

Transformative Decade in India's Capital Markets (2014-2024)



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Over the past decade, the Indian capital markets have undergone a profound transformation driven by regulatory reforms and technological advancements. Spearheaded by the Securities and Exchange Board of India (SEBI), these changes have significantly enhanced market efficiency, transparency, and investor protection, reshaping the landscape of equity markets, debt capital markets, and derivative markets. This period from 2014 to 2024 has been marked by introducing innovative financial instruments, streamlined processes, and a focus on broadening investor participation. SEBI's proactive approach in addressing the evolving needs of the market participants has positioned India's capital markets as a dynamic and resilient entity capable of withstanding global financial challenges and leveraging new opportunities. By fostering an environment encouraging technological integration and regulatory compliance, SEBI has ensured that the Indian capital

markets remain competitive globally, attracting domestic and international investors. This article delves into the specific reforms and advancements that have defined this transformative decade.

Digital Advancements and Algorithmic Trading

The equity markets have seen a surge in algorithmic trading platforms, transforming trading activities using computer algorithms into automated strategies. This growth, estimated at approximately 10X in terms of volumes during the last decade, has contributed to increased market liquidity, reduced trade execution times, and lowered transaction costs. High-frequency trading (HFT), a subset of algorithmic trading, has grown exponentially, injecting liquidity and enabling participants to capitalize on fleeting market opportunities. SEBI's guidelines over these years have also ensured fairness and transparency in algorithmic trading, fostering a balanced trading environment.

The transition from a T+2 to a T+1 and finally onto a T+0 (for select scripts) settlement cycle is a significant milestone in the equity markets. Implemented in phases, this reform has reduced the capital requirements for investors and brokers, enhancing liquidity and market efficiency. The move towards T+0 settlement (real-time), where trades are settled on the same day for all the securities, remains a future goal, with SEBI exploring blockchain technology to achieve this. This transition has reduced settlement risks and freed up capital for further investment, contributing to market growth. As it rolls out across the markets, this shall bring in a slew of changes, starting with lower costs of intermediation and

Enhancing Retail Investor Participation

SEBI's introduction of Aadhaar-based e-KYC and video KYC processes has revolutionized the onboarding of retail investors. This was notable as the COVID-19 lockdown significantly increased retail market participation. These measures have significantly reduced the time and paperwork required for new investors to open Demat accounts, leading to a sharp increase in market participation. During the COVID-19 pandemic, the ease of completing KYC processes online became particularly valuable, reflecting the importance of digital transformation in the equity markets.

Increased retail participation has been a notable trend, with the number of demat accounts witnessing a sharp rise. This growth has been driven by the ease of online KYC processes and the availability of digital trading platforms compared with regular brick-and-mortar brokerages, making it easier for retail investors to enter the market. SEBI's investor education initiatives have further empowered retail investors to make informed decisions, contributing to a more robust market.

Introduction of New Financial Instruments

SEBI's regulatory framework has facilitated the introduction of new financial instruments such as Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs). These instruments have allowed investors to invest in the real estate and infrastructure sectors, offering attractive returns and diversification benefits. The introduction of green and municipal bonds has also supported the causes of sustainable development and municipal funding while broadening the investment options available in the equity markets.

The introduction of green bonds under SEBI's framework in 2017 has enabled companies to raise funds for climate-friendly projects, contributing to the broader goal of sustainable development. Municipal bonds have also played a significant role in providing new avenues for investment, supporting sustainable development projects, and municipal funding.

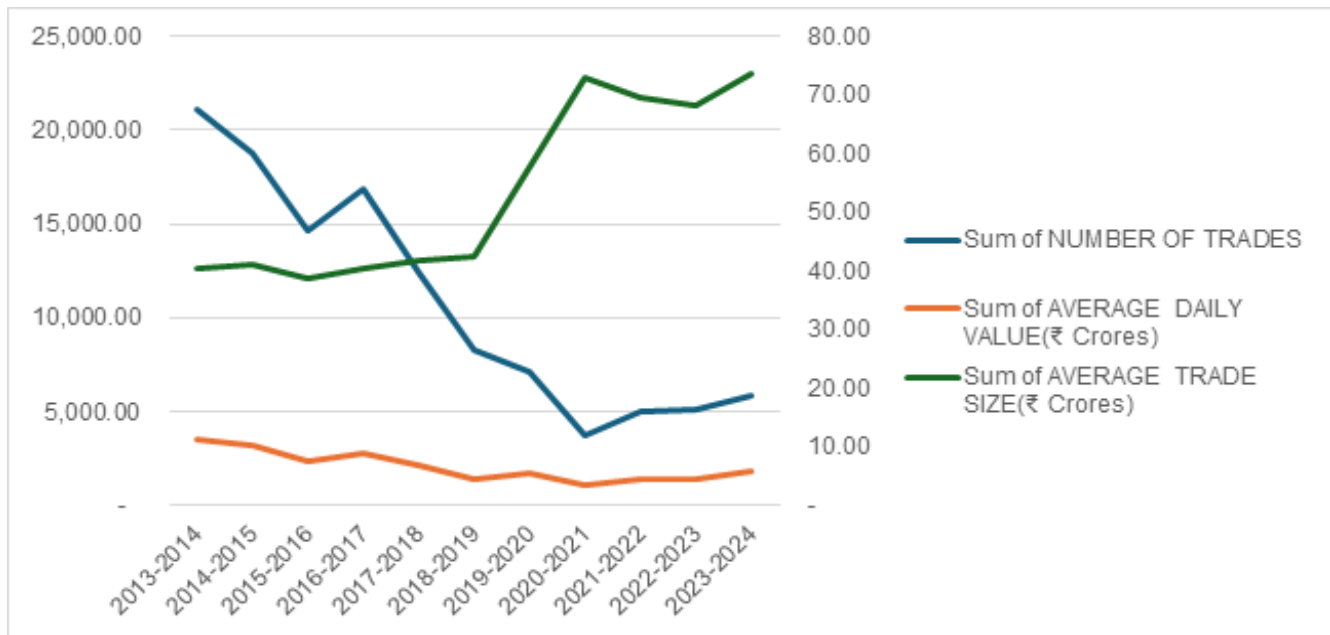
Streamlining Debt Markets and Reducing Minimum Face Value

SEBI has introduced various innovative debt instruments to enhance the market for debt capital instruments. Removing the minimum rating requirement for public issuance of non-convertible redeemable preference shares (NCRPS) and introducing options on debt securities issued on a private placement basis have provided greater flexibility to issuers and investors. These changes have made it easier for companies to raise funds and for investors to manage their portfolios effectively.

A significant regulatory change in the debt markets was reducing the minimum face value of bonds from Rs. 1,00,000 to Rs. 10,000. This change has made bond investments more accessible to retail investors, broadening the investor base and enhancing market liquidity. This move aligns with SEBI’s goal of democratizing access to financial markets and encouraging greater retail participation.

The most recent step that SEBI has taken to reduce ticket size to enable retail participation in debt markets. However, recent data suggests retail participation in the debt segment could have been more impressive. On one side, the SEBI wants to curtail retail participation in derivatives; on the other hand, it is making full efforts to encourage retail participation in debt markets—an excellent move to take the money away from speculative purposes into fundamental purposes of investment and lending. The data for the past ten years suggests that though the exchange-traded debt market is improving, it has been a playground for large ticket investors and institutions. The market capitalization has increased three-fold during the last ten years. However, the average daily volumes and the number of trades have decreased by 50% and 75%, respectively. On the contrary, the average value per trade has doubled, indicating the presence of a few hands exchanging considerable value.

Figure 1- Debt market participation



The reduction in investment ticket size is expected to attract retail investors, who could find a better investment opportunity than traditional bank deposits in the exchange-traded debt segment.

Strengthening Risk Management

SEBI has strengthened the risk management framework in the debt capital markets by introducing regulations on margin collection and the segregation of client-level collateral. These measures ensure that client securities are protected and not misused by trading members, enhancing the integrity and stability of the markets. The introduction of standardized operating procedures for managing collateral and margin requirements has further contributed to the robustness of the debt capital markets. The abrupt convergence of the equity cash and derivative markets has been smoothed with the regulatory mandate of delivery-based settlement starting from 2017/18.

SEBI also implemented the upfront collection of peak margins in a phased manner from December 2020 to September 2021. This drastically reduced the leverage that brokers could offer to their clients. Leverage in equity intraday was capped at 5x, and that of derivatives was reduced to zero. This curtails excessive speculation and also saves many retail traders from heavy losses.

Regulatory Frameworks and Innovations

SEBI has also facilitated the introduction of new derivative instruments to enhance the market’s ability to manage risk and provide investment opportunities. The launch of futures contracts on corporate bond indices and the approval of derivatives on volatility indices have expanded the range of tools available to investors. These developments have contributed to increased liquidity and provided investors with more options for hedging and speculation.

SEBI's introduction of interoperability among clearing corporations has been a pivotal reform in the derivatives market. This framework, implemented in 2018, allows market participants to consolidate their clearing and settlement functions at a single clearing corporation, irrespective of the stock exchange on which the trade is executed. This reform has enhanced efficiency and reduced costs for market participants, contributing to a more integrated and resilient market infrastructure.

SEBI's circular in October 2018 facilitated the integration of commodity derivative exchanges with stock exchanges. Following the circular, the 'commodity derivative exchange' no longer existed. All the exchanges were to be called stock exchanges, operating under a single regulatory framework. This move by SEBI allowed the existing stock exchanges to launch contracts in commodity derivatives, and the commodity exchanges were allowed to launch contracts on equity and equity indices without undergoing additional compliance.

COVID-19 and Increased Market Participation – A Test of Time

The COVID-19 pandemic profoundly impacted market participation, particularly among retail investors. The ease of online KYC processes, the emergence and robustness of digital trading platforms, and increased adoption of online transaction modes led to a surge in new Demat accounts and investments in securities markets as more individuals turned to the markets for investment opportunities during the lockdowns. SEBI's regulatory measures to ensure market stability and protect investors during this period were crucial in maintaining confidence and facilitating increased participation. Significantly, reforms in IPO regulations led many of the mature startups reflecting India's growth story to board the market platforms with successful listings.

The retail investor participation can be seen in the cash as well as the derivative markets, particularly during the year of COVID-19 pandemic, from the following figures;

The average daily turnover in the cash market from 2014 to 2024 jumped by 450%, whereas the average trade size increased by 24% from 23,000 to 29,000. Number of trades during this period also jumped by 370%. This indicates adding a new set of players and increased volumes on the exchange. However, these figures hold for the NSE alone. BSE saw average turnover double in 10 years, the number of trades increased by 16% in the ten years, and the average trade size increased by 63%. On the contrary, this indicated that few new investors traded in the cash segment, and the markets were dominated by lesser but larger investors. Point to ponder upon from a market development perspective.

During the same period, the average daily turnover of NSE saw a CAGR of 69.02%. However, the CAGR from 2020 to 2024 is 84.2%. The number of orders jumped 64 times during the period. However, unlike the cash market, BSE's derivatives segment has seen exponential growth in participation. The CAGR in average daily turnover was 136% for the previous ten years and 377.48% for the previous five years. The trends in the number of orders suggest that exponential growth in orders occurred during the previous five years when retail participation saw the highest growth.

Figure 2 - BSE volumes data

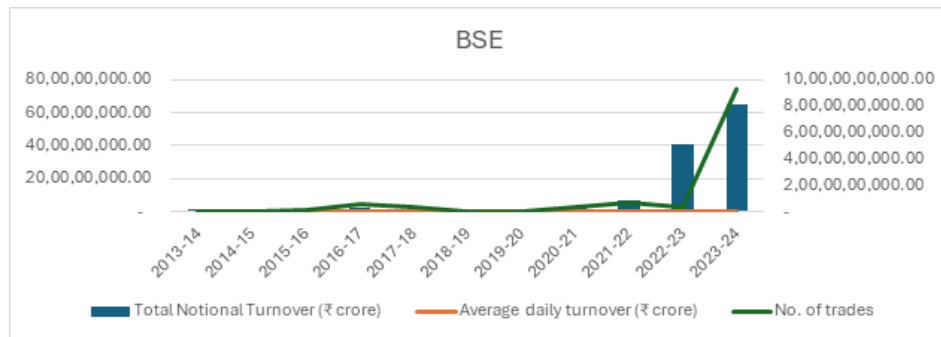


Figure 3- NSE volumes data

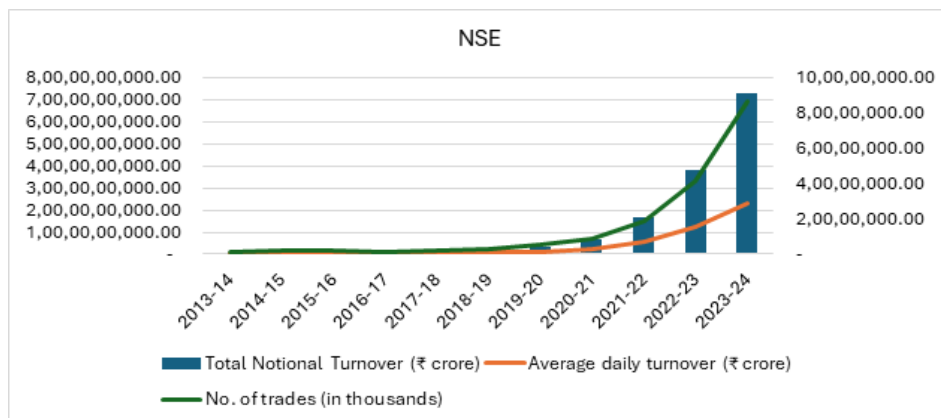


Table 1 - Number of Trades and Trend

BSE			NSE		
Period	no. of orders	Trend	Period	no. of orders	Trend
2013-14	40,38,263.00	1.00	2013-14	12,84,424.32	1.00
2014-15	16,21,989.00	0.40	2014-15	18,37,041.13	1.43
2015-16	10,62,09,394.00	26.30	2015-16	20,98,610.40	1.63
2016-17	50,39,80,418.00	124.80	2016-17	13,99,746.13	1.09
2017-18	29,79,48,879.00	73.78	2017-18	19,13,878.55	1.49
2018-19	31,167.00	0.01	2018-19	31,64,802.42	2.46
2019-20	26,81,883.00	0.66	2019-20	51,25,321.88	3.99
2020-21	33,81,60,958.00	83.74	2020-21	85,34,859.22	6.64
2021-22	67,05,21,024.00	166.04	2021-22	1,86,60,044.14	14.53
2022-23	37,25,85,103.00	92.26	2022-23	4,17,65,769.58	32.52
2023-24	9,26,70,39,132.00	2294.81	2023-24	8,66,94,207.45	67.50

Figure 4 - No of orders BSE

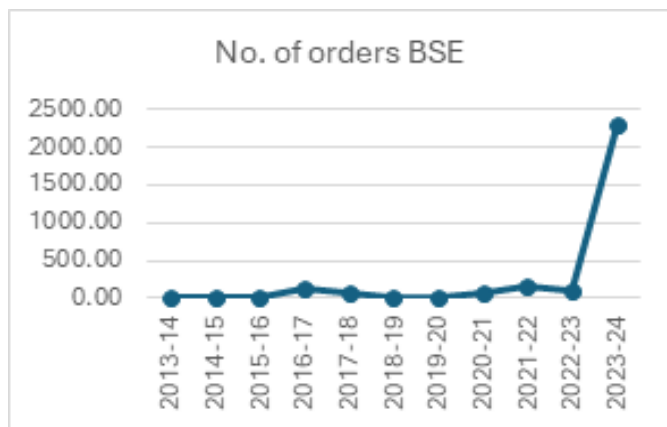
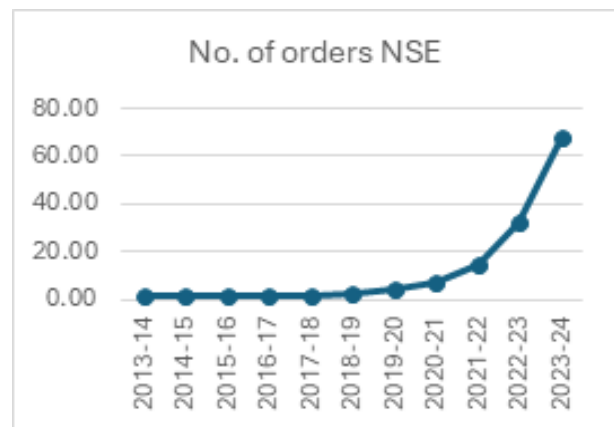


Figure 5 - No of orders NSE



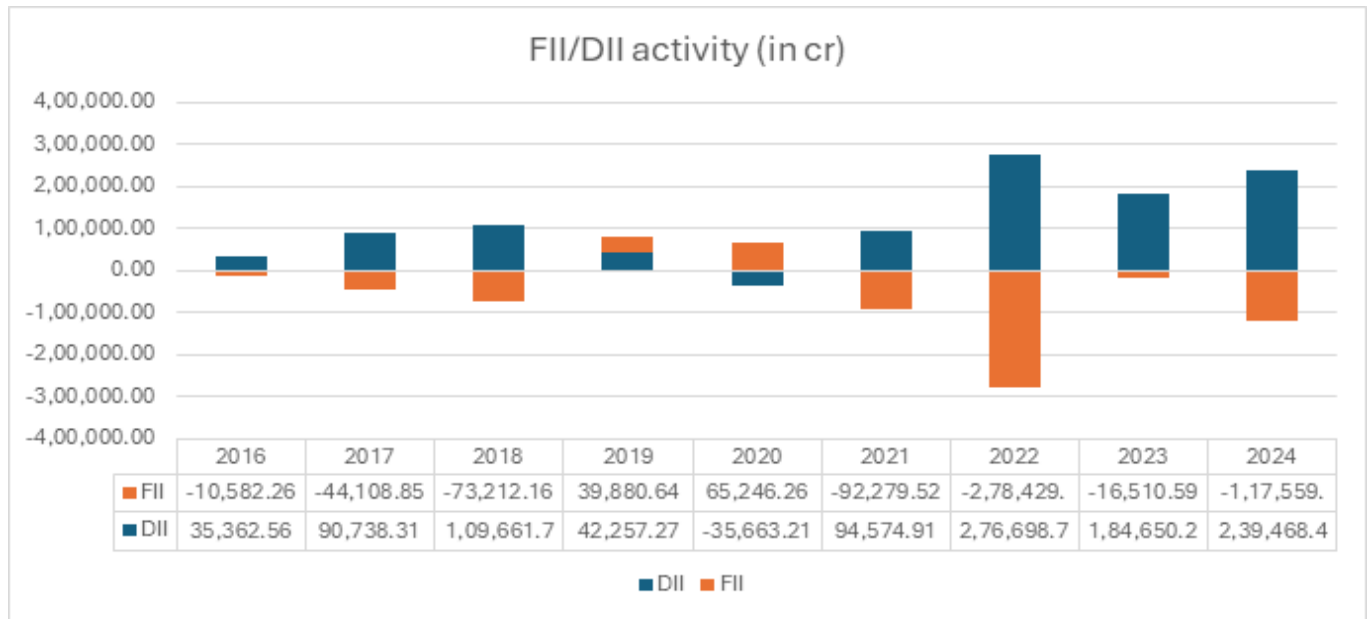
Domestic Institutional Investors (DIIs) in Equity and Derivative Markets

Domestic institutional investors (DIIs) have played an increasingly significant role in the equity and derivative markets. Their participation has surged, providing a stable source of capital and contributing to market stability. DIIs, including mutual funds, insurance companies, and pension funds, have increased their exposure to equities, driven by favorable regulatory changes and growing investor confidence.

DIIs' participation in the derivative markets has increased significantly in recent years. This growth has been driven by regulatory changes that have made it easier for institutional investors to use derivatives for hedging and investment purposes. The increased participation of DIIs has contributed to market liquidity and stability, enhancing the overall efficiency of the derivatives markets.

The Indian stock markets have always been dominated by FII investments and even today, FII activity remains one of the most critical indicators for the markets. However, it is important to note that FIIs have been net sellers in the Indian stock markets in 7 out of the previous nine years. Despite the large scale of selling by the FIIs, the Indian markets have been scaling high year on year. The primary reason for this is the rise of domestic institutions (DIIs). Large inflows into mutual funds, insurance schemes, and provident funds have enabled these institutions to absorb any shock the FIIs have given in the past. DIIs have been net sellers in only 1 out of the previous nine years. Domestic money taking control of your markets is another step towards the vision of 'Aatmanirbar Bharat'.

Figure 6 - FII/DII Activity



Moving Forward with Innovation and Stability

As India’s capital markets continue to evolve, SEBI’s regulatory framework will play a crucial role in maintaining stability and fostering growth. The next decade promises further transformation driven by innovation, future development-oriented regulation, and a commitment to building a more inclusive, efficient, and secure investment landscape for all participants. By addressing these focus areas, India’s capital markets can solidify its position as a global financial powerhouse, propelling the nation towards a brighter financial future.

The introduction of innovative technologies such as Artificial Intelligence (AI) and Big Data analytics is expected to revolutionize the markets further. SEBI’s regulatory framework will likely focus on ensuring the ethical use of these technologies and mitigating potential risks. The rise of FinTech companies demands a regulatory framework that fosters innovation while safeguarding the interests of investors on the last mile. SEBI’s approach of creating a “regulatory sandbox” where FinTech companies can innovate under controlled conditions will pave the way for developing new investment products and cost-effective services and an opportunity to study the evolution of technology to have an adaptive regulatory mechanism. Investor education will remain paramount as the retail investor base expands. Collaborative efforts between SEBI, financial institutions, online platforms, and investor associations will be crucial in developing comprehensive educational programs. Furthermore, with increasing investor and intermediation, more self-regulatory industry bodies can balance the developmental and investor protection roles. Equipping investors with the knowledge and skills to navigate market complexities will be essential for building a more informed and confident investor community.

Sustainability is another area poised for significant growth. As environmental, social, and governance (ESG) considerations gain greater traction, regulations might evolve to encourage the development of sustainable investment products. This could involve creating a framework for green bonds, promoting socially responsible investing (SRI) practices, and ensuring greater transparency in companies’ ESG disclosures. Finally, cybersecurity and data privacy will be critical in the increasingly technology-reliant market. SEBI’s collaboration with market participants to implement stringent data security protocols and establish clear data privacy guidelines will be essential. Building trust in the digital ecosystem by safeguarding investor information will be vital to attracting and retaining investors in the years to come.

Indian Securities Markets – On the Right Path to Fire India’s Growth Engine

The decade from 2014 to 2024 has been marked by substantial regulatory reforms and technological advancements across India’s capital markets. SEBI’s proactive approach in introducing these changes has improved market efficiency and transparency and ensured robust investor protection. The equity markets have seen a surge in algorithmic trading, faster settlement cycles, and the introduction of new financial instruments, including those that connect physical assets to the financial world. The debt capital markets have benefited from innovative debt instruments, strengthened margin obligations, reduced minimum face value of bonds, and introduced green and municipal bonds. The derivatives markets have seen the development of new instruments, regulations for responsible use, and improved market infrastructure.

As India’s capital market evolves, SEBI’s regulatory framework will play a crucial role in maintaining stability and fostering growth. The next decade promises further transformation driven by innovation, responsible regulation, and a commitment to building a more inclusive, efficient, and secure investment landscape for all participants. By addressing these focus areas, India’s capital markets can solidify its position as a global financial powerhouse, propelling the nation towards a brighter financial future.