HEB

A Study on Expense Ratio of Mutual Funds in India: A Concern & Cure

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ABSTRACT:

India is experiencing a huge interest towards investments in Mutual Funds and more of the retail investment. Expenses are concern and SEBI has taken an appropriate measures. The study is with an objective to suggest the strategies to reduce expense ratio by taking an experience of other countries.

Keywords: Mututal Fund, Expense Ratio, Investors

INTRODUCTION:

Mutual fund industry is growing so rapidly in India since a couple of years. We have crossed the record breaking AUM which is ₹24,03,124croreas on 30th November 2018.The AUM of the Indian mutual fund industry has grown from ₹ 4.05 trillion as on 30th November, 2008 to ₹24.03 trillion as on 30th November, 2018. Having said that, the most interesting part is retail investors still don't understand a key terminology which plays a vital role, the one which isbeing covered in this paperis Expense Ratio.The present study is intended to evaluate increasing in the expense is concern or cure and to check perspective of investor on mutual fund investment post capital market regulator SEBI's circular to curb on expense ratio.It is necessary to understand about Indian mutual fund expense ratio as compare to global mutual funds by taking so many factors into consideration right from GDP to saving ratio, Size of the capital market & capital formation, etc.

Annual Fund Operating Expenses is better known as the **Expense Ratio**. It is the percentage of assets paid to administer, manage (including the auditor & advisor fees) and advertise or to meet the other expenses of the mutual fund. If the funds' assets are small, the expense ratio can be quite high so that the fund will be able meet its expenses from a restricted or a smaller asset base. If the net assets of the fund are large, the expense percentage should ideally diminish as expenses are spread across a wider asset base. Basically, there are 3 components of expense ratio: Management Fees, Administration Costs, and Distribution Fees.

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Expense Ratio is composed of numerous charges that are required to run the administration of the mutual fund scheme in a smooth manner. Such cost is recovered from the mutual fund investors on a day-to-day basis but it is disclosed only once in every six months. It has a substantial impact on Investor’s take-home returns.

E.g. If an investor invests Rs 50,000 in a fund with an expense ratio of 2 percent, then he is paying the fund Rs 1000 to manage your money. It can be said that if a fund earns 10 % and has a 2 % expense ratio, it would mean an 8 % return for an investor. The Mutual Fund’s NAVs are reported after netting off the fees and expenses and hence, it is necessary to know how much the fund is deducting or charging as expenses.

Recent Changes Made by SEBI on Calculation of Total Expense Ratio:

On 18 September 2018, SEBI brought about major modifications by reducing the expense ratio of the mutual funds and changing the method of providing commission to the distributors which was a great sign for an investor to invest more in Mutual Funds.

TER for open ended equity schemes are as follows:

AUM Slab (INR Crore)	TER of Equity oriented schemes
0-500	2.25%
500-750	2.00%
750-2000	1.75%
2000-5000	1.60%
5000-10000	1.50%
10000-50000	TER reduction of 0.05% for every increase of 5000crore AUM or part thereof
>50000	1.05%

Review of Literature

Wilcox and Ronald (2003), are of the opinion that investors who wish to purchase shares in mutual funds, balance many types of information, from a variety of sources when making their fund selection. This research examines how investors choose a mutual fund within a given class of funds. They provide experimental evidence, which indicates that consumers pay close attention to fees when selecting mutual funds. Among the major findings are that, investors pay a great deal of attention to past performance and vastly overweight loads relative to expense ratios when evaluating a fund's overall fee structure.

Nigel Finch (2005), examined the role that impersonal data disclosure plays in the selection and retention of Australia's 2,637 retail equity investment funds. They find that fund size, past performance, agency ratings, and the management expense ratio (MER) are widely used by retail investors in investment decision making, but conclude that the only disclosure that provides any valuable utility to a retail investor is the MER. As such, the MER should be the key selection criteria for retail investors when making choices regarding investment funds.

Grinblatt and Titman (1992) in their 10 years study of 279 mutual funds' risk-adjusted returns argue that there are fund managers who are able to earn positive returns; moreover, there is also outperformance persistence. One of the main conclusions they reached to is that there are persistent differences in the fees and transaction costs mutual funds have and thus these differences contribute to one of the groups of funds being "winners" and other "losers". Even though Grinblatt and Titman (1992) admit that these are not all the factors that make some funds perform better and other worse, still there can be some information extracted from a history of returns.

Mr. Raju and Sahadevan44 have contributed by studying the operating expenses of the mutual funds in India. They studied the mutual fund expenses and other related aspects which are generally covered in annual reports of the mutual funds without going into the details of financial performance evaluation of the funds. The book has presented the different forms of expense incurred by a fund and how the expenses are shown in the company annual report.

Objectives:

The primary objective of the project is to identify increasing expense ratios of Indian mutual funds, is concern or cure.

- To compare the expense ratios in India to global MF.
- To suggest the strategies to reduce the expense ratio.
- To ascertain the veracity of the perception in some sections of the industry that the Expense Ratio of Mutual Funds in India is relatively high.
- To know the impact of changes in expense ratio on investor's decision while making an investment.

Research Methodology:

For this research, we have used secondary source of data from the various authenticated sites like value research, Morning star, AMFI, SEBI. 10 mutual fund houses are beingselectedfromIndianmarket as well as Foreignmarket, 5 each. The population is based on type of mutual fund i.e. Equity Mutual funds for the period of Mar 2014 to October 2018. Here, in the research paper we have used convenience sampling method for sampling. We have taken a sample of 10 equity mutual funds. We have calculated Comparative Analysis between Indian and Foreign

Mutual funds. Also, we have calculated Comparative analysis between pre-regulated Expense ratio & Post regulated Expense ratio in India.

Data Analysis & Interpretation:

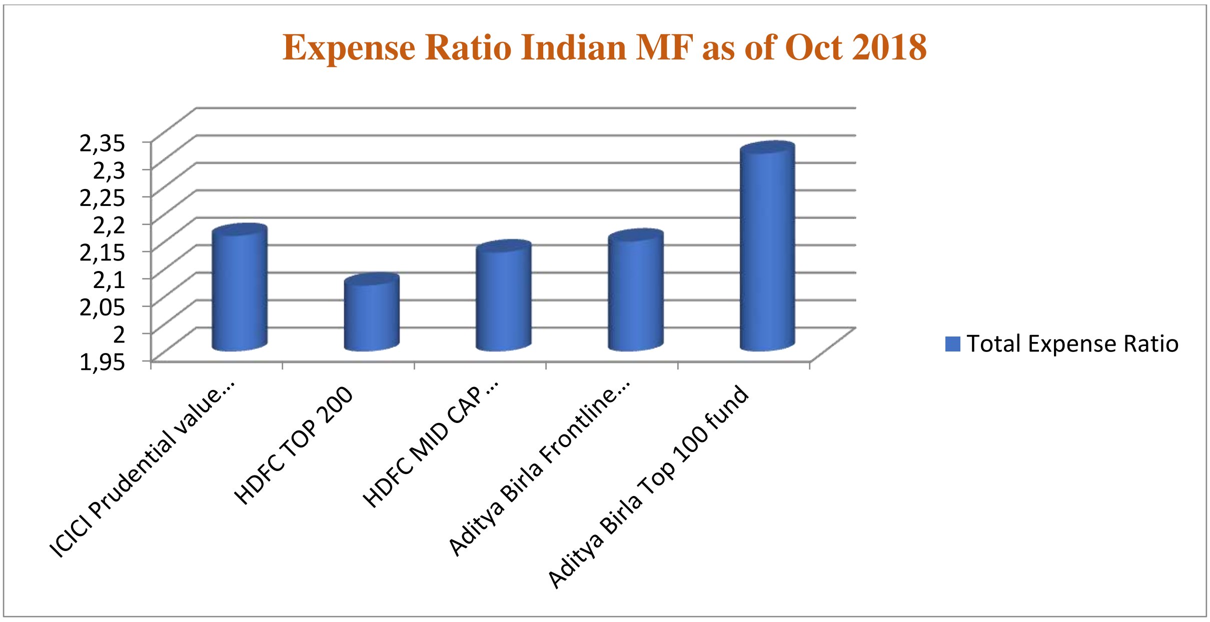

Chart: 1.1

Interpretation:

From the above chart it can be seen that equity funds are currently having expense ratio above 2.07% which states that AMC's levy high cost from investor for every instalment.

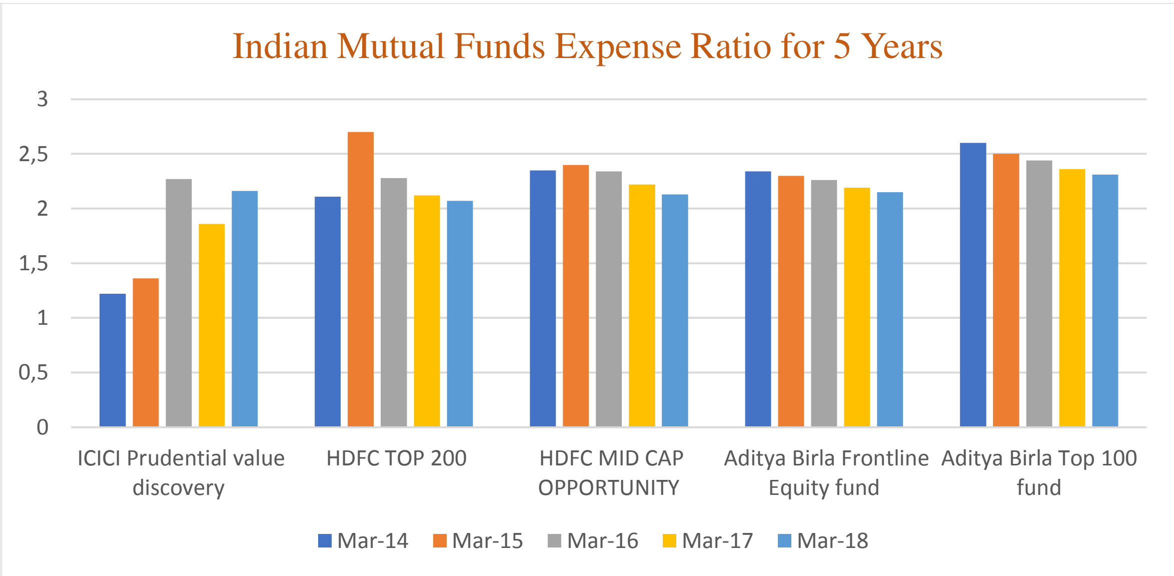

Chart: 1.2

Interpretation:

From the above chart No.1.2, it can be seen expense ratio except ICICI Prudential Value Discovery, has been marginally decreased but remained above 2% which conclude that there is no big relief for an investor. For 3 years, cost ratio was lying between 2.00% -2.50% as per fund's condition.

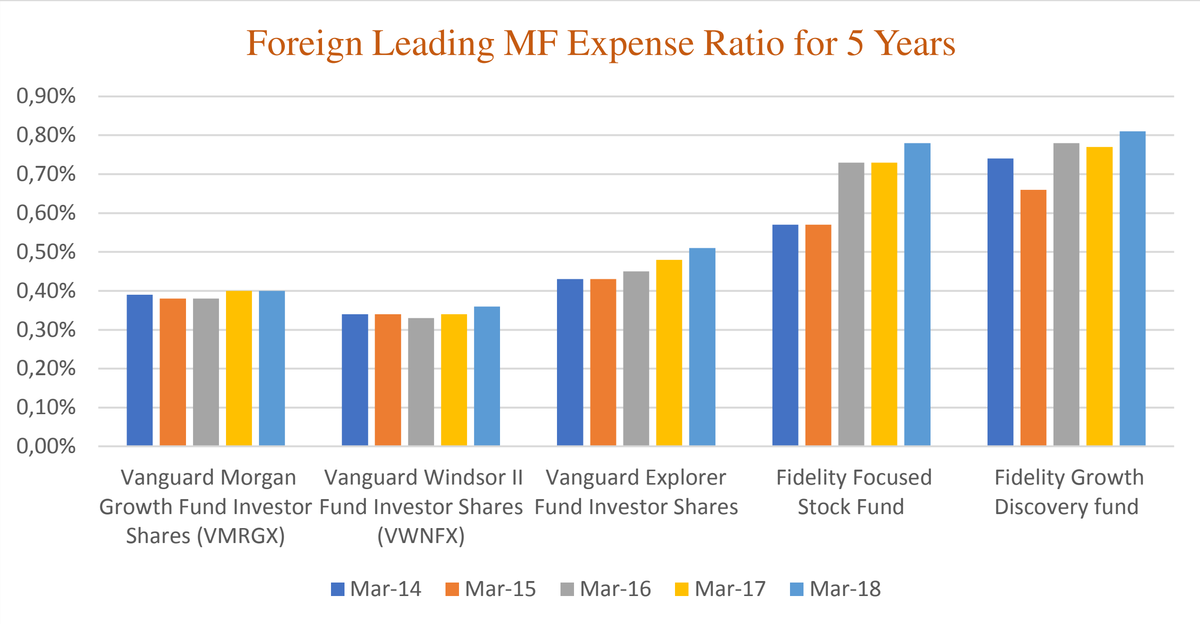

Chart 1.3

Interpretation:

Foreign mutual funds Expense ratio for equity funds are seen in the range of 0.33 -0.81 for 5 years. This states that inflow in the fund must be in huge volume.

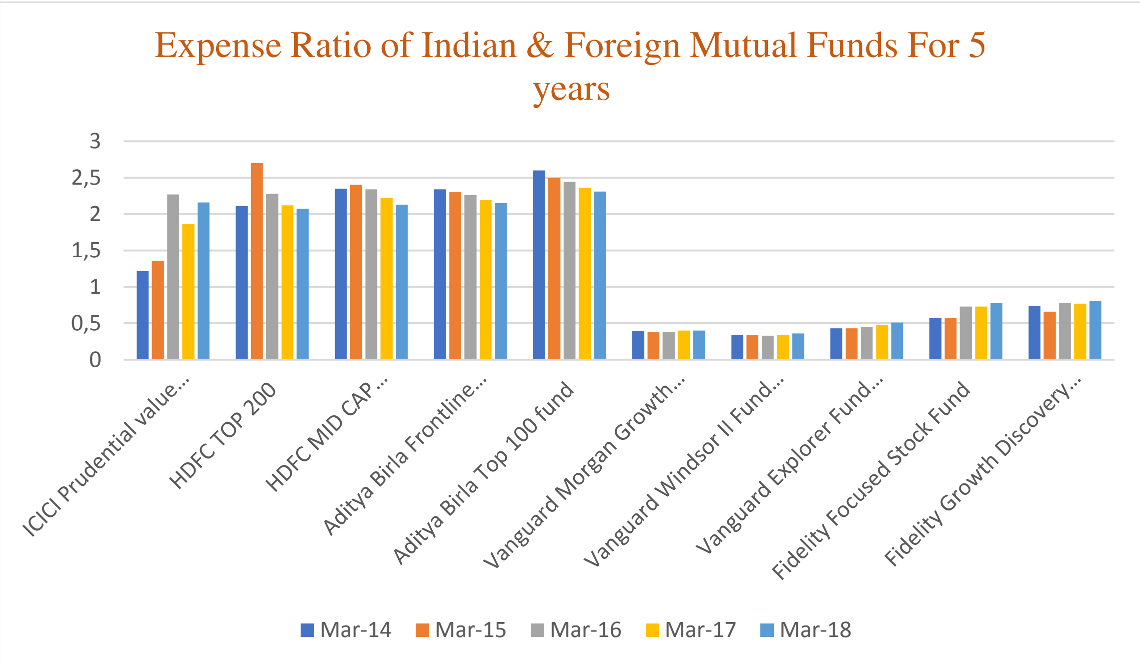

Chart 1.4

Interpretation:

From the above chart it can be seen that Expense ratio of a county other than India has been lying below 1%, whereas Indian mutual funds are lying above 1%. There is no significance relationship between two countries. Vanguard Morgan Growth Fund & Vanguard Windsor II fund are having lowest expense ratio as compare to other funds.

- **Comparison between existing & new recommended expense ratio of 5 funds with the help of AUM:**

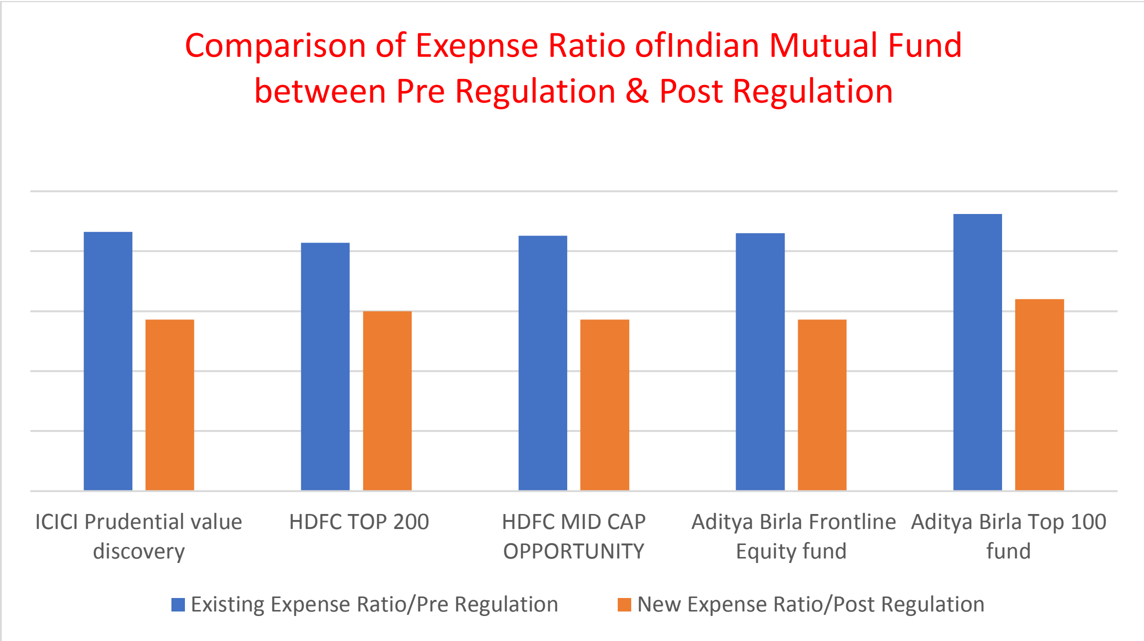

Chart: 1.6

Funds	AUM (Cr)	Existing Expense Ratio/Pre-Regulation (%)	New Expense Ratio/Post Regulation (%)	Difference	Diff in %
ICICI Prudential value discovery	15881.27	2.16	1.43	0.73	33.7963
HDFC TOP 200	14349.85	2.07	1.5	0.57	27.53623
HDFC MID CAP OPPORTUNITY	19428.54	2.13	1.43	0.7	32.86385
Aditya Birla Frontline Equity fund	19704	2.15	1.43	0.72	33.48837
Aditya Birla Top 100 fund	3959.2	2.31	1.6	0.71	30.73593

Table No: 1.1

From the above table No. 1.1, it can be seen that above selected funds are having AUM above 10,000 Crores, so as per new recommendation of SEBI it seems that expense ratios have been decreased significantly. ICICI Prudential Value Discovery Fund, HDFC Mid-cap Opportunity & ABSL frontline equity fund have seen slightly more reduction in an expense ratio due to their size of an AUM as compare to other 2 funds.

❖ **Changes in Expense Ratio & Impact on Investor's Decision While Making an Investment**

*If a person invests 15 lakhs each in 5 funds, then how he would have saved his cost of investment shown in the below table:

Funds	Amount	Existing Expense Ratio/Pre Regulation	Total Cost	New Expense Ratio/Post Regulation	Revised Cost
ICICI Prudential value discovery	15,00,000	2.16	32,400	1.43	21,450
HDFC TOP 200	15,00,000	2.07	31,050	1.5	22,500
HDFC MID CAP OPPORTUNITY	15,00,000	2.13	31,950	1.43	21,450
Aditya Birla Frontline Equity fund	15,00,000	2.15	32,250	1.43	21,450
Aditya Birla Top 100 fund	15,00,000	2.31	34,650	1.6	24,000
			1,62,300	**Total**	1,10,850
				Change in Amount (Cr)	**51,450**
				Change in %	**32**

Table No. 1.2

Interpretation:

From the above table No. 1.2, it can be seen that amount invested 45 lakhs by an investor pre-circular, he had to pay Rs.1,62,300 as a cost while entering into the mutual fund market. Post- Circular, with the same invested amount investor has to pay Rs. 1,10,850. He saves Rs. 51,450 with saving of 32%.

Findings & Recommendation:

Though gross saving rate of India is about 30% as compared to United States which is about 18%, capital infusion has been lower in India because people are still in the illusion with regards to stock market is gamble market. Moreover, Indians are putting their money in Capital Market with lots of emotions which doesn't happen in US. In Unites States people invest money to get good business out of it irrespective of emotions.

Last regulation made before Sept 2018 was in 1996 for more penetration in mutual funds and to increase interest of AMC's. But Indian Government/SEBI took long period of time to reform the TER policy. At least those funds who are crossing AUM above 10000 crores and 50000 crores, TER could have been reduces further, but it took more than 20 years to change the policy.

Capital formation of India is Rs10,652 Billion which is far lower than USA which is about Rs.77845.74 Billion in the year 2018. Also, as far as market size is concern, India stands at 9th rank with market capitalization with $1.5 trillion and US stands at 1st rank with market capitalization about $27.5 trillion. Hence, we could see in the study, there is significance difference of mutual funds expense ratios between Indian Equity Mutual funds with high AUM and Foreign Equity Mutual funds with high AUM.

Conclusion:

Reduction in TER (Total Expense Ratio) will state that mutual funds will grab more attention of investors. Government is also trying mutual funds to be grown henceforth they are advertising "Mutual Funds SahiHai" to reach up to small investors. Educated investors are very particular about expense ratio charge by funds. With new change in policy will lead investor feel happy while investing; because cost is being reduced significantly.As we have seen in this paper that decreasing in cost ratio would help investor to save the cost. it is expected that equity mutual funds invest in substantial stocks or shares which do well in long term. By investing the capital in good equity scheme, you can overcome the uncertainty and gain remarkable income.

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