"If adviser focuses on sale, his advice will be no good"

Glen Baptist

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*Glen Baptist tells **Babar Zaidi** how financial disclosure standards need to improve in India, why direct mutual funds won't suit everyone and whether robo advisers can replace humans.*

There is a big debate going on in India about the cost of investment. How does the cost of investment in India compare with that in other markets?

There have been discussions about transaction costs in all markets. In the US, transaction costs came down dramatically 15 years ago after the tech bust. The advisory business in the US moved from a transaction-based charge to a fee for a wrap account. Advisers charge a 1-1.5% fee on the wrap and the underlying investments carry a very low fee. For example, the annual charges of an ETF are 15-20 basis points, while the institutional share class for a mutual fund costs 35 basis points. This way, there is no conflict of interest for the adviser, as his remuneration primarily comes from the wrap fee, and as such the focus of the adviser is on maintaining assets, not on selling the next product to the investor.

If we look at India, the cost of ownership for mutual funds appears to be quite reasonable. The Indian mutual funds costs are comparable to the all-in costs (wrap fee plus fund cost) in developed markets like the US, while the underlying asset class returns are substantially higher. In addition, actively managed Indian equity funds have outperformed the indices by a healthy margin after all costs.

Direct plans of mutual funds are gaining popularity because their lower costs mean higher returns for investors. But financial literacy is low in India. Do you believe the average Indian investor is capable of investing directly?

Advisers are needed in every market. Even in the US, where financial literacy is comparatively higher, only 25% of investments are done directly. And this is similar to other industries. Some people buy furniture from Ikea and assemble it themselves. Some even do self medication to save on the doctor's fee. But in most cases, people turn to experts for their needs. I believe that a financial adviser is necessary because we get so involved in our daily lives that we cannot pay enough attention to our investments. Even a person like me needs a financial adviser who can look after the finer nuances, such as rebalancing the portfolio or reviewing the holdings and keeping your plan on track.

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Do you think the measures taken by the regulator to bring down costs will bear fruit?

You don't need regulatory intervention to bring down costs of products. Competition does that on its own. For example, in liquid funds, the costs have come down without any regulation.

The regulator has also introduced new rules on compensation disclosures. What are your views?

While the specifics of any rule can be debated, in general, disclosures are good and will bring greater transparency to the system. However, besides fees and compensations, the regulator must also focus on corporate disclosures that help in the fundamental analysis of a company. It should ensure that the financial disclosures by bond issuers and companies are accurate. The standards of disclosures are weak in India and need to be improved.

Are you saying that the bad loans on the books of Indian banks could have been avoided if disclosure norms were more robust in India?

What I mean is that there is pressure on the willful defaulters but not on the factors that led to the defaults. Better financial disclosures by the borrowers at the time of taking those loans and on an ongoing basis could have prevented this problem.

Robo advisory firms are mushrooming in India. How reliable is the investment advice they dish out?

I believe robo advisory services are not very useful because these firms assume too much on the investor's behalf. Everyone's needs are different, and the algorithm-based bot may not be able to differentiate between two people with the same income. This is where the need for a human touch becomes critical. The flipside is that even human advisers can have their flaws. If they are focused only on selling, their advice can do more harm than good.

Small investors in India tend to have a very short-term perspective of equities. Almost 50% of the total inflows into equity funds are redeemed before two years. What are your observations?

This is a conundrum we see in other markets as well. Small investors tend to get it all wrong–they enter at a high and quit at a low. Left to their own devices, nobody is willing to sacrifice short-term gains for long-term prosperity. I think a sustained effort by the industry and the media is needed to drive in the fact that long-term investments in equities can make you wealthy.

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