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Mutual Funds in India: SWOT Analysis

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Abstract: ***Mutual fund sectors are one of the fastest growing sectors in Indian economy that have potential for sustained future growth. Mutual funds make saving and investing simple and affordable. Anybody with an investible surplus of as little as a few hundred rupees can invest in mutual funds. The Indian Mutual Fund industry has already opened up many exciting investment opportunities to Indian investors. The innovative marketing strategies of mutual fund companies in India are influencing the retail investors to invest their surplus funds in different types of securities. Thus, it has become imperative to study the opportunities and challenges of the Indian mutual fund industry. This paper focused attention on the opportunities and challenges of Indian mutual fund industry.***

Keywords: Mutual fund, Strength, opportunities, challenges

1. Introduction

Mutual Fund is an investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors.

A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus. One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of equities, bonds and other securities, which would be quite difficult (if not impossible) to create with a small amount of capital. Each shareholder participates proportionally in the gain or loss of the fund.

Mutual fund units, or shares, are issued and can typically be purchased or redeemed as needed at the fund's current net asset value (NAV) per share, which is sometimes expressed as NAVPS. Mutual funds as an intermediation mechanism and products play an important role in India’s financial sector development. Apart from pooling resources from small investors, they also provide informed decision making mechanism to them. Thus they contribute to not only financial sector participation, but also financial inclusion and thereby enhance market efficiency. Additionally they contribute to financial stability and help in enhancing market transparency.

The Indian mutual fund industry finds itself in an economic landscape which has undergone rapid changes over the past three years. The industry achieved a high water mark when it doubled its AUM (Asset Under Management) from Rs. 3.6 trillion in FY2007 to Rs. 6.13 trillion in FY2010 – clocking an impressive growth rate of 16.2% per year. Since then the Indian economy (coupled with the emerging economies) has faced a slowdown. As per the data released by the Association of mutual funds in India (AMFI), the average assets managed by mutual industry increased by 4.2% during Jan-Mar.2012. The industry has grown at a compound annual growth rate (CAGR) of 18% from 2009-2013. The growth of average assets reported in March 2012 was 12% and increased to a growth of 23% for the year ended march 2013. Coupled with a steep decline in the value of the Indian rupee, the mutual fund industry now finds itself in a capricious global economic environment. However, there is strong reason to believe that the Indian mutual fund industry has not yet seen its global peak and if proper measures are taken, the industry could get back on its former growth path.

Objectives of the Study

- To study concept of mutual funds.
- To analysis the growth and challenges of mutual funds in India.
- To suggest the future prospects of the mutual funds in India.

Research Methodology

The study is descriptive in nature. This study is carried out with the help of secondary data collected from books, articles in journals, and the data published by the AMFI, SEBI& CRISIL.

2. Mutual Funds in India: Growth and Development After Liberalization

The Government handed over the function of regulating Mutual Funds to Securities and Exchange Board of India (SEBI) in March 1991 and also issued guidelines in October 1991 for investors’ protection and regulating the Indian capital market. Ultimately, government accorded a status of autonomous body to SEBI. The idea behind according autonomous body status to Securities Exchange Board of India, perhaps, was to watch and control the working and implementation of guidelines more efficiently and closely, as it was felt that existing Mutual Funds had failed to line up to common investors’ expectations in terms of; after sales service, timely delivery of unit certificates and dividend warrants, promptness in grievance redressal, adequate and timely disclosure of information and under performance of most of the Mutual Funds as against market performance, investors’ right adherence and so on. The launching of private sector Mutual Funds that immediately steeped forward to grab the opportunity worked as a platform for the result of these drawbacks.

With the entry of private sector funds in 1993, a new era 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 1996. The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. From 1996 to 2003 the total distribution of AUM increased from 68,984 crores to 79,464 crores. As at 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.

Since the year 2003 from which the present stage of bull run in the Indian capital markets began, the Mutual fund industry While the growth in terms of the AUM was subdued over the period from 2009-2013, it has gained unprecedented momentum over the four year period until March 2013. Over this latter period of four years, the assets under management have grown from Rs 417,300 crores to as high as 816,657 crores as at the end of March 2013. The compounded annual growth rate of the industry over this period is as high as 40%. This high level of growth has obviously been triggered by the stupendous growth of the Indian capital markets over this period. The NSE index of select 50 stocks over this period has been around 42.60 percent and the Nifty – 50 indexes grew from 2674.6 points to 5697.35 points over the same period.

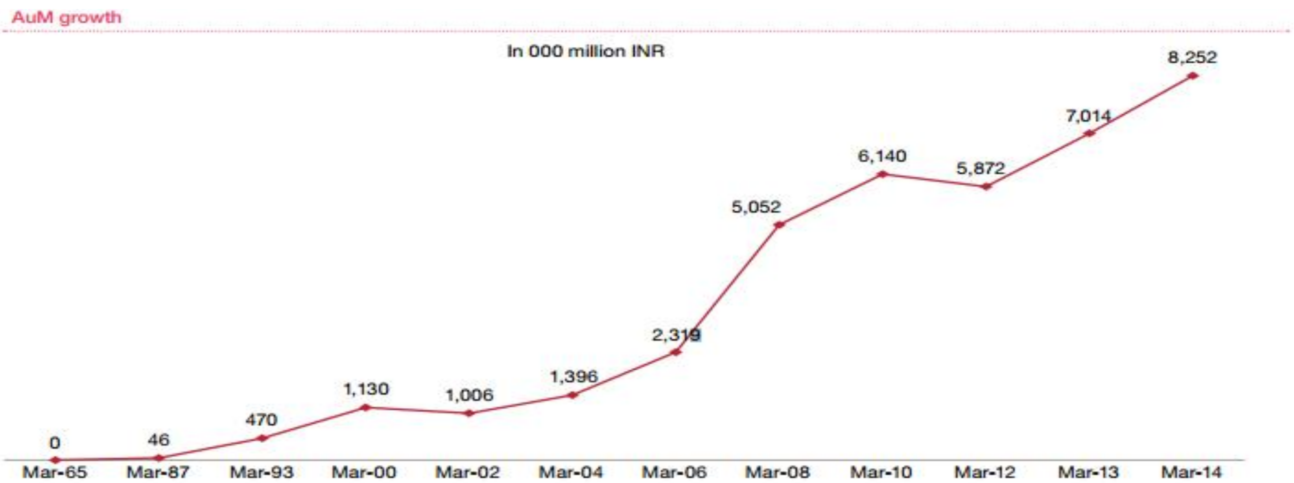
According to AMFI, the growth of the capital markets in terms of BSE-30 share Sensex has been still higher, in absolute terms; this index grew from 3,301.67 points to 18,835.77 points. It is quite clear that the growth of the Mutual fund industry has been in tune with that of the capital market not only the quantitative growth, but also the Indian Mutual fund industry has shown qualitative growth as well. The regulatory environment, under the watchful eyes of the SEBI has been consistently improving. The frequency of reporting by the Mutual fund has increased. The media plays a powerful role for the developments of Mutual fund industry as the fund performance have been reported and evaluated constantly. The advanced growth prospect of the industry has attracted global players as well as splendid fund management talent. Awareness on investment dynamics has become more among the investors. Below is Growth of the Indian Mutual fund industry over the period from 2004-2014 (in Crores).

Table 1: Growth of the Indian Mutual fund industry from 2004-2013

Year	Sales	Redemption	**AUM**
2004	5,90,190	5,43,381	1,39,616
2005	8,39,662	8,37,508	1,49,554
2006	10,98,158	10,45,382	2,31,862
2007	19,38,592	18,44,512	3,26,388
2008	44,64,376	43,10,575	5,05,152
2009	54,26,353	5,454,650	4,17,300
2010	10,019,023	9,935,942	6,13,979
2011	8,859,515	8,908,921	7,00,538
2012	6,819,679	6,841,702	6,64,792
2013	7,267,885	7,191,346	8,16,657

Sources: Compiled from the annual reports of SEBI and the quarterly reports of AMFI, & CRISL Ltd

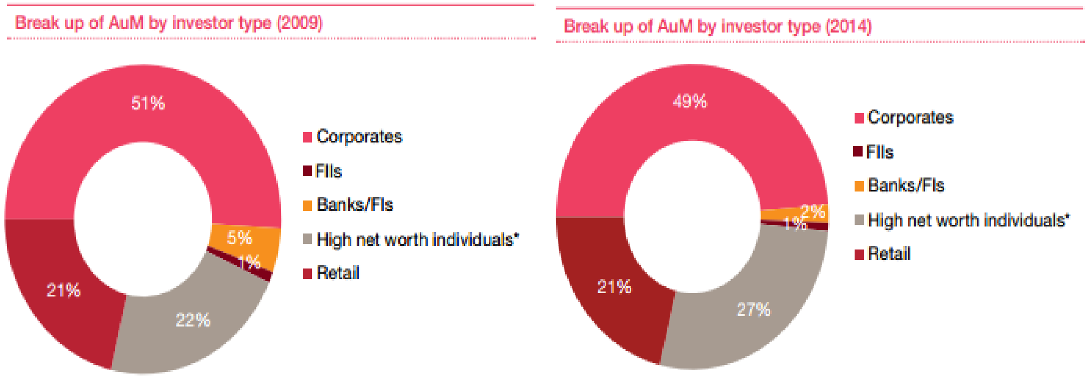
Mutual fund penetration in India is low as compared to global and peer benchmarks. The AUM to GDP ratio stands at 7 to 8% as compared to a global average of 37. AUM of the asset management industry grew from 470 billion INR in 1993 to 1396 billion INR in 2004 and to 8252 billion INR in 2014. While the AUM has grown from approximately 470 billion INR as on 31 March 1993 to approximately 8,250 billion INR as on 31 March 2014 (reflecting a CAGR of 14.6% over the last 21 years), the Sensex has grown from approximately 2280.52 as on 31 March 1993 to 22,386.27 as on 31 March 2014 (reflecting a CAGR of approximately 11.5%).



Graph 1: The growth of Assets Under Management (AUM) over the years

Who is investing in Mutual Funds

The asset management industry held 39.5 million folios as on 31 March 2014, which has declined from around 47.6 million as on 31 March 2009. The composition of the sources of investment for the industry as a whole in 2009 and in 2014 is given in image below. This shows that the industry has not managed to improve the share of retail and individual investors in the Mutual Funds over the last decade.



Graph 2: Comparison of Mutual Funds in 2009 and 2014

Which kind of investments in Mutual Funds are popular

Over the years the industry has developed an extensive product basket covering various investment opportunities. However, the 80-20 rule applies. Over 80% of the AuM is in less than 20% of the product categories.

Table 2: Assets under Management November 30, 2016 Category And Type Wise (Rs in crore)

	Open End	Close End	Interval Fund	Total	% of Total
Income	604,318	144,108	6,236	754,662	46
Infrastructure Debt Fund	-	1,826	-	1,826	@
Equity	411,775	20,636	-	432,411	27
Balanced	61,107	-	-	61,107	4
Liquid/Money Market	277,981	-	-	277,981	17
Gilt	16,832	-	-	16,832	1
ELSS – Equity	49,150	3,241	-	52,391	3
Gold EFT	6,047	-	-	6,047	@
Other EFTs	23,943	-	-	23,943	2
Fund Of Funds Investing Overseas	1,776	-	-	1,776	@
Total	1,452,929	169,811	6,236	1,628,976	100

@ Less than 1%

Source: AMFI newsletter of Nov 2016

The Untapped Market In India

The Indian population is largely under-banked with a very low level of financial inclusion leaving room for further penetration. The extent of under-penetration in the market is a sore point with the banking and financial services industry, with a large amount of savings being channelised into gold and real estate rather than the capital market.

Comparing India to other countries, we realize how financial inclusion is yet to be achieved. While the UK and the US have 25.5 and 35.7 branches per 0.1 million adults and developing countries such as Brazil have 13.8 branches per 0.1 million adults, India is at a staggeringly low figure of 10.9 branches per 0.1 million adults. For savings to be streamlined into the capital market, investors need to first and foremost be made aware of avenues and opportunities.

The mutual fund industry is yet to spread its reach beyond Tier I cities. Penetration in the top five cities increased, whereas for cities beyond the top five, penetration has decreased. One of the prime areas the industry is focusing on is developing the penetration ratio and increasing its presence in other cities.

3. Mutual Funds In India - SWOT Analysis

Mutual funds are among the financial products that benefit from conducting a SWOT analysis. By reviewing their strengths, weaknesses, opportunities and threats, an individual investor can be better informed on where to invest their money, and be positioned to shift gears along with the market.

3.1 Strengths

The most critical strength for a mutual fund is its performance. If a fund is outperforming the market, and particularly if it is at the top of its benchmark, that is a big selling point. If the fund is part of a well-established company with a track record of success and a family of high-performing products, that brand name and historical record may also be a strength. A best-in-class research department or methodology that has a track record of picking winners is a huge asset as well. Different financial metrics may be depending on your investment style and the fund involved: dividend yield may be the key for one investor, total return over a 10-year period for another.

3.2 Weaknesses

One weakness to look at is your fund's fees. A high expense ratio is a weakness even if it pays for an active management currently beating the market with its returns. Even in good times, expenses are a drag on investor return, and they will be more difficult to accept if the performance declines. Size can be a weakness as well, since bigger isn't always better. As a small-cap fund gets bigger, for example, it will have a hard time finding growth opportunities for all of its assets and may have to close or expand outside of its stated objective. Risk may be a weakness for some investors looking for a smaller beta or standard deviation.

3.3 Opportunities

- **Investors**
  Penetration and awareness (through on-ground investor engagement campaigns by AMFI, AMCs and distributors) in Tier II, Tier III (B-15 cities6) and rural markets is expected to increase, leading to expansion of the retail investor base and hence, a greater share of the AUM from the retail segments HNIs and the Mass Affluent segment is expected to dominate the retail segment Institutional segment is likely to witness emergence of new categories of Small and Medium Enterprises (SMEs) seeking investments in MFs.
- **Products**
  Going by trends in other Asian economies and matured economies like the U.S., share of mutual funds products as an investment alternative should grow Traditional debt and equity oriented products could continue to dominate the market with AMCs and distributors pushing high margin products. New product launches could witness a gradual decline till the time Indian investors become more financially sophisticated.
- **Channels**
  Structural shift from "transaction-led" pricing model to an "advisory-led" pricing model has been initiated by the regulator; tiered pricing models based on the relationship value are likely to evolve further. Emerging distribution channels based on online and mobile platform are expected to gain further prominence Effective strategic alliances or partnerships in distribution model has become very crucial.
- **Competition**
  The industry is likely to witness a wave of consolidation as shrinking revenues and escalating costs would put pressure on the existing small and medium sized players. Additionally, regulatory landscape is skewing towards additional capital investment for AMCs. Due to increased competition; it could become imperative for AMCs to not lose their asset base/market share to other players. Retaining and strengthening asset base could become pivotal Industry profitability is likely to increase with favorable structural changes.
- **Operations**
  While revenues are expected to increase with the increase in AMCs reach in B-15 cities, operating expenses are also expected to increase due to increasing distribution and marketing cost. It's not enough to look at the current numbers when evaluating prospective mutual funds. You also need to look at the overall market and consider whether the fund is best positioned to take advantage of trends. A lagging fund may offer the best opportunity for growth if the combination of a management change and economic trends prove beneficial. A change in the government regulatory environment not only affects different industries, but the funds that concentrate in those sectors as well.

3.4 Threats

To some extent, many funds move along with general economic news. Some types of funds do better in a recession while others track well in boom times -- those funds are particularly threatened by a sudden change in the unemployment rate that undermines consumer confidence or a stimulus plan that gets people spending again. In addition, if a fund is dependent on a superstar manager, make sure you have a plan in place if that manager suddenly decides to leave.

4. Mutual Fund- Emerging Challenges

1) **Lack of financial education and awareness**
   Financial literacy is one of the most fundamental factors impeding the growth of penetration of any financial products in the smaller cities and towns. Investors need to be made aware of their financial goals and the means to achieve the same. AMFI and SEBI along with the Industry are making efforts for investor awareness campaign. Fund houses are also mandated by regulation to invest 2 bps from scheme expenses towards, investor education and awareness campaigns but India has a long way to go.
2) **Limited Distribution network**
   The second critical issue for fund houses to distribute their products in smaller cities is the availability of quality distribution infrastructure. Fund houses need infrastructure like branches, adequate number of relationship managers and sales service staff in these locations to be able to increase their sales volume coming from these geographies.
3) **Distribution cost**
   Cost of establishing a distribution network in B-15 cities is quite high. It is the cost per transaction or the low sales volume that makes the pursuit economically unviable or at the least challenging. Although, additional TER can be levied to extend of inflows from these cities (up to 30 bps); entering these markets have a long gestation period and requires a capital investment for distributors.
4) **Cultural bias towards physical assets**
   As of FY13, 46 per cent of total individual wealth in India is invested in physical assets (gold and real estate). Although, in the past few decades, the investors have increasingly relied on financial assets to invest their savings; the contribution of MFs in the asset portfolio is very low. Insurance products constitute 17 per cent of the individual savings in financial assets, whereas the share of mutual funds is much lower at 3.2 per cent.
5) **The Issue of Fluctuating Returns**
   In spite of being a diversified investment solution, mutual funds investment in no way guarantees any return. If the market prices of major shares and bonds fall, then the value of mutual fund shares are sure to go

down, no matter how diversified the mutual fund portfolio be. It can be said that mutual fund investment is somewhat lower risky than Direct Investment in stocks.

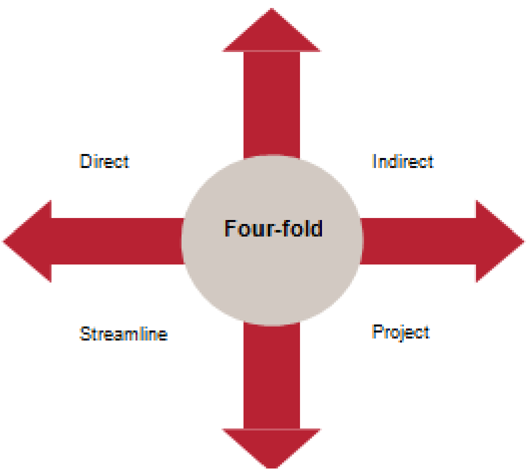
Challenges of an under-penetrated market

The under-penetrated market in India, although showcasing huge opportunities for market players to sell their products, places multiple roadblocks to tap into these opportunities up to their optimum potential. Some basic challenges arise due to very low levels of awareness and financial literacy. The situation in these cases is such that even if the ability to invest exists, these savings are prevented from being directed into mutual fund products. This is because of the slow capital market growth, lack of awareness of mutual funds being a low-cost investment vehicle and the returns they can generate. In this case, there is also the interplay of cultural and behavioural change which prevents savings from being streamlined into investment products, diverted from gold or property. Indians still feel that gold and property is a less risky alternative as compared to investment in the capital markets. Also, investors are not aware of low risk products that they can invest in. A culture change is required in this case, if people are to be convinced to invest in the capital markets.

How to Increase the Rural Footprint

- **Microfinance institutions (MFIs)**
  MFIs have encountered success in reaching out to customers at the bottom of the pyramid. MFIs have focussed on increased access to savings and credit in rural areas and have demonstrated the feasibility of providing customised banking services to customers through self-help groups (SHGs).
- **FMCG industry**
  The FMCG industry is probably one of the first industries that was successful in breaking the physical barriers of reach and penetrating the rural areas with their products. Leading FMCG companies have undertaken projects such as 'Shakti' and 'e-choupal' to stay ahead of their competitors by creating a distinct presence in the rural areas.

Four-fold strategy of a leading FMCG company



- **Direct coverage** -The company appointed the same supplier to supply to all outlets within a town and sell a limited selection of the brand portfolio. Towns are defined as populations of under 50,000 people.
- **Indirect coverage** – The company targeted retailers in accessible villages close to larger urban markets. Retail suppliers were allocated a fixed route ensuring that all accessible villages in the vicinity were served at least once a fortnight.
- **Streamline** – This approach implied leveraging the rural wholesale network to reach markets inaccessible by road. Star Sellers were appointed among wholesalers in a particular village, to purchase stock from a local distributor and then distribute this to retailers in smaller villages using local means of transport such as cycles, rickshaws etc.
- **Project Shakti** – Project Shakti targeted the very small villages (<2,000) and tapped into pre-existing women's self help groups (SHG). Underprivileged rural women were invited to become direct-to-consumer sales distributors for the company's products. Termed Shakti Ammas, these women represent the company and sell its home-care, health, and hygiene products in their villages.
- **The Telecom industry -** Bharati Sanchar Nigam Ltd (BSNL) in India had the first mover advantage of reaching out to the rural belt with telecom connectivity. Now however other private players are present in these markets.Telecom operators have typically followed the strategy of creating awareness with their multiple promotional campaigns providing information to customers, mostly through TV and radio. Also, awareness programmes are conducted in regional languages to establish a better connection. It is of prime importance that rural customers are convinced about the product sold to them, and they are in a position to purchase them. It is interesting to note that the rural segment is more adept at purchasing products in small quantities at a higher frequency.

The mutual fund industry can assess the strategies enumerated above and adapt best practices to penetrate the rural markets better and increase reach.

5. Future Directions of the Mutual Fund Industry In India

1) **Increase the distribution strength**
   Compared to the insurance sales force, the strength of the mutual fund network appears to be dismal. Quoting an industry CEO, "there are over 0.3 million insurance agents in India, while only 16,000 distributors for mutual funds." This data implies that investors are likely to meet insurance agents much more frequently than mutual fund distributors and hence likely to park their surplus funds in insurance policies rather than mutual fund products.
2) **Alternative distribution model**
   The mutual fund industry needs to explore an alternative mode of distribution, for expansion and growth. The option of a tied distribution model could be explored, where the agent is tied to a particular institution. Although this model has worked in some countries it leans towards a closed architecture model, restricting the choice of the investor. The viability of its success in India needs to be measured. Fund houses can also look at the possibility of investing in an active sales

force. The online channel of distribution also exists, although its full potential has not been exploited as yet.

3) **Need to upgrade distribution networks**
In the current scenario, the industry needs willingness from asset management companies to invest more in the distributor community. The smaller asset management companies due to lack of funds, find it more challenging to invest in the distribution channel. Training and educating the distributors are integral to increasing penetration of mutual fund products.

4) **New cadre of distributors to take the industry forward**
The new cadre of distributors such as postal agents, retired officials and school teachers, etc will likely rake in inflows from smaller towns and cities. This cadre of distributors will be crucial in mobilising the savings of the smaller towns and directing these savings towards mutual fund investments.

5) **Product design**
Mutual fund products need to be simplified if they have be sold to the masses through a public sector bank channel. The product needs to mimic a fixed deposit, and provide a predictable income. Also, these products need to be solution oriented. In the past, some fund houses launched similar schemes with minor differences. The SEBI has directed a move towards a consolidation of schemes to make the process simpler for investors. If the right product or solution is not available to be sold to customers, it will be difficult to create a 'pull' factor.

6) **Technology mix**
To overcome operational challenges, measures need to be taken to improve the existing infrastructure and to bring in more efficiency while increasing the scale of operations. This is not possible without the back-up of a good technology mix. It is also a key facilitator to break down underpenetrated markets.

6. Conclusion

We can in effect conclude by saying that all efforts at the moment are being synchronized towards attaining the objective of financial inclusion. The drive to expand reach beyond Tier 1 cities and make mutual fund offerings available to people in smaller towns and cities has indeed taken up the attention of the industry. However, several components of such an initiative, like investor awareness, broadening investor participation and product innovation, need to be aligned in order to fully establish inclusive growth. The industry needs to give due emphasis on the above factors, drawing out an efficient business and operating model to ensure that the inherent challenges that the industry is facing is efficiently dealt with. Designing a competent and all pervasive business model has all the more become important in the current scenario of changing business and regulatory legislations. At a time when amendments to key regulations are being analyzed in terms of impact on the business of the industry, it remains to be seen, how the pace and pattern of growth of the industry takes shape.

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