INVESTING IN INDIA: THE LONG-TERM CHOICE

A. Sheshabalaya, Ascendex IndiaTrack

Presentation to Tijd Academie, De Jachthoorn, Kontich, 21 November 1995

INTRODUCTION

It is important, if I may, to begin with a few definitions. For business people, in particular, some labels carry an emotive message. Simplifications created and re-run by the media simply sow confusion.

India was never a 'socialist' country, in the sense that term is generally understood. It had a mixed economy, with a federally-structured, social democratic form of government. The government was of course interventionist, sometimes highly so, in economic matters.

There was a political logic and rationale to this. India, as everyone knows, is a complex country. It has 15 official languages, including English. Most Indian languages have their own scripts. India is also a religious and ethnic melting pot.

In just over two decades of independence, the republic of India abolished every single residual privilege of its nearly 550 royal families and several ten thousand feudal lords. Two decades before the term 'affirmative action' became popular in the US in the late 1960s, India had begun reserving 25% of government jobs for minorities.

India has now long since reached a stage where members of such 'minority groups' have become cabinet ministers, chiefs of the armed forces, judges of the supreme court, ambassadors and chief ministers, and of course leaders of business. Indeed, both India's longest serving cabinet minister, Jagjivan Ram, and Mayavati, a former Chief Minister of India's largest State, Uttar Pradesh, came from the so-called 'untouchable' community.

Over the years, in brief, the Indian system has evolved into a mature, if occasionally - over-contentious - secular parliamentary democracy. This has been accompanied by a free press and a consistently apolitical army.

For business people, this is a very relevant point - because, quite simply, it means stability. India has no sheikhs, no politico-business dynasties, no military coups, neither sudden leaps forward nor backwards.

In short, it offers an atmosphere of relative predictability.

The contrast with most other developing countries does not need to be further underlined.

HEAVY INDUSTRY: HISTORICAL PRIORITY

Historically, the Indian government's interventionism extended to industrial policy, and was based mainly on import substitution. Its target was self-sufficiency, focused on first-phase industrialization - that is on building up infrastructure and an adequate base of heavy industries. This has now been largely done. But the way has not been smooth, hardly so.

India has lacked a comfortable cushion of energy surpluses. Not only does the Indian economy not gain from hard currency exports of crude or natural gas; it pays foreign exchange for its imports of energy.

To build up its industrial self-sufficiency, India constructed a complex system of licensing and control over imports through fiscal and non-fiscal barriers.

INDIA: A HUGE MARKET FOR INDIANS

Though its 'dirigiste' ideals and spirit often turned into interference, this interventionist State existed alongside a relatively mature corporate culture.

The Indian market is huge. It has always been so, and Indian companies focused almost exclusively on their large and protected domestic market. In brief, the private sector reached a form of maturity, under the protective cover of State, shielded from the winds of international competition.

Today, its relative positioning inside India - across a broad range of sectors - is in general extremely strong.

Whether by the print media, radio - or increasingly TV - product and brand awareness is quite high in India. Even in the still, relatively-low choice consumer segment, companies like Unilever and Nestle - in spite of their immense clout - have preferred to tie up with - or acquire - local companies which have possessed far-superior brand strengths. Pierre Cardin tried on its own, but failed. Similarly, Nike has preferred to license out its brand rather than seek a direct market presence.

Looked at in another direction - India is also now witness to the other symbols of corporate cultural maturity - for example, the ongoing boardroom power struggles in several companies (including one of India's largest, ITC), or the takeover battle between Torrent and Bombay Dyeing for Ahmedabad Electricity Co.. Indeed, the stock market regulatory authority, the SEBI, is currently drafting a takeover code.

BASIC INFRASTRUCTURE

Today, though several serious bottlenecks remain, India's basic infrastructure is, as I have just said, already in place.

The State is now moving out of the driver's seat. The Indian economy is in short becoming increasingly business driven. There is a corresponding shift in emphasis to economic growth, and away from redistribution.

But this is by no means the replacement of a socialist system by a market economy. India's reforms involve neither a wholescale dismantling nor start-up. Instead, what is now underway is a careful and balanced economic policy of transition - once again, no great leap forward.

With over three decades of sustained (if uneven) economic and industrial growth behind it, the industrial base of India is comprehensive, spanning all major industries. It is no wonder that foreign investments in India too, unlike in many other emerging markets, span a near-comprehensive range of industrial sectors - rather than being concentrated in a few - with all its attendant political risks.

In several heavy industrial sectors (cement, petrochemicals, metallurgy, fertilizers etc.), India ranks among the top 3-4 producers in the world and its share is growing further. It is already, for example, the largest producer of tractors, scooters and rail wagons.

India's output of textiles last year was 28 billion square metres. As one of my Belgian associates recently noted, this figure means more as 28,000 square kilometres - almost enough in fact to cover Belgium - and hopefully, as he said, keep away the rain.

A MIXED SYSTEM

Let me make three points to illustrate the success of this mixed system.

. *Food production*

India is now one of the largest producer of foodgrains in the world, the second largest producer of milk, and the third largest producer of wheat. Indeed, it is likely to become the world's second largest wheat producer within 5 years, according to the Consultative Group on International Agriculture Research.

A report by UNICEF last week was categorical :" Malnutrition in India is not a problem of food availability but a problem of behaviour", that is, in terms of educating mothers on nutritional practice for the vital post 6-month period after childbirth.

Figure 1

INDIA: INDICATORS (1950s-1980s)

	1950s	1960s	1970s	1980s
Annual Growth (%)				
GDP	4.7	4.4	3.5	7.3
Population	2.2	2.5	2.4	2.2
Per capita GDP	2.0	1.3	0.7	3.6
Ind. Prodn.	9.8	8.0	5.3	11.3
Exports	0.6	5.1	31.8	11.4
Imports	8.5	-0.8	63.4	5.2
Ratios (%)				
Forex Res/Imports- (non-SDR/gold)	150	17	27	37
Dom Savings/GDP	10.4	12.7	15.7	21.2

Figure 2

INDIA: VITAL SIGNS

	1950	1960	1970	1980	1990
Life Expectancy (years)	32.1	41.3	45.6	50.4	60
Literacy (%)	18.33	28.31	34.45	43.56	52
Foodgrains/population - (kg/person)	141	187	198	190	208

Indeed, India decided to provide free meals to school children some months ago - exactly the same week as the US cut its federal spending program in this area.

. *Space Program*

A second point, at the other end of the scale, is the Indian space program.

U.S.-based EOSAT (a joint venture between Hughes and Martin Marietta) signed a 10-year agreement with India earlier this year on 8 Earth observing satellites to be launched between now and 2005.

This 8-satellite Indian constellation (two of which are already in orbit) will be larger than any other current existing Earth monitoring program. The $750 million program will result in the world's largest single source of Earth observation data..

Along with Intelsat (which will be leasing transponders on the Indian-built INSAT-2C satellite - the first time the organization is using capacity it does not own), the EOSAT contract pays for the costs of India's entire space program over the last decade.

. *Software*

The third sector is software. As you know, software is a value-adding engine for every single economic sector - not just for manufacturing and services, but in agriculture too.

In the four years since reforms began, the global computer majors - IBM, Motorola, Hewlett-Packard, Digital and Texas Instruments - have all set up operations in India, connecting to their overseas headquarters by dedicated satellite links. There are now more than 100 such links in use in India. British Aerospace recently joined the list, as of course have hundreds of smaller, specialized companies. The majority however remain American firms.

Such companies have been more than amply rewarded. Last year, the US military-funded Software Engineering Institute rated more than 200 software teams for technical and managerial excellence. 75% were rated at the most basic Level I. At the highest level, 5, there were only two firms: the US team working on the on-board software for the Space Shuttle, and Motorola's software team in Bangalore.

On their part, Indian companies like Tata Consultancy, Infosys, NIIT, WIPRO and scores of others have also moved overseas - from Singapore to Sweden.

There is also a shift in India towards emphasizing quality and adding higher value to its software. Swissair's entire flight coupon processing is done out of Bombay with a staff strength of 100. In Zurich, this earlier required 200. I am told Singapore Airlines now plans to follow Swissair.

Yet another example is Netquest, set up at Bangalore by a former Indian employee of Microsoft - to provide online trouble-shooting services to US programmers.

India's exports of software are now rising at 35-40% a year. In several of the fastest-growing application niches, Indian companies are now widely recognized as potential world leaders.

HUMAN CAPITAL EXPORTS

Several Indian software engineers have attained a personal reputation worldwide such as Vinod Dham, formerly General Manager of Intel's Pentium Division and co-inventor of the Intel memory cell; Juggy Pandit, General Manager at Thorn-EMI; Bharath Kadaba, who was director of Internet-working and multimedia services for IBM's Advantis; Rajiv Ramaswami, manager of optical services at IBM's Thomas Watson R&D centre; Arun Netravali of AT&T, who will now direct R&D at Bell Laboratories after the retirement of Nobel Laureate Arno Penzias; Raj Reddy, a Legionnaire d'Honneur who founded and heads Carnegie-Mellon University's Robotics Institute.

These are only the best-known tips of a fairly large iceberg. Some estimates in fact place India's exports of human capital well over what it has received in foreign aid. Take for example, Malli Rao, Du Pont Distinguished Scientist, only the third person in the company's history to get this special recognition; Nobel Laureate Hargobind Khurana who paved the way for the biotech revolution; or Ananda Chakravarty, the inventor of the world's first patented life-form, the oil eating bacteria;.

Such people are not just models of inspiration, but also sources of personal and practical advice to the next generation.

Indeed, this - tomorrow's generation - is where, once again, the government has carved a role for itself. Last month, for example, it decided to provide Internet access to Indian university students at subsidized rates.

The government has a job, and will continue to have one. After all, even here in Europe, your own Karel Van Miert said not so long ago, "A market economy isn't an idealistic thing. It has to do with money and power. Let's not be naive about it."

MATURE CORPORATE CULTURE

I earlier spoke of a relatively mature corporate culture.

Two facts illustrate this.

First, several of India's largest private business houses (such as the Tatas, Birlas, the Bajaj and Shriram families) have been around since over a century.

Second, even in 1985 - well before the current reforms - India had 14 stock exchanges, some 7 million investors, 4,344 listed companies and a total market capitalisation of $8.0 billion.

By the end of 1994, this had grown to 23 exchanges, 18 million investors, 7,811 listed companies and a total market capitalization of $172 billion. Egypt's stock market by contrast is capitalized at $4.2 billion. 800 stocks are listed, of which just 40 are actively traded.

In other words, privatization does not (and cannot) drive stock market activity in India; it can at best only supplement it.

Therefore, although the government's privatization plans have recently been unhinged[1], they make only a short-term, marginal and manageable dent in its reform plans; by no means do they derail them.

Correspondingly, the stock markets also have their own institutional and technological momentum. In July, Vadodra Stock Exchange became the fourth exchange in the country to go on-line for trading after the Bombay and Delhi bourses and the National Stock Exchange (NSE). Both the Bombay bourse and the NSE have greatly expanded their reach by allowing members to use VSATs (very small aperture terminals) for trading rather than leasing unreliable telephone lines.

As Figure 3 shows, there are only a handful of State-owned companies (which are shaded in the figure) among the largest in India.

All these companies are currently amidst an extraordinary boom, with net profits rising by a mean of 35-40%.

What is also important is the fact that this boom includes several State-owned companies.

---

[1] The government aims to raise Rs. 70 billion (about $2.5 billion) by the middle of 1996 from the partial privatization of 14 State companies. Its aim is to use the proceeds to contain the budget deficit at 5.5% GDP.

However, the first tranche in early November for four companies (ONGC, CCI, MTNL and SAIL) had a very poor response, largely due to liquidity problems, with only Rs. 1.68 billion raised versus the Rs. 5 billion targetted..

Two or three more tranches are planned.

In the longer-term, the head of India's biggest credit institution ICICI has said that the 51% residual control concept itself needs to be rethought.

Figure 3: INDIA: THE TOP 50 (Capitalization and Estimated Half-Year Results)

%	Company	Sector	Capitalization US $ million (1994)	1995 *(6 months)* Change Sales	Profits **(est.)**
1	SAIL	Steel	5209	14	58
2	Reliance Industries	Chemicals	3173	17	26
3	MTNL	Telecoms	3079	23	45
4	Hindustan Lever	Consumer	2615	20	31
5	Tata Iron & Steel	Iron/Steel	2517	30	130
6	TELCO	Automotive	2482	61	228
7	Hindustan Petroleum	Refining	2137	11	35
8	VSNL	Telecoms	1979	29	58
9	Larsen & Toubro	Engineering	1923	19	39
10	I T C	Tobacco	1866	11	17
11	Bajaj Auto	Scooters	1812	29	31
12	Hindustan Copper	Mining	1605	-	-
13	Colgate-Palmolive	Consumer	1501	-	-
14	Grasim Industries	Chemicals	1498	38	40
15	Bharat Petroleum	Refining	1425	97	36
16	Tata Chemicals	Chemicals	1368	-	-
17	Indian Petrochemicals	Chemicals	1236	28	66
18	Brooke Bond Lipton	Consumer	1210	-	-
19	Hindalco Industries	Aluminium	1209	32	37
20	Associated Cement	Cement	1083	18	47
21	NALCO.	Aluminium	966	-	-
22	BHEL	Engineering	928	-	-
23	ICICI	Finance	859	16	4
24	Ranbaxy Labs	Pharmaceuticals	846	19	33
25	Castrol India	Petroleum	771	-	-
26	Indian Hotels Co.	Hotels	756	24	82
27	HDFC	Finance	754	11	28
28	Motor Industries Co.	Automotive	716	-	-
29	Century Textiles	Textiles	693	19	84
30	Nestle India	Consumer	686	-	-
31	Indian Rayon & Inds.	Textiles	640	19	7
32	Essar Gujarat	Industrial	628	44	-
33	Travancore Fertilisers	Chemicals	601	-	-
34	Asea Brown Boveri	Engineering	582	-	-
35	Mahindra & Mahindra	Automotive	572	51	86
36	Ganapati Exports	Trading	549	-	-
37	Sterlite Industries	Industrial	514	-	-
38	B S E S	Utility	513	13	52
39	Ashok Leyland	Automotive	508	23	130
40	Tata Tea	Tea	505	21	-10
41	East India Hotels	Hotels	490	-	-
42	Cochin Refineries	Refining	490	-	-
43	Indian Aluminium Co.	Aluminium	484	-	-
44	Ambuja Cement	Cement	481	-	-
45	Reliance Capital	Finance	451	-	-
46	Arvind Mills	Textiles	450	-	-
47	Ponds	Consumer	446	-	-
48	Siemens	Engineering	439	-	-
49	Tata Power Co.	Power	420	-	-
50	Great Eastern	Shipping	407	-	-

Following the reforms, many of these companies have made and continue to make Euroissues to finance their expansion.

The largest private company in India is Reliance, a vertically integrated manufacturer of chemicals, fibres and textiles, 26% owned by the Ambani family. Numerous capital projects in the company's pipeline will increase its capacity four-fold by 2000. Grasim (a member of the Aditya Birla group) is the world's largest producer of viscose staple fibre, with operations in Southeast Asia, Africa and elsewhere.

Most such large companies are also diversifying extensively - both upstream, usually into power, sometimes telecoms - as well as downstream. They are also setting up major joint ventures overseas. Overall, Hong Kong's Peregrine estimates heavy-engineering investments in India at $ 65 billion by the year 2000.

In the State sector, SAIL plans investments of $7 billion over the next 7 years to modernize. India's leading aluminium producer NALCO intends to begin making cans and wheels and is undergoing a massive expansion in capacity. Its captive power will be raised from 720 MW to 960 MW, and bauxite mining capacity doubled to 4.8 million tonnes per year. In the UAE, NALCO plans to set up a 12.5 million tonnes smelter.

Indian Petrochemicals Corporation is due to sign a technology agreement with BP Chemicals to raise its polyethylene capacity to 220,000 tonnes a year from 160,000 tonnes.

Overall, India is due to become the world's largest market for ethylene already by 1999, according to Houston-based Pace Consultants, with the commissioning of three new plants and expansions to another two. Annual capacity will increase four-fold from 510,000 tonnes to 2 million tonnes.

There are several such examples from the list in Figure 3, but we unfortunately do not have the time for it.

CRISIS: 1990

The essential reason for such a level of confidence is economic reforms.

The impetus for Indian reforms was largely fiscal and external. Imbalances in the economy began to be felt in 1990 and strengthened seriously in 1991. In 1990, in fact, forex reserves dropped to about 10%, or less than one month's import cover.

The reforms, which were introduced in July 1991, had many goals.

The first was global integration. India did not need to learn a lesson from Albania. Quite simply, one had to either be inside or stay outside of the world economic system.

Other related facts were globalization - factors such as the internationalization of capital flows and the onset of the information age.

The basic aim of the reforms was to accelerate growth, and enhance industrial efficiency and quality towards world standards.

TURNAROUND: 1994

As Figure 4 shows, the liberalization measures already yielded results by 1994.

From near zero, foreign exchange reserves are now at over $20 billion. This has recently been accompanied by a net decline in external debt.

India's exports to Europe last year rose 115% from $3.4 billion to $7.3 billion, while imports grew $6 billion to $7.4 billion. India has a manageable trade deficit, along with a small current account gap (of about $2 billion-$3 billion).

In addition, buttressing this success at the socio-political level, is an agricultural boom. In 1994-95, Indian foodgrains output reached 185 million tonnes. This year, it has reached 192 million tonnes. Buffer stocks of food are now 36 million tonnes.

GDP was up by 5.6% in 1994-95 against 4.3% in 1993-94, and a mere 0.9% in 1991-92.

Figure 4

INDIA: INDICATORS (1990-1994)

	1980s	1991	1992	1993	1994
Annual Growth (%)					
GDP	7.3	0.9	4.3	4.3	5.6
Population	2.4	1.9	1.9	1.8	1.7
Per capita GDP	3.6	-2.0	2.2	2.5	2.7
Ind. Prodn.	11.3	0.6	2.3	4.1	8.0
Exports	11.4	-1.5	3.8	20.0	17.9
Imports	5.2	-19.4	12.7	6.5	21.2
Ratios (%)					
Forex Res/Imports-(non-SDR/gold)	37	29	29	65	74
Dom Savings/GDP	21.2	23.1	20	20.2	20

Figure 5

INDIA: STRUCTURE OF LONG-TERM EXTERNAL DEBT

	1990 Total: US $ 68.5 billion	1994 Total: $ 87 billion
Shares %		
Multilateral	28	29
Bilateral	20	20
NRI	13	15
Commercial Borrowing	14	13
Rupee debt	16	12
IMF	2	6
Export Credit	7	5

In fact, GDP growth for 1994-95 was revised just last week upwards from 5.6% to 6.2%.

Industrial production during the first half of this year rose by 10.5%, with key indicators like car sales rising by 34% and commercial vehicles by as much as 57%.

TARGET: 2000

Most targets now seem achievable. Above all, there is plenty room for manoeuvre.

Among other things, the foreign debt components have remained similar to 1990 (Figure 5), in spite of the immense change in the economic environment.

One of the major short-term aims of the government is to increase NRI financing of India's debt. NRI (for non-resident Indian) refers to the overseas Indian community, most visibly the Indian professionals based in the US.

NRI savings per year are estimated at over $50 billion.

One interesting possibility for foreign investors is the backdoor to the Russian market via India's rupee-denominated foreign debt, largely related to previous defence purchases. With India committed to clearing this backlog at the rate of about $1 billion a year - this is, to say the least, a huge opportunity for foreign companies seeking a piggybacked foothold in both markets.

Given below are the annual growth targets for the medium term.

All of them, as I have said, have indeed already been achieved in the first half of this year, and are therefore quite realistic. As a matter of fact, Peregrine last week raised the forecast for growth in the Indian engineering sector to 20% a year.

Industrial growth:	10-12%
GDP growth:	6-8%
Exports growth:	20%

REFORMS: THE CRUX

The main points of the reforms are summarized in Figure 6.

The Foreign Investment Promotion Board (FIPB) was earlier this year spun off to a new department of industrial policy and promotion. The department will now oversee the FIPB's functioning.

The essential aim of the reforms was to abolish what had become unhappily labelled as a license raj - based as I had mentioned - on import substitution and self sufficiency - in other words, in keeping foreigners out.

Today, foreign private participation is permitted in virtually all industries and foreign investment is generally treated at par with domestic investments.

By November 1 this year, 3,580 joint ventures had been approved with a total foreign investment component of $12 billion.

Since 1994, India has signed investment protection treaties with Britain, Russia, Germany, Malaysia and Denmark, and negotiations are under way with the Netherlands, Italy, Singapore, Australia, Japan, South Korea and Canada.

I am told India will be signing bilateral investment protection agreements sometime this week with both France and Italy.

In the medium-term, India is also expected to sign the OECD Multilateral Agreement on Investment.

CONSENSUS-BUILDING

The reforms in India were neither a stop-go nor symbolic phenomenon.

Most importantly, they have been accompanied by a systematic phase of open debate and discussion, in short transparency - transparency in politics, transparency in business.

There are startling contrasts with the situation in other countries.

Figure 6

REFORMS: AN OVERVIEW

- ☑ Private sector (including foreign) participation opened in all industrial areas except defence, atomic energy and rail transport
  - *Most minerals removed from restricted list*
- ☑ Trade policy reforms
  - *Downscaling of tariff barriers from peak of 300% in 1991 to current 50%*
  - *Streamlining and simplification of import and export licenses*
  - *Free import of all goods except for small Negative List*
  - *Import of second-hand capital goods allowed*
- ☑ Industrial licensing requirements reduced to 16 fields
- ☑ Special investment and tax incentives for exports and certain high-priority sectors (power, electronics, food processing)
- ☑ Corporate taxes cut by 5-10%
- ☑ Board for Industrial and Financial Reconstruction set up to divest or turnaround loss making State (and private) companies

Figure 7

REFORMS: THE INTERNATIONAL DIMENSION

- ☑ Indian capital markets opened to foreign institutional investors
- ☑ Indian companies given access to international capital markets

- ☑ FERA: 40% ceiling abolished
  - *Foreign equity up to 100% allowed*
  - *No requirement for local partner*
  - *Specially empowered Foreign Investment Promotion Board in the Office of the Prime Minister*
  - *Time frame for approval: 6 weeks average*
  - *Foreign acquisitions of Indian plants/companies allowed*
- ☑ Automatic authorization for foreign equity up to 51% in several sectors
  - *Time frame for approval: 2 weeks*
- ☑ Free repatriation of profits and capital investment
- ☑ Entry of foreign brand names and trademarks
- ☑ Special inducements for EOUs/EPZs

Figure 8

FOREIGN DIRECT INVESTORS IN INDIA: FEEDBACK

Findings of study by IFO, Germany

60% OF INVESTORS WOULD NOT HAVE CONSIDERED INVESTING WITHOUT REFORMS.

Major advantages cited

1. Majority control
2. Convertibility of rupee
3. Tariff reductions on capital good imports, spares
4. Eased local content regulations
5. General streamlining of bureaucracy

Other advantages

1. Reduction of corporate tax from 65% to 55%.
2. Simplification of taxation system
3. Infrastructure flexibility for investments
4. Speeding-up of process for permits and licenses

Source: **IFO, Germany**

Figure 9

REFORMS: IN PRACTICE

Switzerland's Benninger set up a 50-50 textile machinery joint venture at Konhapuri with India's R.P. Goenka in 1993. The Rs. 20 million joint venture saw procedural formalities completed within 20 days. It was started up within 15 months.

Turnover in the first year was CHF 8 million. In the second year, turnover rose to CHF 14 million.

A similar pace of progress is being achieved for much larger projects by car manufacturers like Mercedes, Daewoo and Peugeot, by ABB, GEC-Alsthom and Siemens, by Coca Cola and a host of other companies.

Earlier this month, for example, as you would know, China removed duty free privileges on capital goods imports and cut export tax rebates - among others, throwing Hoechst's massive investment plans into public doubt.

Yesterday, Vietnam abolished all imports of second-hand equipment and spare parts - with retroactive effect from November 1. Industries targeted by the decree include energy and power, cement, metallurgy, the manufacture of basic chemicals, food and pharmaceuticals.

Such situations would have been inconceivable in India, even had the authorities wished it. We do of course have our problems - but there is a reliable system of openness. Unlike McDonalds in Beijing, when Kentucky Fried Chicken was ordered to shut down in Bangalore, there was a court to resort to, and the court ordered it reopened. Similarly, people I have spoken to believe that Enron will be back this week or next to renegotiate the Dabhol Power deal.

Above all, in India there is information - timely information, advance market intelligence and analysis - a vast volume of focused media coverage on just about every market sector - along with specialized firms to advice foreign businesses on the rewards and risks of the Indian market.

This is important, because there are indeed risks on the market and a need for specialized know-how.

For example, the same IFO study we saw in the previous figure also found that - in spite of the reforms - 90% of investors found they needed to be better positioned with regard to dealing with the public administration. 76% of joint venture partners said that having a local partner did not automatically spell an escape from entanglements.

REFORMS CONTINUE

The process of reform continues. This year, the government implemented a further series of sweeping cuts in tariffs (Figure 11) and excise. The tax system - as my fellow speaker from Andersen Consulting will no doubt explain - is being streamlined and overhauled.

The government has deregulated several other sectors - from oil exploration to air taxi services and is now targetting the relatively sensitive sectors of mining and ports. On November 2, for example, the government said that - with some exceptions (namely, forests and protected areas) - the limit on private mining concessions would be raised 20-fold from 25 sq. km to 5,000 sq. km. The major international mining companies (BHP, Pasminco, Rio Tinto Zinc and the redoubtable Robert Friedland), are all planning investments.

In the ports sector, where the export boom is creating serious bottlenecks, the government has already received $6 billion investment offers for private sector container handling, so far mainly from Indian companies.

In the face of import tariff cuts, Indian companies across the board - from chemicals and consumer goods to textiles and tyres - are now forced to brace themselves to yet another dose of exposure to international market forces.

I earlier referred to foreign companies facing Indian brand strengths. But such awareness is now also extending to Indian companies. Last week, for example, Bombay brokers Khandwala said that ACC (India's largest cement company) was facing a fast erosion of brand equity, and would be unlikely to maintain its first half performance in the second. On its part, ACC is diversifying furiously, and is expected to shortly sign a major joint venture agreement with Bridgestone of Japan for manufacturing tyres.

Figure 10

TARIFF RATES FOR SELECTED GOODS: 1990-91 TO 1993-94

	1990-91	1991-92	1992-93	1993-94
Import Weighted Averages (%)				
Total	87	64	47	33
Agricultural Products	70	30	25	17
Capital Goods	97	76	50	38
Intermediate Goods	117	55	40	31
Consumer Goods	164	144	*120 (est.)*	*95 (est.)*

Source: CMIE

Figure 11

HIGHLIGHTS OF CHANGES IN IMPORT DUTIES: MARCH 1995

	Previous	1995
Customs peak rate:	65%	50%
Capital goods:		25% (uniform)
Components of capital goods:		25%
Quality and testing equipment:	40-60%	55% (uniform)
Software (systems/applications):		10%

Meanwhile, to encourage Indian exports further, in mid-September, the government relaxed restrictions on overseas commercial borrowings by export companies, lowering average maturity requirements from 7 to 3 years.

FOREIGN PORTFOLIO INVESTMENT

Reforms have also extended to freeing space for foreign portfolio investors. Net foreign portofilo investment on Indian bourses passed the $4 billion mark in September 1995 as compared to $ 3.84 billion in August (see Figure 12).

One interesting observation here is the relative imperviousness of foreign activity on Indian bourses to global crises (e.g the currency crisis in Mexico).

On September 21, the government allowed foreign investors to invest in domestic Indian venture capital funds - or directly in unlisted companies.

Up to 100% control of domestic venture capital funds will henceforth be allowed.

Foreigners can also set up asset management companies to manage funds. Only one-time approval is required. All subsequent investments are fully open. In addition, tax exemptions will be the same as for domestic asset management firms.

Guinness Flight and Hambros are explicitly targetting SMEs in South India. Guinness is also considering an Indian bond fund. Foreign & Colonial has recently said it will increase exposure in India ahead of elections next year - from 7.5% to 11%.

. Capital market weaknesses

The main criticism by foreign institutional investors has been poor liquidity and settlement structures on Indian markets.

There are several reasons for this situation. Banks have to contend with growing competition from a ballooning number of new credit and investment syndicates which do not have statutory reserve requirements.

However, liquidity is expected to improve dramatically with:

1. The resumption of forward trading (at the end of October), which will allow postponement of share delivery and the squaring of deals;
2. The creation of a central share depositary, to eliminate counterparty risk, which is expected in 1996. Industrial Development Bank of India, India's leading term-lending institution is expected to shortly announce such a facility, along with Unit Trust of India, India's biggest institutional investor - and the National Stock Exchange (NSE).

Yesterday, moreover, the Reserve Bank of India injected over $1 billion into the inter-bank call market through repurchase of securities. As a result, inter-bank call rates fell to 22-27% percent from 30-37%.

In the short-term, the current cash squeeze is expected to ease further by the end of November when $1.1 billion (representing government interest on debt is paid). Banks are the chief buyers of government paper.

In the medium-term, furthermore, the important thing is that the economic boom continues, along with an extraordinary level of corporate confidence.

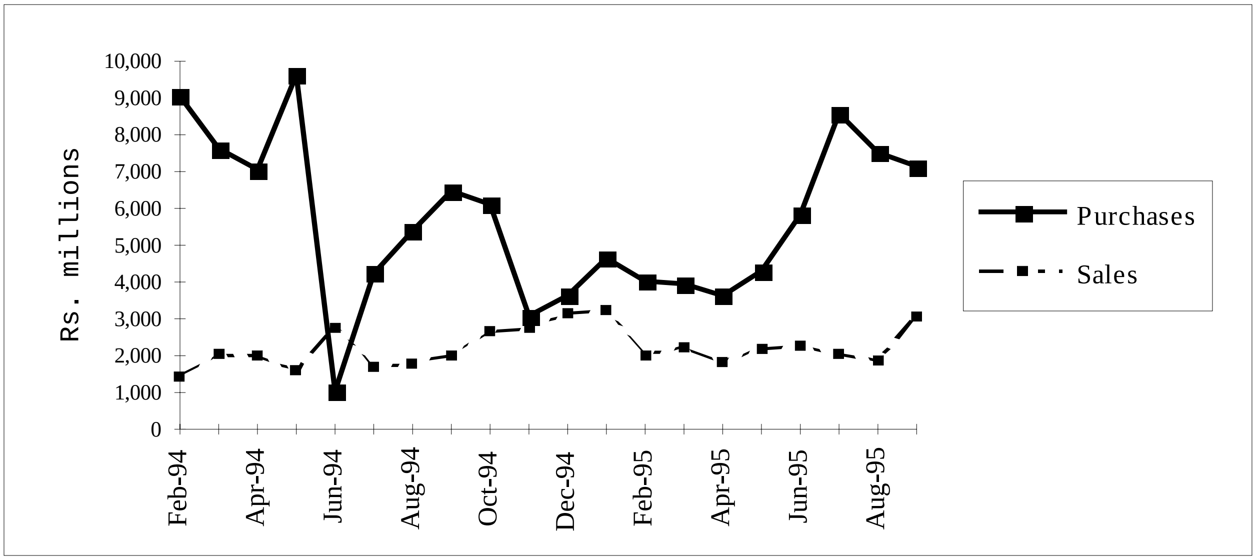
On October 18, Dewe Rogerson consultants ranked India as the favourite primary portfolio investment target among all emerging markets - based on interviews with fund managers in the US, UK, Hong Kong and Singapore.

Indonesia was placed second. Mexico and China were at the end, along with Pakistan.

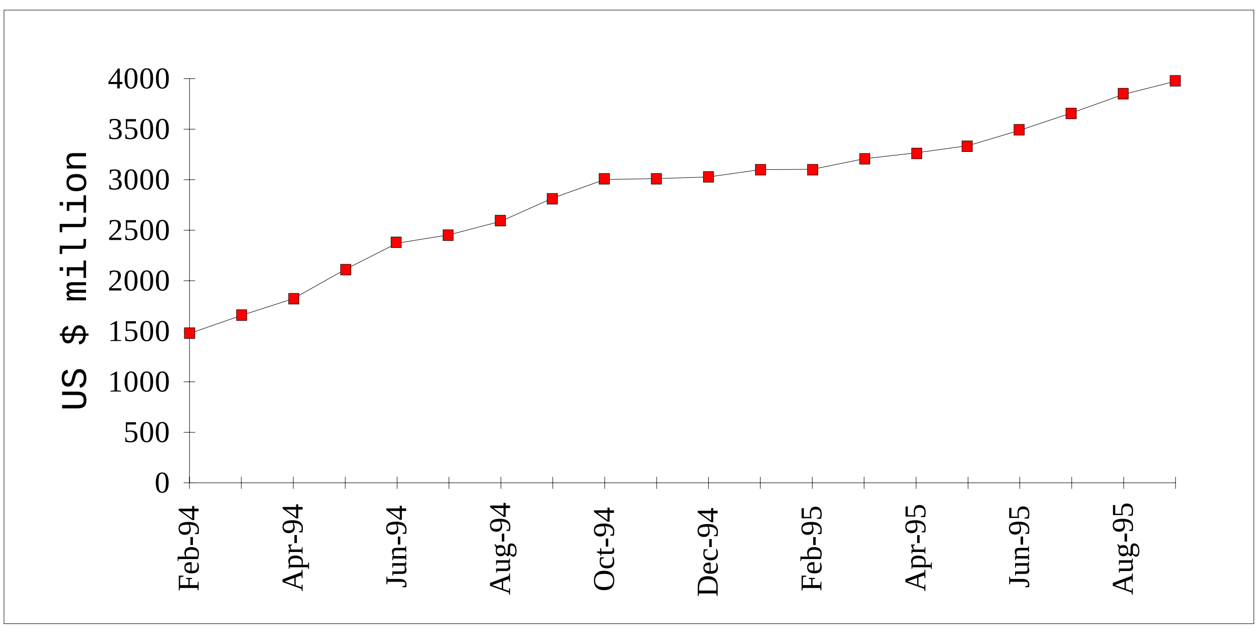
Figure 12

FII IN INDIA: 1994-95

Gross Purchases and Sales



Cumulative Net Investment



COMPANIES LARGE AND SMALL

The large Indian-owned companies have the resources and the ability to weather the reforms.

Indeed, some like Essar (in shipping), Mafatlal and DCM (in textiles), the Mittal group (in steel), Ranbaxy Laboratories and Wockhardt (in pharmaceuticals), UB (in breweries), BHEL (in electrical engineering), the Oberois (in hotels) have for sometime been pursuing acquisitions and joint ventures abroad - from the Middle East, South Africa and Southeast Asia to the US and Europe.

Ispat of the Mittals was for example in the news recently after taking over Irish Steel and facing the wrath of the British. Ispat is the same Indian expatriate-owned multibillion dollar group which is credited with turning around the ailing Hamburger Stahlwerke in one year. There is then of course the giant Hinduja group - with which I understand Belgium's Kredietbank last year signed an agreement to enter India..

Below the largest, there is a well balanced pyramidical structure of smaller companies. Figure 13 shows the Indian corporate structure by tier.

Interestingly, a whole clutch of third and fourth tier companies also aim to reach world-class strengths in selected fields. Note for example, the new entrants to the copper and aluminium markets in Figures 14 and 15. The picture is the same in several industries - from cement and steel to petrochemicals.

Many relatively smaller or new companies, among them WS Industries (electrical engineering), the Sanmar Group (in chemicals), Kirloskar (in diesel engines), have attained ISO-9001 status.

Even smaller State-owned companies are doing well. Bharat Earth Movers, for example, recently announced its half-year results - with sales rising 10% and a small profit of Rs. 22 million against a loss of Rs. 85 million last year.

Yesterday, Indian consumer electronics group Videocon announced that it planned exports to Europe in the wake of a European certification for its brands, the first Indian firm in this sector to receive this.

However, as everywhere, the future of business in India too lies in small- and medium-sized enterprises (SMEs).

These companies are a mixed lot.

In general, most are now facing severe competitive pressures to upgrade technologies - both in keeping with the general trend in India, and to capture some niche business on world markets. Figures 16 and 17 provide a summary of the main forces at work in this sphere.

Let us consider a typical set of SMEs. Figure 18 provides a selection of initial public offerings (IPOs) made over the past week.

The main point in the SME sector, as the figure shows, is diversity. Companies such as these cover every industrial sector conceivable and are spread across the country. These are particularly ripe for joint ventures and technical tie-ups across an open-ended, highly flexible range.

The number of such SMEs is now growing at a brisk pace, underlining the overall health of the corporate sector in India. Indeed, the performance of the primary capital market has surpassed all previous records. IPOs increased dramatically during the 6-month period to September 1995, corresponding to as many as 533 of 571 issues (93%). Issues worth about $ 1.6 billion were floated during the first 6 months as compared to $1.25 billion during the same period last year.

India's reforms are certainly not ignoring SMEs. With small domestic companies, for example, in addition to freeing up the possibility of inward investment by foreign venture capital funds, the government also moved in September to permit foreign loans of up to $1 million, reducing maturity requirements from 7 to 3 years.

Figure 13

CORPORATE INDIA BY TIER: 1994

Rank	Average Capitalization		Average Sales	
Top 10	$ 2.6 bn	(BEF 78.2 bn)	$ 1.99 bn	(BEF 57.6 bn)
Top 50	$ 1.18 bn	(BEF 34.3 bn)	$ 720 mn	(BEF 20.1 bn)
50-100	$ 286.5 mn	(BEF 8.3 bn)	$ 178 mn	(BEF 5.2 bn)
100-200	$ 135.7 mn	(BEF 3.9 bn)	$ 65 mn	(BEF 1.9 bn)

Figure 14

COPPER CAPACITY INCREASES 1994-2000
(tonnes per year)

Company	1994	2000
HCL	48,000	120,000
Sterlite	0	100,000
Metdist	0	150,000
Indogulf	0	100,000
TOTAL	48,000	470,000

Figure 15

ALUMINIUM CAPACITY INCREASES 1994-2000
(tonnes per year)

Company	1994	2000
NALCO	220,000	345,000
HINDALCO	175,000	210,000
BALCO	100,000	100,000
INDAL	117,000	230,000
L&T	0	65,000
TOTAL	610,000	950,000

Figure 16

FOREIGN INVESTMENT IN INDIA: DRIVING FORCES

Indian companies	*Foreign companies*
. Technology access	. Market access
. Quality upgrade	. Low-cost sourcing
. Domestic/Global competitiveness	. Higher returns on capital

Figure 17

MAIN PROBLEMS WITH SMEs IN INDIA

- Over-competition.
- Leading to lower capacity utilization and compromises on quality and standards for price-cutting.

General technology patterns

Manual	57%
Semi-automated	37%
Modern	6%

Source: Friedrich-Naumann Stiftung, Germany

Figure 18

EXAMPLES OF PRIMARY ISSUES

Week: November 8-15 (excl. financial sector)

Name	Amount (Rs. mn.)	Project/Sector	Type	Location
ASTER DRUG	45	Bulk drug plant	SU	Haryana
BALAGI AGRO	31	Rice bran oil extraction	SU	AP
BIHAR TUBES	32	Galvanized pipes/tubes	SU	UP
CENTENIAL	30	Surgical sterile sutures	Exp.	Maharashtra
GG AUTOMOTIVE	71	Locomotive gears/gear pumps	Exp.	MP
DANIM LEATHERS	48	Leather shoes unit	Exp.	UP
IDEAL HOTELS	38	Hotel - bar, pool	Exp.	UP
KANAN STEELS	100	Galvanized steel wires	SU	UP
KRYSTAL KNITWEAR	34	Sales offices for garments	Exp.	Gujarat
MARVEL VINYLS	40	PVC coverings, fabrics	Exp.	UP
NAISARGIK	30	Floriculture (100% EOU)	SU	Karnataka
NORTH STAR GEMS	32	Diamonds (100% EOU)	Exp.	Bombay
PADAM COTTON	39	Cotton yarns factory	SU	Delhi
PITTIE CEMENT	1147	Clinker project	Exp.	Raj./Gujarat
RAJESH EXPORTS	100	Gold and diamond jewellery	SU	Karnataka
SHREE BENZOPHEN	41	Chemical intermediates	SU	Gujarat
SHREE YAAX	42	Herbal medicines	SU	Gujarat
SUGAM AGRO	57	Button mushrooms (EOU)	SU	AP
TUNI TEXTILE	40	Roto texturized yarn	Exp.	Maharashtra
VOLGA AIR	43	Air control equipment	Exp.	Gujarat
TOTAL	Rs. 2078 million			
AVERAGE	Rs. 104 million			
- Excl. Pittie Cements	Rs. 49 million			

Key: SU= Startup
Exp.= Expansion

ENVIRONMENTAL RULES AND SMEs

The regulatory authorities in India are also driving the demand for new (or may I say, relatively newer) technologies.

Figure 19 shows factory closures ordered in one Indian State by the Supreme Court last year for environmental reasons. Re-opening of some of these units was permitted only after the National Environmental Engineering Research Institute or the State Pollution Control Board gave its certification. In addition, another 212 closures were also ordered in the city of Agra (mainly of foundries, glass and lime kilns).

Several such firms are of course constantly on the look-out for newer technologies.

HUMAN RESOURCES

The German IFO study referred to earlier also drew another important conclusion. In India, it said, 83% of its respondents did not find the availability of trained staff to be a problem.

On the other hand, this is considered by many as one of India's major strengths.

In China, on the other hand, I recall Ciba-Geigy's Director Brendan Cummins saying last August that "a shortage of qualified personnel presents the greatest challenge to (his company's) expansion in China."

Nevertheless, as with other countries, there is now a sharp increase in job mobility on the Indian market.

Several international head hunters (e.g Boyden), have set up in India, to provide specialist advice on personnel to foreign companies.

One major opportunity will emerge in software, given that Indian professionals will no longer be allowed to work on temporary contracts in the US after March 1996.

LOW-COST SOURCING

Though the low-cost base of the Indian economy remains a major asset, wages are expected to move upwards as companies upgrade quality - first for the local market and then for world markets. This will be felt most quickly in precisely those sectors most interesting for inward investment.

This has for example, already happened in the software sector, where the cost advantage with Europe has dropped from roughly 4:1 in 1992 to 2:1 at present, according to our own Ascendex estimates.

On the other hand, new comparative advantages will continue to emerge, both from strategic opportunities in a swathe of sectors and from the fact that India is a ‘permanent’ market.

In spite of the sheer pace of industrialization currently underway, there will always be residual potential. To take just two examples: annual Indian per capita consumption of plastics and textiles - two fields in which especially massive capacity expansion is now under way - is still 0.8 kgs and and 2.8 kgs, respectively (compared to a world average of 15.4 kgs and 7.7 kgs).

Furthermore, the relative differentials between the different regions and States of India is unlikely to narrow substantially in even the medium-term.

CONSUMER INDIA

Before closing, a few final remarks.

Many people, especially overnight experts from CNN, question just how much benefits have accrued to India's poor from the reforms.

Given the rush into the country by consumer goods manufacturers (from Reebok, Benetton, and now Revlon, to of course Coca Cola - which returned after leaving in the 1970s and made a profit in its very first year), I believe Figure 20 may illustrate why reforms are working.

Figure 19

FACTORY CLOSURES ORDERED BY SUPREME COURT IN UTTAR PRADESH STATE

Sector	No. of Units	%
Textile companies	66	35
Paper plants	59	31
Engineering	17	9
Chemicals	14	7
Tanneries	2	1
Pharmaceuticals	2	1
Sugar	1	-
Others	29	15
TOTAL	190	

Figure 20

CONSUMER INDIA: A PORTRAIT

YEAR:	1994
LOCATION:	Khankhara village (Punjab State)
PER CAPITA INCOME:	Rs. 35 per day
TV SETS:	3 out of 5 households

WORLD'S TOP-SELLING SOAP BAR:	LIFEBUOY (India)
WORLD'S TOP-SELLING COSMETIC BRAND:	FAIR & LOVELY (India)

Figure 21

OWNERSHIP PATTERN OF CONSUMER DURABLES IN INDIA: 1994

	High	Upper Middle	Lower Middle	Low
	(Rs. 86,000+)	(Rs. 62,000- Rs. 86,000)	(Rs. 20,001- Rs. 40,000)	(<Rs.20,000)
(in %)				
Colour TV	18.8	21.8	24.3	9.8
Washing Machines	33.1	25.7	15.7	4.3
Motorcycles	20.1	18.5	25.2	11.1
Scooters	16.7	19.6	27.6	9.4
Mopeds	7.5	11.1	38.5	17.5

Source: NCAER, 1995

One interesting possibility in the rural market may be the shift to consumer goods away from gold as an instrument for savings. India is the world's largest gold buyer, and its private (non-government) gold reserves are conservatively estimated at 8,500 tonnes - well ahead of Fort Knox.

I have already mentioned the UNICEF report on nutrition. Let us now take a look at a study recently released by the National Council of Applied Economic Research (Figure 21).

These are the kind of figures studied at length by the likes of Daimler Benz (or for that matter Daewoo, GM, Mitsubishi and Ford) - which took account of purchasing power rather than exchange rates - before deciding to build cars in India. Peugeot's Vice President C. Peguet said last week, "We expect the Indian market for medium-sized cars to grow to 500,000 by the turn of the century." Orders for Peugeot's forthcoming 309 model have already reached 106,000.

Just last week, when Samsonite announced its joint venture, it concluded that its own research showed that 100 million Indians could buy its product at the present moment. Visa International estimates that 10 million Indians will be using its cards within the next 5 years.

INDIA: MARKET ENTRY / EXPANSION

The Annex to this document shows a general outline programme for foreign investment in India.

One point to bear in mind is speed. The Indian market is not waiting - for you, me or anyone else.

To cite just two examples from last week. Charles Berger of foods giant Heinz said, "India is the fastest growing unit in the Heinz company -- possibly in Heinz history."

In quite another sector, DHL said - at about the same time - "India is emerging as the fastest grower for air freight within Asia."

In another perspective, figures from Switzerland's VSM engineering federation will show a 6.6% increase in 9-month exports this year, led largely by deliveries to Asia. Indian shipments grew at a record 39%, compared to 22% in Thailand, 18% in Japan and a fall of 16% to China.

Even as I speak, international companies are flocking into India. One major announcement yesterday was from Hyundai which said it had agreed in principle to set up a $1 billion joint venture to manufacture cars onwards from 1998.

PURCHASING POWER

Given the sheer size of India's industrial output and the kind of potential I have just referred to, Figure 22 gives another measure used by economists to assess the market - that of purchasing power parity (PPP). Put quite briefly, PPP adjusts a country's capacity to produce and consume to local costs.

I shall now assume a conservative 7.5% growth rate in India's GDP. I say conservative, because of three factors:

1. Agricultural (and textile) exports under the new WTO agreement. A World Bank study, which will be issued later today, finds that India stands to gain relatively more than its South East Asian counterparts (potentially about $ 7 billion) from the new trade regime.

   India is already exporting food to China, Vietnam. Sometime this week, South Korea is expected to finalize a rice purchase agreement. Finally, India looks set to also grab a share of another hitherto completely closed market for rice, Japan.

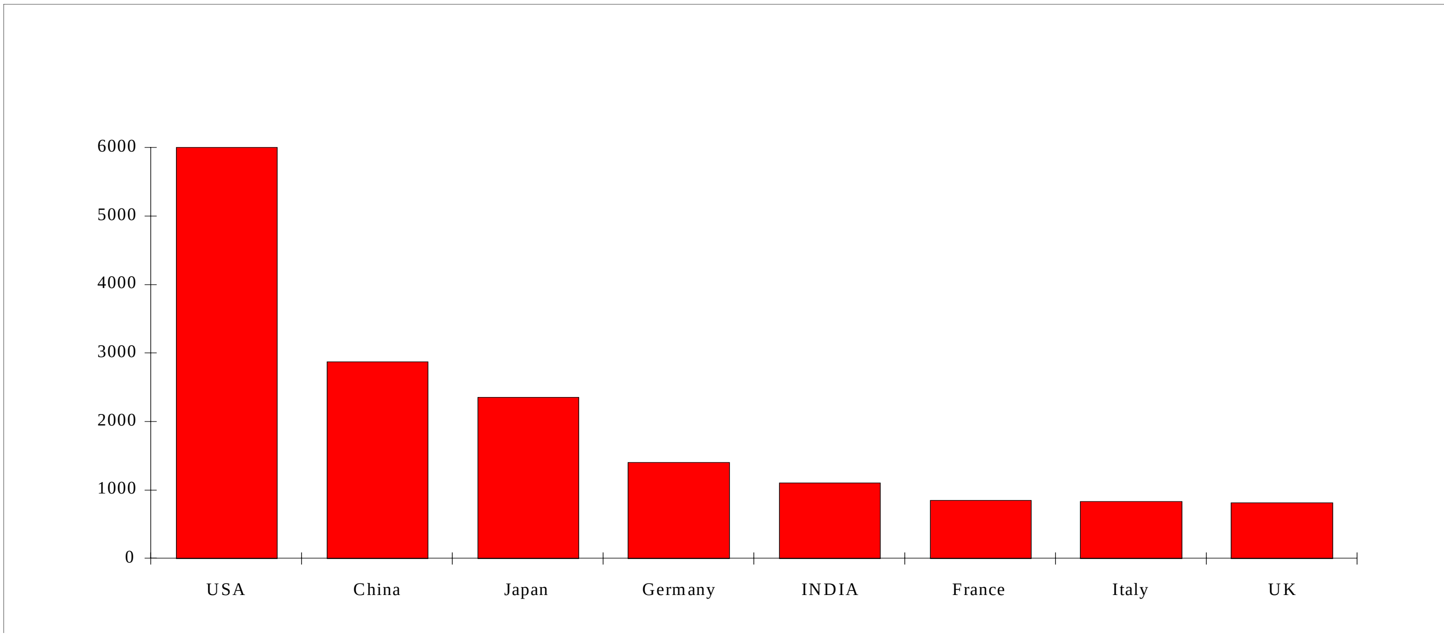
2. The growing share of manufacturing in GDP - corresponding to a classic phase of industrialization.

3. The enormous pace of growth (of 35-40% a year) in one high-value-adding service industry, namely software.

Figure 22

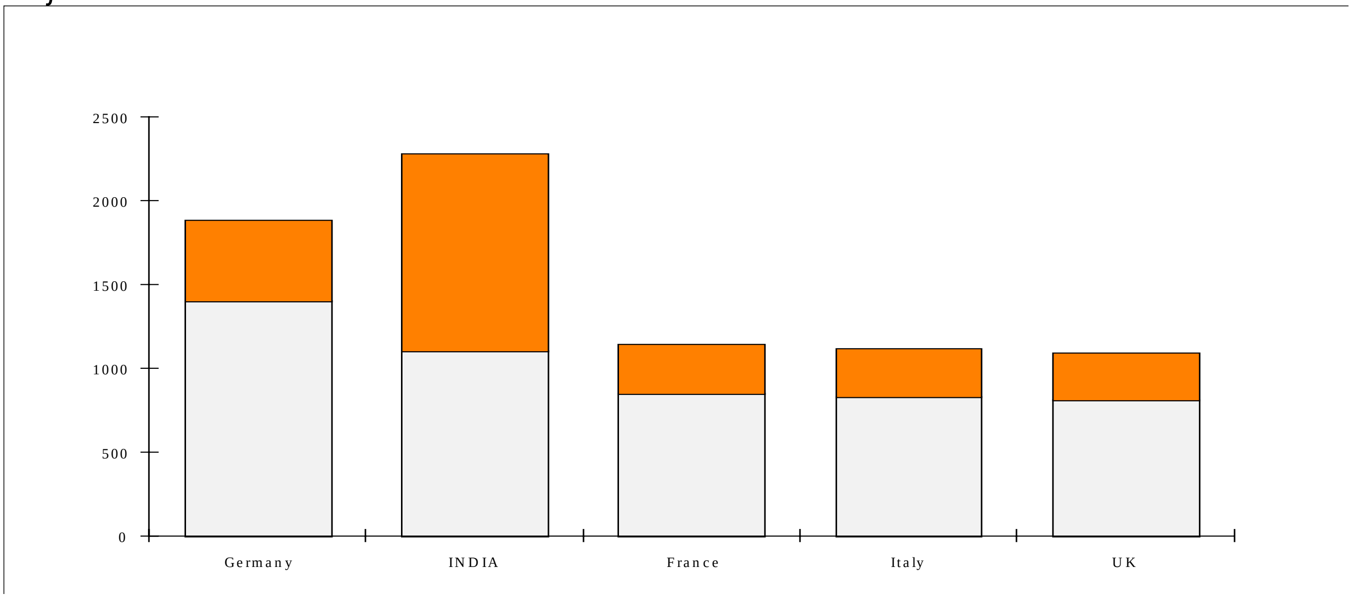
The World GDP Table: (by PPP)
in US $ billions

Year: 1992



Source: World Bank, The Economist, 1993 and 1994

Projections - Year: 2002



Compared to a 3% growth rate for Europe's economies generally held as a consensus, what does this yield ?

Rather than the relative rankings in the second half of Figure 22 - or the academic precision of the methodology used - what is more important is the volume of expansion expected in India’s economy. Though there are problems, bottlenecks and barriers - and these will no doubt continue - quite simply, this translates into business opportunities that cannot be ignored.

REFORMS: THE VERDICT

On its part, India's reforms are here to stay. This is not a declaration of faith, but a belief in pragmatism.

To paraphrase Sir Roger Douglas, a former New Zealand Finance Minister - who himself took the line from an Indian proverb - It is harder for a learner to stop cycling than to continue.

We of course know the alternative.

India's GNP is forecast to increase at 6-8% per year over the next 10 years. The private sector is growing at twice the overall GNP rate.

MORGAN STANLEY

Look at the growth opportunities in India and compare them with the mature markets of North America and Europe and you can get awful excited.

GENERAL ELECTRIC

The 12% yearly increase in numbers of the already 250 million-strong Indian middle class is creating incredible demand for domestically-produced goods.

BARCLAYS DE ZOETE WEDD

Larsen & Toubro sounds an unlikely name for a leading Indian engineering company.

Few realize that its range of products, consultancy and project management services put many European groups to shame.

MORGAN GRAMPIAN

India has streaked ahead of China. Using GDRs it has moved with astonishing rapidity and if that continues India will have a huge advantage.

JARDINE FLEMING

A well-developed private sector providing plenty of potential partners as well as business culture and management experience. China's communist-turned-capitalist leadership has had to try to re-create all these after stifling the entrepreneurial spirit for a generation.

A legal system modelled on that of England, assuring investors of rights of ownership and legal redress. China's lack of an effective legal system is seen as one of its biggest disadvantages. A financial system and stock market which, although in need of more reform, are far more advanced than China's.

India's steady economic growth is seen by some as offering a safer ride than China's roller-coaster switches between inflation-producing booms and periods of austerity.

FINANCIAL TIMES

APPENDIX

OUTLINE PROGRAMME FOR FOREIGN INVESTORS IN INDIA

1. Depending on the level of familiarity or interest in India, begin with a brief/ detailed professional market study. This must be accompanied by a flexibly-structured business plan on routes of entry and expansion in the market - agent, liaison office, branch, JV, partial/wholly-owned subsidiary.
2. Check general as well as sector-specific regulations for foreign investors (esp. on choices and commitments for technology transfer, joint venture, subsidiary).
3. Define method of payment: commission, royalties, lump sums or dividends.
4. Define role and responsibility of local collaborator.
5. Incorporate clause for dispute resolution and method for termination.
6. Take specialist advice on tax and legal matters. Do not rely on local partner. Though you will have common ends, interests may differ.
7. Take steps to protect IP rights and confidential information.
8. Set timetable for implementation of collaboration, length of negotiations and time for execution of agreements and state approvals to be obtained. Consider appointing project manager for negotiations and timetable.
9. Stay in touch with developments in India. It is not only a fast-growing market. It is also a fast-changing one.