Research Paper Commerce

Challenges and Issues Faced By Indian Mutual Fund Industry

Dr. Mehul.P.Desai

Head, Department of Accountancy,Udhna Citizen Commerce College, Surat.

ABSTRACT

Mutual fund sectors are one of the fastest growing sectors in Indian economy that have potential for sustained future growth. Mutual funds make saving and investing simple and affordable.

Anybody with an investible surplus of as little as a few hundred rupees can invest in mutual funds. The innovative marketing strategies of mutual fund companies in India are influencing the retail investors to invest their surplus funds in different types of securities.

The paper evaluates the challenges and opportunities of mutual funds in India. The mutual fund provides opportunity for investors to invest in diversified portfolios and get the benefit of betters along with professional management. However, the poor awareness along with conservative mindset has restricted the growth of mutual funds.

KEYWORDS

Introduction

Financial system comprises financial institutions, services, market and instruments. Financial institutions mobilize resources, purchase and sell instruments and render various services in accordance with the practices and procedures of law. Investing in financial securities is a complex one involving knowledge of various investment tools, terms, concepts, strategies and process. The success of a financial investment activity depends on the knowledge and ability of investors to invest the right amount, in the right type, at the right time. Investor has to use his intellect, which is an art to acquire by learning and experience. Knowledge of financial investment principles and the art of investment management are the basic requirements for a successful investment.

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. Buying a mutual fund is like buying a small slice of a big pizza.

The mutual fund industry spanning almost two decades now has seen its share of success and failure. It is quite commendable that we have reached a mark of almost 12328000 million INR of assets under management as of March 2016. This has been a result of collaboration of all industry stakeholders like the distributor, the asset management company and the regulator who has shaped the way forward for the industry. While the industry has grown significantly and there is much to be satisfied about, there are opportunities for improvement too. The AuM to GDP ratio stands at 7 to 8% as compared to a global average of 37%. Increasing mutual fund penetration will largely depend on increasing investor awareness at grass-roots level and providing access to financial services to the still largely unbanked population. In its effort to increase investor awareness, the industry and the Securities and Exchange Board of India (SEBI) have launched several initiatives. These include literature and campaigns to propagate financial education to various investor segments (including potential investors), such as school and college students, homemakers, executives, etc. The two-pronged approach of increasing awareness of and access to financial products and services has and will go a long way in increasing the penetration of mutual funds in the country.

Opportunities of mutual fund industry in India: Mutual funds makes saving and investment simple, accessible and affordable. The opportunities for investors in mutual fund industry are;

a) Professional Management: The management of the fund is generally assigned to professionals, who are well trained and have adequate experience in the field of investment. The investment decisions of these professionals are always backed by informed judgment and experience. Thus, investors are assured of quality services in their best interest.

b) Diversification: Mutual Funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. Investors achieve this diversification through a Mutual Fund with far less money than one can do on his/her own.

c) Convenient Administration: Investing in a Mutual Fund reduces paperwork and helps investors avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual Funds save time and make investing easy and convenient.

d) Return Potential: Over a medium to long-term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

e) Low Costs: Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage, custodial and other fees translate into lower costs for investors.

f) Liquidity: In open-end schemes, the investor gets the money back promptly at net asset value related prices from the Mutual Fund. In closed-end schemes, the units can be sold on a stock exchange at the prevailing market price or the investor can avail of the facility of direct repurchase at NAV related prices by the Mutual Fund.

g) Transparency: Investors get regular information on the value of their investment in addition to disclosure on the specific investments made by their scheme, the proportion invested in each class of assets and the fund manager's investment

 ISSN - 2250-1991 | IF : 5.215 | IC Value : 77.65

strategy and outlook.

h) Flexibility: Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans; one can systematically invest or withdraw funds according to his/her needs and convenience.

i) Affordability: Investors individually may lack sufficient funds to invest in high-grade stocks. A mutual fund because of its large corpus allows even a small investor to take the benefit of its investment strategy.

j) Tax Benefit: In India, dividend received by the investor is tax free. This enhances the yield of mutual funds marginally as compared to income from other investment options. Also, in the case of long-term (more than one year) capital gains, the investors do not need to pay tax for all equity purchases after March 1, 2003.

k) Choice of Schemes: Mutual Funds offer a family of schemes to suit the investor's varying needs over a lifetime.

l) Well Regulated: All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI.

Growth of Mutual Funds in India

Source: SEBI

Challenges and Issues faced by Indian Mutual Fund Industry

While the Indian mutual fund industry has grown at an impressive rate in the last few years, the recent developments of the past few months triggered by the global financial crisis have impacted the fortunes of the industry resulting in AUM decline, adversely influencing the revenue and profitability.

Researcher has attempted to identify and highlight some of the key issues and challenges being faced by the industry participants that are preventing the industry harnessing its true growth potential.

1. Low Levels of Customer Awareness: Low customer awareness levels and financial literacy pose the biggest challenge to channelising household savings into mutual funds.

A low awareness level 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 and majority of them draw little distinction in their approach to investing in mutual funds and direct stock market investment. A 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.

2. Limited Focus on increasing Retail Penetration: The Indian mutual fund industry had limited focus on building retail AUM and has only recently stepped to make efforts to augment branch presence in towns. Large ticket size, tax arbitrage available to corporates on investing in money market mutual funds, easy accessibility to institutional customers concentrated in Tier 1 cities are the factors instrumental in mutual fund houses focusing 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.

3. Limited focus Beyond the Top 20 cities: The mutual fund industry has continued 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 aware and willing, are unable to invest in mutual funds owing to limited access to suitable distribution channels and investor servicing. 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 focusing on cities beyond the Top 20 by building their branch presence and strengthening distribution reach through non-branch channels.

4. Limited Innovation in Product Offering: The Indian mutual fund industry has largely been product-led and not sufficiently customer focused. The popularity of New Fund Offer (NFOs) triggered a proliferation of schemes with a large number of non-differentiated products. The industry has had a limited focus on innovation and new product development, thereby 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. Further, relatively nascent product categories viz. multi-manager funds that are among 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.

5. 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 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 in limited instances regardless of the service rendered). As a result of the limited engagement, there have been rising instances of mis-selling to customers.

7. Limited Focus of the Public Sector Network on Distribution of Mutual Funds: Public sector banks with a large captive customer base, have so far played a very limited role in mutual funds distribution. The India Post network operating the larges postal network in the world majority of which is in rural areas, is stated to have 250 post office 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 distributors. 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 utilized to date for mutual fund distribution. 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 Cooperative Banks in the rural hinterland has not been fully leveraged to target the retail segment.

8. Availability of a large number of mutual funds schemes makes investment decision complex and difficult: The Indian investor witnessed significant rise in New Fund Offers (NFOs) over the last two to three years from AMCs seeking to augment AUM and diversify product basket. India has over 979 mutual fund schemes resulting in a total AUM of INR 4,173 billion as on 31 March 2009. The ratio of the assets per scheme is one of the highest in the world. Given that there is a plethora of options with limited differentiation across mutual fund schemes, the respondents perceive a difficulty in investing in mutual funds in the absence of quality advice.

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.

To overcome the challenges some of future recommendations are:

Increasing financial literacy will be the key to unlock the doors to B-15 and also to remove the perception that equates mutual fund to only equity. Investor awareness campaigns should be conducted to increase the AUM in smaller cities which would help industry to progress in a holistic manner. AMC, distributors and IFAs are all doing their bit but AMFI and SEBI should also play a major role in creating awareness.

Knowledge about mutual fund industry should be included in **educational curriculum**. The mantra should be—to catch them young.

Fund houses may need to find and partner with the right **distributor** to make the products available to investors in smaller cities. Therefore, Banks and IFAs could play a pivotal role in reaching the investor base. Also, distributors should be incentivised enough to ensure that they project mutual funds as a long-term investment for fulfilling financial goals.

For future growth, **tax could act as an enabler as tax benefits** can be a pull factor for investors

Technology can act as a key enabler and help the fund houses reach investors at a low cost and more efficient manner. AMCs need to make the relevant investments in technology to help reach investors to help ensure transactions on the channels of their choice.

The future potential of **Investment Advisors** could be decided by Investors and the regulators. Presence of an unbiased advisor could build investor trust on the one hand and reward performing products on the other. These measures should help the industry on the path to better growth. However, we need all stakeholders viz. asset management companies, distributors, regulators to work together to help ensure the common goal of growth along with profitability is achieved.

Conclusion:
Increasing mutual fund penetration will largely depend on increasing investor awareness at grass-roots level and providing access to financial services to the still largely unbanked population. In its effort to increase investor awareness, the industry and the Securities and Exchange Board of India (SEBI) have launched several initiatives. The two-pronged approach of increasing awareness of and access to financial products and services has and will go a long way in increasing the penetration of mutual funds in the country.

References:

1. Khan m y, 2007, *indian financial system*, the mcgraw-hill companies, new delhi.
2. Prasanna chandra, 2008, *investment analysis and portfolio management*, tata mcgraw-hill publishing company limited, new delhi.
3. Muralidhar dunna, mutual funds in india –issues, opportunities and challenges, asia pacific journal of marketing & management review,vol.1 no. 2, october 2012
4. Ritu, mutual funds: issues, challenges and opportunities in india, international research journal of management and commerce, volume-1, issue-6 (september 2014)
5. Indian mutual fund industry, report by kpmg Mutual fund summit 2014, pwc report Amfi data