PROBLEMS OF MUTUAL FUNDS IN INDIA

S. M. Alagappan
Ph.d Scholar (Periyar University), Associate Professor, Department of Commerce
Arumugam Pillai Seethai Ammal College, Tiruppattur – 630 211, Sivaganga District

Dr. R. Veeramani M.Com., M.Phil., Ph.D.,
Associate Professor and Head (Retd.), Department of Commerce
Government Arts College, Salem -636 007

Abstract

India is one of the fastest growing economies in the world due to which the income level of people in India is increasing and along with it the savings and investments are also growing. Due to liberalization and deregulation which was announced in Ne Industrial Policy, 1991 has dismantled barriers in the financial market, allowed the entry of newplayers and created environment for efficient allocation of resources. One of the important industries in emerging financial market is the mutual fund industry. The mutual fund industry has played a significant role in the development of capital market, growth of corporate sectors and financial intermediation. Despite all the advantages linked with mutual funds, people still prefer to invest their money independently. So far mutual funds have not been able to introduce the schemes which is suitable to the needs of farmers, small entrepreneurs and merchants to tap the rural savings. Further mutual funds have not yet developed product structuring to tap target customers. There is a lack of product conceptualization and innovation. Weak distribution and marketing channels are another problem which the mutual fund industry are facing today. The merchant banking industry is not sufficiently matured and this has led to slow development of mutual fund industry. The interesting thing is that mutual funds are the most misunderstood financial products in India. Mutual fund industries are also not making efforts in investor awareness programmes which are the need of the day. With an objective to make the investors aware of the problems of mutual funds, an attempt has been made to provide an information on the problems of mutual funds in India.

***Key words**: Mutual funds, problems, shortcomings, suggestions*

Introduction

The MF industry in India is a major constituent of the Indian Financial system today. It has had the existence of hardly 40 years so far. In this short period, it grew fast and also suffered from a equally fast decline. It became sick in its youth itself. In short spam of life, it has witnessed noticeable structural transformation, quantitative growth, qualitative and quantitative decline, and perhaps revival which may put the industry back on the rail. While mutual funds are major players in most established financial markets, they are relatively new to Indian investors. The first Indian mutual fund scheme (from Unit Trust of India) was offered in 1964, but it wasn't until the 1990s that the investor was provided with an array of fund choices of varying investment objectives and quality. Given the dearth of longer-term investment options in emerging markets such as India, one would expect mutual funds to become popular once made available. Yet, that has not happened. Investments in security related investments, including mutual funds, have hovered around 4 to 5% of household savings for more than a decade despite significant governmental concessions. Physical assets such as real estate and gold and the safer bank deposits continue to be the savings vehicle of choice for Indian investors.

Problems of Mutual Funds

1. Problems related to structure

The problems related to structure under SEBI (Mutual Funds) Regulations,1996 are pertaining to regulations 2 (q), 7, 16 (5) , 24 (3) , 21 (b) , 24 (2) , 32, 33,43, & 44. AMFI has taken a lead and made representations to the SEBI and the Central Government to amend the regulations. The problems related to the Indian Trusts Act,1882 are pertaining to individual/collective liability. The post –SEBI mutual funds have opted for trustee company structure. The liability of the trustees is more onerous under the board of trustees structure as compared to the trustee company structure. The Indian Trusts Act does not permit perpetual succession. The companies Act, 1956 permits perpetual succession but it can't protect the interest of the investors due to the privilege of limited liability.

The Government of India should consider enacting a separate comprehensive Mutual Funds Act and clearly spell out rights, duties and obligations of the various constituents of mutual fund to provide a uniform regulatory framework and to create a level playing field for all the mutual funds in the industry including UTI.

2. Problems related to the investors

The success of a mutual fund depends upon the confidence of the investors. UTI has established a marketing network of branches, chief representatives, collection centers and franchise offices through out the country. The marketing network of UTI is its unique strength as compared to other mutual funds. UTI could mobilize Rs.75159 Cr. of investible funds through its 87 schemes due to its well established marketing network. All other mutual funds could not establish such a marketing network and can't compete with UTI in mobilizing public savings from rural and semi-urban areas. All the problems related to the investors are, lack of awareness and poor after sales service to the investors. The investors believed, so far, that the mutual funds promoted by UTI, LIC, and nationalized banks are guaranteed by the Central Government. The majority of the new investors don't understand the concept, operations and advantages of investment in mutual funds before investing.

3. Problems related to working

The inventible funds of the mutual funds increase when sales are more than the redemptions and decrease when the redemptions are more than sales creating the problems of maintaining liquidity The investors prefer to invest in equity funds during boom period and shift their investments to debt funds during the recession period. The most profitable and high income and appreciation potential stocks during the boom period or at the time of investing funds in such stocks may become illiquid over a period of time .The investors can't take decisions of investment due to unavailability of track records of working. HDFC and Standard Chartered Mutual Funds started their operations in 2000, all other mutual funds except UTI have the track record of 3 to 5 years. Unless the track records of working of mutual funds is available covering the several stock market booms and crashes, the investors can't judge which schemes or mutual funds are better alternatives for investments.

There are several problems related to UTI such as non-disclosure of portfolio, inter scheme transfer of funds, lack of professional fund managers, sale & repurchase of units of US-64 at prices not related to its NAV, bureaucratic working, etc. AMFI has constituted committees on valuation, best practices and credit policy and working groups on valuation of gilt-securities, standardization of disclosure, pensions, etc. to ensure uniform working and disclosure practices.

4. Problems related to performance

The investor prefers safety of the principal amount, regular returns, long-term growth, income tax benefits, etc. The mutual fund schemes have been designed based on the preferences of the investors, changes in stock/capital market, returns on various instruments and changing profile of the investors. The schemes are framed and conceptualized by the top management of the mutual funds and marketed by their branches and through the agents. The agents and the sales executives of the mutual funds assure higher returns to the investors and paint a rosy picture about the mutual funds while marketing schemes. The mutual funds in our country have been quite wrongly promoted as an alternative to equity investing and created very high expectations in the minds of the investors. The ignorance of the investors about mutual funds coupled with aggressive selling by promising higher returns to the investors have resulted into loss of investors' confidence due to inability to provide higher returns. All mutual funds set a higher target for mobilization of savings from the investor by launching new schemes and expanding investor base. The agents or distributor of mutual funds are more governed by commissions and incentives they get for selling the schemes and not by the requirements of the investors and quality of the products. They share commissions with the investors and don't explain the risk factors to them.

Shortcomings in Operation of Mutual Funds

Mutual funds have been operating for the last fourteen years. Following are some of the shortcomings in operation of mutual funds:

- All mutual funds are extremely managed. They do not have employees of their own. Also, there is no specific law to supervise the working of mutual funds in India. There are multiple regulations.
- Many of the investors are not willing to invest in mutual funds unless there is an assurance of a minimum return.
- Unrestrained fund-raising by schemes without adequate supply of scrips has created a severe imbalance in the market.
- Many small companies have done very well but mutual funds cannot reap their benefits because they are not allowed to invest in smaller companies.
- The mutual fund in India are formed as trusts. As there is no distinction made between sponsors, trustee and fund managers, the trustees play the role of fund managers.
- An increase in the number of mutual funds under various schemes has increased competition. As a result, they lose their stabilizing factor in the markets.
- Net asset value (NAV) is one of the important factors, which decide the performances of a mutual fund scheme. Till date, no regulations have specified the formula to be used for computation of NAV.
- India is a vast country with a comprehensive demographic profile. But mutual funds are still confined to urban and semi-urban markets.
- Mutual funds do not have a strong distribution network. Apart from a few, most have to depend on broker networks.
- Most of the older schemes have been designed with complicated exit procedures. Further, investors are not adequately informed about the available options, which causes them a lot of confusion. Investors are compelled to resort to liquidate their investments in the market at a highly discounted price.
- Fund managers invest in unlisted securities and sometimes in private limited companies to get better returns lead to new risk profile,
- Lack of well-informed institutional markets is a cause of market inefficiencies.
- The lack of proper marketing and distribution networks is another problem faced by the mutual fund industry in India.
- The Internet and e-commerce which are indispensable now-a-days, have still not been introduced in mutual funds in huge way.
- The biggest problem the mutual funds face today in India is the lack of investors' confidence.

Suggestions to Overcome the Problems

To uplift the all-pervasive pessimism existing in the industry some introspection and some actions have been suggested to improve the current state of affairs.

1. The original spirit should be brought back with which the Government of India ventured to set up a Unit Trust in 1963 – to provide relatively safe, easy and diversified options to the investors to participate in otherwise complex financial markets. The democratization of Finance cannot be achieved without the participation of the common people.
2. The investor education should be intensified at the level of individuals and household where it matters most. In fact, it has to be treated as an all-out war on ignorance and in favor of long-term wealth creation. If India can become a polio-free nation, it can also hope to become a financial-literate society.
3. The possibilities of varied solutions, the mutual fund schemes can offer to investors to meet their needs and goals must be highlighted. The needs can be simple ones like saving and liquidity management. Investing may include meeting specific goals such as children education, and the biggest financial goal of any individual being his or her retirement planning. To achieve the long term goals of the investors, there is a necessity to increase the average holding period from the current abysmally low 24 months to the true ones. While measuring this number, the authorities have to take into account the need for a legitimate portfolio rebalancing to match a client's risk profile.
4. The message of importance being non-cyclical while investing in mutual funds to avoid retail investors falling into the trap of buying at highs and exiting at lows should be conveyed.. Need and goal-based investing is the ideal solution to avoid this trap. Individual Financial Advisors (IFAs) should take up this responsibility upon themselves first as a good business model and then as a true differentiator between them and other kinds of distributors who are often swayed by short-term goals.
5. To overcome the negative perception created because of the exclusive and the Regulation mandated risk, disclosure statement should be communicated effectively. It will need a genius mind to find such a communication which is simple yet effective to overcome a regular barrage of statements about 'riskiness' of the schemes on one hand and the need to use the schemes to meet long term goals on the other.
6. The importance of a strong regulation that emphasizes on systemic transparency and ability to protect investors' interests in real sense should be communicated. Public media, fond of sensationalism, tends to highlight the wrong deeds of minority distributors. IFAs need a strong and uniform narrative to overcome this negative bias.

Within the IFAs, Financial Planners seem to have a natural affinity to recommend mutual fund schemes to build long term investment plans for investors. This natural affinity has to spread pervasively. IFAs must overcome the pessimism and cynicism and discover the vast possibilities of an economy in transition. Instead of wasting their energies on issues such as reduced commissions and the negative publicity arising because of alleged malpractices by some categories of distributors, IFAs should equip themselves with the ability to collect an appropriate fee directly from the clients and establish a strong process to recommend portfolio based solutions to meet the life stage goals of people or a household.

Conclusion

It is hoped that, in the days to come, mutual fund industry gains the much deserving prominent position when it comes to taking the wallet share of the investors in India, in the same way it has happened in many a developed economies of the world and some of the emerging economies too. The greater transparency, increased innovations, better services to the investors, liquidity and higher returns will make mutual fund schemes more popular and investors friendly.