FINOMINA
THE FINANCE CLUB OF IIMU

PRESENTS

ARTHAARTH

THE MEANING OF WEALTH

ISSUE II
March 13

The Sahara Way of Doing Things

Credit Ratings
Are they Reliable?

Face2Face
Mr. Sanjay Anandaram

Air India
Quest to save the sinking ship

Money Ratnam
Split or Bonus?

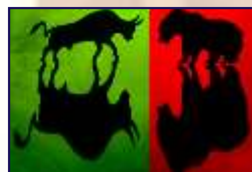
The Bull and the Bear debate over the Dragon !

Visit us at finomina.iimu.ac.in

Editorial Team: Abhinandan Ghosh and Kunal Kochar
Design Team: Ajith Pancily , Prateek Shukla and Vivek Pandey
Printing & Publishing: Aditya Arora
Coordinators: Ajith Pancily, Mamta Bansal, Shiv Marwah and Vivek Pandey

---

Contents



From the Editors' Desk,

Authors:

1. *The Sahara Way of doing Things:* Ajith Pancily, Shiv Marwah, Tanmay Mahale and Vipin Sreekumar

2. *The Bull and the Bear debate over the Dragon:* Anusha Ganne, Prateek Shukla, Saurabh Jain and Sravan Kommuri

3. *Credit Ratings of Nations: Are they Reliable?:* Aman Agrawal, Ratika Mittal and Shiv Marwah.

4. Air India: Quest to save the sinking ship: Parikshit Kapila and Pranav Gupta

5. What's on your mind - split or bonus?": Vivek Pandey and Vivek Batra

6. Face2Face with Mr. Sanjay Anandaram: Aditya Raghunath

It gives us great pleasure to pen down the editorial for the second issue of Arthaarth for two particular reasons. First, a brilliant compendium of articles that forms the contents of this issue of Arthaarth, which have been authored to perfection. They have truly brought out the intricacies of the topics involved. Second, with which we emotionally connect to, is the launch of Arthaarth at the first finance symposium of IIM Udaipur, Arth-Samvaad 2013. The symposium would bring together incumbents from the domain of finance to speak on the topic "Are Indian businesses decoupled from the rest of the world". The symposium would also see teams from premier B-schools across the country compete for the Arth-Samvaad Presentation Challenge. Dare we say, times of trouble loom large on many sectors and firms around the world, and an incomplete understanding of decoupling would only make matters worse!

The article on "The Sahara Way of doing Things" takes a peek into the Sahara debacle and points to failures in the regulatory framework. The cover article, creatively titled as "The Bull and Bear debate over the Dragon", looks at the impact of slowdown on the land of dragons, China. The implications of coupling of growth in nations come out strong and the article explores the future outlook for China and other countries, which brings us to the third article. "Credit Ratings of Nations: Are they Reliable?" provides a snapshot of how the risk of a country is evaluated by premier rating agencies across the world, and the various parameters used by these agencies. The article also looks at the efficacy of these ratings, and their inherent flaws. "Air India: Quest to save the sinking ship" tries to explore the future strategy of Air India, one of the heavily cash-strapped airlines in India. The article highlights the chronology of events that Air India has been through, which is pivotal to understanding the current situation of the airlines industry.

The next section brings back Arthaarth's very own Money Ratnam, the character who simplifies finance. In this superhero edition, "**What's on your mind** - split or bonus?" Money Ratnam explains the differences between Stock Splits and Bonus Shares, and their significance to the stockholder. For our Face2Face series, we have Mr. Sanjay Anandram, a venture capitalist, entrepreneur and founder of Jumpstart VC Fund, who talks to Finomina about the "VC industry in India", and how does the real world scenario look like.

This issue of Arthaarth is truly a collector's edition, with a range of contemporary topics discussed and insights on basic aspects of finance. Wishing you an engaging read ahead, we sign off with the quote from John Fox,

"There is no romance without finance."

The Sahara Way of doing Things!

Supreme Court instructs Sahara to refund investors Rs 27,000 Crore", "Sahara files for extension with SEBI", "Sahara-SEBI case: SAT dismisses deadline extension plea", "Sahara claims it owes only Rs 2,620 crore to investors" – thoroughfare on the front page of almost every respectable business daily in India over the last 4 months or so. The rift involving the SEBI, RBI and Sahara is nothing new to the business world. From "Sahara India Financial Corporation" to "Sahara India Real Estate Corporation Ltd" and "Sahara Housing Investment Corporation Ltd", no subsidiary or move of the Sahara conglomerate has been free of scrutiny from the fourth estate.

Sahara India Pariwar, known all over India for being the sponsor of the Indian Cricket Team and Force India, has diverse business interests ranging from real estate and hospitality to media and retail. Its consistent business relationship with the Indian Cricket team has secured its ties with the BCCI, and the relationship has deepened with Sahara Adventure Sports Limited's purchase of the Pune Warriors India IPL team for $370 million, the highest ever by any single company for a team in the history of the IPL. Sahara has acquired a 42% stake in the Formula 1 team, Sahara Force India for $100 million in October 2011. Sahara India Pariwar has been particularly active in the real estate space when it comes to acquisitions. The iconic Grosvenor House in London and Plaza Hotel in New York were acquired at a price of £470 million and US $570 million respectively over the last 2 years.

All said and done, being one of the few unlisted companies that have grown to a market capitalization of US $25 billion, Sahara's sources of revenue have been a question to many. The Sahara versus SEBI debacle has its origins relating to two queries raised by an individual and the Professional Group for Investment Protection issued separately to the National Housing Bank on 4th January, 2010 and to SEBI at a later date respectively. The query was regarding the housing bonds that had been issued by two companies namely "Sahara India Real Estate Corporation" and "Sahara Housing Investment Corporation" both under the Sahara group. As per the queries, the procedure followed in the issuance of the housing bonds by the two companies was not in line with regulations imposed by SEBI.

It was in March, 2008, that Sahara India Real

Estate Corporation decided to raise funds through the issuance of a financial instrument called "Unsecured OFCDs" where OFCD stands for "Optionally Fully Convertible Debentures". The same was not advertised publicly and the company decided to go in for private placement where the instrument was offered to workers, employees, other group companies and individuals who were affiliated to the organization in some manner. A convertible debenture is a debt security which can be either wholly or partly converted into equity shares at a time subsequent to the issue of the security which is in turn decided at the time of the issue of the security itself. Thus when such a security is issued there always exists, a provision, where the holder of the security can exchange it for the company's stock or equity. On such an exchange the debt obligation of the issuing company is discharged. Convertible debentures are further divided into fully and partially convertible debentures. Fully convertible being those where the entire value of the debenture can be converted into equity and partially convertible being those where only a part of the entire debt obligation on the issuer can be converted into equity. Optionally fully convertible debentures belong to the class of fully convertible debentures and in this case the holder of the security has the option of choosing between converting the owed debt to equity (in place of cash) or not choosing to do the same. However, if one were to look for the silver lining, this case has brought to light the reality of the situation our regulatory bodies are in. As market watchdog, SEBI seems to be doing a good job.

As per the Companies Act, any issue of debt instruments to more than 50 investors shall be deemed a public issue and would therefore come under the jurisdiction of SEBI. According to Sahara, since the issue of shares was a private placement of debentures to individuals by companies (Sahara India Real Estate Corporation and Sahara Housing Investment Corporation) that were not publicly listed; the same doesn't come under the purview of SEBI. How a company was able to raise funds to the tune of Rs. 24,000 crores through an issue of OFCDs to over 30 million investors without the knowledge of the SEBI is beyond anyone's gumption. If one were to dig a little deeper, what's really interesting is the fact that this issue came to SEBI's knowledge purely by accident. Earlier in 2010, the Sahara group had planned a public offering to raise funds for its subsidiary Sahara Prime City Limited, and had filed a Red Herring Prospectus to the SEBI for its clearance and subsequent approval. It was only while going through the financials of the company and that of the group was Mr. K M Abraham, a director with the SEBI, able to identify the issue of OFCDs to the public. The Securities Appellate Tribunal (SAT) in its order dated 18th October 2011, decreed that the Sahara Group was also guilty of concealing facts to the SEBI in its Red Herring Prospectus and had ordered the group to refund the funds raised back to the investors.

In more recent news, the investigation conducted by the Enforcement Directorate (ED) finally cleared the air of the mystery surrounding Sahara and how the group got the money to fund purchases of prime properties abroad. The acquisitions made by Sahara in December 2010 (Grosvenor House, in London's Mayfair area for around Rs 3,525 crore) has come under scrutiny with ED suspecting Sahara to have routed funds in a way so as to avoid taking permission from the RBI which has the last word on cross-border flows.

The deal has its origin with the Sahara India Real Estate Corporation Ltd (SIRECL) and Sahara India Commercial Corporation Ltd. SIRECL came under the glare of the market regulator SEBI as mentioned previously in the article and was recently directed by the Supreme Court to refund investors by the first week of February. The modus operandi adopted by Sahara involved placing part of the money (about Rs 3,620 crore) of the Rs 20,000 crore collected by the companies through convertible debentures as deposits with the Lucknow branch of ING Vysya and the Khar Mumbai branch of State Bank of India. In the next step, the fund was transferred to the account of Sahara Group Company Aamby Valley Ltd at a Lucknow branch of Punjab National Bank as a loan to Aamby Valley by the other two Sahara companies.

The next step which was the most crucial involved converting the unsecured loan into equity thereby increasing the net worth of Aamby Valley from Rs 841.81 crore as of March 31, 2009 to Rs 6,058.91 crore as of March 31, 2010. As per the foreign exchange regulations, a company can invest in an overseas venture up to a maximum of four times its net worth through the automatic route. Taking advantage of the same, a higher net worth enabled Aamby Valley to remit funds offshore under the automatic route i.e. without any prior permission from the RBI. The transition involved Aamby Valley Ltd, a company registered in India, transferring funds to its wholly owned overseas subsidiary Aamby Valley (Mauritius) which then remitted funds to the Royal Bank of Scotland for acquiring the luxury hotel in London. ED is currently investigating whether the transactions, the fund remittance under the automatic route in particular, have been in violation of foreign exchange regulations.

The whole Sahara debacle thus throws light on the various shortfalls the current regulatory framework in India faces despite the presence of strong regulators such as RBI and SEBI. The need to resolve such loopholes in the regulatory framework through which Sahara was able to sneak the OFCD past all three regulators is important for improving investor confidence within the country. Sahara was caught only because of the DRHP sent by its subsidiary indicating serious problems within the system. There could be hundreds of Saharas lurking in the Indian economy feeding off the grey market. Knowing very well that through this article, we have barely scratched the tip of the iceberg, we hope going forward that stronger regulatory frameworks are adopted within the country in order to prevent similar episodes in the future. ■

The Bull and the Bear debate over the Dragon

The GDP figure of China's third quarter marks its seventh consecutive quarterly slowdown. The fourth quarter GDP at 7.8% (Forecasted) is better than most of the world economies. But compared to its past growth, these are notes of caution. China's tremendous growth streak started in the 90s when its economy opened up for foreign investment and mass privatization. This was brought about because of the capitalist principles introduced by the Communist party. Until recently, China has been an investment-led economy, with investments accounting for nearly half of China's economic output. The outcome of such huge investments in infrastructure is seen in the form of Ghost cities scattered all over China. Realizing this, the Chinese government is taking steps towards correcting and rebalancing its internal economic growth. Post 2001 (when China became a WTO member), it has always maintained trade surplus in its Balance of Payments account. One way it has achieved this is by creating an artificial demand for the dollars in the market by purchasing US treasury bonds and dollars. This led to the devaluation of Yuan which made its products competitive in global market. But currently, due to global politics and pressure from other countries, China is being forced to revisit its growth strategy.

China has been experiencing the slowdown for last seven quarters, but according to recent data, industrial production, retail sales and fixed-asset investment have accelerated, reducing the urgency for added stimulus to support the economy. This has made some analysts believe that the "slowing down" has given way to "bottoming out" of the economy, and the economy may show a moderate rebound in the fourth quarter. While others believe that it's too soon to suggest the end of the slowdown. The article attempts to understand both the views through a dialogue between the optimist (Bull) and the pessimist (Bear)

Bull: There have been recent bullish trends in the Shanghai Composite Index (SCI), the country's benchmark stock gauge. Earlier the index had slumped about 14 percent from last year's high on 2ndMarch on concerns that the government isn't loosening monetary policy or introducing stimulus policies fast enough. But the index gained almost 15% in December 2012.

Bear: "An economy which grows at tremendous pace by constantly devaluing its currency and making its products competitive cannot do so for ever. This puts immense pressure on the internal economy of the country and the people in it. China is known for gross labor rights violations and salaries are low compared with countries of similar standards. Off late, the trend has been changing and China is seeing a rise in labor costs. This has reduced the competitive advantage China had in the global market. The days of double digit expansion are a thing of the past. Net trade is no longer contributing to EAP's growth, but domestic demand is robust in most parts of the region. The global economic slowdown has dented exports. Public spending is no substitute to private investment and monetary easing cannot fix structural problems. Weak overseas demand for Chinese exports and government policies aimed at combating inflation and soaring property prices have combined to slow the pace of expansion. "

Bull: "As usual, you are missing the silver lining. This year 58% of the GDP was from domestic consumption which is orthogonal from previous decade when growth was fuelled by investment and exports. It is a big positive sign. China is finally moving towards a consumption –led growth. When growth is fuelled by domestic consumption, this will increase imports and will result in weakening of Yuan in the international markets which will automatically make their products competitive. It is a zero sum game where the internal economy will also grow and so will be the exports. This is the first step towards the ideal case of having a BoP which is neither positive nor negative.

Measures taken on the monetary front earlier this year are finding their way in credit numbers, and the most recent Purchasing Managers' Indices (PMI) data and data on power and cement production suggest some rebound in activity. Further, the central and local governments have recently accelerated project approvals of their investment projects, and therefore could further support the recovery in investment and activity in the quarters to come. The government is confident of achieving annual targets and the risk of a "hard landing" remains small."

Bear: "China witnessed deep internal power struggle between hard-line leftists and reformers. As the nation waited for once-a-decade leadership transition, the government paused for three months from easing the monetary policy in the world's second-biggest economy. Data showed trade, manufacturing and inflation being mitigated during the third quarter, which definitely slowed the growth story and may have effects in future too. The announced local governments' ambitious investment plans could well face funding constraints. As policy makers try to balance their support for growth with their concerns of a rebound in housing prices and of a reversal of hot money flows from QE3 in the U.S., many see a major fiscal stimulus package as unlikely. Thus, economic momentum is expected to be weak during the coming months with limited policy easing, a property market correction, and faltering external demands."

Bull: The manufacturing purchasing managers' index (PMI) of China was at a 7-month high of 50.6 in December 2012. The fixed-asset investment has also grown by 20.7 percent in 2012. These show the positive growth in China's economy. Though the industrial production growth had slowed down in the second quarter and hit a low of 8.9 percent in August 2012, but it has since been on an upward trend and is at 10.3 percent at the end of third quarter.

Bear: China's growth may still face risks due to the uncertain external demand environment. Though China is now less export-dependent than it used to be, it is unsure whether domestic demand would be able to uphold the country's economy.

The major key to recovery has been the strong and necessary investment in the infrastructure and real estate sectors which is finally showing reviving signs after almost three years of strict controls. Last quarter has been good for sales, with a 32 % rise in the floor space sold in November. The sales figures for Vanke (the largest developer in China) increased by more than 100% in December."

After all this…

It is evident that the Chinese economy has been struggling with GDP growth declining but every economy cannot sustain double digit GDP growth for a long term. Government has been taking steps for revival like cutting reserve rates and fastening the infrastructural development. The point to note is that the domestic consumption in China is increasing steadily. With a bleak situation in the global economy and China being an export oriented economy it is bound to affect the Chinese growth.

Impact of the Chinese Slowdown on other Economies & their reactions

Since China is the largest contributor to the global economic output and growth, amounting to nearly 20% of the world's economic output, any slowdown in China will invariably have a severe impact all over the globe.

China is the biggest importer of commodities. Such economic slowdown in China will lead to reduced imports which will help in stabilizing the commodities prices including the high oil prices. Due to such consequences, countries such as Australia, Brazil, Canada, and Indonesia will be hit the most because they are heavily dependent on commodity exports. But on the other hand, such stable and low commodity prices will help USA and EU to get cheap access to the much needed commodities in such turbulent times.

There are very strong trade links between China and South East Asian countries including Japan. Also, China is the biggest trading partner for Indonesia. Any significant slowdown in China will affect Japan & Korea- the two big economies in Asia. As a consequence, FDI from Japan & Korea will get reduced which caters to a good 11% FDI in Indonesia. Thus, Indonesia will witness a hit in FDI and thereby in economic activities. World Bank informed that every 1% slowdown in China will result in 0.5% slowdown in Indonesia.

Chinese currency also has a significant impact on the scenario. RMB Yuan has remained strong which made the exports unattractive. On the other hand, other Currencies like INR, AUD, etc are relatively weaker in terms of USD. So, it made the exports of other countries attractive, thereby further reducing the Chinese exports.

Exports contribute to nearly 25% of the Chinese economy which is badly affected by their export markets slowdown in US and EU. So, they have started focusing on domestic consumption to continue the high growth path. Also, US and other developed economies are putting pressure on China to improve their domestic consumption which will help the companies from developed economies to sell their products. It will be one of the most important lifeline available for these companies because the demand in their existing markets is sluggish and not showing signs of early recovery. So they need to rely on huge Chinese population, as their consumption level is still a long way to reach its peak. It will give way to revive the US and EU to come out of the ongoing slowdown and recession respectively. ■

Credit Ratings of Nations: Are they Reliable?

Credit rating agencies (CRA) entrusted with the task of assessing the sovereign and company specific risk plays an important role in financial markets by reducing the information asymmetry between the investors on one hand and the issuers on the other.

But how are ratings calculated is a big question. For example, S&P's score is majorly a magnified picture of the following scores: political score -how government institutes and policies affect a country's credit fundamentals; economic score - income levels, prospects of growth, economic volatility and diversity; external score -status of currency during international transactions, external liquidity, external indebtedness; fiscal score - sustainability of deficits and debt burden; and monetary score -ability to make use of monetary policies during economic stresses, credibility of monetary policy. Each of the above mentioned factors is evaluated using a six-point scale from 1 (strongest) to 6 (weakest). These are then combined to form the political and economic profile of a nation and the flexibility and performance profile. Various other risks like business risk and financial risks are accommodated in any one of these parameters. Two key indicators that can give insights about the financial condition of a country are the current account balance (CAB) and the ratio of the general gross government debt to the country's gross domestic product (GDP). The current account balance is the net of the value of exports of goods and services and the imports of goods and services. A negative balance indicates that imports are greater than exports. An extremely high value of imports will indicate that the country's economy is not self-reliant and there is dependency. Moreover for financing these imports the government may need to borrow which would further raise the debt. In an economic slowdown it is the government spending that would act as a catalyst to propagate further economic activity, the ratio of gross government debt to GDP would be even more important in such a condition because the government is borrowing under the assumption that it would invest the same in infrastructure, subsidies and other critical areas so as to gain better returns. However if this translation doesn't happen then the government may be trapped in a downward spiral where it would need more borrowing to support itself and may not be able to come out of it. Thus a high ratio should be treated with caution. Table 1 shows the CAB, Gross government debt to GDP ratio and S&P rating for some countries of the world.

The role of CRA has become even more pronounced after receiving a backing from Basel II which incorporates the ratings from CRAs into the rules for setting weights for credit risk. The credit

Country	Debt in % GDP 2011	Debt in % GDP 2012	CAB2011(bn $)	CAB2012 (bn $)	S&P Rating 2012	S&P Rating 2013 (Jan)
United States	102.90	106.50	-470.37	-524.18	AA+	AA+
India	68.00	67.50	-37.52	-40.80	BBB-	BBB-
China	25.80	22.00	579.75	702.00	AA-	AA-
Greece	160.80	153.20	-38.80	-37.16	CCC	B-
Germany	81.50	78.80	92.90	114.17	AAA	AAA
Portugal	106.70	112.30	-18.73	-18.19	BB	BB
Spain	68.40	79.00	-58.50	-56.88	BBB+	BBB-
Italy	120.10	123.30	-65.77	-66.63	BBB+	BBB+
France	86.20	89.00	-29.83	-30.39	AA+	AA+
Finland	48.50	51.50	2.50	3.51	AAA	AAA

Source:http://www.guardian.co.uk/news/datablog/2010/apr/30/credit-ratings-country-fitch-moodys-standard; http://www.nationsonline.org/oneworld/country-government-gross-debt.htm

risk then directly affects the ratings of the treasury bills issued by the government across the globe which in turn dictates the ease and cost of access to the international capital markets. The importance of these CRAs is magnified when a change in the ratings by these agencies aggravates financial crisis, as in the recent past, thereby contributing to instability in the financial arena and cross country contagion. Such is the power vested with these CRA's namely S&P, Moody's and Fitch. But with great power comes great responsibility. Have these agencies acted responsibly? We doubt, and the article will deal with some of the specifics of evaluation of a security by these CRA's which leads to statistically significant deviations in the ratings done by each of the three CRA's for the same underlying security.

There have been reasonable doubts raised by the financial institutions and academicians around the world over the variances in the rating of a security by the above mentioned CRA's. For ex. the ratings done by S&P and Moody's have more or less the same common determinants except the "external balances" variable that is used by S&P only. Moreover, since all other variables are approximately same there are differences in the weights of the same variables used by these two agencies. Moreover, there are qualitative biases built by the agencies which depend on their outlook of the social and political situation in a particular country.

A further dive into the analysis reveals that there are considerable differences in the credit risk models used by each of the three CRA. For ex. S&P seek to capture only the forward looking probability of the occurrence of default and they fail to provide any results of the expected time or mode of default. In contrast, Moody's and Fitch credit risk models focus on expected loss which is a function of both probability of default and the expected recovery rate. (EL= PD(1-RE)). Fitch goes a step further and uses a more hybrid model wherein analysts are expected to be forward looking and be alert to the possibilities of discontinuity between the past track record and future trends. (Elkhoury, 2008)

The variations in these ratings are explained by a relatively smaller number of variables like GDP per capita, GDP growth, inflation, fiscal and the current account deficit as a percentage of GDP. But notably, approximately 80% of this variation is explained by the single variable i.e. GDP per capita. Probably this is one reason why Mr. P. Chidambaram is focusing more on GDP growth rather than cutting fiscal deficit to a level lower than 4.8% of GDP in FY 2014 from the current level of 5.5% of GDP.

Some rating agencies also seem to be using different scales on an absolute basis. The difference may not be only due to the credit standards adopted but also can be biased due to the sample chosen. It is said that agencies like Duff and Fitch provide ratings when demanded, and if the ratings are not found to be above the average of those provided by S&P and Moody's, their ratings are not even purchased by the entity who had earlier asked them to do so. So, most of the times it is the case that Duff and Fitch end up awarding higher rates to entities as compared to the rates awarded by Moody's and S&P.

Another negative aspect these ratings have on the financial markets is that the downgrading of securities results in aggravating the financial crisis, as was observed during the Asian crisis. Ferri, Liu and Stiglitz(1999) have criticized these CRAs for assigning ratings based on qualitative reasons as these ratings were found to be pro-cyclical and significantly deviant from the ratings predicted by econometric models. Furthermore, several academicians have turned a sore eye towards these ratings as they tend to follow the financial crisis rather than lead them. This leads to an excessive inflow of capital during periods of boom when the ratings are improved and a creation of panic among investors when they are downgraded during bust.

The above highlighted problem is more pronounced for emerging economies rather than the developed ones. For developing nations, tapping external credit market through sovereign credit ratings is one of the main resorts to fund its development initiatives. Moreover, there is a significant effect of these ratings by CRA's on the access to capital markets by these developing nations. An increase in ratings improves the cost of borrowing and a decrease worsens it. A decrease in the ratings worsens the economic condition and aggravates problems for the borrowing country.

The ratings also appear to be a failure when we look at the financial crises in Mexico. The most prominent reason seems to be a mismatch between the stability and accuracy of the ratings. A means to check whether the rating is closer to reality or not has now been created, according to which a rating is a failure if is changes by three or more points within a year.

And since such ratings govern the outlook that outside investors will have towards a particular economy it becomes important for CRA's to adapt measures that make these ratings robust and reliable thereby reducing variances reported in rating of a particular security. An increase in the objectivity of the rating decisions and rationalization and transparency of the criteria used by the rating agencies would not only make these ratings consistent but will also prevent them from contributing negatively. ■

Air India: Quest to save the sinking ship

The Airlines Industry

The airlines industry falls under hospitality sector, which also includes hotels, restaurants, railways, travel agencies etc. The sector contributes 8-9 % of the country's GDP.

The Indian aviation sector has witnessed a phenomenal growth in the last decade. Today, India is the 9th largest civil aviation market in the world and ranks 4th in domestic passenger volumes with a market worth of US $12billion. Though there has been an increase in the passenger volumes and freight traffic over the years, some of the airlines have not been performing well due to various reasons like the economic scenario, operational inefficiencies and fierce competition. Even with the increase in the passenger volumes, the Indian aviation industry has been going through a turbulent phase over the past several years due to reasons like:

- High oil prices, fuel being a prime component of airline costs.
- Increase in competition, thus reducing the impact of increase in volumes.
- Limited pricing power contributed by industry-wide over capacity.
- High debt burden and liquidity constraints.

Air India is Government of India owned airline company. It commenced its operations in the year 1932. Air India has major domestic hubs at Indira Gandhi International Airport, New Delhi and Chhatrapati Shivaji Terminus, Mumbai. Air India initially had a fleet of Airbus equipment to cater to services to domestic and international routes.

Merger between Air India & Indian Airlines

The year 2007 saw the beginning of employee integration of Air India and Indian Airlines, which were finally merged in 2011 to form Air India Limited (AIL). Ever since, AIL has run into deep troubles and dropped to No. 4 from being market leader in the domestic routes in 2001, behind Jet Airways, Spice Jet and Indigo. The merger created an organization with more than 30,000 employees. The employee to plane ratio of 214 was very high as compared to international players like Singapore Airlines and British Airways having an E-to-P ratio of 161 and 178 respectively. The high number of employees coupled with a number of union unrest situations has not helped their cause. Also, it was not easy to integrate the huge work force into standardized HR policies. This has led to six strikes being organized by Air India officials between April'09 and May'12. Due to these strikes, the airlines had to take a huge hit towards the 'customer perceived value' as people started preferring private airlines. A strike carried out in 'May'12-June'12' led to revenue loss for the company that exceeded Rs.350cr. Due diligence on such HR issues was not carried out thoroughly.

Post-merger, AIL has been engulfed with a number of issues which have led to calls from the corporate world as well as from within the government regarding the privatization of AIL.

Financial Woes

Air India currently has a total debt of Rs.44000 cr., 50%of which is short term borrowings for working capital requirement. The airline has run in losses in the last few years with loss figures amounting to Rs.6865cr. and Rs.5552 cr. in 2010-11 and 2009-10 respectively. To add to the woes Air India bought 110 new planes in mid 2000s, which was significant from the strategic point of view but the company didn't have the financial health to spend Rs.40000 cr. Air India accounts for 10% of the total projected losses made by aviation industry in the world whereas it carries only .35% of the total global traffic. Adding to the financial woes is the increase in the operating expenses in the aviation sector. With an increase in ATF prices from around Rs.30000/kl to over Rs.60000/kl from Jan-09 to Jan-12 when ATF costs makes up for around 50% of the revenue, there have been increasingly difficult times faced by this inefficient airline.

To support the financing of Air India, the lenders have agreed for debt restructuring of Rs.18000 cr. high cost debt for working capital, out of which Rs.10500 cr. will be converted into long term debt with a repayment period of 10-15 years and Rs.7400 cr. will be paid back to banks through government guaranteed bonds. As part of the restructuring the government recently has planned to infuse an additional Rs.2000 cr. as equity.

Two Aircraft types

In an era where airline companies are combating for market share and reduction of costs and overheads, operating with only single aircraft-type makes compelling sense. Currently Air India is handling Boeing as well as Airbus which is leading to increased service and ground handling costs. part from this there are HR issues related to usage of two aircraft types. Before the merger, Indian Airlines operated on Boeing and Air India on Airbus and post- merger 43 Boeing aircrafts were delivered. Only Indian Airlines pilots were allowed to fly the new aircrafts and due to this there were apprehensions among the Air India pilots regarding their career growth and this became a bone of contention and reason for continuous disruptions and financial losses.

Is Privatization a solution?

Capital Infusion

Privatization will lead to capital infusion in the ailing company which will help in reduction of the financial woes. Moreover, it has been estimated that the government needs to infuse at least Rs.20000 cr. in Air India till 2020 to keep the airline afloat if the airline remains in government control. Taking into account the fiscal deficit which hovers around 5.2% of GDP, the government is not in the position to infuse such huge amounts of capital with no perceivable gains. Apart from this privatization will help government in raising funds.

Adept decision making

With privatization comes efficiency, as private players have the sole motive of making profits and hence they strive hard to reduce costs by improving operational efficiencies. The major operational inefficiency being faced by Air India is two aircraft types. Once privatization is done the private owners will lookinto ways of converting it into single aircraft type over medium term basis, as the decision making will be fast. This over the medium term will help in decrease in the headcount as the service and ground staff required for single aircraft airline is significantly lower than the two aircraft type airline and will bring the employee per aircraft ratio down to industry norms and hence reduction in costs.

Apart from this upon privatization the top management will strive hard to complete the HR integration at a much faster rate which will make sure that the recruitment and promotion policies are uniform the organization which will help in increase in employee satisfaction and reduction of constant disruptions being currently faced by the airline and hence reducing financial losses.

In the short term when the airline will still be in two aircraft type model the top management of the privatized airline will look into the grievance of Air India pilots of not being given an opportunity of equated career growth and further help in smooth HR integration.

Strong leadership and no political interference

With privatization the major crisis of leadership at the top will be solved which will help in bringing major reforms in the airline to bring it out of continuous decline.

The primary gain that the airline will accrue with privatization is the non-interference of government in the decision making and hence the decision making will be squarely based on the efficient working of the company and profit maximization. With this, a strong decision like discontinuing with non-profitable routes can be taken to reduce financial woes.

Flip Side

It has been highlighted above how privatization will help in bringing Air India out of its financial and operating losses, but contrary side also needs to be looked upon. The Indian aviation industry has been hit hard by the global financial crises and the private players operating in the industry are also finding it hard to operate in the current scenario. Kingfisher, once the No. 2 airline company in the aviation sector, today runs in tremendous amount of financial losses and huge debt has piled up. 4 out 5 private players with exception of Indigo are loss making.

The major reasons that are attributed for converting a booming sector into loss making one are:

- Decreased traffic.
- Increase in operational costs because of high fuel prices and taxes levied.
- Operational inefficiencies in the Indian aviation sector.
- Investment hurdles because of tap on the FDI in aviation.
- Infrastructure woes.

The road ahead

The government has recently allowed foreign airlines to invest in aviation sector up to 49%. Though this gives a minority stake to the airlines, it can still be a boost for cash strapped airlines like Air India and Kingfisher. Also, it gives an opportunity to explore the untapped market of Indian subcontinent. Along with privatization, international players can infuse the much needed funds into Air India. With international expertise, Air India can imbibe a lot of efficient operational practices which can help bringing it out of financial distress and compete with the other private players operating in the country. ■

What's on Your Mind - Split or Bonus?

It's Gotham where the rest of the world wants to be tonight. It's *Bane vs. Batman*. Whoever wins tonight gets to stay, and the loser must leave Gotham forever, gentleman's promise.

[An hour into the fight]

Punches exchanged for punches and more punches. The two men refuse to give up. Bane concentrates all his energy (or as the Chinese call it, '*Chi*') into his fist and lands it into Batman's ribcage. The true hero is on ground fighting for breath. He starts hearing voices, of all unknown sorts. But one sound, as shrilled as a blade rubbing against a metal dish, sounds familiar. *Is this Lucifer talking? Am I dead?*

As he opens his eyes, he looks at the clock. Its 4 am. He is in Gotham but in a parallel universe, Bane still has those muscles, but it is more of fat and more importantly Bane is a "she", Money's wife. With his ribcage still paining, he now knows where the punch had come from. *"You deserve it"*, the bane (pain) of his life (wife) yells.

Fault is not hers' but of their neighbors' Mr. Jhun Jhun and family. They are buying a new car and they say it's because of the money they have recently earned by selling shares of *Apna Sapna Ltd. (ASL).* ASL had issued 3:1 bonus shares in early 2012 and within a year, the stock price had more than doubled. Mr. Jhun Jhun and his wife made a killing out of selling those shares. Pain has ensued for Mr. Money Ratnam as his wife is fuming,

© Vivek Pandey, PGP 2012-14, IIM Udaipur

"What the hell is this Bonus? You never got a bonus on your job, and those Jhun Jhuns have got a bonus on shares. How do you explain that?" Money knows that he must find the right answers or forget about living peacefully. He invites his wife over a cup of coffee in front of the BSE Towers on Dalal Street. For the sake of their marriage he also knows that he must be the first person to tell her about stock splits, before she wrongly infers the usual gains from splitting.

Getting into the grove, he wears Batman's raspy voice and explains:

"When a company issues shares to its shareholders in addition to their current holding, it's called a bonus issue. A 3:1 share bonus issue means that for every one share one holds, one gets 3 bonus shares for free". Mrs. Money asked, *"Does that mean that the company quadruples its market capitalization by issuing 3:1 bonus shares?" "No"*, answered Money, *"The market cap remains constant. The market adjusts the share price be-*

cause it does not want to reward a company just for issuing bonus shares." "Then why do companies issue bonus shares?" she asked. *"Well, the reasons are manifold. Theoretically, even after a bonus issue market cap remains constant. But that may not happen in reality. With bonus issues, liquidity of the stock increases, and thus the trading volume can increase. With this increased liquidity, it offers an opportunity for the stock price to go up."* Mrs. Money is impressed, *"That sounds interesting. So, who bears the cost of bonus issue?"*

"A company that wants to issues bonus shares converts some part of its reserves available on its balance sheet into Share Capital. Unlike dividends this is a non-cash conversion", said Money. *"Let me explain you with examples. Within one year after the bonus issue, the stock prices of the following companies increased: Mahindra & Mahindra (year 2005, gain 81.9%), ONGC (year 2006, gain 51.2%). But bonus issue is no elixir; it can also be followed by dip in stock prices that are not explained by bonus issues. For example, Siemens (year 2008, loss 72.9%) and HCL Technologies (year 2007, loss 19.6%)."* Mrs. Money concluded *"So don't' just look at a bonus issue and go bullish. Value the stock first and then be concerned about bonus issues". "Smart one you are!"* Money beamed.

"So now let's talk about Stock Split. What do you think the name suggests?" asked Money. *"Looks like instead of issuing extra shares, a share is split into parts."*

"Well, you are on the right track. A stock split is exactly like splitting a share into equal parts. A 1:1 stock split means that a share now is split into two equal shares and the face value of the shares also is halved." "So does market adjusts the share price now, the way it did in bonus issue?" asked Mrs. Money. *"Bang on, it does. The primary reason for a company to split its stock is to increase liquidity of its share in the market. Typically when the a company's stock price reaches levels that may discourage retail investors to buy its shares, the company can split its stock whereby the market adjust the stock price to reflect the split and theoretically, keeps the market cap constant. But with the increase in liquidity a lot of retail investors are now ready to buy these shares, and thus the stock prices may go up. Remember "may" is the catch here."*

"Who bears the cost and does it impact the share capital?"

"The share capital remains the same as only the number of shares outstanding increase, but the total share capital per se. And yes, it is a non- cash conversion"

"Which one is better?"

Money thought of concluding this whole gyan session *"As an investor into a stock that is about to be split or a bonus is being issued. Don't judge the stock only by this. In the short run, the stock price may be affected positively or negatively by split or bonus. But in the long run, look at the fundamentals of the company. Don't base your decision on stock bonus or split."*

With that, Money can go back to sleep tonight and live his alter-ego in Gotham. *Bane* has just been defeated. ■

VC Industry in India: Interview with Sanjay Anandaram

Mr. Sanjay Anandram is a venture capitalist, entrepreneur and founder of Jumpstart VC Fund. Team Finomina got the opportunity to interview him and talk about the VC industry in India.

Following are the excerpts from the interview:

Q. What are the current opportunities in India for VCs to capitalize on?

Given the fact that India is a developing economy and entrepreneurship is gaining ground, it presents myriad opportunities for VCs to identify budding entrepreneurs. If I have to pick up the preferred sectors then opportunities in India are mainly around the locus of consumer spends - education, travel, entertainment, hospitality, healthcare, financial services etc.

India is a growing secular economy with favorable demographics and increasing aspirations. There is massive unmet demand that creates ample opportunities for entrepreneurs to provide innovative solutions which in turn creates lucrative investment opportunities.

Q. What are the challenges being faced by VCs in investing or exiting from start-ups in India?

Actually, very few Indian startups are addressing unique problems; most are copying models from overseas. Finding good management teams and finding exits is a challenge that most VCs face. But, these are problems that will significantly reduce over a period of time.

Data compiled by Venture Intelligence, a leading research company on the Indian VC/PE industry, shows that over a 12 year period (i.e. 2000 to 2012), only 158 VC and PE backed companies had an exit, including partial exits. Of these, only 20 companies exited via an IPO while 138 saw investors exit fully or partially via M&As. The median age of the companies at exit was about 8 years, companies were about 4 years old at the time of investment and had raised a little over USD 6 million at the time of exit. To cite examples of encouraging exits, Naukri.com was set up in 1997 and went public in India in 2006, MakeMyTrip.com was founded in 2000 and went public in the US in 2010; similarly, JustDial was founded in 1996 and is likely to go public in the near future. It would be almost cruel to compare these numbers with numbers and examples from a highly evolved ecosystem like the US and I will therefore desist from doing so.

The Indian market is still maturing – internet penetration, credit card availability, logistics, access devices, formats, familiarity, laws and the like are still a work in progress. Hence – customer (those who pay!) adoption cycles are long and expensive. The M & A market isn't friendly particularly for young companies; Getting to an IPO is a marathon. And investors need to make a return on their investment in a reasonable time frame, usually 5 years or so. If it takes longer than this to exit and if exit valuations aren't attractive relative to the entry valuation, investors will, naturally, be very hesitant to invest. Exits in turn are related to the financial performance of a company which in turn is a function of the market and customer growth.

Q. Why are some VCs successful while others aren't?

The VC arena has attracted many players who are looking for high returns on investment. However, not everyone has been successful here. The attributes that set apart successful VCs from the rest are disciplined approach, sector specific knowledge, risk taking ability, speedy execution, and the ability to find a "good" entrepreneur.

Though it's a difficult task but by being in the path of many entrepreneurs through events, seminars, referrals, alumni & industry networks, etc. VCs try to identify promising ideas early. Having said that, this exercise is not completely objective and occasionally depends on the VCs past experience within a particular sector.

Q. How can investors leverage the great deal of unrealized value inherent in their start-up investments?

The ecosystem has to develop for M&A, secondary market, financing, etc. While the entrepreneur may want to bequeath the company to his/her next generation, the investor unfortunately doesn't have the same luxury of time, bound as they are by return expectations. While recognizable sets of investors are lining up along different points of a startup's life cycle – seed to growth – the pipelining of startups towards an exit is still a long way off. Market and customer growth, management talent, the right kind of intermediary support system – lawyers, accountants & bankers, creation of stock exchanges that can support small companies and the sophistication and risk appetite of public market investors, all need to come together for the entire entrepreneurial story to be told in 70mm! It is therefore good to see the SME exchange as a welcome incarnation of a 20 plus year old initiative, the OTCEI of 1990!

Q. What are the financing options that are available for start-ups in India? How do they go about choosing one?

There are many financing avenues available like Angels, banks, friends and family, Government schemes, VC/PE funds, etc. Start-ups have to choose depending on a host of factors - collateral, cost and time to access, amount, company type, ownership & control, financials, etc. With regard to what kind of entrepreneur an investor should select, different investors are adopting different strategies. It is important therefore for entrepreneurs to be aware of these approaches.

There's the "spray and pray" approach where investors put in small sums of money (anywhere from Rs 5L to 25L) into an unmanageably large number of companies (30 to 100 companies). It isn't humanly possible for investors to "add value" in such a situation so the "market" and the entrepreneur are relied upon to get the company noticed downstream. Some investors adopting this approach have a large support infrastructure to help filter the companies upwards.

Then, there's the "let's leverage the brand and capital muscle to get in on the category leader" approach. Here, funded companies that have already gained traction, are emergent or clear leaders in a category are approached with a hard to refuse offer. The capital + brand get the investor in the door into the best deals, valuation isn't much of a discussion, speed of deal closure is impressive and before long, such investors have yet another winner in their portfolio.

Third, are the pure financial investors who invest based on numbers. No soft warm fluffy stuff on display here. Just the cold hard calculus of returns. Financial engineering, management team engineering, deal making, packaging of the company for an exit are parameters that differentiate these.

Yet another investor is the one who empathizes with the entrepreneur, who sees himself as a company builder first and foremost. Such an investor attracts attention from the entrepreneur seriously wanting to build a company as opposed to one seeking valuation. There's a lot of hard work, tough decision making and involvement here without any guarantee of success. Unsurprisingly, this kind of investor is in a minority amongst the larger pool.

Then there are the opportunistic investors who are recent entrants, driven by the possibility of making supernormal profits, but without really understanding what investing or company building from scratch is all about. These investors have made money in sectors that are far removed from the areas they wish to invest in and tend to have less than complete understanding of the private company investment process. Sometimes, flexible governance standards are also on display. They become queasy at the first signs of trouble in the company.

So, as an entrepreneur what should you do? Ask yourself what stage of the life-cycle your company and you are in, what kind of investor you want to have on your side with regard to the understanding of the business, approach and chemistry, and what exactly do you want to do (e.g. building a company or looking to get a quick exit). Because raising money from an investor isn't the end point. It is the starting point of a long hard journey towards your dream. There's no right or wrong or good or bad answer. The answer depends on what you, as the entrepreneur, wish to achieve, how you wish to achieve your goals and what you are willing to sacrifice and undertake. ■

Aditya Arora
Ajith Pancily
Amrita Kumari
Arun Kumar P
Kunal Kochar
Manish Jain
Prateek Shukla
Pranav Gupta
Vivek Batra
Parikshit Kapila
Shikha SIngh
Vinay Tejaswi
Sravan Kommuri
Tanmay Mahale
Koshika Sharma

Aditya Raghunath
Aman Agarwal
Anusha Ganne
Khusboo Goyal
Mamta Bansal
N. V. Niveditha
Rahul Agarwal
Ratika Mittal
Saurabh Jain
Shiv Marwah
Swati Arora
Vivek Pandey
Varun Mediratta
Vipin Sreekumar
Abhinandan Ghosh

FINANCE CLUB OF IIMU

Indian Institute of Management Udaipur

For suggestions or queries
Feel free to write to us at: finomina@iimu.ac.in
Visit us at: finomina.iimu.ac.in