

Time to encourage fee-based financial planning

Wealth management, rather than product sale, can help MFs grow



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THE equity and real estate markets have been witnessing a bullish trend since the past few years. All the stakeholders of these markets, be it the product manufacturer, the distributor or the ultimate investor, are enjoying the benefits of this trend. Most of us, too, are satisfied. Hence, no questions are being raised on how these investment products are being distributed. But, what will happen if the trend changes?

Everyone talks about the Indian economy doing well, high savings rate, higher wealth creation, increase in the high net-worth individual (HNI) population, which has gone up by 15% in 2004 as per the Merrill Lynch-Capgemini report. But, have asset management

companies (AMCs) taken advantage of this additional wealth creation?

The assets under management (AUM) of AMCs in the 12-month period (May-end 2004 to May-end 2005) has grown by 10%, while the weighted average return from various asset classes is 11% during the period, which is an indication of no increase in fresh assets. On the other side, the gross sales figures of mutual funds have gone up. The number of offerings from the mutual fund (MF) industry has increased and all these are getting a huge response.

This trend shows that the size of the industry has not been increasing in the true sense. However, the success of initial public offerings (IPOs), increase in gross sales, increase in the number of distributors, are clearly signs of higher churning in the MF industry. But, then, this churning only helps the distributor community, as it increases their income. It is actually negative for the investor, as the transaction cost or taxation cost goes up. While, for AMCs, the effect of the churning is neutral.

If churning is actually going against investor interest, why is it happening?

As the space of wealth management is gaining importance, there is increased circulation of manpower. The shift happens at a higher compensation for a relationship manager, hence, the higher target pressure on him/her. Thus, relationship managers, who want to justify their position in their respective organisation, get into a conflict situation. They need to either increase their AUM or churn the existing portfolio. The latter is an easier route. Even though these managers have loyalties towards their customers, target or growth pressures or organisation loyalties supersede customer loyalty, and this leads to churning.

In this process, the consumer does not realise he is the loser, as moving out of one product and entering into another increases transaction costs in terms of entry or exit loads. Many a time, investors get the impression that they are priority clients for an advisor if their portfolio is churned too often. If the investor/dis-

tributor churns the portfolio to time the market, it can be highly risky, as timing is hard to achieve in the long run.

For a distributor, there is a clear incentive, but the investor should realise the difference between an IPO of a company and that of a MF. Entering into an IPO of fund A or an existing scheme of fund B would entail entering at the same levels. Assuming that the fund manager does a good job, the returns from both the funds should be similar. However, there may be a higher expense ratio for an IPO scheme, as initial marketing expenses are normally levied to the scheme.

Hence, there is definitely a need to change the manner in which investment products are being distributed. Education or training could convert the product distributor into an advisor. Since this is a knowledge industry, following a wealth management process, rather than selling products, would help the industry grow on a sustainable basis. It would help AMCs to increase the AUM. The regulator could also look at making norms stringent for advisors. A minimum qualification of certified or associate financial planner should be imposed on an advisor. In addition, the investor



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There is also a myth that the IPO of a MF is the best option, as investors feel it is available at par (and hence cheaper), and fund managers may try to time the markets for them, etc. The distributor community derives the maximum advantage from these sentiments and leads investors to a higher churn level, by making them enter an IPO and sell the units on listing and get into another IPO.

should have the right to know the amount of money made by an advisor from him/her. Fee-based financial planning should be encouraged. Qualified professionals should be exempt from service tax, as this would encourage distributors to acquire knowledge. Besides, educational institutes should be encouraged to incorporate financial planning in their syllabi at the graduation level.

The writer is founder-partner of Client Associates. The views are personal