Chapter - 1

INTRODUCTION

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1. HISTORICAL BACKGROUND:

National Economy is highly influenced by economic condition of people i.e. income of people and financial system. The financial system is a set of an institutional arrangement through which financial resources in the economy are mobilized from surplus units to deficit spenders. The institutional arrangements includes all conditions & mechanisms governing the production, distribution, exchange & holding of financial assets or instruments of all kinds and the organization as well as the manner of operation of financial market & institutions of all descriptions. In short, financial assets, financial market & financial institutions are the main constituents of any financial system.

A well-organized set-up of financial intermediaries plays an important role for the economic development of country. Intermediaries consists of Money Lenders, Co-operative Societies, Co-Operative Banks, Commercial Banks, Industrial Credit and Investment Corporation of India [ICICI], Life Insurance Corporation of India [LIC], General Insurance Corporation [GIC], Industrial Development Bank of India [IDBI], Agricultural Bank, Unit Trust Of India [UTI] and such other financial institutions.

1.1 SAVINGS:

Financial Intermediaries (FIs) are institutions that mediate or stand between ultimate lenders and ultimate borrowers or between those with budget surplus and those who wish to run budget deficits. The central function of all financial institutions is to collect surplus of people & institutions and lend them to the needy persons and institutions. Financial institutions help in production, capital formation and national development by

A} Encouraging Savings

B} Mobilising savings

C} Allocating them among alternative uses & users.

Financial institutions encourage people to save. People deposit money for safety, convenience and liquidate condition. A financial institution satisfies all these needs. Investors get advantages from the financial institutions that are generating income, greater liquidity, return on their investment, conveniences of dealing & other services. Financial institutions mobilize savings of people i.e. Banks accept deposits and lend money. It means they give loan to a person for starting a new business, to run the business, for modernization of business, for purchase of land, building, goods etc. Small savings of an individual may not develop economy but when it comes in the market and pool saving together then it gets greater importance in economy. With the help of intermediaries, savings come in the financial markets and it becomes productive.

To the great extent, economic development of a country depends on a high level of capital investment i.e. Capital Formation. This is possible by the generation of an adequate volume of savings in the long run, by providing total encouragement of savings by financial institutions, rate of savings and mobilization of savings have seen a considerable increase in terms of investment. Owing to increasing rate of investment, capital formation also goes up which helps in the economic development of any country.

In past, people used to keep their surplus income in their own house. But their savings were not safe. So they started converting their surplus in gold and silver. This form of saving also did not seem to be safe. Their savings were not remunerative and some times instead of returns they use to lose their original savings. Due to such circumstances, people went to sell their gold and silver in the market, but started getting less value than the value they invested in. Such a difference in the value occurred owing to factors like losing its original form and shine, having less knowledge of the metal's actual value and weight.

1.2 DEVELOPMENT OF CO-OPERATIVE BANK

Poor and backward class people were exploited by petty moneylenders to the extent that they were debt-bond all their lives. In villages farmers took money from the moneylender. Moneylenders were charging very high rate of interest. Because of exploitation of poor by the moneylenders, co-operative credit society and Co- Operative Banks emerged. The credit societies emerged wherein the people could keep their savings safely and productively compared to investing in gold and silver. Co-operative Credit society developed habit of saving money among the people. Each member deposits certain amount compulsorily every month and out of such collection it gives loan to the member at soft rate. We find co-operative credit society in each sector of society like Farmer Co-operative credit society, Teachers credit society, Employees credit society, Credit society of particular caste etc. Credit co-operative society is also known as "Saving

Mandal". It may be registered or unregistered. Such co-operative societies became a part of their lives.

With opening of the Co-operative banks, people deposited their savings in it. The first Co-operative bank started in Vadodara in 1889 with the purpose of helping out the poor people from the clutches of moneylenders. Co-operative banks with their extensive branch network and localized operational base plaid a key role in deposit mobilization. People started investing their savings in a bank where their savings were safe and fruitful. They get more value of their investment in the form of interests and also formed securities.

1.3 SAVING WITH COMMERCIAL BANK:

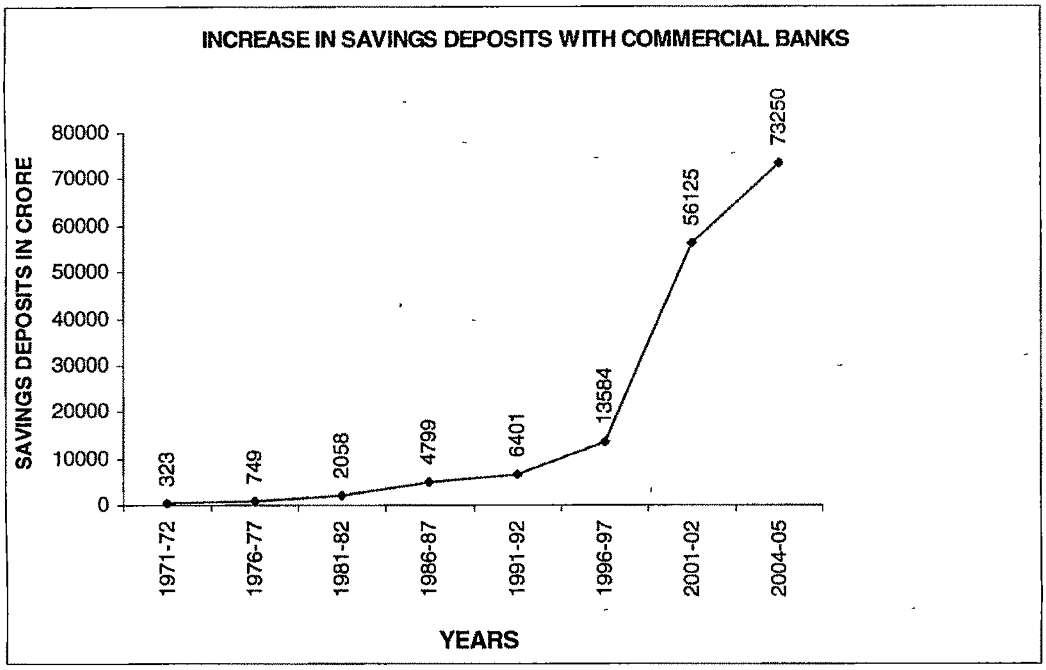
Following table prove that the people depositing their saving in the banks

Table: 1. 1 Savings Deposits With Commercial Bank

YEAR	INDIAN BANKS	FOREIGN BANKS	Total Savings
1970-71	1,408	117	1,525
1971-72	1,713	135	1,848
1972-73	2,076	150	2,226
1973-74	2,519	160	2,679
1974-75	2,923	168	3,091
1975-76	3,,480	182	3,662
1976-77	4,217	193	4,410
1977-78	5,482	208	5,690
1978-79	7,069	224	7,293
1979-80	8,603	241	8,844
1980-81	10,667	270	10,937
1981-82	12,692	304	12,996
1982-83	14,747	318	15,065
1983-84	17,430	381	17,811
1984-85	21,358	429	21,787
1985-86	24,071	485	24,556
1986-87	28,787	567	29,354
1987-88	32,546	625	33,171
1988-89	36,756	690	37,446
1989-90	43,744	823	44,567
1990-91	49,542	959	50,501
1991-92	55,554	1,348	56,902
1992-93	57,256	1,317	58,573
1993-94	69,434	1,718	71,152
1994-95	89,019	2,305	91,324
1995-96	99,347	2,514	1,01,861
1996-97	1,12,570	2,875	1,15,445
1997-98	1,36,770	3,194	1,39,964
1998-99	1,60,889	3,836	1,64,725
1999-00	1,94,180	4,940	1,99,120
2000-01	2,17,452	5,530	2,22,982
2001-02	2,72,119	6,988	2,79,107
2002-03	3,02,816	8,748	3,11,565
2003-04	3,73,137	12,232	3,85,369
2004-05	4,43,573	15,045	458,619

Sources:-Hand Book of Statistics on Indian Economy 2000 & 2005.

Graph: 1.1 Increase In Saving Deposits With Commercial Banks.



The analysis of table reflects the following points when studied in a block of 5 years.

1. The total deposits increased by Rs.1567 Crores from 1970-71 to 1974-75 and the increase percentage is 102.82.
2. Saving Deposits shooted up by Rs.5753 crores at 186.12 per cent during the period from 1975-76 to 1979-80. In the years 1977-78 and 1978-79 it rose by 29.02 % with Rs.1280 crores and 28.17 % with Rs. 1603 crores respectively. In 1978 emergency was called back and due to this commercial activities took boost.
3. During the span of 30 years, between 1977-78 and 1978-79 a significant rise in saving deposits by 29.02 % and 28.17. This rate of increase in saving deposits is not observed even before and after these two years. One of the reason may be in 1978 the emergency was called off and the demand of people of India was satisfied .They were relived from terror of emergency.
4. Saving deposits climbs by Rs. 22780 Crores at 104.56 % during the period from 1984 -85 to 1989-90. Rate of increasing is reduced compared to previous block of years by nearly 50%. It is mainly on account of boom in share market where people get higher returns on their investment and secondly as the bank rate of interest remain constant.

5. Increasing rate of deposits remain almost same in period from 1989-90 to 1994 – 95 i.e. 104.91 %.However, in the year 1992-93, the increasing deposits steeply came down from Rs.6401 crores in1991-92 to Rs.1671 crores in the year 1992-93. It is because of opening of Mutual Fund market for private sector as well as foreign institutional investors and rapid expansion of securities market.
6. In the year 1999-2000 saving deposits with bank rises by 110.13 % compared to the year 1994-1995.This flow of fund to commercial banks is due to down fall in the performance of co-operative bank coupled with scams like Mr.Harshad Mehta in the security market.
7. In the year 2004-05 savings deposits with bank augment by 138.99 % compared to the year 1999-2000.

Thus, the above table and its analysis clearly reveal that:-

1. People have absolutely lost their trust in moneylender.
2. The table reflect continuous rise in saving deposits with bank that proves the having habit of the people increase.
3. The table gives the amount of savings deposited into the bank which are increasing increasingly i.e. people have faith, trust which is developed in the minds of the people.
4. Figure presented in the table compares Indian banks with foreign banks. Deposits with foreign banks are at very low level. It clearly shows people of India have more faith in Indian bank then that of foreign banks. But from 2002-03 growth rat of deposit in foreign bank is high.

The above mention table of increase in deposits is reflection of return on deposits i.e. interest rate. Firstly, saving deposits into the bank are productive i.e. they increases the saving by adding the interest per annum in it and people gets interest on interest. It may be possible that after 6 to 7 years money saved becomes doubled. Secondly, money deposited in the banks is not idle. Bank keeps on rotating it which is used in development of national economy.

People of India have a history of saving. People of India save their today's income for future expenses, accidental expenses, eventual expenses and may be some developmental expenses also.

In western countries we find, people spent their future income today. This discussion makes it clear that savings habits may increase deposits in banks.

A major component to save is to earn interest. So it will be worth to study the interest rate structure in India.

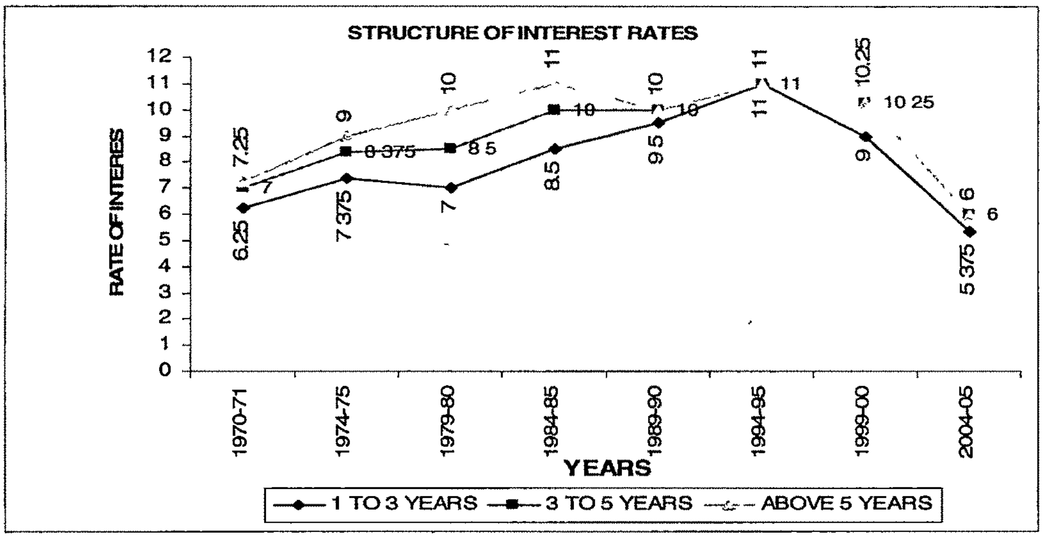
1.4 INTEREST RATE STRUCTURE:

Table: 1.2 Structures Of Interest Rates

YERS	Period		
	1 TO 3 YEARS	3 TO 5 YEARS	ABOVE 5 YEARS
1970-71	6 00-6 5	7	7 25
1971-72	6	6 5	7 25
1972-73	6	6.5	7 25
1973-74	6	7	7 25
1974-75	6.75-8.00	7 75-9 00	8.00-10 00
1975-76	8	9	10
1976-77	8	9	10
1977-78	6	8	9
1978-79	6	7.5	9
1979-80	7	8.5	10
1980-81	7 50-8.50	10	10
1981-82	8 00-9 00	10	10
1982-83	8.00-9.00	10	11
1983-84	8.00-9 00	10	11
1984-85	8.00-9 00	10	11
1985-86	8 50-9.00	10	11
1986-87	8.50-9 00	10	11
1988-89	9 00-10 00	10	10
1989-90	9 00-10 00	10	10
1990-91	9 00-10 00	11	11
1991-92	12	13	13
1992-93	11	11	11
1993-94	10	10	10
1994-95	11	11	11
1995-96	12	13	13
1996-97	11 00-12 00	12 00-13 00	12.5-13 00
1997-98	10.50-11 00	11.50-12 00	11 50-12 00
1998-99	9 00-11.00	10.5-11 50	10 50-11 50
1999-00	8 50-9.50	10 00-10 50	10.00-10 50
2000-01	7.75-10 50	8.75-11 00	8.75-11.00
2001-02	7 25-8 5	8 00-8 75	8 00-8 75
2002-03	5 25-6.75	5 50-7.00	5 50-7 00
2003-04	3 93-7 16	4.41-6.78	5 44-7.72
2004-05	5 25-5.50	5 75 -6 25	5 75- 6.25

***Source*:** HANDBOOK OF STATISTICS ON INDIAN ECONOMY-2004-2005

Graph : 1.2 Structure Of Interest Rate.



Structure of interest rate shows the following trends for the period from 1970-71:

1. Interest remains almost same from the period 1970-71 to 1974-75 i.e. between 6 % to 7.25 %.
2. Deposit holders of all three periods got highest rate of return during last 35 Years that is at 12 % to 13% which is the highest rate of return, till now.
3. The graph reflects continuous decrease in rate of interest from 1996 to 2004. It reaches to its all time lowest level.

The decline in rate of increase in deposits is due to several reasons as given bellow:

1. The rate of interest on different time period deposit declines.
2. The comparative currency rate also was fluctuating speedily.
3. The poor performance of co-operative banks.
4. Many malpractices, scams, scandals and other kind of fraudulent practices of using the deposits were detected.
5. The development of commodities market, real estate market, foreign currency market and capital market started in a well organised manner. People getting better communication facilities like news paper, radio, T.V., telephone, internet, information technology(IT) etc. The knowledge of the people encouraged them to think for the better options.

All such reasons forced people to divert their savings towards stock market.

1.5 DEVELOPMENT OF CAPITAL MARKETS:

Progress of industries is one of the factor in development of capital market. Number of stock exchanges started, to facilitate the trading of shares. The number of stock exchanges increased from 11 in 1990 to 23 at the end of the 2003.All exchanges are fully computerized and offer 100 % on-line trading. To avoid problems of physical delivery of shares like theft, damage of certificate, other irregularities etc., the Depositories Act, 1996 was passed. Even with a less savings person could invest in shares without much difficulty. They started earning huge return compared to bank interest. Initially this market was monitored by Controller of Capital of India (CCI). With the further requirement, to develop the capital market in efficient and effective manner the Stock Exchange Board of India (SEBI) was established in 1988 and it was given statutory power by an ordinance on 30th June 1992.Hence the companies are having the freedom to approach the capital markets without prior government permission subject to getting offer documents cleared by SEBI. Initial Public Offer (IPO) companies are free to fix the price of their securities for public as well as rights. The investors in capital market started making quick money. The Indian capital market has passed through an era of almost 100 years. However, years of 1978, 1985 and 1992 were significant from the point of view of boom in capital market.

In the year1978, the boom in capital market may be because of following reasons;

[1] As the emergency was called off at the end of year 1977.During emergency period bureaucrats had a hold over the entire economic activities whereby the company, the traders, manufacturers as well as general public suffered great difficulties as there was no freedom of speech, report, views etc. As a restrained of emergency by the politicians and public at large, the emergency was called off. With the called off of emergency, people were relived from terror of emergency and once again they started their economic activities with wholehearted interest. As a result commercial activities took a boost which brought boom in capital market.

[2] The removal of dividend control.

[3] The liberalization of-

- ☞ the quantity and price restriction for FERA companies,
- ☞ Industrial Licensing policy
- ☞ Importing capital equipment, Know-how, technology etc,

☞ Licensing for changes in location,

☞ Diversification was allowed in certain industry like machine tools, electric equipments etc.

Because of all such reasons capital market rose up and people who invested in capital market got extra ordinary return.

In the year 1985, once again there was a boom in the capital market .This time also the main reasons were very good monsoon, excellent result declared by FERA companies and bank were also allowed to finance for the capital investment through stock exchanges. The contribution made by Mr. Rajiv Gandhi's government and Mr. Dhirubhai Ambani is worth noting. Mr. Rajiv Gandhi's Govt. has almost closed operational control and opened doors to the private sector. Some important steps taken like modern sophisticated technology was allowed to import freely, liberal attitude in the formalities of import & export procedure, foreign investors to make direct investment in India etc. Mr. Dhirubhai Ambani, who gave the Reliance shareholders such a good return and he was pioneer for bringing the middle class into share market. In addition to 25 % dividend, bonus shares were issued at a 3:5 ratio. Reliance shares were appreciated by 450 %.He was the first industrialist to cater to the needs of the small investors and took the equity culture even to small and remote towns in India.

1.6 FALL OF CAPITAL MARKET:

Further in1992, once again there was a boom in the capital market. But this time main reasons were good monsoon, better irrigation facilities, better seeds, the overall good output of agriculture sector. The rate of interest was reduced by the bank. Therefore more flow of funds started from bank deposits to capital market. Mr. Harshad Mehta came into picture. He brought the rural people into the capital market. The SEBI Act, 1992 was enacted to empower SEBI with statutory powers for protecting the interests of investors in securities, promoting the development of the securities market and regulating the securities market. The information Technology in the development of capital market from cities to villages is also worth noting. The fast development in the capital market brought sea changes in the minds of Indian investors. By now majority of the people know that one can make money by investing in the shares of best managed companies.

A knowledgeable person earns quick and easy money. Capital market player was observed by ordinary rural people and middle class people that the player is earning money in short period which attracted them towards capital market.

"Mr. Harshad Mehta exploited bank receipt instruments to the maximum and used the money derived to speculate the share prices of several blue chip companies. Mr.Harshad perfected the art of diverting money to the stock market from bank's security portfolio by exploiting the loopholes in the system; He took over closed companies, pumped in cash and boosted their shares on the stock market. He was the Pied Piper of 1992. The Bombay Stock Exchange sensitive index danced to his tune, as did a few million shareholders who went into a buying frenzy merely on rumors that the Big Bull - Harshad Mehta, was interested in certain scrip. He led an extraordinary bull run through the second half 1991, fuelled by a seeming endless supply of money. The bull frenzy came to an abrupt halt on April 23, 1992 when it was revealed that the broker was simply dipping into the banking system to finance the boom. Also revealed a complicated web of deceit and illegal deals that had been taking place in money markets under the cover of "accepted market practice". The stock market crash that followed caused huge losses to gullible investors.[1]" Stock market collapse and market price of shares reduced sharply, so investors lost their money. However, the people also understood after stock scams of Mr. Harshad Mehta, that the investments in capital market are also not safe. Thus it is equally easy to lose money through the investment in capital market.

The above episodes taught lesson to the investor that if you want to make money you should go to stock market and if you want to loose money go to Stock market.

1.7 EMERGENCE OF MUTUAL FUNDS:

Due to globalization, the major events in other countries affect considerably the share price of the Indian market. The Gulf War, the crisis in Mexico, the Barings fiasco in Singapore, Tokyo and London, interest rate hike in Unites States have upset Indian stock prices. For e.g. due to the Gulf War,

1 Sucheta Dalal – Times of India

petroleum prices were increased considerably. As a result the transportation cost in India has gone up. Therefore the profitability of the company has been affected adversely. This has indirectly affected the share price of the companies.

Stock playing has become a tough game. The small investors neither they have time nor they are the expert to keep track of all factors like effect of seasons, political changes, companies performance, share price, world events, rumors etc. that affect the stock market. New and more sophisticated techniques of stock picking are coming up e.g. continuous monitoring of data, analyzing corporate result, sifting performance etc. Investors had the money to invest; they perhaps did not have professional knowledge to stock selecting and forecasting of market effectively. It means that they require professional help from persons or institutions having such knowledge for stock selection, security analysis and effectively market forecast. So people started thinking to let some expert person or institution to pool the savings, manage and invest our money on behalf of us. Hence preference has gone towards to Mutual Fund as it provided a professional knowledge of stock market to the investors.

Mutual fund is a Mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document.

1.8 HISTORY AND DEVELOPMENT IN MUTUAL FUNDS:

In India, the first mutual fund was set-up in 1964 with the establishment of the UTI [Unit Trust of India] under the act of Parliament i.e. Unit Trust of India Act, 1963. Finance Minister Mr.T.T.Krishnamachari,who initiated the Act, made it clear to the Parliament that UTI would provide an opportunity for the middle and lower income group to acquire without much difficulty, properly in the form of shares .This initiation is intended to cater mainly to the needs of the individual investors whose means are small. UTI had held a monopolist position over two decades from 1964 to 1986. Middle class of the society attracted to invest in stock market from 1985 and therefore, stock market hotted up. Now corporate sector began to depend on mutual fund to meet their need for long term capital. Reacting positive to this Rajiv Gandhi govt. opened up the Mutual Fund to the public sectors in 1987. By amending Banking Regulation Act in 1987

commercial bank were also allowed to launch Mutual Fund in India. The first public sector Mutual Fund was established by State Bank of India in 1987. Further in 1989 Life Insurance Corporation of India launched its first mutual fund in 1989 and during early 90's IDBI, IFCI and other financial institutions joined mutual fund industry. In February 1993 mutual fund sector got opened for the private corporate and for the Foreign Institutional Investors [FII]. Between 1987 and 1992 the securities market expanded rapidly. In February 1993 Rao Govt. opened up capital market for the private sector and for Foreign Institutional Investors [FII].
To encourage the growth of the industry govt. introduced some favorable taxation policies applying to fund investment and fund themselves in various matters viz.capital gains, TDS, Wealth Tax, Income from units, Income distribution Tax, and Section 88 of the Income Tax Act.

Mutual Funds play very important role in mobilization and effective allocation of resources in India. Necessity of efficient allocation of resources arises due to the process of liberalization, deregulation and restructuring of the Indian economy. In this process Mutual Funds have emerged as financial intermediaries and are playing vital role in bringing stability in the financial system and efficiency to the resource allocation process. With development of capital markets and the emergence of alternative savings instruments, investors tend to move towards more liquid short-term instruments as the units of mutual funds along with corporate equities and debentures. "Mutual Funds have been the fastest growing institution during the period of 1980-81 to 1992-92 in the household savings sector, it increased from 3.7 to 17.2 during this period[2]".

The various investment avenues like Bank Deposits, Real Estate, Gold, Provident Fund etc. have lost their scene. Especially due to fall in interest rates coupled with rising inflation, Mutual Funds have obviously become a viable alternative.

An investor investing in the Mutual Fund is well protected, well introduced and is well regulated.

2. Performance Appraisal of Mutual Fund in India by Chander Ramesh, first edition 2002, pp-2.

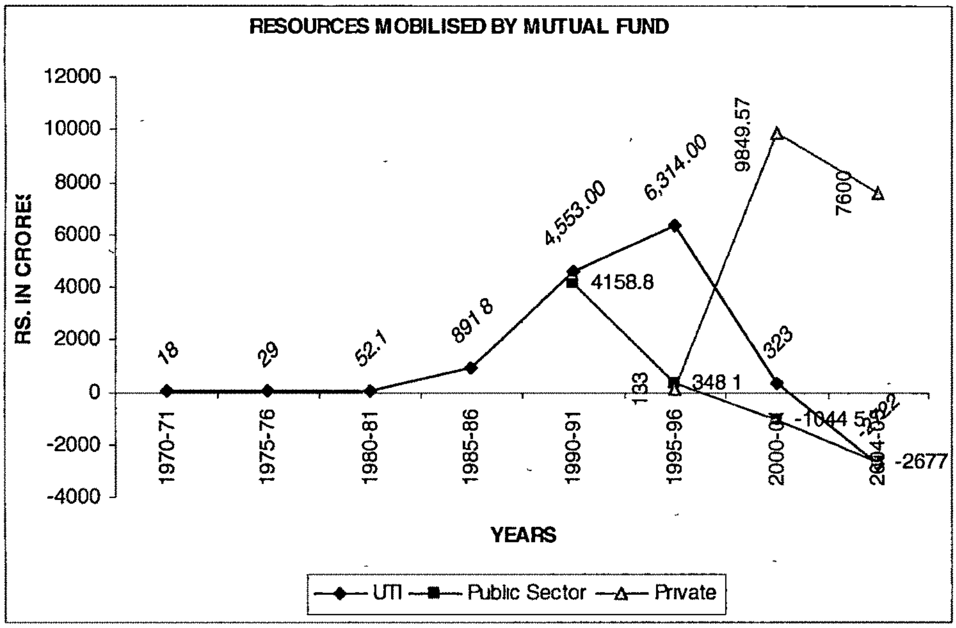
Table: 1.3 Net Resources Mobilised By Mutual Fund (Rs Crores)

YEAR	Public Sectors		PRIVATE SECTOR M.F.	Total
	UTI BANK	Others (Bank and FI-Sponsored M.F.)		
1970-71	18.00	N.A.	N.A.	18.00
1971-72	15.10	N.A.	N.A.	15.10
1972-73	23.20	N.A.	N.A.	23 20
1973-74	30.60	N.A.	N.A.	30.60
1974-75	17.20	N.A.	N.A.	17.20
1975-76	29.00	N.A.	N.A.	29.00
1976-77	34.60	N.A.	N.A.	34.60
1977-78	73.30	N.A.	N.A.	73.30
1978-79	101.50	N.A.	N.A.	101.50
1979-80	57.90	N.A.	N.A.	57.90
1980-81	52.10	N.A.	N.A.	52.10
1981-82	157.40	N.A.	N.A.	157.40
1982-83	166.90	N.A.	N.A.	166.90
1983-84	330.20	N.A.	N.A.	330.20
1984-85	756.20	N.A.	N.A.	756.20
1985-86	891.80	N.A.	N.A.	891.80
1986-87	1261.10	N.A.	N.A	1261.10
1987-88	2059.40	250.30	N.A.	2309.70
1988-89	3855.00	319.70	N.A.	4174.70
1989-90	5583.60	1203.40	N.A.	6787.00
1990-91	4553.00	4158.80	N.A.	8711.80
1991-92	8685.40	2567.50	N.A.	11252.90
1992-93	11057.00	1964.00	N.A.	13021.00
1993-94	9297.00	386.70	1559.50	11243.20
1994-95	8611.00	1341.80	1321.80	11274.60
1995-96	6314.00	348.10	133.00	6795.10
1996-97	3043.00	490.90	863.60	4397.50
1997-98	2875.00	440.30	748.60	4063.90
1998-99	-2737.53	335.16	1452.70	-949.67
1999-00	4548.32	-744.92	15166.48	18969.88
2000-01	323.00	-1044.50	9849.57	9128.07
2001-02	-7284.00	1409.31	13049.89	7175.20
2002-03	-9434.00	1561.05	12069.44	4196.49
2003-04	1666.92	2597.01	42544.50	46808.43
2004-05	-2722.00	-2677.00	7600.00	2201.00

- Not applicable

Source: HANDBOOK OF STATISTICS ON INDIAN ECONOMY-2000.
Reserve Bank of India, Currency and Finance, 1995-96[Vol II]:13
SEBI Annual Report- 98-99 to 03-04.
* UTI has been classifies as bank.

Graph: 1.3 Net Resources Mobilised By Mutual Funds.



Almost 25 years i.e. from the year 1964-1986 the Unit Trust of India [UTI] was the sole player in the mutual fund market. UTI was a monopolist with the total investable fund Rs. 4016.1 Crores. Mr. Rajiv Gandhi has opened up the mutual fund to the public sector in the year 1987-88. State Bank of India & Can Bank have launched their first public sector mutual fund in 1987 and mobilised Rs.250.30 crores which was 10.84 % of total fund mobilised. Mutual fund market developed rapidly probably due to opening of mutual fund for public sector. As a part of economic reforms mechanism, private sectors are allowed to enter in mutual fund industry in 1993-94.Pioneer ITI Mutual Fund, Zurich India Mutual Fund, Prudential ICICI Mutual Fund, Morgan Stanley Mutual Fund and Taurus Mutual Fund entered the arena and mobilised Rs.1559.5 crores. In the year 2004-05, UTI and public sector mutual fund have reported negative mobilization of resources.

Mutual fund competing with commercial bank for getting retail investor's savings & corporate money. "Many investors are now realizing that investment in bank is as good as locking up their deposit in a closet. Due to this concept, in the first quarter of the year 1999-00 mutual fund assets went up by 115% whereas bank deposits rose by only 17 %"[3]. The following table makes clear that why more and more people invest their saving in mutual fund instead of commercial bank.

3 . Think Tank, The financial Express September.

Table: 1.4 Banks V/S Mutual Funds

	BANKS	MUTUAL FUNDS
Returns	Low	Better
Administrative exp.	High	Low
Risk	Low	Moderate
Investment options	Less	More
Network	High penetration	Low but improving
Liquidity	At a cost	Better
Quality of assets	Not transparent	Transparent
Interest calculation	Minimum balance between 10th. & 30th. Of every month	Everyday
Guarantee	Maximum Rs.1 lakh on deposits	None

Source: www.Amfi.com.

1.9 INTERNATIONAL HISTORICAL BACKGROUND OF M.F.

The idea of pooling money together for investing purposes started in Europe in Mid-1800s.The first was started in the Netherland in 1822.In 1868, the Foreign and Colonial Government Trust formed in Landon to resemble a mutual fund. It promised that "investor of modest means will get the same advantages as the large capitalist by spreading the investment over a number of different stocks.

Most of the early British investment companies or trusts resembled today's Close-ended funds by issuing a fixed number of shares to groups of investors whose "pooled" assets were invested in various companies. The Scottish American Investment Trust, formed on 1-2-1873 by fund pioneer Robert Fleming, was significant because it invested in the American Railroad Bonds. The first pooled fund in the U.S. was created in 1893 for the faculty and staff of Harvard University.

The first official Mutual Fund was started on 21st March 1924. It was called the MASSACHUSETTS INVESTORS' TRUST. It began with a portfolio of 45 stocks and $ 50,000 in assets. This was the first so-called open-ended mutual fund with the concept of continuous offering of new shares and redeemable shares that could be sold anytime at current value of the funds assets.

The growth of mutual fund may be slowed because of the stock market crash in 1929 and great depression in the world. Investors madly scrambling to sell their investments even without knowing the current prices and this because of rumors were flying that the Chicago and Buffalo Exchange closed down, eleven well-known speculators had already killed themselves and the New York Stock Exchange (NYSE) closed the visitor's gallery on the wild scenes below. Speculators began to realize that no one could save the market. Investors lost their confidence in mutual fund industry. In just two months, September and October, the stock market had lost 40 % of its value and investors had lost $100 billion in assets. Still this stage there was hardly any regulation governing the activities of such organizations. Due to lack of regulation, many malpractices, cheating using borrowed money etc emerged. Stock market crash of 1929 which washout close-ended fund and great depression arise need of security act and so congress passed the securities Act of 1933 and Securities Exchange Act of 1934. According to this law, fund must be registered with the Securities & they should provide prospective investors with a prospectus.

Mutual funds began to grow in popularity in 1940s because of one important law which was introduced relating to mutual funds and investors protection. It was named as Investment Company Act of 1940. According to this law every fund price is determined on asset based on market value of every day, prohibitions on transactions between fund and it's manager, Leverage limit are unique to the mutual fund industry. By the end of 1906s, the complexion and size of the mutual fund industry dramatically changed as new products and new services were adopted which led to renewed confidence in the stock market and so mutual fund began to develop in a healthy way. At the end of 1960 there were 269 funds with a total of $ 48.3 billion in assets. In 1967 fund hit their best year, one quarter earning at least 50 % with an average return of 67 %, but it was done by cheating using borrowed money, risky options, clever advertising and pumping up return with privately traded "letter stock". But the public's interest soon snuffed out as the market collapsed in 1969-70 and again in 1973-74.

During the year 1971, the first money market funds were established. They offered check writing and higher interest rate of return than bank saving account. In 1974, the Employee Retirement Income Security Act (ERISA) was enacted. The first Tax-Exempt Municipal Bond Funds were offered in 1976 and in same year John C. Bogle opened the first retail fund- First Index Investment Trust, now known as Vanguard 500 index. After three years i.e. in 1979 the Tax-Free Money Market Fund was created. As a result of Tax –Exempt fund and Tax free fund great boom came in mutual fund industry. Assets under the management had gone up during 1980s. It was $ 0.5 billion in net asset in 1940 which reached as high as $ 58.4 billion in 1980.

Major growth came in mutual fund after creating Individual Retirement Account in 1981.The next big change for the industry was in 1991 when Morningstar introduced its "Star rating". Fund managers have developed mutual funds for all economic reasons and all type of investment needs. Mutual Funds are constantly developing and offering new products, services and distribution channels to meet consumers demand. Today toll free 24 hours telephone access, computerized account information etc facilities are provided to the customers.

1.10 SIGNIFICANT EVENTS IN MUTUAL FUND HISTORY- USA

1800 The idea of pooling money together for investing purposes started in Europe in the Mid-1800s.

1822 The first fund was started in the Netherlands.

1868 The Foreign & Colonial Government Trust formed in Landon to resemble a Mutual Fund.

1873 The Scottish American Investment Trust formed by Fund Pioneer Robert Fleming.

1893 The first pooled fund in the U.S. was created for the faculty & staff of Harvard University.

1924 The first official mutual funds called Massachusetts Investors Trust established in Boston.

1928 The first balanced fund-The Wellington Fund was founded.

1933 The Securities Act of 1933 regulates the registration and offering of new securities, including mutual fund shares, to the public.

1934 The Securities Exchange Act of 1934 authorizes the U.S. Securities and Exchange Commission (SEC) to provide for fair and equitable securities markets.

1936 The Revenue Act of 1936 establishes the tax treatment of mutual funds and their shareholders.

1940 The Investment Company Act of 1940 is signed into law, setting the structure and regulatory framework for the modern mutual fund industry.

The forerunner to the National Association of Investment Companies (NAIC) is formed. The NAIC will later become the Investment Company Institute (ICI).

1944 The NAIC began collecting investment company industry statistics.

1951 The total number of mutual funds surpasses 100, and the number of shareholder accounts exceeds one million for the first time.

1954 Households' net purchases of fund shares exceeded those of corporate stock for the first time. NAIC initiated a nationwide public information program emphasizing the role of investors in the U.S. economy and explaining the concept of investment companies.

1955 The first U.S.-based international mutual fund is introduced.

1961 The first tax-free unit investment trust is offered. The NAIC changes its name to the Investment Company Institute and welcomes fund advisers and underwriters as members.

1962 The Self-Employed Individuals Tax Retirement Act creates savings opportunities (Keogh plans) for self-employed individuals.

1971 Money market mutual funds are introduced.

1974 The Employee Retirement Income Security Act (ERISA) creates the Individual Retirement Account (IRA) for workers not covered by employer retirement plans.

1976 The first retail index fund called the First Index Investment Trust established by John C. Bogle. (now called Vanguard 500 Index).

1976 The first Tax-Exempt Municipal Bond Funds were offered.

1978 The Revenue Act of 1978 permits the creation of 401(k) retirement plans and simplified employee pensions (SEPs).

1979 Tax-exempt money market funds are introduced. The SEC permits mutual funds to advertise performance. Mutual fund shareholder accounts total 9.8 million in 524 funds.

1981 Individual Retirement Act (IRA) started.

1986 The Tax Reform Act of 1986 reduces IRA deductibility.

1987 ICI welcomes closed-end funds as members.

1988 The SEC adopts a mutual fund fee table rule standardizing presentation of fund fees in prospectuses.

1990 Mutual fund assets top $1 trillion.

1991 Morningstar introduced its "Star ratings".

1992 Charles Schwab started the first "fund supermarket"

1993 The first exchange-traded fund shares are issued.

1994 ICI publishes Report on Personal Investing by fund personnel, including recommendations to address potential conflicts of interest.1996 The Small Business Job Protection Act creates SIMPLE plans for employees of small businesses.

1997 The Taxpayer Relief Act of 1997 creates the Roth IRA and eliminates restrictions on portfolio management that disadvantage fund shareholders.

1998 The SEC approves the most significant disclosure reforms in the history of U.S. mutual funds, encompassing "plain English," fund profiles, and improved risk disclosure.

1999 The Gramm-Leach-Bliley Act modernizes financial services regulation and enhances financial privacy. ICI publishes Best Practices for, Fund Directors.

2001 The enactment of the Economic Growth and Tax Relief Reconciliation Act.

2001 Significantly expands retirement savings opportunities for millions of working Americans.

2003 Investigations uncover instances of late trading and market timing involving mutual funds. The SEC undertakes a wide-ranging action plan to reexamine and reform relevant fund rules to strengthen investor protection and confidence.

2. OBJECTIVES OF THE STUDY:-

- Prime objective of the study is to examine the present scenario of Indian private mutual fund industry in India.
- To measure and evaluate the performance and experience related to risk and return of selected scheme of mutual fund.
- To study the investment pattern of Indian Private mutual funds and to analysis the same.
- To analyse why the funds are becoming the choice of a new generation?.
- To analyse above objective as a whole and to suggest some ways to help the investment decision making.

3. RESEARCH METHODOLOGY:

Conceptual literature of Mutual Fund is reviewed as the theories and other research literature consisting of studies made earlier with regard to Mutual Fund. Specific mutual fund and their schemes are considered. The data regarding growth of mutual funds in terms of resource mobilization, assets under management and Number of schemes, return and risk associated with return and performance of Mutual Funds are analysed from their annual report, revenue account, balance sheet and portfolio holding by selected mutual funds and were arranged according to the feasibility and requirement to develop necessary framework for computation and good analysis. The data collected are presented in the form of tables and graphs for some supportive and meaningful interpretations. Sharps, Treynor's and Jensen models are used to evaluate return, risk associated with return and performance of Indian private sector mutual funds. For the investors and intermediary' performance and experiences, samples survey of investors and intermediaries are conducted.

3.1 SELECTION OF THE MUTUAL FUNDS:

There were Ten Indian Private sectors mutual funds in India as per AMFI report as on 31-3-05. Nine out of Ten Indian private sectors mutual funds are selected for the study purpose. They are

1. Benchmark Mutual Fund
2. Cholamandalam Mutual Fund
3. Escort Mutual Fund
4. J M Mutual Funds
5. Kotak Mahindra Mutual Fund
6. Reliance Mutual Fund
7. Sundaram Mutual Fund
8. Tata Mutual Fund
9. Taurus Mutual Fund

3.2 SOURCES OF DATA: -

The data for the study comprises of secondary data collected through the various sources like annual report of each selected mutual fund company (2001-02 to 2004-05, AMFI Update Quarterly (2001-02 to 2004-05), SEBI Annual Report (1997-98 to 2004-05), Journal of Business, Journal of Finance, Economic Magazines and Newspaper etc. Primary data collected through construction of questionnaires and specially arranged visits with the officials and investors.

4. HYPOTHESIS:

The study has made attempt to test the following hypothesis developed in the reference of above objectives:

1. The investment performance of mutual funds is influenced by the performance measure used in the evaluation of investment performance.
2. The majority of the schemes have failed to provide a risk premium to the investors.
3. There is no much different regarding investment pattern of mutual funds.
4. There is positive relationship between return earned on mutual fund's schemes and risk associated with them.
5. The majority schemes performance is inferior to the benchmark return.
6. The nature of schemes does influence on the return earned by the schemes.
7. The saving habit is associated with age group, level of income and occupation.
8. Majority of the investors prefers private sectors mutual funds.
9. Equity oriented schemes are preferred over other schemes by the investors.
10. The investment pattern is not influenced by age, occupation and level of income.

5. CHAPTER SCHEME

Study is divided in six chapters. The first chapter provides brief introduction of study like historical background, objective of study, research methodology etc. The second Chapter provides literature review of mutual fund related books, articles, research etc. The third chapter gives conceptual and textual knowledge of the subject and growth of mutual fund industry in various aspects. The fourth Chapter gives a vivid picture of the investment pattern of the selected mutual funds. The fifth chapter discloses the performance appraisal of the selected mutual fund schemes in the term of their risk and returns and the result of opinionistic survey of mutual fund investors and intermediary. Findings, suggestions and conclusion of the study described in the sixth chapter.

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