

# Capital Formation in Indian Capital Market : Opportunities, Gaps & the Way Forward



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India stands at a pivotal point in its economic trajectory, with an aspiration to outshine other economies and emerge as the third-largest economy by 2027. **India's GDP is projected to grow at 6.4% in 2025 and 2026, outperforming its Asian and global peers, where growth is expected to average 2 to 3%.** Whilst China continues to be the strongest market, having enjoyed growth rates of 5%-6%, **India's forecasted GDP between 2024 and 2029 is expected to be 1.3 times that of China, considering the latest changes in the geopolitical situations and heightened global trade tensions with the USA.**

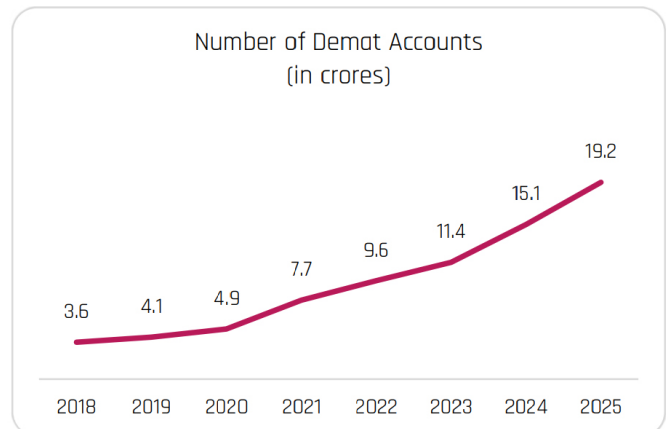
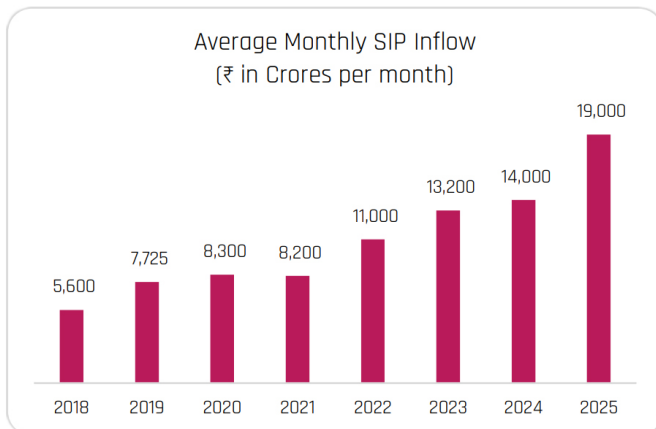
To realize this ambition, robust and sustained capital investment is critical across sectors—from infrastructure and manufacturing to technology, green energy, and social development. Though India's **Gross Fixed Capital Formation (GFCF)**—a key proxy for investment—registered a **7.1% yearover-year growth in FY 2024–25** (i.e., April 2024 to March 2025), overall GFCF growth eased to **8.8% in FY 2024** from ~ 11.4% in FY23, reflecting base effects and moderation in corporate capex.

Despite strong macroeconomic fundamentals, vibrant equity markets, and a surge in domestic liquidity, a fundamental gap persists between the capital our economy needs and the capital it mobilizes. This disparity is not due to a lack of resources but due to a disconnect between availability and effective deployment.

## Supply of Funds & Capital Market Passages

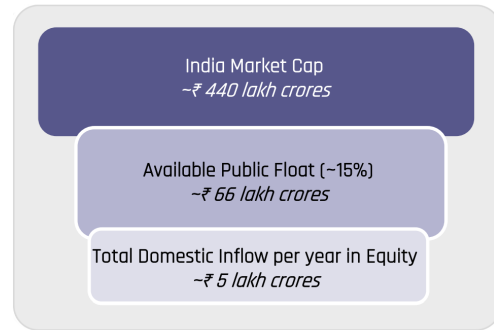
Capital formation in Indian markets is made possible by a broad mix of sources ranging from traditional household savings to institutional pools, public sector investment, foreign investment, and entrepreneurial capital, each playing a distinct yet complementary role in funding national growth. At the domestic level, retail savings continue to be a reliable source of capital. With rising financial literacy, digital penetration, and improved access to market platforms, more Indian households are channelling savings into capital market instruments, especially through mutual funds, SIPs, and direct equity investments. This trend is particularly visible in the rising number of demat accounts and sustained monthly SIP inflows, reflecting increasing retail appetite for long-term wealth creation through capital markets. Currently, equity mutual funds have seen substantial allocations, with Flexi Cap Funds (₹4.36 lakh crore), Sectoral/Thematic Funds (₹4.55 lakh crore), and Large Cap Funds (₹3.60 lakh crore) emerging as the top categories—indicating strong investor participation across varied market strategies.

To achieve a doubling of GDP by 2030, India would require cumulative Gross Fixed Capital Formation (GFCF) averaging around 32% of GDP, amounting to approximately ₹900-950 lakh crore over the period. This implies that annual capital investment must rise to about ₹150–160 lakh crore on average, compared to the current level of around ₹110 lakh crore per year.



Additionally, **India's total equity market capitalization stands at approximately ₹440 lakh crore, with an estimated public float of only about ₹66 lakh crore - roughly 15% of the total market cap.** Annual domestic equity inflows, driven primarily by SIPs, DIIs, retail investors, insurance, and pension funds, amount to around ₹5 lakh crore. To maintain this level of free float and ensure healthy market liquidity, a steady supply of fresh equity is required through IPOs, FPOs, stake dilutions, or new listings.

Of the nearly 19 lakh active companies in India, only about 6,000 are currently listed. As the economy advances and sunrise sectors emerge, the demand for capital will grow significantly. To double GDP by 2030 while sustaining the current free float ratio, India will require fresh equity issuances of at least ₹5 lakh crore annually. This is critical to absorb rising domestic capital inflows, deepen market liquidity, and support broad-based capital formation.



Capital formation thrives when financial systems efficiently convert domestic and global savings into productive investments, and in India, diverse fund flow mechanisms anchor this process. Primary markets play a pivotal role by enabling companies to raise fresh capital through IPOs, FPOs, and QIPs, directly fueling business expansion and innovation. During FY 2025, India raised a capital of ~ ₹1.92 lakh crore by way of IPOs, out of which ~ ₹1.62 lakh crore was raised by 78 mainboard IPOs. Out of 78 companies listed during the FY 24-25, 4 were large-cap, 4 were mid-cap, and 70 were small-cap companies. Secondary markets complement this by providing liquidity and facilitating price discovery, thereby building investor confidence and encouraging continuous market participation. At the same time, SME platforms are helping bridge the financing gap for smaller enterprises by offering a structured route to formal capital markets. Together, the capital formation framework is mobilizing funds across the economic spectrum, deepening financial inclusion, and aligning capital supply with India's evolving growth priorities.

### Factors influencing Capital Formation in India

**Household Savings:** At the heart of India's capital formation is its domestic savings pool, a critical fuel for investment. India traditionally boasts a high savings rate, hovering around 30% of GDP. However, the shift in household preferences from physical assets (like gold and real estate) to financial investments has added momentum to capital markets. This transition is visible in the rising number of demat accounts, record-high monthly SIP flows, and increased participation in IPOs and equity mutual funds. Despite robust growth, investor sentiment continues to be cautious and reactive. While there is a rising interest in market-linked instruments, a substantial share of retail capital remains untapped due to limited awareness, risk aversion, and inadequate financial literacy.

**Ease of Doing Business:** Transparent regulations, efficient dispute resolution, and business-friendly policies encourage both domestic and foreign investment. Excessive regulation or inconsistent policy interpretation can hamper capital mobilization, especially for smaller and newer players.

**Foreign Direct Investment:** In an increasingly interconnected world, global economic trends play a decisive role in shaping capital formation in India. As capital flows transcend borders, India's ability to attract and retain foreign investments becomes a critical factor in financing its growth ambitions. Global risk sentiment, interest rate cycles, commodity prices, and geopolitical developments all influence the direction and volume of capital moving into emerging markets like India. For instance, in a high global interest rate environment such as seen in 2022–2024 investors often rebalance portfolios toward developed markets offering safer returns. Conversely, when global rates normalize or decline, emerging economies with strong fundamentals, like India, become attractive destinations. FDI brings not only money but also technology transfer, managerial expertise, and global market access. FPI, while more volatile, enhances the depth and liquidity of equity and debt markets, supporting broader market development.

### Political and Economic Stability:

India's macroeconomic stability, consistent GDP growth, expanding middle class, and reforms in the financial and regulatory space have helped the country stand out amid global volatility. The capital inflows are not just passive contributors—they actively aid in capital formation.

### Capital Markets in enhancing capital formation:

The role of capital markets is central to how capital formation unfolds in India's growth landscape. Capital markets are not just recipients of capital; they actively fuel capital formation by converting

investor flows into productive business investment. As more sectors such as defense, green energy, electronics, and logistics scale under government support, IPOs and market fundraising have become vital tools for growth. This has led to a self-reinforcing cycle: capital formation enables market listings; listings deepen market participation; deeper markets further fuel investment in emerging sectors. Thus, well-functioning capital markets are both an outcome and a driver of India's capital formation engine.



## Liquidity Flows Strong - Supply Gaps Remain

Equity markets demonstrate healthy domestic flow patterns with continued momentum. Market capitalization grew to ₹440 lakh crore (\$5.1 trillion), positioning India as the fourth-largest equity market globally. Average daily trading volumes grew from ₹0.35 lakh crore in FY19 to over ₹1 lakh crore currently. Key performance indicators show strong momentum: Nifty 50 gained 8.8% during 2024, while Nifty Next 50 saw the highest growth of 27.4%. Nifty Midcap 50 and Nifty Smallcap 50 gained 21.5% and 25.3% respectively. The market capitalization to GDP ratio surged to 145% in 2024, up from 117% in 2023.

However, despite abundant liquidity, gaps in capital deployment persist. The bond market is underdeveloped, with low retail participation and limited product diversity. SME funding is constrained by compliance burdens and a thin investor base. Although retail participation is growing, awareness gaps persist, particularly among new investors. Long-term capital pools such as insurance and pension funds face regulatory constraints that limit their exposure to higher-yield, growth-oriented sectors.

As of June 2025, ~₹ 1.79 lakh crore of cash remains unallocated with mutual funds. India's Gross Fixed Capital Formation at approximately 30% of GDP in 2024 falls short of the investment intensity required to double the economy by 2030.

Despite record equity inflows in CY2024, the country still faces a mobilization gap—India requires at least ₹5 lakh crore annually in equity capital to meet growth targets

## Reasons for Gaps in Capital Formation:

**Lack of Financial Literacy and Retail Awareness:** Research reveals that 35.8% of respondents identified risk as the primary reason for not investing in IPOs, stemming largely from insufficient knowledge rather than rational risk assessment. **Retail investors primarily rely on electronic advertising (38.3%), television sources (35.0%), and general media coverage for IPO information, rather than conducting fundamental analysis. 70% of respondents went by grading before investing in IPOs after COVID-19**, indicating reactive rather than analytical investment approaches.

**Regulatory Framework Challenges:** While SEBI has made significant progress in streamlining processes, further regulatory refinements could unlock greater efficiency in capital mobilization. One such area is the categorization of mutual fund schemes, which currently relies on static market capitalization cut-offs. This often results in a disproportionately large number of companies being grouped under the 'small-cap' category, limiting the optimal flow of capital. Introducing a dynamic or sector-adjusted classification framework could help distribute capital more effectively across the listed universe. Additionally, the concept of a fast-track IPO approval mechanism such as a 3-Day observation framework for compliant issuers holds potential to reduce turnaround time and better align capital raising with market cycles. If implemented with clear eligibility criteria and robust digital validation tools, such a framework could be particularly beneficial for mid-market and time-sensitive issuers. Lastly, reinforcing exit pathways through SME delisting reforms, structured secondary sale platforms, and stronger buyback norms could improve capital recycling and attract a broader pool of risk capital, especially in the early-stage and growth equity segments.

**Sector-Specific Constraints:** Sector-specific fund availability constraints must be addressed to improve capital allocation efficiency. Priority Sector lending mandates for banks, which require 40% of lending to go to designated sectors, often limit the funds available for other productive investments. Similarly, the mutual fund industry faces restrictions, as sector-specific funds can limit diversification and are often perceived as riskier, while regulatory guidelines constrain fund managers' flexibility to deploy capital freely across sectors. Such requirements - including priority sector lending quotas and mutual fund rebalancing rules - create artificial barriers to flexible capital deployment, ultimately reducing the overall efficiency of capital allocation.

**Idle Mutual Fund Capital:** Equity mutual funds are parking a record ~₹1.79 lakh crore in cash—about 4.53% of equity AUM—as of April 2025. Managers are maintaining higher liquidity buffers to navigate market volatility and a pipeline of OFS deals, IPO lock-ins, and large issuances. This leaves a large pool of uninvested money even as India needs an additional ~₹5 lakh crore of fresh equity every year to sustain capital formation—highlighting the gap between available domestic capital and actual deployment

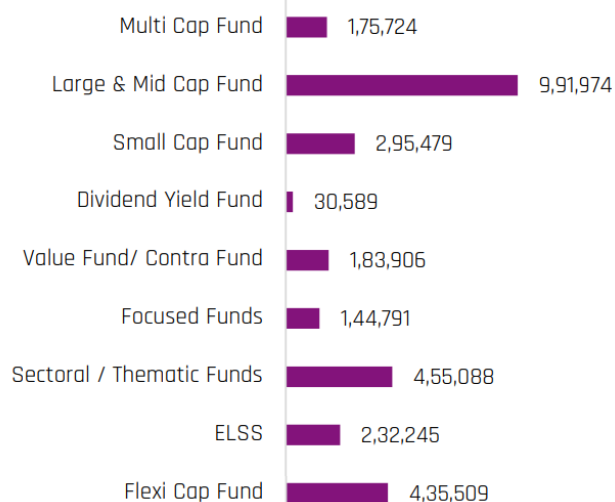


## Reasons for Gaps in Capital Formation:

**Categorisation of Mutual Funds:** Currently, mutual fund schemes in India are classified by market capitalization: large-cap funds must primarily invest in the top 100 companies by full market cap, midcap funds in companies ranked 101st to 250th, and small-cap funds in companies ranked 251st and below. This framework results in a disproportionately large universe of companies being grouped under the 'small-cap' segment. For example, as of December 31, 2024, the market capitalization of the 251st company stood at ₹32,798.88 crore, which still places it in the small-cap category. This structure concentrates capital allocation within a relatively narrow band of larger companies, while a vast base of smaller companies remains bundled together under 'small-cap', often limiting efficient capital mobilization to this broader segment.

**Corporate Bond Market Limitations:** Despite record issuances of ₹9.9 trillion in FY25, the corporate bond market represents only 18% of GDP compared to over 100% in the US. Secondary corporate bond trading volumes have remained relatively flat at around ₹5,722 crore daily despite a 72% growth in outstanding corporate bonds between FY2018-FY2024. Private placements dominate with over 99% of corporate bond deals, while public issuances dropped from 12% of overall corporate bond issuances in 2014 to merely 2% in 2024. This indicates severe limitations in retail participation and market depth.

Net Assets Under Management (₹ in crore)



## Addressing Structural Gaps: Strategic Recommendations



“green channel”; complex cases remain on the existing 6-week scrutiny track-cutting median approval time well below FY24’s 107 days. Furthermore, mandating mutual fund participation and increasing the QIP allocation in public issues could help keep the primary market active even during turbulent times, ensuring continuous capital formation.

**Eliminating Sector-Specific Fund Allocation Constraints:** For Banks, up to 10% of priority-sector obligations through tradable PSL certificates tied to green infrastructure and digital-public-goods projects, releasing at least ₹40,000 crore for other growth sectors without diluting PSL goals should be allowed. For Mutual Funds, permit diversified equity funds to deploy up to 20% outside their declared sector band if the excess is invested in listed infrastructure InvITs/ REITs, giving managers tactical flexibility while retaining core mandates.

**Optimizing Idle Mutual Fund Capital Deployment Solution:** Introduce a staggered fee-rebate, if cash exceeds 5% of AUM for 60 days, the scheme’s Total Expense Ratio drops by 5 bps; beyond 90 days, another 5 bps. Parallely, allow large-cap funds to park idle cash in overnight index ETFs with T+0 settlement, ensuring near-instant deployment and negligible tracking error.

**Enhancing Corporate Bond Market Accessibility:** Cut the minimum face value on listed debt from ₹10,000 to ₹5,000 and mandate two-way quotes by registered market-makers for bonds up to AA(-), raising monthly turnover well above today’s 3.8%. Offer a 50% income-tax rebate on interest (capped at ₹50,000 a year) for first-time retail bond investors for three assessment years, expanding the investor base and diversifying demand away from private placements.

## To conclude

Capital formation remains a cornerstone of India's growth aspirations, underpinning the country's journey toward becoming a more competitive and resilient economy. On the one hand, India requires additional equity capital of around ₹5 lakh crore annually to support its growth ambitions. On the other hand, the presence of significant undeployed funds within mutual funds highlights the need to strengthen capital deployment mechanisms. Addressing this gap through more efficient allocation channels and facilitating timely investment of available capital could help ensure that surplus liquidity translates into productive capital formation.

India's capital markets have evolved from foreign capital dependence to domestic strength, positioning the country to achieve its \$5 trillion economy vision through comprehensive capital formation strategies. Strong policy support, rising domestic participation, regulatory reforms, and technological advancement provide the foundation for sustained growth.



The domestic growth story significantly outweighs structural gaps, positioning India's capital markets as the critical nexus between domestic savings mobilization and productive capital deployment. Every additional percentage point in capital formation represents tangible economic progress.

With continued focus on bridging infrastructure financing gaps, optimizing capital deployment, and expanding sustainable finance offerings, India is well-positioned to maintain its global leadership in capital formation and achieve its long-term economic objectives. The foundation for inclusive and sustainable capital formation is strong, requiring strategic interventions to unlock the full potential of India's capital formation engine.

