MUTUAL FUNDS IN INDIA—CHANGES AND CHALLENGES

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ABSTRACT

Mutual Funds mobilize the hard earned resources of the small investor to deploy the same in a diversified portfolio incorporating various industries. The history of mutual funds in India can be broadly divided into five distinct phases: First Phase - 1964-1987 (formation of Unit Trust of India), Second Phase - 1987-1993 (Entry of Public Sector Funds) Third Phase - 1993-2003 (Entry of Private Sector Funds) Fourth Phase - February 2003 to April 2014 (following the repeal of the Unit Trust of India Act, 1963) and Fifth (Current) Phase – Since May 2014. Mutual funds, being the part of financial system, which is witnessing far reaching changes today, shall have to make changes in their policies and approaches in order to survive and grow. With competition going up in India and most fund houses offering the same bouquet of products to the investors, product differentiation could take center stage going forward. To effectively tide over the challenges, fund houses will have to expand their cost budgets which may put pressure on margins in the short run. They will have to find effective solutions to newly emerging challenges. Lot of changes of the day has set the target before Fund Houses to accept the challenge of making mutual fund investments more popular and investor friendly in India.

Keywords: AMC, UTI, Investor, Fund House, Investments, Schemes, Fund Managers, ETFs, Fees

INTRODUCTION

India’s first mutual fund was established in 1963, namely, Unit Trust of India (UTI), at the initiative of the Government of India and Reserve Bank of India “with a view to encouraging saving and investment and participation in the income, profits and gains accruing to the Corporation from the acquisition, holding, management and disposal of securities”. Simply put, the money pooled in by a large number of investors is what makes up a Mutual Fund. This money is then managed by a professional Fund Manager, who uses his investment management skills to invest it in various financial instruments. In the last few years the MF Industry has grown significantly. The history of Mutual Funds in India can be broadly divided into five distinct phases as follows:

OBJECTIVES OF THE STUDY

This paper attempts to identify the changes and challenges before Mutual Funds Industry in India.

SIGNIFICANCE OF THE STUDY

The paper will help to know the main issues and aspects of Mutual Funds Industry in India. In the present research article, the attempt has been made to focus on the various aspects of Mutual Funds in India, especially, important changes, their impact and challenges ahead in the present situation prevailing in India.

MATERIALS AND METHODS

This is research paper is based on secondary data. Data have been collected from different websites, various magazines, research articles, referred journals and books.
FIRST PHASE - 1964-1987

The Mutual Fund industry in India started in 1963 with formation of UTI in 1963 by an Act of Parliament and functioned under the Regulatory and administrative control of the Reserve Bank of India (RBI). In 1978, UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. Unit Scheme 1964 (US '64) was the first scheme launched by UTI.

SECOND PHASE - 1987-1993 –
ENTRY OF PUBLIC SECTOR MUTUAL FUNDS


THIRD PHASE - 1993-2003 –
ENTRY OF PRIVATE SECTOR MUTUAL FUNDS

The erstwhile Kothari Pioneer (now merged with Franklin Templeton MF) was the first private sector MF registered in July 1993. With the entry of private sector funds in 1993, a new era began in the Indian MF industry, giving the Indian investors a wider choice of MF products.

FOURTH PHASE – SINCE FEBRUARY 2003 – APRIL 2014

In February 2003, following the repeal of the Unit Trust of India Act 1963, UTI was bifurcated into two separate entities, viz., the Specified Undertaking of the Unit Trust of India (SUUTI) and UTI Mutual Fund which functions under the SEBI MF Regulations. With the bifurcation of the erstwhile UTI and several mergers taking place among different private sector funds, the MF industry entered its fourth phase of consolidation.

FIFTH (CURRENT) PHASE – SINCE MAY 2014

Taking cognizance of the lack of penetration of MFs, especially in tier II and tier III cities, and the need for greater alignment of the interest of various stakeholders, SEBI introduced several progressive measures in September 2012 to "re-energize" the Indian Mutual Fund industry and increase MFs’ penetration. Since May 2014, the Industry has witnessed steady inflows and increase in the AUM as well as the number of investor folios (accounts).

GROWTH OF MUTUAL FUNDS IN INDIA

Following two tables denote the growth of Industry.

Since May 2014, the Industry has witnessed steady inflows and increase in the AUM as well as the number of investor folios (accounts).

Table 1. Assets under management and folios -category wise-aggregate- as on December 31, 2016

<table>
<thead>
<tr>
<th>Types of Schemes</th>
<th>Amount (Rs. Cr)</th>
<th>No of Folios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquid/Money Market</td>
<td>308730.58</td>
<td>735113</td>
</tr>
<tr>
<td>Gilt</td>
<td>16937.39</td>
<td>87119</td>
</tr>
<tr>
<td>Debt Oriented</td>
<td>749927.2</td>
<td>8950571</td>
</tr>
<tr>
<td>Equity Oriented</td>
<td>469674.05</td>
<td>39069193</td>
</tr>
<tr>
<td>Balanced</td>
<td>64954.35</td>
<td>3175091</td>
</tr>
<tr>
<td>Gold ETF</td>
<td>5519.33</td>
<td>372188</td>
</tr>
</tbody>
</table>
Table 2. Status of mutual funds for the period April 1, 2016 to December 31, 2016

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Figures in Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobilisation of Funds</td>
<td>12,636,128.14</td>
</tr>
<tr>
<td>Repurchase / Redemption Amt.</td>
<td>12,322,286.18</td>
</tr>
<tr>
<td>Net Inflow/ Outflow (-ve) of funds</td>
<td>313,841.96</td>
</tr>
<tr>
<td>Cumulative Position of net assets as on December 31, 2016 82.42%</td>
<td>1,646,336.93</td>
</tr>
</tbody>
</table>

* Net assets of Rs.5250.66 crores pertaining to Funds of Funds Schemes for December 2016 is not included in the above data.

Source [SEBI]

Changes and challenges

1. Availability of the large number of mutual fund schemes makes investment decision complex and difficult for the average investors.

2. In spite of being a diversified investment solution, mutual funds investment in no way guarantees any return. Every time a person invests in mutual fund, he unavoidably carries the risk of losing money.

3. Many times we witness that mutual funds suffer from weakness of excessive fees.

4. The industry’s drive towards bigger funds is just not the best thing for investors. It is quite amazing that the majority of mutual-fund investors don’t know that fund companies pay their advisors simply to keep clients holding their mutual funds.

5. Many times we witness that mutual funds suffer from short-term focus.

6. Today’s investors’ expectations pushed fund managers to go out of the way and try to find special opportunities in fixed income. As a result we find the increasing popularity of Floating Rate fund and the Income fund, both among the most popular schemes of mutual funds even though fees may be a half point higher for these types of funds.

7. Most of the mutual funds charge Shareholder Fees and Fund Operating Fees from the investors. In the year, in which mutual fund fails to make profit and the investors get no return, these fees only blow up the losses.

8. Low interest rates have led investors to all manner of income-producing investments: dividend paying stocks, municipal bonds, corporate junk bonds and much more. But you can't just gobble up income across the globe and across the credit spectrum and call it diversification. So there has been a push into things like bank participation funds, short-term bond funds.

9. Hedging strategies are popular with people over 55 who want to manage their downside. The flows into such category-killer funds point up another trend: the growth of mutual funds with little correlation to market benchmarks. Financial advisors increasingly embrace these funds for pre-retirees, who don't need to beat a benchmark but must earn something before they call it
quits. Investors in these funds have been willing to pay fees about a half point higher than on traditional funds, valuing more certain, if less robust, gains.

10. It is true that one mutual fund scheme requires only 20 to 30 companies for investment but with so many schemes of one single mutual fund around, it becomes challenging for a mutual fund managers to invest differently.

11. In the current scenario, selecting a good mutual fund scheme has become as challenging as selecting a good stock.

12. The recently announced Rajiv Gandhi Equity Savings Scheme is another opportunity for the mutual fund industry. Given the low financial awareness of new or first time investors in the far flung regions, it is imperative that these investors are channelized into the markets via mutual funds rather than directly investing into equities themselves!

13. Since, investors’ value safety above the potential to beat the market, according to industry experts, ETFs is bound to get their popularity in future.

14. Fund houses presently, offer variants of SIP. and this on the one hand is useful for well informed investors, on the other brings complications for ill-informed investors as they tend to get confused which may lead to wrong decisions. This may bring irritations as wrong decisions may have to be corrected in future with complications and losses.

15. In case of over diversification, investors diversify so much that many time they end up with investing in funds that are highly related and thus the benefit of risk diversification is ruled out.

16. Most of the mutual funds sell substantial amount of their holdings. If they earn profit by this sell, then the investors receive the Profit Income. For most of the mutual funds, the investors are bound to pay taxes on these incomes, even if they reinvest the income.

17. It is often difficult to differentiate two large cap funds. The need for differentiation results into wrong stock selection or in some cases concentration of fund portfolio into selected stocks only.

18. Since comparison with the benchmark index is often seen as the barometer of the performance of the fund, mutual fund schemes put all their energy into beating an index. In the desire to beat the benchmark index, many schemes end up adopting strategies which do not work well in the long run.

19. Beyond a certain asset level, there are very little marginal cost savings from a bigger mutual fund compared to a smaller fund. However, the industry’s goal is to get assets in the door so there is a drive to favor big funds.

20. The industry’s drive towards bigger funds is just not the best thing for investors. It is quite amazing that the majority of mutual-fund investors don’t know that fund companies pay their advisors simply to keep clients holding their mutual funds.

21. The fact that there isn’t a discount on fees for larger clients might be unique in the business world: It simply doesn’t make any sense to charge your biggest clients more than your smaller clients.

22. If you have ever taken a look at the Top 10 holdings of the biggest mutual funds in India, you will find almost the same stocks so investors end up with index-like performance, but pay much more in fees than they would with an equivalent ETF product.

23. Most fund managers — rightly so — like their jobs, and straying too far from the index are a risky proposition for them. If they are wrong, they look pretty bad. But hugging the index and not straying too far from it only ensures, job security for the managers, and mediocre fund performance.
24. Tall claims of fund managers regarding holding of hundreds of different companies is another eyewash as numerous independent studies over the years have proven that the investment benefits of diversification are severely diminished once you get beyond just 20 companies. Not only is it impossible for a fund manager to fully keep track of 200 different companies, it also adds nothing to the fund's risk/return profile.

25. Many times we witness that mutual funds suffer from unnecessary asset gathering.

26. Investors now want the safety of more global exposure.

27. KYC norms are perceived as complicated and that restricts potential investors.

28. A rational look at schemes of an AMC by their management teams is needed to better understand the mix, the cost and the benefits – to the investors as well as to the AMCs.

29. Quality of advice provided today is neither adequate nor sufficient for the future growth of mutual funds.

30. Fund houses so far have showed limited focus on increasing retail penetration.

31. Rural participation in mutual funds continues to be poor. Such poor penetration has much to do with lack of investor awareness, inefficiencies in fund transfer mechanisms, presence of safer substitutes and cost of establishing presence in smaller areas.

32. As and when investment climate turns hostile, investors increasingly seek the security of brand-name mega mutual funds. Even today there are just a handful of popular mega funds, and they are sucking up most of the assets.

33. The rise of ETFs continued through the recession with big inflows for some time, and the pace quickened more than a decade however, with the adverse news and low return expectations of investors created hurdles in the popularity of the ETFs.

34. Today the needs identified by experts of the industry, to shoulder the present challenges before them, include transparency, tact and tax effectiveness.

CONCLUSION

Mutual funds, being the part of financial system, which is witnessing far reaching changes today, shall have to make changes in their policies and approaches in order to survive and grow. The sea of changes in the financial and economic scenario in our country has brought with it a fresh wave of opportunities. These opportunities and challenges can only lead to the betterment of the investment community at large. Strong regulatory framework, greater transparency, increased innovations, better services to the investors, liquidity and higher returns could make mutual fund investments more popular and investor friendly in India.

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