

**CENTRE FOR FINANCIAL MANAGEMENT**

# **CFM QUARTERLY IN FINANCE**

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## ARTICLES /CASES

### 1. TEN LESSONS FROM THE PROFESSIONAL JOURNEY OF A CFO

**Ms. Neeta Revankar, CFO and Whole Time Director, Sasken Technologies Limited**

Our life provides us with immense opportunities to learn. Most of us are fortunate to have the best wishes and wise counsel of our parents, teachers, friends, and family. The beauty of life is such that in some situations we learn and in some we ignore good advice and learn from the mistakes we commit. Where I am today, is in no small measure due to my learning from excellent advice and guidance and the valuable experience I acquired while committing many mistakes and learning from them.

Knowing that my readers are from the smart-generation, I will dispense some learning from my life and hope some of you find something that resonates with your life and situation. Even if a few readers become reflective on reading this, pause and look for opportunities to redirect themselves, I will consider this effort worthwhile.

Our professional pursuit and the payoffs from successfully achieving our goals give us a great sense of pride. It is my firm belief that success involves much hard work, willpower, and numerous sacrifices. Reflecting on the need to work hard brings me to **lesson one, which all of you have already learned: Nothing in life comes easy!**

In my early years, I was an avid cricketer; I played the game at various levels for several years. I played for my college, the University, represented the state of Tamil Nadu and South Zone. Playing a competitive sport taught me many things. I learned to internalize the maxim 'you win some you lose some.' Depending on one's form and other factors we are at times part of the team and at times benched! There are times where we don our whites or colors and are part of the action at times supporting the team as a by carrying towels and drinks for them. In life, each of us will face many such situations. **Lesson two would, therefore, be - Play a sport, so you learn to accept success and failure as a part of life.**

Where life leads us is based on the choices we make and making decisions are never easy. After playing cricket for six years, and having completed my graduate studies, I reached a stage where I had to choose between pursuing my studies in CA or taking a keener interest in cricket. I did not think I could go much further with cricket as I believed that I had reached my potential. My friends and peers continued playing since they felt they had the potential to up the game and excel. Indeed some of them did get ahead. I decided to pursue the Chartered Accountancy course, and I gave up cricket. **The**

**need to make progress brings us to lesson three: It is never too late to create a new beginning or to change the direction of your life. Only compare yourself today, with what you were the day before and move forward. Do not compare yourself or your performance with that of others.**

My first significant job was with a multinational company. I was tasked with preparing the documentation to help the company claim a subsidy from a State Government, based upon a scheme that had just been announced. With all earnestness, I prepared the claim document and tabled it before the authorities. While I naively waited for the money due to us to be received, I was woken up by a reality that plagues our nation. I was told that 'speed money' amounting to 20% of the consideration would do the trick. The person even offered a financial justification for the benefits of using 'speed money'! Was that a lesson in the 'time value of money'? Hardly! It was the excellent advice of my then manager and mentor that I learned a lesson I hold very dear. Though it was way back in 1992, it is something I will never forget. I was told that if one has Integrity, nothing else matters and if one does not have integrity, nothing else matters. **That brings us to lesson four: there are no shortcuts except perhaps to hell and shame.**

While the IT industry has been a forerunner in establishing and upholding high standards of governance and compliance, there are numerous challenges that I have faced. In the accounting profession, I have found that views often differ, and are usually quite polarized. I have had to face many situations where there was enormous pressure from seniors in the profession who held positions of power, to change my point of view, which was often seen as 'conservative.' For me the choice between doing what I believe is right and what is favorable is guided by only one principle - 'do what will stand any scrutiny' something that will never cause the balance to shift from ethical to economic considerations. I have sometimes deferred to others views, but equally, have stood my ground. **Lesson 5 is that there are many perspectives on every issue and each of them is correct. So do not believe that if you are right, the other person is wrong. Lesson 6 is that you must stand up for what you firmly believe.**

Maintain and invest in relationships – both in your personal and professional lives. Create networks that you can rely on, for help and support from time to time. Quantity is not as significant as the quality of the relationships you nurture.

In the global recession of 2008, several admired institutions collapsed, driven as they were, to show supernormal growth. The IT industry was, like others, badly impacted. There were several tough decisions to make; our company had to take its share to ensure we survived. We trimmed our management team size by half, and those of us

that remained took multiple responsibilities. To my existing portfolio of finance, legal and corporate affairs were added Human Resources, Information Technology, and General Administration.

The saying goes 'it is always lonely at the top,' and I experienced it in no small measure during those days. My job demanded that I relentlessly focus on ensuring that the organization stayed afloat and to protect the interests of the majority, tough calls would have to be taken. From letting go people to cutting compensation, I made a series of decisions that pushed my popularity quotient rock bottom! It took a toll on me, more than is perhaps acknowledged. It tested my mental and physical endurance to the limit. To work relentlessly in the face of criticism and scrutiny and continue to make fair decisions in spite of the blame, is probably not easy. As I reflect I think I can share the lesson I learned, **lesson seven: identify and build relationships with people whom you can reach out to, for advice, guidance and help in difficult times. Build a safety net of friends and family that you can look to in your difficult times.** The ability to access people who are free and forthcoming with alternative viewpoints and challenge our opinions is a blessing. While I must admit I am not someone who can be described as overtly social, I have come to value and respect the need for relationships. The value of mentors and well-wishers can never be overemphasized. **I believe that one must turn inward during one's darkest moments and look for strength from within. If the situation gets harder, it is advisable to seek comfort from our wellwishers. One way or the other we have to find our safety net.**

I struggled with time constraints in balancing my life between my home and my work. While at work, I was disciplined and focused. I did not spend time chit-chatting over coffee, having relaxed lunches chatting with colleagues and of course, I did not try to become a part of any of the networks that met over beer every Friday evening and discussed everything, from the flaws in the Corporate vision, strategy, structure, leaders! I prided myself on my work ethic, the fact that I did not waste any time gossiping like the others. So, I was not part of any networks – not formal and not even informal! I did not realize how I had messed up, big time, until much later! I would like to reflect on a few situation where I believe my being relationship savvy would have helped. Around 2003 – 2007, the Company was investing heavily in product development. Being head of Finance, I tried to get some fiscal discipline into decision making. When put through the budgetary efficacy test, many investments failed to clear the hurdle. However, those very ideas did get all the investments they sought! How did that happen? To top it all, it happened repeatedly! Why was I unable to influence the decisions, in spite of having objective information and being head of finance? I had no

clue back then! No one told me! That should've been my early lesson in the power of relationships.

Professional networks are essential, but so are personal networks or support systems. These support systems include family, extended family, friends, domestic help and the like...we often face situations where we need help and we must seek it within our networks – we do not have to deal with them alone – the journey becomes more enjoyable with some support. I had a friend, who stepped in as my coach during the difficult times at work and helped me survive. Siblings and friends living nearby can also be valuable sources of support in our difficult times, and we must reach out to them for help as they allow us to retain our sanity. We are privileged in India to get domestic help and my advise is that we must take good care of them. We would do well, by building some redundancies in these support systems as they are invaluable in helping us tide over the difficult times. Cheers to networks, relationships, and mentors, cultivate them with care.

**Lesson 8 - Read as much as possible.** I cannot belabor the impact reading has, in expanding the mind, building confidence, building relationships with like-minded people, shaping our personality, helping improve our performance at work, making us better people to be around. It also provides us with a retirement-friendly activity. Until I began my career, I was a voracious reader of fiction. Shortly after commencing work, I just stopped reading which is a big mistake. Luckily for me, there has been a recovery. Over the last two decades, of every 25 books I have been advised to read, I have read about one-fourth of them! As a result, I now leave behind a rich library for my daughter!

Learning continually, and being current with your area of expertise is so essential to excel in your career continuously. We need to make opportunities to keep learning through each phase in our profession. I have had many such opportunities to learn and grow. Of course, I wish I had invested more in learning, during my younger days. In the early days of my career, I attended a two month, weekends only, workshop on Strategic Financial Management, traveling 14 Km each way and spending 4 hours on a Saturday afternoon and again on a Sunday morning. It was very, very tough to make the time, but I just grit my teeth and went through it because I thought it was necessary for my career. I am a CA – so mostly competent in accounting and taxation. To make the cut as head of finance, I knew I had to sharpen my skills in financial management. It turned out to be precisely so.

I completed the CS course also, within the first decade of my professional career. I also attended three management programs at Harvard – one for six weeks and another for nine weeks, and the third for five days. These were at gaps of 5-7 years. Of course, I

should've done much more by way of learning and training, but I am reasonably happy with what I managed. So, learn, learn and keep learning and building your skills.

We all learn in school that Health is Wealth. After we finish our schooling most of us make a very expensive tradeoff; we pursue wealth at the cost of health. Time is unforgiving, and the damage we do to our bodies is initially not noticeable. We become adept at giving excuses the most common being 'I do not have time.' We believe it. Once we realize that we make time for the essential things in our lives, we also recognize that we did not consider exercise as a necessary part of our lives. Time is perhaps the only resource equitably available to all from the prince to the pauper! **Investing 60 minutes a day for personal well-being is an absolute must, which is lesson nine.** By health, I mean both physical and mental health. At all stages, we need to ensure that we have a balance of physical exercise and rest and mental exertion and mental relaxation. The form of exercise can change, depending upon our age, our likes, facilities available, etc...it could be a sport that you like until the mid-thirties, and then running/cycling/swimming, then walking and then moving on to yoga, which should take you until the end. Being physically and mentally fit helps in increasing your self-confidence. Being in good health can significantly influence the kind of impact you can make as a leader, and your staying power as a leader.

I have saved the most valuable lesson for the last. We are privileged or should I say blessed to be the beneficiaries of a good education, the love, and support of a family that provides for and takes care of us. Not many are as fortunate as we are. Giving is as important as getting, perhaps more critical. More important than the quantum of giving, is the willingness to give. Cultivate a habit that makes giving a natural choice. That rounds up the **tenth lesson: throughout your life, contribute to the betterment of your community and country in whatever way you can.**

## 2. THE UNUSUAL BILLIONAIRES

### Prasanna Chandra

In his recent book, *The Unusual Billionaires* ( Penguin Books, 2016), Saurabh Mukherjea looks at companies which have demonstrated consistent performance over a long time frame, identifies the common characteristics of these companies, advocates a coffee can portfolio approach based on quantitative filters, and provides a checklist for long- term investors.

#### **COFFEE CAN PORTFOLIO**

In 1984, Robert Kirby a fund manager at the Capital Group, narrated an incident involving his client's husband who purchased stocks recommended by Kirby in denominations of \$ 5000 each. The gentleman left the portfolio untouched for a period of then years. Lo and behold, this approach led to enormous wealth creation, mainly on account of one position (shares of Xerox) which was worth over \$ 800,000. Impressed by the performance of this approach, Kirby coined the term Coffee Can Portfolio (CCP). Before the advent of banks, Americans saved their valuables in a coffee can and kept it under a mattress.

The key insight behind the CCP is that after constructing a sensible portfolio, the investor should remain passive and refrain from the tendency to change it.

Three decades after Kirby formalised the concept of CCP, Peter Thiel, venture capitalist and founder of PayPal, explained in his book *Zero to One*, why leaving a portfolio untouched makes sense. Thiel invokes the Pareto principle proposed by Italian economist Vilfredo Pareto. According to the Pareto principle, 80 per cent of the effects come from 20 per cent of the causes. Applied to the investment world, it means that a few companies in the portfolio deliver outsized returns than all others when held for a long time. Mukherjea found evidence of this phenomenon when he applied the CCP construct in the context of the Indian stock market. As he says, "To be more specific, I have found that holding a portfolio with a healthy mix of large- medium- and small- cap stocks with sound fundamentals for ten years exhibits a similar phenomenon in which a handful of stocks are responsible for the majority of the increase in the value of the portfolio."

#### **CCP in India**

To construct the CCP in India, Mukherjea used a three- step process.

**Step 1 Define Companies** Mukherjea restricted his search to listed companies with a minimum market capitalisation of Rs. 100 crore (as the data on smaller companies is somewhat suspect) and he found that there were about 1500 such companies.

**Step 2 Define Long Periods** Mukherjea defined long period as one decade because a decade in India usually accommodates both the up and down cycles in the economy.

**Step 3 Define Superior Performance** Mukherjea defined superior performance by using the twin filters of growth and profitability: the company should have delivered a revenue growth of 10 per cent and ROCE (EBIT/ Capital employed) of 15 per cent every year for the past ten years.

For companies in the banking and financial services industry (BFSI), Mukherjea used the following filters: (a) Return of equity of 15 percent. (b) Loan growth of 15 per cent.

Mukherjea looked at data from FY1991. For the first ten year period FY1991 to FY 2000 screen, he found that five companies met these requirements. These were NIIT, Cipla, Hero Motors, Swaraj Engines, and HDFC Limited So, the CCP 2000 comprised of these five companies. If Rs. 100 were invested in each of these five stocks for the ten-year period, 30 June 2000 to 30 June 2010, the value of this portfolio would have grown from Rs. 500 to Rs. 2923, implying an annual return of 19.3 per cent versus the 14 per cent per annum delivered by the Sensex over the same period.

Mukherjea repeated this exercise for each year until the FY 2015-16 (the last period covered by his study). Given that each time bucket is ten years, he had six fully completed CCPs. In addition, he had 10 uncompleted CCPs, since he used 5 April 2016 as the cut-off date for measuring price performance. Exhibit 1 shows the back-testing results of completed six- iterations of the CCP. Exhibit 2 shows the back – testing results of incomplete ten iterations of the CCP.

**Exhibit 1 : *Back- Testing Results of Completed Six Iterations of the Coffee Can Portfolio***



Kick-off Year *	All-cap CCP (start)	All-cap CCP (end)	CAGR return	Outperformance relative to Sensex	Large-cap CCP (start)	Large-cap CCP (end)	CAGR return	Outperformance relative to Sensex
2000	500	2923	19.3%	5.3%	100	2602	20.6%	6.5%
2001	600	7362	28.5%	10.0%	300	2685	21.5%	6.0%
2002	800	6057	22.4%	4.1%	500	3348	20.9%	2.6%
2003	900	8668	25.4%	7.1%	600	6754	27.4%	9.1%
2004	1000	14618	30.0%	12.6%	500	3097	20.0%	1.9%
2005	900	5795	20.5%	6.0%	500	2517	17.5%	3.1%

### **Exhibit 2: Back – Testing Results of Incomplete Ten Iterations of the Coffee Can portfolio**

Kick-off Year *	All-cap CCP (start)	All-cap CCP (end)	CAGR return	Outperformance relative to Sensex	Large-cap CCP (start)	Large-cap CCP (end)	CAGR return	Outperformance relative to Sensex
2006	1000	4708	17.2%	8.1%	600	2,333	14.9%	5.8%
2007	1500	5322	15.5%	9.3%	1000	3,282	14.5%	8.3%
2008	1100	4346	19.3%	11.1%	800	2,689	16.9%	8.7%
2009	1100	3806	20.1%	11.8%	900	2,430	15.8%	7.5%
2010	700	1438	13.4%	7.3%	300	693	15.6%	9.5%
2011	1400	1864	6.3%	0.3%	400	682	11.8%	5.8%
2012	2200	4143	18.3%	8.4%	500	802	13.3%	3.4%
2013	1800	3784	30.7%	21.3%	600	1,068	23.1%	13.7%
2014	1600	2114	17.1%	18.3%	700	966	20.0%	21.1%
2015	2000	1957	-2.7%	10.6%	1,200	1,139	-6.6%	6.8

### **FIRST AMONG EQUALS**

Examining the 16 CCPs from 2000 to 2015, Mukherjea found that :

1. In any given year there were around 12 companies in the CCP (the CCP of 2000 had five stocks and the CCP of 2012 had twenty two stocks).
2. On average, the CCP had a churn of 26 per cent (this means in every cycle, for every ten companies in the CCP, three companies were replaced in the next

cycle). This means that very few companies actually managed to sustain their ten- year track record over the next ten years.

Mukherjea searched for companies that featured four or more times in the CCPs. Only fourteen companies have featured in the CCPs four or more times. Out of these fourteen companies, six companies experienced pronounced decline in their performance in recent years. After eliminating these companies, Mukherjea had eight companies which stood out for their consistent, sustained long – term performance. Mukherjea calls them as first among equals (FAE). These companies are shown in Exhibit 3.

### ***Exhibit 3: The Eight Companies Which Are First Among Equals***

Number	Company name	Number of time ROCE > 15% (last 10 years**)	Number of times revenue growth > 10% (last 10 years**)
1	Asian Paints	10	10
2	Astral Poly	10	10
3	Berger Paints	10	10
4	ITC	10	10
5	Marico*	10	10
6	Page Industries	10	10
7	HDFC Bank Ltd***	10	10
8	Axis Bank Ltd***	10	10

### **CREATION OF SUSTAINABLE COMPETITIVE ADVANTAGES**

Mukherjea delved deep into the multi- decadal evolution of these great companies to learn how they have created sustainable competitive advantages. To decode the DNA of these stellar performers, Mukherjea utilised the perspectives provided by John Kay, a British economist, Warren Buffett, an American investor, Phil Rosenzweig, a business professor, and Rama Bijapurkar, a marketing consultant.

Mukherjea believes that there are three distinctive themes that characterise the eight first among equals (FAE) companies:

- **Theme A:** Focus on the long- term (more than ten years) without being distracted by short- term considerations.

- **Theme B** : Relentless deepening of the moat around the core franchise through innovative, brands, architecture, and strategic assets (IBAS).
- **Theme C**: Rational allocation of capital and avoidance of expensive and unrelated forays.

Of course time alone will tell whether these eight FAEs will become part of India's 'Inevitables.'

Mukherjea believes that around 99.8 per cent of the listed Indian companies do not run their businesses in accordance with these themes . Why? As Mukherjea explains “not because there is any great mystery associated with the themes but because as in the highest levels of professional sport, to work hard year after year, in a disciplined manner, with dedication and commitment, is not easy.”

### **A CHECKLIST FOR LONG- TERM INVESTORS**

Inspired by Atul Gawande, an American surgeon and author of the book *The Checklist Manifesto*, Saurabh Mukherjea has prepared a checklist for long- term investors. The check list has three major heads: industry attractiveness, management quality, and competitive advantages. The details under these heads are shown below.

- ***Industry Attractiveness***
  - Dependence on governmental regulation
  - Number of competitors and competitive intensity
  - Overall size of the industry and its growth potential
  - Proportion of value addition
  - Capital intensity and capital efficiency
  - Dependence on the country's broader economic cycle
  - Average return on capital employed
- ***Management Quality***
  - Track record of good governance and clean accounting
  - Connections of the owners to political parties
  - Track record of efficient capital allocation
  - Track record of remaining focused on core operations
- ***Competitive Advantage***
  - Track record on innovation
  - Investment in brands and reputation

- Company's architecture (the network of contracts and relationships with employees, suppliers, customers, and investors)
- Strategic assets (such as intellectual property, licenses and regulatory permissions, access to natural resources, and natural monopolies)

### **A CASE AGAINST CHURNING**

The CCP changes every year because not all companies can simultaneously maintain a revenue growth of more than 10 percent and a ROCE of more than 15 per cent indefinitely. Existing companies which fail the twin filters will exit the portfolio and new companies which meet the twin filters will enter the portfolio. This process of exit and entry is called the churn. So, the question that investors will ask is: Should the Coffee Can be churned every year as companies enter and exit? Mukherjea's answer is an overwhelming 'No' because he believes that rebalancing the CCP every year is not consistent with the basic philosophy of long-term investing, which is a key element of Robert Kirby's original Coffee Can construct.

Mukherjea offers five compelling reasons for keep the CCP intact every year for ten consecutive years.

**Reason 1: Higher Probability of Profits Over Long Term:** In the short-term equities are prone to high volatility, but in the long term the odds of profiting from equity investments are very high.

**Reason 2: Power of Compounding** The power of compounding manifests itself magically over a long term. As Mukherjea says, "Over the longer term the portfolio comes to be dominated by the winning stocks while losing stocks keep declining to eventually become inconsequential. Thus, the positive contribution of the winners disproportionately outweighs the contribution of losers to eventually help the portfolio compound handsomely."

**Reason 3: Neutralising the negatives of 'noise.'** The most effective way of avoiding 'noise' that interferes with the investment process is to hold the investments over the long term.

**Reason 4: No Churning** If a portfolio of stocks is held for ten years, there is no churn. This reduces transaction costs (which include market impact cost, brokerage cost, and so on) and thereby adds to the overall portfolio performance over the long term.

**Reason 5: Back – testing Results Prove that Rebalancing Does not Improve Returns** Using past data, Mukherjea back- tested to check the effect of replacing Coffee Can stocks every year (which means doing annual rebalancing) rather than holding one portfolio for ten years. He back- tested it for all six ten year periods, 2000-2010, 2001-2011, 2002-20012, 2003-2013, 2004-2014, and 2005-2015. The average of all six ten-year periods without rebalancing was 24.5 per cent as against 18.7 per cent for CCP with rebalancing.

### 3. A SHORT HISTORY OF FINANCIAL EUPHORIA

Prasanna Chandra

In his classic book, *A Short history of Financial Euphoria* ( Penguin Books, 1994), Harvard economist John Kenneth Galbraith, one of the great institutional economists of the twentieth century, provides valuable insights into speculative episodes and the world of finance in eloquent terms.

The important messages and themes of the book are briefly described below.

1. ***People associated with money are prone to error*** As Galbraith says: “Let the following be one of the unfailing rules by which the individual investors and, needless to say, the pension and other institutional- fund managers are guided: there is the possibility, even the likelihood, of self- approving and extravagantly error- prone behavior on the part of those closely associated with money.”
2. ***Speculation provides its own momentum*** In most speculative episodes, some seemingly new artifact or development (such as tulips in Holland, gold in Louisiana, liberalisation initiatives of Manmohan Singh as finance minister, and so on) captures the fascination of people. As a result, the price of the object of speculation goes up. The rise in price attracts more buyers and the upward spiral continues. Thus, speculation thrives on its own momentum.
3. ***Speculation buys up the intelligence of people*** The beneficiaries of speculation tend to attribute their gains to superior ability. As Galbraith put it: “No one wishes to believe that this is fortuitous or undeserved; all wish to think that it is the result of their own superior insight or intuition. The very increase in values thus captures the thoughts and minds of those being rewarded. Speculation buys up, in a very practical way, the intelligence of those involved.”
4. ***Financial memory is brief*** An important factor that contributes to speculative euphoria is the brevity of financial memory. As Galbraith said, “There can be few fields of human endeavor in which history counts for so little as in the world of

finance. Past experience, to the extent that it is part of memory at all, is dismissed as the primitive refuge of those who do not have the insight to appreciate the incredible wonders of the present.”

5. ***There is a specious association of money and intelligence*** We tend to associate unusual intelligence with leadership of great institutions.

In practice people often do not rise to the position of leadership in financial institutions on account of exceptional intelligence. Rather, they have the most predictable mentality and, as a consequence, bureaucratically the least inimical of the contending talents. But they invite veneration because of their position. As Galbraith put it:” He, she, or they are then endowed with the authority that encourages acquiescence from their subordinates and applause from their acolytes and that excludes adverse opinion or criticism. They are thus admirably protected in what may be a serious commitment to error.”

Of course, after the speculative collapse the truth of their fallibility emerges. Disgraced, they slide into obscurity. As Galbraith said, “The rule will often be reiterated: the financial genius is before the fall.”

6. ***Speculative episodes will recur*** Galbraith argues that capitalism contains within itself seeds of recurring damage and speculative episodes. To the question When will the next great speculative episode come? his answer is: “No one knows, and anyone who presumes to answer does not know. But one thing is certain there will be another of these episodes and yet more beyond..... Thus it has been for centuries; thus in the long future it will be so.”

## B. SNIPPETS

### 1. WORKING CAPITAL MANAGEMENT PRACTICES IN INDIAN\*

A survey of working capital management (WCM) practices in India revealed the following:

- The majority of sample firms follow a moderate approach in financing. (In the moderate approach the maturity of financing is matched with the maturity of assets).
- Receivables management is regarded as the most important component of WCM. Speeding the collection of receivables is an important facet of receivables management.
- Cash conversion cycle and net working capital are the most important financial measures for monitoring the working capital position.

- Centralised cash management is commonly used.
- Material requirement planning (MRP) and enterprise resource planning (ERP) are the principal tools used for inventory management.

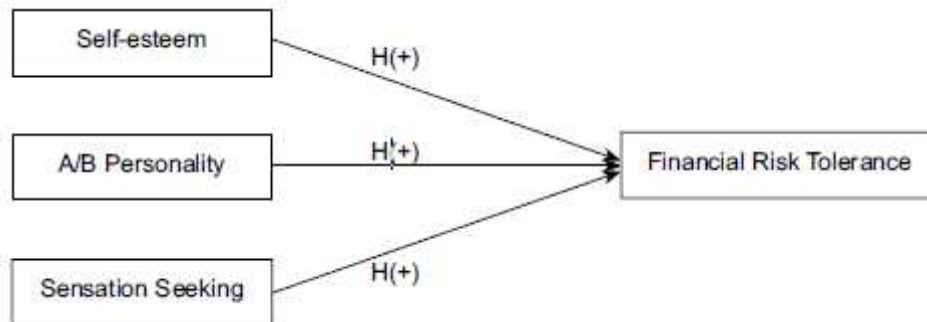
\*Based on H. Kent Baker, Satish Kumar, Sisira Colmbage, Harsh Pratap Singh (2017) "Working capital management practices in India: survey evidence," *Managerial Finance*, vol. 43, Issue:3, pp. 331-353.

## 2. A MODEL OF FINANCIAL RISK TOLERANCE

People react differently to risk. Some are more willing to accept it, while others are inclined to reject it. Financial risk tolerance (FRT) may be defined as a person's willingness to accept the risk of an unfavourable financial result in return for a chance of achieving a favourable financial result.

FRT is influenced by a multitude of environmental (family situation, socioeconomic status, and social transactions) and biopsychosocial (such as age, gender, birth order, personality traits, and ethnicity) factors.

In a paper titled "Relationship between Biopsychosocial Factors and Financial Risk Tolerance," published in April-June 2016 issue of *VIKALPA*, M. Kannadhasan, S. Aramvalarthan, S.K. Mitra, and Vinay Goel have conceptualised the determinants of financial risk tolerance in the following model.



Source: Conceptualization by the authors.

Note that individuals who are competitive, ambitious, aggressive, and impatient are said to have *Type A personality* and individuals who have opposite qualities are said to have *Type B personality*.

## 3. SORTINO RATIO

The Sharpe ratio considers total volatility, which includes both upside deviation (beneficial risk) and downside deviation (harmful risk). Investors, however, welcome upside deviation but dislike downside deviation. To reflect this reality, Frank A. Sortino

has suggested a variation of the Sharpe ratio called the Sortino ratio, which is defined as follows.

$$\text{Sortino Ratio} = \frac{\text{Average rate of return on portfolio} - \text{Average risk-free rate}}{\text{Semi-deviation}}$$

Note that semi-deviation represents the standard deviation of the returns that are lower than the mean deviation. Semi-deviation and standard deviation are calculated the same ways, but the returns used in calculating semi-deviation are those that fall below the mean return.

#### 4. SHARED VALUE

Social problems like ecological degradation are enormous. Traditionally, the primary responsibility for solving social problems lay with the government and, to some extent, with the NGOs (non-governmental organisations). The resources of the government and the NGOs, however, are grossly inadequate in relation to the magnitude of the problems. Resources are largely in the hands of the corporations. For example, in the US the resources available with the corporations in the U.S are \$20 trillion, whereas the resources with the government are just \$3 trillion.

So, corporations must be actively engaged in addressing social problems. They can work out scalable solutions for social problems, provided they can benefit from solving social problems. The conventional wisdom that business profits from *creating* social problems must be replaced by new thinking that business profits from *solving* social problems.

Take the case of pollution. We have learnt that by reducing pollution business can generate profit. Issue by issue it is now being realised that there is no conflict between social progress and economic efficiency in a fundamental sense. Here are some examples: Heart Healthy Oils in the U.S has a profitable operation while promoting healthy nutrition. Jain Irrigation in India is helping in saving water with its drip irrigation business which is a profitable activity. The social forestry project of ITC in India is an economically viable operation.

Addressing social issues with a viable business model, that can be scaled up and hence not constrained by resources, leads to creating shared value. Shared value is capitalism of a higher kind:



Shared Value = Social Value + Economic Value

## **PART C: WIT AND WISDOM**

### **1. HUMOUR**

- "Seven year old John went to his mother and asked a philosophical question: "Mama, where have we come from." His mother replied, "God created the earth. Then he created Adam and Eve. We are the descendants of Adam and Eve." Somewhat unconvinced, John asked his scientist father, "Dad, where have we come from." His father replied, "We have evolved over millions of years, and our ancestors were monkeys." Confused, John went back to his mother and said, "You said that we descended from Adam and Eve, but Dad says that we descended from monkeys. What is the truth?" John's mother said, "I told you about my side of the family, and Dad told you about his side of the family"
- A couple had two sons, aged 8 and 10, who were very mischievous. Every day they got into some trouble or the other. So their mother sent the to the local clergyman, a huge man with a booming voice. The clergyman first called the older boy inside his chamber and asked "Where is God?" The boy didn't answer. When the clergyman repeated the question few more times, each time his voice getting louder, the boy ran home and hid himself in a closet in his room. The younger boy too went home and asked his elder brother what was the problem. The elder brother said, "This time we are in big trouble. God is missing."

### **2. WISE SAWS**

- "You're only as young as the last time you changed your mind."  
Timothy Leary
- "Our life is frittered away by detail.... Simplify, simplify."  
Henry David Thoreau