The New India – Impact on Capital Markets

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Our country achieves 75 years of Independence in 2022. To commemorate this epoch in the life of our nation, our Prime Minister has made a vision statement of New India in 2022! The New India Movement envisages India free from poverty, corruption, terrorism, communalism, casteism and uncleanliness and unites the entire country by adopting righteous governance complimented with best in class technology.

Apart from positively impacting the social construct of the country, this Movement will have a noteworthy economic impact on India. An ethically compliant and an efficiently governed nation will significantly pace the economic growth. An exemplification of this is the discernible movement towards a more formal economy. An increase of c.71% (c.54.2mn) in the total number of income tax returns filed for the year 2018 is indeed a laudable achievement for the country.

The capital markets engine

The vision of New India along with its impact on the economy is bound to re-shape our capital markets by 2022. From a market capitalization of USD 2.3tn in 2017 to an expected USD 5tn in 2022, India is well poised to stage the 3rd/ 4thlargest capital market in the world.

This substantial growth in the market capitalization would indeed positively drive the advancement of primary and secondary market, bond market, fund management sector as well as currency and commodity market. Based on the various current estimates, we expect that the primary market would be facilitating equity resource raising of more than USD 30bn each year by 2022. This will support the growth of secondary market with multiplied volume and higher trading value. We expect secondary market to witness the launch of new and complex products which will enable diverse class of investor's participation.

Bond issuances have grown at a compounded annual growth rate of 15% over the last five years and outstanding issuance, as on March 2018, stands at USD 385bn. Although there has been a shift of investors to debt markets, there is still room to improve their participation in the corporate bond market which is still dominated by government issuances. Going forward, we believe that the bond market will receive a significant impetus through regulatory interventions to ensure engagement of varied participants.

The rising global equity markets and accommodative liquidity conditions coupled with positive business sentiment in India attracted Foreign Portfolio Investors (FPIs) with inflows to the tune of USD 22.6bn. In the last five years, the cumulative equity Assets Under Management of FPIs and domestic institutional investors (mutual funds) has grown 3.6 times. This has put asset management business on the front-seat with significant savings being now deployed in the same, as against the traditional approach of placement in bank deposits. As a result, the industry witnessed substantial growth during 2017-18, backed by strong inflows and increased participation of retail investors, with the Assets under Management (AUM) increasing to c.22% Y-o-Y, which resulted in movement of savings from fixed deposits and non-productive assets to capital markets. The increasing participation of retail investors in the capital market is evident from the growth in SIP inflows by c.64% in 2018, as compared to 2016. However, our pockets of retail savings in the capital market is still much lower compared to developed markets, hence there is a substantial scope for further penetration. We expect the total AUM to likely cross more than USD600bn by 2022.

In the next wave of capital markets growth, apart from the traditional markets i.e. equity, bonds, and currencies, we expect a lot more focus on the commodity markets. Commodity markets play an important role in development of the agricultural sector and related ecosystems. Post the merger of Forward Markets Commission with SEBI, we believe that the integrated capital and commodity markets will evolve much faster.

We are convinced that the journey towards a USD 5tn capital market is real and that the country is equipped with all the appropriate building blocks to successfully achieve the same.

Building an appetite for the anticipated explosion

We brace ourselves with pride given these growth prospects; and we also discern that the robust framework required to manage this explosive growth is mostly in place. It is well understood that a rigorous regulatory framework,robust market infrastructure, mature market participants and most importantly, a seasoned investor base will go a long way to underpin this growth.

In view of the above, SEBI has actively promoted a host of policies and programmes during 2017-18 to provide a sustainable yet empowering ecosystem in order to nurture the capital markets of which a few notable measures worth mentioning are:

- Fair Markets Committee - Constitute a committee under Chairmanship of former law secretary TK Vishwanathan, which has already presented its recommendation for public comments
- Corporate Governance-Approve recommendations by the Kotak Committee which was constituted last year under the Chairmanship of Shri. Uday Kotak to meet the primary objective of improving standards concerning corporate governance of listed companies in India
- Revise framework for non-compliance of listing regulations and amendments to the SEBI (Alternate Investments Funds) Regulations, 2012 to provide ease of business for angel funds
- Provide guidelines for functioning and development of securities market in International Financial Services Centre (IFSC) to facilitate ease of doing business
- Explore new initiatives to tackle the challenge posed by cyber security breaches globally by deploying data analytics and new-age technologies for the marketplace while following necessary data privacy requirements. Additionally, intends to strengthen the algorithmic trading framework to make the capital market more fair, equitable and transparent, while there are plans underway to introduce more commodity options contracts and to put in place new guidelines for index products
- Integrate commodities and securities derivative markets for further streamlining and development of the secondary market. One step forward is that exchanges have been allowed to integrate commodity and equity derivatives from October 1, 2018 to boost participation
- Categorize and rationalize Mutual Fund Schemes to ensure better comparability for investors amongst schemes launched by various fund houses
- Relax start-up net worth requirements and profitability, to allow listing on SME platform such

that small and mid-level startups who cannot list on the main board for higher compliance norms can raise money via this platform

Such a proactive and pragmatic approach of the capital markets regulators is indeed helping establish a transparent and efficient financial ecosystem. However, scraping a little deeper under the skin, we believe that an efficient regulatory intervention in a few more areas could be very useful.

Enabling innovation and the capabilities to foster it, along with financial inclusion

Financial products in India have become quite sophisticated over the years. Liquidity in derivatives products have also increased. Launch of products like options, complex derivative products, hybrid offerings etc. suited to different categories of investors will lead to market size expansion. Besides the ongoing measures, we have now formulated more innovative vehicles such as Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) to allow developers to monetize revenue generating real estate and infrastructure assets, while enabling investors or unit holders to invest in these assets without owning them. For any large and fast-growing market, a certain amount of continuous innovation is needed. We believe, focus on facilitating and regulating globally accepted new products will be an absolute must. To realize our pioneering goal of achieving this pronounced market growth, India requires an ecosystem of robust regulatory framework to safeguard and facilitate the launch of new and innovative products, along with inviolable governance.

The other significant influencer is the impact of Artificial Intelligence. Drawing from it, FinTech is slowly becoming an indispensable plug in the growth story of our economy. Traditionally known for lower rates of technology adoption, Asia is now on path to become a leader in FinTech, led by countries like China and India. These countries have witnessed highest technology adoption rates at c.69% and c.52%,

respectively. Further, with the government laying huge emphasis on entrepreneurship (Start-up India and Stand-up India program, global fund houses setting up offices, etc), we can expect the VC capital flow to be a major factor in shaping the capital market in India. This vaults us to a spurt in VC funding and requires a framework to be in place for VC funds to operate within.

Another area which will propel this growth is financial inclusion. The world's unbanked population has dropped by more than 20% since 2011, with major revelation coming from India, which moved from c.35% to c.80% penetration in 2018. However, it is just the start and the opportunity in India (housing the world's 2nd most unbanked citizens after China) remains huge.

Looking ahead a long winding road

We are aware that this journey may come with its own challenges, and that; only stringent challenges result in exhilarating victories. To begin with one - the current global economic and geo-political situation remains a cause of worry. Recently, in my conversation with one of the global CEOs of a large MNC, I learnt that in the last 400 years of world history, the then existing super-power has been confronted by the next potential super-power on sixteen occasions. Of these, twelve have resulted in a war. In the recent times, we have seen a manifestation of this through the trade related conflicts. While this is unlikely to result in any sort of escalated tensions, it is

indeed a noteworthy development (with similarities to the earlier cold war when there were escalated tensions) to see emerging signals of Trade War.

We are also witnessing significant political, social and institutional changes in the world, which further accentuate the unfolding global dynamics. The kind of unconventional leadership that has been emerging across the globe - be it President Trump's ascension to power or Capt. Imran Khan winning the Pakistan elections - clearly indicates a nationalist phenomenon across the globe. Brexit is also a development in the same direction. Social changes and political alignments in the Middle East, and particularly in Saudi Arabia, are also interesting changes to track.

Additionally, while G7 countries (Canada, France, Germany, Italy, Japan, UK, USA) are still powerful, growing importance of E7 countries (China, India, Brazil, Mexico, Russia, Indonesia and Turkey) is noticeable. Giant establishments like the World Bank and the IMF are losing weight, and newer development institutions like Asian Infrastructure Investment Bank (AIIB) and New Development Bank (NDB) are gradually occupying center stage. The changing global dynamics, leading to rising protectionism, is forcing countries to relook their policies. This is certainly going to impact businesses across the globe, including India. The capital markets would continue to be impacted by an influx of such macro and micro factors. As a country, we must be geared up to manage an ecosystem which would only become more complex.

Reflecting on the past and examining the present, while earmarking the future; we can safely conclude that India has done well and come a long way. Just less than a decade ago, our market capitalization was shy of USD 500bn in 2009; and we managed to successfully quadruple it to USD 2.3tn in 2017. Thus, with the capital market well-aligned to a target of doubling to USD 5tn in the upcoming four years, and with our Prime Minister's vision of 2022, we are looking forward to a bright and New India! ■