



INDIA The Growth Imperative

**Address to HBS
India Business Conference
April 4, 2004**

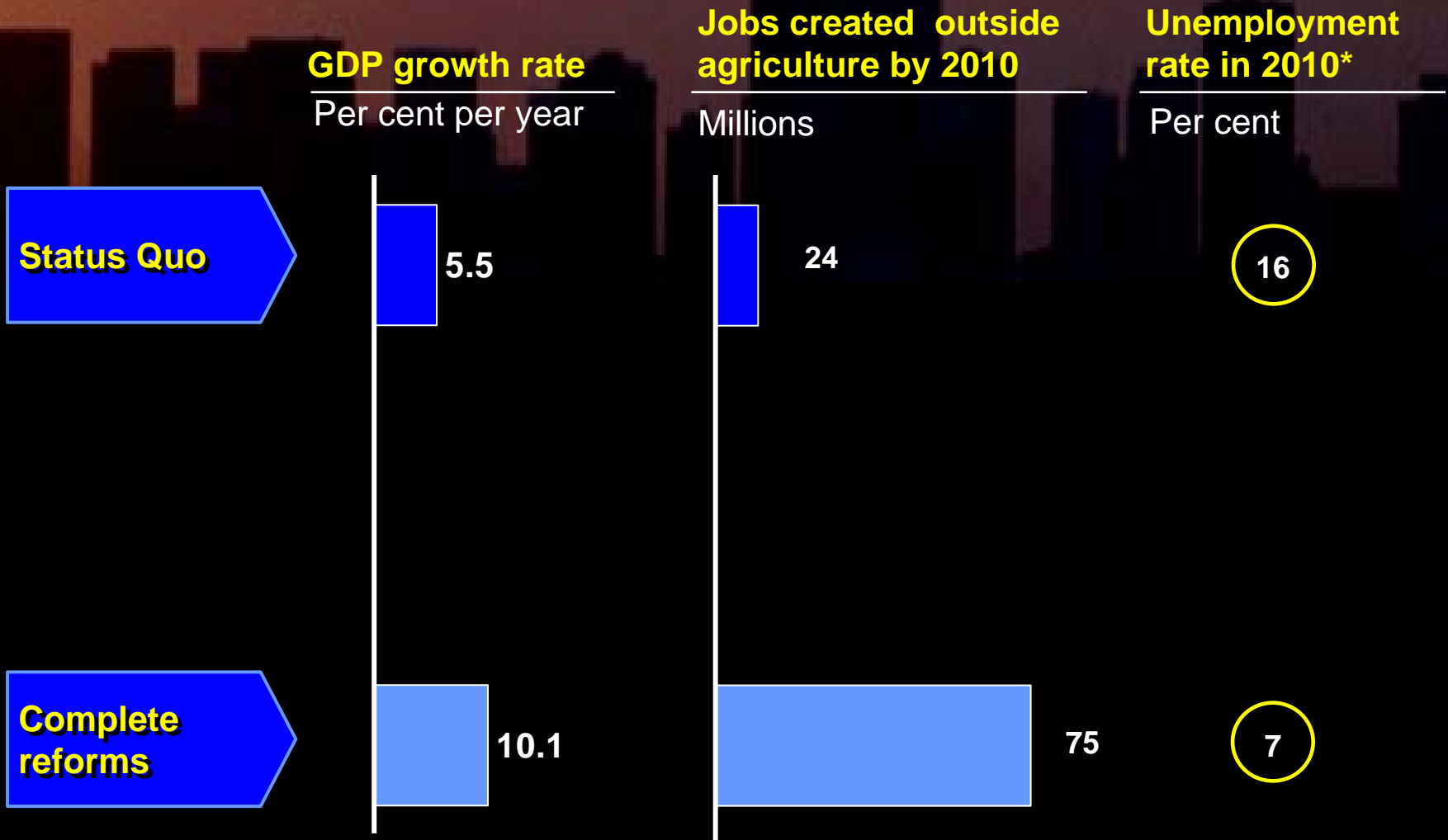
KEY MESSAGES

- **India can grow at 10 per cent over the next 10 years. A 10 per cent GDP growth is not only possible but also necessary**
- **To grow at 10 per cent, India needs to not only maintain the momentum on export-driven services but also drive growth in**
 - **Domestic services (particularly, healthcare)**
 - **Manufacturing**
- **China is the gold-standard on rapid manufacturing growth, and offers valuable lessons for India**
- **India must and can revive its manufacturing sector. This will require**
 - **A seven-point reform agenda from the government**
 - **Lower price points from Indian companies to stimulate domestic demand**
 - **Targeted strategies from Indian companies to drive exports**

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10 PER CENT GROWTH IS NECESSARY TO PREVENT HIGH UNEMPLOYMENT



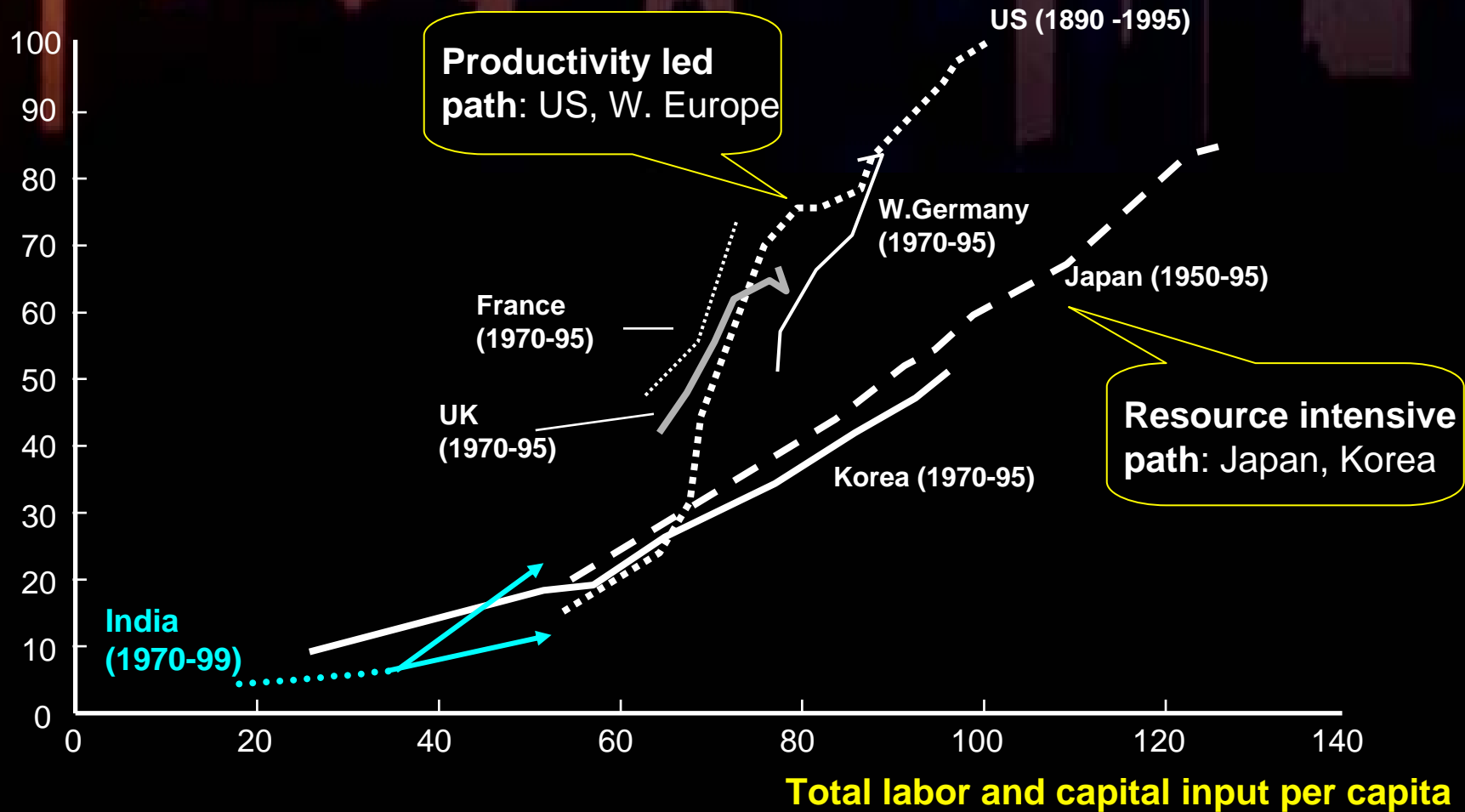
* Current Daily Status, assuming that labour participation rate remains constant

Source: McKinsey analysis

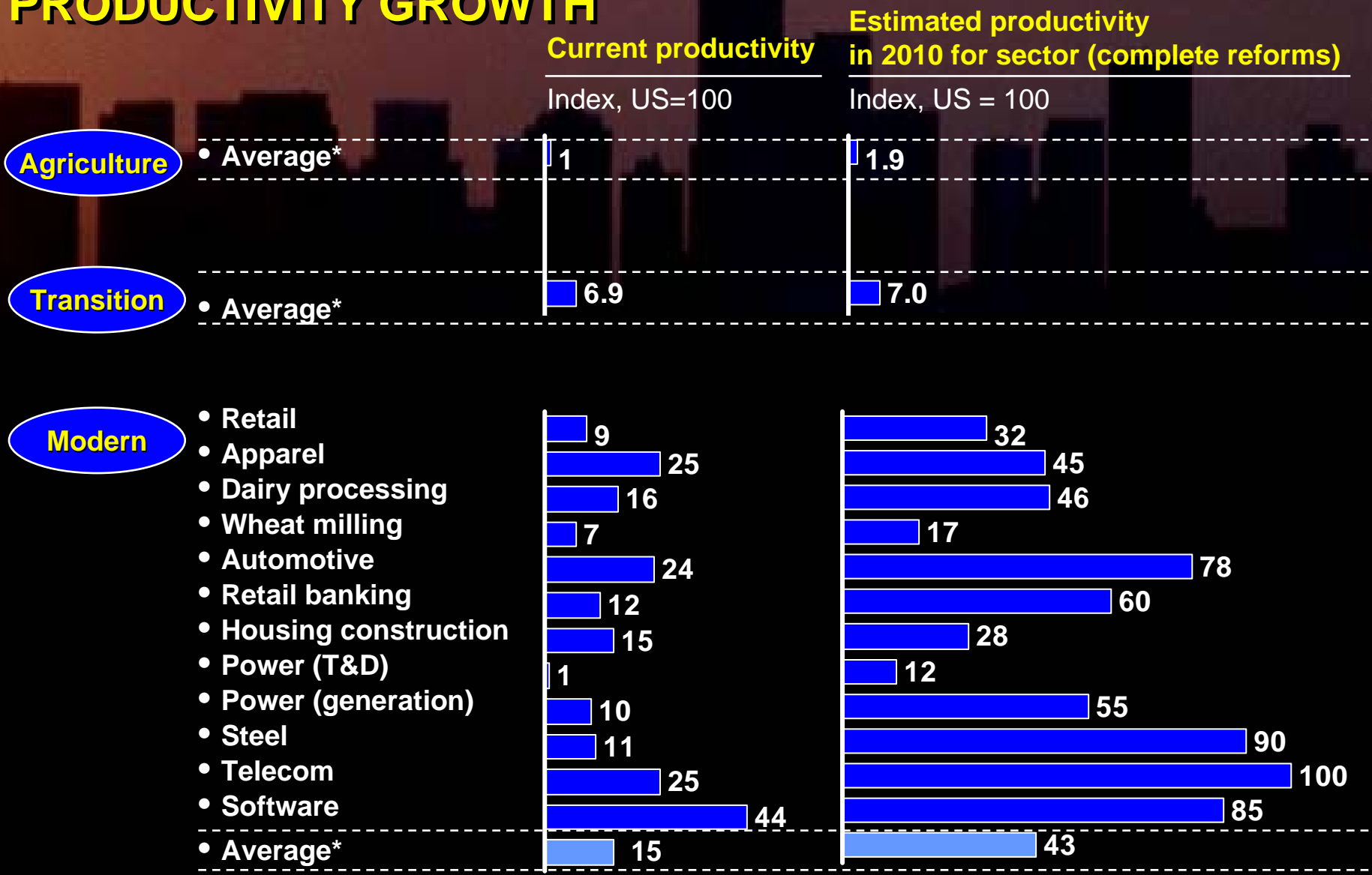
WE RECOMMEND THAT INDIA FOLLOW A PRODUCTIVITY-LED GROWTH PATH

Per cent of US; 1995

Per capita GDP



MODERN SECTORS WILL BE THE KEY DRIVERS OF PRODUCTIVITY GROWTH



* Grossed up to the overall economy

Source: Interviews; McKinsey Analysis

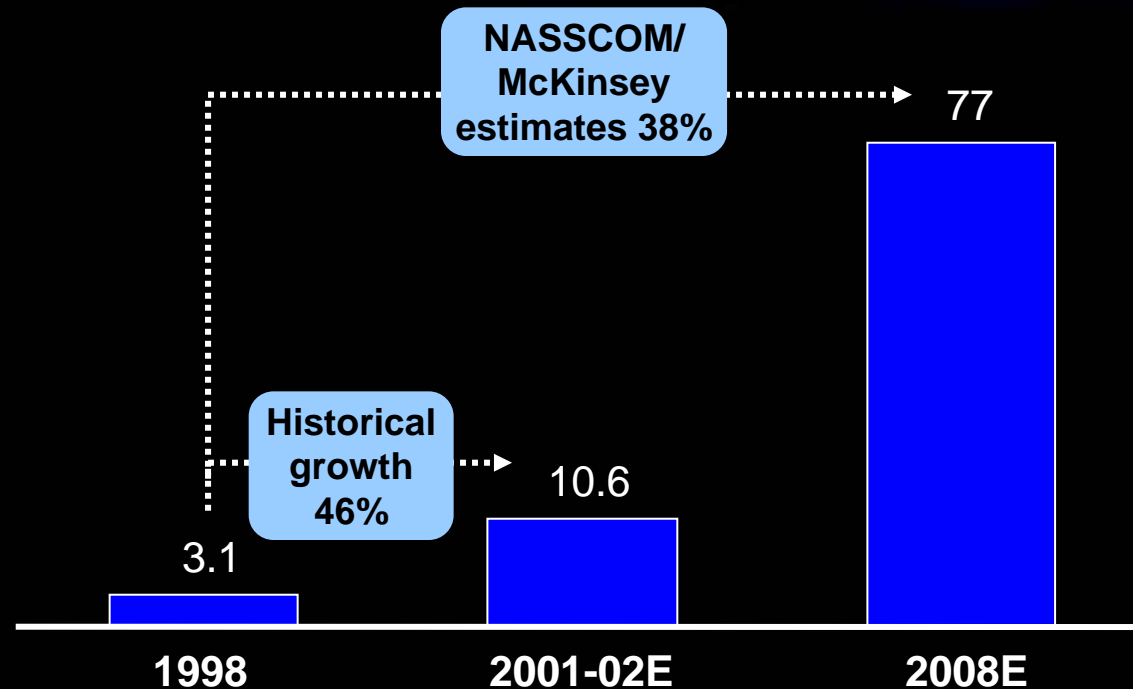
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MOMENTUM ON EXPORT-DRIVEN SERVICES LIKE SOFTWARE AND BPO MUST BE MAINTAINED

Indian software and IT enabled services industry revenues

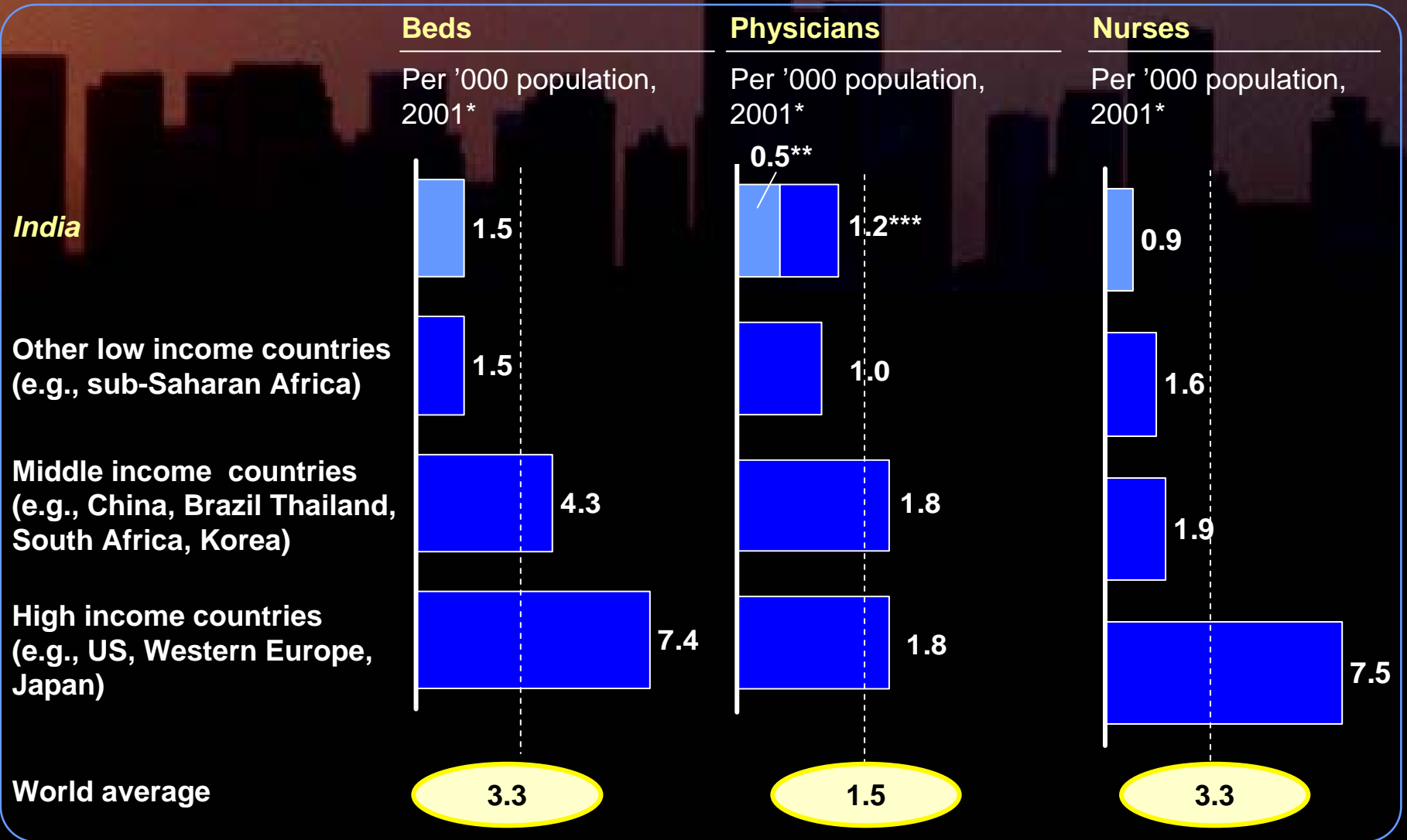
\$ billion



By 2008, the software and BPO sector will contribute

- 10% to India's GDP
- 30% to forex inflows
- Over 2 million new jobs

HOWEVER, CRITICAL DOMESTIC SERVICE SECTORS LIKE HEALTHCARE NEED DRAMATIC IMPROVEMENT

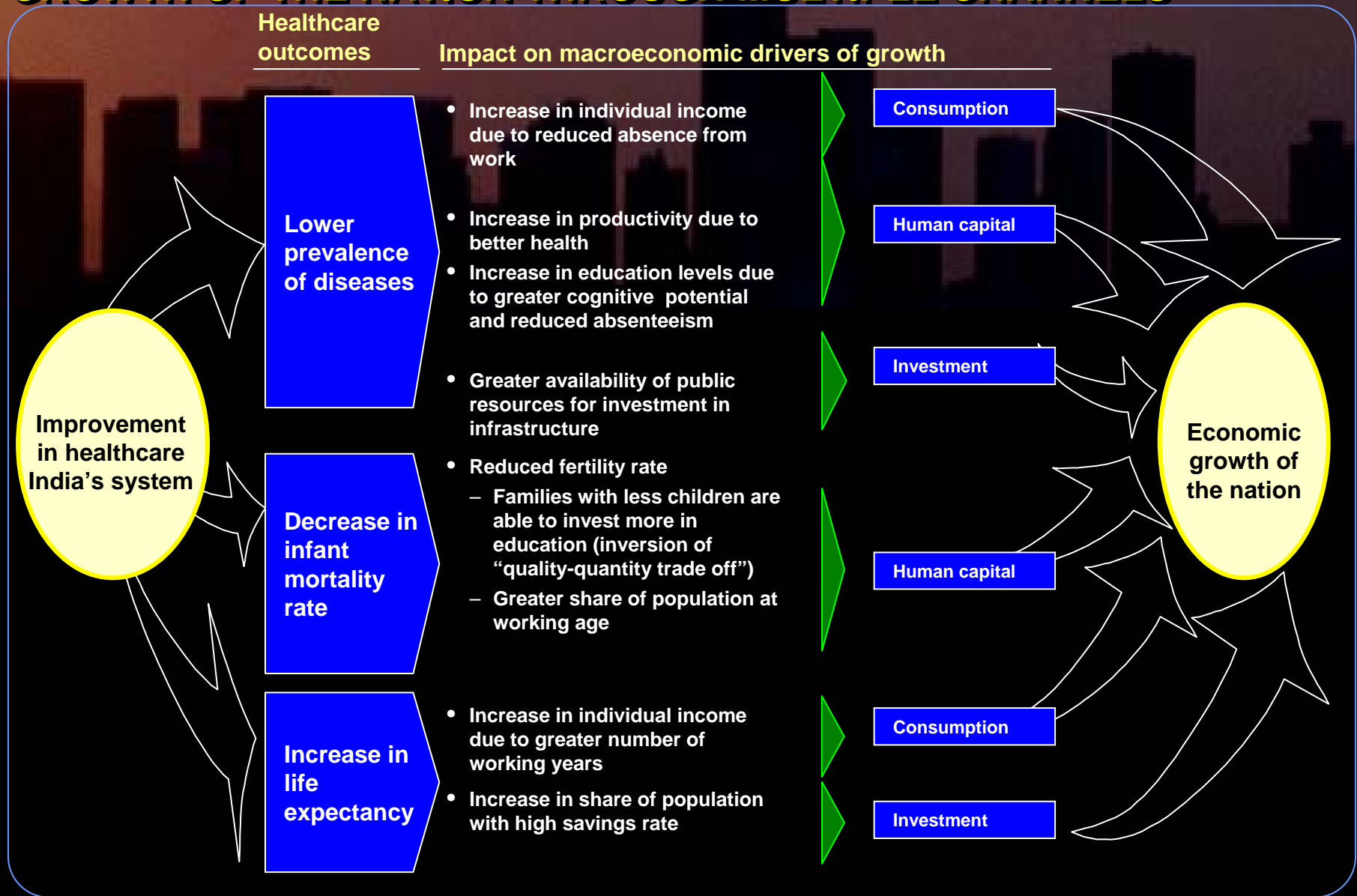


* Latest data available used (1997-2001)

** Registered allopathic physicians only

*** Including registered Indian Systems of Medicine (ISM) physicians but excluding unregistered practitioners

IMPROVEMENT IN HEALTH CAN IMPACT LONG-TERM ECONOMIC GROWTH OF THE NATION THROUGH MULTIPLE CHANNELS

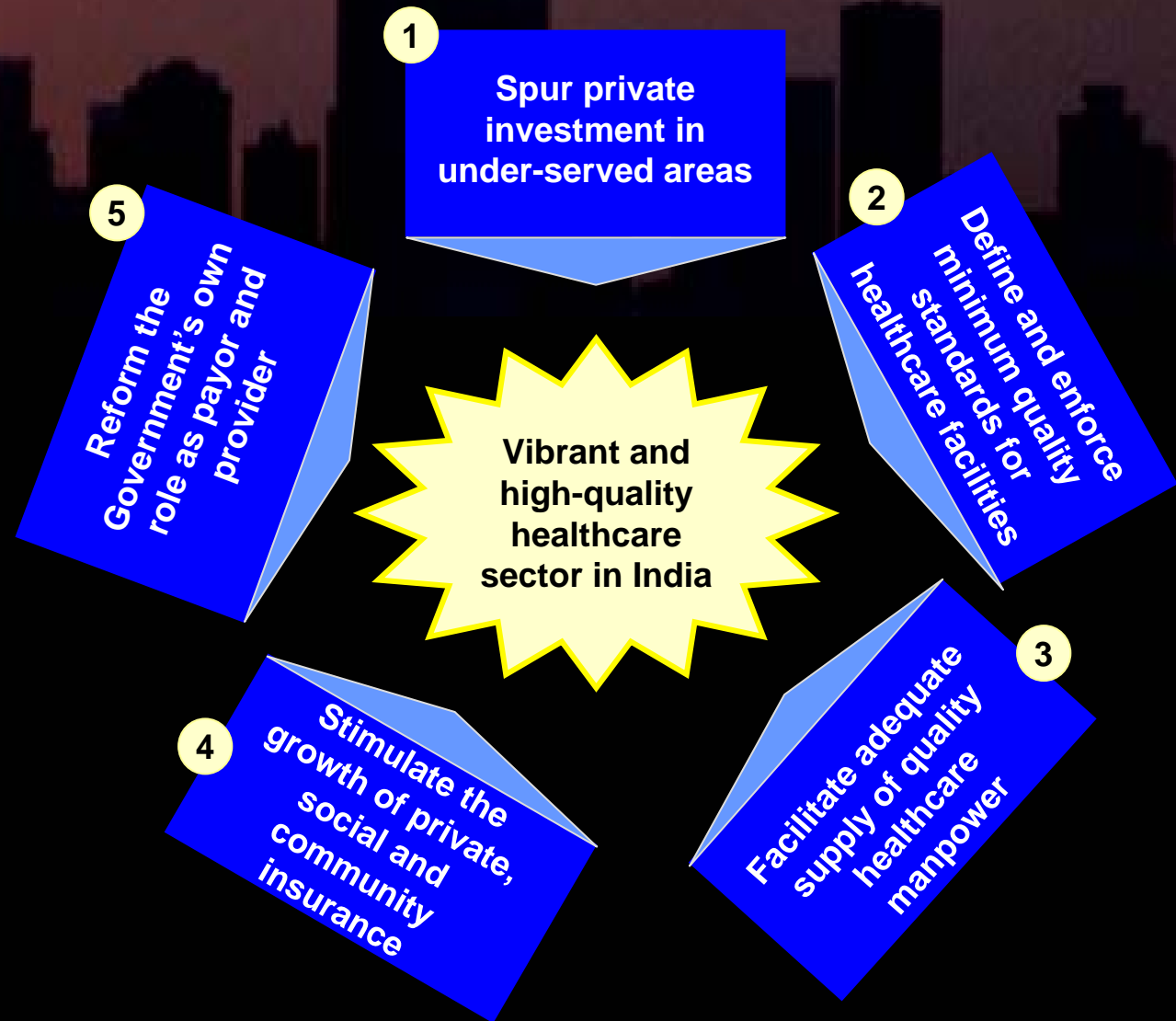


* Parents do not need any more to have many children just to assure themselves that at least one of them will survive till the parents' old age

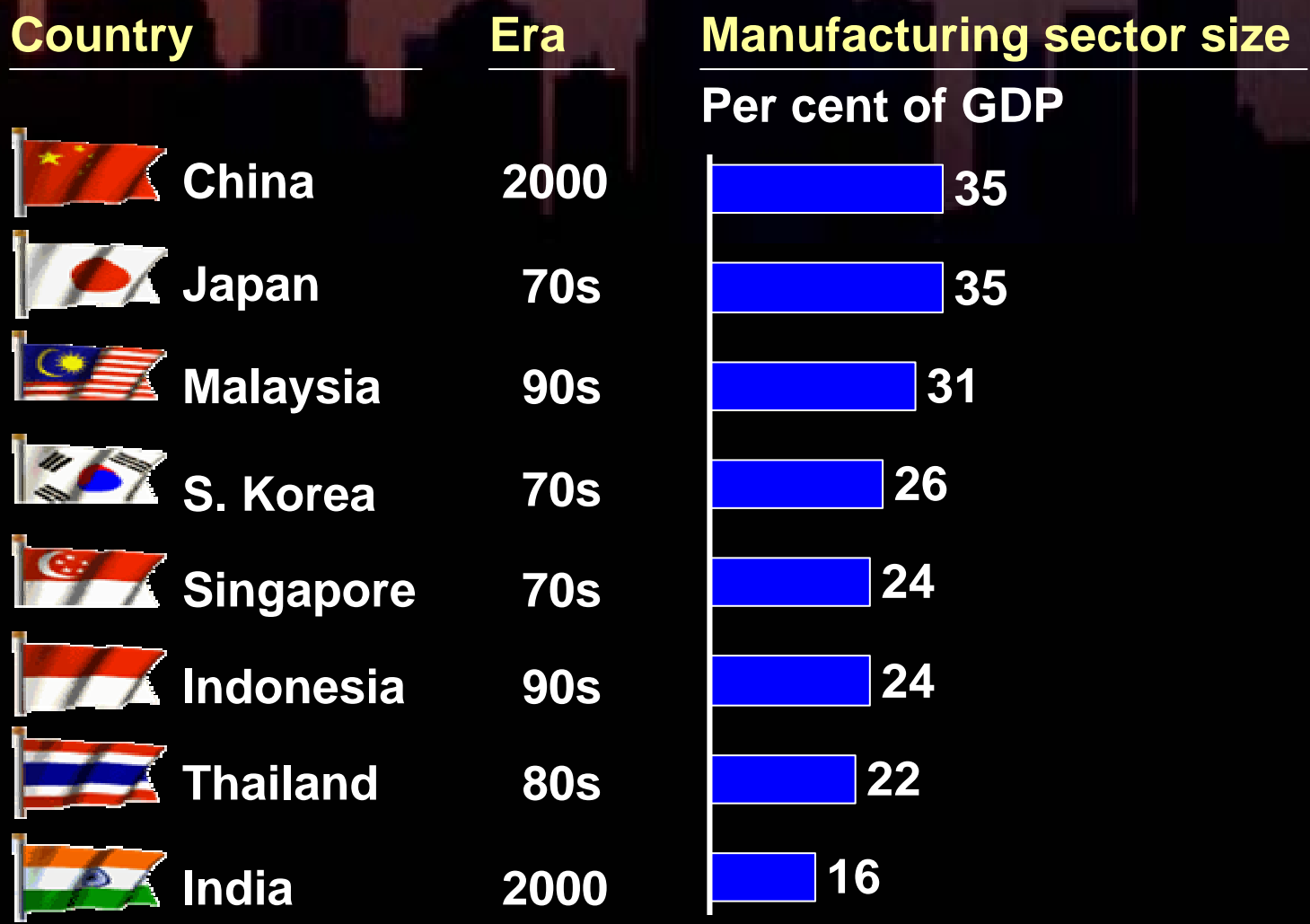
THERE ARE 5 MAJOR AREAS THAT NEED URGENT ACTION FROM THE GOVERNMENT AND INDUSTRY

By 2012, the healthcare delivery sector will

- Grow to about Rs 200,000 crore from about Rs 86,000 crore today
- Require about Rs 100,000 crore of private investments over and above the Rs 40,000 crore expected from the Government and multilateral aid agencies
- Create about 5 million new direct and indirect jobs



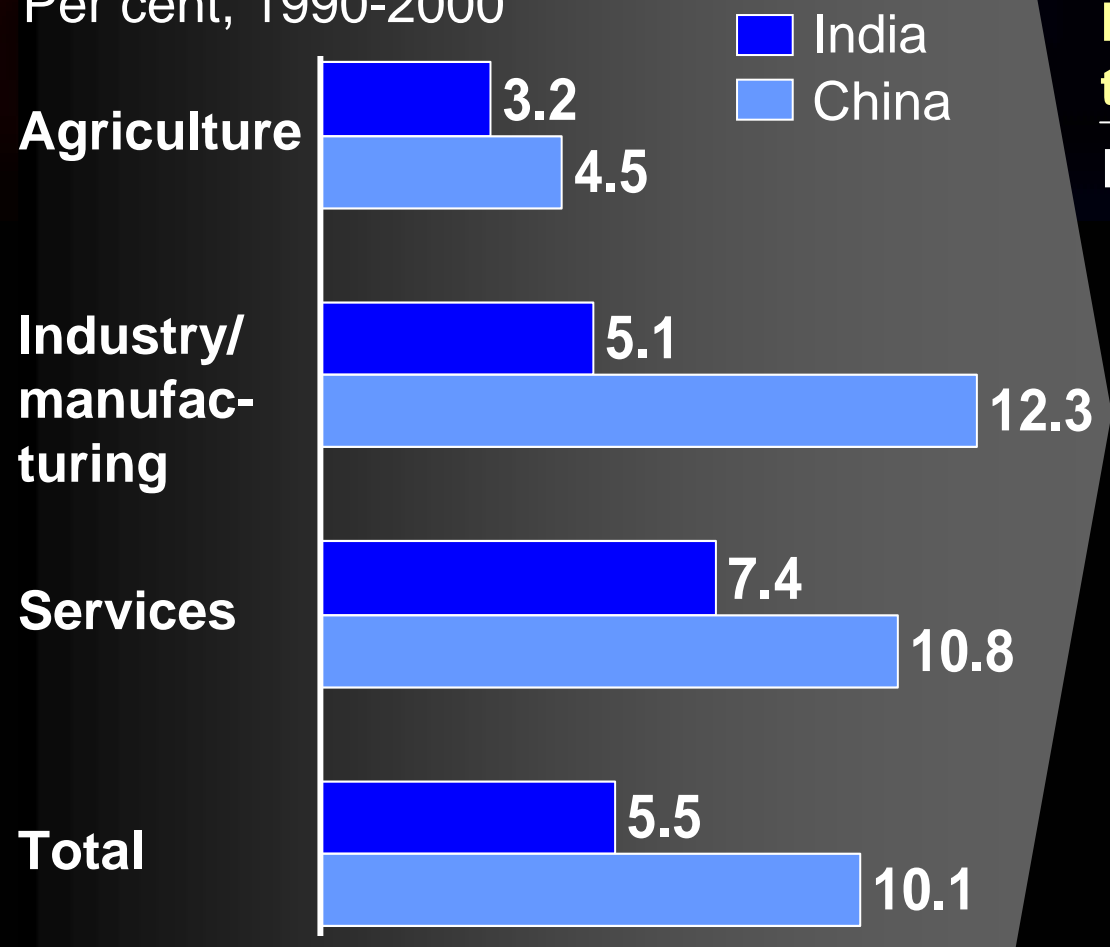
INDIA'S CURRENT MANUFACTURING SECTOR SMALLER THAN OTHER HIGH-GROWTH ECONOMIES



IN ADDITION TO SERVICES, MANUFACTURING IS AN ESSENTIAL GROWTH DRIVER FOR THE ECONOMY

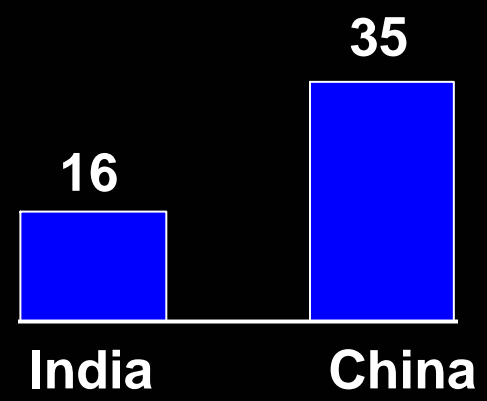
GDP growth

Per cent, 1990-2000



Manufacturing contribution to GDP, 2000

Per cent



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THERE ARE SEVERAL MYTHS ABOUT CHINA'S MANUFACTURING SUCCESS

Myth
1

China's growth was driven by investments, not productivity

Higher growth in China was also driven by rapid growth in productivity

HIGHER GROWTH IN CHINA WAS DRIVEN BY HIGHER LABOUR PRODUCTIVITY GROWTH

Per cent, CAGR, 1990-2000



Source: World Development Indicators, McKinsey analysis

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**Myth
2**

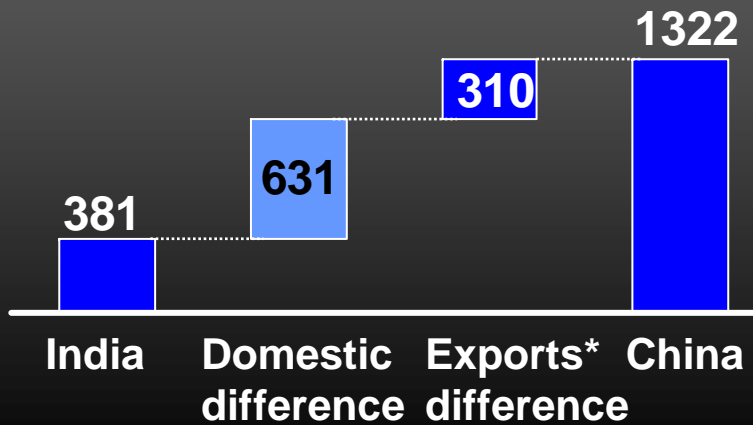
China's manufacturing success is driven only by exports

The domestic sector accounts for most of the difference in manufacturing GDP per capita

TWO-THIRDS OF THE DIFFERENCE IN MANUFACTURING GDP PER CAPITA IS DUE TO THE DOMESTIC SECTOR

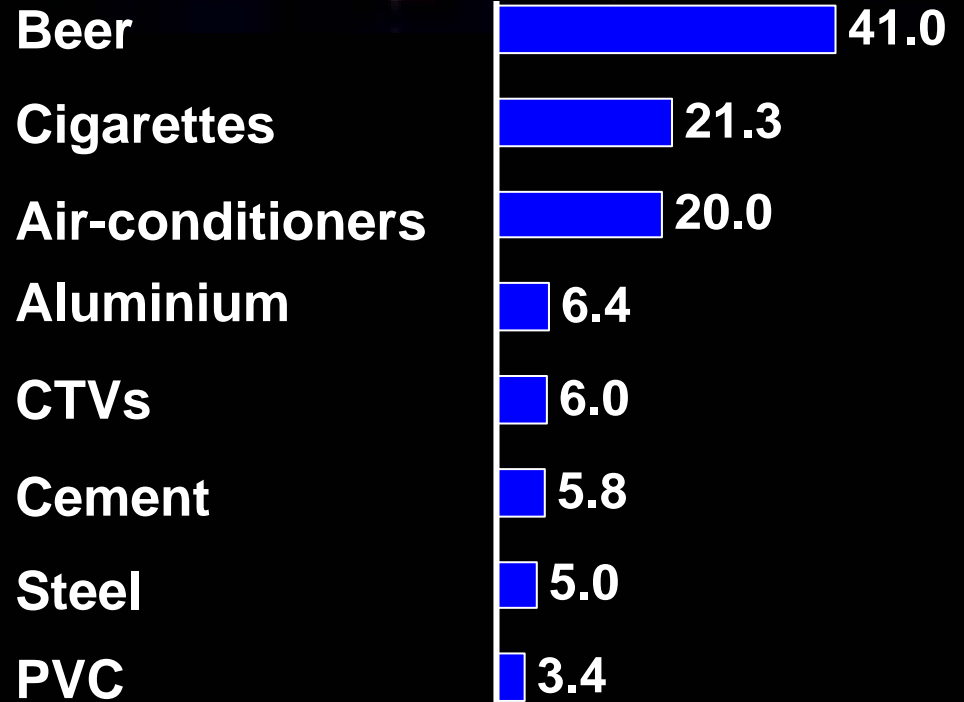
Manufacturing GDP per capita

\$, PPP, 2000



Product

Ratio of Chinese to Indian domestic consumption

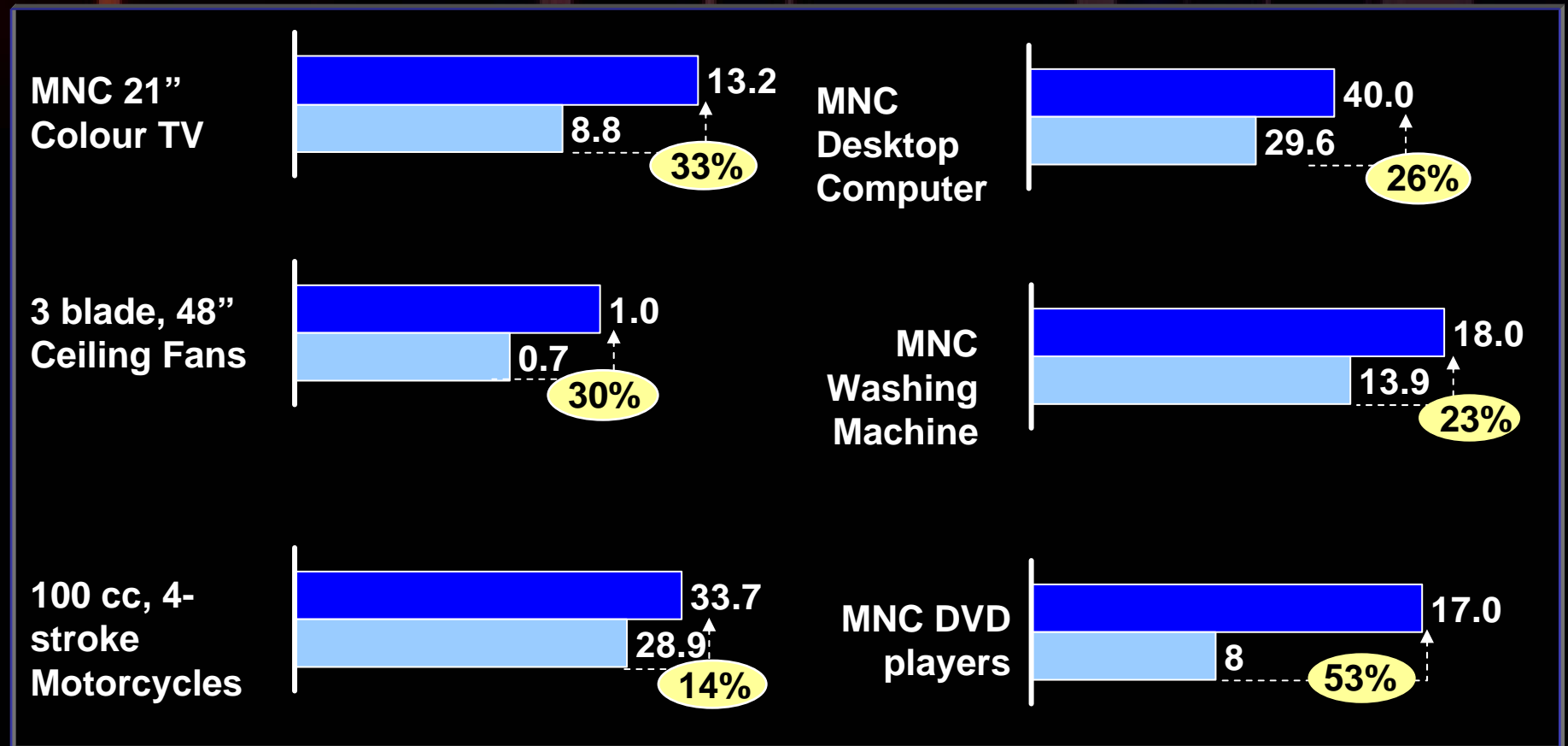


* Exports GDP calculated assuming that half of total exports are from re-exports of imported products, where value-added is 20%

CHINESE RETAIL PRICES ARE MUCH LOWER THAN THOSE OF COMPARABLE PRODUCTS IN INDIA

Rupees '000 per unit

India
China



Note: 8.28 RMB = 1 USD, Rs. 49 = 1 USD
Source: Retail surveys, 2002

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**Myth
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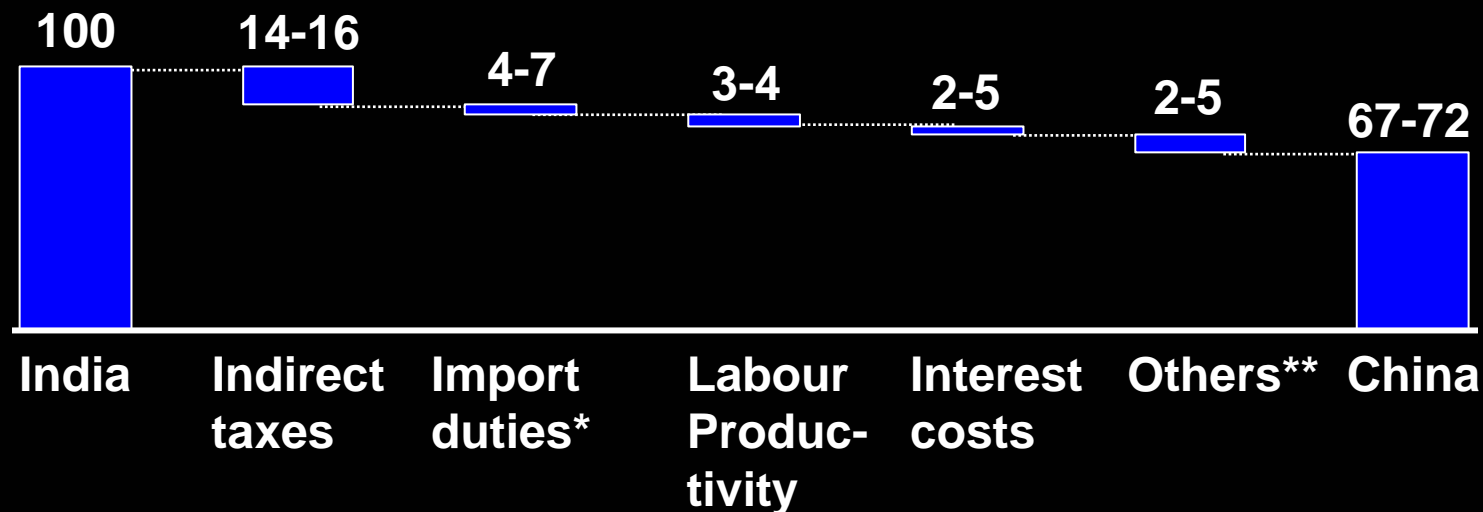
China's domestic prices are driven by marginal pricing and by subsidies

Lower prices are driven by strong fundamentals

THE DRIVERS OF CHINA'S LOW PRICES ARE TAXES, DUTIES, PRODUCTIVITY AND INTEREST RATES

Price structure comparison across products

Indian prices indexed to 100



* Import duties drive lower margins and lower material costs

** Includes capital productivity and lower specifications for products in China

Source : Interviews; plants and store visits; data analysis; McKinsey synthesis

Exhibit 20

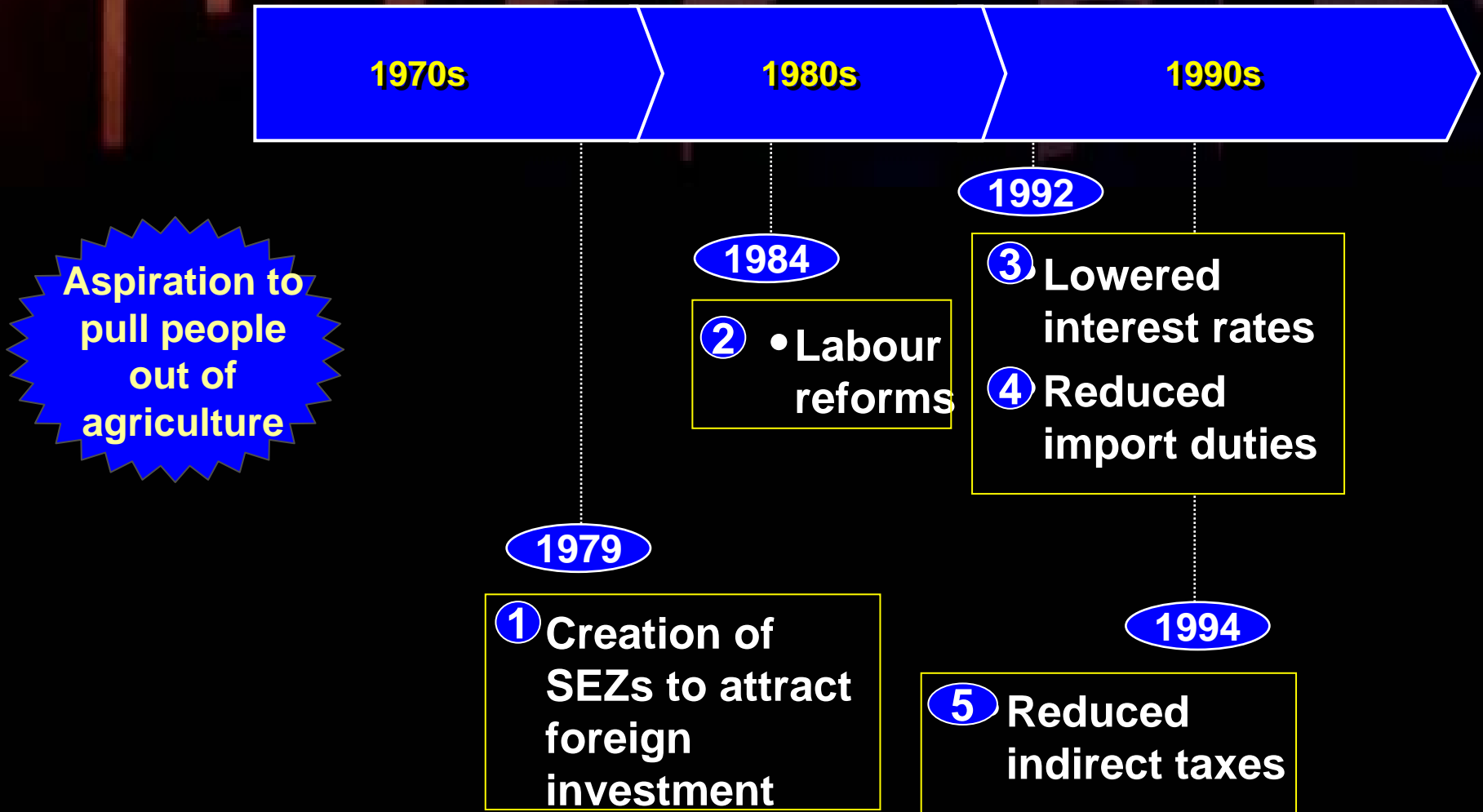
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Myth 4	China's exports are driven by marginal pricing	Apart from price competitiveness, China's exports are driven by FDI

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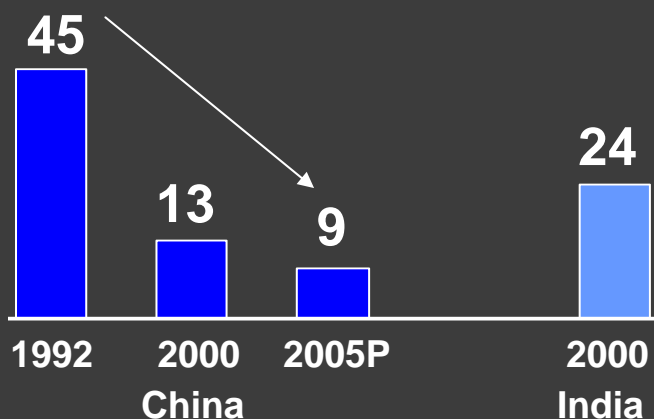
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Myth 4	China's exports are driven by marginal pricing	Apart from price competitiveness, China's exports are driven by FDI
Myth 5	Chinese products are always of poor quality	There are several Chinese manufacturers who make products of world-class standards

CHINA HAS UNDERTAKEN A SERIES OF ECONOMIC REFORMS OVER THE LAST TWO DECADES



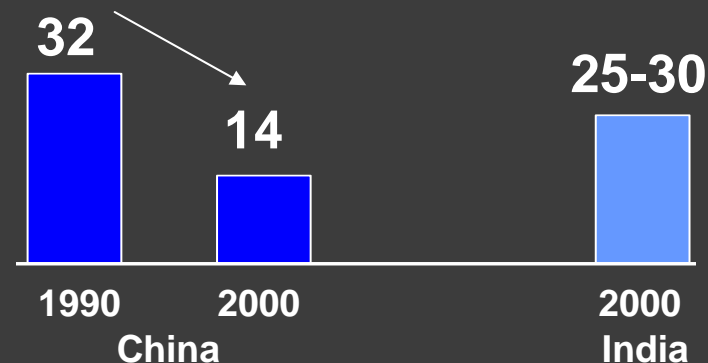
TAXES AND DUTIES WERE REDUCED AND SIMPLIFIED

Average import duties
Per cent, trade-weighted



- Number of rates dramatically reduced
- WTO driving further reductions

Average VAT/domestic taxes
Per cent of retail price



- Uniform VAT across products/states
- Earlier system had over 250 different tax rates

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SEVEN KEY GOVERNMENT INITIATIVES REQUIRED

- 1. Replace all indirect taxes with a VAT, and reduce the rate to 15% of retail price**
- 2. Reduce import duties to 10% by 2006**
- 3. Reform labour laws**
- 4. Kick-start SEZ growth**
 - Allow sales to DTA by paying domestic duties**
 - Ease labour laws**
- 5. Power Reforms**
 - Privatisise distribution**
 - Allow direct sales to consumers of over 0.1 MW**
- 6. Eliminate SSI reservations and fiscal concessions to small scale players**
- 7. Enable lower interest rates through fiscal reforms and by modifying the bankruptcy act**

INDIAN COMPANIES SHOULD STIMULATE DOMESTIC DEMAND THROUGH LOWER PRICES

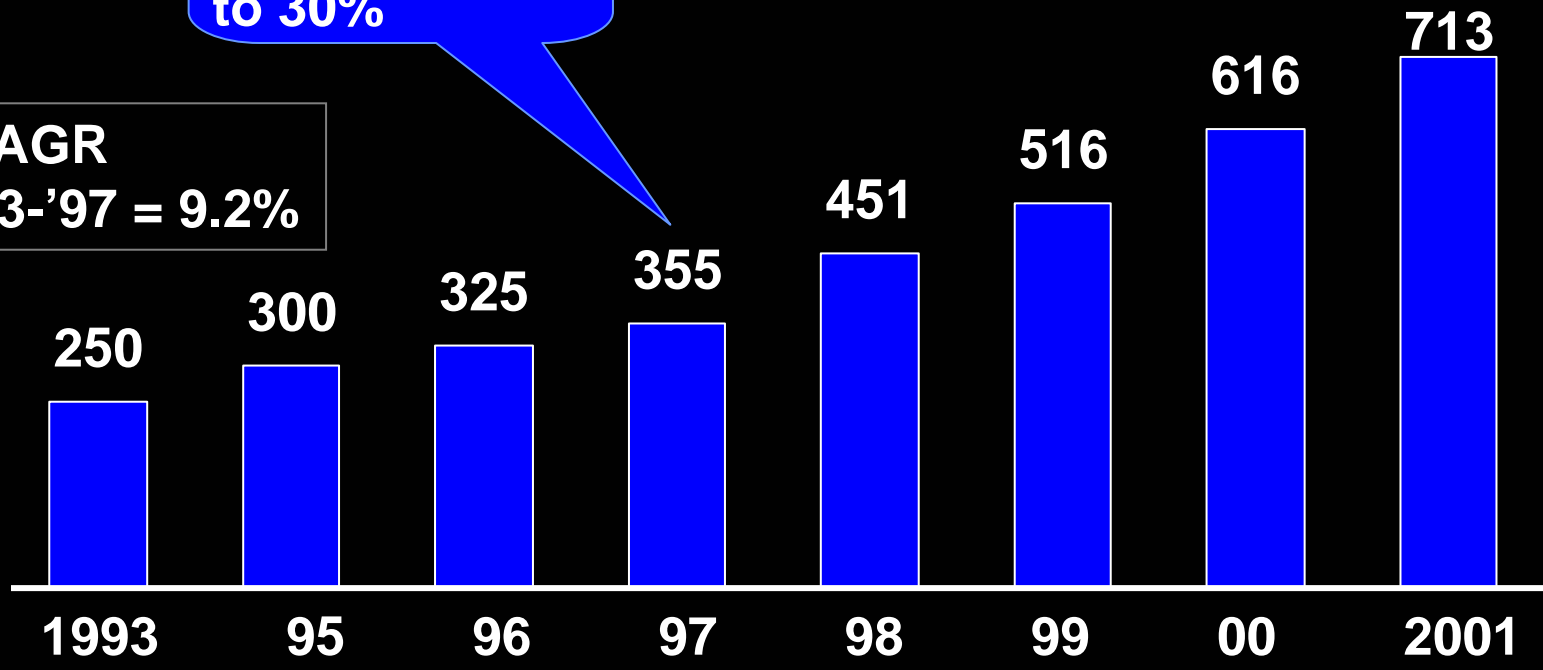
Volumes of room ACs

'000 units

CAGR
'93-'97 = 9.2%

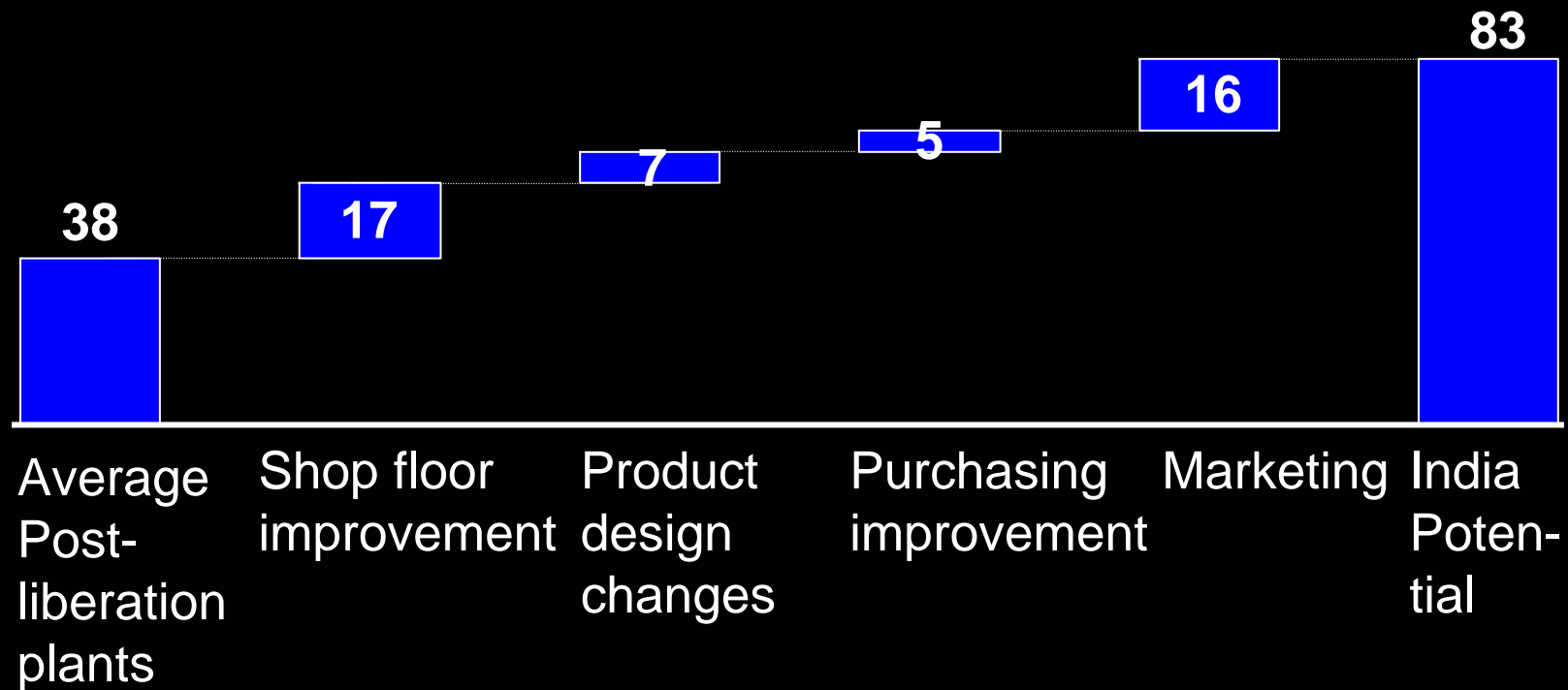
Excise duty cut from 40% to 30%

CAGR
'98-'01 = 16.5%

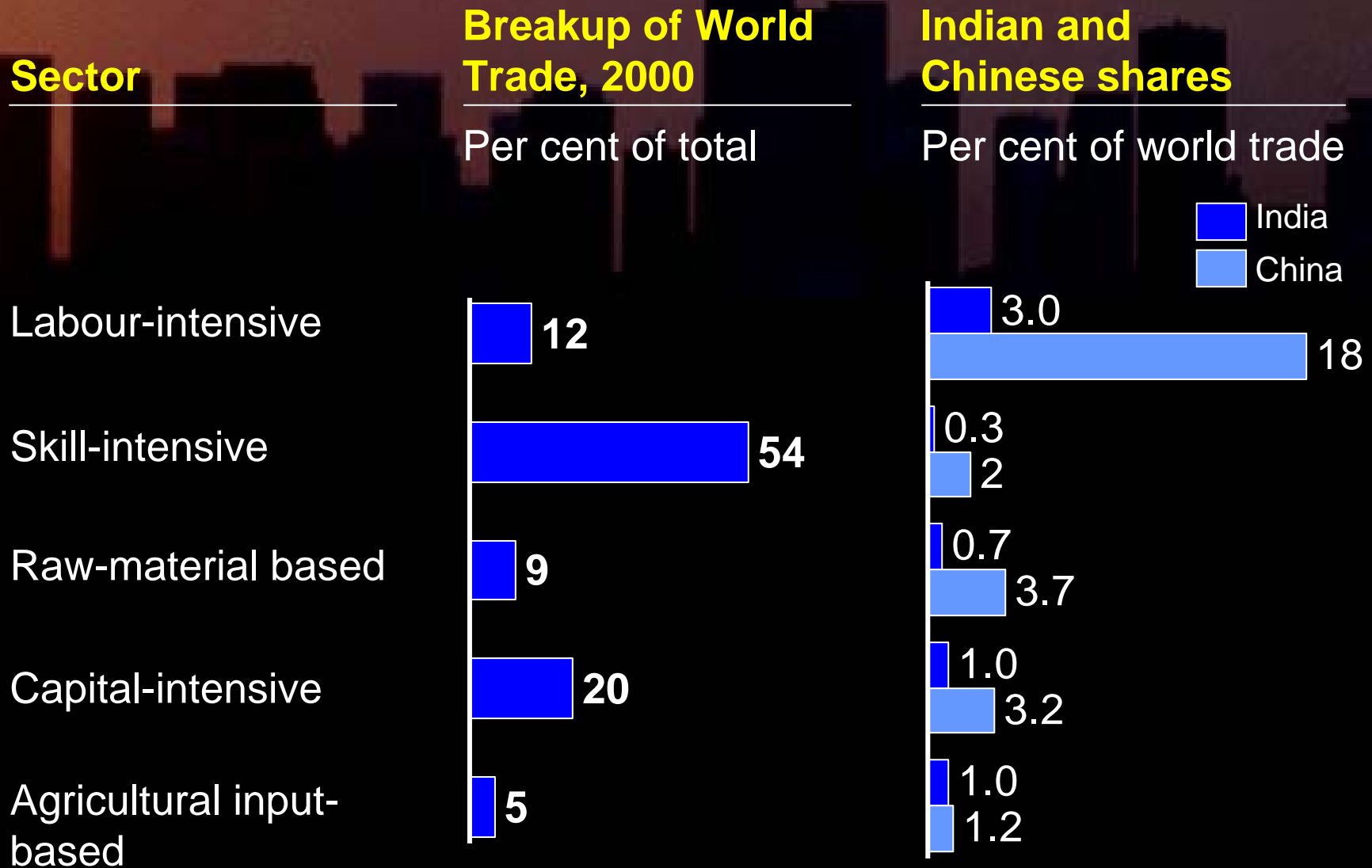


INDIAN COMPANIES CAN USE SEVERAL IMPROVEMENT LEVERS – AUTOMOTIVE EXAMPLE

Equivalent cars per equivalent employee,
Indexed to US average in 1998 = 100



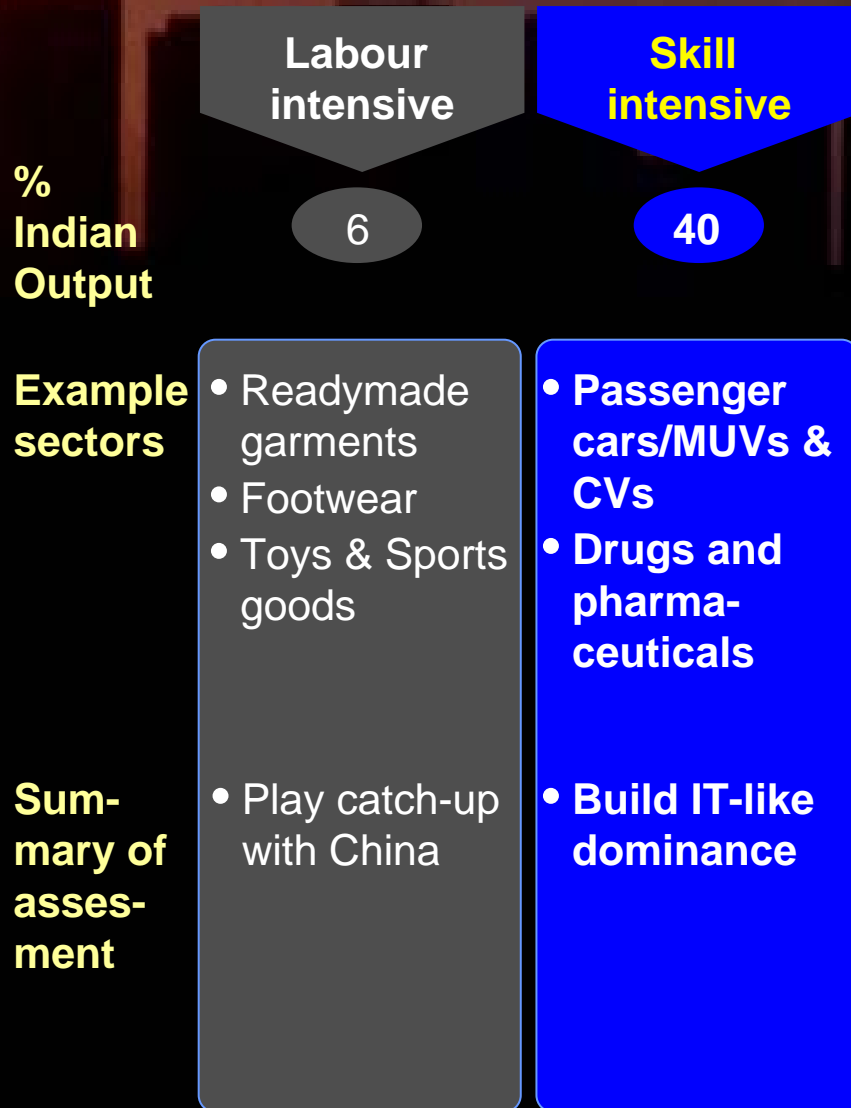
INDIA HAS A LARGE EXPORT OPPORTUNITY



INDIAN MANUFACTURERS CAN BE VERY COMPETITIVE ON EXPORTS IN SEVERAL SECTORS



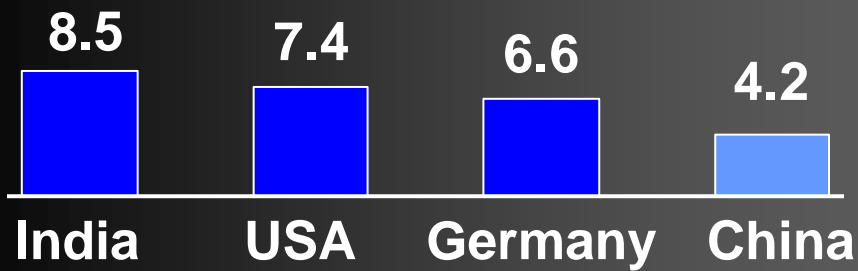
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INDIA HAS A LARGE OPPORTUNITY IN SKILL-INTENSIVE SECTORS – AUTO COMPONENTS EXAMPLE

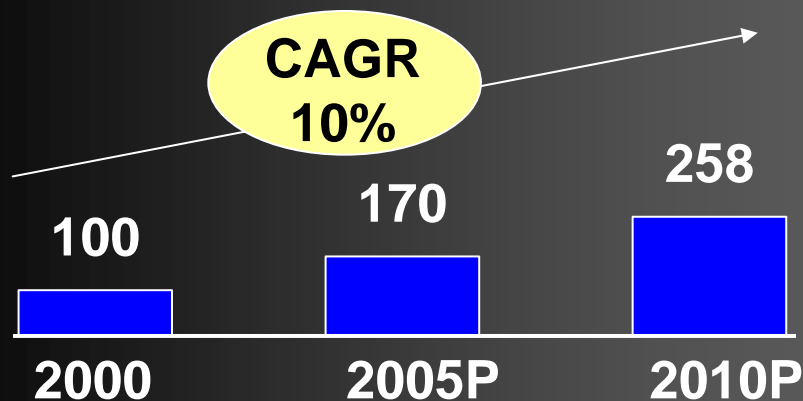
Availability of qualified engineers

IMD survey scores, 2000; 1=low, 10 = high



Growth in auto components outsourcing

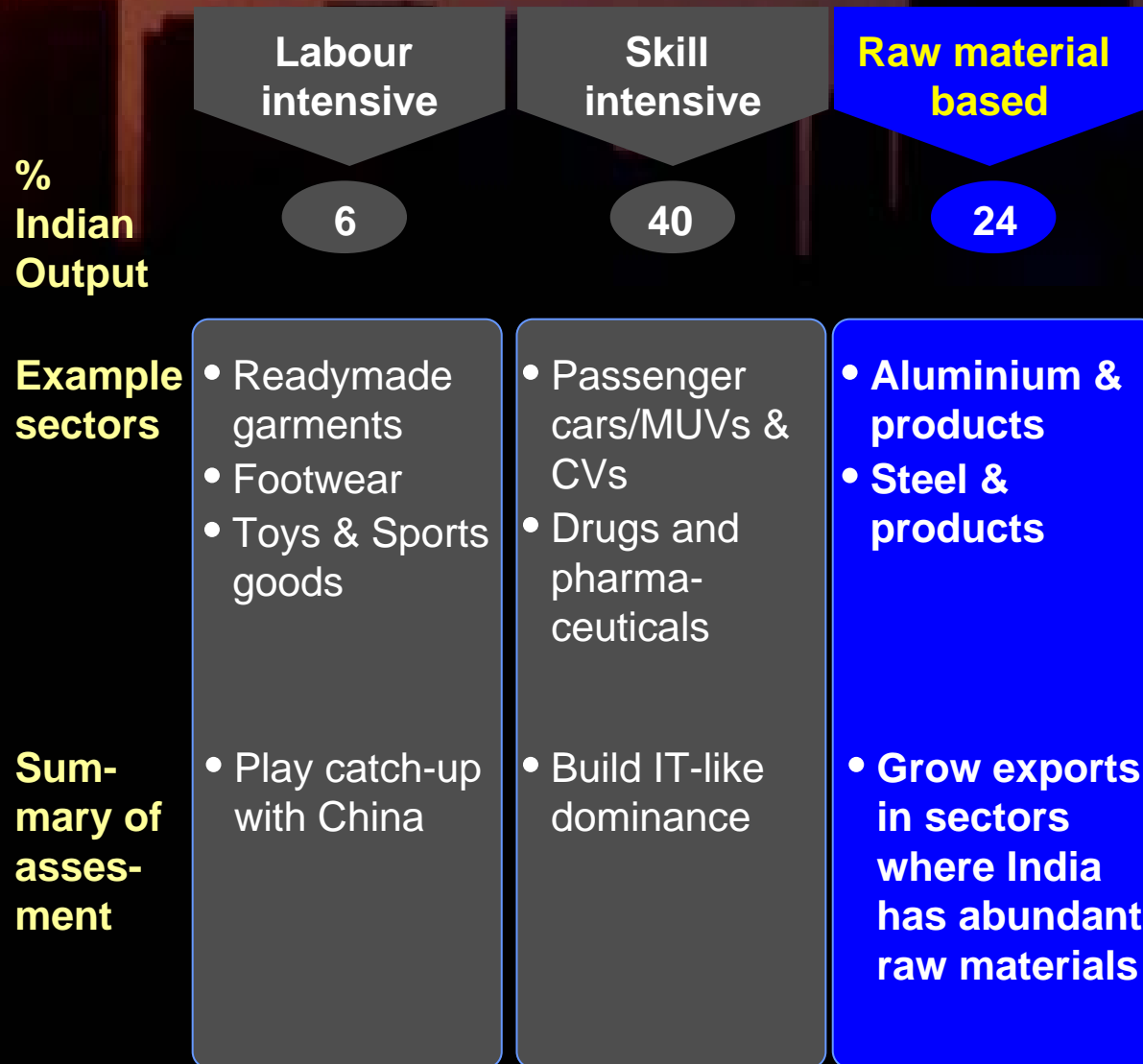
Indexed to trade in '00=100



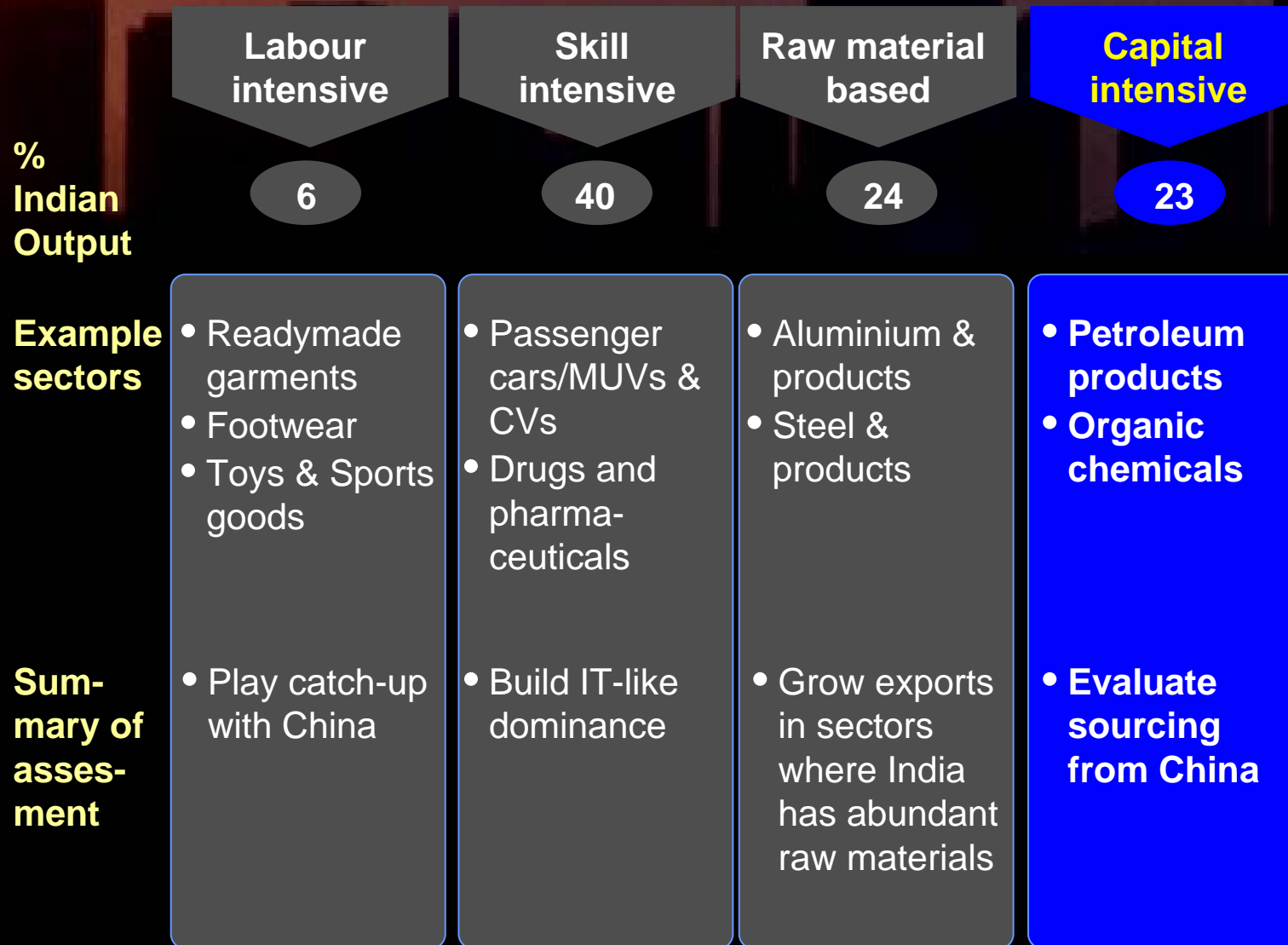
Three key actions for Indian companies

- Strengthen OEM relationships
- Offer technical support/product development services
- Focus on China as a market through JVs

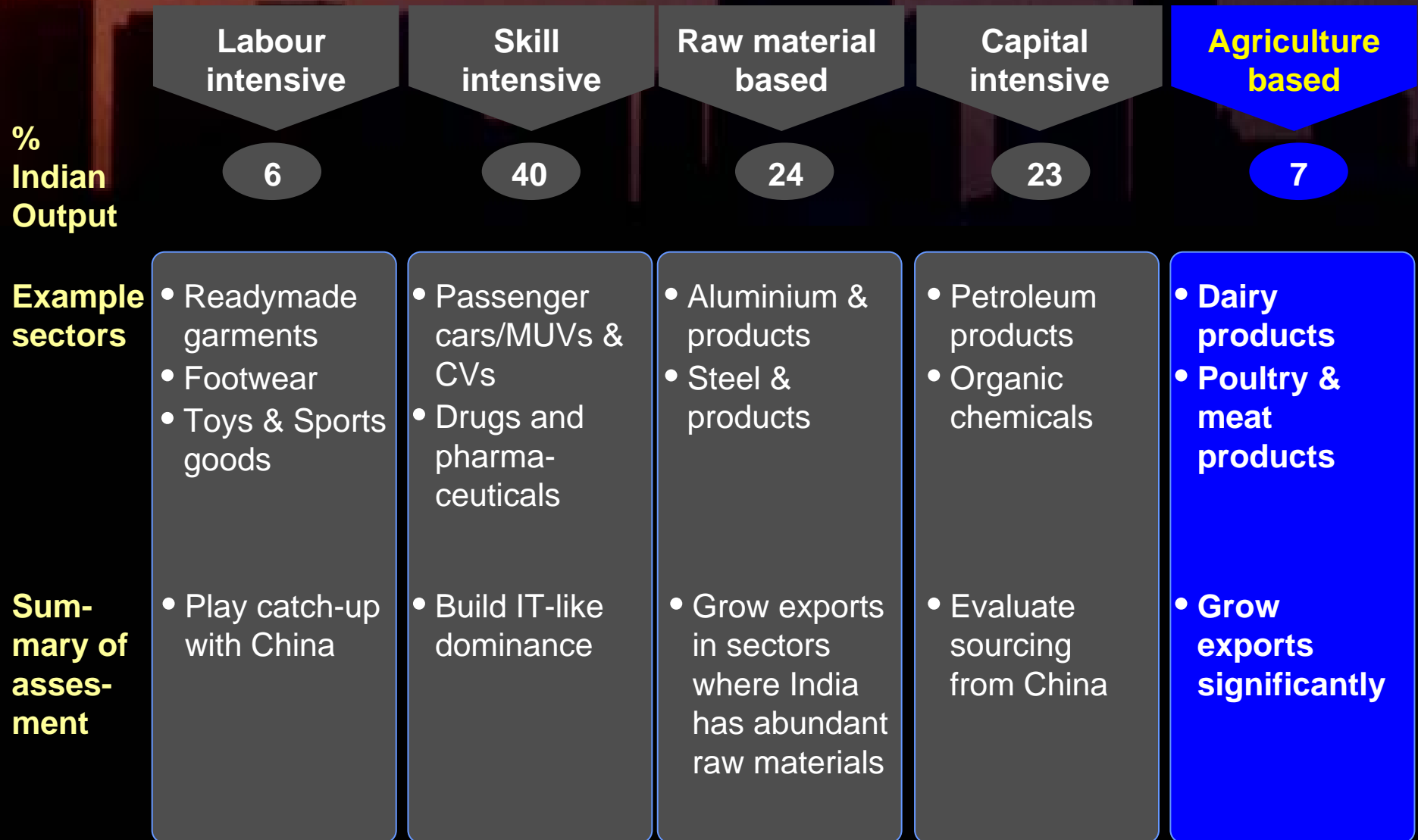
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McKinsey & Company