Global Financial Crisis and Its Impact on Mutual Fund Industry in India

V. Sornaganesh¹, R. Thangarani²
¹, ²Assistant Professor
¹V.O. Chidambaram College
Tuticorin-8, Tamil Nadu
²Kamaraj College (Self Finance)
Tuticorin-3, Tamil Nadu

Abstract
The U.S. financial crisis has made its upshots on both developed and developing economies of the world. However, developing countries like India did not face a full-blown recession, but only experienced an economic deceleration, which is normally considered as a temporary phenomenon. Small savings of individuals should be channelized into capital formulation for the growth of the economy. There are many financial engines like banks, financial institutions, mutual funds, primary capital markets, NBFI, FIIs etc. that are functioning for boosting the economy. Besides banks and financial institutions, Mutual Fund Companies also have a great impact on the investment in the economy. This present paper is an attempt to study the U.S. financial crisis and its impact on mutual fund investments in the Indian economy and their investment performance in equity as well as in debts.

Keywords: Certificate of Deposits, Commercial Paper, Global Financial Crisis, Liquidity Adjustment Facility, Non-Banking Financial Companies, Subprime Mortgage

1 Introduction
The U.S. financial crisis has had its aftershock on both-the-developed and the developing world. This is because the whole world largely depends on the mighty U.S. for their economic activities. The USA constitutes an average 24 percent of the world GDP. Above all, it is the world’s largest exporter, importer, and of course investor in the global financial market. So, the crisis that primarily happened in the U.S. economy was immediately transmitted to its integrated economies, which finally hit their industrial as well as financial markets alike. India is also now closely linked to the world economy by trade in goods as well as trade in services, including investments and its economy is more sensitive to changes in international demands, on account of which the crisis across the globe are bringing in multifarious impact on various sectors of the Indian economy. What impact the crisis might have had on a sector can easily be
traced out from the performance of its corporate firms. In this paper, we made an attempt to investigate the impact of the global financial crisis on mutual funds of the country. An effort is also made to identify whether there are any firm-level differences in receiving the reverberations of the global crisis by a particular sector or in other way, whether the fundamental strength inherent in a firm itself is immune to the crisis.

2 The Genesis of the Financial Crisis

The crisis began with the bursting of the United States housing bubble and high default rates on “subprime” and adjustable-rate mortgages (ARM) beginning in approximately 2005-2006. For a number of years prior to that, declining lending standards (especially reduction of interest rate), an increase in loan incentives such as easy initial terms, and a long-term trend of rising housing prices encouraged borrowers to assume difficult mortgages in the belief they would be able to quickly refinance at more favorable terms. The U.S Fed fund interest rate (base interest rate of the U.S. monetary system) has been showing much volatility for the last 10 years. It fell down from the highest point of 6.53 percent in June 2000 to a low of 1 percent by March 2004, which completed its first phase of cyclical change.

Again, it started to increase and reached a subsequent high of 5.6 percent in March 2007. Once interest rates began to rise, and housing prices started to drop moderately in 2006-2007 in many parts of the U.S., refinancing became more difficult. Defaults and foreclosure activity increased dramatically as easy initial terms expired, home prices failed to go up as anticipated, and ARM interest rates reset higher. Foreclosures accelerated in the United States in late 2006 and triggered a global financial crisis through 2007 and 2008. Then, US central bank intervened to restore equilibrium in the market by slashing interest rates, and as a result, Fed fund rate dropped to an ever-time low of 0.12 percent by the end of 2009. The unsteady monetary policy of the country during such a short interval itself forewarned of the miserable days in the near future.
Who can be blamed for the credit crunch of the US financial crisis? Was it due to the unwise and non judicious polices of the U.S. Central bank and other govt. machinery, or due to the imprudent financial practices adopted by U.S. banks and financial institutions in performing their financial functions? The answer is both. When the Federal Reserve and other Government machinery of U.S. failed to control the bane of financial capitalism through proper monetary measures, the governance system of its financial market collapsed, which made it more asymmetric in terms of information efficiency. Valuation of assets based on future earnings done by third party agencies for deciding lending standards and very liberal but dodgy formalities followed by the financial institutions for advancing loans to their customers – all these factors lead to bursting of the housing bubble – “the most significant risk of the U.S. economy”. Integration of investment banking with commercial banking made the banks and other financial institutions more exposed to stock market imperfections. Loss of value of their investments due to the volatility of the bourses was a double shock for these financial institutions, who had already sustained losses due to the default in payment of loans by their customers.

5 Scope and Objectives
The present paper is based on secondary data. This paper attempts to analyze total resource mobilization by the mutual funds for last five years period i.e., 2006-07 to 2011-12. Major objectives of this paper are:-

1) To analyze total number of schemes under mutual funds
2) To analyze sector-wise as well as nature-wise resources mobilized by mutual fund industry
3) To analyze percentage-wise share of each sector and category in total resources mobilization
4) To calculate overall growth rate in order to show trends in total resources mobilization.
5) To analyze the situation of global financial crisis and its impact on Indian economy

4 Global Financial Crisis and Its Impact on Mutual Fund Industry in India
In September 2008 Global Financial Crisis has put more pressure for this industry because of funding interlink ages among NBFCs, mutual funds and commercial banks. The ripple effect of the turmoil in American and European markets led to liquidity issues and heavy redemption pressure on the mutual funds in India, as several investors, especially institutional investors, started pulling out their investments in liquid and money market funds. Mutual funds being the major subscribers to Commercial Papers and debentures issued by NBFCs, the redemption pressure on MFs translated into funding issues for NBFCs, as they found raising fresh liabilities or rolling over of the maturing liabilities very difficult. Drying up of these sources of funds along with the fact that banks were increasingly becoming risk averse, heightened their funding problems, exacerbating the liquidity tightness. RBI undertook many measures, both conventional as well as unconventional, to enhance availability of liquidity to NBFCs such as allowing augmentation of capital funds of NBFCs through issue of Perpetual Debt Instruments (PDIs), enabling, as a temporary measure, access to short term foreign currency borrowings under the approval route, providing liquidity support under Liquidity Adjustment Facility (LAF) to commercial banks to meet the funding requirements of NBFCs, Housing Finance Companies(HFCs) and Mutual Funds, and relaxing of restrictions on lending and buy-back in respect of the certificates of deposit (CDs) held by mutual funds.
In developing countries like India, there is a great need of investments in the economy. Small savings of individuals should be channelized into capital formulation for the growth of the economy. There are many financial engines like banks, financial institutions, mutual funds, primary capital markets, NBFI, FIIs etc. that are functioning for boosting the economy. Besides banks and financial institutions, Mutual Fund Companies also have a great impact on the investment in the economy. This present paper is an attempt to study the global financial crisis and its impact of mutual fund investments in the Indian economy and their investment performance.

6 Performance of Mutual Funds:

In this paper, an attempt has done to measure performance of mutual funds in terms of schemes, sector-wise and category-wise resource mobilization as shown in tables 1 to 3 respectively.

Table 1: Total number of schemes under mutual funds

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth</th>
<th>ELSS</th>
<th>Income</th>
<th>Balance</th>
<th>Gilt</th>
<th>Liq/MMF</th>
<th>ETF &amp; FF</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-07</td>
<td>227 (30)</td>
<td>40 (5.29)</td>
<td>367 (48.54)</td>
<td>38 (5)</td>
<td>28 (3.70)</td>
<td>55 (7.27)</td>
<td>1 (0.2)</td>
<td>756 (100)</td>
</tr>
<tr>
<td>Mar-08</td>
<td>270 (28.24)</td>
<td>42 (4.39)</td>
<td>506 (52.92)</td>
<td>37 (3.87)</td>
<td>30 (3.13)</td>
<td>58 (6.06)</td>
<td>13 (1.35)</td>
<td>956 (100)</td>
</tr>
<tr>
<td>Mar-09</td>
<td>293 (29.27)</td>
<td>47 (4.69)</td>
<td>509 (50.85)</td>
<td>35 (3.49)</td>
<td>34 (3.39)</td>
<td>56 (5.59)</td>
<td>27 (2.69)</td>
<td>1001 (100)</td>
</tr>
<tr>
<td>Mar-10</td>
<td>307 (34.80)</td>
<td>48 (5.44)</td>
<td>367 (41.60)</td>
<td>33 (3.74)</td>
<td>35 (3.96)</td>
<td>56 (6.35)</td>
<td>36 (4.08)</td>
<td>882 (100)</td>
</tr>
<tr>
<td>Mar-11</td>
<td>328 (29)</td>
<td>48 (4.24)</td>
<td>591 (52.25)</td>
<td>32 (2.82)</td>
<td>37 (3.27)</td>
<td>51 (4.50)</td>
<td>44 (3.89)</td>
<td>1131 (100)</td>
</tr>
<tr>
<td>Mar-12</td>
<td>303 (23.14)</td>
<td>49 (3.74)</td>
<td>775 (59.20)</td>
<td>30 (2.29)</td>
<td>42 (3.20)</td>
<td>55 (4.20)</td>
<td>55 (4.20)</td>
<td>1309 (100)</td>
</tr>
<tr>
<td>Overall Growth Rate</td>
<td>33.48</td>
<td>22.5</td>
<td>111.17</td>
<td>-21.05</td>
<td>50</td>
<td></td>
<td>5400</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Compiled and calculated from the data presented in AMFI publication

Note: 1. Figures in brackets are percentage to total.
2. Figures in brackets for the last raw (Overall growth rate) are indices with the
Base year is considered March 2007 at 100. Table 1 shows:

1. Exchange traded funds have shown the highest overall growth rate (5400%) followed by Income scheme (111.17%).
2. Income fund is the 1st rank since March 2007 to March 2012.
3. Balance scheme have shown negative overall growth rate (21.05%).

Table 2: Sector-wise total resources mobilized by mutual fund industry (Rs. In Crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Unit Trust of India</th>
<th>Public Sector</th>
<th>Private Sector</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-07</td>
<td>35488 (10.88)</td>
<td>28725 (8.81)</td>
<td>262175 (80.31)</td>
<td>326388 (100)</td>
</tr>
<tr>
<td>Mar-08</td>
<td>48983 (9.10)</td>
<td>46583 (8.65)</td>
<td>442942 (82.25)</td>
<td>538508 (100)</td>
</tr>
<tr>
<td>Mar-09</td>
<td>48754 (9.89)</td>
<td>55351 (11.22)</td>
<td>389180 (78.89)</td>
<td>493285 (100)</td>
</tr>
<tr>
<td>Mar-10</td>
<td>80218 (10.73)</td>
<td>92515 (12.37)</td>
<td>574792 (76.90)</td>
<td>747525 (100)</td>
</tr>
<tr>
<td>Mar-11</td>
<td>67189 (9.59)</td>
<td>66804 (9.53)</td>
<td>566545 (80.88)</td>
<td>700538 (100)</td>
</tr>
<tr>
<td>Mar-12</td>
<td>58922 (8.86)</td>
<td>66554 (10.01)</td>
<td>539316 (81.12)</td>
<td>664792 (100)</td>
</tr>
<tr>
<td>Overall growth rate</td>
<td>66.03</td>
<td>131.69</td>
<td>105.7</td>
<td>103.68</td>
</tr>
</tbody>
</table>

Source: Compiled and calculated from the data presented in AMFI publication
Note: 1. Figures in brackets are percentage to total
2. Figures in brackets for the last row (Overall growth rate) are indices with the

Base year is considered March 2007 at 100.

Table 2 shows:

1. Public sector has shown the highest overall growth rate 131.69%
2. Share of Private sector mutual funds have maintained the 80% level of the total mobilization of funds since March 2007.
Table 3: Category-wise resources mobilization by mutual funds

(Rs. In Crores)

Source: Compiled and calculated from the data presented in AMFI publication

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth</th>
<th>ELSS</th>
<th>Income</th>
<th>Balanced</th>
<th>Gilt</th>
<th>Liq/MM</th>
<th>Gold ETF</th>
<th>Other ETF</th>
<th>Fund of Funds</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar-07</td>
<td>113386</td>
<td>10211</td>
<td>119322</td>
<td>9110</td>
<td>2257</td>
<td>72006</td>
<td>96</td>
<td>-</td>
<td>-</td>
<td>326388</td>
</tr>
<tr>
<td>Mar-08</td>
<td>156722</td>
<td>16020</td>
<td>220762</td>
<td>16283</td>
<td>2833</td>
<td>89402</td>
<td>483</td>
<td>2647</td>
<td>-</td>
<td>505152</td>
</tr>
<tr>
<td>Mar-09</td>
<td>95817</td>
<td>12427</td>
<td>197343</td>
<td>10629</td>
<td>6413</td>
<td>90594</td>
<td>136</td>
<td>660</td>
<td>2681</td>
<td>416700</td>
</tr>
<tr>
<td>Mar-10</td>
<td>174054</td>
<td>24066</td>
<td>311715</td>
<td>17246</td>
<td>3395</td>
<td>78094</td>
<td>1590</td>
<td>957</td>
<td>2862</td>
<td>613979</td>
</tr>
<tr>
<td>Mar-11</td>
<td>169754</td>
<td>25569</td>
<td>291975</td>
<td>18445</td>
<td>3409</td>
<td>73616</td>
<td>4400</td>
<td>2516</td>
<td>2516</td>
<td>592250</td>
</tr>
<tr>
<td>Mar-12</td>
<td>158432</td>
<td>23644</td>
<td>290844</td>
<td>16261</td>
<td>3659</td>
<td>80354</td>
<td>9886</td>
<td>1607</td>
<td>2530</td>
<td>587217</td>
</tr>
<tr>
<td>Overall</td>
<td>39.73</td>
<td>131.55</td>
<td>143.75</td>
<td>78.49</td>
<td>62.11</td>
<td>11.6</td>
<td>10197</td>
<td>-0.39</td>
<td>-0.051</td>
<td>-</td>
</tr>
</tbody>
</table>

Note: 1. Figures in brackets are percentage to total
2. Figures in brackets for the last raw (Overall growth rate) are indices with the

Base year is considered March 2007 at 100.

Table -3 shows:-

1. Gold ETF have shown the highest overall growth rate of 10197% during the study period followed by Income funds 143.75%.
2. The Other ETF have shown the highest overall negative growth rate (-) 0.39%, which is followed by Fund of funds (-) 0.051%.
3. Growth funds which were having the largest share with 37% in March 2007, now at present Income fund which is having the largest share with 50% in March 2012.

The last two years were sluggish in mobilization of resources due to slow down in capital market.
7 Conclusion

On the basis of above analysis, it can be concluded that Gold ETF, Income schemes and ELSS have shown growth during the study period due to consistent inflation rate for the former and for the later for tax benefits. In September 2008 Global Financial Crisis has put more pressure for this industry because of funding interlink ages among NBFCs, mutual funds and commercial banks. The ripple effect of the turmoil in American and European markets led to liquidity issues and heavy redemption pressure on the mutual funds in India, as several investors, especially institutional investors, started pulling out their investments in liquid and money market mutual funds. RBIs measures help the financial system strong and resilience during crisis. In terms of resources mobilization, Income schemes and Growth schemes have emerged as the most popular schemes among investors and these two schemes account for more than 70% of the resources. Among various sectors operating mutual fund industry, Private sector mutual funds have become the most prominent players in the industry. Among the various schemes introduced during the study period Income and Growth schemes have account for more than 70%. For their orderly growth, it should be remembered that investors’ interest should be protected and they should not be prejudiced after investments made by them. The investment, services of higher order and equity should be guaranteed besides regular, timely payment of interest and principal according to promise made.

8 References

[1] Bhalla V.K., Investment Management, S. Chand & Company Ltd., 2007,


