

Corporate Governance in Mutual Fund Industries

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A Case Study of Selected Mutual Funds

ABSTRACT

Mutual funds are a vital component of the financial markets for mobilization of savings. Their tremendous popularity in the North American continent is well known. Mutual funds have also progressed significantly in emerging economies. Several new products have been introduced and a number of others are in the pipeline. The Indian mutual fund industry is poised for significant growth in the next years. The success of the business will lie in several factors, one of which will be the role of regulators and their efforts to evolve the code of corporate governance and best practices for the mutual fund industry. SEBI has played a vital role to mutual fund units and guided small investors. Indian economy is under going fast change in all its constituents. The markets have become highly competitive and knowledge economy requires more transparency and accountability into the mutual funds. Good corporate governance increases the confidence of investors, who are more diversified today and have different informational requirements. Corporate governance boosts the development of capital markets." This paper reviews corporate governance in mutual funds and its impact on investor's trust in mutual fund.

1. INTRODUCTION

A large number of studies have been conducted in India and abroad covering different aspects of mutual funds. These include descriptive and empirical studies dealing with mutual fund as a whole or covering some of their specific aspects. The review of the empirical studies here has been undertaken to earmark the problem areas related to mutual funds as well as to study about the different parameters that have been used, generally for measuring performance of mutual funds so far.

Mutual fund units are investment vehicles that provide a means of participation in the stock market for people who have neither the time nor the money, nor perhaps the expertise to undertake direct investment in equities successfully. On another hand they also provide a route into specialist markets where direct investment often demands both time and knowledge than an investor may possess.

2. CORPORATE GOVERNANCE IN INDIAN CONTEXT

In India the concept of corporate governance is gaining importance because of two reasons.

- A) After liberalization, there has been institutionalization of financial markets, FIIs and FIs become dominant players in the stock markets. The market began to discriminate between wealth destroyers. Corporate governance is a critical byproduct of market discipline.
- B) Another factor is the increased role being played by the private sector. Companies are realizing that investors love to stay with those corporate that create values for their investors. This is only possible by adopting fair, honest and transparent corporate practices.

3. CORPORATE GOVERNANCE AND ITS VALUE

The company is committed to follow the best practices in the area of corporate governance. The company believes that proper corporate governance facilitates

effective management and control of business. This, in turn, enables the company to deliver the optimum results to all its investors. The objectives can be summarized as:

- To enhance investors' value.
- To protect interests of investors and other stakeholders including customers, employees and society at large.
- To ensure transparency and integrity in communication and to make available full, accurate and clear information to all concerned.
- To ensure accountability for performance and to achieve excellence at all levels.

4. CURRENT STATE OF MUTUAL FUND INDUSTRY

These are days of volatility in financial markets. World is facing recession. Currencies market is also volatile. Rate of Rupee against dollars, euro and other currencies are changing rapidly. Average Indians are considerably conservative in financial planning. Most Indians save for future and invest regularly. Bank fixed deposits (FD) were traditional investment vehicle but in changing times interest rates has fallen a lot and returns are low and it even exposes a danger of capital erosion due to high inflation so investors has started taking interest in other options. Securities, Mutual funds, Insurance schemes, ULIP are other investment options.

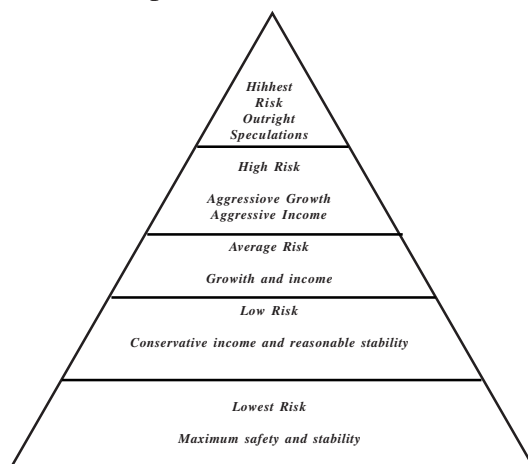


Figure- Familiar Investment Pyramid

Bank FD comes at bottom of pyramid (Lowest risk and low returns) and securities towards top in pyramid. Investment in securities requires good amount of regular studies about companies, their performance, and their strategy along with market trend. Average investor neither has time to do extensive research nor is everyone has understanding of complexities involved in securities. Mutual funds offer a good alternate to investor instead of direct investment in securities. Financial experts in these mutual funds companies collect funds from investors and manage portfolios on their behalf. A proven principle of sound investment is – do not put all eggs in one basket. Mutual funds have large collected pool of funds so they can invest in large basket of shares in different companies. Thus by investing in diverse companies, mutual fund can protect against unexpected fall in value of investment. Despite these advantages of mutual funds, ratio of investors in mutual fund against total number of investors is still low and mutual funds see an opportunity to enlarge investor base.

As investor base is not financial expert and to convince more people to invest in mutual funds it is necessary that corporate governance of Mutual funds are excellent so that people trust their funds and does not lose confidence in mutual fund industry due to poor record of Mutual funds. In next section we would analyze reasons of withdrawal from Mutual fund and their relations with corporate governance.

5. REASON FOR WITHDRAWING INVESTMENT IN MUTUAL FUNDS

The performance of any mutual funds depend upon two major factors :- the trend in the capital market of the country and effectiveness of fund managers' to time the market. It has been observed that mismanagement of funds in UTI and black listing of mutual

funds like CRB capital compelled majority of investors to pull out their investment from mutual funds. The study revealed various reasons which are given in the table, based on survey.

An analysis of the responses shown in the table indicates that investors have assigned great significance to the reasons 'regulatory bodies like SEBI and others have not been able to control funds properly', 'return from mutual funds have been less than expected' and 'insecurity of investment due to connivance between fund managers and corporate houses' have been rated as most important in that order that result in their repulsion investment in mutual funds.

In an effort to improve the transparency of stock market operations, the Securities and Exchange Board of India (SEBI) has come up with the code of ethics for the directors and senior officials of the respective stock exchanges

in the country. SEBI has made it compulsory for all stock exchange directors in India and their officials should disclosed personal trade transactions as a result thereof now all elected and not elected directors and officials of the stock exchanges are providing the information about their personal trading with certain periodical. SEBI is taking strict action against those mutual fund managers' who are not following the code of corporate governance. A number of important governance reforms are been adopted and implemented by the stock exchanges not only in India but also in abroad.

Corporate governance against the backdrop of the globalization has become a delicate and onerous task for survival as well as for seizing the opportunities. It is the general opinion that all organizations and their managers will be forced to re-examine their approaches to management-

TABLE
Reason for withdrawing investment from mutual funds

REASONS	SA*	A	NANDA	DA	SDA*	WAS
Returns from MFs have been less than expected	39(36.8)	53(50.0)	12(11.3)	2(1.90)	0(0.0)	1.22
Regulatory bodies like SEBI and others have not been able to control funds properly	49(46.2)	41(38.7)	12(11.3)	4(3.80)	0(0.0)	1.27
Professionally expert managers have under-performed.	21(19.8)	54(50.9)	27(25.5)	4(3.80)	0(0.0)	0.87
Growth in the unit value has been very slow	26(24.5)	58(54.7)	19(17.9)	2(1.90)	1(0.90)	1.02
Insecurity of investment due to connivance between fund managers and corporate houses	39(36.8)	42(39.6)	19(17.9)	6(5.7)	0(0.0)	1.07
Non understanding of certain technical terms and conditions permitting abrupt withdrawal of scheme by the funds	20(18.9)	37(34.9)	38(35.8)	10(9.40)	1(0.90)	0.61
Absence of any law regarding participation of fund holders in decision concerning portfolio selection	27(25.5)	45(42.5)	25(23.6)	9(8.50)	0(0.0)	0.85
Grievance redressal has not been effective	14(13.2)	45(42.5)	36(34.0)	11(10.4)	0(0.0)	0.58
Management cost charged to the funds have been high	33(31.1)	41(38.7)	36(24.5)	5(4.70)	1(0.90)	0.94

Source : Questionnaire and Interview * SA = Strongly Agree, ** SDA = Strongly Disagree.

audit the skill base, recalibrate their performance and learn new behaviour. Good corporate governance cascades from a set of core values that need to be instilled at all levels of the organization. The quality of governance will become one of the key tests and one of the major drivers of unit holders value. Better governance would facilitate easier access to capital from domestic market. A transparent regulatory framework and better disclosure systems are crucial for attracting foreign investors as well.

6. PROSPECTS OF MUTUAL FUNDS IN INDIA

The study has shown the following conclusions regarding future prospects of mutual funds as below:

a). Although half of the existing investors in survey have decided to opt out of the mutual funds, other half still wants to continue with their investments in mutual funds. Also about 20% of investors surveyed fall in the category of new comers interested for making fresh investment in mutual funds. No doubt, the experience as regards returns on investment from mutual funds of majority of investors has been shaky, but the role of SEBI and the management of the funds by professional managers, too have been equally criticized overall responses of the investors have been mixed.

b). Performance evaluation of only five most preferred mutual funds conducted in this study reveals as on one hand UTI and Templeton India fund have underperformed but on the other, funds namely, Alliance Capital India, Prudential ICICI and Pioneer ITI have posted reasonably good performance too. Further the fact that last few years have been quiet turbulent for the capital markets all over the world, including India cannot be ignored. Also the fund managers cannot escape the responsibility for poor fund management. On the whole performance of mutual funds, too, has been mixed.

c). SEBI and other controlling bodies of capital markets have started monitoring the market movements more closely. A consistent effort is being made by them to refine the working of capital markets and mutual funds. This is expected to go a long way in reviving cost confidence of small investors in mutual funds.

d). Last but not the least, the managers of these mutual funds needs to sharpen their skills further so to manage the pooled money in a professional way. Market timing, during both the bull and the bear run, is the sole factor that would ensure their long term survival in the trade.

7. SETTING UP GOVERNANCE COUNCIL

Corporate governance success depends upon the manner mutual funds are evaluating the effectiveness of members of funds and choosing their chief executive officer. But now in order to improve corporate mutual funds have taken initiatives in this regard. The setting up of a 'Governance Council' by UTI mutual funds is a case in point.

8. CHANGING FACE OF AUDIT COMMITTEE

Earlier the audit committees were required to undertake primarily three functions:

- Review annual accounts and audited statements,
- Review the findings / reports of the internal audition, and
- Maintains an appropriate interface with the management.

But today because of increasing complexity in the mutual funds, regulatory requirements and public pressure on disclosure and transparency requirements the face of audit committee has been changed. Now audit committees, in addition to the above, are performing many more functions such as:

- To seek information from members when required,
- To obtain outside legal and other professional advice,
- To investigate any activity within its terms of reference,
- To secure attendance of outsiders with relevant expertise if it consider necessary,

Thus the new face of audit committee states that mutual funds are ensuring more transparency, fairness and disclosures in their operations. With the corporate governance gaining popularity and importance as a tool for investors, various credit rating agencies have announced to rate Indians mutual funds for their corporate governance compliance. One of the important requirements, of corporate governance is the sharing of quality information with stakeholders

SEBI is taking strict actions against those mutual funds which are not following code of corporate governance. In this direction SEBI has suspended trading in such mutual fund unit, cancellation of registration, monetary penalties and warnings to such units. To increase transparency, SEBI has eliminated use of entry load to cover marketing and distribution costs as various salesman used to promote funds on basis of commission offered

• on sale rather than merits of funds. A number
• of important governance reforms are being
• adopted and implemented by the stock
• exchanges not only in India but also in
• abroad. Such important steps of SEBI has
• improved the transparency of stock
• exchanges and created the investors'
• confidence thus the position of corporate
• governance has also improved. The banking
• sector plays a significant role in mobilizing
• and allocating resources.

9. CONCLUSION

• Mutual funds caught my fascination
• towards the end of the last decade when a
• story about malfunctioning of UTI, the first
• mutual fund institution in India, broke out in
• media. Researcher had the opportunities to
• know the views of some petty investors of
• the capital market except one or two, ever
• confirmed about being successful with their
• direct investments in mutual fund units.
• Mutual funds became to be accepted by
• general investor as better resource allocator
• somehow. Today good governance is needed
• to create a corporate culture of
• consciousness, transparency and openness. It
• is a combination of laws, rules, regulations,
• procedures and voluntary practices; which
• enable the mutual funds to maximize their
• returns and their value.

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