

# Economic Forecast for India Where are the opportunities?

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1

## India

- India is undeniably an important growth markets of the future.
- It has the fourth largest domestic product in PPP terms
- It is young. It has 450 million people below the age of 21, it is just beginning its assumption journey.

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2

## Context

- India is a complex and growing country.
- Despite the achievement listed in this talk almost everybody in India is aware of the fact that India has to go a long way before the country can become what all of us would like it to be.
- There is a common perception that India has a lopsided economy built on information technology and business process outsourcing.
- But all this is changing fast as local and multinational companies scramble to meet the demand of the growing middle class. The rapid expansion of the Indian manufacturing base is creating a huge demand for skilled young working age population.

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## The changing Macro economy of India

- For half a century before independence, the Indian Economy was stagnant . Between 1900 and 1950, the economic growth averaged 0.8 percent a year—exactly the same rate as population growth, resulting in no increase in per capita income.
- In the first decade after independence economic growth picked up averaging 3.5 percent Indian mournfully call this as Hindu rate of growth.
- Of course it has nothing to do with Hinduism Fabian socialist policies of the Indian government.

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4

## A 100 year tale

- Pre 1990 Indian economy was a state dominated Indian economy , it combined the worst features of socialism and capitalism. Development model was inward looking and import substituting rather than outward looking and export promoting, and it denied India a share in the prosperity that a massive expansion in global trade brought in the post – world war two era.
- Ruling congress set up an inefficient and monopolistic public sector , overregulated private enterprises with the most stringent price and production control in the world and discouraged foreign investment—there by causing India to lose out on the benefits of both foreign technology and foreign competition.
- In the 1980s, the governments attitude changed, thanks in part to the underappreciated efforts of Prime minister Rajiv Gandhi—especially lowering marginal tax rates and tariffs and giving some leeway to manufacturers— spurred an increase in growth rate to 5.6 percent.

- But the policies of The 1980s were also profligate and brought India to the point of fiscal crisis by the start of 1990s.
- Fortunately that crisis triggered the critical reforms of 1991, which finally allowed India integration into the global economy. The chief architect of those reform was Dr Man Mohan Singh who is now the Prime Minister of India.
- He lowered tariff and other trade barriers, scrapped industrial licensing, reduced tax rates, devalued the rupee, opened India to foreign investment, and rolled back currency controls.
- Many of these decision were gradual but they signaled a decisive break with India's *dirigiste*
- Past. The economy returned the favor immediately, growth rose, inflation plummeted, export and currency reserves shot up.

## GDP Growth: Business Cycle effect or Shift in the Growth rate

1990-93	4.0
1993-97	7.1
1997-2003	5.2
2003-2006	8.1

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## 1990-93 and 1993-97

- Reform during 1990 was impressive by any standards. IMF conditional loan forced India to liberalize, privatize and globalize. GDP growth reached 7.3 percent in 195-96 and industrial growth to 13.2 percent from a negative growth at the time of economic crisis.

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## 1997-2003

- But this story was short lived
- Despite growing at an average of 6.2 percent and being the second fastest economy in the world, industrial recession along with global meltdown of the dotcom and a poor performing agrarian economy India was on the verge of a crisis.
- All monetary and fiscal stimulus failed to stimulate the economy

## 2003 – 2008 The rise of India

Come October 2003 the Indian economy started looking up.

1. Competing during recession can be said to be one of the prime factors which led to industrial recovery. Indian companies have relentlessly cut costs and reduced working capital and built in flexibility. Supply chain practices which has not only helped them to cut costs but also create flexibility.

## The rise of India

- Companies lowered their financial cost. Interests as a percentage of sales declined significantly, falling to 4.2 percent in 2001-02 from 5.4 percent in 1997-98. The top 300 companies had better bargaining power with their lenders." All this indicated high liquidity in the market and falling interest costs.
- Despite a high fiscal deficit, infrastructure sector improved. The telecom boom, golden quadrilateral, interlinking of the rivers, modernization of ports and airports all led to a kind of Keynesian push and demand in the surged ahead.
- Added to this was the opportunity arising from information technology, outsourcing, biotechnology and bioinformatics have helped Indian exports sector grow significantly.
- Lord Indra the rain god was kind that year and due to growth in agriculture the demand deficit was done away with and a demand led recovery started
- Aided by the rise of the automotive components, gem and jewelry, fruits and vegetables, pharmaceuticals, engineering farm equipment and food processing.

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11

## The rise of India continues

- The economy moved to decisive growth phase. The growth rate has been 8% every year since 2003-04
- The growth of per capita income and consumption has increased from 2.2% and 1.1 percent in 2002-03 to 7.2 and 5.3 respectively in the year 2007-08.
- Rate of growth of Gross capital formation in the economy increased from 12.3% to 15.9 % between the period 2002-03 and 2007-08. what is encouraging is that the sector likes agriculture, Telecommunication, construction, financial and business services and manufacturing have been the major beneficiary.

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12

## Business cycle growth versus shift in growth rate?

1. Despite 9.3% appreciation of the rupee since 2002-03 the trade has grown at an extraordinary pace.
  - Particularly remarkable has been the rapid rise in the ratio of exports of Goods and services to GDP. In 1990-91 this ratio stood at 7.2% and 20.5% in 2005-06.
  - This rise is important as GDP in real terms has risen at 16.5% - This is a clear indication that the Indian Economy is Integrating with the world economy. The share of India in the world trade also has increased from 0.5 percent in 1990-91 to 1 percent as of now.
2. Foreign Investment flows, which had remained sluggish for many years after liberalization has also seen a major shift in the last three years. From just dollar 6 billion in 2002-03 to total FDI in India has risen to \$20bn.
  - Similar dramatic changes have taken place in sectors like telecommunication and Automobile.

1. Trade and Foreign Investment expansion has led to a greater integration of the Indian economy into the global economy.
2. Exchange rate in the current phase has been either stable or appreciated. Given a large stock of foreign reserves – The prospects of large depreciation are quite low. This means that Indian economy is going to sustain itself.
3. The growth rate has remained high despite the global slowdown.

Thus there is clearly a trend towards shift in growth rate

## India and the world financial crisis

- Internal demand hypothesis.
- State stimulus in form of excise reduction.
- Government helping hand in rural India.
- Global confidence in India as a major emerging power.
- Indian economy overheating as food inflation rises to 16.7 percent.

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15

## Rural India and Financial Crisis

Sectors	FY 08 (YOY Growth)	FY 09 (YOY Growth)
Agriculture	4.9	2.6
Industry	8.1	4.8
Services	10.9	9.6
GDP	9.0	7.1

- The rate of growth is forecast to decline in all sectors.
- For the first time in the last four decades, farm sector growth has been positive for four consecutive years @ 4% for previous 3 years & 2.6% this year.

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## Government Spending in Rural

- Rs 1.76 trillion Bharat Nirman rural infrastructure program (2005-09) for improving electricity, roads, housing & irrigation
- Rs 300 bn wage payment under NREGA – 38 million HHs in 330 districts already paid
- Substantial additional money flow through Rs 716 bn loan waiver.

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## Income & Employment

Impacted (30%)

Not Impacted (70%)

### Artisans

- Engaged in handloom, pottery, handicrafts in export dependent clusters are affected but constitute only 4% of work force,

### Salary earners

- Constitute 11% of work force vs 37% in urban
- Most in public sector...no impact, only some pvt sector migrant workers impacted

### Non agri Labour

- Out of 15% work force only 8% in manufacturing somewhat affected

### Farmers

- Largest proportion of rural work force (41%) is self employed

### Farm labour

- Second largest in workforce (19%)
- No impact as there is no decline in agri activity
- 20-30% increase in wages due to shortage of labour supply and NREGA effect

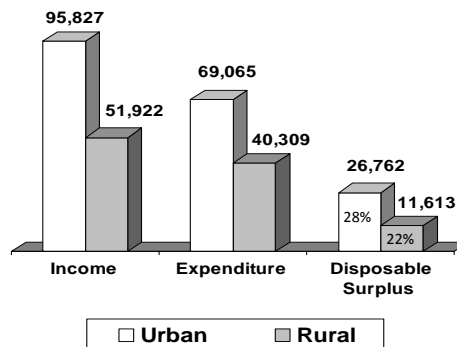
### Self employed in non-agri

- 11% of workforce

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- More than 60% of India's income comes from Rural + Small Towns.
- Disposable surplus as% of income similar in both.

### Annual Household Income (Rs)



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## Some concerns

- What has been peculiar about India's development so far is that high growth is not accompanied by a labor intensive industrial revolution that could transform the lives of tens of millions of Indians still trapped in rural poverty.
- Agricultural sector which employs three fifth of the labor force contributes only about one fifth of the GDP.
- Infrastructure remains a major area of concern.
- Education sectors dominated by state and opportunists has been a drag on societal development.
- Health is another area of concern.
- Labor market rigidities, bankruptcy law etc remains key obstacles for corporate in India.

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## Section - II

# Changing Dynamics of Consumer Segments in India

## Most FAQs

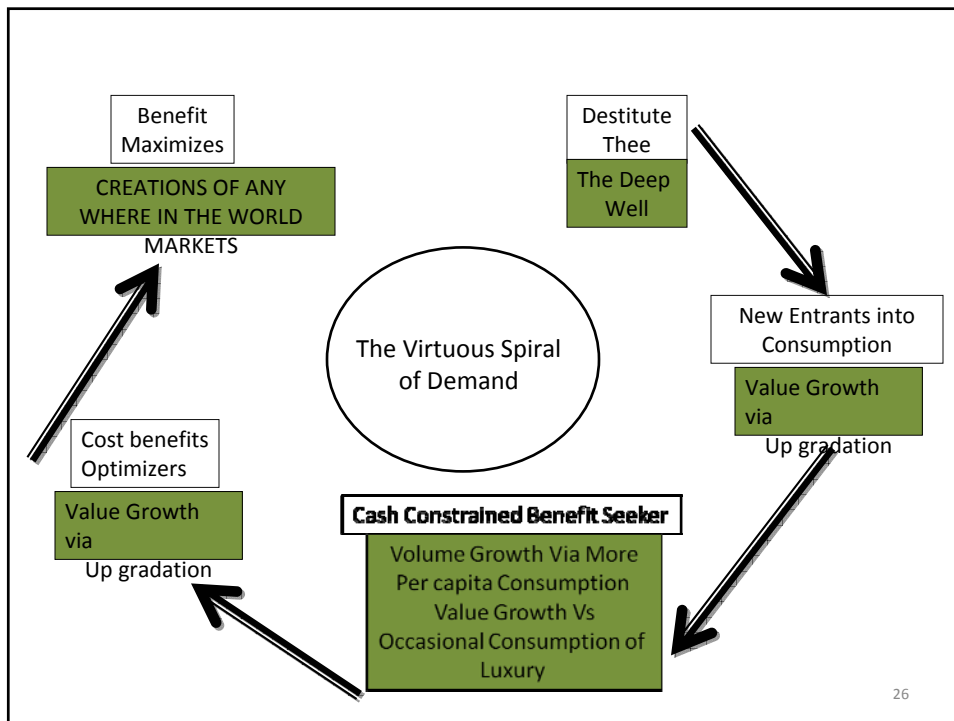
- Why bother with India When I have China?
- Is there enough evidence that India is a consumption powerhouse?
- Tell us about the Indian middle class?
- What is the exact purchasing power of the Market?
- Is there really a fortune at the bottom of the Pyramid?
- Is India a primitive or a sophisticated market?

## Questions About Indian Market

- How much of business interest does this market hold?
- What kind of strategies does it really deserve?

Market Demography Characteristics				
		1995	2000	2006
Destitute	Hands to Mouth existence (Not buyers)	35	24	17
Aspirants	New Entrants into Consumption	48	32	33
Climbers	Cash Constained Benefit Seeker	48	36	78
Consuming Classes	Cost benefit optimisers	29	55	75
Rich	Benefit Maximisers	1	3	6
		Figs in mn households		
Source:(NCAER "India Market D Reports")				

- There is a need to look at Consumer India through multiple lenses and present a zero-base, consumer centric view of India's demand structure and its drivers. It is important that we critically examine the demographic, cultural and the social trends and identifies the strategic themes and approaches that corporations must think about when addressing consumer India, so that they may develop their own mental model's of India

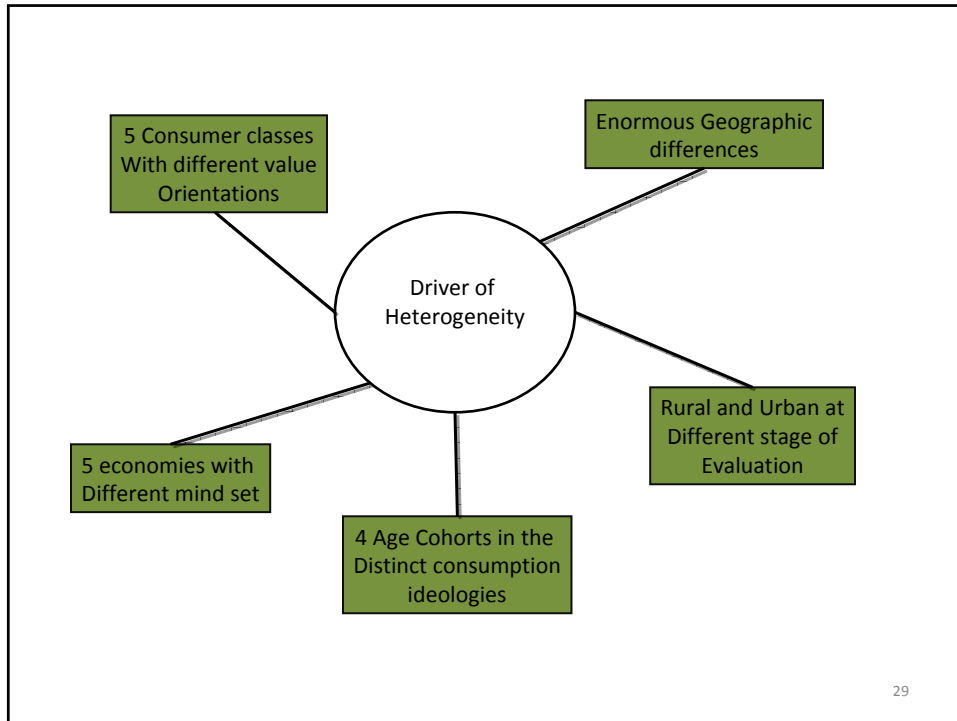


## Indian Market

- Top 30% of Consumer India can be divided into
  - 50 to 60mn People in the Creamy layer
  - A 100mn a layer below it, well on the load of consumption.
  - 100 to 150 m people below that layer – who have Just began there consumption Journey

## The Changing face of Consumer India

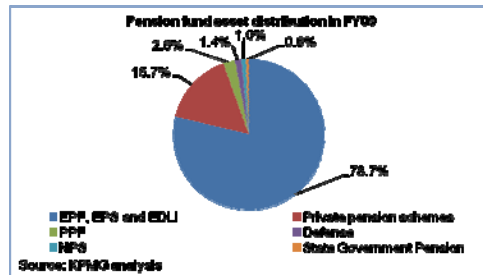
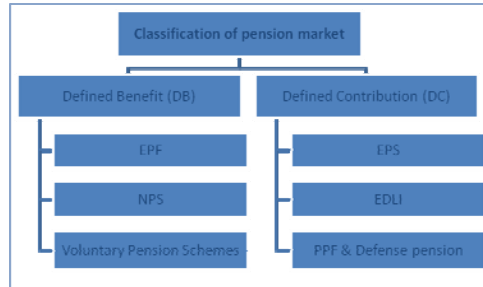
	From	To
1	Two India	One Many India's
2	Rich and Poor India	Many Shades of rich, not so rich, not so poor. Poor India
3	Urban India and Rural Bharat	Many Oases and Desert Within India as well as Bharat
4	Two age works with uniform Consumptions ideologies –all brought up in a socialist ethic	Five age cohorts with two district consumption ideologies and shades in between
5	Three Economies Agriculture, Manufacture, Government	Five economies Agriculture, Manufacture, Government, Ser, IT



## India... Market of future

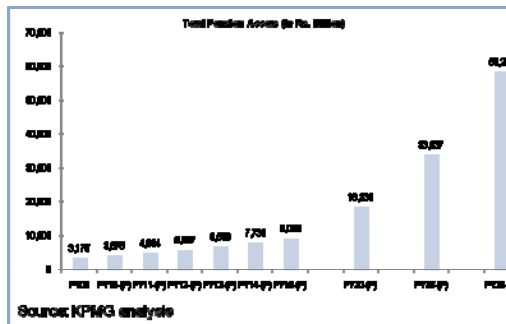
- India thus is an attractive market of the future if the Macro Economic Constraint and structural rigidities are taken care.....
- Foreign firms can enter this market with a different mindset and business model.

- A DC plan is wherein the post retirement benefit is dependent on the return his portfolio generates and a DB plans is where the employee benefit is calculated on the basis of his duration at work and his salary drawn i.e. fixed returns
- Schemes like EPF, EPS and EDLI are regulated by EPFO and schemes like NPS are regulated by PFRDA
- Schemes under EPFO are ideally for individuals working for establishments employing more than 20 employees
- NPS schemes is for state and central government employees, self employed individuals and other entities
- The industry has seen several changes on in recent years with the advent of the NPS scheme which allowed individuals to have an exposure of other financial assets apart from government securities to their pension corpus
- Even private players have been given an opportunity to handle corpus under EPFO
- There are various entities which have emerged in the entire value chain of the pension fund market: CRA, Trustee Bank, Custodian, Distribution and Pension Fund Manager (PFM)
- The investment made in other financial products in the market which are growing at a much faster rate as compared pension assets
- The Indian pension fund market for FY09 stand at Rs. 3,175 billion , approximately 6.0% of India's GDP



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- The investment pattern suggest that the Indian pension fund market is highly under penetrated with only 13% of working population having some kind of pension for retirement
- There are several issues like longer lock in period, paucity of investor orientation, lack of incentives for distribution channels and lack of tax benefit which are creating challenges for the industry
- The under penetration, favorable demographical changes, increase in private players, innovative products are going to drive the growth for the industry
- The market will be largely dominated by DC plans; one can expect larger investment exposure to other financial assets in future
- A large portion of the overall pension assets would still be contributed from schemes under EPFO even in the future



- A largely under penetrated market, the Indian pension fund market is expected to grow at CAGR of 14.9% over the next 20 years to Rs. 58,276 billion which is will be approximately 12.0% of India's GDP
- For projecting the size of pension assets, changes in provident and pension fund was taken as dependent variable and GDP, per capita income, working population and urbanization was taken as independent variable; data for private pension scheme take from OECD report
- Pension assets = Changes in P&PF (+ increase in percentage due to other factors in optimistic scenario / - decrease in percentage due to other factors in pessimistic scenario) - defense (pay-as-you-go scheme) - redemptions made during the year + accumulated size of assets + increase in pension assets due to investments
- Redemption rate was assumed based on historical redemption rate for schemes under EPFO; scenario analysis was done considering a pessimistic and optimistic scenario on independent variables
- For an entrant, the only feasible points of entry in the entire value chain of the pension fund industry is either a distributor of a PFM; since the rest are largely dominated by public sector entities

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## Classification and structure of pension market in India

### Classification of pension market in India

**Defined Contribution (DC) plan:**  
A plan wherein the benefit post retirement depends on the return his portfolio generates i.e. variable returns

Employee Provident Fund Scheme (EPF)

New Pension Fund (NPS)

Voluntary Private Pension Schemes

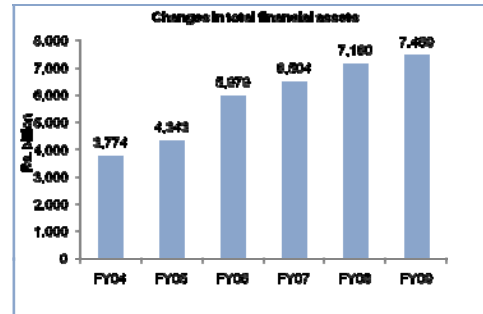
**Defined Benefit (DB) plan:**  
A plan wherein the employee benefit is calculated on the basis of his duration at work and his salary drawn i.e. fixed returns.

Employee Pension Scheme (EPS)

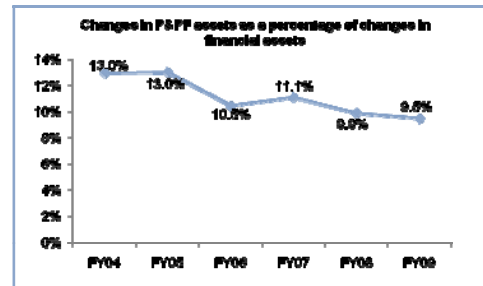
Employee's Deposit linked Insurance Scheme (EDLI)

Public Provident Fund (PPF) & Defense Pension Scheme

- Changes in financial assets have shown a steady growth over the years, currently standing at Rs. 7,469 billion
- Change in P&PF as a percentage of changes in financial assets have been declining steadily from as high as 22.8% in FY00 to 9.5% in FY09
- Other financial product have grown at a much faster rate as compared to provident and pension product
- Largely due to favorable reforms making other financial products more attractive as compared to provident and pension products



The investment pattern in India's household signify a highly under penetrated pension fund investments with huge potential for upside in the future

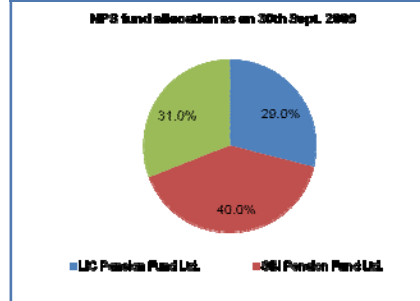


Dominated by public sector entities at different points of value chain

PFM:

**Public sector entities** like LIC Pension Fund Ltd., SBI Pension Funds Private Ltd. And UTI Retirement Solutions Ltd. are key player for schemes like NPS

**Private players** namely: ICICI Prudential Pension Funds Management Company Ltd., IDFC Pension Fund Management Company Ltd., Kotak Mahindra pension fund Ltd. and Reliance Capital pension fund Ltd too are gaining popularity with their private scheme



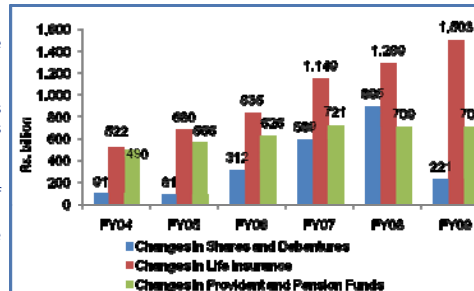
- EPFO too have given three private players to handle a part of their corpus

Distribution:

- Competition is relatively moderate since a large parts of the market still remains untapped

Trustee, Custodian and CRA:

- Dominated only by public sector entities like Bank of India as Trustee Bank; Stock Holding Corporation of India Ltd. (SHCIL) as Custodian and National Securities Depository Ltd. (NSDL) as a CRA
- EPFO handle all functions except fund management
- Private schemes offered by private player handles the function of Trustee, Custodian and CRA on their own
- Other financial products like Mutual Funds and Life Insurance are growing at a much faster rate as compared to P&PF and are in direct competition with pension products



## Current State of the pension fund industry in India

### Challenges within the pension fund industry

#### Customer

- Lack of tax benefit: No tax benefit for Schemes like NPS: capital gain on NPS is taxed
- Longer lock in period: Longer lock in periods makes the schemes less attractive for the customers
- Paucity towards investor orientation: Difficult for investors to track the growth of pension fund assets; longer wait times for individuals to redeem their pension/provident funds; Lack of awareness about a number of schemes within the pension fund industry.
- Lack of investment flexibility: EPFO which has the largest pension assets along with large number of enrollments still does not provide investors an opportunity to invest in other financial assets for higher returns.

#### Value Chain

- Lack of incentives for distributors: Distribution channels pushing for other financial products; Lack of incentive/income for distributor for pushing products like NPS in the market
- Lack of distribution penetration: Distributing channels lack capability to enter the rural markets mainly due to the high fixed cost involved

#### Products

- Competition from other financial products: Other financial products like mutual funds, insurance and shares which are more attractive for investments as they provide higher returns and liquidity.
- Lack of innovative pension products: Innovations in products like micro pensions within the industry still largely absent.

## Current state of the pension fund industry in India

### Drivers for the pension fund market

#### Demand Drivers

- Favorable demographics (++)
- The old age population is growing at a much faster rate at 3.8% as compared to the overall population growth rate 1.8%
- The increase in urbanization & education within the economy are other demographic changes which will assist the growth of pension fund market

#### Supply Drivers

- Innovation in pension products (+++)
- Innovation of pension products, move from DB plans to DC plans are factor which will boost investment in pension products
- Introduction of innovations like micro pensions, would help the larger rural Indian market to contribute in turn fueling growth in the pension fund industry
- Favorable regulatory framework(+++)
- Favorable regulations are expected, which will enhance the growth rate and contribution to pension assets within the economy; establishment of PFRDA was one such step to develop the pension fund market in India
- Growing economy(+++)
- The growing Indian economy will also cause the per capita income to increase, which in turn will people the contribution toward pension fund
- Increase in private players (+)
- Entry of large number of private pension players would imply more options for investments as more products will be pushed over the counter

(+++): Most favorable driver;

(++): More favorable driver;

(+): favorable driver

Year	Market Capture Schemes under EPFO, NPS, PPF, State (PMF)	Market capture Schemes by private players (PFM)	Revenues (Rs.) on new investment made (PFM)	Growth (PFM revenues)	Individuals enrolled	Revenues based on fixed amount (Rs.) Distributor
FY10	0%	2%	3,750,000	NA	25,739	2,573,900
FY11	0%	3%	6,468,750	72.5%	42,285	4,228,500
FY12	0%	4%	9,918,750	53.3%	61,750	6,175,000
FY13	0%	5%	14,258,203	43.8%	84,539	8,453,900
FY14	0%	6%	19,676,320	38.0%	111,108	11,110,800
FY15	0%	7%	26,399,063	34.2%	141,972	14,197,200
FY20	5%	10%	65,952,334	20.1%	327,407	32,740,700
FY25	10%	15%	113,117,901	11.4%	480,705	48,070,500
FY30	15%	15%	115,700,719	0.5%	490,048	49,004,800

### **Subscribers under NPS**

- The number of subscribers enrolled under NPS from 2009 till 8<sup>th</sup> Jan 2010 are as follows, with 115 tier – II account\*activated:
  - i. Central government – 566,279
  - ii. Central government autonomous bodies – 2,421
  - iii. State governments – 122,316
  - iv. Unorganized sector – 3,264

### **Segmenting the Market**

- Farmers = 5.8 million
- Small Retailers = 5.3 million
- Street Vendors = 0.7 million
- Self-employed = 3 million
- Small/medium manufacturers = 0.3 million
- Skilled/semi-skilled wage earners = 2.5 million
- Salaried employees in small firms = 1.5 million
- Others = 0.7 million
- Over 50% of these have incomes of less than Rs. 100K a year

## Entering the market

- 19% have neither a bank or Post Office savings accounts
- 8% bank exclusively with the Post Office
- 56% bank exclusively with banks (one in eleven of whom have accounts with more than one bank)
- 17% have both Post Office and bank savings accounts and
- 44% are customers of life insurance institutions
- Conclusions
  - Banks and life insurers are positioned to be the key players in cross selling
  - Nearly 20% of the prime audience is outside the ambit of cross selling opportunities.

41

## Conclusion

There is a significant dormant market for voluntary pensions in India that extends across economic sectors and occupational groupings and down the income distribution

***Capturing this market will be primarily a matter of effective marketing among low and lower middle income earners that to date appear not to have been fully exploited by the Indian financial sector***

42