

International Journal of Research in Social Sciences (ISSN: 2249-2496)

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INDIAN MUTUAL FUND INDUSTRY: EMERGING ISSUES AND CHALLANGES



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ABSTRACT:

Mutual Funds have become a hot favorite of millions of people all over the world. The driving force of mutual fund is the 'safety of the principal' guaranteed, plus the added advantage of capital appreciation together with the income earned in the form of interest or dividend. A mutual fund is a professionally managed type of collective investment scheme that pools the money from many investors to buy stocks, bonds, money market instruments and other types of securities. It works on the principle of 'small drops of water make a big ocean'. The owner of a mutual fund unit gets a proportional share of the fund's gains, losses, income and expenses. The main objective of this paper is to examine the importance and growth of mutual funds and evaluate the challenges & issues of mutual funds and suggest some measures to make it a successful investment avenue in India.

KEYWORDS: AMC, UTI, CAGR, MUTUAL FUND, NAV, SEBI, AMFI

INTRODUCTION:

Mutual fund is the pool of money, based on the earnings of individuals who shares a common objective of having financial secured for future uncertainty as well as some sort of financial benefits like the capital appreciation and dividend earning. The money collected from the investors is then relocated or invested in capital market instruments such as shares, debenture, and various foreign market. Investors invest money and get the units as per the unit value which can be called as NAV (net assets value). Mutual fund is the most appropriate investment plan from the perspective of a common man as it offers an opportunity to invest in diversified portfolio management. Good research team, professionally managed Indian stock as well as the foreign market, the main aim of the fund manager is to taking the scrip that have under value and future will rising, then fund manager sell out the stock. Fund manager concentration on risk – return trade off, where minimize the risk and maximize the return through diversification of the portfolio. The most common features of the mutual fund unit are low cost, professional investment management, increased diversification.

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HISTORY OF INDIAN MUTUAL FUND:

The Mutual fund in India came in to existence with the formation of UTI in the year 1963 as a result of collaborative strategies made by Government of India and Reserve Bank of India. The history of mutual funds in India can be broadly described into four distinct facets:

1) First Phase - 1964-87(Growth of UTI)

The first scheme launched by Unit Trust of India was unit scheme 1964. It was the first open – ended scheme in the country.

2) <u>Second Phase – 1987-1993</u> (Entry of Public Sector Funds)

State bank of India established the first non-UTI mutual fund –SBI mutual fund in November 1987.

3) <u>Third Phase – 1993-1996</u> (Emergence of Private Sector Funds)

Private and foreign fund houses were permitted to set up Mutual fund in India.Kothari pioneer was the first private sector fund.

4) <u>Fourth Phase – 1996-1999(Growth and SEBI Regulations)</u>

A set of regulations for all mutual funds operating in India was introduced with SEBI (Mutual Fund) Regulations, 1996.

5) Fifth Phase – 1999-2004(Emergence of a large and uniform industry)

In February 2003, UTI Act was repealed; UTI was split in to two and UTI no longer had a special legal status and it also adopted the same structure as any other fund in India. UTI mutual fund is the present name of the erstwhile Unit Trust of India.

6) Sixth Phase – 2004 onwards(Period of Consolidation & Growth)

In this period the industry has witnessed a spate of mergers and takeovers. Also more and more new international and private sector players are entering the fray. This period also saw the growth of the industry.

The Figure I indicates the growth of assets over the years.

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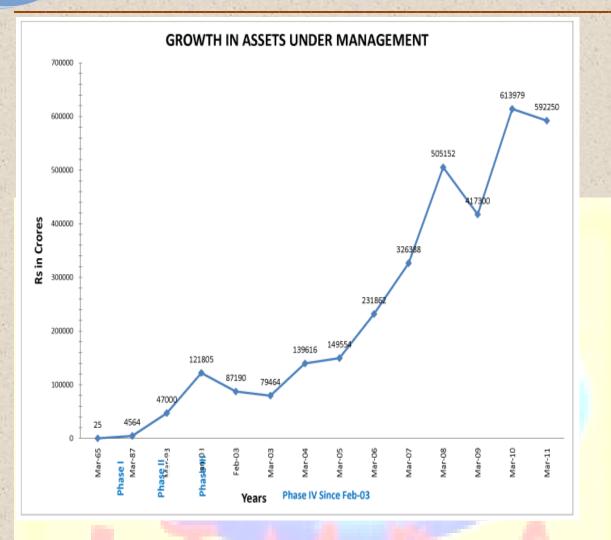


Fig. I

ORGANIZATION STRUCTURE OF MUTUAL FUND:

Mutual funds have organization structure as per the Security Exchange Board of India guideline; Security Exchange Board of India specified authority and responsibility of Trustee and Asset Management Companies. The objectives are to controlling, to promoted, to regulate, to protect the investor's right and efficient trading of units. The structure of mutual fund operations in India envisages a three tier establishment namely:

- 1. A sponsor institution to promote the fund.
- 2. A team of trustees to oversee the operations and to provide checks for the efficient, profitable and transparent operations of the fund.
- 3. An asset management company (AMC) to actually deal with the funds.

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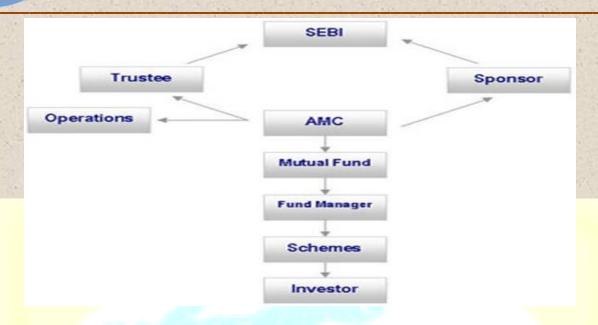


Fig.-II

Sponsoring Institution: The company which sets up the Mutual Fund is called the sponsor. The SEBI has laid down certain criteria to be met by the sponsor. These criteria mainly deal with adequate experience, good past track record, net worth etc.

Trustees: Trustees are people with long experience and good integrity in their respective fields. They carry the crucial responsibility of safeguarding the interest of investors. For this purpose, they monitor the operations of the different schemes. They have wide ranging powers and the can even dismiss asset management companies with the approval of the SEBI.

Asset Management Company (AMC): The AMC actually manages the funds of the various schemes. The AMC employs a large number of the professionals to make investments, carry out research and to do agent and investor servicing. In fact, the success of any Mutual fund depends upon the efficiency of this AMC. The AMC submits a quarterly report on the functioning of the mutual fund to the trustees who will guide and control to AMC.

Operation of Mutual fund start with investors saves their money on mutual fund, than Mutual Fund manager handling the funds and strategic investment on scrip. As per the objectives of particular scheme manager selected scrips. Unit value will become high when fund manager investment policy generates the return on capital market. Unit return depends on fund return and efficient capital market. Also affects international capital market, liquidity and at last economic policy. Below the figure-III indicates how the process was going on to investors to earn returns.

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Mutual fund manager having high responsibility inside of return and how to minimize the risk. When fund provided high return with high risk, investors attract to invest more funds for same scheme.

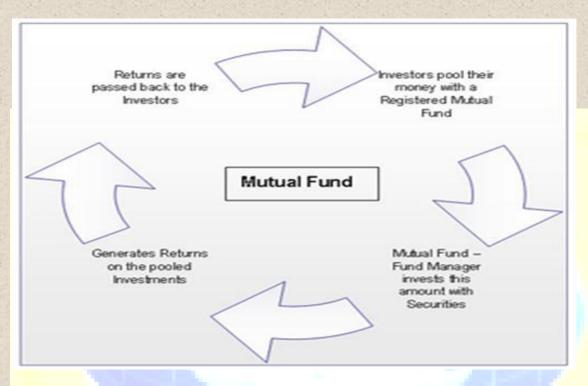


Fig.-III

The Mutual fund organization as per the SEBI formation and necessary formation is needed for sooth activities of the companies and achieved the desire objectives. Transfer agent and custodian play role for dematerialization of the fund and unit holders hold the account statement, but custody of the unit is on particular Asset Management Company. Custodian holds all the fund units on dematerialization form. Sponsor had decided the responsibility of custodian when investor to purchase the fund and to sell the unit. Application forms, transaction slip and other requests received by transfer agent, middle men between investors and Asset Management Companies.

TYPES OF MUTUAL FUND:

In the investment market, one can find a variety of investor with different needs, objectives and risk taking capacities. For instance, a young businessman would like to get more capital

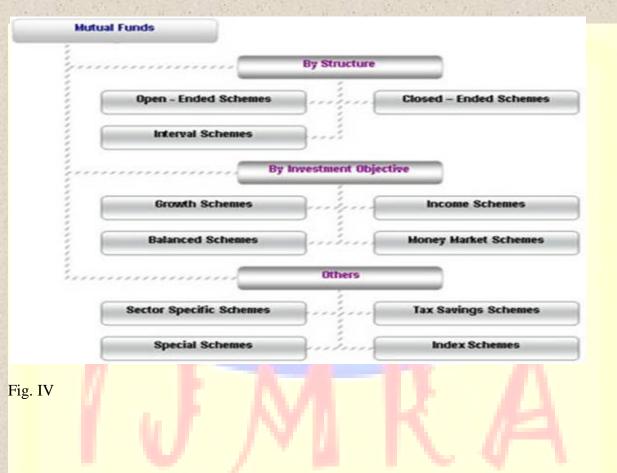


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appreciation for his funds and he would be prepared to take greater risk than a person who is just on the verge of his retiring age. So, it is very difficult to offer one fund to satisfy all the requirement of investors. Just as one shoe is not suitable for all legs, one fund is not suitable to meet the vast requirements of all investor. Therefore, many types of funds are available to the investor. The Figure-IV below gives an overview into the existing types of schemes in the Industry.



IMPORTANCE OF MUTUAL FUND:

Small investors face a lot of problems in the share market, limited resources, lack of professional advice, lack of information etc. Mutual funds have come as a much needed help to these investors. It is a special type of institutional device or an investment vehicle through which the investors pool their savings which are to be invested under the guidance of a team of experts in wide variety of portfolios of corporate securities in such a way, so as to minimize risk, while ensuring safety and steady return on investment. It forms an important part of the capital market,

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providing the benefits of a diversified portfolio and expert fund management to a large number, particularly small investors. Now days, mutual fund is gaining its popularity due to the following reasons:

1) With the availability of profitable factor such as Increase in Individual domestic savings and improvement in deployment of investment through markets, the need and urge for mutual fund among Investors has increased tremendously. The basic purpose of reforms in the financial sector was to enhance the generation of domestic resources by reducing the dependence on outside funds. This calls for a market based institution which can tap the vast potential of domestic savings and chanalise them for profitable investments. Mutual funds are not only best suited for the purpose but also capable of meeting this challenge.

2. An ordinary investor who applies for share in a public issue of any company is not assured of any firm allotment. But mutual funds who subscribe to the capital issue made by companies get firm allotment of shares. Mutual fund latter sell these shares in the same market and to the Promoters of the company at a much higher price. Hence, mutual

Fund creates the investors confidence.

3. The psyche of the typical Indian investor has been summed up by Mr. S.A. Dave, Chairman of UTI, in three words; Yield, Liquidity and Security. The mutual funds, being set up in the public sector, have given the impression of being as safe a conduit for investment as bank deposits. Besides, the assured returns promised by them have investors had great appeal for the typical Indian investor.

4. As mutual funds are managed by professionals, they are considered to have a better knowledge of market behaviors. Besides, they bring a certain competence to their job. They also maximize gains by proper selection and timing of investment.

5. Another important thing is that the dividends and capital gains are reinvested automatically in mutual funds and hence are not frittered away. The automatic reinvestment feature of a mutual fund is a form of forced saving and can make a big difference in the long run.

6. The mutual fund operation provides a reasonable protection to investors. Besides, presently all Schemes of mutual funds provide tax relief under Section 80 L of the Income Tax Act lead to the growth of importance of mutual fund in the minds of the investors.

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7. As mutual funds creates awareness among urban and rural middle class people about the benefits of investment in capital market, through profitable and safe avenues, mutual fund could be able to make up a large amount of the surplus funds available with these people.

8. The mutual fund attracts foreign capital flow in the country and secures profitable investment avenues abroad for domestic savings through the opening of off shore funds in various foreign investors. Lastly another notable thing is that mutual funds are controlled and regulated by S E B I and hence are considered safe. Due to all these benefits the importance of mutual fund has been increasing.

SHORTCOMING IN THE OPERATION OF MUTUAL FUND:

The mutual fund has been operating for the last five to six years. Thus, it is too early to evaluate its operations. However one should not lose sight to the fact that the formation years of any institution is very important to evaluate as they could be able to know the good or bad systems get evolved around this time. Following are some of the shortcomings in operation of mutual fund.

 The mutual funds are externally managed. They do not have employees of their own. Also there is no specific law to supervise the mutual funds in India. There are multiple regulations. While UTI is governed by its own regulations, the banks are supervised by Reserved Bank of India, the Central Government and insurance company mutual regulations funds are regulated by Central Government

2. At present, In India investors take investment in mutual fund as a substitute of fixed deposits in Banks. About 70-80 percent of the investors are not taking interest to invest in mutual funds unless there was any assurance of guaranteed return.

3. Sponsorship of mutual funds has a bearing on the integrity and efficiency of fund management which are key to establishing investor's confidence. So far, only public sector sponsorship or ownership of mutual fund organizations had taken care of this need.

4. Unrestrained fund rising by schemes without adequate supply of scrips can create severe imbalance in the market and exacerbate the distortions

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5. Many small companies did very well last year, by schemes without adequate imbalance in the market but mutual funds can't reap their benefits because they are not allowed to invest in smaller companies. Not only this, a mutual fund is allowed to hold only a fixed maximum percentage of shares in a particular industry.

CHALLENGES AND ISSUES OF MUTUAL FUND:

LOW LEVELS OF CUSTOMER AWARENESS

Low customer awareness levels and financial literacy pose the biggest challenge to channelising household savings into mutual funds.IIMS Dataworks data released in 2007 establishes that low awareness levels among retail investors has a direct bearing on the low mutual fund offtake in the retail segment. The general lack of understanding of mutual fund products amongst Indian investors is pervasive in metros and Tier 2 cities alike and majority of them draw quite distinctive in their approach to investing in mutual

Funds and direct stock market investments. A large majority of retail investors lack an understanding of risk-return, asset allocation and portfolio diversification concepts. Low awareness of SIPs in India has resulted in a majority of the customers investing in a lump sum manner.

LIMITED FOCUS ON INCREASING RETAIL PENETRATION

The Indian mutual fund industry had limited focus on building retail AUM and has only recently stepped up efforts to augment branch presence in Tier 2 and Tier 3 towns. Players have historically garnered AUM by targeting the institutional segment that comprises 63 percent AUM share as at March 2008. Large ticket size, tax arbitrage available to corporate on investing in money market mutual funds, easy accessibility to institutional cutomers concentrated in Tier 1 cities are the factors instrumental in mutual fund houses focussing on the institutional segment. Building retail AUM requires significant distribution capability and a wide footprint to be able to penetrate into Tier 2 and Tier 3 towns, which AMCs have recently started focusing on. Institutional AUM, however, makes the industry vulnerable to the possibility of sudden redemption pressures that impact the fund performance.

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LIMITED REACH

The mutual fund has continues to have limited penetration beyond the top 20 cities. Cities beyond Top 20 only comprise approximately 10 percent of the industry AUM as per industry practitioners. The retail population residing in Tier 2 and Tier 3 towns, even if they are aware and willing, but are unable to invest in mutual funds. The distribution network of most mutual fund houses is largely focused on the Top 20 cities given the high cost associated with deeper penetration into Tier 2 and Tier 3 towns. However, some of the mutual fund houses have begun focussing on cities beyond the Top 20 by building their branch presence and strengthening distribution reach through non-branch channels.

LIMITED INNOVATION IN PRODUCT OFFERINGS

The Indian mutual fund industry has largely focuses in product-led not satisfactory customer focused approach. The popularity of NFOs triggered a proliferation of schemes with a large number of non-differentiated products. The industry has shown less interest on innovation and new product development, thereby always there is error in catering to the limited needs of the customer. Products that cater specifically to customer life stage needs such as education, marriage, and housing are yet to find their way in the Indian market. Despite the regulations for Real Estate Mutual Funds (REMF) being introduced in 2008, the market is still awaiting the first REMF launch. Further, relatively nascent product categories viz. multi-managed funds that are categorized as the most popular hybrid funds globally have not grown in India owing to the prevailing taxation structure. The Indian mutual fund industry offers limited investment options viz. capital guarantee products for the Indian investors, a large majority of whom are risk averse. The Indian market is still to witness the launch of green funds, socially responsible investments.

LIMITED FLEXIBILITY IN FEES AND PRICING STRUCTURES

The fee structure in the Indian mutual fund industry enjoys little flexibility unlike developed markets where the level of management fees depend on a variety of factors such as the investment objective of the fund, fund assets, fund performance, the nature and number of services that a fund offers. While the expenses have continuously risen, the management fee

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levels have remained stagnant. Distributors are compensated for their services through a fixed charge in the form of entry load and additional fees as considered appropriate by the AMC. Regardless of the quality of advice and service provided, the commission payable by the mutual fund customer to the distributors is fixed.

LIMITED CUSTOMER ENGAGEMENT

Mutual fund distributors have been facing questions on their competence, degree of engagement with customer and the value provided to the customer. In the absence of a framework to regulate distributors, both the distributors and the mutual fund houses have exhibited limited interest in continuously engaging with customers post closure of sale as the commissions and incentives had been largely in the form of upfront fees from product sales (although trail commissions have also been paid unlimited instances regardless of the service rendered). As a result of the limited engagement, there have been rising instances of mis-selling to customers.

LIMITED REACHABILITY BY THE PUBLIC SECTOR NETWORK ON DISTRIBUTION OF MUTUAL FUNDS

Public sector banks with a large customer base, has an approach to reach more than 20 cities in semi-urban and rural areas, but the potential to build the retail based investors, have acted a very limited role in mutual funds distribution. The India Post network operating the largest postal network in the world majority of which is in rural areas, is stated to have 250 post offices selling mutual funds of five AMCs only; further most of the post offices selling mutual funds are located in Tier 1 and Tier 2 cities which are already been catered to, by national level and other distributors24. India Post with its customer base of 170 million account holders and branch network of over 154,000 branches, doubling the size of all bank branches put together is a formidable channel which has been under utilised to date for mutual fund distribution25. The postal network also serves as a means to facilitate inclusive and equitable growth to all regions and social groups by providing them with access to financial products such as mutual funds. Further the credibility enjoyed by the Nationalised Banks, Regional Rural Banks and

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Cooperative Banks in the rural hinterland has not been fully leveraged to target the retail segment.

CONFRONTATION BETWEEN MULTIPLE FINANCIAL SERVICES VERTICALS

The regulatory and compliance requirements vary across verticals within the financial services sector specifically mutual funds, insurance and pension funds each of which are governed by an independent regulatory framework and are competing for the same share of the customer's wallet. The mutual fund industry lacks a level playing field in comparison with other verticals within the financial services sector. The mandatory PAN card requirement for investing in mutual funds is perceived to restrict significant potential of the mutual fund industry in being able to tap small ticket investors from investing their money in mutual funds. Whereas, ULIPs which are deemed to be competitive products do not have any mandatory PAN requirement. Secondly, the payment for investment in mutual funds can be made only through banking facilities; the purchase of ULIPs can be undertaken through cash. The recently introduced NPS regulations requiring the AMCs to create a separate legal entity for pension funds management have created an additional cost structure for the mutual fund players. Outsourcing funds management in excess of INR 80 billion by insurance companies is not permitted and thus restricts an additional revenue opportunity for the mutual fund industry. In summary, the challenges and issues faced by the Indian mutual fund industry will need to be addressed at the earliest to ensure long term sustained, profitable growth of the industry.

GROWTH DRIVERS:

Although several macroeconomic and demographic factors affect the growth of the industry, the key underlying drivers for all the categories of funds is the key economic indicator-the GDP growth rate. The growth drivers for customer segments that have been listed in the table below along with the expected:

CUSTOMER	KEY	GROWTH	EXPECTED IMPACT
SEGMENT	DRIVERS		and the second second

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Retail Segment	 Rising disposable incomes and savings Favourable demographics such as increasing proportion of working population (20-59 years) and increasing urbanisation resulting in increased levels of financial savviness Innovations in distribution Increased awareness levels Quality financial planning 	 Increase in disposable incomes and household financial savings may result in households seeking alternate avenues for investments to yield higher returns with reasonable risk. Favourable demographics like urbanisation and a relatively young population having an increased risk appetite, are likely to save more and seek to invest a higher proportion of those savings in market-linked instruments such as mutual funds. Distribution innovations are expected to increased mutual funds. Distribution specifically in Tier 2 and Tier 3 towns thereby expanding the mutual fund customer base.
	FM	 Improved awareness levels and enhanced financial literacy is expected to aid the understanding of mutual fund products. Appropriate asset allocation and potential for wealth creation
Institutional Segment	 Rising corporate earnings Maturing capital markets. Interest rate cycle Call money market rates 	 Increased demand for sophisticated treasury management products. A better economic situation in the country is likely to ensure a steady fall in the interest rates

TABLE-I

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MUTUAL FUND AND CAPITAL MARKET:

Indian institute of capital market (IICM) aim is to educate and build professionals for the securities industry based in India as well as for other developing countries, also concentrates on other objectives like to function as a centre for creating investors awareness through research & training for providing specialized consultancy related to the securities industry.

Capital market plays vital role for the growth of Mutual fund in India. Capital market divided into the two parts one is the primary market and another is secondary market, primary market concern with issue management, as per the mutual fund concern the primary called as the NFO New Fund Offer, all the AMC (Assets Management Company) are issuing all the funds all the way through the NFO, Every NFO came with particularly investment objectives, style of investment and allocation of the funds all that thing depend on the fund manager style of investment. The other portion of the capital market is secondary market, as we have a discussion with reference with mutual fund secondary market means when the market bull stage the investors sole the units. Opposite when the bear stage the investor buy or some of the investor time wait for sale.

ROLE OF SEBI:

According to SBI Norms, Index fund scheme need to be properly clarified 'Index fund scheme' means a mutual fund scheme that invests in securities in the same proportion as an index of securities. A mutual fund may lend and borrow securities in accordance with the framework specified by the Board. A mutual fund may enter into short selling transactions on a recognized stock exchange, subject to the framework relating to short selling and securities lending and borrowing specified by the Board. It is to be noted that in case of an index fund scheme, the investment and advisory fees shall not exceed three fourths of one percent (0.75%) of the weekly average net assets.

As well the total expenses of the scheme including the investment and advisory fees shall not exceed one and one half percent (1.5%) of the weekly average net assets. Every mutual fund shall buy and sell securities on the basis of deliveries. In all cases of purchases, must take delivery of relevant securities & in all cases of sale, deliver the securities.

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ROLE OF AMFI (Association of Mutual Funds in India)

AMFI is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protect and promote the interest of mutual funds unit holders.

Benefits of Mutual fund from Tax Planning perspective

Investors in India opt for the tax-saving mutual fund schemes for the simple reason that it helps them to save money. The tax-saving mutual fund schemes are one of the important types of mutual funds in India that investors can option for. There are several companies in India that offer tax saving mutual fund schemes in the country.

FUTURE OUTLOOK AND SUGGESTION:

As mutual fund has entered into the Indian Capital market, showing enough profitable growth to attract competitors into related area and also encouraging competition among all the mutual fund policy makers. There is always a need to make some useful strategy to bring more confidence among investors through which mutual fund would be able to project the image successfully. The followings are some of the suggestions:

- As there is no comprehensive law to regulate the mutual fund in India, uniform coordinated regulations by a single agency should be formed which would provide the shelter to the investors.
- As the investors are not willing to invest in mutual fund unless a minimum return is assured, it is very essential to educate the investors about mutual fund that they are market instruments and associated with market risk hence the guarantee of assured return can't be offered.
- All the mutual funds are operated in the public sector. Hence private sector may be allowed to float mutual funds, for creating intensifying competition in the industry.
- Due to operations of many mutual funds, there will be need for appropriate guidelines for self-regulation in respect of publicity/advertisement and interscheme transactions within each mutual fund.

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- The growth of mutual fund tends to increase the shareholdings in good companies, give raise to the fear of destabilising among industrial group, hence introduction of nonTripathy, voting shares and lowering the debt-equity ratio help to remove these apprehension.
- As there is no distinction between trustees, sponsors and fund managers, it is necessary to regulate frame work for a clear demarcation between the role of constituents, such as shelter, trustee and fund manager as well as to protect the interest of the small investors.
- Some steps should be taken to make fair and truthful disclosures of information to the investors, so that subscribers know what risk they will have by investing in fund.
- Infrastructure bottlenecks will have to be removed and banking and postal systems will have to be taken place for growth of mutual funds.
- Mutual funds should formulate their working policy with the use of modern technology like computer and tele-communications to render service to the investors.
- Mutual funds are made by investors and investor's interest ought to be paramount by setting standard of behaviours and efficiency through self-regulations and professionalism.

CONCLUSION:

Mutual Funds has played significant role in financial development. Mutual funds are trusts that pool the savings of innumerable small invetors for the purpose of making investment in various financial instruments, capital market and money market, with a view of providing a reasonable return. This is basically focus on the diversification of investors money in a very appropriate/ adequate that will reduce the chances of risk as well increase the percentage of assured return in the pocket of investors. Further, mutual funds offer wide range of products to suit the requirements of a wide spectrum of investors. The operational efficiency of mutual fund can be judged by the NAV of the fund.

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