The numbers don't speak

Data on the growth in the mutual fund industry hides more than it reveals, and can prompt the small investor to take wrong decisions

Prithvi Haldea

It is generally believed that the mutual funds industry has finally come of age, and that small investors now increasingly prefer mutual funds as their investment vehicles. This argument is based on the huge growth in assets under management (AUM) in the re¬cent¬ly concluded fiscal.

Of course there has been a humungous growth in AUM. However, we should not allow the gross data overwhelm us. The problem is that we all love large numbers. Reeling them out gives most a sense of achievement. Inaccurate and unrepresentative figures are also put out by design, and hide much more than they reveal. This is dangerous, as incorrect data can often lead to wrong decisions. We need detailed and relevant data to reach any conclusions.

Window dressing

The data released by Amfi states that the AUM as of 31 March, 2006 increased to Rs 2,31,862 crore -- 55 per cent over Rs 1,49,554 crore as on 31 March, 2005 -- giving an impression that mutual funds have finally found favour with the retail investors. In reality, this figure includes all types of funds, including money market and gilt, which are not relevant. Only about 40 per cent of AUM are in equities.

The figures of equity funds look even more impressive--up 153 per cent from Rs 36,711 crore to Rs 92,867 crore. The truth: most of it happened simply because the market value of the holdings went up. Using a crude, albeit appropriate, method to give a sense, between 1 April, 2005 and 31 March, 2006, the Sensex rose 71 per cent from 6,605 to 11,280. This means that the value of AUM as on 31 March 2005 of Rs 36,711 crore would have gone up to Rs 62,776 crore with very little effort!

We must also not forget that most of the equity AUM increase is due to mis-selling; new funds offerings are still sold by playing on investors' weakness for at par issues and the passbacks that investors are doled out on their new investments.

What they don't say

Let us now move to the category of investors in mutual funds. We have no clue on this. Mutual funds are typically the vehicles for small investors, yet no data is made available on the holdings of these investors. There is no break up between retail on the one hand and corporates and institutions on the other; it is widely believed that corporates and institutions are the biggest investors, holding upwards of 65 per cent of AUM. Geographical distribution of investors is also not known. Nor is there any data on average holding periods. The truth is that though mutual funds should typically represent mid- to long-term money, in 2005-06, while the total funds mobilised by the industry were Rs 10,98,158 crore, redemptions stood at Rs 10,45,382 crore!

There is also total silence on the number of investors in mutual funds as a whole, leave alone for each fund or scheme; the figures range from 5 million to 23 million. According to the latest data made publicly available, the number of mutual fund investors has grown to 23.5 million as of 31 May 2006. In reality, this is the number of folios and not the number of investors. Folios ignore the multiplicity of investors within a scheme and across various schemes of various funds. At the very least, it is like 50 students in a class enrolled for 5 subjects being counted as 250 students! A few years ago, when US-64 had to redeem the units, it realised the folly and then used investors and not the folios as the criterion, the number of 'investors' fell from over 50 million to just about 10 million.

Mutual funds even use incorrect numbers to claim rankings in the industry, again with the objective of misguiding the investors. First, should rankings be done at any given point of time or should they be at based at least on a rolling quarter? Moreover, shouldn't the leadership relate to equity funds alone because that is the true parameter? In this context, it may be worthwhile to recall that a few years ago, when the primary market was down, the Economic Survey had proclaimed otherwise. What it did was to add debt issuances to equity.

The numbers game is misleading in other areas of the capital market too. It is about time that we did a reality check and got rid of the flab. Wrong numbers can make us complacent and lead us to develop policies, products and services that do not benefit the targeted audience.