THE SCANNER

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The Rise of Mutual Funds: Opportunities and Challenges Ahead

Underpinning India's rapid economic ascent is its burgeoning financial services sector. With India's GDP per capita crossing the USD 2,000 mark, inevitably, along with consumption, the demand for the right savings and investment vehicles has gone up. This is evident from the rapid growth being witnessed by India's mutual fund industry which has grown from 30 AMCs **with AUM of INR 2.6 trillion in FY06 to 45 players with AUM of INR 67.26 trillion, as on October 2024[1].** However, considering that India's MF AUM to GDP ratio, currently at 18.4%, is significantly below the **global average of 74%[2],** there persists immense scope for incremental penetration and growth. A further deep dive into the contours of this growth reveal some interesting trends.

Key Trends in India's MF Industry

SIPs : Leading from the Front:

Systematic Investment Plans (SIPs) continue to dominate as the preferred investment route of choice with SIP assets accounting for over 20% of the industry's assets. For FY24, the net inflows through SIPs stood at nearly INR 2 trillion vs INR 1.55 trillion in the previous fiscal year. The number of SIP accounts reached nearly 84 million with an average of 1.7 million accounts added per month. Notably, SIP is positioned as an ideal vehicle for equity exposure, with equity-oriented schemes deriving 35% of their AUM from SIP investments.

Shifting Investor Composition:

The industry has witnessed a gradual shift from institutional, mainly corporate to individual investors. The share of institutional investors, comprising corporates, banks / financial institutions and Foreign Portfolio Investors (FPIs) has gradually declined from 45% as of March 2019 to 37% as of March 2024. Correspondingly, participation from individual investors has witnessed a significant rise with individual AUM growing at a CAGR of 20% (compared to the industry average of 17% from 2019-2024), driven by increased participation in equity funds. . Equity oriented schemes derive 88% of their assets from individual investors (Retail + HNI) while institutional investors dominate liquid and money market schemes (88%), debt-oriented schemes (62%), and ETFs, FoFS (89%).

The Rise of Passive Funds:

With rising popularity of passive funds in India and increased awareness amongst investors about passive funds, benefit of lower expense ratio and ease of investment, passive funds AUM has grown at a CAGR of approximately 44% between March 2012 and March 2024. The share of passive funds AUM (excluding EPFO) in total AUM has increased from 1.7% in March 2012 to 11.1% in March 2023. With several new index funds and ETFs rolling in FY 2024, the AUM of passive funds increased to INR 8.74 trillion as of March 2024. Passive funds, particularly ETFs have sustained asset growth in 2024, led by increased popularity and institutional investments from entities such as provident funds, which have contributed to the segment's expansion.

Drivers of Future Growth

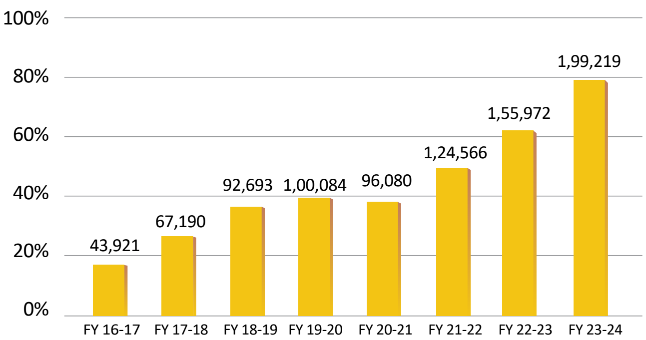
A confluence of factors, including the financialisation of savings, rising affluence and product innovation, is creating fertile ground for AMCs to expand and thrive. Further, India boasts of more than 70 Crore PAN card holders and over 15 Crore demat accounts. However, despite this

[1] https://www.amfiindia.com/indian-mutual#:~:text=Assets%20Under%20Management%20(AUM)%20of,a%20span%20of%2010%20years.
[2] https://www.livemint.com/mutual-fund/mf-news/mf-industry-in-india-remains-significantly-under-penetrated-compared-to-global-averages-deepak-parekh-11656508819068.html

significant financial infrastructure, the Indian mutual fund industry has only reached about 4.5 Crore unique investors. These statistics emphasise a vast untapped potential for growth within the mutual fund sector. As India's working population continues to expand and financial inclusion and digitalisation efforts gain momentum, mutual funds are poised to assume a crucial role in democratising investments and promoting financial literacy. This decade promises significant opportunities for the industry to capture a larger share of India's growing savings pool.

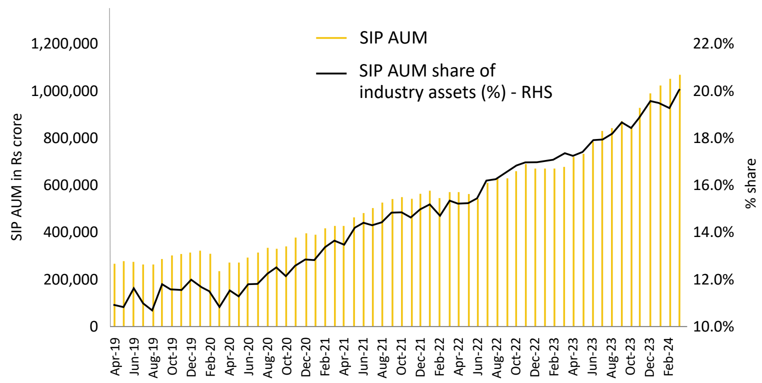
Exhibit: Industry SIP trends

SIP Yearly contribution (Rs. in Cr)



Source: AMFI

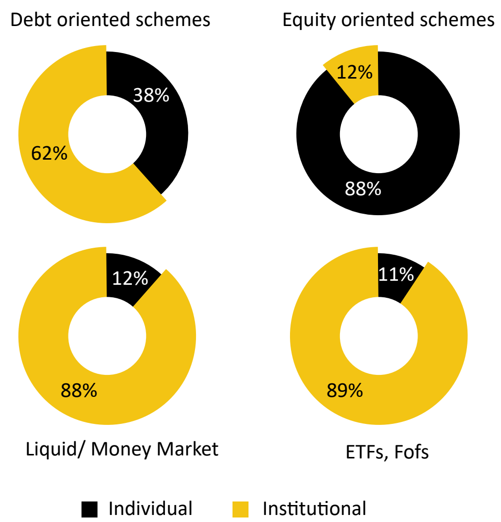
SIP AUM vs Industry Share



Source: AMFI

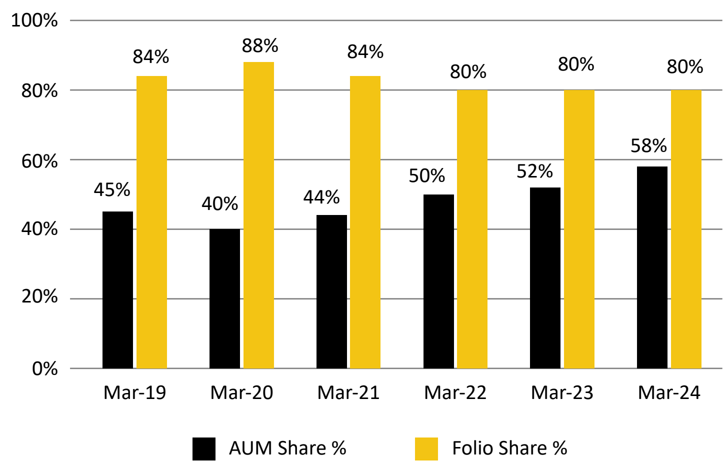
Exhibit: Exposure basis investor segments

Investor categories across scheme types



Source: AMFI

Individual Investor- Oriented schemes share of the industry



Source: AMFI

Exhibit: Growth in passive funds' AUM

Passive Funds (Rs in Cr)	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	CAGR
IndexFunds	-	-	-	-	-	-	-	-	7,972	16,851	52,550	1,37,278	2,06,944	126%
ETFs (including EPFO)	11,146	13,461	10,668	14,371	19,261	42,784	75,793	1,18,809	1,80,540	2,88,123	4,12,938	5,09,454	6,67,446	41%
EPFO	-	-	-	-	6,578	18,873	43,663	74,324	1,05,825	1,37,896	1,59,299	1,96,688		62%
as % of Total ETF					34%	44%	58%	63%	59%	48%	39%	39%		
Total Passive Funds (Including EPFO)	11,146	13,461	10,668	14,371	19,261	42,784	75,793	1,18,809	1,88,512	3,04,974	4,65,488	6,46,732	8,74,390	44%
Total Passive Funds (excluding EPFO)	11,146	13,461	10,668	14,371	12,683	23,911	32,130	44,485	82,687	1,67,078	3,06,189	4,50,044		40%
Total AUM	6,64,792	8,16,657	9,05,121	11,88690	13,53,443	18,29,584	23,05,212	24,48,438	27,03,675	32,10,593	38,37,994	40,51,147	54,13,173	19%
% of Total AUM	1.7%	1.6%	1.2%	1.2%	0.9%	1.3%	1.4%	1.8%	3.1%	5.2%	8.0%	11.1%		

Q&A

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Do you think that financialisation of savings will play a critical role in boosting MF AUM?

As per the estimates of Goldman Sachs and CRISIL the share of net financial savings has increased to nearly 6% of GDP (5.1% in FY23). Post-pandemic there has been a shift from traditional deposits to equities, mutual funds, small savings, and other instruments. Further, this trend is expected to continue. Inarguably, the mutual fund industry will benefit from this shift. For example, as per a study by Franklin Templeton, the AUM of the mutual fund industry is 31.30% of the total bank deposits in India as of March 2024. This proportion has tripled in 10 years from 10.7% in March 2014.

How does India score vis-a-vis global counterparts when it comes to MF AUM as a % of GDP?

India has witnessed impressive growth in its mutual funds industry over the years with AUM-to-GDP ratio reaching an all-time high of 18.2% in FY2024. This was driven by increasing retail participation, increasing folio count, robust growth in investments through SIPs, and ease of access and investing provided by various platforms. FY2024 was a positive year in terms of growth of the mutual fund industry, with the strong gain in industry assets supported by a growth of investors in mutual funds. However, India's mutual fund penetration (AUM-to-GDP) is significantly lower when compared to many developed economies. This reflects that Indian mutual fund industry is still in its infancy and there is a scope for development.

What are the challenges that can impede the growth of the industry?

- Upfront commission to distributors has been discontinued, implying distributors would reduce the portfolio churning but would opt for higher alpha investment. Hence, underperformance could lead to market share decline over time.
- One scheme per category constraint, future inflows would increase the AUM size of scheme and hence, there is a possibility that scheme may not be able to outperform market and peers like before.
- As markets mature over the years, the expense ratio may decline as the alpha generated tapers down. This may limit the operating leverage benefit for the Company. Pressure on margins will continue considering TER structure of the industry.
- Share of passive funds in India is relatively low, however, the share has been growing at a faster rate because the expense ratio tends to be lower.
- Competitive intensity is very high with products lacking differentiation on their own. Competition is more on brand and distribution, as well as past performance, but it is unlikely (and has been seen in past data) that one fund house will consistently outperform everyone else for a long period of time.

As MF AUM grows, what will be the impact on AMCs?

Inevitably, as the industry grows, AMCs would be the likely beneficiary of this growth.

AMCs primarily earn through management fees charged as a percentage of AUM. As AUM increases, their revenue from management fees rises, provided expense ratios remain stable. Further, larger AMCs would be able to harness economies of scale - larger AUM allows AMCs to spread operational costs over a broader base, improving profitability margins. Additionally, larger AUM is often associated with greater trust and credibility in the market, attracting more investors. At the same time, it is important to recognise that what is more important is the consistent performance of the fund across market cycles and the ability of the fund manager to deliver good returns despite varying AUM. If a fund is very large, it may be challenging for it to generate high returns.

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