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INDIAN MUTUAL FUND INDUSTRY - AN OVERVIEW

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Abstract

The success story of any economy can only be determined on the basis of sound financial system of the country. The Indian financial system in general and the mutual fund industry in particular continue to take turn around from early 1990s. Mutual Funds have emerged as an important segment of financial market in India. Indian mutual fund industry is as old as four decades but its growth and awareness has reached the present level only since the last five years. The industry has different phases in its growth. It has also seen many new products and is now allowed to invest in foreign countries. This paper aims to overview the growth and development of mutual funds as a financial service in Indian financial market.

Introduction

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.

Evolution of Indian Mutual Fund Industry

The mutual fund industry in India was introduced in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India (RBI). The history of mutual funds in India can be broadly divided into four distinct phases as described below.

a) First Phase – 1964-87

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India 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 the place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988, UTI had Rs.6, 700 crores of assets under management.

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

The year 1987 marked the entry of non- UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987, followed by Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90) and Bank of Baroda Mutual Fund (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 worth of Rs.47, 004 crores.

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

With the entry of private sector funds in 1993, a new era was started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the 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 (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations of 1996.

The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India. The industry has also witnessed several mergers and acquisitions. By the end of January 2003, there were 33 mutual funds, with total assets of Rs. 1, 21,805 crores. The Unit Trust of India with Rs.44, 541 crores of assets under management was way ahead of other mutual funds.

d) 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 worth Rs.29,835 crores at the end of January 2003, representing broadly, the assets of US 64 scheme, assured returns and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an Administrator and under the rules framed by Government of India, 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 under the Mutual Fund Regulations. With the 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. By the end of September, 2004, there were 29 funds, which manage assets worth Rs.1,53,108 crores under 421 schemes.

Benefits of Investing in Mutual Funds

a) Small Investments

Mutual Funds help us to reap the benefit of returns by a portfolio spread across a wide spectrum of companies.

b) Professional Fund Management

Professionals having considerable expertise, experience and resources, manage the pool of money collected by a mutual fund. They thoroughly analyze the market and economy to pick good investment opportunities.

c) Spreading Risk

An investor with limited funds might be able to invest in only one or two stocks / bonds, thus increasing his or her risk. However, a mutual fund will spread its risk by investing in a number of sound stocks or bonds. A fund is normally invested in companies across a wide range of industries and hence the risk is diversified.

d) Regulations

All mutual funds are registered with SEBI and they function within the provisions of strict regulation designed to protect the interests of the investors.

e) Choice

The large amount of mutual fund offers the investor a wide variety to choose from. An investor can pick up a scheme depending upon his perception of risk / returns profile.

Mechanism of Mutual Fund Industry

A mutual fund is set up in the form of a trust which is administered by a sponsor, trustees, Asset Management Company (AMC) and custodian. The trust is established by a sponsor or more than one sponsor who is the promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. Asset Management Company (AMC), approved by SEBI, manages the funds by making investments in various types of securities. Custodian, who is registered with SEBI, holds the securities of various schemes of the fund in his custody. The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund.

The performance of a particular scheme of a mutual fund is denoted by Net Asset Value (NAV). In simple words, Net Asset Value is the market value of the securities held by the scheme. Since market value of securities changes every day, NAV of a scheme also varies on a quotidian basis. The NAV per unit is the market value of securities of a scheme divided by the total number of units of the scheme on any particular date. For example, if the market value of securities of a mutual fund scheme is Rs 200 lakhs and the mutual fund has issued 10 lakhs units of Rs. 10 each to the investors, then the NAV per unit of the fund is Rs.20. NAV is required to be disclosed by the mutual funds on a regular basis - daily or weekly - depending on the type of scheme.

Prospects of Mutual Fund in India

The entry of private sector mutual funds in the market is likely to create the environment for competitiveness and more freedom of choice to investors. This is likely to give further boost to investments in mutual funds. The important reasons for the growth of mutual funds in the country are as follows.

- A large number of small savers are not happy with the low and fixed returns on bank deposits, post office saving schemes etc. which hardly make up for the inflationary impact on the value of money. But at the same time, they do not have the risk taking attitude and ability to invest directly in the stock market.
- The mutual funds function as a forum for small investors in the capital market, who are generally unable to get securities at the time of public issue by companies due to heavy over subscription (even more than 100 times in some cases). Increase in minimum investment , reduction in public offer and preferential allotment to mutual funds in recent times have further restricted the scope of direct participation in capital market by small investors, thus pushing them to follow the route of mutual funds.
- The investment portfolio of mutual funds is so large that any setback to any security is easily absorbed by spurt in prices of some others and the principal amount of the investors remains well protected.
- The liberalized economic and trade policies and the resultant boom in the capital market has brought in its wake a golden period for mutual funds which have been benefited from the upsurge in equity prices in far greater proportion than individual investors.
- The mutual funds have been granted various tax incentives along with complete exemption from wealth tax. Further, private sector mutual funds have also been granted the same tax benefits as their counterparts in the public sector.

Risks Involved in Investing in Mutual Funds

a) Market Risk

If the overall stocks or bond markets fall on account of overall economic factors, the value of stock or bond holdings in the fund's portfolio can drop, thereby impacting the fund performance.

b) Non- Market Risk

Bad news can pull down the stock price of a company, which can negatively affect fund holdings. This risk can be reduced by having a diversified portfolio that consists of a whole variety of stocks drawn from different industries.

c) Interest Rate Risk

Bond prices and interest rates move in opposite directions. When interest rates rise, bond prices fall and this decline in underlying securities affects the fund negatively.

d) Credit Risk

Bonds are debt obligations. Hence the funds invested in corporate bonds run the risk of the corporate defaulting on their interest and principal payment obligations and when that risk crystallizes, it leads to a fall in the value of the bond, causing the NAV of the fund to take a beating.

Development of Mutual Fund Industry in India

The Mutual Fund vehicle is quite popular with investors who are wary of directly investing in the securities market. **Table-1.1** clearly illustrates the Resource Mobilization by Mutual Funds from 1990-91 to 2005-06. It is clearly understood from the Table that resource mobilization by Mutual Funds remained steady during the period from 1992 to 1995, with annual gross mobilization averaging Rs.110,000 mn per annum during the study period. During the period from 1995-96 to 1996-97, the Mutual Fund Industry suffered. Afterwards Mutual Fund Industry managed to mobilize modest sums during the next two financial years from 1997-98 to 1998-99. During the period 1999-2000, among Public Sector Mutual Funds, compared to Bank Sponsored and FI Sponsored, UTI has mobilized the highest amount of Rs.45,480 mn. Private Sector Mutual Funds mobilized even higher amount of Rs.1,48,920 mn during the period 1999-2000. With reference to Public Sector Mutual Funds during the 2001 to 2003, compared to Bank and FI sponsored Mutual Funds, UTI showed negative trend. From 2000-01 to 2005-06, Private Sector Mutual Funds performed better than Public Sector Mutual Funds. The year 2000-01 witnessed a slowdown with net resource mobilization by all Mutual Funds taken together aggregating only Rs.71,370 mn. During the period 2002-03, the resource mobilization by all Mutual Funds together aggregated a low of Rs.45,800 mn, with UTI having a net outflow of Rs.94,340 mn. The period 2003 -04 and 2004-05 witnessed a sharp rise in the net resources mobilized compared to the previous year, aggregating Rs.4,76840 mn and Rs.,68,090 mn respectively. The same trend was continued in the year 2005-06 also when the net resources mobilized were Rs.5,27,800 mn. The performance of the Private Sector Mutual Funds was consistent at Rs.4,29,770 mn. The overall finding from the Table clearly indicates that Private Sector Mutual Funds mobilized more than Public Sector Mutual Funds during the period from 1998-99 to 2005-06. The Table also indicates that investment in Mutual Funds is considered to be as safe as bank deposits. This is due to the fact that the Mutual Funds in India have primarily been sponsored by Government, banks and FIs.

Trends in Transaction on Stock Exchanges by Mutual Funds

Trends in transaction on stock exchanges by Mutual Funds during the period from 2000-01 to 2005-06 are clearly presented in **Table-1.2**. It is clearly understood from the Table that the net purchases/ sales in stock exchanges by Mutual Funds showed negative trend during the period from 2000-01 to 2002-03. Later it obtained positive trend. During the whole study period, the transactions in the equity segment on stock exchanges by Mutual Funds were high at Rs.14,303 cr. During the study period, the debt market segment registered highest amount of transactions Rs.36,801 crs while it was only Rs.14,303 crs in the equity market segment. When compared with equity market segment, debt market segment showed positive trend during the period from 2000-01 to 2002-03. During the rest of the study period from 2003-04 to 2005-06, transactions in debt market segment on stock exchanges by Mutual Funds performed better than equity market segment. The Table clearly shows that the net purchases / sales transactions on stock exchanges by Mutual Funds steadily increased from 2000-01 to 2003-04. But during 2004-05, it decreased from Rs.24,009 crs to Rs.17,435 crs. The over all findings from the Table clearly indicates that transactions on stock exchanges by Mutual Funds in debt market segment performed better than equity market segment during the whole period of the study from 2000-01 to 2005-06.

Findings of the Study

- 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 Unit Trust of India, with Rs.44,541 crores of assets under management, was way ahead of other mutual funds during the whole period of the study.
- Mutual fund will spread its risk by investing in a number of sound stocks or bonds.
- The Mutual Fund vehicle is quite popular with investors who are wary of directly investing in the securities market.
- Investment in Mutual Funds is considered to be as safe as bank deposits. This is due to the fact that the Mutual Funds in India have primarily been sponsored by Government, banks and FIs.
- During the period from 1995-96 to 1996-97, the Mutual Fund Industry was severely hit.
- During the period 1999-2000, among the Public Sector Mutual Funds, UTI has mobilized the highest amount of Rs.45,480 mn.
- Private Sector Mutual Funds mobilized the highest amount of Rs.1,48,920 mn during the period 1999-2000.
- The overall finding from the study clearly indicates that Private Sector Mutual Funds mobilized more than Public Sector Mutual Funds during the period from 1998-99 to 2005-06.
- It is clearly understood from the study that the net purchases/ sales in the equity segment transactions by Mutual Funds on stock exchanges showed negative trend during the period from 2000-01 to 2002-03.
- During the whole period of the study period, transactions in the equity segment by Mutual Funds were high at Rs.14,303 cr.
- During the study period, the debt market segment registered the highest amount of transactions at Rs.36,801 crs, which was higher than the transaction at Rs.14,303 crs in the equity market segment.
- During the rest of the study period from 2003-04 to 2005-06, transactions on stock exchanges by Mutual Funds on debt market segment performed better than equity market segment.
- The over all findings from the study clearly indicates that transactions on stock exchanges by Mutual Funds in debt market segment performed better than equity market segment during the whole period of the study from 2000-01 to 2005-06.

Conclusion

Mutual funds as an investment option have become very attractive for retail investors who are interested in the financial markets but do not have the time, expertise and experience in good stock picking. The problems faced by small investors in the share market have been offset by the emergence of mutual funds. Indian mutual funds industry is as old as four decades but its growth and awareness has reached the present level only since the last five years. It is the most suitable investment for the common man who invests his savings at regular intervals. It is a mature, well-developed and regulated investment vehicle. However, like any other investment, this, too, carries a certain degree of risk. An investor therefore has to take care of his/her risk taking ability, tax issues, investment period etc. The main challenges of this industry lie in attracting more number of retail investors and manage their interests well. Net mobilization of funds and educating investors about different funds are the other key challenges it faces. The industry has to be innovative and competitive and the members of this industry have to strive for its development and growth and its continuous increase in number. The industry has also realized that managing the investors' money is risky and that it has to be very cautious in its operations.

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Table-1.1
Resource Mobilization by Mutual Funds from 1990-91 to 2005-06

(Rs. in mn)

Year	Public Sector Mutual Funds			Private Sector MFs	Grand Total
	Bank Sponsored	FI Sponsored	UTI		
1990-91	23520	6040	45530	-	75090
1991-92	21400	4270	86850	-	112520
1992-93	12040	7600	110570	-	130210
1993-94	1480	2390	92970	15600	112440
1994-95	7650	5760	86110	13220	112740
1995-96	1130	2350	-63140	1330	-58330
1996-97	60	1370	-30430	8640	-20360
1997-98	2370	2030	28750	7490	40640
1998-99	2310	6910	1700	25190	36110
1999-00	1560	3570	45480	148920	199530
2000-01	-------------------15200------------------		3220	92920	111350
2001-02	------------------14740-------------------		-72840	129470	71370
2002-03	------------------18950-------------------		-94340	121220	45830
2003-04	------------------37610-------------------		10500*	428730	476840
2004-05	------------------16670-------------------		25970	425450	468090
2005-06	------------------63790-------------------		32240	429770	527800

* Data for 2003-04 relate to UTI Mutual Funds for the period February 01, 2003 to March 32, 2004
Source: www.nseindia.com

Table-1.2

Trends in Transactions on Stock Exchanges by Mutual Funds

(Rs. in Crore)

Year	Equity			Debt			Total		
	Gross Purchase	Gross Sales	Net Purchases / Sales	Gross Purchase	Gross Sales	Net Purchases / Sales	Gross Purchase	Gross Sales	Net Purchases / Sales
2000-01	17376	20143	-2767	13512	8489	5023	30888	28631	2257
2001-02	12098	15894	-3796	33557	22594	10963	45655	38488	7167
2002-03	14521	16588	-2067	46664	34059	12604	61185	50647	10538
2003-04	36664	35356	1308	63170	40469	22701	99834	75825	24009
2004-05	45045	44597	448	62186	45199	16987	107232	89796	17435
2005-06	100436	86133	14303	109770	72969	36801	210206	159102	51104

Source: www.sebi.gov.in