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Mutual Fund Industry in India

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Abstract

This research paper is an attempt to explain the growth pattern of mutual fund industry and its impact on the global economic scenario. The main importance has been given to the changes from 1963 till now and what are the new investment avenues has come out for individuals tax payers who are the main investors in the mutual fund market. This paper explains the last years pattern in return to the change in tax slab changes and investment portfolios. The paper also explains the investment pattern with regard to changes in investor's attitude, their financial health, risk averseness appetite and trend of mutual fund market due to the investment patterns. This research paper explains Mutual funds, brief history of mutual funds in India, types of mutual funds and growth phases of mutual funds.
Keywords: *AMC, Open-ended, Close-ended, FMP, Equity Oriented Fund, Debt Fund, Balanced Fund.*

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1. A BRIEF HISTORY OF MUTUAL FUNDS AND THEIR REGULATION IN INDIA

The start of the mutual fund industry was done in the early 1960's, there was one government owned firm namely the Unit Trust of India (UTI). This industry was liberalized in 1993, opening up to other asset management companies (AMC), resulting in a slew of choices in mutual fund products for the Indian investor. Today, the industry stands at 38 asset management companies that manage Rs. 7.1 trillion (USD 160 billion) of Assets under Management (AUM) raised from around 470 million accounts. Since the economic liberalization of the early nineties, mutual funds have been regulated by the securities market regulator, Securities and Exchanges Board of India (SEBI) was itself a very new regulator in the early nineties. At the time, like all the other parts of the financial sector, the industry was lightly regulated with low levels of transparency about the management of funds. It was only in 1998, after a spectacular episode of market misconduct by the CRB group of companies that there was a sea-change in the regulation and supervision of the mutual fund industry. The regulator focused on the production end of the mutual fund industry. This resulted in very high disclosure and transparency of the assets under management and improving the governance of the AMCs, setting it apart from the rest of the fund management industry in India. This path towards greater transparency became the industry norm when UTI, the only AMC that was exempt from full transparency on certain products, developed problems in fulfiling obligations to customers. As part of the government bailout package in 2001, the AMC was broken up into two funds. One had a fixed mandate of winding down upon completing the obligations of the original UTI schemes (primarily US-64) to existing customers. The other was a company where the government was one of other shareholders, that would follow all the regulation of the other mutual fund companies. With this, the mutual fund industry became the only fund management industry in India with a minimal presence of public sector ownership. Since then, there have continued to be changes in the regulation of mutual funds, but largely driven by developments in the broader securities markets. The rules-driven regulatory framework in India has meant that innovation in the securities markets often drives changes in the rules on how mutual funds can access these innovation in offering new products to their customers. However, regulations governing the fund management process has been more or less stable and albeit conservative. However, there has been a certain amount of public sector ownership in the mutual fund industry, primarily through the mutual fund subsidiaries of public sector banks and insurance companies. There is a dominance of large Indian business houses in the mutual fund industry. According to the August 2010 numbers in the CMIE Prowess database, around 24% of the AMCs fall under the category of business groups (including banks like SBI), and these firms managed around 46% of the mutual fund AUM. The recent changes in regulation that have been the cause of much controversy and in the area of the distribution of these products and the cost of distribution attributed to the customer. This has been one of the major aspects of regulatory focus on the mutual fund industry since 2005.

2. NEED FOR THE STUDY

The main purpose of doing this analysis was to know about mutual fund and its growth. This helps to know in details about mutual fund industry right from its inception stage, growth and future prospects. The present study based on prominent funds operated in India and their schemes like equity, income, balance as well as the returns associated with those schemes. The study has been done to ascertain the asset allocation, associated with the mutual funds, growth prospects of mutual fund industry. Thus, this would help in understanding the benefits of mutual funds to investors.

3. LITERATURE REVIEW

The review of some of the literature related to the performance of mutual fund is shown below.

- **Agarwal (2011)** analyzed the Indian Mutual Fund Industry and point out that there has been incredible growth in the mutual fund industry in India, attracting large investments from domestic and foreign investors. Tremendous increase in number of AMCs providing ample of opportunity to the investors in the form of safety, hedging, arbitrage, limited risk with better returns than any other long-term securities has resulted in attracting more investors towards mutual fund investments.
- **Gupta (2001)** in his study examined the growth and development of the mutual fund industry in India during the period 1987 to September 1999. The study revealed that mutual fund industry witnessed major growth in terms of investible funds, number of mutual fund schemes, investor base and range of products offered to the investors.
- **Gupta (2011)** in her paper revealed that low customer awareness levels and financial literacy posed the biggest challenge in channelizing household savings into mutual funds. Further, fund house showed limited focus on increasing retail penetration.
- **Mehru (2004)** in his study analyzed the problems of mutual funds in India. The study highlighted several problems such as lack of awareness among investors, poor after sale services, non-disclosure of portfolio by mutual funds, inter-scheme transfer of funds and lack of professional fund managers. The study point out that mutual fund were wrongly promoted as an alternative to equity investing and created very high expectations in the minds of the investors.
- **Panigrahi (1996)** studied the growth of the mutual fund industry from 1991-92 to 1994-95. Mutual fund collections as a proportion of aggregate bank deposits constantly rose from a meager 8.78 per cent in 1991- 92 to 15.91 per cent in 1994-95. Expenses as a portion of income generated also increased from 2.27 per cent to 4.25 per cent during the period of study. International Journal of Science, Technology & Management www.ijstm.com Volume No.04, Issue No. 04, April 2015 ISSN (online): 2394-1537 56.
- **Ramamurthy and Reddy (2005)** conducted a study to analyze recent trends in Indian mutual fund industry. They concluded that major benefits delivered to small investors by mutual funds are professional management, diversification of investment; return potential, expedient administration, liquidity, transparency, affordability, flexibility, wide choice and appropriate regulation.
- **Singh and Chander (2000)** in their study showed that income/debt schemes outnumbered the growth and balanced schemes. Further the number of open-ended schemes was more than close-ended schemes. The study also found that performance was independent of corpus size and the performance of debt funds was better than equity funds.
- **Syama Sunder (1998)** conducted a survey to get an insight into mutual fund operations of private institutions with special reference to Kothari Pioneer. He found that the awareness about mutual fund as an investment option was poor in small cities. Open–ended schemes

were preferred by investors and age and income played a vital role in selecting the fund schemes. Also brand image and return were the prime considerations for the mutual fund investors.

- **Turan and Bodla (2001)** in their study examined the growth of both public and private sector mutual funds in India in terms of resource mobilization, promotion of various schemes and their investment pattern for a period 1995 to 1998. The study showed that a large majority of both listed and open-ended schemes incurred losses due to the defensive investment strategies adopted by the fund managers.
- **Viramgami (2009)** in his study of resources mobilization by Indian mutual fund industry concluded that Income schemes, Liquid/MM schemes, Growth schemes showed growth between March 2000 to March 2007. In terms of resources mobilization, liquid/money market, Growth, ELSS and Income funds emerged as the most popular schemes among investors and these three accounted for more than 70 per cent of the resources. Among various sectors operating in mutual fund industry, private sector mutual funds were the most prominent players in the industry

Research Gap: I have done study of the area where the work has not been done i.e., an analysis of growth of Mutual Fund Industry in India.

4. Objectives of Analysis

- To give a brief idea about the benefits available from Mutual Fund investment
- To give an idea of the types of schemes available.
- To discuss about the market trends of Mutual Fund investment.
- To observe the fund management process of mutual funds
- To explore the recent developments in the mutual funds in India
- To give an idea about the regulations of mutual funds in India.

5. Research Methodology

The data for the study has been derived basically from secondary sources. The secondary sources include, internet, journals, magazines, books, publications of various research agencies like, AMFI, SEBI Handbook, RBI Report, UTI Annual Report, etc. The data has been properly analyzed and interpreted to draw conclusion and inferences.

6. Scope of Mutual Funds

Mutual funds have grown enormously over the years. In the early stage of mutual funds, when the investment management companies started to offer mutual funds, choices were few. Even though people invested their money in mutual funds as these funds offered them diversified investment option for the first time. By investing in these funds they were able to diversify their investment in common stocks, preferred stocks, bonds and other financial securities. At the same time they also enjoyed the advantage of liquidity. With Mutual Funds, they got the scope of easy access to their invested funds on requirement.

But, in today's world, Scope of Mutual Funds has become so wide, that people sometimes take long time to decide the mutual fund type, they are going to invest in different types of mutual funds as per their requirements. Several Investment Management Companies have emerged over

the years who offer various types of mutual funds; each type of mutual fund carrying unique characteristics and different beneficial features.
To understand the broad scope of Mutual Funds we need to discuss the main types of Mutual Funds that are normally offered by the Mutual fund Companies.
The wide variety in Mutual Funds is as the follows:
Different kinds of Mutual Funds: The mutual fund industry of India is continuously evolving. Along the way, several industry bodies are also investing towards investor education. Yet, according to a report by Boston Analytics, less than 10% of our households consider mutual funds as an investment avenue. It is still considered as a high-risk option. In fact, a basic inquiry about the types of mutual funds reveals that these are perhaps one of the most flexible, comprehensive and hassle free modes of investments that can accommodate various types of investor needs. Various types of mutual funds categories are designed to allow investors to choose a scheme based on the risk they are willing to take, the investable amount, their goals, the investment term, etc. The following chart discusses the different types of mutual funds available is our country:

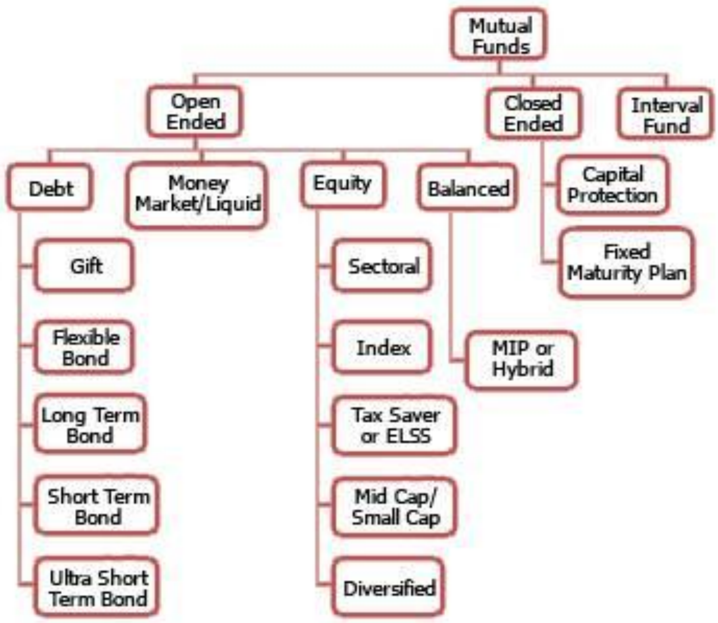

Fig. 1: Types of Mutual Funds in India

Let us have a look at some important mutual fund schemes under the following three categories based on maturity period of investment:

I. Open-Ended - This scheme allows investors to buy or sell units at any point in time. This does not have a fixed maturity date. Open-ended mutual funds are having the following schemes:

- **Debt/ Income** - In a debt/income scheme, a major part of the investable fund are channelized towards debentures, government securities, and other debt instruments. Although capital appreciation is low (compared to the equity mutual funds), this is a relatively low risk-low return investment avenue which is ideal for investors seeing a steady income. **Money Market/ Liquid** - This is ideal for investors looking to utilize their surplus funds in short-term instruments while awaiting better options. These schemes invest in short-term debt instruments and seek to provide reasonable returns for the investors.

- **Equity/Growth** - Equities are a popular mutual fund category amongst retail investors. Although it could be a high-risk investment in the short-term, however, investors can expect capital appreciation in the long run. If you are at your prime earning stage and looking for long-term benefits, growth schemes could be an ideal investment.
  - **Index Scheme** - Index schemes is a widely popular concept in the west. These follow a passive investment strategy where your investments replicate the movements of benchmark indices like Nifty, Sensex, etc.
  - **Sectoral Scheme** – Sectoral funds are invested in a specific sector like infrastructure, IT, pharmaceuticals, etc. or segments of the capital market like large caps, mid caps, etc. This scheme provides a relatively high risk-high return opportunity within the equity space.
  - **Tax Saving** - As the name suggests, this scheme offers tax benefits to its investors. The funds are invested in equities thereby offering long-term growth opportunities. Tax saving mutual funds (called Equity Linked Savings Schemes) has a 3-year lock-in period.
- **Balanced** - This scheme allows investors to enjoy growth and income at regular intervals. Funds are invested in both equities and fixed income securities; the proportion is pre-determined and disclosed in the scheme related offer document. These are ideal for the cautiously aggressive investors.

II. Closed-Ended - In India, this type of scheme has a stipulated maturity period and investors can invest only during the initial launch period known as the NFO (New Fund Offer) period. This type of mutual funds are having two schemes:

1. **Capital Protection** - The primary objective of this scheme is to safeguard the principal amount while trying to deliver reasonable returns. These invest in high-quality fixed income securities with marginal exposure to equities and mature along with the maturity period of the scheme.
2. **Fixed Maturity Plans (FMPs)** - FMPs, as the name suggests, are mutual fund schemes with a defined maturity period. These schemes normally comprise of debt instruments which mature in line with the maturity of the scheme, thereby earning through the interest component (also called coupons) of the securities in the portfolio. FMPs are normally passively managed, i.e. there is no active trading of debt instruments in the portfolio. The expenses which are charged to the scheme, are hence, generally lower than actively managed schemes.

III. Interval - Operating as a combination of open and closed ended schemes, it allows investors to trade units at pre-defined intervals.

Fig. 2: Phases of growth of mutual fund industry.

7. REGULATION OF MUTUAL FUND INDUSTRY

The industry is fully regulated by SEBI and governed broadly by the comprehensive SEBI Mutual Funds Regulations 1993. Prior to SEBI taking over the reins of the industry, mutual funds were regulated through guidelines of the Ministry of Finance and RBI. **Sadhak (2003)** argues that there were no regulatory guidelines for the mutual fund industry till the first such guidelines were issued by RBI in 1989 for mutual funds floated by banks. The Ministry guidelines empowered RBI to be the regulator of Money Market Mutual Funds (MMMFs) set up by banks. These guidelines, inter-alia set precedence for regulation by entity rather than regulation by domain. The regulation also overlooked the inherent conflict of interest that the central bank would face in developing the money market (and indirectly its participants including MMMFs) and the competition MMMFs could potentially pose to banks. The implications of this conflict of interest have been comprehensively examined by Roy (2005). In short, guidelines relating to lock –ins, minimum maturity periods for MMMFs etc ensured that banks do not face undue pressure. The Ministry guidelines also designated SEBI as the regulator of MMMFs floated by non bank mutual funds. Coordination of regulations issued by the two regulators was ensured by requiring SEBI's guidelines for MMMFs to be in conformity with those issued by RBI. Dual parentage of mutual fund industry ended in 2000 when all mutual funds were brought under regulatory jurisdiction of SEBI. Over the years regulations have been strengthened and streamlined by SEBI, often as a response to market crisis to develop the market and protect the interests of the investors. The twin strands of reforms initiated by SEBI are stricter prudential norms (restricting parking of funds in short term deposits, stipulating stricter guideline for advertisements, removing discrimination on levy of exit loads etc.) and deregulation of operating environment (raising aggregate industry wise ceiling for overseas investments by mutual funds in ADR, GDR, foreign security, overseas ETF; enabling short selling etc).

8. TAX REFORMS AND IMPACT ON MUTUAL FUND INDUSTRY

Capital asset typically refers to anything that you own for personal or investment purposes. It includes all kinds of property; movable or immovable, tangible or intangible, fixed or circulating.
Capital assets are further classified as Financial Assets and Non-Financial Assets. Financial assets are intangible and represent the monetary value of a physical item. Stocks *(Shares)* and mutual funds are the best examples of Financial Assets.
The profit *(if any)* that you make on your mutual fund investments when you redeem or sell the MF units is referred to as **Capital Gains**. It can be a Short Term Capital Gain *(STCG)* or a Long Term Capital Gain *(LTCG)* depending upon the 'Period of Holding'. The tax that is applicable on these profits is known as '**Capital Gains Tax**'.
In this post let us understand: What are the factors that determine the tax status of mutual funds? – What are the tax implications on mutual fund investments? – Mutual funds taxation & capital gains tax rates on mutual funds for Financial year 2016-2017 (Assessment year 2017-2018).

Factors determining the tax status of mutual funds

The capital gains tax on mutual fund withdrawals is based on the factors as mentioned below:

a. **Residential Status**
b. **Fund Type** *(whether the fund is an Equity-oriented fund (or) a Non-Equity Oriented Fund)*
c. **Holding Period** *(Duration of your investment)*

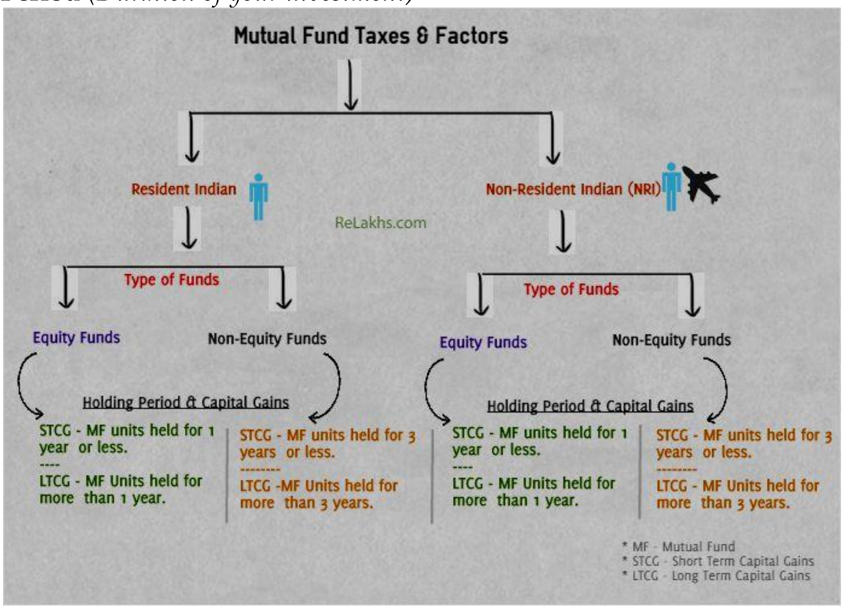

Fig. 3: Mutual Fund Taxes & Factors

a. **Residential Status & Mutual Funds Taxation:** The capital gains tax rates are determined based on the residential status of an individual / investor. Residential status can be either 'Resident Indian' or 'Non-Resident India" *(NRI)*.
b. **Type of Funds & Mutual Funds Taxation:** What are Equity-oriented Mutual Funds? – MF schemes that invest **at least 65%** of its *fund*corpus into *equity* and *equity* related instruments

are known as *equity* mutual funds. Examples are : Large cap, Mid-cap, *Balanced funds* (equity oriented), Sector funds etc.,

What are Non-Equity Mutual Funds? – MF schemes that hold **less than 65%** of their portfolio in equities and equity related instruments are known as Non-Equity Funds / Debt funds. Examples are : Liquid Mutual funds, Money Market funds, Gold funds, Infrastructure debt funds, Balanced funds (Debt oriented) etc.,

c. Period of Holding & Capital Gains on Mutual Funds: Capital gains on Mutual funds could be either long term capital gains or short term capital gains, depending on your investment horizon.

Long-Term Capital Gains

If we make a gain / profit on our investment in a *Equity Mutual Fund scheme* that we have held for over 1 year, it will be classified as Long-Term Capital Gain.

If we make a gain / profit on our investment in a *Non-Equity Mutual Fund scheme(or in a Debt Fund)* that we have held for over 3 years, it will be classified as Long-Term Capital Gain.

Short-Term Capital Gains

If we are holding in a Equity mutual fund scheme is less than 1 year i.e. if we withdraw our mutual fund units before 1 year, after making a profit, then the profit will be considered as Short-Term Capital Gain.

If we make a gain / profit on our Debt fund *(or other than equity oriented schemes)* that we have held for less than 36 months *(3 years)*, it will be treated as Short-Term Capital Gain.

Table 1: Capital Gains Tax Rates on Mutual Funds for FY 2016-17 (AY 2017-2018)

Mutual Funds - Capital Gains Tax Rates - FY 2016/2017 (AY 2017-18)		
Resident Indian		
Type of MF Scheme	Short Term Capital Gains (STCG Tax Rate)	Long Term Capital Gains (LTCG Tax Rate)
Equity Funds *(STCG - units held for less than 1 year LTCG - units held for more than 1 year)*	15%	Nil
Non-Equity Funds *(STCG - units held for less than 3 years LTCG - units held for more than 3 years)*	As per Individual's income tax bracket	20 % *(with indexation)*

Capital Gains Tax Rates on Mutual Fund Investments of a Resident Indian are as follows:

The STCG *(Short Term Capital Gains)* tax rate on equity funds is 15%.

The STCG tax rate on Non-Equity funds (or) Debt funds is as per the investor's income tax slab rate.

The LTCG *(Long Term Capital Gains)* tax rate on equity funds is NIL.

- The LTCG tax rate on non-equity funds is 20% *(with* Indexation benefit*)*

Capital Gains Tax Rates on NRI Mutual Fund Investments for the Financial Year 2016-17 (Assessment Year 2017-18) are as follows:

Table 2: Capital gain tax rates on NRI Mutual Fund Investment for A/Y 2017-18

Mutual Funds - Capital Gains Tax Rates - FY 2016/2017 (AY 2017-18)		
Non Resident Indian (NRI)		
Type of MF Scheme	**Short Term Capital Gains (STCG Tax Rate)**	**Long Term Capital Gains (LTCG Tax Rate)**
Equity Funds *(STCG - units held for 1 year or less, LTCG - units held for more than 1 year)*	15%	Nil
Non-Equity Funds *(STCG - units held for 3 years or less, LTCG - units held for more than 3 years)*	As per Individual's income tax bracket	On Listed Funds - 20% *(with indexation)* Unlisted Funds - 10% *(without indexation)*

The STCG tax rate on equity funds is 15%.
The STCG tax rate on Non-Equity funds (or) Debt funds is as per the investor's income tax slab rate. *(Tax Deducted at Source – TDS @ 30% is applicable)*
The LTCG tax rate on equity funds is NIL.
The LTCG tax rate on non-equity funds is 20% *(with Indexation)* on listed mutual fund units and 10% on unlisted funds.

Taxation of Mutual Fund Dividends

Dividends on Equity Mutual Funds : The dividend received in the hands of unit holder for an equity mutual fund is completely **tax free**. The dividend is also tax free to the mutual fund house.
Dividends on Debt Funds : The dividend income received by a debt fund unit holder is also tax free. But, the mutual fund company has to pay a dividend distribution tax *(DDT)*before distributing this dividend income to its Unit-holders. DDT on Debt Mutual Funds is 28.84%.

NRI Mutual Fund Investments & TDS Rate

Table 3: TDS rate applicable on MF redemptions by NRIs for AY 2017-18.

Mutual Fund Redemptions by NRIs & TDS Rate		
Type of MF Scheme	**STCG & TDS Rate**	**LTCG & TDS Rate**
Equity Oriented Funds	15%	Nil
Debt Mutual Funds	30%	On Listed Funds-20% (with Indexation) Unlisted Fund-10% (with Indexation)

9. CONCLUSION

The mutual fund in India has made great progress since liberalization. The reforms brought in number of far reaching changes in the financial system which ultimately culminated in strong economy more income and financial savings. These changes definitely bear fruits for the mutual fund industry as it is evident from the above discussions. The number of players and the number of schemes has increased manifold. The net resource mobilization of the industry has also gone up considerably during the said period. In the present scenario, with over 950 schemes, it has become quite difficult for investors to choose which scheme to invest. Investors now with the availability of varied scheme can maximize their return by investing in schemes, which suits their needs. Though Indian mutual funds industry has grown by leaps and bounds, there are certain areas which needs immediate attention like adopting a sound and effective fund management policy and taking care of investors education and after sales service.

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