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The Disruption Of The Indian Stockbroker

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ABSTRACT

Stockbrokers are critical financial intermediaries facilitating traders and investors to access the capital markets. These middlemen who connect the end market participants to the stock exchanges and settle their securities face severe recent regulatory moves and are on the edge of getting disrupted. Global trends are that stockbrokers are getting eliminated because of the potential implementation of Direct Market Access (DMA). This explanatory case examines the possibility of such an idea as the Indian capital market regulator, the SEBI, in 2020, gave a hint of the potential implementation of DMA in the country. SEBI also began tightening regulations, such as the peak margin rule, which threatens the stockbroker community. The case discusses the happenings in the capital market ecosystem that lead to broker disruption. It also highlights critical challenges for stock exchanges in implementing DMA. Finance students from Business Schools will have the opportunity to understand the importance and functions of market intermediaries in the capital market as a part of their classroom discussion.

KEYWORDS discount broker, financial advisory, investment adviser, direct market access, financial intermediaries

Introduction

The case revolves around the stockbroker community – a critical financial intermediatory that provides the vital linkages between the investors and traders on one side and the stock exchanges on the other side. The stockbrokers were responsible for providing facilities to their trading and investing clients, from opening a trading and Demat account to routine daily settlements. They rendered services even during the tough COVID-19 times, thanks to the Government for exempting their services from lockdowns. After all, the stock market and the economy have close linkages and are vital for the country.

However, the recent moves, such as the proposed introduction of the Direct Market Access (DMA) facility and a plethora of regulatory requirements as peak margin requirement, by the capital market regulator - the Securities and Exchange Board of India (SEBI) are threatening the stockbroker fraternity. The DMA allows investors to transact directly with the exchanges without the orders going through a stockbroker. The is a severe disruption to the business and threatens the survival of several lakhs of market intermediaries. Stockbroking business revolves around trading and investing activity. The broker business depends on a good track record of recommendations, quality of research, and transparency apart from careful and timely execution of client orders. With the sudden disruption, their growth strategies are put on hold as brokers began thinking about their very survival. Many brokers will wonder whether to surrender their license in a challenging situation or merge with the big brokers. The case study challenges the management students in building business strategies amidst sudden disruptions because of the changing macro environment.

The case study lets finance students discuss and debate the significant disruption and the changing landscape of the Indian stock broking industry. Soon after the shocking news revealed by SEBI, investors would be allowed to trade with the exchanges directly. Share prices of the brokerage firms declined up to 8% on the day of the Direct Market Access (DMA) announcement, i.e., July 27, 2020, and ever more value erosion occurred in the subsequent days. (See Exhibit 2). However, brokers claim that the broking business cannot be done by exchanges themselves become of several intermediate activities.

The implementation of DMA leads to several challenges. Retail traders and investors require both front-office and back-office services, and stock exchanges are not generally ready to offer these services. Deven Choksey, group managing director, K R Choksey Investment Managers, is confident the broking business will not close down, and the topic comes up on social media now and then. (Oberoi, 2020) However, owing to the rapid pace of disruptions, particularly in the age of fintech and blockchain, hints of disruptions should not be taken on a lighter note.

Evolution of the Indian Stockbrokers

The Indian stock market is home to the oldest stock exchange in Asia. In India, the stockbroking concept evolved from trading loan securities in the 18th century to corporate stocks in Bank and Cotton in Bombay during the 1830s. There were only half-a-dozen brokers trading during 1840 and 1850. The number grew to 22 when the trading used to happen under a banyan tree. The number of brokers grew to 250, and the trading activity shifted to a hall in 1875. The hall became the venue for the formal setup called the Bombay Stock Exchange (BSE). The venue later got shifted to the present BSE Building on Dalal Street in 1930. (Kumar, 2015) The SEBI was formed in 1992 to be the capital market regulator. Established the same year, the National Stock Exchange (NSE) got formal recognition to undertake stock trading activities only in April 1993. Several small stock exchanges in the country shot up over the years but eventually got closed over, paving the way for BSE and NSE to be the market leaders in the segment. There are few other exchanges to operate in specialized markets – such as the MCX in commodities, amongst others. The capital raised, volumes traded, and the number of participants has increased multifold over the years as the country grew to become a leading global economy. The turnover of BSE rose from mere Rs. 50,064 crores in 1995-1996 to Rs. 4,96,476 crores (as of March 5, 2021). After all, economics state that the stock market reflects the economic prosperity of the country. (Ray & Vani, 2012)

The capital markets are one of the biggest benefices of the Indian telecom revolution. Stock exchanges allowed trading terminals to be set up across the country with VSAT terminal connectivity to the stock exchange. Later, internet-based trading and now, mobile-based trading apps became the norm. (Sarika, 2011) The Trading and Demat account opening process moved online and became simplified, reducing the trading account opening process quickly and easily. Growing income levels of Indians attracted many to put in their hard-earned money as their trading and investing capital.

Stockbroking business is generally considered an evergreen and lucrative business. Brokers earn their commission irrespective of the client making a profit or not. Of course, despite the introduction of Goods and Services Tax (GST), transactions in the stock market involve several changes, including Securities Transaction Tax (STT), Exchange Transaction Charges, SEBI Turnover Fees, DP Charges, and Stamp Duty (of the respective state). Despite a range of imposed expenses, traders and investors are generally not deterred from their stock market activity.

Types of stockbrokers

The four key financial intermediaries currently operating in the Indian capital markets are:

1. Stockbrokers
2. Depository or Depository Participants (DPs)
3. Banks
4. Clearing Corporation

The death knell of sub-brokers

The SEBI Act, 1992, speaks about the regulations that govern the stockbrokers and their operations in India. Every stockbroker has to register with SEBI before they can start offering services to clients. Trading activities had a golden era as the Indian economy flourished during early 2000. Stockbrokers often extend their reach with the help of sub-brokers who acts on behalf of a trading member as an agent and helps investors deal with securities. (SEBI, 2018) However, a fall in investor sentiment and strict SEBI regulations resulted in about 30,000 sub-brokers going out of business between 2011 and 2014. (Laskar & Sunil, 2014) Later, in 2018, SEBI has done away with the concept of treating sub-brokers as market intermediaries. Time was given till March 2019 for the sub-brokers to convert themselves into an authorized person or a trading member – both of which are complicated options for many small sub-brokers. Finally, the sub-broker show had their curtains down

Rise of Discount Brokers

Thanks to the blessings of market regulations, price and service competition became the key factors in determining types of stockbrokers - full-service brokers and discount brokers. Regulators in some countries allowed full-featured brokers to cut their commission in a bid to attract accounts. (Babb & Cone, 2015)

A full-service broker offers high-quality branding, uses its marketing muscle and branch network to attract traders and investors. Their service offering will include a full bouquet of features such as access to research reports, advisory services, quality, timely customer care, and a stable trading platform. On the other hand, Discount broker services carry no-frills because it includes trading and investing platforms but at a very low-cost. They are suitable to market participants who can take trading and investing decisions themselves and do not depend on the broker for providing add-on services such as research and advisory services, portfolio management services, wealth management, and branch support.

In the Indian context, ICICI Direct, HDFC Securities, Kotak Securities, Motilal Oswal, Sharekhan, IIFL, and Geojit are popular full-service brokers. Zerodha, Upstox, and Trade Smart are young tech-savvy discount brokers.

Indian online trading industry volumes took a quick surge in the recent past, according to an HDFC Securities March 2019 report. While 22% of total trading volumes are online in FY13, it rose to 29% by FY18. This change in trend is large because of increased penetration of internet services, the growing influence of millennials, and an overall rise in financial awareness. Needless to a startup retail discount broker Zerodha became the leading broker in terms of active client accounts, surpassing established and full-service broking service companies.

As of June 30, 2020, 287 brokerage houses were handling 82.11 lakhs of active client accounts. (NSE, 2020) The number jumped up to 163.92 lakh accounts handled by 279 stockbrokers by January 31, 2021. (NSE, 2021)

What is Direct Market Access?

Direct Market Access (DMA) is the facility that stock exchanges provide to registered traders and investors to transact with the stock exchange interface, bypassing the order routing through a stockbroker terminal/server. Under the new system, brokers have to authorize their clients/investment managers by fulfilling KYC for providing the DMA facility. Traders who wish to enter into the DMA facility have to sign terms and conditions. Earlier, it was a broker-client agreement.

Nithin Kamath, Co-founder and CEO of Zerodha say that brokers used to bear client default risks so far, and now, exchanges will have to take that risk as one large entity. Situations like these could accumulate systematic risk, and on extreme volatile days such as that of 2008, could bubble out. Zerodha is the largest stockbroker in India in terms of active clients. It has twice the number of active clients compared to its nearest competitor. (See Exhibit 1) Kamath says that one fat trade by a single trader could bring the entire system down. (Kriplani, 2020) It may be recalled that even institutional investors, whose ticket sizes are no match to most small retail investors, are settling their orders through brokering houses.

Large players who charge low rates in the industry began dominating, making small brokers fall prey. When small brokers are shutting the door, Zerodha added 10 lakh customers during the peak of COVID-19 (April-September 2020). Not just account statistics, but Zerodha leads in transactions volume as well – As much as 12 to 15 percent of retail transactions are through this broker. (Lokeshwarri, 2020) Overall, the stockbroker industry grew eight percent to Rs. 21,000 crores. (Mampatta, 2020) The top-tier brokers, such as Zerodha, IIFL, and Motilal Oswal, gave salary hikes and bonuses for its employees in 2021. (Bhattacharyya, 2021)

DMA is not a new phenomenon. Several stock exchanges around the world are already allowing their institutional clients to trade with the exchanges directly. Algorithm or Robo-trading and ultra-low latency trading require DMA to be effective.

What are the advantages of DMA?

The introduction of DMA will be beneficial to retail investors. The advantages include:

1. Low transaction cost. No oversight, order management, and risk management.
2. Orders are processed directly with at the Exchange itself in almost real-time
3. Provides high liquidity and price opportunities
4. Low possibility of information leakage or delays
5. Data becomes available quicker - usually at low latency or ultra-low latency

The multiplicity of roles by the Exchange

Dhiraj Relli, MD and CEO of HDFC Securities, says that stock exchanges taking over the role of a stockbroker takes much time as the function involves mundane back-office activities that exchanges have to build from scratch. He points out KYC operations itself to be a monotonous task for the exchanges. (Kriplani, 2020) Stock exchanges at present are inspecting brokerages, and with exchanges themselves being brokerage houses, they function both as the regulator and a service provider. Jimeet Modi, CEO of Samco Securities, rules out that the idea is legally and operationally impossible to serve millions of investors. Some experts say that exchanges can automate and take up only settlement functions.

Stock Exchanges need to build specialized front-end and back-end infrastructure to support retail clients. It needs to hire a dedicated workforce to handle and support the operations promptly. The exchanges of late had infrastructure outages. Trading in all market segments of NSE got halted on February 24, 2021, for almost four hours – the most prolonged outage. The outage was primarily because of two reasons - failure of NSE online risk management systems and the two telecom connections that turned unstable (Sultana, 2021) SEBI quickly approved the request of the exchanges to extend trading till 5 PM on that day. However, with crazy price moves, traders and investors were in confusion and avoided taking positions. (ETMarkets, 2021) Apart from the technical glitch, the incident highlighted the failure of two critical elements. Stock exchanges maintain disaster recovery sites, and when the primary sites go down, the orders should automatically re-routed to the disaster site, which did not happen. Another failure was in the promised interoperability functions because NSE Clearing Ltd (NCL) stopped its operations to preserve NSE's monopoly and hold the market to ransom, as charged by BSE. (Philipose, 2021) The event promoted SEBI to prepare a comprehensive framework for exchanges to deal with during technical outages. (ET Now Digital, 2021) India of late had a series of technical glitches and outages as the country is embracing digital culture. (Manoj, 2021) Looking at all these, one would doubt if stock exchanges have enough stable infrastructure to handle retail clients directly?

Challenges for Stockbrokers

Stockbrokers are already facing severe challenges. The year 2019 is considered the "Year of the Great Brokerage War." Many international stockbrokers changing their business models and transformed themselves into commission-free brokers. The list includes TD Ameritrade, E*TRADE, Ally Invest, Fidelity, Robinhood, Charles Schwab, and Vanguard. A similar phenomenon is observed in India too. Besides the competition that got ignited with no-free brokers, the broker fraternity was already facing a spate of headaches. Regulatory tightening and oversight, processes that are costly to implement, are some deterrents.

The stock markets worked, as usual, even the tough COVID-19-led lockdown times. Capital market intermediaries are exempted and allowed to travel during the times. Systems for a work-from-home (WFH) were already there. The number of new Demat accounts opened during the period was at a record high. (See Exhibit 3) Despite this, the stockbroker became a victim. In August 2020, a Kandivali, Mumbai-based stockbroker killed his wife, and himself committed suicide because of lack of work amidst the pandemic. (Thaver, 2020) There are several instances like these that have happed.

New Margin Rules

At the end of July 2020, SEBI released a circular on margin collection that will bring additional cost burden for investors. (SEBI, 2020) According to this, stockbrokers have to collect an upfront margin fee of Rs. 50 per script per lakh when they allow leverage (margin/derivative trading limits) to traders based on the shares held in Demat format. Pledge creation beyond Rs. 1 lakh will be charged at 0.5%. Before this rule was introduced, the general practice of brokers is to transfer shares to a margin account because they have a Power of Attorney (PoA) that allows this. Also, client permission to do this from time to time was not necessary. However, depository participants (DP) such as CDSL and NSDL had to bear the cost burden because of pledge creation and invocation. SEBI discontinued the PoA concept for allowing margin, paving the way to the new margin rules regime. The new system thereby puts additional cost burden apart from brokerage cost and will discourage traders because trading without margin funding is almost impossible, particularly for small retail traders. (Shah, 2020c)

After an uproar by the investor fraternity and repeated representations by the brokers to both SEBI and Finance Ministry, SEBI gave partial relief by allowing both the old and new systems to run till the end of August 2020. (Upadhyay, 2020) With most brokers opposing the rule, SEBI further deferred its decision to September 2020. (Shah, 2020a)

SEBI introduced a staggered approach towards margin money that stockbrokers can allow to their clients. Trading clients had to have at least 25 percent of the broker's peak margin in the first phase that began in December 2020. The minimum margin requirement is increased to 50 percent in the second phase, starting on March 1, 2021. The margin percentage will go up to 75 percent and later to 100 percent in the June-August 2021 and September 2021 phases. Further, brokers have to update the margin money usage to the client multiple times during the day. Earlier, this was done at the end of the day only.

The peak margin rule envisages shielding the broker from default risk. However, the plethora of rules would discourage small retailers from trading altogether because they cannot afford such markets. The result is that retail trading volumes which in turn impacts stockbroker revenues. Thus, regulators will have to do a balanced play between sustainability and stability. (Singh, 2020) Margin funding is one aspect that the stock exchanges might not want to handle when DMA gets introduced. Perhaps, is this one reason why the concept is getting phased out?

Banks gets tough on brokers

Intraday traders need margin money to trade and expect their brokers to provide it to the maximum available extent. Stockbrokers depend on banks to lend them by taking fixed deposits, shares, or property as collateral in a Short-Term Loan (STL) form for this. While this process is acceptable at ordinary times, the hidden systemic risk gets exposed during a crisis.

RBI and SEBI began scrutiny on HDFC Bank for allowing STL to stock and commodity brokers wherein half of the money was lent in the form of an STL, and the remaining half was granted as funded fixed deposit. In some cases, the brokers used the STL money to raise additional money from the bank guarantee, deposited with the clearing corporation to get trading limits. With scrutiny coming in, HDFC Bank reportedly informed brokers that it would not lend STL for margin. The move triggered fears amongst brokers that liquidity issues will kick in and affect the stock market. The linkage between stockbroker IndiaNivesh and Edelweiss Custodial Services Ltd that has put the former into trouble is a case in point. (Shah, 2020b)

Default of Karvy

The stockbroker was due approximately Rs. 2,300 crores to over 2,35,000 investors, faced a ban from SEBI and was disabled (trading rights are withdrawn) on December 2, 2019. Karvy apparently misused a power of attorney (PoA) given by its clients for buying and selling shares and used it to divert client shares into its Demat account, pledge them to avail themselves of loans. Almost a year later, the disciplinary proceedings are still on their way.

Karvy default a boon for discount brokers because it allowed existing discount brokers such as Zerodha and Upstox to get new client account and even fueled the entry of new players such as PayTM into the business. (Prasad, 2020) On the other hand, discount brokers are often dreaded and must come out to explain that they are in for a serious market. (BusinessLine Bureau, 2019) However, on November 17, 2020, the NSE said it had settled Rs. 2,300 crores worth claims and all dues for investors up to Rs. 30,000 as fund balance were settled. (BusinessLine, 2020) In February 2021, Axis Securities and IIFL Securities won the bid for trading and demand accounts of Karvy Stock Broking. Once the transfer of accounts happens, IIFL would become the third-largest stockbroker in India. (ET Now Digital, 2021)

Some experts blame the Karvy episode as an issue of prolonged regulatory failure. Like many other countries, financial market regulations in India are more of a learn-by-experience. However, they are getting robust with each passing day.

Defaults by other brokers

Earlier in 2018, New Delhi-based F6 Finserve (ET Bureau, 2018) winded off its operations. The same year, another Delhi-based broker Ficus Securities Pvt Ltd, siphoned off funds and securities (Moneylife Digital Team, 2018)

Stockbroker default rates are at a record high in 2020 as investor confidence began to dip to new lows. Scams, issues, or defaults of Anugrah Brokers (Moneylife Digital Team, 2020), and Modex International Securities, have rocked and kept investors sleepless throughout the year. In March 2021, SEBI fined Anugrah Rs. 90 lakhs accusing it of misusing client funds and indulging in "illicit and unauthorized transactions." (Business Line, 2021)

BMA Wealth Creators, Vrise Securities, and Kaynet Finance defaulted in February 2020 (PTI, 2020) while listed Mumbai-based Action Financial Services (India) Ltd (AFSL) left investors stuck. (Moneylife Digital Team, 2020) Other brokers who defaulted include Fairwealth Securities, Grovalue Securities, Quantum Global Securities, Wellindia Securities, Bezel Stock Brokers, Conard Securities amongst others. (NSE, 2021a)

In fact, with 18 brokers expelled by NSE, 16 by BSE, and two firms winding up voluntarily, the stockbroker defaults are at an all-time high during the year 2020. Not just that, the situation was so pathetic that the total broker defaults on BSE between September 2019 and September 2020 are more than the sum of 10 years combined and more than the total broker defaults on NSE in the last 15 years! (Mampatta, 2020) Altogether, a total of 21 stockbrokers defaulted between November 2019 till March 2021 on NSE.
The SCORES and Investor Protection Fund (IPF) are available to rescue investors when a broker defaults. However, the actions are often slow, mostly ineffective with deterring brokers (Shah,

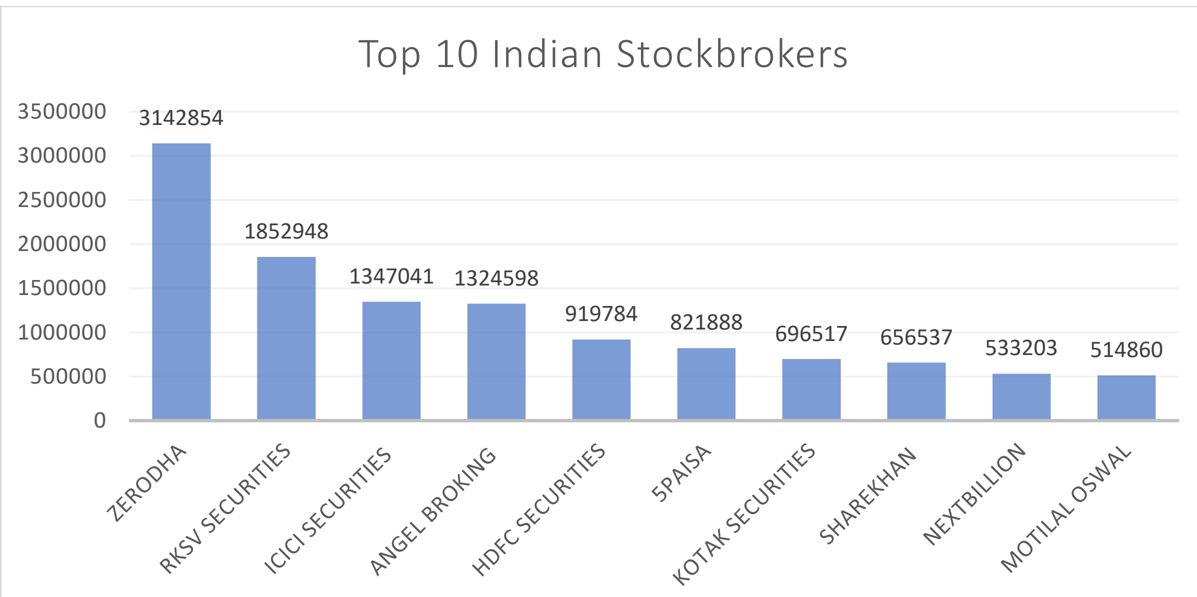
2020), and not up to the expectations of the retail clients.

Industry heading for consolidation?

The Secondary Market Advisory Committee (SMAC) appointed by SEBI deliberating on several more topics that will impact the brokerage fraternity. The topic included the T+1 settlement, capital adequacy norms for stockbrokers, amongst others. (Sharma, 2020) Uday Kotak, President of the Confederation of Indian Industry (CII), has brought up the idea of introducing a capital adequacy framework for stockbrokers. SEBI chairman Ajay Tyagi responded by saying that the stakeholder consultation will be taken up. (FE Bureau, 2020) Once this gets implemented, stockbrokers will have to put in enough and sizeable capital to face any client default. Most small brokers could not afford this. With stockbrokers already working on thin margins, this will mean that only large brokers will remain, and small brokers will have to surrender their license and wind-off their business. With big fish always ready to eat the small fish, the Indian stockbroker community would be heading for a consolidation.

Figures

Exhibit 1: Top 10 Stockbrokers in India and number of client accounts



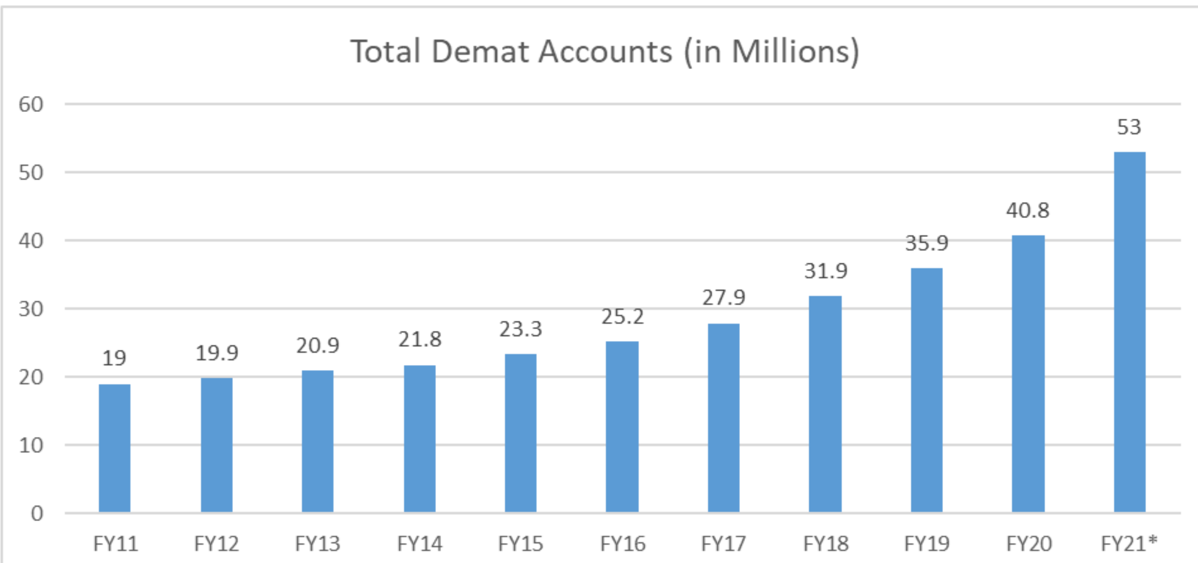
Source: Author compilation with data from NSEIndia.com; Data as of January 31, 2021 (NSE, 2021)

Exhibit 2: Price change of stockbroking stocks between 27 – 30 July 2020

Stockbroker Script	Price Change
5Paise Capital	-18.53%
ICICI Securities	-15.3%
IIFL Securities	-7.43%
Geojit	-7.27%
Motilal Oswal FSL	-5.6%

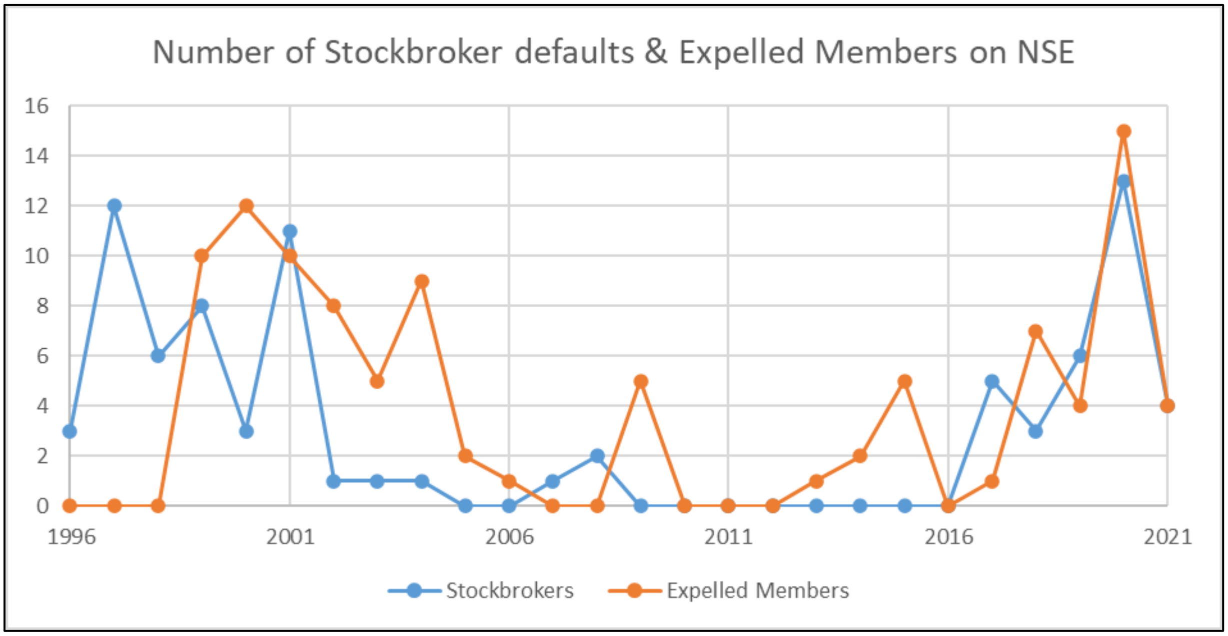
Data Source: Author compilation based on data from NSE

Exhibit 3: Total Number of Demat Accounts in India



Data Source: Author compilation with SEBI Data and other sources; FY21 data is as of February 28, 2021

Exhibit 4: Total Number of Stockbroker defaults & expelled members on NSE



Data Source: Author compilation with data from NSE; Data for 2021 is as of April 6, 2021 (NSE, 2021a)

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Teaching Note

PEDAGOGICAL OBJECTIVES

- To explain the functions of stockbrokers and their importance in the capital market.
- To discuss the consequences of brokerage firms in an emerging economy like India by SEBI decision during the pandemic.
- To illustrate the concept of Direct Market Access (DMA), challenges for stock exchanges to implement it, and impact on the stockbrokers

AUDIENCE

The case has been written for classroom discussion for MBA, Executive MBA, MS, Chartered Accountant Program, as mentioned here.

Program	Course	Section of the Course
MBA, Executive MBA, Chartered Accountant Programs	Capital markets and Indian financial markets courses	Role of the capital market for inclusive economic growth and development.

LEVEL OF DIFFICULTY

Simple/Entry-level

IMMEDIATE ISSUES

1. To understand the consequences of DMA on the stockbroker fraternity.
2. To understand the consequences of small and sub stockbrokers with Direct Market Access (DMA) by SEBI

BASIC ISSUES

1. Difficulties and myths about small and sub stockbrokers
2. Effective monitoring mechanism for stockbrokers

PREREQUISITE CONCEPTUAL UNDERSTANDING

Readers should have a basic idea about the Indian financial markets system. The instructor could suggest the students go through the concepts of the role of the capital market, its impact on economic growth and development, the role and responsibilities, understand how the stock markets and the stockbrokers work.

SUGGESTED TEACHING PLAN

Topic	Suggested Teaching Time
1. Introduction to Indian Financial Markets	9 minutes
2. Role of Capital Markets	9 minutes
3. Role of small and sub stockbrokers	9 minutes
4. Role of SEBI	6 minutes
5. Pandemic impact on Capital Markets	8 minutes
6. Impact of DMA on small and sub stockbrokers	9 minutes
7. Effective monitoring mechanism for stockbrokers	9 minutes
8. Lessons from the DMA	8 minutes
9. Summary	8 minutes
Total	**75 minutes**

ASSIGNMENT QUESTIONS

1. What are the functions of a stockbroker?
2. Will small brokers merge with big brokers? or will they surrender their license?
3. Having spent several decades with the markets and now getting broke, what other options do stockbrokers have?

ANALYSIS

1. What are the functions of a stockbroker?

The SEBI (Stockbrokers and Sub-brokers) Regulations, 1992, explains the procedural aspects of registering as a stockbroker and sub-broker. It also specifies the general obligations and responsibilities. (SEBI, 1992)

A stockbroker is a professional who executes buy and sell orders for stocks and other securities on behalf of clients. Stockbrokers are usually associated with a brokerage firm and handle transactions for retail and institutional customers alike. Stockbrokers often receive commissions for their services, but individual compensation can vary greatly depending on where they are employed. Brokerage firms and broker-dealers are also sometimes referred to as stockbrokers themselves. The most commonly referenced stockbroker firms are discount brokers.

A sub-broker acts on behalf of a trading member as an agent for assisting investors in dealing with securities. A sub-broker acts on behalf of a trading member as an agent for assisting investors in dealing with securities.

SEBI did learn and began tightening the norms since the Karvy Stock Broking crisis of November 2019. (ZeeBiz WebTeam, 2020)

2. What happens to stockbrokers if Direct Market Access (DMA) is introduced?

The Government of India (through its various Ministries and Departments), regulators (such as RBI, SEBI, IRDAI, PFRDA), and SROs (AMFI) encouraged various market participants who provide services to traders and investors. They greatly facilitate and ease the buying and selling of securities or related financial products through the market. Various market intermediaries include the stock exchanges, depositories, depository participants, trading members / stock brokers & sub-brokers, clearing members, custodians, clearing houses / clearing corporations and clearing banks. The necessary legal framework for the smooth function was proposed and is implemented. The regulators were active in firefighting any issue that comes up with due issue of rules, regulations and circulars.

Trading members or stock or stockbrokers are members registered and recognized by the stock exchanges.

SEBI allowed healthy competition amongst brokers by allowing them to reduce brokerage in a big to garner volume. Neck throat competition has forced brokers to reduce brokerage charges. In fact, a new category of brokers called Discount brokers got created with Zerodha leading the pack. Zerodha does not charge for delivery transactions but charges for intraday trading. The flat fee model of Zerodha already disrupted several brokers of the previous generation (those who opened terminals after NSE began offering them in 1996). As of September 2020, Zerodha is handling 12-15% of the Indian stock exchanges' retail transactions, which translate to approximately 50 lakhs to 70 lakh transactions per day.

Brokers who could not afford to migrate to new technology and offer web-based trading platforms got left behind. They neither can offer free delivery transactions. With clients flocking to the new generation brokers, consolidation in the market began to take place. The big fishes will be ready to grab this opportunity coming their way. Some brokers migrated their client base to other brokers, surrendered their licenses, and exited their business. The stockbroker market entered into a consolidation mode.

Meanwhile, there was an increase in Demat account penetration, thus making the untapped market size to become smaller. Getting new accounts opened is getting very difficult and almost impossible. The business is just not viable.

ICICI Securities, in its Annual Report 2019-20, has put forth five points in focus: creating scale, increasing average revenue per user (ARPU), improving customer experience and increasing digitization, and further improving operational efficiency. The company tied up with ICICI Bank and introduced 'Prime' and 'Prepaid' plans.

The discount broker craze is even moving elephants. Sharekhan launched its discount brokerage venture through a new company Espresso in September 2020. Kotak Securities Ltd (KSL) too followed the route through the Trade-Free Plan in mid-November 2020. Experts believe it is not easy for full-scale brokers to take a U-turn and adopt the discount brokerage model. In 2019, Angel Broking experimented by tweaking brokerage plans twice and ended up with Angel iTrade Prime giving discount brokerage services. (Coutinho, 2020)

3. Having spent several decades with the markets and now getting broke, what other options do stockbrokers have?

Having spent several decades with the markets, the small stockbroker community is at the edge of vulnerability. Here are some options that they can explore:

a. Moving to advisory

Some small brokers closed their brokerage services and moved into a fee-based personalized financial advisory and portfolio management role, which is a competitive activity. There are stories of highly educated brokers who started blogs and began using social media to showcase their portfolio building, attract an audience and then go ahead with SEBI registration to start advisory services formally.

b. Selling other financial products

If the stockbroking culture gets disrupted, brokers who till now used to sit before the terminal glued to stock prices will not have to move out of their chair and start seeing their clients face to face. They will have to start marketing and selling non-trading-oriented financial services to collect the commission. For instance, they will have to sell commission-oriented products such as mutual funds, fixed income products such as NCDs, Government products (such as sovereign bonds or gold bonds), and, if required, even insurance products! After all, they have experience in selling financial products and services.

c. Taking technology edge

Emerging disruption technologies like Artificial Intelligence interested some brokers who began giving value addition to their existing business. LotusDew - a Hyderabad startup, began offering Artificial Intelligence-based analytics and data points to create portfolios. Increased digitization and availability of net and mobile-based training have fostered such services.

d. Starting or Migrating to new businesses

Many stockbroking firms have already started doing this, though much of their focus is on getting commission from stock trading. Many brokers even diversified their businesses. Leading stockbroker Zerodha and leading mutual fund distributor NJ Wealth have applied for SEBI permission to enter the asset management business. While the Indian mutual fund market is already crowded, Zerodha expressed optimism that there is a market for passive funds and wants to offer only passive funds as their product offering.

CONCLUSIONS

Though no specific exact date for Direct Market Access implementation was announced by the regulators, the very idea is raising jitters for the Indian stockbroker fraternity, particularly the small stockbrokers who will get displaced. Of course, migrating to the new model takes time and will not be an easy task.

SUGGESTED READING

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2. Indian Share Market for Beginners: Indian Stock Market Basics by Vipin Kats, 2015, Kindle Edition

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