Confidence infrastructure

Investor education, financial literacy, good governance and effective policing is missing from the market superhighway

Small investors need confidence building infrastructure to help them stay on the road

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Contrary to popular perception, India's market regulator Sebi has taken several initiatives over the past few years that have made the Indian stock market state of the art. In fact, we set the standard in areas of technology and systems. The screen based, electronic trading infrastructure is super efficient. The payment cycle has been brought down to an amazing T+2. Moreover, the national depository company, the NSDL has done a remarkable job in making paper nearly obsolete. The list is long and has led to a huge rise in volumes and provided seamless trading and settlement.

On the flip side, this super fast trading highway is designed for the privileged few who happen to be the large investors and the traders- institutions, corporates and operators. The men-on-the-street retail investors, the supposed backbone of the capital market, in whose name incidentally all policies is made, have been largely ignored in the new, improved market place. This shows up in their tiny numbers in the Indian equity market.

Despite the rapid growth in the past couple of years, India has been able to garner about 80 lakh active investors and just about 1.5 per cent of household savings invested in equities. This 80 lakh figure is investors as represented by the depository accounts, and even this number includes inactive and duplicate accounts. Is it not worrisome that in a population of over 100 crore, with 250 crore of these being the well off middle-class, only about 0.8 per cent are equity investors?

Lack of confidence or infrastructure?

The question is: Is the retail investor not in the market because of lack of confidence? And is this lack of confidence due to a lack of appropriate infrastructure? I believe that investor confidence is low due to a lack of a different sort of infrastructure. One that gives the retail investor the confidence to participate in the markets. Though the highway is super efficient, the small guys are not taught the rules of the game nor is the policing effective to induce them onto this road.

Let us first address the issue of investor confidence. A series of scams – almost one a year – through the 90s sent the equity investors into a shell. They became obsessed with preserving their capital, forgetting that returns too are important. Lack of infrastructure for identifying, investigating and punishing scamsters was the key culprit in destroying investor confidence. Though the number of prosecution orders has increased in the past few years, the infrastructure for investigations clearly needs further strengthening. So also, the surveillance infrastructure which can be proactively used for avoiding misdemeanours and for nipping scams right in the bud. It is understood that Sebi is currently developing a robust new system for surveillance and investigations.

Investor confidence is also low because of the inadequacy of infrastructure for redressing investor grievances. Most culprits of the 90s are still at large and worse, India still does not have a system of compensating investors financially for the frauds committed on them. Strangely, the penalties are presently collected by the regulator for the Consolidated Fund. Grievances continue to be treated without adequate urgency and attention. For example, many investors in the offerings of issues like ONGC are still awaiting redress, nearly two years after the fiasco. An investor literally has to still go from pillar to post – in a typical case, he would write to Sebi and then send copies to DCA, the company, its registrar and then also write letters to newspapers/magazines and then wait for ever for redress that never comes. Or is too little, too late.

An area where we have a long way to go is in creating an infrastructure for investor education. While the Securities Market Awareness Campaign made a beginning here, that is all it is. A beginning. Financial literacy in India is very poor, leading to investors not making the informed choices, often ending up losing money. We clearly need to create huge capacities for educating the investors and for delivery of financial information to them. Though the infrastructure for information dissemination has made rapid progress, it is still of little help to most investors. For example, technology has still not been used effectively in the area of continuing disclosures.

Critical also is the need to create an all-India infrastructure for development and growth of investor associations so that they increasingly represent the investors' voice. The number of such associations is still in a single digit, and they too lack direction and focus. Training and research in the capital markets remains under-funded and under-done. Sebi's Securities Research Institute is still to open its doors.

The first step to construct the above infrastructure would be to create a National Investors Database to obtain a clear profile of our investors. This will not only give us a hold on their numbers but also their investment habits. Policy formulation and infrastructure creation would then be tailor-made to become more effective. The retail investor needs a different sort of infrastructure to come into the market. We need to build confidence.