MUTUAL FUND INDUSTRY IN INDIAN: CHALLENGING THE STATUS OF GLOBAL PERSPECTIVES.

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Abstract
The Indian mutual fund industry is passing through a transformation. The Mutual Fund Industry spanning almost two decades now has seen its share of success and failure. On one side it has seen a number of regulatory developments while on the other the overall economy is just recovering from the global crisis of 2008. India is undoubtedly emerging as the next big investment destination, riding on a high savings and investment rate, as compared to other Asian economies. As per a report authored by PwC "The World in 2050", the average real GDP growth in India was likely to be in the range of 5.8% between 2007-50, (the actual average GDP growth between 2007-10 has been 7.6%) with per capita income rising to USD 20,000 from the current USD 2,932. Over 50 per cent of the population is less than 25 years of age, with the proportion of working population likely to increase significantly over the next decade. In this article I describe the Background and Objective, the Global Perspectives, Financial Inclusion, Tax Incentives and Conclusion.

Key Words: Mutual Fund, Tax, AUM, Global, Financial Inclusion.

INTRODUCTION

The trend of rising personal incomes has been witnessed not only amongst the young population, but also the high net worth (HNI) segment, which have sizeable sums to invest. One estimate indicates that there are more than 120,000 dollar millionaires in India and the number is increasing. The house-hold segment therefore proffers immense scope for attracting investments. India has a strong middle class of 250-300 million, which is expected to double over the next two decades.

It is in the backdrop of some of these encouraging statistics that the Indian mutual fund industry has fostered itself. Since the 1990's when the mutual fund space opened up to the private sector, the industry has traversed a long path, adapting itself continuously, to the changes that have come along. Growth in **Assets Under Management** (AUM) experienced has been unprecedented, growing at a CAGR (Compound Annual Growth Rate) of 28% over the last four years, slowing down only over the last two years, as a fallout of the global economic slowdown and financial crisis. Although investor confidence was significantly eroded and AUMs suffered a dent, the sale of mutual funds has revived over the last few quarters, which implies regained confidence of investors, striving to look at alternate investment opportunities and any attendant higher returns, though the markets continue to be choppy.

It has been a little over 20 years since the asset management industry was opened up to the entry of new players. The objective was to expand the business by widening and deepening the market for asset management products. The inclusion of asset management products in the basket of traditional investment avenues such as cash-in-hand, corporate and fixed deposits (FDs), savings accounts, stocks and gold was expected to occur over time. The mid-90s saw the emergence of stock investment trends with large-scale retail investments in the primary and secondary Stock Markets. The IPO boom of the early 90s saw retail investors opting to invest a significant portion of their investible surpluses in the stock markets. The enhanced liquidity chasing stocks correspondingly saw a surge in the BSE Sensex from under 2000 in 1992 to around 5000 as on 31 March 2000. The same period also saw the asset management industry expand rapidly in terms of number of schemes, products and companies. Considering the industry is still relatively young, its evolution and growth over the two decades is impressive. This is true in all aspects and not just about the scale of growth of assets under management (AuM). It applies to the creation of evolved products as well as the human capital and skill development.

The regulatory regime kept pace with the changing environment and the AuM of the asset management industry grew from 470 billion INR in 1993 to 1396 billion INR in 2004 and to 8252 billion INR in 2014.

AUM Growth from 1965 March to 2014 March:

Year	In 000 million INR
March - 1965	0
March – 1987	46
March - 1993	470
March - 2000	1130
March - 2002	1006
March -2004	1396
March -2006	2319

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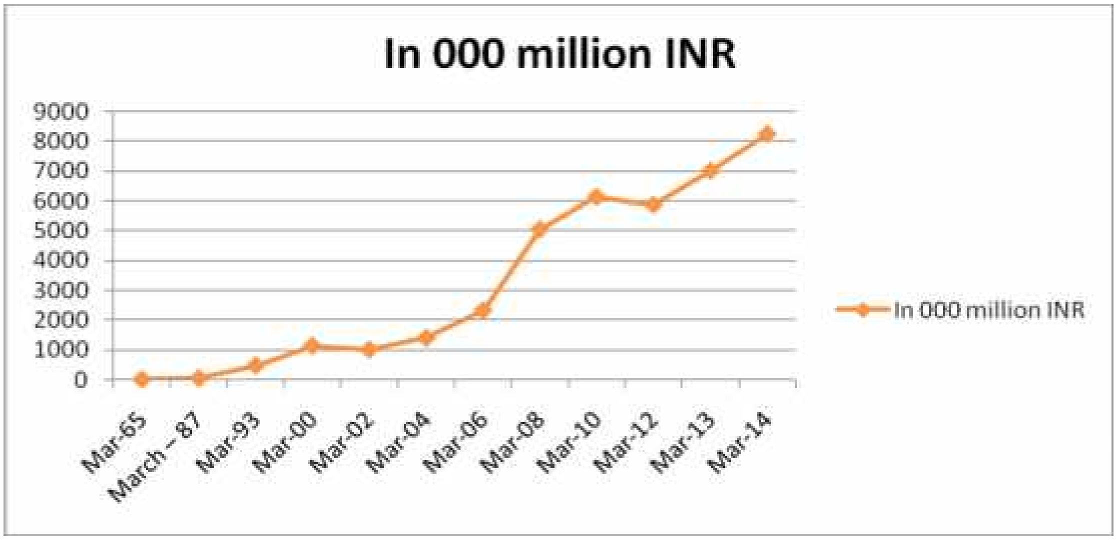
March -2008	5052
March - 2010	6140
March -2012	5872
March - 2013	7014
March - 2014	8252

Sources: PricewaterhouseCoopers Pvt. Ltd.



In today's volatile market environment, mutual funds are looked upon as a transparent and low cost investment vehicle, which attracts a fair share of investor attention, helping spur the growth of the industry. Over time, inclusive growth across the financial sector seems to have taken centre-stage, re-designing all business strategies around this sole objective. The mutual fund industry being no exception, various measures are being taken by fund houses and distributors to spread access and reach to the semi-urban and rural segments. Clearly, the role of technology as a growth enabler has assumed enhanced responsibility in this respect, to enable improved reach, inclined towards efficient distribution.

The landscape of the financial sector in India is continuously evolving, accredited to regulatory changes being undertaken, which is leading market participants like the asset management companies (AMCs) and distributors to restructure their strategies and adopt business models which will yield sustainable benefits. Some of the other trends which have emerged strongly over the past year are heavy outflows triggered by market volatility and partnering of asset management companies with banks, to increase the strength of distribution networks.

It is worthwhile at this point to take note of some of the business and regulatory trends taking shape across the global economies, which might cast a shadow on the Indian markets. Developments on aspects of entry load, management fees paid to asset management companies, regulation of distributors and taxation of mutual funds from the investor point of view, are some of the areas which deserve to be given attention.

The road ahead for the mutual fund industry will be paved by the performance of the capital markets. But, more importantly, it remains to be seen, how fund houses adapt themselves to changes in regulations, thereby shaping growth for the future. A continuously evolving regulatory framework makes it mandatory for the industry to elicit a clear growth path, making it easier to assess obstacles and tide over them with time. It remains to be seen, how the industry progresses towards achieving its growth vision for 2015.

THE GLOBAL PERSPECTIVE

Industry ecosystem: There is rich diversity in the sector as the assets management industry offers a mix of traditional mutual fund products and alternatives (real estate and hedge funds). The investor universe that the industry taps covers insurance funds, pension funds; sovereign wealth funds (SWFs) and high net worth individuals (HNWIs) /mass affluent/retail investors. In 2012, the global asset management industry managed 36.5% of the assets held by pension funds, SWFs, insurance companies and HNWIs/ mass affluent. This represents a huge pool of investible resources that global industry players are able to tap into. It is evident that Indian asset management addresses only a subset of the investors that its global counterparts do. The regulatory mandates in place in evolved economies allow access to the insurance and pension sectors. The industry structure possibly looks to create and harness core competencies in asset management. Industries such as insurance and pensions are allowed to invest in markets via asset managers with regulated and calibrated exposure levels.

Global Trends: I believe the trends of products, customers and distribution and operations, to different degrees, will be relevant to most major markets and geographies.

Products	Alternatives to go mainstream with retailisation
	ETFs here to stay
	Retirement products
Customers and Distribution	Fund houses seeking global growth opportunities
	Big data analytics becoming important to identify opportunities and customer needs
	Continuing transparency and information requirements
Operations	Multiple drivers for investing in technology
	Outsourcing being re-examined over concerns about loss of data/control and fiduciary requirements
	Recordkeeping complexities

Global Strategic Drivers: Strategic drivers are shaping the business as we speak and will continue to be relevant in the near future. The relative importance of one or the other of these will differ from market to market.

KEY CHALLENGES FOR ASSET MANAGEMENT
1. Maintaining and Growing Volumes and revenues
2. Re-Positioning cost bases for value growth
3. Balancing Sustainable Profit and customer outcomes
4. Generating cash and attractive shareholders return
5. Avoiding regulatory intervention

DISTRIBUTORS
1. Distributors moving towards ownership of the customer
2. Seeking providers who can help them reduce costs in other ways
3. Rebuilding a new ‘value chain’

REGULATORS
1. Regulatory scrutiny continues around three themes:
2. — Customer protection
3. — Fairness for customers
4. — Tax
5. Higher cost and focus on evidencing compliance with pressure on excessive returns
   Customers

INVESTORS
1. High demand for income, in the form of dividends
2. • Higher returns on offer in other/overseas markets – shareholders seeking to extract cash / capital to redeploy

GROWTH TRENDS AND EXPECTATIONS
In 2012, the global aggregate AuM with asset managers stood at 64 trillion USD. This broadly comprised mutual fund assets (27 trillion USD), mandated AuM (i.e. asset allocations from global pension funds, insurance industry, SWFs, etc for the management/advisory services of asset managers; 30.4 trillion USD) and alternative investments (6.4 trillion USD).

The global aggregate AuM is expected to exceed 100 trillion USD by 2020! The components of that figure are expected to grow. Significant growth is expected in mandated AuM as well as alternative investments.

Asset Under management (AUM) in Trillion USD

Sl. No	Investment	2004 Beginning Year (rs.)	2007 Ending Year(rs.)	CAGR %	2007 Beginning Year(rs.)	2012 Ending Year(rs.)	CAGR %	2012 Beginning Year(rs.)	2020 Ending Year(rs.)	CAGR (%)
1	Mutual Funds	16.1	25.4	16.3	25.4	27.0	1.3	27.0	41.2	5.4
2	Mandates	18.7	28.8	15.4	28.8	30.4	1.1	30.4	47.5	5.7
3	Alternatives Investment	2.5	5.3	28.5	5.3	6.4	3.8	6.4	13.0	9.3
4	TOTAL	37.3	59.5	16.8	59.5	63.8	1.4	63.8	101.7	6.0

Sources: Compiled from the Collected Data

The growth of global investable assets will be driven by five main trends:

- The rise in retirement savings as the aging of the world's population continues.
- The increased weight of the SWF (sovereign wealth funds) market as new SWFs are formed and assets double.
- The shift in emerging markets from savings to investing cultures.
- The rise in wealth accumulated by HNWIs (High Net Worth Individuals) and mass affluent.
- The move by traditional defined benefits in developed markets into alternative investments.

The South America, Africa, Asia and the Middle East (SAAME) region is expected to see the highest growth rates over the period to 2020. It might well be true that domestic fund managers have outperformed global fund managers in managing investment into Indian capital.

Sl. No	Country	2004 Beginning Year (rs.)	2007 Ending Year(rs.)	CAGR %	2007 Beginning Year(rs.)	2012 Ending Year(rs.)	CAG R%	2012 Beginning Year(rs.)	2020 Ending Year(rs.)	CAGR (%)
1	North America	19.1	30.1	14.8	30.1	33.2	2.0	33.2	49.4	5.1
2	Europe	12.9	21	17.5	21	19.7	-1.2	19.7	27.9	4.4
3	Asia Pacific	3.9	6.4	18.5	6.4	7.7	3.6	7.7	16.2	9.8
4	Middle East & America	0.6	1.6	35.9	1.6	2.6	10.4	25.6	6.7	12.5

Sources: Compiled from the Collected Data

FINANCIAL INCLUSION

Towards the aspect of financial inclusion, the SEBI requires mutual funds to ensure the following:

- Mandatorily make available printed literature on mutual funds in regional languages to ensure investor awareness and education.
- Introduce investor awareness campaign in regional languages, both in print and electronic media.
- Diversity of Indian culture implies that different models need to be explored and executed in order to make a breakthrough in these smaller towns. A few banks intend to adopt the hub-and-spoke model, gradually adding locations to each hub, where the hub could perhaps cater to 2-3 locations each.
- Around 65 percent of savings are with banks or post office deposits and cash at home, while 23 percent are invested in real estate and gold and only 12 percent is channelized towards financial instruments.
- Emergence of Stock Exchange platforms is seen as a suitable means to increase penetration levels of financial assets and thus mutual funds. Currently, it serves as an alternate mechanism for performing mutual fund transactions.

TAX INCENTIVE PROPOSALS

- A long-term product such as a mutual fund linked retirement plan, with an additional tax incentive of 50,000 INR, under 80C of Income tax Act, 1961 (the Act), may be introduced. • Alternatively, the limit of section 80C of the Act may be increased from 1,00,000 INR to 2,00,000 INR to make mutual funds products a priority for investors among the different investment avenues. The Rajiv Gandhi Equity Savings Scheme may also be brought under this enhanced limit.
- Akin to mergers or consolidations of companies, the merger or consolidation of equity mutual funds schemes might not be treated as a transfer and therefore, could be exempted from the purview of capital gains taxation.
- During the year, the CBDT vide its circular7 issued a clarification regarding the applicability of additional income-tax on income distributed by mutual funds to unit holders. By way of this circular, the CBDT has now clarified that the additional income-tax shall be levied only on the income distributed by way of dividends to the unit holders, and shall not be applicable to the income distributed by way of redemption or repurchase of units and allotment of bonus units.

CONCLUSION

Over half of the AuM of the global asset management industry is in areas other than traditional mutual funds. Mandated and alternative assets comprise almost 60% of the total industry AuM and the latter segment is growing rapidly. The asset management industry is growing to a stature comparable to banking and insurance. • While the debate about Indian AMCs accessing the domestic pension corpus will continue, a significant portion of global pension and insurance funds is allocated for investment in Asian capital markets including India. The opportunity to render investment advice to such fund managers is immense. We understand that it will not be easy to win such mandates but the effort would be worth it. It is estimated that 17 to 20% of Indian market capitalization is held by foreign funds. However, a remarkably small fraction of these funds are advised and managed by Indian asset managers. Without a doubt, the asset management industry has grown enormously over the last two decades. It is interesting to also observe the large global trends because surely and inexorably they will affect the domestic industry in the medium term. The era of insulation is almost over! In many ways the industry has shaped itself into a mutual fund industry rather than an asset management industry as defined by global peers. There exists an opportunity to offer products that address multiple investor needs. Taking a cue from global trends, not only does there lie an opportunity to tap into management of pension and insurance funds, but also to increase the penetration of products such as ETFs. Additionally, while asset managers in India are the largest Indian asset managers, they are not necessarily the largest managers of Indian assets - tax certainty and a push by the industry can open the doors for turning India an international asset management hub.

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