

Classes of investors

Role of retail investors

4.110 India's equity market shows striking evidence of the domination of individuals in price discovery, which is considered a highly desirable feature of financial sector development. In April 2004, on the equity spot market, NSE had 31.9 million trades with a value of Rs.1 trillion. This corresponds to an average trade size of Rs.31,646. In March 2004, the average transaction size on BSE was Rs.31,503.

4.111 On the equity derivatives market, the average transaction size in March 2004 was Rs.557,218. Assuming an initial margin of 25 per cent, this means that the participating household would need to pledge a deposit of Rs.140,000. This is feasible for many households, and is not an exclusive preserve of institutional investors.

4.112 Across both spot and derivatives markets, the average transaction size seen is fairly small, and points to a substantial participation from individuals. If large institutional traders were dominant (either domestic or foreign), the average trade size would be much larger.

4.113 To look back at the earlier period, the average trade size on NSE in 1995-96 was Rs.101,505 and in 1996-97 it was Rs.112,086. After 1996-97, the trade size fell sharply till 2001-02, after which it has been at values between Rs.20,000 and Rs.35,000. This points to the increasing participation of

households in the capital markets, and their domination in price discovery. This appears to have also been enabled by (a) The small 'market lot' of the stock market, which is 1 share, and (b) The continuing spread of trading terminals across the country, which has been fueled by dropping prices of telecom services.

4.114 In a related development, the share of Mumbai in NSE equity trading - combining households and institutional investors, in 2003-04 was 44.07 per cent. If the stock market had been dominated by institutional investors, then the share of Mumbai would have been much higher, since almost all institutional investors are in Mumbai.

4.115 Evidence on the growth of retail trading is also found from the client accounts data of the two depositories. In April 2002, NSDL and CDSL had 3.8 million accounts. All institutional investors in India are likely to have already opened depository accounts by this date. This shows that only a small number of households in the country had (as yet) commenced direct participation in the securities markets.

4.116 The number of accounts grew to 4 million by April 2003 and to 5.8 million by March 2004. This growth averages to the opening of 4,200 new accounts per working day. This suggests steady growth and enlargement of the universe of retail investors in the country. The average portfolio size of these 5.8 million accounts works out to Rs.5,12,000. This reflects an averaging across a few very large institutional investors and a large number of small holdings of households.

4.117 The commodity futures markets have also adopted the pattern of having a large number of small participants. As an example, from January 1, 2004 till May 31, 2004, at NCDEX, there were 237,579 trades of value Rs.3,175 crore, giving an average transaction size of Rs.133,640.

4.118 As a counter-example, the NSE WDM segment, which reflects the OTC bond market, had an average trade size in April 2004 of Rs.7 crore. On the currency spot market, the average transaction size at CCIL in 2003-04 was \$1.4 million. These large values come from markets which are dominated by institutional investors as opposed to households.

4.119 On the currency market, we obtain evidence from CCIL, which does netting by novation and thus observes information about the currency market even though the market itself is a fragmented OTC market without centralisation of information. CCIL's data shows that in 2003-04, 0.16 per cent of trading was from cooperative banks, 44.85 per cent was from foreign banks, 37.84 per cent was from public sector banks, 17.11 per cent was from private banks and 0.04 per cent was from financial institutions.

Role of FIIs

4.120 Net FII inflows, comprising both debt and equity, rose dramatically from Rs.2,822 crore in 2002-03 to Rs.48,968 crore in 2003-04. Net FII investments, and offshore primary market issuance, are both shaped by expectations on Indian equity and the Indian rupee, as also strong global investment flows into 'emerging markets'. Hence, offshore primary market issuance also went up from Rs.910 crore in 2002-03 to Rs.3,746 crore in

2003-04. These expectations changed in May 2004, and the largest ever one-month exit by foreign investors took place, of Rs.3,507 crore.

4.121 FIIs were slow to embark on equity derivatives trading in India. Liquidity in the equity derivatives market was first established by retail participants in 2001 and 2002. Until June 2003, the aggregate FII equity derivatives turnover was negligible, attaining values of below Rs.1,000 crore per month. The first month with substantial trading by FIIs on the equity derivatives was June 2003, with Rs.10,905 crore of equity spot market turnover and Rs.1,788 crore of equity derivatives turnover.

4.122 From these modest beginnings, FII turnover has grown steadily. The largest values are found in the most recent period. Hence, in Table 4.11, we focus on Jan-March 2004, i.e. the most recent period. FII turnover data is reported two ways (i.e. buys and sells are added together), while exchange turnover is reported one-way (i.e. each trade is counted once, even though there is one buyer and one seller). Hence FII turnover has to be divided by twice the reported exchange turnover when computing the share in turnover.

4.123 The table shows that in (say) March 2004, FII turnover appears to be quite large : Rs.28,872 crore of volume on the equity spot market and Rs.12,711 crore on the equity derivatives. However, these numbers need to be seen in the context of the large Indian equity market. We find that these maximal values for FII turnover accounted for roughly 8 per cent to 9 per cent of the equity spot turnover, and roughly 2 per cent of the equity derivatives market.

Table 4.11 : Role of FIIs in equity turnover in early 2004

	<i>(Rs. crore)</i>					
	FII (two-way)		India (one-way)		FII share (per cent)	
	Spot	Deriv.	Spot	Deriv.	Spot	Deriv.
January	30,484	13,395	1,99,889	3,27,850	7.6	2.0
February	27,507	10,882	1,60,182	2,73,569	8.6	2.0
March	28,872	12,711	1,55,662	2,60,986	9.3	2.4