Indian Capital Markets – Anchoring the India Story

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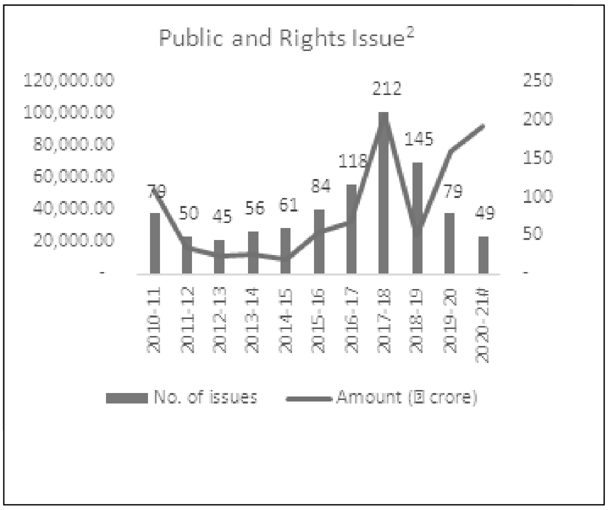
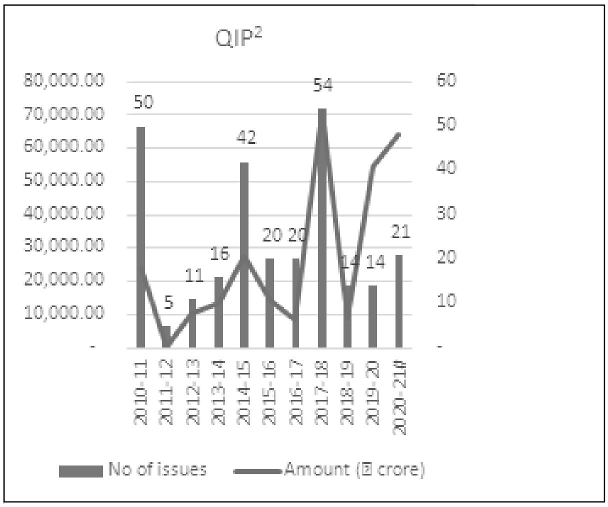
Capital markets being the backbone of an economy, channelize surplus funds from savers to institutions, for investment in business and for economic growth. They facilitate in distributing risk in a financial system through widespread investing by promoting the usage of innovative and cost-effective financial instruments. For a growing economy, an efficient capital market helps in the effective allocation of financial resources for all sectors including infrastructure. The average fundraising through capital markets in the last few years has just been short of INR 10 trillion for equity as well as debt put together[1]. Currently, Indian capital markets being at an all-time high even amidst the recurring waves of the COVID-19 pandemic, reflect the exceptional resilience shown by Indian corporates.

Government of India's (GOI's) structural reforms and sustained policy action in the past few years has resulted in improvements across both Corporate as well as Bank's balance sheets. The Insolvency & Bankruptcy Code of 2016, as amended from time to time, the GST reforms in 2017 and a tweak in the corporate tax rate in 2019, are all reforms that have strengthened the economy and induced greater issuer as well as investor confidence. Foreign investment has been, by and large, steady over the past few years, and India's position for attracting manufacturing investment has gradually improved. While these may appear to create a win-win on their own, there is also the strong element of Production-linked Incentive (PLI) to support the domestic industry. The existing competitiveness, therefore, now has a broader canvas through the PLI scheme of Government of India. Added to this is a strong focus to discourage non-essential imports. Corporate earnings as well as the resurgence in the BFSI sector have amply demonstrated that the India growth story remains intact and the initiatives by GOI have brought India on the cusp of a sustained economic growth cycle. On the pandemic side, everything is dependent on the vaccination programme, where the Government is targeting to vaccinate a very substantial portion of the population by 2021 end.

The corporate investment cycle continues to be subdued resulting in the Government shouldering the growth engine responsibility with an aspirational target of a $5 trillion economy. The focus continues to be on developing world-class infrastructure with an eye on simultaneously fast-tracking economic growth. The National Infrastructure Pipeline (NIP) plan announced in August 2020 with an outlay of around INR 111 trillion over FY'20 to FY'25, is a major step in this direction. The funding of these projects through asset monetization, equity/ debt fundraising brings capital markets into sharp focus for generating capital to be invested to not only drive infrastructure development but also achieve sustainable long-term growth. When you add to this the focus on improving the operating environment in the form of corporate tax and labour reforms, the growth intent is more than abundantly clear. The market itself is very focused on the normalisation of the demand situation as well as the efficiency gains due to innovations to combat tough times. A higher influx of global capital and rapid regulatory strides have consequently advanced Indian capital markets.

Indian corporates have a wide range of instruments at their disposal to raise both equity and debt capital. SEBI needs to be commended in this regard in constantly evaluating the regulatory regime and bringing in best practices. While the capital issued through public and rights issues have shown a marked recovery, in terms of capital issued, from FY'18 to FY'21, the number of corporates accessing capital markets has steadily declined from over 200 in FY'18 to less than 50 in FY'21 (till December 31, 2020). A similar trend is evident for qualified institutions placements as well.





While some of the recent impact can be attributed to the pandemic, one must hasten to add that SEBI has been extremely proactive in terms of easing the regulatory regime so that corporates can raise much-needed capital to tide over the hard times.

The fresh demand for capital is likely to emanate from:

1. Capacity utilization steadily increasing will result in private investment witnessing a pickup sooner rather than later. As demand picks up, companies in the manufacturing sector will look to the capital markets to fulfil their need for equity.
2. The GOI's focus on raising fiscal resources results in not only the investors getting a chance to own a piece of the large public sector giants but also gives resources in the hands of the Government to invest mainly in infrastructure projects, which have a multiplier effect on all sections of the economy.
3. India's mature and vibrant ecosystem harbours numerous start-ups and new-age companies that are coming of age. As and when these companies scale up and go public, the demand for capital is likely to be humungous.
4. GOI's ambitious disinvestment plan includes the mega public issue of the Life Insurance Corporation of India, which could potentially be the largest initial capital issuance the Indian markets have ever seen.
5. Banks are also priming themselves for the credit requirement of the economy and have been raising capital from the markets, a trend that is expected to continue going forward.

All of the above bodes well for Indian capital markets simply due to the scale of the requirement and the diversity of the issuers.

The next phase of growth requires greater use of technology to enhance the capabilities of market intermediaries, like the introduction and wider usage of UPI in public issuances.

1. SEBI has, as ever, been in the forefront of making Market friendly changes, which include inter alia the appointment of Independent Directors mandatorily through a special resolution and rationalizing the disclosure requirements for public and rights issues. While the former will bring out better Corporate Governance, the latter will reduce the time taken by corporates to raise capital from the markets. Preferential issue, the most widely used method to bring in capital through private placement, has been further liberalized by providing a pricing formula for diverse situations which is a welcome departure from a 'one size fits all' approach. QIPs can now be a combination of fresh and offer for sale and are one of the modes to achieve minimum public shareholding.
2. Incidentally, SEBI's discussion paper with respect to reducing lock-in period, rationalizing definition of promoter group, streamlining disclosures for group companies, and replacing the concept of promoter with controlling shareholders, as and when notified, will bring the Indian regulatory regime closer to its global peers and will further enhance the attractiveness of Indian markets for foreign portfolio investors.
3. The Government's focus on opening various sectors to foreign direct investments, in terms of which limit has been raised from 49% to 74% in the insurance sector, also paves the way in a sector where there is a huge, untapped growth opportunity and requirement of substantial capital to fund growth.
4. Depository institutions - CDSL and NSDL, increased the foreign ownership limits for all listed companies to their sectoral limits and have started disclosing the foreign investment limits for Indian securities addressing the concerns on the timeliness, quality, and standardization of the data. This is a big positive for India as its weightage will go up in the index funds.

The last couple of years have seen a declining trend in the number of issuers raising capital through SEBI prescribed modes. India has numerous small and midcap companies who are participating in the India growth story and have the potential to scale greater heights. Specific policy initiatives are the need of the hour to provide such companies with greater access to capital and ease of doing business. Focus on governance quality and auditing standards have long been recognised as imperative for wider investor participation.

Going forward, further work can be done in the following areas to develop the capital markets:
1. **REIT / INVIT** - SEBI has been taking gradual steps to enhance retail participation in REIT and INVIT.
2. **Listing of AIFs in India** – Regulatory framework can be revisited to popularise listing of AIFs. These would provide another avenue for investors to participate, based on their risk appetite.
3. **SPACs** – SPACs have been gaining popularity in the US markets. As the role of private equity funds is increasing in Indian companies, such innovative structures can be looked at to develop the public issue market.
4. **Making it easier for companies coming out of IBC to go public** – IBC has been successfully helping the Indian economy to deal with NPAs which have accumulated in the banking system. A framework that can facilitate breaks from the past in terms of compliance, consolidation and illiquidity needs to be put in place to enable such companies to raise capital.
5. **Privatisation of Public Sector Banks** – While the Government has announced its intention on the issue, a clearer path in this direction will help the market in ensuring a win-win for the Government as well as the investors.

India has a target to be a $5trillion economy and efficient capital markets along with focused regulatory action will definitely help anchor this objective.

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1 Source – SBICAP-Investec Research
2 Source – SEBI Handbook of Statistics 2020