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Financial Management - Indian Trends

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Background

Indian economy is going through a major change. Not only as part of the global changes that are taking place today, but by herself, India by itself is going through a phase of very quick heating and cooling. The way economic indicators like inflation, the sensex, and foreign exchange rates have been fluctuating in the last few years shows the dynamic nature of the activities. Too many activities are taking place at such a fast pace that to get a comprehensive idea about what is really happening seems very difficult.

It is stated that BRIC economies (Brazil, Russia, India and China) would be the leaders in the version 2.0 of the economic performance after the cold war. The end of 20th century and the beginning of the 21st saw the emergence of India as a super power in information technology, nuclear research, and even as owner of global businesses. No single attribute can be singled out as the main reason for such a performance.

This paper deals with the trends that are likely to take place in the field of finance. The field of finance encompasses both private and public sectors. Today the differences between the private and public finance are reducing due to the development that are taking place not only in terms of financial and information technology but also the demand of the users for an accountable and transparent system. At this juncture this paper looks at the strengths of the Indian financial management as it used to be, the issues that are currently influencing the finance field and the likely trends. The paper concludes with identification of a few major issues that need to be dealt with, based on the Indian Management Thought.

Strengths of Indian Financial Management – as they were

The entire financial world is wondering how India has been doing well despite the global economic meltdown. The global economic meltdown is the result of unscientific and inhuman thinking of a few in power and position. Glitz and glamour coupled with avaricious human nature and greed resulted in a domino effect that completely battered the world economy these last few years. India was also definitely affected due to its connectivity with global issues.

Before getting into the trends in the financial world with which India has to catch up, it may be worthwhile examining the strengths of Indian financial management practices. This will also indirectly tell us why the impact of the meltdown on the Indian economy was relatively less.

Indian financial management practices have been considered very 'conservative'. This word conservative has been thoroughly misused. When someone does scientific risk analysis he is scientific because he is conservative. When someone does audit of the accounts of an organization he will be a good auditor if he is very conservative. A cautious financial manager could be termed as a conservative one; but he would deliver what he has to, and that is what India did.

Let us examine some of the salient features of the so called conservative financial management in India. Unfortunately many of these features are slowly vanishing. Indian financial managers are also becoming brash and impulsive. However, the inherent strengths arise from these features of the Indian financial management practices.

Propriety is the key word in Indian financial management, as far as Indian businesses are concerned. This term implies 'ownership with responsibility'. The employees of the organization need to appreciate the propriety that is bestowed on them, and accordingly be responsible. This concept when extended to financial management implies that the employees shall be fully accountable for the financial decisions they are taking. Depending on the

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values of the Management, individuals tend to take risk in financial decision. This could be one of the reasons why Indian financial managers are called 'conservative'.

Accounts based MIS has enabled Indian companies, particularly those run in the western part of India to be more financially efficient. In general the top management would route the entire MIS through the finance and accounts department. This means that every bit of key managerial information will be 'as per the books' or confirmed transactions. This check is extremely important for overall control. This looking at the MIS through accounting information is typically Indian and is now increasingly recognized by the west.

Cash flow based management is the key for Indian organizations, despite their size. The focus on cash flow based management has enabled these organizations to be effective with regard to debtors management, purchase decisions and inventory management. However it is sad to note that India was one of the last countries to introduce cash flow statement as part of audited financial statements.

Cost control has always been a real challenge in any organization. In India frugality plays a very important part in middle class life. This idea is also extended to organizations and cost control is one of the most important parts of the financial management function. India is one of the few countries where cost accountants exist as independent from financial accountants, and even the government has a separate mandate of cost audits.

Lending based on tangible assets/earning capacity is possibly one of the main reasons why the banks in India did not face the fate of some of its counterparts in the west. Though the government has been talking about 'development financing', in India it has been basically money lending. India has a long tradition of money lending, which is based on the asset base of the borrower. However, thanks to the modernization of the lending processes, the banks and financial institutions look for earning capacity and the inherent ability of a project to generate profits. Hence apart from the debt:equity ratio, the Indian banks also focus on debt service coverage and internal rate of return. This approach coupled with the NPA chase made by the RBI has been able to make the financial managers take decisions that do not make their organizations unviable. While there are a lot of criticisms in this regard, it is the strict adherence to such basics that have enabled many of the organizations to sail above the critical performance levels.

Risk aversion with high value addition is another inherent part of Indian financial management. While the science of finance talks about 'risk returns' correlations, in reality the text book conditions do not exist. Also it is in reality not possible to assign proper weights for any of the external factors in India. For instance politics can pose a deadly risk and with policies getting amended with retrospective effect, it is almost impossible to assess true risks. So the risk averse attitude of the Indian financial managers has really helped organizations. As an extension of this Indian entrepreneurs choose projects with low BEP or high value addition. This approach provides cushion for the risks that might affect the project.

Long term vision – emotional commitment. In India nobody starts an organization to sell it. They rear it as their own child. Indian entrepreneurs want their organizations to grow from strength to strength and exist happily ever after. This long term attitude enables the promoters to patiently wait for grounding the organizations strongly. This is very much reflected in the financial management of the organization also. Hence the financial managers take decisions based on long-term considerations. Even the short term considerations factor in the long term vision. Hence the financial management decisions contribute for stability of organizations.

Ethics is possibly the core of Indian Management. The word 'ethics' has several meanings and is expressed in different contexts. However, when it comes to business, ethics is the "fair way" to do business. Ethics is defined as 'moral principles that control or influence a person's behaviour'. It is also about right and wrong. When it comes to ethical business, the question of right and wrong comes up in every situation. In the field of accounting and financial management of organizations, ethics form the basis for every voucher that is passed and every entry that is made in the books of account. It is the misgivings and compromises in entries passed that result in 'scams'. In every scam it is the financial propriety that is under question. The conservative, tight fisted, accounts based management system results in a system that is built up on ethical principles. This enables a financial management that is not flamboyant or extravagant, but is precise and perfect.

An evaluation of Indian Financial Management Practices – as they are

If someone asked the question today as to whether Indian organizations follow these principles today, a strong affirmative answer cannot be given. The competitive spirit seems to have influenced the Indian society also with all the vices that are associated with 'greed'. Let us look at the recent scams. The Satyam scam has been sent into back burner by several other scams

- 2 G scam
- Adarsh society scam
- CWG/IPL scams.

Every time there is a new scam, the old one is easily forgotten, be it Bofors, Harshad Mehta, Ketan Parek, Reliance import scam, and so on. Another important point is that in each of these scams the role of private sector is as much as the public sector. But it is customary to highlight the problems only in the government sector – because it is easy. In any case there is no scam without professionals; and there is no scam without money. This means that in every scam there are financial professionals who are involved. This has a lot of implications for the financial management community.

Various strengths of the Indian financial management practices mentioned earlier are slowly getting watered down. The line between moral and immoral decision is very thin. People have started compromising on everything for the sake of money. They are no more managing money – money seems to manage people and organizations now. That is the reason why even after introduction of technology, robust rules and regulations, stringent control measures, and more qualified professionals, scams have also increased. That is the reason why India too felt some impact of the recession.

The average Indian citizen can afford a much better 'quality of life' only at the expense of 30% of his countrymen, whose life has not changed. Corporate Social Responsibility is another facade that is totally inoperative and remains only on paper; though there are definitely a few organizations and individuals who are trying to help the persons in need. The students in universities are excited over the rate of growth of the telecom industry that is scam and inefficiency ridden without any idea of how a huge number of schools in the city are without even proper toilets leave alone teachers. An average Indian student does not wish to become a teacher and his/her parent would feel completely desolated in case he/she becomes one. This is the state of nation building. While there are about 250 Universities in India, more than this number of foreign educational institutions have entered India to improve the quality of education. While the salaries of the corporate executives have increased several times (multiples of 10) the salaries paid to the servant maid in the metro houses and the price paid for farm products to agriculturists have remained much below minimum/survival levels.

These points are extremely important as they form the genesis for change in the behaviour of Indian society that has resulted in the erosion of the financial management practices in the recent times. The very base of Indian financial management – ethics – are slowly giving way. This point needs to be appreciated and then the trends that are taking place in Indian Finance need to be understood. Next few years are very important in the history of Indian financial management as sweeping changes are expected. The only way to handle them is to get back in time and strengthen basics that are cemented well with ethics.

Trends In Indian Finance – as they will be

Indians play a very important role in global corporate finance. Every top company of the globe has Indian operations. Indian executives occupy key positions in such companies. Indian professionals are respected across the world. The globalization trend is increasingly intensive with online trade, e-commerce and instant transfer of information. India is also an active player in the field of information technology and so its role is bound to be significant in the coming years. Literally the second fastest growing economy next only to China, the responsibility of the Indian corporate world is increasing. It is expected that in the next few years the world is likely to see financial recovery of various economies, improved performance of manufacturing sector, realignment of emerging economies, and of course be ridden with surprises and shocks. At this juncture in 2011, following are some of the major trends that will be witnessed by Indian Finance. Here Indian Finance includes both the corporate and government sectors.

More Regulations: India is going to witness increased regulations. We are aware that India is one of the highly regulated countries and there are several views about such 'high regulations'. It is known that less government means better governance. But nevertheless, there has to be some basic systems that act as outline for organizational performance. While we say that we are heavily legislated, there are absolutely no rules or regulations governing NGOs; and MFIs are scantily regulated – scams and mismanagement in these areas are slowly surfacing. Regulations on intellectual property, unification of tax code, introduction of GST, move towards capital account convertibility, laws for increasing transparency, regulations for increased involvement of citizens/civil societies, regulations monitoring cross border transactions and investments, etc. will be coming forth and getting implemented. This means increased role for professionals.

One area that would open out will be area of municipal bonds: like the stock market the municipal bond market will become a major area of public participation. People will get interested in investing in public projects which when managed well will produce much better results than the corporate sector at the same time achieving social objectives. More finance professionals will be required for this.

More Technology is a point that everyone understands and appreciates. Thanks to the success of railway ticket booking, slowly every other public service is being upgraded with the help of technology. The technology in the field of finance will be significantly upgraded. Increased facilities for e-commerce, second phase of user-friendly and mid-level ERPs, increased use of business intelligence tools, increased interface between government assessees (both individual and corporate), and government accepting increased e filing for official purposes. Even ordinary organizations will move towards technology backed up operational and decision support systems. This will naturally impact the way financial management is conducted in organizations. Organizations would need more of financial technicians – finance managers with exposure to information technology tools.

More Specializations would be needed for finance professionals to survive. Today we are in an era of specialization. What happened to the field of medicine a few years ago is happening to the field of finance. The field of finance that began with accounting (finance management begins where accounting ends) has today embraced several specializations apart from the hardcore financial management, and includes financial audit, information systems audit, forensic accounting/audit, management audit, internal audit, management accounting, corporate finance including financial market, private equity, debt funding, futures and options, derivatives, business valuations, wealth management, and risk management. Government finance is moving towards accrual accounting and now includes several areas of professional financial skill involvement including output/outcome budgeting, geriatric (senior citizen) budgeting, gender budgeting, performance budgeting and so on. There will be increased use of quantitative and statistical techniques in the field of finance. The impact of technology on financial management and related areas will increase and in order to survive with success in this field the finance managers will have to upgrade themselves with the appropriate qualifications and certifications.

More Accountability is a natural result of increasing responsibilities of finance professionals. Finance Managers to Financial Controllers to Financial Directors is the graphical elevation of finance professionals in organizations today. This means increased roles and responsibility in corporate decision making; and hence accountability. More independent directors with financial background will be inducted into Boards of organizations. The finance professionals working in the organizations and those working from outside (like independent auditors) will be more accountable for the decisions they take (and of course, they will be paid more!).

More Transparency will be a result of increased accountability. While the latter is the ability to account for one's actions, the former deals with sharing of information with an increased audience. Organizations will be asked to be more transparent in sharing key information with the stakeholders. This will not only be in the corporate sector, but in the government sector as well. Both changes in regulations and technology (discussed earlier) will impact the extent and rules of transparency. With increased use of public money both in corporate and government sectors, financial information needs to be much more transparent. Government organizations will publish their financials in newspapers and shareholders will have more access to financial information enabled through technology. There will be involvement of citizens in reviewing the activities and performance of governments starting with local bodies and, in the increased net of governance processes there is a huge scope for the involvement of finance professionals.

More Integration. The words integration and harmonization have several ramifications. As discussed elsewhere the move towards capital convertibility will require improved macro economic performance coupled with proper regulation, stabilized economy, and demand for Indian goods and services. This is one integration of economies that is likely to take place in a medium to long term perspective. However there are other corporate level integrations that are sure to occur.

The move to IFRS era is one such harmonization initiative. The Indian corporate starting from April 1st 2011, will be reporting as per IFRS. The IFRS provide the reporting standards for the corporate sector (commercial, insurance, banks) for harmonization with the international accounting standards. While there are several debates as to the correctness of this decision to move to IFRS, there is a huge amount of work that requires to be done by finance professionals in this regard. It is expected that even SMEs will be covered eventually. The challenge is the way the accounting entries now have to be conceived as per the IFRS, which in several cases differs distinctly from Indian GAAP, and would require a huge amount of professional inputs. A finance manager without IFRS knowledge will soon find no place in the market. Even accounting standards in alignment with international accounting standards are being formulated for Government entities by Government Accounting Standards Board (GASAB) and already accounting standards are being developed for Local Bodies by ICAI based on IPSAS (International Public Sector Accounting Standards). These changes are likely to have a huge impact in the field of financial management.

The next major change is the way books of accounts are maintained and the way the financial reports are generated and filed with authorities. XBRL – extensible business reporting language is already on. Making use of XML technology, the XBRL provides tags to every financial transaction recorded in the books of accounts and by a simple method provides fast and automatic compilation of accounts. The strength of the technology is that classification mistakes are made zero resulting in very easy extraction and consolidation of financial information. Also the technology enables easy reporting templates to tax authorities and the filing can be made automatic without any human intervention. This technology has already been implemented in several countries at the behest of the respective governments. In India already RBI, SEBI, ICAI are on the job. The taxonomy forming the basis for account head classification in organizations has already been completed. This effort will consume a huge number of finance professionals in years to come!

Addressing the Key Issues

Having analyzed the likely trends in the Indian Financial

Management System, three major areas need to be addressed.

Finance Education

Indian education in the areas relating to finance is totally splintered. There is no particular centre for excellence in accounting/finance education. The Institute of Chartered Accountants of India focuses more on the practice areas than the academic education. The university granted commerce stream is totally devoid of upgrades and is far removed from realities of the business world. There is a total disconnect between these and the MBA in finance. A field that is full of hard business concepts and a lot of methods of practice seem to be specialized in just about two years of academic work. Though finance begins where accounting ends, the finance courses are totally devoid of strong accounting base and legal considerations. There is a strong need to restructure the finance education in India. This is the need of the hour. The demand for professionals in finance related areas needs to be filled and there is no supply to match this demand.

Integration of resources

The resources that are under consideration here are the intellectual resources in the area of finance. The ICAI, ICWAI, ICSI, Universities, IITs, IIMs, etc. need to converge on the overall agenda and formulate basic standards of education and training. With so many areas of specializations available in the field of finance, there is so much scope for several such institutions. Organizations like SEBI, RBI, IBA, Finance Ministry, various governmental agencies, institutions like CII, AIMA, ASSOCHEM, etc. need to get together to clearly state the requirements of the industry. There has to be a link between academics and the industry. Faculty development initiatives in academic institutions need to be completely reoriented. With harmonization accounting standards and practices, increased use of information technology in finance related matters, increased need for standardized reporting and compliance requirements the various institutions and agencies need to purposely get together for the common cause. Also increased monitoring of the economy can take place only with the cooperation of all stakeholders concerned. There is also a strong need to make the policy makers, economists and other concerned decision makers come together on a common platform with the finance professionals to reduce the disconnect between policy and practice.

Reinstatement of Values

This is the real need of the hour. The ethics and values of the traditional Indian business need to be reinstated forthwith. The credibility gap that has been increasing in recent times needs to be filled. India has produced the best thinkers right from vedic times to recent times. Vivekananda, Ramana Maharishi, J.Krishnamurthi, and Mahatma Gandhi, to name a few, have established a benchmark for Indian thinking based on human values in recent times. The selfless life with eternal search for truth and happiness formed the basis for strong values of Indian society. In the words of Gandhi 'simple living high thinking' needs to be appreciated and completely internalized in every facet of Indian organizations. Right from the times of Arthasasthra (350 BC) there are documentary evidences for Indian management style that worked based on the principle of unity in diversity. Once every individual understands that he just a part of the whole there is no differences or aberration in his thinking. His decision making abilities improve and he is able to take a decision that is balanced and that is good for all the stakeholders involved. It is towards this line of thinking that actions need to be taken.

There is a lot of work to be done!