THE CASE FOR INDIA

DECEMBER **2006**

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India is one of the world's economic success stories of recent years thanks to reforms that have overturned decades of central policies. The country's reform drive over the past 15 years has helped India's economy emerge as the 12th largest when output is measured in US dollars and the fourth-largest in terms of purchasing-power parity.[1]

This paper looks at why India was forced into economic reforms, what those reforms entailed and the results they have so far achieved. It looks at India's economic advantages that point to robust growth in coming years and some of the challenges it must deal with to meet its potential.

INDIA'S REFORMS

Old-style India might best be glimpsed by its decision in the 1970s to force out Coca-Cola. The drive against the popular soft drink reflected the self-sufficiency or "swadeshi" mentality that pervaded the country's economic policies from independence in 1947.

During this time, policy-makers favoured central planning, kept out foreign investors and placed infrastructure, utilities, banking and other key industries under state control. The consequence was that India's economy stagnated at an annual growth rate of 3.5% from the 1950s to the 1970s. This was only equal to per capita growth of 1.5% per annum, a non-achievement that was derided as the "Hindu rate of growth".[2]

It was always going to take a shock to jolt India out of its economic mis-management and that duly arrived in 1990 when India faced a balance-of-payments crisis. Shortly after in 1991 when the problem had morphed into a currency crisis, the near-broke government turned for help to the World Bank and the International Monetary Fund. These bodies agreed to provide financial aid to India on condition the country made immediate free-market reforms.

THE CURE

The broad thrusts of the reforms were financial stability, outward-looking policies and deregulation. They consisted of two parts; immediate stabilisation steps and longer-term adjustments.

The short-term medicine aimed to restore equilibrium in the foreign-exchange market by reducing demand, reforming trade policy, cutting the fiscal deficit and freeing capital flows. The value of the rupee was slashed to boost India's competitiveness.

The medium-term remedies included fiscal, exchange rate, trade and industrial reforms as well as policies to shake up the public sector, the financial industry and capital markets. These reforms included deregulating prices and investments, a rehaul of taxation and public expenditure, the sale of government assets and opening the Indian economy to the world. (See breakout on page 2 that highlights key reforms.)

THE STARTLING RESULT

India's industrial revolution is the outcome. Endless reforms since the 1990s have fanned impressive export and industrial growth that in turn have created a sense of optimism around the country - and for good reason.

Fast growing economy

India's economic performance in recent years has been among the best in the world. The long-term trend rate of India's economic growth has jumped and the country has recorded an average annual economic growth of more than 8% over the past three years.[3]

1 Source: imf.org 2006. Purchasing-power parity, when used to measure the size of an economy, adjusts official exchange rates to allow for cost-of-living differences between countries.
2 Economist Intelligence Unit (EIU), Country Profile 2005, India.
3 Source: rbi.org.in. Macroeconomic and Monetary Developments publication.

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Growth is forecast to remain robust in coming years for an economy that is now the third largest in Asia when output is measured in US dollars.[4]

Taming inflation

Inflation of around 5% to 7% a year is much lower than the near double-digit annual results recorded between 1992 and 1996 thanks in part to good management by the Reserve Bank of India. Interest rates near their lowest in about three decades encourage investment and consumption.

Improved external sector

The country's trade and net debt position has improved vastly since the early 1990s due to foreign investment inflows and a better export performance – the latter helped India record current-account surpluses between 2001-02 and 2003-04.[5]

India is getting better at exporting. India exports totaled US$79.2 billion in 2004/05, up from $36.8 billion only five years earlier.[6] About half of India's exports are textiles, cut gems and automobile components but the real success story is IT services. In fiscal 2004-5, software and IT-enabled services exports reached US$16.6 billion, up from US$4.6 billion three years earlier.[7] And more robust export growth from this sector is forecast. With all goods and services, the country is experiencing strong demand from China, and increasingly from the US and Europe.

INDIA SNAPSHOT

GDP: 8.9% (12 months ended 30 June 2006)*

Inflation (Consumer Prices): 6.6% (Year to September 2006)*

Federal budget % GDP: -4.4% (March quarter 2006)**

Current account % GDP: -1.5% (June quarter 2006)*

Jobless rate: 9.9% (Estimate for 2005)***

Population: 1.1 billion (31 March 2005)***

Government: Constitutional federal democracy

Sources: *Bloomberg, **Centre for Monitoring the Indian Economy (an independent body based in Mumbai), ***CIA Factfile

INDIA'S MAIN ECONOMIC REFORMS SINCE 1991

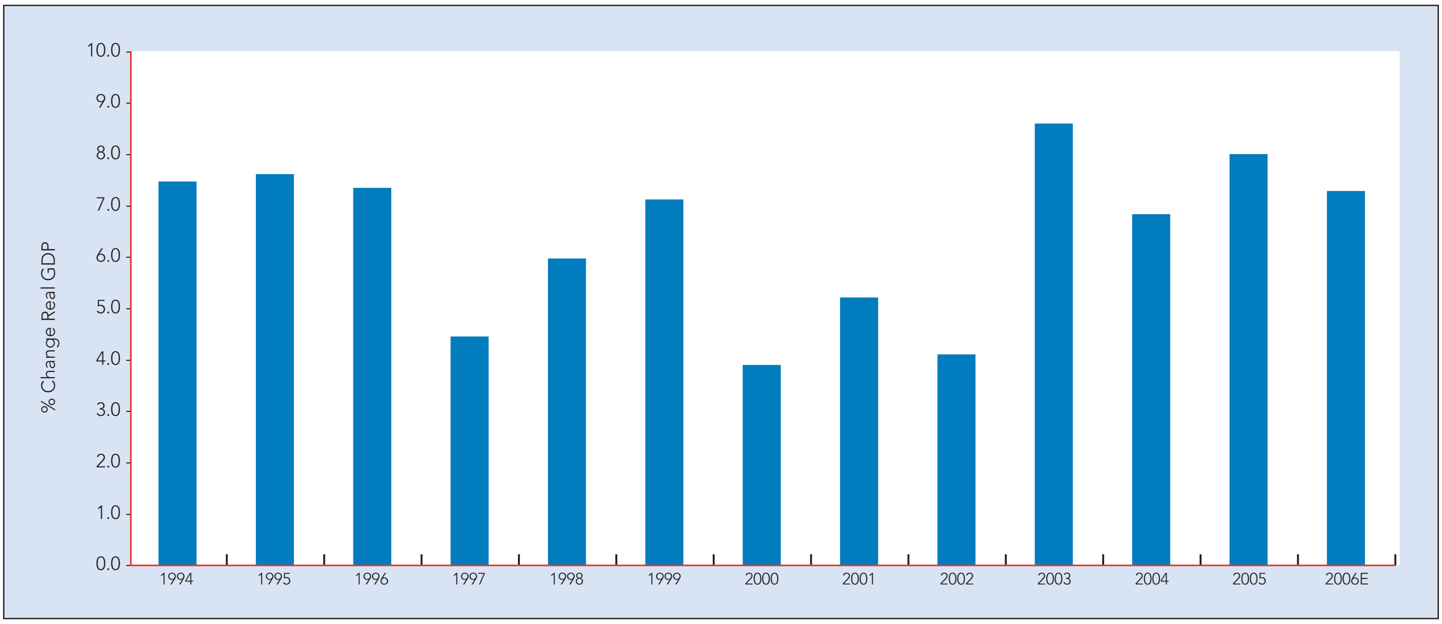
India's reforms since 1991 have been substantial:

- More sectors were opened to private investment, including power, steel, oil refining and exploration, road construction, air transport, telecommunications, ports, mining, pharmaceuticals and finance. Sectors such as garments and textiles that were previously reserved for small-scale industries were also de-licenced.
- Policymakers sought to encourage foreign direct investment (except in some strategic sectors) and portfolio investment.
- Most industries were de-licensed (previously licenses restricted companies to produce a prescribed number of items) to encourage competition.
- Trade policy was liberalised. Some import quotas were converted into tariffs and the tariff system was simplified. In 2001 all quantitative restrictions on imports were removed although tariffs remain high.
- Some aspects of business decision-making, such as the location of new enterprises, were taken out of the state's control. (Labour relations and the shutting down of loss-making enterprises remain regulated.)
- The exchange-rate regime was liberalised. A market-determined exchange rate was introduced in 1993 and current-account convertibility began in 1994. The rupee is not yet fully convertible on the capital account.

Source: The Economist Intelligence Unit (EIU),Country Profile 2005, India

4 Bloomberg.
5 EIU, op. cit.
6 India's Directorate General of Commercial Intelligence and Statistics, found on rbi.org in 2006.
7 EIU, op. cit.

India's economic growth since 1994



Source: Asia Pacific Consensus Forecasts, Thomson Financial DataStream, 2006

INDIA'S POLITICAL STRUCTURE

An economy needs some crucial foundations in place to prosper including political stability. This is best done by a democratic system because checks and balances are generally in place that disperse power; an independent legal system that secures property rights; a free media operates; the transparency involved limits corruption; and the system can better absorb stresses.

India can boast that it is the world's largest democracy. The constitutional federal democracy of 28 states and seven union territories has held regular and largely free elections since independence for its two houses of parliament.

National elections are held every five years (earlier if leading parties lose majority), with universal adult suffrage for the lower house, or Lok Sabha, which appoints the prime minister. The country's constitution provides for an independent judiciary with high courts in every state and a Supreme Court in the capital of New Delhi.

Since 2004, India has been ruled by a coalition of 12 parties led by Prime Minister Manmohan Singh. The size of the coalition and the fact that it includes Communist MPs slows policy making and implementation.

Since the collapse of the Soviet Union, India has built closer ties with the West including the US and has turned itself into a nuclear power. Tensions exist with neighbouring Pakistan, Bangladesh and China though these appear to be under control.

For investors, it is important to note that the numerous governments in power since the early 1990s have persisted with free-market reforms, albeit with different levels of enthusiasm, room to move and success.

INDIA'S UPBEAT ECONOMIC OUTLOOK

An economy needs some advantages to flourish. As well as having favourable political and legal systems and a pro-business government, India's economy possesses three key advantages that augur well for its long-term economic growth; an expanding middle class, favourable demographics and a skilled workforce.

Expanding middle class

A middle class has emerged in India that is set to boost and alter consumption within the country.

The National Council for Applied Economic Research, a private non-profit economic research firm based in New Delhi, estimates that India's middle class has tripled to 300 million in the past 20 years thanks to the recent economic growth. Bloomberg quotes government estimates that indicate that India's annual per-capita income has jumped 62% to 25,788 rupees (US$580) in the past six years.[8]

8 Source: www.ncaer.org 2006.

If you assume that Indian consumption patterns will mirror those in Western countries as Indians become wealthier, there is vast potential for consumer sales because few Indians have what many in richer countries regard as essentials; a car, a TV, a PC and a mobile phone, as the table shows.

The consulting firm McKinsey & Co. estimated in the McKinsey Quarterly publication in 2005, that India's market for consumer goods may expand to US$400 billion by 2010 from $250 billion in 2003.

A surge in demand for services is mirroring the jump in demand for fast-moving consumer goods and durables. The financial services, media, entertainment and leisure sectors are expanding at a brisk pace.

Consumer durables – Penetration rates per 1,000 people

	Passenger Cars	Two-Wheelers	TVs	PCs	Mobile Phones
India	6	53	83	7	52
China	12	26	350	28	269
Brazil	64	28	349	75	263
France	491	40	632	347	647
Japan	428	106	785	382	637
Mexico	107	n/a	282	82	n/a
USA	480	15	938	658	488

Source: CLSA 2005

CRAZY SALES IN INDIA

When Big Bazaar held its biggest-ever sale on 26 January 2006, about three-quarters of the 24 outlets of India's biggest chain of discount stores had to close early. That's because more than two million people flocked to the sale and staff at most Big Bazaar stores couldn't cope.

Such is the popularity of Western-style malls, which only came to India in 2001, hypermarkets and other outlets in a country where income has doubled in the past decade and where about 97% of retail sales are still made at small family-owned stores or roadside markets.

Local and foreign companies have big plans to capitalise on the demand for retail products and services in India, which grew 5% to US$219 billion in 2005. Technopak Advisors Pvt., a Gurgaon-based consulting company, estimates that retail chains only took in just US$8.2 billion of the 2005 sales figure.

India overtook Hungary, China and Slovakia to jump to No. 2 behind Russia on consulting firm's A.T. Kearney's 2004 Global Retail Development Index, which ranks emerging markets by the size of the opportunity they present to international retailers.

Unsurprisingly, home-grown Reliance Industries Ltd. has aired plans to open 1,575 warehouse-style stores across India. Foreign retailers have been barred from opening stories in India. But Wal Mart Stores Inc., the world's biggest retailer, has sought permission to open an office in India.

Investors in listed Indian retailers have profited because retail stocks have jumped on expectations that the fascination that Indians have with malls will last.

Source: Bloomberg. "Pantaloon, Indian Retailers Push Chain Stores to Hook Shoppers." 4 April 2006.
Reference to individual companies does not constitute a recommendation or necessarily reflect a stock-holding status of any kind.

Favourable demographics

India's population is a melting pot of languages, religions, castes and classes that overall possesses some demographic traits that are favourable for economic development.

India's 1.1 billion population is young when compared with Western countries and even developing countries such as China, where a one-child-per-family policy has operated in much of the country for decades.

About 30% of India's population is under 15.[9] When these youngsters move into the 15 to 49 year old age group they will be entering the age when they will be at their most productive and when they will consume their most. This aging process is likely to boost India's consumer base.

As well, about 60% of Indians are 15 to 64 years old,[10] a high percentage by international standards. This means India has a relatively low number of dependents in percentage terms of the population. It's generally accepted that as more people in an economy work to support fewer people, discretionary consumer spending is likely to jump. India's dependency ratio is expected to stay low well past 2035, unlike in many other developing countries where the population is aging, as the table shows.

India's low elderly dependency ratio

Elderly Dependency Ratio	2000 (%)	2035 (%)
China	10	30
India	8	16
Korea	10	39
Philippines	6	13
Singapore	10	53
Taiwan	9	n/a
Thailand	8	24
Vietnam	9	18
EU15	24	47
Japan	25	57
UK	24	37
US	19	32

Source: OECD 2002

Skilled workforce

India's other big advantage is that many of its young workforce are highly skilled, even though it has a large number of uneducated people. (It has 17% of the world's population and 40% of the world's illiterates, according to the Economist Intelligence Unit).

India's large number of scientists, engineers, lawyers and financial managers are helping high-value industries succeed in India and are attracting foreign investment into the country. One of the key reasons foreign investors are attracted, of course, is that it is generally much cheaper for them to employ a well-qualified person in India than a person with similar skills in a Western country.

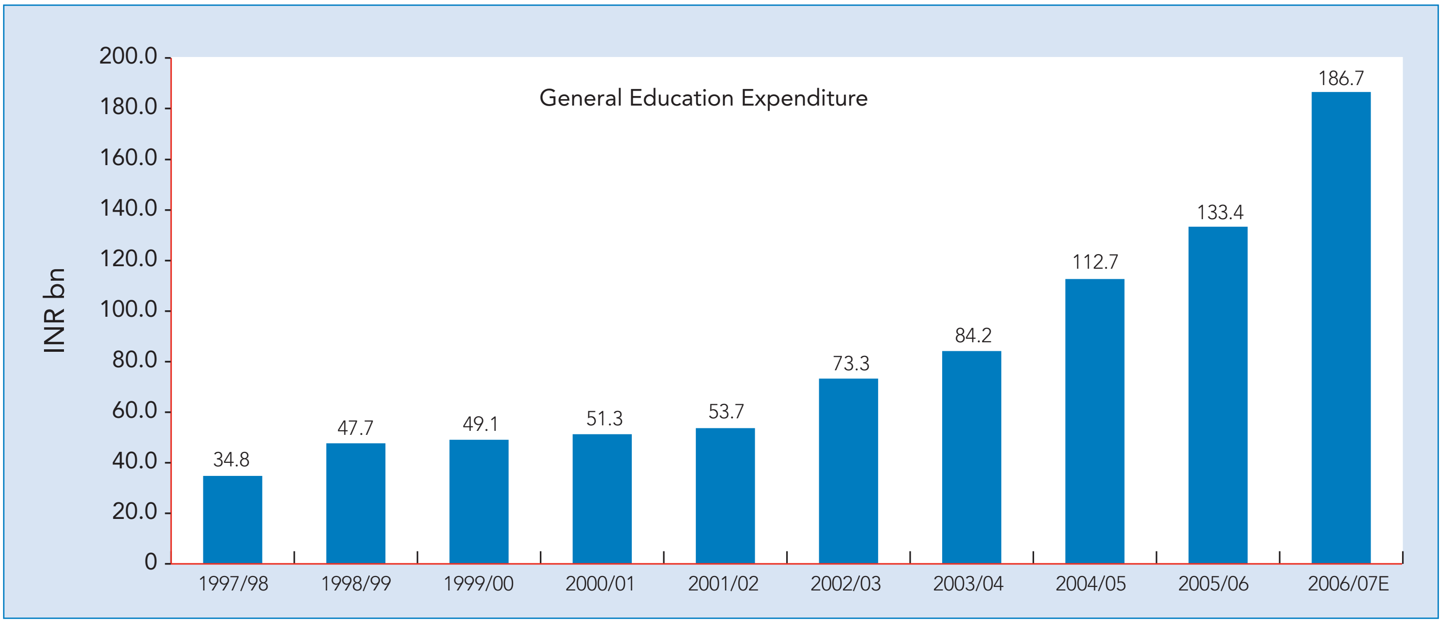
One of the skills of the Indian workforce is that English is widely spoken as a second language in a country with 15 official languages. The ability of many Indians to speak English is one of the reasons so many companies have outsourced call centres or set up IT operations in India.

The workforce is skilled largely because the country decided more than 30 years ago to boost spending on education and to build more universities. (The chart shows how spending on education in India has increased over the past decade or so.) At last count, the country boasted 225 universities, 6,800 affiliated colleges and 1,128 polytechnics, according to the Economist Intelligence Unit.

9&10 Asian Development Bank and US Census Bureau.

Government incentives for businesses to further educate their staff and stepped-up government spending on education are expected to ensure that skill levels in India rise further. However, the demand for some skilled workers has been rising faster than supply. This has resulted in shortages and caused some salary levels to rise in the past couple of years.

India has boosted spending on education in the past decade



SOME OF INDIA'S COMPANY SUCCESS STORIES

Cipla – pharmaceuticals for the world

Cipla Ltd. is the second-largest pharmaceutical company in India, manufacturing generic products for respiratory illnesses and cardiac problems. The Mumbai-based company, which was founded in 1935, also makes anti-infection, gastrointestinal and pain management drugs.

During fiscal 2005, Cipla derived nearly half of its revenues from exports. North America, Africa and Europe are its major export markets.

Unlike other companies in this highly competitive space, the company has strong process technology and niche capabilities in areas such as inhalers and injectables. Its strategy to act as a supplier of drugs to other generic companies helps lower risk because it does not directly get involved in expensive patent challenges. Legal expenses for challenging patents have been a major cost component for generic drug manufacturers.

Cipla has a healthy product pipeline, with about 160 products in various stages of development. Its partners had filed about 80 to 90 abbreviated new drug applications in the US by March 2006.

The anti-AIDS business has jumped in importance for the company. During the first nine months of fiscal 2006, the segment constituted 35% of the company's exports. Cipla recently received tentative approval from the US Federal Drug Authority for two drugs used in AIDS treatment.

The company has developed a range of CFC-free inhalers and started to register them in some major European markets. This is expected to be beneficial in the long term, as CFC inhalers are to be phased out from Europe by 2010.

The management is undertaking projects worth about 8 billion rupees (about $230 million) between 2005 and 2008, for expansion and upgrading facilities.

On the negative side, margins are being squeezed in the export business where they are highly volatile due to the dependence on customer orders and pricing pressures, especially in the US.

Sources for Cipla: UBS Report (30 May 2006), Motilal Oswal Report (24 May 2006)
Reference to individual companies does not constitute a recommendation or necessarily reflect a stock-holding status of any kind.

Suzlon – powered by the wind

Suzlon Energy Ltd. provides total wind-power solutions including consultancy, manufacturing, operations and maintenance services. At the end of 2005, the company based in Navrangpura, Ahmedabad was the fifth-largest wind turbine generator manufacturer in the world and the largest in India.

The company has enjoyed strong growth of late. Firstly, the industry expanded by 40% in 2005. Secondly, Suzlon's key markets, the US and India, emerged as the fastest growing in the world. As a result, its share in the global market increased by 2.5% during 2005 to reach 6.1%. Additionally, the company remains highly profitable, unlike many of its larger global peers. Its strategy to integrate vertically, by setting up production facilities in the US and China to cater to local markets, has proved beneficial.

At sector level, wind power is expected to expand further, buoyed by favourable government policies, such as those in the US, European Union, China, India and Australia that favour clean sources of energy. Higher fossil fuel prices have made wind power relatively less expensive and boosted demand for wind energy.

To meet growing demand, Suzlon plans to increase its capacity from the current 1500 MW to 2570 MW by September 2007. The company has tied up for supply of components. Besides, it is setting up generator and tower manufacturing capacities in China. India is also proposed to serve as a base to supply components in the US. The recent acquisition of Hansen, the world's second-largest gearbox manufacturer, has been beneficial, considering the shortages of components around the globe.

However, effective integration of supply chain would be critical for success in the future. Since growth in the industry is constrained by component shortages, success would depend on timely commissioning of component manufacturing facilities. Another key risk is the pressure on margins, once supply catches up with demand.

Sources for Suzlon: Fidelity Research Note (19 May 2006), Batlivala & Karani Report (23 May 2006), Enam research (17 May 2006)
Reference to individual companies does not constitute a recommendation or necessarily reflect a stock-holding status of any kind.

Bharti – connecting Indians

Bharti Airtel Ltd. is the largest private sector telecommunications service provider in India. Singtel holds a 33% stake in the company while Vodafone has another 10%. Bharti derives 68% of its revenues from the fast growing cellular services and 15% from fixed-line services.

In the Indian mobile services sector, the New Delhi-based company is the market leader with a 22% market share. Favourable demographics, rising affordability and widening geographical reach are boosting the number of subscribers in the country. With about four million subscriber additions every month, the figure has beaten all analyst expectations. Nevertheless, Bharti has been able to outpace the industry growth rate of net subscriber additions, due to aggressive expansion in smaller towns and rural areas. Focus on value-added services has also aided revenue growth.

The company is well-positioned to benefit from the increasing penetration of telecommunication services in India, expected to rise from 6.5% in 2006 to 18% by 2008.

Network expansion has been the key, and the company aims to cover 5,161 cities by the end of this fiscal year, compared with 3,800 cities a year earlier.

Besides, the company is aggressively rolling out its broadband services, which enjoy similar margins as the mobile-services business. To finance these expansions, capital expenditure of US$2 billion has been budgeted for this fiscal year.

On the flip side, intense competition in the market has led to price cuts and significant reduction in average revenues per user during the past two years. Rising capital expenditure and network roll-outs in less wealthy smaller cities may put pressure in margins. Thus, growth in subscriber base and successful roll-outs of value-added services would be critical for success in the long term.

Sources for Bharti: Fidelity Research Note (15 May 2006), Batlivala & Karani Research (2 June 2006), CLSA (24 May 2006)
Reference to individual companies does not constitute a recommendation or necessarily reflect a stock-holding status of any kind.

Infosys – leading India's IT charge

Nasdaq-listed Infosys Technologies Ltd. is India's leading IT services exporter, with revenues in excess of US$2 billion and an employee base of over 52,000. Its service offerings include application development and management, package implementation, consulting and business process outsourcing.

Strong management, strategic positioning and investments in building domain expertise make Infosys unique among Indian IT service majors. The company also benefits from a robust client-base by cross-selling of value-added services. It has been adding over 30 clients per quarter on a consistent basis.

Infosys is well placed to gain from the global trend towards outsourcing IT services to other countries, an expected increase in IT spending and its focus on value-added services. A strong brand name also helps with new client acquisitions and to attract skilled professionals.

The company has aggressive expansion plans to meet the growing global demand. It spent about US$240 million during the financial year ended March 2006 to develop office and training infrastructure. Office space to accommodate about 20,200 professionals is under construction. The company also has plans to expand operations in China, by recruiting about 10,000 professionals over the next four years.

On the contrary, the company is exposed to the risk that the rupee appreciates. Shortage of skilled man-power also poses a challenge, as the company may be forced to raise wages to retain talent. However, the management has been able to retain operating margins in the past. As an indication, salary costs as a percentage of sales have remained stable at around 50.5% in the past few quarters, despite the steep rise in absolute terms.

Sources for Infosys: Fidelity Research Note (31 May 2006), Company website (http://www.infosys.com/investor/reports/quarterly/2005-2006/Q4/Press_Conf_Q4_2005_06.pdf), Credit Suisse Report (2 June 2006), Motilal Oswal Research (30 May 2006).
Reference to individual companies does not constitute a recommendation or necessarily reflect a stock-holding status of any kind.

INDIA'S ECONOMIC CHALLENGES

India faces pressure on its natural resources especially when considering that it is home to about 17% of the world's population yet they are only living on 2.4% of the world's surface. Also, being a developing country, resources need to be adequately exploited. As with any country, India faces challenges.

Poor infrastructure

India's biggest challenge may well be that infrastructure of all sorts is rudimentary and a hindrance to growth.

With transport, the country has the world's most extensive rail network, at more than 63,000 kilometres of track, but it suffers from underinvestment and underpricing. India has only 65,000 kilometres of national highways compared with China's 1.8 million kilometres. The country's 12 major ports are inefficient and the airline system requires infrastructure upgrades.

Energy is another problem. India cannot produce enough power to satisfy demand and charges, on average, double what it costs in the US to provide power. Only 55% of Indian households have electricity. Importantly in an era when oil is fetching record prices, India is a net oil importer – a factor that has led to its current-account sliding into deficit since 2004-05.

The telecommunications system is modern even though the ratios of phones or mobile phones per 100 people are low by international standards. India is in fact the world's fastest growing mobile market. It is expected to have 300 million subscribers by 2009 from 77.6 million at the end of 2005.[11]

The government recognizes the need to improve infrastructure and progress is being made, albeit at a slow pace, and it is hoping to rely on foreign investors to help alleviate the problem. The Ministry of Finance estimates India has the "potential to absorb US$150 billion of foreign direct investment in the next five years in the infrastructure sector alone."[12] Morgan Stanley has estimated that India has earmarked about US$40 billion to spend on roads, ports, telecommunications, airports, railways and power by 2009.

India's infrastructure versus China	India	China
Power capacity (GW)	112	430
Port handling capacity (in tonnes)	287	758
Railways - track length ('000km)	63	70
Of which electrified ('000km)	16	18
All roads (m km)	3.0	14.6
National highways ('000km)	65.6	1800.0
Domestic aviation (bn passenger km)	12.8	126.0
Freight traffic (m MT km)	522	5386
Passenger traffic (bn passenger km)	508	1381
Cement consumption (kg per head)	110	497
Steel consumption (kg per head)	31	202
Oil consumption (kg per head)	98	206
Telephone lines - fixed lines (per 1000)	38	202
Cellular phones (per 1000)	27	205
No. of passenger cars (per 1000)	8.0	14.3
Commercial vehicles (per 1000)	3.8	6.2

Source: CLSA

11 Source: Gartner Inc., a US-based technology research company, as quoted by Bloomberg 28 February 2006.
12 Economic Survey 2005-2006. India's Ministry of Finance website finmin.nic.in

Macro-economic concerns

India faces numerous, but surmountable, macro-economic challenges.

Hefty budget deficit

The federal government's deficit may well be India's biggest macro-economic challenge. The government's budget shortfall was equal to about 4.1% of output in fiscal year ended 31 March 2006.[13] In the fiscal year underway, the government has forecast a budget deficit of 3.8%.[14] The problem is seen as unsustainable and an impediment to growth because unproductive public spending is crowding out private investment.

The government's budget is structurally weak and many politically difficult issues would need to be tackled to fix it. These include reducing subsidies, cutting government employment, closing loss-making state businesses and raising the tax take by expanding the number paying income tax. (The Economist Intelligence Unit estimates that only two million people in India pay income tax.)[15]

External constraints

A current-account deficit of about 1.5% to 2.5% of output needs to be watched. Export growth of 20% per year in recent years should help but exports only account for 11% of gross domestic product[16] compared with more than 100% in some more developed Asian countries such as Singapore and Taiwan.

But to put India's export performance into more perspective, India only accounted for 0.82% of world total exports as measured by merchandise trade in 2004 compared with China which accounted for 6.46% in the same year, according to the latest data available from the World Trade Organsation.[17]

On the import side, oil is a problem for India. The balance-of-payments crisis of 1990 was triggered when oil prices jumped after Iraq invaded Kuwait. Some analysts say that India would be able to attract cheaper capital if the rupee was fully convertible. In March 2006, the prime minister announced plans to ease restrictions on Indians converting rupees to other currencies. A government committee subsequently set up is expected to make recommendations this year on how to make the capital account more convertible.

Since 1993, India has operated a managed-float exchange-rate regime. Under this system, where the current account is fully convertible, the Reserve Bank of India influences the value of the rupee by selling or purchasing dollars from banks.

Sector-level challenges

India's growth is still subject to the quality of the monsoons. Agriculture employs about 60% of India's workforce, according to the Economist Intelligence Unit[18], and any crop failures due to a lack, or abundance, of rain can hamper output and growth in rural areas. Another problem for agriculture is that it is still subject to skewed government incentives for wheat and rice. These schemes encourage the overproduction of these crops and the underproduction of others that could even be sold for export.

Heavy industries in India such as steel, shipbuilding, engineering and chemicals are dominated by inefficient state-owned enterprises. The government has pledged to reduce ownership in non-strategic public-sector businesses to boost efficiency and accountability. But political opposition has hampered this proposal. Burdensome labour laws, a lack of finance and a lack of will tied to public ownership have prevented many heavy industries reaching their potential.

For service industries such as retail, the shortage of good-quality urban real estate is dampening prospects. India's property market is fragmented because it specifies land use based on 1930s British views of what a city should look like.

13&14 Budget speech delivered on 28 February 2006. India's Ministry of Finance website finmin.nic.in
15 EIU, op. cit.
16 CLSA, CLSA Estimates, September 2005.
17 Country profiles of India and China found on wto.org 2006.
18 EIU, op. cit.

INVESTING IN INDIA

Sustainable economic growth is the first prerequisite to a thriving share market. If an economy is doing well, then companies will generally be able to increase their sales and earnings.

That said, investors need to gain confidence in the infrastructure surrounding a stock market before they invest. They will want comfort on its disclosure requirements, the level of transparency and even its day-to-day capacity to operate efficiently.

Developed market

India is home to 23 stock exchanges including Asia's oldest. The longest-running exchange is the Bombay Stock Exchange (BSE), which was set up in 1875, three years before the Tokyo Stock Exchange was formed.

While India has multiple stock exchanges, more than 99% of total trading volume is handled at the BSE and the National Stock Exchange (NSE).

The BSE boasts a large number of listings, second only to the New York Stock Exchange, a number that reflects the Indian entrepreneurial spirit. The top 100 companies on the BSE account for about 70% of the total market capitalisation. The NSE was set up in 1994 and introduced online trading to India. It has more recently overtaken the BSE to become the busiest exchange in India, handling more than twice the number of transactions than the BSE, and a derivative market in which it has a virtual monopoly.

India's stock market is on a par with developed market exchanges around the world. The introduction of a modern index and stock options and futures in 2000 has spawned one of the most vibrant derivatives markets in Asia. Modern trading and settlements systems have been introduced. All trading is electronic and more than 70% of outstanding shares are held electronically.

Many multi-national listings

India has a large number of US and European multinational company listings. Some of these multinationals include AstraZeneca Pharmaceuticals, Colgate-Palmolive, GlaxoSmithKline Pharmaceuticals, Gillette, Hero Honda Motors, Hindustan Lever and Siemens India Ltd.

Reference to individual companies does not constitute a recommendation or necessarily reflect a stock-holding status of any kind.

Expanding industry selection

India's stock market boasts an ever-expanding number of industries and its market capitalisation has soared in recent years. While part of the growth in the market cap has been due to rising stock prices, there has been a steady stream of equity issuance such as IPOs and follow-on issues. This number of issues is expected to increase because the government is privatising enterprises and smaller companies are turning to the stock exchange to raise capital.

Better corporate governance

Recent initiatives by the Securities & Exchange Board of India have improved corporate governance, particularly since 2001. According to the CG Watch Publication, CLSA Asia-Pacific Markets and the Hong Kong based Asian Corporate Governance Association (an independent non-profit organisation) in 2004, India rated third in corporate governance in Asia, behind Singapore and Hong Kong.

A long-term view is essential

But investors should be aware that India is a long-term investment option. As an emerging market, India's stock market lacks depth and liquidity. Market capitalisation as a percentage of gross domestic product remains low, and only a relatively small number of companies are actively traded. Therefore, capital inflows tend to trigger large price movements.

The foreign capital attracted to India's thriving economy in recent years was behind the more than doubling in the benchmark Sensex Index in the year ended 10 May 2006. When global investors became more risk conscious in May some of this money was withdrawn which accounted for the Indian share market's abrupt decline in that month.

SUMMARY

India is setting itself up to be an economic force; a country of vast size and population where an industrial revolution is underway. Still, certain challenges need to be overcome and there are risks.

India's greatest advantage is that its development is "bottom-up". Its people are driven and innovative. They have created world-class companies and modern financial markets, including a liquid bond market and flourishing stock markets. All it took was for them to be unleashed from state control.

India's political system delivers stability. The rule of law applies, which means that property and intellectual property rights are secure. People are encouraged to invent solutions because they can benefit from them financially, and not see their countrymen steal their ideas and wealth. The media is unfettered, which means the greater availability of information creates more certainty for businesses to invest. The country's demography will aid economic development. As education is valued, there is a swelling pool of English speakers and professionals to staff local and foreign businesses. These people are cheap to employ by global comparison.

As an added bonus, China's remarkable rise is creating competition between the two neighbours that will, no doubt, help both become economic powerhouses at some point before this century is too old where Coca-Cola and every other type of business can thrive.

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