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Investment Management - P16MC41

Unit – V

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Unit – V

Investment Companies in India

Financial System

The financial system of a country consists of a network of financial markets, institutions, investors, services and regulators. A well fortified structure is able to encourage public and institutional support leading to an organized network of supporting financial markets.

The financial system comprises the following agencies:

1. Financial Markets
2. Financial Institutions
3. Banks
4. Financial Instruments
5. Market Regulators
6. Market participants

Structure of the Financial Markets

The financial system of any country comprises within its fold the financial markets and its supporting financial institutions. The financial markets which exist in India are:

1. Organised and Unorganised Market
2. Treasury Bill Market
3. Call Money Market
4. Commercial Bills Market
5. Market for Financial Guarantees
6. Market for Mortgages
7. Foreign Exchange Market
8. Government (Gilt-edged) Securities Market
9. Industrial Securities Market
10. Commodity Market

Financial Institutions

The various financial markets in the country which have been briefly described have several supporting financial institutions and development banks.

1. **Reserve Bank of India**

The Reserve Bank of India is the nerve centre of the monetary system of the country. It is the central bank of the country and it started operating since April 1, 1935 subsequent to the RBI Act in 1934 under private shareholders' institutions. The Reserve Bank of India is empowered to control, regulate, guide and supervise the financial system of the country through its monetary and credit policies.

2. **Commercial Banks**

The Commercial banks are the oldest institutions in the financial market in India. Commercial can be both scheduled and non-scheduled and in the public and private sector. Further they can be Indian and foreign banks.

3. **Universal Banks**

Universal Banks are the **one-stop** shops. These institutions sell a wide portfolio of financial products integrating commercial banking term lending, retail operations, investment banking, mutual funds and pension funds, insurance and underwriting of issues.

4. **Life Insurance Corporation**

The LIC was set-up in 1956 after amalgamating 245 companies and was governed by the Insurance Act of 1938 under section – 27 A. In 1980, this monolithic institution was again sought to be broken up into four units because of its widely structure and vast increase in business during the last 24 years.

5. **Private Life Insurance Companies**

Life Insurance has been extended to the private sector as well. A large number of new companies have been floated for providing life insurance cover.

6. **General Insurance Corporation**

GIC is governed by the Insurance Act of 1938 under section 27B. GIC was formed as a government company under section 9 of the General Insurance Business ACT 1972 and registered as a private company under the Companies Act 1956.

7. Unit Trust of India

The objective of setting up UTI was to encourage savings and to make available the benefits of equity investments to small investors to enable them to get a fair return on their investments with the benefit of having trustees to manage their investments.

8. Mutual Funds

Mutual funds came into existence with the issue of Master Shares by the UTI in 1986. The RBI provided guidelines on July 7, 1989 to govern the funds to provide measures of confidence to the investors.

9. Investment Companies

Investment companies in India find their origin in business houses. They provide finance mainly to companies belonging their associated industrial group. Most of these companies are not independent and owe their existence to another controlling company.

10. The Development Banks

The Development banks are special institutions have been essentially viewed as gap fillers. They are like artificial limbs specially instituted to compensate for the slow growth of the normal sources of finance.

11. Industrial Development Bank of India

The IDBI was set-up in 1964 as a subsidiary of the RBI. Subsequently it was de-linked and made an independent institution in 1975 under the Public Financial Institutions Act. It is now the apex special financial institution in the economy. Its objective is to strengthen the resources of financial institutions including banks.

12. Industrial Finance Corporation

IFC was set-up in 1948. It is a pioneer bank in India. Its main objective is to provide long and medium-term requirements of capital to industry. It does not give assistance for short-term purposes, i.e., for working capital or for repayment of existing liabilities but the

IFC encourages loans for setting up new industrial projects and also loans for expansions of existing units' diversification, modernization and renovation.

13. Industrial Credit and Investment Corporation of India

The ICICI was conceived as a 'private sector development bank' for providing 'foreign currency loans' and for developing 'underwriting facilities in the NIM'. It was set-up in 1955. The special feature of the ICICI was that it was to be privately owned and its assistance was to be given to private sector industries only.

14. State Financial Corporations

Many state level institutions have been set-up to provide assistance to State level industrial units but the SFCs were established as far back as 1951 under the State Financial Corporation Act with the specific purpose of being development banks for promotion and balanced development of each state.

15. Foreign Institutional Investors

Foreign Institutional Investors came into India in 1993 bringing with them a large volume of funds termed as 'hot money'. Although capital inflows into India and other developing countries from capital surplus countries encourages growth and provide finance in their investment programs they also bring certain inherent risks and problems. The countries receiving large inflows have felt several market related effects.

Unit Trust of India

Unit Trust of India is a significant financial institution in India. UTI started with an initial capital of Rs.5 crores contributed by RBI, LIC, State Bank of India and other financial institutions. The general supervision, direction and management of the units business is vested in a Board of Trustees consisting of Chairman, Executive Trustee and other Trustee Members.

i) Units Scheme

UTI sells units under various plans. There are the unit Scheme 1964, Reinvestment plan 1966, Children's Gift plan, Unit Linked Insurance plan 1971, Capital Unit scheme 1976 and Units Income Scheme 1985.

ii) Investments

UTI invests in industrial securities through direct subscriptions, underwriting and private placing. Among these methods, it prefers private placing. LIC has withdrawn from the capital market and UTI took its place as the single most dominating institution in the New issue market. UTI invest generally as a long term investor but it also invests in short-term market in the form of bridge finance, deposits with companies and call deposits with banks. It has also participated in LIC and GIC in participating certificates. UTI has also made inter-corporate deposits.

In recent years, UTI has provided assistance to priority sector projects and in backward areas. It has also diversified its investments towards a better and well-balance portfolio. These measure have helped the small investor to participate indirectly in the Industrial Securities market. The UTI has thus 'bridged' the gap between the corporate sector and small saving community.

The objective of the UTI continues to be mobilization of saving through the various schemes. It operates as a mutual fund. Its main interest is to control a large reservoir of funds and to invest these funds in corporate and non-corporate investments to get the maximum rate of return for its unit holders. It functioned as a monolithic institution in the public sector it had a dominating role to play in the Indian financial system.

In India it has been the sole mutual fund till 1987 and has emerged as a financial conglomerate. It introduced a large number of schemes ranging from the unit scheme of 1964 to cover every kind of need and requirement in the economy covering children, retired people, women, education, insurance, stock exchange, speculative investments, monthly income plans, charitable trusts and institutions. It has both open ended and close ended schemes.

iii) Capital Market Strategy

As an investment institution, UTI's investment pattern has been changing according to the economy's economic policies, changes in financial market and its own requirements of capital appreciation. Since, its inception in 1964 and until 1980 none-tenth of its total investment was in corporate securities. In order to maximize its income UTI changed its policy and around two-thirds of its investments were in corporate securities.

iv) Promotional role

UTI has co-promoted financial institutions like Credit Rating Information Services of India, Infrastructural leasing and financing services, Stock Holding Corporation of India, Housing Promotion and Finance Co. Ltd., Canfin Homes Ltd., Technology Development and Information Company of India Ltd., Tourism Finance Corporation of India, Over the Counter Exchange of India, UTI institute of capital market. These institutions have been promoted to meet the changing requirements of finance in the economy.

v) Crash of UTI

UTI had built a public image and gathered the confidence of the middle income group of people. The small saver invested in its flagship scheme called UTI 1964. UTI invested a large part of this money into equities of different companies. Since, these companies did not do well in business UTI began to face a cash crunch. In July 2001 it announced that the 1964 scheme had crashed out UTI could not fulfill its promise of giving a good return to the small investors. The falling of UTI shook the confidence of the small savers. In December 2001 a new scheme has been brought about by Government to bail out the investments of the small investor through restructuring from January 1, 2002. The units repurchase price would be based on Net Asset Value. UTI would repurchase units under the US-64 scheme.

Mutual Fund

Mutual Fund is a mechanism of pooling resources by issuing units to investors and investing their funds in securities to get a good return. Out of the returns received by investors, the mutual fund keeps a margin for its costs and distributes the profits to the investors. These funds have to be invested according to the objectives provided in offer documents. Investments in securities are spread across a wide cross-section of industries, sectors and thus the risk is reduced. Unit Trust of India was the first mutual fund started in India.

i) Structure of Mutual Fund

The structure of a mutual fund consists of the following:

i. Asset Management Company
ii. Sponsor
iii. Board of Trustees

iv. Custodian

ii) Features of Mutual Funds

Mutual funds provide an attractive investment choice because they generally offer the following features:

i. Management
ii. Small saver
iii. Liquidity
iv. Diversification
v. Analysis and Selection of Securities
vi. Professional Management

iii) Classification of Mutual Funds

The mutual funds operate under the advantages of (a) diversification (b) quality of management and (c) liquidity of funds. These companies are of different kinds. The most important difference between them is that of closed-ended and open-ended funds. The following classification is given of mutual funds:

1. Open-Ended
2. Closed Ended
3. Income Fund
4. Growth Funds
5. Dual Funds
6. Index Funds
7. Exchange Traded Funds
8. Money Market Funds
9. Municipal Bond Funds
10. Pension Funds
11. Off shore Funds
12. Balanced Fund
13. Gilt Fund
14. Sector Specific Fund
15. Tax Saving schemes
16. Fund of funds

iv) NET ASSET VALUE

Mutual Funds invest the money collected from the investors in securities market. Market value of securities changes every day. This is the reason that NAV also varies from day to day. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme of any particular date. NAV can be calculated as

$$\text{NAV} = \frac{\text{Value of Securities} - \text{Liabilities}}{\text{No. of Outstanding Units}}$$

v) Costs in Mutual Fund Investments

Mutual fund have different kinds of expenses in order to run the business enterprise. These costs are called operating costs. These costs are administrative expenses, consultation fess given to trustees and expenses on brokerage. The operating costs are deducted from the closing NAV assets. This cost is spread out on the unit holders as they receive a reduced NAV to cover the costs of the mutual funds.

$$\text{Expense Ratio} = \frac{\text{Total Annual Operating Expense}}{\text{Average Assets under Management}}$$

vi) SEBI and Mutual Fund Regulations

SEBI regulated the mutual funds to protect the interest of the investors. In 1996 new guidelines were issued to regulate the mutual fund investments in India. Some of the important provisions are:

- All mutual funds must be compulsorily registered with SEBI.
- The sponsors of mutual funds should have contributed a minimum of 40% of the net worth of the Asset Management Company and should have a record of good reputation in financial service for at least 5 years.
- All new mutual funds schemes have to approved by the trustees of the mutual fund.
- Mutual funds have to follow investment norms provided by SEBI to protect the investor from high-risk exposure.
- A report has to be published by the mutual fund for each new scheme that it launches.

- A mutual fund has to publish sale price and repurchase price of a unit in open-ended schemes at least once a week.
- The repurchase price of a unit should not be less than 93% of NAV and sale price should not be more than 107% NAV. In closed ended scheme the repurchase price should not be less than 95% of the NAV.
- SEBI permits mutual funds to participate in its Security Lending Scheme.
- SEBI permits mutual funds to invest in Indian and Foreign ADRs and GDRs within its guidelines.
- SEBI has provided that 90% of the mutual fund profits should be distributed every year and the earnings have to be shown as current income, short term capital gains and long term capital gain.
- To protect the investors SEBI can impose monetary penalties on mutual funds for violating regulations and guidelines.

Mutual Funds have many benefits for investors but there are other investments which lend diversification elements due to the features that they provide to an investor in terms of risk and return.

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