UTTAR PRADESH RAJARSHI TANDON OPEN UNIVERSITY
PRAYAGRAJ

AWARENESS COURSE ON SHARE MARKET AND MUTUAL FUNDS

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SCHOOL OF MANAGEMENT STUDIES

UNIT 1 SHARE MARKET

Unit structure

1.0 OBJECTIVES

1.1 INTRODUCTION TO THE INDIAN STOCK MARKET

1.2 NATIONAL STOCK EXCHANGE OF INDIA

1.3 BOMBAY STOCK EXCHANGE

1.4 REGULATION OF THE INDIAN STOCK MARKETS

1.5. TYPES OF SHARE MARKETS

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1.0 OBJECTIVES

After reading this unit the learner have knowledge of

Indian stock market

NSE and BSE

Types of stock market

Working of stock market

1.1 INTRODUCTION TO THE INDIAN STOCK MARKET

A stock market is a platform where investors come to trade in financial instruments like shares, bonds, and derivatives. The stock exchange works as a facilitator of this transaction and enables the buying and selling of shares.

Stock markets form the largest avenues for investments. There are primarily two stock exchanges in India, the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Companies list their shares for the first time in the primary market and in the secondary markets investors can buy and sell their shares during an Initial Public Offering. The two stock exchanges in India have on some occasions witnessed stocks worth INR 6,00,000 crores being traded. The uninitiated in India often consider investing in stocks markets gambling, but a basic understanding of the share market can change that perception.

1.2 NATIONAL STOCK EXCHANGE OF INDIA

National Stock Exchange of India Limited (NSE) is the leading stock exchange of India, located in Mumbai, Maharashtra. NSE was established in 1992 as the first dematerialized electronic exchange in the country. NSE was the first exchange in the country to provide a modern, fully automated screen-based electronic trading system which offered easy trading facilities to investors spread across the length and breadth of the country. Vikram Limaye is Managing Director & Chief Executive Officer of NSE.

National Stock Exchange has a total market capitalization of more than US$2.27 trillion, making it the world's 11th-largest stock exchange as of April 2018. NSE's flagship index, the NIFTY 50, a 50 stock index is used extensively by investors in India and around the world as a barometer of the Indian capital market. The NIFTY 50 index was launched in 1996 by NSE. However, Vaidyanathan (2016) estimates that only about 4% of the Indian economy / GDP is actually derived from the stock exchanges in India.

Unlike countries like the United States where nearly 70% of the country's GDP is derived from large companies in the corporate sector, the corporate sector in India accounts for only 12-14% of the national GDP (as of October 2016). Of these only 7,800 companies are listed of which only 4000 trade on the stock exchanges at BSE and NSE. Hence the stocks trading at the BSE and NSE account for only around 4% of the Indian economy, which derives most of its income-related activity from the so-called unorganized sector and household spending

1.3 BOMBAY STOCK EXCHANGE

Bombay Stock Exchange Limited is now synonymous with Dalal Street, it was not always so. In the 1850s, five stock brokers gathered together under Banyan tree in front of Mumbai Town Hall, where Horniman Circle is now situated. A decade later, the brokers moved their location to another leafy setting, this time under banyan trees at the junction of Meadows Street and what was then called Esplanade Road, now Mahatma Gandhi Road. With a rapid increase in the number of brokers, they had to shift places repeatedly. At last, in 1874, the brokers found a permanent location, the one that they could call their own. The brokers group became an official organization known as "The Native Share & Stock Brokers Association" in 1875.

The Bombay Stock Exchange continued to operate out of a building near the Town Hall until 1928. The present site near Horniman Circle was acquired by the exchange in 1928, and a building was constructed and occupied in 1930. The street on which the site is located came to be called Dalal Street in Hindi (English: Broker Street) due to the location of the exchange.

On 31 August 1957, the BSE became the first stock exchange to be recognized by the Indian Government under the Securities Contracts Regulation Act. Construction of the present building, the Phiroze Jeejeebhoy Towers at Dalal Street, Fort area, began in the late 1970s and was completed and occupied by the BSE in 1980. Initially named the BSE Towers, the name of the building was changed soon after occupation, in memory of Sir Phiroze Jamshedji Jeejeebhoy, chairman of the BSE since 1966, following his death.

In 1986, the BSE developed the S&P BSE SENSEX index, giving the BSE a means to measure the overall performance of the exchange. In 2000, the BSE used this index to open its derivatives market, trading S&P BSE SENSEX futures contracts. The development of S&P BSE SENSEX options along with equity derivatives followed in 2001 and 2002, expanding the BSE's trading platform.

Historically an open outcry floor trading exchange, the Bombay Stock Exchange switched to an electronic trading system developed by CMC Ltd. in 1995. It took the exchange only 50 days to make this transition. This automated, screen-based trading platform called BSE On-Line Trading (BOLT) had a capacity of 8 million orders per day. Now BSE has raised capital by issuing shares and as on 3 May 2017 the BSE share which is traded in NSE only closed with ₹999 .

The BSE is also a Partner Exchange of the United Nations Sustainable Stock Exchange initiative, joining in September 2012. BSE established India INX on 30 December 2016. India INX is the first international exchange of India. BSE launches commodity derivatives contract in gold, silver.

1.4 REGULATION OF THE INDIAN STOCK MARKETS

The regulation and supervision of the stocks markets in India rest with the Securities and Exchange Board of India. SEBI was formed as an independent identity under the SEBI Act of 1992 and has the power to conduct inspections of the stock exchanges. The inspections review the operations of the market and the organizational structure along with aspects of administrative control.

The main role of SEBI includes:

Ensuring a fair and equitable market for investors to grow in

Compliance of the exchange organization, the system its practices in accordance with the rules framed under the Securities Contracts (Regulation) Act (SC(R) Act), 1956

Ensure implementation of the guidelines and directions issued by the SEBI

Check if the exchange has complied with all the conditions and has renewed the grants, if needed, under Section 4 of the SC(R) Act of 1956.

1.5. TYPES OF SHARE MARKETS

There are two kinds of share markets namely the Primary and the Secondary Markets.

a. Primary Share Market

It is in the primary market that companies register themselves to issue their shares and raise money. This process is also known as listing on the stock exchange. The purpose of entering into the primary market is to raise money and if the company is selling their shares for the very first time it is referred to as the Initial Public Offering (IPO). Through this process, the company becomes a public entity.

b. Secondary Market

The shares of a company are traded in the secondary market once the new securities are sold in the primary market. This way investors can exit by selling their shares. These transactions that take place in the secondary market are called trades. It involves the activity of investors buying from each other and selling amongst themselves at an agreed upon price. A broker is the intermediary that facilitates these transactions.

1.6 HOW DO THE SHARE MARKETS WORK

a. Understanding the Stock Exchange Platform

b. Listing of the Company in the Primary Market

c. Trading in the Secondary Market

d. Stock Brokers

e. Passing of your order

f. Settlement

a. Understanding the Stock Exchange Platform

A stock exchange is precisely a platform that conducts the trading of financial instruments like stocks and derivatives. The activities on this platform are regulated by the Securities and Exchange Board of India. The participants have to register with SEBI and the stock exchange in order to conduct trades. Trading activities include brokering, issuing of shares by companies, etc.

b. Listing of the Company in the Primary Market

A new company is listed in the primary market through the process of an Initial Public Offering, where the company lists details about itself, the stocks it is issuing, etc. The allotment of stocks take place during the process of listing and investors who bid for the stocks get their share.

c. Trading in the Secondary Market

Once the company has been listed and issued stocks, these can be traded in the secondary market by the investors. This is the marketplace for the buyers and sellers to transact and make profits or incur losses.

d. Stock Brokers

Because of the magnitude of investors who number in thousands, it is difficult to have them assemble in one location. Therefore, to conduct trade, stock brokers and brokerage firms come in the picture. These are entities that are registered with the Stock Exchange and act as intermediaries between the investors and the exchange itself. When you place an order to buy any share at a given rate, the broker processes it at the exchange where there are multiple parties involved.

e. Passing of your order

Your buy order is passed on to the exchange by the broker, where it is matched for a sell order for the same. The exchange takes place when the seller and the buyer agree upon a price and finalize it; the order is then considered confirmed.

f. Settlement

Once you finalize on a price, the exchange confirms the details to ensure that there is no default in the transaction. The exchange then facilitates the transfer of ownership of the shares which is known as Settlement. You receive a message once this takes place. This communication of this message involves multiple parties like the brokerage order department, the exchange floor traders, etc. The settlement time earlier took weeks to materialize which now is done in T+2 days. This means that if you trade today, the shares are reflected in your demat account in two working days time. Investing in the share market is subject to market risks. It is recommended you seek expert guidance before investing. Visit Clear Tax to browse through our handpicked mutual funds and pick one based on your suitability.

1.7 SUMMARY

A stock market is a platform where investors come to trade in financial instruments like shares, bonds, and derivatives. The stock exchange works as a facilitator of this transaction and enables the buying and selling of shares.

The regulation and supervision of the stocks markets in India rest with the Securities and Exchange Board of India. SEBI was formed as an independent identity under the SEBI Act of 1992 and has the power to conduct inspections of the stock exchanges. The inspections review the operations of the market and the organizational structure along with aspects of administrative control.

1.8 TEST YOUR PROGRESS

- What is stock market
- Explain the mechanism of stock market in India
- What is primary market?
- What is secondary market?

1.9 SUGGESTED READINGS

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UNIT 2 : TRADING IN SHARE MARKET

Unit Structure

2.0 OBJECTIVES

After reading this unit the learner have knowledge of

- Mechanism of stock market
- Online trading
- MCX and NCDEX

2.1 TRADING MECHANISM OF SECURITIES

Now we are moving to the real-life scenario of stock market i.e. how trading occurs and what are the criteria for trading. Before moving to trading we have to know two important terms, stock exchange and broker. Basically stock exchange is an entity that provides facility or service to the broker and trader to trade on stocks, bonds, derivatives.

In India we have two stock exchanges

BSE (Bombay Stock Exchange)

NSE (National Stock Exchange

2.1.1 About BSE (Bombay Stock Exchange)

BSE is the oldest stock exchange of Asia established way back in 1875 and is located in the Dalal Street, Mumbai. Some of the features of BSE are as follows:

Market Capitalization data was reported at 154,380.146 INR bn in May 2019. This records an increase from the previous number of 152,540.281 INR bn for Apr 2019. India's BSE: Market Capitalization data is updated monthly, averaging 27,121.440 INR bn from Jan 1993 to May 2019, with 317 observations. The data reached an all-time high of 159,346.958 INR bn in Aug 2018 and a record low of 1,750.930 INR bn in Apr 1993.It has 5,749 listing of companies ranging from small capitalization to large capitalization companies.

It is also called as BSE 30 or simply SENSEX

It is the 12th largest stock exchange in the world and claims to be the fastest stock exchange in the world with a median trading speed of 6 micro seconds.

2.1.2About NSE (National Stock Exchange)

NSE is the most influential stock exchange in India, the reason being that it provides derivatives trading apart from the normal shares trading. Salient features of NSE are as follows:

NSE has a market Capitalization of more than US$1.41 trillion.

It is the 10th largest Stock Exchange in India.

It is also called as NSE 50 or Nifty.

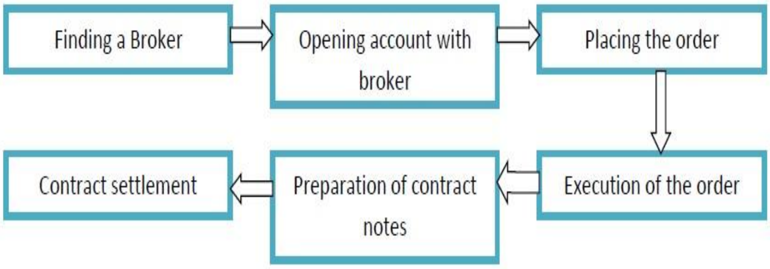
It provides trading in equity, derivatives and debt.

2.2 MECHANISM OF TRADING

Now we will be dealing on the trading platforms or the software used for trading. In order to induce more transparency and efficiency in the trading system, NSE and BSE introduced nationwide online fully automated “Screen Based Trading System”. The trading platform used by BSE is called BOLT-Bombay Online Trading. The order of investors is placed on the basis of time and price basis.

Recently BSE has launched new software for trading called BEST (BSE Electronic Smart Trader). It can be downloaded directly from Android play store and an investor can enjoy zero transaction charges for 6 months on cross currency derivatives.

2.3 THE TRADING PROCESS



STEP 1: Finding a Broker

A broker acts as an intermediary or a mediator between the investor and the stock exchange. The work of a broker is transfer of order electronically from the investor to the exchange. Any transaction that occurs in stock market is taken care by the stock exchange. Normally in India the stock exchange for trading is active from 9:15 AM to 3:30 PM. However from 1st October, 2018 SEBI has decided to extend the trading hours till 11:55 pm in a move to attract the investors dealing in Indian products on overseas exchanges. The brokers should be selected on the following basis:

Watching out for fees taken for opening an online trading account

Having a proper look at ratings and customer service.

Brokerage charge for intraday trading

Brokerage charge on selling a long held share

Margin provided by the broker on intraday trading

The broker must provide information regarding investment opportunities on a regular basis.

STEP 2: Opening Account With the Broker

Having selected a broker it is time to open an online trading account with the broker. A broker always opens a trading account in the name of the investor/ client only if he/she is satisfied about the credit worthiness of the client. If the broker feels satisfied with the client he/she will open the account by writing the client’s name in the broker’s book. The minimum requirement for opening a trading account is PAN card, and bank account failing to which the account cannot be opened.

Open Free Online Trading Account

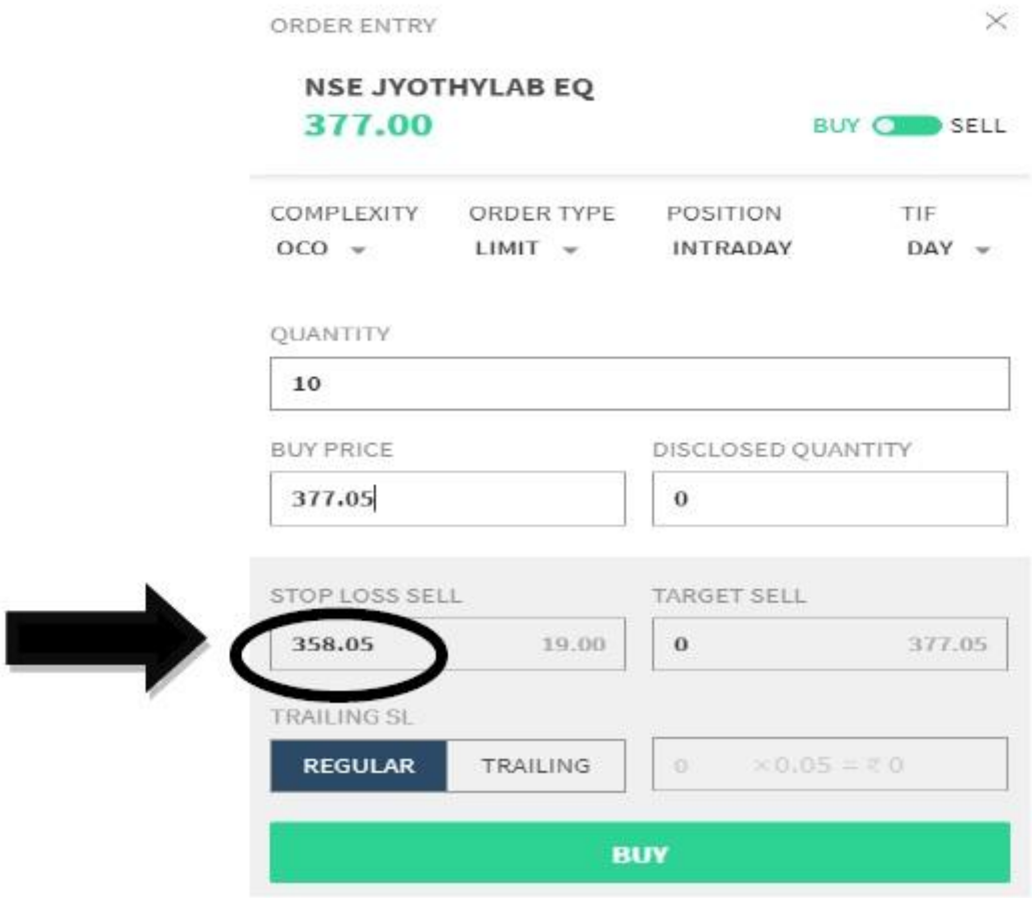
STEP 3: Placing the Order

After the account is opened successfully a notification will be provided via email or message. Then the investor can begin the trading as per his/her wish. The trading or investment is done by purchasing a specified number of shares of a particular company. The order when placed is incomplete until the order status shows complete. Different online trading platforms follow different symbols to mark the order placing. Order can also be placed via a telephonic call with the broker. There are different types of orders:

Buy Orders

Buy orders are placed when the price of the share is expected to rise. This can be understood by simple Demand-Supply curve. As the demand increases people buy more and the price gradually rises. The same logic applies in the share market. As the price of the share rises, the investors feel the price will further rise and they buy the shares. However the amount of quantity is fully dependent on the availability of funds and risk associated with the particular share.

The window for a buy order is shown below

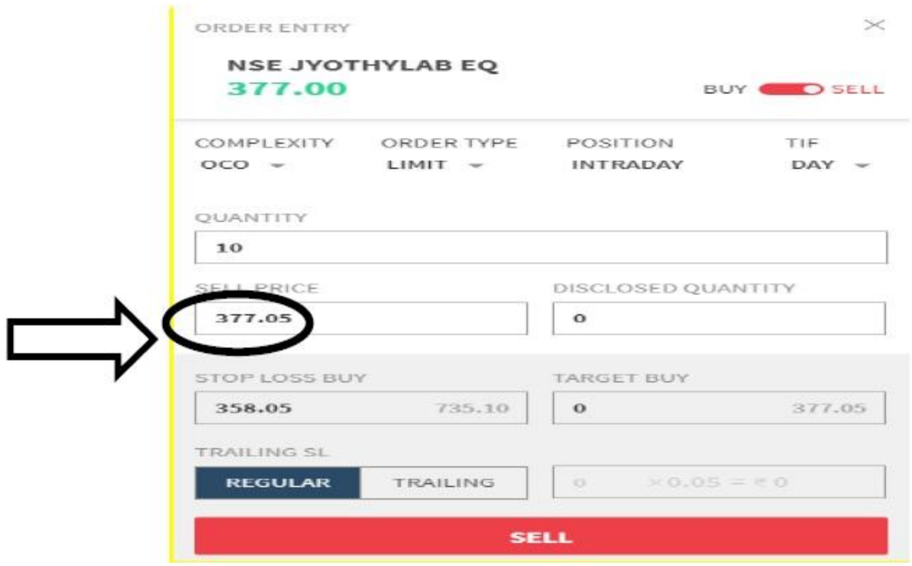


Here the buy price is Rs. 377.05 and the order quantity is 10. The position of trading is intraday

Sell orders

Sell orders are executed when the investor feels that the price of the share will decline from now on. However it is totally based on analysis and predictions.

The window for a sell order is shown below



Here the sell price is set at Rs. 377.05 and the order quantity is 10. The trading is for intraday.

Limit order

It is an order for buying or selling of securities at a particular price as set by the investor. However there is no guarantee that the limit order will be executed. For example the price of a Share X is Rs. 234.65 and the investor places an order to buy the share X 100 quantity at Rs. 223.05 or less. But if the price of share X doesn't fall till Rs. 223.05 then the investor cannot buy the shares.

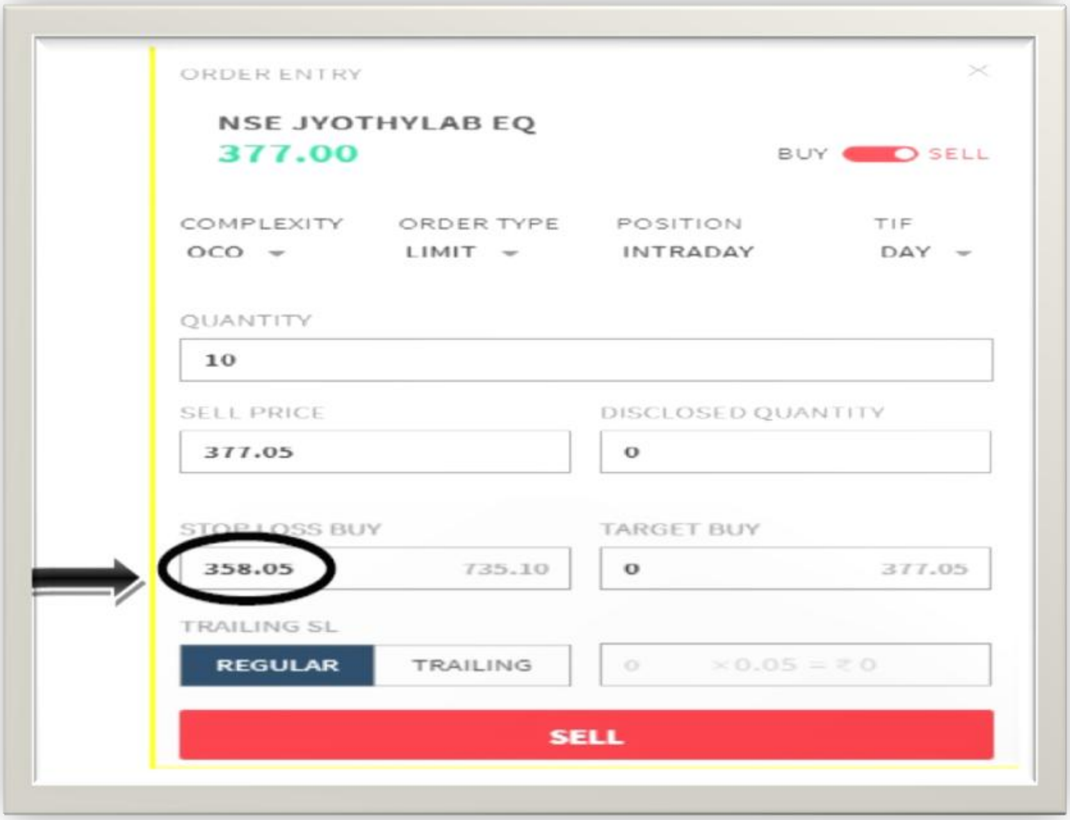
Stop Loss order

It is an order to sell the shares as soon as the price of the share falls up to a particular level or from the buy side to buy the share when the price rises up to a specified level. This is set by the client to avert the loss which can occur in share market. This is done to not suffer loss more than the specified limit.

Let us take an example:
Buy Price: Rs. 234.95, Quantity: 300, Sell Price: Rs. 295.05, Stop Loss: Rs. 220.50,

Suppose the stock price falls to 220.50 and when the share will reach Rs. 220.50 the order will be sold and the loss amount will be (234.95- 220.50)*300 =Rs. 4335. However if the Stop loss has not been kept and the price falls to Rs. 205.75 then the loss would have been (234.95- 205.75)*300 = Rs. 8760.

So due to stop loss the loss had been averted.
Placing a stop loss in intraday trading terminal:



Here the stop loss is set at Rs. 358.05. This means if the price of the share falls to 358.05 then the share will be sold directly.

Fixed Price order

When the investor specifies the price at which he/she wants to buy/sell the shares is called fixed price order.

Market order:

A market order is executed at CMP (Current Market Price). It occurs mainly during intraday trading. When the buyer has bought the shares and has not sold the shares before 3:15pm then from the broker side the shares are sold at CMP.

Discretionary order

It is normally done by the broker from their side when the investor has complete faith and trusts the broker. It is an order to the broker to buy/sell the shares at whatever price the broker thinks will be good for the investor.

Cancel order

If the price is not matched then the order is cancelled and new fresh orders have to be placed again. Also, however if the margins are insufficient then order is cancelled. In that case the trader has to place order with a reduced number of order quantity.

Day order

The validity of these orders is for the day in which they are put in the trading platform. However if they are not executed (buy/sell) then the orders are cancelled automatically from the broker side.

Good Till Day order

An order can be placed by the investor specifying the number of days for which the orders will remain open. However even after the price level is not met then the order has to be cancelled and it is automatically cancelled.

Market Depth

Market depth shows the number of Buy and Sell orders for a security at various price levels at a single point of time. In the left side we have JYOTHYLAB's market depth where the bid quantity along with the bid price is mentioned and at the end we have the Total Buy Quantity.

In sell side we have the ask price and the ask quantity along with the Total Sell Quantity.

Let us take an example to understand its working in details. You have placed an order to BUY 20 shares intraday at a price of Rs. 447.65 then the order will be placed for 20 quantities, similar in case of sell quantity. Let us take one more instance say you want to BUY 10 shares for Rs. 447.63 then we have to BUY at Rs. 447.65 instead of Rs. 447.60.

STEP 4:Execution of the Order

The orders are executed by the broker on behalf of the clients. The buy orders must tally the sell orders if not then the broker will sell/buy to match the order. For this the broker charges an amount. Normally in an electronic platform the execution occurs automatically.

STEP5: Preparation of Contract Notes

A contract note is a written agreement between the broker and the investor for smooth execution of the transaction. A contract note is sent through an automated message and via mail through the registered phone and mail respectively by the end of the day. However it varies from broker to broker and the timing varies.

A contract contains the transaction name, brokerage charges, trading on BSE/ NSE, SEBI registration number of the broker, settlement number and a digital signature by the broker.

Below is the portion of a contract note, showing the final amount to be paid by the client

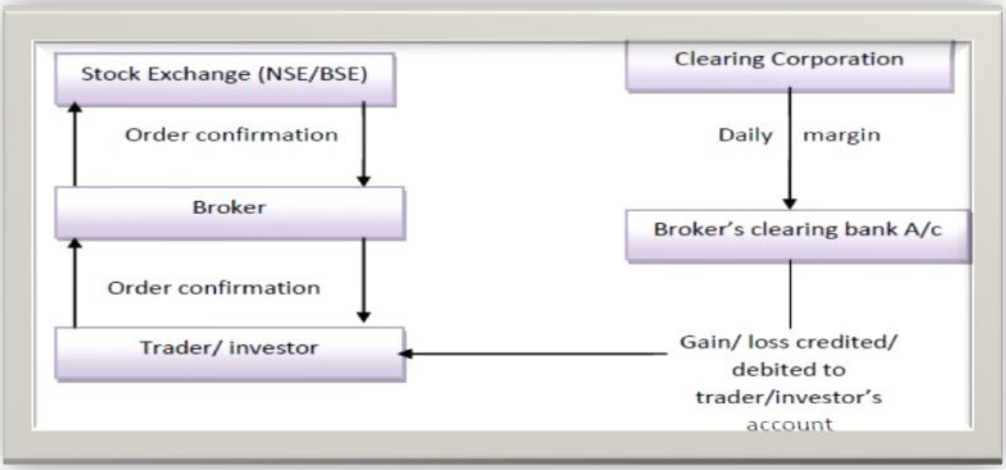
	NSE-EQ	Total
PAY IN / PAY OUT OBLIGATION	94.28	94.28
[IGST 18% On Brokerage]	1.90	1.90
[IGST 18% On Charges]	0.62	0.62
[SEBI FEES]	0.16	0.16
[STAMP DUTY]	2.11	2.11
[STT-RND]	-0.19	-0.19
[STT-SQUP]	13.19	13.19
[TURNOVER CHG*]	3.43	3.43
Net Amount (-) receivable by Client / (+) payable by Client	***115.50***	***115.50***

So, it shows that the client has to pay Rs. 115.50 for the transaction that he has done inclusive the taxes. The amount is debited directly from the client's account.

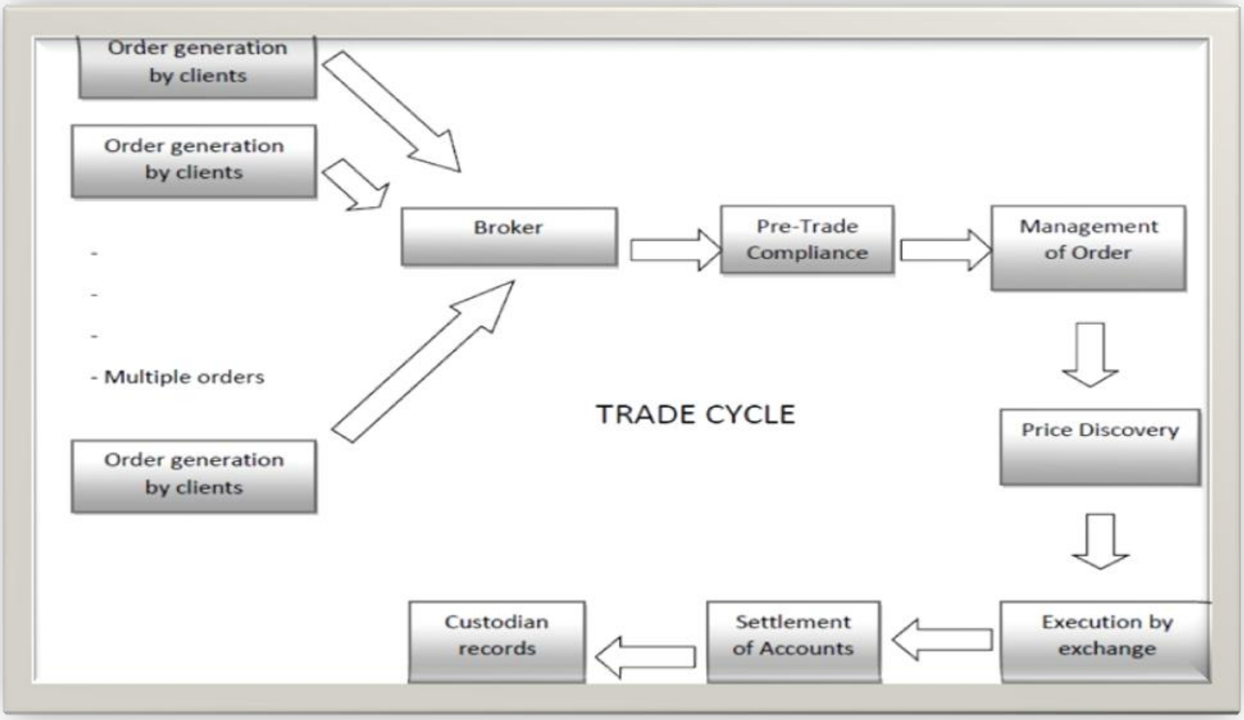
STEP 6: Contract Settlement

The settlement is done by the clearing agency which functions in each stock exchange. The clearing agency delivers the share certificates by the end of the day.

2.4 Flowchart of Trading



2.5 TRADING CYCLE PROCESS



Investing is very much essential these days as savings alone is not adequate to fulfill all our financial goals and also to beat inflation. There are several investment options available and you can choose them as per your needs and convenience. You have to start your investments right from a young age so as to get good returns. Investment habit brings a sense of financial discipline in a person's life as it makes you allocate a certain amount of money periodically for the purpose of investment. Based on your risk appetite and time horizon to achieve your financial goals, you can select the appropriate investment option. There are some financial assets that help you achieve your short term goals and other assets that help you achieve your long term goals. In today's busy world, technological advances have made the entire process of investing and managing investments easier without any hassles. Anyone can have a complete hold on investments even through Smartphone. You can stay connected with the market always as investing in the stocks requires constant monitoring of the stock market.

Trading in the stock market has become less time consuming these days as you can trade all by yourself without the assistance of a broker by means of online trading. Just like shopping for groceries online, you can buy and sell stocks online. You need not be an expert to begin online trading as these trading platforms are user friendly and do not necessitate any special learning. Mobile trading apps have even made things easier for an investor or trader as you can carry out any transaction in the stock market through your Smartphone itself. You can trade from anywhere anytime through the mobile trading app.

Trading platforms provide all the necessary support and assistance by providing secured real time access to trading, research reports, price analysis of stocks, market news, etc. You can buy or sell shares if you have a trading account and an internet connection. Not only that, you can trade in currency, commodity, etc. through one single trading platform. Online trading platforms help you trade without any difficulty as these platforms enable high speed trading. These platforms have revolutionized the way trading is done. You can simply download these to your system or mobile and can begin trading.

2.6 WHAT IS ONLINE TRADING?

You can place trade orders or cancel orders at your will from the comforts of your home. It allows you to make your own decision with regards to trading without any interference of the broker. You can buy shares or invest in IPO or buy mutual funds as well.

Online trading can be done by simply opening a demat and trading account with any SEBI registered broker. Account opening can be done in a matter of 15 minutes. The documents required to open an account are PAN card, address proof, AADHAAR card, mobile number linked to AADHAAR, bank statement, cancelled cheque leaf and passport photograph.

2.7 DOCUMENTS ISSUED BY TRADING MEMBER/BROKER:

Contract note:

The trading member or the broker has to issue contract note within 24 hrs of the execution of trade. Digital contract notes are issued these days. You have to check the contract notes regularly and any discrepancy has to be taken up with the broker immediately. The broker also issues a quarterly statement of funds in digital format.

Benefits of Online Trading:

2.8 THE ADVANTAGES OF ONLINE TRADING ARE:

It’s Simple

It is Less Expensive

Quick & less time consuming.

Complete Control

Chances of Error is less

Monitor Investment All time

Access Reports.

It is simple:

It enables a trader to have a hassle free trading experience. Anyone can use these platforms as specific skill is not required to carry out trading online.

It is less expensive:

It is less expensive as compared to traditional mode of trading. Brokers also promote online trading as it reduces maintenance and other costs incurred by the broker.

Quick and less time consuming:

Trading can be done in a seamless manner and in less time. Before the advent of online technologies, trading was a cumbersome process as you had to visit the broker or call your broker for placing or cancelling trade orders. Now, you can carry out trading even through a Smartphone in the simplest way.

Complete control:

It allows you to have complete control over your portfolio. You can place trade orders from anywhere anytime. That is the kind of flexibility you get due to online trading.

Chances of error are less:

In case of traditional offline trading, there were more chances of errors due to miscommunication between the traders and brokers. But in online trading, you can place trade orders or cancel without broker's interference and hence can manage trade transactions by yourself.

Monitor investment at all times:

You can monitor investments anytime. There are mobile trading apps that can be downloaded in your Smartphone which help you stay in touch with the markets and also monitor your investment anytime and take proper strategic moves accordingly. Loss making stocks can be removed and profit making stocks can be added to your portfolio by observing the way the market moves.

Access to research reports:

You can get access to top research recommendations, reports, analysis on stock price based on various charts. There are various brokerage websites through which you can have discussions with research experts as well. You can take the best move with the help of financial advisors too.

Safety measures that have to be taken in case of online trading:

Trade orders should not be placed from shared PCs or cyber cafes.

Always log out after carrying out trade in order to avoid any misuse of your account.

Personal computers have to be protected against viruses by installing anti-virus solution.

Do not click on "remember me" option when you sign in to your trading account from a different location.

Investment in financial assets is offered by several brokers. You can choose that which suits your needs and demands after comparison of brokers on the basis of services, brokerage charges, etc. Online trading helps you trade or invest in the most secured way. It’s simple, easy and fast to trade online.

2.9 PAYMENT AND SETTLEMENT SYSTEMS IN INDIA

The mission statement of RBI for payment and settlement system states that the endeavour would be “*to ensure that all payment and settlement systems operating in the country are safe, secure, sound, efficient, accessible and authorised*”. The Payment and Settlement Systems Act, 2007 (‘PSS Act, 2007’), legislated in December 2007, governs and regulates all the modes of payment systems used in India. Under the PSS Act, 2007 the RBI is given the power to direct and regulate the payment systems and the payment system participants in India. The PSS Act, 2007 has been enacted to govern and regulate the activities which involve payment and settlement of transaction in substitute of paying or settling a transaction by cash or other means of physical movement of payment instruments to settle a transaction.

Under the PSS Act, 2007, two Regulations have been made by the RBI, namely, the Board for Regulation and Supervision of Payment and Settlement Systems Regulations, 2008 (BPSS Regulations) and the Payment and Settlement Systems Regulations, 2008 (‘PPS Regulations, 2008’). Both these Regulations came into force along with the PSS Act, 2007 on 12th August 2008. They together provide the necessary statutory backing to the RBI for over viewing the payment and settlement systems in the country.

The Board for Regulation and Supervision of Payment and Settlement Systems (BPSS), a sub-committee of the Central Board of the RBI is the highest policy making body on payment systems. The BPSS is empowered for authorising, prescribing policies and setting standards for regulating and supervising all the payment and settlement systems in the country. The Department of Payment and Settlement Systems of the RBI serves as the Secretariat to the Board and executes its directions. The BPSS Regulations deals with the composition of the BPSS, its powers and functions, exercising of powers on behalf of BPSS, meetings of the BPSS and quorum, the constitution of Sub-Committees/Advisory Committees by BPSS, etc. The BPSS exercises the powers on behalf of the RBI, for regulation and supervision of the payment and settlement systems under the PSS Act, 2007.

The PPS Regulations, 2008 lays down the procedural requirements for commencing or carrying on a payment system. It covers matters like form of application for authorization for commencing/ carrying on a payment system and grant of authorization, payment instructions and determination of standards of payment systems. It also further lays the regular compliance requirements, such as furnishing of returns/documents/other information, furnishing of accounts and balance sheets by system provider etc to the RBI.

RBI also has its FAQs on the aforesaid PSS Act, 2007 and Regulations (‘RBI FAQs on PSS’), with intent to provide better understanding of the provisions contained therein.

2.10 CONCEPT OF PAYMENT SYSTEM AND SETTLEMENT

Section 2(1) (i) of the PSS Act, 2007 defines a ‘payment system’ to mean *a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange*[1]. It is further stated by way of an explanation that a “payment system” includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations.

All systems (except stock exchanges and clearing corporations set up under stock exchanges) carrying out either clearing or settlement or payment operations or all of them are regarded as payment systems. To decide whether a particular entity operates the payment system, it must perform either the clearing or payment or settlement function or all of them.

Though the Indian payment systems have always been dominated by paper-based transactions, e-payments are not far behind. In the case of India, the RBI has played a pivotal role in facilitating e-payments by making it compulsory for banks to route high value transactions through Real Time Gross Settlement (RTGS) and also by introducing NEFT (National Electronic Funds Transfer) and NECS (National Electronic Clearing Services) which has encouraged individuals and businesses to switch to electronic methods of payment.

As per the PSS Act, 2007, ‘Settlement’ means *the settlement of payment instructions received and these include settlement of securities, foreign exchange or derivatives or other transactions. Settlement can take place either on a net basis or on a gross basis*. Further, the term ‘netting’ has been defined as *the determination by the system provider of the amount of money or securities, due or payable or deliverable, as a result of setting off or adjusting, the payment obligations or delivery obligations among the system participants, including the claims and obligations arising out of the termination by the system provider, on the insolvency or dissolution or winding up of any system participant or such other circumstances as the system provider may specify in its rules or regulations or bye-laws (by whatever name called), of the* *transactions admitted for settlement at a future date so that only a net claim be demanded or a net obligation be owned.*

The PSS Act, 2007 also legally recognizes settlement finality and the loss allocation among system participants and payment system, where the rules provide for this mechanism. It states that a settlement, whether gross or net, will be final and irrevocable as soon as the money, securities, foreign exchange or derivatives or other transactions payable as a result of such settlement is determined, whether or not such money, securities or foreign exchange or other transactions is actually paid. In case a system participant is declared insolvent, or is dissolved or is wound up, no other law can affect any settlement which has become final and irrevocable and the right of the system provider to appropriate the collaterals contributed by the system participants towards settlement or other obligations.

2.11 AMBIGUITY REGARDING ISSUANCE OF CREDIT CARDS

In India 'plastics' or 'electronic payments' have been fast replacing 'paper based payments'. Card payments form an integral part of electronic payments in India because customers make many payments on their card-paying their bills, transferring funds and shopping. The issuance of Debit Card by banks have been growing in number however, Credit Cards have shown a relatively slower growth.

The term "credit card" usually/generally refers to a plastic card assigned to a cardholder, usually with a credit limit, that can be used to purchase goods and services on credit or obtain cash advances. Earlier, smart cards/ debit cards/ stored value cards/ value added cards etc. were issued only by banks and non-banking entities were not permitted to issue such cards. Prior approval of the RBI is not necessary for banks desirous of undertaking credit card business either independently or in tie-up arrangement with other card issuing banks. However, Non-Banking Financial Companies (NBFCs) are not allowed to undertake credit card business without prior approval of RBI. The instructions issued by RBI on credit card operations of banks are applicable, *mutatis-mutandis*, to NBFCs issuing credit cards.

Banking, including credit card operations, is a heavily regulated business, with high transaction and operating costs, and fairly constant business models. In recent times, fintech entities are also creating on-demand credit and currency markets, using self-learning models to analyse risk and making it easier for businesses and individuals to transact. Such retail fintech businesses, especially, have an advantage over traditional banking. Instead of relying on large transactions, they can process small transactions in large volumes. This makes them ideal vehicles to make banking services accessible to individuals and small businesses. However, though the credit card operations are covered under the definition of payment system, there are no further directions issued by the RBI for payment system providers, in this regard. Presently, under the PSS Act, 2007, American Express Banking Corp, USA; Diners Club International Ltd, USA; MasterCard Asia/ Pacific Pte. Ltd., Singapore; and Visa Worldwide Pte Ltd, Singapore, have been authorised to issue credit cards in India.

Further, since credit card operations are not covered under the purview of prepaid instrument, and in the absence of any specific regulatory framework under the PSS Act, 2007, it still remains a gray area for fintech entities. In the opinion of this article, in the absence of any enabling provisions, it can be inferred that the issuance of credit card is restricted for banks and permitted NBFCs only. In the meantime, the regulators must also come up with comprehensive regulation to keep check on the activities of such emerging fintech business activities.

2.12 ENTITIES AUTHORIZED BY RBI UNDER PSS ACT, 2007

As per the provisions of Section 4 of the PSS Act, no person other than the RBI (RBI) can commence or operate a payment system in India unless authorised by RBI. Accordingly, RBI has authorised payment system operators of pre-paid payment instruments, card schemes, cross-border in-bound money transfers, Automated Teller Machine (ATM) networks and centralised clearing arrangements.

All entities operating payment systems or desirous of setting up such systems are required to apply for authorization under the PSS Act, 2007. Any unauthorized operation of a payment system would be an offence under the PSS Act, 2007 and accordingly liable for penal action under that Act.

Further, the application for authorisation of a payment system operator is assessed by the RBI against the criteria specified for a particular payment system. For example, the application for issuance and operation of PPI is assessed against the Policy Guidelines on Issuance and Operation of Pre-paid Payment Instruments in India.

Upon registration, the payment system provider is required to operate the payment system in accordance with the provisions of the PSS Act, 2007 and the Regulations, the terms and conditions of authorization and the directions given by the RBI from time to time. Section 20 to 22 of the PSS Act, 2007 requires the system provider to disclose the terms and conditions including the charges, limitations of liability etc., under the payment system to the system participants. It further also requires the system provider to provide copies of all the rules and regulations governing the operation of the payment system and other relevant documents to the system participants. The system provider is required to keep the documents and its contents, provided to it by the system participants, as confidential and is prohibited from disclosing the same, except in accordance with the provisions of law.

2.13 PREPAID PAYMENT INSTRUMENTS

Under the PSS Act, the RBI has permitted the issuance of such instrument which can be used to access the prepaid amount to settle transaction, that is to say prepaid payment instruments, in the country and has also laid down the means to settle transactions.

The guidelines define the term 'Pre-paid payment instruments' as payment instruments that facilitate purchase of goods and services, including funds transfer, against the value stored on such instruments. The value stored on such instruments represents the value paid for by the holders by cash, by debit to a bank account, or by credit card. The pre-paid instruments can be issued as smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instrument which can be used to access the pre-paid amount (collectively called Prepaid Payment Instruments hereafter). The pre-paid payment instruments that can be issued in the country are classified under three categories viz. (i) Closed system payment instruments (ii) Semi-closed system payment instruments and (iii) Open system payment instruments.

RBI is in the process of revising the existing guidelines of pre-paid instruments and have prepared draft policy guidelines ('Draft policy guidelines on PPIs') to facilitate the Prepaid Payment Instrument Issuers, System Providers, System Participants and all other Prospective Prepaid Payment Instrument Issuers to have all the extant instructions on the subject at one place.

2.14 ELECTRONIC WALLETS

Prepaid instruments are a convenient cashless payment method and facilitate e-payment for goods or services purchased via the internet or mobile phone. Recently, electronic-based transactions are registering phenomenal growth in India. The limited accessibility and availability of bank accounts to a substantial population of the country has paved way for the growth of electronic payment instruments. Specifically, electronic wallets are becoming the preferred electronic payment mode for both consumers and retailers. The ease of using electronic wallets as a substitute to physical wallets have made electronic wallets as one of the most convenient ways of making payment through the use of mobile phones.

The market participants, including NBFCs and other companies apart from banks, who have availed the license for providing such services under the governing laws and provisions, are also finding the operation of electronic wallets as a lucrative business opportunity.

Under the PSS Act, 2007 prepaid payment instruments that can be issued in the country are classified under three categories viz. (i) Closed system payment instruments (ii) Semi-closed system payment instruments and (iii) Open system payment instruments.

Only the banks are allowed to issue open system payment instruments which can be used for purchase of goods and services, and also permit cash withdrawals from ATMs. These are payment instruments that can be used at any card-accepting merchant locations (point of sale terminals) and also permit cash withdrawal from ATMs. Example of these are credit cards, debit cards, etc.

Closed system payment instruments are used when the goods or services are acquired directly from the entity which issues this instrument. They do not allow cash withdrawal or redemption. Like in case of "Ola money" or "free charge" wallet, where the amount so credited can be utilized only for either travelling or recharging of mobile respectively.

Mobile wallets are categorized under semi-closed system payment instruments. The definition of semi-closed system payment instruments, as per the guidelines, is as reproduced below:

"Semi-Closed System Payment Instruments: These are payment instruments which can be used for purchase of goods and services, including financial services at a group of clearly identified merchant locations/ establishments which have a specific contract with the issuer to accept the payment instruments. These instruments do not permit cash withdrawal or redemption by the holder."

It can be inferred from the aforesaid definition that these are payment instruments that are redeemable at a group of clearly identified merchant locations/ establishments, which contract specifically with the issuer to accept the payment instruments. These instruments do not permit cash withdrawal or redemption by the holder.

As per the aforesaid definition, electronic wallets, in the nature of semi-closed payment instrument can be used for availing financial services also. A view can be taken that financial services includes services such as availing funding facility and the repayment of such facility, where the lender has a specific contract with the issuer of prepaid payment instrument.

The abovementioned guidelines further provides safeguard for the interests of customers using these payment instruments to ensure that their payments are duly accounted for by the issuers and intermediaries, so that transactions are completed in a safe and secured manner. The RBI stipulates that non-bank persons issuing payment instruments are required to maintain their outstanding balance in an escrow account with any scheduled commercial bank. The permitted debits and credits that can be effected in and from the said escrow account is also specifically mentioned in the guidelines, as reproduced below:

Credits:

Payments received towards sale / reload of PPIs, including at agent locations

Refunds received for failed / disputed / returned / cancelled transactions.

Debits:

Payments to various merchants/service providers towards reimbursement of claims received from them

Payment to sponsor bank for processing funds transfer instructions received from PPI holders as permitted by RBI from time to time.

Payment towards applicable Government taxes (received along with PPI sale/reload amount from the buyers)

Refunds towards cancellation of transactions in a PPI in case of PPIs loaded / reloaded erroneously or through fraudulent means (on establishment of erroneous transfer /fraud). The funds have to be credited back to the same source from where these were received. These funds are not to be forfeited till the disposal of the case.

Any other payment due to the PPI issuer in the normal course of operating the PPI business (for instance, service charges, forfeited amount, commissions)

Any other debit as directed by the regulator / courts / law enforcement agencies.

2.15 SETTLEMENT OF PAYMENTS FOR ELECTRONIC PAYMENT INSTRUMENTS

As mentioned earlier, the use of electronic modes of payments to merchants for their goods and services has been gaining popularity. Banks and prepaid payment instrument issuers have also been facilitating the use of electronic modes by customers for payments to merchants. Here, the intermediaries such as aggregators and payment gateway service providers, including e-commerce and m-commerce service providers, are playing a major role for facilitating the use of electronic mode of payment. These intermediaries include all entities that collect monies received from customers for payment to merchants using any electronic/online payment mode, for goods and services availed by them and subsequently facilitate the transfer of these monies to the merchants in final settlement of the obligations of the paying customers.

The arrangement, involving such intermediaries, involves the flow of funds as mentioned herein below:

A lot of risk is involved in the aforesaid arrangement, for the customers and the merchants, as any delay in the transfer of the funds by the intermediaries to the merchants account will impact the payment system as a whole. It is vital to ensure that the interests of the customers are safeguarded and that the payments made by them are duly accounted for by the intermediaries receiving such payments and subsequently remitted to the accounts of the merchants who have supplied the goods and services without undue delay. Accordingly, the RBI has considered it necessary to frame specific guidelines and directions for the safe and orderly conduct of these transactions .

Intermediaries, like aggregators and payment gateways, which facilitate payment services, though not authorised by RBI under the PSS Act, 2007 are however required to route their transactions only through a nodal account opened with a bank under the aforesaid guidelines. The RBI further stipulates that all accounts opened and maintained by banks for facilitating collection of payments by intermediaries from customers of merchants are to be treated as internal accounts of the banks. The permitted credits/debits in these accounts are provided herein below:

Credits

Payments from various persons towards purchase of goods/services.

Transfers from other banks as per pre-determined agreement into the account, if this account is the nodal bank account for the intermediary.

Transfers representing refunds for failed/disputed transactions.

Debits

Payments to various merchants/service providers.

Transfers to other banks as per pre-determined agreement into the account, if that account is the nodal bank account for the intermediary.

Transfers representing refunds for failed/disputed transactions.

Commissions to the intermediaries. These amounts shall be at pre-determined rates/frequency.

The RBI has also further mandated that banks shall implement a settlement cycle for all final settlements to merchants. This settlement arrangement shall increase the efficiency of the payment process; accordingly, banks shall transfer funds to the ultimate beneficiaries with minimum time delay in the following manner-

All payments to merchants which do not involve transfer of funds to nodal banks shall be effected within a maximum of T+2 settlement cycle (where T is defined as the day of intimation regarding the completion of transaction).

All payments to merchants involving nodal banks shall be effected within a maximum of T+3 settlement cycle

2.16 DEFINITION OF NATIONAL COMMODITIES AND DERIVATIVES EXCHANGE (NCDEX)

The National Commodities and Derivatives Exchange (NCDEX) is a commodities exchange dealing primarily in agricultural commodities in India. The National Commodities and Derivatives Exchange was established in 2003. The exchange was founded by some of India's leading financial institutions such as ICICI Bank Limited, the National Stock Exchange of India and the National Bank for Agricultural and Rural Development, among others.

Understanding National Commodities And Derivatives Exchange (NCDEX)

The National Commodities and Derivatives Exchange (NCDEX) is one of the top commodity exchanges in India based on value and the number of contracts, second only to the Multi Commodity Exchange (MCX) with its focus on energy and precious metals. The National Commodities and Derivatives Exchange is located in Mumbai but has offices across the country to facilitate trade. Trading is done on 27 commodity contracts as of March 2018. These include 25 contracts for agricultural products. NCDEX is run by an independent board of directors with no direct interest in agriculture.

NCDEX and Indian Agriculture

India is a world power in terms of agriculture. It is one of the largest producers of wheat, rice, milk and many types of fruits and vegetables. The size of India's agriculture sector is somewhat hidden internationally because the populous nation consumes a lot of what it makes. However, increasing farm-level productivity is making the strength of India's agricultural sector more apparent. And, of course, NCDEX plays a critical role in that agriculture sector.

In establishing and maintaining an online futures market for crops, NCDEX has helped increase market transparency. This has resulted in farmers in India conduct price discovery, helping them price their goods more accurately even if they are not active in the futures market. Middlemen called commission agents previously controlled much of the market information in India, so the introduction of online commodity exchanges like NCDEX has greatly improved the information asymmetry.

Exchanges like NCDEX have also played a key role in improving Indian agricultural practices. By standardizing the quality specifications of various crops through contracts, the NCDEX has raised quality awareness. Farmers in India are increasingly focussed on testing requirements and enacting farming practices that result in consistent, high-quality yields.

NCDEX as a Benchmark

Due to its grounding in agricultural products, NCDEX hosts some contracts that are defacto global benchmarks for commodities like coriander, cumin and chickpeas. NCDEX is seen as a major source for information on spices, as India is the leading producer and consumer of spices. Although the NCDEX is still young by some standards and heavily used for delivery, traders and large market participants are using contracts to hedge and speculate. This trend will continue as India's agricultural sector grows in terms of productivity and exports.

2.17 WHAT ARE MCX AND NCDEX

MCX or Multi Commodity Exchange of India Ltd is an electronic commodity futures trading exchange. National Commodity & Derivates Exchange Limited or NCDEX is an online multi commodity trading exchange. In a world where investors are increasingly turning to the internet for their trading and transactions, trading exchanges like MCX and NCDEX are gaining popularity by leaps and bounds. A comparative study of the two portals is often undertaken by investors. In fact MCX Vs NCDEX is an interesting subject and is likely to yield interesting results.

2.18 ABOUT MCX AND NCDEX

MCX started its operations in November 2003 and NCDEX in April 2003. Both exchanges have their headquarters in Mumbai and both MCX and NCDEX have been demutualised. Whereas MCX specialises in bullions and precious metals like gold and silver, NCDEX is highly trusted for the trading of agri-based products like oil and oil seeds, cereals, etc.

In fact it is a fact well-known among the investor community that MCX is the best platform for trading gold and silver and other globally traded metals and NCDEX provides the best returns in trading of agri-based products.

2.19 MCX VS NCDEX – COMMODITIES TRADED:

MCX deals in the trading of 40 commodities which include bullions, precious metals, plantations and more; and NCDEX offers 34 commodities of which 23 are agri-based and the rest include precious metals, energy, polymer, etc. To increase the convenience of trading for its members and promote fair-trade, both MCX and NCDEX have several nationalised as well as private sector banks that take care of the clearings and transactions for its members. NCDEX has fifteen and MCX sixteen banks empanelled as its clearing banks.

MCX Clearing banks:

Axis Bank Ltd
Bank Of India
Canara Bank
Citibank n.a.
Corporation Bank
Development credit bank ltd
Dhanlaxmi bank
HDFC bank
ICICI bank
Indusind bank
Kotak mahindra bank ltd.
Punjab National Bank
State Bank of India
Tamilnad Mercantile Bank Ltd

NCDEX Clearing banks:

Axis Bank Limited
Bank of India
Canara Bank
Development Credit Bank Limited
Dhanlaxmi Bank Limited
HDFC Bank Limited
ICICI Bank Limited
IndusInd Bank Limited
Kotak Mahindra Bank Ltd
Punjab National Bank
Standard Chartered Bank Ltd
State Bank of India
Tamilnad Mercantile Bank Limited
Union Bank of India
Union Bank Of India
Yes bank

2.20 MCX VS NCDEX: PROMOTERS AND SHAREHOLDERS

NCDEX is the single commodity exchange in India that is promoted by institutions like ICICI Bank Limited, NABARD, LIC, and NSE. On the other hand the promoters of the MCX include international names like National Spot Exchange Limited (NSEL), Singapore Mercantile Exchange (SMX), Bahrain Financial Exchange (BFX), Global Board of Trade (GBOT) and more.

2.21 MCX AND NCDEX - TECHNOLOGY

Both MCX and NCDEX use state-of-the-art technological infrastructure to facilitate fast and error free trading for its members. Both MCX and NCDEX operate on weekdays (Monday to Friday) during which new member registrations can happen. Both Exchanges ensure that all member requests are resolved at the earliest and with minimum possible glitch. The online trading platforms of MCX and NCDEX can be accessed by all members throughout the country with computer-to-computer link ("CTCL") as well as through trader workstations with the use of multiple connectivity media like VPN, VSATs, leased lines and internet.

2.22 MCX VS NCDEX: WEBSITES

The official website for the MCX is www.mcxindia.com and that for the NCDEX is www.ncdex.com. Both these Exchanges ensure that their websites offer all information that might be of help to an existing member or a prospective member. All related market data including rates of various commodities, indices, overall market performance can be tracked from their websites. In addition to that, all information related to the Exchanges like the details of their shareholders, promoters, awards, press releases, procedures of trading, dos and don'ts of trading, etc. are also available on their websites.

On the whole, it can safely be concluded that since NCDEX and MCX deal in different commodities, they cannot be straight away classified or judged against each other. The type of commodity to be traded should determine the platform and not the other way round. Every sensible investor should in fact become members of both Exchanges in order to make the most of a good market and to curb losses relatively when markets are down. Considering the volatile nature of the global markets at present, trading should be distributed among various commodities and therefore, among various commodity trading exchanges.

2.23 SUMMARY

The mission statement of RBI for payment and settlement system states that the endeavour would be "*to ensure that all payment and settlement systems operating in the country are safe, secure, sound, efficient, accessible and authorised*". The Payment and Settlement Systems Act, 2007 ('PSS Act, 2007'), legislated in December 2007, governs and regulates all the modes of payment systems used in India. Under the PSS Act, 2007 the RBI is given the power to direct and regulate the payment systems and the payment system participants in

India. The PSS Act, 2007 has been enacted to govern and regulate the activities which involve payment and settlement of transaction in substitute of paying or settling a transaction by cash or other means of physical movement of payment instruments to settle a transaction.

Under the PSS Act, 2007, two Regulations have been made by the RBI, namely, the Board for Regulation and Supervision of Payment and Settlement Systems Regulations, 2008 (BPSS Regulations) and the Payment and Settlement Systems Regulations, 2008 ('PPS Regulations, 2008'). Both these Regulations came into force along with the PSS Act, 2007 on 12th August 2008. They together provide the necessary statutory backing to the RBI for over viewing the payment and settlement systems in the country.

2.24 TEST YOURSELF

- Explain trading mechanism of securities
- Write about BSE (bombay stock exchange)
- Write about NSE (national stock exchange)
- Explain mechanism of trading
- Discuss trading process in bse
- Elucidate flowchart of trading
- What is online trading?
- What documents issued by trading member/broker?
- What are the advantages of online trading are:
- What is electronic wallets

2.25 SUGGESTED READINGS

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UNIT 03: MUTUAL FUNDS

Unit Structure

03.0 OBJECTIVES

After studying this module, you shall be able to:

- Learn about the growth and performance of Mutual funds in India
- Learn about the evolution and contribution in the form of associates and promotional institutions to the industrial sector of economy by the UTI
- Learn about various products offered by the UTI

- Evaluate the difference between the public and private mutual funds in India

03.1 INTRODUCTION

A mutual fund is simply a financial intermediary that allows a group of investors to pool their money together with a predetermined investment objective. The mutual funds are one of the best investments ever created because they are very cost efficient and very easy to invest in. By pooling money together in a mutual fund, the investors can purchase stocks or bonds with much lower trading costs than if they tried to do it on their own. But the biggest advantage of mutual funds is diversification. The money collected is invested in different types of securities by the fund manager depending upon the objective of the scheme. The income earned through these investments and the capital appreciation realised by the scheme are shared by its unit holders in proportion to the number of units owned by them (pro-rata).

The combined holdings, the mutual fund owns, are known as its portfolio. The income earned through these investments and the capital appreciation realised are shared by its unit holders in proportion to the number of units owned by them.

03.2 HISTORY OF MUTUAL FUND INDUSTRY IN INDIA

The origin of mutual fund industry in India was with the introduction of the concept of mutual fund by Unit Trust of India in the year 1963. Though the growth was slow, but it accelerated from the year 1987 when non-UTI players entered the industry. The Indian mutual fund industry can be broadly put into the following four phases according to the development of the sector:

First Phase (1964-1987)

The Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from RBI. The first scheme launched by UTI was Unit Scheme 1964 (US-64). The other notable and popular schemes launched by UTI were Unit Linked Insurance Plan (ULIP), Monthly Income Scheme (MIS), Children Gift Growth Fund (CGGF) during this phase.

Second Phase (1987-1993) Entry of Public Sector Funds

This phase started with the entry of non-UTI mutual funds. The SBI Mutual Fund (1987) was the first followed by Canbank Mutual Fund(1987), Punjab National Bank Mutual Fund (1989), Indian Bank Mutual Fund(1989), Bank of

India Mutual Fund (1990), Bank of Baroda Mutual Fund(1992). LIC Mutual Fund in 1989 and GIC Mutual Fund in 1990.

Third Phase-(1993-2003) Entry of Private Sector Funds

In the third phase, with the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer mutual fund (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now started functioning under the SEBI (Mutual Fund) Regulations 1996. The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry witnessed several mergers and acquisitions.

Fourth Phase- since February 2003

This phase had bitter experience for UTI. It was bifurcated into two separate entities. The first specified undertaking of the Unit Trust of India with AUMs of Rs.29, 835 crores (as on January 2003). It functions under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations, governed by SEBI.

The second is the UTI Mutual Fund Ltd, jointly sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs.76, 000 crores of AUMs and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth.

In the year 1992, Securities and Exchange Board of India (SEBI) Act was passed with the objectives to protect the interests of investors in securities and to promote the development of and to regulate the securities market. As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interests of the investors. SEBI notified the regulations for the mutual funds in 1993. The regulations were fully revised in 1996 and have been amended thereafter from time to time. The SEBI has also issued guidelines to the mutual funds periodically to protect the interests of investors.

03.3 SIGNIFICANCE OF MUTUAL FUNDS

All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI. The risks associated with the schemes launched by the mutual funds sponsored by these entities are of similar type.

A mutual fund is an ideal investment vehicle for today's complex and modern financial scenario. The markets for equity shares, bonds and other instruments, real estate, 60 derivatives and other assets have become mature and information driven. The price changes in these assets are driven by global events occurring in different countries. The mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing the funds in securities in accordance with objectives as disclosed in the offer document. Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. The mutual fund issues units to the investors in accordance with quantum of money invested by them. The investors of mutual funds are known as unit holders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund in India is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets, before it can collect funds from the public.

If one is quite knowledgeable about investing, have enough money to purchase shares of companies in different industries to allow for diversification, and have time to research stocks, then may be investing in individual shares is a good starting point. On the other hand If one has limited knowledge about investing, have a small amount of money that one can invest regularly, and is not comfortable with the ups and downs of individual shares, then mutual funds may be a better fit.

03.4 FEATURES OF MUTUAL FUNDS

The various features of mutual funds are as follows:

1) Mutual funds is a non- depository or non- banking financial intermediary.

2) Mutual funds mobilizes the savings from the people and invest them in the mix of corporate and government securities.

3) Mutual funds brings a variety of securities within the reach of the most modest investors.

4) Mutual funds create awareness among the urban and rural middle class about the benefits of investment in capital markets.

5) Mutual funds are controlled and regulated by SEBI and are therefore considered to be safe.

6) Mutual fund is an indirect form of investment i.e the investors invest in mutual funds and the mutual fund invest in shares, bonds, debentures and other securities in the capital market.

7) Mutual fund works as the representatives of the investors.

Some common mistakes, mutual fund investors make and should avoid :

1. Failing to have a good understanding of the objectives, policies and risks of the funds the investors buy. This can lead to unsuitable investments and unexpected losses.

2. Investing in the wrong funds even though they may be in the right categories. Losers will tend to exhibit either high costs, excessive sales charges or poor management.

3. Using the rear-view mirror approach of buying volatile funds that were top performers over the most recent year or quarter.

4. Failing to follow a consistent long-term view of buy- and-hold investing.

03.5 WORKING OF MUTUAL FUND

Working of a mutual fund begins with pooling of money to form fund. Various investors pool in their money to form a big fund. These funds are taken by an Asset management company (AMC) to manage the funds according to various goals of the investor. These asset management companies employ financial experts and managers to understand the current scenario of market and invest the fund in the most profitable sectors of the society.

There are also Trustees of mutual funds who make sure that asset management companies are working in best interest of the investors and their money is safely invested. The asset management company pool money from small investors and invest it into various securities such as shares, stocks and fixed income investments. As everyone knows that t is not always possible that different securities of different sectors work well at the same time, so an asset management company invests the pooled funds in different sectors such as steel, banking, real estate, entertainment etc .Now if a particular sector say steel industries are not giving good returns but other sectors are doing well then the average return of mutual fund investment remains stable. That is the task of financial experts of an asset management company to maintain an average return. Investors in this way are saved from the fluctuations of stock markets and at the same time get an opportunity that even with a meagre contribution they get an opportunity to invest in share market and debt market.

Investors get the benefit of growth in equity and stability of debts. Till now it is clear how a mutual fund work but the question arises what an investor get s as soon as it gives its money to an asset management company. They get 'units'. Units represent the money invested in the fund. These units are redeemable to get back the money. These units have Net Asset Value (NAV).

NAV represents the value of one unit of investor's investment. Total number of units with investors multiplied by NAV gives market value of investors holding. NAV is calculated after deducting all fund expenses and fee of AMC. Investments in mutual funds can be made in lump sum manner or in small amounts at some pre determined intervals. This makes them favourable for all kinds of investors such as salaried people, businessman etc. Every mutual fund has a set benchmark to measure its performance. It is based on Nifty or Sensex. These benchmarks are used to measure the performance of a mutual fund.

The fund managers' task is to analyse the market and cross the set benchmark of the fund. This is the reason for hiring fund managers.

When we invest in a mutual fund, we purchase a certain number of units of the fund. The fund manager buys and sells the investments in the securities markets to maximise returns for the investors within the investment guidelines of a scheme outlined in the prospectus. The fund's value and the value of the units can go up or down on a day to day basis. Some funds will fluctuate more than others and we would like to consider this factor when we choose a fund.

Many factors influence how the mutual fund performs, including the value of the underlying investments, changes in interest rates and other economic trends, even the buy/sell process. When we purchase units in a mutual fund, we pay certain fees and expenses usually deducted directly from our investment. We should understand these fees, well for both buying and selling the units.

03.5.1 UTI AND MUTUAL FUNDS:

The formation of Unit Trust of India marked the evolution of the Indian mutual fund industry in the year 1963. The main objective of it was to attract the small investors. It was made possible through the collective efforts of the Government of India and the Reserve Bank of India. Eventually many public sector,private sector and foreign fund management companies entered the mutual fund market.

In November 1987, SBI Mutual Fund from the State Bank of India became the first non-UTI mutual fund in India. The Unit Trust of India is one of the leading mutual fund service providers in India. It is commonly known as UTI Mutual Fund all over India. It is managed by UTI Asset Management Company Private Limited which was established on January 14, 2003. UTI Asset Management Company Private Limited has been formed by the UTI Trustee Company Private Limited for dealing with various schemes developed by UTI mutual fund. UTI Asset Management Company Private Limited is located at Mumbai in India.

This will correspond with the provisions of Investment Management Agreement, the Trust Deed, the SEBI (Mutual Funds) Regulations and the objectives that are being assumed by various schemes. Unit Trust of India came into effect from 1st February, 2003. The UTI Mutual Fund offers scheme for the need of various investors. The Unit Trust of India has 70 UTI Financial Centers and UTI International offices in Dubai, London, and Bahrain. The establishment of Unit trust of India actually harbingers the scheme of mutual fund in India.

03.5.2 Various products offered by the UTI:

UTI being the pioneer of mutual funds in India offer various schemes to suit the requirements of the various categories of investors. It keeps in mind the risk taking ability of an investor and offers them with a suitable scheme. Some of the schemes are as follows:

Equity Funds

In this option funds are invested in stock of various companies. Here benefits for unit holders are secured by capital appreciation. Funds are invested in equity shares and convertible and non convertible bonds. This product is beneficial for those investors who want Long term capital growth and are ready to take high risk.

Theme Based Mutual Funds

Contra, Dividend Yield, Global, Lifestyle, Value etc are some of the popular themes that the mutual fund industry has played with. The objective of theme based fund is to give best returns by investing the pooled fund in those stocks which are in agreement with a particular theme. So these investments can be in multi sector, international stocks, commodity market etc.

Sector funds

A sector fund is a mutual fund or exchange-traded fund that concentrates its investments in a single sector of the market. These funds are focused on stocks within a certain business or industry. They are more volatile than the stock markets. The different sectors may be Technology, Financials, Communications, Utilities, Natural Resources, Healthcare, Real Estate, Precious Metals etc.

Tax planning funds

These funds satisfy the tax saving need of the investor. They are usually close ended schemes with some lock in period. These funds are related to portfolios that include those securities that make the maximum benefit of the tax exemption under section 80C of the income tax act.

Arbitrage Funds Arbitrage mutual funds are those funds that are made up of such schemes that take the maximum advantage and benefit of arbitrage opportunities current and the futures market.

Gilt Fund

In these funds money is merely invested in government securities. Government securities are usually risk free. NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt oriented schemes.

Index Funds

Index Funds replicate the portfolio of a particular index such as the BSE Sensitive index, S&P NSE 50 index (Nifty), etc. These schemes invest in the securities in the same weightage comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage.

Segment Focused Funds

These funds focus on particular need segment such as retirement benefit, children career etc. These funds retain the flexibility to invest in entire range of equity, debt and money market instruments.

Monthly Income Plan

Monthly income plan of mutual fund is a debt-oriented scheme that generally 75 to 80 percent funds in debt instruments and the remaining in equity instruments. MIPs aim to provide investors with regular income. They are basically taken by passive investors. In short there are many more schemes offered by UTI for their investors. In fact, they keep on developing new schemes according to the requirements. Above mentioned schemes are some of the currently offered schemes or plans.

03.6 STRUCTURE OF MUTUAL FUNDS IN INDIA

The structure of Mutual Funds in India is a three-tier one. There are three distinct entities involved in the process – the sponsor (who creates a Mutual Fund), trustees and the asset management company (which oversees the fund management). The structure of Mutual Funds has come into existence due to SEBI (Securities and Exchange Board of India) Mutual Fund Regulations, 1996. Under these regulations, a Mutual Fund is created as a Public Trust. We will look into the structure of Mutual Funds in a detailed manner.

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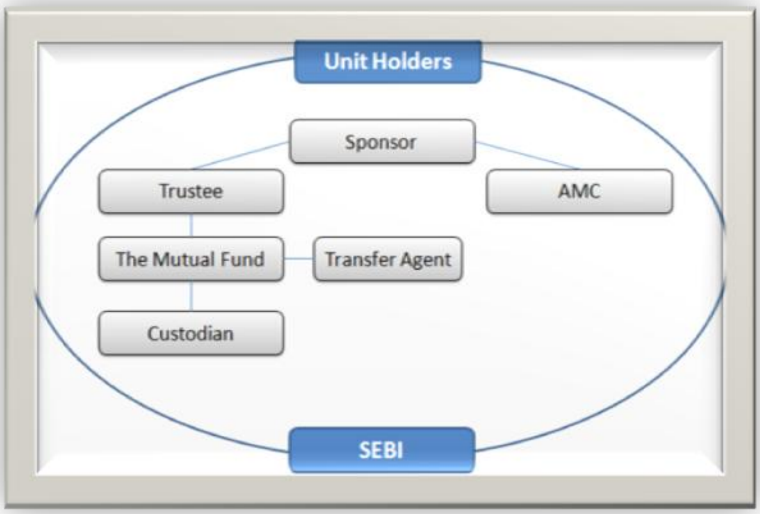

The Structure of Mutual Fund

A. The Fund Sponsor:

The Fund Sponsor is the first layer in the three-tier structure of Mutual Funds in India. SEBI regulations say that a fund sponsor is any person or any entity that can set up a Mutual Fund to earn money by fund management. This fund management is done through an associate company which manages the investment of the fund. A sponsor can be seen as the promoter of the associate company. A sponsor has to approach SEBI to seek permission for a setting up a Mutual Fund. Once SEBI agrees to the inception, a Public Trust is formed under the Indian Trust Act, 0382 and is registered with SEBI. Trustees are appointed to manage the trust and an asset management company is created complying with the Companies Act, 1956.

There are eligibility criteria given by SEBI for the fund sponsor:

i.The sponsor must have experience in financial services for a minimum of five years with a positive Net worth for all the previous five years.

ii.The net worth of the sponsor in the immediate last year has to be greater than the capital contribution of the AMC.

iii.The sponsor must show profits in at least three out of five years which includes the last year as well.

iv.The sponsor must have at least 40% share in the net worth of the asset management company.

v.Any entity that fulfills the above criteria can be termed as a sponsor of the Mutual Fund.

B. Trust and Trustees:

Trust and trustees form the second layer of the structure of Mutual Funds in India. A trust is created by the fund sponsor in favour of the trustees, through a document called a trust deed. The trust is managed by the trustees and they are answerable to investors. They can be seen as primary guardians of fund and assets. Trustees can be formed by two ways – a Trustee Company or a Board of Trustees. The trustees work to monitor the activities of the Mutual Fund and check its compliance with SEBI (Mutual Fund) regulations. They also monitor the systems, procedures, and overall working of the asset management company. Without the trustees' approval, AMC cannot float any scheme in the market. The trustees have to report to SEBI every six months about the activities of the AMC.

C.Asset Management Companies:

Asset Management Companies are the third layer in the structure of Mutual Funds. The asset management company acts as the fund manager or as an investment manager for the trust. A small fee is paid to the AMC for managing the fund. The AMC is responsible for all the fund-related activities. It initiates various schemes and launches the same. The AMC is bound to manage funds and provide services to the investor. It solicits these services with other elements like brokers, auditors, bankers, registrars, lawyers, etc. and works with them. To ensure that there is no conflict between the AMCs, there are certain restrictions imposed on the business activities of the companies.

Other Components in the Structure of Mutual Funds are:

Custodian: A custodian is responsible for the safekeeping of the securities of the Mutual Fund. They manage the investment account of the Mutual Fund, ensure the delivery and transfer of the securities. They also collect and track the dividends & interests received on the Mutual Fund investment.

Registrar and Transfer Agents (RTAS): These are the entities who provide services to Mutual Funds. RTAs are more like the operational arm of Mutual Funds. Since the operations of all Mutual Fund companies are similar, it is economical in scale and cost effective for all the 44 AMCs to seek the services of RTAs. CAMS, Karvy, Sundaram, Principal, Templeton, etc are some of the well-known RTAs in India. Their services include:

i.Processing investors' application

ii.Keeping a record of investors' details

iii.Sending out account statements to the investors

iv.Sending out periodic reports

v.Processing the payouts of the dividends

vi.Updating the investor details i.e. adding new members and removing those who have withdrawn from the fund.

Auditor: Auditors audit and scrutinise record books of accounts and annual reports of various schemes. Each AMC hires an independent auditor to analyse the books so as to keep their transparency and integrity intact.

Brokers: AMC uses the services of brokers to buy and sell securities on the stock market. The AMCs uses research reports and recommendations from many brokers to plan their market moves. The three-tier structure of the Mutual Funds is in place keeping the fiduciary nature of the Mutual Funds in mind. It ensures that each element of the system works independently and efficiently. This structure of Mutual Funds is in line with the international standards and thus there is a proper separation of responsibilities and functioning of each constituent of the structure.

03.7 TYPES OF MUTUAL FUND SCHEMES :

The Mutual Funds offer a wide variety of schemes to the investors according to the objectives of the scheme, appetite of the investors, extent of diversification, financial position, risk tolerance and returns expectations. The following broad types of schemes are offered by the Mutual Funds:-

BROAD TYPE	MAJOR FEATURES
By Structure:	
Open-ended schemes	Schemes open throughout the year. Sale and repurchase of units on a daily basis at NAV
Close-ended schemes	Schemes open for subscription for a specific period only. Repurchase permitted at NAV, after the lock in period, if any
Interval schemes	Schemes that combine the features of open ended and close-ended schemes, making the fund open for sale or redemption during predetermined intervals.
By Investment Objective:	
Growth schemes	Aim is to achieve capital appreciation by investing in equity shares of companies that are experiencing significant earnings or revenue 65 growth. In general, growth funds are more volatile than other types of funds.
Income schemes	Schemes that primarily concentrate on investment in bonds with an objective of earning regular income and providing regular dividend to the

	investors
Balanced schemes	Schemes use a combination of strategies, typically including some level of investment in bonds, to stay more conservative when it comes to risk and also invest in equity shares to aim for some growth.
Money market schemes	Schemes that invest in short term money market instruments, entail the least risk, as well as lower rates of return. Money market units are liquid and redeemable at any time. These schemes exclusively invest in money market instruments. These funds are open ended, transacting in short term debt instruments, like Treasury Bills, Government Securities, call money, commercial paper, certificate of deposits. The investment in such securities is for a shorter tenure, so volume of investment is big. Such funds serve two important purposes:- 1. Providing access of money market benefits to ordinary investors. 2. Acting as a balancing instrument for stabilizing volatile interest rates. The emergence and working of MMMF is linked with the features of macro-economic environment in a country. Where interest rates are on higher sides with wide fluctuations, such mutual funds are suitable alternative. The average portfolio of money market funds is only in highly liquid securities. A minimum lock in

	period is prescribed. The NAV is calculated on the basis of market price of money market instruments.
Other Schemes:	
Tax saving schemes	Schemes that offer to the investors rebates in taxes under the Income Tax Act 1961. Usually have a three year lock in period. The fund 66 manager of the Tax Saving Funds in India invests the money in instruments that are related to equity. The dividends of Tax Saving schemes in India are tax free.
Index funds	Funds which maintain investments in companies that are part of major stock indices, such as the BSE or NSE. The assets of an index fund are managed, to closely approximate the performance of a particular published index. An index fund manager makes fewer trades and thus the funds generally have lower trading expenses.
Sector specific schemes	Schemes that invest solely in companies that operate in a particular industry or sector of the economy. Because the holdings of this type of scheme are in the same industry, there is an inherent lack of diversification associated with these schemes.
Gilt edged schemes	Schemes which invest their pooled money in Government securities and generally provide a fixed rate of return.

03.8 CLASSIFICATION OF MUTUAL FUNDS:

Mutual funds are classified on various basis such as functional basis, geographical basis, and portfolio basis and on miscellaneous basis which are discussed as follows: 4.1 Functional classification of mutual fund On functional basis mutual funds are classified into open ended , close ended and interval schemes or funds

A. Open ended mutual fund schemes:

An open ended mutual fund is one that continuously offers to sell and repurchase its units at net assets value. The maturity period of these schemes are not specified. An investor can buy or sell units at NAV which are declared on a daily basis. Thus these funds provide investors a freedom to enter and exit from the scheme at any time during the life of the fund. Since these schemes have perpetual succession and flexible corpus, these schemes provide instant liquidity to the investors. Unlike close ended schemes, these schemes do not have to be listed on the stock exchange rather they are transacted by the mutual fund themselves. The fluctuation in stock price causes the purchase price and sales price of these funds to change daily. Therefore when there is bearish in the stock market, the NAV of these schemes decreases and the transactions of buying and selling can be done at low price and vice a versa. The corpus of these schemes are not fixed and goes on increasing or decreasing depending upon the redemption and purchase of the units by the investors.

B. Close ended mutual fund schemes:

Close ended mutual fund schemes have a fixed corpus, stipulated maturity period and a specified subscription period. They are like any other company operating in an industry. The investors are allowed to investor in close ended schemes, when it is launched and that too up to the specified date. Once the initial subscription is over, the units of these schemes are listed on the stock exchange. As the units are listed on the stock exchange it provides liquidity to the investors. The shares of close ended schemes are often sells at discount because from the point of view of the investor’s close ended schemes are more risky as compared to the open ended schemes. It is worthwhile for an investor to make investment in close ended scheme only when the discount is very high.

C. Interval schemes:

A scheme that combines the features of both the open ended and close ended schemes is called the interval scheme. In this scheme there is predetermined intervals during which the sale or redemption of units are open at the NAV related prices

03.9 PERFORMANCE MEASUREMENT AND EVALUATION OF MUTUAL FUND SCHEMES

The mutual fund investments are considered to be less risky investment avenues as compared to direct investments in stock markets. All mutual fund schemes provide market related returns. The performance of mutual funds can be evaluated with resources mobilized by mutual funds over a period, net inflow or outflow of funds and trading of mutual fund units in the market.

03.9.1 Net Asset Value (NAV) of a scheme:

The performance of a particular scheme of a mutual fund is denoted by the Net Asset Value (NAV). The mutual funds invest the money collected from the investors in securities markets. In simple words, Net Asset Value is the market value of the securities held by the scheme. Since the market value of securities changes every day, NAV of a scheme also varies on day to day basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. For example, if the market value of securities of a mutual fund scheme is Rs 200 lakhs and the mutual fund has issued 10 lakhs units of Rs. 10 each to the investors, then the NAV per unit of the fund is Rs.20. The NAV is required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.

NAV of a mutual fund unit is calculated as:

$$NAV=\frac{\text{Market value of investments} + \text{Receivables} + \text{other accrued Income} + \text{Other Assets} - \text{Accrued expenses} - \text{other payables} - \text{other liabilities}}{\text{No.of units outstanding as on NAV date}}$$

The NAV is calculated once in a day by marking the balance sheet of the scheme to the market. First, the total market value of all the stocks held is computed. The total of the market value is added to the scheme's cash and equivalent holdings. The Liabilities (including accrued expenses) are subtracted. The result is total net assets. Dividing the total assets by the number of units outstanding, give the NAV per unit.

The proper performance measurement of mutual fund schemes involve recognition of both, the return and the riskiness of the investments. The central issue in performance measurement is both a measurement of risk with return. Benchmarking and peer group analysis of mutual fund schemes help the investors to understand the performance in more meaningful terms. The investors should monitor the performance of their mutual fund schemes on a regular basis.

03.9.2 The concept of return:

The performance in the context of the mutual funds, is to compare the expected return with the actual return. Therefore, the performance measurement exercise needs to begin by carefully understanding the objectives of the fund and then comparing the actual performance against these objectives. The most vital statistic in measuring the performance of a mutual fund is the rate of return.

03.9.3 The concept of risk:

The risk is the key dimension of the performance measurement and a decisive factor in determining a fund manager's skills. One cannot make a judgment about how skilful a fund manager is in a particular period by looking at return only. Market value of investments + Receivables + other accrued Income + Other Assets - Accrued expenses - other payables - other liabilities No. of units outstanding as on NAV date NAV= 68 Risk in a generic sense is the possibility of loss, damage, or harm. For investment purposes a more specific definition of risk has to be given. It refers to variability in the expected return.

For a mutual fund, the following factors cause variability of the investment performance:

• The kind of securities in the portfolio. e.g., small cap stocks may be more volatile than large cap stocks.

• The degree of diversification. e.g., a portfolio of only 5 stocks may be more volatile than a portfolio comprising of 15 stocks.

• The extent to which the portfolio manager times the market. e.g., an 'index fund tends to be less volatile than an aggressive growth fund.

03.9.4 Standard deviation:

Standard deviation is a measure of dispersion in return. It quantifies the degree to which returns fluctuate around their average. A higher value of standard deviation means higher risk. The standard deviation is used probably more than any other measure to describe the risk of a security (or portfolio of securities). It's not just a financial tool though.

Standard Deviation for Mutual Funds- When used to measure the volatility of the performance of a security or a portfolio of securities, standard deviation is generally calculated for monthly returns over a specific time period usually, 36 months. And, because most people think about returns on an annual and not on monthly basis, the resulting number is then modified to produce an annualized standard deviation. Though standard deviation measures volatility on both the upside and the downside, it’s a good proxy for measuring the risk of loss with any security. One of the strengths of standard deviation is that is can be used across the board for any type of portfolio with any type of security. The calculation is the same for a portfolio of bonds as it is for a portfolio of growth stocks.

03.9.5 Performance evaluation: After measuring the performance, next important step is to evaluate it against some suitable benchmark to address more important issues like how the reassured return measures up to the similar investment opportunities. Performance evaluation will also enable the fund's sponsor and the asset management committee to determine if the fund manager has enhanced the fund's value beyond what could be obtained from a passive indexed strategy. The performance evaluation involves benchmarking and peer group analysis.

03.10 DIFFERENCE BETWEEN PUBLIC AND PRIVATE MUTUAL FUND IN INDIA

A mutual fund is an investment instrument which takes funds from many different kinds of investors to invest in stocks, bonds, money market instruments and other financial assets. Mutual funds can be either public or private. Both types of mutual funds have their own intricacies and benefits.

Public Mutual Funds:

Public mutual funds, as their name suggests, are open to the public to invest in. They are managed by professional fund managers, who actively invest in various securities to achieve the mutual funds’ stated objectives, which could be capital growth or income.

Private Mutual Funds:

Private mutual funds are an exclusive investment with a limited number of investors. The minimal investment for a share of a private mutual fund is much higher than that of a public mutual fund. Depending upon the number of investors in a private mutual fund, there is little or no government regulation.

Points of Difference:

1. Public mutual funds are open to public whereas in private mutual funds only few investors can participate.

2. Comparatively, there is less governmental regulation in private mutual fund than public mutual fund.

3. Private funds are prone to greater investment risks than public mutual funds

4. Public mutual funds comparatively cater larger number of investors than private mutual funds.

In general, it has been seen that investors feel safer with public mutual funds than private mutual funds.

03.11 ADVANTAGES OF INVESTING IN MUTUAL FUNDS

The investment in Mutual funds have several benefits, including:

1.Professional Money Management: The Professional fund managers have the qualifications, training and experience to manage investments effectively. Investing in mutual funds has the benefit of the expertise of professionals who have the resources to thoroughly research potential investments, churn the portfolio and balance the risk-return trade-off. They monitor the market and the economic trends and then take a conscious investment decision on the basis of their analysis.

2.Risk Diversification: Diversification is a key to intelligent investing. Because of the economies of scale provided by mutual funds, even a small investment is diversified. When the money is invested in a mutual fund, the holding always represents an array of shares, bonds and/or other investments and this diversified investment portfolio helps in reducing the level of risks.

3.Flexibility: The Mutual funds are considered as flexible investments as the investor has a variety of plans to choose from - income or growth plan, dividend or re-investment plan, Systematic Investment Plan or Systematic Withdrawal Plan, Children Benefit Plan or Tax Saving Plan . They offer multiple schemes / options to allow investors to switch easily between various schemes. This flexibility gives the investor a convenient way to change the mix of his portfolio over time, quite easily as compared to changing shares portfolio.

4.Convenience: The investments in Mutual funds are simple to buy and sell. When one buys mutual funds, one gains the benefit of diversification without having to research and track numerous individual investments. They give detailed reports to review mutual funds’ performance through the quarterly disclosure reports. The facilities of periodic purchase/ withdrawals and re-investment are available to investors. Each investor is issued units electronically, receives an account statement which is non transferable. Hence, he does not have to worry about theft of the physical certificates or loss in transit.

5.Long-Term Growth: The Mutual funds have more long term growth potential than short term investment vehicles such as savings accounts and money market funds.

6.Reduction in Costs: The Mutual funds have a large pool of money that they have to invest. So they are often involved in buying and selling of large amounts of securities that will cost much lower than when we invest on our own. The fund expenses are often no more than 1.5% of the investment expenses. For Index Funds the expenses are less than that, because index funds are not actively managed. Instead, they automatically buy stock in companies that are listed on a specific index like BSE.

7.Liquidity: A mutual fund investor can sell off the investments and get the current market value of the investments based on NAV. in a short time. With open-ended mutual funds, one can 63 redeem all or part of the units any time. Such liquidity makes mutual funds much more attractive than illiquid instruments such as fixed deposits and bonds.

8.Transparency: The Mutual funds are very transparent. All mutual fund schemes disclose their NAV daily and full portfolio quarterly. They give detailed information about investments, the proportion in which the investments have been made in different asset categories, fund manager's investment strategy and objective of the scheme. This level of transparency where the investor himself sees the underlying assets bought with his money, is unmatched by any other financial instrument.

9.Well Regulated: The Securities and Exchange Board of India (SEBI), the mutual fund’s regulator has clearly defined rules which govern all mutual funds in India. These regulations relate to the formation, administration and management of mutual funds and also prescribe disclosure and accounting requirements. Such a high level of regulation seeks to protect the investors from misuse of their money. This regulatory control and check are not available in such detail in case of other investments.

10.Choice of Schemes: The Mutual funds investment offer a tremendous variety of schemes. It is beneficial in two ways: first, it offers different types of schemes to investors with different needs and risk appetites; secondly, it offers a chance to an investor to invest sums across a variety of schemes, both debt and equity.

11.Advanced Portfolio Management: When you buy a mutual fund, you pay a management fee as part of your expense ratio, which is used to hire a professional portfolio manager who buys and sells stocks, bonds, etc.

This is a relatively small price to pay for getting professional help in the management of an investment portfolio.

12.Dividend Reinvestment:

As dividends and other interest income sources are declared for the fund, it can be used to purchase additional shares in the mutual fund, therefore helping your investment grow.

03.12 DRAWBACKS OF MUTUAL FUNDS

Akin to most investments, mutual funds offer both advantages and disadvantages, which should be analyzed before you choose to buy one. The Mutual fund investments have their own following drawbacks, however may not be for everyone:

1.No Guarantees: In the mutual fund investment, no investment is risk free. If the stock market falls, the value of mutual fund units go down as well, no matter how balanced the portfolio is. Anyone who invests through a mutual fund runs the risk of losing money.

2.Fees and Commissions: All mutual funds charge administrative fee to cover their day-to-day expenses. Some funds also charge sales commissions or “loads" to compensate the brokers, financial consultant, or financial planners. Even if one doesn’t use a broker or other financial adviser one will pay a sales commission if one buys units in a Load fund.

3.Management Risk: When one invests in a mutual fund one depends on the fund manager to make the right decisions regarding the fund’s portfolio. If the manager does not perform as well as we had hoped, we might not make as much money on our investments as expected. Of course, if we invest in Index Funds, we forego management risk because these funds are passively managed.

4.Fluctuating returns: Mutual funds do not offer fixed guaranteed returns in that you should always be prepared for any eventuality including depreciation in the value of your mutual fund. In other words, mutual funds entail a wide range of price fluctuations. Professional management of a fund by a team of experts does not insulate you from bad performance of your fund.

5.No Control: All types of mutual funds are managed by fund managers. In many cases, the fund manager may be supported by a team of analysts. Consequently, as an investor, you do not have any control over your investment.

All major decisions concerning your fund are taken by your fund manager. However, you can examine some important parameters such as disclosure norms, corpus and overall investment strategy followed by an Asset Management Company (AMC).

6.Diversification: Diversification is often cited as one of the main advantages of a mutual fund. However, there is always the risk of over diversification, which may increase the operating cost of a fund, demands greater due diligence and dilutes the relative advantages of diversification.

7.Fund Evaluation: Many investors may find it difficult to extensively research and evaluate the value of different funds. A mutual fund's net asset value (NAV) provides investors the value of a fund's portfolio. However, investors have to study various parameters such as sharpe ratio and standard deviation among others to ascertain how one fund has fared compared to another which can be complicated to some extent.

8.Past performance: Ratings and advertisements issued by companies are only an indicator of the past performance of a fund. It is important to note that robust past performance of a fund is not a guarantee of a similar performance in the future. As an investor, you should analyse the investment philosophy, transparency, ethics, compliance and overall performance of a fund house across different phases in the market over a period of time. Ratings can be taken as a reference point.

9.Costs: The value of a mutual fund may fluctuate depending on the changing market conditions. Furthermore, there are fees and expenses involved towards professional management of a mutual fund which is not the case for buying stocks or securities directly in the market. There is an entry load which has to be borne by an investor when buying a mutual fund. Furthermore, some companies charge an exit cost as well when an investor chooses to exit from a mutual fund.

10.CAGR: The performance of a mutual fund vis-a-vis the compounded annualised growth rate (CAGR) neither provides investors adequate information about the amount of risk facing a mutual fund nor the process of investment involved. It is therefore, only one of the indicators to gauge the performance of a fund but is far from being comprehensive.

11.Fund managers: According to experts, as an investor, you would do well not to be carried away by the so-called ‘star fund managers’. Even a highly skilled manager can make a positive difference in the short-term but cannot dramatically change the performance of a fund in the long-term. Also, there is always the likelihood of a star fund manager joining another company. It is, therefore, more prudent to examine the processes which are followed by a fund house rather than the star appeal of just one individual.

03.13 THE GROWTH AND PERFORMANCE OF MUTUAL FUNDS IN INDIA

The concept of mutual fund in India started in 1964 with the setting up of Unit Trust of India (UTI). The growth and performance of mutual funds in India can be divided in four phases:

Phase-I: 1964-1987- During this phase, UTI enjoyed monopoly of being the only mutual fund in India. The first scheme launched by the UTI was US-64 which gained a lot of popularity. Later on, the UTI launched other schemes like Unit Linked Insurance plan etc. Later on UTI diversified its business in banking, securities trading, investor servicing etc. by setting up associates companies.

Phase-II: 1987-1993- During this second phase, other players such as SBI, LIC, Canara Bank entered in the mutual fund market. This period experienced a lot of competition and improvement in terms and conditions to the investors in mutual funds in India.

Phase-III: 1993-1996- This phase witnessed the increased competition in the mutual fund market with the entry of private sector and foreign mutual funds in the industry. Then the SEBI came out with mutual fund regulations during this phase to ensure safety of investors money and smooth functioning of the mutual fund industry in India.

Phase-IV: 1996 onwards- During this phase SEBI felt the need for modifying the regulation issued in 1996. It circulated a consultative paper “mutual fund-2000” to make amendments. The content of the paper was deliberated among all the players in the mutual fund market and a new set of SEBI Regulation, 1996 was released to bring private sector mutual funds at par with public sector mutual funds.

In the beginning the UTI enjoyed the total monopoly in the mutual funds industry. Gradually between 1987 and1992, mutual funds were set up by nationalized banks and insurance companies. In 1992, the government allowed the setting up of mutual funds by the private and joint sectors. In short the industry has moved from a complete monopoly to that of a monopolistic competition.

The investor's increasing interest in the mutual funds is because to the fact that while the investor is blessed with little or no knowledge about capital market whereas the asset management company is equipped with economic and financial experts to manage the pooled resources. Also a single small investor would not be able to invest his money wisely in diversified securities. Around

60 to 70 per cent of middle class households in India invest in mutual funds units.

In India, there has been a gradual increase in the share of mutual funds. Since 1988-89 mutual funds Gross savings of the household sector. The financial assets has increased from Rs 12.1 03 crore in 1980-81 to Rs 1, 35,348 crore in 1994-95. The banking sector role has declined relatively. The most marketable growth was seen during 1980-81 to 1992-93 when units of UTI increased from 0 3 per cent of the total household savings in 1980-81 to 70 per cent in 1992-93. However this increase was slowed down later but is still growing. The amounts of deposits in banks are falling from previous years on proportionate basis. Investors now look mutual funds as an alternative option to put their savings into.

03.13.1 Evolution and contribution in the form of associates and promotional institutions to the industrial growth of economy by the UTI

Mutual fund is an instrument for pooling the resources from various investors in small quantities by issuing units to the investors and investing the large amount of fund so formed by these small contributions indifferent kinds of securities and debentures in accordance with objectives as make known in offer document. Here investments are made in diversified assets and securities of various sectors of industries. This diversification helps in reducing the risk of a particular investment. . Investors of mutual funds are known as unit holders. The profits or losses are shared by the investors in proportion to their investments. All mutual funds are regulated by SEBI.

03.14 SUMMARY

Mutual funds are therefore great instrument of investing for those investors who have little money to invest and also little knowledge of finance. These funds help the investors to park their money in a professional manner by seeking advice of experts from Asset Management Company. The growth of mutual funds can be seen from increasing number of investors in this sector. Mutual funds are a great means of investing for investors of different needs. There are various kinds of schemes and plans that are offered by mutual fund companies for the benefit of investors.

03.15 TEST YOUR PROGRESS

- Explain the significance of Mutual Funds
- What are the features of Mutual Funds
- Describe the Working of Mutual Funds
- Explain the Structure of Mutual Funds In India
- What are various types of Mutual Funds Schemes

- Explain the Classification of Mutual Funds
- Differentiate between Performance Measurement and Evaluation of Mutual Fund Schemes
- Differentiate between Public And Private Mutual Funds In India
- What are the advantages Of Investing In Mutual Funds

03.16 SUGGESTED READINGS

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