Wealth Creation

Mission Seven Charitable Trust

The Securities Academy & Faculty of e-Education

Growth opportunities

Edelweiss Capital, a financial service company, debuted on the stock exchanges with a large market capitalisation of over Rs 11,000 crore. On the same day Reliance Capital divested about 5% stake in its 100%-owned asset management venture Reliance Capital Asset Management to a foreign investor for Rs 501 crore, valuing the mutual fund company at Rs 10,000 crore. These are not isolated cases of over-the-top valuations. Instead, these are instances of what has merely become the norm across the financial services spectrum. Brokerages, corporate finance/advisory, securities or portfolio management firms are all enjoying enormous investor responses on the bourses. The re-ratings are largely driven by the enormous growth potential in both corporate and retail segments.

Brokerages have been one of the biggest beneficiaries of the rise in market capitalisation and trading volumes. The growing retail participation in the equity market is evident from the growing number of demat accounts every year. In the past four years, there has been in over 80% growth in the number of demat accounts from 67 lakhs in December '04 to more than 120 lakhs by the end of December '07. Having consolidated their brokering business, many large players are now diversifying into related activities including investment banking, merchant banking, and margin funding.

Also, India has emerged as a hub of banking and financial services at the global level. One big reason is India's current economic growth story. It has improved income levels of Indian and hence, the overall savings. Banks and other financial services are end beneficiaries of this boom. This is clearly reflected in the composition of gross household finance savings. The share of the bank deposits, savings in the form of mutual funds and equity shares has gone up significantly from 38.4% in FY04 to 62.0% in FY07.

Apart from the retail segment, corporates are big users of banking and financial services. Increasing corporate savings are either parked with banks or mutual funds. Investment demand is a major driver for the current surge in economy and will be the same in forthcoming years. Thus, to finance the huge capital demand, India Inc will rely on banks, non-banking financial companies or the equity market. The financial services sector is currently being looked upon as one of the most sought-after sectors and most analysts believe that there are lots of growth opportunities yet to be unearthed.

Edelweiss capital:

Edelweiss capital (Offer price: Rs 825) debuted on the bourses with 75% listing gains (Listing price Rs. 1,443.75). At the listing price, its market capitalisation is over Rs 11,000 crore, the second largest in the non-banking financial company (NBFC) space after Indiabulls Financial Services. The company is new compared to its peers as far as the nature of its operations is concerned. From its basket of eight businesses, more than half are newly incorporated, and are less than a couple of years old.

Reliance Capital:

Reliance Capital Asset Management, controlled by Anil Ambani, has sold a 5% stake to Eton Park Capital Management in a deal that for the first time puts a value on India's largest mutual fund. US-based Eton Park will pay $ 127 million for the stake in Reliance mutual fund – valuing it at Rs 10,000 crore. The investment by Eton Park, valued the mutual fund at 13% of assets under management, twice the valuation of previous such deals in the asset management industry.

1. FINANCIAL ADVISORS:
Weigh impact on investors

Regulatory impact assessment

The government is all set to change the way financial regulators make and announce their decisions by making them more responsible and accountable, while arming the investors with enough chances to question their decision. The finance minister would introduce a mechanism called ‘regulatory impact assessment’, which will mandate all regulators to do their home work more thoroughly and specify the potential impact of their decision upfront. That is, the regulator should quantify the cost, risks and possible benefits and stipulate while announcing a decision how the benefits outweigh the risks involved.

This will allow a market participant to question the regulator’s wisdom and judgment in the light of past experience and evidence emerging after the decision. For example, if Sebi wants to amend the disclosure requirements or broker registration norms, then it has to say upfront how it will help the system, investors and other stake holders and what is the cost of compliance involved. Later, if the regulator’s calculations go wrong or does not achieve the goal, the affected parties could ask ‘why?’

It is understood that there is total consensus on this decision among the government and various financial regulators. The government has already started working on this and is expected to take some serious steps. An expert committee appointed by the finance ministry on how to make Mumbai an international financial centre mooted the proposal.

The idea of introducing regulatory impact assessment – something widely followed by many OECD countries – is to provide world-class financial regulation and supervision in terms of policy, approach, attitude and practice. The committee’s recommendations went far beyond making Mumbai a global financial nerve centre and suggested how to revolutionise the regulatory system into market friendly one.

Monetary compensation to Scam-hit investors

This could well signal a new beginning in the country financial sector in terms of compensating investors who have been defrauded. A committee mandated by capital market regulator to work out an equitable method to compensate individual investors, who were short changed in IPOs, has recommended that they be compensated in monetary terms. The IPO scam of 2005-06 featured a clutch of operators who put in thousands of fictitious applications in several IPOs to be eligible for allotment under the retail category. After allotment, these operators transferred the shares to another set of players, who in turn transferred them to financiers who had provided the funds for investing in the IPOs. .

The Justice Wadhwa committee has worked out a compensation of Rs 92 crore for investors who had applied for shares in the retail category in 21 IPOs. This is based on the closing price on listing day for all these IPOs, which include IDFC, Jet Airways and Suzlon. In almost all the 21 IPOs, the shares were listed at a premium to the offer price.

The compensation can be paid out by selling securities worth over Rs 140 crore of operators involved in the IPO scam that have been frozen in their depository accounts. Investors who lost out in these IPOs should be paid the difference between the offer price and the closing price on listing day. First in line to be compensated should be those retail investors who failed to get any allotment of shares followed by those who were allotted fewer shares than what they had applied for. The Sebi board will now have to consider the Wadhwa committee’s recommendations and then take suitable action.

Preferential allotment to promoters' vs minority shareholders

A promoter of a listed company is allowed to directly increase his ownership primarily through two mechanisms – creeping acquisition and preferential allotments. Experts argue that preferential allotments are usually positive for the small investors. Under the creeping acquisition route, a promoter can purchase a maximum of 5% of the equity in a financial year through the stock exchange at the prevailing market price and the seller may or may not have the knowledge that he is selling to the promoter. However, a preferential allotment is announced to stock exchanges and investors are aware of the promoter's intentions. It is a strong signal to the investment community of the company's future prospects. A preferential allotment has to be at least at the highest closing price of the previous 15 days and usually this represents fair valuation.

In many cases, preferential allotments are made by way of convertible warrants. A convertible warrant is a security issued by the company which can be converted into equity at a fixed price any time over 18 months from the date of issue, usually at the option of the holder. Under Sebi regulation, a warrant holder has to pay a minimum 10% of the total consideration at the time of the issue of warrants and the balance at the time of conversion. This structure allows promoters to increase their stake at a fixed price by paying just 10% of the consideration and paying the balance over 18 months.

Experts argue that for a long time, most companies were run as promoters' fiefdoms and little thought was given to the interests of minority shareholders. One notable area is the issuance of equity warrants to promoters, which gives a right to the subscriber to buy a share but impose no obligation. In the past five years, a number of listed companies have issued equity warrants to promoters. This is done basically to shore up the promoter's holding. It is a double whammy for minority shareholders:

(a) They are denied participation at the same level as promoter shareholders; and
(b) The promoters, while subscribing to the warrants, essentially get an option from the company to pay only 10% of the equity warrant's value and an additional 18 months to pay the balance.

In most cases, equity warrants are fully paid only if the market price of a particular company's share is higher than the equity warrant's price. Since the period available to subscribe is fairly long (18 months), it gives promoters a huge opportunity to ride the stock market. Thus, there is a clear evidence of promoters profiteering by the issuance of such equity warrants.

The issuance of equity warrants to promoters is done in connivance with the company over which they have complete control and, in most cases; this is shown to meet the company's capital requirements. All classes of shareholders have the right to participate on an equal basis and any preferential allotment to a certain class of shareholders is a breach of the minority shareholders' trust. A right issue of shares, allowing all shareholders to participate, would not have allowed them to disproportionately increase their holding in the company.

R-ADAG:

Anil Ambani and firms controlled by him will invest Rs 8000 crore in Reliance Energy (REL) in a move that would help the company to double its net worth and increase its borrowing limit. The preferential offer will be made at a 5% premium to the market price at Rs 1,812 per share over Friday (30/11/07) closing price of Rs 1,738.10. The promoter's stake will increase to 43-45% from the current 35.89%. It is significant considering that Anil Ambani invested in REL at about Rs 600 per share two years ago.

2. WEALTH MANAGERS

Map out the details to translate into benefits

Managing NRI wealth

With India emerging as a lucrative market for investors globally, wealth management companies are now targeting the Indian diaspora to invest in the India story. According to a World Bank study, India gets the largest remittances in the world - $ 27 billion pa – and the number of Indian immigrants is around 30 million. Earlier, the RBI in its report on remittances had said that North America has replaced Gulf countries as the most important source of remittances. It estimated that 44% of remittances originate in North America, 24% in the Gulf region, and 13% in Europe. The traditional investment from NRIs has been in the form of bank deposits, in equity markets and real estate. A major chunk of the remittances were used to meet family expenses.

The brokerage arm of the Ranbaxy Group, Religare has recently signed a joint venture agreement with Australia-based Macquarie Bank. Group CEO, Religare Enterprises said "All companies believe that if they've to attract the NRI clientele, they have to project not only the Indian growth story but map out the details that how it will translate into benefits for a particular customer.

There is a wrong perception that NRIs invest in India because they are emotionally attached to it. Once they go out of India, the country as an investment destination has to compete vis-à-vis other emerging markets. This segment has big potential, which has remained under-utilised till now. Our company has a dedicated set-up for catering to NRI segment and has already opened an office in London. Soon we will open our offices in Zurich, Singapore, Hong Kong, Dubai, and Saudi Arabia.

Centurion Bank of Punjab (CBoP) is also bullish on its NRI wealth management plans and it's planning to set up offices in Singapore and UK. The bank already has an office in Canada. It is important for us to be present in locations where our consumers are. Our plans have also got a boost from the astounding results that we've received. In the last one year, we have seen almost a 100% jump in business from the NRI.

However some analysts believe that it would be tough to retain the NRI clients as they are more or less like FIIs, who would move their money out at the first opportunity if they are not getting the desired returns. NRI living in the different parts of the world behave differently. It may be easier to convince an NRI in the Middle East, but if you go Europe it's a completely different story. They are more sophisticated and used to a certain standard of living and service.

Managing postal life funds

The government has allowed the Postal Life Insurance Fund (POLIF) and Rural Postal Life Insurance Fund (RPOLIF) to enter the markets through investments in public sector mutual funds. The Union cabinet appointed UTIMF and SBIMF as managers of the over Rs 10,000-crore corpus of these two funds. It has also approved setting up of an investment board for deciding investment policies.

Finance minister P Chidambaram said the PSU fund managers are expected "to follow safe and conservative investment policies" for money raised largely from rural areas. Much of the money has already invested in government bonds, but the MFs will manage the accumulated funds. While focusing on safety of investments the fund managers would seek investment avenues that would fetch better returns for these funds, In effect, this could mean investing part of the corpus of these funds in stocks and mutual funds, which provide higher returns.

3. FINANCIAL PLANNERS

Value unlocking for investors

Listing:

33 mini-ratnas

The government is planning discussion with 34 unlisted mini-ratna companies to get them listed on the stock exchanges and unlock their value. The list of companies with which the government plans to initiate talks includes Bharat Sanchar Nigam (BSNL), Coal India (CIL), and Rashtriya Ispat Nigam (RINL).

The government wants every profitable PSU to be listed on the stock exchange and would soon initiate consultation in this regard. The talks may also focus on dilution of government's stake in the companies through the IPOs. The government wishes to list BSNL and CIL at the earliest. The Sebi has also eased the rules regarding disclosure and investor protection guidelines for government companies engaged in infrastructure sector. This relaxation would make it easier for companies to go for listing.

Right Issue:

State Bank of India

The Union Cabinet approved investment of Rs 10,000 crore in State Bank of India through a rights issue. The infusion of capital will enhance the capital base of the biggest bank in the country. Further, it will not only boost the valuation but also help meet its capital requirement for the implementation of new norms in capital adequacy and accounting due next fiscal.

SBI chairman O P Bhatt has said the bank require Rs 5,000 crore just for meeting Basel II norms. The bank also needs capital for complying with AS15 accounting standard that mandates disclosure of pension liabilities up to Rs 5,000 crore. The government currently holds 59.7% in the bank. A rights issue will allow the bank to raise tier-I capital without diluting the government shareholding.

The government, which owns 59.7% in SBI, would pay for the shares by issuing marketable government securities. The government is counting on the future dividends from the bank to justify the investment. The difference between dividends and the interest cost of the bonds will flow into a securities redemption fund that will pay for the bonds on maturity. The bonds can be classified under SLR category.

Finance Minister P Chidambaram said the revenue that will come to the government above the interest cost will be kept in a securities redemption fund. It would cost us 790 crore a year. This is a kind of deferred payment, which will accrue to SBI every year. The government investment in the issue would help it get dividend and taxes amounting to Rs 1,358 crore from the bank in 2008-09 against an estimated expenditure of Rs 790 crore as interest to be paid for the proposed securities. Subsequently, it would receive Rs 1,552 crore and in 2010-11 the amount would rise to Rs 1,892 crore. The government in consultation with the Bank, after factoring in Sebi guidelines, market conditions and other relevant factors will work out the modalities of the transaction.

Qualified Institutional Placement (QIP):

GMR Infra

A clutch of domestic banks and foreign financial investors picked up around 9% stake in GMR Infrastructure, the flagship company of GMR Group, for around $ 1 billion, through a qualified institutional placement (QIP), the largest among such recent deals. The investors include SBI, Canara Bank, Capital International, Citigroup, T Rowe Price, Credit Agricole, UBS, and Kotak Mahindra.

The deal involves selling part-stake by promoters and issuing fresh shares. Post-issue, the promoters' holding will fall to 74% with the remaining 26% stake to be held by the public and new investors together. GMR Infrastructure CFO Madhu Terdal said the funds would be used for the construction of GMR Istanbul's airport in Turkey as well as buyouts in the international power and airport markets.

Stake sale:

MCX

Headquartered in Mumbai, Multi Commodity Exchange of India (MCX) started operations in November 2003 and has close to 70% market share for the quarter ended June 30, '07. MCX offers futures trading in 56 commodities, defined in terms of the type of contracts offered, from various market segments including bullion, energy, ferrous and non-ferrous metals, oils and oil seeds, cereals, pulses, plantations, spices, plastics and fibers.

Leading financial services groups, ICICI (3.55%), IL&FS (5%) and Kotak (1%) have bought a combined 9.55% stake in the country's largest commodity derivatives exchange, (MCX). The transactions give MCX a valuation of over $ 1 billion. This will shrink the holding of Financial Technologies (FT) – the exchange's primary promoter – to 37.5%. According to ICICI Bank CEO KV Kamath, it's the bank's "philosophy to partner with growth-oriented companies that seek to leverage technology and the power of markets for economic transformation". The compelling valuation story in exchanges – as earlier reflected in institutional interest in leading bourses like NSE and BSE – has been the driver behind the investment.

Merger (Bundling):

Indus Towers Ltd

India's leading GSM players Bharti Airtel, Vodafone Essar and Idea Cellular announced the merger of their wireless infrastructure businesses in 16 circles to share 70,000 tower units and also form the world's largest 'independent' tower company. Called Indus Towers Ltd, Bharti and Vodafone will each have 42% equity in the infrastructure firm, while Idea Cellular will hold the remaining 16%. Bharti and Vodafone will contribute 29,400 towers each to Indus with Idea bringing in 11,200 towers.

Bharti Airtel's joint MD, Akhil Gupta said, "The idea is that Indus will be a truly independent tower company, where no player enjoys a majority stake. We are looking at listing Indus Towers at the earliest. Bharti Infratel, the hived off tower arm of Bharti Airtel will retain the company's passive infrastructure in the remaining 7 telecom circles. Infratel will be left with about 20,000 after the creation of Indus. Currently; Indus will be restricted to only 16 circles as Vodafone Essar operates only these many circles, while Idea provides telecom services in 11 circles.

Indus Towers will provide passive infrastructure services to all operators on a nondiscriminatory basis. The move will enable all three-service providers to increase efficiencies and reduce expansion costs. Also, Indus Towers would provide them with significant scale benefits, and help them undertake a significant rollout of the mobile sector towards achieving rural coverage goals within the next few years.

Acquisition (Buy out):

Indiabulls Wholesale Services

Indiabulls Real Estate (IBREL) has acquired the Ashoka Piramal group's 63.9% stake in Piramyd Retail for Rs 208 crore, kick-starting the first phase of consolidation in the nascent India retail space. The acquisition has been routed through IBREL's 100% subsidiary, Indiabulls Wholesale Services. Indiabulls will also make an open offer for upto additional 20% of the fully diluted paid up capital.

The acquisition clearly highlights Indiabulls plan to be the leader in the retail industry in India by making sure their presence in all the major retail verticals. As announced earlier Indiabulls is already in the process of opening 30 big wholesale club stores all across the country. With this acquisition Indiabulls will have a very strong presence across wholesale / cash and carry, lifestyle and convenience store formats. Indiabulls aim to provide the Indian shopper the best possible value for their money and a par excellence shopping experience coupled with stellar customer service.

Demerger (Unbundling):

Videocon Natural Resource Ltd (VNRL)

Videocon Industries is spinning off its myriad energy businesses stretching from coal fields in Indonesia to oil and gas blocks in Brazil into a separate company. In an attempt to help investors value them better. The company will spin off six different units into a separate company called Videocon Natural Resources.

VRNL will be an independent energy company with a large and growing presence in conventional and non-conventional energy. But the spin-off, however, will not include Videocon's stake in the hugely profitable Ravva oil field. The unbundling will help Videocon Group get rerated in the Market. Each business will get focused management effort. Videocon chairman Venugopal Dhoot said: "There is a tremendous growth opportunity in the energy space, both globally and in the domestic market, and we want to be a part of it.

Special purpose vehicle:

Shapoorji Pallonji Group

Shapoorji Pallonji Group struck a $ 290-million deal – the largest far in the real estate space – with clutch of foreign investors, which picked up a 15% stake in a SPV floated by the group. The deal arranged by HDFC Realty, includes investments in six large FDI-compliant projects, including commercial, residential and shopping malls. The projects are located in Pune, Kolkata and Nagpur, among others.

Sources said the earlier plan was to create different SPVs for each project, and bring in financial investors accordingly. However, they finally settled down for a single SPV, which is holding all the 6-7 large projects, with the Shapoorji Pallonji Group holding the remaining 85%.

4. INCLUSIVE CEOs

Innovative responses to problems

The problem of abundant inflows

The government admitted that managing plentiful capital inflows without endangering growth and price stability is indeed a challenge in the short-term. There are international experiences in this regard with some successful and painful adjustment process. However, the specific Indian context requires innovative policy responses. Going forward, this would be a major challenge.

Forex flowing into Indian stocks had boosted the rupee appreciation and made it difficult for the RBI to manage the inflows, which is hurting exporters. The policy options involve trade-off and appropriate mix of responses, each of which has its costs. The fiscal cost of sterilisation of the inflows, which was envisaged at Rs 3,700 crore in the last year's Budget, is now being supplemented with Rs 4,500 crore.

Go for the best buy: Finance ministry

Uco Bank, which has a business mix of Rs 1.20 lakh crore, is looking to acquire a smaller public sector bank to strengthen its balance sheet and it had tossed up the merger idea of United Bank of India (UBI). The reasoning within Uco headquarters is that the bank is looking to acquire a smaller public sector bank so that it can grow inorganically before March 2009. This is the cut-off date after which the union government is expected to throw open the domestic banking sector for easier foreign entry.

When Uco Bank sent word to the Union ministry suggesting a merger with UBI, Finance ministry shot back: Why UBI? The bank next door is okay, but what's the harm in casting the net wider? Uco has been asked to look around a bit more before taking a final call. The ministry is understood to have advised Uco to look for geographic as well as technological synergy for merger. It felt that a bank in the west or in the south would provide Uco that much-needed synergy. Out of Uco's 1,881 domestic branches, the majorities are located in the eastern region. Therefore, a merger with UBI, which has a strong presence in this part of the country, may not be a good idea."

Front-To-Back Review of Citigroup

A fortnight after an Arab fund bailed out Citigroup –the world's biggest bank –a person of Indian origin will now take a hard look at it, and shape the destiny of the American company that sells almost all financial products under the sky. Vikram Pandit said soon after taking over as the Citigroup CEO, "We will undertake an objective and dispassionate review of all our business. We will do it individually and on an aggregate basis to make sure that we are positioned for the future." Mr Pandit is the first Indian to head Citi at a time when Citi is nursing the wounds of subprime blows that have sparked speculations that loss-making divisions would be sold off. There have been even rumours of a possible break-up of Citi.

Pandit has spelt out that as CEO one of his top priorities would be "improving and enhancing productivity". He will also look at ways to simplify the organisational structure around Citi and align business with appropriate economic goals. Citi would "reallocate resources around the business opportunities that we see around the world. Citi will continue to have a 'performance-oriented culture. Mr Pandit initial sound bytes are being interpreted as hints that Citi could be in for sweeping changes. There are reasons: Citi has already lost over $ 120 billion, and stock is close to a five-year low. And fears are there could be more loan writedowns.

5. RISK MANAGEMENT CONSULTANTS

Educate – Engineer and Enforce

Due diligence process for engagement of recovery agents

This draft guideline for recovery agents comes against the backdrop of the rise in the number of litigations against banks for engaging recovery agents in the recent past. The RBI is of the view that the adverse publicity could result in serious reputational risk for the banking sector as a whole. So, banks have to ensure that agents engaged by them for debt collection refrain from actions that could damage the integrity and reputation of the bank.

To ensure that recovery agents are properly trained and handle customer cases with sensitivity, the RBI has requested the Indian Bank's Association (IBA) in consultation with Indian Institute of Banking and Finance (IIBF), to formulate a certificate course for direct sales agents and direct marketing agents and recovery agents with minimum 100 hours of training.

Banks would have to put in place a mechanism where the borrower's grievances with regard to the recovery process can be addressed. Banks should also have a due diligence process in place for engagement of recovery agents. The RBI stated that banks set very stiff recovery targets or offer high incentives to recovery agents. This induces the recovery agents to use intimidatory and questionable methods for recovery of dues. It has thus directed banks to ensure that the contracts with the recovery agents do not induce adoption of uncivilised, unlawful and questionable behaviour or recovery process.

In the draft guidelines, the central bank has stipulated that any violation of the guidelines would be viewed seriously. It may consider imposing a ban on a bank from engaging recovery agents in a particular area. In case of persistent breach of the guidelines, RBI may consider extending the period of ban or the area of ban. Similar supervisory action could be attracted when the high court or the Supreme Court pass strictures or impose penalties against any bank or its directors/ officers/agents with regard to policy, practice and procedure related to the recovery process.

GE Money India:

What's brewing at GE Money India? The consumer finance arm of General Electric has either shut down or pruned businesses like car loans, two-wheeler loans and consumer durable financing. Besides, existing partnership failed to generate desired results. The JV with LIC has been delayed, and there has been a sharp rise in provisions/write-offs of SBI Cards and Payment Services Limited (SBICPSL) – a JV with SBI. Also GE Money Hosing Finance suffers from a thin margins and higher delinquencies. In the past, GE had put in efforts to get a banking licence. But RBI turned this down.

GE Money India is grappling with plummeting profits. The unlisted NBFC saw its profits slip to Rs 10 crore for the year ended March 31, '07 as against Rs 50 crore the previous fiscal. Rating agency Crisil has said its earnings profile is curbed by high operating costs and average asset quality.

The strategy is to focus on partnership that would deliver high growth, high profitability businesses that meet the needs of Indian customers. There is growing buzz that GE will restructure its consumer finance operations in India, *sell off some of its assets* and *rope in new partners.* GE chairman & CEO Jeff Immelt said: There's going to be capital redeployment opportunities from GE Money into Commercial Finance.

6. MICROFINANCE PROFESSIONALS

Developing alternative credit delivery models

Small-Ticket Personal Loans (STPL)

The higher margins enjoyed by some of the players saw a host of new players aggressively entering the system. Players can make profit in this segment once they build up a huge base and if delinquencies are controlled. As most of the customers do not have proper documentation, newer players used the payment history with existing players as a surrogate. This customer segment is considered as the subprime category in India. Interests on loans to the STPL segment range anywhere between 30-60% and the average ticket size of these loans is in the range of around Rs 25,000.

Faced with customer activism, regulatory pressures and over leveraging by customers, banks across the system have applied breaks on high-interest STPL. Delinquencies, which were at around 7%, have now moved up to as high as 15%. Customers started over leveraging themselves as they started to borrow from multiple players. Many of these private and foreign banks, which had in the recent past aggressively lent in this segment, have either pulled out or changed their lending strategies. They include ICICI Bank, HDFC Bank, Centurion Bank of Punjab, Development Credit Bank and IndusInd Bank. Foreign NBFCs, including Citi Financial and Others like Prime Credit of Stan Chart, have also changed their stance.

Players like HDFC Bank have stopped offering loans above 30%, while others like ICICI Bank are now offering loans at only sub-20%. Citi Financial, one of the oldest players has tightened credit norms and started credit counseling. Most banks have started offering loans above Rs 40,000 only. In other cases, they have brought down interest rates, but have tightened credit norms.

Bandhan ranks second on Forbes MFI list

Five years ago, when Chandra Shekhar Ghosh set up Bandhan, all he was trying to do was to fight poverty with micro-loans. Today, when Bandhan sits 15 notches above Grameen Bank founded by Nobel laureate Mohammed Yunus on an international list, all Ghosh says is, “it means my model works.” If Bandhan does not occupy your mindspace, blame it on simplicity. That is the cornerstone of Ghosh’s philosophy; for whom remaining “simple, transparent and focused” is more important than dreaming big.

Ghosh and his Bandhan upstaged several domestic and international stalwarts to make it to the second rank on Forbes magazine’s first-ever listing of the ‘World’s Top 50 Microfinance Institutions. He was one among seven Indian MFIs that made the cut; the largest from any one country, Bangladesh had an equal number. In fact, the Forbes list comes as a shot in the arm for micro finance movement in India with several players finding mention. The others are Microcredit Foundation of India (13th), Saadhana Microfin Society (15th), Grameen Koota (19th), Sharda’s Women’s Association for Weaker Section (23rd), Asmita Microfin (29th), and Vkram Akula’s SKS sits at 44th.

Though Grameen Bank has been ranked 17th, the list is topped by ASA, another Bangla heavy weight. For Mr Ghosh, the recognition perhaps vindicates his core MFI strategy of keeping a tight rein on operating costs. A follower of the ASA model, he could well emerge as a darling for private equity funds who are queuing up to park their monies in micro finance. But Ghosh, for now, wishes to keep them at bay.

7. CREDIT COUNSELORS

Resolve convertibility and recompensation issue

India Inc: Freedom to exit CDR

When companies default due to extraneous circumstances, lender refers them to an Industry level Corporate Debt Restructuring cell (CDR) comprising bank chiefs to chart out a recovery road map. The restructuring involves some sacrifice from lenders in return of a promise from the borrower not to squander money in new ventures. If the borrower sees a turnaround in fortunes and wishes to make new investments or raise fresh loans he can do so only after he compensate banks for the sacrifice they have made earlier (in terms of waiver of principal or charging lower interest rate). As per the current formula, a company has to repay the principal that lenders had scarified while restructuring the loan. Also, they have to pay interest at the rate, which is calculated as BPLR plus term premium and credit risk premium. The interest is calculated on compounded basis.

Several corporates who have cut deals with banks to restructure loans under the CDR mechanism are unhappy about the high cost that is involved if they wish to exit CDR prematurely. Borrowers are of the view that the recompensation formula is totally skewed in favour of lender. Corporates are also keen to get out of the CDR as private equity players shy away from corporates locked in CDR. As a result more and more companies which have turned around are keen to get out of the CDR.

IFCI: Debt conversion in Equity

Public sector banks and financial institutions had converted 50% of their non-SLR investments in IFCI into 20-year debenture repayable in 2022, as a part of the exercise under GoI, in 2002, to restructure liabilities of IFCI. Subsequently, the government inverted again in October'07, to resolve convertibility and recompensation issues to give clarity to the on-going process of the sale of 26% in IFCI. And, thereafter, banks and financial institutions reached a consensus regarding convertibility and recompensation of the debentures worth Rs 1,479 crore.

At its board meeting, the IFCI management allowed banks and financial institutions to convert their debt into equity. As much as Rs 1,400-crore of Zero Coupon Optionally Convertible Debentures (ZCOCDs) will be converted into equity. The conversion price would be calculated as per the SEBI formula of six months average closing price. The government, however, would not convert its debt of Rs 923 crore into equity. The debt will be converted into equity only in 2022 as per original agreement. The government was also willing to provide Rs 1,300 crore to IFCI as budgeted in this fiscal (Budget 2007-08).

While banks have agreed to convert their holding in ZCOCDs into equity, LIC, GIC and associates have agreed to convert that part of ZCOCDs into equity which retains their holding in IFCI in percentage terms at existing levels. Public sector insurers currently hold about 13.67% in IFCI. The balance amount held by LIC and other Financial Institutions would carry an interest rate of 75 basis points below 15 year G-Sec for the first 3 years and 75 basis points above 15 years G-Sec, after 3 years post induction of strategic investors. This is expected to cost IFCI about Rs 16 crore per annum.

Creditors' banks and financial institutions converted their debt into equity at Rs 107 per share on December 17, '07, when the shares were allocated by IFCI. With public sector banks and insurers converting their debt to equity, it raised the stake of government-controlled firms to 39%. Banks had converted their debt assuming the strategic sale of 26% stake in IFCI followed by 20% open offer by strategic investor will materialise.

8. TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system

Reddy's men take first steps on street to short selling

Short selling is a transaction where an investor can sell stocks without owning them. In what could set the stage for rolling out of short selling, RBI is working on the framework for stock lending and borrowing. The central bank has given in-principle concurrence for the move and will take a call on the exact timing of its rollout keeping in view concerns about capital inflows. The central bank feels that short selling would lead to an increase in inflows into the country and wants it to be launched at the time when such inflows would not be a concern for the economy.

The central bank also wants certain safeguards to be put in place before short selling is rolled out. These safeguards may be included in the final short selling guidelines the stock market watchdog announces. SEBI has already readied its set of detailed guidelines. Initially, however, short selling will be allowed only in 159 stocks in which derivative trading is already allowed. At present, institutions are allowed to take positions in the futures and options market to short sell. The move, allowing them to short sell in cash market, is expected to deepen the stock market further and allow stock values to reflect more accurately the opinions of all investors.

It's for all stock players

Short selling moved a step closer to reality with Sebi formally laying down the framework for short selling and securities lending and borrowing (SLB) scheme for all market participants. Sebi allowed all market participants to short sell, but forbade institutional investors from naked short sales and intra-day squaring up of trades. This means that institutions that do not own a certain stock can sell it short, but will have to deliver the stock by borrowing it. Naked short sale is where the sale is not backed by delivery of shares. The stock exchanges and depositories have also been asked to put necessary systems in place so as to distinguish the lending and borrowing transactions executed in the framework from the normal market transactions in the demat system.

It's a two-way-bet

SEBI's decision to allow short sales to all classes of investors would help deepen the market, improve liquidity and reduce volatility. Stock exchanges should now get the proposal going and put in place appropriate checks and balances. Short selling had been banned in the mistaken belief that it allows bears to hammer down market. In reality, this is not possible beyond a point as there is a limited supply of shares and at some stage short-sellers would have to buy and settle their positions. The ban in short selling has only distorted the field in favour of bulls. It allows price manipulation involved in the common practice of 'ramping' up shares, as there are no short-sellers to check manipulators.

Short selling in cash segment would allow equal opportunities to optimists and pessimists. This would increase liquidity, which would reduce volatility, a dominant concern in the Indian market of late. Undue volatility tends to discourage long-term investors, who end up waiting for right opportunity. But for short selling to work it's necessary that there are enough investors willing to lend their shares to short-sellers. That is possible if there is an easy mechanism for lending and borrowing of shares. This would help retail investors, who can earn some extra returns from their long-term holdings.

Sebi's norms for quicker capital assess

Sebi's decision to allow easier norms for select listed companies to raise equity through rights and follow-on issues would enable quicker capital market assess for leading Indian companies. According to current disclosure and investor protection (DIP) guidelines, companies have to go through a routine almost similar to that for new companies. However, it makes sense to allow listed companies access to public money more easily.

The regulator has rightly limited the facility to companies with a minimum three-year listing and a good investor grievance redressal record. This would prevent misuse of fast-track rule. But, the minimum Rs 10,000-crore free float market capitalisation condition is too stiff – only about 30 companies would be eligible – and needs to be relaxed.

Treat all investors equally

Sebi is reportedly discussing proposals to complete the public offer process within seven days and bring qualified institutional investors (QIBs), on par with retail investors, with regard to application money. While retail investors have to put the entire application money in a public offer of equity, QIBs have to bring in only 10% of the total value of shares bid.

This distorts the playing field among various participants in IPOs and tends to result in overbidding in the QIB portion. A proportionate allotment system encourages large application bids in the hope of substantial gains on allotment. Unrealistic QIBs bidding has implications for the retail segment – retailers typically look to the QIB portion for clues. The small margin requirement makes it easier for merchant bankers to drum-up support for the issue from QIBs and thus secure retail participations.

Discount to retail investors

The other important amendment allowing companies to give up to 10% discount to retail investors in public offers would enable companies to obtain a more diversified shareholding. This flexibility may not be of much use in a booming market but would come in handy in a difficult primary market situation.

Retail investors' participation in GDRs

Also allowing all investors, including retail, to invest in the Indian Depository Receipts (IDRs) and lowering threshold from a minimum of Rs 2 lakh to Rs 20,000 is a logical reform, considering that individuals are now allowed to invest in shares listed overseas. As of now only QIBs were allowed to invest in IDRs. However, this is academic, as IDRs have not taken off so far.

PAN mandatory in equity issues

The decision to make PAN mandatory in all public and rights issues irrespective of the application amount is justified, though in the short-term it may affect retail participation in IPOs.

Efficient and reliable Payment Systems in India

The Reserve Bank of India (RBI) has called for regulation of the entire payment system infrastructure – institutions, instruments, rules, procedures, standards and technical means – to ensure an efficient and reliable payments and settlement system in India. RBI, in its report on "Oversight of Payment Systems in India ", has said that certain large value transaction and securities settlement in the financial market can go so high that settlements for two to three days can be equivalent to a country's GDP. Such high-value payment systems are termed Systematically Important Payment Systems (SIPS).

In India too, SIPS are high, though not as high as in many of the matured markets. According to the report, the turnover in the SIPS segment constituted more than four-fifth of the total turnover – Rs 3,51,16,277 crore of the total Rs 4,23,74,063 crore – in 2006-07. The central bank has made a detailed assessment of the SIPS against the international standards published by the Committee on Payment and Settlement System (CPSS) and the Bank for International Settlements (BIS).

While in most areas, it found the compliance level close to the international benchmarks; it says that some areas still needed improvement. For instance, the integration of the Integrated Accounting System (IAS) with Real-Time Gross Settlement system (RTGS) has been implemented in July 2006. But the liquidity management is to be done by participants themselves. The monitoring of the request for Intra-Day Liquidity (IDL) and its usage by individual participants is not being done currently, but would be taken up, the report said.

It needs to be ensured that participants also are transparent about services offered to their customers. The participants should also do a self-assessment and understand the risks they face and follow self-discipline. Banks should also be transparent about their policies for the services they provide to users. Though the central bank, from time to time, has indicated the need for this, only a few banks are seen to be following it as has been observed from a recent survey conducted by DPSS, RBI.

Standalone wealth management solutions

I-FLEX Solutions said it has launched a new banking solution, which will enable the IT consulting firm to foray into private banking and wealth management space. The company said the new solution – Flexcube Private Banking Suite – can be integrated with the existing back office applications and would be cost effective for lenders and financial institutions.

The solution enables institutions to deploy wealth management offerings that provide competitive differentiation. The solution would help the banks reduce costs by giving them the ability to come up with standalone wealth management solutions.

With booming markets, especially in Asia, Central and Eastern Europe and Latin America, and the number of high net worth individuals rising, banks and financial institutions are working to create more sophisticated and personalised offerings to address the needs of this segment.

The solution would enable financial institutions and their customers manage multiple asset classes, including equity, mutual funds, bonds, structured products, real estate and commodities, whether held within the bank or with other external institutions.

9. ONE-STOP-SHOPS

Dedicated to offer related services under a roof

A dedicated portal for disclosures

The Indian primary market for equities is set to witness further reforms over the next few months. The move will ensure that raising funds through public offerings become easier, faster and cost-effective. Policy managers say that a proposal is now being considered which seeks to ease the burden for listed firms. The plan envisages the creation of a separate dedicated portal maintained by either the securities market regulator or the stock exchanges, which will have all disclosures of the listed firms. Each time, these companies go in for a follow on offer or right issue-the incremental disclosures can be added to the information already provided by the issuer in the dedicated portal. This will obviate the need to file lengthy disclosures and documents while launching a public offering.

Such a move could translate into savings both in terms of time and cost for issuers in India. The regulator has kicked off the first phase of the proposed changes by permitting fast track issuances for follow on offerings and right issues. Apart from listed firms, even unlisted firms, which are seeking to tap the capital markets, could also provide information and financial disclosures through the proposed portal and thus avoid the cumbersome process of filing lengthy documents and awaiting approval from the regulator.

The proposed reforms in the equities market will be preceded by changes in the architecture of the corporate bond market. The current guidelines will be amended to facilitate electronic issuances of corporate bond offerings. Corporate bond issues are mostly done on a private placement basis to institutional investors. The regulators and the government now want a wider participation to include retail investors. E-issuance of corporate bonds could help attract retail investors who are now virtually kept out of this market. The disclosure norms could be simplified and the entire process far more streamlined.

Governing committee for SEZ

The Union commerce ministry has expedited the process of creating a corporate governance structure for upcoming special economic zones (SEZs) in the country. It plans to set up a governing committee for SEZs in each state comprising SEZ developers, representatives from the state government and the units functioning at the SEZ. The committee will also have representatives from among the employees.

The process has been stepped up after the commerce ministry received complaints from states regarding the functioning of SEZ developers. The parliamentary standing committee on SEZs chaired by Murli Manohar Joshi had also expressed apprehensions that in the absence of a representative governing committee, infrastructure and other needs of SEZs may not be adequately addressed. The urban development ministry, too, has voiced the need to come up with guidelines on governance structure for SEZ townships.

Official in the commerce ministry said “A number of stakeholders are involved in the process. We have to create a prototype on the governance structure before advising state government. A string of investments and a whole lot of employment is involved in the SEZs. Therefore, we cannot take a chance,” the officials added. At present, the number of valid SEZ approvals is 232 and notified SEZs are 172. Once all these SEZs become functional, 4 million additional jobs will be created. The commerce ministry is expecting an investment of Rs 3-lakh crore in these SEZs. This figure will rise further when the 165 in-principle approvals get a formal approval status.

10. CONTINUING LEARNING CENTRES

Know all financial products under the sky

Put your money where his mouth is

Jim Rogers has three pearls of investment wisdom to pitch:

- **Get out of the dollar;**
- **Teach your children Chinese; and**
- **Buy commodities.**

Rogers, 65, co-founded the Quantum Hedge Fund with George Soros, pocketing enough money to retire at 37 and fund a series of around-the-world road trips. In "A Bull in China: Investing Profitably in the World's Greatest Market", Rogers details how to put your money where his mouth is.

Just as the 19th century belonged to England and the 20th century to America, so the 21st century will be China's turn to set the agenda and rule the roost, he writes. "Whatever the risks, this much is clear: It's scarier to have all your savings in the US stock market than it is put a portion in China – whether investing in China's growth or as a hedge against a potential US slowdown."

Rogers spies opportunities in most of the challenges China faces. Surging energy needs make oil and coal producers potentially lucrative. Water shortages and droughts boost the attractiveness of utilities in Singapore able to meet China's needs. For every 1,000 people, the US has 700 cars, Rogers writes. At last count, and despite the increased congestion, China had only 24 cars per 1,000 people. There are big gains to be had from China climbing into the driver's seat of the world auto industry. The best way to play that evolution however might be by investing in toll-road companies, rather than carmakers or auto-parts manufacturers, Rogers says.

Playing in a volatile market is the latest fad

Volatility is in these days. 'Playing safe' and 'going long term' plays no longer a role in the modus operandi of the new-age investor in India. The new breed on investors likes to play the market and thrives on taking risks. While volatility is generally perceived as an indicator of high risk, it can also be used to one's advantage by utilising it to earn returns in a very short span of time. But surfing on volatility may not be so easy after all. For an investor who's trying to encash volatility, the real art lies in being aware of the changing dynamics of the market.

Tipsy world of stock market

The stock market seems to be flooded with information via news channels, newspapers, websites, hotlines, and even astrology linked tips, continuously feeding us with stock picks. Retail investors, especially first time investors are becoming easy prey hoping to make quick bucks sitting at home. Making investments based on these heard-on-the-street tips not only makes investors lose their hard earned money but also sends wrong notions that stock market is meant to be understood by a niche few. It's not that one should keep him totally aloof from these recommendations. The stock ideas one gets from various sources may act as a cue but needs to be validated by checking the fundamentals (and if possible the technicals) yourself.

11. GLOBAL OUTLOOK

Government-owned investment vehicles

Sovereign wealth funds: Economic and security concerns

Sovereign Wealth Funds (SWFs) are government-owned investment vehicles promoted by various countries. The finance ministry is carrying out a study, which will look into issues that could confront the country if such funds make investments through stock markets or through the FDI route. For instance some SWFs such as Temasek are already present in India and have made investment via the FDI route. Some other SWFs such as the one promoted by Abu Dhabi Investment Agency are registered institutional investors. Though these funds have been present in the country for some time, what has made the government up its ante is neighbour China floating a $ 200-billion SWF – China Investment Corporation – in September '07. China has also invested close to $ 5 billion in Blackstone.

The total quantum of funds with SWFs the world over is estimated at about $ 2.2 trillion. Even a trickle from these funds could have huge ramifications for the Indian stock markets and the economy on the whole. Besides economic implications, there are security issues too, which the ministry will examine. On the stock market side, the restriction of 10% investment by each FII can give some comfort. However, the government cannot draw similar comfort on the FDI side, especially in sectors, which have been opened completely. Some sectors of strategic and economic importance are the matter of concern. Since government controls SWFs, it is felt that they would follow the agenda set by the country concerned. Management control of an Indian company slipping into the hands of a fund owned by a hostile country could pose an enormous problem. There are also issues about some of the countries promoting SWFs not enjoying market-economy status.

The report that the government is seriously considering whether a special investment framework is required to regulate SWFs comes hot on the heels of the National Security Advisor voicing apprehension about such funds. Such concern is not unusual – governments everywhere, even in extremely open, market-friendly countries like Sweden and New Zealand developed cold feet in the face of attempts by SWFs to acquire a stake in their domestic companies.

However, policymakers would do well not to react in haste. Or go in with a sledgehammer where more skilful use of normal checks at its disposal might suffice. It is true the defining characteristic of SWFs is ownership by a sovereign state and to that extent SWFs can in theory be influenced by extraneous, non-market related factors. But that is likely to be the exception rather than the rule.

Most SWFs, in common with other wealth funds, are looking investment opportunities, of which countries like India offer many. Hence, any attempt to impose restrictions will only be counter-productive. Given the quantum of funds at the disposal of SWFs – estimated $ 2.2 trillion and growing – it will mean the country will not benefit from this huge pile of money.

Moreover, a study by Standard Chartered Bank in association with Oxford Analytica revealed, SWFs are here to stay. Unlike in the past when they were from countries like Norway and Singapore, today they are from China, Russia and the Middle East. But that is entirely in keeping with the shift in the global economic power. So rather than resist SWFs, it might be a good idea for countries to frame common ground rules and a code of practice. Multilateral groups like the IMF and the World Bank or even the WTO could draw up such code. Yes, they may not be foolproof. But the longer the global community delays drawing up a code of best practice, the greater the risk of self-defeating protectionism.

China fund:

Buys $ 5 billion Morgan pie

Morgan Stanley posted a stunning fourth-quarter loss after recording a bigger-than-expected $ 9.4 billion of write-downs and said it sold a $ 5 billion stake to China Investment Corp to bolster its capital. The second-largest US investment bank posted a net loss from continuing operations of $ 3.59 billion, or $ 3.61 a share, in the quarter ended November 30, '07.

India fund:

SPV based in London

The proposal to use the forex reserves was first mooted two years ago by the Planning Commission. Since 2004-05, the country has been hard-pressed to deal with the problem of mounting forex reserves and the attendant carrying costs.

Typically, RBI invests forex reserves in low-yielding safe sovereign securities abroad. The government also issues bonds to mop up increased liquidity in the system due to foreign inflows. The problem is, these bonds carry an interest that is higher than the return RBI earns from its incremental investments abroad. This, in turn, adds to the country's fiscal deficit.

The plan to put the country's foreign exchange reserves to better use by financing infrastructure projects of local firms is finally set to take off. The government and the Reserve Bank of India, the custodian of the country's forex reserves have approved a proposal to form a special purpose vehicle based in London.

The SPV, which will be a fully owned subsidiary of India Infrastructure Finance Company (IIFCL), will access a part of the forex reserves and then lend it to Indian companies to fund capital expenditure abroad. RBI has agreed to set aside $ 5 billion for this. As things stand, the London-based subsidiary will borrow funds from RBI in the form of long-term securities issued in foreign currency.

RBI will subscribe to these securities and the SPV will then provide foreign currency funds to Indian companies in the infrastructure sector at good rates. The move is aimed at making such projects more viable, apart from helping RBI and the government earns more on forex reserve, which currently earn an average return of 3.5-4%. To begin with, the SPV will borrow in small trenches of about $ 300 million and raise more money progressively within the overall cap of $ 5 billion.

IIFCL has got the regulatory go-ahead to set-up an offshore investment vehicle in Britain. It will also get $ 250 million in the first round of funding from the central bank's currency reserve to spend on local infrastructural projects.

12. ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise

Financial market:

Honour commitment to pay

The financial market revolves around one simple act of honouring commitment to pay on the agreed date. But, defaults occur due to variety of reasons including an attitude on the part of the borrowers that loan repayment can be done if and when it's convenient to them. It is important to note that in a system of free enterprise one has freedom to get into debt as well as freedom to fail. There is no denying that every financial system has its own share of villains and there are always cases of cheating, misappropriation, breach of trust, fraud and corruption.

The matter raises policy issue: "Whether there is any need to place restriction on retail lending by banks and direct banks to observe restraint in aggressive marketing of consumer loans".

The issue has a crystal clear answer in the overall growth-oriented policy considerations. It is well established that credit is the driving force of the economy and growth rates can improve if the state encourages growth of credit in the economy. Fortunes of industries engaged in manufacturing variety of goods are dependent on lending policies of banks. If the banks decide to restrict retail lending, growth rates of such industries will be adversely affected. Since credit is the engine for economic growth the policy needs to be directed towards growth of credit and the State has to create an environment, which is conducive to such growth. The individual borrowers can be trusted to take their own decisions whether to borrow and to what extent after assessing one's capacity to repay. It is prudent policy to recognise party autonomy and refrain from regulatory intervention in the matter of marketing of retail loans.

Insurance regulator:

Stepping in to safeguard consumer interest

IRDA seems to have decided to shed its perceived image of being soft. The gloves are now off as Irda has signaled that it will step in and restore sanity in a market which has been freed if it comes to the regulator's notice that market players indulging in unfair practices. Insurance regulator C S Rao has made it clear that "any departure from the guidelines or breach of discipline will be severely dealt with". The trigger for this warning was the regulator's experience in health insurance, particularly mediclaim. Irda had to intervene to prevent public sector companies from charging hefty premiums on renewals of mediclaim. Insurers justified high premiums saying their medical insurance portfolio was loss making. But Irda has now set caps on the premiums that these companies can charge on renewals. The industry views such intervention as retrograde, given that they have moved into a de-tariffed regime.

Disclosure of cost structure in Ulip

Scores of individuals investing in Ulips are set to give a break-up of all the charges they have to pay and the exact amount that will be available for investment during the premium payment period. This will ensure grater transparency. IRDA, which has reviewed the cost structure in Ulips, has circulated a benefit illustration to life insurance companies. The new norms will come into force once the regulator gets the feedback from life insurers.

Insurance regulator has earlier said that IRDA had received several complaints on mis-selling of Ulips during the course of inspection of life insurance companies. According to reports, in many cases Ulips have been sold as investment schemes such as those offered by mutual funds. What is not made clear to the policy holder is the fact that of every Rs 100 invested in the first year, a substantial portion goes towards commissions and other charges.

Going by the benefit illustration, insurers have to give a break-up of the premium to be paid for each policy year along-with a charges statement. Charges at the start of the year will include premium allocation charge, policy administration charges, rider charge, if any, mortality charge and any other charges. The difference between premium payable each year and total charges will be the amount available for investment.

Insurers will also have to list out charges at the end of each policy year, factoring in the interest rates approved by the insurance regulator in the file and use application. These charges will include fund management charges, surrender charge and any other charge.

The policyholder and the marketing official selling the product will be signatories to the premium-cum-charges statement. Any change in the charges while under-writing or finalising the deal will also have to be approved by the policyholder. The exercise is aimed at ensuring that the policyholder is fully aware of the cost structure and investment risks.

Commodity markets regulator:

Ban futures on the exchange platform

NCDEX, which accounts for a major portion of the agriculture volumes, bore the brunt of the drastic rise in prices of essential commodities in 2006. This resulted in the banning of rice, wheat, urad and tur futures on the exchange platform. In January 2007, under the directive of the regulator of commodity markets, Forward Markets Commission (FMC), a high-level committee under the chairmanship of Justice PN Bhagwati was formed to probe into urad, chana price settlement issue. The exchange, which had grown exponentially in its first few years since its inception in 2003, suddenly saw volumes halve in 2007, to Rs 6.74 lakh crore from 12.4 lakh crore last year.

Fair trade watchdog:

Desist from cartelisation

The country's fair trade watchdog held 42 cement makers, including L&T Cement, Birla Cement, Grasim and ACC guilty of cartelisation under the aegis of Cement Manufacturers' Association. A good decision by Monopolies Commission and bad behaviour on the part of the cement industry; but the only problem is that this finding relates to 1990.

The regulator also asked the cement companies to desist from cartelisation. Just because the finding comes 17 years after the offence was committed, it is not entirely without teeth. The verdict will come in handy for the government to take tough decisions to rein in cement prices, after its unsuccessful attempts to persuade industry to lower prices.

Regulating mergers and acquisitions

It is a proven theory that competition brings about lower prices, better quality and spurs innovation. It is widely acknowledged that competition benefits both the consumers and enterprises. Throughout the last century, there was proliferation of competition laws in countries across the globe and, as of now, there are 106 of these. Almost all of these have merger control provisions. Such large number overwhelmingly demonstrates the necessity of having competition law, including provisions of merger control in spite of the International experience “That 80-85% of merger and acquisitions do not raise competitive concerns”.

Enterprises have an innate desire to acquire monopoly position or substantial market power, even if for a brief period. This desire leads to expansion of business, either through organic or inorganic growth. As for the latter, while most merger and acquisitions bring about efficiency and are thus beneficial, some can have anti-competitive effects through unilateral or co-ordinated effects. If combining enterprises come to wield substantial market power, they can raise prices or reduce outputs or do both, without, bothering consumers and competitors.

IFCI

Ensure a proper strategic sale

IFCI and the Sterlite-Morgan Stanley consortium – the only bidder for the Institution’s 26% stake – will finalise the deal. The bid price is not an issue. The strategic investor will become the majority shareholder in IFCI with management control, once the deal, including an open offer for 20%, is closed. Sterlite-Morgan is expected to submit a vision statement outlined their business plan for IFCI.

However, a few other issues need to be addressed. IFCI will continue to function as a finance institution; there is no question of a change in its status. There is no plan to convert IFCI into a bank. Negotiations are still on. Some of the issues need to be sorted out.

The IFCI board called off the sale of 26% stake to the only bidder over irreconcilable differences over management control. IFCI CMD Atul Rai conceded that the entire effort that lasted six months did not translate into deal. But the board was not agreeable to the conditional offer made by the only bidder. While IFCI offered two seats on the eight-member board, the bidder wanted three. Sterlite also wanted to replace the CEO.

The botched attempt to sell a 26% stake in IFCI is an embarrassment, to all concerned, IFCI and the government. It is nonetheless a measure of the desperation of foreign financial majors seeking to enter India that the Sterlite-Morgan Stanley combine bid of Rs 2,800 crore, valuing IFCI at over Rs 11,000 crore, not bad for a bankrupt financial institution. The strategic investor was getting only two out of eight board seats and had no right to appoint the CEO!

IFCI badly needs access to capital; it also needs a large promoter-shareholder with the management skills to convert it into a major NBFC, in the absence of a banking licence; and able to compete with the market leaders. The government can get LIC or IDBI to take over the company. Alternatively, it should ensure a proper strategic sale, i.e., the strategic investor gets to run the company and appoint the top management. IFCI’s interest, as distinct from that of its current management, needs to be paramount.

India's consumption story – a missing link in the Sensex

There's a story behind every bull-run. In the late 1990s, the fodder for the bulls came from the lure of a dot-com economy. The current bull-run, on the other hand, is led by investment-led sectors such as infrastructure, capital goods & construction, metals, cement, energy, real estate and financial services. India is right now in the midst of the biggest investment boom in its 60-year history. Not surprisingly, investment-driven sectors now account for over two-thirds of the BSE Sensex's market capitalisation. In contrast, companies offering consumer products and services account form less than a quarter of the index market capitalisation. The balance is accounted for by IT services.

India's capital market is not alone in showing this bias. The three other BRIC countries – Brazil, Russia and China – show a similar level of affection for investment-led sectors. It is obvious that these countries are passing through a great economic transformation, which means investment in industrial and physical infrastructure. In China, for example, these sectors have a 75% weightage in Shanghai-50 index.

So, how long will investment-heavy sectors lead the bull-run? Can they continue to ignore the 'king' consumer? If the Dow Jones is any indicator, you can't keep the king suppressed for long. As the economy grows and per capita income rises, the consumption demand in India will catch up with that in rich economies of North America, Europe and Japan. As a result, consumption growth will outpace investment demand. And the stock market is bound to reflect this change. In Dow Jones, consumption-driven sectors account for nearly half of the market capitalisation. And we can expect a similar composition of the BSE Sensex over the long run, as India gets more prosperous.

Increasingly income levels have resulted in changing consumption and savings pattern across the world. Watching movies, eating out and higher use of mobile phones will all lead to higher consumers spending. So sectors, which rely greatly on domestic demand, seem to be the obvious winners. McDonald's and Wal-Mart are a part of the American Index, but here in India, we do not have any companies from media, retail or hospitality sectors in the Sensex. This can pave way for the current listed Pantaloon or Shopper's Stop or a Hotel Leela Venture to be a part of the Sensex. That's already beginning to happen in a small way. India's largest property developer DLF moved in the Sensex.

Dow Jones' composition also reveals that even though we are the second most populated country, consumer durables and FMCG are two sectors, which do not have a fair representation on the Indian bourses. In fact, the coverage of consumer durables in India is confined to auto manufacturers only. We do not have big companies manufacturing semi-conductors or computer hardware. Similar is the case for the FMCG sector. ITC and Hindustan Unilever are the only companies in the benchmark index. Together with pharma companies they make up 8% of the Sensex, vis-à-vis 22% for similar companies in the US. But as consumer become more refind and the level of income goes up, we will see more spend on branded products like fresh juices, packed 'atta' and ready-to-eat food mix. This will lead to better growth of companies and higher valuations of the sector.

For the first time, our direct tax collection has been higher than indirect taxes, making it amply clear that we are poised to start on a mass consumption spree. And we are not far away from a time when consumer-led stocks will find a greater representation in the Sensex.

New frontiers for 2008

From roads and railways to ports and airports, and from power plants to hydrocarbon infrastructure, India ranks among the lowest in the world in terms of infrastructure availability. The catching up, which has just begun, will go on for years to come and is set to drive India Inc's future growth.

India is set to emerge as one of the world's largest economies. This is not achievable unless infrastructure improves, and the process has already begun. But even as you raise the toast and get started; here's how and where to catch the action as it unfolds. In an attempt to get the first-mover advantage explore the new frontiers (read sectors) which could propel growth, the outperformers and dark horses, and attract the attention of both Indian and foreign investors.

Taking off from the hot sectors of 2007 such as SEZs, real estate, telecom and retail, it's now the turn of infrastructure space, particularly in the backdrop of the government's estimates that India should spend $ 100 billion in building roads, railways, ports, airports, telecom network and others in 2008 itself and around $ 500 billion in five years.

Another sizzling story has been building around the business of education, with much headroom left for 2008 and beyond. Microfinance is yet another space, which could bring in big opportunities for social enterprises, thanks to the interest being shown by private equity players and venture capitalists in this space. And the climate concerns could accelerate the emerging business outlook of alternative energy and its promises to charge up the investment horizon.

CORE SECTOR
The infrastructure story

Infrastructure is the pillar of economic, as well as social development. If various reports and studies are to be believed, India is set to emerge as one of the world's largest economies. This is not achievable unless infrastructure improves. In the current scenario, lack of proper infrastructure is a bottleneck in the growth of the Indian economy. Sectors like power, rail and ports have to improve substantially if they want to meet the rising demand from India Inc. Infrastructure investment requires huge initial capital outlay, which was considered to be a big hurdle in the past. With rising government revenues, a bullish stock market, huge foreign capital inflows and burgeoning corporate balance sheets, mega investment projects in infrastructure are no more a dream.

The infrastructure growth in India has reached an inflexion point and historical growth may no longer act as guidance for the future. So, will we ultimately see the kind of airports, ports, trains and roads that we have so far seen only in Bollywood movies? Looking at the revolution in the telecom sector, this cannot be ruled out. This growth will have a cascading effect across a number of sectors, ranging from construction, cement and metals, to capital equipments and project finance, among others.

India will remain the hub of the world infrastructure business for many years to come. The size and scale of the operations and steady returns for a longer period of time have not only attracted global giants to bet on India's core story, but also lured India Inc to jump into the infrastructure bandwagon.

While traditional construction and infrastructure companies such as L&T and GMR have consolidated their positions in the recent past, many others including DLF, Unitech and Videocon are entering into pure core sector space. The scale-up in the market cap of the core sector companies in '07 was reflected on the bourses too, which acknowledged the potential of the core activities.

Prof G Raghunath, infrastructure specialist at IIM-Ahmedabad feels that India has learnt the language of infrastructure. "We have understood the need for infrastructure in India, and the funds are beginning to flow in. As more projects are now being executed in PPP-mode, political risks are getting marginalised substantially". In fact, the PPP is a preferred mode not just to hedge political risks. It also facilitates a company to project its topline better, as unlike small-sized one-time contracts, PPP projects see regular income flow for a number of years.

Significantly, the core sector companies will not be the sole beneficiaries of this buzz. As the infrastructure story spreads, its spin-offs will be noticed in the entire industrial space, which in turn, will boost the total productivity of the nation. Industrial infrastructure, in particular, is critical to improve the global competitiveness of the Indian industries. Whether its water supply or skill development infrastructure – all contribute to the lowering of costs and improving of the delivery.

EDUCATION SECTOR
Business of education

Its boom time for the education sector in India as the concept of 'business of education' catches on with India Inc. Considered a 'social responsibility' all these years till now and plagued by inefficient infrastructure, the Indian education sector has huge room for improvement. Increasingly, there are companies on the horizon providing e-learning services, tutoring for kids, coaching institutes expending their ambit to provide mainstream education, setting up schools, entering the B-school segment et al.

Surely this is in sync with the scope. According to a conservative estimate the entire education market could be pegged at Rs 150,000 crore. About 540 mn people are under the age of 26 and at least 10 lakh individuals could be seeking management education. Out of this, 2.5 lakh itself take the common admission test every year. It's a whole world of opportunity waiting to be tapped.

In the e-learning space too, a subset of the education sector, several companies have been witnessing substantial growth. For instance, NIIT, a major IT training company, has invested around Rs 150 crore in the last two years itself in creating new offerings for sectors like insurance, banking and others. Another example is Educomp, which is growing at 200% every year, and working with 5,950 government schools to set up learning labs, a virtual classroom and digital library. The success of e-learning has in fact prompted the government to increase spend on IT-aided education to Rs 600 crore from Rs 250 crore last year under the Sarva Shikhsa Abhiyan and ICT@schools schemes.

Only if the efforts to revive the Industrial Training Institutes (ITIs) are taken into consideration, results would be immediately visible. The government's announcement to provide financial support for the upgradation of ITIs through PPP has given a new lease of life to the scheme. A total of 1,396 ITIs have been proposed to upgrade into the centres of excellence in specific trades and skills under PPP. According to CII, companies such as Hero Honda, ITC, L&T, Ashok Leyland, BHEL, Coca Cola, HCL, Wipro, Kirloskar and TATA have already shown interest in adopting ITIs for upgradation.

MICROFINANCE SECTOR
Reaching out to financially excluded

When Professor Mohammed Yunus of Bangladesh's Grameen Ban won the Nobel Peace Prize in 2006, the microfinance sector came of age, in a way and captured the imagination of not just investors but also the common man across the world. After that, 2007 was another big year when the sector earned greater credibility and its social dimension seemed to offer the right balance between profitability and responsibility towards society.

In India, microfinance is increasingly seen to be providing a platform for the banking industry to reach out the financially excluded sections in the country – which is around half of India's population.

In the last two years, the Indian microfinance industry attracted a lot of large institutional players. Bankers have been increasingly talking about financial inclusion and no frills accounts. The intent within government circles is to reach banking services to the unbanked. MFIs are in the best position to cover the last mile for banks. Technologically, too, there has been a lot of interest and progress on bridging the urban-rural divide. The sector is therefore poised for growth.

There are big deals being done in the microfinance sector with big banks, VCs and PE funds making a foray into these earlier uncharted waters. From being a grant sustained development intervention, microfinance in India has now become a sustainable form of development that is achieving both bottom lines – the social as well as commercial. Besides the capability of attracting large international institutional investors, the sector is also attracting a number of professionals from corporate backgrounds who are coming forward to set up new age MFIs.

In the larger global context and in India, the change in mindset is seen as having a big impact on the microfinance sector. Microfinance is evolving and the coming years will see it making a definite impact across rural and urban India. The demand for microfinance is huge and if funds come in and MFIs are able to not just meet this demand but also ensure they maintain their service quality levels and recovery rates, it could be a very powerful tool in allowing the poor to access services they have never been exposed and had to always pay a premium for.

The entry of foreign VCs will ensure more professionalism and accountability. MFIs are best placed to offer that opportunity to the millions who have not been able to find a way out of poverty for the last 60 years of Indian independence. It looks like a win-win deal – an industry with a heart of gold is all set to find its pot of gold.

RENEWABLE ENERGY
Small hydro, wind and solar energy

As debate over global warming hots up, the government has speeded up its incentive-based initiatives to promote renewable energy sources. Minister of state for new and renewable energy Vilas Muttemwar said that the government would surpass its target of producing 14,000 MW of renewable energy in five years, which in turn, will ensure an investment of whopping Rs 90,000 crore. The wind energy will contribute the maximum here. The other components will include small hydro projects up to 25 MW, bio-mass, solar energy etc. also, we still stand by our target that one million hydrogen cars will be on Indian roads by 2020. The R&D work is on. It can happen any day.

The solar energy sector in India can witness a monumental growth if production costs can be substantially lowered. At present, generating 1 MW of solar energy, for example, costs Rs 20 crore against Rs 4 to 6 crore for generating I MW of hydro or thermal project. India receives a solar energy of over 5,000 trillion KW per year. So, such projects can come up anywhere in the country.

Experts agree that the next round of investments would largely be in solar technology and environment-based companies. The trend may take time to come to India but it's pretty much the emerging trend for the West in 2008. Whereas more big players are foraying into wind energy, leading to a massive growth in that segment, no big private player will enter into the business of solar energy just for the limited incentives that the government has announced recently.

The key question is whether input costs will come down or not. And that will determine the entry of big players and initiation of mega business actions.

TELECOM SECTOR
Telecom infrastructure entities

The Indian telecom subscriber base is growing at a tremendous pace. India has about 264 million telecom subscribers but three-fourths of population still remains without phone. And therein lies the growth potential of the telecom operators. 2008 promises to be a great year for Indian telecom, with lower tariffs, spectrum allocation for 3G and 2G mobile services, wimax broadband, dwindling ARPUs, mobile number portability, and listing of infrastructure entities of telecom majors. Investors will be interested in IPOs of infrastructural entities. All operators – be it Reliance Communications, Airtel, Vodafone, Idea Cellular and Tata Teleservices – have hived off their infrastructure arms and plan to list them. A tariff war is imminent due to multiple players and the likelihood of mobile number portability (MNP) becoming operational in metro cities. After MNP, a cheaper tariff plan and rental along with greater effort on customer retention and allocation will be the focus of telecom companies.

URBAN INFRASTRUCTURE
Clogged cities open doors to investment

India's urban space is back in the news, at least from the pure business prospective. In the last couple of years, as many as 1,100 projects worth Rs 43,000 crore have been sanctioned, targeting 63 cities of the country. The magnitude of the business opportunities could be realised from the fact that the Centre has made a commitment to dole out a grant worth Rs 50,000 crore in seven years, which will be supplemented by a matching amount from internal resources of municipalities along with raising of debts and equities.

The year 2008 may witness several infrastructure majors entering into municipality work owing to the reforms, which are being rolled out by the city administration. For instance, cities such as Hyderabad, Vizag, Raipur and Rajkot have set up e-governance, while Chennai and Vizag have demonstrated a 100% cost recovery in water supply.

POWER SECTOR
Power to all by 2012

If India's growth story has been music to ears, plug into the power play – right here, right now; and why not? After IT in the mid-1990s and real estate and retail a couple of years ago, corporate India is now jumping on to the energy bandwagon in a big way. Where several companies foresaw the winds of change and rode the wave by getting into the sector a couple of years ago; the rest are joining the party. Analysts say that most companies are diversifying into power to be part of action. Also, no player can now ignore the stockmarket momentum in the sector, which is happening in anticipation of future potential.

Power to all by 2012 – the government tagline reads aloud an ambitious target in just four years, as more than half of India's population is excluded from the power purview. The plan is to add 78,000 MW of power generating capacity between 2007 and 2012. Experts argue that the power sector is no longer government-dominated. Private players have seen flexibility in government policies related to power. According to government policies, the private sector is permitted to set up coal, gas or liquid-based thermal projects, hydel projects and wind or solar projects of any size.

A growing economy needs power, both for domestic and industrial use. India is highly energy-deficient. This coupled with the fact that the affluent Indian middle class is spending a lot on domestic appliances, and a growing manufacturing industry needs more power to meet its energy needs, provides tremendous growth potential for companies in the power sector.

An average capital cost of Rs 4 crore is required to generate one mw of power. About 30% of this will go to EPC contractors (such as L&T, HCC and IVRCL). The bulk of the balance will be spent on buying equipments from suppliers (such as Bhel, Siemens and Alstom). As metal (especially steel) is a major raw material for equipment manufacturers, 50% of the capital expenditure in the power sector is likely to be captured by metal producers such as SAIL, Tata Steel, Sterlite Industries and Hindalco.

The additional generating capacity will translate into huge upside for power generators like NTPC, Reliance Energy and Tata Power. More power will require additional transmission and distribution infrastructure. It will also lead to more power trading, as merchant power plants may become the norm. This will give greater upside to companies such as Power Grid Corp, which is building a national power grid, and PTC, the largest player in the power trading business.

CRUDE OIL
International refining hub

An economy energy matrix is incomplete without hydrocarbons. Carbon-based fuels such as crude oil, natural gas and coal are the original sources of energy used to run power plants, transport networks and industries. In the last 10 years, India's crude oil consumption has witnessed a CAGR of 4.9%, making it the world's fifth-largest energy consumer. Despite this, the per capita consumption of petroleum products in India is among the lowest in the world.

Out of India's current annual need of crude oil of 120mt, a little less than 30% is met through domestic production, while the remaining has to be imported. So, it has become imperative for India to invest in exploration projects, to boost production and reduce dependency on imports. Most of India's oil & gas reserves remain untapped, mainly due to lack of E&P infrastructure.

Billions of dollars of investment will be required to identify and monetise India's oil reserves. An investment of $ 33 billion is expected over the next five years in this sector according to the Planning Commission of India. These investments will benefit companies, which provide support to E&P majors. This include Shiv-Vani Oil, Aban Offshore, Jindal drilling, Maharashtra Seamless and Deep Industries.

Downstream refining and marketing infrastructure is also witnessing an investment boom. India is increasing its refining capacities, aiming to become an international petroleum-refining hub. In the next three years, domestic refining capacity is slated to cross 190 mt with an investment of $ 15 billion. Creation of refinery infrastructure will boost the outputs of refining companies such as Reliance Petroleum and Essar Oil.

NATURAL GAS
National gas grid

In the near future, the availability of natural gas is expected to grow faster than oil in India. As a result, a number of companies, including Gail, RIL, and Gujrat State Petronet are investing in pipeline network. Cross-country pipelines are being laid to connect the natural gas production centres with consumption centres. These initiatives will create a national gas grid and will also support a number of city gas distribution projects. Around $ 8 billion will be invested in creating the pipeline infrastructure during the 11th Plan period.

ROAD SECTOR
Highways & Express ways

If the sound financial engineering of the road projects in India is any indication, the sector has come to age. The PPP model, which National Highways Authority of India (NHAI) has been experimenting over the years, is finally entering into various other infrastructure domains. Although sectors such as power and airports may still remain more bullish in 2008, the action in road sector may not cease to exist.

In fact, India's road network of 3.3 million km is the second highest in the world, and a very little has been done in modernising those roads. Rohit Modi, CEO, developmental projects, L&T explains: If everything is on track, these will be at least 30 projects in NHAI in 2008, in which private sector investments will be no less than Rs 30,000 crore. What's more, business opportunities will emerge from state government as well.

Already, the Rs 30,000-crore Ganga Expressway project, connecting Greater Noida to Ballia in Uttar Pradesh, has attracted bids from 18 companies, including Anil Ambani owned Reliance Energy, GMR Infra, JP Associates as well as real estate majors such as DLF and Unitech. In Gujrat, where projects for 500-km-long state highways are up, bidders have even offered to go for a revenue-sharing model with the state government, unlike on earlier occasions where developers asked for grants from most state governments.

Once the construction phase is over, the growth will also come from road maintenance and re-engineering. More modern technologies will hit the road as we proceed on construction and rehabilitation of roads. Recycling for bituminous roads, for example, is already available.

RILWAYS
Commercial exploitation

In railways, the PPP cell has become quite active, and many projects will now be undertaken in partnership with private players. Mega business opportunities will also emerge from eastern and western dedicated freight corridor, for which the government has given an approval of Rs 28,000 crore. Prof G Raghuram, infrastructure specialist from IIM-Ahmedabad, says: “I feel, the commercial exploitation of at least 50 big railway stations can unlock a huge value and initiate big business. The process has already begun. Also, a few private companies are now running container trains. But a day will come when ‘steel trains’ or ‘foodgrain trains’ will be run by private players.”

PORTS
Global trade

Ports are required to carry out international trade, as 95% of the global trade by volume is conducted by sea. Development of ports and their cargo-handling capacities influence foreign trade. Thanks to the coastline of over 7,500 km, India has nearly 200 ports. But their capacities are way below global standards. The average per capita cargo handled at Chinese ports stood at 4,265 kg in ’06, while the average per capita cargo handled at Indian ports was at 572 kg. If India has to reach the halfway mark of China’s current level, heavy investments are required in this sector. According to Planning Commission, the domestic port sector needs investments of $ 18 billion by ’12. Of these $ 13.5 billion will be invested to boost the infrastructure at major ports under the National Maritime Development Programme (NMDP), while the remaining will be needed to improve minor ports. Mundra Port and SEZ, which is developing a port at Gujrat, has already tapped the capital market. More such beneficiaries will emerge over the next few years, as and when more port development projects are commissioned.

AIRPORTS
Regional connectivity

Air travel has made the world shorter, but it’s still beyond the reach of most Indians. As the economy grows, the number of people traveling by air will explode, which will require expansion of the existing airports and building new ones. Currently, India has 125 airports in total, of which, 12 are international ones. But there is huge scope for improvement in passenger traffic. Currently, only 71 persons out of every 1,000 individuals travel by air every year in India. The ratio is 151 in China and as high as 4,780 in the US. If India is to reach even China’s current standard in the next couple of years, the annual passenger traffic will have to double. This will require huge investments in airport infrastructure.

The movement has already begun with the privatisation of Mumbai and Delhi airports and construction of Greenfield airports at Bangalore and Hyderabad. Next in the line are Kolkata and Chennai airports. The government has also begun the groundwork for second airports at Mumbai and Delhi. Capacity expansion and upgradation of 35 smaller airports are also on the anvil. The Investment Commission estimates an investment of $ 10 billion will be required in this sector over the next five years.

Premium class

Income inequality, a perennial subject of discussion, has acquired a greater significance in India. Not, everyone has gained uniformly from India's growth story. As Corporate India generates huge profits, the stakeholders – i.e. the promoters, top management, shareholders and employees – are witnessing an unprecedented rise in income and therefore, their standard of living.

Eventually this has created a new class of consumers with aspirations and money to jump to the next level of consumption. Consumers are spending on luxury like never before. This has opened up a goldmine of opportunity for companies willing to fulfill the lifestyle aspirations of this new class of brand-conscious consumers. Though we are aware that as income and wealth crosses a certain level, Individuals may switch to a foreign luxury brand, however, new entrants into the rungs of the upper-middle class will compensate that leakage.

For an opportunist investor, this trend provides an opportunity to make money. Investors are advised to put their money in companies that sell goods and services to the swelling upper-middle class. The potential investment targets can either be manufacturers of high-end consumer goods, lifestyle products or providers of leisure and entertainment. The majority of Indian companies have a mix of products catering to all segments of consumers. But, you need to explore listed Indian companies, which are top end in their respective categories.

Food & Beverages

Food is one of the major areas of expenditure for consumers. The taste of consumers becomes more refined as their income level increases. It has been observed that consumption of liquor and fresh fruit juices beefs up as economic status rises. United Spirits has the largest portfolio of high-end liquor brand. Freshtrop Fruits exports fresh fruits to various parts of Europe and the Middle East and now plans to enter the domestic market in a tie up with retailers. Jain Irrigation Systems supplies fruit pulp and concentrates to most of the fruit juice manufacturers in India.

Clothing

Clothing is yet another segment which attracts the bulk of expenditure from consumers. As incomes rise, preference for branded clothes increases. This also explains the growth in designer labels in the domestic consumer market. Among Indian clothing brands, Raymond is the most premium and sought-after brand in the made-to-order suit category. It also owns a host of premium brands in the ready-to-wear segment. Other companies with good growth prospects in this league are Zodiac Clothing and Provogue India.

Accessories

Indian premium brands in accessories like watches, jewellery and luggage also come under the lens when we talk of high-end consumer spend. Companies in this category can be a good buy for investors interested in tapping the growing consumerism. Titan Industries – with its timepieces and jewellery brand, Tanishq – and Gitanjali Gems – with its jewellery and diamond brands – are attractive picks in this category. VIP Industries is also an attractive player in this segment, since it attracts consumers looking at buying high-end luggage to suit their tastes.

Apartments

The best way to flaunt your wealth is by living in a smart and upmarket house. Thanks to rising income levels in high growth sectors like IT, retail and real estate, not only has the average age at which people purchase houses come down, but the average spend per flat has also gone up. People don't mind paying extra for dedicated parking slots or designer interiors these days. This has opened up big opportunities for companies such as Orbit Corporation, DLF and Godrej Properties (promoted by Godrej Industries).

Hotels

Till decade ago, visiting a five-star hotel was unheard off among the urban middle class. Now, New Year bashes or annual holidays at a five-star property are becoming commonplace among the growing urban middle class. As salaries and wealth at the upper end grow the potential market for hospitality chains like Taj (Indian Hotels), Oberoi (EIH) and The Leela is only getting bigger by the day. This, coupled with graduation of households to the upper middle class, will add to demand for travel and tourism in India. This has also given a fillip to the concept of 'eating out' particularly at speciality restaurants, the best of which are housed in five-star hotels.

Home Furnishings

With good homes comes the dead for top-class interiors and home furnishings. Hindustan Sanitaryware, Nitco, Somany Ceramics and Kajaria Ceramics are companies to reckon with in the case of interiors. Bombay Dyeing and Welspun India are leading brands in towels, bed linen and various home décor items. Besides quality, high-end consumers seek aesthetics while decorating homes. The category, which is ancillary to the real estate and hospitality industries, will also get a boost due to consumption boom.

Entertainment

The media sector is expected to be one of the major beneficiaries of the growing economy and increasing consumerism. The increasing focus on advertising, growing number of multiplex cinema theatres and launches of new TV channels are some of the triggers for companies in this sector. The media sector is classified into four segments – print media, broadcasting, content production and production, distribution and exhibition of movies.

The year 2008 is likely to be a bonanza year for media stocks. Experts feel that ad spends are likely to trace the broader growth in the economy and consumerism. According to reports by E&Y, over Rs 22,700 crore is spent annually on advertising in India. This is set to increase substantially in the coming year. While ad spends will provide a trigger for good performance by broadcasting companies, increasing penetration of content distribution methods, including DTH and CAS, are likely to add sparks to the party. Apart from broadcasting, content providers also have a busy schedule lined up, given the ever growing number of TV channels and shows. This spells a bonanza for companies, which are engaged in the production of TV shows and animation. Moreover, the increasing number of multiplexes and aggressive promotion of movies mean that companies engaged in the business of production, distribution and exhibition on movies will also have a good time.

All said and done, the party holds promise for only a handful of players, as most of them are already looking richly valued. This means investors have to look for growth stocks. Companies, which enjoy a pan-India presence and offer services in various media segments, are likely to be the biggest beneficiaries of these trends.

Assets under management (AUM) of domestic mutual funds of Rs 5.22 lakh crore on December 31, 2007 is a healthy 61% higher than what it was at on December 31 2006. On the whole, 2007 has been a good year for the mutual fund industry, and booming stock markets has been the key driver. India happens to be one of the fastest growing markets for mutual funds and is attracting international players. With new mutual funds launching new products, a Boston consulting survey has pointed out that mutual funds will have to play a bigger role in the overall asset management market than ever before.

The domestic mutual fund industry is still at a nascent stage vis-à-vis the developed countries. However, the industry's growth in the past few years indicates its future potential. In the past seven years, the AUM of mutual funds has jumped by around six times. The industry has, however only scratched the market surface, so far. Equity investment accounts for less than 7% of all financial savings of households in India. In a market like the US, the corresponding figure is above 50%. The industry's growth will be stupendous if it is able to capture even a quarter of India's household savings.

Personal disposable income in India is also growing in high double digits and the market regulator has now opened up a new growth avenue for the industry – real estate mutual funds and short selling of equities. The industry has also gained after RBI raised the overseas investment limit for the mutual fund industry to $ 5 billion.

In '08, pension funds expect to get a nod from the government to invest in equities via the mutual fund route. And given the large number of mega IPOs this year, ample IPO proceeds are expected to park by corporates in short-term debt mutual funds.

Real Estate Mutual Funds (REMFs)

Real estate, as an investment option, has always ranked high as an investment option for Indians. But with prices moving northward, the real estate seems to be slipping out of the hands of an average investor. Today, almost everyone wants to be a part of this exciting sector. Analysts say, that if you want to enjoy the returns given by the real estate and at the same time invest smaller amount with low risk exposure, REMF is the best bet. "It is an attractive proposition which gives you the advantage of putting your money in smaller amount and with little difficulty." Analysts feel that investing in such a fund is a better option than in real estates, as it scores a big plus in terms of liquidity and is easily redeemable.

On the other hand, though investment in property fetches you good returns, it's a time-consuming process. Also, the cost you incur on buying and selling properties are very high. It also requires you to invest large amounts at one go. If you don't get a good buyer, there is a risk of your funds getting locked up for a long time. Most fund houses believe that if the real estate boom has to sustain, the retail investor has to play an active part. This sector is considered to be highly volatile and investors are wary of investing directly. Fund managers diversify the allocation in various sub-sectors such as cement, steel and construction, which hedges the risk. This is a win-win situation for many investors. So, if you're looking for investment in real estate mutual funds, it's pertinent that you check out the various segments where your investments will be allocated. Find out how your fund defines a real estate company. Keeping these simple points in mind while investing will not only help you in the long run but also get the most out of your fund.

Rising Star

The BANKEX, a representative of banking stocks in India, has significantly outperformed the BSE Sensex, the broad-based BSE 500 index and other sectorial indices in ’07 for the first time in the past couple of years. It has offered a return of 60%, against the 45% return given by the Sensex last year. The bull-run in banking and financial stocks is likely to continue in ’08 and beyond.

Banks

Indian banks are yet to tap their huge business potential. As of now, only one in three Indians has a bank account. If the domestic banking sector succeeds in bringing even half of the excluded population under the formal banking channel, it will open up the floodgates of stupendous growth. Banks are also trying to broaden their business base. Aggressive expansion on the international front, aided by a rapid growth in India’s international trade, overseas mergers & acquisitions and foreign capital inflows will strengthen bank’s financials from current levels.

Besides, investors can also expect to gain from an impending consolidation in the industry. Beginning April ’09, foreign banks may be allowed to pick up stake in domestic banks, triggering a big round of merger & acquisitions in the industry. State Bank of India, the largest PSU bank, has already initiated the merger process of its associates. Other PSU banks are also expected to follow suit.

Looking at the future growth of Indian banks, investors can increase their exposure to this sector. Within the sector, besides the usual favourites like SBI, Punjab National Bank, HDFC Bank, ICICI Bank and Kotak Mahindra Bank, many small and medium players including Canara Bank, Central Bank, Oriental Bank of Commerce and Bank of Baroda offer great value to investors.

NBFCs

With all segment of the financial sector witnessing explosive growth, non-banking financial services companies can hardly afford to miss the action. The 11th Five Year Plan is expected to lay a huge emphasis on infrastructure growth, with estimated investments to the tune of $ 320 billion. This will lead to a substantial surge in demand for project capital.

With banks being unable to meet the entire demand for long-term capital, the door remains wide open for specialised institutions such as Power Finance Corporation, SREI Infrastructure Finance, IDBI, and soon-to-be-listed Rural Electrification Corporation, among others, to tap this opportunity.

Other growth segments include mortgage banking and commercial vehicle finance. Despite the recent surge in house-building, India faces a housing shortage of over 20 million, which can only be met through further expansion in the lending activities of mortgage banks such as HDFC, LIC Housing Finance and GIC Housing Finance, among others.

Venture Capital

Venture capital is a fledgling industry today and that do not change materially in 2008. It is an industry which contributed less than $ 1 billion in the year gone by. Given the fact that it is coming off such a small base, it will not be surprising if it grows by 50%.

This industry has seen a large influx of capital from one of the word's most sophisticated investors – the Ivy League Universities. They will continue to increase their allocation to venture capital, especially in emerging markets like India. The Indian venture capital industry that has so far been largely funded by the US will see an influx of funds from Europe and Asia in this year. Also, venture firms originating from mature economies like the US will strengthen their operations in India. It promises to be a year where deal flow and capital supply will be well matched!

The year 2008 is slated to an interesting year for entrepreneurs and venture capitalists alike. With the mobile subscribers of over 200 million and a growing internet penetration base, growing middle class and over 70 million TV and satellite homes, entrepreneurs are coming up with innovative ideas and VCs are not stopping short of funding them.

In 2007, VC funding in start-ups in India just stopped short of $ 900 million. In 2008, the VC industry is slated top become worth over $ 1 billion. And interestingly, it will not be run-of-the-mill IT services. In fact, in a distinct shift, VCs will shy away from investing in IT outsourcing and BPO start-ups due to the rise in value of the rupee. Tax breaks to IT and BPO companies are ending in 2009. Unless that gets revived in the Budget this year, VC investment in the tech outsourcing start-ups will decline. Investments in high-end KPO kind of services like analytics; research and legal outsourcing will continue to see traction. But dollar-driven businesses will surely see a decline.

However, consumer businesses will gain momentum, thanks to the great Indian middle class. The hottest areas for tech start-ups in 2008 would be like – Mobile Data Services, Online-Education, E-commerce/M-commerce, Online Financial Services, Digital Entertainment, Gaming, Local language internet, Search (Web/Local), Ad Networks, Enterprise Technology, Social Networking Online Travel etc.

Investment-banking

The flurry of billion-dollar deals by Indian corporates has pushed up investment banking (I-banking) revenues from the country, till recently a backwater for Wall Street banks, to a record high. For the first time, I-banking revenues from India have crossed the $ 1 billion-mark. According to Dealogic, an investment firm that tracks global M&A transactions, revenues from India were at $ 1.069 billion, though industry officials feel that revenues could be at least 20-30% higher.

According to Dealogic, India was the third-largest market in Asia-Pacific after Australia ($ 2.595 billion) and China ($ 2.26 billion). It was bigger than Hong Kong ($ 724 million) and South Korea ($ 524 million). These I-banking fees include fees from debt capital market (DCM), equity capital market (ECM), M&A and loan transactions. Accordingly Dealogic has not included leveraged financing. Also, it excludes forex and derivatives revenues.

In revenue terms, the biggest players include Citi, Merrill Lynch, ABN Amro, UBS, Deustche Bank. Incidentally, the top 10 bankers this time around were three local players – ICICI Bank, Kotak Mahindra and SBI Capital Markets. For Banks like ICICI, 2007 was the first full year of operation. Kalpesh Kikani, global head investment banking ICICI Bank says, “The ability to do an end-to-end product advisory, along with financing, will differentiate the larger players from niche players.”

Some of the biggest cross-border deals like Tata Steel’s acquisition of Corus, Vodafone’s acquisition of Hutchison’s 67% stake in Hutchison Essar, Hindalco’s acquisition of Novelis, among others, were such last year. If sources are to be believed fees for one of the largest acquisition amounted to around $ 150 million. Incidentally, Essar paid Citi $ 25 million for the Hutch deal even though it lost the deal. Banks have made more fees in financing, where non-recourse financing was involved. According to bankers, fees for non-recourse financing ranged anywhere between 0.6% and 1%. Fees for IPOs were anywhere between 1-3%, convertibles 1%, GDR and QIPs around 1-2%.

Frank Hanckock, MD corporate finance, ABN Amro says, “The size of the M&A pool has almost doubled in the past one year with most of the transactions now being cross-border. Fees for these deals are set according to the international benchmark and are typically higher than the domestic M&A market, which has suffered from fee compression. While we have seen some fee compression for more standard products, the rapid growth of the pool has more than compensated for this.”

I-banks, which had a banking presence in the country, have gained from the increase in the activity as they also earned fees on the financing and derivatives side. Sanjay Nayar, CFO, Citi India, says, “We began investments into India in debt, equity, and cross-border and local business. We are expanding our customer base and getting into SME and middle market.” In the I-banking space, India is among the largest Asia-Pacific for Citi. It saw a 70% rise in the revenue in 2007 against 2006. However the subprime effect has had its effect on the market with deal flows slowing down.

Managing GRC for global growth

Over past four years, Indian economy registered significant growth rate, averaging around 9% pa, one of the highest in the world. This high growth rate enabled Indian companies to expand globally, resulting in the global growth of Indian banks to tap huge India-linked business opportunities.

Currently, many Indian banks have presence in international locations (SBI – 32, Bank of India – 25, Bank of Baroda – 23, ICICI Bank – 18). Further, ICICI Bank’s international balance sheet was $ 17 billion (as of March 2007). Similarly, SBI’s international advances were $ 9.7 billion (March 2007). On the borrowing side too, Indian banks are likely to overtake South Korea to emerge as leading issuers in Asia with share of Indian banks standing at 20% out of total issuance in Asian market.

But international growth poses challenges of implementing Global governance standards, compliance with multiple Regulatory requirements and managing Cross-border risks. GRC received considerable attention internationally with Basel II pronouncement supplemented the Basel guidelines on corporate governance, risk management and compliance. Further, the Financial Action Task Force (FATF) recommendations on Anti Money Laundering (AML) and Sarbanes-Oxley Act in the US advocate the integrated approach to govern activities of a bank to manage risks in a manner compliant with applicable regulations. GRC thus by far has become the mantra of regulations world over.

Implementation of global governance standards

RBI is also proactive in creating a regulatory level playing field for Indian banking sector by prescribing GRC standards on par with international regulations and capital adequacy regulations in line with Basel II. International growth strategy needs to be balanced with GRC standards. These initiatives are aimed at making Global Indian banks compete with and stand on par with international banks. In fact, global Indian banks are still in the nascent stage of growth. For instance, no Indian bank is in a position to singly finance a deal of the size of Tata-Corus and on a global list based on market capitalisation.

Compliance with multiple regulatory requirements

RBI guidelines on compliance function in banks are also based on Basel guidelines and recognise the need of compliance function as one of the key facets of enterprise wide risk management framework. RBI recommended formulation of a group-wide compliance programme that helps banks in addressing legal and reputation risks across the group as a whole. In order to monitor systematically important financial conglomerates, as per international standards, a working group comprising RBI, Sebi and IRDA has been constituted and RBI issues related guidelines. Expectations of GRC framework differ from regulator to regulator and from nation to nation posing the challenge of dealing with multiple regulators in various jurisdictions.

Managing Cross-border risks

RBI has issued AML regulations in line with FATF recommendations. In addition, RBI also mentioned, during mid-term review of the Annual Policy for 2007-08 about the creation of a working group to lay down the road map for cross-border supervision and supervisory co-operation with overseas regulators.

The Indian banks are poised for huge international growth. However, they need to inculcate a paradigm shift in viewing regulations as opportunities to improve their GRC framework. Such paradigm shift results in transforming banks into more transparent entities making them more attractive to investors, more respectable before regulators and more competitive with other international counterparts. This is what precisely GRC attempts to achieve in the long run.

Bank licensing

The ministry of finance is reported to have suggested abolition of bank branch licensing to Reserve Bank of India, which loves controls. Indeed, the RBI last year extended licensing even to ATMs, claiming they were bank branches of a short. The traditional rationale for licensing, since the days of bank nationalised in 1969, was to oblige banks to go to rural and semi-urban areas, and not limit themselves to profitable urban centres. However, private and public sector banks are now expending aggressively into rural and semi-urban areas, which hold great profit potential for the future. So, licensing can be abolished outright.

The most capital-intensive in the service sector

Less than 20 listed companies have a paid up capital of over Rs 1,000 crore. But in the business of life insurance almost a dozen companies expect their paid up capital to cross Rs 1,000 crore by their 10th year when they are expected to go public. The largest private life insurance insurer ICICI Prudential has a paid up capital of more than 2,300 crore. Birla Sun Life Insurance already has the capital base of Rs 1,000 crore. And other players are pumping more and more funds in their companies.

For potential investors in life companies, it is interesting to see how their bloated capital base will be serviced in future. At present, the mood is so bullish that investors are not asking any question on how the capital will be services. Somewhere down the line investors are going to look for returns that will make up for the losses in the earlier years and also generate a post-tax return on equity of around 15%. For life insurers with a paid up capital of Rs 1,000 crore, there should be pre-tax profits of at least Rs 250 crore to generate these returns. So far, most insurers continue to make losses even after seven years of operations. Most of them attribute the losses to the higher-than-expected growth in the Indian market and immediate provisions that they have to make for front-ended acquisition costs.

Life insurers have only two sources of income – charges for mortality and policy administration and fees for asset management. Mortality charges are risk premium collected for paying out death claims. Although mortality charges add to a company's bottom line, earning from this segment are under pressure. This is because rising life expectancy and increased competition is bringing down premium rates. Like mortality charges, policy administration charges are also charged on the sum insured. Since the relevance of both these charges diminishes over the term of the policy, it is asset management fees that work out to be more relevant source of income over the long-term.

Experts feel that it is reasonable to assume that over 50% of the earnings of a life insurer would come through fund management charges. Since fund management charges are around 1.5%, an insurer would need to have at least Rs 10,000 crore of life insurance assets under management to service a capital of Rs 1,000 crore. Having assets under management of Rs 10,000 crore would appear easily within reach for most insurers.

Need to look beyond asset under management

But insurers warn that looking at assets under management to arrive at profits is a very simplistic approach. There are a number of factors that will decide profits. To a large extent, a company's ability to break-even will depend on the extent of loss it suffers on the first year business of a policy. On an average, over 50% of the contributions of the first year premium paid by policyholders go into their accounts. The rest is usually deducted as charges. But more often than not, these charges are not enough to meet the expenses of an insurer. If an insurer experiences a high level of lapsation, the break-even date would be pushed behind. Lapsation has a huge impact on the growth of a life insurer. Insurers usually stop making losses when renewal premium surpasses premium from policies sold during the year. For a private life insurer growing at 40%, renewal premiums should outstrip new business premium from the fifth year if lapsations are contained at 25% and all policies sold are those with recurring premium income. So, when the time comes to service the equity, the first year charges and level of lapsation will play a much bigger role.

THE ART AND SCIENCE OF WEALTH CREATION

Raamdeo Agrawal, Director, & Co-founder Motilal Oswal Financial Services

LOCATING A 'WEALTH CREATOR'

The first rule to investing is 'Don't lose money'. The second rule to investing is 'Don't forget rule no. 1! It is essential to stick to these rules when it comes to investing, in order to avoid the possibility of capital erosion. To apply these rules successfully and to create wealth through equity investing, I identify five parameters that you must evaluate. They are:

I. Assess the Entry Barriers created by a company

Remember, a stock is nothing but a stake in the company's business. So, observe the company's business and the entry barriers created by it. **The entry barrier should be more 'intellectual' in character rather than 'physical'**. This is because while it is next to impossible to compete with strong brand (an intellectual barrier), competitive advantage associated with a piece of land (a physical barrier) disappears when a competitor acquires one as well.

Strong brands such as 'Thums-Up', 'Parle-G', etc. have enabled their companies to retain the top spot. However, at times, there could be exceptions. For instance, the entry barrier associated with TISCO would be its large base of iron ore and coal (physical assets), which allows it to lower its raw material cost drastically vis-à-vis its competitors for long time to come.

An entry barrier should not only be strong, but also long lasting. Such companies will keep making money because their entry barriers keep working for them. For instance, Britannia may not be the best managed company but its strong brand continuously earns money for it.

As an investor, buy into such businesses ahead of the crowd. If an entry barrier has been established very recently, it may not yet be exploited by the business. Accordingly, the market would not have valued it in the company's share price. For instance, when Financial Technologies (promoter of MCX) got its commodity exchange license and launched it, the popular opinion held was that it would be unable to execute the business well. But, today, it has emerged as a premier commodity exchange. Investing in such companies before the market sees their potential delivers best appreciation.

"Though difficult to predict, think ahead of the crowd."

II. Management should be competent and passionate

Choose companies that are led by a team and are competent and passionate. Both these attributes are equally important. Competence or passion alone will not work. An individual with local degree combined with passion would have greater growth prospects than one who has a Harvard degree but no passion. A company like Pantaloon Retail is a shining example of how passion can create wealth.

"The definition of great company is one that will remain great for many years."

III. Management should have integrity

Integrity is the most crucial quality that a company's management must have. Such companies not only run their businesses in an honest manner, but, are honest to all their stakeholders, whether they are employees, the government or the shareholders. If honesty is part of a company's DNA, it will be fair to its smallest stakeholders – the minority retail shareholders. Companies such as Tata and Infosys have this quality, which has added to their growth and market attractiveness immensely.

"Without management integrity no margin of safety can be high enough."

The above-mentioned three characteristics (long lasting intellectual entry barrier, competent and passionate management and integrity) must all be simultaneously present in a company that you choose to invest in.

IV. Buy low

The price that you pay for a stock determines your rate return. So, it is essential that you get your purchase price right. While some companies come out on top with respect to all the first three parameters, the returns falter when it comes to the purchase price.

For instance, HLL comes on top with respect to all the first three parameters but has not delivered as much as far as its stock goes. Its stock delivered a CAGR of approximately just 3 per cent over the last 5 years, when the market delivered a CAGR of approximately 44 per cent over the same period. The quote – "In the bible it is said that love takes care of a lot of sins. In investments, purchase price takes care of a lot of mistakes" – is very apt. You can make mistakes on assessing the first three parameters, since they are subjective in nature, but getting the right purchase price covers up for all your mistakes. Hence, estimate the expected value / intrinsic value of the company and keep an adequate **margin of safety** in the purchase price.

"It is much more important to buy cheap than to sell dear."

V. Have patience

When you buy a house you don't expect it to appreciate overnight. You look at its appreciation over a long period. The same goes with equity. After having bought a company that conforms to all the above four criteria, you need to have patience. Investing in equities is often driven by two emotions – greed and fear. And patience is the mantra that helps overcome these emotions. Patience makes the difference between investing and speculation. It's like a fertiliser to the investment process.

"In reality, patience is crucial, but it is a rare commodity."

End Note

Investing is laying out today's money for more in the future. It's about performance of the underlying assets. Success in investing is the outcome of a disciplined approach. Happy Investing!

MARGIN OF SAFETY

Earlier, *margin of safety* principles were applicable only physical assets; where, one bought physical assets at a considerable price discount. For instance, considering that a property with underlying value of Rs 100 crore was purchased for say Rs 10-20 crore, this would be a classic case of *margin of safety*. A long time back, I realised that *margin of safety* is the cornerstone of wealth creation. Steeper the margin of safety, faster, larger and more consistent will be the wealth creation. *Margin of safety* affects size and speed of wealth creation.

In today's continuously innovating and fast changing world when the size of opportunity is huge for several companies, my sense is that *margin of safety* emerges from your ability to forecast the company's value five, seven, ten years into the future and compare it to what price you are paying today. When looking at *margin of safety* you are not just looking at the book value; you are also visualising the future expected value. When you forecast a company's value, you need to take into account the **evolving business environment including monopolistic position, favourable regulatory environments, management's ability to seize the opportunity and execute, etc.** The value that will emerge in the future has to be accounted when calculating this *margin of safety*.

For example, Bharti Airtel, which has created huge wealth for its investors, just a few years ago was making losses and was available at a price which was almost half of its issue price. The margin of safety, which was available here, was the huge wireless market that was completely untapped in India and the entrepreneur's management capability to execute the project.

Evolving business environment including monopolistic position:

The very essence of a good business is a **sustained tailwind and an entry barrier**. Both are essential as an entry barrier will keep competition away while the tailwind will make the business grow. In fact, there are some businesses like tobacco where there is no great growth tailwind. But tobacco companies' profits are booming because of the huge entry barriers.

Management's ability to seize the opportunity and execute:

Firstly, any management should realise a business opportunity – **the nature of business and seize of opportunity**. If there is no business opportunity, there is no scope of wealth creation. An extremely good management without business opportunity can do nothing. For that matter, even Bill Gates in Bangladesh wouldn't be able to work any wonders. Secondly, even if there is business opportunity, the management has to be top-notch.

The dynamism of the management to exploit business opportunity is very important: like what Reliance is doing in E&P, where it is removing all bottlenecks and executing projects for extracting oil/gas from the sea bed. It's not everybody cup of tea. You need a competent management in place, which has thorough understanding of its business and is passionate and ambitious about the projects it has undertaken.

Favourable regulatory environments:

Integrity, value system, playing by the rules of the game – are all very essential, but one has to understand the environment in which these virtues are being practiced in and the size of the opportunity. Business ethics in India are compromised for some reason or the other. For instance, if you want to be very big in the liquor business, the rules of the game would involve skipping certain rules and regulations because the policies are so restricting, or you decide not to be a big player.

However, if an organisation inherently has weak management ethos (*I call it right hand driving*); it can only go so far. A favourable business environment in the hands of incompetent management leads to transient wealth creation. *I call this Barsati Mendak effect i.e.* it's only in the monsoon when even tadpoles make noise. In good times people think even companies with bad management are great companies. It's only when the tailwind goes off that one gets to **identify a great company.**

Identify a great company:

For deep understanding of business and what are the key drivers of the business, one has to read extensively – magazines, newspapers and books. You will often find situations where there is disequilibrium. That is where the opportunity lies. For instance; I spotted Hero Honda in 1995-96, when the company was available for just about Rs 500 crore. When I started studying the company, I was stunned by the sheer opportunity in it. Demand for two-wheelers then was huge and the country was slowly moving from scooter to motorcycles. There was excess demand and there was just one supplier – Hero Honda. That's when I realised that a company with a turnover of about Rs 1,000 crore, available at Rs 500 crore was a huge opportunity. I could have bought a business growing 30-50% at a very modest price. Equities are an exponential asset class and one of the few avenues open to own a business. So we should control our **greed and fear**, buy for the long term, and enjoy the process of wealth creation.

Greed and fear

Greed and fear are two of the most important elements of investment behaviour. One needs mental discipline to be content and happy with a good deal and not be greedy for a better one. What is important is to find truly deep *margin of safety* and go for such deals.

Fear arises from the unknown. When the market or a stock crashing, one is often gripped with fear. At these times, your knowledge of the share and its true value will give you the conviction to hold on and possibly invest more. At such times, strong and robust businesses are available with a very high *margin of safety*. It's your knowledge of what you are buying or holding that will reduce risk and the consequent fear. One has to capitalise on the underlying value and more importantly remain invested during bad times. Everyday 'Mr Market' will check your conviction. The questions to be asked are – does the current price surpass the *margin of safety*? Is the expected value in the next 3-5 years at a significant discount to the current price? Most importantly, you need to understand that what you own is not just a piece of paper whose price will hopefully go up but a price of business which will grow in value over time.

The chance of wealth creation is higher today than what it was in the past. We are in an era where hyper entrepreneurialism is the order of the day. The Indian economy has grown 10-fold and is likely to double in the next six years from 1 to 2 trillion dollars. This has enabled an individual starting with nothing to see an explosion of opportunities – both in India and abroad. However, this requires a lot of groundwork and strong inclination to pursue and succeed. However, for individuals who lack the time and passion, professional help in must.