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Seizing the India opportunity

AJAY SRINIVASAN

We must leverage our high savings rate.

Between January 2011 and December 2012, India went on from being the BRIC nation with the highest growth potential over the next 50 years to the danger of losing its investment-grade credit rating.

Undoubtedly, fiscal 2012 was a difficult period for India: the economy was in the grip of a downturn with polity paralysed and markets depressed. Nonetheless, as with most things about India, for every pessimistic view, an opposite and equally credible view exists.

While many believe that the potential growth rate of the country has fallen considerably, others believe in the structural positives and that the real India story has only begun to unravel. India, these optimists would point out, is the third largest in the world in terms of gross domestic product based on purchasing power parity, according to data released by the IMF.

Buoyant capital markets are important for financial intermediation. — V. V. Krishnan

Not only is India's growth still attractive relative to a slowing world, India's saving rate at 32.3 per cent at the end of March 2012 is quite high from a global perspective. However, both sides will agree that India needs 7-8 per cent growth if we have to pull our people out of poverty.

FINANCIAL PLANNING

The financial sector plays an important role in channelising the savings in the economy to borrowing entities, thus driving economic growth. All over the world, financial deepening or an increased choice of financial products, accompanies and leads to rapid economic progress. Compared to other emerging economies, financial services in India remain significantly under-penetrated.

Only 40 per cent of India's 1.2-billion people have bank accounts. Of India's 600,000 villages, only 30,000 have direct access to banks. Penetration of other financial services products such as life insurance, mutual funds, brokerage accounts, and so on, will show even lower penetration levels compared to many other markets.

Indian investors rightly expect positive and reasonably safe real returns from their investments. The macro situation in India of high inflation and slowing growth has meant that savings have found their way from financial to physical savings. The latest report by the World Gold Council states that Indian households have amassed as much as 20,000 tonnes of gold worth $1.16 trillion. Real-estate demand continues to grow at a robust pace. In fact, the financial planning followed by most Indians is to buy gold for their children's education and marriage and a home for retirement.

If we are to leverage the high savings rate we have as a country, then these savings need to be channelised into forms that have the highest multiplier effect on the economy and those tend to be financial savings. Turning the trend and getting money into financial assets though, is going to mean positive real rates of return and a buoyant stock market.

DISTRIBUTTON MODEL

Over the last few years, rapid and considerable regulatory changes have altered the landscape for sectors like life insurance and mutual funds. The biggest impact has been on the distribution model in both sectors.

In 2011-12, lending businesses outperformed fee-based businesses. Banks and non-banking financial companies (NBFCs) had another good year. Book sizes grew in excess of 20 per cent and profits of 24 major NBFCs in 2011-12 rose by 24 per cent as compared with 16 per cent for banks. On the other hand, total new business premium of life insurance companies in the country declined in 2011-12.

The mutual fund industry saw its total asset base shrink by about 5 per cent in 2011-12. The drop in high-yielding cash market volumes sharply affected the overall equity brokerage revenue pool that declined significantly in FY-2012. During the first three quarters of the last fiscal, according to some reports, three lakh agents quit the industry.

POLICY CHANGES

Simultaneously, the mutual fund industry, according to reports, saw about 40 per cent reduction in distribution, mainly of Independent Financial Advisors (IFAs).

In a country like India, reaching the retail masses and ensuring a viable business model for the distributor is essential if we are to channelise savings to investments to fund our growth. If distribution shrinks or gets skewed to one channel, then the interests of the very customer we are trying to serve will not be achieved.

To realise the potential of its long-term prospects, India has to take policy measures to win back investor confidence. We need to kick-start investments again and that will require positive policy action and lower interest rates.

Funding this investment is going to require us to get domestic savings through the right channels to be able to reach the borrowers. A number of reform measures have recently been unleashed.

If we can unleash the power of continued reform and leverage the many advantages we have as a country, there is no stopping India from becoming one of the most attractive investment destinations in the world. Let us in 2013 look towards re-launching the India growth story!

(The author is Chief Executive – Financial Services, Aditya Birla Group.)