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MUTUAL FUNDS IN INDIA: AN APPRAISAL

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INTRODUCTION

While the Indian mutual fund industry has registered a six-fold increase in AUM over the last 10 years, it is yet to emerge as the preferred investment choice for retail investors in India.

More than 50 years have gone by since UTI started its first sale in July 1964, and we believe that in the next few years, the industry will perform closer to the original mandate of encouraging and mobilizing savings of small investors.

The confluence of emerging technology and enabling regulation will facilitate the industry to broaden and deepen its reach amongst retail investors.

- Evaluation of e-commerce platforms to sell mutual funds is currently underway, and a positive outcome will help unlock the buying power of the 400 mn Internet users and 1 bn mobile phone users in India;
- Financial inclusion has received a fillip with the JAM number trinity (Jan Dhan, Aadhar & Mobile), and opening of 192 mn Jan Dhan accounts in 15 months with a deposit base of Rs. 27,000 crore. This builds the case for evaluating adoption of a similar model and cross-selling opportunities;
- More clarity on E-KYC and its subsequent adoption will aid the penetration amongst the hitherto un-served segment;
- The recently approved payment banks, with permission to sell third-party mutual fund products are expected to improve the reach.

In the context of improving the financial literacy and awareness among retail investors, AMCs have conducted around 60,000 investor awareness programmes in the past 60-odd months across 500 cities in India, and have reached out to 1.8 mn participants. This is an on-going initiative and is expected to improve the low penetration of mutual funds in the Indian market. With individual investors relying heavily on distributors for purchase of mutual funds, MCs will continue their focus on distribution network along with an emphasis on increasing sale of direct plans.

It is believed that these enablers will help the industry to increase its customer base in a cost-effective manner from 42 mn retail accounts and increase their ticket size. While these measures will enable customer acquisition, AMCs need to focus on retaining customers through sale of simpler products, demonstrating better fund performance, better service quality and deployment of analytics. The industry has witnessed consolidation, and the trend is expected to continue with increasing focus on improving performance.

GROWTH DRIVERS

Apart from registering AUM growth, the last few years has seen the industry demonstrate growth on other fronts including increase in individual investors, serving hitherto un-served markets, etc. Interplay across three critical factors has culminated in this increase, with the key growth drivers being:

Improvement in Key Economic Parameters

An improvement in the economic environment over the last 3-4 years has helped all categories of mutual fund investors to increase their investment in mutual funds. Increase in personal income fuelled by growth in GDP has led to an improvement in the surplus available for household saving. Indian households saving pattern has for the first time in 15 years shown a decline in savings in physical assets, and the same has been channelized to financial assets.

While Indian households have always shown a preference for bank and non-bank deposits, FY15 household financial savings data reveal a declining trend in bank and bank-deposits, yet again for the first time in 15 years. There is an 11% decline from FY12 level and a corresponding increase in other financial assets (note: level of currency has remained constant during the period).

Indian markets have demonstrated a high correlation between market performance and equity inflows. Improving stock market performance in the last 24-30 months has resulted in stronger equity inflows which is visible in the growth of demat accounts over the last 12-18 months as well as rise in equity assets of mutual funds.

The rise in household savings, as well as the shift away from physical assets to financial assets and the subsequent substitution from bank deposits to equity, mutual funds, insurance, etc augurs well for the industry. Analysis of historical data reveals that equity mutual funds have outperformed other asset classes in the run.

Chart – 1

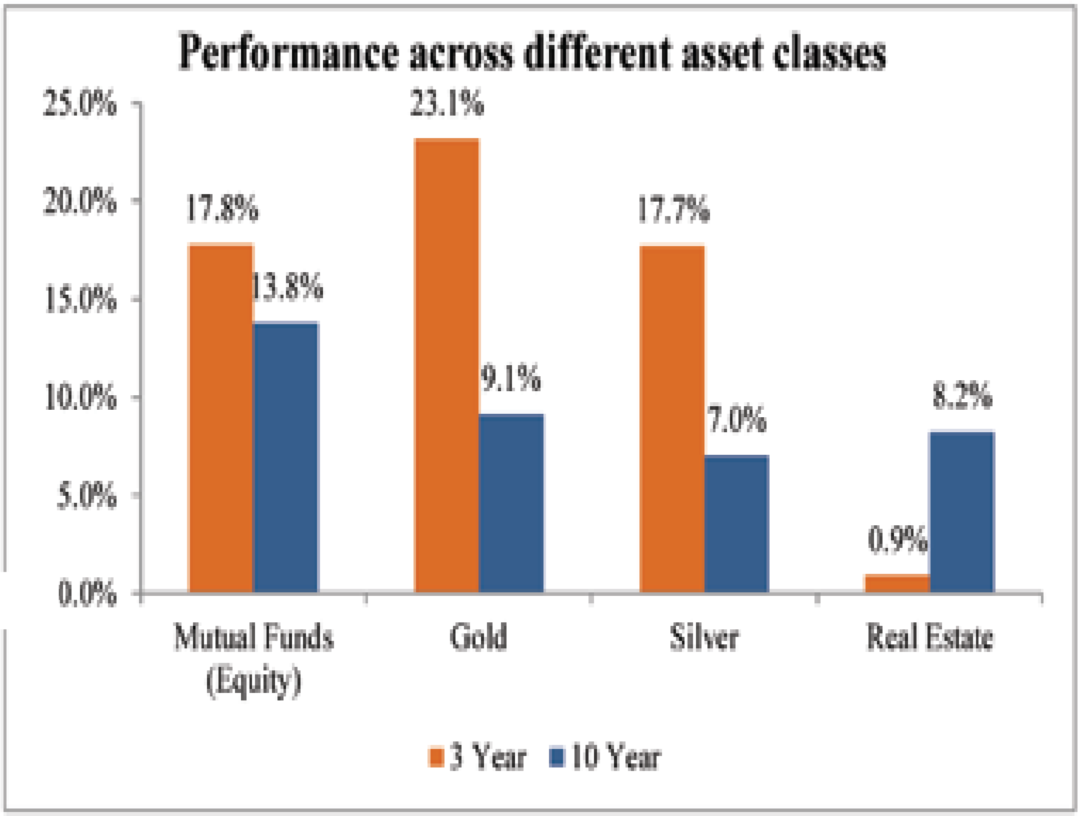

Chart4.4 *Source: Reuters Eikon, NHB, ICRON Analysis*

Aligning Product, Promotion and Distribution

Awareness creation and growing emphasis by AMCs on advising individuals to invest through the SIP route appear to have yielded results. The SIP count increased from 6.2 million in March 2014 to 7.3 million over the 12-month period. Larger number of SIPs from B15 reflects the efficacy of IAP as well as the higher commission paid to distributors for B15 sales. The average value of SIP has also increased from Rs 2000 to Rs 2600.

Chart – 2

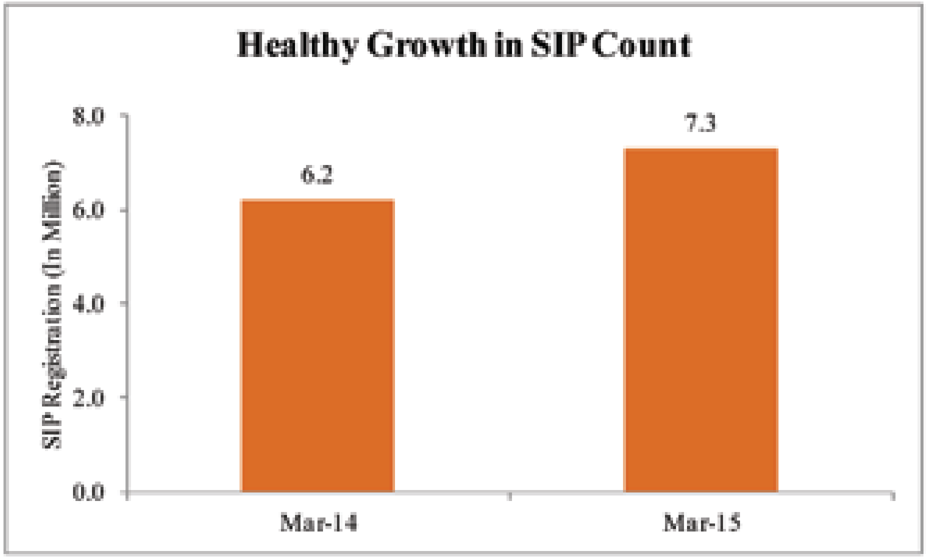

Chart4.5 *Source: ICRON Analysis*

Regulatory and Technology Enablers

Using technology to sell direct plans through mobile apps as well as launch of the MF Utility portal has made sale possible on a 24*7 basis and made the presence of an intermediary redundant. Acceptance of E-KYC by some AMCs and using technology to do the In-Person Verification has also made the transactions easier.

An increase in GDP as well as good stock market performance over the last two three years provided investors and especially retail investors with an opportunity to use mutual funds to create wealth. The shift in preference from traditional savings channels to mutual funds and other assets has been made possible due to the awareness building exercises undertaken by the AMCs, demographic shift in customer base as well as availability of products that match the needs of the customers.

This has been accentuated by the roll-out and subsequent customer adoption of initiatives that leveraged technology and the interplay amongst all these factors helped in the growth of the industry.

FINDINGS OF THE STUDY

Growth & Development of Mutual Fund Industry in India

- During the first state UTI achieved a formative growth because no competitor was available there.

- Due to corruption and red tapism in government sector public sector funds did not show any meaningful growth.
- Market moves approximate by five times as compared to 1993 but Mutual times, public sector Mutual fund get sixty four times and private sector Mutual funds get forty times growth during this period.
- Out of the total resource mobilized by all the Mutual fund, UTI still holds the maximum share. However, trend has moved in favour of private sector, more sharply after 1998-99.
- At the end of 1992 there were 116 schemes in operation, which was now increased and becomes 441 as on March 31, 2014.
- Therefore, Mutual fund industry shows a tremendous growth during this period.

Performance Evaluation and Market Timing Abilities of Selected Mutual Fund Schemes

- Risk & return analysis indicates that majority of the schemes fund manager are investing its collection in risky assets for getting maximum return.
- Beta value shows that only tax planning schemes are not investing according to their systematic risk.
- Out of total 65% schemes are there which have lower unique risk than diversification and only 35% schemes have high unique risk as compared to diversification. 48% schemes have lower than average unique risk but have higher degree of diversification, 21% schemes have higher unique risk and have low degree of diversification. However, rent of the 30% schemes has moderate unique risk due to moderate diversification, which concludes that the sample schemes are not adequately diversified.
- Overall results of Sharpe, Treynor, Jensen differential, Sharpe differential and Appraisal Modules indicates that most of the schemes were performing very well.
- Out of total Mutual fund schemes selected for performance evaluation Reliance growth Bonus and Reliance growth G were performing better in all the modules for the period of study as compared to others, however, Dhan tax saver 95, JM Equity G and Libra tax shield 96 were performing poor performance at all the levels.
- Market timing modules results indicate that Indian fund managers are not seriously showing any market timing abilities and they are

  relying only on stock selection skills, therefore, they are generating superior performance due to largely involvement in security selection but they fail in timing the market correctly

Problems Associated with the Mutual Fund Industry

- The mutual funds are externally managed. They do not have employees of their own. Also, there is no specific law to supervise the mutual funds in India. There are multiple regulations. While UTI is government by its own regulations, the banks are supervised by Reserve Bank of India, the Central Government and insurance company mutual regulations funds are regulated by Central Government.
- At present, the investors in Indian prefer to invest in mutual fund as a substitute of fixed deposits in Banks. About 75 per cent of the investors are not willing to invest in mutual funds unless there was a promise of a minimum retain.
- Sponsorship of mutual funds has a bearing on the integrity and efficiency of fund management, which are keys to establishing investor's confidence. So far, only public sector sponsorship or ownership of mutual fund organizations had taken care of this need.
- Unrestrained fund rising by schemes without adequate supply of scrips can create severe imbalance in the market and exacerbate the distortions.
- Many small companies did very well last year, by schemes without adequate imbalance in the market but mutual funds cannot reap their benefits because they are not allowed to invest in smaller companies. Not only this, a mutual fund is allowed to hold only a fixed maximum percentage of shares in a particular industry.
- The mutual funds in India are formed as trusts. As there is not distinction made between sponsors, trustees and fund managers; the trustees play the role of fund managers.
- The increase in the number of mutual funds and various schemes have increased competition. Hence, it has been remarked by a senior Banker, "mutual funds are too busy trying to race against each other." As a result, they lose their stabilizing factor in the market.
- While UTI publishes details of accounts of their investments, mutual funds have not published any Profit and Loss Account and Balance Sheet even after its operation.
- The mutual funds have eroded the financial clout of institutions in the stock market for which cross transaction between mutual funds and financial institutions are not only allowing speculators to manipulate price, but also providing cash, leading to the distortion of balanced growth of market.
- Mutual funds are very poor in standard of efficiency in investors' service; such as despatch of certificates, repurchase and attending to inquiries lead to the deterioration of interest of the investors towards mutual funds.

- Transparency is another area in mutual funds, which was neglected till recently. Investors have the right to know and Asset Management Companies have an obligation to inform investors where and how their money has been deployed. But, investors are deprived of getting the information.

GAME CHANGERS

We expect to witness the coming together of multiple factors in the near future, whose combined power has the potential to catapult the Indian industry to greater heights. These game changers span multiple domains, and the key ones are listed below:

1. Demographic dividend – India is a young nation with 605 million people below the age of 25. International Labour Organization has predicted that by 2020, India will have 116 mn workers in the age group of 20-24;
2. Increase in the number of HNI and ultra HNI – A recent study by Kotak Wealth Management has predicted the increase in the number of ultra HNI from current levels of 137,000 to 348,00 in 2020, along with a corresponding rise in networth from Rs. 128 trillion to Rs. 415 trillion;
3. Any positive outcome of the evaluation underway of the proposal of using e-commerce platforms to sell mutual funds when seen in the context of 1 bn mobile subscribers and 400 mn Internet users;
4. The opening of 190 million Jan Dhan bank accounts in 15 months through e-KYC and mobilization of Rs 27,000 crore (about 37% account are zero balance accounts) makes it imperative to evaluate the usage of this route to sell mutual funds;
5. Any positive outcome on the decision to use Aadhar as E-KYC for mutual funds and other financial assets would have a huge impact in increasing the catchment area;
6. Granting of approval to 11 payment banks that will be allowed to sell third-party mutual funds should help increase the market size;
7. Usage of big data and analytics and using data-driven models for improving offerings and customer engagement.

These seven are powerful when seen in isolation, and if they were to act in tandem, they have the potential to transform the industry.

THE ROAD AHEAD

The industry has utilized the last couple of years' productivity in capacity building initiatives by augmenting its technology platform as well as awareness building programmes and thus creating markets where none existed earlier. Technology can be put to dual use – both for acquiring customers and meeting compliance requirements in a cost-effective and time-efficient manner. These new customers are expected to be more from the individual investor segment with higher preference for equity schemes, which will have a positive impact on the profitability.

The game changers are expected to supplement this trend base;

1. The demographic shift towards a younger workforce that is more aligned with technology will provide the industry with a larger customer base;
2. The expected growth of HNIs augurs well for the industry, especially in the context of the ticket size of their investment and preference for equity;
3. If e-commerce platforms are allowed to sell mutual funds coupled with simpler e-KYC process, this would open up a larger market for mutual funds;
4. Replicating the model adopted for Jan Dhan savings accounts as well as using the payment banks to sell mutual funds, could lead to further increase in the customers base;
5. Using analytics and data-driven models would help to retain and mine the customers better;
6. Deploying technology to build gamification models for customer engagement would resonate better with the young and technologically savvy customer base.

US retail investors and the country's investment framework have helped the US mutual fund industry to emerge as the global leader. The fruition of the game changers would also enable the transformation of the Indian mutual fund industry to operating model that is more focused on the individual investor, and thereby enable it to move towards its goal of Rs. 20 trillion profitable AUM by 2020.

CONCLUSION

India is likely to witness the entry of global fund super-markets enabled by regulatory changes. Cooperative sector, though beset with internal administrative issues, are likely to emerge as another channel, which should be tapped by Mutual Funds. Tapping the large network of NGOs, recognized by local authorities, to interact and to reach out to the lower middle class and poorer segments of population are important steps to increase mutual fund penetration. Distributors are likely to explore the possibility of innovations such as a common online platform and the usage of debit and credit cards for transactions.

The regulatory and compliance framework for mutual funds is likely to get aligned with the frameworks across the financial services spectrum. Regulators across Financial services spectrum viz. mutual funds and capital markets, pension, insurance and banking are expected to work towards harmonization of policies, with support from industry bodies like the CII and the respective industry associations. Thrust of the regulatory and compliance framework is expected to enhance resilience and sustainability, investor protection and good governance.

With the structural liberalization policies, the Indian economy, no double, is likely to return to a high grow path in few years. Hence, mutual fund organizations are needed to upgrade their skills and technology. It has to overcome the bottlenecks in the growth of mutual fund industry. There is a need of strong regulatory framework, transparency and disclosure policies, customer involvement, wider approach to cover Tier 2 and Tier 3 cities, up gradation of technology, innovation in products, customer satisfaction etc. to survive in the competitive environment. There is need to make strategies to bring more confidence among investors. The Indian mutual fund industry is expected to witness rapid growth in AUM over the next few years. The industry, however, faces the challenge of achieving sustained profitable growth while increasing retail penetration and expanding the reach of mutual funds into rural areas.

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