



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.

With the very first edition of our newsletter, 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 a hope that these pieces help you enhance your knowledge, we wish that you have a pleasant reading experience.

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TABLE OF CONTENTS

FINANCIAL HEADLINES

- Nirmala Sitharaman participated in 3rd G20 FMCGM
- India and Sri Lanka sign currency swap
- China is the first economy to grow since the pandemic
- GST, I-T MOP Up in Q1 indicate Economic Recovery
- Aditya Puri, MD of HDFC bank, sells his 95% stake
- CBDT issues > 71,000 crores of tax refund
- All about Reliance's 43rd Annual General Meeting
- Unfolding the rising Gold
- Govt to ease borrowing cap in relief for discoms

FEATURED ARTICLES

- The Re-emerging Importance of Stress Testing
- A Leader's Guide to Corporate Culture
- Prospect Theory - A User's guide to Decision-making
- The Spotify Spectacle
- Refinements in the Banking Sector

EDITORIAL

- The Gambler's Fallacy
- NPAs and the Visionary Economy
- Why Printing more Money causes inflation?

FIN FUN

- Stock Market takeaways
- Did you know?
- Solve a puzzle

FINANCIAL HIGHLIGHTS

Keep yourself updated



Nirmala Sitharaman participated in 3rd G20 finance ministers and central governors meet

On 18th July, 2020 the Union Minister for Finance and Corporate Affairs participated in the 3rd G20 meeting via video conferencing for discussion of the global economic view, the effects of the pandemic, sustainable recovery and measures to achieve global financial coordination. Sitharaman emphasised the importance of international coordination and addressed the spill-over effects of exit strategies so that the plan remains relevant and effective. Raising the point of how the economies are balancing their supply-side and demand-side measures in response to COVID-19, she talked about ensuring this balance through credit schemes for greater liquidity, direct benefit transfers, and employment guarantee schemes. She specifically talked about the Indian comprehensive economic package that is about 10 percent of India's GDP.

In the second session of the meeting, there were deliberations over the developments on G20 Finance Track deliverables under the Saudi Arabian Presidency. Sitharaman had discussed two such deliverables: firstly, enhancing access to opportunities for Women, Youth and SMEs, and secondly, referring to the International Taxation agenda and the intended deliverable of formulating a solution for addressing challenges related to digital taxation.



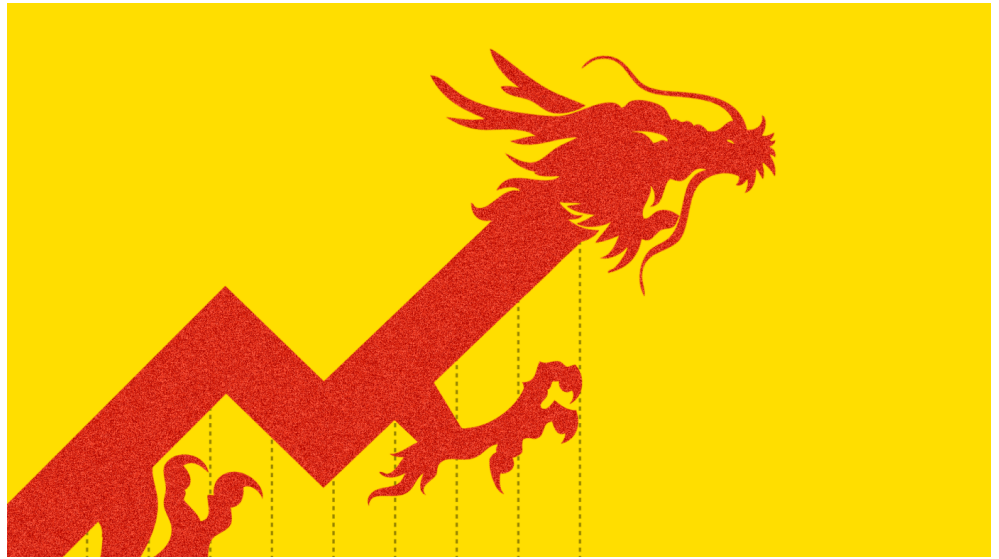
India & Sri Lanka sign currency swap agreement for 400 million dollars

On 24th July, 2020 the Reserve Bank of India signed an agreement for extending a currency swap to the Central Bank of Sri Lanka worth \$ 400 million. This move was made to help Sri Lanka boost the foreign reserves and ensure financial stability, given the economic hardships the country faced due to the pandemic, following the request for the facility under SAARC Currency Swap framework. The arrangement will remain intact till November 2022. In a swap arrangement, a country provides dollars to a foreign central bank, which, at the same time, provides the equivalent funds in its currency to the former, based on the market exchange rate at the time of the transaction.



The parties agree to swap back these quantities of their two currencies at a specified date in the future, by means of the same exchange rate as in the first transaction. In Sri Lanka's case, it's more than two years.

China becomes the first economy to grow since the Covid-19 pandemic



China, where the pandemic began in December 2019, was the first country to shut down its economy and is now the first economy showing growth since the pandemic. The economy faced a contraction of 6.8% in Q1 of 2020 but has shown a tremendous improvement by the end of Q2 with a raise of 4.4% recovering from the previous quarter's 8.4% contraction. An unexpected expansion of 3.2% has been recorded in the latest quarter since the lockdown has lifted and the factories have reopened. The manufacturing industry is in the lead followed by other industries though consumer spending is low owing to fear of losing jobs. With experts forecasting a fall in demand due to the reduction in sale of masks and other medical supplies along with cancelling of export orders by the US and the Europeans, it will be a tough terrain for China as it is for the world to walk its way through an unemployment cobbled road.

Encouraging GST, I-T MOP Up in Q1 indicate Economic Recovery

Finance Secretary, Ajay Bhushan Pandey said that the tax mop up in the first quarter of the current fiscal year is "very encouraging" and indicates a recovery of the economy earlier than anticipated. He also mentioned the desire of the Revenue department to bring self-reliance among tax payers by making all data of financial transaction available at time of filing income tax returns via form 26AS. The income tax collection through advance tax and TDS in the April-June quarter was about 80 per cent of what was collected in the same period last year.



Aditya Puri, Managing Director HDFC bank, sells his 95% stake in the bank

The managing director of HDFC bank, Aditya Puri has sold shares valued 843 crores (95% stake) in the bank. As per the insider trading data, he had sold 74.2 lakh shares of the bank between July 21 and Jul 24, prior to which he was holding 0.14% of equity capital i.e. 77.96 lakh shares. This is the second time of stake sale after February 2020 when he had sold 2.5 lakh shares of the bank for about Rs 156. In spite of HDFC's radiating progress of becoming the biggest player having more than 25 percent in advances and deposits on an incremental basis in past one year, its stock has been underperforming with its yearly low of Rs 765 on March 24 because of the bank's asset quality. But more than this, the imminent management change of whether an insider or outsider would take over Puri, is one big mote in the air hovering over the stock's performance.



CBDT issues more than 71,000 crores of tax refund

In a bid to assist taxpayers with liquidity amidst the Covid-19 pandemic, the Central Board of Direct Taxes (CBDT) had decided on issuance of tax refunds on 8th April, 2020 and had successfully issued refunds of a hefty amount of 71,229 crore in more than 21.24 lakh cases till July 11, 2020. As per the statement released by the CBDT, income tax refunds to the tune of Rs 24,603 crore had been issued in 19.79 lakh cases to taxpayers along with issuing corporate tax refunds amounting to Rs 46,626 crore in 1.45 lakh cases. Further, they said that the government is paying great attention to deliver hassle free tax related services following which all refund requests will be taken on a priority basis and would be completed by 31st August. They also appealed to the public for patience and cooperation to ensure effective deliverance of services to the taxpayers.



Reliance's 43rd Annual General Meeting adds glitters to gold



In a first of its kind completely virtual AGM, Reliance Industries Chairman Mukesh Ambani had a flurry of good news for his shareholders. As already promised, Reliance not only brought down its net debt to zero but also generated sufficient capital for itself to vie for other investment avenues. With RIL stocks already aggrandising more than expected, Mr. Ambani had one big shot for his supporters. He announced an investment of Rs 33,737 crores by Google for a 7.7% stake in Jio platforms, adding to the investments already made by Facebook, Silver Lake, KKR, IBM Intel among others. Through invention and innovation, Jio brought before the world its plan to launch its very own indigenously developed 5G solution. In a one of its kind development, Jio announced its business plans in the hardware segment by announcing the launch of Jio TV Plus and Jio Glass. While Jio TV binds together all the subscription-based channels under one platform, Jio Glass aims to revolutionize 3D watching and VR experience. With state-of-the-art plans, we can already say that Jio has begun the race of becoming the next hardware maestro.

Here's why: Unfold the rising Gold

With Covid-19 turning to be one of the most deleterious crises mankind may ever face again, some major Gold importing countries are remaining on the sidelines avoiding much trading engagement. This is and will continue to be the primary reason behind a magnanimous fall in imports by the majorly importing countries like India, China among others. In a historic trading like never before, Gold closed at Rs 5,200 per gram last week. The reason behind this wide-scale aggrandisement can be attributed to the fact that investors are skeptical with regards to other avenues of investment thus treating gold to be relatively safer at a time when real estate, mutual funds and corporate investments are still grappling with the economic ramifications of the virus. At a time when yield in T-Bills, such as the US Treasury Bills or our very own Post Office accounts are growing excessively low, investors are looking for a relatively secure source of investment and Gold is coming to be the safe haven.



Govt to ease borrowing cap in relief for discoms

The Union Power Ministry requested the cabinet to consider raising the borrowing limits of debt-laden state electricity distribution companies, also known as discoms, so that they qualify for the ₹1.25 trillion reform-linked loan package. The government had announced the liquidity injection into discoms as part of a stimulus package to revive India's virus-battered economy. The money is to be raised by state-owned Power Finance Corp. and Rural Electrification Corp. from the market against the receivables of these discoms. The package of 90,000 crores will be raised to 1.25 trillion which will enable the restart of the power cycle from the currently trapped scenario.

The package aims to take care of the digital payment interfaces, prepaid metering in government departments and preparing action plans to reduce losses among others. Furthermore, the state government can ask for auxiliary relaxation if it's required in addition to what's proposed under the UDAY scheme.



FEATURED ARTICLES

More than just finance





The Re-emerging Importance of Stress Testing

By Raghav Monga
(Vice President)

The nature of major financial distresses and risks has always been unexpected. Many crises are a repercussion of risks which are extremely difficult to predict. The 2008 financial crisis had taught us the importance of risk management and today, the Covid-19 pandemic has reminded us of the same. Stress testing is a method used to test the ability of an institution to handle extreme situation. It can be looked at as quantifying a risk-averse mind which considers that the worst might happen and tests its resilience to handle the stress. The idea of stress testing was substantiated in the Basel III accord in 2009 to improve the capacities of banks to handle shocks.

Why do we need Stress Testing?

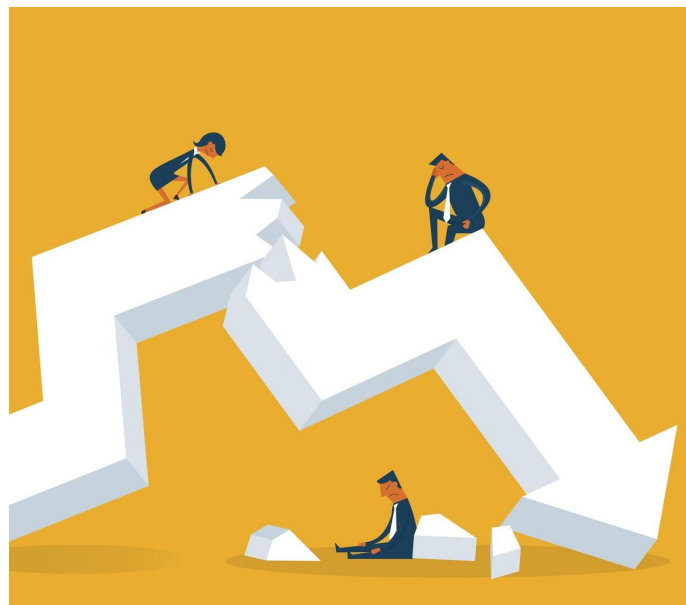
With increasing dependency on other organizations, threat of climate change, possibility of natural disasters, conflicts, and various other developments, there is a need for having a proactive approach to handle risk. Stress testing supersedes traditional methods of risk measurements because it is a forward-looking measure. Traditional methods consider historical information as the best predictor of future happenings. Since a deviation from the prediction can lead to disastrous consequences,

it is paramount that events with smaller probabilities are taken into account which is very well encompassed in the activity of stress testing. Further, it gives a good measure of the risk appetite of the organization. Risk appetite is the maximum level of risk an organization can take. Calculating the risk appetite is fundamental to all risk management processes. It becomes easier for any organization to decide its strategies with a constraint on its risk-taking ability. To give an example, a bank with a high sensitivity to default risk should evaluate the next loan application with more scrutiny, give a higher weightage to the credit score and increase the collateral haircut. Bank stress tests are particularly designed to test whether the capital is adequate to handle the stress. Banks have an important application of stress testing, since failure of banks can cause a chain reaction leading to the disruption of the whole economy. For this reason, it becomes imperative that the monetary authority of the economy monitors the ability of the banks to bear the losses.

What are the approaches to Stress Testing?

Stress testing can be done from a historical method or a hypothetical scenario method. A historical method deals with assessing the

ability of the institution to handle a historical crisis. For example, investors can measure the impact on their current portfolios given a tech bubble happens again and banks in the future could rationally estimate the impact of the spread of another deadly virus. Occurrence of a historical event in the exact same fashion as it had in the past, is a remote possibility but it still gives an idea of the overall impact of the event. Another way to measure resilience is by introducing hypothetical changes that can take place to account for the surprising nature of risks. Checking whether your portfolio can handle a 150 bps increase in interest rates, assessing the impact of 50% of the depositors withdrawing all their money in the following week, or the losses faced by the tourism sector if the temperature increases beyond the regular levels are all examples of hypothetical scenarios. A scenario involving multiple events taking place may require adjustment in many other variables which are related to each other. Worst Case Scenario (WCS), as the name suggests, refers to the method which measures the impact of an extremely unfavorable condition. This method is used to address tail risks since an extreme situation which is considered the “worst” has a miniscule probability.



COVID Stress Testing in India

We are in a thick soup right now and it is only prudent to promote stress testing. Shaktikanta

Das, the RBI Governor, has emphasized on the importance of this activity in the recent SBI Banking and Economics Conclave as he said, “The lockdown and anticipated post-lockdown compression in economic growth may result in higher non-performing assets (NPAs) and capital erosion of banks. A recapitalization plan for PSBs and private banks has, therefore, become necessary.” After the Yes Bank crisis, a public-private partnership model looks feasible to handle a situation like this. In addition to the banks, SEBI has recently reviewed the stress testing methodology of commodity derivatives for Clearing Corporations (CCs). A default on derivative contracts will put pressure on the solvency of CCs and therefore, scenarios have to be updated accordingly.

Stress Testing methodology should be considered as an important aspect of major organizations since there has been a normalization of downturns. Threats increase fear that induces reactions for survival. A large number of threats, on the other hand, make us ready and aware to handle the next problem efficiently. The world should have reached this stage by now. It is impossible to predict the future and therefore it is all the more rational to consider stress testing for their lies the possibility that things may not always go according to the plan.



A Leader's Guide to Corporate Culture

By Keshav Gupta and Vedant Shandilya
(Organising and Sponsorship Department)

A strong positive corporate culture is essential for building organizational resiliency. The foundation that enables a culture to thrive is the extent to which employees are empowered, engaged, feel valued and their concerns are heard. This is where leadership plays a fundamental role. Culture is the tacit social order of an organization. It shapes attitudes and behaviours in wide-ranging and durable ways. Cultural norms define what is encouraged, discouraged, accepted, or rejected within a group. When properly aligned with personal values, drives, and needs, culture can unleash tremendous amounts of energy towards a shared purpose and foster an organization's capacity to thrive. A leader must focus on 6 essential elements:

Defining a Purpose

Purpose defines our core reason for being and the positive impact we have on the world. It shapes strategy, inspires employees, engages customers, provides a moral compass in moments of truth and is essential to culture. It is the reason a company exists. A true leader must embed a purpose which resonates with every employee.

A 2019 McKinsey and Co. survey found 82% of employees said it was important to have a resonate purpose and 72% said that purpose should receive more weight than profits.

Empower your Employees

Empowerment is more than giving another authority, it is about having employees feel ownership in the business outcomes that the leaders strive for daily. It is about the employees' growth, independence, and autonomy. Create an environment where your employees can speak freely. Allow employees to speak their minds without fear of reprisal, rebuke, or retribution. When employees can voice their concerns freely, organizations see increased retention and stronger performance. Learn to delegate the outcomes, not the process. You must learn to delegate effectively, or you limit your reach and eventually your career. Give employees meaningful work. Leaders must communicate how important this work is to the success of the company and achieving the company's purpose. Creating interesting and achievable challenges allows employees to grow and build new "muscle" as companies evolve and build resiliency.

Embracing Diversity

Hire people who are not like you and embrace diversity of strengths and personalities. When you include others with traits different from your own, you expand the capacity of your team. Embrace diversity and inclusion because it is the right thing to do and it achieves better outcomes; recent research clearly yields that organizations with diversity perform better than those without it.



Be Vulnerable and have a Positive Character

Do not equate vulnerability to weakness as too many executives do. Vulnerability builds trust and trust builds great teams. Being vulnerable means leaders admit their shortcomings, ask for help, rely upon others, and own their mistakes. Being vulnerable builds your credibility and adds positively to your character. “Leadership is a potent combination of strategy and character. But if you must be without one, be without strategy.” Remarkable leadership is about EQ, not IQ. Emotional intelligence (EQ) accounts for 80% of the success of a leader. In fact, what gets executives fired most often is not about profitability or strategy, it is about character. It’s about self-awareness and managing your behaviours. Develop cognitive empathy. Cognitive empathy, which differs from the more common emotional empathy, is the largely conscious drive to recognize and understand another person’s emotional state. When you see someone in pain, you need to have an appropriate humane response, even if it is just to listen. Empathy is a huge factor in leadership success and building your credibility.

Invest in your Employees

The most important asset to any company’s success is its employees. It defies logic that any company would not invest in their development, yet altogether too many employers see benefits, training, or even concern for their well-being as only as an expense to be managed and minimized. While today’s pandemic has momentarily altered the near-term strategy for many employers, their employees will always be what matters most.

Invest in employee development. 70% of an employee’s development should be through on the job (OTJ) activities, tasks, and assignments. Sending them to a conference is the least effective way to encourage real growth. Job shadowing, mentoring programs, structured interviews, and other OTJ ideas help in developing executives.

Invest in employee’s health and well-being. Corporate health and wellness programs are becoming more prominent with employers as means to improve productivity and reduce health care costs. Engage the help of external experts and align them with passionate internal advocates; together, they can recommend strategies that work for you. Building a strong positive culture takes time and many efforts, both large and small. The greatest asset and greatest Achilles’ heel of any company is its culture. It is the beating heart of any organization. Leaders must listen to it and note the irregular rhythms. Once heard, the six elements of shaping the culture must be woven together to form an impenetrable fabric of success for employees and stakeholders. Leaders must also role model the behaviours to bring the six elements alive. It is not what they say, not what they intend, it is how they behave – the actions they take – that defines them as leaders and impact their culture the most.

Learn, then lead.



PROSPECT THEORY

A User's Guide to Decision-Making

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

In 1995, a study on Olympic medallists found that bronze medal winners seemed far happier on average than silver medal winners. The reason has to do with perceived gains or losses around a reference point. The silver medallist focused on coming first with any other outcome being considered a loss, while the bronze medallist's focus lay somewhere around the 4th or 5th place, so any outcome above not winning a medal at all is considered a gain. This explains the irrational behaviour silver medal winners have over being first loser rather than thinking of themselves as the second best in the world. This is where Prospect Theory comes into the scenario as it explains that people avoid losses and optimize the certain wins because the pain of losing is greater than the satisfaction of an equivalent gain. It shows how people decide between alternatives that involve risk and uncertainty (e.g. % likelihood of gains or losses).

This theory was developed by Daniel Kahneman and Amos Tversky in 1979 to provide insights into the actual behaviour of people contrary to the expected utility theory which reflects the

decision perfectly rational agents would make. In the expected utility model, the crucial axioms of rational decision making are dominance, invariance and transitivity which are assumptions about behaviour that traditional economists view as self-evident. Yet there are circumstances in which people demonstrate how frequently and reliably they violate those very assumptions. Prospect Theory states that people tend to be risk averse when a gain is involved, preferring solutions that lead to a lower expected utility but high certainty, whereas a risk seeking behaviour is reflected when placed in a domain of losses, preferring solutions that lead to a lower expected utility as long as it has the potential to avoid losses altogether. This interplay shows that an event with a lower probability is over weighted by decision makers while an event with a medium to high probability is under weighted and the person is not concerned enough with the outcome of that probability.

Prospect Theory divides the decision-making process into two phases:

PHASE ONE

Framing, or editing is the first phase of prospect theory. A decision “frame” is the decision-maker’s view of the outcomes and risks associated with a particular choice. Decision frames are largely controlled by the formulation of the problem. It has been shown extensively, in hundreds of studies with thousands of participants, that the way a decision is “framed” can cause respondents to switch their selection between options. Often, small changes in vocabulary, without altering any options available, can cause a decision maker to change their selection among choices, and in predictable ways. This phenomenon is called framing effects and decision makers often remain unaware of these and resort to intuitive assessments of predetermined options.

To give an example, a large car manufacturer has recently been hit with a number of economic difficulties, and it appears as if three plants need to be closed and 6,000 employees laid off. The vice-president of production has been exploring alternative ways to avoid this crisis. Plan A will save one of the three plants and 2,000 jobs. Plan B has a $\frac{1}{3}$ probability of saving all three plants and all 6,000 jobs, but has a $\frac{2}{3}$ probability of saving no plants and no jobs. Plan C: This plan will result in the loss of two of the three plants and 4,000 jobs. Plan D: This plan has a $\frac{2}{3}$ probability of resulting in the loss of all three plants and all 6,000 jobs, but has a $\frac{1}{3}$ probability of losing no plants and no jobs.

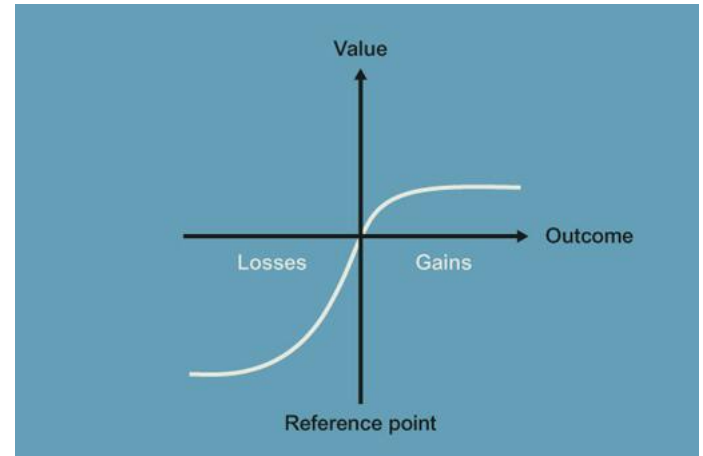
Plans A and C are identical, but are “framed” differently

Program A is given in terms of jobs saved

Program C is given in terms of jobs lost

The same applies to programs B and D

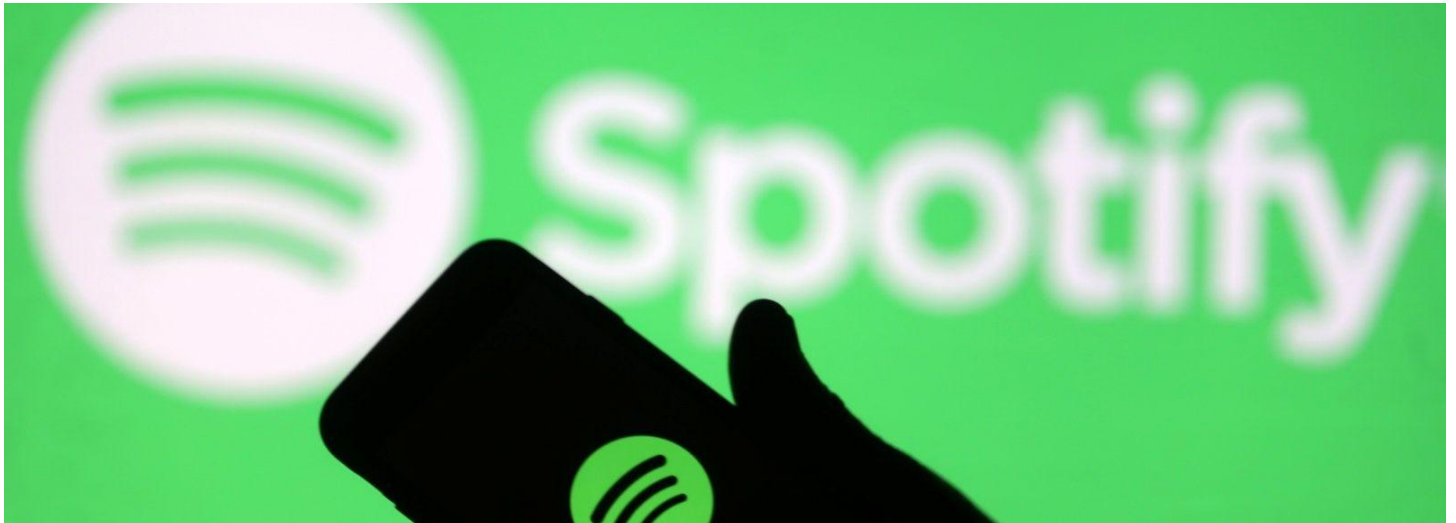
Options framed in terms of gains versus losses are treated differently, and can cause people to “flip” their preferences. People are typically prepared to gamble to avoid losses, but become risk-averse in the context of gains.



PHASE TWO

Evaluation is the second phase of prospect theory. Once the prospects are framed, or edited the decision maker evaluates the options and makes a choice among them. Marginal (incremental) value decreases over gains as the second 50 rupees earned gives lesser satisfaction than the first 50 rupees earned but marginal value increases over losses as the second 50 rupees loss is less significant to us than the first 50 rupees loss. The prospect theory utility function is asymmetric in nature as it is steeper over losses than over gains. This implies that Loss Aversion is also an important aspect of prospect theory. The statement that Losses loom larger than gains aptly describes the above mentioned aspect.

Prospect Theory is based on psychological models that investigate judgement and decision making. It predicts that the domain of either gains or losses affect risk propensity. People like to believe that they are rational thinkers when in reality they are highly susceptible to cognitive biases. Understanding these biases can help one make informed financial decisions and inherently guard themselves against large losses.



The Spotify Spectacle

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

Problem Statement

Spotify is a Swedish music streaming and media services provider. Spotify conquered Europe with their elaborate model and gained success in the buzzing markets of the USA. However in the Indian market they have gained ground but have been incapable at converting it to fodder. With 71 million subscribers and not too many premium account holders, Spotify is still struggling to gain major market share in India. Approaching this problem, following are the most lucrative solutions to this market penetration case.

Solution

COMPREHENSIVE GROWTH STRATEGY

- Over the years, Spotify has seen falling net income trends and that is majorly because of its revenue model. It is dependent on ads and its premium subscribers for its revenue.
- The reason could be their pricing structure. India is approaching a time where a majority of its population will be in the age group of 18-30 years for which it becomes essential to target the student community effectively. The student subscription plan is priced at Rs. 59 which is higher than its competitors.

- It should follow a price discrimination policy to penetrate the Indian market. This can be done by lowering the premium account fee and bringing it down to an average of Rs 40-50. This in itself brings a change of 16-32% which makes many free account users interested to avail the offer.
- Further, it currently focuses on large music production houses to get access to music rights which increases the number of songs they can stream on their network though there is still less diversity in music. With 21 languages in India, the listener/user in different regions have different tastes as far as music is concerned. Thus, to increase its users on free accounts also, it will have to tap small bands, local singers who are heard by the masses in a concentrated region.

SWOT Analysis of Spotify

STRENGTHS

- Large music base and 71 million paying subscribers.
- Music personalization and recommended feeds based on user preferences through machine learning.
- Easy app set up feature of editing and sharing one's playlists with others.

- Enjoys the advantage of the Freemium model.

WEAKNESSES

- Relies on mass advertisement for income.
- Difficulties in maintaining positive cooperation with artists and labels.
- Technical difficulties like charging subscribers' fee even after the cancellation of plans from their side etc. can lead to reputation loss.

OPPORTUNITIES

- Develop interactive music experiences.
- As a streaming service, expanding into live music streaming, live television and film.
- Growth through new partnerships with mobile device manufacturers, telecoms and other firms.

THREATS

- Artists would drop away due to low wage; other platforms (Wynk, Jio Saavn, Gaana etc.) could buy more and more "exclusive" and well-known artists.
- Major music streaming platforms are backed by a bigger brand, someone to rely on and even subsidize losses upon.

Potential Strategies for Growth (Based on the SWOT Analysis)

- Spotify is not paying artists enough in return of their tracks. Offering more to the artists for their music piece can keep them running alongside the other platforms and can even make them stronger than them.
- More Spotify events to promote branding. Example - silent discos sponsored by Spotify.
- Making music app available for blind and deaf people. Example - voice recognition and vibration.
- It can introduce the feature of 'Acoustic Wave Phone System'. The basic purpose of this is to create a giant unified speaker by using multiple phones. The person will have

an option of hosting or joining a party. A four-digit code will be created which everyone will be supposed to fill, provided they have the app. It will then allow everyone to beam music to their phones perfectly in sync with the music coming out of the host device.

- As analysed, Spotify relies more on advertisements for its income because the Freemium feature sometimes implies low wages. Hence, in order to increase its revenue, it needs to focus on increasing its paid subscribers. This will require a comprehensive addition of superior features in its Premium version which will drive more people into becoming a paid consumer.

Marketing Strategies

ORIGINAL CONTENT

Spotify could invest efforts in creating original content in India. Even if a few of such songs were to go viral, it would result in great publicity where users would end up downloading the app in order to listen to more such music.

FREE SUBSCRIPTION ON REFERRALS

It can offer free subscriptions to users based on a minimum number of people they invite who end up signing up on Spotify.

MAKE ARTISTS PROMOTE SPOTIFY

It could incentivize music artists to promote its platform to their followers or maybe to Spotify-Only releases to some of their albums or songs.

How Spotify can win in India?

According to a report by Deloitte and the Indian Music Industry (IMI), the music streaming industry in India currently generates revenues of ₹270 crore, while the overall music industry in India is valued at ₹1068 crore. As far as the target audience is concerned, it is not feasible to target everyone immediately. Ideally, Spotify should be able to use a few beachhead segments before expanding to other segments. In the next 5 years internet usage will also rise and given the cheap data rates in the country usage will only go up. It is imperative that they utilise these golden mantras and make the most of this time to get more and more investors on board.



Refinements in the Banking Sector

By Rashim Bansal, Mohammad Ovais and Ridhima Gupta
(Senior Members)

Introduction

To sustain the high growth rate India has achieved, it should carry out banking sector reforms; continue with fiscal consolidation, simplify and streamline GST; and renew impetus on reforms, says the IMF. IMF added, India must address the ongoing crisis in its banking sector to support investments and inclusive growth agenda. Historically, India's banking sector reforms — especially in the 1990 — focused majorly on enhancing competition, strengthening governance and regulation. Future reforms should build upon these areas and should be drawn after taking lessons from their past experiences.

Present Status

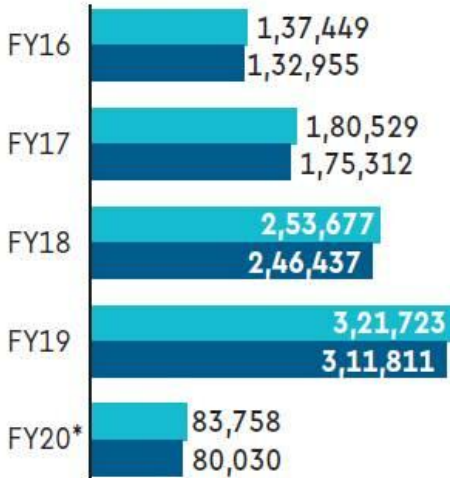
- India's banking system is characterised by a high share of Public Sector Banks (PSBs), accounting for over 70% of total assets.
- A steady deterioration of the banking sector in successive quarters can be seen.
- There has been policy inaction on reforming the governance of the banking system to keep it separate from politics.
- Since the RBI launched the Asset Quality Review (AQR) in the year 2015, Indian banks

have had to progressively reveal the true extent of their NPAs.

- The gross non-performing asset (GNPA) of the Scheduled Commercial Banks (SCBs) has deteriorated from 10.4% in September 2017 to 11.6% in March 2018.
- The deterioration with regards to public sector banks is even sharper: from 13.7% to 15.6%.
- Rising NPAs also put a strain on the health of the PSBs, reflected in their declining Return on Assets (ROA) and Return on Equity (ROE) ratios.
- The decline in bank's profits is largely owing to the higher growth in risk provisions; loan write offs and decline in the net interest income.
- The stresses in the banking sector have translated into a slowdown in industrial credit.
- They also limit banks' ability to meet international capital requirements.
- Banks are witnessing a surge in wilful defaults or refusal of repayment obligations by the borrowers.

The break-up

(₹ cr) ■ Sanction ■ Disbursement



*As of August 23

Concerns/Challenges

- Deteriorating profitability and asset quality pose elevated risks to banking sector stability.
- RBI has warned of further worsening of the NPA situation.
- Issues like Punjab National Bank fraud raise the concern for banking sector reform in India. With growing Internet and mobile banking, cybercrime is becoming an even greater threat.
- Rising wilful defaults in PSBs hurts the confidence of investors.
- Political interference while granting loans.
- More exposure to corporate loans by PSBs while private banks maintain a balance between corporate and retail sector loans.
- India's banks lag behind global counterparts in terms of financial depth or the size of banks.
- Moreover, India has low levels of private credit to GDP and credit to deposit ratio in comparison to other emerging economies of the world.
- With oil prices rising it is difficult to control the fiscal deficit, current account deficit and inflation rates.

Way Forward

- There is an urgent need to build capacity in the PSBs to evaluate lendable projects.

- Urgent need for freeing PSBs from political interference.
- Reducing the government equity below 51%, and attracting some strategic investors.
- It will not only reduce the pressure on the government for recapitalization, it will also set the stage for a more commercial orientation for public sector banks.
- Comprehensive approach to improve the capacity, risk management and governance of the PSBs.
- Revive bank credit and enhance the efficiency of credit provision; accelerate the clean-up of bank and corporate balance sheets.
- Wilful default must be recognised at the earliest and followed by a quick action.
- Ensure balanced exposure to retail and corporate sector lendings.
- Amalgamate banks into bigger entities by mergers and acquisitions and ensure capital adequacy as per the Basel norms.
- Developing corporate bond markets to relieve pressure from banks as lending sources.
- Banks need to do forensic audits for ascertaining the end use of funds.
- To build a robust banking system, recapitalization will have to be complemented by lower entry barriers, improved financial supervision, and an efficient debt recovery mechanism.

EDITORIAL

Direct from the desk



The Gambler's Fallacy

By Sanaah Jain
(Co-Editor)

Las Vegas, 18th August, 1913. A night in the Monte Carlo Casino now called the MGM Park. The roulette wheel's ball had fallen on black several times on the trot. Watching this, the gamblers believed that it would fall on the red square in the next turn, and thus started to chip in higher bets on red as they thought it was due. However, in an unusual occurrence, it fell on the red square after 27 turns. This incident became so epochal as by the end of the night, the casino owners were dancing in loads of money whereas many gamblers were left with just the lint in their pockets. This was the incident where Gambler's fallacy or popularly called the Monte Carlo fallacy was first observed. It occurs when an individual fallaciously believes that a certain event is more likely or less likely to happen based on a previous event or a series of events that have occurred in the past. This line of thought reflects an incorrect understanding of probability because in independent events, past outcomes do not have a bearing on the future outcomes. Let us understand this fallacy through the common example of a toss of a fair coin.

Let X be the number of heads or tails.

$P(X)$ = Number of favorable outcomes/Total outcomes

The odds of a head or tails is 50% and this remains same in the first toss, second toss and even in the 100th toss. Further the events are independent of each other i.e. the outcome of one will not influence the outcome of another. In the 1st toss chance of a head is $\frac{1}{2}$ and so is the probability. Now over two consecutive tosses, the chance of two heads is $\frac{1}{2} * \frac{1}{2} = \frac{1}{4}$.

Similarly, the probability of getting successive heads in three tosses is $\frac{1}{8}$ and in five tosses, is $\frac{1}{32}$. This shows that as the number of total outcomes increases, the probability of the repeated outcome decreases.



Therefore, it is natural for the gambler to think that when heads have come four times in a row, the probability of getting a head in the fifth toss is 1 in 32 and it is more likely that the fifth toss may result in a tail. However, the gambler forgets that the coin has no memory. $\frac{1}{32}$ probability existed when no coin was tossed. Once the fourth toss is done, all previous outcomes (four heads) have now become one known outcome and the probability of getting a head in the fifth toss is $\frac{1}{2}$ again, which remains so in the sixth, seventh tosses ad infinitum because they are all independent events. The fallacy comes when gamblers reason that the next toss will be a tail instead of a head as it is due and due to past tosses, that can influence the future outcomes.

This fallacy occurs due to a number of reasons. First, psychologically the mind tends to find relations and patterns in random events and try to predict what is likely to happen in future. Second comes the "law of small numbers" where we often take small samples representative of the bigger population from which they are drawn. Renowned psychologists Amos Tversky and Daniel Kahneman described this phenomenon as an "insensitivity to sample size." They believed that our insensitivity to sample size can largely be attributed to the "representativeness heuristic."

A heuristic is a rough rule of thumb to make difficult judgements. According to this heuristic, we often predict the likelihood of future events by analyzing its similarity to past experiences or choose a past event that should be representative of an ideal future outcome. And last, we consider chance as a self-correcting process wherein it maintains the equilibrium to a long series of a known outcome by an opposite result.

The Gambler's fallacy also known as the fallacy of "Maturity of Chances" is very commonly seen in the world of investing. This can be explained by taking an example from a case study of Bombay Stock Exchange (BSE). The research paper covered a number of aspects in which one of them was about whether investors tend to assume that a "trend" exists based on a previous series of events that seem to be non-random and connected. They were presented with a hypothetical situation in which they had to predict the price of a stock based on the given historical information.

The situation was as follows-

Suppose a stock's price had been rising up by 5 points (10, 15, 20) for the last three weeks. What would be the probability that its price would rise by exact 5 points in the next week?

68% of investors predicted that since the stock's price had been going up by 5 points in a row for three weeks, it would go up by exact 5 points in the following week too. This is an example of the fallacy where the investors mistake a random series of events as a non-random pattern.

This can also be seen as an effect on financial analysis when investors tend to liquidate a position after it has gone up or down in a long series of trading sessions. According to economists Hersh Shefrin and Meir Statman, investors tend to hold onto stocks that have depreciated and sell stocks that have appreciated. They call this a "general disposition to sell winners too early and hold losers too long." They falsely believe that there has been a long string of same successive outcomes and it is now likely to go in the opposite direction.

This cognitive bias can be avoided by identifying the casual independence in events. We need to understand the process of how an event takes place and comprehend that its resemblance to a past event does not play a role in unravelling a future outcome.

Sadly, the human mind misses that and gets off-targeted by the fallacy.

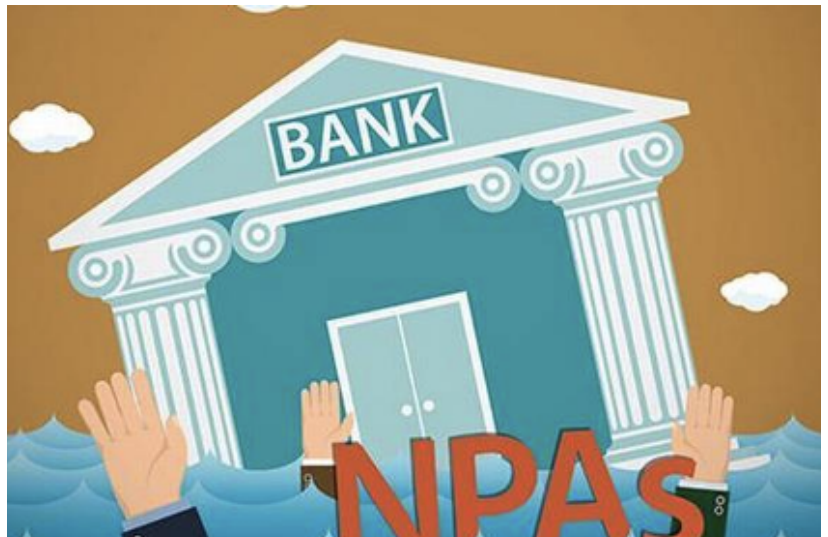


NPAs and the Visionary Economy

By Vipriya Anjum
(Co-Editor)

Every flourishing economy has a strong foothold in terms of its banking sector, the downfall of which may adversely affect the other sectors. NPAs have in recent times become one of the major concerns for the banking sector in our country as they reflect the performance of the banks. An issue discussed at length, it affects not only the banks but the economy as well. To unfurl this delinquency lets understand more about its roots. An asset, including a leased asset, becomes non-performing when it ceases to generate income for the bank. In simpler terms, NPA refers to the classification of loans and advances where the interest and/ or instalment of principal remains overdue for a period of more than 90 days. These non-performing assets are classified by banks into three categories based upon their period of non-performance. Sub-standard NPAs refer to those assets which have remained as an NPA for a period less than or equal to 18 months while a doubtful asset is one, which remains NPA for a period exceeding 18 months. A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. Such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

When we look into the reasons that pertain to assets transforming into NPAs, we find several factors that are responsible for this ever-increasing size of NPAs. A major portion of such bad debts arise out of lending to the priority sector, at the dictates of politicians and bureaucrats, while a huge amount can be related to the macro-economic environment changes like recessions, infrastructure bottlenecks, changes in government policies, etc. that result in some lending of banks becoming unproductive and borrowers turning defaulters.



The lack of sincere corporate culture, and presence of poor auditing practices leads to an overwhelming increase in such cases. While failure on part of promoters to bring in their own share of equity is also an integral factor in the rise of this unprecedented problem. The boom phase of the Indian economy from 2000-2008 caused banks to start lending extensively to companies, the relaxed norms which forgo the analysis of financials and credit ratings of big corporate houses also contributed widely to this issue.

However, soon after realising the gravity of the problem there have been several recent developments to tackle NPAs including the development of the Insolvency and Bankruptcy Code in 2016. The credit risk management strategies undertaken by banks along with the tightening of credit monitoring systems has brought about a lot of change. Imposition of more haircuts by banks has surely helped the PSU lenders to cover for the losses created by NPAs. Looking into details of the Insolvency and Bankruptcy Code (IBC) that was enacted in May 2016, its aim is to provide a time-bound 180-day recovery process for insolvent accounts (where the borrowers are unable to pay their dues). Under the same, the creditors of these insolvent accounts, presided over by an insolvency professional, decide whether to restructure the loan, or to sell the defaulter's assets to recover the outstanding amount.



If a timely decision is not arrived at, the defaulter's assets are liquidated. Proceedings under the IBC are adjudicated by the Debt Recovery Tribunal for personal insolvencies, and the National Company Law Tribunal (NCLT) for corporate insolvencies. 701 cases have been registered and 176 cases had been resolved by March 2018.

Over the years, the RBI has issued various guidelines aimed at the resolution of stressed assets of banks. This included starting of certain schemes such as the Strategic Debt Restructuring that allowed banks to change the management of the defaulting company, and the Joint Lenders' Forum, where lenders evolved a resolution plan and voted on its implementation.

From the above discussion, it can be concluded that the intensifying NPAs have posed a boundless challenge for the survival of the Indian banking sector and with this industry smitten with NPA, we might drown our desire to become an economic superpower by making it a superfluous daydream.

Why Printing more money causes Inflation

By Tejas Agarwal
(Co-Editor)

In the words of Milton Friedman, "when too much money chases too few goods, inflation is bound to happen." By and far, the concept of inflation and rising prices is inherent in every economic structure present in practice. The stereotypical thought of associating inflation with an economic disaster or a calculated economic failure is incorrect to a certain extent. This is because inflation is bound to exist, as aforesaid, in every institutionalized economic framework and a decent percentage of it is actually a stimulus to production. No inflation YOY means a perfect equilibrium in demand and supply which is neither feasible nor advisable. However, we shall understand how printing more money (be it any form of the host's currency) causes inflation amongst several other economic ramifications. Lot of us think a lot of times as to why we can't simply print more money to pay off debt. Much of the macroeconomic problems like mass poverty, under-financed public institutions and capital starved economies can be easily answered by printing more currency notes to finance them all. However sadly this is not true. We must understand that a piece of paper is accepted as a medium of exchange only because we have caused it to be so. Shifting from the concept of commodity money or representational money to fiat money has brought with itself the idea of nominal value and real value. We cannot consider ourselves to be rich even if we've too much money to buy a too few things. What's important to decipher and understand is the amount of goods and services that money can buy at a given point of time. The value of goods and services is simply determined on the basis of the fundamental economic concept of demand and supply. If the supply of money is high (say owing to rampant printing of currency notes), it implies that people have more disposable income. Under given circumstances of fixed supplies, the demand for such supplies is bound to increase. With no alternative left to meet the rising consumer demand, producers and the government have no other option but to raise the prices of goods and services.

Henceforth the brunt of the administrative decision to print more money is borne by everyday consumers by forcing him/her to pay more for metabolic purchases. Given the aforementioned microeconomic explanation, let's now give a macroeconomic hue. Price value is simply the quotient of the available money in the economy (say there's only one good to purchase) with respect to the availability of goods and services. Let's say for example, the amount of money in the economy rises due to increased printing of currency notes, this will ultimately lead to the price of goods and services going up thus causing inflation.



Normally, the decision of the government to inject money into the economy can also grow into an economic failure causing inflation in the event its not backed by effective statutory rules and regulations. For example, to lift the economy from the reeling effects of Covid-19, the Union government announced a colossal economic stimulus package. Arguably this might shoot price of goods and services by it essentially won't give the prevailing conditions of plummeting demand and liquidity limitations. Thus, we must understand that having more money serves no good provided its value isn't diluted in relative terms. Often governmental institutions like the central bank and other economic institutions underscore the monetary policy of raising bank rate to control inflation beyond limits. Till the time money isn't let out by commercial banks to their clients, inflation by and far is a dream. To prevent this dream from becoming a reality, economic institutions raise the bank rates so that giving out money becomes more difficult thus keeping a check on liquidity overflow.

History has borne a testimony to the fact as to how printing money causes inflation. The case with Hungary in 1946 and Zimbabwe in 2015, cements the concept of preventing over issuance of currency notes. Both Zimbabwe and Hungary, in an economic fiasco, failed to estimate the consequences of a liquidity overflow. With an intention of funding wide-scale public infrastructure projects and paying off government debt by printing more money, the central banks of both the countries continued printing more and more money only to pave way for hyperinflation. With inflation rates soaring over 500 billion percent (yes you read the number correct) the average doubling time period of commodity prices were 15 hours and 24 hours respectively in Hungary and Zimbabwe. The entire world witnessed how people took with themselves a wheelbarrow full of money to purchase a loaf of bread, and a truckload of currency notes to get a student admitted into a new school. Thus, major economic happenings in the past have often prevented over-ambitious governments from inviting a monumental problem for themselves thus preventing inordinate printing of currency notes.

So the next time you curse the government for not printing paper currency according to your whims and fancies, remember that it's not the amount of money that's important but what you can purchase with that amount actually is.



FINFUN

Even finance can be fun

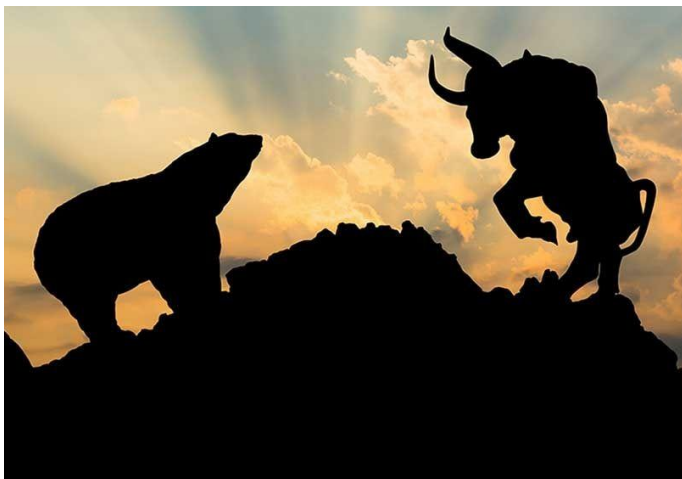




Stock Market Takeaways

Pirate Exchange

Ever wondered what can be effectively traded beyond stocks and securities? Well to your good notice, nothing in this world is devoid of facile realities and not are stock markets. Reports suggest that the world's first pirate stock exchange was established in 2009 in Harardheere in Somalia. The exchange is open round the clock and allows investors to profit from ransoms, hijacking missions, planning robberies and other loot collected. Sources mentioned that over 70 entities are listed on the exchange. Don't vie for trading in such items which is beyond the established legal framework but next time someone mentions you about it, don't get surprised. It exists!

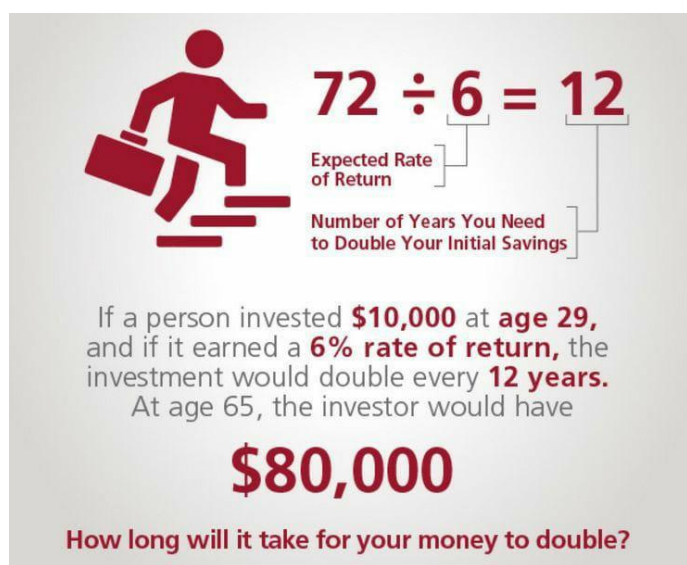
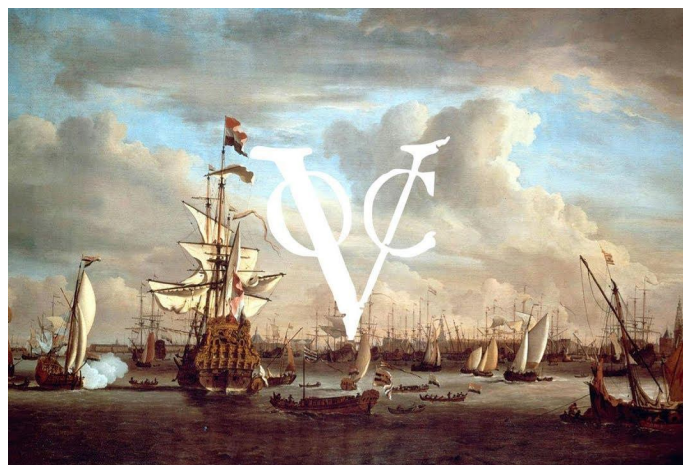


Bulls or Bears

The stock market got the names “bear and bull” because of caballeros (spanish knights) in California. The caballeros put California grizzlies in battle with bulls. They observed bears swiped downwards and bulls hooked upwards, thus lending the analogy. A bullish market is when stocks are rising and market is positive (hooked upwards) whereas a bearish market is when there's a negative and defensive sentiment prevailing all through (swiped downwards).

First of its kind

The Dutch East India Company was the first multinational corporation in existence, created in 1602. It is the first company to issue stocks and is the granddaddy of all corporations today. Shareholders didn't have much influence – the company was controlled by its directors. However, shareholders were richly rewarded. The annual dividends were 16% on average over the first half of the 17th century. You could have had a good fortune provided your ancestors were wise enough to capitalise on this economic opportunity in the company which arguably never witnessed dusk.



Rule of 72

Investors tend to ask the time investment would take to double itself. It can be calculated based on The Rule of 72. The rule is a simple way of determining how much time will an investment take to double given a fixed annual rate of interest. By dividing 72 by the rate of return, an investor may get an estimate on how many years it will take for the initial investment to double itself. Let us see an example, assume you are investing Rs 4,00,000 at 6% returns, then as per rule of 72; it would take twelve years for the amount to double ($72/6=12$).

Skeptical September

History has been a testimony to the fact that, on average, the market in the US performs the poorest in September. Since 1950, the Dow has declined 1.1% and the S&P 500 has declined 0.7% on average during the month of September. Since the Nasdaq was created in 1971, its composite index has fallen an average of 1% in September. A mere coincidence of 70 years or a calculated economic happening, the mystery behind is still to be decoded.



Did you know?

Hair Cut

Quarantine has made all of us miss having haircuts, but have you wondered what haircuts refer to in the financial world? The word holds significance as two important aspects.

A haircut refers to the percentage difference between the market value of an asset and the amount that can be used as collateral for loan. The reduction in the value is made to account for the market price fluctuations over time. For example, if a person needs a loan against property, and his property has a market value of 1 crore, the banks usually recognize it as a collateral worth 80 lakhs, here the 20 crore or the 20% reduction is known as the haircut.

It is also less commonly referred to the market maker's spread. A market maker is a firm or a person who buys and sells securities throughout the trading sessions and help in maintenance of market liquidity.



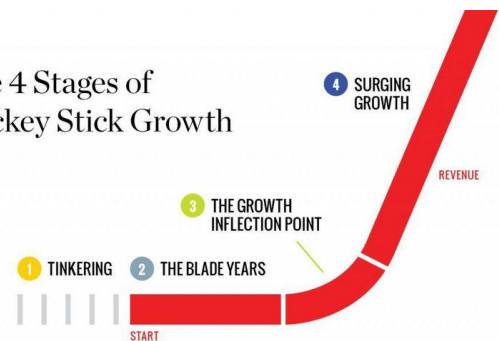
Let's assume the shares of a Company ABC aren't moving, the market maker will make bids and offers to accommodate orders. Let's say the shares are bought at 60 rupees per share and will attempt to sell them at a little higher than that at say 61 rupees per share. These slivers of profits that a market maker makes like the rupee 1 per share in the example above are called haircuts.

Hockey Stick Effect

You'd know hockey as one of the most popular sports, however it also does hold significance when one assesses a business.

Characterised by a sharp rise or fall of data points after a long flat period in a graph, it commands immediate attention. The peak in corporate might showcases an important growth in revenues, EBITDA and EBITDA margins.

The 4 Stages of Hockey Stick Growth



This dramatic shift that occurs from a flat period with no activity to the hockey-stick curve clearly indicate the need to assess the underlying factors. In a business the chart maybe representative of large problems in sales department which must be analysed and corrected.



Solve a Puzzle

(Hint: The answers to the questions lie in our weekly articles of this month i.e. July)

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



Answers
 A.1. Fungibility, A.2. Germany, A.3. Cultural, A.4. Novl, A.5. Lithuania, A.6. Coffee, A.7. Black Rock, A.8. Pizza, A.9. America, A.10. Grey

Q.1. Which principle states that money is interchangeable or same irrespective of its source or intended use?

Q.2. Which country's newspaper released the documents of the Panama Papers scandal?

Q.3. Which type of economic moats protect the companies from unique value propositions?

Q.4. Find the next word in order: Facebook, Calibra, Libra,

Q.5. Which country's bank has issued the world's first digital collector coin?

Q.6. Which product's brand name is taken from Herman Melville's Moby Dick?

Q.7. Which wealth management company's CEO appealed to industrial leaders to take initiative in socially responsible investing?

Q.8. What food item was sold by the restaurant in Mumbai that was the first one in India to accept Bitcoin payments?

Q.9. The Credit crisis of 1772 led to the famous revolution of which country?

Q.10. Which type of swan refers to a highly probable but a predictable event?

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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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