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SLOW BUT NOT DOWN – A FOCUS ON COSTS

by Suresh S.

Director, DMS Financial Services (P) Ltd.

What has been the approach of Corporates to face the onslaught of Slowdown? Here are some notable illustrations. These have been compiled from issues of The Economic Times and from our clients:

- Delhi based Out Of Home (OOH) Digital media company **LIVEMEDIA** decided to bring the production of video content for its LCD screens installed in restaurants and other public places, in house. They found that doing this work themselves is saving up to 40% in production costs
- The art of negotiation could never have been more critical than now. It is surprising at the extent to which hotels are willing to concede today. But still the options to reduce travel costs especially for one-to-one meetings are possible. Many companies have used Skype and other low-cost video conferencing software to avoid travel and reduce communication costs.
- **United Lex** is a legal process outsourcing firm. The costs to train a law graduate are about as much the same as training non-legal person. But non-legal persons are available much cheaper. “We took a decision to replace the high cost resources with lower cost ones.” says the COO Anup Bhasin.

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- Downturn can be a good time to hire – the same people you would have talked to two to three months back would be available at 20 to 30% lower compensation.
- One more practice is that firms have stopped buying out notice period salaries of those joining them. This can save quite a chunk.
- **Vishal Retail**, the retail giant has precisely demonstrated how cost reduction can help ride out the slump: the Group President Ambeek Khemka has said that they have been able to renegotiate rents of 20 to 25% and in some cases upto 40%. Considering this involves a number representing five lakh sq. feet, the savings is a whopping Rs.30 lakhs per month.
- **Edelweiss Capital** had multiple offices in places such as Delhi, Bangalore and Kolkatta. Now it has opened a consolidated office per city. This is strategic to also position the company as a ‘one-stop destination’ for its investors.
- Corporates reserve additional space with developers for say, a couple of years in case they come up with expansion plans in the near future. Property advisory firm **DTZ** director Vivek Dahiya says that some companies such as **Accenture** and **Deutsche Bank** have surrendered this option at Mumbai and **EDS Technologies** at Bangalore whereas others have shortened the option term to just six months.
- Corporates also resort to sub-lease the space at least for the short run. This would give them the leeway to expand after the term expires .Enabling sub-lease to third party has started becoming a regular clause in new agreements. Tenants get the double-benefit of avoiding penalty if they need to vacate interim, before the completion of the lock-in period. Developers are inclined to permit such clauses to get off the strain of finding good credit-worthy tenants, according to Kaustav Roy, director-transaction services, **Cushman & Wakefield**.
- **Kotak Mahindra Bank** has launched a ‘kill bill’ campaign to reduce costs. Posters are exhibited in conference rooms – where the maximum damage can take place, and at entry/exit points and focus on air-conditioners, computer monitors etc.
- **SBI** is rewarding its customers with 400 points if they accept credit card statements by email instead of post, and also make payments over the internet. The ‘per customer’ saving is Rs. 40.
- **HDFC Securities** opens 20000 new broking accounts every month. When it sends a welcome kit, the courier cost is Rs. 30- 40.If the same can be sent through email, the savings would work out to Rs.6 lakhs per month.
- Another brokerage house **Cubs** has offered waiver of annual depository fees if members agree to receive statements by email and digitally signed contract notes. Each contract note costs about Rs. 2 to print and Rs. 10 for courier. Thus if the customer does more than one transaction per month, Cubs stands to gain.

- **Sharekhan** has reduced the print run of its research report by as much as 25% to save on Stationery costs.
- **Elbee Express** has resorted to ‘pay-as-you-use’ model for software applications to reduce the upfront costs of software licensing and hardware systems. This is a model that has the potential to attract seven million SME units and could take on traditional software makers including SAP and Oracle.

How have Angel investors helped investee companies manage costs?

- ❑ Avinash Bajaj , founder of the **Matrix Partners**, says it is best to lay off people in one go rather than laying off people in multiple steps. That can scare your bright stars too.
 - ❑ “One of the strategies at our investee companyies is moving from monthly to weekly reporting and some even to daily reporting to keep a tab on expenses” says Sudhir Sethi, MD, **IDG Ventures India**. “Bringing in a culture of questioning each expense has enabled us to get a bigger bang for our money” says M.Srinivas Rao, CEO, **Aujas Networks**.
 - ❑ One of the team an investee company sub-leased some of it is office space in Bangalore to another start up being a win win situation.
 - ❑ **Helion Venture Partners** leveraged its network by negotiations for its investee companies from service providers. It has been able to save 25 to 30 percent or more on Internet costs by striking deals for bulk connections with Sify and VSNL.
 - ❑ **Helion** has encouraged its investee companies to use each others’ services. Hummingbird suites is one of its investee companes and corporate travellers can use that while on business. By encouraging other units to use these apartments, the units get better rates and at the same time, Hummingbird gets more business.
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INDIA VISION 2020

-THE INFRASTRUCTURE CHALLENGE

by Padmalatha S.

India's potential to become one of the superpowers of the world cannot be disputed. But potential alone is not sufficient for achievement. Dogged by poor infrastructure, corruption, ineffective accountability mechanisms for improving service delivery, and antiquated regulatory environment, India remains an economic enigma. The problem lies not in the policy but the results on the ground, is the problem of infrastructure a problem of mere financing? Then, in an increasingly globalizing environment, it should not be difficult to find the funds through innovative structures. But it has been seen that emerging infrastructure constraints require systemic reforms that, according to the World Bank, not only "fix the pipes", but also "fix the institutions that fix the pipes".

Towards 2020....some voices

"India will grow at about 8 per cent until 2020..... Goldman now predicts that India's economy, measured in absolute dollar terms, will overtake those of Italy, France and the UK by 2017. It will overtake Germany's in 12 years and Japan's in 18."

Financial Times reporting on January 24, 2007[on the latest Goldman Sachs Brics report]

I am convinced that the government, at every level, is today not adequately equipped and attuned to deal with this challenge and meet the aspirations of the people. To be able to do so, we require the reform of government and of public institutions ... No objective in this development agenda can be met if we do not reform the instrument in our hand with which we have to work, namely the government and public institutions. Clearly, this will be my main concern and challenge in the days to come.

Prime Minister Manmohan Singh, June 24, 2004

I must caution that outlays do not necessarily mean outcomes. The people of the country are concerned with outcomes. The prime minister has repeatedly emphasized the need to improve the quality of implementation and enhance the efficiency and accountability of the delivery mechanism.

Minister of Finance Budget Speech, February 28, 2005.

.....and some ground realities

India is an economic enigma. Look at the following table:

Share in world GDPⁱ[figures show percentages]

YEAR AD	INDIA	CHINA	JAPAN	USA	EUROPE	REST OF THE WORLD
1	33	27	1	0	14	25
1500	25	25	3	0	21	26
1820	15	33	3	2	27	20
1870	12	17	2	9	38	22
1913	8	8	4	21	39	20
1950	4	5	3	28	31	29
1973	3	5	8	23	29	32
2001	4	7	8	23	21	37
2008	6	13	7	21	19	34

SOURCE: The Economic Times

India rolled out its first car in 1948, Japan in 1952, and South Korea in 1962. By 1971 Japan had swept the US market, and by 1980 South Korea was ranked among the important players in the world auto market. India was left behind.

India set up a Planning commission much before Japan and S Korea did. Yet the Indian government could not play a pivotal role in ‘catching up’ as the other two economies did. India is the world’s largest democracy, but has not been able to equal the achievements of ‘authoritarian’ states such as Indonesia or Vietnam, not just economically, but in human development outcomes as well.

India’s potential to become one of the superpowers of the world cannot be disputed. But potential alone is not sufficient for achievement. Dogged by poor infrastructure, corruption, ineffective accountability mechanisms for improving service delivery, and antiquated regulatory environment, India remains a difficult economic enigma.

The problem lies not in the policy – the objectives are lofty, and on paper the policies and their design seem just right for the environment. The problem lies in the results on the ground – lack of attention or accountability to the actual delivery of quality services. A World Bank reportii notes, “The result is that in the same country that is gaining a reputation as a place for “medical tourism,” the typical public doctor in the capital city gives substandard care; in the same country that boasts technical institute graduates who set not just the national but the global standard, the typical Indian child is woefully undereducated. This is not just an issue of the availability of schools. Even when there are schools, the learning achievement is often low, in part because the accountability of the public sector providers is limited.”

The same report further adds, “India’s Supreme Court is justly world renowned, but local courts are backlogged and ineffective and local police are frequently a miasma of corruption and brutality. Similarly, in economic performance, while parts of urban India compete for business in software engineering and biomedical research, parts of rural India have poverty rates comparable

to borderline “failed states,” such as Haiti and Nigeria, and have child malnutrition rates higher than any country in the world.”

Is this the failure of public governance? Or is this a demonstration of the lack of cohesive power of a huge electorate? Or is this a signal for the non-governmental / private sector to move in and take control of social and governance issues?

Infrastructure – the binding constraint?

Is there any relationship between providing adequate ‘Infrastructure’, and solving social or ethical issues like the ones outlined above? Many, including the World Bank, seem to think there is a positive connection.

Here is an example. India, contributing to 10% of the world’s fruit production, is the second largest producer of fruits and vegetables in the world. However, just about 1.3% of these get processed in India, as contrasted with 80% in the US, 70% in France, 80% in Malaysia and 30% in Thailand. More disturbing is the fact that about 43% of the production is wasted because of lack of cold storage facilities and energy infrastructure.

Growth in infrastructure has already been shown by research and practical examples to be a driver of rapid economic growth. But infrastructure is also an ‘economic equalizer’ – when, for example, investments in all weather roads to remote villages reach farmers’ produce to market more efficiently, or investments that help raise rural productivity, or investments that help jobs to be moved to people.

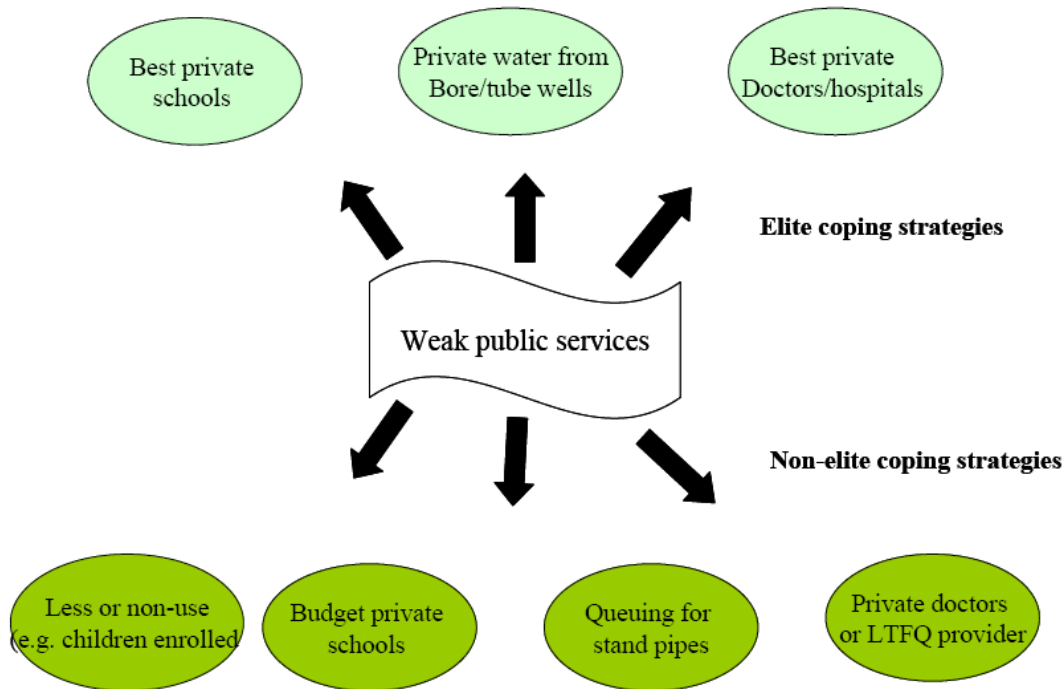
Consider the projections made by the Planning Commission in its ‘Vision 2020’ document. Total population of India will exceed 1.3 billion by 2020, with unequal rates of population and economic growth aggravating regional disparities. Urban population would be up from the current 28% to 40% of total population, which is likely to concentrate itself in 60 to 70 large cities. If the current disparities between urban and rural centres in providing basic infrastructure in the form of education, health care, transport, communication, power, and water and sanitation are allowed to persist, migration to cities and the rapid expansion of urban slums will be a natural outcome.

A recent Mckinsey survey estimates the size of the Indian rural market at USD 500-600 billion by 2020. The survey also reinforces the direct correlation between the provision of basic infrastructure and growth drivers – districts with minimum infrastructure have up to 30% more per capita income than deprived districts.

Then why is adequate infrastructure not being provided? Why is the country unfailingly falling short of its infrastructure investment targets? Is it a mere financing problem – India must invest around 3-4% more of its GDP on infrastructure to sustain a growth of around 8%, after addressing existing gaps? Or is it a problem of unsatisfactory delivery of infrastructure and services to consumers, post completion?

Public Private Partnerships [PPP] to the rescue?

When the public sector is found inadequate in delivering services, it is found that coping strategies emerge from the private sector. However, sadly, the way in which the 'elite' cope is quite different from the way in which the non elite cope. The World bank document presents a typical strategy in the figure below.



Source: World Bank documents

When the route to privatization is an unplanned one, caused by the failure of the government to provide 'public goods'- it does not come with the responsibility of inclusive growth. Today, this is the state of PPPs in India's infrastructure development, where policies rather than planned and effective implementation are seeking to drive private rendering of public goods to the country.

Take a stark case- the essential commodity called 'water'. In the 1980s, water was available in Bangalore and Chennai for around 20 hours a day. Today, the availability has dwindled to around 1.5 – 2 hours a day. A recent study in Delhi has found that the elite pay an average price of Rs 262 per month for declining public service and accountability in water supply, through capital expenditure in pumps, borewells and overhead storage equipment; in the same city, the non elite pay the cost with their only asset – time – since they spend more than two hours every day just to collect water.

How are governments tackling the problem of closing the infrastructure gap? Quietly, all over the world, a paradigm shift has occurred in the way governments provide infrastructure –

through involvement of the private sector. Once a rare phenomenon, private-public partnerships [PPP] has now emerged as the most important model used to finance and deliver public goods – roads, airports, ports, telecommunication systems, power, water, hospitals, schools and even prisons!

Mounting fiscal pressures and their desire to fund badly needed infrastructure improvements and innovations prompted governments to involve the private sector in public projects. Another reason was that the private sector, with its purely commercial objective towards project selection and implementation, would be more efficient in delivering high quality infrastructure services at an affordable cost.

PPPs and Project finance

PPPs typically involve long term contracts between the private sponsors and the governments for providing infrastructure assets or services. The Infrastructure Journal reports financial closure of USD36 bn of PPP deals during 2006, significantly up from USD23 bn in 2005.

Globally, 'Project finance'ⁱⁱⁱ is the preferred financing alternative for infrastructure projects involving private investment. In 2006 alone, project financed investment touched a historic high of USD 328 billion, an increase of 23% over 2005 levels and 40% over 2004. The debt to value ratios averaged around 75%, which implied that these project companies were highly leveraged. Bank loans [86%] and project bonds [14%] provided almost all the project debt. What is more significant was that the average loan size doubled over the last decade to stand at USD 334 million, while average bond size exceeded USD 420 million over the last two years.^v

The India infrastructure financing challenge

So how much of infrastructure investment would India require by 2020? Assuming that the requirement is 10% of GDP [China currently invests 20% of its GDP in infrastructure, while India invests hardly 6%!] at the minimum, and taking the Goldman Sachs projection^{vi} of USD2104 bn as GDP in 2020, the country would need close to USD 200 bn per year as infrastructure investment. Contrast this with the about USD 60 bn average annual investment projected for the 11th Plan period.

If the private sector has to take the lead in investing in infrastructure, and with typical debt to value ratios of about 75%, the debt financing requirement would translate to about USD 150 bn per year! This would roughly translate into a debt requirement of about Rs. 60 lakh crore by 2020. At present, the credit growth in the Indian banking system is around Rs. 4 lakh crore – of which only about 40% is received by the private sector, and of which the credit to infrastructure is around 20%. This implies that the share of bank credit to infrastructure is about 8%, hardly sufficient to fulfil vision 2020.

Then who will finance infrastructure growth in India?

The other prevalent financing option – long term project bonds – is sadly in a nascent stage in India. In contrast to the government bond market, the corporate bond market [corporate issuers plus financial institutions] amounts to just USD 16.8 billion [less than 2% of GDP] at the end of

June 2006. The shallowness of this market can be gauged from the size of China's corporate bond market at over 10 per cent of its GDP, and that of Japanese, Korean and Malaysian markets at over 40 per cent. Another issue is the meagre turnover of corporate bonds in the secondary market – just 3.6% - largely due to the limited supply arising out of preference for private placements. Contrast this with the 70% turnover accounted for by the secondary market in government bonds in India, and about 50%- 70% in the corporate bond segment in countries like the USA

India also has one of the lowest proportions of corporate bonds to total bonds [about 12%] and corporate bonds to bank loans [about 12%] among comparable developing nations. The potential of a vibrant corporate bond market would be evident from the fact that in the USA, corporate bonds constitute more than 60% of the total bond market, and the bond market is about 1.5 times the size of the bank loan market! Interestingly, global studies show that the larger the size of the corporate bond market, the larger the bank credit market. [source: Bank for International settlements, World Bank, Deutsche bank]. The statistics also lead to two conclusions — one, India's equity market is more vibrant compared with its debt market, and, two, India needs to deepen its bond market without further delay to expand the size of its long term bank credit market.

Though India has been seriously considering long-term bond markets as a viable alternative, and the Patil Committee's report is more than a couple of years old, little tangible result has emerged. Does this mean that ‘vision 2020’ will remain a mere dream? Not if innovative financing modes are adopted and the requisite reforms and systems are put in place with a sense of urgency and purpose.

Innovative instruments and structures, however, cannot change fundamental risks in credit markets — they only reallocate risks. For effective reallocation, regulators should ensure against new risks emerging.

To make innovations sustainable and result oriented, the deals will have to ensure sufficient incentives for capital [equity and debt] providers to invest in these projects. Recent research has underscored the role of institutional and contractual arrangements in infrastructure delivery, and “the importance of the stability and enforceability of institutions and stability of political environment to derive an appropriate governance mechanism for private investment in infrastructure.”vii

Therefore, simultaneous and speedy progress on multiple fronts is necessary.

Back to Vision 2020

Innovations, whether in the financial or social sector, cannot, by themselves, lead to fruition of a vision. They are mere catalysts that would accelerate the process of ‘reaching there’ – only if backed by commitment, ethical practices and adequate regulation.

India can be justifiably proud of its achievements in the recent past. In purchasing power parity terms, it is the fourth largest economy in the world. Its economic growth has been supported by reforms, and has averted major crises of the types that have struck other Asian countries. It is

increasingly claiming a niche internationally as a superpower of the 21st century. Hence its ‘vision’ does seem realistic.....

But achievements bring new challenges as well..... and old lacunae get highlighted as drags on progress.

One such potential showstopper is ‘infrastructure’. While everyone agrees that infrastructure could indeed become a binding constraint, there are no satisfactory answers on ‘how’ to address the problem.

Is the problem of infrastructure a problem of mere financing?

But it has been seen that emerging infrastructure constraints require systemic reforms that, according to the World Bank, not only “fix the pipes”, but also “fix the institutions that fix the pipes”. We have seen that people are coping with inadequate services in many ways, including by large-scale recourse to the private sector. What are some of the factors that destroy service quality? The World Bank observes that absence [of quality], incompetence, indifference, and corruption of staff, as well as underutilization and under maintenance of assets are some of the key factors.

It is thus evident that unless financial, regulatory, governance and legal reforms, as well as attitudinal changes in the leadership, happen simultaneously and at a scorching pace, infrastructure-driven economic growth would remain a vision — a well articulated, well debated, but distant dream

Services offered by DMS Financial Services Co. (P) Ltd.

- Outsourcing in the financial function
- Placement of human resources
- Training in finance, sales, operations and soft skills

For details, please contact Mr.Karthi on 044-24995672.

¹1. 2008, January 29, Sabharwal, Jaspal Singh, “The return of India & China”, page 20, The Economic Times, India

2.2006, Development Policy review, the World Bank

3. Prof Benjamin Esty of the Harvard Business School defines ‘Project finance’ as involving “the creation of a legally independent project company financed with non recourse debt [and equity from one or more

corporations known as sponsoring firms] for the purpose of financing investment in a single purpose capital asset, usually with a finite life.” The term ‘non recourse’ here signifies that the lenders look only to the cash flows from the project company for their repayment, and not to the sponsors.

4. This figure constitutes investment through private sector equity, commercial bank loans, bonds and international development finance institutions,

5. 2007, Esty, Benjamin C, and Sesia Jr, Aldo, “An overview of project finance and infrastructure finance- a 2006 update”, Harvard Business School

6. 2007, Wilson, Dominic, and Purushothaman, Roopa. “Dreaming with BRICS: the path to 2050”, Goldman Sachs

7. Devapriya, KAK and Alfen, Wilhelm H, 2003, “Role of institutional arrangements in financing project companies in Asia”, Knowledge Centre @ Weimar, Bauhaus-Universität Weimar, Germany
