Mutual Funds - From Here to Where?

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Mutual funds in India have had a roller coaster ride. While the industry presently manages assets worth Rs.1,02,000 crores, it has had its own share of ups and downs. However, its transformation over the years has been quite amazing to say the least. From one player industry in 1964, it has become fierecely competitive one wherein 35 players through more than 400 schemes compete for the attention of investing public. Out of these, 26 players are in the private sector as against 9 in the public sector. However, the domination of UTI and other public sector mutual funds is fast coming under pressure from their peers in the private sector. While UTI and other public sector mutual funds manage assets worth Rs.56850 Crores, players in the private sector manage assets worth Rs.45150 Crores. Another important thing that requires attention is that contrary to the common perception whereby mutual funds are equated with equity, the assets under management in different product categories tell a different story. The assets under management for debt and debt-oriented products are more than double of those under equity and equity and equity related products. At present, debt funds have an asset base of Rs.71950 crores as against Rs.30055 crores under equity funds.

In the last 3 years or so, the private sector players have started dominating the industry in terms of fresh mobilizations, innovations in client servicing and products, increasing awareness about mutual funds and improving the quality of advice. Certainly, they deserve the credit for their achievements as well as for their efforts in positioning mutual funds as the most ideal investment vehicle. No doubt, a lot of work still has to be done in spreading the culture of mutual funds across the length and breadth of the country. The most encouraging factor is that all the necessary ingredients required to achieve this goal are present. The fact that this industry is a well-regulated one could provide lot of comfort to the first timers. On the other hand, the body of mutual funds i.e. Association of Mutual Funds in India (AMFI) has done fantastic work by raising some very important issues with the regulators time and again. To its credit, Securities and Exchange Board of India (SEBI) has been working very closely with AMFI for not only improving the working of the industry but also in making it accountable, transparent, enhancing investors' awareness as well as improving the quality of distributors etc. No doubt, the stage is set for mutual fund industry to take off in a big way. The industry has just the right kind of platform required for it to achieve the status of the most preferred investment vehicle.

However, it is important for mutual funds to have a very focused approach with a long-term view to ensure that not only the momentum in growth is maintained but also they enhance their abilities to tackle the challenges that lie ahead. Let us look at some of these challenges and the approach mutual funds need to take to tackle them effectively.

First of all, mutual funds will have to focus on providing good investment performance on a consistent basis. While in the past, the industry has performed very well in patches, on certain occasions it has been found wanting. No doubt, there have been instances where mutual funds have performed in line with the market or even out performed the market, unrealistic expectations of investors created misperception in their minds with regard to the performance. Like any other industry in its nascent stage, players have given a mix of exceptional, average and below average performances. Going forward, mutual funds that fail to provide above average performance on a consistent basis will find it tough to survive. In fact, the key to success would be to integrate new technologies to offer unique products and services along with consistent good performance. In other words, there will no place for non-performers in the market place. Of course, investors will need to have realistic expectations from their investment in mutual funds.

SEBI has made it mandatory for mutual funds to use market indices as benchmarks for their schemes and disclose the performance of the appropriate market indices along with the performance both in the offer document and in the half-yearly results. Further, the Trustees are required to review the performance of schemes on a periodical basis with reference to the market indices. In a major and unique initiative taken by SEBI and AMFI, 8 new market indices as benchmarks for debt and balanced funds were launched recently. These will provide a scientific tool for investors, distributors and analysts for evaluating the performance of different types of mutual fund schemes. This will help the investors and others to keep a track of the performance and also to make a proper investment decision.

Another important area where the industry needs to have a special focus is distribution. During the last couple of years, mutual funds have done a lot of work for developing ways to expand their distribution. In fact, the changing distribution landscape is a result of the innovative methods that mutual funds are adopting in order to gather assets. No longer are mutual funds content to sell through traditional channels, as to do so is to ignore an evolution in both product structure and delivery that is underway in the mutual fund industry. Channel barriers, over the years, have collapsed under the weight of product innovations and the forging of distribution alliances. Going forward, mutual funds will require some more innovative and unconventional distribution channels to reach out to the target investors. As we all know, the best way to sell a mutual fund scheme is to target investors on "one to one' basis. Therefore, those channels that allow access to the investing public in such a manner needs to be explored and developed. In this regard, public sector banks will have an important role of play. It is time they learnt from their private sector counterparts especially handling the fear of cannibalization of deposit base playing in the minds of their employees. Banks like Standard chartered, Citi and HDFC provide the perfect examples to follow. In addition, there is a need to explore the possibility of involving entities like safe deposit companies and departmental stores etc. for merchandising of mutual fund products.

While the process for certification and registration of distributors has already begun, there is a need to ensure that this process is completed soon. It is important because in the past mutual funds have suffered time and again on account of wrong positioning of products, mis-selling and lack of knowledge among the investing public. Therefore, it is essential for the industry to have qualified and professional distributors to ensure that not only investors have realistic expectations but also participate in the decision making process. This will go a long way in tackling the perception issue that the industry has had to face time and again.

Both AMFI and SEBI have realized the importance of this process and have been working hard on achieving this on a war footing. SEBI has already made it mandatory for mutual funds to enroll only AMFI certified distributor w.e.f. November 1, 2001. In addition, all existing distributors will have to get certified before March 2003. SEBI's Code of Conduct is another step in the right direction. AMFI on its part, apart from pursuing its members to encourage their distributors, has taken steps to expedite this process. Some of the recent steps taken by AMFI are organizing training programmes, introducing written test in addition to the automated computerized testing conducted by the NSE and encouraging its members to provide training to their distributors to enable them to pass this exam. Going forward, this initiative alone will ensure tremendous growth for mutual funds through increased participation of the retail segment. However, to achieve this, each and every player of the industry will have to take the initiative and encourage the distributors. It is very critical as there is no concept of tied agents in India for mutual funds.

In terms of physical presence, apart from UTI and other public sector mutual funds, rest of the industry has been concentrating mainly on the top 15-20 cities. It is not that private sector players do not want to tap investors in the smaller towns; factors like questionable quality of distributors, absence of R & T Agents and banks wiling to handle collection process and non-availability of resources required to expand the market in these places have been responsible for their absence. The question that mutual funds need to address is whether they would set up their own offices or take the help of the R & T Agents in expanding their physical presence. Post offices are another channel that needs to nursed and supported. They alone can help the industry in reaching out to the remotest of places. Considering that computerization drive is on a full swing in the post offices, they can provide the perfect collection mechanism to the industry. Moreover, ensuring that these cities also have the quality distribution channels like major towns is another challenge that the industry will have to face once it decides to make a serious effort in this direction.

Another major challenge that the mutual fund industry needs to tackle is to win over the retail segment especially non-tax payers. So far, mutual funds have mainly been positioned as an efficient tax savings vehicle. Therefore, the focus has been on tapping investors looking for better post-tax returns. Not that non-tax payers have not been investing in mutual funds. This segment has, time and again, invested in mutual funds to make a quick buck from equity funds. When they failed to do so, they formed their own perception about mutual funds. Therefore, the industry will have to go all out and highlight advantages like liquidity, diversification, multiple investment options and ease of investment etc. In fact, the key would be to make them invest at least once in the right product considering factors like their investment horizon, risk profile etc. Once that happens, investors themselves will take initiatives to learn more about mutual funds and improve their knowledge. As a result, they will become more demanding both in terms of performance and investor servicing- a perfect situation that will keep mutual funds on their toes and help them immensely in achieving their objectives. Moreover, healthy competition among the players will benefit all concerned in the long run.

Also, as we all know, the best way for investors to benefit from the expertise of professionals is to maintain the discipline of investing at pre-determined intervals, thereby avoiding the market timing. World over, investors have benefited by following this concept. Unfortunately in India, not enough has been done to propagate this theory among the investing public. Moreover, the absence of proper infrastructure dissuaded investors from practicing this concept of "Rupee Cost Averaging". In other words, there is a need for the mutual fund industry to make regular investing possible for investors. At present, only those banks that are involved in the third party distribution accept standing instructions from their clients to debit their account and remit the funds to the mutual fund concerned. The only option available for others is to submit post-dated cheques, which is not only risky but also a very inconvenient method. Moreover, "payroll subscription" that allows investors to save at the place where they earn money has not taken off mainly on account of reluctance on the part of the employers. The industry needs to seek co-operation of the banking industry as well as make serious efforts to make payroll subscription acceptable to employers. Of course, R & T Agents will have an important role to play here in working out the logistics to achieve this.

Going forward, product innovation and product proliferation will also play an important role in the growth of the industry. The encouraging part here is that in the past couple of years, mutual funds have demonstrated their abilities to innovate in terms of product offerings and thereby both retain and capture assets. While the industry continue to focus on plain vanilla products, launch of Fixed Maturity Plans, Short-term Plans, and Floating Rate Fund etc. are examples of how the industry enabled investors in not only tackling the volatility in the debt market but also earn returns in line with the market. In addition funds like PE Ratio, Asset Allocation Plans are the perfect examples of niche products. It is this ability of the industry that will build up confidence of investors and encourage them to remain with the industry even during the volatile times. Also, the industry will have to develop products to cultivate long-term savings habits among the investing public as well educate them about market related products. This will also ensure that mutual funds get inflows on an- going basis as well as have access to long-term funds. The biggest challenge that awaits the mutual fund industry is to sell and manage pension funds.

Investor servicing is another area where the industry will have to demonstrate not only their skills and abilities but also its intent to the investing public. While the industry has reached a stage where it is able to meet clients' expectations consistently, the key in the future would be to exceed their expectations. Mutual funds will have to display commitment to superior service and constantly work on providing investors with investment information they want, whenever they want and wherever they want. To achieve this, they will have to rely more and more on technology. ATM linked investments as well as redemptions, cheque writing facilities, multiple systematic investment plans are some of the examples of how the industry will need to service their clients. We have already seen some of the mutual funds using the automated trading, clearing and settlement systems of stock exchanges for sale and redemptions of units.

Another area where the industry needs to work hard is to improve its cost efficiency. Considering that in the last couple of years the assets have grown mainly from debt oriented products and that too from liquid and short-term plans etc., where mutual funds earn negligible fees, the income levels have gone down considerably especially for the mid-sized and small players. Mutual funds will have to work very diligently on improving the cost efficiency to be able sustain and garner resources to expand the market.

All in all, mutual funds have a bright future in India. However, to achieve the desired growth, it is important for the industry to work as a close-nit unit and in a cohesive manner. A long-term view on the business will ensure prosperity for the industry.

(The views expressed are personal)