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# India's Emerging Market and the Mutual Fund Industry

May 2023

The Associated Chambers of Commerce and Industry of India

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**Mr. Deeapk Sood**
Secretary General, ASSOCHAM

## MESSAGE

The Indian financial system has always encouraged a robust mechanism for supporting the investment requirements of individuals and funding requirements of companies. Financial markets provide a platform for wealth creation in the economy, and India is one of the fastest-growing wealth management markets in the world. With the purchasing power of average Indian improving over the years, the Indian mutual fund market today is witnessing growth,diversity, maturity, inclusivity, and modernization as it offers-one of the most attractive investment opportunities for the investors in India.

The mutual fund industry has seen a paradigm shift in the last decade. It has emerged as an important financial services sector in the Indian economy, channelizing the savings of millions of individuals into equity and debt instruments. Mutual funds are viewed as transparent and affordable investment solutions in today's dynamic market environment, drawing considerable amount of investor interest. The benefits from the high growth story of India need to percolate to the smaller towns and cities so that savings of individual investors are channelized into financial instruments matching their risk profile.

In a deposit-dominated market like India, it is important for mutual funds to be able to offer differentiated risk-rewards and gain shelf-space. New product development in mutual funds space must match consumer profile, requirements, return expectations and risk appetite. Mutual Fund industry must target an increased share of the retail investments through expanding the line of innovative mutual fund products. In addition, the mutual fund industry must focus on deeper retail penetration by expanding its presence in almost all bankable urban and rural locations.

In India, the financial planning strategies of the common man have seen an interesting shift over the past few years owing to the advancement of technologies and availability of multiple financial tools for investors. This trend has helped the mutual fund industry expand its reach to all segments of the retail consumer. As India marches into the *Amrit Kaal,* the Indian mutual fund industry will be well poised to support India's growth story in which rural economy will also play big role.

ASSOCHAM jointly with the Resurgent India has come out with this report on the subject highlighting various aspects of Mutual Fund Industry. We hope that the contents of the report will provide valuable insights to policy makers, retail investors and industry stakeholders and the deliberations at the conference will further help in laying the roadmap for future growth and development of Indian mutual fund industry in its journey during *Amrit Kaal.*

**Deepak Sood**

**Mr. Jyoti Prakash Gadia**
Managing Director
Resurgent India Limited

# MESSAGE

The mutual fund industry in India has witnessed a remarkable transformation in recent years, driven by the dynamic interplay of digital technologies, shifting investor preferences, and an ever-expanding reach across the nation. One of the significant shifts in the mutual fund industry has been the redistribution of assets and the increasing focus on smaller cities and towns. Enabled by the rapid adoption of digital technologies and faster data speeds, retail contributions through systematic investment plans (SIPs) have surged, showcasing the deepening digital footprint and the growing investor interest in mutual funds.

Currently, the market landscape is dominated by a handful of distributor entities, limiting the reach and accessibility of mutual fund schemes. To overcome this hurdle, industry players need to offer standardized tools that empower fintech platforms to expand their network of distributors and attract a larger customer base. The demand for integrated platforms that offer seamless experiences and cater to various desired services is growing. This convergence of services blurs the boundaries between retail e-commerce and fintech e-commerce, underscoring the need for a more interconnected and customer-centric approach. This report explores the implications of this trend and provides insights into the future direction of the industry.

Transitioning from awareness to education is another pivotal aspect that demands attention. While the industry currently invests in investor education initiatives, there is a need to cultivate organic investor interest and understanding. Incorporating financial investment, particularly mutual funds, into high school or college curricula could play a crucial role in nurturing a culture of early savings among students.

Through an in-depth analysis of its intricate dynamics, emerging trends, and significant shifts, this report aim to unveil the trajectory that lies ahead.

**Mr. Jyoti Prakash Gadia**

# INDEX

# Chapter 1: A Brief Overview

The mutual fund landscape in India has undergone a remarkable transformation in the recent years, characterized by a significant redistribution of assets and a growing emphasis on smaller cities and towns. This shift has been driven by the rapid adoption of digital technologies and the availability of faster data speeds. An evident manifestation of this trend is the substantial increase in retail contributions through systematic investment plans (SIPs), highlighting the pervasive digital presence across the nation.

Over the past decade, the Indian mutual fund industry has experienced remarkable growth in its assets under management (AUM). As of April 30, 2023, the industry's AUM stood at ₹41,61,822 crore, a substantial increase from ₹8.26 trillion recorded in 2013. This significant growth signifies a fivefold surge in AUM within a span of ten years, underscoring the industry's robust performance and the growing confidence of investors.

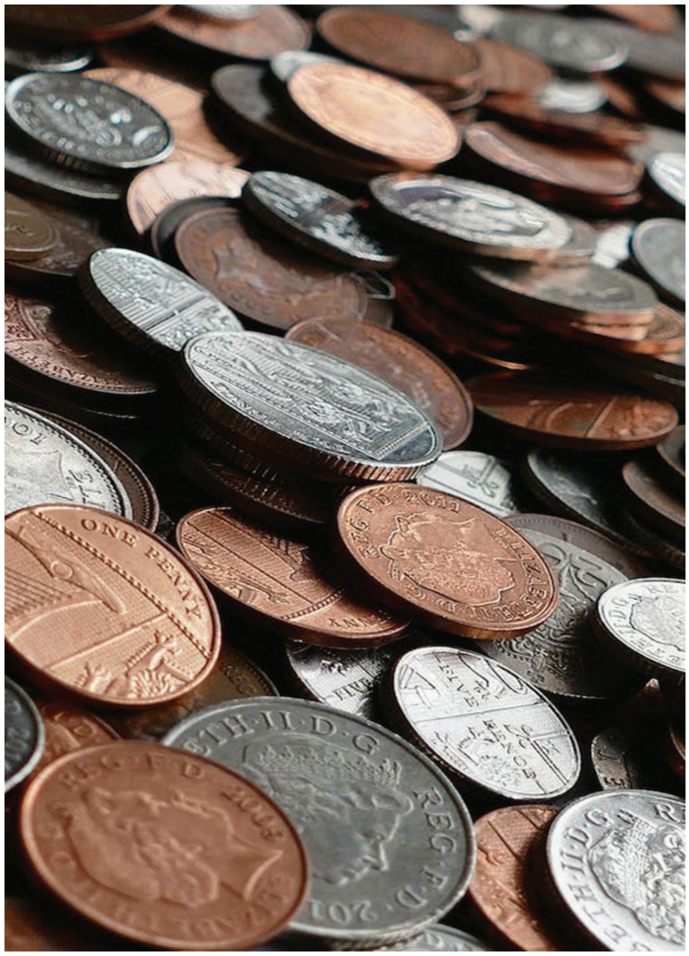
The journey of the industry's AUM has been punctuated by noteworthy milestones. In May 2014, it surpassed the ₹10 trillion mark for the first time, signalling its increasing significance. Within a brief period of approximately three years, the AUM size more than doubled, surpassing ₹20 trillion in August 2017. Continuing its upward trajectory, the AUM crossed ₹30 trillion in November 2020, solidifying the industry's growth and influence.

Another notable aspect of the industry's growth is the substantial increase in the number of folios, which represent individual accounts and indicate a rise in retail participation. In May 2021, the industry surpassed a significant milestone of 10 crore folios. As of April 30, 2023, the total number of folios stood at 14.64 crore, with approximately 11.69 crore folios under Equity, Hybrid, and Solution Oriented Schemes, where the majority of retail investments are concentrated.

These figures vividly illustrate the continuous growth and increasing popularity of the Indian mutual fund industry, both in terms of assets under management and retail participation. The industry's ability to foster and maintain investor trust has played a pivotal role in its remarkable journey of expansion and development.

This surge in AUM can be attributed to a combination of factors, including the rapid penetration of digital technologies, the impetus provided by smart city initiatives, and the enhancement of data speeds. Together, these elements have facilitated the successful penetration of mutual fund investments in smaller cities and towns. Moreover, the industry's concerted efforts to enhance retail participation through SIPs underscore the seamless integration of digital platforms and the growing appeal of mutual funds among retail investors.

The Indian mutual fund industry has not only weathered challenges but has emerged resilient and robust. This tenacious rebound has been fuelled by a paradigm shift towards digital channels, with retail investors actively embracing SIPs as a preferred investment vehicle. The consistent growth in assets under management, surpassing significant milestones along the way, exemplifies the industry's unwavering determination and its potential for further expansion.




## Trends shaping the mutual fund markets:

The India Mutual Fund Market has witnessed notable trends that are shaping the industry's landscape. With a focus on growth, diversification, and digitalization, the market has experienced significant changes in asset size, investor behaviour, and the adoption of technology-driven solutions.

## Industry Trends:

1. There has been a shift in AUM from active debt to active equity, as well as a rise in passive schemes. The market share of equity-oriented funds increased from 48.9% to 51.6% of the overall AUM mix between March 2022 and March 2023. Active longer-period debt funds' share fell from 23.1% to 19.6%, while liquid funds' share decreased from 16.4% to 15.8%. Passive ETFs and FOFs saw their share of AUM rise from 11.6% to 13.1% during the same period.

2. Individual participation in mutual funds has increased, with the share of individuals in the overall AUM composition rising from 55.2% to 58.1% between March 2022 and March 2023. Conversely, the share of institutions and corporates decreased from 44.8% to 41.9%.

3. Individual investors have a significant share of 89% in equity fund AUM but only 11% in ETFs and FOFs. On the other hand, institutional investors and corporates allocate 32% of their corpus to liquid funds, 28% to ETFs/FOFs, 27% to long-period debt funds, and only 13% to active equity funds.

## Folios and Ticket Sizes:

1. As of March 2023, there were a total of 14.57 crore folios (accounts unique to an AMC). Retail investors accounted for 91.1% of the total folios, HNIs accounted for 8.2%, and institutions made up the remainder.

2. In debt funds, retail investors accounted for 67.5% of the folios, while HNIs accounted for 30.7%. HNIs also had a significant share of folios in liquid funds and hybrid funds.

3. The number of mutual fund folios experienced a sharp increase of nearly 270% between September 2014 and March 2023, reaching 14.57 crore. This growth was in contrast to the 5-year period post the 2008-09 global financial crisis when the number of folios compressed.

4. The average ticket size of a retail investor in equity funds increased to Rs 0.71 lakhs, largely due to the persistence of Systematic Investment Plans (SIPs). Retail investors demonstrated a longer holding period, with nearly 57.2% of their equity fund investments held for more than 2 years and over 75% held for more than 1 year.

## Geographical Mix:

1. Smaller towns and cities are showing an increased interest in equity and equity funds, indicating a shift towards the financialization of savings.

2. B30 cities (cities beyond the top 30) accounted for 17% of the overall AUM of mutual funds as of March 2023, experiencing a growth rate of 9.6% year-on-year. This growth can be attributed to greater awareness, higher income levels, and incentivized distribution in these cities.

3. The B30 cities appear to have a higher inclination towards equity assets compared to the T30 cities (top 30 cities). However, considering that T30 cities house most institutional treasuries, the equity fund AUM mix may be skewed. As of March 2023, 26% of individual assets were located in B30 cities, while 74% were in T30 cities, suggesting increasing investment savvy in B30 cities.

4. Retail investors still underutilize direct schemes, as less than 15% of retail equity AUM comes through the direct route, whereas HNIs and institutions leverage direct schemes more effectively.

The mutual fund industry traces its origins back to 1963 when it first emerged, setting the stage for a transformative journey of growth and development. Since its inception, the industry has witnessed a series of pivotal events that have played a crucial role in shaping its trajectory. Here is a chronological overview:

- 1963: The government established the Unit Trust of India, marking the beginning of the mutual fund industry.

- 1964: The Unit Trust of India introduced its first scheme, known as the Unit Scheme.

- 1987: Public sector fund houses made their entry, with SBI Mutual Fund becoming the first PSU fund house.

- 1993: Private sector fund houses emerged, with Franklin Templeton (formerly Kothari Pioneer) being the first private sector fund house.

- 1993-2003: This decade witnessed various developments, including the Securities and Exchange Board of India (SEBI) assuming regulatory control over mutual funds. The industry experienced numerous mergers, acquisitions, and the establishment of foreign funds.

- 2009: The practice of charging entry loads was discontinued.
- 2012: A portion of the Total Expense Ratio (TER) was mandated to be allocated for investor education. The Rajiv Gandhi Equity Savings Scheme (RGESS) was launched.
- 2013: The Securities Transaction Tax (STT) for equity funds was reduced, and direct plans for mutual fund schemes were introduced.
- 2014: The definition of long-term was revised to 36 months from 12 months for debt mutual funds. The exemption limit under Section 80C was raised to Rs 1.5 lakhs.
- 2017: Tax benefits associated with RGESS were discontinued, and SEBI implemented a re-categorization of mutual funds, impacting the fund houses.
- 2018: SEBI slashed the total expense ratio (TER) for all mutual funds.

# Chapter 2: Paving the Way for Expansion: Government Policy Reforms and the Growth of Mutual Funds in India

In recent years, SEBI and the government of India have implemented a series of measures aimed at establishing a robust and trustworthy regulatory framework for the mutual fund industry. SEBI's proactive approach has significantly contributed to the development of a comprehensive and reliable ecosystem for mutual fund investments.

**Implementation of a new categorization and rationalization system for mutual fund schemes to make it easier for investors to understand and compare different schemes.**

The mutual fund structure in India underwent a significant transformation with the introduction of a circular by the Securities and Exchange Board of India in 2017. Before the circular, there was no legal requirement for fund houses to categorize mutual funds, allowing them to invest in a wide range of securities, which often left investors confused and overwhelmed. The circular aims to establish consistency in the types of schemes offered by fund houses based on market cap and risk arrangements. Its purpose is to simplify the process of selecting and comparing mutual funds for investors, especially considering the multitude of open-ended schemes available prior to the circular.

**Introduction of the Bharat 22 Exchange Traded Fund (ETF) to encourage retail investors to participate in the divestment program of the government.**

The Government of India (GOI) introduced an Exchange Traded Fund (ETF) known as the Bharat 22 ETF. This ETF includes shares of listed Central Public Sector Enterprises (CPSEs), strategic holdings of the Specified Undertaking of Unit Trust of India (SUUTI), and other corporate entities. The creation, launch, and management of the Bharat 22 ETF was entrusted to ICICI Prudential Asset Management Company Limited (ICICI Prudential AMC).

The primary objective behind introducing the Bharat 22 ETF is to facilitate the government's disinvestment program while encouraging retail investors to actively participate in the divestment of government-owned companies. By investing in this ETF, retail investors have the opportunity to contribute to the growth of these entities and benefit from potential returns.

The portfolio of the Bharat 22 ETF comprises shares of 22 CPSEs, representing a diversified range of companies across various sectors. This includes blue-chip companies that are well-established and renowned in their respective industries. Through the launch of the Bharat 22 ETF, retail investors are provided with a convenient and accessible means to invest in a diverse basket of government-owned companies, thereby diversifying their investment portfolio and potentially capitalizing on the growth prospects of these entities.

### Measures to Reduce Total Expense Ratio (TER) in Mutual Fund Schemes

In an effort to enhance the cost-effectiveness of mutual fund schemes for investors, the Securities and Exchange Board of India (SEBI) has implemented measures to reduce the Total Expense Ratio (TER). The TER encompasses various operating expenses charged by mutual funds, including sales and marketing costs, administrative expenses, transaction costs, and investment management fees.

In 2018, SEBI introduced caps on the TER for different types of mutual fund schemes. For equity-oriented schemes, the TER was capped at 1.25 per cent, while for other schemes, the cap was set at 1 per cent. Fund of funds schemes were subject to a TER cap of 2.25 per cent for equity-oriented schemes and 2 per cent for other schemes. These caps aimed to ensure greater transparency and affordability for investors.

Since the regulatory framework for expense ratios was revised by SEBI in September 2018, the mutual fund industry has witnessed a significant increase in its Assets Under Management (AUM), which has grown by nearly 65 per cent. Building on this success, SEBI is currently contemplating further changes to standardize a uniform TER across all mutual fund schemes. This move aims to prevent agents from misleading investors into investing in underperforming funds, ensuring greater investor protection.

***Effective April 1, 2020, the TER limit has been revised as follows.***

| Assets Under Management (AUM) | Maximum TER as a percentage of daily net assets | |
|---|---|---|
| | TER for Equity funds | TER for Debt funds |
| On the first Rs. 500 crore | 2.25% | 2.00% |
| On the next Rs. 250 crore | 2.00% | 1.75% |
| On the next Rs. 1,250 crore | 1.75% | 1.50% |
| On the next Rs. 3,000 crore | 1.60% | 1.35% |
| On the next Rs. 5,000 crore | 1.50% | 1.25% |
| On the next Rs. 40,000 crore | Total expense ratio reduction of 0.05% for every increase of Rs. 5,000 crores of daily net assets or part thereof. | Total expense ratio reduction of 0.05% for every increase of Rs. 5,000crorese of daily net assets or part thereof. |
| Above Rs. 50,000 crore | 1.05% | 0.80% |

SEBI's recent guidelines stipulate that all commissions and expenses associated with mutual funds must be borne by the scheme itself. Furthermore, SEBI has encouraged the adoption of a full-trail model of commission, eliminating the practice of upfront commissions. These measures are intended to align the interests of distributors and investors, promote transparency, and ensure that investors receive the maximum value from their mutual fund investments.

SEBI's initiatives to reduce the TER and introduce greater uniformity in mutual fund expenses highlight its commitment to creating a more investor-friendly environment. By reducing costs and promoting transparency, these measures aim to strengthen investor confidence, foster long-term wealth creation, and support the sustainable growth of the mutual fund industry.

## Riskometer

The implementation of the Riskometer by SEBI in January 2021 was a significant step towards promoting transparency and enabling investors to better understand the risk associated with mutual fund schemes. The Riskometer serves as a standardized tool that visually represents the risk level of a mutual fund scheme. Its purpose is to assist investors in assessing the risk-return profile of a scheme and making well-informed investment decisions that align with their individual risk tolerance.

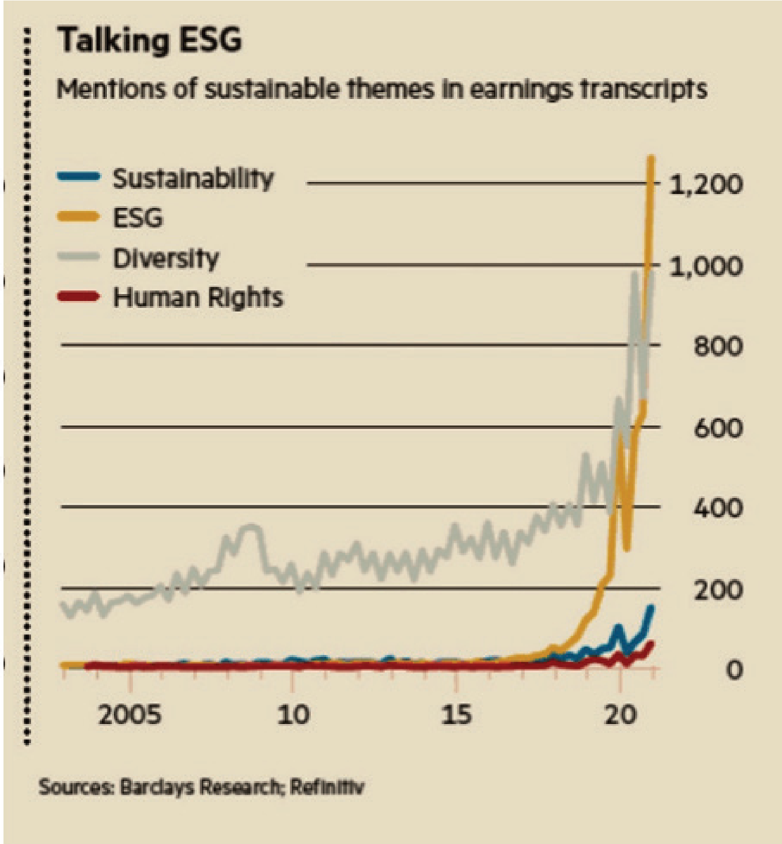
By offering a consistent risk assessment mechanism, the Riskometer simplifies the process of comparing different mutual fund schemes. Investors can easily evaluate the risk involved in a scheme and determine if it matches their investment objectives and risk appetite. Moreover, the Riskometer aids investors in diversifying their portfolios by enabling them to select schemes with varying risk levels, thereby promoting a balanced and well-diversified investment strategy. Overall, the introduction of the Riskometer enhances transparency, empowers investors, and facilitates better risk management within the mutual fund industry.

| Risk Levels | Suitable for Investor Category | Mutual Fund Product Types |
|---|---|---|
| Low | Conservative | Gilt funds / Income funds with maturity of less than 90 days |
| Moderately Low | Moderately Conservative | 91 to 3 years short-term bonds |
| Moderate | Moderate | MIPs / Hybrid debt-oriented funds |
| Moderately High | Moderately Aggressive | Index Funds / Gold ETFs / Balanced equity funds up to 20% in the portfolio / Generally large-cap funds |
| High | Aggressive | Micro-cap funds / International funds / Sectoral funds |
| Very High | Overly aggressive | Not yet classified |

# Chapter 3: Emerging Trends in Mutual Fund Investments

Thematic funds are a type of equity mutual fund that focus on investing in stocks tied to specific themes or ideas, providing a broader investment approach compared to sectoral funds. Within the realm of conscious investing, there is a growing demand for companies that embody sustainability, with investors seeking businesses that prioritize environmental, social, and governance (ESG) factors. Sustainable or ESG investing involves making investment decisions based on firms' adherence to ethical practices while also aiming for profitability.

ESG investing revolves around evaluating companies based on their environmental impact, social responsibility, and corporate governance practices. Companies that score well on ESG parameters demonstrate a commitment to sustainable actions and are more likely to mitigate risks associated with regulatory penalties and environmental crises. In recent years, ESG investing has gained global recognition, with investment funds incorporating this approach into their strategies.




Source : FT

While India is relatively new to ESG investing, it has witnessed a surge in popularity, particularly in the wake of the COVID-19 crisis. Several fund houses, including AXIS AMC, ICICI Prudential, Quantum India AMC, and SBI Mutual Fund, have launched ESG thematic funds or reclassified existing funds as ESG funds. Investors believe that companies practicing good ESG principles can generate higher profits through brand building and increased customer loyalty. An example of a socially responsible company in India is the Tata Group, which provided accommodation at the Taj Hotel to healthcare and frontline workers during the early days of the pandemic, demonstrating their commitment to social responsibility.

ESG investing provides investors with an opportunity to align their investment choices with their values, supporting companies that prioritize sustainable practices and contribute to a more socially and environmentally conscious world.

## Shifting investor preferences and behaviour

### Robo advisors

A robo-advisor is a digital financial advisor that offers online financial advice and portfolio management with minimal human intervention. It can be seen as a pre-programmed personal financial advice platform that automates investment management and facilitates the purchase of financial products with minimal human involvement. Robo advisors rely on rule-based logic conditions, often claiming to utilize Machine Learning and Artificial Intelligence. In India, there has been recent funding in the robo-advisory space. While different robo-advisory platforms may offer various options for quick, transparent, and data-driven investment advice, the fundamental premise remains the same: allocating to equities for long-term goals exceeding five years and to fixed-income investments for short-term needs.

***Robo advisors offer several benefits to investors, transforming the traditional investment landscape:***

**Low Fees:** Robo advisory platforms have disrupted the industry by offering professionally managed investment assistance at significantly lower fees than the previously prevailing rate of 1.0% of Assets Under Management (AUM). This cost-effective approach makes investment guidance accessible to a wider range of investors.

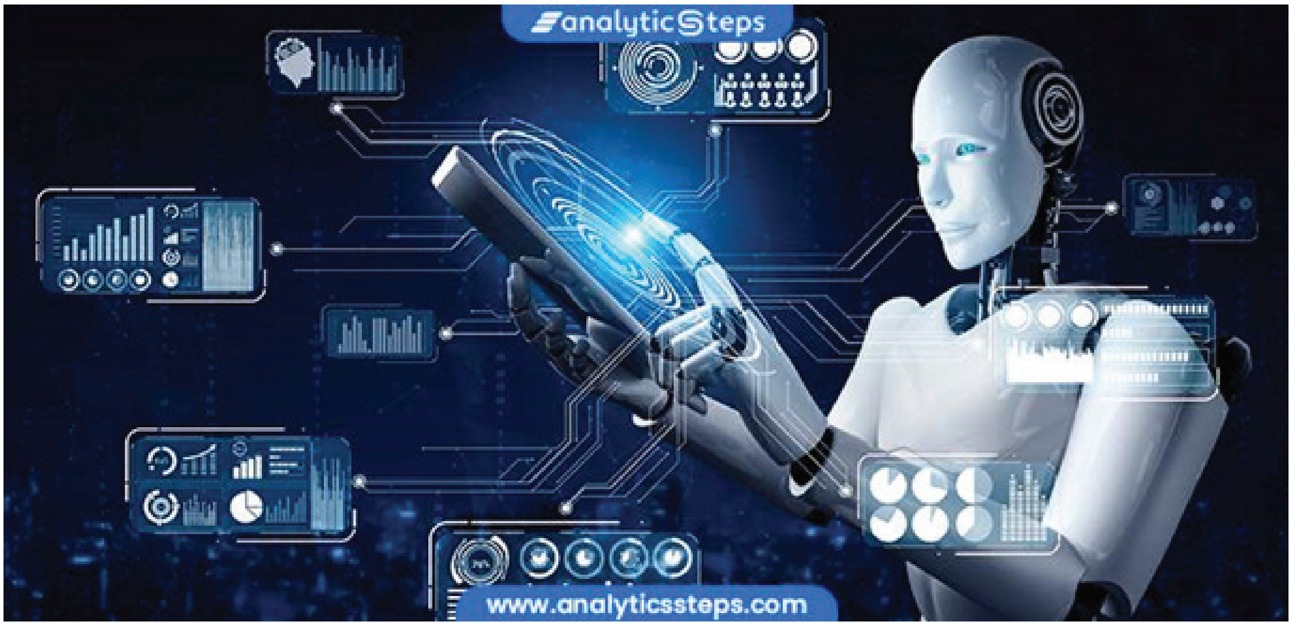
**Low Minimum Balances:** Robo advisors have made professional investment management accessible to individuals with small net worth. With technologies that support zero minimum balance requirements, investors can benefit from the services of robo advisors even with limited resources. Some platforms, like Personal Capital, even offer free portfolio monitoring for those interested, while higher balance tiers provide access to dedicated financial advice.

**Tax Optimization:** Taxes can significantly impact investment returns, especially regarding capital gains that are subject to regular income tax rates. Robo advisors are designed to optimize tax efficiency through automation. By minimizing capital gains taxation, these platforms aim to enhance after-tax returns for investors.

**Regular Rebalancing:** Over time, even a well-allocated portfolio can drift out of balance due to fluctuations in asset categories. Changes in market conditions can cause distortions in the portfolio allocation. Regular rebalancing is crucial to maintain the desired asset allocation. Robo advisors automate this process, ensuring that portfolios are rebalanced at least annually and, in some cases, even more frequently to adapt to market shifts.

Robo advisors bring a new level of affordability, accessibility, tax optimization, and portfolio maintenance to investment management, empowering investors to navigate the financial markets with greater ease and efficiency.

However, there are notable differences between the robo-advisory services offered in the United States and India. Here are three key distinctions:




Automation Level: In the US, robo-advisory services are typically fully automated, where funds are selected and invested automatically without user intervention. On the other hand, in India, the services require users to initiate transactions manually and do not operate on autopilot.

**Investment Instruments:** In the US, investor funds are often directed towards Exchange Traded Funds (ETFs), which are passive investments. Robo-advisory services in the US are considered alternatives to traditional actively managed funds. In contrast, India is still in the early stages of ETF adoption, and robo-advisory platforms predominantly invest user funds in actively managed mutual funds.

**Fee Structure:** In the US, robo-advisory services typically charge a fee based on the Assets Under Management (AUM). For example, Wealthfront charges 0.25% of AUM annually, while Betterment charges 0.15% to 0.35% based on AUM. In India, the fee structure varies, with some platforms offering free services or charging a flat annual fee along with fixed charges per transaction.

There are additional differences to consider. In the US, users are accustomed to paying advisory fees, while in India, where advisors often earn commissions, there is a potential conflict of interest. Encouraging users in India to pay for the advice or services they receive becomes essential when commission-free online investment products are introduced. Moreover, robo-advisory services in the US provide a cost-effective solution for existing investors, while in India, the aim is to increase market penetration by offering affordable advice to a broader user base. Additionally, tax loss harvesting, a strategy to offset gains by selling loss-making investments, is a significant feature of robo-advisory services in the US, whereas tax optimization is not yet a major focus in India.

As robo-advisory services continue to evolve and gain prominence in India, further adaptations and developments specific to the Indian market are expected to emerge.

## A surge in Systematic Investment Plans

SIP has gained popularity among Indian mutual fund investors due to its advantages. It helps in Rupee Cost Averaging, which means that investors can benefit from purchasing more units when prices are low and fewer units when prices are high, thereby potentially reducing the average cost per unit over time. Additionally, SIP promotes disciplined investing by removing concerns about market volatility and the need to time the market.

| Month | | SIP Contribution ₹ crore | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2023-24 | 2022-23 | 2021-22 | 2020-21 | 2019-20 | 2018-19 | 2017-18 | 2016-17 |
| Total during FY | 13,728 | 1,55,972 | 1,24,566 | 96,080 | 1,00,084 | 92,693 | 67,190 | 43,921 |
| March | | 14,276 | 12,328 | 9,182 | 8,641 | 8,055 | 7,119 | 4,335 |
| February | | 13,686 | 11,438 | 7,528 | 8,513 | 8,095 | 6,425 | 4,050 |
| January | | 13,856 | 11,517 | 8,023 | 8,532 | 8,064 | 6,644 | 4,095 |
| December | | 13,573 | 11,305 | 8,418 | 8,518 | 8,022 | 6,222 | 3,973 |
| November | | 13,306 | 11,005 | 7,302 | 8,273 | 7,985 | 5,893 | 3,884 |
| October | | 13,041 | 10,519 | 7,800 | 8,246 | 7,985 | 5,621 | 3,434 |
| September | | 12,976 | 10,351 | 7,788 | 8,263 | 7,727 | 5,516 | 3,698 |
| August | | 12,693 | 9,923 | 7,792 | 8,231 | 7,658 | 5,206 | 3,497 |
| July | | 12,140 | 9,609 | 7,831 | 8,324 | 7,554 | 4,947 | 3,334 |
| Jun | | 12,276 | 9,156 | 7,917 | 8,122 | 7,554 | 4,744 | 3,310 |
| May | | 12,286 | 8,819 | 8,123 | 8,183 | 7,304 | 4,584 | 3,189 |
| April | 13,728 | 11,863 | 8,596 | 8,376 | 8,238 | 6,690 | 4,269 | 3,122 |

## Impact of Technology and Digitalization on the Mutual Fund Industry

Mutual funds and asset management are also being impacted by the changing investor preferences and the adoption of new technologies. Here's how these technologies are influencing mutual funds and asset management:

**Data Analytics:** Asset management firms are leveraging data analytics to gain insights into market trends, investor behaviour, and portfolio performance. By analysing vast amounts of data, including market data, economic indicators, and customer preferences, asset managers can make data-driven investment decisions and optimize portfolio performance.

**Digital Distribution:** The shift towards digital channels has transformed the distribution of mutual funds. Investors can now access and invest in mutual funds online through various platforms and mobile applications. Digital distribution has made investing more accessible, convenient, and efficient for investors, leading to increased adoption of mutual funds.

**Blockchain and Smart Contracts:** Blockchain technology is being explored for its potential to improve transparency, security, and efficiency in the mutual fund industry. Smart contracts, built on blockchain, enable automated and secure transactions, reducing the need for intermediaries. Blockchain can also enhance the tracking and verification of fund transactions, ensuring compliance with regulations.

# Chapter 4: Prospects and Challenges Facing Mutual Funds Industry

The mutual fund industry stands at crossroads, brimming with both promising prospects and formidable challenges. As investors seek diverse and reliable avenues to grow their wealth, mutual funds present an enticing opportunity for wealth accumulation. The industry is poised to tap into the ever-expanding middle-class population, coupled with a rising culture of investment. However, amidst the promising outlook, there are challenges that demand attention. From navigating market volatility to addressing evolving investor preferences and increasing competition, the mutual fund industry must adapt and innovate to remain resilient. Let's take a closer look:

## Transitioning from awareness to education:

The industry currently allocates around two basis points or approximately Rs. 500 crore per year towards investor education. However, the need of the hour is to shift mutual funds from being a product that is promoted to one that attracts investors organically. One potential solution is to incorporate financial investment (specifically mutual funds) into high school or college curricula. These efforts would help cultivate the habit of early savings among students.

## Increasing the number of distributors:

There is a pressing requirement for a larger number of distributors and advisors to disseminate the message of investing in mutual funds more extensively. Due to a general inclination towards risk aversion and a lack of solid financial literacy among Indians, many individuals refrain from investing in market-linked products simply because they lack understanding.

To tackle this issue, we need a well-trained army of financial advisors who can effectively educate potential investors about modern investment tools like mutual funds.

## Streamlining operational processes:

Although the mutual fund industry has made considerable progress in standardizing processes, a few challenges still persist. These include simplifying the Know Your Customer (KYC) procedures to ensure hassle-free onboarding, allowing Aadhaar to be used interchangeably with PAN (Permanent Account Number), and enabling investments based on 'Bank KYC'. Addressing these challenges would enhance the ease and convenience of investing in mutual funds.

## Mass Marketing of Mutual Funds

The primary hurdle lies in the mass marketing of mutual funds, as the current market landscape consists of only a handful of distributor entities. To address this challenge, industry players have the potential to offer standardized tools that can empower fintech platforms to expand their network of distributors and attract a larger customer base.

However, it is important to exercise caution and consider an important aspect. Mutual funds are inherently advisory-led products, and customers tend to rely on trusted sources when making investment decisions in this domain. While digitization has undoubtedly made access to mutual funds easier, it has also made personalized advisory services more challenging to provide. This situation presents a significant window of opportunity for fintech platforms to bridge this gap by offering innovative solutions that can effectively provide the much-needed advisory support to investors. By leveraging technology and expertise, these platforms can play a vital role in guiding and assisting customers, thereby enhancing the overall investment experience and driving further growth in the mutual fund industry.

## Key Opportunities for the Mutual Fund Industry

India can gain valuable insights from other countries when it comes to shaping its mutual fund industry. One important lesson is to provide individual investors with a diverse range of investment opportunities. In the United States, for example, investors have access to a wide selection of investment options, including international investments and domestic funds that offer exposure to foreign assets. By offering such opportunities, India can enable investors to diversify their portfolios and potentially reduce risk.

Additionally, it is crucial for India to recognize the significance of international diversification. Vanguard, a renowned investment management company, suggests that allocating at least 20% of a portfolio to international stocks and bonds can enhance diversification and improve risk-adjusted returns. This lesson highlights the importance of educating investors about the benefits of including international assets in their investment strategies.

Europe has a well-established mutual fund industry with a strong emphasis on investor protection and regulatory oversight. The implementation of the Undertakings for the Collective Investment in Transferable Securities (UCITS) framework across European Union member states demonstrates the commitment to uniform regulations for investment funds. India can learn from Europe's focus on investor protection and the importance of a robust regulatory framework.

***Below are the rankings of countries where the AUM to GDP percentage is the highest in the world.***

| Country | AUM to GDP (%) | Rank in the World |
|---|---|---|
| Luxembourg | 8330.59% | 1 |
| Singapore | 998.32% | 2 |
| Ireland | 957.79% | 3 |
| Hong Kong | 575.72% | 4 |
| Australia | 185.10% | 5 |
| USA | 140.16% | 6 |
| Netherlands | 126.62% | 7 |
| Sweden | 104.54% | 8 |
| Switzerland | 99.61% | 9 |
| Canada | 97.56% | 10 |
| India | 15.84% | 36 |

*Source: TheGlobalEconomy.com*

This comparative analysis serves as a reference point to gauge the growth potential and aspirations of the Indian mutual fund sector, helping stakeholders envision the path towards a thriving future.

In addition to drawing lessons from the experience of mutual funds outside India, there are several other factors that India can consider to shape its mutual fund industry.

**Technology and Innovation:** Embracing technology and innovation can bring significant advancements to the mutual fund industry. India can leverage digital platforms, mobile applications, and online investment portals to enhance accessibility, convenience, and efficiency for investors. Robo-advisory services, online transaction capabilities, and data analytics can further streamline processes and improve customer experience.

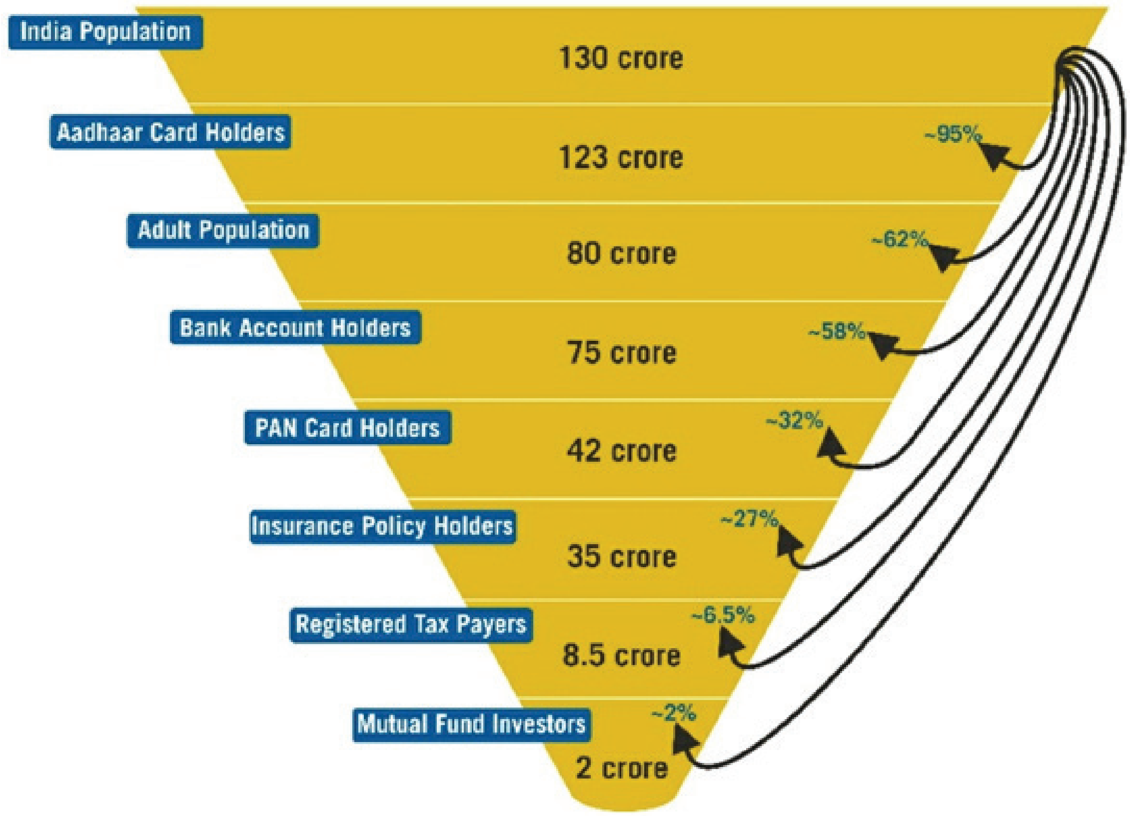
**Distribution Channels:** India can explore various distribution channels to expand the reach of mutual fund investments. This includes leveraging technology-driven platforms, partnering with financial institutions, and engaging with independent financial advisors to provide easy access to mutual funds for a wider range of investors. Emphasizing the use of digital channels can help reach investors in remote areas and promote financial inclusion.

**Cost-effectiveness:** India can work towards offering cost-effective mutual fund options. This includes minimizing expense ratios, reducing transaction costs, and providing low-cost investment opportunities for retail investors. By offering competitive pricing, India can make mutual fund investments more accessible and attractive, especially for small investors.

**Corporate Governance and Transparency:** Ensuring strong corporate governance practices and transparency within the mutual fund industry is crucial. India can focus on strengthening disclosure requirements, promoting ethical conduct, and establishing independent boards for mutual fund companies. Clear communication of fund performance, investment strategies, and fees can build trust and encourage long-term investor engagement.

**Collaborative Approach:** India can encourage collaboration between market participants, regulators, and industry associations to foster a healthy and vibrant mutual fund ecosystem. Regular dialogue, knowledge sharing, and collective efforts can drive industry growth, address challenges, and promote best practices.

The statistics highlight a significant potential that lies ahead, urging industry leaders to direct their attention towards the B30 category cities, encompassing Tier 2 and 3 cities in India. These cities are home to nearly 90 per cent of the country's population and contribute to approximately 16 per cent of the overall market. It is imperative that the industry extends its reach and support to these smaller cities, integrating them into its operations and initiatives.



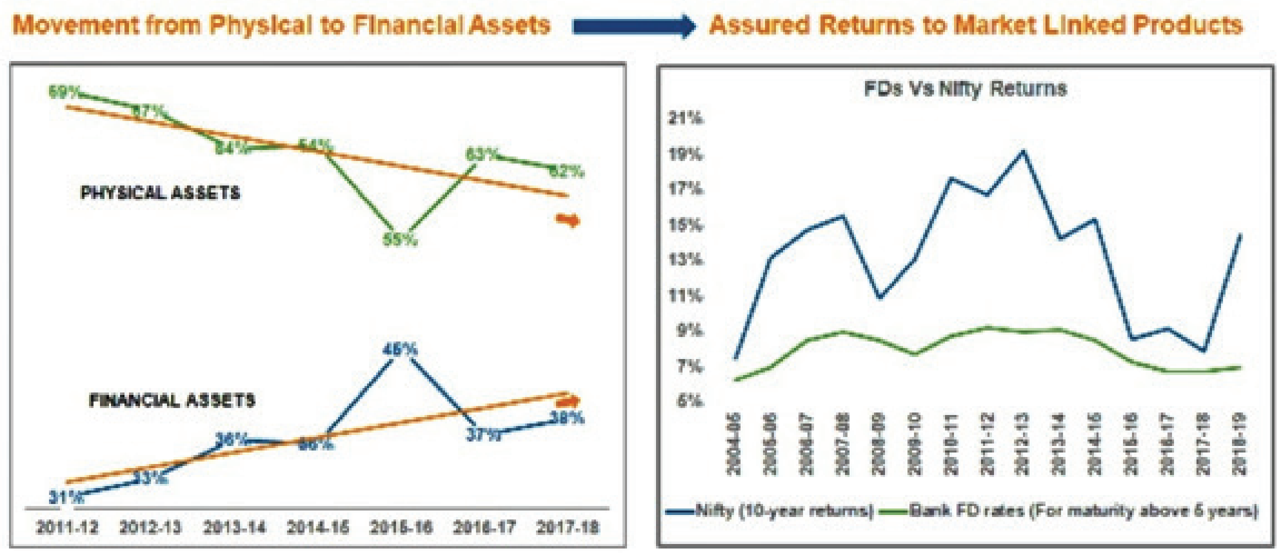

## Market Growth Potential

The mutual fund industry in India presents a compelling landscape of potential growth, characterized by remarkable opportunities. According to the comprehensive analysis conducted by Mordor Intelligence, the industry is projected to achieve a remarkable Compound Annual Growth Rate (CAGR) of 21.5% by 2027.

This surge is driven by a confluence of factors that synergistically contribute to its growth trajectory. Firstly, the burgeoning investments from both retail and institutional investors unequivocally signify an escalating appetite for mutual funds as a preferred investment avenue. Furthermore, the escalating digital penetration and the proliferation of user-friendly online platforms have engendered unprecedented convenience, enabling investors to seamlessly access and engage in mutual fund investments. The confluence of rising investments, digital prowess, and the government's unwavering support and initiatives aimed at bolstering financial inclusivity has nurtured an expansive investor base. Additionally, the industry's potential for product diversification and relentless innovation, exemplified by the advent of Exchange-Traded Funds (ETFs) and sector-specific funds, proffers investors an enticing assortment of risk-return profiles to align with their unique investment objectives.

The commendable regulatory environment, under the aegis of the Securities and Exchange Board of India (SEBI), has galvanized investor confidence through comprehensive reforms aimed at transparency, safeguarding investor interests, and fostering industry growth. As the industry navigates the dynamic terrain, fortuitous opportunities beckon, particularly in the realm of pension and insurance fund management, where mutual funds can deftly leverage their expertise to provide steadfast returns and cater to the exigencies of retirement planning and insurance needs.

Moreover, concerted efforts are being undertaken to amplify investor education, bridge knowledge gaps, and empower investors to make informed decisions. In light of these multifaceted factors, the mutual fund industry in India stands poised to traverse an upward trajectory, poised for robust growth and heralding a new era of investment prospects.




The above chart indicates a noticeable trend towards a shift from physical assets such as gold and real estate to financial assets. Additionally, there is a transition from traditional investment products to market-linked ones. In the present scenario, individuals are increasingly recognizing the importance of embracing some degree of market risk, particularly due to rising expenses and declining interest rates. Consequently, they are realizing that investment vehicles such as mutual funds provide a suitable avenue for effectively managing this risk and optimizing their returns.

Millennials make up one-third of our population. Recent findings reveal that they contribute 70 per cent of the total household income and represent 46 per cent of the workforce. Undoubtedly, this demographic presents significant growth potential.

Nevertheless, as the number of senior citizens grows, India is projected to have approximately 3.5 crore individuals in this age group by 2030. With the rise in life expectancy, the absence of social security, and increasing medical expenses, senior citizens require solutions that not only surpass inflation but also provide support during their retirement years. The opportunity lies in providing accumulation solutions to millennials and decumulation solutions to seniors, both of which are well-suited for mutual funds to accomplish.

# Chapter 5: The Pathway of Mutual Fund Industry

In the evolving landscape of customer expectations, there is a growing demand for integrated platforms that offer a seamless experience by bringing together various desired services. Industry experts anticipate that this trend will eventually blur the boundaries between retail e-commerce and fintech e-commerce. For example, a customer browsing a retail e-commerce platform may desire the flexibility to purchase a phone using their mutual fund assets as a form of currency. This convergence of services signifies a shift towards a more interconnected and customer-centric approach, where traditional boundaries between different sectors are transcended to meet the evolving needs and preferences of consumers.

With the widespread adoption of the Unified Payments Interface (UPI), customers now anticipate a unified payment experience that seamlessly facilitates fund transfers. In light of this expectation, the mutual fund industry may need to adapt and establish a cohesive system. For instance, imagine a scenario where a customer engages with a mutual fund company, and completes the necessary verification and Know Your Customer (KYC) process successfully. In such a situation, it is imperative that this customer can leverage the services of any other fintech company without having to undergo the KYC process repeatedly. This approach ensures that customers can enjoy a seamless and uninterrupted experience across various fintech entities, eliminating the need for redundant procedures and enhancing convenience.

The Mutual Fund industry in India is one of the fastest-growing markets in the world, with a CAGR growth of 17.5% over the past five years. The asset management industry is witnessing a transformative shift in the distribution landscape, as digital investment platforms and fintech firms continue to emerge, targeting retail investors. This wave of disruption has prompted asset managers to re-evaluate their retail distribution strategies, seeking innovation and adaptation. While digital channels provide new avenues for distribution, both retail and institutional sales teams must also reassess their reliance on selling proprietary funds and leverage external platforms that offer greater openness and transparency.

Failing to embrace this broader ecosystem could result in the loss of retail clients to more independent platforms, while institutional clients may seek more competitive alternatives. To strengthen their competitive position, asset management firms must be willing to explore partnerships with key market participants beyond the financial industry, tapping into untapped potential. While only a few innovative firms have embarked on this path so far, selecting the right partner will depend on factors such as market position, size, investment focus, brand value, and client base of each asset management firm. Adaptation and collaboration are key to shaping the future of distribution in the asset management industry.

*Here are the key factors that will have a positive impact on mutual funds and how they will shape the industry:*

## Economic Growth Transcending Previous Expectations:

The projected 11% growth in nominal GDP between FY 2021 and FY 2025 will benefit the mutual fund industry. The report highlights that economic growth, coupled with the increase in the middle-income population and financial savings, is expected to boost the industry in India.

## Financial Inclusion and investor education:

Regulatory and government initiatives to raise the masses' financial awareness will contribute to higher mutual fund penetration. Investor education, improved risk management, and transparency within the industry will enhance investor confidence, leading to increased investments and industry growth.

## Retirement planning and tax benefits:

Retirement planning remains an untapped market in India, presenting significant potential for mutual funds to improve household penetration. The report suggests that channelling retirement savings through mutual funds can help tap into this market. Additionally, the tax benefits offered by Equity-Linked Savings Schemes (ELSS) are expected to drive the growth of mutual funds as more individuals join the formal sector.

## Risk Factors Impacting the Growth of Mutual Funds in India

### Stamp duty:

The introduction of stamp duty of 0.005% on mutual fund purchases starting July 1, 2020, has become a hurdle for the industry. This duty increases transaction costs and has particularly impacted large corporates that invest in liquid funds for shorter periods.

### Competition from other financial instruments:

Unit-linked insurance products (ULIPs) pose strong competition to mutual funds. ULIPs offer the combined benefits of protection and long-term savings, thereby competing for market share within the financial industry.

### High cost of retail expansion:

Expanding into the B30 markets (smaller cities and towns) requires substantial investments in marketing and distribution. This expenditure may exert pressure on the profit margins of mutual fund houses.

Understanding and addressing these risks and challenges will be crucial for the sustainable growth and success of the mutual fund industry.

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## About ASSOCHAM

# The Knowledge Architect of Corporate India

The Associated Chambers of Commerce & Industry of India (ASSOCHAM) is the country's oldest apex chamber. It brings in actionable insights to strengthen the Indian ecosystem, leveraging its network of more than 4,50,000 members, of which MSMEs represent a large segment. With a strong presence in states, and key cities globally, ASSOCHAM also has more than 400 associations, federations, and regional chambers in its fold.

Aligned with the vision of creating a New India, ASSOCHAM works as a conduit between the industry and the Government. The Chamber is an agile and forward-looking institution, leading various initiatives to enhance the global competitiveness of the Indian industry, while strengthening the domestic ecosystem.

With more than 100 national and regional sector councils, ASSOCHAM is an impactful representative of the Indian industry. These Councils are led by well-known industry leaders, academicians, economists and independent professionals. The Chamber focuses on aligning critical needs and interests of the industry with the growth aspirations of the nation.

ASSOCHAM is driving four strategic priorities – Sustainability, Empowerment, Entrepreneurship and Digitisation. The Chamber believes that affirmative action in these areas would help drive an inclusive and sustainable socio-economic growth for the country.

ASSOCHAM is working hand in hand with the government, regulators, and national and international think tanks to contribute to the policy making process and share vital feedback on implementation of decisions of far-reaching consequences. In line with its focus on being future-ready, the Chamber is building a strong network of knowledge architects. Thus, ASSOCHAM is all set to redefine the dynamics of growth and development in the technology-driven 'Knowledge-Based Economy. The Chamber aims to empower stakeholders in the Indian economy by inculcating knowledge that will be the catalyst of growth in the dynamic global environment.

The Chamber also supports civil society through citizenship programmes, to drive inclusive development. ASSOCHAM's member network leads initiatives in various segments such as empowerment, healthcare, education and skilling, hygiene, affirmative action, road safety, livelihood, life skills, sustainability, to name a few.

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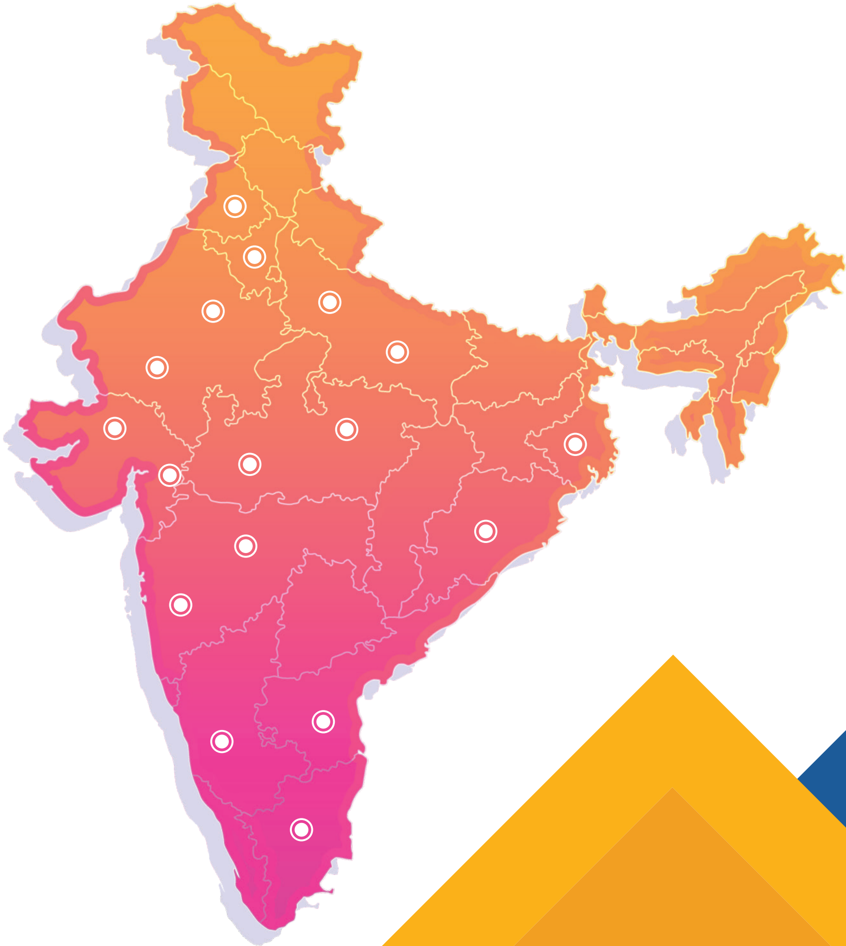

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