Reduce cost, restore profitability

It is imperative to reorient fertiliser policies to facilitate development of innovative and situation-specific products

FARM VIEW

SURINDER SUD

Incredibly, as much as 70 per cent of the farmers' investment in fertilisers normally goes waste. The reason is outmoded fertiliser products and their inefficient use. In the case of urea, the largest consumed and the most heavily subsidised nitrogenous (N) fertiliser, between 50 and 70 per cent of the applied material is generally lost due to leaching, volatilisation and other causes. In other words, only 30 to 50 per cent of it is actually gainfully utilised by the crops. The fate of phosphatic (P) fertilisers, which are costlier than urea, is even worse. The wastage is as high as 70 to 85 per cent. The loss of potassic (K) fertilisers is, however, relatively meagre, at 20 to 30 per cent, though even this is not insignificant.

In monetary terms, the cumulative losses to the farmers in fertiliser usage come to nearly $7 billion. It includes the loss of $4.2 billion in urea and $2.7 billion in phosphatic fertilisers. These numbers are reported by the National Academy of Agricultural Sciences (NAAS) in a strategy paper, brought out in February 2019, titled "Development and adoption of novel fertiliser materials". This paper holds paucity of research and development (R&D) in the fertiliser sector, cumbersome procedures for the approval of new products and flawed subsidy regime responsible for discouraging the development and commercial production of more efficient and less wastage-prone fertilisers. Barring neem-coating of urea, hardly any other significant innovation has been carried out in this sector to mitigate nutrient losses.

Indian farmers use the same fertilisers today that they were using decades ago. In contrast, farmers in other countries now have a range of new fertiliser products to choose from. These are highly efficient in delivering nutrients to the plants in the right amount and at the right time. The nitrogenous fertilisers sector has witnessed the introduction of the largest variety of such innovative slow nutrient releasing formulations. The wastage of these fertilisers is relatively low. Novel and efficiency-enhanced products of phosphatic and potassic fertilisers, though fewer in numbers, are also quite effective in curbing nutrient losses.

India takes pride in having one of the world's largest agricultural research networks engaged in the R&D of almost all major aspects of agriculture. But there is yet no research facility devoted exclusively to fertiliser technologies and development of new and better fertiliser products suited specifically for local soils and agro-ecological conditions. This lacuna is reflected also in the low number of patents for innovative fertiliser products. In the past 20 years, only 176 patents have been awarded and only 110 more applied for in India. A sizable number of patent holders and applicants are the foreign companies. What is worse, most of these new and patented products, including the much-needed nutrient mixtures, have failed to hit the market for want of necessary approvals for commercial production, sale and field use. "Almost no fertiliser in India is a patented product (with the exception of only zinc polyphosphate)", laments the NAAS paper.

This aside, the ill-advised policy of limiting the nutrient-based subsidy to only a few selected fertilisers is proving to be a formidable hurdle in the introduction of innovative, efficient and situation-specific fertilisers. Without fiscal concessions, the new products cannot compete with the subsidised old, outmoded and wastage-prone fertilisers. The customised fertiliser products, which some manufacturers had begun to produce, failed to thrive in the Indian market for this reason. Sulphur-coating of urea to overcome the widespread deficiency of this micronutrient in the Indian soils was also a victim of this policy deficiency.

Thus, the entire gamut of policies governing the fertilisers sector needs to be revisited. It is imperative to reorient the policies to facilitate development of innovative and situation-specific fertilisers capable of releasing nutrients according to the requirement of the plants. Such products would help minimise the wastage and optimise the gains from fertiliser use. Reduction in input costs is vital to restore the profitability of agriculture that has been severely eroded.

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CHINESE WHISPERS

Nath's optimism

After many early hiccups, Madhya Pradesh Chief Minister Kamal Nath (*pictured*) appears upbeat and not without reason, He told his partymen recently that the Congress would increase its strength in the Assembly with two-three more MLAs. He is pinning his hopes on winning the Pawai Assembly seat, which fell vacant recently. The Madhya Pradesh Assembly Secretariat announced disqualification of the Bharatiya Janata Party MLA from the seat, Prahlad Lodhi, following his conviction in a criminal case. It also informed the Election Commission that the seat was vacant and so a by-poll was in order. Recently, a Bhopal court sentenced Lodhi and 12 others to two years in jail for attacking a tehsildar (revenue official) in 2014.

United we oppose

Opposition parties plan to protest against the Centre over the continuing economic slowdown, in and outside Parliament. The 13 Opposition parties that met on Monday at the Constitutional Club in Delhi discussed issues related to the economy and the implications of India's stand on the Regional Comprehensive Economic Partnership. The meeting was convened by Ghulam Nabi Azad, who is the leader of the Opposition in the Rajya Sabha. It was attended by Ahmed Patel, Randeep Singh Surjewala, and R Shukla of the Congress, D Kupendra Reddy of the JD(S), the LJD's Sharad Yadav, the DMK's TR Balu, Manoj Jha of the RJD, and the TMC's Md Nadimul Haque, among others. Notable absentees were Congress President Sonia Gandhi and NCP chief Sharad Pawar. There was no representation from the Samajwadi Party, the Bahujan Samaj Party, and the Aam Aadmi Party.

Odd-even spooks metro

On the very first day of the odd-even passenger vehicle scheme in Delhi, metro rail services at Laxmi Nagar station were affected as a huge number of passengers gathered at the station to board trains to various destinations. Due to the rush, the door of one of the compartments in a train would not close, forcing the train to be stopped for about half an hour. The odd-even scheme is one of the many steps taken by the Delhi government to control air pollution in Delhi and adjoining areas. The scheme will remain in place till November 15.

Why the world needs cut-backs in steel

China's contention that the goal of curbing overcapacity in steel has been achieved is only partially true and doesn't bode well for India

KUNAL BOSE

China was the only voice of dissonance at the recent Tokyo conclave of Global Forum on Steel Excess Capacity (GFSEC), where it remained inflexible in its demand for its dissolution. Beijing's stand is based on the specious ground that in the three years since the constitution of GFSEC, the Chinese steel industry has undergone some radical transformation and the goal of curbing overcapacity that periodically causes global steel prices to fall, eroding the margins of steelmakers everywhere, is largely achieved.

One doesn't have to look beyond China, which alone makes more than half the world's steel, for an appreciation of how badly the industry is now faring.

Commodities insight provider Platts says rebar margins in China during July-September quarter were sharply down to $29 a tonne from $153 a tonne in the same period of 2018. To go by World Steel Association (WSA) statistics and its short range outlook published in October, Chinese steel demand, particularly from the construction sector, has remained at a fairly high level since last year. China, according to the WSA, is likely to end 2019 with steel use of 900.1 million tonnes (mt), a rise of 7.8 per cent over last year's 835 mt when demand growth was 7.9 per cent. But WSA forecast that steel demand growth in China will recede to just 1 per cent to 909 mt in 2020 is causing concern to the rest of the world industry, including ours, since crude steel production in that country continues to grow rapidly.

In the first nine months till September, China's steel production was up 8.4 per cent to 748 mt from 691 mt in the same period of last year. The point of concern of Indian industry officials is, the supply there is already in excess of demand. Baneful consequences of overcapacity in the world's largest producing country would already have been visible in the form of exports of low-cost steel products—made possible by large addition of technologically advanced capacity and hidden subsidy— had it not been for the consumption strength displayed by the property construction sector.

While this is so, experts believe demand for steel from the construction sector is due to fall next year. At the same time, signs of recovery of the manufacturing sector, specially the automobile industry are still not visible. For now, China's steel exports are down 5 per cent to 50.3 mt in the first three quarters of 2019. But it may not be long before the country emerges as an aggressive seller of steel products in the world market, either directly or via south-east Asian countries. Trade tensions with the US and the European Union will lead China to target countries such as India where the use of the metal is to register a growth of 5 to 6 per cent in spite of economic downturn to leave its surplus steel.

Our steel minister Dharmendra Pradhan delivered a warning at the GFSEC meeting that unless "suitable corrective measures continue to be taken," the industry might once again lapse into a crisis, created in no small way by excess capacity. This is rightly seen by many as a counterpoint to Chinese argument that the forum having achieved its "mission" should be dissolved by year-end. Why GFSEC remains relevant is aptly summed up by Pradhan: "The forum has in a unique way enabled information sharing among steel producing countries. This in turn is enabling formulation of policies for improvement in working of the global steel industry. Members' willingness to exchange data on steel capacity and all the direct and indirect support for steel is benefiting the industry as a whole."

China's strident opposition to extend the term of GSEC beyond 2019 contradicts ground reality. It is no one's case that the industry, more relevantly in China because of its gargantuan capacity has not undergone any transformation since the 2015 crisis, when global excess capacity at 700 mt was at its peak. That is now down to 400 mt. But this is still nearly four times India's 2018 steel production of 106 mt. Whenever steel prices are at a level that threatens the viability of the industry, the accusing finger is invariably pointed at China. This is because any time the Chinese industry faces excess production it leaves the surplus in the world market at prices proving injurious to steelmakers in other places. For example, China's record exports of 112 mt in 2015, which was more than what Japan, then the world's second largest producer made that year, invited strong protests from steelmakers in the US and EU, blaming burgeoning overseas shipments from the Asian nation for the deep steel crisis.

Global outrage left China with no alternative but to rein in steel exports since 2015. Even then, the country exported 68.8 mt last year. Where, however, China can claim credit is in its carrying out a multi-year programme of shuttering old, inefficient and polluting steelmaking capacity. This, however, does not mean that the country is ridding itself of excess capacity. Beijing is allowing new capacity creation on a replacement basis, that is, a new unit in lieu of a pulled down plant. As a result, says a Platts report, the country will have its net crude steel capacity expanded by 37.65 mt a year over 2019-23, of which as much as 34.88 mt will be commissioned this year itself. New capacity building in place of the old will make China the owner of a 1.2 billion-tonne steel industry. The new Chinese mills being embedded with most modern technologies are capable to make a lot more steel than their nameplate capacity.

India, which recently replaced Japan as the second largest steel producer, is on a massive capacity building drive. In the next one decade, the country will strive to commission 160 mt capacity to own a 300 mt industry. Pradhan gave assurances to GSFEC delegates that like in the past, the country would not contribute to global overcapacity as the new planned capacity was aimed at raising our per capita steel use from 72 kg to 160 kg by 2030-31, which is, however, much lower than the present world per capita average of 212 kg. No doubt, if the country is able to spend $1.4 trillion in infrastructure development in the next five years, then the steel intensity of our economy will get a boost.

ON THE JOB

Unemployment rate a poor indicator

The rising unemployment problem is only one half of the problem, possibly a simpler one than that of low labour participation rate

MAHESH VYAS

The unemployment rate in India rose to 8.5 per cent in October 2019. This is the highest unemployment rate in over three years — highest in 38 months to be precise.

India is reverting to the high unemployment rates that were seen during the first three quarters of 2016.

But the high unemployment rate being experienced in current times is at a much lower labour participation rate than was experienced during 2016. A far smaller proportion of the working age population today is participating in the labour markets than the proportion three years ago. And, even these relatively fewer people are not finding jobs at the same rate as witnessed in 2016.

The high unemployment rate therefore being witnessed today is not only the highest in three years but is far more debilitating for the economy than the similar unemployment rates witnessed in 2016. The unemployment rate alone does not adequately reflect the stress in the economy and in particular in the labour markets.

A low labour participation rate implies that fewer people are willing to work. In 2016, 47-48 per cent of the working age population was willing to work of which, 8 per cent could not find jobs. Today, only 43 per cent of the working age population is willing to work and of these again, 8 per cent cannot find jobs.

This means that the economy is able to provide jobs to a smaller proportion of the working age population. Jobs haven't shrunk between 2016 and 2019, but the proportion of working age people who are employed has shrunk. This proportion — of the employed to the working age population — is called the employment rate.

The employment rate is a better reflector of the health of the economy than the unemployment rate.

The unemployment rate is a ratio of the unemployed to the working age population that is willing to work. It therefore considers only a part of the working age population — the part that is willing to work.

The concept of unemployment is important to deal with a limited problem -- that of the openly unemployed. It tells us how much investments need to grow to absorb labour that cannot find jobs. An 8 per cent open unemployment rate is high which requires urgent attention. And, in this respect it is worrisome that investments are not growing.

But, a bigger problem is of the larger numbers who should be looking for work but are not. It is important to restate the labour markets problem in India. It is about increasing the low labour participation rate and also reducing the high unemployment rate.

The rising unemployment problem is only one half of the problem, possibly a simpler problem than the problem of low labour participation rate.

The employment rate, which is a better reflector of the economy's health, was 39.5 per cent in October 2019. This is among the lowest employment rate recorded since January 2016. The employment rate has been falling steadily since 2016 when it averaged at about 43 per cent. By August 2018 it had fallen below 40 per cent. Since then, the rate has been largely below 40 per cent. But, it hasn't been falling much below this. The average employment rate between August 2018 and October 2019 was 39.8 per cent.

It is imperative that the employment rate rises. The unemployment rate is an inadequate measure. When the unemployment rate was at its lowest level in July 2017, the employment rate was not correspondingly high. In fact, it was lower than its earlier levels.

The inadequacy of the unemployment rate is evident from this simple comparison of the rate in July 2017 with its earlier levels. In July 2017, the unemployment rate was 3.4 per cent. This was less than half the 9.7 per cent rate over a year ago in May 2016. It was also significantly lower than the 4.1 per cent unemployment rate a month ago, in June 2017. However, such a sharp fall in the unemployment rate did not improve the employment rate. The employment rate in July 2017 at 42 per cent was lower than it was a year ago and also a month ago.

Perhaps, it makes a lot more sense to use the monthly employment rate as a leading indicator of the health of the economy. Since this indicator is derived from households it covers all sectors of the economy — the organised and unorganised, large, medium, small and micro organisations, formal and informal employment, etc.

Finally, what matters is employment not unemployment. Next, what matters is wages and wage rates. We will get to these measurements soon.

The author is the MD & CEO of CMIE

LETTERS

Focus on exports

This refers to "WTO backs US in trade dispute, says India's export subsidies illegal" (November 1). The ruling by the World Trade Organisation (WTO) in a critical trade dispute that India must stop all its export promotion schemes — as, under the WTO rules, these are reserved only for the poorest countries or those with a per capita income of less than $1,000 -- is along expected lines and doesn't spring a surprise. While our country could prevent the implementation of the WTO ruling by appealing against it in WTO's appellate body, we should not be oblivious to the fact that despite the existence of such export promotion schemes, our exports have not improved and we have continued with our dismal performance. That our country's merchandise exports have barely improved in the last five years is a case in point. It is time the government addressed the issues afflicting the competitiveness of the countrys exports without any delay considering its huge impact on the country's economic growth.

M Jeyaram Tamil Nadu

A(ir)pocalypse Now

Air pollution has made our cities less safe and less liveable and has earned them the epithet 'gas chambers'. Breathing the polluted air in the affected areas is said to be equivalent to smoking more than 30 cigarettes a day. Victims of air pollution are de facto chain smokers. The WHO has rightly described air pollution as the "new tobacco". Breathing polluted air shortens life expectancy. Clogging up of the windpipe or trachea and lungs with particulate matter causes irreversible damage to the respiratory system and, by extension, to the entire body. The correlation between air pollution and various medical conditions is well documented. The vulnerability of children should add a new urgency to the fight against air pollution. The importance of securing the future of our children should galvanise bickering politicians into seeking remedial action.

Air pollution is a man-made crisis with unfavourable meteorological conditions making only a minimal contribution. It has resulted from bursting crackers, burning crop stubble as seen by us and NASA satellites (successive governments have failed to make cultivation in Punjab, Haryana and Uttar Pradesh scientific and sustainable and offer help to get rid of agricultural residue without farmers having to burn the crop stubble), garbage burning, road dust, exhaust fumes from vehicular traffic ("odd-even" rule certainly reduces the number of cars on the roads and the level of pollution and hence is a good thing), reckless construction work (₹1 lakh fine now imposed by the Supreme Court should halt it), old power plants, overuse of air-conditioners and so on. The soaring sales of face-masks, air purifiers and related medicine are a fallout of the very alarming Air Quality Index (AQI) levels leading to the declaration of public health emergency.

Clearly, we have brought it upon ourselves. While we become wiser after an event, we are also prone to relapsing into our bad old ways once things improve a bit.

G David Milton Maruthancode

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HAMBONE

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An inward turn

India's decision to not join RCEP will have adverse implications

India has decided not to join the Regional Comprehensive Economic Partnership — at least for now. The 15 other nations in this new trading bloc, consisting of the Association of South East Asian Nations and other countries with which it has trading links including Australia, New Zealand, Japan and Korea, have come to a satisfactory conclusion of their negotiations, and will be moving forward to operationalise the pact without India. This is not the conclusion that anyone could have wished. It is unfortunate that a major reconfiguration of the trade architecture is taking place on India's doorstep and it is unable to join in. In fact, it reflects poorly on successive governments' inability to raise the competitiveness of Indian industry leading to fears about the consequences of joining the RCEP. This is unfortunate as there were clear benefits of open trade with such a large proportion of the world's population and GDP. Despite the concerns, the government should have taken into account the deeper strategic pitfalls of walking out of the talks. The country risks being cut out of the rule-making process for the RCEP and give China further space in the regional trade and security architecture.

There was some acrimony connected to how the issues played out, with the state-controlled Chinese media in particular claiming that India had raised new concerns at the last minute, an allegation that was forcefully denied by Indian government sources. The prime minister himself insisted that India had participated in the negotiations in good faith, and its eventual exclusion was determined by the Gandhian principle of ensuring that the poorest be benefited by every policy decision. But the truth is that greater openness to trade would certainly have benefited the poorest by raising their ability to buy goods produced at competitive prices. The issue was, in the end, the protection of Indian industry and the fate of services trade, in which India believes it has a comparative advantage. Certainly, there is no reason to suppose the blame is not shared for this outcome. India's concerns about rules of origin and the non-market nature of the economy of the People's Republic of China are entirely warranted, and there should have been greater effort made by the other 15 countries to take these legitimate issues on board. The final going statement by the 16 leaders was more conciliatory, noting India's outstanding issues and saying that India's joining the agreement would depend upon how the other countries managed those issues going forward. But it is not clear under what circumstances that additional negotiation would take place, or if indeed all energy has gone out of the effort now.

While many producers in India, particularly in vulnerable sectors like dairy, might draw a sigh of relief, this is overall a welfare loss for India and one that will hurt the economy increasingly over time. It is now clear that the government has turned protectionist — recent optimistic statements about the perceived gains from RCEP by senior officials and ministers have turned out to be belied. Nor is the Opposition better, since the Congress Party, for example, was very harsh on the prospect of signing the RCEP — an agreement that its own government had taken the initiative to begin in 2012. Instead of seeing RCEP as an opportunity to conduct competitiveness-enhancing reform at home, the Indian political class has instead decided to turn inward. Future generations will rue this shift.

Protecting privacy

Pegasus has exposed systemic vulnerabilities

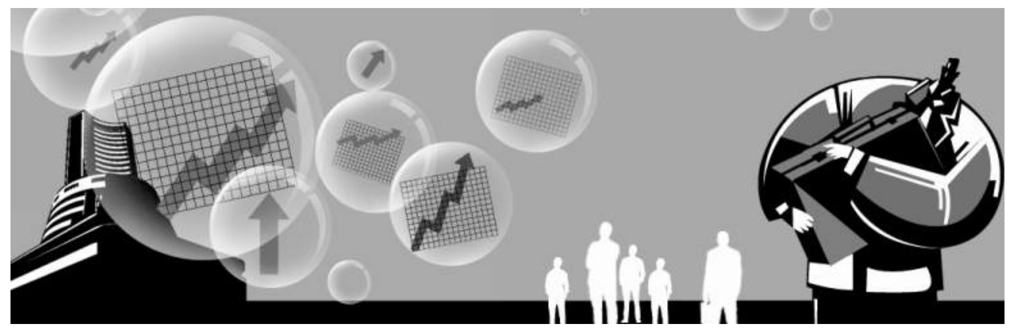
The revelation that an Israeli company illegally installed surveillance software on the mobile devices of at least 121 Indians has highlighted long-standing problems with India's data-protection and privacy laws. The Instant messenger, WhatsApp, which is a subsidiary of Facebook, has sued the Israeli company, NSO Group, in a US court for exploiting a vulnerability in the messenger app to clandestinely install surveillance software, Pegasus, which monitors, logs, and transmits more or less all activity on the infected mobile phone. This vulnerability allowed Pegasus to be installed by simply giving a missed call on WhatsApp. Over 1,500 people are said to have been infected worldwide by Pegasus. WhatsApp claims that the intrusions occurred during April-May this year, and that it has since patched the vulnerability.

On its part, NSO claims that it sells its software only to government agencies, which further complicates the issue. A glance at NSO's client list does suggest its clients are mainly government. Pegasus software and associated monitoring services are very expensive and it has been sold to the governments of Mexico and Egypt, among others. The list of targeted Indians includes many well-known civil rights activists, lawyers, journalists, and politicians. Since this was the period when India was conducting general elections and a substantial number of the named targets are either members of the Opposition or individuals who have had run-ins with the government, conspiracy theories are inevitably doing the rounds.

The Indian government claims that WhatsApp has not clearly spelt out the vulnerability and used "technical jargon" when it informed the Indian Computer Emergency Response Team and other government agencies about the security issue in May. The government has now convened two parliamentary committees to investigate the issue. More details are likely to emerge as the case is heard in the US. Whichever entity was responsible for targeting Indian citizens and clandestinely installing Pegasus, it clearly broke Indian law. No government agency has yet been identified, as carrying out this operation. If it wasn't done by a government agency, the law was broken, by definition. Even government agencies are supposed to obtain permission to carry out surveillance operations at a high level, while stating the need for such violations of privacy.

It is also true that the government has delayed putting privacy protection laws in place, which could have allowed a more specific definition of the crime and the appropriate punishment. The Supreme Court ruled in August 2017 that privacy is a fundamental right. Consequent to that, a commission headed by Justice (retired) B N Srikrishna drafted a piece of model personal data protection privacy legislation, which was released in July last year and incorporated public comments by October 2018. Plenty of legislation has been cleared and passed by Parliament since then, but that draft has remained in abeyance. In the absence of such legislation, there are grey areas without a clear definition of when surveillance can be instituted, by which agency, and the safeguards against wantonly monitoring private citizens. This incident brings to light the inherent dichotomy between a Constitution that recognises privacy as a fundamental right and a legislative arm that indefinitely delays passing laws that offer specific protection to that right.

ILLUSTRATION: AJAY MOHANTY



A bubble in quality?

Companies with safe balance sheets and clean governance have benefited disproportionately from elevated stock specific risks

Sunil Singhania of Abakkus Asset Manager has written an interesting piece on a bubble in quality stocks in India. Mr Singhania is a smart investor, has a good track record and is a veteran of the markets, having seen both bull and bear phases. All serious investors and students of stock market should read his piece.

Mr Singhania basically makes the point that quality stocks in India trade at very high multiples. These multiples cannot be justified if we look at the financial performance of these companies, or compare them with global peers. Given the high starting valuations, these companies will deliver very low to negative returns over the coming 10 years. He, therefore, argues that investors must move out of these companies and broaden their portfolio.

To support his arguments, he has studied these high quality, high P/E stocks and done a deep dive into their financial performance since 2010. He has compiled an illustrative list of 27 quality stocks that includes HUL, Asian Paints, Nestle India, ABB, Berger Paints and Pidilite. This basket was trading at a trailing P/E multiple of over 65 times. Studying the financials of these companies, Mr Singhania realised that over the last nine years they have delivered on an average a top line and EBIDTA growth of only 12 per cent, and net profit growth of 11 per cent. These numbers, while better than the broad market are still below nominal GDP growth of 13 per cent (over the same period). He asks why investors should pay elevated multiples if these companies only deliver nominal GDP-type growth rates at best. In fact, in the list, the only large cap company with a profit growth greater than 20 per cent is Titan, showing just how rare it is for a company to deliver 20 per cent profit growth for an extended period.

AKASH PRAKASH

The paper then looks at the valuations from a more fundamental perspective, doing a reverse DCF (discounted cash flow) to understand the growth expectations already embedded into current prices. The team at Abakkus found that in the case of HUL, for example, even after modelling an artificially low cost of equity, the company would have to deliver 25 years of 12 per cent growth in free cash flow and then a terminal growth rate of 5 per cent just to justify current valuations. Not impossible, but hardly trivial.

The paper compares Asian Paints and Sherwin Williams, making the point that Sherwin William delivered higher earnings growth and return on equity than Asian Paints over the last nine years, but trades at one-third the multiple. Similarly, Facebook and Alphabet have even better free cash flow metrics and growth than most of the Indian quality stocks, but trade at less than 30-times earnings.

The paper also compares sectors and makes the point that the market cap of HUL and Nestle India alone is equal to the entire market cap of the cement, steel and metals sector in India. This despite the core sector stocks having 16 times the sales and almost 10 times the profits (at peak).

The core of Mr Singhania's argument is that if one were to assume the same growth rates over the coming nine years as these companies have delivered in the last nine, the vast majority of these companies would have to trade at P/E multiples of between 55 and 75 times FY 28 earnings to even deliver a 12 per cent CAGR in share price appreciation.

He makes a valid point — that with inflation in structural decline, nominal GDP will not compound at 13 per cent over the coming nine years and with a higher base for all these companies, even to repeat the growth rates of the last nine years is not easy. In almost no market in the world have large cap stocks traded at these types of multiples for a decade at a stretch. If high-quality companies in India are able to trade at 60 or 70 times earnings even in FY28 needed to deliver a 12 per cent share price CAGR), it would be a rare occurrence indeed.

I have great sympathy for the arguments presented in the paper. I believe the valuation gap has gone to an extreme. There is no doubt that the companies Abakkus highlights are outstanding businesses with phenomenal returns on capital and free cash flow, everyone would want to own them at a price. They are simply trading too expensive.

In India over the last six to seven years, the quality valuation premium has expanded. This is due to weak profitability across corporate India. In 2009, corporate profit share-to-GDP for India and the US was similar at near 8 per cent; today the same ratio for the US is over 10 per cent, while for India it is below 3.5 per cent. The earnings per share (EPS) growth for Indian equity markets has been less than 5 per cent over the last six years. With such weak profitability, any company delivering stable double-digit earnings has been bid up disproportionately.

We have also had a series of corporate governance blow-ups, and a clean-up is under way in corporate India. With elevated stock specific risk, companies with safe balance sheets and clean governance have benefited disproportionately.

Due to a series of regulatory and judicial interventions, combined with risk aversion and tight liquidity in the financial system, capital intensive business models have been challenged. Investors have favoured businesses with limited investment needs.

A combination of all of the above created a positive backdrop for high-quality, consumer-facing, capital-light business models. As these companies have outperformed massively, it has now become fashionable for investors in India to say that their investment approach is to buy good companies and never sell. There are a handful of companies with superior businesses and great management for which never-selling may be the right approach. However, these businesses are incredibly rare, not even 1 per cent of companies can fit this description. Are you smart enough to build a portfolio full of these outliers? Most investors are not.

The vast majority of today's 75 P/E stocks will only flatter to deceive. They will not deliver the sustained, long duration growth rates and capital efficiency built into their valuations. They will deliver sub-optimal share price returns from here. A small minority of companies will deliver on their growth expectations, but even here, given today's starting valuations, the days of super normal share price performance are over.

With improved economic growth, better corporate profitability and governance, markets will broaden, as EPS growth gets back into double digits. This is critical for India's long-term growth story. Capital intensive companies in India today have a high cost of equity capital and almost no access to equity markets. This has to change if we are going to build out infrastructure and restart the private sector investment cycle. A reduction in the quality premium is required for longer-term macro-economic stability.

As fear subsides, liquidity conditions normalise and governance blow-ups come to an end, investors' risk appetite will also stabilise. The quality premium will regress to the mean. Today, you are being well paid to make this bet.

The writer is with Amansa Capital

Black hole in the economy

On the highly complex and emotive issue of black money, the Parliamentary Standing Committee on Finance in March tabled its 73rd report on the status of unaccounted wealth.

One of the highlights of the report, titled the "Status of Unaccounted Income/ Wealth both Inside and Outside Country —A critical analysis", was that three leading economic institutes of India, working under identical terms of reference, made varying estimates on the size of the black economy. It is obvious that the task of estimating unaccounted income and wealth was going to be a herculean one, given the very emphasis on their "unaccounted" aspect. However, the fact that the estimates of the size of the black economy in India varied from 7 per cent to 120 per cent of GDP is a matter of surprise — and some concern.

PANKAJ KUMAR SINGH

In order to flag key issues, I draw reference to paragraph 10 of the report dedicated to "Estimates of Unaccounted Wealth Outside the Country", largely dealing with illicit financial flows across international borders.

Cross-border illicit financial flows (IFFs) may happen due to tangible illegal activities, such as trafficking of drugs or wildlife, illicit trade, or due to intangible activities such as corruption, betting in sports and piracy or import of services related to software or consultancy. In this analysis, I exclude drugs or wildlife crimes, which are more difficult to quantify. The article, therefore, identifies the most sensitive sectors prone to illicit cross-border trade in goods or services. In India, gold and jewellery; diamond; and software and consultancy imports are sensitive. These sectors are considered risky globally as well.

Yellow metal

The two sectors—gold (precious metals) and diamonds (precious stones)— may generally be considered identical in their mode of generating black money and integrating it into the economy. However, in reality, they may not be so. While black money generation in gold is primarily export-driven, for diamonds it is largely import-driven. While gold frauds add to black money generation within India, diamond may be misused to legitimise black money by inserting it into the financial mainstream and facilitating transfer of this illicit wealth abroad.

These two risk prone sectors complement each other in this sense. In fact, most sectors generating and consuming black money are complimentary. These debit / credit requirements in such sectors makes *hawala* (informal banking) thrive in India.

Law enforcement agencies have made a number of detections of fictitious exports of gold jewellery from India. This includes gold jewellery that were never actually exported. This is done by adopting Bollywood-type *modus operandi* involving exchange of bags at Indian or international airports or alternatively exporting just scrap, while mis-declaring them as gold jewellery. After making such fictitious exports, the gold would then be diverted and sold within India in cash. A number of these fraudulent businesses are running on high quantum of bank credit.

UN COMTRADE (International Trade Statistics Database) reveals that over the past 10 years, in quantity terms, 75 per cent to 85 per cent of India's gold jewellery export is made only to two countries, viz the UAE and the US. This is not a diverse export basket. In 2008, when the Lehmann Brothers collapsed, sending tremors across the world, the export of gold jewellery from India to the US (normally in the range of 15-20 per cent) shot up to 97 per cent in quantity terms. Data during periods of such disruption are critical for black money estimation.

Diamond trade

In the diamond sector detections by law enforcement agencies indicate overvaluation in imports of rough diamonds. This basically means that the importer is ready to pay ₹100 for an import that is actually worth ₹10, thereby paying an excess amount of ₹90. No prudent business would enter into this kind of transaction, unless it is dealing with public money, which is being used for making excess import payment, or it is proceeds of crime being laundered.

UN COMTRADE data indicates that more than three-fourths of Indian rough diamond imports in caratage (quantity terms) are from Belgium and the UAE. These two countries again figure as prime destinations for Indian exports of finished diamonds. Notwithstanding the major trading country status of the two countries, a closer look at this sector is required for black money estimation.

Intangible sectors

Imports of services, such as software, consultancy and tours and travels, result in outflow of foreign exchange, which is indeed welcome for genuine transactions. However, these imports of services, when they are fake transactions, may also be used for laundering money.

Globally, intangibles contribute significantly to illicit money transfers using the formal banking channels. The use of intangibles is preferred because it is difficult to establish whether services were actually offered or not, as unlike trade in goods, there is hardly any physical footprint of these transactions.

Quantifying black economy

This analysis provides a snapshot as to how businesses can be misused to generate and launder black money. Sensitive sectors such as real estate, pharmaceuticals, mining, *pan masala* & tobacco, plastics (to name a few) have their own peculiar methodologies for contributing to the black economy.

One approach of quantifying black economy could be: Identifying sensitive sectors, estimating quantum of black money in each in consultation with stakeholders and doing a summation of their estimated contribution; and statistical analysis of estimates in the other less risky sectors.

Inability to effectively tackle this chronic problem of black money results in injury to domestic industries, job losses and credit squeeze for genuine businesses. Identifying these sectors, dealing with them holistically and introducing fair-trade practices would make them globally competitive.

The writer is an Indian Revenue Service officer. Views expressed are personal

Celebrating the unmentionable

BOOK REVIEW

ANIL SWARUP

The Swachh Bharat Mission (SBM) "has become India's sanitation revolution and one of the biggest behaviour change mass movements in history" writes Parameswaran Iyer, the man behind this movement and editor of *The Swachh Bharat Revolution*. SBM has proved that "impossible is indeed nothing". "Rules were broken" as Valerie Curtis, professor, London School of Hygiene and Tropical Medicine, puts it, and the team dared to tread "a path never travelled". She goes on to state that "the discourse has changed to the extent that ornaments that look like 'shit' are now sold at gift shops". The SBM revolution has already provided inspiration to many countries. Suleiman H Adamu, Nigeria's minister for water resources, admits that he was "awed and sold" and that "the Nigeria ODF [open defecation free] campaign is now being modelled on the same lines as SBM". Kevin Rudd, former prime minister of Australia, writes that "India stands out as an example for all of us" in the context of SBM.

The essays and articles in the book reflect the interests and commitments of each section of society in "making it happen". The introduction to the book written by the editor explains the "why" and "how" of the success of the scheme. Mr Iyer puts it succinctly: "A major contributor to the success of SBM has been the policy shift towards an outcome-oriented approach, as opposed to an output-oriented one." The real challenge, however, was in weaning "people away from the habit of open defecation and therefore a behaviour change campaign".

What really made the difference was the approach Mr Iyer adopted. He led from the front as the "team at the Ministry ... travelled extensively to different states to actively engage with and motivate all levels of state government officials to put SBM in mission-mode in their own domains". The role played by primary schools in mass awareness about sanitation is recognised in the opening chapter.

Most of the essays and articles are written by those that were active participants in the movement. Thus Raghubar Das, chief minister of Jharkhand, who anchored the movement in the difficult terrain of his state confesses that the success of the scheme in the state could be attributed to "a demand-driven and community-centric approach" and he could do so "by investing a significant amount of ... time in the programme".

The article by Rajiv Mehrishi, Comptroller and Auditor General, reflects how the SBM team managed to engage with opinion makers and those who mattered to inculcate acceptance about an issue that could "hardly [be] a subject of regular dinner-table conversation". Priyanka Shukla, district collector, Jashpur, Chhattisgarh, explains how they managed to implement what appeared at the start to be a difficult task through innovative measures. As she puts it, "The outcome has not resulted from fear or force but from sheer willingness to be a part of the change".

Arun Jaitley, who was then finance minister, explained how "sometimes a big, hard, audacious goal set by a strong leader brings out the best in people and institutions". This perhaps was the greater contribution of Prime Minister Narendra Modi who pushed all to come out of their "comfort zones" to achieve the "impossible". He made them "think big and aim high". This is one of the most eloquently written articles in the book as the author goes on to explain how "the 'unmentionable' toilet has been placed at the forefront of India's developmental and political discourse".

There could be doubts about the calculations made by UNICEF that "every rural family in an open defecation-free village in free India saves an average of ₹50,000 per year" but no one questions the fact that "investments in sanitation deliver a high return". World Bank's regional vice-president Hartwig Schafer believes, like many others, that it was "about changing the mindsets and encouraging people". The real challenge, as the UNICEF report clearly brings out, would be the "efforts... needed to sustain the intervention".

There are articles by people such as Adil Zainulbhai, chairman, Quality Council of India, that quote surveys to prove that most (91.29 per cent) of the "households with access to toilets were also using them regularly".

Celebrities such as Amitabh Bachchan and Akshay Kumar had major roles to play in communicating with the masses and in making SBM into a mass movement. They also contribute by way of articles in the book. Amitabh Bachchan call it a "Jan Andolan" and Akshay Kumar converted reality to reel life in his block buster *Toilet – Ek Prem Katha*.

The book is a must-read especially for civil servants and all those who aspire to bring about transformation in their spheres of activity. The essays will help them understand the "how" of doing the "impossible".

The writer is a former Indian bureaucrat

THE SWACHH BHARAT REVOLUTION: Four Pillars of India's Behavioural Transformation
Parameswaran Iyer (Ed)
Harper Collins, ₹699, 280 pages