

CHAPTER 5: INVESTING IN INDIA: THE ROAD AHEAD

The Growing Investment Opportunity

Since the advent of liberalisation, the Indian economy has seen rapid change in its structure with new opportunities for growth and expansion. The Indian manufacturing sector has streamlined itself and is on the road to becoming globally competitive. Sunrise industries such as pharmaceuticals and auto components have emerged on the horizon and established a presence not only in the domestic market but also in the international markets. The service sector has seen dramatic growth, fuelled by Information Technology, Business Process Outsourcing (BPO), consumer retailing and tourism. New opportunities have emerged in agriculture and allied sectors in areas such as food processing & packaging, contract farming

This change in structure has come on the heels of rapid growth. The average annual GDP growth rate of 6.1 per cent over the last decade has been amongst the highest rates of growth seen across the world and is likely to accelerate further. This combination of growth and structural change has opened up a range of investment opportunities for the three key sets of players:

- Domestic investors
- Foreign investors
- The Government

Explaining the Investment Opportunity

From an analytical perspective, investment opportunities are driven by two sets of factors:

- The existence and growth of markets
- The availability of resources and global competitiveness

The Indian economy offers an abundance of both these factors. For one, there has been an exponential growth in the market for a wide range of consumer products. This has had strong backward linkages with basic goods and intermediates. For instance, a boom in the passenger car markets has translated into a sharp growth in steel demand. The housing boom has had strong linkages to cement and 'long' products in steel.

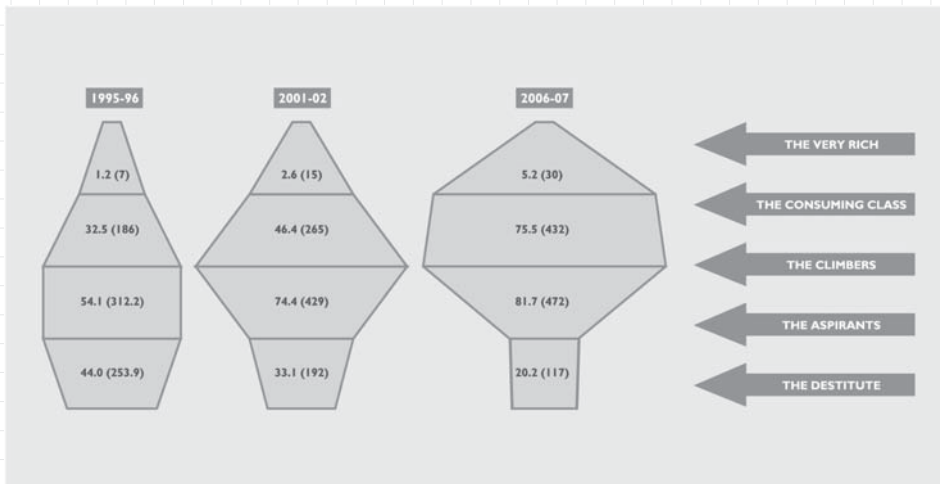
Table 5.1: Key Consumer Markets: Growth and Size

(US\$ Million)	2001-02	1998-99	CAGR(%)	Share(%)
New Housing	26,042	22,821	4.5	69.8
Passenger Car	4,369	2,602	18.9	11.7
Two wheelers	3,079	2,085	13.9	8.3
Consumer durables	3,194	2,390	10.1	8.6
-Colour Television	1,350	1,108	6.8	3.6
-Washing machine	283	188	14.9	0.8
-Refrigerator	690	458	14.5	1.8
-AC (window & mini split)	325	292	3.6	0.9
-Music system	229	135	19.2	0.6
-B/W Television	317	208	15	0.8
Personal computers	273	167	17.9	0.7
Mobile handsets	350	79	64.6	0.9
Total	37,306	30,144	7.4	100

Source: Industry estimates

The boom in consumer demand has come in the wake of demographic transition that has put a larger percentage of the population in the income earning age-groups. This trend, coupled with rising economic growth has translated into growing levels of affluence. Estimates and forecasts by leading agencies such as the National Council of Applied Economic Research (NCAER) show a sharp fall in the numbers and proportion of destitute families and a significant increase in the consuming classes.

Chart 5.1: Household Income Distribution (households & population in millions)

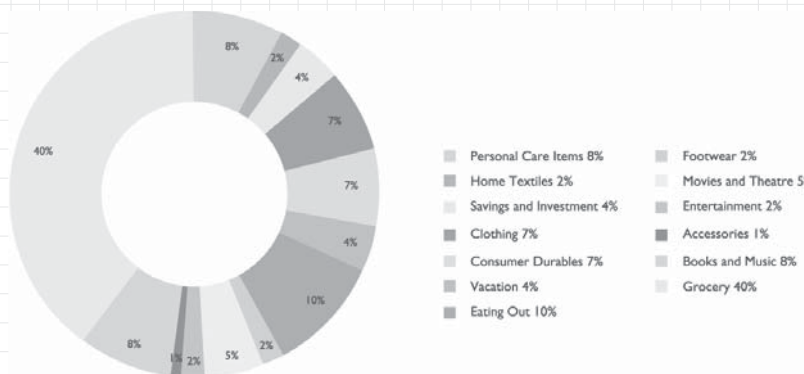


Source: NCAER.

Certain critical institutional changes have also lent a helping hand to the boom in consumer spending. The expansion of retail credit disbursement from the banking system is a good example. A sharp fall in interest rates coupled with aggressive forays by Indian banks into retail lending has seen Indian consumers borrowing to buy. According to banking industry estimates, personal credit off-take has increased from about US\$ 10,417 million in 2000 to about US\$ 33,333 million in 2003.

Finally, the Indian middle-class consumer's consumption patterns are also witnessing a rapid transformation and this is driving the rapid change in the markets for goods and services. The Indian consumer is spending a significant fraction on 'discretionary' items like entertainment, books and music and consumer goods. Thus, the market characteristics of the Indian middle class and top strata of society are fast approaching the sophistication levels of the developed markets.

Chart 5.2: Indian Consumption Pie

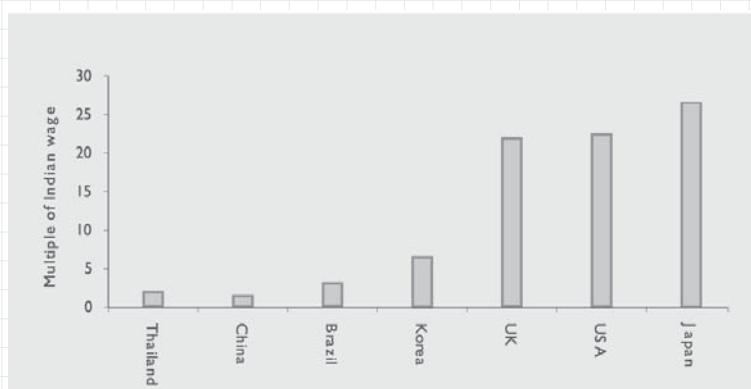


Source: KSA Technopak Consumer Outlook 2004

The Resource Factor and Global Competitiveness

India also offers a number of critical resources that enhance its attraction as an investment destination. The most critical resource is the large pool of cost-effective and highly skilled labour giving the Indian industry an edge over others. This, naturally, translates into low wage levels. Chart 5.3 describes the average wage in an equivalent job as a multiple of the Indian wage against a selection of developed and developing economies.

Chart 5.3: Country-Wise Wages (multiple of Indian wages) -2002



Source: CRIS INFAC

Box 5.1: The Manpower Advantage and Global Sourcing

Given the advantages that India offers in terms of availability of quality manpower, India has become a major base for sourcing manufactured products as well as research and development. Some examples are:

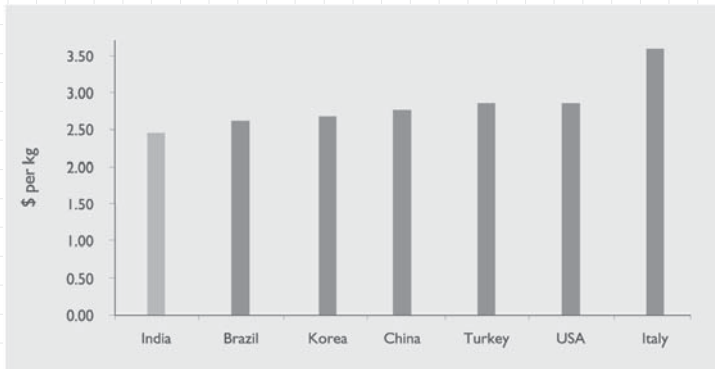
- GE's largest R&D centre outside the US is located in India
- Most major MNCs like Volvo, GM, GE, Chrysler, Ford, Toyota and Delphi source components and hardware from India
- Korean auto manufacturer Hyundai Motors has India as its global base for the manufacture of small cars
- China purchases steel worth more than US\$ 1 billion from India

Besides, it is not just the cost of labour, but also the availability of skilled manpower that gives India an advantage over other developing economies. There are about 380 universities and 1500 research institutions that account for an annual increment of 200,000 engineering graduates, 300,000 post-graduates from non-engineering backgrounds, 2,100,000 other graduates and roughly 9000 PhDs. It is among the only three Asian countries with super-computing competence.

Unlike a number of other emerging economies, India has a large domestic entrepreneur class responsible for indigenous investment initiatives. Its financial infrastructure is among the best in the world - India has highly developed capital markets and a banking system that follows international best practices. It has a strong judicial structure with continuous improvement in areas like Intellectual Property Rights (IPR). For instance, from 2005, Indian IPR laws will recognise both product and process patents.

India is also richly endowed with natural resources that help keep costs of production at competitive levels. For instance, India is an indigenous producer of cotton and this will give it an enormous competitive advantage in competing in global markets when the textile quotas under the WTO's Agreement on Textiles and Clothing (ATC) are dismantled.

Chart 5.4: Cotton Yarn Manufacturing Cost Comparison -2003

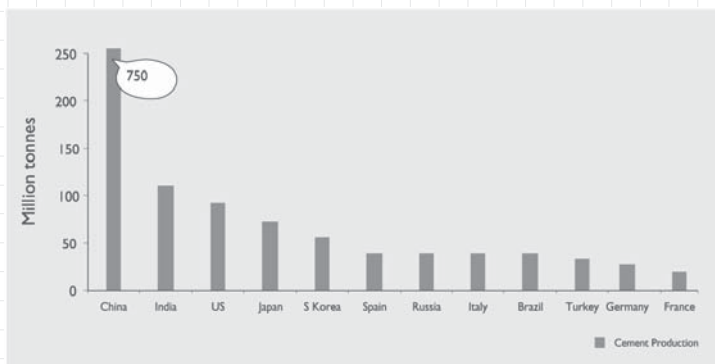


Source: Indian Cotton Manufacturers Federation.

edge to cement producers. In fact, the combination of indigenously available inputs and the ability of cement producers to absorb cutting edge technology have together made India the second largest producer of cement in the world.

India is also a signatory to all major international trade and investment agreements and enjoys many bilateral and multilateral Free Trade Agreements/Common Market Agreements. India has developed several product specific industrial/service clusters of global class. The infrastructure improvement programmes undertaken also make India an attractive investment destination.

Chart 5.5: World Cement Production - 2003



Source: US Geological survey

India's growth and investment potential has drawn the attention of most global investors. According to US investment bank, Goldman Sachs, India, China, Brazil and Russia (the BRIC economies) are expected to be the key players in the global economy in the next fifty years. Of these, India will show the most rapid growth. In fact, while growth rates in the other economies is expected to decline, India's growth rate remains over 5% through the period and has the potential to raise per capita income in 2050, to 35 times the current levels.

India's Critical Advantages, according to this report, are:

- Growing proportion of working age population
- Growth in capital stock in the wake of rapid growth in investment
- Technological progress manifested in improving productivity levels

To take another example, India has large reserves of limestone and coal, lending a competitive The Link with Infrastructure

The rapid growth in the conventional industry as well as 'sunrise' sectors like IT, retailing and services, in turn entails expansion in infrastructure support. The sustenance of high growth rates in IT and BPO, for instance, is contingent on the expansion in telecommunications. On the other hand, for the more conventional manufacturing industry, infrastructure inputs such as roads, port facilities and power hold the key to sustained expansion. This requires a combination of private and public initiatives. The Government's strategy has been to focus on creating incentives for the private sector as well as participate directly as a key investor. Some of the steps taken in this direction are:

- Progressively reducing Government control and allowing easy entry of the private sector. Foreign Direct Investment norms, for instance, have been continuously eased with 100 per cent investment allowed in most of the sectors
- Announcing consistent long-term policy measures and delegating control to independent regulators. The enactment of the Electricity Act in 2003 and the establishment of the Telecom Regulatory Authority of India (TRAI) are important examples.
- Undertaking programmes to step up the quantum of infrastructure facilities through public-private partnerships

These measures have led to a significant expansion in the opportunities for private participation in infrastructure investment. Some of the specific policy initiatives in each sector along with the opportunities for private participation that they present are discussed in the next section.

Finally, in areas where there is an established history of 'market failure' such as in health, education and poverty alleviation, the Government has a direct role to play. In fact, as it withdraws from direct participation in production, it is imperative for it to step up investments in the social sectors. The Government is currently an active investor in these sectors and has committed to enhancing its share of social sector investments to 6 per cent of GDP over the long term.

Critical Changes and Emerging Opportunities for Investing in Infrastructure

The opportunities for investment thrown up by the critical infrastructural segments of power, IT & telecom, civil aviation, roads, railways and ports & shipping, and regulatory changes are mentioned below.

Power

Changes	Opportunities
<ul style="list-style-type: none"> • CERC and SERC set up • Indian Electricity Grid Code established • Accelerated Power Development and Reforms Programme formulated • Electricity Act notified in 2003 • Automatic approval for 100 per cent foreign equity • Power generation completely delicensed 	<ul style="list-style-type: none"> • Private sector entry into generation, transmission, distribution and trade • Investment of US\$ 200 billion during 2002-12 • 41,110 MW generation capacity target during 2002-07 • Import of LNG for combined cycle power plants • Renovation and modernisation • Cross country grids • Energy auditing and monitoring

Telecommunication and Information Technology

Changes

- Introduction of Calling Party Pays in May 2003
- Unified Access Service Licensing Regime introduced in Oct 2003
- Communication Convergence Bill 2001 to oversee national infrastructure for information based society
- Interconnection User Charge introduced in 2003-04
- No industrial licence required for telecom equipment manufacturing

Opportunities

- Low tele-density, high potential
- Excellent growth potential in rural areas as the rural area is virtually untapped
- Cellular subscribers to rise by 100 million during 2004-07
- 175 million basic telephone connections by 2010
- No restriction on number of players in ILD, NLD, Basic telephony, Internet Services
- 100 per cent FDI in telecom equipment manufacturing

Civil Aviation

Changes

- Private equity participation in airport infrastructure permitted
- Private sector participation in greenfield airports with 100 per cent equity stake
- Inland Air Travel Tax abolished
- Bilateral aviation agreements based on reciprocity initiated

Opportunities

- Delhi, Mumbai airports to be modernised/restructured with private participation
- Target of US\$ 800 million set by AAI for modernisation
- New international airports to come up in Hyderabad, Bangalore and Goa
- Low penetration rate
- Passenger traffic to touch 85.3 million passengers by 2016-17

Roads

Changes

- Private participation through BOT toll-based and annuity based structures
- 100 per cent FDI allowed in roads sector
- 10 year corporate tax holiday
- NHAI permitted to participate in equity in BOT projects up to 30 per cent
- Duty-free import of specified modern high capacity equipment for highway construction
- Capital grant of 40 per cent of project cost by NHAI

Opportunities

- National Highways Development Project covering 13,140 km of highway development.
- Estimated investment of US\$ 11.5 billion in NHDP
- Private sector as investors – BOT projects and direct borrowings
- Consultancy in feasibility studies, project preparation, construction supervision
- Construction equipment manufacturing

Railways

Changes

- Computerised Freight Operation Information System
- Online passenger reservation system
- Private participation in projects through BOT scheme
- State participation through cost sharing and SPVs
- Tariff rebalancing and rationalisation of fare and freight structures
- National Rail Vikas Yojana announced in August 2002

Opportunities

- 1310 km of new lines to be completed during 2002-07
- More than US\$ 3 billion investment in removing capacity bottlenecks
- Investment in port connectivity at US\$ 0.63 billion
- Provision of complete logistics chain
- Investment in railway infrastructure and rolling stock
- Production of railway equipment

Ports and Shipping

Changes

- Public-private partnership including joint ventures
- Inland water transport policy approved by the Government
- Introduction of tonnage tax

Opportunities

- Private investment of about US\$ 2345 million expected
- Increased thrust on public-private partnerships for the development of ports
- Private participation with respect to inland transport infrastructure connecting ports
- Investment needs of US\$ 20 billion in the ports sector