Evolution of Mutual Funds & Outlook

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When it comes to investments, Indians typically tend to invest all their savings into traditional savings instruments. Over the last five years, however, there has been a difference in this pattern, i.e., retail investors have been largely opting for financial assets over physical assets. Meanwhile, the mutual industry as a whole has been reaching out to the retail investors through its campaign 'Mutual Funds Sahi Hai'. Through this initiative coupled with the efforts of the Asset Management Companies (AMCs) and the distributor community, the awareness about mutual funds as a suitable investment vehicle has improved, especially among the retail investors.

Over the last two decades, the mutual fund industry too was on a learning curve through the many lessons learnt the hard way with the bust of IT boom in 2000, infrastructure bubble in 2008 and the recent mid & small-cap boom in 2017. The industry has also evolved to adopt global best practices with the end investor in mind. Some of the key developments here include removal of entry load, allocating a portion of total expense ratio (TER) for investor education and penetration to the hinterland and adaptation of technology to ease the overall investment process. Further, a robust regulatory framework and supervision aim to keep the investor interest protected, at all times, thereby making it one of the most transparent investment products available for the retail investors.

Industry Growth

The growth witnessed by the mutual fund industry over the past few years has been phenomenal. The overall industry AUM grew at around 25% from Rs. 7 lakh crores in March 2013 to Rs. 23.57 lakh crores in June 2018. Indian retail investors are slowly recognizing the fact that mutual funds are not just a product, but indeed a solution.

Owing to the overall efforts of the regulator, AMCs, and the distributor community, retail investors have started preferring mutual funds as a tool for wealth creation through regular and consistent savings. Consequently, Systematic Investment Plans (SIP) has become popular across households and is widely understood as a concept, just like the benefits of yoga. Around 41% and 26% of the total equity fund flows in the FY 2016-17, and FY 2017-18 respectively came from SIPs. In congruence, the SIP book size more than doubled from Rs. 3,120 crores in April 2016 to approx. Rs. 7,120 crores in March 2018. As a result of this robust inflow every month, the Indian equity market could absorb the adverse impact of FII outflows from the exchange.

Further, Equity Linked Savings Scheme (ELSS) has also been growing to feature as a preferred investment product as the AUM for ELSS grew at a CAGR of around 29% to reach Rs. 80,600 crores in March 2018.

Innovation

The MF industry has evolved over the past two decades, in tandem with the changing investor needs and market scenarios. Regulations have been brought about which largely aims at making investment process transparent and straightforward for the retail investors to discern. Further, we are witnessing the emergence of new product categories like Credit Risk Funds, Balanced Advantage Funds, etc. which are catering to the needs of a retail investor.

The use of technology has also been increasing to disseminate relevant information to the investor at low costs and the lowest possible transit time. Reflecting the total gains made by the investor by investing in various mutual fund schemes is helping the investors to review their investments real time. The recent push by the government towards a digitally empowered economy adds to the allure.

As we move forward, technology is expected to play a pivotal role in taking the industry to the next level. Through technology the mutual fund industry is looking to reach the untapped geographies in a cost-effective and commercially viable manner. With e-KYC procedures already in place for most of the fund houses, it is becoming easier for the young investing population to invest online in mutual funds.

Amidst all this, financial advisors have played a vital role in the entire mutual fund value chain. Retail investors who are not investment-savvy should ideally consult a financial advisor when it comes to planning their financial goals. In fact, a financial advisor becomes as important as a family doctor to keep the family's financial health in check. Aligning the investments with financial goals and then making sure that such goals are on track with the investment horizon, your financial advisor will help you take a constructive approach to your financial future.

The Way Ahead

Despite the growth in assets, mutual fund penetration, as measured by AUM to GDP ratio, is an unimpressive 11.8% compared with the global average of 54%. Nevertheless, the stage seems set for next big leap with factors such as adoption of technology by the industry, growing acceptance among the investing population that mutual funds are an ideal wealth creation for long term wealth creation, growing participation of retail investors through SIPs and finally influx of pension money.

The growth is also expected to be fuelled by the continued focus on increasing the mutual fund penetration into the geographies beyond big cities, for which SEBI has allowed additional 30 bps expenses in “Beyond-30” cities. Also, the recent re-categorization by SEBI to eliminate multiple schemes under the same category may also make it easier for the investors to make an informed decision on selecting a specific mutual fund scheme.

A recent analysis by CRISIL Research estimates that the industry AUM may grow by around 19% over the next five years to reach Rs. 48.40 lakh crores. These estimates are likely to be a reality as well owing to increased speed in technology-enabled transactions coupled with easing investment rules. As the industry evolves further, the number of innovative product offering too is bound to rise.

At the same time, we need to address three pertinent issues so that the industry's growth momentum remains consistent. First, for a retail investor, the default understanding is that mutual fund means investing into equity market. This thought process needs change. There is a plethora of funds available under debt mutual funds which can be used by individuals of varying risk profiles to meet short to medium term financial needs. Second, the distribution space should be made more lucrative, making mutual fund distribution a viable career path for new entrants. This is because a stronger impetus on intermediaries will go a long way in ensuring sustainable growth for the industry. Third, mutual funds should be allowed to accept the bank KYC thereby reducing paperwork and helping improve the onboarding procedure.