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# THE EMERGING ASIA PACIFIC CAPITAL MARKETS: CHALLENGES AND OPPORTUNITIES - INDIA

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# THE EMERGING ASIA PACIFIC CAPITAL MARKETS

## Challenges and Opportunities

Larry Cao, CFA, and Luis Garcia-Feijóo, CFA, CIPM
*Editors*

# RF EMERGING APAC CAPITAL MARKETS BRIEF

ARX and CFA Society India Webinar
5 May 2021

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# THE EMERGING APAC CAPITAL MARKETS


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## The Emerging Asia Pacific Capital Markets: Challenges and Opportunities

Larry Cao, CFA, Luis Garcia-Feijóo, CFA, CIPM

Asia-Pacific emerging and frontier markets continue to evolve rapidly. With insights from authors based in 11 local markets, this publication offers insights about regulatory developments, market structure, and financial history in the region.

### Overview

Emerging and frontier financial markets in the Asia-Pacific region have experienced significant changes in recent years in areas affecting regulation, market participants, and products. This collection presents perspectives from authors in local markets who provide their analysis of the history, current development, and future outlook for 11 countries: Bangladesh, Cambodia, India, Indonesia, Malaysia, Mongolia, Pakistan, the Philippines, Sri Lanka, Thailand, and Vietnam. The brief should be particularly valuable for prospective investors interested in learning about regulatory developments, market structure, and financial history in the region.

# THE EMERGING APAC CAPITAL MARKETS

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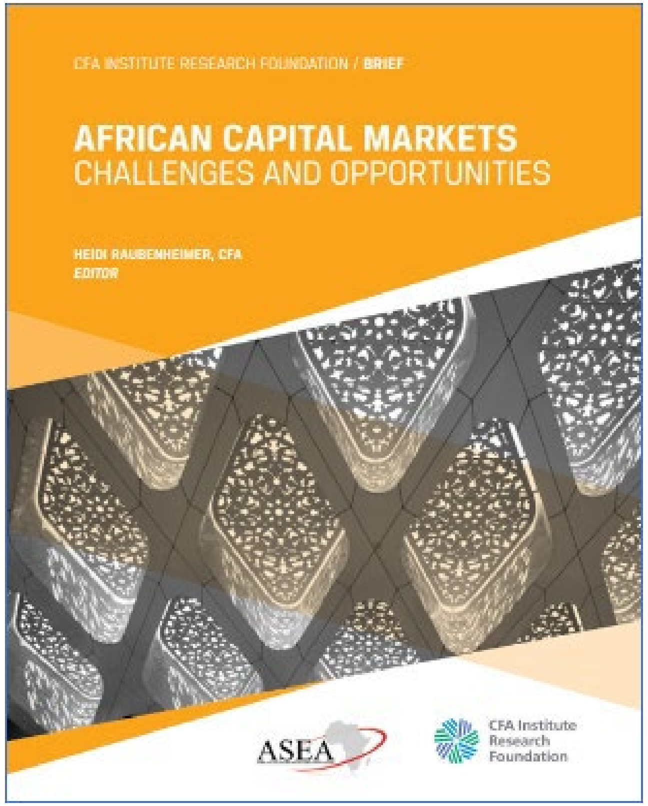
# EMERGING CAPITAL MARKETS SERIES

# OVERVIEW

**Forward**

The world of investing is in a state of flux with, perhaps, too much money chasing after too few assets that are perceived to be investment-ready.

A wall of liquidity – fuelled by quantitative easing – has resulted in low yields and high correlation amongst traditional assets. Trends in technology and geopolitics – exacerbated since the onset of the pandemic – continue to upend business models and supply chains. The search for “alternatives” – from private markets to crypto assets – continues apace.

At the same time, significant parts of the world fail to receive investments commensurate with their fundamentals of growth and demographics, or opportunities in infrastructure, insurance and pensions.

A critical barrier between the demand for, and supply of investment capital is the quality of the conduit that is capital markets.

It is the ecosystem of regulatory climate, market structure, history and culture of professionalism that enables match-making between sources and uses of funds. Fostering this ecosystem unleashes the power of investments to make real impact on real lives in the real economy.

A deliberate and continuous pursuit of education, ethical standards and professional excellence can fuel the flywheel of knowledge, confidence, and investment in developing markets.

I congratulate the Research Foundation for this timely and valuable contribution to the body of knowledge surrounding these eleven emerging and frontier economies in Asia. At different stages of development, virtually all of these markets provide a mix of domestic fundamentals, insulation and connectivity to the global economy. This set of detailed, country-level perspectives produced by highly qualified, in-country experts should catalyse greater understanding, debate, and inclusion of these economies in the global investment dialogue.

*Lutfey Siddiqi*

*Managing Director, Global Regions & Society Relations*

## Introduction

Many have argued that the 21st century will be the Asian Century. And yet many capital markets in Asia, particularly emerging markets, remain a mystery to much of the outside world. We hope this brief will help to fill that knowledge gap.

The MSCI Emerging Markets Asia Index, launched at the beginning of the century, includes nine markets today. The relatively large and liquid capital markets of China (A shares), South Korea, and Taiwan are better known in global markets partly because of the international success of local tech giants. This brief covers the remaining six markets in the index—India, Indonesia, Malaysia, Pakistan, the Philippines, and Thailand—plus five other up-and-coming Asian markets—Bangladesh, Cambodia, Mongolia, Sri Lanka, and Vietnam. In each chapter, local authors review the history, current characteristics, and challenges and opportunities of their respective capital markets.

The selected countries exhibit certain economic and financial similarities. Having traveled to the majority of the covered countries, we believe they also have another important attribute in common: hope. These countries witnessed how neighbors such as Japan, South Korea, Singapore, and, more recently, China have improved living standards for their people since the 1960s. Their citizens share a strong belief that hard work will pay off. So, despite conditions that many from developed markets may find challenging, throughout these countries you can hear the upbeat tone in the voices and see the smiles on the faces of people going about their business.

Still, these markets are substantially different in many ways. We venture three differences here to highlight the practical value of this brief:

## History

Countries such as India, Malaysia, Pakistan, the Philippines, and Sri Lanka inherited a legal system influenced by the British system. Some even had exchanges set up centuries ago. Because of their history, their capital markets are more consistent with expectations formed from investing in the US or UK markets. In contrast, Mongolia and Vietnam were part of the Soviet area of influence after the Second World War. Their regulatory systems are now in transition toward Western standards.

## Economy

The size of these economies varies greatly. Based on data from the World Bank, in 2019, India's GDP was USD2,875 billion and Indonesia's was USD1,119 billion. On the other end of the spectrum, in 2019 Mongolia had a GDP of USD13.9 billion and Cambodia of USD27.1 billion. GDP per capita in 2019 ranges from USD1,285 for Pakistan to USD11,415 for Malaysia. This disparity is of course an important consideration for institutional investors because the economy is the foundation of capital markets and the main driver of their growth. Asian economies in general have experienced healthy growth in recent decades, and so have many of the covered countries, other than those that witnessed political turmoil. Consistent with these economic differences, the size of capital markets differs greatly among the 11 countries covered.

## Market Maturity

Market maturity is an important factor to consider when investing in emerging and frontier markets. More-mature markets offer increased levels of information disclosure and tend to experience less dramatic swings in prices. Where data is available, authors report the share of institutional ownership in a market and other indicators of market maturity.

History buffs may find it easy to understand why in some markets banking channels play a more important role in financing, whereas in others capital markets are more important—although market maturity also has some bearing on this.

The concept of the Asian Century was not without controversy from the beginning. Whether you are a believer or a skeptic, we sincerely hope that this research brief will help you identify new opportunities and navigate risks in the Asian emerging and frontier markets.

# REGIONAL EXPERTS

Larry Cao, CFA replied to Raza Jafri, CFA'S comment on this

Larry Cao, CFA
Senior Director, Industry Research at CFA Institute
4d •

The Emerging Asia Pacific Capital Markets, a research brief published by CFA Institute Research Foundation and edited by myself and Luis Garcia-Feijoo, Ph.D., CFA is now online!

We thank Lutfey Siddiqi for endorsing the project in the forward he wrote for this brief.

We thank the contributors from each of the 11 markets for their diligent research work
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# INDIAN CAPITAL MARKETS – CHALLENGES & OPPORTUNITIES

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8 July 2021

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# OBJECTIVE

**Providing a summary of history, current characteristics, challenges, and opportunities of Indian capital markets**

- Evolution of India’s Capital Markets, its History and important milestones along the way
- The establishment of Capital Markets Regulator & the development of market structure and growth of Equity, Debt & Derivatives market
- The key challenges & opportunities that an emerging market like India provides & its place within the Emerging Markets of Asia Pacific
- India as one of the countries along with 10 other EM Asia countries

# EVOLUTION OF INDIAN CAPITAL MARKETS

**Pre-Independence**

- First traces - Loan securities of the East India Company were being traded at the end of 18th century
- In 1875, a handful of brokers formed the Native Share and Stock Brokers' Association (or BSE)
- Expansion of cotton and jute industries  in other parts of the countries led to the formation of new exchanges
- The Swadeshi or Home Rule movement, along with establishment of domestic companies such as Tata Iron and Steel Company led to further development of Indian businesses

# EVOLUTION OF INDIAN CAPITAL MARKETS

## Post-Independence

**1952** — The Forward Contracts (Regulation) Act, 1952, led to the establishment of the Forward Markets Commission of India in 1953.

**1955** — The Capital Issues (Control) Act, 1947, was passed by Parliament. Issuers in India needed to get government permission regarding the timing, size, and price of their issues.

**1956** — The Companies Act, 1956, enabled companies to be formed by registration; set out the responsibilities of companies, their directors, and their secretaries; and provided procedures for liquidation of companies; The Securities Contracts (Regulation) Act, 1956 (SCRA), was created to regulate stock markets.

**1963** — The Unit Trust of India Act, 1963, provided for the formation of the Unit Trust of India.

**1992** — The Securities and Exchange Board of India Act, 1992, established the SEBI to protect the interests of investors in securities.

# EVOLUTION OF INDIAN CAPITAL MARKETS

**Post-Independence**

**1993**

The Securities and Exchange Board of India (Mutual Funds) Regulations, 1993, were established.

**1999**

The Foreign Exchange Management Act, 1999, consolidated and amended the laws relating to foreign exchange and replaced the Foreign Exchange Regulation Act, 1973; The Insurance Regulatory and Development Authority of India Act, 1999, established IRDAI, an autonomous apex statutory body for regulating and developing the insurance industry.

**2016**

The Insolvency and Bankruptcy Code, 2016, instituted a time-bound process to resolve insolvency.

# EQUITY MARKETS

# EQUITY MARKETS

**Two major exchanges – BSE and NSE**

- BSE and NSE are the 10th and 11th largest exchanges by market cap in the world
- BSE has more than 5,000 listed companies
- NSE has a lion's share of the market (>90%) in terms of liquidity
- Dynamic change in SENSEX's sector composition over two decades – earlier dominated by manufacturing industries (26/30), now dominated by private sector, esp. finance services

| | |
|---|---|
| Equity Market Capitalization (USD)* | **1,506** Bn |
| Equity Market Cap/GDP* | 56% |
| Equity Market Share Volume Traded (USD)** | **1,282,000** Mn |
| Number of Listed Com-panies* | 5,539 |

**As of March 2020*

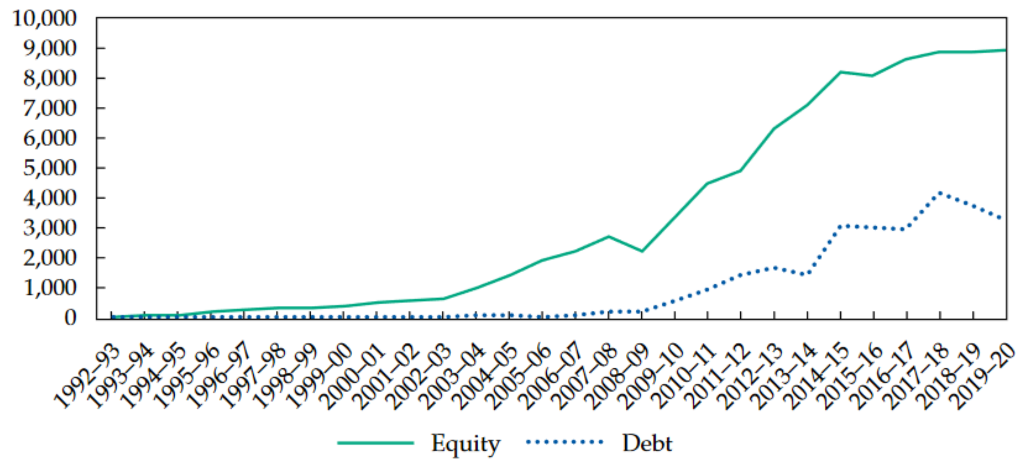
***Fiscal Year 2020 (April 2019 – March 2020)*

# EQUITY MARKETS

**Mutual fund industry and retail investors have become an integral part of the ecosystem**

- Mutual fund industry now an integral part of country's financial landscape – owning ~19% of BSE 500 stocks in Sep'19, compared to ~12% in Sep'15
- Consistent growth in retail investors participation in owning equities - ~41 million demat accounts at FY20 end
- Foreign investments have grown significantly since globalization, but still constrained by regulations around ownership limits

Cumulative FPI Inflows (INR billions)



# FIXED INCOME MARKETS

# FIXED INCOME MARKETS

**Government securities constitute the largest share and are more liquid**

- Four major segments –
  i) government securities,
  ii) corporate and public sector debt,
  iii) money market securities, and
  iv) bank and corporate deposits

- Dated G-secs constitute the highest share, with > 40% of the market, followed by Corporate (~30%) and State Development Loans (~20%)

| | |
|---|---|
| **1,797** Bn | Debt Market Capitalization (USD)* |
| 67% | Domestic Debt Market Cap/GDP |
| **2,057,000** Mn | Debt Market Instrument Volume Traded (USD)** |
| ~29,000 | Number of Issuers (Bonds) |

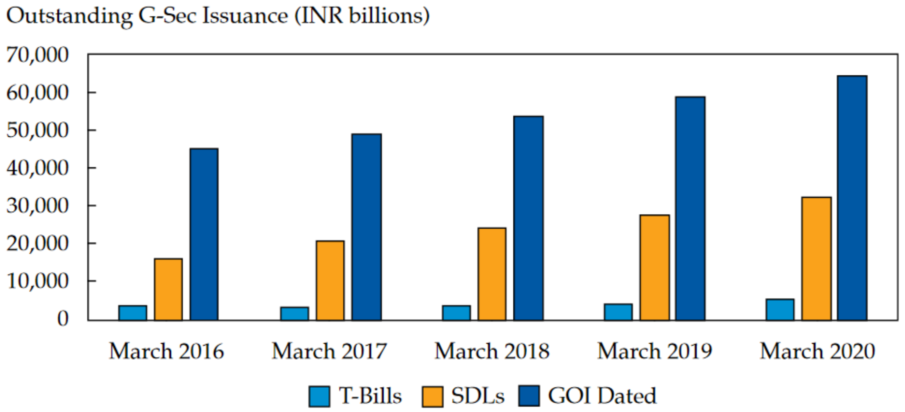
**As of March 2020*

***Fiscal Year 2020 (April 2019 – March 2020)*

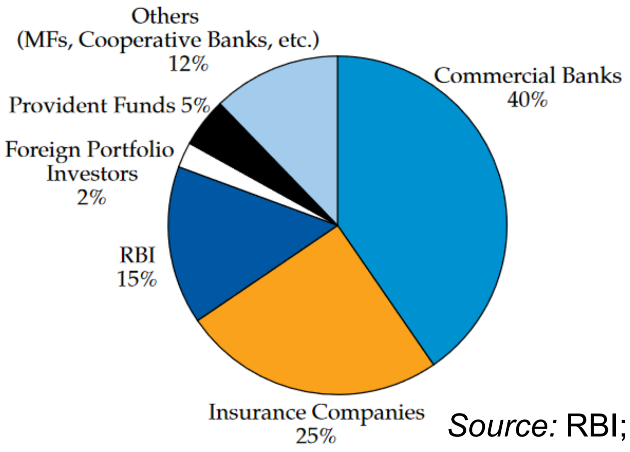
# FIXED INCOME MARKETS

**The government securities segment is amongst the largest in Asia but sees lower retail and oversees participation**

- Indian G-Secs have experienced significant growth since the implementation of structural and policy changes in 2012; 3rd largest govt debt market in Asia
- The market is still fairly skewed towards institutional players with commercial banks (~40%) and insurance companies (25%) representing the highest share
- Retail participant is still very low. Major reasons include - Low awareness, high transaction costs, and the availability of similar instruments
- In order to increase oversees investments, RBI introduced Medium Term Framework and Voluntary Retention Route




Ownership of GOI Dated Bonds

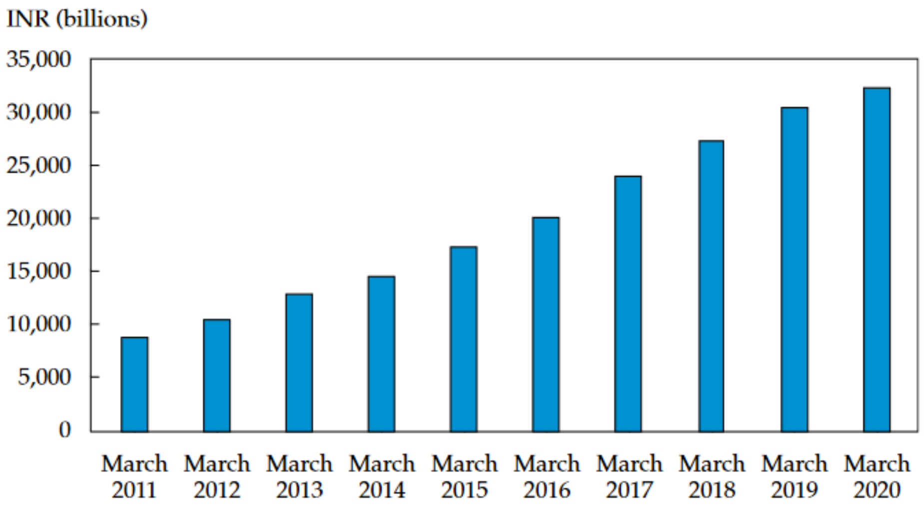



*Source:* RBI; ownership as of Mar 2020

# FIXED INCOME MARKETS

**Liquidity in corporate bonds segment is critical to attract retail and institutional investors**

- Corporate bond market consists of bonds issued by public sector undertakings and private corporations
- However, the segment is much smaller than government bonds in terms of size and liquidity
- ~80% of the market consists of AAA and AA issuers, most of them private placements
- According to CRISIL, mutual funds and insurance products represent around 42% of market share
- The market is still underdeveloped due to regulatory hurdles and corporations mostly rely on banks for capital



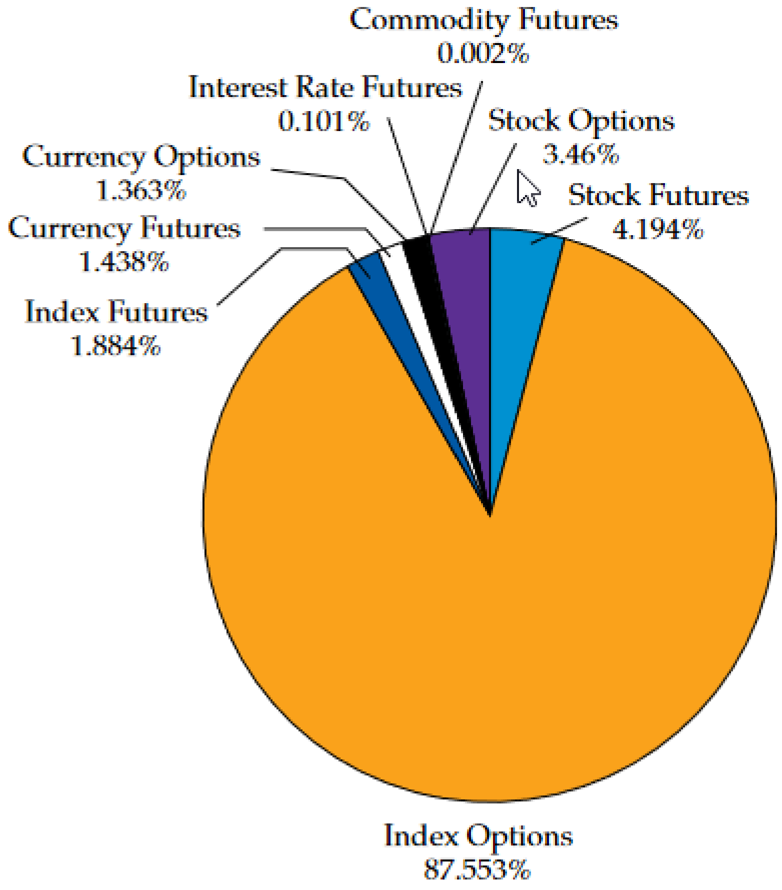

*Source:* SEBI

# DERIVATIVES MARKET

# DERIVATIVES

**The segment is in nascent stage but has seen significant growth**

- NSE and BSE are major exchanges that provide trading in futures & options for indices, stocks and currency
- NSE offers the most liquid segment for index futures stock futures, index options and stock options; currently the world's largest exchange by *number of contracts*
- NSE's Commodities segment still in nascent stage; merger of SEBI and Forward Markets Commission a major development




*Source:* NSE, authors' calculations

# CHALLENGES AND OPPORTUNITIES

# CHALLENGES & OPPORTUNITIES

**While reckoned to have a young population and growing economy, we need to take measures that can help India quickly achieve the goal  of a $5 trillion economy**

- India has a low level of participation in equity markets. Just 6% of the population have equity broking accounts and an even smaller number have MF investments
- While India’s favorable demographics is an advantage, low level of financial literacy and a low per capita income despite an impressive growth in GDP are key challenges
- A progressive capital markets regulator in SEBI has ensured several path breaking regulations being introduced in recent times
- SEBI has taken multiple steps in recent past to protect investor interest – principal among them being the implementation of Kotak Committee Report to strengthen corporate governance, introduction of Investment Advisors’ regulation, Restrictions on Insider Trading, Transparency in MF portfolio and fees.
- Despite these steps, a lot of ground needs to be covered –
    - Multiplicity of regulators
    - Deepen the bond markets
    - Recognize ETFs as distinct from Mutual Funds for regulations
    - Relaxing of compliance restrictions on FIIs
    - Make overseas listing seamless
    - Creating a growth environment for FinTech companies

# The Emerging Asia Pacific Capital Markets: Challenges and Opportunities - India

## Q&A

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# THANK YOU