# ANALYTIQUE

Vol. VIII · No. 3 · Jul - Sep 2012

Strengthening SMEs Capabilities for Global Competitiveness

*Dr. K.C. Chakrabarty*

How To Improve SMEs Access To Finance

*T.C. A. Ranganathan*

Challenges of Inclusive Banking

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Common Financial Mistakes

*Mehrab Irani*

Select Economic Indicators

Quarterly Journal of the Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies

BOMBAY CHAMBER

# Bombay Chamber of Commerce & Industry

The Bombay Chamber of Commerce and Industry is India's premier Chamber of Commerce and Industry situated in Mumbai, the industrial, financial and commercial capital of India. Established in 1836, it is one of the oldest Chambers in the country and has a long and illustrious history of continuous service to trade and industry.

The Chamber can boast not only of its longevity but also of its impeccable lineage. With more than 4000 prime companies as its members, the Chamber represents the cream of Indian Industry, Commerce and Services. While the name 'Bombay Chamber' conjures images of an organization representing exclusively a city-based membership, in reality it represents a wide spectrum of highly reputed and professionally run companies which are based in the city of Mumbai, but whose manufacturing facilities and commercial influence spread not only all over India but also internationally.

The Chamber uniquely represents large and medium sized Corporations, Banking and Financial Institutions, professional Consulting Companies and a large number of Multinationals. It comes as no surprise that today the Bombay Chamber's membership represents as much as a third of the country's GDP in the manufacturing and service sectors.

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Vol. VIII • No. 3 • July-September 2012

## *From the Editor's Desk*

*As we go to the press with our third issue of 2012-13, there appears to be a renewed sense of purpose in the economic policy sphere of the UPA II government. A few important but long delayed decisions regarding investment in the retail sector and in the insurance sector have resulted in buoyancy in the stock market. The downward slide of the rupee also has been halted, if not reversed. But the projection of the growth rate is still agonizingly hovering around 5.5%, which is disappointing.*

*The importance of Small and Medium Enterprises therefore cannot be overstated. The Bombay Chamber has over 2500 members from SME sector. Their contribution to GOP & exports is immense. But their problems are many too. The Chamber has taken a conscious decision to focus on activities to address the needs of our SME members. A separate Committee under the Chairmanship of Mr Saroj Dutta has been constituted to focus exclusively on services & events  for SME members. The current issue reflects the focus of our activities towards the needs of our SME members.*

*The Chamber had invited Dr. K C Chakrabarty, Deputy Governor, RBI to speak on Strengthening SMEs Capabilities for Global Competitiveness. A large percentage of our SME members are exporters and for them, competitiveness in the international stage is of paramount importance. On the subject of access to finance, we had the good fortune to hear TCA Ranganathan, Managing Director of Export Import Bank of India. Finally, we heard the views of A. Krishna Kumar, Managing Director of State Bank of India on the subject of Inclusive Banking. In this issue, we are happy to reproduce those three speeches. Finally, we feature something that all of us can use: information on how to avoid common financial mistakes. The author of the piece, Mehrab Irani, is soon releasing his book on the same subject which will help all of us to avoid common mistakes.*

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**Disclaimer -** The articles published in Analytique do not necessarily reflect the views of the Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies.

Printed at Uchitha Graphic Printers Pvt. Ltd.

Published and Printed by Dr. Atindra Sen, Bombay Chamber of Commerce & Industry Trust for Economic and Management Studies,
Mackinnon Mackenzie Building, Ballard Estate, Mumbai 400 001 • Tel.: 91-22-49100200 • Email: analytique@bombaychamber.com

# Strengthening SMEs Capabilities for Global Competitiveness

*Dr. K.C. Chakrabarty**

It is, indeed, a matter of great pleasure for me to be present here today at this interactive session on 'Strengthening SMEs Capabilities for Global Competitiveness' organized by the Bombay Chamber of Commerce and Industry and share some of my thoughts. The Bombay Chamber, which was established in 1836, is, I am told, India's oldest Chamber of Commerce to serve its members without a break for 176 years. It has more than 4500 member companies with a large proportion of them being small corporates. It has been associated with several historic developments in the city of Mumbai and I congratulate the Chamber for its achievements. It is a matter of great privilege for me to be invited to address the members of the Chamber and I thank the Chamber for this opportunity.

The current economic situation, with political and economic integration and technological breakthroughs, warrants the need to make our Small and Medium Enterprises (SMEs) globally competitive. One of the results of globalization is that the costs of distance have been reduced dramatically. Businesses can operate in more markets and transactions can be done much faster and at lower cost. Similarly, consumers have more insight into where to buy the best products and services at the best rates. As a result, even smaller and locally orientated businesses have to see themselves in a global context. SMEs have to, now, deal with increased competition as a result of globalization. Instead of competing merely with local companies, SMEs now compete with various international competitors, be they MNCs or other SMEs. Competition brings pressures on SMEs to reduce costs, innovate and manage knowledge in similar ways to large companies, often without having surplus resources to invest for such activities, in a fast changing environment.

I appreciate the initiative taken by the Bombay Chamber for organizing this session since SMEs play a vital role in national development. Fostering a dynamic Micro, Small and Medium Enterprise (MSME) sector is seen as a priority amongst economic development goals, in both developed and emerging economies. MSMEs are a primary driver for job creation and GDP growth. They greatly contribute to economic diversification, exports and social stability. As per data

Address by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at the Interactive Session on "Strengthening SMEs Capabilities" organized by the Bombay Chamber of Commerce and Industry on 8 October, 2012 at Mumbai.

* Reprinted from RBI website: www.rbi.org.in

released by the Ministry of MSME, Government of India, there are about 26.1 million enterprises in this sector. The sector accounts for 45 per cent of manufactured output and 8 per cent of the GDP. MSMEs contributed close to 40 per cent of all exports from the country and employed nearly 59.7 million people, which is next only to the agricultural sector. Equally importantly, they serve as a feeder line for the large corporates of tomorrow as it is from among these small companies that the MNCs and large corporates will emerge. There are numerous examples of large corporates of today, which began as small business ventures some time back.

I firmly believe that the next level of growth in the economy will have to come from the MSMEs. It is this sector that can propel India's growth rate from around 5.5 per cent at present to a sustainable 9 plus per cent in the medium-to long-term, which is considered as India's desirable growth rate. In fact, it is not possible to think of a healthy Indian economy without a vibrant and healthy MSME sector. However, this is not possible without SMEs developing their capabilities to compete at a global scale, and hence, the relevance of the topic of today's deliberations.

## A. Access to Finance

The MSMEs primarily rely on bank finance for their operations. For small corporates, access to timely and adequate finance is a priority, provided the rates charged are not exploitative. Over the years, there has been a significant increase in credit extended to this sector by banks. As at the end of March 2012, the total outstanding credit provided by all Scheduled Commercial Banks (SCBs) to the Micro and Small Enterprises (MSE) sector stood at Rs.5286.17 billion as against Rs.4785.27 billion in March 2011 and Rs. 3622.91 billion in March 2010. Despite the increase in credit outstanding to the sector, the MSME borrowers feel that the lenders are not doing enough for the MSMEs and are catering more to the needs of the large corporates.

## B. Problems Faced by Banks in Lending to MSMEs

Commercial banks are reluctant to service MSMEs for a number of reasons, though at times, not based on facts. MSMEs are regarded by creditors as high-risk borrowers because of insufficient assets and low capitalization, vulnerability to market fluctuations and high mortality rates. Information asymmetry arising from SMEs' lack of accounting records, inadequate financial statements or business plans also makes it difficult for creditors to assess the creditworthiness of potential SME proposals. Besides, high administrative/ transaction costs of lending to small amounts may not make SME financing a profitable business.

To encourage commercial banks to lend to SMEs, the Government and Reserve Bank of India have an important role to play by setting out a policy framework for channeling adequate funds to the SME sector. SMEs, on their part, need to be more transparent while representing their businesses and future plans before bankers so that they gain the trust and confidence of creditors to extend finance to them.

### C. Steps Taken by Government of India / Reserve Bank of India

Recognizing the important role played by MSMEs in economic development and its sizeable contribution to employment and GDP, and realizing that financial access is critical for MSME growth and development, Government and Reserve Bank of India are taking the lead in supporting initiatives that improve access to finance. In view of the high level of financial exclusion in this sector (93%), the drive to universal financial access, including SME finance, is no longer a policy choice, but a compulsion. The Reserve Bank of India has intensified a number of measures and endorsed quantitative access targets over the last few years to further financial inclusion. Let me very briefly touch upon a few of them.

With an objective of ensuring uniform progress in provision of banking services in all parts of the country, banks were advised to draw up a roadmap to provide banking services through a banking outlet in every unbanked village having a population of over 2,000 by March 2012. The Reserve Bank advised banks that such banking services need not necessarily be extended through a brick and mortar branch but could be provided also through any of the various forms of Information and Communication Technology (ICT) - based models, including Business Correspondents (BCs). As at the end of March 2012, as reported by the State Level Bankers' Committees of various States/ Union Territories, banking outlets have been opened in 74199 villages across the various States in the country. This comprises of 2493 branches, 69374 business correspondents and 2332 other modes like rural ATMs, mobile vans, etc. The process for ensuring coverage of villages with population below 2000 is underway.

To ensure enhanced credit flow to the sector, in terms of the recommendations of the Prime Minister's Task Force on MSMEs constituted by the Government of India, banks were advised to achieve a 20 per cent year-on-year growth in credit to micro and small enterprises; with allocation of 60% of the MSE advances to micro enterprises, which is to be achieved in stages viz. 50% in the year 2010-11, 55% in the year 2011-12 and 60% in the year 2012-13 and achieve a 10% annual growth in number of micro enterprise accounts. The Reserve Bank is closely monitoring the achievement of targets by banks on a quarterly basis. The matter is followed up with the laggard banks to know their constraints and impress upon them the need to devise strategies to gear up the credit mechanism for the sector.

As the MSE borrowers, especially new generation entrepreneurs, do not have collaterals to offer to avail of bank finance, we have, in terms of the recommendations of the Working Group constituted by the Reserve Bank of India to review the Credit Guarantee Scheme (CGS) of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), mandated banks, on May 6, 2010, to provide collateral free loans to the MSE sector up to Rs.10 lakh, which was increased from Rs. 5 lakh earlier and the banks, in turn, could take cover for the collateral free credit facilities under CGS.

All Scheduled Commercial Banks have also been advised on May 4, 2009, to review and put in place an MSE Loan policy, Restructuring / rehabilitation policy and Non-discretionary One Time Settlement Scheme for recovery of non-performing loans, duly approved by their Board of Directors. Banks were advised in December 2009 to give wide publicity to the Non-discretionary One Time Settlement Scheme for recovery of non-performing loans for the MSE sector by placing it on their website and through other possible modes of dissemination.

To address the complaints received from various Industry Associations/ Chambers that banks are not acknowledging their loan applications, we have, on January 4, 2012, mandated banks to acknowledge all loan applications, submitted manually or online, by their MSME borrowers and ensure that a running serial number is recorded on the application form and on the acknowledgement receipt.

As the lack of financial literacy, operational skills, including accounting and finance, business planning, etc. represents formidable challenge for MSE borrowers, we have, on August 1, 2012, advised banks to play a more proactive role in the affairs of their MSE clients by providing them with financial literacy and consultancy support. For this, banks could either separately set up special cells at their branches, or vertically integrate this function in the Financial Literacy Centres (FLCs) set up by them, as per their comparative advantage. We have also stated that the bank staff should be trained through customised training programs to meet the specific needs of the sector.

On the issue of alternate sources of credit, dedicated Exchange for MSMEs, marketing, technology up-gradation and infrastructure, the PM's Task Force has examined the issues and has made several recommendations to address the bottlenecks. The implementation of the recommendations in a time bound manner is being monitored by the Government of India.

## D. What More Needs to be Done?

### i. Need to Relook Business Processes and Strategy and to Innovate

Globalization is bringing new opportunities and the SME entrepreneurs have to seize these opportunities. For this, MSME entrepreneurs have to have a relook at their business strategies and innovate.

To successfully do so, four major aspects need to be kept in mind. Firstly, MSME entrepreneurs have to apply the discipline of innovation to identify and develop new business. As rightly pointed out by Peter F. Drucker, innovation requires us to systematically identify changes that have already occurred in the business – in demographics, in value, in technology - and then look at them as opportunities. Entrepreneurs have also to be prepared to face the fact that new inventions or product / service is not always successful in the market for which they were originally designed, but could be successful in a totally different market. He should be on the lookout for new opportunities for application of the product instead of focusing on the original markets alone. Secondly, business should pay attention to cash flows. Entrepreneurs believe that profit is what matters most in a new enterprise. But profit is secondary. It is the cash flow that matters. A business that grows fast devours cash. Constant investments have to be made to just keep even. Thirdly, when a business grows, it is necessary to create a management team. Young entrepreneurs cannot pay to bring in a management team. It is, therefore, necessary to identify the core competencies of the people working with you so that your business is geared to seize the opportunities opening up. This planning should take place well in advance. Lastly, when the business is a success, the entrepreneur needs to ask what the business needs at this stage and whether he is concentrating on the right things. As successful entrepreneurs, they have gained experience and wisdom from their mistakes and going forward, it is necessary to ensure that the same mistakes are not repeated.

### ii. Access to Equity Capital

Access to Equity capital is a genuine problem. At present, there is almost negligible flow of equity capital into this sector. Availability of sound equity capital base is essential as it enhances the loss absorptive capacity of new ventures. Absence of equity capital may pose a serious challenge to development of knowledge-based industries, particularly those that are sought to be promoted by the first-generation entrepreneurs with the requisite expertise and knowledge. Most MSMEs, particularly the knowledge based enterprises, when starting off, have negative cash flows and no collateral and therefore, find it difficult to access debt capital or bank financing. Venture/ Risk capital is often a more appropriate financing instrument for high-growth-potential and start-up SMEs. Firms typically look for venture capital to provide them with the financing they need, to expand, break into new markets and grow faster. Thus, the ability of MSMEs (especially those involving innovations and new technologies) to access alternative sources of capital like angel funds/risk capital needs to be enhanced considerably to encourage and develop entrepreneurship. For this purpose, removing fiscal/regulatory impediments to the use of such funds by the MSMEs should be considered on priority. There is a demand for a dedicated Exchange for MSMEs. In the Union Budget 2012-13 the Finance Minister has announced to set up a Rs.50 billion India Opportunities Venture Fund with SIDBI to enhance the availability of equity to the MSME sector. Based on the recommendations of the PM's Task Force on MSMEs, the Bombay Stock Exchange and the National Stock Exchange have also set up separate dedicated exchange / platform for listing and trading of shares of SMEs, making it easier for them to raise equity capital.

### iii. Factoring Services

Timely payments from customers will help SMEs in reducing their working capital requirements, leading to lower interest costs, improved profitability and a positive impact on the long-term health and sustainability of India's SME sector. Delays in settlement of dues adversely affect the recycling of funds and business operations of the SME units. A study of 5000 SMEs by CRISIL shows that high quantum of receivables is an endemic problem across industry sectors and geographies in the SME space. Smaller SMEs, perhaps due to their lower bargaining power, are in a more disadvantageous position with weaker receivables positions. The CRISIL study estimates that SMEs can enhance profits by at least 15 percent if they receive payments on time from their large corporate customers.

It is, therefore, critical to ensure that the small entities are able to raise liquidity against their receivables. This problem can be institutionally tackled by factoring, which provides liquidity to SMEs against their receivables and can be an alternative source of working capital. World over, factoring is a preferred route of accessing working capital for SMEs and even larger organisations. Some banks and financial institutions in India have already launched factoring services and I would urge more banks to offer such services, particularly for the MSMEs. To provide a legislative framework for factoring services, the Parliament has recently passed the Factoring Regulation Bill that would address delays in payment and liquidity problems of micro and small enterprises.

### iv. Access to Technology

With the increasing competition, globalization and the uncertainty due to the global downturn, it is essential for SMEs to be technology literate. SMEs will have to continuously incorporate the latest technology into their production processes as well as in their marketing and management functions, to cut costs, gain efficiency and consistency. There are additional challenges to be met. The influx of low-cost products from China has made it even more difficult for Indian manufacturers to compete solely on the price front. China is considered the world's manufacturing backyard, due to its low manufacturing and labour costs when compared to those elsewhere. What SMEs need today is knowledge and access to new technology. In fact, innovation and technology are the two tools MSMEs have with them that need to be capitalized fully to compete with firms much larger in size. SMEs will have to continuously strive to incorporate the latest technology into their production processes as well as in their marketing and management functions, to cut costs, gain efficiency and consistency. Let me reiterate that technology should not be adopted just for the sake of it, but should be aimed at improving the quality of products and bringing greater productivity and efficiency.

Technology, however, does not come free. The high costs of installing and maintaining information systems and recruiting skilled workforce to operate them would be a concern for many smaller firms. The new concepts such as cloud computing, which enable collaborative sharing of resources, facilitate even smaller firms to leverage on advanced technologies. Such arrangements also free up critical resources of MSMEs, which could be used for focusing on core activities. MSMEs, therefore, need to be updated on the latest technological developments. The Prime Minister's Task Force on MSMEs recommended several measures having a bearing on the functioning of MSMEs, viz., credit, marketing, labour, exit policy, infrastructure/technology/skill development and taxation.

### v. Coping with the Economic Downturn and Checking Sickness in MSME Units

The world is presently facing economic crisis due to which economies world over are facing slowdown in economic activities. These are, indeed, challenging times for all of us. In order to cope with the downturn, I would urge upon the MSMEs to plan for the future and be transparent in their dealing with the banks. They should approach the banks well in advance with their problems and articulate what they specifically want from the banks. Transparency in approach is the key. Very often the entrepreneur tends to mix his own transactions with that of the business. They should delink the two and plan well in advance as to what is needed for the business. In this context, I would like to mention that timely detection of sickness is critical to make the possibility of revival of potentially viable sick units bright. In order to hasten the process of identification of a unit as sick, a proposal for modifying the extant definition of sickness, in line with the recommendations of the Working Group on Rehabilitation of Sick SMEs set up by Reserve Bank of India, is under consideration of the Government of India and Reserve Bank of India.

### vi. Skilled Manpower and Managerial Talent

Human Resource Development issues are fundamental in improving SMEs competitiveness. The ability of SMEs to adjust to the competitive pressures that come with trade liberalization and globalization will depend on the level of skills available domestically. It is, indeed, ironic that in a nation of more than a billion individuals, skilled labour is cited as scarce. India needs to capitalize on its unique demographic dividend (it has a very large and young workforce). The Government of India and various State governments have been implementing a number of schemes and programs over the years for skill development. The Rural Self Employment Training Institutes (RSETIs) are also working in this direction. However, given the growing requirements of the MSME sector and the huge 'demographic capital' we possess, significant efforts are still needed for skill and entrepreneurship development. In addition to the initiatives taken by Government agencies, the industry has to contribute to building up a large base of appropriately skilled workforce available for employment in MSMEs. There should be training programmes by the industry associations to upgrade the skills of the workers and to acquaint them with the skills compatible with the new technology. There is a need to incorporate entrepreneurship training in school curricula. Several studies have cited lack of entrepreneurship skills as a major shortcoming for women entrepreneurs, which can be addressed by incorporation of entrepreneurship training in secondary school curricula. Investment needs to be made in a big way on skill and entrepreneurship development.

### vii. Corporate Governance

Weak corporate governance of small firms, burdened further with poor availability of crucial inputs, has made these firms extremely vulnerable. Good governance practices in SMEs will help them grow or attract additional investors. The absence of good corporate governance practices makes it difficult for them to access finance from banks or investors. Adoption of sound corporate governance by SMEs is indispensable for taking this sector to a higher growth trajectory. The lack of corporate governance is attributable to lack of awareness about corporate governance practices and its impact on corporate performance. There is a need to educate SMEs about benefits of adopting sound corporate governance practices and industry associations have a key role to play in it.

### viii. Role of MSME Associations

The MSME Associations and Chambers of Commerce have an important role to play in stepping up credit to this segment. Asymmetry of information and lack of transparency and reliability of data has been a major concern for organizations dealing with MSMEs world over. The Associations need to, therefore, proactively engage themselves in organising workshops and training programmes for their members to enlighten them about cash flow cycles, various financial products, accounting practices, etc. In this regard, I would urge upon the MSME Associations and Chambers of Commerce to collaborate with banks, NIBM or any other training institute in banking and finance, basic accountancy and information technology for the benefit of MSMEs.

**ix) Separate Umbrella Organization**

It is felt that a centralized umbrella organization providing focused attention to the development of the MSME sector as a whole, including the unorganized sector, may help in bringing the sector in proper focus of the policy makers. Although the Ministry of MSME, RBI and SIDBI have taken several initiatives in the promotion, financing and development of MSMEs in the country, there should be an umbrella organization for overseeing the coordinated development of the MSME sector with a view to fully exploit its growth potential. This umbrella organization may focus not only on the availability of funds but also provide all round support including technological support, design output, facilitating raw material supplies, marketing support, etc.

## Conclusion

The MSME sector is vital for the nation's economic progress and hence, needs to be carefully nurtured and supported. MSMEs are the best vehicle for inclusive growth in the country, to create local demand and consumption. Besides supporting employment generation activities, they also act as feeder lines for the MNCs and large corporates of tomorrow. I, therefore, urge all banks and financial institutions to implement our guidelines in both letter and spirit to increase the credit flow to this vital sector. I would encourage SMEs, on their part, to be transparent, particularly when in distress, so as to gain the trust and confidence of lenders. Besides, SMEs need to constantly innovate, both in terms of products and processes and have a wide vision, so that they are able to spot new opportunities for their products/ services. MSME Associations and Chambers of Commerce also have an important role to play in this formidable task of building a robust MSME sector by generating awareness about good practices. With the concerted efforts of all the stakeholders, I am sure that the MSME sector would become globally competitive and offer significant contribution to India's economic development.

I congratulate the Bombay Chamber of Commerce and Industry for organizing this interaction and once again thank the Chamber for providing me the opportunity to be present here today.

Thank You.

# How To Improve SMEs Access To Finance

*T.C. A. Ranganathan**

## Introduction

Since 30 years of its inception, EXIM Bank has actively been promoting, facilitating and financing the globalisation efforts of Small and Medium Enterprises (SMEs) in India.

The MSME sector today contributes about 45% of the manufacturing output and 40% of the total exports of the country. The sector is estimated to employ about 70 million persons in over 30 million units throughout the country. There are over 6000 products ranging from traditional to high-tech items, which are being manufactured by the MSMEs in India.

With such vital statistics the importance of the sector assumes significance.

## SME Finance

Rapid pace of globalisation has augmented the competition among enterprises.

The heat however is primarily felt when it comes to funding of SMEs. Access to finance represents one of the most significant challenges for entrepreneurs and for the creation, survival and growth of small businesses.

There are several barriers to financing MSMEs. According to a survey by OECD, in many countries, deficient information about various financing options constitute as barriers to finance. Even entrepreneurs with considerable experience in their own specialities often lack knowledge about the possibilities in obtaining finance for their operations.

Banks and private equity investors offer an array of products with which some MSMEs may have only cursory familiarity. In many cases, some of the MSMEs may not be fully aware of the implications for the firm's cash flow that some types of credit may entail, or of the implications for the firm that various forms of equity may involve.

There may often be a contrast between some MSMEs that complain of non-availability of finance on appropriate terms, and the prospective lenders or investors who simultaneously complain of a dearth of "bankable" or "credit-worthy" projects.

In many cases, some of the MSMEs lack capability to articulate a business plan that meets the requirements of the bankers or investors. Bridging the information divide between entrepreneurs and financiers would

[*] Keynote address delivered by T.C. A. Ranganathan, Chairman & Managing Director at Export-Import Bank of India at the event on "How to Improve Access to Finance" on 28 June, 2012 organised by Bombay Chamber of Commerce & Industry at Mumbai. He can be reached at tcaranganathan@eximbankindia.in

thus become an important aspect of increasing credit to MSME sector.

While there might be a slowdown in the overall economy, the potential for increasing lending to the under-banked MSME segment remains significant. Although MSMEs have been growing in size and importance, they at times lack access to timely and adequate credit to meet working capital needs, incur high cost of credit, are technologically backward and also lack infrastructure and skilled manpower. MSME financing hence presents a unique and scalable funding opportunity.

These are some of the issues that plague the SME segment when it comes to finance, and hence efforts are to be made in mitigating them, in order to move up the value chain while being competitive.

Nevertheless, in my address, I would like to cover pertinent strategies which I feel is essential for the SME sector to progress in a globalised business environment.

### i. Redefine the Ceiling Limit of Medium Enterprises

The MSME sector in India, with some exceptions, is characterized by low technology levels, which act as a handicap in the emerging global market. Although MSMEs play an important role in India's economic growth, be it in terms of its contribution to manufacturing value-added, exports or employment generation, not many units have ability to access technological expertise or mobilize resources for in-house innovation.

Also, the cap on plant and machinery for the purpose of classifying the units as MSMEs does not encourage Indian MSMEs to move up the value chain. It may be observed that some countries (such as EU and China) have positioned the ceiling on investment for medium enterprises at a high level, encouraging capital intensiveness, technology upgradation, quality improvement, export orientation and employment generation.

Considering the above, the ceiling on capital investment for medium enterprises in India may be increased, at least to an extent of US$ 10 million to US$ 12 million. The hike in investment ceiling for medium enterprises would encourage higher investments for technology absorption, quality upgradation, and export orientation.

### ii. Export Credit Support to MSME Sector

Export credit is not a part of mandatory priority sector lending for domestic commercial banks; while foreign banks are set with a 12% sub-target for export credit under the mandatory priority sector lending.

Share of export credit, though growing in absolute terms, has been falling down in terms of its share in Net Bank Credit (NBC), over the years – from a level of 9.8% as of end-March 2000 to 4.2% as of end-December 2011. MSMEs are estimated to be contributing about 40% of India's total exports. Hence they require enhanced level of export credit support.

A Working Group constituted by the RBI (July 2008) for fixing a target export credit for MSME sector has delineated that commercial banks have extended around 38% of their total export credit to MSME sector. The Working Group further suggested that 50% of export credit of commercial banks to be provided to MSME sector as a desired target level. The export credit as a share of NBC was 4.2% as of end December 2011. Assuming that the desired level (50% of export credit to MSME sector) has been achieved by now, export credit share to MSME sector should have been around 2.1% of NBC.

The share of export credit to MSMEs therefore should be doubled (4.2% of NBC) to support the export credit needs of MSME sector. It is suggested that RBI may consider fixing a mandatory target of 4.2% of NBC as export credit to MSME sector, under the overall priority sector target of 40%, and for foreign banks under the 12% mandated export credit target. This measure will also help improve the overall export credit to around 8.5% of NBC, if non-MSME sector is continued to get support at the same level.

### iii. Facilitating Technological Intervention

In the emerging global industrial and trade configuration, technological sophistication is assuming increasing importance for growth. Technological development is central to specialisation and competitiveness in the global arena. Technological development means more than creating new technological knowledge or even acquiring existing technological knowledge. It also involves developing the ability to assess, choose and adapt such knowledge.

The essence of industrialisation continues to be the interaction of technological change, specialisation and trade. And the key to success is to choose policies that allow economies to utilise this interaction fully to their advantage. In light of this, India must improve upon the technological sophistication of manufactures in order not only to sustain export momentum but also to enhance future export prospects.

Maintaining a lead in exports of manufactures would require constant moving up the value chain, vacating low-end products to less developed countries, and upgrading technological sophistication of industry with focus on specialised, value added niche products.

It may be noted that India's share in Hi-tech exports has increased from 6.5% in 2001 to just 7% in 2010; in the Mid-tech category from 21% in 2001 to 29.5% in 2010; whereas in the low-tech category it declined from 45.9% to 28.6% during the same time period.

India has established a range of dedicated institutions to provide diverse support services to MSMEs, such as finance, credit guarantee, credit rating, and entrepreneurship development. There are also few technology oriented institutions supporting the R&D activities in general, including those of MSMEs.

However, there may be a need for a focused institution encouraging technology development and R&D activities in MSME sector in a coordinated manner. The proposed institution may identify thrust areas for research, new areas for technology application, opportunities for commercialization of R&D, and hand-holding of MSMEs in their R&D intensification.

### iv. Access to Alternate Sources of Capital

Alternative sources of capital like angel funds/risk capital are not available to Indian MSMEs. Access to equity capital is a genuine problem. At present, there is almost negligible flow of equity capital into this sector.

Absence of equity capital may pose a serious challenge for development of knowledge-based MSMEs, particularly those that are sought to be promoted by the first generation entrepreneurs with the requisite expertise and knowledge.

Several countries have policies and programmes to stimulate equity capital in the MSME sector.

Australian Government has been supporting Venture Capital Limited Partnerships (VCLPs), and Pooled Development Funds (PDFs) with tax incentives for providing equity capital to growing SME sector in Australia. Italian Private Equity and Venture Capital Association, and the Italian Business Angels Network are supported by Government of Italy for providing necessary funds, equity seed capital and start-up financing to new SME ventures.

Though not as advanced as developed markets in terms of depth and liquidity, Thailand has established a Market for Alternative Investment (MAI) to enable access to capital for smaller companies. MAI serves as a much needed avenue to facilitate equity financing in Thailand SMEs. India also needs to develop programme that would support SMEs to access alternate sources of capital.

### v. Promoting Synergy

In most of the countries, there is a tendency of keeping a 'decentralised institutional arrangement' for MSME development, which is the case in India too. It is essential to achieve integration with regard to institutions and programmes, in order to achieve desired outcomes.

Thus, the requisite mantra should be 'achieving synergy' in various policy support programmes, and institutions meant for MSME development. In all the cases, duplication of existing delivery mechanism and institutional support system may be avoided.

Analysis of institutional framework across the countries reveal that support and delivery mechanisms are available in the MSME value chain, starting from business incubation, technology innovation, product development, and financing, to market development and promotion.

However, within the MSME strata, there are limited institutional support mechanism, especially targeting certain niche groups, geographies and sectors.

I would like mention here that the idea is not to create new institutions targeting new groups, but to integrate policy oriented measures within the existing framework of support infrastructure.

## Concluding Remarks

I have today mainly spoken about select challenges facing the sector, and some very important factors and solutions, that if may be considered by the policy makers, may go a long way in ameliorating many of the issues faced by the sector.

In meeting new challenges, it is important to utilize the strength unique to SMEs. Merits of SMEs are "quick in decision-making" and "can turn on a dime." Because of their small size, SMEs can make bold decisions according to changes in the surrounding environment, and thus have potential for a great leap forward. "Able to make finely-tuned responses" is also a merit of SMEs. Given such unique strengths, SMEs in India have a critical role to play.

Infact, what is necessary for the revival of the Indian economy today is that these individual SME firms which has remained as the backbone of the Indian economy, to continue to meet the challenges so that such underlying strength will be exerted as the strength of India's economy to the maximum extent.

# Challenges of Inclusive Banking

*A. Krishna Kumar**

## Introduction

State Bank of India has been at the forefront of financial inclusion efforts mandated by the Government and Reserve Bank of India. After all, SBI was created pursuant to All India Rural Credit Survey (Gorewala) Committee Report which recommended creation of a strong bank to meet the need for formal credit in rural areas. SBI Act in fact mandated setting up of a minimum 400 branches in 5 years (between 1955 and 1960). In other words, financial inclusion and reaching out to the customer are the very reason for creation of SBI.

Inclusive growth basically means broad based or shared growth which does not by pass the poor. Sustained poverty reduction requires inclusive growth that allows people to contribute to and benefit from economic growth.

Financial inclusion, which envisages access to formal financial sector for all segments of the society, is one of the enablers for inclusive growth.

## Why Financial Inclusion

Financial Inclusion has great significance on an economy such as India where a vast number of people with low incomes do not have access to formal financial sector.

### Benefits of Inclusion

For the community as a whole, inclusion uplifts financial conditions and standard of living, increases economic activities, reduces class conflicts in the society.

Overall, Financial Inclusion and Human Development Index move closely with each other. A comparison of Index of Financial Inclusion (IFI) values with Human Development Index (HDI) shows that all countries with high and medium IFI also have high HDI. Higher the exclusion - greater the income disparities. Since income disparities result in social tensions, increased financial inclusion is essential for ensuring social stability.

For banks, inclusion results in increased and wider customer base for low cost deposits (due to higher disposable incomes) and greater business opportunities in loans and other financial products (such as insurance, mutual funds, etc.)

A large base of small value customers provides stability to the banks (and financial system) even during crisis period. The poor customers that we include today will be a better off, loyal customer of the bank tomorrow.

* This speech was delivered by A. Krishna Kumar, MD&GE (NB), State Bank of India at the Sixth Lecture of the Lecture Series on “Challenges of Inclusive Banking” organized by Bombay Chamber of Commerce & Industry on September 04, 2012.

## How Does India Fare in the Global Community in Terms of Financial Inclusion?

India ranks quite low in terms of financial inclusion. Ranking based on two dimensions (banking penetration[1] and availability of banking services) shows India at 50th position amongst 100 countries surveyed. China (rank: 32), South Africa (rank: 43) and Brazil (rank: 44) rank above us. In BRICS countries, only Russia (rank: 83) is behind India. (ICRIER Working paper).

## Indian Approach to Financial Inclusion

Unlike many other countries which relied on single product (like remittance led model of Kenya, Loan led model of Chile), Indian approach has been to provide a bouquet of products.

"Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general, and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated mainstream institutional players" (Dr. K.C. Chakraborty, Dy. Governor, RBI).

Minimum products to be offered are:

Savings, Loan, Remittances and Non-banking financial products like Insurance.

There are multiple delivery channels – Commercial Banks, RRBs, Urban Cooperative Banks, Post Offices, SHGs and MFIs.

## Challenges

Since the banks cannot reach out to all the customers through the traditional brick and mortar branches, they have to necessarily depend on alliances with Business Correspondents, Micro Finance Institutions, etc.

### i. Alliances:

**Business Correspondents (BCs):**

The Business Correspondent (BC) Channel approved in 2006 by RBI is one of the major innovations that helped financial inclusion in the last decade. The Channel is more cost effective than the brick & mortar branch channel branches and can be scaled up more rapidly. RBI has been liberalizing the channel gradually and now all entities (except NBFCs) can be engaged as BCs.

Challenges with all outsourcing models are associated with this channel also. Some of these are,

a) Reputation Risk: Since it is the intermediary who sells the services, the banks are exposed to the risk of 'mis-selling' – either by an uninformed BC or by a motivated BC who is pushing his 'other' services.

b) Violation of KYC/AML Rules: BCs may violate KYC/AML rules either

[1] Banking penetration: Ratio of number of accounts to total population. Availability of banking services: Number of bank outlets per 1,000 population.

due to 'business considerations' or due to lack of training.

c) Operational Risk.

What the banks need to appreciate is that there should be good training for the BCs and there should not be any slackness in oversight.

d) Viability: A crucial risk with the BC model is the poor viability of the channel in general. Income levels are pretty low, especially in rural areas due to low levels of transactions. There may be case for financial support from the Government for FI efforts in rural areas. Sharing of income by Corporate BCs with their field level staff/agents is another area of concern.

e) The BC model works only on technology. Development of user friendly and cost effective technology and introduction of multiple products is essential to make the channel sustainable in the long run.

f) Expectations: The stake holders (Banks, GoI and RBI) should not have unduly high expectations from this channel which is still in its infancy. The mandate of covering less than 74,000 villages with population 2,000 more than in 2 years (2010-12) and the addition to this by addition of villages with population less than 1,000 and more than 2,000 to be covered in one year (2012-13) possibly has no parallel anywhere else in the world. Perhaps, banks would need to pause and strengthen their internal systems and procedures and controls and build oversight and control mechanism of the outsourced agents.

**MFIs:** MFIs have been able to reach the last mile more efficiently as compared to the Commercial Banks and have been able to serve the unbanked/under banked and have met their need for micro credit. There have been, unfortunately, issues of corporate governance and ethics with regard to conduct of business.

While MFIs will most certainly need to re-visit at their business models, the key to the sustainability of this delivery channel depends on development of due oversight. Acceptance of voluntary code of conduct recently by MFIs and the Micro Finance Legislation on the anvil will perhaps ensure that this channel not only survives but also gains in strength.

### SHGs:

The SHG project is a major success in terms of reaching the small value customers, Lowered transaction costs; and improved recovery rates (the NPA levels are very low).

Challenges in this channel are:

a) Delay in opening of accounts/ disbursal of loans.

b) Non-renewal of loans.

c) Multiple memberships and multiple borrowings by members.

i. One reason for delays in opening of accounts/disbursal of loans is that the ticket size is small (even when aggregated due to the group borrowing). This issue can be overcome by migration of the transactions in SHG accounts to the lower cost BC channel. SHGs will thus get to transact at the BC counter much closer to their habitations, bank branch gets decongested and the BC sees increased foot falls and improved earnings – a truly win-win situation.

ii. Technology: Technology is critical for success of all delivery platforms (branches or BCs) if the operations have to happen in a cost effective and user friendly manner. Banks should invest substantially in development of technology in spite of the fact that reaching the unbanked/under banked shall be profitable only in the long term.

iii. Products and Processes: Banks should develop simple (to understand and use) products exclusively for use by the under-reached customers who may not have the ability to use more complex products that elite customers use. The processes, too, should be revisited to make them simple. For example, an account opening form in vernacular language will make it much more user friendly compared to a document in English.

**External Challenges:**

- ***Infrastructure:*** The country is not evenly developed and many locations suffer from lack of network connectivity, power supply, etc.
- ***Law and Order:*** Many areas are affected by Left Wing Extremism.
- ***Financial literacy:*** Mere availability of financial services is not of much use unless the target beneficiaries have financial literacy as well as awareness to utilize these services. Banks have set up Financial Literacy Centers (FLCs) as part of their financial inclusion efforts. These have to be supplemented by general education channels by introduction of financial literacy subject in the school curriculum.

Financial Inclusion/availability of banking services can happen only as part of overall development of economy.

## Conclusion:

As I said earlier, Financial Inclusion is an enabler for inclusive growth which in turn results in sustained and rapid decline in poverty. The increased 'disposable surplus' with the hitherto unbanked and under-banked results leads to increased consumption (of goods produced by factories). The broad basing of consumption also helps the industry in meeting the down turns of the type being witnessed now. Such an increased consumption may encourage the industry to move closer to the consumers leading to increased employment opportunities in the rural areas leading to further increase in disposal surplus and consumption – a virtuous circle.

**SBI's Journey in Financial Inclusion:**

SBI has been reaching out to the customers through the traditional Brick & Mortar branches and alternate channels such as ATMs and Business Correspondents.

Between March 2007 and June 2012, the reach of the bank has grown in rural and semi urban areas as under.

| | |
|---|---|
| • Branches: | 6,647 to 9,401 |
| • ATMs: | 1,649 to 8,984 |
| • Outlets of Business Correspondents: | 13 to 26,517 |

Accepting the Business Correspondent Channel as a viable, long term business model, SBI has developed the channel after putting the requisite infrastructure in place.

Building enablers:

- A separate vertical - Outreach department responsible for financial inclusion (in both urban and rural areas),
- Operational manuals for Business Correspondents and Business Facilitators prepared,
- Channel Management Software for tracking the performance of the BCs and BFs developed,
- All products and transactions and transactions in BC channel technology enabled,
- Incentives to branches for Financial Inclusion introduced through Transfer Pricing Mechanism,
- Intermediary Structure for managing BCs – Financial Inclusion Centers set up,
- Customer charging introduced to improve viability of the channel,
- Central Processing Centers set up for improving credit processing capacity in rural areas,
- All accounts are in Bank's CBS and online.

As at the end of FY 2011-12, BC channel acquired 105 lakh No Frills Accounts with aggregate balance of Rs. 305 Crores (Average balance per account Rs. 290 – up from Rs. 62 in 2009-10) and handled 203 lakh transactions (up from 100 lakh transactions in 2009-10).

# Common Financial Mistakes

Mehrab Irani*

## Abstract

*What do you think – is money a problem or solution? If you don't have the answer to it then read on. If you believe that "money is the problem" or "money is the solution" then I am afraid that you are a "prisoner of money". Have you ever imagined of setting yourself on the incredible journey of your freedom from your current position as a "prisoner of money" to the attainment of "financial independence"?*

*We all are social animals and we remain the same social animals while thinking about money and investments. This study paper attempts to explore the common financial mistakes which we human beings make as social animals and to understand that we have to branch out to "Behavior Economics" which combines the twin disciplines of psychology and economics to explain why and how rational people make totally irrational decisions when they spend, invest, save and borrow money. Therefore, if you aim to achieve financial freedom then you have to avoid these "common financial mistakes" at every step of your dealing with money.*

## Introduction

Money is a very strange thing–human beings make rational decisions while dealing with most aspects of life but make serious errors of judgment when it comes to dealing with money – at the time of dealing with different aspects of money and finance including earning, protecting, budgeting, saving, spending, leveraging, investing and insuring.

Completely rational investors take totally irrational decisions when part of crowd – their own individual rational minds come down many levels to the irrational level of the crowd. Many a times, individual rational intelligent persons commit simple mistakes while making investment decisions in common stocks. And those mistakes get compounded while investing in mutual funds. Fund managers, marketers as well as the markets themselves have its own ways of finding and exploiting human weaknesses. This paper tries to articulate the most common financial mistakes, at the time of dealing with money, investing in equities and investing Mutual Funds. Then it will provide the readers a framework of the "action steps" to take in order to avoid these mistakes.

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## Common Financial Mistakes

### Mistake 1: Sunk Cost fallacy - Throwing Good Money after Bad

Imagine that somebody has given you a play ticket "free" in which your favourite star in acting. Now, hours before the play is going to commence you come to know that your favorite star may not be able to act that day and there is big weather problem and going to the theatre and coming back might be risky. Now, imagine that you had actually "paid" and purchased that ticket. The likely answer is that in the first instance you might not go for the play while in the second instance you might go for the play even though your favorite star is not acting in it and risk traveling in the dangerous weather. This is called "sunk cost" fallacy – in the first instance since you have not paid for the ticket you don't mind skipping the event but in the second instance since you paid hard cash for the ticket you don't want to "waste" the money which is actually already wasted or sunk. The same way in investments many a times because we buy a certain stock of a bad company at a certain price and then it halves then in the name of "averaging" we invest more in it throwing good money after bad. The lesson we learned from this behavior is that we should not sell winning investments more readily than loosing ones and not take money out of the stock market just because markets have fallen.

### Mistake 2: Loss Aversion

One of the main tenants of behavior economics is that people are loss averse. The pain people feel from loosing Rs.100 is more than the pleasure they get from gaining Rs.100. This explains why people behave inconsistently while taking risks. For example, the same person can act conservatively when protecting gains (by selling successful investments to guarantee the profits) but recklessly when seeking to avoid losses (by holding on to loosing investments in the hope that they'll become profitable). Loss aversion causes investors to sell all their investments during periods of unusual market turmoil. If you had sold most of your equities during the bottom in the year 2008 or contemplating of selling your "good quality" banking or infrastructure stocks currently, then probably you are suffering from "loss aversion".

### Mistake 3: Mental Accounting

This term "mental accounting" refers to describe people who treat money differently depending from where it has been received. For example, a person may treat salary (earned money) as sacred and be over cautious with it while the same person might treat gifts, unexpected bonus, written off tax refunds, huge inheritance as "free money" and be careless with it. The sacredness may lead the person to let the money just remain idle in savings account and thus getting beaten down by inflation and the carelessness may lead the person to just spend the money or invest in risky ventures and eventually loosing the funds. The lesson is that money is money from whatever source it is received – deposit any windfall gains first in your savings account and mentally count is as part of your wealth and then there is less likelihood of you squandering away that money.

### Mistake 4: Bigness Bias

Most of us try to think big as far as money is concerned but easily forget the small things which when compounded over a period of time result into much bigger losses. This is because of our ignorance to the basic principles of mathematics. For example, the tendency to dismiss or discount small numbers as insignificant can lead us to pay more that we have to pay for brokerage, commissions, mutual fund expenses, income taxes which has a surprisingly deleterious effect on our investment decisions over time.

### Mistake 5: Decision Paralysis

Whether it is investments, insurance, spending or any other money matter, many a times we are not able to make a decision and just maintain status quo. However, we don't realize that not making a decision is also a decision in itself that we have voted in confidence for the way we are doing things. The lesson we learned from this behavior is that by not taking the right decisions many a times we continue to promote the wrong decisions, the opportunity cost of which may prove to be very costly over the long term.

### Mistake 6: Money Illusion

Most of us have illusion with money – the more the money the more we think we have earned and vice versa. But, this may not always be the case. I explain this with a simple example. Suppose, an employee got a 10% salary increment when the inflation is 12% while in another case the same employee got 5% increment when the inflation is 3% - which one would he prefer. There are chances that he will prefer the first case of 10% increment although in the case the employee is getting negative real increment since inflation is more than the increment while in the second case he is getting positive real increment since inflation is less than the increment. This is called money illusion and one of the main reasons why people prefer investment in fixed deposit at negative real interest rates after tax than long term tax free gains through stocks.

### Mistake 7: Cash Fallacy

Suppose, we go to buy an expensive gift item for say Rs.1 lac. If we have to actually remove cash from our bank account and then pay for it we will feel the "pain" of loosing cash and therefore we would think twice before buying it. In the same instance, if we just pay through our credit card then we may be very comfortable and have the illusionary thought of not seeing the pain of loosing cash. This is called "cash fallacy" and is the main cause of lot of unwanted and avoidable expenses in the modern plastic word. Remember, if you buy things you don't need, soon you will have to sell things which you need.

### Mistake 8: Over or Under Confidence

These are the other two enemies of investors. If you are over confident on your abilities then you would only look at your successes and boost about it while trying to "explain away" your losses. On the other hand if you are under confident then you would not be able to take control of your finances, make investment and spending decisions based solely on the opinions of friends, colleagues or worst than that the so called "investment advisors" *(including myself)*. Both these psychological characters are not good for your money and hence beware of it. The lesson form this is that "either you act on your own judgment or entirely on the judgment of another" and that another should be a family member with equal stake in the outcome of the decision and not just a friend or worse than that a financial advisor *(including myself)*.

Now, we will embark on the incredible journey of understanding and appreciating some most common equity investment mistakes which we humans commit at the time of committing our hard earned money in the stock markets. It will focus on those factors which make others like the company promoters, stock brokers, fund managers, portfolio advisors, financial planners, credit rating agencies etc rich at the expense of the common investor. I will term all those common mistakes committed by naïve investors in the stock markets as "Common Stocks – Common Mistakes".

## Common Stocks – Common Mistakes

### Mistake 1: Trying to catch the top and bottom

This is one of the most common mistake while investing in equities which most of the investors commit. Trying to catch the top and the bottom little realizing that only fools can catch the top or the bottom. No Government, Central Bank, company management, fund manager, analyst or anybody knows what will be the exact top or bottom of any stock, then how does a common investor believe that he / she will be able to catch the top or bottom. Instead of that, determine the value and target price of any stock in which you intend to invest by whatever method you may follow – fundamental, technical or any other method- and then buy it within 5% to 10% range of your that "buy price". You may pace out the purchase over a period of time keeping in mind the current performance of that company and or the overall market conditions. But, once you determine the "correct price" for a stock to buy by whatever method you may follow and once that price approaches then don't wait to "buy at the bottom" because you will probably never be able to do that. Remember that if you wait too long to buy, until every uncertainty is removed and every doubt is lifted at the bottom of a market cycle, you may keep waiting and waiting. The same rule will apply while selling also.

### Mistake 2: It will come back

This is another common mistake which most of the investors commit while investing in equities – whether on the buying or selling side. If they see a certain price for a certain stock and they miss buying / selling at that price, then they keep waiting in anticipation that the same price will come back, irrespective of market or individual stock considerations. For example, somebody might have decided on whatever kind of analysis he / she might have done that Unitech is to be sold. Then he / she saw the price of Rs.530 in January 2008 but "missed" selling at that price and after that the stock started falling because of general market weakness and fundamental deterioration in the company. But, the investor who is influenced by this common mistake and waiting for the "price to come back" might still be waiting with the current price around Rs.26 and I don't know whether the price of Rs.530 will ever come back! The lesson to be learned is that if the price of the stock has gone up / down for a change in the prospects of that company or sector, then there is no point being in illusion that the "price will come back".

### Mistake 3: Already fallen so much – cant fall further

This is one another serious mistake which many investors commit while investing in equities. A stock might have fallen "considerably" and hence they believe that now it cannot fall further. Nothing can be further from truth as this is one of the grave mistakes which results in multiplication of investor losses. Continuing with the Unitech example, the stock fell from Rs.530 in January 2008 to Rs.240 by March 2008, a massive fall of 45% in just two months. Now, any investor who might have believed that it cannot fall further because it has fallen 45% in 2 months and hence held on to it or purchased it was in for a rude shock as it fell to Rs.20 by December 2008, a massive 96% from the top and also a substantial fall of 92% from the March 2008 level of Rs.240. Unless the stock becomes attractive on a standalone basis on fundamental or technical or whatever analysis you may believe in, there is simply no logic in believing that "because it has already fallen so much and therefore it cannot fall further".

### Mistake 4: Already risen so much – cant rise further

This is the corollary of mistake number 3 – many times investors believe that since the stock has risen so much, hence it cannot rise further. For example, Titan rose from around Rs.5 in July 2004 to Rs.42 by March 2006, stupendous jump of more than 8 times in less than 2 years. Anybody, thinking that the stock has risen so much and therefore cannot rise further and sold it was for a rude surprise as the stock rose to Rs.237 by September 2011, not only swelling by 47 times from its July 2004 price of Rs.5 but even multiplying by around 5.5 times from its march 2006 level of Rs.42. Hence, unless the stock becomes expensive on valuation basis / future growth expectation basis or any other "price determination" parameter which you might be successfully applying, simply because the stock has risen so much does not warrant a sufficient reason to sell.

### Mistake 5: Protect your profits or cut your losses

Many readers might not agree with me on this point. Unless you are a short term trader or investing on costly leveraged funds, there is no point in simply trying to "protect the profits" or "cut losses". Unless the stock becomes costly on valuation basis or its fundamentals deteriorate on a long term basis or because of some other "price determination" parameter which you might be using, just because a stock on which you are making money corrects, it does not necessitate you to panic and sell out of it to "protect your profits". Lets continue with the above example of Titan. After multiplying by about 8 times from Rs.5 in July 2004 to Rs.42 in March 2006, the stock corrected to Rs.21 by May 2006, almost halved from its peak of March 2006 in just two months. Any investor who might have panicked and sold the stock then would be in for a nasty surprise as the stock then went on to Rs.85 by December 2007 i.e. 4 times jump from the May 2006 low and beyond that as we now know it has touched Rs.237 by September 2011. The same principle would apply for cutting losses as you might be cutting your losses just before the stock is on the verge of embarking on its dream run. Lets continue with the Titan example above. Now, suppose you purchased the stock at Rs.42 in March 2006 and it halved to Rs.21 in the subsequent two months and you are nursing a massive 50% loss. On the fallacy of "cutting your losses" if you sell the stock at Rs.21 then you have sold it just before it was getting ready for its next dream run which would lead to many times price multiplication over the next few years. Hence, remember that after doing your analysis if you feel that the price is right for selling then only sell the stock and not on the misleading notion of protecting your profits because in fact by doing that you might be cutting any probability of serious wealth creation in the future. The same would apply to "cut your losses" fallacy also.

### Mistake 6: Price Averaging

This is another grave mistake which investors do which takes them deeper and deeper down the loss lane. There is a wrong notion then averaging brings down the purchase cost and hence would be able to sell it at some marginal profit or atleast closer to cost price. Let us move back to the example of Unitech, suppose you invested in 1 share at Rs.530 in January 2008, then "averaged" by buying one more share at Rs.300 in February 2008 and further averaged by purchasing another one share at Rs.240 in March 2008 so that now your reduced "average cost" is Rs.357. But, what purpose has that served, today the stock is quoting around Rs.26, down by a phenomenal 93% from the reduced "averaged cost". One caveat, that sometimes an investor might get an opportunity to exit in the averaged stock at close to the "average cost" but those opportunities are rare and only for a short period of time and therefore very difficult to capitalize at that point of time. And finally, if you would not otherwise want to buy a particular stock at a particular price then what is the logic for averaging it if you already own your stock. Remember, never throw good money after bad money. If you have made a mistake in selecting a wrong stock, humbly accept your mistake, sell it and book your loss and move ahead, - utilize the proceeds from sale to buy better investments with potential of price appreciation in future.

### Mistake 7: Stocks gone up so I am right or gone down so I am wrong – The Market Trap

Ego and lack of self confidence are both negative qualities of a human being and an investor. If you buy a stock and it goes up for no real reason but for market abnormalities then be smart enough to sell it and get out of it instead of pampering your ego that you are an astute investor or a great stock picker. Don't forget that the market is a great deflator of all egos. The same can be true when you might have invested in a stock at a decent price after all your analysis and the stock falls for no deterioration in the company's performance but for some uncontrollable market reasons – during that point of time there is no need to panic and loose self confidence and start believing that you are wrong. Remember that market can be wrong and is infact wrong most of the times, so try to take advantage of it abnormalities by using your knowledge, experience and judgment instead of getting swayed away by it and loosing your self confidence.

### Mistake 8: Efficient Market Theory

Don't blindly believe in the efficient market theory – infact remember that market is inefficient for almost 95% of the time – its like a pendulum moving from over valuation to under valuation and then vice versa. Only like a pendulum's movement from one side (over valuation) to the other side (under valuation) it is just by chance that it passes through the middle (fair valuation). And if the market was indeed always efficient it would simply be impossible for so many investment gurus and fund mangers to "claim that they can beat the market". Having said that, over the long term the pendulum does move in the direction of what is right – if the country, economy, sector and the individual stock does perform well than over the longer term the pendulum does put its weight behind it, otherwise not.

### Mistake 9: Blindly follow the Guru

There is a saying that either you completely trust your judgment or the judgment of another person. And the another person in the market is the investment guru or fund managers etc. Kindly note, that you may trust any investment guru of your choice and some investor gurus will beat the market at certain points of time but all the investor gurus cannot in totality beat the whole market on a continuous basis because they only make up the market. Simply put, everybody cant beat everybody – for there to be a winner, there has to be a looser also. And kindly note, the buyer and seller are always on the opposite side of the trade and they both mysteriously believe that they are right – but one of them is infact wrong! So don't trust any of the so called Investment gurus as face value *(including myself although I don't claim to be any investment guru but just a student of investing)*.

### Mistake 10: Penny Stocks

This is another common mistake which most of the investors commit – buying into penny stocks thinking that the price is already "so low", most probably in single digit, little realizing their own thinking folly. The amount of loss which can happen in common stock investing is reported in percentage terms and measured in rupee terms, whether it be a penny stock of Re.1 or a high priced stock of Rs.1000. Therefore, if a Re.1 stock falls to 10 paise or a Rs.1000 stock falls to Rs.100, the loss is 90% in both cases. And most importantly, if you invest say Rs.1000 in either of the above mentioned two stocks and both of them suppose become zero, then you loose your full investment of Rs.1000, irrespective of the initial price of the stock. So, remember the old saying "penny wise, pound foolish", the stock price is just a quote in the market and on its own does not have any significance whatsoever, it has to be measured in conjunction with the company's performance, earnings, book value, dividends etc – a high priced stock may actually be cheap on valuation basis while a low priced penny stock may actually be very costly if the underlying business does not support even that much of a price.

### Mistake 11: Fail to past the test of patience and character

Market is a place which will test your patience and character. Many times you might have bought a stock for all the right reasons at the right price but the stock refuses to go up for a long period of time – just hang on to it because the day you get frustrated and sell it off, there are chances the stock will then start rising. Hence, patience and character are key virtues which will be repeatedly tested by the market.

We just studied how individual rational intelligent persons commit simple mistakes while making investment decisions in common stocks. And those mistakes get compounded while investing in mutual funds. Now, I try to explain and explore some common mistakes which investors almost mutually commit while investing in Mutual Funds (MF) which I call as "Mutual Funds – Mutual Mistakes".

## Mutual Funds – Mutual Mistakes

### Mistake 1: Imagining that Low NAV is Cheap

This is one of the most silliest of mistakes which an investor commits while investing in Mutual Funds. The investor feels that a fund with a lower Net Asset Value (NAV) is cheap compared to a fund with a higher NAV. There is nothing further from truth. This mistake stems from the simple fact of a person who does not know the meaning of mutual fund. This blunder is because the investor neither understands nor appreciates the difference between price and value. A MF unit in itself has no value – it is "not" an asset like a house property, bond, equity stock, gold etc. Yes, the MF unit in itself simply has no value on its own – it derives the value from the underlying asset which it owns. The NAV is nothing but the value of the total underlying assets of the fund divided by the number of units. For example, if a fund has equity shares in different companies whose current value sums upto Rs.1000 crores and has

50 crore units then its NAV is Rs.20 per unit while another fund whose current total value of equity shares is again Rs.1000 crores but has 100 crore units then its NAV amounts to Rs.10 per unit. Does it mean that the second fund with a NAV of Rs.10 per unit is cheaper than the one with Rs.20 per unit? Certainly not. This is because the total value of the assets of each fund is the same Rs.1000 crores – in the first case it is distributed among 50 crore unit holders while in the second case it is among 100 crore unit holders.

### Mistake 2: Too costly or very cheap

This is a continuation of the first mistake. A MF unit can't be costly or cheap – it is not an asset in itself which can be costly or cheap – it derives its value from the underlying investment. If the value of the underlying investment goes up then the NAV will go up and vice versa. For example, there are two funds – A and B. Now, the NAV of Fund A is Rs.10 per unit while the NAV of Fund B is Rs.50 per unit. Does this mean that Fund A is cheaper than Fund B. Not at all. The NAV simply means that Fund A is holding such assets in totality which when divided by the total number of units results in a NAV of Rs.10 and ditto computation for Fund B which results in NAV of Rs.50. Further assume, that the portfolio of both these Funds is exactly the similar. In that case, a 20% rise in the value of the portfolio will result in a commensurate 20% increase in the value of the NAV of the Funds – Rs.2 in the case of Fund A while Rs.10 in the case of Fund B. Hence, while investing in MFs don't look at the price of the NAV but rather the underlying value which is derived from the portfolio of the Fund.

### Mistake 3: Buying MF NFO at "par"

This is another derivative of the first two mistakes – an investor can't become more foolish when he or she invests in a MF NFO simply because it is available at "par value". As explained above, the MF NAV is meaningless in itself as it is merely the value of the underlying asset. Therefore, buying a MF unit because it is available at par value would be one of the most silliest mistake which an investor can commit with its money. Remember that MF unit is not a scarce resource – a MF can create as many units as the inflows into the fund – it has to just print the units and send it to the investor – similar to how the Government can infinitely print currency notes. The same is not true for an equity share because a company can't just print its shares without diluting the holding of its assets.

### Mistake 4: Fancy Funds, fads and fantasies

Many new funds and schemes prop up during times of exuberance. Banking Funds will be launched when banking stocks have performed well, infrastructure funds when the infrastructure stocks are rising or IT funds when the technology boom is underway, so on and so forth. These sector funds are simply smart tactics to collect money from the gullible investors. No sector or theme continuously performs well over a longer term. Even worse than it, a sector fund is generally launched after the sector has already performed well because the fund has to show good past performance to attract fresh investor money. And by applying the "law of averages", it becomes more likely that the sectors which have already performed well in the past will actually not perform so well in the future. Hence, never fall prey to fund gimmicks and invest in sector or theme based funds.

### Mistake 5: Ignoring Index Funds

This is another very common mistake which MF investors commit – ignoring a simple low cost index fund in favour of the high cost actively managed fund. You will get these kind of advice most of the time from majority of the people that equity investments are for the experts and if you don't know how to pick your stocks then you should entrust your money to the expert fund manger etc. However, I dare to say that these are probably one of the most useless advice which you can ever receive. Hold on, I am not saying that you don't entrust your money to the experts and start picking your own stocks – no their may not be a bigger financial suicide than this. I just humbly submit that it's very difficult, if not impossible, to beat the stock market indices consistently over a longer period of time. If that were not the case, then why over a periods of a decade or more, approximately 75% of all "actively" managed stock funds underperform the passively constructed stock indices. The fact of the matter is that most people have no reason whatsoever to believe that they can pick winning stocks or time the markets and their success at it would be the same as it would be like throwing darts at the financial pages. I would like to quote Dr. William Bernstein who told that "there are two kinds of investors, be they large or small: those who don't know where the market is headed, and those who don't know that they don't know where the market is headed. Then again, there is a third type of investor – the investment professional, who indeed knows that he or she doesn't know, but whose livelihood depends upon appearing to know where the market is headed". Nothing more succinctly explains the real world of professional investing and stock picking. Mr. Merton Miller, Nobel laureate and professor of Economics of Chicago commented that "if there are 10000 people looking at the stocks and trying to pick winners, one in 10000 is going to score, by chance alone, a great coup, and that's all that's going on. It's a game, it's a chance operation, and people think they are doing something purposeful, but they're really not". Then I would quote Mr. Rex Sinquefield, co-author of Stocks, bonds, ills and inflation that "we all know that active management fees are high. Poor performance does not come cheap. You have to pay dearly for it". Thus, active fund management is nothing but paying heavy fees for underperforming the passive indices! Then for the investors who are always on the look out for the next hot fund, the next great sector fund or so, Bethany McLean, columnist for Fortune magazine wrote "skepticism about past returns is crucial, the truth is, much as you may wish you could know which funds will be hot, you cannot and neither can the legions of advisors and publications that claim they can. That's why building a portfolio around index funds isn't really settling for the average. It's just refusing to believe in magic". And let me further quote Mr. Jon Bogle, founder and retired CEO of the Vanguard Group "Index funds eliminate the risks of individual stocks, market sectors, and manger selection. Only stock market risks remain". In other words, when you invest in a passively managed index fund then all the risk relating to the fund manager, his / her stock selection and market timing, individual sectors etc all go and the only risk which remains is the risk of the whole stock market and that is precisely the risk which would like to expose yourself to when you invest in equities. Mr. Nicholas Taleb has written an excellent book titled "Fooled by Randomness" wherein he explains the role of chance in life and in the markets and I will recommend that book to anyone who believes that he / she can consistently pick winning stocks and / or time the markets to perfection. Last but not the least, I would like to jot the words of the great legendary investor Mr. Warren Buffet who once said that "most investors, both institutional and individual, will find the best way to own common stocks is through an index fund that charges minimal fees. Those following this path are sure to bear the net results (after fees and expenses) delivered by the great majority of investment professionals".

The conclusion therefore is that there is no reason for you or anybody else to believe that they can pick winning stocks or time the markets. Hence, the best solution for any equity investor is to stock into low cost passively managed index funds because year after year they would beat atleast 75% of the actively managed funds and over the longer term in most probabilities beat almost all the funds.

### Mistake 6: Selling Winning Funds While Sticking on to the Loosing Ones

This is a grave mistake which people commit with MFs, equity stocks, other kind of investments as well as in many real life situations – sticking on to the loosing ones while selling the winning ones. It's important to be realistic about investments that are performing badly including MFs. Recognizing the losers is hard because it's also an acknowledgement of your own mistake. But, it's important to accept and book a loss or else future loss would be even higher.

### Mistake 7: Fund Churning

This is a common advice which might be showered on you by your MF Distributor. Instead of churning your fund just churn the MF distributor who gave you that advice. Distributors love the churning game – simply because it gives them extra commissions and fees while it gives you extra income tax, expenses and most probably a sub optimal fund.

### Mistake 8: Paying Credence to Recent Past Performance

A common mistake which a fund investor does is by looking at recent past performance. Past performance is certainly important but if you give too much importance to "continuous performance by looking at daily NAV" then you are inviting unnecessary worries for you in the form of selling a good fund and moving to a not so good fund, the MF churning advisors, income tax, higher commissions and other costs etc.

### Mistake 9: The Dividend Temptation

You may be advised by the MF Distributors and marketers that a fund has declared dividend and it is trading cum-dividend and therefore take the advantage of earning free dividends. But, there is no free lunch in this world – particularly not in the world of investments and mutual funds. The dividend which a fund pays to an investor is immediately reduced from the NAV of the fund. So what is the sense of the dividend when on one hand you receive the cash and on other hand your NAV falls by that much amount? On the contrary, I would say that don't invest in a fund which has declared lofty dividends because that is against your purpose of investments – you are entrusting your money to the Fund Manager to manage it on your behalf and not to return back to you! (unless ofcouse you require regular income in the form of dividends).

### Mistake 10: Not Understanding the Type of Funds

The primary purpose of MFs is to make your life simpler by investing your money on your behalf. However, actually they have made your life difficult by making available a plethora of different categories and schemes. Hence, before biting the bullet get acquainted with which category of Fund you are investing in – Equity, Fixed Income, Balanced, Commodity and within them the various sub-sets like sector, theme, gilt, income, short-term, liquid etc in which you are investing. The risk, expected return, income tax, expenses, required time horizon are immensely different in each of those categories. So don't commit the unpardonable mistake of investing your money in a fund without actually knowing where and in which asset class it is going to deploy your money.

### Action Steps to Avoid the Common Financial Mistakes

Certain simple steps to take in order to avoid big financial mistakes over time are:

Take proper insurance and let it be pure insurance (term policy).

Make proper retirement plans.

Pay off credit card bills with so called "emergency" funds lying idle in your savings account.

Make proper asset allocation and diversify your investments.

Put maximum of your equity allocation in index funds – it will save you a lot in fund management expenses and avoid the randomness bias of Fund Managers.

Review your assets and take stock of your entire portfolio including equities, bonds, mutual funds, real estate, art, retirement plans etc.

Set up a “direct payroll deduction” to some kind of recurring savings / SIP.

Keep reviewing your plan.

## Conclusion

Market is a place which will test your patience and character. Many times you might have bought the right stock or Mutual Fund for all the right reasons at the right price but it simply refuses to go up for a long period of time – just hang on to it because the day you get frustrated and sell it off, there are chances it will then start rising. Hence, patience and character are key virtues which will be repeatedly tested by the market.

To conclude, there are many simple and avoidable mistakes which we human beings as social animals succumb to at different levels of our dealing with money, be it at the time of earning, protecting, budgeting, saving, spending, leveraging, investing and insuring. This article made a humble attempt to explain some most common financial mistakes at the time of dealing with money, investing in equities and mutual funds.

Kindly note, that simple logical things work far better in the market place rather than complex algorithms, theorems, valuations principles, DCF etc. And there is no other place to test your virtues than at the time of dealing with money – be it common sense, logical thinking, patience, perseverance, mental balance, emotional intelligence, performing under stress etc. All the qualities which make a successful human being will be tested by the money market –it has its own method of finding and exploiting human weaknesses. Investing is not about beating the market or anybody else, its simply beating your own self, your own negative traits and once you are able to master your own self and become a complete human being, then only you would also become a successful investor. Articulate your investment goals, know your time horizon, recognize your risk appetite, understand your need for income and growth, invest regularly although it may be in small lots, do your thinking and research and after doing it don’t panic just because the market went against you, accept your mistakes and flaws and avoid the common mistakes which human beings commit while dealing with money and investing so as to embark on becoming your own a successful “money manager” and a complete human being.

Safe Investing and Happy honest Living!

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# Notes for Contributors

- **ANALYTIQUE** welcomes original articles or essays on any subject of interest related to commerce and industry such as macro economy, industrial performance, international trade, banking and finance, etc.
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- Authors are requested to provide full details for correspondence: postal address, day-time phone numbers and e-mail address for our records. Only author’s affiliation and e-mail address will be published along with the articles unless otherwise directed.

# Select Economic Indicators

## Agriculture & Industrial Production

| Industry | April- June (Q1) | |
|---|---|---|
| | Percentage change over previous year Q1 | |
| | 2011-12 | 2012-13 |
| **Agriculture, Forestry & Fishing** | **16.5** | **14.2** |
| **Industry** | | |
| Mining and Quarrying | 17.4 | 13.5 |
| Manufacturing | 15.3 | 5.3 |
| Electricity, Gas & Water Supply | 8.2 | 10.6 |
| **Serivces** | | |
| Construction | 13.5 | 19.2 |
| Trade, Hotels, Transport and Communication | 23.1 | 10.4 |
| Financing Institutions, Real Estates & Business Services | 19.9 | 19.5 |
| Communtiy, Social & Personal Services | 12.9 | 17.1 |
| **GDP at factor cost** | **17.7** | **13.5** |

*Source: Ministry of Statistics and Programme Implementation, Government of India. Estimates of Gross Domestic Product (at current price).*

## Performance of Core-Industries

### Sector- wise Growth Rate (%) in production (Weight in IIP: 37.90%)

| | April- Aug 2011-12 | April- Aug 2012-13 |
|---|---|---|
| Overall Index | 2.8 | 5.5 |
| Coal | 6.3 | -2.3 |
| Crude Oil | -0.6 | 6.1 |
| Natural Gas | -12.1 | -8.9 |
| Refinery Products | 4.3 | 4.7 |
| Fertilizers | -7.9 | 1.2 |
| Steel | 2.7 | 9.9 |
| Cement | 5.4 | 4.1 |
| Electricity | 4.9 | 9.4 |

*Compiled by BCCI; Source of data Office of the Economic Advisor*

# External Sector

## Exports and Imports (in US $ million)

| Item | 2012-13<br>(Apr-Sep) | 2011-12<br>(Apr-Sep) | September | |
|---|---|---|---|---|
| | | | 2012-13 | 2011-12 |
| Exports | 143675.66 | 154148.82 | 23698.3 | 26561.2 |
| Imports | 232927.13 | 243546.21 | 41778.68 | 39756.07 |
| Oil Imports | 80783.7 | 75653.3 | 14093.60 | 10779.5 |
| Non-Oil Imports | 152143.4 | 167892.9 | 27685 | 28976.5 |
| Trade Balance | -89251.47 | -89397.39 | -18080.38 | -13194.87 |

*Source: Ministry of Commerce and Industry.*

## Foreign Currency Assets

**For the Quarter June- September 2012**

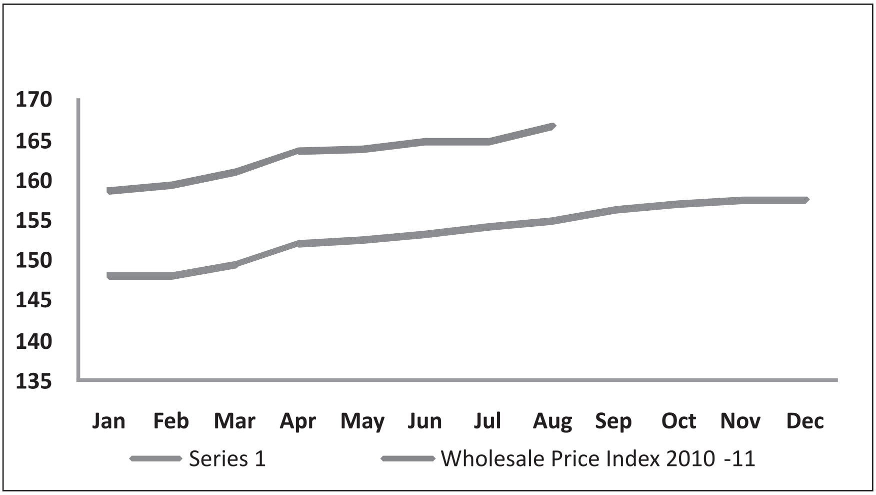
| Currency | Rate |
|---|---|
| USD | 55.1950 |
| GBP | 87.1275 |
| EURO | 69.0125 |
| JPY | 70.2725 |
| CHF | 57.3425 |
| AUD | 57.2625 |
| HKD | 7.1175 |
| SGD | 44.2250 |
| CAD | 55.4000 |

Source: Foreign Exchange Dealers' Association of India.

# Prices

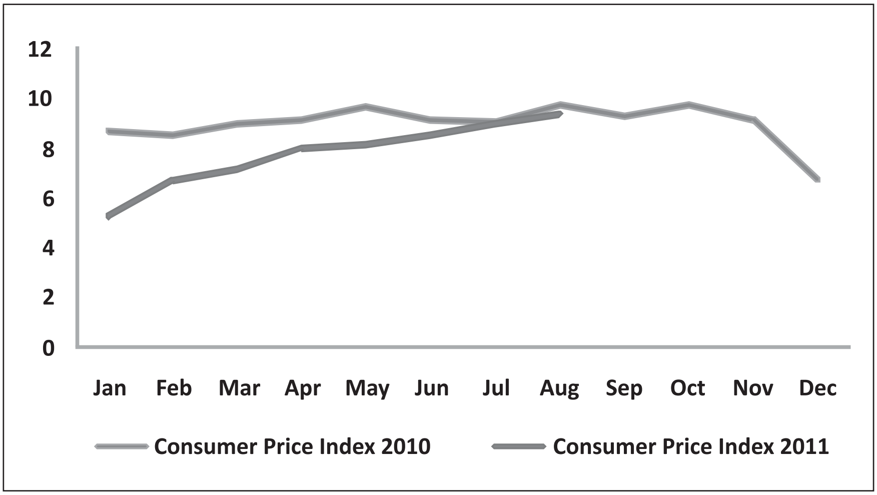
**Current price situation based on monthly Wholesale Price Index in September, 2012 (Base: 2004-05=100)**

| Items/Groups | Weight(%) | Cumulative change (%) Since March | | Inflation (%) (Year-on-Year) | | Inflation(%) Average of last 12 months | |
|---|---|---|---|---|---|---|---|
| | | 2012-13 | 2011-12 | 2012-13 | 2011-12 | 2012-13 | 2011-12 |
| **All Commodities** | 100 | 3.48 | 3.61 | 7.55 | 9.78 | 1.09 | 0.45 |
| Primary articles | 20.11 | 5.63 | 5.95 | 10.08 | 12.46 | 0.32 | 0.61 |
| Food Articles | 14.33 | 7.26 | 8.21 | 9.14 | 9.62 | -0.38 | 0.47 |
| Fuel and Power group | 14.91 | 1.80 | 6.03 | 8.32 | 12.91 | 3.13 | 0.91 |
| Manufactured Products | 64.97 | 3.02 | 2.06 | 6.14 | 7.87 | 0.82 | 0.29 |



*All Commodities Wholesale Price Index Base 2004-0= 100*

## Point to Point Rate of Growth



*Point to Point Rate of Inflation (%) Base 2001= 100*

# World Prices of Select Commodities

| Commodity | Unit | Annual Averages | | | Monthly Averages | | |
|---|---|---|---|---|---|---|---|
| | | Jan-Dec<br>2010 | Jan-Dec<br>2011 | Jan-Sep<br>2012 | Jul<br>2012 | Aug<br>2012 | Sep<br>2012 |
| **Energy** | | | | | | | |
| Coal, Australia | $/mt | 98.97 | 121.45 | 99.64 | 88.24 | 91.00 | 90.00 |
| Crude Oil, Average | $/bbl | 79.04 | 104.01 | 106.04 | 96.75 | 105.27 | 106.28 |
| Crude Oil, Brent | $/bbl | 79.64 | 110.94 | 112.47 | 103.14 | 113.34 | 113.38 |
| Crude Oil, Dubai | $/bbl | 78.06 | 106.03 | 109.48 | 99.22 | 108.37 | 110.96 |
| "Crude Oil, West Texas Int." | $/bbl | 79.43 | 95.05 | 96..17 | 87.90 | 94.11 | 94.51 |
| Natural gas, Europe | $/mmbtu | 8.29 | 10.52 | 11.39 | 11.13 | 11.18 | 11.08 |
| **Agriculture Beverages** | | | | | | | |
| Coffee, Robusta | c/kg | 173.6 | 240.8 | 227.9 | 300.2 | 297.2 | 302.6 |
| Tea, Auctions(3), Average | c/kg | 288.5 | 292.1 | 277.7 | 300.2 | 297.2 | 302.6 |
| **Food** | | | | | | | |
| Coconut oil | $/mt | 1124 | 1,730 | 1,200 | 1,070 | 1,001 | 969 |
| Groundnut oil | $/mt | 1404 | 1988 | — | 2468 | 2553 | 2408 |
| Copra | $/mt | 750 | 1,157 | 799 | 714 | 656 | 645 |
| Palm oil | $/mt | 901 | 1125 | 1,063 | 1015 | 997 | 973 |
| Palm kernel oil | $/mt | 1184 | 1,648 | 1,210 | 1,067 | 1,008 | 987 |
| Soybean meal | $/mt | 378 | 398 | 504 | 601 | 644 | 649 |
| Soybean oil | $/mt | 1005 | 1,299 | 1,250 | 1,239 | 1,252 | 1,288 |
| Soybeans | $/mt | 450 | 541 | 587 | 662 | 684 | 673 |
| **Grains** | | | | | | | |
| Barley | $/mt | 158.4 | 207.2 | 236.7 | 249.0 | 266.8 | 262.5 |
| Maize | $/mt | 185.9 | 291.7 | 292.2 | 333.1 | 332.0 | 320.8 |
| Rice, Thailand, 25% | $/mt | 441.5 | 506.0 | — | 555.0 | 545 | 545 |
| Wheat, Canada | $/mt | 312.4 | 439.6 | — | — | — | — |
| Sugar, world | c/kg | 46.93 | 57.32 | 48.88 | 50.44 | 46.03 | 44.07 |
| **Raw Materials** | | | | | | | |
| Logs, Malaysia | $/cum | 278.2 | 390.5 | 362.9 | 357.2 | 354.7 | 351.7 |
| Plywood | c/sheets | 569.1 | 607.5 | 610.0 | 606.7 | 606.7 | 608.1 |
| Cotton A Index | c/kg | 228.3 | 332.9 | 202.0 | 185.1 | 186.1 | 185.5 |
| Rubber RSS3 | c/kg | 365.4 | 482.3 | 347.1 | 307.8 | 279.3 | 303.8 |
| **Metals and Minerals** | | | | | | | |
| Aluminium | $/mt | 2,173 | 2,401 | 2,030 | 1,876 | 1,845 | 2,064 |
| Copper | $/mt | 7,535 | 8,828 | 7,979 | 7,584 | 7,516 | 8,088 |
| Gold | $/toz | 1225 | 1,569 | 1,653 | 1,594 | 1,630 | 1,745 |
| Iron ore, spot, cfr China | c/dmt | 145.9 | 167.8 | 131.0 | 127.9 | 107.5 | 99.5 |

*Source: World bank-The Pink Sheet*

# Government Accounts

## Trends in Central Government Finances: April-March 2011-12

| | Budget Estimates 2012-13 | April-July | | 2011-12 | 2012-13 | Per cent change over preceding year | |
|---|---|---|---|---|---|---|---|
| Item | | 2011-12 | 2012-13 | BE | BE | 2011-12 | 2012-13 |
| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| **1. Revenue Receipts** | **935,685** | **137,155** | **168,826** | **17.4** | **18.0** | **-42.5** | **23.1** |
| Gross tax revenue | 1,077,612 | 190,463 | 230,370 | 20.4 | 21.4 | 9.8 | 21.0 |
| Tax (net to Centre) | 771,071 | 114,078 | 142,789 | 17.2 | 18.5 | 1.1 | 25.2 |
| Non Tax | 164,614 | 23,077 | 26,037 | 18.4 | 15.8 | -81.6 | 12.8 |
| **2. Capital Receipts** | **555,241** | **238,010** | **268,465** | **50.9** | **48.4** | **152.7** | **12.8** |
| Recovery of Loans | 11,650 | 8,112 | 2,703 | 54.0 | 23.2 | 285.7 | -66.7 |
| Other Receipts | 30,000 | 1,145 | 1,330 | 2.9 | 4.4 | -1.1 | 16.2 |
| Borrowing and other liabilities | 513,500 | 228,753 | 264,432 | 55.4 | 51.5 | 151.6 | 15.6 |
| **3. Total Receits (1+)** | **1,490,925** | **375,165** | **437,291** | **29.8** | **29.3** | **12.8** | **16.6** |
| **4. Non- Plan Expenditure** | **969,900** | **263,497** | **323,295** | **32.3** | **33.3** | **18.2** | **22.7** |
| (a) Revenue Account: | 865,596 | 234,595 | 290,354 | 32.0 | 33.5 | 20.8 | 23.8 |
| Interest payments | 319,759 | 67,541 | 80,615 | 25.2 | 25.2 | 15.7 | 19.4 |
| Major subsidies | 179,554 | 47,440 | 96,914 | 35.3 | 54.0 | 13.2 | 104.3 |
| Pensions | 63,183 | 19,907 | 18,715 | 36.5 | 29.6 | 29.2 | -6.0 |
| (b) Capital Account | 104,304 | 28,902 | 32,941 | 35.0 | 31.6 | 0.5 | 14.0 |
| **5. Plan Expenditure (i)+(ii)** | **521,025** | **111,668** | **113,996** | **25.3** | **21.9** | **1.7** | **2.1** |
| (i) Revenue Account | 420,513 | 97,480 | 93,190 | 26.8 | 22.2 | 3.2 | -4.4 |
| (ii) Capital Account | 100,512 | 14,188 | 20,806 | 18.2 | 20.7 | -7.5 | 46.6 |
| **6. Total Expenditure (4)+(5)=(a)+(b)** | **1,490,925** | **375,165** | **437,291** | **29.8** | **29.3** | **12.8** | **16.6** |
| (a) Revenue Expenditure | 1,286,109 | 332,075 | 383,544 | 30.3 | 29.8 | 15.1 | 15.5 |
| (b) Of which Grants for creation of Capital Assets | 164,672 | 30,539 | 30,145 | 20.8 | 18.3 | 179.8 | -1.3 |
| (c) Capital Expenditure | 204,816 | 43,090 | 53,747 | 26.8 | 26.2 | -2.3 | 24.7 |
| **7. Revenue Deficit** | **350,424** | **194,920** | **214,718** | **63.4** | **61.3** | **289.3** | **10.2** |
| **8. Effective Revenue Deficit (7-6(b))** | **185,752** | **164,381** | **184,573** | **102.5** | **99.4** | **319.8** | **12.3** |
| **9. Fiscal Deficit** | **513,590** | **228,753** | **264,432** | **55.4** | **51.5** | **151.6** | **15.6** |
| **10. Primary Deficit** | **193,831** | **161,212** | **183,817** | **111.3** | **94.8** | **395.4** | **14.0** |

*Source: Review of Union Government Accounts, July 2012.*

# Money & Banking

## Money Stock - Components and Sources (₹ Billion)

| Items | Outstanding as on | | Variation over (per cent) | | | |
|---|---|---|---|---|---|---|
| | 2012 | | Financial Year so Far | | Year on Year | |
| | Mar. 31 | Sep. 21 | 2011-12 | 2012-13 | 2011 | 2012 |
| M3 | 73,592.0 | 77,993.8 | 5.8 | 6.0 | 16.6 | 13.4 |
| **Components (i+ii+iii+iv)** | | | | | | |
| (i) Currency with the Public | 10,265.0 | 10,638.4 | 3.3 | 3.6 | 14.0 | 12.9 |
| (ii) Demand Deposits with Banks | 7,049.1 | 6,799.3 | -11.6 | -3.5 | -7.3 | 6.4 |
| (iii) Time Deposits with Banks | 56,249.7 | 60,538.7 | 8.8 | 7.6 | 20.9 | 14.3 |
| (iv) "Other" Deposits with Reserve Bank | 28.2 | 17.4 | -36.6 | -38.4 | -42.6 | -24.9 |
| **Sources (i+ii+iii+iv)** | | | | | | |
| (i) Net Bank Credit to Government (a+b) | 23695.5 | 25844.1 | 8.5 | 9.1 | 22.0 | 20.1 |
| (a) Reserve Bank | 5357.4 | 5362.0 | -398.9 | 4.7 | – | – |
| (b) Other Banks | 18338.1 | 20482.0 | 13.1 | 11.7 | 15.3 | 14.1 |
| (ii) Bank Credit to Commercail Sector (a+b) | 49594.3 | 51271.3 | 4.2 | 3.4 | 19.5 | 16.1 |
| (a) Reserve Bank | 39.6 | 36.2 | – | – | – | – |
| (b) Other Banks | 49554.7 | 51235.2 | 4.3 | 3.4 | 19.5 | 16.1 |
| (iii) Net Foreign Exchange Assets of Banking Sector* | 15437.8 | 16.84.7 | 11.5 | 4.2 | 14.0 | 3.5 |
| (iv) Government's Currency Liabilities to the Public | 142.7 | 150.5 | 4.6 | 5.4 | 10.9 | 13.0 |
| (v) Banking Sector's Net Non- Monetary Liabilities | 15278.3 | 15356.7 | 11.9 | 0.5 | 34.1 | 22.2 |
| *of which* | | | | | | |
| Net Non-Monetary Liabilities of RBI | 6038.4 | 6801.0 | 43.0 | 12.6 | 51.4 | 29.1 |

**: Includes Investments in foreign currency denominated bonds issued by IIFC(UK) since March 20, 2009.*
*Note: Government Balances as on March 31, 2012 are before closure of accounts.*

## Select Scheduled Commercial Banks - Business in India

| Items | 2012-13 Outstanding as on (₹ Crore) | Percentage Variation | | | |
|---|---|---|---|---|---|
| | | Financial Year So Far | | Year on Year | |
| | September 21, 2012 | 2010-11 | 2011-12 | 2010 | 2011 |
| Bank Credit | 47,665 | 1527.4 | 1546.4 | 6696.0 | 6716.6 |
| Non-Food Credits | 46,739 | 1487.8 | 1433.6 | 6515.8 | 6473.3 |
| Aggregate Deposits | 62,909 | 3268.8 | 3817.9 | 8235.7 | 7560.3 |

## Cash Reserve Ratio/ Interest Rate

| Item / Week Ended | 2011 | 2012 |
|---|---|---|
| | September 23, 2011 | September 21, 2012 |
| Cash Reserve Ratio (per cent) (1) | 6.00 | 4.75 |
| Bank Rate | 6.00 | 9.00 |
| Base Rate | 10.00/10.75 | 9.75/10.50 |
| Term Deposit Rate | 8.50/9.25 | 8.50/9.25 |
| Saving Deposit Rate | 4.00 | 4.00 |
| Call Money Rate | 8.26 | 8.02 |

(1) Cash Reserve Ratio relates to the Scheduled Commercial Banks (exclusing Regional Rural Banks).
(2) Deposit Rate related to major Banks for deposits of more than one year maturity.

# Bombay Chamber of Commerce and Industry Trust for Economic and Management Studies

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 of this 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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# “E - Information Service”

The **“E - Information Service”** is provided through an online newsletter called **‘E - weekly’** to disseminate useful information on business and commerce in India and International countries. This service is provided to both the members of Bombay Chamber as well as non-members. The information contains notifications, circulars and reports issued by respective Department on:

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