Mutual Fund Industry: Problems and Prospects in India

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Abstract: *The landscape of the financial sector in India is continuously evolving, accredited to regulatory changes being under taken, which is leading market participant like the asset management companies (AMCs) and distributors to restructure their strategies and adopt business models which will yield sustainable benefits. Some of the other trends which have emerged strongly over the past year are heavy outflows triggered by market volatility and partnering of asset management companies with banks, to increase the strength of distribution networks. The whole paper is divided into five sections. In the first part discussed the conceptual framework of mutual fund. In the next section focused on the growth of mutual fund industry in India. In the third section, analysed the trends in the mutual fund industry. Then, the challenges of mutual fund industry and finally, the way ahead for mutual fund industry in India.*

Keywords: Mutual Funds, Growth, Challenges, Business models, Regulatory

I. Conceptual Framework

Mutual Fund is an investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus. One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of equities, bonds and other securities, which would be quite difficult (if not impossible) to create with a small amount of capital. Each shareholder participates proportionally in the gain or loss of the fund. Mutual fund units, or shares, are issued and can typically be purchased or redeemed as needed at the fund's current net asset value (NAV) per share, which is sometimes expressed as NAVPS. Mutual funds as an intermediation mechanism and products play an important role in Indias financial sector development. Apart from pooling resources from small investors, they also provide informed decision making mechanism to them. Thus they contribute to not only financial sector participation, but also financial inclusion and thereby enhance market efficiency. Additionally they contribute to financial stability and help in enhancing market transparency.

II. Growth of Mutual Fund Industry

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank. Unit Trust of India (UTI) was established on 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs.6,700 crores of assets under management.

The year 1987 marked the entry of non- UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non- UTI Mutual Fund established in June 1987 followed by Can bank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990.At the end of 1993, the mutual fund industry had assets under management of Rs.47,004 crores. With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996.

The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs.44,541 crores of assets under management was way ahead of other mutual funds. Indian mutual fund industry has grown at a Compounded Annual Growth Rate (CAGR) of 15 per cent from FY07 to FY13, the growth performance in the recent years have been rather subdued. However, Assets under Management (AUM) as a per cent of GDP for India is about 5 to 6 per cent, significantly lower than some other emerging economies, for example, 40 percent for Brazil and around 33 per cent for South Africa**.** This indicates significant headroom for growth. However, the industry growth will continue to be characterized by external factors such as volatility and performance of the capital markets, and macro-economic drivers such as GDP growth, inflation and interest rates. The Indian mutual fund industry has shown relatively slow growth in the period FY 10-13 growing at a CAGR of approximately 3.2 per cent. Average (AUM) stood at INR 8,140 billion as of September 2013. However, AUM increased to INR 8,800 billion as of December 2013**.**Lackluster stock market performance, rising inflation and anticipation of a rise in interest rates has led to a tapering of growth in the Indian mutual fund industry in the recent years. In comparison to global markets, India's AUM penetration as a per cent of GDP is between 5-6 per cent while it is around 77 per cent for the U.S., 40 per cent for Brazil and 31 per cent for South Africa. Despite the relatively low penetration of mutual funds in India, the market is highly concentrated. Though, there are44 AMCs operating in the sector, approximately 80 per cent of the AUM is concentrated with 8 of the leading players in the market**.** There have been recent instances of consolidation in the market and market concentration is expected to remain in the near-term.

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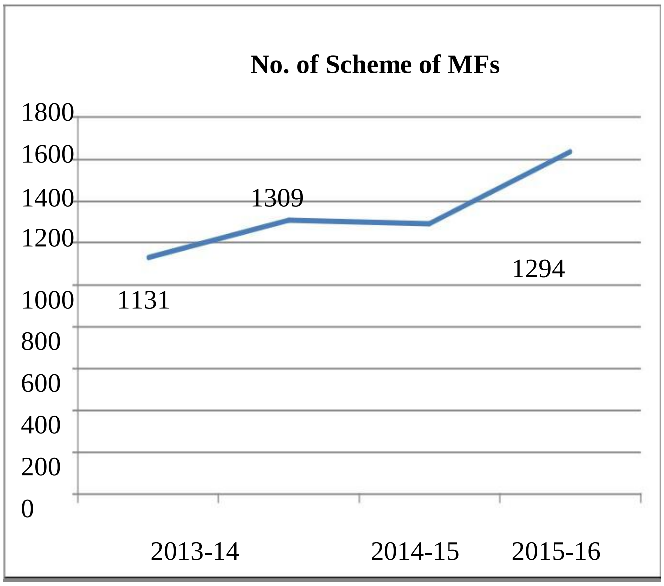
III. **Trends in Mutual Fund Industry**

1. *Number of Schemes under Mutual Funds*

TABLE1: NUMBER OF SCHEMES UNDER MUTUAL FUNDS DURING THE PERIOD 2010-2014

Year	Debt	Income	Balanced	ETFs	Overseas	Total
2013-14	679	376	32	28	16	1131
2014-15	872	352	30	35	20	1309
2015-16	857	347	32	37	21	1294
2016-17	1178	363	30	40	27	1638



Source: SEBI

The total number of schemes under MFs have increased during the period 2016-17 and it increased very steepely between 2013-14 to 2014-15. The growth rate of number of schemes in debt is greater than income, balanced, ETFs and overseas.

B. Fund Mobilization under Mutual funds

TABLE2: FUNDS MOBILIZED UNDER MUTUAL FUNDS DURING PERIOD 2010-14

Year	Debt	Income	Balanced	ETFs	Overseas	Total
2013-14	8777034.17	66592.30	7490.28	7709.25	969.39	8859515.38
2014-15	6754113.22	50618.80	5027.29	8563.39	1355.81	6819678.51
2015-16	7213578.19	43364.31	5204.88	5052.35	685.53	7267885.26
2016-17	9709762.04	46092.99	3434.89	6869.63	1941	9768100.54

Source: SEBI

The total Fund mobilized by the mutual fund have declined in the year 2013-14 from Rs 8859515.38 crore to 6819679.51 crore but again the industry gained momentum and it increased to 9768100.54 in 2016-17.

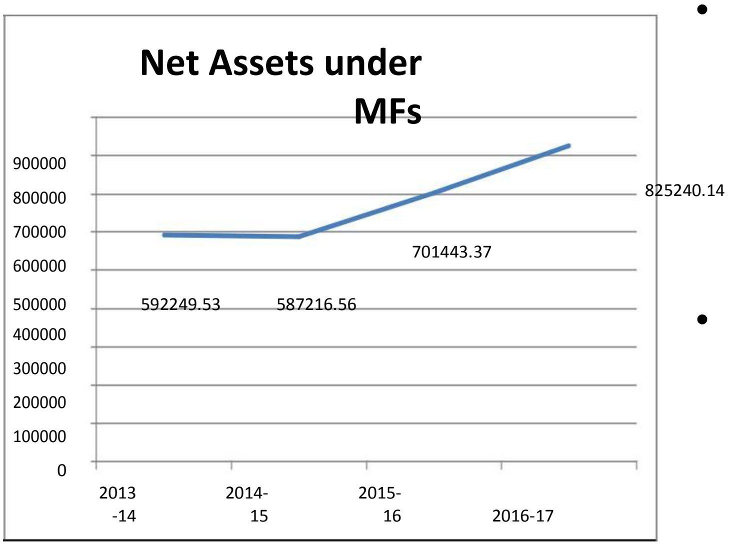
The major chunk of mutual fund industry is invested in debt securities where as the share of investment in balanced and ETFs is more or less same. Thus we can conclude from above that the mutual fund industry is one of the major investor in the debt securities of the capital market

C.Net assets under Mutual Funds

TABLE 3: NET ASSETS UNDER MUTUAL FUNDS DURING 2013-14 to 2016-17

Year	Debt	Income	Balanced	ETFs	Overseas	Total
2013-14	369049.22	95322.39	18445.09	6916.67	2516.17	592249.53
2014-15	374856.70	182075.86	16261.10	11492.58	2530.31	587216.56
2015-16	497451.17	172507.78	16307.21	13124.33	2052.87	701443.37
2016-17	600944.82	191107.08	16792.61	13204.83	3190.80	825240.14

Source: SEBI



The Net Assets under mutual funds have remained almost stagnant during 2013-14 to 2014-15 and it increased very steeply between 2015-16 to 2016-17.

IV. Challenges for Mutual Fund Industry

- *Lack of Financial Education and Awareness*: Financial literacy is the one of the most fundamental factor impeding the growth of penetration of any financial product in the smaller cities and towns. Investors need to be made aware of their financial goals and the means to achieve the same.SEBI is making efforts for the investor awareness campaign.

- Limited Distribution Network: The second critical issue for fund houses to distribute their products in smaller cities is the availability of quality distribution infrastructure. Fund houses need infrastructure like branched, adequate number of relationship managers and sales service staff in these locations to be able to increase their sales volume coming from these geographies.

- Distribution cost: Cost of establishing A Distribution network in B-15 cities is quite high. It is the cost per transaction or the low sales volume that makes the pursuit economically unviable or at least challenging

- *Cultural Bias*: Cultural Bias towards physical assets, as of FY13, 46 percent of total individual wealth in India is invested in physical assets. Although, in the past few decades, the investors have increasingly relied on financial assets to invest their savings, the contribution of MFs in the asset portfolio is very low.

V. The way forward

The Mutual fund industry needs to have an outside-in perspective as compared to inside-out perspective. Understanding investors needs should be followed by a product channel alignment.

Increasing financial literacy will be the key to unlock the doors to B-15 and also to remove the perception that equates mutual fund to only equity. Investor awareness campaigns should be conducted to increase the AUM in smaller cities which would help industry to progress in a holistic manner. Knowledge about mutual fund industry should be included in educational curriculum. Fund houses may need to find and partner with the right distributor to make the products available to investors in smaller cities. Therefore, Banks and IFAs could play a pivotal role in reaching the investor base. Also, distributors should be incentivized enough to ensure that they project mutual funds as a long-term investment for fulfilling financial goals. For future growth, tax could act as an enabler as tax benefits can be a pull factor for investors. For example, fund of funds does not get the required tax benefit from the government. May be, government could look at such funds and few offshore funds from India for tax benefits.

Technology can act as a key enabler and help the fund houses reach investors at a low cost and more efficient manner. AMCs need to make the relevant investments in technology to help reach investors to help ensure transactions on the channels of their choice.

VI. Conclusion

The road ahead for the mutual fund industry will be paved by the performance of the capital markets. But, more importantly, it remains to be seen, how fund houses adapt themselves to changes in regulations, Thereby shaping growth for the future. A continuously evolving regulatory framework makes it mandatory for the industry to elicit a clear growth path, making it easier to assess obstacles and tide over them with time.

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