Capital Markets and 'Aatmanirbhar Bharat'

Navneet Munot
Managing Director & CEO
HDFC Asset Management Co.Ltd.

Over the last few years, India has been rising up the pecking order of global economic landscape on various parameters. Indian capital markets too have come a long way. From a dozen odd brokers trading under a banyan tree over a century ago, to becoming the 5th most valued stock market in the world, Indian capital markets have traversed an interesting journey. Some call India 'the bright spot' in global economy, others call it 'an oasis of hope' in an otherwise challenging global macro-economic environment. All said and done, India's ascent in global economic landscape has been quite commendable. A unique combination of Democracy, Demographics, Demand and Digitization give India a potent force to take the next step, or rather the next leap towards becoming a global superpower.

India recently surpassed China as the most populous country in the world. While this headline may have caught the attention of people around the world, India's candidature as the next big economic superpower had already been established before this change in the demographic pecking order. Going forward, emphasis on ease of doing business, focus on physical, virtual and social infrastructure, improvement in quality of life can pave the path for a robust, sustainable and inclusive growth. Unlike China, where the growth model has been state-driven and environmentally unsustainable, in India, one can expect the growth to be more inclusive, driven by entrepreneurship and with the Government acting as a facilitator. Vibrancy of Indian capital markets makes India's growth more inclusive too.

India young today!! Need to brace for the future though

While change in population pecking order happened recently, this development was on the cards for quite some time. China's now-discontinued but once controversial one-child policy meant that this reversal in population leaderboard would happen sooner or later. Few months ago, China reported a decline in its population and brought the focus back on demographics. While an aging and shrinking China has many implications for the global economy, it has also brought into focus the potential challenges that could be faced by the elderly, especially in an aging country, where the working age population could be outnumbered by the elderly. With an inverted pyramid, also known as 4-2-1 problem (4 grandparents and 2 parents being dependent on a single child) and lack of social security benefits, China is staring at a demographic predicament. Although, India's population is relatively young (median age of 28 years vs 38 years for China) and is expected to decline only after 2050, steps in the right direction today could avoid the possibility of a large greying population without any means for sustenance. As ironic as it may sound, gradually increase in life expectancy (doubled from ~35 in 1950s to ~70 now and expected to increase further) creates a different set of challenges.

Financial Planning for retirement: A goal not too far

India, on its part, has done a commendable job on the front of social security over the last few years. Success of JAM trinity (Jan Dhan Account, Aadhar, Mobile Number), which facilitates direct benefits transfer of welfare subsidies into bank accounts of the needy, being a case in point. Other flagship schemes like Pradhan Mantri Awas Yojana (PMAY) -Housing for All, Swachh Bharat Abhiyan for universal sanitation coverage, PM Ujwalla Yojana, PM Suraksha Bima Yojana, Atal Pension Yojana etc. have also been steps in the right direction. However, even beyond the efforts of the Government, a lot needs to be done for social security of the masses, especially those in old-age. Rise in share of gig workers, without noteworthy social security benefits, also brings into the focus the need for financial planning. Consequently, the onus shifts to the often-overlooked financial goal of retirement. In fact, it would be fair to say that retirement planning is by far the most critical financial goal owing to multiple factors. Firstly, for most people, retirement is a certainty. Secondly, with medical advancement and increasing life expectancy, the numbers of years one lives post-retirement has increased; however, the number of years is an unknown variable which makes retirement planning critical, yet challenging. Further, considering that retirement is a goal which is in the distant future, most people tend to put off planning for retirement till it's too late. And even those who do plan, undermine the impact of inflation (both, price and lifestyle) over a long-time frame.

Lack of retirement preparedness a challenge for developed nations too

The lack of financial preparedness is not restricted to India alone. Globally too, retirement savings gap has widened over the years. According to World Economic Forum, the retirement savings gap had widened to USD 70 Trillion in 2015 for eight of the world's largest economies. That number is expected to further increase to USD400 Trillion by 2050. In US too, a staggering 26% of non-retired adults did not have any retirement savings, as per a US Federal Reserve Survey of 2020. In US though, existence of social security still provided the saving grace, which was the most common source of income in retirement (~80% US retirees received income from social security in 2020, as per US Federal Reserve Survey). Even developed European nations like UK, France etc are facing challenges on this front. This goes to show that the challenge of inadequate retirement planning has not even spared developed economies with a long history of investing in capital markets.

Long term wealth creation through equities the way to go

In India, in absence of similar retirement benefits, and with retirement age lower than most major economies, the most likely avenue for creating retirement corpus is through investments in risk assets like equities, provided the same is done with long-term investment horizon. From a long-term stand point, equity happens to be a key asset class to generate inflation-outpacing returns. Equities, especially Equity MFs, could intuitively be the go-to investment avenue for investors to create a retirement corpus over a 15-20 year time horizon, if not more.

Historically, household savings have been skewed towards physical assets

Over the years, Indian households have allocated a disproportionately high share of wealth to physical assets. An average Indian household holds majority of its wealth in Real Estate and Gold, with financial assets accounting for a significantly small component. This is pretty unusual in the global context. Equally noteworthy fact here is that despite the large component of real estate in household wealth, not many Indian households expect to use it to meet their expenses in old age. As per RBI's Household Finance Committee Report (2017), more than 50% of households expect to rely on support from their children during old age, banking on the uncertain income-generating capacity of future generations. Thus, large component of nation's wealth being locked in largely illiquid assets does not help either the country at large or the investors themselves in old age.

Change in household savings mix already underway

Recently, this trend has changed with an increase in financialization of savings. More importantly, mix of financial savings has witnessed a transformation too, with many investors diversifying their portfolio beyond conventional instruments like Fixed Deposits. Increase in Demat accounts and SIPs bear testimony to this. In spite of the recent increase, there is still a long runway ahead, considering that overall equity penetration in India is barely 5%. Direct participation in equities may not be the way to go though. A recent study by SEBI showed that 89% of individual traders in the equity F&O segment incurred losses, with an average loss of Rs 1.11 lakh during FY22. Excessive risk taking by investors dabbling in direct equity is fraught with risk. A more prudent way of investing in equities is through wide array of Mutual Funds and with a long-term horizon.

Even beyond wealth creation, capital markets play a critical role for the economy

Increase in depth of capital markets is critical for India's growth aspirations. Mutual Funds, investing in a wide array of instruments like Equities, Debt, Commodities, REITs, InvITs etc can play a key role here. To meet India's ambitious infrastructure development and growth objectives, there is a huge need of risk capital, which could be met through domestic as well as foreign flows.

Healthy equity flows will also help the Government to feasibly monetise its assets. Even in start-up ecosystem, there is an enormous need for risk capital. While, entrepreneurial ambitions of young India combined with a funding boom, post 2020, has spelt a golden period for Indian start-up ecosystem, bulk of this funding has been from foreign VC firms. Looking ahead, getting Indian risk capital to fund entrepreneurial ambitions in the country is another goal worth pursuing.

Over the past few months, India has witnessed surge in FPI inflows. This follows a prolonged period of outflows over the last 2 fiscal years. While foreign flows into equities here are more than welcome, they tend to be volatile and expose the equity market to the risk of capital flight during tough times. Robust domestic equity flows make the equity market less susceptible to shocks from foreign capital flight – something which we witnessed last year, when inflows from DIIs, especially Mutual Funds, helped to counterbalance FII outflows and kept Indian equity markets largely resilient. This has a positive ripple effect on the overall health of financial markets, and in turn, macro-economic stability of the country. Further, having wider participation in equity markets could enable more equitable distribution of wealth in the society as more people would be able to participate indirectly in the nation's growth story.

Strong domestic equity flows can also encourage foreign investors, as the counterbalancing stability provided by domestic flows can provide another dimension for foreign investors looking to invest here. Over the years, foreign investors have viewed India as one of the preferred investment destinations, owing to favourable macros and diverse bottom-up stock-picking opportunities at the micro level. Stability provided by domestic flows can provide the third element of interest for foreign investors.

While we have overtaken China demographically, we still have a long way to go on other fronts. For instance, in 2021, China's per capita income ($12,556) was 6 times that of India's ($2,256). Bewilderingly enough, in 1990, India's per capita income ($368) was higher than China's ($318). This divergence over last 3 decades could be attributable to China's focus on manufacturing and infrastructure, both fronts which have been at the forefront of Indian policymakers' agenda over the last few years. Likewise, India could take other cues as well from the east and the west, emulate their fruitful measures, avoid their follies; and unlock our true potential in Amritkaal (2022-2047).

In view of the above, it is imperative that policy environment remains conducive for encouraging investment in long-term risk-assets like equities, through investment vehicles like Mutual Funds. All said and done, while we focus on indigenization of various aspects of our economy, we would do well to not overlook the importance of domestic risk capital in making the nation economically and our population financially 'Aatmanirbhar'.