# Broking Goes Mainstream

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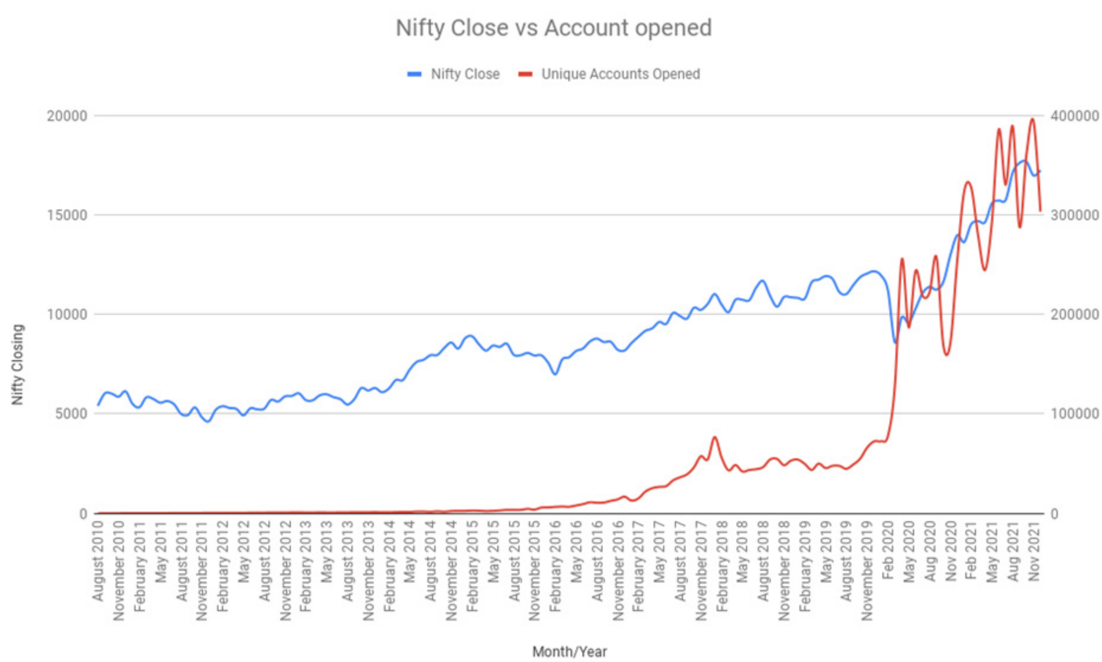
I was at the Blossom Book House in Bengaluru last week buying some comics for my son, when a 20-year-old recognised me (behind a mask!) and got really excited. In my head, I thought to myself, "hmm… why?". And this reaction pretty much defines how the last two years of the business have been for me. The broking business, and in turn, Zerodha, are now mainstream.

From personal trainers to cab drivers, to prominent business people, almost everyone seems to be slowly and steadily increasing their exposure to stock markets. I have, like many others, been questioning what all of this growth means for the capital markets, and in turn, for the country. I thought I should answer a frequently asked question around user growth, share some learnings, and as we head into the new year, maybe also take a shot at predicting the future of the broking businesses.

I would like to remind everyone that I have been horribly wrong with many of my predictions about our industry in the recent past. Actually, I have never been so wrong as I have been in the last couple of years, while thankfully ending up on the right side in terms of business outcomes. I have been right because, even though my predictions were wrong, my decisions inadvertently stuck to the trend. If I were a trader and Zerodha was a stock, maybe I would have tried to do the impossible, which is to time the market, and may have tried to exit early. I am reminded over and over that the only way to create wealth when investing is to be able to sit tight, ride long term trends, and let the magic of compounding do its thing.

**The user growth**

This chart of our monthly user growth plotted against the Nifty broadly shows our journey over the last eleven years.




**Nifty vs our account openings**

It took us six years to get the first 100,000 customers and nine months for the next 100,000. It took us eight years to reach 1 million customers and only 1.5 years for the next 1 million. It took us almost ten years to get to 2 million customers, which was around the time COVID hit, and then we added our next ~6 million customers in just 18 months. Just for added context, we added 400,000 customers in October 2021, while it took us seven years to add our first 400,000. So yes, the last 18 months have been spectacular, not just for us, but broking businesses around the world.

I think that this trend of user growth at Zerodha is maybe a better gauge of the actual market sentiments than the overall exchange data that everyone tracks. This is because all our user acquisition is organic without any marketing or advertising pushes from us. In addition, we actually charge a small account opening fee on user signups to cover our compliance costs. Most importantly, we do not incentivise people to sign up by offering random freebies. So, our new users come to us of their own accord, with a clear intent to trade or invest.

## The journey

Until mid-2015, we offered the same 3rd party white-labelled trading platforms that many other brokers also offered at the time. The first serious uptick in our user growth started when we launched our in-house platform, Kite, in late 2015. Our gut-based decision to offer 0 brokerage on all equity delivery trades in Dec 2015, along with love for the newly launched Kite, gave the business virality for the first time.

However, the tipping point was when users could finally open an account fully online using (Aadhaar linked) digital signatures around mid-2016. Until then, like banks, brokers with the most offline branches acquired the most users as opening an account involved printing and signing several dozen sheets of an account opening booklet.

Online onboarding disrupted the status quo. The convenience of opening an account online has been one of the biggest reasons for the massive increase in retail participation over the last few years. Within a year of launching online account opening, we went from opening 5000 new accounts a month to almost 30,000 new accounts a month. Of course, the launch of the Kite mobile app, Coin (our direct mutual fund platform), the success of Varsity, Rainmatter partnerships and other initiatives were why users were coming to us in the first place, all via word of mouth.

From the beginning of our business, user growth at Zerodha has been a mirror image of the Nifty mid-cap index. That changed in February 2020. For the first time, we saw a divergence. We went from opening 70,000 accounts a month towards the end of 2019 to almost 250,000 a month by April 2020, all while the markets collapsed due to COVID.

The divergence wasn't just between the underlying markets and user growth correlation. I can't remember the last time in the last 20+ years of trading the markets when so many new users made so much profit so quickly when markets recovered. This, I think, was another tipping point for the industry, not just in India but across the world. The stock market became cool for a certain younger segment of the society when they were stuck at home and had some extra disposable income to invest, which they could now, fully online. Quick profits also triggered greed, which helped market participation increase faster, probably the fastest ever in the history of capital markets. IPOs listing at lucrative premiums also caught the fancy of this younger audience. Many opened new trading accounts for extended family members, hoping to get lucky with an allotment by applying to IPO through multiple accounts. Many of these accounts that were initially opened for IPO also transitioned into direct investing and mutual funds.

## The plateau

While the growth over the last 18 months has been spectacular, we are starting to see a slowdown. This plateau coincides with the markets topping out. While the broader indices are not very far off from highs thanks to a few heavyweights, there are significant drawdowns underneath the indices. The general user behaviour we have seen in the past is that if the investments don't recover quickly from a drawdown, most users become inactive fairly quickly. So, if the markets don't bounce back quickly, the plateau could soon turn into a steep drop. It took the Indian capital markets almost ten years to add the same number of trading accounts in a year after the previous peak made in 2007, just before the financial crisis.

## This time could be different though

While I can look at the past and anticipate what could happen if the markets don't bounce back, it could potentially be different this time. The best part about the huge user addition over the past two years has been that the majority of these users are under 40 years. These users are trading with comparatively smaller amounts of money compared to their future earning potential. I don't think we have ever seen such an influx of young people as we have seen this time around In the history of capital markets around the world.

The younger users trading with smaller amounts of money, making smaller mistakes, can learn without losing as much capital as older folks did trading with the majority of their life savings. So maybe this new breed of users will not become inactive when there is a drawdown in the account, unlike in the past. And as long as this audience is active, they will continue to influence others to invest in the markets through social media. It will be interesting to see the behaviour whenever markets have a large drawdown of over 20%.

The growth in users bodes well for India. Maybe finally, our dependency on foreign capital to determine our fate and fortune will reduce over the next decade. Philosophically, this is also one of the key reasons why we do what we do as Zerodha. We believe that our country can be truly financially independent if more Indians back Indian entrepreneurs by investing in their companies vs keeping money in gold, real estate, or FDs. Wealth creation could happen locally and more inclusively.

## Future of broking

Broking is as unpredictable and as cyclical as an industry can get. Except for those two months last year, user growth has been dependent on how the underlying markets perform. New user growth is extremely important for brokerage businesses because, as I mentioned earlier, existing users tend to become inactive quickly whenever there is a drawdown in their portfolios. Brokerages have to keep adding new customers just to be able to maintain the same revenue. It almost feels like being on a treadmill, having to constantly run just to stay where you are.

With venture capital (VC) chasing the brokerage industry, the competition is also now picking up the pace like never before. The industry works on wafer-thin margins, and unlike international broking firms, there aren't as many options to generate revenue in India. At such low margins, the only brokers who will be able to scale well are those who will be able to survive the next three years. Scaling well does not only mean getting large enough for economies of scale to kick in but being ready technologically to handle the scale when it materialises. The technology required to run a brokerage firm is extremely complex due to the numerous dependencies from exchanges, depositories, clearing corporations to banks and to the vast and ever-changing regulatory and compliance requirements. What users see on the outside, the trading platforms, are just the tip of the iceberg.

As the competition gets tougher, the cost of acquisition per user is going up. The biggest challenge with the now defacto discounted pricing model is that it is quite tough to generate revenues. Instant signups also have a flip side; users aren't as sticky anymore. The industry is already finding it tough to generate enough lifetime value (LTV) to cover the cost of acquisition (CAC). Thankfully, at Zerodha, we don't spend any money on marketing or advertising or promotions, so we don't really have a CAC to worry about or compete on. Moreover, we are in no hurry to grow faster. We believe that if we focus on the quality of products and services, the rest will happen on its own. This mantra is what has worked for us over the last decade.

I do feel that we have maybe hit the near term peak in terms of an industry, and it will likely get worse before we hit the next new peak. This is because the increased competition will mean new customers getting distributed amongst multiple players. To do well in a low-cost business model, you need to be able to scale, which becomes tough when customers get distributed. Consolidation within the industry is tricky because of regulations. We are also probably close to hitting the near term peak in terms of tapping the target audience or customers with disposable income with an intent to trade or invest. With large drawdowns in international tech-first brokerage firms (Robinhood is ~40% below its IPO price and ~75% below 52-week high), new funding may not be that easy as well.

**Who will do well**

While everyone focuses on adding more users, I think brokers who can find ways to retain existing customers by finding ways to reduce the money mistakes they commit will do better than their counterparts. This potentially means foregoing revenue in the short term. It is maybe finding the right product for the users and nudging customers away from higher-risk products, while this is the antithesis of popular business models in the industry. It may sound weird coming from me, but I believe that most Indians aren't ready yet for equity as an asset class. Maybe the right product is a fixed income product where the risk is lower than equity but returns higher than bank fixed deposits. From there, equity can be introduced gradually as risk tolerance increases. Another approach might be building an advisory-first platform. These are things that I spend a lot of time thinking about.

All that said, these are exciting times for everyone tracking the capital markets. I look forward to updating this post at the same time next year, maybe every year going forward. We are in uncharted territory, and I am sure everyone who loves trading will want to track what happens to the broking industry as well.

**The ultimate investment**

As we head into the new year, the other thing I wanted to remind everyone is the importance of taking care of your physical and mental health. Full-time trading can be mentally taxing, and when you're stressed, it ultimately shows up physically.

I had also shared this recently. The number of people developing severe heart issues in my extended circle going up was a rude reminder for me. It's very easy to get caught up in the hustle and bustle of things and take your health for granted. This is even trickier given that many of us are working from home. So please do take care of your health, your ultimate investment.

Wishing that the new year brings you a lot of health, wealth, and happiness. Also hoping that 2022 will see COVID being handled much more safely and effectively.