Developing Capital Markets to Develop the Economy

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Indian capital markets have attracted a lot attention across the globe. Besides poising robust growth over the last decade backed by returns, Indian Capital markets have attracted huge capital inflow from domestic as well as foreign investors. However, domestic savings into the Indian capital markets remains under penetrated. There arises a need to create a suitable mechanism backed by strong processes and innovative financial instruments which encourage savings right from the grass root level, mobilizing them into the capital markets. Additionally, the changing landscape of financial markets brought about by evolving regulations, shift in consumer demand and changing demographics is redefining the financial services industry.

The Growth so far: After the global financial loom and after effects, 2010-11 witnessed a strong recovery of Indian capital Markets. Not only has it shown the resilience of the underlying economy backing the capital markets but also has set pace for steady growth in the coming months. The confidence reposed in the Indian capital markets and increased appetite for risk, strongly reflects in some key markets indicators.Growth of the Indian economy was 8.6% during 2011-12, this fueled full measure activity in the capital market. Net capital inflows increased to USD 123.3 Bn in April 2011 as compared to USD 92.1Bn in the same period of 2010. The dominant flows obviously came from foreign institutions investors and trade credits, however foreign direct investment remained on the lower side. 40 companies listed on the BSE-NSE in 2010-11 with a consolidated value which was 33% higher as compared to the 39 companies which listed in the previous year. Resources mobilized through the capital markets 3.5 times higher in 2009-10 at Rs 57,555 Crs as compared to 2008-9. The derivatives market was equally buoyant in 2009-10. Equity derivatives segment of the NSE increased by 60.4% over the previous year. Currency futures segment at NSE recorded Rs. 17,82,608Crs in 2009-10 as compared to Rs. 1,62,563 Crs during 2008-09. Trading on the mutual funds was Rs. 62,959 Crs as of April'11 with an inflow of Rs.9,629 Cr in equity and Rs.1,01,333 Crs in the debt segment. Outflows as of April'11 were relatively lower at Rs 48,466 Crs as compared to Rs 65,372Crs reported in April'10. These key data points only point to the fact that the formidable Indian bourses have done well.

This growth in mobilization of resources has been spear headed by a favorable macro-economic environment. It is but time that we take some steps collectively to ensure that this growth is participative, sustainable & resilient, for India to remain a favored destination.

Good corporate governance; Concerns of institution as well as retail investors remain the same, they only vary by the degree understanding. Practices are a reflection of the integrity and credibility if capital market players. Transparency and disclosure norms by way of effective corporate governance practice lay the foundation for a robust and resilient financial system that is trusted by investors. To implement strong corporate governance practices the financial system needs to be complimented by a strong risk and control function. Over time, this should become a self-propelling process aimed at identifying and monitoring internal control.

Wider Participation: India by itself today is a formidable savings nation, with a savings rate as high as 33.7% there is a favorable environment to boost investment demand. However, the main challenge faced in these areas is lack of awareness about the diverse range of financial products available for investment. This segment of the population invests primarily in traditional assets like gold and land. It is investment into these asset classes that needs to be channelized into appropriate investment avenues. Even urban investors today possess limited knowledge and information on products, their benefits and risk attached. This is a deterrent to investment. Financial literacy and easy availability and accessibility of information is the need of the hour. Deregulation of the financial services industry and increased competition has created the need to design newer products backed by better processes and effective solutions for increasingly complex financial problems. Capital markets have the immense potential to drive the agenda of financial inclusion by not only providing investors with the opportunity for wealth creation but also by providing long term stability to the market at large by creating an ever increasing set of consumers participating the financial growth of India. Today the FMCG industry exhibits an enviable distribution model that claims to have a high penetration into rural India. This pool of customers poses an immense business opportunity symbiotic in nature. Increased penetration of capital markets is imperative for growth in the long run. With increasing needs of infrastructure funding there is a need on the development of the bond market seeking more broad based participation from both retail and institutional investors. Further most of the trading volume is dominated in the metro cities. 10 cities contribute to 80% of the trading volume in 2010 as per a SEBI report.

Corporate Bond Market Development –Funding Future Growth: The debt market in India, especially the corporate bond market has yet to make a strong foothold within the Capital Markets. As demand for infrastructure funding soars, there is an immense potential. Low retail participation, limited investors, small lot sizes and high costs of issuance are some challenges that need to be tackled with. A mature and well developed bond market is the key to economic growth, long term financing of infrastructure, housing and private sector development. Concerted efforts need to be made to make investors aware and educated on this asset class. Despite a robust regulator and a well-developed financial system, the corporate bond market is currently only at 3.3% of the GDP as compared to 10.6% in China & 41.7% in Japan. Favorable interest rates have attracted inflows from foreign investors in the corporate bond market however, this has been mostly in the short end (tenor of 1-3years) of the market. Data released by SEBI indicates that corporate bonds raised by companies in 2009-10 wereRs 21.3Crs as compared to Rs 17.3Crs. While we have seen a number of public issues, private placements have remained a preferred route of raising debt.

Technology will play a critical role in increasing penetration for a variety of financial services and products and will be the mainstay in facilitating the next wave of financial services growth in this country. This will largely be driven by improved accessibility and reduced costs. Considering India's mobile & internet penetration (active internet users) has grown significantly with already ~617 million & ~60 million subscribers respectively as June'2010, integrating mobile telephony, into customer targeting will become extremely critical over the time to come. Further, we are likely to see increasing interaction via mobile based applications, as mobile payments (e.g. e-money) will reduce check transactions. Transaction costs will see a significant drop as technology plays an important role to reach customers cost-effectively.

We have already established a fairly robust **regulatory system** in place through the various reforms over the past two decades. In the wake of the recent crisis, Indian financial system has shown great resilience partly due to the prudent regulatory framework and proactive response by the regulators. Prudency and customer protection will continue to be the core agenda for the regulators. However, the Indian regulators will need greater alignment with the foreign regulations, as increased globalization introduces common vulnerabilities and increasing demands from foreign nations towards harmonization. On the domestic front, greater integration among domestic regulators will be the natural course towards improved accessibility and investor confidence.

The fundamentals of the Indian growth story remain unchanged and by 2020 as suggested by many studies, Indian GDP is expected to grow multifold. India finds itself at the centre stage of global interest and growth. The financial sector as part of this growth story finds itself at a critical juncture in India. The various initiatives taken by the Government to meet the challenges of a complex financial architecture have ensured that a new face of the Indian financial sector is crystallizing into a strong, transparent and resilient system. And even though a sound and resilient banking system and well – functioning financial markets have helped Indian economy to rebound buoyantly and remain largely resistant from the communicable effect of the global meltdown, India cannot afford to be complacent. Over the next decade, Indian financial services sector, supported by sound regulatory decisions, promises to offer immense growth opportunities and will serve as key enabler towards reorienting both domestic and global capital flows into Indian financial markets.