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DETERMINANTS OF VALUATION: AN EMPIRICAL STUDY OF MERGERS AND ACQUISITIONS IN INDIAN MUTUAL FUND INDUSTRY

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Abstract

The article sums up the commonalities found across Mergers and Acquisitions (M&As) in the Mutual Fund Industry during the last 25 years of 1987-2012. The Elements of Value Creation in the M&As of Indian Mutual Funds are arrived at using Case Study method. Population and sample size equals to 43 being the number of AMC mergers, AMC takeovers and Scheme takeovers. It is for the first time, such a comprehensive study is taking place in the Indian Mutual Fund Industry hence adding to knowledge base. It helps to understand how value creation is sought after in the marketplace by Mutual Funds. Though the factors identified are not having equal weightage in valuation, further studies can be taken up to establish the significance and extend of influence on valuations. For beginners in Portfolio Management & Mutual Funds, it offers useful guidance to dirty their hands on designing strategies and practitioners can draw insight from the differing outcomes of these events.

Key Words: Mutual Fund Industry, Mergers & Acquisitions, Value Creation**.**

1.Introduction

Merger refers to the situation of target company is absorbed into the buyer company and converted to a branch office (loss of company charter, CEO, and board of directors. Acquisition means that the target company is incorporated into the holding company of the buyer as a separate company. Companies engage in Mergers & Acquisitions (M&As) due to synergies that lead to cost reductions or revenue enhancements. Mutual Funds (MFs)are offering standardized portfolios managed according to stated objective. They are basically set up as Trust under Indian Trust Act 1882. The Trust is formed by the Sponsor of the MF, having sound track record and holding 40 per cent Net worth of Asset management Co(AMC). AMC is set up under companies Act 1956. The Asset management, Custody of valuables, R&T functions are at arms-length relationship and at the oversight of the Trust under the regulator Securities Exchange Board of India (SEBI).

Prominent studies on M&As in India are available about companies; but no such effort is available about those that operate in the Indian Mutual Fund Industry (IMFI). IMFI began with solitary Unit Trust of India's launch of Unit Scheme 1964 has become a level playing field in 2003 only. As on Dec 2011, there are 44 MFs, out of which 15 are JVs with foreign partners and 9 are Foreign with major sponsors belonging to Japan, France, Italy, USA among others. And witnessed 41 M&As during the same period.

2. Literature Review

The first author in her study on the different types of MF products on offer in the Indian financial markets has looked into features of new and innovative MF products, their growth prospects in the ongoing regime of globalization in India (Monica, 2010) [1].

SEBI, the regulator of securities markets in India including MF industry, in its detailed working paper on IMFI has highlighted the huge growth prospects of the industry in India in view of the low penetration of this product as a percentage of the GDP. The paper points out the need for re-energizing the MF industry, the steps being taken by SEBI in the above direction, and lastly suggests what needs to be done further to ensure sustained and more dynamic growth of MF industry considering the major challenges that the industry faces. (SEBI, 2012) [2].

The first author in her study of the structure of IMFI has made an elaborate discussion on dynamics of IMFI by adopting a census method (ie. by considering all the players in the industry) throughout the period of 08 years under study viz. March 2003 to March 2010. Performance parameters like Return on assets, Growth of assets under management etc. used for analysis. Tools like ***Herfindahl-Hirschman Index (HHI) have been used for analysis***. It has been noted that every player is in a monopolistic situation indicating room for further growth in the industry in terms of number of players and thereby Assets Under Management (AUM).(Monica, 2012).[3].

KPMG, the world famous management consultancy organization, has made a comprehensive review of the growth prospects of IMFI, in the backdrop of the SEBI initiatives to re-energize the sector. The commendable performance in respect of AUM (Asset Under Management) of IMFI with a CAGR of 13 percent during FY 2007 to FY 2012 period, but the poor performance during FY 2011 (-6.3 percent) and FY 2012 (-5.1 percent) periods have been highlighted in the paper. The need to enhance TER (Total Expenses Ratio) up to 30 basis points and charging services tax separately have been pointed by the KPMG report for faster growth of IMFI. Besides, it has been suggested that long-term initiatives from SEBI are required for sustained growth. (KPMG, 2012)[4].

CII (Confederation of Indian Industry) in collaboration with PwC (Price Waterhouse Coopers, an international management consultancy firm) has done a very recent study of IMFI. It has been noted that there has been 18 per cent growth in AUM for IMFI industry during the period FY 2009 to FY 2013; with Debt instruments showing maximum relative growth, followed by Equity instruments. The huge untapped market for MFs in view of the low financial inclusion in India has been pointed out. The need to expand the market distribution in less penetrated areas, significance of proper training etc. have been highlighted in the study. (CII & PwC, 2013) [5].

In view of the foregoing, it is noted that empirical studies on IMF as a whole and that too in the context of frequent M&As among MFs are virtually nil, though there are a number of studies on the performance of MFs, their valuation, the structure of IMFI etc. This study makes an empirical analysis of the value creation of MFs in India.

3. SEBI Regulations on MFs and M&As

The constitution of a running fund may change in any of the following five possible ways:

i. Trustees may decide to change the AMC and handover the scheme to a new AMC

ii. The scheme may be merged with another scheme of the same AMC
iii. The AMC is taken over by another set of sponsors
iv. One AMC may merge with another AMC
v. Just the schemes may be taken over by another set of trustees

The approvals applicable in respect of these five types are summarized in Table I.

Table I: Types of Changes in Constitution of MFs and Approvals Applicable

Transaction Type	Trustee Approval	SEBI Approval	High Court Approval
AMC Takeover by new sponsor	Yes	Yes	No
AMC Merger	Yes	Yes	Yes
Trustees changing AMC	Yes	Yes	No
Schemes taken over by another AMC	Yes	Yes	No
Scheme Merger	Yes	Yes	No

4. Significance of the Study

Any AMC which is actually doing any business and has investors will have enough value for someone else to acquire either the corporate entity or the funds. The investor money is completely insulated from the AMC's business is due to the way the India's mutual fund regulatory setup works. The only two instances where investors lost money was that of CRB MF and also erstwhile Unit Trust of India due to lack of strong regulatory framework at that time. There are 44 mutual funds in India with total assets worth Rs. 6.81 trillion as of the quarter ended December 2011 increased from 1 in June 1964. An analysis of the M&As of this industry is of particular interest to students of Finance as also to industry experts. Although there has been several studies about the marketing mix, market structure so far no academic effort is available about the M&A space in IMFI. It is in this context, the study assumes significance and could be used by not only students and academicians, but also industry to understand value creation processes/strategies. The individual elements arrived at could be subjected to further study to empirically establish the extent of impact and whether they resulted the anticipated outcome.

5. Objective of the Study

(i) To make an overall study of the growth prospects and challenges of Indian Mutual Fund Industry (IMFI);
(ii) To make a detailed study to identify the determinants of valuation in Mergers and Acquisitions (M&As) among the Mutual Funds (MFs) comprising IMFI.
(iii) To make suggestions for faster and sustained growth of MFs based on the findings.

6. Materials and Methods

The snapshot of the industry at close of March 2012 is subjected to this study. The period from 1987 to 2012 is considered adequate as it begin with the breaching of unitary existence of Unit Trust of India since 1964. Other details are as follows:

i) ***Research Methodology:*** A combination of descriptive, historic and exploratory approach has been adopted. This is necessitated by the mere fact that this research area is unexplored in India till date.

So logically, what followed was to observe how the individual fund houses engaged in M&As did and what followed next.

ii) ***Population and Sample:*** The population for this study is the number of M&As that took place during 1987-2012 in the MF space including stake sales and sold off cases. Authors have located 43 events (as of March 2012) of all the three types: AMC mergers, AMC takeovers, Scheme takeovers. A Census of the full population, instead of a sample study, is used as otherwise no appropriate picture would emerge.

iii) ***Tools and Techniques*****:** Following a case to case analysis of M&As the intention of the event was noted as also its outcome. The reports that appeared in the MF websites, other websites that regularly follow MF products were surveyed in addition to financial Newspapers and Magazines that regularly cover happenings in the MF space. The elements of value creation in M&As of MFs were generalized from the motives of the merged entity and the outcomes followed. The unique elements were derived out of them. Cross tabulations, simple ratios used for comparative presentation.

iv) ***Procedure of Data Collection*****:** Using secondary data M&As were watched to figure out exclusive motives that were non-existent hitherto. Multiple experts in the field were consulted to avoid duplication as also verified from published facts about the issue in leading research websites like valueresearchonline.com, moneycontrol.com. etc. in addition to the MF websites. Leading financial dailies, magazines were scanned for event coverage as the study related to 25 years, even before internet is widely used in India. In order to cover the legal aspects and official views, the websites/annual reports of AMFI, SEBI and RBI were liberally made use of. The query strings used included the words 'Merger', 'Acquisition', 'Takeover' , 'Stake sale' along with 'Mutual Funds in India'

7. Scope and Limitations of the Study

The study has relied upon secondary data and used case study method to arrive at the elements leading to value creation in M&As during 1987-2012. Detailed data is not available on some of the M&As, many cases valuations were not disclosed. So the limitations of methods accompany the results obtained but moderated by authors' experience in the industry (11 years 1992-2003 with UTI)and academic research(2004-2012). Scheme mergers as also implications of M&As for distributors and investors are left to further study among others.

8. Indian Mutual Fund Industry (IMFI): An Overview

IMFI has got excellent prospects for growth, one of the best chances across the economies in the whole world. This is because of the huge untapped demand and grossly underpenetrated market potential. As of FY 2011, the Assets under Management (AUM) to GDP ratio for India is at an abysmal level of just 04.70 percent as against 77 percent for US, 44.10 percent for Europe and as high as 44 percent for the whole world. (KPMG, 2012) [4]. From a broader perspective of financial inclusion also, the case of India is 10.9 branches and 5.4 ATMs per 1 lakh adults as against 24.5 branches and 64.6 ATMs for UK and 35.7 branches and 173.8 ATMs for US. (CII & PwC, 2013)[5]. The MFs in India have their operations highly concentrated in metros, as 5 cities account for 74 percent of the total AUM. Apart from the immense growth potential as noted above, the latest reports suggests very appreciable performance of MFs in the last few years. The CAGR for growth in AUM is as high as 18 percent for FY 2009 to FY 2013 period, the year to year growth rates being 12 percent for FY 2012 and 23 percent for FY 2013. In short, given the huge growth potential and commendable growth rates during the last few years in general, the current need is to sustain and improve the performance of IMFI. Identifying the determinants of valuation and that too in the backdrop of frequent M&As taking place in IMFI is relevant in the above context for taking suitable policy decisions for faster and sustained growth of MF sector. This study is an effort in that direction.

9. Data Analysis and Interpretation

The motives were observed as appearing from published interviews / press releases / analytical reports. The commonalities were grouped under 11 heads viz. (i) Asset mix, (ii) Global-Economic factors, (iii) Long-term earning prospects, (iv) Legal aspects, (v) Network strength, (vi) Size, (vii) Profitability, (viii) Retail folios, (ix) Strategic reasons, (x) Taxes, and (xi) Timing.

- Asset Mix refers to the proportion of asset classes handled by the respective Mutual Fund (For example, Equity. Debt, Gold, Derivatives etc.).
- Global Economic elements refer to those aspects due to global happenings on which the firm has no control.
- Long-term Earning prospects are drawn from average expenses incurred by the fund and fund management revenue from other permissible businesses.
- Legal aspects should be in conformity with MF regulations of SEBI. It is more or less stabilized in the Indian context with SEBI MF regulations 1996. So, only the latest changes have been captured.
- Network Strength means the reach enjoyed by the MF in the market. The level of market penetration is assessed in this respect
- Size matters due to market leadership and also income earned as management fees.
- Profitability obviously is about the MF's stated profit as per final accounts
- Retail folios are considered to be sticky in uncertain/falling market conditions
- Strategic Reasons include aligning to core competency of the firm, Winding up business among other things
- Taxes under section 72 of the Income-Tax Act 1961, a mutual fund is allowed to carry forward its losses for eight years. But, under section 79 of the law, this loss is not allowed to be carried forward if there is a change in ownership of the company. This can be avoided through another clause of section 79, which allows losses to be carried forward, post the deal, only if the Indian company is a subsidiary of a foreign company and the change in ownership arises as a result of amalgamation or demerger of the foreign company.
- Timing involves travelling with market moves as reflected in BSE Sensex or Nifty.

10. Discussion of Results and Implications of the Study

The study helps one to understand broadly how M&As of MFs are stitched in the Indian Context. This is not replacing any existing studies but augmenting to the existing knowledge on designing fresh combines. Further studies are done to empirically prove or disprove the strength of these elements in M&As of the Mutual Fund Industry of India.

❖ ***Element 1 (Asset Mix)***

The higher the amount of equity AUM over the long term, the greater the valuation it fetches. This is because equity mutual fund schemes earn better commissions compared with debt and other fund categories in a given tenure. Equity related and monthly installment plans earn a commission of 80-90 basis points (bps) of the investment made, while debt schemes, such as fixed-maturity plans, earn 30-40 bps in commissions. Gold exchange traded funds, or ETFs, earn commission of 50-60 bps. One basis point is one-hundredth of a percentage point. At least 65 percent of Reliance Mutual Fund's assets are in long-term debt, equity and gold in the form of ETFs and fund of funds. Equity accounted for roughly a third of total assets managed by Reliance Mutual for the December 2011 quarter. Reliance commanded better premium among all the M&As both in 2007 and 2012 (Annexure-2) Attractive valuations obtained for FIL Fund Management Pvt Ltd (March 2012) at At Rs. 550 Crore, the deal value is 6.2 percent of the AUM. At the end of December 2011, it managed assets worth at least Rs. 6,184.61 Crore in equity schemes and Rs. 2,695.84 Crore in debt schemes (Value Research, New Delhi). As on Dec. 2010, Benchmark AMC', the leader in FTF space had average AUM of at Rs 2,935 Crore, while equity AUM stands at Rs 955.8 Crore. Benchmark got reasonable valuations unlike UTI MF and LIC MF.

❖ ***Element 2 (Global Economic Factors)***

A plunging global market, anemic economic recovery in US and Europe has forced Zurich to consider drastic action in 2002. In Nov. 2008, Lotus India MF was bought by Religare. While StanChart benefited from the sale by booking profits at the peak of valuations, Lotus suffered a near distress sale, owing to pressures by sponsors to exit a business where it was finding its liabilities rising by the day. However, both the acquisitions were for the same reason—the buyers wanted an entry in the MF space. Stand alone domestic companies that see their market share decreasing need strong partners to bring in more money and expertise, to be able to face competition better. After Robeco acquired a stake in Canbank AMC, the fund house improved its internal systems, hired new fund managers and performance has dramatically improved. In 2009, Japanese money manager Nomura AMC picked up a 35 percent stake in LIC Mutual Fund AMC for Rs308 Crore, or 2.4 percent of the valuation of the latter's assets at the time. In 2009, L&T Investment Management Ltd paid Rs.45 Crore to buy out DBS Cholamandalam AMC —1.7 per cent of the value of the latter's assets. Goldman Sachs has chosen Benchmark deliberately because it wanted to take the passive route to chart its mutual funds' foray having registered its mutual fund operations with SEBI as far back as 2008. It is estimated that the deal to be around Rs 120-130 Crore or 4-4.5 per cent of AUM. Though ETFs have only a 0.5 per cent market share of the mutual fund assets in India, they are a big hit in the global context. Natixis Global Asset Management (NGAM), France (Dec 2010) acquire 25 per cent stake in IDFC AMC for an undisclosed sum. NGAM, with AUM of USD719 Billion as of 30 Sept.2010, is already having a significant presence in Asia, including Japan, Taiwan, Singapore and China.

❖ ***Element 3 (Long-Term Earning Prospects)***

Expenses kept low means your bottom lines go on bulging. Fund houses that create systems and processes that maintain the cost at lower levels are adding value to the acquirer. Japan's troubled Shinsei Bank and billionaire investor Rakesh Jhunjhunwala sold out their Indian mutual fund joint venture to Daiwa for about USD10 million, as industry profitability erodes on rising competition and regulatory restrictions[7]. Another stress sale was DBS Cholamandalam that was bought over by L&T finance for a petty sum of Rs 45 Crore, or 1.7 per cent of the latter's AUM DBS Chola Mutual Fund managed over Rs 2890 Crore (average AUM for Aug 2009). It is one of the oldest AMCs in India, operating since 1996 and managed six debt funds 11 equity funds. The average AUM has grown from Rs 1023 Crores in March 2009 to Rs 2893 Crore in August 2009.

❖ ***Element 4 (Legal Aspects)***

The Reserve Bank of India (RBI) had asked public sector banks which promoted mutual funds, to sell off their mutual fund business and concentrate on their core activity, ie banking. This ensured that weak bank sponsored funds, most of which have dismal track records, moving their schemes into the hands of stronger players. Canbank Mutual Fund, PNB Mutual Fund and Bank of Baroda Mutual Fund went on the lookout for buyers, while SBI and LIC searched for partners who could bring in the expertise required to run a mutual fund. DLF had in Dec. 2007 signed an agreement to set up a mutual fund joint venture DLF Pramerica Asset Managers, with Prudential Finance picking up 61 per cent. The sale of 39 per cent stake in mutual fund joint venture DLF Pramerica Asset Managers to partner Prudential Finance took place in 2010 as DLF's participation is not in conformity with SEBI's modified guidelines. RBI had disallowed Swiss Bank UBS to acquire Stanchart AMC. UBS at that time was paying USD120 mn for the deal. Standard Chartered MF has around Rs.14000 Crore in assets of which Rs.4000 Crore is in equity while rest is in debt. Later, Infrastructure Development Finance Corporation (IDFC) has outbid other bidders such as Shinsei Bank, Indiabulls to emerge as winner in race to acquire Standard Chartered Mutual Fund for USD205 million. Sundaram Finance has bought out BNP Paribas' stake in their joint venture Sundaram BNP Paribas Mutual consequent to later buying into Fortis MF as part of global strategy. SEBI does not allow one AMC to hold stake in another AMC.

The SEBI abolished entry loads on mutual fund investments, slowing inflows for asset management companies. Banks, a major source of assets for mutual funds, have been asked by the Reserve Bank of India not to keep more than 10 per cent of capital invested in MFs[15].Making distributor disclose commissions received by them, recording advice given by the distributor[16], writing separate cheque for services rendered by the distributor and opening stock exchange channel for distribution of MF products have kept Independent Mutual Fund Advisors (IFAs) vulnerable channel. UTI MF is a typical example in this case getting less premium on stake sales compared to others.

❖ ***Element 5 (Network Strength)***

SBI had offloaded 37 per cent of its stake in favour of the French AMC viz. Societe Generale for around 8.8 per cent of its AUM in July 2004; while for Canara Bank it was a win-win deal with the Robeco Group NV of the Netherlands. The latter had acquired a 49 per cent stake in Canbank, at a whopping valuation of 10.7 per cent of the formers' AUM in March 2007. The strong pan-India presence commanded by both SBI and Canara, through their wide banking and distribution network, was a major peg in commanding healthy valuations by both these banks. UTI AMC also possessed similar strengths but more dependent on Independent financial Advisors (IFAs). The StanChart AMC was sold for Rs 820 Crore to the financial services company IDFC in March 2008, setting a new benchmark in the asset management space. The deal was a winner for StanChart considering the price and the fact that it got to retain its distribution network through which it continues to sell mutual funds. For IDFC, the reasons to buy an existing fund house were to get a head start and the low cost of starting operations. With Rs 14,000 Crore in AUM, StanChart was a medium-sized fund house. Religare has bought Lotus (2008) as it gives it ready access to a market where Lotus had 38 branches and was servicing over 1.5 lakh customers. In Jan. 2010, T Rowe Price had taken 6.5 per cent each from the 4 sponsors – State Bank of India, Punjab National Bank, Bank of Baroda and Life Insurance Corporation – for Rs 650 Crore.

SEBI's new norm relating to introduction of a variable load structure for the MF industry has given an edge to those fund houses which have a strong banking distribution network vis-à-vis those which rely on independent advisors for distribution services. Japan-based Nomura AMC acquired a 35 per cent stake in LIC's AMC mutual for just around 2.4 per cent of the latter's assets in July this year. Both UTI and LIC has been a victim of these discounted valuations. It is difficult for smaller AMCs to accommodate the acute stress on their financial statements in the near term. The financials are likely to be impacted not only because of slump in product sales but also because AMCs will now be under pressure to compensate distributors.

❖ ***Element 6 (Size)***

Size dictates revenue and much need visibility in the market. An AUM of Rs 3,000 Crore was sufficient to achieve breakeven in 2004; in 2009 that level has gone up to Rs 10,000 Crore. In the early 1990s, ITC Threadneedle, which was a joint venture between ITC and Threadneedle was acquired by Zurich, which also acquired 20th Century Mutual Fund. Threadneedle was a 100 per cent subsidiary of BAT Financial Services which was taken over by Zurich Financial Services. Threadneedle was transferred to the Zurich group. Swiss-based Zurich Financial Services Group merged the two schemes of ITC Threadneedle Mutual Fund into Zurich India Mutual Fund. After the merger, the Zurich India Mutual Fund managed six schemes with an asset base of Rs 340 Crore under management with a total of 1.66 lakh unit-holders covering 8 cities. The merger encompassed the transfer of fund managers, the compliance and distribution staff. HDFC Mutual Fund acquired Zurich to become second largest MF reaching 12 per cent of total AUM by May 31, 2003. The combined corpus of HDFC MF and Zurich India MF as on May 31, 2003 has been Rs 11,870 Crore, Rs 264 Crore higher compared with Prudential ICICI's 11,606 Crore. The acquisition is being done at a price slightly less than 4.5 per cent of the assets of Zurich. This come to roughly around Rs 148 Crore. While an integration of the total 70 employees of Zurich MF into HDFC MF was taking place, around 15-20 people from the former looked for jobs elsewhere since there would be no place to absorb them. Most of the senior functionaries with the exception of Zurich MF president S V Prasad, formed part of the merged entity.

The erstwhile Kothari Pioneer Mutual Fund became Pioneer-ITI when the Kothari stake was acquired by ITI(Oct 1999) Pioneer ITI has emerged as one of India's leading mutual funds managing assets of Rs.3000 Crores for over 730,000 investors. The entire outfit was later acquired by Franklin Templeton Investments (Jul 2002). The same Pioneerfrom Italy is back in India in April 2011 as a partner of Bank of Baroda in Baroda Pioneer Mutual Fund. Post acquisition of Apple Mutual Funds, Birla MF has become the largest Indian mutual fund after the Unit Trust of India with total assets under management of over Rs 37.50 billion during 1999. BMF recorded a growth of 160 per cent against the industry growth rate of 35 per cent it relaunched the two acquired equity funds from Apple: Birla IT Fund (formerly Apple Platinum Share) and Birla MNC Fund (formerly Apple Midas Fund-the Goldshare). As of July end, 2005, Alliance Capital had Rs 1,400 Crore assets under management, of which over Rs 700 Crore is of equity assets. Though Alliance Capital has lost some Rs 300 Crore since the announcement of the takeover by Birla MF October 2004, most of these funds were from the debt schemes. Birla MF would pay the US firm based on the asset under management (AUM) post exit option, which was open till August 31. Apart from taking over the assets of SUN F&C in 2003, Principal merged some existing schemes having similar investment objective with its own schemes. With this takeover, Principal's assets rose by nearly Rs 500 Crore. It managed Rs 1,900 Crore of assets, as on June 30, 2003. Also, another 70,000 investors added to its kitty, taking the total to 230,000 investors. The takeover news came days after the AMC re-christened itself as Principal Mutual, after buying out IDBI's entire stake in the erstwhile IDBI-Principal Mutual Fund. Later partnered with Punjab National Bank and finally decided to remain single. Sahara MF, which took over (April 2004) the Dr A C Muthiah-promoted First India MF is still quite near the bottom of the pile.

When T Rowe Price, USA completed stake purchase in early 2010, the fund house was managing Rs 78,203 Crore and was the fourth-largest manager by assets. It has since slipped to fifth spot, with assets of Rs 62,579 Crore this Sept. 2011. Reliance Capital Ltd completed (Oct 2011) a 26 per cent stake sale in Reliance Life Insurance to Nippon Life Insurance, Japan for Rs3,062 Crore, pegging the total valuation of Reliance Life Insurance at close to Rs11,500 Crore, making it the largest foreign direct investment in the country’s financial services sector by a wide margin. Reliance Capital is the parent company of Reliance Mutual Fund and Reliance Life Insurance.

- ***Element 7 (Profitability)***

Operating profits for AMCs in India, as a percentage of average assets under management, were at 32 basis points in 2006-07, while the number was 12 bps in UK, 17 bps in Germany and 18 bps in the US, in the same time frame. The total AUM of the Indian mutual fund industry could grow to USD350-440 billion by 2012, expanding 33 per cent annually. While the revenue and profit (PAT) pools of Indian AMCs are pegged at USD542 million and USD220 million respectively, it is at par with fund houses in developed economies (2007-08) (McKinsey 2008). In 2010-11, only a handful of the 43 asset management companies were profitable. For the fiscal year 2011, Reliance Mutual Fund posted a 34 per cent jump in profit to Rs261 Crore from Rs195 Crore in the year before. Reliance MF led with the highest profits followed by HDFC MF's Rs 242 Crore. While figures of UTI's MF's were not available for the latest fiscal, Franklin Templeton currently ranks as the third most profitable with a PAT of Rs97 Crore (for fiscal year ended September 2010). Most of fund houses follow the April-March financial year and among the top 10 include Birla Sun Life AMC with a PAT of Rs85 Crore, followed by SBI AMC (Rs79 Crore), ICICI Prudential AMC (Rs72 Crore), DSP AMC (Rs47 Crore), Tata AMC (Rs17 Crore) and Kotak AMC (Rs11 Crore).

A higher-than-industry average valuation for the stake sale can also be explained by the profitability of the fund house. Reliance Mutual Fund recorded the maximum profit in the industry in fiscal 2011. The fund house has beaten HDFC Mutual Fund in terms of profit, while losing its top ranking to the latter in terms of average AUM. L&T Investment Management Ltd, carried forward a total loss of Rs. 124.44 Crore on 31 March 2011 after losing Rs. 39.57 Crore in 2010-11. Fidelity Mutual Fund has a cumulative loss of Rs. 333 Crore. In 2010-11, its losses more than doubled to Rs. 62.39 Crore from a year earlier. In the merger deal (March 2012), Fidelity would be keeping its losses. Of the 39 AMCs that declared their earnings last year, 16 recorded a total profit of around Rs. 1,100 Crore and 23 booked losses that added up to some Rs. 550 Crore.

❖ ***Element 8 (Retail Folios)***

The erosion of NAV in Zurich India was exceptional at this juncture, when the deal between Zurich and HDFC awaits the final seal. Despite claims that HDFC Mutual Fund would do justice to the fund management business of Zurich, industry representatives maintain that the faith of retail investors has been shaken regarding the fund management capabilities of the AMC. Infrastructure Development Finance Corporation (IDFC) has outbid other bidders such as Shinsei Bank, Indiabulls to emerge as winner in race to acquire Standard Chartered Mutual Fund for USD205 million. Earlier, RBI had disallowed Swiss Bank UBS to acquire Stanchart AMC. UBS at that time was paying USD120 mn for the deal. Now with a local player acquiring the MF biz, getting regulatory approval would be much easier.Standard Chartered MF has around Rs.14000 Crore in assets of which Rs.4000 Crore is in equity while rest is in debt.IDFC is one of India’s oldest lending institutions, and the deal would give it a foothold into the retail sector and improve its high margin fee based income.

T Rowe has got a good deal from the perspective that they are buying into an AMC with a large retail asset base. Retail assets are sticky and it is not easy to create this kind of an asset base. Unlike peers, which have built up their brands and retail businesses in the high-potential Asian asset-management industry, T. Rowe is primarily focused on attracting institutional money. UTI is a mass retail fund firm with a presence in more than 450 districts with one of the biggest distribution networks in India. It also offers a product that allows those with low income to invest 200 rupees (about USD4) a month. Birla Sun Life Asset Management Company has decided to expand the scope of its arrangement with Apple Mutual Fund and soon plans to take over the latter's schemes which has assets close to Rs 70 Crore and a retail investor base of over 1.3 lakhs.

❖ ***Element 9 (Strategic Reasons)***

Among the less high-profile cases are Jardine/Sun F&C (Principal), IL&FS (UTI) and GIC (Canbank) and Indbank (Tata). A few overseas players — like TD Waterhouse, Cazenove and Newton — have otherwise moved out of JVs with Tata, Chola and Sundaram. The last two have since entered into fresh tie-ups with DBS and BNP Paribas, respectively. Those cases where a fund company has ceased operations include Shriram, Dundee, and Anagram. These funds are wound up and the investors returned their money, the transaction being no different than a normal redemption. Sahara bought the First India Mutual Fund, and the resultant entity has not proved very successful. Then there’s the complex history of the Principal group, which entered India in partnership with IDBI, bought IDBI’s stake, purchased Sun F&C, then partnered with Punjab National Bank, and has later decided to go solo (2008). More time and effort has been spent on restructuring operations than on money management, much to the detriment of the investors. The acquisition of Fidelity is expected to provide L&T Mutual Fund the necessary scale, products and access to retail customers to grow profitably. The combined entity would have a market share of 2 per cent in terms of AUM. L&T Mutual Fund currently managed (March 2012) assets worth Rs. 4,616 Crore.

❖ ***Element 10 (Tax)***

HDFC and Pramerica’s bids value Fidelity MF at 4-5 per cent of its average assets, a sizable amount in light of the AMC’s cumulative losses of Rs. 333 Crore, the highest in the industry. In 2011, its losses more than doubled to Rs. 62.39 Crore over the last year. Fidelity MF in India is a subsidiary of Fidelity Mauritius, which in turn is a subsidiary of Fidelity Worldwide Investment, or FIL Ltd, that manages at least USD212 billion. If a bidder buys Fidelity Mauritius and reverse merges the company with Fidelity MF in India, it will be able to carry forward the losses of Fidelity MF as there will not be any direct change in ownership of Fidelity MF in India. If indeed this happens, the acquirer will not only be able to carry forward the losses of Fidelity MF for eight years but also save on taxes till such time its profit gets offset by past losses. For this reason, the bidders are willing to pay a little more than average valuations for an acquisition.

❖ ***Element 11 (Timing)***

Reliance Capital Asset Management has managed to secure a high valuation for its mutual fund arm through stake sale (Oct 2011) to Nippon Life Insurance. At Rs 1,450 Crore for a 26 per cent stake, the deal values Reliance Mutual Fund at 6.8 per cent of its assets under management (as of December 2011 quarter). This is at a steep premium to deals sewn up by other fund houses in recent times, which have gone through at 1.5-4 per cent of assets. It must be noted that Reliance Capital had, in end 2007, sold a minority 5-per cent stake to Eton Park Capital, New York, USA at a stiff valuation of 12.9 per cent of assets managed. That was weeks before the 2008 market crash; Reliance was also the largest asset management company then. It is now ranked second among domestic fund houses in terms of assets managed.

11. Major Findings and Suggestions

Going through the M&As happened in the IMFI during 1987-2012, one can conclude that consolidations are inevitable. Factors like Asset mix, Global Economic factors, Long-term earnings prospects, Legal aspects, Network strength, Profitability, and Retail folios, Size, Strategic reasons, Taxes and have played major role in commanding valuations, though they do not have equal weightage. M&As are happening among domestic players and international players. Based on these findings, the following suggestions are made:

1. As industry consolidations tend to enhance the operational efficiency of individual MFs by way of 'Synergies' as well as the health of the industry as a whole (IMFI) by reducing the number of players; such consolidation moves should be promoted;
2. Consolidations in IMFI would reduce the number of players and would result in a few number of very strong players who are capable of effectively competing with the international players in MF industry. Because such moves are desirable for the whole financial system in general and IFMI in particular, they need encouragement.
3. Consolidations in IMFI fall in line with the recommendations of Narasimham Committee – II relating to the second phase of the ongoing banking sector reforms in India. Accordingly, consolidations were to be encouraged so that a very few number of globally competitive banks alone would remain in the long run, as against a large number of relatively weak ones.
4. As the natural corollary of the globally competitive MFs alone existing in the system, customers would get better services at better terms and conditions, including various charges, like, brokerages and commissions. Therefore, from the customers' perspective too consolidations deserve due encouragement.
5. More encouragement is required from stakeholders like SEBI, Courts, Government etc. in granting approvals to M&As, thus making the process smoother and faster.

6. Long term policies or policies that are sustainable in the long run needs to be formulated, particularly in view of the fact that vast majority of the untapped market potential corresponds to the rural and remote areas where these services not available at all, at present. A delivery mechanism that effectively utilizes the immense potential of the fast advances in ICT, particularly the most popularly used technologies can attract more investments into this instrument. (eg. Mobile Phones have a subscriber base of over 90 million in India) Similarly, the Government can consider the possibility of selling MF products through post offices, as there are over 1,39,000 post offices in India in the rural areas alone.

12. Concluding Remarks

In view of the foregoing discussions, it may be stated that given the huge growth potential of MFs in India, the appreciable growth rates in the recent years and the very favorable macro-economic and demographic environment, the future of the individual players as well as IMFI as a whole appears to be bright. The favorable steps recently adopted by the industry regulator viz. SEBI, with a view to re-energize the sector, were in the right direction. The most recent performance of IMFI (FY 2012 and FY 2013) has been quite appreciable too, as it has registered growth rates in AUM of 12 percent and 23 percent respectively. The efforts of SEBI and Government need to be continued with a focus on long term and sustainable results, and such efforts will not at all be futile.

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