



## Zerodha - A Success Story(A)

In October 2015, Zerodha was yet again the recipient of the BSE-D&B *Emerging Equity Broking House* award. Since inception, the company recorded a phenomenal growth with an exponentially growing customer base. Zerodha had a team of about 200 and served close to 60,000 clients across India. Even though receiving the award for two consecutive years was a massive feat, Zerodha was still an emerging broking house. Nithin Kamath, Co-founder and CEO of Zerodha, wanted Zerodha to develop a strong foothold over the Indian Brokerage Industry. It was almost five years since they started Zerodha and he thought it was about time to launch their latest product “Kite” that he hoped would make trading intuitive for everyone. Zerodha had been riding on the wave of zero brokerage in long-term equity trades and Kamath wanted to continue with it. However, he had concerns about the sustainability of the strategy in the long term. He decided to call a meeting with his Chief of Operations, Venu Madhav and Chief of Client Relations, Hanan Delvi, to understand the results of beta testing of the product and discuss their future strategy.

### INDIAN BROKERAGE INDUSTRY

The stock market industry came into existence as a platform between investors and businesses that needed capital. Stock market enables companies to raise capital in exchange for a small fraction of ownership of the company by issuing stocks to investors. This market has evolved over the years and now offers much more complex products to investors. Today, stock exchanges are platforms that aggregate buyers and sellers who want to trade in different classes of assets like stocks, bonds, commodities, options, etc. Currently, in India, there are over 21 stock exchanges with the largest being BSE and NSE. The stock market industry in India is regulated by the Securities and Exchange Board of India (SEBI). To trade on the NSE/BSE, one needs to become a registered trading member/broker on the exchange which is mandated by SEBI. The criteria to become a trading member are stringent and expensive. Therefore, the public can gain access to the exchange only via a broker. Also, in India, stocks and other financial securities are held electronically in special accounts known as the dematerialized or demat accounts. Each investor has a demat account which is opened by a broker on behalf of the investor.

The Indian Capital Market underwent a myriad of changes in the 1990s. The Bombay Stock Exchange (BSE) faced stiff competition from National Stock Exchange (NSE) as it emerged as the more prominent exchange. As a result, new reforms by both the exchanges made it significantly easier for investors to trade and reduced the barrier to entry for new brokerage firms. Post these changes, hundreds of broking houses came into existence and several others filed for bankruptcy. In spite of these reforms, the broad participation remained weak due to

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lack of knowledge and trust in the capital markets. In 2010, India had only about two crores<sup>1</sup> demat accounts from a population base of over 120 crores. A large number of these demat accounts were either dormant or belonged to the same individuals/families. In fact, according to SEBI, about 80% of the trading volume was generated in 10 cities in 2010. Slow growing investor base along with little barriers to entry, high risk-return characteristics of the business, and a visible shift to low revenue generating transactions like futures and options kept the industry highly competitive.

Some firms were able to establish their brand in the Indian Brokerage Industry. These firms/broking houses provided *full-service brokerage* to clients and potential investors. Full-service brokerage firms were licensed broker-dealer entities that provided a wide variety of services like customized support and trade facilitation (including providing online and offline trading platforms), research and advisory, tax and financial planning, retirement planning, etc. Well known and top broking houses included Angel Broking, IIFL, Motilal Oswal, Edelweiss, HDFC, etc. (See **Exhibit 1**).

These broking houses developed a huge network of branches and franchises across India. This network of franchises helped these brokerage houses to have personal and direct interactions with investors and form a great support system. Angel broking had one of the largest networks of branches and franchises with over 8500 franchises in more than 900 cities. Similarly, Sharekhan, a well-known, brokerage house had 1950 branches and franchises in 575 cities. They also provided access to trading via multiple online and offline platforms like email, fax, mobile and desktop. To provide these services, these brokers charged a fee based on the number of transactions and the volume of transactions executed by the investor, over and above the transaction fee charged by the exchange. These transaction charges could be as high as 2.5% of the transaction value. High transaction costs in turn reduced the return an investor could reap from the stock market and made a large number of people averse to stock markets. Brokers charged a fixed percentage of transaction value as a charge to the customers in exchange for advisory and execution services irrespective of the services required by the customer.

Due to the structure of the industry, brokers who had higher knowledge and expertise dominated the industry. Advisory services offered by the brokers could be misleading as the risks associated with the advice were often not communicated to the investors. These services were aimed at increasing the number and volume of transactions executed and hence had a profit maximization objective for the brokerage house. However, as the risks associated were often not communicated, investors lost money, labeling investment in the stock market as *gambling*. This resulted in a decline in trust in stock markets which was the primary cause of weak participation in the market.

## **ZERODHA - AN ONLINE BROKER**

Back in 2010, Kamath (the founder and CEO) had a vision and was of the opinion that the way forward was online. Technology had come a long way since the days of public outcry and hard share certificates. As of 2010, everything was going online. A person could buy or sell online and receive shares through demat account. In order to ride on this rising wave, he decided to set up an online brokerage platform which was capable of meeting the required needs of customers in the most efficient way.

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<sup>1</sup> 1 crore = 10 million

Foundation of Zerodha was based on the principle of *technology first*. It considered itself as a technology company offering financial services and their focus had always been on providing better technology.

## HOW ZERODHA EVOLVED FROM 2010 TO 2015

In the 1990s and 2000s, technology was a major cost for a stock brokerage company. Apart from that, exchanges also used to collect significant interest-free deposits. A good brokerage house generally spent INR 3 - 4 crores per year on technological research and IT infrastructure and maintenance. In 2010 NSE came up with a new platform called NSE NOW (Neat On Web). This enabled free of cost service to brokerage firms as well as for downstream retail customer. Zerodha applied for NSE membership in January 2010. Their license came in July 2010 and they started operations in August 2010. In the beginning, Zerodha was active only in segments offered by NSE NOW. However, Zerodha was a partnership firm at that time. Whenever any person opened an account at the broking house, they needed a trading account as well as a demat account. For opening a demat account, the company required depository license which was provided by two entities in India namely Central Depository Services Limited (CDSL) and National Security Deposit Limited (NSDL). But the basic requirement was that the broking company should be a corporate entity for becoming a member of CDSL or NSDL. This prevented Zerodha from opening demat accounts for customers. This left them with two options. Either they could change their firm structure from a Partnership entity to Corporate entity and infuse more capital to purchase the depository license, or they could tie up with a third party. In the beginning, they decided to go with the second option. They tied up with Infrastructure leasing & financial services (IL&FS) which was the biggest depository participant. They started offering trading account through Zerodha and demat account through IL&FS. Later on, in 2014, Zerodha Securities Pvt. Ltd. was set up as a corporate entity which became a member of the exchange and obtained depository license from CDSL.

It was difficult to get the first set of customers and gain momentum. To build credibility, they started writing answers on online discussion forums like Quora and other financial/trading forums and started advertising there. Their clientele started to increase due to word-of-mouth publicity. Customers started asking for the trading facility on other exchanges such as BSE as well. In 2011, they tied up with Omnesys technologies. Omnesys was an exchange vendor which provided the trading platform. The benefit of using that platform was that it provided a seamless trading experience across multiple exchanges. Trading platform as a technology had not evolved as much and the screen looked the same as that accessed by people seven years back. Zerodha planned for optimizing operations through investments in technology and invested in a company called Tradelab in 2013-14. They had a trading platform called PI which was for professional traders and provided facilities of using simple algorithms for trading. Zerodha was working hard to integrate technology further to optimize their processes.

Zerodha's objective was to be uniquely positioned vis-a-vis other brokerage houses. They wanted to have some key differentiating factors which provided them with distinct competitive advantage.

## CUSTOMERS

The customer base of Zerodha was in the age group of 18-70. Although Zerodha believed in a standardized product offering and had not segmented their customer on any criteria, the

majority of the customers were male in the age group of 23 to 35. Their active client base was consistently growing at a rapid pace. (See **Exhibit 2**)

## **PRODUCT OFFERING**

Zerodha tried to reduce the complexity associated with product offerings by developing products which were standardized and were on the lines of “one size fits all.” Typical brokerages provided multiple slabs of brokerage based on the type of client, expected volumes, etc. Zerodha decided a single brokerage slab, applicable to all customers regardless of size, volume of trade or any other factor. One such example was their offering for intra-day equity traders.

Madhav remarked, “Generally intra-day trade brokers provide additional leverage to customers depending on the investment size. If a person is planning to invest INR 1 lakh<sup>2</sup> for intraday trade, the broker will provide with additional leverage of (say ten lakhs) so that customer can purchase stocks worth eleven lakhs. Since brokerage is charged on INR 11 lakhs, it is in the vested interest of broker to offer higher leverage to clients. However, there is a risk involved as well because if a stock price goes down by more than 10% on a single day, then it means broker’s capital is getting eroded. Thus, each brokerage house has to invest resources to keep track of different kinds of customers. Since Zerodha is providing the same benefits to all customers as well as charging same brokerage (one size fits all), it can save on a lot of costs. It reduces operational complexity as they do not have to keep a separate team to keep track of special clients to whom they have provided additional leverage.”

## **PROMOTIONS**

Zerodha did not follow conventional methods of advertising for creating awareness about their offerings among the potential customers. They rely on word of mouth and referral. They understood that word-of-mouth publicity spread quite fast among the community of serious traders and thus decided to leverage it. This also aligned with their strategy of onboarding only serious customers.

Although, in the initial years, they had a strategy of not opening physical offices; later, they started to have branches across the city. However, the primary objective of having these branches was that over the last few years they realized that a certain set of the public wanted to see an office if they wanted to open an account. This would help them scale-up. So instead of setting up a typical branch, they set up a one-man/two-man office whose primary objective was to concentrate on sales. Thus, these offices were primarily targeted at those clients who liked to walk in to an office, get a list of documents that were required to open an account and meet someone before getting on-board onto the platform.

## **OPERATIONS**

Zerodha’s leadership was of the view that in a technologically advanced era, there was no requirement for a broking entity to have large offices in every small city. Thus, they decided to have minimal brick and mortar presence. They just set up one headquarter in Bangalore and started most of their operations online. This helped them eliminate infrastructure and overhead costs related to setting up and operating physical office space.

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<sup>2</sup> 10 lakhs - 1 million

Zerodha strongly believed that better technology, service and tools were much more important than price. Thus, they developed a user-friendly interface which was way more intuitive to understand as only relevant options were provided there (See **Exhibit 3**). They purposely decided not to provide rarely used complex options at the same place which helped them eliminate the clutter. Apart from interactive Graphical User Interface (GUI), they tried to optimize their operations by making efficient use of technology. For example, they completely automated the process of fund update. Earlier, the process of updating transfer of funds from bank account to demat account was manual. Zerodha developed Application Programming Interfaces (API) which automated the whole process and provided the facility of real-time fund transfer instantly transferring the funds.

## PRICING

Zerodha charged a fixed account opening fees of INR 500 in the beginning. (See **Exhibit 4** for detailed break-up) This is because they wanted to bring in only those customers on the platform who had a real intent of investing in the market. They did not want dummy accounts to get opened on their platform because there were significant governance and legal compliance costs. Many customers tended to open multiple accounts just because the product was free or very low cost.

They further charged INR 20 per trade for futures, options and other derivatives, and also for intra-day equity trading. (See **Exhibit 5**). They decided to go for zero pricing for long-term equity trading. Though the larger set of customers were long-term positional traders and a smaller set were intra-day traders, they went ahead with competitive pricing, and also hoped that those who were trading long-term would move to intra-day trading or futures and options trading and they would be able to make profits from them in future. The other broker houses tried to copy the pricing model of Zerodha, given their phenomenal growth. However, such a move from the competitors would cannibalize their own businesses as their fixed operating costs were high and could not lower their prices.

## CHALLENGE AHEAD

The meeting with Madhav and Delvi started on a celebratory note on account of the BSE-D&B *Emerging Equity Broking House* award, but there were important decisions to be made for the year 2016 and ahead. Zerodha was aware that the participation in the stock markets from the public was low. While the total number of demat accounts in India was two crores (which was about 1-2% of the population), it was abysmal as compared to developed markets like the USA where penetration was as high as 30-35%. Kamath remarked, "Zerodha will benefit more by being a small fish in a big sea rather than big fish in a small sea."

To attract new customers, both those who were new to the industry and also by grabbing market share from competition, Zerodha was planning a two-pronged strategy. Their new product Kite would make trading easier and bring new customers to the industry; at the same time, zero brokerage in long-term equity trades would allow them to capture market share from competition. While this would keep the "virality going" Kamath was apprehensive of the sustainability of the zero-brokerage strategy. He gave Madhav and Delvi the task of reviewing their current operations to ensure compliance with the overall strategy, which would enable Zerodha to maintain its competitive edge.

## EXHIBIT 1 Overview of Leading Brokerage Houses in India

**Angel Broking:** Incorporated in 1987, Angel Broking had become one of the most respected Stock-Broking and Wealth Management Companies in India. They built up a huge network of Branches and Franchises (more than 900 cities and 8500 franchises) thereby maintaining a great support system for investors who prefer human interactions while trading. Alternatively, one could use their Trading platforms for the device of their choice be it the Web, Smartphones, Tablets and Desktops. They had more than 10 lakh clients who traded with them.

**ICICI Direct:** By far the biggest and best-known full-service stock broker in India. They had good service and easy to use user interface. Their brokerage varied from 0.55% to 0.20% depending on the value of trades done with them. Their biggest selling point was their seamless integration with the ICICI bank account which made transfer/withdrawal of funds easy and quick. They also offered a special product like valid-till-cancel and even T+90 trading in BSE segment.

**Motilal Oswal:** One of the oldest and reputed brokers operating in India. They were also full-service brokers providing a gamut of financial services to the customer. They were best known for the advisory services provided by them. They had more than 8 lakh customers trading with them.

**ShareKhan:** Incorporated in February 2000, Sharekhan was India's 2<sup>nd</sup> largest stockbroker with respect to the number of customers, providing brokerage services through its online trading website Sharekhan.com and 1950 Share shops which included branches & franchises in more than 575 cities across India. They were full-service brokers and provided various other services like asset management, etc. BNP Paribas purchased ShareKhan for INR 2,200 crore in 2016.

**HDFC Security:** They were one of the larger broking houses in India and with their bank branches; they had one of the largest networks, second only to ICICI. They had a vast network of bank branches in even smaller town. Most of the investors who had a bank account ended up opening a trading/demat account with them. They were good full-service brokers providing all major services like research desk, mutual fund investments and portfolio management services.

**Kotak Securities:** They were one of the better-known names in Financial services and with their bank branches in big cities they catered to clients in big cities. Their online service was decent, but brokerage was not that competitive.

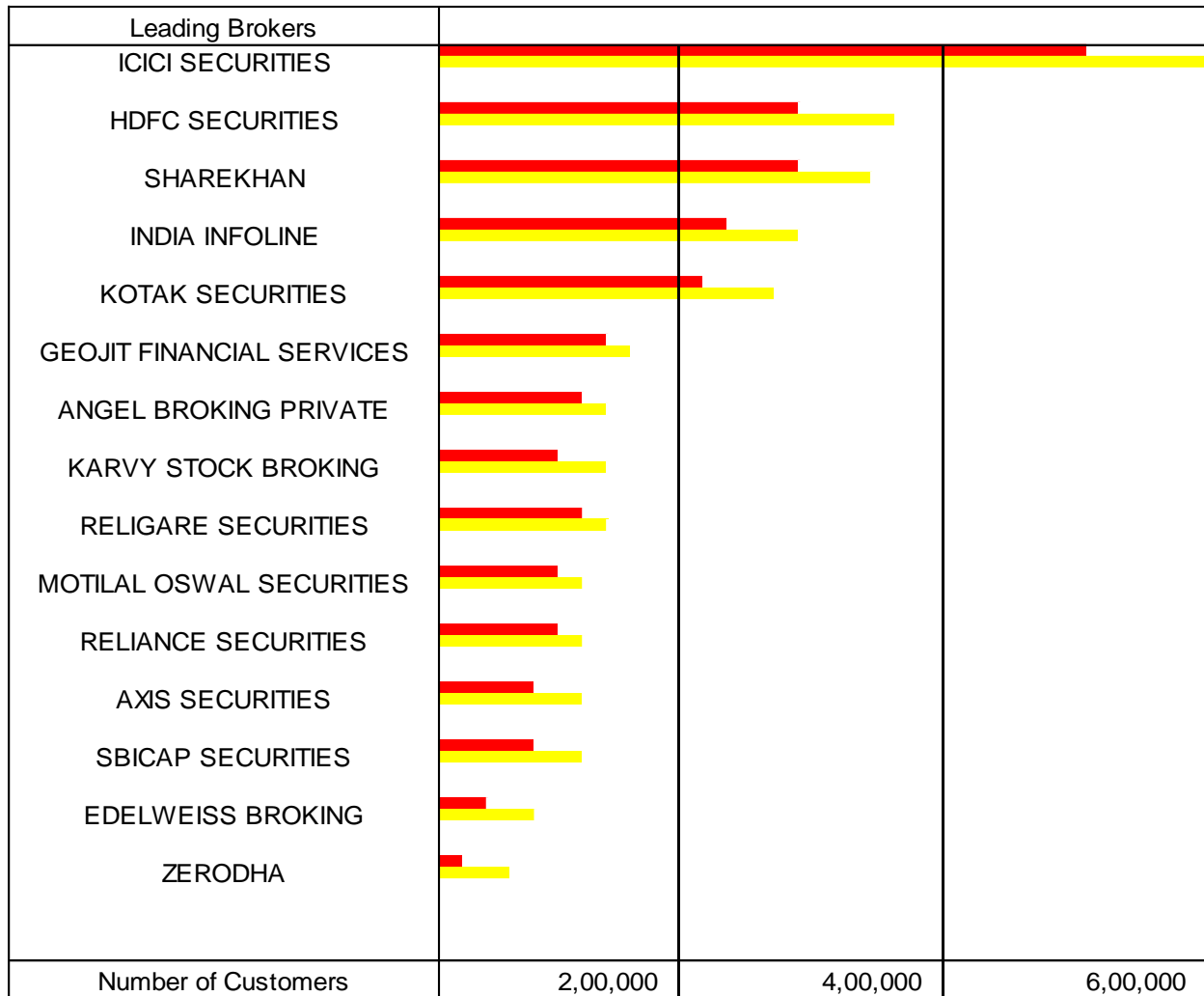
**Reliance Money:** They came with a bang but lately had lost a lot of sheen with their name. There had been lots of questions about their business practices.

Apart from this, some other notable names in brokerage industry in India were Karvy, Axis direct and SBI cap.

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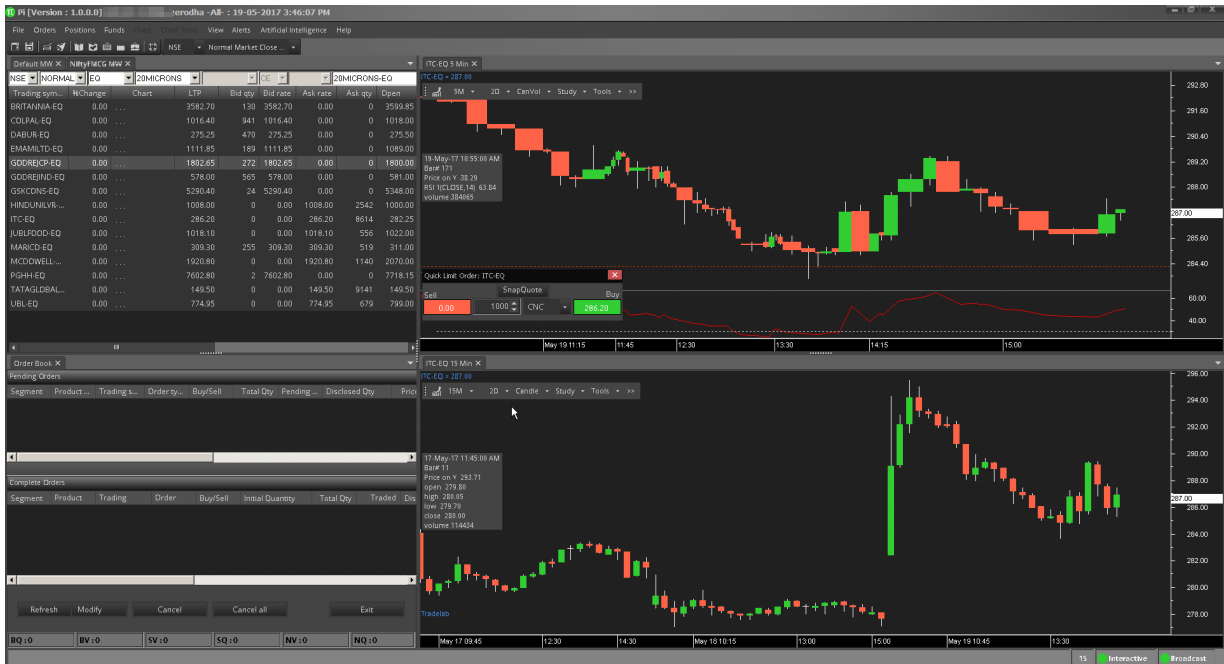
**EXHIBIT 2**  
**Leading brokers and their market shares in terms of number of customers**



**Source:** Company website. Retrieved from <https://zerodha.com/z-connect/zerodha/bulletin-latest-at-zerodha/we-are-now-the-3rd-largest-stock-broker-in-india/> on September 14, 2018 5:10 PM

### EXHIBIT 3 GUIs of different brokers

#### Zerodha's PI GUI



#### ICICI Direct GUI



## HDFC Securities GUI

The screenshot displays the HDFC Securities trading platform interface. At the top, there are navigation tabs for various services like Trading, DIY SIP, GOLD, etc. Below this, a 'Market Watch' section shows a list of stocks with their respective prices and quantities. The main area is divided into several panels: 'Quickie' (Order Book, Demat Balance, Limits, Statements), 'Top Gainers & Losers' (a table of stock performance), and 'Chart'.

Buy	Sell	DIYSIP	Each	Instr	Symbol	Company Name	Buy Qty	Buy Price	Sell Price	Sell Qty	LTP
					OLMATEQNR	ONGC LTD	820	275.15	275.35	329	275.15
					MAHMAEQNR	MAHINDRA & MAHINDRA LTD	18	1306.30	1306.80	33	1306.80
					LARTOUEQNR	LARGEN & TOUBRO LTD	2	1394.15	1394.90	5	1394.00
					INFOSYSQNR	INFOSYS LTD	1	932.80	932.80	119	933.00
					ICIBANQNR	ICICI BANK LTD.	181	286.85	286.85	2733	286.85
					HDFBANEQNR	HDFC BANK LTD	29	1272.30	1272.75	164	1272.75
					ACCOTREQNR	ACC LTD	50	1396.20	1396.55	44	1396.55
					ABBLTREQNR	ABB INDIA LIMITED	1	1056.15	1061.80	10	1060.20

		Symbol	LTP	Open	Close	High
+	APCOEQNR	358.15	333	333	358.8	
+	SIBCTEQNR	1391.25	1391.25	1371.25	1391.25	
+	INDRETNR	1725	1725	1725	1725	
+	WINDLEQNR	1979	1948	1944.95	1979	
+	BSPALQNR	778.25	769.9	747.9	825	
+	BSPHMQNR	752.3	690	668.2	758	
-	RAIAPPQNR	829	888	798.5	879	

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1. Top10stockbroker (January 2, 2018). Zerodha PI review - Desktop based trading terminal. Retrieved from <https://top10stockbroker.com/zerodha-pi-review/> on September 18, 2017 5:10 PM
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**EXHIBIT 4**  
**Zerodha's account opening charges**

<b>Item</b>	<b>Charges</b>
Trading Account Opening (for self-printed form)	INR 200 (One time)
Trading Account Opening (for using Zerodha's form)	INR 300 (One time)
Demat Account Opening	INR 100
Trading Account Maintenance	Nil
Demat Account Annual Maintenance	INR 300 per year

Other charges

<b>Item</b>	<b>Charges</b>
Call and Trade feature	INR 20 per Call
Digital Copies of Contract Note	Free
Physical Copies of Contract Note	INR 20 per Contract + Courier charges
Trade SMS Alert	INR 1.00 for Equity, F&O & Currency trade INR 0.50 for Commodity
Instant Payment Gateway Charges	INR 9.00 per Fund transfer
DP Charges for Delivery based Equity (Sell)	INR13.50 per transaction
DP Charges for Delivery based Equity (Buy)	Nil

**Standard NSE charges, transaction charges and statutory levies charged**

**Source:** TopShareBrokers (March 18, 2018). Zerodha review – Number one Discount Share Broker India 2018. Retrieved from <http://www.topsharebrokers.com/discount/zerodha-review/> on September 18, 2017 5:10 PM

**EXHIBIT 5**  
**Zerodha trading brokerages**

<b>Product</b>	<b>Brokerage (per executed order)</b>
Equity Delivery Trading	Free
Equity Intraday Trading	0.01% or INR 20 (whichever is lower)
Equity Future Trading	0.01% or INR 20 (whichever is lower)
Equity Options Trading	0.01% or INR 20 (whichever is lower)
Commodity Trading	0.01% or INR 20 (whichever is lower)
Currency Futures	0.01% or INR 20 (whichever is lower)
Currency Options	0.01% or INR 20 (whichever is lower)

**Source:** TopShareBrokers (March 18, 2018). Zerodha review – Number one Discount Share Broker India 2018. Retrieved from <http://www.topsharebrokers.com/discount/zerodha-review/> on September 18, 2017 5:10 PM