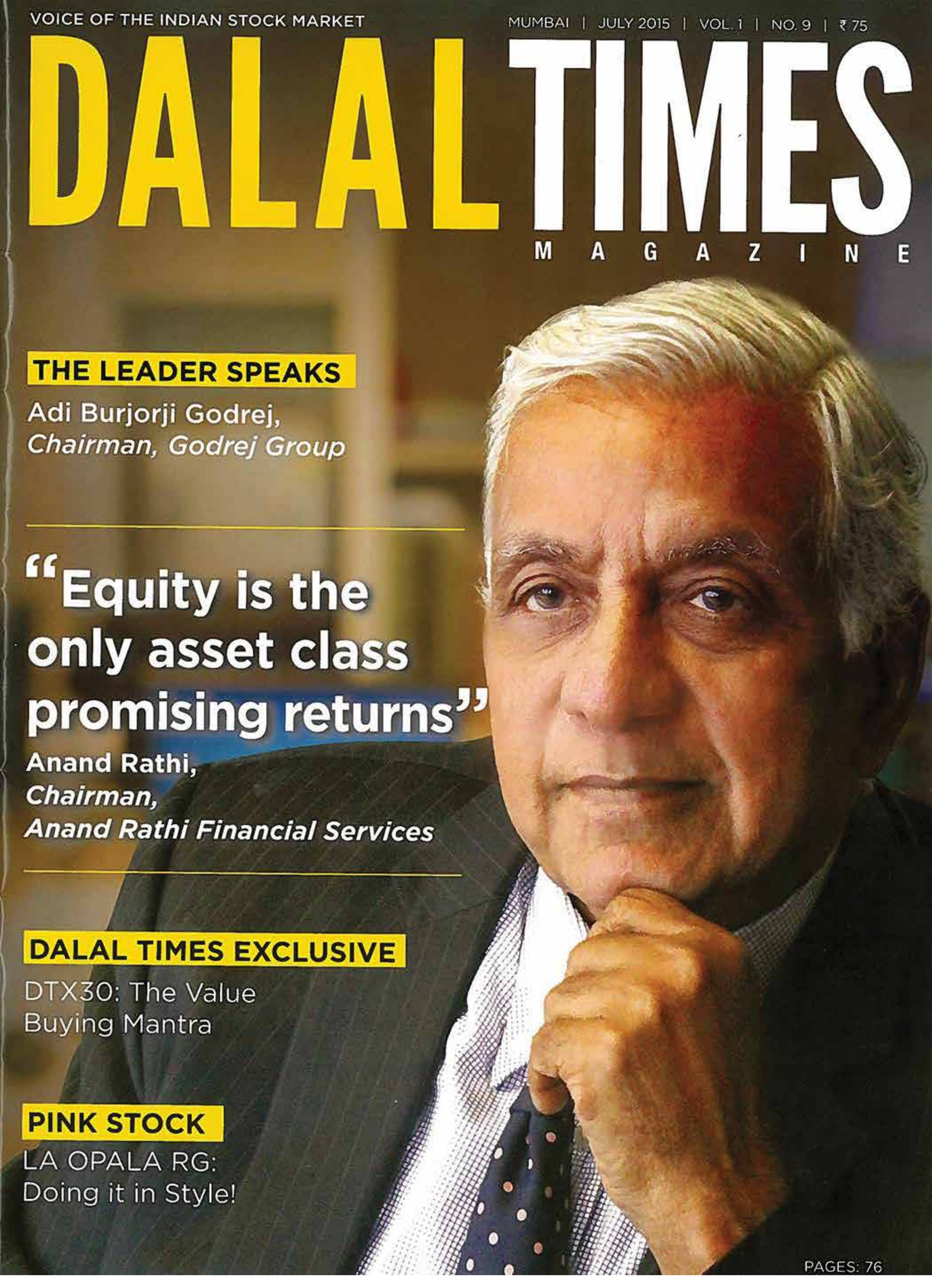

'EQUITY IS THE ONLY ASSET CLASS PROMISING RETURNS'

When Anand Rathi decided to become a member of the Bombay Stock Exchange, he was leaving behind years of rewarding experience to take up a new challenge. It was a challenge to professionalise the oldest exchange of India; a challenge to take it beyond competition, beyond its then existing image. Years later, Anand Rathi Financial Services is a much revered name. Here the man himself speaks with ***Prasanna Bidkar*** and ***Saikat Mitra*** about his journey and his future outlook about the Indian markets.

You began your career in financial services in 1994 with the founding of Anand Rathi Financial Services. How has the journey been so far?

I started my career with DCM as a senior management trainee and laid the foundation of my professional career. I helped in setting up the first computerised environment in the company. I worked directly with Dr. Vinay Bharat Ramin in the textile operations. Eventually, I went on to work with Swadeshi Polytex near Delhi and then with the Birla Group. I worked directly with Mr. Aditya Birla for 21 years. It was a great journey; I became the President of Indian Rayon and the youngest President of the Birla Group at the age of 35. In December 1993, an opportunity came my way to become a member of the Bombay Stock Exchange. At that time, they were inviting professionals to become members at concessional rates; that is when I decided to branch out on my own.

During my time with Birla Group, I had been involved in setting up their financial services business, so Birla Global Finance was the first set-up established by me, and then I set up Birla Mutual Fund. That is where I got a larger exposure to financial services. I understood that this was the sunrise of a growing business unknown to people at that time. People did not realise that this business could grow. A dalal was a dalal at that time, that's it. So, that is how my journey began in financial services.

Post the setting up of Anand Rathi Financial Services, you have also led the BSE, bringing in many operational and organisational changes. How challenging was the experience?

It was obviously very challenging. When I became a member of the BSE, I was among the first few professionals to become a part of it. I had a lot of industry experience including in technology. So, the moment I became a member, I was also made the Chairman of the Computer Committee of the BSE. This was also the time when online trading system was in the process of being introduced. So, I got involved in implementing the BOLT system. Three years later, I decided to take the opportunity to become a part of the Board of Exchange. After two years in the Board of Exchange, I was chosen as the President of the exchange. Historically, it had never happened that

a member with five years of experience becomes a President. There were a lot of challenges primarily because National Stock Exchange (NSE) started in 1994-95. They were allowed to operate throughout the country. BSE was restricted by the regulator to remain within Mumbai region because it was considered to be a regional exchange. By the time I became the President, BSE was far behind NSE.

One challenge was to catch up with the NSE. Meanwhile, NSDL was set up during the period. This was another challenge as NSDL used to charge even for the custody. We felt that it was a huge cost for the investor, so I conceived the idea of Central Depository Services (CDSL). We launched CDSL with an idea to make customers pay no charges for the custody. At that point of time, BSE did not have a good image with either the government or the regulator. This is because brokers had gone on strike just before I became a member. It was considered as a sort of broker's club. It came upon me to change the image of the exchange in the eyes of the regulator. I had to upgrade the technology and set up the depository services and trade guarantee fund. During the two years of my tenure as President, between 1999 and 2001, BSE's financial position improved significantly because we sold the maximum number of new memberships. This was after I persuaded the existing members to encourage new entrants. After all, they enabled us in expanding the business. Three-four months before I stopped serving as the President, we almost caught up with NSE in terms of turnover. So, we brought in a lot of innovation. We learned from everywhere in the world; be it the New York Stock Exchange or the London Stock Exchange. We identified good practices and incorporated them in the BSE that made the exchange financially stronger.

In the past two decades, your engagement with the stock market has seen both good and bad times. How is Anand Rathi as a firm prepared to withstand that?

In any business, you must be prepared for the worst and also the best opportunities coming your way. When opportunities come, you should be able to capitalise on them. With my experience in financial services as a part of the Birla Group, I had done a large number of equity issues, debenture issues and so on. I understood the global scenario and foresaw the tremendous opportunities coming our way. Obviously, businesses can be affected when the downturn comes. My biggest focus was, and has always been, on developing teams and people. When you train high quality individuals, you develop them, empower them, and give them the authority to deal with situations. I believe that there are no tough times for good people. There are opportunities in both good and bad times.

I think I never faced any difficulty during changing times. Yes, profitability fluctuates but it is in bad times when you distinguish between man and boys. Even customers understand the difference in your advice or your capabilities only during tough times. I have seen a lot of downturns as well as upsides in this industry, and I believe ideally one should prepare an organisation in a manner that it can face any challenge.

Coming to the markets, you witnessed the global meltdown of 2008. How prepared are the Indian markets at this juncture, if such a meltdown were to occur?

When there is a meltdown, the most critical thing is risk management at the exchange level and at the brokers' level. There is also a need to manage risks at the investor's level. When I was serving as the President of BSE, I am proud to say that a lot of risk and failure of brokers was prevented by us, particularly during the Ketan Parekh incident. Today, because of strict regulations by the exchanges and SEBI, you do not feel risk at the exchange level at all as adequate margins are collected. At the brokers' level, there has been a tremendous improvement since 2008. If we have strong risk management at all levels, I think you can pass through any meltdowns, because if the investors get into trouble, brokers will get into trouble.

There have been a lot of expectations from the Modi Government, but the past three quarters' financial numbers have not reflected it. What are your views on India Inc.'s performance? When do you feel actual numbers will trickle down the balance sheet and impact will be seen in the markets?

It is a phenomenon that you notice all the time. When there is optimism in the market, people always run ahead of time. We have seen all kinds of cycles. Do you remember the way markets ran around the time of Harshad Mehta scam? That happened because high expectations were building up around the country's economic liberalisation. When the new NDA government came to power, there were huge expectations and therefore market drained. Something similar is happening now as well, especially when the past five years had been very critical. People started believing that the Bharatiya Janata Party will come to power under Mr Modi's leadership; markets began rising from thereon. In fact, they did not wait even for the elections to go through and the results to come.

When there is expectation, there is euphoria. Markets are like a pendulum. When there are good things, it will go to the extreme. But when everything is going down, it will go to another extreme. That is why we saw Sensex at 21,000 and then coming down to 9,000. Now neither 21,000 was natural or justified nor is 9,000. The unfortunate part is that people lose patience when markets become bad and they start selling at unusually low prices.

Irrespective of all this, one needs to realise that no new government can do wonders overnight. It takes a long time. If interest rates are reduced, by the time the advantage reaches everybody, it takes six to nine months. I agree that expectations were high but I would not say that they were completely unrealistic. The corporate earnings have not done very well in the last 3-4 quarters, but that is a cycle. One of the major impact on corporate profitability is the inventory effect. When commodity prices come down, you hold old inventories at higher prices whereas your selling prices get adjusted towards the raw material prices coming down. Thus, profits are always made by corporates when the commodity price cycle is rising. This time corporates incurred inventory losses. As a result, the new capex cycle has not taken off and therefore despite the GDP of 6.5 percent, you cannot notice the impact at the earnings level. One is the inventory effect, and another is the pipeline effect. The pipeline stocks rise when commodity prices are going down. When prices go down, nobody wants to keep the stock. These two things have an effect on the corporate earnings. I feel that numbers would start improving in the current year but you will see the actual impact in the next two years.

Do you think valuations will catch up till that time on the downside?

No, valuations are no more stressed. The markets have already corrected a little more than 10 percent from the peak. So, the fluff has been taken out. Today if you look at the valuations, they are not over-priced. Markets have zoomed more than 100 percent in the last one year. Markets will do well, corporate earnings will improve. At a given point of time, markets are competing asset classes. Money goes wherever returns-related expectations are higher.

As the saying goes, 'Savings Chase Earnings'. In the last five years, money went into real estate because real estate was doing well. Money went into gold, because it was doing well. Today, the only asset class promising returns is equity. Going by our own assessment, we are very negative on real estate. You can see the amount of unsold inventories across the country. Gold is going nowhere either. So, I think these financial savings which have gone into real estate and gold will also come to

this market. I believe that the next three-five years are extremely good for equity investment.

How much is India insulated against any global turmoil?

We are not insulated because we are globalised. Presently, a lot of foreign institutional investments (FII) are coming in from overseas; obviously it is important for markets to continue receiving those investments. If there is a reason for them to pull out of the Indian markets, we still have the possibility that our own money will come into the equities. Right now, very little amount of our financial savings are going into equity; there is a tremendous scope in that. The government recently decided to allocate some of the pension funds and provident funds to equity. I think we need those long-term funds in equity to establish the market. If we save 30 percent, out of which 2-3 percent can come into the market, we will be able to compensate any possible decline in FIIs investment.

Having said this, I do not think that these FII investments will come down at all, because, as I said, savings chase earnings. Where will the global liquidity get invested? India would be the preferred destination for investment when compared to any other country. Therefore I don't expect inflows to come down. On the other hand, Mr. Modi has created an excellent image of India globally. The government has built strong relations with all the important economies of the world: the USA, Japan, China, Australia, the United Kingdom, France and Germany. He is talking about Make in India, creating the right business environment and boosting tourism. Since he has announced visa on arrival, the number of tourists have increased. As we make things easier for people to come and make business easier, money will flow.

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You mentioned that large Indian savings are coming into equity markets. But equity markets are not considered as a very good investment in India. Where are we lacking? What are the steps that need to be taken to develop equity as an asset class?

The most important thing is investor education. If people do not prefer equities, what is the basis? There is no basis to this thought. If you look at equity returns since the index started in 1979, it has given 17-18 percent return cumulatively. No other asset class has given this kind of returns. People are afraid because it is volatile; it is not like a fixed deposit. That is where people need to be educated and that is where people should look at going through the investment route rather than the speculation route.

There is another reason for the lack of retail investors in the market: we are an over-speculative market. We need to bring down speculation through whatever futures and options we have done either by increasing margins or by reducing the number of scrips in which we need to do it. I have seen that people who invest in the cash market normally do not lose money. Invest in good mutual funds for more than five years and you will surely get 15-18 percent returns. No need to go to individual stocks. We invest our own money in mutual funds.

Should one take equity investment as a full-time profession or should one consider it a second source of income?

If you are a trader, you need to do full-time trading. I would advise people with very small resources not to do trading. Most people invest their surplus funds and savings to earn extra money. Expertise is available - go to an expert who can help you to invest. Become a passive investor. To make money in this market you should remain a passive investor and not a day-to-day trader with small money.

Which are the sectors you are betting upon?

In a growing economy like India, you will find diamonds in every sector. I would always prefer a company-based approach rather than a sector-based approach. When you have a large portfolio and you want to diversify, that is when you should look into sectors. If infrastructure is not doing well as a sector, then even a good company will not yield much. I think you should select individual companies. Every sector in a growing economy will undergo change over a period of time.

I expect interest rates to go down. Therefore, interest rate cyclical sectors - that are dependent on interest rates - like automobiles should do well. Pharma and healthcare are also very good sectors to invest in. Infrastructure should pick up once the capex cycle starts; the government has already started placing a lot of orders for new roads, ports and so on. When infrastructure sector improves, capital goods should also do well. The consumption story will continue in FMCG but you cannot expect a huge turnaround. Ultimately, look at the quality of management and their product innovation capability.

Would you like to give any advice to the retail investors?

I would advise retail investors to put at least 50 percent of their savings in the equity market. Out of that, a large portion should go to mutual funds. The bigger the investor becomes, the more he can spend his time and energy to analyse companies and take some reasonable risk. Go into company-specific stocks where you understand the business and the company. A doctor can invest well in pharma because he knows which pharma company is going to come out with new products. If you do not have the knowledge of stocks, go for mutual funds. DT