International Conference on Emerging Economies - Prospects and Challenges (ICEE-2012)

The BRIC mutual fund industry

Padmini Sundaram*

Research Scholar, Symbiosis International University, Symbiosis Knowledge Village, Lavale, Tahasil Mulshi, Pune -411042, India

Abstract

This paper discusses the progression of the Mutual Fund Industry - in the four main Emerging Economies namely: Brazil, Russia, India & China post 1990. It discusses the diversity of these BRIC markets, a comparison of their current market capitalisation, the various asset classes prevalent, distribution channels, and classification of mutual funds with fees along with the reforms that are implemented and needed going ahead for a faster progression.

© 2012 Published by Elsevier Ltd. Selection and/or peer-review under responsibility of Symbiosis Institute of International Business (SIIB)

Keywords: BRIC countries; Mutual Fund Reforms; Regulatory Framework; Asset Allocation; Investment Management Companies

1. Introduction

As defined by International Monetary Fund (IMF), Emerging Markets (EM) refers to the capital markets of developing countries that have liberalized their financial systems to promote capital flows with non-residents and are broadly accessible to foreign investors.

Why this Paper?: BRIC – referring to Brazil, Russia, India, China was the acronym coined in the famous Goldman Sachs paper written by Jim O Neil in 2001. This paper is an attempt to capture in one frame, the uniqueness of each of the four’s country’s Mutual Fund Industry progression, development and identifying country specific reform needs. This research draws extensively on data available from World Bank, IMF, EBRD-World Bank Business Environment and Enterprise Performance Survey, ICI Factbook from 1999 to 2010 and also uses country specific data from registered sources wherever applicable. This study though restricting itself to the four main emerging markets, compares the four countries Mutual Fund Markets on their current Assets Under Management (AUM), No of Mutual Funds, contribution to the World Mutual Fund Industry Asset Class wise, key initiatives undertaken by the Governments of each

* Corresponding author. Tel.: +91-20-32943545;
E-mail address: padmisun@yahoo.co.in.
country to expand the Mutual Fund Markets for Growth & Business Environment Constraints of these markets.

Neil (2010) that based on GDP forecast for the next 10 years, these four would be the new emerging market drivers and leaders with their GDP growth surpassing the G7 individual GDP growth. It clearly viewed that by 2011, China would actually be as big as Germany. Taking a look at these forecasts in today’s times the Growth figures stand as mentioned in Table 1 and the forecast stands validated.

As per IMF, BRIC share in Global GDP grew from 13.2% (2007) to 17.4% (2010); in Global Trade from 12% (2007) to 15.2% (2010); and Global Foreign Exchange from 36.7% (2007) to 42.2% (2010).

Table 1. BRIC GDP Growth

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP Growth % (2010) - Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>5.08</td>
</tr>
<tr>
<td>Russia</td>
<td>5.60</td>
</tr>
<tr>
<td>India</td>
<td>6.07</td>
</tr>
<tr>
<td>China</td>
<td>9.00</td>
</tr>
</tbody>
</table>

World Bank Figure

Table 2. BRIC & US Economies: Real GDP, CP, Current Acc Balance, Unemployment

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BRAZIL</td>
<td>7.5</td>
<td>4.5</td>
<td>4.1</td>
<td>5.0</td>
<td>6.3</td>
<td>4.8</td>
<td>-2.3</td>
<td>-2.6</td>
</tr>
<tr>
<td>RUSSIA</td>
<td>4.6</td>
<td>5.0</td>
<td>4.7</td>
<td>7.2</td>
<td>9.6</td>
<td>8.1</td>
<td>3.8</td>
<td>4.7</td>
</tr>
<tr>
<td>INDIA</td>
<td>10.4</td>
<td>8.2</td>
<td>7.8</td>
<td>13.2</td>
<td>7.5</td>
<td>6.9</td>
<td>-3.2</td>
<td>-3.7</td>
</tr>
<tr>
<td>CHINA</td>
<td>10.3</td>
<td>9.6</td>
<td>9.5</td>
<td>3.3</td>
<td>5.0</td>
<td>2.5</td>
<td>5.2</td>
<td>5.7</td>
</tr>
<tr>
<td>US</td>
<td>2.8</td>
<td>2.8</td>
<td>2.9</td>
<td>1.6</td>
<td>2.2</td>
<td>1.6</td>
<td>-3.2</td>
<td>-3.2</td>
</tr>
</tbody>
</table>

Table 2 captures the current state of the BRIC & US Economies with relation to Real GDP, Consumer Price Index (CPI), Current Account Balance & Unemployment. China & India have GDP actual and projected above 7.5%, higher than Russia and China. High Inflation is a cause of worry for all the four and huge current account deficits in the books of India and Brazil need immediate intervention.

2. World Mutual Fund Industry & BRIC

World Mutual Fund Industry has witnessed exponential growth in the last decade in spite of witnessing one of the world’s worst financial crisis. Currently Worldwide assets in Mutual Funds are at 246 Trillion US D. In Table 3 we compare the BRIC Mutual Fund Industry growth with the Worldwide Mutual Fund Growth. It captures the Mutual Fund Total Net Assets from 1999 for the World Economy, BRIC & US.

Table 3 shows that world mutual fund assets have grown by 14% annually since 1999, for the BRIC it has grown at 24%. This can be explained by the above average growth rate of Brazil, inclusion of China and the accelerated growth of India and Russia.
Table 3 Mutual Fund WorldWide Assets in USD Million.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>11,762,345</td>
<td>11,324,128</td>
<td>17,771,027</td>
<td>26,130,686</td>
</tr>
<tr>
<td>BRAZIL</td>
<td>117,758</td>
<td>96,729</td>
<td>302,927</td>
<td>615,365</td>
</tr>
<tr>
<td>RUSSIA</td>
<td>177</td>
<td>372</td>
<td>2,417</td>
<td>7,175</td>
</tr>
<tr>
<td>INDIA</td>
<td>13,065</td>
<td>20,364</td>
<td>40,546</td>
<td>108,582</td>
</tr>
<tr>
<td>CHINA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>434,063</td>
</tr>
<tr>
<td>USA</td>
<td>6,846,339</td>
<td>6,390,358</td>
<td>8,904,824</td>
<td>12,000,645</td>
</tr>
</tbody>
</table>

Source: ICI FactBook

In absolute terms the US continues to be the largest contributor at a median contribution of 52%.

Amongst the BRIC, it is Brazil and China with an above 1.5% contribution to World Mutual Fund Assets, the remaining two are a mere .0095% for Russia and .22% for India.

Table 4: Total Net Assets in MUSD by Type of Funds 2011 Q1

<table>
<thead>
<tr>
<th>Country</th>
<th>Total</th>
<th>Equity</th>
<th>Bond</th>
<th>Money Market</th>
<th>Bal/Mix</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>25,614,168</td>
<td>11,081,374</td>
<td>5,606,670</td>
<td>4,969,758</td>
<td>2,877,623</td>
<td>1,078,743</td>
</tr>
<tr>
<td>BRAZIL</td>
<td>1,055,418</td>
<td>121,848</td>
<td>556,941</td>
<td>43,957</td>
<td>248,994</td>
<td>83,678</td>
</tr>
<tr>
<td>RUSSIA</td>
<td>4,448</td>
<td>2914</td>
<td>571</td>
<td>24</td>
<td>939</td>
<td></td>
</tr>
<tr>
<td>INDIA</td>
<td>98,187</td>
<td>37596</td>
<td>34366</td>
<td>16523</td>
<td>3894</td>
<td>5808</td>
</tr>
<tr>
<td>CHINA</td>
<td>353,064</td>
<td>208692</td>
<td>23,576</td>
<td>20,789</td>
<td>100,007</td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>12,179,692</td>
<td>6003297</td>
<td>2,658,457</td>
<td>2,727,334</td>
<td>790,604</td>
<td></td>
</tr>
</tbody>
</table>

Source: ICI2011 Factbook

As per Table 4 Overall, the World Mutual Fund AUM comprises of 43% in Equity, 22% in Bonds, 19% in Money Markets and 11% in Mixed / Balanced for Q1 2011. Amongst the BRIC, Russia has Equity 65%, Debt 12.84%, India Equity 38% Debt 33%, China Equity 59% and Debt 6.68%. Brazil clearly ducked the trend in the quarter and is at Debt 52.77% and Equity a mere 11.54%.


3.1 Brazil Mutual Fund Industry

Varga G, Wengert M (2010) in their paper have undertaken a detailed analysis of the Brazil Mutual Fund industry and this paper bases its discussion on it.

Table 5 below shows the evolution of the Brazil Mutual Fund AUM versus savings and commercial banks total assets. Both Banks and Mutual Funds have increased their market share.

Table 5: Total Assets of Main intermediaries in Brazil. USD Billion.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Banks</td>
<td>369</td>
<td>286</td>
<td>239</td>
<td>924</td>
<td>1640</td>
</tr>
<tr>
<td>Savings</td>
<td>69</td>
<td>62</td>
<td>40</td>
<td>72</td>
<td>116</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>110</td>
<td>123</td>
<td>100</td>
<td>305</td>
<td>442</td>
</tr>
</tbody>
</table>

3.1.1 Brief History & Organisation Structure

Brazilian Central Bank (BCB) takes care of the monetary control and banking supervision. CVM is equivalent to Securities & Exchange Commission (SEC). The first mutual fund was created in 1957 and until 1970 only 11 funds existed. Special Fund *Fundo 157* created in 1967, which aimed to stimulate investment with a 10% reduction in income tax owed by individual and private companies. In 1984 BCB created two categories of mutual funds: Equity & Debt funds. From 1984 onwards, variations in the mutual fund constitutions leading to newer products including a charge on returns for premature exits was introduced. After 1994, new derivative instruments were launched increasing the depth of to 1968. The Sao Paulo Stock Exchange Index (IBOVESPA) is the oldest and the main stock market index in Brazil. Indices used to track the Brazilian Fixed Income Market are CDI, Quantum Prefixado, Quantum Cambial, IRFM, IMA.

![Fig. 1: The Brazilian Mutual Fund Industry Organisation Structure. Varga et all (2010)](image)

3.1.2 Details of the Classification of Brazilian Mutual Funds based on official CVM classification

a. Fixed Income Funds: have at least 80% portfolio in Fixed income bonds
b. Multimercado Funds: Pursue diversification in several asset classes
c. Referenciado: Minimum 95% of the assets in the portfolio linked to the reference index announced by the fund.
d. Equities: at least 65% invested in Equities.
e. Fixed Term: Short Term Funds are fixed income funds where all their bonds have a maturity of less than 375 days and are held less than 60 days.

3.1.3 Details of the Classification of Management Companies in Brazil:

- Commercial Banks (CB)
- Investment Banks (IB)
- Independent Manager (IM)
- Pension Funds (PF)
- Insurance Company (I)
- Broker (B)

The AUMs are primarily managed both for Regular Funds (FI) and Fund of Funds (FIC) by Commercial Banks followed by IB in case of Regular Funds and IM in case of FIC.
3.1.4 Who can invest in these Funds

- Exclusive: Single Investor or from restricted portion of the public, Aimed at reducing costs
- Qualified Investor: High Fees and sophisticated strategies.
- Institutional Investor: Conservative and very constrained investment policy, cost is low.
- General Investors

3.1.5 Market Share of Each type of Mutual Fund Manager:

In 2008, 77% of the AUM was managed by CB, followed by IB & IM at 9% , PF at 3% and I & B at 1% each. In this market there are only 3 types of Managers – CB, IB and IM.

3.1.6 Fees

Table 6 gives the fees charged by various categories of mutual funds. If compared with the US, the debt funds are the most expensive type of funds whereas across the world these are mostly the cheapest.

Table 6. Administrative fees charged by type of Fund per annum (2008) in Brazil

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>No of Funds</th>
<th>Arithmetic mean of fees</th>
<th>Std Deviation</th>
<th>Fees are weighed by AUM % of Funds that charge Performance Fees.</th>
</tr>
</thead>
<tbody>
<tr>
<td>FI</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>406</td>
<td>2.37</td>
<td>1.34</td>
<td>0.83</td>
</tr>
<tr>
<td>FI Short Term</td>
<td>19</td>
<td>2.1</td>
<td>1.34</td>
<td>0.79</td>
</tr>
<tr>
<td>Multimercado</td>
<td>455</td>
<td>1.51</td>
<td>0.69</td>
<td>1.25</td>
</tr>
<tr>
<td>Referenciado Fixed Income</td>
<td>80</td>
<td>0.5</td>
<td>0.34</td>
<td>0.26</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>151</td>
<td>0.8</td>
<td>0.83</td>
<td>0.55</td>
</tr>
<tr>
<td>FIC</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>185</td>
<td>2.13</td>
<td>1.24</td>
<td>2.27</td>
</tr>
<tr>
<td>FI Short Term</td>
<td>55</td>
<td>2.77</td>
<td>2.02</td>
<td>2.94</td>
</tr>
<tr>
<td>Multimercado</td>
<td>468</td>
<td>1.03</td>
<td>0.78</td>
<td>1.02</td>
</tr>
<tr>
<td>Referenciado Fixed Income</td>
<td>223</td>
<td>1.34</td>
<td>1.23</td>
<td>1.34</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>196</td>
<td>1.38</td>
<td>1.08</td>
<td>1.07</td>
</tr>
</tbody>
</table>

Source Quantum

3.1.7 Mutual Fund Statistics Brazil

Table 7. Brazil Mutual Fund Date

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>4169</td>
<td>4744</td>
<td>5618</td>
</tr>
<tr>
<td>No of Funds</td>
<td>479,321</td>
<td>783,970</td>
<td>980,448</td>
</tr>
<tr>
<td>AUM in MUSD</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
3.1.5.1 Investors into Brazil MF:

Fund distributions can be direct or indirect. In Indirect sales, selling happens to third parties. Individuals are direct investors and indirect investors through Pension Funds, Retirement Funds, Wealth Managers, Family Offices.

3.2. Russian Mutual Fund Industry:

Vladimir (2008) traces the history and the characteristics of the Russian Capital Markets as hereunder.

3.2.1. History of Russian Mutual Fund Industry

1990 Birth of Russian stock market: the USSR government issues two decrees:
   - “Regarding Share Holding Companies”
   - “Regarding Valuable Papers” First shares issued and actually sold: shares of Russian commodity exchanges, accounting for 80 per cent of all shares until November 1991.

1992 Stock Exchange
   Creation of The Moscow Interbank Currency Exchange, the Moscow Central Currency Exchange, the Russian Commodity Exchange, St. Petersburg Stock Exchange and the South-Ural Stock Exchange

1993 In this year
   1. Beginning of the sale of shares of privatizing companies
   2. Beginning of the state bond market- GKO

1996 Establishment of the stock, currency, derivative, and interbank credit markets.
   - The biggest of these was the currency market.
   - Daily interbank credits reached the value of 300 billion rubles.
   - Due to the high risk of this market, securitization takes off

1998 Destabilization of the Russian stock market, following the Asian crisis. August 17- following payment crisis, Russian government declares Ruble default and amoratorium on private and state obligations to foreign creditors.

Figure 2 and 3 Russian Stock Market in 1994 & 2007 by Kvint Vladimir (2008)
2008 Trends
  - Total capitalization of the Russian market: $1.463 trillion.
  - Since 2003, market capitalization increased by a factor of ten.
  - Contrary to popular opinion, the market capitalization of the oil and gas sector is a little lower (by $6 billion) than capitalization of all other publicly traded companies.
  - The 100 biggest publicly traded companies of Russia account for 92.12% of the total market capitalization.

3.2.2 Features of Russian Stock Market

- Extremely high rate of growth:
  - 2005: 150%
  - 2006: 200%
  - 2007: 10% (six months)
- High concentration of capitalization in terms of emitters and industries
  - Gazprom: 25.5% of the market.
  - The ten major companies, (Norilsk Nickel, Lukoil, MTS Telecom, and Sberbank, among others): more than 70%
  - Three industries- Energy, Financial and Metallurgy: 90%
  - Increasing role of the financial sector (3.5 times, 2007)
- Declining role of depository receipts of Russian companies on foreign stock exchanges (since 2004)

Major contribution to the rapid expansion was the high returns on Russian stocks — on average, over 40% a year after 1998.

3.2.3: Russian Mutual Fund Industry Statistics & Growth Impediments

Table 7 Russian MF Industry

<table>
<thead>
<tr>
<th>Russia Mutual Fund Industry</th>
<th>2001</th>
<th>2006</th>
<th>% Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Companies</td>
<td>35</td>
<td>282</td>
<td>706%</td>
</tr>
<tr>
<td>No of Funds</td>
<td>55</td>
<td>587</td>
<td>967%</td>
</tr>
<tr>
<td>AUM</td>
<td>30MUSD</td>
<td>16BUSD</td>
<td></td>
</tr>
<tr>
<td>% of GDP</td>
<td>0.50%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Goriaev (2007)

Goriaev (2007) states that in 2001 there were only 35 management companies offering 55 funds, at the end of 2006 investors had an option to choose from among 587 funds and 282 management companies. During the same period, the Assets under Management increased from US$30 million to US$16 billion, or 0.5% of Russian GDP (for comparison, in the US this ratio is about 70%).

Amongst the Major impediments to growth, the paper lists Poor Financial Education which in turn leads to Low Market Penetration, Underdeveloped Russian Stock Market leading to creation of non diversified mutual fund portfolio.

- In Soviet Times since Financial education was irrelevant since the major risk was with the State Government, there had been no impetus to get this rolled out and the market penetration stood as low as 2% of the Russian Population.
o The number of stocks traded on the exchange are very limited with Liquid Stock Concentration in Extraction/Mining Sector. Hence, Mutual Funds are unable to give a truly diversified portfolio and their returns are determined by Russia’s country risk and other Non Quantifiable factors.

3.3. Country Review Mutual Fund Industry in India:

It was in 1960 that the Mutual Fund Industry in India began with the setting up of a Government owned fund Unit Trust of India. Along with rest of the sectors and as a part of the overall reforms process, the Mutual Fund industry was also liberalized in 1993, opening up to other Asset Management Companies (AMC). This resulted in a slew of changes for the investor. Today the Indian Mutual Fund Industry stands at INR 7.1 trillion of Assets under Management raised from 470 million accounts.

Table 8 Total % of Assets of Main Financial intermediaries in Indian Households.

<table>
<thead>
<tr>
<th></th>
<th>2008/9</th>
<th>2009/10</th>
<th>2009/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial Banks</td>
<td>52%</td>
<td>41.7%</td>
<td>42%</td>
</tr>
<tr>
<td>PF</td>
<td>10.1%</td>
<td>11.5%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Mutual Funds</td>
<td>-1.4%</td>
<td>3.3%</td>
<td>-1.8%</td>
</tr>
<tr>
<td>LIC</td>
<td>21%</td>
<td>22%</td>
<td>24.2%</td>
</tr>
</tbody>
</table>

Source: From RBI

Mutual Funds account for very miniscule component of Indian Individual Investor’s wallet and can be gauged from the total asset figures for MF’s in Table 8.

3.3.1. Structure of the Industry

The industry comprises of the Asset Management Companies (AMC) or manufacturers of the Mutual Fund, Distributors comprising of Banks, Independent Financial Advisors (IFA), National Distributors, Direct customers, Investors – Retail and Corporate and the governing body is Securities and Exchange Board of India (Sebi). Currently there are over 41 Asset Management companies with 1216 Mutual Fund schemes.

3.3.2. Classification of Indian Mutual Funds based on official classification

Equity Funds & Debt Funds. Debt:
- Liquid Funds: Invest in short term debt instruments with a 91D maturity.
- Ultra Short Term Bond Fund: Invest in high credit quality instruments that mature in short period.
- Floating rate Funds: Invest into debt instruments with variable coupon rate that are linked to predetermined indices.
- Short Term Income Funds: Invest into fixed income security having shorter maturity periods.
- Dynamic Bond Funds: Invest into debt instruments like corporate bonds, government securities, money market instruments, securitized debt etc.
- Income/Bond Fund: Invest into corporate bonds, government securities, money market instrument and securitized debt of varying maturities.
- Short Term gilt fund: Invest into short-term government securities and into money market instruments.
• Gilt Fund: Invest into government securities across various maturities and into money market instruments.
• Fixed Maturity Plan: These are closed-ended funds by AMCs with a defined tenure. The underlying investments are into debt securities whose maturity mature on or before the date of maturity of the Scheme.
• *Equity*: Diversified Equity Fund: Invest into well-diversified portfolio of equity stock.
• Large Cap Funds: Invest mostly into companies having a large market capitalization. Large cap companies tend to be financially stable and are widely traded.
• Mid/Small cap Funds: Invest into medium and small sized companies that are smaller than large cap companies in their market capitalization.
• Flexible cap/Multi-Cap funds: Invest into stock across market capitalization i.e. large, mid and small caps.

Hybrid Funds: These are predominantly debt fund, historically seen to be investing between 70% - 95% into debt assets with the balance being invested into equity.
• Balanced Fund: These funds attempt to provide a balanced exposure across debt and equity investments.

3.3.3 Who distributes these Mutual Funds
• Following is the breakup in % of AUM distributor wise as per CAMS which manages over 50% of the industry AUM as per Shah et all (2010):
  • Independent Financial Advisors (IFA): 28%
  • Banks: 29% (PSU 4%)
  • Large Distributors: 36%
  • Direct: 6%

3.3.5 Mutual Fund Fees in India

The expenses included in a Mutual Fund Product are Indirect Costs & Direct Costs.
• Indirect Costs are the costs involved in the computation of NAV (Net asset Value). They include Initial Issue expenses and Annual Recurring Expenses.
• Direct Costs include Entry Load, Exit Load, STT and Income Tax.

Table 10 Summary of Charges in Open & Close Ended Schemes [Source: Thomas S (2010)]

<table>
<thead>
<tr>
<th>Summary of changes in costs across Open &amp; Close ended MF</th>
<th>Maximum charges allowed across open ended &amp; close ended Equity mutual funds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Upto April 2006</td>
</tr>
<tr>
<td></td>
<td>Open</td>
</tr>
<tr>
<td>Initial Issue Expense</td>
<td>6</td>
</tr>
<tr>
<td>Entry Load</td>
<td>6</td>
</tr>
<tr>
<td>Exit Load</td>
<td>6</td>
</tr>
<tr>
<td>Expense Ratio *</td>
<td>2.5</td>
</tr>
</tbody>
</table>

There have been changes in the Fee structures of the Funds and currently as per August 2009 Sebi regulation, has done away with the entry load which used to be passed on to the distributor for sale of the fund. This has led to introduction of a structure where the distributor has now either charge the investor for the advise given or survive with the trail commissions. Post July 2011 there have been new drafts tabled on the model to follow- Advisory or Agent. The Indian Mutual Fund industry is in the midst of evolvement in terms of a regulatory framework and has witnessed drop in AUM’s especially in 2009. Till such time as the industry structure mainly, fee structure evolves growth of AUM may not accelerate.

3.4. Country Review of Mutual Fund Industry in China

3.4.1. Background and Reforms for the Mutual Fund Industry in China

Chen et all (2006) analyses the Chinese Stock Market and the impact of Open Reforms. In his paper he discusses the development of the Chinese Stock Markets and its journey. In this paper we have also China, namely has two main stock exchanges, the Shanghai Stock Exchange (SHSE) and the Shenzhen Stock Exchange (SZSE), which were established in December 1990 and July 1991, respectively. The combined capitalization of the two markets reached US$500 billion, which accounted for about 50% of China’s GDP in 2002. The total number of investors in the two exchanges is now estimated to exceed 50 million people.

To further open up its equity markets to international investors, China also introduced the Qualified Foreign Institutional Investor (QFII) system in November 2002. Effective from December 1, 2002, the program allows approved foreign institutional investors to access China’s domestic capital markets including China’s Class A share markets.

3.4.2 Growth of Mutual Fund Industry

In 1998, five contractual closed-end funds were launched. In 2001, the first contractual open-end fund was launched. Since then, the number of funds has grown and the funds have expanded their offered product mix such as equity funds, bond funds, index funds, capital guaranteed funds, money market funds, LOFs and ETFs etc. The management experience and investment operational skills of the fund management companies have been greatly enhanced. So have their internal control and risk management. It is regulated by China Securities Regulatory Commission (CSRC). As per recent updates the Chinese Asset Management Industry is 2373.65 CNY.
3.4.3 Fund Management Companies & their history

Statistics show that the net assets of the mutual funds accounted for 28% of the aggregated tradable market capitalization on the Shenzhen and Shanghai Stock Exchanges. The first joint venture fund management company was founded in the end of 2002. As of the end of 2004, 14 joint venture fund management companies had been established, which accounted for 28% of all fund management companies. As of Oct 2011 there were 68 Joint Venture companies.

3.4.4 Types of Mutual Funds in China

- Equity
- Hybrid
- Bond Fund
- Money Market Fund
- Guaranteed
- Closed
- QDII

In 2004 there were 53 Funds, mainly being Hybrid 35 and Equity 10. As of 2011 there are 214 Funds, with number of equity funds being highest at 93 followed by Bond Funds 29 nos. In market capitalization this translates into 90 Bn Yuan and 58 Bn Yuan respectively for that class.

3.4.4 Distribution Channels in China

There are over 154 distribution channels in China and enclosed hereunder is the approximate market share:

<table>
<thead>
<tr>
<th>Channels</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBC</td>
<td>29.7%</td>
</tr>
<tr>
<td>CCB</td>
<td>25.1%</td>
</tr>
<tr>
<td>BOC</td>
<td>16.8%</td>
</tr>
<tr>
<td>ABC</td>
<td>11.9%</td>
</tr>
<tr>
<td>BANK OF COMM</td>
<td>8.2%</td>
</tr>
<tr>
<td>CMB</td>
<td>2.2%</td>
</tr>
</tbody>
</table>

Source: Chinese MF Market estimates

3.4.5 Fees Structure:

Ramos et al (2009) summarizes the fee structure of 27 World Developed and emerging Economies and lists for China, charges for Equity 1.19% against an industry average of 1.382%, for Bonds 0.58% against an industry average of 0.806%, Mixed Assets 1.48% against an industry average of 1.208% and for Money markets 0.33 industry average 0.581%.
3.4.7 Reforms for Growth

As per the CSRC four main areas for the Securities Industry to pursue reforms in 2011 for the progression of the Markets:
1. Reform of Law on Funds for investment in Securities
2. Establishing governance of Fund management (Asset Management Firms)
3. Reforming the sales channel.

Progress in establishing a legal framework for capital markets remains the most important agenda and a key driver for the future.

4. Analysis of the Environment Constraints

An analysis of the top 3 constraints helps determine the issues that each of the BRIC economies is grappling with, which in turn would affect its overall development and Efficient Market Development. Here, India is unique in its struggle against basic infrastructure – Electricity and Corruption issue dominant of the top 3 constraint factor, for the other 3 Tax Rates, Lack of Educated Workforce are the dominant.

Brazil: 1) Tax Rate 2) Tax Administration 3) Educated Workforce
Russia: 1) Tax Rate 2) Access to Finance 3) Inadequate Educated Workforce
India: 1) Electricity (infrastructure) 2) Tax Rate 3) Corruption
China: 1) Tax Rates 2) Economic & Regulation Policy 3) Skill & Education of Workforce

![Figure 4 & 5: Top 10 Business Environment Constraints for Firms. Source: EBRD World Bank Survey. Source: EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS)](image-url)
5. Conclusion

The BRICs Mutual Fund Markets have witnessed extremely diverse mutual fund industry roadmap in the last two decades. Each country witnessed unique challenges due to the country’s historical origins, diverse political orientation, structural and legal framework. What is imperative in today’s times of monetary crisis is to continue with the reform rollout along with efforts at building stronger regulatory and legal framework including providing a level playing field for all intermediaries with an emphasis on investor education. The BRIC Mutual Fund Industry is poised to play an important role in the World Economy. With the growth engines of the world being led by China, these markets will witness large FII inflows and exponential growth in the future. Robust Regulatory framework structure and transparency of operation will be the two main cornerstones for these markets future growth trajectory and integration with World Markets.

References


Prasad Eswar S () XYZ – Financial Sector Regulations and Reforms in Emerging Market : An Overview pp 3-23


Subbarao (2009). Impact of the Global Financial Crisis on India Collateral Damage and Response. Institute for International Monetary Affairs, Tokyo


World Economic Forum (2010)

China’s Global M&A Research Centre (2009)

China’s Securities and Futures Markets Handbook. CSRC (2005)

http://www.bovespa.com.br, last accessed September 2011

Institute of World Economy & Politics

China Europe International Business School