An Analysis of Future Prospects of Traditional Brokerage System with the Emergence of Online Discount Brokerage System in India.

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Abstract

The purpose of this paper was to dwell into the future prospects of traditional brokers and broking firms with the emergence of discount broking.

Traditionally stock trading is done through brokers in the stock market, either personally or through phone call. As a result of enormous Increase in number of people trading in stock market in last few years, the brokers and broking firms started facing issues like location constrains, busy phone lines, miss communication, etc.

Information technology in this sector like the stock market softwares helps stock brokers in solving these problems with Online Stock Trading. The rise of millennial investors who are tech savvy found online trading platforms easier and efficient to work on. Investors can trade shares through a website without any manual intervention from Stock brokers. Moreover Indian investors have always been price conscious. Discount brokers in India have capitalised on this trait by charging a flat fee (nominal charges) for transactions. They are able to pull this off as discount brokers provide all their services online and don't offer investment advice that requires maintaining a team of qualified analysts therefore saving on overheads. This benefit is passed to consumers in the form of reduction in costs. Brokerage houses have realised broking income will go on reducing in a gradual fashion as India's broking industry is moving towards zero to nil commission era.

Therefore, threat to big broking firms seems to be very real.

The aim of this research was to study this general notion in detail to find out the ways (Positive or negative) in which online discount broking affects the future of traditional broking in India through various secondary and primary sources of data like personal interview with stock brokers, articles and guidelines published by the regulatory body of SEBI, articles published by finance experts in different forms of media.

It was observed that the traditional or full-service broking system is not going to vanish anytime soon and is here to stay in the market individually as well as in a cohesive manner with the online discount broking system.

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1. Introduction

While the full-service brokers have always enjoyed a significant presence and preference among investors, the shift towards technology has given rise to a new breed of stock brokers who we know as discount brokers.

Discount brokers carry out orders at less cost, but they only just execute orders for their clients. These brokers do not offer personal consultations, research, advice, estate planning and tax planning services for customers. The absence of these services, and because they do not spend money closing deals with HNI's (high-net-worth individuals, means that discount brokers can offer very low fees. Additionally, most discount brokers operate their businesses online where the overheads are comparatively lower. While a full-service broker is a licensed financial broker-dealer firm that provides a large variety of services to its clients, including research and advice, retirement planning, tax tips, customized support and interaction in facilitating trades, managing portfolios, financial planning, and wealth management services for clients. All this comes at a price, as commissions at full-service broker. Clients are assigned to individual stockbrokers and/or financial advisors. They are the main point of contact at a full-service brokerage firm.

An enormous number of people are shifting towards the system of discount broking because of several reasons as stated below-

*Discount brokers charge zero to very low commissions on orders. In fact, some platforms levy zero commissions for delivery trades.

*seamless account opening processes such as an online demat account which eliminates paperwork and has made life easier for an investor.

*Easy-to-use, secure and hassle-free trading platforms that help place trade orders with no lag.

*Discount brokers provide Investors with powerful analysis tools needed to analyse and study the markets on their own.

Several issues are also being faced by traditional broking service providers like:

*location constraints faced by Investors.

*busy phone lines.

*Presence of complex processes for opening account or resolving issues forces customers to move towards the ease and convenience provided by online platforms.

*discount brokerage has put pressure on big brokerages to bring down the prices.

*if traditional brokerage system has to totally zero down in terms of its brokerage revenue to stay relevant in the market then it must have other ways to generate revenue which is very limited in India since these firms earn a major chunk of their revenues from brokerage only.

*SEBI's new margin norms may hit traditional brokers harder than the new-age discount brokers.

Most of the research studies and articles on internet, newspapers, and other forms of media talk about the future of new discount broking system in India. Not much heed is paid to the future of traditional broking service providers i.e. if they are going to disappear from the environment or if they can take some steps to adopt different business and revenue models to survive and stay relevant in market.

2. Research Methodology

2.1 Research Motive

This research aims to analyse how increasing popularity of discount broking has affected the traditional broking firms as a whole and their profitability, clientele and working system. Therefore, also understanding the relevance of traditional broking firms in future.

2.2 Problem Statement

This paper tries to answer questions regarding the survival of traditional broking firms in coming future with the increasing popularity of discount broking.

2. 3 Research Objectives

The objectives of this research are stated as follows:

1. To find out if the new online discount broking system is actually a threat to the traditional broking system.

2. To investigate deep into the workings of traditional broking system to find out their relevance in the coming future.

3. Literature Review:

Barbara Black (2000) the author examines the regulatory consequences of online trading developments and the difficulties in applying traditional broking obligations to online discount brokers.

Lal Bhasin, Madan (2004) portrays the prospects for an e-broking industry around the globe. Despite all the challenges, the e-broking industry seems like a sector set to grow day-by-day. Paperless environments, virtual organizations, mass customizations, and the Internet-based customer services are some of the hallmarks of organizations in the new millennium.

Sharma, Jaya (2016) the objective of this research paper was to Gain Knowledge regarding the emergence and growth of the online Trading in India, people perspective about the same and to make a comparative study of some stock brokers.

Dr. Ramesh Onkareppa Olekar, Chanabasappa Y Talawar (2013) this study is intended to identify the various concepts about Demat and the online trading and its way of functioning.

V. E. Krylov, L. V. KrylovaV. A. Eronin,M. P. Vahromeeva, G. A. Trofimova, N. B. Mihalik (2020) The largest commercial electronic trading platforms and the scope of their activities are described with the prospects of development of electronic trading platforms are considered.

Mary F. Mobley, Nabil Ibrahim (2008) Two-group discriminant analysis was used to determine what differences, if any, exist between clients of full-service and discount brokerage firms. Results suggest that a number of demographic and attitudinal variables are the key predictors of such differences.

4. Research Design:

4.1. Nature of Study

This research is of analytical nature as it confines to existing information. It is based on interviews, online articles, information available on SEBI’s website and research papers on the advent of online discount broking system.

4.2 Scope of Study

The scope of the research is based on the personal interview conducted with real time stock brokers as well as information available online in form of articles written by financial and market experts. The study is derived after taking into account the point of view of brokers and experts in the market.

4.3 Collection of Data and Number of Respondents

In this research, both primary, as well as secondary data were, considered. Collection of primary data involved 3 brokers as respondents. Advantages and disadvantages of both full service broking and discount broking will be listed to understand the potential effect of online discount broking over full service broking. Primary data was collected through personal one on one interview with real time brokers to get their perception on future of traditional broking in India. Moreover to get factual data about the working systems and sources of revenue of traditional broking firms. Secondary data was collected through articles written by experienced professionals as well as economists.

5. Data Interpretation and Analysis

Personal Interview:

Broker 1- Mr.Ravi

Aditya Birla Capital-7 years

Total experience-15 years

Broker 2- Mr. Dinesh Tak

Achintya Capital pvt. Ltd.

Total experience-17 years

Broker 3- Mr. Ankur Chopra

CA by profession, taken franchise of Aditya Birla Capital

Total experience-2 years

On being asked about reduction of clientele because of discount broking, brokers mentioned that they did face a reduction in clientele especially during the initial phase of Covid-19 in the country but also mentioned that lot of clients who had closed their accounts with them, came back to reopen their accounts with traditional broking firms as they were not satisfied with the system of discount broking. Moreover, the HNI's and other huge businesses form a solid customer base for them as these customers require the services provided by them and do not have time to do it all by themselves as under discount broking system.

When asked about sustainability of traditional broking firms with zero brokerage, the brokers answered that it would be difficult for them initially but firms like Kotak Securities had already launched trade plans with zero brokerage and that it is definitely possible as they have many products to offer their clients like mutual funds, insurance, IPO, 3 in 1 accounts, etc. Therefore, if they focus on other products and services provided by them, they can definitely survive and stay relevant in the market.

On being asked about the ways in which a traditional broking firm earns revenue, brokers told that brokerage constitutes a major chunk of the total revenue and apart from brokerage, they earn through other products and services provided by them like mutual funds, insurance, portfolio management services, etc.

When asked about the SEBI's new margin norms, brokers said that the new norms have reduced their incomes as broking firms but SEBI has come up with a new system in which clients can pledge their stocks and then can use it as margin. This new system is brought into existence in interests of the investors, so that they can be safeguarded from frauds.

On being asked about the advantages of full service broking system, brokers mentioned that the customer service provided by the traditional system is excellent and many traders require a personal touch which can be only provided through this system and moreover it's not possible for a client to drop a mail regarding their smallest queries (as done in discount broking system) and wait for a solution mail but under the traditional system, clients can directly call or visit to the local office for resolving their queries and getting personalised advice and solutions.

When asked about the future of traditional system in their opinion, brokers answered that this system will not totally vanish but there will be a definite change in the working system (more online services) and the products and services provided by them.

Pros and Cons of discount broking:

Pros

1. It has helped to bring in new and first time investors in large numbers in the market leading to expansion of market.
2. Online system has replaced the personal questions based two factor authentication for login with a six digit PIN and TOTP (Time-Based One Time Password) system for security.
3. Millennials and tech savvy investors find it easier and efficient to work on online trading platforms.
4. Discount brokerages can build core competencies in their operations with the introduction of artificial intelligence in the arena of fintech.
5. Because discount brokers do not offer any advice there lies no interest of discount brokers in trying to make customers buy or sell a particular stock. Hence, ensuring provision of unbiased services.

6. Established discount brokers offer extensive educational materials at their offices or on their websites.

Cons

1. Investors may exit the platforms in large numbers when market crashes because thin margin and heavy discounts lead to traders losing big amount in a short span.
2. They do not offer personal consultations, advice and research to customers. They do not provide any expert guidance.
3. The services provided discount brokers are aimed at self-directed traders and investors, whereas full-service/traditional brokers offer additional services can include portfolio analysis and construction, estate planning, tax advice, etc.
4. They don't offer a three-in-one account (banking + trading + Demat), unlike the full-service brokers.
5. Commissions aren't the only way of making money for discount brokers. Many discount brokers charge extra for services that one might think are included, such as hidden fees for issuing a stock certificate or mailing a statement.
6. Minimal customer service is provided by the discount brokers.
7. Technical issues can cause system failures or crashes creating disturbance in processing orders especially the big trades.

Pros and Cons of Full-service Broking

Pros

1. With the disclosure of information about client's finances and financial goals, the broker gives recommendations about stocks and funds that are suitable for client.
2. Broker knows about the investment goals of the client and *then* offers advice and answers questions about how specific investments and strategies can help them accomplish their investment objectives.
3. Full-service brokers can give access to their investment research department, which can give in-depth information and analysis on a particular company to help clients make their decisions regarding which companies to trade or invest in.
4. Full-service brokers can actually make decisions for their client's account with their authorization. This is also referred to as a *discretionary* account.
5. Excellent customer service is provided by full-service brokers.
6. Full-service brokers provide customized support, financial planning services, portfolio management services and services relating to wealth management to their clients and offer a variety of products such as debt instruments, IPO, FPO, mutual fund schemes, loans product, insurance, and etc. apart from stocks.

Cons

1. They charge a higher commission than discount brokers because of the many services they offer. Therefore it can prove to be an expensive affair when compared to discount broking system.

2. The transaction costs in full-service broking are usually high.

3. There is a disparity in the brokerage plans offered to traders with high transaction volume who are allowed lower brokerage than the traders with lower transaction volume.

4. A process full of extensive paper work is still used for opening of trading and dmat accounts which also make the process very slow in comparison with online discount broking system.

5. Miscommunication between client and broker, busy phone lines and location constraints for investors add to the problems with full-service broking system.

With the analysis of pros and cons of both full-service and online discount broking system, it is understood that there is no one reason considering which all the customers of a traditional broking system would shift discount broking system. Customers make their choice between the two systems based on their personal needs and preferences.

For example: If a person who –

- is a beginner in the stock market and requires more guidance than any other investor in the market.
- does not have the required amount of time to get involved in the process of researching about different companies in the market, their growth prospects and trading opportunities.
- can afford the higher fees and commissions and also has large amount of funds to be invested and managed.

Then such a person would definitely choose full-service broker over a discount broker.

While if a person who –

- is more tech savvy and wants take and execute his/her investment or trade decisions quickly.
- has limited amount of funds to invest and cannot afford to pay high commissions and fees.
- is well equipped with the knowledge of technical and fundamental analysis of socks and is keen on researching on his/her own to take investment or trading decisions.

Then such a person will definitely choose discount broking system over full-service.

According to the information provided by stock brokers in the personal interview, major chunk of the revenue of a broking house comes from the brokerage, commissions and fees charged by them. While most of the clients shift towards discount broking system because of low brokerage, it implies an enormous fall in revenues of broking houses putting a question mark on the existence of these traditional broking houses. Therefore, to analyse the future prospects of traditional broking system, there is a need to look at the revenue model of a traditional broking house.

1. **Commission and fees** - Charging investors a fee to buy/sell securities.
2. **Marginal Trading:** This is usually big chunk of money as lot of traders have some marginal funds (over client's own capital) to trade with. Broking firms charge them interest and financial charges like banks would charge on credit cards.

3. **Sells other services**: Brokers have other business units or partners which deals with traditional loans, credit cards, insurance policies, mutual funds.etc

4. **Misc charges:** They charge some fees on optional trading settlements, expedited money transfers, premium services.

The revenue model clearly shows that the traditional broking houses do not rely completely on brokerage as their only source of income.

But the new regulation of SEBI doesn't allow brokerage firms to pledge client securities to an NBFC or any third party went live from 1st October 2020. This means that brokerage firms who offered **margin funding** (allow clients to buy stocks for more money than what's in their account, and charge interest for the shortfall) by keeping the unpaid securities in their own account, and in turn pledged it to another NBFC to raise funds, they can't do it anymore. So brokerage firms going forward can only lend to the extent of their own capital. This has caused damage to most of the traditional brokerage firms.

The new norms have brought the following changes:

- The stock will remain in investor's account and can be directly pledged to the concerned person/authority which means investors will continue to enjoy all corporate benefits on their shares. Under the old system, investors either had to give Power of Attorney (POA) to the broker or transfer their shares to the brokers' account.
- Brokers must collect margins from investors upfront for any purchase or sale of stocks. Any client failing to do so will attract a penalty.

Brokerage firms are compelled to look for different sources of income because of the severe hit suffered by the stock market starting from January this year. The market has faced enormous pressure with the indices brought down more than 60% from the recorded highs whereas the traded turn over has declined by almost half.

In this desperation of waiting for the stock market to recover, giant companies like Motilal Oswal Securities, Edelweiss, Infoline and ICICI securities have now stepped into various new business functions to keep their business alive. They now offer services like Private Equity fund management, sell third party insurance products, and even lease their website space for advertisements.

Surprisingly stepping into these new opportunities has worked well for some companies. For example- Motilal Oswal, chairman and managing director at Motilal Oswal Financial Services said that they have experienced 25-30% growth in the last quarter from non-broking business activities like private equity and wealth management.

6. Conclusion

According to the data analysis and interpretation:

During the times of Covid 19(during financial year 2020) millions of new demat accounts were opened but and a lot of them were opened with online trading platforms and some clients of traditional broking system also shifted towards the online discount broking system. But the clients who switched platforms soon came back to traditional system, reason being most of the clients felt the lack of good customer care services, advice from experienced stock brokers, additional services like portfolio management, estate planning, tax advice, etc., most of the clients do not have sufficient time nor the fundamental and technical analysis skills to select stocks for investment or trading. Thus, forcing clients to move back to the traditional broking system.

The industry giants and big players of the market neither shifted nor are going to shift towards online discount broking system because they require the expertise, experience and premium services provided by the traditional system. Moreover, technical issues and glitches in online broking systems cause problems and delay in execution of big trades (large order quantities) which is definitely not preferred by the big players of the market.

As far as SEBI’s new margin norms are concerned the stricter regulations are brought to minimise the risk of frauds. As earlier some brokers were illegally transferring client’s investments to their own account and were pledging them without authorisation. As a result of the norms clients now have to pay either the upfront cash margin or pledge the shares to cover margin.

Even if the traditional broking houses are forced to cut down their brokerage charges which is apparently a major portion of their income, they will be able to survive in the market as these broking houses have other by-products and have entered new spaces like insurance, fund management for private entities, MF and ad space selling, etc.

From the above stated observations it can be concluded that though online discount broking system has gained popularity in past few years, traditional broking system is here to stay as it has the trust and reliability of many clients and amidst the inherently volatile market and pressing times, expert guidance of full service brokers is a necessity. In the coming future both the traditional and online discount broking systems will be exiting cohesively.

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