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Mutual Funds in India – A Comprehensive Growth Analysis

KEYWORDS: Mutual Fund, Net Asset Value, Asset Management Company

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ABSTRACT *The Indian mutual funds industry is witnessing a rapid growth as a result 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 like Fixed Deposits (FDs) and postal savings that are considered safe but give comparatively low returns. This report provides a detailed analysis along with future outlook of the Indian mutual fund industry and explores the market development and potential along with the changes in costs and regulations. The forecasts and estimations given in this report 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.*

Introduction
A mutual fund is a professionally managed investment instrument that pools money from many investors to buy securities. The fund manager invests this large pool of money in a portfolio of various assets. A mutual fund may include investments in stocks, bonds, currencies, options, futures, etc. The income earned through these investments and the capital appreciation realized is shared by the unit holders in proportion to the number of units owned by them. Thus a mutual fund is one of the most suitable investments for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

Net Asset Value
Net asset value (NAV) measures the value of a fund's assets, minus its liabilities.

NAV = (Market Value of All Securities Held by Fund + Cash and Equivalent Holdings - Fund Liabilities) / Total Fund Shares Outstanding

Let's assume at the close of trading yesterday that a particular mutual fund held INR 10,500,000 worth of securities, INR 2,000,000 of cash, and INR 500,000 of liabilities. If the fund had 1,000,000 shares outstanding, then yesterday's NAV would be:

NAV = (10,500,000 + 2,000,000 - 500,000) / 1,000,000 = INR 12.00

Net asset values are like stock prices in that they measure the value of one share of a fund. Also, they give investors a way to compare a fund's performance with market or industry benchmarks.

Operation of Mutual Fund

Figure - 1: Operation of Mutual Funds

1. Fund Sponsor
A "sponsor" is any person who, acting alone or in combination with another body corporate, establishes a MF. The sponsor of a fund is similar to the promoter of a company. In accordance with SEBI Regulations, the sponsor forms a trust and appoints a Board of Trustees, and also generally appoints an AMC as fund manager.

2. Trustees
The MF or trust can either be managed by the Board of Trustees or by a Trust Company. Most of the funds in India are managed by Board of Trustees. The trustees, however, do not directly manage the portfolio securities.

3. Asset Management Company (AMC)
The AMC, which is appointed by the sponsor or the trustees and approved by SEBI, acts like the investment manager of the trust. The AMC functions under the supervision of its own Board of Directors, and also under the direction of the trustees and SEBI.

4. Others:
Apart from these, the MF has some other fund constituents, such as custodians and depositories, banks, transfer agents and distributors. The custodian is appointed for safe keeping of securities and participating in the clearing system through approved depository. The bankers handle the financial dealings of the fund. Transfer agents are responsible for issue and redemption of units of MF.

History and Growth of Mutual Funds in India
The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and the RBI. The history of mutual funds in India can be broadly divided into four distinct phases.

First Phase - 1964-87
- Started in 1963 with Unit Trust of India, Government of India & RBI.
- Unit Trust of India (UTI) was established on 1963 by an Act of Parliament. It was set up by the RBI and functioned under the regulatory and administrative control of the Reserve Bank of India.
- 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.
- First scheme launched by UTI was Unit Scheme 1964.
- In 1988 UTI had Rs.6,700 crores of Assets Under Management.

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Second Phase - 1987-1993 (Entry of Public Sector Funds)

- In 1987 public sector banks and Life Insurance Corporation of India (LIC) and GeneralInsurance Corporation of India (GIC) got the Entry in MF Industry.
- SBI was the first non- UTI Fund established in June 1987 followed by Canbank (Dec 87),
  Punjab National Bank (Aug 89), Indian Bank (Nov 89), Bank of India (Jun 90), Bank of Baroda (Oct 92).
- LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990.
- At the end of 1993, the mutual fund industry had Assets Under Management of Rs.47,004 crores.

Third Phase -1993-2003 (Entry of Private Sector Funds)

- In 1993, a new era started in the Indian MF industry, giving the Indian investors a wider choice of fund families.
- In 1993 first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.
- The 1993 SEBI Regulations were substituted by a more comprehensive and revised Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996.
- The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions.
- As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores.

Fourth Phase since February 2003

- In February 2003, following the repeal of the Unit Trust of India Act 1963, UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs.29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India functioned under an administrator and rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.
- The second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI and setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth. Today, the industry stands at 46 asset management companies that manage Rs. 8.5 trillion (over USD 140 billion) of Assets under Management (AUM) raised from around 47 million accounts. The rules-driven regulatory framework in India has meant that innovation in the securities markets often drives changes in the rules on how mutual funds can access these innovations in offering new products to their customers. However, regulations governing the fund management process have been more or less stable, albeit conservative.

Costs and Regulations

There are various expenses incurred in a typical mutual fund product, some of which are listed below:

❖ Indirect costs - These costs are charged to the scheme and are accounted for in the computation of Net asset value (NAV).

▪ Initial issue expense: These costs include sales and distribution fees. e.g. marketing, advertising, registration, printing, bank charges etc pertaining to the new fund owner (NFO).

▪ Annual scheme recurring expenses: These are operating charges of the scheme. Includes management and advisory fees (charged by AMC), registrar and transfer agents' fee, marketing and selling costs etc.

❖ Direct costs - These costs are directly paid by the investors and are over and above NAV. These include:

▪ Entry load
▪ Exit load
▪ Securities transaction tax
▪ Income tax

SEBI regulations control the expenses that can be charged to the customers in two ways: setting a list of the expenses that cannot be charged and setting limits on some other expenses. As expected, each of these regulatory changes has engendered a reaction in the behavior of industry. Based on the major regulatory changes that have taken place with regards to costs charged by the mutual fund industry, we list the following regulatory regimes:

❖ Pre-2006 : Both open and closed end funds were allowed to charge maximum of 6% as initial issue expense as well as entry and exit loads. The regulatory limit for loads was 7%. In reality, a fund could charge up to 7% of NAV, provided the repurchase price was not lower than 93% of the sale price. Recurring expense ratio had the maximum of 2.5% which remained unchanged until 2010. For many mutual funds it has remained a standard entry load of 2.25%. Industry practice was to charge a maximum load of 2.5% on equity funds whereas entry loads on debt funds were virtually non-existent.

❖ 2006-2008 : From April 2006 onwards till the start of 2008. The features of the change were as follows:
Initial issue expenses were only permitted for closed-ended schemes, with a maximum limit at 6% subject to amortization provisions. Since open ended schemes were not permitted these expenses, they were stipulated to meet all expenses connected with sales and distribution of schemes from the entry load (maximum 6%). Since closed-ended schemes are allowed to charge initial issue expenses, they were not permitted to charge entry load.

❖ 2008 : In January 2008, initial issue expense (and related amortization) was no longer permitted. Mutual fund schemes had to adjust expenses connected with sales and distribution of schemes from the entry load.

❖ 2009, Phase I : August 2009, the entry load was removed from all types of mutual fund schemes and exit load was made uniform across all fund categories, subject to a maximum of 1%.

❖ 2009, Phase II : November 2009, all mutual funds were made tradable - both for entry as well as exit - through the stock exchanges trading platform.

Conclusion

Year	FY07	FY08	FY09	FY10	FY11	FY12	FY13
AUM	3.53	5.3	4.9	7.5	7.0	6.7	8.2
AMCs	35	37	39	43	42	44	45

Table-1: Trend in AUM volumes (Rs. Trillion) and no. of AMCs during FY07-FY13

India has witnessed significant growth in the past few years driven by several favorable economic and demographic factors such as rising income levels and the increasing reach of Asset Management companies (AMCs). Current state of Indian mutual fund market is; the growth rate of Indian mutual fund industry is more than the global average. India is one of the fastest growing markets for mutual funds. The future opportunity for Indian mutual fund industry is also very bright. It is due to the high volatility in the Indian market. As companies, mutual funds are providing an eye-catching return to the investors with a better safe-guard.

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