Research Paper Commerce

General Concept of Mutual Fund

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ABSTRACT

There are many investment avenues available in the financial market for an investor. Investors can invest in bank deposits, corporate debentures and bonds, post office saving schemes etc. Where, there is low risk together with low return. They may invest in stock of companies where the risk is high and sometimes the returns are also proportionately high. A Mutual Fund is a collective investment vehicle formed with the specific objective of raising money from a large number of individuals and investing it according to a pre-specified objective, with the benefits accrued to be shared among the investors on a pro-rata basis in proportion to their investment

KEYWORDS Mutual Funds, Stock, investment, pool money, Risk

Introduction :

According to Encyclopedia Americana, "Mutual funds are open end investment companies that invest shareholders' money in portfolio or securities. They are open ended in that they normally offer new shares to the public on a continuing basis and promise to redeem outstanding shares on any business day

According to Securities and Exchange Board of India Regulations, 1996 a mutual fund means "a fund established in the form of 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".

For retail investors, who do not have the time and expertise to analyze and invest in stock, Mutual Funds is a viable investment alternative. This is because Mutual Funds provide the benefit of cheap access to expensive stocks.

Types of Mutual Fund Schemes

Mutual Fund schemes may be classified on the basis of its structure and investment objective.

An open-ended fund is one that is available for subscription all through the year. These do not have a fixed maturity. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices. The key feature of open-end schemes is liquidity.

A closed-ended fund has a stipulated maturity period which generally ranges from three to fifteen years. The fund is open for subscription only during a specified period. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where they are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the Mutual Fund through periodic repurchase at NAV related prices.

Interval funds combine the features of open-ended and close-ended schemes. They are open for sale or redemption during pre-determined intervals at NAV related prices.

Based on Investment Objective:

The aim of growth funds is to provide capital appreciation over medium to long- term. Such schemes normally invest a majority of their corpus in equities. Studies have shown that returns from stocks, have outperformed most other forms of investments held over long term. (Baruan Varuan(1991), Obaidulla and Sridhar (1991), Adhikari and Bhosale (1994), Gupta and Sehgal (1997), Sapar, Narayan R. and Madava, R. (2003), Rao, D. N. (2006)). Growth schemes are ideal for investors having a long-term outlook seeking growth over a period of time.

The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures and Government securities. Income Funds are ideal for capital stability and regular income.

The aim of balanced funds is to provide both growth and regular income. Such schemes periodically distribute a part of their earning and invest both in equities and fixed income securities in the proportion indicated in their offer documents. In a rising stock market, the NAV of these schemes may not normally keep pace, or fall equally when the market falls. These are ideal for investors looking for a combination of income and moderate growth.

The aim of money market funds is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money. Returns on these schemes may fluctuate depending upon the interest rates prevailing in the market. These are ideal for corporate and individual investors as a means to park their surplus funds for short periods.

These schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues. Investments made in Equity Linked Savings Schemes (ELSS) and Pension Schemes are allowed as deduction u/s 88 of the Income Tax Act, 1961. The Act also provides opportunities to investors to save capital gains u/s 54EA and 54EB by investing in Mutual Funds.

Industry Specific Schemes invest only in the industries specified in the offer document. The investment of these funds is limited to specific industries like InfoTech, Fast Moving Consumer Goods (FMCG), and Pharmaceuticals etc.

Index Funds attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE.

Sectoral Funds are those, which invest exclusively in a specified industry or a group of industries or various segments such as 'A' Group shares or initial public offerings.

Traded Funds

Exchange Traded Funds, (ETF) just like their index fund counterparts, also track indexes. The difference is that the stocks of individual companies that comprise a given index are bundled into an equity-like investment vehicle that is traded on an exchange, exactly like a stock. That means that those purchasing ETF shares can place orders for them throughout the day, and even use limit orders to make trades. Because they are traded on an exchange and share many of the attributes of individual equities, ETFs can also be shorted and offer underlying options as an investment opportunity.

Advantages of Mutual Funds

Mutual Funds are professionally managed companies or schemes that pool money from investors and invest it in stock markets, shares, derivative markets and other securities. By investing in Mutual funds, investors can avail of the following advantages:-

Professional Management

The investor avails of the services of experienced and skilled professionals who are backed by a dedicated investment research team which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

Mutual Funds invest in a number of companies across a broad cross- section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. This diversification is achieved through a Mutual Fund.

Convenient Administration

Investing in a Mutual Fund reduces paperwork and helps to avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual Funds save time and makes investing easy and convenient.

Over medium to long-term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because of the benefits of scale in brokerage, custodial and other fees which translate into lower costs for investors.

In open-end schemes, an investor can get his money back promptly at net asset value. With closed-ended schemes, an investor can sell his units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase at NAV related prices which some close- ended and interval schemes offer periodically.

Regular information can be obtained by the investors on the value of investment in addition to disclosure on the specific investments made in the scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, an investor can systematically invest or withdraw funds according to his needs and convenience.

Mutual Funds offer a family of schemes to suit an investor's varying needs over a lifetime. For e.g. Growth schemes are ideal for investors having a long-term outlook seeking growth over a period of time. Income Funds are ideal for capital stability and regular income. Balanced Funds are ideal for investors looking for a combination of income and moderate growth. Money Market Funds are ideal for corporate and individual investors as a means to park their surplus funds for short periods.

All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI.

Mutual funds allow even small investors to indirectly reap the benefit of investment in shares of a big company because of its large corpus, which an individual investor may not be able to do so because of insufficient funds.

Limitations of Mutual Funds

Following are some of the limitations of mutual funds.

Although, the returns on investment are quite high, a mutual fund cannot guarantee lower tax bills. The tax amounts are usually high, especially in case of short-term gains.

A mutual fund requires a deep and long term analysis of the amount of investment and its potential investment areas. If the company fund manager changes regularly, it may adversely affect the returns on investment.

Mutual funds are like many other investments where there is always the possibility that the value of mutual fund will depreciate, unlike fixed income products, such as bonds and treasury bills, mutual funds experience price fluctuations along with the stocks that make up the fund.

Although diversification is one of the keys to successful investing, many mutual fund investors tend to over diversify. The idea of diversification is to reduce the risks associated with holding a single security; over diversification occurs when investors acquire many funds that are highly related and, as a result, reduce benefits of diversification.

Mutual funds provide investors with professional management, but it comes at a cost. Funds will typically have a range of different fees that reduce the overall payout. In mutual funds, the fees are classified into two categories: shareholder fees and annual operating fees. The shareholder fees, in the forms of loads and redemption fees are paid directly by shareholders purchasing or selling the funds. The annual fund operating fees are charged as an annual percentage – usually ranging from 1-3%. These fees are assessed to mutual fund investors regardless of the performance of the fund. Mutual funds are subjected to market risks or assets risks. If the investment is not sufficiently diversified, it may involve huge losses.

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