Mutual Fund Industry in India – A way forward

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1. History

1.1 While the first Investment Trust in India viz. Financial Association of India and China was established as early as 1869, and a few attempts to set up investment companies were made in 1930s, the history of Mutual Fund industry in India actually starts with Unit Trust of India. RBI, SBI, LIC, IFCI, ICICI were its main shareholders. It is amusing that the immediate provocation for the measure was setting up of a similar institution in Pakistan in the year 1963. Since the Trust was being set up by the Government, the functions of Promoter and Trustee – which are separated in a normal Unit Trust – were combined. Unit Scheme 64, the first scheme launched by UTI in July 1964 succeeded in raising a sum of Rs.17 crores, during the intial issue period, from about 1.25 lakhs investors which was about 20% of all capital raised by new and existing companies and 41% of all capital raised by new companies in the whole year!

1.2 Interestingly, during the debates in the Parliament on the UTI Bill, the idea of a general law which could lead to setting up of a private Unit Trust was not permitted although MPs like M.R.Masani made a strong plea towards the same. It took 42 years for the Government to permit others viz. Banks to set up Mutual Funds which could compete with UTI. The monopoly of UTI continued till 1986 when public sector Banks/FIs were permitted to launch Mutual Funds. It was only in 1993 that setting up of Mutual Funds by private sector was permitted. By 1995 there were 18 Asset Management Companies with over 150 funds to choose from. The first guidelines were issued by the Ministry of Finance in 1990 which were revised in 1992 and finally the SEBI Mutual Fund Regulations came into force on 20th January 1993.

2. Perception

In a survey on saving habits in the country conducted by ADB in the year 2004, the finding about the confidence levels regarding Mutual Funds was that households were fairly uncertain about the role, function and contribution of the Mutual Fund industry. While Postal savings, Bank deposits, Insurance, Provident Funds and even direct purchase of securities were well understood, the finding pointed out that in the risk-return matrix, Mutual Funds have a diffused placing. Those who were "safe" investors felt mystified about Mutual Funds as to whether it was something worth taking a risk at all and those who were used to buying and selling securities directly, felt that the Industry has not delivered the returns commensurate with the risk taken and the added disadvantage was the loss of "thrill" in dealing with securities directly.

Table 1

Institutional Confidence Levels of Earners in the Taxpaying range		
Institution	**Confidence Level**	**Taxpaying Group - (%)**
Nationalised banks	Would definitely trust	96
	Might trust	3
Regional Rural Banks	Would definitely trust	55
	Might trust	24
Indian Private Banks	Would definitely trust	21
	Might trust	21
Registered co-operative Societies	Would definitely trust	32
	Might trust	25
LIC of India	Would definitely trust	83
	Might trust	10
Other Insurance cos.	Would definitely trust	29
	Might trust	16
Mutual Funds	Would definitely trust	17
	Might trust	20

Source: ADB Survey, November 2004

Table 1 above gives the preference of earners in the tax paying range. While the confidence level for nationalised banks is as high as 99% and for LIC 93%, for the Mutual Fund industry it is as low as 37%. Not only that, the trust level ranks lower than Regional Rural Banks, Private Banks and even Co-operative societies.

3. Present Position

3.1 There are 29 Mutual Funds having a combined assets under management of Rs.2,31,624 crores as on 31-3-2006. Table 2 below will show how the assets have changed during the last three years.

Table 2

Industry Data (Assets under management)

Figures in Rs. crores

	Industry AUM classification					
	Liquid	**Debt**	**Equity**	**Balanced**	**Gilt**	**Total**
31-3-2003						
Industry	12028	35750	9497	6882	2714	69725
Weightage	17.25%	51.27%	13.62%	9.87%	3.89%	
31-3-2004						
Industry	41292	57362	25156	8659	6185	138958
Weightage	29.72%	41.28%	18.10%	6.23%	4.45%	
31-3-2005						
Industry	44528	51669	38660	9323	5578	149842
Weightage	29.72%	34.48%	25.80%	6.22%	3.72%	
31-3-2006						
Industry	53093	62214	100376	12033	3223	231624
Weightage	22.92%	26.86%	43.34%	5.20%	1.39%	
30-6-2006						
Industry	97404	59294	93221	11249	2567	264493
Weightage	36.83%	22.42%	35.25%	4.25%	0.97%	

Source: Amfi, mfiexplorer

3.2 While the above gives a very optimistic picture about the growth of the industry, it will be useful to examine what component is because of the revaluation of the assets and what has been the fresh mobilisation by the Industry. The industry AUM of Rs.1,49,842 cr. as on 31-3-2005 if transposed to the market level of 31-3-2006, assuming no fresh inflows or redemptions during the year, comes to Rs.1,81,783 crores. As such, fresh inflows during the "dream year" has been only Rs.49,841 crores out of which Rs.8565 crores was in the category of liquid funds – largely invested by corporates. If the same is contrasted with the market cap or the FII inflows, the position becomes even more clearer. Against the market cap of Rs.2813201 cr. as on 31-3-2006, the total Mutual Fund assets were at Rs.231624 crores representing 8.2% and the stock of FII investments were higher than the industry AUM, even though FII inflows started only in early 90s.

3.3 It is also important to examine the components of the AUM. The industry AUM in Liquid Funds at the end of March 2006 was Rs.53093 crores. From 17.25% in 2003-04, it increased to 22.92% in 2005-06. In the first quarter of 2006-07, the weightage of liquid funds further jumped to 36.83% with some Mutual Funds having as high a percentage as 50%. Unlike developed markets where contribution of individuals in liquid assets are substantial, in India it is large corporates who avail of this route – primarily for the advantage of tax arbitrage.

4. Penetration and Investor base

4.1 While the industry claims the number of investors to be close to 20 million, the fact remains that these are number of folios rather than investors and about 8 million out of this are with one Mutual Fund i.e. UTI Mutual Fund. According to the data received from Registrars, five cities, namely, Mumbai, New Delhi, Bangalore, Kolkata and Chennai contribute 83.45% of the AUM of the MF industry (except UTI MF) as on June end, 2006.

Table 3

	Top 10 cities	**Top 15 cities**	**Top 20 cities**
Liquid	97.41%	98.71%	99.20%
Non Liquid	85.29%	90.35%	93.37%
Total	91.57%	94.51%	96.44%

Source: CAMS and Karvy Data

4.2 For the sake of comparison, if the data for UTI Mutual Fund is taken from its Leadership Equity Fund, the percentage from top 5 cities was 27.88%, from top 15 cities 39.36% and from top 20 cities 56.80%. Large parts of the country lie untapped by majority of the players, whose presence in smaller towns and cities are in no way comparable to that of the insurance industry or the banking industry. No wonder that at the end of 2004-05 the share of MF industry in the financial savings of households was close to 1% against that of insurance industry at 13% and banking industry at 37%.

4.3 The trend so far appears to be to increase the AUM in a softer way, either through corporate connection and Liquid Funds or by concentration in a smaller number of large cities in the country. While this has been the approach even in the other markets like FMCG, Insurance, Banks etc. for new players, it is worth taking note that even after 13 years of Mutual Fund regulations and 29 players in the market, the same bias continues. Recent trends of sales through banks with large branch network or through Post Offices is, however, a welcome development.

5. Other countries

The table below provides net assets of selected countries across the world.

Table 4

World wide total net assets of Mutual Funds

Millions of US $, end of year

Country	1998	2001	2005
Chile	2910	5090	13969
Mexico	NA	31723	47253
United States	5525209	6974913	8905174
France	626154	713378	1362671
Luxembourg	508441	758720	1635785
Australia	295403	334016	700068
India	8685	15284	40546
Korea	165028	119439	198994
United Kingdom	277551	316702	547103

Source: ICI Fact Book

5.1 USA has the largest size in Mutual Fund Industry in the world, followed by United Kingdom and Luxembourg. In the USA, 48% of the households owned mutual funds in 2004 against 6% in the year 1980. Of the financial assets owned by households, 19.5% was in mutual funds in 2004 against 6.8% in 1990. Of the total assets in the industry, 90% are owned by individuals. Business, State corporations or local bodies own the balance 10%. An important aspect of US mutual fund industry is that 60% of the funds in the industry are due to retirement plans which have seen more than twenty-fold increase since 1990.

5.2 In UK 80% of the assets are invested on behalf of institutional investors, the retail accounting for less than 20%. Within the institutional market, corporate Pension Funds and Insurance companies account for 75% of total business. Even in developing countries, the trend is towards institutionalisation of retail assets and retirement assets forming greater part of the MF industry. Mix of distribution channels in different countries have been guided by the regulatory environment. Direct sales force contribute a small proportion generally across the countries, but in countries where banks are permitted to sell third party products, the percentage of the channel has grown – being more than 80% in countries like Singapore, Thailand and China. Independent brokers and IFAs constitute a high proportion in Korea and Japan. Trends towards increased use of new technology in selling MF products is being noticed across countries.

6. Way forward

Globally, investment in financial products show a marked improvement with the rise in per-capita income beyond a threshold point - which can vary from country to country. If the present growth in the Indian economy continues, investment in financial savings are likely to show a substantial increase. However, what proportion will be allocated to different industry segments will depend to some extent on policy and regulatory environment; but to a large extent on the vision, imagination and efforts shown by the mutual fund industry. Looking at the trends since 1992 when financial sector reforms got kick-started, it would be legitimate to assume that interest rate deregulation will stay, propensity of Government to appropriate savings through administered rate instruments will diminish, policy and regulations will be non-preferential to any particular sector and the tax reforms will show preference towards encouraging long term savings. Looking into these aspects, some of the directions for the mutual fund industry in the near future are enumerated below:-

6.1 Retirement Savings

6.1.1 Even in the USA, the Mutual Fund industry received a shot in the arm post 1980 when retirement savings started coming to the Mutual Fund industry. Unfortunately, the existing Government mandated Provident Funds like Employees' Provident Fund Organisation (EPFO), Coal Miners Provident Fund etc. do not invest in Mutual Funds - except in liquid schemes to a small extent; even though the investment guidelines issued by the Ministry of Finance permit the same. It will be safe to assume that over a period of time, the pressure of providing higher returns to the workers would impel these funds to move towards mutual fund in a gradual manner. There are more than 400 million workers in the country. EPFO system has more than 40 million accounts. With rising longevity, changing demographic profile leading to financial pressures on employers in providing defined benefit pension and breakdown of the joint family system, saving for old age income security has become an imperative.

6.1.2 However, it is the unorganised workers or the voluntary retirement planning which holds promise for the industry. Even though the PFRDA Bill is pending for approval of the Parliament, it is possible for the industry to provide avenues for retirement planning - both for tax-payers and non-taxpayers. The Micro Pension scheme of UTI Mutual Fund launched recently for SEWA members - where 25000 women members joined the scheme on a single day, is an example of how workers can be motivated to start saving for their old age. The scheme, which has a balanced portfolio with a small portion invested in equity, has given a return much higher than the fixed income instruments. While inaugurating the Scheme in Ahmedabad, the Union Finance Minister, Shri P. Chidambaram termed it as “the beginning of a pension revolution in the country”. More number of such schemes by the entire industry are required.

6.2 Technology

Twenty years back, workers in India could start thinking of saving only when they had attained the age of 40 or more. Today young professionals in early twenties have disposable surplus. Unlike their parents, they would not like to stand in a queue outside the mutual fund office to lodge their applications or wait for a couple of weeks for statements to arrive. Convenience in transactions and high standards of transparency will be expected by such clients. Technology will play a large role even in reaching out to investors in distant places. The stock exchanges with terminals in over 400 cities with thousands of brokers conducting online, real time transactions are examples of how systems innovation can bring about complete transformation in the business environment. MF industry has to bring about the necessary paradigm shift to reach out to large number of potential investors, where convenience and transparency is guaranteed.

6.3 Investor Awareness

One of the singular contributions of IRDA since inception is to create massive awareness about the insurance sector. The mutual fund industry and AMFI have yet to take any concerted action comparable to what insurance industry has done. In spite of the illusion in the minds of industry players about dedicated agents or channels, the same IFA at the field level sells insurance, mutual fund, postal savings and other financial instruments. In view of the diffused understanding about mutual funds, a programme to encourage an active financial planning movement in the country is urgently required. The programme should focus on simple messages about product differentiators, risk-return spectrum and information about cost and fees. The industry will have to take direct measures to support the financial planning movement. Qualified financial planners having no direct linkage to a manufacturer in the industry are the key to sustained growth of entire financial sector industry.

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