FIN STREET
...the path to Financial Excellence!

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FINNOMICS

K J Somaiya Institute Of Management Studies and Research

OIL & GAS SECTOR

About Finnomics...

As we are writing for Finnomics, we are experiencing a gush of feelings that we have never experienced before because this moment is different from the last time, as it is the dawn of a new era for this committee. We are not the members of FINANCE FORUM any more; but we are a part of the committee that constitutes FIN-STREET. Our Vision has changed – now we work **"to facilitate financial excellence"**. Our focus was first on enhanced financial knowledge for all but not anymore, now we yearn for holistic development of all in the financial domain. Things have changed; it feels like we are standing at the start line and getting ready for a whole new journey, wherein we would be venturing into unknown territories. Amidst all these uncertainties, there is familiarity too; we still have the Knowledge Sharing Sessions, Finnomics is still being rolled out and of course, there are financial events along with a series of guest lectures. Yes, we are different now as members of FIN-STREET, yet we are still the same.

But it is not just us; even Finnomics is different. Its focus has now shifted from just providing information to actually analyzing it to derive ideas. The approach has changed from being theoretical to that of being practical. Finnomics is now growing and will continue to grow till it becomes fit of being circulated in the corporate world. There is no looking back now, because we are onward-bound.

In this issue you will read what we feel about the buzz generated by **"FDI in retail"** and get an insight on the **"Oil and Gas Sector"** in ways you might never have heard before. Also, we have for you an interesting and perhaps un-debatable analysis of the correlation between commodity prices and currency movements, in the article **"Commodity prices- An indicator to currency movements"**, along with our views on whether or not corporations should be allowed into the Indian banking system in **"Bank Licenses – A Hobson' Choice".** And yes, you would also get a bird's-eye view on the history of Japan and have a lesson in **"Learning from history".** And that is not it; in the next edition we plan to bring you even more surprises in the form of a special edition on stock valuation, along with interviews of experts.

Finnomics is truly evolving. We now are bent on going outside the portals of SIMSR. We want Finnomics to be sought after. We can go on and on, but we'll halt and just say that we are now "breaking free". Be a part of this evolution, be a part of Finnomics. Join us in our journey for now and forever.

- THE FINSTREET TEAM

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RBI Norms for new private banks—Prospects and Apprehensions

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Background

Pursuant to the announcement made by Union Finance Minister in his budget speech and the Reserve Bank's Annual Policy Statement for the year 2010-11, a discussion paper on 'Entry of new banks in the private sector' was placed on RBI website on August 11, 2010.

The discussion paper broadly emphasized international practices, Indian experience as well as the extant ownership and governance (O&G) guidelines. The Reserve Bank had sought views/comments from banks, non-banking financial institutions, industrial houses, other institutions and the public at large. Discussions were also held with major stakeholders to seek their comments and suggestions on the issues pointed out in the paper.

The gist of comments on various issues received through emails, letters and discussions was placed on Reserve Bank's website on December 23, 2010. The draft guidelines have been prepared based on the responses received, extensive internal discussions and consultation with the Government of India.

Present Draft norms

On 29th August,2011 Reserve Bank of India released the draft guidelines for licensing of New Banks in Private sector.

The key features of the draft guidelines are:

(i) Eligible promoters: Entities/groups in the private sector, owned and controlled by residents, with diversified ownership, sound credentials and integrity and having successful track record of at least 10 years will be eligible to promote banks.

Entities/groups having significant (10 per cent or more) income or assets or both from real estate construction and/or broking activities individually or taken together in the last three years will not be eligible.

(ii) Corporate structure: New banks will be set up only through a wholly owned Non-Operative Holding Companies (NOHC) which will be registered with the Reserve Bank as a non-banking finance companies (NBFC). The NOHC will hold the bank as well as all the other financial companies in the promoter group.

(iii) Minimum capital requirement: Minimum capital requirement will be Rs 500 crore.

Subject to this, actual capital to be brought in will depend on the business plan of the promoters. NOHC shall hold minimum 40 per cent of the paid-up capital of the bank for a period of five years from the date of licensing of the bank.

Shareholding by NOHC in excess of 40 per cent shall be brought down to 20 per cent within 10 years and to 15 per cent within 12 years from the date of licensing of the bank.

(iv) Foreign shareholding: The aggregate non-resident shareholding in the new bank shall not exceed 49 per cent for the first 5 years after which it will be as per the extant policy.

(v) Corporate governance: At least 50 per cent of the directors of the NOHC should be independent directors. The corporate structure should be such that it does not impede

effective supervision of the bank and the NOHC on a consolidated basis by the Reserve Bank.

(vi) Business Model: The business model of the new bank should be realistic and viable and it should address how the bank proposes to achieve financial inclusion.

(vii) Other conditions:

a. The exposure of the new bank to any entity in the promoter group shall not exceed 10 per cent and the aggregate exposure to all the entities in the group shall not exceed 20 per cent of the paid-up capital and reserves of the bank.

b. The bank shall get its shares listed on the stock exchanges within two years of licensing.

c. The bank shall open at least 25 per cent of its branches in unbanked rural centers (population upto 9,999 as per 2001 census)

d. Existing NBFCs, if considered eligible, may be permitted to either promote a new bank or convert themselves into banks.

(viii) In respect of promoter groups having 40 per cent or more assets/income from non-financial business, certain additional requirements have been stipulated.

Future Prospects

Even today vast population of our country is not covered by basic banking facilities. While the public sector banks have limited access to this area, the existing private banks are shy to enter into un-banked areas. By allowing private banks into unbanked areas, there will be a ray of hope for the

people of these areas to get the banking facilities.

(ii) Now Core Banking Solution has been stabilized and most of the banking services are cheaper. With more players in the field, the banking services will be speedier and still cheaper.

(iii) Due to more competition, there will be further improvement in the quality of banking services.

(iv) With increase in number of bank branches, there be employment generation in the banking sector and will reduce unemployment to some extent.

Apprehensions

(i) With provision of banking facilities in the un-banked areas, the business of the post offices and cooperative societies/banks will be further reduced.

(ii) The corporate who were hitherto depending on the existing banks for their financial and banking needs will switch over to their own banks resulting in reduction of the business levels of many banks.

(iii) In the present era of deregulated interest rate regime, the interest rate war will further deepen. The survival of the weak banks will be difficult and merger and acquisition may take place.

(iv) With increase in the number of bank branches, there will be increased pressure on the regulator as far as supervision is concerned.

(v) There may be attrition of senior officers and executives from the existing banks to the new private banks and the shortage expected to arise in the coming 2/3 years due to mass retirement will further increase.

The final guidelines will be issued and the process of inviting applications for setting up of new banks in the private sector will be initiated thereafter.

After receiving feedback, comments and suggestions on the draft guidelines, and after certain vital amendments to Banking Regulation Act, 1949 are in place.

The Reserve Bank has sought views/comments on the draft guidelines from banks, non-banking financial institutions, industrial houses, other institutions and the public at large to be received at its Central Office at Mumbai by October 31, 2011.

Krishna Ambadasu—PGDM Finance

The mood was grim in the Indian markets just before the start of August month. It was mainly because of the announcement came from Reserve Bank of India (RBI) Governor, Dr. D. Subbarao on 26th July, 2011 about an increase of 50bps in the policy rate, taking the repo to 8%. This was not anticipated by the markets and hence, Indian markets sailed into troubled waters. Nifty opened at 5527 points on 1st Aug and ended marginally higher on that day. Soon a big blow came on Aug 5th when S&P downgraded the US sovereign debt status from AAA to AA+ with negative outlook despite US House of Representatives voting for an increase in Debt ceiling and decrease in spending cuts on Aug 2nd. This shocked the entire global markets and the tremors reached our markets too. There was a 10% downfall in Nifty in just 10 days! Finally after much hammering in August, Nifty touched 5000 and ended the month just one point above the psychological mark of 5000. Nifty touched a low, in 18 months, of 4720 on Aug 26th, which was also the expiry day for Nifty F&O. Panic selling by foreign funds in equity markets was at record levels that day.

August was the worst month for expiry since 2 years. August 2011 expiry saw Nifty Futures ending lower by 11.81% on a month on month basis. The Index futures saw 69.93% rollover into new series. For this month, FIIs were sellers in the index futures segment to the tune of Rs. 1,682 crores, but FIIs were net buyers in the stock futures to the tune of Rs. 2,054 crores.

Sensex was a mere shadow of Nifty. It started at 18197 points and started strong on the first day gaining 1%. But then the trouble started. Sensex touched its 2011 low at 17306 points on Aug 5th, the day US got downgraded. Soon it plunged into new lows. It hit a low of 15848 points on 26th Aug, which was its low after Feb 2010. This was mainly due to panic in global markets ahead of US Fed Governor, Mr. Ben Bernanke's speech at Jackson Hole. August would have been even worse, thanks to the last two day gains of 828 points, enabling the Sensex to close at 16676.

At the start of the month, Reliance Industries was undoubtedly the most valuable company on the Bombay Stock Exchange (BSE). But this month saw an interesting battle for the number one spot among Reliance Industries Ltd (RIL), Coal India Ltd (CIL) and Oil and Natural Gas Corporation (ONGC). On Aug 17, Coal India dethroned RIL to become the country's top valued firm. This is an incredible feat for CIL considering the fact that it got listed only in Nov 2010. But this position was short lived for CIL as ONGC took the throne then. Even this was short lived. It wasMukesh Ambani's RIL that reclaimed the numero uno position by the end of the month reaching a market capitalization of 242283 crores and ONGC and CIL moving to second and third position respectively.

The mood of Dalal Street was reflected in the number of Initial Public Offerings (IPO) for the month of August. Two major IPOs were listed in this month - L&T finance holding ltd at a discount while Tree House Education and Accessories Ltd at a premium. Other prominent IPOs that were issued in this month were TD Power Systems, SRS Limited and Brooks Labs.

Indian Markets saw a huge out flow of foreign funds of over 9500 crores. The Indian Rupee exchange rate for August, 2011 averaged 45.31 INR to USD. This is 91.7 basis points higher than the July, 2011 rate of 44.40. This was due to fall in Indian markets owing mainly to huge outflows and also due to strong dollar. Dollar strengthened due to speculation that Fed may go for further measures to improve US economy.

Gold started the month of August with a price of 23084/ 10 grams. The price of gold at the end of the month was at 26932/ 10 grams. It saw a huge increase of over 16% in this month. This month saw the biggest single-day gain of 1310/ 10 grams on 19th Aug and also posted the second biggest single-day gain of 950/10 grams on 26th Aug. Investors all over the world fled to the safe havens like Gold. Uncertainty over European situation, mounting US debt and domestic inflationary concerns led the rise in Gold prices.

In all, Indian markets danced to the tunes of global cues particularly in the month of August. US debt situation and concerns over European banks were the major negatives this month. The positives came in the form of the Jackson Hole speech by Fed chairman. The market took the words of Fed chairman in a positive light. Though there was disappointment with no announcement on the third round of Quantitative Easing (QE3), but the markets rose after that due to the positive outlook given by the chairman about the US economy.

The month of September is going to be crucial for the Indian markets and also for the global. There are plenty of major things to watch out. The biggest thing for the Indian markets being the RBI quarterly Review on Sep 16th. IIP and inflation figures hold the key for the outcome of this RBI meet. Global events like President Obama's speech on Labour Day and Federal open market committee (FOMC) meeting could also dictate the direction of the Indian Markets in the next coming days.

1. Introduction:

The oil and gas sector has emerged from its beginning in North America to become an international industry. The industry is divided into 3 sectors the upstream, midstream and the downstream. Upstream is further divided into on shore and off shore. Upstream produces crude oil and natural gas. This is also known as Exploration and Production (E & P) sector. Mid-stream processes, stores and transports crude oil and natural gas. The downstream refines and markets ie. sells crude oil, natural gas, LPG, diesel oil etc.

2. Major Player:

(A). Oil & Natural Gas Corporation of India: ONGC is a public sector petroleum company. ONGC contributes 77% & 81% to India's crude oil production and natural gas production respectively. It is also into exploration and exploitation of hydrocarbons in 26 sedimentary basins of India. ONGC has also implemented Improved Oil Recovery and Enhanced Oil Recovery Project in 15 fields which has helped improve recovery factor of 15 fields from 27.5% in 2000 to 33.5% in 2010. Such schemes help in arresting natural decline in mature fields (of 25-30 years vintage) & maintaining production levels. ONGC most recent success was in Persian Gulf off the coast of Iran where it discovered 1 billion barrels of crude reserve.

(B). Indian Oil Corporation (IOC): IOC accounts for 48%, 34% and 71% of petroleum product, natural refining and downstream pipelines capacity respectively. IOC operates 10 out of 20 refineries in India with a refining capacity of 60.2 million metric tones per annum (MMTPA). Being the national oil company in downstream sector IOC reaches petroleum products backed by 167 bulk storage terminals & depots, 101 aviation fuel station and 89 LPG bottling station. It has a network of crude oil and product pipelines which span for 10,000 km is largest in the country. IOC has initiated technological innovation to reach LNG directly to bulk consumers through cryogenic containers for industrial as well as captive power application. It has also ventured into wind energy business, the current capacity of which is 159 million KW.

(C). Gas Authority of India Ltd.(GAIL): The 2800 km Hazira-Vijaipur-Jagdishpur allowed GAIL to be a regional gas distribution in various part of India. In 2001 GAIL commissioned worlds longest and India's first cross country LPG transmission pipeline from Jamnagar to Loni. GAIL is into petrochemicals, telecom, liquid hydrocarbon and gas infrastructure. GAIL currently has 7,200 km of natural gas high pressure trunk pipeline, 1922 km of LPG transmission pipeline network, 27 oil and gas block, 3 coal bed methane. It also has 13,000 km of OFC network offering highly dependable bandwidth for telecom providers. It also supplies PNG to household and commercial sector and CNG to transport sector in various cities like Mumbai, Delhi, Hyderabad, Pune, Ahmedabad etc.

(D). Reliance Industries Ltd. (RIL): RIL the largest private company of India by market capitalization gets a lion share from KG D-6 basin. KG D-6 accounts for 35% of fuel consumption in India. It caters to 57 critical customers in power, fertilizers, steel, petrochemicals and refinery. RIL has entered into a Joint Venture with Atlas Energy Inc. through this RIL becomes a partner in approximately 3,00,000 net acres of underdeveloped leasehold in the core area of Marcellus shale in South-western Pennsylvania. This area has net potential of 5.3 TCFe to RIL.

3. Current State:

Indian has 5.6 billion barrel of proven reserve as of January 2009. India's natural gas production ranked 23rd, with 1% of world market share or gas production of 27.5 million tones of oil equivalent. China leads both Oil and Natural gas lion

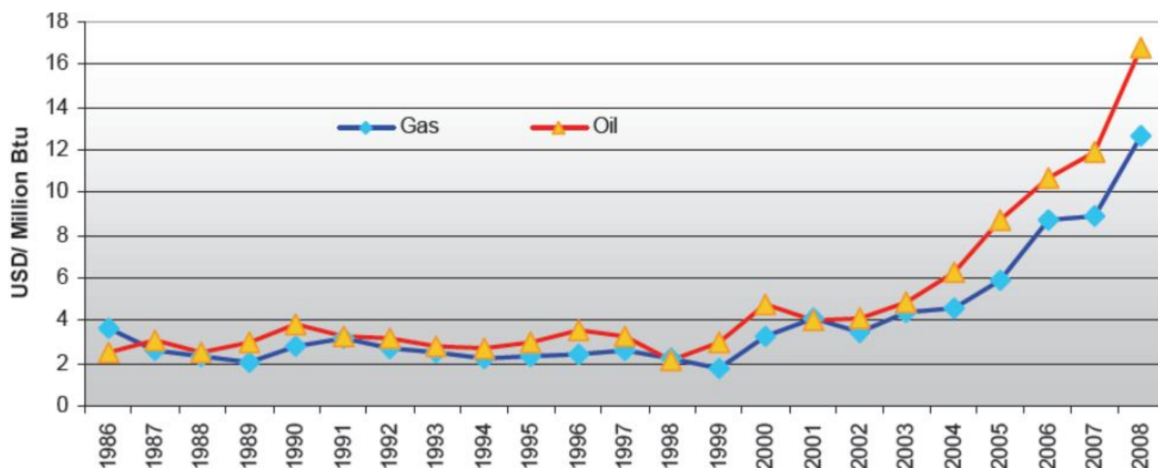
gas production ranked 23rd, with 1% of world market share or gas production of 27.5 million tones of oil equivalent. China leads both Oil and Natural gas production with 190 million tonnes and 68.5 million tonnes respectively. Of the proven oil reserves 47% are in western off shore, 6% in eastern offshore. Gujarat has 22%, Assam 18% and balance in Tamil Nadu, Andhra Pradesh and Rajasthan. The distribution of natural gas is located mainly in Panna and Mukti fields and onshore in Assam, Andhra Pradesh and Gujarat states.

Petroleum and Natural gas sector which includes transportation, refining and marketing of petroleum products and gas together contributed 15% of GDP. Royalties from crude oil stood at INR 79.45 billion while gas contributed INR 8.34 billion. According, to Ministry of Petroleum and Natural gas, India has exported 36.93 million tonnes of petroleum product worth valued at INR 1160 billion.

(A) Capacity: Indian today possesses surplus refining capacity with expansion of capacity on plates. Commencement of Reliance Industries Ltd. Krishna Godavri (KG) basin and scheduled commencement of production from Cairn India Ltd field will provide a boost to domestic oil and gas sector in India.

(B) Pricing and Subsidies: Government of India introduced some reforms to deregulate petroleum products way back in 2001. Government reinstates Administered Pricing Mechanism with Market Determined Pricing Mechanism in 2002. Even though MDPM is benchmarked with international oil prices government subsidizes petrol, diesel, kerosene, LPG heavily. Thus government influences demand of these products.

Government of India control prices of 4 petroleum products and share the subsidies with ONGC and GAIL. Private companies are allowed to sell some of their petroleum products at their price. Price increase in fuel has not been substantial hitting hard the Oil Marketing Companies and refining companies. Demand of diesel increased by 25% between 2006 to 2008 but price increase was just 10%. After this increase inflation jumped to 8.2% y-o-y. In 2010 a government appointed a committee has suggested to reduce increase price of petroleum sector or else companies might have to go bankrupt. Kerosene which is heavily subsidized is used by poor household. Due to its inexpensive price it is use for adulteration in motors. But now with crude oil at $90-110 barrel level prices of petroleum products has increased several times giving some relief to companies and improving their bottom line.



Source: BP Statistical Review of World Energy June 2011

4. Macro Environment: Energy market in India has improved over the past 18 months due improved economic growth and higher demand for petroleum products. In 2010, global oil demand grew by 3.4% which is highest in last 30 years. Crude oil prices have increased by 25% over the past one year. India and China accounts for approximately 40% of the oil demand increase. In 2011 US benchmark Henry Hub gas prices averaged $4.13/MMBTU. Price remained range bound due to excess drilling and lack of export infrastructure.

Since 2004 more than 2000 discoveries have been reported from different part of world (Source-Global Data) except the large discovery in Gulf of Mexico all are small discoveries. A large number of these discoveries are in deepwater and ultra deepwater for which technologies are in challenge. The mean field size post 1995 has decreased in most of the regions except those in African and Former Soviet Union region where explorations mobilized in last decade. Total investment in the sector reached $864 billion by 2008 (Source-Global Data). Companies also explored unconventional source and challenging geographical locations. But companies are now revisiting their Capex plan and caution approach is adopted due to higher oil prices. Lower oil prices will certainly deter players from making big moves.

5. Industry Drivers and Challenges: India is world's fifth biggest energy consumer & it continues to grow with more than 7.5% pa. Oil still accounts for 31% of India's energy mix. India imports 70% of its crude oil requirements. Hence, given such high scope the consumption of Indian economy will drive the Oil and Gas sector.

The biggest driver in future will be Shale gas production in USA. Shale gas revolution of USA will change the rules of game. Shale gas now constitute for 20% of gas production in USA which will be 35% by 2035. Higher GDP growth rate of India will increase the energy consumption of India. Per-capita consumption of India is well below that of industrialized countries creating huge opportunity for companies.

Gas business has got the biggest thrust after the Supreme Court of India fixed a price of USD 4.2/mmbtu for D-6 basin. This will help the critical sector like power, fertilizer etc. to get gas at reasonable price. Also, Government of India increased the price of Administered Price Mechanism gas from USD 1.79/mmbtu to USD 4.2/mmbtu this will drastically reduce the under-recoveries of companies which are heavily burdened. Demand-Supply mismatch also offers firms an opportunity to look at India's market and serve more than 1.2 billion populations.

33% of sedimentary basins in India are unexplored which has a treasure of 138 billion barrels of oil and oil equivalent of gas. These basins offer an opportunity to companies to take lead in these basins. An inexorable move by Government of India from New Exploration Licensing Policy to Open Acreage License Policy will provide a vast and variety of geo-scientific data which will boost the Exploration and Production activity.

Currently, more than 85% of oil and gas reserve are controlled by National Oil Companies partnering with them provides access to this unexplored market. Commercialization of new source of energy like Shale gas, Coal Bed Methane (CBM), Under Ground Coal (UGC) gasification will also be important drivers of the industry.

Oil and Gas is the only industry in the world which requires diverse set of technical, human and mechanical. Rising demand of oil and natural gas has driven companies to explore in remote, hostile and difficult locations where logistics and labours are costly. More and more complex the E & P activity is to be effective personnel must be trained. Information gathering and analyzing from different sources is also a grueling task. Complex problems like sanding- where sand encroaches and affects the production process- requires tools and techniques to analyze data that will help companies to make critical decisions in such a highly competitive industry..

6. Investment in Oil and Gas sector: Government of India realizes the importance of energy security and it is working on to overhaul its petroleum sector. Rising consumption has made the government to focus more on E & P activity by supporting large scale capital investment. NELP provided a fair playing ground to industry players and several new players entered the industry after 1999. With such high bureaucracy in India and to create a transparent system Government provides single window clearance for procuring new licenses and renewing their licenses for their joint venture in India. This has led to huge inflow of Foreign Direct Investment in the country. Foreign investor along with sovereign wealth fund of China, Singapore and Middle East has invested into India's E & P activity. Japanese banks are also focusing on India due to surplus cash. By January 2010 India attracted a total sum of USD 10.3 billion. Also the unexplored acreage has reduced to 15% in 2007 from 43% in 1997.

7. Future Outlook and Conclusion: Oil and Gas will constitute to be the major source of energy supply in the years to come. Despite of the recent developments in renewable energy sector, Shale Gas and BP Oil spill which has caused a loss of staggering $35 billion Oil and Gas will lead the pack. The interest in Shale Gas began after Henry Hub price skyrocketed in 2006. The cost of drilling and fracturing has come down drastically in last 6-8 years and hence shale gas can now compete. Although, in Indian context more research is required as prospect of shale gas exist in Krishna Godavari, Cauveri, Indo Gagantic and Cambay basins. Government of India has recently signed an agreement with U.S Geological Survey for knowledge sharing in this area. Also changes in legislation will have to be made for first ever exploration of shale gas according to Director General of Hydrocarbon (DGH).

Reliance Industries Ltd. (RIL) has entered into a strategic partnership with BP for its oil and gas portfolio. This partnership will attempt to accelerate creation of infrastructure for receiving, transporting and marketing of natural gas in India. Also, BP will bring in its superior technical expertise and capabilities of deep water exploration and development.

Oil and Energy Companies are facing obstacles on account of losses on sale of bond, volatile crude oil price, shift of energy pattern in transportation sector and stricter environmental regulation making the investment vulnerable; need to make available Motor Spirit (MS) and High Speed Diesel (HSD) comply with higher specification from April 2010 ET.

Abhilash Nair—PGDM B

Japan has seen it all. Imperialism, Trade & Commerce, European influences, Nuclear warfare, capitalism, closely-knit government-industry policies, stellar growth, asset price inflation, decline, recessions, periods of mediocre growth, an ageing population and even a tsunami-earthquake combo.

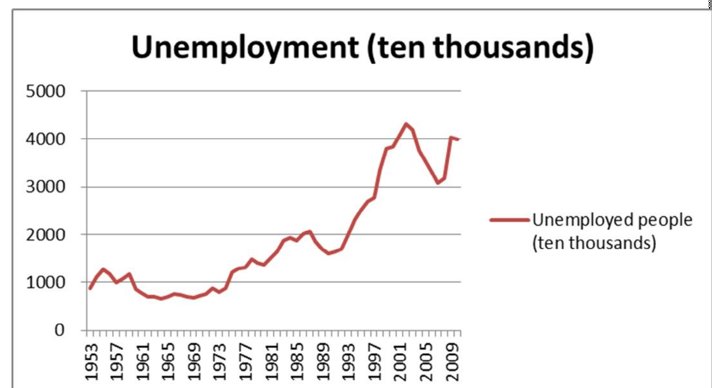
The brunt of the big wars and the horrendous consequences did not see them go down in a dump. Rather, they rose, like a phoenix out of the (radioactive) ashes. And rise they did. It was a tale of glory, fit to be told for generations to come. It started with their tradition of rigorous work ethic, attitude for quality and the resulting production of superior goods. Industrial production was at its efficient and impressive best. The years starting from the early 60's saw unprecedented growth. Japan would soon become the country with the second largest economy in the world (and would stay there for quite some time before being swept away by a red wave).

From success and affluence comes avarice. Policy makers became oblivious to the norms of basic banking activities like lending (Haven't we heard that story before!). An asset price bubble burst was on its way, which led to the infamous *lost decade* of flat-lined Japanese economic growth. What did the US learn from the whole fiasco before doing a whole western version re-run? Not much. What we witnessed come 2008 was the thunderous rupture of another bubble-burst which, although manifest in different ways, had fundamentally similar root causes, primarily that of reckless lending practices.

It starts out more or less in the same way. It could be the birth of a nation, a new breakthrough invention, a social or political ideology proclaiming the abundance of resources and potential; anything that arouses the spirit of a people towards a better future, usually riding on a wave of technological prowess. This is followed by a period of growth that evokes awe (or at least modest recognition). Corruption of the basic goodness of the system begins, more sooner than later. Focus shifts from finding new breakthroughs to doing better the things which begin to show chinks in their old armor.

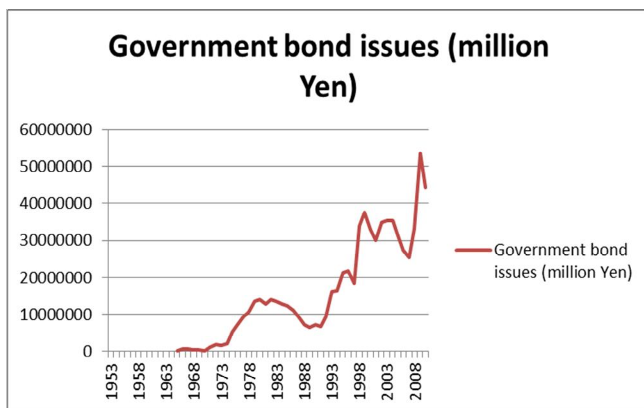
There are many indicators of recession. Some are more easily manifest and more prominent than others. The most important of them is negative GDP. Another is the unemployment rate. (It only takes one to follow the chain of events to see how a recession leads to jobs not being readily available). Shown in the chart is the rise in the number of people without jobs post the early 90's in Japan. (Of course, that is when the bubble went pop). But these are only lagging indicators, more of the effect or fallout of a recession. Certainly not very useful when you would want to portend gloom.

Source: http://www.stat.go.jp/english/



Something that could foretell the onslaught could be handier. One of them could be the flight from safe and assured investments such as Government bonds (shown in the second chart). The period starting from the early 80's

was one of the longest slumps in the rejection of safe investments for more aggressive and speculative ones. But such behaviors, taken singly, do not necessarily indicate a slump. They have to be monitored together with other factors.



The bone of contention is that the whole story is probably going to be retold in various parts of the world. We tend to get so myopic, and so cyclically. Considering the mortgage sector in India, a meager 7-8% of GDP currently and set to grow at 30% annually. With factors such as a growing population, accelerated urbanization and increasing buying power working in contradistinction, we still have some way to go before we run out of credible borrowers. In the mean time, we could learn to be more prudent and evade venturing into modes of inorganic growth. And not just within the purview of home loans.

Erica Fernandes—PGDM IB

They say if you wait long enough you just might get what you want. For the many aspirants waiting to enter the Indian banking sector, the wait might have just gotten a bit longer.RBI released the long anticipated draft guidelines for new bank licenses. According to the draft guidelines only private firms and NBFCs owned and controlled by Indian residents can seek banking licenses. There goes the hope of the likes of contenders like Power Finance Corporation Ltd, Life Insurance Corporation of India, Rural Electrification Corporation Ltd.

The draft guidelines also lay down that groups or entities with more than 10% income or assets from real estate or broking are excluded, thus aspirants like India Infoline, Edelweiss Capital as well as real estate companies may not be able to seek licences. Thus the guidelines seem to act more like a filter, so as to ensure that only companies that have sound credentials and that are serious about entering the banking sector stay in the fray.

RBI has set the minimum paid up capital at 500 crores with the minimum capital adequacy being kept at 12%, which is much higher than the 9% laid down for current banks. It also requires banks to have a public listing within 2 years of acquiring the license. Foreign ownership has been capped at 49%, as opposed to 74% for regular banks. Hence, compared to the already existing regulations governing banks, the draft guidelines are much more stringent. There are strong limitations on the exposure of banks capital to the business group promoting it and boards must have 50% independent directors. A significant aspect is the floating of a NOHC (Non Operative Holding Company) to promote the bank. A reason for this could be the fact that the Reserve Bank is trying to ensure that large group entities do not use banks as a source of cheap funding and a separation between business and financial activities of a group thus allowing enhanced supervision.

When banking was first opened to the private sector in 1993, the objective was to create a competitive environment. Though it was achieved, what it failed to do was spread banking services to a greater extent in the rural areas. The new draft guidelines strongly focus on financial inclusion requiring new banks to set up at least 25% of branches in rural areas. The holding companies must also share business plans with the RBI and the plans must contain explicit details about rural expansion plans.

All in all, India is still under-banked and there is a need for more competition in the banking sector. The final guidelines that will take shape in the course of the months to come may hopefully accomplish greater financial inclusion and provide better financial products and services to all Indians. Though RBI's stance seems tough, it will help attract only the serious players. RBI's caution and prudence in expanding the banking sector is understandable as the global economy grinds towards a slowdown limiting opportunities in the financial sector. Also given the environment of corruption & lack of international standards on corporate governance, the Reserve Bank prefers to be safe than sorry.

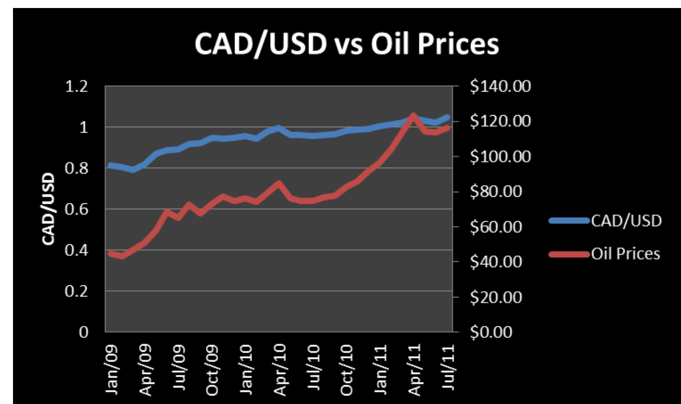
R V Karthik—PGDM Finance

Predicting the movement of an underlying is the most difficult thing to do in the financial markets be it a stock, commodity or a currency. However putting the concepts into practical action is much harder than it sounds. The fact is especially true in the case of currency trading which are moved by a host of factors like supply, demand, politics, economic growth, inflation etc. Speculators hence try to find any sort of a correlation between the observable parameters which can help them take positions which result in gains.

The movement of a country's currency mainly depends on the level of exports and imports. It is but natural that the currency may be heavily linked to the commodity prices as growth and exports are linked heavily to the domestic industry. If a speculator is able to understand which currency shows a correlation with what commodity, it will go a long way in predicting the future market movements. The only catch here is the trader should be able to identify the currency-commodity pairing. In very simple terms, we can assume that commodities which form a major chunk of exports or imports can be used as an indicator to establishing the movements in the home country currency. For instance if oil forms a major share of exports in a country, the change in oil prices is likely to affect the fluctuation of the currency. An increase in the oil prices is likely to benefit the exports of countries like Saudi Arabia, Canada etc for which are the major exporters of oil in the world. The increase in their exports will automatically increase the inflow of US Dollars (as dollar being the invoicing currency) into the home country. This will cause the home currency to appreciate against the dollar. In the same way, a decline in the oil prices will benefit the consumers more and is a nightmare for the producers. This will cause the home currency to depreciate against the dollar. The case is the exact opposite for oil importers like Japan, India which will benefit from the decline in oil prices causing their currencies to appreciate and will suffer from rising oil prices.

Examining the relation between the Canadian dollar vs. the crude oil prices

Commodity prices including the price of oil has been fluctuating quite a lot over the past 2 years with the oil prices hitting a high of $147 in 2008 and falling to $40 in 2009 before again raising to $80 a barrel in 2011. Such volatility in commodity prices can be a golden opportunity for traders to book gains on the currencies which are linked closely to these commodities. Over here we look at how the value of the Canadian Dollar vs. the US dollar has fluctuated



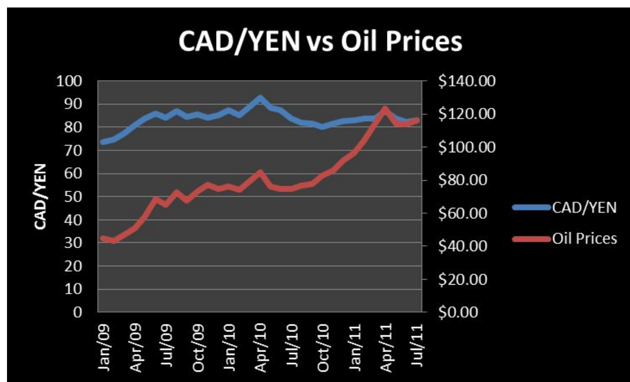
with fluctuating oil prices.

Correlation=93%

The above figure clearly shows a positive correlation between oil prices and the Canadian dollar. We can also establish the fact that oil prices act as a leading indicator for the currency fluctuations of the CAD/USD. This empirically proves our theoretical hypothesis that when the oil prices go up, so does the price of the Canadian Dollar and vice versa.

Perspective of a net oil importer country to the change in the oil prices

On the other side of the spectrum we have Japan which nearly imports much of its oil. This makes Japan very sensitive to oil price changes. Skyrocketing oil prices affect the Japanese economy very profoundly as is the case for other major importers of oil including India.



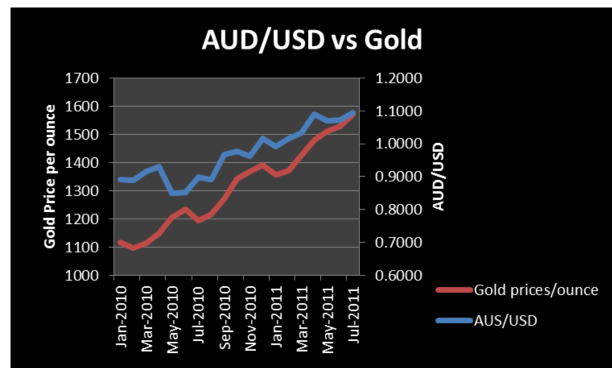
Correlation=81%

The above figure illustrates a strong correlation between the oil prices and the Japanese Yen. Even in this case, oil price acts as a lead indicator with considerable delay to predict the movements of the Yen.

In the same manner, various currency-commodity pairings can be analyzed around the world to help take profitable speculative positions while doing currencies. One other example is the Australian Dollar which is heavily correlated to the global prices of gold.

Gold and the Australian Dollar

A similar relation can be observed between the prices of gold and the movement of the Australian dollar. Australia being the third largest producer of gold in the world sees a very tight correlation between its currency and the gold prices. This means that when the gold prices move up, the Australian dollar appreciates and vice versa.



Correlation=91%

New Zealand which is a close neighbour and a trading partner to Australia also shows strong correlations with gold prices although not as much as that of Australia. Since the economy of New Zealand is closely related to that of Australia, the New Zealand also shows a strong correlation with that of the Australian Dollar.

Many a times it happened to all of us that we buy products or services we don't want to but have no other choice because of unavailability of desired one. Are our retail players not efficient enough to make the consumers' experience large enough? Why we don't have Tesco or Carrefour in India? A simple question to ask, but not so simple to answer!

As per the current regulatory regime, retail trading (except under single-brand product retailing-FDI up to 51 per cent, under the Government route) is prohibited in India. Simply put, for a company to be able to get foreign funding, products sold by it to the general public should only be of a 'single-brand' (e.g. Nike, Louis Vuitton); this condition being in addition to a few other conditions to be adhered to. That explains why we do not have Tesco or Carrefour in India.

Government's Stand towards FDI

The government in a series of moves has opened up the retail sector slowly to Foreign Direct Investment ("FDI"). In 1997, FDI in cash and carry (wholesale) with 100 percent ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. 51 percent investment in a single brand retail outlet was also permitted in 2006. FDI in Multi-Brand retailing, as of now, is prohibited in India.

A discussion paper, prepared by the Department of Industrial Policy and Promotion (DIPP) for eliciting public opinion, has made out a strong case for the entry of multinational multi-brand retailers into the country. The paper, released for public comments, has favored allowing 51 per cent Foreign Direct Investment (FDI) in the multi-brand retail sector which would allow the global giants to directly set up shops in the country. This report is now with Cabinet for approval.

Whatever benefits Government may embark regarding allowing FDI in multi brand retail, it would fail to explain the delay towards the inception of FDI in retail in India but Government's hastiness towards the implication of the above mentioned can be explained more on political grounds.

India being a signatory to World Trade Organization's General Agreement on Trade in Services, which include wholesale and retailing services also, has no option but to open up the retail trade sector to foreign investment. And from here we clearly estimate the role of the US on our government for opening up retail to International players.

Let's have a closer look at the retail sector in India and its entangled relationship with FDI.

The retail industry can be divided into **(i) organized large, (ii) unorganized and (iii) informal sector enterprises**. The first category retailers comprise traders who possess legal permissions or licenses to undertake the activity, are registered with sales tax/VAT etc. Such enterprises are super markets, hypermarkets, retail chains, and also the privately-owned large retail businesses. Their presence on scene, though of a recent origin, is gradually gaining in importance, and slowly eating in to the business of second category of retailers.

By unorganized retail trade enterprises, we mean all those local *kirana* & *general* shops, family managed – Own Account trade enterprises (Mom-Pop shops), registered under the Shops and Establishment Act (s), administered by the local authorities. Their number is very large and this category of enterprises dominate Indian scenario with a whopping 98 per cent estimated share in the total establishments. At this juncture, they, apparently, are providing tough competition to large retail outlets.

The third category of retailers includes small shops such as tiny grocery and vegetable shops run from a room of a house, *paan*/*beedi* kiosks (often selling a variety of items, like small toothpaste tubes, tooth brushes, soaps, pouches

of shampoo, etc), way-side vendors, and hand carts operating without any licenses. This is not any past-time activity for owners, but is an economic necessity.

The Government in all probability could face severe resistance from the second and third category of retail trading enterprises as a large number of workers -either paid and/or unpaid -- would likely to be affected. Such a perceived impact on a huge chunk of our population could make it a political issue. Already Bharatiya Janta Party advised UPA Government against taking "any hasty step".

Some 25.1 million people are employed in the retail trade enterprise sector, 41.8 per cent of total non-agricultural establishments' falls under the category of retail trade category. The high employment in the segment is also reflected in the NSSO 64th round data quoted by the 'Discussion Paper' when it observed that "More than 2/3rd of the total employment, in the broad category of trade, hotels and restaurants, is in the retail sector". The retail sector is currently worth around US$ 395.96 billion and accounts for 22% of the GDP. It also contributes a healthy 8% to the country's employment. Domestic "power players" like the Future Group, Reliance and Tata (Trent) amongst others; continue to adopt a high scalability strategy and are increasingly experimenting with new formats that are gaining greater acceptance with an ever evolving and perceptive consumer. A slew of hypermarkets, supermarkets, departmental, convenience and specialty stores are rapidly replacing the traditional mom-and-pop *kirana* stores; raising grave concerns regarding their profitable existence in the long term. However, these figures need not truly and fully reflect the size of the sector and its contribution, given the limitations in collecting data and information.

Table: Share of retailing in employment across different countries

Source: Presentation to FICCI by Alan Rosling (Chairman, Jardine Matheson Group): "International Experience on Policy Issues."

Country Employment	(%)
India	**8**
USA	**16**
Poland	**12**
Brazil	**15**
China	**7**

Given the recent numbers indicated by other studies, this is only indicative of the magnitude of expansion the retail trade is experiencing, both due to economic expansion as well as the 'jobless growth' that we have seen in the past decade. It must be noted that even within the organized sector, the number of individually-owned retail outlets far outnumber the corporate backed institutions. Though these numbers translate to approximately 8% of the workforce in the country (half the normal share in developed countries) there are far more retailers in India than other countries in absolute numbers, because of the demographic profile and the preponderance of youth.

Organized retail is still in the stages of finding its feet in India even now. Though organized trade makes up over 70-80% of total trade in developed economies, India's figure is low even in comparison with other Asian developing economies like China, Thailand, South Korea and Philippines, all of whom have figures hovering around the 20-25% mark. These figures quite accurately reveal the relative underdevelopment of the retail industry in India. (Here development is used in the narrowest sense of the term, implying lean employment and high automation)

Table: Retail Trade in India & Southeast Asia

Countries	Organized	Unorganized
India	2	98
China	20	80
South Korea	15	85
Indonesia	25	75
Philippines	35	65
Thailand	40	60
Malaysia	50	50

Source: CRISIL

Real picture of retail sector in India – Forced Employment

It is important to understand how retailing works in our economy, and what role it plays in the lives of its citizens, from a social as well as an economic perspective. India still predominantly houses the traditional formats of retailing, that is, the local kirana shop, *paan/beedi* shop, hardware stores, weekly haats, convenience stores, and bazaars, which together form the bulk. Most importantly, Indian retail is highly fragmented, with about 11 million outlets operating in the country and only 4% of them being larger than 500 square feet in size. Compare this with the figure of just 0.9 million in the US, yet catering to more than 13 times of the Indian retail market size.

The Indian retail industry was, and continues to be, highly fragmented. According to the global consultancy firms AC Nielsen and KSA Technopak, India has the highest shop density in the world. In 2008 they estimated there were 14 outlets for every 1,000 people. Further, a report prepared by McKinsey & Company and the Confederation of Indian Industry (CII) predicted that the Indian retail market holds the potential of becoming a $400 billion per year market by 2015, provided the sector is opened up significantly. It does not talk about creating additional jobs however, which should be the prime concern of the policy maker.

One of the principal reasons behind the explosion of retail and its fragmented nature in the country is the fact that retailing is probably the primary form of disguised unemployment/underemployment in the country. Given the already over-crowded agriculture sector, and the stagnating manufacturing sector, and the hard nature and relatively low wages of jobs in both, many million Indians are virtually forced into the services sector. Here, given the lack of opportunities, it is almost a natural decision for an individual to set up a small shop or store, depending on his or her means and capital. And thus, a retailer is born, seemingly out of circumstance rather than choice. This phenomenon quite aptly explains the millions of kirana shops and small stores. The explosion of retail outlets in the more busy streets of Indian villages and towns is a visible testimony of this.

The presence of more than one retailer for every hundred persons is indicative of the lack of economic opportunities that is forcing people into this form of self-employment, even though much of it is marginal. Because of this fragmentation, the Indian retail sector typically suffers from limited access to capital, labour and real estate options. The typical traditional retailer follows the low-cost-and-size format, functioning at a small-scale level, rarely eligible for tax and following a cheap model of operations.

As on January 1st of this year, there were 472.88 lakh job seekers registered at the Employment Exchange. They register at the exchange, to enjoy the benefits and security that a job in the organized sector provides – lifetime employment, pension, and union membership etc. But over the period 2002-03 to 2010-11, only a total of 44,000 jobs have been added in the organized sector in the whole country
A vast majority is aware of what these figures signify – that they are most unlikely to get such jobs. Therefore, they find jobs in the informal sector, mostly in retail. Retailing is by far the easiest business to enter, with low capital and infrastructure needs, and as such, performs a vital function in the

economy as a social security net for the unemployed. India, being a free and democratic country, provides its people with this cushion of being able to make a living for oneself through self-employment, as opposed to an economy like China, where employment is regulated. Yet, even this does not annul the fact that a multitude of these so-called 'self-employed' retailers are simply trying to scrape together a living, in the face of limited opportunities for employment. In this light, one could brand this sector as one of "forced employment", where the retailer is pushed into it, purely because of the paucity of opportunities in other sectors.

Thumbs up for allowing FDI in multi brand retailing

- India's supply chains require substantial backend investment in order to build retail businesses. FDI in retail will bring in the much-needed international technologies to help India move toward a world-class supply chain.
- While all income groups saved through organized retail purchases, the survey revealed that lower income consumers saved more. Thus, organized retail is relatively more beneficial to the less well-off consumers.
- Unorganized retailers have significant competitive strengths that include consumer goodwill, credit sales, and amenability to bargaining, ability to sell loose items, convenient timings, and home delivery. So the impact of allowing FDI into multi brand retail will not have significant impact on them.
- Profit realization for farmers selling directly to organized retailers is about 60 per cent higher than that received from selling in the mandi (from 2010-11 survey) and FDI's entry into multi brand retailing will tap some other sectors also for procurement and hence will be beneficial to farmers.
- Permitting foreign investment in food-based retailing is likely to ensure adequate flow of capital into the country & its productive use, in a manner likely to promote the welfare of all sections of society, particularly farmers and consumers. It would also help bring about improvements in farmer income & agricultural growth and assist in lowering consumer prices inflation.

Thumbs down for allowing FDI in multi brand retailing

- It would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets, leading to large scale displacement of persons employed in the retail sector. Further, as the manufacturing sector has not been growing fast enough, the persons displaced from the retail sector would not be absorbed there.
- The Indian retail sector, particularly organized retail, is still under-developed and in a nascent stage and that, therefore, it is important that the domestic retail sector is allowed to grow and consolidate first, before opening this sector to foreign investors.
- The global retailers would conspire and exercise monopolistic power to raise prices and monopolistic (big buying) power to reduce the prices received by the suppliers
- It would lead to asymmetrical growth in cities, causing discontent and social tension elsewhere. Hence, both the consumers and the suppliers would lose, while the profit margins of such retail chains would go up.

Some issues to be undertaken before allowing FDI (if allowed) into multi brand retailing

The retail sector is severely constrained by limited availability of bank finance. The Government and the RBI need to evolve suitable policies like Extension of institutional credit, at lower rates, by public sector banks, to help improve efficiencies of small retailers; undertaking of proactive programme for assisting small retailers to upgrade themselves

A National Commission should be set up to study the problems of the retail sector which should also evolve a clear set of conditionality on foreign retailers on procurement of farm produce, domestically manufactured merchandise and imported goods. This conditionality must state minimum space, size and other details like construction and storage standards.

Entry of foreign players must be gradual with social safeguards so that the effects of labour dislocation can be analysed and policy fine tuned. Foreign players should initially be allowed only in metros.

Manufacturing sector in India must be developed to address the dislocation of existing retailers.

Establishment of in-built policy to re-employ/ re-locate people dislocated due to opening of big malls in the vicinity of their shops and preparation of a legal and regulatory framework and enforcement mechanism to ensure that large retailers are not able to dislocate small retailers by unfair means.

Authorities can stipulate a spatial distance of say two kilometres between two large retailers to provide some space to small players to operate while permitting FDI in multi-brand retail trade. Such an approach would also eliminate competition between and among corporate or large retailers and eventual casualty of one, as well as provide operational space and scope for small players to live along

Setting-up of a Retail Regulatory Authority to look into problems and to act as a whistle-blower.

No doubt that Entrance of FDI in multi brand retail sector will be beneficial for all consumers and to some extent for our economy also but government should look at all dimensions before taking any step forward as a big chunk of population will get affected by it.

SPOT GAME

Spot the Words

B	R	D	I	V	I	D	E	N	D
U	E	G	N	A	H	C	X	E	E
D	R	B	A	S	E	L	R	Z	F
G	O	K	O	S	P	I	N	I	L
E	B	W	V	T	V	R	A	T	A
T	I	R	C	A	B	T	P	R	T
Z	L	O	T	Y	L	E	Z	O	I
J	Z	I	N	U	L	K	T	M	O
K	V	N	O	I	T	C	U	A	N
E	G	D	E	H	Y	D	P	F	I

An instrument whose value is derived from another
Another name for currency
Depreciation of intangibles
Competitive bids on assets and services
Interbank money market rate
Choice but not the obligation to sell
Polish Currency
Banking Regulations & norms
In money market, what is the term used for the non-convertible paper money
Sensitivity of a security in comparison to the market
A distribution of a part of a company's earnings, decided by the board of directors
An investment position intended to offset potential losses
Estimation of the revenue and expenses over a specified future period of time
Decline in prices
Korean Stock Exchange

RULES:
Find the hidden finance related words in the given crossword using the hints below. The words may be arranged horizontally, vertically, diagonally either from left to right or from right to left. Apply yourself to arrive at the right answer.

:: Answers for the puzzle will be published in the next issue of Finnomics ::

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