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Chartered Accountants

Present Economic Crisis Trying Times or Time to Reap

Milin Mehta
Vadodara

Story of Man-eating Leopard



Present Crisis

- It is clearly beyond debate that current recession is going to be deeper and recovery longer than earlier thought - Dr. Subba Rao - Governor RBI 18/2/09
- Global Growth Rate estimated to be modest 3 % is October, 2008 further downward revised to 0.3 % [on Purchasing Power Parity Basis]
- World GDP likely to actually shrink by 0.6 %
- US / Europe and Japan firmly going into recession
- World trade likely to decline by 2.8 % in 2009

Effect of the Crisis – World Wide

- Demand has slumped
- Production is Plunging
- Job Losses are rising
- Credit Market is in seizure

This is coupled with the following unprecedented phenomena

- Major fall in the prices of commodities and crude
- Severe unpredictable volatility in Forex rates

Global Crisis and India

- Original “Decoupling Theory”
 - Strong Foreign Exchange Reserves;
 - Improved Policy Frame-work;
 - Robust Corporate balance sheets;
 - Relatively healthy banking sector;
 - Low reliance on the external demands

THIS IS NOT WORKING

- Two-way Trade has increased from 21.2 % of GDP in 1997-98 to 34.7 % in 2007-08
- Total External Transactions (current and capital) rose to 117.4 % of GDP in 2007 -08, which were only 46.8 % in 1997-98
- India was therefore not so insulated as it was predicted

Some Impacts

- Agriculture outlook appears to be satisfactory
- Industrial Growth decelerated sharply during last quarter
 - Use based categories viz. the basic, capital and intermediate goods showed decline growth rates;
 - Consumer goods, the growth accelerated
 - Service sector is slowing, primarily in transport, communication, trade, hotels and restaurant sub-sectors;
- Foreign Exchange reserves showed decline over 2008, in \$ terms due to valuation loss, though there is an increase in Rupee terms
- Manufacturing Sector grew by only 4 % during April – November, 2008 (compared to 9.8 % for April – Nov 2007) – Chemicals grew by 3.7 %
- Indian Stock Market fell by 40 % over March, 2008 level

End of dream run for last 5 years where we grew @ 9 %

NICE – Non-Inflationary Consistently Expansionary Era – Mervyn King

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Emerging Economies as a whole

- Growth rate for 2009 revised from 6.1 % to 5.1 %

However, entire world's growth in 2009 would come only from Emerging Economies

What is expected in times to come

- Depressed international demand situation
 - Though domestic demand is likely to go up for consumer goods; Reasons: Sixth Pay Commission awards, debt waiver for farmers, pre-election expenditure, changing pattern of demographic profile
- Further lowering of the prices of crude and metals due to depressed demand;
- Volatility in Forex market;
- Depressed fund availability due to sheer confidence factor [Business Confidence Index continues to decline sharply]



Turning the Present Crisis to our Advantage

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Basic Strategies

- Do not take long positions on new investments, etc. till the situation become clearer;
- Keep the risk exposure to basic activities and cover on day to day basis:
 - Count profitability on the basis of the current rates and immediately cover the exposure
 - Forex, Metal, Commodities and whatever that can be covered;
- Tighten the belt – but do not tighten so much that the business suffocates
 - Dream run has brought in several avoidable expenses;
 - Persons at all levels are mentally expecting the tightening exercise
 - Control working capital
- Keep cash, but do not sleep over it

Distinct strategies

- Gearing Cost Advantages
- Leverage Trust Factor
- Make Infra-structure Investment
- Eye Technology / product acquisitions
- Protect Purchasing Power of Massive Middle Class
- Act quickly and take advantage of suddenness of crisis

Cost

- World wide there is increased pressure for costs
 - Europe suddenly have realised that they are practically unviable in all areas due to cost disadvantage;
 - Creating manufacturing facilities in India / China is becoming a survival issue for developed countries;
- Dilemma of quality Vs. cost is likely be resolved in favour of cost
 - With 5 % lowering of quality standards, if there is 30 % saving in costs, it may be worth-while to do so;
- Though there is going to be reduced demand, the demand would not reduce to zero. The persons on the lower end of the cost curve would survive.
- Good time to leverage our cost advantage

Trust

- Our personal observation that in recent times, small companies have started exploring the possibilities of investing in India
- Reason – Higher Trust factor
 - High Country comfort
 - Strong family values [Europe]
 - Higher business ethics
 - Better protection to IPRs
 - Entrepreneurial outlook
 - Good body of laws
 - Language
- Need to leverage this and explore the possibilities of having strategic alliances with sharing of production facilities, know-how, markets, etc.
- Make Relative Advantage Matrix for strategic alliance

Infra-structure Investments

- Country as a whole was behind in infra-structure development;
- Huge investments are required [like “Marshall Plan”] and this is the time where we can effectively do it;
 - Low inflation
 - Low cost
 - Quickly fuels the demand
 - Gradually will bridge the gap
- With good position on Reserve Front – good idea to utilize it for building infra-structure

Acquisitions

- Many technology companies would come under sheer pressure of survival in present scenario;
 - May be available at throw away prices, zero cash deals (equity swaps), contingent payments, etc.
- Keep eyes open and even scout for such opportunities
- Build proper technology / product portfolio;
 - quality standards;
 - the manufacturing processes;
 - marketing strategies;
 - contracts, etc.

Massive Middle Class

- India has distinct advantage of domestic consumption and its dependence on export market is low;
- Indian purchasing power pre-dominantly comprise of middle and lower middle income groups;
- Re-structuring the wages and more equated salaries would keep in tact the purchasing power of the middle class and demands;
- Measures to enhance their purchasing power should be taken

Suddenness of the Crisis

- Before we could blink, the economic crisis had gripped the world;
- Its pervasiveness is baffling : Crude Prices, Metal Prices, Credit Crunch, Failure of financial system, all happening at the same time;
- This would therefore result into:
 - World wide change in mental attitude [preparedness to work for far lower wages]
 - World-wide Protection regime with artificial barriers
 - Change in political order
- It would take time for people to react mentally – like acceptance of low wages
 - Time to act fast and beat the changes;
 - Ring Fence Indian Industry;
 - Give incentives for channeling expenditure and investment in sectors which quickly fuel growth;
 - Take aggressive position against artificial barriers in world economic forums;

Ponder

- Man-eating leopard in the form of global recession is on the prowl and we can't wish him away;
- The whole world is not going to get destroyed, there are going to be some survivors;
- Do we want to be the ones on the surviving side?
- If yes, it is time to wear the best sports shoes available and start running.

Act proactively and do not wait till you are compelled to move

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Thank you...

milin.mehta@kcmehta.com

2nd Floor, Meghdhanush, Race Course, Vadodara 390 007, INDIA Phone: +91 265 2341626 / 3089501 Fax: Extn. 200 / 300 / 400

Branch: D 83 / 847, MIG Colony, Near Kala Nagar, Bandra (E), Mumbai 400 051, INDIA Phone: +91 22 26424364

e-mail: office@kcmehta.com; **website:** www.kcmehta.com