# India's Mutual Fund Industry

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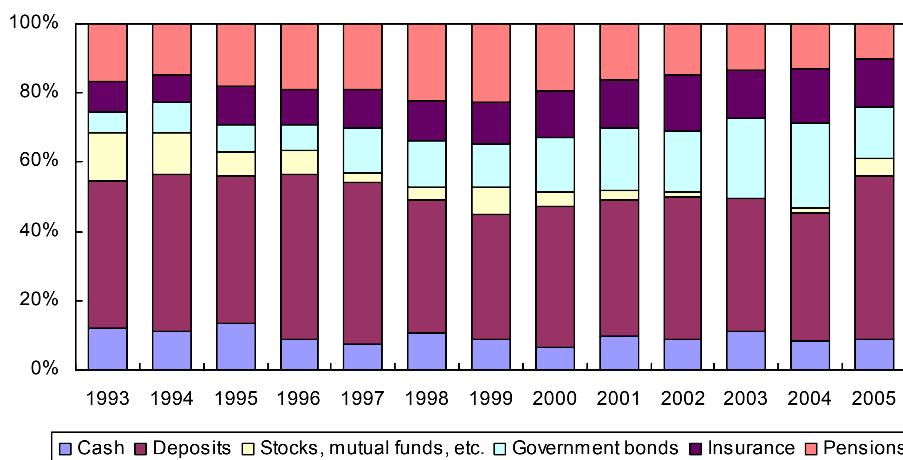
## I. Introduction

Establishing a business base in the BRICs[1] economies has become a key business theme for the world's financial institutions, and this has increasingly shined a spotlight on the future growth potential of India's mutual fund industry.

Stocks and mutual funds only account for 4.9% of personal financial assets in India, suggesting that India's individual investors have a tendency to avoid risk assets (Figure 1).

This could also be interpreted, however, as an indication of the huge potential in India for growth in investments by individuals into mutual funds and other risk assets. India has recently seen a rapid decline in the number of its extremely poor, along with an increase in its wealthy and middle-income segments, with the latter referred to as the "new middle class." In India, the owners of mutual funds include not only the wealthy but also regular retail investors, and because of this growth in the middle-class should further broaden the market of potential mutual fund investors.

**Figure 1: Household financial assets**




Note: The horizontal axis shows the fiscal year ending March
Source: Nomura Institute of Capital Markets Research, based on materials from the Reserve Bank of India

[1] BRICs, an acronym for Brazil, Russia, India, and China, has caught on rapidly as a term to refer to those four emerging markets ever since Goldman Sachs' Indian strategist, Roopa Purushothaman, used the term in his 2003 report entitled, "Dreaming with BRICs, the Path to 2050."

In this paper, we first provide an overview of the assets managed by India's mutual fund industry, both now and in the past, and of the legal framework for mutual funds, and then discuss the current situation and recent trends in financial products, sales channels and asset management companies.

## II. Overview of the mutual fund industry

### 1. Assets under management

As of the end of March 2007, India's mutual funds had assets under management of 3.3 trillion rupees (Rs 3.3 trillion). India's market for mutual funds has generated substantial growth in assets under management over the past 10 years, but as shown in Figure 2, this rate of growth has been particularly impressive over the past two years, in FY2005 and FY2006.

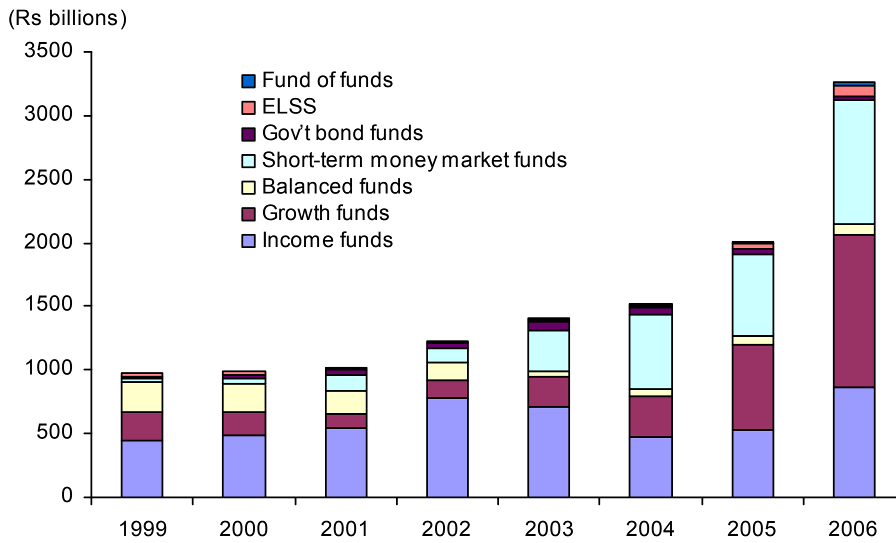
A detailed breakdown of the fund inflows over the past two fiscal years shows particularly strong inflows into equity funds, an indication that investors in India see strong growth potential for India's domestic firms (Figure 3). Most of the money flowing into equity funds is from individual investors, and appears to include both funds owned by the wealthy, which tend to invest via the growing private banking channel, and funds from regular retail investors, who are growing in number in step with growth in the middle class.

### 2. Ownership of mutual fund shares

One notable characteristic of India's mutual fund market is the high percentage of shares owned by corporations. According to the Association of Mutual Funds in India (AMFI), individual investors held slightly under 50% of mutual fund assets, and corporations held slightly over 50%, as of the end of March 2007 (Figure 4). This high percentage of corporate ownership can be traced back to tax reforms instituted in 1999 that lowered the tax rate on dividend and interest income from mutual funds, and made that rate lower than the corporate tax rate levied on income from securities held directly by corporations.

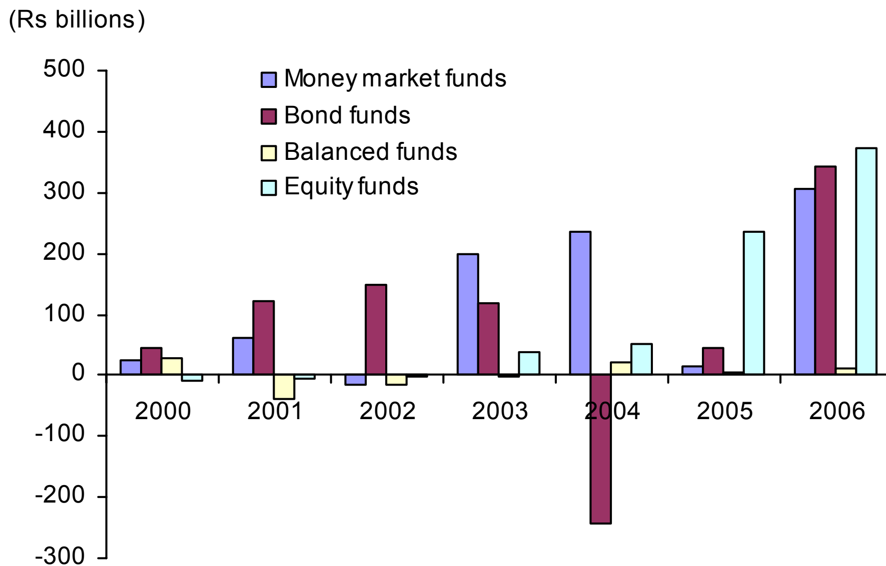
Although there is no official data regarding the type investor in each asset class, the typical pattern seems to be that individual investors primarily invest in equity funds, while corporate investors favor bond funds, particularly short-term money market products that provide a way for corporations to invest surplus cash.

**Figure 2: Assets under management in India's mutual fund market**




Source: Nomura Institute of Capital Markets Research, based on materials from the Association of Mutual Funds in India

**Figure 3: Money inflows by type of fund**




Note: The outflow of money from bond funds in 2004 was sparked by rate hikes in the US

Source: Nomura Institute of Capital Markets Research, based on materials from Cerulli Associates

**Figure 4: Ownership of mutual funds (as of end-March 2007)**

| | Ownership share (%) | Asset amount (%) |
|---|---|---|
| Individuals | 96.09 | 42.83 |
| Non-resident Indians | 1.66 | 4.95 |
| Foreign institutional investors | 1.21 | 1.21 |
| Corporations, domestic institutional investors | 2.24 | 51.01 |
| Total | 100 | 100 |

Source: Association of Mutual Funds in India

## 3. The history of mutual funds

The development of India's mutual fund industry can be separated into four distinct phases. The first phase was from 1964 until 1987. In 1963, India's central bank, the Reserve Bank of India (RBI), established the Unit Trust of India (UTI), control of which was passed from the RBI to the Development Bank of India in 1978. The first fund created by the UTI was the Unit Scheme 1964, which had managed assets at the end of 1988 totaling Rs 67 billion.

The second phase was from 1987 until 1993. The first non-UTI fund was SBI Mutual Fund, which was established by the State Bank of India in June 1987. This was followed by several other funds introduced by public sector banks and insurance companies. As of the end of 1993, India's mutual fund industry had assets under management of Rs 470 billion.

The third phase was from 1993 until 2003. In 1993, the Securities and Exchange Board of India (SEBI) introduced a comprehensive set of regulations governing mutual funds, known as SEBI (Mutual Fund) Regulation 1993, to regulate, and require the registration of, all non-UTI funds. These regulations were completely overhauled in 1996, and now it is the SEBI (Mutual Funds) Regulation 1996 that regulates mutual funds. Since 1993, private-sector asset management companies have been actively involved in the mutual fund industry. The first private-sector fund to be registered was Kothari Pioneer in July 1993, a fund that has since merged with Franklin Templeton. The number of asset management companies has continued to grow, while there have also been a number of mergers and acquisitions in the sector. As of the end of January 2003, India's mutual fund industry had 33 asset management companies managing assets totaling Rs 1.218 trillion, and the largest of these was UTI, with assets of Rs 445.4 billion.

The fourth phase began in 2003. The Unit Trust of India Act 1963 was repealed in February 2003, resulting in UTI being split into two different entities. The first was the Specified Undertaking of the Unit Trust of India, which was made up of UTI's flagship fund Unit Scheme 1964 and closed-end funds, and managed assets as of the end of January 2003 totaling Rs 298.3 billion.[2] The other entity was UTI Mutual Fund, the major shareholders of which were four public-sector financial institutions,

[2] The company is run by the Indian government, but plans call for it to be eventually phased out of existence.

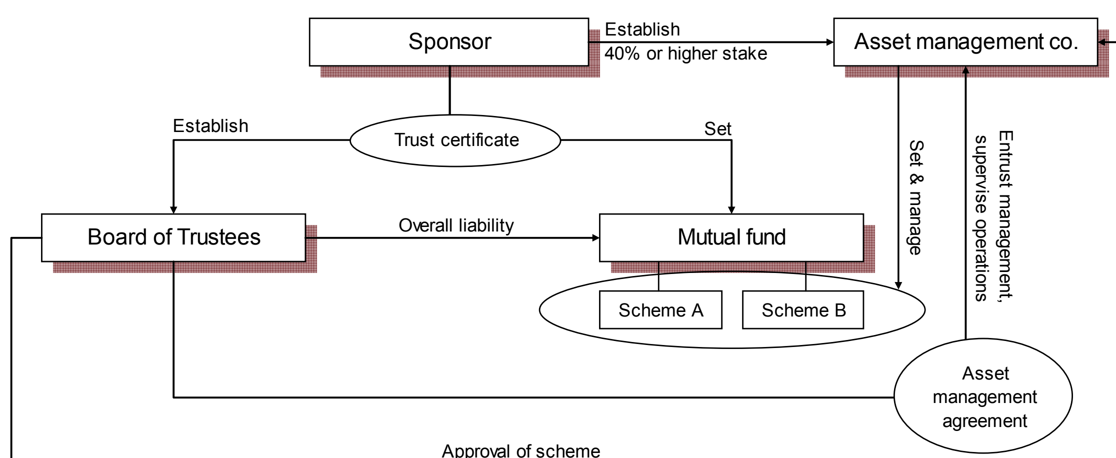
including the State Bank of India. These funds were registered with the SEBI and subject to SEBI's mutual fund regulations. This split up of UTI, along with mergers and acquisitions within India's mutual fund industry, propelled the industry into a new era of growth and restructuring.

Mutual funds in India have thus had a fairly long history, although it was probably not until private-sector asset management companies began to participate in the 1990s that it began to take shape as a single industry.

## III. Legal framework for mutual funds

The regulation of mutual funds in India is set forth in the SEBI (Mutual Fund) Regulations. The mutual funds defined in these regulations are modeled after the UK's Unit Trust, and are contractual plans. The legal framework for India's mutual funds, as described below, is built around the concept of a sponsor, a mutual fund, a board of trustees, and an asset management company (Exhibit 5).

**Exhibit 5: Institutions involved with mutual funds in India**




Source: Nomura Institute of Capital Markets Research

The sponsor establishes the mutual fund, board of trustees, and asset management company. SEBI regulations require that a sponsor own at least a 40% share of an asset management company and have a track record of at least five years in the financial industry.

The concept of a mutual fund under SEBI regulations, unlike that in Europe and the US, does not mean an individual fund offered as a product to final investors. Such individual funds are referred to as schemes in India. A mutual fund is defined as a fund established in the form of a trust, and with a trust deed. It is therefore a pass-through vehicle that does not make decisions or have the status of a juridical person. In fact, the typical use of the term mutual fund in India is similar to what is known as

a fund family in the US; the group of schemes managed by UTI is called the UTI Mutual Fund.

The board of trustees has the authority to make all decisions related to the mutual fund, and is governed by both SEBI regulations and the Indian Trusts Act. Many of these mutual funds take the form of a trustee company, in which case the 1956 Companies Act applies. The Board of Trustees shoulders all of a mutual fund's liabilities, retains oversight over the asset management company, and has the role of protecting the rights and interests of the final investors. Specifically, the Board of Trustees (1) names the asset management company (prior approval from the SEBI is required), (2) approves the schemes (individual mutual funds) set by the asset management company, (3) concludes an investment management agreement with the asset management company to entrust management of the assets, (4) submits to the SEBI a semiannual mutual fund activity report and a sworn statement that the asset management company managed the scheme independent of its other activities, and (5) names a custodian. Two-thirds of the trustees must be independent of the sponsor.

The asset management company, upon approval from the Board of Trustees and the SEBI, establishes and manages a scheme under the mutual fund. At least half of the asset management company's board of directors must not be an associate of, or associated in any manner with, the sponsor or the trustees. The asset-management company must maintain at all times a net worth of Rs 100 million.

## IV. Products

As noted above, equity funds are the most popular type of funds on a flow basis (net money flowing in), and this is also true on a stock basis (total assets). As of the end of 2006, 39% of all fund assets were in equity funds, including growth funds and equity linked savings schemes (ELSS).[3]

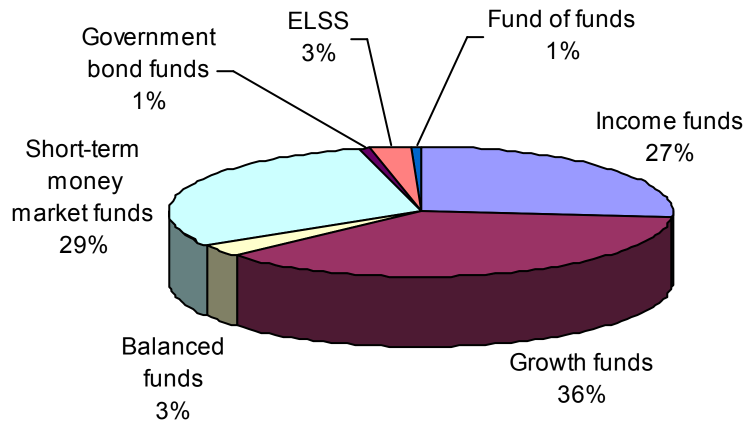
In addition to growth funds and income funds, the classic mutual fund products, the SEBI began allowing several new types of mutual funds in 2000, including gold ETFs, real estate funds[4], capital protection oriented schemes, and funds of funds.

A market for these products has yet to fully form given the short time since their introduction, but as the idea of investment diversification catches on in India, a widening of the base of mutual fund investors should bring with it the potential for growth in these newer products.

3 Tax-advantaged mutual funds. An income deduction of up to Rs 10 million is allowed, and at least 80% of the portfolio must be in stocks.

4 Unlike J-REITs, these funds do not invest in securitized real estate, but rather invest directly in actual real estate or real estate-related projects, as well as in the stock of real estate-related businesses.

**Exhibit 6: Breakdown by asset class**

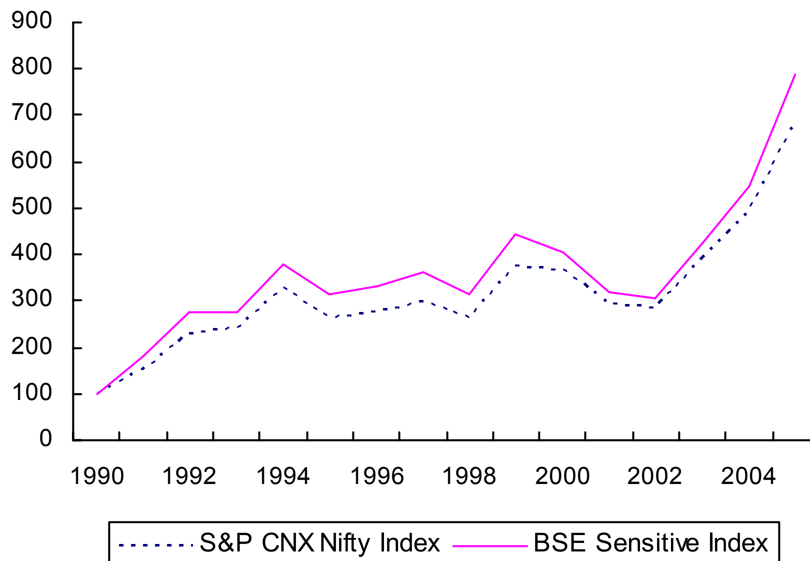



Source: Association of Mutual Funds in India

## 1. Overseas securities funds

Nearly all of India's equity funds are domestic equity funds; as of the end of 2006 there were only two funds that had a primary objective of investing in overseas stocks, with assets under management of USD96 million. One reason that domestic equity funds have such a dominating share of the market in India is that Indian investors have had little incentive to invest in overseas stocks, in view of the strong performance of the Indian stock market over the past few years (Figure 7).

**Figure 7: Majors stock indices in India**




Source: Nomura Institute of Capital Markets Research, based on materials from the Securities and Exchange Board of India

In addition, an SEBI Circular[5] set maximum limits on overseas investments by India's mutual funds, and restricted the list of eligible investments. The investments deemed eligible were (1) ADRs and GDRs issued by either Indian firms or overseas firms, (2) the shares of overseas firms listed on an overseas exchange, (3) securities offered publicly on overseas exchanges, (4) both short-term and long-term debt instruments with an investment grade or higher rating, (5) short-term money market instruments rated investment grade or higher, (6) repo transactions with a counterparty that is rated investment grade or higher, (7) government bonds rated investment grade or higher, (8) derivatives listed on overseas exchanges (only for hedging purposes), (9) short-term deposits at overseas banks rated investment grade or higher, and (10) oversees mutual funds that invest in (a) items (1) to (9) above, (b) listed REITs, and (c) unlisted overseas securities.

The maximum overseas investment amount is USD5 billion in aggregate for all of India's mutual funds, while for each asset management company it is the lesser of either 10% of invested assets or USD200 million. The maximum amount of investment in overseas ETFs is USD1 billion in aggregate for all of India's mutual funds, while for each asset management company it is the lesser of either 10% of invested assets or USD50 million.[6]

Given the current size of India's overseas securities funds, these maximum limits do not yet constitute a barrier to investing in overseas securities, but if India's domestic market starts to slow and domestic investors start to turn their attention overseas, there is a possibility that these restrictions on investing in overseas securities may start to be seen as a problem.

## 2. Management fees

The maximum fees that can be charged by India's mutual funds are regulated by the SEBI. The maximum sales fee on mutual funds is 6%. In actual practice, however, there are a number of equity funds, for example, that charge a sales fee of 2.25% for investments below a certain amount,[7] and offer a declining scale of sales fees as the amount of investment increases. Many funds do not charge any redemption fees, although there are some funds that charge a fairly high fee for redemptions within a short timeframe. The minimum initial investment for many equity funds is set at Rs 5000.

The maximum management fee, meanwhile, is 1.25% for amounts up to Rs 1 billion, and 1.00% for amounts greater than that. There is also a maximum for the

[5] SEBI Circular "Investment in ADRs/GDRs/Foreign Securities and Overseas ETFs by Mutual Funds" (2 August 2006 and 14 May 2007), "Overseas Investment by Mutual Funds - Liberalisation," 26 September 2007.The RBI has expanded the list of eligible investments and raised the maximum investment amount over the years.

[6] Certain requirements must be met in order for Indian mutual funds to invest in overseas ETFs, including the asset management company having a certain level of experience.

[7] This is often set at between Rs 10 and Rs 25 million.

total of management fees and various other ongoing expenses[8] related to fund management, which starts at 2.5% on amounts up to Rs 1 billion, and then declines as the amount of assets invested increases, down to 1.75% for amounts over Rs 7 billion. Many equity funds set their total fees at between 2.25% and 2.5%. The maximum total fees for bond funds are set 0.25 percentage points lower (Figure 8). Although these fees are paid for out of customer assets, SEBI regulations prohibit the use of customer assets for payment of fees related to fund accounting.

**Figure 8: Regulations on mutual fund fees**

| | Average weekly net assets | Stocks | Bonds | Fund of funds |
|---|---|---|---|---|
| Sales fees: | | 6.00% | | |
| Management fees: | Up to Rs 1 billion | 1.25% | | |
| | Over Rs 1 billion | 1.00% | | |
| (Additional maximum for no-load funds) | | +1.00% | | |
| Ongoing cost:<br>Sales & marketing<br>Brokerage<br>Transfer agent<br>Trustee<br>Auditing<br>Custody<br>Investor customer service | | | | |
| Management fee + ongoing cost: | Up to Rs 1 billion | 2.50% | 2.25% | 0.75% |
| | Rs 1 billion to Rs 4 billion | 2.25% | 2.00% | |
| | Rs 4 billion to Rs 7 billion | 2.00% | 1.75% | |
| | Over Rs 7 billion | 1.75% | 1.50% | |

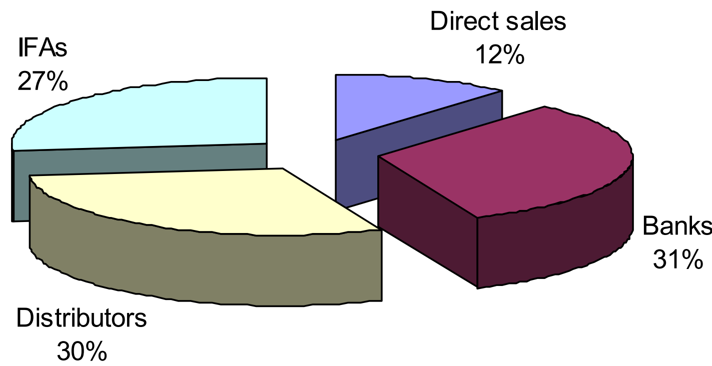
Source: Nomura Institute of Capital Markets Research, based on SEBI (MF) Regulations

## V. Distribution channels

The primary distribution channels for mutual funds in India are (1) banks (approximately 80), (2) national and regional distributors (approximately 3000), and (3) independent financial advisers (approximately 40,000) (Figure 9).

[8] Ongoing expenses related to fund management include expenses related to trustees, custodians, transfer agents, marketing, printing and delivery, and legal services.

**Figure 9: Share of mutual funds sales for each distribution channel**




Note: Asset basis, as of end-June 2006
Source: Cerulli Associates

Banks are one of the primary distribution channels for mutual funds, given their access to a nationwide network of branches. Independent financial advisers (IFAs) do not belong to any particular financial institution, and many of them apparently work out of private offices to serve a local and familiar clientele. Many IFAs in India started out as either sales agents for the state-run insurance company or as employees of a securities firm. To that extent, they have a similar presence to that of IFAs in the UK. Compared with the banks and the national and regional distributors, IFAs are more likely to use a fee schedule based on the amount of assets, and therefore appear to be the preferred route for attracting funds from longer-term investors, particularly by the traditional domestically capitalized asset management companies. One large domestically capitalized asset management company, for example, gives desk space, as well as access to company resources such as PCs and fax machines, to its top-selling IFAs.

One factor that sets India's mutual fund sales channels apart is that national and regional distributors, who specialize in the sale of financial products (particularly mutual funds), have a share of the market. Both are considered non-banking financial companies under the 1956 Companies Act, and thus are in principle unable to take deposits or make loans.[9] These distributors had various origins. Some, for example, used to be a securities firm or bank and then began specializing in the sale of financial products, while others started out as a division within a leading financial institution. The difference between a national distributor and a regional distributor is that, as the name implies, the former operates on a nationwide basis, while the latter targets only a specific region. Some of the leading national distributors, such as Birla Sunlife Distribution Co. Ltd, Bajaj Capital Ltd, and IL&FS Investmart, have name recognition equal to that of India's leading domestic banks.

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9 Nevertheless, some of the leading national distributors also perform brokerage duties as stock exchange members and also engage in deposit taking and lending within the limited scope allowed by regulations.

In addition, India's post offices have also begun selling mutual funds in some cases. India Post, which runs India's largest domestic bank, the Post Office Savings Bank, began selling mutual funds in January 2001, and currently distributes mutual funds for UTI, ICICI Prudential, and SBI. Although no official data exists, mutual fund sales by the post office are said to be on a very small scale. Some view the post office's nationwide network as having substantial sales potential, however, and this makes it a sales channel that may bear watching in the future.

The rough division of labor among sales channels appears to be that the banks and the national distributors target wealthy and corporate clients, while the regional distributors, IFAs, and India Post primarily target regular retail investors.

Guidance from the SEBI in 2003 requires that personnel who sell mutual funds in India pass the AMFI Mutual Fund Advisors Module and receive a registration number from the AMFI.[10] This requirement has been helpful in improving the knowledge and skills of personnel working in all of the above sales channels, and of IFAs, in particular. As of the end of 2006, 53,308 individuals had passed the AMFI's sales personnel test and been given a registration number.[11]

## VI. Asset management companies

As of the end of July 2007, 32 companies were registered with the SEBI as mutual fund asset managers (Figure 10). As noted above, owing to the way that events transpired in India, public-sector asset management companies had gotten an initial head start, but since the 1990s a growing number of private-sector asset management companies have entered the market. Consequently there are now more private-sector than public-sector asset management companies, and they manage a larger amount of assets. Over the past five years, the amount of assets managed by public-sector asset management companies have grown at a 4% annual rate, while assets managed by the private-sector have grown at an annual rate of 34%. In addition, as shown in Figure 10, although there are a few asset management companies with roughly a 10% market share, there are also a number of companies with less than a 1% market share. This suggests the possibility of a consolidation of asset management companies within India's mutual fund industry in the future.

[10] Other tests administered by the AMFI include the AMFI Mutual Funds Basic Module, a test of basic mutual fund knowledge that can be taken by anyone. All of these tests were first given in 1999.

[11] According to Cerulli Associates, however, only approximately 10,000 individuals are employed full time giving advice on financial products.

**Figure 10: Assets managed by the asset management companies (as of end-July 2007)**

| | Assets under management (INR billions) | Share |
|---|---|---|
| Public sector | | |
| Bank capital | | |
| SBI Funds Management Pvt. Ltd. | 258.78 | 5.3% |
| BOB Asset Management Co. Ltd. | 1.19 | 0.0% |
| Canbank Investment Management Services Ltd. | 33.32 | 0.7% |
| UTI Asset Management Co. Pvt. Ltd. | 425.48 | 8.7% |
| Insurance company capital | | |
| LIC Mutual Fund Asset Management Co. Ltd. | 136.53 | 2.8% |
| Private sector | | |
| Domestically capitalized | | |
| Benchmark Asset Management Co. Pvt. Ltd. | 70.86 | 1.5% |
| DBS Cholamandalam Asset Management Ltd. | 50.64 | 1.0% |
| Deutsche Asset Management (India) Pvt. Ltd. | 105.28 | 2.2% |
| Escorts Asset Management Ltd. | 1.38 | 0.0% |
| J.M. Financial Asset Management Pvt. Ltd. | 43.83 | 0.9% |
| Kotak Mahindra Asset Management Co. Ltd. | 228.23 | 4.7% |
| Quantum Asset Management Co. Pvt. Ltd. | 0.58 | 0.0% |
| Reliance Capital Asset Management Ltd. | 664.20 | 13.6% |
| Sahara Asset Management Co. Pvt. Ltd. | 1.90 | 0.0% |
| Tata Asset Management Ltd. | 204.80 | 4.2% |
| Taurus Asset Management Co. Ltd. | 3.23 | 0.1% |
| Foreign-capitalized | | |
| AIG Global Asset Management Company (India) Pvt. Ltd. | 11.40 | 0.2% |
| Franklin Templeton Asset Management (India) Pvt. Ltd. | 322.14 | 6.6% |
| Joint ventures (majority domestically owned) | | |
| Birla Sun Life Asset Management Co. Ltd. | 260.84 | 5.4% |
| DSP Merrill Lynch Fund Managers Ltd. | 160.75 | 3.3% |
| HDFC Asset Management Co. Ltd. | 401.53 | 8.3% |
| ICICI Prudential Asset Management Co. Ltd. | 486.89 | 10.0% |
| Sundaram BNP Paribas Asset Management Co. Ltd. | 106.38 | 2.2% |
| Joint ventures (majority foreign-owned) | | |
| ABN Amro Asset Management (India) Ltd. | 71.48 | 1.5% |
| Fidelity Fund Management Pvt. Ltd. | 95.61 | 2.0% |
| HSBC Asset Management (India) Pvt. Ltd. | 182.99 | 3.8% |
| ING Investment Management (India) Pvt. Ltd. | 80.23 | 1.6% |
| JP Morgan Asset Management (India) Pvt. Ltd. | 9.25 | 0.2% |
| Lotus India Asset Management Co. Pvt. Ltd. | 72.48 | 1.5% |
| Morgan Stanley Investment Management Pvt. Ltd. | 34.04 | 0.7% |
| Principal Pnb Asset Management Co. Pvt. Ltd. | 173.22 | 3.6% |
| Standard Chartered Asset Management Co. Pvt. Ltd. | 167.00 | 3.4% |
| Total: | 4,866.46 | 100.0% |

Source: Association of Mutual Funds in India

## 1. Personnel structure of asset management companies

What makes the personnel structure of India's asset management companies unusual is the extremely large number of people in the sales department (Figure 11). Probable reasons for this include (1) the need to assign sales personnel to each region, owing to the geographical dispersion of India's population and (2) the need for sufficient personnel to deal with individual IFAs, given the importance of IFAs in mutual fund sales.

Hiring competent personnel has been a challenge for India's asset management companies, whether domestically capitalized or foreign-capitalized, and India now has recruitment agencies that specialize in the asset management industry. Another unique trait is the sharp rise over the past few years in personnel costs, for both asset managers and leading sales personnel.

**Figure 11: Personnel structure of India's asset management companies**

| | Investment research | Sales & marketing | Back office | Total | Number of offices |
|---|---|---|---|---|---|
| Company A (domestic) | 50 | 1,000 | 150~200<br>Fund accounting: 100<br>Transfer agency: 50~100 | 1,500 | 100 |
| Company B (foreign) | 2<br>+7~8 | NA<br>+31~34 | NA<br>+7~8 | 11<br>+50 | NA |
| Company C (foreign) | 8 | 28 | 10 | 46 | 7<br>+18 |
| Company D (foreign) | 7 | 27 | NA | 44 | 9 |

Note: The figures on the lower line that are preceded by a + are the expected increase in personnel. The TA in the back office personnel column for company A stands for transfer agent

Source: Nomura Institute of Capital Markets Research, based on interviews with each company

## 2. Foreign-capitalized asset management companies

### 1) Capital structure

Another unique trait of India's asset management companies, as shown in Figure 10, is the large number of joint ventures with asset management companies based in Europe and the US. Unlike in the case of banks and insurance companies, there are no regulatory restrictions on the maximum level of foreign equity participation in asset management companies.[12]

Consequently, overseas asset management companies are able to establish wholly owned asset management subsidiaries in India, with approval contingent only upon the proper notifications being made.[13]

Nevertheless, when an overseas asset management company has between a 75% and 100% stake in a domestic asset management company, India's Ministry of Finance rules require capital of USD50 million. For ownership of between 51% and 75%, the capital requirement is USD5 million, and for ownership up to 51%, it is USD500,000. This effectively serves as a barrier to foreign-capitalized companies establishing a wholly owned asset management subsidiary in India, and as a consequence many

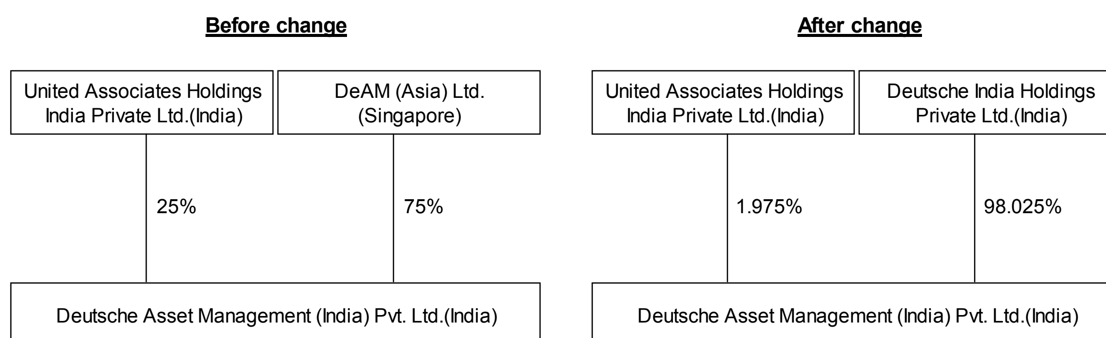
[12] An RBI circular established the upper limit on foreign equity participation at 74% (10% of voting rights) for the banks and 26% for the insurance companies.

[13] India's automatic approval system allows for approval based on notification only for those sectors not specifically blacklisted by regulation.

foreign asset management companies enter the Indian market through joint ventures.[14] Those joint ventures with majority foreign ownership are not necessarily made with domestically capitalized asset management companies. Another common arrangement is for foreign asset management companies (or financial groups) to establish an India-domiciled corporation and then establish a joint venture with that corporation, effectively achieving 100% ownership.

One example of this is Deutsche Asset Management (India), which was originally owned 75% by Singapore-based Deutsche Asset Management (Asia) and 25% by United Associates Holdings India, an India-domiciled Corporation established by the Deutsche Bank Group, and therefore effectively 100% foreign-owned, but still classified as a majority foreign-owned joint venture. Changes in the capital relationships in 2007 led to Deutsche India Holdings, an India-domiciled corporation established as a holding company for the Deutsche Bank Group's India businesses, owning 98.025% and United Associates Holdings India owning 1.975% (Figure 12). Consequently, the company is now classified as a domestically capitalized asset management company, despite its still effectively being wholly foreign owned (Figure 10 again).

**Figure 12: Capital relationships of Deutsche Asset Management (India)**




Source: Nomura Institute of Capital Markets Research, based on fund offer documents from Deutsche Asset Management (India)

2) Characteristics of foreign-capitalized asset management companies

The first notable characteristic of foreign-capitalized asset management companies in India is the localization of their operations. This is true not only of the asset management industry but of nearly all foreign companies doing business in India. The author did not come across a single office worker who looked to be a Westerner when visiting European and US-capitalized asset management companies in India.

A second characteristic is that foreign-capitalized banks are an important distribution channel. Citigroup, ABN Amro, and Standard Chartered seem to have a particularly strong presence. These foreign-capitalized banks all have a long history of

[14] These regulations apply not only to the asset management industry, but also to all other finance sectors outside of banking and insurance.

successfully doing business in India, and operate branches in cities throughout India. For example, Citigroup's branch network covers 27 cities, ABN Amro's 21 cities, and Standard Chartered's 34 cities.

A third characteristic is the large extent to which back office operations are being outsourced. For example, Company C shown in Figure 11 outsources some of its fund accounting and other back office operations to a local subsidiary of Company D's group, and likewise Company D outsources some of its back office operations to a local subsidiary of Company C's group. A local subsidiary of Company D's group offers mutual fund transfer agent services in India, but Company D itself uses a local Indian firm, Karvy Consultants[15], as its transfer agent. The reason is that Company D decided that it would not be a good idea for the first customer of the group's local transfer agent subsidiary to be an asset management company within the group, although it does plan to transfer the business to its local transfer agent subsidiary in the future. In addition, Company B has consolidated the back office operations for its global asset management business in India, and created a separate corporation for that purpose.

## VII. Conclusion

There are a number of barriers to the entry of foreign-capitalized asset management companies in India's mutual fund market. The biggest difficulty is probably in the staffing of their sales operations. It is no easy task for foreign-capitalized asset management companies that have recently entered the market to match the marketing muscle of the large, long-standing domestically capitalized asset management companies like Reliance and UTI. Because it is the IFA channel that has an especially large need for wholesalers, a key business decision facing new market entrants is how much importance to place on regular retail investors, the market segment that the IFA channel is best at handling. As the examples given in this report show, the most realistic strategy for foreign-capitalized asset management companies seems to be to start out by focusing on supplying product to the wealthy through foreign-capitalized banks, and to consider other distribution channels, as conditions dictate, while delaying any concerted effort at offering mutual funds to retail investors.

Another barrier to market entry is the difficulty in gathering information and preparing documentation on the financial condition and litigation history of the sponsor (the parent company of the asset management company) in order to fulfill requirements in the SEBI (Mutual Fund) Regulations. Roadway congestion, unreliable

[15] This company is apparently India's second-leading transfer agent, with a market share of approximately 30%. In addition to providing transfer agency for mutual funds, the company also serves as a transfer agent for individual stocks as well as a broker of financial products. Computer Age Management Services is the market leader, with roughly a 60% market share, and works exclusively as a mutual fund transfer agent. In principle, transfer agents in India can handle investor enrollment and redemptions on a T+1 basis, but most of the tasks evidently require the involvement of a large number of personnel.

electric power supplies,[16] uncertainty in the real estate leasing market, and other features of India's social infrastructure could also be considered barriers to market entry by asset management companies and other foreign-capitalized firms.

That having been said, progress is being made in establishing an infrastructure for India's mutual fund industry, and recent growth in the economy and in individual financial assets suggests that India's market has huge potential. Japan's Nikko Asset Management announced in December 2006 that it was entering India's mutual fund market through a joint venture with the India-based securities firm Ambit RSM.[17] We expect overseas asset management companies and financial groups to continue moving into India's mutual fund market in the future.

[16] Power outages are apparently fairly infrequent in Mumbai, however, where the Tata group is the supplier of electric power.

[17] Nikko Asset Management owns 74.9% of the joint venture, and Ambit RSM 25.1%.