4
Investment and Investors’ Analysis

4.0 Introduction

In mutual fund organizations, the mutual fund trust appoints the ‘Asset Management Company’ (AMC) to look after the funds of trustees of mutual funds. AMC is in charge of funds management and allocation of assets of unit holders. Such allocation of assets is nothing but a judicious ‘investment’ of ‘resources mobilized’ from investors. Resource mobilization patterns and projections for the mutual fund industry and factors influencing resource mobilization were discussed in Chapter 3.

4.0.1 Theoretical background

Teynor and Mazuy’s (1966) study used the investment performance outcomes of 57 investment managers to find evidence of market timing abilities and found no statistical evidence that the investment managers of any of the sample funds had successfully outguessed the market. Michael C. Jensen’s (1967) study of mutual funds indicates that the selected funds are not able to predict security prices well enough to outperform a buy-the-market-and-hold policy. Fama (1972) devised a mechanism for segregating part of an observed investment return due to managers’ ability to pick up the best securities at a given level of risk from part that is due to the prediction of general market price movements. Bauman and Miller (1995) studied the persistence of pension and investment fund performance by type of investment organization and investment style. Bala Ramasamy and Yeung’s (2003) survey points to three important factors that dominate the choice of mutual funds. These are consistent past performance, size of funds and costs of transaction. Amit Singh Sisodiya (2004) explains that a fund’s performance when viewed on the basis of returns alone would not give a true picture of the risk the fund would have taken. Hence, a comparison of risk-adjusted return is the criterion for analysis.

In this context, this chapter examines the trends in investments by mutual fund organizations in India across various schemes and financial
instruments. The changes in investment pattern during the post-liberalization period, that is, 1993–2009, are also examined. It also focuses on guidelines issued by SEBI and AMFI with respect to investment practices of mutual fund organizations. Finally, the contributions to mutual funds by various categories of investors are presented across important categories of schemes suggested by AMFI.

4.1 SEBI guidelines on investment patterns of mutual funds

The Securities Exchange Board of India (SEBI) formulates policies and regulates mutual funds. It specified regulations in 1993 (fully revised in 1996) and issues guidelines from time to time. Mutual funds either promoted by public or by private sector entities, including those promoted by foreign entities, are governed by these regulations.

The notification of the SEBI (Mutual Fund) Regulations of 1993 brought about a restructuring of the mutual fund industry. An arm’s length relationship is required among the fund sponsor, trustees, custodians and asset management companies. This is in contrast to the previous practice where all three functions, namely, trusteeship, custodianship and asset management, were often performed by one body, usually the fund sponsor or its subsidiary. The regulations prescribed disclosure and advertisement norms for mutual funds, and, for the first time, permitted the entry of private sector mutual funds. FIIs registered with SEBI may invest in domestic mutual funds, whether listed or unlisted.

The 1993 Regulations have been revised on the basis of the recommendations of the Mutual Funds 2000 Report prepared by SEBI. The revised regulations strongly emphasize the governance of mutual funds and increase the responsibility of the trustees in overseeing the functions of the asset management company. Mutual funds are now required to obtain the consent of investors for any change in the ‘fundamental attributes’ of a scheme, on the basis of which unit holders have invested. The revised regulations require disclosures in terms of portfolio composition, and transactions through schemes of mutual funds with sponsors or affiliates of sponsors, with the asset management company and trustees, and also with respect to personal transactions of key personnel of asset management companies and trustees.

The SEBI-approved AMC manages the funds by making investments in various types of securities. Custodian, registered with SEBI, holds the securities of various schemes of the fund in its custody. The general power of superintendence and direction over AMC lies with the trustees. According to SEBI regulations, the number of independent directors among the directors appointed for trustee company should be two-thirds (of the total directors). They should not be associated with the sponsors. Fifty percent of the directors of AMC must be independent. All mutual funds are required to be registered with SEBI before they launch any scheme. Increase in load above the level mentioned in the offer document is applicable only to prospective