The cogs

Intermediaries are at the heart of the mutual fund industry

March 2023

Contents

Executive summary

The mutual fund industry in India has clocked a scorching pace of growth in recent years to over Rs 40 lakh crore in assets under management and around 14 crore folios as of December 2022 compared with around Rs 25 lakh crore of assets and 8 crore folios as of April 2019.

However, despite this headroom and the aggressive growth seen in recent years, the mutual fund industry has not even scratched the surface of its potential as a large part of Bharat remains deprived of investing their monies in mutual funds to benefit from the capital market.

To be sure, mutual funds present a huge investment opportunity for investors to benefit from the capital market and earn better returns compared with traditional fixed-income instruments such as bank fixed deposits.

Investing in mutual funds over a long term can also be a win-win for the mutual fund industry given the large young population of the country, which translates into a large workforce and individuals with long investment horizons.

In the milieu, intermediaries are expected to continue playing a critical role in growth of the mutual fund industry in years to come.

As things stand, investors new and old alike need guidance. A look at the break-up of money invested in mutual funds by individual investors shows that over 77% of their investment is invested through regular plans.

Typically, investors tend to panic and exit when markets are volatile. While this has changed with investor bent shifting towards systematic investment plans (SIPs), net flows into the industry remain lumpy.

An analysis of money coming into the direct and regular equity and hybrid mutual funds of Edelweiss Mutual Fund shows regular plans are accumulating assets at an increasing pace during both secular and volatile market phases compared with direct plans.

Further, holding period data of equity and hybrid schemes shows 32% of investors stay invested in the scheme for over 24 months when investing through a regular plan compared with just 14% when the investment is made through a direct plan.

Thus, there is no reiterating the need for a developed intermediary system. Seen in the global context, there is much headroom.

In India, the insurance industry has the lead in intermediation, mainly due to the vintage and wide footprint of the Life Insurance Corporation of India.

Achieving the huge potential of the mutual fund industry will take a large workforce — and one equipped with skills and tools to better-support investors.

Lack of growth of distributors is also linked to insufficient incentivisation, which can lead to unviable business models.

Distributors, on their part, will need to leverage technology to realign business models, improve scale, increase reach, adhere to compliance needs, and reduce costs.

The Covid-19 pandemic has accelerated the adoption of digital platforms or assisted digital services. Rising penetration of internet and sales of smartphones in the country have enabled new business models in the distribution space that are lean in structure and also foster robust scaling-up of the business.

Further, majority of new investors in the country are millennials, who are tech-savvy and are comfortable in undertaking transactions on their own via digital mode or through assisted digital mode, i.e., sold digitally but with the assistance of a physical representative.

Therefore, it is critical for all distributors to have platforms that can aid in customer onboarding, update customer information, streamline execution, and offer value-added services.

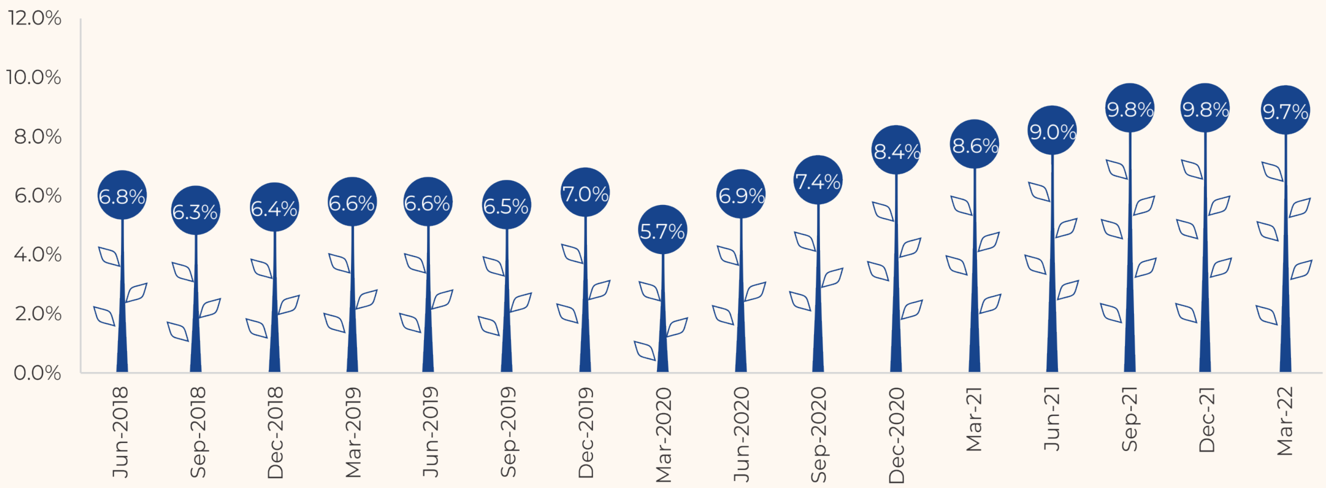
As such, it has become imperative for all distributors to develop their in-house digital platforms or collaborate with larger NDs or fintech platforms which have the requisite technological capabilities for long-term sustenance.

Mutual fund industry gains significantly from intermediary push

The mutual fund industry has grown exponentially over the past few years, with assets under management (AUM) at Rs 40 lakh crore as of December 2022 vis-à-vis Rs 21 lakh crore in December 2017. A large part of the increase is because of aggressive participation of intermediaries in guiding individuals towards the benefits of investing in mutual funds.

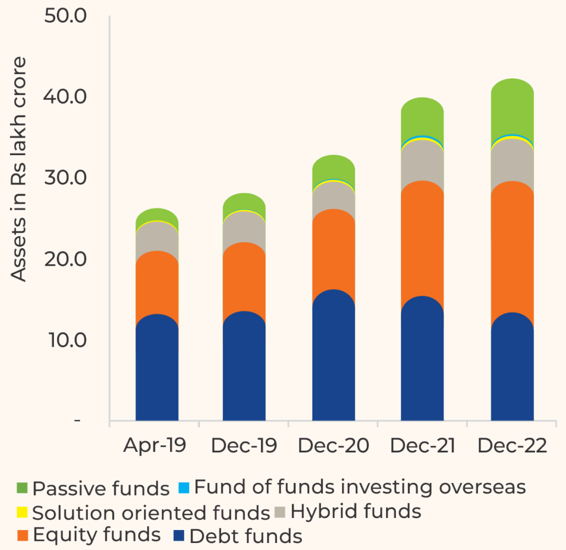
But before we delve into how intermediaries could further propel the mutual fund industry, let's review the current trajectory of the industry.

Share of mutual funds in household savings pie rising



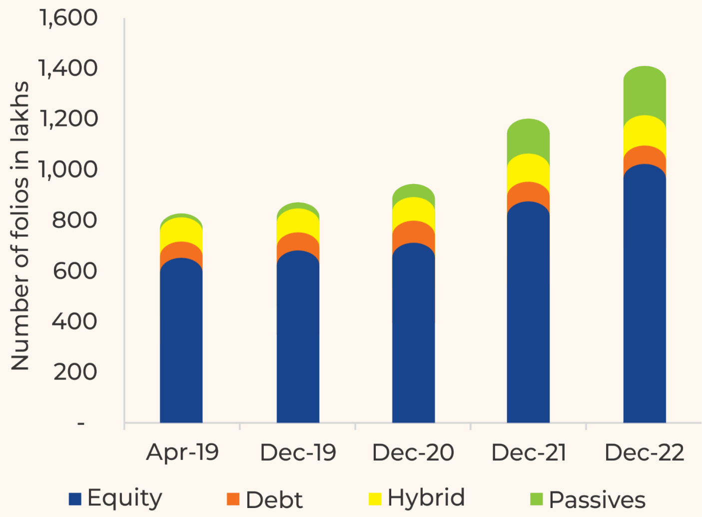
Source: Association of Mutual Funds in India (AMFI), CRISIL MI&A Research

Mutual fund industry size has expanded 60% since April 2019 with pure equity funds dominating



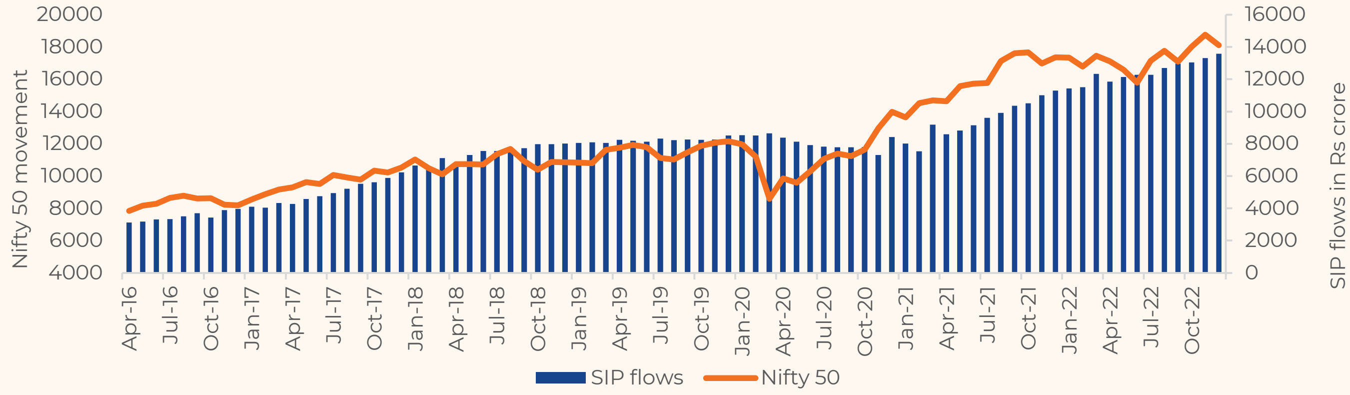
Source: AMFI, CRISIL MI&A Research

Investor folios have grown over 70% since April 2019; equity folios comprise bulk of the share



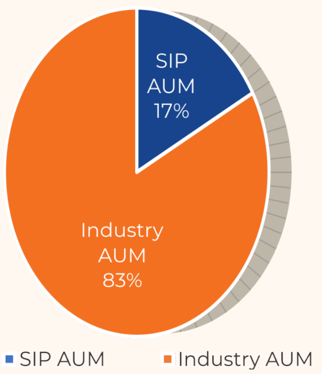
Source: AMFI, CRISIL MI&A Research

SIP is the new investment mantra, rising to ~Rs 14,000 crore per month despite market volatility



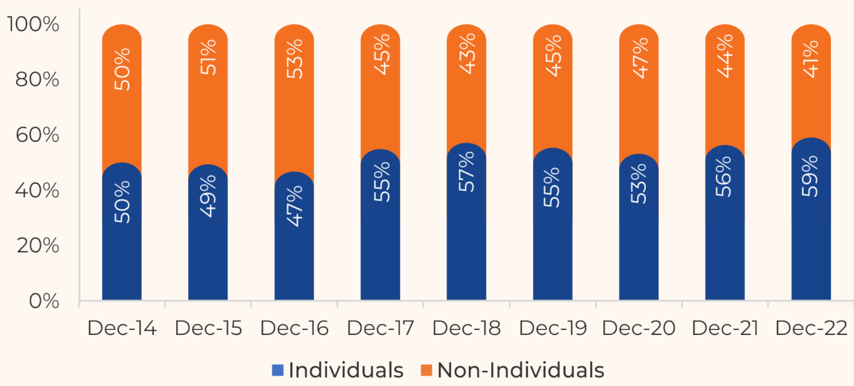
SIP: Systematic investment plan
Source: AMFI, CRISIL MI&A Research

SIP AUM at nearly Rs 7 lakh crore accounts for 17% of industry assets



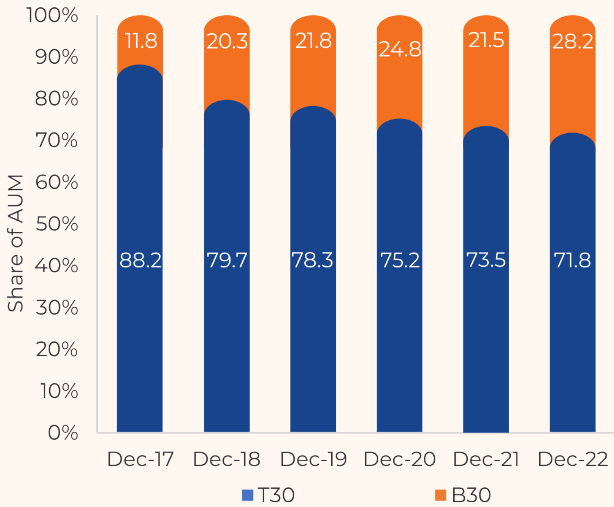
Source: AMFI, CRISIL MI&A Research

Individuals comprising larger share of AUM



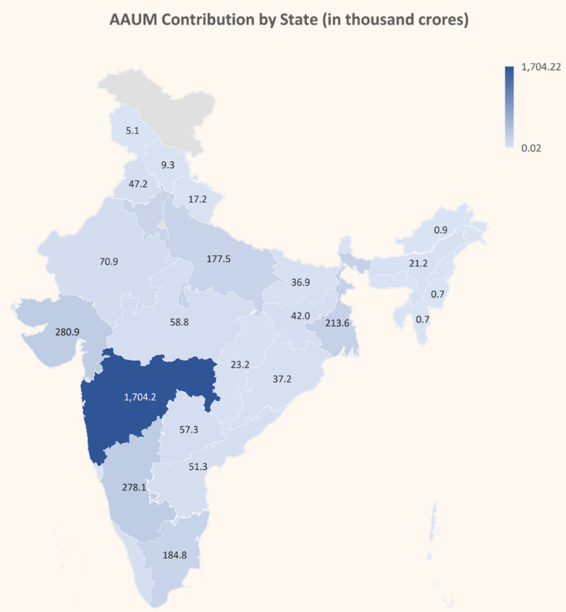
AUM: Asset under management
Source: AMFI, CRISIL MI&A Research

Share of B-30 at ~28% from ~10% five years ago



* Including non-resident Indians and overseas investors
T30: Top 30 cities; B30: Beyond 30 cities
Note: Data is based on monthly average AUM
Source: AMFI, CRISIL MI&A Research

Industry has reached all corners of Bharat (December 2022)

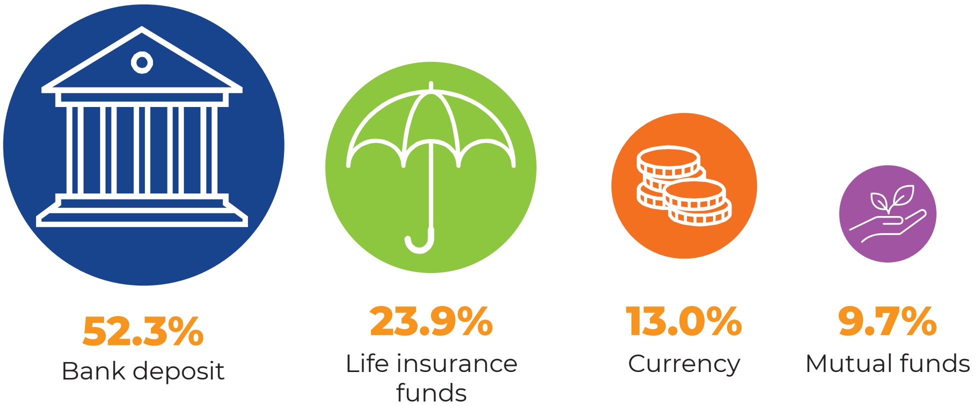


Source: AMFI, CRISIL MI&A Research

Much more needs to be done to deepen penetration, though

Despite the industry reaching Bharat, mutual funds are still at the bottom when it comes to investment preference. For instance, bank deposits accounted for ~52% of household savings as of March 2022, while life insurance held ~24% share. Even holdings in currency pipped investments in mutual funds, with 13% share.

Break-up of household financial savings into investment assets as of March 2022



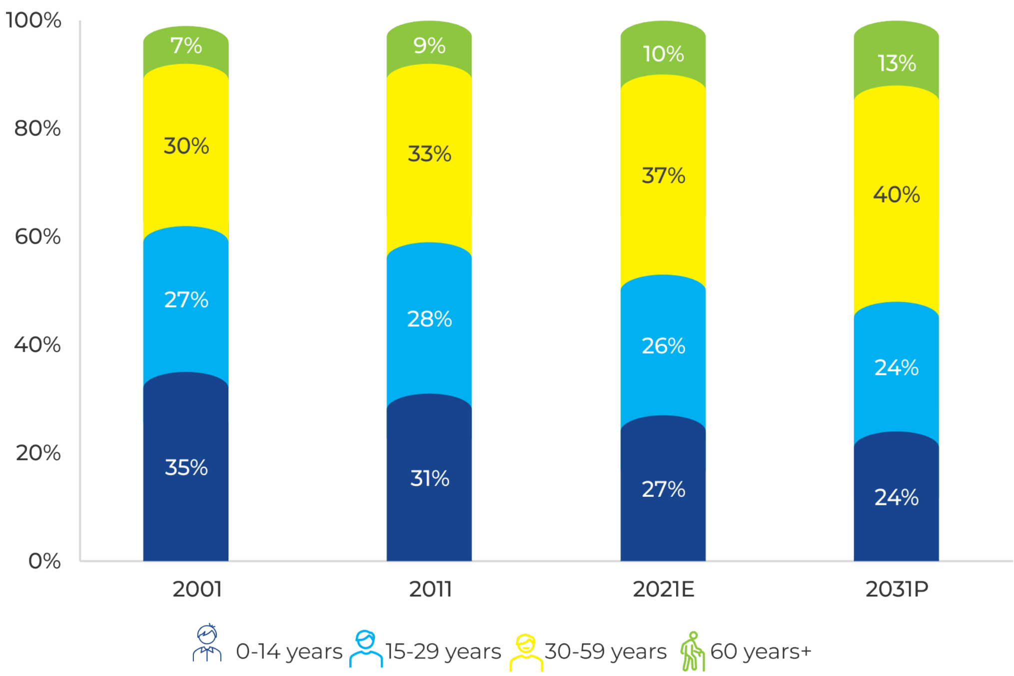
Source: Reserve Bank of India stock of financial assets and liabilities, CRISIL MI&A Research

However, intermediaries could potentially continue to capitalise on tailwinds

Demographic dividend provides benefit of extended investment time horizon

India has one of the youngest populations in the world, with a median age of 28 years as of 2020. In fact, according to United Nations' estimates, ~90% of Indians were below 60 years in 2021, and 63% of them were between 15-59 years. In comparison, the age of the populations of the US, China and Brazil below 60 years was 77%, 83% and 86%, respectively, in 2020.

India's demographic dividend



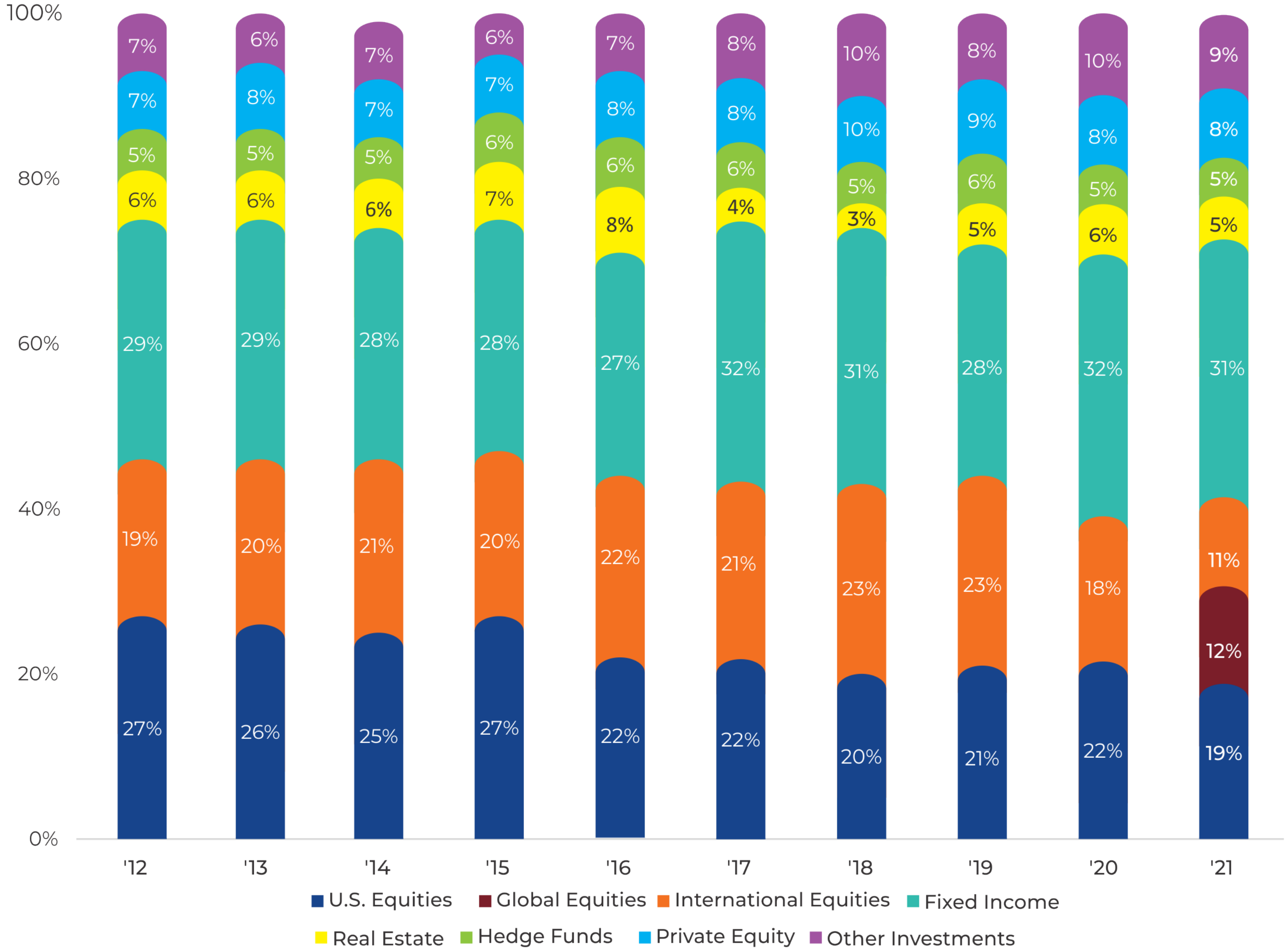
E: Estimated, P: Projected
Source: United Nations Department of Economic and Social Affairs, CRISIL MI&A Research

A large and young population translates into a large workforce and individuals with a longer investment horizon, which, when directed efficiently, could emerge as a win-win for investors as well as the mutual fund industry. Indeed, data has amply shown that the longer the duration with a mutual fund investment especially equity mutual funds, the more superior the accrued returns.

Equities and other risky assets alternatives play important roles in international asset allocation

But if we compare the asset allocation of India with the international investment landscape, equities and other long-term products tend to have a higher role in the investment space. For instance, in the US, equities and alternates (private equity, hedge funds and real estate) account for ~60% of the investment pool.

US investment industry's asset allocation trends



Note: Other investments include multi-asset, infrastructure, commodities, money market, private debt and others. International equities include emerging markets.
Source: Coalition Greenwich 2021 U.S. Institutional Investors Study.

Footprint in B-30 cities growing

Even in terms of penetration, the share of beyond 30 (B-30) cities has improved to 28% of industry assets. However, it continues to comprise a small portion of the industry.

It is, therefore, clear that much needs to be done to improve the penetration of the industry in the country, both in terms of cornering a larger pie of household savings as well as better allocation of money for the populace.

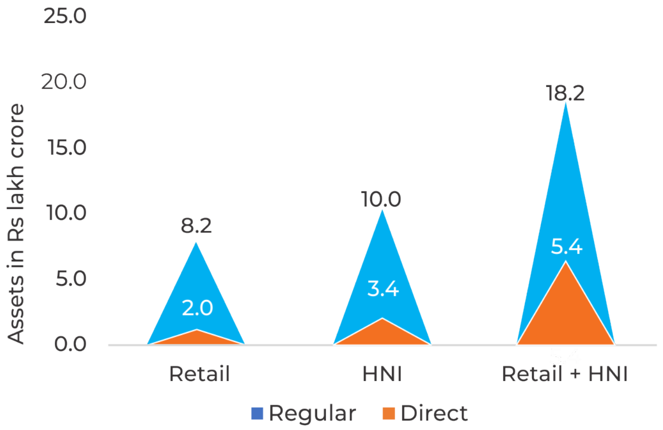
Role of mutual fund intermediaries

Intermediaries are expected to continue to play a critical role in growth of the mutual fund industry in India. The reasons are not far to seek.

Most individual investors need guidance

A look at the break-up of money invested in mutual funds by individual investors shows that over 80% of the investment by retail investors, or Rs 8.2 lakh crore, is via regular plans, i.e., those that are through intermediaries. Even in the case of high-net-worth individuals (HNIs; investors investing Rs 2 lakh and above), nearly 75% of their money, or Rs 10.0 lakh crore, is parked in regular plans. If we look at individual investors (retail + HNI), nearly 77% of the Rs 18.2 lakh crore is invested through regular plans.

Retail and HNI investment break-up into direct and regular plans (December 2022)



Source: AMFI, CRISIL MI&A Research

Handholding during market volatility

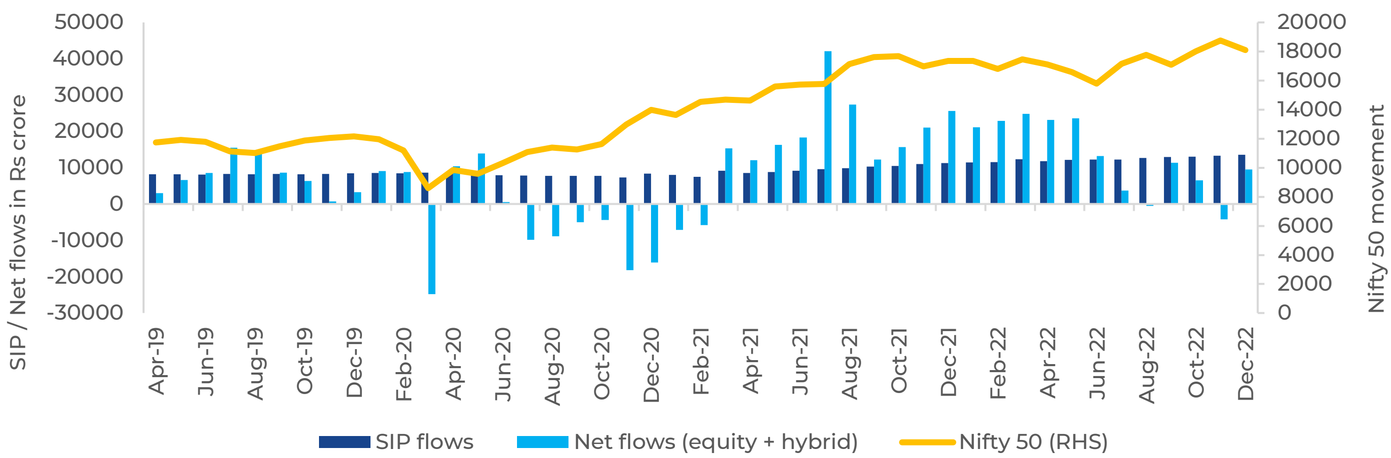
Traditionally, investors tend to exit when markets are volatile. This was especially seen during the global financial crisis of 2008, when mutual fund investors sold their investments lumpsum. While this has changed with investor bent shifting towards systematic investment plans (SIPs), net flows into the industry remains lumpy.

For instance, during most of 2020 following the outbreak of Covid-19 and subsequent lockdowns that affected the economy and financial markets, we saw net outflows from equity as well as hybrid mutual funds, while most individual investors investing through SIPs remained steadfast.

Even in 2022, after Russia's invasion of Ukraine and its fallout on inflation and monetary tightening by global central banks, net flows into equity and hybrid mutual funds moved sideways as was the case with the markets, while SIP investments remained steady.

But any prolonged disruption in the financial markets or liquidity conditions may test investor patience. Hence, handholding of the investor will be all the more important to provide studied guidance so that there is no knee-jerk reaction on the investors' part and, thereby, ensure continued growth of the industry as well.

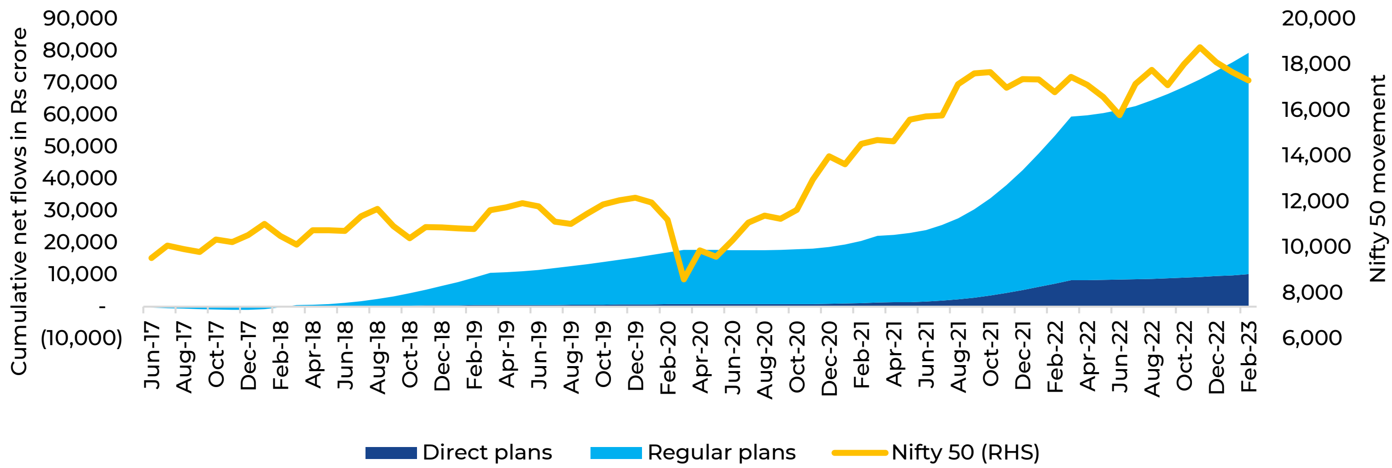
Net flow into equity and hybrid funds versus SIP flows and Nifty 50 movement



Source: AMFI, National Stock Exchange, CRISIL MI&A Research

A comparison of this data with money coming into the direct and regular equity and hybrid mutual funds of Edelweiss mutual fund shows regular plans are accumulating assets at an increasing pace during both secular and volatile market phases compared with direct plans.

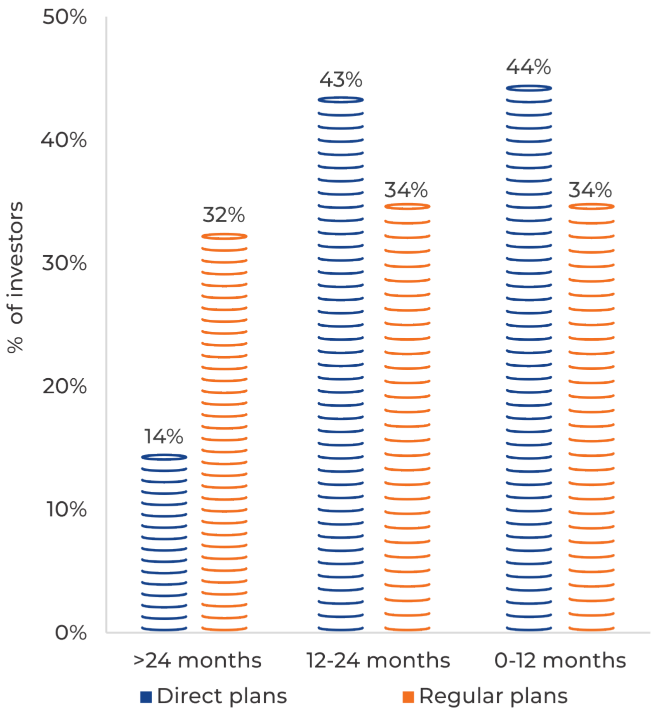
Cumulative net flow into direct and regular plans of equity and hybrid funds vs Nifty 50 movement



Source: Edelweiss Mutual Fund

The importance of handholding is also corroborated by the holding period data of equity and hybrid schemes, which shows 32% of investors stay invested in the scheme for over 24 months when investing through a regular plan compared with just 14% when the investment is made through a direct plan.

Comparative analysis of holding periods between direct and regular plans



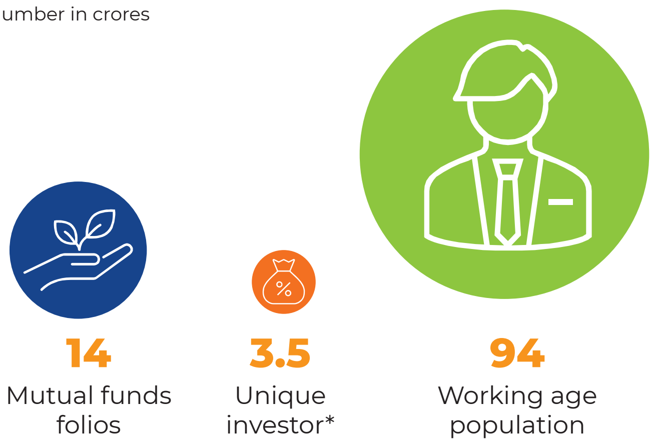
Source: Edelweiss Mutual Fund

Feet on the street to penetrate Bharat

Despite the sharp growth in mutual fund industry assets and folios, the industry has just scratched the surface of Indian households in the country. For instance, the folio count of 14.0 crore looks impressive; however, if one delves deeper, the actual investor count, based on a safe assumption of four folios per investor, would whittle to just ~3.5 crore, which is a fraction when compared to the working age (15-64 years) population of over 94 crore in the country.

Mutual fund folios versus unique investors and working age population of India

Number in crores



*Based on consensus of four folios per investor
Source: World Bank, AMFI

A key issue is the lack of development of the distributor segment. Not only do intermediaries add subscribers/investors, but also handhold the investors while spreading awareness and maintaining persistency.

It is, therefore, important to have a developed intermediary system.

Seen in the global context, there is much headroom

In the US, the world's largest mutual fund market, there were 612,457 registered representatives selling capital market securities, including mutual funds, at the end of 2021.

That's 0.3% of the working-age population (15-64)[1], compared with less than 0.01% for distributors[2] in India.

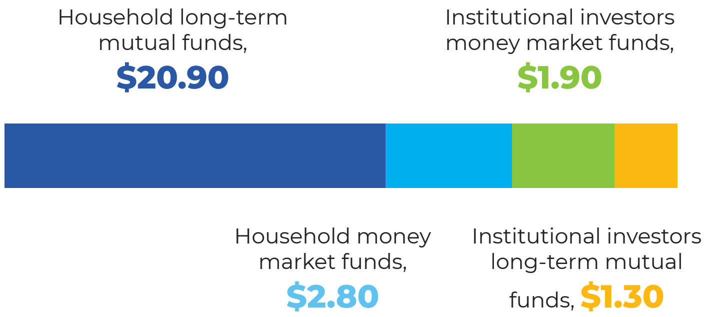
Besides, as many as 10.8 crore individuals across 6.2 crore households owned funds, which means 47.9% of households in that country had exposure to mutual funds. In comparison, India has just around 3.5 crore mutual fund investors, assuming 4 funds per investor at a total folio count of 14 crore.

612,457 registered representatives	**133,148** ARN holders
0.3% of working age population	**0.01%** of working age population
10.8 crore individual MF investors	**3.5 crore** individual MF investors

Further, the awareness of mutual funds and investments is far greater in the US, with households holding 88%, or the vast majority of the $27 trillion mutual fund industry assets, at the end of 2021. The proportion of long-term mutual fund net assets held by retail investors was even higher a 94%. And despite the awareness of mutual funds and investments, outside of the employer-sponsored retirement plans, over 51% of the investments were done through investment professionals compared with 35% through direct plans, showcasing the importance of intermediation.

[1]Defined by Organisation for Economic Co-operation and Development (OECD)
[2]ARN holders as of March 2022

Households held 88% of US mutual fund net assets as of 2021 ($ trillion)



Source: ICI Org

Registered representative[3]

The term "registered representative" means an employee engaged in solicitation or handling of accounts or orders for purchase or sale of securities, or other similar instruments, for the accounts of customers of his employer or in the solicitation or handling of business in connection with investment advisory or investment management services furnished on a fee basis by his employer.

In India, insurance industry has the lead in intermediation due to its vintage

Back in India, the insurance industry has taken a lead, mainly due to the vintage and wide footprint of the Life Insurance Corporation of India.

The segment has more than 24.0 lakh agents selling products across the country, vis-à-vis just ~1.25 lakh distributors in the mutual fund industry.

Further, within active AMFI Registration Numbers (ARNs), a mere ~1,500 agents received commissions of over Rs 5 lakh in fiscal 2022 from selling mutual funds.

Unlocking MF industry potential will need support of intermediation

Achieving the huge potential of the industry will take a large workforce. It is also important that this workforce be equipped with skills and tools to better-support investors.

Lack of growth of distributors is also linked to insufficient incentivisation, which can lead to unviable business models. Further, the registered investment advisor has failed to take off due to the inability to receive a fee from investors — something that is also seen globally.

Hence, it is important to have a developed intermediation system to sell mutual fund products.

[3]FINRA

Overview of the mutual fund intermediary industry in India

The financial intermediary industry in India has grown rapidly since the late 1990s following the emergence of private banks, national distributors (NDs), and technology-enabled brokerage platforms and aggregators, which have simplified transactional challenges and introduced mutual fund products to the mass retail segment, HNIs and ultra-high net worth individuals (UHNIs).

Banks are a major financial intermediary in the country through their branch networks. In fact, several private sector banks have set up verticals offering wealth management services.

NDs and stockbrokers too have their own wealth management services while typically, an independent individual distributor caters to retail investors, whereas some of the larger distributors have expanded across regions.

In recent years, with the advent of superior internet and mobile services, several online portals/ online channels of distribution have been launched to cater to the needs of retail investors. The new age models, though, require investors to be financially attuned and internet savvy.

Snapshot of the mutual fund intermediation landscape

Distributors segment	Sub-category	Products	Geographical reach	Target segment
Banks	Foreign banks	Mutual funds, insurance, structured products, PMS, AIFs	Select locations restricted to tier I and II cities	UHNI, HNI
	Private banks	Mutual funds, Insurance, structured products, PMS, AIFs	Select locations restricted to tier I and II cities	UHNI, HNI, mass affluent
	PSU banks	Mutual funds, insurance	Across the country	Retail
National Distributors	NDs – private wealth	Mutual funds, insurance, structured products, PMS, AIFs, corporate deposits	Select locations restricted to tier I and II cities	HNI, mass affluent
	Retail-focused NDs	Mutual funds, insurance, corporate deposits	Across the country	Mass affluent and Retail
Individual distributors	Independent distributors	Mutual funds, Insurance, corporate deposits	Category is spread across the country, with individuals having presence in small pockets in cities	Mass affluent and retail
	Large/evolved distributors and financial planners	Mutual funds, Insurance, corporate deposits	Category is spread across the country, with individuals having presence in small pockets in cities	HNI and mass affluent
	Tied agents	Insurance	Category is spread across the country, with individuals having presence in small pockets in cities	Retail

PSU; Public sector undertaking; PMS: Portfolio management service, AIFs: Alternative investment funds; UHNI: Ultra high net worth individual; HNI: High net worth individual
Source: CRISIL MI&A Research

Technology will play a major role in mutual fund distribution

In September 2018, the Securities and Exchange Board of India rationalised the total expense ratio (please refer mutual fund chapter for detailed regulation) of mutual fund houses, which led to a sudden dip in the commission paid to distributors beginning fiscal 2019. Further, the market regulator in a March 2023 ruling has also directed fund houses to stop the additional 30 basis point expense ratio for penetrating B-30 cities in the country till some of its concerns are addressed.

These moves, while impacting the industry, will be especially acute on small distributors owing to their scale of operations and higher proportion of fixed costs. With the drop in commissions as a % of AUM, re-alignment of business models and reduction of fixed costs have become urgent requirements for such small players.

The requirement to reduce costs and increasing digital penetration have necessitated the need to develop in-house platforms. The Covid-19 pandemic has further accelerated the adoption of digital platforms or assisted digital services. As such, it has become imperative for all distributors to develop their in-house digital platforms or collaborate with larger NDs or fintech platforms which have the requisite technological capabilities for long-term sustenance.

Tech-based platforms have become critical for all distributors

Rising penetration of internet and sales of smartphones in the country have enabled new business models in the distribution space that are lean in structure and also foster robust scaling up of the business.

Branch-based presence is no more a key requirement for distribution as online platforms/ mobile apps can enable the same at a much lower cost. Though physical presence may be required from product education to investors, the on-boarding and workflow post this will require substantial investment in technology. Development of digital-model also helps rationalise cost structures for the distributor over the long-run as expenses on physical branches and relationship managers will substantially reduce.

Further, majority of new investors in the country are millennials, who are tech-savvy and are comfortable in undertaking transactions on their own via digital mode or through assisted digital mode, i.e., sold digitally but with the assistance of a physical representative.

Therefore, it is critical for all distributors to have platforms that can aid in customer onboarding, update customer information, streamline execution, and offer value-added services.

Impact of technology disruption on mutual fund distribution workflow

Pre-digital era	Aspect	Post technology disruption
Client acquisitions majorly done physically	Sourcing	Client acquisitions through digital channels, in addition to physical channels
Physical submission of KYC documents	On-boarding	e-KYC adoption making on-boarding process simpler
Need to have physical branches in new geographies	Business expansion	Digital and online platforms being used by distributors to expand geographically
Portfolio reviews, report generation done through offline channels	Client servicing	Online / digital apps providing ability to generate reports at the click of a button
Product information and knowledge imparted physically	Product information	Online mediums of product information and knowledge working in tandem with physical interactions

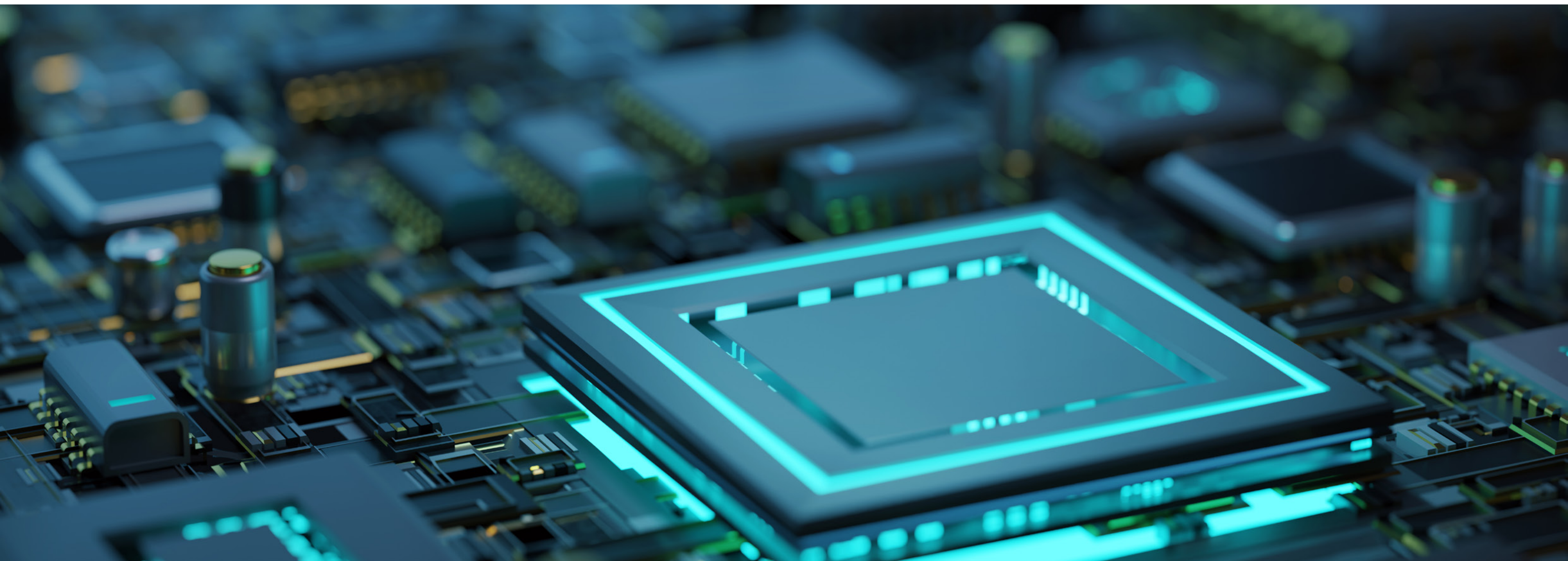
Source: CRISIL MI&A Research

Small individual distributors collaborating with larger distributors to leverage on latter's platform

Before the digital era, all customers' requirements, such as report generation, investment tracking and query resolution, were addressed through the offline mode. However, with changing customer mode of transacting in the case of investments, in-house technology platform has become a pre-requisite for all distributors.

But many small distributors do not have the scale to invest in developing their own technology platforms, given the considerable upfront cost. Therefore, many of these small distributors have partnered with NDs as sub-distributors to leverage on the NDs technology platforms.

The benefits of this are two-fold. First, the customers of the sub-distributor have access to the technology infrastructure of the ND, thereby enriching the clients' experience. Second, as the ND has significantly higher bargaining power with the asset management companies due to scale, the commission paid to the sub-distributor is in-line or slightly higher as compared with the commissions earned while operating on standalone basis.



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