BY INVITATION

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GROUND REALITY: With the explosion of mass media, multiple sources of information are available to investors, mostly free. So, they are no longer dependent on brokers for information to guide their buy and sell choices. Investors who can't follow financial markets either due to lack of time or skill would continue to remain with full service broking firms

A big opportunity waiting to be tapped

DISCOUNT brokerage is only around five years old in India, while it has been around for over two decades in the more advanced financial markets like the US, where it continues to exist with the traditional broking firms. Although the emergence of discount broking has not rung the death knell for traditional brokerages or full service broking firms yet, it has been causing a lot of anxiety to the market participants.

Investors in every market are mostly swayed by the price and cost transaction, but there are also discerning buyers who don't mind paying a higher price, provided the value proposition is right. As the term itself suggests, the USP of discount broking is its extremely low rates of commission. As far as services are concerned, it offers none, except trade execution. Full service broking firms, on the other hand, offer an entire gamut of services, ranging from research reports and trading inputs to financial planning and wealth management. Therefore, both cater to two different segments of the market.

Discount broking is meant to attract day traders who, otherwise, end up paying high brokerage on their trades. It also attracts more enterprising investors who, like the day traders, do their own research before investing. With the explosion of mass media, multiple sources of information are available to investors, mostly free. So, they are no longer dependent on brokers for information to guide their buy and sell choices. Such investors, however, are few and far between.

Investors who cannot follow financial markets either due to lack of time or skill would continue to remain with the full service broking firms, as they depend on their research, recommendations and trading tips, since they mostly follow the buy-and-hold philosophy.

Traditional brokers also retain the advantage of human factor. Investment in equities is complex and a little handholding is always welcome. Hence, a large number of investors prefer investment advisers with whom they can talk and interact. The traditional broking firms will deal with the emerging competition with discount brokers by either moving up or down the value chain. One way to deal with it is to unbundle the services and offer them according to the prospective client's willingness to pay. Thus, within the same broking outfit, one can either opt for discount broking or a more premium service, where brokerage is bundled with research or market reports. We are already seeing this happening.

Since the traditional firms will only be able to charge a higher brokerage for value added services, their quality of research is likely to improve, which, in turn, will also upgrade the overall resilience and quality of information in the market. Some of the smaller brokerages whose research reports are not worth the paper on which they are printed, would either have to improve their quality drastically or downgrade to discount broking. This might also lead to consolidation in the broking industry, as with falling margins and increasing compliance and regulatory cost, firms would try to achieve a certain size to reap the economies of scale. So, before discount broking and the accompanying cut-throat competition becomes a menace, market regulator Securities and Exchange Board of India (Sebi) should relax the norms governing the merger and acquisition of broking business to help the industry to consolidate. Even the exchanges need to do a lot with regard to fees, while the government must change the several tax laws to facilitate mergers and acquisitions.

We believe that following a Luddite approach in this matter is in nobody's interest. We work in the equities market where the investors reward enterprises that do well and penalise that don't. So, to demand any kind of restriction on discount broking runs against the basic philosophy of the stockbroking business. So, no matter how much we insist on curbs, the desired results will not be achieved in a free market scenario.

It is for this reason that the Association of national exchanges members of India (ANMI) had reservations regarding the demand of a regulation on minimum brokerage. It is likely that some of the traditional broking firms might perish in the face of this new challenge, but then, more efficient and innovative firms would replace them. This is the perennial gale of creative destruction that Joseph Schumpeter so eloquently talked about.

It is pertinent to note that the cost of brokerage has never held back investors from the equity market and to expect that discount broking will usher in equity culture in the country is completely misplaced.

With slightly over 20 million demat account and around 5 million retail investors, we have not even scratched the surface properly; there is a humongous opportunity waiting to be tapped. This not only makes business sense, but is also in the interest of our country where investments needs are mind-boggling. It is time for the discount broking firms to join other industry players to work for spreading financial literacy and increase the size of the market.

The relentless march of technological advancement brings with it changes, some of which are disruptive in nature, but the human effort has always been to rise up to it. When the settled way of things change abruptly, there is fear of the unknown and even some over-reaction, but then that is not wholly unexpected. This is not the first time that there has been a major shift in the way business is done in the stock market. We have covered a long journey from meeting under the banyan tree in Mumbai to hiding behind computer screens and executing trades at the speed of light.

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