FINANCIAL LITERACY

Indispensable asset

Warning Indian corporates, especially banks, about the risks of derivatives, K.C. Chakrabarty, chairman and managing director, Punjab National Bank, describes financial derivatives as "weapons of mass destruction", if improperly used. Derivatives are useful tools, mainly in a low-volatility environment, but they should not be used for hedging, says Chakrabarty, who delivered the inaugural address at a one-day seminar on *Derivatives demystified* in Bangalore last fortnight.

The seminar, organised by credit rating agency Brickwork Ratings India, focussed on how the misuse of derivatives resulted in disasters for both financial and non-financial companies the world over and India in particular. "Financial literacy is our mission," explains Vivek Kulkarni, managing director, Brickwork; "especially, in the context of the huge losses incurred by Indian corporates on account of currency derivatives." Kulkarni, who is also a professor at the Indian Institute of Science, Bangalore, adds that this is not expert knowledge but "just enough for the common man to protect himself and make informed decisions".

SORAB MEHTA

Derivatives should not be used for hedging, warns Chakrabarty

The seminar broadly focussed on three sections. The first part took a closer look at how the Indian corporate sector, including large as well as small and medium enterprises, has been using derivatives in risk management. The second was based on how the commercial banks and investment banks have made substantial forays into derivatives. The final section dealt with the recognition, measurement and presentation of accounts of corporates due to risk management factors and contingent liabilities.

While banking professionals were urged to adopt a holistic approach, some of the main areas of discussion were on maintaining a balance between risk-taking and risk management, the role of rating agencies, quality of credit and the benefits of moderate regulation. The importance of risk management as a corporate asset was established. In an increasingly inter-connected global economic scenario, experts suggest, corporates should shed their insular approach.

N. Balasubramanian, chairman, Brickwork Ratings, and former chairman and managing director, Small Industries Development Bank of India (SIDBI), stresses the fact that Indian corporates must be educated on the issues of corporate governance and risk management. "We believe that an understanding of risk is crucial in speculation," he adds.

According to K.N. Prithviraj, administrator, Special Undertakings of Unit Trust of India (SUUTI), all countries must possess an international financial infrastructure to understand volatility. Drawing attention to the fact that Indian public sector banks have been accustomed to tackling crises in the past, he observes that, even as India gets integrated into the global economy, more challenges can be anticipated. However, he believes that their conservatism has helped the Indian economy hold its own and deal with the effects of the current global, economic meltdown.

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