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MANAGEMENT REVIEW 2013

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Symbiosis Institute of Business Management Pune

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DIRECTOR'S NOTE

"Research is to see what everybody else has seen, and to think what nobody else has thought."
- Albert Szent-Gyorgyi (Hungarian Biochemist and Nobel Laureate)

Dear Reader,

I am delighted to introduce the third edition of 'Beacon Management Review', an initiative of the students of Symbiosis Institute of Business Management, Pune. The Beacon Management Review has been conceptualized to showcase the talent of the students and their deep understanding on important management and general issues that are relevant in today's dynamic corporate environment.

This edition is a collection of articles and research papers based on Marketing, Human Resources, Operations and Financial Management written by the students of SIBM, Pune. Some of the key topics that have been discussed are related to the compensation packages of the CEOs, Employer Branding, Quantitative Easing, Last Mile Delivery etc. At SIBM Pune, we are privileged to have students who put a lot of emphasis on building their scholastic ability and show interest in undertaking research work in the field of management.

This publication is an initiative of the Research & Scholastic Development Team at SIBM Pune which assists the students in channelizing their enthusiasm for research work and giving them recognition for their work. I appreciate the efforts of Research & Scholastic Development Team in getting live projects from across industry which has benefited the students in developing an analytical approach and honing their consulting skills. They have worked on projects by the Citi Group, GLOASP, Healthberries and are making excellent progress on some key ongoing projects.

Every year, we endeavour to enhance the magazine so that we are able to bring the best for you to the table. This year's edition has incorporated few improvements by making the work more expressive and stressing particularly on domain specific matters. I hope with this edition, you find the experience of reading as delightful and enlightening as the students found in the course of developing it.

Dr. Vivek Sane
Director, SIBM Pune

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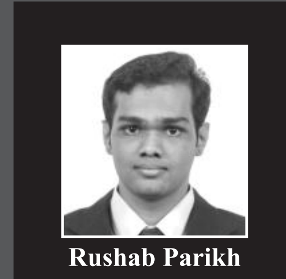
The Conundrum Called Executive Compensation



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Abstract

Executive compensation is the total remuneration that an officer, having administrative or managerial authority in a firm, gets for his services. The issue of executive compensation has always been a highly controversial one all over the world. This debate came to a head in the aftermath of the 2008 economic crisis. The chief objective of this essay is to dispassionately bring out the various aspects of executive compensation in detail. It highlights the principles to be followed while determining pay packages. It explores the factors that push up executive pay and explains why excessive executive pay is bad. The article touches upon certain controversial issues such as regulation of pay, extent of shareholder say in deciding compensation packages and the effectiveness of equity-based pay. It also suggests recommendations for companies to improve the situation. Lastly, it looks at the current scenario prevalent in Indian companies.

Introduction

The issue of executive compensation has always touched a raw nerve all over the world. The 2008 economic crisis only precipitated the issue. People's anger over executive pay was due to reasons such as: the apparent lack of penalty to executives who caused the credit crisis and the financial service meltdown, the pay structures that rewarded greed, the seeming reluctance of companies that caused the problem to give easier credit since the crisis and the outrageous symbolic acts such as plane purchases, office decorations and billions in bonus. The G-20, too, acknowledged that excessive compensation, which encouraged executives to take undue risks in order to gain quick profits irrespective of their long-term implications, was a key contributor to the financial crisis.

Just how much is a CEO worth?

The aim of executive compensation should be to ensure that CEOs bring lasting prosperity to their respective companies. The pay structure should be such that it attracts the right executives and gives them enough incentives to lead their companies to perform outstandingly. Compensation should not be too high. At the same time, it should be reasonable as it is basic human nature to expect compensation that is in line with ones' efforts. The six main components of executive compensation are basic salary, short term incentives (STIs), long term incentive plans (LTIPs), perquisites, enhanced benefits package and deferred compensation earnings.

Principles to be followed in determining executive pay

Fairness

Pay must be commensurate with the position held and the targeted performance. It must ensure an equitable and reliable sharing of company profits between management and shareholders. For instance, according to a 2006 Watson Wyatt Survey, 90% of institutional investors in America were of the opinion that corporate executives were dramatically overpaid and 85% of them said that the prevalent executive compensation system hurts Corporate America's image. Also, companies should stop employing egregious pay practices such as over the top severance packages, defined-benefits plans, guaranteed returns on deferred compensation, change-in-control payments and golden parachutes. From the executives' point of view, a 2012 study done by PricewaterhouseCoopers and London School of Economics and Political Science concluded that most executives would rather receive a lesser pay in absolute terms than a higher salary which was lesser than their peers. Fairness in pay was the most important for Indian CEOs.

Accountability

Pay must be directly proportional to the performance of the individual. For example, the 78% pay hike that Sunil Mittal got in FY2006 was perfectly justified as he had led his company Bharti Airtel to 100% profit the previous year. However, it is questionable that Ford's CEO Jacques Nasser deserved $20 million in compensation in 2001 when the company had reported a loss of $5.45 billion. For that matter, AIG earned widespread criticism for granting its executives huge bonuses from the US government bailout package. A below-market salary together with high performance-based incentive pay is likely to attract self-motivated individuals.

Alignment

Pay must incentivize executives in alignment with the goals of the company. Besides total shareholder return, companies should focus on their social and environmental performance as well. Performance measures such as customer satisfaction, risk audits, adherence to company ethics, innovation, branding and leadership development should be measured in quantifiable terms. A board should pay its CEO for implementing long-term beneficial strategies rather than for just short-term glorious results.

Transparency

The principles and practices followed in determining the pay structure should be clearly disclosed to and understood by everyone in the organization.

Factors that push up CEO pay

The main factors pushing up CEO pay are:

- CEO pay is high because the boards perceive they are worth it. Many companies believe that it is necessary to compensate its executives handsomely to avoid losing them to competitors. As the CEOs have several job opportunities which they can avail of, it becomes essential to pay high to retain them
- Instead of employing effective succession planning strategies, there is a rising trend in the number of companies looking to hire 'superstar' CEOs to solve their financial woes. Such a scenario is perfect for CEOs to demand huge compensation packages. Reliance on external consultants also inflates the pay
- Research shows that the difference in performance sees an exponential increase with rise in complexity of the job. This essentially means that a star blue collar employee working on the traditional assembly line would be 40% more productive than a typical worker and this performance advantage may exceed 1000% for star workers in complex jobs such as a computer programmer. Thus, CEO's performance, given the high complexity of the job, commands much higher compensation
- Experts like Gretchen Morgenson blame a practice called 'Peer-group Benchmarking' for the booming pay packages. This practice is based on the assumption by boards that since CEOs have wide-ranging skills they can easily switch to other companies across industries and sectors. Even a remote possibility of the CEO leaving the company makes boards compare compensation packages that executives at other peer companies are getting and then fixing CEO pay based on this. When the compensation of one executive rises, all others want a similar increase. No one wants to be left behind. This, in turn, pushes up pay

packages across the board. A study by two professors at the University of Delaware, Charles Elson and Craig Ferrere, however, claims that CEO talent is not transferrable as assumed and that, when these persons move out of their specific industry, they fail to deliver

- Another main reason is the size of the company. As Gabaix and Landier wrote in the Quarterly Journal of Economics, if a company replaces the most talented CEO with the 250th most talented CEO, its market capitalization would increase by only 0.016%. This difference might seem miniscule; however, one realizes the significance of this statistic when one considers the fact that, for a $500 billion company, 0.016% amounts to a huge $80 million. Thus, the impact that a CEO has is much more for a large-sized company. As American companies are amongst the largest in the world, their CEOs are in general, paid the highest in comparison with CEOs in other large economies

Why excessive CEO pay is bad

- With an increase in gap between what the executive gets and what the average worker earns, there is seen to be a decrease in employee morale, loyalty and productivity. The reputation of the firm is also hit adversely. According to an Edelman study, only one-fifth of all Britons think that the CEO is a credible spokesperson
- People are not motivated by monetary gains only. As pointed out by Maslow's Hierarchy of Needs, beyond a certain point, factors like sense of personal growth and deeper purpose become more important than financial considerations. According to a 2012 study carried out by PricewaterhouseCoopers, executives were willing to take a 28% pay cut in exchange for their ideal job
- It is morally wrong to pay millions to one individual while the company is reducing its workforce to cut costs
- High rewards from executive pay discourage risking own capital and hence entrepreneurship
- High executive pay increases income disparity and leads to social unrest. This has led to worldwide protests, most notably, the Occupy Wall Street (OWS) movement. Society cannot grow when the rich receive a disproportionate amount of income at the expense of others
- Studies have shown that executives earning huge salaries have a false sense of security, are less empathetic and are more susceptible to unethical and corrupt behaviour. The human brain has a 'pleasure centre' and an 'altruism centre' and, as studies have concluded, when these two centres go head to head, financial incentives take precedence over altruistic drives
- The wealthy wield undue political influence and often shape public policy for their own interest

Should CEO pay be regulated?

India has long had regulatory measures in place. In fact, a rule under the Companies Act 1956 made it illegal for managing directors to earn more than the President of India. In the 1970s, this amounted to a maximum salary of Rs. 7500 a month. The Companies Bill 2011, that was passed in Parliament on December 18, 2012, states that a director's pay should be limited to 5% of the company's net profit. The Obama administration went as far as appointing a compensation czar for TARP (Troubled Asset Relief Program) companies in the wake of the economic crisis.

Proponents of this strategy suggest various methods such as caps on pay, shareholder "say on pay", ceilings on ratios of CEO pay to worker pay, appointment of a pay czar, and labeling of incentive pay as pay that encourages unwarranted risks. They say that the government has a responsibility to protect shareholders and the economy from an incentive system that encourages reckless risk-taking and irresponsible judgment-making. This practice brings in greater transparency and removes the objectionable nexus between the compensation committee and executives. They point out that companies like Microsoft have already implemented this policy.

There are many people, however, who oppose the regulation of CEO pay. They cite the following reasons:

- Regulation of CEO pay will hinder innovation and reduce competitiveness and flexibility of companies. It could result in job-creating investments moving to other countries
- The compensation which an executive gets should be decided by only the shareholders as they are in the best position to determine the needs and demands of the company
- Regulation may adversely affect the incentives to effort and risk-taking
- It may discourage the most talented businesspeople from becoming corporate executives, who may instead opt for consulting deals to escape public scrutiny
- It may lower the morale of honest CEOs if there is a constant scrutiny with regards to their integrity
- Second-guessing on the part of the government and shareholders will create an environment of fear. Boards would become wary of implementing out-of-the-box strategies
- Government regulations tend to be 'one size fits all.' Compensation practices should, instead, be allowed to vary with the business strategies followed, the size of the companies and their profits and turnover in various financial years

- Executive pay should depend on the prevailing market standards which cannot be predetermined by prescribed government ceilings
- Government regulations can have several unintended consequences. For instance, when the Clinton administration fixed a $1 million cap on cash pay-outs for companies to be eligible for tax incentives, many firms decided to pay their top employees inflated guaranteed bonuses, the case in point being the highly controversial AIG pay-outs. Also, if a maximum ratio of CEO pay to worker pay were introduced, companies might outsource the work of the lowest paid workers thus increasing unemployment. Further, the best talent may decide to work in countries having no such restrictions
- This is a very slippery slope. Should the government then curb the compensation of sport personalities, movie stars and other celebrities as well? Should it limit the earnings of proprietary and partnership-based businesses?
- The thousands of non-profit organizations who rely on the charities of the wealthy will see their funds fall sharply

Should shareholders be given a ‘say on pay’?

In 2003, UK approved ‘say on pay’, i.e., shareholders’ right to an advisory vote on the proposed compensation plans for top company executives. Since then, countries like Australia, Sweden, Norway, Spain, and the Netherlands have also adopted it. In Australia, for instance, if more than 25% of shareholders vote against the remuneration package of directors in two consecutive meetings, the directors have to stand for election again within 90 days. Following the economic crisis of 2008, the US passed the Dodd–Frank Wall Street Reform and Consumer Protection Act in 2010 which included ‘say on pay’ provisions.

Proponents of this policy state that this step is necessary to narrow the big gap between ownership and management. Institutional investors, who own most of the company’s stock, typically refrain from taking an active role in corporate governance, of which executive compensation is an essential component. Instead, if they are unhappy with a company, they simply sell off the stock. Proponents say that institutional investors should be encouraged to hold on to the company’s stock for much longer periods so that they have a more long-term interest in the running of the business. They should be encouraged to join the boards of companies they invest in. Ultimately, CEO compensation should be decided by the owners of the business.

However, there are others who doubt the efficacy of this policy. They make the following reservations:

- There is no typical shareholder. Instead, there are big and small investors; public and private pension funds; several types of mutual funds; endowment funds for non-profit institutions; and a wide assortment of hedge funds
- Many of these shareholders are only interested in engaging in short-term investments and making quick profits. They are not interested in creating long-term economic value
- It is the fund managers, authorized by the powerful institutional investors themselves, who often pressurize CEOs and CFOs to make quick profits
- As outsiders, shareholders do not possess all of the information or are aware of all the considerations that go into designing compensation packages
- This is, again, a very slippery slope. If shareholders next demand a say in the employee working conditions or the amount of carbon footprint a company leaves, should they then be granted these demands as well?

Such persons are in favor of non-interfering regulations such as tax benefits for companies that voluntarily set sensible compensation limits and strengthening of clawback provisions. They propose that, instead of giving shareholders a say on executive pay, it should be made easier for shareholders to elect and remove directors. This will make boards more accountable. For example, in Sweden, the largest 3-5 shareholders are invited to sit on the nominations committee to screen and propose director candidates for shareholder approval at the annual general meeting.

Is equity-based pay good?

Stock-based compensation is typically in the form of shares of stock, stock options and restricted stock. Other less frequently used methods are stock appreciation rights and phantom stock. As share price directly affects executive pay, this form of compensation seeks to align the executive's interests with those of the shareholders, not only while he is active but also in retirement.

Stock options are the right to buy a specific number of shares of the company's stock during a specified time at a specified price called the strike price. Restricted stock is company stock awarded to an employee subject to fulfilling certain conditions and which typically realizes in value several years after it is granted under a vesting scheme.

Two major problems with equity compensation are executives' tendency to quickly liquidate their equity compensation and their ability to manipulate the timing of both the granting of options and sale of equities after the options are realized. The possibility of quick gains based

on short term rise of stock price induces executives to take undue risks. Hence, a good equity compensation plan should ensure that there is a time lag when options and restricted stock can be cashed out from the time they vest. The practice whereby equity is granted shortly before good news is expected is called springloading. To reduce this malpractice, grants should be given only on specified dates. Payoff should depend on the average stock prices over a significant period. Executives should be made to reveal their unwinding plan in advance. Such approaches would make it more difficult for executives to profit from using inside information to time their stock sales, and also reduce the incentive to manipulate short-term stock prices.

Proponents of restricted stock say that it allows a company to reward its top officers handsomely and also gives some incentive to executives to focus on long-term performance; at the same time, the rewards are not that high as to encourage manipulative practices. Its detractors say that since the value of restricted stock is equal to the market value of the stock at the time of grant, it does not penalize executives if the stock depreciates in value.

A ground-breaking HBR article written by Michael Jensen in 1990, in which he stated that boards should compensate executives based on company performance as indicated by its stock price, led to an explosion of companies granting stock-options to their top executives.

Supporters of stock options say they incentivize CEOs to perform better, as stock options are valuable only if the stock prices are high, which, in turn, happen only when the company is performing well. As stock options are counted as a corporate expense, which is accounted for in the income statements, the use of stock options is a more transparent form of compensation.

Opponents, however, make the following points while putting forth their case:

- Executive pay has shot up since the introduction of stock options
- Executive stock options have, over the years, been a contributing factor to several accounting malpractices and manipulations such as options backdating and springloading
- Executive stock options have encouraged stock buybacks, wherein executives exercise their options, taking undue advantage of the reduced stock supply and the resultant rise in prices
- Stock options reward risk-taking as the value of a call option increases with increased volatility
- Stock options give potential benefits to executives but have no corresponding risks (if the stock value decreases, the option is not exercised)
- If the stock prices fall, stock options are worth little. Hence, the executive loses an important

incentive to perform at a time when it is most required

In 1999, former Kellogg Professor Alfred Rappaport wrote a HBR article, in which he recommended that executives should receive options whose strike prices were tagged to an index of peer group of companies. He suggested that if a company outshined its competitors, the executive should be rewarded handsomely. If, however, the company did not outrival its competitors or did worse, the executive should not receive any reward. Also, a manager guiding a company to high performance in a falling market should receive the maximum compensation. In this way, Rappaport wanted to avoid situations where the executive made profits regardless of his own performance, only because the market, in general, was on the upswing.

Some experts are in favor of scrapping stock-based compensation altogether and instead using measures such as EPS, ROIC and market share to compensate executives. They make the following arguments:

- Executives should be compensated for obtaining a desired outcome over which he has some control. A stock price is the result of the market's expectations about the future performance of the company. Executives, however, have very little control over increasing the market's expectations, as evidenced by the fact that expectations fluctuate significantly more than the actual results of companies
- Executives should not be compensated for achieving something the company does not exactly want. Companies should aim to improve real measures such as EPS and ROIC rather than looking to increase the market expectations. If these measures grow, expectations will, in any case, rise. Expectations do not rise forever. Expectations fluctuate as they are the result of speculation. As it is impossible to keep expectations rising forever, executives do so in the short term and sell their stake before expectations fall. This practice has, thus, increased market volatility and hindered long-term company growth

Recommendations for Companies to Remedy the Situation

- Companies should act immediately to restructure their compensation structure keeping in mind the interest of all stakeholders
- The private sector should voluntarily come up with a set of guidelines to regulate compensation practices
- It should be ensured that pay consultants are fully independent and in no way obliged to the CEO
- Companies should publish both the highest 20 and the lowest 20 compensation figures, for

instance

- More emphasis should be given to long-term incentives. It is necessary to relook vesting and holding requirements to prevent managers from unilaterally cashing out equity-based pay
- While determining executive pay, boards should look at the company's financial, social and environmental performance. This will result in more sustainable performance in the long-run
- Boards should deemphasize pay and avoid hiring persons whose overriding priority is money
- It is needed to overhaul the manner in which boards are elected and to ensure that compensation committees should be truly independent
- CEOs themselves need to take a stand on this issue. Says Rakesh Khurana, professor at Harvard Business School, "In the wake of the crisis, what's really impressed me about the business community is their deafening silence. The lack of business leaders standing up and saying 'Here's what went wrong with compensation, here's what we're doing' is disappointing." Many leaders such as Jeffrey Immelt of GE took voluntary pay cuts in the midst of the 2008 economic crisis

The Indian Scenario

India has long had in place stringent regulations on executive compensation. Under Companies Act 1956, compensation to management was restricted to 5% of net profit and directors' compensation could not exceed 11% of profit. In addition, managerial compensation was subject to shareholders' and Central government approval. Under the new Companies Bill, no director can obtain more than 5% of the company's net profit. Independent directors will no longer be eligible for stock options; instead, they will be given fees and profit-linked commission.

In recent years, there has been a rapid increase in executive pay in India. In his capacity as Chairman and Managing Director of Jindal Steel and Power Ltd., Naveen Jindal received a total remuneration of Rs. 73.42 crore in FY2012 and topped the executive pay charts for Indian executives. Second and third in the list, with an annual compensation of Rs. 57.01 crore each, were Sun TV Network's Kalanithi and Kavery Maran. Hero MotoCorp's Pawan Munjal (Rs 34.47 crore) and Brijmohan Lall Munjal (Rs 34.44 crore) complete the top-5 list. According to latest figures, chief executives in India were commanding an average annual compensation of Rs 2 crore while those working in large organizations took home annual salaries in excess of Rs

7 crore. In February 2012, consulting and outsourcing firm Aon Hewitt had predicted a further upward trend of 11.9% in 2012.

In 2009, the then Corporate Affairs minister Salman Khurshid and the Deputy Chairman of the Planning Commission Montek Singh Ahluwalia had urged Indian executives to show restraint in commissioning huge pay packages for themselves. "Indecent CEO salaries have become a global cause of worry," Ahluwalia had said. Salman Khurshid had termed the salary figures as 'vulgar'. Earlier, too, in 2007, Prime Minister Manmohan Singh had warned that such widening inequalities could spawn social unrest in India.

There are several reasons for this rise – primary among them being market demand, health of the economy, culture in which the rich are worshipped, impatience for results, growing companies and ambition. Globalization, too, has played a key part. Every M&A results in staff moving from one country to another. These global executives thus demand compensation packages comparable to global standards. As the number of multinational companies increases and they become more centralized, it becomes cost-effective for them to maintain standard compensation structures globally. Employees and trade unions are increasingly using the Internet to compare compensation. A benefit given somewhere in the world soon becomes a demand everywhere else. Also, the HR function in India has become more professional. Today, professional approaches such as peer reviews and 360-degree feedback are being employed to decide compensation.

The situation in India is not as bad as it was in the US in 2008. This is due to the following main reasons:

- Most companies are promoter-controlled. It is in the interest of these promoters to keep costs at a minimum
- Indian companies are not massively leveraged, as evidenced by the fact that no Indian company needed a bailout from the government in the aftermath of the 2008 economic crisis
- Most of the gains that promoters make come from capital appreciation and dividends. Hence, it is not required for him to award himself a huge salary, which would also attract a higher tax burden
- Indian salaries are still not as high as in other countries. For example, a study conducted by Economic Times of India showed that CEOs of top Indian companies earned 68 times the average pay of employees in FY2010. This figure is in the range of 300-500 in the United States

India, however, does face certain other challenges:

- In most Indian companies, the compensation committee of the Board is not given its due importance. The independence of these committees is also questionable
- Due to lack of participation of the shareholders and institutional investors in the running of the business, there is inadequate discussion on executive compensation issues

Conclusion

Executive compensation has been an issue of immense discussion and debate over the years – and is likely to be one in future as well. Principles of fairness, accountability, alignment and transparency should be followed while deciding the compensation of executives. It is precisely when these principles are not adhered to that criticism happens. Ideally, companies should self-regulate the salaries their top executives are taking home; else, as has been the case in many countries including India, the government will step in and do it for them. It is always better to be seen as part of the solution than as part of the problem.

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Strategic Role of HRs in Mergers and Acquisition

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Abstract

Mergers and acquisitions have become an important tool for organizations all over the world to acquire competencies and increase their geographical reach. In most mergers and acquisitions both employees and managers are unprepared to cope with the new situation. Typically a huge portion of employees of the acquired firm find difficulty in coping with the trauma of mergers involving their companies. To the employees of the acquired companies the new management is in some way alien. Furthermore they do not enjoy the advantages of previous good relationships with clients. Motivation and employee output are things which need to be addressed by HR managers. All these point to the tremendous role that HR professionals have to play in order to make the merger or acquisition successful. Many studies have been done over the years to gauge the success of mergers and acquisitions, and the result: The failure rate of merger & acquisitions is dauntingly high. The main reasons behind the failure of mergers and acquisitions are not financial and technical issues but personnel related issues. These issues may include employee resistance, mass exits by talented employees, declining morale and productivity, inadequate financial incentives and unexpectedly high benefits' expenses. This article aims to analyze how HR should create value for mergers and acquisitions.

Introduction

According to the results of Mercer's 2012 Asia Pacific Cross-Border Post-Merger Integration Survey Talent management, executive rewards, coupled with governance and organizational culture have emerged as key factors to successful cross-border M&A. The survey also says that Failure to address "people-centric" issues appropriately can jeopardize the overall success of a cross-border M&A deal.

During the survey Mercer interviewed 41 multinational companies and large local companies across a wide range of industries (retail, energy, food and beverage, financial services, engineering and technology) across Asia Pacific that had acquired a new overseas-based business. Those interviewed on a one-to-one basis from these companies include Human Resource Directors, Business Development and Corporate Strategy Executives.

Only 24% of the respondents cited sale price as a critical success factor for their M&A. The majority, 76%, said that business and organization integration was the most important success factor, followed by talent retention (59%), pointing to a strong emphasis on people-related issues. Interestingly, almost 60% of respondents identified culture as a top key challenge during integration, but most companies' integration plans lack the right kind of detail. The survey also revealed "working with HR on a robust integration plan prior to deal-close is vital, and requires that critical people-related details are properly addressed and managed" .The experiences of survey respondents indicate that engaging HR professionals from the outset helps protect against unanticipated people issues arising during integration.

The survey also indicated that 66% of companies see executive compensation and benefits as their primary focus during HR due diligence. However, many companies do not have a clear strategy for managing differing executive reward schemes. Handling discrepancies between pay packages on a case-by-case basis can lead to prolonged and costly negotiations. Further, 61% viewed governance of the acquired company as the second most important initiative during integration. Strategies reported range from taking majority board seats and appointing key executives, to leaving the new company in the experienced hands of its existing leadership. Either way, organizational governance is seen as a key consideration when mergers span borders. The report also found that a culture integration strategy will not fly without the buy-in of senior leaders. Any successful plan needs to be developed, owned and driven by these key influencers.

Most of the mergers and acquisitions do not achieve the desired level of success due to people issues. There are many reasons for the negligence of the human resource issues and activities.

Some of the reasons are as follows:

- Lack of awareness about the criticality of people issues
- No person to articulate these issues
- There is no model or tool to understand and to manage personnel issues
- The focus during M&A deals are on other activities rather than on personnel related issues

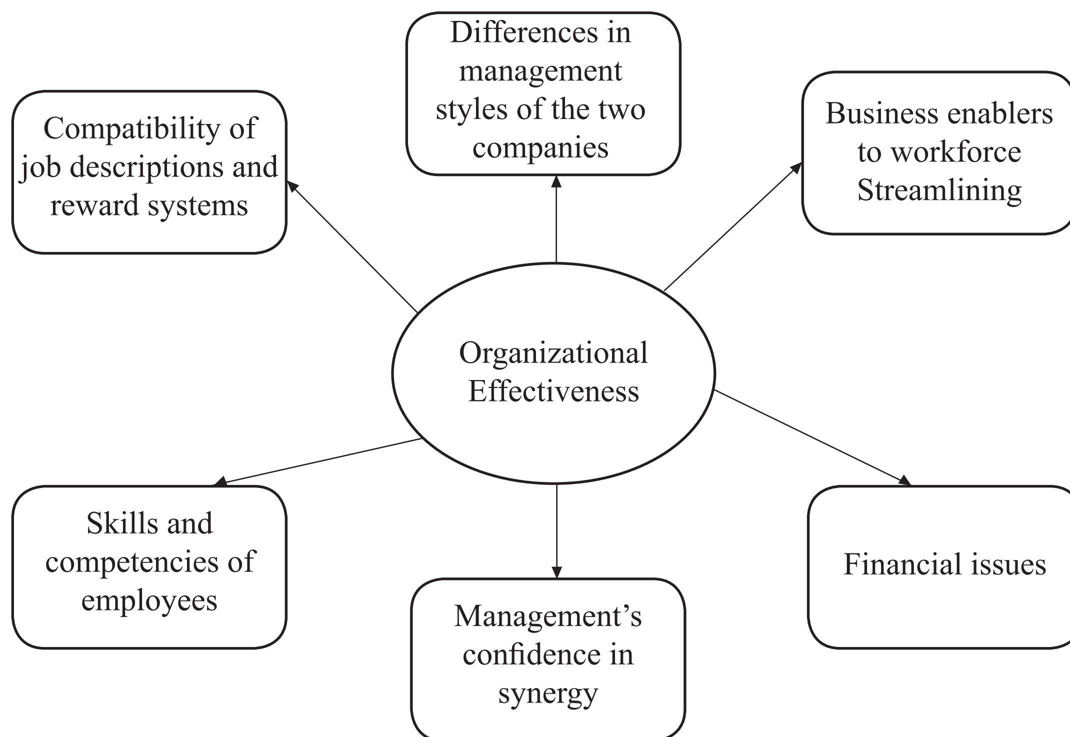

Fig 1: Various factors affecting an organization's effectiveness during M&As.

Pre M&A Stage	During M&A Stage	Post M&A
• Forming the M&A team • Identifying and assessing people issues and cultural issues • Estimating people related costs and savings	• Developing employee culture sensitive communication strategies • Designing key talent retention programs • Monitoring the process of organizational and people related integration activities	• Aligning HR policies especially total rewards • Initiating learning processes for future M&As

Fig 2: Three stages of M&A process-Pre M&A, During M&A and Post M&A

Pre M&A Stage

Before finalizing the deal, it is very important for the acquirer or merger partners to perform due-diligence reviews to ensure they know what they are getting into. Pre merger and acquisition stage is a very good opportunity for the HR department of an organization to appraise its own systems and identify the ones which are not creating a value for the employees by having a look at the fellow company's processes and strategies. During this stage all the strategic expectations of employees should be analyzed. HR department must alert the due-diligence team to the ways people and organizational or cultural issues can affect the deal. HR department should also take into account the corporate attitudes and management style differences. Due-diligence reviews done by the HR department should include reviewing organizational culture and structure, employee compensation and benefits, industrial relations, human resource policies and procedures and analysis of key talent. HR professionals can play a very important role by identifying and evaluating the cultural characteristics of the organization across several dimensions of organizational culture and highlighting where significant "culture clash" will impact organizational effectiveness. This will not only help in eliminating the loss of focus and energy resulting from "culture clash" but also enable the organizations to complete their M&A deals more effectively and efficiently.

During M&A Stage

HR policies determine the condition of employee relations within an organization. Key talent employees should be interviewed and assessed to determine their individual competencies, roles and potential for advancement. Along with this, the objectives for M&A need to be in sync to retain the talent. The HR team has numerous responsibilities as the merger & acquisition moves into the integration stage. During the first few months of M&A the HR team needs to address various critical issues such as ensuring effective top management leadership, communicating effectively with employees, retaining key talent and aligning the cultures of the organizations. Organizational culture includes the basic values its employees share and the ways in which these values manifest themselves in the company's ways of doing things and in their employees' behavior. During M&A, blending the organizational cultures of two firms is the most challenging aspect. The HR department can play a very important role in creating and sustaining the right corporate culture by making it clear to the employees what the organization pays attention to, measures and controls. The HR department should also communicate the priorities based on which the employees would receive rewards and appraisals.

Post M&A Stage

Some of the tasks that must be carried out by Human Resource Managers in most post-merger situations are evaluating and revising HR systems, following an equivalent evaluation of talent

across both organizations, convey the benefits of the merger to the employees, establishing a sense of social security among the employees, negotiating with employees, maintaining momentum immediately after the merger by clarifying relationships and by ensuring the continuity of credit facilities. HR department also needs to eliminate redundant executive positions and unproductive employees. Development of newly formed teams, countering problems arising due to interpersonal conflicts, unclear demarcation of team boundaries as well as roles and responsibilities ought to be another thrust area of HR. HR's key role in any M&A is the reinforcement of the new culture. It needs to assist the management in preserving the best aspects of the organization. In order to do this HR can find out through surveys what cultural values are valued and which of them should be preserved. HR department should keep all employees informed of all crucial decisions. Especially, in the case of acquisitions, the HR needs to ensure an equitable and fair treatment of employees. HR department should also maintain open forums where employees can come together and discuss the deal and allay their fears and insecurities surrounding it and enhance effective communication by involving line managers. Post-integration the issues of compensation, benefits, training also need to be given due attention. Product and systems trainings are obvious areas in which training is likely to be needed. In addition to this, cultural training is also important as it might help the employees adapt to changes in organizational culture and new methods of working. The role of HR department is to harmonize all activities in different phases leading to the creation of an organization with a mission, vision, a clear purpose and values from two culturally different groups.

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Predictive Analysis of Attrition

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Abstract

Employee attrition refers to the loss of employees through circumstances such as resignation and retirement. Each industry has its own standards for acceptable attrition rates, and these rates can also differ between skilled and unskilled positions. Due to the expenses associated with training new employees, any type of employee attrition is typically seen to have a monetary cost.

This article begins by understanding the impact and financial implications associated with attrition. The next step is to identify the factors that contribute to voluntary turnover and devise methods to analyze the trends associated with employee turnover, which can be used to develop an analytical system to predict and preempt attrition. The different factors affecting attrition are analyzed by studying the responses of a group of 103 working professionals in the age group 18-55. The responses are then analyzed and attrition risks inferred from it. The article concludes that, a certain minimum level attrition is inevitable and examines the steps that can be taken to adapt to this reality and minimize its adverse impacts.

Introduction

The cause of attrition may be either voluntary or involuntary, though employer-initiated events such as layoffs are not typically included in the definition. Attrition is a serious issue for all organizations, but particularly for hi-technology industries (IT, telecom, and manufacturing), service organizations (banking, finance, insurance) and support organizations (service desks, call centers, BPO). Regular attrition is often distinguished from infant attrition, where an employee leaves within, say, six months of joining. An interesting observation is that there are three types of knowledge that are under attack through attrition. These are

- Cultural knowledge – this includes management practices, values, respect for hierarchy, and decision flows

- Historical knowledge – this includes the organization's journey from the day it was founded till the present
- Functional knowledge – this includes technical, operational, process related and client information

The acquiring company would also design its recruitment strategies based on what type of knowledge it needs from the competitor. It is evident therefore, that attrition rate among junior employees (2-4 yrs) would be higher for the functional knowledge part – associated with technical and operational processes. At higher levels, the attrition warfare would be more for gaining historical knowledge (business portfolio changes down the years, etc) and cultural knowledge from the competitors.

From the organization's point of view, the counter strategy is to predict attrition "zones" which depend on the criticality or type of knowledge that is important to the organization, and thereby evolve plans to counter loss of human assets from those positions.

Personal	Work	Facilities	Supervisor
Marriage and subsequent relocation	Salary perks (loans, vehicle etc)	Commuting and transportation issues	Issues with supervisor/ colleagues; grievances
Higher education	Overseas deputation/travel	Food and canteen	Appraisal related issues
Need to relocate near to family	Promotion and career growth path	Timings and shift-related issues	Lack of appreciation, harassment
Medical and other personal reasons	Desired roles, responsibilities, skills, projects	Working conditions and facilities	Work culture
	Better offer for competitor		Leadership and company image/brand values

Fig 1 : Some typical reasons for attrition

Attrition is a pain area in any organization that intends to have a knowledge management system in place. Attrition has been discussed as one of the key areas in the field of KM (Knowledge Management), because vacancy of a position might be easier to fill in through the proper people-sourcing approaches, but filling in the knowledge gap is not. This is particularly in context of a tough economy where the concept of all-size-fits-all is no longer working, and vacancy of a position by attrition is basically vacancy of a knowledge-base, and this vacancy in knowledge base cannot be filled in by any person.

Objective

The objectives of this study are as follows:

- To understand the financial implications of attrition
- To examine the various factors affecting to attrition ranging from phases in the employee lifecycle, root causes and symptoms of attrition
- To suggest a predictive analytical model for preempting attrition

Methodology

The purpose of the research was to explore the extent and nature of connection between a numbers of factors i.e. personal and demographic factors, work factors, team dynamics and HR intervention factors on employee attrition. It was carried out by first conducting an extensive literature review intended to identify factors that contribute to employee retention and voluntary turnover and then accordingly preparing a questionnaire for working professionals in the age group 18-15. The sample size was 103. The responses were analyzed and attrition risks were inferred from it.

Understanding Financial Implications

Typically, HR departments look at attrition only from the perspective of direct recruitment costs, however a comprehensive turnover analysis should examine:

- Total cost of the recruitment process – It comprises direct external expenditure (advertising charges, agency fees, etc) and internal costs (HR and management resource allocated to recruitment, etc). Ultimately, it includes opportunity cost from the diversion of resources to the recruitment effort
- Training costs – It includes cost of formal training services and the management and peer-level resource required for "on the job" education
- Productivity costs - The loss of an employee (hence, loss of employee knowledge and experience) and introduction of a replacement invariably leads to a short-term deterioration in productivity
- Loss of customer/supplier/partner value capacity - The departure of employees may have a detrimental effect on key business relationships
- Loss of team impetus - The loss of a key team member should be seen in the context of their positive impact on group activities
- Impact across the business- The loss of senior member may hamper the growth of the

business or may be a hindrance to its profitability. For example, the departure of a senior manager in product design may slow a development project and delay product release, impacting sales and marketing strategy and delaying revenue generation

- Employee churn rates can be as high as 17-20% annually. Moreover, attrition happens throughout the year. Thus, high churn organizations are continuously engaged in "fire-fighting" attrition

It is seen that the cost of employee attrition easily reaches 150% of the employee's annual compensation figure. The cost will be significantly higher (200% to 250% of annual compensation) for managerial and sales positions. This cost carries a significant financial impact for companies.

The illustration below is based on a whitepaper published by a consulting firm Furst Person, based in Chicago. Assuming that an IT company, X has 5000 employees and is experiencing an annual attrition rate of 17 %. (As per average All India Attrition rate reported in Annual Survey of Industries 2008-09- Report on Absenteeism, Labor Turnover, and Employment & Labor Cost) The average annual revenue produced by an employee is $27,500 or $2,292 per month. The variable cost of turnover is assumed to be $2000. Attrition reduction per year is conservative at 10%. For a lost new hire, we assume the replacement time is two months, meaning total lost revenue is $4,584 per term.

Variable Cost of Turnover $2,000.00					
Current Process	**Baseline**	**Year 1**	**Year 2**	**Year 3**	**Total**
Headcount required for production	5000	5000	5000	5000	
Attrition Rate*	17%	17%	17%	17%	
Replacement Hires	850	850	850	850	
Total Cost of Turnover @ $4500 Variable cost	$17,00,000	$17,00,000	$17,00,000	$17,00,000	$68,00,000
Improved process	**Baseline**	**Year 1**	**Year 2**	**Year 3**	**Total**
Headcount required for production	5000	5000	5000	5000	
Attrition Rate*	17%	15%	14%	12%	
Replacement Hires	850	765	688.5	619.65	
Total Cost of Turnover @ $4500 Variable cost	$17,00,000	$15,30,000	$13,77,000	$12,39,300	$58,46,300
Attrition Savings	Nil	$1,70,000	$3,23,000	$4,60,700	$9,53,700

Table 1: Employee Turnover Saving Analysis

Revenue generated per employee/ month $ 2,292					
Current Process	**Baseline**	**Year 1**	**Year 2**	**Year 3**	**Total**
Open Seats Per Month (170/12)	71	71	71	71	
Revenue loss per month (2292 /12 * 14)	$1,62,350	$1,62,350	$1,62,350	$1,62,350	
Revenue loss per year	$19,48,200	$19,48,200	$19,48,200	$19,48,200	$77,92,800
Improved process	**Baseline**	**Year 1**	**Year 2**	**Year 3**	**Total**
Open Seats Per Month	71	64	57	52	
Revenue loss per month	$1,62,350	$1,46,115	$1,31,504	$1,18,353	
Revenue loss per year	$19,48,200	$17,53,380	$15,78,042	$14,20,238	$66,99,860
Revenue Savings	Nil	$1,94,820	$3,70,158	$5,27,962	$10,92,940

Table 2: Revenue Saving Analysis

ROI Analysis	
Total Revenue Expected (5000 * 4* 27500)	$ 5,50,00,00,000
Total Loss (Turnover +Revenue) Current Process	$1,45,92,800
Total Loss as % Expected Revenue	27%
Total Loss (Improved Process)	$1,25,46,160
Total Loss as % Expected Revenue	23%
Turnover Savings (Improved Processes)	$9,53,700
Revenue Savings (Improved Processes)	$10,92,940
Total Savings	$20,46,640
Total Savings as % of Revenue	4%

Table 3: Financial Implications of Employee Turnover

Analyzing Attrition

Although use of analytical tools is relatively low within HR - especially compared to the finance department - there's no disputing the fact that most organizations are awash with employee-related statistical data. HR departments routinely carry out employee satisfaction surveys, collate information about turnover and absence, or receive formal feedback from employees through appraisal processes. As such, they have a large amount of raw material which, combined with the right analytical tools, could provide much needed insight into the effectiveness of their people management strategies.

Predictive workforce analytics can help companies reduce voluntary turnover by identifying employees in critical roles who may be at high risk of leaving. These applications incorporate a variety of data, including an individual's salary, the size and date of their last raise, the results of their most recent performance review, their tenure, the amount of vacation time they have taken in the last 12 months, and the length of their commutation. Factoring in these attributes, the program generates a risk score for each employee, showing his likelihood of leaving during the next 6-12 months.

Alternatively, advanced data mining techniques, such as subgroup discovery can identify logically related groups of employees having unusually high risk of attrition. A hypothetical example of such an interesting group of employees might be: "candidates with BE AND MBA degrees AND age between 28-30 AND gender = male AND number of job changes > 3 AND major_skill = Microsoft_Technologies". This set of employees might show an attrition rate of 19% whereas the overall attrition levels might be 7%. One may design target analytics to identify top root-causes of attrition for such a group of employees. For example, the top root-causes might be related to role, salary or supervisor. The HR executives, then, can design an optimal retention plan to reduce the attrition levels within this specific group, by taking into account the root-causes of attrition in it. Insights derived from attrition data can also help during recruitment: Prefer recruiting candidates with high propensity for stability ("green flags for attrition"), identify and address (with remedial measures) candidates with high propensity for attrition ("red flags for attrition"). Such candidates are likely to have issues that may escalate to attrition in near future. Pro-active identification of employees at high risk of attrition will allow the company to plan for training and deployment of "back-up" team members for critical tasks and core employees, creation and implementation of a succession plan for leadership positions etc. In order to track and monitor attrition health of the company a dashboard can be developed tracking a set of KPI (Key Performance Indicators) parameters. An Attrition Dashboard usually displays various charts to depict the evolution of each KPI parameter over time, across locations etc. Some KPI parameters for attrition are listed below.

D = Average delay (in number of days) for replacing cases of attrition

C = Average cost for replacing cases of attrition

n_p = number of projects "seriously affected" by attrition

n_c = number of clients "seriously affected" by attrition

Δ_o= count for cases of overseas attrition (employees who left when traveling abroad)

Δ_e = count of attrition cases that "violated" the required notice period

Δ_b = count of attrition cases that "violated" the service bond

P = Percentage of attrition cases for which a replacement was successfuully found

R_1, R_2, R_3 = Top 3 reasons for attrition, along with the % of attrition cases attributed to each

Fig 2: Some KPI parameters for attrition

Exploratory slice-and-dice analysis can also be done to drill down into attrition levels seen in specific groups of employees. This analysis can help us to develop reports and charts that can summarize and depict attrition at specific organizational levels: location-wise, business-unit-wise, designation-wise, age-wise, education-wise, experience-wise, gender-wise and more. Further statistical analysis such as correlation, regression, association and dependency analysis, temporal analysis, e.g. trends, seasonality, peaks, can help to get deeper insight and build predictive models. A predictive and learning system can be developed by taking a set of records, each labeled with one of k distinct class labels, a learn function f which classifies every new record into one of the k classes. The set of labeled records is called training data. The new records for which the class label is to be predicted (not a part of training data set) are called test data. The method used to find function f is referred to as a learning algorithm. In this context, given a set of employee records labeled with churned or not churned, the supervised learning task is to discover a rule which can then be used to classify a new employee record into one of the two categories. This learned function f would thus be a predictive model. The learned function needs to be validated and tested using several techniques including cross-validation and the use of a separate validation data set. In cross validation, the training data is split into m equal sets and function f is learned using (m-1) sets as training data and effectiveness is tested against the set which was left out. The overall accuracy is the average of the accuracy seen in m experiments.

Special case on Royal Bank of Scotland

Although few organizations take such a comprehensive approach to attrition analysis, Royal Bank of Scotland, the world's fifth largest bank, has investigated the issue in depth and come up with a novel model.

Its analysis factors in a wide range of recruitment costs; spanning the point where an employee resigns to the time they're replaced with someone of similar competency levels. This includes the time spent by HR and line managers on finding new staff, and an allowance for reductions in productivity as the employee works out their notice. ***Having established the full extent of the costs involved, RBS was able to define a break-even point for a typical employee, representing the moment in time when they start to add net value to the organization rather than being a net cost.*** *From a financial perspective, its research demonstrated that this point typically arises after around one year's salary has been spent.*

RBS is also at the forefront of HR strategy in the way that it analyzes employee 'engagement' and sets it in the context of critical HR issues. The company built its engagement model on the back of extensive research into other organizations' experiences, and subsequently validated it through a questionnaire sent to some 6000 of its 115,000 worldwide staff. The model incorporates eight major research categories, such as work/life balance, total rewards and leadership. Each of these is then broken into sub-components - for example, there are a dozen questions on the quality of leadership. ***This survey is one of many data sources designed to***

establish perceptions about the bank, including information drawn from joiners and leavers, and more unusually, from external individuals who were offered jobs but turned them down. *Pulled into a central data warehouse, this information is then mapped onto other HR-related data and used to address key business issues, demonstrating the power of multi-dimensional analysis.*

For example, the bank recently analyzed employee turnover in its call centers where attrition rates across industry are traditionally high. It found that in some centers, turnover rates were slightly higher than expected - despite the fact that the broad feedback from employee surveys was good. That finding prompted it to carry out further drill-down analysis, which threw forward issues specific to individual business units. Using this data, the HR was able to provide each business unit with an action plan to tackle the issues raised.

Findings

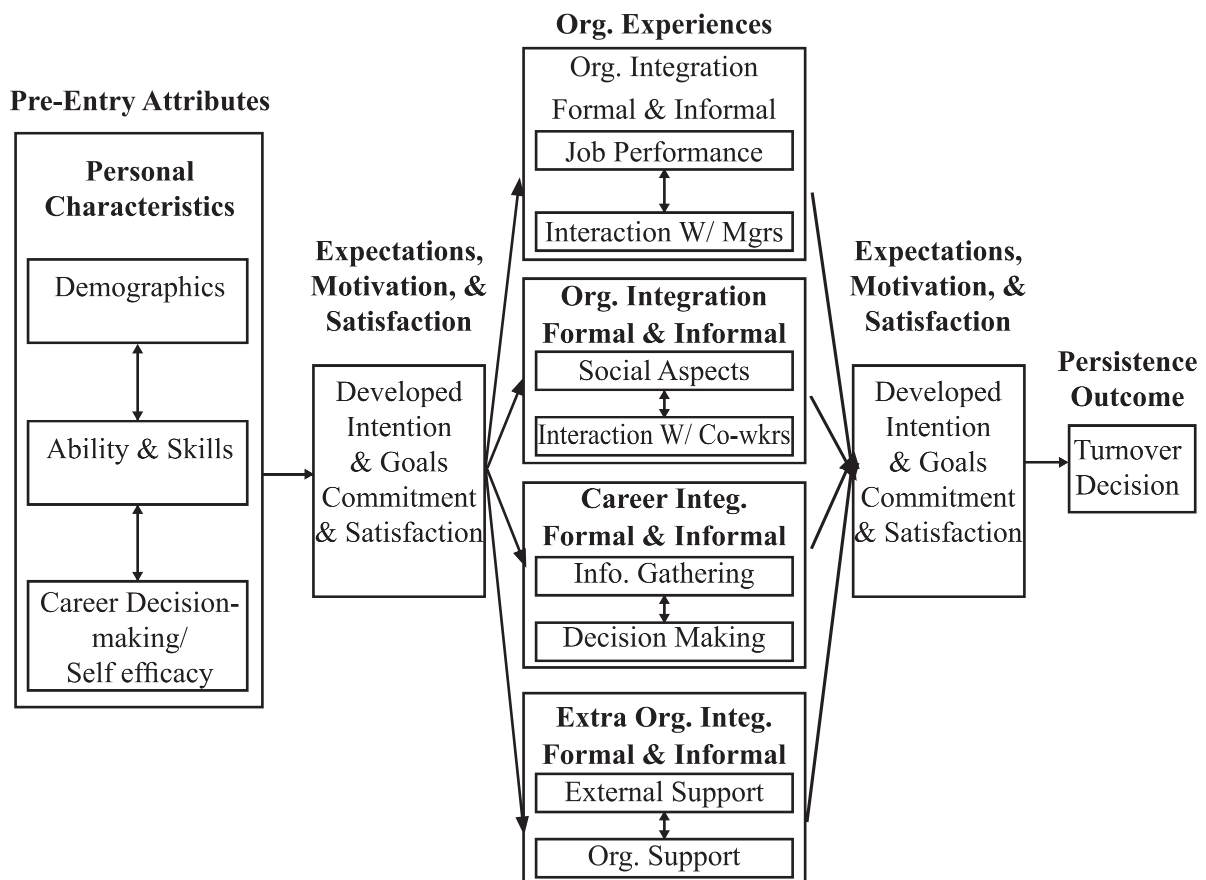

Fig.3: Organizational Model of Employee Persistence

Cotton and Tuttle (1986) found that the strongest predictors for voluntary turnover were age, tenure, pay, overall job satisfaction, and employee's perceptions of fairness.

Factors affecting voluntary turnover can be categorized into three camps. The demographic camp focused on the influence that age, gender, ethnicity, education, marital status, etc., have on an employee's cognitive behaviour leading to turnover or voluntary turnover itself

The second camp, the work characteristic determinants of voluntary turnover camp, have focused on salary, working conditions, supervision, advancement, recognition, growth potential, etc. Traditional HRD interventions related to training and development (T&D) and career development (CD) by definition fall into this category.

The third camp of voluntary turnover factor comprised of psychometric factors namely, job satisfaction, perceived support, fairness.

A comprehensive list of factors affecting attrition and metrics that need to be tracked are given in the table below

Type	Metrics to track	Factor	Data Source	Perceived effect on attrition
Demographic	Age, Gender, Marital Status, No. of Dependents	Age	HRIS	Older employees are less inclined to voluntary turnover than their younger, less tenured counterparts.
		Gender	HRIS	Females tend to have higher attrition rates due to familial considerations and they also experience barriers to advancement.
		Ethnicity	HRIS	Attrition rates among employees belonging to the non-predominant ethnic group in an organization have been found to be higher. They often experience impenetrable barriers progressing into managerial roles.
	Degree Specialization College, University grade, marks	Education Level and Performance	HRIS	Highly educated employees are expected to have higher job mobility.
Work Related	Current Designation,	HRD Interventions	HRIS	Developmental initiatives are expected to help in reducing

	Previous Experience, No of Job Changes, Average Job duration, Current project, Project Location, Home Location, Type of work, Role, Total Duration in project, Promoted in last year, No. of role changes in project, Time spent overseas, Past projects, Date of last designation change, Date of last grade change,Last	& Trainings		employee attrition.
		Salary	HRIS	The wider the discrepancy between self and others, lower the individual pay satisfaction. Performance based pay systems could encourage good performers to stay and poor performers to leave.
		Tenure and Career Opportunities	HRIS	Individuals who perceive strong opportunities for career growth are less likely to leave the organization.
		Job Performance	HRIS	Inverse relationship between performance and voluntary turnover was supported by voluntary turnover path models (Allen & Griffeth, 2001). McEvoy and Cascio (1987) rationalized the relationship stating that low performance leads to job alternative search prompted by high levels of job stress.
		Supervisor Influence	Engagement Scores and E-Sat surveys, Exit Interviews	Role ambiguity and lack of goal clarity are primary influencers on voluntary turnover (Firth, Mellor, Moore, & Loquet, 2004). Absence of supervisor support leads to declining organizational commitment, a precursor of turnover intent and ultimately voluntary turnover.
Psychometric	Current leave balance for various types of leaves, leaves in current quarter, leaves in last quarter	Job Satisfaction	Engagement Scores and E-Sat surveys, Exit Interviews	There is a large body of analytical evidence that job satisfaction and organizational commitment could explain 16-20% of voluntary turnover intention (Cotton & Tuttle, 1986). As

				job satisfaction declines, employers have observed higher levels of employee withdrawal behaviours, such as increasing absenteeism, tardiness, and declining performance.

Table 4: List of factors affecting attrition & metrics that need to be tracked

Analysis of Survey Responses

A total of 103 responses were received for the survey of causal analysis of attrition for different categories of employees.

- For IT engineers in the 18-25 age group (28 respondents) , the findings were as follows:

Higher education and salary were the most prominent reasons for leaving the last job

Reasons for Leaving Previous Companies (Mark all applicable)

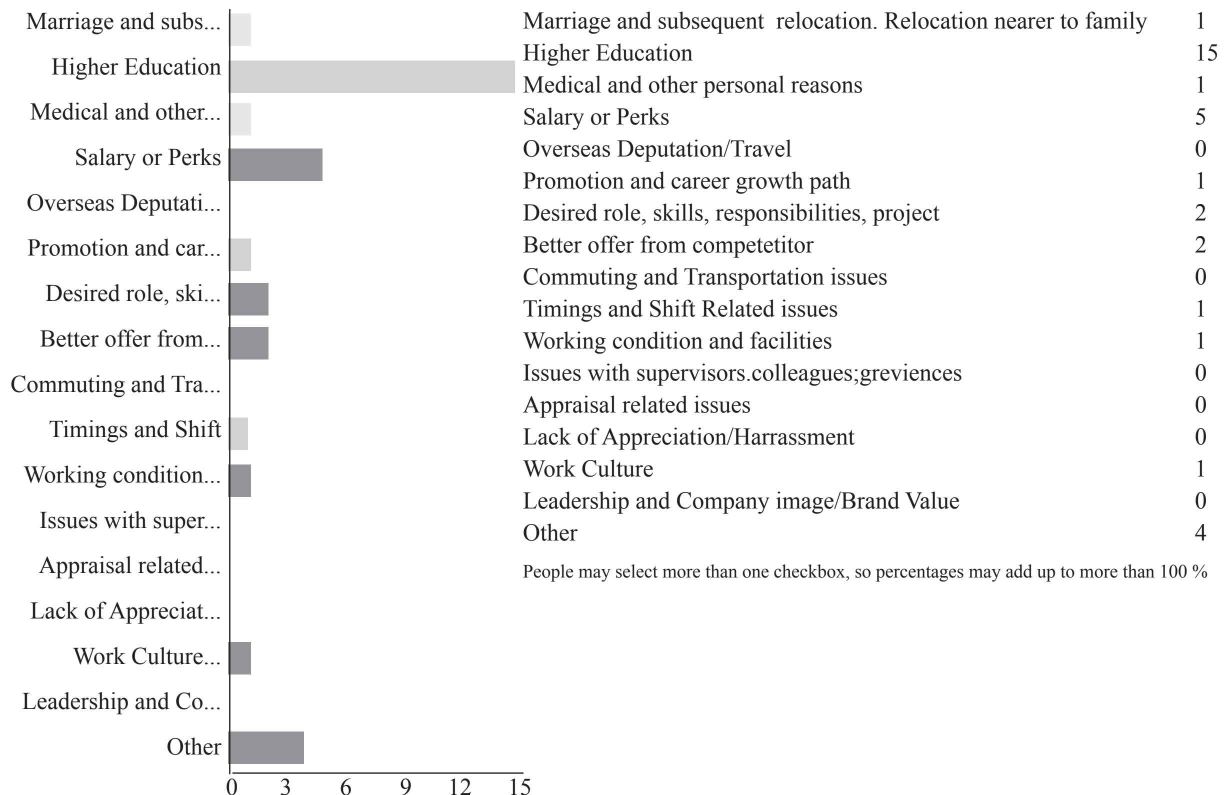

Fig 4: Most prominent reasons for leaving the last job for IT Engineers

Respondents were most dissatisfied with travel opportunities, leadership, and salary. Since salary is a prominent reason for attrition among this category, the employees who are dissatisfied with salary are at high risk of attrition.

Indicate weather you are satisfied with the below parameters in your present job-opportunities for travel and overseas deputation

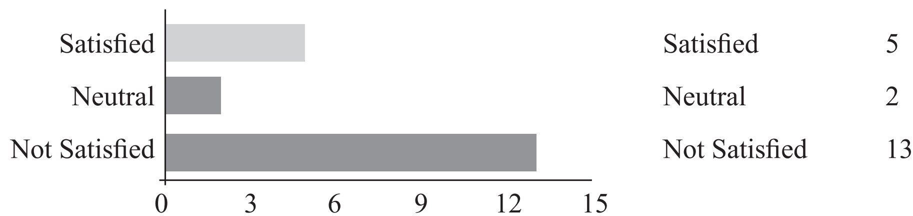

Fig 5: Percentage of satisfaction for 'Opportunities for travel and overseas deputation'

Indicate weather you are satisfied with the below parameters in your present job-Leadership and ability of management

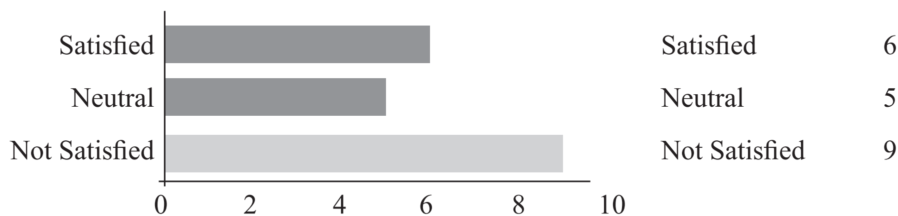

Fig 6: Percentage of satisfaction for 'Leadership and ability of top management'

Indicate weather you are satisfied with the below parameters in your present job-Salary Benefits

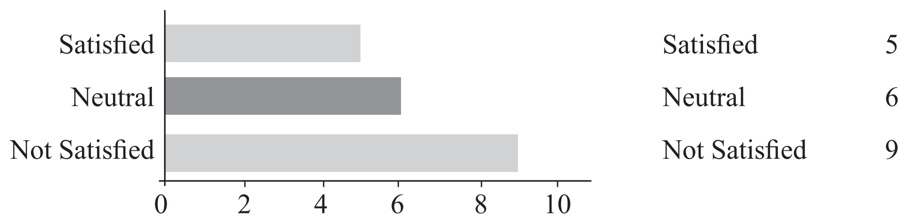

Fig 7: Percentage of satisfaction for 'Salary Benefits'

- The above findings can be contrasted with that of IT employees in the 25-30 age group (16 respondents), the findings were as follows: Desired role and responsibilities, salary, better offers from competitors were the most prominent reasons for leaving the last job.

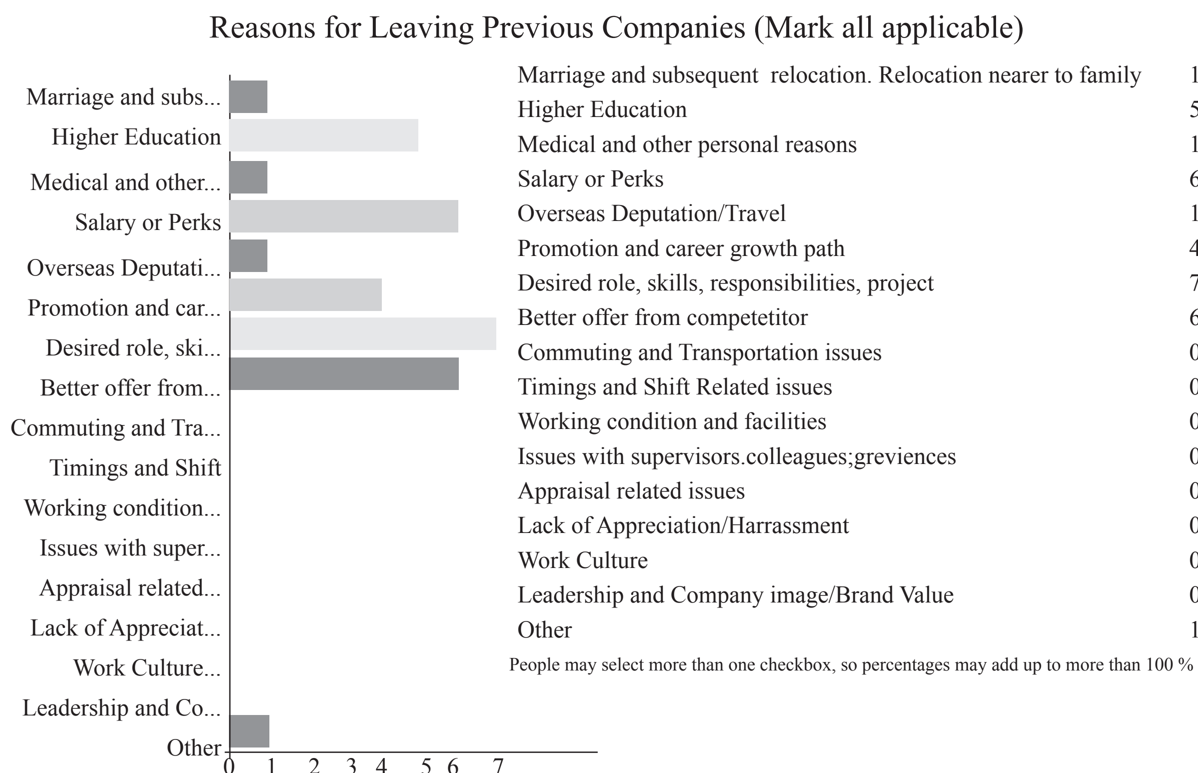

Fig 8: Reasons for leaving previous companies

Most respondents felt that their skills and abilities were being well utilized and were satisfied with their team and supervisors. They were not strongly dissatisfied with salary and perks or leadership. They were however dissatisfied with overseas opportunities like their younger counterparts.

Indicate weather you are satisfied with the below parameters in your present job-Use of my skills and abilities

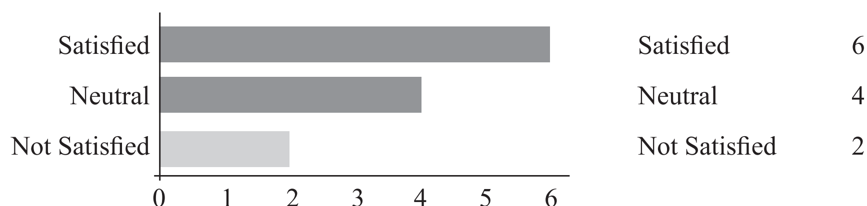

Fig 9: Percentage of satisfaction for 'Use of my skills and abilities'

Indicate weather you are satisfied with the below parameters in your present job-Supervisor and team bonding

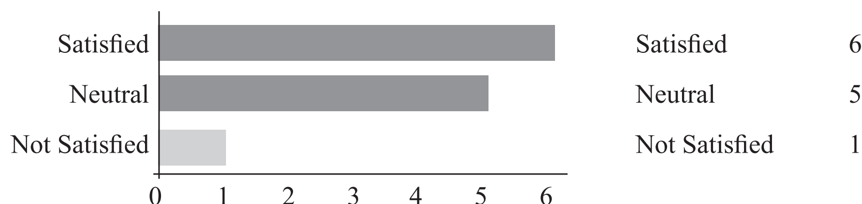

Fig 10: Percentage of satisfaction for 'Supervisor and team building'

Indicate weather you are satisfied with the below parameters in your present job-Opportunities for travel and overseas deputation

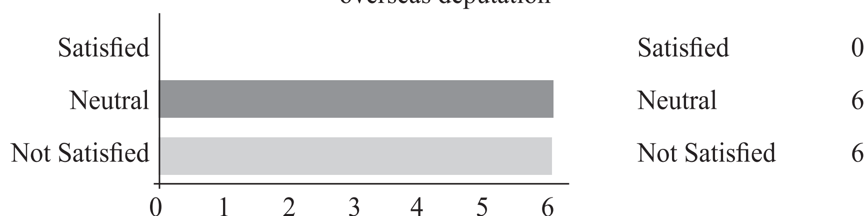

Fig 11: Percentage of satisfaction for 'Opportunities for travel and overseas deputation'

Indicate weather you are satisfied with the below parameters in your present job-Salary/Benefits

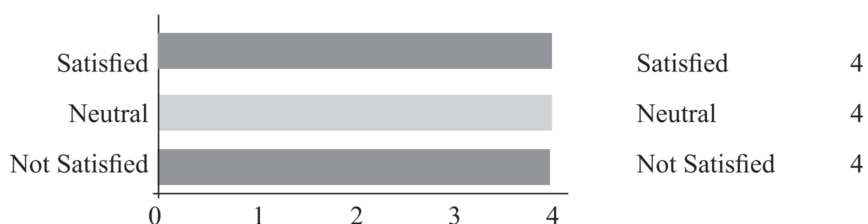

Fig 12: Percentage of satisfaction for 'Salary Benefits'

Indicate weather you are satisfied with the below parameters in your present job-Leadership and ability of top management

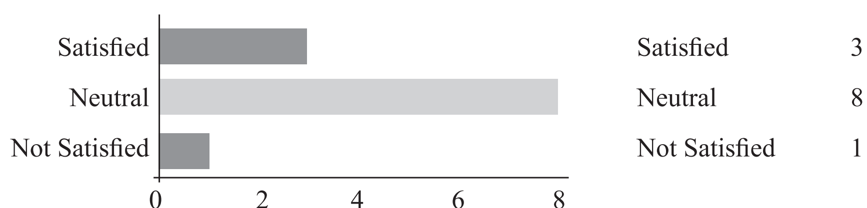

Fig 13: Percentage of satisfaction for 'Leadership and ability of top management'

Conclusion

Despite earnest efforts of executives to reduce turnover, employee mobility remains a fact of life. The traditional approach has been to focus on employee retention programs. Turnover hurts a company not just in terms of the increased administrative expenses (in recruiting, hiring and training replacements) but also because employees are repositories of human capital, an organization's knowledge, skill and know-how.

A Portfolio Approach to Employee Turnover

In dealing with worker turnover, companies should consider two factors: the knowledge and destination of the departing employees. When employees possess knowledge of low strategic importance and are leaving to work at competitors (Scenario 1), for example, the use of defensive action (improving the work environment so that employees will be less inclined to leave) might be the most appropriate response.

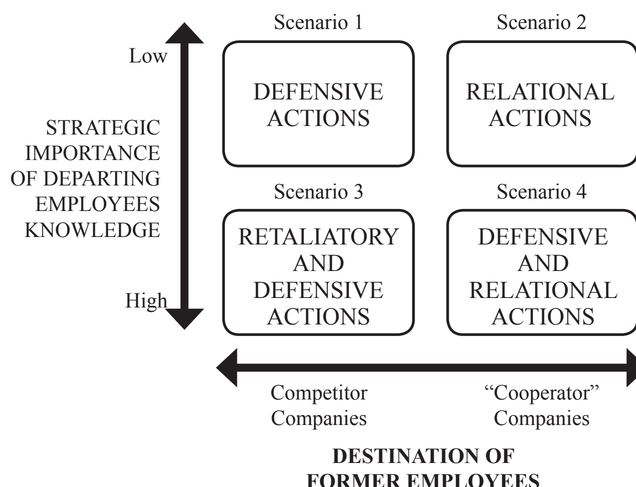

Fig 14: Rethinking the War of Talent, MIT Sloan Management Review

When a talented employee quits taking another job, she takes with her generic as well as company specific knowledge (e.g. Trade secrets). However, on the flipside, when employees move between companies they often maintain contact with former colleagues. These ties can create a conduit for knowledge sharing between organizations. These relationships can serve as a basis for future business dealings between companies and can make inter-organizational endeavors more efficient.

An implicit assumption is that departing employees are lost to competitors. Yet employees also leave to join potential and existing "co-operators" such as customer companies, suppliers and partners and such movement can facilitate creation and strengthening of business relationships.

Traditionally there are two types of strategic responses to turnover. One is defensive, wherein managers try to reduce the motivation of employees to leave with interventions like increasing salary and benefits, training employees, succession planning etc. The other approach is retaliatory, wherein companies take actions to threaten or harm the departing employees or the companies that hire them (e.g. non-compete clauses, retaliatory poaching). The aim of both is to reduce employee turnover. Firms can benefit from adopting a third approach called the

relational approach, wherein it focuses on maintaining and leveraging positive relationships with former employees. This can be done through initiatives such as online communities, social gatherings, conferences, alumni programs. This approach can enhance access to potential clients, increase pool of human capital (referrals) and generate organizational good will. The approach that should be followed in dealing with attrition depends on the organization to which the employee is departing and to the strategic importance of his knowledge.

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Organic Farming: Towards Sustainable Development

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Abstract

Organic farming system in India is not new and has been followed from ancient times. It is a method of farming system which is primarily aimed at cultivating the land and raising crops in such a way, as to keep the soil alive and in good health by use of organic wastes (crop, animal and farm wastes, aquatic wastes) and other biological materials along with beneficial microbes (bio fertilizers) to release nutrients to crops for increased sustainable production in an eco friendly pollution free environment.

Yet over the years, chemical "inputs" — namely, fertilizer and pesticides — have depleted soil, and inefficient irrigation has caused water tables to plunge in many parts of India. For many farmers, crop yields have fallen even as India's food demand has increased. Now farmers and experts are looking for improved farming methods. In some cases, this means a back-to-basics approach.

Navdanya, which is leading the charge for organic farming and biodiversity in India says that "ecological agriculture is highly productive and the only lasting solution to hunger and poverty." With organic farming holding such significance in the sustainable development of India, it becomes crucial to study and analyse existing successful models in order to create and support the development of new ones.

In this study, the reasons for re-emergence of organic farming have been analysed. The business model of an organization that is successfully producing and distributing organic produce all over Pune city has been studied. Finally, the level of involvement and support provided by the government towards organic methods of farming has been examined.

Organic Farming – An Introduction

Organic farming is a method of farming that works in harmony with nature rather than against it. This involves using techniques to achieve good crop yields without harming the natural environment or the people who live and work in it.

The methods and materials that organic farmers use are summarized as follows:

- To keep and build good soil structure and fertility: recycled and composted crop wastes and animal manures, the right soil cultivation at the right time, crop rotation, green manures and legumes, mulching on the soil surface
- To control pests, diseases and weeds: careful planning and crop choice, the use of resistant crops, good cultivation practice, crop rotation, encouraging useful predators that eat pests, increasing genetic diversity, using natural pesticides

Organic farming also involves: careful use of water resources, good animal husbandry. Organic farming does not mean going 'back' to traditional methods. Many of the farming methods used in the past are still useful today. Organic farming takes the best of these and combines them with modern scientific knowledge.

Organic farming provides long-term benefits to people and the environment. Organic farming aims to:

- increase long-term soil fertility
- control pests and diseases without harming the environment
- ensure that water stays clean and safe
- use resources which the farmer already has, so the farmer needs less money to buy farm inputs
- produce nutritious food, feed for animals and high quality crops to sell at a good price

A Train Ride to Cancer

The crowd waiting to board train no. 339 from Bathinda Railway Junction shares more than the overnight journey to Bikaner (Rajasthan), its passengers are bound together by the misery of cancer and the hope of getting cured. On any given night, there are about 70 to 100 cancer patients on this platform, says a station attendant. The cancer-affected on this train are small farmers from the southern districts of Punjab: Bathinda, Faridkot, Moga, Muktsar, Ferozepur, Sangrur and Mansa. Known together as the Malwa region, farmers and families here are grappling with cancer and health problems that have crept into their homes through the backdoor as the farmers of India's grain bowl fed the nation. The latest data from the health department puts the number of cancer patients in Malwa region at 120-125 per lakh against 71, which is the national average. The department states

that there is a jump of 80% in the number of cases from the region in 2010 compared to 2009.

The lush fields hide a scary tale. Farmers live in a disturbing cesspool of toxicity, a result of excessive and unregulated use of pesticides and chemical fertilizers. For one, Punjab farmers' use of pesticides is 923 g/ha (grams per hectare), way above the national average of 570 g/ha. Malwa is also Punjab's cotton belt; cotton crops are prone to pests. Farmers here use at least 15 different pesticide sprays. Of the top 15 pesticides used, the US's Environmental Protection Agency considers 7 used on cotton in the US as 'possible', 'likely', 'probable,' or 'known' human carcinogens. Worse, farmers use the empty pesticide cans to store water and food. Not just cancer, there are scary reports of a reproductive health crisis, from spontaneous abortions to premature deliveries, reduced sperm counts and neural canal birth defects in infants. "Declare Malwa an ecological and environmental health emergency", says Dutt, who promotes organic farming.

Nandita Sengupta, Times of India, Aug 16, 2011

Major Products Produced in India by Organic Farming

Type of Product	Products
Commodity	Tea, Coffee, Rice, Wheat
Spices	Cardamom, Black pepper, White pepper, Ginger, Turmeric, Vanilla, Tamarind, Clove, Cinnamon, Nutmeg, Mace, Chilli
Pulses	Red gram, Black gram
Fruits	Mango, Banana, Pineapple, Passion fruit, Sugarcane, Orange, Cashew nut, Walnut
Vegetables	Okra, Brinjal, Garlic, Onion, Tomato, Potato
Oil seeds	Mustard, Sesame, Castor, Sunflower
Others	Cotton, Herbal extracts

Table 1: Popular Products from Organic Farming

Some Key Statistics

- More than 60 % of India's arable land is under traditional agriculture, where no synthetic inputs are being used
- Area under organic farming has grown many-fold in six years in India on the back of the thrust given to the chemical-free mode of cultivation
- From 42,000 hectares under organic certification in 2003-04, more than 4.4 million hectares was under organic certification in the country as on March 2010, according to

an official statement

- During 2008-09, India produced about 18.78 lakh tonnes of certified organic products. Of this, nearly 54,000 tonnes of food items worth Rs 591 crore were exported
- With more than 77,000 tonnes of organic cotton lint production, India became the largest organic cotton grower in the world a year ago
- Indian organic exports include cereals, pulses, honey, tea, spices, oil seeds, fruits, vegetables, cotton fibre, cosmetics and body care products

Live Cases

GOMUKH Centre for Rural Sustainability (GORUS)

Located about 40 km from Pune, GORUS is an innovative idea that marries convenience for consumers, assured market for farmers and a quest for sustainable farming. GORUS aims at helping small farmers grow organic food and market it directly to urban consumers at their doorsteps.

It started off as an initiative for watershed management and soil conservation in the Kolwan Valley. They started organic cultivation in the summer of 2008 by cultivating a small plot of land at Gomukh trust's farm in Mulshi taluka. Vegetables were planted on raised beds mixed with cattle manure and compost. Since water was limited, plants were drip irrigated and weeds growing between the rows were uprooted and used for mulching the beds. Soon, the vegetables were ready and they started selling the vegetables to five or six families in Pune, mostly acquaintances.

In May, GORUS invited a few local farmers to the farm. Most of them had never seen vegetables like zucchini or herbs like parsley, but what surprised them most was the fact that more than 15 vegetables were planted on a quarter of an acre and gave excellent yield with nothing but cattle manure. By the end of 2009, there were about 15 farmers in the GORUS Organic Farmers Collective with nearly 100 families buying farm produce on a weekly basis. Today, there are about 25 farmers in the group and more than 200 Pune families get 3 tonnes of vegetables home delivered every week. New customers are added only at the beginning of a quarter depending on availability of required production capacity (land and farmers). They have to pay a fee anywhere between Rs. 2500-4000 depending on the size of the basket they want delivered every week (Large- 9.5 Kg, Standard- 4.5 Kg, Mini- 3.5 Kg). A list of vegetables and grains that will be cultivated that season is published at the beginning of the quarters and customers select the vegetables they want in their basket. The ease of placing the order and doorstep delivery is a great help for working couples and senior citizens. Today they have 8 full time employees (3 Women, 5 Men) working to fetch from various farmers, clean and segregate all the collected organic

produce and sort and pack for each of their customers in a separate tray, with the bill. These, then, are all home delivered and cash collected instantly.

One of the key pillars of GORUS strategy is backward integration, ensuring that what the farmers grow is a good match with the demand. At the start of every growing season, GORUS staff and all the farmers get together and make a crop plan. They begin by estimating the likely demand for vegetables in the season based on the experience of the earlier year, the number of orders in the past and the change in the consumer numbers. Once they have an estimate of what quantities of which vegetables are to be produced - for example so much of tomatoes and so much of palak etc. - they estimate the land that will be required to grow it. This is matched against the total land that the farmers have, and the quantities are allotted to each farmer on a pro rata basis. Thus, beginning of each season, the farmer is allotted the area of each vegetable that he/she is to grow. This is very important. Some years back, farmers had grown tomatoes in large numbers, and when the crop was ready, they found that there was a glut in the market, and hence the prices collapsed. Due to this, it was not viable for the farmers to even harvest the tomatoes, let alone transport them to the market. Ultimately, the farmers had to feed them to the cattle. Such stories are a regular occurrence, emphasizing the uncertainty of market for farmers and underscoring the importance of an assured market. The backward integration put in place by GORUS is precisely to ensure that they don’t have a glut (and hence an unmarketable surplus) of some vegetables, at the same time they can provide what the consumers want.

The prices are declared in January and remain fixed throughout the year. Farmers in our collective receive a flat rate of Rs 20/kg for Indian vegetables and Rs 40-50/kg for exotic vegetables, throughout the year. Most people would think that organic produce will be expensive. That is not the case. When onions were being sold at prices above Rs 35 per kg, the price of onions at the collective was Rs 20 in November 2010. The rates in the GORUS’ price-list for 2012 are at par with market retail prices of conventional produce or even lower in some cases, not to mention that the prices are inclusive of home delivery.

They pay the farmers the same rate per kilo, no matter which vegetable they bring in. Thus, tomatoes may be cheaper in the market than broccoli, but the farmer gets the same rate for it at GORUS. This measure, combined with the above described crop allocation, promotes equity and ensures that all farmers get a good return for their produce. Also most of the farm inputs viz fertilizers (Nimpet and Jivamrud) and seeds are provided by GOMUKH. The farmers are allowed to keep upto 20% of the farm produce for their family consumption.

With organic farming, input costs have gone down, a lot of money is saved which would otherwise be spent on chemicals, and the requirement of water is also significantly reduced.

In the conventional marketing process which involves several middlemen and other costs, the farmer maybe getting as little as 20-30% of what the consumer pays. But in the GORUS system the farmer gets as much as 60-65% of what the consumer has paid.

All farmers associated with GORUS practice ‘mixed’ cropping, where plants belonging to

different botanical families are carefully selected and 'mixed' so that there are at least 8 to 10 different vegetables growing in any particular farm plot at any time of the year. Knowledge of 'companion crops' is also useful. For example, onions grow well with tomatoes; corn grows well with beans, etc. Simple techniques such as planting a few rows of marigold in the vegetable plots, or planting mustard (belonging to the same family as the cole crops) which flowers earlier and diverts the attention of the pests from the economic crop, are useful tools for the organic farmer.

In any organic farm produce marketing arrangement, one of the most crucial aspects is to instill confidence in the consumer that the crop has been grown using only organic inputs. The conventional way in which this is done is through third-party certification. But this method is very costly, as it involves highly paid consultants who fly in to verify the farmers' practices. Instead, they have devised a system which they call Peer Certification. In this system, three times a year, one representative of the farmers and one staff member from GORUS takes a round of every field to check that only organic farming methods have been used. Farmers are given cross training, i.e. by allowing novice organic farmers to interact and work with more experienced ones. GORUS also organizes interactions between consumers and the farmers in the form of a cooking workshop, field day (when customers come and work in the farm a full day and eat fully organic lunch). All this ensures a peer and moral pressure on the farmer.

The collective has responded to changing rainfall patterns by constructing low-cost greenhouses using Casuarina wood, bamboo, and plastic. These greenhouses, which shield the crops from excessive rain and solar radiation, enable farmers to produce a wide variety of Indian as well as exotic vegetables throughout the year, and improves their chances to supply vegetables to urban consumers without any major interruption.

As the demand is growing, collection and distribution of organic produce/perishables is becoming very tough and demanding. The farms are present across the state in locations such as Pabad, Shirur, Purandar, Shikrapur etc. Almost 12% of the produce spoils in the commute from farmer to consumer. This is a major loss and challenge facing the enterprise.

To a large extent, organic farming today is a 'return' to pre-chemical farming. However, organic farming today is even more challenging than it was 60 – 70 years ago, because the resources available with the farmer (soil, water, local seeds, cattle manure, and human labor) are either in short supply or their quality has depleted beyond redemption. Thus, contemporary organic farming not only needs to return to pre-chemical/ traditional ways of farming, but also adapt to today's realities such as population growth, elevated cost of living, season-neutral attitude of the market, dominance of mechanized/ large-scale farming, globalization, and even climate change.

Maharashtra Organic Farming Federation

MOFF is a state level confederation of 120 NGOs & 1,42,000 individual farmers, thinkers, scientists, activists & experts from Maharashtra State (India) covering 307690 sq. km area &

about 100 million population. MOFF has been active in promoting Sustainable Agriculture Technology mainly for small land holder farmers & creating awareness for poison-free food consumption in urban society.

Today after five years of relentless travel, deliberations, thought process & massive struggle, MOFF has become a People's Movement, by the farmers, of the farmers & for the farmers. It is a rock-solid platform for the distressed farmers. This concept and MOFF's ideology is being adopted by the other states of India, as a role model, since MOFF offers precise solution, based on low cost, no loan principles for the rural distress.

Good quality seed selection & treatment
Mixed cropping for early income, more yield & less pest attack
Soil & water conservation by trenches, bunds, farm ponds etc.
Bio-fertilizer, using green manure, cow-dung slurry & microbes cultures
Bio-control of pests & diseases, with cow-urine, plants, microbes or insects
Post-harvest processing & marketing for higher unit price
Farmers' counselling on farm management as above or other family worries etc.
Establishment of International Institute for Sustainable Agriculture (IISA), at Pune (Maharashtra)

Table 3: Activities of MOFF

Training

A living soil can be maintained by continuous incorporation of crop & weed biomass, use of animal dung, urine based manures, compost (Fym, NADEP, vermicompost), bio-fertilizers, bio-enhancers, special liquid formulations (vermiwash) etc. during a crop rotation. As a thumb rule, crop residues should be returned to the plot, directly or indirectly.

It was revealed that there is a considerable support from the farmer's community & NGOs throughout the State demanding more trainings for creating awareness of organic farming. It has been observed that organic farming is badly needed by small land holder farmers who constitute 85% of the farmers' community. MOFF proposes to take up extensive organic training programs in almost all the districts of Maharashtra State.

Basic Principles of Sustainable Agriculture
National & International scope for organic farming
Importance of indigenous seeds & seed banks
Nutrient Management Practices in organic crop cultivation
Weed Management Methods
Consumers' awareness for organic food consumption

Table 4: Some Training Topics

Training Features

- Lectures of organic experts on all aspects of organic crop cultivation
- Written examination of trainees at the end of the training
- Distribution of "Certificate" to trainees
- Practical & demonstrations
- Farm Visits
- Participation of female trainees
- Trainees equipped with training kit , containing letter pad, pen, literature, C.D, slogans & sticker of MOFF membership etc
- Group discussion & feedback on various aspects of sustainable livelihood

Challenges

Organic grain farming can increase farmers' incomes significantly, but there are also challenges, particularly in transitioning to organic.

Awareness

It is a fact that many farmers in the country have only vague ideas about organic farming and its advantages as against the conventional farming methods. Use of bio-fertilizers and bio pesticides requires awareness and willingness on the part of the farming community. Knowledge about the availability and usefulness of supplementary nutrients to enrich the soil is also vital to increase productivity.

High Input Costs

The small and marginal cultivators have difficulties in getting the organic manures compared to the chemical fertilizers, which can be bought easily, of course if they have the financial ability. But they have to either produce the organic manures by utilizing the bio-mass they have or they have to be collected from the locality with a minimum effort and cost. Increasing pressure of population and the disappearance of the common lands including the wastes and government lands make the task difficult. The costs of the organic inputs are higher than those of industrially produced chemical fertilizers and pesticides making them unaffordable to the small cultivators.

Output Marketing Problems

It is found that before the beginning of the cultivation of organic crops, their marketability and that too at a premium over the conventional produce has to be assured. It was found that the

farmers of organic wheat in Rajasthan got lower prices than those of the conventional wheat. The cost of marketing of both types of products was also same and the buyers of wheat were not prepared to pay higher prices to the organic variety.

Loss of Yields

In many cases the farmers experience some loss in yields on discarding synthetic inputs on conversion of their farming method from conventional to organic. Restoration of full biological activity in terms of growth of beneficial insect populations, nitrogen fixation from legumes, pest suppression and fertility problems will take some time and the reduction in the yield rates is the result in the interregnum.

Lack of Financial Support

The developing countries like India have to design a plethora of national and regional standards in attune with those of the developed countries. The adoption and maintenance of such a regulatory framework and its implementation will be costly.

Political and Social Factors

Agriculture in India is subject to political interventions with the objectives of dispensing favors for electoral benefits. Subsidies and other supports from both the Central and State governments, government controlled prices of inputs like chemical fertilizers, the public sector units' dominant role in the production of fertilizers, government support/floor prices for many agricultural products, supply of inputs like power and water either free of cost or at a subsidized rate, etc. are the tools often used to achieve political objectives. Any movement for the promotion of organic farming in India will have to counter opposition from the sections who benefit from such policies in the conventional farming system.

Government Initiatives

Recognizing the importance of organic farming in Indian Agriculture, Government of India has taken various initiatives to promote and support organic production. Some of the major ones are:

- Setting up of National Centre of Organic Farming with regional centres at various places
- Launching of the National Programme on Organic Production encompassing National Standards and Accreditation Programme for Certification Agencies

Increasing Investments

As part of 10th Five year Plan, Government of India has earmarked about Rs. 100crores for the promotion of organic agriculture in the country. The main components of this initiative include farming of standards, negotiating with different countries and putting in place a system of certification for organic products.

Promoting Input Market

Central Government is also promoting the production and use of bio-fertilizer to make it popular. Government has initiated a project "National Project on Development and Use of Bio fertilizers" for this purpose. Main objectives of this project are as following:

- Production and distribution of Bio fertilizers (BFs)
- Developing Standards for different BFs and Quality control
- Releasing of grants for setting up BF units
- Training and Publicity

Promoting green agriculture market

To promote the organic agriculture in India the government has also taken some initiatives in recent past. APEDA (Planning Commission, 2001) is the nodal agency to promote the Indian organic agriculture and its exports opportunities

Producers'/Distributors':	1. Lack of proper infrastructure for distribution and conservation of bio-inputs 2. Existence of poor quality bio-inputs in market reduces the credibility of input providers
From Users' (farmers'):	1. Bio-fertilizers and bio-pesticides are perceived as less yielding 2. Some climatic regions and soil conditions are not suitable for specific strains of organic production 3. For some strains limited shelf life is also a constrain as most of the bio-input lasts only for about 4-6 months 4. Given the mandated gestation period of around 3 years for a conventional farm to become an organic farm the benefits perceived by farmers in general and small and marginal farmers in particular tend to be limited as they have short term orientation
From Promoters' (Government's):	1. There is a requirement for reorienting these official organizations towards organic (green) agriculture 2.Changing the cropping and cultivation patterns is slow and time-consuming process given the high levels of illiteracy and large number of small and marginal farmers it makes the change process difficult 3. Subsidies on chemical fertilizers and pesticide impede the growth of organic agriculture

Table 5: Challenges faced by different stakeholders

NABARD

NABARD, as an apex institution in the field of agriculture and rural development has identified Organic Farming as a thrust area and has taken various initiatives for its promotion. These initiatives include building capacities of bankers, NGOs, farmers through training programmes, exposure visits etc., technology development and its dissemination through various funds and suggesting policy measures for financing organic farming.

Sikkim Organic Mission

Sikkim is a unique state in North East India. Neatly tucked in the lap of the Holy Mt. Khangchendzonga, world's third highest mountain, and sandwiched between Nepal and

Bhutan, Sikkim is bestowed with a host of rich flora and fauna. Sikkim's economy is basically agrarian. More than 64% of the population depends on agriculture for their livelihood. Farmers commonly follow mixed farming, which is ideally suited and fits well in the developmental process of making Sikkim an organic State. This is in line with the notification issued by the State Government in 2003 to convert the entire conventional farming practices into organic farming practices by 2009. Thus, from the year 2003 onwards all chemical farm inputs have been banned in Sikkim by legislation. Now, even that seems to be on the fast track. Of 70,000 hectares of arable land in Sikkim, 6000 hectares is already organic-certified. By 2015, Sikkim aims to be completely organic certified. Organic farming combines ecologically sound modern technology with traditional agricultural practices including crop rotation, green manure and biological pest control to ensure reduction or total elimination of chemical inputs. In several parts of Sikkim, farmers have succeeded in growing completely organic maize, paddy, ginger, cardamom and turmeric while expanding the practices to other horticultural crops. Sikkim has a competitive advantage for its organic produces, due to the rich medicinal and aromatic heritage, which is a distinctive characteristic of the region. Apart from the financial gains, organic farming will go a long way in supplementing eco-tourism too. "Tourists put up in homestays can relish the bucolic beauty as well as the healthy food. Vegetables and fruits grown in our farms are already organic as we use only manure and humus. We point out this fact to tourists who enjoy our local cuisine. The organic farming will be a great step towards the promotion of eco-tourism," said a homestay owner in Dzongu.

-Bijoy Gurung, The Telegraph, December 13, 2011

Future Prospects

- The organic farming industry is likely to grow at 10-15 %
- 5% of more land would be under organic farming

- The main driving force would be the Indian domestic market
- The domestic market is likely to grow to 10,000 crores in five years
- According to the Indian Competence Centre for Organic Agriculture, the global market for organically produced foods is $26 billion and is estimated to increase to $102 billion by 2020
- Marginal growth is slowly becoming evident in the increase in organized producers, retailers and product offerings in the market, where the movement had been driven entirely by the spirit of individual initiatives of the farmers, the odd entrepreneur and non-governmental organizations

The impacts of organic farming can be analyzed under three aspects:

Long-term productivity

Protecting soils and enhancing their fertility or land stewardship implies ensuring productive capacity for future generations.

Food security and stability

Organic agriculture can contribute to local food security in several ways. Organic farmers do not incur high initial expenses so less money is borrowed. Synthetic inputs, unaffordable to an increasing number of resource-poor farmers due to decreased subsidies and the need for foreign currency, are not used. Organic soil improvement may be the only economically sound system for resource-poor, small-scale farmers. This characteristic of the production process on organic farms means that organic farmer-consumers are less dependent on a factor over which they may have little control, thereby increasing the food security situation.

Environmental Impact

Organic farmers forego the use of synthetic fertilizers. There are environmental advantages to this: non-renewable fossil energy needs and nitrogen leaching are often reduced. Instead, farmers enhance soil fertility through use of manure crop residues, legumes and green manures, and other natural fertilizers. Soil protection techniques used in organic agriculture combat soil erosion, compaction, salinization, and degradation of soils, especially through the use of crop rotations and organic materials which improve soil fertility and structure. Techniques used in organic agriculture also reduce water pollution and help conserve water on the farm.

Conclusion

Organic farming is nothing new to India, but the need of the hour is the chalking out of a definite nationwide strategy on this issue and the linking of the sources of production to the market for the same. A concerted effort on part of the government in the policy level, active participation of the private sector (for effectively bringing out the commercial face of the concept) and participation of the general public is needed for boosting the demand for the organic agricultural products. Farmers need to be provided with requisite economic and structural backup for increasing the marketability of their products. Technology should also be harnessed in a big way to provide this age-old format of agricultural production with the desired level of improvisation and adaptation. Some fear that a complete conversion to the organic methodology will lead to a decline in food supply. However, modelling studies in India have not yet supported this hypothesis.

Experts opine that considerable crop diversification and investment in R&D would bring out the best of this form of cultivation. While the adoption of the certification procedure (for the maintenance of the designated standard for organic agricultural products) is all very fine, the process itself may leave in the lurch poor farmers, who in spite of producing organic products will completely lose their market, due to their inability to pay the desired fees for obtaining the official certifications.

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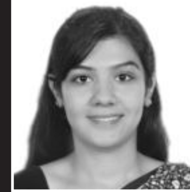
Outreach on Social Networks-Strategy for Companies in the Service Sector



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Abstract

Community-based websites, more commonly known as social networking websites, have come to the forefront of the online world in recent times. Even though there have been many platforms, both online and offline, that have attempted to connect people, none have succeeded as much as these websites, which each boast over 60 million unique users per month. With more and more people starting to go digital to maintain their relationship circles, companies, predictably, are eyeing social networks as an important medium for reaching out to their customers and doing business differently; through changes, both internal and external.

Most corporations have already created multiple methods of advertising in this new medium.

These range from the traditional form of search engine advertising that was pioneered by Google to newer forms such as the creation of product groups that people can join on Facebook.

The services sector can also take a leaf out of the successful ad campaigns and make their presence felt on the social networking space. Thus given the current dog-eat-dog scenario of running businesses, these social networking websites are no less than an opportunity in the crisis. The only thing that makes a difference is how companies utilize this opportunity to reap rich dividends better than their competitors.

This article attempts to make the most of social networks as a platform for improving internal processes and improving the quality of external interactions.

Introduction

A social networking service is an online service, platform, or site that focuses on building and reflecting of social networks or social relations among people, who, for example, share interests

and/or activities. A social network service consists of a representation of each user, his/her social links, and a variety of additional services. Social networking sites allow users to share ideas, activities, events, and interests within their individual networks.

Evolution of Social Networking Websites

The first social networking website that was launched in 1997 was SixDegrees.com. It allowed its users to create profiles, list their friends and peruse others' friend lists. In promoting itself as "a tool to help people connect and send messages to each other", it attracted millions of users. However, the company failed to create a financially viable business model and closed its doors in 2000. Other websites such as Asian Avenue, BlackPlanet, Cyworld and LiveJournal, were also launched in this timeframe.

MySpace was launched in 2003. In addition to becoming a hub for Indie rock bands, the website also began adding features according to user demand and allowed users to customize their profile pages. **Orkut**, Google's foray into social networking, **Windows Live Spaces**, Microsoft's social network became popular within their target demographics. When launched in 2004, **Facebook** was accessible to American college students. It later on opened its doors to anyone with a registered email address. So one can imagine the astronomical proportions these websites are going to assume.

Phenomenal Rise

The rise of social networking websites such as MySpace and Facebook over the past decade has been nothing short of phenomenal. Once regarded as nothing more than a passing 'fad', these websites have grown to astronomical proportions; each website currently boasts 60+ million unique visitors each month. Facebook's user base has grown to approximately 100 million, MySpace too can boast of over 100 million user accounts. As of February 2008, the company You Tube commands a 56% share of the US online video market and over 150,000 videos are uploaded daily. US consumers spend 46% of their time on these websites. An example of social networking being used for business purposes is LinkedIn.com, which aims to interconnect professionals. LinkedIn has over 100 million users in over 200 countries.

Business Application

Social networks connect people at low cost; this can be beneficial for entrepreneurs and small businesses looking to expand their contact bases. Businesses are beginning to notice the potential for reaching out to their target audiences through this new medium and have already begun a series of advertising efforts in order to do so. These networks often act as a customer relationship management tool for companies selling products and services. Since businesses operate globally, social networks can make it easier to keep in touch with contacts around the

world. Another application of social networking sites is brand networking. Brand networking is a new way to capitalize on social trends as a marketing tool.

According to Jody Nimetz, author of Marketing Jive, there are five major uses for businesses and social media: to create brand awareness, as an online reputation management tool, for recruiting, to learn about new technologies and competitors, and as a lead generation tool to intercept potential prospects.

There are three main reasons for social networks playing a pivotal role in companies' advertising strategies:

Large reach: In December 2007, Facebook, MySpace and YouTube, had roughly 161 million unique visitors combined in the US alone. This accounted for roughly two-thirds of the total US population online and nearly half of the total US population. Additionally, internet users worldwide are spending increasing amounts of time on activities with social connections. Currently, the time spent by consumers online far outweighs the advertising spend on online media. US consumers spend 46% of their time online. Internet advertising is expected to grow at a healthy CAGR of above 30% for the next 3-4 years. India alone has a $10-billion e-commerce market.

Cost efficiency: Advertising on social networks is relatively cheap compared to other traditional media; it usually has a similar or expanded reach at much lower costs. In addition, it is possible for companies to generate free publicity through creative advertising techniques. There have been a number of successful viral marketing campaigns on YouTube and Facebook in recent years.

Targeted advertising: Advertisers have access to a great deal of information about users and their interests, allowing them to customize and target their ads to a degree not yet seen in any other advertising medium. For example, if a user lists 'pro wrestling' as an interest on their Facebook profile, the website's advertising system will generate advertisements based on that particular interest

Name of platform	Number of users (India)	Characteristics of platform
Facebook	34.6 million	Predominantly relationship-driven
Orkut	18 million	Predominantly relationship-driven
LinkedIn	9 million	Skill- driven
Google+	2.85 million	Predominantly relationship-driven
Twitter	2.7 million	Predominantly content-driven

Table 1: User base and characteristics of some major social networking sites

Research Methodology

Successful advertisement campaigns were observed and analyzed. The success theory was then postulated to the services sector and possible strategies were worked upon.

Successful Advertisement Campaigns

Cadbury's, the British confectioner, created a campaign called "Gorilla" and uploaded the commercial to YouTube after it was first aired on television. It received over 500,000 views within the first week and also spawned a series of authorized spoofs on the website, further promoting the company's products indirectly.

APPLE iPod touch: Nick Haley, an eighteen year old student at the University of Leeds in the UK, was inspired by Apple's new MP3 player, the Apple iPod touch. He put together a 30 second video clip using images and video clips taken from Apple's official website set to a song by a popular Brazilian band, CSS, within a day and uploaded it to YouTube in September 2007. The clip received overwhelmingly positive responses from its viewers and a rating of 4 out of 5 stars. Among the home-made video's viewers were some of Apple's marketing employees, who were impressed by what they saw. They got in touch with Haley through their advertising agency about producing a professional version of his commercial. Haley then flew to the company's headquarters where his concept video was edited and filmed in high - definition. He received a generous contribution towards his university education and several Apple products for his efforts. The advertisement eventually formed the cornerstone of the iPod touch campaign with over 1.5 million views on YouTube till date.

Criteria for Successful Ad Campaigns

There are three criteria that advertising campaigns on social networks need to fulfill in order to be successful:

It has to be unobtrusive: The inception of the internet saw the first iteration of online advertising in the form of pop-up ads: these opened new browsing windows flashing advertisements that would distract users from optimally experiencing the website. Consumer preferences have evolved along with the internet: they no longer want intrusive, flashing and irrelevant ads that taint their online experience. Advertisers have had to adapt their tactics to reach out to consumers. Thus, in order to be successful on social networks, advertising campaigns have to be unobtrusive to ensure that users listen to their messages.

It has to be creative: In order to attract attention, companies need to deliver their message in imaginative ways that have never been done before. They should take advantage of the structure of social networks, such as applications on Facebook and MySpace, and the easy sharing between parties in order to spread awareness among users.

It has to engage users: The technology behind the websites has enabled its users to fully display their unique personalities online. Companies can harness this expression of creativity by engaging the users in the advertising process themselves through social networks. This will give users a greater sense of involvement with established brands, eventually identifying themselves with the companies.

Services Sector

In economics, a service is an intangible commodity. More specifically, services are an intangible equivalent of economic goods. Some examples of sectors that can be categorized under services head are: technology, media, telecom, communication, information, entertainment, courier, banking, insurance, malls, multiplexes, multi-cuisine restaurants, health, hospitality etc.

The companies in the services sector can also take a leaf out of the above mentioned successful marketing campaign's book and avail maximum benefit of the social networking sites which are assuming humongous proportions in terms of user presence.

Strategy for Service Sector Companies

- **Telecom:** They can launch voice message application, for example, the Apollo-group promoted telecom brand, Aircel, has launched a voice message application on Facebook, which allows friends to leave each other voice messages instead of plain text posts. Within ten days, Aircel managed to get 190 users to sign up for the voicemail application.
- **Technology:** The companies in this sector can make use of the recent 'Live feeds' feature of these websites. People these days like to stay updated about the happenings in the lives of their near and dear ones which can be facilitated by technology companies. For example Foursquare gained popularity as it allowed for users to "check-in" to places that they are frequenting at that moment. Clixtr, though in the real-time space, is also a location-based social networking site since events created by users are automatically geo-tagged, and users can view events occurring nearby through the Clixtr iPhone app.
- **Philanthropists/ charitable organisations:** They can create online communities through web pages on social networking sites. Through these, they can create awareness about the welfare initiatives taken by them and how it benefitted the masses by uploading pertinent pictures and videos. They can also provide a link where people would like to donate to these organisations and in turn can avail tax benefits.
- **Information companies:** They can provide news through the 'Live Feeds' feature and can encourage people to voice their opinion on their web page. Cases like 'Jessica Lal murder case' could have got instant support from the public had the people been empowered by social networking during that timeframe.
- **Entertainment companies:** They can create awareness about their upcoming flicks and promote them through the various applications available on these sites. For example,

an action movie can launch an online game on these sites with the actors of the movie playing the animated characters of the game. If somebody listened to a particular song of the movie then it can be notified to his friends through the 'notification feature' of these sites. They can also encourage people to write scripts, lyrics of a song or give their suggestions directly to the directors and producers and the best script may be rewarded.

- **Malls:** They can make use of 'Gift application' of these sites which enables them to send virtual gifts to their friends. These gifts cost $1 each and there are certain discounts available when bought in bulk. They can partner with these sites to release gifts that promote their mall's products. For example, GE's 'Save Energy' badges for Earth day helped in promoting the company's products.

- **Banking & Insurance:** They can launch a graffiti contest on these sites. By creating a wall specifically dedicated to the contest, they can enable the users to submit their art work on a particular theme pre-decided by the company. The wall should display the logo of the company. The best art work to be then selected through user votes and a panel of judges. The winner should receive a monetary reward by these companies.

- **Tourism:** The travel agencies and hotels in this sector can create a web page on these sites through which they can apprise people of their special packages for families, newly wedded couples or simply a group of college friends. They can encourage their customers to upload their excursion pictures and narrate their experiences on the wall/ web page. They can also encourage people to upload their videos and then reward the video with the highest ratings or most likes with a free holiday package.

- **Health:** Social networks can be adopted by healthcare professionals as a means to manage institutional knowledge, disseminate peer to peer knowledge and to highlight individual physicians and institutions. Health sector companies can form online communities where people can ask the advice of famous physicians, engage in discussions and take second-opinion in case surgery is referred to somebody. The companies can charge some fee for the advices. For alcoholics and addicts, these sites can give people in recovery the ability to communicate with one another and strengthen their recovery through the encouragement of others who can relate to their situation. For example SoberCircle and PatientsLikeMe are social networking websites in health sector.

- **Restaurants & cafés:** Many social networks provide an online environment for people to communicate and exchange personal information for dating purposes. Starbucks and

Cafe Coffee Day can make use of this data. They can create exclusive clubs on these sites which restrict entry to couples only. The clubs can enable the couples to dedicate songs to their partner, send virtual gifts and can create virtual dating ambience.

- **Political parties:** They can launch online groups on these sites and launch their campaigns through these. These groups can also be a vehicle to inviting people to suggest what changes they wish to see in the government, infrastructure facilities, etc thereby giving a platform to people to voice their opinions. The members of the group can be updated about the latest election campaigns of the party and their results. Videos and pictures of chairman's speech and any community initiative taken by the party can be uploaded.

- **Brand management companies:** Certain service sector companies that help manage other brands on social networking sites can help their clients listen to their customers more intelligently. Beyond monitoring dashboard, which tracks mentions on more than 100 million social media sites, they offer updating companies' blogs, Twitter and Facebook accounts all in one spot. They also apply spam management techniques and text analysis to clean data sets, assess emotions surrounding their clients' brand pre-, mid- and post campaign so that they can adjust their strategies accordingly. Some examples of these companies are: Collective Intellect and Lithium

Conclusion

Incorporating social networks as a medium of interaction internally, would facilitate a more open platform where ideas and knowledge could be shared effectively and efficiently. Externally, it would facilitate effective media interaction, industry networking and brand building, developing strategic information for better decision-making and providing an alternative customer service channel. Companies can very well harness these capabilities to complement their existing information base and fine-tune their awareness about market sentiments.

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Brand from the Inside

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Abstract

When the competition gets fierce, it exists at all levels. To companies, it is becoming increasingly evident that the one basic ingredient for success is: People, both external as well as internal. External People vis-à-vis your customers are the ones who keep you in business; hence it is seen that the increased emphasis on customer satisfaction and high level of customer service is helping companies differentiate their products. Internal People vis-à-vis your employees are the ones who run your business for you, hence the increasing emphasis on hiring and retention of the right talent. Employer branding is the process of not only attracting talent as employees but also impacting your external customers and investors. Through this article the author endeavors to create an understanding for the term 'Employer Branding', understand the need & importance for Employer branding and enumerate fundamental methods to create a strong Employer brand. The author has conducted a fundamental research to develop the findings of the article. In order to create a competitive edge for the company/organization it is important to create a differentiator, which sets it apart from its competitors. Employer branding helps create that differentiating factor to attract talented people who can help in the growth of the company/organization, and increase profitability. Basic things like investing in a tag line, and internal commitment to Employer brand promise, can help create your Employer brand in the market place.

Introduction

In a world that is changing with the blink of the eye, opportunities are endless. Technological progress exposes us to newer ways of life itself. Distances are increasingly becoming meaningless and employment across borders is no big arrangement today. Now, the companies are in a talent war and this war knows no boundaries. Multinational companies are procuring talent from across nationalities. And everyone has their eyes set to get the best.

Employer branding is the process of not only attracting talent as employees but also impacting your external customers. Today, companies around the globe are battling problems related to talent and skills shortage, perception of an organization or occupation as well as attitudes of young workforce who are constantly torn between organizational loyalty and career progression, and fierce competition to retain and acquire talent. The employee perception creates your brand value in the labor market. In such a scenario, Employer Branding can help the company/organization create a differentiator for them self in the labor market.

Methodology

This is a fundamental research conducted in order to better understand the meaning of the term 'Employer Branding' and develop its importance. The researcher identified its key objectives as the following:

- Create an understanding for the term 'Employer Branding'
- Understand the need & importance for Employer branding
- Enumerate fundamental methods to create a strong Employer brand

The author has studied various current trends, journals, articles, books and papers to deliver these findings. A detailed reference of the same has been made in the 'References' section of this research paper. These are based on a fundamental research format and enable to create a clearer understanding of the underlying concepts.

The article goes a step ahead and suggests ways of incorporating the findings for use by organizations and companies to benefit from these results.

Findings and Recommendations

What is 'Employer Branding'?
Employer Branding is the reputation of the company/organization held by the stakeholders. The stakeholders maybe in any form e.g. employee, customer or investor, although majorly Employer branding deals with the potential and existing employees. A strong employer brand should bond a company/organization's values, its people strategy and HR policies and be in sync with its vision and mission. Employer brand is the true essence of the employer-employee contract. It is the reason people join a particular company/organization and also, the reason they stay.

Just as a consumer brand signifies certain qualities of a product or service, similarly, an employer brand signifies the qualities/offerings of a company/ organization. It is what helps organization choose their employer. Just as a living organism, every brand also experiences its own triumphs, failures and succumbs to the changing trends. While building its brand, a company/organization, essentially focuses on three key areas: the marketplace, the consumers and its employees.

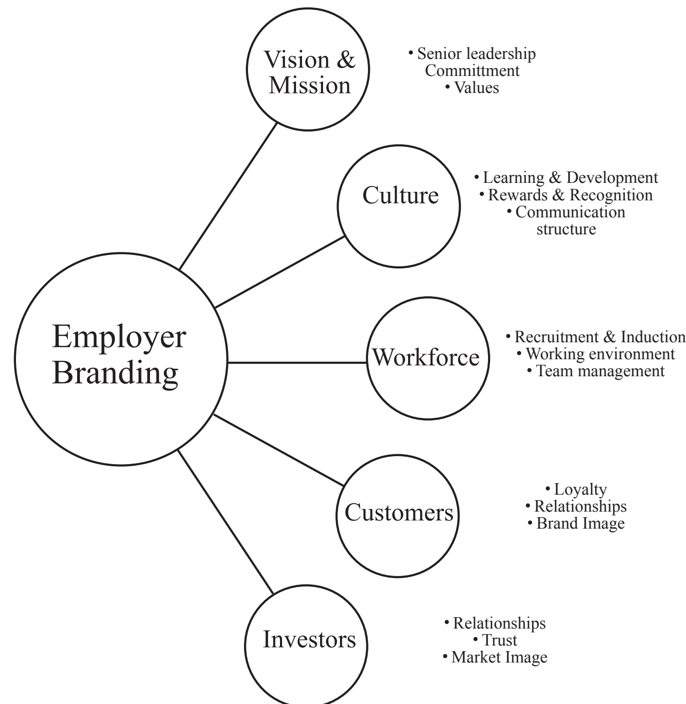

Fig 1: Employer Branding

The Need & Importance for Employer Branding

Market realities that emphasize the need for Employer Branding:

- **Shrinking employability leads to a talent war:** Manpower Group, the world leader in innovative workforce solutions, in its seventh annual Talent Shortage Survey in 2012, explained the world's ongoing talent shortage crisis — in which one in three employers (34%) globally reported difficulty in filling jobs due to lack of available talent. This has mainly been blamed on the lack of competent applicants. This further leads to a rush to hire and retain employees. Strong employer branding can help both attract talent as well as retain it

- **Rising attrition rate:** Technological advancements have made people more independent. Today, each individual is free to search jobs all across the globe with the help of email and various job e-portals. With this rise in the number of opportunities we also see a rise in the number of people switching jobs and hence the rising attrition rate. In such a scenario, a strong employer brand helps create loyalty among employees, provided the company/organisation delivers its commitment promised by its brand

- **High cost of talent acquisition:** Hiring new employees means more than just the salary which can be substantial all by itself. It also includes the cost of recruiting, training and more. The cost of recruiting includes: advertisements, time cost of internal recruiter,

time cost of recruiter's assistant in reviewing resumes and performing other recruitment-related tasks, time cost of the person conducting the interviews, medical check-up and background checks, and various pre-employment assessment tests. The cost of training also gets added; recruitment is just the first step in the process; once the right person is in place, businesses need to provide adequate training so the new employee can do the work and start producing for the company. The cost of salary plus benefits: the obvious cost of a new employee - the salary - comes with its own bundle of perks and benefits, as well. Benefits range from the minor things like free coffee to the major such as gym memberships, life insurance, disability coverage, dental plans, tuition reimbursement and the list goes on. Another cost is the cost of workplace integration: A company/organization has to provide much more than simply providing a computer and a desk-and-chair; there's also the cost of physical space as well as software, cell phone, travel and any special equipment or resources required for the job. All these costs added up together, make the cost of talent acquisition very high. This process can be avoided by retention of talent within the organisation. A strong employer brand can deter an employee's decision to leave the organisation

- **Fierce competition:** Today, talent has become more important than capital, strategy, or R&D, considering the popular sources of competitive advantage that companies have: capital, business strategy, technology, and talent. Today, capital is accessible for good ideas and good projects, with venture capitalists ready to fund new ideas. Strategies have become transparent: even if you have a smart strategy, others can simply copy it and the rate of advancement of technology is simply awe-inspiring. For many companies/organizations, that means that people are the prime source of competitive advantage. Talented people not only have ideas but can also execute those ideas better and even develop other people in the company/organization

- **Awareness levels of consumers and investors:** With rapid growth in information exchange levels across the globe, the customer is more aware about the brand he purchases. Just as good customer service and high level of CSR activity can help create brand equity, similarly a strong employer brand helps towards creating an overall brand image in the marketplace

Business advantages that stress on the importance for employer branding:

Considering profit to be the main aim in any business, it is important to align all efforts to contribute to the bottom line. Employer branding can help make money in the following ways:

- **Create value:** A well-defined employer brand is well integrated with the business strategy and articulates the shared responsibilities for achieving success. The Return on Investment (ROI) is not just an HR metric (i.e. cost-per-hire, time-to-fill, training cost, etc) but rather revenue growth. Employee satisfaction drives customer satisfaction/

loyalty and revenue growth. Employer branding fuels employee engagement, engagement fosters productivity, and productivity, in turn, fuels profitability

- **Saves money:** Good employer branding connects employees with cultures and the chance of a hiring misfire is greatly reduced. There is transparency in the employer-employee agreement and the turnover goes down, thereby reducing recruiting costs
- **Low cost initiative:** Top management discussions, communication audit, employer branding surveys, executive interviews and internal focus groups can be used to define the employer brand

Fundamental Methods to Create a Strong Employer Brand

After understanding the meaning of employer branding for any company/organization, and its importance, below are the fundamental methods to create an employer brand:

- **Invest in a tag line:** Brand differentiators and employer value proposition must be highlighted in the tagline. This can be used in a multitude of ways - part of recruitment marketing materials, internal communications and conferences. The essence of the employer value proposition can be communicated in many ways, varying by business unit, country, or corporate initiative
- **Employee testimonials create a difference:** A potential candidate would read and trust the testimonial of the existent employee of the company/ organization. It is common knowledge that positive feedbacks/reviews tend to affect the purchasing behaviour of other customers. The same can be extended to companies and employment as well
- **Employer brand strategy must involve marketers:** Top management must understand that any company/organization has only one brand and managing the different, interconnected parts e.g. employer brand, consumer brand, corporate brand can no longer be managed independently given the speed at which the dynamics of the workplace are evolving. It is important to involve business functions like marketing to promote the employer brand
- **Enumerate your differentiators as an employer:** Certain specific qualities that a company/organization displays as an employer should be recognised, built upon and popularised. This can help attract talent to the company/organisation
- **Live up to the promise:** In order to build any brand, it is important to live up to the promise created by the brand. Employees are the messengers to the outside world. Only if there is a consistent effort and commitment to create an employer brand, will it truly make a difference

Conclusion

Employer Brand is the image of the employer in the minds of the existent and future employees. The need of having an employer brand is not only emphasized by the various market realities surrounding us, but also by the economic advantages of having a strong employer brand. Market realities such as shrinking employability leading to a talent war, rising attrition rate, high cost of talent acquisition, fierce competition, and awareness levels of consumers and investors push for creating and maintaining an employer brand. Economic advantages like employer brand as a means of revenue generation, as a money saver, and as an economically viable activity support its creation.

Moreover, the entire process of employer branding can help in realigning your goal and processes. This would further result in an overall efficient organizational structure.

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Being Competitive and Managing Aspirations

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Abstract

With the rising aspirations of the present talent pool, talent management as an organizational function has lately gained significance. Organizations across borders are implementing innovative practices to nurture and preserve the best fits. This article discusses the disparity that arises in an organization due to conflict between the individual aspirations and the companies' intentions. GenY is an indecisive lot, attracting their attention has become a daunting task for the organizations and also their ability to retain them is becoming a challenge. The present mood of the talent pool is different; they want autonomy, dynamism, and a concerted effort towards learning and gaining experience. This can be further validated by some concepts like aqui-hiring etc.

Taking into consideration the changes in the mind-set and competitiveness between organizations, the authors will share their point of view on how the companies can identify the aspirations and attitude of the GenY and keep effective procedures in place to match up to their demands and at the same time create an active pool of talent for their organizations.

The Recent Trends in Talent Management: As a Practice

There is an intense demographic shift occurring in the workforce. The organizations have been dominated enough by the baby boomers. Now the time has come where the organizations have realized the prominence of tapping in the young talent and this has become critical for future organizational success as well. Along with this there is a notion of career changing. Companies are not only besieged to hold onto their young talent but also to build their career ladder, which is conveniently called a *Career Lattice* or a career web – where one works in the corporate world for a period of time, takes time off, goes for higher studies or starts one's own business, and go back to their previous organization do a non-profit work there and then

take a sabbatical. Mostly Americans have chosen this path. But this trend is hardly promoted by Indian corporate scenario.

The focus of this article is on how can companies tap in the best of the young minds and motivate them to work harder. Human resource is the ultimate reserve that an organization would always want to invest in. But if this investment goes wrong then a firm can be in a big fiasco. Nowadays companies go an extra mile to bring in the people with the innate ability to do strenuous and value added work.

The idea of acquiring the company that has the best minds working seems to be more appealing to the companies. Yes, that is true; the companies are now acquiring small companies majorly the start-ups; the chief reason is to seize the intellect behind these start-ups. The companies acquiring them may not even be in the similar line of business. It is purely the talent that is intended to be brought inside the firm. This concept of hiring talent is called *Aqui-hiring*.

These day's companies spend a huge amount of money in search of a 'perfect' candidate for their organization. For a particular job opening they hunt vigorously for a person who can prove to be an all in one candidate-someone who has the right skills, knowledge, education and experience. In short he/she is an all-rounder. Such a rare candidate is defined as *Purple Squirrel* by the hiring managers. Companies like Google and Microsoft have such exceptional talent in their organization. Often such candidates are never materialized to work as companies are too focused to hire only them and in this race of acquiring them they end up taking wrong hasty decisions. To bring them on-board companies need to realize that their career progression is kept in mind and more importantly the recruitment process needs to be made robust.

Managing Aspirations of Gen-Y

There are various problems faced by a firm when engaging young talent. Their aspirations are high and they want to achieve success at the earliest. Research shows that Gen Y looks for a job that is challenging and where certain amount of autonomy is given to them. They are more experimental at this stage and work to gain maximum experience. In this case there are high chances of them switching over recurrently from one job to another. Also an expression is used to describe the Gen Y and that is FOMO- Fear of Missing Out. They feel that by executing a particular role in an organization may make their career graph stagnant and they have a constant fear of moving on one path only. They also prefer less stifling, open and constructive work environment, that is why new concepts of work from anywhere have gained acceptance. Gen Y wants to move out of their cubicles and experience networking and face real challenges at the ground level. They are all ready to work by being at the forefront. This is something that needs to be fortified by the companies as they are still under the impression that the trend of 'work from home', and the desire among the youth to have comfortable cubicles is what they want. These requirements have been well opted for, but only at a later stage in their career.

According to a survey the major difference between the Gen X and the Gen Y working is in terms of technology. Technology changes from new to 'improved' in the blink of an eye. Generation Y seeks technology to expand every aspect of their lives whether it is to make employment simple, or have well-organized control over time and to bring relations and associates closer. The rift between the generations also occurs because of cultural clash. The baby boomers may want the organization to function in a structured manner thereby following a hierarchy where the reporting relation of the employees are defined whereas Gen Y believes in a more informal approach which will help them to work at liberty in the firm thereby stimulating them to think and be innovative as there are no restrictions imposed on them. They believe that such an atmosphere will help them in approaching their superiors and cultivating ideas to create a more collaborative work culture.

It, therefore, is significant to effectively manage the aspirations of the target talent. It also becomes imperative to manage your current employees to reduce attrition and to ensure that they are able to fulfill their personal goals and career growth. It is suggested that a well-structured talent management system should be incorporated by an organization, starting with sophisticated recruiting, powerful on-boarding process and superior retention practices.

Social Media and Technology: A Tool for Hiring the Best-Fit

In this war for talent, building relationships with prospective candidates helps undoubtedly. Concepts like candidate relationship management (CRM) are gaining popularity; the only goal of candidate relationship management is to develop a pre-screened pool of candidates for positions you have or might have in the future. Many organizations use customized software (e.g. Applicant Tracking Systems) for keeping a robust database of candidates. It helps them to track a previous candidate who would fit into a current job opening; it saves time and also helps to contact eligible people through e-mail. It also has other features which are designed according to the requirements of different organizations. For example, if a position comes up, the database could be searched for prospective candidates and those people could be contacted immediately, without wasting time in searching through traditional sources or putting up job advertisements.

With the internet gaining importance in various fields of life, it has also gained significance in hiring. With that, talent communities have come into focus which have become a source of social recruiting. A talent community is a network of candidates, employees, alumni, and our social and professional networks allowing productive two-way communication between all permitting and willing connections. A community is engaged in collaborations and the sharing of information. The benefits of this are that recruiters can do passive screening, which allows them to passively meet and screen active candidates one-on-one. Discussions reveal the candidates' career aspirations, experience, and perspectives on various issues. Some of these could be relevant information based on which recruiters can find out not only if the person is

right for the job but also whether he/she would fit into the organization. Social networking sites like LinkedIn, Facebook, and Twitter are such examples where we see talent communities. The concept of social hiring is not new, but has not been utilized to its fullest.

A Systematic Approach to Talent Management

It is imperative for organizations to manage talent effectively to be competitive. It should start from planning an effective recruiting process. It is the first step for an organization to come into the awareness set of the applicants. With multiple sources of talent acquisition, employment branding is all the more relevant in the present scenario, to communicate its brand across all sources. Thus focus is required to make the organization appealing and a prospective employer *to attract talent*. Campus branding is an important way through which fresh graduates get to know more about the company. Organizations also encourage active participation from students by way of various competitions, which also helps them gain fresh perspectives and out of the box and non-conventional business solutions. In the current situation where the Gen Y is looking for a learning experience more than anything else, the image a company projects is very important. A company that is considered traditional or conservative may not rank very high on their list.

The second step is the hiring process; it should be a *positive experience* for all the applicants, because they would go out and speak about their encounter with the company, and share it with colleagues, thus creating a positive front becomes significant. Thus even the candidates who do not get selected, should speak of a great experience during the procedure. Many application procedures are too detailed and lengthy often making them cumbersome. A simplified and hassle free application system, should be in place for convenience. This is especially relevant for passive candidates who are presently employed elsewhere, but looking for another job, they would want a quick application process, preferably a well-designed online form, in the company website. Another approach could be of 'live-interview', which can be given from anywhere, not requiring them to travel to a specific venue; this would save time and resources to schedule an elaborate process. An online application process could also make use of certain iPhone and android applications available on smartphones these days. Almost every task can be done on a mobile platform, also the number of smartphone users is increasing day by day, and hence it makes sense to explore this aspect of the current scene.

The third step is to understand the present mood of the employees. With changing times expectations also change and effectively managing rising aspirations has become the core of talent management systems. This is crucial for *engaging and developing* talent within the organization. Need of the hour demands for talent management leaders who are agile, who learn fast, and who know how to operate under constraints and stiff industry competition for the same talent pool. Talent leaders should be proactive in defining present and future numbers, required by the organization, so that people needed to fill certain posts are ready and in place for

a smooth transition. Thus leaders who streamline the employees and keep replacements in place in case of turnover or retirement become important assets of the company, and identifying such managers should become the starting point of a talent management process.

Employee engagement, simply defined, means that the employees are willfully doing the tasks that are assigned to them. We often forget that we have a thriving internal talent pool within the organization itself, which if properly groomed and distinguished can serve the purpose of succession planning. Employees with similar skill sets and competencies should be grouped together for easy references. In fact the need of the hour stresses for the HR department to be more analytical in its approach to deal with various situations. *HR-Analytics* or workforce metrics, compiles the employee information in a described format, and also helps to interpret certain situations like reasons for attrition, through past trends etc. HR department should therefore be adapted to make use of the data made available to them. Otherwise the company would need to hire specialist staff to make data driven decisions thus increasing cost. Also talent management software can be installed to make the process simpler. This would help sort out the best of the talents within the organization.

Integrated Software that keeps track of employee performances and achievements will help identify high performing individuals within the organizations, and tracing their progress. These individuals can be assigned more challenging roles, to check their mettle and can be used for promotions as well. An organization wide forum where the employees can themselves update their recent successes, will lead to *talent visibility* within the internal talent pool. This would be beneficial to actively involve the employees and make them proactive, to contribute more and add value. Because their contribution is lauded and recognized they would be motivated. Further, the others would be compelled to buck-up to reach up to the mark, promoting healthy competition among the employees.

The involvement of top-brass in development programs emanates a serious and concerted effort to build an effective workforce. *Career sketching* is one tool where an employee can be groomed to take future roles, the employee can be identified early in his career and his progress in the organization can be monitored and tracked, thus making them ready to replace the incumbents. Guidance is essential when an employee is trying to find his way, or else there is a tendency for him to drift away, thereby losing a talent or keeping the potential underutilized. Thus coaching and mentoring are important aspects and must be done faithfully. At certain points in their jobs, employees feel the need to take up challenging roles, thus such an environment must be cultivated where they come up with innovative ideas or projects, and should be given a chance to implement those ideas. A suggestion would be an organization wise competition for developing a new marketing scheme for a new market. For example, such brain storming and open discussions would make them more involved in the process; this could also lead to tangible results for the company, bringing fresh perspectives. This would also give autonomy to them and sense of personal fulfillment which matches the objectives of the present talent pool.

The final step in the talent management process is *retention*; talent management leaders

must realize that employees are restless and uncertain due to various reasons. They look for meaningful work and greater engagement; they are always looking for better opportunities, therefore until the organizations make efforts to understand their perspectives and factors that make them choose that company, it will be difficult to keep them in the long run. Thus organizations must identify those aspects that make the company a desirable one and those factors must be enhanced and other features must be cultivated so that the present employees are satisfied and working at optimum levels, and people searching for jobs look at the organization as a prospective employer.

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Business Outcomes Model, the new buzzword

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Abstract

IT Service providers are now experimenting with new business models for pricing, to stay ahead of the market competition, while maintaining their profitability and also supporting the bottom line goals of the customer. One such model is the Business Outcomes Model. This model charges the customer based on the outcome of the business irrespective of the magnitude of resources deployed during the execution of the project. This model helps the customers in de-risking their business with service providers, across the globe, on the lines of technology, pricing and deliverables which eventually improves the efficiency and effectiveness of the overall resources employed in an organization. Customers do not have to spend their time and energy in tracking if they are making value for the money that they pay. In business outcomes model, the customers just have to track the tangible business outcomes. The model also helps the customers to shove off the fixed cost charged by the IT companies in the traditional model.

Introduction

IT Industry: Year 2012-the only industry to sustain its growth trajectory in spite of technology challenges and uncertain market environment by developing and implementing business models which are sustainable with a positive impact on the bottom line of the organization. Service providers of IT industry have come up with a wide range of innovative services from cloud computing to mobile apps, business analytics to social media collaboration with mobile world to be ahead of the competitors.

The deployment of technologies by the domestic market in India has also increased drastically to expedite processes. One of the major users of technology in the domestic market is the

government which is moving towards e-processing in most of its departments; some of the leading states to pioneer in this paradigm shift are Tamil Nadu, Gujarat, and Bihar. Technology helps the government and SMEs in India to improve the efficiency and increases the delivery rate of its services and products.

With over 1000 IT start ups in India in the year 2012, the path for the growth of the industry has no stopping. "A paradigm shift in technology trends and application is leading to the emergence of new companies from India to serve global and local markets", said Som Mittal, President, National Association of Software and Services Companies (Nasscom).

The domestic market is expected to grow 13-16% this fiscal as against 17% last fiscal to Rs.91,800 crore (Rs.918 billion) from Rs.78,600 crore (Rs.786 billion) in 2010-11. Software exports are expected to grow 11% this fiscal to $77 billion despite currency volatility from $69 billion in 2011-12, according to Nasscom. The industry is forecasted to have a solid double digit growth despite slowdown in the year 2013.

Business Outcomes Model

Business Outcomes model works on the principle-"Pay only for the outcomes", unlike traditional method where the pricing is done based on the time, effort, man power, technology, infrastructure etc. that go into achieving the outcomes. This model helps the customers in de-risking their business with IT Companies, across the globe, on the lines of technology, pricing and deliverables which eventually improves the efficiency and effectiveness of all the resources employed in an organization. Customers do not have to spend their time and energy in tracking if they are making value for the money that they pay. In business outcomes model, the customers just have to track the tangible business outcomes.

Example

A banking company aims to sells 1000 new home loans based on its market demand estimation and pays an IT company for the services. However, the actual number of home loans it managed to sell is 800. As per the traditional method, the customer has to pay a fixed cost to the IT company for the entire 1000 loans which results in huge monetary loss for the customer. In Business Outcomes model, the customer pays only for the actual number of home loans sold and thus not paying a fixed cost but a variable cost.

The Business Outcomes model helps in aligning the customer's bottom line goals with the service provider's compensation. The model also helps the customers to shove off the fixed cost charged by the IT companies in the traditional model. The critical success factor of Business Outcomes model is the "Domain Knowledge". In today's competitive market, customers expect the service providers to come with solutions for stated problems which are innovative and also

improve the overall process thus helping to manage the business profitably with least cost. From service providers point of view, there is a huge investment required in terms of training the employee with the latest technologies thus empowering them to take the right technical decisions which increases the overall value of the organization. Hence, the main focus of the service provider should be in creating a brand for itself which can relate to its power in domain knowledge. Currently there are various maturity models like CMM (Capability Maturity Model), CSCMM (Cyber Security Capability Maturity Model), CCMM (Cloud Computing Maturity Model) and many others on which the maturity level of the service providers are judged. There will come a time when the service providers are going to be judged by the maturity model named DKMM (Domain Knowledge Maturity Model).

Summary

Business Outcomes Model is appropriate when the objective of the business dealing between the customer and the service provider goes beyond pricing to delivering a measurable impact on business results. Further, the customer's and service provider's paths must align so that they can work collaboratively towards the same goal.

Business Outcomes model is a more sophisticated pricing model that requires clear definition of outcomes and tangible measurement of value creation in order to work in collaboration. This model works best in engagements where the outcome is based on meeting SLA (Service Level Agreements), deliverable or deadlines.

This model is increasingly used by business process outsourcing and IT managed service firms in India. Services firms are also beginning to adopt this model for outsourced product engineering services including software maintenance and new product development.

For successful implementation of Business Outcomes model, the following parameters are evaluated before the business deal between the customer and the service provider:

- **Access to top management:** Service provider should have an exceptional working relationship with customers, access to its top management and executives, a defined problem escalation path will create trust among the customers
- **Customer's business knowledge:** Service providers must maintain strong insights into customer's business model, operations and industry nuances. Customers keep service provider in the communication loop when making major decisions regarding business direction or response to market conditions
- **Clearly defined scope of business:** The scope of work directly affects the business outcome. Customers and service providers must have a clear understanding of the scope of business and its measurable results

- **Process control:** Services firm must have the ability to control elements of the process that affect the business outcome and make timely upgradation of the process which makes the business sustainable. Upgradation must be planned in a proactive manner
- **Risk management:** Risk involved in any sort of business is at least partially within firm's control. Risks can be calculated for each stage of the engagement, and an appropriate mitigation strategy has to be applied. The effect of external variable affecting the business has to be minimal in such a way that the service provider is able to influence the outcome
- **Measurable outcomes:** Service levels and performance goals are clearly defined and measurable. All parameters, variables, reports and formulas used to compute results and measure outcomes is thoroughly discussed, and easy to develop or readily available
- **Proven delivery:** Firm has proven delivery capabilities for this engagement

Results-Findings and Recommendations

Challenges

Challenges exist for both the customer and the service provider when entering into and implementing Business Outcomes model. Implementing this model requires new evaluation techniques, new management approaches, improved top-level know-how for designing and managing contract relationships, better logistics systems and a whole new set of skills.

The service provider must do his due diligence, design a fully defined scope of business contract specifying customer obligations and assign a highly talented and well-assembled team which is prepared to manage performance commitments.

Risk evaluation processes must align with the amount of risk undertaken by the project with predefinitions for how the risks are distributed, planned for, and mitigated between the client and services firm. A business outcome engagement could have a lower risk than a time and materials or fixed-fee engagement as the services firm has assumed more accountability and responsibility for the integrity of the delivery process.

A service provider must also define the amount of bearable risk given the firm's process maturity and state of its business before offering an outcome-based model. The ability to accurately calculate process costs is critical to determining risk throughout the engagement

Benefits

From the customer's point of view, this type of model provides assurance that the service provider shares the risk with his business. Thus, a better assurance of the outcome exists when the outcome is rewarded by the customer than the amount of effort that went in during its execution. The way cost is predicted also becomes an advantage for the customer, as they will able to allocate the finance for the particular project in an efficient manner .It also helps in reducing the total cost of investment which every business is looking for.

From the service provider's point of view, business outcomes model provides great motivation and incentive to innovate to complete the work faster, meet or exceed client's expected results and deliver profit back to the firm. This model will pre-empt the competitor.

Typically, the driver of this type of engagement is the services provider, not the customer. Many firms see this model as a way to break out of the linear growth model and delink pricing from effort and head count. Also, more progressive firms that learn to manage risk effectively can use this approach as a powerful market differentiator.

Global economic conditions, technological advancements and outsourcing have increased the need for the implementation of the Business Outcomes model. This type of model can be successful and enriching both the service providers and customers with the right business environment and most significantly, arriving at a common beneficial outcome requires a strong and open relationship between the two parties.

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Last Mile Delivery: Practices and Challenges in the Indian Context

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Abstract

This paper aims to explain the concept of last mile delivery, with special reference to India. Last mile delivery, the activity of delivering the product to the end customer, faces a lot of hurdles many of which are unique to India. At the same time last mile delivery has become very significant with the proliferation of click and mortar companies. This paper intends to highlight the challenges faced in last mile delivery and tries to explore a few options of tackling them. Some of the typical challenges facing the Indian logistics industry are inadequate road network, poor road quality, high level of fragmentation of the trucking industry, multiple check points etc. The paper also covers last mile delivery of unconventional goods such as the goods distributed via the public distribution system or even the task of direct cash transfers to individuals.

Introduction

Logistics is the flow of goods and information within the supply chain. The last mile in logistics refers to the delivery of goods and services to the end customer. As the saying goes 'the last mile is the longest mile', it is true even in the logistics field, where delivering to the end customer is the toughest link of the supply chain.

The last mile, is, due to its very specific delivery needs, considered as the most expensive part of the supply chain. The last-mile part accounts, depending on several factors/characteristics, for 13% to 75% of the total supply chain costs. Related to these high costs are many inefficiencies in the last mile and the poor environmental performance.

Last mile delivery of goods has become more important than ever. As India grows, its cities will expand and new cities will emerge. The Indian demographics will go through significant changes

that will drive unique supply chain complexities, says research firm McKinsey & Company. Research by McKinsey Global Institute suggests that by 2030, there will be 68 cities, each with population greater than one million (up from 42 cities in 2008). This is nearly 60% growth over two decades. Cities will begin to cater to a significantly large population.

By 2030, around 590 million people will live in Indian cities, and around 200 million rural Indians living in the proximity of cities will depend on cities for growth. By 2030, the per capita disposable income in urban India is expected to grow four-fold. Around 100 million households will move up to the middle class (annual income between Rs 2 lakh and Rs 10 lakh). McKinsey in a report on supply chain evolution "Managing the new normal released, at the Logistics Summit 2012", said that increasing demand from across the country will drive significant network complexity.

Logistical hubs and new innovations in delivery will evolve to manage service levels and last mile delivery.

Methodology

The case method is followed. Last mile logistics has been explained in brief and is followed by the major issues faced with particular reference to India. Except for the few theories that are being postulated for the first time, most of the theories are accompanied with relevant examples. The cases are developed with the help of secondary research, and interviews of industry professionals.

Issues Affecting Logistics in India

The core issues plaguing logistics growth in India are infrastructure, regulatory environment and fragmented nature of the industry.

India's spend on logistics activities - equivalent to 13% of its GDP is higher than that of the developed nations (as shown in Table 1). The key reason for this is the relatively higher level of inefficiencies in the system, with lower average trucking speeds, higher turnaround time at ports and high cost of administrative delays being just a few of the examples.

Country	Logistics Cost/GDP	Share of 3PL in overall Logistics
China, India	13-15%	<10%
U.S.	9.90%	57%
Europe	10%	30-40%
Japan	11.40%	80%

Table 1: Comparison of the spend on logistics
Source: Logistics in India SSKI

These inefficiencies have arisen over the years from a combination of a non-conducive policy

environment, extensive industry fragmentation and lack of good basic infrastructure. India's indirect tax regime discouraged large centralized warehouses and led, over time, to fragmentation in the warehousing sector. At the same time, the absence of a single logistics 'champion' (whether in form of a ministry or otherwise) in the government (or industry) has led to a disintegrated approach to development of the sector. *Extensive fragmentation* means the incapacity of industry players to develop the industry. Apart from being of key infrastructural value, an efficient transport system also plays a significant role in connecting the various parts of the country. However, despite its apparent importance the transport sector in India has received scant attention. The inadequacy of transport infrastructure and lack of funding from government have been the crux of problems confronting the road freight sector as a whole and poor support infrastructure, such as roads, ports and telecom, led to a situation where the opportunity to create value is limited.

Figure 1 shows the relative value of transportation costs vis-à-vis other elements of the logistics costs in India. The transportation industry is *fragmented and largely un-organized* – a large number of independent players with regional or national permits that carry freight, often with small fleet size of one or two single-axle trucks. This segment carries a large percent of the national load and almost the entire regional load. This fragmented segment comprises owners and employees with inadequate skills, perspectives or abilities to organize or manage their operations effectively. Low cost has been traditionally achieved by employing *low level of technology, low wages* (due to lower education levels), poor maintenance of equipment, overloading of the truck beyond capacity, and price competition amongst a large number of service providers in the industry. Often, one finds transportation cartels that regulate supply of trucks and transport costs. However, the long run average cost of transport operations across the entire supply chain may not turn out to be low.

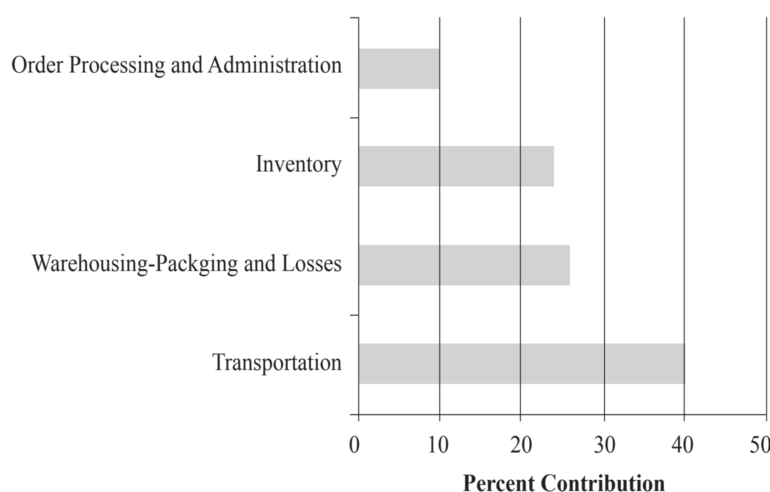

Fig 1: Relative value of transportation costs vis-à-vis other elements of the logistics costs
Source: Sanyal (2006)

The other issue faced is the significant *skill gap* between western logistics personnel and their Indian counterparts. A lack of focus on developing manpower and skills for the logistics sector

has resulted in a significant gap in the numbers and quality of manpower in the sector. This gap, unless addressed urgently, is likely to be a key impediment in the growth of the logistics sector in India, and in consequence, could impact growth in industry and manufacturing sectors as well. This underscores the need for identifying areas where such manpower and skill gaps are critical, and developing focused action plans to improve the situation.

There have been a few tentative steps taken by the government to address the issues in the current system. The government has demonstrated commitment towards providing an enabling infrastructure and creating conducive regulations. There is significant current and planned investment in infrastructure to the tune of INR 15 trillion over the next few years and an increased emphasis on public-private partnership. At the same time, regulations around rationalization of tax structures and prevention of overloading for example are creating an environment of positive change. Players now have the opportunity to leverage economies of scale, complemented with better infrastructure, to provide integrated logistics solutions which are cost effective.

In addition, the evolving business landscape and increasing competition across industries, is creating the need for more efficient and reliable logistics services than what exist today. For example, rapid growth of organized retail and the need to reach out to the large untapped rural markets in India are necessitating development of strong back end and front end supply network.

Outsourcing vs. Close Control

Last mile logistics is increasingly being *outsourced* to third party vendors. This allows the businesses to concentrate on their core functions while the last mile needs are taken care of by an expert in the field.

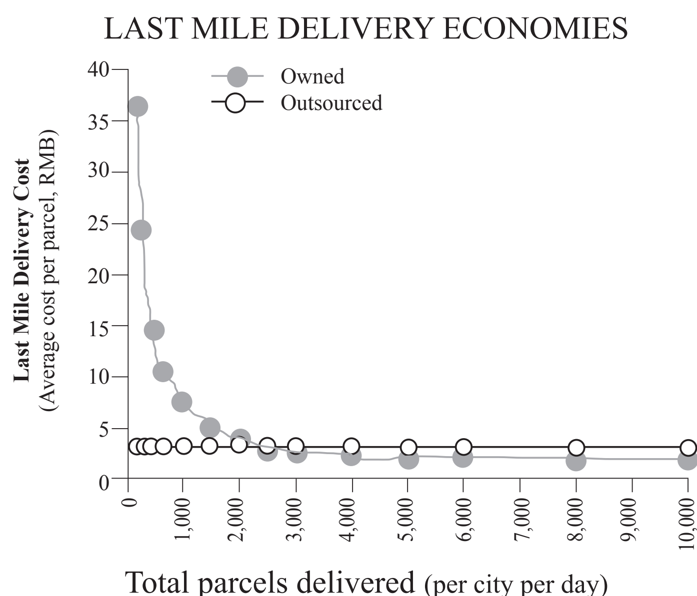

Fig 2: Last-mile delivery cost vs. total parcels delivered

The above cost clearly indicates the benefits of last mile delivery with increasing volume of delivery. Another advantage of outsourcing last-mile is having a transactional-style business relationship. If the volumes go up or down, the providers adjust; the company still pays the same price per unit, which brings a great financial benefit. Also, when volumes fluctuate, there are no underutilized assets like they would be if deliveries were handled in-house. Major Chinese e-commerce giants like Taobao.com are increasingly adopting outsourcing strategies.

On the other hand, having a *close control* over last mile logistics has its own set of advantages. The past decade has seen a lot of firms trying to extend their supply chains directly to the end customer, which will help them to observe the effect of their strategies directly on the target customers, thus gaining valuable feedback. This is critical for managers, which will allow them to tweak their strategies to have the maximum effect at the quickest. In other words it increases the *responsiveness* of the supply chain to customer demand. An Indian example of this strategy is CavinKare who are setting up exclusive distribution centers for controlling the distribution more closely. This model hasn't yet been a success, but the logic behind the idea is impeccable.

Corporate Solutions to the Last Mile Delivery Problem

Enterprises have addressed the last mile delivery problems in many innovative ways. Dell has followed the online distribution model to work its way towards a dominant share of the market.

A major way in which Indian companies have addressed the distribution problem is by leveraging the entrepreneurial urge of common Indians. HUL via its '*Shaktimaan*' initiative has rapidly expanded into rural India. Through this initiative, men from the Shakti Amma families have been distributing HUL products to villages adjoining the respective Shakti village. The GIS (Geographical Information System) tracks villages around the 'Shakti' families and on the basis of which the Shaktimaan is allotted five to six villages. They go on bicycles (provided by HUL) to these villages and sell HUL products. HUL currently has over 30,000 Shaktimaans on board ranging across the country.

Another example of the *entrepreneurship* idea is that of the LIC policy agents. In the public sector LIC has differentiated itself from the rest by giving LIC agents ownership of the insurance policy marketing. There are currently about 12 lakh LIC agents in the country. By offering them a commission on policies sold, the performance of the agents is directly tied down to their incomes.

Another strategy recommended is to use *piggy-backing*. The idea behind this is to utilize the distribution channel of another company to sell products of your own. This idea is generally used in overseas distribution, however given the challenges faced to reach the "Bottom of Pyramid" consumers it will be a good idea to replicate the piggy-back strategies in India. It

is only government agencies that have been able to penetrate to the heart of India. Consider the case of India Post. India has the largest postal network in the world with over 1,55,015 post offices, as on 31.03.2009, of which 1, 39,144 (89.76%) are in the rural areas. At the time of independence, there were 23,344 post offices, which were primarily in urban areas. Thus, the network has registered a seven-fold growth since independence, with the focus of this expansion primarily in rural areas. On an average, a post office serves an area of 21.21 Sq. Km and a population of 7175 people.

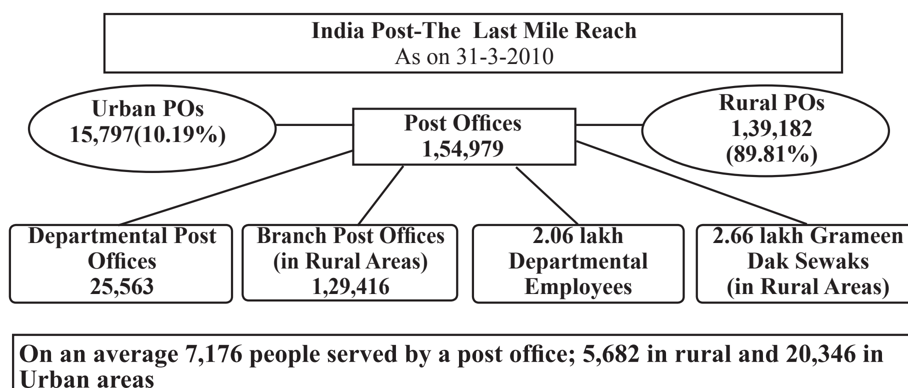

Fig 3: India post network

Collaboration with India post has already been started by foreign companies like Thomas Cook and Western Union Money Transfer. But there is scope of achieving much more.

The direct cash transfer scheme started by the Government of India has led to a setting up of a network of micro-ATMs all over the country side. F&B players like PepsiCo and Coca-Cola can have an opportunity to pair these micro-ATMs with vending machines in the vicinity using the same power source as the micro-ATMs.

Last Mile in Inland Freight Distribution

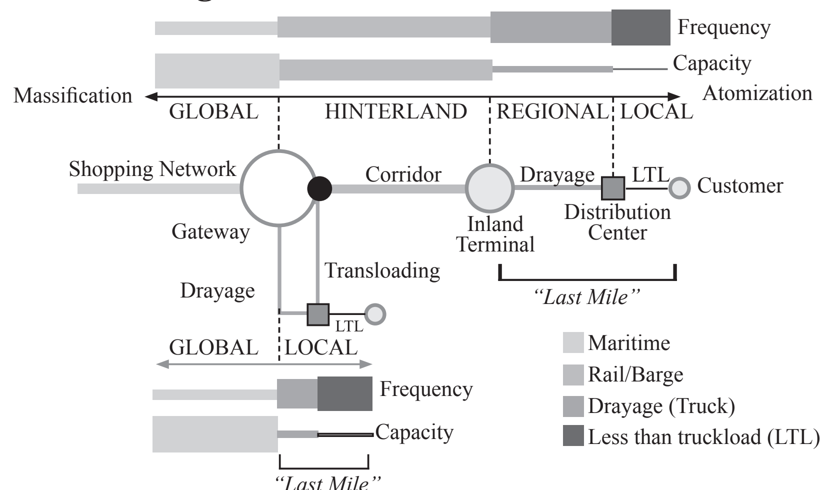

Fig 4: The 'Last Mile' in inland freight distribution

Long distance transportation tends to be well serviced by high capacity modes and terminals and is prone to economies of scale (massification). As we get closer to the final customer, economies of scale are increasingly difficult to apply as the size of batches tends to diminish (atomization). It would be rare, for instance, for a single customer to be the consignee of the cargo of a whole containership. For an international shipment, the global shipping network offers very high capacity levels and, depending on the routes, a reasonable frequency of services (for instance, one port call every two days). The "Last Mile", notably for retailing, often consists of truck deliveries taking place over short distances, but likely in a congested urban setting and in less than full truck load. It is often one of the most complex elements of the commodity chain to organize as it reconciles many customers, a variety of shipments and reliability difficulties related to congestion. The "Last Mile" concept also applies to the "First Mile", albeit in reverse, which involves consolidation to a nearby transport terminal of the output of potentially several producers. For inland freight distribution there are two types of last mile logistics:

- Gateway-based where the cargo is either bound to a local (or regional if long distance trucking is involved) consignee or transloaded into a domestic container and then brought back to an intermodal terminal for inland shipping
- Hinterland-based, which links gateways to inland terminals often using rail or barge services, is of lower capacity but of higher frequency

The containerization process is thus confronted with a growing tension between a **massification** at sea and an atomization on land. Growing vessel size has led to the massification of unit cargo at sea. On terminals and at the landside, massification makes place for an atomization process whereby each individual container has to find its way to its final destination. A major challenge consists in extending the massification concept as far inland as possible. Postponing the atomization of container batches shifts the container sorting function to the inland and as such eases the pressure on port terminals. High-volume rail and barge corridors including inland terminals play a crucial role in this process.

Last Mile Delivery of Online Firms

Online shopping viz-a-viz retail shopping has given an added importance to last mile logistics. Delivering the product to last mile allows vehicles to use delivering in bulk and using vehicle routing algorithms to maximize profit, while minimizing losses.

Last mile logistics has many connotations but none more significant than online retailing.

A country's prospect for online retail success is closely related to how many people use the internet and how many are comfortable purchasing or buying online. Though India is ranked 5th in Global Retail Development Index (GRDI), it is not ranked in the E-commerce Index, as the internet penetration is still low when compared to global average and those who are

connected to internet avoid E-commerce because of poor infrastructure that prevents reliable delivery and returns. Below is the classification of top 30 Countries in GRDI as per their E-commerce potential.

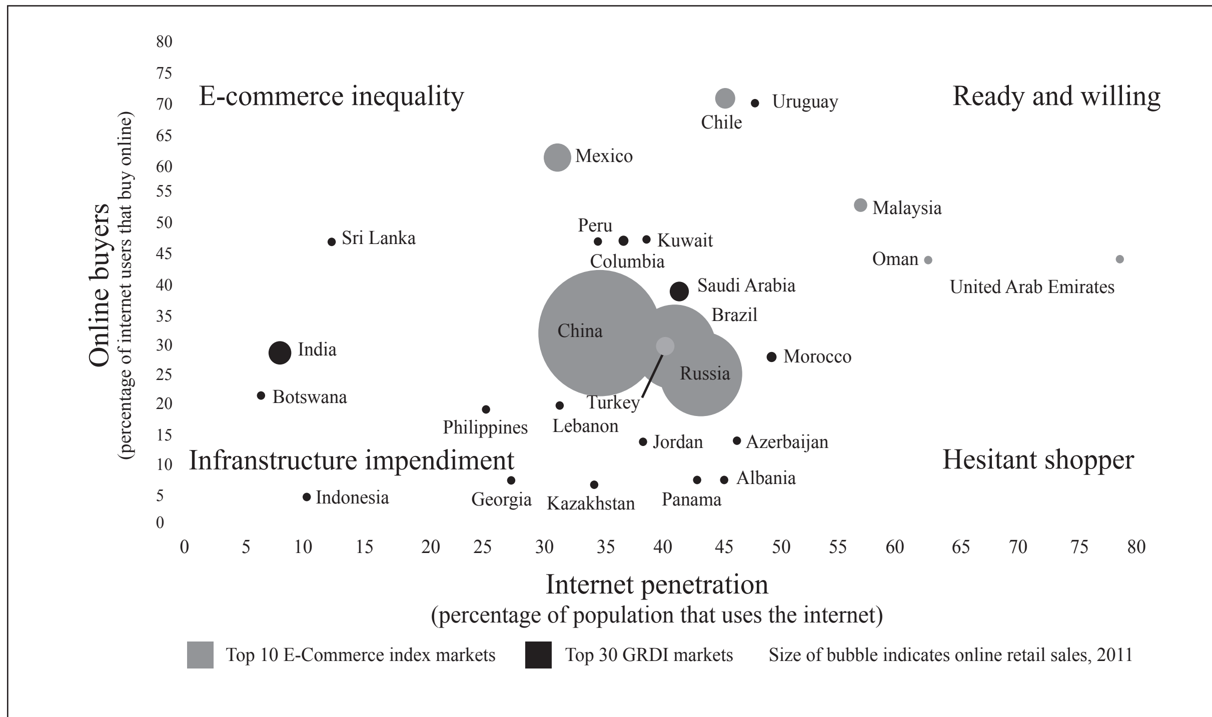

Fig 5: Comparison of internet use with online shopping habits
Source: Euromonitor, International Telecommunication Union; A.T.Kearney analysis

The analysis put India in Infrastructure impediment quadrant as internet penetration and supply chain infrastructure for E-commerce is lower than global standards, still the sales for E-commerce in India as the size of the bubble indicates are more than many top ranked countries in the ecommerce index.

Though the Indian market has a long way to go for E-commerce and unranked in top 10 by the consulting firm, we feel it still offers an early mover advantage and the growth of the market seems inevitable due to following reasons:

- With 8-10% of internet penetration it offers a huge market for growth potential as around 120 million of the population is accessing internet
- Number of online shoppers in India is on a sharp rise as the market is building; new customers are getting acquired every day
- Rate of internet penetration is 10.2% according to Internet world stats
- Mobile & smartphone penetration rates are high where users are switching to smartphones for internet and there is a rise in mobile shopping

- Logistics services in India are aggressively coping up with the current demand of E-commerce players with new specialized players coming to the scene
- Rise of disposable income and middle class is adding to consumers' willingness to spend
- Low penetration of organized retail and lack of availability of products is facilitating E-commerce transaction in Tier 2/Tier 3 cities which are witnessing sharp increase in demand

Online retailing however, has had to be modified to fit the Indian psyche. For example Indians are still very conservative when it comes to paying online.

Recognizing this business opportunity a number of niche companies have mushroomed, specializing on last mile delivery and cash collection. Chhotu.in is one such company which offers last mile delivery and cash collection. Online retailer, Myntra.com has tied up with Chhotu to conduct their last mile delivery. The case of Chhotu.in has been discussed in more detail below. Gharpay which works with Cleartrip.com is another such venture.

Online shopping viz-a-viz retail shopping has given an added importance to last mile logistics. Delivering the product to last mile allows vehicles to use consolidation strategies and using vehicle routing algorithms to plan the best route.

The Delivery Box Issue

There are a number of generic problems facing last mile delivery firms over the world. The number of working households increased by 22% between 1992 and 2012. As a result, parcel carriers must cope with increasing incidence of failed delivery. This can be solved by having a reception box or delivery box. These boxes can either be refrigerated or otherwise. The concept behind this is dropping off the items in the delivery box. This has been pioneered by DHL who call it *PUDO* (pick up drop off).

In India such issues are dealt by contacting the recipient before the dispatch is made to confirm availability to receive the parcel. This method while utilitarian does have some drawbacks. If the delivery window falls in the working hours of the day, it is unlikely that there will be a person to receive even if a call is made.

A suggested modification to the delivery box concept will be to have the delivery box located at the collection office itself. This will address the twin issues of unavailability of recipients to collect the parcels and security while delivering the parcels. While this concept hasn't been tried on a large scale in India, a version is already in practice in the one of the major IT company: Infosys where the software professionals request parcel delivery at the office address, and the delivery is made to the in house collection point, whence the parcel is collected at leisure.

Cases

A few cases are discussed in brief:

- Chhotu.in

  Chhotu.in is a start up taking care of the last mile delivery for online retailers.

- Gati Ltd

  Gati Ltd is one of the big logistics players in the Indian logistics industry. The business model of Gati is explored with particular focus on how Gati faced challenges with last mile delivery. This paper intends to find out how Gati leverages its status as one of the pre-eminent players in the Indian logistics space to its advantage.

- Palande Couriers

  The Indian logistics industry is growing at the rate of 15% and is currently valued at $125 billion. The big logistics firms haven't been able to satisfy the burgeoning demand for good quality logistics services especially to individual customers. This has led to the mushrooming of a number of smaller players like Palande Couriers who truly take care of the last mile delivery.

Chhotu.in

Indian logistics infrastructure wasn't ready for the tremendous E-commerce growth that it witnessed. In other words, the infrastructure neither supported quick deliveries of smaller packages within cities nor had technology around it. This forced the e-tailers to think of alternatives. This was solved by Chhotu.in so that E-commerce companies could focus more on technology, sales, marketing and solid vendor management.

Chhotu, started by Navneet Singh and Aadhar Aggarwal, is less than a year old catering to the last mile logistics solutions for E-commerce Indian players. It has already made strong headway in the fast growing E-commerce space in India. Chhotu.in has partnered with Myntra.com and now Groupon.com. Based in Delhi, Chhotu.in is a last mile delivery solution targeting the niche E-commerce logistics space. The startup claims to be E-commerce friendly as it is technology driven and wants to be an extension to the E-commerce sales channel. Going the typical technology product prototype route, they are keeping investments in control with last mile delivery only, for now. Chhotu.in differentiates itself from other logistics players by treating the customers of their clients as their own customers. Chhotu.in charges their clients only when a sale is made, in other words if a sale is lost to during cash on delivery (because the recipient doesn't pay up) Chhotu.in don't charge their client for that delivery. Chhotu.in promises delivery within 24 hours. The other place where they score over bigger players is in their responsiveness. Navdeep is very tech savvy and keeps everything very responsive, be it

their website, customer support or shipment.

The company claims to be handling around 800 transactions on a daily basis, with a monthly transaction size ranging from Rs 75 lakh to Rs 1 crore. It currently has more than 100 employees on board. Santa Claus Couriers which operates Chhotu.in, has raised an undisclosed amount of funding from Global Super Angels, reports VC Circle. The company intends to use the money raised to expand its operations to more cities and hire more people.

Gati Ltd

Gati is the leading express logistics and supply chain solutions provider in India. With an annual turnover of Rs 12094 million, Gati today offers an integrated Express Distribution and customized Supply Chain Solutions to customers across diverse industry verticals. Gati operates a fleet of 4000 vehicles on road, 3 marine vessels and over 7000 plus business partners across India. Gati was one of the first companies to print its delivery date on the docket and offer money back guarantee, by accepting payment after producing proof of delivery – a POD. Gati started the practice which is now perceived as a standard norm in the industry. Gati has managed to spread its reach to 622 out of the 626 districts of India that is around 140000 pin codes in India.

Gati started its operations as a door-to-door cargo company, a division of Transport Corporation of India (TCI) in 1989. Mr.Mahendra Agarwal, Founder & CEO of Gati Ltd, wanted to rebuild TCI based on processes, systems and manage it professionally to meet consumer implicit and explicit delivery needs.

Over period of 7 years, under the leadership of Mr. Mahendra Agarwal the division flourished into a small business and in 1994, Gati was ready to separate from TCI and perform on its own. The actual legal separation took place in 1996 and the division emerged, Gati came into being an 18 crores cargo business, splitting from its 200 crores mother company, TCI. During the initial four years of its operation, delivery commitments took priority over complete utilization of capacity and Gati was focused on to its aim to provide time bound and point-to-point delivery.

Gati was the first of its kind in India to implement Integrated Warehouse Management System. All the products are bar coded and automatic identification and data capture technology is used to track the efficient flow of goods. Gati also uses a proprietary Gati Enterprise Management System (GEMS) to for route scheduling.

Gati offers dedicated last mile delivery to E-commerce businesses. Gati has adopted a forward integration strategy to enter the online retailing space by launching makemygiftz which was later rebranded as Gati Connect. The delivery model followed by Gati is shown below.

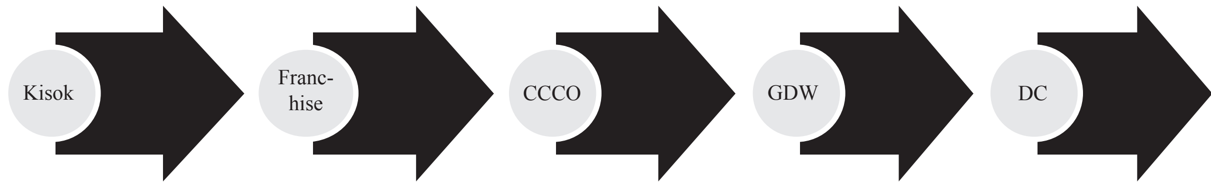

Fig. 6: Distribution Model of Gati

Kiosk: This is a collection centre which can serve any courier/cargo company.

Franchise: This is a collection centre that can serve only Gati.

CCCO-Collection Centre Company Owned: This is an operational unit in Gati. These are company owned depots used as a goods collection centre.

GDW-Goods Distribution Warehouse: This is the second last link in Gati's collection model. This is generally located in a predefined zone. The goods transported from the collection centers are consolidated in the warehouses.

DC-The Distribution Centre is used for last mile distribution. The goods received from the GDW are sorted and assigned to the end customer.

Gati differentiates itself from the chasing pack by its unmatched quality assurance. Gati has a policy of insuring the goods, so that the customer doesn't have to pay for insurance damage. In case the goods are already insured by a third party, Gati provides assistance with the survey officers to get the claim approved. In order to leverage its strengths better, Gati imposes a minimum weight criteria on any cargo delivery. However they operate in both part TL as well as full TL cargo delivery. It follows a hub and spoke distribution model with consolidation and route scheduling happening at both hub level and last mile distribution centre level where additionally the goods are sorted.

Gati has a dedicated network of vendor vehicles who take of interstate movement, but the last mile delivery is taken care of by Gati employees. Gati Kausar provides last mile from distribution centers or cold storage facilities to end users through deployment of fast and efficient in-city vehicles. With its wide basket of services, Gati intends to extend its domination over express logistics both in India and abroad.

Palande Couriers

Palande Couriers started as a courier company, was founded in 1968 by Mr. Yeshwant V Palande with a capital of only INR 100, to provide service between Pune-Mumbai in India when the word courier was not known because of the strong presence of the traditional system. Palande Couriers has its Head Office in Pune and own branch offices in Mumbai, Ratnagiri,

Kolhapur, Karad and Satara. Rest of the network is operated as Exclusive Franchise model. Palande Couriers has its own network of over 300 centers / franchisees and over 400 serviceable locations in Maharashtra, an auto, agro, educational, industrial and Information Technology Hub of India. It promises delivery within 48 hours from any of its distribution centers.

Palande Couriers is probably the best representation of the smaller players who in spite of not having sophisticated technology manage to make a niche for themselves by their unmatched knowledge of the local network. Palande couriers speak the local language and know the terrain best, in this aspect their small size actually works in their favor. They have the widest network in the interior of Maharashtra.

Another way they differentiate themselves from the bigger players like DTDC, Blue Dart is by catering to any kind of loads - there is no minimum weight for Palande Couriers. Their clientele is very different from that of larger courier-cargo services. They service SMEs and individual customers wanting to delivery couriers to the interior Maharashtra, very different from that of larger courier-cargo services.

Palande Couriers are large employment generators for rural youth who are contracted to do the day to day delivery. However, they face significant resource constraints both in finance and manpower. They deal with manpower crunch by contracting out the last mile delivery; however they feel a lot can be done by the government when it comes to making available affordable finance for their working capital requirements. While Palande Couriers do not employ bar coding or any other technological tool, they operate via a hub and spoke model due to which their processes are on par with the best of the world.

Palande Couriers have ambitious expansion plans and intend to do international deliveries as well. With their advantage of reaching the remote hinterlands they are truly the last mile connect that rural India requires.

Conclusion

This article defines the last mile logistics problem. It details a how enterprises have dealt with last mile logistics issues and makes a few recommendations to solve the delivery problem. A few cases are covered which bring out how smaller companies are thriving in spite of the organized logistics companies having near monopoly when it comes to express logistics. An innovative last mile logistics business model has also been discussed.

Acknowledgements

Mr. Kranthi Kumar - Deputy Manager, Supply Chain Solutions, Gati Kinetsu Pvt. Ltd
Mr. Ashish Palande – Owner, Palande Couriers

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Hostile Takeovers: An Indian Perspective

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Abstract

The study makes an attempt to understand the most acerbic of takeovers- Hostile Takeovers. Put in simple words, it refers to a takeover which goes against the wishes of the target company's management and board of directors. Generally, this would be done by going directly to the company's shareholders or fighting to replace the management in order to successfully get through the acquisition. This study would essentially talk about the impact of hostile takeovers, even the possibility of it, to the decisions of the management of the target company. In the subsequent section, various strategies like Poison Pill, Jonestown Defense etc. which companies resort to, in order to foil the hostile takeover attempt are discussed. In addition, various laws that deal with the takeovers, in general and hostile takeovers, in specific are dealt with. In the concluding section some examples- both recent and old; both attempted and foiled bids of hostile takeover are elaborated.

Introduction

"Guys, This is Lakshmi Mittal, I am calling you as a matter of courtesy to tell you that Mittal Steel will be announcing an offer directly to your shareholders for all the shares of Arcelor" [Ousey, 2008] -A conversation between Lakshmi Mittal of Mittal Steel and Guy Dollé, CEO of Arcelor, marking the beginning of one of the biggest takeover battles in the history of European Steel Industry which quite lucidly elucidates the essence of a ***Hostile Takeover.***

Hostile Takeover is characterized by the acquisition or control of the target company by the acquirer company without any contract or mutual understanding with the management of the company. Management attitude is *hostile* towards the bid and it practices every defensive

strategy possible to thwart the efforts of the acquirer company. The term can also be applied if a bid is placed for the shares of the target company without informing its board and is directly aimed to the shareholders.

A hostile takeover can be conducted in several ways. A tender offer can be made where the acquiring company makes a public offer at a fixed price above the current market price. An acquiring company can also engage in a proxy fight, whereby it tries to persuade enough shareholders, usually a simple majority, to replace the management with a new one which will approve the takeover. Another method involves quietly purchasing enough stock on the open market, known as a "creeping tender offer", to effect a change in management.

The main consequence of a bid being considered hostile is practical rather than legal. If the board of the target cooperates, the bidder can conduct extensive due diligence into the affairs of the target company, providing the bidder with a comprehensive analysis of the target company's finances. In contrast, a hostile bidder will only have more limited, publicly-available information about the target company available, rendering the bidder vulnerable to hidden risks regarding the target company's finances. An additional problem is that takeovers often require loans provided by banks in order to service the offer, but banks are often less willing to back a hostile bidder because of the relative lack of target information which is available to them.

Perspective of the Acquiring Companies

Reasons for Takeovers:

There are multitudes of reasons why takeovers take place:

- Synergy in operating economics: Combined efforts produce better results than two separate undertakings because of saving in operating costs
- Taxation advantage: A profitable company can buy a loss maker to target tax write-offs
- Other advantages: Growth, diversification, operating efficiencies, procurement of supplies, financial assets because of larger size of merger

Adverse Features

Merger of two companies in the same field may involve reduction in the number of competing firms in an industry and tend to dilute competition in the market. They generally contribute directly to the concentration of economic power and are likely to lead the merger entities to a dominant position of market power. It may result in lesser substitutes in the market, which would affect consumers' welfare. Yet another adverse feature may surface, if a large undertaking after merger, because of resulting dominance, becomes complacent and suffers from deterioration

over the years in its performance.

These adverse features may or may not be outweighed by the positive features such as economies of scale, utilization of idle funds, nursing a sick unit etc. That is why competition law seeks to enforce strict regulation.

Takeover Defenses

Takeover defenses include all actions by managers to resist having their firms being acquired. Attempts by target managers to defeat outstanding takeover proposals are overt forms of takeover defenses. Resistance also includes actions that occur before a takeover offer is made which make the firm more difficult to acquire.

The target firm's management may wish to defend itself from a takeover for a number of reasons, most obvious of which concerns potential loss of employment, position or power in the firm. However, some takeover defenses are initiated to enable shareholders to receive a better offer for their shares; fending off or delaying a takeover can lead to competing offers or better bids by the prospective acquirer.

The first step in defending against hostile takeovers is to gauge the firm's desirability as a takeover candidate. If management of a potential target firm is concerned about being taken over, it may closely follow transactions for its stock, noting unusual buying activity. Once it is concluded that the firm is a potential target, the following is a partial list of some of the most commonly used takeover defenses. However, it is important to note that each defense strategy depends on the firms inherent characteristics and businesses have to adopt the strategies accordingly. [Chaudhary, 2012]

Defense Mechanisms Involving Charters, Voting and Control Structures

Super-majority voting rights: Requiring more than 50% of shareholders (typically 2/3 or 75%) to approve a takeover. This increases the number of shares required to be acquired in a hostile takeover

Taking the company private: An LBO (Leveraged Buy Out) or significant ESOP (Employee Stock Option) transaction can effectively remove the company from the market and keep the management intact. In many cases, a hostile bid can be defended even when only a fraction of shares are held by an ESOP

Staggered Board: Staggered Board is one where the board is classified into three equal groups and only one group is elected each year. Staggering board members' terms makes it difficult for a new majority shareholder to obtain a majority on the board

Poison Pill: Poison Pills give shareholders the right to buy shares of the target and/or of the acquirer at a significantly discounted price if any single shareholder or affiliated group of shareholders acquires more than a specified percentage of the company's shares. The poison pill, triggered when a prospective acquirer has acquired a given percentage of the target's shares, is intended to dilute the prospective acquirer's stake in the target company, making a hostile takeover attempt prohibitively expensive. Since corporate boards are almost always authorized to declare dividends, virtually any threatened company can quickly and easily adopt a poison pill without a shareholder vote. Furthermore, they are frequently very effective in defending against hostile takeovers. However it can be argued that poison pills reduce performance by insulating the managers from the threat of takeover. In addition to depriving shareholders of lucrative takeover premiums, critics of poison pills argue that the protection from takeovers they provide entrenches possibly incompetent managers and exacerbates agency problems. With less risk of takeover, managers are freer to retain free cash flows, over-diversify, or otherwise invest firm resources in a self-serving manner

Lock-up provisions: Used in conjunction with other defenses, lock-up provisions prevent a hostile raider from quickly dismantling takeover defenses

Equal protection provisions: Require that non-tendering shareholders receive at least as high a price for their shares as those shareholders who do tender. Equal protection provisions (also called fair price provisions) are intended to prevent two tiered offers. Preventing two-tier offers discourages takeovers by enabling target firm shareholders to free ride off value created by the prospective acquirer

Dual class recapitalizations: These plans restructure the equity of the firm into two classes with different voting rights. Usually, the class with inferior voting rights has one vote per share and the class with superior voting rights has ten votes per share. The superior voting stock is typically distributed to shareholders. It can then be exchanged for ordinary common stock. The superior voting stock generally has lower dividends or reduced marketability; this induces stockholders to exchange their superior voting stock for inferior voting common stock. The managers of the firm do not participate in the exchange. This shifts the voting power of the corporation. Managers with relatively small equity holdings can control a majority of the votes after the recapitalization. This gives managers veto rights over control changes

Shark Repellent: A general maneuver, including many discussed above, which amends the corporate charter in a manner that renders the firm a less desirable takeover candidate or more difficult to acquire or control. Such amendments are usually completed before an offer is made. Super-majority vote requirements; equal protection provisions and dual class recapitalization may serve this purpose as well

Corporate Suicide: Dissolve the corporation as an entity

Concentrated ownership, pyramid structures and cross-ownership: Many publicly traded European firms are insulated from hostile takeovers due to concentrated ownership by families

and banks, pyramid structures and cross-ownership. These structures have been diminishing recently due to capital market integration, the E.U. and prevalence of governance codes and regulation. This is also one of the reasons explaining the unpopularity of hostile takeovers in the Indian scenario

Legal and Regulatory

Litigation: The most common form of post-offer defense is to file some sort of suit against the bidding firm. The litigation seems to serve two purposes. First, it delays the bidder, thereby encouraging the entry of competing bidders. Second, the litigation encourages the bidder to raise the offer price to induce the target to drop the suit and thereby avoid legal expenses

Moving the firm's state of incorporation: Move to a regulatory environment that would be hostile to the acquiring firm

Creating antitrust problems: Purchasing a subsidiary that would create antitrust problems for the acquirer may prevent the takeover attempt

Operations and Balance Sheet Changes

Selling the "Crown Jewels": Very often a hostile bid is made based on the targeted firm's assets or ongoing operations. By implementing a defense strategy such as the Crown Jewel defense, the target company has the right to sell of the entire or some of the company's most valuable assets (Crown Jewels) when facing a hostile bid, in hope to make the company less attractive in the eyes of the acquiring company and to force a drawback of the bid. Another way of implementing this type of defense strategy is for the target company to sell its Crown Jewels to another friendly company (white knight) and later on, when and if the acquiring company withdraws its offer, buy back the assets sold to the white knight at a fixed price agreed in advance

Cyanide Capsule: Taking a cyanide capsule is one of the most drastic moves a company can make when threatened with a hostile takeover. The cyanide capsule is a big loan with a stipulation that the entire amount must be repaid immediately if the company is acquired. The objective is to discourage a potential acquirer with the necessity of repaying enormous debt once his takeover attempt is successful

Seeking Competing Offers, Attacking or Compensating the Bidder

White Knight: There are two variations in this defense strategy and both these measures require and involve a third party. In the first, the targeted firm seeks for a friendly firm which can acquire a majority stake in the company and is therefore called a white knight. With a white knight the management of the targeted company can negotiate several deals that do not have to include a full takeover of the firm and risk losing their positions. A white knight can be chosen for several reasons such as; friendly intentions, belief of better fit, belief of better synergies, belief of not dismissing employees or historical good relationships. The intention of

the white knight strategy is to make sure that the company remains independent but could also be used to play the other two parties against each other to further sweeten the bid. However, the most common outcome of a white knight strategy would be that targeted firm eventually gets overtaken by the white knight. This implies that it is not always certain that the targeted company will remain independent but instead slips away from a hostile bidder which would suggest greater restructuring of the firm.

The second variation of the white knight strategy is the white squire. Instead of acquiring a majority stake in the targeted company the white squire acquires a smaller portion, but enough to hinder the hostile bidder from acquiring a majority stake and thereby fending off an attack. A white squire is not always needed to be found but can also be created by raising an investment fund with the help of financial advisors

Pac Man defense: Acquire the bidder. This strategy was named after the video game where the player and his opponent simultaneously "eat each other up," and was first implemented when Martin Marietta shareholders received a tender offer from Bendix Corporation in 1982. In response, Martin Marietta made an offer for Bendix stock with the aim of assuming control over the company. Bendix eventually persuaded Allied Corporation to act as a "white knight," selling out to Allied later that year

Greenmail: Once having secured a large share of a target company, instead of completing the hostile takeover, the hostile raider offers to end the threat to the victim company by selling his share back to it, but at a substantial premium to the fair market stock price. Greenmail involves the repurchasing a block of shares at a premium over the stock price in return for an agreement called a standstill agreement. In this standstill agreement it is stated that the hostile bidder will no longer be able to buy more shares of the target company for a period of time, often longer than five years. Thereby, the hostile attack will end but what is worth re-mentioning is that this is only proven effective towards bidders seeking short term profits and not against bidders who are seeking long-termed synergy effects and control in the company

A few other strategies used are:

Golden Parachute: Golden parachute as a defense strategy is a special and lucrative package, which aims to stagger and make hostile takeovers more expensive by distributing what is usually a large payment to the board of directors of the target company. The defense strategy sets in motion as soon as the acquiring firm has acquired a specific amount of the target company's shares. The golden parachute's primary function in a hostile takeover is to align incentives between shareholders and the executives of the target company as there generally are concerns about executives who face a hostile takeover while risking losing their jobs, oppose the bid even when it increases the value for shareholders. Implementing a golden parachute defense strategy could potentially help stagger and make a hostile takeover more expensive, though only to a certain degree. In general the cash payments as a cause of the golden parachute strategy are only a drop in the ocean compared to what the whole acquirement as a whole would cost and for this

reason, one could argue the real effectiveness of the golden parachute strategy

Contemporary Laws and Regulatory Framework for Takeovers in India

The primary regulators governing M&A activity in India are the Securities and Exchange Board of India, the Reserve Bank of India, the Foreign Investment Promotion Board and the Competition Commission of India, termed as SEBI, RBI, FIPB, and CCI respectively. The following list is an indicative but not an exhaustive list of the various frameworks in place that govern mergers and acquisitions in India:

- **Companies Act, 1956**

  The Companies Act is the statute primarily governing all matters relating to companies incorporated in India. [Indian Companies Act, 1956] Among other things, the Companies Act specifically provides for the manner in which mergers, demergers, amalgamations and/or arrangements may take place pursuant to an Indian court sanctioned scheme. Sections 391- 396 describe the various rules applicable to mergers and amalgamations under the Companies Act.

- **SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997**

  This will henceforth be called as the Takeover Code. The Takeover Code, as the name suggests, regulates takeovers of (and substantial acquisitions in) listed companies in India. Any change in control of shareholding or consolidation of shareholding beyond certain thresholds requires an open offer to be made to the public. In addition to the above, the Takeover Code also specifies certain triggers which attract disclosure requirements including as regards share pledges.

- **SEBI (Issue of Capital and Disclosure Requirements), 2009**

  ICDR Regulations deal with the issue of further capital by companies that are listed or proposed to be listed on a recognized stock exchange in India. [Securities and Exchange Board of India] The ICDR Regulations inter alia regulate acquisitions that may take place by making preferential allotments. However, it is relevant to note that allotments which result in a change in control are required to comply with the provisions of the Takeover Code in addition to the provisions of the ICDR Regulations. This would henceforth be called as ICDR Regulations.

- **The Competition Act, 2002**

  The Competition Act as amended by the Competition (Amendment) Act, 2007, inter alia provides for control over M&A activity and abuse of dominant position in the market. Prior approval of the CCI is required for mergers and acquisitions above specified thresholds. The CCI has extra territorial jurisdiction as regards to mergers or combinations taking place outside India.

- **Income Tax Act, 1961**

  Any M&A transaction requires detailed evaluation of the tax consequences. [Income Tax Act,

1961]The Income Tax Act governs all direct taxation within India and grants or withdraws certain benefits in the case of change of control/shareholdings subject to certain conditions. Indirect taxation may be in the form of value added tax, excise, etc. and is governed by various state and central statutes. Under the present taxation system in India, taxes vary for each method of acquisition. For example, an asset transfer by way of slump sale may result in higher income for the seller and higher value added tax liability for the buyer, whereas M&A under the court scheme may result in additional benefits under the Income Tax Act and stamp duty laws when compared to an M&A by private arrangement.

- **Foreign Exchange Management Act, 1999**

  FEMA and the various rules, regulations, circulars, etc. issued under FEMA consolidate the law relating to foreign exchange with the objective of facilitating external trade and payments and promoting the orderly development and maintenance of the foreign exchange market in India. [Finance Ministry, 1999] The provisions of FEMA specify the current and capital account transactions which may be carried on with general or specific permission of the RBI and/or the FIPB. The two most relevant regulations under FEMA from an M&A perspective are:

  (i) Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000:

  This would be called as FDI Regulations for further discussions. The FDI Regulations and the press notes issued there under govern investments by persons resident outside India in shares, debentures (convertible and non-convertible), security receipts and warrants of companies incorporated in India; in effect regulating inbound investments/acquisitions. In most sectors, 100% foreign direct investment is permitted (with or without conditions) without the prior approval of FIPB. In certain sectors it is permitted only to the extent prescribed, subject to conditions set out in the sectoral policy, without the prior approval of FIPB. Hostile takeovers on a cross border basis are effectively precluded.

  (ii) Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004:

  Outbound investments by residents in India are regulated by the Foreign Security Regulations. Indian companies are permitted to invest up to 400% of their net worth in joint ventures or wholly owned subsidiaries abroad under the automatic route.

- **Stamp Duty**

  The stamp duty payable on documents varies across different states as it is governed by the provisions of the Indian Stamp Act, 1899, or the legislations enacted by certain states, as the case may be. Stamp duty is a documentary impost and not a transaction tax. It is payable (i) prior to or at the time of execution of the document, or (ii) within three months of the executed document first being delivered and received in that part of India where either anything under the document is to be done or performed, and/or the property to which the document relates is situated.

The term ‘amalgamation’ has been defined in the Income Tax Act, under sec. 2(1B). The definition of amalgamation in the Income Tax Act does not differentiate between a merger and an amalgamation and defines amalgamation as merger of one or more companies into another company or the merger of two or more companies to form one company such that, pursuant to the amalgamation, the assets and liabilities of the amalgamating company become the assets and liabilities of the amalgamated company and shareholders holding not less than three fourths in value of the amalgamating company become shareholders of the amalgamated company. The benefits of carried forward losses and unabsorbed depreciation of an amalgamating company are available only for certain types of companies falling within the scope of shipping, hotel, banking and industrial undertakings and further subject to continuity of the business for three years before the amalgamation and five years after the amalgamation. Further, stringent conditions are also applicable for closely held companies. Although not defined in the Companies Act, a likely successor to the Companies Act, the Companies Bill, 2009, currently placed before the Parliament of India (the “Companies Bill”), defines ‘merger’ as defined under the English Companies Act, 2006: distinguishing between a merger by absorption, where one or more existing companies merge into an existing company and a merger by formation of a new company which involves merging of two or more companies to form a new company. The two primary ways of restructuring a company are:

- **Organic restructuring,** which refers to an internal change in the structure of the company without a change in the actual corporate entity undergoing the restructuring
- **Non organic restructuring,** which involves the corporate entity being restructured, itself undergoing a change

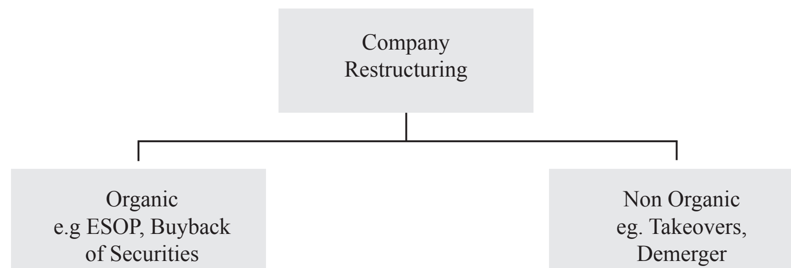

Fig 1: Methods of company restructuring

Overview of the New Takeover Code

New thresholds for attracting public offer (15% to 25%)

The initial threshold limit for triggering open offer has been increased from 15% to 25% of voting rights of the Target Company. [Article on the New Takeover Code- a Report by BMR Advisors]This is a significant development and is clearly a liberalization exercise. The impact of the above amendment can be quite significant:

1. With the increased limit, the level of activity in listed companies by PE's/ strategic investors will increase to more material stakes (up to 24.99%). Also, "head room" for foreign technical collaborators / minority foreign partners to increase their shareholding without triggering cumbersome and costly takeover regulations will increase. Companies would be able to raise expansion capital in a more cost effective manner (i.e. without triggering open offer till 25% stake)

2. For the economy, more investment from PE/ foreign partners should be expected in the coming months, which should give a fillip to FDI numbers which have been languishing in the recent past

3. With a 24.99% threshold limit, the acquirers would be able to block special resolutions in target companies with relative ease. Let us assume a promoter who holds 45% stake in the target company. If a hostile acquirer were to reach 24.99%, such acquirer can effectively have ~ 35% voting right (24.99/(24.99+45)) and therefore can easily block special resolutions (assuming that the participation by minority public shareholders either in physical meeting or postal ballot is negligible (which is invariably the case))

Facilitating consolidation through increase in offer size from 20% to 26% and also introduction of concept of voluntary offer (i.e. open offer for minimum 10% stake)

Now with the increase in the initial threshold to 25% and the increase in open offer size to 26%, there is a possibility of the acquirer getting simple majority (25% + 26%). This would be welcome for M&A transactions because there is significant comfort that acquirers get when they hold more than 50% stake directly and therefore do not need to depend on other shareholders for passing simple corporate law resolutions. In case the public offer results in public shareholding falling below 25%, then the acquirer is obligated to reduce his shareholding so that the minimum 25% public float is maintained.

Increase of creeping acquisition range from 15-55% to 25-75%

The new regulation will facilitate consolidation of promoter shareholding to the maximum permissible level i.e. 75% which was a challenge in the earlier regulation.

This would be welcome move for the promoters who will have more flexibility to bump-up their shareholding. However, the reduction of "public float" due to this measure and consequential impact on trading volumes/ reflection of real "market" price of such scrips on bourses would need to be watched.

Examples of Hostile Takeovers in India

Hostile takeovers occur rarely even in the most mature economies, so it should not be surprising that in India, where the economy was only liberalized in 1991, a mere dozen or so hostile takeovers have been attempted. [Jayesh, 2011] The four cases below are meant to provide historical context to the current situation and illustrate some of the political and technical barriers that a foreign hostile acquirer might face today.

Swaraj Paul's failed bids for Escorts and DCM

In 1984, long before the liberalization of the Indian economy or the promulgation of the takeover code, British businessman Swaraj Paul attempted to unilaterally take control of two Indian corporations, Escorts Limited and DCM. Although he accumulated more than the promoters of each corporation (roughly 7.5% and 13% stakes in Escorts and DCM, respectively), the two companies resisted his takeover attempts and each blocked the transactions by refusing to register Paul's newly purchased shares. The promoters used their political clout against Paul, despite his personal ties to Prime Minister Indira Gandhi. "Paul was also opposed by The Life Insurance Corporation of India, a state owned financial institution that held a minority stake in the companies. Paul finally retracted his bid". Although unsuccessful, Paul's hostile threat sent shockwaves through the otherwise complacent Indian business world.

Current Indian law highly constrains the ability of a target company to refuse to register shares. Pursuant to an amendment to the Companies Act providing for free transferability of shares, companies may not refuse to register shares unless the Indian Company Law Board finds the transfer to violate the law and suspends the voting rights of the shares.

Asian Paints/ ICI

Nearly fifteen years after Swaraj Paul's failed hostile bids, the Indian government and business community were still not prepared to accept a hostile foreign acquisition. ICI, a paint company headquartered in the U.K., agreed with Atul Choksey, the managing director and co-founder of an Indian paint company, Asian Paints, to purchase his 9.1% stake. His three other co-founders, however, opposed his sale to a foreign party, and threatened to refuse to register ICI's shares in the same fashion as Escorts and DCM. Ultimately, the government of India, through its Foreign Investment Promotion Board (FIPB) thwarted the bid, ruling that foreign acquirers taking control of an Indian company needed first to obtain approval of the board of directors of the Indian target. This was peculiar, given that the remaining co-founders retained well above ICI's 9.1% stake and hence would have maintained control over the company. Without the support of the other three founders, however, the deal failed to win the ICI board's approval, and, as a result, ICI was ultimately forced to sell its stake in Asian Paints to UTI, a government-owned mutual fund, and to two other cofounders.

As will be discussed in the next section, government approval of most foreign takeovers today

only involves industrial sector-specific enforcement of limitations on foreign direct investment. Of course, a government keen to block a foreign takeover may find ways outside of the formal regulatory structure to scuttle such a bid.

Indian Cements/ Raasi Cements

The only hostile takeover in Indian history resulting in ultimate acquisition of the target by the hostile bidder occurred in 1998 when BV Raju sold his 32% stake in Raasi Cements to India Cements. India Cements made an open offer for Raasi shares, and it acquired roughly 20% on the open market, but faced resistance from the founders of Raasi as well as the Indian financial institutions which also owned substantial stakes in the firm. However, following a protracted battle which involved press conferences featuring the children and grandchildren of the founding family protesting the hostile bid, Raju ultimately sold out to India Cements in a privately negotiated transaction.

Dalmia/GESCO

The Dalmia group's purchase and sale of its 10% stake in the real estate firm GESCO for an approximate 125% premium in 2000, is the closest India has come to greenmail. This hostile bid, for 45% of the company, was only averted thanks to a white knight recruited by the founding Sheth family, the Mahindra group, which offered to buy-out the entire remaining float for an even higher premium. After an intense bidding war that drove the initial offer price up roughly 100%, the Mahindra-Sheth group agreed to buy-out the Dalmias' 10% stake.

Observations & Conclusion

The top 5 takeovers in the history of Indian corporate sector are listed as follows:

Acquirer	Target Company	Country targeted	Deal Value ($ millions)	Industry
Tata Steel	Corus Group	UK	12000	Steel
Bharti Airtel	Zain Africa	Africa	10700	Steel
Hindalco	Novelis	Atlanta	6000	Aluminum
ONGC	Imperial Energy	U.K.	1900	Energy
Tata Motors	Jaguar Cars and Land Rover	U.K.	2300	Automobile

Table 1: Top 5 takeovers
Source: Silicon India News

Till recent past, the incidents of Indian entrepreneurs acquiring foreign enterprises were not so common. The situation has undergone a sea change in the last decade. Acquisition of foreign companies by the Indian businesses has been the latest trend in the Indian corporate sector. There are different factors that played their parts in facilitating acquisitions in India. Favorable government policies, buoyancy in economy, additional liquidity in the corporate sector and dynamic attitudes of the Indian entrepreneurs are the key factors behind the changing trends of mergers and acquisitions in India. In the light of all these it becomes even more evident that hostile takeovers be seriously taken as both an opportunity and a threat by the Indian corporate sector.

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The Rise and Fall of Research in Motion (RIM)

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Abstract

The objective of this article is to examine the phenomenal rise of Research in Motion (RIM) and the factors that have led to its downfall. Once considered indispensable to a corporate executive, today BlackBerry phones seem outdated. The market share of RIM has been constantly falling under the onslaught of iPhones and Android based phones. Can the plethora of patents and the hoard of cash save RIM and help rediscover its mojo? Or will it see the fate of early innovators who just couldn't keep up with the pace of change of consumer's tastes? Is RIM headed the Kodak way? For this we have to trace RIM's journey from modest beginnings in 1984 to the behemoth it became in early 2008. What were the factors that led to the explosion of BlackBerry and how they have the first mover advantage?

Introduction

Research in Motion (RIM), maker of the BlackBerry smartphone, is revered as the company which broke the shackles of email from the PC and gave it a new meaning in the form of email from phone. It freed corporate executives from being glued to their PCs, letting them use email and be accessible anywhere in the world. RIM pioneered working from anywhere any time. Through the BlackBerry Messenger they ensured connectivity across the globe at a cheaper prices like never before. There was huge instant data transfer and without surprises it rose to be an indispensable tool and a facilitator of business for a corporate executive. That was then, now it is a different story altogether. Fierce competition, the trademark of the technology industry, does not forgive those who fail to innovate. Customers blessed with choices and improvements lost interest and now the company is battling with plethora of issues. RIM's story is no lesser than a Greek Tragedy. A dominant force was made to submit to an ever evolving market.

Research in Motion started its journey in 1999 with the launch of the BlackBerry two-way pager. The BlackBerry smartphone, as the world came to know it, was launched in 2003. The BlackBerry smartphone supported push email, mobile telephone, text messaging, Internet faxing, web browsing and other wireless information services. It was after the launch of the BlackBerry smartphone that the share price of RIM began rising and the company became synonymous with the corporate smartphone. A BlackBerry was considered indispensable for a corporate executive. President Barack Obama couldn't bear to part with his BlackBerry. Oprah Winfrey declared it one of her "favourite things". It could be so addictive that it was nicknamed "the CrackBerry". At the height of its success, RIM was Canada's most valuable company with a market value of $83 billion in June 2008 with its share price hitting $148 a share. Since those glory days, RIM has faltered and faltered badly. The launch of a new generation of competing smartphones, beginning with Apple's iPhone and followed by the phones powered by Google's Android operating system rapidly ate into RIM's market share. RIM's market share in smartphones has decreased from a high of close to 20% in 2009 to as low as 7% in 2012. For the past few quarters it has been burning through cash at such an alarming pace that there are fears that it may come perilously close to bankruptcy unless drastic changes are implemented. A couple of important decisions have already been taken. On January 22, 2012 RIM announced that founder Mike Lazaridis, who served as its co-CEO along with Jim Balsillie would step down and the new CEO will be Thorsten Heins. RIM has reduced its global workforce by nearly 50% over the past few months. It employed nearly 19000 people in 2011 but that number has come down to 9500 in June 2012. RIM's plans to launch new smartphones and win back market share were hit badly when the company announced that it would not be able to launch the next generation of its smartphones based on BlackBerry OS 10 until 2013 rather the earlier expected launch date of the first quarter of 2012.

RIM has made several mistakes over the past few years. RIM's downfall can be blamed primarily on two factors: it failed to innovate and it lost sight of who its customers were. The biggest mistake, though, that RIM has made over the past few years is to underestimate its competition. When the iPhone was launched in the summer of 2007, RIM's then CEO Jim Balsillie said "The iPhone's impact on our business will be minimal". He also said at that time "It's kind of one more entrant into an already very busy space with lots of choice for consumers. But in terms of a sort of sea-change for BlackBerry, I would think that's overstating it". History, though, has turned out to be something else altogether. Apple sold 33 million smartphones in the first quarter of 2012 compared to the 10 million smartphones sold by RIM. It seems that RIM has still not learnt its lesson. On taking over as CEO, Thorsten Heins said, "There's nothing wrong with the company as it exists right now". He also said RIM is not in a 'death spiral'. If RIM's top brass continues to be in such a denial mode, history may remember RIM as the company the pioneered the smartphone but failed to take advantage of it. RIM has not lost hope of making a comeback in the market. It plans to launch five new smartphones based on its BlackBerry OS 10 in 2013 and also plans to launch the next generation of its Playbook tablet. Only time will tell whether RIM succeeds but from what we have seen so far, the company should give the market one hell of a fight.

Methodology

To understand the rise and fall of RIM, a timeline highlighting all the major events has been chalked out. Such an autopsy of events is, although important to provide roots to the research carried out, it alone is not sufficient. Tools of marketing like SWOT analysis have been applied to get an overall understanding of the company profile and its competitive strength.

Research in Motion (RIM)

Research in Motion (RIM) is a Canada based company that is a pioneer in the wireless data industry. It is essentially the first smartphone maker and is best known as the developer of the BlackBerry smartphone in 2002. BlackBerry is primarily known for its ability to "push" or to send and receive Internet e-mail wherever mobile network service coverage is present. Traditionally, RIM has focused on the enterprise market because of their secure servers and information confidentiality guarantee. Presently, RIM focuses on expanding into the non-enterprise segment where customers are more price-sensitive. RIM is introducing more competitively priced phones to grow market share in international markets as well as the retail consumer market. Revenues and subscription rates for RIM have accelerated in the international market, and nearly 52% of RIM's subscriber base was international in the most recent quarter. RIM currently holds close to 7% of the global smartphone market share in the mobile phone industry, though this has decreased significantly over the past few years due to increased competition in the smartphone market.

Research in Motion (RIM), makers of the venerable BlackBerry devices, will always be remembered as the company who liberated corporate email from the PC. In fact, you could make a compelling case that the first Blackberry's kicked off the post PC era. They freed mobile workers from being chained to their PCs, letting them email and be productive anywhere.

Unfortunately that may be all RIM is remembered for, as the company is battling a range of issues from waning customer interest, declining market share and fierce competition. How is it possible that a company once so dominant is now facing so many uphill battles? Two reasons can be attributed to this:

- It lost sight of who its customers were

Losing sight of your core customer is one of the most dangerous things a company can do. It's a business rule that transcends every industry. RIM, unfortunately, in an attempt to capture the more glamorous but also very finicky consumer market, failed to innovate and compete for its core customers, which were businesses.

RIM's business was built around robust corporate solutions that included hardware, software and secure services specifically targeting the enterprise. It did this well and defended it well even against Microsoft's continued assault through advancements in Exchange Servers and Windows Mobile.

We firmly believe that the turning point was when RIM began chasing mainstream consumers. Not because a company can't offer products and solutions for two completely different market segments, but because RIM's core value and business strengths did not translate into value in consumer markets.

What consumers want is very different from what corporate customers want. RIM was positioned well to serve one and not necessarily the other. To successfully enter the consumer market RIM needed to re-invent itself specifically for that market, and that is exactly what it did not do. In short, making consumer products was not in the company's DNA.

- RIM failed to innovate

When talking about the most innovative companies over the past five years, RIM rarely enters the discussion. When you dominate a market like RIM did, there is a tendency to become complacent and believe you are untouchable. However when you combine the rapid pace of technology advancements with a free market society, no company is ever really safe at the top. A company's ability to innovate stems directly from the culture cultivated internally. Some companies do this better than others. Apple fostered a culture of innovation internally which is one of the main reasons why competing with it is so hard. In creating products for consumers, RIM only copied competitors.

Is There Hope?

We believe that if drastic changes do not happen within RIM, a turnaround may remain an elusive dream. RIM needs to change leadership at the top, regain a laser focus on its corporate and business customers and focus on innovating for the core needs of these customers and exit the consumer market entirely. There is also talk of RIM being an acquisition target. This is another viable option for a turnaround, although one that we believe is not likely to happen. Ultimately, focusing purely on enterprise customers is not as elegant or flashy as the consumer market; however it is a solid business and one that is still lucrative if done right.

Company Segments

- Devices: Almost 80% of RIM's revenue mix in 2010 was from wireless devices
- Service: Nearly 14% of the revenue mix from 2010 was from services
- Software: This constituted about 2% of their revenue. RIM charges subscriber fees for BlackBerry Enterprise Server Software and BlackBerry Client Access Licenses
- Other: About 3% of their revenue came from miscellaneous items

RIM's Comparative Advantages

Brand: Recognizable brand that has the reputation of corporate mobility, giving it the "white-collar" sentimentality

Enterprise Security: RIM has over 20 years of experience in developing and ensuring information security and user confidentiality

Sticky Platform: A sticky platform needs to be easy to use and difficult to stop using

- **BBM:** Users often become addicted to the messaging service and use it as their primary method of text-based communication with the people they are closest to. If your circle of friends uses BBM, you probably are not willing to leave the BlackBerry platform. BBM is the largest proprietary IM platform in the mobile industry
- **QWERTY:** Many of its professional users prefer the BlackBerry specifically for the physical nature of its keyboard, especially compared to the recent trend in the consumer segment focusing more on mobile touch screen technology

Profitability: RIM has consistently maintained above average ROE and the number of subscribers each quarter continues to increase

Why RIM now?

- We believe RIM is being undervalued and that the bearish sentiments are too focused on the U.S. and disregarding RIM's international growth potential. Analysts have continued to doubt RIM since the introduction of the Apple iPhone in 2007. However, for the past few years, both have been able to co-exist. BlackBerry continues to see good revenues and subscriber growth, despite competition with Apple and Android
- It makes no sense that competitors like Nokia and Motorola are selling higher than RIM when it has consistently beat them in most financial metrics and has better growth potential. It is important to have the perspective of the cellular market, not just the so called "smartphone" market, when looking at RIM and its growth prospects
- Also the smartphone market is clearly growing and has room for more than one competitor. The acceleration of smartphone unit sales allows RIM to benefit from the higher incremental penetration of smartphones in the overall mobile phone industry. We believe RIM will take over the entry level smartphone segment by offering compelling products at tiered pricing. Smartphone penetration is lower internationally and lower pricing will definitely be a competitive advantage in developing countries

- Despite the global economy, RIM has remained profitable until the past year. It had an enormous consistent ROE around 33% that makes it competitive even outside the mobile industry. Many companies have large ROE because they are highly leveraged; however, RIM currently operates with zero debt financing. Moreover RIM's cash reserves have grown to 2.3 billion dollars and that gives it plenty of money to stave off bankruptcy in the near future

Strategy

Consumer Products

Historically, RIM has been focused on enterprise services and is considered the market share leader. However, as companies like Apple attempt to become business secure and businesses adapt to RIM's competitors' security policies, RIM may lose some enterprise market share in the future. However, contrary to the belief that RIM is solely dependent on its enterprise segment, in the past quarter over 50% of its subscriber base was from non-enterprise customers. Furthermore, it has recently made a few acquisitions and developments to become competitive within the smartphone sector.

App World

On August 24, 2010, RIM acquired California based company called Cellmania. This acquisition was made to strengthen RIM's App Store. Cellmania, founded in 1999, focuses on building and licensing software elements for mobile stores. This includes mobile infrastructure such as App Store Infrastructure, letting mobile operators control the home screens of their customers' phones, and a content distribution network. This acquisition could play a big role in growing RIM's operating system, user interface, and software ecosystem on the same level of Apple's and Google's.

Touch Screen

On August 24, 2009, RIM acquired Torch Mobile, a developer of Web-kit solutions for mobile and embedded devices. Its first product, BlackBerry Torch 9800 smartphone was the first phone to combine BlackBerry's keyboard with a full touchscreen experience. This was RIM's first true step toward making headway into the touch screen focused side of the smartphone consumer segment.

All Sized Enterprises

BlackBerry has extensive experience with providing convergence security for enterprises. In addition to branching out into the individual consumers market, RIM is also allowing small-to-middle sized business to take advantage of their software.

BlackBerry Enterprise Server Express

It uses the same robust market-leading security as the premium BlackBerry Enterprise Server. It is a free download designed for personal BlackBerry smartphones to connect to their work email. It also encourages businesses to get started using BlackBerry smartphones to increase organizational responsiveness, improve productivity, and to help employees manage time and multitask.

International Growth

Due to declining revenue growth rates in the U.S., RIM is focusing on expanding into international emerging markets. While the U.S. is a leading smartphone market, international smartphone penetration is low. RIM is looking to build strong international growth by launching tiered pricing and targeted products and services within new market segments and geographies. Devices like BlackBerry Curve 8520 and the new BlackBerry Curve 9220 have been marketed as the cheap, introductory smartphones for developing countries with a pay-as-you-go plan. The table below demonstrates the revenue trend weighing more towards international expansion. "Other" revenue went from 21% to almost 37% of revenue from Q2 2010 to Q2 2011. This has been driven by the fact that international subscriber base has nearly doubled in fiscal 2010 as shown in the table above. A key driver to this growth is from entry level smartphones, like BlackBerry Curve and the BlackBerry Bold, and from popular applications like BlackBerry Messenger (BBM).

	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2
Canada	5.39%	6.54%	5.94%	5.53%	6.18%
U.S.	64.84%	56.70%	46.16%	48.97%	48.05%
U.K.	8.82%	9.59%	11.95%	11.08%	9.28%
Other	20.95%	27.17%	35.96%	34.42%	36.49%

Table 1: Quarterly revenue-geographic mix

SWOT Analysis

Strengths

Brand: First smart phone; many of its competitors have a mobile platform that includes everything. BlackBerry phones are recognizable and are often associated with businessmen and business women. The market is adapting to more "convergence" devices and eventually smartphones will be the mobile industry.

QWERTY keyboard: Many smartphone users use phone features strictly for work where professional email communication is key. The QWERTY keyboard, a trademark for BlackBerry phones, is the corporate standard for enterprise mobility.

BlackBerry Messenger: BBM is the largest proprietary instant messaging system for the

mobility industry. Users rely on this as their main text-based communication.

High cash reserves: RIM currently has over 2 billion dollars in cash which should help it survive until the launch of the next generation of BlackBerry smartphones.

Adobe Systems alliance: Creative professionals and application developers will be able to use the Adobe Flash Platform technology and Adobe Creative Suite content development and authoring tools to easily create rich content and application experiences for BlackBerry smartphones. Apple does not embrace Adobe Flash for their phones currently.

Security: With large enterprises as their users, BlackBerry has extensive experience and foundation for encryption. Many government agencies and even the President of the United States use and trust in the server accessing work emails through their personal BlackBerry.

Tiered-pricing: With their expansion into the international market, RIMM is moving away from only a higher priced enterprise market and introducing more competitively priced entry level smartphones.

Weaknesses

Competitive pressure: RIM is behind in developing consumer products in comparison to competitors like Apple who have already made a big name for their consumer targeted products. RIMM must be innovative and keep up with new trends in technology.

Media- generated content: RIM is behind in providing an interface conducive for a developer community and application environment for its products. However, RIM recognizes this and has made efforts to improve on this.

Declining margins: Increasing competition within the smartphone market and RIM's international focus on lower priced devices have led to declines in the company's profit margins.

Opportunities

App world: RIM has been able to convince developers to make apps for the new OS 10. It has to make sure that its apps store will be able to compete with the iOS apps store and Google Play. Their acquisition of Cellmania will help them better structure their application store. There is potential to produce a highly efficient and easily navigable app store compared to their competitors.

Emerging markets: There is lower penetration internationally in the smartphone market. By producing "cheaper" products and with a recognizable brand, BlackBerry has the potential to grow and takeover this market share.

Playbook: RIM's tablet flopped badly the first time it was launched but the second generation of the tablet could be the key to RIM's fortunes and it has to compete head to head with the

iPad and other Android tablets. The enterprise tablet market is where it could potentially be the match-winner.

Threats

International security demands: Because of RIMs' effective security encryption, many Middle Eastern and Asian countries want RIM's encryption code to monitor communication within, to, and from their country. Recently, they have threatened to ban the BlackBerry if RIM does not comply. However, many businesses rely on RIM because of their information security guarantee. RIM could lose market share if bans are implemented.

Competitive pricing: Rise in competitive products could lead to competitive pricing, further reducing margins and profits.

Enterprise market share: Businesses are accepting more personal consumer based products like the iPhone.

Obsolete perception: Because RIM was late to the innovative touch screen mobile market and tablet industry, some may have the perception that its QWERTY keyboard and classic features are not trendy enough.

Foreign exchange risk: While revenues and raw materials are purchased in U.S. dollars, other expenses like salaries, certain operating costs and manufacturing overhead are incurred primarily in Canadian dollars. RIM engages in foreign currency hedging activities using derivative financial instruments like currency forward contracts and currency options.

The RIM Disaster Timeline: BlackBerry's Collapse

Research in Motion was the pioneer of the smartphone segment with its BlackBerry device - it's now more like Palm, about to be forgotten. Over the past five years, RIM has experienced near continuous months of turmoil while Apple and Android continue to eat up the market it once owned.

While RIM weathered the storm initially, since the summer of 2008 it has been a company self-destructing before the eyes of the world. The company was once a gem of Canada, it now has lost even that market to Apple. What's unique about the case is not that it lost to Apple and Google, but how it lost. (After all, many saw this coming.) Late last year, amidst major executive changes, RIM made the case that better marketing was the key to its turnaround - not better products.

- **RIM was started by two Canadian college students in 1984**

Research in Motion was founded by Mike Lazaridis and Douglas Fregin in 1984 while they were both engineering students in Canada. RIM began with products for Mobitex's networks.

In 1996, it introduced the Inter@ctive Pager, the first messaging pager. A year later it was listed on the Toronto Stock Exchange.

- **BlackBerry pioneered and led the smartphone segment for decade**

By 1999, RIM was listed on Nasdaq, but the bigger news was in the introduction of BlackBerry software and RIM 850, the first BlackBerry. It truly was the first fully-featured smartphone and led the category for a decade. By Q1 2008, RIM had 44.5% share of the smartphone market according to IDC.

- **When Apple got into the category in 2007 - RIM dismissed the iPhone**

Analysts argued that the iPhone will never be a threat to the BlackBerry. Some said that the two devices were intended for two different markets and the products would live in almost totally disjoint worlds. In recent years though, the iPhone has come to dominate the workplace and BlackBerry sales have plummeted.

- **It failed to defeat the iPhone with the Storm**

The Storm was supposed to be the iPhone killer, but it wasn't. It came out a year later, didn't have Wi-Fi, and was really a poor excuse for a touchscreen phone, let alone an iPhone copy. While it posted decent initial sales, users weren't thrilled about it.

- **And the Bold was a huge flop**
- **By 2008 the wheels were coming off**

While things were fine early in the year, the Q1 numbers were bad, really bad. While it barely missed analysts' expectations, the expectation was RIM was going to easily beat those numbers. By the end of summer, panic was brewing and the Q2 call did not go any better with misses pretty much everywhere on both guidance and estimates. A month later (October 2008) it was reported the iPhone was outselling the BlackBerry for the first time in history. There was a brief recovery in 2009 —but it was in the middle of a recession. Apple was cooler and better, and BlackBerry was struggling to catch up.

- **The October 2011 outage**

On October 12, 2011, the BlackBerry network went down due to a switch outage that shutdown BBM and e-mail for a day in the U.S. It was the largest and most embarrassing outage in history, and came shortly after various European outages. RIM not only apologized, but offered users a $100 of apps for free.

• The PlayBook

The PlayBook was a huge flop. BBM and e-mail, the two biggest selling points for a

BlackBerry, didn't work and consumers didn't want the PlayBook. Things got so bad there were rumours RIM had actually halted production. By December, RIM announced it would take one-time charge of $485 million to cover the Q3 losses, largely due to the PlayBook's dismal performance.

• The solution: a new beginning

In January, Balsillie and Lazaridis resigned finally ending the reign of the most famous co-CEOs in the world. Thorsten Heins, the man tasked with taking over the company picked up right where they left off - in absolute denial. Delusional Research in Motion CEO, Thorsten Heins said 'There's nothing wrong with the company as it exists right now'. BB10 is escribed as "BlackBerry's last chance to beat the iPhone" - a new OS that borrowed many of the popular features from iOS and Android. While there were only glimpses of the unfinished OS, it seemed BlackBerry was at least finally catching up - even if it was only catching up. A few weeks back RIM shares hit $6.78, a new low. On June 20, 2008 RIM closed at $144.56, 49 months later to the day on July 20, 2012 it closed at $6.78—a near 95% loss.

Conclusion

Research in Motion today faces some of its toughest decisions ever. Should it return to its roots and concentrate on enterprise and corporate customers or should it continue to divide its time, energy and most importantly money on the consumer segment of the market. RIM once owned the corporate market all over the world but that is rapidly shrinking today and there is a steady trickle of major enterprise/corporate/government clients who are switching completely away from Blackberry and (usually) to the iPhone. RIM will find it increasingly hard to even stabilize the market in the enterprise/corporate sector in those countries where it is relatively strong and find it hard to crack new markets in this sector.

Meanwhile the enterprise/corporate sector, especially in the industrialized world, are already nearly fully saturated in smartphones. There is almost no growth in this sector. Yes, RIM can find replacement sales here, but even if every existing Blackberry is replaced 1 to 1 by another Blackberry, it would mean Blackberry's global market share would erode from the current 7% to about 4%-5% within a year (assuming the rest of Blackberry sales would not fall). No matter how you spin it, if the primary focus of RIM will be the enterprise/corporate sector this year, it means Blackberry's market share will continue to fall dramatically, and that means very bad news every quarter.

The growth in smartphones is with the consumer market; and even that is becoming saturated over the next few years in the Industrialized World. Here in some of the most advanced Asia-Pacific countries like Singapore, Australia, Hong Kong, UAE etc - the proportion of smartphones out of all new mobile phones sold is well past 80%. In Western Europe it is past 70% and in the USA it is well past 60%. So the growth potential of consumer smartphones is not

strong anymore in the Industrialized World nations, where today more than half of all phones in use already are smartphones. The growth opportunity is mostly in the emerging world markets where about half of all smartphones will be sold this year. Out of all active mobile phone accounts, 80% are in the Emerging World countries and only one in five is in 'the west' i.e. the Industrialized World countries.

For the emerging world, we need lower-cost smartphones near the 100 dollar price (without subsidy included). The average Blackberry device costs over 300 dollars and is priced far too high to be a mass market proposition in most of the Emerging World markets. Blackberry did have strong success in many surprising emerging world markets from India to Nigeria to Venezuela and Indonesia but RIM seems not to have been able to fully capitalize on that and to spread into the rest of the world.

There are many countries where the Blackberry is not strongly welcome by the carriers/ operators (like China) or where the local regulators are concerned about the level of 'too much' security on the Blackberry service (like several countries in the Middle East). These all have hurt Blackberry's chances. And of course there is the added pain of having launched the tablet which does not support Blackberry's other business well and has been an enormous drain on RIM's profitability while selling in modest numbers only, compared to the market dominant iPad.

Quarterly results from RIM are just getting worse with every passing quarter and while it was up and down several times in the last two years, there is now both a giant drop in market share, and the first time RIM has gone from generating profits to generating consecutive losses. We think we've seen another giant fall off a cliff. And how astonishingly, RIM was the world's second largest smartphone maker just over a year ago.

RIM has bet the house on its forthcoming BlackBerry OS 10. But it could be a case of too little, too late. Smartphones based on BlackBerry OS 10 will have hit the markets and RIM's CEO Thorsten Heins was quoted saying that they would not deliver a product to the market that is not ready to meet the needs of customers or provide anything less than an outstanding user experience with the quality that is expected of a BlackBerry product and that there would be no compromise on this issue. Hopefully for Heins and his team at Research in Motion, this admirable dedication to quality will pay off in the long run. Their fates depend on the BlackBerry 10.

Addendum

Blackberry: The Re-invention

Seldom do we see a company's survival hang on just a single product. Even rarer is a company changing its corporate brand name. As of today, Research in Motion has been renamed Blackberry. CEO Thorsten Heins is of the belief-"We have reinvented the company and we

want to represent this in our brand". The reinvention that he is talking about is the launch of BB10. The BlackBerry Z10 is the first all-touch smartphone to run the BlackBerry 10 OS and represents a major bet by the company to compete in a modern smartphone ecosystem while the BlackBerry Q10 QWERTY smartphone hopes to regain the strong corporate footing it once had. Both the phones function on the new BB OS 10. With so many expectations pinned upon the new phones, they have delivered at some level. Initial opinions seem to largely favour the phones. The share prices of Blackberry also reflected positively by gaining 287% from their lows. Although the huge change is because of a miserably small base, it's in the right direction. While other platforms in the market have seen incremental upgrades, BB10 has been built from ground up. The messenger has been upgraded to integrate video chat, further, new and unique aspects like *Peak*, *Flow* and *Balance* have been featured. The survival of the company now depends upon the market response and it seems like it will be a waiting game. On one hand Blackberry still holds a strong emotional connect with its previous and current users, the competition is cut throat in the mobile market and Blackberry might just be a gash too late on the other. While Blackberry's brand new operating system BB10 and its combination of new devices is a good start and good enough for now, its success in the long run would depend upon several factors including its ability to add relevant applications. It should be noted that Android has around 700,000 applications, Blackberry has around 70,000. It appears as if Blackberry has done its job and they have come up with a very relevant product, the only thing to be seen is if it's too late.

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Quantitative Easing - A Blessing or a Curse?

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Abstract

As another round of Quantitative easing (QE) by the Federal Reserve is making headlines, people are proving skeptical that it would help increase discretionary spending. As lackluster growth continues to haunt the job market and the economy remains sluggish despite the previous two rounds of QE, it is time to raise questions whether this unconventional monetary policy tool is really a blessing or a curse. Through this article, the macroeconomic effects of quantitative easing have been analyzed and an attempt has been made to weigh its intended and unintended consequences. In this process, the effectiveness of such an unconventional monetary policy tool in overcoming the recession has also been evaluated.

This article can be roughly divided into three sections. The first section begins with a brief explanation of the quantitative easing process and highlights the economic conditions that have warranted the use of QE in the past. The second section gives an in-depth analysis of the impact of QE on the US economy, the liquidity in emerging markets, the stock prices, the housing market and unemployment. The third and final section draws up the main conclusions of this study regarding the effectiveness of QE in the current economic conditions.

Introduction

More than five years have passed since the global financial crisis imploded, and yet its repercussions continue to make headlines even today. In 2007, when the housing market in the U.S collapsed, it brought down along with it the entire financial system. Following close on its heels was the European sovereign debt crisis which further crippled the world economy as consumer and investor sentiments nosedived and the most powerful economies started slipping into a recession. Since the beginning of the Great Recession, many forms of Quantitative Easing (QE) have been used by the U.S Federal Reserve, the Bank of England and the Euro zone in attempting to revive consumer spending and economic growth.

In the midst of the 2008 financial crisis, slow growth accompanied by high unemployment forced the Fed to stimulate the economy through QE in the interval from November 2008 through June 2010. But the program could do precious little in improving real growth or employment, so the Fed announced an expansion of the program from $600 billion to $1.25 trillion.

But with the conclusion of the first bout of quantitative easing, the economy again suffered from slower growth, the rise of the European debt crisis, and renewed instability in the financial markets. The Fed then introduced a second stimulus package, which came to be known as 'QE2' and involved the purchase of $600 billion worth of short-term bonds. This program ran from November 2010 through June 2011 and although it sparked a rally in the financial markets, it did not help in creating sustainable economic growth. Thus, the conclusion of QE2 was immediately followed by weak economic data.

As of September 2012, the Fed has already spent $2.3tn (£1.4tn) in quantitative easing and further pledged to add $40bn (£35bn) per month in its third round (QE3). On the other hand, Bank of England (BoE) has committed a total of £375bn to QE so far.

Quantitative Easing: A Definition

Quantitative easing (QE) is an unconventional monetary policy used by central banks to stimulate the economy when conventional monetary policy has become ineffective.
If the nominal interest rate is at or very near zero, the central bank cannot lower it further. Such a situation, called a liquidity trap can occur, during deflation or when inflation is very low. In such a situation, the central bank may perform quantitative easing by purchasing a predetermined amount of bonds or other assets from financial institutions. This increases the demand for the bonds and raises the prices or conversely lowers the yield on the bonds issued.
The goal of this policy is to increase the money supply and stimulate demand rather than to decrease the interest rate, which cannot be decreased further.

Quantitative Easing Process

In response to the financial crisis of 2008, the major central banks of the world loosened their monetary policy to facilitate growth. As the interest rates could not be lowered further, the Banks resorted to unconventional monetary policy measures such as financing asset purchases to inject liquidity into the markets, which came to be known as Quantitative Easing.

When the central bank purchases assets using the new central bank money, it boosts the amount of money held by banks also the amount of money held in deposits by firms and households. This additional money works though a number of different channels to provide a stimulus to nominal spending in order to achieve the target inflation rate. Figure 1 illustrates how the asset purchases work to revive nominal spending.

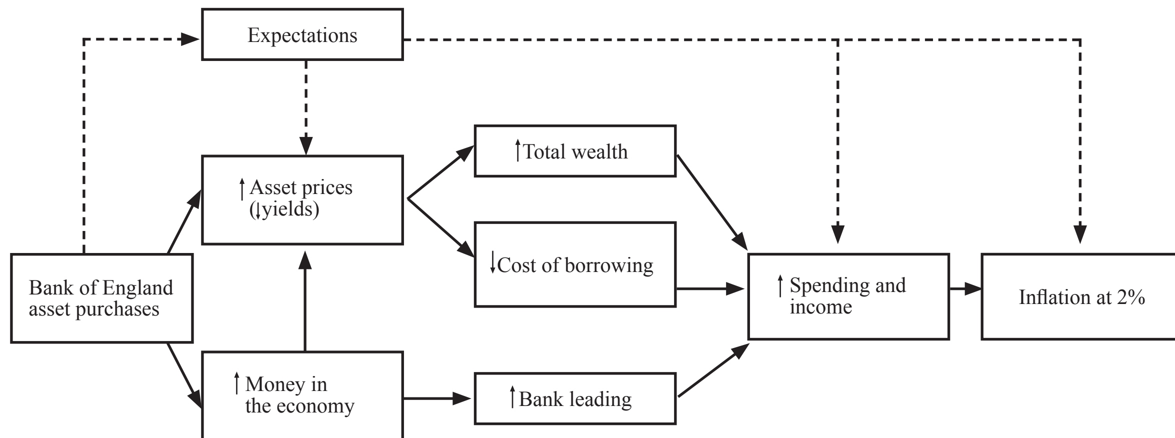

Fig 1: Transmission mechanism for asset purchases
Source: Bank of England.

In order to understand the working of the QE process, we first need to understand the terms 'broad money' and 'narrow money'. The term 'broad money' is used to indicate the deposits held by commercial banks for their customers. These deposits are used by both households and companies for purchasing goods and services. The term 'narrow money' denotes the monetary base, which is highly liquid money comprising coins, paper money and commercial banks' reserves with the central bank.

When the central bank purchases an asset from a non-bank company, it pays for the asset via the seller's bank. This is done by crediting the reserve account of the seller's bank with the required funds and the seller's bank, in turn, credits the account of the seller with a deposit. This leads to an increase in the monetary base and broad money at the same time. On the other hand, when the central bank purchases an asset from a bank, it increases the monetary base (or 'narrow money').

The expansion of broad money forms a key part of the transmission mechanism for quantitative easing and it effectively leads to an increase in the asset prices and spending, which help in achieving the inflation target. As the yield on the assets purchased drops, investors are encouraged to purchase other types of assets, thus leading to an increase in their prices as well. Also, the Bank's purchase of corporate bonds and commercial paper has a direct bearing on the condition of the corporate debt markets. Such purchases help in improving investor confidence and increasing the amount of financing available. Asset purchases have an important impact on expectations and help in keeping the inflation close to the target when there is a risk that inflation would otherwise have fallen.

Need for Quantitative Easing

In the aftermath of the U.S financial crisis, spending in the economy slowed very sharply and the unemployment levels reached new lows as the Global Recession gathered pace. This led to

contraction of the real output and price deflation in the U.S. Moreover, the specter of financial shocks emanating from Europe on account of the troubled Euro zone economies further fueled investor distrust and led to a reduced pace of growth. As the Fed has a dual mandate to maintain price stability and achieve full employment, the relative lack of inflation has given the Fed an opportunity to act on improving the employment picture. The U.S economy growth has registered a paltry 1.3% annual rate in the second quarter of 2012. At the same time, the unemployment rate continues to be above the 8% level as employers were able to add only 96,000 jobs to payrolls in August 2012 as against economists' forecasts of 125,000 jobs.

In this scenario where inflation is below even the official target of 2% for both the BoE and the Fed, QE, which is often seen as a trade-off between inflation and unemployment, is thought by many to be the obvious choice. Also, in the absence of any intervention by the Fed, the continued sluggish economy may result in deflation which is a bigger threat to economic growth than inflation. The housing sector in the U.S is one such sector which is suffering from deflation. Owing to a nearly 30% decline in the home prices, people are hesitant about buying homes until prices start trending up again. This lack of demand translates into a further fall in home prices and aggravates the deflationary pressure. Hence, with the launch of QE3, which will pump $40 billion into the US economy each month, the Fed aims to reduce the unemployment levels and revive the housing sector.

Effect on Interest rates

The purchase of assets is expected to drive up their prices and lower the yield. Lower interest rates would help recover the housing sector and increase mortgage lending. But as seen from Figure 2, the size of the Fed's balance sheet shows a very low correlation with the yield on the 10-year treasury. While the size of the balance sheet has been continuously increasing with the implementation of quantitative easing, yet the yield on treasury has remained high during most part of the years 2008-10. Also, it should be noted that even as the yields are going lower with continued asset purchases, they are adding to the risks of treasury dumping and a stock market bubble.

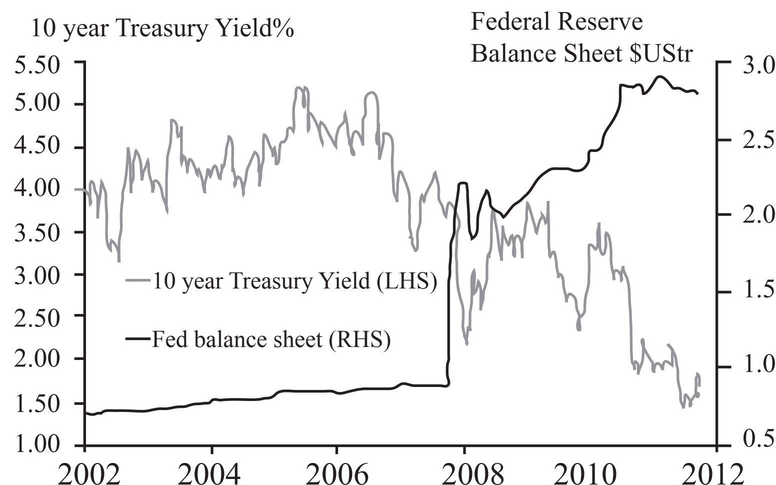

Fig 2: Federal Reserve balance sheet and 10-year bond yield
Source: Federal Reserve, Bloomberg.

Impact on Emerging Markets

QE leads to greater availability of credit in developed markets which has not been offset by demand, resulting in an abundance of excess liquidity. Much of this surplus capital flows into emerging markets, and has adverse effects on their currency exchange rates, inflation levels, export competitiveness, and more.

Emerging markets have been a popular target of excess capital for a number of reasons:

- Their overall ability to take on debt remains strong
- They have experienced minimal balance sheet impairment compared to developed markets
- Investment yields have been high relative to sovereign competitors
- They have relatively innocuous levels of pre-existing leverage

Specific Effects and Risks of QE on Emerging Markets

- **Global inflation:** Increased liquidity in the markets will aggravate the inflation rate further. This is manageable in the developed countries due to slow the economic activity but it will hurt emerging markets like India which are already facing a high rate of inflation
- **Currency depreciation:** The dollar is expected to weaken against major world currencies, thus improving its export competitiveness. This could be quite bad for emerging markets, which are more dependent on exports and have less well developed domestic consumer economies
- **The financialization of commodities:** As the emerging nations are a major driving force of commodities from both a demand and supply perspective, the effects of commodity price inflation on core inflation are felt more strongly in these markets than in advanced ones. One recent trend observed in the global financial markets is the increased correlation between disparate asset classes. An example of this is the relationship between equity and commodity markets. In the past, these two asset classes have shown a low degree of correlation, but recent data has shown that commodity prices and equities are beginning to move in lockstep. If this trend continues, the increased correlation would detract from the diversification benefits of commodities which earlier served as the main rationale behind investing in commodities. Also, as a result of this drift, the commodity prices may become decoupled from the real factors of demand and supply and become more directly linked to the financial markets. Thus the monetary policy would come to have a direct influence on the financial markets. Thus the implementation of quantitative easing has the potential to affect core inflation in the emerging markets through financialization of commodities. Figure 3 below shows the correlation between the Thomson Reuters/Jefferies CRB Index (TR/J CRB) and the S&P 500 stock index. Since 2009, stocks and commodities have shown to follow matching trends and post similar returns

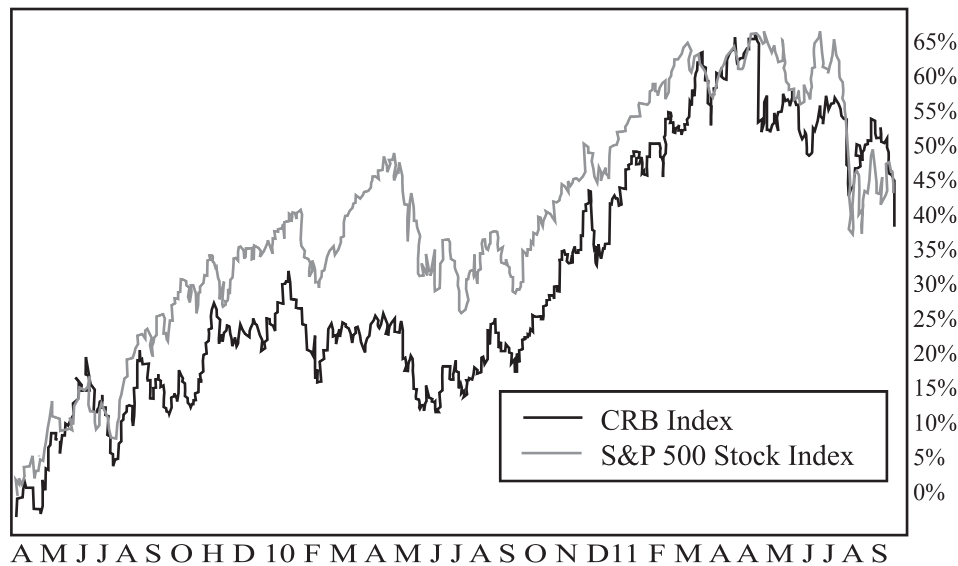

Fig 3: Correlation between S&P 500 Stock Index and Thomson Reuters/Jefferies CRB Index Source: Stockcharts.com

- **Currency Carry Trade:** QE facilitates 'currency carry trade' in which speculators borrow money at low interest rates and invest it in developing countries at a much higher rate. Private speculators gather profits on the interest rate spread and the appreciation of the currency of developing countries. So, the massive amount of money flowing into the emerging markets will create de-stabilizing effects of rapid currency appreciation and asset bubbles

- **Threats of retaliatory measures:** In the recent years, globalization and fewer trade barriers have lead to the creation of a global modern-day financial system where the monetary policies of major powers like US and UK could have important implications on the other economies as well. In such scenario, the traditional view that central banks should frame policies to keep only their domestic financial systems stable does not hold good and the consequences of unconventional policy tools such as QE should be a first-order concern. If the monetary policy is solely based on domestic variables, it bears the threat of retaliation from emerging markets in the form on trade barriers and capital controls which may prove counterproductive

Effect on S&P 500 prices

Quantitative easing tends to pump up the prices of financial assets such as stocks and commodities. Hence, as shown in Figure 4 below, the expansion of the Central Bank's balance sheet leads to a rise in the S&P 500 prices, but as the money-printing effects start to wear off, the index shows a downward trend. Thus, by forcing interest rates lower, QE makes

bonds less attractive and therefore stocks seem like a better alternative. This effectively inflates a false stock market bubble that could burst once the intervention ends.

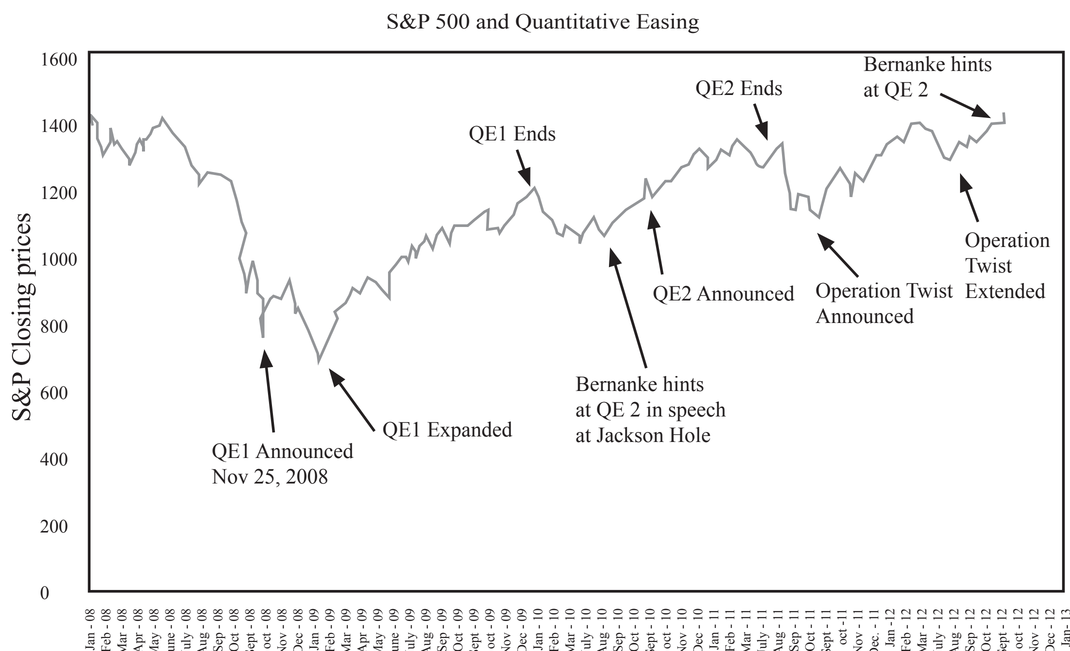

Fig 4: The S&P started to rise when QE started and stopped rising when QE was terminated
Source: CBS News

Effect on Employment

A major motive behind the unprecedented use of quantitative easing has been the high unemployment levels and the sluggish job recovery since the financial crisis. With the introduction of QE and better financial conditions in place, households and businesses were expected to be more willing to spend, thus improving employment prospects and raising incomes.

In actual fact, however, unemployment levels have remained stubbornly high over 9%, the population participation rate in the labor force has constantly decreased and the employment-population ratio has shown no signs of improvement during the last two years. Figure 5 illustrates that QE has not been very successful in aiding the unemployed.

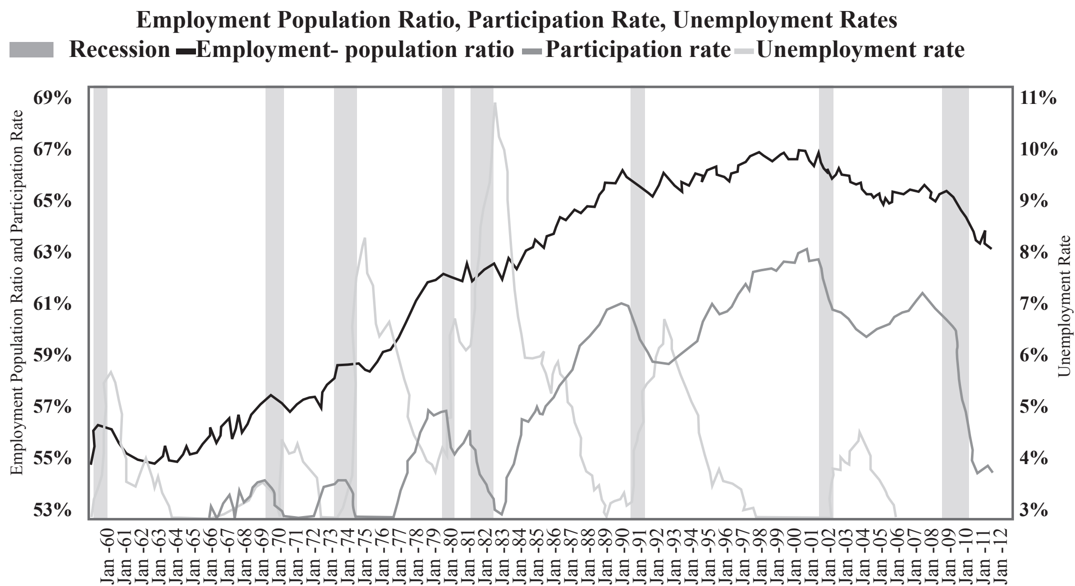

Fig 5: Unemployment levels have remained high; participation rate and employment-population ratio have fallen
Source: U.S Bureau of Labor Statistics.

Effect on Mortgage Lending and Housing Markets

The Federal Reserve has mentioned that QE has been implemented to support mortgage lending and housing markets with lower interest rates. But according to the data released by S&P Indices for its S&P/Case-Shiller Home Price Indices, the leading measure of U.S. home prices, all three headline composites – the national composite and the 10- and 20-City composites have ended the first quarter of 2012 at new post-crisis lows. Figure 6 shows that QE has clearly failed to recover the housing sector and at best, it has just reduced the rate by which it is weakening.

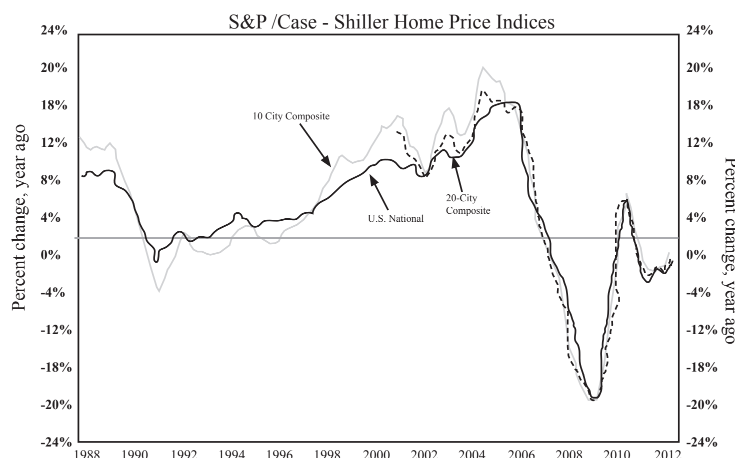

Fig 6: Case-Shiller Home Price index after a brief rebound from its lows, is once again heading downwards.
Source: S&P Indices & FiServ, as of May 29, 2012.

What is wrong with QE?

When the central bank expands its balance sheet by purchasing assets from a bank, there is no guarantee that the bank will lend out the money to its customers. There are several reasons why a bank may choose to hold on to the extra cash instead of lending. Some reasons are given below.

When the economy is going through a bad phase, the banks may not have a lot of extra cash. So they may reduce lending in order to reduce the risk of being unable to pay their own debts.

Also, in a bad economy, many potential customers may not be credit worthy, which may deter the banks from lending out much cash.

A third scenario may be that even when the banks are ready to lend, they do not find many customers as people may be already too indebted to borrow. Also, the high unemployment levels in such a condition further reduce the possibility of borrowing.

Such a situation is being faced currently in the US and the UK, and is also known as Balance Sheet Recession (BSR), a term coined by economist Richard Koo. A debt-financed asset bubble serves as a precursor to a balance sheet recession. When the bubble pops, the asset prices start declining well below the value of the corresponding liabilities, i.e., mortgages, and cause impairment of the private sector balance sheets. This is accompanied by a change in the priorities of asset owners from profit maximization to debt minimization. As the private sector begins the deleveraging process and refrains from taking on additional liabilities, the monetary policy of QE proves ineffective.

In the US, this deleveraging impact has been seen in the falling need for household funding as shown in Figure 7 below. As consumers reduced consumption and started saving for the future, the economy lost almost $1.4 trillion due to lower funding needs and the personal saving rate went up from 2.5% to 8.2%.

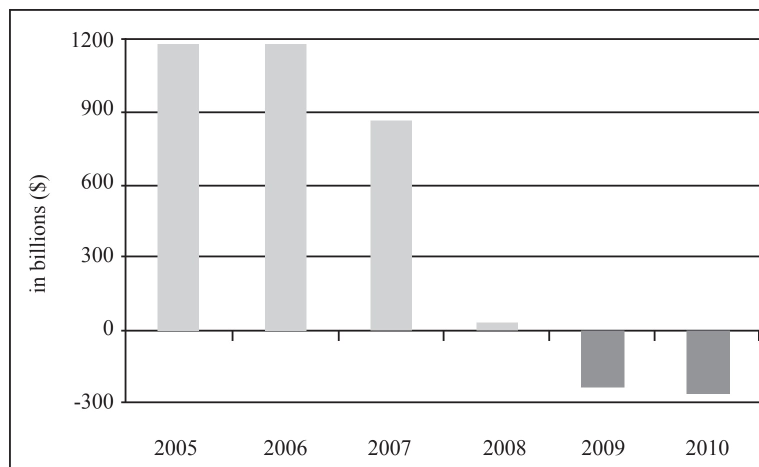

Fig 7: Total household borrowing declined after the housing bubble burst.
Source: Federal Reserve: Flow of Funds.

In order to stabilize the short-term funding markets, the Fed supplied excess reserves into the banking system. The monetary base saw a three-fold increase from $850 billion in 2007 to $2.7 trillion in 2011. But due to the deleveraging effect and the plunging money multiplier ratio, the money supply did not grow in spite of the growth in the monetary base. The money multiplier ratio, which measures the increase in money supply per dollar increase in the monetary base, fell to less than 50% of its 2007 level. Figure 8 shows the ineffectiveness of the monetary policy in a balance sheet recession when the households take on less debt and commercial banks find fewer creditworthy customers.

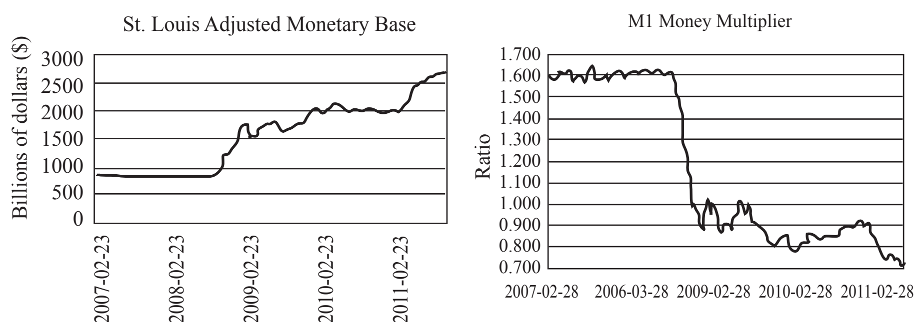

Fig 8: U.S Monetary Base & M1 Money multiplier
Source: Federal Reserve Bank of St. Louis

Another problem with QE is its increased dependence on the rising stock prices to spur economic growth and stimulate spending. In his speech in Aug 2012, Federal Reserve Bank Chairman Ben Bernanke said that QE had contributed to an increase in stock prices and this would provide an impetus to spending by businesses and households. But this involves the assumption that the stock market really reflects the real economy. Moreover, most equity shares in the U.S are owned by the wealthiest 10% of the population simple because with higher disposable incomes, they have a better ability to take ownership stakes in companies. This implies that QE can provide benefits to a narrow segment of people rather than the society as a whole.

In Aug 2012, Bank of England released a report showing that its quantitative easing program has disproportionately benefitted the wealthiest. The BoE admitted that the value of shares and bonds had risen by 26% or £600 billion as a result of QE, but 40% of the gains had gone to the richest 5% of households in the UK. Thus, the distribution of financial assets is highly skewed and only adds to income inequality.

Alternatives to Quantitative Easing

In a balance sheet recession, the private sector has the tendency to move from a net borrowing to a net saving position by paying down debt and saving money. This leads to a fall in the GDP when the demand for funds is lesser than the supply even with near-zero interest rates. In order to bring down the threat of a deflationary spiral and keep the GDP from falling, the

excess savings need to be brought into the economy's input stream by borrowing and spending those savings in the private sector. This calls for a fiscal policy that is focused on government spending. Further, as the private sector is in a deleveraging mode, government spending will not lead to crowding out private investment or inflation. It will also help in sustaining the money supply & prevent contraction of bank's assets.

Hence, in a balance sheet recession, the monetary policy produces limited results and the government becomes the main source of borrowing and spending to offset the falling demand from private sector. If the government withdraws stimulus before the balance sheet recession ends, the economy runs the risk of entering into a deflation state. Instead, an expansive fiscal policy involving government expenditure on infrastructure and other productive activities will serve as a robust mechanism in mitigating the risks of public sector deleveraging.

Conclusion

Analyzing the effects of QE policy of the U.S Fed, we can draw the following conclusions:

By the use of quantitative easing the Fed has not been able to reduce unemployment in a meaningful manner or create a recovery in the housing market. Additional QE will add to the already enormous national deficit without dealing with the underlying causes of our current economic weakness. Even though the interest rates are already at historic lows, businesses and homeowners are still having trouble borrowing as banks have not taken an aggressive stance on lending. So a major risk with more QE is that it may fail to achieve the desired result of boosting economic growth because Americans are so indebted they do not want to borrow more, no matter how cheap the loan is.

Another risk is that the banks and other investors may take the money and stick it into assets like shares and commodities, rather than lending it for more productive purposes like business investment. This will further push the asset prices higher, including in already over-heated developing markets as cheap money will flood out of the US looking for better returns. The massive amounts of flowing into emerging markets as a result of expansionary monetary actions in developed markets will lead to skyrocketing levels of foreign investment into these emerging markets, resulting in an overvaluation of the their currencies and subsequently damaging exports.

Also, further QE may add to our problems when the Central Bank has to unload all the bonds it has purchased. When the Fed decides to sell all the bonds it bought during the three phases of QE, interest rates will be driven up and may stall the economic recovery just when it has finally taken off. When the economy is in a balance sheet recession and faces the risk of entering a deflationary environment, monetary policy easing in the form of QE leads to a liquidity trap as banks are unable to lend out excess reserves.

Another fact is that quantitative easing can trigger hyperinflation if too much money is injected

into the economy. This makes it a risky strategy to employ. Ultra-easy monetary policies such as QE can be a threat to the health of financial institutions and the functioning of financial markets. Temporary, higher-than-normal inflation, as a result of such a policy, causes wage and price adjustments and erodes the real value of household debts. It should also be noted that when nominal interest rates are close to zero, a higher inflation rate translates to a much lower real interest rate. Thus, we can conclude that, supply of additional liquidity through QE is a questionable solution towards resurrecting today's economy and, not a panacea in creating sustainable demand.

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Govern to Gain

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Abstract

Corporate governance has emerged as one of the key issues in the Indian economy as more and more companies, foreign and domestic, are looking to compete in the Indian market. Good corporate governance practices ensure that companies are run in an ethical, transparent and equitable manner. The chief objective of this article is to highlight the main challenges that need to be overcome to raise the quality of corporate governance in India. It stresses the importance of having good governance practices and traces the history of corporate governance in India. It examines how India is faring currently and also the various measures being taken by the government in this regard. It explains why the Anglo-American standards of corporate governance that have thus far been employed are not the answer to India's governance problems. This article is an exhaustive study of all the governance challenges faced by the country today.

What is Corporate Governance?

"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations, and society."

-*Sir Adrian Cadbury in 'Global Corporate Governance Forum'*

"The primary purpose of corporate leadership is to create wealth legally and ethically. This translates to bringing a high level of satisfaction to five constituencies -- customers, employees,

investors, vendors and the society-at-large. The raison d'être of every corporate body is to ensure predictability, sustainability and profitability of revenues year after year. Corporate governance is about owners and managers operating as the trustees on behalf of every shareholder – large or small."

-*N. R. Narayan Murthy, Chairman Emeritus, Infosys Technologies Ltd.*

Good corporate governance practices entail the following:

- Organizations should respect the rights of shareholders. They should help shareholders by giving them all relevant company information and by encouraging them to attend general meetings
- Organizations should take into account the interests of other stakeholders as well – the employees, investors, creditors, suppliers, customers, local communities and policy makers
- Corporate governance is very complex as it involves human behaviour – ethics, principles, integrity, and honesty. Organizations should adopt a code of conduct for the management that encourages responsible decision making and imposes strict penalties for digression
- Organizations should be transparent in their functioning and maintain the books of account so as to reveal the correct financial position of the company
- Organizations should clearly define the role and responsibilities of the board. They should equip them with all relevant company information so that they can effectively carry out their duty. The efficacy of the board should be increased by granting them adequate level of independence

Hence, a good governance system is one which is transparent, accountable, equitable, inclusive, effective and efficient. The three aspects of corporate governance are: shareholders' interests, company performance and corporate social responsibility.

Importance of Having Good Corporate Governance Practices

Good corporate governance practices reduce the perceived risk of investing in companies. It instills trust in the company among its investors, vendors, employees, customers and the society in general.

A company's favourable reputation for the environmental, social, and governance programs

it carries out can help it achieve its financially valuable objectives such as better regulatory settlements, price premiums, increased sales, higher valuation for an impending IPO and greater talent retention.

In 2002, McKinsey's global investor opinion survey showed that equity investors were willing to pay a premium of up to 40% for emerging-market companies with strong boards of directors. In 2005, credit rating company Moody's upgraded GS Caltex and SK Corporation (South Korea) because of their improved corporate governance practices.

There are several stakeholders in the running of a business, each of whom brings different things to the table for the firm. Firms need to decide the priority hierarchy of all the stakeholders depending on how valuable their contribution is to the firm. Corporate governance is all about balancing the interests of all stakeholders such that those who provide the most value to the firm are given the maximum benefit during distribution of the firm's wealth.

As more companies seek investment from the general public to grow and compete globally, the need and importance of strong governance will only increase.

History of Corporate Governance in India

Unlike in the South-East and East Asian countries which experienced the 1997 Asian economic crisis, or the US which passed the Sarbanes-Oxley Act in 2002 after several high-profile corporate scandals (including Enron and WorldCom), the corporate governance initiative in India was not triggered by any serious financial, banking or economic collapse. Corporate governance in India gained prominence in the 1990s due to liberalization and deregulation of industry and business. In December 1995, the industry association Confederation of Indian Industry (CII) first brought the concept of corporate governance to India that finally resulted in the release of the first voluntary code for corporate governance in April 1998 titled 'Desirable Corporate Governance: A Code'. In 2000, Securities and Exchange Board of India (SEBI) incorporated the recommendations of the Birla Committee (that was formed under the chairmanship of Kumar Mangalam Birla by SEBI in 1999) into Clause 49 of the Listing Agreement of the Stock Exchanges, thus making it mandatory for listed companies to comply with these norms. Two other important initiatives on corporate governance were the recommendations of the Naresh Chandra committee that was set up in 2002 by the Department of Company Affairs (DCA) and those of the Narayana Murthy committee that was formed by SEBI in 2003. In 2009, the Ministry of Corporate Affairs released a set of voluntary guidelines for corporate governance. Again, however, by incorporating several important corporate governance norms into the Companies Bill, 2011, there is a shift towards making compliance with corporate governance norms mandatory.

Both the Birla and the Murthy Committees referred to the Anglo-American standards of governance when coming up with their suggestions. Hence, it is not surprising to find that

India's current corporate governance norms have a lot in common with the norms in other countries that adopted the same model. However, as Jayanth Rama Varma pointed out in his article titled 'Corporate Governance in India: Disciplining the Dominant Shareholder' which appeared in 'IIMB Management Review' in 1997, the main corporate governance issues in India are very different from those in, say, the US and hence the current provisions to ensure good corporate governance may not serve their purpose. In the US, the primary objective of corporate governance is that of disciplining the management and protecting the rights of the owners, each of whom individually own only a miniscule proportion of a firm's total equity. The corporate governance norms look to minimize the gap between interests of management and shareholders. In India, though, it is mainly about disciplining the dominant shareholder who has the tendency to capture most of the company's resources to serve his own interests, often to the detriment of others' interests. Further, the norms followed in Western countries focus a lot on strengthening the effectiveness of boards. In India, however, the shareholders hold more importance than the board and it is the majority shareholders who have the final say in all the major decisions that the company takes.

On the occasion of releasing a compendium titled 'State of Corporate Governance in India-Policies to Reality', Union Corporate Affairs Minister Dr Veerappa Moily said that the concept of corporate governance was still nascent in India where norms required a constant state of refinement to build a balance between voluntary and mandatory approaches. He said that, in an uncertain global scenario, it had become imperative for countries to have a robust legal and compliance framework.

In the Governance Metrics International 2010 rankings, India was ranked 20th out of 38 big economies. In the CLSA Corporate Governance Watch 2012 list, India was ranked 7th best in the Asia-Pacific region in terms of corporate governance. Moreover, only five Indian companies – Infosys, HUL, Wipro, Titan Industries and Yes Bank – featured in the list of the 50 best governed companies in the region. To improve corporate governance in India, the Ministry of Corporate Affairs, Government of India, has set up National Foundation for Corporate Governance (NFCG) in partnership with CII, Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI).

The Companies Bill 2011 seeks to improve corporate governance, bring in more transparency and make independent directors more accountable. It was passed in Parliament on December 18, 2012. The bill gives more powers to the Serious Fraud Investigation Office (SFIO). It provides for effective coordination between central and state investigative agencies, information technology ministry and SFIO. In an effort to curb the practice of illegal routing of funds through multiple subsidiaries (many of which are established in tax havens), the government has included a clause in the bill which makes it mandatory companies owning one or more subsidiaries to prepare a consolidated balance sheet of all its subsidiaries, apart from the individual balance sheets. Companies having either net worth in excess of Rs 5 billion, or

turnover of Rs 10 billion or net profit of Rs 50 million will have to set aside 2% of their average profits of the previous three years for Corporate Social Responsibility (CSR) activities. The bill also provides for class action suits, wherein a group of individuals all having the same grievance may file a lawsuit if they are of the opinion that the company is being mismanaged. The tenure of auditors has been fixed at five years. Further, the auditors will need to obtain annual endorsement from the shareholders in the Annual General Meetings (AGMs) and not just from the respective boards. Also, no auditor can take up more than 20 assignments at a time. It also seeks to provide better protection to whistleblowers. It seeks to regulate managerial compensation. Directors will now be entitled to no more than 5% of the annual net profit of their companies. Independent directors will no longer be eligible for stock options; they will, instead, be awarded fees and profit-linked commission. The bill makes independents more accountable; they will now constitute at least one-third of the board. Insider trading will now be considered a criminal offense. Experts like Krishnamurthy Subramanian, assistant professor, ISB Hyderabad, are of the opinion that although the bill is a step in the right direction, the clause to control managerial compensation may hurt companies trying to rope in the services of the best managers. According to Subramanian, the clause to make independents more accountable may discourage them from joining company boards. J.J. Irani, former director of Tata Steel, is of the belief that it is wrong on the part of the government to make it mandatory for companies to spend on CSR activities as such decisions should remain the sole discretion of the shareholders of the respective firms.

Challenges of Corporate Governance in India

The main challenges for improving corporate governance in India are:

Excessive power of the dominant shareholder

A feature that is unique in the Indian context is the large presence of promoter-led companies. Promoters manage the company's operations and take important decisions even though, in many cases, their holding is lower than that of other shareholders. According to a McKinsey report titled 'Improving board performance in emerging markets', 95% of the listed companies and almost all of the 42 million unlisted companies in India are family-owned businesses. Together, these companies represent more than 70 per cent of the market capitalization, 75 per cent of the GDP and 57 per cent of the employment in the country. Hence, the primary problem in Indian corporate governance is a conflict between the dominant shareholders and the minority shareholders.

The problem of the dominant shareholder arises in three categories of Indian companies. First are the public sector units (PSUs) where the government is the dominant shareholder and the general public holds a minority stake. Second are the multinational companies (MNCs) where the foreign parent company is the dominant shareholder. Third are the Indian business groups where the promoters (together with their friends and relatives) are the dominant shareholders

and the balance is held by the general public.

Public Sector Units

As PSUs are an extension of the State under Article 12 of the Constitution, they are subject to high levels of interference from the government, making the Board almost redundant. The Board of Directors has almost no power to select the Chief Executive Officer, who is chosen at the sole discretion of the relevant ministry of the Government and the Public Enterprises Selection Board. The Board does not have the power to decide the tenure and compensation of the CEO either. The company's audit is mainly done by the Comptroller and Auditor General (CAG) rather than by the Audit Committee. Thus, almost all the important strategic decisions are made by the government rather than by the Board.

Often, decisions are taken not necessarily in the best interests of the company but keeping the political implications in mind. For example, although, officially, the petrol prices have been deregulated and are decided by the oil companies based on international oil prices, it is a well-known fact that these companies cannot change the prices without the permission of the government, thus often resulting in situations wherein there are elections around the corner and hence petrol prices are not hiked even as the oil companies are suffering millions of rupees worth of losses every day.

In yet another such instance, The Children's Investment Fund of UK (TCIF), the second largest shareholder of Coal India (90% of which is owned by the government), accused the board of yielding to the government when it refused to hike coal prices and entered into unfavourable fuel supply agreements with power producers at the Prime Minister's behest. TCIF further threatened to take legal recourse. In such cases, however, the popular opinion is that the government is right in giving precedence to national interests over shareholder interests.

Also, as it happened a few years ago, disputes may arise between companies wholly owned and those partially owned by the government. As the amount of government disinvestment increases, such conflicts will only increase.

Further, the labor laws are highly obsolete and need reforms. For example, many non-functional PSUs still own and maintain outdated resources and pay their staff as it is very difficult and time-consuming under the current labor laws to lay off employees and also to close businesses. According to a 2011 KPMG report titled 'Corporate Governance – Value Beyond Compliance', about a third of India's state owned companies collectively lost $3.4 billion in FY11.

Multinational Companies

Given the financial implications, the foreign parent company usually plays a very proactive role in the running of its Indian subsidiaries. Over the years, the government restrictions on the

extent of ownership that a foreign parent company can have in its subsidiaries in India have resulted in severe corporate governance problems. For example, in the 1970s, government price controls forced MNCs to issue shares to the general public at substantial discounts. Later, when the government raised the amount of ownership that a parent company can have in its Indian subsidiaries, the parent companies resorted to preferential issue of shares to themselves at huge discounts, causing big losses to the minority shareholders. Such decisions, which were clearly biased in favour of the majority shareholder, were taken in the general meeting. This was possible as the parent company, having dominant shareholding, could easily overrule the will of the minority shareholders.

Further, there have been frequent allegations of parent companies transferring their most profitable brands and businesses from their old partially owned subsidiary to their new wholly owned subsidiary at rates substantially below the market rates, thus causing huge losses to the shareholders of the partially owned subsidiary.

A third problem arises when a parent company demands huge fees from its subsidiaries for its services, thus causing a severe dent in the earnings of these subsidiaries.

Fourth, the subsidiaries are often made to undertake undue risks for the benefit of the parent company.

Finally, it is generally a local manager who is given the responsibility of ensuring that the subsidiary complies with local governance laws but, as is often is the case, the manager does not have the desired level of authority to effectively carry out his duty.

Indian family businesses and business groups

Family business groups are highly prevalent in India because of the uncertain nature of the external environment and its underdeveloped capital markets. It is believed that group firms can support each other, thus giving them a better chance of survival than individual firms. Due to liberalization and globalization, one may have expected the prevalence of family business groups to reduce. However, research shows that ownership concentration of shares is actually on the rise and many of the promoters are buying back equity.

In India, it is difficult to accurately identify the true holding of the promoter groups because these holdings are often distributed among several friends and relatives. Also, in many cases, the holding of the promoter is much lesser than the majority stake. What makes the promoters the majority shareholders is the fact that a significant proportion of the equity is owned by state-owned financial institutions which typically play a passive role in the functioning of the company. Thus, these promoters are able to pass biased resolutions such as tunneling of resources from one group company to another, preferential allotment of shares to the dominant shareholder etc. in the general meeting.

People wanting to invest in group companies should keep in mind that, due to the prevalence of

cross-holdings by group firms (i.e. a significant proportion of a firm's stock owned by a group firm), such companies are subject to both firm-level and group-level risks.

Corporate governance becomes all the more complex when promoters own shares lesser than the majority stake. In such cases, the promoters have a particularly high incentive in keeping the stock prices high. Satyam is a case in point. As of December 31, 2008 its promoters, the Raju family, owned only 5% of the company's shares and although the institutional investors collectively owned 60% of the stock, the highest individual holding of an institutional investor was only 3.76%. This gave the Raju family power in the management of the company that was highly skewed relative to their voting rights. In his confessional letter post exposure of the Satyam scam, Ramalinga Raju admitted, "As the promoters held a small percentage of equity, the concern was that poor performance would result in a takeover, thereby exposing the gap. It was like riding a tiger, not knowing how to get off without being eaten."

Also, a large parallel economy has emerged over the years due to transactions that are dealt with in cash and not recorded in the books of account. This practice not only robs the government of taxes but also cheats the minority shareholders of their rightful earnings. Often, the actual financial health of the company is much better than is shown in the books of account and the minority shareholders are unable to take advantage of this fact as they are not privy to the secret dealings of the company.

Poor enforcement

India has good governance standards but is lagging behind in enforcement. Part of the problem is that business and political circles are closely intertwined due to which conflicts of interest frequently arise. Our institutions are still under-developed and there is a lack of coordination among these institutions. The courts are already burdened with a huge backlog of cases and also face a shortage of competent judges having experience in business litigation. For instance, a research paper by PRS Legislative Research estimates that, as of 2009, there were 53000 cases pending with the Supreme Court, 40 lakh with the High Courts and 2.7 crore cases with various lower courts. Often, regulators don't have the adequate staff or budget to conduct rigorous investigations. Enforcement becomes difficult and slow also due to the presence of several government departments, all having their own set of rules and regulations. There is often inter-departmental rivalry between these departments causing more delay. Enforcement thus needs to be the collective effort of the whole system that includes the banks, the media, stock exchanges, institutional investors, equity analysts, accountants and market regulators. In China, for example, the financial magazine 'Caijing' has exposed several major corporate ill-practices. This has earned it widespread praise.

An external corporate governance mechanism that has been effective in many markets is the market for corporate control. If there is any wrongdoing in a particular firm, the issue is raised

by another company that is following the rules and hence this practice proactively discourages any wrongdoing. The market for corporate control in India practically does not exist. The average ownership by the promoters in India is about 48% and in some cases it is as high as 80%. The US market is run by professional managers who do not own the firm. Even if they do, their equity share is minimal as a proportion of the total equity of the firm. Hence, there is a market for corporate control in the US. In India, due to concentration of ownership, this is not the case.

Another problem is corruption. On 9 August 2012, Minister of State in Finance Ministry, replying to a question in the Rajya Sabha, said that three SEBI officers - Jerome K Alexander, Rajesh Pratap Singh and Avarjeet Singh - were under investigation for corruption.

Limited role of the independent directors

There is a dearth of independent directors in Indian companies. Many boards that look competent on paper are just that. In practice, independent directors are appointed by the incumbent management and hence are likely to be loyal to the business family. In order to be more effective, the independents must ask management tough questions, actively help set the corporate strategy, contribute to the CEO succession plans, and ensure that companies meet their targets. As Jamshed Irani of the Tata Group once noted, the problem isn't "the number of independents but the quality of their contribution." The performance of independent directors can be improved through better selection, training, clear definition of roles, sharing of all relevant company information and higher compensation.

Limited role of the institutional investors

There are two types of institutional investors – the active ones (which include mutual funds, private equity players and pension fund players) and the passive ones (for example, financial institutions). In India, it has been observed that most domestic institutional investors in India are relatively passive. They do not challenge management when governance issues crop up and are unwilling to get involved. This is again due to concentration of ownership – as most of the ownership lies with the promoters, it is highly unlikely that the institutional investors will get to overrule their interests and hence the institutional investors refrain from taking an active part in the functioning of the business. Foreign Institutional Investors have been seen to raise more concerns than the domestic institutional investors. This was seen in the case of Satyam. Though SEBI has given several incentives to the institutional investors, this situation is unlikely to change in the near future, given the dominance of family owned businesses in the Indian markets.

Role of the audit profession

There should be greater regulation and scrutiny of the audit profession in India. There are many companies that cook up their books of account as a result of which their true financial

health is unknown to the small shareholders. Satyam is a case in point. It won Golden Peacock Global Award for excellence in Corporate Governance. It was also named the winner by the World Council for Corporate Governance in September 2008. This was possible because PricewaterhouseCoopers (which is one of the 'Big Four' global auditing companies) was not able to detect the huge corporate fraud that was being perpetrated by Satyam's former head Ramalinga Raju. This episode casts doubts on the credibility and quality of auditors in the country. The bankers to Satyam included Bank of Baroda, BNP Paribas, ICICI, HDFC, Citi Bank and HSBC. Not even a single bank questioned Satyam when it published false account details in its balance sheet.

Lack of performance of the boards

Boards need to be made more accountable for their actions and decisions. For instance, CEO succession planning, which has far-reaching consequences for the firm, is a subject often neglected by many boards. As Infosys Technologies acknowledges in its annual report, "An active, well-informed, and independent board is necessary to ensure the highest standards of corporate governance." Six factors - high concentration of ownership, weak recruitment processes and a shortage of experienced directors, poor focus, inadequate supply of information, complex cultural traditions and underdeveloped legal regimes - all undermine the effectiveness of corporate boards.

Many successful family-owned businesses are still run by a founder who, having built the business on his own, is reluctant to devolve authority to a professional board. It is important to secure the support of the dominant shareholders as they have the resources and motive to influence their companies. A research study done by McKinsey showed that the level of support for professional boards usually rises as the control of such companies passes on to a younger generation.

In order to recruit the right people, boards should use the informal approach—word of mouth and personal networks—and also hire an executive search firm simultaneously. In addition to the skills and personal attributes, it must be verified that a candidate has enough time to devote for carrying out his responsibilities. Due to a dearth of local suitable directors, companies like Posco have hired foreign directors. While hiring these foreign nationals, it must be ensured that they have a thorough understanding of the local culture besides possessing knowledge of the company and the industry.

Due to a lack of clarity in roles between the board and management, a dearth of management talent, and poor prioritization, many boards end up spending too much time on short-term matters rather than on long-term important decisions such as strategy, CEO succession, and

leadership development. On the other hand, some boards are too passive. The board should provide meaningful inputs to management and actively help make strategic decisions.

Many a time, there exists an information gap between the management and the board. This gap may arise either due to lack of communication between management and the board as to what type of information the board needs to make informed decisions or due to management's deliberate attempt to keep the board in the dark.

In daily operations of the board, the local culture of the country in which the company is running must be kept in mind. For example, it is uncommon to see a young director challenge openly an older colleague in India; instead, he (she) may use a more subtle approach.

In the absence of strong legal systems, some companies prefer to keep independent directors in the dark rather than divulging commercially sensitive information to them as they are not sure that the information will not leak outside.

Lack of incentive

There is a lack of incentive for companies to implement governance reform measures as many companies still do not see any direct relation between investment in expensive governance systems and corresponding financial benefit.

Conclusion

Good corporate governance practices ensure that all stakeholders of the firm are given their due. The concept of corporate governance is still nascent in India. Though India has made significant progress in addressing its corporate governance issues, there definitely still exist many challenges that need to be overcome. The governance norms need to be aligned with ground realities. The government needs to be commended for taking bold steps in this regard. The Companies Bill 2011 tackles many of these issues.

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Implications of the Companies Bill

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Abstract

The aim of this article is to study the major provisions of the Companies Bill, 2012 which was recently passed in the Lok Sabha (December 18, 2012) and their implications, after being first introduced in the Lok Sabha on December 14, 2011 after several revisions starting in 2008. The Bill is pending approval from the Rajya Sabha and the President of India, but major changes are not expected. The article will analyze the purpose of having a Companies law, the objectives of the Companies Act of 1956, compare the Bill to the Act and study the possible impact of the Bill. A historical perspective has been provided so that the relevance of Company law is emphasized, and the provisions of the Bill can be understood in context of the existing Companies Act. Some of the stakeholders of the bill are industry chambers, government departments, legal experts, professionals and investors; however this article has been written from a practical viewpoint, emphasizing on relevant issues and the major provisions which will have a major impact are the ones which have been analyzed.

Introduction

The Companies Bill is one of the major reforms the UPA has introduced, roughly a year ahead of the 2014 elections. The bill is to replace the Companies Act of 1956, and thus be up-to-date with the current economic and commercial scenario in India, as well as worldwide. Several recent cases of corporate and accounting fraud have made the Bill even more crucial. The newly introduced various reformatory and contemporary provisions of the Bill, along with the omission of existing obsolete compliance requirements are expected to be a boost to India Inc. as well as investors. Managers should necessarily be aware at least of the main implications of such an important bill, if not the details, since the Bill will most likely be passed within

a year without too many modifications, and quite possibly implemented in the near future. Corporations would have to take steps to be compliant with the new provisions since many of them may require time for implementation and professionals have to stay updated with the latest developments since they will be impacted greatly.

The Companies Bill 2012, the revised and updated version of The Companies Bill 2011, which in turn is a result of previous modifications, was finally passed in the Lok Sabha on December 18th, 2012. It is aimed to be in consonance with the changes in national and international economic environment in modifying and revising the existing company law.

It has 29 chapters with 470 clauses and 7 schedules and has achieved compactness by deleting redundant provisions, regrouping related ones and modifying some for easier interpretation. It has introduced enhanced corporate governance standards, and has provisions relating to audit, corporate social responsibility, mandatory valuation and private placement of securities among other things. While some provisions provide clarity to existing law and thus may help attract investors, others help the employees and even the general public. The stricter norms regarding auditing and corporate government standards are meant to keep a closer watch on companies and to help discourage as well as identify cases of fraud.

History

Companies' law is the field of law concerning businesses and their organizations and is formed to carry on commercial enterprises. Government's intention is to facilitate investment in profitable businesses by creating rules to protect investors, especially the retail investors, as well as the businesses from being held personally liable to debts incurred by them.

Companies' law in India has always been inspired, similar to most other Commonwealth nations, by the laws in UK and most importantly the UK Companies Act, 1948. The earliest legislation in India towards this purpose was in the Act of 1857. Several laws were enacted after this, however the Companies Act, 1956 is the most important one and empowers the Central Government to regulate the formation, financing, functioning and closing down of companies. It is quite detailed and provides for the powers and responsibilities of directors and managers, raising of funds, holding meetings, maintenance and audit of accounts and powers of inspection, among other things. Being the most important legislation in the field of company law in the past century, the Companies Act, 1956 should be understood at least in principle while studying the present Companies Bill as it provides a context for better understanding the provisions, the required changes and the reasons for the same.

Companies Act, 1956

According to a press release by the government, the main objectives of the act are as follows:

- Maintain good behaviour and business honesty in company promotion and management

- Due recognition of the legitimate interest of shareholders and creditors and of the duty of managements not to prejudice to jeopardize those interests
- Provision for effective control over and voice in the management for shareholders
- A fair and true disclosure of the affairs of companies in their annual published balance sheet and profit and loss accounts
- Proper standard of accounting and auditing
- Recognition of the rights of shareholders to receive reasonable information and facilities for exercising an intelligent judgement with reference to the management
- A ceiling on the share of profits payable to managements as remuneration for services
- A check on their transactions where there was a possibility of conflict of duty
- A provision for investigation into the affairs of any company managed in a manner oppressive to minority of the shareholders or to the interest of the company as a whole
- Enforcement of the performance of their duties by those engaged in the management of public companies or of private companies which are subsidiaries of public companies by providing sanctions in the case of breach and subjecting the latter also to the more restrictive provisions of law applicable to public companies

Lead up to the Companies Bill, 2012

The Ministry of Corporate Affairs decided to go for a detailed revision of this act in 2003, since the number of companies had expanded from 30000 in 1956 to nearly 7 lakhs, along with other factors such as the fast mobilization of resources by Indian companies and thus emerging as internationally competitive firms for providing goods and services, while increasing employment opportunities at home as well. Also, increasing avenues for business, trade and capital flows have created a need for harnessing entrepreneurial and economic resources efficiently while attracting investments for growth. All these requirements necessitated a revision and updating of the existing Company law. After several consultations, and recommendations by an expert committee, a Companies Bill 2008 was introduced in the Lok Sabha on October 23, 2008. Due to dissolution of the Lok Sabha, the Bill lapsed. Several modifications were made to it over the years and it was re-introduced in the Lok Sabha as Companies Bill, 2011 on 14th December 2011. It was then sent to the Parliamentary Standing Committee on Finance, which suggested further modifications, most of which were accepted, and the Bill was passed in the Lok Sabha on 18th December 2012.

Major Differences from Companies Act, 1956

The major differences from the current law are that it would give more power to those responsible for investigating fraud while making corporate social responsibility a legal obligation. It would make it tougher for smaller companies to raise funds by accepting deposits from the public. The proposed law will only allow companies with a minimum net worth, an amount not specified in the bill, to raise deposits. Companies would be compelled to set aside assets equivalent to the value of the deposits, so that depositors may be paid their dues even if the company is in financial trouble.

Important provisions of the Companies Bill, 2012

PRIVATE COMPANY 2 (68):
Except "One Person Company" private company limits number of members to two hundred.

ONE PERSON COMPANY 2 (62):
Can be incorporated only as a private company. Word "One Person Company" should be a mentioned below the name of the company.

SMALL COMPANY: 2(85)
It cannot be a public Company, Holding or Subsidiary, Company registered under section 8 or body corporate governed any special act. Paid-Up capital dose not exceed '50,00,000.

DORMANT COMPANY: 455
A Company formed and registerrd under the act for a future project (or) to hold an asset or intellectual property and has no accounting transaction can be called as **"DORMANT COMPANY"**

INACTIVE COMPANY:
When a company does not carry on any business, has not made any accounting transactions and has not filed returns with the ROC for the last two years will come under the category of **"INACTIVE COMPANY"**

Fig 1: Definition of different forms of companies

Some of the important provisions with the most impact are as follows. Analysis has been done from a neutral point of view i.e., one of the general public. Provisions directly related to professionals have been listed under a separate header.

Class Action Suit

With the Lok Sabha clearing the Companies Bill, 2011, one of the biggest boost for the small investor comes in the form of the provision for class-action lawsuits, which may be filed by investors if they are of the opinion that the affairs of the company are being conducted in a manner detrimental to the interest of the company and its shareholders not present in the current provision.

Advantage

It will also help improve the quality of financial reporting as well as the quality of corporate governance in India Inc.

The following example will cite the need for such a provision and prevalence of strict laws in other countries. For example, even three years after the Satyam fraud, Indian investors are yet to get any meaningful compensation in the 8,000-crore fraud allegedly committed by the promoters of Satyam Computer Services. But some of their American counterparts, who owned American depositary receipts (ADR), have made the company agree to pay $125 million (over 625 crore) in settlement due to a strong class-action framework in the US. Firms stand to benefit from a reduced cost of capital and increased access to global capital markets.

Disadvantage

Easing the rules for shareholder litigation can also lead to frivolous lawsuits where investors sue with the intention of extorting from firms' deep pockets. Such frivolous lawsuits impose severe economic costs. But there is a solution to the above problem by forcing the litigator to refund the defendant's legal cost.

Electronic Member Voting

The Companies Bill 2011, pending in Parliament, has provision for eVoting for all types of meetings. Clause 108 of the bill is a new clause and it proposes to empower the Central Government to prescribe class or classes of companies and manner in which a member may exercise his right to vote at a meeting by electronic means.

Advantage

- The biggest benefit of eVoting will be realized once it is adopted for AGMs, EGMs and CCMs. eVoting will make one share equivalent to one vote. The current practice at AGMs, EGMs, and CCMs of voting by "show of hands" is not truly representative of investor votes
- eVoting will truly empower investors to exercise their votes and is a step in the right direction for greater shareholder participation

One Man Company

The person forming the Company has to give the following information:

- The name of the One Person Company (OPC)

- The nature of activities of the OPC
- A nominee to take the place of the single member (in case of death, disability, bankruptcy etc.)

One small rule is that like every private limited company has the suffix Pvt. Ltd., every One Person Company should have the suffix OPC in brackets.

Positive Side

An entrepreneur with a major new idea or innovation which he may want to deploy on the cloud may not need the burden of a co-founder. It goes without saying that freelancers, designers and developers who are one man armies will now be able to form one man companies with the passing of the bill. It also brings the possibility of investors investing in promising young entrepreneur's companies.

Controversial Point

As per Singapore law, a Company can be the one person in a One Person Company. So, if you have an existing Company where you are a director, you can form a One Person Company with your Company as the sole director. But the Companies Bill, 2011 is so far unclear on whether a Company can be the single person in a One Person Company.

Independent Directors

The term independent director is not defined by the Companies Act 1956. The Companies Act 1956 has not expressly distinguished the duties or liabilities of independent directors from that of other directors and deals with both independent and other directors under the term directors. This has led to a situation where independent directors are frequently hunted for offences committed by management of company relating to business of which the independent directors (IDs) were not aware of. Following the Satyam scam, the number of independent directors exiting the companies increased considerably and this tendency shows that the position of IDs in India is exposed to unlimited liabilities and risk.

The definition of an ID has been considerably tightened. For example, if a director is a chief executive of an NGO that receives funding from the company to a certain extent, the person would not qualify as an independent director. The Central Government is also vested with the power to prescribe qualifications for IDs. Every ID is also required to declare that he or she meets the criteria of independence.

In order to ensure that IDs maintain their independence and do not become too familiar with the management and promoters, minimum tenure requirements have been prescribed. The initial term shall be 5 years, following which further appointment of the director would require a special resolution of the shareholders. However, the total tenure shall not exceed 2 consecutive terms.

One of the key criticisms of the current regime for IDs is that they are appointed like any other director, thereby leaving promoters with tremendous influence in determining the identity of the IDs. That has been partially addressed by making a nomination and remuneration committee mandatory .The committee is required to consider candidates for appointment as IDs and to recommend them to the board. This brings about greater objectivity to the ID nomination process, at least to some extent. However, the Bill does not go to the extent of providing greater participation by minority shareholders in the ID appointment process through methods such as cumulative voting or proportionate representation, which continue to be optional for companies to adopt rather than a mandatory requirement.

Under the Bill, IDs are entitled only to fees for attending meetings of the board, and possibly commissions within certain limits. The Bill expressly disallows IDs from obtaining stock options in companies. The present provisions leave little room for companies to attract the required talent by remunerating directors for the services they provide.

In order to balance the extensive nature of functions and obligations imposed on IDs, the Bill seeks to limit their liability to matters directly relatable to them. The Bill limits the liability of an ID "only in respect of acts of omission or commission by a company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently."

Important aspect

- Only an independent director can be appointed as alternate director to an independent director
- The Bill requires listed companies to have at least 1/3rd independent directors on the board
- Independent directors are not liable to retire by rotation at GM
- Where meeting of BoD is called at short notice to transact urgent business atleast one independent director shall be present
- CSR committee set up under the bill shall consist of atleast one independent director

Corporate Social Responsibility (Clause 135)

This section applies to every company having net worth of Rs.500 crore or more or turnover of Rs.1000 crore or more or a net profit of Rs.5 crore or more during any financial year. The balance sheets of these companies will be affected by this clause. The corporate-social responsibility (CSR) expenditure now is nearly being mandated at 2 percent. The wording is not mandatory, but companies may spend. Yet a board member will have to be in a committee,

which will monitor this expense and give credible explanations, if that 2 percent is not met. This will probably, therefore, begin to impact the P&L in some fashion.

There are two very important provisions in the clause. The first clause is that the board is mandated to ensure that the company will spend on the CSR. Second thing is that they have to give their explanation. So, effectively although there is no mandatory obligation on the company, but a responsibility is cast upon the board members.

Added with the responsibility to give the explanation for non-implementation or implementation makes it mandatory. When you are not able to give a satisfactory explanation about not spending on CSR activities then the regulator will certainly have a power to question the roles and responsibility of the directors. So, effectively it gives a teeth, it is not just a provision on the paper, but it puts an obligation on the board, which they cannot easily get away with. So, one thing is very clear that the new bill has looked into this provision extremely carefully. Although not mandatory, but a binding obligation is on the board to make sure that the company will spend on the CSR.

The type of activities for which the company has to spend for its social responsibilities, as listed in Schedule VII, are as under:

- Eradicating extreme hunger and poverty
- Promotion of education, gender equity, empowerment of women, reducing child mortality and improving maternal health
- Combating HIV, AIDS, malaria and other diseases
- Ensuring environment sustainability
- Enhancing vocational skills and social business projects
- Contribution to P.M. National Relief Fund or any other fund set up by Central or State Governments for social development and relief work, welfare of SC, ST and backward classes, minorities and women

In keeping with the government's focus on inclusive growth, CSR would be one of the good means to achieve it. India would be the first country to introduce a contribution in this format. In concept, this is an interesting move. As a tax on net profits, it is almost like an additional income tax.

Parliament technically has the power to collect 2% more income tax and to then spend it in the way that it would like to. Instead, what it has chosen to do is to have companies spend this 2% as a part of their CSR programme. This is perhaps better than a higher income tax, since companies would probably spend it with more direct impact than the government would, even if the spending was in its own catchment area.

Woman Director (Clause 149)

At least one woman director has been made mandatory in the prescribed class or classes of companies. India is going to be first among the Asian countries to bring legislation to bring women quota on boards and in senior positions after Norway - first country globally to introduce gender quota. However, most of the developed countries including US, UK, Canada, Germany, Singapore & Australia don't have any such quota or legislation in place

Even among large companies, the number of women on board is minimal. At least 24 of the top-50 listed firms that form the Nifty index do not have a single woman director.

The clause says: "Every company shall have a Board of Directors consisting of individuals as directors and shall have (a) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and (b) a maximum of 15 directors: provided that a company may appoint more than 15 directors after passing a special resolution, provided further that such class or classes of companies as may be prescribed shall have at least one woman director."

Advantage

One of the prime reasons for introducing this clause is that it will instil confidence in women by providing them with an environment to take critical decisions at a time when the nation is debating on ways to make life better for women. It will definitely increase the per capita income of the country and Human Development Index (HDI).

Impact on Professionals

The following points outline the major impacts that the bill will have on professionals, namely auditors, company secretaries and cost accountants. The analysis has been done mostly from the point of view of the professionals under concern, unless specified otherwise.

Auditors

- For listed companies, individual auditors have to retire every five years, and ten years in the case of a firm of auditors.
- For other companies, the auditor is to be appointed for a term of 5 years and the appointment is to be ratified in each Annual General Meeting (AGM).

The main objective of this move is to prevent excessive familiarity between the auditors and the Company. Apart from the auditor, the audit firm should be rotated as familiarity with a company makes an audit firm more likely to understand and appreciate the intricacies of the business of the firm.

General Disadvantages

- The likely consequence of this move will be that the audits of large companies will be circulated among a few major audit firms and prove detrimental to small individual auditors and smaller firms
- Also the transition time from one audit firm to another is considerably high. Companies will be forced to spend extra time and effort to manage the rotation process and bring the new auditor up to speed

General Advantages

- The rotation of audit firms is that every firm will bring in a new perspective
- Mandatory audit firm rotation reduces competition in the audit market because the current audit could not be eligible, even if there is no alternative

Favorable points for auditors

- Internal audit may be made compulsory for prescribed companies
- The limit for the maximum number of companies in which a person can be appointed as auditor has been proposed as twenty

Restrictive points for auditors

- Auditors are not to render other services like book-keeping and accounting directly or indirectly to the company or its holding company or subsidiary company
- Members of a company may resolve to provide that in the audit form appointed by the company, the auditing partner and his team shall be rotated at such intervals as resolved by them

Company Secretaries

Company Secretaries are recognized as whole time key managerial personnel along with Managing Director, Chief Executive Officers and Managers. For all companies whether private or public, listed or unlisted, the annual return has to be signed by either a company secretary in employment or by a company secretary in practice. Appointment of Company Secretary is now mandatory. A company failing in the criteria to appoint CS cannot escape its liability to appoint a CS because of poor economic condition.

The penalty for non-appointment was Rs 500 per day which has now been made more severe.

- On Company- one lakh which may extend to 5 lakhs
- On every director and KMP who is in default –Rs 50000 and Rs 1000 per day if contravention continues

Certain functions of a Company Secretary have been proposed for the very first time:

- To report to the board about the compliance with the provisions of the Act
- To ensure the company complies with the applicable secretarial standards issued by ICISI and approved by the Central Government

This goes to show that the law makers are quite serious regarding the position of Company Secretaries in the corporate and this is the reason why major responsibilities are prescribed for Company Secretaries in new Companies Bill. From the perspective of growth in profession, it is a welcome approach. It is indeed completely a new beginning for Company Secretary profession. In the Companies Bill 2011, due recognition has given to the CS professionals and the Institute of Company Secretaries of India. It is the beginning of a new era where non-financial standards have been given importance and statutory recognition besides financial standards.

Cost Auditors

Cost auditing standards have been mandated in the new Bill. According to the provisions of the Bill, the Central Government may direct that the audit of cost records of class of companies which are required to maintain cost records and which have a net worth of such amount as prescribed, or having the prescribed turnover, would be conducted in the manner as is specified in the order. The Central Government, after consultation may direct class of companies engaged in production of such goods or providing services as prescribed to include in the books of accounts particulars relating to utilization of material or labor, or to such items of cost.

Criticism

Although the bill is comprehensive in nature, there have been several criticisms leveled against it, some regarding provisions that should have been there and some regarding certain controversial provisions which either got added or is a result of modification of previous ones. One common criticism is regarding the role of audit committee in the appointment of auditors. In most of the developed economies, the appointment of auditors requires the approval of an independent audit committee. The Bill only provides for seeking the recommendation of the audit committee in matters of appointment and filling casual vacancy of an auditor- it can only recommend. The final decision is that of the shareholders, which results in shareholders having a large controlling stake having a bigger influence in the choice of auditors. There are criticisms for many other provisions as well, including the one which makes CSR almost compulsory

without properly defining CSR itself, and the clause about Independent Directors which leaves room for them to be influenced by the promoters. However most of these criticisms have strong ‘for’ and ‘against’ arguments.

Conclusion

It is clear that the Bill is crucial for India Inc. as well as for the government and among other things, it helps in better governance for the companies which in turn help them become more efficient in the long run, and better prospects for investment while it helps the government in better monitoring the company in order to avoid fraud. It is undoubtedly a huge evolution from the existing laws and in spite of the small criticisms it is bound to have a huge impact on corporate India and raise the Company law to a level that is comparable to international standards- particularly those of developed nations. There is still a long way to go, but Companies Bill, which will probably get passed in 2013, will be a major step in the right direction.

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Petroleum Products Pricing Model of India – The Reality Check on the Pricing Model which Drives the Economy

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Abstract

The pricing of petroleum products is very crucial for our economy, but oil companies take petroleum products' prices in the international market as benchmark for pricing, making cost of petrol and diesel high. The difference between the benchmark price of petroleum products and the price at which oil companies provide it to dealers is treated as "under recovery". These under recoveries are paid back by the government as cash and oil bonds, which we refer to as subsidies given on petroleum products. In this article, an analysis on why the government and oil companies follow an archaic cost model and why it is still being followed, are done. An attempt to analyze how being a developing nation gives India a competitive advantage over other countries in refinery industry; and how this opportunity can be exploited in a more fruitful way has also been carried out. Viable solutions for problems like how fiscal deficit can be reduced, how inflation can be controlled, how our exports can be increased so that one day our exports will be way higher than our imports thereby appreciating the value of rupee and how to help other sectors which are directly or indirectly dependent on diesel for their operational purpose are also suggested.

Introduction

The subsidies given to petroleum products contribute towards a major chunk in the fiscal deficit of our country which is around 5.9% of GDP. The gap between our imports and exports is rising to astronomical levels with crude oil being the major reason for the high import bill. Our import bill has escalated and the fact that the rupee has depreciated a lot doesn't help. There are a number of sectors that are directly or indirectly dependent on fuel and are facing an inevitable fall in their profit margins; with the aviation industry infamous for running losses for the past few years. The costs of day to day essential products, which are considered as basic needs of people have increased a lot and are nowhere proportionate to the increase in per capita income.

With scarcity in power production, dependency on diesel for generators has increased a lot in the past few years serving as a no-win situation.

During the last week of December 2012, Prime Minister Dr. Manmohan Singh called for a “phased price adjustment” as a solution for the under-priced petroleum products in India. Later the oil ministry proposed raising prices of diesel by Rs 10 a litre over the next 10 months and of kerosene by Rs 10 a litre over the next two years. Planning Commission Deputy Chairman Dr. Montek Singh Ahluwalia said that a failure to do so will push up fiscal deficit, which is already too high. “Any government, particularly a democracy, would want to avoid increasing the price. What the public doesn’t seem to realize is that if you don’t increase the price, there would be consequences”, he said in an interview to a private TV channel. The consequences of not raising the prices of petroleum products, Ahluwalia said, would be rise in subsidy bill, causing more burdens on the budget, lesser resources for social sector schemes and deterioration in health of oil companies. Ahluwalia said, “The total under recovery (on petroleum products) is about Rs. 160 thousand crore even after the recent diesel price hike.” Pitching for aligning the energy prices in India with global rates he said, “We will need to reduce that burden (of subsidies on energy) if you want all the health expenditure, etc.”

In July 2012, the same Prime Minister himself described raising diesel prices as “a very delicate issue” and stated that, “if you try to raise the prices of diesel, it has a cascading effect on the economy, via sectors such as transport and agriculture; and significant impact on inflation. It is extremely difficult for us to absolutely decontrol diesel at the moment because it would impact the economy in an extremely serious manner.” These prove the fact that oil has ability to drive an economy uphill or downhill.

One of the major reasons for high oil prices are the State and Central government taxes, hence the government must reduce the tax rates. This is the most commonly suggested solution by laymen. But the government already has a huge fiscal deficit and tax on petroleum products is one of their major sources of income; hence they can’t go for a tax rate cut. So what is the way out?

Table 1 shows the economic indicators of India and role of petroleum products in figures like fiscal deficit, trade deficit, rupee depreciation, foreign reserves etc.

If petroleum products prices are deregulated or increased to control fiscal deficit, then inflation would increase and industries that are dependent on diesel for operation purposes would suffer. Due to increased transportation charges, prices of basic needs would also rise. If government goes ahead with subsidies, then they will not be able to reach their fiscal deficit targets. For trade deficit, we need to reduce our dependency on petroleum products and shift to other sources of energies. India has been trying to do this for a long time, but has been unsuccessful till now. With pricing of petroleum products being very critical for the economy, it is very important to check that petroleum products are priced appropriately rather than being under or overpriced.

Economic Indicators	Statistics	Impact of Petroleum on Economy
Nominal GDP	$ 1847 billion	
GDP in PPP (IMF)	$ 4460 billion	
GDP growth rate (World Bank)	5.3% (Q2, 2012)	
	6.9% annual (2011-12)	
Inflation	WPI: 7.45% (Oct 2012)	
	CPI: 9.9% (Nov 2012)	
Exports	$ 307 billion	• Crude oil imports are equivalent to country's 52.12% of exports • 18.57% of exports are petroleum products
Imports	$ 492 billion	• $ 160 billion of imports are crude oil
Trade Deficit	$ 185 billion	
Budget Deficit	5.9% of GDP	
Revenues	$197 billion (est.)	
Expenses	$306 billion (est.)	
Budget Deficit	$ 109 billion	$ 25.34 billion - subsidies given on petroleum products (i.e.) 22.23% of budget deficit is due to subsidies on petroleum products
Foreign Reserves	$ 294.5 billion	
US Dollar / Rupee	$ 1 / 54.67	

Table1: Current Economic Condition of India

Existing Price Model

Our government and oil companies follow an archaic pricing model for petroleum products. Why government adopted this archaic pricing model and what does the term called "under recovery" claimed by oil companies mean? Under recovery is the price difference between the international selling price of petroleum products and domestic selling price of petroleum products excluding taxes to the dealers as regulated by the government. The critical point to note here is, these under recoveries are not losses for oil companies i.e. without considering the under recoveries, oil companies would still make

profits. Here the million dollar question is when India is importing crude oil (raw material), why is that the price of petrol and diesel (final product) are taken as a standard? In India, we take petrol price of Singapore market and diesel price of Dubai market as the standard. In an ideal situation, the import cost of crude oil must be considered as basic input cost, then refinery cost, marketing, transportation cost and taxes must be added – this is how the cost of petroleum products should be discovered or found. But we take international prices of petroleum products which we donot import as the standard. Moreover around 20% of crude oil (raw material) upstream had been provided by domestic players like ONGC at a rate lesser than the international price of crude oil. Even these cost savings are not adjusted in this archaic cost pricing model.

The accounting methods used by domestic refineries for calculating cost were traditional costing methods. The profit is calculated by subtracting all the expenses from the total sales. They were not following advanced cost accounting techniques like activity based costing, which give almost a correct estimate of cost.

Why India Adopted this Pricing Model?

Post 1991, there was a shortage of refineries in India and we were importing petroleum products. To encourage investments in domestic refinery market, government decided to use this archaic concept so that high profit margin would attract investors. But now refineries in India are producing more than 220 million tonnes of petroleum products and our demand is only 165 million tonnes. We are exporting almost 25% of petroleum products to other countries, the situation has changed drastically and sticking to the same archaic costing model does not make any sense anymore.

"The end products of refinery plants include petrol, diesel, LPG, kerosene, jet fuel, fuel oil, naphtha. Beyond refining cost, other costs like transportation and marketing charges which forms a major chunk of the cost are also there. Hence applying advanced cost techniques like activity based costing to refineries were very difficult", said Mr. R.S.Butola, chairman of IOCL, at the Annual General Meeting. Hence they continued using the traditional cost approach model.

Analysis of the Existing Pricing Model

Many economists may say that Indian government adopted this pricing model due to the concept of import parity price. Recently Bloomberg conducted a research in about 63 countries and found the highest and cheapest gas prices by country. As per the research, average daily income in India is $3.97 and an average Indian needs to work almost 1.4 days to afford a gallon of gasoline. It also reported that due to the extreme relative cost, the country of 1.24 billion

people has the lowest per-capita gas consumption.

Indicators / Countries	India	Singapore (India's Petrol Benchmark)	Dubai (India's Diesel Benchmark)
Average Daily Income	$ 3.97	$ 138	$ 191
Price per gallon of premium gasoline (Average 2012 rate)	$ 5.44	$ 6.8	$ 1.89 (Government subsidized rate)
Cost of a gallon of gasoline	1.4 days salary	4.4% of 1 day salary	Nearly 1% of 1 day salary

Table 2: Comparison of India's petroleum products prices with Singapore & Dubai

Here, it is very clear that our average salary is not on par with countries like Singapore and UAE; hence taking the petroleum products prices of these international markets as benchmark cannot be accepted. If government is considering international standards for pricing of petroleum products, why are they not considering the same for fixing wages of workers? Since time immemorial, India has been known for cheap labor, which both the government and multinationals have used to their advantage. So India is a country where average wage of the workers are very low, but the costs of petroleum products are equivalent to one of the most expensive countries like Singapore. If government is following international prices as standards for petroleum products, then they must follow it for other things also; which is not the case in India. Hence taking international prices as standard should be changed.

Recommendations & its Benefits

Applying advanced costing techniques

Applying advanced cost techniques might not be an easy solution, but it is practically possible. Big players like BP, Exxon Mobil do follow these advanced cost approaches and are constantly involved in cost cutting to increase their Net Refinery Margin.

Gross Refinery Margin (GRM) is the difference between total value of petroleum products and price of crude oil. Higher the GRMs, higher the profit yields. So if crude is at $100/barrel and basket of diesel or petrol is sold at $120/barrel, GRM is at $20/barrel. Continuing the example, if a refinery experiences operating costs of $2/ barrel, then the Net Refinery Margin is $18/ barrel.

Advanced cost techniques like "Activity Based Costing" (ABC) identifies all the activities that a firm performs, and then assigns indirect costs to products. An activity based costing (ABC)

system recognizes the relationship between costs, activities and products, and through this relationship assigns indirect costs to products less arbitrarily than traditional methods. Some costs like transport and marketing costs are difficult to assign through traditional method of cost accounting. For this reason, this method has found its niche in the large industries like manufacturing sector, refinery sector etc. It is high time for the government and oil companies to take a look at the structure of the existing petroleum products pricing model in India and try to adopt advanced costing techniques like Activity Based Costing systems.

If refinery companies like IOCL adopt Activity Based Costing techniques, the cost involved in refining of crude oil can be easily reduced; thus the total cost involved would be way lower than the subsidized domestic price in India. Hence the concept of under recovery can be removed, so that the government need not pay anything to the oil companies; thus reducing India's fiscal deficit to a great extent.

Increasing Refinery capacity and take advantage of being a developing country

For the year 2012, our trade deficit has been $185 billion with total exports of $307 billion and imports being $492 billion. Out of the imports, $160 billion was spent on import of crude oil. The crude oil imports of India were equivalent to 52.12% of its total exports. Our demand for petrol and diesel in 2012 was around 165 million tonnes and our production was 220 million tonnes. We have been exporting around 25% of our production of petrol and diesel. Generally, domestic oil companies export petrol and diesel at international price to other countries. To take advantage of this situation, government must expand and construct new refineries; and then multiply the petrol and diesel export to other countries.

Refinery rich countries like Singapore and India usually export these petroleum products to developed countries like North America, Europe, etc. Here a question can be raised: Why don't these countries construct their own refineries rather than exporting petroleum products from Singapore and India? But in developed countries like North America and Europe, the pollution levels are already very high and these countries are trying hard to reduce it. Hence for these countries, getting environmental clearances for construction of new refineries might not be possible. The last refinery in America was built way back in 1976, but these older refineries in America have added new facilities in the last 10 years. Still more than half of the refining capacities of America are from the older refineries. This is where India scores ahead of America, only post 1991 India started to encourage investors into refinery industries. Hence India got the best in class technologies and is way better than most developed nations. So India must take advantage of this opportunity, import crude oil to export more petrol and diesel to other countries. Thus, by multiplying our existing capacity, our exports will shoot up thereby nullifying or reducing the trade deficit. If the government executes this effectively, then there might be trade surplus also. If exports are increased, then demand for rupee will increase and it will appreciate to a great extent. Moreover India's foreign reserves will also increase.

Let us now consider that IOCL after refinery expansion and adopting advanced costing

techniques, sells 40% of petroleum products at regulated prices in domestic market and exports remaining 60% of petroleum products at international prices, this would help them to increase their profit margin and hence share value of the company will increase. With government being a major shareholder in it, it will also increase the market value of their holdings.

Is increasing of refinery capacity a viable solution?

Let's look at the case of China, in 2011 when crude oil prices were above $80/barrel, Chinese government regulated the refinery companies to sell the petroleum products at lower price in domestic market. This price difference squeezed their profit margins. To compensate for this, Chinese government allowed the companies to export petroleum products in more volumes during the same period. In 2011, China imported crude oil of approximately 1 million barrels/day and exported 615,000 barrels/day of petroleum products, including LPG, petrol, diesel, jet fuel, fuel oil, and lubricants. Hence expanding and constructing new refineries is a viable solution.

Singapore imports even their basic food materials, consumer goods, machinery and equipment, but still they have a trade surplus as they export 70% of the petroleum products produced in their country. These countries allow refineries to export more than half of their production of petroleum products to improve their economic condition; this could be implemented in India.

Conclusion

We should not consider international prices of petroleum products like diesel and petrol as benchmark for calculating domestic prices. Oil companies must adopt advanced cost approaching techniques like activity based costing for right pricing of petroleum products in domestic market. An ideal situation is one where the import cost of crude oil is considered as basic input cost, and then refinery cost, marketing, transportation cost and taxes are added. This eliminates the concept of under recovery, thus reducing the fiscal deficit. Moreover due to the new costing techniques, the domestic price of petroleum products will be low thus the inflation would also be reduced; this would also help other industries which are directly or indirectly dependent on diesel for their operation purposes.

The Indian government along with the oil companies should multiply our existing refinery capacity, so that they can import more volumes of crude oil to export more petroleum products to other countries at international prices. Thus India's export will shoot up and thereby nullify or reduce the trade deficit. Due to increase in exports, rupee will appreciate and India's foreign reserves will also increase. As mentioned earlier, if IOCL sells 40% of petroleum products at regulated prices in domestic market and exports remaining 60% of petroleum products at international prices, this would also help them to increase their profit margin; thus share value of the company will increase. With government being a major shareholder in it, it will also

increase the market value of its holdings.

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