

Exchange Traded Funds in India

Whither Future?

The Analyst

Even after 10 years of existence in the Indian market, ETFs have not been able to make any inroads in the investor portfolio. Performance-wise certain ETFs like gold have given more and consistent returns than the broad market in the last 2-3 volatile years. But if we compare equity ETFs performance with diversified equity mutual funds in longer horizons, ETFs appear to be far behind. Can ETFs be still relevant? *The Analyst* invited eminent experts including Hemant Beniwal, A K Prabhakar, and Harsimrat Sharma to share their perceptions on this issue.

Do you think ETFs have failed to elicit much investor response in India, given their lackluster performances?

It is true that ETFs have failed in India. The introductory stride has been lost. Even after 10 years of existence in the Indian market, they have not been able to make any space in investor's portfolio. If we talk about Indian Mutual Fund industry, ETF share is less than 1% and if we remove Gold ETFs which were or are in fancy these days, the picture is even worse. The reason should not be performance, because most of the ETFs are passive funds in India and try to mimic the performance of some index. Performance-wise certain ETFs like gold have given more and

ETF is lower expenses, but even on this aspect Indian funds score low. Internationally, ETFs average charges are close to 0.53% but in India most of the equity-related ETFs are charging more than this—some even charging 1%. Vanguard, which is one of the biggest ETF players, charges just 0.16% and in some cases as low as 0.07%. This is possible due to economies of scale but still difference is huge. Over and above the basic fees, investor has to pay brokerage and other charges relating to manage his equity account.

Why do you think an investor should opt for an ETF instead of a regular equity-oriented fund?

Right now, we are not suggesting an investor to go through ETF route due to above-mentioned reasons. As ETFs are not very popular in India, they are very illiquid too. Few of the ETFs have not even traded a single unit in 30-40% of the transaction days in year 2010. So investors have a good chance to get stuck or be taken for a ride. In 2006, ICICI Pru Spice Fund, which actually tracks Sensex, was up by 200% in a fortnight. Due to unawareness and poor volumes, someone spiraled the prices just by a wrong trade.

What needs to be done to make these instruments popular with investors again?

ETFs are traded through stock ex-

changes and are suggested by brokers—not by mutual fund advisors. ETFs are meant for passive long-term investors and that's not a good thing for a stock broker. Stock brokers earn on volumes rather than if somebody holds it for long-term, so there is clear conflict of interest. So I don't think much can be done on this but if investors are made aware about the benefits, there is a chance that things can be better in future. One more thing that can be done is bringing the variety right now. Most of the ETFs are either gold or large cap equity funds. Only two ETFs are there which give you international exposure—so there is still scope to bring variety which can increase the interest. Even on commodity side, there is a big scope but there is no clarity who will govern them—due to conflict between Securities and Exchange Board of India (SEBI) and Forward Market Commission (FMC) even Silver ETFs are stuck.

How do you see the comparative performances of Indian ETFs vis-à-vis global ETFs, particularly those in the US?

In the US, ETFs have been there since the last 20 years—as a segment it is growing at a pace of 32% every year and the major reasons are the lower cost, fund managers inability to beat broader index and the variety of ETFs available. Indian ETFs fail on all these criteria. Biggest ETF in the US is \$89

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consistent returns than the broad market in the last 2-3 volatile years. But if we compare equity ETFs performance with diversified equity mutual funds in longer horizons, ETFs appear to be far behind.

Have these ETFs suffered due to high operational/tracking costs?

Biggest benefit an investor seeks in

bn, which is more than half of the Indian Mutual Fund Industry size. And total ETF assets in the US stands at \$1 tn which is close to 2/3 of total Indian Market Capitalization. In the US, there are more than 2,000 ETFs listed and in India, the number is just 29—another 13 are with Sebi for clearance. So one can clearly see the difference, but this is the same case if we talk about Indian Mutual Funds—in the US 39% of the households invest more than 50% of their financial assets through Mutual Funds but in India, less than 1% have ever invested a penny in it. This can be blamed to poor Financial Literacy in India, lack of distribution facilities, higher operational cost and quality manpower.

Any other view?

India is a fast growing economy and with the kind of demography we have, there is a big scope for newer and better financial products. Goldman Sachs who is a specialized player in ETF, has signaled regarding the growth of ETF by buying India's Benchmark AMC which was a niche ETF player. That even IDBI AMCs is focusing on Index Funds and Motilal Oswal AMC is trying something new with ETFs, shows it's a beginning towards passive investing. Hope for a better picture of ETF in future.