REMOVAL OF ENTRY LOAD ON MUTUAL FUND SCHEMES – IMPACT ON NET NEW MONEY

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ABSTRACT

Retail investors have nice time to enjoy the initiation taken by the market regulator SEBI i.e. Removal of entry load on all mutual fund schemes. In any case this norm does not affect the investment style of investors who invest more than Rs. 5 Crore but truly bring change in the investment style of retail category. This act by market regulator brings in certain amount of advantages as well as disadvantages to the core participants say Investors, Distributors, Government and obviously Mutual fund. This study basically proposes to analyse the impact of removal of entry load on NNM of mutual fund industry as a whole because NNM is the prime barometer for any scheme. In order to understand whether the removal of entry load has significant impact on NNM or insignificant, ***ANOVA and Levene statistic*** *have been used to test the assumption and found that removal of entry load does not have significant impact on the Net New Money.*

Key words: Retail Investors, Entry Load, NNM, SEBI, Mutual Fund

Introduction

Assets Under Management (AUM) is the term used by all mutual funds to weight how much money they are actively managing. AUM would be the appropriate parameter to evaluate their relative performance with their competitors in the market. It is also defined as the market value of all assets managed by a mutual fund on behalf of their investors. The Net New Money (NNM) is the term used to understand the difference between the Redemptions and Sales made by the funds during specific period.

The entry load is a cost to the investors at the time of investing in mutual fund schemes. Entry load may vary from 2.25% to 2.75% depending upon the style investment and investment objective of the scheme. Especially when any global FOF or Thematic funds are floated that would certainly attract 2.75% as entry load. This entry load is charged in order to compensate the distributors who basically market the mutual fund products as well as facilitate the investor's services like switching, closure etc. If the mutual fund offers a NFO, which has a property of lock-in period for about 3 years, the mutual fund may waive off the entry load but it is not common to all schemes.

On 1st August 2009, the market regulator SEBI demolished the entry load charged on all the mutual funds investments. This initiative affects,

1. The interest of distributors to market MF schemes.
2. Overall profitability of mutual funds
3. Service tax collections etc.

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Review of Literatures

SEBI Chief Mr. M. Damodaran (2009) said if the stock market regulator has its way, investors could walk into the office of a mutual fund firm, buy any of its funds and walk out without paying any kind of entry load. SEBI proposes to waive the entry fee for direct applications received by mutual fund companies either through their investor service centers' or the Internet. SEBI's argument is that since the entry charge is utilized by fund firms towards meeting the distributor's commission, investors making direct investments shouldn't be asked to pay this charge. If implemented, the plan can bring down the cost of investing in mutual funds.

Mr. Dhirendra Kumar, CEO, Value Research India Pvt. Ltd, a Delhi-based mutual fund research house (2009), said the current norms have been unfair to the do-it-yourself kind of investor who thinks he doesn't need guidance or advice of the distributors. But these investors have no incentive for going to the fund company as he still had to pay the entry fee.

Mr. Ajay Bagga, chief executive officer of Lotus Asset Management Co. said (2009) that SEBI's proposal has merit, but adds that firms need to ensure that the direct route is not exploited by the investors. "Since there will be no entry load, investors can make quick entry and exit from the fund depending on the stock market movement. So the industry will need to ensure that there are sufficient exit barriers also.

Mr. Saikat Das, Economic Times (2009), stated that SEBI removing the entry load from mutual fund unit buying, wealth advisory firms find reason to rejoice such a decision foreseeing huge market potential for them. Going forward, such a decision is expected to give a "big push" to the wealth management services which is still at a nascent stage in India. Wealth managers believe that this move may lead to a dominant emergence of advisory services considering the virtual end of distribution services in mutual fund schemes. They are of the opinion that investors will not desist from seeking investment advice and portfolio services. If they deliver quality advisory backed by strong independent research, retail investors would not hesitate to accept wealth management services at a nominal cost of 1-2 per cent advisory fees. After all, selection among 300-400 equity schemes is no joke. Earlier, major distributors were selling MF schemes charging around 2.25 per cent entry load – which was deducted from investors' money. There were cases of large scale "push selling" in a pass back system wherein an independent financial advisor shares a part of his commission with the investor by pushing a particular mutual fund scheme, which may not be worth buying, according to the wealth managers.

Mr. Kaustav Majumdar, Dy. CEO & Executive Director, SMC Wealth Management Services (2009) said the mantle of power is going to shift from product pushers into a holistic financial planning model wherein any wealth advisory service with a strong research background is bound to witness triple digit growth, provided MF industry grows by 30 per cent CAGR.

Mr. Vikas Agnihotri, CEO Religare Macquarie Wealth Management (2009), said, "We plan to capitalize on Religare's network to reach out to investors in Tier I and Tier II cities. From being subjected to a product push environment, Indian investors are being introduced by select players to quality advisory services. In our experience, customers are ready to pay for quality and holistic advice backed by qualitative and quantitative research.

Mr. Rajesh Saluja, CEO and Managing Partner, ASK Wealth Advisors (2009), mentioned SEBI's decision is both in the interest of investors and wealth managers. It leads to transparency with no involvement of hidden cost like load structure. Under this scenario, advisory is the only way forward.

Mr. Krishnan Sitaraman, Head, FundService, Crisil (2009), said, as a concept the move is very good as it links loads (fee) to the extent of service rendered by the distributors, but the key issue is implementation. With poor financial awareness among investors, operational difficulties would always be there with this norm. Mutual fund investors, at present pay an entry load (or commission) of 2.5 per cent to the distributors. Besides that, asset management companies pay a commission of anything between 50 basis points and 3.5 per cent to their distributors.

Objectives of the study

To analyse the removal of entry load on mutual fund schemes and its short-term impact on Net New Money of all fund houses.

Data and Methodology

Currently Indian mutual fund industry consisting of 38 Asset Management companies offering multiple schemes that would cater to the needs of various category of investors. Among 38 AMCs' only NNMs' of 34 fund houses have been taken into consideration for analysis and apparently 4 AMCs' namely,

1. Axis mutual fund
2. Goldman Sachs mutual fund
3. Religare AEGON mutual fund
4. Shinsei mutual fund

have been discarded from analysis on account of their recent entry into the market. The NNM various fund houses have been obtained from Association of Mutual funds in India (AMFI) for 14 months period that would exactly split the NNM for 7 months period.

Period I – Before removal – January'09 to July'09

Period II – After removal – August'09 to February'10

Hypothesis

Ho: The norm of removing entry load does not significantly affect the NNM of the mutual funds.

ì = Average Net New Money, ó² = Variance of Net New Money

$$\text{ì}_{After} = \text{ì}_{Before}$$

$$\text{ó}^2_{After} = \text{ó}^2_{Before}$$

H_1: The norm of removing entry load significantly affects the NNM of the mutual funds.

$$\text{ì}_{After} \neq \text{ì}_{Before}$$

$$\text{ó}^2_{After} \neq \text{ó}^2_{Before}$$

One-Way ANOVA:

The One-Way ANOVA procedure produces a one-way analysis of variance for a quantitative dependent variable by a single factor (independent) variable. Analysis of variance is used to test the hypothesis that several means are equal. This technique is an extension of the two-sample't' test.

Levene's Statistic

Levene's test is an inferential statistic used to assess the equality of in different samples. Some common statistical procedures assume that variances of the populations from which different samples are drawn are equal. Levene's test assesses this assumption. It tests the null hypothesis that the population variances are equal. If the resulting p-value of Levene's test is less than some critical value (typically 0.05), the obtained differences in sample variances are unlikely to have occurred based on random sampling. Thus, the null hypothesis of equal variances is rejected and it is concluded that there is a difference between the variances in the population.

Analysis and Findings

Analysis: 1 - Descriptive statistics

Table No.: 1

S.No.	Parameter	Value
1	Average Net New Money	Rs. 17670.07 Crores
2	Standard deviation of NNM (Before)	Rs. 88702.64 Crores
3	Standard deviation of NNM (After)	Rs. 105588.66 Crores
4	Serial (Auto) Correlation coefficient	- 0.48 (First Lag)
5	R-Squared	0.23

It is evident from the table that the standard deviation of NNM is too high and thus indicates that the removal of entry load on mutual fund schemes had much impact on the Net new money of the mutual fund schemes. Though there was increment in the value, this could be possibly because of enhanced investment form the investors end.

The auto correlation coefficient signifies that there is a low degree of negative correlation between current NNM and the lagged NNM to the extent of -48% from January'09 till February'10 and apparently to the extent of 23% variation in the current NNM be explained by the previous months' NNM. In order to have perfectly fit model, the R-squared value should have to be more than 90%, but according to current model this would not be perfectly fit since the coefficient determination value is only 23%. Thus, the extent of 77% variation in the NNM would be because of the removal of entry load on all mutual fund schemes.

Analysis: 2 – Levene statistic (Test of homogeneity of Variances of NNM before and after removal of entry load)

Group – I = NNM of all mutual funds for Period – I (7 Months)

Group – II = NNM of all mutual funds for Period – II (7 Months)

This exact bifurcation has been ascertained to have equality in number of observations in order to test the hypothesis. The maximum probability that the researcher would like have risk is 5% (á = 0.05). This would be the probability of rejecting null hypothesis when it is true.

Compiled data from the analysis

Levene Statistic	df1	df2	Sig.
0.266	1	12	0.615

*Significant at 5% LOF.

From the analysis, it is prudent that the significant value is greater than the probability; hence the researcher accepts the null hypothesis at 5% level of significance and concludes that the norm of removing the entry load is insignificant and variance of NNM before and after removal of entry load is equal.

Analysis: 3 – ANOVA (Test of equality of Average NNM before and after removal of entry load)

Source of Variance	Sum of Squares	DF	Mean Square	F	Sig.
Between Groups	3003338057.79	1	3003338057.79	0.271	0.612
Within Groups	133119870559.14	12	11093322546.60		
Total	136123208616.93	13			

*Significant @ 0.05

From the analysis, it is evident that the significant value is greater than the probability at which the researcher would like to assume risk and apparently we can not reject the null hypothesis at 5% level of significance. It signifies that despite the change in policy the average Net New Money (before) and Net New Money (after) remains same.

Conclusion and Implications

The removal of entry load on all mutual fund schemes would be attractive from the investors view point but still the portfolio management charges certainly exist. Probably, one would say, a portion of cost to investors has been off loaded. The market watchdog SEBI emphasized that even the marketing and distribution charges incurred by AMCs' can not be recovered from the investors thus leading to reduction in the overall profitability of the fund and directly affecting the NAV of the respective fund. The analysis enumerates that the initiation has been brought in by SEBI significantly did not affect the NNM of mutual funds to a great extent. The variation in NNM could have happened on account of the following reasons.

1. Investors would have thought of to exploit the opportunity given by SEBI.

2. AMCs' would have thought of to introduce more schemes in order to enhance their asset base to cater various needs of investors. (Nine fresh NFO came with in less than 30 days from 18th June'09 to 15th July'09 and more)

But one should understand that the incentives are getting transferred from one pocket to another pocket. We should be aware that all the expenses whether it is charged in the beginning or later, obviously get adjusted while determining the Net Asset Value (NAV). Thus, this would be Two-person Zero-Sum game.

This initiative perhaps badly hits the Service Tax Collections and poses serious threat to the tax authorities because earlier the mutual fund directly deducts the tax at source on the commission payable to the distributors and paid the service tax directly to Government and now on account of removal entry load the commission would not be paid by the mutual fund and apparently commission comes from the investors, hence service tax should have to be paid by the distributor directly to the Government, leads to complications in determining the amount of service tax even perhaps lead to tax evasion. In the previous year Rs. 150 crore has been collected from the mutual funds in the form of service tax but this year it may hit the service tax collections.

The incentive earned by the distributors from the mutual fund is collected in the form of entry load by the mutual fund from the investors. Since, the entry load has been discarded, most of the distributors may perhaps not be interested in floating the MF schemes aggressively as they were earlier, leading to marketability risk.

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