

Chapter 2: CONCEPT AND ROLE OF A MUTUAL FUND

2.1 Concept of a Mutual Fund

A mutual fund is a type of investment vehicle that pools money from many investors to purchase a diversified portfolio of stocks, bonds, or other securities. The combined holdings of the mutual fund are known as its portfolio. Each investor in the mutual fund owns shares, which represent a portion of the holdings of the fund.

Key Characteristics:

Diversification: Mutual funds invest in a variety of securities, which reduces risk compared to investing in a single security.

Professional Management: Funds are managed by professional fund managers who make investment decisions on behalf of the investors.

Liquidity: Mutual fund units can be bought and sold easily, providing liquidity to investors.

Accessibility: Mutual funds are accessible to small investors due to their low minimum investment requirements.

Regulation: In India, mutual funds are regulated by the Securities and Exchange Board of India (SEBI) to ensure transparency and protect investor interests.

Quiz Questions:

What is a mutual fund?

- A. A savings account with a bank
- B. An investment vehicle that pools money from investors to buy a diversified portfolio of securities
- C. A fixed deposit in a company

Answer: B

Who manages the investments in a mutual fund?

- A. Individual investors
- B. Professional fund managers
- C. Bank clerks

Answer: B

2.2 Classification of Mutual Funds

Mutual funds can be classified based on various criteria:

By Structure:

Open-Ended Funds: Investors can buy and sell units at any time at the current Net Asset Value (NAV).

Close-ended Funds: These funds have a fixed maturity date and units can only be bought during the initial offer period. After this period, units can be traded on the stock exchange.

Interval Funds: These funds combine features of both open-ended and close-ended schemes. They are open for purchase or redemption at specific intervals.

By Investment Objective:

Equity Funds: Invest primarily in stocks and aim for capital growth.

Debt Funds: Invest in fixed-income securities like bonds and aim for regular income.

Hybrid Funds: Invest in a mix of equity and debt to balance risk and return.

Money Market Funds: Invest in short-term instruments and provide high liquidity with low risk.

By Specialty:

Sector Funds: Invest in a specific sector of the economy, like technology or healthcare.

Index Funds: Track a specific index like the Nifty 50 or Sensex.

Fund of Funds: Invest in other mutual funds.

Quiz Questions:

Which type of mutual fund can be traded on the stock exchange after the initial offer period?

A. Open-ended funds

B. Close-ended funds

C. Interval funds

Answer: B

What type of fund aims to provide high liquidity and low risk?

A. Equity funds

B. Debt funds

C. Money market funds

Answer: C

2.3 Growth of the Mutual Fund Industry in India

The mutual fund industry in India has seen significant growth over the years, driven by increasing investor awareness, regulatory support, and the rise of the middle class.

Key Milestones:

1963: The Unit Trust of India (UTI) was established, marking the beginning of the mutual fund industry in India.

1987-1993: Public sector banks and financial institutions were allowed to set up mutual funds.

1993: The mutual fund industry was opened to the private sector, leading to the entry of many domestic and international players.

1996: SEBI introduced regulations to ensure transparency and protect investor interests.

2000s: The introduction of systematic investment plans (SIPs) made mutual funds more accessible to retail investors.

Recent Years: Digital platforms have facilitated easier access to mutual fund investments, contributing to rapid growth in assets under management (AUM).

Factors Contributing to Growth:

Regulatory Framework: Strong regulations by SEBI have boosted investor confidence.

Financial Literacy: Increased awareness and education about mutual funds among investors.

Economic Growth: Rising incomes and savings have led to higher investments in mutual funds.

Technology: Online platforms and mobile apps have made investing in mutual funds convenient and accessible.

Quiz Questions:

When was the Unit Trust of India (UTI) established?

A. 1963

B. 1987

C. 1993

Answer: A

Which regulatory body oversees the mutual fund industry in India?

A. Reserve Bank of India (RBI)

B. Securities and Exchange Board of India (SEBI)

C. Ministry of Finance

Answer: B