Increasing the retail investor participation in capital markets

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The Indian capital market is one of the most vibrant and efficient markets in the world. The steps taken by the government and Securities and Exchange Board of India (SEBI) in a short period of 17 years has brought in adoption of international quality trading, risk monitoring mechanism, best in class settlement mechanism and reduction in transaction costs. We today have a very strong foundation to foster and deepen the participation of retail investors in the capital markets.

Currently, the retail exposure to the Indian capital markets is very limited; with just over 20 million demat accounts. The percentage of demat accounts to total population in India is approximately 1.4% as compared to 9.4% in China, 2.2% in Russia and 16-18% in the developed countries like the UK and USA. The majority of Indian households do not participate in the markets. Current disposition of retail investors towards equity as an asset class is inadequate. The Indian retail investor participation is very low at 8% as against 20-33% in South Korea and China.

The effort to increase the retail participation, to the extent we would expect to do, will be no less than a social change. A whole new eco-system will need to be created, starting with understanding the predisposing factors and motives of the Indian investors, creating an environment that will foster positive belief and confidence in the markets, making it easy for investors to transact so as to minimise inertia and finally engaging with the investors till they truly benefit from the markets.

India has amongst the highest savings rates. However the savings have primarily been restricted to insurance, real assets and fixed deposits. Culturally, we are more disposed to investing in risk-free fixed income instruments or real assets. The Invest India Incomes and Savings Survey 2007 found that three in every four of 94 million earners in urban India are risk averse and are disinclined to take risks with their investments. The support of a joint family structure, large employment opportunities with the Government, defined benefit pension system, high saving rates and limited consumerism ensured that one could meet most of the financial goals with investment instruments like bank deposits or post office deposits. The urge for investments in markets will partly be driven by social changes like increase in consumption, ambitions and need for financial independence. Amongst the most important is planning for retirement. Only about 12 per cent of the working population in India is covered by some form of retirement benefit scheme. Today retirement planning investments are largely limited to the EPS, PF and PPF schemes with a small portion being directed to the voluntary pension scheme administered by LIC, MF and other insurance companies. The steps taken by the government to provide for a sustainable solution for pension to the masses and establishing PFRDA, is an important step. While the primary aim of the pension reforms is to provide for better pension coverage, the effort will lead to better returns and a deeper retail participation in the capital markets. As a country we have to continue our reform efforts in this area.

Increasing investor confidence is another key lever to increasing the overall participation. Investor confidence comprises the returns that they can expect or have experienced and the overall safety net available to retail investors. There is a need to create more interactions and triggers for discussions through credible stakeholders so that even a first time investors can understand the markets and the safety nets better. This way we can create safe opportunities for people to try and experience success which will give them more confidence to participate. Undoubtedly, the performance of the capital markets in the last five years has impacted investor confidence. Equity Markets by their very nature are volatile. An important part of investing into the markets is investor education at the time of investment. That is the moment of truth for all new investors. The financial intermediaries play an important role in ensuring that the investors truly understand the risks and allocate their assets as per the risk appetite. In a country where 85% of investments emanates from top 5 cities, enhancing distribution should be a key priority. The financial intermediaries are a key catalyst and should be encouraged further to continue with the efforts of introducing new investors to the markets. One can take a leaf from the stupendous growth and efforts of the Banking Sector in India. Amongst the key to this was focus on depth of the intermediaries (banks), the minimum capital requirements and an objective/principle based regulation (instead of rule based). Simultaneously a safety net in terms of quick redressal of investor grievances,better disclosure norms and maintaining integrity of the markets are extremely important. Recent steps taken and proposed by SEBI with respect to these are in the right direction.

Another perspective to building a safety net for new investors can come in form of fostering product innovation. Given the low risk appetite of Indian investors there is a need to review and encourage capital protected products which can bring in partial participation and introduce the markets to new investors.

Investments and planning for finances does not come naturally to all. There is therefore a need to nudge the investors by reducing the inertia and by incentivising. It is extremely important that the processes relating to investments including account opening is easy and simple. The recent regulations by SEBI with respect to KYC Registration Agency is a big step towards making its easier for investors to open accounts and transact. This will also have long term impact in reducing the cost of efforts in reaching to new customers. However efforts need to continue to enable investors open an investment account immediately over the counter. There is also a burning need to rationalize and standardization processes related to investments into Mutual Funds. Lack of standardization of processes creates a barrier and impedes the experience of the investors. A higher level of engagement and empowerment is required between all the stakeholders including the intermediaries along with the regulators in an effort to simplify the processes.

Incentivising the investors has always helped gain share of mind of investors. Introduction of the Rajiv Gandhi Equity Savings Scheme in the last budget will help in incentivising customers.

We are in the era of high growth in our economy. This will not be possible without equity risk capital to support the growth. Part of this will come through the profitability of the corporate themselves, yet the risk capital gap is likely to be wide. This will have to be met either through the external funding or through domestic funding. Over reliance on external funding creates volatility in the market and plans. Thus a balance is desirable. It is here that retail investors will play a major role. Allocation towards equity either direct or indirect is absolutely critical.

The flow of household savings in financial assets is heavily skewed towards banking products and other administered rate products. Direct or indirect allocation through mutual fund route or insurance route is less than 15%(only part of insurance funds are deployed in equities). The imbalance is stark. Each stakeholder viz policy makers, manufacturers of the product, distributors of the product and consumers of the product must do their bit to move the flywheel. Retail then will then become the engine of “risk capital security” to power the growth in our economy and be the beneficiary of the same.