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Mandatory MF pension policy is need of the hour: Harshendu Bindal, Franklin Templeton Investments-India

Harshendu Bindal, President, Franklin Templeton Investments – India.

Even after 20 years of the industry's presence, less than 5% Indians own mutual fund units. What, according to you, have been the major deterrents to the growth of the MF industry? Is there likely to be any change in these deterrents going forward?

While you are saying that 'the glass is half empty', I would like to say that 'the glass is half full'. Let me explain. Unlike traditional forms of investments which offer assured returns, mutual funds offer market-linked returns. With the Indian investor psyche taking time to make the transition to market-linked returns, the mutual fund industry has largely looked upon the tax-paying audience as the first port of call. With the current tax-payers numbering only about 4 crore and the industry having about 1.5 crore unique investors with PAN cards, the penetration in the tax-paying population works out to over one third. So, to say we, as an industry, have not penetrated the market would not be completely correct.

But yes, I agree that we have a long way to go if we want to become a mass investment product like, say, bank fixed deposits. Bank FDs aggregate over Rs 90 lakh crore and have grown by over Rs 9 lakh crore last year vis-a-vis mutual funds which have an AUM of about Rs 13 lakh crore. However, I am more optimistic than ever that the macro environment now is very conducive for our industry to grow exponentially going forward.

Let me give a perspective. When we started off 20 years ago, traditional forms of investment were offering assured double digit returns. So, the biggest challenge was to convince people to invest in a product which offered market-linked returns and not assured returns. While assured return products continue to sell even now, a big change that has occurred is that interest rates have fallen steeply and are likely to fall further. In the latest monetary policy announced by the RBI on September 29, 2015, the repo rate was cut by another 50 basis points, taking the total cut to 125 basis points over the year since January. Hence, investors have begun to realise that it is important to invest in products which are able to beat inflation with a reasonably good margin.

Secondly, mutual funds, over the last two decades, have displayed a good performance track record across multiple market cycles. For instance, equity funds represented by the CRISIL-AMFI Equity Fund Performance Index have given annualised returns of 17.53% over the past 10 years till June 30, 2015, much higher than what traditional investments have given. Equity returns via capital gains beyond one year are also 'tax-free' as per current tax laws. Further, more and more investors have started understanding mutual funds and their benefits, thanks to the regulatory push for investor education. Every Asset Management Company (AMC) spends 2 basis points of its Assets Under Management (AUM) every year on this education effort. The effects are beginning to show with the industry adding over 43 lakh folios in the past year till August 2015, out of which over 40 lakh folios are in equity-oriented funds.

What do you feel would be the key challenges to be addressed to pump prime the industry over the next decade?

With higher disposable incomes, technology and products creating the right base for the growth of the industry in the next decade, the mutual fund ecosystem needs to be developed in 3 ways viz., Push, Pull and Operational efficiencies.

MFs being a push product, the industry still needs a wide distribution network to sell to the masses. Though the industry has about 70,000 KYD-compliant ARN holders, only about 15,000 are active. This is clearly not enough if our objective is mass penetration. To improve our distribution strength, we may need to look at two big distribution channels- i) India Post and ii) PSU banks. India Post has the largest postal network in the world with over 1.5 lakh post offices across the country while PSU banks have a network of nearly one lakh branches.

Another important aspect is 'cost of distribution'. If our aim is to acquire new investors and grow the pie, we cannot look upon distribution as only cost. In fact, let us look at it as 'cost of new investor acquisition'. I agree that costs need to come down but we must wait for the industry to mature. It would be unfair to compare costs in India with that in the developed world where MFs have a far higher penetration. Besides, the nature of the market in most of those countries is also long term and driven by pension reforms. However, in the same breath, I would strongly advocate stricter regulations to prevent mis-selling and excessive churning. All of this would lead to a win-win situation for all stakeholders, including investors.

To improve pull, we could look at 3 options:

i) Provide regulatory incentives to popularize mutual funds as pension and annuity avenues besides allowing us to manage insurance and pension portfolios;

ii) Make the next generation aware about mutual funds by including investment education in school and college syllabus; and

iii) Give wider publicity to performance of mutual funds through simple but consistent messaging besides providing some flexibility in performance advertising guidelines. The flexibility is needed so that we can advertise in a way which is easily understood by the investor so as to enable him to move not only from physical to financial assets but also from assured return to market-linked return products.

On the operational front, there is a need to improve efficiencies and make mutual funds a convenient product by: i) Replacing PAN with AADHAR as the mandatory document for KYC;

ii) Making bank KYC as acceptable KYC for mutual funds; and iii) leveraging technology and moving to a digitized product through platforms like stock exchanges, MF Utility, among others. If we can combine all these three initiatives and open the industry's doors to almost 90 crore AADHAR card holders enabling them to become mutual fund investors, the penetration of mutual funds will surely get a huge fillip.

Investors often feel that returns generated by equity funds or the markets in the past are not in sync with what they have actually earned. How can we bridge the gap between market returns and investor returns?

A big reason for this disconnect in returns is that investors attempt to time the market rather than spend more time in the market. For example, in a SIP, investors start investing in a bull market and generally tend to redeem their mutual fund units in a bear market, thereby losing the benefit of 'rupee cost averaging' as well as 'power of compounding'. Under 'rupee cost averaging', an investor buys more units when the markets are down and buys less units when the markets are up. In fact, the former is more important than the latter. Doing this over longer periods of time not only reduces the average cost of units substantially but also helps to compound the returns. A disciplined investment approach through SIPs will help. Over and above this, we must educate investors through sustained communication to stay invested in equity funds for the long term and create wealth like they do in case of real estate and gold. Lastly, I would like to add that a mandatory mutual fund pension policy is the need of the hour as the long-term play involved would surely work in favour of investors.

Mutual funds have several advantages. What, according to you, are some of the key aspects that we need to highlight to investors?

Mutual funds offer both variety and convenience besides various other advantages. Key advantages include diversification across asset classes, professional investment expertise, economies of scale, tax efficiencies, liquidity (whenever needed) and lower ticket size (minimum investment of Rs 500 per month), among others. Most importantly, though mutual funds do not offer assured returns, they have the potential to comfortably beat inflation over the long run. As interest rates in the economy decline, investors would have to necessarily look beyond traditional products in search of r higher inflation-adjusted and tax-adjusted returns. As stated earlier, the CRISIL-AMFI Equity Fund Performance Index has given annualised returns of 17.53% over the past 10 years till June 30, 2015 - much higher than returns offered by traditional investment products. An equity fund investor who has stayed invested since 2005 (10 years) would have thus multiplied his principal by over 5 times compared to nearly 2.5 times in case of traditional investment products. New investors can begin by allocating some portion of their savings to equity and debt funds through SIPs and test the waters. In fact, one should ideally take the help of a professional financial advisor before making mutual fund investments.

There is always an urge to invest directly in stocks rather than invest through mutual funds. What would you advise such investors?

Firstly, direct investment in stocks is only meant for seasoned professionals who invest in thoroughly-researched stocks. For others, who rely on 'friendly advice' and 'hearsay', I would recommend the mutual fund route. Investors may note that mutual fund portfolios are managed by professionals who have decades of experience and are backed by a strong research team. They have seen multiple market cycles and have a deep understanding of the sectors and the companies that they invest in. Not only do they look at quantitative aspects like balance sheets, cash flows etc, they also look at qualitative factors like pedigree of the company's management and their long-term strategy before taking investment decisions. Regular interactions with the company's management are also a key ingredient in the decision-making process. Individual investors would not have the ability to choose companies in this manner. I would also like to highlight here that we are already witnessing a trend in favour of mutual funds. As mentioned above, the number of folios opened in equity-oriented funds during the year till August 2015 is over 40 lakh. In comparision, the number of new demat accounts opened in this period at 17.7 lakh is less than half the mutual fund folios added.