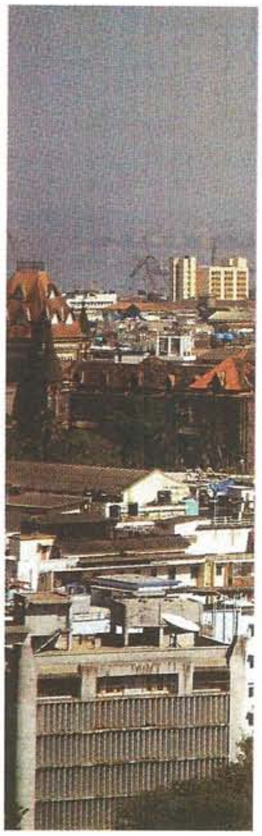

Mumbai connect

The financial upheaval in Dubai creates an opportunity for Mumbai to emerge as the next regional financial centre. But is Mumbai ready to don the mantle?

According to the World Bank, India, as the 12th largest economy in the world, is already moving up on the economic league tables. It is the second fastest growing economy in the world. It has also been ranked 45th in the recently released 2009 Legatum Prosperity Index – which embraces social and political data to provide a wider measure of national success. As per the London-based Legatum, India, whose GDP has risen 193 per cent in the past decade – from \$416 billion in 1998 to \$1.22 trillion in 2008 – is expected to occupy a stronger position in the next five years and be the world's economic leader in 20 years' time (2030).

"With rapid GDP growth, cross-border flows on both current and capital accounts on the rise and the location – time zone – there is no doubt that a country like India should become the regional financial centre (RFC) on this side of the globe. And if so, Mumbai, recognised as the financial capital of the country, should be the preferred destination for the international regional financial hub," is the consensus within the financial community, which has been discussing how Mumbai can become a strong contender for this coveted position.

This is not a new topic; it has been widely discussed in many forums. In a report prepared a few years ago by Bombay First, a group of professionals and institutions focussing on the future of Bombay, it has been clearly stated that Mumbai has the first mover advantage *vis-à-vis* other centres in India. "It has a high density of both formal and informal financial firms, which create positive externalities. The city also has the best social infrastructure in terms of education, health and work culture, in addition to the availability of high standards of professional services in the area of finance. Time-zone wise, Mumbai's geographical location is almost a midpoint between the important international financial centres in Tokyo and Singapore on the one hand, and London, Frankfurt and Paris on the other. This makes Mumbai an ideal city to develop as an active international financial centre, which could serve as an effective financial bridge for the South Asian region as a whole."

But the fine print of the study cautions that Mumbai can develop as an international financial centre only if it can provide necessary, cost-effective and high-quality physical and regulatory infrastructure. Major changes will also have to be brought about in the urban land use regulations and tenancy laws, so as to improve quality and availability of housing and office space in Mumbai.

Several additional reports have been prepared, but the action is lacking. "Mumbai still does not have the requisite enablers in place," says Raju Menon, chairman and group CEO, Morison Menon, a Middle East financial consulting and accounting firm, pointing to the infrastructure in Mumbai, which is still not adequate to cope with the demands of the existing population.

He lists some of the deterrent factors: it takes two hours from the airport to reach certain business districts in peak hour time. There are political

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matters as well. An international financial centre cannot have ethnic domicile issues – jobs only for certain sections of the people. "So, even the posturing and the signals have to be right," notes Menon. "As a country, we need to demonstrate that we can create and execute appropriate infrastructure – build an environment where people across the world can come and stay in Mumbai, practice their faith, educate their children in appropriate schools and universities and enjoy relative tax advantages which other jurisdictions try to position."

He maintains that India does have the capability to do this, but "we need to amend laws, aspects like culture, tax, convertibility, systems, city infrastructure, product variety and sophistication, coupled with strict risk controls, and then tell the world, 'Come and experience it'". Menon admits we are not there as yet, but India will have to have a time-bound goal, transform Mumbai and put enablers, before proclaiming that it is ready to be a financial centre – and not because others are in difficulty, but because Mumbai belongs to one of the most promising markets that is growing.

Concurs Ashvin Parekh, partner, Ernst & Young, and member of a World Bank study on this subject, "Neither the market regulators nor the government have worked towards this. Till about five years ago, our financial markets were fairly closed. From the policy point of view, they are content with a domestic play. We do have some of the right attributes, like skilled manpower and the time zone proximity as a window to Singapore and London. But the biggest disadvantage is the cost of commercial estate, infrastructure and living conditions." Parekh suggests that the government ought to create a zone where real estate is available and those entities can enjoy a certain independence from tax rules and laws of the nation. "One has to create a different regulatory framework for funds to move in and out. Given the current scenario, it is difficult to attract large banks and private equity players sitting in tax havens." People forget that while the UK is a heavily taxed country, all kinds of exemptions have been made in favour of foreigners and foreign capital, even though Gordon Brown's Labour government is threatening to whittle away some of the main exemptions that foreigners enjoy.

"If Mumbai has to become a regional financial centre, it must be prepared to serve the financial needs of not only India, but also of the companies and other corporate entities of other countries in this part of the globe, i.e., Central Asia, Southeast Asia and even East European countries," says Lalit Dangi, chairman of Libord Financial Services. He thinks that since Mumbai houses the country's oldest stock exchange in Asia and has a developed network of market intermediaries, it can be developed as an RFC. His reasons are plain: Mumbai alone generates about 5 per cent of the total GDP. It serves as the country's economic hub, contributing a large portion of factory employment, industrial output, direct and indirect tax collections and India's foreign trade. Above all, it has a workaholic population. In a nutshell, Mumbai has all the essential ingredients to qualify as "a very vibrant and lovable RFC", reasons Dangi.

There is no doubt that India has sophisticated and developed equity market, a well-developed commodity market, but not a vibrant bonds, debt and forex derivatives market. "The latter are essential ingredients of a financial hub. A liquid financial market thrives on breadth, depth and risk appetite, which are provided by unlimited credit availability at a price. In any developed financial centre, money, of course, matters, but credit counts a lot too," says Ashok Rout, a Singapore-based finance person, who spent some time with the Bombay Stock Exchange (BSE) during its makeover.

Liquidity level

Dangi points out that a lot of effort is required to boost the bonds, currency and derivatives market to make it comparable with international or regional centres. The level of liquidity is missing in terms of size, visibility and capability of those in New York and London.

Today, the level of liquidity is largely based on price discovery by non-institutional investors in the equity market. Moreover, banks and insurance companies are restrained, if not banned, from undertaking risk, hedging activities and any other kinds of sophisticated business due to regulatory restrictions. These measures reduce the level of liquidity.

The debt market is shallow, according to financial analysts, who allude to the restrictions on certain sectors in terms of the percentage of foreign holding. Monies are not fully convertible on the capital account. While this prudence may have helped us, it may be necessary for a full-fledged financial centre to enable investors to enter and exit without restrictions, while keeping in mind the interest of the overall system within the country. And the issue will be whether the Reserve Bank of India (RBI) and government will be happy to let go their control and dominance of our financial markets.

Convertibility is a primary requisite to attract large pools of capital, to take things forward for a competitive financial centre – even as appropriate defence mechanisms will have to be thought of in light of the recent financial crisis, when countries were reported to be placing selective limits to protect their interests.

Others demur. Even without convertibility, progress can be made, they say, since strong fundamentals were being exhibited in terms of GDP and its components. "Today's dominant players in the Indian capital market are looking at the prospects of our economy as a whole," says V.V.L.N. Sastry of First Call India. Convertibility is not an issue holding Mumbai back from emerging as an RFC. Rather, its lack of basic infrastructure is a big issue.

The ability to conduct international business is an important component of any aspiring financial centre. Says R.H. Patil, chairman, financial services committee, Bombay First, and former managing director, National Stock Exchange, in his preface to an EXIM Bank report, "It is not necessary for exchange control regulations to be totally abolished or full capital account convertibility to be introduced for Mumbai to emerge as an international financial centre. This is amply proved from the experience of London, which is next only to New York as the world's most dominant financial centre. During the 1960s, when the euro-dollar market blossomed in London, and it became a major force in international financial markets, London's exchange control regime was perhaps as tight as it is today in India. All that is needed is to accord freedom of movement to

Menon: 'We are clearly not there yet'

funds that belong to entities who are not otherwise subject to exchange control restrictions."

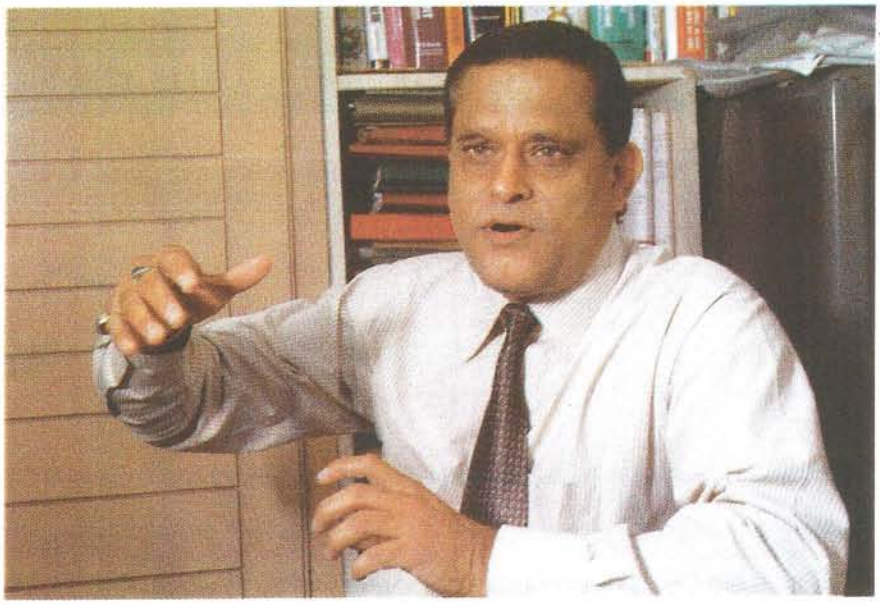
Growth engines

There is a misconception in India that capital will fly out of the country if there is convertibility. In fact, the reverse will happen. The challenge for India will then be to line up growth engines to absorb the enormous capital that will potentially flow to Mumbai. "These growth engines will create jobs, spur consumption and catapult India to its rightful place in the league table of the world's powerful economies," adds Rout. So, is the solution again to start with a free trade conclave, or few or no SEZ, where restrictions apply, but equally, monies from the free zone do not enter the local markets, or vice versa?

But others feel India can wait. It's already a partially convertible currency nation, says Anish Jhaveri, CEO, Antique Stock Broking. "And very few citizens are actually using the yearly convertible option in terms of buying foreign assets to the tune we are allowed." With the US economy weakening and the dollar losing its shine, India has done very well to protect itself from any adverse impact in the face of global financial meltdown, he says.

Meanwhile, the RBI has recently again sought to examine whether we have enough capability to switch over to complete capital account convertibility. It is very clear that the government, too, is not very keen to go for convertibility, in the near future at least. The question of capital account convertibility now weighs heavily on China and India, where financial systems with structured weaknesses, legal constraints and varying degrees of state domination now confront the irresistible force of globalisation.

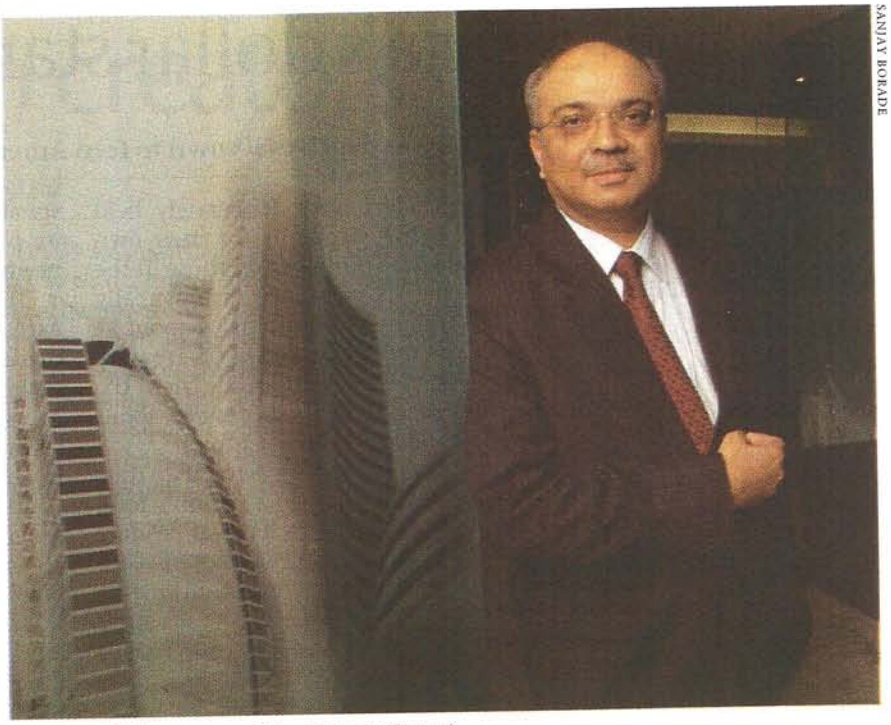
As far as convertibility of capital account in India is concerned, it is linked to the currency crisis that India avoided successfully over the period 1999 to 2007. But now, India has



SANJAY BORADE

Dangi: 'Mumbai has all the ingredients for an RFC' sufficient foreign reserves to take care of any currency crisis, and if Mumbai is to be made an RFC, then convertibility has to be implemented, which will have twin advantages. Firstly, it will accommodate the accepted international consensus that a country moving to convertibility must have liquid and efficient financial markets and strong institutions. Secondly, India's opportunity to export international financial services will really open up after convertibility.

With the ball in the government's court, most people from the financial community feel that the government should actively promote Mumbai as an RFC (not only to emerge out of the Dubai crisis, but on its own), and not merely pay lip service. It should invite world-class companies to set up base in Mumbai, and if necessary, provide tax holidays for five years. These firms can bring huge capital, an impressive array of products, execution skills and an enormous appetite for risk.


SANJAY BORADE

Parekh: 'We have some of the right attributes'

Filling the vacuum

India has a huge domestic market that is the envy of the world. India has talents, technology, a vibrant democracy and rules of law. It can fill the vacuum created by the recent crisis in Dubai, provided it acts fast. Singapore and Hong Kong are already trying hard to lure global companies, talents and capital away from Dubai by providing lucrative incentives, including multi-year tax holidays. But in promoting the idea for a regional centre, we must also be clear what we can or cannot do. Can we really service the Middle East markets? Not really. Both Abu Dhabi and Qatar, with their large capital surpluses, see themselves as emerging financial centres of the Middle East. But as a regional centre, Mumbai can take over several of the functions performed in Dubai, or for that matter, even Singapore, for the domestic market and the South Asia region.

Mumbai has to be projected as a city with reasonable autonomy with respect to day-to-day decisions. Other centres, such as Dubai and Singapore, are sovereign countries, managed as business models. In the case of Mumbai, it is the capital of a state within the federal structure of the Union of India. The state under the Constitution has limited powers and all decisions under the Union list are the jurisdiction of the Centre. So, there has to be some system by which the financial system in Mumbai works under a super regulator, that becomes a nodal authority for all major clearances with respect to the financial markets. There has to be a strong and efficient bureaucratic work culture where decisions are taken, and not delayed.

But if we do take up the challenge, the benefits to India and Mumbai will be enormous. Of course, it will create a number of jobs and will revitalise Mumbai city. But that is a small payoff. More importantly, it will help deepen our own capital markets and help mobilise not just foreign capital, but also domestic capital, for efficient deployment in India and around the region. This will allow us to play a regional role in our neighbouring countries, including Central Asia and even parts of Southeast Asia.

Our government has been pushing for free trade in services at various WTO forums. We have, as a first step, signed free trade agreements (FTAS) with Thailand and Singapore. We should be able to leverage on our strengths to become a leader in services too. But is the government really ready to allow Indian financial service companies the freedom to become strong regional players?

And while we do not have the oil and gas income of Abu Dhabi and Qatar, we have a strongly developed capital market, one of the oldest stock markets and high rate of savings. Also, the 66 listed stocks on the Dubai Financial Market have a total market capitalisation of $36 billion. Nasdaq Dubai is worth $26 billion, but ports operator DP World, which is 77 per cent owned by the troubled Dubai World, accounts for a large part of the market cap. The combined market capitalisation of the two Dubai exchanges is less than that of the Abu Dhabi stock exchange and is dwarfed by the $324 billion listed on the Saudi Tadawul. Companies traded on NSE have a market capitalisation of over $1,022 billion!

It is for these reasons that the idea of a regional finance centre is an idea whose time has come. The government and the RBI should be persuaded and pushed into taking quick steps to make Mumbai an RFC. And unless we take those steps now, the idea will remain just a dream.

• LANCELOT JOSEPH