

Finance, Management and Development A Vision for the IFMR Business School

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More than a year ago the governing Board of the IFMR¹ Business School constituted a sub-committee of the Academic Affairs Committee (hereafter the Committee) for reviewing the IFMR Business School and its MBA Programmes and coming up with a vision for their future. The Committee was chaired by me with Mr. Narayan Sethuram (IFMR Business School Board Member and Chennai based industrialist); Professor G. Balasubramanian (IFMR Business School); Professor Sankar De (Indian School of Business, Hyderabad); Professor Shyam Sunder (School of Management, Yale University); Dr. Nachiket Mor (IFMR Business School Board Member and President, ICICI Foundation), and Professor Bobby Srinivasan (President, IFMR Business School) (ex officio), as the other members. The Board wanted the review be completed ahead of the construction of the proposed new IFMR Business School campus at Mahindra World City. It felt that it would be useful to take stock of the functioning the various research centres, laboratories and innovative product development units that had been set up a few years earlier on a somewhat ad hoc basis, each with its own structure and relationship with the rest of the IFMR Business School including the MBA Programmes and try to articulate a more formal structure in which the IFMR Business School as an institute with several constituent units that would function

¹ The IFMR eco-system comprises the IFMR Business School – a research and teaching focused academic institution comprising seven research centres and a growing MBA and Ph.D. programme and the IFMR Trust – an independently managed but kindred non-profit action-research cum advocacy organization that is focused on the universalisation of financial access in India.

in cooperation with each other and would individually and severally in pursuit of a common vision.

After extensive consultation within and outside the IFMR Business School and its stakeholders the Committee came with its vision for the IFMR Business School and its MBA Programmes and a proposal to offer an integrated MBA programme in place of the current three part structure of the MBA Programme. This programme would have few parallels in the world in its integration of development, finance and management, and perhaps be unique in this respect. With its focus on financial management and research, the IFMR Business School is located in a dynamic developing and emerging economy and has a proven record of research on finance and development. It is ideally suited to offer such an innovative program. What follows is the rationale for the Committee's vision for the IFMR Business School and the proposed MBA Programme, written by me to include the deliberations of the Committee and expressed views of its members.

Considered alone, development, finance and management is each a vast field, albeit with substantial overlaps among them. The academic rationale for the new vision of the IFMR Business School is that it has a potential comparative advantage that could make it into a globally leading institution in exploiting the overlap. IFMR Business School's MBA Programme is focused on management; its Centre for Advanced Financial Studies (CAFS) on advanced financial tools and engineering; its Centre for Development Finance (CDF) on financial aspects of development; its Centre for Micro Finance (CMF) on micro-finance dimension of finance as well as development; its Small Enterprise Finance Centre (SEFC) focusing on financial access to small enterprises which in many parts of the world are engines of innovation, new employment and growth; its Centre for

Insurance and Risk Management (CIRM) on specialised insurance areas such as rainfall and health; and its Centre for Innovative Financial Design (CIFD) on new financial product development exploring the linkages between finance and the behaviours of individuals. Together, they cover the research, teaching and training aspects of the overlap. This understanding led the Committee to suggest that if the IFMR Business School develops the research, teaching and outreach programmes of its constituent units, and recruits teaching and research faculty, sets performance criteria etc. that go with the vision on exploiting the overlap, its potential comparative advantage would be realized.

Let me illustrate the overlap by means of an example which has relevance from a historical and contemporary perspective, namely, the central role of finance and management in development. At the early stages of economic development, agriculture and related activities employ almost all the resources and provide work and livelihood for the entire population. Even today the dominance of agriculture in India and South Asia is evident. The dominant asset and non-labour factor of production, historically for millennia until the emergence of large scale manufacturing and industry, was land. Agriculture, broadly defined to include animal husbandry, with land and labour as primary inputs was the production activity around which all other services, trade, arts and petty manufacturing were organized at early stages of development, if not always. Economy was the idealized self-sufficient village community or small areas reachable with the relatively primitive transport and communications technologies.

Two features of agriculture illustrate the significance of finance, credit and management in development. First, the inputs and their allocation—of land across various crops and of labour across land preparation, irrigation and application of

fertilizers prior to sowing—must be committed at the beginning of the crop cycle. The farmer has very limited flexibility to adjust the allocations during the crop cycle in response to weather and demand shocks. Other inputs such as fertilizer, labour for irrigation and weeding, etc., can be adjusted to realized shocks. Second, while most inputs are committed during the crop cycle, the output being subject to additional weather shocks is not known until the harvest is processed and securely stored. Further, the value of the output depends on post-harvest spot prices. Since at best only the joint probability distribution of shocks, prices, etc., and not their actual realizations can be known, the environment of agricultural production is highly uncertain.

The uncertainty and risk of committing land and other inputs in advance of realization of value generates demand for credit to finance inputs and to sustain the farmer's consumption during the crop cycle. The length of this cycle varies from a few months for seasonal crops to a year or more for annual and tree crops. Moreover in areas where there is ample rainfall or assured irrigation more than one crop can be raised on the same plot of land. This allows the possibility that the loss of crop in one season could be offset by a bountiful crop in the next. Indeed, in parts of India where Kharif crops could be lost because of floods, the retained moisture and silt from floods could enable more extensive cultivation and higher yields of crops in the following Rabi season. Thus the agricultural risk—ex ante and realized—could change from year to year due to natural disasters of floods and droughts.

Historically, in addition to credit, risk taking, and risk sharing arrangements have evolved, first in agriculture and then elsewhere as development proceeded, eventually to a specialized and complex financial sector. On the supply side, only those who had

enough accumulated resources, social and legal instruments for collecting the principal and interest, and a capacity and taste to bear the default risk, could extend credit. It is no surprise that only landlords with large landholdings and traders in agricultural inputs and outputs had the capacity, desire and ability in adequate combinations to become large players in providing credit. And the demand for credit arose not only for financing the crop cycle but also for covering households in general for variations in cash flows subject to health shocks, demographic events (e.g. births and deaths), social and religious expenditures (marriages, funerals) whose timing and costs are uncertain. Credit is necessary for household consumption smoothing, i.e., to shield their consumption stream from large variations in their income stream. The virtual absence of means of insurance against various risks across families or communities meant that credit was a joint mechanism for inter-temporal resource allocation through borrowing and lending as well as means of insurance against risks. Serving two related but different objectives through the single instrument of credit forced inevitable compromises in the service of each. In other words, a single instrument will almost never achieve two objectives as well as two instruments—one for each objective—could.

Various forms of tenancy developed early on such as share-cropping, fixed produce rent, fixed cash rent to provide a range of arrangements for risk-sharing, each with its own risk and expected return patterns for the landlord and tenant. The attractiveness of each arrangement to individual landlords and potential tenants depended in large part on the sources of risk and covariations (in physical yields per hectare, in spot price per unit of output at harvest, cost and capacity to store harvested output to gain flexibility in the time of its sale, and so on) and the capacity to bear risk and risk

preferences. The fact that a landlord (or trader) is often a provider of credit to his/her tenant meant that the landlord and tenant have a bilateral relation with respect to land and credit (whose supplier is the landlord and the tenant is the demander), and labour (whose supplier is the tenant and demander is the landlord). Such simultaneity of bilateral relations across three markets (land, labour and credit) might confer more market power on one of the two parties (usually the landlord or trader) relative to independent pairing in the three markets.

In the case of a trader (who is the supplier of credit, agricultural inputs and marketing service for output) and his agriculturist (who is demander of credit and inputs and supplier of outputs) the situation is analogous. In addition to making a portfolio choice of allocating her land among crops, the cultivator also decides on inputs (e.g., when and how much fertilizer to use), allocates her and her family's labour between self-employment on her land and supplying it to others, and chooses when and how much to sell her harvests of different crops net of her family consumption, etc. Responsibility for making these decisions makes her a manager of resources. Thus finance and management have been core functions in agriculture at all stages of development, increasing in complexity and specialization as development proceeded².

The post Second World War literature on development was devoted to the analysis of the efficiency and distributional implications of alternative credit, insurance, marketing and other arrangements. While these arrangements may have originated in the historical past in what were then called "underdeveloped" countries, they remain present,

² The lesson from the economic history from the days of the Industrial Revolution and technological advances of the late 18th and 19th centuries is one of a shift away from agriculture and other lower productivity activities to initially labour intensive manufacturing and subsequently to other industries and services. Sadly India has ignored this lesson of economic history in its choice of development strategy.

if not endemic, in contemporary developing countries. The sophistication of the tools of analysis increased in step with their development in economic theory and econometrics.

It is no accident that historically the interest rate on finance or credit has been the target of attention of religious, literary and secular analysts. Apart from the Islamic prohibition of the charging of interest on loans, fulminations against “usurious” interest rates and characterization of money lenders as heartless “usurers” with no compassion for adverse shocks experienced by borrowers are ubiquitous in almost all religions. A very early attempt to regulate interest rates is seen in Kautilya’s Arthasāstrā (commonly dated as a work of 4th century BCE). Kautilya’s sophisticated understanding of the link between interest rate and risk (regulated interest rate steeply rising from a ‘risk free’ 1.5% per month as the transactions financed become riskier and riskier and of legal aspects of liabilities for repayment) in loan transactions in Arthāsastrā is nothing short of remarkable, leaving aside the privileges to Brahmins and higher castes in rewards and punishments. Appendix I contains an extract from Arthāsastrā on interest rate regulations. In fact the sophisticated understanding of Kautilya of many aspects of economics and finance including the role of the state (i.e., the King) for provision of irrigation through construction of dams, standardization, weights and measures, preparation of budgets and audits with a clear understanding of income and expenditures, the possibility of corruption by public servants and incentive aspects of payment of adequate salaries for them, import and export taxes, etc., is truly amazing. Appendix II contains brief excerpts from R.P. Kangle’s (1972) translation that include, (i) Pages 90-98 on accounts, audit and definitions of revenues and expenditures, (ii) Pages 98-103 on administrative corruption,

(iii) Pages 145-148 on Trade, (iv) pages 162-165 on Customs duties and tolls and (v) finally pages 350-351 on salaries of civil servants.

It is widely believed that the state described by Kautilya is a police state or at least a high centralized state. While there is some evidence in support of such a view, Kangle provides a much more nuanced view that it was a bureaucratic welfare state. Kautilya lists at least twenty departments! Indeed, one can claim that India has been a bureaucratic state for millennia, whether under Mauryas whom Kautilya helped to gain power, Mughals, the British or since independence, though the efficiency of the bureaucracy is another matter altogether. Appendix III contains Kangle's analysis of Kautilya's conception of the state.

In contemporary developed countries, agriculture has only a very small share in GDP and employment compared to larger share in GDP (and much large share in employment) in India and other South Asian countries. Indeed the primary challenge of development in India and South Asia is to shift the currently unsustainable levels of population and labour force engaged in low productivity agricultural and other primary activities largely in rural areas to higher and rising productivity activities outside of agriculture and rural areas. The crucial role played by finance and management in the economic history of developed countries in meeting the development challenge successfully is well understood. The IFMR Business School focused on finance and management should concentrate on this role in the Committee's view.

All governments, of developed and developing countries, intervene in the agricultural sector, usually at a significant cost to the treasury, which few developing countries can sustain indefinitely. In addition to interventions in agriculture, developing

country governments play a greater role in many areas of the economy, ostensibly to accelerate growth, promote industrialization and social welfare, and reduce poverty, etc. Public policy interventions in the financial sector alone ranging from customary prudential regulations to government ownership of commercial banks are many. The fact that segments crucial to development such as poor households, small enterprises, exporters, and innovators are not adequately served by the current system of finance is well recognized. The IFMR Business School should, as it is doing already, identify the finance needs of each segment and its relative contribution to development. Its research, both in-house and in collaboration with others, will serve to develop theoretical and empirical tools of analysis specific to alternative contexts, and undertake needed data collection based on appropriate surveys, etc.

The central role of management in development and finance is obvious and needs no elaboration. Briefly, at the core, the tasks of development are basically two: first, to enable the economy to accumulate from domestic and external sources the inputs (capital, labour of various skills, stock of knowledge/technology) at appropriate rates and, second, to raise and sustain the growth in productivity of inputs measured in terms of total factor productivity. Well-managed enterprises in all sectors of the economy will be in a position to access their needed resources at lower costs, and will allocate the resources productively. Well managed financial enterprises and the system as a whole with appropriate regulatory agencies monitoring them and laying down policy guidelines will provide the financial infrastructure for households to save and invest, to insure against shocks faced by them and provide for their retirement, and for enterprises to grow, raise resources from equity and bond markets and serve the economy. The centres and

laboratories are already doing imaginative work through research, innovative product development and testing, experimentation with alternative interventions and evaluating them. All the Review Committee did was to articulate a vision for the IFMR Business School that provides a focus and coherence to the activities of its constituent units.

The proposed two year integrated MBA Programme on Finance, Management and Development would be designed by the Core Group. I would expect the first year to be devoted to teaching the basic courses in theories and analytical tools in each of development, finance and management. Courses in relevant economic theory, including game theory (though my personal prejudice is that common knowledge based non-cooperative game and bargaining theories as they are taught in most schools are of limited practical relevance), micro and macro and trade theories, optimization techniques, econometrics, would have to be designed. These would be the required courses for all students.

Second year is the year for courses in fields of specialization, as well as seminars, individual projects and so on.

The difficult task is of designing individual courses, their sequencing and combinations that would provide both core analytical tools and also cultivate the ability to think independently in response to circumstances as they emerge. Drawing on the courses on experience of policy schools at Harvard, Michigan and other leading US universities, and from Europe would be of help. But we should avoid uncritical imitation - it may be the best form of flattery but not much else -- we should adapt and innovate and surely not imitate.