Surging Growth of India’s Mutual Fund Industry

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Introduction

In recent years, India's mutual fund industry has emerged as a powerhouse, attracting a surge of investors seeking avenues for wealth creation and financial growth. This growth story is multifaceted, driven by a combination of factors that have reshaped the investment landscape in the country.

Recent Developments

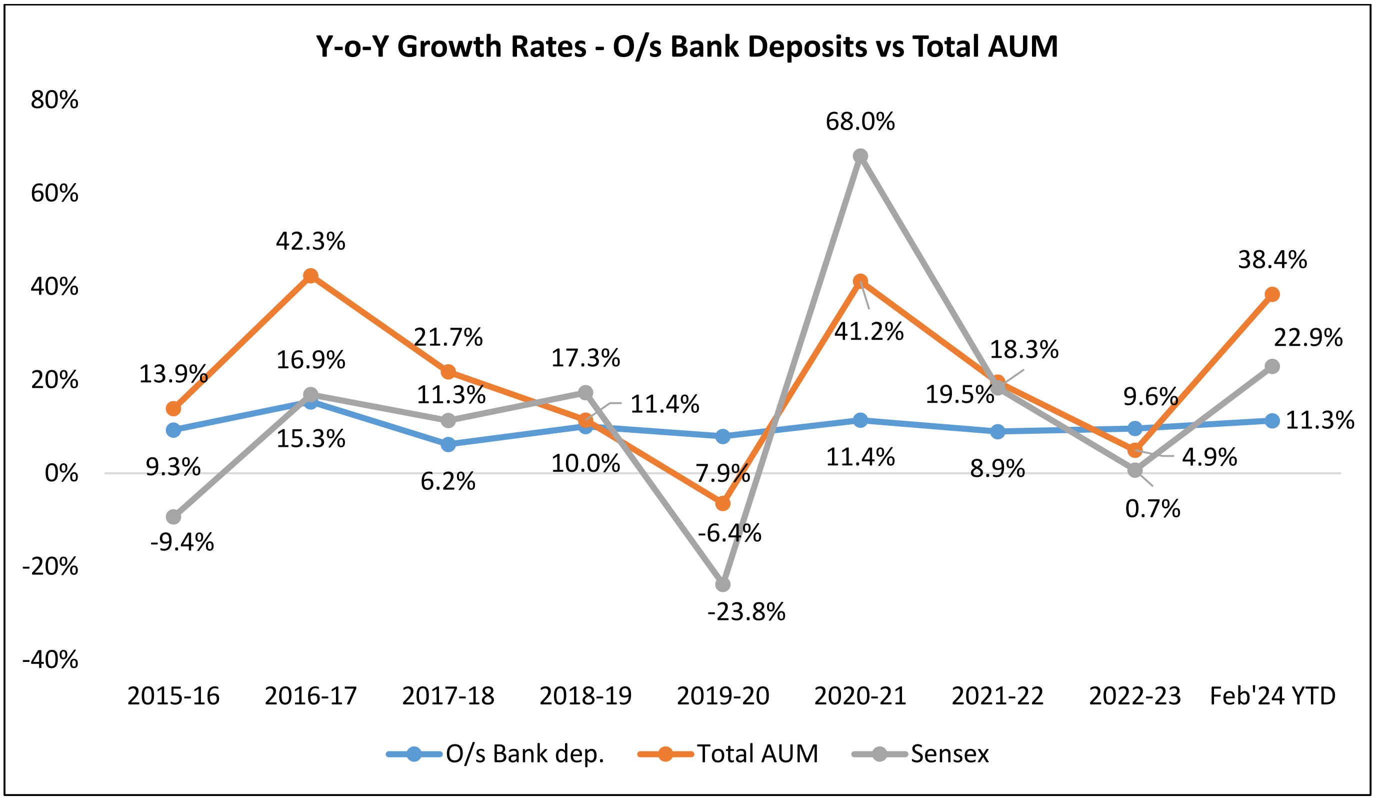
One of the pivotal factors behind the rapid growth of the mutual fund industry in India is the rising level of investor awareness. With access to information becoming easier than ever before, Indian investors are increasingly knowledgeable about various investment avenues beyond traditional options like bank deposits.

The advent of digital platforms and online investment portals has revolutionized the way investors access and invest in mutual funds. These technological advancements have democratized investing, making it more accessible and convenient for individuals across urban and rural areas.

The industry achieved a significant milestone when its Assets Under Management (AUM) crossed ₹10 lakh crore for the first time in May 2014. Within a short span of about three years, the AUM more than doubled in size, crossing ₹20 lakh crore in August 2017.

Post 2019, a significant transformation occurred in the financial landscape, with interest rates being kept at historical lows. Subsequently, the AUM crossed the ₹30 lakh crore mark for the first time in November 2020. As of February 29, 2024, the Industry AUM stood at ₹54.54 lakh crore, recording a CAGR of 20% over the last 9 years. In comparison, bank deposits have grown at a CAGR of 10% during this period.

Mutual funds present the potential for higher returns; however, they also entail market-linked risks, making them susceptible to volatility. On the other hand, bank deposits are considered safer and more conservative, offering assured returns.



Source: AMFI, RBI, CMIE

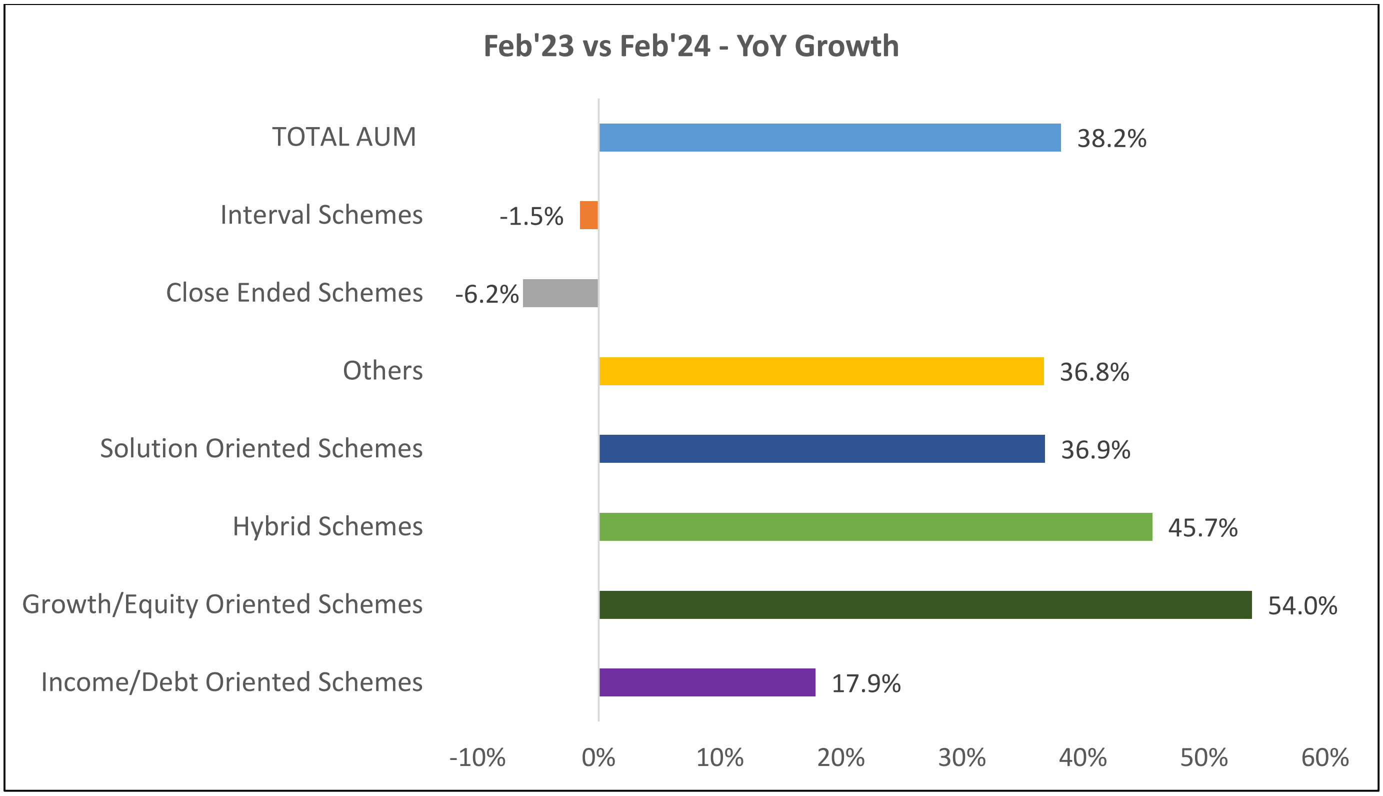
In the above chart, it is clear that post FY20, while y-o-y growth rates of bank deposits have remained largely stable, there has been a substantial jump in growth rate of AUM of the mutual fund industry in line with growth in the benchmark BSE Sensex Index. As the y-o-y growth of Sensex slipped to 0.7% in FY23 on the back of volatility in financial markets fueled by geopolitical conflicts in Ukraine and Middle East and the resultant supply chain disruptions, the growth of AUM also fell to 4.9%.

However, growth in bank deposits remained stable at 9.6% during this period. This was also driven by an increase in Weighted Average Term Deposit Rates of SCBs, which rose from 5.07% in May'22 to 6.16% in Mar'23.

Mutual Fund Growth – Story so far

The chart below shows the y-o-y growth in various categories of mutual fund investments in Feb'24. The total AUM of the industry grew by 38.2% during this period. Notably, the growth in Bank Deposits during this period stood at 12.4%.

Mutual funds offer a diverse range of investment options tailored to different risk profiles and investment objectives. This diversity has been instrumental in attracting investors who seek opportunities for growth beyond conventional avenues.



Source: AMFI, RBI, CMIE

High growth rates (>30%) have been witnessed across equity, hybrid, solution oriented and others segment. In the equity segment, growth was driven by inflows in mid and small cap segments. Investor interest in hybrid schemes has increased consistently post a change in taxation laws for debt funds in April 2023.

All these changes are largely indicative of the higher risk taking appetite of retail investors who have preferred to invest in growth/equity oriented schemes in anticipation of higher returns especially as inflation has remained above 5%.

Analysis

The data for AUM and O/s Bank deposits reveals a strong positive Pearson's correlation coefficient of 0.98, indicating that an increase in bank deposits leads to an increase in AUM of the industry and vice versa. Any fears that the mutual fund industry will eat into the deposit growth of banks seems to be misplaced.

To supplement this claim, a regression analysis (with AUM as independent variable and bank deposits as a dependent variable) reveals that for a 1 per cent change in the AUM of mutual fund industry, there will be a 0.92 percent change in the O/s deposits of the SCBs, all else remaining equal. Thus, with an increase in GDP and disposable income of people, there will be an increase in both AUM and bank deposits in future.

The data for the flow of household sector savings into various instruments during FY23 further reveals that households have been fairly conservative and have invested only 6% of their gross financial savings into mutual funds and 1% towards equity, with the balance 93% going towards fixed-income instruments like bank deposits, PPF, small savings schemes etc.

Concluding Observations

While the mutual fund industry and banking sector in India may compete for the same pool of savings and investments, they also exhibit complementary characteristics. Banks and mutual funds can collaborate to offer innovative financial products and services. For instance, banks can distribute mutual fund products through their branches, leveraging their extensive network and customer base. This collaboration enhances customer reach for mutual funds while providing banks with additional revenue streams. Regulations like ASBA, which ensure increased customer interaction and transaction load for the banks along with earnings in the form of custodian fees for holding funds on behalf of investors, are likely to shape the future of both the industries.

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