THE FINANCE GAZETTE

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The Finance and Investment Cell
Hansraj College

FROM THE CONVENOR'S DESK

Ashutosh Yadav

The Finance and Investment Cell, Hansraj College is a voluntary group of students aiming to disseminate quintessential knowledge on finance, investment and related aspects through the conduct of its activities throughout the year.

Since its inception in 2012, the cell has traversed a great path to grow in size, scope and shape so as to make it more engaging for its members and community. We've diversified ourselves from activities eponymous to the name by launching our very own in-house mentorship and consulting wing and social wing last year.

Moving ahead a successful volume 1, in the first edition of volume 2, we hope that we can curate the best content for all our readers so as to make it not only informative but also interesting and relatable. We promise to be unfettered in our efforts so as to make finance easy and simple for you. With the hope that these pieces help you enhance your knowledge, we wish that you have a pleasant reading experience.

The FIC Editorial Board

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FINANCIAL HIGHLIGHTS

Keep yourself updated

CAIT lambasted ICICI bank over investments from People's Bank of China

The Confederation of All India Traders(CAIT) has berated the ICICI bank for permitting investments from the People's Bank of China into the Indian bank amid the strained relations between the two countries. CAIT Secretary General Praveen Khandelwal said that it is quite apparently a strategy of intrusion into the Indian banking system.

A second investment by China in an Indian bank after its central bank's acquisition of 1.01% stake in HDFC bank earlier in March 2020, is a clarion call for the entire banking sector and the RBI. CAIT National President BC Bhartia and the Secretary General have requested FM Nirmala Sitharaman to take an instant cognizance of the matter and formulate the necessary policy framework to protect the banking sovereignty and the financial health of the country.

PNB received first tranche of recovery from the US in the Nirav Modi Scam

On 24th August, the Punjab National Bank (PNB) informed the Ministry of Corporate Affairs (MCA) that it had received $3.25 million (equivalent of ₹24.33 crore) from the US as part of its first portion of recoveries in the Nirav Modi case. In a series of flashbacks, in January 2018, the bank had brought to MCA's notice that three companies promoted by Modi- Firestar Diamond, A. Jaffe and Fantasy (all Inc) had filed for bankruptcy protection in the Southern District of New York. It requested the ministry to join the legal proceedings in New York, US, to assist the lender in realizing the debtor's assets. Following which the US Bankruptcy Court of Southern District of New York in its order dated 26th July, 2018, had recognised the claims of PNB. In a media release, the MCA informed that upon liquidation of debtors' assets by the US Chapter 11 Trustee, a sum of $ 11.04 million (equivalent of ₹ 82.66 crore) is available for distribution to unsecured creditors including PNB. Though the first portion has been recovered, further recuperations thereon is subject to other expenses and settlement of claims of other claimants.

Further, the MCA has also commenced proceedings for disgorgement of monies from the perpetrators- the entities promoted and/or controlled by Nirav Modi/Mehul Choksi, and parallelly the Interpol has issued Red corner notice against wife Ami Modi in connection with the money laundering cases registered against her in India.

Monetary Policy Report of RBI dated Aug 6, 2020

The six-member led panel headed by RBI governor Shaktikanta Das announced a slew of monetary measures on August 6. To begin with, RBI kept the repo rate under the liquidity adjustment facility constant at 4%. The reverse repo rate, under the leaf again remained constant at 3.35% and the marginal standing rate and the bank rate at 4.25%. In the MPC's assessment, global economic activity remained fragile owing to a surge in the number of coronavirus cases all around the world. The MPC announced that Consumer Price Inflation (CPI), stood at 6.1% for June 2020 as against 5.8% of March 2020. India's merchandise exports contracted for the fourth straight time recording a surplus of 0.8 billion dollars. The net foreign direct investment moderated to 4.4 billion dollars in April May 2020 as against 7.2 billion dollars a year ago. In 2020-21 (April-July), net foreign portfolio investment (FPI) in equities at US$ 5.3 billion was higher than US$ 1.2 billion a year ago. Against this backdrop, the MPC was of the view that supply chain disruptions on account of COVID-19 persist, with implications for both food and non-food prices. The MPC is also favourable on the outlook of the domestic demand recovering in Q1 of 2021-2022.

India INX media to launch Gold Quanto and Silver Quanto futures contracts

BSE’s India International Exchange (India INX) has received regulatory approval for launching Gold Quanto and Silver Quanto futures contracts. Trading in these Quanto futures contracts at India INX will commence from Monday, August 31, 2020, as per a release on 26th August. The underlying assets for Gold Quanto futures is Indian Gold spot purity 995 and for Silver Quanto futures is Indian Silver spot purity 999.

These Quanto futures contracts will provide the market participants an effective hedge against exchange rate fluctuations. It will further enhance India INX's position as an international exchange where one will get all products at one place, seamlessly. It'll be a few of the examples where a company will be launching future contracts in the manner described above.

UPI is leading the race in recent times

UPI transactions in India have ballooned over the last two years, giving a strong boost to Prime Minister Narendra Modi's 'Digital India' mission. The volume of UPI transactions shot up by nearly 13 times while the value of transactions skyrocketed by around 20 times during FY18 and FY20, according to the Reserve Bank of India. Speaking about the leapfrogging digital payments in India, Amitabh Kant, CEO, Niti Aayog said in a tweet that UPI with 18 billion transactions annually has surpassed Amex at 8 billion. Amex, Visa, and Mastercard are all decades old, but a five-year old UPI has overtaken Amex and will definitely surpass Visa and Mastercard over the course of the next 3 years.

Apollo Global may assist Piramal Capital to raise $500 million

Apollo Global Management, one of the world's largest alternative asset managers, is in the final stages of discussion to help the finance services wing of Piramal Enterprises to raise over 500 million dollars. A point to note is that if the deal materialises it would be among the chief debt transactions in non-banking/home finance this year. The funds would be secured by pledging a portion of its developers' loans portfolio, which has already been created. The deal is set to be finalised within a few weeks.

Piramal

Govt. considers granting the dealers an MSME status

Union Minister Nitin Gadkari expressed that the dealers might me granted the MSME status for it will enable them to reap benefits offered to the micro, small and medium enterprises. The several subsidies and benefits offered under various government schemes will then be accessible for the dealers as well. The registered MSMEs receive several benefits like tariff subsidies and tax and capital subsidies as well coupled with an aid in getting government tenders and an access to loans at lower interest rates.

Alibaba Group's FDI on hold amidst Indo-China Tensions

In the upcoming months the Chinese tech giant is unlikely to sign any fresh deals with the companies of the sub-continent under scrutiny of the recent relation quotients of the two nations. After the changes in FDI rules in April, laying down that investment from all countries that share a land border with India require prior mandatory government approval, several Chinese investors have also paused the funding of Indian startups.

The light was shed on the matter when Reuters reported the same. While Chinese investors had put in a lucrative 641 million dollars in the Indian startups last year, the tally till July this year has been 166 million as compared to the 197 million last year.

FEATURED ARTICLES

More than just finance

Newton's Law of International Trade: The Gravity Model

By Lawi Singh

(Vice President)

International trade allows countries to expand their markets for both goods and services that otherwise may not have been available domestically. As a result of international trade, the market is more competitive which leads to a more competitive pricing that further brings a cheaper product home to the consumer.

An interesting approach in international trade to determine the value of trade between two countries is approached by the gravity model.

Why is it named so?

The reason for this name is the analogy to Newton's Law of Gravitation. As per the Newton's Law of Gravitation, the gravitational force (of attraction) between any two objects is proportional to the product of their masses and inversely proportional to the square of the distance from the center of the two objects, with 'G' as the proportionality constant.

Fij= G*(MiMj/D2ij)

Where,
Fij is the gravitational attraction
Mi, *Mj* are the mass of two objects
Dij is the distance G is the gravitational constant

In a similar fashion, there is a strong empirical relationship between the size of a country's economy and the volume of both its imports and exports. As per the gravity model, ceteris paribus, the value of trade between any two countries is proportional to the product of the two countries' GDPs and diminishes with the distance between the two countries.

Tij = A YiYj/Dij

Tij, is the total trade flow from origin country i to destination country j
Yi, *Yj* are the economic size of two country i and j.
Yi, *Yj* are usually gross domestic product (GDP) or gross national product (GNP)
Dij is the distance between the two countries i and j A is a constant term.

Why does the gravity model work?

While considering large economies, which often tend to contribute a large proportion of imports due to large incomes. But, they also tend to attract large shares of other countries' spending because they produce a wide range of products. Keeping other factors constant, the trade between any two economies is larger - the larger is either economy.

Why aren't other things equal?

Let's consider two large economies, say the United States and the European Union. The large economies often spend most of their income at home (within the domestic borders). The United States and the European Union each account for 25 percent of the world's GDP, but across domestic borders they contribute only about 2 percent of each other's spending.

What is the purpose of the gravity model?

The principle use of the gravity model is to identify anomalies in trade; it seeks reasons for why international trade value between two economies differ as predicted by the gravity model. Let's understand this through an example.

The shares of Netherlands, Belgium and Ireland with the total trade of the United States with European Union in reality, is much higher than that predicted by the gravity model. The international trade value as predicted by the gravity model underpredicts due to the distance between the domestic borders between the United States and Netherlands, Belgium and Ireland (individually) is large. Thus the gravity model expects a low trade value, but in reality this is not the case.

For Ireland, the country itself is a host for many US based multinational corporations. Apart from that, the factor of cultural affinity i.e millions of Americans are Irish immigrants, also comes into the picture.

In the case of Netherlands and Belgium geographical location and low transportation costs explain the anomaly of large trade value with the United States. Both of these countries are located near the mouth of Rhine, the longest river of Western Europe due to which Netherlands and Belgium have traditionally been the point of entry in Northwestern Europe with a strong control over ports, Rotterdam in the Netherlands and Antwerp in Belgium ranks second.

Considering Canada and Mexico to be neighbouring countries with the United States we can expect the international trade value to be large which is certainly the case, but there exists an anomaly that the international trade value is extremely high. So why does the United States do so much more trade with its North American neighbours rather than with European partners? This question can be partly answered considering the distance factor between these neighboring countries, which does play a significant role but this reasoning is not entirely effective. It's important to note that all estimated gravity models show a strong negative effect of distance on international trade. The typical estimates say that a 1 percent increase in the distance between two countries is associated with a fall of 0.7 to 1 percent in the trade between those two countries and is reflected by increased costs of transporting goods and services.

In addition to being U.S. neighbours, Canada and Mexico are a part of a trade agreement with the United States, the North American Free Trade Agreement, or NAFTA, which ensures that most goods shipped among these three countries are not a subject to tariffs or other barriers to international trade.

The gravity model is just one of the few steps towards understanding globalisation.

Helicopter Money

By Mehul Talwar and Aneesha Bajesaria (Research and Development Department)

With no quick escape in sight for COVID ravaged economies, governments around the world are going back to the drawing board to find strategies to deal with this crisis. One such strategy being debated upon is ‘helicopter money’. It basically means non-repayable money transfer from the central bank to the government. It seeks to lure people into spending more and thereby boost the sagging economy.

What exactly is Helicopter Money?

Imagine a helicopter is flying over a community and drops a load of money. People scramble to pick up as much of it as they can. What will they do with that extra money? They will spend it, in turn boosting the economy and stimulating inflation.

Helicopter drop is an expansionary fiscal policy that is financed by an increase in an economy's money supply. It could be an increase in spending or a tax cut, but it involves printing large sums of money and distributing it to the public in order to stimulate the economy. Mostly, the term 'helicopter drop' is largely a metaphor for unconventional measures to revive the economy during deflationary periods.

The Background

The name "helicopter money" was first coined in 1969 by Milton Friedman, when he wrote a parable of dropping money from a helicopter to illustrate the effects of monetary expansion. The Nobel Prize-winning economist envisaged a whirlybird flying over a community dropping paper money from the sky as a thought experiment to see what a never-to-be-repeated increase in the money supply would do to spending and saving. The idea was made famous in 2002 by Ben Bernanke when, as the Federal Reserve Governor, he referred to it while arguing that a central bank can always stoke inflation if needed. In today’s debates, it is believed that helicopter money would be distributed either by crediting people's bank balances or as a tax rebate. The key is that it would come as a result of a one-time creation of money by the central bank, rather than being borrowed by the government or coming out of existing spending.

Helicopter Money Vs Quantitative Easing

Like all expansionary monetary policies in general, quantitative easing (QE) and helicopter money involves money creation by central banks to expand the money supply. However, the effect on the central bank's balance sheet of helicopter money is different than with QE. Under QE, central banks create reserves by purchasing bonds or other financial assets, conducting an 'asset swap'. The swap is reversible. On the other hand, with helicopter money, central banks give away the money created, without increasing assets on their balance sheet.

The Argument

Friedman used the helicopter as a metaphor to argue that the central bank could always create inflation by printing enough money. As people spend the money, the nominal GDP would rise, either through the production of more goods and services or higher prices, or both. Another argument in favour of helicopter money is that it would enable the central bank to inject money directly into the real economy in order to overcome the deflationary phase that has prevailed since the financial crisis.

Moving on to the other side of the coin, helicopter money would nourish the illusion that central banks could simply print more and more money for their citizens in order to solve their problems. People would learn that they would not have to earn money through work, and in the next crisis voters (or politicians) would demand that the central bank once again fire up the rotors. Several prominent economists such as Raghuram Rajan are against helicopter money on the grounds that it would be ineffective because people would not spend it. Another range of critics involve the idea that there cannot be such a thing as "free money" or as economists say "there is no such thing as a free lunch." They believe that helicopter drops to citizens would necessarily involve the central bank to pay interests on the extra reserves being supplied.

There is a good reason why the issue of paper money has traditionally been subject to tight constraints: it is a dangerous power that once unleashed can easily get out of control. History teaches that we ignore that lesson at our peril, but that from time to time we do so all the same.

Air-In, A Mess!

By Anoushka Bharadwaj, Ayush Bakshi and Juhi Karamchandani
(Mentorship and Consulting Department)

ORIGIN

Founded in 1932, Air India is the flag carrier airline of India. Initially, the airline was called 'Tata Airlines' and was named after its founder J.R.D. Tata. Post-independence, the government decided to buy a majority stake in the carrier, thereby nationalizing it. Since then, Air India has been the primary domestic and international carrier for Indians. After the airline was nationalized in 1953, Tata Airlines split into two units; Air India for international flights and Indian Airlines for domestic flights. Until 2000, Air India performed pretty well by introducing some important connections and ordering modern aircraft. Since then, Air India has been key to the development of international connectivity from India. Indian Airlines, on the other hand, did not turn out to be successful. The government of India's decision to liberalize the private sector in the mid-80s resulted in the formation of several private airlines. Yet till 2005, Indian Airlines was the second-largest airline in the country. Unfortunately, the rise of low-cost carriers in 2003, forced the airline to rethink its strategy. As a result, Indian Airlines and Air India were merged in 2011 under the name of Air India. This was a major setback to the new airline and the start of the downfall for Air India. As of today, Air India is completely debt-laden and a liability to the government. Air India, now an international airline, flies passenger and cargo flights in southern and east Asia, the Middle East, Europe, Africa, the United States, and Canada. It holds the distinction of being the world's first all-jet airline.

SWOT ANALYSIS

Strengths

- Air India, an extensive flight service provider is a part of the coveted Star Alliance that gives it immense credibility. It is also the flag carrier airline of India.
- Air India is India's largest state-owned airline. Therefore, it enjoys a strong backing by the government of India.
- Online ticketing and low prices have increased the sales of Air India. The airline also offers in-flight entertainment, lounge services etc. which make it one of the most preferred airlines for travel. Therefore, it has a good reputation for the quality of its services.
- As of 2020, Air India is one of the leading brands in the airlines sector known for its high-quality advertising and branding.

- The company has its presence in more than 20+ countries and covers approximately 50 destinations in India.

Weaknesses

- Air India is in a financially vulnerable situation. It incurred a net loss at over Rs 3,500 crore (Economic Times, 2018). The accumulation of these massive losses ultimately led to financial crisis leading to payment issues of employees. The Indian government has declared a decision to sell the carrier, due to financial problems and some other issues.
- The high-cost structure of the airline and the compulsions to be a member of the public sector are the reasons it suffered a loss and will continue to make losses for a few more quarters.
- Thus, labour problems and political intervention is a cause of worry for Air India.

Opportunities

- India, being the second most populous nation in the world, provides the domestic market for Air India to boost its business. The airline can therefore explore immense opportunities of growth in the domestic industry.
- Expansion of routes and international destinations, tourism and deregulation of Global skies give Air India many opportunities for international growth as well.
- The recent move of Air India to launch its second long-haul route from Mumbai to London is a step in the right direction.
- Solving internal issues regarding workforce can hugely boost image and operations.

Threats

- Fear of losing the market share because of fierce competition in the international skies posed by other well renowned airline companies.
- Local small airlines and their price wars are also deemed as threats to Air India. Thus, innovation and creativity in terms of the facilities and amenities provided by Air India must be the way forward.
- Rising labour and fuel costs can directly impact its business operations and running costs.

CONCLUSION

The future of Air India is at risk. The state-owned enterprise is currently fighting for its survival, bogged down by crippling debts, loss-making operations, decreasing passenger revenue and mismanagement.

In view of these losses, the government of India issued an Expression of Interest (EOI) in 2018 to sell a 76% stake of Air India. According to the EOI, the new owner would have to take on a debt of US$ 4.7 billion. Unfortunately, the bidding system was unfruitful as no private airline showed interest. In late-2019, the government decided to sell a 100% share of the airline and announced an EOI on 27th January, 2020. This time the debt amount was substantially reduced. However, the ongoing pandemic might have been a significant factor as to why Air India hasn't received any interest yet.

Neo Banking

By Mannat Kalra

(The Social Wing)

The 21st century is all about gadgets and gizmos. The advent of the digital revolution and technological changes have transformed everything. Several industries' working was disrupted, and those who failed to adapt were left behind. Technology and finance are both extensive worlds with obscure concepts. On merging the two, it seems that something unpredictable awaits you at every turn.

The introduction of financial technology, commonly called 'FinTech', refers to innovation and technology towards challenging traditional methods used in the financial services industry. Although it seems simple enough, 'fintech' is an umbrella term, covering a vast number of services that are changing in the new digital era. These range from mobile payments, digital payments, banking and insurance, to cryptocurrency, blockchain etc.

The fintech landscape includes big tech companies and established financial institutions, as well as the trailblazing young start-ups that are challenging the dominance of both. One major aspect that connects them all is a willingness to overhaul traditional systems and processes, making things cheaper, faster and more efficient. Many will use artificial intelligence and machine learning to help in effective customer needs with laser focus.

In the banking arena, the fintech revolution is well underway. Many new technologies (like contactless payments, digital wallets, etc) have become such a big part of our daily routines that it would be difficult to imagine life without them. 'NeoBank' is a catch-all term for the new wave of app-based digital banks that have entered the scene in recent years.

Banks have been around forever. In India, the history of banking dates way back to 1750 BC. We have traditionally been dependent on banks for all of our financial needs, as individuals as well as businesses. Banks have offered us everything that we have required – from current or savings accounts to credit cards, various types of loans and also, insurance and investment plans. But with fintech startups, the dependency on traditional banks for these services is gradually decreasing, especially for businesses. These new-age banking services providers are commonly known as neobanks.

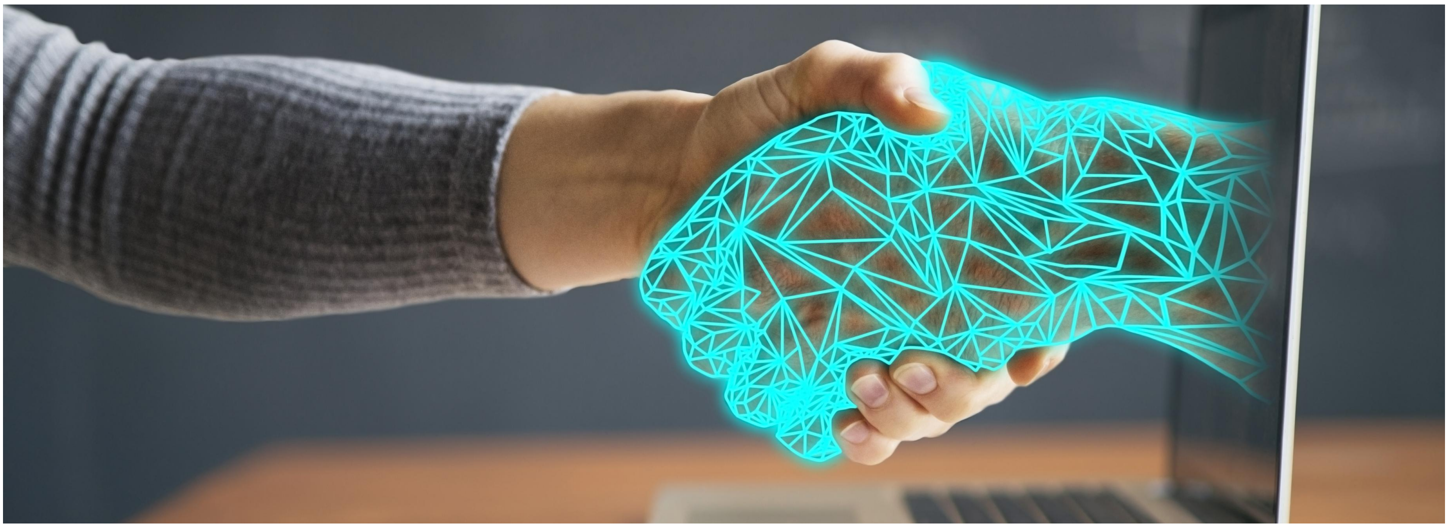
They are using technology to unbundle traditional banks. "Neobank" has become somewhat of a buzzword in the fintech space. These neobanks are often associated as being a part of the 'Gig Economy'. The gig economy is ruled by one agenda- “Be your own boss!” Banking has moved forward in leaps and bounds in the past few years. The way businesses and individuals consume financial services has changed significantly ever since neobanking, API banking, and open banking became prominent in 2016.

These are technology-driven smart banks that offer their services online and via mobile apps. In other words, they don’t expect you to go to some branch and stand in queues to open an account or transfer funds. And while most neo banks don’t have a banking license, they provide the same services by partnering with a traditional bank. ‘All to push the limits of how much a bank can do for you.’

The idea is to attract a growing customer base by prioritizing 3 things — unrivalled customer experience, well-designed and intuitive interface and a range of unique functionalities. It’s no secret that traditional banks are on the front of increased competition from many arcs of the digital world. Neobanks are expanding rapidly, using state-of-the-art tech to win over customers, who demand simpler, faster, and more efficient financial services. In recent years, neobanks have become the next big thing in fintech.

Fintech startups all over the world, especially in banking and financial services have over 15 million consumers, out of which, over 50% of the consumers are acquired by neobanks. The incredible growth opportunity for NeoBanking platforms is sprouted by their low-cost business model, which has resulted in high adoption by small and medium-sized enterprises, as well as businesses with variable incomes and earnings, and businesses that embrace innovative tech. The speed of neobank adoption has intrigued investors, corporates, as well as venture capitalists all over the world.

Neobanks are and will be an integral part of the progressive payments and financial solutions in digital India and will be the fastest collaborator with the evolved banking system, with the focus on digital payments and digital way of doing business.



FinTech - The Fourth Industrial Revolution?

By Vivek Sigchi and Kunal Shroff

(The Technical Department)

If you've ever paid for something with your phone, transferred money using an app or checked your bank statement online, then you're already a part of a multi-billion-dollar industry. It's called fintech and it is changing economies around the world. Splitting the coffee bill with your friend or paying for groceries has never been easier than it is today. A click and you are done.

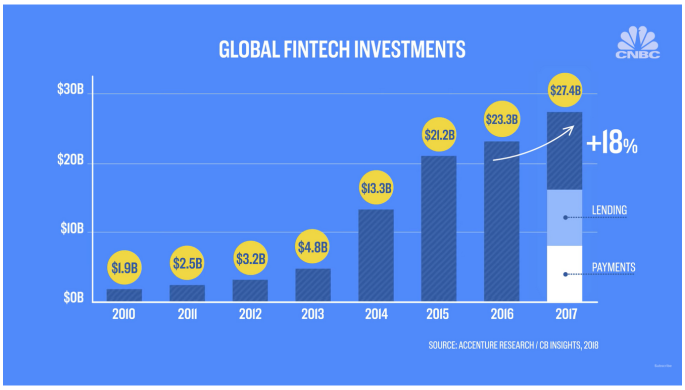
What is FinTech?

Fintech is a portmanteau of the terms "finance" and "technology" and refers to any business that uses technology to enhance or automate financial services and processes. The term is a broad and rapidly growing industry serving both consumers and businesses. From mobile banking and insurance to cryptocurrency and investment apps, fintech has a wide range of applications.

It is not a new industry, it's just one that has evolved very quickly. Technology to some degree, has always been a part of the financial world, whether it's the introduction of credit cards in the 1950s or the Automated Teller Machines (ATMs). In fact, there's now an entire subset of regulatory technology dubbed "regtech" designed to navigate the complex world of compliance and regulatory issues of industries like, you guessed it, fintech.

Growth in the FinTech Industry

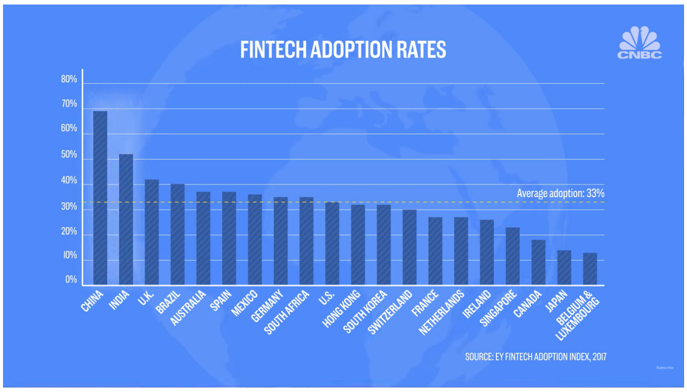
Global investment in the fintech sector has added up to nearly $100 billion since 2010. In 2017 alone, investment in this sector surged 18%. Startups focusing on payment and lending technologies received the majority of those funds. But, it's not just startups that are getting into fintech. Some of the world's biggest companies from Apple to Alibaba are going big on it, too. Just think of Apple Pay or Alipay.



One reason for all of this investment?

Consumers are adopting fintech - fast. One out of every three people across 20 major economies report of using at least two fintech services in the last six months. China and India are leading the way with more than half of consumers using services like money transfers, financial planning, borrowing and insurance. (Source: EY fintech adoption index, 2017).

The rise of fintech has forced traditional lenders, insurers and asset managers to embrace new digital technologies. For example, wealth managers now have to compete with robo-advisors which are automated financial planning services. Talk about rise of the robots, right? Thanks to high-tech algorithms, these services are available 24/7 and can be more affordable than traditional asset managers. That helps explain why robo-advisors already have billions of dollars under management.



FinTech is helping many

Financial technology has filled a void for people around the world who don't have access to traditional banking services. In fact, it's estimated that nearly two billion people worldwide are without bank accounts. Now, thanks to fintech, all you need is your phone to take out a loan or insurance.

Take Kenya for example, which pioneered a mobile banking system called M-Pesa. Kenyans access their M-Pesa accounts directly on their mobile phones to transfer money, pay bills or take out loans. Today, an estimated 96% of households in Kenya use M-Pesa (Source: MIT, 2016) and one study found that it has helped lift roughly 2% of Kenyan households out of extreme poverty.

A walk in the park?

Like any growing industry, fintech isn't without risks. And some regulators have struggled to keep up with the fast pace of innovation. Think of peer-to-peer lending platforms, where individuals borrow and lend without going through a bank. Compared to traditional banks, these services might not be required to set aside as much money, in case customers default on their loans. This can be risky for companies and consumers. Data privacy is another major concern. As more financial services go digital, cyber-attacks become a bigger risk. The challenges faced by financial technology are likely to grow as more and more businesses go digital. But for many of the companies and consumers here - fintech is more than a buzzword. It's a big business opportunity.

FinTech – The Fourth Industrial Revolution

We stand on the brink of a technological revolution that will fundamentally alter the way we live, work, and relate to one another. In its scale, scope, and complexity, the transformation will be unlike anything humankind has experienced before. The key thing here is that the pace of innovation has increased quite a lot. So, what we talk about today is the fourth industrial revolution, the second information technology revolution. It's a world where it is artificial intelligence, big data, internet of things moving very rapidly. Fintech used to be a back-office support function, but now, it's defining an industry. The bankers of the future will be very different from the bankers today and the future of fintech has never been brighter. We do not yet know just how it will unfold, but one thing is clear – the revolution is coming.

How Small Finance Banks could turn the game for Indian Banking?

By Aditya K. Dhyani (Shaheed Bhagat Singh College)

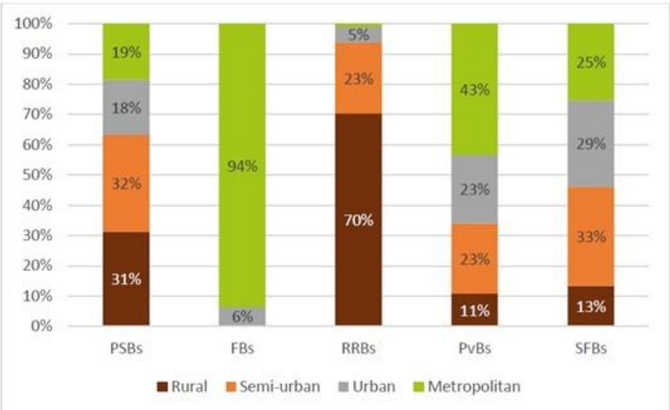
Background

The credit demand that has been a major challenge for PSBs and other financial institutions must be addressed. Inefficient lending due to lack of capital, losses in rural branches, high operational cost, minimum deposit requirement has barred people from availing the benefits. According to a survey only 40% adults in India have bank account and 90% of businesses in rural area fail to get financial support. The economic growth of a country depends on consumption and spending by its citizens which leads to higher aggregate demand, therefore higher production and thereby high growth and prosperity of the nation. In order to reduce this divide and increase rural and underserved demand, RBI and Government of India came up with formation of Small Financial Banks (SFBs) in 2015. Initially 10 of the MFIs and some NBFCs were converted into SFBs to become operational.

Role of Small Finance Banks

SFBs were formed with the goal of providing financial benefits and banking facilities to underserved group, marginal farmers, low income group and MSMEs so that they also could avail credits and make deposits and simultaneously focusing on being technology driven. SFBs are an amalgamation of MFIs and commercial banks. Unlike MFIs they also accept deposits and thus are strictly regulated by the RBI.

Main focus of a Small Financial Bank is to provide loans to the priority sector. Therefore, as per the guidelines laid by the RBI, 75% of the loans have to be given to the priority sector with 50% of the loan portfolio to be less than 25 lacs. Lending is strictly restricted to big corporates and large businesses.

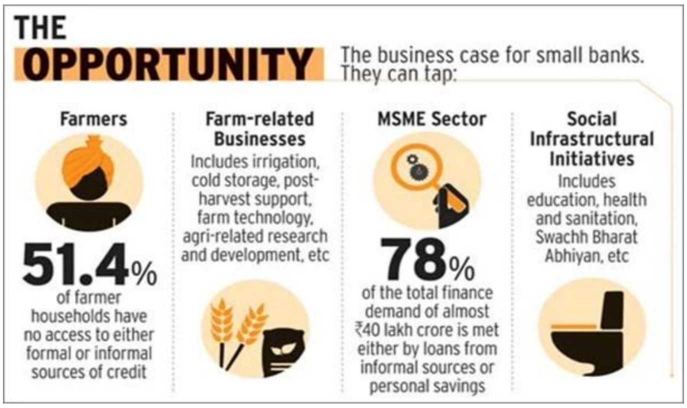


Geographic Spread of Number of Deposit Accounts of Bank Groups – March 2018

Growth and Opportunities

In spite of the aftermath of demonetization SFBs have maintained good NIM (Net Interest Margin), Return on Assets and Return on equity (apart from Fincare) since their inception. The best factor for these banks has been the tremendous increase in credit growths and number of savings and current account (CASA) opened. Their reach and increasing customer base in rural semi-urban and semi-rural which had far been lagged by banking sector are contributing to their growth. Due to high interest rates offered on deposits and low rates on availing loans, the crowd is willing to shift to these banks post Covid. In fact, majority of the SFBs have highest interest rate offered on deposits than commercial and universal banks. CASA ratio of these banks is increasing at a steady pace while some of SFBs like North East Capital, Equitas Bank, AU Small Financial Bank maintained a ratio around 40%.

The profitability of these entities has increased multifold by shifting to SFBs. Since MFIs could not accept deposits, they had to rely on bonds and loans for capital. Profitability will help these SFBs to meet their capital requirements and further expand their branches and be technologically more centric. They will be looking for financial products like wallet. SFBs are expected to grow at a CAGR of 20-25% for next 3-4 years. Though the share of microfinancing in these banks is still high it is expected to decrease in upcoming years on pretext of more deposits and awareness among unserved sector and areas.



Challenges

- Due to the high-risk factor, RBI has laid strict norms to prevent credit default risk. Capital Adequacy Ratio of these banks have to be maintained at 15% which is much higher than commercial and universal banks. CAR along with high CRR and SLR restricts lending capacity of these SFBs.
- Many people residing in rural areas are ignorant of these banks. They still fall in the trap of moneylenders who charge interest rates of 20% and even 100%. Awareness campaign should be undertaken by GOI to educate people for availing the benefits of SFBs.
- Since SFBs cannot open a branch in each and every corner, technology plays an important role to widen customer base, but they will have to face the challenge of raising capital for technological shift and introducing financial products and mobile banking for their customers to facilitate banking transactions.
- Controlling NPAs would be a major challenge for SFBs due to the cyclical nature of businesses in rural and semi urban areas. Slowdown in any major sector would critically affect SMEs.
- Facing stiff competition from rural banks and PSBs.

Conclusion

SFBs will help bring a revolutionary change in the Indian Banking System. It will help in making banking more competitive and affordable to common man. Though financial sector has been facing tough times in the recent years, SFBs have performed well economically and simultaneously helped in social welfare of underserved regions and sectors. Outlook on these banks looks promising in spite of the stringent mandates by RBI. However, one must not jump to conclusions as these banks have loads of challenges and with them opportunities come handy. The model of SFBs is still very nascent and it will be interesting to see how these banks approach further to increase operations and building infrastructure, being technology centric and creating a digital infrastructure for banking.

EDITORIAL

Direct from the desk

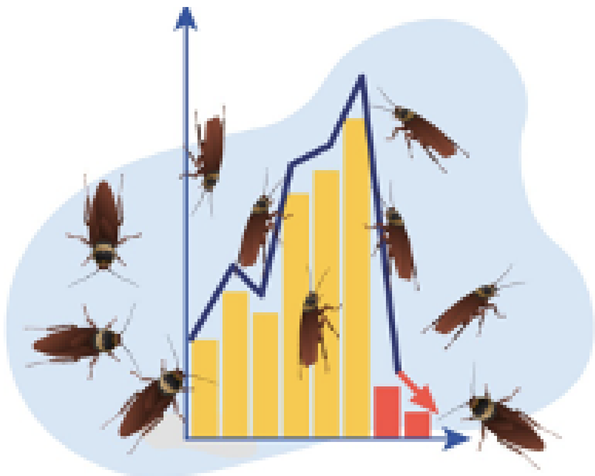
The Cockroach Theory

By Sanaah Jain
(Co-Editor)

Ever heard of Katsaridaphobia?
No, it's not the fear of creatures who walk through the shadows with a piercing gaze, if you thought so. It's the fear of the creepy crawly cockroaches, who have an amazing power to survive even in extreme conditions. And the most awful thing about them is their ability to multiply at an alarming rate. The moment you spot one, you know that there are many more skulking in the vicinity. Surprisingly, these species of the Kingdom Animalia have not just made our kitchens, washrooms and the dark sneaky places of our homes their home, but have also crept in into our houses of finance where they literally have a theory in their name.

The cockroach theory is a non-scientific market theory that states that when a company reveals bad news to the public, many more related negative news or events may be divulged in future.

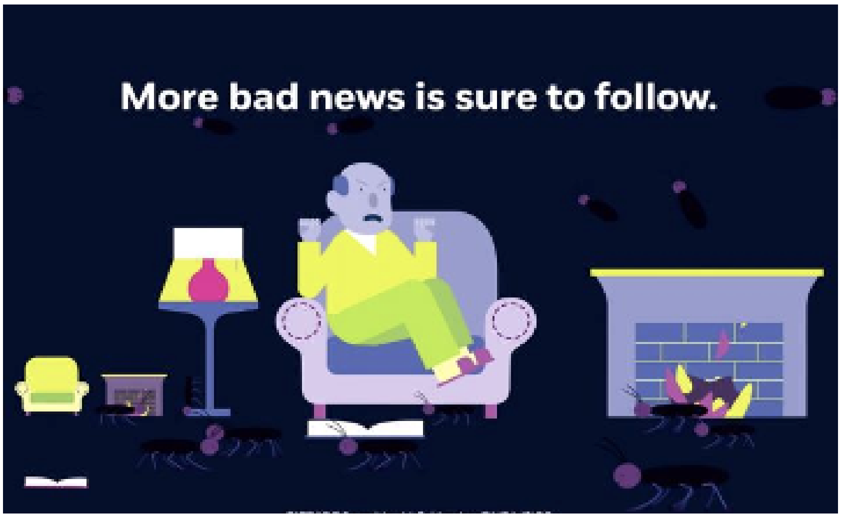
The bad news could be a lawsuit or a miss in earnings or any other unfortunate event. The theory is predicted on the idea that both internal and external forces have an effect on a company's performance and its approach of operations, and therefore it may not just be affected by one piece of bad news. However, when a negative news is babbled about a company; it is very likely to see similar misfortunes being bestowed upon other related companies in the industry as they have implausible possibility of immunity against these external forces.



Diving deep into this theory, it is unveiled that it has its ill effects on the stock markets too. When an unfortunate news about a company takes to town, investors begin to rethink on their investments in the industry in question. Adding fuel to fire, if the news is convincing enough, then investors also start to divest leading to a drop in the value of the particular company's stock. Ultimately the panic created in the market spurs the government agencies to scrutinize the working of the other companies in the industry as well, which may raise the chances of prices across an entire sector to plummet. However, there are many instances where the senior management of a company tries to detract the black of a news by mixing few tinges of white to it, in spite of the news affecting the share prices of the company. Nonetheless, some clever investors successfully see through these public relations strategies and take timely decisions while the naive ones fall prey to it.

The theory has been used to describe many key events in the financial history. One of them was the revelation of accounting scandals post the fall of a Wall Street darling, Enron Corporation. Based in Houston, Texas, Enron Corporation was an energy-trading and utilities company. The **first cockroach** was discovered in August 2001, when reports emerged that the company which was endorsed as a model of success for US corporations, was engaged in fraudulent accounting practices and had been hiding the actual financial position of the company from the public and its investors and creditors. Following which the **second cockroach** was in the form of downgraded rating of Enron's stock by analysts with the stock descending to a 52-week low of $39.95. By October 16, it had reported its first quarterly loss while the U.S. Securities and Exchange Commission (SEC) had begun to investigate into the matter.

The **third cockroach** came in, that by the end of 2000, Enron had losses $591 million and had $690 million in debt.
On 28th November, 2001, another bad news, the **fourth cockroach** appeared, when Dynegy backed out of its prior deal of merger with Enron as its credit rating had sunk to high-risk junk-bond status, ultimately leading Enron to file for bankruptcy on Dec 1, 2001. As far as the implications on the stock market is concerned, Enron's shares had traded as high as $90.56 before the fraud was discovered, but had dropped to around



$0.25 in the sell-off after the revelation. By August 2002, Enron was in bankruptcy and its shareholders had lost about $74 billion. Parallelly its auditor Arthur Andersen had surrendered its CPA license with about the loss of jobs of 85,000 people. The fall of "*America's Most Innovative Company*" (by Fortune for six years in a row) was a strong indicator that many such illegal accounting practices were widespread. With government regulators on their toes, light was shed on similar accounting scandals which had pulled down a host of companies including WorldCom (2002), Tyco International (2002), and Adelphia (2002).

The Enron scandal which was one of the biggest bankruptcy cases in the history of America clearly exhibits that how spotting of one cockroach (Enron) indicates the presence of many more (WorldCom, Tyco, and Adelphia) in the vicinity.

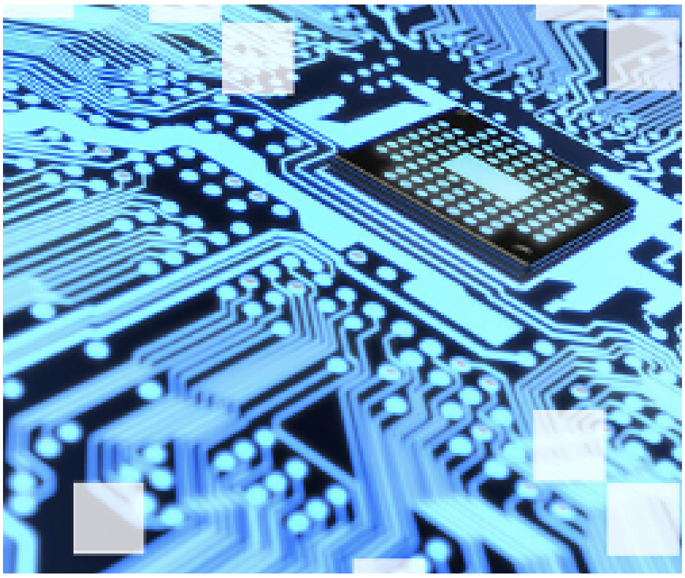
Alas! Financial cockroaches are inevitable and unavoidable. They have a very harmful impact on the health of our investments. Therefore, as investors we should diversify our holdings, invest in good quality stocks for a long term and be cautious of company leaders' attempts to downplay the infectivity of any such cockroaches so that we can at least attain some success in insulating our portfolios from these financial cockroaches if not our homes from the biological ones.

AI in Finance

By Vipriya Anjum
(Co-Editor)

The world is changing at a fast pace every day, with new ideas, new innovations and new advancements. Even our interactions with money are transforming as Artificial Intelligence is helping the finance industry streamline and optimize processes ranging from credit decisions to quantitative trading and financial risk management as well. There are in recent times plenty reasons to believe that AI will spur the next revolution in the way we handle money and wealth, and the foundation to it has already been laid. As we ponder over the importance and scope of Artificial Intelligence, we must first touch upon what it implies. AI is an area of computer science focused on creation of intelligent machines that function like humans. They are designed to perform human functions like learning, planning, decision making and even speech recognition. AI enables machines to improve their performance continuously without human instructions on how to proceed. Top tier consulting firm PWC also reinforced that AI is "not a monolithic subject area. It comprises a number of things that all add to our notion of what it means to be 'intelligent.'" Machine Learning, Deep Learning, the Internet of Things and Natural Language Processing are some of the most popular aspects of AI.

The investments in AI are rapidly growing as financial sector continue to see the value it offers. It has made companies enhance their ability to make powerful determinations for their organisations with a greater efficiency and speed as well. Among the primary benefits it offers are affordable business models for with software taking over work of hundreds of employees there is significant saving of funds that help in implementation of new ideas that once lacked necessary investments. It has also assisted in accurate market analysis, one such example is AI used by financial investment firms, which is designed to gather information and calculate market sentiment based on Tweets from influencers and the responses.



Another innovation that most people have already encountered with banks is the AI chatbots under the conversational banking initiative which are designed to provide services to as many customers as possible at the same time. Pairing these chatbots to the convenience of online banking is what will create the financial literacy that every country is trying to target in the long run. All thanks to AI, several companies are redefining creditworthiness and risk assessment in loans to provide better opportunities for everyone. Take an example of the Singapore-based fintech start-up Lenddo, which uses machine learning and "alternative data" to determine how likely it is that an applicant will repay their loans. With the help of AI several merchants and financial institutions can now make a more granular analysis of the tons of data available about transactions and customers and better tell the difference between regular and fraudulent activities. Taking an example of MasterCard, after successful acquisition of AI start-up Brighterion, launched its machine learning-based fraud detection system that evaluates transactions based on ever-evolving, real-time conditions. With this, the payments processor can constantly update its system and specialize its rules based on region and industry and predict efficiently which transactions are fraudulent. The system has helped MasterCard reduce false declines by 50 percent.

AI is also assisting in trading and a recent study performed by investment research fim Eurekahedge tracked the performance of 23 hedge funds utilizing AI from 2010-2016, finding that they outperformed those managed by more traditional quants and generalized hedge funds. One of the banking areas that have seen a considerable investment in AI is wealth management. Both incumbents and newcomers are now realizing that the digital shift happening in the banking space would affect this sector.

Hoping to build AI engines, which can provide insights on how to best service their high-net-worth clients. By automating large parts of the wealth management process, they would be able to offer personalized, tax-optimized investments to clients, who have far less in investable assets than what would usually qualify for professional wealth management.

In India, quite a few banks have discovered the use of AI, it has primarily been used to improve customer experience by adding chatbots as an additional interface for customers like SIA by State Bank of India, Eva by HDFC and iPal by ICICI. State-owned banks have been slow to control AI, largely because AI implementation requires banks to operate outside of the traditional privacy framework. India still lacks strong data protection and privacy policies. The Reserve Bank of India needs to take on a more dynamic role in framing of regulations on emerging technologies, data privacy and ensuring the business interests of the banks. These banks must embrace new business models simultaneously to integrate AI into their strategic plans and explore the use of AI for analytics and not only to improve customer experience. However, reliance on inherited systems, absence of data science talent, and cost constraints have hindered unified acceptance of AI.

As for the world status quo on acceptance of AI, a recent study of Deloitte found that financial services firms can be divided into three clusters based on the number of full AI implementations and the financial return achieved from them which identify respondent firms based on the different phases of AI maturity each has achieved. 30% of respondent firms are frontrunners or those organizations who have achieved the highest financial returns from a significant number of AI implementations. 43% are followers who are in the middle ground of AI implementations and financial returns. And 27% are at the start of their AI journey and are lagging in the level of return achieved from AI implementations.

With change being the only constant, a high wave of AI is set to sweep over the financial mainland for good. With utmost benefits aligned and thousands of AI companies vying for dominance in this new market, it is quite realistic that most financial organisations will switch to AI-based databases, analysis and customer support systems by the beginning of the next decade. All we have to do is be prepared for that change to become a part of it.

Microfinance: the past, present and the future

By Tejas Agarwal
(Co-Editor)

"Extending credit can end poverty."
The above adage very poignantly justifies the meaning and the rationale that governs microfinancing. Microfinance can be understood as the source of finance and credit of smaller quantums for small institutions/entrepreneurs or households. It leads the race of providing financial services to those group of people who aren't covered by the retail banking framework. Microfinancing is done primarily in two ways. It's individual based financing wherein microfinance institutions funds or extends credit support to people who aren't covered by the pan banking system. Secondly group-based microfinancing is a technique wherein a group of people/institution collectively apply for a loan or a cash credit facility which is then granted to them, the responsibility of which is mutually exhaustive.

The benefits of microfinancing are irrefutably galore. By and far, the perks of an effective, consolidated and meticulously administered microfinance structure can be attributed to having a system in place which shall become a safe heaven of all the people untouched by the commonly understood banking nexus. Providing timely and need based credit to impoverished and underserved people at relatively lower rates than what's otherwise prevalent can go a long way in alleviating the jeopardized conditions of individuals, institutions and corporations. To a rural person who's otherwise secluded from the financial system of the country and has otherwise no access to financial services, microfinance can do sufficiently enough in fulfilling its basic needs of proper education, a safe shelter and adequate proportion of nutrition. For a commercial enterprise, microfinancing can help in funding operational expenses and paying way for stronger business avenues in the future. A well curated system of microfinancing can run an altogether parallel system in the so-called low potential areas by creating employment, demand, supply and greater economic integration on the whole.

Though the concept of microfinancing seems very rosy, it's fundamentally laden with a lot of problems. Operational expenses and high-risk factor for lenders leads to a high rate of borrowing, as much as 30%, for the general public. Critics say that given higher chances of loan default by the lenders, the rate of microfinancing is deliberately kept higher so as to provide a cushion for uncertain happenings. However, in the recent years, microfinance institutions had adopted the concept of providing affordability rather than quantity. This however has done little in reducing the rates of microfinance thus paving way for greater defaults whether intentionally or inadvertently. The modern world and changing metric of things has provided micro financial institutions an altogether newer dynamic of solidarity lending.

Surveys have established that microfinancing institutions provide more loans to women rather than men in a view of the fact that the default rate will be lower owing to the healthy relationship that has been cemented. This inarguably is close to being true since the percentage default for individual loans in case of women is only 0.3% as compared to a much higher rate for men. A blessing in disguise, this has ensured easier access of finances to women as compared to the availability earlier.

Fraught with challenges, though a greater likelihood of lending to women has brought about their financial inclusion, helping build a better household and strengthening the earlier precarious social system, it has a great opportunity cost in terms of lower profits for such financing institutions. It's because the funds so provided undoubtedly did a lot in building resilience, self subsistence and sufficiency for women but it has done little in adding back more to the financial system. Maintaining labels of gender equality isn't very strongly satisfying its core intention of adding value to the current system of things. Though accessibility of microfinancing has undoubtedly benefitted thousands of poverty-stricken individuals and families, it has still a long way to go so as to become full-proof and totally satisfying.

This calls for a much more structurally regulated yet operationally friendly microfinancing system, focusing on capacity building and fortifying the future of local financial governance. As aforementioned, strengthening microfinance institutions by providing them governmental support and backing and integrating it with everyday administration is what will ensure bridging the hiccups that are currently existent. Inarguably microfinance must pay for itself because the poor doesn't only need money but also savings. Thus, only a tried and tested system in place can justify the fundamentals of microfinancing and be an effective tool of socio-economic development.

The future of microfinancing can be imagined as a much more technologically oriented framework. This implies use of automation and machine learning to make the process more transparent and result oriented. Being the cusp of change, going digital is the key of going forward. Technology can help in identifying the blanks, minimising wastages and laying foundations for better policies and establishments for the future. Human touch combined with a quintessential enabler known as technology can give a future of immense prosperity to microfinancing.

FINFUN

Even finance can be fun

Weird Wizard

Finance is rather a topic of serious concern for commercial enterprises and definitely for the government on the whole. Though it's a subject that requires serious deliberations and discussions, there are a few finance and money related facts that will make you argue about the seriousness or stability of the world of finance and investments.

Zimbabwe has experienced the worst inflation in the history of the world. It recorded an inflation of sextillion times (6.5*10^21 times). Yes you heard that right. The sights of wheelbarrows filled with money to buy a loaf of bread haven't yet faded from the minds of the people.

Starbucks operates in more number of countries than Goldman Sachs and JP Morgan Chase combined. It's weird yet real to assume that the coffee maker operates in more number of countries than the two biggest investment banking companies combined. It operates in nearly 80 countries.

The typical lifespan of a $1 bill is just 18 months. It either meets the cutting machine or is drawn out of circulation after its life period. While the lifespan of a $100 bill is close to 9 years. And you thought dogs aged fast!

Money is dirty. We've all heard how dirty money is and how reportedly there are traces of **cocaine on 90%** of paper money, but did you know that money is dirtier than a household toilet.

Learn Finance from our Weird Wizard. We bet you'll love him!

The Secret Service was originally made to fight counterfeiting. In July of 1865, the U.S. Secret Service was created during the Civil War to fight counterfeiting. By the end of the war between 1/3 and 1/2 of all U.S. paper currency in circulation was counterfeit. Who would have imagined that one day they would be so busy protecting the US President?

Only 8% of the world's currency is actual physical money. No, the rest isn't Bitcoin. The majority of transactions are all done digitally so no physical currency exchanges hands.

Apple has more than twice the amount of liquid money for investments than the US Treasury. Hardware maestro Apple has 160 billion dollars in liquid cash which is humongous as compared to the 49 billion dollars of the US Treasury itself. Dark days Fed? Book the next flight to Palo Alto.

The global bond market was valued at more than $99 trillion in 2011, according to a report from Morgan Stanley. That's nearly twice as large as the global stock market in 2011, which was valued around $54 trillion.

Warren Buffett claims the worst investment he ever made was in 1993 when he bought Dexter Shoes. The loss to Berkshire shareholders was $3.5 billion. The dexterous Oracle of Omaha unfortunately didn't have a good time with Dexter.

It is thought that 80% of the world's gold is still in the ground. Though most of the gold in circulation has occurred naturally critics claim that there's more inside than ever imagined. So unearth your backyard the coming weekend in the hopes of becoming a golden hero.

Did you know?

Gross Gaming Revenue

All of us have had at least once in our lifetimes a phase where Gaming meant the world to us, or perhaps just slightly something.

We however are seemingly unaware of game yield or the gross gaming revenue, a key metric utilised by several gambling and betting companies. It essentially refers to the difference between the amount wagered by the players minus the amount that they win.

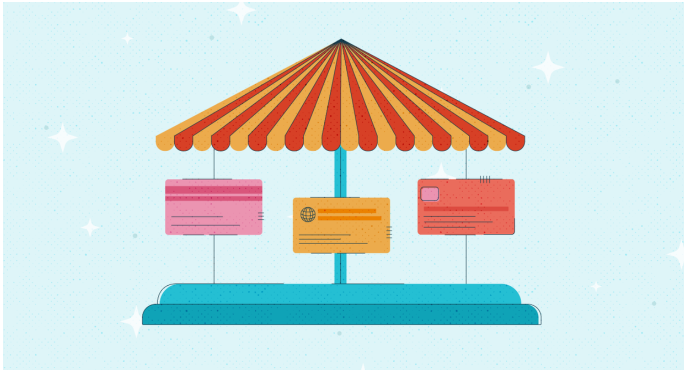
Gross Gaming Revenue = Amount Wagered – Winning Payouts

Here, the amount wagered refers to the money collected from betting or gambling transactions, while winning payouts represent the amount paid to the customers if they win.

Revolver Debt

With no real significance to the revolvers as an ammunition, revolver debt is a form of credit that can be utilised by individuals, firms as well as corporations. The borrower in this case is given a line of credit with an upper or maximum limit of which he can withdraw any amount at any time and doesn't have a specified time within which he must pay back the loan. Interest accrues for outstanding funds borrowed.

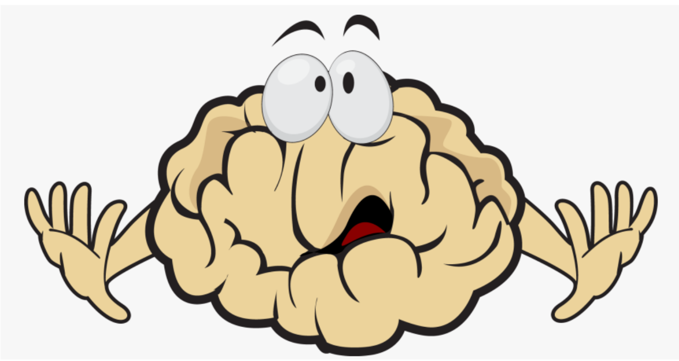
Taking an example, let's assume that a borrower has a maximum limit of Rs 1,00,000 by a bank to start a business in a revolving line of credit. He can take out Rs 0, Rs. 10,000 or Rs. 95,000. However, in case he borrows any amount, the interest would be calculated for the period he borrows it for at rate mentioned in the revolving debt agreement.



Solve a Puzzle

(Hint: The answers to the questions lie in our featured articles of this issue)

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



Answers

A.1. Expansionary, A.2. Air India, A.3. Assets, A.4. NAFTA, A.5. Insurance, A.6. Deflation, A.7. Domestic, A.8. Gig, A.9. Gravity, A.10. Helicopter

Q.1. As a fiscal policy, what is the nature of a Helicopter drop?

Q.2. Which flight service provider is the flag barrier of India?

Q.3. Quantitative easing brings a change on which side of the balance sheet?

Q.4. Name the agreement among Canada, Mexico and the United States that created a trilateral trade bloc in North America.

Q.5. Fill the next word in the series - Fintech, Blockchain, API banking, ...

Q.6. Which economic situation can be overcome by helicopter money?

Q.7. Which nature of travel was served by the Indian Airlines post the split of Tata Airlines into two units?

Q.8. What is the popular name of the economy that associates neobanks with itself?

Q.9. I am an important theory of Economics and an essential law of Physics. What's my name?

Q.10. Fill the next word in the series - Friedman, Deflation, Inflation, ...

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Want to read more about economic concepts like Moat, or the crises that left us devastated only to learn from them? Read more at www.fichansraj.com

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