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A Study on Scope of Mutual Funds in Indian Financial Services Industry

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Abstract: *Investing in mutual funds offers customers a lucrative route to make their wealth to increase, which is the key reason for their popularity in present times. This new found majority has been further compounded by the fact that traditional investment routes such as fixed deposits and public provident fund etc. have witnessed sustained ROI decrease in recent years due to multiple interest rate cuts. However, investing in the right fund is vitally important in order to ensure that the principal amount invested grows in the desired fashion over time. Higher expense ratios and exit loads decrease payout benefits even if slightly, so are they worth it? Most investors prefer to seek out funds that have lower expense ratios and if possible no exit load. Alternately, you might select to stay invested for the period during which the exit load applies, if the scheme is providing the desired/expected returns.*

Keywords: *Return on Investment(ROI), Exit load, Hybrid, Capital appreciation.*

INTRODUCTION

The world is rapidly responding to India's digital revolution. The country is on the cusp of a breakthrough backed by several initiatives which are all anchored in digital technology. Since the demonetisation announcement on 8 November 2016, India has seen a concerted effort to move towards a cashless economy. Events from the last few weeks of 2016 illustrate both the challenges and tremendous opportunities for the growth of the mutual fund (MF) industry in India. With approximately 14 lakh crore INR having recently entered through formal banking channels, a significant new universe is now not only an integral part of the banking fold but also potentially within the tax ambit. This will in turn encourage them to think more about investment avenues which not only are tax efficient but can also beat inflation in the long run.

As awareness increases, MFs could become one of the first choices for both short-term and long-term investments. While MF products are not suitable for all kinds of investors, the sector has shown tremendous growth by exceeding 17 lakh crore INR in assets under management (AUM), with inflows worth nearly 4 lakh crore INR in the last 2 years alone.[1]

The industry will see growth of above 25% over the next financial year, up from 14% to 15% in the current year.[2] Traditional

[1] Economics Times. (Jan 2017). 'Mutual funds see Rs 2.86 lakh cr inflow in 2016'. Retrieved from http://economictimes.indiatimes.com/mf/mf-news/mutual-funds-see-rs-2-86-lakh-cr-inflow-in-2016/articleshow/56422364.cms

[2] Hubbis. (Jan 2017). 'Readying for an AUM surge in India'. Retrieved from http://www.hubbis.com/articles-content/5628/1484906545/Readying%20fo

products will continue to garner demand. However, to cater to different audiences and bring more investors into the fold, the industry will need to innovate and develop new specialised products. For instance, SEBI is promoting the alternative investment fund (AIF) platform, which will allow for product innovation around real estate and structured credit and eventually other forms of products such as infrastructure investment trusts (INvITs)

Looking back at 2016, much of the growth is attributed to an increasing number of investor accounts, steadily growing monthly investments into equity MF schemes from retail customers, beyond top 15 (B15) city applications and a surge in inflows into exchange traded funds (ETFs). A surprisingly sharp rise in systematic investment plans (SIPs) promoted more sustainable growth for the industry as more people moved away from the concept of large lump sum investments. Over the last 2 years, MFs have proved to be a low-cost, compliant and transparent entity to channelise savings towards financial investments.

With the demonetisation effect, rapid digitisation, government incentives, regulatory initiatives, and a deliberate push for improving investor education, the next 2–3 years should see the AUM reaching another great milestone. In the immediate future, with interest rates declining, it is reasonable to predict that debt funds will be the drivers of growth in the first half of 2017, while the effects of the Goods and Services Tax (GST) will be felt in the second half.

r%20an%20AUM%20surge%20in%20India

The mutual fund (MF) industry had a compound annual growth rate (CAGR) of 18% over the past 10 years. Despite the global economic slowdown of 2010–13, there has been a remarkable increase in MF investments in India. Till now, lack of awareness about financial instruments and prevalence of low financial knowledge resulted in a lower inflow of investments as compared to that in other BRIC nations like China and Brazil. However, factors such as favourable demographics, rising income levels and ongoing government initiatives continue to make it one of the most attractive sectors in the financial services industry.

In an attempt to curb black money in the economy, the Prime Minister announced the demonetisation of Indian high-value currency in November 2016. Despite this move, the unlikely presidential win of Donald Trump, Brexit, uninspiring equity markets and surging oil prices, the Indian mutual fund (MF) industry did exceptionally well in 2016, recording its highest growth in 7 years and reaching a total corpus of 17 lakh crore INR.[3]

capital markets. At present, the penetration is just around 3%, but recent events illustrate both challenges and tremendous opportunities.Asset management companies grew their average assets by approximately 30%, [4]

[3] Economics Times. (Jan 2017). Mutual funds see Rs 2.86 lakh cr inflow in 2016' Retrieved from http://economictimes.indiatimes.com/mf/mf-news/mutual-funds-see rs-2-86-lakh-cr-inflow-in-2016/articleshow/56422364.cms

[4] AMFI website

adding nearly 4 lakh crore INR to their MF portfolios.[5]

SIP accounts reached 1.2 crore INR with close to 4,000 crore INR collected during the month of December 2016.[6]

Systematic investment plans (SIPs) were large contributors to this growth. Registrations increased significantly, with outstanding SIPs of the industry reaching over 1 crore customers in monthly subscriptions. According to Association of Mutual Funds of India (AMFI), the MF industry has been adding about 6.19 lakh SIP accounts each month, with an average SIP size of about 3,200 INR per SIP account. [7]The SIP book makes up around 50% of the total contribution of the industry's monthly inflow in equity schemes. Assets under management (AUM), particularly from B-15 cities, recorded a growth of about 33% in 2016[8] which was greater than the overall industry growth. SIPs formed a major portion of these investments.

To further popularise MFs and propel their growth, he Securities and Exchange Board of India (SEBI) has been introducing several new reforms. The introduction and rise of direct plans and extensive investor education campaigns have boosted the growth of individual investors, which stood at 23% year-on-year and 7.61 lakh crore INR in December 2016.[9]

THE WAY FORWARD

The MF industry has a long way to go.

While its growth in 2016 may look significant in absolute numbers for a relatively new industry, as a percentage of GDP, it is very low at 8.4%.[10]

However, one should not get discouraged. There has been a visible shift in how households are investing, which is a good sign. This is due to an increasing awareness about the industry.

SEBI and asset management companies (AMCs) themselves have made several efforts to increase the familiarity retail investors have with investment jargon. This has made them more comfortable

[5] Livemint. (Jan 2017). 'Mutual funds record highest growth in 7 years, Rs3.71 trillion added to their kitty'. Retrieved from http://www.livemint.com/Money/NlqLYBLal46gyih1ILa09L/Mutual-funds-record-the-highest-growth-in-7-years-add-Rs-3.html

[6] AMFI website

[7] The Financial Express. (Jan 2017). 'AUMs at all-time high of Rs 16.46-trillion in December, may cross Rs20 trillion'. Retrieved from http://www.financialexpress.com/economy/aums-at-all-time-high-of-rs-16-46-trillion-in-december-may-cross-rs20-trillion/510357/

[8] Café Mutual. (Feb 2017). 'B15 assets on the rise, reach Rs. 2.86 lakh crore'. Retrieved from http://cafemutual.com/news/trends/806-b15-assets-on-the-rise-reach-rs-286-lakh-crore

[9] AMFI website. (Jan 2017). 'Individual investors'. Retrieved from: https://www.amfiindia.com/Themes/.../Individual-Investors-December-2016.pdf

[10] The Tribune. (Jan 2017). 'MF investments rising in smaller towns: CAMS'. Retrieved from http://www.tribuneindia.com/news/business/mf-investments-rising-in-smaller-towns-cams/342616.html

with the idea of investing in MFs over traditional alternatives such as real estate and gold.

MFs offer a more versatile combination of product options and plans, investing options and superior tax efficiency.

Gold and real estate have become unattractive for long-term investments, having failed to yield good returns in the last 2–3 years. With increased awareness and a better understanding of the MF industry, investors are instead taking advantage of SIPs, a disciplined way to build long-term portfolio and manage the inherent volatility of the equity markets.

The cost of MFs is also falling as the industry continues to build scale. Technology has played a significant role, with many opportunities for the industry to leverage.

TECHNOLOGY: THE GAME CHANGER

Technology has now become an integral part of the MF industry and is used widely in each and every aspect—from fund management to transaction processing, and from customer servicing to distribution. With the increasing use of smartphones, there lies a huge opportunity for MF houses to leverage them for a successful business-to-consumer (B2C) model and pass on the benefit of commission to the end customer.

Robo-advisors, artificial intelligence, blockchain, cloud computing, big data and analytics are soon going to replace the traditional model. We expect that in the future, fund houses will primarily depend on such robotic applications to understand client requirements, their spending behaviour as well as future goals, and accordingly make calculated suggestions with regard to the right investment portfolio. This will make the entire sales as well as client onboarding process more efficient and help increase the market reach of the industry.

Both the government and the regulator (SEBI and AMFI) are supporting the adoption of technology by launching several initiatives to promote its use in the industry.

KEY TRENDS AND OPPORTUNITIES

With lower bank interest rates and demonetisation, the AUM of the Indian MF industry are expected to touch 20 lakh crore INR sooner than expected. [11] Investors are increasingly concerned about keeping their surplus funds in savings bank accounts and the use of digitisation has made the industry more appealing. The industry will see robust growth in the next 2–3 years, driven by opportunities in the following areas:

Digitalisation and digitisation

- Improved distribution efficiencies has enhanced reach across the country as distributors can now provide ready analysis to customers on the field.
- Range of mobile and online apps for tracking and transacting—end-to-end platforms have enabled seamless customer experience.
- Mutual fund utility (MFU) has allowed investors to place orders with

[11] The Economics Times. (Jan 2017). 'AUM of Indian mutual fund industry may touch Rs 20 lakh cr'. Retrieved from http://economictimes.indiatimes.com/mf/mf-news/indian-mutual-fund-industry-may-touch-rs-20-lakh-cr-sooner-than-expected/articleshow/56335183.cms?from=mobile

multiple AMCs and transfer funds seamlessly, all through a single window.

- e-KYC using Aadhar has proved to be a game changer for online investing; in the future, technology platforms and Aadhar will be leveraged for various government schemes.
- Increasing use of robo-advisory has made it simpler for investors to make decisions.
- Redemption of MFs (ultra-short funds) using a debit card—offered by two popular robo-advisory platforms, as well as top fund houses have made the transaction process more convenient.

Government initiatives and regulatory push:

- Demonetisation has created a surge of inflows into structured investments such as MFs.
- Advisory regulations have allowed investors to get into advisory-only arrangements with financial advisors.
- Capping of MF commissions will help to prevent mis-selling; it also promotes innovation in customer acquisition and enables cost efficiencies.
- Special commissions for MF distribution in below 15 cities will increase penetration.
- SEBI has proposed allowing the sale of MFs through leading e-commerce websites.
- Introduction of payments banks and small finance banks has improved financial inclusion.
- For Budget 2017, SEBI had recommended that the period of holding in respect of long-term debt fund units be reduced to one year from the existing 3 years, and an increase in the investment limit for
- tax-saving MF schemes. However, this has been shelved till a later date.

Consolidation, specialty products and alternative investment options:

- Debt funds dominate the Indian markets; however, with increasing investor education, equity funds have witnessed an increase in the past 2 years.
- SEBI has taken the initiative to consolidate fund houses and schemes to facilitate better understanding and increased investment.
- To promote investment in the semi-urban and rural parts of the country, fund houses are focusing on specific schemes for customers in these parts of the country.
- Within alternative investment funds (AIFs), exchange-traded funds (ETFs) are likely to be one of the main products to drive significant growth, propelled by the deflationary impact to rates from the blow of demonetisation.
- Recently, SEBI has relaxed the norms for real estate investment trusts (REITs)—allowing them to invest a larger portion of their funds (up to 20% from the current level of 10%) in assets under construction, along with proposed changes to facilitate easier entry for offshore fund managers.

GLOBAL TRENDS IN PRODUCT INNOVATION BY MFS[12]

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[12] European ETF Market Outlook for 2016, Lyxor Asset Management. Retrieved from www.lyxor.com/uploads/tx.../European_ETF_Market_Outlook_for_2016.pdf

Financial Times. (June 2014). 'What are proposed collective pension plans?'. Retrieved from https://www.ft.com/content/e5c29ee8-ea37-11e3-afb3-00144feabdc0Towers & Watson. (February 2016). Global Pension Assets Study 2016. Retrieved from

Globally, various new products are being introduced into the markets to meet the investment demand of the growing retail segment. Some of the global trends include:

Liquid alternative MFs:

Various alternative funds have been introduced in the American and European MF market. Products like alternative/hedged MFs employ investment tactics like use of leverage, derivatives and short selling, and providing retail investors access to a diverse range of asset classes and investment strategies. Assets in liquid alternative MFs in the US doubled between 2011 and 2014.

Growth of ETFs:

ETFs continued to achieve market share gains and witnessed record growth globally (fivefold, which translates to 2.9 trillion USD over the past decade [as of December 2015]) on account of lower cost, tax efficiency, liquidity, better risk management and transparency

Offerings for global pension funds:

The move from defined benefits to defined contribution has resulted in the demand for alternative avenues to protect against volatility and improve returns. One major innovation within the pension landscape is collective defined contribution (CDC) schemes. Such mega-funds could be major investors in domestic funds. Funds would need to create attractive products for such offshore structures.

GAMIFICATION

In order to tap new client segments such as the millennial generation and rural households, fund houses and online distribution platforms are using games as a means of inculcating good investment behaviour in MF investors.

Gamification refers to the concept of applying game mechanics and game design techniques to engage players (investors) and motivate them to add value to their investment goals. Gamification has the potential to demystify seemingly complex MF concepts by using features such as interactive tutorials, quizzes, reward badges and peer ranking to communicate the benefits of investing.

There have been a quite a few attempts recently to use gamification in the online investing space in India. A leading fund house launched a gamified investor education platform to introduce retail investors to investment planning and personal finance management in a way that is relevant, engaging, self-timed and self guided. Similarly, an online investment platform also launched gamification features such as peer ranking to assess individual financial health among other investors. Apart from a score, the gamification platform allows investors to earn badges. Positive investing behaviour will earn investor badges, recognising their efforts toward disciplined investing.

Gamification models will surely increase customer stickiness and enhance customer experience, and will resonate

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https://www.willistowerswatson.com/en/insights/2016/02/global-pensions-asset-study-2016

Towers & Watson. (February 2014). Global pension fund assets hit record high in 2013. Retrieved from https://www.towerswatson.com/en-IN/Press/2014/02/Global-pension-fund-assets-hit-record-high-in-2013 better with the young and technologically savvy customer base.

Demonetisation offers an opportunity to invest in mutual funds:

Volatility in the equity markets notwithstanding, the MF industry is confident of attracting new investors and hopes to benefit from the macro changes post-demonetisation.

Demonetisation has created a new 'unlikely' class of investors in the Indian housewife. Like most financially prudent housewives, she has some 'loose cash' that she has saved over a period of time; the outcome of several years of haggling with sabziwallahs, the local baniya and

autowallahs—in a nutshell, everyone from whom she was able to extract a good bargain. This little kitty of her savings is her prized asset.

For MFs, 'she' is an untapped new investor. Besides developing new products and services which are customised to her specific needs, technology will play a key role in increasing the penetration of this new customer segment. Social media and target marketing, customised distribution models and education using e-modules and video tutorials could help to channel these savings, thus further contributing to its upward trajectory over the next few years.

IMPROVING DISTRIBUTION[13]:

Distributors play an active role in encouraging MF penetration. One of the ways of achieving their goals of expansion involves efforts to improve the distribution network. This does not necessarily mean only adding new distributors or channel partners but also entails enhancing the quality and depth of the engagement with them.

Revised Commission and compensation structures

- Issues of interest alignment may be partially mitigated by revised compensation structures; a blend of up-front and trail compensation.
- One method is by allowing investors to judge the quality and quantity of advisory services they receive to agree on compensation with the distributor.

Better utilisation of banking channels

- With a wide network and the trust of people, banks have a ripe opportunity to distribute mutual fund products.
- However, the conundrum for front-line staff might be the loss of CASA deposits while gaining distribution fees.

Investment by distributors

- With the help of AMCs, distributors can invest in and innovate theirown businesses.

- Structuring the commission such that the distributor's interests are aligned with the interests of the investor will go a long way in attuning the distribution of mutual fund products to investor needs.

USING TECHNOLOGY TO ENABLE DISTRIBUTORS:

The growing digital environment can provide a rich set of capabilities which will empower distributors and help drive disruptive changes.

[13] Café Mutual. (Apr 2016). 'Competition in online MF distribution heats up'. Retrieved from http://cafemutual.com/news/industry/5179-competition-in-online-mf-distribution-heats-up

Technology will become the key enabler in the distribution process and can be leveraged for the following:

- Leveraging or replicating the banking correspondents model for Independent Financial Advisors (IFAs) and advisors
- Usage of handheld devices to conduct transactions on real-time basis, with General Packet Radio Service (GPRS) or Code Division Multiple Access (CDMA) connectivity linking to banking systems, payment gateways and the overall MF transaction ecosystem
- The purchase of MF units will soon be allowed through digital wallets and electronic payment applications.
- Customer relationship management (CRM) systems can be used by fund houses not just to track investor relationships but also to engage with channel partners in a meaningful and differentiated manner.
- Enabling sales force and channel partners with relevant and actionable insights to manage day-to-day activities and sell better will lead to an increase in the distributor's business with the respective fund house.
- Usage of mobile and social platforms will be crucial in engaging effectively with the distributor community and building a mobile point of sale.
- Advanced analytics and big data collected from structured transactional data from Registrar and Transfer (R&T) and other sources can be leveraged and unstructured data
from social media and other platforms will help to extract insightful information on investor or distributor behaviour. Using this information, there can be better targeting of specific investor groups.
- Analytic techniques can also be used to cross-sell or up-sell products and increase each investor's stake, among other applications.

UPCOMING TRENDS IN DISTRIBUTION USING TECHNOLOGY:

ROBO-ADVISORY: THE NEXT WAVE

Robo-advisors are provided as a service by various third-party platforms which help investors surpass traditional advisory firms and allow them to invest directly.

Global market: BI Intelligence estimates 10% of global assets under management (AUM) to be managed by robo-advisors by 2020. Major players in this industry include Betterman and Wealthfront.

Indian market: At the early stages, many start-ups have emerged in this space—Scripbox, FundsIndia, Arthayantra to name a few. Due to their inexpensive nature they will be used to target rural and semi-urban customers, which is where they will add the most value.

Investments in the future will be based on algorithms and patterns charted by robots. Robo-advisory has emerged as the next big disruption in the space. The advent of technologies

like big data, analytics, machine learning and automation has bolstered robo-advisory. Several factors are influencing its rising popularity in the financial services space:

- Growing online transactions rates are making it easier for companies to understand their users while creating a persona for them and assessing their risk appetite.
- Consumer financial data is abundant and easily available. Multiple financial imprints left by consumers

through online transactions allow recommendation engines to evolve and customise requests.

- AI has come of age and is showing promise

Robo-advisory will soon become a core product offered by MFs, banks and other financial services organisations. As the industry gets more commoditised, fintech companies will

become services providers to the financial services sector.

As the cost of investment in the workforce and the capital required for customer acquisition increases, there will be a greater push to move to automated advisory services and hence robo-advisory.

With the advances in technology, availability of more data, customer information and imprints, computing power and digital practices in investing, we expect more to explore the option of partnerships with fintech robo-advisors in the market to advise their clients and use interfaces where clients can take investment decisions easily.

E-COMMERCE:

Mobile penetration has led to the growth of e-commerce companies across India. Thus, SEBI submitted a recommendation in May 2016 to leverage this trend.

- It is set to allow online marketplaces like Flipkart and Amazon to sell mutual funds on their portal.
- This is a very important step to bring in more innovation in the mutual funds distribution business.
- It would also garner trust and make MFs more accessible to the people residing in semi-urban parts of the country

AUTOMATION OF TRADITIONAL CHANNELS:

In addition to investing in new channels, many AMC companies across the globe are also using technology to improve their traditional distribution channels by automating them.

- One such example is the IFAXpress platform launched by DSP Blackrock.
- IFAXpress aims at solving the problems of independent financial advisors (IFAs) across the sales cycle while they recommend a scheme at the time of facilitating transactions due to cumbersome paperwork and those related to post sales service like account statements, portfolio monitoring and reviews, among others.

'PASS-PORTING': USING PASSPORTS AS A MEDIUM TO ACCESS FOREIGN ASSETS

Pass-porting is a regulatory mechanism allowing Indian MF schemes to be sold in other Asian countries without requiring exclusive regulatory approvals from the countries in question. SEBI, along with the International Organization of Securities Commissions (IOSC) and Asian regulators, is working to make this plan successful. While Indian MFs could benefit from the move, schemes of these countries will also be permitted to be sold in India. India-based asset managers who are approved under the scheme will have access to foreign investors. Also, Indian investors will be able to buy foreign funds directly. This route has proved to be quite effective in cases like the ASEAN Collective Investment Schemes (CIS) and the Asia Region Funds Passport (ARFP).

BUDGET 2017:

The budget appears to be well balanced and growth oriented, with a focus on making financial markets better regulated and introducing measures to strengthen the same. From a broader and more holistic perspective, there are no negatives. However, there may be some missed opportunities.

Here are some of the highlights and views on how they could impact the overall industry:

- There is a deliberate thrust being given to sectors such as cement, housing and infrastructure and an impetus to the rural economy. This is a big positive as the housing sector is not only a big employment generator but also has a large multiplier effect for the economy.
- Banning cash transactions above 3 lakh INR will also facilitate digitisation and reduce transactions in the parallel economy.[14]
- The finance minister has also proposed a change to the base year for calculating the indexation benefit from 1981 to 2001 in the budget. Debt MFs qualify for long-term capital gains tax of 20% with indexation benefit if held for more than 3 years. Although this could affect the MF investor, individuals very rarely invest in debt funds for the long term. Also, only a marginal number of individuals are likely to hold debt funds which are pre-2001.[15]
- Other measures to perk up the financial sector include further integration of the commodities and securities derivatives market and a complete online process for registration of financial market intermediaries like MFs, brokers and portfolio managers to improve ease of doing business.
- With over 2,200 MF schemes being offered across various categories, in 2016, the capital market regulator was urging MF merge certain schemes. The government had also provided tax neutrality to the transfer of units in a consolidating plan of MF schemes. However, there remained some ambiguity regarding the holding period. This was clarified in the proposed Financial Bill, 2017, and will further boost the consolidation of MF schemes.
- The disposable income for individuals earning between 2.5–5 lakh INR will increase due to the reduction in tax to 5% from the current 10%. This will help to encourage lower- and middle-income groups to invest in instruments such as insurance, MFs and fixed deposits.[16]

CONCLUSION:

[14] Economic Times. (Feb 2017). 'Mutual fund players share their view on Budget 2017'.Retrieved from http://economictimes.indiatimes.com/mf/analysis/mutual-fund-players-share-their-view-on-budget-2017/articleshow/56916911.cms

[15] Business Standard. (Feb 2017). 'Clarification on schemes' merger in Budget relieves mutual fund investors'. Retrieved from http://www.business-standard.com/budget/article/clarification-on-schemes-merger-in-budget-relieves-mutual-fund-investors-117020100952_1.html

[16] The Financial Express. (Feb 2017). 'Encouraging lower and middle class to invest in insurance, mutual funds, fixed deposits'. Retrieved from http://www.financialexpress.com/budget/encouraging-lower-and-middle-class-to-invest-in-insurance-mutual-funds-fixed-deposits/533633/

The MF industry has grown exponentially over the last decade. However, opportunities for further growth exist. The demonetisation exercise has disrupted the economy in general and the financial sector in particular. Digital payments have been further encouraged on the back of promoting a cashless economy, one of the key outcomes of demonetisation. The rural and semi-urban population is now 'financially included', indicating that there is potential to create specific products to suit their needs. Also, pension and insurance funds will see more traction and penetration into products such as ETFs will increase. As individuals start to invest directly and show interest in structured investments, the demand for investor education services and investment advisory is likely to increase. Robo-advisory firms will see a fillip in growth in the next 2 to 3 years. The overall outlook for the sector is promising. A few challenges remain, but these can be easily overcome as the regulator continues to declare more incentives through innovative initiatives.