chapter 2

21st Century IFS provided by IFCs

The 21st century is witnessing the world's transformation into a global village. This is being caused by: (a) an inexorable process of ***internationalization*** – that is linking countries through trade, investment and cultural exchange; and (b) equally inexorable ***deregulation.*** Both forces were unleashed by regulatory relaxation in the 1980s. Their impact was amplified in the 1990s with the rediscovery and acceptance of market economics following the collapse of socialism as an alternative. More countries are shifting to market economics from socialist paradigms to drive their development models. Their governments, firms, and civil societies – which were inward-looking and myopic – have revised their views about their respective roles. They have become long-sighted, outward-orientated and global in outlook.

Markets – for goods and services, finance, factors of production, and knowledge – are no longer confined to national geographies. Products and services are no longer designed and made for domestic and export customers separately with different quality standards for each. Resources are no longer restricted to those available domestically. Investments are no longer limited to domestic projects. In other words, economic boundaries have become porous. Among other things, this new world – in which economics and finance are no longer constrained by geography – is making new demands on financial firms, services, systems and markets. New financial products/services are being demanded from traditional financial firms to meet the needs of clients who have suddenly emerged as global players.

A modern financial system includes banking, insurance, asset management, securities dealing, derivatives and risk management. An IFC provides individuals, corporations and governments around the world with a range of financial products and services in this globalised world. The sections of this chapter look at some key IFS products/services provided by IFCs. While London and New York provide all of them, other IFCs around the world provide some combination of them.

1. Fund Raising in IFCs: What is involved? Who does it and how?

An IFC provides a platform for entities to raise large amounts of funds on a *global* rather than domestic scale. This includes: (a) debt and quasi-debt across all maturity and currency spectra; (b) equity and quasi-equity for private, public, multilateral and public-private entities; as well as (c) diverse risk-management appendages to primary fund-raising transactions. Such arrangements permit the risk exposure of the primary fund-raising entity (to currency, interest rate, credit, market, operational and political risks) to be contained within tolerable limits. The presence of large investment banks and global securities firms in an IFC facilitates access to a huge pool of global finance unconstrained by domestic boundaries.

As the example of London illustrates, this calls for dynamic, transparent and highly liquid capital and derivative markets with firm, principles-based yet flexible regulation that is unintrusive and does not involve micro-management.

It is often asserted that modern communications technologies have resulted in the 'death of distance'. It is therefore possible for geographically dispersed investors and issuers to interact without needing a geographically focused IFC. However, the empirical reality is that – even after large changes in technologies of communication –

Box 2.1: *The Range of Financial Service Providers called Banks*

Commercial banks: Take time and savings deposits and make loans to businesses and individuals
Savings banks: Attract only term savings deposits and make loans to individuals and families
Cooperative banks: Help farmers, ranchers, groups and consumers acquire goods and services
Mortgage banks: Provide mortgage loans on new or old homes and finance real estate projects
Community banks: Are smaller, locally focused commercial and savings banks
Money Centre banks: Are large commercial banks based in leading financial centres
Investment banks: Wholesale players that solve financing problems faced by customers by utilising capital markets
Merchant banks: Discount trade bills and supply both debt and equity capital to business
Wholesale banks: Are larger commercial banks serving corporations and governments
Retail banks: Are smaller banks serving primarily households and small businesses
Bankers' banks: Supply financial process services (*e.g.*, cheque clearing and security trading) to banks
Affiliated banks: Are wholly or partly owned by a holding company that is a financial conglomerate
Fringe banks: Offer payday and title loans, cash checks, operate as pawn shops or rent-to-own firms.

the most important aspects of fund raising still take place through face-to-face meetings in London, New York, or other IFCs. People still prefer to do primary 'front-office' business in their own daylight while outsourcing back-office functions to be performed elsewhere on a 24-hour basis. The primacy of IFCs in fund raising is unlikely to change in the foreseeable future.

Fund-raising for investment in an IFC is now invariably done through investment or universal banks and rarely through commercial banks. The fund-raising entity does not have to use an investment bank, but it usually does so because it is less costly than trying to sell securities directly to the public. The most common method of raising funds is by issuing and selling new securities, such as stocks or bonds of a wide variety of types. An investment bank usually helps in this process by providing its expertise and a global market base of customers to buy the securities.

Investment banks are not like commercial banks; although large global conglomerates (like Citigroup or HSBC) often house both activities under the same brand umbrella. Unlike commercial banks, investment banks do not generally attempt to attract small retail depositors through checking or savings accounts; nor do they make auto, home or personal loans. Generally, they do not deal at all with small individual retail depositors although some investment banks do attract high net worth clients by providing personal wealth management services of a different type and scale.

Whereas commercial banks generally raise resources at the retail (depositor) end, investment banks are wholesale intermediaries. They help businesses, governments, and a variety of other agencies to get bulk-financing from investors in capital markets through a variety of instruments and vehicles. By contrast commercial banks help users of funds to obtain financing by lending them money that the banks' own customers have deposited in savings, checking, money market and CD accounts. Investment banks connect users of money with a variety of sources of money on a bulk-basis, whereas commercial banks connect users of funds with their own retail and individual sources of deposits, though the vehicle of loans that might be syndicated with other commercial banks to spread risk.

A commercial bank usually takes the full credit risk on the loans it makes. Sometimes it lays all or part of that risk off through the purchase of market-traded credit derivatives. But that is rarely possible in bank-dominated financial systems; doing so requires sophisticated capital markets. An investment bank operating in capital markets rarely takes the credit risk of its clients on its own book except for a short period under an underwriting obligation (see Box 2.2). Thus, despite the word *bank* in their names, investment banks are securities issuing/buying firms that match users (usually corporates or governments) and providers (usually buyers of equities and bonds) of bulk funds in capital markets. When they are not operating in an IFC, their activities (*i.e.*, connecting users and sources of funds) are confined to domestic markets. But, in an IFC, national borders cease to matter in determining either the geographical origins of clients or the geographical residence of funds being tapped.

In capital-market dominated financial systems, entities that need funds can discuss a variety of options and possibilities with investment bankers. But in bank-dominated

Table 2.1: Markets for foreign equities (2005)

	Turnover ($bn)	% of global turnover	No. of Foreign cos. listed
London	2,496	43	554
NYSE	1,234	21	452
Switzerland	896	16	116
Nasdaq	591	10	332
Germany	165	3	116
Others	401	7	1,285
Total	**5,783**	**100**	**2,635**

Source: World Federation of Exchanges, LSE

Table 2.2: International Bond Markets (2005)

	Net issues ($bn)	% share
UK	361	19
Spain	211	11
US	199	11
Germany	157	8
France	132	7
Italy	89	5
Netherlands	84	5
Others	989	53
Total	**1,861**	**100**

Source: Bank of International Settlements

systems their choice is usually restricted to loans from commercial banks.

Tables 2.1 and 2.2 show the amount of equities and bonds issued in global capital markets in 2005. The bulk of the bond market is in domestic bonds issued by companies in their own country and currency. But the share of international bond issues in the total bond market has risen in recent years. The value of bonds issued worldwide totalled over $44 trillion at end-2005. Table 2.2 shows the percentage share by nationality of the bond issuer. International bonds, which include Eurobonds and foreign bonds, totalling $1,861 billion were issued in 2005. UK issuers had the largest share in 2005 with nearly a fifth of the total, followed by Spain and the US.

There is a natural synergy between global funds seeking investment opportunities (with a wide range of risk/return possibilities) and global seekers of funds. Their mutual interests converge in an IFC. Each induces network effects that feed off the other. It is not possible to conceive of one without the other. For that reason India does not have the luxury of prioritizing either one or the other of these two elements in sequencing the emergence of Mumbai as an IFC. Both have to be accommodated simultaneously. Another key facet that needs to be emphasised from a sequencing viewpoint is that efficient and cost-effective fund-raising in any IFC requires mature, deep and liquid financial markets in all segments at all levels; *i.e.*, it requires:

1. An efficient, liquid, large and globally connected, equity market that can support equity issuance by issuers not just from India but elsewhere,
2. A liquid and efficient bond market with a traded yield curve in the currency of the IFC that enables global corporate and sovereign bond issuance,
3. A large and liquid currency trading market,
4. Robust derivatives markets that permit laying off a variety of risks *i.e.*, including credit, interest rate, maturity and duration, currency, and political risk,
5. Efficient and globally open banking markets that minimize or eliminate the conflicts-of-interest that arise with state-ownership and domination of the banking system; and
6. Globally efficient *insurance* and *re-insurance* markets open to global players with all the necessary products and services available.

Global fund-raising is one of the most prominent revenue sources in every IFC, and a tangible goal that every IFC aspires for. However, this prominent activity requires an underlying infrastructure in the form of these markets. Hence, the development of public markets for securities, banking and insurance on an international scale is a *sine qua non* for global fund-raising capability. In other words, whether generally recognized or not, **the call for creating an IFC in Mumbai is a metaphor for (and synonymous with) deregulating, liberalising and globalising, all parts of the Indian financial system at a faster rate than is presently the case. Raising the issue of creating an IFC in Mumbai at this time, suggests that the need for more intensive deregulation and**

Box 2.2: *What Investment Banks do in Global Capital Markets*

Capital markets permit investment bankers to provide users of funds with greater flexibility (in terms of instrumentation, timing and risk management appurtenances) in: (a) accommodating how much money is required and when; (b) what type of security should be sold and to whom, in order to maximize efficiency and minimize costs of fund-raising; (c) what special features such securities might have depending on the credit rating and cash-flow circumstances of the entity concerned; (d) at what price it should be sold and when; and (e) how much the fund raising activity will cost.

To reduce its own uncertainty and risk, a user-of-funds may decide to go in for an underwriting agreement with its investment bank. Under this arrangement, called the *firm commitment*, the investment bank buys the new securities for an agreed price and resells the securities to the public at a mark-up, bearing all of the expenses associated with the sale. Usually, the investment bank becomes a broker-dealer or market-maker in the new security sold. Through underwriting, the issuer (user-of-funds) gets the funds on a guaranteed basis even if the investment bank does not succeed in selling all of the securities issued. Thus, the investment bank takes a calculated risk for a short period. But it can also profit significantly if the issue is greatly desired by investors, allowing the investment bank to charge a higher mark-up and book an immediate profit. Under stable market conditions knowledgeable investment banks are rarely trapped into having to hold underwritten securities for long. But sometimes market conditions can change suddenly in response to an unforeseeable shock. Investment banks can then be caught holding the bag for longer than they wanted thus tying up capital that could be used for other (higher-return) purposes.

Direct responsibilities in an underwriting include registering new securities with the concerned regulator, deciding the offer price, and forming/managing a syndicate to market the new securities. Often the investment bank pegs the price of a new issue by buying in the open market. Successful underwriting is about selecting the right issue, offering it at the right price, and selling it at the right time. The investment bank may have to lower the price of the new issue to below what it paid for it, thereby resulting in a loss. Furthermore, the initial customers who paid a higher price for the new issue will be disappointed that they paid a higher price, and the investment bank may lose these customers in a future offering.

Investment banking is a very competitive business in global capital markets and established IFCs. Every deal forms an input for future business possibilities for the banker both from the issuer and other companies.

Most agreements for the sale of new securities get underwritten. But when the issuer is perceived as risky, the investment bank may use a *best efforts* approach; *i.e.*, it undertakes to do its best to sell all of the new securities, but does not guarantee it. The issuer bears the risk that the investment bank may fail to sell all of the new issue, thereby reducing the amount of money that the company receives. Underwriters make money by selling the new securities at a mark-up from what they paid for it, known as the underwriting discount, or underwriting spread. The underwriting discount is set by bidding and negotiation, but is influenced by the size of the new issue, whether it is equities or bonds, and the perceived difficulty of selling the new issue. More speculative issues require a larger underwriting spread for the increased risk involved.

The liquidity risk taken in an underwriting transaction can be 'laid off' in the risk market using derivatives. Investment banks utilize sophisticated financial economics in quantifying their exposure. They establish a set of exchange-traded and OTC positions in derivatives markets (for credit, interest rate, and currency risks) through which the bulk of their risk is transferred to buyers of risk in the derivatives market. The residual risk is borne by investment banks against equity capital, and is required to earn a high rate of return. Hence, to the extent that risk-markets support laying-off through exposure hedging, the lower is the unhedged component of the risk, and thus the lower is the cost of capital for the unhedged portion.

The total flotation costs of bringing new issues to the capital market also includes legal, accounting, and other costs borne by the issuer in addition to the underwriting discount. Economies of scale result in flotation costs for small issues generally being a larger percentage of the total sale of new securities than for larger issues. They are also greater for equities than for bonds. The underwriting spread may vary from about 1% for investment-grade bonds to almost 25% for the stocks of small unknown companies. As additional compensation, the underwriting firm may get rights to buy additional securities at a specified price (pre-negotiated call options), or receive a membership on the board of directors of the issuing company. The underwriting firm frequently becomes a market maker in the new security, keeping an inventory and providing a firm bid and offer price for the new security to provide a secondary market, so that investors can buy or sell the new securities after primary sale. This ensures liquidity for investors and thus increases the value of the primary offering, since few investors would buy a new security if they couldn't sell it at will.

Sometimes investment banks form syndicates and enlist the help of other investment banks to sell securities. The 'lead' investment bank selects the members of the syndicate and determines how many shares each will get and manages the overall process. In addition, each member of the syndicate, including the originating investment bank may have selling groups, consisting of other investment bankers, dealers, and brokers that may also sell to investors. The main advantage of syndication is that it reduces risk by sharing it among the syndicate members, and each syndicate member and their selling groups have their own customers to whom they can sell the new issues.

liberalization of the financial system has been anticipated by India's policy-makers and regulators and that the IFC is an additional device to accelerate movement in that direction. An IFC will not be created quickly in Mumbai, nor will it

succeed, if action on further deregulation and liberalisation is not taken in real time.

2. Asset management and global portfolio diversification

Asset management is a large and important global industry in its own right. All types of asset managers are responsible for the management of trillions of dollars, euros, pounds and yen invested in a large variety of funds and vehicles. Many of the world's largest financial conglomerates are at least in part asset managers. And the bulk of global asset management (over 65%) is transacted through the world's GFCs. As a approximate estimate, the stock of globally managed assets (including non-financial assets such as real-estate) was believed to be about $125 trillion in 2005, or nearly thrice of world GDP.

At an average cost of asset management of about 1% of assets under management, global revenues from asset management are roughly $1 trillion per year, which makes it one of the world's largest industries given that world GDP is just over $45 trillion. Because of a legacy of financial suppression, India's share of global asset management – in terms of AUM, revenues, efficiency and cost-effectiveness – is infinitesimal and insignificant for an economy that is emerging as one of the world's largest, and that is likely to account for a rapidly increasing share in global portfolios. That situation is clearly unacceptable and needs to be rectified urgently.

Table 2.3 shows the sources of global financial assets under management in three visible categories – pensions, insurance and mutual funds – by end-2004. Assets of the global fund management industry increased for the second year running in 2004 to reach a record $49.4 trillion. This was up 6% on the previous year and 40% on 2002. Pension assets accounted for $18.8 trillion of funds in 2004, with a further $16.2 trillion invested in mutual funds and $14.5 trillion in insurance funds. Merrill Lynch estimates the value of private wealth at $30.8 trillion of which about a third was incorporated in other forms of conventional investment management. The US was the largest source of funds under management in 2004 with 49% of the world total. It was followed by Japan with 11% and the UK with 7.6%. The Asia-Pacific region has shown the strongest growth in recent years.

Box 2.3: *Global Asset Management*

Asset managers of various hues – *i.e.*, mutual funds, open or closed ended investment companies or trusts, public or private pension funds, insurance premium funds, and, increasingly, of highly mobile and flexible hedge and arbitrage funds – look for an array of investment choices at home and overseas, including equities, bonds, property, commodities and cash diversified in terms of geography, or sector of activity. A viable IFC must have the necessary market, institutional and regulatory infrastructure to attract asset management and global portfolio diversification services undertaken by a variety of national, regional and global asset managers. Very often, revenues from asset management are directly linked to market valuations, so in the event of a major fall in asset prices, revenues decline relative to costs.

Asset management includes a combination of front and back office functions. *Front-office* activities include *inter alia*: objective setting for targeted returns, risk and capital preservation, based on the future pay-out obligations of the funds being managed (*e.g.*, pensions); active marketing of funds to potential investors; continuous real-time global research into individual assets and asset classes across all sectors and geographies; in-depth financial analysis; asset selection; plan implementation; buy-sell trading/dealing/transacting; and continuous monitoring of investments to keep pace with domestic and global changes in financial and demographic environments and circumstances. *Back-office* functions (*i.e.*, tracking and recording of all buy/sell transactions, and minute-to-minute fund valuations, for thousands of different clients per institution) usually involve activities such as: payment and settlements for billions of daily transactions; ensuring increasingly complex national and global compliance for a variety of purposes; book-keeping and financial control; trade confirmations; fault correction and dispute resolution; continuous real-time internal auditing; and the preparation of a variety of internal and external reports (by day, week, month, quarter, year) for managers and clients.

3. Personal wealth management

The large and rapidly growing number of wealthy individuals around the world, with a net worth of more than US$ 1 million each, provides substantial opportunities for a wide range of firms and institutions that deliver professional wealth management (private banking) services to this community. High net-worth individuals (HNWIs) are globally mobile (*globile*) with several residences, tax domiciles, as well as revenues and expenditures, accruing in multiple jurisdictions. This activity is estimated to involve the management of trillions of dollars worth of personal assets. Some of it is double-counted in the asset management figures shown in the previous section.

Personal wealth management takes place in established IFCs but is skewed towards specialized IFCs offering special tax exemptions or advantages to non-residents in centres in Switzerland, Luxembourg, Monaco, Lichtenstein and the Channel Islands for the EU and Africa; Atlantic and Caribbean offshore centres for the US and Latin America; Bahrain, Dubai and Mauritius for the Middle East and South Asia, Singapore, Hong Kong and some Pacific Island offshore centres for East/North Asia. Merrill Lynch, Cap Gemini, and Ernst and Young's annual World Wealth Report 2005 estimated that the value of funds managed on behalf of 8.3 million high net worth individuals with over $1 million of investable assets was $30.8 trillion in 2004.

In its annual report Global Wealth 2005, Boston Consulting Group estimated that the total value of assets managed on behalf of all investors totalled $85.3 trillion in 2004. These figures, based on surveys of private bankers are probably understated as they probably do not include full disclosure of all private accounts held by: (a) politically prominent people (especially from developing countries and regions) who are reticent to have their holdings reported or disclosed; or (b) generated from illicit income flows in prohibited (but nevertheless large) industries involving drugs, arms and human trafficking and illegal gambling. Table 2.4 illustrates in broad indicative terms the size of the worldwide international private client market.

Overseas Indians (NRIs) are estimated to hold financial wealth (*i.e.*, apart from real estate, gold, art, *etc.*) of over $500 billion and total wealth of over $1 trillion. They are a natural beachhead as a customer base where an Indian PWM industry can get

Table 2.3: Global assets under management in three visible categories ($bn 2004)

	Pension funds	Insurance assets	Mutual funds	Total
US	11,090	4,968	8,107	24,165
Japan	3,108	2,058	400	5,566
UK	1,464	1,797	493	3,754
France	150	984	1,371	2,505
Germany	104	1,055	296	1,455
Netherlands	630	291	90	1,011
Switzerland	426	258	94	778
Others	1,788	3,064	5,301	10,153
Total	18,760	14,476	16,152	49,388

Source: IFSL estimates, City Business Series, April 2006

Box 2.4: *Private Banking and Personal Wealth Management*

Personal wealth managers (or private bankers) customize investment programs to meet specific client needs and provide an array of related investment services including securities, real-estate, art, jewellery, commodities (*i.e.*, precious metals or in commodities such as oil/gas, base metals *etc.*), vintage wines and collections of antiques, automobiles, stamps, photographs, *etc.*. Wealth management involves:

1. Developing an investment profile through in-depth client consultation in order to establish clear investment goals for income generation and further wealth accrual/protection. These are based on the investment time frame, tolerance for risk, income needs, and specific account circumstances (such as multiple currency account needs).
2. Setting asset allocation parameters: *i.e.*, asset allocation guidelines are set by establishing long-term asset class targets based on return/risk relationship for each client. Asset allocation ranges are set to establish guidelines around the long-term targets designed to add incremental return and control risk.
3. Establishing and managing personalized wealth portfolios: A portfolio is developed that focuses on diversification across and within each asset class to provide the client with attractive risk-adjusted returns. The portfolio is managed on a continual basis while maintaining the quality standards and market diversification necessary to achieve the set goals.
4. The portfolio is continually reviewed and the client kept informed by way of in-depth reporting, internet access, and personalized meetings. Investment goals are periodically reassessed.

In recent decades, the functions of personal wealth management have mutated far beyond a simple notion of managing a liquid financial securities portfolio to a broad array of tailored services for customers. These range from management of real estate to arranging exotic travel services. In these aspects, personal wealth management is a highly labour intensive area; one that requires a large number of man-hours of staff time in order to provide meticulous personalised services to the customer. This suggests that it is an area in India might be naturally competitive.

Table 2.4: Number of wealthy individuals and value of their wealth ($ trillion)

Year	Number in millions	Value of wealth of high net worth individuals	Value of wealth of all investors
1997	5.2	19.1	
1998	5.9	21.6	
1999	7.0	25.5	71.5
2000	7.0	25.5	67.8
2001	7.0	26.0	64.1
2002	7.2	26.7	65.5
2003	7.7	28.8	78.2
2004	8.3	30.8	85.3

Source: Merrill Lynch Cap Gemini and The Boston Consulting Group

started. Their wealth management services are presently sourced almost exclusively abroad.

4. Global transfer pricing

Transfer pricing is a generic term used to describe all aspects of intra-group pricing arrangements between related business entities operating across borders; including: transfers of intellectual property; transfers of tangible goods; service fees, loans and other financing transactions. Intra-group (inter-company) transactions across borders are growing rapidly and becoming more complex. Compliance with the differing requirements of multiple overlapping tax jurisdictions is a complicated, time-consuming task. National revenue authorities (especially in high-tax OECD jurisdictions with increased tax avoidance and evasion) are becoming increasingly sensitive to the ways in which transfer pricing can affect their tax revenues. Governments and revenue authorities are responding by strengthening their legislation and their enforcement capabilities, demanding stricter documentation of transfer pricing practices, and imposing higher penalties for non-compliance. Most countries adhere to the arm's length principle as defined in the OECD Transfer Pricing Guidelines for multinational enterprises and tax administrations.

London is the world's major centre for international legal and tax related services. Globalisation of business and finance has strengthened its position in recent years. The provision of international legal services in London remains the preserve of internationally active law firms.

Transfer pricing is an activity that the Government of India (GoI) looks at askance. Yet it needs to accept that such activity will take place in a global economy dominated by: (a) a growing amount of cross-border trade and investment undertaken increasingly *within* MNCs; (b) the provision of professional global tax management services by global firms of accountants, lawyers and tax advisors present in all major IFCs around the world including tax havens; (c) widely divergent national tax regimes dictated by the revenue and cash-flow needs of particular economies facing entirely different circumstances; and (d) a growing number of mobile HNW entrepreneurs and professionals who, like MNCs, are not wedded to nationality for tax purposes. Collectively they form a vibrant network that is driving the process of globalisation in a variety of sunrise industries – *e.g.*, in IT services, financial services, sports, leisure, hospitality, media and entertainment services industries *etc.*

The OECD as an institutionalized collective is attempting, somewhat ineffectually, to discourage such activity by exerting pressure on developing countries and offshore tax-havens. Yet, oddly, transfer pricing and tax arbitrage are actively encouraged by a number of individual countries that are members of OECD: (i) several states in the USA– *e.g.*, Delaware, Nevada, *etc.*; (ii) a number of European IFCs located in capitals such as London, Amsterdam, Paris and Frankfurt as well as (iii) European havens such as Luxembourg, Lichtenstein, Monaco and Switzerland.

Box 2.5: *Transfer Pricing Services*

Planning transfer pricing strategies, optimising tax exposures, and defending a company's tax position and transfer pricing practices on a global basis, requires knowledge of a complex web of tax laws, regulations, rulings, methods and requirements around the world. Optimisation of transfer pricing also requires an understanding of the capital controls found in some countries. Thus transfer pricing has become a critical element in global tax planning. Global consultants based at IFCs have large teams of economists, tax practitioners and financial analysts who help clients with transfer pricing planning worldwide. A global network of professionals operates throughout the world, supported by the relevant local tax practices. Services provided include:

1. Developing and implementing commercially viable transfer pricing policies.
2. Complying with local revenue requirements and preparing documentation for strong first-line defence against revenue authority audits.
3. Preparing and negotiating appropriate responses to revenue authority challenges, and assessing the risk of revenue authority challenge.
4. Identifying appropriate strategies and approaches to advance pricing agreements, and assisting in preparing these agreements.

An effective global transfer pricing strategy embraces all the cross-border transactions of a MNC. It encompasses not only the pricing of tangible goods, but also transfers of intangible assets (knowledge, royalties), services, or group financing. It incorporates transfer pricing planning, controversy resolution and compliance.

Of course, discriminatory dual tax regimes, created specifically for *non-residents* by tax-havens (in order to attract wealth management and corporate transfer pricing business) raise a complex set of issues insofar as supposedly '*harmful*' tax competition is concerned. Countries like India affected by such regimes might legitimately be concerned about them. But the economic structures of many oil-exporting (OPEC) countries in the Persian Gulf can afford to eschew levying personal income, corporate and excise taxes on nationals and residents. They are sovereign and free to offer the same advantages to non-residents under a non-discriminatory, open-economy regime.

No outside country can afford to argue that a benign low-tax regime for nationals of such a country should not be open to non-residents if the jurisdiction concerned wishes to extend that privilege. To do so would infringe upon the sovereign rights of nations to determine their own fiscal and macroeconomic policies and thus undermine a key pillar of international law. Indian MNCs as well as HNWIs (especially NRIs) are customers of services created by legitimate global tax arbitrage opportunities in countries in the Gulf that are not tax havens. In an environment where adequate support for them is not available in Mumbai, these services are being purchased in Delaware, London, Switzerland, Mauritius, Singapore, Hong Kong, Dubai or elsewhere.

Transfer pricing services require large amounts of skilled labour engaged in providing professional tax, accounting, auditing and consulting services, a high level of labour-force numeracy, and IT support. The provision of transfer pricing services is thus an area that an Indian IFC can excel in.

The HPEC believes that India should permit the development of Indian institutional capacity (in its accounting, legal and business consulting industries) for providing global transfer-pricing services in a Mumbai-based IFC. GoI should adopt the same stance as the US and EU governments whose official and actual positions on this issue seem somewhat contradictory.

India should override external concerns and pressures exerted by OECD that are, in reality, more self-serving (in preserving the competitiveness of their own capitals and IFCs by protecting established market share in this lucrative and growing business) than globally effectual, in addressing the genuine concerns of harmful tax practices, tax competition and revenue leakage.

5. Global tax management and cross-border tax optimization

Related to transfer pricing is the service of global tax management; it deals with international tax treaties and international aspects of domestic income tax laws. Multinational businesses, and individuals with income sources in multiple countries, are increasingly affected by tax, legislative and regulatory developments around the world. Understanding the impact of these developments on business operations and transactions between countries is vital for a company's profitability and survival. MNCs usually employ a battery of international tax specialists to minimise worldwide tax. International taxation is a specialisation among lawyers and accountants; so much so that several universities offer post-graduate programmes in that specialisation.

Box 2.6: *Global Tax Management*

"The world's six biggest accountancy firms are in the top rank in virtually every country in the world, except where they are barred by law. Yet auditing and accounting are intensely local affairs, requiring detailed knowledge of local rules and regulations. Arthur Anderson or Price Waterhouse ought not, to have an advantage over domestic competitors except with multinational clients – which, though large, are almost always a minority. Why, then, have these firms themselves become such successful multinationals? One answer may lie in their ancillary businesses such as consulting, in which they have special skills; another may lie in their ability to buy and organize information technology. But these are not enough to explain such widespread dominance. *Reputation, the power of the brand name, must play the biggest part.* The market for accounting and auditing is an imperfect one: buyers lack the information to tell a good accountant from a bad one, or find it costly to find out, which comes to the same thing. They also seek the accountant's brand name as a means to convince others about their own worth, especially investors and creditors, who are similarly, short of information."

Source: *Multinationals*, a supplement in *The Economist*, March 27, 1993.

Global tax management provides an opportunity for financial, accounting and law firms, to assist MNC clients in constructing effective cross-border strategies, aimed at optimizing their global tax liabilities, while adhering to all applicable laws. Such firms also keep their clients abreast of new developments in the international arena that could affect their business and assist by providing expertise in:

- Tax efficient holding company locations
- Cross-border financing and treasury solutions
- Controlled foreign companies tax planning
- Income tax treaties, profit repatriation, loss utilization
- Inbound and outbound structuring
- Managing intellectual property and intangible assets
- Tax efficient supply chain and shared services; and
- Regional tax issues *e.g.*, EU tax harmonization.

London is a leading international centre for the provision of accounting and related global tax management services. Services that include auditing, taxation, corporate finance and consultancy and are dominated by the big four accounting firms. According to Accountancy Age's 2005 league table, fee income amongst the Top 50 accounting firms rose from £6.3 billion to £7.0 billion. Table 2.5 shows the fee income earned by some of the largest accounting firms in the UK. While there are around 20,000 accounting firms in the UK, the bulk of services provided to larger companies and organizations including cross border and international services are the preserve of a relatively small number of large firms, particularly the Big Four.

6. Global/regional corporate treasury management

IFCs provide the infrastructure necessary for global investment banks to provide international treasury management services for MNCs. These banks provide support systems that enable organizations to: (a) optimize cash management and working capital while earning high returns on surplus liquidity; (b) streamline their receivables using sophisticated information technology to monitor and direct daily cash flows; (c) manage their payables through their supply chain in keeping with the rhythm of their incoming cash flows from customers; and (d) execute transactions electronically across a wide array of currencies, bank account holdings, tradable bills of exchange and letters of credit, as well as temporary investments in treasury bills and corporate money market instruments across a number of national markets.

Broadly, CTM services include depository, collection and disbursement, liquidity and cash management services and export and import related financing services. Most global banks such as Chase, Citicorp, and HSBC offer all of the above services. They have their own cash management systems, often suitably modified to take into account a particular corporation's needs. They use techniques such as netting, exposure management and cash pooling to reduce transac-

Table 2.5: Largest accounting firms in the UK

Firm	Fee income (£million)
PwC LLP	1780.0
Deloitte LLP	1350.0
KPMG LLP	1066.0
Ernst and Young LLP	828.0
Grant Thornton UK LLP	254.3
BDO Stoy Hayward LLP	224.0
Baker Tilly	172.9
Smith and Williamson LLP	127.5
PKF (UK) LLP	113.7

Source: Accountancy Age Top 50, June 2005

Box 2.7: *Corporate Treasury Management services provided by Banks*

Depository services: These include: cash vault services to provide protection and processing capabilities; electronic cash letters to enable scanning and transmitting cheque images and data for deposit into accounts; pre-encoded deposits that provide faster check clearance; returned items solutions to help manage returned items with detailed images; activity reporting to improve efficiency and increase collection rates; zero balance sweep accounts that concentrate funds into one centralized account to use cash resources productively while retaining a centralized disbursing authority and remote deposit solutions to scan checks at the company end and electronically send the images for deposit.

Collection and disbursement services: This involves helping setting up systems to collect funds from customers or other sundry debtors (payers). It also includes flexibility in payment options for international transactions such as cash in advance, open account, letter of credit, or payment on a collection basis. Check image deposit solutions are designed to make check deposits electronically into the business deposit accounts, with both speed and accuracy directly from the company's office; lockbox imaging to view, retrieve and store remittance documents information; automated clearing house to deliver debits and credits on an electronic and automated basis and wire transfers that offer same-day availability.

CTM service providers also enable disbursement of funds to vendors, employees, investors, or other payees. They provide account analysis, itemized information on accounts and balances, account reconcilement with detailed checking account information, outsourcing the printing and distribution of payables and payroll checks, controlled disbursement accounts that provide precise dollar totals of checks that will clear daily so that the business can make accurate funding and investment decisions, disbursement imaging viewing to retrieve and manage check images online, check matching services that protect businesses against check fraud by matching issued checks with those presented for payment on a daily basis.

Liquidity and cash management services: This includes liquid reserve accounts with flexibility to earn a competitive return on investing excess daily cash balances while providing daily investment confirmations and automated repurchases that ensures that bills are paid on time and the excess funds put to good use. Help is provided to link business checking accounts with money market mutual funds, allowing firms to minimize idle cash balances in their checking accounts and maximize the return earned on excess funds invested.

Export and import related services: Exporters are assisted by providing a range of related services that help in hastening the delivery of goods in order to expedite receipt of payment, manage liquidity by ensuring that payment is received within the agreed time period, ensure that the payment is correct and settlement is directed to the bank where a depository account is maintained. Export licenses vary from country to country and stringent conditions usually apply to products related to natural resources, national security, safety or health. Export services help in adapting products for exports to meet such conditions, provide assistance with freight forwarding and insurance against loss, damage and delay in transit since international shipment coverage is significantly different from domestic coverage.

tions costs, manage risks and make effective use of available funds. Major money markets in London, New York and Zurich offer a wide variety of highly liquid short-term instruments so that firms practically hold no idle cash. CTM providers in turn set up money management systems that allow client organizations to borrow from their open lines of credit and repay commercial lines of credit automatically without manual intervention.

In recent years, banks have created enormously sophisticated Internet-based offerings where the services of the bank take over, on an outsourcing basis, many functions of handling an upstream or downstream vendor network of a firm. This involves a complex blend of payments services and Internet technology. Indian financial firms could excel in this area, given India's strengths in computer technology, and the ability to run low cost call centres in India.

7. Global and regional risk management and insurance/re-insurance operations

Historically, a corporate treasury's involvement with risk management has focused on asset-liability management and on identifying and hedging financial exposures to currency and interest rate risks. The company treasurer's classical responsibilities were to: establish policies for financial risk management, execute related practices, and track and report on results.

Today, however, risk management is concerned with an increasingly broad range of risks, financial and operational. Risks such as: liquidity risk, counterparty risk, operational (including employee) risk, and country risk, confront all corporate contenders in today's complex and volatile global environment. They have

Table 2.6: Largest insurance markets

Country	Total ($bn)	% share of world
US	1,098	34
Japan	492	15
UK	295	9
France	195	6
Germany	191	6
Italy	129	4
Canada	79	2
Others	765	24
World	3,244	100

Source: Swiss Re

become important considerations in overall corporate risk management.

Risk management has become so important that individual financial institutions invest an average of $10 million annually in risk management technology. Many of the largest institutions have invested hundreds of millions of dollars. Independent risk management consultants collaborate with corporations to identify their business-specific needs and design integrated solutions delivered through a seamless distribution network to meet marketplace challenges.

This involves employing highly sophisticated exchange traded and tailored derivatives (futures, options, swaps, swaptions, caps and collars) as well as world class derivatives exchanges networking together for trading a wide variety of global contracts. It also involves providing insurance and reinsurance related services.

Table 2.6 shows the fees earned by the largest insurance markets in the world. The US insurance industry is the largest followed by Japan and the UK. It consists of groups and companies such as Lloyd's, underwriters, brokers and intermediaries and their clients. The London market is the world's leading market for internationally traded insurance and reinsurance.

8. Global/Regional exchange trading of securities, commodities and derivatives in financial instruments and indices in commodities

Capital (and derivatives) markets have a crucial role to play in enabling enterprise, innovation and growth at national, regional and global levels. Financial markets, especially equity markets, have grown dramatically in developed and developing countries over the last two decades. Sovereign and corporate bond markets of interest to global investors have grown rapidly since 1987 in the emerging countries of Latin America and Europe.[1] But that has not been the case in Asia or Africa. Derivatives markets have grown explosively and become extremely deep and liquid in OECD capital markets but remain nascent in most emerging markets.

In Europe, capital markets have become increasingly *regionalised*. Globalisation has resulted in: substantially increased cross-border capital flows, tighter links among financial markets, and greater commercial presence of foreign financial firms around the world. Indeed, one feature of London, as perhaps the best-connected GFC in the world, is the extent of foreign involvement and ownership of financial firms, exchanges and markets (as well as the employment of large numbers of foreigners) in the City. Up to the 1970s, British investment and merchant banks played a prominent role in offering IFS to global clients. But in 2005 there was no independent British-owned global investment bank left standing. They had all been taken over by, or had merged with, other global firms. IFS in the City

[1] This was due largely to the global trading of Brady bonds (deep discount, low-coupon, and face value protected) issued in 1987–90 as a means for converting the bank debt of highly indebted Latin American and European countries in crises into market tradable debt. That mechanism enabled country risk to be spread more widely across a global institutional and individual investor base; rather than being concentrated in a few banks, thus endangering the stability of the global banking system. Brady bonds were credited with not just developing bond markets in these two regions but with bringing an end to a developing country debt crisis that had been prolonged unnecessarily, and at great expense to debtors and creditors alike, throughout the 'lost decade' of the 1980s. Such bond markets were instrumental in dealing more expeditiously with smaller debt crises that occurred in other emerging markets through the 1990s. Had such markets existed in Asia during the Asian debt crisis of 1997–99, it is arguable that Asia might have escaped the worst effects without recourse to the IMF, and with much lower overall economic costs being incurred, especially by Indonesia, and without the unnecessary spread of contagion into the secure markets of Singapore and Hong Kong.

of London are now offered by a plethora of multinational, American, Japanese and European investment banks along with a few from emerging markets. Yet, contrary to popular belief that the success of an IFC is characterised by the strong presence of indigenous financial firms, London has thrived and grown as an IFC rather than suffered any loss of influence as a result of foreign presence.

This is an important lesson for Indian policy-makers and regulators to imbibe: *i.e.*, the success of an IFC and the revenues a country derives from IFS exports should not be confused with reserving space and ensuring gains for indigenous firms alone. An IFC succeeds because it is *international* in every sense of that word. What makes an IFC *international* is the multinational origin of players operating in it. An IFC in Mumbai dominated by Indian financial firms, or reserved for them, would not be as successful as an IFC that embraced all the global players that already operate in the world's other GFCs and IFCs .

A key feature of financial globalisation has been the migration of stock exchange activities abroad, particularly in from European and emerging markets. There is now an increasing tendency toward multiple listings of financial securities, and of derivative/commodity contracts, on different exchanges with emerging investor demand for 24×7×365 trading of all listed securities across all exchanges. Many firms, from the EU and emerging markets, now cross-list their shares on international exchanges in the form of ADRs and GDRs. For example, the shares of HSBC are listed and traded in Hong Kong, London and New York; they should perhaps be listed and traded in Mumbai and Shanghai as well. By the same token the shares of several Indian multinational companies and transnational financial firms, public and private, are traded in New York (ADRs) and Luxembourg (GDRs).

Remote access to trading systems is ubiquitous, implying that the services offered by stock exchanges can now be accessed from anywhere, including firms having their stocks traded on international exchanges while still being accessible to local investors. Given the network properties of stock exchanges, high liquidity further increases the value of additional transactions at exchanges such as New York or London, leading to even greater concentration of order flow and increased liquidity at these exchanges. As a natural extension of these tendencies the first steps were taken in 2006 to cross-link ownership and management of corporate exchanges in the US and EU through take-over bids such as those launched by Nasdaq and the Deutsche Bourse for the London Stock Exchange. In response the LSE has developed closer partnership arrangements with the Tokyo stock exchange.

Even more recently, in September 2006, a group of global investment banks announced their intention of collaborating to establish a global corporate exchange that would provide a more efficient, less expensive global securities trading platform to compete with established exchanges. Those types of developments will undoubtedly spread world-wide with capital market exchange platforms being globally owned and operating on universal standards of accepted best practice to meet the needs of global investors. It is unlikely that Indian exchanges will remain exempt from such trends for too long.

Table 2.7 shows the growth of the global futures and options market, in units of a million contracts that is used internationally. India performs well in equity indexes and individual equity derivatives. But India lacks interest rate or currency contracts; both of which have now become integral features in the emergence of viable bond markets. London is the biggest market in the world for derivatives traded over-the-counter, and the second largest for exchange-traded futures and options; both of whose turnover has doubled in recent years.

Mumbai is better placed to develop these particular capacities more quickly than other emergent IFCs owing to the presence of strong exchange institutions, highly efficient and cost-effective computerized and fully automated trading platforms, rapid real-time gross settlements and delivery. At the same time, the present situation is daunting, with a huge gap between

Table 2.7: Global futures and options volume by sector (million contracts)

	Jan–Jun 2005	Jan–Jun 2006	Percentage change
Equity indices	1780	2252	26.5
Interest rate	1320	1637	24.0
Individual equity	1139	1463	28.5
Agriculture	164	205	25.3
Energy	131	172	31.2
Currency	75	116	55.0
Non-precious metals	24	41	70.9
Precious metals	24	41	70.9
Total	4681	5944	27.0

Source: Futures industry magazine

Box 2.8: *Is India's National Stock Exchange (NSE) a globally competitive derivatives trading exchange?*

When thinking of an NSE-traded USD/GBP currency futures that competes against other exchanges, such as the USD/GBP futures that are available at the Chicago Mercantile Exchange (CME), there are two components of the total cost as seen by a customer. The first is the direct charges paid to the the government, the exchange and the broker. The second is the 'impact cost' when placing an order. The latter depends on the diversity and sophistication of the participants who trade on the NSE. The former is directly influenced by policies. In order to compare charges other than impact cost, we compare NSE against e-CBOT, the CBOT electronic platform and the CME Globex electronic platform.

The tariffs at NSE is made up of the following components. There is a 0.2 basis point charge by NSE; a 0.01 basis point charge for an 'Investor Protection Fund', there is a stamp duty of 0.2 basis points, there is a service tax which is 12.24% of the brokerage fee and there is the securities transaction tax which is 1.7 basis points on sales only. External levies work out to roughly 2 basis points while the NSE charge works out to a tenth of this.

These are enormous numbers when compared with the CBOT. The tariff at CBOT is $0.11 to $0.16 per contract (summing across the exchange fee and the clearing fee). It is a per contract charge, which does not vary with the value of the transaction. CBOT does not suffer from payments to an 'Investor Protection Fund', stamp duty, service tax on brokerage and securities transaction tax. At CME, the charge for equity products is $0.35 per contract. In addition, CME has a provision where the payments associated with all proprietary transactions originating from one clearing firm are capped at $50 per day for futures plus $200 a day for options. Thus, for a proprietary trading firm, a payment of $250 per day gives unlimited trading services for futures and options.

For comparability, the specific transaction that we focus is 8.29 Nifty contracts, which have the same notional value as one S&P e-mini contract. We assume that the 'unlimited trading services' provisions do not come into play. In both cases, on 8 November 2006, the notional value of the transaction was Rs.3,77,730 or $69,575. We measure the total round-trip transactions costs faced under three cases: (1) Proprietary trading by a securities firm, where there is no brokerage; (2) A retail customer of a brokerage firm (assumed 4 basis point charge, ad valorem, in India, but $3 per contract in the US) and (3) A high-volume customer of a brokerage firm (assumed 1 basis point, ad valorem, charge in India, but $0.05 per contract in the US). The round-trip charges are reported in rupees.

	NSE	CME
Retail customer	3343.52	374.40
High-volume customer	1235.07	108.90
Proprietary	788.98	31.05

This table shows a huge gap in competitiveness faced in doing IFS in India. The service which can be bought by a high-volume customer in Chicago for Rs. 31 is being sold in India for Rs. 788.98. It shows that NSE is the costlier venue by a factor of 9 times, 11 times or 25 times, depending on the choice of perspective: a retail customer, a high-volume customer or proprietary trading by the securities firm. This is a particularly unusual situation because the charges imposed by NSE itself, or by the brokerage firm itself, make up a very small part of the overall costs paid by the customer. The overwhelming contribution to the costs as seen by the customer is from the external levies – securities transaction tax, stamp duty, contribution to investor protection fund and service tax on brokerage.

Source: Calculations made by Nathan Corson and Raghvendra Kedia at the request of the HPEC. The full spreadsheet with their calculations can be accessed on the MIFC web page.

Table 2.8: OTC derivatives turnover (average daily turnover in April $bn)

	1998	2001	2004
UK	171	275	643
US	91	135	355
France	46	67	154
Germany	34	97	46
Italy	5	24	41
Belgium	42	22	39
Netherlands	6	14	32
Others	79	130	198
Total	474	764	1,508

Source: Bank of international settlements

Indian prices and world prices (see Box 2.8). Significant policy reforms will be necessary in order to translate India's latent strengths in this regard into global competitiveness.

9. Financial engineering and architecture for large complex projects

Large projects (over US$ 1 billion or more) in energy and infrastructure now require blocks of wholesale funding sourced from national and global capital markets, export credit agencies and banks. Often these funds have to be raised with complex risk-management instruments attached. Investment banks situated in IFCs are best suited for putting together the funding and the risk management of such projects in place.

A decade ago, funding of such projects was mostly done using convertibles, cum-warrant bonds, credit-linked notes and forex-linked bonds. Today, while these products still exist, more complex products, including a whole range of CDOs (CBOs as well as CLOs), exchangeables and reverse convertibles as well as a huge number of certificates linked to all kinds of underlyings such as indices, baskets, securities, funds and hedge funds are available. A large proportion of risk management for these projects is done using global OTC derivatives. A range of innovative products are developed for clients and governments around the world. Table 2.8 shows the average daily turnover of OTC derivatives.

10. Cross-border mergers and acquisitions (M&A)

Global corporate deal-making (whether in the form of voluntary or hostile M&A, or divestiture, disinvestment, unbundling, privatization *etc.*) has become an important activity as organizations expand and diversify across the world. Global M&A advisors provide cross-border support and opportunities for clients who wish to complete acquisitions, company sales, buy-outs and buy-ins, fund raising and other corporate finance transactions. The objective is to obtain the best combination of price, form of consideration, deal structure, and compatible purchaser within a targeted timescale.

Comprehensive research, involving cooperation and expertise of relevant partners is used to generate an agreed list of recommended buyers with most to gain from acquiring the business. By creating a competitive bidding situation and actively managing the sale process through to legal completion, the advisor delivers the best possible deal, structured for maximum tax effectiveness, whilst maintaining strict confidentiality throughout.

In the global M&A arena, India was ranked second last in terms of dollar value of M&A in a recent ranking by Bloomberg. But, what is important in the data for regional breakdowns by target countries is that, with a 175% volume change, India's M&A growth is blazing enough to take the country to the third slot, next only to France and Hong Kong, each of which have achieved more than 200% growth. Latin America and Canada are at distant fourth and fifth places, with 108% and 106% increase, respectively. Clearly global M&A is an activity that will become increasingly important in India and for which a considerable amount of back-office BPO/KPO and due diligence research work is already outsourced to India.

11. Financing for public-private partnerships (PPP)

This relatively new activity has emerged on scene with considerable force since the development of the London Underground

Box 2.9: *Services provided by global M&A advisors*

Takeovers and acquisitions: Global M&A advisors collaborate actively to create attractive acquisition opportunities, by carrying out an exclusive search, to a brief agreed with the client, for relevant 'best-fit' targets in designated territories. Through dedicated research and extensive local and international contacts, they produce a recommended list of attractive businesses. Once the client agrees upon the target companies, the advisors initiate discussions with prospective vendors. They also provide assistance in obtaining additional information, value the target and then recommend the most suitable way to structure a deal. Then, in conjunction with the client, they negotiate terms, draft the letter of intent and manage the transaction safely to legal completion.

Fund raising, venture capital and restructuring: For clients wishing to raise development or venture capital, or refinance or restructure the balance sheet of an existing business, global M&A advisors assist in raising and negotiating the necessary mix of funding. This could cover the areas of equity, mezzanine, senior debt, working capital facilities and asset financing. The clients business is presented in the most favourable light to an agreed list of senior decision-makers, within relevant financial institutions, drawn from the advisors extensive list of contacts. By obtaining competing offers, the most attractive terms are sought to be made available. They also assist over-leveraged companies in working out new financing arrangements with their creditors including the raising of new capital and/or the sale of assets.

IPOs*, stock market flotations and 'take-privates'*: For unlisted companies with an established trading record, a flotation on a suitable stock market may be a sensible strategic step forward. The global mergers and acquisitions advisors evaluate the suitability of the business for a stock market flotation or initial public offering (IPO) and recommend a programme of preparatory work, before approaching an agreed short list of potential sponsors or investors directly. They then help the company to select the most relevant brokers, lawyers and other members of the advisory team to make the flotation a success. In case it is felt that the continued growth of a public company is best ensured by taking the company off the stock market into private hands, the advisors seek out the best financing partner and assist in all aspects of the public to private transaction.

MBOs*,* MBIs*, private equity transactions*: M&A advisors assist companies to raise private equity funding on the best available terms for a management buy-out (MBO) or buy-in (MBI). MBOs and MBIs are technically complicated, time-consuming and often risky for management teams. These advisors help protect management from risk and introduce them to relevant financial institutions to raise the finance required. They work with the management team to produce a business plan, which sells the investment opportunity and guides them through the minefield of issues which they will inevitably face. They also negotiate with financial institutions to achieve the best possible equity deal for the management team and negotiate the purchase of the business on the most favourable terms available. Partners of these firms have regular personal contact with the leading private equity investors and providers of debt finance.

Box 2.10: *Why has the UK been so successful with PPPs?*

The UK Government took a hard look at its problems with public procurement and public service delivery during the 1980s and was not at all satisfied. Cost and time overruns were common in major projects with conflict between contractors and the public sector sponsor a major cause of poor performance. Buildings in the education, health and other public service sectors were also poorly maintained, which inevitably affected the quality of services provided. Yet, elsewhere in the UK, such as in the offshore oil and gas sector, examples of what could be done by removing the conflict between project sponsor and contractor were providing some startling results in the cost, delivery and ongoing maintenance throughout the life of the project. In other words doing things differently at the start could favourably affect the whole life costs of the project.

In both the public and private sector, attitudes had been influenced by a decade of expertise developed in the UK's programme of privatization of large-scale infrastructure such as power, water and transportation. That programme demonstrated that bringing together private sector skills with better informed public sector procurement delivers better services for the public.

A key principle is to allocate the risks in the project such that each sector takes responsibility for those risks it is best able to manage. The principal driver for the UK Government is to achieve best value for money for the taxpayer. The best value for money normally comes when the private sector manages the risks of financing, design, build and delivery of the service facility. There is no payment until the facility is delivered and fully operational. Maintaining the facility at constant or improved standards over the life of the project (normally around 25 years) is also the contractor's responsibility. There are agreed service levels and financial penalties if the contractor fails to deliver these standards.

Two important factors became clear at an early stage of this new process. The first was that putting private sector capital at risk, not just its profit, creates a powerful incentive for the private sector to build the assets on time, maintain and deliver high standards throughout the contract life. The second was that if the private sector money was to be attracted and take on the attendant risks, the Government needed to show a strong commitment to the process of PPP, give clear indications on project priorities and demonstrate a 'deal flow' of projects.

To assist confidence levels in both the private and public sectors the UK Government recognized the need for a systematic and 'top down' driven approach to generate momentum in PPP projects. One of the contributory factors to the UK success was setting up of a high level task force in 1997, comprising experts from both public and private sectors, to look at critical issues, and focus on driving through projects. It was also to act as an important repository of knowledge for the public sector.

Another key to success has been the full involvement of Local Authorities through the agency known as the Public Private Partnerships Programme (or 4Ps for short). The agency provides practical support and guidance to all local authorities in England and Wales to enable them to improve their procurement capability, particularly for large projects, through partnership structures. Having worked with 200 local authorities to date, 4Ps is recognized as an unrivalled source of best practice and practical guidance on project procurement.

(LU) PPP. Expert consultants, who help in putting together a PPP deal, provide legal, accounting, consulting and other business support services to the public and private parties co-operating under PPPs, providing comprehensive support from the beginning

to the end of a transaction. The consultant advises on the most appropriate way to develop and structure PPP projects and drafts all necessary documents to implement the structure, keeping in mind the needs of potential financing parties. Typically they provide value to restructurings and renegotiation throughout the lifespan of projects. This would include:

- Advising governments on best practices for engaging the private sector in traditional government monopoly sectors.
- The creation of regulations for sector-based or multi sector-based authorities, whose function is to oversee the development of the competition in the private sector, the economic policies defined by the public authorities, and the security standards and quality of service.
- Drafting:
  - Tender notices and invitation letters by which the private contractors submit their tenders
  - Constituent documents for project companies
  - Agreements, including concessions and licenses, between the public and private parties
- Designing alternative financial/legal structures
- Assisting in every aspect of the PPP operation
- Financing models and project documents

Public private partnerships (PPP) have been more widely developed in the UK and the EU than elsewhere. In the UK, new facilities for schools, hospitals, prisons and roads financed through PPPs have delivered substantial benefits. In India, which is short of fiscal headroom for financing urgently needed infrastructure, PPPs offer the obvious vehicle for expanding its physical and social infrastructure rapidly. However, going beyond India, there is a substantial PPP-related IFC market worldwide. The skills required in this business are available in India. Hence, it offers a major business opportunity for Mumbai as an IFC.