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The Day of the Forex Expert

The forex market is no longer about products that nobody understood. A new breed of business models help firms make sense of their currency exposure

Image: Vikas Khot

CURRENCY KING: Veteran Jamal Mecklai

Pankaj Sampath was a tense man at the turn of the last decade. A dealer in edible nuts and oil-seeds, Sampath also ran his own trading firm, Samson Trading Corporation. The rupee had appreciated by Rs. 3 in ten days and he had an export contract payment of $5 million. He was not sure if he should cover his positions as the direction of the rupee was difficult to predict. He knew that he would lose money. The question was how much.

He called up Jamal Mecklai, a foreign exchange (forex) consultant who decided to rejig the forex positions and cut losses for the firm. The rupee continued to appreciate. But Mecklai reduced the losses by almost 90 percent of what was feared.

Anil Patwardhan, chief financial officer (CFO), KPIT Cummins recounts a similar incident. Three years ago, Cummins had huge forex exposures which would have had severe implications on his accounts. Many companies were getting duped by toxic deriavative instruments and Patwardhan did not want to add to the list. He asked an old friend, Manis Thanawala of Greenback Forex, to advise him on his derivative positions.

Patwardhan felt that it just made sense to hire a consultant and fix the problem. “There was a clear case for forex consultants in the market as banks had pushed their products and the implications came much later on,” says Patwardhan. “Since companies need advice and strategies to reduce the impact of their foreign currency exposures in a volatile market, the role of the forex consultant is only going to go up,” he adds. Patwardhan hedges almost 65 percent of his exposures, most of which are in European markets.

A Bigger Role

These examples highlight the growing importance of forex consultants in India. Corporate India’s exposure to different currencies has steadily been increasing over the past decade. Big companies usually have their own treasury departments that hire professionals to deal with these issues. Other companies look to the forex consultant who advices and trains these firms in understanding their exposure to forex markets.

Consequently, the forex consultant’s role is getting bigger. While forex firms were traditionally advisors to their clients, they will now be in a position to also execute the trades. In the next five years, they will derive bulk of their business through currency futures broking.

Forex trading is the most liquid market in the world with a daily turnover of $3 trillion. In India, the entire forex trade was on the over-the-counter (OTC) market. The introduction of currency derivatives on the exchanges has boosted the market. India’s OTC market is at $33 billion and the exchange traded market is around a few billion on MCX and NSE.

For the month of January 2010, the average daily turnover for currency futures stood at Rs. 28,454 crore which was higher than the cash equity turnover for BSE and NSE which worked to Rs. 23,975 crore.

According to a report by brokerage firm IDFC SSKI, the OTC market in India will touch $40 billion by FY 2014 and around $8 billion take place on the exchanges. Greenback Forex is gearing up for this opportunity. Manis Thanawala and Subramanian Sharma run Greenback Forex from Vikhroli, a North Mumbai suburb.

Thanawala, a chartered accountant, started the firm in 1995 after completing his MBA from Pace university, USA. He belongs to a family of CAs and was a topper in the CA finals. His speciality is finding inefficiencies in financial markets. Today he sees a huge opportunity in hedge accounting and is focussing his attention there. “Currency broking and AS 30, the new derivative accounting standards, are the biggest opportunities for forex players. We believe that in the next few years advisory business will be priced lower for our other clients who take our broking and accounting services,” he says.

Currency broking is big even for Mecklai Financial. The firm has achieved an 18 percent return for their clients, trading currency on the Indian exchanges. CEO Jamal Mecklai feels that the currency exchange has a long way to go in terms of liquidity but it is slowly getting there.

HEDGE OR PERISH: Manish Thanawala, Image :Alok Brahmbhatt

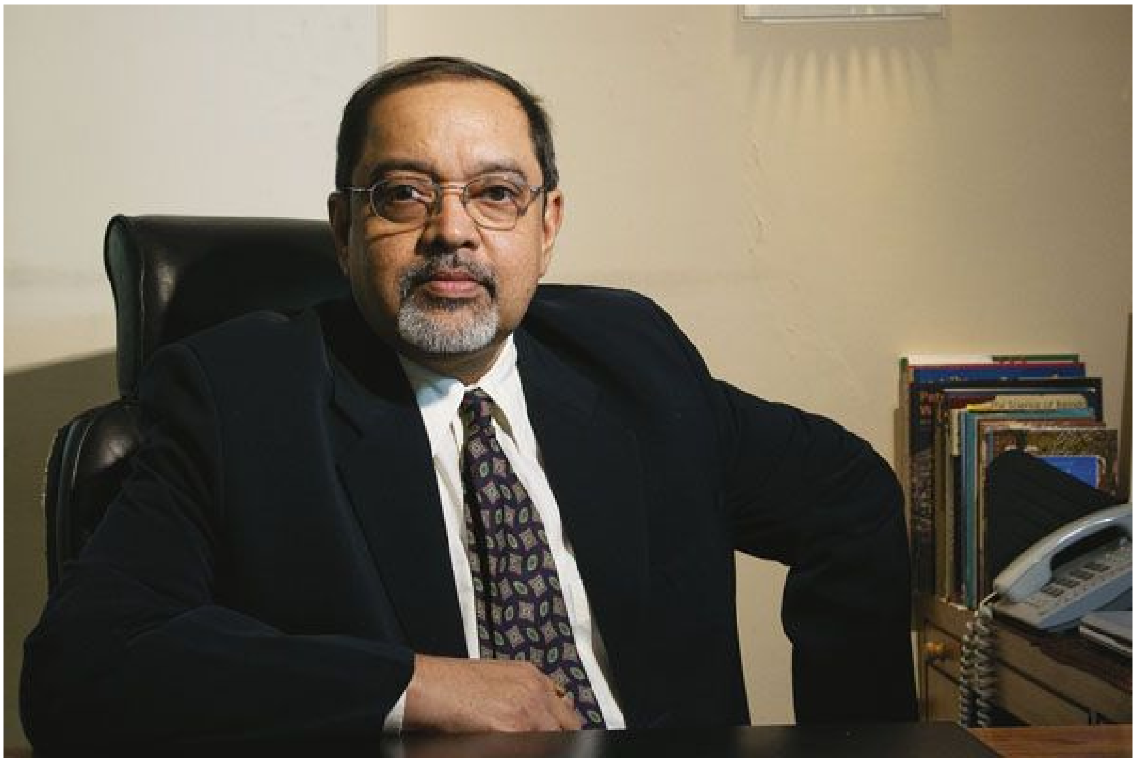

Image: Vikas Khot

SOUND ADVICE: Satyajit Kanjilal

He is taking technology based approach to his clients where he is managing their forex risks based on the data provided by his clients. An IT company with a strong treasury was taking readings from the Mecklai model since October 2008 for hedging. The company, which has $250 million of exports, realised that if they followed the model they would have saved $5 million on their positions. After looking at the results, the company moved to the Mecklai analytical model. Mecklai says that since 2007-2009, based on simulations, the model has done 3 percent better than the targets set by their clients.

Critics of this approach say that the software approach has been used before but has not really worked as companies are not yet clear about the functionality.

But Mecklai knows what his clients expect of him. He has been in the forex consultancy business since the early eighties after he moved in from the US to help his father who was managing Mecklai and Mecklai, a firm that was into inter-bank broking since the early seventies. Mecklai, a chemical engineer from IIT did not have any idea that he would end up in forex. But the going has been good. Companies like Samson Trading have relied on Mecklai for 20 years.

“You draw a box. Put the market inside this box. As long as the market is inside the box, you don’t have to do anything. But once it comes and touches any of the corners, either against you or in your favour you have to act,” says Mecklai. He believes that his software driven approach will help his clients solve 80 percent of their risk management related problems.

Forex consultants say clients are in dire need of advisory services. The problem is that the clients think consultants typically take punts on the exchange rate and this can often go wrong. The derivative crisis proved just that. But Satyajit Kanjilal has a different view. The CEO of Forexserve, a risk management consultancy, spends most of his time helping companies manage their risks in such a way that their balance sheets do not have to bleed for the positions that they take.

A chemical company with a Rs. 2,000 crore turnover approached Kanjilal. It had $8 million debt in foreign currency at a total cost of borrowing that worked out to 9 percent on a covered basis. Many banks had approached the company to sell products that they could not understand. Kanjilal hedged the loan in forwards on the assumption that the rupee would fall. His rationalisation saved the company Rs. 6 crore within four months. The company realised the power of hedging and has been with Kanjilal since then. Corporates are realising that a good hedging policy can help them save a lot of cash based on sound advisory policy.

But the business is moving from a view -based model to a risk management model especially after the derivative debacle. Companies want to have risk management solutions that will help them avoid the problems of the past two years where they were totally dependent on the view -based advisory.

Kanjilal feels that contrary to what others think, firms going for a complete risk management approach might just help him a lot as they would still require a view as there is always a premium on good advisory. “We need to have a view and then a strategy to back that view. But first we need to identify if the balance sheet requires this view and then use this view to take advantage of the market. As advisors, it is important to give realistic views that work for these companies”, he says. These days his firm is getting more involved with training equity brokers to get into forex business. He feels that this is an important step as education itself will have the power to drive in the volumes.

The new derivative accounting standards that have come into force are the biggest opportunities for forex players. The rupee is still volatile and the markets are in a tizzy. The need for managing currency risk is not about to go away soon.