Investing strategy of Retail Investor in Indian Capital Market: Portfolio and Profitability

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Introduction

After the Liberalization, Privatization and Globalization (LPG), beginning from the early 1990s, The Government of India has initiated several reforms to regulate and develop the markets and to ensure adequate protection for the Indian investor. With this end in view, the Securities and Exchange Board of India (SEBI) set up in 1988 was strengthened. Permitting of FIIs, global mutual funds and merchant bankers poured in new dynamism and vitality into the markets. Further, several steps were taken to promote the primary markets and streamline the secondary market operations. Most importantly, the National Stock Exchange, a state-of-the art technology driven new stock exchange and central depositories, the NSDL and the CDSL were established. This entire path breaking initiatives together with abolition of taxation on dividend, reduction of long term capital gains tax and allotment of quota in IPO for small investors have begun to attract the Indian investors to the capital markets in droves and the number of retail investors had increased multi-fold in the post-reforms era. A SEBI/NCAER study revealed that by the year 2000-01, 21 million individual investors had invested in equity/debentures.

As per SEBI definition, a retail investor is one who finances a listed company in the form of equity (shareholder) or debt (debenture holder) upto Rupees one lakh through an IPO.

Methodology

The study is based on a random sample survey of one hundred retail investors conducted in the city of Faridabad near Delhi in October 2010. The retail investors, drawn from those who visited two Depository Participants' and five Brokers' offices (Angle Broking, Sharekhan, 5 Paisa, Reliance Money, ICICI) were administered a questionnaire. The data obtained through the questionnaire has been supplemented with secondary data from business newspapers and the Internet.

Results

According to the survey, major chunk of the investors is located in east Faridabad (60%) which is across the railway line and (40%) in west Faridabad which is new industrial town includes male (70%) and female (30%) of which 86% are well educated with a graduate or higher degree. The typical investor is married and past middle age with a monthly income ranging between Rs.25,000 and above and is employed in white-collar jobs as well as self employed due to small industrial units. There seems to be active participation of the upper middle-income individuals in the share market. It can be surmised from Table 1 that share market participation is more among men than women and increases with the level of income and it appears to increase with age and education. The level of education and work environment of the typical investor suggest that his entry into the stock markets is an informed one rather than a stray foray.

Reason for investing in the stock market: An overwhelming majority, 87%, invests in the stock market for capital gains and the remaining 13% invest for dividends and bonus. A majority had begun with investing small sums in the stock market. About 26% had an original investment of less than Rs.25,000, about 52% had an original investment ranging between Rs.25,000 and Rs. 40,000 and about 22% had an original investment of more than Rs.40,000.

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They sourced their capital for stock market investments from their own personal finances and none borrowed for investing in the stock market.

Stock market experience: Over the past decade, the various investor friendly market reforms seem to have brought new investors to the capital markets. Table 2 indicates the investment experience of the retail investors. The data indicates that a majority of the investors, (68%), are rather new entrants with less than 5 years experience, while 30% of the respondents have less than two years experience. About 20% has five to ten years of exposure to the markets, while only 12% has experience of more than ten years.

Share of stock market securities in financial assets: A recent nationwide survey of over 60,000 households by National Council of Applied Economic Research (NCAER) and Max New York Life entitled 'How India Earns, Spends and Saves', reveals that most Indians prefer keeping 65 percent of their savings in liquid assets like bank or post office deposits and cash at home, while investing 23 percent in physical investments like real estate and gold and only 12 percent in financial instruments. The survey found that only 0.5 percent of the Indians invest in equities. Table 2 reflects the share of stock market investments in the total financial assets of the investors such as shares, debentures, bank/post office deposits, company deposits and Government/public sector bonds. The data shows that a majority of respondents, 48%, have invested 10% to 25% of their financial assets in the stock market. 40% of the respondents have less than 10% of their financial assets in the stock market. Only 12% of the respondents invested more than 25% of their financial assets in the stock market. The investors seen to be cautious about the risk involved in the stock market.

Investing through primary market: In recent years, guidelines issued by SEBI to streamline public issues together with the prospect of making a quick gain on listing of the shares in a buoyant market, public issues are becoming an avenue for investment for retail investors. Investing through the primary market might be important considering that once the shares debut for trading, they usually become dearer to invest in, if the company is reputed one. The primary market investors are entitled to get right shares, majority of the respondents, (42%), have invested less than 25% through primary market. They seem to be buying in the secondary market after the stocks have performed well. Several surveys found that many first-time equity investors enter the stock market through the Initial Public Offering route.

Investments in debentures and public deposits: Equity share capital appears to be the most popular mode of investing in the capital market. 80% respondents have invested in equity shares, while 12% have invested in debentures and only 8% have invested in public deposits. Of late, the government had begun to mobilize resources through disinvestment of public sector shares. Major public sector concerns such as Coal India Limited, NHPC, SJVNL, SAIL, BALCO, ONGC, BHEL and NTPC had made hugely successful public issues. In the sample, 46% of the respondents have made investments in public sector concerns.

Investment in mutual funds: According to the 'India Household Investor Survey', 2006, majority of retail investors do not regard mutual fund equity schemes as a superior investment alternative to direct holding of equity shares. The percentage of households who owned equity shares directly is more than 2.5 times the percentage of those who owned any mutual schemes. As per another survey, the penetration of mutual funds in the retail investor segment is still low at 6 per cent of GDP against 70 percent in US. The data reveals that a considerable majority, (two third), have not invested in mutual funds. The failure of the Unit Trust of India, a highly popular public sector Mutual Fund, could have discouraged the investors from Mutual Funds, although there is a mushroom growth of such Funds in recent years.

Trading on-line: On-line trading is a new invention in the Indian stock market. There are several on-line trading companies and the investors in cities are reportedly using this trading channel rather than trading through brokers. The commission charged for on-line trading is much lower that what brokers charge for buying/selling shares. The data indicates that a majority of the retail investors, (48%), are yet to use this

channel, due to high-risk perception and lack of familiarity with on-line systems. Nevertheless, the proportion of those who trade on-line is quite considerable (52%).

Knowledge about promoters of companies: Competent management is a sine quo non for the profitability of a company and capital market gains, therefore, imperative on the investors to examine the background of promoters /directors before making investment decisions. While a substantial majority of the respondents, (84%), look into the standing and credibility the promoters or directors of a company before investing in shares of a company and the remaining 16% do not examine the track record of promoters/directors of the company before taking investment decisions. The retail investors seem to exercise due diligence about the management of companies.

Diversification of risk: Diversifiable risk is that risk which can be eliminated by investing in different types of companies. According to the risk theory, such risk becomes zero if an investor invests in 15 companies. Beyond that diversification does not help. The data suggests that about 20% of the retail investors have not completely eliminated the diversifiable risk as they have invested in less than 15 companies.

Trade or hold ? As an investor gains experience in the stock market, he tends to trade his stocks taking advantage of price movements rather than be a passive investor. Table 2 reveals that a majority of the respondents, (70%), trade regularly and the remaining 30% just buy and hold stocks do not trade at all. Those who trade regularly can be considered as the active players. Stock traders who trade more frequently tended to have a larger deal size and a larger total transaction value. There is a tendency to buy and hold shares especially among the less knowledgeable. They are only stockholders but not stock traders.

Taking investment advice from a share broker: For retail investors who trade on-line, a broker would be dispensed with. However, for those who trade through exchanges, broker suggestions on the trading decisions may have considerable weight. The study reveals that about three-fourths of the respondents buy/sell shares always/often based on the advice of their broker. On the other side 60% retail investors follows the tips given on various news channels and sites. About 5% investors used the SMS facilities provided by the paid agencies as intraday tips.

Timing of the disinvestment: A prudent investor closely watches share price movements and sells or buys to maximize profits and minimize losses. Table 2 shows that 73% of the respondents sell when the share price goes up, 14% sell when the share price goes down considerably, 8% sell when **a** company is in losses while 5% do not relate their disinvestment decisions to share price movements. Those who generally buy and hold also mentioned that they disinvest when the share prices go up substantially.

Trading in futures: The SEBI has introduced the first derivatives product index futures in June 2000. Mostly, the institutional investors/high net worth investor's trade in futures due to the high margins and higher investment required. Table 2 indicates the popularity or otherwise of futures trading among the smaller investors. It shows that about two-thirds of the retail investors deal in futures market indicating their responsiveness to developments in the capital markets and their propensity to taking risk.

Returns from the stock market: Returns from the capital market comprise dividends, capital gains and bonus shares. The returns from stock market are evaluated against bank interest rate. The number of times the original investment has grown is also taken into account. It is apparent from the data in Table 2 that a vast majority of the respondents, 82%, have got more than bank interest rates, 12% have got returns equal to bank interest rate and 6% have got less than bank interest rates. Hence, one can conclude that a majority of the respondents have benefited by investing in the stock market.

Growth of original investment: As indicated by the investors, capital appreciation is the main reason why they invest in the stock market. Table 2 concludes that most of the investors' investment grew much

faster than bank/post office deposits, which will take more than seven years to grow two times.

Gains/Losses from the Stock Market: The study tried to find out whether the investors have gained considerably from their stock market investments. It is heartening to note that most of the respondents, (about 82%), have gained considerably from their stock market investments and they mentioned that it is worthwhile investing in the stock market. Only about 18% have lost their money in stock market operations.

Watching share price movements and business news: About 85% of respondents monitor the share price movements by reading and listening to business news every day. Aspects such as knowledge about the promoters watching business news and share price movements are looked into, in order to know whether the investor is taking informed decisions or not. Recently introduced 20 : 20 by CNBC on the basis if IPL 20 : 20 and previously GUL & TULSIAN program shown by the same channel influenced the retail investors in majority.

Buying and selling shares based on market movements: Unless investors react quickly to market changes, they cannot benefit from their stock market operations. A large chunk, (85%), buys/sells shares based on market movements. Hence, most of the investors may be deemed to be active players in the market.

Re-investment of capital gains and dividends in the capital market: About three-fourths reinvested their capital gains from the market in the market and about two-thirds reinvested the dividends. The retail investors do not seem to depend on stock market returns for running the households due to income from salaries, business or profession or other sources.

Conclusion

According to the findings of the sample survey, the typical retail investor in Faridabad is well educated and belongs to the upper middle class strata of the society. The investor is a relatively new entrant to the capital markets possibly drawn to it by the investor friendly, easy to access markets of the liberalized era. The findings of the study are encouraging in that the majority of the investors seem to be well aware of the nuances of the markets and the risk involved. Equity is more popular than debentures, debt or mutual funds. The retail investors are investing in both primary and secondary markets and are timing their investment/disinvestment decisions in tune with market movements. The level of involvement of the respondents in the stock market is high and their participation is demonstrated by greater diversification and trading activity. This demonstrates the stock market investors' recognition that they must take control of their own stock market destiny by being watchful and alert to market movements. The investors seem to know what they are doing and why they are doing it. New developments in the markets like online and futures trading seem to have found favour with quite a good number of the investors. A good percentage of the investors have gained from the markets and reinvested the same in capital markets. The sample investors are generally positive about the stock market and showed a higher degree of satisfaction. From the findings of the survey it may be concluded that the retail investor is hereto stay and the capital markets may well emerge as strong contenders for traditional investment avenues like bank/post office deposits.

Table: 1 Profile of the Retail Investor

SL.No.	Character	Response %
1.	**Gender**	
	Male	70
	Female	30
2.	**Age in Years**	
	Below 25	14
	25 To 40	36

	40 To 60	35
	60 and above	15
3.	**Education**	
	Under Graduates	14
	Graduates	26
	Post Graduates	42
	Professionals	18
4.	**Income per Month (in Rs.)**	
	Less than 10,000	8
	10,000 To 25,000	18
	25,000 To 40,000	52
	40,000 and above	22
5.	**Employment Status**	
	Employed	38
	Self employed	41
	Retired	21
6.	**Objective of Investment**	
	Capital Gain	87
	Dividend and Bonus Shares	13

Table: 2 Investments by Retail Investor

SL. No.	Character	Response %
1.	**Entry into the Market**	
	Less than 2 years	30
	2 To 5 Years	38
	5 To 10 Years	20
	10 and above Years	12
2.	**Share of Stock Market in Financial Assets**	
	Less than 10 %	40
	10 to 25 %	48
	25% and above	12
3.	**Percentage Investment through Primary Market**	
	Less than 25%	
	25 To 50 %	42
	50 To 75 %	36
	75 % and above	12
		10
4.	**Mode of Investment**	
	Equities	82
	Debentures	10
	Public Deposits	8
5.	**Invested in Mutual Funds**	
	Yes	36
	No	64
6.	**Trading On-Line**	
	Yes	52
	No	48
7.	**Knowledge about Promoters of Companies**	
	Know	84
	Do Not Know	16
8.	**Diversification of Risk**	

	Less than 5 companies	20
	5 To 10 companies	44
	10 To 15 companies	20
	15 to 20 companies	12
	20 and above companies	4
9.	**Trade V/s Hold**	
	Generally buy and hold	30
	Trade regularly	70
10.	**Time of Selling Shares**	
	When a company's price goes up	73
	When a company's price goes down	14
	When a company is in losses	8
	Not Applicable	5
11.	**Trading in Futures**	
	Yes	65
	No	35
12.	**Return from Stock Market vis-à-vis Bank Interest**	
	Bank Interest Rate	
	Less than Bank Interest Rate	12
	More than Bank Interest rate	6
		82
13.	**Growth of Original Investment**	
	Less than Two times	18
	Two times	38
	Three times	27
	Four and more than Four times	17
14.	**Gains/ Losses from Stock Market**	
	Gains considerably	82
	Lost some money	18
15.	**Watching Share Price Movements and Business News**	
	Yes	
	No	85
		15

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