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From the Editor's Desk

Though Maharashtra is one of the most industrialised and progressive states of India and were one of the major contributors to the growth acceleration in India after 1991-92, currently the state is at cross roads. Maharashtra slipped to second position on parameter of State of origin of exports from India. Slow pace of setting up of SEZs in the state. No significant impact of FDI received on spread of industrialization, vitiated business climate in state due to VAT issues are being identified as the major reasons. Maharashtra has the highest number of companies viz 35664 which are not in operation. Maharashtra has become the most debt ridden state in country. The debt burden of Maharashtra as on 31 March, 2012 has crossed Rs. 2,530.85 billion or Rs. 2.53 lakh crore.

In order to increase exports from the state and create opportunities of employment generation, the Maharashtra Government has taken initiatives to establish SEZs as per the SEZ act of the Government of India. SEZs are geographical regions having economic laws different from the country's economic laws applicable elsewhere. SEZs aim to attract FDI into the country besides boosting exports from the country. A number of incentives ,both ficscal and non fiscal are extended to the units operating in SEZs. Similarly several measures have also been adopted to improve the procedures and customs rules. Though Maharashtra's per capita consumption of power is high when compared to that for all India, high T&D losses, poor maintenance, poor monitoring of consumption and distortions in pricing of electricity have adversely affected the growth of power sector and also the profitability of MSEB. The gap between electricity production and demand is affecting both manufacturing and overall growth.

Hence, it is high time the state's policies are reviewed and corrective steps taken wherever necessary so that the state could realise its growth potential.

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India and the Global Productivity Race

*Sumit K. Majumdar**

India can be justly proud of her growth story, and there is no absolutely no doubt that the income of her residents have risen substantially over the course of the last two decades. Especially in the last ten years several mega-fortunes have been made. Some have never had it so good! Yet, there are many millions who still struggle on as if nothing had ever happened.

Also, has the quality of life improved in a substantially meaningful and substantive way? If money incomes have risen, in several cases over ten times, with real incomes also rising, the physical quality of life has perhaps improved only marginally. The same infrastructure, the same organizations and the same set of administrative processes remain to serve a burgeoning population with rising incomes. To put it mildly, India is an extremely inefficient country.

Why sing a song about efficiency? Efficiency means discipline and hard work. That is so boring! Yet, productivity is the key to economic performance and resource utilization the ultimate measure of success. Productivity drives growth. If resources from economic activities are not properly utilized, then further resources are simply unavailable to make further investments and future growth has to be based on continuous borrowings.

If India does become a nation of substantial borrowing, and every indication shows this to be the case, the likely consequences are catastrophic as the current United States malaise reveals. Growth without productivity is growth without sustainability.

That rising productivity levels is the principal growth driver is **the** lesson from *all* of economic history. The economic history of mankind is a history of productivity driven growth. The great nations of the world reached a pre-eminent position only because of being efficient in utilizing resources.

The massive growth spurts that Britain experienced in the first half of the 19th century, that Germany and the United States experienced in the second half of the 19th century, that Japan experienced from the 1950s onwards, that South Korea is experiencing from the 1970s, and that China is experiencing from the 1980s have been driven by rising productivity levels.

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These countries leapfrogged all other nations in their performance. Thereafter, they charged ahead in their abilities to increase the incomes of their residents while simultaneously enhancing the quality of their residents' lives.

How does India fare? My research compared India's productivity relative to that of OECD countries, such as the United States, the United Kingdom, Germany, France, Netherlands and Spain. I evaluated the manufacturing sector, which accounts for a substantial portion of India's GDP.

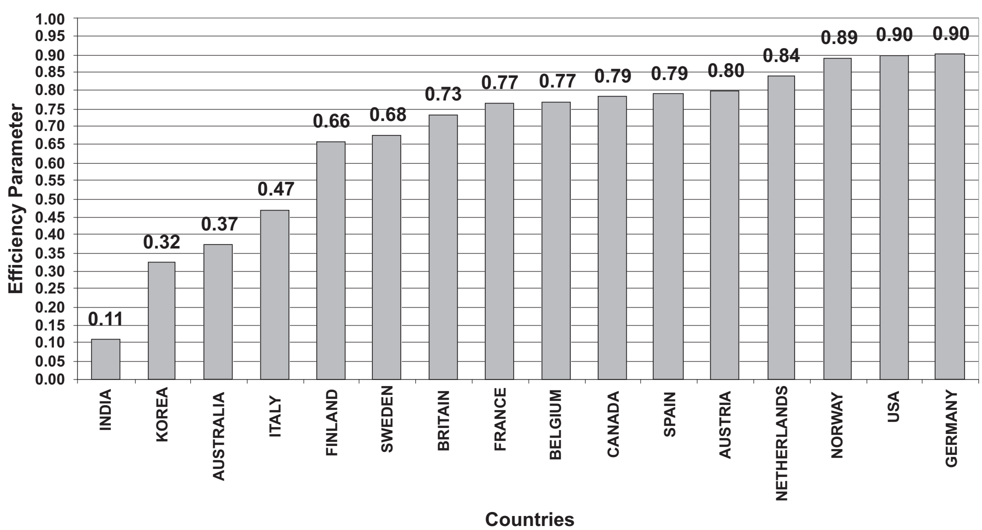
I used data from the *International Monetary Fund (IMF)*, the *Organization for Economic Cooperation and Development (OECD)* and the *Reserve Bank of India (RBI)*. These data were suitably translated into real terms and to an appropriate exchange rate. Thus, comparability between countries has been achieved.

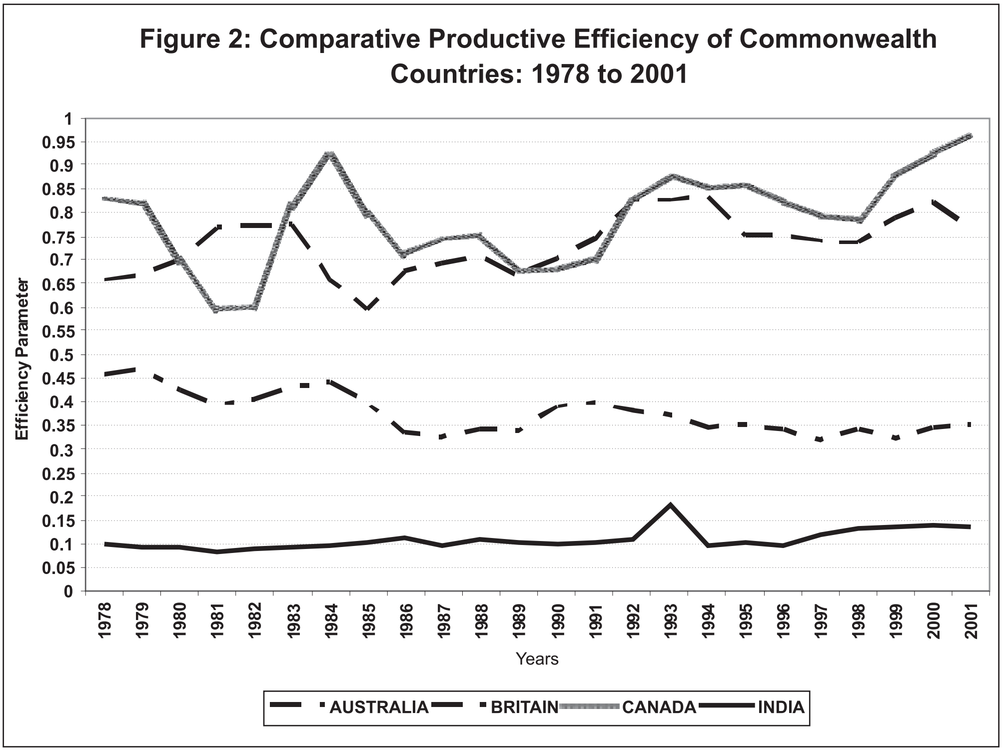
In comparison to the OECD countries, India's industrial productivity, as evaluated, is just **one-eighth** of the overall productivity levels of those countries. Other sectors in India, such as agriculture, education, infrastructure and services are no different and are likely to be worse in comparison.

The figure below tells the whole story. Countries are ranked from the lowest to highest productivity parameter on the X scale, read from left to right. The productivity measure is an average for the several years, measured on a scale of 0 to 1. No guesses are, I am sure, necessary as to where India's position is!

How may Indian performance compare over the time period as a whole. Is there enhancement of the productivity parameter or is there stagnation? Relative to Commonwealth sisters, Australia, Britain and Canada, India compares no better.

Figure 1: Global Comparative Productive Efficiency from 1978 to 2001: How Does India Compare?





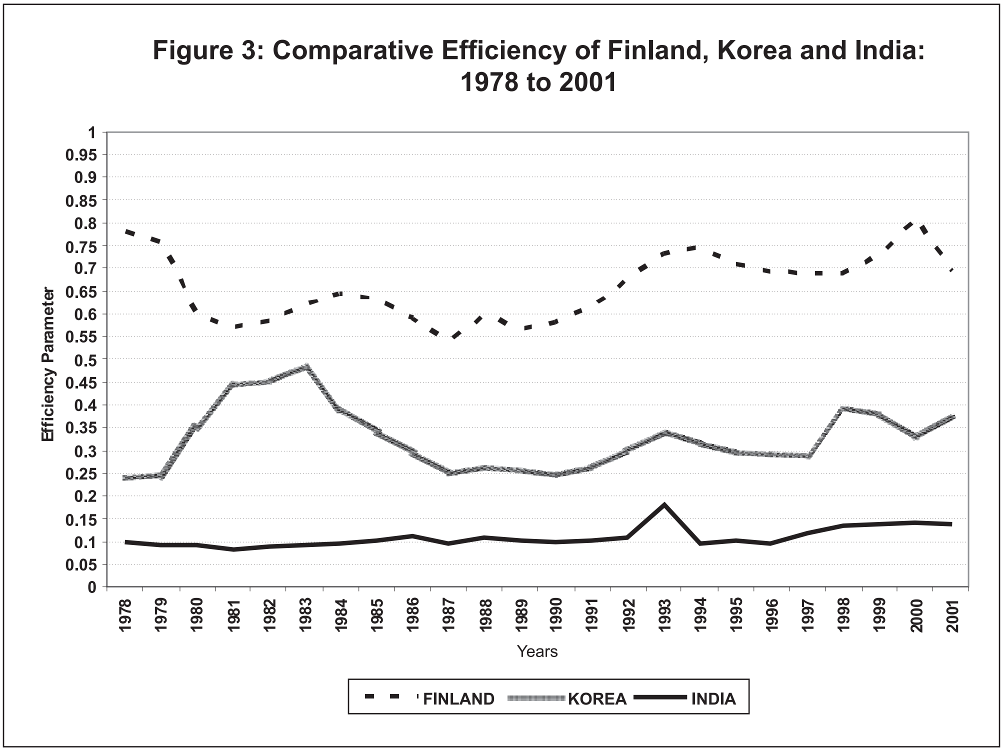
Again Figure 2 tells the story. India is not relatively badly off, in manner of speaking, relative to her latest nemesis: Australia. Compared to her North American commonwealth sister, Canada, or her European commonwealth sister, United Kingdom, Indian manufacturing productivity is simply appallingly low.

If one compares India to the newly emerged economic powerhouses, such as South Korea and Finland, the picture is no different. These new economies started on their journey of economic development and industrialization only in the 1960s and the 1970s, decades after India started hers in 1947. India's productivity is just a **fourth** to a **third** of the productivity of these countries.

Also, it is best to keep in mind that countries such as Finland and South Korea have made mind-bogglingly substantial quantities of investments in their human capital, in education, knowledge, individual and corporate capabilities. They will be the economic powerhouses of tomorrow, controlling the contours of technology-driven growth, as well as the conversation on corporate and economic policy.

India, on the education, knowledge, individual and corporate capability development front, stands absolutely nowhere. The investments that the Indian state and the Indian corporate sector make are just a drop in the ocean.

Almost all nations, of the twenty three that I analyzed for an overall period of thirty plus years, I am just showing the findings from 1978 onwards, also experienced rising levels of productivity



over time. As countries have caught up with each other, there are many instances of countries charging ahead because of leapfrogging. But, India is simply lagging.

India's comparative productivity growth during the overall period was stagnant. Other than a small rising blip just after the 1991 liberalization, by 1994 India's productivity levels had fallen back and had settled back at the levels that they had been in the past!

The implications are absolutely frightful. As other countries have become more efficient, India has stagnated and the gap between India and the OECD countries is steadily increasing. Hence, while quantitatively India may have grown in output generation, in qualitative terms the benefits of this growth has been absolutely non-existent.

Both government and business are singularly culpable for this state of affairs, as it is ultimately the firms that use the resources to generate the output within a framework defined by government.

India has experienced extensive growth but not intensive growth. As outputs have risen, inputs have risen equally fast to match the additional resource needed to generate the additional outputs. This phenomenon has simply left no resources to be re-invested for the future. Growth without productivity is hollow. It is growth without sustainability.

As all other countries march ahead, with their productivity levels consistently rising, India remains desperately trying to catch up. The possibilities of India leapfrogging and charging ahead, leading the global pack, are simply a theoretical dream or a set of delusional ideas divorced from reality. They are based on an absence of facts, insights and genuine knowledge of what matters, and, most palpably, on an ignorance of history.

India is undergoing an economic transformation, accompanied by a social revolution along multiple dimensions, but the key institutional and organizational transformations needed, that influence productivity growth, have been completely trivial, inadequate or non-existent. Yet, if these transformations are not forthcoming, India will be condemned to be the laggard in the world's economic and social league tables.

Debt Capital Markets In India & Some Recent Transaction Developments

*Mukesh Bhasin**

Abstract

The Debt Capital Markets in India have been painfully slow in developing compared to the Equity markets. This is despite several well-meaning reports and political assertions from time to time. The key obstacles to the development of the Debt Capital Markets are well known and commonly outlined by most knowledgeable experts: narrow investor base, illiquidity, crowding out of private sector by government borrowing, cumbersome issuance guidelines, inadequate credit information, inefficient clearing and settlement, poor enforcement laws, regulatory weaknesses etc etc. While this article provides a birds eye view of the key characteristics of India's Debt markets, it also aims to outline a silver lining in terms of some recent developments. These developments indicate that the development gap between the debt and equity markets is fast diminishing. It's a matter of time before the debt capital markets reach the size of the equity markets as well as Bank credit and perform a significant role in corporate balance sheets.

Introduction

There is no doubt that amid the recovering gloom in global markets, India continues to shine. This is amply demonstrated by most yardsticks for comparison – be it GDP growth rates, the ever peaking equity capital markets, corporate performances, Indian professionals leading global companies, Indian Billionares making front page news in US financial dailies, Bollywood raking in multiple of USD 100 mn for star movies etc etc. Inspite of the successes, India continues to be still counted as a developing nation and has miles to catch up with the developed nations. Other developing nations such as China have raced ahead through sustained growth rates of over 10% while India is still referred to as the "Tortoise" trying to catch the "Hare". One of the key drivers for growth is the massive need for physical as well as human capital and undoubtedly building physical capital involves tremendous amounts of economic capital --- "lots of money". The booming Indian stock markets coupled with global Private Equity [PE] investor interest in India have ensured that there is no dearth of equity money required for growth. However, debt continues to be a challenge for "riskier" ventures and the state of Indian Debt Capital Markets [DCM] needs to improve significantly if India aims to quickly transition "the developing to

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developed gap". Enough debate has happened over the last two decades of economic reforms on the constraints relating to DCM and what needs to be done. The objective of this article is not to repeat what has already been said by government appointed committees, regulators, senior business leaders and market professionals. What this article aims to achieve is to give an Investment Bankers [I-Banker] broad perspective on the Debt Markets including on some of the new kind of transactions that have taken place over the last couple of years.

The article is broadly presented to cover the key characteristics of the Indian Debt & Debt Capital markets, the key market participants, the recent developments in the market and finally concluding with what we see as the scenario over the next five years.

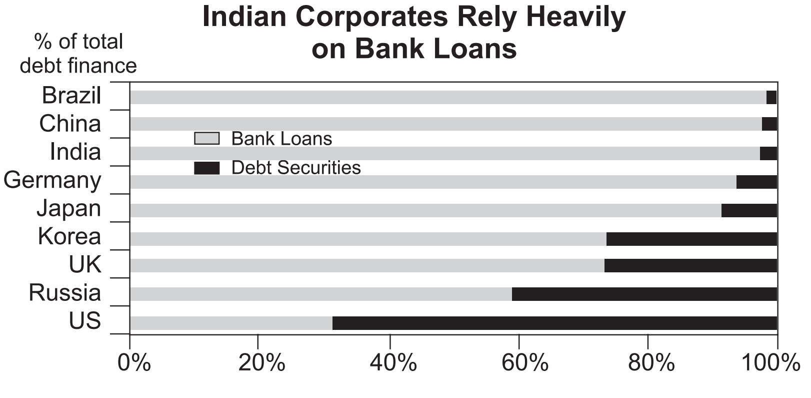
Key Characteristics of Indian Debt & Debt Capital Markets

Debt is a very critical source of capital for most corporate entities who intend to take on expansion for growth opportunities. This is on account of the limited equity funds available from internal sources as well as the relatively higher cost of equity capital. Given the relative importance of debt and the context of the current subject, it is prudent to first outline the key characteristics of the Indian Debt & Debt Capital Markets as follows:

First, Banks are the main providers of Debt: Unlike in developed countries, Banks contribute over 90% of the debt requirements of Corporates in India and less than 5% of the total debt is taken from the DCM. This is unlike most developed countries [such as US, UK etc] where DCM caters to upto 70% of the corporate debt requirements.

Second, Government is the largest issuer of Bonds: While the Indian DCM comprises of government as well as corporate bonds, government bonds are predominant (constituting over 75% of primary issuances and 90% of traded volume) and they are the most

Figure 1



Source: *National Central Banks, various exchanges. Goldman Sachs.*

liquid components of the Bond market. Table 1 below depicts the comparative growth of resource mobilization in the G-Sec [government bonds] and corporate bond markets in India

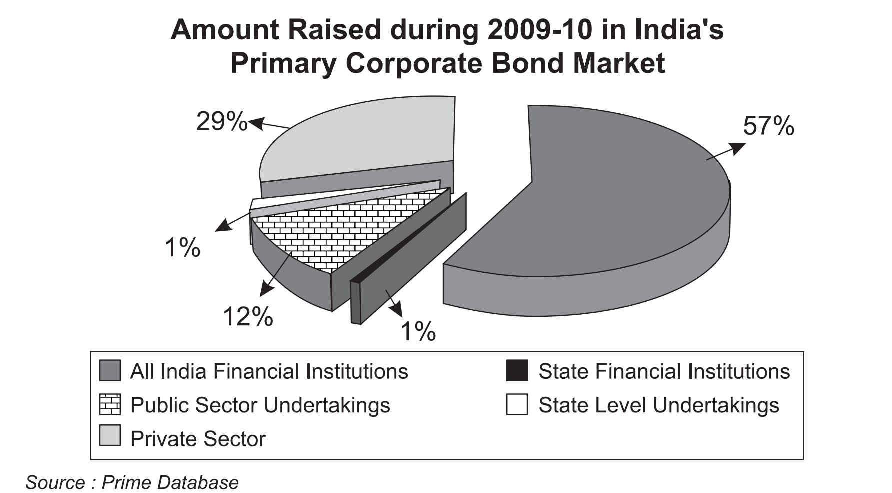
Table 1: Resource Mobilisation in the Bond Market

		[₹ Bn]
Year	Central Government Securities	Corporate Bonds
FY2004	1215	484
FY2005	800	554
FY2006	1310	818
FY2007	1950	938
FY2008	1560	1154
FY2009	2610	1743
FY2010	3250	1025

Source : CCIL, Prime Database

Third, primary corporate bond market is dominated by high rated issuers such as All India Financial Institutions (FI), Public Sector Undertakings: During the year 2009-10, the top issuers of Corporate Debt in India included FI's such as Rural Electrification Corporation (Rs 14,254 crores, AAA rating), Power Finance Corporation (Rs 12,289 crores, AAA rating), ICICI (Rs 8,700 cr, AAA rating) and PSU's such as Powergrid Corporation (Rs 5478 crores, AAA rating), SAIL (Rs 3,153 crores), ONGC Videsh (Rs 2,340 crores). While issuances from Private Sector Bonds has increased from 9.7% of the total issuance in FY2006 to 29% in FY2010, a majority of Indian firms still view Bank finance is the main source of funding. Further, over 90% of Debt issuances carry a rating of AA or better.

Figure 2



Source : Prime Database

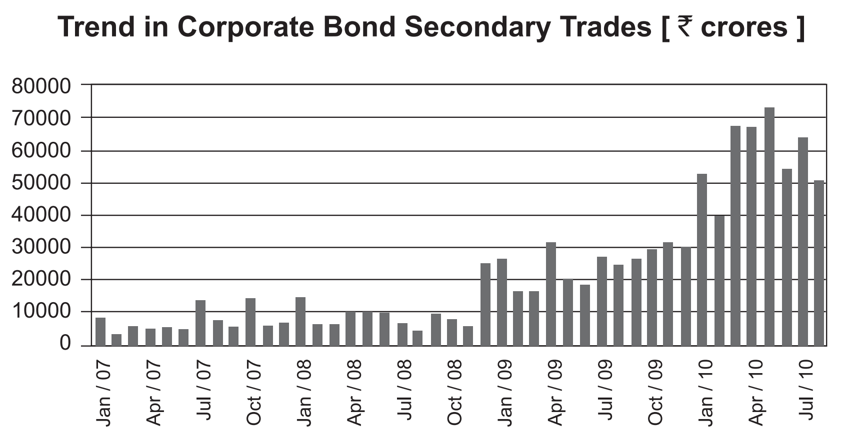
Fourth, secondary market trading in Corporate Bonds has been picking up: Based on various regulatory initiatives and market bodies such as FIMMDA, there has been pickup in secondary trading of Corporate Bonds. One key development is the recent increase in FII limit for investments in Indian Bonds.

Traditional Market Participants in the Debt Markets: A Broad classification of the traditional market participants in the Indian Debt Markets can be made in terms of Issuers, Investors and Support institutions:

Some Recent Developments in the Indian Debt Capital Markets

1. Long Term Infrastructure Financing: Till a few years back, Corporate Bonds over 10 year tenors were extremely rare. However, there have been numerous issues of tenors ranging between 15 to 25 years in the last one year. The interesting point to note is that in some of these issues, the objective has been to refinance Banks due to availability of cheaper funds through DCM.

Figure 3



Source : SEBI

Table 2

Investors	Issuers	Support Institutions
Banks and Financial Institutions	All India Financial Institutions	Investment Banks
Insurance Companies	Public Sector Undertakings	Rating Agencies
Mutual Funds	Private Sector Corporates	Debenture / Security Trustees
Pension Funds	State Financial Institutions	Legal Counsels
Foreign Institutional Investors	State Level Undertakings	R&T Agents

Table 3: Some of the Rated Long Term Bond issuances over 15 year tenor during 2010

	Issuer	Amount (₹ crore)	Tenor	Issue Month
1	Rural Electrification Corporation	500	15 yrs	July 2010
2	Patel KNR Infrastructures Ltd	409	17 yrs	April 2010
3	Steel Authority of India Ltd	300	15 Years	August 2009
4	GMR Pochanpalli Expressways Ltd	650	16 years	March 2010
5	IFCI Ltd	250	20 yrs	May 2010
6	IFCI Ltd	1000	30 yrs	July 2010
7	IRFC	1100	25 yrs	May-10
8	NTPC	150	15 yrs	June 2010
9	IDFC	400	15 yrs	July & Aug 2010
10	IL&FS Ltd	150	25 yrs	Aug 2010

2. Real Estate Financing [Land acquisition, Construction Finance, Commercial Mortgage Backed Securities] : In India, Banks as well as top Housing Finance NBFC's have been regulated to stop any financing for Land acquisition to contain the so called "real estate bubble". Inspite of this perception that real estate is a high risk option and the top real estate firms in the country struggling to get a A+ rating from rating agencies, there are innumerable deals happening in the Debt Capital Market. In most instances, the investors in such bonds are highly sophisticated institutional investors who transact with "the best of the available lot" real estate developers. In the bargain, they are able to squeeze out high returns in the 16-24% bracket for land acquisition bond deals and around 12-18% on the construction finance deals. Even deal sizes of Rs 500 crores and upwards are not undoable for good quality firms and there are instances of investors/i-banks underwriting large deals on a syndicate basis. The next round of sophistication is expected to bring in internationally accepted DCM products such as CMBS and there are already multiple deals at the discussion stage

3. Promoter Financing: The practice of promoters pledging their shareholding in listed corporate entities for raising finance is not new to India. A number of institutions such as IL&FS have been catering to these requirements for close to two decades. During depressed stock markets, many large Indian promoters have often use this product for shoring up their holdings through creeping acquisitions, preferential allotments etc. In fact, even during times of peaking stock markets, promoters have leveraged their stock holdings to raise finances for acquisitions

and for investments in their other high growth businesses. The one notable development in the DCM relating to promoter finance has been the NBFC's facing competition from Mutual Funds, FII's and even HNI's for investment in the bonds issued by investment companies owned by the promoters. Promoter of reputed corporates such as Asian Paints, Zee Group, Max Healthcare Group, Ranbaxy, Unitech, Amtek Auto, Sun TV, Era Infrastructure, Crompton Greaves, Jindal Steel have raised funds through Bonds issued by their investment companies. While there was a brief period during 2008-09 wherein stocks of companies involving promoters share pledge witnessed bear hammering, it appears that the better quality promoters have been excused by the stock market to continue with their personal leverages as long as they continue the good job at their respective company level

4. High Networth Individuals Participation: The unpredictable stock market swings have influenced the most savvy equity swearing investors to look at alternate asset classes for investment. This accompanied by the growing breed of Indian super rich class has led to a highly focused breed of private wealth managers and family office advisory firms. These firms have done a decent job of educating the HNI investors to invest in fixed income instruments that offer yields in the range of 12-16%, are relatively risk free and are available in tenors of upto three year tenors. It's not uncommon these days for private wealth management firms to push I-Bank/NBFC firms for originating bond deals that can be exclusively marketed to HNI investors. We have seen deals relating to real estate, promoter financing as well as the usual Bond market issuances getting lapped up by the HNI segment in no time

5. FII Investment in Indian Corporate Bonds: Arguably, Foreign Institutional Investors drive the Indian equity markets. As I write this article, FII's have infused over USD 25 Bn in Indian equities during 2010 and this has driven the Sensex to cross 21,000 already and rising. It isn't too difficult to predict that the same story appears set to repeat in the Indian Debt Capital Markets. The Government has recently hikes FII investment limits to USD 30 Bn. While the incremental USD 10 Bn hike comes with riders relating to sector [only Infrastructure financing allowed] and tenor [min 5 year residual maturity], most I-Bankers would agree to significantly higher FII interest in the Indian Debt markets. Inspite of the restrictions on FII investment in only rated bonds; there have been instances of FII's being far more adventurous and having invested in Bonds with rating as low as BB-. Many local NBFC/Banks have also been

making significant fee incomes from warehousing bonds deals till listing [it typically takes upto 7 days from issuance date] and then downselling these bonds to FII's. This is inspite of some niggling issues such as withholding tax that is applicable for many FII's. Given the huge mismatch between demand and supply of capital in the country, and the close to zero interest rates in some large developed markets, the trend of FII investment in Indian Bonds would only see one way direction

6. NBFC Participation: Non Banking Finance Companies [NBFC's] are relatively the nimble footed financing entities who have been continuously evolving business models in India over the last two decades. NBFC's get into a niche business wherein they donot compete directly with Banks and build sustainable business models. As far as DCM is concerned, it started with NBFC's booking loan assets on Balance Sheet backed by downsell of the credit to investors. This business of converting Loan assets to rated tradeable Pass Through Certificates [PTC's] and then selling the same to investors resulted in over Rs 50,000 crores of business during 2005-08 till RBI came out with guidelines that restricted such transactions mainly on account of the mandatory one year seasoning requirement. The new development is that some NBFC's are now booking loan assets as freely transferable Non Convertible Debentures and taking the risk on their books before offloading these to other investors. In some instances, NBFC's are even acting on informal back to back commitments from investors to subscribe to such NCD's before the primary funding is done

Conclusion

The Debt Capital Markets appear to be at an interesting stage of evolution in India. It appears all set to give the equity markets a tough competition in terms of growth prospects. As financial sector participants, we have more often than not heard of companies seeking Debt Equity in the ratio of 2:1 for their capital expenditure. Of late, there have been increasing cases of Bank debt being taken during the early stages of project risk and the same getting refinanced from Bond issuances as the projects near completion or start generating cashflows. This trend is expected to get far greater fillip with the government encouraging greather deepening of the markets. So, while the role of Banks in Corporate credit will not go away, we feel that it wont be too long before the 5% share of DCM moves to 50% making the corporate capital financing ratio to become 1:1:1 in favour of DCM: Bank Credit: Equity. We expect this scenario of emerge over the next five years in India.

The Union Budget 2014-15: Beginning of a Roadmap for Reform

*Dr Brinda Jagirdar**

The Union Budget presented by India's Finance Minister on 10 July 2014 aims to contain the fiscal deficit, revive economic growth and curb inflation. The new Government had barely two months to prepare and present the Budget, so it will not be fair to look for big bang announcements from a fledging team. However, there are enough indications, both in the Budget and in the statements from the Finance Minister and his team, that this is just the beginning and there is more to come. Understandably, it will be a tough task to change the business environment, cut red tape and facilitate ease of doing business, but some steps have been announced in this direction, including greater intervention of technology, and these are decidedly welcome.

The Finance Minister has signaled a commitment to fiscal prudence and structural reforms and has announced wide ranging measures to facilitate investment in agriculture, energy, manufacturing and infrastructure, all of which are crucial for growth, employment and inflation control. The reduction in the threshold for investment allowance from Rs 1 billion to Rs 25 million comes as a shot in the arm for a large number of MSMEs also. Excise cuts for a range of labour intensive industries like food processing and footwear will help job creation. The thrust to infrastructure and skill development will give a push to industry. Banks lending for infrastructure has been facilitated by allowing banks to raise long term infrastructure funds, unencumbered by pre-emptions like CRR, SLR and priority sector lending constraints and eliminating asset-liability mismatch.

The actions to achieve these goals will involve some tough decisions in the short term, but will pave the way for sustained long term growth. As I had expected, tax rates have not been hiked to raise revenue, and some relief to the retail investor has actually given by way of increased exemption limit, increased tax deduction for interest on housing loan and increase in investment under public provident fund scheme. The GST and DTC are close to being finalized and their introduction will lead to revenue gains for the government and substantial relief for tax payers.

However, to raise revenue, there is a strong case for streamlining tax administration and widening the tax net. The Indian economy has doubled in the last seven years to $2 trillion, per capita incomes have risen sharply and India now has the largest number of billionaires in Asia (ex-Japan). Yet only

* Independent Economist and former Chief Economist, State Bank of India

3% of Indians pay income tax and the tax-GDP ratio has risen only marginally from 10.49% in 1979-80 to 11.07% in 2013-14.

Following in the steps of the Railway Budget, the Finance Minister has efforts to tap new domestic and global sources of funding and leverage economies of scale and economies of scope. Raising the cap on FDI in select sectors like defence and insurance from 26% to 49%, and more recently in Railways infrastructure to 100%, will attract long-term stable capital flows.

Other options to increase revenue must be pursued like cutting wasteful expenditure, increasing productivity and finding innovative ways to access funds. Around 40% of the tax collected is spent on subsidies, which can otherwise be ploughed into investment. So going forward we need to see attempts to bring down the subsidy on fuel (Rs 60,000 cr) by better targeting and cutting the subsidy on LPG. Inefficiencies in fertilizer subsidy (Rs 68,000 cr) could be reduced by targeting these towards poor farmers, while a revised policy could be worked out in line with gas pricing. In a drought year it may not be possible to reduce the subsidy on food (Rs 125,000 lakh cr), though efficiencies in food procurement, storage and transportation remain on the table.

Unlike in previous years, there is no cut in Plan Expenditure to meet the fiscal deficit target and in my view, this is the only way to kick start investment and revive the economy. The Finance Minister must synergise various overlapping schemes often aimed at the same segment, which will remove inefficiencies and cut wasteful expenditure. The most important, however, will be reviving disinvestment – this will not only help fill the hole in the fisc, but will revive the primary market, get the retail investor back into the market and channel household savings away from gold and real estate and into financial savings.

Given the need for capital to fund investment projects, the effort to reach out to private investors and get them on board is understandable, but the big dependence on PPP appears to be too optimistic. The past experience with PPP has not been too encouraging. These are mired in controversies and it appears that promoters are looking for exit rather than entry. So to kick start investment, it is imperative to address these issues while putting in place an enabling environment and sharply improving the ease of doing business. However, it does appear that the Government is willing to take bold and far reaching measures, albeit at a calibrated pace, to revive the economy. If the Railway Budget, the Union Budget and subsequent policy pronouncements from the Government are any indication, then we can expect to see consistent policy to put in place a framework for sustained economic growth in the coming years.

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The Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies was constituted in 1996 by the Bombay Chamber of Commerce and Industry to undertake independent research activities on various economic and management issues and for providing analytical views on macro-economic scenario, industrial performance and other issues of topical interest.

The Trust started publishing the quarterly magazine 'AnalytiQue' for the quarter October-December in the year of 1999 to serve as an effective vehicle of communication between the government, industry, economists, thinkers, management consultants and scholars. In its short journey the magazine had some trying spells and after the issue of January-March, 2006 there has been no issue. However, after four years, the Trust published the next issue as Journal in March, 2010. While retaining its basic purpose and character, AnalytiQue now continues to serve members, who are drawn mainly from the world of business and commerce and deals with contemporary economic issues while documenting some of the important developments of the Indian economy.

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