# CHAPTER 9

## SIGNIFICANCE OF MUTUAL FUNDS IN INDIAN ECONOMY

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**ABSTRACT**

Mutual Fund is an investment company which collects money from majority of investors and invests the collected amount effectively in securities of different companies through diversification so that investors can get maximum return and their risk can be reduced. Investors have many investment options such as direct investment and indirect investment. In direct investment, he himself invests his money by investing in shares from the primary market or by purchasing shares from the secondary market, which involves more risk but also expects attractive returns, for which he needs to understand the basics of share market. It is very important to have information. There are two types of investors, firstly those who have the ability to bear the risk and secondly those who do not have the ability to bear the risk because they lack time, lack of knowledge about the stock market and the instability of the stock market. Prevents from investing in the stock market. This is the reason why people have to settle for low returns by investing their hard-earned money in traditional means of investment. Mutual funds are a great investment option for such investors. Mutual funds are the easiest way to invest for those investors who want to invest in the stock market but are afraid of taking too much risk and do not have knowledge of the stock market. In such a situation, mutual fund becomes an investment option for them which gives them the benefit of the

stock market boom without entering the stock market and also reduces the risk ratio.

### 9.1 MEANING OF MUTUAL FUNDS

An investment corporation or trust that pools the resources of its indirect investors in order to meet their investment goals, diversify their holdings, and receive fixed returns on those investments is known as a mutual fund. Mutual funds, then, function as financial middlemen, combining investor capital and allocating it effectively to generate the highest possible returns. A mutual fund is essentially an institutional setup wherein small investors' money is pooled and invested in the best financial instruments. A mutual fund is a type of trust where investors with similar financial objectives combine their savings. The money that mutual funds get from investors is reinvested in securities, debentures, and other capital market products. The mutual fund unit holders get distributions of income and capital appreciation through these instruments based on the number of units they own. Therefore, mutual funds are a preferable option for investors who wish to participate in the stock market but are hesitant to buy shares because they don't understand the market or are concerned about the dangers involved. Mutual fund investors have a number of advantages, including expert management, portfolio diversification, lower risk, and investment liquidity. Mutual funds provide a range of plans, including equity schemes, tax saving schemes, systematic investing schemes, and others, to meet the demands of diverse investor types.

When it comes to efficiently allocating resources and combining them, mutual funds are crucial. These funds are crucial to the growth of capital markets, financial intermediation, and the financial industry overall. The relevance of mutual funds is growing as a result of shifting financial conditions, falling nominal rates of bank deposits, and unpredictable capital markets. Currently, mutual funds handle more money than banks combined.

The values of equities shares, bonds, real estate, derivatives, etc., have fluctuated rapidly in the globalisation period. A typical investor must maintain records of his assets, investments, progress, amount due, brokerage, and bank transactions, among other things. If you find it difficult to invest, mutual funds can help with all of these issues. Small and medium-sized investors can engage in the complicated financial environment of today with the aid of mutual funds. By acquiring mutual fund units, investors can take part in mutual funds. The income from these assets and any

capital gains are distributed among the unit holder based on the number of units they have taken.

When it comes to effectively allocating and mobilising resources, mutual funds are crucial. These funds are crucial to the growth of the financial industry, capital markets, and financial intermediation. Mutual funds are highly prevalent in the money and capital markets, indicating their active involvement in economic development.

### 9.1.2 MUTUAL FUND DEFINITIONS

Scholars have defined mutual funds in a variety of ways. According to K. Reilly, a mutual fund is an investing business that uses investor money to buy shares, stocks, bonds, and other securities.
According to John A. Halin, it is an investment firm that invests client funds in a variety of securities after pooling the funds of clients with similar financial objectives.

Mutual funds, as defined by the Securities and Exchange Board of India (SEBI), are trusts that combine the savings of several individuals who have banded together to pursue a common objective. A few thousand rupees or even a little sum can be invested in mutual funds by anyone having an investable surplus. These investors purchase mutual fund scheme units in order to achieve a particular investing goal. The fund manager then invests the money thus obtained in a variety of securities. Depending on the scheme's goals, it might accept money market products like shares and debentures. Based on the number of units they own, each unit holder receives income and capital appreciation from these assets. Therefore, a mutual funds is the ideal choice for the typical investor. It provides diversification and professional securities management at a relatively low cost.

## 9.2. MANAGEMENT OF INVESTMENTS AND MUTUAL FUNDS

It is vital to define the terms "investment" and "investment management" in this context after learning that a mutual fund is a type of investment vehicle in which funds raised by a group of investors are allocated to a variety of assets by fund managers. It should be provided in order to ensure a thorough understanding of the mutual fund investment management system.

### 9.2.1 INVESTMENT'S SIGNIFICANCE

Giving up some current value in exchange for an erratic future return is what is meant by investing. By investing his current finances for a period of time in one or more assets, an investor hopes to generate capital gains or interest in the future. The factors of investing must be kept in mind when working with different investment possibilities.

### 9.2.2 INVESTMENT TYPES

Generally speaking, there are two types of investments: (1) direct investments and (2) indirect investments. These are both explained here.

Investing Directly, Direct investing is the process by which an investor purchases shares, bonds, or real estate directly from the investor. There is no need for a middleman when investing directly.
Indirect investment is the term used to describe an investment kind in which an investor donates his money to an investment business rather than making an investment himself.
An indirect investment is one that is made through financial intermediary like bank, UTI, mutual funds, Investment Company, and housing and involves marketable and non-market securities. Financial assets that can be invested in include capital growth securities, fixed income securities, non-fixed income securities, and regular income securities. Real estate investments might contain gold, antiques, furniture, and other items. Financial asset investments include things like cash deposits, gilts, stocks, and securities.

### 9.2.3 MANAGEMENT OF INVESTMENTS

To assist investors in achieving particular investment goals, investment management is the expert asset management of different assets (such as shares, bonds, and debentures). Institutions such as insurance companies, pension funds, and educational institutions, among others, can be considered investors, as can private investors who invest directly or through mutual funds or exchange-traded funds, among other collective investment schemes.

The management of collective investments is frequently referred to as an asset. Aspects of financial statement analysis, asset selection, plan implementation, and

continuous investment monitoring are all included in the provision of investment management services. Financial services employ millions of people worldwide, including millions of investment managers and many of the largest corporations. The phrase "fund manager" is frequently used to refer to two different entities: first, a company that offers services connected to investment management, and second, an individual who provides guidance on fund management choices. Asset management, another name for investment management, is the process by which an asset manager allocates the funds provided by a client among a variety of investment vehicles while keeping the customer's goals in mind.

### 9.2.4 ASSET ALLOCATION AND MUTUAL FUND MANAGEMENT FORMAT

The investment philosophy of the offer documents released by different mutual fund companies is attempted to be clarified using the mutual fund management and asset allocation format. This is crucial in figuring out the profits the investor will get and the fund management's level of experience. In order to help with the analysis, operating expenses are extensively scrutinised in order to yield information on specific ratios such investable funds and gross income. Examined are additional facets of investment policy, such as non-performing investments and portfolio turnover rate. The idea of investment policy is then discussed, along with its various forms and constituent parts. Subsequently, the mutual fund disclosure procedures concerning investment policy are examined, and lastly, the mutual fund's yearly investment technique and investment objectives are encompassed. The following things are explained:

#### 9.2.4.1 DETERMINING INVESTMENT GOALS AND THEIR BARRIERS

An institutional fund management has goals for their investments, just like any other investor. These goals are established based on the investors' tolerance for risk. Increasing current income, gaining tax advantages, and capital appreciation are some of these goals. The goals of creating the fund determine what investments should be made. For instance, the investment goals of development plans and tax-saving schemes are distinct. Every fund is unique based on its goals, and various management techniques are also covered here. The risk attached to a fund is determined by the sum of these components. Every fund manager encounters the following challenges:

One important factor influencing fund management and performance is time. Returns are evaluated throughout time in relation to investors' short-, medium-, and long-term investment objectives. The risk-return relationship of a portfolio is impacted by changes in the business cycle, which makes timing crucial for both performance and management.

A significant challenge in managing funds comes from the fund's liquidity, which the fund manager must manage.

An additional obstacle to fund management is taxation on funds.

Institutional fund management ought to be done in accordance with investing regulations. For instance, IRDA regulates insurance businesses, while SEBI regulates mutual funds through a comprehensive investment policy. Within the parameters of these recommendations, the policy for asset allocation, portfolio selection, etc., should be determined.

### 9.2.4.2 SOURCES OR REFERENCES

After determining the investment goals and related limitations, the financial Manager needs to choose an effective portfolio that includes asset allocations. Along with developing an appropriate management style, they should think about the right timing for the market. Nonetheless, the fund's final success is contingent upon the skills of the fund management and the state of the market. The portfolio's composition has a significant impact on the result; the asset class and two important factors are when to enter and leave the market.

### 9.2.4.3 CHOOSING A PORTFOLIO

A portfolio that offers significant returns with little risk is considered efficient. One such portfolio model, created by Harry Markawitz, is to quantify portfolio risk and provide a framework for creating the ideal portfolio. The expected (average) return and variance (standard deviation) of investor returns serve as the foundation for his approach. It is a widely held belief that investors like investing in securities that offer greater returns while also seeking to minimise risk. The underlying presumptions of this model are as follows:

> The projected return from a portfolio is represented by the weighted average return of its holdings.

>The volatility in a portfolio's returns is part of its risk.

>When the risk penalty is deducted from the portfolio's potential return, the risk-adjusted return—also referred to as the utility of the portfolio—is what determines an ideal portfolio.

An investor's best portfolio is the one that maximises his or her utility. William Sharp used the cut-off point and beta return ratio, two more crucial ideas, to create a technique of gauging the success of portfolios. A stock's inclusion in the portfolio under this model is based on its excess return over its beta ratio, which is calculated by taking the stock's expected return into account. One percent change in market returns is correlated with the predicted change in returns from stocks and risk-free assets. Additionally, the portfolio includes stocks that are above the cut-off point. The market index fluctuation is taken into consideration while determining the cutoff rate; the market index and stock movement fluctuate independently. In order to create the ideal portfolio, the percentage of money to be put in each security is finally determined. A new security can be added to the optimal portfolio if the ratio of return to risk increases above the threshold.

Based on the analysis of the aforementioned data, it can be concluded that fund managers must exercise judgement when deciding on the structure of management and asset allocation for mutual funds. Some of the areas that require consideration are identifying investment objectives and limits, identifying performance sources, choosing a portfolio, etc.

## 9.3 INDIA'S HISTORY WITH MUTUAL-FUNDS

In India, mutual-funds first appeared between 1963 and 1964. In India, the mutual-funds industries have not had an easy time growing. Investor sentiment was split on this issue; some were against the promotion of mutual funds, while others supported it.

The history of mutual-funds in India began with the establishment of UTI. UTI began operations in July 1964. It began operations with the intention of creating a

formal institution to support middle class and lower class individuals' savings and investments. India was going through a period of extreme political and economic upheaval when UTI first appeared. In addition to the financial market experiencing an economic crisis and the ongoing border conflict, businesspeople were hesitant to use the capital market.

Investors were not reacting appropriately to emerging issues, and even established corporations were having trouble raising additional financing. It was founded to expedite the process of industrial development and to make good use of the community's savings and deposits. Establishing a Unit Trust, "in which any person or institution would have free rein to purchase the units offered by the Trust," was the concept put up by TT Krishnamachari, the Finance Minister at the time. Here, too, efforts will be made to accommodate the requirements of private investors.His concepts were implemented as the Unit Trust of India, which acted as a middleman to combine retail savings and investments and assist in achieving the goals of assisting small investors by using their savings to make capital market investments.

UTI began operations in July 1964 with the goal of promoting income investment and savings as well as the holding, management, and sale of securities as well as the corporation's acquisition-related profits. Through a number of clauses, the UTI Act specifies the Trust's powers and functions, regulatory and disclosure obligations, and management structure.

The mutual fund industry was monopolised by UTI until 1986. However, public sector banks such as State Bank of India and Can Bank Mutual Fund entered the market in 1987, breaking UTI's monopoly. Public sector banks went on to create other mutual fund businesses after this.

Public sector mutual funds are reported to have entered the market between 1986 and 1993. whereas there was just one UTI in this business in 1985. Their number rose to eight in 1993. When private sector mutual funds started to participate in the stock market in 1993, it saw a surge.

International mutual funds including Morgan Stanley, Jordan Fleming, JP Morgan, Soros, and Capital International joined domestic mutual funds in the Indian mutual fund market once asset management was made available to the private sector in 1993. However, the years 1994–1996 were among the worst in Indian mutual fund history.

Over the 36 years since they were first introduced, mutual funds have changed in many ways, but in 1999 the industry started to consider the enormous potential that awaited them. This year is recognised as the mutual fund industry's renaissance and the recovery of investor trust in them. This time, the asset management business, unit holders, and other interested parties were all included in the fund's resuscitation. This budget changed a lot in a single stroke. The idea to offer mutual fund tax benefits was presented following the release of the Union Budget. This budget gave mutual funds a centralised platform, increased their appeal, and won over investorsDividends paid on equity-based mutual funds were rendered tax-free in the Union Budget. This protection extended to mutual funds as well as investors.

In order to grow their company, mutual funds sought to raise the size of their assets. In other words, they sought to implement a number of schemes to both increase the size of their assets and the number of investors they could reach. Consequently, new IPOs had to be brought for new schemes. Mutual funds launch new plans just to draw in investors because of this. To control themselves and gain the trust of investors, mutual funds also founded the Association of Mutual Funds of India (AMFI).

## 9.4 STAGES OF INDIAN MUTUAL FUND DEVELOPMENT

Unit Trust of India (UTI) was founded in 1963, marking the start of the mutual fund sector in India. The Reserve Bank of India and the Indian government worked together to create UTI. The phases of mutual fund development in India can be broadly categorised as follows and explained as follows:

### 9.4.1 FIRST PHASE (UTI MONOPOLY) 1964–1987

In 1963, a parliamentary act founded UTI. Its establishment, regulation, and control were carried out by the Reserve Bank of India. After UTI split off from the Reserve Bank of India in 1987, the RBI handed up responsibility for managing and overseeing it to the Industrial Development Bank of India (IDBI), which also assumed control over UTI's management and operations. Unit system 1964 was the initial UTI system to be introduced. This unrestricted programme brought in Rs 24.67 crore. By the end of 1988, UTI's managed assets were valued at Rs 6700 crore, with the fund's size having increased steadily from UTI's founding in 1964 to 1986–1987.

While resource mobilisation increased by 5.15 percent in the first year, there was a notable surge in resources over the next four years. In 1966–1967, UTI introduced the Reinvestment policy. Two years later, in 1971, UTI introduced the Unit Linked Insurance Plan (ULIP), an open-ended policy. Following its 1978 split from the R.B.I, U.T.I introduced six new programmes. In the years 1984–1987 UTI introduced many innovatives and well-received scheme, such as the 'Children's-Gift- Growth -Fund -Scheme' in 1986 and the 'Master –Share- Scheme, that was India's first closed-ended scheme, in October 1986. Aside from this, the Bharat Fund, the first offshore fund, was introduced in August 1987. Listings for the growth/income fund were made on the London Stock Exchange. As a result, by June 1987, UTI's investable funds had grown to Rs 4563.68 crore thanks to positive public response. UTI maintained its monopoly by growing steadily until 1987.

### 9.4.2 SECOND PHASE, PUBLIC SECTOR MUTUAL FUND ENTRY, 1987–1993

In 1987, public sector banks, General Insurance Corporation (GIC) and Life Insurance Corporation of India (LIC) launched mutual fund businesses that had nothing to do with UTI. 1987 saw the establishment of the State Bank of India Mutual Fund (SBI Mutual Fund), which was followed in December 1987 by CBMF, August 1989 by PNB Mutual-Funds, and November 1989 by IB Mutual-Funds.

Bank of Baroda Mutual Fund, for example, was founded in October 1992, and Bank of India Mutual Fund in June 1990. In June 1989, Life Insurance Corporation of India introduced its mutual fund plan, and in December 1990, General Insurance Corporation did the same.

By the end of 1993, the mutual-funds industry had Rs 47.004 crore worth of assets under management. In other words, over the course of these five years, the total amount of money raised from the stock market and the trading of market securities both expanded very quickly, and after new mutual funds entered the market, the total amount of resources mobilised by mutual funds also increased very quickly

Not only did mutual funds mobilise more net resources at this time, but they also steadily increased the number of schemes they introduced. At the end of 1993, the mutual-funds industry managed assets valued at a total of Rs 47004 billion.

### 9.4.3 THIRD PHASE: PRIVATE SECTOR MUTUAL FUND ENTRY, 1993–2003

In 1993, Private sector funds were brought to the Indian mutual fund industry. a new era of investment opportunities and fund selection flexibility was opened for Indian investors. Aside from this, the first mutual fund rule was introduced in 1993 and mandated that all mutual funds, with the exception of UTI, be registered and operated. In July 1993, (Kothari Pioneer), which has merged with (Franklin Templeton), was the first mutual-funds in the private segment. The 1993 Act was superseded by a more extensive and revised SEBI (Mutual Funds) Act in 1996. The SEBI Mutual Fund Act of 1996 currently governs the mutual fund businessThe number of mutual fund businesses in India is growing quickly due to the expansion of several foreign mutual-funds companies in India as well as mergers and acquisitions of numerous mutual fund firms in recent years. 33 mutual fund companies had a total asset value of Rs 1.21,805 crore at the end of January 2003. Unit Trust of India (UTI), which managed assets worth Rs 44,541 crore, was far ahead of other mutual funds. The fluctuations in the mutual fund sector from 1992-1993 to 2002-03. 33 mutual fund companies and the assets they managed were valued at Rs 1,21,805 crore by the end of 2003. Additionally, mutual funds raised resources valued at Rs 4582 crore. With Rs 44541 crore in assets under administration, UTI, on the other hand, was far ahead of other mutual funds.

### 9.4.4 FOURTH PHASE: APRIL 2014 TO FEBRUARY 2003

The government split UTI into two sections in February 2003. One section began operating under UTI as a special undertaking of UTI, and end of January 2003, it was Rs 29.835 crore in total assets, all of which were invested in the USM plan, which allowed investors to make an investment. There was a promise of receiving official acknowledgment. This project did not fall under the Mutual Fund Act; rather, it operated under Indian government regulations. The second is the UTI Mutual Fund, which is supported by the Life Insurance Corporation of India, Punjab National Bank, State Bank of India, and Bank of Baroda. It complies with mutual fund regulations and is registered with SEBI. At the end of March 2000, the assets managed by UTI Mutual Fund had a value of Rs 76,000 crore, following the breakup of the erstwhile UTI. In addition, the mergers and acquisitions of numerous mutual fund businesses have ushered in the present phase of expansion and consolidation for the mutual fund sector.

### 9.4.5 MAY 2014 UPDATES TO THE FIFTH PHASE

In 2012, SEBI implemented a number of reform measures to ease the entry of mutual funds into the market, taking into account the protection of different stakeholders and the decline in mutual- funds penetration and growth in Tier 2 and Tier 3 cities. One is able to accelerate. Following the worldwide downturn in the mutual-funds industry, a new administration was sworn in in May 2014, and as a result of the administration's numerous reform initiatives, the mutual-funds industry saw significant improvement. The mutual-funds industry has had a notable increase in the number of investors and average assets under administration since May 2014. In May 2014, the industry average assets crossed the Rs 10 lakh crore threshold for the first time. Two years later, by July 2016, it had crossed the Rs 15 crore threshold as well.

In less than a decade, the mutual fund business in India had a five-fold growth, rising from Rs 3.26 trillion on March 31, 2007, to Rs 15.63 trillion in August 2016.

The mutual fund industry, which had an average of Rs. 5.87 trillion under management as of March 31, 2012, had grown to Rs. 12.33 trillion in March 2016, and by August 31, 2016, it had grown to Rs. 15.63 trillion. In fact, the industry has doubled in size in just four years. As of August 31, 2016, there were 49 crore investor folios, up from 3.95 crore on March 31, 2014.

Over the course of the two years since June 2014, an average of 3.38 lakh new folios have been added monthly. The sector grew significantly as a result of the actions taken by S.E.B.I in September 2012 to revitalize the mutual-funds business.

Mutual fund distributors, particularly those in smaller communities, assist investors in maintaining their investments by giving them access to as much information as possible about mutual fund investments and by informing them of market fluctuations.

In actuality, the Indian securities market did not fare well in the 2014–15 fiscal year as a result of withdrawals by foreign institutional investors; yet, month after month, the mutual fund sector in India had positive net inflow growth. Distributors have been instrumental in spreading awareness of the mutual fund industry's Systematic Investment Plan (SIP).

## 9.5 BENEFITS OF INVESTING IN MUTUAL FUNDS

Investors get many benefits by investing in mutual funds because it is the responsibility of the fund managers to manage the money of the investors and they make investment plans keeping in mind the investment capacity and investment needs of the investors. Some of the major benefits are as follows-

### 9.5.1 EXPERIENCED AND TRAINED MANAGEMENT

Mutual fund provides efficient and effective professional services because the people working in it are knowledgeable about investment related matters and they also have enough experience about investment related matters, due to which investors can take advantage of their experience and knowledge by investing in mutual fund. Apart from this, investing in mutual funds is also beneficial for those investors who are unable to invest in the stock market due to not being able to analyse the conditions of the stock market. It reduces the risks of their investment by providing them the facility of analysis and fund management.

### 9.5.2 DIVERSITY

If an investor invests small amount in the stock market then he is not able to get diversity because with his limited amount the investor can invest only in a few companies of one or two sectors, because if the investor wants to invest in diverse types of shares. So he will need lakhs of rupees. On the contrary, if investors invest in mutual funds, then the small amount invested by them is also invested in all the major companies of the stock market.

For example, if an investor invests Rs 10,000 in the equity fund of Reliance Company through a mutual fund, then the fund manager provides the benefit of diversification to the investor by investing this amount in more than 50 companies. This diversification reduces risk because it is rare for all stocks to fall at the same time.

Since investors' money is invested in various companies through mutual funds, even if there are fluctuations in the market, if the price of shares of some companies falls too low, then it is compensated by the higher prices of shares of some companies. This diversification can reduce risk and provide investors with a consistent average return.

### 9.5.3 TRANSPARENCY

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An important feature of mutual fund investment is that whenever a scheme is presented in the market for investment, complete information about that scheme is given by the mutual fund company, such as what is the size of that scheme, its objective. What is it and what is the current NAV value of that scheme, through this investors get complete information about that scheme. Since mutual fund schemes are operated as per the guidelines of SEBI (Securities and Exchange Board of India), there is complete transparency in it.

### 9.5.4 EASE OF PURCHASING AND SELLING

Before purchasing a mutual fund, investors want to buy any scheme only after studying its performance NAV. If the performance of the scheme is good then only they invest in that scheme.

Investors can easily purchase it through banks nearest to their area, through financial advisor phones, through investors and trustee companies. In this, if the investor wishes, he can invest even a small amount at the rate of per month through a systematic investment plan.

Investors can convert the investment made in mutual funds into cash by selling it anytime as per their need. At present, many mutual fund companies are providing sales facilities to their investors through mobile applications. Through this, investors can sell their invested money in mutual funds through their mobile phones on the basis of the current NAV price of that scheme.

### 9.5.5 BETTER CUSTOMER SERVICES

Mutual fund companies generally provide good customer services to their clients through asset management companies. These companies provide appropriate solutions to all the queries of the investors through their customer representatives and help them in buying and selling the units.

Apart from this, it provides necessary facilities to the investors through automatic investment and withdrawal facility, facility of automatic reinvestment of interest amount, dividend and capital gain, facility to the investor to operate his account through mobile, retirement planning and tax saving schemes etc.

### 9.5.6 EASY PROCESS OF ENTRY AND WITHDRAWAL OF FUNDS

In a mutual fund scheme, investors can easily purchase any fund as per their requirement and get the units of the mutual fund in proportion to their invested money in that scheme, and can choose from various options available in the fund to meet their financial goals. You can choose any one option as per your requirement. Investors in a mutual fund scheme can easily exit the scheme at any time as per their need by selling the units of the fund. At present, all the mutual fund companies are issuing such schemes so that investors can exit the scheme as per their need, as a result of which mutual funds have become a very good investment medium for those investors who need short-arm liquidity.

## 9.6 RISKS ASSOCIATED WITH INVESTING IN MUTUAL FUNDS

While investors get some benefits by investing in mutual funds, investors also have to face some risks. Some of the major risks related to investing in mutual funds are as follows-

### 9.6.1 RISK RATION

Generally there is risk associated with all investments. The amount of risk involved in indirect investment is less as compared to direct investment. Investment in mutual funds comes in the category of indirect investment because under the mutual fund scheme, the right to manage the fund is not in the hands of the investor but in the hands of the fund managers and it is also managed by the same fund manager. One has to depend on one's discretion and investment skills in which there is always risk.

### 9.6.2 DEPENDENCE ON FUND MANAGERS IN SELECTING FUNDS

The biggest drawback of the mutual fund system is that investors are not able to choose the fund as per their discretion, for this they depend on the fund managers and the fund managers give them information only about some schemes so that they can choose one of those schemes. They have to choose the scheme. Thus, it can be said that under the mutual fund system, investors depend on fund managers in the selection of funds, which is the biggest shortcoming of this system.

### 9.6.3 MARKET RISK

Investments in mutual funds are subject to market risks. From time to time, due to external influences, prices of all instruments in the market rise or fall. The result of such fluctuations is that sometimes the investor gets maximum return on his investment and sometimes very less, due to which the investor does not get the expected return on his investment.

### 9.6.4 INFLATION RISK

Investment in mutual-funds is also subject to inflation risk because whenever inflation increases faster than the return on investment, an investor, considering the actual risk, may buy smaller amounts of mutual fund units rather than purchasing them in larger quantities. Therefore, inflation risk is sometimes also called loss of purchasing power. Inflation risk can also occur when prices rise faster than returns on investments.

### 9.6.5- CREDIT RISK

In this type of risk, it is analyzed whether a mutual fund company will be able to pay a fixed rate of interest in the future on the loan it is taking as an investment and whether it will be able to return the principal amount on its maturity.

## 9.7 MUTUAL FUNDS' FUNCTION AND SIGNIFICANCE IN THE INDIAN ECONOMY

An essential part of the financial system's development is played by mutual funds. Initially, they combine their resources with those of small investors and strive towards the smooth functioning and integration of the market; as a result, their involvement in the financial markets is growing quickly. Second, because individual investors typically do not have access to market analysis tools, mutual funds—which are institutional investors—offer small investors investment-related services. For this class of investors, decisions that are made with a thorough understanding of risk and reward also help to lower market risk. Third, it is simple to incorporate transparency in investment plans and outcomes.

The money market, the market for government securities, and the foreign currency market are the three areas in which the Reserve Bank of India oversees the

financial markets. The Reserve Bank is contributing significantly to the development of the first two markets, the money market and the government securities market, where mutual funds are available. The following arguments help to clarify the role of mutual-funds have had in the expansion of the Indian economy.

### 9.7.1 MUTUAL FUNDS AS A TYPE OF FINANCIAL SERVICE

A variety of mutual fund options are now available to investors due to the entry of new fund houses and funds into the market. In the mutual fund business, total assets under administration were as high as 46,71,687 crore in 2014, 8,25,240 crore in 1987, and 4,100 crore in 1991, according to a report released by AMFI. Since then, this number has climbed even more, offering insight into the effectiveness and expansion of the mutual fund sector.

### 9.7.2 DEVELOPMENT OF THE MARKET AND MUTUAL FUNDS

Mutual funds have played a major role in the expansion of the money market's several categories and, to a lesser extent, in the growth of the market for government securities. Money Market Mutual Funds (MMMFs) were first created in India in 1991 with the intention of giving investors access to money market instruments and small investment opportunities.

The Reserve Bank released guidelines for money market mutual funds in April 1992. To improve the scheme's flexibility and appeal to banks and other financial institutions, the Reserve Bank made a number of adjustments. These recommendations were included in the subsequently modified SEBI Act.

Within the existing commercial paper limits, money market mutual funds were allowed to invest in corporate bonds and debentures with a residual maturity of up to one year in October 1997. This scheme's Minimum-Lock-in Period was progressively lowered to 15 days, which increases its appeal.

Unprecedented expansion in the mutual fund issue market occurred during this time. Money market mutual fund assets under administration as of May 31, 2011, amounted to Rs 1,82,622 crore, or 25% of all mutual fund assets under management. Mutual funds introduced gilt funds to invest in government securities with the goal of expanding the investor base and encouraging retail holdings in

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these assets. In December 1998, India's first gilt fund was established, albeit its growth was rather mild. The entire assets under management of gilt funds as of May 31, 2011, were valued at Rs 3,336 crore, or 0.5 percent of the total assets under administration of mutual funds.

Additionally, mutual funds have given the secondary market sectors for Commercial Paper (CPs) and Certificates of Deposit (CDs) enough liquidity. Its growing portfolio investments in the money market correspond with its growing activities in the secondary market. Participation in mutual funds has helped all money market categories. By setting up daily surplus to grow its exposure to all market sectors and market repo and collateralized transactions (CBLO), it expanded the market's scope. On the other hand, mutual fund activity in the market for government securities has not been especially positive. The minimal participation of mutual funds in the government securities market may be attributed, in part, to investors' disinterest in gilt mutual funds because of their high interest rate risk.

### 9.7.3 INCLUSION AND MUTUAL FUNDS

Mutual funds have not been very successful in promoting savings in India. In India, mutual fund assets, despite their long history, represent less than 10% of GDP. Mutual-funds are well-liked worldwide, according to comparisons with other nations, however India has comparatively smaller mutual fund assets than other developing nations. The fact that mutual funds are comparatively unpopular in India's small towns and rural areas is one of the primary causes of this.

It is widely held that mutual funds are more popular among middle-class and upper-class individuals and have not yet attracted lower-class investors. Consequently, in order to grow this industry, suitable programmes for low-class investors must be put in place, particularly in rural areas where they can draw savings. In order to address this, mutual fund firms ought to launch a few new mutual fund schemes that are tailored to the demands of investors in the lower income bracket. Ensuring the participation of all categories in the financial markets is crucial for their continuous development, and this is the only way to achieve it. As a result, more investors will engage in mutual fund investing, which will boost the growth of the economy and the financial industry as a whole.

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