fin-sight
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Sameer Kamath, Chief Financial Officer

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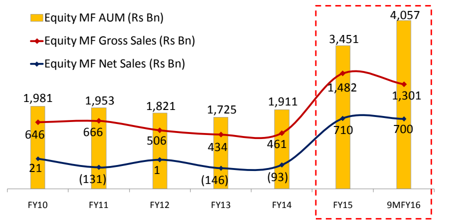
Reasons for the surge in retail interest in equity mutual funds; & learnings from the evolution in USA

Last 2 years witnessed rapid uptick in equity mutual funds; but headroom for further growth still exists

Equity mutual funds, where maximum retail interest lies, saw its AUM grow at a 54% CAGR from FY14 to Dec 15, way higher than the 13% CAGR from FY10 to Dec 15. Overall mutual funds AUM grew at a 28% CAGR from FY14 to Dec 15, lower than that in equity mutual funds. After 9 successive quarters of net outflows, the last 8 quarters have seen equity mutual funds clock positive net flows led by strong gross sales. Most of these flows are Individual-led. Their AUM of Rs 3.4 trillion in equity funds grew 101% from Mar 2014 to Dec 15 vs a growth of only 25% in the AUM they held in non-equity funds. Further headroom for growth exists. With ~34 million individual investor folios in equity mutual funds, the penetration is 3-4% of India's population. Many are yet to make it a part for their portfolios, despite having sizable savings.

Equity MFs have seen renewed interest since the last 2 years



Reasons for uptick in retail interest in equity mutual funds

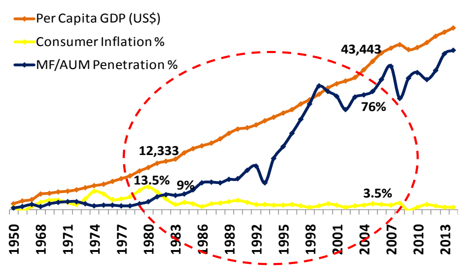
Rise in disposable incomes pushes discretionary allocations towards equities:

A combination of rising per capita income with low inflation expands disposable income, which pushes the allocation to discretionaries. In USA, economic stability started from the post-1950s. However, it took about 25-30 years till the 1980s to reach that ideal combination of growing incomes and low inflation, which is when mutual fund penetration truly took off, as seen from the 1980s till the pre-2008 years in the graph.

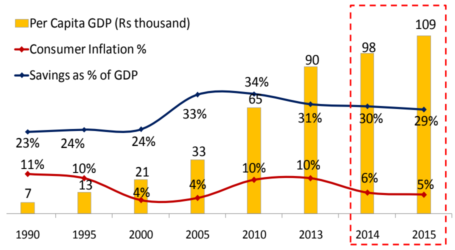
If one assumes post-1990s to represent the start of economic stable years in India, then we are now, 25 years later, at the cusp of a similar inflection point. 2014-onwards has seen rising income and low inflation deepening mutual funds penetration. Evidence is visible, as equity AUM per folio of individuals reached Rs 98,100 in Dec 2015, up from Rs 58,000 in Mar 2014 and Rs 42,500 in Mar 2010. The proportion of equity per individual folio also rose from 20% in Mar 2014 to 27% in Dec 2015, indicating tilting preferences. IMF estimates India's per capital income to grow at 12% CAGR from FY15-FY20 (to 2X of present-level), consumer inflation to be muted at ~5% and savings rate to hold at ~29% for the 5 years till 2020. These estimates augur well for continued growth in disposable incomes and increased allocation to equities, just like it did in USA from 1908s onwards.

In short, while this ideal combination of macros has created positive traction from 2014, there is still immense opportunity to grow further. The AUM/GDP ratio in USA reached 90% by 2014, from 9% in early 1980s, a ~10X growth. This number is still 8% in India as of 2015. The median mutual funds assets in a US household is $103,000, half of its $200,000 median household financial assets. In India, shares/debentures were only ~5% of changes in household financial assets in 2015. ~89% of US mutual fund assets are held by retail households, while only ~9% of urban households in India have invested in mutual funds. As mass-affluent families expand further in India, it will deepen the market further.

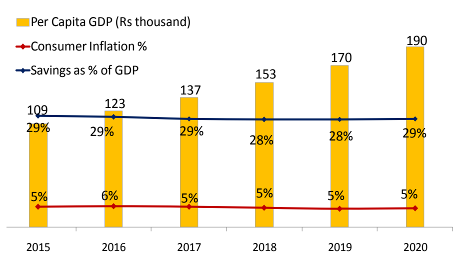
Inflection-point in US took ~30 years after stability in 1950s



Combination of stable macros in India from 2014 onwards



Economic projections in India till 2020 look opportune



Expansion into smaller towns across the hinterland:

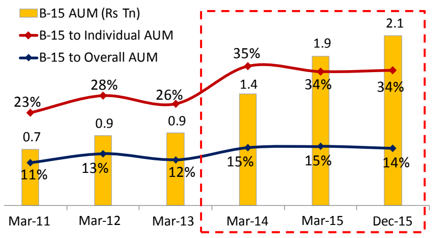
Smaller towns have been an important source of incremental flows in India. B-15 AUM (Beyond Top-15 towns) grew 52% from FY14 to Dec 2015, to Rs 2.1 billion. There has been a definite push to reach clients in B-15 through investor education seminars. Of the ~Rs 750 billion net inflows into equity funds this year so far, ~40% are from B-15. Almost half of the incremental folios this year also came from B-15. Moreover, B-15 has a more favourable mix of equity within their AUM, since T-15 cities have most of the institutions & corporates who prefer debt funds. B-15 AUM had ~48% in equity funds, while T-15 AUM had only ~27%. Hence, this mix earns mutual funds a better blended yield in B-15.

However, while B-15 showed an uptick, so did T-15, as even overall AUM grew at 54% CAGR from FY14 to Dec 2015. Its proportion in the mix is yet to take off. Moreover, B-15 AUM grew at a slower pace than overall AUM from FY15 onwards – 13% vs. 18%.

Growth in bank deposits in urban/semi-urban areas exceeded metro cities in recent years - indicating a pool of opportunity in B-15 which can be re-allocated towards equity funds. The spread of distributors has to expand to capture the B-15 opportunity further. India's lower 50% regions by GDP represent 17% of the economy, but have only ~ 4% of the IFAs.

As disposable incomes grew, younger generations in USA started investing in mutual funds at an earlier age than their parents. This shows that the investing lifetime itself also expands, apart from widening of the base & deepening of wallet-share

Despite uptick in AUM, B-15's proportion remains flat



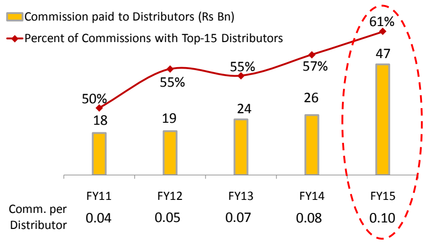
Role of Distributors critical for asset flows into mutual funds:

India is primarily distributor-driven. Direct channel accounted for only ~13% of individual assets, of which 11% were from T-15 only. The role played by distributors to boost inflows can be gauged by the surge in commission earned by AMFI-disclosed brokers - up 84% YoY to Rs 47 billion in FY15, way higher than the 9%, 26% and 5% in prior years. The number of disclosed brokers meeting AMFI's disclosure criteria also increased, from 332 in FY13 to 467 in FY15, after dipping from 403 in FY11. This indicates several distributors have invested to expand their distribution network and reached the threshold scale of assets in recent years.

Also, inflows were driven by Top-15 distributors as their commissions rose 94% YoY in FY15. Their proportion rose from 50% in FY11 to 61% in FY15, with maximum traction seen in FY15.

Many of the Top-15 distributors were banks. Banks may emerge a critical channel in India as India's financial inclusion objective deepens. Global experience shows clients use 6-8 financial products, with his primary banking relationship accounting for a major portion of his assets.

Uptick in AUM largely a result of distributor network



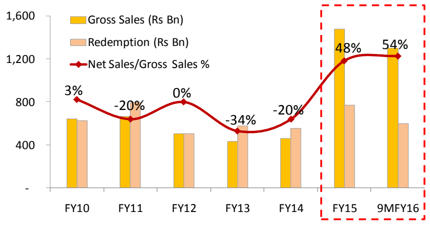
Even the USA is Advisor-driven, with 40% of households buying solely with professionals & 13% buying only direct. IFAs managed 66% assets in US. Similar proliferation of IFAs in India can garner more inflows, esp from B-15

DIY clients are few, while most others need investment advisors. Given this leaning towards intermediaries, there remains a need to expand the distributor base further. The proposal to exempt small distributors from service-tax will benefit many, as only 1,200 out of 5,000 active distributors earn over Rs 1 million annually. Even mutual funds prefer dealing with distributors, since a large sales force of their own would eat into what they can keep for intermediaries. Incentivizing trail fee for long-term holding can also help improve profitability for intermediaries.

Investors have matured in the way they now view equities for the long-term:

Despite the lack of market performance in CY2015, there were no high redemptions as would have been in the past. Investors acted with maturity in holding their funds for the long-term, despite short-term volatilities impacting returns. This absence of panic-induced redemption was an achievement in itself. The net sales to gross sales ratio were ~50% in the last 2 years, while it was ~ 0% in earlier years, bring stability in AUM. Secondly, SIPs increased manifold as investors developed the comfort to take on long-term commitment towards mutual funds, and looked to beat market volatility by investing regularly for their future savings corpus.

Panic-induced redemptions reduced in last 2 years

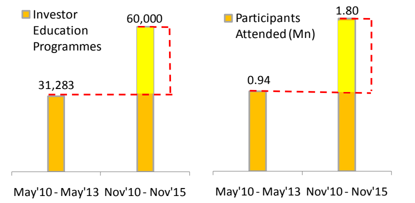


Even mutual funds have been moving from a product-push approach to a solution-based approach. There are pitching their investing process, USPs and differentiation so that clients can match it with their investing objectives and find a good-fit. As clients evolve using mutual funds and their investing corpus deepens, they can be pitched Managed Accounts (PMS) to capture those flows. As the market matures further, it may open the opportunity further for foreign equities. In USA, the last 10 years saw equal amounts flowing into world and domestic equity funds.

Investor education improved peoples' awareness about the very need for mutual funds:

Relentless education seminars by mutual funds improved peoples' awareness of mutual funds. Apart from on-ground seminars, this includes TVC and internet campaigns. These have been key in widening the investor base by bringing in new retail investors into equity funds. The impetus given in this direction in the last 2 years can be gauged as the number of investor education programmes and participants in the last 2 years is almost equal to those done in the 3 years prior to that, as per rough data of the last 5 years.

Efforts in the last 2 years equals that of prior 3 years

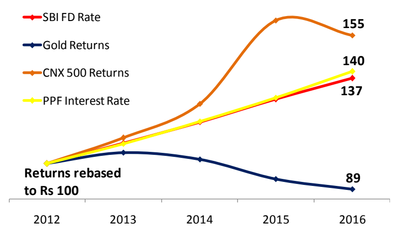


Following on its earlier rule for mutual funds to set aside 2 bps of their NAV for investor education and awareness initiatives, SEBI has now also asked them to transfer 50% of their unutilized funds to AMFI, so that it can ensure that the allocated monies are used for this purpose only.

Relative attractiveness of other savings products reduced vs. equity in recent years:

Habits change with Generations is an apt adage now, as the era of 10%+ FDs and GOI Relief bonds is over and the amount of gold passed down by each generation is reducing. The uptick in equity flows is also due to reducing relative attraction of other products. ~70% of household savings goes to gold and real estate. Gold returns were stagnant in recent years. ~90% of financial savings goes to banks, PPF and life insurance. But FD rates have declined; and are expected to dip further. Many companies are not contributing to EPF. Investors need inflation-adjusted long-term returns, and are accepting that an equity component is needed.

Equities have outperformed others in recent years



New online platforms have enabled easy and convenient access to buy mutual funds:

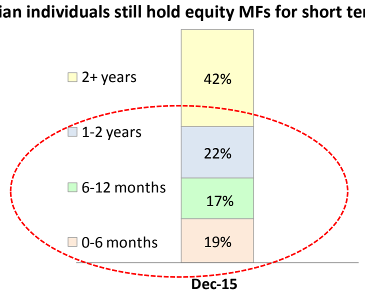
Robo-advisors like Aditya Birla's My Universe, Arthayantra and FundsIndia give financial planning by recommending a basket of mutual funds based on user's risk-return profile. Such platforms have seen rapid traction in users in recent years. Invezta also offers direct plans for DIY clients, and has started reimbursing users their quarterly fee if its recommended funds underperform. AMFI also set up its MF Utility platform, and concerns regarding equal-sharing of fixed costs by all mutual funds instead of pro-rata sharing as per transactions done are being discussed. For these platforms, the ease and convenience of the platform is critical to determine user experience - be it during account opening, SIP registration during account opening itself, or choosing products on the website. While most are compensated by commissions or flat annual fees as of now, the shift to advisory-fee on assets managed may help expand mutual fund flows on such platforms further.

Long-term retirement products can fuel maximum interest in equity funds, just like in USA:

In USA, retirement has been the main goal why households save in equity mutual funds. Employer-sponsored retirement plans or IRAs have often been the 1st purchase of funds. The 90 million US individuals who hold mutual funds held 89% of it via retirement plans, directly or indirectly. Mutual funds managed 55% of assets in 401K/DC plans and 48% in IRAs in 2014.

Long-term retirement planning also implies the demand is for growth (hence, equity) rather than income (debt). This enables AUM stability, as equity assets have longer holding period than non-equity assets; something yet to become visible in India's case. Long-term planning also broadens the number of funds held for diversification (median #funds in the US is 4).

Indian individuals still hold equity MFs for short tenure



Such a retirement-driven demand for equity mutual funds is yet to occur meaningfully in India. The Rs 8.5 trillion EPFO (India's contribution retirement plan) invests only 5% of its incremental Rs 1 trillion flows, that too only through index equity ETFs. The NPS opportunity is also hardly appealing, given the management fee is only 1 bp. With social security almost non-existent and life-tenures increasing, there is a need to save adequately for retirement planning. This push can be instrumental for the next level of growth for mutual funds in India.

As people save more for retirement goals, the target customer here may start mirroring that in USA – where the median household income that is almost double the national per capita income, and majority of mutual fund investors are married and employed

Conclusion

The 'pull' aspect of mutual funds is believed to be only 3-5% in India today. This can rise to much healthier levels in coming years by:-

- Packaging funds into asset allocation products, fund of funds, advice-based portfolios or equity/debt switch products can help sell solutions, not just funds
- The new government's focus on financial inclusion as a policy indicates its firm commitment to enable citizens to participate in long-term investment avenues
- SEBI is working to speed the on-boarding process by using biometric unique ID (Aadhar) for KYC. This should simplify the process, and spur further growth
- SEBI's efforts to expand the distributor fraternity with retired government officers, bank officers, postal agents can help expand the base in local areas
- Reducing the imbalance between commissions paid for insurance vs mutual fund should ensure a level-playing field, as both compete for same investors
- Transparency in commission/trips/gifts paid to distributors, salaries paid to top management, expense ratio of direct vs regular schemes may fuel interest
- Fund performance will remain the main differentiator, hence quality fund managers will always be in demand, helping push interest in their funds

Large states which offer maximum opportunity for distributors

Large States	AAUM Rs Bn	Equity to AUM	Per Capita AUM	AUM % to GDP
MP	103	64%	1,420	2%
Ker	134	43%	4,010	3%
Tel	152	40%	4,330	4%
AP	204	42%	4,170	4%
PB	129	48%	4,650	4%
UP	431	48%	2,160	4%
TN	628	32%	8,710	6%
Odi	91	40%	2,160	3%
JH	60	67%	1,830	3%
RJ	414	19%	6,030	7%
CG	51	45%	1,990	2%
BH	62	72%	600	2%
AS	37	49%	1,180	2%
WB	720	33%	7,880	9%
GJ	806	36%	13,350	9%
KA	951	33%	15,560	14%
HR	668	17%	26,330	15%
DL	1,415	29%	84,470	31%
MH	5,852	25%	52,080	35%

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