The rising clout of mutual funds

The influence of MFs has made the market more resilient to pullouts by foreign portfolio investors

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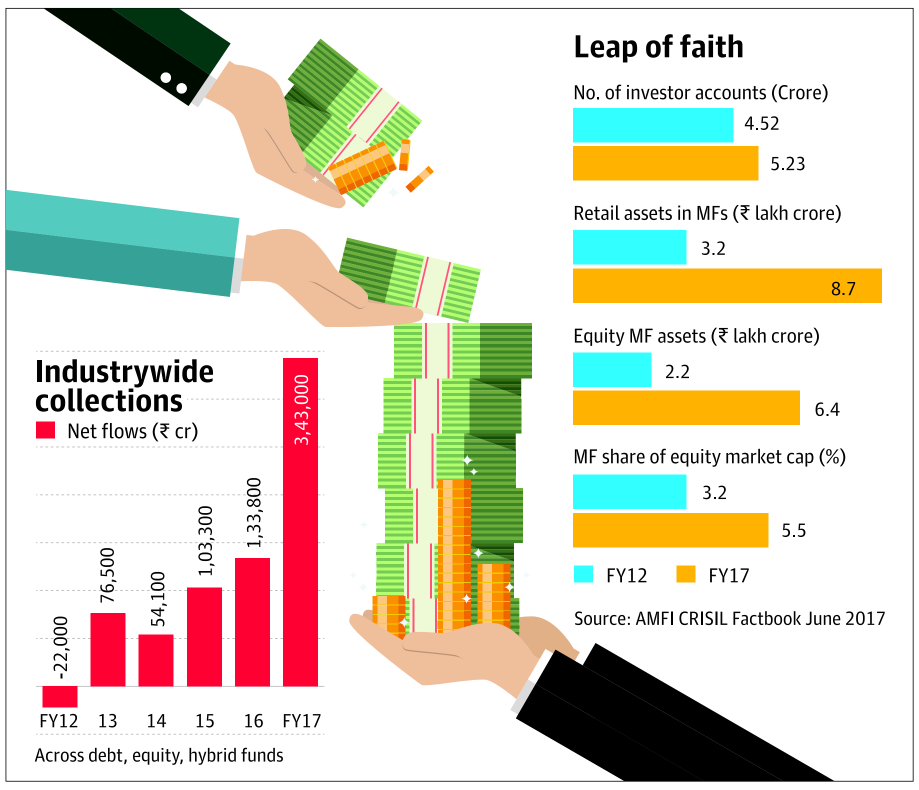
Last week, the mood was celebratory as the mutual fund industry congregated at the annual AMFI Mutual Fund Summit, in Mumbai.

And why not? The total assets managed by Indian MFs, at ₹19.5 lakh crore is at a record and has more than trebled in the last five years. Interestingly, this expansion has been driven as much by retail investors, as the conventional corporate treasuries.

As of end-March 2017, retail investors had parked a whopping ₹8.7 lakh crore with domestic mutual funds. This is up from ₹3.2 lakh crore just five years ago, a study by the industry body AMFI jointly with CRISIL shows. Indian mutual funds now feature more than 5.2 crore retail investor accounts.

Clearly, MFs are breaking free from the crisis of confidence five years ago, to emerge as a popular investing vehicle for retail investors. This has structural implications for the market itself.



More market clout

A few years ago, FPIs had the Indian stock market by the scruff of its neck. If FPIs brought in more money, the indices would promptly spiral upwards. If they left the party, they would swoon. But the rising clout of domestic institutions such as mutual funds has changed this.

MF equity assets have expanded from ₹2.2 lakh crore to ₹6.4 lakh crore between March 2012 and March 2017. More money under management has meant greater clout for domestic funds in the stock market. Data from the AMFI-CRISIL study shows that, from owning 2.9% of the outstanding shares in the market by value (full market capitalisation) just three years ago, mutual funds now own 5.5%.

This number is more significant than it may seem. As promoters control 47% of the outstanding shares in the Indian market, only 53% are freely tradeable.

Therefore, mutual funds now own more than 10% of the freely tradeable shares by value. With insurers sitting on another 8-9%, domestic institutions now carry at least half the market clout of the all-powerful FPIs (who own about 40% of the free float).

This has rendered the Indian stock market more resilient to FPI pull-outs.

To cite an instance, between October 2016 and January 2017, foreign investors withdrew a net ₹39,979 crore (roughly $5.8 billion) from Indian equities. A few years ago, this would have set off a market rout.

But on this occasion, the BSE Sensex saw a barely-felt 1% dip over the four-month period. This is because as FPIs sold, domestic institutions stepped in with almost matching net purchases of ₹39,823 crore.

In fact, MFs gaining muscle is a trend that isn't restricted to the stock markets alone. With better tax treatment of returns, debt funds have been gaining ground as an alternative to bank deposits with retail investors. Mutual funds today corner 10.4% of the outstanding debt issuances in India too.

Bull markets always trigger a retail rush into equity MFs. But the enthusiasm usually wanes the moment the music stops.

If stock prices pause in their rally or decline, fund flows are usually quick to dry up. This time too, retail interest in equity MFs did pick up well after the stock markets took off, in 2014.

But the interest hasn't waned during choppy or downbeat markets. Net inflows into equity-oriented MFs have held up at more than ₹90,000 crore for each of the last three fiscal years.

> MFs are also gaining muscle in the debt funds space

This is despite the BSE Sensex charting a very different path in these three years. It delivered a bumper return of 25% in FY15, slumped by 6% in FY16 and notched up modest gains of 16% in FY17.

It is the runaway popularity of SIPs, or systematic investment plans, that should take credit for the stability of MF flows.

Five years ago, about a fourth of total inflows into equity funds came in by way of SIPs. In FY17, SIPs brought in ₹43,921 crore, or nearly half of all inflows.

The popularity of the SIP route has wrought a sea change in retail investor behaviour, because it takes away the temptation to closely watch the markets and alter one's investments based on its ups and downs. SIPs, by allowing investors to set up standing instructions with the bank to invest a fixed instalment each month, essentially put one's investments on autopilot.

Today, with equity MFs raking in close to ₹4,600 crore every month via SIPs, domestic MF managers always have some powder dry to deploy in the stock market. That's a break from the past. When lump sum investments were in vogue, domestic fund managers would be flush with cash at market highs and staring at empty coffers after a free fall. They would therefore end up buying at highs and selling at lows, like novice investors.

Contrarian view

But, with SIPs smoothing out the flows, fund managers can now take a contrarian position to FPIs if they wish. If domestic fund managers use this new-found clout wisely, it may mean a higher floor to the stock market when foreign investors are in a jumpy mood.

Despite the recent surge in retail interest though, MFs are nowhere close to displacing bank deposits or the provident fund/insurance policies as the favourite investment channel for Indian households. MFs accounted for just a 2% share of gross financial savings in FY16, while bank deposits hogged 44% and provident funds/insurance took up 36%.

Optimists may like to look at this as a glass half full. After all, a 2% share for MFs in the savings pie means that 98% of that pie is still waiting to be devoured. But that expansion is contingent on two factors.

One, it is dependent on income growth and a rapid expansion of the urban elite in India. The saver's allocation to market-linked investment vehicles depends on his ability to take risks in the market.

Deposits still mainstay

It would be unreasonable to expect savers at a subsistence level of income to allocate any part of their savings to MFs, whether debt or equity. For them, bank deposits would still constitute the mainstay.

Therefore, further asset growth for the MF industry is closely intertwined with income growth in India and the ability of more savers to climb up from the lower- and middle- income groups to the mass-affluent category.

Two, some of the new-found investor fancy for this vehicle is also due to the impressive recent records of both equity and debt funds. Retail investors, the world over, chase past returns.

In the last three years, diversified equity funds, as a category, piggybacking on a favourable market delivered an 18% CAGR (data sourced from CRISIL AMFI) while liquid funds notched up 8.1%. These returns are well above long-term averages.

When both equity and debt markets are coming off a particularly good spell, it is all the more challenging for fund managers to sustain those returns on a high base.

Whether fund houses manage that feat and serve up a good return experience for retail savers who are recent converts to MFs, will also decide if this party will go on.

GUEST COLUMN

Integration of oil & gas majors is best avoided

RABINDRA KUMAR JENA

In his fourth budget speech, Finance minister Arun Jaitley revisited the idea of an integrated oil and gas sector. The idea first made its appearance during Atal Bihari Vajpayee's government in 1998. The proposal was then rejected for encouraging a monopolistic scenario in distribution of essential goods like LPG, petrol, kerosene etc. In 2005, the Krishnamurthy committee formed by the UPA government debunked the idea as it would reduce competition and manpower in the oil and gas sector.

Why, then, did the idea of an integrated oil major surface again in 2017 even after being rejected twice?

Five reasons

Mr. Jaitley stated five major reasons for the same: better capacity to bear higher risks, avail economies of scale, create more shareholder value, make better investment decisions and be more competent globally. From the table, it is apparent that Indian firms are much smaller in size compared with top international oil companies. The Government's track record of consolidating state run firms has not borne good results. The aviation sector suffered a major setback following the merger of Air India and Indian Airlines in 2007 and has not yet fully recovered. In oil and gas, minimum political interference and liberalisation have proven better in creating more shareholder value compared with integration. ONGC's decision to bail out debt-ridden Gujarat State Petroleum Corporation has been said to be the result of political interference. With oil firms facing such allegations and inefficiencies, giving complete autonomy to one entity can risk the nation's energy security.

> The financials of all oil PSUs show they have more enough in the cash chest

Another concern is employment generation. The graph shows that the sector has seen a continuous decline in manpower since FY11. The Krishnamurthy Committee had earlier deduced that such integration will result in manpower reduction. At a time when the government is struggling with job creation, it will be difficult to justify job losses due to restructuring.

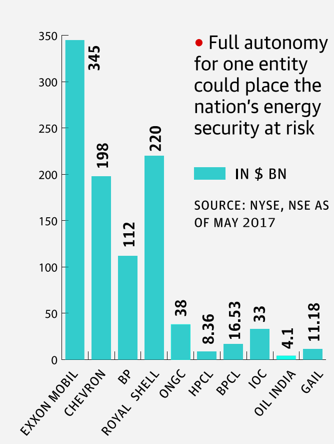
The ability of a company to take higher risks depends on the amount of capital it has. The financials of all six major oil PSUs show that they have more than the minimum amount of capital required. Size is also not the only factor that facilitates acquisition of offshore projects. Ireland's Tullow Oil, with a market cap of only $3.62 billion, has expanded in several countries by forming consortia with local oil firms. Therefore, companies should focus on better strategy, techniques and management practices to negate shortcomings of their size. The Indian oil market today has hardly any competition and is dominated by IOCL, HPCL and BPCL. Curbing competition in the past has already adversely affected the aviation and banking sectors.

So, any decision that creates a monopoly in the oil and gas sector must be carefully thought through. An important question here is whether a bigger oil company will help achieve the aims stated by Mr. Jaitley. Or, will it create new problems for the Indian people at large?

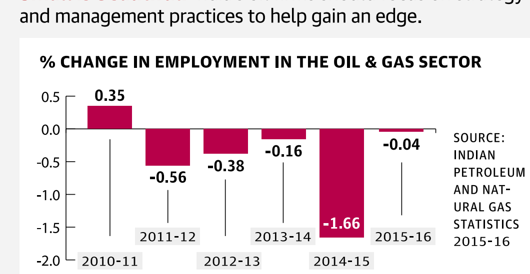
(The author is a BJD Member of Parliament and views are personal)

TO MERGE OR NOT TO MERGE

In the oil and gas sector, minimum political interference and liberalisation have contributed to creating more shareholder value as compared with integration.



Small is beautiful: India's oil firms should focus on strategy and management practices to help gain an edge.

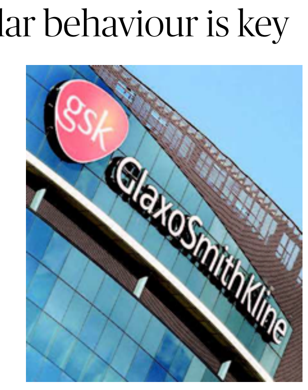


Pharma turns to AI to hasten drug discovery

Predicting molecular behaviour is key

REUTERS
LONDON

The world's leading drug companies are turning to artificial intelligence to improve the hit-and-miss business of finding new medicines, with GlaxoSmithKline unveiling a new $43 million deal in the field on Sunday.



Other pharmaceutical giants including Merck & Co, Johnson & Johnson and Sanofi are also exploring the potential of artificial intelligence (AI) to help streamline the drug discovery process.

The aim is to harness modern supercomputers and machine learning systems to predict how molecules will behave and how likely they are to make a useful drug, thereby saving time and money on unnecessary tests.

AI systems play a central role in other high-tech areas such as the development of driverless cars and facial recognition software. "Many large pharma companies are starting to realise the potential of this approach and how it can help improve efficiencies," said Andrew Hopkins, chief executive of privately owned Exscientia, which announced the new tie-up with GSK.

Lower costs

Hopkins, who used to work at Pfizer, said Exscientia's AI system could deliver drug candidates in roughly one-quarter of the time and at one-quarter of the cost of traditional approaches.

The Scotland-based company, which also signed a deal with Sanofi in May, is one of a growing number of start-ups on both sides of the Atlantic that are applying AI to drug research. Others include U.S. firms Berg, Numerate, twoXAR and Atomwise, as well as Britain's BenevolentAI.

"In pharma's eyes these companies are essentially digital biotechs that they can strike partnerships with and which help feed the pipeline," said Nooman Haque, head of life sciences at Silicon Valley Bank in London. "If this technology really proves itself, you may start to see M&A with pharma, and closer integration of these AI engines into pharma R&D."

It is not the first time drugmakers have turned to high-tech solutions to boost R&D productivity. The introduction of "high throughput screening", using robots to rapidly test millions of compounds, generated mountains of leads in the early 2000s but notably failed to solve inefficiencies in the research process.

When it comes to AI, big pharma is treading cautiously, in the knowledge that the technology has yet to demonstrate it can successfully bring a new molecule from computer screen to lab to clinic and finally to market.

INTERVIEW | ILYA SACHKOV

'A single boxer in a ring is not a winner'

'Those protecting critical infrastructure think they are safe; that's because hackers are busy elsewhere making money'

K. BHARAT KUMAR

Ilya Sachkov is the CEO of Russian cybersecurity firm Group-IB. He looks and acts every bit the software intellectual stereotype - gentlemanly, suave and unflappable, even as he dishes out a shocker in the middle of an interview with The Hindu. *He pulls out his laptop, boots up the security tool developed by his firm and displays the screen to this writer: what you see is data on a recent breach by hackers compromising login credentials of a user in the Ministry of External Affairs, Government of India!*

Group-IB, which Mr. Sachkov started 14 years ago, had recently contributed to the prosecution in its 120th case involving cybercrime. The last was the toughest - where the criminals got 20 years in prison for financial fraud against victims across 60 countries. Excerpts:

> Ransomware WannaCry is good education for enterprise users. In 2017, you should have backups. Else, don't use the Internet or a computer

There seems to be a surfeit of cybercrime cases now? Why?

■ Organised cybercrime is mostly done for money. Banking frauds are common here. When hackers attack corporate accounts, they might also affect critical infrastructure, true. But if you look at the intent for the hacking, the main reason is money. The ratio of hacking for money, versus hacking for anything else (i.e. political information or cyber-terrorism etc.) is 99:1. When these tools, used to hack for financial gains, are put to use in cyber espionage, that is a dangerous thing. The same tools and viruses work well in both scenarios. That is why it is important for someone like us to chase after culprits of both kinds, as the methods are the same. Methods used originally by organised crime groups were redeveloped and used by North Korea special forces for cyber espionage. The trail in the case of the $81 million heist at the Bank of Bangladesh clearly leads back to North Korea, our own investigation tells us.

What is your speciality?

■ Our primary expertise and business has been in digital crime investigation and digital forensic investigation. We are the biggest forensic lab in Eastern Europe, both 'classic digital' and 'malware forensic'. We protect huge levels of infrastructure at an ISP level in several countries, with botnets and the like. We offer threat intelligence services.

We are part of 1,000 hacker forums globally. Most are private, and it's not easy to be part of such forums. We are also responsible for protecting Russian domains such as .ru, .rf, .su, etc. How do you protect someone if you don't know the cyber criminal? So, infrastructure and human intelligence skills are key. We currently have 200 people in our team; eyeing 300 next year. Our clients are IT firms, BFSI sector units, government agencies and companies with famous brands as brand protection is a core area of us.

You have a joint venture with state-owned arm Rostec. An unlikely combination?

■ We are a start-up and Rostec is a large state-owned corporation with diversified businesses under its umbrella. Through Rostec, we get to be part of huge projects. From their side, they need high-level technology. Hence the JV. We use technology to protect critical infrastructure and intend to export this technology to different countries. Working with, for example, a huge government agency in another country takes 3 years, just to lay out the basic preparation. We prefer to move faster. Rostec helps us in this.

What's missing in the protection of critical infrastructure, globally?

■ All countries need cybercrime law. Though the safety of critical infrastructure is critical, hackers predominantly focus on money. We all get the feeling that critical infrastructure is protected; but that is because not too many people attack this. If they do, we will have a problem with critical infrastructure. Those responsible for protecting such infrastructure feel things are all right, while that is not really the case. It is like a single boxer feeling good about his skills - you need two parties to do this.

Do you sell in India?

■ We are in the process of setting up sales infrastructure in India. We are setting up a base in Dubai which will also cover India. We are looking for channel partners, or integrators, In India, Rostec would be interested in offering protection in government, military installations or infrastructure etc..

We see huge potential in banks, financial services, insurance firms in India, while Rostec sees potential in protection of Indian military and government assets. The security market in India is starting to boom. We also aim to offer managed security services on subscription basis and not just sale of products.

You showed us an example of a breach. How does this work?

■ In tracking data theft, it is important to track network communication, without any installations and to do this remotely. We track these and then contact our customers if there is a breach.

Hackers use phishing websites and malicious software to obtain account details. They usually hunt for login details from internal corporate systems or external client services such as online banking. Malicious programs upload stolen data to C&C servers controlled by attackers. Such servers are central data collection points. We monitor compromised data by analysing network protocols used by malware for communication with its C&C server.

To perform such monitoring Group-IB uses specialised sensors deployed in various network segments. The sensors are designed to identify C&C servers and scan malware communications with this server for compromised data. Due to joint investigative activity with law enforcement agencies and cooperation with hosting providers, Group-IB obtains copies of hackers' servers that often contain large amounts of compromised data.

In the case of phishing attacks, intercepted data logs can be temporarily or permanently stored locally or forwarded to hackers' email addresses. Group-IB specialists monitor phishing resources and collect configuration files of these websites to identify the methods used by hackers to store logs with stolen data and then locate it in order to identify all compromised users.

What is the most difficult case you have worked on?

■ The most difficult criminal cases we have dealt with are Carberp, Anunak and Cron. Anunak was a Russian cybercriminal group that attacked financial institutions and stole up to $ 25 million in just over a year in 2014. Cron infected up to 3,500 mobile devices daily, totaling about 1 million devices.

Ransomware WannaCry is good education for enterprise users. In 2017, you should have backups. Without that, don't use the Net or a computer. It is good that media gave it so much importance. Technically, Wannacry is not very exciting for us. But the increase in awareness was perfect for us. Everyone was talking about cybersecurity. If the same methods are adopted by cyberterrorists, consequences may be worse.

Which countries would you rate high on cybersecurity?

■ Japan and Germany are among the first to protect their systems. It's part of their culture, I think. Customers elsewhere start to think about information security after an incident occurs. It is understandable. Usually, people start thinking about good health after bad health hits them.

(The writer was in Russia at the invitation of Rostec)