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End of the 'Gold'en Moments?

Blame it on the Law of Gravity!

The law of gravity finally catches up for the yellow metal, after being on a song for more than a decade. The bullion bulls caught off guard when the precious metal crashed 9 per cent, its biggest ever drop on a single day on April 15, after having lost nearly 5% in value a week before, which sent the prices below the crucial $1501 an ounce level. Gold futures for June delivery went down to $1361 an ounce on April 15 on the Comex in New York. In India too, the precious metal went through the hammer, which saw it register the largest ever single-day decline of Rs1200 to Rs.28,350 per 10 grams on April 13.

Bullion bears blame it on the huge speculative activities that have led to the rising dominance of what they call, 'paper gold', all these years ever since the gold went into an overdrive. According to Bud Conrad, Chief Economist at Casey Research, a firm that specializes in natural resource and precious metals investing, paper gold market (or, gold futures) has over the years become so large that today they easily overshadow the physical gold market.

As per him, a review of the movement in speculative position vis-à-vis physical gold prices offers significant insights into how they provide advance warnings about the probability of a crash. Based on his study of the last 20 years' trend, during the early 2000s large speculators were holding net negative positions during the lowest point of the gold price; when the net speculative position is above zero, it suggests this group is betting on rising gold prices and vice versa. As the prices headed north, their positions went net long, and they profited.

Interestingly, the speculators had turned bearish long before the impact on the physical gold market could be felt. Conrad's study shows that increasing amount of net longs reversed itself before gold peaked in 2011, suggesting that these large speculators became slightly less bullish all the way back in 2010, he writes in a recent column. 'The balance remains net long, but it remains to be seen how long that lasts', he avers. Interestingly, the signs of an impending crash became visible once again when George Soros, the billionaire investor and hedge fund manager, slashed his fund holdings in the SPDR Gold ETF, the world's biggest gold ETF fund, by as much as 55% towards the end of 2012. The warning signs flashed once again as the giant Goldman Sachs on April 10th warned of a fall in gold price, and subsequently lowered its target price, a day after the rumours of a possible withdrawal of quantitative easing started doing the rounds.

Since then a barrage of news from Cyprus' sell-off its gold reserves to the tune of 400 million euros to restore health to its banking sector and revival of its economy, to the possibility of similar actions from other trouble-hit nations in the euro zone have only added to the woes of the gold bulls. Expectations of a sustained recovery in the US which have strengthened dollar, weak economic data from developing economies, especially India and China, raising hopes of a lower inflation, falling demand for commodities, and sell-offs by some top international gold-ETF funds, have accelerated the decline in gold prices, of late.

It's no surprise that gold bears have had a field day. Given, can gold make a comeback? Maybe. Look no further than India. Gold prices in the country have been firming up after having beaten down in the wake of the battering the metal met in international markets. The prices after crashing down below Rs.26,000 per 10 grams, it has recovered smartly to trade at now Rs. 27,000, though it is still much below the record high of Rs.32,500 ($602) per 10 gram reached last September, as retail consumers rush to grab the opportunity, much ahead of the ensuing wedding and festival seasons.

Similar buying frenzy is seen across markets of the US, China and other parts of the world, hinting of a huge latent demand on part of retail consumers. But the big question is: Can they replace institutional players? Whatever, the lure of the metal, which has fascinated human beings for over 5,000 years is here to stay!

Amit Singh Sisodiya

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Gold, like other commodities benefitted from what was widely termed as commodity super cycle that began in the early 2000s and lasted for more than a decade. The period also marked the rise of the emerging markets, notably BRICS, an acronym for Brazil, Russia, India, China and South Africa. The boom in these economies lifted commodity prices out of their deep slumber during the 90s which saw services sector powering the growth of the western economies – from the US to Europe – as they began shifting away from manufacturing in favor of the former. In fact, the prices touched rock bottom during the last decade of the 20th century, prompting many to predict a prolonged bear market in commodities. However, it was not to be.

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Ambani Brothers Seal a Deal

After eight years dividing their business empire, India's most famous billionaire brothers and 20th richest in world, Mukesh Ambani and Anil Ambani joined together with two telecommunications companies controlled by them signing a contract to share their networks. Since 2005, when they split the conglomerate built by their father, Dhirubhai Ambani, first time they are coming together. Stock Market pundit says it is a positive development for the investors.

Under the agreement, Anil Ambani-controlled Reliance Communications will share its optic-fiber network with Reliance Jio Infocomm, the telecom venture of Mukesh Ambani's Reliance Industries. Against this contract, Reliance Jio Infocomm will pay 12 billion rupees to Reliance Communications as a one-time fee to use its network. Reliance Communications will also be allowed to use Reliance Jio Infocomm's network.

Under their agreement at that time, the telecom business along with businesses such as power, infrastructure and finance went to Anil Ambani, the younger brother. Mukesh Ambani got Reliance Industries, which focuses mainly on petrochemicals. Analysts are of the view that the deal will bring in much needed funds for debt-laden Reliance Communications. It had more than $6 billion in debt at the end of December, taken mostly in 2010 to buy bandwidth to provide third-generation services and expand its network. To cut its debt, Anil Ambani had tried unsuccessfully to sell stakes in Reliance Communications, its tower unit as well as an undersea cable network in the past few years.

Indian Bank Conferred with National Excellence Award

Indian Bank has attained the first rank and has been conferred with the National Award for Excellence in Lending to Micro Enterprises for FY 2012. Shri T M Bhasin, Chairman and MD, has received the coveted National award from the august hands of Hon'ble President of India, Shri Pranab Mukherjee on 03rd April 2013 at Vigyan Bhawan, New Delhi.

- The Bank has far exceeded the stipulated 40 per cent target and has reached X.36,641 crore (42.35%) lending to Priority Sector as on 31st March 2013.
- Under lending to the Micro and Small Enterprises, Indian Bank has achieved a growth of 32.18 per cent as against the GOI's guideline of 20 per cent.
- Under Micro, Small and Medium Enterprises sector, the Bank has recorded a growth of 29.73 per cent during the year.
- Indian Bank has extended 72.36 per cent credit to Micro enterprises as against the GOI's stipulation of 60 per cent under MSE lending to Micro enterprises.

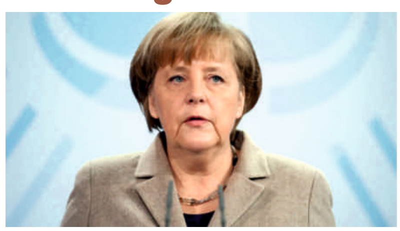
National Award for Excellence in MSME Lending

Starting its operations in the year 1937, Indian Overseas Bank recently completed 75 glorious years of banking service to the nation. IOB has been a front-runner in extending credit to the personal segment and the priority sector. IOB has also been consciously extending credit to the MSME Sector.

As a recognition to the Bank's contribution to financing MSME sector, IOB was awarded the first prize under "National Award for Excellence in MSE lending" for the year 2010-11.

Seen in the photograph Dr.M.Narendra, Chairman & Managing Director, Indian Overseas Bank receiving the award from Shri.Pranab Mukherjee, Hon'ble President of India.

Economic Output near Stagnation



According to a closely watched survey, Germany's economy slowed to near stagnation in March 2013, while

France's recorded its biggest contraction for four years. The Markit (a financial information services company) composite purchasing managers' index (PMI), which measures both the manufacturing and services sectors, declined to 50.6 in Germany in March 2013, from 53.3 in February. Any figure above 50 indicates growth. France's reading fell to 41.9 points, its worst since March 2009. For the eurozone as a whole, the index fell to 46.5 from 47.9 in February.

Chris Williamson, Chief Economist, Markit, declared that the latest data painted a gloomy picture. He further adds, the [eurozone] recession is deepening once again as businesses report that they have become increasingly worried about the region's debt crisis and political instability. The botched bail-out of Cyprus could well filter through to a further worsening of business sentiment across the region in April.

The weak data from Germany suggests that the only source of bright light in an otherwise gloomy region has once again begun to fade. Germany's index reading was the worst in the country for three months.

Future fuel is not oil – it is Gas

The fear over Cyprus crisis has kept the mainstream focus on the Mediterranean in recent past. The snatching of bank deposits may have marked another major turning point in the saga of the eurozone. However, the Med played host to another major development – a far more positive one – that has not drawn quite as much attention.

Israel started gas production at the Tamar field in the eastern Mediterranean Sea. According to Bloomberg, there's enough gas under the Med to supply the country for 150 years. The country could even become an energy exporter in the future, selling liquefied natural gas (LNG) around the world. It's all part of the energy market revolution – and it's a trend you should be looking to profit from. Oil experts say suspect that crude oil's best days are behind it. They suggest that investors should instead focus on the commodity that will increasingly act as a substitute for oil – natural gas.

Central Banks Are Creating Financial Instability

While the crisis in Europe is one of the serious concern in George Soros' mind, but another biggest concern in what he calls is the "disarray in global cooperation," or what we would labelled 'duelling central banks'. The most brilliant minds in the history of investing observe that the almost universal adaptation of quantitative easing worries. He opine that Europe is the last bastion of orthodoxy," in this regard as the aging hedgie warns. Europe is entering a situation that Japan is desperate to escape from, as Japan has just abandoned – after 25 years of stagnation – a process that Germany is just in the process of imposing on Europe.

But perhaps his clearest concern in this brief clip is that no matter what we are told, the central banks' actions are 'creating' increasing financial instability because, "let's face it, quantitative easing is really and directly competitive devaluation." Soros says that the recent move by the Bank of Japan should be most concerning. He warns that "What Japan is doing is actually quite dangerous because they are doing it after 25 years of just simply accumulating deficits and not getting the economy going."

World's Most Billionaires

According to the Hurun Global Rich List, the world has at least 1,453 billionaires, with about half of those residing in the US and China. In terms of cities, Moscow is home to the greatest number of billionaires with 76, followed by New York (70), Hong Kong (52), Beijing (41) and London (40). Rupert Hoogewerf, Chairman and Chief Researcher of Hurun Report, a Shanghai-based publishing group that tracks China's wealthy says "For every billionaire that Hurun Report has found, I estimate we have missed at least two, meaning that today there are probably 4,000 billionaires in the world."

Viewpoint

Novartis' Glivec Patent Case

As per Indian companies, it will give freedom to launch me-too product. Moreover, with generic being a major proportion of the overall market, the growth of the Indian markets will not change because of the judgment."

Sarabjit Kour Nangra
VP - Research, Pharma, Angel Broking, Mumbai

In a landmark judgment, India's apex court recently rejected the Swiss drug maker Novartis' plea for granting patent protection to a new version of its anti-cancer drug Glivec on the ground that it's not a genuine invention, that is, the new formulation is not substantially different from the older drug so as to be granted a patent. Undoubtedly, the verdict promises to go a long way in India's efforts to ensuring access to cheaper medicines for its poor and needy people. Expectedly while the verdict has been hailed by the $26bn domestic generics industry and healthcare activists alike, some industry experts have expressed concern that this (development) might deter MNC pharma firms from investing in drug research & development, which, in turn, could affect the availability of more powerful drugs which could effectively fight deadly diseases such as cancer, Alzheimer, etc.

While there is no denying the fact that innovation is of foremost importance for drug makers, globally, at the same time, it is equally important to ensure that such life-saving drugs are also not beyond the reach of the millions of poor patients. However, a much bigger issue to be debated is whether western drug giants are justified in their bid to get patents for even cosmetic changes in existing drugs. This would certainly be a major blow to the multinational drug firms' attempts to the practice of "evergreening" (by getting the patent life of an existing drug extended through slight tweaks to its formulation). Also, whether the threat of global drug makers to ignore such markets which do not strictly follow the product patent regime is justified, given that these MNC majors hardly introduce new patented drugs in developing nations like India? Further, what could be the implications of the recent ruling for the domestic pharmaceutical industry?

"Novartis AG lost a seven-year long legal battle for getting its blood cancer drug Glivec patented in India and to restrain Indian companies from manufacturing generic drugs, with the Supreme Court rejecting the multinational company's plea. In its judgment, the apex court also held that 'imatinibmesylate' used in Glivec is a known substance and Novartis can't claim patent over the drug for using this chemical. Novartis had approached the apex court in 2009 against the order of Chennai-based Intellectual Property Appellate Board (IPAB), which had rejected its claim for patent.

The multinational company (MNC) had applied for patent in 2006. Novartis' claim was opposed by Indian pharma companies, which are manufacturing generic drugs, as well as by health aid activists in the apex court. They had claimed that the MNC is not entitled for patent and it is indulging in "ever-greening" of patent by simply changing the composition of the ingredients of the drug. Ever-greening of patent right is a strategy allegedly adopted by the innovators having patent rights over products to renew them by bringing in some minor changes such as adding new mixtures or formulations. It is done when their patent is about to expire.

A patent on the new form would have given Novartis a 20-year monopoly on the drug. Earlier, the Comptroller General of Patent and Design had denied patent to Glivec on several grounds including its alleged failure to meet stipulations under sections 3(d) and 3(b) of the Indian Patent Law.

As per the implications, we believe that the event will have a neutral impact on the Industry dynamics. The growth of the Industry will not be impacted by the same. Also, while the MNC's while be cautious in terms of product launches, it will not dither them from launching the products, more so ever, it can be viewed as teething problems in terms of implementation of the patents law. As per Indian companies, it will give freedom to launch me- too product. Moreover, with generic being a major proportion of the overall market, the growth of the Indian markets will not change because of the judgment."

India on its way to become the world's number one

According to a latest research from consultancy firm Zinnov, India is well poised to emerge as the world's top country with the number of SMEs swelling to a record high of nearly 5 crore. The SME sector in the country employs around 8.11 crore people. And as the sector continues to attract new entrants with the start-up culture gathering momentum, it would well become the major driver of the domestic economy. According to Praveen Bhadada, Director- Market Expansion, Zinnov, "The SMB sector in India is growing at an exceptional rate and has the potential to be one of the primary drivers of the Indian economy.

Today 1.5 million SMBs export their products or services outside India which is a sign of the sector's rapid evolution." The sector, which has been growing at a compound annual growth rate (CAGR) of 5.29 per cent, has the potential to emerge as the largest employment generator in the country as well. According to the official statistics (4th Census of MSME Sector), the MSME (Micro, Small and Medium Enterprises) sector employs an estimated 60 million persons spread over 26 million enterprises. Further, in terms of value, MSME sector accounts for an estimated 45 per cent of the manufacturing output and around 40 per cent of the total export of the country. Also, there are over 6000 products ranging from traditional to high-tech items, which are being manufactured by the MSMEs in the country. The MSME sector, which offers most growth opportunitiesin terms of self-employment and wage-employment, outside the agriculture sector, contributes not only to higher rate of economic growth, but also in building an inclusive and sustainable society. The MSME sector in the country is largely dominated by micro scale enterprises, which account for the lion's share of 95 per cent of the overall industry, followed by the small scale (4.8 per cent) and the medium scale enterprises accounting for the rest. In terms of geographical concentration, around 55 per cent of such units are located in the urban areas while the rural areas account for the remaining ones.

Defining MSMEs

Under Section 7 of the Micro, Small and Medium Enterprises Development Act, 2006, the micro, small and medium enterprises are defined as under:-

a) In case of enterprises engaged in the manufacturing or production of goods, as–

I A micro enterprises, where the investment in plant and machinery does not exceed twenty-five lakh rupees;

ii A small enterprise, where the investment in plant and machinery is more than twenty-five lakh rupees but does not exceed five crore rupees;

iii A medium enterprise, where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees;

b) in the case of the enterprises engaged in providing or rendering of services, as—

I A micro enterprise, where the investment in equipment does not exceed ten lakh rupees;

ii A small enterprise, where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees; or

iii A medium enterprise, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

Source: Ministry of Micro, Small and Medium Enterprises, Government of India

In terms of performance too, the sector has been ahead of the overall industrial growth. According to official statistics, the MSME sector has consistently outperformedthe overall growth of the industrial sector since 2002-03. At the same time, it has also improved its tally in the GDP growth from 39.74 per cent in 1999-00 to nearly 45 per cent by 2008-09. Like in most parts of the world,in India too, the MSME sector has acted as a major engine of economic growth. As per the government data, the MSME sector has consistently registered higher growth rate compared to the overall industrial sector, in the recent years, having successfully navigated the turbulent waters in the wake of the 2008 global economic crisis.

However, there remain a number of challenges before the sector. First and foremost, a majority of the units remain outside the mainstream sector, with an alarming level of informal sector enterprises atthe bottom of 'MSME Pyramid', according to the government data. Further, introducing global best practices, improving transparency in operations as well as governance standards, are the other significant challenges. Given, it calls for some concrete and bold measures to help the sector unleash its true potential. TGA

Cyprus

Of the Crisis, Bailout and Lessons

The exit of Cyprus from the EU itself seems unlikely as it would bring with it completely new dimensions and dramatic dynamics of disintegration of this union, which too is avoidable at this juncture.

Krithika Subramanian

Associate Economist
CARE Ratings, Mumbai

In what is being viewed as a resurfacing of the Euro-zone crisis, Cyprus has entered the group of Euro-zone countries that are on the verge of default, carryingwithit increased threat of contagion. While Cyprus as a nation might be small (having a rather insignificant contribution of 0.2per cent in EU's output); it has sprung to the limelight for its not-so-welcome addition to the already precarious state of affairs in the troubled Euro-zone. Suffice to say that Cyprus is the fifth country of this region to have approached IMF and EU for bailout funds (after Ireland, Portugal, Spain and Greece). So does the securing of bailout funds mean that the crisis has come under control? Or is there a lot more that remains to be objectively analysed? Also, what are the key lessons for other nations?

The story behind the Cypriot Fall

The Cypriot economy after registering a growth of over 5 per cent in 2007 moved to a rather stagnant stage with near-zero growth in 2011 and has only seen itself in a contraction phase in the ensuing period. The output gap has accordingly widened, with investments and savings on a downslide path, clearly indicating deterioration in economic fundamentals. Along-side, inflationary pressures in the economy have jumped up when unemployment has turned rampant.

Simultaneously, banking sector health has frazzled, with lending from banks growing disproportionately larger than the country's productive capacity. In 2011, the IMF reported that bank assets in Cyprus stood at 835per cent of GDP. A large part of these loan assets were made to the Greek government, which evidently went bad as Greece entered the crisis phase and the value of Greek debt was cut by 75per cent. Economists in the region, also point out that sliding competitiveness has exacerbated problems in the banking sector with added pressures on account of public and private debt growing to unsustainable levels.

In terms of government finances, both government expenditure and borrowing have increased causing structural imbalance in the fiscal situation of the Cypriot government to widen. The country, since January 2012, has been relying on emergency loans from Russia to the tune of € 2.5billion (US$ 3.2 billion), valid for 4.5 years. This funding has so far been used to cover its budget deficit and to re-finance maturing debt. It was originally expected that Cyprus would be able to fund itself from the first quarter of 2013;however this expectation has palpably not materialised. If at all anything, the situation has only grown more confrontational.

In short, what Cyprus is witnessing today is an easily recognizable adversity - weakness in the banking sector coupled with a stressed fiscal situation for the government, perpetuated by economic slowdown - something that many crucial EU countries have already experienced. If the scenario is something that is so familiar, then why is to worry? Decision-makers, be it fiscal or monetary authorities of the European Union (EU), European Central Bank (ECB) and International Monetary Fund (IMF), given experiences from the recent past in this region would have a relatively better prepared pragmatic resolution of the situation. However, the gravity of the problem particularly magnifies in case of Cyprus because the Cypriot crisis now threatens to retract progress made in other EU countries in a clamber out of recession.

Examining available options

Cyprus like any other sovereignor government has three available options when faced with impending default – one of course is the most dramatic and grave option of defaulting, but this does not go down well in financial markets and for that matter in the history of management of government finances and economic turmoil. The second and a more tolerable moderate and acceptable approach is that of restructuring debt. This again can be done in two ways – firstly to retain the structure of the liability as it is but indirectly impact valuations of the same by devaluing the currency in order that obligations on the government automatically diminish and secondly to change the terms of debt-service obligations and/or nature of the liability itself (including maturity, redemptions and interest pay-outs). And thirdly, approaching external funding (through multi-lateral institutions) and accepting strong reforms-oriented 'conditionalities'.

Now, having set before us all the options, it is important to examine the feasibility of each of them. Firstly, default – it is a rather extreme situation and no country really wants to willingly move towards a dooms day situation. This remains a last resort, rather a resort which is entered into very reluctantly in the absence of any other viable option. In case of Cyprus, dynamics of default are more threatening as it is a part of the EU monetary union and brings with it huge concerns of contagion. There would inevitably be pressures from other member countries to avert such an adverse credit event, which also brings us to the issue sovereign of credit-ratings and downgrades, to not just junk status but default category. This would be unacceptable to policy-makers in the EU. In short – we rule out default. At the same time, the ousting of Cyprus from the EU itself seems unlikely as it would bring with it completely new dimensions and dramaticdynamics of disintegration of this union, which too is avoidable at this juncture. The other options here are also examined given the assumption of Cyprus continuing as a part of the EU.

Secondly, the country has the option to voluntarily devalue its currency, so that the ultimate burden of debt-service in monetary terms declines. Again, given the Cyprus is a part of the EU monetary Union, a devaluation of currency would imply weakening the Euro, which would not just affect Cyprus but the whole set of 17 member nations, a risk too large to be a solution.Hence, devaluation of currency – ruled out again.

This leaves us with two options, namely restructuring of debt and external funding – both of which have been merged in the bailout package outlined for Cyprus by the Troika (EU, ECB and IMF). Firstly, the second largest bank of the country, Laiki, is set to be merged with the largest bank, the Cyprus Popular Bank in order that the banking system retains some credentials. Further, the bailout package is designed such that large bank deposits have been subject to a high levy.Cyprus has been used as a tax haven and has been home to routing of substantial deposits originating from money laundering activities. Bank deposits greater than €100,000 have been subject to a levy of 9.9per cent and a levy of 6.75per cent on deposits less than this amount.Also, 37.5per cent of these larges assets are set to be converted to shares to aid bank capitalization. Up to 22.5per cent would not earn any interest, but could be subject to further write-offs. The remaining 40per centof large bank assets are expected to earn regular interest, this interest payment is however highly contingent on good performance of the bank; an unlikely circumstance in itself.

In other words, while this move of a levy on bank deposits would help the government exchequer to boost its revenue base in the face of approaching external funding, it also means that individual depositors could lose as much as 60per cent of their savings as per this arrangement. Socio-political arguments against such levies are also driven on account of fairness of policies. The taxation measure may be a pragmatic one, but it is not successful in differentiating between money-launderers and authentic innocentsavers. Haircuts faced by asset holders, in turn translates as a diminishing of household level net-worth valuations, which are of particular significance when regular livelihood is also in question.

The immediate reaction of most domestic depositors would be to rush to withdraw their savings deposits and this exactly what happened in Cyprus too. Withdrawal limits for depositors have been placed in order to avert a run on the banks.International depositors are no different. For instance, in a flight of capital, Russian remittances/fund repatriationaway from Cyprus has increased substantially. This is very contrary to their usual trend, as Russians over the years,given obvious advantages,have preferred retaining deposits in Cypriot banks. Further, we would see a whole set of capital controls and closer monitoring of bank accounts that would come into effect, which nearly changes the entire structure and identity of the Cypriot economy and banking system that has revolved around funds from other countries routed via its banks.

Challenges

Often as has been noticed and confirmed time after time in the recent past, the intensity of such crisis unravels only in due course of time and funding requirements increase commensurately. Post the formalisation of the bailout package in March, recent news pegs an increase in the cost of the Troika bailout to surge to € 23 billion, from earlier estimates of € 17.5 billion. Ripple effects on account of domestic linkages are yet to surface strongly to the fore. Currently the country's two major banks have been affected, but it must be recognised that these two banks are an integral part of banking space of the country and have pertinent linkages with the rest of the Euro-zone as well.

This additional cost implies that the Cypriot government qualifies for accessing these gross financing needs (over the 3 year bailout programme i.e. until first quarter of 2016) only if it is able to source an additional € 6-8 billion in the initial stage. Currently, the haircuts and levies are expected to pool together € 7 billion, which would have helped secure the € 17.5 billion funding support to help finance recapitalization needs of the banking sector, redemption of maturing debt (both medium-and long-term including loan facilities)along with the funding of fiscal gaps. However, there is now a huge shortfall and with the IMF not really willing to expand the size of the bailout package, the pressure falls entirely on the Cypriot government and to some extent on the EU depending on how much the member nations are willing to accommodate these needs.

With each of the EU nations grappling with a set of problems of its own, co-ordinated monetary and fiscal stance in an over-accommodative nature appears little likely. While there may be some leeway with an ultimate aim of retaining the sanctity of the EU, all financial support may be expected to come with harsh conditions pointing to rather dramatic reforms. While pre-conditions may be laid out very specifically, the extent of their fulfilment particularly, in the context of fiscal consolidation remains questionable. Going ahead, as the Cypriot government has the difficult task of balancing its budgets and majorly curtailing expenditure, the agenda of economic and financial reforms could come under pressure. This would be relevant in the context of duty prescribing the government to provide counter-cyclical financial inducements to pump-up a crisis stricken economy, but 'conditionalities' prescribing otherwise.

Light at the End of the Tunnel

In a bid to exit the crisis, Cyprus would also have to undertake considerable structural changes in its economy. In moving away from being an offshore financial haven, it would have to move towards reconstructing itself based on the strength of its domestic banking activities. Given the small size of the economy, real productive activity would be limited and it would take time for financial activities to pick up. Even in case of foreign investments that could prospectively flow into the country, they would eventually need to be backed by a restoration of investor confidence in the new financial regime and environment of Cyprus.

There would be two major challenges in this regard – firstly, with capital controls not really being that stringent currently, the Cypriot government would have to engage in legislative reforms pertaining to the financial sector. Loose threads would have to be tied up and alternative business avenues would have to be sought in order to retain momentum and keep robustness in the banking space alive (especially, in the absence of external funds being parked in the country). Mechanisms for scrutiny and accountability would gain more significance under the new financial framework.

This is however, a long-term picture and the canvas looks rather different in the short- and/or medium-term.Which, brings us to the second and the biggest challenge of all, namely economic revival. The financial loss at the level of individual savers would weigh heavily on the economic growth of the country. With jobless at a peak of 15per cent and economic adversities increasing, the situation would only become grimmer as more business activities come to a standstill. The entire cycle of manufacturing, production, supply and consumption is bound to face headwinds.In time the economy would have to be brought closer to its productive capacity, nearing its long-term average growth trajectory with greater essentials of competitiveness. With troubles in the Euro-zone countries increasing each day, these efforts would have to be streamlined and time-bound.

In a trade-off between fiscal stringency and economic revival, the immediate-run policies may address fiscal concerns in the coming year or two. Being a part of the EU monetary regime, fiscal prudence would be the most crucial to begin with. However, Cyprus at an individual level cannot ignore its economic growth needs and simultaneously, efforts at improving employment opportunities and enhancing employability would have to be under-way. This would take the forefront of policy decisions in ensuing years. TGA

CAN INDIA BECOME A MAJOR GLOBAL FORCE?

IN CONVERSATION WITH THE CHAIRMAN DR. STEPHEN ROULAC

Global Property - Real Estate Expert & Head - Roulac Global LLC

India's soft real estate infrastructure is primitive, generally, and especially relative to major powers, specifically China and the United States, with which India would like to be considered as in the same company.

Without a best-in-class property goods and services system, India is at a profound competitive disadvantage to those countries that already possess a world class property market system.India cannot be a great power without a great property market system. By the most sympathetic, yet objective standard, India today is far, far short of having a great property market system, opines Dr. Stephen Roulac, an authority on global realty sector and former head of Roulac Global Places LLC, a global strategy and financial economics advisory firm. In a free-wheeling interaction with Divyanshu Sharma, a partner at realism.IN, an India-based real estate research & education firm, Dr Roulac shares his discusses about what puts India at a major competitive disadvantage globally, especially, relative to China and the US, and the which steps should be taken to improve the real estate scenario in the country and make it a global force.

Photography by : ***Angie Capri*** *for* The Global ANALYST

Recently, the Economist editorialized that internal security and strategic leadership are the key stumbling blocks in the way of India becoming a great power?

Certainly security, both internal as well as external, is a necessary condition for a great and powerful country. Especially considering that India shares its border with many countries, security matters are of paramount importance. Indeed, security and power are synonymous. Safety, aka security, is the most basic of human needs. But a great power possesses and exemplifies more than security per se. A great power is a great place. And, you cannot create and sustain a great place without a great property market system.

To be a great power, India must be a great place. While India possesses many great places, these are more the beauty and wonder of the extraordinary natural environment and the grand legacy properties—temples, palaces, and forts—of another era. Missing are the great properties as well as infrastructure to support the priority property goods and services needs of the people who live in and experience India for the 21st century.

The economic dynamics of India are very unique. The diversity and the scale of the population amidst a democratic setup make it very difficult and challenging to implement decisions. Strategic leadership is definitely required to take right decisions, and then grit is necessary to implement them in the right spirits.

So, is the lack of physical infrastructure and 21st century properties the primary problem?

No. As important as are the lack of physical infrastructure and 21st century properties, this shortfall can be considered the symptom of the real problem. The real problem is that India lacks the soft real estate infrastructure necessary to support efficient, effective, elegant, and sustainable place experiences. Today India's soft real estate infrastructure is primitive, generally, and especially relative to major powers, specifically China and the United States, with which India would like to be considered as in the same company.

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Why is real estate so important to most major economies?

Real estate's importance derives from its very scale, reach, and economic significance. In a mature, established, stabilized economy, real estate represents between 45 to 50 per cent of all economic activity—when secondary and tertiary effects, in an input-output economic context, are taken into account. In a growing, expanding economy, such as India's, real estate represents at least 50 per cent to as much as 55 per cent or even more of overall economic activity.

A strong economy creates demand for real estate goods and services. A strong real estate market drives the economy. But a place cannot have a strong economy if the real estate sector underperforms, is unsophisticated, and does not provide world class property goods and services.

The country loses the employment opportunities that would emerge from the development of the real estate sector: both directly stimulating several other sectors, and also the positive impetus to the economy at large. The latter is a very important but little recognized consequence, for real estate activity has very high multiplier effects, as far as stimulating spending and creating jobs.

Given that real estate is such a large part of the economy, any country whose real estate markets fall short of effective, equitable, and efficient functioning is at a major competitive disadvantage. An unsophisticated and under-performing real estate sector imposes a needless and burdensome handicap on the society, both constraining those within the country and deterring new market participants from entering the market.

Why is the concept of place, the property discipline, and its institutions so important?

Place, along with relationships and work, is one of the three essentials of life. Place is the stage on which the drama of life is lived and played, where relationships are established and experienced, where work is inspired and performed. Place is integral to marketing, at both the micro transaction level and also the macro brand level.

The property discipline and its institutions enable the use and experience of places. Great places follow from great property function.

Without great property institutions and highly competent property professionals, you cannot have great places.

Places and properties are the platform of society, culture, the economy, and families. Just as a robust, responsive, seamless communications system is integral to an efficiently functioning, highly effective society, so, too, are great place and property resources and system necessary.

You have just completed a major research project concerning the global real estate research priorities and productivity of every major region in the world. What can you tell us about the implications of that research for India?

My colleagues, Dr. Andreas Pfnür and Dr. Annette Kaempf-Dernof Technische Universität Darmstadt in Germany, and I just completed a major study of research papers, presented over the last decade to the eight major real estate societies' meetings throughout the world.

In this study, we examine, evaluate, and analyze the contents of 10,000 research papers. While India represents 15 per cent of global population and 6 per cent of the world's economic productivity—Indian scholars—excluding my research, which exceeds the aggregate of all other India research presented at the Global Real Estate Research Societies accounted for but 25 papers of global research output over the last decade.

India's real estate research output—just one quarter of one percent of global research productivity over the last 10 years—lags far behind the world's top countries.

How does India's real estate research output compare to China?

The comparison to China is striking. During the period that India scholars produced 25 papers, Chinese researchers produced perhaps 1,500 papers.

Not only are scores of Chinese researchers affiliated with Chinese universities, numerous Chinese property scholars doing distinguished work hold prestigious positions in the faculties of leading universities in Europe and United States.

Individuals connected to China represent more than half of the Asian Real Estate Society leadership. And while 98 individuals are listed as officers and directors of the Global Chinese Real Estate Congress, no parallel organization for India real estate scholars exists.

How visible are India's researchers in the global real estate research community?

None of the officers or directors of the Asian Real Estate Society—comprised of that continents' thought leaders—are connected to India, through working there, having studied there, or having grown up there.

While there are many distinguished Indian management scholars—as well as Chinese scholars— on the faculties of leading business schools in Europe and United States it is striking that Indian property scholars are not evident in the faculties of programs concerning property, real estate, and the built environment.

Of 63 individuals in editorial board capacities for the International Real Estate Review, the scholarly research journal of the Asian Real Estate Society, more than half are from China, but only two—myself and Kanak Patel, who works at the University of Cambridge in England – have a connection to India.

Why is India so underrepresented in the thought leadership ranks of the property discipline?

> "India needs to develop the soft real estate infrastructure, specifically the knowledge concerning the role and application of decision tools plus information concerning the markets, to complement the intuitive genius of many Indian investors, entrepreneurs, executives, and professionals."

While various factors contribute to this curious divergence, an important consideration is that the property discipline in India lacks an education and research tradition, such as exists for the study of management. In India, resources are not devoted to property, as they are to other disciplines. Globally, every other major country assigns much more emphasis to property than does India.

India has many strong economics programs: Delhi, Madras, and several others. There are many institutions of graduate management study in India,: the Indian Institutes of Management and numerous other strong business schools. However, there are no parallel curriculums, courses of instruction, or professional programs for the property discipline.

While India has produced several renowned management gurus, no Indian is recognized as an authority in the property discipline.

What is the consequence of a place having a low level of representation at and participation in major research meetings?

Places whose scholars, researchers, and thought leaders do not participate in major global meetings risk being isolated, marginalized, and disadvantaged. Inevitably, their research risks being less relevant, their teaching less informed, their work less significant.

Over the decade studied, the 10 meetings annually totaled nearly 100 gatherings. The 25 Indian papers covered 17 meetings—so Indians would not be represented at the vast majority of the meetings. Those leading real estate researchers and professionals from around the world who attended these meetings would not hear the message of India's thought leaders. And, India's thought leaders would miss out on the learning, creativity stimulus, connections, relationships, and opportunities that can be derived from these meetings. The learning by all of the people of India is compromised, because the articles and books that might be written

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for Indian audiences are not written, causing India's citizens to miss the knowledge that they might benefit from.

What are the implications of the country having such a low research profile as does India?

A country with a low research profile is not an important member of the global research community. Low research profile indicates limited stature, influence, and thought leadership. India's indigenous thought leaders are not having an impact globally or even within India.

When it comes to real estate, India seems to be mimicking the 19th century posture of Japan and China, which countries closed their borders to trade and therefore to ideas and innovation. Progress in those places was stalled, until they opened their boarders to the best ideas of the world.

India's real estate leaders are not engaged with their counterparts who are active in the leading the real estate research societies, which societies bring together the thought leaders of the people in those places. Simply stated, India is not represented at the table of the best minds of the global community of real estate thought leaders. Not being at the table, Indian researches and scholars do not have access to the ideas and thinking of the world's best real estate professionals, scholars, and researchers. Consequently, their work is constrained. Their teaching may not be informed by global best practices. In the property realm, India is operating in an isolated, remote position.

This circumstance is especially ironic, because India's first Prime Minister Jawaharlal Nehru prophetically proclaimed that to be Indian is to be international.

Why is the Indian Real Estate Market so disadvantaged in comparison to other countries?

From the time of the Industrial Revolution, while other economies were implementing innovations India has been handicapped in implementing the institutional structures needed to drive economic progress and global competitiveness in the 21stcentury.

For two centuries, while other places were pursuing innovations leading to creative destruction, through establishing new industries and expanding their economies India's industries during the British occupation, all too often were subjected to the most perverse form of creative destruction,: industries were destroyed and creativity was suppressed.

While technology-driven innovation can proceed on a fast-track basis, creating educational institutions and research traditions necessarily moves at a slower pace. Just as it takes much longer to build a great physical structure than to establish a new virtual enterprise, so, too, does it take much longer to create the soft real estate infrastructure needed to propel the economy forward and to sustain its vitality for the long-term.

While India derived certain valuable resources from the British occupancy of the country, sadly the legacy of the British Chartered Surveyor system, the first form of professional real estate services, which has emerged to be the model adopted throughout the world, was not meaningfully exported to and implemented in India.

Do cultural differences between India and China explain why real estate has advanced in China and stagnated in India?

China's top-down command style economy more readily creates institutions, particularly those requiring substantial investments and societal integration, such as universities dedicated to higher education. Institution building in India, by contrast, is more daunting, for the entrepreneurial bottom-up style is less conducive to creating the type of institutional structures that China has put in place.

India's oral tradition, as contrasted to China's written tradition, represents a cultural and economic disadvantage for the former and an advantage for the latter. While India enjoys a meaningful advantage, as English is both the global business language, and the dominant language of the property discipline, India's advantage has not been extended into research, documentation of knowledge discovery, and teaching.

Chinese property scholars, though at a language disadvantage, have produced an impressive body of property scholarship. China's property research excellence continues a long leadership tradition of knowledge creation and documentation, for by 1750 more books had been published in China than in the entire rest of the world. The discipline of thinking in prose through writing leads to documentation of logic and promotes analytic rigor.

Do Indian real estate professionals possess world class competence?

There are many brilliant real estate professionals working in India. But there are too few of them. And they tend to keep their brilliance to themselves, rather than passing their mastery on to the next generation.

Indian real estate market participants tend to rely largely on intuition, and to operate without the advantage of professional knowledge and training. While all great real estate strategists and entrepreneurs are highly intuitive, most often they employ their intuitive gifts in concert with extensive training. Too few of India's real estate professionals have the required knowledge and training that property professionals in other places possess.

India has a legacy of extraordinary real estate brilliance. After all, such great properties as the Taj Mahal, the Red Fort, and the Taj Mahal Hotel in Mumbai—my favorite hotel—could never have been created, unless the leading real estate professionals of the day possessed extraordinary acumen, ingenuity, and artistic excellence.

India's property markets tend to mirror the caste system: the very best property good and services experiences in India are reserved for the highest social strata. The functioning of the Indian real estate markets could be interpreted through the lens of the caste system, disadvantaging all who are not of the highest socio-economic standing. While this model may serve the desires of the ultra rich, because it does not drive productivity and competitiveness, it is not sustainable.

India needs to develop the soft real estate infrastructure, specifically the knowledge concerning the role and application of decision tools plus information concerning the markets, to complement the intuitive genius of many Indian investors, entrepreneurs, executives, and professionals.

What are the main characteristics of a developed real estate market?

A developed real estate market has several primary attributes:

- Institutional arrangements that facilitate market function and transactions, enabling users of property goods and services to access space, professional services, and financing, in a reliable, clear, economical way.
- Competence as evidenced by professional service providers, builders and developers, investment managers of company facilities, and especially public officials being knowledgeable, professional, and ethical in their conduct.
- Government structures that (1) facilitate rather than frustrate market function, (2) provide clear, predictable rules and regulations, and (3) offer a ready and equitable means of resolving disputes.
- Information ecology of public agencies and private enterprises providing information on market attributes, driving forces, conditions, and transactions.
- A strong educational system with significant preparation at all educational levels: undergraduate, graduate, doctoral, and continuing professional development.
- A commitment to research to drive knowledge discovery, advance sound policy, and inform practice based on best practice.

What steps should be taken to improve the Indian real estate market?

The Indian real estate market can be improved by the following:

1. Institutional reform to facilitate market function, by eliminating bureaucracies, delays, and burdensome costs.
2. Stimulating investments in physical infrastructure, especially transportation connectivity.
3. Prioritizing high-rise construction, so that India's urban expansion builds up rather than out.
4. Establishing an educational and research commitment comparable to that of China, the United States, and such leading European countries as the United Kingdom and Germany.
5. Create compelling reasons for Indian scholars, now working in other countries, to return to India to build programs at Indian universities and also attract leading scholars from throughout the world to Indian universities.
6. Promote outstanding research productivity on the critical, issues of the day.
7. Encourage creation by both public agencies and private enterprises, of a robust informative ecology of information on market attributes, driving forces, conditions, and transactions.
8. Stimulate the global professional societies, particularly the Royal Institute of Chartered Surveyors and the Urban Land Institute, to establish major presence in India through building strong chapters.
9. Create the real estate equivalent of TiE (The Indus Entrepreneurs) of which organization I am proud to be a member.

These steps can be advanced through policy initiatives by the government.

Indian real estate market is known for lack of transparency and inefficient data. How do you account for such a problem when you analyze real estate properties in the Indian market?

Market inefficiency makes analysis more difficult and less reliable, thereby leading to greater uncertainty, and—from an investor's perspective—greater risk. Participants in more inefficient markets reasonably expect a higher return for their involvement. As investors who are risk adverse require a premium to compensate for the additional risk, capital costs are higher, and, necessarily, investors expect higher returns to put their capital at risk.

Higher capital costs translate into more expensive property goods and services. In such conditions, supply is necessarily constrained. Along with higher priced property goods and services, there is less supply, so those controlling the supply can and do charge more.

These factors must be taken into account in analyzing properties in markets with the types of characteristics that apply in the Indian real estate markets. Doing so involves first recognizing the inherent variability, uncertainty, and risks of the inefficient market and then incorporating those factors into the analysis.

The inefficient market offers a greater reward for superior expertise and imposes a greater penalty for miscalculation. Consequently, for those with the right knowledge and professional competence, involvement in the Indian real estate markets can be more rewarding than might apply in other more efficient markets.

The majority of real estate professionals in the Indian real estate market come from allied fields that lack specialized knowledge in real estate. How does it affect the Indian real estate market?

Lacking specialized knowledge in real estate, individuals participating will tend to be less sophisticated, relying more on intuition than analytic sophistication, and consequently take on more risk, some of which they most probably do not recognize, let alone understand, than might apply, were they to have greater knowledge. Less sophistication leads to suboptimal decisions, the less efficient use of resources, and diminished quality of property goods and services on offer, relative to what might be, were market participants more knowledgeable.

The opportunity for individual professionals is to gain the knowledge comparable to that in the most advanced markets. As more and more real estate professionals take the initiative to do this, a rising tide lifts all boats effect shall necessarily lead to improvements in the Indian real estate market.

What is the need for specialized training/education for Indian real estate professionals?

From the above, there is an extraordinary need for specialized real estate training and education.

While a select number of motivated Indian professionals have pursued graduate studies in the United States, the United Kingdom, and other places, there is need for them to return to India and build programs at universities within India. But as a practical matter, the need is so great that India cannot afford to export its talented young minds to obtain real estate training in other places and then come back to build programs in India. Rather, India must attract the leading real estate scholars from other places to partner with Indian leaders and educators in various training and educational programs to build education in India.

What are the implications of India's limited soft real estate infrastructure for those motivated property professionals who take the initiative to obtain the necessary training and knowledge and education?

Taking the initiative to invest in the proper professional training can have a high return on investment. By obtaining training, one can (1) identify opportunities that might otherwise be missed; (2) identify risks that others would not perceive; (3) take the initiative to put in place the appropriate strategies to mitigate the consequences of those risks.

Those who obtain professional training shall have a meaningful edge the majority who lack that professional training. TGA

Interview Conducted by
Divyanshu Sharma
Partner, realism.IN

Exchange Traded Funds

A Game Changer!

ETFs are mostly index funds that trade like stocks and help achieve diversification, benchmark returns, get access to multiple assets and real-time asset allocation at a low cost. Although in existence since 1993, it is only in the last few years that they have accumulated scale. As of Dec 2012, 4,806 exchange traded products had assets of ~$2.1tn globally vs. 1541 and ~$851bn in 2007 and 297 and ~$146bn in 2002.

ETF growth has been seen to be a result of net inflows rather than price appreciation. Global ETFs have seen consistently high net inflows since the past 4-5 years, with 2011 clocking ~$164bn. Increase in new money inflows generated new ETF launches and product development giving investors' access to multiple assets, many of which were not easily within reach earlier.

The industry has seen higher number of launches each year between 2009 and 2012. New ETFs from China, South Korea and the US in 2012 rank amongst the largest fund launches made recently. A larger portion of the ETFs in the US today were launched in the last 5 years itself. ETFs now account for over a third of US passive investing (index mutual funds) given its advantages of tradability and lower costs. With the industry maturing, the move towards novel funds should intensify, which also provides an entry for smaller, boutique AMCs. Though active ETF products have also started from 2008, they still constitute a very small portion.

Challenging the Traditional

ETF challenges traditional distribution models as it pays little or no distribution fee and it is tough to track subsequent flows coming through brokerages. However, it is finding favour from the fee-for-advice model as it benefits financial advisors. Traditionally, ETFs globally were held initially by institutions and financial advisors, due to its lower cost, risk diversification, new beta exposure and short-term liquidity management. Though slow to pick up in the retail space, it has started gaining acceptance of late, to the extent that retail now holds nearly

Tough economic scenario, pressure to perform despite volatile markets, inability in attaining alpha consistently, increased regulations post-2008 and heightened competition have brought the focus back on passive investing, especially Exchange Traded Funds.

Sourajit Aiyer

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half of global ETF assets. However, many emerging markets like India actually saw ETFs demanded more by retail initially, though this is attributable to the proliferation of gold ETFs.

ETF AUM has advanced within mutual fund assets, though the proportion is still quite small at ~6 per cent. Equity, though still the largest constituent within global ETF assets, has declined in proportion from 92 per cent in 2007 to 77 per cent as of May 2012, attributable to the volatile equity climate which shifted focus towards uncorrelated assets for diversification and risk reduction. The share of the US, Japan and Europe declined from 95 per cent to 91 per cent in the last decade, while Asia Pacific (ex Japan), Latin America and Canada showed stellar growth. While ETF assets grew globally, the average AUM per Fund declined, particularly in Asia, owing to strong addition to fund count. India has been an exception given its rapid addition to gold assets, though it is in line with Asia in terms of equity ETFs specifically.

Trends in evolved markets like the US show that as ETF volumes grew, its contribution towards cash equities volumes showed more resilience even during a drop in overall cash volumes. During downturns, there is a shift in the investors' preference towards passive products from active investing. Despite lower trading volumes, there was asset addition in the ETF space, demonstrating the increased appetite for such products. The bigger the fund, the better it achieves economies of scale and break-even. Hence, increase in smaller sized funds outside the Top 10 ETFs may present a concern, since this could impact the players' profitability.

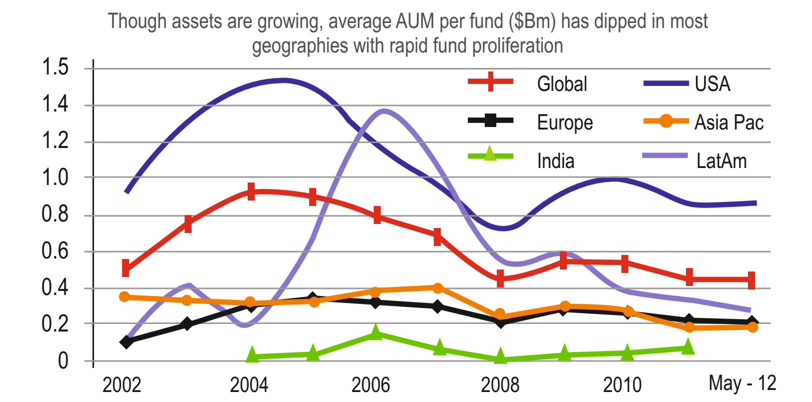
Tough economic scenario, pressure to perform despite volatile markets, inability in attaining alpha consistently, increased regulations post-2008 and heightened competition have caused the recent popularity in passive investing, especially low-cost ETFs.

What is Aiding to their Popularity

Low fees and trading costs (including marketing and distribution costs) have been a key factor as most ETFs are not actively managed, and hence role of the portfolio manager is limited. ETFs can give targeted exposure to certain sectors, markets and to assets like commodities, currencies which may be uncorrelated to each other. It may even include niche exposures like the infra sector of Brazil, mining sector of Australia etc.

ETFs have made commodities accessible for retail investors, which were otherwise cost-prohibitive as it had to be bought in lots. ETFs have helped achieve portfolio completion and access to alternative assets. Since ETFs are listed on an exchange, they are tradable like shares. Investors can trade real-time using intraday price movements. Costs related to any short term inflows/outflows into mutual funds (STT, brokerage etc) impacts all the investors in that fund. But in the case of ETFs, the cost of trade while buying/selling the underlying ETF basket shares is borne by those particular investors only. Thus, long term investors into ETF are not impacted by inflows/outflows from the ETF.

Different Trends



Source: Blockrock ETF report, capitaline

ETFs are also able to maintain low levels of cash which helps reduce tracking error. This is because flows are added to its AUM only when the underlying portfolio baskets are received by the ETF and not when applications are received originally. Features (similar to equities) such as the ability to buy on margin, sell short, trade with stop/limit orders, replicate hedge fund-like strategies, etc., have too added to its growing popularity. ETFs, including active ETFs, disclose the composition of their portfolios daily, hence investors know what they own each day.

Advantage Passive Investing!

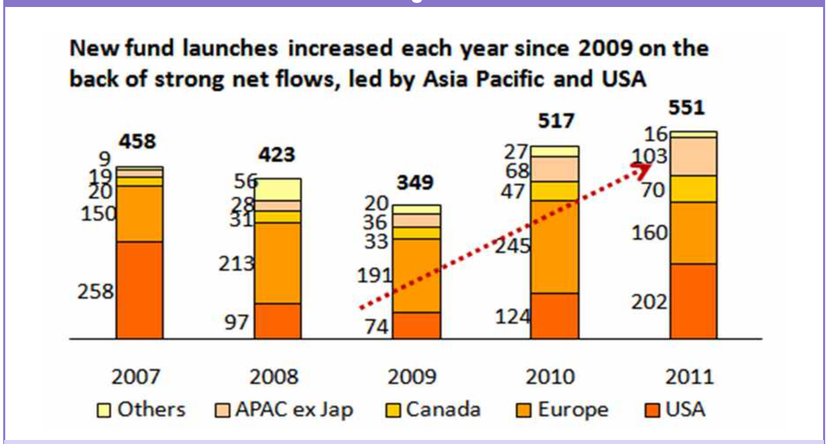
In volatile times, diversity is key. Since 2008, market volatility has increased perceived risk and the inability to beat benchmarks consistently (alpha). This brought the focus on benefits of passive, un-correlated and diversified investments. As investors seek to balance growth with risks, they are increasingly looking at lower-correlated assets. ETF products help in this. Financial advisory is seeing a gradual shift from commission based to fee based advisory.

This is largely due to the inability of investors to pick correct options, given the product proliferation, volatile markets and shifting focus to newer assets which many are yet to understand – thus increasing the demand for advice. Since advisory services charge a fee-for-advice over and above other portfolio costs, they seek low-cost options and ETFs fit this bill. This trend is a boon for ETFs, as many distributors were otherwise reluctant due to the low commissions earned on ETFs. Regulatory changes banning commissions have also given ETFs a boost.

Core-Satellite investing, like often used for institutional portfolios, is now popular in retail portfolios as well. This may involve passive investing for core exposure seeking benchmark performance to minimize the risk of lagging the market, which may be ideally serviced by the numerous low-cost ETFs tracking broad indices. Actively managed satellites seek concentrated, targeted exposure to certain sectors, assets and markets to tap outperformance. ETFs can be a useful way to go overweight/ underweight in markets, based on short term views. Short-term market movements may render certain sectors relatively undervalued.

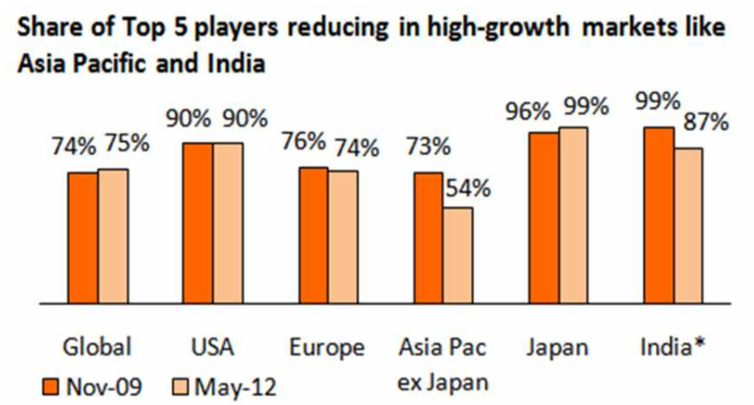
Assuming such sectors to typically converge to their true value in the long run, such sector ETFs may often be used. Those with deep understanding of markets might use ETFs to capture stock vs. sector performance differential - buy the stock and short its sector ETF if the company is expected to better its peers, and vice versa. Investors with cash parked in their portfolios for some time may use ETFs like short-duration bond ETFs instead of money market funds, as they may often pay better yields than money-market funds. Fixed income ETFs, which can reduce the risk of investing in single bonds, offers a bond basket with single trade and replaces maturing bonds. Dividend ETF portfolios for current income may be appealing in the current scenario, with each underlying paying a dividend monthly.

Growing Flows



Source: Blockrock ETF report

Share of Top Players



Source: Blockrock ETF report

Links to Less Exotic Indices, Helpful

Given the competition, it is worth taking a look at some of the broad characteristics that were specific to the more successful ETFs Some of the best performing ETFs were linked to less exotic indices. Performances of most exotic funds were unable to match that of regular ETFs, because exotic ETFs were difficult for most investors to understand – Given the nascent stage of this segment, the simpler the ETF strategy, the better it is. Despite many ETFs launched to benefit from current market situations, they may have a limited success life. Being linked to an index with a long-term appeal has usually been more attractive for investors. As the ETF market evolved, the demand for more innovative products grew including non-cap weight index ETFs, alternate asset ETFs, inverse ETFs etc, as well as proliferation outside traditional equities like fixed income etc. Lastly, ETFs with low tracking error (difference between fund and benchmark returns) have generally been more successful.

Immense Growth Potential

The initial period of entry into ETFs ushered in first-movers who had manufacturing capabilities due to their experience in index mutual funds. The next stage will require AMCs to target specific, focused segments. Growing investor acceptance, new entrants and fund proliferation means competition will intensify. New entrants may also need to compete with niche, novel products to grab market share from larger rivals. This will require product innovation to differentiate from a multitude of funds, incentivizing distribution channels, technology for service capabilities. Thus, build a unique value proposition in an increasingly crowded market for clients who are becoming much better informed. Smaller players are already making a mark, especially in growth markets like Asia Pacific. For example, Samsung and Huatai, who did not figure amongst the Top 5 players in Asia by AUM back in 2009, have scaled up rapidly to break into the Top 5 rankings by May 2012.

How is the global ETF market expected to evolve?

Product segments are diverging – (a) Vanilla, beta products competing on being low-cost, high-volume and offering favourable pricing to clients, (b) Specific exposures targeting non-correlated assets, (c) Sophisticated products targeting niche, unmet investor needs, (d) Quasi-active ETF products that track indices created for that ETF particularly, similar to active managers.

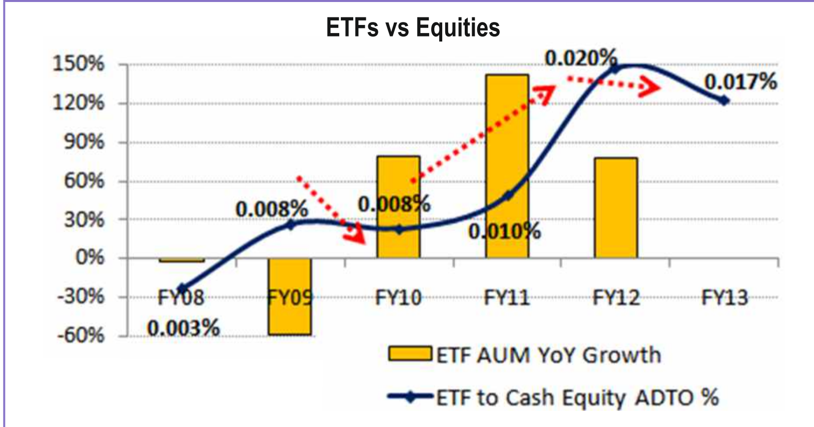
Changes in the way business is run – (a) Balance operating costs for higher marketing/advertising needs by outsourcing non-core processes, (b) Distributors may increasingly need to seek manufacturing

Global ETF Industry Growth Attribution in 2011 vs. 2010

	USA	Europe	Global	USA	Europe	Global	USA	Europe	Global
	Total industry growth			From cash flows			From asset prices		
Equity	-0.4%	-8.7%	-1.4%	8.5%	9.2%	10.0%	-8.9%	-17.8%	-11.4%
Fixed Income	32.8%	-0.9%	23.5%	32.8%	-0.7%	23.6%	-0.1%	-0.2%	-0.1%
Commodity	NA	15.3%	15.9%	NA	16.8%	17.2%	NA	-1.4%	-1.3%
Total	**5.1%**	**-4.9%**	**3.2%**	**12.5%**	**7.8%**	**12.5%**	**-7.5%**	**-12.7%**	**-9.3%**

Source: Deutsche Bank Report 2011

Trading Volumes



Source: Captaline

capabilities or enter into partnerships with smaller ETF players who are looking to achieve scale, (c) Build operational processes that are adaptable to handle rapidly growing and evolving businesses across assets, markets, currencies and client types.

Potential opportunities – (a) Grow ETFs as a substitute for index mutual funds, (b) Expand into segments where ETFs are yet to gain share like mid-cap equity etc, (c) Other revenue sources like securities lending to make up for the rise in costs due to newer regulations, (d) ETFs of ETFs and ETF Wraps may become popular negating the exposure risk to narrow-strategy ETFs, (e) Non-traditional ETFs like commodity (copper, hard commodities), inverse, quasi-alpha funds etc.

Trends that may support – (a) Growing focus on fund costs owing to poor returns from active funds, (b) Demand for diversification through uncorrelated assets, (c) Growing trend towards fee-based advisory aligning focus on low-cost products like ETFs, (d) Pressure by distributors on AMCs for a larger revenue share, (e) Regulators demanding greater disclosures and transparency.

Some concerns – (a) Possible increase in non-performing ETFs and inability to mobilize assets to reach a profitable scale, (b) Level of investor awareness and understanding is still relatively less which can lead to misinformation, (c) Although overall liquidity of ETFs has picked up, every ETF may not be very liquid by itself.

Scope in India

Indian ETF assets were ~$2.5bn as of Dec 2012, a CAGR of over 20 per cent since the last 7 years. Surge in gold prices and volatile equity markets have shifted the focus to gold since 2008. By 2012, gold ETFs comprised over 80 per cent of Indian ETF assets and majority of the Top 10 funds. Despite this skewness towards gold ETF products vs. equity ETF products, India presents a large growth potential. For instance, with mutual fund assets at ~$122bn in Mar 2012 and ETFs comprising just ~2 per cent of it, a significant opportunity exists to expand that 2 per cent itself. Past figures show that this per cent proportion figure has doubled within the last 5 years itself. This opportunity is more expansive in the Equity ETF space which just comprised ~0.6 per cent of equity MF assets.

However, certain challenges exist – (a) Ability to develop product varieties at effective pricing as an USP to tap market share away from mutual funds players in the ETF space, (b) Rapid growth of ETFs with small asset size a key concern to remain profitable, (c) Banks, one of the largest distributors in India, prefer selling mutual funds as they don't require demat A/Cs, (d) Liquidity of the underlying stocks is a major driver for ETF players to mirror a particular index as it may restrict the number of indices on which ETFs can be modeled, (e) Lack of investor awareness & education may lead to misinformed decisions and slower acceptance, (f) Brokerage, a key revenue source for ETF sales channels like brokers, might be impacted as recent years show that ETF trading volumes in India have varied, rather lagged, in line with the YoY growth in assets. TGA

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Advantage ETFs

India: Rise in number of ETFs with AUM <Rs1bn ($20

	FY06	FY08	FY10	FY12
> Rs 3bn	1	2	4	8
Rs 1-3bn	2	5	3	2
<Rs 1bn	3	5	14	24
Total	6	12	21	34

Source: Capitaline

Fund Management

Performance, not Size, Matters!

Fund managers are good at managing funds and advisors are good at gathering assets but it does not help investors invested in the fund. Investors consistently make wrong timing decisions leading to under performance as compared to the fund manager. Fund houses and advisors do not assist investors in helping them on their timing dilemma leading to such discounts. The mantra is: Be fearful when the market rallies and get adventurous when the market tanks. It is psychologically difficult, but produces investment magic!

How many times have we invested in a fund based on its past performance? In fact, almost all the time. How many times, in spite of the lofty performance credentials of the fund, the actual return of our investment sucks. (Leave that to you!)

The difference lies in the concept of how performance is measured. A fund's performance is normally time weighted return (TWR) and is a simple compounding of fund's Net Asset Value (NAV) over a period of time. This measure is presented over various time horizons (YTD, 1-year, 3-years, etc). This is the return earned by the fund manager on the fund.

However, this return metric does not provide a completely accurate view of how much return the investors have made on their capital; to find this, an internal rate of return must be calculated to discern the return on the average capital in the fund. In simple terms, the Capital Weighted Return (CWR) takes into account the cash flows at the beginning and end of the month and is the average rate of return of the investors in the fund.

Why does this difference matter? Because it is quite important.

The first tells you how well the fund manager did over time while the second tells you how well his investors did. When fund managers

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CFA, FRM, Head of Research
Kuwait Financial Center (Markaz), Middle East

do better than investors, we call that situation as "discount". It is quite possible that a fund gains a TWR of 5 per cent p.a over the last three years while its CWR may be -10 per cent. What this means is that even though the fund manager did manage a positive performance, his investors (as a group) suffered a loss. How can this happen? Because investors may be bad in terms of timing their investments.

Conversely, when investors do better than fund managers we call it as "premium". In all earnest, the optimum situation is to aim for premium and avoid discounts. Various studies and reports have been commissioned to analyze and illustrate the difference between CWR and TWR and how using TWR exclusively can be misleading to investors. It has been found that CWRs trailed TWRs in major indices by an average of 5 percentage points/year over a 25 year period (Enough, John C. Bogle, 2008).

Moreover, a Wall Street Journal article highlighted the CGM Focus Fund (which had been named the best-performing US diversified stock mutual fund of the decade by Morningstar); according to the article, the fund produced a TWR of 18 per cent over the last 10 years while underlying investors actually lost 11 per cent per year ending in November 2009! This comes out to a discount of an average of 29 percentage points every year for a decade!

Discounts (CWR being less than TWR) are generally caused by rapid asset growth and mistiming of inflows to the fund by the investors. In other words, investors return may be poor due to wrong timing (buy and sell). Conversely, a Premium is the result of a substantial inflow (as a per cent of AUM) which is also well-timed in terms of market performance. In short, cash flows into a fund matter more than standalone performance. It is no surprise that as per updated standards of GIPS (Global Investment Performance Standards), it is now recommended that NAVs be calculated and reported as on the date of significant cash flows reiterating the importance of cash flows.

We looked at 5 equity funds from the HDFC Bank staple to see if there is a difference between fund performance and the performance of investors underlying the fund. The analysis was done over 3 time periods (3 years, 5 years, and 7 years). In all but only three instances, the TWR was higher than the CWR leading to a discount. In other words, investors in the fund made lower returns (due to wrong timing) than the fund manager. In some cases, the difference was significant. Take for instance HDFC Prudence fund. For the 3 year period ending Dec 2012, the fund returned an impressive annualized 14.42 per cent while the investors in the fund made only 9.74 per cent leading to a discount of 4.68 per cent.

We can observe similar discounts throughout the calculation except in three cases (highlighted in red) where we see a premium. Another contributing factor to the discount apart from poor market timing by investors could be the rapid growth in assets under management. Invariably, all funds experienced extraordinary growth in their asset base. The funds under study grew by an annualized 36.98 per cent for the last 7 years. Incredible indeed!

Case Study - HDFC Bank Equity funds (Dec 2005- Dec 2012)

Fund	7 years			5 years			3 years			CAGR of Assets
	CWR	TWR	Outperform	CWR	TWR	Outperform	CWR	TWR	Outperform	(Sep'05 - Dec'12)
HDFC Top 200	12.20%	16.37%	-4.17%	8.10%	6.36%	1.74%	7.12%	8.59%	-1.47%	48.09%
HDFC Equity	13.42%	15.85%	-2.43%	4.85%	6.06%	-1.21%	6.89%	9.06%	-2.17%	30.59%
HDFC Growth	12.70%	16.27%	-3.57%	4.65%	3.67%	0.97%	9.46%	9.75%	-0.29%	22.34%
HDFC Prudance	13.88%	16.02%	-2.14%	6.99%	8.20%	-1.21%	9.74%	14.42%	-4.68%	26.79%
HDFC Tax Saver	10.10%	12.32%	-2.21%	4.97%	3.81%	1.15%	6.48%	7.73%	-1.25%	57.07%
									Average	**36.98%**

What does it say?

Fund managers are good at managing funds and advisors are good at gathering assets but it does not help investors invested in the fund. Investors consistently make wrong timing decisions (both buy and sell) leading to under performance as compared to the fund manager. Fund houses and advisors do not assist investors in helping them on their timing dilemma leading to such discounts. For them, investment is recommended any time of the year/market cycle.

How can fund managers increase "premium"?

As discussed before, it should be the objective both for the fund manager and the investor to generate a premium. When a premium is generated, a win-win situation is created whereas when a discount occurs, we have created a win-lose situation where the fund manager wins while his investors do poorly. Fund managers can create a premium by restricting inflows during a rising market and encouraging inflows during the falling market. While the first can be done easily by just closing the gates to new investment, the second proposition is difficult and can be achieved if the investor group is comprised of high net worth individuals (HNIs).

What should you do as an Investor?

Never base your decision to invest solely on the past performance of the fund. Insist on looking at the CWR as well. A fund that is focused on the returns its investors make should be a better bet. Since you cannot successfully time the market, always spread your investments over a period as this reduces the possibility of a discount in terms of your performance compared to the fund performance.

Be fearful when the market rallies and adventurous when the market tanks. It is psychologically difficult, but produces investment magic! And, also enables you to mitigate the timing risk. Since TWR calculates fund manager's performance its calculation depends upon the NAV and hence the 3 year time weighted annual TWR = (127.5/100)^1/3 i.e. 8.43 per cent.

However, the CWR calculates returns generated by the investors and hence its calculation depends upon the total cash flows for the investors. Using the IRR formula in spreadsheets, the yearly IRR for following cash flows (Y0= -100,000, Y1= 60,000, Y2= -50,000 and Y3= 102,000) would come out to be 4.96 per cent. These calculations clearly show that although the fund manager achieved an annualized return of 8.43 per cent over the three year time period, the investors put together gained only an annualized return of 4.96 per cent over the three year time horizon.

The reason for this difference is understood from the fact that investors remained invested in the fund during Year 1 and Year 3 which returned only 0 per cent and 2 per cent respectively, however, investors withdrew from the fund during Year 2 which produced the highest return of 25 per cent. In short, we can say that investors completely mistimed their investment decision. TGA

Calculations for TWR and CWR

The reasons for difference between TWR and CWR can be understood from a simple example.

Let us take into consideration a three year time period. Assuming that 1000 investors invest Rs 100 each in year 0. (Y0, AUM= Rs 100,000 & NAV = Rs 100). The fund generates no return in year 1 and hence the fund situation after year 1 remains the same. (Y1, AUM= Rs 100,000 & NAV = Rs 100). Since the fund generates no return in year 1, 600 investors decide to withdraw their investments at the start of year 2 (i.e. at the end of year 1). However, year 2 turns out to be a good year for the fund manager and he generates a return of 25 per cent.(Y2, AUM=Rs 50,000 & NAV=Rs125).In anticipation of a greater return 400 new investors join the fund at the current NAV at the start of year 3. However, year 3 turns out to be an ordinary year for the fund manager and he gains only 2 per cent (Y3, AUM=102,000 and NAV = Rs 127.5).

The year wise data can be summarized as follows:

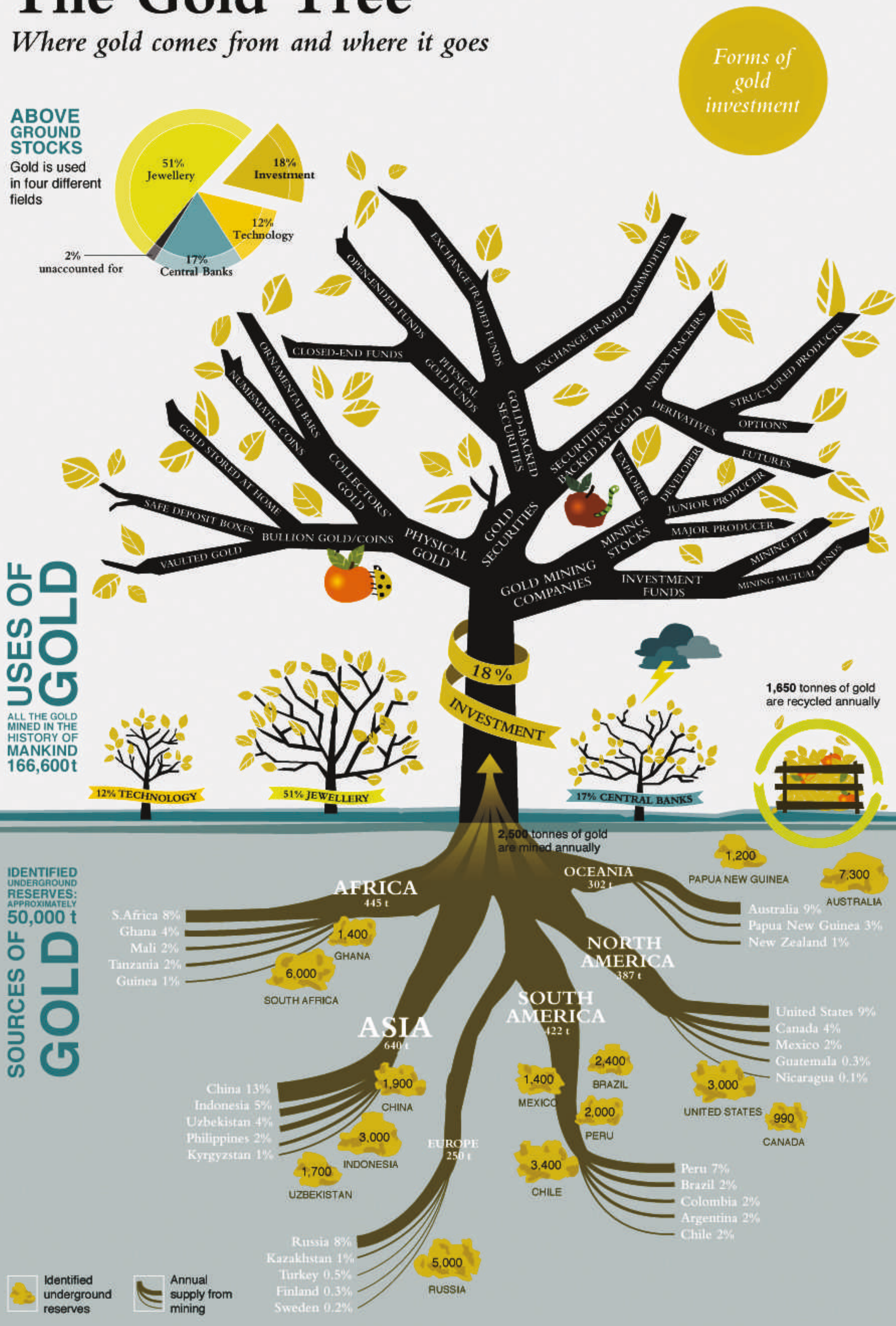
Year	Asset Under Management (Rs)	NAV (Rs)	Cash flow for Investors (Rs)
Year0	100,000	100	-100,000
Year1	100,000	100	60,000
Year2	50,000	125	-50,000
Year 3	102,000	127.5	102,000

AUM for a particular period has been calculated as follows: [Beginning period AUM (plus/minus) investment made into the fund] (multiply) [1+ percent return generated]. Hence, AUM for year 2 has been calculated as [Rs100,000 minus Rs 60,000] multiply [1.25] = Rs 50,000.

NAV for a particular period has been calculated as follows: Total AUM at the end of period (divide) total number of investors in the fund. Hence, NAV for year 2 has been calculated as Rs 50,000 (divide) 400 investors (1000-600) = Rs 125.

The Gold Tree

Where gold comes from and where it goes



Sources:
U.S. Geological Survey, GFMS, World Gold Council, Trustable Gold

"When interest rates are low we have conditions for asset bubbles to develop, and they are developing at the moment. The ultimate asset bubble is gold."

- George Soros
Billionaire Investor & Hedge Fund Manager

After over a decade of a strong rally that lifted prices to a record high of above $1900 an ounce, the yellow metal witnessed a dramatic sell-off on April 15, 2013, losing 9% on a single day, its biggest fall in 30 years! In India too the prices of the precious metal, which has followed the trend in the international markets, fell sharply in the futures market to go below Rs.26,000 per 10 grams, lowest in the last two years since prices touched all-time record high of Rs. 32,464 per 10 grams last November.

The fall in gold prices in India and elsewhere has accelerated in recent times, driven by rising hopes of recovery in the US, the world's top economy, expectations of end of quantitative easing in the US and Europe, weak economic data from China, which in turn could depress demand for gold and other commodities. But the yellow metal has staged a smart recovery after touching record lows in Mid-April. Given, it would be too early to forecast end of a gold'en' run which began in the early 2000s.

The Great Meltdown

Amit Singh Sisodiya with Abhijit Sharma

"In US dollars, gold has gone up for 12 years straight; for UK investors, it has risen every year except one since 1998. That's a remarkable stretch, far longer than gold's successive gains in the 1970s and longer even than the US stock market's record-breaking run from 1982 to 1989."

- Adrian Ash

Head of Research, BullionVault, the world's largest online investment gold service

Long before the gold bulls could read the writing on the wall, the bullion bears had already written epitaph for what is clearly one of the most sought after precious metals – gold, which for long had been viewed as the best hedge against inflation, and other market risks.

Gold logged its biggest single day decline on April 15, 2013, losing over $125 an ounce, its highest fall in the last three decades, in the spot market to trade below, as bears went on a rampage, hammering the precious metal to its record lows after a staggered bull run that lasted for nearly 12 years, as the news of Cyprus resorting to a gold selling spree hit headlines, prompting speculators to assume that other debt-stricken euro zone nations might follow the suit.

The earlier record (of a price crash) was recorded on January 22, 1980, when it lost 17 per cent of its value (after touching it's then record high of $850 an ounce a day earlier) in a single day, triggered by a worldwide panic over fears of an oil spike in the wake of the then Soviet Union's intervention in Afghanistan and the fluid political situation in Iran. In the futures market too, gold for June delivery crashed by over $140 an ounce to well below $1,400, after posting a fall of 5 per cent on April 12. The gold contract, which has lost 29 per cent after touching a record high in September 2011, is clearly in the bears' grip, according to the industry observers.

And for the first time in last several years, the yellow metal seems to be under real threat to lose its status as a safe haven.

As industry experts' reports predicting dooms days ahead for the yellow metal continue to pour in and some of the world's top commodity investors cut their gold exposure, it raises the question – has the law of gravity finally caught up with the yellow metal? And, also, does it herald what many say the end of the commodity super cycle?

What Goes up must Come Down

"There's a perception that risk has been lessened, and with that, investors are looking for assets that either generate income or have growth potential, neither of which gold has."

- Anthony Valeri

Market Strategist, LPL Finance Corporation

Gold, like other commodities benefitted from what was widely termed as commodity super cycle that began in the early 2000s and lasted for more than a decade? It was the period that marked the rise of the emerging markets, notably BRICS, an acronym for Brazil, Russia, India, China and South Africa. The boom in these economies lifted commodity prices out of their deep slumber during the 90s which saw services sector powering the growth of the western economies – from US to Europe – as they began shifting away from manufacturing in favor of the former. In fact, the prices touched rock bottom during the last decade of the 20th century, prompting many to predict a prolonged bear market in commodities. However, it was not to be. And the reversal began with the surge in demand for material from cement to steel, and oil to copper, and virtually for all sorts of commodities as growth momentum picked up in India and China among other developing nations. Prices of metals to minerals sparked, never to return. A strong bull market followed and investors, as in other previous rallies, became overconfident of the rally sustaining forever.

However, the recent selling spree in gold, silver, and other precious metals, which follows an already weak market in key commodities including copper and coal, globally, is a stark reminder of the fact that what goes up must come down.

Decline in gold has accelerated in the wake of unraveling of the crisis in Cyprus. It sounds surprising given that uncertain time is the most opportune for gold bulls as investors turn bearish in other assets such as equities, oil, realty, etc. So, why is it so that uncertain global environment is casting its net wide over gold this time around? The reason is the selling of its gold reserves by Cyprus and the fear that other euro zone countries could follow the suit.

The news that the Central bank of Cyprus could sell gold worth €400m of gold 400 million euros towards the rescue effort (it was recently bailed out by the European Union) drove investors press the exit button, pushing the precious metal go down the psychological level of $1,500 an ounce. "The pressure from proposed sale of Cyprus gold is one of the factors, and once one of them start they all run from the hen house," said

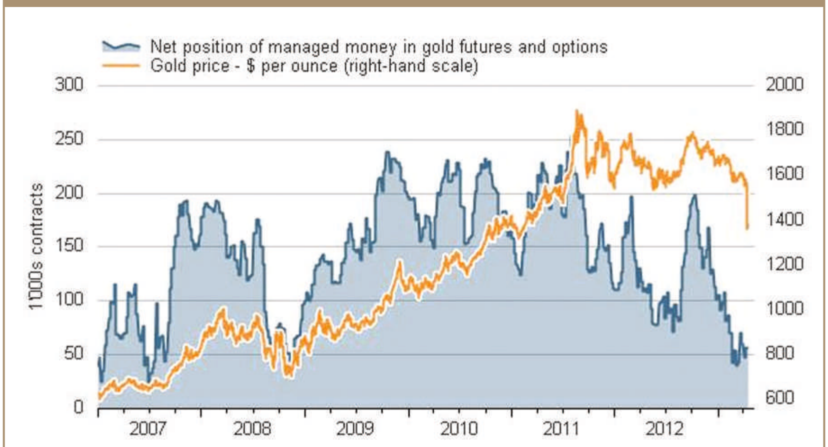
Robert Richardson, senior account executive and trading officer at Canadian broker-dealer W.D. Latimer Co. Ltd, in an interview. Cyprus became the fifth nation in the trouble-hit euro zone to receive a bailout package, one of the pre-conditions of which required Cyprus to sell its excess gold. "A proposal that Cyprus sell some of its gold reserves to support its banks also spooked investors, leading them to worry that Spain, Italy and other weak European countries might flood the market just as demand for the metal is weakening," a report from Ventura Commodities said.

Central banks hold about 19 per cent of all gold ever mined, and last year they boosted holdings by the most since 1964, Bloomberg said citing data from the World Gold Council. "The US and Germany are the biggest holders, with the metal accounting for more than 70 per cent of their reserves. The US and Germany are the biggest holders, with the metal accounting for more than 70 per cent of their total reserves. Russia, the seventh-biggest holder with 976.9 tons, boosted buying in the past seven years," the business and information services firm added.

What has also added to the woes of gold bulls is unwinding of holdings by speculators and traders, and subsequent panic selling by investors in the western countries. Further, selling by some of the top gold ETFs, including SPDR Gold ETF, the world's largest gold ETF too has added to the pressure on the yellow metal. Liquidation came from all quarters, including exchange-traded funds, speculators and even physical bullion owners in China and India, the world's largest bullion markets, said David Govett, head of precious metals at Marex Spectron in London. "This is a market that has only got one thing on its mind ... get me out," he said. Traders also cited liquidation by prominent hedge funds in gold exchange traded funds, especially the SPDR Gold Trust (GLD.P), which was one of the most-active trading US stocks. The gold ETF posted a record monthly outflow in February.

The reversal of yen carry trades, in which investors borrowed cheaply in the Japanese currency to reinvest the money in higher yield assets, also led to some gold selling as the yen rebounded from a four-year low against the dollar. Gold exchange-traded funds such as the SPDR Gold Trust and the iShares Gold Trust which purchase and store gold on behalf of investors, have seen a surge in activity. More than USD 1 billion alone flowed out of the SPDR fund Friday, the third-highest withdrawal on record, according to research firm IndexUniverse.

Gold Futures Positioning: Warning Signs!



Source: Thomson Reuters Datastream, CFTC

Flows out of the fund are likely to have been even higher Monday, traders said, after volume in the SPDR fund surged to an all-time high. Gold-backed ETFs can accelerate price declines in the metal as investors' cash out, releasing physical gold into the market.

Holdings in the SPDR Gold Trust, the biggest ETF backed by bullion, fell to 1,154.34 metric tons yesterday, the lowest since April 2010, data on the company's website showed. That's 15 per cent, or 199 tons, below the peak reached in December

It raises the concern that whether gold is entering a bearish phase, given that it has lost over 30 per cent in its value, much above the crucial level of 20 per cent to qualify as a bear market. The concern has also grown as central governments from the US to Europe seem all set to end the recent spree of quantitative easing – Fed-speak for printing money – as recovery signs become clear and inflation remains benign. Also, with stock markets across the globe on a fire, literally, the interest in gold seems to be waning.

Whither Bottom?

"Conservative estimates think the gold price will drop another $100 at least before people start buying again – that would be a drop of more than 30 per cent from its 2011 peak and mean half the gains made in the gold price since the economy fell apart in 2008 would be lost," said a Reuters report. "Purely looking at the charts, support would now be at $1,300," Ole Hansen, a senior official of Saxo Bank, told the firm. In fact, some industry experts foresee a much bigger fall. "Between January 1975 and September 1976, the price of gold in dollars fell by almost one-half," it quoted BullionVault's Ash as saying. "A repeat of that fall would see the price dive to around $1,000 an ounce." However, according to some analysts, the future for gold looks bright.

For instance, according to Adrian Lowcock of Hargreaves Lansdown, "Longer term the outlook for gold is more positive, particularly as it gets cheaper," adding, "The loose monetary policy of Japan, UK and US and huge amounts of Quantitative Easing are storing up problems for the future and are likely to weaken currencies, potentially driving up inflation." "Gold provides an insurance against this and investors should be wary of selling their insurance policy just because it appears they didn't need it in the past," he told Reuters.

Is Gold Still the Safe Haven?

The history of gold is as rich and complex as the metal itself. Ancient Egyptians portray gold as the brilliance of the sun and the modern astronomers use gold-coated mirrors to capture the pictures of heavens. Gold is the most attractive precious metal, it is used not only for jewellery purpose, but it is also extensively used in dental field and for safe investments thus it enjoys more liquidity than any other precious stone found on the earth. No surprise then why it has become a kind of standard, a barometer for the prosperity, of not only individuals, but also society and nations. As Gold enjoys more liquidity than its peers, it is considered as the safe haven by people during troubled times. Even countries keep gold as a part of their reserves which they can use during the time of crisis, economic slowdown to repay debt or to inject money in the economy.

However, its reputation as a safe haven is now being questioned as global growth slows down, led by India and China, and threat of recessionary pressure subsides in most part of the world; even India is experiencing a gradual decline in key inflation indices such as WPI, though CPI still remains above the comfort zone, hovering near high single digit. With the US and major economies appearing in no mood to continue their quantitative easing spree, this also deals a blow to gold, with dollar and equities firming up, at the same time.

Boom in Gold Prices

For a very long period, approximately from the early 80s to the end of the 20th century, gold prices remained depressed throughout. However, the prices began firming up since the early 2000s. In 2005 gold prices started to soar up from $444/oz and never looked back until the early April this year since which the prices have been southward, crashing from record high of above $1900 an ounce to around $1350 an ounce.

To understand the boom in the gold prices in the past years the reasons should be traced back from 2001 when slowing economic growth in the US led to the decline in the value of dollar forcing investors to turn towards the precious metal to hedge against the inflation as gold is considered as most appropriate instrument for hedging during inflationary times. Thereafter, post the economic crisis of 2008, the Federal Reserve started to pump up more dollars in the US economy via quantitative easing policies, which stoked fears of a spurt in inflation pressure. What also helped the gold rush was the fact that investors lost interest in bonds and other securities because of declining credit rating across leading economies of the world. Sovereign debt crisis of Europe especially in the Greece and Spain resulted in the decline in demand for the government bonds and securities and perked up investors' appetite for gold, which fueled an unprecedented bull run in gold, taking it to a high of $1800/oz in 2011.

Many countries purchased gold in heavy quantities and increased their gold reserves when IMF decided to sell its reserves to finance some of its development projects in 2009. Reserve bank of India increased its gold reserves to 357.75 tonnes. China too increased its reserves to 1054 tonnes that very same year. Besides, many other central banks from Russia to Brazil did similar

Gold ETFs – Reeling under Redemption Pressure

- Overall holdings in gold exchange traded funds have fallen by 13 per cent so far in 2013 to 2,299 tons
- Redemptions along with crash in prices have shaved $36 billion off the value from gold ETFs
- SPDR Gold Shares, the world's largest gold ETF, gold reserves fell from a high of about 1,351 tons at the end of 2012 to 1,093 metric tons
- SPDR Gold Shares has experienced outflows of nearly $13 billion this year as the metal's sell-off has sent many investors fleeing from bullion-backed ETFs

Source: Bloomberg, Yahoo Finance

operations creating huge demand for the gold, causing a sustained rally in international gold prices.

Weaker economies, volatile equity markets which became unattractive after the global meltdown of 2008 shifted investor's interest towards the commodities, specially gold and other gold related instruments such as gold Exchange Traded Funds (ETF), boosting prices like never before. Bullion-backed ETFs such as Gold SPDRs became hugely popular amongst investors, investing huge sums in these funds. Sustained fall in bank deposit rates, which reached to near zero-level in some countries also played a part in discouraging investors for depositing in banks and instead seek refuse in gold.

End of the 'Gold'en Era?

The recent fall in gold prices of around $300 in international markets and up to Rs 4000 in India indicates that the booming era of this precious metal is likely to end, and that gold can lose its position as a savior during economic uncertainty and during periods of extreme volatility. From the beginning of FY'13 many fund managers at leading global funds got bearish on gold as they anticipated this fall in the prices due to present macro-economic conditions and fast changing scenarios. There are several factors which triggered this slump in the gold prices, one of the drivers is the indication given by the US Fed that it will tighten the monetary policy by stopping the ongoing quantitative easing in the near future, which means there will be lower inflow of money in the US economy resulting in the decline in inflation, which seems to have triggered the spate of unwinding on part of institutional investors including hedge funds, Gold ETFs, and speculators.

The major trigger for the decline was when Cyprus announced recently that it is planning to sell a major portion of its gold reserves to tide over its debt crisis. The news panicked investors, who assumed that following Cyprus, other troubled countries like Greece, Italy, Spain might also start selling gold thus adding more supply amid weakening demand. With more and more countries reducing their gold reserves, thus, adding to the bearish sentiment.

Staging a Comeback?

Source: Goldprice.org

Surging equity markets across leading countries with the US Dow Jones touching 14k mark after seven years and seeing comparatively lesser volatility and corrections in the equities, investors seem to be a hurry to join the bull run in equities.

India too has taken significant steps to curb gold imports in order to contain its Current Account Deficit. The increase in import duty on gold has resulted into 24 per cent decline in amount of gold imported. Also, Indian equities are also performing well thus investors are now seeking to invest more in the equities than in gold thus reducing the demand.

But, Recovery Might have some Steam Left in it

It is widely anticipated that international gold prices can decline further before finding support at $1200-$1100 level. Further, it will show little signs of growth in the long-term in absence of some exceptional strong growth drivers which can spike gold prices. Or, so the swift rebound in gold prices in the last few days suggests. For instance, in the USA, gold futures for June 2013 contract closed at $1462 with a gain of 2.69 per cent on April 24th. In India too, the yellow metal has made a sharp recovery.

It crossed the psychological mark of 28,000 per 10 grams on April 25th, driven by sustained buying amid anticipation of a further uptrend. And the bullion traders suggest that the gold rally might have some more steam left in it given the ensuing wedding season. And given Indians' unsatiated appetite for the yellow metal, and growing rush among retail consumers in other developing nations, the gold might just be well poised to recoup the lost ground! TGA

GOLD
Whither Bottom?

Lack of counter party risk makes the old monetary metals objects of ridicule by the global financial industry, who market fraudulent "financial assets" by the trillions of dollars, euros and other currencies.

Mark J Lundeen
Independent Analyst, Financial Markets, US

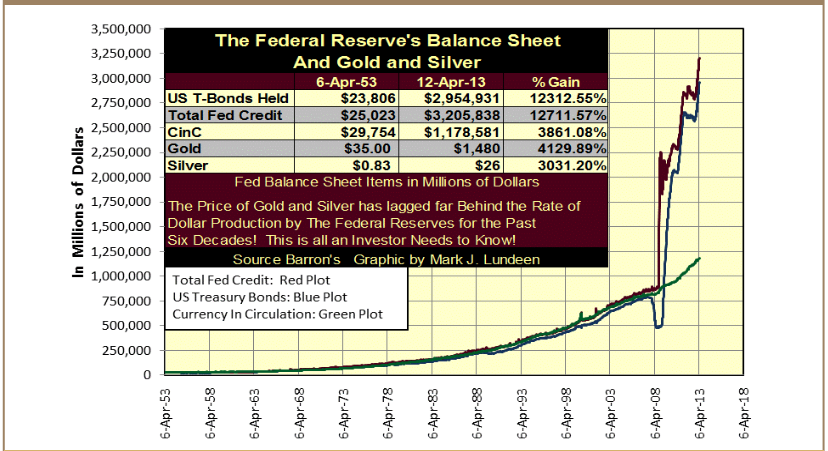
Precious metals investors can't look back at the recent declines in gold and silver and be a little upset. But it's important to keep in mind that nothing happened in the recent few weeks that reversed the decade long bullish trends for gold and silver. So, keep in mind that for over a decade gold and silver have gone up for a reason; the mismanagement of the world's monetary system by the global central banks. That plus all financial assets today have huge counter-party risk thanks to the fraud plagued OTC derivatives market, whose notional value is in the hundreds of trillions. Physical gold and silver have no counter-party risks for their owners, and this makes them especially attractive to forward thinking investors. This lack of counter party risk also makes the old monetary metals objects of ridicule by the global financial industry, who market fraudulent "financial assets" by the trillions of dollars, euros and other currencies.

Are there any indications that central bankers have seen the error of their ways at the end of this week? Good grief no! The Bank of Japan has reaffirmed its commitment to destroy the yen as an economic asset, and the ECB is scheming to confiscate Cypress's "excess gold reserves". Our Doctor Bernanke is no monetary slouch either. Look at the post credit crisis Federal Reserve's balance sheet in the chart below. Since 2008 the supply of newly created digital dollars has exploded. If US Currency in Circulation (CinC / Green Plot) lags behind the growth in digital dollars (Blue and Red Plots), it is most likely because the Earth doesn't grow enough cotton to supply both the world's textile mills and the US Treasury's need for high-grade cotton based paper for its paper money production. That's a scary thought that just might be true!

If the price of gold and silver have been correcting since 2011, it's because after over four decades since the US closed its gold window, where foreign central banks could exchange their excess paper dollars for US government gold, the world at large has forgotten that once there was a linkage between the supply of dollars and the price of gold. This is true today: gold has been decoupled from the concept of money in the minds of most people. But remember that in the past few years, foreign central banks have once again seen value increasing their holdings of gold as a monetary asset, and have voiced concerns over the management of the worlds' "reserve currency"; the US dollar. China and India are buying huge amounts of gold, as is Russia and other eastern central banks. The European Central Bank is looking at increasing its gold horde too. It has snatched Cypress's "excess gold reserves" as part of its bailout package.

Currently, US Treasury bonds are the mainstay reserve asset for central bank "monetary policy", but with the United States refusing to conduct its fiscal policy in a responsible manner, the ever rising US National Debt must be causing great concern for the future value of Uncle Sam's IOUs. One week last November, the holdings of foreign CBs US treasuries dropped by 11.63 per cent. We haven't seen anything like that since the "Asian Contagion" of 1998. But the 1998 sell off was widely reported on in the financial media, but strangely last November's 11 per cent one week decline was not. This was a reduction of $420 billion dollars in the foreign central

Federal Reserve Balance Sheet



Source: Barrons

bank holdings of US Treasury bonds. How much of this money was used to purchase gold?

Back when Alan Greenspan could move the markets by mumbling total economic nonsense, it seemed to make sense to have America de-industrialize, and ship its manufacturing capacity overseas. The world would make what America wanted to purchase in exchange for digital dollars and AAA-rated US Treasury debt. How else could China have industrialized in just a few decades after Mao's death? If Washington hadn't burdened American manufacturers with unreasonable environmental, and other self-destructive regulations and a tax system that made domestic manufacturing unprofitable, former third-world countries, like China, would never have achieved the current world class manufacturing base they now have, and the American middle-class would not now be in dire straits for lack of viable employment opportunities. Obama's healthcare law is just the latest of many legislated burdens on American industry the Democratic party has inflicted on the economy, and the Republican party will refuse to free business of.

Losing Glitter

However in the age of Bernanke, the benefits of accepting digital dollars and stockpiling US Treasury debt in return for manufacturing merchandise for the United States is beginning to become unacceptable to America's trading partners. Currently, there is a growing trend where international trade is being conducted without the use of the American "reserve currency." This trend has profound implications for the US dollar, and the price of gold and silver, as taken to its logical conclusion means that the world will no longer have an economic reason to hold dollars and US Treasury debt to conduct international trade. Trillions of dollars and US Treasury bonds will one day return to the one country that must accept them – the United States. The inflationary impact on consumer prices in the US will be significant as dollars flood back into the US, and consumer goods exit American markets. Can this happen? With the entrenched political interest now in control of Washington, what is there to prevent it from happening?

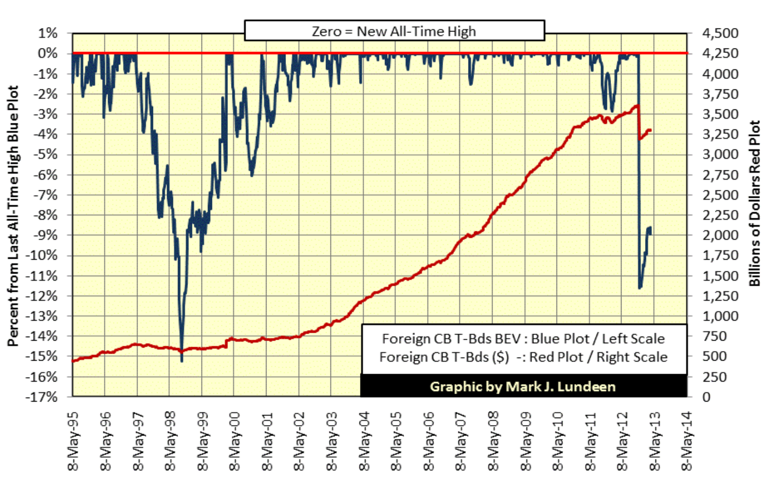
The United States faces real problems today, problems that are not being addressed by Washington. Look at our Electrical Power (EP) Consumption. Its last all-time high was seen in August 2008, and has been struggling for almost five years now. Washington's economists and statisticians may claim that we are now seeing "economic growth", but most of their statistics are measured in dollar terms. Go back and look at the Federal Reserve's balance sheet chart above. Doctor Bernanke has increased the supply of dollars in the economy by over 200 per cent in a vain effort to "stimulate" the economy. It's actually shocking how little impact Bernanke's quantitative easings have had on American economic demand for kilowatts.

When interest rates and bond yields once again rise to levels last seen in 2008, I expect to see demand for EP to break below its lows of 2009, and for the same reason; an interest-rate derivatives disaster that will disrupt the banking system ability to function. Absolutely nothing has changed since 2008. Washington is once again attempting to inflate a bubble in the real estate market as a means to "stimulate" the economy. It's just a matter of time before we see another and larger credit crisis.

Some Interesting Facts

All and all, the reasons for owning gold and silver have never been stronger. The problem with the old monetary metals is that governments around the world currently don't want to see precious metals prices increase as they over issue their fiat currencies. So, they look the other way as their banking systems use the world's futures markets to flood the gold and silver paper markets with promises to deliver gold and silver that doesn't exist to suppress metal prices. But this scheme can only work as long as the physical market can deliver real metal at artificial low prices. The West's central banks have

Foreign Central Bank US Debt Holding in Billions & BEV



Source: Barron's

kept this scam going for well over a decade, but how much longer can they continue it? For as long as their gold reserves last I suspect.

Here's an ugly chart! Clearly the "policy makers" are hoping to begin a selling panic in the gold pits. But the price of gold has been in a downtrend since August 2011. I doubt the gold bulls are shocked by this now old trick by the big NY and London banks. The buyers who like to purchase real gold by the ton, like Eastern central banks must be hoping for more of the same next week. No matter, even if the paper traders in the gold market can force another huge sell off, gold and silver's current correction is getting very stale. I expect the price of gold in 2013 will become the thirteenth up year in a row. But even if I'm wrong, it changes nothing in a world whose "monetary policy" is controlled by incompetent bankers, academics and politicians.

Gold's Bear's Eye View chart is probable the best chart to see the damaged done to the price of gold since its last all-time high of August 2011. From the beginning of the bull market in gold in 2001, we've seen worse declines. Also note that if we compare our current bull market to the 1969-80 bull market in gold, our current bull market in gold has been a real pussy cat of a bull market when it comes to volatility and deep corrections. Look at the 2008 credit-crisis correction, gold declined only 29 per cent when the Dow Jones saw a 53 per cent decline. The truth is that since 2001, gold and silver bullion have been superior investments to blue-chip stocks for those investing for the long term, though this is a point never presented to the public at large by the financial media.

In silver's BEV chart below, we see how silver is the more volatile of the two monetary metals, but actually silver has been more profitable than gold since their bull markets began over a decade ago. This has also been true since their credit crisis bottoms in October 2008. Silver's D correction (the credit crisis) looks pretty bad, but it was only 4 per cent points deeper than the Dow's 53 per cent correction, and then silver went on to new BEV Zeros in 2010, three years before the Dow Jones did. I can't argue that correction E hasn't been deep in both time and valuation, but it is only a correction in a continuing bull market; a time when one can accumulate silver at cheaper prices.

Silver still has a good way to go before it breaks below its decline of October 2008. It would have to fall to $20.80 to see a similar 57 per cent decline. The question is can the big NY banks sell enough paper silver to make that happen? Sure they can, but what happens if someone should ask for actual delivery to settle their contracts with J.P. Morgan? Morgan is a bank, not a silver miner. It doesn't have sufficient silver of its own to settle their massive short position that currently is counted in the hundreds of millions of ounces.

The Luster could Last

Normally this isn't a problem, as most future contracts are settled in dollars. But it seems to me that we are currently living in historic times that to our great misfortune will be remembered for many generations to come. Wall Street and Washington have pushed things right up to the edge of the abyss. Something really bad is going to happen and it will start with an unexpected event that is off most people's radar. Seeing J.P. Morgan defaulting on their naked short position could very well be the trigger to another economic crisis. But if not that, it will be something else will come along and knock this house of cards down in the financial markets.

One thing for sure is that many eastern central banks are now moving into gold, and away from the US dollar and US bonds for very good reasons. Knowing that is probably the best investment tip one could take in 2013.

Shared CFO Services

Promising Future

With high influx of sophisticated investors such as private equity players and venture capitalists, there is a growing need for optimum financial management, need for integrating business & finance function well. But the current skill deficit and cost for full time CFO to a majority of SMEs is often prohibitive. But help is now at hand, thanks to the concept of shared CFO services, a new yet robust concept pioneered and popularised by a Mumbai-based promising start-up, IxCFO. In a candid interview with The Global ANALYST, Sanjay Gaggar, Founder Partner, IxCFO, shares his firm's objectives, growth opportunities, his experiences so far, competitive landscape, and challenges, going forward.

Where did the idea to start CFO outsourcing services come from?

The fundamental objective behind setting up a shared services centres (SSC) was to leverage economy of scale, manpower productivity, standardisation of non-core processes and liberate management time for more focus on business issues. Shared services for major back office functions like talent management, administration, accounting, monitoring statutory compliances, implementation and maintenance of computerised systems, etc., are very common in large business setups.

Of late, we have seen fundamental changes in Indian economy and business transformations across sectors and industries. Some of them are:

- Globalisation and integration of Indian economy with the world economy to a significant extent;
- Aspiration of Indian businesses to grow across geographies;
- Generation shift in ownership pattern with strategic shift to business outlook;
- Influx of highly sophisticated capital, e.g., Private Equity / Venture Capital Investors;
- Large advancement in share of services sector to about 64.8 per cent of India's GDP (Source – Economic Survey, Ministry of Finance, 2012-13, GoI) leading to plethora of new services and innovation around them;
- Advancement in all forms of communication and internet technology, and so on.

This led to our belief that it is the right time to get into this space by positioning a Shared CFO Platform. And thus was born the IxCFO platform. The model, while catering to MSME businesses also offers gainful and job enriching opportunities to highly skilled practicing CFOs/Controllers.

Can you explain about the business model of your firm? How does the concept work?

Our competent CFOs/Controller Partners manage multiple SME business owners under agreed virtual and shared CFO services mandate with high level of multi-faceted professional competencies and standards. While Virtual CFO is more about serving clients off-site via telecommunication technology, shared CFO is largely on-site presence at our clients' offices. We have also chalked out unique proprietary engagement model keeping in mind traditional and strategic role of CFOs.

We also have extensive network of specialised advisors working under our guidance while providing CFO services and assist us in business and finance integration engagement per standard and customised solutions that defined quantifiable measurable matrix across our deliverables.

We first get into understanding of the complete business in terms of its size and complexities, organization structure, role of finance and accounts functions, etc. We also understand the current gaps in various back office functions required to support the client's business and then map them to our CFO services engagement products in order to figure out expectations of the concerned business owners to bridge the gaps. This may take typically two to three meetings with the business owner, his senior leadership team and auditors, if required, to agree on a common page of clear understanding of issues.

Based on this understanding, a detailed draft of CFO services mandate is given to business owners in terms of engagement unfolding on quality matrix, timeline and commercial factors.

In terms of our pricing, we generally adopt very flexible engagement on many criteria like initial ramping up phase, ramping down and then even virtual CFO only. Pricing is the factor of company size, complexities, timeline for deliverables, knowledge, skill to resolve issue and our efforts required to address with the mix of CFO resources we need to plug-in. However, in a typical engagement for CFO retainership (virtual or shared CFO), our monthly engagement commands a price bandwidth of say Rs. 50,000 to Rs.3,00,000 per month (for a typical traditional operation centric CFO role in finance).

What are the various types of services your firm offers?

We are serving business owners under different ownership patterns like family setups, technocrats, professionals, PE/VC fund portfolio Companies and mid-size corporates on traditional CFO role under the following two services:

- Tx = Transaction Assurance, Processes and Controls, and
- Fx = Financial Health Management and Business Support Services

Under Tx offering, we believe that right IT platform for financial scorekeeping with robust interface with various other sub-systems on operations, CRM, etc., is the key to streamline and integrate processes centric controls. In the event clients soliciting our services to set up a suitable IT enabled platform for their financial accounting and reporting systems, we provide specialised services also which can in other words be termed as the services of a CIO.

With regard to Fx offering, this has to be seen with respect to measuring key KPIs coming from sound MIS system. Fx offering is key to monitor the business sustainability and growth measurement while addressing concerns on profitability, cash flow and line items of assets and liabilities in balance sheet at its core.

On CFO's strategic side, we have an offering called Ix = Inorganic and Organic Growth business plan Xecution Services

Under this offering, we focus more on integrating finance with business strategy as an enabler and effective execution capabilities which will require high level of skill set at the disposal of CFO. Some of the issues, which we address here, are like post integration M&A issues, raising capital by addressing equity and / or business valuation / dilution issues as appropriate, corporate restructuring involving spin-offs, slump-sale, off-shore/on-shore cross country structuring and tax optimisation led business combinations, etc. In all of the above service products, we stick to our logo of integrating best of management practices with excellence (X factor) and Integrity (Core of I)

How do you plan to differentiate your offerings from the competition? How is it different from the existing CA firms that offer consultancy and tax planning services amongst others?

It is very important to add clarity in terms of measurable matrix with defined drill down engagement under structured bucketed offering. This is then followed with proactive periodical review with business owners, cross-functional operations review led by our CFO partner so as to assess the impact on deliverables. This gives visibility on cost vis-a-vis benefit to Indian MSME business owners.

Our offerings are clearly packaged and bucketed to add clarity in terms of our engagement flow from bottom-up approach. It is very important to get into business understanding with MSME business owner by performing traditional CFO role and then gradually moving into high level of strategic deliverables, once business achieve scale, ready to accept our CFO Partner into more strategic assignment.

One big differentiating factor in our engagement is our people centric role led by a professional CFO/Controller with not less than 10 years' industry experience and that makes entire engagement highly productive from day one with real value added to our clients.

Practicing CAs, we believe, bring altogether different set of expertise for governance, compliance, taxation, audit functions etc. This has been traditional forte of these professionals. And with growing complexities across tax / non-tax laws as regulatory forces are becoming more active on governance certification from independent professionals, all these leave little time to focus on the role of CFO at their end. This has created the need to have different set of professionals offering CFO services like us.

Your target client base essentially comprises of MSME. Why did you choose this segment? Can this service be extended to large corporates too?

SME in India is large segments if we look at the following statistical analyses: "Worldwide, micro, small and medium enterprises (MSMEs) have been accepted as the engine of economic growth and for promoting equitable development. MSMEs constitute over 90 per cent of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production, services and exports.

In India too, they play a pivotal role in the overall industrial economy of the country. MSMEs in India account for more than 80 per cent of the total number of industrial enterprises and produce over 8000 value-added products. It is estimated that in terms of value, the sector accounts for 45 per cent of the manufacturing output and 40 per cent of the total exports of the country and employs over 6 crore people." (Source – msmementor.in, Ministry of MSME, India)

Given the exposure of the above magnitude, we believe that shared CFO services has large market to address coupled with the fundamental shift in business outlook as pointed out earlier.

We do offer specialised assignments based offering to large corporates as they already have full time CFO function in-house. Our services are largely in the nature of assistance to existing CFO function in the form of providing value-added skills which large companies may not have in-house.

What kind of hurdles do you face while convincing clients of the value proposition your firm offers?

Many times, Clients in SMEs lack even basic understanding of finance, role and critical importance of back office function, including statutory compliances, and we need to build their finance function from scratch. This is where our standard and customised approach towards our traditional CFO offerings Tx and Fx come handy.

As we roll out our engagement, significant time is being spend in creating awareness and providing learning curve to business owners on CFO function. At times, we see lot of resistance to both 'must have and good to have' practices, which we recommend and this poses as a stumbling block while phasing out old systems, controls and reporting mechanisms. Principles around 'Change Management' is something which CFOs in SMEs must be able to tread with taking all stakeholders in confidence creating a mid to long term all pervasive impact.

Given that the CFO function is vital from any firm's point of view, do you feel that this can act as a major hindrance in convincing clients to go for shared services like yours?

Since our engagements are for MSME business owners, who have never experienced or hired full time CFO in past, in all our engagement, we practically work with BOOT (build-own-operate-transfer) model wherein we engage ourselves as Shared-CFOs by starting building finance function, take the complete responsibility on deliverables, as if we are a full time CFOs, operate for defined period of retainership engagement, say one year to start with, and then transfer the entire knowledge by recommending hiring a full time CFO and / or Controller at an appropriate point of time.

We realise the importance of CFO function at a time when business is into growth / hyper growth mode with full scalable traction. At that time, shared CFO services should better be migrated to full time CFO services and we proactively recommend this to business owners for transition.

In such migration, business owner may decide to continue our engagement in a strategic business consultant's role

How do you view the competitive landscape in the shared CFO space in the country?

There are very few dedicated, organised and knowledge-led platforms like IxCFO with presence of experienced CFO partners across all major metros and Tier-1 Cities. Many of these SMEs are relying on traditional services from CAs / local city based ex-finance professionals / freelancers to build CFO finance backbone which falls short of requirements due to change in time, increasingly stringent regulatory provisions and multi-faceted business dynamics.

Also, with growing standardisation and customisable approach across our bucket-based offerings, our CFO services are a leading differentiation to our competitors and mitigate the risk of failed CFO function.

In a recent unofficial (but very reliable sources) based assessment on some of the niche criteria and regulatory filings, IxCFO stands amongst the top three organised CFO services providers in India.

We also believe that is important to have healthy competition in a nascent market like India at this stage to create awareness and for the future growth of CFO services market just as they are in other developed markets like the US, European zone. In CFO services space, we believe that knowledge management, benchmarking practices by raising the bar constantly and ethical practices will be key to differentiation in the long run.

• How big is the market size, and also how do you plan to scale up your operations?

It is too difficult to estimate the market size. However, given that USD 8-10 billion of FDI flow coming every year via Private Equity into high growth sectors and large amount of money flowing in the MSME sector as priority sector lending via Banks / FIs, we presume that market is quietly carved out and if one focuses with right offerings, successful past case studies, our shared CFO services will command good amount of market size with 100 per cent growth expected over next 3 years on current base.

We regularly interact and network with various trade, knowledge and apex bodies in SME world. This gives us the platform to present our services via our "customer acquisition and retention" programme for the benefit of all. Our last 30 months' learning experience has given us enough lead on conversion / renewals or extension of existing CFO mandates based on relationship, trust, quality of deliverables with strict turnaround on timeline factors.

Are you also looking at external funding sources such as Private Equity or Angel Investors?

At present, we do not have plans to tap funds from Angel and VC. However, there is some very preliminary level of interest shown by big financial services firm, but we have not got back to them. PE investing is something which is far away given the current position about our company's top-line and the number of clients.

As a part of our growth strategy, we are focused at present on customer service and our internal guidance to all our partners is "Listen to customer and deliver with speed and quality" to create high impact of shared CFO bringing valuation in the form of intangibles, brand building and sustained knowledge-based 'Intellectual Practices' which we are creating in the process.

We will be keen to certify our model with ISO certification as time progresses so as to take advantages of our inherent strengths around structured services offerings.

What are the key challenges your firm could face, going ahead? Also, what strategy do you have in place to deal with them?

Our key challenges will be as under –

- Lack of awareness about such services;
- Finance, being back office function, is a non-priority area for many of these SME's;
- The given reality that the CFO as the key driver of business values along with the CEO, adopting partner centric approach, is not being understood by many owners of SME owners,
- Talent crunch; i.e., the challenge to tap right skill with very balance state of 'consulting' cum 'implementation' ability.

Way Forward

We are absolutely confident that with our dedication, professional ethics, commitment and sustained efforts for ensuring quality and speed of deliverables, we shall be able to continue pioneering this niche area of providing value added services to our MSME clients . We think, with great team work, our platform will be our humble contribution to vast growing role of MSME sectors of country in nation building, coupled and making businesses more sustainable and competitive in time to come. We believe that this should give our business community an edge over the others MSME's of the world. TGA

Consumer Electronics

Winning the Technology War – What it Takes!

Wireless will be the center of the universe going forward for many years to come. Not every company will win, but the industry in general will reward companies that stay on track, keep innovating and know how to market.

Jeff Kagan

Technology Industry Analyst
Atlanta, Georgia, US

What are the new opportunities and challenges for the wireless industry and Smartphones going forward? There are plenty of both. During the last decade, the global consumer electronics industry has gone through a rapid disruption and reinvention. Today new technologies are leading, while yesterday's leaders are getting lost in the dust. Let's take a look at where we've come from, where we are today, and where we are heading tomorrow. As a technology industry analyst and consultant I have worked with and followed countless companies over the last 25 years. I regularly comment on the changing industry and can say I see no slowdown ahead. However things will be different. Until about five or six years ago the wireless segment was growing and changing at a normal pace.

Leaders were companies like Nokia and RIM Blackberry. Apple and Google were not even on the map yet. Motorola had fallen off the growth track, but started doing a decent job with their Razr. The Palm

Smartphone was smaller, but solid. Then the earth shook as the Apple iPhone and Google Android were introduced about six years ago, and everything changed overnight. Suddenly the Smartphone was the place to be. Suddenly apps increased from a few hundreds to nearly a million so far.

Customers rushed the stores and consumed these devices. The consumer electronics industry snapped into action and started down this Smartphone path. Some companies are doing better than others. Today Apple and Google with their iPhone and Android operating systems lead. According to some reports they have roughly 90% of the marketplace. Today Apple and Samsung lead the way with handsets.

At the same time, past leaders like Blackberry and Nokia after dropping like a rock, are struggling to hang on, reinvent themselves and grow once again. They have recently introduced some new and good technology, but they still have not broken through to the big time with their devices. Back in their heydays both RIM Blackberry and Nokia looked invincible. And at that moment in time, they were. But as time passes no company can remain invincible. Today it's Apple and Google who look invincible. How long will they last in that position?

Creating the Waves, and not just Riding the Old One holds the Key!

Every company rides the growth wave until it consumes them. They are either growing on the wave, or they are cresting, or they are falling. It happens to every company and every technology. There are countless examples. Remember the Sony Walkman as another example? Some companies can extend their ride on the way up the wave by creating the next wave to ride on, like Apple. Other companies can't and simply ride their one wave up and back down again, like Motorola.

Apple is a great example of a company that created wave after wave and kept growing since their low point in the 1990's. The iPod started their climb, then the iPhone and the iPad. That's good, but unfortunately they have had no new introductions in the past year or two so the waves they rode to success may be cresting. The Apple intensity is easing. Motorola is a great example of a company who was a leader for decades, but whose growth wave stopped in the mid 1990's. Motorola had a come back moment with the Razr that lasted a few years in the early 2000's, but that was just one wave. Without a next wave to ride they simply rode that one up then back down again.

Now they are rebuilding once again with Google Android and the Droid brand. Sometimes these waves are created by the normal course of time. Other times they are created by a sudden event like a technology or marketing earthquake. That's what Apple and Google presented to us six years ago. Samsung, using Google Android also grew to be a leader. Now these three are the leaders in the wireless operating system and handset space. New replacing the old.

Carriers like AT&T Mobility and Verizon Wireless who have won more than 70 percent market share in the United States are great examples of companies who are pushing past old conceptions and transforming the wireless industry into new areas. They are active in not only expanding the Smartphone industry, but also welcoming new ideas and technology and updating other industries as well. This is a path and opportunity I think every carrier, worldwide will take.

Knowing the Tomorrow

So if the marketplace can and does often change quickly, what's coming next? What does tomorrow look like? That is the question we all would like to know.

There is no way to know for sure, but we can look at current events and the dreams of leaders and make some educated guesses. Remember, the current wave we are riding just started five years ago. If the same question was asked five years ago would anyone have said RIM and Nokia would no longer lead, and Apple, Google and Samsung would. I don't think so. If that is the case, let's think about what will the marketplace look like in another five years? Who will the leaders be? What new technology ideas will we be using?

Today, Google Android, Apple iPhone and Samsung handsets are leading so we expect them to continue. However, we thought Apple was bullet proof until last year; didn't we? Suddenly they are showing slowing growth. No company rides the growth side of the wave forever. There are ebbs and flows. New ideas and technologies take the industry to new places we are not even thinking about today.

Shape of Things to Come!

So what is brand new and what is coming in the wireless world. There are a number of different areas to keep your eyes on. One is obviously change in the traditional Smartphone market. During the last few years the focus has been on Apple iPhone and Google Android. Now that is shifting. We are paying attention to companies like Samsung, leader in Android handsets.

We are also looking to see who will win the number three spot. Companies like Blackberry and Nokia are trying to capture that spot, but so are other handset makers. Companies like Microsoft on the operating systems side and like Sony Mobile Xperia, Motorola, Huawei, HTC, ZTE, LG on the handset side are all trying to capture a larger market share as well, and have number three in their sites. Always ask, how will the marketplace change, because you know it will. Which of these companies will hit number three? Sure, any of them can. It's not just about the handset technology, but it's also about the marketing, advertising and public relations.

Technology and marketing are two important pieces of this puzzle. A few weeks ago, at Carnegie Hall in New York City, Samsung introduced their Galaxy 4 in what may be the largest show biz type introductory event of all time in the wireless industry. This event raised Samsung in the consciousness of the marketplace. That helped Samsung, but the question I have is simple. On one hand this may have been great, but on the other hand, how will they top it next time? And how will others compete in this new environment? The bar is continually rising. It appears that over the last several years, wireless, show business and entertainment are coming together. So what's next? Plenty.

Can Facebook Launcher be a Game Changer?

Facebook, a non-wireless company recently held their large Facebook Home announcement and attracted the kind of media attention that would make Steve Jobs of Apple proud. Facebook, like Apple when it started, is not a wireless company. They are just using wireless Launchers to expand their business. However, like Apple, Facebook could change the industry in new and uncertain ways. Facebook is using wireless Launchers, which are brand new to the marketplace, but will play an increasingly large role going forward. Launchers are on the handset screen.

This announcement had a Launcher or customized home page created by Facebook. That opens the door to many other companies to do the same thing. We are watching the beginning of a new sector in wireless. Launchers. So expect many other similar introductions going forward. But it goes far beyond this one company and this one Launcher, or even more of them from more companies. Some customers may like this Facebook home page, but others may only like it once in a while. Perhaps the user would like several of these Launcher home screens from different companies.

That means as a next step we have to come up with a way to manage multiple Launchers or home screens. And what about developing your own, personal Launcher that looks the way you like, and includes companies and items of interest to you. Can you imagine companies jumping on this opportunity? I can. Plus there are other industries, which want to use wireless to drag themselves into the future. Some companies in every industry will be first. This will give them a competitive advantage for a while. Then after a little time, suddenly every competitor jumps into the same space because customers love it and want it. Then it changes from a competitive advantage to a key service every company needs. Some will be better than others at this.

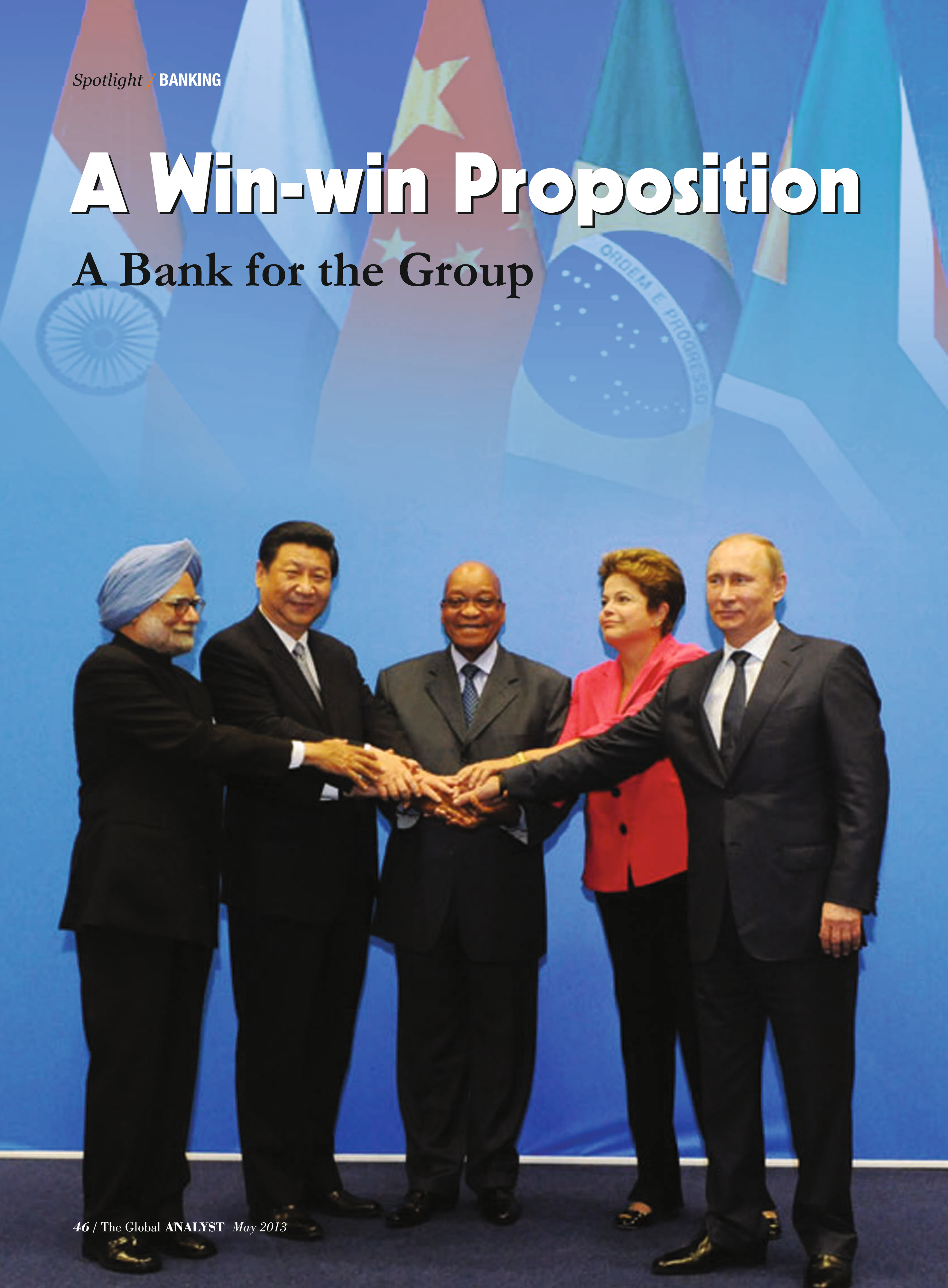
Industry after industry can use the wireless industry to update the way they do business. Retail stores will sense you are walking into their store and text your personalized coupons based on past visits and purchases. You'll be able to test your diabetes blood sugar numbers and send them to your doctor for ongoing management skipping one doctor's appointment. Imagine what else we have in store. We are seeing this already from industries like retail, automotive and healthcare, but the opportunity is huge with every industry. Helping every other industry is one of the big growth opportunities for the wireless industry. The big challenge is getting wireless executives to understand and communicate with other industry executives to make these dreams come true.

But not Everyone would Win

We are surrounded by both challenges and opportunities. Wireless will become the center of the universe for industry after industry. Plus there will be new technologies we haven't even thought of yet. Wireless will be the center of the universe going forward for many years to come. Not every company will win, but the industry in general will reward companies that stay on track, keep innovating and know how to market. Leaders who blaze new trails will not only win, but will pave the road we will all ride on over the next decade as customers, investors and workers. TGA

A Win-win Proposition

A Bank for the Group



The new development bank will be conducive to inter-BRICS cooperation and the steady growth and development of the world economy. It will open up more opportunities for achieving mutual benefit and win-win results amongst BRICS nations.

Rajesh Mokashi

Deputy Managing Director,
CARE Ratings, Mumbai

The concept of a BRICS development bank, prima facie, looks a good idea. An agreement amongst BRICS nations to establish a new development bank can be hailed as a boon to the five emerging economies as well as the global economy. The top five emerging economies which account for around 43 per cent of the world's population and contribute 25 per cent of world GDP are putting together a bank which helps not just these nations but others too. The bank's main objective would be disbursing funds to core sector projects within the five-nation grouping and other emerging economies.

The bank would help strengthen economic cooperation amongst the BRICS nations and provide for additional and niche financing. The bank would provide developing countries with financing support and policy consultation in areas of infrastructure investment, trade facilitation and poverty reduction. The BRICS bank would help stabilize the financial market by funding infrastructure construction in developing nations and smoothing possible capital market fluctuations.

The new development bank will be conducive to inter-BRICS cooperation and the steady growth and development of the world economy. It will open up more opportunities for achieving mutual benefit and win-win results amongst BRICS nations (Brazil, Russia, India, China and South Africa), and these opportunities will outweigh the challenges brought by diverging interests. As emerging forces on the global economic arena, the BRICS nations have enjoyed increasing shares in the world's combined GDP and trade volume, and they have started to play a more important role in improving global governance.

Need for the BRICS Bank and Key Objectives

Multilateral bodies such as World Bank, IMF, and ADB, etc., have helped create a "liberal order" for the world, promoting free markets and democratic governance in the way they provide economic assistance or agree on rules for commerce. Most of all that order has spread the very notion of a global system based on values and not just national interests.

Currently, countries gain access to international capital through loans from the World Bank and International Monetary Fund (IMF). Both institutions, which provide loans to fund major infrastructure projects or stabilize economies that are in trouble, are based in Washington, D.C. The creation of a BRICS development bank could offer countries a way to negotiate for various loans much more directly. BRICS partners appear to regard the bank as an alternative to the World Bank and the IMF, suggesting they would want to invest in each other and possibly other emerging countries' infrastructure projects much more directly.

The BRICS bank is seen as a way of challenging the rules set by existing institutions like the World Bank, countering Europe's economic crisis and addressing the $4.5tn in infrastructure spending the BRICS are estimated to need over the next five years. The stated goal of the new BRICS development bank is to provide its members with a way to pool money for investment in targeted infrastructure projects amongst themselves. But the project also aims to support increased commerce between the BRICS and other emerging economies. Along with the creation of development bank, creation of a $100bn Contingent Reserve Agreement (CRA)to pool reserves was also proposed, with China contributing $41bn, Brazil, India and Russia $18bneach and South Africa shelling out $5bn.

The need for establishment of a new bank hints that the funds provided by the multilateral development banks (MDBs), mainly World Bank and IMF, have fallen short of the investment needs of these countries. The BRICS countries want a new financing institution for several reasons. Firstly, the investment needs of these countries are massive. All the multilateral development banks (MDBs) taken together are able to finance only about 5 per cent of these needs. Anew development bank would primarily serve the needs of BRICS countries, especially for countries that badly need a large investment in infrastructure, such as India. Generally speaking, all of the BRICS need to improve their infrastructure. Therefore, a development bank could provide resources in addition to those given by the central government. Secondly, the processes and requirements of the MDBs are too slow, cumbersome and restrictive.

There are governance problems, reforms of the IMF and the World Bank have been considerably delayed because of governance issues. The BRICS countries require a more responsive and agile institution to help them with their evolving needs. Thirdly, the BRICS countries lack adequate voice in the MDBs. With their growing political stature and economic strengths, they need an institution in which they have the ability to influence the vision and direction.

The idea of a BRICS Bank addresses most of these concerns. It also helps in rebalancing global financial flows. These countries have large reserves and high saving rates, although these ironically coexist with huge investment needs. Predominantly these reserves are invested in western countries. Using these resources domestically could improve the welfare of their people and strengthen the fundamental conditions for sustainable economic growth. The establishment of a BRICS Bank opens up exciting opportunities with substantial financing coming from the BRICS Bank and the other MDBs playing complementary role. Knowing each other's urgent needs, the BRICS countries could deliver mutual assistance in a more equal and effective way via the bank, as well as enhance the group's standing in the global financial system.

There are also political incentives behind this new development bank. The World Bank has been dominated by the West for more than half century. A BRICS development bank represents the growing influence of developing countries. It could provide a platform for BRICS to promote international financial system reform. Furthermore, a BRICS development bank could serve as a vehicle of concrete cooperation. A new common development bank by the BRICS could become meaningful point of cooperation and help the world focus on improved global financial governance.

The setting up of the bank would be an important step which can address gaps and challenges in critical sectors. The public and private sectors in these countries could be expected to seize opportunities and evolve collaboration at the level of group, bilateral as well as third country collaborations. The bank's very existence would play to the idea of a free market of ideas, or a competition based on merit. And it will likely be run in a democratic way. The success of the new bank will depend on how the BRICS governments lay the foundation on key issues of concern like capital, membership and governance.

Challenges Ahead of BRICS

The "club" of BRICS nations – Brazil, Russia, India, China, and South Africa – was started only four years ago. Although a BRICS development bank could play a critical role in global development, many risks and challenges lie ahead. The BRICS countries have certain dissimilarities which could come in the way of policy making. Three of the five nations are at different levels of growth rate.

Further, unemployment levels are much higher for South Africa and India, which compels governments to play a more active role in social programmes. Inflation appears to be fairly high in 4 of the 5 nations, with India topping at 7.5 per cent (average FY13). Differential inflation will provide an advantage to the country with high inflation as it can use other currencies to procure cheaper goods. Interest rates are again high in three of the group countries and low in China and Brazil, which will make it attractive for the others to borrow from these markets and currencies. The BRICS countries also differ in development levels and foreign trade and investment influences, and face diverse domestic and international problems. These factors may lead to different goals and demands.

Before the BRICS countries can agree to the establishment of a development bank, the countries must decide how the bank will be governed. In addition to the technical issues, there are some sensitive issues such as where to set up headquarters and how to choose a president and high ranking officials of the bank and the currency of transactions. BRICS, after all, have many differences in political and economic systems and in the international geopolitical status. It was the international financial crisis and the instability in international markets that put them into similarly difficult situations, and they tried to avoid the damage of external shocks by cooperating.

Although their cooperation is increasing recently, there is competition amongst the BRICS and they have different views on many issues. It will take time to build political and economic trust amongst the BRICS. So a new development bank would have to overcome many difficult challenges before it could play an important role as mentioned above.

Growing economic strength has given BRICS more confidence to take responsibility in providing global development finance and working for global stability and governance. All five countries are willing to enhance their internal trade and investment to create a wider base for further cooperation.

China vs. BRIS countries

The Indian finance ministry has been given the responsibility to work out a road map for the proposed BRICS bank. Experts from the Finance Ministry and the RBI will be jointly drawing a rough road map, which could be informally discussed at an interim summit at St. Petersburg in Russia in September 2013 and later fleshed out before a full BRICS summit at Brazil in 2014.

Also, in the next summit, BRICS countries need to reach a consensus on the capital composition, governance structure, location, the person heading the proposed organization amongst others. Shareholding pattern would be amongst the important decisions since that would decide the voting pattern.

China, which has the largest forex reserves of over $3.2tn, would be expected to pitch for control of the bank by offering a bigger initial contribution. However, the capital contribution and voting rights should be based on the principle of equity so as to ensure that the BRICS bank should not duplicate asymmetries of the Bretton Woods institutions. This would also ensure that no country has the power to influence who is given loans. Another important aspect would be the currency involved. Much of both the trade and investment is expected to be led by China. In fact, China, which is continuing to power itself to becoming the largest economy in the world, would be pushing for usage of Yuan in the lending as well as trading activities. However, it is only fair to use the dollar or Euro in any of the transactions before the BRICS committee decides on a universal currency to use.

Following the consensus on the various aspects required, the BRICS Bank could be seen as a potential game-changer in the BRICS' larger project of remapping the global financial governance architecture and in spurring infrastructure building in the developing world. The BRICS strategists are also working on new initiatives to scale up intra-BRICS trade to $500bn by 2015.

Way ahead

BRICS was born in the crucible of the global financial crisis during 2009 in the Russian city of Yekaterinburg and had remained focused on economic issues for the first three years. The BRICS group, comprising five emerging economies, has facilitated multilateral cooperation in the world. After four years of development, BRICS has transformed itself from a political idea into a tangible symbol of a multi-polar world. The BRICS countries, especially India, Russia and China, look at this grouping as a platform that provides a counter-narrative to the West-dictated agendas and approach on regional and international issues.

The main mission of BRICS is to find a counterbalance for the structures controlled by the traditional centres of the world economic and political power. In other words, the historical destination of BRICS needs to re-establish a balance in the world system. The ability of BRICS to fulfil this is determined by several factors. The first is their increasing potential power. The second is their readiness to find a "common denominator" in the full range of their national interests. The third is their ability to establish multilateral and bilateral cooperation within the five-member format. Finally, to establish and transmit the mutual interests and positions to the influential international structures and provide the decision-making that will take into account the role of developing centres in the world system. TGA

A New Beginning

Each of the BRICS members sees its own benefits for the BRICS bank to happen. In a world gravitating towards the Emerging and Growth Leading Economies including the BRICS, at a time when Africa, the vast frontier of the developing world is about to take-off, there is a lot of common direction for the BRICS to set aside their differences and cooperate in making the BRICS bank project a success.

The World Bank and the IMF are post World War II Bretton Woods institutions led by the US and a few major European powers. They have called the shots for the past half century in setting the political tone and economic agendas for the developing world. Their recipes, however, have not always proved to be successful and in the best interests of debtor countries.

In "Making Globalization Work" (2006), Joseph Stiglitz (Nobel laureate 2001) exposed how these institutions were not only "not doing all they could to help (the developing)... countries but they were sometimes making their life more difficult. IMF programs had clearly worsened the East Asian crisis and the "shock therapy" they had pushed in the former Soviet Union and its satellites played an important role in the failures of the transition." (Preface to the volume)

"The international institutions... who have been entrusted with writing the rules of the game and managing the global economy, reflect the interests of the advanced industrial countries- or, more particularly, special interests (like agriculture and oil) within these countries... This imbalance is seen both in the agenda and in the outcomes in every arena of globalization, from trade to the environment to finance."

Now, world power dynamics has changed. According to a research report by BBVA in March 2013, global growth will be decidedly driven by the Emerging and Growth Leading Economies (EAGLEs) and NEST countries. Between 2012 and 2022, these emerging markets are expected to contribute 68 per cent to world growth. The BRICS countries are top of the pack, led by China and India, both with a higher share than the US. In contrast, the G7 economies will add a mere 16 per cent.

Not only do the BRICS now have the financial wherewithal, their own development paths have largely been the outcome of their own hard struggles, rather than the largess of Bretton Woods institutions. They are therefore inclined to feel that their own development models, albeit not identical with one another, may offer invaluable experience for the developing world while their combined financial muscle may provide the latter with much needed infrastructural and other capacity-building projects better geared to local realities.

These initiatives could supplement the efforts of the World Bank and the IMF at a time when their resources are stretched in meeting the growing demands for development funding. The BRICS approach to solving developmental issues is also likely to be better received than some World Bank/IMF prescriptions of pre-mature liberalism with a Washington Consensus bias.

Andrew P Leung

Chairman and CEO, Andrew Leung International Consultants, Hong Kong

How realistic are the goals?

While much of the detail of a BRICS bank remains unclear, the Thekwini Declaration in Durban embracesa shared goal, as stated below, of building BRICS into a fully-fledged mechanism for coordinating approaches to global economic and political issues with a commitment to global peace, stability, development and cooperation. In particular, its objectives are intended to meet the special needs of the developing world which the Bretton Woods institutions may fail to address.

"We aim at progressively developing BRICS into a full-fledged mechanism of current and long-term coordination on a wide range of key issues of the world economy and politics. The prevailing global governance architecture is regulated by institutions which were conceived in circumstances when the international landscape in all its aspects was characterised by very different challenges and opportunities. As the global economy is being reshaped, we are committed to exploring new models and approaches towards more equitable development and inclusive global growth by emphasising complementarities and building on our respective economic strengths".

An examination of the Declaration reveals the following salient features

(a) A shared BRICS solidarity towards the promotion of international law, multilateralism and the central role of the United Nations (UN)in promoting equitable and sustainable development and inclusive global growth, including the attainment of the Millennium Development Gaols (MDG) by the original target date of 2015 and the affirming of the United Nations Conference on Trade and Development (UNCTAD) as the focal point for interrelated issues of trade, investment, finance and technology from a development perspective;

(b) Highlighting Africa as a target for infrastructural and other development projects to be funded by the BRICS bank;

© Expressing concern about the impact on developing countries of advanced countries' unconventional monetary policy actions which have increased global liquidity and volatility of capital flows, currencies and commodity prices;

(d) Creation of a Contingent Reserve Arrangement (CRA) with an initial size of $100 billion to forestall short-term liquidity pressures, to provide mutual support and to further strengthen the global financial safety net as an additional line of defence for developing countries; and

(e) Calling for timely implementation of reform of International Financial Institutions, particularly the IMF, to make them more representative and to reflect the growing weight of BRICS and other developing countries, and for the next Director-General of the WTO to be a representative of a developing country.

Pending further clarification, the objectives of the BRICS bank are already relatively focused. Africa is a continent on the prowl. According to The Economist, over the 10 years to 2010, six of the world's 10 fastest-growing economies were in sub-Saharan Africa. However, many developmental barriers and challenges remain. Amongst them the lack of capacity-building infrastructure such as transport, schools and hospitals have locked many African countries in a poverty trap of aid addiction. So a BRICS bank geared to infrastructural development particularly in Africa is extremely timely. Additionally, the CRA facility is a welcome insurance policy for the developing world against the tailwind of the West's relentless resort to quantitative easing as an economic tool. The CRA's initial funding of $100 billion is a credible and realistic sum to be shared amongst the BRICS members.

Key priorities before the founding members

As always, the devil is in the detail. The key priorities before the founding members of a BRICS bank would be working out its initial capitalization, its financial share and guarantees amongst Members, its corporate governance and decision-making mechanisms, and its scope for raising funds in capital markets worldwide. The Durban declaration calls for the respective Finance Ministers and Central Bank Governors to negotiate and conclude the necessary agreements to establish the new Development Bank and the Contingent Reserve Arrangement, with progress to be reviewed at the next BRICS meeting in September 2013.

Challenges for the now envisaged bank

In "BRICS without mortar" an article for Project Syndicate dated 3 April, 2013, Joseph Nye, Harvard University professor and former Chairman of the US National Intelligence Council, reiterated his earlier scepticism that "BRIC is not likely to become a serious political organization of like-minded states." His doubt is based on the Members' disparate economic sizes, growth rates, economic models, and political ideologies as well as inherent geopolitical rivalry amongst China, India and Russia, the grouping's three key members.

A Reuters article of March 27, 2013 noted similar doubts by seasoned BRICS observers, noting that the grouping has no political commonality, and lacks concrete institutions to consolidate and leverage their collective clout on the global stage.

To be sure, such observations are valid. Above all, India views China as a geopolitical rival forming strategic ports and outposts in a "string of pearls" stretching from Myanmar, Sri Lanka and Pakistan surrounding India. In addition, long-lasting territorial disputes between China and India continue to be a source of friction. Russia is wary of China's growing economic influence in Central Asia and in her sparsely-populated far eastern territory. Brazil, for its part, sets great store on its proximity and relationship to the United States both as the extant superpower and as the world's largest market. Naturally, the BRICS leaders themselves are only too aware of these realities.

However, zero-sum, binary, all-or-nothing thinking is becoming less and less productive. So is the concept of permanent geopolitical power blocs. In an increasingly multilateral and multi-polar world, countries may choose to cooperate on some issues while adopting a rival position over others. As far as the BRICS are concerned, there are two important imperatives.

First, all BRICS members adopt a strategy of avoiding to belong to a rigid bloc, guarding their respective sovereignty jealously. Second, there are now more common grounds and avenues for cooperation between them than people used to think. For example, in March 2013, China has overtaken the US as Brazil's largest trading partner, a historic milestone since the 1930s. Likewise, China has become South Africa's largest trading partner and is set to become India's largest trading partner within a few years.

As for Russia, China's new President Xi chose it as his first port of call and the two sides have agreed energy deals including a tripling of oil exports to China by Rosneft from 15 million tonnes last year to 45-50 million tonnes, possibly by 2018. According to an article of 23 March 2013in The Diplomat, an online international current-affairs magazine, this will make China the largest consumer of Russian oil. This would be of huge strategic importance to Russia if the European Union should switch its energy imports from Russia to the United States. This prospect is quite likely in the wake of the current American shale gas revolution, turning the United States as an energy-exporter, while a free trade agreement is now being mooted between the United States and the EU.

As for the proposed BRICS bank, the main challenges are how the pooled financial resources are to be disbursed in the light of competing priorities amongst the BRICS members. While there is a common interest in Africa as a vast and promising frontier of the developing world, there could be divergence of views amongst BRICS members as regards individual projects and recipient countries. Such possible differences of opinions may also apply to other regions outside Africa, possibly with greater force. A mechanism must be found so that any such differences are settled quickly and amicably.

Another challenge is the sharing of the financial burden, at least initially, pending the viability of other options such as tapping into global capital markets. On the one hand, all Members want to be treated as equals. On the other, there is little doubt that China is best able to come up with the lion's share. While other BRICS members are wary of China's dominant voice in the BRICS bank, China herself may not necessarily seek one, at least not a veto power similar to that of the US in the IMF. How to come up with a burden sharing formula while apportioning agreeable decision-making powers may tax the vision and ingenuity of BRICS members.

But why another bank?

As explained above, the Bretton Woods institutions founded in a different era are viewed by the developing world as imbued with agendas of the leading advanced countries. Moreover, pending an acceptable outcome of their promised reform, the more financially-capable BRICS are now in a position to seize the initiative in projecting their collective and individual influence by creating an alternative funding platform for the developing world, particularly Africa, where most of the BRICS' common interests lie.

Challenges for India

Amongst the BRICS, China's economy and foreign currency reserve are respectively bigger than the rest of the group combined. Given the economic clout of China, including its position as the largest trading partner and the center of the global production and supply chain, India's challenge is that even if all BRICS members have equal voting powers, the final decision may well be loaded in favor of China. For the bank to work, as an overweight member, China must tread carefully in building trust and solidarity, not unlike during the early days when China adopted the "ASEAN way" of friendship, equality, and consensus in her engagement with ASEAN member countries.

Outlook

It is common knowledge that China already has an extensive financial footprint all over Africa, supported by an array of well-funded Chinese national institutions including the China Development Bank (CDB), Industrial and Commercial Bank of China (ICBC), China International Trade and Investment Corporation (CITIC), China Export and Credit Insurance Corporation (CECIC), Sinosure and the China Export-Import Bank. In addition, a China-Africa Development Fund was established in March 2007 with $1 billion of initial funding by the China Development Bank, which is envisioned to grow to $5 billion in the future.

It has been estimated that China's total direct investment in Africa comes to some $40 billion. In addition, former President Hu Jintao in July 2012 promised loans of $20 billion to African governments for infrastructure and agriculture in the next three years. Moreover, China has surpassed the US and European countries to become Africa's largest trading partner, with two-way trade worth nearly $200 billion in 2012.

The BRICS bank has singled out Africa as a target. With such a predominant presence in Africa, why is China still interested in a BRICS bank which targets Africa?

The probable answer is that China wants to build greater solidarity amongst BRICS countries and with the developing world as a whole as a powerful counterweight against the West. The BRICS bank is a useful alternative to the Bretton Woods financial institutions while Africa is its best theatre where China has built up a vast network and a valuable pool of experience. However, in face of mounting negative backlash, China doesn't want to be seen as seizing the lion's share of investments in Africa. As an added advantage, the likely delivery of early results of BRICS bank projects in Africa would open up avenues for quickening the internationalization of the RMB, the Chinese yuan, in keeping with China's desire to play a greater role in the global financial architecture.

As for the other BRICS members, they equally want to position themselves as global players. As the largest nation in South America, Brazil sees Africa as a huge market for its multinationals, including agricultural products such as food, seeds and machinery, with bilateral trade expanding from$4 billion in 2002 to $20 billion in 2010. Likewise, Indian companies have invested in key sectors like automobile, engineering, chemicals, banking, IT, telecom, drugs, pharmaceuticals, healthcare, education and services. A case in point is Bharti Airtel's recent acquisition of 15 telecom operations in sub-Saharan Africa for $10.7 billion. Not to be outdone, with its Soviet-era ties with Africa, Russian conglomerates have joined in the scramble, not only for the continent's natural resources, but also, as in the case of Russia's Renaissance Group, in capitalizing on Africa's nascent financial sector.

In the final analysis, each of the BRICS members sees its own benefits for the BRICS bank to happen. In a world gravitating towards the Emerging and Growth Leading Economies including the BRICS, at a time when Africa, the vast frontier of the developing world is about to take-off, there is a lot of common direction for the BRICS to set aside their differences and cooperate in making the BRICS bank project a success. TGA

Prospects and Challenges

Success of BRICS Development Bank will pave the way for improving relationship among BRICS nations, creating more opportunities for absorption of surplus capital within the group and channelling resources within the region to needy developing countries. **- MG Warrier.**

The adage 'Necessity is the mother of invention' is true not only in the context of things and ideas generally included in the broad category of inventions, but also in respect of evolution of institutional structure which takes care of governance, administration of law and regulations and management of organisations in various fields including financial sector. If this position is acceptable, one need not be too much on the defensive, when stake-holders in the existing international finance management architecture criticize the proposal for a BRICS Development Bank with a mandate to supplement the long-term financing and foreign direct investment support needed to help developing countries face the challenges of infrastructure development. There is enough space for new development institutions, provided they get the resources and skill support from those who manage material resources and workforce. Having said this, one has to reckon the existence of three institutions having professed objectives, almost identical to those which BRICS Development Bank may pursue. A brief mention of the emergence of these three organisations is considered necessary for clarity in the observations that follow.

World Bank

Conceived at the Bretton Wood Conference in 1944, World Bank came into being in June 1946. The World Bank, comprising two development institutions, namely IBRD and International Development Association (IDA) supports developing countries by providing technical and financial assistance. The large membership (about 185 member countries) and dominance of developed nations like US in policy and guidance have made this institution somewhat unwieldy and to some extent, unpopular among developing countries. India and China, the two major member nations in the BRICS Group, are amongst the first 10 largest shareholders in World Bank with almost 3% and 5% voting rights.

Asian Development Bank

ADB, a regional development bank established in 1966 and operating from Manila, Philippines pursues initiatives aimed at economic development of countries in Asia. It has about 70 member-countries of which more than two-thirds are from the Asian region. In 1974, ADB launched the Asian Development Fund for providing concessional credit to the needy members.

BRICS

BRICS comprising Brazil, Russia, India, China and South Africa(South Africa joined the group in 2010) is an accidental assortment of five nations which have come together not because of their geographical proximity or similarities in approach to common issues or even any proximity on the growth path.

What all of them have in common is the feeling of neglect by the developed world, occasionally trespassing the borders of acceptable levels of ill-treatment and insult in international forums. Some of them, including India, have experienced such neglect even in meetings of bodies of which they are members or were attending on invitation. The irony is, even Durban meeting of BRICS saw the head of a member country being treated shabbily, may be due to the lack of experience of South Africa's 'Event Managers'. The reference here is to the reported stay arrangements for Prime Minister Dr Manmohan Singh, some 40 km away from the city, while his counterparts stayed in posh hotels in Durban close to the venue of the meeting. Being a mature and experienced statesman, he took it in his stride.

The Durban Proposal

The March 27, 2013 announcement from Durban talked about the BRICS decision to establish a new development bank to finance infrastructure and to create a $100 billion Contingency Reserve Arrangement to tackle any financial crisis in emerging economies. The amount may look meager, as the bailout of Cyprus financial sector during the week that followed had talked about the same amount ($100 billion) and the size of that country in terms of population was 0ne-fiftieth of the smallest country in the BRICS group. Still, to make a beginning, $100 billion is not a small amount. In an extended session of the BRICS summit, leaders of the inter-continental grouping considered the proposal for BRICS Development Bank with inputs from their respective finance ministers and declared that they were satisfied about the feasibility and viability of the proposed new international finance institution.

It may be recalled that the idea to set up a new development bank was mooted by India at last year's BRICS summit in Delhi. Here, a word of appreciation for Dr Manmohan Singh would be appropriate. Whatever view one may have about his capabilities in politics and diplomacy, he is the one person who has successfully guided the management of both monetary and fiscal policy in India during trying times. A strong BRICS Development Bank will change not only the fate of economic development in the so called third world, but bring about a change in attitude and the way in which developed countries treat the geographical areas, which, now they believe will perennially remain poor and beg for their mercy for all time to come. The World Bank took note of the proposal for 'BRICS Development Bank' without loss of time, and described it as a significant development, making a promise to work closely with the new bank to end poverty throughout the developing world.

Enough 'Space' for the New Development Bank

Let us first remove the misconception that this development bank is an alternative which will take over the role of the Bretton Woods twins, the IMF and the World Bank in the geographical area covered by BRICS nations. At least initially, the declared objective of the new development bank is to support members of BRICS group and other developing countries in meeting long term investment needs in infrastructure and providing emergency assistance to developing countries in removing poverty. Viewed from this perspective, the new institution's initiatives will only supplement the role being played by IMF and World Bank and there is enough unattended space for the new bank.

In his book 'The end of poverty' (Penguin, 2005), Jeffrey D Sachs made the following observation on capital needed to alleviate extreme poverty: At the most basic level, the key to ending extreme poverty is to enable the poorest of the poor to get their foot on the ladder of development. The development ladder hovers overhead, and the poorest of the poor are stuck beneath it. They lack the minimum amount of capital necessary to get a foothold, and therefore need a boost up to the first rung. The extreme poor lack six major kinds of capital:

- Human capital: health, nutrition, and skills needed for each person to be economically productive
- Business capital: the machinery, facilities, motorized transport used in agriculture, industry, and services
- Infrastructure: roads, power, water and sanitation, airports and seaports, and telecommunication systems, that are critical inputs into business productivity
- Natural capital: arable land, healthy soils, biodiversity, and well-functioning ecosystems that provide the environmental services needed by human society
- Public institutional capital: the commercial law, judicial systems, government services and policing that underpin the peaceful and prosperous division of labour
- Knowledge capital: the scientific and technological know-how that raises productivity in business output and the promotion of physical and natural capital"

The twin objectives of supporting infrastructure development and creating a Contingency Reserve Fund to assist needy developing countries accepted by the BRICS leadership while mooting the idea of a new development bank in themselves carry the theme which can be developed into a transparent vision statement which could be supportive of financing and pursuing the above needs.

Business Model for BRICS Development Bank

The BRICS leadership has before it the models of IMF, World Bank and Asian Development Bank which have been doing substantial work in mobilization of resources and providing technical and financial support for economic development in different geographical areas for a variety of purposes. BRICS can also count on the experience of India's central bank (Reserve bank of India) which has acquired professional expertise and experience in handling issues like financial inclusion, priority sector lending, institution-building for meeting diverse needs of financial sector, forex reserves management and public debt management, besides the core central banking functions which the Reserve Bank of India has managed well during the last 78 years of its existence.

The bank could consider a share-holding and contribution (to contingency reserve fund etc) pattern based on the proportion of member nation's GDP. There should be appropriate upper ceiling for voting

Why another bank is needed?

The outreach of IMF and World Bank is insignificant in regions covered by BRICS countries and generally in geographical areas covered by developing countries where they do not find 'cheap resources' which they are interested in 'exploiting'. Just as moving towards 'full literacy is not on India's agenda, poverty alleviation (ending poverty globally) is not on the agenda of international bodies dominated by developed countries. Just as the controlling forces (rich and the powerful) in India has a vested interest in keeping the feeder sources for cheap labour illiterate, developed countries are interested in a large chunk of humanity poor for obvious reasons.

Has IMF, WB, failed to deliver?

They do not have a system in place to monitor sources and uses of resources globally and ensuring equitable distribution at least to ensure a decent lifestyle for all. Diplomacy and politics today are dominated by money power.

What are the key challenges the bank could face?

Main challenge will come from developed countries in the form of manipulation of economic policies to suffocate and stifle the new entity making its survival difficult. But, if the people in developing countries look forward to 'ending poverty' they should make a number of institutions like BRICS Development Bank succeed. Resources will not be a problem. To mention one, the potential for exploitation of 'surface gold stock' in India is immense.

MG Warrier
Former General Manager
Reserve Bank of India, Mumbai

What could be the modalities of the bank?

Democratic functioning and resource participation in proportion to GDP should be ensured. See paragraphs under Business model in the article.

Role and dominance of China, and any possible conflict with other member countries?

Each country will have country-specific interests to protect. We need not be too much sceptic about China. China's views are pragmatic and practical when it comes to economic development. Conflicts will be there. But they are surmountable.

How India could benefit?

Playing a major role in institution-building at international level will definitely benefit India. The partnership could help in further pursuing cooperation in economic development in this region. I foresee the possibility of improving our (India's) relationships with all neighbours including China.

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rights of individual nations, to ensure that the mighty does not dictate terms, just because they have contributed more. Learning from the failures of the institutions dominated by the rich developed nations will save the new bank from repeating same mistakes. If developing countries outside BRICS Group who may become the beneficiaries of services provided by the bank are allowed share-holding in the bank, BRICS should retain the right to ensure that the BRICS Group's share-holding does not fall below a certain level. Reasonable institutional autonomy to ensure adequate resources mobilization, evolving a pragmatic lending policy which factors in reasonable return on investment and covers risk-related matters and management of HR-related issues should be given to the bank's management.

Future

The diversity in the systems of governance in the countries that constitute BRICS should not be seen as a disadvantage. It should take us back to the principles of peaceful coexistence preached by Jawaharlal Nehru and make us think about channelling our efforts to make the world a better place to live, not only for the people in developed countries and those belonging to the upper strata of 'economic divide' in other countries. Success of BRICS Development Bank will pave the way for improving relationship among BRICS nations, creating more opportunities for absorption of surplus capital within the group and channelling resources within the region to needy developing countries. Nations which have 'tasted' poverty and problems related to poverty in the recent past will be able to appreciate the problems of the survivors of an estimated eight million human beings who die across the world each year, because they are too poor to stay alive.

As Jeffrey D Sachs has argued in his book referred to earlier in this article, our generation can choose to end poverty in a couple of decades, if we make appropriate realignment of priorities. The idea to establish BRICS Development Bank should be seen as one small step in the right direction towards achieving this goal. TGA

- MG Warrier
Former General Manager
Reserve Bank of India, Mumbai

US Economy

Is a Revival in Offing?

Although the Fed's goal of kick-starting the US economy has not been successful, its goal of inflating assets all over the world has been. The billion dollar question is - What will happen when the free money disappears?

William Gamble

Founder President, Emerging Market Strategies, Newport, US

Share prices in the US seem to hit record highs every day. The housing market is up substantially over last year and inventories are at an all time low. US consumers are buying cars in record numbers. Last month the Michigan survey of consumer sentiment beat all expectations. It has rebounded from the lows of 2011. The Federal Reserve's stimulus known as QE3 is set to continue at least into midyear and perhaps longer. The OECD forecast for the first quarter for the US economy has been upgraded to 3.5 per cent a major improvement on the 0.4 per cent reported in the last quarter of 2012. So the US economy has revived and its growth will accelerate for the rest of the year. Or will it?

The main driver of the US economy is the US central bank, the Federal Reserve (Fed), and third program of quantitative easing known as QE3. Since the Federal Reserve announced an open ended program of QE last September, the US stock markets have been on a tear. Like the recent Japanese stock market rally, the promise of free money seems to be the cure for all the economic problems of the world.

The problem with QE, like any other government attempts to distort markets, is that although it appears to work at least in the short term, it has longer term unintended consequences that may destroy its purpose. Also QE does not exist in a vacuum. There are many other forces at work within the US and the global economy, which might dilute its potential effects.

One would assume that the US equity markets continue to rise because corporations consistently produce record profits. But that may not be the case. The S&P is up an astonishing 16 per cent since the beginning of this year, but as we enter the reporting season, first quarter profits are expected to rise only 0.7 per cent. If this forecast is accurate it would be a sharp drop from the 7.7 per cent growth in profits posted in the last reporting season. The forecasts are also a lot lower than previous predictions. American managers are past masters of controlling analyst sentiment. Over the last four quarters they have successfully reduced expectations to such an extent that when the reports actually came out, they routinely beat the forecasts. The recent data suggests that this season might be different in that positive surprises will be lower than the prior quarter.

The meaning of the earnings has also changed thanks to the Federal Reserve's stimulus. There are several ways in which corporations can boost their earnings without actual economic growth. Most CEOs compensation includes stock options. This gives them a large incentive to at least give the impression of consistent improvement in earnings. Cheap money can help in two ways. The CEO can increase debt and therefore leverage or they can buy back share and spread the earnings among fewer shareholders.

The process of boosting earnings with debt has been proceeding on a vast scale. Last year American companies borrowed around $400 billion to buy back their own shares. This is equal to about 2.6 per cent of GDP. It is still increasing almost exponentially. In the first quarter America companies announced buy backs had increased 96 per cent over the same period as last year. But this method of increasing earnings is of course limited. Eventually the companies are actually going to have to increase their earnings by growing revenue, which might prove difficult.

The cheap money will impact earnings in another way. Despite gains from stocks, US corporate pension funds are not earning enough interest from their fixed income investments to provide for their liabilities. Despite contributing $60 billion to their pension funds the top 1500 US companies finished the year with their highest deficit ever: $557 billion. The Federal Reserve has not only inflated share prices. Many Americans are feeling richer because the value of their homes has increased. By buying mortgage backed securities, the Federal Reserve has pushed down the cost of owning a home. Mortgage rates are at historical lows.

Thanks to low interest rates house prices are finally recovering from the disaster of the past few years. Prices of existing homes have risen 10 per cent since last year. Last year sales of existing homes reached 4.66 million which is still below the 5.04 million recorded in 2007 but almost 10 per cent higher than in 2011. With prices and sales rising so has construction. In February contractors applied for building permits at an annualized rate of 946,000 which is over 30 per cent higher than last year and the highest since before the crash in 2008. Not only has construction increased, but also everything that goes into building a house. Lumber prices have risen to an 8 year high.

Caveat speculators!

All of this is good news, but there are some caveats. By suppressing interest rates and yields, the Fed has encouraged people to become home owners. It has also encouraged investors to speculate: hedge funds, private equity vehicles and some individual entrepreneurs. Investors are not looking to purchase the home for the long term. They want to purchase the home for rental income and eventually a sale, preferably quickly, what is known in the US as flipping. Wall Street has even given this asset class a more respectable name, Real estate owned (REO) to rental and it is probably quite large. Most of these purchases are for cash, so the exact size of this class is difficult to determine. It is estimated that a third of the recent real estate purchases were by investors. We do know that the number of people who took out mortgages to purchase for investment or as a second home climbed to 13.6 per cent of mortgages. This beat a previous record of 13.4 per cent which was established at the peak of the market frenzy in 2006.

Speculators also have better access to cheap money than normal home buyers. The Fed can insure that interest rates are low, but they do not control lending standards. Tighter lending standards, high unemployment, and low savings are preventing would be home buyers from entering into the market. Even well qualified purchasers are having difficulty competing with investors. Investors pay cash and do not have to qualify or get an appraisal. So their bids win even at the same price. But the real problem with someone who is buying for profit as opposed to someone who wants a place to live is that if the possibility of profit should disappear, say with the prospect of higher interest rates, speculators will most likely leave the market as quickly as they entered it.

The flip side of the largess

Another problem with the US recovery is that the Fed's largess is not reaching small businesses. Small businesses are the largest creator of US jobs. They generated over 65 per cent of the new jobs over the past 17 years. While they create more jobs, they are getting fewer bank loans. Their share of bank loans has declined from 52 per cent in 1995 to 29 per cent in 2012. Falling bank loans to small business has been due to a number of factors. The first has to do with securitization. Over the past 15 years the packaging of loans for sale to third parties has dramatically increased. To be securitized, loans must first be standardized. Small business loans are often unique. Second banks have consolidated destroying small local banks, a major source of small business lending. Third, as the banking industry became more competitive, the cost of making nonstandard small business loans became less profitable. The result is that even with low interest rates, small businesses and the jobs they create lose out.

The present party going on in shares and housing may be slowed or even stopped in its tracks by the so called sequester. The sequester is basically an austerity program like the ones in Europe. Thanks mainly to the recession and high unemployment; the US deficit has more than doubled in the past few years. It now stands at over $16 trillion dollars possibly more than 100 per cent of GDP. Although the relationship between government debt and real GDP growth is weak for debt/GDP ratios below 90 per cent of GDP, above 90 per cent, growth rates fall by 1 per cent. To rein in the debt, the US government has agreed to cut spending. It also has raised taxes. The sequester was the spending part of the so-called fiscal cliff. The fiscal cliff was a result of an agreement in the US Congress in 2011. It was basically created because the two main parties in the US Congress, the Republicans and Democrats, could not agree on a compromise budget. The Republicans wanted dramatic spending cuts and the Democrats wanted tax hikes.

Under the agreement as of January 1st, 2013, there would be an automatic tax rise and spending would be cut across the board, something both parties disliked. On January 1 at the last minute, the fiscal cliff was avoided. Congress agreed to small tax rises for people earning over $450,000, spending cuts were delayed until March 1. This was a strategic mistake for the Democrats. The Republicans might have agreed to tax hikes to get spending cuts. But the spending cuts were automatic, and the tax issues were off the table, so the Republicans had no reason to bargain. The sequestration duly took effect March 1.

The Republicans also had another advantage. Tax rises went into effect immediately. The political effects were instantaneous and muted. In contrast the effects of the sequester occur very slowly. Staff can be given short furloughs. Investments can be delayed. Vacancies can go unfilled. This can go on until the fall. The U.S. federal government's fiscal year begins on the first of October. By then the temporary cuts will no longer suffice and fundamental restructuring will have to occur. Employees will actually be fired. Programs will be cut. Services curtailed. But until these things occur, there will not be any complaints and politicians will not be under any pressure to avoid the cuts. Although the impact has already started as of April 1st, the full effects will not come into force until the end of the summer.

Threat of a jump in unemployment?

The sequester will increase the level of unemployment, which has not rebounded since the start of the recession. For the unemployment rate to start going down, the economy has to produce at least 300,000 new jobs a month. Over the past two years the economy seems to get going in one month, but then loses momentum the next. Job creation had been steadily increasing since last summer, but started to decline again. The hope engendered by last month's increase of 246,000 new jobs was dashed with this month's creation of only 88,000 less than half the number predicted.

With job creation at low levels, the number of long term unemployed grows. The US has over 5 million people who have been out of work for more than six months. The unemployment rate this month did drop from 7.7 per cent to 7.6 per cent, but only because more people dropped out of the labour market. The broader unemployment rate which includes people working part time because they couldn't find a full-time job and people who wanted a job but haven't looked for work in the past four weeks is 14 per cent. As businesses plan for a slowdown in government demand, new job creation has apparently suffered. It will get a lot worse as the year wears on and the real cuts begin to kick in.

The impact of unemployment is especially important to younger workers, usually the most vibrant part of any economy. When younger workers are unable to find jobs or find jobs below their skill level, their future earnings are adversely impacted. In addition the skills of the long unemployed atrophy along with their finances, prospects, mental and physical health. Many of these workers are burdened by student loans. These have risen to more than $1 trillion and act as a drag on every segment of the economy. First time home buyers usually make up 40 per cent of the market, but this has dropped to 30 per cent. Home buyers are also large consumer of every other type of durable goods. But these potential consumers and their impact on the economy has declined as they have been forced to continue to rent or move back in with their parents perhaps for years to come.

Along with the better job numbers last month, it appeared that consumer sentiment was increasing. The University of Michigan Consumer Sentiment Index had been steadily rising over the first quarter and last month came in at 78 beating the estimated 71. But it did not agree with another consumer index, the Consumer Confidence Index which came in much lower than predicted. Like last month's job numbers, the University of Michigan Index preliminary fell back to 72.

Not yet out of woods!

While much of the recent economic gains have been attributed to the actions of the Federal Reserve, the Fed could be harming as much as it is helping. American companies are sitting on about $1.8 trillion. European companies have $1 trillion. Instead of building factories and creating jobs it is sitting in company accounts earning almost nothing. The simple reason is uncertainty. The minutes of the recent Fed meeting were not encouraging. The Fed has lost its consensus. Member opinions went from stopping QE immediately to keeping it going indefinitely. Meanwhile although the Fed's goal of kick starting the US economy has not been successful, its goal of inflating assets all over the world has been. The question will be what happens when the free money disappears? At that time we will finally know the true state of the US economy and it is not promising. TGA

Stock Market

Sudip Bandyopadhyay
Managing Director and CEO
Destimoney Securities, Mumbai

Indian equity market will continue to deliver 15 per cent + average return on an average over a long period of time. However in short term, the market will continue to remain choppy.

After the initial surge in the early 2013, the market sentiment turned bearish and has remained so for long. While the domestic factors such as slowdown in economic growth, disappointing earnings data, and worsening fiscal deficit scenario have added to investors' concerns, what is further worrying investors are the adverse developments in other parts of the world, says Sudip Bandyopadhyay, Managing Director and CEO of Destimoney Securities, in a free-wheeling discussion with The Global ANALYST.

Destimoney Securities is a full service financial organisation, promoted by New Silk Route – an Asia focused growth capital private equity firm with over $1.5 billion under management. However, he feels that India's long term story still remains intact, notwithstanding the current turbulences. Given, he avers, for a long term investor, it is a good time to buy growth-oriented mid- and large-cap stocks from sectors such as FMCG and Pharmaceutical. Read further to know where he sees the market heading in the near- as well as long-term, the steps the policy makers need to take to tackle the challenges before the domestic economy, FIIs' inflows and what strategies investors should adopt amid uncertain market conditions.

The Indian stock market has continued to be choppy. What factors do you attribute to the persistent sluggishness in the market?

Global economic uncertainties along with domestic economic woes have led to this sluggishness in our capital markets. The GDP growth has slowed down significantly from around 9 per cent to around 5 per cent. This coupled with policy bottlenecks particularly on the critical economic resource allocation front, has spooked our markets.

Do you believe that the investor sentiment has turned bearish more on account of issues on the domestic front, rather than on growing global concerns over the on-going troubles in the euro zone or the US fiscal cliff or Japan's stagflation?

The recent downward movement in the market is predominantly driven by domestic factors which has made the foreign investors extremely worried about India's short-medium term economic outlook. The domestic economic woes require efficient steering of the economy to ensure speedy recovery. However, the recent political uncertainties and the forthcoming general election do not inspire confidence, in this regard.

Do you foresee any glimmer of hope amidst all the gloom and doom? If so, what according to you could be the major drivers for the market, going ahead?

Unfortunately, the major driver for the domestic markets, even in the near future will remain the Global developments. Global "risk on" mood will determine inflow into India which will in turn move the Indian markets. Improvement of liquidity through domestic developments will also help our markets.

What is your view about the revival in the corporate earnings? Do you see corporate earnings bottoming out any time soon?

We believe that corporate earnings are very close to their bottom. However, clear signals of improvement are not yet visible. Unreasonably high interest rates have been the main culprit. With slowing down of inflation, there is a strong possibility of interest rates coming down and facilitating economic recovery which in turn will lead to improvements in corporate earnings.

How do you foresee the trend in the FII inflows for the rest of 2013? Do you feel that there could be slowdown in the inflows?

We feel that FIIs inflows in 2013 will lower than 2012. However, inflows may pick up in the 2nd half of 2013.

What kind of investment strategy you're recommending to your clients in this kind of a gloomy scenario? Do you believe that a contrarian perspective could just be the right kind of winning approach for investors in today's listless market?

We have been recommending clients to focus on select sectors and stocks. Our view has been that Pharmaceutical and FMCG sectors will continue to perform well. Even now, there are significant opportunities in the above sectors. However, one needs to be company specific and not take top down approach even in these sectors.

What would be your advice to retail investors?

Contrarian view like vale buying in rate sensitive sectors/stocks, including infrastructure may not be advisable at this juncture. While valuations may look compelling in these sectors, we believe that the pain is not yet over. It is better to stick to growth oriented companies in Pharma and FMCG sectors for the next 3-6 months.

Which are the sectors you would bet on today and why?

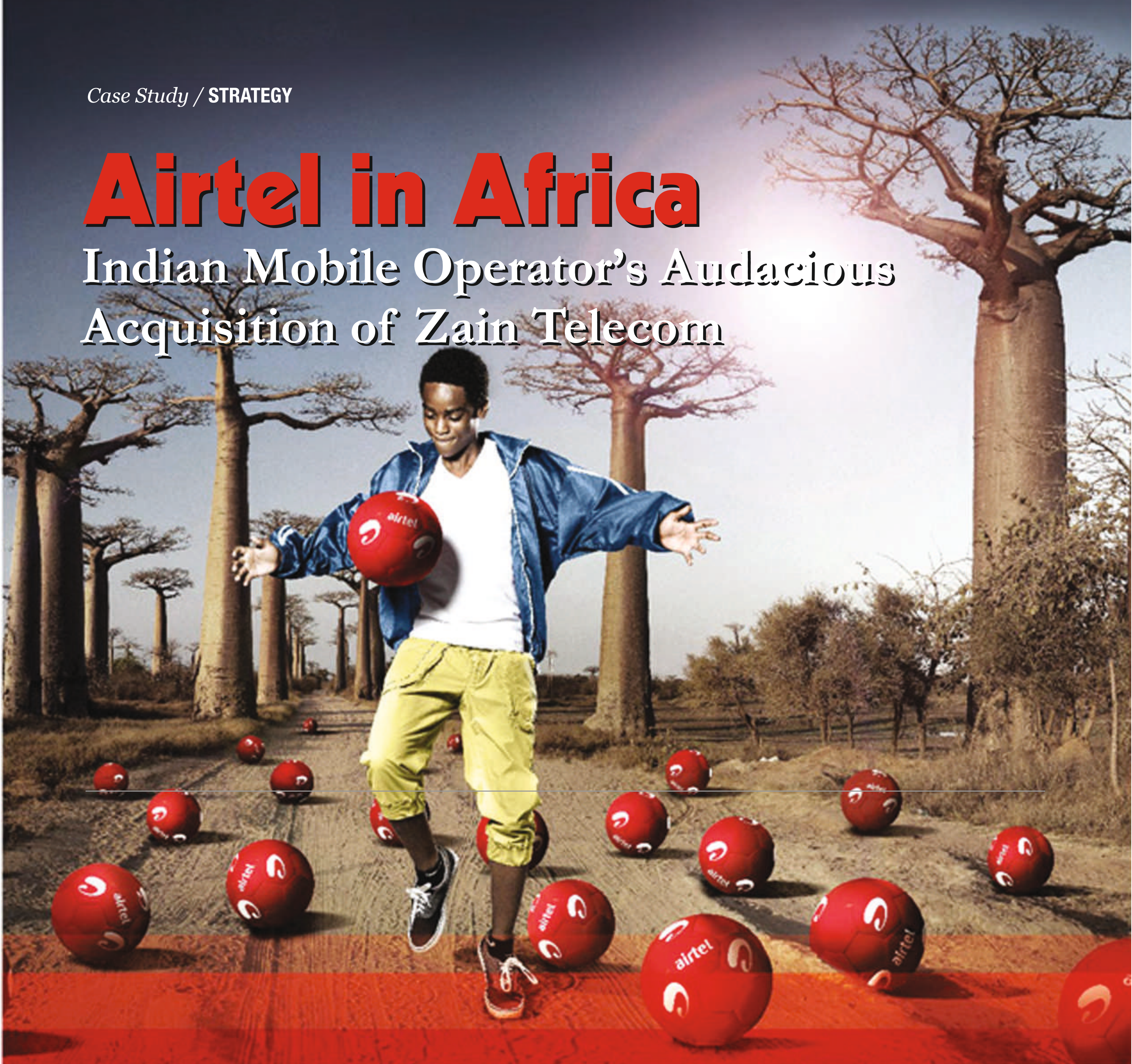
We advise retail investors to refrain from adopting top down approach. We suggest them to buy select PMCG and Pharma companies.

What's your outlook of the macro-economic numbers, in general, and equities, in particular, going forward?

The long term India story is intact in spite of the current turbulence. Thus for a long term investor, it is a good time to buy growth oriented mid & large cap stocks in FMCG and Pharma. Indian equity market will continue to deliver 15 per cent + average return on an average over a long period of time. However in short term, the market will continue to remain choppy. TGA

Airtel in Africa

Indian Mobile Operator's Audacious Acquisition of Zain Telecom



Bharti, which is keen on tapping the African market, had earlier made two failed attempts to acquire the South Africa-based MTN. Though the MTN deal would have been better buyout for Bharti, Zain does offer the company unique advantages. Zain is a market leader in most of its operations, with 50-75 per cent market share in seven countries. Though Zain's acquisition would be a strategic fit for Bharti in Africa's high growth market, Bharti's move seems to be a desperate attempt to avert a decline in its growth trajectory as the domestic market gets increasingly competitive. Bharti Airtel's African safari has so far been a struggle. But it can still salvage its chances.

When Bharti Airtel, India's largest and fifth largest mobile phone operator in the world, made two failed attempts for two successive years, first in 2008 and then again in 2009, to acquire MTN, Africa's top carrier, it made skeptics wonder why the heck Indian operator chased this deal in the first place? Many felt that the company was simply becoming a laughing stuff when it rebid in 2009 and failed again to woo the African telco. But Airtel made its critics eat humble pie when it successfully acquired Kuwait-based Zain Telecom's African business for $10.7 billion (about Rs 48,000 crore).

The deal, dubbed as the largest ever cross-border deal by an Indian firm, which was announced in March 2010 and consummated two months later, in early June, gave Bharti significance presence across 16 African countries including Nigeria, Ghana and Rwanda, and a subscriber base of 42 million, which boosted its overall subscriber base to around 179 mn.

On November 30, 2011, Bharti Airtel reached a major milestone when its subscriber base touched the 50 million-mark in Africa. The Company achieved this feat within a span of just 17 months after it entered the African markets with its storied acquisition of Zain Telecom's mobile operations in 16 African countries in 2009. "This milestone demonstrates our continued dedication and commitment to Africa," said Manoj Kohli, CEO (International) and Joint Managing Director, Bharti airtel Limited. "We would like to thank our customers for reposing their faith in brand airtel and we are committed to serving them with world-class services.

I would also like to thank the governments and regulators for their support and would like to reiterate that we share their vision of bridging the digital divide with affordable telecom services," he further said. According to IMF World Economic Outlook 2011, Africa is home to over 1 billion people and is also the world's youngest population with people under the age of 25 accounting for 60% of the total population, compared with around 30% in developed countries. Further, after China and India, nearly all the world's fastest growing economies are in Africa.

Industry experts said the Company's ability in replicating its India low-cost model has helped it emerge as a formidable player in such a short span of time in the fiercely competitive African markets. "Bharti has been consistently adding about two million subscribers per quarter in its Africa business, leading to increase in minutes of usage," said a research analyst at the Mumbai-based brokerage house Angel Broking.[4] The Company added 14 million users in the first 17 months of its operations in the African telecom market, on the back of low and innovative rate plans.

Beginning of the African Safari

On June 8, 2010, Bharti Airtel 'took a giant step towards becoming a global emerging market telecom operator by completing the acquisition of Zain Group's mobile operations in 15 countries across Africa for an enterprise valuation of $10.7 billion'. The acquisition, the largest ever cross-border by an Indian firm, catapulted Bharti Airtel into the big league, with a global footprint. The acquisition made Bharti the fifth largest mobile operator with operations in 18 countries and a subscriber base of about 180 million.

For Bharti which had been looking to expand beyond India for some time the acquisition would not have come at a more opportune time as For, it was facing rising competition (with the entry of a host of new players post-the new licenses distributed by the government during the last few years) that led call rates to touch rock bottom, thereby hurting operators' margins, and prospect of a maturing market (mobile phone teledensity in India is expected to reach 97% by 2015).

In contrast, Africa presented a huge growth opportunity. Only 3 out of 10 people in the country had a mobile phone as compared to 7 in India, according to a report by IMF. Further, it took Africa 20 years to reach a mobilephone population of 200 million handsets, however, it took it less than three years to get to the next 200 million, according to a report from McKinsey & Co. Besides, the region also offered huge opportunities in mobile value-added services (MVAS).

According to the study, Rural Connectivity Report in Africa, by Informa Telecoms & Media, a UKbased consultancy, the MVAS market in Africa is expected to grow 20 percent annually to reach $11.5 billion by 2014 from $4.5 billion (80% of which came from messaging services while mobile Internet contributed 14 percent and mobile entertainment such as music and television contributed 3.5 percent) in 2009. Also, as the digital subscriber line (DSL) was not yet developed, there was huge scope to grow Internet penetration

through broadband route. "There is no DSL (digital subscriber line) in

4 *http://www.business-standard.com/india/news/50-mn-africans-dial-airtel/457225/*

Africa, so wireless broadband is very important internet play in Africa. Median age is 17-18 years, so the youth in Africa will love to browse Internet on Airtel," Kohli had said in November 2010. DSL technology provides digital data transmission over wires of local telephone networks. "DSL technology provides digital data transmission over wires of local telephone networks."[5] Besides, 3G also offered opportunity to boost Internet penetration in the region. "We have 3G licences in nine markets out of 16 and we will definitely fully utilise the 3G services," Kohli added.

Exhibits: African Mark

According to industry estimates, there are more than 500 million mobile phone subscribers in Africa now, up from 246 million in 2008. In 2000, the number of mobile phones first exceeded that of fixed telephones. The four biggest mobile phone markets in Africa are Nigeria, South Africa, Kenya, and Ghana. Strategic investors in Africa's mobile industry include South Africa's MTN, India's Bharti Airtel, France Telecom (via its Orange brand), Britian's Vodafone and Luxembourg's Millicom. The largest fixed line broadband market is South Africa, followed in order of market size by Egypt, Morocco, Algeria and Tunisia. According to Facebook statistics tracker Socialbakers, there were around 10.5 million Facebook users in Africa in 2010. Mobile broadband subscribers in Africa — users of data cards and USB devices via cellular 3G networks – crossed 3 million in September 2009 and were expected to break the 4-million milestone in the first quarter of 2010. In total, 4.54 Terabytes of cable capacity is available across 13 submarine cables in Africa. These will further expand to 24.5 terabytes by 2011, according to Africa Analysis.

Source: Mobile Africa Report 2011, Dr Madanmohan Rao, MobileMonday

'Minutes Factory' Model Fuels Growth

Bharti's decision to enter the African market was driven by the huge growth potential the continent offered - low telecom density. In 2010, only three out of every 10 people owned a mobile phone in Africa compared with seven in India. Given the low per capital income of the African nations[6], the Company's task was cut out. "Bharti's primary challenge was to replicate its highly successful 'minutes factory' model, which involves low tariffs and high usage, in that continent."[7]

The Company though initially refused to wage any pricing war saying it was not needed as it enjoyed pricing power. "We retained the pricing power in Africa – there is no intention of any price war by Bharti in Africa – we want competitive tariffs and we will always be competitive," Manoj Kohli, CEO of the Indian telco's African operations had then remarked. "I feel that after two quarters of restructuring of these areas, we should be able to achieve much healthier share of business. Already, we are seeing higher incremental customer addition," he told reporters during a press conference in early November 2010, barely a few weeks away from introducing the Airtel brand in African nations, while releasing the Company's quarterly result for the period ended September 30, 2010, which showed lower profits and fall in its market share.

However, the operator was 'already head deep in the price war in Ghana,'[8] where it lowered tariff by nearly a third to 8 Ghana cedis (about 6 cents) per minute from 12 Ghana cedis, responding to an earlier move by rival Vodafone Ghana to slash call rates in the country. "The move by Vodafone set the stage for a furious price war as the telecom firms tried to outpace each other. Zain (Airtel's Ghana operations) announced a drastic reduction in call rates to all networks by 33 per cent to 8Gp with no conditions attached, as compared to Vodafone where customers have to subscribe to enjoy the rates." Soon a fierce price war ensued as the operators tried to wean away subscribers from competition. Interestingly, it was the Zain which began the pricing war. "It all started with the entry of Zain in the 4th quarter of 2008."[9] "The number of operators is prompting a race to the bottom on call rates," commented a report in Bloomberg[10].

According to it, in Tanzania, call rates had crashed 90% during the last 18 months beginning mid-2009. Operators in Tanzania too faced high churn rates, one of the highest in the world. All these along with patchy infrastructure made return on investment difficult, said Bloomberg. The ongoing tariff war has seen call rates drop sharply in many of the markets in Africa where the Indian Carrier operates. "When we took over Zain, their tariffs were

5 *http://www.dnaindia.com/money/report_bharti-wont-wage-price-war-in-africa_1464957*

6 *Ghana's per capita income stood at $2,725 while that of Nigeria was $2,437 in 2010, according to International Monetary Fund 2010 data. India's per capita income, in comparison, stood at $3,408, during the same period. Source: Wikipedia*

7 *http://articles.economictimes.indiatimes.com/2011-02-03/news/28429986_1_quarterly-profit-net-profit-bharti-airtel-s-q3*

8 *http://www.ghanabusinessnews.com/2010/11/14/bharti-airtel-says-no-price-war-intent-in-africa-but%E2%80%A6/*

9 *http://www.thecorporateguardian.com/communications.php?articleID=85*

10 *http://mobile.bloomberg.com/news/2010-11-11/vodafone-bharti-struggle-to-squeeze-profit-from-africa-as-call-rates-drop*

Bharti's African Play				
Countries	Total Subscribers	Market Leaders	Airtel's Position	Total Operators
Nigeria	73,099,000	MTN (45)	3 (20)	4
Kenya	19,365,000	Safaricom (81)	2 (09)	4
Tanzania	17,677,000	Vodacom (41)	2 (28)	4
Ghana	15,109,000	MTN (51)	4 (10)	5
Congo (DRC)	10,163,000	Airtel	1 (38)	5
Uganda	9,384,000	MTN (53)	3 (18)	6
Madagascar	5,997,000	Orange (40)	2 (37)	3
Zambia	4,407,000	Airtel	1 (60)	3
Burkina Faso	3,299,000	Onatel/Maroc (44)	2 (39)	3
Chad	2,686,000	Airtel	1 (53)	2
Niger	2,599,000	Airtel	1 (55)	5
Malawi	2,400,000	Airtel	1 (63)	2
Brazzaville	2,171,000	Airtel	1 (46)	3
Gabon	1,373000	Airtel	1 (52)	3
Sierra Leone	1,160,000	Africall (43)	3 (24)	4
Seychelle	60,000	Airtel	1 (57)	2

Source: Nomura Research, BW research

at a premium of 30-40 per cent. We were clear that this won't work and brought it down to competitive levels,"[11] said Kohli while justifying the move to slash call rates.

Outsourcing Helps in keeping Costs Under Check

The Company also opted for outsourcing model to manage its infrastructure such as information technology, telecom network and call center business etc to keep costs under check, something which it has already been doing successfully in India, its home market. Last year, in July, the Carrier signed a 10-year contract with global IT firm IBM to provide help-desk and other software-support services to its operations in 16 African countries. In October'11, it tied up with Nokia Siemens Networks to implement advanced automated device management solution in order to offer its customers seamless mobile internet browsing experience and multimedia messaging services. "Nokia Siemens Networks' robust mobile device management solution will allow our customers in Africa to enjoy the latest services by enabling seamless internet connectivity and excellent customer care support.

The solution will benefit Airtel from reduced operational costs when introducing new devices or services," observed Kohli while signing the deal. Nokia Siemens Networks' SADM Serve atOnce Device Management (SADM), a 'Customer Experience Management,' software, allow a mobile operator to remotely and automatically manage and configure user devices for new data services. The software also enables the operator to gain valuable insights on device capabilities to make right business decisions when introducing new services.[12]

Bharti Airtel tied up with Mumbai-based Spanco to manage its contact centers in African region. It also roped in Tech Mahindra to manage its customer care services in seven African countries. Though the transition to outsourcing model had been relatively smooth it did have to confront concerns raised by a third of the 6,500 African employees of Zain whom it had to transfer to these new partners. Those who received transferred orders feared they would lose their jobs. However, the Company offered these employees. "Bharti offered them a package they could not refuse: Everyone would be transferred on existing terms and conditions; and they had the option to come back into the Bharti fold within two years. This ensured Zain's operations were not flooded with expats from India. Most ex-Zain employees have been put through a rigorous retraining programme, imbibing the Bharti way."[13] "I believe that Zain now smells like Bharti," remarked the satisfied head of Bharti's African operations.

Kohli is now eyeing infrastructure sharing to further reduce its operational costs. "I think it will also be good to collaborate in terms of network sharing, infrastructure sharing and towers, fibre optics etc," he told. "The shared infrastructure model has helped Airtel grow its presence in the domestic market and it plans to extend the same model to Africa as well."[14] "We cover 4,50,000 villages in India and we have made that market very viable. We would have a similar strategy for Africa as well," added Kohli.

11 *http://www.business-standard.com/india/news/bharti-airtel%5Cs-african-safari/438570/*
12 *http://www.nokiasiemensnetworks.com/news-events/press-room/press-releases/bharti-airtel-africa-enhances-mobile-internet-browsingexperience-and-multi-media-messagin*
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Growth Sans Profits – A Major Concern

Though Airtel's African sojourn has been quite impressive when it comes to grabbing market share and in terms of subscriber growth, but it disappoints when it comes to churning profits. "With losses of Rs 416 crore in the March quarter this year (FY 2010- Every carrier is losing money, there are systemic issue. 10 Case Studies on Marketing, Innovation, and Strategy 11) from its African operations and an Ebitda margin of only 26 per cent, analysts say the former Zain assets are not good for the company."[15] Its results for the September quarter of FY 2011-12 disappointed even further as it reported a "bigger-than-expected fall in profit that was its seventh consecutive quarterly profit drop."[16] Bharti Airtel said that its consolidated net profit fell to Rs 1,027 crore for the quarter ended September 2011 from Rs. 1,661 crore in the same quarter a year ago. However, its consolidated revenue grew to Rs 17, 276 crore from Rs 15,231 crore, during the said period. Its African operation made a net loss of Rs 427 crore during the quarter though revenues grew nearly 23%. In terms of ARPU, a key metric for telecom players, the Carrier's African ARPU fell 1% to $7.3; its Indian ARPU too declined 9% to Rs 183.

"Airtel's Africa operations have missed most internal targets that it first set out for the first year — from revenues, subscriber base to profitability," commented The Economic Times.[17] "Airtel had initially hoped to turn them around in 12-15 months. Outsourcing non-core operations — a practice Airtel pioneered in India — have taken longer than it was expected to in Africa. The company underestimated the cost of turning around Africa operations," it adds. "Africa with 16 countries is far more complex than India. One size fits all will not work here. They took a simplistic approach," told Federico Membrillera, managing partner, Delta Partners. "The bad news from Africa — both on costs and timelines — has come as a bigger surprise. Africa-based experts point to three things.

One, the company underestimated the level of complexity and set unrealistically aggressive targets. Two, Zain had made little investment in infrastructure in the African operations. So, Airtel had to invest more than it had budgeted. Three, Airtel is great at centralisation and squeezing inefficiencies out, something that they have done well in India. But Africa, with 16 different countries, different rules and regulators, markets, languages and culture, is difficult to centralise like India." Africa's challenges make for a sobering read for all who had bet on Airtel replicating its India model there. "The vendor ecosystem in Africa is poor. We have had to build it almost from scratch," says Inder Walia, director (HR), Bharti Group.

Airtel has had to take all its vendor partners like IBM, Spanco, Mahindra Tech from India who are building their operations, entailing more time and costs. Perhaps, the most complex and niggling problems come from the fragmented African market, with many governments and many rules as well as a different African work culture. For example, Airtel is facing constraints in importing telecom equipment into some countries that have a forex neutrality clause in place, which ensures that the value of goods it imports cannot be more than its exports from the country. Duty exemptions don't come easy. In Kenya, duty exemptions took almost three months to process. Most of the 16 countries where Airtel operates have not signed double taxation avoidance treaties. This has cost and logistical implications. If one of Airtel's Kenya-based vendors were to set up central billing for all the 16 operations, Airtel will lose lot of money in taxes. And now, to meet the growth targets there, Airtel

has had to increase its Africa capex by 50% in 2011-12. "Africa with 16 countries is far more complex than India. One size fits all will not work here. They took a simplistic approach," said Federico Membrillera, managing partner, Delta Partners.

Kohli & Co, however, believe the Indian telecom behemoth's African unit is on track to achieve its goal of achieving $5 billion in revenue and $2 billion in operating profit from Africa by end of FY 2012-13, pinning much hope on faster rollout of 3G and data services, would need to look beyond outsourcing strategy to rein in costs, quickly. He can get support from a different/unexpected quarter – the regulators and governments in the African region as he looks at ways to trim costs further – through lower interconnection charges and funding support. "Most African governments ask us two key questions – one, how will you roll out in rural areas, and, second, how can you become more affordable. We have told them that we can roll out in rural areas if there is USO funding support," said Kohli.

- Amit Singh Sisodiya

15 *http://www.business-standard.com/india/news/bharti-airtel%5Cs-african-safari/438570/*

16 *http://www.cnbc.com/id/45159855?__source=RSS*tag*&par=RSS*

17 *Can Airtel Africa take the weight off Sunil Mittal 's Airtel India? The Economic Times, June 26, 2011*