Indian Mutual Fund Industry: Paving the Path for the Next Big Leap

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The Indian mutual fund industry has witnessed remarkable growth over the past decade, positioning itself as a cornerstone of the country's financial ecosystem.This growth is set against a backdrop of strong economic performance, with the Indian GDP experiencing an average growth rate of 6 to 7% over the last ten years. Looking ahead, India's real GDP is expected to grow by 7.2% during 2024-25, with inflation projected at around 4.5%. Consequently, the nominal GDP growth is anticipated to be around 11 to 12% during 2024-25, with similar trends expected over the next three years. Other supportive macroeconomic factors, including the finances of the government, contribute to this robust GDP growth outlook. Historical data shows a strong positive correlation between India's nominal GDP growth and the performance of the Nifty 50, suggesting that with nominal GDP growth of 11 to 12%, the Nifty 50 is expected to grow at least by similar rates.

Surge in Mutual Fund Investments by Indian households

The growth trajectory of household assets in India has been impressive, with a 14% increase in total assets over the past year alone, and financial assets specifically seeing a 15% rise. The proportion of financial assets in the overall portfolio of Indian households has grown from 47.7% in March 2012 to 51% in March 2024. This shift depicts a growing inclination towards financial instruments, driven by greater awareness and confidence in the financial markets.

Annual gross financial savings have experienced a compound annual growth rate (CAGR) of 11.1% over the past 11 years. While bank deposits dominated household financial savings in 2011-12, contributing 57%, their share has dropped to 37% in 2022-23. This decline is indicative of a significant shift towards more diverse and potentially higher-yielding investment avenues, such as mutual funds.

One of the most notable trends has been the rise in investments in mutual funds, which have grown from less than 1% of gross savings a decade ago to 6% in 2022-23. Annual flows towards mutual funds and equities have skyrocketed from Rs. 16,500 crores in FY12 to Rs. 2.1 lakh crores in FY23, reflecting a twelve-fold increase. This surge can be attributed to a combination of regulatory reforms, enhanced investor awareness, and the appealing performance of mutual funds.

If we combine the expected growth rate of equities along with the growth in annual savings of Indian households in Mutual Funds and extrapolate it for the next 10 years, then the mutual fund industry would witness a 5x- 6x jump in assets.

Broad based participation from investors

Various initiatives from all industry participants namely, asset management companies, Banks and other distributors, regulators have resulted in increased financial literacy, accessibility and awareness of mutual fund as an investment avenue. This has led to broader participation from even tier 2 and tier 3 cities. According to Amfi data, there has been almost 40% increase in assets coming from beyond the top 30 cities in just the last one year.

And this to our mind is just the tip of the iceberg. As access to formal banking and investment channels increase, we could easily expect the share of household in Equity increasing by 2x – 3x in the next few years.

Regulatory Body plays a key role in the multifold increase in assets and interest in mutual funds

Regulatory body namely SEBI has been instrumental in driving market awareness and fostering investor confidence. Their efforts in educating investors and promoting transparency have played a critical role in the industry's growth. Various initiatives been taken by SEBI over the years whether it is clear categorization of mutual funds to make it clear and understandable to an investor to know what he / she is buying, initiatives to bring down mis selling by streamlining commissions for distributors, tracking down instances of mis-selling by regular audits, bringing in disclosure norms and strict transparency rules have all been steps towards increasing investor confidence. A highly regulated product and the confidence that regulator is closely watching and protecting investor interest would go a long way in making it the most preferred investment avenue.

Product innovations and use of technology would play a crucial role in expansion over the next decade

There are 43 asset management companies as on date and given the SEBI framework within which each of them have to operate there is an increased competitiveness and necessity to differentiate products from one to another. For example, with a large cap fund where as per regulation 80% has to be invested in top 100 companies as per market cap, AMCs are using innovate ways to differentiate themselves while keeping a close eye on return and risk. The need for having a strong research team, use of technology and artificial intelligence to extract and mine data, get meaningful insights from the data analytics and implement it at the fastest possible speed is increasing. AMCs have identified this and have been spending a lot on this aspect. This would play a big role in the coming years in creating differentiated investing products with active returns at reasonable risk levels being made for investors.

Strategic Recommendations for Investors

As the mutual fund industry continues to evolve, it is imperative for investors to adopt a strategic and diversified approach. Building a long-term investment strategy that spans various asset classes, market caps, and sectors can help mitigate risks and capitalize on growth opportunities. Diversification should not only be optical but also technical, ensuring minimal portfolio overlap and exposure to different investment styles.

Investors are advised to diversify their portfolios across 8-10 fund houses and 10-15 schemes to leverage the advantages of various fund managers and reduce risks associated with individual AMCs and fund managers. A prudent allocation strategy would limit exposure to a single fund manager to 12-15% and to a single fund house to no more than 20%. This balanced approach provides a robust framework for managing market risks and achieving sustainable returns.

The Indian mutual fund industry is on a robust growth trajectory, driven by increased investor participation, regulatory reforms, and a strong economic backdrop. With the market capitalization expanding across segments and the AUM of top AMCs growing substantially, the industry is well-positioned for its next big leap. Like said earlier By adopting a disciplined and diversified investment strategy, investors can navigate the evolving landscape and capitalize on the opportunities presented by this dynamic market.