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Review Article

Indian Mutual Fund Industry: Current State and Future Outlook

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Abstract

The success story of any economy can only be scripted on the basis of sound financial system of the country. Economy reform process of 1991 had a great impact on the financial system of the country leading to the overall development of the Indian economy. Today, India's financial system is considered to be sound and stable as compared to many other Asian countries where the financial market is facing many crises. During last one decade or so, role of Indian mutual fund industry as a significant financial service in financial market has really been noteworthy. In fact, mutual funds have important segment of financial market of India, especially as a result of the initiatives taken by Govt. of India for resolving problems relating to UTI's US-64 and liberalize tax liabilities on the incomes earned by the mutual funds. They now play a very significant role in channelizing the saving of millions of individuals into the investment in equity and debt instruments. This paper aims at making a critical study of the mutual funds as a financial service in Indian financial market, equally addressing the present status and focusing on its future possible outlook.

KEYWORDS:*Mutual Fund, Reform, Growth, Prospect, Financial Market, Prospect, Investors*

Introduction

The major cause of underdevelopment of a country is the poor capital formation. The famous economist Prof. Ragnar Nurkse's concept of vicious circle of poverty clearly established this fact. Therefore, the mobilization of savings is most important for the development of any economy and for mobilization of savings sound financial system is necessity for any country. Resource mobilization by mutual funds is an important activity in the capital markets. India's mutual fund and stock market have witnessed phenomenal growth over the last few years. According to a study, mutual funds would be one of the major instruments of wealth creation and wealth saving in the years to come, giving positive results.

Mutual fund can be described as a collective investment vehicle where customers pool in their monetary resources towards a common financial objective. The money that is collected is then invested by the fund managers in different types of securities depending upon the objective of the scheme. These could spread among various capital market instruments like equities, debt, derivatives and other government securities. The incomesecured in the course of these investments and the capital appreciation realized is shared among unit holders in proportion to the number of units held by them. A mutual fund thereby helps the common man to realize their investment needs by offering an opportunity to invest in a diversified, professionally managed basket of securities at a relatively lower risk.

The role of financial sector as well as the role of mutual funds industry in India as an important segment of financial market for resource mobilization in capital market is very significant. Mutual fund act as a vital link between the retail/small investors and the capital market by mobilizing the funds from innumerable investors across the country and thereafter investing the same in capital market in most scientific way so as to maximize the return on investment.

The Indian mutual fund industry came into existence following the establishment of the Unit Trust of India (UTI) at the initiative of the Government of India and the Reserve Bank of India. The Unit Trust of India enjoyed the monopoly with no other player permitted to enter the industry. However, the scenario changed drastically following the opening of the industry to private and foreign institutions in 1993. The fund mobilization by mutual funds in India has been on the increase since their inception in 1964. Initialization of the policy of liberalization and reforms in the financial sector has brought about a sea change in income, consumption, savings and investment pattern of average household in India.

India is one of the top five economies in the world in terms of market potential and is placed above countries like France, Italy, Russia and the United Kingdom. India is also ranked as the third biggest economy in Asia in terms of gross domestic product (GDP). All these make investment in India a lucrative option for the world. The investment market in India offers many possibilities for the investors as the level of purchasing power is improving over time. The investors stand to gain in each and every areas of business in India.

The present study provides a detail analysis along with the current and future outlook of the Indian mutual fund industry and explores the market developments and potential. Forecasts and estimations presented here are not based on a complex economic model, but are intended as a rough guide to the direction, in which, the industry is likely to move in future.

Indian mutual funds industry is witnessing a rapid growth on the back of infrastructural development, increase in personal financial assets, and rise in foreign participation. With the growing risk appetite, rising income, and increasing awareness, mutual funds in India are becoming a preferred investment option compared to other investment vehicles. The industry is expected to secure growth by catering to the needs of retail customers. The industry has been largely product-led and not customer focused as the players are not concentrating on new product development as per the needs of the consumers. The industry seeks to target an increased share of the customer pocket through the expansion of innovative products combined with deeper retail penetration by expanding its presence in urban and rural locations.

Literature Review

A large number of studies on the growth and financial performance of mutual funds have been carried out during the past, in the developed and developing countries. Brief reviews of the following research works reveal the wealth of contributions towards the performance evaluation of mutual fund, market timing and stock selection abilities of fund managers. The pioneering work on the mutual funds in U.S.A. was done by Friend, et al., (1962) in Wharton School of Finance and Commerce for the period 1953 to 1958. The following is a brief account of research articles published in books, financial dailies, magazines and research journals by academicians, professionals and journalists explaining the concepts of mutual funds, its importance, features, schemes, investment pattern, method of reading a mutual fund prospectus, how to choose a scheme and significance of IMFI in the economic development of India. Gupta L C, Peeush Ranjan Agarwal, Srivastava S K were a few academicians and professionals who have studied the need for radical changes in the Indian financial system, emergence of mutual fund operations in India, regulatory framework and the impact of taxation on mutual fund performance. Verma's book on mutual funds covers the conceptual and regulatory framework of the mutual funds in India with guidelines for mutual fund selection. A brief account of the research works of Indian academicians are as follows:

Sanjay Kant Khare (2007) opined that investors could purchase stocks or bonds with much lower trading costs through mutual funds and enjoy the advantages of diversification and lower risk. The researcher identified that, with a higher savings rate of 23 percent, channeling savings into mutual funds sector has been growing rapidly as retail investors were gradually keeping out of the primary and secondary market. Mutual funds have to penetrate into rural areas with diversified products, better corporate governance and through introduction of financial planners. The reviews bring to light the importance of mutual funds in the Indian financial scenario; highlight the need for adequate investor protection, single regulatory authority, higher return for a given risk as per investors' expectation, greater convenience and liquidity, and the expectations that mutual funds should act as a catalytic agent of economic growth and foster investors' interest.

Agarwal (2) analyzed the Indian Mutual Fund Industry and point out that there has been incredible growth in the mutual fund industry in India, attracting large investments from domestic and foreign investors. Tremendous increase in number of AMCs providing ample of opportunity to the investors in the form of safety, hedging, arbitrage, limited risk with better returns than any other long-term securities has resulted in attracting more investors towards mutual fund investments.

Gupta (3) in his study examined the growth and development of the mutual fund industry in India during the period 1987 to September 1999. The study revealed that mutual fund industry witnessed major growth in terms of investible funds, number of mutual fund schemes, investor base and range of products offered to the investors.

Gupta (4) in her paper revealed that low customer awareness levels and financial literacy posed the biggest challenge in channelizing household savings into mutual funds. Further, fund house showed limited focus on increasing retail penetration.

Mehru (5) in his study analyzed the problems of mutual funds in India. The study highlighted several problems such as lack of awareness among investors, poor after sale services, non-disclosure of portfolio by mutual funds, inter-scheme transfer of funds and lack of professional fund managers. The study point out that mutual fund were wrongly promoted as an alternative to equity investing and created very high expectations in the minds of the investors.

Panigrahi (6) studied the growth of the mutual fund industry from 1991-92 to 1994-95. Mutual fund collections as a proportion of aggregate bank deposits constantly rose from a meager 8.78 per cent in 1991- 92 to 15.91 per cent in 1994-95. Expenses as a portion of income generated also increased from 2.27 per cent to 4.25 per cent during the period of study.

Objective of Study

- To know the role of mutual funds in the economic development India,
- To focus on the current scenario of the Indian mutual funds,
- To identify future perspective of Indian mutual fund industry in the changing mindset of the investors.

Growth of Mutual Funds in India

By the year 1970, the industry had 361 Funds with combined total assets of 47.6 billion dollars in 10.7 million shareholder's account. However, from 1970 and on wards rising interest rates, stock market stagnation, inflation and investors some other reservations about the profitability of Mutual Funds, Adversely affected the growth of mutual funds. Hence Mutual Funds realized the need to introduce new types of Mutual Funds, which were in tune with changing requirements and interests of the investors. The 1970's saw a new kind of fund innovation; Funds with no sales commissions called " no load " funds. The largest and most successful no load family of funds is the Vanguard Funds, created by John Bogle in 1977.

In the series of new product, the First Money Market Mutual Fund (MMMF) i.e. The Reserve Fund" was started in November 1971. This new concept signaled a dramatic change in Mutual Fund Industry. Most importantly, it attracted new small and individual investors to mutual fund concept and sparked a surge of creativity in the industry.

Mutual Fund & Capital Market

Indian institute of capital market (IICM) aims is to educate and develop professionals for the securities industry in India and other developing countries, other objectives like to function on a Centre for creating investors awareness through research & turning and to provide specialized consultancy related to the securities industry.

Capital market play 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. 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.

Tax Planning and Mutual Fund

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 funds or the equity-linked savings schemes (ELSS) receive certain tax exemptions under Section 88 of the Income Tax Act. That is one of the reasons why the investors in India add the tax-saving mutual fund schemes to their portfolio. 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.

Recent Trend of Mutual Fund

India is at the first stage of a revolution that has already peaked in the U.S. The U.S. boasts of an Asset base that is much higher than its bank deposits. In India, mutual fund assets are not even 10% of the bank deposits, but this trend is beginning to change. Recent figures indicate that in the first quarter of the current fiscal year mutual fund assets went up by 115% whereas bank deposits rose by only 17%. (Source: Think tank, the Financial Express September, 99) This is forcing a large number of banks to adopt the concept of narrow banking wherein the deposits are kept in Gilts and some other assets which improves liquidity and reduces risk. The basic fact lies that banks cannot be ignored and they will not close down completely. Their role as intermediaries cannot be ignored. It is just that Mutual Funds are going to change the way banks do business in the future.

Comparison of investment in Banks V/S Mutual Funds

PARTICULAR	BANK	MUTUALFUNDS
Returns	Low	Better
Administrative exp.	High	Low
Risk	Low	Moderate
Investment options	Less	More
Network	High penetration	Low but improving
Liquidity	At a cost	Better
Quality of assets	Not transparent	Transparent
Interest calculation	Minimum balance between 10th& 30th of every month	Everyday
Guarantee	Maximum Rs. 5 lakh on deposits	None

The most important trend in the mutual fund industry is the aggressive expansion of the foreign owned mutual fund companies and the decline of the companies floated by nationalized banks and smaller private sector players.

Many nationalized banks got into the mutual fund business in the early nineties and got off to a good start due to the stock market boom prevailing then. These banks did not really understand the mutual fund business and they just viewed it as another kind of banking activity. Few hired specialized staff and generally chose to transfer staff from the parent organizations. The performance of most of the schemes floated by these funds was not good. Some schemes had offered guaranteed returns and their parent organizations had to bail out these AMCs by paying large amounts of money as the difference between the guaranteed and actual returns. The service levels were also very bad. Most of these AMCs have not been able to retain staff, float new schemes etc. and it is doubtful whether, barring a few exceptions, they have serious plans of continuing the activity in a major way.

The experience of some of the AMCs floated by private sector Indian companies was also very similar. They quickly realized that the AMC business is a business, which makes money in the long term and requires deep-pocketed support in the intermediate years. Some have sold out to foreign owned companies, some have merged with others and there is general restructuring going on.

They can be credited with introducing many new practices such as new product innovation, sharp improvement in service standards and disclosure, usage of technology, broker education and support etc. In fact, they have forced the industry to upgrade itself and service levels of organizations like UTI have improved dramatically in the last few years in response to the competition provided by these.

Performance of mutual funds in India from the day the concept of mutual fund took birth in India. The year was 1963. Unit Trust of India invited investors or rather to those who believed in savings, to park their money in UTI Mutual Fund. The performance of mutual funds in India in the initial phase was not even closer to satisfactory level. People rarely understood, and of course investing was out of question. But yes, some 24 million shareholders were accustomed with guaranteed high returns by the beginning of liberalization of the industry in 1992. This good record of UTI became marketing tool for new entrants. The expectations of investors touched the sky in profitability factor. However, people were miles away from the preparedness of risks factor after the liberalization.

The Assets under Management of UTI was Rs. 67bn. by the end of 1987. Let me concentrate about the performance of mutual funds in India through figures. From Rs. 67bn. the Assets Under Management rose to Rs. 470 bn. in March 1993 and the figure had a three times higher performance by April 2004. It rose as high as Rs. 1,540bn. The net asset value (NAV) of mutual funds in India declined when stock prices started falling in the year 1992. Those days, the market regulations did not allow portfolio shifts into alternative investments. There was rather no choice apart from holding the cash or to further continue investing in shares. One more thing to be noted, since only closed-end funds were floated in the market, the investors disinvested by selling at a loss in the secondary market.

The performance of mutual funds in India suffered qualitatively. The 1992 stock market scandal, the losses by disinvestments and of course the lack of transparent rules in the whereabouts rocked confidence among the investors. Partly owing to a relatively weak stock market performance, mutual funds have not yet recovered, with funds trading at an average discount of 10.20 percent of their net asset value. The measure was taken to make mutual funds the key instrument for long-term saving. The more the variety offered, the quantitative will be investors. At last to mention, as long as mutual fund companies are performing with lower risks and higher profitability within a short span of time, more and more people will be inclined to invest until and unless they are fully educated with the dos and don'ts of mutual funds.

Problems of Mutual Funds in India

The following are some of the main problems that are being faced by Indian Mutual Funds

• **Liquidity Crisis:** Mutual Funds in India face liquidity problems. Investors are not able to draw back from some of the schemes. There is no exit route. “Bad delivery” has caused a lot of problems and liquidity crisis for the mutual funds.

• **Lack of Innovation:** Mutual funds in India have not been able to provide innovative schemes in terms of risk, liquidity and choice of the investors.

• **Inadequate Research:** Most of the mutual funds in India are suffering due to inadequate research facilities. Most of the funds depend upon external research and have no facilities for inhouse research. They should provide more money on the research and development if they want to be successful in future.

• **Conventional Pattern of Investment:** Mutual funds in India have been following conservative pattern of investment. Theyhave not been able to diversify the risk to a larger extent, which has caused low return on investments.

• **No Provision for Performance Guarantee:** Mutual funds in India have so far failed to provide performance guarantee to the investors. In some cases, there has been erosion of capital.

• **Inadequate Disclosures:** There have not been adequate and timely disclosures of material information to the investors by the mutual funds in India.

• **Delays in Services:** Mutual funds in India have also not been able to provide quick and adequate service to the investors. In many cases, there is no response to the investor’s grievances.

• **No Rural Sector Investment Base:** Indian mutual funds, so far, have not been able to create rural sector investment base. Sufficient efforts have not been made to educate the potential investors. Mutual funds should launch investor’s education programmer and expand their activities in rural areas.

• **Poor Risk Management:** About 50% of the mutual funds are not managing properly and another 50% do not have documented risk procedures or dedicated risk managers.

Future of Indian Mutual Fund Industry

* In spite of the above bottlenecks, the mutual fund industry is having a good prospect in our country. It is likely to show a good progress in the coming years due to a variety of factors.

* SEBI is lending its full support for the promotion of the mutual fund industry directly as well as indirectly.

* Ever since the disbanding of the Controller of Capital Issues Office, many companies have entered into the market with a petty premium on their shares. Naturally, the small investors find them out of reach. Hence, they have to seek the blessings of the mutual fund industry. One can easily subscribe to mutual funds shares at par with one’s little investment.

* In recent times, the interest rates on bank deposits have been declining. The household savers are looking for alternative avenues which could bring higher returns. The returns on the mutual

fund schemes compare favorably with the returns on bank deposits.

* The trend of rising PE ratio, the entry of large domestic institutional investors, the opening of the market to the foreign investors etc., would make stock market inaccessible to the small investors. Hence, they have to necessarily go to the mutual fund industry.

* Mutual Fund provides a wider range of products so as to meet the diverse needs of the investing public. The investors have a good choice to meet their different expectations like security, growth and liquidity.

* The Government has also given the necessary impetus by providing tax concessions and tax exemptions. When the mutual fund industry is receiving a preferential treatment at the hands of the Government, it is bound to grow in future

* The Department of Company Affairs has agreed to amend the companies Act to grant voting rights to companies for mutual funds.

* Mutual Funds have been permitted to underwrite shares also.

* The Union Budget 1998-1999 contains many measures to encourage the mutual fund industry. All these factors would go a long way in making mutual funds as increasingly popular, lucrative and cost-efficient vehicle for investment. If mutual funds ensure good returns, quick liquidity and safety and create a good rapport with the investors, their future will be very bright.

Measures for Satisfactory Performance of Mutual Funds in India

As the mutual fund has entered the capital market, growing profitable enough to attract competition. Into this cherished territory encouraging competition among all the mutual fund operators, there is need to take some strategy to bring more confidence among investors for which mutual would be able to project the image successfully. The following are some of the suggestions.

* As the investors are unwilling to invest in mutual fund unless a minimum return is guaranteed, it is very essential to create in the mind of investors that mutual funds are market instruments and associated with market risk, hence , mutual funds could not offer guaranteed income.

* Growth of mutual fund tends to increase the share holdings in good companies give rise the fear of destabilizing among industrial group, hence, introduction of non-voting shares and lowering the debt-equity ratio help to remove these apprehensions.

* Steps should be taken for funds to make fair and truthful disclosures of information to the investors so that subscribers know what risk they are taking by investing in fund.

* Mutual funds are made by investors and investors’ interest ought to be paramount by setting standard of behaviors and efficiency through self-regulations and professionalism.

* Mutual funds should develop product structuring to tap target customers (VI) Mutual fund should communicate to the investors about their organization and operation.

* Internet and thereby e-commerce which is inevitable now-a –days has to be introduced in mutual funds.

* Proper marketing and distribution system should be developed by mutual funds

* Well-informed institutional market must be developed to remove market inefficiencies
* Mutual funds must make efforts in investor awareness programme which is the need of the day.

Conclusion

India is witnessing a significant growth in the mutual fund market. The growth rate of Indian mutual fund industry is more than that of average growth rate of the global average. Now India is one of the fastest growing markets for mutual fund. The future opportunity for Indian mutual fund industry is also very bright. It is due to the high volatile in the Indian stock market and also due to global recession. As companies the mutual fund are providing an eye-catching return to the investors with a batter safe-guard.

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