AL-QURMOSHI INSTITUTE OF BUSINESS MANAGEMENT

 # 18-11-26/7, JAMAL BANDA, BARKAS, HYDERABAD-05

MBA – II Year

Subject: MB 404.1 - Investment Management

ASSIGNMENT QUESTIONS-CUM-INTERNAL ASSESSMENT TEST –II FOR 15 MARKS.

Roll No.	1	4	0	1	1	8	6	7	2			

(5 x 3 = 15 Marks)

NOTE: Answer all the questions in essay type. Each question carries 5 marks.

1. What do you understand by “Common Stock”? Explain the various characteristics of common stock.
2. What is “CAPM”? Discuss its assumptions.
3. Explain the Sharpe’s “Reward to Variability Index” and Treynor’s “Reward to Volatility Index”. Compare and contrast both the indexes.

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Case Study for 5 Marks

Note: Study the case (Pg. No 2-7) and answer the following questions?

1. Explain the main features of Mutual Funds.
2. What are the types of Mutual Funds Schemes?
3. Explain the regulation of Mutual Funds in India.
4. What are the future prospects of Mutual Funds in India?
5. Explain the advantages of Mutual Funds.

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CASE STUDY

Mutual Funds

A mutual fund is a collective investment arrangement. Mutual funds are association of trusts of public members who wish to make investment in the financial instruments or assets of the business sector or corporate sector for the mutual benefit of its members. The fund collects the money of these members from their savings and invests them in a diversified portfolio of financial assets with a view to reduce risks and to maximize their income and capital appreciation for distribution of its members. They enjoy collectively the benefits of expertise in investment by specialists in the trust. Mutual fund is thus a concept of mutual help of subscribers for portfolio management and management of these investments by experts in the field.

A Mutual Fund or unit trust is a financial intermediary established in the form of a trust. It is sponsored by banks, insurance, financial and other industrial companies to mobilize savings from the public at large. It invests the pooled savings (fund) in various instruments of capital and money markets. The funds so mobilized are managed by professionals and are invested in various securities of divergent companies of different industries, which facilitates the diversification and minimizes the risk.

In India, the only mutual fund operating for a long time since 1964 was the UTI. It was an open-ended mutual fund, whose units can be sold and repurchased at any time. It is the public sector, enjoying monopoly position until 1987. Mutual funds have recorded a very impressive growth in India in the last several years. While there is only one mutual fund in India viz., the Unit Trust of India, till 1987, presently there are a number of mutual funds in both the public sector as well as private sector. Of course, UTI, with its massive resources, continues to dominate the mutual fund scene in India. The SBI, Canara Bank, Punjab National Bank, Axis Bank, HDFC bank and some other nationalized banks have set up their own mutual funds. These funds cater mainly to individual investors and small savers.

Types of Mutual Funds

Mutual funds are of various types and set for various purposes and objectives. Broadly, they are classified along two dimensions : (a) nature of the scheme, and (b) objective of the scheme.

Nature of Scheme: A mutual fund scheme may be a closed-end or an open-end scheme. The salient features of these schemes are:

- The subscription to a closed-end scheme is kept open only for a limited period (usually one month or three months) whereas an open-end scheme accepts funds from investors by offering its units or shares on a continuing basis.
- A closed-end scheme does not allow investors to withdraw funds as and when they like, whereas an open-end scheme permits investors to withdraw funds on a continuing basis under a re-purchase arrangement.
- A closed-end scheme has a fixed maturity period (usually five to fifteen years) whereas an open-end scheme has no maturity period.
- The closed-end schemes are listed on the secondary market, whereas the open-end schemes are ordinarily not listed.

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

A closed-end scheme has a stipulated maturity period which generally ranging from 3 to 15 years. The fund is open for subscription only during a specified period. Investors can invest in the scheme at the time of the new fund offer and thereafter they can buy and sell the units of the scheme on the stock exchanges where they are listed.

Objectives of Scheme: In terms of the objective sought, the mutual fund schemes fall into the following broad types, as follows:

- Income Schemes: These schemes primarily seek to provide a fairly predictable stream of income over time, consistent with the preservation of the capital value. The aim of income funds is to provide regular and steady income to investors.
- Growth Schemes: These schemes typically emphasize capital appreciation, with the generation of current income being a secondary concern. The aim of growth funds is to provide capital appreciation over the medium or long term.
- Balanced Schemes: These schemes strive for a balanced achievement of three objectives, viz., income, growth and stability. The aim of balanced funds is to provide both growth and regular income. These are ideal for investors looking for a combination of income and moderate growth.
- Money market funds: The aim of money market funds is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer short term instruments such as treasury bills, certificates of deposits, commercial paper and inter-bank call money.
- Tax savings schemes: These schemes offer tax breaks to the investors under specific provisions of the Income Tax Laws as the Government offers tax incentives for investments in specified avenues. Investments made in Equity Linked Savings Schemes and Pension Schemes are allowed as deduction u/s 88 of the Income Tax Act, 1961.

Regulation of Mutual Funds

Leaving aside UTI, which has been existing since 1964, two Financial Institutions, namely, LIC and GIC has set up their Mutual Funds in 1989 and 1990 respectively. Since 1987, starting with SBI, a number of Public Sector banks has set up Mutual Funds, which have been regulated by the RBI. The Mutual Funds of LIC and GIC were regulated by the Investment division of Ministry of Finance. After SEBI got legal status in 1992, all Mutual Funds have been brought under its supervision, except the Money Market Mutual Funds and Offshore Mutual Funds, which also bound by the guidelines of RBI, and Ministry of finance. The Mutual Fund movement has got a startling momentum by 1990-91, but there was a setback to this in 1992, following the securities scam in which a number of banks and Mutual Funds were involved in financial irregularities. Since then, the SEBI has tightened its regulations.

The new guidelines were laid down in respect of Mutual Funds for authorization and licensing of all Mutual Funds and each of their individual schemes. As visualized by the Government Policy, not only public sector but private sector and joint sector mutual funds are now permitted and licensed by the SEBI.

Licensing and authorization of existing mutual funds was initiated by the SEBI, along with the licensing of Merchant Bankers. As mutual funds were set up by the public sector banks, they were authorized by the RBI and each of their schemes were to be approved by the latter. But gradually SEBI took over the responsibility of authorizing and supervising them except in the case of pure Money Market Mutual Funds of the offshore Mutual Funds which are governed by the regulations of RBI and Ministry of Finance. All Mutual Funds which not exclusively dealing in Money Market instruments require authorization from the SEBI. This authorization is granted by the SEBI as per government guidelines issued in March, 1992.

Problems and Prospects of Indian Mutual Fund Industry

The Indian Mutual Fund industry has been around for more than 55 years since inception in 1964. The mutual fund industry has experienced its share of ups and downs. The industry was one entity till 1987 and the UTI was a monopoly. The public sector mutual funds made their debut, followed by the announcement permitting nationalized banks to extend their services to mutual fund business. State Bank of India (SBI) , the largest commercial bank in the country launched a mutual fund. Canara Bank followed suit by securing Government of India's permission to set up its mutual fund. LIC also launched its scheme in June, 1989 and the Indian Bank Mutual Fund scheme. The entry of public sector mutual funds created waves in the market and attracted small investors.

Before 1989, there were no regulatory guidelines for the mutual fund industry in India. The first such guidelines for setting up and regulating mutual funds were issued by the RBI In October 1989, but they were applicable only toe the mutual funds floated by banks. The Government of India issued comprehensive guidelines in June 1990, covering all mutual funds and making them mandatory to be registered with SEBI.

The entry of private sector funds in 1993 began a new era in mutual fund industry. The new private sector funds have distinctive operational advantages. Most of them are jointly floated by Indian organizations along with experienced foreign asset management companies, facilitating access to the latest technology and foreign fund management strategies. Private sector funds are able to attract the best managerial talent from the public sector.

The first private sector fund is by Madras based Kothari Pioneer Mutual Fund. During 1993-94, the five private sector mutual funds – Kothari Pioneer Mutual Fund, ICICI Mutual Fund, 20^{th} Century Mutual Fund, Morgan Stanley Mutual Fund and Taurus Mutual Fund lauched their schemes.

During 1995 and 1996, as capital market conditions were not conducive, the NAV's of the equity funds declined and closed funds traded at a discount to the NAV. For the first time, investors saw an erosion in the value of their investments. Due to the very fast growth in the number of investors accounts, and the inadequacy of servicing infrastructure like Registers and Transfer facilities, postal services and banking network, the quality of service also declined.

Industry observers see a number of factors driving the industry's growth in the future like the high household saving rate. Only a small percentage of households savings are being invested in the mutual fund. The population of India being more than 120 crores there is a lot of potential to mutual fund industry to grow. The foreign players are contributing to the exponential growth of the industry with variety of schemes. They have enhanced the standards of the industry by bringing the best practices developed across the globe. The mutual funds are not yet in the top the Indian investor's list, as the investor still prefers bank deposits, government bonds, insurance and equities. Against one out of every two households buying mutual fund products in the advanced economies of the world, in India, it is only one out of every 10 that prefer mutual funds. But this is a good opportunity for the mutual fund firms to tap the potential market.
In countries like USA and UK, there are funds to satisfy everybody's requirement, but in India it is yet to be explored. The assured returns made investors happily give their money and stay invested for

years. The investors have accepted the fact that the mutual fund investment has a risk element. They have learnt a good lesson from UTI's debacle and its rescue by the government bailout. The investors are preferring private sector mutual funds over public sector mutual funds for the variety of funds, good services and world class practices.

Advantages of Mutual Fund

Mutual Fund increases the mobilization of investible funds of the community by pooling the resources of a large number of small savers for corporate investments. Mutual funds reduce the risk of shareholding for the holder, by evolving schemes, suitable to the preferences of the saver looking for either income or capital gains. The mutual funds develop the expertise by setting up a professionally managed structure which would look after the needs of the investing public for gainful and low risk investment. The mutual funds can promote the investment habit of the rural and semi-urban areas and increase the proportion of investing public and of the shareholding population in India. With a view to making the mutual fund schemes more popular with the small investors, the Government of India has permitted various tax concessions to the investors. The LIC and GIC have additional benefits of insurance cover to a certain extent. The investors investing in a mutual fund can automatically reap benefits of research and a wide range of low cost information services. The major advantages of investing in mutual funds are as follows:

- Professional management.
- Diversification benefits.
- Low transaction costs.
- Convenient record keeping.
- Availability of various schemes.
- Switching.
- Investment protection.
- Low initial investment.
- Liquidity.
- Tax benefits.

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