

Communication

MUTUAL FUND: A RESOURCE MOBILIZER IN FINANCIAL MARKET

*P. Hanumantha Rao**
*Vijay Kr. Mishra***

ABSTRACT

The success story of any economy can only be scripted on the basis of sound financial system of the country. Economic reform process of 1991 had a great impact on the financial system of the country leading to the overall development of the Indian economy. Today, India's financial system is considered to be sound and stable as compared to many other Asian countries where the financial market is facing many crises. During last one decade or so, role of Indian mutual funds industry as a significant financial service in financial market has really been noteworthy. In fact, Mutual funds have emerged as an important segment of financial market of India, especially as a result of the initiatives taken by the Govt. of India for resolving problems relating to UTI's US-64 and to liberalize tax liabilities on the incomes earned by the mutual funds. They now play a very significant role in channelizing the saving of millions of individuals into the investment in equity and debt instruments. This paper aims at making a critical study of the role performed by mutual funds as a financial service in Indian financial market.

Introduction

The economic and financial scenario of India prior to 1991 was somehow not optimistic. Indian economy at that time was suffering from low savings, low GDP, high inflation, high unemployment, high rates of interest, low forex reserve, etc.. When India approached IMF for financial assistance in 1991, we were imposed certain conditions on the basis of which the financial assistance was sanctioned to India. These restrictions which we accepted under the pressure from IMF were actually the starting point of economic reforms popularly known as LPG process. The result of the LPG process of 1991 is more clearly visible now. India is now being ranked as one of the fastest growing economy of the world. As the eleventh five year planning is about to start, we are already targeting a GDP growth of 9%. The saving of the country is now around 29%. Foreign investors are finding Indian market with high potential. India's forex reserve is around \$175 billion. Inflation is also at 5% which is considered good for developing economies. So, Indian economy is really booming today.

* Faculty Member (Finance), ICAFI National College, Varanasi.

** Visiting Faculty Member (Economics), ICAFI National College, Varanasi.

Some experts have opined that, the share of the US in world GDP is expected to fall (from 21 per cent to 18 per cent) and that of India to rise (from 6 per cent to 11 per cent in 2025), and hence India will emerge as the third pole in the global economy after the US and China. All these favorable things could have not been possible without the sound financial market. It is the financial market which finances economic development. It is the financial market which channelizes the saving of the people into the investment. Indian financial markets are getting more and more institutionalized. Foreign investors, local institutions and mutual funds are now playing a bigger role. This is the case in developed markets. Mutual Fund is an instrument of investing money. Nowadays, bank rates have fallen down below the inflation rate. Therefore, keeping large amounts of money in bank is not a wise option, as in real terms the value of money decreases over a period of time. One of the options available is to invest the money in stock market. But a common investor is not well informed and competent enough to understand the complexities involved in the price movement of shares in the stock market. This is where mutual funds come to rescue them. The role of mutual funds will increase in the Indian markets also. This means that retail investors will opt for mutual funds. In the US, 35 to 40 per cent of the investments currently come through mutual funds while in India it is very negligible. With the stock markets reaching to newer heights in 2006, mutual funds could not be far behind. Total assets under management of 30 funds rose by Rs. 1,25,296 crore, or 63 per cent, to Rs. 3,23,601 crore during the calendar year 2006, according to the data published by the Association of Mutual Funds of India (AMFI). Mutual funds saw record resource mobilization as investors lined up to take advantage of the stock market boom. Reliance Mutual Fund — controlled by the Anil Ambani group — has toppled Prudential ICICI MF as the country's largest private sector fund house, while UTI MF retained its leading position across both public and private sector funds in December. The paper aims at analyzing the significant role played by the Mutual Funds in Indian financial market by channelizing the saving of the investors (mostly of retails investors) into the investment in corporate.

Financial System of India

In order to critically examine the role of mutual funds in Indian financial market, we should first of all have a good idea about the Indian financial system. The financial system in India comprises of financial institutions, financial markets, financial instruments and services. Financial market refers to those places where financial assets are created and traded. Financial assets represent a claim for the payment of principal amount some times in future date and for periodic payment of money in the form of interest or dividends. The Reserve Bank of India (RBI) as the main regulator of credit is the apex institution in the financial system. Other important financial institutions are the commercial banks (in the public and private sector), cooperative banks, regional rural banks and development banks. Non-bank financial institutions include finance and leasing companies and other institutions like LIC, GIC, UTI, Mutual funds, Provident Funds, Post Office, Banks etc.. The banking system is, by far, the most dominant segment of the financial sector accounting for over 80 per cent of the funds flowing

through the financial sector. The Indian financial sector reforms aim at improving the productivity and efficiency of the economy. It remained stable, even when other markets in the Asian region were facing a crisis. The opening of the Indian financial market to foreign and private Indian players has resulted in increased competition and better product offerings to consumers. The main function of all these financial institutions is financial intermediation i.e., facilitating the flow of saving from common man to industrial houses. In the initial stages, the role of the intermediary was mostly related to ensure transfer of funds from the lender to the borrower. This service was offered by banks, FIs, brokers, and dealers. However, as the financial system widened along with the developments taking place in the financial markets, the scope of its operations also widened. Some of the important intermediaries operating in the financial markets include investment bankers, underwriters, stock exchanges, registrars, depositories, custodians, portfolio managers, mutual funds, financial advertisers, financial consultants, primary dealers, satellite dealers, self regulatory organizations, etc..

Financial Markets are mainly classified as Money Market and Capital Market. The term, 'money market' is used to denote the financial institutions which deal with the short term borrowing and lending of money. The term, 'capital market' is used to mean the institutes which deals with the lending and borrowing of long-term money. Resource mobilization by mutual funds is an important activity in the capital markets. India's mutual fund and stock market have witnessed phenomenal growth over the last few years. According to a study, mutual funds would be one of the major instruments of wealth creation and wealth saving in the years to come, giving positive results. As India is targeting a GDP growth rate of 9 % in the Eleventh Plan Period, the role of financial sector as well as the role of mutual funds industry in India as an important segment of financial market for resource mobilization in capital market is going to be very significant. The consistency in the performance of mutual funds has been a major factor that has attracted many investors. The mutual fund industry growth is estimated at about 50 per cent, much higher than that of bank fixed deposits which are growing at about 20 per cent.

Mutual Funds as a Financial service

According to the Global Asset Management 2006 Report from Boston Consulting Group, India-managed assets will exceed more than \$1 trillion by 2015. This means an annual growth rate of 21% for the next nine years. The Indian mutual funds industry has been growing at a healthy pace of 16.68 per cent for the past eight years and the trend will move further as has been emphasized by the report. With the entrance of new fund houses and the introduction of new funds into the market, investors are now being presented with a broad array of Mutual Fund choices. The total asset under management of Mutual Fund industry rose by 9.45% from Rs.309953.04 crores to 339232.46 crores in November, 2006 as published by AMFI. In 1987, its size was Rs.1,000 crores, which went up to Rs. 4,100 crores in 1991 and subsequently touched a figure of Rs.72,000 crores in 1998. Since then this figure has been increasing tremendously and thus revealing the efficiency of growth in the mutual fund industry. It has generally been observed that as the GDP of a country starts moving up, the share of

AUM as a percentage of household financial assets start to increase. At present, India has a GDP of around \$3,000 on a per capita basis and the AUM as a percentage of household financial assets is under 4%. This is undoubtedly very low as compared to other countries. As India's GDP is expected to maintain its growth rate, households will surely be holding more assets through mutual fund than ever before.

The tremendous growth of Indian Mutual Funds industry is an indicator of the efficient financial market we are currently having and the trust which investors have on the regulatory environment. Mutual Funds are essentially investment vehicles where people with similar investment objective come together to pool their money and then invest accordingly. Each unit of any scheme represents the proportion of pool owned by the unit holder (investor). Appreciation or reduction in value of investments is reflected in net asset value (NAV) of the concerned scheme, which is declared by the fund from time to time. Mutual fund schemes are managed by respective Asset Management Companies (AMC). Different business groups / financial institutions / banks have sponsored these AMCs, either alone or in collaboration with reputed international firms. Several international funds like Alliance and Templeton are also operating independently in India. Many more international Mutual Fund giants are expected to come into Indian markets in the near future.

Mutual Funds invest according to the underlying investment objective as specified at the time of launching a scheme. So, we have equity funds, debt funds, gilt funds and many others that cater to the different needs of the investor. The availability of these options makes them a good option. While equity funds can be as risky as the stock markets themselves, debt funds offer the kind of security that is aimed for at the time of making investments. Money market funds offer the liquidity that is desired by big investors who wish to park surplus funds for very short-term periods. Balance Funds cater to the need of investors having an appetite for risk greater than that of the debt funds but less than the equity funds. The only pertinent factor here is that the fund has to be selected keeping the risk profile of the investor in mind because the products listed above have different risks associated with them. So, while equity funds are a good bet for a long term, they may not find favour with corporates or High Net-worth Individuals (HNIs) who have short-term needs.

Mutual Fund for Retail investors

Pure equity new fund offerings (NFOs) collected a whopping Rs 32,309 crore in 2006, almost 33% more than the money raised by Indian corporates through initial and follow-on issues. This is a clear indication that retail investors are increasingly tapping the stock market through the mutual fund route. The mutual fund (MF), as a capital market intermediary, has emerged as new avenue for capital resources. It bridges the gap between retail investors and capital markets. According to Value Research data, the top five equity NFOs were Reliance Equity (Rs. 5,790 crore), SBI Bluechip (Rs. 2,850 crore), Reliance Long Term Equity (Rs. 2,100 crore), UTI Leadership Equity (Rs. 2,080 crore) and Templeton India Equity Income (Rs. 2,030 crore). Close to 40 NFOs were made in 2006 with average collections of Rs. 950 crore. The top five IPOs of 2006 were

made by the following companies — Cairn India (Rs. 5,260 crore), Reliance Petroleum (Rs. 2,700 crore), Bank of Baroda (Rs. 1,633 crore), Parsvnath Developers (Rs. 1,089 crore) and Lanco Infratech (Rs. 1,067 crore). So, it is clearly evident that MF is providing more opportunities for the corporates to raise more funds. It is offering several options in structured forms. The industry is going to play a major role model in the capital markets. According to a study conducted by the Associated Chambers of Commerce and Industry of India, the size of the Mutual Funds industry is expected to be worth Rs. 4 lakh crores by 2010. Mutual Funds would be one of the major instruments of wealth creation and wealth saving in the years to come, giving positive results. The consistency in the performance of mutual funds has been a major factor that has attracted many retail investors. The Indian Mutual Funds industry has been growing at a healthy pace of 16.68 per cent for the past eight years and the trend will move further. According a study, it has been found out that almost 54 % of people invests for security and certainty while 38 % of the people invests for current spending. Some 53 % of the people prefer long term investment whereas 23% people each prefer medium term and small term investment. All these studies relate to retail investors. Actually, it is the consistence performance of mutual funds which is attracting retail investors towards it. Today, MF equity portfolio is worth around \$32 billion, while individual investors own \$88 billion. It is the retail investors who have been heavily investing in equities through MFs over the past couple of years. This observation can be made from the fact that close to \$17 billion of NFO collections made in the last four years from equity funds. Eventually, money collected on these have made their way to equity market. On an average, MF net investments into equity markets remained at around 50% of that by FIIs in the past three to four years. As retail investor's investments are typically long-term oriented, they are therefore important for maintaining stability in any equity market. Another very significant development for retail investors in the field of mutual funds is the entry of mutual funds in real estates. For the last three years the real estate sector has been growing at a fast pace of 30-40 %, especially in the metros. But for retail investors, participating in this growth was not easy. By opening the real estate investment for mutual funds, retail investors, who cannot invest directly in real estates (which needs huge investments to start with), are actually allowed to investment in real estates through mutual funds. Retail investors are expected to account for 60% of the industry's AUM. But this can be possible only if mutual funds in the country manage to enter into non-urban cities. This becomes more important because this is where savings deposits account for 49% of the total assets. These small towns account for only 30% of their holdings in mutual funds. So, one thing can be said for sure that retail investors are going to participate more and more in mutual funds in the times to come and thereby a lot of financial resources are going to be mobilized to financial market of India.

Money Market Mutual Fund

A money market fund is a mutual fund that invests solely in money market instruments. Money market instruments are forms of debt that mature in less than one year and are very liquid. Treasury bills make up the bulk of the money market instruments. Securities in the money market are relatively risk-free. Money market funds

are generally the safest and most secure of mutual fund investments. The goal of a money-market fund is to preserve principal while yielding a modest return. Money-market mutual fund is similar to a high-yield bank account but can not be said to be entirely risk free. When investing in a money-market fund, one should be more attentive to the interest rate that is being offered. Money market mutual funds are very significant financial resource mobilizer for short term period.

Future Scenario

During last few years, India's position as a market having potential for long-term growth has really been noteworthy as the Indian economy is being ranked among the top 10 globally (in terms of GDP), and as the fourth-largest [in terms of purchasing power parity (PPP)]. Another good thing to note about Indian mutual funds industry is that it has grown at a rapid pace of 16.4% during the last 8 years as compared to global growth rate of 13% during the same period. However, when it comes to assets under management (AUM) of the global mutual fund (MF) industry, India's ranks is 25th which is not very satisfactory, rather dismal. With assets of around \$76.5 billion (Rs. 3.41 lakh crore) as per AMFI figures at the end of November '06, India forms just 0.4% of the world's global MF AUMs. MF assets worldwide stood at \$19.41 trillion at the end of the second quarter of 2006. US with \$12.4 trillion of MF assets is the topper, followed by Luxembourg (\$1.9 trillion), France (\$1.6 trillion) and Australia (\$723 billion). Another important criterion which is used by the analysts as parameter to judge the majority of a country's mutual fund industry is MF assets to GDP (PPP basis) ratio. According to available data, the ratio was 75.2% for US and 34.9% for UK. Even in the emerging economies' list, India's numbers were far from encouraging. The figure was 23.1% for Brazil, 26% for Russia, as compared to 1.3% for India. There are few other threats which Indian mutual fund is currently facing. Mutual funds must realize that there are some small saving schemes like NSC and PPF which are still offering high return than debt and income funds. Too much focus is being given to equity and any downswing in equity market would severely dent investor's confidence. Again, there is a lack of investor education which results in risk-return mismatch for investors investing in mutual funds. However, it can be said, in coming years, mutual fund industry is going to take off to newer heights. The Indian equity market has seen unbelievable rise in the last couple of years. From an index level of 5,590 as at March 31, 2004 to 14,000 during December, 2006, the markets have moved in top gear, at breathtaking speed, tumbling records after records in this unrelenting journey. The prices of gold and real estate have reached to sky high levels not only in India but also throughout the world. And both these traditional investment avenues have been extremely popular with Indian investors. Regulations have also favored these two classes of investments with the Securities and Exchange Board of India introducing norms for gold-traded funds and the government relaxing norms for foreign direct investments in real estate ventures. Retail investors have largely participated through mutual funds and this is clearly evident from the number of equity funds that have been launched in the last couple of years and the record collections they have witnessed. The Reserve Bank of India has relaxed norms for overseas investments

thereby opening up more investment avenues. In recent years, SEBI has taken several steps to consolidate the Indian MF industry. There are some changes in guidelines that include standardization of the Funds Portfolios and disclosure of the balance sheet of the fund. Among other changes that are scheduled is reduction in the time taken by AMC's to complete formalities from 90 to 42 days. Also proposed is the use of unclaimed money for investor education. The present structure of funds is likely to change from the three - tier framework. This is expected to streamline the operations of the funds and will give them more flexibility. Finally, though mutual funds are primarily composed of stocks, there is a slight difference between these two which makes mutual funds more advantageous to the common investors. Diversification is the biggest advantage associated with mutual funds. Diversification is the idea of investing money across many different types of investment avenues. When one investment is not doing well, other might be yielding good profit. Diversification reduces risk significantly. In addition to this, by purchasing mutual funds, one is actually hiring a professional manager at an especially inexpensive price. Now-a-days, a higher portion of investors' savings is now invested in market-linked avenues like mutual funds as compared to earlier times. However, if we compare proportion of people investing in mutual funds in India with that in U.S then we find that in U.S more than 50 % people invest in mutual funds whereas in India the proportion is less than 10%. This gives the indication that there is much more untapped potential for growth in this industry in India which must be explored in the coming time. In conclusion, it can be said that despite few problems, the recent changes in the mutual funds industry in India has really favoured its amazing growth and in conclusion it can be said that in times to come mutual funds will continue to be a significant resource mobilizer in the Indian financial market.

References

- The Economic Times, 21st December, 2006
The Economic Times, 3rd January, 2007
Gupta Shasi K. and Sharma R. K., Financial Management, Kalyani Publishers.
Van Horne, J. C. (1995), Financial Management & Policy, Prentice Hall
International
www.sebi.com
www.moneycontrol.com
www.amfi.org
www.mutualfundsindia.com
The Economic Times, 3rd December, 2006
The Hindu, 6th May, 2006