

# Conceptual Framework of Mutual Fund

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**ABSTRACT:** The study examines mutual fund performance based on results of a sample of mutual funds because of large and diverse nature of entire universe of these funds. The study is mainly based on secondary data. The secondary data is used to examine and evaluate the ex-post performance of mutual funds. The study uses closing monthly net asset value of sample mutual fund schemes. Initially, 586 open-ended mutual fund schemes are considered. Finally, 275 open-ended mutual fund schemes are selected after the exclusion of schemes, which have provided returns below the risk-free rate. It is observed that some of the schemes have stopped their operations during the study period also taken into consideration. The data on net asset value (NAV) is used to examine the performance. The preference for use of such data over price data is guided by the consideration that these are not affected by the double incidence of market volatilities. The information of NAV obtains from secondary sources like amfindia.com, websites of respective mutual funds, mutualfundindia.com etc. The respective sources are crossed-checked with other sources that to ensure validity of the data and observed same.

**KEYWORDS:** Mutual Fund Schemes, Unit holder, Sponsor, Trustees, AMC, The mutual fund, Custodian, Registrar and Transfer agent.

## I.INTRODUCTION

According to Securities Exchange Board of India, mutual fund is defined as 'A fund established in the form of a trust to raise money through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments or gold or gold related instruments [1]. A mutual fund is a common pool of money into which the investors place their contributions that are to be invested in accordance with a stated objective. Thus mutual fund is created when investors put their money together and is invested by the fund manager in different types of securities depending upon the objective of the scheme. These could range from shares to debenture to money market instruments.

The income earned through these investments and the capital appreciation realized by the scheme, both are shared by its unit holders in proportion to the number of units owned by them. Each mutual fund scheme has its own investment objective and strategy. A mutual fund is the ideal investment option for today's complex and modern financial scenario. A typical individual is unlikely to have the knowledge, skills, inclination and time to keep track of financial events, understand their implication and act speedily [2].

A mutual fund is an answer to all these situations. It appoints professionally qualified and experienced staff that manages each of these functions on a full-time basis. The large pool of money collected in the fund allows it to hire such staff at a very low cost to each investor. The mutual fund, in its present form, is a 21st century phenomenon. In fact, it gained popularity only after the second world war. Today, mutual funds collectively manage almost as much money as compared to banks According to Hirsch, "A mutual fund is a professionally managed investment company that combines the money of many people whose goals are similar and invest this money in a wide variety of securities".

According to UK Investment Trust and Companies, "A mutual fund is a vehicle that enables a number of investors to pool their money and have it jointly managed by a professional money manager" [3]. Investment company Institute USA defines, "The term mutual fund is a type of Investment Company that gathers assets from investors and collectively invests those assets in stock, bonds or money market instruments". In sum, a mutual fund is a form of collective investment brought in by a large group of investors for the mutual benefit of savers as well as investors. Each fund is divided into equal portions or units. Anyone investing in the fund is allocated with units in proportion to the size of one's investment.

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## II. ECONOMIC MOTIVES OF MUTUAL FUND INVESTMENT

The mutual fund industry has enjoyed substantial growth in terms of the assets under management as well as the investors' accounts. For many reasons that contributed to the growth of mutual fund industry, the fundamental one is the increasing complexity of modern investment. The number of securities available for investment has increased substantially. The varied and interrelated forces influence the prices of the securities and the technical and analytical study of securities' value made it difficult for the man of small means and limited knowledge to make sound and profitable investment decisions.

Beat Inflation Mutual fund help investors generate better inflation-adjusted returns, without spending a lot of time and energy on it. The stock provides a return of 20%-25% annually [4]. This is much higher than bank deposits. The mutual fund investment will generate high inflation-adjusted return if the maturity period is long. As inflation erodes the real value of money, therefore the total return of the fund will not actually be beneficial to the investors. In such case, mutual fund found to be an efficient alternative to beat inflation by getting good returns according to the changes in the stock market which are directly influenced by economic conditions. Most people prefer bank deposits for safety purpose, but they are not compensated by inflation risk. Mutual Funds provide an ideal investment option for investment for a long-term inflation adjusted growth so that the purchasing power of hard earned money does not plummet over the years.

Professional Management It is generally not possible for a layman to invest their money in different investment options available in modern scenario due to lack of adequate knowledge awareness and skill. Many people are having the drawback of lack of financial literacy. Such investors find it difficult to understand all concepts and issues. Thus, they are unable to analyze and judge the financial ability of all investment options. Such individuals need a support of financial expert. Mutual fund is backed by a dedicated research team where investors are provided with the services of an experienced fund manager who handles the financial decisions based on the performance and prospects available in the market to achieve the objectives of the mutual fund scheme [5].

Convenience Mutual funds can be traded easily with the very less initial amount (Rs 500 per months) and with little or no transaction costs. Also no brokerage is charged. Mutual funds are an ideal investment option in terms of convenience and time-saving opportunity. With low investment amount alternatives, the ability to buy and sell them on any business day and a multitude of choices based on an individual's goal and investment need, investors are free to pursue their course of life while their investments earn for them

Low Cost Probably the biggest advantage for any investor is the low cost of investment that mutual funds offer, as compared to investing directly in capital markets. Most stock options require significant capital, which may not be possible for young investors who are just starting out. Mutual funds, on the other hand, are relatively less expensive. The benefit of scale in brokerage and fees translates to lower costs for investors. One can start with a low as Rs 500 and get the advantage of long-term equity investment.

Diversification Following the theory, 'Do not put all your eggs in one basket', mutual funds help to mitigate risks to a large extent by distributing investment across a diverse range of assets. Mutual funds offer a great investment opportunity to investors who have a limited investment capital. This is possible due to the support of skilled fund managers who can analyze and put the money in a combination of different securities. This reduces the risk level of the investors and increases the return level.

Liquidity Investors have the advantage of getting their money back promptly, in case of openended schemes based on the Net Asset Value (NAV) at that time. In case of a close-ended investment, it can be traded on the stock exchange, as offered by some schemes. There is always a ready market available for sale/purchase of mutual fund units due to its high demand. The money can be retrieved very quickly.

Higher Return Potential Based on medium and long-term investment, mutual funds have the potential to generate a higher return, due to proper diversification by skilled fund managers the risk level reduces increasing the return benefits of mutual funds. Also as the stock market returns are more due to the presence of more risk, therefore fund yield also shows high return.

### III. ORGANIZATIONAL STRUCTURE OF MUTUAL FUND

Indian mutual fund sector is regulated by Securities and Exchange Board of India (SEBI). It prescribes a comprehensive set of guidelines through SEBI MF regulations 1996. It stipulates mutual fund into main 3 tier structure consisting sponsor, trustees, and Asset Management Company. But however, there are many parties who are involved in the organization of mutual funds. The structure provides the duties and obligations of each party with inherent checks and balance so as to protect investor's interest. The diagram shows the organization structure of mutual funds facilitated by the following parties:

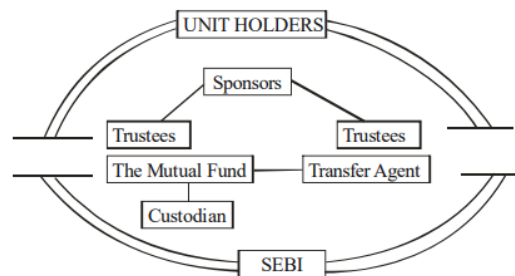


Fig. 1: ORGANIZATIONAL STRUCTURE OF MUTUAL FUND

- Unit holder
- Sponsor
- Trustees
- AMC
- The mutual fund
- Custodian
- Registrar and Transfer agent

Besides, the regulatory authorities are –

- Securities and exchange board of India (SEBI)
- Association of mutual funds in India (AMFI)

#### Unit holder

They are the individuals who are investing their money in units of mutual fund schemes. They are different than shareholders, as the assets of investments are different for both. Also, unit holders are provided with specific rights as per fund declaration. A unit holder can be one or more people, a company, a trustee of a family trust or any other trust or a combination of them all.

#### Sponsor

SEBI regulation act 1996, defines sponsor as a person who, is acting alone or in combination with another body corporate, establishes a mutual fund. The sponsor of a mutual fund is similar to the promoter of a company. The sponsor may be a bank, a financial institution or a financial services company from the domestic territory or abroad. The sponsor has to obtain a license from SEBI for which it has to satisfy several conditions relating to capital, profits, track records and default-free dealings. The sponsor is responsible for the setting off and establishing the mutual fund. The sponsor is the settler of the mutual fund trust. The sponsor delegates functions to the trustees.

#### Trustees

A trust is a national entity that cannot contract in its own name. So, the trust enters into contracts in the name of trustees. Appointed by the sponsor, the trustees can be either individual or a corporate body. It ensures that the trustees are fair and impartial. They are like a primary guardian of unitholders SEBI mandate that at least two third of the trustees are independent. This means that they have no association with the sponsor. The trustee appointed the AMCs secures necessary approval, periodically monitor how the AMC functions, and hold the properties of the various schemes in trust for the benefit of investors. Trustees can be held accountable for the financial irregularities of mutual fund.

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### AMC

AMC is registered under Companies act, 1956. It is authorized to deal with every affair of mutual funds. It provides diversification and investment options to investors. The AMC is referred to as the investment manager, is a separate company appointed by the trustees to run the mutual fund on the recommendation of the sponsor by entering into an agreement called "Investment- Management Agreement" containing all duties and rights of AMC.

### Custodian

A custodian is appointed by the board of trustees by entering into a custodial agreement. A person who has the responsibility for seizing care of the assets of the fund is called custodian. Registration with SEBI is mandatory for all custodians. The trustees and the custodians are two parties who are involved in a custodial agreement. A custodian can only be apportioned for the mutual fund operation if: 50% or most of the shares of a custodian are controlled by the sponsor or its associates. 50% or more of the directors of a custodian represent the interest of the sponsor or its associates.

### Registrar and Transfer Agent (RTA)

The main function of RTA is to wield the documentation of investors. Maturity dates, new offers and all another investor-friendly information provided by RTA prolong their role. They handle investor related services such as issuing units, sending facts, sheets and annual reports etc. Every day the fund houses have to deal with numerous financial and nonfinancial transactions. This may be overload for such houses due to lack of adequate time and skilled manpower. So, such task is outsourced by an external agency known as registrar and transfer agents (RTA). However, it is not compulsory for AMC to appoint RTA if they prefer to deal with recording those transactions internally. But, if appointed then RTA requires SEBI registration.

### Distributors

The distributor is "An individual or an entity facilitating buying and selling of units of a mutual fund by investors. A distributor earns upfront trail commission for bringing in investors into the mutual fund schemes".

### Collecting bankers

The money invested by the investors on the different scheme is stored into the bank accounts. The AMC allot some collection bankers who maintain these accounts. Commercial banks are playing a major role in accepting and depositing the invested money with enabling uninterrupted availability of money for investment by AMC. Also, the investor assures themselves regarding safety and security of their money. Payment instruments for applications are handed over to branches of AMC. Even RTA should be blocked up with collecting bankers

### Fund accountants

Mutual fund accounting is the process of accurate pricing of the investment vehicles and contributing reasonable income to unitholders. Basic task of fund accountants are – Calculate the value of investment portfolio (NAV) on daily basis. Estimating and recording all incomes including dividends and interest. Amortizing properly any discount/premium on bonds purchases/sales. Recording every security transactions

**Auditors** The auditors of a mutual fund shall be a firm including limited liability firm, contributed under LLP Act 2008, and appointed in terms of regulation 55 of SEBI regulations. Also, no mutual fund shall appoint the same auditor for more than 2 terms of maximum 5 years in consecutive. The auditors are called for auditing the accounts. Accounts of the scheme and of the AMC are maintained separately. Thus, the accounts should also be audited separately by different auditors. Because the scheme auditor is prescribed by the trustees, while the AMC auditor is prescribed by the AMC.

**KYC registration agencies (KYCRA)** KYC registration agencies are registered with SEBI. Know your customers (KYC) norms have been made mandatory before investments in mutual funds. KYCRA maintains KYC records of investors, centrally on behalf of capital market intermediaries, registered with SEBI, illuminating the need to repeat KYC.



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#### IV. CONCLUSION

In past few years, mutual fund companies are doing much effort to expand its operation. The various regulatory authorities are also supporting the fund houses as well as investors. Many regulations have been formulated to protect the interest of investors. A wide range of schemes have been innovated keeping the investor's requirement and demand in view. However, the industry has to resolve many challenges for its sustainable growth. A study on the status and operation of mutual fund helps both the fund managers and investors to acquire better knowledge and information regarding the investment opportunity.

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