

Mutual funds  
**Enormous  
growth potential**



The vibrant asset management industry in India, projected to see a near quadrupling of assets over the next seven years, has attracted several new international and domestic players, who are expected to launch a slew of mutual fund schemes over the next few months. A report by **Anand Kumar**.

INDIA'S buoyant asset management industry, set to continue expanding at a breathtaking pace, is attracting several new players, both international and domestic. Over a score of funds are awaiting approval, and about a dozen are expected to start operations over the next one year.

The Indian mutual fund industry – with 33 mutual funds – had assets under management (AUMs) of about \$133.5 billion towards the end of April, according to the Association of Mutual Funds in India (AMFI). Assets have increased by nearly 60 per cent over the past one year.

What is attracting a growing number of asset management firms is the enormous potential for growth. McKinsey & Co projects that the industry is likely to surge to \$440 billion by 2012, growing at 33 per cent per annum. The Boston Consulting Group estimates that it would expand to \$520 billion by 2015.

The retail segment is likely to grow at about 40 per cent per annum, boosted by the huge gross domestic savings rate in India, currently placed at 32 per cent. Institutional investments are expected to surge by about 30 per cent every year, according to McKinsey & Co. Consequently, the product offering will also expand, as asset management firms are expected to offer dedicated funds for the real estate, infrastructure and entertainment industries.

A.P. Kurien, chairman, AMFI, notes that there is room for many more players, as the existing mutual funds have just scratched the surface. Barely five per cent of Indian households are investing in mutual funds, notes Kurien. The AMFI chief says over a dozen new mutual fund companies will start operations over the next 12 months.

New international fund-houses that are awaiting the nod from the Securities

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and Exchange Board of India (SEBI), the capital markets regulator, include UBS of Switzerland, Japan's Shinsei Bank and US-based Goldman Sachs.

"We will bring in new asset classes, better service standards," says Sanjay Sachdev, country manager, fund management, South-East Asia, Shinsei Bank. "The funds that already exist in India have only gone for the low-hanging fruits. We wish to expand the market."

The Foreign Investment Promotion Board (FIPB) of the Government of India had in October cleared the proposal of Goldman Sachs to set up an asset management company in India with an initial investment of \$50 million. The investment bank, which is registered as a foreign institutional investor with SEBI, already has a licence for merchant banking and brokerage services.

"We are ready to look at all opportunities in India," says L. Brooks Entwistle, managing director and ceo, Goldman Sachs India. "Having a significant presence in India is a must for any firm that describes itself as global." The firm, which is awaiting SEBI's approval, has already relocated its Hong Kong-based chief financial officer to India to head its asset management business.

French finance major AXA is also entering the mutual fund segment. The group has a joint venture, Bharti AXA Life Insurance, with India's leading telecommunications group. Says Sandeep Dasgupta, ceo, Bharti AXA Investment Managers: "We are determined to go the whole hog. Initially, the focus will be to build a strong domestic retail-oriented business."

According to Dasgupta, the Indian mutual fund industry is at an inflection point. "I expect it to grow at about 35 per cent annually for the next seven-eight years," he notes. "The presence of mutual funds is confined to about six to eight of

the largest cities. But now mutual funds are seeing a lot of retail participation from tier II and tier III cities."

Starting a fund-house in a bearish market also has its advantages, explains Dasgupta. "Since the market is already low, the downside risk is less. Customers also start out with moderate expectations."

Other top international investment banks, including Merrill Lynch, Morgan Stanley and JPMorgan Chase & Co, already have a strong presence in the Indian asset management business. International fund-houses have been growing

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their presence in the Indian mutual fund sector, which today has 33 players, both domestic and foreign.

Earlier this year, South Korea's biggest mutual fund firm, Mirae Asset Management, launched its first fund in the country. Last year saw American International Group Inc and JPMorgan Chase launch their asset management companies in India. And Morgan Stanley launched a fund after nearly 15 years in February.

UK-based Schroders Plc, an over 200-year-old global asset management company, is also keen on entering the Indian asset management business. The group is looking for potential partners and is in talks with many domestic groups.

Several domestic players, including brokerage houses, are also planning to set up asset management companies. Bajaj Finserv Ltd, the newly incorporated

subsidiary of Bajaj Holdings and Investment Ltd (formerly Bajaj Auto Ltd), is one of them.

"This is the right time to get into the asset management business," says Sanjiv Bajaj, managing director of Bajaj Finserv. "India's young population, earning like never before, wants investment opportunities other than the low-yield fixed interest rates of banks. In the next five years, 50-60 per cent of our business top-line will come from asset management, lending and distribution business. The rest will come from insurance."

It is also looking for a strategic inter-

national partner for its asset management business. "We intend to freeze the details of the venture including any possible overseas partner by September," adds Bajaj.

Another new asset management company that plans to launch its fund by September is Religare Aegon Asset Management, a joint venture between Dutch insurer Aegon and financial services company Religare Enterprises, formerly the financial arm of pharmaceutical major Ranbaxy Laboratories.

Says Saurabh Nanavati, ceo, Religare Aegon Mutual Fund: "We may be the



35th asset management company to be opening shop in India but we want to get into the top 10 from a distribution perspective." The company aims to be present in at least 100 cities in the first two years of its operation. And like many of the new entrants, Religare also aims to strengthen its presence in tier II and tier III cities.

India's real estate giant, the DLF group,



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has set up a joint venture with Prudential Financial Inc of the US, which is also planning a foray into the mutual fund business. DLF Pramerica Asset Managers Pvt Ltd will offer a range of mutual funds and investment products; it will also have a separate life insurance company.

"India poses a great opportunity with the economy on the upswing," says

Stephen Pelletier, chairman and ceo, Prudential International Investment. "As much as \$140 billion of assets are under management in India and it is growing significantly."

Half a dozen brokerages and financial services firms are also planning mutual fund forays in India. The first off the mark is Edelweiss Capital, which recently got regulatory approval from SEBI. The new asset management company plans to launch nine products over the next 12 months. "We believe that the time is right for us to enter the market by offering customer-specific solutions across the range of debt, arbitrage and equity products," explains Jimmy A. Patel, ceo, Edelweiss Asset Management. "The Indian mutual fund industry has been growing at a rapid pace of 47 per cent year-on-year over the last five years. However, current penetration levels are just three to four per cent of household savings, clearly indicating the vast untapped potential."

Another new entrant, with SEBI's approval for a fund, is Indiabulls Financial Services Ltd. Gagan Banga, the company ceo, says the first mutual fund scheme would be launched by October. The company is also planning to set up a life insurance venture with Sogecap, a subsidiary of French bank Societe Generale.

SEBI chairman C.B. Bhave says, "As India integrates with the world, and with our markets getting more sophisticated, we will see more complex products for investment available. Understanding these products and their inherent risks will become increasingly important. We may need to hone our skills to understand these products better."

Bhave wants the burgeoning mutual fund industry to tap into the non-metro market in India. "There is a market out there, which is untapped. This is a challenge for all of us as to how to reach this market. We have to see that the message is delivered in a language the investor understands," he adds.

SEBI, together with the country's central bank, the Reserve Bank of India (RBI), has enhanced the overseas investment ceiling for mutual funds to \$7 billion. Indian mutual funds can invest in American depository and global depository receipts, equity of overseas companies, foreign debt securities in countries with

fully convertible currencies and money market instruments rated not below investment grade.

But international money managers are expected to continue making a beeline for India, as several sectors throw up opportunities. They include real estate and entertainment and media. Top international investors including Blackstone, Warburg Pincus, Goldman Sachs, Lehman Brothers and Temasek already have a strong exposure to the burgeoning entertainment and media sectors.

Asset management firms are now expected to float thematic funds focussed on these rapidly expanding sectors of the Indian economy. A couple of them – Reliance Mutual and Sundaram BNP Paribas – have already launched focussed funds.

But the most popular funds are equity-linked savings schemes (ELSS), with small savers lapping up such products launched by a growing number of fund houses. According to the AMFI, assets of ELSS funds have jumped by almost 10 times

over the last three years. In fiscal 2008, ELSS funds gained by almost 60 per cent, as against less than 40 per cent growth for diversified equity funds.

These schemes are popular as they entitle investors to avail of tax breaks of up to \$2,350 a year. They have also

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churned out hefty returns to investors.

Similarly, systematic investment plans (SIPs) are proving to be extremely popular among small investors, as they enable them to save a fixed sum – from as low as \$24 a month – regularly.

The mutual fund industry could see some churning, as companies that are not faring well decide to sell off schemes or funds to others. With competition growing, size will indeed matter. According to the Boston Consulting Group, an asset management company would need a corpus of at least \$2.5 billion to break even. Just about half of the existing fund houses have assets exceeding that sum.

The potential for growth for the Indian mutual fund industry is indeed enormous. There's a huge generational shift in investment habits and patterns, especially among the young. Not content with plain old vanilla bank deposits, a growing number of Indians are seeking out more exciting and lucrative products. And fund houses are whetting their appetite through attractive schemes.

## FUNDING REALTY

THE asset management industry in India got a boost recently, with the Securities and Exchange Board of India (SEBI), the capital market regulator, giving the go-ahead for the launch of real estate mutual funds (REMFs).

"This opens up a new avenue for the common investor," points out A.P. Kurian, chairman, Association of Mutual Funds in India. "He can now access the real estate market with whatever small amount he has by buying units of such funds. It works just like any other mutual fund, but with real estate and related securities as the underlying assets."

Several international and domestic asset management companies are likely to launch REMFs over the coming weeks. "The entry of institutions will broaden and deepen the market and also create liquidity," explains Sumeet Mehta, vice-president, Capital Markets, Jones Lang La Salle Meghraj (India), a real estate consultancy firm. "Scientific investment methods and financial models will be used widely,

which will result in a better price-discovery mechanism."

Fund houses plan to launch REMFs, enabling investors to acquire stakes in real estate projects in major Indian cities for as little as \$120. According to the SEBI guidelines on REMFs, they will be close-ended funds and a minimum of 35 per cent of the corpus has to be invested in real estate assets. The balance could be invested indirectly through investment in mortgage-backed securities and securities in companies dealing in real estate development. About a quarter of the corpus can be invested in other instruments. REMFs have to declare their net asset value on a daily basis and list them on the stock exchanges; they have to get their assets valued every 90 days by two valuers. All physical assets must be in large cities – with a population of over a million.

The opening up of the real estate sector for mutual funds has elicited keen interest from international fund houses. John A. Thain, chairman and ceo,

Merrill Lynch, says his firm is looking at opportunities in the REMF business in India in due course. "We have big plans for India, which is still one of the world's fastest growing economies, and are well poised to advise Indian companies acquiring assets abroad," adds Thain.

Old Mutual Investment Group Property Investments (OMIGPI), the real estate unit of the leading South African fund house, also plans to set up a real estate mutual fund. According to Colin Young, director, OMIGPI, the fund will raise money locally and invest in realty assets. The group also plans to be among the top retail developers in India and one of the largest real estate asset managers in India, with an exposure of over a billion dollars through four funds.

The real estate sector in India, growing at double-digit rates over the past few years, is set to see a lot more of liquidity soon with the launch of REMFs by both international and domestic fund houses.



UNTAPPED POTENTIAL: The challenge for capital market players is to reach out to the vast untapped segment