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Undimmed ambition as economy's lights flicker

Growth has slowed at home but cash-rich, family-owned groups are still in the mood to expand overseas, writes **James Lamont**

The Mahindra & Mahindra stand at the Delhi motor show tells a story of powerful domestic demand and undimmed global ambition.

Thousands of young people swarm around gleaming sports SUVs, electric cars and trucks, even before the show has opened to the public.

From a balcony above the fray, Anand Mahindra, managing director, is laying out his plans to make his car marque a global one in the years ahead.

A milestone on the way has been passed. His company has just overtaken Illinois-based John Deere as the world's largest tractor producer by volume, propelled by India's buoyant rural economy.

At Mr Mahindra's side are his Korean partners. He bought Ssangyong, the Korean carmaker, last year for $400m, and so far has done a better job than its previous Chinese owners, Shanghai Automotive Industry Corporation.

Now, the Mumbai-based businessman is keeping his "periscope up", he says, for other opportunities in a depressed global market.

At a time of tumult in global markets, and uncertain outlook in the US and Europe, Mr Mahindra's ambitions are striking. They are a reminder that with a fast-growing economy at their back and entrepreneurial flair, India's family-owned, cash-rich groups are still in the mood for international expansion.

Some of India's global leaders are, however, battening down the hatches. Ratan Tata, the 74-year-old chairman of the Tata Group and owner of the UK car marques Jaguar and Land Rover, has ruled out new acquisitions and told his employees to brace for austerity.

As with Mr Mahindra, he is turning to markets among Bric economies and fast-growing Asian countries such as Malaysia, Indonesia and Thailand.

Many industrialists and bankers have been discouraged by a dismal year at home. India's economic growth has slipped from earlier forecasts of 9 per cent to 7 per cent for this fiscal year. Some independent forecasts predict nearer 6 per cent.

Double digit growth, says Richard Iley, economist at French bank BNP Paribas, is firmly in the "rear view mirror".

Pessimism has grown about India's prospects after months of political bickering and a high profile corruption scandal in the telecoms sector.

The edge has been further taken off an earlier mood of euphoria in the business community by near double-digit inflation, rising borrowing costs and delays in government approvals.

Expectations that Manmohan Singh, the prime minister and a respected economist, would use his second term in office for bold reforms have quickly drained away. Instead, the Congress party-led coalition has suffered repeated setbacks at the hands of the opposition, its allies and civil society activists.

Amid a policy paralysis, the government was assailed during the second half of last year by an anti-corruption movement that brought middle-class Indians out on to the streets to protest against poor governance and widespread cheating.

"We in India have had our share of problems. The Indian economy slowed down and inflation edged up. Concern about corruption moved to the centre stage," acknowledges Mr Singh.

To add to its woes, the government made an embarrassing U-turn on allowing greater foreign investment in multi-brand retail (supermarkets). A tax overhaul, described by Adi Godrej, the chairman of consumer group Godrej, as one of the biggest catalysts to boost economic growth, has stalled.

Such setbacks have fuelled speculation about differences between Mr Singh and Sonia Gandhi, the left-leaning president of the ruling Congress party. They have also sharpened expectations of the succession of Rahul, her son, as premier.

The financial markets exacted their punishment. An exit of foreign capital was reflected by Sensex, the benchmark index on the Bombay Stock Exchange, languishing as one of the world's worst performers last year. Likewise, the rupee fell 16 per cent over the year.

Foreign direct investment slumped from a previous $24bn to $19bn in 2011, just at a time when policymakers were trying to entice foreign partners to build infrastructure.

Export growth, which rose sharply in the first half of the year as new markets such as Latin America, Africa and Asia opened up, has slowed.

Many senior economists, such as Shankar Acharya, an economist at the Indian Council for Research on International Economic Relations, consider India's problems largely homegrown, and fear 2012 will be a tough year.

Such were the high-tempo domestic preoccupations that they have almost entirely eclipsed both the global outlook of the previous year – when India played host to the leaders of the UN Security Council Permanent Five powers – and more traditional anxieties about neighbouring Pakistan and China.

Economists have steadily become more downbeat. "2011 [was] an unfortunate cocktail of domestic policy issues and a slowing global environment," says Rohini Malkani, economist for Citigroup in Mumbai.

"India is not beyond repair. Measures that will help include incentivising investments, attracting foreign exchange flows and executing proposed fiscal reform."

Mr Singh has responded this year with an effort to get back on the offensive. He is under pressure to halt the decline, and defy critics of his administration's inaction.

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A clean sweep? A billboard for the state assembly elections including, centre, Sonia Gandhi, Congress Party president Getty

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Debate over growth after fight to trim inflation rate

Economy

James Lamont finds business leaders and economists warning of 'excessive pessimism'

India's policymakers have battled grimly over the past year to bring down near double-digit inflation, the highest among Bric nations (which encompass Brazil, Russia and China, too).

Signs are that they are finally winning, but only as economic growth slows from a forecast for the year of 8.5 per cent to below 7 per cent.

Some economists predict that inflation will fall from the 9 per cent and above that persisted for most of 2011t o an annual rate of 6.5 per cent in January. By April, inflation could be below 6 per cent.

"Rather than economic growth, we expect downside surprises to come through on inflation," says Robert Prior-Wandesforde, economist at Credit Suisse in Singapore.

The achievement has come at a price.

To the growing consternation of the country's industrialists, policymakers have leant heavily on monetary tightening to rein back rising prices in the fastest growing large economy after China. The central bank has lifted benchmark lending rates 13 times over the past two years.

The central bank's critics say it has been "behind the curve" in the fight against inflation and has continued lifting rates when other emerging markets have begun to cut them to protect growth rates. They say it acted too timidly early on, with small rises in lending rates, and too late to stop a spread of fast rising food prices into more generalised inflation.

"The Reserve Bank of India was initially caught off guard as inflation rose in the post-crisis recovery, and then was too meek when it decided to hit the brakes," says Glenn Levine, senior economist at Moody's Analytics. "This has produced the worst of both worlds: growth has been hit but with no noticeable effect on inflation."

Industrialists blame higher borrowing costs for choking off growth and deterring investment. But in the first weeks of 2012, there are encouraging signs that the inflationary tide is turning. Food inflation, a key source of rising prices over the past three years, has dropped sharply in past weeks.

Pranab Mukherjee, the finance minister, has spoken of a "substantial improvement".

Better still, the RBI has signalled that the interest rate cycle has now peaked. Rate cuts are likely in the coming months. The first cut in the repo rate could come in April, say some economists, possibly even before.

"We have seen the worst of the [rate] rises," says Kaushik Basu, the finance ministry's chief economic adviser.

Reducing stubbornly high inflation could not come soon enough. Inflation is viewed as a powerful vote loser in India as rival political parties square up for a crucial election in Uttar Pradesh, India's most populous state, next month. It has repeatedly defied repeated forecasts by Manmohan Singh, the prime minister, and Montek Singh Ahluwalia, one of his chief advisers, of a cooling.

C. Rangarajan, Mr Singh's chief economic adviser, forecasts that inflation may now fall below 7 per cent by the end of March. He remains convinced that India, a country of 1.2bn mostly poor people, must bring inflation down towards a more comfortable rate of no more than 5 per cent to achieve sustainable growth.

Others in the central bank similarly hold the view that the Indian economy cannot grow above 8 per cent without inflicting unsustainably high inflation on the nation's poor.

Some prominent business leaders do not agree. Ratan Tata, the chairman of the Tata Group, has appealed to the government to prioritise India's high growth rates over inflation and considers this goal worthy of living with higher prices.

He and others have also appealed to the Congress-led government to push ahead with structural reform and address supply constraints by encouraging greater domestic investment and improving the country's decrepit infrastructure.

Many senior economists warn against what they call "excessive pessimism".

Arvind Panagariya, economist at Columbia University in the US, says India can quickly recover the 2 percentage points of economic growth that it has lost during the global financial crisis.

Former World Bank chief economist Joseph Stiglitz calls growth of 7 per cent this year an "achievement" in a global downturn. To do better, policymakers need a road map to modernise and open the economy.

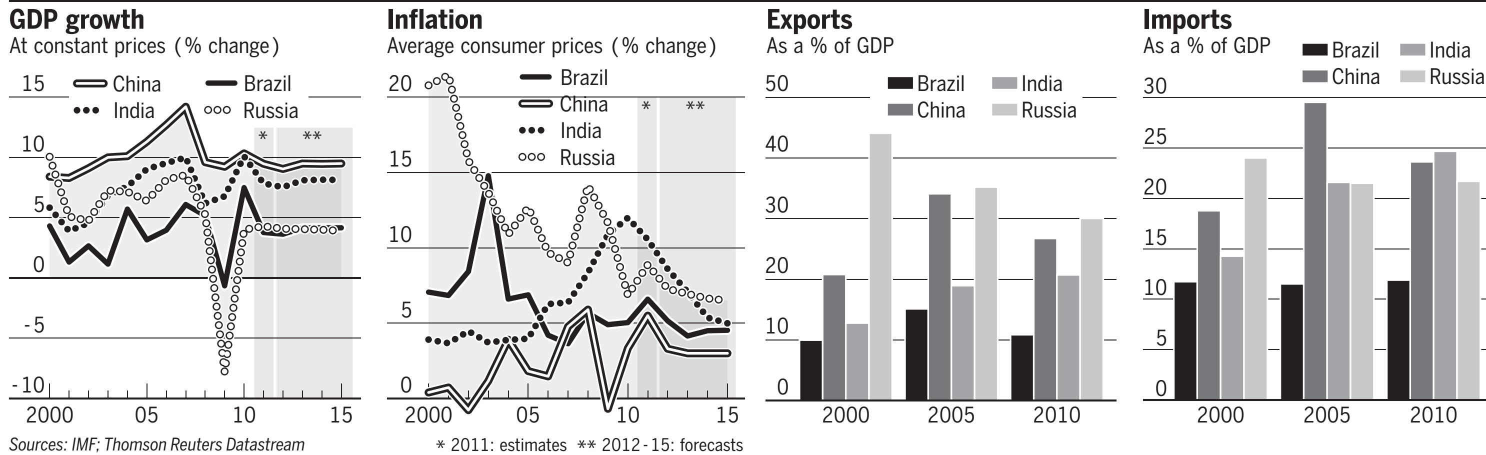
India is better placed than other Brics, says Nouriel Roubini, economist at New York University's Stern School of Business. But he warns that Asia's third-largest economy has to grow at 9 per cent economic growth to tackle its socioeconomic and fiscal problems.

Yet high inflation makes India an outlier among emerging economies. A new worry has emerged. The RBI is anxious about the weaker rupee, which fell to record lows against the US dollar at the end of last year. It fears that currency depreciation in a country that runs a current account deficit and imports most of its oil may fuel imported inflation this year.

Cooling rising prices is a key test for 2012.

'The Reserve Bank was initially caught off guard as inflation rose . . . and was too meek when it decided to hit the brakes'

Money worries: the rupee fell to record lows against the dollar at the end of last year, causing anxiety for the central bank Getty



Interview IFC's Lars Thunell stresses importance of domestic demand

Europe's sovereign debt crisis has served as a convenient scapegoat for India's domestic tribulations in past months.

Respected Indian economists such as Shankar Acharya fear for their country's outlook in 2012 and beyond, but they differ from senior policymakers by arguing that the reasons for underperforming equity markets and local currency lie at home.

India remains a sheltered economy, protected by restrictions on capital flows and market instruments, with a largely domestically-driven growth story. Exports represent only 18.5 per cent of GDP, compared with China's 30 per cent.

Nonetheless, India's increasing globalisation over the past 20 years has made it vulnerable to shocks from big trading partners such as the US and Europe though not as sensitive as economies in Latin America, Africa and elsewhere in Asia.

One threat to global trading, and to India, is the severe contraction in the balance sheets of stressed European banks, according to the International Finance Corporation, the private sector arm of the World Bank.

The short term effect on India, China and Brazil for trade flows, direct investments, bond and equity flows and remittances is worrying.

"We are an interdependent global financial market," says Lars Thunell, the IFC's chief executive, in an interview with the Financial Times in New Delhi.

"Emerging markets must try to keep their economies going based on domestic demand as much as possible. The debate about domestic consumption in India, China and Indonesia is important."

The retreat of European capital, however, presents opportunities for financial institutions from big emerging markets.

"For local banks in India and China this is an opportunity to pick up good assets," he predicts.

"We'll see a new ownership structure ... This is the time when we may see some Chinese or Indian banks getting into Europe."

India represents the Washington-based IFC's single largest investment portfolio. Last year, it was worth about $3.5bn, 10 per cent of the global portfolio. The group plans a further $1bn investment this year with a focus on supporting entrepreneurial companies working with the world's poorest people.

A key target market is people living off $3.5 a day, and supporting investments in solar and hydro power and water in India's poorest states.

There is an opportunity for Indian and Chinese banks to pick up good assets, says Lars Thunell

Mr Thunell identifies global opportunities for a group of fast-growing Indian companies – in areas such as logistics, farming and financial services – that are developing "inclusive business models" to serve low income customers. The operations and products of companies such as Jain Irrigation, Bharti Airtel and Fino, a Mumbai-based financial services company, have the potential to take root in populous markets in Indonesia, Nigeria and Ethiopia.

Their innovation may also find acceptance in developed markets that are embracing austerity.

"Indian companies are leaders at getting to the bottom of the pyramid. They have a national advantage in the number of people [they can reach]. Indian companies have extraordinary scale," he says.

"When I first met Fino, they were aiming at 1m [customers]. They are now at 38m and they are aiming for 100m. That can't happen in many countries around the world."

Such dynamism is unusual in the current global context. It may help India weather an exit of capital from the global trading system. Senior IFC executives also expect it to hasten a shift in productivity and wealth generation towards emerging markets that economists predicted would take 20 years, but now may take as little as five.

James Lamont

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Ambition bright but lights flicker

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The prime minister has opened equity markets to more foreign investment. Foreign single-brand retailers, such as Sweden's Ikea and the UK's Marks and Spencer, have been given the right to own their Indian stores outright. However. Ikea is withholding entry into India as it sees a requirement that single-brand retailers source 30 per cent of goods from local small and medium-sized companies as an obstacle to investment that needs reviewing.

Mr Singh's latest move is a stimulus package with $35bn of public sector investment, forcing state-owned companies such as Coal India and the Oil and Natural Gas Corporation to invest cash piles to strengthen the country's energy security.

European diplomats speak more enthusiastically about reaching a long-awaited bilateral trade deal between European Union and India in coming weeks once sticking points over cars, wines and spirits, services and migration are overcome.

"In the last three weeks there's been a definite intent to move things along [by the government]," says Samiran Chakraborty, head of research at Standard Chartered Bank in Mumbai. "There's an impression legislation is not possible, but executive decisions can happen. There seems to be some urgency."

"Amid the pervasive gloom, a few signs are pointing to better times returning sooner rather than later," says Anand Shanbhag, head of research at Avendus Capital, a Mumbai-based investment bank.

The view from outside a sheltered, domestically-driven economy is more optimistic. Ben Verwaayen, chief executive of Alcatel-Lucent, the telecoms company, says the pessimism about India's economy is "overdone" when compared with the outlook in western markets.

Sanjeev Dhuna, a partner at London-based law firm Allen & Overy, says a bad 2011 has not derailed India's globalisation. Lower stock market valuations and a depreciated rupee could revive greater inward M&A activity in the second half. He also expects more outward investments by Indian companies in resources, and in Africa.

'Amid the pervasive gloom, a few signs are pointing to better times returning sooner rather than later'

"The underlying reason for globalisation does not change," Mr Dhuna says. "Indian companies are looking very aggressively at what's out there. There will be acquisitions in Africa. It's the next frontier."

Although some policymakers said India cannot grow above 8 per cent without inflicting unbearable price pressure on its rural population, Mr Singh at least has not lost touch with the dream of taking India to double-digit growth to rival China.

"We need to do more than halt the current slowdown," he says. He has identified as priorities agricultural output, boosting industrialisation and managing better rapid urbanisation.

A worry is the country's fiscal position, a blight of past administrations, and uncomfortable external sector management of the current account deficit and foreign borrowings.

The national budget, presented in March by finance minister Pranab Mukherjee, is expected to bring an admission that a fiscal deficit target of 4.6 per cent will be missed.

Fiscal restraint will become more difficult the nearer the Congress party gets to 2014 parliamentary elections, which are often won by doling out freebies and welfare programmes to the poor. Already a vote-winning food security bill is in the works.

The second half of this year may bring a bounceback. Elections in five states in February and March will be over, and the results may give the Congress party a reboot. As importantly, the interest rate cycle is likely to turn and the RBI begins to cut rates that have risen steadily over the past two years.

"There was a party going on and it's as if suddenly the lights went out," says Mr Mahindra of business sentiment.

"There isn't a firm hand guiding you back to the switch. But in India the lights go out quite frequently. The generator kicks in and the lights go on again. We will get 6 per cent growth. But the question is when will we get back to 8 per cent growth?"

Ailing private carriers get that sinking feeling

Wings clipped: Kingfisher's condition is critical, say analysts Alamy

Airlines

The sector is defying financial gravity, writes **James Fontanella-Khan**

India's airline industry is on the verge of crisis. After a decade that saw all leading carriers expand their operations, most industry analysts predict that 2012 will be the year when an Indian airline will go bankrupt.

Extortionate taxes, high fuel prices and a bruising price war set in motion by state-run Air India are the main challenges India's private airlines face.

Jet Airways, SpiceJet and Kingfisher, India's three listed airlines, all lost more than 60 per cent of their market value in 2011.

Meanwhile, Air India is still flying thanks to a series of government bail-outs that have kept the national carrier airborne. However, analysts say state aid has seriously distorted the market and contributed to the sector's financial troubles.

Indigo, a private sector carrier that is not listed on the stock exchange, is the only profitable airline in the country. But nobody really knows its secret.

The sector's ailing conditions seem inexplicable given that India's passenger numbers soared nearly 20 per cent in 2011 to nearly 60m fliers compared with the previous year, and capacity is expected to be outstripped by a surge in demand.

Yet the airlines are still bleeding red ink and are heavily dependent on bank loans to stay in business.

The carrier in by far the most critical condition is Kingfisher, controlled by Vijay Mallya, the flamboyant billionaire and liquor tycoon.

"It is very likely that one airline will go bust this year and the most likely candidate is Kingfisher," says Jasdeep Walia, an aviation analyst at Kotak Mahindra, a Mumbai-based bank. "They are running out of time to find a solution to their problems."

With net debt of about $1.25bn, Kingfisher is beleaguered by a series of problems, including loan payment defaults and penalties linked to unpaid taxes and salary dues.

The tycoon's airline has interest expense to net sales ratio of 21 per cent, against 6.8 per cent for its main Indian competitor, Jet Airways.

In September Kingfisher decided to shut down its low-cost operations to cut costs and focus more on its premium and higher yielding business. However, this was not enough to rein in the group's mounting debts.

In November it slashed 50 out of 340 of its premium flights and this month the country's aviation regulator warned that its financial troubles could affect passenger safety. Kingfisher said it was operating all its flights with "utmost safety".

All this is having an impact on the airline's market share. Passengers, who once took pride in travelling with Kingfisher as it was rated as one of India's best airlines, have started to desert the carrier.

Since its financial problems emerged late last year, Kingfisher has fallen from India's second-largest domestic airline – carrying just under a fifth of domestic passengers – to fifth place, transporting 14 per cent of the 55m people flying in India.

Most airline experts and the government's aviation minister think that foreign investment could provide some respite to the ailing industry.

Analysts say state aid has seriously distorted the market and contributed to airlines' financial troubles

A government-backed panel recommended a radical reform early this year that would allow foreign carriers such as British Airways, Lufthansa and Singapore Airlines to invest up to 49 per cent in domestic operators.

The entry of foreign airlines, which are not allowed to make any investments in India, could provide a vital lifeline to the country's cash-strapped carriers, analysts say.

"This is good news [for Indian airlines] as they desperately need the cash," says Sharan Lillaney, an aviation analyst at Mumbai-based Angel Broking. "It would be an absolute game changer for Indian carriers as they would join a bigger network of airlines and it would improve the quality of their services."

British Airways, Singapore Airlines and Lufthansa are among a number of airlines that have often been rumoured as potentially interested in entering India's fast growing market.

However, some analysts fear that the government's move to open the industry might have come a little too late to save it, and in particular Kingfisher.

Mahantesh Sabarad, an aviation analyst at Fortune Equity, a Mumbai-based brokerage, says foreign airlines would be deterred by India's tough operating environment and the poor state of domestic airlines' finances.

"I doubt we would see foreign airlines rushing into the Indian market given [its] current condition," says Mr Sabarad. "They [Indian airlines] need to fix their problems before they can become attractive to foreign buyers."

Analysts say there is little airlines can do to address their problems, as most of the challenges they face are out of their control.

Mr Walia at Kotak says slashing airport and fuel taxes, as well as stopping the bail-out of the national carrier, would help private airlines to push up their ticket prices and boost margins.

But that is very unlikely, say industry experts. Moreover, it all might be too little, too late to prevent one of the main airlines going bankrupt.

Problems in store for ambitious incomers

Retailing

James Fontanella-Khan on the outlook for foreign groups after the shelving of a landmark reform

Global supermarket chains have long been salivating at the prospect of entering India's buoyant retail sector. With an underserved market of 1.2bn people and worth about $450bn, and a rising middle class eager to access modern global products, Asia's third-largest economy is by far one of the most attractive retail markets in the world, analysts say.

However, in November, when New Delhi announced plans to throw the industry open to the likes of Walmart, Carrefour and Tesco, the retail giants were surprisingly reticent. In hindsight, their caution made sense, as the ruling Congress party was forced to shelve the landmark reform just two weeks after it was announced.

The proposal to permit foreign groups to own up to 51 per cent of supermarkets sparked protests and paralysed parliament, with opponents arguing it would kill off the small, family-run shops that make up more than 90 per cent of the sector.

The policy reversal disappointed both domestic and foreign retailers.

Tesco branded the U-turn a "missed opportunity". Meanwhile, Harsh Mariwala, the head of Marico, one of India's largest consumer products companies, called the reversal a "highly regressive move" – one that deeply disappointed a business community eager for economic reforms.

Rajiv Kumar, of the Federation of Indian Chambers of Commerce and Industry, one of the leading business bodies, says opponents of the reform had irresponsibly whipped up xenophobic sentiments about the return of the East India Company of colonial days to set back a debate about modernising a key sector.

"This is not the India of the 1700s that we are dealing with now," he says.

These complaints added pressure on the government, which had already been criticised for doing too little too late. India's legislative machine has been at a standstill after a series of corruption scandals paralysed decision making.

To make up for the embarrassing U-turn, the government led by Manmohan Singh, prime minister, agreed this month to open up its retail sector to allow 100 per cent foreign ownership of single brand stores in India. This was an attempt to reassure global investors that the ruling Congress government is committed to pushing through key reforms.

The move falls short of opening the retail sector to foreign supermarkets. But it will allow global brands such as Ikea, Adidas, and Marks and Spencer, which were already allowed to own up to 51 per cent of a store, to operate in India without a domestic partner.

Global single-brand retailers are expected to take advantage of the reform, analysts say. The decision "is likely to result in more foreign companies entering the market or expanding their presence," says Fitch, the credit agency.

> Operating in India is plagued with risks – the World Bank ranks it 132nd out of 183 countries for ease of doing business

The move was also welcomed by existing Indian retailers, as they see the decision to remove restrictions in single-brand retail as an important step towards further reforms in the multi-brand sector, as supermarkets are described in India.

"This is a welcome move with a clear potential to lift the general mood in the economy," says Rajan Bharti Mittal, vice-chairman and managing director of Bharti Enterprises, one of the country's largest retailers. "We hope the initiative is a precursor to further liberalisation in the sector in the days to come."

However, even in this case retailers have shown some reservations over whether they plan to enter India or boost their stakes in their existing joint ventures. Many still fear the risk of a policy reversal or protests once they set up on the ground.

Ikea, the Swedish furniture retailer, which does not have operations in India, has repeatedly said it would be keen to open stores across the country. But it is not expected to make a move any time soon.

M&S, one of the UK's leading retailers in India, says it will continue to work with its partner there, as it argues that it is useful to have a partner that understands the market when operating in a country such as India.

The reticence towards going solo underlines the challenges retailers face when expanding in India. Operating there is plagued with risks – the World Bank ranks it 132nd out of 183 countries for ease of doing business.

The risks are not exclusively linked to the government's feeble decision-making process. Other common problems include buying affordable land or commercial real estate for stores as well as understanding India's unique consumer habits.

"India is a very heterogeneous market and any retailer planning to be successful here would have to tailor its products to the many different tastes present. The customer in Delhi is very different from one in Chennai [Madras]," says Arvind Singhal, chairman of Technopak, an Indian retail consultancy.

No matter what happens, the evolution of India's retail sector will take time, say analysts.

Web takes hassle out of bringing up baby

Online shopping

The arrival of sites selling nappies and toys heralds an internet revolution, says **Amy Kazmin**

It is a common complaint of parents in India: the tiny mom-and-pop shops that dominate the country's retail landscape cannot be relied on to have the nappies brand you want in the required size at the time you need them.

But rather than search one grubby hole-in-the-wall store after another to find a dusty pack of nappies, many Indian parents are now turning to a clutch of new, online baby goods websites that offer more modern, hassle-free shopping experiences and a broad selection of products.

These baby goods sites – Firstcry.com, Babyoye.com and Hoopos.com – peddle everything from essential daily supplies such as nappies, baby oil and wipes to more elaborate items such as toys, children's book and furniture. They deliver to the home, and, recognising Indian customers' reluctance to use credit cards online and the cards' low penetration rate anyway, they mostly accept cash on delivery.

These websites are harbingers of what many expect to be a fast-growing business in India: internet retailing, propelled by the sheer hassle of trying to find what you want in India's stunted bricks-and-mortar retail industry.

"Retail establishments are the physical link between products and customers, but in India, speciality retail channels are not evolved, so it is a challenge for the consumer and manufacturer to discover each other," says Neelesh Hundakari, a principal at consultancy AT Kearney. "The internet is a medium that mediates that."

India may seem an odd candidate for an internet retail boom. Its domestic internet penetration rate is less than 10 per cent, with less than 121m of its 1.2bn people online. And many Indians access the net from cybercafes, rather than their own personal devices.

But India's physical retail industry is severely constrained by strict limits on foreign direct investment and a dire shortage of affordable commercial property for new shops in the biggest cities. Consumers in increasingly smaller cities also have few outlets where they can buy goods to fulfil their aspirations.

As a result, analysts believe the popularity of purchasing goods online is likely to grow sharply. "Real estate prices and the amount of time required to travel in cities are both so high that it is forcing people to get online," says Raghav Gupta, a principal at consultancy Booz & Co.

> 'Real estate prices and the time required to travel in cities . . . are forcing people to go online'

Currently, Indians buy an estimated $600m worth of merchandise – including books, clothing, baby supplies and other items – online. That is just a fraction of the $8bn they spend each year on online travel purchases, such as airline tickets and hotel rooms.

But analysts and investors say the market for online merchandise could be worth $4bn to $7bn within the next five years, as internet penetration, through mobile phones and low-cost tablets, deepens.

"Nobody knows exactly how fast it will grow, but access to the internet is changing so quickly, and internet retail will definitely be significant in the next five years," says Mr Gupta.

India's best known e-retailer – outside the travel sector – is Flipkart.com, which was set up in 2007 by two former Amazon employees. Flipkart began mainly with books and has now branched out to categories such as mobile phones and electronics.

Websites selling high-end clothing, and accessories such as bags and watches – such as Myntra.com, 99labels and FashionandYou.com – have also attracted consumer attention, especially from smaller Indian towns, where foreign brands are not easily available.

"If hinterland consumers want to buy luxury products like perfume or purses or apparel, they have to physically come to Mumbai so many of them are ordering on the net," says Mr Hundekari.

Baby products are a fast-growing e-retail niche, while Mumbai-based FreshnDaily.com peddles fresh vegetables and other grocery items to residents of India's business capital. At Saffronart.com even cutting edge contemporary Indian art is for sale.

The limitations of India's brick-and-mortar retail sector still do not offer any guarantee of success for e-retailers. While travel sites such as MakeMyTrip have done very well, internet retailers selling physical products such as clothes, books and baby goods still face serious distribution challenges.

Some companies – such as Flipkart – have opted to build their own in-house distribution networks, while others are relying on courier companies.

Overall, e-commerce looks set to be an increasingly important part of India's retail landscape.

Coals to Newcastle: a saleswoman arranges scarves inside a Hermès showroom in Mumbai, but the company has also been selling saris in India Reuters

Big names look beyond obstacles

Luxury retailers

The global brands know India will be crucial for growth, writes **Neil Munshi**

In October last year, Hermès, the French haute couture company, did something audacious: months after launching its flagship Indian store in a fully-refurbished heritage building near Mumbai's financial centre, the company announced its arrival in India by selling saris for up to $8,200 to the country's upper crust.

The move shocked – even insulted – some local designers, miffed at the "Gallic gall" exhibited by the fashion house, better known for year-long waiting lists for Birkin handbags and silk scarves woven from the cocoons of mulberry moths.

The obstacles to luxury retail success in India are myriad, including the poor quality and high price of infrastructure in cities where it can take hours to travel 20km, and high duties and taxes that make well-travelled Indians more likely to buy foreign goods when they are abroad.

But global brands such as Hermès are realising that despite such shortcomings, the Indian market will be crucial to their future success, and tend to plan longer term than smaller, local brands – accepting the obstacles, and tough economic years like 2011, as par for the course.

To a certain extent, luxury retailers must simply resolve themselves to a 20-year game in India as the market matures – it is expected to grow from $4.76bn in 2009 to $14.7bn by 2015, according to a report from the Confederation of Indian Industry – both from a consumer and an infrastructural standpoint.

But they were handed a bonus in January in the form of a government regulation that will allow foreign single-brand retailers to invest 100 per cent in the country.

That means foreign luxury retailers such as Canali, Ferragamo and Louis Vuitton will be able to enter with wholly-owned subsidiaries, giving them more control over their brands.

"Most of the larger brands would prefer the 100 per cent model because they have a very set strategy and they don't want anyone to tinker with it," says Pinakiranjan Mishra, head of retail and consumer goods for India at Ernst & Young, the professional services group. "This would make it far more attractive to them."

> 'The market is still small but it is growing, even if we still have barriers to address [to face]'

For now, though, luxury brands remain focused on China, where there is greater space, better infrastructure, less red tape and a luxury market that dwarfs India's, says Laxman Narasimhan, head of consumer and retail in India at consultancy McKinsey.

"In India, the market is still small, but it is growing, even if we still have [a lot of] barriers to address, including real estate availability."

With shopping malls dedicated solely to luxury such as Delhi's DLF Emporio, Mumbai's Palladium, and Bangalore's UB City cropping up in major cities, retailers do have access to some global-standard showrooms – but prices remain high and space limited.

India's lack of infrastructure adds another impediment. Though Palladium is centrally located, in heavy traffic it can take 90 minutes to travel the 12km from South Mumbai, limiting the number of customers and increasing the need for more stores.

Those customers who do make it to the stores are likely to find products at wildly inflated prices compared with what they might cost in the west. India's import tariffs range from 28 to 208 per cent for luxury goods, and consumers usually pay 40 to 60 per cent more than they would elsewhere in the world.

However audacious Hermès may have been – its selling of saris has been compared with Indian vintners setting up shop in Bordeaux – it did tackle another of India's significant obstacles: the company localised its products.

Over the past few years, some 60 global luxury fashion and accessories brands have established themselves in India, but few have done more than import an identical – though often more limited – selection of the lines they sell in the west.

Mr Mishra says localisation is a crucial step toward cornering the Indian market. "You cannot take the same products that work in Europe here in India and expect to make scale," he says. "The clothes we wear are very cotton oriented, so that's one thing to look at; the second is the cut; the most critical part is the simple things like having brighter colours than the muted colours you see in a typical European store."

Students forced to play numbers game

Higher education

Kanupriya Kapoor finds places at top quality universities are in short supply

The students milling about in a leafy, outdoor cafeteria at the Indian Institute of Technology-Bombay bear with remarkable nonchalance the burden of being the face of the country's demographic dividend.

Part of the largest and fastest-growing segment of India's 1.2bn-strong population, these youths seem poised, with degrees in hand, to restore the country to its double-digit growth dreams.

But beneath a façade of teenage jostling and trendy gadgetry is an acute awareness of the relentless scramble they faced from millions of peers clamouring to get places at the right universities, which are in severely short supply.

In a country where only 15 per cent make it to college, good quality higher education is a luxury reserved for the brilliant and affluent. Many top universities are funded by the government, but observers say India has only recently begun to focus on addressing this shortage by including it in its policy framework and inviting foreign investment.

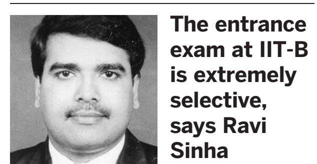
Though the government has generally targeted the improvement of higher education in the past decade, the issue has become a focal point in the country's 12th five-year plan for economic development, a policy framework due to be implemented this year, says an international development worker.

"There wasn't as much money or policy attention [paid] to higher education in the past 10 years ... as there is now," the development worker says.

"A lot more is going to happen. The upcoming 12th five-year plan discusses resources and changes that need to take place ... to address the general expansion issue."

Sheer numbers threaten to overwhelm a creaky system that has failed to keep up with exponential population growth. The country's decades-old network of 16 prestigious technical institutes, including IIT-B, admitted a mere 1.3 per cent of 450,000 applicants last year: the same network, along with a handful of other top private and public universities, cater in total to less than 5 per cent of the country's nearly 300m people of college age.

The chance of getting into such an institution is likely to be lower than anywhere else in the world, according to Ravi Sinha, professor of civil engineering and placement officer at IIT-B.



The entrance exam at IIT-B is extremely selective, says Ravi Sinha

"Our entrance exam is extremely selective," he says. "It's probably the most difficult in the world in terms of how many candidates apply and how many we accept. Generally in India, there's a shortage of places in colleges ... and a perception that there is a small number of good quality institutions to begin with."

In spite of their coveted standing, India's best universities have yet to be included in the league of globally-ranked institutions such as Cambridge or Princeton. IIT-B was the only Indian university to feature in Times Higher Education magazine's 2011 list, though it was ranked in the 301-350 category. Experts say the size of the student population and limited interdisciplinary research at top Indian institutions keep them off global lists.

"The world's best universities typically have 10,000 students, while Indian universities are smaller," the development worker says. "There isn't enough interdisciplinary work as IITs offer [narrow] streams and courses. They have to attract faculty from different disciplines and involve their students in more research."

At second-tier public universities, a lack of accountability and autonomy reduces incentive for quality assurance, despite the need for improvement.

Developed economies such as Canada see an opportunity in helping India develop "knowledge infrastructure" to narrow the gaps in quality of, and access to, higher education.

"There is room for [us] to participate in areas like ... education, because India has a very significant education deficit," says Edward Fast, Canadian minister for trade. "It has very ambitious plans to double the number of students attending tertiary educational institutions ... and they're going to need help."

In spite of the strains on the Indian education system, students appreciate the opportunity to learn, hoping a degree will catapult them towards a respectable, productive job – thus kicking off a virtuous cycle that should eventually benefit the country.

"Whether at the best universities or not, we all face the burden to get jobs and perform in the workplace," says one IIT-B student.

"But we're determined to prove ourselves . . . and contribute to the country's success."

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Moving up the value chain: the Infosys campus in Bangalore (above). Along with big rivals TCS and Wipro, Infosys is reducing its dependence on more familiar business process and back office outsourcing operations

New aims are set but old image dies hard

Outsourcing

James Crabtree charts the shift from call centres to value-added services

Picture an Indian outsourcing company, and many still conjure up open-plan call-centres where operators talk patiently to distant customers about utility bills or flight tickets problems.

Such images infuriate executives from the largest in India's increasingly global software and outsourcing sector.

Their companies, they complain with justification, long ago abandoned a business model whose success stemmed from the combination of a low-cost English speaking labour force with smart technology.

Yet for India's three most established, Infosys, Tata Consultancy Services and Wipro, this misperception is the least of the problems they face as they try to maintain their traditionally impressive growth rates in the aftermath of the global financial crisis.

India's biggest outsourcers remain fast-growing businesses. TCS, for instance, the largest of the three, saw revenues shoot up 24 per cent to $8.2bn in 2011 – a near fourfold increase since 2005.

But while revenue growth still resembles the stellar performance of a decade ago, the companies, operations are now starkly different.

Moving beyond the call centres has meant expansion into "value added" services, from bespoke software development to research, design and consultancy services, while also entering areas such as cloud computing.

These activities increasingly replace the more familiar business process and back office outsourcing operations.

Today all three also earn the vast majority of their income from clients in advanced markets – as Infosys proved in its most recent quarterly results, where it earned 64 per cent of its revenue in the US, compared with just 2 per cent in India.

This combination of more complex higher-end offerings provided to big global companies has also seen the companies shift more of their operations abroad. While most of their workers still remain in India, they are increasingly hiring elsewhere: TCS took on more than 1,000 workers in the US last year.

Yet if these businesses are ever-more technologically sophisticated they also face new pressures, often the direct consequence of their own successful globalisation.

The first is a new vulnerability to the economic weaknesses of Europe and the US, where so many of their clients are based.

India's outsourcers were hit in the aftermath of the 2008 financial crisis, as these clients cut their budgets (most obviously in the financial services industry) and this fed through quickly to their own bottom line.

BG Srinivas, head of European operations at Infosys, says the sector has learnt from these lessons, and is well placed to avoid the same outcome as it copes with the effects of the eurozone crisis and ongoing weak growth in North America.

Nonetheless he notes that in Europe, where his company earns more than 20 per cent of its revenue, "market uncertainty is still continuing, and clients are cautious". This in turn leads clients to reduce spending and delay projects – prompting Infosys to cut its full-year revenue forecast for this financial year.

These difficulties in Europe stem in part from a second success: moving into new geographies. Infosys pushed into Europe to lessen its reliance on its US business, yet it is precisely this move that now makes it vulnerable.

Meanwhile more ambitious attempts to win business in other emerging markets such as China and Mexico bring fresh management and cultural challenges, but as yet not much in the way of significant income.

The final problem is one of new competition. Some of the old call-centre business has moved to other countries, with the Philippines on some measures now boasting more call-centre employees than India.

Meanwhile there are other pressures at home as fast-growing Indian firms such as Cognizant and HCL Technologies strive to break into the top tier. And as India's giants have raised their game, so they increasingly must fend off competition from the elite western consulting and software houses, such as IBM, Capgemini and Accenture.

The result has seen the share prices of the Indian three firms stay steady at best over the past year, with caution over future earnings counteracting the benefits they ought to have received from India's falling rupee – which plunged by around 20 per cent over the course of 2011.

Yet for all this the fundamentals underlying the sector's future remain promising. In 2006 the US economist Alan Blinder wrote a provocative article in the journal *Foreign Affairs* predicting an unstoppable wave of new service sector outsourcing from the advanced to the developing world.

As once-protected jobs in the education, health, financial, legal, and even the public sectors headed overseas Mr Blinder estimated somewhere between 22 and 29 per cent (about 25m-30m) US jobs could end up offshore.

The projections panicked western politicians, but they also partially underpin the projections of Nasscom, an Indian trade organisation representing outsourcers, that the global industry will grow to produce revenues of $225bn by 2020, more than tripling in size over the decade.

If something even approaching the shift predicted by Mr Blinder comes to pass, it is a world in which India's outsourcing giants should be well placed to take advantage. If they do, they will have left the old world of call centres far behind.

Corporate profile Tata chief strikes cautious note as he prepares to hand over reins

After more than 10 years of heady international expansion Ratan Tata's message to his employees at the start of this year sounded a decidedly cautious note.

The company his ancestors began as a small cotton trading business more than a century earlier had grown sharply over the previous decade to earn revenues of $83bn during 2011, more than half of which came outside India.

In November he had also found time to unveil the long-awaited choice of his successor – and in appointing 43 year old Cyrus Mistry he revealed a low-profile candidate who caught India's business establishment by surprise.

Overall the head of India's most recognisable and global company seemed content that his group had weathered the worst of a tough year.

Even so his remarks made clear that the task facing Mr Mistry, who takes over later this year, will be far from easy – and raised questions about whether the group's period of bold growth overseas has now come, at least temporarily, to a close.

Tata's spate of international acquisitions began in 2000 with the purchase of Britain's Tetley tea. Its height came in the later part of the decade, first in 2008 with a $13.1bn deal to pick up Anglo-Dutch steelmaker Corus, and then a year later with Tata Motors' purchase of the ailing Jaguar Land Rover from Ford for $2.3bn.

These moves followed a pattern, with the group expanding existing business lines through a major foreign takeover. But the two largest placed considerable strain on the group's finances, especially during the worst of the 2008 financial crisis, and have since left Tata carrying a sizeable debt pile.

The group's steel and motor arms also endured a difficult time during 2011, although for different reasons. Tata Steel, Europe's second biggest steel producer and India's largest, lost almost half its stock market value against the backdrop of tough trading conditions amid the eurozone crisis.

Tata Motors also struggled during the year, although the reasons were almost the reverse: it suffered losses from its domestic operations, with notably poor results from its low-cost Nano model, despite a relatively strong performance from its UK acquisition.

Some of the group's other 31 listed companies were also dragged down by India's growing economic worries.

Tata was embroiled, too, in the nation's sprawling 2G telecoms corruption scandals, although the company – which prides itself on its ethical reputation – strenuously denies any wrongdoing.

Other businesses did better, notably Tata Consultancy Services, the IT and services division that remains one of the most valuable companies on India's

Cyrus Mistry: surprise appointment

stock market. The business continues to hire tens of thousands of new staff each year, and contributed a healthy slice of the overall group's improved full-year after-tax profits in 2011.

But it was the perils that have come with his group's new global status that seemed to worry Mr Tata most, as his message warned that "the troubled times will probably continue" for the world economy, and called on his companies to "review and moderate their earlier future projections".

Following his lead, senior executives are cautious when asked if this is the right moment for Tata to continue – and deepen – its push abroad.

Ishaat Hussain, finance director at Tata Sons, the group holding company, says: "In 2012, companies in the Tata Group will continue to consolidate on the acquisitions they have made in the previous years. But, should an opportunity arise which is of strategic importance to a company, we will consider it."

If the group does find money to spend, its recent purchases will also be first in line. During 2011 Kishor Chaukar, managing director of Tata Industries, said that the wider group already had plans to invest more than $23bn over the coming five years. Considerable investment will certainly be needed in the steel and car arms.

Looking across the group Jagannadham Thunuguntla, head of research at SMC Global, a Delhi-based brokerage, says he does not expect these investments to lead to a restart of the company's buying spree: "Immediate major acquisitions are unlikely under the new leadership. Mr Mistry is know for his conservatism, and the chances are he will prefer to look for organic growth."

Mr Tata concluded what will be his final such end-of-year report with what could be interpreted as a message to the next generation: "We must not be so risk-averse that we lose out on the interesting opportunities." Mr Mistry will take this to heart – just not quite yet, perhaps.

James Crabtree

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Car industry

Gujarat has struck out on its own, writes **Neil Munshi**

In the middle of a strike at Maruti Suzuki's main factory that would cost India's largest carmaker $500m in lost production, the company negotiated a deal to invest $1bn in new facilities on the subcontinent.

It was an unusual move, but – despite the troubles it and many other companies have had in India – Maruti was confident its new plant would roll out on time and without any hitches, for one reason: it will be built in the western state of Gujarat.

Ever since Tata Motors was unceremoniously ousted from the eastern state of West Bengal in 2008 over a land dispute, and successfully relocated to Gujarat, the state – and its controversial chief minister, Narendra Modi – have become known for their business-friendly, anti-union environment and emerged as India's answer to Detroit of the US.

"The main reason is because of the initiatives that have been undertaken by the chief minister," says Yaresh Kothari, auto analyst for Angel Broking. "He has been very proactive about inviting industrialists to the state and offering them quick access to land, which has become a major problem in the country."

This year alone, Ford and Peugeot Citroen have joined Maruti and Tata in making massive investments in the state, drawn in by attractive tax incentives, improved infrastructure and a streamlined land acquisition and approvals process absent from many other states in a country that seems to relish bureaucratic red tape.

Last year saw growth in the industry fall to an anaemic 4.3 per cent on the back of high interest rates, Maruti's production problems and a general slowdown in the domestic economy, after two consecutive years at around 30 per cent.

But India remains one of the world's fastest growing, and most attractive, auto markets. Gujarat's pro-business mentality makes it more attractive still, removing the uncertainty many foreign, and domestic, companies face when entering Asia's third-largest economy.

In 2008, Tata Motors learnt first-hand how India's fickle political winds can turn a done deal into a dead deal when construction of its plant in Sringur, West Bengal was halted by weeks of violent protest by local farmers.

The protests by the farmers – who claimed they had been forced to give up their land and had not received sufficient compensation – were stoked by Mamata Banerjee, then West Bengal's opposition leader, and now chief minister.

Tata shut down construction, though the plant – which was meant to produce the low-cost Nano – was around 85 per cent complete, and two years later announced the launch of its plant in the village of Sanand, Gujarat.

Part of the $500m investment included a 375-acre "vendor park" for suppliers. The park promoted the growth of a supplier ecosystem, and Tata's smooth acquisition of the land and rollout of the plant gave Gujarat a reputation as a place where carmakers could do business worry-free.

And so last year foreign companies clamouring to tap into an Indian market whose recent hiccups have largely been understood as an anomaly followed suit.

In February Peugeot announced an investment of nearly $800m in Sanand as part of its aim of generating 50 per cent of its sales outside Europe by 2015, compared with 39 per cent in 2010.

And Ford soon followed, announcing in July its investment of $1bn in a plant in Sanand that should be in production by 2014, and will have an initial capacity of 240,000 vehicles. This is more than double the capacity of the US carmaker's facility in the southern city of Chennai, a popular destination for carmakers that has lost some of its relevance amid Gujarat's rise.

At the time, Joe Hinrichs, Ford's head of Asia-Pacific and Africa, said Gujarat was selected over other states for its geographical location and ports from which to export cars to other emerging markets. Ford ships the Figo from India to 50 other countries, including South Africa, Mexico and the United Arab Emirates.

"Gujarat is well on its way to become the automotive hub as every auto manufacturer is looking towards the state, thanks to the pro-investment policies and infrastructure," says Michael Boneham, president and managing director of Ford India. "When Ford began to consider an additional site to construct a manufacturing facility in India it was almost impossible to ignore the impressive changes and progress enacted by the state government and fast tracked approval process."

Gujarat's port infrastructure was also a big selling point for Maruti when it announced its $1bn plant investment in September – in 2008, it signed a $1.75bn joint venture with the state's private Mundra port for a "mega car terminal" to buoy the company's export plans.

Gujarat could be seen as potentially politically sensitive as Mr Modi, the state's Hindu nationalist leader and main architect of its economic revival since 2001, has been criticised for his lax role during the 2002 communal riots when at least 2,000 people – mainly Muslims – were killed. But few auto executives have addressed the issue, and it does not seem to have stopped the industry from accepting his invitations.

There is little doubt that more foreign carmakers will be following suit.

Made in India: the Ford Figo is shipped to 50 other countries