**“Mutual Funds in India- Exploring the Economic & Other Key Dimensions”**

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**Abstract**

*After crossing various hurdles or bottlenecks, mutual funds have occupied a centre stage in Indian financial system and has emerged as one of the preferred destination for investors to park their surplus funds with the objective of generating higher returns. The concept of portfolio building which even had existence was not known to many investors, but with the onset of various mutual fund schemes portfolio management have gained tremendous significance. Now the market is witnessing presence of numerous Mutual Fund or Asset Management Companies. In view of this, it is imperative to comprehend the overall functioning of asset management companies from a different angle than normally embraced, i.e. NAV; Portfolio Return; Systematic Risks etc. Generally, an investor both existing and potential view an asset management company from the dimension of NAV and returns it provide on its various schemes, but it is equally rather more important to judge the mutual fund industry and a company from other angles also. This article tries to traverse through the other trajectory of mutual fund industry by studying the impact of global economic crisis on its performance, SWOT analysis and sustainability.*

***Keywords*: Genesis of Mutual Funds; Global Economic Crisis; SWOT Analysis; Regulatory Framework; Sustainability**

**JEL Classification: Financial Institutions and Services**

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**Full-length paper**

## Prologue

The asset management industry refers to professional fund management industry. Whenever individual or retail investors pool together their resources and allow a professional fund manager to invest it, the exercise can be considered to be part of this industry. It does not need to necessarily involving pooling of funds, professional management of the assets of high net worth individuals (HNI) may also be considered part of this industry.

In general there are a few broad kinds of pooled investment structures. The most common and the most visible are the mutual funds. These are typically open-ended funds from whom individual investors can buy shares or redeem them and their investment in aggregated and channelled into the equity or debt markets or a combination thereof depending upon the mandate of the fund in question.

In India, the asset management industry is broadly made up of a vibrant mutual fund sector and a growing pension fund sector. Though started way back in 1960s, the Indian mutual fund industry has grown in both the size of assets under management and the number of funds after the foray of the private players in the 90s. The ensuing paragraphs focus upon the genesis and growth of mutual funds in India.

The mutual fund industry was born in the year 1963 with the setting up of Unit Trust of India, at the initiative of the Government and Reserve Bank of India. The history of mutual funds in India can be broadly divided into four different phases

*First Phase: 1964-1987*

Unit Trust of India (UTI) was established in 1963 by an act of Parliament. It was established by the Reserve Bank of India and operated under the regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was delinked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative controls in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the close of 1988 UTI had INR6,700 crores of assets under management.

*Second Phase: 1987-1993 (Entry of Public Sector Funds)*

1987 marked the foray of non-UTI, public sector mutual funds established by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation (GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (December 87), Punjab National Bank Mutual Fund (August 89), Indian Bank Mutual Fund (November 89), Bank of India (June 90), Bank of Baroda Mutual Fund (October 92). LIC set up its mutual fund in June 1989 while GIC established its mutual fund in December 1990.

By the close of 1993, the mutual fund industry possessed assets under management of INR 47,004 crores.

*Third Phase: 1993-2003 (Arrival of Private Sector Funds)*

With the entry of private sector funds in 1993, a new epoch commenced in the mutual fund industry, giving the Indian investor a broader choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into existence, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more complete and revised Mutual Fund Regulations in 1996. The industry now operates under the SEBI (Mutual Fund) Regulations 1996.

The number of mutual fund houses surged, with several foreign mutual funds setting up funds in India and also the industry has witnessed numerous mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of INR 1,21,805 crores. The Unit Trust of India with INR 44,541 crores of assets under management was way ahead of other mutual funds.

*Fourth Phase: since February 2003*

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two different entities. One is the Specific Undertaking of the Unit Trust of India with assets under management of INR 29,835 crores as at closure of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, operating under an administrator and under the rules formulated by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than INR 76,000 crores of assets under management and with the establishing of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers happening among various private sector funds, the mutual fund industry has forayed its current phase of consolidation and growth.

**Review of literature**

Sivkumar et al. (2010) made a performance evaluation of mutual fund industry in India and this study evaluates the performance of mutual fund players in India based on their resource mobilization during the past decade. The players are broadly classified into private and public participants. The study revealed that there is significant contribution by all the participants for the growth of the mutual fund industry in India. At the same time, this study also observed that the private participants play a greater role in resource mobilization compared to those of public sector.

Saha and Dey (2011) conducted an analysis of factors influencing investors perception of mutual fund investment made to assess the prospects of any form of product irrespective of its nature, one must be aware of the behaviour of the consumer. The study focuses on gauging the investors expectation and their preference. It also attempts to measure the factors that they take into consideration before making any investment in mutual fund, as well as the awareness level among individual investors regarding mutual fund investment.

Santhi and Gurnathan (2012) made an analysis of risk-adjusted return on tax saving mutual fund schemes in India. In the study, an attempt was made to evaluate the performance of 32 growth-oriented open ended Equity Linked Savings Scheme (ELSS) of tax saving mutual funds in India. Performance was analyzed by comparing the monthly returns of the funds with that of Indian Stock Market Benchmark S&P CNX NIFTY.

Bhavaneswari (2013) made a study on investor's perception towards equity/tax saving mutual funds where researcher carried out the study with the objective of finding out the investor's perception towards equity/tax saving mutual funds. The researcher shows interest in identifying, the major factors that contribute towards investor's perception in the area of equity/tax saving mutual funds.

**Objectives of the study**

1) To understand the economic performance of asset management companies operating in India.

2) To comprehend the impact of global economic crisis on Indian mutual fund industry.

3) To understand the sustainability of asset management companies in India.

**Research Methodology**

1) KRUSKAL WALLIS TEST OR H-TEST: This non-parametric test will assist in understanding whether there was a significant impact on the Profits after Tax of three important Asset Management Companies, viz; Birla Sunlife Asset Management Company Limited; HDFC Asset Management Company Limited and ICICI Prudential Asset Management Company Limited due to Global Economic Crisis.

2) Expected Rate of Growth: This financial tool will assist in judging the sustainability of asset management companies considered for the study, i.e. Birla Sunlife Asset Management Company Limited; HDFC Asset Management Company Limited and ICICI Prudential Asset Management Company Limited

3) SWOT Analysis: To understand the Strengths, Weakness, Social, Opportunities and Threats of Indian mutual fund industry

**Limitations of the study**

1) Due to various technical constraints only three major asset management companies have been studied, i.e. Birla Sunlife Asset Management Company Limited; HDFC Asset Management Company Limited and ICICI Prudential Asset Management Company Limited.

2) The study is based upon secondary data

3) Since the study is based solely on secondary data so analysis may not fully reflect the economic performance of the asset management companies considered for the study.

**Impact of Global Economic Crisis**

The financial crisis that commenced late 2007 engulfed the mutual fund industry along with all other sectors of the financial markets. Looking at the impact felt on both the total amount of resources garnered by the industry and the composition of assets in the post-crisis years, it can be observed from exhibits 1 and 2 that the immediate effect of global financial crisis was in the shape of decline in net assets of mutual funds. On a global scale the net assets registered a fall by over 2.5 percent (in US$ terms) in 2008. There was a robust revival of more than 20 percent in 2009, and thereafter, barring the second quarter of 2010, net assets of mutual funds globally continued to move north, till they dropped drastically by over 10 percent in the third quarter of 2011. The initial drop in net assets worldwide reflected falling valuation of assets more than the crisis-induced liquidity crunch, with share prices plunging by more than 40 percent between end 2007 and end 2008. Net inflows to global mutual funds industry were not impacted in 2008 as the main effect of the crisis felt towards the end of the year. Net new flows to worldwide mutual funds started plummeting from 2009, with considerable outflows registered in the first two quarters of 2010. With signs of global economic recovery evident since early 2012, there was a strong pick-up in net inflows to mutual funds globally during the second half of 2010. Thereafter, with the emergence of weaknesses in the global economy towards end-2010, net new flows showed significant fluctuations in early 2011. The worsening of the Eurozone debt crisis caused a sharp outflow from funds worldwide during the third quarter of 2011.

The US, which houses world's largest mutual fund industry consisting of almost half the global industry share in terms of assets, had registered a 20 percent fall in assets in 2008. Net assets of US mutual funds witnessed a recovery by nearly 16 percent in 2009 and another 6 percent in 2010.

Now taking the case of India, combined assets under management (AUM) of all Indian mutual funds enhanced by 54.8 percent at end-March 2008 over the previous year (2007). This was followed by contraction of approximately 17 percent at end-March 2009 under the impact of global economic crisis and consequent liquidity crunch and uncertainties in the Indian financial markets. Along with a decrease in valuation of assets of equity mutual funds due to the equity price crash, net new inflows suffered in a big way during the year ending March 2009 (please

refer exhibit 3). By end March-2010, the combined AUM of Indian mutual funds jumped by over 45 percent over end-March 2009; this was the combined outcome of valuation effects and net inflows during the course of the year. This growth was in line with the trends of a revival in global mutual fund assets and was accentuated by a landmark decision by the Indian regulator, the Securities and Exchange Board of India (SEBI), to repeal entry load for all mutual funds effective August 2009. Thereafter, AUM more or less stabilized with a fall in AUM by nearly 4 percent in the next year ending March 2011 as the industry faced net outflows, followed by an increase of 3 percent between end-March and end-December 2011, with net flows turning positive.

A category-wise fund categorization reveals that in India, the highest percentage of mutual fund assets is held by income funds; their share enhance from 44 percent to 51 percent between end-March 2008 and 2010. For most part of 2010 and 2011, the share of income funds' assets remained stagnant. Between end-March 2008 and 2009, the share of equity funds in total mutual fund assets declined quite steeply from 31 to 23 percent, before recouping through most of 2009 and 2010 to touch 29 percent by end-March 2011. However, by the end of the year 2011, which was marked by renewed global uncertainties coupled with domestic slowdown, the share of equity mutual funds in total AUM fell back to the 23 percent witnessed during the crisis period (end-March 2009). On the contrary, the share of liquid funds, which had contracted substantially during the recovery years, went back to the crisis level of approximately 20 percent during 2011. Globally, the share of money market mutual funds in total net assets worldwide enhanced from 18.3 percent in the fourth quarter to 2010 to 21 percent in the third quarter of 2011.

The sales of (funds mobilized / inflow into) and redemptions from (outflow from) mutual funds provide a clear picture of the trends in the changes in the asset base of various categories of funds mentioned above.

Further to comprehend the economic performance of three major asset management companies pre and post global economic crisis, KRUSKAL WALLIS or H-Test is being applied to Profit after Tax of three major asset management companies, viz; Birla Sunlife Asset Management Company Ltd, HDFC Asset Management Company Ltd and ICICI Prudential Asset Management Co. Ltd.

**KRUSKAL WALLIS or H-Test**

**Null Hypothesis (H0) : There is no significant difference in Profit After Tax of Birla Sunlife Asset Management Company Limited; HDFC Asset Management Company Limited and ICICI Prudential Asset Management Company Ltd. due to Global Economic Crisis**

**Alternative Hypothesis (H1) : There is a significant difference in Profit After Tax of Birla Sunlife Asset Management Company Limited; HDFC Asset Management Company Limited and ICICI Prudential Asset Management Company Ltd. due to Global Economic Crisis**

| Years | Birla Sunlife Asset Management Company Limited (Profit After Tax in INR crore) | HDFC Asset Management Company Limited (Profit After Tax in INR crore) | ICICI Prudential Asset Management Co. Ltd. (Profit After Tax in INR crore) |
|---|---|---|---|
| March 2000 | | 0.023 | |
| March 2001 | | 5.41 | |
| March 2002 | | 8.33 | |
| March 2003 | 13.72 | 14.17 | |
| March 2004 | 15.35 | 28.54 | |
| March 2005 | 19.68 | 31.61 | 17.17 |
| March 2006 | 19.90 | 45.48 | 31.13 |
| March 2007 | 14.27 | 67.54 | 48.38 |
| March 2008 | 0.98 | 117.74 | 82.10 |
| **March 2009** | **92.73** | **129.1** | **0.711** |
| March 2010 | 48.45 | 208.36 | 128.03 |
| March 2011 | 84.54 | 242.18 | 71.83 |
| March 2012 | 76.30 | 269.14 | 88.06 |
| March 2013 | 87.30 | 318.75 | 110.20 |
| March 2014 | 105.64 | 357.77 | 182.69 |
| March 2015 | 126.34 | 415.5 | 247.89 |

| Profit After Tax | Ranks |
|---|---|
| 0.023 | 1 |
| 0.98 | 2 |
| 5.41 | 3 |
| 8.33 | 4 |
| 13.72 | 5 |
| 14.17 | 6 |
| 14.27 | 7 |
| 15.35 | 8 |
| 17.17 | 9 |
| 19.68 | 10 |
| 19.90 | 11 |
| 28.54 | 12 |
| 31.13 | 13 |
| 31.61 | 14 |
| 45.48 | 15 |
| 48.38 | 16 |
| 48.45 | 17 |
| 67.54 | 18 |
| 71.83 | 19 |

| | |
|---|---|
| 76.3 | 20 |
| 82.1 | 21 |
| 84.54 | 22 |
| 87.3 | 23 |
| 88.06 | 24 |
| 105.64 | 25 |
| 110.20 | 26 |
| 117.74 | 27 |
| 126.34 | 28 |
| 128.03 | 29 |
| 129.10 | 30 |
| 182.69 | 31 |
| 208.36 | 32 |
| 242.18 | 33 |
| 247.89 | 34 |
| 269.14 | 35 |
| 318.75 | 36 |
| 357.77 | 37 |
| 415.5 | 38 |

**Rank Table**

| Birla Sunlife Asset Management Company Limited | HDFC Asset Management Company Limited | ICICI Prudential Asset Management Company Limited |
|---|---|---|
| 5 | 1 | 9 |
| 8 | 3 | 13 |
| 10 | 4 | 16 |
| 11 | 6 | 21 |
| 7 | 12 | 29 |
| 2 | 14 | 19 |
| 17 | 15 | 24 |
| 22 | 18 | 26 |
| 20 | 27 | 31 |
| 23 | 32 | 34 |
| 25 | 33 | |
| 28 | 35 | |
| | 36 | |
| | 37 | |
| | 38 | |
| | | |
| 178 = R1 | 311= R2 | 222 = R3 |

**Note:** *In the calculation it is assumed that Global Economic Crisis was at its pinnacle during 2009.*

**Decision:** Accept H0 if H<ψ0.05

Now 5.55>5.991

=> H < ψ²0.05

=> **The null hypothesis H0 is accepted and the alternative hypothesis H1 is rejected. It can be concluded that there is no significant difference on Profit After Tax of three asset management companies, i.e. Birla Sunlife Asset Management Company Limited, HDFC Asset Management Company Limited and ICICI Prudential Asset Management Company Limited.**

For detailed calculation please refer Appendix 1.

**SWOT Analysis**

*Strength of Indian Mutual Fund Industry*

The opening of Indian asset management industry to private players a little over 20 years have proved to be a blessing. The objective was to expand the business by broadening and deepening the market for asset management products. The inclusion of asset management products in the basket of traditional investment avenues like, cash-in-hand, corporate and fixed deposits (FDs), savings accounts, stocks and gold have provided investors with another important investment alternative.

The favourable regulatory regime which is playing a crucial role in providing steam to the mutual fund industry. The regulatory framework has maintained pace with the changing environment which in turn has assisted the AuM of the asset management companies to grew from 470 billion INR in 1993 to 1396 billion INR in 2004 and to 8252 billion INR in 2014 (please refer exhibit 4)

The asset management industry provide a rich diversity in the shape of mix of traditional mutual fund products and alternatives (real estate and hedge funds). It enjoys a broad investor base as it encompasses insurance funds, pension funds, sovereign wealth funds (SWFs) and high net worth individuals (HNWIs) / mass / affluent / retail investors. Next going by the global trends in 2012, the global aggregate AuM with asset managers stood at 64 trillion USD. This broadly consisted of 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 AuM is expected to surpass 100 trillion USD by 2020. Significant growth is estimated in mandated AuM as well as alternative investments. So in this expected mammoth growth ofAuM, India is definitely going to receive a substantial pie.

*Weakness of Indian Mutual Fund Industry*

The asset management industry held 39.5 million folios as on 31st March 2014, which has moved southwards from approximately 47.6 million as on 31st March 2009. In the following years also there has not been a discernible change in statistical trends as yet. The industry AuM

from towns other than in the top 15 cities was nearly 871.4 billion INR as on 31st March 2012 and was nearly 1126.5 billion INR as on 31st March 2014 (reflecting a CAGR of approximately 13.7%). This translates into 14.84% and 13.65% of industry AuM in the respective years.

No doubt, it is true that there are investible surpluses available in cities beyond top 15, at least more than what has been tapped by the asset management industry so far. It has been observed that share of AuM from the top metros has remained relatively high in comparison to Tier 2 and 3 towns.

The industry also witnesses shortcomings in its product basket. Over the years the industry has developed an extensive product basket covering various investment opportunities. However, the 80-20 rule applies. More than 80% of the AuM is in less than 20% of the product categories.

The industry has been operating on what we know as the 'open architecture' distribution model, with no tied agents. Although the ability to invest directly now exists, the industry is hugely dependent on the distributor fraternity at the front end.

Over the years, the distribution economics have been changed to correct a few glitches such as churn, etc. However, as things stand, the number of AMFI registration numbers (ARNs) has gone down from nearly 82,015 as on 31st March 2011 to 58,167 as on December 2013.

The industry needs to analyze this trend in all aspects. Unfortunately, there may not be a 'one-size-fits-all' solution that will work.

*Opportunities for Indian Mutual Fund Industry*

The opportunities may knock the doors of the Indian mutual fund industry if it espouses an '**outside-in' perspective** as compared to '**inside-out' perspective**. Understanding investors' needs should be followed by a product channel alignment.

If it focuses upon catalysts such as technology, investment in B-15 cities, investment advisor etc. then it can ensure the accomplishment of overall objective of prudent growth and profitability. It needs to work towards enhancing financial literacy, as it can act as a key to unlock the doors to B-15 cities and also to remove the outlook that equates mutual fund to only equity. By conducting investor awareness campaigns in smaller cities, it can assist asset management companies to increase the AuM in smaller cities which would assist industry to progress in a holistic manner. Fund houses by partnering with the correct distributor can make their products available to investors in smaller towns. In this regard, Banks and IFAs could play a crucial role in reaching the investor base. Also, distributors needs to incentivised enough to make sure that they project mutual funds as a long-term investment for attaining financial goals.

Asset Management Companies should make optimum utilization of technology in future, as it may go a long way in accessing investors at a low cost and in a more efficient manner. AMCs need to make the pertinent investments in technology to help reach investors to help ensure transactions on the channels of their choice.

Based upon a research report by NOVONOUS (The key findings of Mutual Funds Market 2015-2020), the asset management companies can explore opportunities in the following segments:

a) Equity based mutual funds market in India is expected to grow at a CAGR of 11%.

b) Debt based mutual funds market in India is expected to grow at a CAGR of 17%.

c) Liquid/money market based mutual funds in India is expected to grow at a CAGR of 16%.

d) ELSS-equity based mutual funds market in India is estimated to grow at a CAGR of 15%.

e) Balanced scheme based mutual funds market in India is estimated to grow at a CAGR of 10%.

f) Gold ETF, Gilt, Other ETF's based mutual funds market in India is expected to grow at a CAGR of 15%.

*Threats for Indian Mutual Fund Industry*

The decision of the capital market regulator, Securities and Exchange Board of India to increase the minimum net worth requirement for asset management companies (AMCs) from INR 10 crore to INR 50 crore is expected to change the face of the mutual fund industry radically. The objective is to ensure that mutual funds attain a reasonable size and play a significant role in accomplishing the objective of financial inclusion while further strengthening transparency to assist investors in taking informed decisions.

Another blow for small players can be the decision of SEBI, wherein it encourages merger and consolidation of equity fund schemes. According to SEBI, similar to merger / consolidation of companies, the merger / consolidation of equity mutual fund schemes also may not be treated as transfer, and, therefore, may be exempted from capital gains taxation. This will effectively bring down the entry of new players and thereby de-clutter multiple offerings. Going by this approach, a mutual fund investor will have to look at lesser number of mutual funds before short-listing where to invest.

Further, AMCs which are under- capitalized as of date, their shareholders needs to be convinced that there is a business case to enhance the capital base, considering the returns they would expect given this infusion. Now, these shareholders would potentially look at local partners / overseas partners, as the case may be, to enhance their capital and bring in a new player. This may prove to be a challenging task given that a third shareholder will have to be convinced about the future of the AMCs' profitability.

Another bigger threat is in the shape of Ponzi schemes and other unregulated parallel market investment schemes that are affecting the growth of mutual fund sector. A ponzi scheme is a fraudulent investment operation that pays returns to its investors from own money or money paid by subsequent investors, rather than from profit earned by the individual or organization running the organization. While expenses chargeable by MFs and the promises they can make are highly regulated by the Securities and Exchange Board of India (SEBI), illegal schemes

that stay out of the regulatory ambit follow none of these. MF agents, who earn much less than those of illegal schemes, are left with the burden of pitching a regulated product that comes with huge disclaimers on market risks against schemes claiming fanciful returns.

While SEBI has been formulating regulations for regulated MFs, it has not been able to rein in illegal schemes effectively.

Another significant peril to mutual fund industry is the presence of parallel economy, which has acted as an impediment in penetrating market for asset management companies. On the contrary in developed markets, where the magnitude of black money is less experience higher market penetration. For instance, South Korea, which is smaller than Uttar Pradesh of India, has a MF market twice the size of India.

**Regulatory Framework**

A robust and favourable regulatory framework is a sina-qua-non for the growth and development of Indian mutual fund industry. In this regard, the industry regulator, Securities and Exchange Board of India (SEBI) has focused more on investor protection, introducing numerous regulations to empower retail investors in Mutual Funds (MFs). The regulatory approach by SEBI commenced with prohibition of charging of initial issue expenses, which were allowed for closed-ended schemes, and mandating that such MF schemes shall recover sales and distribution expenses through entry load only. These moves aimed at bringing in more transparency in fees paid by investors and helping make informed decisions.

Subsequently, w.e.f. August 1st, 2009, SEBI banned the entry load that was deducted from the invested amount, and instead permitted customers the right to negotiate and decide commissions directly with distributors based on investors' assessment of different factors and related services to be rendered. The objective was to bring in more transparency in commissions and engender long-term investment. Though the intent of amendment was to benefit the investor, it has affected the margins of AMCs.

Further, SEBI has scrapped the additional management fee of 1% charged by AMCs on schemes launched on a no load basis resulting into further squeeze in margins earned by the AMC.

Another significant development on the anvil, Direct Tax Code (DTC), taxability of income from mutual funds, at the hands of investors will also have a bearing on the growth of the mutual funds industry. Unlike the existing tax provisions, DTC does not provide for any benefit for investment in equity linked savings scheme, and also proposes to enhance the compliance in the hands of MFs by broadening the scope of deduction of tax to include payments made to residents. The code has also created inconsistency on the taxability of the MF investors. It is unclear whether the income earned will be exempt or taxed in the hands of the investors on accrual basis, as mentioned in the Discussion Paper on the DTC.

The capital market regulator, SEBI, had formed the "Committee on Review of Eligibility Norms" (CORE) to revisit the eligibility rules and other functional angles prescribed for various intermediaries. Amongst other recommendations, the important ones are pertaining to increase in the minimum net worth of AMCs from INR 10 crores to INR 50 crores, change in the definition of net worth, sponsor to be a regulated entity and change in definition of control.

The objective of the mentioned recommendations was to permit only the serious players to enter / remain in the market. This can go a long way in better governance of MF players.

SEBI has also permitted trading of MF units on recognized stock exchanges. Subsequently, BSE and NSE have launched trading platforms assisting investors to invest by availing services of stock brokers. While trading through the stock exchange, the investor would get to know about the validity of his order and the value at which the units would get credited / redeemed to his account by the end of the day. Whereas, while investing through MF distributor or directly with the MF, the investor receives information of the subscription and redemption details only in the shape of direct communication from the MF/AMC. Therefore, by trading through stock exchange, the investor would be able to optimise his investment decisions due to the reduced time lag in the movement of funds. This transparency in ascertaining the status of order till completion assist in bringing down disputes. Further, the investor would able to get a single view of his portfolio across multiple assets, like, MF units etc.

**Sustainability of Mutual Funds / Asset Management Companies**

It is imperative to understand both for an existing and potential investor regarding the sustainability of the asset management companies where the money have been invested. Since as a practice one generally focuses upon Net Asset Values across various schemes and return on portfolio, but it is equally rather more important to ascertain the solvency of the mutual fund or asset management companies who are managing gargantuan funds. In view of this, the three major asset management companies that have been considered for the study, i.e. Birla Sunlife Asset Management Co. Ltd.; HDFC Asset Management Co. Ltd. and ICICI Prudential Asset Management Company Limited.

In order to judge the sustainability of the aforesaid asset management companies, Expected Growth Rate is computed. The period considered for the study is 2010-2015.

*Expected Growth Rate = Reinvestment Rate x Return on Capital*

*Return on Capital = EBIT (1-T) / Book Value of Debt + Book Value of Equity- Cash*

*T signifies Effective Tax Rate. It is derived by subtracting Profit After Tax from Profit / Earnings Before Tax and dividing the balance amount by Profit After Tax / Earnings Before Tax.*

*Reinvestment Rate = Capital expenditure - Depreciation + Change in noncash Working Capital / EBIT (1- T)*

*For deriving the figure for Capital Expenditure, Cash Flows from Investing Activities is referred.*

Birla Sunlife Asset Management Co. Ltd.

Expected Growth Rate

| Years | Expected Growth Rate |
|---|---|
| 2010 | 21.22% |
| 2011 | 14.96% |
| 2012 | 15.15% |
| 2013 | 11.99% |
| 2014 | -5.3% |
| 2015 | 9.6% |

HDFC Asset Management Co. Ltd.

| | |
|---|---|
| 2010 | -113.91% |
| 2011 | - 4.8% |
| 2012 | 13.3% |
| 2013 | 9.8% |
| 2014 | 6.60% |
| 2015 | 10.62% |

ICICI Prudential Asset Management Co. Ltd.

| | |
|---|---|
| 2010 | 6.9% |
| 2011 | 3.5% |
| 2012 | 8.97% |
| 2013 | 8.84% |
| 2014 | -2.1% |
| 2015 | 6.74% |

Please refer Appendix 2, 3 & 4 for detailed calculations for Birla Sunlife Asset Management Co. Ltd.; HDFC Asset Management Co. Ltd. and ICICI Prudential Asset Management Co. Ltd. respectively.

**Data Analysis or Findings**

First analyzing the impact of global economic crisis on mutual fund industry, especially on the profit after tax of three asset management companies considered for the study, it can be said that the impact was not of higher magnitude. However, it overall affected the Financial Services sector of Indian economy. Next coming to judging the sustainability of asset management

companies, the parameter used is 'Expected Rate of Growth', as growth signifies a business optimism and sustainable operations. In this regard, from the analysis of financial data of three asset management companies, viz; Birla Sunlife Asset Management Company Limited; HDFC Asset Management Company Limited and ICICI Prudential Asset Management Company Limited, it can be observed that in 2010 and 2011, HDFC Asset Management Company Limited witnessed negative expected rate of growth. However, the scenario improved from 2012 and its expected rate of growth forayed into positive territory.

In case of Birla Sunlife Asset Management Company Limited and ICICI Prudential Asset Management Company Limited their Expected Rate of Growth have entered negative zone in the year 2014. But overall the performance of all the three asset management companies appears to be satisfactory and their growth rate is expected to be rising given the positive business environment in India.

**Way Forward**

The Indian mutual fund industry is witnessing a metamorphosis. On one side it has witnessed numerous regulatory development while on the other hand, the overall economy is recouping from the aftermath of Global Economic crisis and Eurozone crisis. But the silver lining is that India is undoubtedly emerging as the next big investment destination, riding on high savings and investment rate, as compared to other Asian economies. As per 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. More than 50 percent of the population is below 25 years of age, with the proportion of working population likely to move up over the next decade. The trend of increasing personal incomes has been observed not only amongst the young population, but also high net worth (HNI) segment, which have sizeable sum to invest. One estimate reveals that there are more than 120,000 dollar millionaires in India and the number is growing. The household segment therefore offers huge scope for enticing investments. India has a robust middle class of 250-300 million, which is estimated to double over the next two decades. It is in the backdrop of some of these statistics that Indian mutual fund industry has fostered itself.

In current volatile market environment, mutual funds are considered as transparent and low cost investment vehicle, which lures a fair share of investor attention helping spur the growth of the industry. Over time, inclusive growth across the financial sector, seems to have occupied centre-stage, re-designing all business strategies around this sole objective. The mutual fund industry being no exception, various initiatives are being initiated by fund houses and distributors to spread access and reach to semi-urban and rural segments.

## Appendix 1

Here N1 =12,  N2=15,  N3= 10

**N = N1 + N2 + N3 =** 12+15+10 = 37

R1= 178

R2 = 311

R3 = 222

**$H = 12 / N (N+1) [ R1^2/ N1 + R2^2/N2 + R3^2/N3] – 3 (N+1)$**

$= 12 / 37 (38) [ (178)^2/ 12 + (311)^2 / 15 + (222)^2 / 10] – 3 (38)$

$= 12 / 1406 [ 2640 + 6448 + 4928] – 114$

= **5.55**

**Degrees of freedom = k-1 = 3-1 =2**

**Level of significance**: Here $\alpha = 0.05$

**The value of $\psi^2$ for 2 degrees of freedom for $\alpha$ =0.05 is 5.991**

## Appendix 2

## Birla Sunlife Asset Management Co. Ltd.

Expected Growth Rate for the year 2010

ROC = 72.61 (1-0.33) / 172.31 = 28%

Reinvestment Rate = 36.87 / 48.65 x 100 = 75.79%

Expected Growth Rate = 28% x 75.79% = 21.22%

Expected Growth Rate for the year 2011

ROC = 84.52 / 219.26 x 100 = 38.54%

Reinvestment Rate = 50.85 / 84.52 x 100 = 60.16%

Expected Growth Rate = 24.86% x 60.16% = 14.96%

Expected Growth Rate for the year 2012

ROC = 76.44 / 307.44 x 100 = 24.86%

Reinvestment Rate = 46.60 / 76.44 x 100 = 60.96%

Expected Growth Rate = 24.86% x 60.96% = 15.15%

Expected Growth Rate for the year 2013

ROC = 121.36 x 0.72 / 386.10 x 100 = 22.63%

Reinvestment Rate = 87.38 / 164.91 x 100 = 52.98%

Expected Growth Rate = 22.63% x 52.98% = 11.99%

Expected Growth Rate for the year 2014

ROC = 151.23 (1-.30) / 493.02 = 21.55

Reinvestment Rate = -26.06 / 105.86 x 100 = -24.62%

Expected Growth Rate = 21.55 % x -24.62% = -5.3%

Expected Growth Rate for the year 2015

ROC = 126.38 / 631.32 x 100 = 20.01%

Reinvestment Rate = 60.77 / 126.38 x 100 = 48.09%

Expected Growth Rate = 0.2001 x 0.4809 = 9.6%

## Appendix 3

## HDFC Asset Management Co. Ltd.

Expected Growth Rate for the year 2010

ROC = 316.29 (0.66) / 432.36 x 100 = 48.28%

Reinvestment Rate = -492.52 / 208.75 x 100 = -235.94%

Expected Growth Rate = 48.28% x -235.94% = -113.91%

Expected Growth Rate for the year 2011

ROC = 355.78 x (0.68) / 512.90 x 100 = 47.17%

Reinvestment Rate = -24.78 / 241.93 x 100 = -10.24%

Expected Growth Rate = 47.17% x -10.24% = -4.8%

Expected Growth Rate for the year 2012

ROC = 381.49 x (0.71) / 600.57 x 100 = 45.10%

Reinvestment Rate = 71.24 / 241.93 x 100 = 29.45%

Expected Growth Rate = 45.10% x 29.45% = 13.3%

Expected Growth Rate for the year 2013

ROC = 317.24 / 701.28 x 100 = 45.24%

Reinvestment Rate = 70.02 / 317.24 x 100 = 22.07%

Expected Growth Rate = 45.24% x 22.07% = 9.98%

Expected Growth Rate for the year 2014

ROC = 355.27 / 900.37 x 100 = 39.46%

Reinvestment Rate = 59.43 / 355.27 x 100 = 16.73%

Expected Growth Rate = 39.46% x 16.73% = 6.60%

Expected Growth Rate for the year 2015

ROC = 622.60 (1-0.33) / 1117.47 x 100 = 37.33%

Reinvestment Rate = 118.63 / 417.14 x 100 = 28.44%

Expected Growth Rate = 37.33% x 28.44% = 10.62%

## Appendix 4

## ICICI Prudential Asset Management Company Limited

Expected Growth Rate for 2010

ROC = 127.18 / 105.10 x 100 = 121%

Reinvestment Rate = 7.24 / 127.18 x 100 = 5.7%

Expected Growth Rate = 121%  x 5.7% = 6.9%

Expected Growth Rate for 2011

ROC = 103.37 (1-0.31) / 95.31 x 100 = 74.8%

Reinvestment Rate = 5.95 / 127.18 x 100 = 4.68%

Expected Growth Rate = 74.8% x 4.68% = 3.5%

Expected Growth Rate for 2012

ROC = 886.79 / 1566.5 x 100 = 56.61%

Reinvestment Rate = 167.5 – 8.8 / 886.79 x 100 = 15.84%

Expected Growth Rate = 56.61% x 15.84% = 8.97%

Expected Growth Rate for 2013

ROC = 1100.88 / 2019.5 x 100 = 54.51%

Reinvestment Rate = 178.5 / 1100.88 x 100 = 16.21%

Expected Growth Rate = 54.51% x 16.21% = 8.84%

Expected Growth Rate for 2014

ROC = 1826.022 / 2355.40 x 100 = 77.5%

Reinvestment Rate = -50.1 / 1826.022 x 100 = -2.74%

Expected Growth Rate = 77.5% x -2.74% = -2.1%

Expected Growth Rate for 2015

ROC= 2766.7 x (1-0.34) / 4543.5 x 100 = 40.19%

Reinvestment Rate = 306.3 / 1826.022 x 100 = 16.77%

Expected Growth Rate = 40.19% x 16.77 % = 6.74%

**Note**: *All the figures are in INR Crore.*

## Exhibit 1

## Total Net Assets and Net Sales of Mutual Funds Worldwide, 2007-11

US$ billion

| | 2007 | 2008 | 2009 | 2010 | | | | 2011 | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| *Total Net Assets* | | | | | | | | | | |
| All Funds | 26132 | 18920 | 22953 | 23017 | 21445 | 23696 | 24699 | 25617 | 25928 | 23127 |
| | | | | | | | | | | |
| Equity | 12343 | 6435 | 8874 | 9215 | 8220 | 9295 | 10470 | 11002 | 11004 | 9043 |
| Bond | 4288 | 3400 | 4567 | 4736 | 4767 | 5290 | 5434 | 5638 | 5868 | 5638 |
| Money Market | 4940 | 5786 | 5317 | 4840 | 4475 | 4586 | 4995 | 4970 | 4933 | 4746 |
| Balanced/Mixed | 2726 | 1825 | 2399 | 2382 | 2248 | 2610 | 2771 | 2937 | 3019 | 2693 |
| Other | 884 | 676 | 840 | 862 | 814 | 949 | 1029 | 1070 | 1103 | 1006 |
| *Net Sales* | | | | | | | | | | |
| All Funds | 276 | 272 | 191 | –72 | –84 | 196 | 152 | 79 | 109 | –171 |
| | | | | | | | | | | |
| Equity | –372 | 188 | 134 | 70 | –2 | –23 | 89 | 57 | 23 | –109 |
| Bond | –196 | 628 | 468 | 170 | 103 | 163 | 33 | 62 | 101 | 10 |
| Balanced/Mixed | 888 | –640 | –710 | 52 | 45 | 37 | 39 | 47 | 59 | –20 |
| Other | –80 | 116 | 174 | 8 | 4 | 13 | 10 | 13 | 10 | 10 |
| Money Market | 35 | –19 | 34 | –395 | –253 | –17 | –45 | –101 | –85 | –63 |

Source: Investment Company Institute

## Exhibit 2

## Worldwide Mutual Fund Assets

(Total Net Assets in US$ terms, US$ million)

| | 2007 | 2008 | 2009 | 2010 | | | | 2011 | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| World | 26,132,315 | 18,920,012 | 22,952,849 | 23,016,700 | 21,444,650 | 23,695,966 | 24,699,197 | 25,617,273 | 25,927,681 | 23,127,048 |
| Americas | 13,423,908 | 10,581,943 | 12,585,819 | 12,742,608 | 11,993,232 | 12,914,576 | 13,586,870 | 14,074,307 | 14,178,242 | 12,854,169 |
| Brazil | 615,365 | 479,321 | 783,970 | 4,522 | 4,155 | 922,663 | 980,448 | 1,055,418 | 1,104,956 | 952,039 |
| Mexico | 75,428 | 60,435 | 70,659 | 81,363 | 83,776 | 92,502 | 98,094 | 100,349 | 106,261 | 90,662 |
| United States | 12,002,282 | 9,603,604 | 11,120,196 | 11,203,919 | 10,502,747 | 11,266,667 | 11,820,677 | 12,188,665 | 12,238,259 | 11,052,166 |
| Europe | 8,934,861 | 6,231,116 | 7,545,535 | 7,511,015 | 6,794,684 | 7,779,834 | 7,903,389 | 8,322,160 | 8,425,134 | 7,313,179 |
| France | 1,989,690 | 1,591,082 | 1,805,641 | 1,727,396 | 1,486,573 | 1,669,231 | 1,617,176 | 1,700,497 | 1,695,270 | 1,458,840 |
| Germany | 372,072 | 237,986 | 317,543 | 314,609 | 279,947 | 323,372 | 333,713 | 351,633 | 357,476 | 299,650 |
| Greece | 29,807 | 12,189 | 12,434 | 10,743 | 7,964 | 9,072 | 8,627 | 9,301 | 8,222 | 6,399 |
| Italy | 419,687 | 263,588 | 279,474 | 260,967 | 225,774 | 248,630 | 234,313 | 238,206 | 234,042 | 201,696 |
| Spain | 396,534 | 270,983 | 269,611 | 252,720 | 211,332 | 231,952 | 216,915 | 235,409 | 234,168 | 206,315 |
| United Kingdom | 897,460 | 504,681 | 729,141 | 732,636 | 687,119 | 808,750 | 854,413 | 885,250 | 895,759 | 785,318 |
| Asia Pacific | 3,678,325 | 2,037,536 | 2,715,234 | 2,757,171 | 2,549,346 | 2,875,271 | 3,067,323 | 3,078,863 | 3,181,155 | 2,839,233 |
| China | 434,063 | 276,303 | 381,207 | 345,665 | 298,308 | 344,517 | 364,985 | 353,064 | 348,751 | 319,975 |
| India | 108,582 | 62,805 | 130,284 | 117,432 | 118,380 | 123,395 | 111,421 | 98,186 | 118,992 | 102,183 |
| Japan | 713,998 | 575,327 | 660,666 | 681,487 | 671,814 | 749,058 | 785,504 | 785,658 | 816,325 | 751,210 |
| Korea | 329,979 | 221,992 | 264,573 | 281,282 | 252,851 | 269,406 | 266,495 | 259,985 | 254,410 | 223,805 |
| Taiwan | 58,323 | 46,116 | 58,297 | 56,644 | 52,440 | 53,841 | 59,032 | 56,913 | 60,604 | 51,829 |
| South Africa | 95,221 | 69,417 | 106,261 | 112,226 | 107,388 | 126,285 | 141,615 | 141,943 | 143,150 | 120,467 |

Source: Worldwide Mutual Fund Assets and Flows Quarterly, Investment Company Instit

## Exhibit 3

## Category-wise, Net Investments, Sales and Redemptions of all Mutual Funds

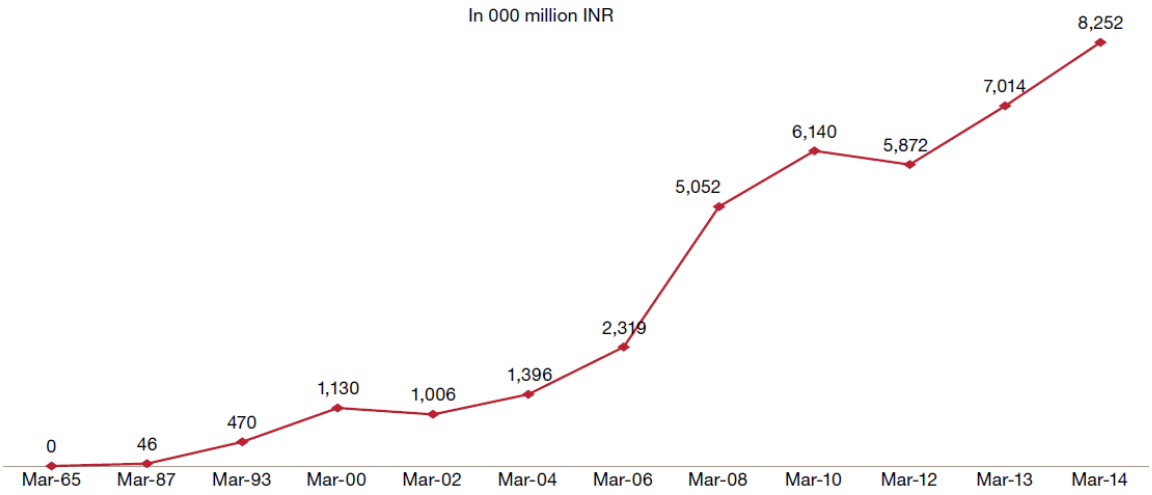
(Rs. crore)

| As of March 31 | 2008 | 2009 | 2010 | 2011 | end-2011 |
|---|---|---|---|---|---|
| ***Net Inflow/Outflow*** | | | | | |
| Income | 88456 | –32168 | 96578 | –36706 | –5422.06 |
| Equity | 40782 | 1056 | 595 | –13405 | 3596.87 |
| Balanced | 5768 | 60 | –693 | 1344 | 620.74 |
| Liquid/Money Market | 14977 | –3599 | –12073 | –3520 | 36144 |
| Gilt | 434 | 3606 | –3297 | –116 | –506 |
| ELSS-Equity | 6151 | 2968 | 1554 | 266 | –376 |
| Gold ETFs | 277 | 84 | 804 | 2250 | 3248.05 |
| Other ETFs | –3044 | –1082 | –20 | 1388 | –541 |
| Fund of Funds Investing Overseas | | 778 | –367 | –907 | 133 |
| Total | 153801 | –28297 | 83081 | –49406 | 36918 |
| ***Sales*** | | | | | |
| Income | 881345 | 1180694 | 2895901 | 2172860 | 604867.49 |
| Equity | 119838 | 29481 | 61114 | 63142 | 37193.74 |
| Balanced | 11488 | 2695 | 4693 | 7490 | 3777.97 |
| Liquid/Money Market | 3432738 | 4187977 | 7044818 | 6599724 | 4424675 |
| Gilt | 3180 | 14696 | 3974 | 4450 | 2120 |
| ELSS-Equity | 6448 | 3324 | 3601 | 3450 | 1566 |
| Gold ETFs | 433 | 271 | 997 | 2843 | 4719.83 |
| Other ETFs | 8906 | 5448 | 2538 | 4867 | 2879 |
| Fund of Funds Investing Overseas | .. | 1767 | 1387 | 689 | 913 |
| Total | 4464376 | 5426353 | 10019023 | 8859515 | 5082845 |
| ***Redemptions*** | | | | | |
| Income | 792889 | 1212862 | 2799323 | 2209566 | 610289.55 |
| Equity | 79056 | 28425 | 60519 | 76547 | 33596.87 |
| Balanced | 5720 | 2635 | 5386 | 6146 | 3157.23 |
| Liquid/Money Market | 3417761 | 4191576 | 7056891 | 6603244 | 4388531 |
| Gilt | 2746 | 11090 | 7271 | 4566 | 2626 |
| ELSS-Equity | 297 | 356 | 2047 | 3184 | 1922 |
| Gold ETFs | 156 | 187 | 193 | 593 | 1471.78 |
| Other ETFs | 11950 | 6530 | 2558 | 3479 | 3420 |
| Fund of Funds Investing Overseas | .. | 989 | 1754 | 1596 | 1046 |
| Total | 4310575 | 5454650 | 9935942 | 8908921 | 5045927 |

Source: SEBI

**Exhibit 4**

**AuM Growth**




Source: PwC

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