Indian mutual fund industry, will be further enhanced either directly or working through AMFI or an association of distributors.

Disclosures

Members shall disclose timely dissemination of all unit holders of adequate, accurate and explicit information presented in a

simple language about the investment objectives, investment policies, financial positions and general affairs of the scheme.

Members shall disclose to unit holders investment pattern, portfolio details, ratios of expenses to net asset and total income and portfolio turnover wherever applicable in respect of schemes on annual basis.

Members shall in respect of transactions of purchase and sale of securities entered into with any of their associates or any significant unit holder:

- Submit to the Board of Trustees details of such transactions, justifying its fairness to the scheme.
- Disclosure to the unit holders details of the transaction in brief through annual and half yearly reports.

All transactions of purchase and sale of securities by key personnel who are directly involved in investment operations shall be disclosed to the compliance officer of the member at least on half yearly basis and subsequently reported to the Board of Trustees if found having conflict of interest with the transactions of the fund.

Investor Sophistication

Increased investor sophistication, wealth and power have led to significant influence on the growth of mutual funds market. Investors are demanding better level of services, transparency in prices and more product variety. On the political front, there is a drive to lower costs and standardization to encourage savings. The competition in UK fund industry has increased due to low entry barriers encouraging new players. The increased level of competition is putting pressure on prices. There has been trend in the industry to focus on core activities and outsource the rest.

The pace of changes is very rapid, resulting in steep increase in Volumes. New products are launched, and newer distribution methods are explored. The mutual fund industry in UK is witnessing a restructuring wave and the outcome is powerful brand leaders. With the rising demand for mutual funds in the 1990s, fund companies and distribution companies developed new outlets for selling mutual funds and expanded traditional sales channels. Many funds primarily marketed directly to investors turned increasingly to third parties and intermediaries for distribution. Funds that were traditionally sold through a sales force of brokers shifted increasingly to non-traditional sources of sales such as employee-sponsored pension plans, banks and life insurance companies in the 1990s.

Empirical Results

The effect of mutual funds on earnings Informativeness:

Hypothesis 1(a) predicts that mutual funds in China are neither independent nor long term oriented, and, therefore, will lower the informativeness of earnings. As previously discussed, we follow prior studies (e.g. Warfield et al 1995; Fan and Wong 2002; Firth et al 2007) and use earnings return association to capture the informativeness of accounting earnings.

Consistent with our prediction our results show that the presence of mutual funds as one of the top ten tradable shareholders significantly reduces the informativeness of earnings and, therefore, the involvements of funds has negative influence on corporate transparency. Whereas the coefficient ion earnings is significantly positive (1.072 and significant at the 5% level), the coefficient on the cross term of fund and earnings is significantly negative, although it's economically insignificant due to its small value. This shows that when there is at least one mutual fund existing among the ten largest tradable shareholders, the earnings informativeness decreases.

Furthermore, we find that the larger the holdings by mutual funds, the less informative earnings, since the coefficient on the cross term of fund percentage and earnings is -3.727, significant at 1% level. In the meantime, we find that both coefficients on the earnings and the percentage of ownership held by mutual funds are significantly positive (2.034 and 2.328, respectively and both significant at that 1% level). A combination of the above three coefficients shows that, although both a higher value of earnings and a higher institutional ownership may help enhance the market return, these two factors have to be well balanced for earnings informativeness; otherwise, high institutional holdings lower the earnings informativeness. Given our previous discussion that mutual funds in China have close business ties with listed companies and trade frequently for short term gain, our findings suggest that institutional investors may not serve as an effective monitor unless criteria are met.

Mutual funds in China may prefer trading to voice. While silence doesn't improve earnings informativeness, trading by funds with information advantage results in a negative effect of larger fund holdings in earning informativeness. It suggests that the larger the fund holding, possibly the more fund trading, and the more serious the price is away from earnings. The coefficient on fund percentage is significantly positive, which may be caused by the collusion of the finn and fund to boost the stock price. The fact that the involvement of funds actually deteriorates the informativeness of earnings, is consistent with Ping and Li (2000) in which mutual fund

managers collude with the listed companies to expropriate minority shareholders. These also correspond to Anderson et al. (2008) whose findings conclude that the primary channel through which expropriation of minority shareholders occurs is corporate opacity.

By testing hypotheses 1(b) and 1(c), our analysis further reveals that the type of mutual funds matters. Both cross terms of banks fund variable and earnings, "Earn x Bank fund" and "Earn x Bank Fund", have significantly positive coefficients. Although the presence of mutual funds fails to improve informativeness of earnings, we find that mutual funds affiliated with banks to their counterparts affiliated with non-bank entities such as security companies, significantly increases corporate transparency. Our findings suggest that bank affiliated funds are better behaved institutional investors in China. We further examine if firms with bank affiliated mutual funds disclose more informative earnings than those without fund involvement. Our findings, which are not tabulated, show that the involvement of bank affiliated mutual funds significantly improves the informativeness of earnings (p=0.33). On the other hand, our findings also indicate that within the bank owned mutual funds, those affiliated with the Big four state banks are worse monitors. Our finding offers evidence to La Porta et al. (2002) that the government ownership of banks fail to play constructive role, suggesting that the ongoing banking system reform including the recent IPOs of the Big four is a worthwhile direction.

Multiple categories of tests using sub-samples have been done to ensure the validity of the empirical evidence and to help further investigate the subtle effects of the funds involvement on earnings informativeness. We include two categories of them in [panel B of table two, entitled performance effects and controlling stake effects respectively, to further illustrate the monitoring effects of mutual funds in Chinese publicly listed companies.

In panel B of Table 2, we first present results about performance effects based on sub-samples formed by different cut-offs of earnings. We first form a "profit" group and a "loss" group; then we form two groups by comparing earnings of each firm with the sample average of Earn (0.025). We find that for "profit" or "greater than or equal to sample average" groups, the effects of having mutual fund(s) among the ten largest tradable shareholders (fund) remain the same as those discussed above. When there is at least one mutual fund among them, a higher value of earnings leads to lower market return since the coefficient on the cross term "Earn x Fund" is significantly negative {(-0.055 when Earn >-(greater or equal to) 0 and -0.044 when Earn>- 0.025} at the 1% level. This shows a negative effect of fund involvement on earnings informativeness. When the value of the firm is negative ("loss" group) or lower than the sample average, however, earnings informativeness of firms with mutual funds among the ten largest tradable shareholders is not significantly different from that of firm without them. These results again support the observations and empirical evidence about the behavior of mutual fund managers in the Chinese markets. Fund managers tend to invest in firms with good performance and only when firm performance is good, is ambiguous disclosure preferred so that extra benefits could be extracted.

We also present the results about controlling stake effects in Panel B of Table 2 based on three sub samples constructed using the ownership held by the largest shareholder (largest%). According to the descriptive analysis, the cut-off points of the variable largest% are 28% for the 25 percentile and 55% for the 75 percentile, respectively. Interestingly, we find that the effect of fund involvement on earnings informativeness is only significant in the sub sample with the controlling stake higher than 55%, and the coefficient on the cross term "Earn X Fund" is significantly negative (-0.039) at the 5% level. In the other two sub samples, however, the effects of fund involvement in earning informativeness are weak. These results show that in firms with dominant shareholders, fund involvement lowers the earnings informativeness since mutual funds are more likely to collude with the majority shareholders and controlling shareholders are more likely to disclose opaque information to expropriate minority shareholders.

Hypothesis 2(a) predicts that mutual funds in China are not able to monitor executive compensation effectively. Following Hartzell and Starks (2003), we examine the effects of fund involvement on the level of executive compensation, and present the results on the level of executive pay in Table 3.

The involvement of mutual funds significantly increases, rather than reduces as concluded in previous studies such as Hartzell and Starks (2003), the level of executive pay, which includes the total compensation of directors, top management and supervisors. The findings are consistent with our prediction that mutual funds in China are unable to serve the monitoring function due to their lack of independence, long term horizon, and large shareholdings. In China, the rising of executive compensation has raised a great debate. For example, Mr. Ma Mingzhe, the board chair of Ping An China, a listed firm in Shanghai Stock Exchange, had a total compensation of 66 million RMB in 2007, which is considered to be too high to be accepted by shareholders. Mutual funds seem not to be a good device to hurdle this trend; rather vote against the "managerial power", they vote with the management. This makes a closer tie between institutional

owners, such as mutual funds, and management which makes future short horizon trading more profitable. Similarly, we find that the presence of bank affiliated mutual funds mitigates the problem; compared to their non-bank related counterparts. Mutual funds affiliated with the banks are more likely to reduce the level of total executive compensation. We also find that among the bank-related mutual funds, funds affiliated with state owned banks are less effective than those affiliated with joint equity banks.

We further test how the involvement of bank-affiliated funds affects the level of executive compensation by excluding the firms with non -bank affiliated funds from the full sample, and find that the dummy variable Bank Fund is positively related to all ten executive compensation variables, and its coefficients are always significant at 1% level. This indicates that although bank -affiliated funds do a better job in monitoring executive compensation than those non-bank affiliated funds, firms with bank-affiliated finds still tend to pay their executives higher than do those without fund involvement. Chinese listed companies don't disclose individual compensation information until 2005; before that, compensation of sub-groups, such as the total compensation of top three paid board directors and that of top three paid members in the management team, were disclosed. Panel B presents the results using these two sub-group compensations as the dependant variables, respectively. Consistent with the results presented in Panel A, the presence of mutual funds significantly increases these three compensations. For firms with fund involvement, bank-related mutual funds are more likely to serve as effective monitors of compensation, but there is no difference between funds affiliated with the Big four state banks and those affiliated with other banks.

In general, the empirical results based on the three executive compensation variables are consistent to each other and support Hypothesis 2. In table 3, in addition, when we use different executive compensation variables, the coefficient of the cross term between fund variable and the lagged total tradable market value are positive and significant at the 1% level. This suggests that for larger firms, mutual funds are more likely to vote with the management because they tend to hold fewer stakes in larger firms so that they are less possible to voice. This is consistent with our story that only mutual funds with larger stake of stock will be effective monitors. Also, in firms with funds among their ten largest, firm's market capitalization is positively related to executive compensation.

The examination of the effect of mutual fund involvement on the level of executive compensation, thus convincingly shows that the involvement of mutual funds, especially mutual funds controlled by non-bank entities, fails to curb executive compensation. The collusion between mutual funds and listed companies for short-term gains and their close business ties make monitoring a costly activity for mutual funds, as active monitoring by mutual funds would make listed companies unhappy; thus mutual funds may face the possibility of losing "cooperation" with listed companies. The positive association between mutual fund presence and executive pay, therefore, is consistent with Almazan et al.'s (2005) prediction that the level of executive compensation could be increasing with the cost of monitoring by institutional investors. Our findings also correspond to Brickley et al. (1988) that institutional investors that frequently "derives benefits from lines of business from portfolio firms are less likely to oppose management.

Since the firm's information could also be identified from the ten largest shareholders, instead of ten largest tradable shareholders, we have also done the robustness tests for both Hypothesis 1(about the effects of fund involvement on the informativeness of earnings) and Hypothesis 2 (about those effects on executive compensation) using fund information identified from ten largest shareholders, but found no qualitative change. Results from robustness test are available upon request.

To further investigate the effects of fund involvement on executive compensation in Chinese publicly listed companies, we also use sub-samples to return Model 5 by considering the influence of controlling stake. As before we also form three sub samples using the 25 percentile and 75 percentile points of the variable Largest% , 28% and 55% respectively. To avoid presenting repetitive results, we only include the results based on the dependant variable TotalPay and three dummy fund variables, Fund BankFund and SOBFund in Panel C of Table 3.

Empirical findings tell that in all three sub-samples, fund involvement increases the total pay received by all executives, but bank-affiliated funds only make a difference in the sub-sample with a smaller stake held by the largest shareholder, the sub-sample with firms in which ownership held by the largest shareholder is lower than 28%. These results show that when the ownership concentration is high, involvement of bank controlled funds can't improve monitoring since they do not have enough voting power. On the contrary, if the ownership concentration is sufficiently low, bank-controlled funds play an effective monitoring role and help lower the total compensation received by all executives.

Future Research

Previous studies in the literature on institutional investors' influence on public companies centered on industrialized

economies; most work illustrated positive monitoring effects while others not. To develop a method to combine the voice and speculation hypothesis in one empirical setting is necessary to see what choice the funds are exactly making. Meanwhile, with the increasingly important role played by the emerging markets in the global economy, it's worth investigating the effects of institutional investors such as mutual funds in these markets. This study intends to help fill in these by focusing in these issues in Chinese capital markets, and examines the effectiveness of monitoring roles played by mutual funds in mitigating the agency problems between majority and minority shareholders and those between owners and managers. Empirical results suggest that in general, mutual funds among the ten largest tradable shareholders in Chinese public companies fail to be effective monitors. Fund involvement deteriorates the informativeness of accounting earnings, and increases the incentive compensation paid to the executives.

To help audience better understand the monitoring effects of mutual fund involvement on the corporate transparencies, we also highlight the subtle effects of fund involvement through addressing the monitoring roles played by bank-affiliated mutual funds and state owned bank-affiliated ones in Chinese public companies. Interestingly, we find that compared to those non-bank affiliated funds, bank-affiliated ones improve the corporate transparency and lowers executive compensation if they are among the ten largest tradable shareholders. Furthermore, compared to firms without mutual fund involvement, those with bank controlled funds tend to have a higher level of earnings informativeness. In general, thus these results suggest that bank-controlled funds are more likely to be better monitors than other funds. In addition, we also find that state owned bank-affiliated funds are less effective monitors than funds affiliated with joint equity banks. These findings reflect the effect of special ownership structure of certain commercial banks in the Chinese economy.

As stated in the introduction we expect to make multiple contributions. First, this study is among the first to systematically address the monitoring effects of mutual fund involvement on two types of agency problems, those between majority and minority shareholders and those between owners and managers, together in one of the typical emerging markets. Second empirical results highlight the difference in monitoring effects of institutional investors between industrialized economy and emerging markets, and therefore provide critical implications for policy makers and international investors. Third, this research adds to the corporate governance literature by examining the interaction between the involvement of institutional investors and ownership structure, and those between fund involvement and corporate governance characteristics.

Several limitations are acknowledged. First, the institutional ownership in developed countries is much higher than in China; unprecedented development of mutual funds in China notwithstanding the average ownership held by mutual funds in China is still low.

Concluding observations

To sum up, one may note that Mutual funds in India have largely resorted to the retail markets and placed products through brokers and agents. The presence of these financial intermediaries along with the sheer size of the investment community of diverse background, has complicated matters to a large extent. Lack of complete information about the clientele along with existing SEBI guidelines, that prohibits any sort of projections of return (so vital to investment decision making) has only compounded problem. For this, a concerted effort needs to be made to create a cost effective mechanism for communication. Disclosure standards need to be trimmed from a lengthy but sketchy set of rules, to an effective and meaningful one. Finally, increasing awareness through investor education is of paramount importance. A technically ill-equipped investor may not be able to reap full advantage from a system of complete information if he is not trained in how to process and optimally use it for valuation of assets.

The views of the regulators and the industry on the appropriate method of' setting banks capital standards for market have evolved away from the use of regulatory standards model approaches and towards the use bank's internal risk estimates. This evolution represents a promising development as internal model based approaches have clear advantages, both in terms of the efficiency as well as effectiveness of risk-based capital standards. While the internal models approach focuses solely on risk measurement of a static portfolio and ignores the fundamentally important determinants of bank's trading risk taking strategy and its management ability, the pre-commitment approach, on the other hand, is yet to gain international recognition.

Mutual funds in India has played significant role in mobilizing the savings from large number of public and channelizing to the development of capital market. Thus, now, it has been emerging as popular investment vehicle besides major source of finance for economic development of India. The nationalized banks were allowed to set up mutual funds in 1987. The doors were opened to private sector companies to set up mutual funds in 1993. Since then mutual funds have

mobilized large savings. A share of AUMF (Assets under Management of Mutual Funds) or private sector mutual funds was just 2.8% of the total AUMF of the industry in 1996 and remained less than 10% till 1999. During 1996-2004 their share suddenly increased to more than two folds (40.7%) at the end of the March 2002 and further to more than three forms (75.2%) in at the end of March 2004. This shows the popularity of the private mutual funds vis-à-vis PSU mutual funds. The empirical evidence shown by the present study clearly reveals that performance of private sector mutual funds has far exceeded the performance of PSU mutual funds in terms of rates of return.

This method of regulation provides an inbuilt mechanism of testing the abilities and accountability of the fund managers, as well as strengthening transparency and corporate governance. The Indian regulator must think about designing an appropriate prudent person regulation to enhance the fund manager's ability and accountability as well as operational transparency, which would ultimately increase the safety of the investors' funds.

The performance of sample funds based on different ownership patterns disclose that the difference in performance could be traced to difference in their ownership pattern. The data clearly showed that the performance of the private equity funds have summarily outclassed the performance of PSU mutual funds. It has also been observed that large number of small sized equity funds have been floated by private sector mutual funds (far end funds. domestic funds and joint venture funds). In other words, investors might not have confidence in private sector mutual funds leading to poor response in their initial offers. Possibly small or optimal sized portfolio, might have allowed the fund managers to study the capital market in depth and identify the undervalued growth stocks for that portfolios and earn better returns compared to medium and large sized funds. The major reasons for more numbers of large sized funds under the management of PSU mutual funds were in monopoly until 1993. Other comparable avenues of investments were not available for the investing public. Investments in PSU mutual funds were perceived as safer compared to private mutual funds.

The shift was evident in 1999-2002 when AUMF of private sector mutual funds rose from 9.6% to 40.7%. Poor performance of PSU funds during 1993-2002 might have been a major reason for such a shift and saw investor moving away from the PSU mutual funds to the private sector mutual hinds. Apart from poor financial performance, after sales service and transparency in operations were other factors of declining popularity of PSU mutual funds. It may be pertinent to mention that the PSU mutual funds had an advantage over the private sector mutual funds as PSU mutual funds were already well established for three decades, before private sector mutual funds appeared in 1993. During this period SEBI's various initiatives of investor protection including comprehensive mutual funds regulation acts of 1996 began to yield dividends in the form of consolidation of the different forces emerging into powerful financial intermediary. Further analysis was carried out to find out whether the difference in performance in terms of benchmark comparison may be due to the type of the fund (open ended or closed ended, size or ownership pattern). The findings of the study proved that different groups of the sample mutual funds have produced differential performance in terms of benchmark comparison. The performance of the open-ended, small sized and private sector sample equity funds has shown better performance. An overall poor performance of large size sample equity funds irrespective of the ownership class indicates that large-size funds are likely to perform poorly irrespective of the ownership class. This leads to the conclusion that there may be an optimal size of managed portfolio, which may produce better performance.

It is clear from that mutual funds have displayed a phenomenal growth since the initiation of economics reforms in 1991. However, this growth has posed a difficulty to investors in making selection of suitable schemes. At present there are more than 400 schemes. The issues related to the choice between the public and private sector funds on the one hand and growth, income, balanced, tax saving and money market schemes on the other hand, have become highly important because even a single wrong decision may put the financial crisis, sometimes leading to their bankruptcy. A proper performance evaluation measure will remove such confusion and help the small investors in selecting various mutual fund schemes for investment. Further, with growing competition in the market, the fund managers also need to satisfy themselves that the management fees and research expenses are justified keeping in view the returns generated. Moreover, there is need to investigate how efficiently the hard earned money of the investors and scarce resources of the economy are being utilized by the mutual funds.

In order to judge the performance of MF schemes in an objective manner and offer investors, an easy way to identify funds that have performed better in relation to their peers, a number of entities are being evaluated and ranked according to their performance. The most popular of them are ranking/ evaluations by CRISIL, Value Research India, and Credence Analytics. The composite performance ranking by CRISIL, covers all open ended schemes which have disclosed their net asset value for at least two years and make a 100% disclosure of their portfolio composition. The Fund Rating of value Research is a composite measure of risk and return

and gives a quick summary of how a fund has performed historically relative to its peers. Each scheme is assigned a risk grade and fund rating is determined by subtracting risk grade from its return grade. Top 10% in the category is considered five star, next 22.5% four star, next 35% three star, next 22.5% two star and last 10% one star performance.

However the above mentioned entities generally evaluate short term performance- 3 months, 1 year or 3 year of mutual funds schemes. The onus of evaluating long term performance lies with the academicians and research.

There are a number of barriers to the entry of foreign-capitalized asset management companies in India's mutual fund market. The biggest difficulty is probably in the staffing of their sales operations. It is no easy task for foreign-capitalized asset management companies that have recently entered the market to match the marketing muscle of the large, long-standing domestically capitalized asset management companies like Reliance and UTI. Because it is the IFA channel that has an especially large need for wholesalers, a key business decision facing new market entrants is how much importance to place on regular retail investors, the market segment that the IFA channel is best at handling. As the examples given in this report show, the most realistic strategy for foreign-capitalized asset management companies seems to be to start out by focusing on supplying product to the wealthy through foreign-capitalized banks, and to consider other distribution channels, as conditions dictate, while delaying any concerted effort at offering mutual funds to retail investors.

Another barrier to market entry is the difficulty in gathering information and preparing documentation on the financial condition and litigation history of the sponsor (the parent company of the asset management company) in order to fulfill requirements in the SEBI (Mutual Fund) Regulations. Roadway congestion, unreliable electric power supplies,[10] uncertainty in the real estate leasing market, and other features of India's social infrastructure could also be considered barriers to market entry by asset management companies and other foreign-capitalized firms.

That having been said, progress is being made in establishing an infrastructure for India's mutual fund industry, and recent growth in the economy and in individual financial assets suggests that India's market has huge potential. Japan's Nikko Asset Management announced in December 2006 that it was entering India's mutual fund market through a joint venture with the India-based securities firm Ambit RSM[11]. We expect overseas asset management companies and financial groups to continue moving into India's mutual fund market in the future.

The biggest problem of the mutual fund industry is that the funds preferred bulk investors over retail investors and hence the distribution mechanism remains underdeveloped. Mutual funds have been in existence for 45years in India and it is time they take the rightful place as major pillar of financial system. The core problem of MF industry is dependence on institutional funds. UTI legislation being drafted by the ministry of finance and RBI were opposed to institutional investors being allowed to invest in India. Other suggestions are:

1. Mutual fund required separating; each came into retail and institutional.
2. The tax benefits should be available only to the retail investors. Institutional investors would no doubt use strong pressures but the authorities should fight a battle of attrition to put this tax proposed into affect.
3. The total corpus of a mutual fund should be prescribed in such a way that not more 50% is institutional. The 50% ceiling should be gradually lowered so that MFs predominantly depend on retail investors. The total corpus of MFs would initially shrink but it may be desirable. There are concrete cases of banks placing the funds with mutual funds which in turn purchase the equity shares with the banks.
4. The AMC minimum net worth should be gradually raised in gentle phases to Rs 50 crore.
5. The proliferation of the schemes (reportedly 1000 schemes, 5000 variants) should be consolidated over a period of time. The number of schemes permitted should be linked to the net owned fund. At present the investor is confused by the plethora of schemes.
6. Inter scheme transfers are a cause for concern. It is rare that there would be double coincidence of wants. Fund managers don't have total autonomy and invariably one scheme would benefit at the cost of the other. SEBI should describe that MFs can't undertake inter-scheme transfers in excess of a prescribed ceiling which over time should be brought down. Furthermore, when inter-schemes transfers are taken, there should be a transparent rationale why they are undertaken and a mutual scheme to both should be visible.
7. The MFs resort to excessive churning and these needs to be carefully monitored as SEBI recently pointed out that

[10] *Power outages are apparently fairly infrequent in Mumbai, however, where the Tata group is the supplier of electric power.*

[11] *Nikko Asset Management owns 74.9% of the joint venture, and Ambit RSM 25.1%.*

MFs are operating like traders rather than long term investors. For certain scheme, its churning is as high as 20 times.

8. The redressal system in the case of MFs is extremely weak unlike in banks where there are well set norms for a variety of issues in dealing with customers. Each MF follows its own practice. In the case of ECS crediting of dividends, some MFs have a practice of not informing the unit holder. In the case of the monthly schemes when MFs skips a dividend, there is no information to the individual unit holder and not even is there a public announcement. Again, the names of the schemes by the same mutual funds are so similar that even individuals who are financially literate can't make out which is the scheme. In some case, the unit holder doesn't get the sale proceeds for months on end even after submission for reduction and even though the unit holder's name is no longer on the fund's books.
9. Where there can be aggrieved unit-holder seek redressal? The Association of mutual funds India is essentially an industry lobby and its focus is not on redressal. While the SEBI tries to fill the gap, it is a powerful regulator and people are afraid to approach it. The absence of complaints doesn't mean that there are no complaints.
10. The transparency of operations is a problem in the financial sector but more so in MFs. There is a need to develop a code of conduct for the funds wherein they give unit holders a commitment of a minimum standard of service. This could be modeled on the Banking Codes and Standards Boards of India (BCSBI).

Several broad conclusions can be inferred from the above study. These are listed as under:

1. Given the wide heterogeneity across public sector banks in terms of their productive sophistication and customer orientation as well as their adjustment response, the regulatory framework should be designed so as to encourage individual banks to maintain higher CRAR than the stipulated minimum so as to reflect their differential risk profiles.
2. The second aspect of the study has been to test the hypothesis of how CRAR is impacted upon by a range of conditioning variable and whether there has been any discernible shift from towards relatively less risky assets, during our period of study, such an econometric exercise has two risky assets, viz., it allows distinction between long-run and short run capital ratios and secondly it allows for testing the impact of various regime shifts. Our analysis reveals that (a) capital remains a useful regulatory tool in the hands of policy makers for influencing bank's behavior and (b) there is no conclusive evidence to support a shift from high-risk towards low risk asset category by banks.
3. In view of the composite rating for banks introduced by the RBI in June 2000 and the need to evolve a system wherein regulators might need to take corrective action depending on the bank's risk profile, the study examines the impact of putting in place a Prompt Corrective Action (PCA) based on capital for the PSBs. Based in data availability, the framework is studied only for year 1998. Our analysis reveals that PCA might prove to be an effective framework for arresting banks' deterioration and prevent systematic failure of banks.
4. Fourthly in view of the growing internationalization and universalisation of banking operations, the risks emanating from idiosyncratic failures might have far more serious repercussion throughout the system as a whole. The Basel Committee on Banking Supervision (BCBS) has proposed the new Capital Adequacy Accord which not only endeavourer banks to hold higher levels of capital, but also envisages a greater role for the market (or for that matter the credit rating agencies). Although the role of International Credit rating agency has been put under a cloud ever since the South-East Asian Crisis, the fact nonetheless remains that rating agencies would need to play far more important role in the future, once the New Accord is put in place. Our analysis reveals that capital ratios of banks are a crucial determinant of bank ratings, especially in the short ten¯n.
5. Finally to the extent that the role of the market is expected to be far more important under the new Accord and an increased emphasis is going to be placed on market risks, newer models of measurement of market risks viz., Value at Risk (VaR) and the Pre-Commitment Approach (PA) have gained currency in recent years. International experience with their applicability is also a testimony to the growing popularity of these models. To syncopate, banking regulation and supervision are extremely complex areas where the regulator has to tread a careful middle path between the ex-cathedra over zeal for intervention and a complacent belief in the ability of the banking system to self-rectify all its own deficiencies. In a recent contribution, Caprio and Honohan (1999) remind us in a similar vain "banking regulation must be seen as evolutionary struggle and regulatory innovation will remain a constant challenge".

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ANNEXURE-I

Rate of Return on Sample Equity Mutual Funds, vis-à-vis Returns on BSE 100 Index on Monthly Basis, 1997-2007

Fund code	*mutual Fund*	*month/year of inception*	*Monthly Rate of Return of Sample Funds*			*Monthly Rate of Return of 364-days T-Bills*		
			08-07	*07-06*	*06-04*	*04-02*	*98-02*	*93-98*
1	Alliance Equity Fund-Growth	Aug-98	NA	2.17	2.17	NA	0.63	0.63
2	Birla Advantage Equity Fund	Jan-95	0.48	3.45	2.15	0.81	0.02	0.04
3	Prudential ICICI Growth Fund	Jun-98	NA	1.53	1.53	NA	0.41	0.41
4	Tata Pure Equity Fund	May-98	NA	1.33	1.33	NA	-0.07	-0.07
5	KID Bluechip-Growth Option	Dec-93	0.34	2.19	1.29	-0.29	0.02	-0.59
6	Reliance Growth Fund-Growth	Oct-95	0.96	1.26	1.15	0.23	0.02	0.1
7	DSP Merrill Lynch Equity Fund	Apr-97	1.44	0.99	1.08	0.26	0.02	0.07
8	Zurich India Equity Fund	Nov-94	0.77	2.3	0.92	-0.24	-0.16	0.15
9	SUN F&C Value Fund-Growth	Jul-97	0.88	0.92	0.92	-0.82	0.001	0
10	Zurich India Top 200 Fund	Aug-96	1.46	0.44	0.73	0.35	0.02	0.12
11	UTI-Equity Opportunity Fund	Aug-96	-0.16	1.02	0.67	1.76	-0.1	0.43
12	Reliance Vision	Oct-95	0.74	0.59	0.65	0.43	-0.06	0.13
13	Templeton India Growth Fund	Aug-96	-0.14	0.87	0.58	0.35	0.01	0.11
14	JM Equity Fund-Growth Fund	' Mar-95	-0.08	1.02	0.55	0.15	0.02	0.08
15	UTI-Primary Equity Fund 95	Apr-95	0.23	0.7	0.51	0.23	0.02	0.11
16	KID Prima-Growth Option	Dec-93	-1.09	2.01	0.5	-0.29	0.02	-0.13
17	Sundaram Growth Fund	Mar-97	0.13	0.42	0.36	1.24	0.01	0.06
18	UTI-UGS 2000	Dec-90	0.55	-0.04	0.34	0.85	0.55	0.74
19	UTI-Matergrowth 93	Jan-93	1.04	-0.64	0.28	0.88	0.02	0.49
20	UTI-Matergrowth 91	Dec-91	0.85	-0.49	0.25	0.85	0.02	0.48
21	Morgan Stanley Equity Fund	Jan-94	-0.18	0.63	0.22	-0.07	0.02	-0.02
22	UTI Mastergain 92	May-92	0.55	-0.33	0.16	0.85	0.02	0.48
23	ICICI Premium	Feb-94	0.7	0.93	0.13	-0.29	0.01	-0.14
24	Zurich India Capital Builder Growth	Oct-94	-0.62	0.86	0.1	0.1	0.02	0.06
25	GIC Growth Plus fl	Nov-95	-0.5	0.58	0.05	-0.29	0.02	-0.13
26	UTI Grandmaster 93	Nov-92	0.53	-0.54	0.05	0.96	0.02	0.54
27	BOB Growth 95	Nov-95	0.23	-0.09	0.03	0.76	0.02	0.3
28	UTI Unit Scheme 92	Nov-92	0.27	-0.27	0.01	0.19	0.02	0.11
29	UTI Mastergain 86	Oct-86	0.84	-1.05	0	0.85	0.02	0.48
30	UTI-UGC 5000	Oct-91	0.67	-0.99	-0.04	0.85	-0.19	0.4
31	IDBI Principal Equity Fund Growth	May-95	-0.31	0.17	-0.06	0.24	0.03	0.13
32	SBI Morgan Equity Fund	Jan-91	-0.75	0.58	-0.07	-0.29	0.02	0.13
33	SBI Morgan Multiplier Plus 1993	Mar-93	-0.59	-0.23	-0.41	-0.29	0.02	-0.13
34	GIC Fortune 94	Dec-94	-0.68	-0.32	0.48	-0.06	0.02	-0.01
35	Canbonus	Jul-91	-0.88	-0.5	-0.68	-0.29	0.02	-0.13
36	LIC Dhanvikas (1)	Jun-93	-1.32	-0.59	-0.94	-0.48	0.18	-0.13
	Mean		0.15	0.58	0.44	0.29	0.05	0.14
	Maximum		1.46	3.45	2.17	1.76	0.63	0.74
	Minimum		-1.32	-1.05	-0.94	-0.82	-0.19	-0.59
	Median		0.23	0.59	0.31	0.23	0.02	0.11

ANNEXURE-II

Equity Mutual Funds (Category-wise) showing Better Rate of Return than BSE 100 Index, 1997-2007

Fund Category	*Total Funds*	*Number of Funds Showing Superior Returns than BSE at 100 Index*	*Number at Column 3 as percentage of number Column 2*
PSU Mutual Funds	17	0	0%
Foreign Mutual Funds	8	4	50%
Domestic Mutual Funds	6	3	50%
Joint venture mutual funds	5	2	40%
Total	36	9	25%

ANNEXURE-III

Mean, Range and Median Monthly Returns of Sample Equity Mutual Funds (Ownership-wise)
Vis-à-vis BSE 100 Index, 1997-2007.

Statistical Measures	*Monthly rate of Return on sample Equity Mutual Funds*			*Monthly Rate of Return on BSE 100 Index*		
	93-98	*98-02*	*93-02*	*93-98*	*98-02*	*93-02*
PSU Equity Funds						
Mean	0.05	-0.19	-0.02	0.43	0.04	0.23
Maximum	1.04	1.02	0.67	1.76	0.55	0.74
Minimum	-1.32	-1.05	-0.94	-0.48	-0.19	-0.13
Median	0.23	-0.32	0.03	0.76	0.02	0.3
Foreign Equity Funds						
Mean	0.52	1.15	0.84	-0.01	0.07	0.1
Maximum	1.46	2.3	2.17	0.35	0.63	0.63
Minimum	-0.62	0.44	0.1	-0.82	-0.16	-0.15
Median	0.77	0.9	0.82	0.1	0.02	0.07
Domestic Equity Funds						
Mean	0.45	1.34	1.03	0.58	-0.01	0.09
Maximum	0.96	3.45	2.15	1.24	0.02	0.26
Minimum	-0.08	0.42	0.36	0.15	-0.07	-0.07
Median	0.48	1.14	0.9	0.43	0.02	0.09
Joint Venture Equity Funds						
Mean	-0.44	1.37	0.68	-0.16	0.1	-0.06
Maximum	0.34	2.19	1.53	0.24	0.41	0.41
Minimum	-1.09	0.17	-0.06	-0.29	0.01	-0.59
Median	-0.5	1.53	0.5	-0.29	0.02	-0.13

ANNEXURE-IV

Number of Equity Mutual Funds Showing Positive and Statistically Significant Alpha Values as per Ownership-class, 1997-2007

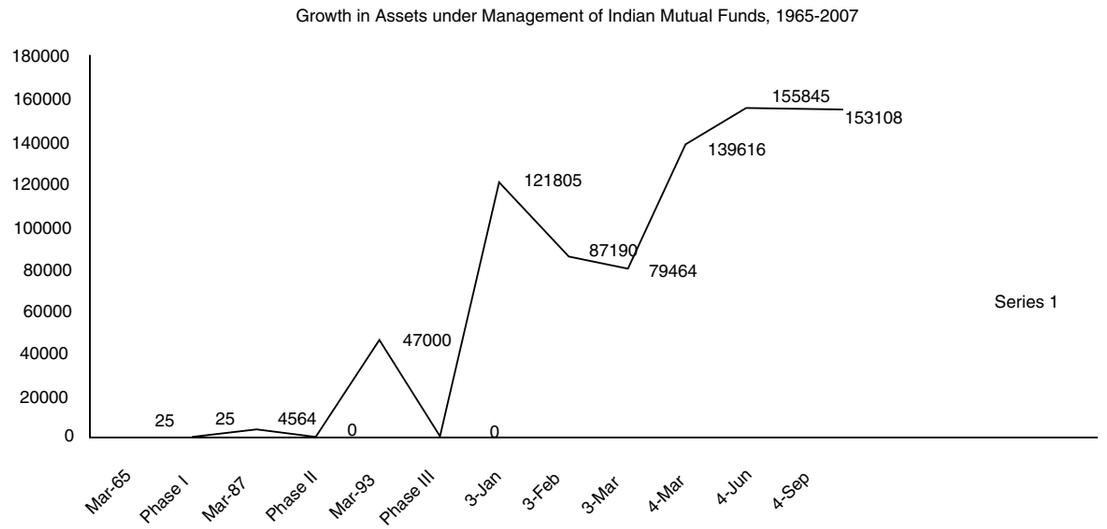
S.No	*Equity Mutual Funds (ownership class)*	*Total Funds*	*Number of funds showing positive Alphas*	*Number of funds showing Statistically Significant*	*Positive alpha as percentage of total alphas*	*Significant alphas as percentage of positive Alphas*
1	2	3	4	5	6	7
1	PSU Funds	17	4	0	24%	0%
2	Foreign Funds	8	7	2	88%	29%
3	Domestic Funds	6	6	2	100%	33%
4	Joint Venture Funds	5	3	1	60%	33%
	Total	36	20	5	56%	25%

ANNEXURE-V

Growth of Assets Under Management of Mutual Funds in India on Year-to-year During 1997-2007

year	*Growth of PSU Mutual Funds (Rs Million)*	*Growth of Private Mutual Funds (Rs Million)*	*Growth of Total AUM (Rs million)*	*Growth of PSU Mutual Funds (%)*	*Growth of private Mutual Funds (%)*	*Growth of Total AUM %*
1993	477335	0	477335			
1994	623209	1092	624301	30.6		
1995	707350	22322	729672	13.5		16.9
1996	722382	20771	743153	2.1	-7	1.8
1997	678745	23230	701974	-6	11.8	-5.5
1998	549996	39186	589182	-19	68.7	-16.1
1999	638423	67812	706235	16.1	73.1	19.9
2000	779656	254874	1034530	22.1	275.9	46.5
2001	648570	257300	905870	-16.8	1	-12.4
2002	596380	409610	1005990	-8	59.2	11.1
2003	239420	555220	794640	-59.9	35.5	-21
2004	346240	1049920	1396160	44.6	89.1	75.7

ANNEXURE-VI



ANNEXURE-VI

Growth of Assets Under Management of Growth Funds and Pure Equity Funds, 1996-2007

Year	*Assets Under Management of Growth Funds**	*Assets Under Management of Pure Equity Funds**
1996	455044	162561
1997	384294	144351
1998	276437	109437
1999	291274	118427
2000	491731	146806
2001	327560	134830
2002	308060	138520
2003	130280	98870
2004	276930	236130