Indian Capital Markets – Story so far and outlook for 2020

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Capital markets in India have developed in phased manner, first phase being from independence to the pre 90s' era, the period of slow growth with a very cautious approach and second phase began post 90s' when the first set of significant economic liberalization took place. Post 90s' the capital markets growth has been exponential with the introduction of the Securities and Exchange Board of India (SEBI) which created a regulatory and governance architecture around securities market, significant liberalization in the foreign capital flows and other regulatory changes and the emergence of internet and technology. For run up to 2020, there appears to be exciting times ahead with the continuous disruptive innovation in the capital market space, the regulators gearing up for the changes and government's proactive approach towards reforms to steaming the overall growth momentum. India continues to remain a bright spot amongst emerging market peers amidst the slowdown in various global economies and also the concerns raised by the recent Britain's exit from the European Union. In this article, I have discussed the recent trends, some of the key reforms under way on the regulatory side, the challenges posing the Indian capital market in near future and other related aspects.

Recent Trends

Talking about the recent trends in the Indian context, we are witnessing a proactive government involvement in promoting the growth of the economy, Indian regulators proactively revamping the regulatory system in response to the changing market, healthy competition in the e-commerce industry, a boom in the startups and technology penetration by market players and so on and so forth. The changes in recent times are very dynamic and these have led to the businesses including the financial services and capital market players to think and modify their business structures.

In recent past, SEBI, Reserve Bank of India (RBI) and Government of India have been constantly coming up with various reforms / consultation papers to ensure continuous capital flow to the economy, create a strong governance structure and to ensure that the Indian capital market grows continuously to supplement the overall economic growth.

Recent / Upcoming Changes

- **Changes impacting the Fund Industry:** Fund industry is one of the key pioneers to supplement the capital needs for various sectors in India. SEBI in 2012 notified the SEBI (Alternative Investment Funds) Regulations, 2012, replacing the erstwhile Venture Capital Fund regulation of 1996. AIF is a privately pooled investment vehicle which collects funds from investors in accordance with its defined investment policy for the benefit of its investors. Based on the quarterly / monthly information submitted with SEBI, total commitments of Rs. 38,879 Crores[1] have been raised as on 31 March 2016. Recently foreign entities have also been permitted to invest in AIFs to attract more overseas money into the country; this is a very positive move for the fund industry.

  In 2014, SEBI notified two key regulations viz. for the Real Estate Investment Trusts, ('REITs') and for Infrastructure Investment Trusts (InvITs). REITs are likely to provide easier access to funds to real estate developers and create a new investment class for the institutional and high net worth individuals. REIT schemes in a nutshell are to be close ended real estate investment schemes that will invest in property with an aim to provide returns to the unit holders. The returns will mainly be in the form of rental income / capital gains from real estate. Similar to REITs, InvITs are likely to provide a structure for financing/ refinancing of infrastructure projects in the country.

  SEBI has played a pivotal role in identifying the need for the legislature at the right time and by constantly evolving the legislature which will act as an enabler for SMEs / start-ups to raise funds. The impact of the above will be seen in the near future given the growing entrepreneurship capabilities amongst the Indian youths.

  For India's long term growth story as well as for run up to 2020, Fund industry will play a pivotal role in mobilizing the savings and generating capital flows for businesses.

- **Opening up of various sectors for Foreign Investment:** Government of India foreseeing the potential for growth, has allowed more foreign direct investment (FDI) in core sectors like retail, defense and civil aviation etc. in recent times. Many other sectors have been allowed 100% or near 100% FDI with government approval or through the automatic route. The objective of 100% FDI and other relaxations is to promote employment and improve infrastructure, along with greater FDI inflows and the ease of doing business in India. Cumulative total FDI into India from financial year 2000-01 to financial year 2015-16 totals to USD 424,167 millions[2]. Similar to the growth of the domestic fund industry, another key constituent for generating capital flow for businesses is the funding that India shall receive from the foreign participants.

- **SEBI-FMC Merger:** In order to strengthen regulation of commodity forward markets and reduce wild speculations, the Forward Markets Commission has been merged with SEBI recently. Forward Contracts Regulation Act (FCRA), 1952 has been repealed and the regulation of commodity derivatives market has been shifted to the SEBI under the Securities Contracts Regulation Act (SCRA), 1956, with effect from September 2015. There are numerous benefits of the FMC merger with SEBI and this is a very positive step of moving towards an integrated platform.

- **RBI Banking License:** Since April 2014, the RBI has granted 23 banking licenses to new players - two were given universal banking licenses, 11 were issued payments banks licenses and 10 were given licenses for small finance banks. The niche banks like small finance and payments banks have been set up to further the objective of deepening financial inclusion. RBI has also issued a discussion paper on on-tap licensing of Banks which will enable more private participation in the banking sector. Depending on the RBIs' approach, there may be more players in the banking space which will help the RBI and the Government of India to achieve greater financial inclusion.

- **International Financial Service Centre (IFSC):** IFSC is a dedicated hub of financial services participants within a country, which has laws and regulations different from the rest of the country. The first IFSC in India is already in the process of being operationalised in Gujarat i.e. Gujarat International Finance Tec-City (GIFT), near Ahmedabad. Government, IRDA, SEBI & RBI have also swiftly come up with a regulatory framework for governance of the IFSCs. Similarly, based on the media report, it transpires that the state government of Maharashtra is also exploring to create an IFSC hub in Mumbai. For the run up to 2020, success of IFSC in India will be critical for the growth of the Indian financial sector in general and capital markets in particular.

- **Indian Financial Code:** The Ministry of Finance, Government of India, constituted the Financial Sector Legislative Reforms Commission (FSLRC/the Commission) in March 2011 with a view to rewriting and cleaning up the financial sector laws to bring them in line with the current requirements. The Commission laid down a draft framework, namely, 'Indian Financial Code' proposing to replace the bulk of the existing financial laws. Draft IFC has been revised in the light of the comments received and hosted on the website of the Ministry of Finance as revised Draft IFC which was open for comments. IFC is a key regulatory change that is possible in the near future which will further strengthen the regulatory framework, allow a single control system for the regulator and will benefit financial services sector as a whole.

- **Other Changes:**
  Crowd funding has been an emerging source of funding avenue that has been used in many economies. SEBI in 2014 had released a consultation paper on crowd funding in order to create funding avenues for start-ups and small companies. Crowd funding essentially means solicitation of funds from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause. Peer to Peer lending is another form of crowd funding that is prevalent in many economies including India. RBI recently introduced a discussion paper to create a regulatory framework around the same. RBI also proposed to introduce a separate category of NBFC called Non-Banking Financial Company - Account Aggregator (NBFC-AA) to provide account aggregation services, which hither to was unregulated. There have been several such regulations / discussion papers that have been put up in place by the regulatory authorities for the capital market and financial services sector as a whole. To that end, Regulators in India have been proactive in perceiving the key risk areas emanating from the innovative products emerging in the financial services space by way of introducing suitable Regulations without necessarily disrupting the businesses.

Key Challenges

Global changes

As India continues to progress, there are various challenges that the global geopolitical and financial environment poses for the future. While the world is still recovering from the aftermath of the global financial crisis of 2008-09, in a very short span of times we have witnessed a concern over the global growth resulting from the falling oil prices, slow down in Chinese economy, the exit of Britain from European Union etc. However, India continues to be a bright spot given the Government and Regulators commitment to continuously monitor risk and mitigate the impact that the global uncertainties create.

Technology

Use of technology in the banking and financial services including capital markets space has been a key theme and growth driver for the Financial Services sector in past couple of decades. From internet banking, mobile banking, real time transfer of funds and payment wallets, the financial services space has come a very long way, and my sense is this will persist for a foreseeable future. The traditional funding sources also face the challenge as the new and innovative ways of fund raising emerges such as peer to peer lending, crowd funding etc. The regulators will need to gear up to regulate and manage such disruptions by addressing the key concern in areas like investor interest, data security etc well in time. In the run up to 2020, the technological advancements is likely to continue to be a key disruptor as well as a major enabler to act as a growth driver for financial services space across globe.

Development of vibrant Bond Market

While equity and quasi equity markets have been performing well, it is important to also develop a vibrant bond market to support the development of infrastructure and other allied sectors in the country. In the current years' budget, the finance minister also proposed key initiatives including extending foreign investment to unlisted debt securities and pass-through securities. Going forward it will be important for the government to take initiatives which will create a deeper bond market for meeting the long term capital need. Bond market in the country is just picking up pace and still at a very nascent stage of development and a lot needs to be done towards this end.

Success of Direct Benefit Transfer

Under the 'Direct Benefits Transfer' or 'DBT', the entitled benefit from several schemes of the central government in the form of subsidy, stipend, scholarship or other monetary benefits is directly transferred to the beneficiary's bank account which will eventually be linked to an 'Aadhaar' number. During financial year 2015-16, an amount of over Rs. 61,000 crore was distributed to over 30 crore beneficiaries, using Direct Benefit Transfer[3].

DBT has resulted in significant savings across welfare schemes. The Prime Minister emphasized the importance of creating a platform that is error-free, and would ensure that the targeted beneficiaries receive their benefits in time.

The government has also asked the states to set up their own 'DBT Cells' which will create a better impact. DBT significantly helps curtailing the red tapism as well as reduce the out go on account of duplication of transferring the benefit. In the next five years, success of DBT schemes will allow the government to channelize the savings and resources for alternative purposes.

Financial Inclusion

Financial inclusion is an important priority of the government. The objective of Financial Inclusion is to extend financial services to the large hitherto un-served population of the country to unlock its growth potential. Pradhan Mantri Jan-Dhan Yojana (PMJDY) envisages universal access to banking facilities with at least one basic banking account for every household, financial literacy, access to credit, insurance and pension. Under PMJDY 22.18 crore accounts have been opened with a deposit mobilization of Rs. 39,153 crore (http://www.pmjdy.gov.in/).

Other areas

Investor education, introduction of innovative products, increasing the participation of the masses in the capital market, creating tax and administrative friendly architecture for investors, etc are likely to be other key areas which would pose some challenges in the near future.

Conclusion

To conclude, the pace of the technology and the innovative financial products is the theme of the recent times. We have come a very long way from the more capital restrictive policies pre 1990s to almost near capital free economy in the year 2016. The continuous opening up of various sectors by allowing foreign capital participation will be beneficial to the economy. This will definitely help a sustainable growth for the capital market players in India in the long term. What the government needs to focus is on gearing its resources and strengthen the regulatory and governance structures to match the pace to cope up with the change. I think, currently the SEBI, RBI and the Government of India is doing well on this path to transformation and coming up with the relevant guidelines and regulations well in time. On one hand, the government is providing necessary impetus to the start ups and providing them a good platform to grow, expand and nurture the entrepreneurial capabilities, on the other hand, the established Financial Services sector players will need to be aware about the challenging times ahead and nurture and promote culture of innovation, continue to transform their business models and device strategies to cope up with the change. Given the changing times, the financial services sector as whole and capital markets in particular will be faced with many challenges but at the same time, it will provide enough opportunities for proactive players to emerge as outperformers.

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1 www.sebi.com

2 Fact Sheet on FDI from April 2000 to March 2016 published on the website of DIPP.

3 PIB Press Release dated 10 May 2016 titled "PM reviews progress of Aadhar and Direct Benefit Transfer programmes"