

India and You: Opportunities and Constraints

Deepak Parekh

Mr. Deepak Parekh Chairman of Housing Development Finance Corporation Limited (HDFC Ltd) addressed the EPGP participants of IIM Indore in May 2010 in Mumbai. In his presentation, he covered a range of issues related to the potential pre-eminence role of India and the changes that are happening in India. Indore Management Journal is pleased to bring an edited version of his presentation to the wider audience for their reading and reflection.

To my memory, India has never been in such a strong position ever before. There would have been many times that we were about to take off but we did not take off. Every time there is a transition and India is about to take off, something happens internally or something falls through, but this time looking at the weakening world economic condition, I think that we are in an extremely strong position. Every international company, however large or small, has India on its radar. No international company can afford to ignore or avoid India any longer. How to generate wealth in India, how to invest in India, how to use India's services, how to import from India, how to export to India, are some of the areas of interest for these companies. We are in a very privileged position.

India is the second fastest growing economy in the world after China and it will continue to be so in foreseeable future. One of the features that distinguishes us from China, and I guess it is a commonly known fact, is that we have a domestic consumption driven economy, unlike an export driven economy in China. When I was of your age, consumption was a 'bad word'. Today, consumption is not a bad word. The Indian economy is booming and is insulated from global crises because of the large domestic market and increasing consumerism. If you look at the Asian Financial crisis which happened in Thailand, Malaysia, and Singapore,

India to a large extent remained immune to it. The dot-com bubble was another such crisis in the list. We were all worried that the Information Technology industry would collapse after the dot-com bubble, but India stood firm and escaped not only the dot-com bubble but also the recent subprime crisis spread across the globe. The global financial crisis had some impact on India as we are not totally insulated, but still the impact on us has been minimal which is the reason why our recovery from Global financial crisis has been faster.

During the last decade, GDP growth was phenomenal. The growth rate for India was 9% for three consecutive years. Though there was a decline in the GDP growth rate following the global financial crisis, India bounced back with a GDP growth rate of about 8.5%.

The shift in composition of GDP has been significant over the years. Service industry constitutes about 65% of the GDP. Services include IT and ITES, banking, insurance, telecom, domestic airlines, travel and tourism. While agriculture growth has been erratic, manufacturing sector has always remained the same. What bothers the policy makers is that about 70% of our population depends directly or indirectly on farm labour, farm production and is from rural India. Given that 70% of the population depends on agriculture, it contributes only 17% to the GDP. Though the data may be skewed as everyone in rural India is not involved in agriculture, still 70% of the population contributing to 17% of GDP is not desirable. Something is wrong in the agriculture sector, something is wrong with farm productivity.

In the last 6 months, food inflation was around 18-19%, but the farmers are not getting remunerative prices and the consumers are paying too high a price. The leakage is really in the distribution system - from the farm gate to the food plate, the middlemen, transportation and warehousing. A lot needs to be

done on the agriculture side; it is one of our real challenges if we want to grow. The other thing that is impacting the food shortage is the National Rural Employment Guarantee Scheme (NREGS). The Scheme guarantees at least 100 days employment to the people living in rural areas and willing to do unskilled work with a wage rate of Rs. 100/- per day. Food consumption has increased significantly of which is contributed by schemes such as NREGS. On the other hand, the food production has remained more or less stagnant during the last couple of years. So we have to address this issue. We perhaps need another Green Revolution. We need to invest in that.

Rural India is a huge opportunity. Many companies are looking at how to sell goods in rural India. It took 60 years for India to grow to a US\$ 1 trillion economy; the next trillion will come in 7 years. So in 2007, we became a trillion dollar economy, 2014 we will become a two trillion dollar economy, in 2016 the next trillion will come, so the best years in India are yet to come and all of you will be the beneficiaries.

There are certain challenges which we have to meet. For instance, let me talk about the issues of the growing middle class. Currently, 250 million constitute India's middle class, they say by 2020, the number will go up to 800 million. This 800 million-consumer class having some income in their wallets, having employment, having money to spend, will boost economic growth, but with that comes a threat of urbanization. Today, it is estimated approximately 300 million people live in urban India and in 10 years from now, this will be 600 million. The urban population in India will be a problem. Where will they live, where will they work, how will they commute, what will be their transport systems - where are the new schemes for India's development? China is developing 900 new cities, and more are under construction. China this year is going to spend US\$ 90 billion on railways to improve connectivity, whereas, India plans to spend US\$ 2 billion on railways. If China is spending 6 to 10 times of what we spend in every sector, the gap will increase. We have to get our act together - whether it is roads or railways, there is a need for huge investments in the

infrastructure sector.

There are a number of successes also. The telecom revolution was a great success. Teledensity in urban India is over 100%. The private sector is now looking at the rural market on how to increase the revenue by additional services, so I think telecom is a real success story and it happened because the government allowed the private sector to invest in telecom. On the other hand, the public sector companies are not performing at their potential. For example, take the case of BSNL. BSNL has 3.5 lakh employees and it has 95% of landline telephones in India. It is the largest public sector player, but it is going the Air India way because they have not kept up with technology, they have not done any equipment order, the management is still slow, unions run the company rather than managers. Compare this with the private sector. The private sector telecom companies have grown rapidly (although they are now slowing down because of increased competition and consolidation has not yet happened in the sector).

In 1991, I remember we had a reserve of US\$ 1 billion that was just enough for 14 days of imports. Today, we have little less than US\$ 300 billion. FDI is increasing significantly, FII stakes are increasing. IT industry has evolved. Within a year IT and ITES size would be US\$ 100 billion of which, 75% is foreign and 25% is domestic revenues. IT and ITES employs 2.2 million people and for every IT employee there are 4 new jobs created because of administration, logistics, housing, canteens etc. There is a huge incentive in whatever you look at. What stance the US government will take with outsourcing is a question mark. Will they stop outsourcing, will they put a tax on outsourcing, so again that is a big concern that we have. But outsourcing so far has given us huge amount of revenues. Outsourcing and NRI advances are sustaining India so far and NRI advances are US\$ 40 to 50 billion. Earlier much of it was coming through illegal channels, unofficial channels; now 99% comes through the official channels.

India's financial sector is very well regulated. We have a very cautious approach, even now if you take the European countries; Indian banks' exposure to

Spain, Italy, Greece, and Portugal is almost non-existent. Our export to these five countries put together is less than 4%, so we are not that impacted. It is the attitude of foreign investors because they are really interested in these countries and if their money start depreciating and disappearing, then the behavior of foreign investments takes a hit and so we need to bear that in our mind. They say that there is a unique reason why some of the countries have escaped the subprime crisis like India, Australia, South Africa and Canada. Now what have these four countries got in common that they escaped the subprime crisis. The common thing in all the four countries is that the foreign banks do not constitute more than 10% of the respective country's banking business and so foreign banks do not run the national economy or the national banking sector. In a recent visit to India, the Canadian Governor said that they are so close to United States, but they have never allowed all the foreign banks put together to contribute more than 10% of the Canadian banking sector or 10% of Canadian business. We have developed local banks. They may not be known internationally, but we have a strong domestic banking system. I think in India probably all foreign banks put together constitute 4-5% of our banking sector. So that is another reason which has prevented us from going bust.

Now some of the issues and concerns which we all are aware of include agriculture, infrastructure and inflation. You must have seen a number of debates on growth versus inflation, should we go for growth or should we contain inflation as there is always a thin line of balance between growth and inflation. The Reserve Bank of India always wants to have inflation under control. The finance ministry, the government of India, also wants to control inflation. The rise of food inflation was predominantly due to inefficient functioning of Food Corporation of India (FCI). Not many of us know about it, but it is one of the largest public sector companies. It has a monopoly on warehousing. No one knows about the food stocks it actually has. It is solely responsible for the distribution of food from their warehouses to different parts of the country. How much food is there, is that

food edible, how the food grains are stored, how the transportation happens, are the food grains transported on time and so on are some of the concerns. There is a pressing need to change or at least reform the way FCI operates. Besides food inflation, logistics, freight costs, raw material costs are also going up.

Another concern is fiscal deficit. Somehow RBI feels that part of the problem is large fiscal deficits. I think RBI is going to be extremely cautious and may be even more cautious than necessary to contain inflation. They have started an increasing interest rate which is detrimental to every company. The era of soft interest rates or low interest rates is over. Inflation in developing economies where so many people live below the poverty line is a big concern, especially when the government is looking at inclusive growth.

Fiscal deficits are worrisome. If you have 8-9% growth, (my personal view is that) you can easily live with 4-6% fiscal deficit. You cannot live with a high fiscal deficit, if the GDP growth is low. See the bonanza that the government received with 3G licenses. The Finance Minister in the Union Budget 2010-11 set an ambitious target of generating Rs. 36,000 crores from the auction of 3G spectrum licenses and they got more than double the amount. Last year the oil subsidy was Rs. 1 lakh crore. This year, oil prices have come down in the last 2-3 months. So there is a fair amount of cushion and now the government has to ensure that the fiscal deficit does not hit the roof.

However fiscal deficit and inflation are always going to haunt a developing country like ours where we have a large number of people living below the poverty line. So fiscal deficit and inflation are of concern, agriculture is concern. High dependency on oil is a negative thing.

Almost 75% of our oil requirement is imported. Now I am not willing to believe why Yemen which is close to India has huge amounts of oil and there is not enough amount of oil in India. No big foreign oil company has a sizable presence in oil exploration in India. BP is one of the largest European companies that is here in lubricants and solar power, but not in

oil exploration. Exxon Mobile does not have a presence in India, one of the world's largest companies. They don't want to come. Shell has a small presence in Gujarat and Rajasthan, but nothing much to talk about, but these are globally giant companies. When oil prices go high, our import becomes US\$ 100 billion, it is huge because of the rising crude prices and 75% of it is imported and is increasing because our domestic production is not much. Now they say we have found lot of natural gas, but how to evacuate gas and to build the pipeline needs serious attention.

Exploration Licensing Policy: petroleum ministers need to address these issues. The foreign oil companies do not want to enter into oil exploration in India and the main reason they say is that all the good fields are taken by the Indian companies (both public and private) and the most difficult ones are put on auction, so we are not interested. But oil is Indian economy's weakness. It is the single largest item on our import bill. I think oil dependency is a concern, and again because it is a concern, it is an opportunity. One has to get big into exploration onshore and offshore. It is a risky business. There are high risks, but there are high rewards as well.

Land issues, artificial shortages are of concern too. Land laws have not changed for last 100 years. We have not done anything on land so how do we bring more land into circulation - be it for industrial use, for housing, or for office space, land prices in urban India are unaffordable. POSCO is a single largest FDI investment in India. It is about US\$ 10 billion investment. It's been five years and they are still struggling to get approvals. The issues are mainly land issues. Orissa has no dearth of land; but land acquisition is the critical one. Tata Steel's Orissa plant is also on the drawing board for the last 6 years, still no work has been done because they have only 60% of the land and the balance land acquisition is still to be worked upon. We saw what happened to the Nano factory. I think land and legal reforms are huge issues and need to be tackled.

We have other issues like that of Naxalism, terrorism and disturbances across our borders which are other

dangers that can really ruin our country. The world is seeing the prosperity of India and there is a huge amount of jealousy amongst our neighbors and anything adverse on that will delay our progress and our growth. We need to be vigilant, we need to spend money on defence equipments and we need to properly secure our borders and our coastal lines. If you look at some defence areas, to my mind the facilities are not that great. Morale is there, determination is there but all the other things are not there. Terrorism, both domestic and international is a big worry.

Corruption is another major problem. If you ask me, which are the two problems India has, I would say corruption and bureaucracy. Bureaucracy and corruption, along with terrorism, are the major areas which can make us uncompetitive and make us more vulnerable, but other than that I think we are in best time ever in our history.

Still, there are concerns. In India's history we have only built 2-3 kilometers of roads a day. The Highway Ministry claims to take it to 7 kilometers per day. The amount of money required for growth is huge. When I was growing up, when I was of your age, Shapoorji Pallonji and HCC and L&T were there. Today also these companies are there. But, where are the new L&Ts? Small companies come up but they are tiny, they can do 20-30 kilometers at a time but there is no company (other than 3-4 big contractors) which can build 500 kilometers or 1000 kilometers at a time. For some reason, contracting work has not grown as expected but a huge amount of activity is expected in the future especially in road construction.

On the whole I think, India is on a sure footing: for example, see the results of companies. Every company is coming out with excellent results. Normally auto sales are worst impacted in the month of April (2010) as a large majority buy cars in February and March prior to the budget announcements and taxation changes. This year in April auto sales grew by about 38%. There is a shortage of tyres; there is a shortage of other auto ancillaries, nonetheless, the auto sector is booming and so is the Indian economy, unleashing numerous opportunities for the youth, for you all.

Realizing Leadership Potential*

Since you are all potential leaders of the future and most definitely an integral part of India's growth story, I have a few markers that you might like to keep as post-its on your screens as you navigate life hereafter. It is a recipe of experience, wisdom, lessons learnt and lessons imparted.

You have got to find what you love. Your work is going to fill a large part of your life and the only way to be truly satisfied is to do what you believe is great work. And the only way to do great work, imbued with as much passion and perfection you can muster, is to love what you do. If you have not found it, keep looking. Do not settle for the next best. As with all matters of the heart, you will know when you find it. It will be there in the smallest idea, a train ride, a journey quite mundane, a shower, a rain storm, an insipid or gourmet meal - in the most inconceivable circumstance, it will rear its head! And like any great relationship, it just gets better as the years roll on. In the trajectory of this search, you have to trust in something - your instinct, your destiny, life, karma, promise whatever. This approach has never let me down; it has been the single - lane bridge from mediocrity to excellence.

You will be tested to keep your ethical and moral fortitude and it is very easy to get carried away. It is up to you to stay alert and not get sucked into disreputable conduct, business practices or anything else which has even the slightest whiff of impropriety. It is true that your education from this institute will definitely give you the upper hand at the beginning. But in the long run it is your reputation which will determine how much success you ultimately achieve. The more successful you get, the higher the chances of being pulled into unethical and immoral business practices. And the most common excuse for such unethical behaviour is, "everyone is doing it". Always bear in mind that your reputation once lost, is almost impossible to earn back. There is no such thing as a temporary breach of integrity - you cannot make amendments later. So do not stay in any place where

doing the right thing is not an option. Work honestly, make people trust you and let them depend on your integrity.

Be a good team player. It isn't always possible to run the whole mile alone. Remember that being able to get along and work with other people is a great asset in the real world. People are important and nothing can happen without them. It is people and your colleagues who help make things happen for you - who give you the chance to prove your worth. Any organisation is only as good as its people. Stay humble, but know and believe in yourself. Humility is essential for self-preservation - it helps you to remain approachable to people.

People say that success has a thousand fathers, but failure is an orphan. Some failure in life is inevitable - it is impossible to live without failing at something, unless you live so cautiously that you might as well not have lived at all! Always remember, the risk of making mistakes is respected, so long as you own them and learn from them.

The world needs you now more than ever before; your bold ideas, your energy and passion. It needs doers, dreamers and optimists. It needs people who believe that things can get better and people who are willing to work to make them better.

Deepak Parekh, Chairman, HDFC spearheads India's leading Financial Services conglomerate with presence in Banking, Asset Management, Life Insurance, General Insurance, Real Estate Venture Fund and Education Loans. He is the Non-Executive Chairman of Glaxo Smithkline Pharmaceuticals, IDFC and Siemens India. He is on the boards of Castrol, Hindustan Unilever, Mahindra & Mahindra, and Indian Hotels among others and international boards of WNS Holdings and DP World. He is also on the Advisory Boards of several Indian Corporate and MNCs. He is dubbed as the unofficial crisis consultant of the Government and is a member of various high-powered Advisory Committees and Task Forces. Some of his most important recognitions are; the Padma Bhushan in 2006. "Knight in the Order of the Legion of Honour" one of the highest distinction by the French Republic in 2010; and the first International Recipient of the ICAEW Outstanding Achievement Award - 2010.

* Part of the speech delivered in the Convocation at FLAME, Pune on May 07, 2011.