International Journal of Business and Management Invention
ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X
www.ijbmi.org Volume 2 Issue 1 || January. 2013 || PP.01-06

A step towards improvement of mutual fund industry

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I. PROLEGOMENON

There are many challenges facing mutual fund industry which is of prime concern to the people who have an investment spree. People find mutual fund investments so much interesting because they think they can gain high rate of return by diversifying their investment and risk. But, in reality this scope of high rate of returns is just one side of the coin. On the other side, there is the harsh reality of highly **fluctuating rate of returns.** Though there are other disadvantages also, this concern of fluctuating returns is most possibly the **greatest challenge** faced by the mutual fund.

Securities and Exchange Board of India, the market watchdog, has always raised an existential issue for the mutual fund industry. For example the former Chairman C.B. Bhave asked in 2010 about the industry to introspect[1]: "***You need to question what the rationale for the industry is"***. His point was if investors really found value in mutual funds, the latter would not need artificial proposals to sell its products. ***"If we have not been able to convince investors even with thousands of schemes, there is some problem with the products."***

In June 2011, in a mutual fund summit held in Mumbai, SEBI chief U.K. Sinha had asked the fund houses to reveal the track record of their fund managers. Sinha has been taking a number of initiatives to help mutual fund investors take better decisions while investing as well as ensure growth for the industry. His moves are well in line with the steps taken by his predecessor C.B. Bhave.

Mutual fund is like a dream, 'everybody wants to sell it but nobody wants to buy it.' This statement in a nutshell, symbolizes the state of blues that mutual fund industry in India finds itself in. This is basically because of the faulty structure of mutual fund organization. Mutual funds are increasing, developing financial markets and uplifting the national economy. A mutual fund is basically a trust that pools the savings of investors who share a common goal. The main purpose of mutual funds is to encourage and mobilize saving of the community and channelize them into productive corporate investment, but due to its **management problems** it suffers a lot.

Given below are the specific suggestions for the improvement of mutual fund industry:

1. Organization And Management:

The basic problem, as we have seen that mutual funds are structured in a different Organizational structure where **the authority is not very clear.** The trustees who form a trust are sponsored and thus they have a strong hold on the decisions of mutual funds actions. A strong and clear authority is very much the need of the mutual fund industry. The AMC must be made strong and should be given powers to make independent decisions, of trustees.

1) Then there is a custodian also, who keeps all the securities of various funds in its custody. The **span of control** is weakened here again because while reshuffling the portfolios the Fund manager cannot take decision. It can be understood that these all arrangements are there to keep the investors money in safe hands but due to this somewhere the AMC cannot function independently as other profit-making companies do and hence the decision making process is seriously hampered. The basic principles of management must be followed in mutual fund industry and the AMC should get complete authority to make decisions (say up to Rs 100 crore) independently.

2. Working Procedures:

The inventible funds of the mutual funds increase when sales are more than the redemptions and decrease when the redemptions are more than sales creating the problems of maintaining liquidity. The investors prefer to invest in equity funds during boom period and shift their investments to debt funds during the recession period. The most profitable and high income and appreciation potential stocks during the boom period or at the time of investing funds in such stocks may become illiquid over a period of time. Unless the track records of

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1 "DO WE REALLY NEED MUTUAL FUNDS ANYMORE?"R JAGANNATHAN | SUNDAY, DNA JUNE 27, 2010

working of mutual funds is available covering the several stock market booms and crashes, the investors can't judge which schemes or mutual funds are better alternatives for investments.

The investors can't take decisions of investment due to unavailability of track records of working. Housing Development and Finance Corporation and Standard Chartered mutual funds started their operations in year 2000; all other mutual funds except UTI have the track record of 03 to 05 years.

AMFI has constituted committees on valuation, best practices and credit policy and working groups on valuation of gilt-securities, standardization of disclosure, pensions, etc. to ensure uniform working and disclosure practices.

1. **To Satisfy investor's needs:** Application of pull and push strategies depends on the customer level of awareness about the Mutual Fund Offer. It is found that mutual funds are subjected to market risks. Risk in mutual fund is much higher when compared to bank interest rates and for every investment PAN card is a must. The essence of marketing concept in the mutual fund industry as well as distributor-network is that they must adopt investor oriented features and focus their attention on building programs, offerings and strategies that satisfy investor's needs and wants.
2. **Educative working strategy:** The investors won't be having good knowledge regarding the mutual funds. So the distributors as well as the industry should help the investors in providing the required information and suggest them to invest in good fund. The working strategy of the distributors towards mutual fund as well as individuals is also important. The suggestions should be given to investors on funds in a right way.
3. **Distributor's benefits:** The industry must increase the commission of distributors and reduce profit percentage of the mutual funds as companies. Distributor is an intermediary between the mutual fund and investor. Distributor can provide the required information regarding the fund performance based on the experience gained and the information provided by different AMC'S regarding different funds. Distributors should have good knowledge on all the funds so; campaigns are to be conducted through seminars and demos for them. Distributors play an important role for all AMC'S to sell their funds. The AMCs has to motivate the distributors by providing better incentives/gifts. The company should conduct advertising campaigns for its services providing.
4. **Optimum use of technology:** Investors should be encouraged to use online account information system of the organization. Investors should be given right investment decisions by the Individual Financial Advisors. The investors to decide in advance before investing of "how much to be invested" so that the investor should not incur loss if something goes wrong. Lastly, the industry can now try to focus on rural sector which has got a lot of potential.
5. **Proper knowledge about distributors:** However, the investors must be educated that the mutual funds schemes being marketed by banks and post offices should not be taken as their own schemes because no assurance of returns is given by them. The only role of banks and post offices is to help in distribution of mutual funds schemes to the investors. Investors should not be carried away by commission/gifts given by agents/distributors for investing in a particular scheme. On the other hand they must be told to consider the track record of the mutual fund and should take objective decisions.

Marketing and Distribution channels

In India, AMCs work with five distinct distribution channels those are Direct; Banking; Retail; Corporate and Individual financial adviser.

- **The direct channels**

In the direct channel, customers invest in the schemes directly through AMC. In most cases, the company does not provide any investment advice, so these investors have to carry out their own research and select schemes themselves. The fund companies provide several tools to investors who invest through this channel. This includes monthly a/c statement, processing of transaction, and maintenance of records. In this channel most investors can invest through websites, or receive information through telephonic services provided by the company. About 10-20% of the total sales of an AMC come through this direct channel.

- **The banking channel:**

The large customer base of banks, in developed countries, has played an important role in the selling MFs. In the recent years, this channel has also opened up in India. Banks operating in India, including public sector, private and foreign banks have established tie-up with various fund companies for providing distribution and servicing.

The banking channel is likely to develop as the most vital distribution channel for fund companies there are several reasons for the same. Customers remain invested in banks for long periods of time and therefore banks maintain a relationship of trust with their customers. Customers rely on advice provided to them by bankers as they are always on the lookout for better investment avenues. Managers are guiding to customers about various funds.

An additional advantage that banks provide is that the concerned customer becomes a permanent contact of the banks and therefore can be reached during launch of (new fund offer) NFO or new schemes any time in the future.

- **The retail channel**

A customer can deal with directly with a sub broker belonging to a distribution company, instead of taking trouble of dealing with several agents. Distribution companies sell the schemes of several fund houses simultaneously and brokerage is paid by the AMC whose funds they sell. The retail channel offers the benefits of specialist knowledge and established client contact and, therefore private fund houses are generally prefer this channel. Some of the major players in India in this in this channel are national players like Karvey, Birla sunlife, IL&FS and Cholamandalam. The key factor for this channel to sell a company's fund used to be the brokerage paid. The banking and retail channel generally contribute to about 50-70% of the total Asset under Management (AUM).

- **The corporate channel:**

The corporate channel includes a variety of institutions that invest in shares on the company's name. These are businesses, trust, and even state and local governments. For institutional investors, fund managers prefer to create special funds and share classes. Corporate can either invest directly in mutual funds, or through an intermediary such as a distribution house or a bank. Corporate sector exhibits varying degrees of awareness of mutual fund products. Most of the established corporate groups, such as the TVS industries in Hyderabad, are well-versed with the performance and composition of various funds. The smaller companies and start-up firms, however, need to be educating on several aspects of mutual funds. In order to provide information to such clients, fund companies usually organize presentation for these companies or set-up meetings with the finance managers.

- **Individual Financial Advisors (IFA) or Agents**

The IFA channel is the oldest channel for distribution and was widely employed at the time when Unit Trust of India monopoly in the market. In recent times with the emergence of other players it is significantly decreased.

An agent or broker, who basically acts as an interface between the customer and the fund house, there is a unique systems in place in India , wherein several sub-brokers are working under one main broker. The huge network of sub-brokers, thus ensure larger market penetration and geographic coverage. As per AMFI, over one lakh agents are registered to sell mutual funds and other financial products such as insurance across the country.

II. GOVERNMENT POLICIES AND REGULATORY ENVIRONMENT:

The primary responsibilities of the government and regulators are to protect investors and to inspire trust and confidence in them. Regulators must keep up with the growth of the industry and change, with additional resources and new approaches to regulation. The problems related to structure under SEBI (mutual funds) regulations, 1996 are pertaining to certain regulations. AMFI has taken a lead and made representations time and again to the SEBI and the central government. to amend the regulations. The problems related to the Indian Trusts Act, 1882 are pertaining to individual/collective liability. The post–SEBI mutual funds have opted for trustee company structure. **The liability of the trustees is more onerous under the board of trustee's structure as compared to the trustee company structure**. The Indian trusts act does not permit perpetual succession. The companies Act, 1956 permits perpetual succession but it can't protect the interest of the investors due to the privilege of limited liability. This duality in perpetual succession in both acts creates an anomaly.

The government of India should consider **enacting a separate comprehensive mutual funds act and clearly spell out rights, duties and obligations of the various constituents of mutual fund** to provide a uniform regulatory framework and to create a level playing field for all the mutual funds in the industry including Unit Trust of India.

1. **A Strong SEBI**: It has been witnessed that the industry owes its credibility and growth to the efficient and effective regulation by SEBI. Hence, the SEBI should be made more powerful and more authoritative in its decisions.

2. **On-site Checking:** It can be suggested that as the industry grows, it will become more important to add ***auditors and inspectors*** to periodically check the internal controls and operations of funds with on-site examinations apart from auditing the accounts and transactions.

3. **Establishing the SRO:** The AMFI should be made the SRO in real sense with Government Fiat. The Association of Mutual Funds in India (AMFI) is a voluntary association of the industry which acts as a representative body for the industry members enabling the growth of the industry through various committees and deliberations in various forums and also creates and spreads awareness about the industry.

4. To Make the Technology User Friendly: One of the key challenges would be to enhance the use of technology for efficient and seamless investor transactions between all the stakeholders like the Fund House, Registrar and the Bankers. The Government should make the Paper Less Transactions its priority.

5. Robust Regulatory Framework for Future: The Indian mutual fund industry in terms of *regulatory frame work* is believed to match up to the most developed markets globally. The regulator, *Securities and Exchange Board of India* **(SEBI),** has consistently introduced several regulatory measures and amendments aimed at protecting the interests of the small investor that augurs well for the long term growth of the industry.

The implementation of ***Prevention of Money Laundering (PMLA) Rules,*** the latest guidelines issued in December 2008, as part of the risk management practices and procedures is expected to gain further momentum.

The current ***Anti Money Laundering (AML)*** and *Combating Financing of Terrorism (CFT)* measures cover two main aspects of:

Know Your Customer (KYC)

Suspicious transaction monitoring and reporting.

The regulatory and compliance ambit seeks to dwell on a range of issues including the financial capability of the players to ensure resilience and sustainability through increase in minimum net worth and capital adequacy, investor protection and education through disclosure norms for more information to investors, distribution related regulations aimed at introducing more transparency in the distribution system by reducing the information gap between investors and distributors, and by improving the mechanism for distributor remuneration.

The success of the relatively nascent mutual fund industry in India, in its march forward, will be contingent on further evolving a robust regulatory and compliance framework that in supporting the growth needs of the industry ensures that only the fittest and the most prudent players survive.

III. MARKET CONDITIONS AND BUSINESS SITUATION

The mutual fund industry must meet the challenge of marketing the funds and its business by making all its constituents to think in broader strategic terms about their responses to increasing competition, advertising, corporate governance and disclosure.

1. Portfolio Management: The MF Industry must ***fight with the increasing rates of interests*** and metal market. The strategy should be two fold;

- ***First,*** it should design and launch some new products with guaranteed results and money back on regular intervals,
- **Secondly,** which is very clear from the MF nature, is *Portfolio Management***.** It should press upon the Fund managers to invest in such a way in market, so that the investors must get true value of their money.

2. Strategic Planning: Industry should adopt such strategic plans which could help it to tap more and more resources to increase the Net assets under management. The problem of small against institutional investors is a big problem which must be addressed keeping in the view that the capital structure of this industry should be like this that the major chunk of the capital should come from small investors and not from foreign institutional investors or FIIs, so that it can be a mutual fund in real sense. ***Product positioning*** is more important now, for the industry to build up a confidence and trust in the small investor/individual to invest. The mutual fund concepts and developments are to be disseminated across the country. It requires an enormous amount of time, energy and money, to educate, communicate and provide the infrastructure, place and personnel.

3. PRODUCT INNOVATION: The industry needs to come out with new products with market hedging capabilities which can enhance returns for investors as well as Asset Management Companies. There has to be increased level of sophistication in the products offered in the market. In order to obtain better returns for the investments, fund managers have to look towards more structured products and absolute return investment products to increase overall fund performance. For example- we can have long term funds which tap the retirement money of individuals. In fact, it is an important aspect of business. Investors' needs are in tune with their risk appetites and returns expected. They also revolve around competition and growth in the industry. It is imperative to be innovative ahead of market trends. The advantage is specifically to those who have global experience. The products in future are expected to be children- oriented and investment protection products. Derivative based products and international investment products can also emerge as good options.

IV. POLITICAL CONDITIONS

1. **In built mechanism of governance:** The financial markets should have such built-in procedures in which political conditions should not affect them, is the ideal situation. If we talk particularly of mutual funds the decision making bodies, either the sponsors, or the board of the mutual funds should not get affected by the political situation prevailing in the country at any particular time. The act and rules should be made like this, that some very basic constituents of the industry may remain unchanged.
2. **Independent boards:** Most of the boards of AMCs now have 50 % independent directors but still we cannot deny the fact that most of the funds are bank sponsored in India and in public sector all the big mutual funds are bank sponsored. In a country like India where we have government controlled banks, the interference of government cannot be denied and in turn the political bosses interfere with the decisions. Political bosses get affected by political conditions of the country and so on. This is a vicious-circle.
3. **3)Free and fair Regulators:** We have to go step by step, first cleaning the political arena, secondly making regulators of financial institutions free and fair, and lastly, regulate the capital markets and mutual fund industry.

V. TAXATION POLICIES

1. ***Securities Transaction Tax*** (STT) could be avoided, because it nullifies the **No income tax** relief for investors.
2. ***Long-term capital gain tax*** on debt funds should also be avoided like on equity funds.
3. The government must provide a favorable tax regime for Fund of Funds that implies extending tax benefits to investors and also to the funds.
4. The government must provide tax sops to encourage investment in equity (including overseas equity) as a long term saving and to encourage investments in the infrastructure sector (debt as well as equity); tax sops should also be extended to schemes investing in these areas as well.
5. The candidate is also a bit critical about more tax soaps to be given to mutual fund investments (purely on individual basis) because than the small investor will be lured unnecessarily to invest in risky schemes of mutual funds for getting the tax benefits.
6. It may be recollected that the *"Report of the Working Group on Foreign Investment"* (Working Group Report) had proposed for a single window for portfolio investment, wherein investors intending to make portfolio investments (to be defined by the government) would be categorized under a single investment regime, thereby doing away with their categorization as a FII, FVCI or FDI with respect to such portfolio investments.

Last but not the least, the problems of the mutual fund industry are many fold and there is no ready solution for them but the **Ethics in Business, (Basic rules)** if followed the industry can grow in terms of quantity and quality both.

As the mutual fund industry is growing at a fast pace

1) The industry must avoid searching for **get-rich-quick** schemes.
2) The industry should always try to hold on to a **high ethical** standard.
3) The industry must overcome **greed cultivated tricks**.

One can say that problem solving is easier said than done, and it's true also. It can be asserted that the problems are formidable, but they can be overcome. The main Problem which MF Industry is facing is from within and not from outside. The other means of investment are not less (in number) or not less lucrative. We can find the market flooded with a variety of investment options which includes mutual funds, equities, fixed income bonds, corporate debentures, company fixed deposits, bank deposits, PPF, life insurance, gold, real estate etc. The major problem is "How to maintain the tempo of investment and more importantly how to remain on Top?"

The findings of this study, as discussed above, they prove to be of great use to the Government for streamlining the working of capital markets through its regulatory bodies like SEBI, etc. so to check the exploitation of small investors who are one of the major reservoirs of capital needed for economic growth of the country. It may help SEBI to control effectively the working of mutual funds so to regain lost confidence with the investors and take effective steps for confirming investors' right adherence by them. As reported in the study, the mutual funds Icon, can earmark and try to improve upon their weak areas regarding the factors that influence investors decision making as regards choice of a mutual fund, the facilities or options they expect from a mutual fund, the criteria they generally believe to be the best for performance appraisal of a fund, their general perceptions towards mutual funds at present and the problems which they encountered that resulted in development of aversion toward mutual funds in the minds of investors Mutual funds should extend full support to the investors in terms of:

(a) Participation in investment decision making of the concerned fund,
(b) Ensuring full disclosure of relevant information to investors by the fund,
(c) Consultancy regarding understandability of terms of issue of different schemes, etc,

So, to help the common investor to regain confidence in this channel of investment that is most dependable reservoir of funds required for development of Indian capital market. As seen, the enormous growth of mutual fund industry, if controlled effectively, could be canalized for achieving better economic growth. The industry must solve its own organizational problems, its distribution channel problems and make the dealers and commission agents happy without hampering the interest of investors, particularly small and medium individual investors.

Now, it is the responsibility of the industry to spread across the country for increase in investment not only in Urban areas but in Rural areas also, to ensure consistent growth in number of Investors, to provide highest returns to investors, to give maximum secured options of investment, to provide a wide range of products, to make the processes easy to understand and execute. Then only the mutual fund industry will be able to compete in this Era of *liberalisation, privatisation and globalisation.*

For the purpose of studying the perceptions of investors, a primary survey was undertaken by the candidate. Fully filled ***questionnaires of 260 respondents*** were considered for this study.

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