Getting more Retail Investors

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Development of a vibrant capital market is key for the growth of any economy and is no different for India. The Indian capital markets have grown manifold in the last few years and to some extent channelised domestic savings. However, channelising retail funds into the capital markets has been a key challenge and at the same time offers immense opportunities. In this article, we have tried to highlight some issues and action points for increased retail participation in the Debt Capital Markets (DCM) and Equity Capital Markets(ECM), both of which are key for the capital formation in the country.

I. Corporate Debt

The splendid response to the recent public bond issuance by a few large & reputed corporate groups has ignited the debate, how corporate bonds can be made popular amongst the retail investors.

The Indian economy has been marked by a strong economic growth coupled with more robust, transparent and efficient markets. The equity markets have attracted significant investor participation over the years, both institutional and retail investors. Further the banking sector has also witnessed significant growth in credit. However, while the government and corporate bond markets have grown in size, they remain illiquid and the investor base remains largely skewed towards QIBs. The retail participation in the bond market in India is negligible and the retail bond market itself is at a nascent stage of development.

There are a number of issues that are possibly acting as hurdles in the development of a vibrant bond market, which need to be examined and resolved to bring depth and liquidity to the bond market. Some of the key challenges are highlighted below:

a. Inherent Illiquid Market

The corporate bond market in India suffers from the lack of liquidity. In many respects the bond market is dissimilar from the equity market. As in most parts of the world, the equity markets have largely got institutionalized and equity is held widely by retail as well as institutional investors. Moreover retail investors are also active in the secondary market. The bond market on the contrary continues to be dominated by institutional investors both in the primary and secondary markets. The beauty of equity markets is that the investor can get to know the price of his stock by the click of a mouse. Until such a scenario happens in the corporate bond markets, retail investors may not bite the bullet. Typically around 90-95% of the trading happens only in Government Securities (G-secs) and the balance in corporate bonds. Institutional investors are the major investors in corporate bonds and a large section of them are ‘buy’ and ‘hold’. All these restricts the trading in corporate bonds to a few private sector banks, mutual funds and some private sector insurance companies. All this has resulted in a very illiquid corporate bond market and also a very scanty secondary market for corporate bonds.

The development of the retail bond market hinges on the growth of the wholesale market. Therefore efforts should be made to deepen the wholesale market by making it more transparent, both from the issuer and investor perspective. More issuers should be encouraged to approach the market, across the tenors and across the rating spectrum. As discussed above for the development of the secondary market, market making capabilities must be encouraged, just as a concept of primary dealer exists in the G-sec market. The R.H Patil committee’s report on ‘Development of Corporate Bond Market’ has suggested that bonds from the banks can serve as a bait to attract retail investors to the debt market, eventually paving the way for other issuers. In the recent past only ICICI Bank had raised debt through the public issue. We understand from market reports that, State Bank of India is planning to raise debt by tapping the retail investors through a public issue.

b. Skewed investor base

If one analyses the investor base in corporate bonds, it is very much skewed to large QIBs, viz, banks, mutual funds, insurance companies, pension & PF trusts etc. There is also virtually no retail participation in the corporate bond market, despite a high savings rate as a proportion of GDP, due to an illiquid secondary market coupled with alternative investment opportunities offered by attractive small savings schemes. The trading activity is also restricted to large investors and the market lot is also in the range Rs. 5- Rs. 10 crores which keeps away the retail investors. This is despite the fact the corporate deposits have been a long and tested way by corporates to raise money, mainly because of the broker push for such products. However, corporate bonds have not found much favour with investors, though they share a lot of similarities with deposits and are liquid compared to a deposit. There has to be an effort to educate the retail investor about the advantages of investing in corporate debt.

Most of the placements of debt happen on a private placement basis where the maximum number of investors should not exceed 49 and this restricts participation to only a few large investors. This should be further liberalized to enable wider participation. Moreover, the face value of bonds is normally kept at Rs. 10 lacs and this does not allow large retail participation even in secondary market. The face value needs to be reduced to enable retail participation and widen investor base.

c.Streamlining the clearing and settlement mechanism

There is no structured clearing and settlement mechanism in the corporate bond market, unlike the one we have in the equity markets. Earlier the settlement process was done on a bilateral Delivery versus Payment (DVP) basis but counter party risk still remained. Under the new settlement regime, only the transactions are settled on the settlement platform of the exchanges, but still counter party risks remain. The Stock Exchanges provide the facilities for settlement of Debt Papers on T+2 days basis, similar to equity settlement. However the market practice of settlement of debt papers is T+0 or T+1 days. This is one of the reason why the debt trading in stock exchanges has not picked up. Further, there is lack of awareness among the retail investors and intermediaries also regarding the process flow of settlement of debt papers.

d.Lack of price discovery

The corporate debt market in India is typically Over the counter (OTC) market with trades being confirmed over phone and only settled through the exchanges. This is unlike the equity markets, wherein the prices discovery process is transparent and the price of any stock is available on real time basis.

e.Stamp duty and tax related issues

Stamp duty is one big negative factor in issuance of debt instruments, whether secured or unsecured. In case of unsecured issues it is payable as per Indian Stamp Act, 1881. However in case of secured debt instruments it depends on the security offered, “movable or immovable assets” and the state where the security offered is situated. There are differential stamp duty in various states and provisions governing its enforceability. For the development of debt market and increasing liquidity, either stamp duty should be totally eliminated or coordinated and harmonized across the states at a lower level to reduce the complexity arising from inter-state differences in stamp duty rates.

Tax issue is a major factor which hampers the development of debt markets. Government has exempted the listed corporate debt from TDS, however other debt papers like PTCs (Pass Through Certificates) are still not covered in it. There is a need to evolve a broad principle in taxing PTCs and tax the accrued income. Currently there is a differential application of taxes depending upon the end buyers of the bond. Insurance companies and mutual funds are exempted from taxes as they are ‘pass through’ financial firms. However, banks, individuals and companies belong to non-exempt category. This essentially means that tax treatment of corporate bond differs depending upon the buyer of the bond for a particular transaction.

II. Equity

In India, growth of equity markets has been the central objective right from the inception of the planning process. Accordingly, over the years, various Governments have taken initiatives to address the issue of inclusive growth. Notwithstanding the rapid increase in overall GDP and per capita income in recent years, a significant proportion of the population in both rural and urban areas are unable to participate in the mainstream financial growth and in fact experience difficulties in accessing the formal financial system.

Focus on the financial inclusion has resulted in substantial improvement in savings account penetration both in the urban and rural areas, and is evident from the fact that there were in excess of 3700 lacs savings bank accounts in India. Despite a high savings rate in India (amongst the highest in the world) the retail funds are either invested in low return risk-free securities or simply kept idle without being put to any productive use.

Investments into capital market directly or through mutual funds and insurance companies have been growing at a very slow pace. As a country, India has been attracting a lot of overseas money in form of portfolio inflows as well as direct investments into various businesses. We have seen increased level of confidence in our capital markets coming from those countries that are predominantly driven by retail investors looking for alternatives to fixed deposit that currently offers close to zero return in their respective countries.

The Indian equity market, although, has been one of the better performing markets in terms of returns, the widespread participation from the domestic retail investors eludes this market with the number of retail equity investors constituting less than 2 per cent of the total population. Of this, around 40 per cent of the investors are located in Maharashtra and Gujarat indicating negligible or lack of participation from the other States and Union Territories. According to the data available from National Securities Depository, the leading depository, nearly 62.8 per cent of the demat accounts are in the five states – Maharashtra, Gujarat, Delhi, Tamil Nadu and Karnataka. Despite a large population in the country, there are only around 165 lacs demat accounts in India, which held about 80% of the total securities, with the rest being held in physical form. Of these about 40 lacs new demat accounts were opened only over the last two years. These accountholders are spread across about 1,000 cities/towns in the country. A closer look at retail participation by geography reveals that the top-10 cities (Tier-I) contribute 90 percent of the total trading volume and 78 percent of mutual fund ownership but account for only 37 percent of the total urban income pool. This indicates the immense potential offered by Tier-II and Tier-III cities.

Although disposable household income in these cities is less than that of Tier-I cities, owing to a lower share of high net-worth individuals and the affluent segment, there is a huge opportunity to be tapped. Following are few points which may help increasing retail participation beyond Tier-I cities:

- A reduction in the complexity and cost of opening dematerialised accounts to encourage people to invest in the equities even beyond the top-10 centres;
- Increased investor education and awareness in semi-urban centres, e.g., investor camps in key centres, nationwide programmes with a focus on ethical selling practices by financial services companies;
- Increased indirect investor participation through mutual funds and long-term retirement products such as the New Pension Scheme 2009.

Of the approx. 1880 lacs investors holding financial assets, only 80 lacs participate in debt and equity either directly or indirectly and these include mutual funds and market-linked insurance plans. Mutual fund penetration in India is just around 3%, according to the Economic Survey 2008-09, nearly two decades after the industry was opened up, first to nationalised banks and later to private and foreign funds. About, 80% of the investment comes from eight cities, thereby showing little market penetration, and only 7.70% of financial savings are allocated to mutual funds.

The lack of retail participation in the recent public offerings is also reflective of the additional measures that need to be undertaken to increase their participation in such offerings.

Well governed corporates have generated wealth for all investors including retail investors over a period of time. Return in equity markets, especially when coupled with the power of compounding, can serve as very important tool of wealth creation. Also it has been statistically proved that over a longer time horizon, Equity Markets have out performed all the other asset classes globally.

It has always been a challenge to attract retail investors' participation in the capital market but even with a few initiatives being taken, as mentioned above, would help changing the complexion of the equity markets in the country with large scale retail participation.

Conclusion

The need for expeditious development and deepening of the retail market in India is the need of the hour. One key point for the involvement of retail investors in both the markets is investor education and awareness, particularly in semi –urban centers. A healthy retail participation in both, corporate bond & equity markets would facilitate interest among the investors to facilitate the gross capital formation process in the country.

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