What is Deepening Investor Pools in Indian Capital Markets?

Gaurav Sood
Head-Equity Capital Market
Avendus Capital Pvt.Ltd.

With India on the cusp of establishing itself as an economic superpower, it has become impossible for any large global Investor to ignore the India growth story. While there have been periods of high volatility due to market disrupting events such as Demonetisation, the DHFL Crisis and the COVID-19 Pandemic, overall depth in both primary and secondary markets has improved significantly. This in turn has led to the evolution of the Indian Capital Markets over the last few years.

Over the years, secondary market performance has been as a leading indicator to primary market activity. With volatile markets in the near term, the market is in a wait and watch strategy with respect to IPOs. We feel that there will be an uptick in Pre-IPO fund raising activity in the quarters to come as companies that had planned a fund raising through the public market route will now need alternative avenues till markets stabilise. Opportunistically, Pre - IPOs will also be used for establishing a pricing benchmark, supporting the current company valuation, improving the public perception of the company by roping in marquee investors, discretionary allocation to large investors, and downsizing large Private Equity stakes in the company before going public. In the long term, however, IPOs will continue to be a very important strategic consideration for corporates.

In terms of investor interest, Foreign Institutional Investors (FIIs), including Sovereign Wealth Funds (SWFs) and Pension Funds, have been big believers in the India growth story. FIIs in the last few years have increased weightage for India vis-à-vis other emerging markets and we believe that this trend is only the beginning of a long journey. Although FIIs have been net sellers since the beginning of October 2021, they have been net buyers in 7 out of the last 9 calendar years since the beginning of 2014. In the period 2014 – Sep 2021, FIIs have invested a record total of ~ INR 4,800 billion in the Indian Capital Markets. Today, the confidence in the Indian growth story is so robust in the minds of FIIs that even classical public market investors are taking positions in series E/F/ late stage/ Pre - IPO fund-raising rounds.

FII pool has further widened in the last few years as we have seen new classes of investors such as SWFs, Pension Funds and new to India FIIs, emerge as Anchor Investors in capital market transactions. Anchor Investors (referred to as cornerstone investors in some global markets) lead the IPO in terms of both pricing and demand. This helps in creating momentum with other investor classes such as High Networth Individuals (HNIs), Institutional Investors and Retail Investors. The response by anchors investors has a strong bearing on demand, after market performance and overall success of the IPO. In today's volatile market conditions, the importance of having a high-quality anchor book has become even more critical as the broader investor universe wants a reassurance that the IPO is valued fairly.

There has been a strong influx of new investors in Indian primary markets especially in the consumer technology and overall technology space. Tech IPOs in India saw strong demand from global investors driven by India's strong consumption story and the significant growth opportunity vis-à-vis the Total Addressable Market (TAM) represented by 600 million+ internet users. Going forward, while there is a strong pipeline of issuers getting ready to list in India, along with strong interest from investors for these issues, investors will want to invest in companies that are fundamentally strong and show a path to profitability in the near term.

While the above investors are driven by the growth opportunity in India, in the last 5 - 6 years, yield focussed investors such as SWFs, Pension Funds and Insurance Companies have shown strong appetite for Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs). These investors have a long-term investment horizon, prefer a mix of equity and fixed income like security which offers predictable cash flows at fixed intervals, want capital gains at the end of expiry from their investments and ideally look for high single digit dollar returns. Professional management of assets, mandatory distribution of income with unit-holders, growth options by acquiring new assets and having the government as a counter party to big ticket infra projects boosts investor confidence in this space. Retail investors, too, get an exposure to commercial real estate/ big infrastructure projects due to the relatively low-ticket size of investments, low risk, steady returns, and easy exit if the underlying projects don't deliver, as opposed to privately owning the property and taking on complete investment risk. REITs/InvITs collectively raised a total of INR 548 billion in FY21. With favourable government policies and opening of private investments in critical infrastructure sectors such as power, digital infra, ports, highways and railways will further attract marquee investors bullish on the India growth story.

Over the last few years, another theme beginning to emerge among FIIs, in capital markets is ESG(Environment, Social and Governance). Record volumes of funds have entered the global ESG space, and this momentum is expected to continue in the years to come. While Europe accounts for half of the global ESG assets, the United States has had the strongest expansion over the last 2 years. The next wave of growth in ESG could come from Asia — particularly Japan, China, Malaysia, and India. Exclusionary screening (excludes from the investment universe, companies, sectors, or countries involved in activities that don't align with global standards across human rights, labour practices, environment, anti-corruption, or with the moral values of investors) makes up the biggest proportion of ESG investing. Even in the Indian Asset Management Industry, ESG funds are significantly growing year-on-year. Asset Management Companies (AMCs) are launching equity schemes and Exchange Traded Funds (ETFs) in the ESG space under the thematic category. There was an inflow of INR 49 billion in FY 20-21 in the ESG space. Assets Under Management (AUM) of ESG schemes has jumped over three times over the past two financial years to INR 118 billion. SEBI has also now made it mandatory for the top 1,000 listed companies by market capitalisation to publish structured sustainability reports from FY 22-23. While India has been slower to adopt the ESG theme compared to western counterparts, going forward, we feel that ESG considerations will become an integral part of the overall investing framework for asset managers in India. A key challenge for market participants has been to manage growth in a way that combats rising concerns about greenwashing - a form of marketing spin in which green PR and green marketing are deceptively used to persuade the public that a firm's products, aims, and policies are ESG friendly.

While FIIs have continued to invest in India, participation from Domestic Institutional Investors (DIIs) in the capital markets has also grown significantly. DIIs have put in > INR 2,200 billion since the start of 2021 in the markets. DIIs are actively participating and leading IPO valuation and demand and are looking for allocations at the same level and stature as FIIs. Multiple IPOs since 2015-16 have been led by DIIs. Most recently, LIC, the biggest IPO ever in India, saw ~ 90% of the anchor book being allotted to DIIs. The emergence of DIIs is led by strong inflow of retail money getting channelised through SIPs and direct equity routes. Active DEMAT accounts jumped by ~ 63% in FY22 to > 90 million. The Mutual Fund (MF) Industry has seen a constant growth over the last few years and this trend is expected to continue as the industry penetration is still low compared to other global markets. Despite a healthy compounded annual growth rate of 16% in AUM over the past five years, the MF industry in India remains significantly under-penetrated. Compared to other global peers, India's mutual fund AUM-to-gross domestic product (GDP) ratio is as low as 16%, against the global average of 74%.

Overall, from a long-term perspective, we have never seen such abundance of liquidity in Indian capital markets. While there can be temporary blips driven by both global and local factors, we feel that there is strong potential for growth and development of the market ecosystem in India in the years ahead.