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The Indian Mutual Fund Industry : Road Ahead

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Abstract
From a single-player monopoly in 1964, the Indian mutual fund industry has evolved into a high-growth and competitive market on the back of favorable economic and demographic factors. As of now, 44 asset management companies (AMCs) are operating in India with assets under management (AUM) of 24.55 trillion as on May 31, 2020.This was the second consecutive yearly rise in the industry's assets, after a drop in asset base for two preceding years. Most of the gains in 2020 came on the back of strong inflows into liquid and debt funds since investors are only cautiously positive about investing in stocks.This paper aims to provide the opportunities which are unexplored and the challenges which the Mutual Fund Industry is facing in the current slow economic growth scenario.

Keywords: *MF (Mutual Fund), AUM (Asset under management), AMC (asset Management Companies), NAV (Net Asset value)*

[1] Introduction

Over the years, the financial services in India have undergone revolutionary changes and had become more sophisticated, in response to the varied needs of the economy. The advent of mutual funds has helped in garnering the investible funds of this category of investors in a significant way. A mutual fund is a mediator that brings together a group of people and invests their money in stocks, bonds and other securities. Each investor owns shares, which represent a portion of the holdings of the fund. Thus, a mutual fund is one of the most viable investment options for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

The financial services landscape is transforming, with a plethora of changes taking place on the regulatory front. Against this backdrop, asset management companies (AMCs) need to re-structure their businesses in order to meet the evolving needs of their clients and provide them with complete investment solutions.

In India, the concept of mutual fund was coined in 1964 with the establishment of Unit Trust of India. By the end of 1986-87, UTI had launched 20 schemes mobilizing funds amounting to Rs.4,56,500 crores. 1987 marked the entry of non-UTI, public sector mutual funds set up by public sector banks. 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. In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities.Since then, the mutual funds have established themselves as an alternative investment vehicle and are now an integral part of the Indian financial system.

The period from 2013 to 2020 saw a number of major events, a very significant one being the global meltdown in the banking and financial services industry (BFSI), which had knock-on effects on almost all business sectors along with the turmoil in the NBFC sector with the major playes IL & FS and Deewan Housing debt crisis. The mutual fund industry was beset by net redemptions by investors and adverse global and local market conditions due to covid 19 situation in which the sensex corrected from 24,469 to 36,021level.

The total industry AUM stood at Rs. 24.7 lakh crore in March 2020 which was Rs 8.9 lakh crore at the end of 2013. The growth in the AUM has been in the fixed income category and liquid funds.. Equity fund and gold ETF saw their AUMs portfolio count falling. Apart from that MF industry has lost 42 lakh equity portfolios, which is a very disturbing sign.

More explicitly, the benefits of investing in equities and debt instruments are supposedly much better if done through Mutual Fund. Firstly, fund managers are more skilled. They are trained to identify the best investment options and to assess the portfolio on a continual basis.

Secondly, they are able to invest in a diversified portfolio consisting of 15-20 different stocks or bonds or a combination of them. For an individual such diversification reduces the risk but can demand a lot of effort and cost.

Even though mutual fund industry is growing, still there is a long way to go. The penetration level in rural areas is not very high. The funds have grown more because of the changing demographic profile. More number of investors, particularly youth, whose disposable income has gone up opt mutual fund to enter securities market indirectly. Low customer awareness and financial literacy are one of the biggest roadblocks in channelizing household savings into mutual funds. Securities and Exchange Board of India (SEBI) has adopted certain measures to re-energize the mutual fund industry with an objective to restore sustainable high growth.

[2] Review of Literature

The performance of Mutual Fund across various countries including India was studied by Ferreira, Keswani, Miguel, and Ramos (2011) .He found that there is persistence in performance only for poorly performing mutual funds. The study pointed out that, unlike in the US, funds that are located outside the US do not face decreasing returns to scale. Klapper, L., Sulla, V., & Vittas, D. (2004) points that in the absence of academic studies, industry agencies such as S&P/CRISIL come out with their evaluation of the industry in India. A recent S&P/CRISIL report suggests that the majority of actively managed mutual funds in India underperformed their benchmarks over the five years between 2007 and 2011. Also, given the limited investable universe for Indian fund managers, it is possible that herding is much more significant in India than in the US.

The economy has been opened up and many developments have been taking place in the Indian money market and capital market was concluded by Mridula E and Raju P (2006), He also concluded that the Indian capital market has been increasing tremendously during last few years. With the reforms of economy, reforms of industrial policy, reforms of public sector and reforms of financial sector.

The factors influencing the selection of funds and buying decision was studied by Jambodekar (2009) . This study has revealed that under the prevalent market conditions, income and open ended schemes are more preferred that growth and close ended schemes. Investors more focus on safety of principal and liquidity and choose newspapers and televisions as their mode of awareness regarding this investment.

Rama Murthy B.M and Reddy S (2005) in the study "Recent Trends in Mutual Fund Industry" presents the under penetration situation of India with the participation mostly by the metro cities. He estimated an increase in the AUM of the industry by atleast 10% every year.

[3] Objective of the study

a) To study and analyze the all around view of the dynamics and have focused on looking for the hidden opportunities.

b) The paper also covers the regulatory changes which are anticipated and the global trends which may change the business landscape of the Mutual fund industry in India.

c) To analyze the challenges the Mutual fund industry is facing in the dynamic financial services landscape

[4] Research Methodology

The adopted research methodology is of exploratory in nature based on secondary data where it seeks to explore the challenges the Mutual Fund Industry is facing in the continuous changing and tough market

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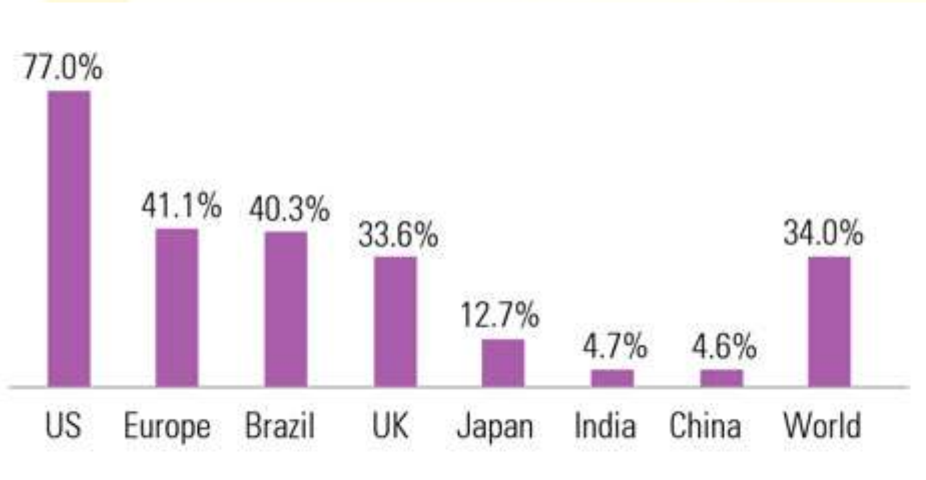
environment. The paper seeks to explore the reasons which led to the decrease in number of equity folios by 40 lakhs. The paper has used secondary data/information available on various sites like value research, AMFI etc., newspapers, journals, annual Reports of CII, KPMG etc. The research tries to explore the hidden and unexplored opportunities, the MF industry exhibits. The paper also highlights the operational issues, the distribution challenges, and the low penetration.

[5] Data Analysis and Interpretation

Low penetration: India has amongst the highest household saving rate globally. The current saving rate is around 33% and is projected to touch $ 5 billion by the year 2020 surpassing that of U.S. Mutual fund being an efficient vehicle offering varied investment products at a reasonable cost to households is contributing towards the long-term growth prospects of our economy. The penetration of mutual funds in India (as measured by the AUM/GDP ratio) remains low at 4.7 percent as compared to 77.0 percent in the US, 41.1 percent in Europe and 33.6 percent in the UK. Mutual funds also constitute only 3.3 percent of households' financial savings in FY10, which further contracted to -1.2 percent and -1.1 percent in FY11 and FY12, respectively, due to large redemption and capital losses (CII Report). Apart from that, the national population is still largely under banked with a very low level of financial inclusion.



AUM to GDP ratio (%FY2019) (Value Research data)

Low penetration arises due to very low levels of awareness and financial literacy .Also, investors are not aware of low risk products that they can invest in. A culture change is required in this case if people are to be convinced to invest in capital market

Unequal geographical contribution: Besides low penetration, concentration of mutual funds to a few major cities has been another concern for the sector. The business of Indian mutual funds (MFs) industry is largely confined within the Tier 1 cities, however, the industry is focused on developing the penetration ratio and increasing its presence in other cities. Most AMCs and distributors have limited focus beyond the top 20 cities, as is evident from the limited distribution channels and limited investor servicing available beyond these cities. The top five cities contributed approximately 71.1 percent of the total AUM of the mutual fund sector, with Mumbai only accounting for about 42.1 percent in FY20. Lack of incentives for distributors to expand in small cities has resulted in mutual funds becoming an investment product in the hands of urban Indians.

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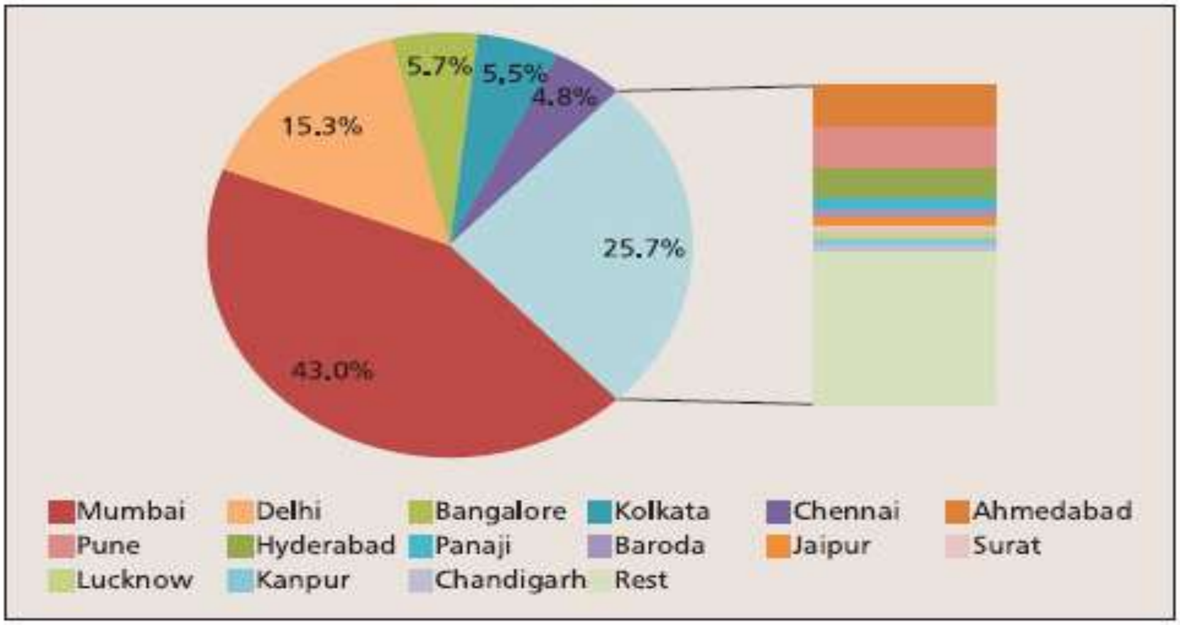


AUM by Geography as on March 2020(KPMG Report)

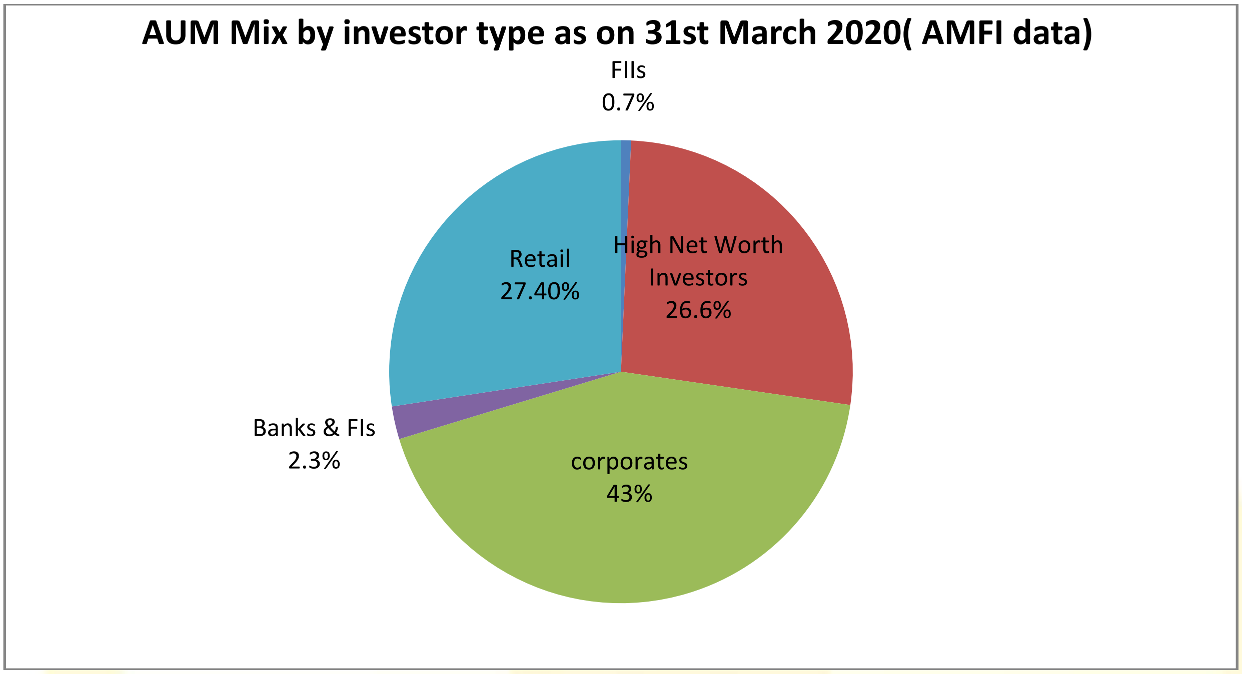
The top five cities (Mumbai, Delhi, Bangalore, Kolkata and Chennai) contribute over 71% of the total AUM, with Mumbai alone accounting for more than 42%.

The Mutual Fund Industry can reach out to the customers by customizing the products as well as the product delivery system making it client oriented. In order to reach the bottom of the pyramid the model of SHGs of MFIs (Microfinance institutions) can be used who were able to access savings and credit in the rural areas

Skewed Investment in Debt Schemes: AUM is mirrored by disproportionate contribution from retail investors. The retail participation in mutual fund is very low. As on 31st March 2020 (AMFI data), the retail contribution is about 27% while corporate, Banks & FIIs contributes more than 46%. High net worth individuals' contribution is as high as 26.6%.The statistical analysis throws up a few more facts:

• Over 43% of the AUM is from corporate investors.
• Over 90% of corporate investor funds are invested in non-equity schemes.
• Almost 85% of corporate investors keep their funds in schemes for less than 12 months.

A large number of corporate investors are contributing more towards the debt oriented or non-equity schemes. As more than 90% of the corporate funds are invested in non- equity funds , an overwhelming majority of the funds garnered from the urban non-retail segment are short-term investments. Further, this is not a short-term trend as it has been noticed over a period of a few years. Therefore, if the industry wants to change the age profile of the funds it has at its disposal, it needs to seriously look at the other investors i.e. retail investors and high net-worth individuals (HNIs) in the urban and semi-urban areas. This will also help fulfill the objectives of financial inclusion.



Distribution related challenges: In insurance distribution the agents work exclusively for one Insurance company. Agents are well compensated and penetration is also deep. In mutual Fund distributors are free to distribute or offer products from multiple asset management companies (AMCs). As a result, the bond between the AMC and the distributor is relatively weaker. An AMC cannot go on spending resources on developing the distributor skills as the latter could then easily use these improved skills to sell other competing products.

Compared to the insurance sales force, the strength of the Mutual fund network appeared to be dismal. There are about 0.3million insurance agents in India, while only16,000 distributors for Mutual fund. This implies that investors are more likely to meet insurance agents much more frequently than mutual fund distributors and hence likely to park their surplus funds in insurance policies rather than Mutual Fund products

Fund houses can look at the possibility of investing in active sales force and a tied distribution model, where the agent is tied to a particular Institution. Training and educating the distributors are integral to increasing penetration of mutual fund products.

Operational Issues: Some of the AMCs offer large number of products which have overlapping objectives and investments. Each scheme brings with it operational costs driven by regulatory, compliance and risk requirements. Overlapping schemes may be analyzed and the possibility of merging overlapping schemes, or discontinuing such schemes or schemes with a less-than optimal AUM size could be evaluated.

Another aspect which impacts the operations of the AMCs is the increased level of regulatory disclosure requirements. Over the years, the information and data disclosures required from AMCs and schemes have increased steadily. Operating teams are required to make multiple disclosures at regular intervals, which in turn increase compliance costs.

To overcome operational challenges, measures need to be taken to improve the existing infrastructure and to bring in more efficiency while increasing the scale of operation. This is possible with good technology mix which is also a key facilitator to break down underpenetrated market.

Conclusion: The outlook of the Mutual Fund Industry is governed to a great extent by the economic situation in the country, which can be volatile due to the upcoming elections in may 2014.The current economic scenario with rising inflation can result in depressed equity inflows into the market. Steps need to be taken to instill

confidence in the minds of the investor and to encourage them to invest in mutual fund.
Allowing the fund houses to sell pension products will act as huge catalyst for growth of the industry. Rather than focusing on large number of schemes, the fund houses should plan to manage assets and not just gather assets. Mutual fund industry manifests huge opportunity for growth and further penetration and this can be achieved over time with support from technology. The key lies in strengthening distribution networks and enhancing levels of investor education to increase presence in rural areas.

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