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Mutual Funds as a Tool for Financial Inclusion

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Abstract

Financial Inclusion includes delivery of not only core banking, but also other financial products and services like pension, insurance, mutual funds etc. delivered at affordable and though market driven costs to the lower income segments or rural communities. The importance of an inclusive financial system is widely recognized in policy circles and has become a policy priority in many countries. The challenge for the success of financial inclusion lies in the fact that the reach of financial products to villages and small towns has to be made convenient. The present paper throws a light on the concept of financial inclusion and how mutual funds can be an effective tool to achieve financial inclusion. As Mutual Funds pool the savings of retail investors and offer steady returns, is good way through which investors can enter the capital market and get financially included However, there are plenty of challenges ahead for the fund houses to approve this concept. But if there is broad agreement that appropriately regulated Mutual Fund activity can play a large part in financial development in all its dimensions, these barriers can surely be addressed in a collaborative way. The paper also provides suggestions for further improvements for mutual funds to aid financial inclusion.

Keywords: *Financial inclusion, Mutual Funds, Growth under Management.*

Introduction

India's economy has grown tremendously in the last decade. But one of the biggest challenges has been inclusive growth. Financial inclusion in particular has been limited even though the savings rate of 37 per cents is one of the highest in the world. The poor and the middle class find it difficult to access the financial sector and do not invest their savings in mainstream products. Traditional products and the banking channel have not been able to make much difference. There are about 600 million people who do not have a bank account and only 15 million invest in the Indian stock market. This shows that there is a huge gap between savings and its productive deployment. The government is trying its best to use the banking channel to deepen financial inclusion. Banks which have the largest customer base can become true catalysts to bring about financial inclusion. But banks alone will not be able to achieve this if we do not find alternative vehicles. Mutual funds, an indirect route for investment in the equity market, can effectively be used for the purpose of financial inclusion. Mutual funds have emerged as a key player of savings and investment in today's financial market. The role of mutual funds has gained importance due to increasing emphasis on well structured management of funds. Mutual funds, which are an instrument where the investment required is low and any salaried person or person with limited income, can invest. Mutual funds are considered ideal for entering the capital market as they have low risk, offer high returns, no long-term taxation, high liquidity and safety of capital.

Literature Review

Nair. R (2014) study covers the institutional set up and performance of mutual fund. The study shows that total asset management of mutual fund is on the rise. It is a powerful tool and financial product to mobilize scattered savings among investors and channelize this fund to infrastructural development and thereby economic development of the country.

Dr. B. Amarnath; Dr. S. Raghunatha Reddy; Mr. Thulasi Krishna.K(2012) covers the concept of financial inclusion and its benefit for inclusive growth and showed that role of mutual fund in promoting savings is insignificant. The introduction of daily and weekly SIP by fund houses has helped attract smaller-ticket size customers. The paper also highlighted challenges for mutual fund industry. Some of these have to do with penetration, others with the preferences of investors, particularly with respect to duration, some more with legitimate regulatory concerns about systemic risk and yet others with gaps or imbalances in the broader regulatory framework. Vyas (2012) suggested the ways to penetrate deep in the Indian society through the mode of mutual fund. He also gave some suggestions to the investors regarding investments. The investor should have a habit of regular saving and must invest a reasonable part of investment in to liquid security so as to meet any contingency. But in order to maintain their confidence in mutual funds they should be provided with timely information relating to different trends in the mutual fund industry (Saini; Anjum ; Saini,2011).

Objectives

Study the concept of mutual funds.

Analyze how mutual funds can aid financial inclusion.

Throw light on constraints for Financial Inclusion through Mutual Fund.

Financial Inclusion

Financial inclusion ensures access to appropriate financial products and services needed by people which belongs to low income sections and rural communities at an affordable cost in a fair and transparent manner by institutional players. It has become one of the most critical aspects in the context of inclusive growth and development of a country like India. Several countries across the globe now look at financial inclusion as the means to more comprehensive growth, wherein each citizen of the country is able to use earnings as a financial resource that can be put to work to improve future financial status and adding to the nation's progress. Financial regulators like SEBI and RBI, government and banking sector has come forward to take initiatives for financial inclusion. Banking sector has an important role to play in the promotion of financial inclusion. An inclusive financial system means a system that recognizes both the market potential and the development opportunities.

Mutual Fund and its Growth

A Mutual Fund is a trust that collects money from investors who share a common financial goal, and invest the proceeds in different asset classes, as defined by the investment objective. In a simple language, mutual fund is a financial intermediary, set up with an objective to professionally manage the money pooled from the investors at large. By pooling money together in a mutual fund, investors can enjoy economies of scale and can purchase stocks or bonds at a much lower trading costs compared to direct investing in capital markets.

Mutual fund is one of the investment avenues which provide a number of alternative schemes for the small investors to participate indirectly in the capital market. It is a fast growing segment of the Indian financial market and it provides a variety of schemes to suit the needs and risk return profile of different categories of investors. It is also an alternative source of investment for small and medium scale investors. The rapid growth of mutual funds indicates the need for a deeper look into the performance of the mutual funds, taking into account the expectations of the investors from the capital market. Mutual funds are the most important among the newer capital market institutions. Several public sector banks and financial institutions have set up mutual funds on a tax exemption basis, virtually on the same footing as the Unit Trust of India.

Table 1 Growth of Assets under Management

Year	AUM
October 2017	11630549
March 2017	1829584
March 2016	1353443
March 2015	1188690

March 2014	905120
March 2013	816657
March 2012	664792
March 2011	701258
March 2010	613979
March 2009	417300
March 2008	505152

The Table 1 shows the significant progress of mutual funds. The last ten plus years was the booming period of mutual fund business in India. The total asset management of Mutual fund business in India during the year of 2015 was rupees 1188690 crores which increased to 1353443 crores in 2016. The trend shows the positive growth and increasing tendency of assets management under mutual fund business in India. Indian mutual funds are playing a vital role in the resource mobilization from small and medium investors.

Role of Mutual Fund

Mutual Funds have contributed significantly when it comes to shaping our economy. The Indian financial market has seen great rise in the early years of eighties and nineties. And Mutual Fund investments have primarily acted as a bridge to connect the void between the supply and demand of the funds in the financial markets. Efficiency, stability, transparency and inclusion, the four critical attributes of financial system play a significant role in the process of financial sector development. Therefore, there is an emergence of intermediation mechanisms and products that will help in improving one or more of these attributes without causing others to weaken. From this perspective, mutual funds play an important role in development of financial system. By pooling funds of small investors into a common corpus and investing in financial markets, they help in financial inclusion. Mutual fund houses being professionally managed by a group of experts, the investment decision is made in a more rational manner on the basis of analysis of risk and returns of individual investment avenue helping to achieve financial stability. These entities being operated under the close scanner of market regulators, it ensures transparency in investment strategies.

Let's break down the role and contribution of Mutual Fund investment in India :

(A). Forefront in helping the development of the financial sector:

The mutual fund industry has been developing at great speed of nearly 20% per year over a last decade. Naturally it has significantly contributed to the development of the financial sector of India. Mutual fund investments pool resources from investors – small or big – and thus increase the participation in the market. Also, with good return generation attracts new investors to invest and for old ones to reinvest.

(B). It has become a major source of investment:

Investing in mutual funds have become hugely popular since 2003. To add to it and bring awareness among investors and non-investors alike, AMFI (Association of Mutual Funds in India) has started 'Mutual Funds Sahi Hai' campaign. It is interesting to see that majority of the salaried population of India tends to invest in Mutual Funds. One of the major reasons behind it is the diversification of the fund schemes that allows more investors to come in and invest. Also, investing Mutual funds provide tax exemption for the salaried class and thus, they opt towards investing in Mutual funds.

(C). House Hold Savings in Investments: Since last year, mutual funds have been leading light in the investment sector. A large amount of money funneled in Mutual funds is from the household savings. Investors are gradually opting for Mutual funds over investing in physical assets. The net inflows into equity market are touching the degree that was previously observed.

Strategy for financial inclusion through mutual funds

The increasing awareness amongst investors about mutual fund products and the change in the commission structure for mutual fund distributors is leading to a discernible shift in the product mix being sold to customers today. There has been a significant increase in the inflows in Systematic Investment Plans (SIP), and the introduction of daily and weekly SIP by fund houses has helped attract smaller-ticket size customers, now many financial advisors have started advising retail investors of investing in Fixed Maturity Plans as compared to bank fixed deposits. India Post is using its low cost service along with other strategic partners like Mutual fund and Insurance companies to spread reach to rural communities and low income households through different awareness campaign. Since many banks are offering Insurance and mutual fund products, financial inclusion gives opportunities to cross sell these products and earn fee based income. Mutual funds have their independent financial advisors which ensure that the products reach the masses.

On 6 October 2017, the Securities and Exchange Board of India (SEBI) issued a circular in order to rationalize and categories open-ended mutual fund schemes in India. SEBI's circular on mutual fund scheme categorization and rationalization aims at decluttering the existing industry by simplifying mutual fund investments for investors and enhancing comparability within the schemes offered. This is a positive step towards scheme rationalization and it will act as a catalyst for the growth of the mutual funds industry.

Constraints for Financial Inclusion through Mutual Fund

In India, a large number of national and regional initiatives have taken place to promote financial inclusion. However, despite significant contributions made over the years to improving access to financial services for the poor and for micro enterprises and concerted attempts by all stakeholders, financial inclusion still remains a challenge, particularly in the low income states of India. There are some reasons which act as a constraint for financial inclusion through mutual funds which are discussed as follows :

- The foremost reason for not investing in mutual funds is the lack of trust and knowledge about the concept. The lack of awareness among the rural and semi-urban investors curtails the growth of the mutual fund industry in these areas. Thus the reach of financial products to villages and small towns has to be made convenient.
- Bank deposits are considered the biggest competition to mutual fund products. With complete safety, assured returns and liquidity, bank deposits are the first preference of households. The Asset under Management of the mutual fund industry is only 9% of the total bank deposits in India.
- The expansion of the Mutual fund industry in the rural areas in India is hindered by the fact that it would require a lot of investment in infrastructure and thus would require huge resources.
- Taxes-Every year, most of the mutual funds sell substantial amount of their holdings. If they earn profit by this sell, then the investors receive the Profit Income. For most of the mutual funds, the investors are bound to pay taxes on these incomes, even if they reinvest the income.
- Costs- Most of the mutual funds charge shareholder fees and fund operating fees from the investors. In the year, in which mutual fund fails to make profit and the investors get no return, these fees only blow up the losses.
- The Issue of Fluctuating Returns- In spite of being a diversified investment solution, mutual funds investment in no way guarantees any return. If the market prices of major shares and bonds fall, then the value of mutual fund shares are sure to go down, no matter how diversified the mutual fund portfolio be. But, every time a person invests in mutual fund, he unavoidably carries the risk of losing money.

- When compared to the foreign mutual fund industry, the schemes offered by the Indian mutual funds are very few and do not suit all the requirements of the investors. Mutual funds in developed countries like the United States of America and the United Kingdom offer diversified products.
- The mutual fund industry is a distributor-driven business where the distributor is the first point of contact for the investor. According to the data, there are around eight lakh agents in the insurance industry and four lakh agents in the direct marketing of the Fast Moving Consumer Goods industry whereas there are only around 52,000 agents in the mutual fund industry. Thus, it faces the problem of a poor distribution networks.
- Lack of clarity about the risks associated with new and existing schemes, poor transparency in the computation of the Net Asset Value (NAV) and lack of marketing efforts on the part of the mutual fund firms are the other issues that keep the investors away from mutual funds.

Suggestions to Improve Mutual Funds to Aid Financial Inclusion

There is a scope for extending the reach of mutual fund industry in India through investor's education, awareness building program and use of IT to untouched area or segments. Fund houses need to conduct more and more investors' awareness program every month.

Systematic Investment plan (SIP) could be discussed with rural people where there are daily and weekly SIP by fund houses to attract many retail small segment customers. Awareness campaign should be organized by Government and mutual fund companies in association with Panchayat. The mutual fund schemes and the rules and regulations should be discussed in such a manner that could be understood even by a lay man. The perception or mindset of the low income people or rural communities should be changed so that rural India could become rich.

India is a country where the farmers in majority of areas are dependent on monsoon for agriculture growth and thus there earning depend on monsoon season. Hence the farmers could be a potential target group of customers for mutual fund companies. Mutual fund could prove as a good investment options if there is a natural disaster i.e. failure of monsoon season. Mutual fund companies in association with SEBI should try to focus on creating a scheme or financial product for farmers which could protect them against financial stress due to monsoon season failure.

Two key drivers for mutual fund industry's growth will be financial inclusion and financial advisory. Deeper penetration in tier 1 and tier 2 cities and focusing on small and medium income investors would increase the investor base. Mutual fund advisors must do in-depth research of the market to explain the differentiator(s) which make the product being advised as better than the others in the fray. After all, investors want facts, not fiction. Advisors should monitor clients' portfolio performance, help change asset allocation strategies when appropriate, and stay alert for major changes in the markets. By going beyond just product selling, advisors will be able to enhance customer loyalty and create real financial value for customers.

There must be more initiatives from AMCs in the areas of cost competence, product design and positioning, alternative distribution models, revenue diversification and capacity creation.

Conclusion

Mutual Funds pool the savings of retail investors, the financial inclusion concept may be adopted experimentally. However, there are plenty of constraints for the fund houses to implement this concept in an effective manner. The paper concludes that if there is broad agreement that appropriately regulated Mutual Fund activity can play a large part in financial development in all its dimensions, these barriers can surely be addressed in a collaborative way between the three stakeholders – the investors, the fund managers and the regulators. Mutual Funds clearly have a significant role to play in financial development. It is the high time for Asset Management Companies to tap the low-income groups especially in rural areas by devising appropriate schemes for them. There is an opportune time for the industry to learn and experience from the past mistakes and develop a roadmap through a collaborative effort across all stakeholders to achieve sustained economic growth through financial inclusion. The regulator through its recent proposals and announcements has given a much needed boost to the mutual fund sector, but the industry is still waiting for an enduring initiative that will put this sector amongst the most favored instruments of investment.

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