How to get 10% of India to participate in the Capital Markets

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To understand India, you must first understand her past.

1986 saw the launch of the SENSEX. Coined by Deepak Mohoni, the index was created with 1979 as the base year and served as the market barometer ever since. In those days, trading was onerous and the entire turnover of the market over a year now constitutes a day's worth of trades. The 1990s witnessed the SENSEX hovering around the 5000s and was punctuated by several scams, the most infamous being the ones by Harshad Mehta and Ketan Parekh. But with heightened regulation came better governance and confidence in the Indian growth story. This is best exemplified by the SENSEX's growth to 20,000 in 2008 and 40,000 in 2019.

Overall, Indian equities have yielded a CAGR of over 16% in rupee terms from its base year till 2019 when measured by the SENSEX.

Yet while India has benefited from a healthy stock market, Indians by and large have not. India has a household savings rate of around 30%, yet the bulk of this money is still routed to the same assets for the past 40 years: FDs, gold and real estate. In spite of Indian equities outperforming all 3 asset classes, India witnessed retail participation of only 25 million people in FY 2016, out of a total population of 1300 million people. This 2% participation meant that India was at the mercy of foreign capital inflows in the form of Foreign Institutional Investors (FIIs) and Foreign Portfolio Investors (FPIs).

As a testament to the sway foreign capital had in the country, the Indian markets would ebb and flow purely on the basis of FII outflows and inflows. Even our lawmakers were cognizant of this and drafted regulations to cater to their needs. This is best manifested in income tax with all securities held by FIIs being unequivocally classified as "capital assets" and subject to capital gains, while Indian investors run the risk of it being classified as stock-in-trade and subject to tax as "income from business and profession" instead of capital gains.

Yet this changed since November 2016.

The demonetisation exercise, which saw the erstwhile rupee 500 and 1000 notes being denotified in one day, saw crores of rupees flood into the Indian markets. This converged with the rise of fintech startups with a no-broking model which fulfilled KYC norms on the back of India Stack, the combination of Jan Dhan bank accounts, Aadhar for KYC and cheap mobile phones and data packs. This cocktail of events – of digitisation and demonetisation – constituted the greatest fillip to domestic equity participation the likes of which India had never witnessed before. In 2018, while FIIs were net sellers to the tune of Rs. 340 billion, DII or Domestic Institutional Investors, were net buyers of more than Rs. 1090 billion. A prime example of this is February 6, 2018, when India introduced long term capital gains on listed equities. February 6 witnessed the Sensex crashing 1,275 points and Nifty over 300 points intraday. FIIs pulled out Rs 2,326 crore from the Indian market whereas DIIs bought in Rs 1,699 crore. This shows the bulwark of domestic capital against the "hot money" of FPIs.

Mutual funds by far represent the bulk of Indian retail participation in the stock market. As per AMFI (Association of Mutual Funds of India), the average assets under management for May 2019 stood at 25.94 lakh crore, with 8.32 crore folios. This was the culmination of 60 consecutive months of folio growth. Out of this, the number of folios in Equity, Hybrid and Solution Oriented Schemes, wherein the maximum investment is from the retail segment, stood at 7.51 crore. Adjusting for duplicates of around 33%, this translates to around 5Cr individual investors. This represents 3.85% of the population and 6.67% of the population that has a bank account (around 75 crore individual bank accounts). India needs far more participation from her populace to democratise the gains that the stock market has generated and will continue to generate.

The Indian government has articulated a vision of becoming a 5 trillion-dollar economy by 2025, with this figuring in the election speeches as well as the President's address to Parliament in June 2019. This implies a growth of at least 12% on nominal terms and requires an investment of $ 100 billion for infrastructure within the same period. For

this, the government has suggested a deepening of the debt market, increased minimum public holding from 25% to 35%, easier transfer of treasury bills and government securities between RBI and SEBI depositories, etc.
But like demonetisation, India needs bold measures to increase market access and participation amongst its populace. The key drivers for this will be:
1. Digital Access
2. Small ticket sizes
3. Calibrated risk buckets

In this regard, the following steps should be taken:

Create a mutual fund demat ac for every Jan Dhan account holder
The Jan Dhan scheme, which aimed to ensure that every household has at least one bank account, has witnessed over 36 crore Indian families getting bank accounts, with close to 1 lakh crore balances in those accounts.

Along these lines, the government should mandate that a zero charge demat account be opened for every Jan Dhan account holder. Along with this, select high-quality mutual funds with a long lock-in period should be made available to them with small investment tickets ranging from Rs 10 onwards via a SIP.

This one access will vastly improve household savings and the lock-in will ensure that the money will be used towards building a retirement corpus via compounding.

Create a 401(K) structure with mutual funds for Indian employees
India should emulate the 401(k) from the US in principle and allow Indian employees to invest part of their salaries into a suite of safe mutual funds (either dividend or growth) with low expense ratio and a lock-in period to match their employment. Allowing a tax deduction (mentioned below) linked to this will further incentivise employee and employer participation in the scheme.

Allow switches between PF and NPS to Mutual Funds with longer lock-ins
By allowing Indians to channel their provident fund or pension scheme amounts to mutual funds (debt and equity) with a similar lock-in to provident funds or pension schemes, India can vastly increase capital market participation from the over 6 crore provident fund holders while ensuring mitigated risk.

Separate tax deductions for investments into mutual funds
Specific mutual funds such as those for retirement or as a substitute for their provident fund or pension scheme should be created and investments into these should qualify for a tax deduction similar to that for the pension scheme. The current practise of placing ELSS (Equity Linked Savings Scheme) in the crowded 80C bucket should be done away with in favour of a separate category.

Allow for credit against a Mutual Fund portfolio
With the above schemes, it is imperative that credit lines be established against one's mutual fund portfolio to ensure that investors do not have to redeem their funds for emergencies. This will be especially helpful to the Jan Dhan Mutual Fund holders to ensure security along with equity participation.

Create investor education programmes in schools and at the *gram panchayat* level
One of the reasons for the low level of capital market participation is the lack of awareness of this product across India. Most investor camps are concentrated in urban areas, whereas rural participation is imperative in order to democratise our capital markets. Vernacular content along with leveraging the postal system will deepen access of these products.

Along with this, schools should have sessions on taxes and investing from class 8 onwards so that students can become comfortable with the idea of investing in a young age and can educate their parents on the same.

India is unique amongst developing nations to have strong financial markets with a deep history in financial products and yet it paradoxically has the lowest retail participation in these markets. Equities as a percentage of household wealth is a mere 6% for India, compared to 44% in the US and 48% in Hong Kong. A phased manner of introduction of the populace into equities via instruments such as ETFs and mutual funds will allow for the much needed deepening of the capital markets of India for Indians and by Indians.

India should aim to become a 5 trillion-dollar economy by 2025 and have at least 15 crore people as participants in the capital markets. The greatest growth story the world has witnessed should have Indians as active participants, not as mute spectators.