India Report 2017

Capital Market Structure

Indian capital market has a history of setting up the first stock exchange in Asia in 1875.

Currently, India has three major equity stock exchanges viz Bombay Stock Exchange (BSE), National Stock Exchange (NSE) and Metropolitan Stock Exchange of India (MSEI) and two major commodity exchanges being Multi Commodities Exchange (MCX) and National Commodities & Derivatives Exchange (NCDEX). India’s leading stock exchanges BSE & NSE are at leading position of 11th & 12th receptively in terms of market capitalization in the world.

There are two major depositories CDSL and NSDL which have completely online system today, accounting for assets worth $ 2.38 trillion in listed stocks.

There are over 2000 registered broker-dealers doing proprietary trading, retail and institutional clientele business.

India has a very robust banking network made up of large nationalized banks and private sector banks. This forms the base of any financial market.

India has a very strong regulator SEBI (Securities Exchange Board of India) set up in year 1993. SEBI is not only a strong regulator but also a strong proponent of new age ideas, practices, products & services to strengthen the fabric of the Indian financial market.
Geographical Statistics

Unity in diversity is how we would define India, which has 36 states and union territories, 780 languages, many religions and different cultures across the country. A total land of 3.28 million sq km is divided into 640,000 villages and 330 towns/cities. India with a population of 1.3 billion is the second most populous country. The population is spread across geography, though very densely populated in central states and less densely populated in north eastern states. It is like many mini markets within one big market.

Key Economic Statistics

Population

India with a population of 1.3 billion has the second highest population in the world moving towards becoming the country with the largest population. This has led to a large consumption driven growth in the economy and likely to gain pace as it is driven by a young population. Many economies are purely dependent on world consumption whereas India’s prospects are bright as it has a large consumption plus a large production base with 65% of the population being below the age of 35 years. The population assists in growth of the economy at the same time increases pressure on the existing infrastructure of the economy.
Also it is a challenge to employ such a large existing workforce with 15 million added to these numbers every year. The population has a relatively low level of literacy, which makes it even more challenging to gainfully employ the new workforce.

![Population chart]

**GDP**

Fifth largest and the fastest growing economy in the world having a GDP of $2.54 trillion has grown approx 7.5% p.a. vs. 3.3% p.a. of world growth in the last 3 years. India’s industrial sector accounts for 29.09% of the GDP, agriculture is 13%, and service sector dominates with 53.5%. This makes it part of the industrialized nations of the world.

India draws its strength from its own growing consumption story which is likely to stay for many years to come. Recent government initiatives on export and MAKE IN INDIA, along with strong infrastructure development and a large scope to grow infrastructure from its current levels is likely to see India growing at a fast pace.

Agriculture accounts for 13% of the GDP, while about 52% depend on it for living. There is clearly an over dependence of GDP on the services sector and which may pose a challenge to sustain current level of growth.
Market Capitalization

BSE has more than 5500 companies listed on it with a market capitalization of more than $2.2 trillion. The market capitalization has been steadily increasing. It has grown more than 30% in the last 5 years.

Indian stock markets have a large number of companies bringing in the diversification and robustness in the market. Though Indian markets have a high market capitalization, it is concentrated among the top few companies. 93% of the market capitalization is accounted for by the top 500 companies. Over 15% of this is held by FIIs (Foreign Institutional Investors). Many of these companies have reached the threshold limit of FIIs investing in the company. The reason for the markets not looking beyond the top 500 companies is the confidence on the corporate governance in these companies.
Transparency and governance are likely to improve with regulations becoming stringent and many forward looking changes being enacted. Government is taking huge steps towards digitization of payments and other processes which will also help overcome this obstacle of corporate governance in the coming years.

**Investor Base**

In India Investor base is very transparent. Each and every investor needs to register his ‘know your client’ details as per norms of the regulator and government. This also makes it easier to understand the demographics of the investors and plan strategies in the market. India has a base of 29.7 million demat account holders. Additionally, the number of mutual fund folios in the equity mutual funds as on September 2017 stood at 45.8 million. Total investor accounts have grown over 40% in last 5 years.

![Investor Base Chart](chart.png)

(Total equity investor accounts = 75.5 mn. Estimated unique accounts = approx 50.0 mn)

The total percentage of the population investing in equity markets is less than 4%, which is lower than many countries like USA where the number is as high as 55%. There is scope to increase the investor base, which would increase with overall increase in literacy levels and efforts by regulator, exchanges and other market participants to disseminate knowledge through investor awareness seminars. One important reason for low investor base is the love for physical assets like property and gold in India. India is the largest importer of gold in the world and among the top 5 components of imports in India. A self owned property is pre-requisite to having a basic standing in the society for every family. Equity markets are also looked upon by Indian diaspora as speculative in nature rather than a long term investment avenue. These pose a strong challenge to the growth in Investor base.
Indian Capital Markets Framework

Indian stock markets have evolved as leaders in terms of technology. There is completely 100% screen-based trading in India and the complete trading is in dematerialized mode. BSE boast of being the fastest exchange in the world with a median trade speed of 6 microseconds. We are currently practicing T+2 system, which means settlement of position is done on the third day, while for derivatives it is T+1. There is strong prevalence of HFT & Algo based trading. The capital market structure is well developed with regulator, exchanges, depositories, banks, broker-dealers making a very cohesive, comprehensive and coherent structure. There is a large participation of foreign institutional investors. They account for more than 20% of the market turnover. There is a vibrant derivative market across equities, commodities and currencies. The total turnover in equities derivatives market was $14.5 trillion and $1 trillion each in commodity and currency derivatives market during year ending March 2017.

The industry has a large number of broker dealers, who compete mostly on the pricing, bringing down yields consistently year or year, whereas the cost of operations is increasing due to newer technologies being adopted regularly in the industry which will have cost benefits in the long run, but is weighing heavy on the balance sheets in the short run.

Government sees the stock markets as a means of increasing the revenue base, by introducing taxes. Government finds ease in introducing these taxes as it is seen as a tax on disposable income which is invested, which is a politically safe move. The result of the high taxation is that FIIs have found alternative markets like the Singapore exchange which replicated the NIFTY index. They benefit from lower cost as well as ease of transaction where in India there are registration formalities. FIIs also shy away from the changing stance by the government on tax treatment of foreign entities especially on capital gains. This is a big challenge which the industry faces. High cost and strong regulation has also led to an informal market running parallel with the organized market. SEBI is a boon to the industry, but also due to higher number of regulations and micro management to some extent has led to impediment in the smooth working, and at the same time increases the cost of operation.

Recent Reforms

The current government has been doing a lot of reforms.

Demonetization: The use of all 500 and 1000 rupee banknotes became invalid overnight in November 2016, which accounted for 86% of the total currency issued by RBI. The Demonetization was done to tackle the issue of black money, lower the circulation of cash, which is directly linked to corruption and eliminate fake currency.

Goods and Services Tax (GST): There were numerous taxes levied by state and central
Governments. GST unified many such taxes into one common tax across the country. This is seen as one the biggest reform in the Indian economy. GST has led to ease of doing business and reduction in logistic costs.

**FDI In several sectors:** Cumulative FDI in India stood at $ 498.9 billion. The country received the highest ever FDI flow of $ 43.5 billion in 2016-17. Government has announced several steps to attract foreign inflows. The measures include liberalization of FDI policy and improvement in business climate. India has become the fastest growing investment region for foreign investors in 2016, led by an increase in investments in real estate and infrastructure sectors.

**Thrust on Make in India:** This initiative ensured reduction in custom duty on many items, proposal to cut corporate tax over the next four years, cutback in taxes for technical services, facilitating cheaper technology transfer, tax breaks and incentives in many sectors, placing restrictions on direct purchase of supplies that are not adding significant value. The initiative invites large corporates across the world to manufacture in India offering them markets and incentives to set up manufacturing facilities in India.

**Infrastructural Development:** The infrastructure sector is one of the key drivers of the Indian economy. Government has allocated $ 9.8 billion for national highways and state governments have allocated $ 1.2 billion for road development. Government also announced the construction of 2000km of coastal connectivity roads. Power sector is the thrust area of the current government which has the aim to electrify 8,452 un-electrified villages within 1,000 days by May 1, 2018. The country is setting up high speed corridors, with the first bullet train to come up from Ahmedabad – Mumbai. Metro rail is being promoted across various urban cities. Overall there are large infrastructural developments happening across the country.

**Ease of doing business:** India’s performance in world Bank’s ease of doing business report has jumped up 30 ranks to come at top 100. This significant jump has been the result of multiple reforms of the government over the last few years. India is among the top ten improvers this year with an improvement in ranking of six out of the ten indicators. It is even more significant because since it is happening in such a large and complex country. In protecting minority investors, India is ranked fourth, up from thirteenth place last year.

With all the strengths and challenges, we believe Indian capital markets should further mature and will attract more domestic and foreign capital in the years to come.