Mutual Funds – Long growth runway ahead

Manoj Menon
Head of Research
ICICI Securities Ltd.

Vinod Karki
Strategist
ICICI Securities Ltd.

HISTORY

History of Mutual funds (MF) in India began with the establishment of the Unit Trust of India (UTI), at the initiative of the Government of India and RBI. UTI was established in 1963 by an Act of Parliament. The first scheme launched by UTI was named Unit Scheme 1964 and by 1988, UTI's AUM (Assets under management) rose to Rs67 bn. Other Public sector entities such as LIC, SBI, Canbank, PNB etc entered the mutual fund business starting from 1987 and by the end of 1993, total mutual fund AUM reached Rs 470 bn. Private sector players were allowed into the MF business in 1993 and Kothari Pioneer was the first private MF to be set up.

GROWTH PHASE

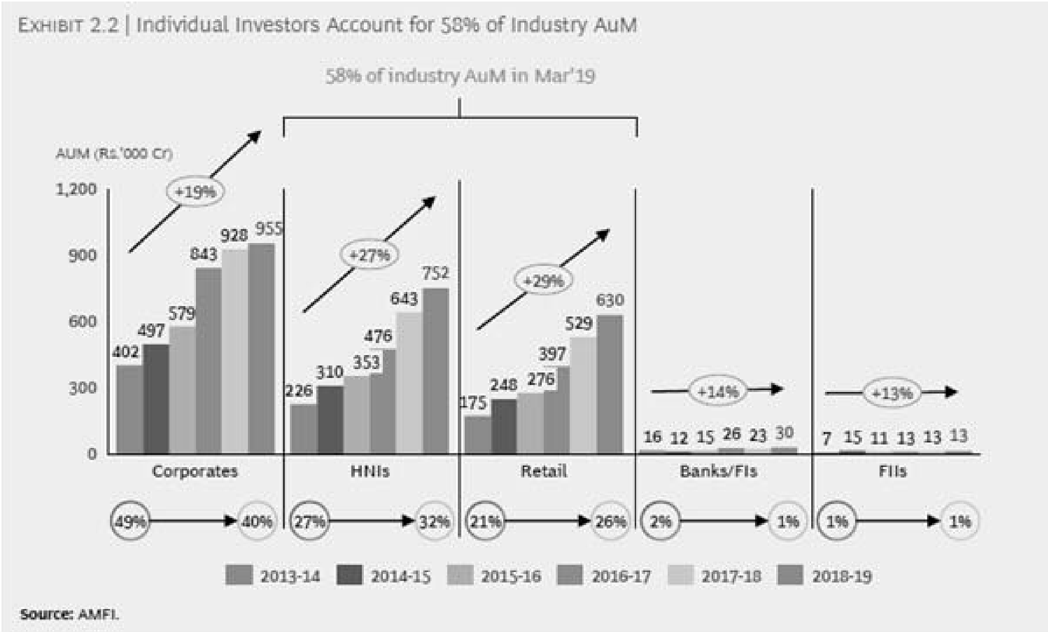
MF AUM's really took off in a big way from 2003-2008 reaching Rs 5 tn by March 2008. Global financial crisis in 2008 and the period of volatility and stagnation till 2013 resulted in a slowdown for the MF industry. However, the landslide victory for the NDA government in 2014 and sharp rise in broader equity markets ushered in a sense of confidence thereby resulting in a multifold increase in MF AUM reaching Rs 24 tn by March 2018. Bulk of the increase in AUM since 2013 has been driven by equity schemes of MFs which rose four fold during the same time to reach Rs6.6 tn by March 2018.

DRIVERS OF GROWTH PHASE

Key drivers of the rapid increase in MF AUM from 2014 to 2018 has been the sharp rally in broader equity market, increased channelizing of retail savings into MF schemes, improving awareness as a financial instrument providing various solutions such as long term wealth creation in growth oriented funds to providing short term liquidity through liquid debt funds. Distribution reach of Banks, Pan India intermediaries, Individual financial advisors, direct sales and on line channels has helped drive growth. Introduction of new products such as SIPs and equity ETF have turned out to be runaway success after starting on a small scale. Equity ETFs in particular have seen an exponential rise from Rs15 bn in 2013 to Rs1.7 tn currently. Increased distribution reach into smaller cities by private sector funds and widespread use of digital medium have all helped in growing the MF industry.

Investor profile - RETAIL VS INSTITUTIONS

HNIs and Retail investors grew their holdings in MFs by 27% and 29% respectively between from 2014 to 2019 to reach 58% of the total AUM. Amongst Institutional investors corporates have the highest share with 40% of the AUM while FIIs, financial institutions and Banks together contribute about 2% of AUM. Bulk of individual investor assets (68%) are in equity-oriented funds while Institutional investors prefer debt and liquid/money market funds. Individual investors tend to remain invested much longer than Institutional investors.



GLOBAL COMPARISON

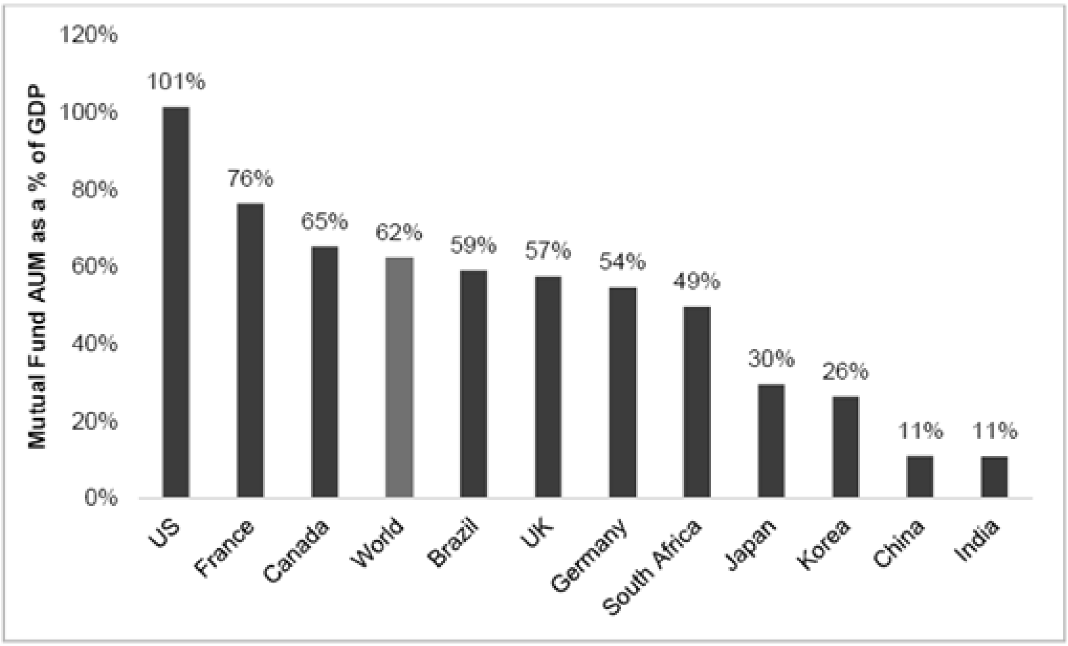
India's mutual fund penetration in terms of AUM to GDP at 11% is significantly lower than the world average of 62%. Developed economies have much higher penetration such as US (101%), France (76%), Canada (65%) and UK (57%) and even emerging economies like Brazil (59%) and South Africa (49%).

Growth of Indian MF industry over the past decade has been much ahead of major geographies such as North America, Europe and Asia (ex- India).

MF Industry structure in India is similar to the global average with top 10 MFs having ~83% market share although the concentration is lower in countries like UK (46%) and China (47%).

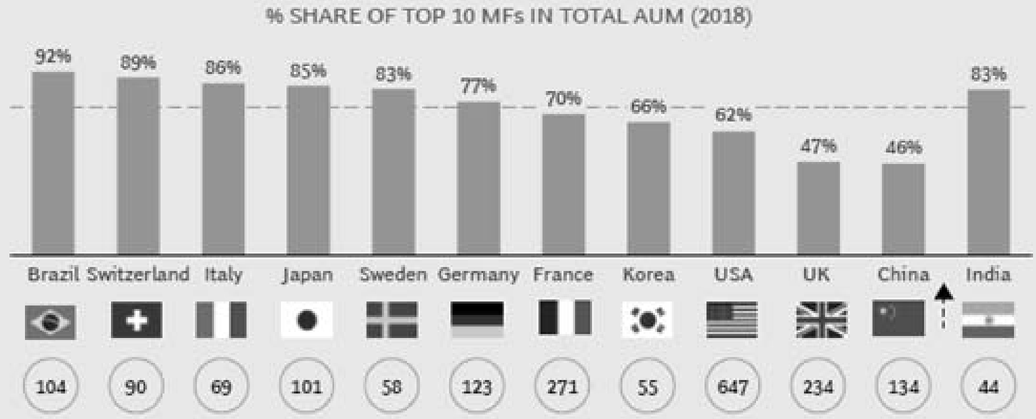
In terms of the product mix, equity AUMs in India at ~45% of AUM is comparable to countries like US at 54% and UK at 45% while much ahead of developing economies such as China and Brazil at less than 10%.

Penetration of mutual funds lower than global average, but expected to improve



IMF, The International Investment Funds Association ("IIFA"), CRISIL Research; Note: data as of December 2016; Fiscal 2017 GDP and AUM as of March 2017 used for India; only open-ended funds have been considered

EXHIBIT 2.1 | Industry Structure—Concentrated Market as in the Rest of the World



Sources: Strategic Insight - Simfund, Value Research.
Notes: Global data for calendar year 2018; India data for financial year 2019.

CURRENT SLOW DOWN

Since 2018 the AUM growth has flattened largely impacted by a correction phase in broader equity markets which comprises of mid and small market capitalisation stocks and the IL&FS episode likely impacting debt funds. COVID-19 has resulted in a flight to safety by retail investors resulting in higher demand for fixed deposits, cash in hand and gold which is impacting demand for risk assets like equities while debt funds have been impacted by rising credit risk.

GROWTH DRIVERS AHEAD

Despite the rapid growth in AUM's since 2014 the MF penetration in India in terms of AUM to GDP remains low at 11% and has huge potential for growth. AUM growth is driven by the incremental savings which in turn is expected to grow faster than the nominal GDP growth of 10-12 %. The other driver for AUM expansion is the expected return from the underlying assets and in India equity assets have expected return of ~14% in the long run. So it is not unrealistic to expect more than 20% growth in equity AUMs and closer to GDP growth for debt funds in the medium term for India without factoring in any significant shift in savings towards MF schemes by retail investors.

Equity funds are expected to drive the next leg of growth as well driven by growing investor base of Individuals and improving financial savings by households. Equity as an investment vehicle for long term wealth creation is getting wide spread recognition though awareness programmes. Debt funds growth will be driven by corporates and HNIs. The liquid/money-market funds segment will be dominated by corporate investors, who use these to park funds for short-term purposes.

Secular uptrend in per capita income, attractive demographics and increasing share of financial savings are the key factors which will drive the growth of MF industry in India.

Currently the top 15 cities contribute to 81% of the MF AUM and as distribution and awareness reaches smaller cities the smaller cities will start contributing much higher to the growth.

Other key factors which will drive MF growth in India include, SEBI directed spending of minimum 2bps on creating awareness by MF's, regulations to incentivise investments in smaller cities, higher allocation of retirement money including EPFO, and Increased use of technology platforms.
