

Rise of retail investors and the risks therein

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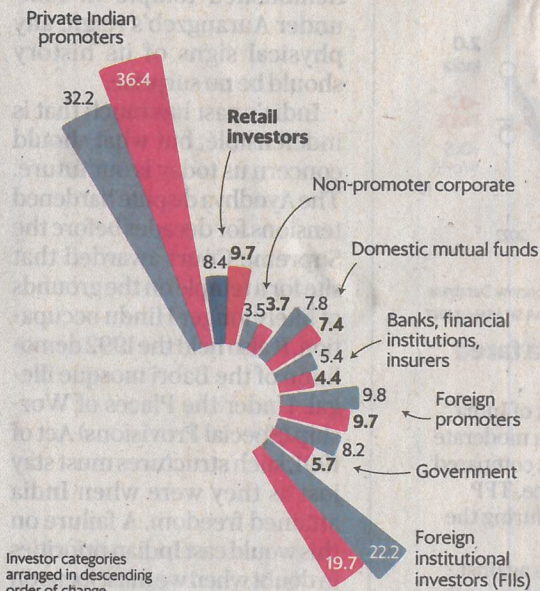
On 4 April, Union finance minister Nirmala Sitharaman hailed Indian retail investors for investing large sums of money in Indian stocks, thereby cushioning the markets from external shocks. This was in response to a question in Parliament on the flight of foreign institutional investors (FIIs) against the backdrop of a war in Ukraine and a hike in interest rates by central banks worldwide. Greater buying of Indian stocks by retail investors is partly offsetting such sales, though this has its own vulnerabilities.

As of December 2021, the latest month with official data available, retail investors owned 9.7% of companies listed on the National Stock Exchange (NSE), a 14-year high. In December 2019, this was 8.4% and has risen steadily since. Of the eight categories of investors, private Indian promoters and retail investors are significant gainers in ownership share. FIIs, the second-largest, have seen the largest drop in share, along with the government. The December 2021 FII share of 19.7% was a nine-year low. Direct investment by retail investors in Indian equities, as opposed to indirectly through mutual funds, has seen a significant increase over the past two years. This has been spurred by people being homebound because of the covid-19 pandemic, mobile apps that made share trading easier, and rising stock markets. The total number of active demat accounts, which one needs to trade on stock exchanges, has more than doubled between March 2020 and March 2022, and is 89.7 million at present. This is likely to have further increased during the initial public offering (IPO) of the Life Insurance Corporation of India (LIC).

In the last 2 years, retail investors saw the second-highest ownership increase

Breakup of ownership of companies listed on the National Stock Exchange by investor category (%)

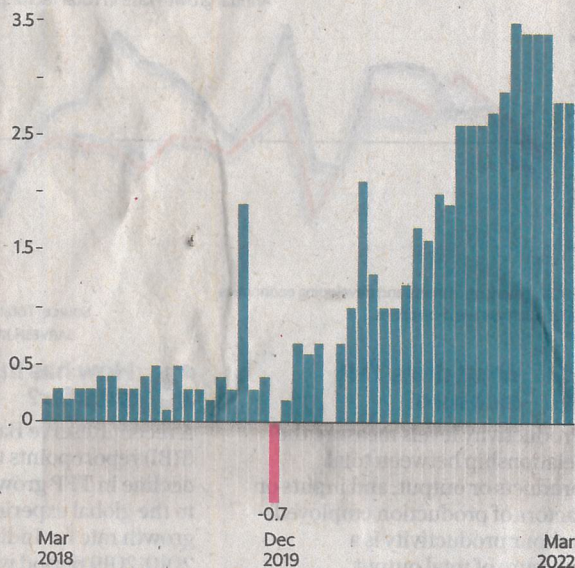
December 2019 December 2021



Source: National Stock Exchange India Ownership Tracker, Securities and Exchange Board of India (Sebi)

The surge in retail investors coincided with the pandemic and growth in trading apps

Number of new demat accounts (million)



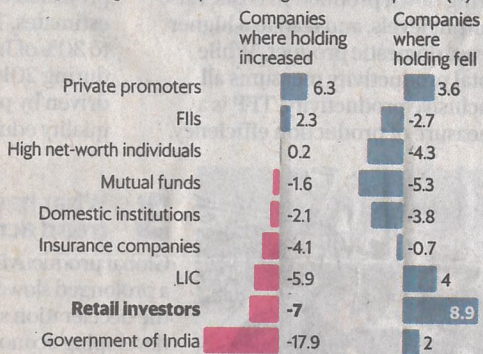
Risk Factors

A MARKET laden with stories has held out the promise of quick gains and stoked interest among retail investors. Since March 2020, the Nifty has appreciated 89%. A significant section of corporate India has delivered higher profits. New businesses have listed, including internet businesses such as Zomato and Paytm. Many new retail investors have only seen gains. But how will their portfolios perform amid growing volatility like now or even a sliding market?

Retail investors are naturally disadvantaged in market understanding and information flow. This gets highlighted in challenging markets. In the March quarter, for example, retail investors saw their shareholding increase in 994 NSE-listed companies, but the average stock returns delivered by this set was (-)7%. Further, the set of 699 companies where retail investors trimmed their shareholding posted average stock gains of 8.9% during the quarter.

In the March quarter, retail investors were caught out by the market

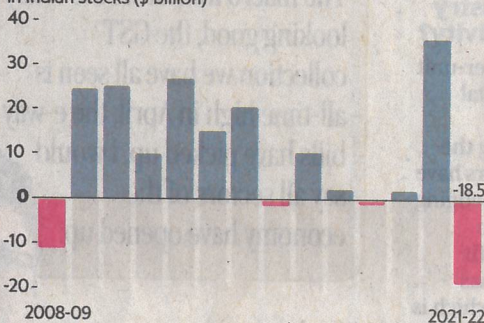
Average change in stock price during March 2022 quarter (%)



Source: Prime Infobase

Foreign investments have swung between extremes in the last two years

Net investments by foreign institutional investors (FIIs) in Indian stocks (\$ billion)



Source: National Stock Exchange India Ownership Tracker

Point And Counterpoint

FOR NOW, the significance of retail investors in the domestic equity market is underscored by the volatility of foreign fund inflows into India over the past decade. Foreign investment is typically hot money and is extremely responsive to interest rate differentials between countries. FII inflows into India remained consistently high between 2009-10 and 2014-15. With interest rates in developed economies being very low because of a monetary stimulus following the 2008 financial crisis, investors sought higher returns elsewhere.

However, net FII flows remained muted between FY16 and FY20, before surging to a record \$36.2 billion in FY21, as the covid-19 pandemic necessitated a monetary stimulus and a cut in interest rates. However, in FY22 negative global cues led to a record net outflow of \$18 billion. A strong domestic retail investor base can countervail the extreme volatility of FIIs.

Sectoral Spread

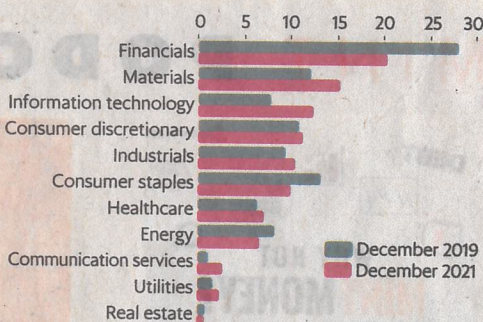
AFTER A three-year hiatus, domestic retail investors turned net buyers in 2020, making net purchases of ₹51,200 crore on NSE. In 2021, this increased further to ₹1.43 trillion. A sector-wise analysis reveals that retail investors are diversified across sectors. Financials (20.3%), followed by materials (15.3%) and information technology (12.5%), are the top picks of retail investors. Unlike the government and FIIs, which have high exposure to the financial sector (38.5% and 34.8%, respectively), retail investors have a more even spread.

Over the past two years, retail investors have increased ownership in eight of the 11 sectors studied. This includes those that benefited from the pandemic, such as IT and healthcare, while stakes in financials and energy came down. The current volatility in stock markets will test the resolve of Indian retail investors and will determine if they are here to stay or not.

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In the pandemic years, retail investors increased their holding in 8 of 11 sectors

Retail investor ownership on the National Stock Exchange by sectors (%)



Source: National Stock Exchange India Ownership Tracker

AHMED RAZA KHAN/MINT