# CHAPTER-III

## - GROWTH OF INVESTMENT TRUST AND - UNIT TRUST OF INDIA

In this Chapter the nature of investment trusts, their object, characterstics and classification are outlined in short. The origin and development of Unit Trust, its nature, features are examined. Similarly the historical background for the formation of Unit Trust of India and its distinguishing features are described here.

### 3.1 INVESTMENT TRUST :- Meaning :-

Investment Companies - or investment trusts as they are often known - are financial institutions which obtain funds from a large number of investors through the selling of shares and debentures. These funds are then placed in a pool under professional management, and securities (Financial Assets) are purchased for the benefit of all the shareholders. While investments in the fund may be made by either large or small savers, the investment company exists primarily to offer the small saver a means to diversify assets portfolios in a manner attainable except with a very large portfolio. [1]

Thus the investment trust does not carry any trading or industrial activities, but it simply carries on the financial activities. Thus it is one of the financial intermediaries which mobilises the savings of the society and channelizes the same to industrial investment.

## 3.2 NATURE OF INVESTMENT TRUST :-

Investment trust is an institution which is primarily engaged in the investment, disinvestment and reinvestment of the securities. An investment trust is defined by HOAGLAND, - "The trust collects investible surpluses of a large number of people and invest them in a diversified group of securities in order to distribute the risk involved." [2] Investment trusts and companies have the common purpose of pooling the funds of individual investors and diversifying the resultant investment. Robinson defines, "An investment trust is an agency by which the combined funds of different participants are placed in securities showing a distribution of risk such as to introduce the 'Law of average' in protection of the principle and which aims solely at the safe and resonably profitable employment of the subscribed investment funds, while definitely avoiding any and all of these responsibilities of control, management, finance, direction or special interest which are sometimes tied in with investment." [3]

Thus investment trusts are formed in public limited as well as Private Limited companies issue their shares or bonds for the sale to their share-holders, and they buy securities of varied industries not to the control but only for investment. Interest and dividend received from these investment, and such amount distributed amonges their own securities.

## 3.3 OBJECTS AND CHARACTERISTIC FEATURES OF INVESTMENT TRUST :-

i) Objects :- The following are the important objects of investment trust -

1) The formation of investment trust to service a large number of small investors.
2) To mobilise their investment in various portfolios for their benefits.
3) Provide the advantages of an experienced management.
4) It mobilise small savings of investors through the issue of shares and debentures.

5) To invest it into the securities of various industries.

ii) <u>Characteristics</u> :-

From the various deffinations and description of investment trust, its vital characteristic features are as under.

1) The investment trusts are the financial intermediaries. They mobilise the savings of the society through sale of units or issue of shares and debentures and proceeds are utilised for the investments in shares and debentures of different companies.
2) They deal in the corporate securities. Their Stock-in-trade is various corporate securities. They constantly change their investment portfolio through investment, disinvestment and re-investment of different securities on the basis of their expected profitability.
3) The investment trusts are not interested in controlling the corporations in which they have an investment, and this is exactly where they must be distinguished from holding companies.
4) Investment trusts keep a constant watch on the

operations of client organisations to ensure that their funds are safe and intact.

5) Investment trusts try their utmost to get for their clients a higher return on their savings than would be possible for the latter, if they invest on their own.

From the above discussion it is clear that, the investment trust aims to afford investors greater safety of principal and greater return on their investment than would be possible by individual investment. It accomplishes its purpose through diversification of risk and skillful management of securities.

## 3.4 TYPES OF INVESTMENT TRUST :-

Investment companies or trusts fall into two general categories :-

i) Closed-end companies or trusts.

ii) Open-end companies or trusts.

i) Closed-end companies :- These companies operate in much the same fashion as any industrial company. It issues a fixed number of shares which may be listed on a stock exchange and bought and sold like any company's shares. The price of its shares is not related to the asset value, but it is determined by supply and demand in the market. There is no provision for issuance or redemption of shares on day-to-day basis.

ii) Open-end companies :- These companies raise capital through issue of shares, which are not trades on stock exchanges, but handled by specified dealers in over-the-counter transactions. The money collection from the sale of shares is invested directly in the shares of other companies. Agreement is made with the shareholders to purchase shares from them at the prevailing net asset value per share. Such types of investment trusts are more popular in U.S.A. known as "Mutual Investment Funds". And that such type of investment company in India is the Unit Trust of India. Fixed investment trust also called unit trusts.

## 3.5 ORIGIN AND HISTORICAL GROWTH OF INVESTMENT TRUSTS :-

### i) In other Countries :-

The investment trust has long existed in certain European countries, where it was organised as a means of facilitating the marketing of foreign securities.

It was expected that this institution would play a similar role in the United States; but the trend has in fact been otherwise.[4] The origin of the investment trust may be traced to the formation of the "SOCIETE GENERALE DE BELGIQUE" in the first quarter of the nineteenth century in Belgium this institution was formed by the royal family of Holland before the separation of Belgium and Holland. [5] The investment trust made considerable progress in Switzerland, but had little success in France, Germany or the rest of continent. Its greatest growth took place in Great - Britain in the third quarter of the century. [6] The first investment trust, the Foreign and Colonial Government Trust, was founded in London in 1868, Scottish American Investment Trust established in Dundee in 1873. The investment trust movement in U.S.A. was not developed until after the I World War. The period between 1925 and 1929 witnessed substantial expansion in the movement.

ii) <u>In India</u> :-

In India, investment trust developed only after 1930. The late and slow development of investment trust in India is caused by late industrialization, slow economic growth, unorganized capital market and poor growth of joint stock companies. The Central Banking Inquiry Committee highlighted the poor growth of investment trusts in India and emphasized the need for their development. The committee observed that "an immeasurable benefit to India is bound to grow from the establishment of investment trusts and the assistance which they will give to the investor in the creation of intermediate securities which do not exist now in providing channel for investment industrial and other fields where the primary investor would be too scared or too ignorant." The investment trusts or companies were established in India only in recent years. The first investment trust in India, The Industrial Investment Trust Ltd. started in Bombay in 1935 by the well-known firm of M/s Premchand Roychand and Sons. But, it must be noted that the well-known managing agency firm of Bird and Co. of Calcutta had actually been the first in the field with two investment trusts viz. the Investment and Finance Co. Ltd., which was registered as a private Limited Company in 1896, and the General Investment and Trust Co. Ltd., which was registered in 1908. Following the establishment of the Industrial Investment Trust in Bombay, two important investment trusts were set up in Calcutta in

1936 viz. the New India Investment Corporation Ltd. (under the auspices of M/s Ramdutt Ramkissendas), and Birds Investment Ltd. (with which the managing agency firm of Bird and Co. was associated). Various Investment trusts have been established since then in Bombay, Calcutta, Madras and some Centres in Northern India. Mostly the Investment Trusts were started by the industrial groups like Tata, Birla, Dalmia, Goenka, J.K.Group etc. [7] The Tata promoted the Investment Corporation of India and Tata Investment Trust. The Birlas promoted the New India Investment Corporation and The Hindustan Investment Corporation. The Goenkas promoted the Jaipur Investment Company and Calcutta Investment Company Ltd.

During the Second World War, the movement received further impetus because the important managing agency firms took initiative informing new investment trusts. For Example - Tata, Birla, J.K.Group etc. started their own investment trust companies. But after passing of companies Act, 1956 trust movement slowed down further due to restrictions on developments. At the end of March 1957, there were 619 investment and trusts companies with a paid up capital of Rs. 37 Crores. From 1947-48 to 1955-56 number of investment companies increased from 465 with paid up capital of Rs. 17.7 Crores to 626 with paid capital of 36.9 Crores. At the end of 1957, the number investment trust companies decreased by 7 over the number of March 1956. This might have due to the restrictions laid down by the companies Act, 1956, on investment.

According to RBI study, 'Investment Trusts' published in R.B.I. Bulletin, Oct. 1960 there were 595 investment companies with paid up capital of Rs. 37.70 Crores in 1958-59. In Aug. 1963 the Dept. of Company Affairs, Government of India, compiled for the first time a complete list of investment companies in an unpublished brochure entitled "Investment companies at work in India". According to this estimate 524 companies having a paid up capital of Rs. 42.28 Crores in 1960-61 might be classified as investment companies. [8] In 1973 Aradhava Investment Ltd. Bengal was formed, his capital is Rs. 60,00,000 in 6,00,000 equity shares of Rs. 10 each. In 1974 Blue Horizon Investment Ltd., Calcutta, Deccan Finance Ltd. - 1980. [9] These are the investment companies formed in India.

In India investment companies in the private sector are close ended companies; but most of them are often not genuine. Being closely associated with the managing agency houses, investment and trust companies in India have been made use of in many cases to finance or control companies in which these houses were interested. Most of these companies are really finance companies, for their main activity is financing other companies, trading in shares, guaranteeing loans, mortgage lending, debentures, hire-purchase etc.

## 3.6 NATURE OF UNIT TRUST :-

A unit trust is a new type of investment trust gaining more popularity in many countries. "Unit trust is to mobilise savings and invest them in industrial securities with the object of providing a good return to savers and to reduce the risk of losses by diversifying investment". It is a legal constitution which may be used in the administration of simple financial operation namely the pooling of a large number small unequals in a common fund to be invested by skilled managers.[10] Unit Trusts - often called open-end investment companies or mutual funds, as they are designated in the U.S.A. - continuously offer their shares or units for sale to the existing or new investors. This fund is then invested by the professional manager on the stock exchange. Therefore it is simply a joint co-operative venture in investment.

## 3.7 FEATURES OF UNIT TRUST :-

The above telling in words of unit trust gives an intention of its following important features :

A) In the formation of unit trust there are three parties viz. the Management Company, the trustee, and the unit holder. The management company participates as distinct entry from the trust conducts. The trustee is usually a well known banker or insurance company. The unit holder occupies the beneficiaries under the trust deed.

B) The prices of units at which the unit trust will sell and buy are calculated in accordance with a formula laid down in the trust deed.

C) The owner of these units are entitled to the appropriate share of the profits earned by the trust.

D) The units can be resold to the trust whenever the investor wishes to do so.

E) Unit trust is not the security issuing body because, there is absence of the power to borrow money through the issue of debentures. Therefore, there is no borrowed capital in the unit trust.

F) Unit trust is constituted by a trust deed. It covers the main aspect of the running of the trust. The trust deed must be approved by legal authority. For Example, in England, the trust deed is approved by the Department of Trade and Industry.

## 3.8 HISTORICAL DEVELOPMENT OF UNIT TRUST :-

Unit trust were mostly developed in many parts of the world. It is firmly established in the U.S.A. at the end of the decade of 1920's and in U.K. in 1968, Canada, Switzerland, Australia, Japan and South Africa. The historical development of unit trusts in the advanced countries particularly in U.K. and in U.S.A.

i) United Kingdom :- In 1868, the first unit trust was started in this country by the name "The Foreign and Colonial Government Trust", but in 1879 this trust was held illegal.

In the period from 1870 to 1930 more than 200 investment trust were established but with the outbreak of Great Depression in 1929, many of these failed. This led again to a move back to the fixed type of investment trust with the result a flood of fixed or Unit Trusts began in 1931.

In 1934, the Foreign Government Bond Trust was established in flexible trust. The beginning of 1938 there were 73 unit trust, and by the beginning of 1973 there were 347 authorised unit trusts managed by 90 different management companies in United Kingdom. [11]

ii) United States of America :- Unit trusts in U.S.A. are called mutual funds or open-end companies. Their real development took place only after the Great Depression 1929. But even before that, the movement of fixed Trust had taken place.

The development of Fixed Investment Trust in U.S.A., had connection with some of the Scottish investment trust companies, with their aspiration, the first American Trust Company was formed in 1873 which made available to the investors investment in American Railway Mortgage Bonds. In 1893, Boston Personal Property Trust was formed. Then in 1923 the first fixed trust, called "United Bankers Oil Company", was formed. Thereafter the first open-end investment company called Massachusetts was formed in 1924. During 1930 there are 100 fixed trusts were formed in that year. 1932 can be marked as the year during and after which almost all newly organised investment companies for the next quarter of a century took a form of 'Mutual', since then they came to be known as "Investment Companies". Then it was realised that the investors required legal protection against past abuses of investment trust. So considering the recommendations of Security and Exchange Commission, 1936, the Investment Companies Act was passed in 1940. At the end of year 1975 there are 423 mutual investment companies in U.S.A. [12]

iii) <u>India</u> :- Compared to the U.S.A., U.K. and Japan Unit Trust in India came rather late. The investment companies and trusts are more popular in European countries, but the investment companies in India were really not performing the role of intermediaries between the small and moderate savers and investors. So, need for establishing unit trust of investing institution was acutely felt as early as in 1931, and recommended by the following three committees to the Government of India.

III-A Indian Central Banking Committee headed by Manu Subhedar : The Committee observed that an immeasurable benefit to India is bound to grow from the establishment and proper working of Unit Trust and the assistance which they will extend to the investors in creating intermediate securities which does not exist at present, also in providing a channel for investment in industrial and other fields where the primary investor would be too scared or too ignorant. [13]

III-B <u>Shroff Committee</u> :- The Shroff Committee on finance for private sector 1954, recommended the case for the establishment of unit trust in India. The report of the Committee says, "Unit trust are eminently suited to the catering for the middle and poorer classes; whose individual savings may not be large enough to make direct operations much easier on the stock exchanges. The unit trust will catter to the needs of poor people having meagre income. Also since each unit represents a fraction of a number of securities. The risk undertaken by an investor in a unit is spread over a number of securities and is thus minimised. It is also advantageous in as much as the actual operations in buying and selling securities conducted by the specialised management company on behalf of unit holders. [14]

III-C A study of Reserve Bank of India also pointed out [15] "Investment trust in India have not so far played any important role either in the promotion of savings or in the channelling of such savings into investment." There is also the need for a fairly large organisation on a country wide basis on the lines of the network of organisation and selling techniques of the U.S. some of more prominent industrial houses, brokers, firms and insurance companies would seen to be oppropriate agencies to organise and sponsor unit trust in India.

It was also thought that apart from the mobilisation of savings of the relatively small investor, the formation of unit trust would also contribute to the democratisation of industrial ownership. Similarly in the task of mobilisation of large resources for progressively bigger plans, the need was felt for the creation of new financial intermediaries which will appeal to the varies interests and preferences of investing public.

Relying on the recommendations made by there three committees the Government of India decided to mobilise the savings of people into productive investment so as to give thrust to industrial growth in the country. And Unit Trust of India came into being and thus the dream was materialised when Unit Trust of India was duly established in 1964. The recommendation of the three committees consisting of eminent experts gave rise to Unit Trust of India, a financial institute working in investments of all kinds.

## 3.9 UNIT TRUST OF INDIA :-

The Unit Trust of India is statutory Public Sector investment institution, which was established on February 1, 1964. According to the Unit Trust of India Act 1963, was enacted by Parliament in December 1963 With view to encouraging savings and investment and enabling small savers to participate in capital appreciation in the economy and obtain a good return on their savings. The Unit Trust of India, actually commenced its operations with effect from July, 1964, with an initial capital of Rs. 5 Crores raised by Reserve Bank of India, State Bank of India, Life Insurance Corporation of India and Scheduled Banks and other special financial Institutions. [16]

Prior to 16'th February 1976 the trust was an associate institution of R.B.I. which held half of the initial capital and was also given several powers under the Unit Trust of India Act 1963. But as a result of various amendments to the UTI Act, made by the Public Financial Institution Laws (Amendment) Act 1975, the trust became an associate institution of Industrial Development Bank of India, (which itself was delinked from the R.B.I. from the above date). [17]

The Unit trust raises the financial resources through the sale of units under the open-end and close-ended schemes. These savings are then invested in the shares and debentures of various companies for the benefit of unit holder according to the provision of the Unit Trust of India Act - 1963.

The basic principle underlying the establishment of the trust is to afford the small investor a means of acqu ring a share in the industrial growth of the country with the minimum of risk and resonable return.

## 3.10 OBJECTIVES OF UNIT TRUST OF INDIA :-

The basic objectives for which UTI was established will be clear from the following.

While, the former Union Finance Minister Mr. T. T. Krishnammachari introducing the bill for Unit Trust of India in Nov. 1963, he point out that the basic idea underlying the creation of Unit Trust, as with similar trusts in other countries, is to afford the small savers a means of acquiring a share in widening prosperity based on steady industrial growth of the country through providing facilities for investment which combines the benefits of wide diversification, a resonable return and expert services of management talent. [18] Similarly, while inaugurating the sale of units to public, the finance Minister also observed that "the basic idea behind the setting up of the unit trust was to promote savings and investment habit among the people. [19]

From the above, its twin objectives are :-

i) It mobilise the savings of the community and channelises them into productive investment. By promising savers triple benefits of safety, liquidity and profitability of investments, the Trust encourages individual savings.

ii) It gives every one a chance to indirectly own shares and debentures in a large number of select companies and thus enables the investors to share in the widening prosperity of industrial growth.

These two-fold objectives would be achieved through a three-fold approach :-

A) By selling Units of the trust amonges many investors as possible in different parts of country and Non-resident Indians and other persons resident out side India.

B) By investing the sale proceeds of the Units and also the initial capital fund of the Rs. 5 Crores in industrial and corporate securities.

C) By paying dividends to those who have bought the units of the trust.

It also aims at inculcating the habit of savings and investments among the people.

3.11 FEATURES OF UNIT TRUST OF INDIA :-

Majority of the Unit Trusts in the world are mutual societies and they are working very well in the sphere of pool the savings from small investors. The Unit Trust of India was formed on U.K. and U.S.A. pattern of unit trusts.

Special features of U.T.I. :-

1) UTI is the first financial institution established in public sector under the Unit Trust of India Act 1963.

2) The management of the UTI, is run by a Board of Trustees, consisting of specialists in industry, banking, finance and investment, manages the affairs of the Trust. The Chairman of the Board is appointed by the Central Government while other members are appointed by Industrial Development Bank of India, Reserve Bank of India, Life Insurance Corporation of India, State Bank of India, Commercial Banks and certain other financial institutions who have contributed to the initial capital of the Trust.

   The Head Office of UTI is in Bombay, and four Regional Offices is set up in Bombay, Calcutta, Madras and New Delhi. The UTI has been opened

Branch Offices in all over country in order to provide effective and quick services to unit holders and probable investors. These offices locketed at Ahmedabad, Bangalor, Bhubaneshwar, Gauhati, Jaipur, Kanpur, Ludhiana, Patna, Trichur, Vijayawada.

3) The initial share capital of the UTI was Rs. 5 Crores, which was contributed by -

| | | | |
|---|---|---|---|
| R.B.I. (transfer in favour of IDBI - from 1976) | | | 2.50 |
| L.I.C. | ... | ... | 0.75 |
| S.B.I. | ... | ... | 0.75 |
| Scheduled Banks and other financial - Institutions. | | | 1.00 |
| | | Total | 5.00 |

There is a provision in the UTI Act, 1963 for refunding the initial capital when sufficient unit capital is collected through the sale of units to the public.

4) The Government of India give tax concessions in respect of income tax and welth tax exclusively applicable to investment in units. Such tax concessions are not available to unit holders of

the other unit trusts in the world.

5) Unit are sold by the Trust at the price prevalent on the day on which the bank, the post office or the office of the Trust, branches of selected Co-operative banks; accepts completed applications and money.

6) Unit of UTI have face value of Rs. 10 each. (Under unit scheme 1964) Units of the unit trusts in U.K. have no such face value. There a unit simply represents a participation in the total equity of the trust.

7) Unit holders has to right of dividend income from investment and the beneficial ownership of the assets of the Trust.

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