Performance Evaluation and Future Prospects of Mutual Fund Industry in India

** Shyam Lal Dev Pandey*
*** Dr. G.S. Rathore*
**** S.P. Khare*

INTRODUCTION

There is a saying that "Money talks! "But sadly, for most of us it talks only when it has to say "good-bye!" Here in reference to mutual funds money fails to say good-bye. The mutual funds were started with an aim to provide a platform for enabling the common man to invest in a professionally managed and risk diversified basket of securities at relatively low cost. The term "Mutual funds" describes a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objective as laid down in the offer document. Investing in basket of securities reduces the risk because all stocks may not move in the same direction in the same portion at the same time, therefore mutual funds are least risky avenue of investment. Mutual funds issue units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unit holders. The profit and losses are shared by investors in proportion to their investments. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI).

FORMATION OF MUTUAL FUND

A mutual fund is setup in the form of a trust, which has sponsor, trustees, assets management company (AMC) and custodian. A sponsor, who is like promoter of company, establishes the trust. The trustee of mutual fund holds its property for the benefit of the unit holders. Assets Management Company (AMC) approved by SEBI, manages the fund by making investments in various type of securities. An AMC shall not act as a trustee of any mutual fund; it shall not take any other business activity except in the nature of management and advisory services to offshore funds, pension funds, provident funds, venture capital funds, and management of insurance funds, financial consultancy and exchange of research on commercial basis. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in its custody. The trustees are having power to control and direct the activities of AMC. They monitor the performance and compliance of SEBI regulations by the mutual fund. All mutual funds, in India, except Unit Trust of India, are governed by SEBI (Mutual Funds) Regulations Act, 1996. SEBI has set up certain norms for the trustee, sponsor, AMC and custodian. SEBI regulation requires that at least two-third of the directors of the Trustee Company or board of trustees must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme.

PERFORMANCE MEASURES OF MUTUAL FUNDS

With a plethora of schemes to choose from, the retail investor faces problems in selecting funds. Factors such as *investment strategy* and management style are qualitative, but the funds record is an important indicator too. Though past performance alone cannot be indicative of future performance, it is, frankly, the only quantitative way to judge how good a fund is at present. Therefore, there is a need to correctly assess the past performance of different mutual funds. Return alone should not be considered as the basis of measurement of the performance of a mutual fund scheme, it should also include the risk taken by the fund manager because different funds will have different levels of risk attached to them. Risk associated with a fund, in a general, can be defined as variability or fluctuations in the returns generated by it. These fluctuations in the returns generated by a fund are resultant of two guiding forces. ***First,*** general market fluctuations, which affect all the securities, present in the market, called market risk or systematic risk and ***second,*** fluctuations due to specific securities present in the portfolio of the fund, called unsystematic risk. The Total Risk of a given fund is sum of these two and is measured in terms of standard deviation of returns of the fund. Systematic risk, on the other hand, is measured in terms of Beta, which represents fluctuations in the NAV of the fund vis-à-vis market. The more responsive the NAV of a mutual fund is to the changes in the market; higher will be its beta. Beta is calculated by relating the returns on a mutual fund with the returns in the market.

* *Lecturer,* School of Management Sciences, Khushipur, Bachhaon, Varanasi - 221 011, U.P. E-mail: shyamlaldev@gmail.com
** *Reader& Dean,* Department of Commerce, Uday Pratap Autonomous College, Varanasi.
*** *Head of Department,* Department of Commerce, SKBB Govt. P.G. College, Harak (Barabanki).

In order to determine the risk-adjusted returns of investment portfolios, several eminent authors have worked since 1960s to develop composite performance indices to evaluate a portfolio by comparing alternative portfolios within a particular risk class. The most important and widely used measures of performance are: **1. The Treynor Measure 2. The Sharpe Measure 3. Jenson Model 4. Fama Model**

THE TREYNOR MEASURE

Developed by Jack Treynor, this performance measure evaluates funds on the basis of Treynor's Index. This Index is a ratio of return generated by the fund over and above risk free rate of return (generally taken to be the return on securities backed by the government, as there is no credit risk associated), during a given period and systematic risk associated with it (beta). Symbolically, it can be represented as:

Treynor's Index (Ti) = (Ri - Rf)/Bi.

Where, Ri represents return on fund, Rf is risk free rate of return and Bi is beta of the fund.

THE SHARPE MEASURE

In this model, performance of a fund is evaluated on the basis of Sharpe Ratio, which is a ratio of returns generated by the fund over and above risk free rate of return and the total risk associated with it. According to Sharpe, it is the total risk of the fund that the investors are concerned about. So, the model evaluates funds on the basis of reward per unit of total risk. Symbolically, it can be written as:

Sharpe Index (Si) = (Ri - Rf)/Si

Where, Si is standard deviation of the fund.

While a high and positive Sharpe Ratio shows a superior risk-adjusted performance of a fund, a low and negative Sharpe Ratio is an indication of unfavorable performance.

JENSON MODEL

This model was developed by Michael Jenson and is sometimes referred to as the Differential Return Method. This measure involves evaluation of the returns that the fund has generated vs. the returns actually expected out of the fund given the level of its systematic risk. The surplus between the two returns is called Alpha, which measures the performance of a fund compared with the actual returns over the period. Required return of a fund at a given level of risk (Bi) can be calculated as:

Ri = Rf + Bi (Rm - Rf)

Where, Rm is average market return during the given period. After calculating it, alpha can be obtained by subtracting required return from the actual return of the fund.

Higher alpha represents superior performance of the fund and vice versa. Limitation of this model is that it considers only systematic risk not the entire risk associated with the fund and an ordinary investor cannot mitigate unsystematic risk, as his knowledge of market is primitive.

FAMA MODEL

This model compares the performance, measured in terms of returns, of a fund with the required return commensurate with the total risk associated with it. The difference between these two is taken as a measure of the performance of the fund and is called net selectivity.

The net selectivity represents the stock selection skill of the fund manager, as it is the excess returns over and above the return required to compensate for the total risk taken by the fund manager. Higher value of which indicates that fund manager has earned returns well above the return commensurate with the level of risk taken by him.

Required return can be calculated as: Ri = Rf + Si/Sm*(Rm - Rf)

Where, Sm is standard deviation of market returns. The net selectivity is then calculated by subtracting this required return from the actual return of the fund.

HISTORY AND PROGRESS OF MUTUAL FUNDS IN INDIA

Mutual funds have come a long way since the incorporation of Unit Trust of India (UTI) in 1963. Till 1987 UTI was the only mutual fund in India. In early 1990s, Government allowed public sector banks and institutions to setup mutual funds. State Bank of India and Canara Bank established their mutual funds followed by other financial institutions. Till 1993 there were 7 mutual funds, all established in public sector, which had launched 116 schemes with Rs. 8011crore assets under their management. 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 (Mutual Funds) Regulations 1996. A growth from Rs. 25 million assets under management (AUM) in 1965 to Rs. 3263.88 billion on 31st March 2007, is not a small achievement by any standards. According to Association of Mutual funds in India (AMFI), growth from a single player, single scheme industry to 30 player with 460 scheme is nothing but exceptional.

Capital Raised: Industry-Wise Classification

(Figure in Rs. Crore)

Industry	Jan-07		Jan-06		2005-06*		2004-05		2003-04	
	No.	Amt	No	Amt.	No.	Amt	No.	Amt.	No.	Amt.
Banking/FIs	1	997	2	2398	12	12439	12	11311	11	5428
Cement and Const.	0	0	0	0	11	1020	2	169	1	7.8
Chemical	0	0	0	0	2	128	4	128	7	522
Electronics	1	75	0	0	2	54	2	61	4	247
Engineering	0	0	0	0	6	1124	3	133	1	993
Entertainment	1	138	2	412	7	710	3	154	2	153
Finance	2	393	0	0	7	824	3	116	2	71
Food Processing	0	0	1	15	9	427	6	317	1	8
Health Care	0	0	0	0	10	651	2	109	1	14
IT	2	593	0	0	15	902	5	5095	9	804
Paper & Pulp	0	0	1	25	4	182	1	60	0	0
Plastic	1	6	0	0	0	0	0	0	0	0
Power	0	0	1	35	6	2164	2	5854	0	0
Printing	0	0	0	0	1	43	1	130	0	0
Telecommunication	0	0	0	0	0	0	2	25	0	0
Textile	2	344	2	104	13	771	0	0	4	61
Others	4	454	4	809	34	5944	12	4595	14	14964
Total	14	3000	13	3798	139	27382	60	28256	57	23272

*Source: SEBI Bulletin, * Revised figure*

The Table shows that there has been dominance of Banking/FIs industry in regard with the capital raised through mutual fund followed by other industries and power sector. But as per number of issues are concerned, large number of units have been issued by IT sector (15 in FY 2005-06), followed by Banking/FIs (12 in FY 2005-06) while other sector has always been one of the largest unit issuer, e.g., 34 in 2005 -06, 12 in 2004-05 and 14 in 2003-04. As whole, capital raised through issuing MF Units was Rs. 23272 crore in 2003-04, increased up to Rs. 28256 crore in 2004-05, further it came down to Rs.27382 crore in 2005-06.This down fall was mainly because of poor performance shown by IT and Power industries. Though there has been some degree of stability in mutual fund market because of commendable performance shown by Banking /FIs sector units. The market share of different industry in total capital raised has been changing, as it is clear from following table:

Percentage of Different Industry in Fund Mobilization through MF

Years / Industries	January 2007	2005-06	2004-05	2003-04
Banking/FIs	**33**	**46**	**40**	**23**
Engineering	0	4	0.5	4
Entertainment	4.6	3	0.5	1
Finance	13.1	3	0.4	0.5
IT	**19.8**	**3.3**	**18**	**3.5**
Power	0	9	21	0
Textile	11.5	3	0	0.5
Others	**18**	**28.7**	**19.6**	**67.5**
Total (in %)	100	100	100	100

Above analysis proves that Banking/FIs industry has emerged as the absolute leader of mutual fund industry in regard with the capital rose through issuing MF unit with having market share 46, 40 and 23 percent respectively in last three year starting from FY 2003-04 to 2005-06. The IT industry which had shown remarkable growth in FY 2004-05 with market share 18% came down poorly up to 3.3% in 2005 -06, though in Jan. 2007 its market share grew up to 19.8%. The total fund generated by MF in Jan. 2007 was Rs. 3000 crore out of which Rs. 997 crore was raised only by Banking/FIs industry which account one third of total market share.

GROWTH PATTERN OF MUTUAL FUNDS

Worldwide, Mutual Fund or Unit Trust as referred to in some parts of the world, has a long and successful history. The popularity of mutual fund has increased manifold in developed financial markets, like the United States. As at the end of March 2006, in the US alone, there were 8,002 mutual funds with total assets of over US $ 9.36 trillion.

Trends in Transactions on Stock Exchanges by Mutual Funds

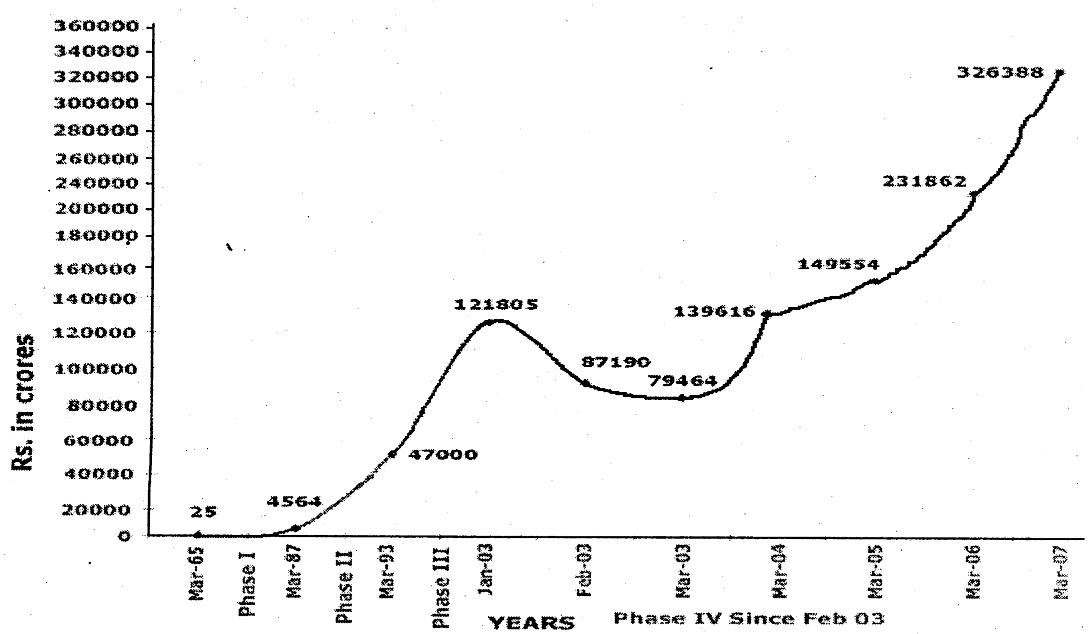
Period	Sales (Rs. Crore)		Purchases (Rs. Crore)		Net Invest. (Rs. Crore)	
	Equity	Debt	Equity	Debt	Equity	Debt
2000-01	20143	8489	11376	13512	-2767	5024
2001-02	15894	22624	1298	33584	-3796	10959
2002-03	16588	34059	14521	46664	-2067	12604
2003-04	35356	40469	36664	63170	1308	22701
2004-05	44597	45199	45045	62186	448	16987
2005-06	86134	73004	100436	109305	14302	36801
2006-07	126888	101190	135948	153733	9062	52544

Source: www.sebi.gov.in

Above data's clearly shows that there has been tremendous growth in trading volume of Mutual Funds on stock exchanges .The growth in the trading volume of Debt Fund has been significant. The total volume of sales, which was Rs. 8489cr only in the financial 2000-01 increased to Rs.101190cr. in 2006-07. Purchases of debt fund also registered significant increase during same period, it was Rs.13512cr. only in 2000-01which has reached at Rs. 153733 cr. during April 06- March07.As per the net investment is concerned ,during initial years of the present decade, it was poor for Equity fund market since it was negative in first three years, then it grew up to Rs. 9062 cr., during 2006-07, which was much below to net investment in Debt fund that show picture of Rs. 52544cr, during same time horizon.

GROWTH IN ASSETS UNDER MANAGEMENT

Following chart shows the growth of AUM in all four phases of mutual fund development in India:



Source: amfi

Above growth line shows that total AUM has boomed from Rs. 25 crores in 1965 to Rs 326388 crores at the end of 31st March 2007.Initially there has been very slow growth in starting phase of mutual fund business in India. Mutual fund industry had accelerated its growth since Feb. 2003 just after UTI scam; In Feb 2003 total AUM was Rs.87190 crores, which has been increased up to Rs. 231862 crores.

EFFECT OF PRIVATIZATION ON MUTUAL FUND INDUSTRIES

UTI enjoyed its monopoly in fund-based services especially in MF in India, nearly 23 years. Finally the year 1987 marked the entry of other mutual funds set-ups by LIC, GIC and Public sector banks. They gave necessary and needed boost to the industry. Privatisation has most telling effect on Mutual Fund Industry in India. Private players had brought dynamism through professionalism, product innovation and marketing technique to the industry and guide it towards higher rate of growth. The industry that had grown from Rs. 45 billion to Rs. 470 billion in the period of 1987-1993, has now boomed up to Rs. 3263.88 billion by 31st March 2007, it is because of operation of private player in industry. Private Player had covered significant share of industry since the establishment of Kothari Pioneer Mutual Fund, the first private sector mutual fund. It is private sector that transformed whole industry and brings internationalization in picture by joint venture with global players. Today private sector holds nearly 85% of totals assets under management, which is Rs.3263.88 billion today.

The emerging buzz in mutual fund industry is consolidation; intensifying competition has given the birth to this consolidation. This consolidation is an attempt to gain economizes of scale by reducing costs for providing better services to the customer. Merger and acquisition had left significant effect on the growth of MFs industry in India." bigger and better". Market share as per category as on June 2005 was as under–

Private Sector Indian	20%
Joint venture-predominantly Indian	20%
Joint venture-predominantly foreign	39%
Institution	2%
Bank Sponsored	19%
Total	**100%**

Source - AMFI

Above figure clearly shows the dominance of foreign-joint venture in total market share. Will the private player make industry more attractive and feasible for general investor? Will M & A stimulate the growth of industry or cause them to fall down like a house of cards due to their own weight? Time will tell us. Mutual funds should reach out to investors and develop tailor-made products to suit the specific need of retail investors. Mutual funds have introduced several plan e.g. Systematic Investment Plans, Systematic Withdrawal Plans, sectoral funds tax saver funds. MFs are not only coming with product innovation but also modernizing selling. Agents are leading in the distribution of Units; the distribution of mutual funds through specialized agencies and tie-ups with financial institution is a better idea because they possess large number of potential customers.

FUTURE OF MUTUAL FUNDS IN INDIA

Mutual fund Industry is in its young age in India, where conditions are much more favorable for its growth, with saving rate of about 32.4% and a booming economy. Followings are the major set back for the industry:

- The major set back for the industry is its penetration as only 13.7% unit holders come from rural households while 38% from urban households.
- Over conservation of fund manager also threatening the industry.
- Regulation of mutual fund industry is another key area. There should be a separate regulatory body to control the industry affairs since SEBI is over loaded by regulatory function as it has to extend its supervision over capital market. SEBI merely gets time to regulate the operation and management of mutual funds.
- Several controversies that took place (Alliance Capital Mutual Fund and Samir Arora) send clear message for the requirement of careful watchdogs for industry.
- Limit for MFs overseas investment is also an area where regulator must think, as at present it is only $150 million.

(Contd. on page 32)

However, it's ultimately the people who deliver results. Realising the benefits, which it can provide, the responsibility lies on the companies, as to how much importance can they or do they give to their HR.

CONCLUSION

Human resource accounting aims at (I) increased managerial awareness of the values of human resources, (2) better decisions about people, based on improved information systems, (3) greater accountability on the part of management for its human resources, (4) developing new measures of effective manpower utilization, (5) enabling a longer time horizon for planning and budgeting, and (6) better human resource planning.

HRA illustrates how intellectual conceptualization and empirical testing in academic settings can serve industry's practical needs. After a 30-year history of intellectual development, firms are initiating new projects involving the application of HRA. Accountants, lawyers, corporate acquisition specialists, and company management, including human resource professionals, are applying HRA. Now that firms have begun to apply HRA, its development might be expected to proceed at an increasing rate. At the same time, study needs to be undertaken on how HRA technology can be adapted and extended to the measure of various types of intellectual property. In addition to improving internal managerial decisions such as in layoffs, implementation of HRA will lead to better overall firm valuation techniques and better decision making in buy-sell-merge transactions.

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(Contd. from page 25)

The attitudes of Indian Investor are extremely apprehensive in regard to stock market investment. Several security scam and scandals harmed the faith of investor in the market. It is matter of strong communication strategy on part of market player that they should try to win the faith of investors. Good communication will create an environment of transparency and trust. After all it is not so very difficult for mutual fund to grow and create wealth mutually in India.

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