Evaluation of Mutual Funds Industry: Emerging Trends in India

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Abstract - Three sector Globalization, economic liberalization and financial sector reforms generated and augmented the interest of Indian investors in equity. With the growing institutionalization, retail investors have started to keep out of the primary and secondary market, and are looking forward to mutual funds for their investments. Mutual funds have become the most favored investment route for small and medium investors to reap the benefits of diversification even with an inadequate amount of investment in the capital market in an indirect route. As the idea of mutual fund is gaining more and more importance with a wide array of institutions struggling to lure the investing public, a proper evaluation of performance of mutual funds, ability of the funds to diversify and time their investment is of practical importance for a valued judgment. In India, mutual funds are offering a variety of schemes based on purpose to suit the needs of varied class of investors, namely, income, growth, balanced, equity linked savings, gilt, money market. Hence, this research paper intends to study the evaluation of mutual fund industry and its growth perspectives and emerging trends in India.

Keywords – ***Mutual fund industry, evaluation, growth perspective, emerging trends***.

1. Introduction

The financial services scenery is transforming, with a plethora of changes taking place on the regulatory front. Against this backdrop, Asset Management Companies (AMCs) realize that they need to re-structure their businesses in order to meet the evolving needs of their clients and provide them with complete investment solutions. Although emerging markets such as India provide a wide range of opportunities, it is significant to tap into these avenues to fuel the growth of the mutual fund industry. Mutual fund Industry today, is one of the most preferred investment options all over the world. It plays a crucial role in the economic development of a country. Mutual funds active involvement can be seen by their dominant presence in the money market as well as capital market. They are also found very active in the stock market by way of ensuring stability as a supplier of large funds through steady absorption of floating stocks. A mutual fund is an entity in the form of a trust which pools the money of large investors and invests the same in the different investment avenues. Such investment may be in the form of equity shares, debt securities, money market instruments, government securities, fixed deposits, precious metals etc. With transitory time Indian mutual fund industry is experiencing great growth which is cooked by infrastructural development in India and supported by high saving and increasing foreign participation. Throughout the period rising income and awareness boosted risk taking skill of common investors and mutual fund became the most preferred and safest investment option among all class. Later than liberalization and globalization of Indian economy, market witness vast crowd towards the option of investing in mutual funds but investment in a particular funds needs a lot of condition like- investor's aim, cost, availability of funds, risk & return factors etc. and thus invite fundamental study for better future and growth.

1. Purpose of Study and Sources of Data

With the changing business environment investment avenues also changed to match the pace according to prevailing circumstances. Mutual Fund Industry has emerged as a dark horse in financial market and adjusted itself according to its strength. It is growing with balance pace and will continue to grow in correlation with economic growth and thus invites researches to discover the market potential, its growth perspectives and emerging trends. With this view the main purpose of the study is evaluation of mutual fund industry with its growth perspectives and emerging trends in India.

The present study is based on secondary data. The relevant secondary data was collected through comprehensive review of existing literature i.e. books, journals, magazines, newspapers, reports and internet.

2. Beginning of Mutual Funds Industry

Historians are uncertain of the origins of investment funds; some cite the closed-end investment companies launched in the Netherlands in 1822 by King William I as the first mutual funds, while others point to a Dutch merchant named Adriaan van Ketwich whose investment trust created in 1774 may have given the king the idea. Ketwich probably theorized that diversification would increase the appeal of investments to smaller investors with minimal capital. The name of Ketwich's fund, Eendragt Maakt Magt, translates to "unity creates strength". The next signal of near-mutual funds included an investment trust launched in Switzerland in 1849, followed by similar vehicles created in Scotland in the 1880s.

The mutual fund industry continued to expand. In 1954, the financial markets overcame their 1929 peak, and the mutual fund industry began to grow in earnest, adding some 50 new funds over the course of the decade. The 1960s saw the rise of aggressive growth funds, with more than 100 new funds established and billions of dollars in new asset inflows.

Hundreds of new funds were launched throughout the 1960s until the bear market of 1969 cooled the public appetite for mutual funds. Money flowed out of mutual funds as quickly as investors could redeem their shares, but the industry's growth later resumed. Mutual funds actually captured the public's mind in the 1980s and '90s when mutual fund investment hit record highs and investors saw incredible returns. However, the concept of pooling assets for investment purposes has been around for a extended time. A mutual fund is a scheme in which several investors invest their money for a common financial reason. The collected money invests in the money market and the capital market, which they earned, is divided based on the number of units, which they hold. The mutual fund industry started in India in a small way with the UTI Act creating what was effectively a small savings division within the RBI. Over a period of 25 years this grew fairly successfully and gave investors a good return, and therefore in 1989, as the next logical step, public sector banks and financial institutions were allowed to float mutual funds and their success encouraged the government to allow the private sector to foray into this area.

3. Present Status of Mutual Fund Industry

The mutual fund business is among the most winning recent financial innovations. Over the past few decades, the mutual fund industry, both in the US and elsewhere, has exploded. The growth of the mutual fund industry in the US Mutual Fund Industry has played an extremely important role in the economy. This trend has spread to a significant number of countries around the world. Mutual funds industry controls a sizeable stake of corporate equity and plays a fundamental role in the determination of the stock prices. As a result, investors are increasingly concerned about fund selection and demanding detailed mutual fund information and investment advice

4. Structure of Mutual Funds in India

In India, the mutual fund business is regulated with a view to imparting operational clearness and defensive the investor's interest. The structure of a mutual fund is designed by SEBI regulations. These regulations need a fund to be established in the form of a trust under the Indian Trust Act, 1882. A mutual fund is typically externally managed. It is now an operating company with employees in the traditional sense. Instead, a fund relies upon third parties that are either affiliated organizations or independent contractors to carry out its business activities such as investing in securities. A mutual fund operates through a four-tier structure. The four parties that are required to be involved are a sponsor, Board of Trustees, an asset management company and a custodian.

a) **Sponsor:** A sponsor is a body corporate who establishes a mutual fund. It may be one person acting alone or together with another corporate body. Additionally, the sponsor is expected to contribute at least 40% to the net worth of the AMC. However, if any person holds 40% or more of the net worth of an AMC, he shall be deemed to be a sponsor and will be required to fulfill the eligibility criteria mentioned in the mutual fund regulation.

b) **Board of Trustees:** A mutual fund house must have an independent Board of Trustees, where two-thirds of the trustees are independent persons who are not associated with the sponsor in any manner. The Board of Trustees of the trustee company holds the property of the mutual fund in trust for the benefit of the unit-holders. They are responsible for protecting the unit-holder's interest.

c) **Asset Management Company:** The role of an AMC is highly significant in the mutual fund operation. They are the fund managers i.e. they invest investors' money in various securities (equity, debt and money market instruments) after proper research of market conditions and the financial performance of individual companies and specific securities in the effort to meet or beat average market return and analysis. They also look after the administrative functions of a mutual fund for which they charge management fee.

d) **Custodian:** The mutual fund is required by law to protect their portfolio securities by placing them with a custodian. Nearly all mutual funds use qualified bank custodians. Only a registered custodian under the SEBI regulation can act as a custodian to a mutual fund.

Over the years, with the involvement of the RBI and SEBI, the mutual fund industry has evolved in a big way giving investors an opportunity to make the most of this investment avenue. With a proper structure in place, the industry has been able to cater to more number of investors. With the increase in awareness about mutual funds several new players have joined the bandwagon.

5. Indian Mutual Fund Industry: Emerging Trends

The mutual fund industry has been in India for a long time. But the year of 1993 marked the beginning of a new era in the Indian mutual fund industry with the entry of private players like Morgan Stanley, J.P Morgan, and Capital International. This was the first time when the mutual fund regulations came into existence. SEBI (Security Exchange Board of India) was established under which all the mutual funds in India were required to be registered. SEBI was set up as a governing body to protect the interest of investor. By the end of 2008, the number of players in the industry grew enormously with 462 fund houses functioning in the country. With the rise of the mutual fund industry, establishing a mutual fund association became a prerequisite. This is when AMFI (Association of Mutual Funds India) was set up in 1995 as a nonprofit organization. Today AMFI ensures mutual funds function in a professional and healthy manner thereby protecting the interest of the mutual funds as well as its investors. The mutual fund industry is considered as one of the most dominant players in the world economy and is an important constituent of the financial sector and India is no exception. Mutual funds are considered as one of the best available investment options as compare to others alternatives. They are very cost competent and also simple to invest in. The biggest advantage of mutual funds is they provide diversification, by reducing risk & maximizing returns. India is ranked one of the fastest growing economies in the world. Regardless of this vast progression in the industry, there still lies huge potential and room for growth. India has a saving rate of more than 35% of GDP, with 80% of the population who save. These investments could be channelized in the mutual funds industry as it offers a wide investment option. In addition, focusing on the fast growing tier II and tier III cities within India will provide a huge scope for this sector. Additional tapping rural markets in India will advantage mutual fund companies from the growth in agriculture and allied sectors. With subsequent reduction of regulations, it is estimated that the mutual fund industry will grow at a rate of 30% - 35% in the next 3 to 5 years and reach US 400 billion by 2021. As it can be observed that there is vast growth and potential in the mutual fund industry. In order for the mutual fund industry to look at new trends for growth, KPMG in India has analysed a few areas which may impact growth in a positive manner. Despite constant attempt of the regulator to increase penetration of mutual fund products beyond top 15 cities, the AUM composition has only marginally changed since SEBI directive on additional TER on inflows from smaller cities was implemented in October 1st, 2012. Drivers like lack of financial education and awareness, limited distribution network, cultural bias towards physical assets are some of the key impediments to growth in B-15 cities. In order to boost the geographical reach of mutual funds, the fund houses are now allowed to charge an extra load of 30 basis points from existing schemes 1 subject to meeting certain conditions. The regulation has incentivized fund houses to drive mutual fund products in cities beyond the top 15. The industry has adopted multi-pronged approach to reach out to investors in B-15 cities which includes investor consciousness, training and enrolling new cadre of distributors. In addition, fund houses are paying additional commission to source applications from these areas.

6. Conclusion

The outlook of the mutual fund industry is governed to a great extent by the economic situation in the country. The present economic scenario with sticky inflation and rising fuel prices is likely to adversely impact perceptions, resulting in depressed equity inflows into the market. Steps need to be taken to instill confidence in the minds of the investor and to encourage him to invest in mutual funds, even in times of uncertainty. Thus it can be believed that the mutual fund industry manifests huge opportunity for growth and further penetration, and this can be achieved over time, with support from technology. The key lies in strengthening distribution networks and enhancing levels of investor education to increase presence in rural areas. In terms of opportunity, the infrastructure debt market has become very attractive, luring investors to invest in this space. Also, it is critical for the industry at this point to assess and capitalize the value that pension products bring to the growth of the mutual fund industry. Lastly, it may perhaps be useful if the mutual fund industry emulated some best practices from other industries and sectors to transition to the next level of growth.

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