RECENT TRENDS AND CHALLENGES FACED BY MUTUAL FUNDS IN INDIA

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ABSTRACT

Mutual Funds have emerged as an important investment alternative to invest in the capital market. After the announcement of the liberalization policy in 1991, the growth of the Indian economy has been miraculous and the per capita income has also increased. The Indian Mutual Fund Industry is witnessing a rapid growth as a result of infrastructural development, increase in personal financial assets, and rise in foreign participation. Mutual Funds in India are becoming a preferred investment option compared to other investment vehicles like Fixed Deposits (FDs) and Postal Savings that are considered safe. During the past two decades the growth of the upper middle and middle class in India has also been fabulous, and this is the group, which due to increase in income has enormous and changing needs, and is targeted by almost all mutual fund companies, but it is seen that these mutual fund companies have not succeeded enough to attract individual to invest in their products. The future of Mutual Funds to a great extent depends on Government policies and expectations of small investors. Transparency, innovative schemes, better services, liquidity, safety and higher returns in future will make Mutual Funds more effective provided if the industry meets the challenges prevailing.

Introduction

A Mutual Fund is type of professionally managed collective investment vehicle that pools money from many investors to purchase securities. A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The money thus collected is then invested in capital market instruments such as shares, debentures and other securities. The income earned through these investments and the capital appreciation realized is shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment 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 Association of Mutual Funds of India (AMFI) is a self-governing association of Indian Mutual Funds that regulates its member's sales, distribution and communication practices. It was incorporated on 22nd August, 1995. (AMFI) modeled on the lines of a Self Regulating Organization (SRO)

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with a view to 'promoting and protecting the interest of mutual funds and their unit-holders, increasing public awareness of mutual funds, and serving the investor's interest by defining and maintaining high ethical and professional standards in the mutual funds industry'. Investors can invest in Indian mutual funds directly or through distributors under codes of practice developed by AMFI.

There are 46 Mutual Funds in India. As of 30 June 2013, the Indian Mutual Fund industry manages assets worth approximately Rs.847,000 crore. In May 2014, mutual funds in India reached a historic high of 10 lakh crore AUM. Asset Under Management (AUM) is a financial term denoting the market value of all the fund being managed by a financial institution (a mutual fund, hedge fund, private equity firm, venture capital firm, or brokerage house) on behalf on its clients, investors, partners depositors, etc.

Every Mutual Fund is managed by a fund manager, who, by using his investment management skills and the necessary research work, ensures better returns than what an investor can manage on his own. The capital appreciation and other incomes earned from these investments are passed on to the investors in proportion of the number of units they own. However, all mutual fund investments are subject to market risk and every fund manager is expected to design the portfolio keeping in view the investment objective of a particular mutual fund scheme.

The income earned through these investments and capital appreciations realized by the scheme are shared by its unit holders in proportion to the number of units owned by them. Thus mutual fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

Concept of Mutual Fund :

SEBI (Mutual Funds) Regulations 1993, define Mutual Fund as follows

"A fund established in the form of a trust by a sponsor to raise monies by the trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with these regulations**".**

Frank Reilly defines, Mutual Funds "as financial intermediaries which bring a wide variety of securities within the reach of the most modest investors"

Review of Literature

Mehry (2004) 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 managers. The author suggested that greater transparency, increased innovations, better services

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to the investors, liquidity and higher returns could make mutual fund schemes more popular and investor friendly in India.

Rajeshwari and Ramamoorthy (2001) In this study attempted to measure the awareness of retail investors about the concept and functioning of mutual funds in Bombay, Bangalore and Hyderabad. The study revealed that 56.7 percent of the men and 52 percent of the women among the potential investors had poor / inadequate awareness about mutual funds. Among the present investors, 33.3 percent men and 65.5 percent women had poor/inadequate awareness.

Shyam Sundar (1998) The survey revealed that the awareness about mutual fund concepts was poor during that time in small cities like Vishakhapatnam. Agents play a vital role in spreading the mutual fund culture, open-end schemes were much preferred then, age and income are the two important determinants in the selection of funds/scheme, brand image and return are their prime considerations.

Harrison (2000) The study analyzed that majority of investors who invest in mutual funds themselves are not clear with the objective and constraints of their investment, in addition to this, the most important critical gap that exist in this process is the lack of awareness about presence of risk elements in mutual fund investment.

Objective

The main objective of the study is, to study recent trends in Mutual Fund and to study the challenges faced by Mutual Fund in India.

Methodology

The study is based upon secondary information collected from various Annual Reports of Banks, some information also collected from different economic survey, reputed journals, magazines and websites.

Investor mix

The asset management industry held 39.5 million folios as on 31 March 2014, which has declined from around 47.6 million as on 31 March 2009. The composition of the sources of investment for the industry as a whole in 2009 and in 2014 is given here. This shows that the industry has not managed to improve the share of retail and individual investors in the AUM of the industry over the last decade. The share of AUM from the top metros has remained relatively high and recently SEBI has amended relevant guidelines to improve the economics of selling to investors in cities other than the top 15. This was done to revitalize mechanisms for reaching the larger mass investor in Tier 2 and 3 towns, not only through distribution economics but by enabling distribution through multiple channels such as retired government employees, etc.

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Product basket

Over the years the industry has developed an extensive product basket covering various investment opportunities. However, the 80-20 rule applies. Over 80% of the AuM is in less than 20% of the product categories. Is there room for simplification of the product basket?

Regulatory updates

Long-term policy on mutual funds :

The Securities and Exchange Board of India (SEBI) has framed a long-term policy1 for mutual funds. The policy covers aspects including enhancing the reach of mutual fund products, promoting financial inclusion, tax treatment, obligation of various stakeholders, increasing transparency, etc. Its recommendations have been separated into non-tax proposals and tax-related proposals. Most of the non-tax proposals have been notified by the SEBI by way of circulars or notifications. The salient features of the policy are as follows:

Non-tax incentive amendments and proposals :

Increase in net worth requirement to 500 million INR The SEBI has recently notified regulations enhancing the net worth requirement of asset management companies (AMCs) from 100 million INR to 500 million INR. AMCs have been provided a period of three years to comply with the increased net worth requirement. They shall be permitted to launch new schemes only after they comply with the new net-worth requirement. For AMCs eligible to launch only infrastructure debt schemes, the minimum net- worth requirement has been retained at 100 million INR.

Introduction of the concept of 'seed capital'

- The sponsor or the AMC is now required to invest at least 1% or 5 million INR, whichever is less, (in new open-ended fund offerings) of the amount raised in the growth option. Furthermore, such investments cannot be redeemed until the scheme is wound up.
- For existing open-ended schemes, the sponsor or the AMC needs to comply with the above stipulation within a period of one year.

Disclosures of assets under management (AUM)

In order to enhance transparency and increase the quality of the disclosures for investors, mutual funds are required to disclose on their websites, on a monthly basis, different types of AuMs, and also to share these with the Association of Mutual Funds of India (AMFI).

Disclosure of votes cast by mutual funds:

To improve transparency and to encourage mutual funds, AMCs will be required to diligently exercise their voting rights:

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- Record and disclose the specific reasons supporting the voting decision with respect to each voting proposal.
- Disclose these reasons on their websites (on a quarterly basis) and in their annual report.
- To obtain voting reports certified by the auditors on an annual basis. The board of directors of the AMC and the trustees of the mutual fund shall be required to review and ensure that the AMCs have voted on important decisions that may affect the interest of the investors, and that the rationale recorded for the voting decision is prudent and adequate.

Features of the mutual funds

- With the Mutual Funds investment, risk is spread out over many stocks of many companies, not just one. **Less risk** is associated. The ups and downs in the value of investment are potentially less with a Mutual Fund than with an individual stock because investments are more diversified.
- Mutual Funds make it easy for investor to invest in stocks and bonds. The two main advantages of investing money in Mutual Funds are a) **Receive professional money** management and b) investor able to **diversify his holdings** with a small sum of money.
- Each Mutual Fund has one or more **fund managers** who are skilled in the principles of money management. They have access to a huge database of research.
- Each fund also has a particular objective. That objective is defined in the **fund's prospectus,** which describes a mutual fund and offers its shares for sale. The prospectus provides information such as investment objectives, charges, expenses, and operating policies. A prospectus must be provided to an investor at the time of sale. The investor should read it carefully before sending money or investing.
- The objective could be, for example, **long-term growth, current income, or a combination of income and growth.** For example, the objective of XYZ fund is long-term growth. To accomplish the fund's objective, the fund manager invests the money received from its shareholders (that's investor) by purchasing shares of many individual companies (or leaving a small portion in cash).

Characteristics of Mutual Funds

The specific characteristics of Indian Mutual Fund Schemes can be narrated as listed below.

- **Assurance of minimum returns:** In general mutual funds do not assure any minimum returns to their investors. However, Indian Mutual Fund Schemes launched during 1987 to 1990 assured specific returns till 1991, when the SEBI and Union Ministry of Finance order

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the mutual funds not to assure minimum returns. Recently, SEBI has formulated a policy that, mutual funds with a track record of five years will be allowed to offer fixed returns not exceeding one year period.

- **Multiple Options:** Most of the mutual fund schemes are offering different options to the investors under one scheme. For example, a growth oriented scheme may offer option of either regular income or re-investment of income. Under the regular income plan, dividend shall be distributed to investors and under the second dividend will be reinvested and total amount shall be paid at time of redemption.
- **Lock in Period:** Mutual Fund Schemes offer documents that contain a clause of lock-in period ranging from one year to three years. Till the completion of the minimum period the investors are to trade neither the units on the stock exchange nor to avail themselves of repurchase facility.
- **Liquidity:** Generally open-ended funds offer the facility of repurchase and the close ended are traded at stock exchange offering repurchase after a minimum lock in period of two to three years. Mutual funds also have a facility to pledge or mortgage at banks to obtain loan and can be transferred in favour of any individual.
- **Incentives to early subscribers:** Most of the close-ended mutual fund schemes are offering incentives to encourage early subscription to investors. This is more often in the tax planning schemes. For instance, if the scheme is open for a period of three months, the investor may be allowed a deduction from the amount to be invested at a certain specified rate, if the subscriptions were during the specified time limits.

Future Outlook of Mutual Fund

Mutual Funds are restructuring their business models to provide for increased efficiencies and investor satisfaction.

- **Easy access**: Because of the technology advancement, in the next 10 years, investors can expect to find a Mutual Fund office wherever they reside which makes sure those investors can access any Mutual Fund at a press of button.
- **Meeting all of the investor's needs**: Rather than depositing all his savings in the bank, investor will start investing in the debt and equity solutions offered by the category.
- **More comprehensive disclosures**: Higher levels of disclosures would help investors choose the right fund.
- **Better risk control** : Investors in the future can expect higher sophistication in risk control techniques.

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- **Greater awareness**: More Indians should become aware of the benefits of investing in Mutual Funds and consider this as a referred vehicle for investment.
- **Superior advice**: With increase in the number of Mutual Fund Houses and schemes, choosing the right product is also becoming complex. Add to this the new lines that will emerge, and investors should expect the industry's advisory skills to improve by introducing regulatory standards, financial planning and analysis tools.
- **From relative performance to outcome orientation**: Beside the traditional products, Mutual Fund investors could expect outcome oriented products for principal protection and retirement, which will provide more choice to match their return and risk expectations.

Challenges faced by Mutual Fund Industry

People find mutual fund investment so much interesting because they think they can gain high rate of return by diversifying their investment and risk. But, in reality this scope of high rate of returns is just one side of the coin. On the other side, there is the harsh reality of highly fluctuating rate of returns. Though there are other disadvantages also, this concern of fluctuating returns is most possibly the greatest challenge faced by the mutual fund.

- **Low Investor awareness levels and financial literacy**: Majority of the investors lack an understanding of risk-return, asset allocation and portfolio diversification concepts.
- **Limited innovation in product offerings**: Products schemes that outfit specifically to investor life stage needs such as education, marriage and housing are yet to find their way in the Indian market. Like in other countries, the Indian Mutual Fund industry has to launch the Green funds, socially responsible investments, Fund of Hedge funds, Enhanced money market funds, renewable and energy/climate change funds.
- **Strict enforcement of regulations**: The Indian Mutual Fund industry is governed by the strict enforcement of SEBI (Mutual Fund) Regulations1993. PAN card requirement to invest in Mutual Funds, payment only through banking facilities, creating a separate legal entity for Pension Funds by the Asset Management Companies and many other complex rules pose a serious challenge to the Mutual Fund industry.
- **Inefficiency of Mutual Fund distributors**: Mutual Fund distributors have been facing questions on their competence, degree of engagement with investor and the value provided to the investor. This also causes a serious problem to the industry.
- **Domination of private sector Mutual Funds**: As the public sector mutual funds are not able to offer the services as like private sector, they are unable to compete with them. Further, the credibility enjoyed by the Nationalized Banks, Regional Rural Banks and Co-

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operative Banks in the rural vicinity has not been fully leveraged to target the retail segment.

- **Multiple regulatory frameworks governing financial services sector 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 frame work and are competing for the same share of the investor's wallet. The Mutual Fund industry lacks a level playing field in comparison with other areas within the financial services sector.

Suggestions

- Mutual Funds are not simple investments; they require a good amount of awareness about the capital markets and the related laws. This necessitates a need for investor's education through seminars, conferences etc. This can also be done through regular use of the Tv, the Internet, Newspapers and Professional Magazines/Journals.
- Winning the investor's confidence and protecting their right is the common objective of all mutual fund companies. SEBI should see to it that mutual fund companies follow corporate governance regulations, and their working is transparent.
- Due changing scenario, the need for online trading of securities is felt. Effort should be made to promote online trading of mutual funds. This will save time and cost.
- Each mutual fund should be required to establish its own investor's grievance cell. This will help to sort out the grievances of the investors.
- Mutual Funds should build investor's confidence through schemes meeting the diversified needs of investors, speedy disposal of information, improved transparency in operations, better customer services and assured benefits due to professionalism.

Conclusions

The Mutual Fund industry in our country has witnessed a significant growth in the past few years driven by several favorable economic and demographic factors such as rising income levels, increased investor's education, and the increasing reach of Asset Management Companies and Distributors. The success of Mutual Funds rely at improving the margins by identifying the competitive advantage in the areas of professional management of funds, marketing the schemes in the rural and semi urban regions, designing the schemes with innovative benefits and improving the quality of investor service.

Thus Mutual funds in India have displayed a phenomenon growth since the initiation of economic reforms in 1991. But Mutual Funds are facing a host of affecting factors that has been recognized as barriers in their growth. In this context financial reforms managing especially the

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Mutual Funds has become more challenging than ever before. New models of management are required. Such models will demand new ways of thinking, new knowledge, new skills and new techniques. The Mutual Fund management must acquire these traits. One has to appreciate that mere launching of schemes by the institutions alone will not be sufficient to bring in necessary performance improvement and to get the competitive edge.

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