The Indian Mutual Fund Industry: From Inception to Advancement

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Abstract

Inception of the Indian mutual fund industry was a consequence of progressive liberalization that brought about dramatic changes in the Indian financial system. Liberalization of economic policies caused rapid growth of the capital market, money market, and financial services industry. The Indian mutual fund industry is one of the major results of financial novelty in the Indian context. However, its popularity as an investment option is still debatable. The study was concerned with the journey of the Indian mutual fund industry since its beginning in India. To serve the purpose, the study focused on the following areas : historical perspectives of the Indian mutual fund segment, growth aspect of the mutual fund industry, and the last section highlighted major challenges, issues, and growth prospects of the Indian mutual fund industry.

Keywords: mutual fund, asset under management, resource mobilization

JEL Classification: G20, G23, G24

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Progressive liberalization has brought about dramatic changes in the Indian financial system. Liberalization of economic policies caused rapid growth of the capital market, money market, and financial services industry. The Indian economy is going to be the next big investment destination backed by high savings and growth rate. The economic uncertainty of 2008 stifled the stupendous growth of the Indian mutual fund industry, but the industry is recovering itself quickly. Between 2000-01 and 2007-08, equity and debt transaction by mutual funds in Indian markets rose by multiples over 12 times, with net investment rising about 40 times. Obviously, the importance of the impact of mutual funds in the Indian capital market can be understood. The objective of this study to exhibit the journey of the Indian mutual fund industry since its inception and to analyze how the industry experienced various structural changes. Furthermore, the study has also made an attempt to exhibit trends of growth, challenges, and major issues. Keeping in mind the objectives of the study, the research design selected for this study is hybrid in nature. The data used to serve the purpose of the study are secondary in nature. Data were collected from online sources, surveys, annual reports of SEBI, RBI, AMFI, magazines, and books. To analyze the secondary data, basic statistical tools like average, percentage, trend, and CAGR were used.

Historical Background

The genesis of mutual funds in India begins from the year 1963, when the Indian Parliament enacted the Unit Trust of India (UTI) Act. The then Finance minister, Govt. of India, Mr. T.T. Krishnamachari, stated the rational for setting up of UTI in the Parliament with such erudite words, "UTI would provide an opportunity for the middle and lower-income groups to acquire, without much difficulty, property in the form of shares….This institution is intended to cater mainly to the needs of individual investors whose means are small" (Raju, 2000, p. 39). Thus,

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UTI came into action in July 1964 by launching its first scheme, US-64. Phase I (1964-1987) was concerned with beginning of Indian mutual funds and monopoly years of UTI. The first decade of UTI was a formative one. The second decade of UTI was the period of consolidation and expansion. The second decade witnessed delinkage of UTI from RBI. Since UTI was the only player during the period, as a result, the growth of the industry was synonymous with the growth of UTI.

Phase II (1987-1992) encountered an entry of public sector mutual funds due to the impact of liberalization. The State Bank of India, the largest commercial bank in the country, became the first bank to set up a mutual fund in November 1987. This step was soon followed by other banks - Canara Bank, Bank of India, Indian Bank, Punjab National Bank, and Bank of Baroda. Other public sector financial institutions such as LIC and GIC also joined the mutual fund industry. Thus, this period (1987-1992) was marked by entry of eight new mutual funds, six by public sector banks and two by the insurance corporations. However, even after the entry of the banking sector, there was not much competition, and the Indian mutual funds were more or less characterized by UTI until 1993 (Jaydev, 1998).

The Phase III (1993-1996) is well recognized as the hallmark period in the Indian mutual fund segment with the entry of private players and SEBI regulation of the mutual fund industry. GOI, in wake of policies of liberalization and globalization, permitted the private sector to set up mutual fund companies. Kothari Pioneer (now a part of Franklin Templeton Mutual Fund) was the first private sector mutual fund to enter the market in 1993 with the country's first open ended growth-oriented fund. Private players with their foreign partners revolutionized the Indian mutual fund industry. In the first year, five private sector mutual funds namely, Kothari Pioneer Mutual Fund, ICICI Mutual Fund, Taurus Mutual Fund, Morgan Stanley Mutual Fund, and 20th Century Mutual Fund started their operations. The U.S. based fund Morgan Stanley entered in 1994 by floating ₹ 900 crores against a target amount of ₹ 300 crores (Jaydev, 1998). The private sector, with innovative products and better services, gradually captured not only the market share, but also the mind share of the investors. It is a fact that only after the entry of the private sector that the Indian mutual fund segment was recognized as an industry in the true sense.

Phase IV (1996-1999) of the Indian mutual fund industry saw tighter regulations and higher growth. Deregulation and liberalization of the Indian economy had introduced competition and provided an impetus for the growth of the industry. Measures were taken both by SEBI (to protect the investors) and the government (to enhance investors' return through tax benefits) (AMFI Workbook, 2006).

Phase V (1999-2004) was concerned with the other major development in the mutual fund industry - which was the creation of a level playing field for all mutual funds in India. During the same phase, UTI experienced a financial and governance crisis. While UTI functioned under a separate law of the Indian Parliament earlier, UTI mutual fund was under SEBI's (Mutual Funds) Regulations, 1996 (like all other mutual funds in India). All new schemes offered by UTI Mutual Fund had to be SEBI approved. Other schemes (US 64, Assured Return Schemes) of erstwhile UTI were placed with a special undertaking administered by the Government of India. These schemes were gradually wound up. Thus, the emergence of a uniform industry with the same structure, operations, and regulation made it easier for distributers and investors to deal with any fund house in India (AMFI Workbook, 2006).

The Phase VI (2004 onwards) witnessed a spate of mergers and acquisitions (AMFI Workbook, 2006). It was Franklin Templeton, which fired the first salvo at the competition by acquiring Kothari Pioneer Mutual Fund. According to industry experts, consolidation seemed inevitable given the fact that markets became more and more competitive. This put further pressure on the margins and choked the growth for those with low asset bases. The UTI scandal first led to a decline in the overall asset under management for the industry, but the sector eventually recovered over the years (Chakrabarti, 2010).

The Indian mutual fund industry experienced unprecedented growth from 2005 to 2007 with a growth rate of 32%, 62%, and 68%, respectively. Furthermore, from 1999 to 2008, the Indian mutual fund industry grew at 21% CAGR and managed to record a compounded growth of 28% over 2006-2010. By the end of March 2011, Indian mutual funds had managed ₹ 700538 crores under 1131 schemes. All these figures are a testimony to the fact that investors have confidence in the regulation of the Indian mutual fund industry. Furthermore, a number of regulatory changes were made keeping in mind the best interests of the investors.

However, the growth and success of the mutual fund industry depend upon the sound financial management policies and investment practices it pursues to bring about value addition to the financial assets it manages. The subject assumes greater significance now than ever before, in view of the present dynamic and turbulent capital market environment as well as the economic scenario of liberalization and globalization leading to more intense competition (Sondhi & Jain, 2006)

Resource Mobilization by Mutual Funds

This section deals with the growth of the Indian mutual fund industry in terms of resource mobilization, asset under management, industry investor mix, number of schemes, and penetration. Even after the entry of bank

Table 1. Mobilization of Net Resources by Mutual Funds (₹ in Crores)

Year	UTI	Growth Index (UTI)	Bank Sponsored	Growth (%)	FI Sponsored	Growth (%)	Total
1970-71	18.00	1.00	------	------	------	------	18.00
1971-72	15.10	0.84	------	------	------	------	15.10
1972-73	23.20	1.29	------	------	------	------	23.20
1973-74	30.60	1.70	------	------	------	------	30.60
1974-75	17.20	0.95	------	------	------		17.20
1975-76	29.00	1.61	------	------	------	------	29.00
1976-77	34.60	1.92	------	------	------	------	34.60
1977-78	73.30	4.07	------	------	------	------	73.30
1978-79	101.50	5.64	------	------	------	------	101.50
1979-80	57.90	2.22	------	------	------	------	57.90
1980-81	52.10	2.89	------	------	------	------	52.10
1981-82	157.40	8.74	------	------	------	------	157.40
1982-83	166.90	9.27	------	------	------		166.90
1983-84	330.20	18.34	------	------	------	------	330.20
1984-85	756.20	42.01	------	------	------	------	756.20
1985-86	891.80	49.54	------	------	------	------	891.80
1986-87	1261.10	70.06	------	------	------	------	1261.10
1987-88	2059.4 **(89.16)**	114.10	250.3 **(10.84)**	0	0	0	2309.70
1988-89	3855 **(92.34)**	214.20	319.7 **(7.66)**	27.72	0	0	4174.80
1989-90	5583.6 **(82.27)**	310.20	888.1 **(13.08)**	177.80	315.30 **(4.65)**	0	6786.90
1990-91	4553 (60.64)	252.90	2351.9 (31.33)	164.82	603.50 (8.03)	91.40	7508.50
1991-92	8685.4 (77.18)	482.50	2140.4 (19.02)	-9.00	427.10 (3.80)	-29.23	11252.00
1992-93	11057 (84.92)	614.30	1204 (9.25)	-43.75	760.00 (5.83)	78.00	13021.00
CAGR	**32.20**						**33.14**

Source: Reserve Bank of India (Various Years)

(1 crore = 10 million)

Figures in parentheses indicate percentage sponsored and financial institution sponsored mutual funds, UTI retained its monopoly position in the industry. As can be inferred from the Table 1, UTI retained about 76% of the total net mobilization even after entry of financial institutions from 1989-90 to 1992-93, while it shared about 79% of the mobilization from 1987-88 to 1992-93. This indicates that financial institutions could not compete with UTI even with their sound track record and well established distribution channel. They could affect only 3% share of UTI on average. UTI, in particular, had to face downtrend in mobilization in 1971-72 (₹ 15.1 crore) from ₹18 crore in 1970-71. In terms of compounded annual growth rate, resource mobilization by UTI increased at CAGR of 32.20% during the period of 23 years (from 1970-71 to 1992-93). The mutual fund industry as whole reported a CAGR of 33.14 %. This indicates that other public sector and financial institution sponsored mutual funds, even after 5-6 years of experience, could not contribute significantly to the growth of the Indian mutual fund industry (Yadav, 2010).

The Table 2 exhibits contribution of different categories of AMCs in net resource mobilization of the mutual fund industry. The Table shows that over the years, it is only the private sector mutual funds that could maintain positive net mobilization of the industry. Contribution of UTI and FI sponsored mutual funds was observed to be downbeat. However, bank sponsored mutual funds could contribute marginally towards positive inflows. Over the years, particularly after the entry of private sector mutual funds, there has been a stupendous increase in resource mobilization by mutual funds. However, at the same time, redemptions have also increased. As a result, the ratio between gross mobilization and net mobilization declined over the years.

The Table 3 shows that in 47 years of existence, the industry attained a CAGR of 24.34% in assets under management. From a meager amount of ₹ 25 crore in 1965, it achieved an impressive figure of ₹ 700538 crore by

Table 2. Mobilization of Net Resources by Mutual Funds (₹ in Crores)

Years	UTI	(%)	Bank Sponsored	(%)	FI Sponsored	(%)	Private Sector	(%)	Total
1993-94	9297	**82.70**	148	**1.3**	238	**2.0**	1560	**13.9**	11243
1994-95	8611	**76.4**	766	**6.8**	576	**5.10**	1322	**11.7**	11275
1995-96	-6314	**-108.2**	113	**1.9**	235	**4.0**	0133	**2.3**	-05833
1996-97	-3043	**-149.5**	007	**0.00**	137	**6.7**	0864	**42.0**	-02035
1997-98	2875	**70.7**	237	**5.8**	204	**5.0**	0749	**18.4**	04065
1998-99	0170	**06.30**	-089	**-03.0**	547	**20.0**	2067	**76.70**	02695
1999-00	4548	**20.5**	336	**1.5**	296	**1.3**	16938	**76.6**	22118
2000-01	322	**02.9**	249	**2.2**	1273	**11.4**	9292	**83.4**	11136
2001-02	-7284	**-72.0**	863	**8.5**	406	**4.0**	16134	**159.4**	10119
2002-03	-9434	**-205.8**	1033	**22.5**	861	**18.8**	12122	**264.5**	04582
2003-04	1050	**02.2**	4526	**9.4**	787	**1.6**	41510	**86.70**	47873
2004-05	-2467	**-88.5**	706	**25.3**	-3384	**-121.3**	7933	**284.5**	02788
2005-06	3424	**06.5**	5365	**10.2**	2112	**4.0**	41581	**79.2**	52482
2006-07	7326	**07.8**	3033	**3.2**	4226	**4.5**	79477	**84.5**	94063
2007-08	10678	**07.2**	7597	**5.1**	2178	**1.5**	128032	**86.2**	148485
2008-09	-3659	**-14.8**	4489	**18.2**	5954	**24.1**	-31425	**-127.5**	-24641
2009-10	15653	**20.0**	9855	**12.5**	4871	**6.2**	48166	**61.3**	78545
2010-11	-16636	**-34.0**	1304	**26.7**	-16988	**-34.8**	-16493	**-33.7**	-48813
2011-12	-3179	**-07.0**	1054	**2.0**	-3098	**-07.0**	-38520	**-88.0**	-43744
Average	-----	**-19.82**	-----	**8.42**	-----	**-2.26**	-----	**62.21**	-----

Source: Reserve Bank of India (Various Years)
(1 crore = 10 million)

Annual data (from 2004-05 onwards) pertaining to UTI Mutual Fund only the year 2012. The Figure 1 exhibits the pattern of AUM growth over the years.

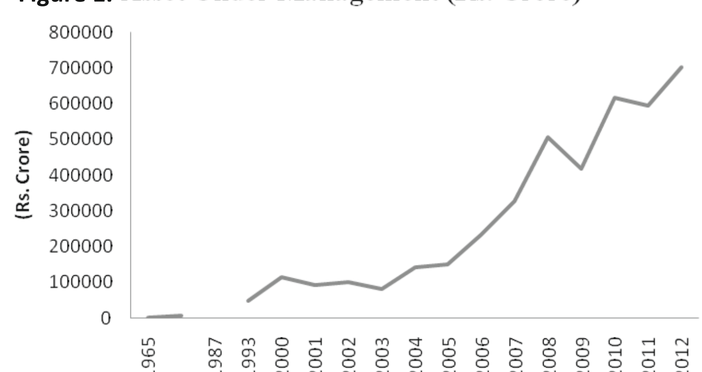
The Table 4 highlights the innovative schemes in the Indian mutual fund segment. Birla Sun Life Mutual Fund launched the first liquid fund in 1997, while in 1998, Kotak Mutual Fund became the first fund house to launch a gilt scheme that invested only in government bonds. The year 1998-99 also saw the emergence of sector funds such as technology, FMCG, and pharma. Monthly income plans (MIPs), fixed maturity plans (FMPs), and capital protection-oriented funds were other innovations in the fixed-income category. In 2001, Benchmark Mutual Fund (now Goldman Sachs Mutual Fund) launched the first equity exchange-traded fund (ETF) and introduced the concept of passive fund management. Fund of funds schemes came into existence in the year 2003. In 2007, Benchmark launched the first gold ETF, introducing the concept of paper gold in the country (Chakrabarti, 2010).

Table 3. Assets Under Management (AUM)

Year	Assets Under Management (₹ Crore)	% Increase (Decrease)
1965	25	------
1987	4564	18156
1993	47000	929.80
2000	113005	140.43
2001	090587	-19.83
2002	100594	11.046
2003	079464	-21.00
2004	139616	75.69
2005	149554	07.12
2006	231862	55.03
2007	326388	40.77
2008	505152	54.77
2009	417300	-17.39
2010	613979	47.13
2011	592250	-3.54
2012	700538	18.28
CAGR	**24.34%**	

Source: Association of Mutual Funds in India (n.d.)
(Data pertaining for the month of March of every year.
(1 crore = 10 million)

Figure 1. Asset Under Management (Rs. Crore)



Source: Table 3

➢ **Share of Schemes in Total AUM of the Mutual Fund Industry:** It can be inferred from the Table 5 that over the years, income and growth oriented funds remained the highest priorities of investors. The figures given in the Table 5 exhibit that from 2003 onwards, the share of debt funds in total AUM continuously decreased till 2006. The same time frame showed that growth funds enjoyed increased share in total AUM. However, after the year 2006, the trend changed in favor of debt funds may be because of increased preferences and increasing uncertainties at the global level that ultimately appeared as the financial crisis in 2008.

For the debt funds, due their less risky nature, their growth was not hampered in comparison to equity funds. Share of gold ETFs (not exhibited in table) between 2007 to 2011varied in the range 0% - 1%, but other funds like

Table 4. Inception of New Schemes

Year	1997	1998	1999	2001	2003	2007
Schemes	Money Market Mutual Funds	Gilt Funds	Index Funds & Sector Funds	Exchange Traded Funds	Fund of funds	Gold ETFs

Table 5. Share of Different Schemes in AUM of the Mutual Fund Industry (₹ crore)

Schemes / Years	Income	Balanced	ELSS	Money Market	Growth	Gilt
2001	48863	19273	2523	4128	13483	2317
	(54%)	**(21%)**	**(03%)**	**(4.5%)**	**(15%)**	**(2.5%)**
2002	55788	16954	1768	8069	13852	4163
	(55%)	**(17%)**	**(1.7%)**	**(8.2%)**	**(14%)**	**(4.1%)**
2003	47564	3141	1228	13734	9887	3910
	(59.8%)	**(4%)**	**(1.5%)**	**(17.3%)**	**(12.4%)**	**(5%)**
2004	62524	4080	1669	41704	23613	6026
	(45%)	**(03%)**	**(1.2%)**	**(29.8%)**	**(17%)**	**(04%)**
2005	047605	04867	01727	54068	036757	4576
	(32%)	**(03%)**	**(01%)**	**(36%)**	**(25%)**	**(03%)**
2006	060278	07493	06589	61500	092867	3135
	(26%)	**(03%)**	**(03%)**	**(27%)**	**(40%)**	**(01%)**
2007	119322	09110	10211	72006	113386	2257
	(36%)	**(03%)**	**(03%)**	**(22%)**	**(35%)**	**(01%)**
2008	220762	16283	16020	89402	156722	2833
	(44%)	**(03%)**	**(03%)**	**(17%)**	**(31%)**	**(01%)**
2009	197343	10629	12427	90594	95817	6413
	(47%)	**(03%)**	**(03%)**	**(22%)**	**(23%)**	**(1.3%)**
2010	311715	17246	24066	78094	174054	3395
	(51%)	**(03%)**	**(04%)**	**(13%)**	**(28%)**	**(1%)**
2011	291975	18445	25569	73666	169754	3409
	(49%)	**(03%)**	**(04%)**	**(13%)**	**(29%)**	**(1%)**
2012	290844	16261	23644	80354	158432	158432
	(50%)	**(03%)**	**(04%)**	**(14%)**	**(27%)**	**(0.62%)**
CAGR	**16.03%**	**-1.41%**	**20.50%**	**28.07**	**22.79%**	**3.88%**

Source: Association of Mutual Funds in India (n.d.)
(1 crore = 10 million)
Data pertain for the month of March every year.
Note: Figures in the parentheses shows percentage

Table 6. Fall in Share of Equity Mutual Funds in Total AUM

Month/Year	(%) Decline
Sep 07	35
Dec 07	38
Mar 08	33
Jun 08	27
Sep 08	27
Jan 08	26

Source: Parekh (2010)

FOFs, other ETFs, and offshore funds could not attract even 1% of AUMs. In the year 2012, gold ETFs attracted 2% of the total AUM. Gilt funds, except the initial years, continuously experienced fall in their acceptance as an investment option.

The Table 6 exhibits the extent of the impact of the global downturn in 2008. As an immediate effect of the global financial crisis, net assets of mutual funds worldwide declined sharply by over 25% in 2008. Net inflows to worldwide mutual funds started declining from 2009, with considerable outflows recorded in the first two quarters of 2010 (Bose, 2012). As far as the Indian mutual funds were concerned, the major impact was on equity based funds because FIIs pulled out their investments to pump funds in their home countries in recession, resulting in rapid fall in the share of equity funds to one fourth in overall assets under management. However, debt funds, on the other hand, were not much affected. In October 2008, the liquidity crisis catalyzed the steep fall in debt AUM (Table 6).

➯ **Holding Pattern of Assets Under Management by AMCs:** The Table 7 exhibits holding pattern of AUM by asset management companies. UTI, after the year 2003, lost its individual presence and fell under banking mutual funds category. Bank sponsored mutual funds held about 14% of the total AUM on an average. In bank sponsored mutual funds, joint ventures also came into the scene since 2005. Mutual funds sponsored by institutions were not in a strong position as far as holding of AUM was concerned. They have only 3.52% of total AUM of the industry. Private sector mutual funds were in a dominating position as they held about more than 70% of the total AUM. However, within private sector AMCs, joint ventures (predominantly Indian) and Indian AMC held 46% of the total AUM; while predominantly foreign joint ventures captured about 18%. Foreign AMCs had a minor share (6.35%) in the private sector category. Moreover, the integrated scenario shows that the mutual fund industry was dominated by private sector mutual funds, and they held about 70% of the total market share (AUM).

➯ **Industry-Investor Mix in AUM:** The Table 8 exhibits percentage holdings of various participants in the Indian mutual fund industry. The highest share in AUM is still enjoyed by corporate houses and institutions. A close look at the Table reveals that the average shareholding of the corporates during 2007-2010 was about 54%. Individuals enjoyed merely 31.55% of the total AUM of the industry. FIIs had only 1.55% shareholding in total AUM.

➯ **Growth in Number of Schemes:** While concerned with growth of schemes (Table 9), it can be observed that right from the entry of private sector mutual funds in the year 1993, the number of schemes launched increased by many folds.

➯ **Growth in Number of AMCs:** The Table 10 shows that from only 9 AMCs in 1993, the number of AMCs in the Indian mutual fund industry touched the figure of 41 as on March 31, 2011. From 1993 to 2011, the cumulative growth in number of AMCs was 16.37%.

Table 7. Share (%) of Mutual Funds in Total Assets Under Management of the MF Industry

Year	UTI	Bank Sponsored	Institutions	Private Sector Mutual Funds			
				Indian	Foreign	Joint Venture: Predominantly Indian	Joint Venture: Predominantly Foreign
2000	67.7	07.0	3.0	02.0	-----	08.6	11.5
2001	64.0	03.7	3.9	03.7	-----	09.5	15.2
2002	51.1	04.0	4.2	05.1	-----	15.4	20.1
2003	17.0	05.6	7.4	13.0	-----	19.4	37.6
2004	-----	20.1	4.7	14.2	2.6	23.7	34.6
2005	-----	19.5	2.0	20.6	-----	20.6	37.3
2006	-----	19.4	2.2	22.0	-----	32.0	24.4
2007	-----	16.4	3.0	24.0	-----	33.0	23.6
2008	-----	15.1	2.7	30.8	5.8	30.8	14.8
2009	-----	16.4	4.7	31.2	6.6	36.5	04.6
2010	-----	17.4	5.6	31.5	6.7	35.8	03.0
2011	-----	17.5	1.6	34.4	7.8	36.2	02.4
2012	-----	18.0	0.87	28.7	8.6	41.3	02.5
Average Holding		13.85	3.52	20.09	6.35	26.36	17.81
CAGR	-----	8.19%	-9.80%	24.85%	16.13%**	13.97%	-11.94%

Source: Association of Mutual Funds in India. (n.d.)

Data pertaining for the month of March every year.

** CAGR for 8 years.

Table 8. Industry-Investor Mix in AUM (%)

Participants / Year	FIIs	NRIs	Corporate/Institutions/ Others	High Net Worth Individuals	Individuals
2007	2.40	5.30	49.90	NA	42.30
2008	1.65	4.86	56.55	NA	36.93
2009	1.17	NA	55.50	22.00	21.00
2010	1.00	NA	54.00	19.00	26.00
2012	2.30 (including banks)	NA	43.10	26.60	27.40

Source: PricewaterhouseCoopers (2010)

➯ **Share of MFs in Households' Gross Financial Savings:** The Table 11 shows the share of Indian mutual funds in household savings that indicates a steady but an increasing trend over the years. Particularly, from the year 2006, the share of mutual funds in household financial savings showed a rising trend. But as compared with other countries, it is observed that Indians still seem to be following the traditional format of the investment style.

➯ **AUM to GDP Ratio for India:** The Table 12 shows the ratio of AUM to GDP that also shows an increasing trend. Over the period of the last 5 years, the AUM to GDP ratio of mutual funds (on an average) was maintained at 10%.

➯ **AUM to GDP Ratio of Major Countries:** As it can be inferred from the Table 13, Hong Kong, Australia, and the U.S. are the top most beneficiaries of mutual funds.

Table 9. Cumulative Growth in No. of Schemes

Year	No of Schemes
1964-74	0005
1976-86	0010
1989	0021
1993	0059
1994	0167
1999	0277
2000	0344
2002	0417
2004	0403
2005	0451
2006	0592
2007	0756
2008	0956
2009	1001
2010	0882
2011	1131
2012	1309
2013	1294

Source: Association of Mutual Funds in India. (n.d.).
Data pertaining for the month of March every year.

Table 10. Cumulative Growth in No. of AMCs

Year	No of AMCs
1964	01
1989	08
1993	09
1996	26
2000	33
2005	30
2006	30
2007	32
2008	35
2009	38
2010	38
2011	41
2012	44

Source: Association of Mutual Funds in India. (n.d.).
Data pertaining for the month of March every year.

Table 11. Share of MFs in Households' Gross Financial Savings

Year	Share (%)
2004	1.2%
2005	0.4%
2006	3.8%
2007	4.8%
2008	7.7%

Source: Investment Company Institute (n.d.)

Table 12. AUM to GDP Ratio for India

Year	Share (%)
2005	06%
2006	08%
2007	10%
2008	15%
2009	11%

Source: Investment Company Institute (n.d.)

➬ **Growth Rate of AUM in Different Countries:** It is evident from the Table 14 that since 2004, India has been identified and recognized as amongst the fastest growing market for mutual funds. During the period from 2004-2008, the Indian mutual fund industry grew at the 29% growth rate as against the growth rate of other developed nations as well as the global average growth rate of mutual funds. However, the share of Indian mutual funds in global AUM (USD 18.97 trillion) comprised of only 0.32% as on December 2008. However, China and Brazil have emerged as a close competitor for the Indian mutual fund market at the international level.

➬ **Geographical Spread of Mutual Fund Investors:** A large number of corporate investors contributing to the skew towards the debt oriented or non-equity AUM is mirrored by the disproportionate contribution from Mumbai (Table 15). The top five cities (Mumbai, New Delhi, Bangalore, Kolkata, and Chennai) contributed over 71% of the total AUM, with Mumbai alone accounting for more than 42%. Contribution from others may consist of tier-I

Table 13. AUM to GDP Ratio of Major Countries

Countries	Share
U.S.	74%
Australia	100%
Brazil	45%
India	**11%**
Hongkong	270%

Source: Investment Company Institute. (n.d.)

Table 14. Growth Rate of AUM in Different Countries (2004-2008)

Countries	AUM growth Rate (CAGR)
China	63%
Brazil	21%
Russia	11%
Japan	10%
France	04%
U.S.A.	04%
U.K.	02%
India	**29%**
World	**04%**

Source: Investment Company Institute. (n.d.)

Table 15. Geographical Spread of AUM (Year: 2012)

Area	Distribution (%)
Mumbai	42.10
New Delhi	13.20
Kolkata	06.40
Bangalore	05.50
Chennai	04.80
Others	28.90

Source: Investment Company Institute. (n.d.)

and tier-II cities (As defined by the RBI, tier-II cities are those that have a population base of 50,000 and above people, while tier-III cities have a population base of upto 50,000).

Recent Investor Friendly Regulatory Developments Undertaken by SEBI

(1) More Transparency: SEBI has directed AMCs to be more transparent in their advertisements and other mode of information given to investors. AMCs, along with NAVs, also have to exhibit benchmark performance and comparison with the SENSEX and the govt (Dwivedi , 2011).

(2) Transaction Charges : To increase penetration in small towns, SEBI is motivating agents/distributors by granting them ₹ 100 as per transaction charge (subject to maximum investment of ₹ 10000). Furthermore, new investors from small towns will be charged ₹ 50 extra (Dwivedi , 2011).

(3) Common Account Statement: Every mutual fund investor will now get a common account statement containing information about details of investment by concerned AMC, the transaction charges, and so on. Moreover, in every 6 months, the investors will get common account statement of non transacted folios (Dwivedi , 2011).

(4) All Operations to be Carried out from India: SEBI has directed mutual fund companies to perform their operations like trading desk, unit holder services, and investments from India. Companies operating outside India have to declare about non continuation of their operations from abroad that have to be shifted to India within 1 year (subject to extension of 1 year by SEBI) (Dwivedi , 2011).

(5) Entry Load Abolition: SEBI scraped the entry load from August 2009, thereby empowering investors to decide the commission that needed to be paid to distributers. Distributers, on the other hand, to cope with the situation, turned themselves into advisors that would, to some extent, tackle the problem of financial literacy of the investors. Moreover, earlier, in NFOs, a fund house could deduct 6% of the invested amount straightaway. A big part of this was for paying distributors. There was a time when the starting NAV of a fund (whose unit's face value was ₹10) used to be ₹ 9.40. That's why distributors sold NFOs more aggressively than the existing funds, leading to miss-selling. This changed when SEBI banned entry load - a 2.5% fee charged by the distributors upfront - in 2009 (Dwivedi , 2011 ; Sridhar, 2010).

(6) Investor Safety and Risk Mitigation: Over the years, SEBI brought new or tweaked existing regulations to ensure that investors were protected from undue risks. Starting at the structural level, where the fund management team was kept at an arm's length from the asset management company, SEBI stipulated strict investment norms such as exposure limits to ensure that the portfolio was not too concentrated. Now, an equity fund cannot invest more than 10% of its total NAV in one company, except in index/sector funds. A debt fund cannot invest more than 15% assets in rated bonds and 10% in unrated bonds of a single issuer. Besides, a fund cannot invest more than 25% net assets in stocks of group companies of its own sponsor.

All schemes should have at least 25 investors, and all investors should be informed about any changes in the scheme's objective and given an option to exit without paying a fee. After reports of frauds, SEBI also asked mutual funds not to accept third party cheques, except in case of minors (Dwivedi , 2011 ; Mondal & Varma , 2013).

(7) Creation of a Separate Mutual Fund Trading Platform on the stock exchange for convenient and single point transactions for investors (Dwivedi , 2011).

(8) Close Ended Funds are now being listed and there would be no redemption before maturity (Dwivedi , 2011).

Table 16. Major Regulatory Changes Introduced by SEBI

Criteria	Before	Now
Expense Ratio Charged	Maximum 2.5% allowed (depending on the AUM)	Now, additional 30 basis points (0.3%) are allowed if the fresh inflows are from smaller towns
Internal Limits on Expense Ratio	Internal Limits of 1.25% for Fund Management Charges, 0.5% for distribution costs	No internal limits now
Exit Load	Went to a separate fund used for marketing and sales	Added back to Scheme AUM, but will not benefit investors because of equivalent increase in expense ratio (limited to 20 basis points)
Direct Scheme of Mutual Funds	Earlier there was no distinction between a investment made by an agent or directly with AMC	A new category called "Direct" has been introduced with a lower expense ratio.
Service Tax	Borne by AMC	Borne by the Investors
Distinction between Adviser and Distributor	There was no distinction earlier	The regulations are now coming in. Advisor and Distributor will be separated.

Source: Chauhan (n.d.)

Major Regulatory Changes : At a Glance

The Table 16 illustrates the six major changes introduced by SEBI to revive the Indian mutual fund industry. It is important to keep in mind that around 87% of the AUMs in mutual funds come from top 15 cities in India, which means that only a minute 13% of the mutual funds money is channelized from small cities in India. If a mutual fund is able to get more than 30% of its AUM from other than top 15 cities in India, they can charge a 30 basis points expense ratio higher than its current expense ratio. A lower contribution means proportionately lower expense ratios. So, the inflow from smaller cities will affect investors from bigger cities. Investors from big cities will have to bear the burden of an increased expense ratio. Removal of the internal limit on expense ratio means more advertisements, more commissions to the distributors, and more aggressive selling. Though this is a very big encouraging change on the part of AMCs, they will still have to keep a check on the expense ratio because of competition from other AMCs.

Since January 2013, SEBI has made it compulsory for every fund house to offer a direct plan for every fund. Now, investors have both the options, either invest through an agent or go directly for the mutual fund schemes. The latter option, obviously, does not involve distribution or other charges concerned with intermediaries. In this case, the direct plan would be an economical option. Since the inception of the direct plan option, it has accounted for 30% of the total assets under management of mutual funds ; 50% of the liquid funds (ranging from few days to few weeks) can be opted through the direct plan ; 26% of the total fixed income securities are being preferred through the direct plan ; 3% of the investment in equity based funds and SIPs are routed through the direct plan.

Corporates have been shifted towards the direct plan. As far as individual investors are concerned, their shift towards the direct plan depends upon their knowledge, experience, and information. The key concern is that with the introduction of the direct plan, the distribution part of the mutual fund schemes is going to end. Thus, gradually, intermediaries seem to disappear as far as distribution of mutual fund schemes is concerned.

Besides remarkable growth and expansion, the Indian mutual fund industry is still facing some serious challenges. However, the government, the policy makers, and the industry experts are trying to resolve the below mentioned issues, but the results have not exhibited impressive footmark towards its solution.

➩ Challenges that Continue to Stick with the Industry

(1) Under-penetrated population,
(2) Inaccessibility in smaller towns and cities due to lack of an efficient distribution network,
(3) Heavy reliance on institutional sales,
(4) Low financial literacy levels and,
(5) Cost pressures emanating as a result of inefficiencies in systems and processes.

However, while dealing with the above-mentioned challenges, some key issues as well as growth drivers have been identified by CII and KPMG in the course of evaluating the Indian mutual fund industry.

➩ Key Issues and Growth Drivers Before the Industry Players

According to a KPMG Report (2010) :

(1) The industry may have to compromise with its revenues due to the focus on low margin products to attract investors from tier-II and tier-III cities. Furthermore, the penetration and setting up own branches into these cities may cause an increase in their operating cost.

(2) Decline in investment management fees is expected as risk averse customers prefer investments in debt products.

Table 17. Projected Growth in AUM (₹ billion)

Year	Assuming CAGR 22%	Assuming CAGR 25%
2012	8859	16087
2015	9529	18611

Source: KPMG Report (2010)

Table 18. Projected Growth in AUM (₹ billion)

Year	Assuming CAGR 15%	Assuming CAGR 18%
2012	8568	15559
2015	8766	17122

Source: KPMG Report (2010)

(3) High margin products such as equity and select debt products are likely to continue to contribute a significant share of industry AUM.

(4) Competition is expected to intensify further with the entry of global players, that may result in fall in market share of the top 10 players.

(5) The share of the top 10 cities is expected to decline as retail investors from smaller cities, towns, and rural areas consider mutual funds as one of the attractive investment alternatives.

(6) Domestic players are expected to tap the overseas market to grow their AUM through alliance with global players.

(7) Cooperative sectors, though beset with internal administrative issues, are likely to emerge as another distribution channel. Further tapping the large network of recognized NGOs to reach out to the lower middle class and poorer segments of the population are important steps to increase penetration as well as financial inclusion.

Future Prospects

It was predicted that the Indian mutual sector would grow at a growth rate of 22-25% (Table 17) in the period from 2010 to 2015 with the expectations of quick economic revival and would attain a relatively lower growth of 15-18% with slow economic revival (Table 18). Furthermore, increased focus on growing investors' awareness and increasing financial literacy was expected to further increase the contribution of the retail sector to the industry AUM in the range of 46-48% by 2015.

At the broad level, due to the ongoing process of economic reforms along with the liberalization measures, the Indian economy has been facing challenges in terms of both external shocks and internal issues. The external shocks are concerned with phenomenal foreign capital inflows, exchange rate volatility, oil shocks, and contagion effects. Internal structural issues have been in terms of slow pace of legal and agricultural reforms, lack of social security system, industrial restructuring, non-performing assets in the banking sector, accompanied by macroeconomic uncertainty, that has given rise to several risks impinging on banks, mutual funds, financial firms, and non financial firms. Macroeconomic risk in terms of exchange rate, inflation, interest rates, and liquidity risks would affect the financial performance of the entities, companies, and financial institutions, and so forth (Shukla, 2011).

Conclusion

The Indian economy is expected to deliver high-growth performance in a few years. However, the Indian mutual fund segment is further required to strengthen its skills and technology based services. Though SEBI is continuously contributing towards a strong regulatory framework ; still, there is some vacuum towards disclosure and insolvency. Fund houses should adopt a wider and a more comprehensive approach while covering tier-I and tier-II cities and contribute towards financial inclusion. Mutual funds still are not recognized as one of the most favorable investment opportunities in investors' communities. Even regular investors in the share market consider them to be more risky than equity shares. Obviously, then, it is an arguable issue that how can risk averse investors be impressed is such a scenario?

The Indian mutual fund industry is primarily debt-oriented with debt funds forming 64% of the AUM. Low penetration and lack of awareness are hurting the industry. There are just over 3,800 mutual fund folios per lakh of population in India as against over 50,000 savings bank accounts and over 26,500 life insurance policies (Moneycontrol. com, n.d.).

There is a huge potential in distribution channels of the public sector with a large captive base. The well-established distribution channels of banks and post offices have not been utilized to a significant level. Taken as a whole, the industry has to disburse great efforts towards ensuring stabilizing factors and sustained profitable growth rather than focusing upon profitability and short term growth.

The study was conducted in isolation covering only mutual funds. A broader study can be conducted covering the impact of macroeconomic variables on the mutual fund industry over a period of time. Furthermore, mutual fund transactions (buying and selling) in the stock market may have a significant impact on movement of stock market indices. Future studies can also ascertain the extent of impact of mutual fund transactions by developing a linear regression model.

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