Mutual Funds-After a stupendous growth, the future ahead

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There is no upper limit to growth if it brings prosperity and well-being. Nifty at 5,000 used to look high. And Nifty at 10,000 looks low.

From a logical point of view, till the time there is growth, the aspirational individuals will continue to seek opportunities to benefit from it. I say this with my experience of 25 plus years in the investment management industry. I have seen the buy side and the sell side. I have had the opportunity to meet the happy investors and the aggrieved investors. The underlying theme was always the same for me. Was I, and my organisation, creating value for the channel partners and the investors? Will they come back and stay with me. I believe that till the time we MF professionals keep asking this question, the growth will continue to happen.

If we disregard the last 2 years, Mutual funds have long been a 'less-glamourous' industry in comparison to their larger cousins, the banking and the insurance. Our aggregate aum was lower, our penetration was lesser and our appeal was also less visible. I remember the time when in my early decade of work; the total MF house aum of even few hundred crores looked like a sizeable achievement. The demographic penetration levels were in few basis points then.

All breakout industries show a relatively prolonged period of linear growth. This is then followed by rapid expansion for a couple of years or even a decade(s). We may be witnessing something similar in the MF industry as well. The industry has been growing by more than 20% cagr since last 2 years now.

There are many factors that can be attributed for this expansion in size. For one, the demonetisation led to a forced reset on how money was being invested. Latent cash found its way into the formal system. So there was a natural spill over effect; where some of that inflow found way into the MFs.

But more important was the two pronged effect of low interest rates and a sharp bull rally in the markets. Interest rates in the banking system had fallen sharply in 2016 and in 2017. The tide of deposit inflows and an already low inflation rate, led to further fall in deposit rates (albeit, the real rates continued to be high). In the similar period, the equities market and the debt market witnessed a sharp price rally. The equities market has grown by 13% cagr since Jan-16. The news of this rapid growth caught up and attracted massive investor attention.

To add to that, the cumulative effect of Investor awareness programmes is also coming into form. AMFI initiatives; and MF & distributor collaboration, has seen significant increase in investor outreach. This trifecta compounded successfully for the industry. The industry today accounts for more than Rs 23.4 lakh cr of fund's under management. This is around 20% of the banking sector deposits.

We believe that this high growth levels will continue to remain. We must appreciate that a momentum has its force. So the aum momentum is likely to continue to bring in fresh inflows. Having said that, in a long term growth trajectory, we do see interim periods of pause or decline. But if you step back and look at the longer picture, an upward trend becomes clearly visible. Same may happen with mutual funds. The market volatilities may see moderation in inflows (or an occasional decline) from time to time. But the inflows and the aum size is likely to grow over a period of time.

My optimism is based on trends that I see and the facts that have been visible globally. The first major trend is the India growth story. Our per capita is currently at US$ 1900. As the growth spreads and prosperity increases, more and more people will join the middle class. They will not only want better houses, cars, facilities but also better investment avenues. This demand for commodities will boost industrial growth and corporate earnings. But this aspirational Indian will also have a memory of his previous generations (poor parents/grandparents) and will not want reversion to that situation. So savings and pursuit of investments for wealth creation will be high. This trend was visible in China. And this will be also seen in India.

But in India's favour, there is democracy, rule by law and higher liberty for enterprise. This leads to higher information flow, transparency in transaction and competent regulatory framework. For that reason, financialisation of savings is much more likely than was witnessed in China (though their too the MF industry took off sharply).

For next 3-5 years the mass shift in investing behaviour may see the allocation to MFs continuing to rise. In this phase, strong distribution network, performance orientation and communication delivery would play a key role in gaining higher allocation.

Moreover, the growth in our economy is structural and the opportunity to create alpha will remain for atleast 7 – 10 years. This is a sufficient period for the mutual funds to prove their mettle and create a legacy performance. But here the serious players and 'also rans' may begin to stand out.

Fund houses who have invested in performance management systems, who have built knowledge processes, and who have a method in their market appraisals would be creating an intangible engine within their organisations. Such MFs would be creating culture of knowledge and learning for investment purpose. Immediate impact may not be noticeable. But like any good compounding effect, the passage of time will make such Fund house(s) standout as their knowledge bank begins to provide that extra edge.

Such fund houses may end up creating brand within a commoditised segment. Their value propositions may be clear to the distributors / investors. And the service delivery too may be distinct. The industry will continue to provide space for a wide number of players. But the game in the big league will be set by how well the value proposition stands out.

Savvy mutual funds distributors may also see their networks spread across geographies. We may also see many individual IFAs coming together to corporatize and institutionalise their legacies. This may lead to expansion of not only the outreach; but of the coming of age of the distribution industry. Many large distribution setups / IFA Incs may also become more sophisticated financial enterprises - providing a wide range section of services and products. In fact I won't be surprised if some distributorships have their businesses serving overseas markets.

Mutual funds will become all the more responsive to the global corporate governance standards. ESG and UNPRI standards may become a marking feature amongst investors to select a fund. Investor sensitivity regarding the MF participation / decision practises with regard to investments may begin to rise. Technology and regulatory changes may be the main challenge as well as the avenue of opportunities in this future environment.

Investors profile will be increasingly diverse. Already the penetration levels into semi-urban and in the 'other than B15' cities is expanding. The product profiling, the communication; the investment facilitation as well as the disbursement may need to adapt to these changing patterns. For all we know, there may emerge an all new product category catering to the unique requirements of this segment.

In closing, our traditionalism has made us a savings oriented people. Its upto the Mutual funds to tap into this instinct and convert this into the financial power to fuel nation's growth while also generate higher wealth for its investor. And we – the MF industry - are quite upto the task for it.