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Sources & Uses of Funds

Nirma Ltd. Rs Crore (Non-Annualised)	Mar 1999 12 mths	Mar 2000 12 mths	Mar 2001 12 mths	Mar 2002 12 mths	Mar 2003 12 mths	Mar 2004 12 mths
Sources of funds						
Internal sources	191.1	147.67	358.15	64.67	−33.73	365.35
Retained profits	159.21	84.99	233.11	−42.56	−141.83	253.87
Depreciation	31.89	62.68	125.04	107.23	108.1	111.48
External sources	256.88	726.82	39.82	−335.67	199.66	−334.91
Fresh capital (excl. bonus issue)	0	0	227.49	0.4	2.39	0
Share premium reserves	0	0	181.99	0	0	0
Borrowings	158.2	615.97	−63.05	−322.86	261.57	−360.96
Bank borrowings	17.47	6.36	37.85	−55.32	137.69	−105.37
Short term bank borrowings	−37.79	−42.13	132.93	−51.95	−92.09	74.71
Financial institutional borrowings	0	0	0	0	0	0
Debentures/bonds	110.73	318.34	189.44	−212.21	146.61	−283.77
Fixed deposits	−9.36	−5.46	−4.54	−1.25	−0.84	0
Borrowings from corporate bodies	14.36	222.48	−236.6	20.97	−21.21	28.94
Group/associate cos.	0	0	0	0	0	0
Other borrowings	25	74.25	−49.2	−75.05	−0.68	−0.78
Current liabilities & provisions	98.68	110.85	−124.62	−13.21	−65.3	26.68
Sundry creditors	11.9	174.68	−136.67	−69.81	−6.02	[illegible]
Deferred tax liabilities	0	0	0	307.08	−4.6	[illegible]
Uses of funds						
Gross fixed assets	424.04	827.55	165.59	98.57	82.02	35.87
Capital WIP	379.67	−168.21	−275.06	49	−49.87	−31.84
Investments	−2.45	0.47	0.16	0.16	0	−0.13
In group/associate cos.	0	0	0	0.66	0	0
Current assets	26.39	46.47	232.22	−74.35	65.11	70.63
Inventories	7.88	46.05	169.91	−64.88	1.9	44.94
Debtors	−13.18	21.65	15.93	17.27	−3.74	2.15
Cash & bank balance	26.98	−25.22	0.02	1.9	2.42	−2.17
Advances/loans to corporate bodies	0	0	0	0	0	0
Group/associate cos.	0	0	0	0	0	0
Other receivables	4.71	3.99	46.36	−28.64	64.58	25.71
Deferred tax assets	0	0	0	11.7	13.2	−21.5
Total sources/uses of funds	447.98	874.49	397.97	36.08	160.33	84.67

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Executive summary

Nirma Ltd. Rs Crore (Non-Annualised)	Mar 1999 12 mths	Mar 2000 12 mths	Mar 2001 12 mths	Mar 2002 12 mths	Mar 2003 12 mths	Mar 2004 12 mths
Gross sales	1473.09	1718.68	2429.22	2276.05	2441.58	2622.35
Net sales	1220.92	1430.05	2008.8	1896.62	2046.5	2213.36
VOP	1227.37	1443.17	2094.38	1880.11	2025.46	2202.06
Other income	23.01	33.84	11.12	18.34	23.34	25.4
Cost of production	1010.05	1124.19	1649.86	1456.09	1575.39	1698.36
Selling & marketing expenses	0.88	1.97	8.54	13.5	40.63	58.81
Distribution expenses	2.77	3.08	7.5	9.16	13.18	18.35
PBDIT (NNRT)	253.09	384.85	513.07	517.4	515.24	578.24
PBDT (NNRT)	222.66	329.15	412.35	411.67	455.3	534.35
PBT (NNRT)	190.65	266.1	272.05	289.58	325.39	378.78
PAT (NNRT)	170.9	235.35	248.95	185.9	308.89	248.55
Exports	15.94	24.65	23.85	52.13	60.87	60.37
Imports	394.54	487.73	235.2	148.89	177.38	227.53
Gross fixed assets (excl. reval. & WIP)	594.8	1726.13	2152.76	2188.32	2635.79	2660.22
Current assets	442.81	488.24	720.49	645.71	712.22	782.85
Net worth (net of reval. & DRE)	637.66	858.22	1304.8	1248.23	1424.77	1635.56
Equity capital	33.88	33.88	79.38	79.38	82.17	79.38
Long term borrowings	424.38	1132.48	861.5	665.59	1019.25	583.58
Capital employed	1062.04	1990.7	2166.3	1913.82	2444.02	2219.14
Current liabilities & provisions	356.58	375.3	458.61	318.45	161.06	261.82
Total assets/liabilities (excl. reval. & DRE)	1410.67	2348.9	2610.09	2519.78	2833.97	2725.68
Growth (%)						
Gross sales	13.96	17.03	19.01	−1.7	8.88	8.06
Cost of production	23.58	11.3	46.76	−11.74	8.19	7.81
PBDIT	30.06	52.06	33.32	0.84	−0.42	12.23
PAT	12.23	37.71	5.78	−25.33	66.16	−19.53
GFA	8.06	167.41	27.7	2.44	6.34	3.05
Total assets	41.84	66.51	11.12	−3.46	12.47	−3.82
Margins ratios (%)						
PBDIT (NNRT)/sales	17.18	22.39	21.12	22.73	21.1	22.05
PBDT (NNRT)/sales	15.12	19.15	16.97	18.09	18.65	20.38
PAT (NNRT)/sales	11.6	13.69	10.25	8.17	12.65	9.48
PBDIT (NNRT)/net sales	20.73	26.91	25.54	27.28	25.18	26.12
PBDT (NNRT)/net sales	18.24	23.02	20.53	21.71	22.25	24.14
PAT (NNRT)/net sales	14	16.46	12.39	9.8	15.09	11.23

(continues)

Nirma Ltd. Rs Crore (Non-Annualised)	Mar 1999 12 mths	Mar 2000 12 mths	Mar 2001 12 mths	Mar 2002 12 mths	Mar 2003 12 mths	Mar 2004 12 mths
Returns ratios (%)						
PAT (NNRT)/net worth	30.62	31.47	23.02	14.56	23.11	16.24
PAT (NNRT)/total assets	14.21	12.52	10.04	7.25	11.54	8.94
PBIT (NNRT)/capital employed	24.65	21.08	17.93	19.38	17.68	18.13
PAT (NNRT)/capital employed	19.05	15.42	11.98	9.11	14.18	10.66
Liquidity ratios (times)						
Long term debt/equity	0.666	1.32	0.66	0.533	0.715	0.357
Total debt/equity	0.86	1.357	0.844	0.624	0.73	0.415
Current ratio	1.242	1.301	1.571	2.028	4.422	2.99
Interest cover	7.27	5.78	3.7	3.74	6.43	9.63
Grow working capital cycle (days)	81	81	91	126	104	104
Net working capital cycle (days)	34	9	37	92	82	82
Avg. days of debtors	32	29	28	32	30	28
Avg. days of creditors	46	71	54	33	21	22
Asset utilisation ratios (times)						
VOP/total assets	1.02	0.77	0.84	0.73	0.76	0.79
VOP/GFA	2.14	1.32	1.16	0.91	0.94	0.98

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Profit & Loss Statement

Nirma Ltd. Rs Crore (Non-Annualised)	Mar 1999 12 mths	Mar 2000 12 mths	Mar 2001 12 mths	Mar 2002 12 mths	Mar 2003 12 mths	Mar 2004 12 mths
Income						
Sales	1473.09	1718.68	2429.22	2276.05	2441.58	2622.35
Other income	23.01	33.84	11.12	18.34	23.34	25.4
Change in stocks	6.45	13.12	85.58	–16.51	–21.04	–11.3
Non-recurring income	0	0	0.83	0.2	18.05	0.64
Expenditure						
Raw materials, stores, etc.	897.23	954.64	1332.01	1100.43	1189.84	1269.75
Wages & salaries	29.64	31.41	44.8	37.66	41.07	40.99
Energy (power & fuel)	50.52	80.33	154.72	159.27	179.56	181.21
Indirect taxes (excise, etc.)	252.17	288.63	420.42	379.43	395.08	408.99
Advertising & marketing expenses	0.88	1.97	8.54	13.5	40.63	58.81
Distribution expenses	2.77	3.08	7.5	9.16	13.18	18.35
Others	16.39	20.98	44.86	61.03	69.28	80.11
Less: expensis capitalised	0.14	0.25	0	0	0	0
Non-recurring expenses	0.41	1.25	0.07	1.39	110.58	2.39
Profits/losses						
PBDIT	252.68	383.6	513.83	516.21	422.71	576.49
Financial charges (incl. lease rent)	30.43	55.7	100.72	105.73	59.94	43.89
PBDT	222.25	327.9	413.11	410.48	362.77	532.6
Depreciation	32.01	63.05	140.3	122.09	129.91	155.57
PBT	190.24	264.85	272.81	288.39	232.86	377.03
Tax provision	19.75	30.75	23.1	103.68	16.5	130.23
PAT	170.49	234.1	249.71	184.71	216.36	246.8
Appropriation of profits						
Dividends	11.28	13.54	30.62	27.78	35.82	36.01
Retained earnings	159.21	220.56	219.09	156.93	180.54	210.79

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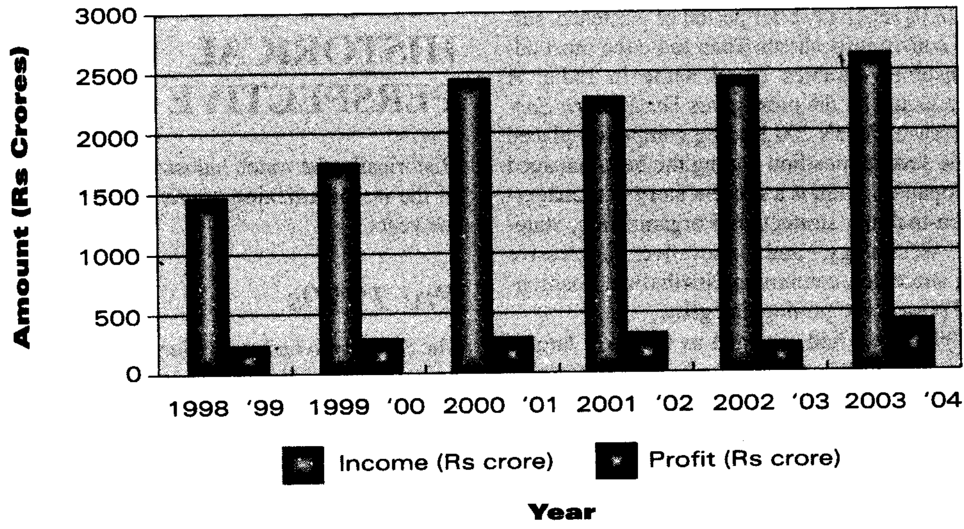
Financial Year	Income (Rs Crore)	Profit (Rs Crore)
1998–'99	1472.09	190.24
1999–'00	1718.68	264.86
2000–'01	2429.22	272.81
2001–'02	2276.05	288.38
2002–'03	2441.58	232.58
2003–'04	2622.35	377.03



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Titan Watches*—Redefining Time

Titan celebrated two decades of high-profile existence in 2006 (another such company being Gujarat Ambuja Cement). In its relatively brief period of existence, surveys have consistently shown Titan to be the most admired consumer durables brand name in India. A survey conducted by the prestigious *Far Eastern Economic Review* of Asia's 200 leading companies placed Titan in the seventh position among the best-managed Indian companies. Titan is a success story of managerial decision-making, strategy and organization, state-of-the-art technology, and innovative, aggressive marketing strategies, combining distribution, positioning, brand power, and product integrity.

By 1999, Titan had emerged as the sixth largest 'manufacturer-brand' in the world after Casio, Citizen, Seiko, Swatch and Timex of America, in the watch business. A 'manufacturer brand' is one that is owned by a company which also manufactures the product. It differs from the likes of 'Guess' where owners have rights only over the name. In the case of Titan, it manufactures virtually all its watch components. In 1998–99, the company sold 4.76 million watches in the domestic market. Cumulatively it had sold more than 30 million watches till 1999. The return on capital employed for the domestic watch business is over 20 per cent. Titan Industries considers brand as one of its most important assets. It has taken steps to get a complete brand valuation. Strategically, the company aims to be present in all product segments. Truely with the times, it has shifted its growth strategy from emphasis on equipment and manpower addition (assets) to fresh ideas and greater operating efficiency by benchmarking best global practices.

* This case was prepared by Professor Arun Kumar Jain.

BACKGROUND: THE WATCH INDUSTRY: A HISTORICAL PERSPECTIVE

Historically, the watch industry can be studied in terms of the major inflexion points that have occurred over the years.

Pre 1950s

The Swiss who had reputation for precision machining dominated the industry. The watches were sold through jewelry shops.

1950-'70s

The introduction of standardization and mass production in watch manufacturing led to Timex becoming the dominant player in the industry while the Swiss were relegated to the premium and super premium by catering to the end of high precision. The distribution of the watches also moved out from the hands of jewelers to specialist watch shops.

1970-'80s

The introduction of quartz movements by Seiko created a major impact as good precision watches could be manufactured at low cost. The quartz watches were also very user-friendly in terms of doing away with the concept of daily winding and were lighter in weight.

The Japanese troika of Seiko, Casio and Citizen dominated in this period.

1980-till date

The Swiss staged a comeback with Swatch group redefining the way watches were marketed. They brought in the concept of specialist watch boutiques and tied the product to changing fashion trends. Also, the demand for watches as a status symbol surged, thus helping the Swiss industry to come out of hibernation.

Today all the players have learnt to coexist in their own dominant markets and niches. The Japanese have been focusing on digital watches while the Swiss continue to retain the super premium market on the strength of their enormous credibility and very high precision performance. Timex continues to hold its own in United States where it is still the largest player.

GLOBAL ENVIRONMENTAL CONDITIONS

The global watch industry is fragmented and diverse, as there are umpteen countries and umpteen regions that have varied environmental conditions. The main divide that can be seen in between the developed and the developing/underdeveloped countries. The environmental factors below try to represent the characteristics on a general level.

Socio-cultural: Fashion Statement

The watch that a consumer possesses has come to represent the underlying fashion trends. This can be best seen with the global fashion houses having come up with their own watch offerings. This has also led to decrease in the throwaway life of the watches.

Multiple Ownership

An average consumer today has more than one watch for use on different occasions. A Swatch watch would be used in beaches, a digital watch would be used on a workout while a formal style watch would be used for office.

Politico-legal: Differential tariffs

A plethora of tariffs exist in India which restrict free trade of watches. These have been erected to offer protection to the domestic watch industry in their respective countries. These discriminating tariff barriers are slated to go down once the WTO regime comes in to full force. This is a significant opportunity, as it will lead to opening of those markets that have been closed to the existing global players, as well as a threat to those players who have been prospering under the protective tariff regime.

Economic

In the last few years the surge in the expansion of the world economy as a whole has led to the increase in the disposable incomes of people across the world. This increase in the disposable income is going to create a favourable situation for the producers and marketers of watches.

Technology

Ever since the introduction of quartz movements, key technology, have been stable but there have been improvements and these have acted as differentiators. Most notable would be the digital and analog-digital watches that have been introduced over the years. Apart from these, technological developments in the field of design using CAD/CAM have significantly brought down the time and costs of new model developments.

TITAN'S ENTRY STRATEGY

In 1985, Titan Watches Limited came into being as a joint sector company promoted by Tamil Nadu Industrial Development Corporation and Tata Sons. The company was founded in technical collaboration with France Ebauches, part of the world's largest manufacturers of quartz movements with an installed capacity of 2 million quartz analog watches at the company's plant at Hosur (Tamil Nadu).

Titan is credited with having revolutionized watch marketing in India. Titan entered the market in

1987–'88 with nearly 70 models, each targeted for a different market segment. The only other established Indian player, HMT, then had 40 odd variants of just 4 basic designs. Titan underpriced replacement costs for repair and the battery was priced below its cost. Titan took the watch to unconventional outlets like boutiques and jewelry shops. A market survey at that time showed that consumers perceived existing outlets as 'watch stores' and not showrooms. Titan changed this perception. It embarked on a three-pronged strategy. First, it made the product visible, affordable and available at unconventional locations like bookstores, gift shops and boutiques. Second, the company upgraded the sales outlets. Third, it set out to advance the average first watch buying age from 21 to 19. As an extension of the third strategy, Titan persuaded customers to own more than one watch. Titan, with the first ever colour campaign released by any Indian watch manufacturer, tapped the latent demand for quartz watches in the country.

In order to get an initial edge, Titan heavily advertised the various designs and models through attractive layouts, thereby offering consumers the convenience of making a preliminary choice at home.

Product Range

Titan started off with Exacta—stainless steel watches for rough day-to-day wear, Classique—gold case and leather strap fashion watches, and Royale—gold case and gold strap elegant dress watches, which are still in vogue. Later it added the Spectra—gold and stainless steel watches, and Raga—ladies watches with an ethnic appeal. It introduced Aqura—a sporty watch with plastic casting, which was later merged with Timex. Titan also revived the concept of pocket watches. It later added a range called Regalia which is basically a lower priced dress watch and several multi-functional watches like Calendar, World Time and Galileo. In 1994–'95, Titan introduced a European collection.

Gradually, Titan has built up a very strong brand equity in India. It has almost 100 exclusive retail showrooms and another 100 Titan Shops across the length and breadth of India. With its exclusive showrooms and display counters Titan has succeeded in attracting discretionary spending from other commodities to watches. Titan successfully changed the attitude of Indians from purchasing a watch as a well-planned decision (shift from consumer-durable mentality) to an impulsive one (FMCG mentality). The launch of Raga collection in 1992 was to reinforce this strategy.

Market Segmentation

Internationally, the watch market has been traditionally segmented into three categories based on offered prices. The first category is low priced "C" watches and includes watches sold at a retail price of under Sfr.120. The mid price or "B" watches range from Sfr.120 to 700 at retail. Electronic watches dominate both the C and B price segments. The third or "A" category are watches ranging from Sfr.700 to 5000. Manufacturers of luxury watches, the "AA" class, sell to a small exclusive group willing to pay several thousands Swiss francs for a special, custom-designed jeweled watch.

Close on the heels of its launch of Dashl for kids, Titan made a foray into the digital watch market with Fastrack Digital. Jacob Kurian, vice-president-marketing, explained that "the decision to enter this segment was inspired by the resurgence of digital watches internationally and the need to revitalize a dormant segment of the Indian watch market. It also extends the width of our offer to the fashion conscious youth of India." Breaking away from the traditional, functional platform, Titan positioned the Fastrack Digital collection on a fashion platform. The range consisted of full function chronographs with features that include multiple time zones and alarms, countdown timers, stopwatch and lap times functions, chime and a distinctive large format digital display. Designed exclusively for the young, sporty and trendy, the watches come in 22 designs—from the simple classic to the latest space-age looking digitals and the futuristic ana-digi model. The price ranges from Rs 600 to Rs 1,500.

The new range is retailed through the 'World of Titan' showrooms, Time Zone and select premier outlets in New Delhi, Mumbai, Kolkata, Chennai, Bangalore, Hyderabad, Ahmedabad and Pune. Titan is the third player, along with Timex and Sitco, in the 1.6 lakh digital watch market. From a strategic perspective. Titan is gearing itself to competition from Swatch—a Swiss major brand in promoting trendy watch-wear especially amongst the young and sporty.

Positioning

A key factor in Titan's success has been its ability to position watches as lifestyle products as opposed to

time-keeping devices. The use of innovative marketing techniques and access to a strong distribution network has enabled Titan to carve out a niche in the quartz market. The company offers over 550 different models and has pioneered a range of jewelry watches as well as jewelry products. Grant Walker (an UK firm) was the prime consultant to the jewelry project. The jewelry watches are being marketed worldwide through a subsidiary company controlled by Titan with its main operating base in London. Specimens and designs of jewelry and jewelry watches of Titan have been displayed at the Inhorgenta Fair in Munich and at the Basle fair, where the designs won much acclaim.

Neutralizing the Gray Market With an intention to neutralize the burgeoning gray market for cheap imported watches in India, Titan tied up with Timex, the world's fourth largest watch making company. Before its break with Timex, the company offered about 250 styles in four distinct ranges under the Timex name. The company plans to launch more than 800 models in a phased manner over a period of five years. The selling and distribution model is designed for full utilization of the Titan infrastructure. Timex watches are presently sold through all the existing exclusive show rooms and retail outlets of Titan.

Titan started targeting the upper end of the market by a launching jewelry watches. It launched massive road shows in the metros and several towns for its *Celeste* range of jewelry and jewelry watches, the cost of which ranges from Rs 25,000 for 9 carat going up to Rs 1 lakh plus for a diamond studded model. By moving into the jewelry and jewelry watch business, Titan also reiterated that it was not in the business of making time keeping devices but had a wide concept of watches as fashion accessories. A point to note is Titan's decision to change its name from Titan Watches Limited to Titan Industries Limited.

Titan refuses to go rural where a huge market exists for a good quality, rugged and reasonably priced watch. Timex was launched to cater to the lower segment of the market, but the perception is that of fragility with its plastic body.

TITAN'S INTERNATIONAL OPERATIONS

India has a minuscule presence in the world watches market. Few Indian companies have shown interest in exploring the international market since there has always been a large unsatisfied domestic demand. Another factor could be the negative 'Made in India' label. Given this constraint, Titan has been proactive. It decided to go international sometime in 1990. This was because the Indian economy was liberalizing and it was felt that global players would come to the Indian market sooner than later. This prompted Titan to test out the international waters to acquire competencies to combat the incoming competitions. Thus, it was a proactive strategic move rather than merely a disjointed export thrust.

Titan took the crucial decision of selling under its own brand name rather than under a private lable. Investing in a brand calls for an enormous amount of financial, marketing and strategic commitment which would pay dividends in the long run. By going in for a long-term brand building exercise rather than short term profits, Titan showed its intention of capturing and retaining a large market share in due course of time.

Titan decided to enter the Middle East market first as it provided them with a somewhat familiar potential clientele in the Indian expatriates and yet provided the opportunity to compete with all the global brands.

Titan Watches took its first step to go global in the second week of November 1992 when it registered a company in UK in the name of Titan International Marketing Ltd., for spearheading Titan's European rollout. Titan launched 4 models of its watch in the United Kingdom in 1993. The importance of the international division can be gauged from the fact that its chief executive reports directly to the Managing Director. Thus, Titan progressed from an exclusively domestic operator to a consistent exporter. HMT remains a peripatetic exporter. Titan is currently in the process of becoming a company with operations abroad with the long-term intent of becoming a multi-country operator. The floating of companies in the UK and Netherlands was a step in this direction.

As of March 31, 1999, Titan had invested $37 m in its European operations, of which Titan Industries in the form of equity, loan and credit provided $22.4 m. The balance was raised abroad. The funds mainly went into brand building and stocks. Europe, according to Titan, was its 'most important though most difficult overseas market'. Titan could sell 3.5 lakh watches in this market since its inception. Titan International Holdings BV, Titan's wholly owned subsidiary in the

Netherlands ended the year 1999 with a small profit. During the year, the rights to the Titan brand were transferred to a wholly owned subsidiary in the Netherlands Antilles, for technical reasons. These rights are only for the international markets.

Titan's exports declined in 1998–99 for the second year in succession from Rs 35.8 crore to Rs 31.6 crore. This was mainly due to a fall in jewelry exports to the US and a decline in watch exports to the Middle East.

Titan's Strategy in The Middle East

Titan's first export was to Bahrain in mid-1991. Its international operations started initially by the appointment of a distributor who ordered watches on a demand basis. Today, Titan has grown to be a fairly important player in the Middle East market with showrooms in Dubai and Oman.

Titan exports to five middle-east countries, namely Bahrain, Qatar, Oman, UAE and Kuwait. In these markets, the distribution is through one main distributor in each country who in turn supplies to downstream retailers. Titan chalked out an elaborate entry strategy for the Middle East markets. Some of the steps were:

- Titan conducted detailed market studies of customer preferences and competitor strengths before it entered the market. It was observed that Titan had a cost advantage due to lower domestic labour costs.
- The design of Titan watches required some adaptation to suit the customer tastes in these markets. It became necessary for Titan to create new product offerings and establish a distinctive product line. For example, the Exacta range was not found acceptable whereas the all-gold finish Classique and Royale were accepted.
- Titan did a detailed analysis of the distribution channels before choosing its distributors and showrooms. Since most distributors were new and had little experience of selling watches, Titan had to provide the necessary training in this regard.
- In the initial years, Titan faced problems with the established retail network since many of them did not want to carry an Indian brand. Moreover, some distributors demanded six months credit and consignment sales terms.
- Titan ensured that its advertisements were adapted to suit local tastes and cultures. It has been basically indulging in product advertising with little emphasis on lifestyle as the products are still in the introduction phase.

THE INDIAN WATCH INDUSTRY

The Indian watch industry is nearly three decades old. It started in the early 1960s with the setting up of Hindustan Machine Tools (HMT) in collaboration with the Japanese Citizen Watch Company in order to meet the domestic demands and also to restrict smuggling of watches. In 1972, licenses were issued to companies like Hyderabad-Allwyn in joint sector and Jayco, Purewal, Indo-Swiss, Bifora in the private sector. HMT was heavily protected by the Government and thus became the major watch manufacturer in the country. By 1982, the objective of increasing the watch production in the country had not materialized. As a result, the Government approved that the indigenous watch manufacturers step up established capacities. The expansion of HMT and Bifora was approved.

The size of the Indian watch market is estimated to have increased from 16.9 million watches in 1990–'91 to 24.0 million watches in 1995–'96. The organized sector production accounts for about 13 million watches a year while the balance is accounted for by the "gray" sector which comprises smugglers or Indians returning from abroad. Recessionary pressures adversely affected the watch industry's performance in 1992 and 1993, and, with the exception of Titan, all other firms registered negative rates of growth in this period.

India with its large population is potentially one of the largest markets in the world. The Indian market is expected to grow both at the lower and (less than Rs 500) and higher end (above Rs 7,500). This has prompted many major international players to come to the Indian market. This is because the number of watches per thousand people is as low as 21 and a huge potential exists for companies which can penetrate markets by proper customer education and addressing customer needs.

INDUSTRY STRUCTURE

India's 700-crore plus watch industry can be classified broadly in three categories:

- the organized sector, with HMT in the public sector and Titan in the joint sector and Timex, being the leading players;
- the small-scale sector where popular names are Bifora, Jayco, IST, Purewal, etc;
- the invisible sector, i.e., smuggled and spurious watches

At present, three major players i.e., Titan, Timex and HMT dominate the industry. Titan dominates the upper end market with its exclusive range of watches and its access to world-class technology. The public sector giant has been trying to compete with the other two players by launching new brands and watches for the lower end of the market. Though Titan entered into a partnership with Timex Inc. to compete with HMT in the lower-end segments, Timex is now more identified with the active urban youth.

Mostly smuggled watches have served the luxury segment of the Indian watch market. Brands such as, Cartier, Piaget and Patec Philippe are popular. Till recently, Raymond Weil and Longines were the only foreign brands available through regular channels in India. Raymond Weil has a wide range of watches with prices ranging from Rs 5000 to Rs 50000, while Longines models cost between Rs 9000 and Rs 30000. The final cost, however, depends on the individual choices of the customer. Hence, a watch worth Rs 10,000 may cost a lakh of rupees. Raymond Weil and Longines are marketing the models as a part of male jewelry sets which usually contains a pair of cuff-links, tie pins, collar pins and sometimes wrist bands.

Titan has launched a new range of jewelry watches called Tanishq to compete in this segment. These are available in the range of Rs 20000 to Rs 100000.

By end of 1999 the Indian markets were liberated. The time-keepers to the nation now come from almost every nationality. The Swiss, the French and the Japanese, among others, have hurriedly added to their sparse product range, opening exclusive showrooms and even appointing Indian brand ambassadors.

Ever since the government liberalized import of watches in the Exim (Export-Import) Policy in April 1999 and allowed watches below Rs 35,000 to be brought in directly, the approximately 40 million pieces per year Indian watch market is seeing hectic activity. While some brands like Givenchy and Casio have decided to make a debut following the announcement, almost every other brand has expanded its range, bringing in watches in the lower price segments. The more ambitious ones have already reached small towns like Sultanpur, Sambalpur and Muzaffarnagar.

With the liberalization of the Indian watch industry, now a larger range is available from the Swatch group, which sells Omega, Longines, Rado and Tissot, besides Swatch in India. Its price range across various brands now swings from Rs 1,250 (for Swatch) right up to Rs 30,000-plus (for Omega). Similarly, Egana Intergold has introduced a new line that starts from Rs 3,500 onwards. The company, which also sells Esprit in India, brought in a range that starts at Rs 1,750. And Casio, among the recent entrants, beings at Rs 495.

And this is despite the tariff barriers still remaining high. Says Ravi Thakran, regional general manager (South Asia), Swatch group: "Duties are still considerable. For example, there is a customs duty of 40 per cent and a countervailing duty of 16 per cent. Furthermore, the company also has to surrender SIL (special import licence) three times the value of imports, which further inflates the costs." The April Exim Policy had also shifted watches from restricted to SIL list.

However, the announcements were obviously enough to create a minor stampede in the Indian marketplace for watches. Casio, for example, had been watching India for quite some time. Kulbhushan Seth, senior manager (marketing) of Casio India said that: "we were keen on manufacturing and hence thinking of a one-year timeframe to start our operations in India. Once the policy was announced, we decided to move in immediately and were in the market in June." There was a minor change in plans though. Instead of manufacturing watches, Casio India decided to import them for some time. Seth put the blame squarely on the high duties: "It is more economical to import a complete unit since duties on components is still high. We will have to import components to maintain quality." Manufacturing plans have not been dropped, though. Casio is studying the market and trying to identify fast-moving models that can subsequently be manufactured.

Others are also thinking along similar lines. Says Vishal Gurtu, country manager (sales and marketing) of Egana Intergold: "We want to make India a manufacturing hub for exports of watches by the year 2002." In fact, the Hong Kong-based Egana, which entered India in 1997, bought out its Indian partner, Intergold's, stake in the joint venture completely barely a fortnight

back, a fact that further illustrates the group's growing interest in India. There are reasons, of course. The brand's sales have grown three times in the last nine months. The fallout: The brand will now travel to the smaller towns with an expanded (read lower priced) range. The names that came immediately to Gurtu's mind included Nasik, Kolhapur, Rajkot, Ludhiana, Agra, Patna, Sambalpur and Muzaffarnagar. The company has already more than doubled its outlets from 30 to 75 in the last nine months.

The Swatch group too has similar plans. Says Thakran: "Since our products are fashion statements our initial focus has been on the top eight cities. Now we plan to expand to the top 15." Westend Watches from Switzerland, which have maintained their presence in the country by bringing in semi-knocked pieces (a common practice before the policy announcement), has reacted by launching a wider range in August. Says Francis Mendonca, representative: "While we were selling 2000–3000 watches a year earlier, we are now selling 1000 pieces a month." The company has worked out a publicity budget and is talking of upgrading dealers. The reason for the sales surge is not merely the wider range but also the fact that they are now completely imported pieces and not "semi-knocked down and subsequently assembled-in-India" watches that customers regarded with suspicion. As Punit Chainani, who sells Givenchy in India says: "The change in policy allowed us to be free with the customers. Now we can tell them it has been imported directly and not assembled. That makes a difference in perception."

Echoes Mendonca: "Earlier the small scale units were obtaining import licenses and assembling these watches. This meant that one had little control over quality. Now that we are importing directly, it makes a difference to both quality and consumer perception." Of course, what the industry is waiting for now is a slash in the tariff barriers. Thakran of Swatch estimates that if duty levels come down to 10–15 per cent, as is the case in rest of South East Asia, the market size could almost double in 10 years to 80 million pieces.

THE INDIAN CONSUMER—CHANGING TRENDS

Consumer preferences for watches are undergoing change. With increased literacy and urbanization and exposure to the outside world through satellite television, the desire to own a watch has increased among Indian consumers. Watches are being bought much earlier in life; among the more affluent families, a seven year old child may now possess an imported watch. There is a change in the attitude towards watches and it is being seen less as a time keeping device and more as a statement of an individual's taste and style. Therefore, products with high style and design content are in demand. Simultaneously, consumers are owning more than one watch, primarily to suit different occasions like daily wear, casual wear and evening wear.

A watch is also seen as an ideal gift with a wide range of prices and variety, and thus competes with many other gift items like clothes, kitchenware, crockery and even jewelry. A new segment that is steadily growing is the institutional buyer. Watches are being given as gifts to employees, used for dealer promotion schemes and as gifts to customers with other purchases.

MAJOR DOMESTIC COMPETITORS

HMT was set up in 1961 in technical collaboration with Citizen. Presently it has five watch manufacturing units and thirteen assembly units across the country with an installed capacity of 7.2 million watches annually. HMT is into both mechanical and quartz watches. Since the inception of Titan, HMT has lost market share rapidly. HMT's first calculated response to Titan's strategy came in 1990, when it recognized the need for aesthetics details and introduced Elegance—a dress watch priced at Rs 1000 plus. In 1991, HMT set up a product development centre for watch design for the first time. In the same year it also launched Pace and Astra ranges. In 1992, HMT pre-empted Titan with its Zap-children's watches. HMT launched *Utsav*, a brand adorned with ethnic motifs which positions itself directly against Titan's Raga range of watches.

HMT does not focus on its sub-brands the way Titan does. It still continues to position its watches as time-keeping devices and does not stress on the aesthetics and prestige value of a watch. This limits its segmentation of the market and also pricing flexibility. HMT incurred a loss of Rs 10.70 crores on a sale of 246.43 crores in the year 1992–93. The company has of late has not been as aggressive as in the past in its

marketing and advertising. The other problems it has are common with several Indian public sector undertakings, such as lack of freedom in decision-making, and political interference.

To counter the internal and external worsening competitive environment, HMT has gone in for market-oriented production, better working capital management, cost reduction, waste elimination and creating demand pull schemes. HMT initiated a dialogue with global groups to explore the possibility of a joint working in the areas of technology transfer, equity participation and marketing infrastructure. The government has approved HMT's restructuring plans over a period of ten years. As a part of this plan, the watch division will become a separate company which then will align itself with a multinational. HMT has already negotiated with Japan's Citizens Watch Co. but the matter is still in abeyance. HMT International has also set up an office in Hong Kong. While the movements (the time base) are being sent from India, the cases are procured in Hong Kong. The watches assembled in Honk Kong are then exported to the Middle East by the HMT.

THE WATCH-MAKING TECHNOLOGY

Every watch is composed of four basic elements: a time base (movement), a source of energy, a transmission and a display. Movements come in two major technologies, viz., mechanical and electronic. Mechanical movements can be further subdivided into manual and automatic winding types. In an automatic watch, the movements of the wearer's wrist wind the mainspring. Electronic watches use batteries for power and a quartz crystal to generate pulse. These watches are of three types, namely, quartz analog, quartz digital and quartz ana-digi. The most important difference between an electronic watch and a mechanical watch is that the former is much easier to manufacture. A mechanical watch is an intricate piece of machinery whose assembly necessitates high human skills, a tradition associated with the Swiss watch craftsmen. The electronic watch on the other hand lends itself well to mass production and automated processes.

The quartz crystal watch appeared in the marketplace at the end of the 1960s. An electric current is passed through a quartz crystal to stimulate high frequency vibration which can be converted into precise time increments. Micro-circuitry sub-divides the crystal's frequency into an electric pulse which drives the watch. The pulse operates a tiny electric stepping motor or is transmitted through conductors and integrated circuits to drive the gears and watch-hands.

The technology has now been developed where wrist watches can connect remotely with computers and telephone networks. This promises to initiate a high technology revolution. Consumers can enter and edit data on their PCs and select information on the screen to download into the watch by holding its face 6 to 12 inches from the monitor.

TANISHQ TO NEBULA

In order to revamp its Tanishq foray, Titan decided to discontinue selling its gold watches from the Tanishq division and to launch it as Nebula brand. Consumer feedback had revealed that Tanishq was seen more as a jewelery brand and, therefore, a feminine brand. Nebula will be under the umbrella of Titan Industries and would be available in all World of Titan showrooms, Time Zones and other select outlets across the country. "We felt that the best opportunities for tackling the gold watch business existed under Titan," said Jacob Kurien.

Further, it was felt by Titan that gold-watches were in good demand from business executives and sportsmen and hence it could launch this category of watches under its brand name. According to Kurien, 'Titan will be a complete watch company. It will now focus on developing the market and addressing the opportunities that exist in this area.' Under Tanishq, watches were secondary to the jewelry business. For Titan this marks a move up the value chain, giving consumers a chance to upgrade to a higher value product. Kurien said it was difficult to estimate the market size as, traditionally, Indian consumers have been getting their watches gold electroplated or attached to a gold bracelet by a jeweler. The company was expecting a turnover of Rs 15–20 crore from gold watches in the first year of their launch.

Pricing

Watches with solid gold cases and leather straps were priced in the range of Rs 5,950 to Rs 13,500. The all-gold women's collection was priced between Rs 15,000

to Rs 32,000. The Nebula leather collection has 12 watches, eight designs for men and four for women. All watches are crafted in 18-carat gold.

The pricing was kept affordable for the Indian market, considering that a similar international brand is valued above Rs 80,000. Prices also lower than of watches under Tanishq. The company had test marketed these watches in the markets of Mumbai, Delhi and Vijayawada and found the response to pricing favourable.

FUTURE OPPORTUNITIES

Titan's growth has been impressive thus far. Yet, it was far removed from its stated target of Rs 1000 crore turnover mark by year 2000 AD. On March 31, 1999, the company's turnover stood at Rs 484.45 crore, with jewelery accounting for Rs 100 crore.

For the future, there exist opportunities for Titan to take advantage of, viz.:

1. Titan has set up a good introductory network in the Gulf. It is already present in five countries in the region and is entering the large market of Saudi Arabia which it had been studying for last three years. Even though there are strong international brands in this market, Titan hopes to establish itself as a major player here. Concomitant with brand building exercises, it is also establishing exclusive showrooms in countries of its operation.

   An important point is that Titan has a limited offering in the "Royale" segment (golden dial and strap watches). The Gulf market is characterized by a strong demand for these kind of watches. This may necessitate Titan to come out with an extended range of models in this category.
2. There is a good prospect for Titan to enter the CIS market. The "Made in India' label does not have a negative connotation there as in the developed markets. India was one of the largest exporters to the erstwhile Soviet Union and it has a good image in that market.
3. Titan has taken a bold step by setting up two subsidiaries in UK and the Netherlands. It has also enlisted the services of French designers for its Euro collection of watches and jewelers for competing in the super premium AA category. Titan has been selective in choosing its distributors and retail outlets for the Euro markets.
4. African markets offer a sizable potential. Egypt Nigeria, Libya, Kenya. Tanzania, Ghana, South Africa have a burgeoning consumer market. Titan has already supplied watches to Ghana. India has a favourable image in these countries and there is a sizable Indian population there. Importantly, Tata Exports had a long standing market expertise in these countries which could be successfully leveraged by Titan.

FINALLY ...

Titan laid out its corporate objectives clearly: these read

To be a significant and respected global Watch, Clock & Jewelry brand and also be the market leader in India, including being the premier retailer of these products

The company strongly believed that success in global markets in crucial to its future well-being, especially since the Indian market is quite restrictive. It had already secured significant market beachheads for its watches. It has developed several competencies to latch upon the major opportunities in the entire range of lower, middle and upper segments and has exhibited a strong commitment by allocating some of its best human and financial resources for the purpose.

Swiss Protectionism

Titan planned to sell over 700,000 watches and jewelry pieces in international markets at a total export value of over US$ 25 million, i.e., almost Rs 100 crores by the end of year 1997–'98. However, it encountered unexpected resistance from the Swiss watch industry which sought to exclude Indian products from the International Watch, Clock and Jewelry Fair held annually in Basel, Switzerland. Participation in this Fair is important for a watchmaker or jeweler especially if it has global aspirations. Titan had been participating in this fair for a number of years, but was denied the opportunity in 1995–'96 and '96–'97 for the ostensible reason that the Government of India's import policies were 'too' protectionist for outside-India products to be brought in. Titan's executives, however, felt that the attempt to debar Indian products from this international Fair is motivated by the Swiss authorities' desire to wrest concessions from the Government of India and to thwart Titan in its bid for a significant share of the

European market. According to Swiss authorities, all they were demanding was that India should remove all quantitative restrictions and that duties be brought below 20 percent as per the international norms for free and fair competition in Indian markets.

Leveraging Core Competencies

For the strategist, however there was an interesting question looming ahead. Over the years, Titan has built an impressive array of complex competencies and skills in the areas of micro-precision engineering, electronic assembly, prestigious personal use articles, decorative objects and retailing (especially of luxury goods and brands). The question is: should Titan diversify into these product-markets or should it stick to it's knitting, i.e. watch-making (and jewelry!)?

appendix | 1

Annual Results

Profit & loss account						
Titan Industries Ltd. Rs Crore (Non-Annualised)	**Mar 1999 12 mths**	**Mar 2000 12 mths**	**Mar 2001 12 mths**	**Mar 2002 12 mths**	**Mar 2003 12 mths**	**Mar 2004 12 mths**
Income						
Sales	483.61	632.23	699	727.69	800.54	961.12
Other income	13.12	6.58	6.06	8.24	19.76	9.54
Change in stocks	0.41	10.03	–28.27	–18.84	5.04	34.66
Non-recurring income	0	10.38	9.66	1.06	2.99	6.45
Expenditure						
Raw materials, stores, etc.	218.53	313.31	341.2	379.23	473.23	593.47
Wages & salaries	54.04	72.18	74.06	76.32	71.56	84.97
Energy (power & fuel)	7.05	7.81	8.55	7.85	8.16	8.9
Indirect taxes (excise, etc.)	52.64	72.6	69.03	69.98	72.48	76.63
Advertising & marketing expenses	28.93	54.37	54.1	52.49	65.05	79.32
Distribution expenses	8.8	0	0	0	0	0
Others	31.2	42.79	41.86	37.85	44.07	72.28
Less: expenses capitalized	1.04	0.5	0.78	0.74	0.91	0.81
Non-recurring expenses	0	0	0	0.4	11.76	10.33
Profits/losses						
PBDIT	96.99	96.66	98.43	94.77	82.93	86.68
Financial charges (incl. lease rent)	57.92	54.82	51.93	52.28	50.71	45.07
PBDT	39.07	41.84	46.5	42.49	32.22	41.61
Depreciation	20.14	20.4	20.93	23.28	21.14	21.47
PBT	18.93	21.44	25.57	19.21	11.08	20.14
Tax provision	1.87	2.16	2.09	6.12	4.87	8.96
PAT	17.06	19.28	23.48	13.09	6.21	11.18
Appropriation of profits						
Dividends	16.7	16.79	16.95	10.13	8.44	8.52
Retained earnings	0.36	2.49	6.53	2.96	–2.23	2.66

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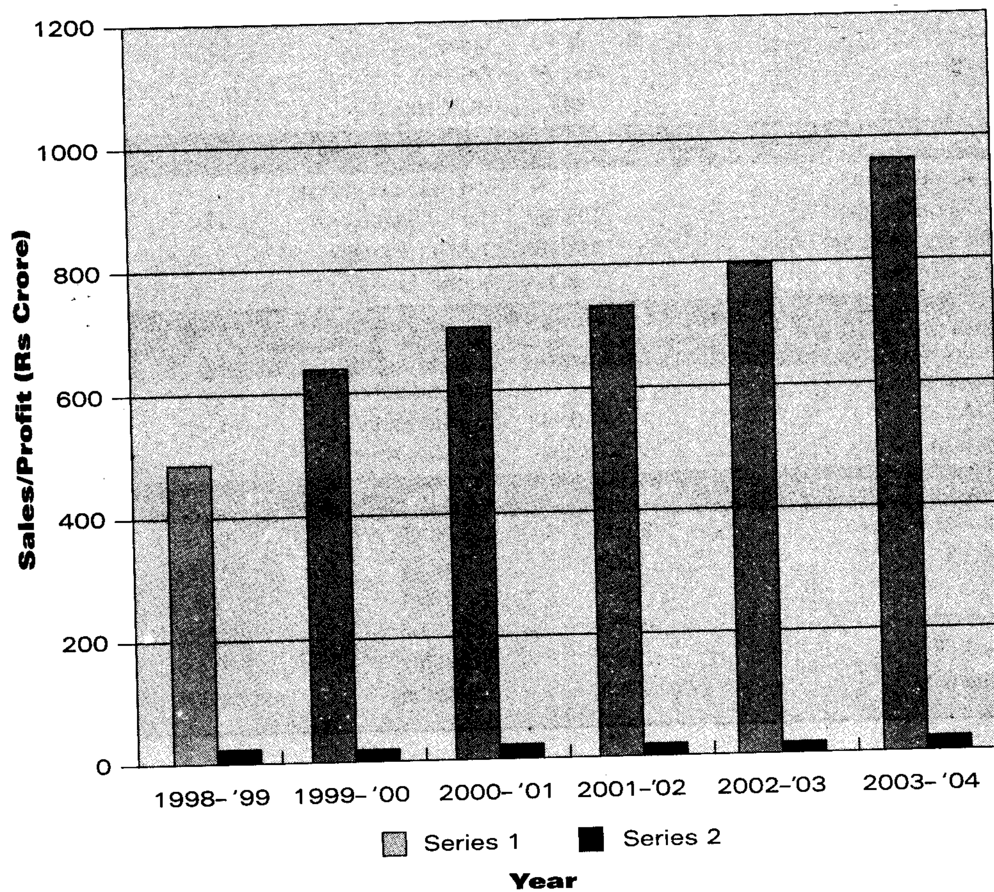
Yearly Sales and Profit Details

Year	Sales (Rs Crore)	Profit (Rs Crore)
1998–'99	483.61	18.93
1999–'00	632.23	21.44
2000–'01	699	25.57
2001–'02	727.69	19.21
2002–'03	800.54	11.08
2003–'04	961.12	20.14



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Investment indicators

Titan Industries Ltd.			
Share price performance		Finance year Trading date	: Mar 2004 : 9-Feb-05
Market price (Rs)	: 225.1	Face value (Rs.)	: 10
EPS (Rs)	: 4.87	Beta	: 0.87
CPS (Rs)	: 9.26	P/E (times)	: 48.16
BV per share (Rs)	: 30.67	P/B (times)	: 7.34
Turnover	: 18.354	Market capitalisation	: 951.64
(Rs Crore) Financial indicators (Rs Crore)		**(Rs Crore)**	
Net worth	: 131.83	Total assets	: 759.85
Equity capital	: 42.28	Sales	: 961.12
Borrowing	: 406.71	PAT	: 11.18
GFA	: 393.4	PAT/Sales (%)	: 1.16
Capitalization ratios			
Bonus equity/eq. cap (%)	: 0	Mkt. cap/ent. val(%)	: 70.06
Free reserves/eq. cap (%)	: 195.65	Capital gearing ratio	: 3.389
Mkt. cap/eq. cap+prem (%)	: 914.95	Debt equity ratio	: 3.085
Enterprise value	: 1358.35	Current ratio	: 1.136
(Rs Crore) Yield analysis			
Dividend rate (%)	: 10	Dividend cover	: 1.51
Yield (%)	: 0.44	Div./Net worth (%)	: 3.94
Pay out ratio (%)	: 46.51		

Stock returns & volatility	1 Month	3 Months	6 Months	12 Months
Returns (%)	20.89	30.68	94.89	136.63
Volatility (%)	28.08	12.79	11.54	11.98
High price (Rs)	225.1	225.1	225.1	225.1
High price date	9/2/05	9/2/05	9/2/05	9/2/05
Low price (Rs)	155.1	155.1	114.5	83
Low price date	17/01/2005	17/01/2005	16/08/2004	17/05/2004

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Gujarat Ambuja Cement Ltd.* —Innovating to Leadership Position

Gujarat Ambuja Cement Ltd. (GACL) achieved a position of market dominance as one of India's largest, energy efficient, and technologically advanced cement manufacturers within 10 years of existence. Its continuous drive for cost efficiency and quality are derived from an emphasis on replicating global best practices and continuous innovation. Global standards of plant maintenance and a constant effort to end bottlenecks have raised productivity and capacity use. Energy efficiency has been an important element in the strategy. Crucially, GACL's innovations have created major strategic advantages in marketing and distribution, particularly in areas such as brands and logistics. The company, though just ten years old, has consistently achieved global recognition. *Asiamoney*, a reputed international business magazine, after a worldwide poll of institutional investors, ranked Ambuja among the 10 best managed companies in India. The criteria for this selection included business strategy, financial management, fairness to minority shareholders and investor relations. A survey by Arthur D. Little ranked Gujarat Ambuja Cements as one the top 20 most competitive companies in Asia. Since inception, the shares of this company have been the darling of the bourses. The future plans of Ambuja Cements are very ambitious. For the student of business policy, there would be several insights about capability development and internal resource creations.

THE EMERGING SCENARIO IN THE NEW MILLENNIUM

The war for a foothold in the Indian cement market—the second largest in the world—was hotting up unabated. Lafarge, a European cement major, in two separate deals, had paid Rs 785 crore and Rs 550 crore for the Raymonds and Tisco cement divisions, respectively. After Lafarge's foray into the Indian market, it was the turn of the other European cement major, Italcementi, to gain an entry into the Indian market. The Italy-based cement major, through its group company Ciments Francais, agreed to pay $80 per tonne for acquiring a 50 per cent stake in the proposed joint venture with K K Birla-promoted Zuari Industries Ltd. (ZIL). The agreement paved the way for the setting up of a separate company, Zuari Cement Ltd. (ZCL), with 50 per cent stake binding on both parties.

Though the enterprise value of the deal has been calculated at Rs 740 crore by both partners, the deal itself has been put at around Rs 598 crore. With half the stake, the multinational would invest about Rs 299 crore in the new venture for its maiden entry into the Indian market. The price at $80 per tonne was at par with prices paid internationally.

The deal was brokered through investment bankers, Lazard India, which acted as advisors for Ciments Francais. Bank of America acted as the advisors for ZIL in the deal. The proposed joint venture agreement involves hiving off Zuari's cement division with a capacity of 1.7 MTPA plant at Yerraguntla in Andhra Pradesh. ZIL will transfer all assets and liabilities of its cement division to ZCL. ZIL will initially hold 100 per cent equity in the new company till all necessary approvals are received by Ciments Francais.

THE BEGINNING

GACL's main promoter, N. Sekhsaria, was earlier an established cotton trader. As he puts it, there were

* This case was prepared by Professor Arun Kumar Jain.

certain key industry characteristics that immediately appealed to him. Among the main reasons were:

- Cement is a capital intensive industry. This means that competition is limited to mainly a small group of large industrial houses, all ethical players.
- Cement is a relatively stable product not susceptible to rapid usage declines or obsolescence. The processes are also relatively consistent.
- It is a basic industry, one that is critical to any growing country where infrastructure is under massive development.

GACL started off in 1986 with a modest 0.7 million tonnes per annum (tpa) plant. In the short time since inception, it has become the third largest player in India, with a 5 m tpa capacity. GACL has primary manufacturing facilities at two locations—Gujarat (which gives access to the markets of Gujarat, Kerala, Mumbai and exports) and Himachal Pradesh (which gives access to the high growth markets of Punjab, West UP, and Haryana). It owns a fleet of five ships used exclusively for transporting cement to west coastal regions, bringing in coal from South Africa, and exporting clinker and cement. GACL is by far the largest exporter of cement in India with major markets being Bangladesh, Sri Lanka and the Middle East.

GUJARAT AMBUJA'S GROWTH STRATEGY

Working on Industry Critical Success Factors

Cement is 40 percent capital cost and another 40 percent energy cost and mostly a commodity. If any company has to succeed in this business, it would have to focus primarily on management of these issues. For a new entrant competing with older and established companies having fully depreciated plants, it is important to have the lowest capital cost per ton of cement. For achieving this aim, large plant capacities are essential. To spread out large overheads, capacity utilization would have to be at least 100 percent in the quickest possible time. Simultaneously, power consumption would have to be amongst the lowest. Finally, to be able to offset the cyclicity of the industry and be able to charge premium, a successful competitor must develop new markets, new products, and establish brand equity.

Focus on Cement

During the early 1990s to mid-90s, many high growth companies, flush with funds, overstretched and diversified into unrelated areas, thereby running into severe liquidity problems. GACL, for a while, also seriously considered the idea of moving into shipping, commercial power generation, plants construction, real estate townships, etc. GACL now says it is sharply focused on cement and all diversification plans have been shelved. It intends setting up only a captive power plant of 60 MW. The growth strategy is clear—get volumes and achieve dominant market shares! GACL has tapped new markets and aggressively increased market shares in existing markets. Volumes have grown 26 percent annually since the 1990s. Over the next two years, debt-financed expansions will drive volumes 28 percent annually and GACL's volumes will rise from 3.1 million tonnes in 1996 to an estimated 10 million tonnes by 2002 AD. Exports and foreign operations which already account for approximately 15 percent of sales are expected to contribute upto 25 percent within next 3 years. The gameplan involves reaching a production capacity of 10 million tonnes next 3 years. This would come through creation of new plants, expanding capacity of existing plants, or even, as a company executive puts it, 'cajoling others to sell'.

AMBUJA'S STRATEGIC INVESTMENTS

Unit at Himachal Pradesh

Gujarat Ambuja has redefined industry structure and competition with its unusual strategies over the past few years. In 1995, production at the new 1.5 million tonne kiln at Suli in Himachal Pradesh was stabilized within three months of commissioning. A task of this nature usually takes upto 18 months. Coupled with the heavy odds faced by GACL in a difficult and remote terrain, this is a feat in itself. Since then the average production at the plant has been over 100 percent. This plant supports three mills at the grinding units at Suli and Ropar in Punjab.

In 1996, with rising demand for cement from neighbouring states, another cement mill at Himachal plant was added. To achieve greater flexibility in its west UP distribution network, the company purchased

land at Saharanpur which would serve as another site for grinding cement in future.

The Himachal Pradesh plant with grinding facility in Punjab was a master-stroke which has given GACL handsome sustainable advantage over competitors' plants located in Rajasthan and Madhya Pradesh. While competitors have to transport cement over an average distance of 800 kilometers to reach Punjab, Ambuja's transport costs are only a fraction of theirs.

Bulk Cement Transportation at Port Ambuja: Creating an Industry Inflexion Point

At some point of time, some companies, through a fundamental innovation, change the entire industry structure forever. Such inflexion points are rare but are tremendous lessons in human creativity. One such moment came in September 1993 in India's cement industry when *Ambuja Shikhar* became the country's first-ever ship to carry bulk cement as it sailed from GACL's Muldwarka jetty to New Bombay terminal. For a product which has been traditionally transported by rail or road and in ready-to-delivery packings, the concept of bulk deliveries was new. For GACL, it meant a reduction of 40 percent in transport costs in one stroke. Since then the principles of logistics management, cement packaging and delivery mechanisms have been permanently transformed. How did this discontinuity-causing innovation come about? What drove it in the first place?

Mumbai is the country's largest market for cement consuming above 2 lakh tonnes per annum. Competition, naturally, is intense. The consumers are well educated and informed and they look for low-cost as well as a differentiated product. Selling cement to such a clientele therefore is both a challenge and an opportunity. For Gujarat Ambuja, Mumbai was a distance of 1060 km. by rail from its plants in Gujarat entailing huge transportation and packing costs, not to mention the delay in reaching the destination. The in-house intense debate about capturing this huge but difficult market brought forth the idea: *why not ship cement to Mumbai through sea, which would bridge the distance to just 315 km*? It also dawned that the entire west coast of India would become nearer for the entire year. Exports would become possible to the emerging and growing markets of Middle East. Once clarity emerged on the feasibility of the seemingly preposterous idea, the process of making it possible began. But it meant new capital investments and creating infrastructure and port jetties not only at Kodinar but also at Mumbai and Surat. More importantly, it called for human endeavour, team-work, dedication and intense planning.

Opening the Sea Route

The new system of bulk transportation entails cement being carried in sealed tankers from the plant to the Kodinar terminal, where it is transferred mechanically to cement silos. From these silos, cement is mechanically loaded into airtight holds in the ships. The vessels traverse the distance to Bombay and Surat in less than a day, and once docked, the cement is unloaded in a similar manner. At destination, after automatic extraction from the ship's holds, cement is placed in silos, and then pumped into sealed tankers which carry it to the various construction sites.

Customers are provided small storage tanks into which bulk cement is pumped from the sealed tankers. By the 'fluidization' process, the cement is made to flow like liquid due to force of air. It remains untouched by human hands, and is available to customers on tap as an when required. For customers who prefer to buy bagged cement, the company has arranged for packing facilities at the unloading terminals. This has helped GACL deliver cement to virtually every corner of Bombay.

By 1995, Port Ambuja was fully operational. Apart from dealing with the local sea transportation, the port also handled the company's entire export transportation needs. GACL's three ships, Ambuja Vaibhava, Ambuja Gaurava and Ambuja Shikhar, carried 8.24 lac tonnes of cement during the year compared to 7.48 lac tonnes in 1994–'95, resulting in increase in the company's share of Mumbai and Surat markets. Bulk transportation by sea slashed costs by over 65 percent for these markets.

A second landmark occurred when GACL successfully handled coal imports at Port Ambuja. With minor modifications, GACL equipped the port to handle coal imports. In 1996, about 105,000 tonnes of imported coal docked at Port Ambuja reducing fuel costs substantially. Earlier, imported coal, though superior in quality and costing 40 percent less for equivalent calorific value, was an unviable proposition, due to costs of handling the consignment at public ports, and transporting it to the plant.

Thus, Port Ambuja, designed basically for loading bulk cement for coastal markets, now provides Gujarat Ambuja economies of scale and scope by handling export of cement and clinker, as well as import of coal. The company has further strengthened its port facilities to handle larger and multiple cargo at an additional capital expenditure of Rs 400 crore.

In nutshell, the sea movement not only gives flexibility but also substantial savings in freight costs over rail and road. While the freight cost for Indian cement industry is rising constantly, Ambuja has been able to reduce them consistently. Moreover, with these strategic investments, Ambuja has achieved the flexibility to transcend geographical boundaries. With over-capacities looming large, the key factors for cement companies in the future will be distribution and marketing, apart from production efficiency and superior product quality.

Expansion at Ambujanagar

The kiln of the second 1 million tonne cement plant, called *Gajambuja Cement* at Ambujanagar was lit on March 1, 1993. In line with a tradition for executing difficult projects in record times, the company's engineers set up this plant in just 13 months which is an outstanding feat by any standards. Company executives maintain that no plant in the country has been put up in such a short period of time.

The company set up a third 1 million tonne cement plant at Ambujanagar in 1996. It further consolidated GACL's presence in western India markets and took its capacity at Ambujanagar alone to 3 million tonnes.

A HISTORY OF PROCESS AND PRODUCT INNOVATIONS

Port Ambuja is an example of large-scale innovation. GACL however, is also a success story of continuous entrepreneurship a *can-do* approach, constantly working on the critical success factors, innovation and aggression.

- The company has continuously improved efficiencies in one of the most critical areas, energy consumption. In 1992–'93, the company's engineers ran the existing plant at 149 percent capacity, as opposed to the previous year's 143 percent. Coal consumption was brought down from 761 to 720 kcal per kg. of clinker. Power consumption was reduced substantially from the previous year's 92 units to 88 units per tonne of cement. In 1994–'95, the same people further improved plant productivity by 9 percent, and reduced fuel consumption by 7 percent, and power consumption by 4 percent.
- One particularly vexing problem faced by GACL was of protecting sugar cane fields surrounding the limestone mines at the factory. A law existed that prohibited blasting within 500 meters of an inhabited place which meant that limestone deposits in the mines were unavailable for commercial exploitation. While on a visit to Mumbai, a team of engineers was caught in a traffic jam. The engineers came out to see that the cause was a large machine that was stripping asphalt on the road prior to concreting it. This was it. Could they convert the machine to strip limestone back home? GACL engineers contacted the machine manufacturer, Wirtgen, located in Germany. The German company was delighted with such an enquiry and readily agreed to help adapt machines for GACL's needs. If successful, it would mean a new business for them too. The engineers began by hiring one machine on a trial basis. The company now has three such machines working in the limestone mines leading to increase in usable limestone deposits by an estimated 10 percent. Additionally, the machine scrapes the limestone pieces so fine that the need for heavy crushing is eliminated saving time and electricity consumption.
- In India, thermal power plants produce huge quantities of fly ash which are dumped in open areas. Fly ash makes land infertile and causes air and water pollution. It has been one of the major environmental hazards faced by our country. In other countries cement manufacturing companies have used large quantities of fly ash to produce Pozzolana Portland Cement (PPC). GACL, in association with Punjab State Electricity Board put up a model grinding plant at Ropar adjacent to Ropar Super Thermal Power Station which consumes fly ash. The plant produces various grades of cement and other fly ash based products.
- Some time ago, a mega project was coming up in Mumbai—The Bharat Diamond Bourse, the largest bourse in Asia. This was a large and prestigious project and many companies were in the

race for supplying cement. Ambuja too was interested, but there were problems. Ordinary cement would not work because the site was on a soil that was rich in chlorides which attack ordinary cement weakening it over time. The only appropriate cement for such soil conditions is PPC. The problem with PPC is that it gained strength slower than other cements, slowing down the construction speed. For a large project, the delay can substantially increase construction costs.

A huge opportunity for bagging a big contract and in the process developing a new product lay for an enterprising firm which could develop a cement with the durability of PPC, but one that gained strength quickly. GACL, after extensive tests at its R&D facilities in Ambujanagar, produced a new cement that fulfilled the Bourse's conditions and bagged the order. After further refinement, the new chloride resistant cement was launched in Punjab as Ambuja Silicate (using fly ash). In just six months GACL captured 20 percent cement market.

- As one goes around Ambujanagar, the landscape is full of trees. They are planted across used mines and line factory roads, providing shade in the parks and gardens that dot the township. This is a marvel considering the fact that it is an area prone to frequent droughts, and where village women have to walk miles to fetch a bucket of water. GACL, under such environmentally tough conditions set up a water recycling facility which takes waste water from the Ambuja residential township and processes it for reuse for watering the plantations. It set up an extensive drainage system connected to a sewage treatment plant at one of the mine pits.
- Emission levels are well below the international standards. GACL has introduced methods for minimizing the noise and vibration that occurs during the conventional drilling, blasting and crushing process. A new Australian device called the Surface Miner is used which, besides eliminating noise and vibration, is more energy efficient, and recovers more material from a given area.
- The company issued Foreign Currency Convertible Bonds for a sum of US $80 million in December, 1993. The total demand for the bonds was US $1163 million, almost 15 times the issue size. These bonds, convertible at the option of bondholders, carry an interest rate of 3.5 percent p.a. The maturity price of the shares on conversion of bonds was fixed at Rs 373.45 per share, a premium of 7.6 percent to the then prevailing market price at the Bombay Stock Exchange.

Employee Involvement Through Empowerment

Innovations and improvements are impossible without sustained employee commitment, motivation, and encouragement. The managing philosophy is that the '*I can*' culture and an environment of peer pressure (the fear of being dubbed mediocre) will make people set standards for themselves. If cost control is a critical success factor, then it would be absurd for junior engineers and managers to check back with their seniors for every little decision. 'The time lost would be far more expensive than any errors they would make'. The company believes that it makes immense sense to listen to people who work day and night on the plant and in the frontlines.

Brand Building

The company realized that in an open economy, the only way to survive would be to offer a product of consistent and higher quality than the markets were used to. The next logical step from consistent quality was to push a commodity into a brand. The approach has paid off. Company's brands are sold at premium and, in consumer surveys, have been reported to be the first choice cement. Over time GACL has built a reputation as:

(i) a company with better track-record of financial performance
(ii) a low-cost advantage player (across important parameters like power and coal consumption and cost of transportation)
(iii) a brand that commands a premium, and,
(iv) a steady company despite the industry's susceptibility of prices fluctuations and pressures on profits.

Environment Management and Rural Development

Over the years, GACL has succeeded in bringing about innovations raising the general standard of

environmental conditions in and around the plants at Kodinar in Gujarat. The area has been adopted for all-round development by GACL. The company has initiated programmes in health, agriculture, afforestation, energy conservation and water management. Some examples are:

- The rehabilitation of mined areas adds a new dimension to the company's efforts towards preserving the environment. Through effort over years, GACL has created a large water reservoir at the exhausted mine pits. This has been achieved by channeling rain water into six interconnected pits resulting in an increase in the water table in nearby areas. Wells in neighbouring villages, previously dry for at least seven months a year, now retain water for practically the whole year.
- More and more check dams in the villages are being repaired or built with the active participation of villagers. This has helped in increasing the water table, recharging the wells and increasing the area of irrigation. More than 2000 acres of land in 18 villages have become fertile while reclaimed wasteland produces cattle fodder.
- Many social development programmes are undertaken by Ambuja Cement Foundation. So far, this department has covered 11 villages under the health care programme through a mobile dispensary. Three check-dams have been repaired resulting in recharging of 170 wells in eight villages. 100 bio-gas plants have been installed in 12 villages. Over 1,40,00 saplings have been distributed in 40 villages, and additionally, 90,000 trees have been planted in and around the plant area.

NEW ACQUISITIONS

The Indian cement industry is witnessing an intense phase of consolidation. The battle for volumes was being fought not only by Indian established players such as Grasim, and GACL, but also by European majors.

Gujarat Ambuja Cement took over DLF Cement, Grasim Industries is also consolidated its operations integrated with Century Textiles' cement division and buying out L&T's cement business. Grasim has already benefited from the integration of its (5.2 mtpa) and Indian Rayons' (3.2 mtpa) capacities with year-on-year volumes growth to October 99 at 22.1 per cent being higher than the industry average of 18.5 per cent for the same period.

Gujarat Ambuja made an open offer to the shareholders of DLF Cement mopping up 3.18 crore shares, aggregating to about 13 per cent of DLF Cement's holding. With this, Gujarat Ambuja's holding in the company went up to 42.2 percent. Anil Singhvi, executive director of GACL, mentioned that the company had initiated the process of changing DLF Cement's name. The cement manufactured in DLF Cement's plant was being marketed under the 'Ambuja' brand name. With DLF Cement's acquisition, Gujarat Ambuja's capacity in the north has risen to about four million tonnes. Anil Singhvi justified the acquisition saying that 'while his company had been active in other parts of the northern region, DLF's takeover would enable it to establish a presence in Delhi. We are very excited by the acquisition of DLF Cement. We will introduce our superior business model and efficiencies to DLF. The takeover will prove beneficial to DLF shareholders'.

DLF had a debt burden of Rs 300 crore and an interest outgo of Rs 52 crore. Mr Singhvi said Gujarat Ambuja would bring down this interest burden to Rs 200 per tonne or Rs 36 crore through a debt restructuring exercise which was likely to involve retiring old debt and fund infusion. DLF has obtained shareholders' permission for a Rs 150-crore preferential allotment to Gujarat Ambuja at Rs 13.85 per share. Mr Singhvi said it was possible that the entire amount may not be raised and only a part of the preferential allotment might take place.

The master stroke was yet to come. In January 2000, GACL had almost acquired a majority stake in ACC, and with it took a step closer to taking control of India's largest cement company. GACL's managing director Narotam Sekhsaria became the deputy chairman of ACC, following the 7.2 percent stake in ACC for Rs 445 crore on spot delivery basis from the Tatas—the promoter group—on December 21, 1999. Sekhsaria and A L Kapur were appointed as whole time directors on the ACC board on December 27, 1999. "The Tata's and Ambuja Cement equally hold a 7.2 percent stake in ACC. Mr Sekhsaria being an important co-promoter, the board of ACC felt that he rightly deserved to be deputy chairman at ACC. And Mr Pallonji Mistry continues to be the chairman," said ACC officials. "As and

when the Tatas decide to divest their remaining stake of 7.2 percent, it could be picked up by GACL. Until then, Gujarat Ambuja Cement will continue to be a our strategic partner and both companies will work together and mutually benefit each other." added officials. ACC currently has a capacity of 12 mt while GACL has 7.9 mt. after its acquisition of DLF Cement.

L&T (before its demerger of cement units) was the largest producer of cement in the country with a capacity of 12 mtpa and its plants are located in Gujarat, Maharashtra, Madhya Pradesh and Andhra Pradesh. It was looking for further acquisitions in the western and southern parts of the country as part of its growth plans in the cement sector. "We are open to acquiring modern cement plants in the western and southern parts only as we have good presence in these regions," according to A Ramakrishna, L&T member of board and president (operations).

L&T had acquired Narmada Cement with a capacity of 1.4 million tonnes per annum (mtpa) for Rs 263 crore in 1999 and if similar opportunities come up, "the company was open for it". Ramakrishna felt that since L&T enjoys good presence in southern and western parts of the country, the company may not be interested in acquiring cement parts in other parts of India. In the last few years, the western region has witnessed a growth of 9.4 percent per annum which was higher than in northern and southern region, which registered a 8.5 percent growth. According to industry analysts, western zone will remain a deficit region in coming years with north and east while surplus of around 4 mpts.

FURTHER PROGRESS

Over the next years, GACL intended to push sales such that it continued to grow at 28 percent annually. Volume increase from a new 1 mtpa plant in Gujarat commissioned in March 1997, and a 33 percent capacity expansion at the Himachal plant (effected in December 1996), and the recent acquisitions would be driving this growth. Operating margins were, however, expected to decline owing to soft cement prices and rising transportation, freight and energy costs.

Ambuja's Unique Position

Within a short period, GACL has achieved a unique position amongst the cement manufacturers in India. With plants in Gujarat, Himachal Pradesh and Punjab, and a complete infrastructure of bulk cement sea movement, the company has access to the richest markets in India, viz., Gujarat, Maharashtra, Kerala, Punjab, wet UP, and Haryana. The dedicated fleet of ships lends tremendous flexibility to select the most lucrative markets along the Indian coast and overseas as well.

New Capacities and Growth Opportunities

Ambuja was aiming a 10 million tonne capacity in the next five years. For this the company planned to invest Rs 1500 crore during the period. The company hoped to generate Rs 1,000 crore from internal accruals and the remaining Rs 500 crore from the debt market. The optimism about internal accruals was based on the calculation that cash earnings will be Rs 200 crore each year. This was be the second time the company would be making such massive investments. It had a history and successful track record of continuous expansions. In the last five years the company had already invested Rs 1500 crore, with one third coming from debt, equity and internal accruals each. Turnover had grown at 36.5 percent compounded annually during the 1990s driven by a 26 percent annual increase in volumes and an 8.6 percent annual increase in cement prices.

GACL's net profit for the second quarter ended December 1999, rose 90 percent to Rs 55 crore against Rs 29 crore for the corresponding previous period. Turnover during the period rose from 6.09 percent to Rs 331 crore from Rs 312 crore. GACL also declared an interim dividend of 25 percent for 1999–2000 on the enhanced equity of Rs 147.10 crore (post-bonus issue in the ratio of 1:1). All-round cost control was the key to profitability, according to Mr Sekhsaria. "I expect prices to be strong in the January–June period, which is traditionally the case," he said, adding, 'we hope to leverage on our association with ACC for distribution, especially in areas where we are not strong.' He took over as ACC deputy chairman on Wednesday following GACL's acquisition of a 7.2 percent stake in the company.

Interest costs during the quarter declined by 21 percent to Rs 22 crore against Rs 28 crore. "Interest costs have been low due to the large pre-payment of loans in the previous financial year," said Mr Anil Singhvi, director at GACL.

According to Mr Singhvi, interest costs for FY2000 will continue to be low as the acquisition of ACC at Rs 455 crore will be reflected in the accounts of GACL subsidiary—Ambuja Cement Holdings. According to Mr Singhvi, GACL will need to borrow another Rs 100 crore to finance its recent Rs 350-crore acquisition of DLF Cement. Sales volume for the quarter ended December 1999 declined marginally by two percent to 1.47 million tonne (mt) against 1.50 mt while production was 1.49 mt against 1.51 mt. For the six months ended December 1999, net profit was up by 128 percent to Rs 105 crore against Rs 46 crore in the previous quartar. Turnover for the period was up by 10.5 percent to Rs 612 crore against Rs 554 core. Interest costs for six months too declined by 20 percent to Rs 44 crore against Rs 55 crore and depreciation costs were higher by 5 percent to Rs 62 crore against Rs 59 crore.

GACL was confident of its position in the industry and was looking at various avenues for further growth. The demand impetus, which started during the year, is continuing and it is expected that demand growth during the year will be above 15 percent. "The economy is doing very well and it is believed that various policy initiatives taken by the government will trigger the demand further and the surplus situation which prevailed during the last three years is coming to an end," a senior executive of the company stated.

Anil Singhvi added the punch to company's perspective 'This year (2001) the cost of production will be brought down to the levels of 1986 when the company started'. According to him: 'The cash cost of production will be Rs 750, with current 5–8 percent inflation rate. The cost will be 30 percent lower in dollar terms. In a competitive market, it is good that people think we have exhausted all our weapons.' The immediate worry for Gujarat Ambuja was obviously margins, which are under pressure in year 2000, largely because of the glut in the market.

"It is how you position yourself in the market. In Gujarat, we changed the credit period from 90 days to 4–6 days. In the East, 40 percent of our sales are on cash and carry in less than six months time," according to Singhvi. Despite the skepticism, analysts maintain that Gujarat Ambuja continues to remain a well-managed company. According to as analyst, "The management is great at utilization of capacities, and logistics and cash management. They are the best in the sector and have exploited all the benefits so far."

The strengths of the company also came to the fore through its vision. From Gujarat, Gujarat Ambuja expanded into Punjab, a rich state with a per capita consumption of 165 kg compared to all of India which is at an average of 82 kg. Incidentally, Punjab also has higher prices than other major markets like Gujarat and Maharashtra. The Modi Cements acquisition has given the company the much needed exposure to the east.

And despite the problems faced by the company in Kerala, where the prices are the highest, it managed to sell nearly 20,000 tonnes. So even when prices in Gujarat fell to Rs 90, Gujarat Ambuja could realize profits from other more lucrative markets. Says Singhvi: "We are geared towards production and sales that are larger than our capacities. Of our total capacity, we are confident of selling 5.5 million tonnes (excluding Modi Cement capacity)."

In 2004, GACL embarked upon expanding the captive power capacity at its various plants. Out of the total 75 MW addition, 30 MW was to be at Punjab and Gujarat plants and 15 MW for Ambuja Cement Eastern Limited. "We expect the new plants to be set up within 12–15 months. This will make power available to our plants at half the grid cost," according to GACL executive director Anil Singhvi. Such initiative will further strengthen Ambuja's position as one of the lowest cost producers in India.[1] "We would like to consolidate our position in the west and the northern markets," said Mr Singhvi.[2]

Further, to derive economies of scale in the northern and western regions of the country GACL announced in 2004, increase in capacity from the current 15.5 million tonnes to 20 million tonnes over next three years. The decision had been taken keeping in mind the growth prospects in the housing and infrastructure sector. Other associated factors such as rising incomes, low interest rates and realistic real estate rates would propel the cement demand. This will also lead to firmer prices in the north and west as also in the export market. Singhvi said: "We plan to achieve this through a mix of acquisitions, brown field projects and capacity enhancement at existing units."

[1]GACL Increasing Capacity of Captive Power to Save Costs http://www.financialexpress.com/fe full story.php? content id=57631

[2]Gujarat Ambuja Earmarks Rs 1,000 Cr for Buyouts http:/www.financialexpress.com/fe_full_story.php? content_id=60594

Posted

In 2004, the northern India market which includes Punjab, Haryana, Himachal, J&K, Delhi and Rajasthan, was the major market for the GACL. It accounts for around 45% of its cement sales. The western markets including Mumbai, rest of Maharashtra and Gujarat contribute 30% of the sales and 10% sales came from the east from Chattisgarh and West Bengal. With respect to the export front, it accounted for the 15% of the total sale.[3]

MNC Presence

A large number of international players such as Lafarge, Cemex and Holderbank had created positions in cement industry in India. In 2000 itself, Cemex had appointed an unnamed investment bank to scout around for a potential takeover. Holderbank had a stake in Kalyanpur Cement and was looking to invest more money in the country.

What appealed to these foreign giants was the potential Indian market offered. Compared to the average international per capita cement consumption of 250 kg, India lagged way behind with just 80 kg. From the country's current installed capacity of 120 million tonnes in 2003, only about 85 million tonnes was produced. Explains Saumen Karkun of Holtec Consulting, a Delhi based cement advisory: "We have to differentiate between demand and offtake. Latent demand is huge but liquidity constraints tend to put brakes on purchases. In the long term, this is what makes India attractive. As the economy grows and more finance is released into the system, the offtake will get closer to the real demand."[4]

The new developments in 2005–'06 were that L&T had demerged its cement unit selling it to Grasim; while Holcim had taken over management control of Gujarat Ambuja Cement.

[3]Gujarat Ambuja bullish on northern, western markets
http://www.financialexpress.com/fe_full_story.php?content id=74636

[4]Cementing its Position
Business World/10 January 2000/page 48–52

appendix | 1

GUJARAT AMBUJA CEMENTS

- India's most profitable cement company and biggest exporter of cement
- Has a strong presence in the western and northern markets in India
- Has held 13.83 percent stake in ACC, India's single largest cement company with a pan-India presence
- 2003–04 sales: Rs 2,305 crore
- 2003–04 profits: Rs 337 crore

HOLCIM

- The Switzerland-based company is the world's second largest cement manufacturer with a presence in over 70 countries
- A third of its sales comes from emerging markets
- 2003 sales: Swiss Francs 12.6 million
- 2003 profits: Swiss Francs 686 million

appendix | 2

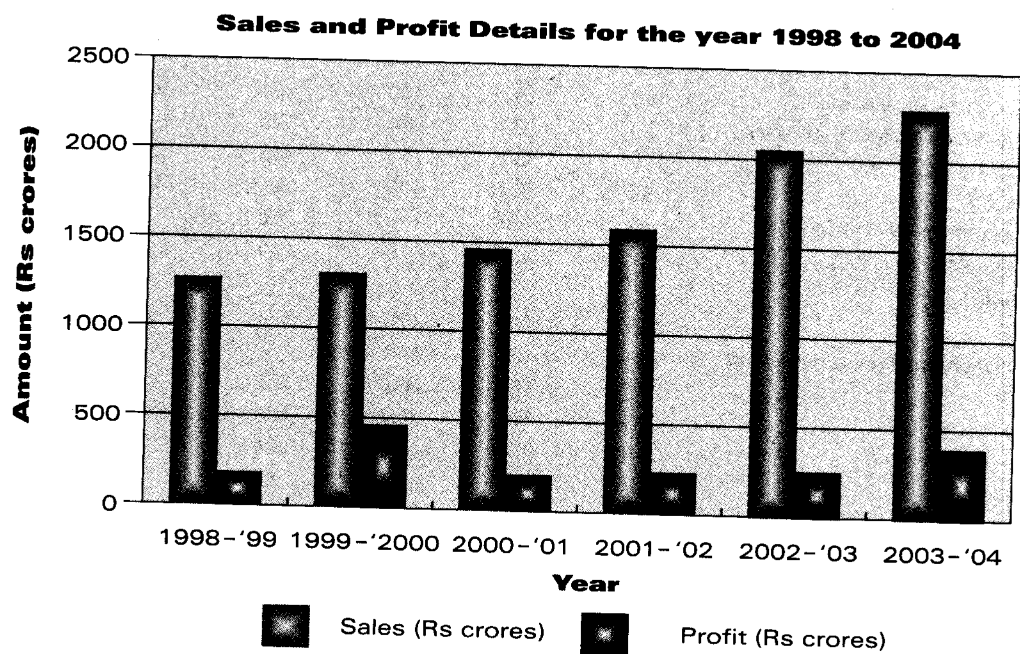
Annual Results from the year 1998 to 2003

Profit & loss account						
Gujarat Ambuja Cements Ltd. Rs Crore (Non-Annualised)	**Jun 1999 12 mths**	**Jun 2000 12 mths**	**Jun 2001 12 mths**	**Jun 2002 12 mths**	**Jun 2003 12 mths**	**Jun 2004 12 mths**
Income						
Sales	1252	1303	1449	1584	2033	2307
Other income	36	42	17	38	65	72
Change in stocks	–16	12	10	–12	6	2
Non-recurring income	13	294	18	7	12	77
Expenditure						
Raw materials, stores, etc.	139	169	203	229	310	326
Wages & salaries	34	44	46	53	69	89
Energy (power & fuel)	240	279	296	324	431	464
Indirect taxes (excise, etc.)	193	187	180	201	294	346
Advertising & marketing expenses	20	22	24	29	43	58
Distribution expenses	165	150	153	168	275	313
Others	89	93	108	121	136	167
Less: expenses capitalised	0	0	0	0	0	0
Non-recurring expenses	2	2	6	13	3	30
Profits/losses						
PBDIT	403	705	478	478	554	664
Financial charges (incl. lease rent)	130	125	142	116	129	111
PBDT	274	580	337	362	425	552
Depreciation	123	124	129	138	171	169
PBT	151	456	207	224	254	384
Tax provision	0	28	15	45	32	47
PAT	151	428	193	179	222	337
Appropriation of profits						
Dividends	68	79	85	93	123	160
Retained earnings	83	349	108	86	99	176

appendix | 3

Yearly Sales and Profit Details

Year	Sales (Rs Crore)	Profit (Rs Crore)
1998–'99	1252	150
1999–'00	1303	456
2000–'01	1448	207
2001–'02	1584	224
2002–'03	2033	253
2003–'04	2306	383



appendix | 4

Investment indicators (BSE)

Gujarat Ambuja Cements Ltd. Share price performance		Finance year Trading date	: Jun 2004 : 9-Feb-05
Market price (Rs)	: 456.05	Face value (Rs.)	: 10
EPS (Rs)	: 24.65	Beta	: 0.65
CPS (Rs)	: 35.06	P/E (times)	: 18.5
BV per share (Rs)	: 122.67	P/B (times)	: 3.72
Turnover	: 4.3242	Market capitalisation	: 8185.6
(Rs Crore) Financial indicators (Rs Crore)		**(Rs Crore)**	
Net worth	: 2012.85	Total assets	: 4024.21
Equity capital	: 179.45	Sales	: 2306.7
Borrowing	: 1269.68	PAT	: 336.79
GFA	: 3651.84	PAT/Sales(%)	: 14.6
Capitalisation ratios			
Bonus equity/eq. cap (%)	: 58.27	Mkt. cap/ent. val(%)	: 86.57
Free reserves/eq. cap (%)	: 762.76	Capital gearing ratio	: 0.631
Mkt. cap/eq. cap+prem (%)	: 745.33	Debt equity ratio	: 0.631
Enterprise value	: 9455.28	Current ratio	: 0.61
(Rs Crore) Yield analysis			
Dividend rate (%)	: 80	Dividend cover	: 2.1
Yield (%)	: 1.75	Div./Net worth (%)	: 7.97
Pay out ratio (%)	: 47.63		

Stock returns & volatility	3 Months	12 Months	1 Month	6 Months
Returns (%)	9.19	28.86	49.75	54.81
Volality (%)	6.83	3.4	2.79	4.84
High price (Rs.)	46.8	468.8	468.8	468.8
High price date	31/01/2005	31/01/2005	31/01/2005	31/01/2005
Low price (Rs.)	398	348.15	302	250
Low price date	12/1/05	16/11/2004	16/08/2004	17/05/2004

case | 6

Bharat Aluminium Company*

A Case Study on First Big-Ticket Successful PSU Disinvestment

BALCO ON THE BOIL

Shri Anil Agrawal, chairman and managing director of Vedanta Industries (then, Sterlite Industries Ltd.), heaved a sigh of relief as the trade unions agreed to call off their 67-day long strike at the Korba plant of Bharat Aluminum Company Limited (BALCO). The new owner of this aluminum major had not expected the intensity of protest by the employees against its privatisation by the coalition National Democratic Alliance government at the Centre. The decision to resume work was reached after the intervention of the Supreme Court of India. The apex court also forced the confrontationist Chattisgarh state government to go on defensive on the issue of BALCO's land deed. The court asked the government to justify its stand in cancelling the land allotment to BALCO while permitting such allotments to the two other private companies—Daewoo Power and Essar Steel (cf. Appendix 1 for chronology of events).

The disinvestment process of BALCO was completed on March 2, 2001 after the Lok Sabha endorsed the government stand. Sterlite acquired 11.2 crore shares of BALCO for Rs 551.5 crore which is a 51% controlling stake in this profit making aluminium company. Incorporated in 1965, BALCO has one unit at Korba (Bilaspur) in Chattisgarh and another at Bidhanbag (Asansol) in West Bengal. It's PAT (Profit After Tax) has come down: from Rs 60 crore in Year 2000 to Rs 23 crore in Year 2001 (Table 1).

For the Rs 500-crore Sterlite group, the BALCO acquisition was a landmark. The group was split two into last year, Sterlite Optical Technology—the optic fibre company, and Sterlite Industries (SIL)—the metal company. SIL is in Zinc, Copper and Aluminium. Sterlite had shown its strong intentions of backward integration through entry into aluminium production after acquisition of MALCO in 1995 and unsuccessful attempt at acquiring INDAL. It had plans of greenfield aluminium plant in Orissa which were subsequently shelved. For Anil Agrawal, BALCO made a great acquisition. He has articulated a dream to be amongst the biggest players in this basic metal business. It allowed him to buy one of the country's largest aluminium makers. However, BALCO's acquistion posed its own challenges for Sterlite.

The privatisation sent a strong signal to the investor community and the industry at large on the government's seriousness about its privatisation programme. This also cleared the way for the privatisation of VSNL, Maruti, Air India and 24 other PSUs (see Appendix 2). It appeared after this sale that the government had finally got its act and guts together. The Budgetary estimate for PSU disinvestment proceeds was increased to Rs 12000 crore for year 2001–2002, of which Rs 7000 crore is to be used for public sector restructuring and Rs 5000 crore for social infrastructure sectors. The target for year 2000–2001 was Rs 10,000 crore, of which only a small fraction could be realized. Mr Arun Shourie, minister for disinvestment said that the government could not achieve its sales target as most of the year was spent in polls and the fact that, "we could have collected a lot more if we had offloaded minority holdings in bits and pieces but that would have neither got us the best value nor been a part of any long term planning. It was decided that the better course was to wait and disinvest as a part of a

* This case was prepared by Professor Arun Kumar Jain.

road map specific to each PSU". The process of disinvestment of BALCO was a test case of its will-power (cf. Appendix 2 for disinvestment schedule).

ABOUT BALCO

Bharat Aluminium Company Ltd (BALCO) was incorporated in 1965 as a public sector undertaking the Ministry of Mines. The company manufactures aluminum rods, rolled products and extruded products. In April 1997, the Disinvestment Commission recommended the sale of 40 percent of BALCO's stake to a strategic partner. In April 1997, the then disnivestement commission report recommended that 40 percent of BALCO's equity be sold off to a strategic partner and 34 percent to the public, financial institutions and employees within two years of the partner's entry. This recommendation envisaged reduction in the Government's stake to 26 percent. In November 1998, an inter-ministerial group set-up for disinvestment of BALCO, recommended that 51 percent of BALCO's equity, instead of 40 percent be sold to a strategic partner.[1]

BALCO manufactures aluminium rolled products, extruded products, properzi, rods and billets at its two plants located at Korba (Madhya Pradesh) and Bidhanbag (West Bengal). The company had a metal capacity of 1 lakh tonnes per annum and an alumina capacity of 2 lakh tonnes per annum. It is reported to have an inefficient smelter compared to most of its rivals in the aluminium industry. This probably explains why its consumption of power per tonne of aluminum produced has been higher than its peers from 1990–'91 onwards. Financial performance indicators of BALCO are presented in the exhibit on page C-338.

WHY DISINVESTMENT ?

The Indian Government has invested more than Rs 2,00,000 crore in 240 public sector units. More than Rs 7000 crore is spent annually to offset losses in half of these companies.[2] Mr. Arun Shourie, the disinvestments minister, lamented that the fiscal crisis left the government with no option but to privatise. Some 78 percent of Central tax revenue pays for interest on debt, he explained, meaning that "all government salaries, all defence spending, all pensions and more are paid for by borrowing... so privatisation is the only way to save jobs and save (PSU) units by getting aggressive partners into these enterprises".[3]

Moreover, privatisation winds are sweeping across the world, since the abandonment of communism in the eastern bloc. Only a few 'inward-looking' countries were resisting privatisation, such as, Myanmar, Libya, Cuba, North Korea. In India, too, privatisation has become acceptable in intellectual debates. It was generally agreed that hanging on to PSUs meant creating efficiency drawbacks for the entire economy, as well as the recurrent costs of employees' salaries and handouts that most PSUs need to keep going. It was felt that the longer the government holds on to PSUs, the lower the values of the bids it's likely to get. Most major Indian newspapers support market-based reforms, and few politicians offer reasons not to privatise—they mostly limit their objections to stalling tactics or trying to convince the government to privatise someone else's PSU first.

With the government hard pressed for resources, the funds locked up in non-strategic PSUs could alternatively be deployed in areas of much higher on social priority, such as public health, family welfare, education and social and essential infrastructure.[4] There are strong arguments that the government should concentrate on its basic objectives of providing governance and infrastructure support instead of running non-core businesses. India's Executive Director to the IMF and former Finance Secretary, Dr Vijay Kelkar, said that "the only strategic public sector enterprises should be those dealing with atomic energy, space and defence, and PSUs in other areas should be privatised."[5]

Some lessons can be drawn from the experiences of countries. For example, the New Zealand experiment exemplified that "governments should concentrate on what they do best i.e., establishing the regulatory and economic milieu, financing public

[1]From *Prowess—CMIE Database*.

[2]See website www.ciionline.org for a report on Department of Disinvestement Presentation, May 2001.

[3]Aurn Shourie's comments reported in *The Economic Times*, April 14, 2001.

[4]In the Union Budget 2001–2002.

[5]Pune Spring Lecture, May 1999 at Pune. Also see Disinvestment Commission Report, 2001 which uses almost similar language while defining strategic business areas for the government.

infrastructure and ensuring the delivery of public goods with reforms driven by the same central desire: to improve macroeconomic performance by reducing the negative impact of the public sector."[6]

DISINVESTMENT POLICY OF THE GOVERNMENT

The erstwhile Disinvestment Commission submitted a dozen reports suggesting a slew of measures including strategic sale, equity sale and closure, besides making general recommendations on 58 PSUs (see Appendix 3). But the Government is yet to take up a host of general suggestions including setting up a disinvestment fund, de-linking of the disinvestment process from the budgetary exercise, transfer of management to the strategic buyer while selling a substantial stake in an undertaking, reduction of government equity below the level of investment offered to the strategic buyer, and framing of a policy statement on the terms of voluntary retirement scheme.

Since 1991, ad-hoc sales of government equity in 50 PSUs have realized about Rs 18,000 crore. Prevention of ad-hoc sales and development of a transparent framework for disinvestment were among the reasons for setting up the Department of Disinvestment in early 2000. The Cabinet Committee on Disinvestment clears all proposals for disinvestment. A core group of secretaries, an inter-ministerial group and administrative ministry, all vet disinvestment proposals.

According to the minister, "Disinvestment was now planned as part of a systematic pattern that includes a down-the-tunnel road map for each PSU. The methodology used for privatisation would continue to be the strategic sale route and receipts from this would be used for meeting the expenditure in social sectors, restructuring of PSUs and retiring government debt."[7]

He emphasised that new schemes would be formulated to protect workmen and pointed out that a tax exemption on the VRS scheme had been proposed in the budget. Additionally, the government had stipulated that shareholder agreements in case of disinvestment provided for some security mechanism for existing employees. It was done, according to him, since "it will be important to get the workmen on the side of the disinvestment process—we need to create a proper safety net..., the employees must realise that the emphasis is not on closure but to run the same companies more professionally."

As far as BALCO was concerned, the now disbanded Disinvestment Commission initially recommended a 40% divestment in 1997.

THE PROCESS OF SELLING OF BALCO

After coming to power in 1999, the NDA government decided to offload a controlling stake of 51% to a private-sector strategic partner. On June 15, 2000, it invited bids for disposal of the shares. Initial media reports suggested that there were seven bidders for the 'mini ratna' including global majors, Alcoa and Kaiser and Indian companies, Hindalco and Sterlite. The bids were submitted to Jardine Fleming who was designated as global adviser on the sale of BALCO. Incidentally, jardine Fleming also co-ordinated the National Democratic Alliance government's controversial disinvestment in Gas Authority of India Ltd. (GAIL) in November 1999.

For the valuation of the company's land, building, plant and machinery, BALCO's screening committee P.V. Rao and Co. Indian Bureau of Mines was chosen for valuation of the captive mines. The reserve price for the bid was Rs 514.40 crore for the 51% stake in the company and a premium of 25% was factored into the reserve price.

Valuation Perspective

Sterlite acquired 51% of BALCO's shares for Rs 551.5 crore which amounted to paying Rs 49 per share. The figure of Rs 551 crore as the value of the controlling stake in the company gave rise to many controversies. Some analysts argued that the company was worth Rs 5500 crore. The total assets of BALCO stood at Rs 1130 crore as on March 1999 (refer to the exhibit on page C-338), giving the estimate of Rs 551 crore quite near to the value of 51% stake. Valuations in an acquisition are done mostly on the basis of discounted cash flow. In this method the projected future cash flows are discounted by the companies weighted average cost of capital. As per these calculations BALCO's value ranges from Rs 651 crore to Rs 994 crore, thus making Sterlite's offer of Rs 551 crore for the 51% stake quite reasonable. Sterlite thus valued BALCO at

[6]Disinvestment Commission, First Report, September 1996; Crisil.com.

[7]*The Times of India*, March 01, 2001.

18.8 times its EPS while the stock markets themselves gave a low P/E multiple to the aluminium industry.[8]

Mr Arun Shourie strongly defended the valuation and the price of Rs 5.51 billion charged for selling majority government shares holding that the divestment was in line with the recommendations of the Disinvestment Commission. Laying his statement on the motion in the House, Mr Shourie said, "the valuation for BALCO was determined by the Discounted Cash Flow (DCF) method, which is an appropriate method for a going concern. The DCF method assesses the future earning prospects of the company, discounts the stream of future earning to the present by a measure of the opportunity cost of capital."[9]
He said that "this exercise included:

- the current market share of the company,
- valuation of its brand,
- the competition it is likely to face,
- the prospective price that it is liable to fetch for its products,
- the likely movement in costs, etc."

For 51 percent of equity advisors had placed the valuation through DCF method at Rs 332–507 crore. In addition, the advisors decided to add 25 percent to the valuation by way of premium for transfer of the management to the bidder. "By these steps they (advisors) fixed the Reserve Price at Rs 5.14 billion, "he said.

Mr Shourie said while the Asset Valuation was not an appropriate method for a going concern, it is used for a company being shut down along with disposal of the land and building, the government had decided to get the valuation done through this method as well. The value of assets was placed around Rs 1072 crore, 51 percent of which would be around Rs 547 crore. The Minister reiterated that once the transaction was completed, all documents and papers relating to BALCO disinvestments would be submitted to the Office of the Comptroller and Auditor General. "In this case as in every other of disinvestment, the CAG will prepare a thorough assessment, send it to Parliament and release to the people," he said.

Valuation had been a difficult area for the government essentially because of the lack of clarity on the methodology. The approaches to valuation also needed to take into account strategic value including the cost of control.

The government was quick to consummate the deal after the opposition's motion was defeated in the Lok Sabha—239 votes against and 119 for with three abstentions. Speaking hours after the governments victory, Anil Agarwal declared that "the deal will serve as a model for other disinvestments in future". On March 2, Sterlite handed over a cheque for Rs 551.50 crore and signed the share purchase agreement and a shareholders' pact with Union Government.[10] For detailed events see chronology of events given in the Appendix 1.

STAND OF DIFFERENT STAKEHOLDERS

State Government of Chattisgarh

The state government of Chattisgarh was opposed to the disinvestment of BALCO. The state Chief Minister, Ajit Jogi opposed the deal on three counts. He alleged that BALCO's assets had been "sold for a song" and that it pointed to "corruption at the highest level of government', implying the involvement of the Prime Minister's office (PMO). He raised the following questions: "How can a property valued at Rs 6000–7000 crore be sold for a meagre Rs 551 crore? They floated global tenders, then how come there were just two bids for BALCO? Of these two bids only one was above the reserve price. How can this be explained?" Ajit Jogi denied the claim made by the Minister for Disinvestment, Arun Shourie, that the Chattisgarh government was consulted at every stage about the BALCO sale. Spokesperson of the ruling BJP added a new dimension to the worsening relations between the Union and Chattisgarh governments by announcing on March 7 that BALCO's losses from the strike would be recovered from the Central assistance pool due to the state. One of the reasons cited by Mr Jogi for his opposition to the deal stemmed from his contention that the sale violated constitutional provisions on several counts notably those aimed at protecting tribal people from being alienated from their lands. He marshalled court

[8]In *Business Today*, March 21, 2001
[9]In *Indian Express*: News archives on the internet

[10]In *Frontline*, March 2001

rulings to back his contention that the sale jeopardised the interests of the tribal people. Jogi supported his statements by citing a Supreme Court judgement, known as the 'Samatha Judgement' (*Samatha* vs. *The State of Andhra Pradesh and others*, decided in 1996 and reported in 1997). The judgement said that no factory, no establishment, no mining activity, no industrial activity could be undertaken by a private person on a Schedule V area (land that are mentioned as tribal areas in the constitution). Only tribal people or a co-operative society of tribal people or a government undertaking could do such activity. According to Mr Jogi, Mr Agarwal (Sterlite) was not eligible to run BALCO on such an area.

The Chief Minister warned Sterlite to offload its majority stake in BALCO and quit the state. Mr Jogi was unwilling to relent from his decision on the disinvestment and stated that harsh measures were in if the warning was not taken seriously. These include increase in royalty rates for the minerals, as also imposition of further taxes in the forthcoming State Budget, which would make it virtually impossible for the company to register profits in 2002. Mr Ajit Jogi gave SIL three options:

(a) To sell of 2 percent out of Sterlite's 51 percent stake in the company back to the Government, making it a minority with no absolute control.
(b) To accept the Rs 552 crore offered by Chattisgarh and quit peacefully before the plant becomes inoperational and incurs heavier loss.
(c) To disclose the names of 21 persons alleged to have accepted grease money to clear the deal.

Trade Unions

Government's move on disinvestment in public sector undertakings (PSUs) on the basis of "non-core, non-strategic sectors" and the setting up of a Disinvestment Commission, as outlined in its common minimum programme (CMP), ran into troubled waters with Central trade unions expressing their opposition to the game-plan at the outset, in no uncertain terms.

The trade unions, namely INTUC, CITU and AITUC, joined hands with other political party affiliates like HMS and BMS for a united opposition to the common cause. In a joint statement, while demanding that the Government should strengthen the public sector, they have said: "The need of the hour is to take steps to strengthen the public sector, which must also include revival of sick industries."[11]

Opposition Parties at the Centre

The Opposition in the Rajay Sabha mounted a frontal attack on the government over the controversial divestment of the public sector BALCO, alleging that "it was an outright sale and scandalous". Senior Congress member Pranab Mukherjee questioned the very purpose of the divestment of the government's 51 percent equity to private sector Sterlite industries for Rs 551.5 crore when the aluminium giant was making steady progress and profits.

He said that though BALCO was profit making, the government had decided to divest its shares "simply because the Divestment Commission has recommended". He questioned the government's ultimate objective of the disinvestment, whether it was to bridge the revenue gap? He said what they could understand from the budget presented by the Government during the last three years was that money to be realized through disinvestment would be used for reducing expenditure gap but it had failed to achieve the target.

Supporting the Congress, Communist Party of India-Marxist member Dipankar Mukherjee said that the divestment process of BALCO was 'scandalous'. He wondered how the reserve price of Rs 514.40 crore for 51 percent government equity of BALCO could be determined by an executive order. "I feel this (reserve price) has to be decided by Parliament and Parliament alone". Mr Mukherjee also expressed doubts about the highest bid and sought confirmation from the Government.

He asked what the government was proposing to do with the proceeds of the BALCO divestment and why the government was silent on the 270-MW captive power plant in BALCO, the cost of which at today's price would be around Rs 1,200 crore. Dipankar Mukherjee asked the reason for the hurry for the government to go ahead with the divestment of BALCO, saying that the "government should have the courage and admit it was in distress."

Labour Union of BALCO

The Union's position on the deal hinges crucially on the manner in which the valuation has been done. They

[11]*Business Line*, July 18, 1999.

alleged that Sterlite's 51 percent holding would enable it to control BALCO's assets which were in several multiples of the amount it had paid to get the controlling stake. According to Brahma Singh, general secretary of the BALCO's Employees Union, 'the company had fixed deposits that amounted to about Rs 350 crore. The company had invested Rs 200 crore in a cold rolling mill and a sheet caster, which had not even started commercial operations and the government handed the brand new machinery on a platter to Sterlite'; also there were Rs 90 crore worth of saleable material lying on the plant premises. He said that 'Sterlite has now gained access to scrap worth Rs 50 crore, invetory worth Rs 70 crore and raw materials worth Rs 100 crore in the plant'. 'In addition, BALCO's 270 megawatt captive power plant had materials worth about Rs 100 crore on its premises on the day Sterlite took over the company'. Brahma Singh estimated the company's prime real estate possessions in Mumbai, New Delhi, Kolkata and Chennai at Rs 100 crore. The Union leader felt that Sterlite had gained access to assets worth Rs 900 crore. Several experts pointed out that the captive power plant was worth at least Rs 1000 crore even after accounting for depreciation.

The union of the Karba plant thus adopted a tough stand going on strike on the day the controlling stake of the company was transferred to Sterlite. In fact Sterlite had a problem in taking over the possession of the plant. The state government supported the union. Sterlite Group, which took over as the new management of BALCO, had asked the striking employees unions for a meeting at New Delhi to negotiate with them in order to resolve the problem. But, the seven striking employees' union after the meeting, informed the management that it was not possible. They also turned down the proposal of the management saying that the discussion was only possible at Karba.

Besides, the seven unions, under the banner of the Samiti, are on strike demanding return of BALCO to its orginal public sector undertaking status.

INVOLVING THE SUPREME COURT

The Supreme Court, upon an urgent application filed by the Union Government, directed the Chattisgarh government to protect the workers and officers of the plant who wish to resume work, it also directed the state government to ensure that essential supplies were not disrupted to those inside the plant. The opposition parties charged it with attempt to breaking a peaceful strike by going to court on 'false premises'. Shourie claimed that the government sought the court's intervention because it feared sabotage and 'imminent danger' to the plant and breakdown of law and order in Karba in view of the inflammatory statements made by political leaders of Chattisgarh.

[12]IndianExpress.com(Business News Archives)

A FEW OTHER IMPORTANT ISSUES

The contention of the state government, the opposition parties and the union raise the following contentious issues on the disinvestment process of BALCO:

- Constitutional provision not allowing private parties to buy land or construct plant in tribal areas
- The question of valuation of assets
- Transparency of the disinvestment process
- State government denying the infrastructure facilities like power and roads to plant other measures like increase in royalty for mining, taxes and levies.
- The bidding system to be followed
- The purpose to which disinvestment proceeds will be put
- How employee interest will be addressed

STERLITE'S VISION FOR BALCO: GLOBAL PLAYER, MODERN TECHNOLOGY

As per Sterlite Group chairman Anil Agarwal, the company planned to take several initiatives to make Bharat Aluminium Company Ltd. (BALCO) an international player with most modern technology. According to him, "BALCO employees would be given incentives and stock options to improve output and efficiency. Sterlite also plans to make large investments to modernise the plant, increase production capacity and increase generation of captive power."[13]

[13]See *Financial Express*, Feb. 25, 2001

Mr Agarwal was of the view that BALCO would go public at a later state to part-finance its expansion and modernisation programme. "Once we get into the company and decide on the funds required, we will work out the mix of debt and equity. BALCO will go public," he said. His first priority was to cut BALCO's production cost from Rs 73,000 per tonne to about Rs 60,000–62,000 per tonne, which was the present production cost of its group company Madras Aluminium Company (MALCO).

According to Mr Agarwal, BALCO's net profit could be increased from the current level of about Rs 60 crore to around Rs 100–125 crore with the existing set-up and without making major fresh investment. According to him, going by Sterlite's experience with MALCO, a joint venture of Tamil Nadu government acquired in 1995–96, he did not foresee any retrenchment of BALCO's work force. "All this talk about us retrenching BALCO people is nonsense. We did not retrench even a single person in MALCO, in which Tamil Nadu government had a majority stake before we it took over. On the other hand, there was an increase in employment as a number of ancillary units came for supply of inputs,"[14]

About his vision for BALCO, Mr Agarwal said, "Sterlite has not acquired BALCO to keep it as it is. We will invest a lot of money and make it a world class aluminium producing company with most modern technology,"[15]. He declined to comment on the Chattisgarh chief minister Ajit Jogi's threat to cancel BALCO's mining lease post-privatisation but said that increase in BALCO's production and expansion of its production capacity will bring much higher returns for the state government by way of sales tax and mining royalty income.

Expressing his views on valuation of Rs 551.5 crore was a high price for BALCO's 51 percent stake when Hindalco's bid was reportedly much lower, Mr Agarwal said "HINDALCO is already a large player and Sterlite wanted to add a large capacity to its existing aluminium producing capacity." And so his valuation included a premium for that. According to him just as India has an advantage in software, it has an edge in aluminium industry as it is cheapest aluminium producer due to easy availability of the raw material, bauxite.

[14]Ibid

[15]Ibid

FUTURE CHALLENGES AND OPPORTUNITIES

Where would BALCO go from Here?

The new management faced a tough task of resolving a strike which is supported by the government of the state. In addition to managing the strong workforce of the PSU era, Sterlite also faces a tough task of managing a company that is among the *most expensive producer of aluminium in the world.*[16] Every tonne of aluminium produced by BALCO cost Rs 75,000; in contrast, it costs HINDALCO just Rs 46,000 per ton. Agarwal, who thinks India is the best place to produce aluminium for global markets, hopes to make a beginning by slashing BALCO's production costs (cf. Annexure IX).

Also there are questions about the capability of Sterlite running large metal plants and reducing production costs going in for retrenchments. However, the Sterlite Chairman was optimistic. He said "we faced something similar when we took over MALCO, but managed to up productivity and profits without retrenching anyone. "For the record, MALCO was raising capacity to 49,000 tpa from 33,000 tpa.

Problem of Resources

Before the Rs 552 crore BALCO acquisition, Sterlite had cash resources of about Rs 360 crore. Of this, about Rs 300 crore was used for BALCO acquisition, with the balance coming from borrowings.[17] Sterlite may thus face cash crunch implementing the restructuring plan at BALCO. The company had a health D/E ratio of 0.6 before the acquisition. This problem may further be aggravated considering the ban imposed by SEBI on Sterlite, barring it from accessing the capital market for two years. This ban imposed by SEBI is for alleged involvement of the company in manipulating its shares. This development may also lead to fresh outcry from the few stakeholders opposing the BALCO deal (cf. Annexures VI and VII).

The Central government has incorporated a three-years lock-in period in its agreement with Sterlite, banning it from selling any of its 51 percent stake in BALCO during the period. However, government planned to offload a part of its 49 percent stake to the public.

[16]*Business Today*, March 21, 2001

[17]*The Economic Times*, April 21, 2001

appendix | 1

Chronology of Events Leading to Disinvestment of BALCO

1. Bharat Aluminium Company Ltd. (BALCO) was one of the first companies to be referred to the erstwhile Disinvestment Commissioin, in 1997 by the government. It was among the 12 public sector corporations taken for disinvestment in the phase of the 24 corporations.

   Incorporated in 1965, BALCO has a unit at Korba in Bilaspur district in Chattisgarh and another unit a Bidhanbag near Asansol in West Bengal. It is a profit making PSU although it's PAT is coming down: from Rs 60 crore to an expected figure of Rs. 23 crore this year.

   The erstwhile Disinvestments Commission had 4 years back in 1997 recommended that the government should immediately divest 40 percent its equity in BALCO to a strategic partner, foreign or domestic, through a transparent and competitive global bidding process, with an agreement to reduce government holding to 26 percent through public issue in two years.
2. June 15, 2000: Government of India invited bids from strategic partners for sale of 51 percent stake along with management control in the second largest public sector aluminium company, BALCO. Jardine Fleming was appointed as global advisors to the government for privatisation of BALCO.
3. July 7, 2000: Seven companies including US-based Alcoa and Aditya Birla group company HINDALCO, Kaiser, Sterlite, BWA of Germany submitted Expressions of Interest and technical bids to takeover BALCO.
4. Oct 10, 2000: Three firms, HINDALCO of Aditya Birla group, Sterlite Industries India Limited and US-based Alcoa are selected for final bidding. The three companies expected to start the process of undertaking the due diligence exercise.
5. Jan 21, 2001: The government decides to call financial bids for the sale.
6. Feb 4, 2001: The board of directors of BALCO approve writing off nearly ten percent of its equity prior to privatisation. The authorised capital of the company is Rs 500 crore. As a result, BALCO's paid up equity capital will stand reduced to Rs 220.62 crore down from the previous Rs 244.42 crore.
7. Feb 13, 2001: The Government appointed licensed evaluators for undertaking a valuation of the assets.
8. Feb 16, 2001: The Government states that it will open the final bids for the disinvestment of majority stake in BALCO and will take a final decision, taking into account the prices offered by the bidders and their business plans. Alcoa repairs from the final bids.
9. Feb 21, 2001: The Government announced to sell its 51 percent equity in BALCO to Sterlite Industries for Rs 551.5 crore on Feb. 26, after it won the race for the profit maing PSU, beating HINDALCO of AV Birla group.
10. Feb 22, 2001: The Government came under intense criticism from the opposition parties in Parliament which accused the Government of selling BALCO "for a song". The Government strongly defended the sale of BALCO. The Opposition demanded a freeze on the transfer of assets to Sterlite till the deal was debated and cleared by both the Houses of Parliament.
11. Feb 23, 2001: In a bid to placate the Opposition in Parliament, the Government contemplates to defer the signing of BALCO sale papers till a debate takes place in the Parliament.
12. Feb 24, 2001: The Government sought the resignation of the three functional directors of BALCO as part of its pre-signing formalities for sale of 51 percent stake to Sterlite Industries.
13. Feb 26, 2001: The Government adopts a strict line on the disinvestment process. The Center does not take Chattisgarh Chief Minister Ajit Jogi's threats to cancel BALCO's mining lease in case the Centre does not reconsider decision to sell majority stake to Stelite at a 'throwaway price', seriously. Disinvestment minister, Arun Shourie ruled out a joint parliamentary probe (JPC) into BALCO divestment in the Rajya Sabha, saying that strictest of norms were followed for all procedures, including the all-important valuation of the company.

The Union Government has also incorporated a three year lock-in period in its shareholder agreement with Sterlite barring it from selling any of its 51 percent stake in BALCO during the period. However, the Government plans to offload a part of its 49 percent stake to the public and offer part of it as ESOP. The advisor to Sterlite on the disinvestment has been ICICI Securities, who were also advisors to HLL in case of disinvestment of Modern Foods.

14. Mar 1, 2001: Lok Sabha endorses the BALCO deal. The Opposition charged the Government in the Lok Sabha on Thursday with perpetrating a "fraud" on the nation by selling its equity in the Bharat Aluminium Company (BALCO) at a low price in a "clandestine" manner. The opposition termed the BALCO deal as "sell off" of the company by the Governement saying that the company is worth much higher than the price offered by Sterlite. The Opposition disagreed with the whole privatisation policy of the Government. The Government then opted for a vote in the house. The calculation was that an endorsement could come in handy for taking the privatisation process further. Finally the Government emerged as the winner.
15. Mar 2, 2001 : A day after getting Lok Sabha's endorsement for the Bharat Aluminium Company deal, the Governement sold it's 51% equity in BALCO to Sterlite Industries for Rs 551.5 crore. The Supreme Court halted proceedings in the lower courts on petitions challenging the privatisation of state owned Bharat Aluminium Company Ltd. The employee union called for a strike supported by the state government and about 6000 workers of the Korba plant strike work for an indefinite period.
16. Sterlite hands over a cheque of Rs 551.5 crore to the Government after signing the shareholders' agreement and share purchase agreement. The shareholder agreements and share transfer agreements were signed by Aruna Bagchi, Joint Secretary, Ministry of Mines, on behalf of the Government, S.C. Tripathi, Additional Secretary, Ministry of Mines and the Chairman and Managing Director BALCO on behalf of the PSU and Mr Tarun Jain, Director (Finance), for Sterlite Industries.

exhibit Comparative Performance Analysis

(Rs in crore)

Sales					
Company Name	1996	1997	1998	1999	2000
Bharat Aluminium Co. Ltd.	692.23	762.1	857.19	877.21	1903.44
HINDALCO Industries Ltd.	1424.17	1316.32	1671.91	2014.53	2309.37
Indian Aluminium Co. Ltd.	1179.19	1152.13	1156	1144.09	1167.99
National Aluminium Co. Ltd.	1751.92	1786.07	1866.58	1588.92	2234.53
PAT					
Company Name	1996	1997	1998	1999	2000
Bharat Aluminium Co. Ltd.	163.33	61.79	79.84	76.32	55.87
HINDALCO Industries Ltd.	401.14	390.3	496.21	566.78	612.37
Indian Aluminium Co. Ltd.	111.73	59.19	71.37	76.36	83.94
National Aluminium Co. Ltd.	614.56	491.76	546.96	248.25	511.53

appendix | 2

List of PSUs Approved for Disinvestment & Names of the Advisors Appointed[18]

Company	Advisor (nature of entity)
1. Air India	JM Morgan Stanley (Indian-Foreign joint venture)
2. CMC Ltd.	KPMG India Private Limited (Indian subsidary of foreign investment bank)
3. Hindustan Copper Ltd.	IDBI (Indian)–Sumitomo Bank (foreign)
4. Hind. Insecticide Ltd.	A.F. Ferguson (Indian subsidiary of a foreign investment bank)
5. Hind. Org. Chem. Ltd.	A.F. Ferguson (Indian subsidiary of a foreign investment bank)
6. HTL Investment Bank	KPMG India Private Ltd.
7. Hindustan Zinc Limited	BNP Paribas (foreign)
8. Indian Airlines	IDIBI (Indian)-ANZ Grindlays Bank (Indian subsidiary of a foreign investment bank)-Speedwing (foreign)
9. IBP Ltd.	HSBC Securities & Capital Markets (I) Ltd. (Indian subsidiary of a foreign investment bank)
10. IPCL	Warburg Dillon Read (Foreign investment bank)
11. ITDC	Lazard India Ltd. (Indian subsidiary of FIB)
12. Madras Fertilizer Ltd.	ICICI Securities (Indian)-Bank of America (foreign)
13. Maruti Udyog Ltd.	To be appointed.
14. Metal Scrap Trd. Corpn.	Disinvestment process yet to begin
15. Min. & Metals Trd. Corpn.	Disinvestment process yet to begin
16. National Fertilizers Ltd.	Rabo Finance Private Ltd. (Indian sub. of FIB)
17. Paradeep Phospht. Ltd.	Deloitte Touche Tohmatsu India Pvt. Ltd.
18. Sponge Iron India Ltd.	A.F. Ferguson (Indian subsidiary of FIB)
19. State Trading Corpn.	Disinvestment process yet to begin
20. VSNL	SBI Caps Limited (Indian) & CS First Boston (Foreign)
21. Bharat Hvy. Plts. & Vessels	S.B. Billimoria (Indian co.)
22. Bharat Pumps & Comp	SBI Capital Markets Ltd. (Indian co.)
23. Hindustan Cables Ltd.	ICICI Securities (Indian co.)
24. Hindustan Salts	SBI Capital Markets Ltd. (Indian co.)
25. Instrumentation Ltd.	IDBI (Indian co.)
26. Jessop & Co.	A.F. Ferguson (Indian subsidiary of FIB)
27. NEPA Ltd.	SBI Capital Markets Ltd. (Indian co.)
28. Praga Tools	None
29. Scooters India Ltd.	Price Waterhouse Coopers (Indian subsidiary of FIB)
30. Tungabhadra Steels	IDBI (Indian co.)

[18]www.ciionline.org, Department of Disinvestment, Presentation, May 2001

case | 7

The BPO-ITES Industry

Challenges for Sustaining India's Global Leadership[1]

THE BEGINNINGS

Mr. Kiran Rao—India's chief of National Association of Software and Services Companies (NASSCOM), the apex national association of software and services providers—went through the following report that had apparently blown the issue of outsourcing to affect even the Presidential elections of the most powerful economy in the world. Given India's peculiar position in the midst of it all, he wondered how quickly the scenarios changed. So just a few years ago, the BPO industry had started its infant steps in India; now in a span of less then five years its success had grown to become such a gigantic issue at the global level.

US Presidential Elections 2004 *Political Divide on Outsourcing* (01. 04. 2004). *Presidential elections for a sitting president in US is a referendum on his policies. The electorate may like the current policies and re-elect him (one time only) or reject him. One issue, which affects India economically, has become the focus of the presidential election debate in 2004. That issue is BPO outsourcing to India (and also elsewhere). The media led a campaign against it and have forced this issue to the centerstage. Now the incumbent, President Bush, alarmed by sudden publicity blitz mounted by the media and the Democratic Presidential candidate (to be) Senator John Kerry has found himself backed into a corner. Both the print and the electronic media have widely covered the merits of this issue. Still the raging debate is focusing on loss of office jobs from mainland America. The debate, currently, is ignoring the benefits.*

Mr Rao looked at some of the other headings and news items clipped on the board in his office. Some of these were interesting and held their own glimpses about the future trends on this yet fledgling but high potential industry.

Global firms hasten march to India back-office (*The Economic Times*, April 16, 2002). K. Rao remembered how the offshoring wave was started first in 1994 by the then small software firms like Infosys, which stressed primarily on process offshoring. Hospital transcription for insurance claims for US clients was a major activity in India at that time. The major boost came in 1999 with the incoming of global major firms including GE, Citibank, Amex and British Airways. This triggered the emergence of BPO for the first time in India.

ICICI sets up ICICI OneSource for BPO, Buys CustomerAsset (*Financial Express*, May 28, 2002). Then came a phase of global economic slowdown from 1999 till 2002 and people believed that BPO was no more than just a rising wave which had slowed down and will not be able to take the gigantic shape it was expected to. Still the era was marked by the entry of many more players in the BPO industry like Spectramind, Daksh, ICICI OneSource, HCL, etc. The boom in BPO presented Indian firms with a unique opportunity in a manner similar to the Y2K opportunity.

[1]Case by Professor Arun Kumar Jain, Alekh Tiwari, Anshu Karwa, Sudeep Mathur (all of Indian Institute of Management—Lucknow) for the purpose of classroom discussion only. Copyright 2005, Arun Kumar Jain.

Nasscom McKinsey analysis projects revenue of USD 64 billion for ITES by 2012 (*The Economic Times*, August 21, 2003). The next and the most vibrant phase in BPO commenced somewhere around mid-2002. A Nasscom-McKinsey study project that BPO was going to become one of the key growth areas for Indian technology services companies. Client firms were trying captive models, hybrid models, joint ventures, and even entering into BOT contracts with Indian ou tsourcing providers.

Rao was encouraged as he glanced through some more headlines:

Hotel Industry grad? BPOs want you (*Indiatimes News Network*, December 15, 2004).
Hitching on to the BPO bandwagon (*Times New Network*, April 29, 2002)
EXL soon to be listed on Nasdaq (*The Economic Times*, December 15, 2004).
Human Resources: On the Ascent *"The BPO industry in addition created about 80,000 new jobs during the year and now hires 249,900 people. Together, the IT and BPO industry hire 684,900 people–arguably the fastest growing job market in the country. This year saw a growing demand for domain skills, team leader and middle management experience even as good old English continued to top the demand charts"*.

Rao attributed India's BPO success to the trained manpower which was created during the mid-1990s due to the Y2K boom. Projects executed at that time had successfully and uniquely positioned India to meet complex international demands for software. He realized that within a short span of five years, the BPO industry in India had matured to a level to which several other industries had taken decades to reach.

Coming back to the present global scenario amidst the rising backlash and competition from other developing countries, Rao wondered how the BPO industry would have fared if the incumbent of US Presidential office decided to turn the screws on offshoring of US jobs. The industry had come a long way in India, but the future was challenging and full of uncertainties. He kept wondering about these issues and sat down to list some of the benefits that Indian companies presented to the Western world clients compared to other nations:

- Cost reductions leading to better shareholder value and superior competitiveness
- Improved service quality
- Superior competency
- Access to leading technology
- More freedom to focus on strategic activities
- Shared business risks

Once through with this elementary analysis, Rao felt he had to strategically think through the entire edifice on which the BPO-ITES industry was built, the reasons for its rapid globalization, the emerging industry trends, and finally what it would require to sustain India's position as a preferred destination for business process outsourcing. He called in his staff to make a presentation on these issues.

STRATEGIC REVIEW OF THE BPO INDUSTRY

Rao's staff began the presentation, beginning with the definitions.

Business Process Outsourcing is the act of transferring some of an organization's repeated non-core and core business processes to an outside provider to achieve cost reductions while improving service quality and increasing shareholder value. According to the Gartner Group, Business Process Outsourcing is the delegation of one or more *business processes* to an *external provider* who, in turn, *owns, administers, and manages* the selected process(es), based upon *defined and measurable* performance metrics to *improve overall business performance*.

Outsourcing has its conceptualization roots in the David Ricardo's comparative advantage theory. However, the definition of outsourcing has undergone a sea-change in the past few decades. What started off as a shift of manufacturing to countries with cheap labor during the Industrial Revolution, has taken a new connotation in the post-Industrial Society scenario.

New networking technologies had made it possible for global companies to seek the lowest cost solutions from anywhere in the world for all the activities that could be digitized. Companies could outsource their non-core functions such as human resources, finance and accounting, customer relationship management, IT services, etc. to a third party mainly to be able to focus their resources on their core activities and hence, reduce their operational costs.

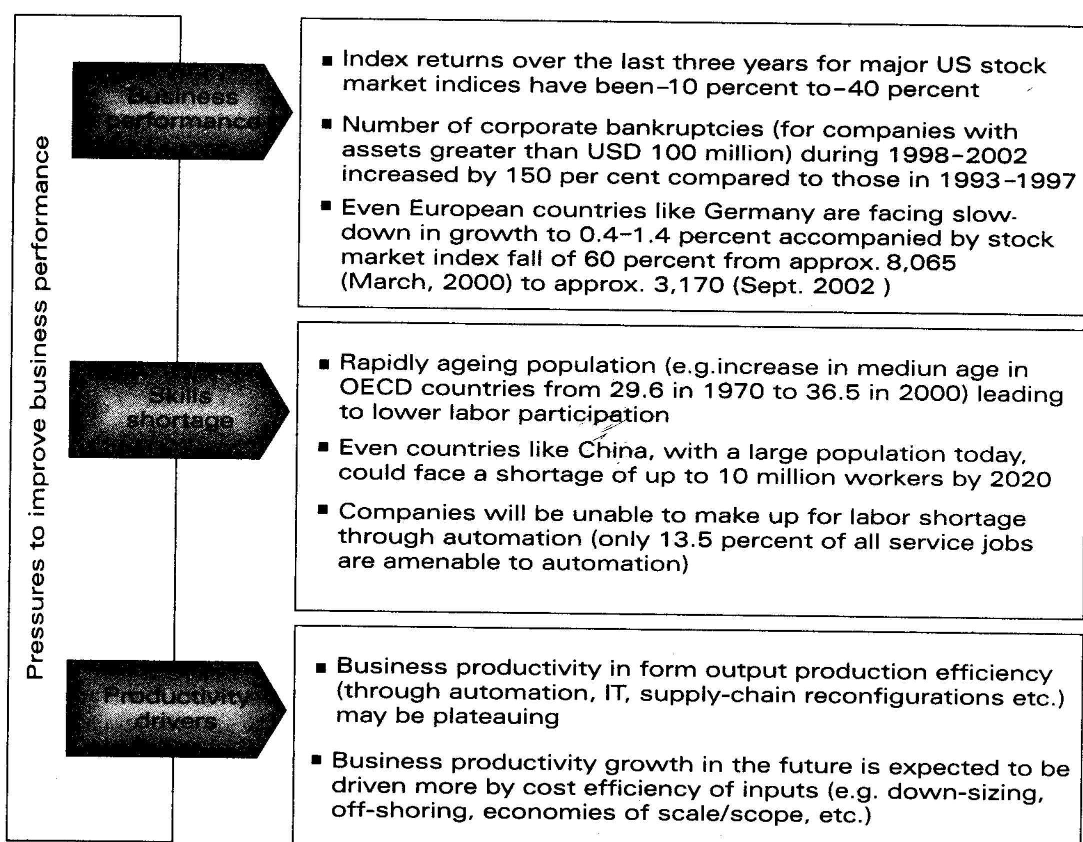
The business rationale behind BPO was that outsourcing saves money and focuses scarce management time and resources on a few core competencies. The real reason behind the surge in BPO was that companies were becoming increasingly demanding towards value-added services. Clients want to see, and have come to expect, transformational changes from their outsourcing efforts—from changing how human resource function was managed to changing the way the supply chain operates. The ultimate goal was to link business performance to increase business value.

The Changed Thinking in 21st Century—The Pressures on MNCs

Rao asked his associates to cut through the clutter. They went ahead and highlighted the pressures global companies faced in the 21st century business paradigm (Exhibit 1).

exhibit 1 Reasons for companies offshoring their processes

Companies world-wide are faced with increasing pressures to improve business performance...



Source: Press reprts, BCG, NASSCOM KPMG, 2003-2004.

... even as overall budgets get reduced

Classifying the Industry

IT Enabled Services-Business Process Outsourcing, (ITES-BPO) could broadly be categorised, into two major components, viz.:

(i) The sectors or verticals (manufacturing, ICT, energy, financial services, technology, energy, government and public sector, retail and transportation, leisure and tourism, health sector); and,

(ii) The service lines or process areas or horizontals. These are primarily categorized into there main sub-categories and sub-processes (Exhibit 2):

Although used interchangeably, there is a marked difference between BPO and IT services outsourcing. BPO involves an entire end-to-end process, not just a task, as is often the case with IT outsourcing.

SERVICES OFFERED UNDER BPO

Offshoring opportunities for BPO-ITES players exist both across a wide range of processes as well as across multiple verticals. The various types of services currently outsourced to India could be structured as in Exhibit 3:

Top three service lines: Customer Care, HR and Administration constitute about 70% of the long term ITES potential. Banking and insurance (within financial services) were likely to provide the maximum opportunity driven by the high cost base and high extent of offshorable processes in these verticals. Medical BPO, too, was emerging as an attractive opportunity and large healthcare companies have set up Medical BPO facilities. In addition, the verticals offer large opportunities (Exhibit 4):

exhibit 2 **BPO Service Lines**

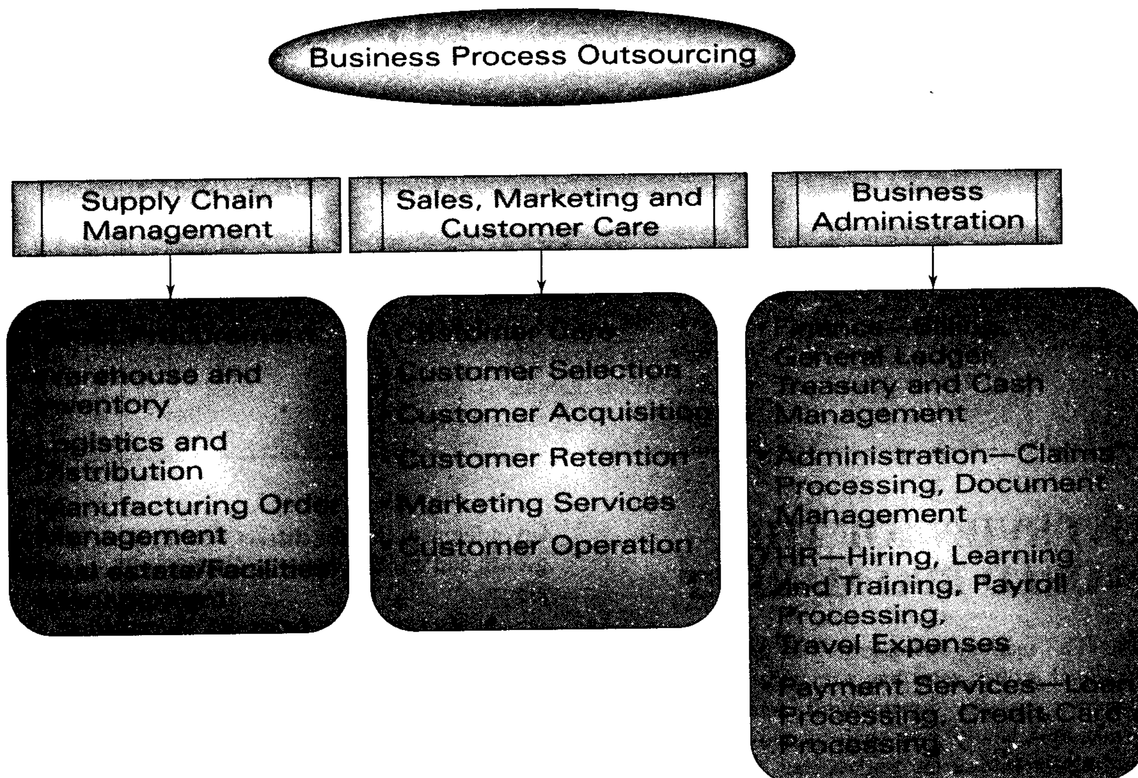


exhibit 3 **BPO Service Offerings**

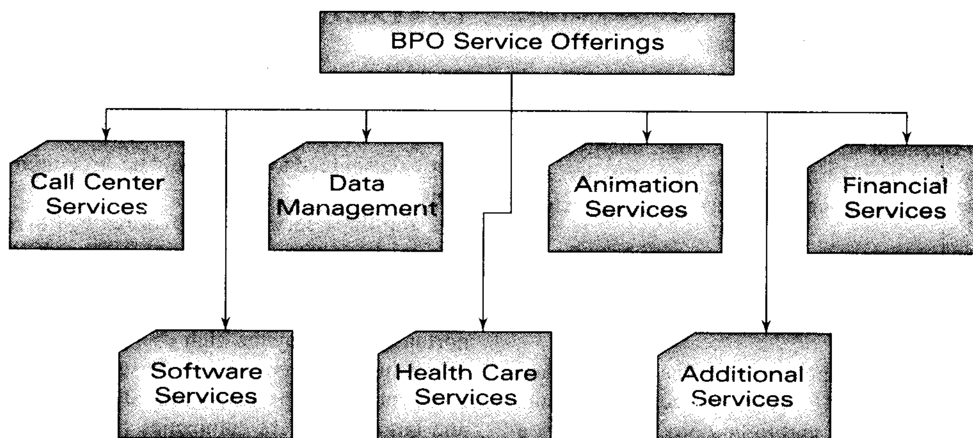


exhibit 4 **ITES opportunities across key verticals**

Vertical	Key opportunity areas
Insurance	• Claim processing • Servicing • Call Centre operations
Retail Financial Services/Retail Banking Services	• Loan Processing • Call Centre Operations
Pharmaceuticals	• Research & Development
Telecom	• Call Center Operations • Billing
Automotive	• Engineering and Design • Accounts Payable/Receivable
Airlines	• Revenue Accounting • Call Centre Operations • Frequent Flyer programmes

OVERVIEW OF THE WORLD BPO MARKET

The ITES market, owing to its vast potential and exceptional growth rates has attracted the attention of business research organizations across the globe. While each has its own analysis and assessment regarding the size of the market, they all agree on one key inference, that the market was heading for rapid growth and was capable of generating millions of new jobs.

Another survey estimates that the worldwide BPO market is likely to grow at an annual rate of 9 percent to touch USD 1 trillion by 2006 from USD 773 billion in 2002. The survey predicts that the BPO industry in India would grow at 54 percent annually for 2002–2006 from USD 2 billion 2002 to 12 billion in

2006. Focus on customer satisfaction and a constant thrust to improve the existing client servicing levels help the companies to capitalize on this opportunity. In addition, strong partnering and alliance strategies were crucial for satisfactory service delivery.

However a study by Gartner on the emerging BPO market shows that by 2005 the number of outsourced business processes will have doubled as compared to the existing numbers. The study shows that BPO industry was centered on the US market which in revenue terms accounted for US $70.6 billion of the overall industry. The trend is likely to continue till 2005 as the US is expected to outsource US $135.9 billion worth of business. The Gartner study also indicates that Europe, Asia Pacific, Japan, Canada and rest of the world will account for the remaining contributions.

Another Gartner study shows that in terms of the processes being outsourced, Human resources lead the way with an existing share of US $33.4 billion (out of a total US $119.4 billion). Supply chain management, payment services, sales, marketing and customer care, finance and accounting and administration are the other contributors. This trend is likely to continue until 2005 with the mix remaining the same.

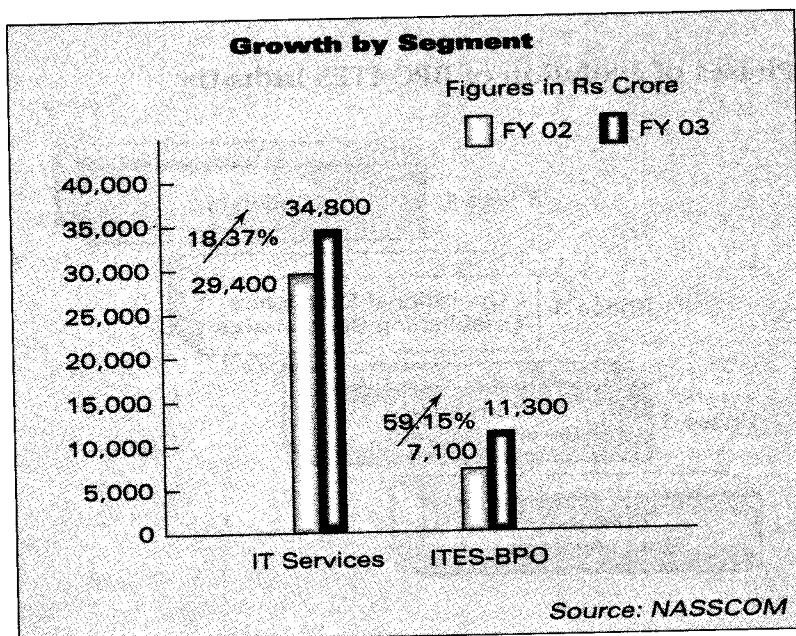
THE INDIAN BPO INDUSTRY

The IT industry in India began as a domestic industry and eventually spread to international markets. The BPO business, on the other hand, started with a strong export focus. While this industry began with a few key foreign investments in Bangalore around IC design, the real momentum arose from the immigration patterns of individuals and the offering of skilled labor via "body shopping" to firms in the US. The driver of this—consistent with the constraints of software development—was not labor cost, but access to skilled-labor.

Declining enrollments by US citizens within engineering professions, the increasing expansion of foreign enrollments at US universities, the growth of US demand, and the limits on Indian domestic industry opportunities combined to create a demand for new sources of skilled-labor for the US software industry. The growth of Indian IT and BPO sectors across the years is provided in Exhibit 5.

With the rise in quality of the offshore environment, improved management capabilities and new gov-

exhibit 5 **IT/ITES growth during 2002 and 2003**



Source: www.nasscom.org website accessed on 26, Dec 2004

ernment policies tailored specifically for software, the shackles towards foreign investments in India were loosened. Global firms began to locate development centers within India to access the highest quality labor at the lowest search and employment cost. The combination of these trends—maximization of cost savings, access to labor at the source, and the benefits of agglomerated production—underpinned the emergence of new regional sites of software within India.

The mid-1990s witnessed the rise of new centers of software development, beyond Bangalore, most importantly Hydrabad, and Andhra Pradesh. Successful BPO companies understood the need to invest in quality and consistency at early stages using tools such as Six Sigma, COPC, and ISO. India became world class with respect to many of these operational measures.

The ITES-BPO sector steadily increased its share, in total revenue of India's IT software and services industry, rising from 6.5 percent in 1998–'99 to an estimated 29 percent by 2004. It grew by 46 percent in 2003–'04 to $3.6 billion and currently employs around 250,000 professionals. It was expected to contribute 37% to the revenues of Indian IT software and services industry by 2007. Global clients save costs in the range of 40–60 percent depending on the process 'offshored'.

FOUR PHASES OF INDUSTRY EVOLUTION

The evolution of BPO-ITES industry can be classified as follows in four phases (cf. Exhibit 6).

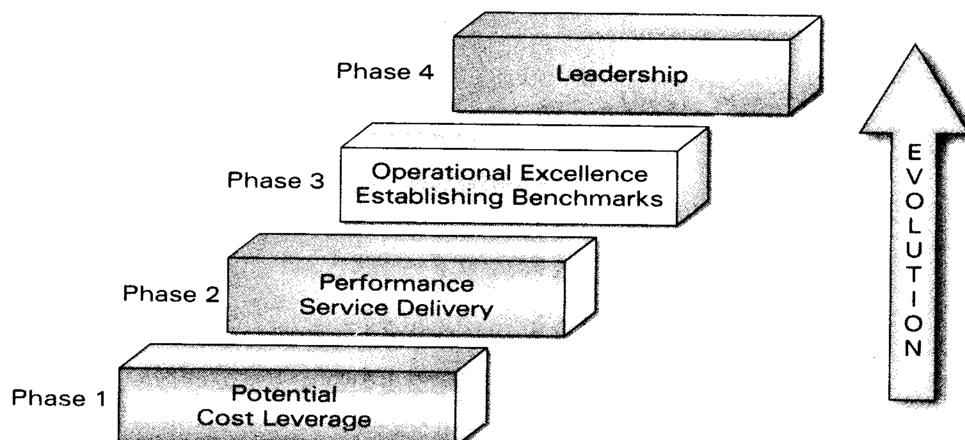
Phase I: Potential-Cost Leverage

Labor arbitrage has been one of the key drivers for business outsource in India. This is why the initial buyers came, and still come to India. This is geo-economics at play.

Phase II: Performance Delivery

After the honeymoon period is over, buyers start taking a hard look at the impact of outsourcing relationship on their end-customers. This phase is about delivering customer satisfaction through responsiveness and quality, which is why buyers stay.

exhibit 6 **Phases of evolution of BPO-ITES Industry**



Adapted from QAI Nasscom Survey, Nov. 2004

Phase III: Operational Excellence

This phase is about delivering performance at global efficiencies. This would institutionalize success.

Phase IV: Leadership

Using innovation and technology to create entry barriers.

At this point, Rao took a break to mull over the presentation so far. He thought that the Indian ITES-BPO industry was predominantly in Phase II of evolution cycle (i.e., it was still moving from the Potential to the Performance phase). He realized that the Indian ITES-BPO firms had now started looking beyond contract fulfillment to identify opportunities for delivering high quality service to end-customers. Indian firms were also conscious of the need to align internal systems to ensure higher levels of client satisfaction. These were the building blocks for future successes adn for moving on to the Phase III and IV levels.

WHAT MAKES INDIA GLOBALLY COMPETITIVE IN BPO-ITES INDUSTRY

India and Ireland surpass all other competitors in terms of employment, number of companies sourcing ITES and the spectrum of verticals and services lines it offers. India is the largest ITES player in the world in terms of manpower and has the potential to generate direct employment for one million by 2008. India, in particular, is witnessing rapid growth due to its cost advantage, the early success achieved by the reference of light house customers and government initiatives implemented to improve location attractiveness.

The manpower cost in India is around 70 to 80% less than in US and UK. Salaries in the US are still, on an average, nearly 10 times higher than those in India ($80,286 versus $8,593).

India's proposition was based on the availability of a significant pool of appropriately skilled and trained resources at a competitive price. It was driven by:

- Availability of appropriately skilled resources
- Lower cost of manpower (1/5th to 1/10th) and
- Ability to generate better quality of work, more efficiently

There are examples of companies with off-shored services being provided from India which have improved service levels by 5–10 percent across different parameters like customer satisfaction, response time, accuracy, speed, etc.

Another compelling rationale for IT-enabled service companies to base operations in India was that it allows them to capitalize on time zone differences and provide services round-the-clock each day of the week.

The comparative chart for various countries and the relative ranking on the various relevant parameters were as follows (Exhibit 7).

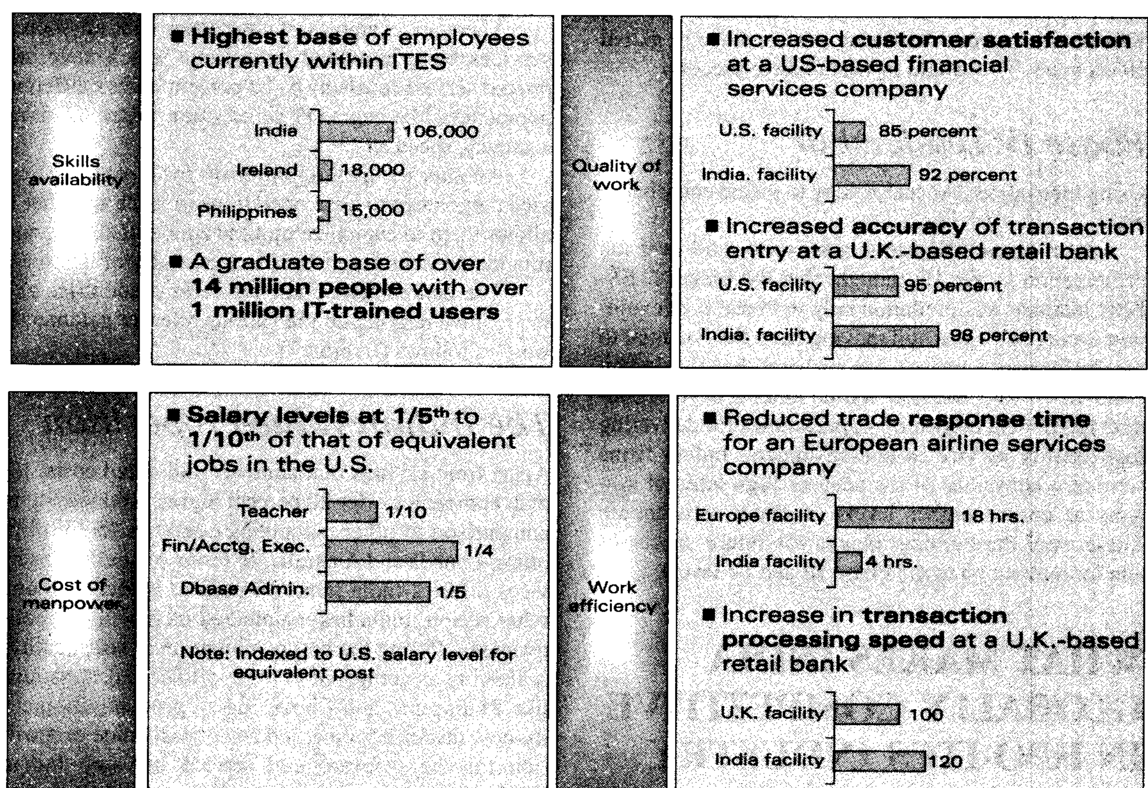
The Indian Value-Proposition

Apart from savings in manpower and allied costs, Indian companies offer 20 percent higher productivity in comparison to other competing countries like Philippines, Canada and Australia. In terms of quality of services offered, India ranks 30 percent higher than any other region. India has maintained its global competitiveness, offering the best combination of cost-quality-scalability as compared to other off-shore destinations like Philippines and China. Indian productivity-quality-cost model has emerged as optimal value proposition for the software and service industry. Indian ITES-BPO companies ware adopting global quality standards like Six-sigma, COPC and ISO 9001.

India had quickly emerged as a leader in the field of IT-enabled or remote services. The country's competitive advantage in providing these services is well known: cost effectiveness, world-class quality, high reliability, and rapid delivery, all of it powered by state-of-the-art technologies. Apart from these advantages, India offers:

- A huge pool of English speaking and computer literate graduate manpower which can continue to cater to the growing demand for professionals for IT-enabled Services
- Cost of qualified personnel is amongst the lowest in the world
- Income tax holiday till 2010 for export IT-enabled Services
- Favorable and stable legislative and economic framework

exhibit 7 **Comparative matrix showing relative strengths**



Source: NASSCOM, KPMG, 2002-2003

- Support of Government of India for all IT-led industries
- Many State Governments in India offer special incentives and infrastructure for setting up IT-enabled Services
- Thrust by Government of India to make India an IT-driven nation with a focus on services sector where potential for addition, and thus premium, is higher.

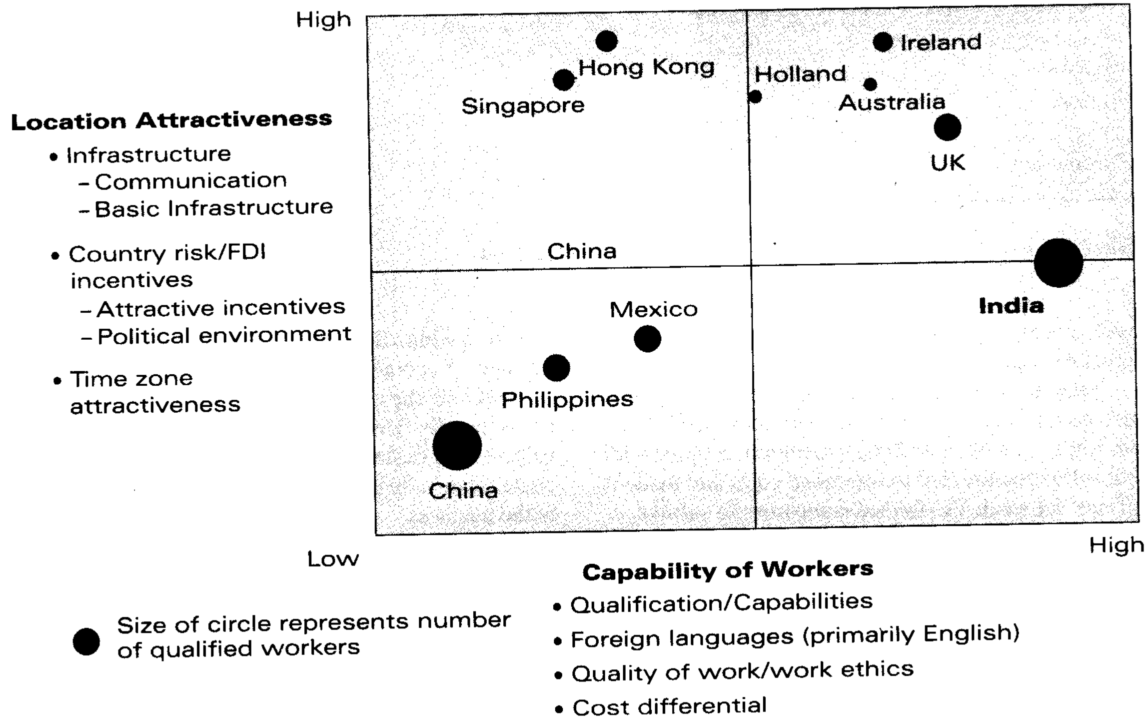
Exhibit 8 provides a map of India's advantages vis-à-vis other countries. The location attractiveness and capability of the workers are on the two axes.

MAJOR WORRIES FOR THE INDIAN BPO-ITES INDUSTRY

Reckless Start-ups

Although the BPO Industry promises huge profits and potential yet a vast majority of the 310 start-ups are headed for a dead-end was alarming news. According to industry research, the capacity utilization of these firms was less than one of the three shifts. These companies have driven down prices to grab

exhibit 8 **Location/Capability of workers**



Source: NASSCOM-McKinsey Analysis, 2002

business, but have failed to deliver. Moreover they do not show much acumen towards people, processes or technologies—the three key elements of the BPO business.

Poor Infrastructure

Another major concern was poor infrastructure. Although state of art technology was used for telecom networks, getting a connection still takes up to three months. Unreliable power supply was forcing units to create their own back-ups. In terms of roads and airports also, there was a dire need of repairs and upgrades.

High Attrition Rates & Rising Aspirations

A major problem was the high attrition and growth aspirations of the workforce. At the end of March 2004, Indian BPO industry employed around 245,100 people compared to 171,000 last year. The industry witnessed a hiring growth rate of 40–42%. At least 60,000 of the 171,000 workforce changed jobs within one year. Thus such an attrition rate clubbed with the high hiring growth rate seemed a matter of concern. Looking at the value chain, attrition rates were much higher at the lower end of value chain (like call centers) compared to the higher end (like engineering). Similarly, attrition rates in non-voice

exhibit 9 **Attrition rates in BPO-ITES industry across the globe**

Attrition rates	%
US	42
Australia	29
Europe	24
India	18
Global Average	24

**Source*: Times News New York (2003), accessed on 26, Dec 2004

based processing was much lesser compared to voice based processing (cf. Exhibit 9).

Team leaders wanted to quickly become supervisors, quality professionals or operations heads. The growing aspiration of a young generation, coupled with poor infrastructure, led to increased costs and made it difficult for small VC-funded companies to survive.

Other Challenges

As the Indian BPO industry climbed the maturity curve, it realized that some of the factors that led to its success in the past may not be relevant to be a winner in the future.

Over-dependence on the voice business

Voice business is the major revenue earner of BPO companies. Presently, upwards of 60% of the BPO business coming to India is voice-related, and over-dependence on the voice business could actually lead to disaster. For instance, HCLT BPO had 90%, EXL 75%, Wipro Spectramind 80%, and Daksh had 70% of its BPO revenues from voice business.

Cost Pressures The main reason for this is the fixed costs of the voice business, like dialer running and maintenance, bandwidth costs, employee wages and related expenses. Of these, dialer running and maintenance alone cost $1.5 per person per hour.

Yet, intense competition was driving down prices. Price is crucial as employees on voice processes are paid 12–15% higher wages than their non-voice colleagues. That's because the odd hours and stress has caused an attrition rate of 40–45% among voice employees as against 30–35% for non-voice work. This increases recruitment and training costs. An estimate of Rs 45,000–50,000 is spent on training an agent and if he leaves within three to five months, it increases overall costs of operations.

Second, the overall costs of BPO operations were rising rapidly. Unless Indian firms graduate to more value-added business—or contain costs—they will become financially unviable given the rock-bottom prices in the business.

For non-voice work, like transactions processing, a company billing below $6 will be unable to recover costs. So, if small players desperate for deals want to survive, price cutting will only lead to quicker end.

The weakening dollar added to cost pressure. Added to this, for some companies, especially the ones into technology help-disk operations, customer acquisition cost run to about 10–15% of the revenues.

Lack of Managerial expertise The third factor is the lack of managerial experience in dealing with large > $100-million contracts. In fact, for the dozen-odd big Indian players, getting to the $100-million club will depend on their ability to ramp up operations rapidly. Here, 40% average attrition rate is the biggest hurdle. More importantly, firms will need to consolidate business within a few clients. Ideally, for a 10,000-people centre, there should be only 25 clients. Otherwise, the management will be stretched too thin. Relationship building will be a problem and companies will start losing control.

But ramping up operations with just a handful of clients will, in turn, depend on how are quickly Indian BPO companies are able to capture more business from the same clients. The winners will be those who can convince their clients to trust them with more end-to-end processes. Most companies were doing business task outsourcing—data entry, staffing, payroll processing or call centre work. These are subsets of large processes.

BPO-ITES: THE ROAD AHEAD FOR INDIAN FIRMS?

According to research by META Group Inc., 80% of global organizations will outsource at least one function by 2005, while 70% of that group wil renew their outsourcing contracts; many will reduce both the scope and the duration of the original agreement. With an increased focus to integrate business functions with an intended IT strategy and architecture, combined with the emerging trend of asset-leasing arrangements provided by third party vendors, there was a possibility that firms might go for curtailing their outsourcing engagements. However, despite reduced scope and duration of outsourcing, it still seems to be a viable option for firms seeking to remain competitive. Immediate market growth lies in application development and maintenance (20 percent). The offshore outsourcing market was expected to continue to grow by nearly 20 percent annually through 2008.

With so much happening in so little time, Mr Kiran Rao felt that the entire set up was turbulent to say the least. Each new day brought forth a different set of opportunities and challenges. The industry had grown phenomenally within a few years in India and there definitely existed opportunities for firms to move into more profitable segments, but the risks were also emerging from many directions. He was wondering about the strategic dirrection which industry leaders needed to take to maintain global leadership. He knew that although the victory of President Bush had subsided the backlash (of local job losses) temporarily, there had to be a more permanent solution. As he was thinking, his eyes glanced across another piece in the newspaper: **BPO-Growth All the Way, Despite the Backlash:** "*Though India became public enemy No. 1 for the US and UK anti-outsourcing brigade, the Indian BPO industry still clocked a healthy growth of 45%*"!

With the presentation over, Rao looked at some of the exhibits and sat in a reflective mood. He knew he had to move fast at various fronts simultaneously! Strategic thinking and strategic actions had to be dovetailed as part of the learning process.

case | 8

Global Trust Bank

A Tale of Greed, Systematic Failures and Misplaced Ambitions

On July 26, 2004, the depositors at the Global Trust Bank (GTB) were dumbstruck on reading the following notice pasted on the branches' locked doors:

"We have been advised by Reserve Bank of India that in exercise of powers conferred by sub-section (2) of section 45 of the Banking Regulation Act, 1949, the Government of India have issued an order of moratorium dated 24th July, 2004, in respect of our bank for the period from the close of business on 24th July, 2004, up to and inclusive of 23rd October, 2004.

Further, Reserve Bank of India in exercise of the powers conferred under Section (1) 36 AB of the Banking Regulation Act, 1949, have appointed Sri R V Iyer and Sri G Padmanabhan as RBI nominee directors on the board of our bank.

We have therefore suspended the operations of ATMs in the interim and we regret the inconvenience caused to customers. We also request the customers to contact head of their branch for further guidance."

The closure notice sent ripples across the banking industry, shaking the confidence of depositors and investors. This also signaled the rapid end of one of biggest and quickest success stories in the private banking sector in India.

Eventually the (de)ceased GTB was amalgamated with Oriental Bank of Commerce—a public sector bank—with effect from August 14, 2004. At least the depositors' money was now safe. The same could not be said of the small and retail equity investors who got zero compensation from the merger.

FORMATIVE YEARS OF GTB

Global Trust Bank was promoted by Ramesh Gelli, Jayanta Madhab and Sridhar Subasri. In addition to the 40% contribution by the core promoters, the bank managed to rope in International Finance Corporation (IFC) and Asian Development Bank (ADB) as the other major shareholders. The banking license from RBI was issued in the name of Jayanta Madhab who after a short while returned to his home state Assam. Global Trust Bank opened its first branch in Secunderabad on October 30, 1994, and on the first day of operation collected Rs 100 crores of deposits—a commendable achievement. This was more than what the promoter Mr Ramesh Gelli had dreamt of. The bank's amazing opening showed that it could stand shoulder to shoulder with its powerful competitors. The New Generation Bank, as GTB called itself, was making waves from day one.

Windows of Opportunities Post-Liberalization

In the early nineties, the process of liberalization and deregulation were setting the tone for the creation of new private sector banks in India. The Reserve Bank of India opened the doors of the banking industry to new players, and the era of the "New Generation Banks" was about to begin. The private banks were vying with the larger and more established banks for th huge market that India offered. GTB, just like ICICI and HDFC banks, was a new force in the banking industry.

Global Trust Bank was probably the only well known private sector bank started in the nineties that did not have a powerful established lineage and a huge deposit base. For instance, HDFC, ICICI and UTI were established and powerful financial institutions before entering banking operations and were able to leverage their reputation and cash reserves to establish early credibility and financial stability.

CORPORATE MISSION

GTB started with uncomplicated vision and mission statements. It simply said its mission was ***"To be a modern and model bank".***

* This case was prepared by Professor Arun Kumar Jain.

One of the cornerstones of the mission of Global Trust Bank was to improve customer satisfaction and service through reduction in cost of operation and intermediation and spur innovation of specialized, customer-friendly products. Based on this premise, the corporate vision was formulated as a bank that will:

- Build the Business and the Institution
- Create Shareholder Value
- Grow Profitably
- Develop a Complete Financial Services Organization
- Foster a Caring and Sensitive Organization

RAMESH GELLI, THE FOUNDER

Ramesh Gelli was the Chief Managing Director (CMD) of Vysya Bank for ten consecutive years before starting GTB in 1994. He had studied at Asian Institute of Management, London Business School and Osmania University. In 1990, he became the first Indian banker to be awarded the coveted national honour of *Padmashri*. By then, he had established a name for bringing a sea change in banking industry in the country.

Mr Gelli was a member on the Andhra Pradesh State Planning Board and a member on the Board of Governors of Administrative Staff College of India, and Centre for Organization Development. Mr Gelli was also the trustee of India Brand Equity Fund and Naandi, a well-known voluntary not-for-profit organization. He also served as the president of All India Management as Association, as Chairman of Bharatidasan Institute of Management and Honorary Secretary of Indian Banks Association.

Gelli was credited with turning around a staid Vysya Bank into the darling of the stock market. Gelli was one of the first to take up the opportunity when the government opened the banking sector for private players. Under his leadership, the bank's IPO was over-subscribed over a hundred times. The bank could attract investment from the International Finance Corporation, the World Bank's equity arm. Gelli modeled GTB on Vysya Bank.

The bank's model was different from that of other major newcomers, such as HDFC Bank, ICICI Bank, and IndusInd, which based themselves securely in Mumbai even while they ventured out into the countryside. Gelli positioned Global Trust Bank as a regional bank, catering to local industry and trade. He made Secunderabad its base and then spread the operations throughout Andhra Pradesh. But while the bank's focus was regional, his outlook was global. Under his leadership the bank's profits in the first two-and-a-half years exceeded its equity capital.

RAPID RISE OF GTB

At the time of its inception, Global Trust Bank was dreamt of as a bank that would rise as a new benchmark in banking. Six years later, Global Trust bank was more than just a bank. It had evolved from an idea to an organization. Some of its landmark achievements were:

- The bank created records of sorts, even before it started operations. The Initial Public Issue of Rs 1040 million received subscriptions of Rs 62.40 billion from over 1 million investors. This meant an over-subscription by a record 60 times.
- On day one of its operations, the bank received Rs 1 billion of deposits which exploded to Rs 10 billion by the end of the first year, and to Rs 27 billion at the end of almost three years. At the end of this year, the total business exceeded Rs 43 billion, making Global Trust Bank one of the fastest growing banks in India.
- In just over two years the bank won the Best Export Performance Award from the Gem and Jewelry industry.
- It established more than five hundred thousand client relationships.
- It had a presence in all the major cities and was systematically spreading coverage in smaller cities, and thus, in a phased manner throughout the country.
- It was rated "first" amongst India Best Banks according to the survey done by *Financial Express*, a leading business daily of India, in February 2001.

Appendices 1 and 2 show the balance sheet and profit-loss statements for the bank indicating its financial performance.

The Business Model of GTB

In order to fund its initial growth, a bank needs large depositors and high net worth individuals who can provide a large volume of deposits in a short time, since building up of retail customers takes time. At the same time, a new bank has to invest in ATMs and branches network, as well as in technology, in order to attract large number of customers. Here GTB was at a disadvantage–competitors like HDFC Bank and UTI Bank could rely on the brand names of their parents to approach large depositors and access technology.

Therefore in order to remain competitive, GTB adopted the simple expedient of offering high deposit rates to investors. Between 1996 and 1999, GTB's cost of deposits varied from a minimum of 7.5 percent to as high as 11 percent, with an average of 9.43 percent. In contrast, over the same period the average cost of deposits for ICICI Bank and HDFC Bank was just around 6.76 percent and 6.24 percent. Between the three private banks, GTB was the only bank whose cost of deposits actually rose by a percentage point (though it fluctuated substantially) between 1996 and 2001. Both ICICI Bank and HDFC Bank managed to reduce their deposit costs over the years.[1]

"There was tremendous pressure on branch managers to raise deposits in those early years," said an executive at GTB. In large number of cases, when potential borrowers approached a GTB branch manager, the manager asked them to also bring in deposit business. The borrower, in turn, would tap certain brokers who specialized in raising large-scale deposits for a commission. "These brokers are largely found in Mumbai. As long as the borrower brought in these deposits, there was very little rigorous appraisal of the loan".

In these cases, loans would be given mainly on the basis of a personal guarantee without any collateral security. For GTB such a practice was fairly common

In order to successfully run its banking operation, the GTB had to spread the higher deposit rates over its lending rates. Any established business group was unlikely to borrow at high rates of interest when cheaper loans were available. Therefore, since its inception, GTB adopted an altogether different strategy. GTB focused its lending to the small and medium companies (SMEs), which could be charged higher rate of interest. Between 1996 and 1999, the average return earned on loans by GTB was 14.67 per cent. In comparison, over the same period, the return on loans earned by HDFC Bank and ICICI Bank was 12.83 percent and 12.75 percent respectively. Although GTB earned high average return, advancing loans to SMEs ran the higher risk of default. Within the SMEs, GTB mainly focused on the exporters of garments, IT, diamonds and pharmaceuticals, etc., where the entrepreneurs were willing to take loans at higher interest rates because of higher profitability but requiring quicker and more efficient service. About 75 percent of the total credit was to the export sector, mainly to companies in the above four industries. (See statement of Sources & Uses of Funds in Appendix 8.)

[1]Celestine A. and Dhoot V. 'Flawed Birth', *Business World*, August 30, 2004.

CRITICAL SUCCESS FACTORS

There were a number of factors that led to the rapid growth of GTB in the initial years. *Firstly,* the Indian market was large enough to accommodate a number of competitors and the environment was conducive enough for the private banks to accumulate a good base of depositors. In a short period, GTB was able to garner a strong customer base.

Secondly, the burgeoning 200 million odd middle class was looking for new banking options after getting tired of the poor vanilla-type service of the public sector banks. Multinational banks like Citibank and HSBC were not an automatic substitute for these public sector banks, since the customers were not yet able to afford the cost of the superior services provided by them and the higher level of minimum deposits required.

Thirdly, the presence of Mr Ramesh Gelli probably worked for the bank. Considered a banking genius, Ramesh Gelli evoked an aura that he was the right man for the GTB. Although the banking license was granted to Jayanta Madhab, who was associated with the Asian Development Bank (ADB), the public image of the bank was always associated with Ramesh Gelli. He had played a key role in mobilizing funds when the operations started. It is also widely held that diamond traders contributed substantially to the Rs 100 crore mobilized when the bank had just started operations. Gelli was responsible for building the image of GTB and winning the confidence of customers.

Lastly, GTB was one of the few banks that made excellent use of technology to serve its customers. It entered into technical and financial arrangement with the Hambrecht & Quist Group of USA for technology transfer in capital-market related products (underwriting, placement, syndication, research, etc.) and with TA Enterprise of Malaysia (TAE) for debt-related products and services like securitization, financial derivatives, etc. The bank installed quick and powerful foolproof systems that gave the front office attendant time to provide the customer with a warm personal touch. The human side of the bank was friendly and simple. The banking transactions were quick and uncomplicated, thus making the customers happy and satisfied. It was a pioneer effort in computerization and Internet banking. The branches kept open two hours longer than the rest, and customers had the flexibility to do business at any counter and at any branch, and it even forwarded mails that customers sent through it. The bank's communications had talked about 'redefining banking' and to a certain extent; this promise was fulfilled and the bank slowly built its brand equity for customer-friendliness.

FIRST SIGNS OF TROUBLE

In order to reduce the over centralization and the influence of some prominent persons in the loan disbursement process at GTB, the RBI in 1998, directed the bank to broadbase its credit decision process. From then onwards, an executive credit committee and a committee of board members approved all major loan decisions. Gelli was the chairman of the both committees, and he continued to call the main shots. Thus although the new structure was put into place, but as banker puts it: 'the centralization continued.'[2]

GTB's performance for five continuous years was seemingly stellar. However, in years 2000, the bank fell short of capital and Gelli started looking for inorganic growth through mergers with other banks. Here too, street smartness came in between survival and comfort. As a result there were negotiations with HDFC Bank and then IndusInd Bank, but these did not make much headway. Later in 2001, there were talks with UTI, which progressed to a point where the boards of the two banks approved the merger on a swap ratio of 9 UTI Bank shares to 4 GTB shares. But then allegations of rigging of GTB share price started surfacing and ultimately the proposed merger was called off.

It became evident that in its early years, GTB indulged in reckless lending in pursuit of growth. The initial problems surfaced in 1997–'98 when it was revealed that it advances made to small and medium-sized corporates were highly risky. To make matters worse, instead of adopting a more conservative approach, GTB actively fuelled the Ketan Parekh-led bull-run in the stock market between December 2000 and March 2001. It lent heavily to players in the capital market and when the market crashed the bank's balance sheet suffered a gaping hole. When it was attempting a merger with UTI Bank in 2001, GTB had lent more than Rs 800 crore to suspect and high-risk accounts. Much of the lending proved injudicious. Appendix 3 shows the movement of the share prices of GTB over the period of its existence.

THE DOWNFALL

The manner in which the operations at GTB were run could be gauged from the following case in point: GTB's main stockmarket business was carried out in the Central Business District (CBD) of south Mumbai. In this part of Mumbai, where Bombay Stock Exchange (BSE) is located, almost every single bank in the country–private, public or foreign-owned–have their branches. A large chunk of the business for these branches comes from funding stockbrokers. They transact hundreds of crores of business every day. Most banks post only senior managers with decades of experience in credit appraisal to head these branches because of the risks associated with lending to stock brokers and because of the high volumes of daily transactions. In the case of GTB, the branch manager who handled this business had previously worked in a Grameen (rural) bank where the biggest loan he had made was for Rs 5,000. In other cases, managers who had never handled or made credit decisions were deputed, and put in charge of making large value loans.[3] Most of such loans later turned sour.

Ketan Parekh, the infamous stockbroker responsible for the stock market crisis of 2001, was considered close to Ramesh Gelli. He lured GTB into the share market in 2001. As a result the bank lent aggressively to brokers and diamond traders, disregarding the

[2]Roshni Jayakar and E. Kumar Sharma, 'Who Fouled Up at GTB', *Business Today*, August 29, 2004.

[3]Excerpted from Celestine A. and Dhoot, A., 'Flawed Birth', *Business World*, August 30, 2004.

prudential norms laid down by the RBI, to which every bank in the country has to abide. These norms state that no bank can lend more than 20 percent of its money to more than one sector. But Gelli ignored these sacrosanct norms and put GTB into trouble. Moreover good banking practices say that the decision to give a loan should not vest with a single individual. There has to be a credit committee consisting of three or more persons who jointly sanction loans purely on merit. Apparently Gelli violated all these practices and committees must have been set up only to exist on paper.

A special review of disbursals by Global Trust Bank in late 2000 and early 2001, carried out by auditors and consultants Ernst & Young in late 2001, demonstrated the nexus between the HFCL group, entities related or directly controlled by one-time big bull Ketan Parekh and some top GTB officials, including chairman and managing director Ramesh Gelli. The review pointed to glaring lapses on the part of the top management of GTB, committed in connivance with HFCL and KP groups, that were never made public. GTB had appointed E&Y to undertake a special review of key accounts, which included accounts belonging to group companies of Himachal Futuristics Communications Ltd. and Ketan Parekh.

The UTI Merger Episode

Apart from lending huge sums of money to Parekh and other brokers, it was accused that Gelli was also busy rigging up the GTB stock to gain advantage of the impending merger with UTI Bank. Following this, the Securities and Exchange Board of India (SEBI) initiated a detailed enquiry into the allegations. Consequently UTI Bank threatened to pull out of the proposed merger. UTI demanded a fresh evaluation to review the share swap ratio. This was raised on the grounds that SBI capital markets, which did the evaluation did not take into consideration the quality of GTB's assets and, more particularly, its capital marekt exposure. UTI Bank appointed Deloitte, Haskins & Sells to conduct the fresh valuation within a week and submit the report to the Reserve Bank of India. Initially GTB resisted this move stating that the two sides should await SEBI's report on the alleged price-rigging in the GTB script prior to the merger, before taking a decision in this regard. But they gave in to UTI's demand later on.

Originally UTI did not make an issue about the ratio 9:4, which was entirely loaded in favour of GTB shareholders, since it wanted the merger to go through smoothly. More importantly the UTI management treated the unfavourable swap ratio as the price for control over the merged entity. UTI Bank's concern about the original valuation arose from the fact that the ratio was arrived at on the basis of the average values of the shares of the two entities, which in the case of GTB, as was being alleged, had been manipulated for several months before the merger deal was finalized.

UTI Bank was also very unsure about GTB's exposure to capital market funding. Further, the case for going in for a fresh valuation gained ground, as UTI Bank shareholders felt that the prevailing fall in GTB's share price will further erode the value of their holdings. It was openly alleged that brokers and non-banking financial companies (NBFCs) borrowed money from the GTB and used it to buy its shares in the market. As a result, there was an upward spiral in the share price of GTB, which helped it achieve a better swap ratio in the merger. However, GTB officals denied that the share price movement had anything to do with the swap ratio, since the swap ratio was not purely based on the market price of GTB and UTI shares. Ultimately the deal did not materialize. Meanwhile Gelli was removed as a director of the bank by the Reserve Bank of India.

Regulatory Interventions: The Parliamentary Probe and the Reserve Bank

The stock market scam of 2001 led to huge losses for the retail investors. The public furore generated heat to an extent that the Parliament set up a Joint Parliamentary Committee (JPC) to carry out a probe and fix responsibility. In September 2001, the JPC found that Gelli and other promoters of the bank colluded with Ketan Parekh to push up GTB's share price. The JPC observed that the bank was guilty of not monitoring the end-use of the funds that it lent. It also opined that the bank ought to have acted because there was a definite evidence of misappropriation of funds. Depositions by bank officials before the JPC conformed SEBI's finding of diversion of funds lent by GTB to several companies, among them Ketan Parekh-linked companies, Zee Telefilms and Himachal Futuristic Communications Ltd. (HFCL).

On March 31, 2000, GTB had allotted 1.48 crore shares of Rs 10 each at a premium of Rs 75 per share to various institutions, mutual funds, and corporate bodies on a private placement basis. Since it also involved some foreign collaborators of the bank, necessary RBI and SEBI clearances were obtained. But the RBI pointed out that the GTB scrip price had risen

34.86 percent from Rs 68.70 on October 13, 2000 to Rs 92.65 on November 10, 2000 on the Bombay Stock Exchange (BSE).

Independently India's central bank—the Reserve Bank of India (RBI)—proceeded with its own investigations. On inspection of GTB's accounts as on March 31, 2002, RBI found that GTB's net worth had turned negative. This was in sharp contrast to the claim of the bank's management that its net worth was about Rs 400 crores. This meant that the troubled bank had chosen to indulge in window dressing rather than correct its course of action of reckless lending. The central bank removed the bank's auditors and made a complaint about the auditor to the Institute for Chartered Accountants of India.

In spite of RBI's actions, the central bank could not remove Gelli's influence from the bank. The new chief appointed in place of Gelli quit within six months telling the RBI that he was not being allowed to function by Gelli and his supporters. Gelli managed to get his son elected on to the bank's board and even got himself reelected later in February 2004. But then he had to resign again when several complaints were made to the RBI about his induction.

Ban by SEBI

The Securities and Exchange Board of India (SEBI) imposed a ban on Ramesh Gelli on June 13, 2003, barring him from dealing in the Global Trust Bank securities till June 30, 2004. The total period of debarment amounted to 18 months from December 31, 2002. Along with Ramesh Gelli, SEBI also barred Premkala Gelli, Jayant Madhav, Girish Gelli, Niraj Gelli, Sridhar Subasri, Annapurna Sridhar and the associate entities Anjanaya Traders Pvt. Ltd., Chiranjeevi Traders Pvt. Ltd., Gajanan Financial Services Pvt. Ltd., Gajmukh Investments Pvt. Ltd., Kadrish Finance & Investments Pvt. Ltd., and Bombay Mahalakshmi Traders Pvt. Ltd.

An investigation in the price movements in the scrip *prima facie* revealed irregularities in the trading pattern such as the "synchronisation of logging in of trades in a pre meditated fashion, creation of artificial volumes, circular trading, churning of the same stock, market manipulation, among others." In an *ex-parte* order issued on December 31, 2002, SEBI prohibited the promoters and associated entities from dealing in the GTB securities till investigations were completed.

SEBI maintained the ban after giving a post decisional hearing on June 13, 2003. Subsequently, a show cause notice was issued on October 21, 2003 communicating the findings of the investigation and charges. SEBI investigations revealed that price of the shares of Global Trust Bank were manipulated during the period October 2000 to February 2001 prior to announcement of its proposed merger with UTI Bank. During the period before this, the Ketan Parekh (KP) entities had cornered large number of shares and the price was manipulated by them.

Passing the order, the market regulator said that the investigations "show that the price and volumes of GTB were artificially manipulated. The promoters and entities, though not responsible for the price manipulation, were certainly responsible for creation of artifical volumes in the scrip. By their commissions and omissions, the regulator said that the entities had directly and indirectly aided and abetted Ketan Parekh entities to manipulate the prices and volumes of the scrip." Further, "the prohibition, which is remedial in nature is not a total prohibition from dealing in securities, it is only a partial prohibition restraining the said entities from dealing in the securities of GTB.

Shri GN Bajpai, SEBI chairman further said that "looking into all the facts and circumstances, I am of the considered view that it would be in the interest of investors and orderly development of the securities market that the said partial prohibition continues for some time more".

Towards an Inglorious Demise

On September 30, 2003, the auditors of GTB, PriceWaterhouseCoopers (PwC), *submitted a heavily qualified report. The report pointed out that "accounts are prepared on a going concern basis even though the net worth of the bank has been substantially eroded after considering the loss for the year on account of substantial provision against non-performing assets, taking into account management's assessment of growth of business, infusion of capital... These accounts do not include adjustments aforesaid in case the management's business plans do not materialize..."* (For detailed audit report, see Appendix 9).

In case the principle of going concern does not hold or it is not possible to arrive at an opinion, the auditor is supposed to give a disclaimer and not express his opinion. In GTB's case there were many ifs and buts. For example, the audit report showed that:

- Accounts were prepared on going concern basis even though the net worth had been substantially eroded;
- Advances worth Rs 311.61 crore were considered good although the loans were not fully secured;
- No provision was made for assets valued at Rs 181.75 crore as the bank can hold the property for seven years;

- Accounting method is consistent except in case of the additional provision through stautory reserve permitted by the RBI; and
- The accounts give a fair view subject to points (relating to Rs 311.61 crore and Rs 181.75 crore). The impact of which is indeterminate.

Following this audit report, GTB sacked PwC and appointed M Bhaskar Rao & Co as their auditors. It audited the quarterly results for 2003–'04 and raised questions on the going concern status of the bank. It made a qualification for the third quarter of 2003–'04 which said, "Despite the net worth of the bank being considerably eroded, it was considered a going concern."

Later, RBI asked GTB to curb its activities related to capital market exposure, declaration of dividend, advances and withdrawal of deposits. RBI then decided to monitor the bank on a monthly basis and permitted the bank till September 2003 to publish its revised accounts. But then, the new set of accounts raised more issues. GTB reported a marginally positive net worth but RBI found that the net worth was plunging and the capital adequacy ratio had turned negative.

In November 2003, RBI gave the opportunity to GTB to inject fresh capital through domestic sources or through a merger so that its capital adequacy ratio could be pumped up to the stipulated 9 percent. The RBI asked the bank to draw up a schedule to achieve this. In May 2004, Gelli made a last ditch effort to rescue the ailing bank. To this end, he submitted a proposal for restructuring to the RBI wherein he showed that he was backed by a US private equity fund, Newbridge Capital. Gelli's investment bankers, Lazard, Ambit and Morgan Stanley had tapped at least 12 other investors across the globe. As per the proposal, Newbridge would bring in around Rs 800 crore. Another Rs 700 crore would be infused through domestic institutions. In return, Newbridge asked for numerous exemptions from the RBI—on the amount of capital it needed to set aside for each loan made, on priority-sector (agricultural) lending norms, and on the classification of non-performing assets (NPA). It also wanted to bring in a new management team. The existing one would have no say in GTB under this structure. The other strategic investors in the bank, International Finance Corporation, Washington, and Keppel Bank, Singapore, also met the RBI for an indication on the future of the bank. Nothing concrete materialized from these discussions.

Even as this proposal was being made, the RBI was already considering other options. RBI was uncomfortable with Newbridge's conditions. If it gave in to such demands for waiver of norms on capital adequacy, provisioning, and accounting for bad loans, it would set a precedent. Future bidders for banks might also ask for the same concessions. RBI also wanted to avoid unnecessary controversy by allowing a Cayman Islands-registered company to take a large stake in a bank already dogged by controversy and corruption charges. Finally, RBI decided to play safe and chose to follow standard practice and merge GTB with a big public sector bank.

In July 2004, RBI rejected the proposal and applied to the Central Government to place the bank under moratorium for three months with effect from July 25, 2004. RBI announced on July 26 that GTB would be taken over by Oriental Bank of Commerce, a public sector bank. This marked the death of a private bank, which was at one time considered to be one with huge potential, to establish itself as a major force in the Indian banking scenario.

Insider Trading Charges

In December 2002, SEBI through its internal investigation, found that there was a *prima facie* evidence against the promoters of GTB because of sudden rise in the price of GTB scrip in 2001. Further the regulatory authority found that GTB had colluded with Mr Ketan Parekh, a tainted sharebroker who had spent considerable time in jail for stock market manipulation, to jack up the price of the GTB scrip in order to have a upper hand in the proposed merger talk with the UTI bank.[4] There was unusual trading activity in GTB shares in the stock market before and after the announcement of takeover of GTB by OBC. This was certainly unusal for an institution that was on its last legs. Meanwhile, reports from the market indicated that large entities including promoters, foreign institutional investors and Overseas Corporate Bodies and Non-Resident Indians, had offloaded their holdings in the GTB scrip in the weeks before the moratorium was declared by the RBI. According to reports, nearly 16 percent of GTB shares were offloaded by these investors between June 14 and July 24. As a result, the holdings of smaller investors increased from 44 percent to 51 percent by the time the bank was declared dead. In fact, there are some reports that these

[4] *Is RBI responsible for GTB crisis?* Source: http://www.rediff.com/money/2004/aug/02guest3.htm accessed on Dec. 13, 2004.

holdings could account for almost 60 percent of the shares (See Exhibit 7)[5]. Clearly the smart people in the know of future events had offloaded their dud investments on the unwary and unssuspecting small retail investors.

In August 2004, SEBI announced that it was examining trade data during the last six months to see whether the activity in the market indicated insider trading. However, speculation is rife because it is now known that OBC gave the RBI its letter of intent in mid-July 2004. The possibility of insider trading is not difficult to fathom. If the promoters and the well-connected knew of the impending merger, it would explain their selling the GTB shares. Obviously, those who were in the inside track knew where the bank was headed and quickly dumped their stock. But as happens in the stock market, those outside the information loop were the losers.

The Future of Ramesh Gelli[6]

Ramesh Gelli in 1983 was 37 when he became the youngest chairman in the Indian banking industry when he headed Vysya Bank. In 2004, he planned to retire fron banking for ever. He refused to take the blame for Global Trust Bank's failure but thought his management style of total delegation of power to senior managers and his hands-off approach responsible for the bank's collapse. According to him, "In the two years between 1999–2000 and 2000–'01, the bank's capital market exposure went up to around 30 percent of its total assets. When the market collapsed in February-March 2001, the value of securities came down drastically and the bank could not recover from this even, though its exposure was reduced".

He admitted that "There were violations of internal procedures in sanctions and disbursements. Then, the loan appraisal system was faulty. A handful of employees were responsible for these aberrations, and the bank board dismissed them after an investigation. The collapse of the market—(is) a systemic problem. Perhaps the bank had taken a very aggressive stance".

Gelli claimed that he had decided to become non-executive chairman of the bank in March 1999" and not to get involved in day-to-day operations. It was also decided that the bank's executive director, Sridhar Subasri, would be made the managing director. So from April 2000 on an experimental basis, I followed a hands-off approach and Subasri was running the show". On a question about his future, Gelli replied, "I have not thought about it. My career as a banker is over. I may pursue academics or be a mentor to new entrepreneurs."

[5]Sridhar, V., 'The Collapse of a Bank', *Frontline*, Aug. 14–27, 2004.

[6]Based on interview published in *Business Standard*, Mumbai, July 27, 2004.

appendix | 1

Balance sheet for Global Trust Bank from inception till March 2003

Year	Mar 03	Mar 02	Mar 01	Mar 00	Mar 99	Mar 98	Mar 97	Mar 96	Mar 95	Sep 94
Capital and Liabilities										
Capital +	121.36	121.36	121.36	121.36	104	104	104	104	104	8.25
Reserves and Surplus +	−118.92	272.96	467.05	406.78	186.25	137.72	79.73	37.93	10.06	0.55
Deposits +	6,920.92	6,443.08	7,734.23	6,198.85	4,096.80	3,285.37	2,279.34	1,324.30	632.03	0.66
Borrowings +	26.42	64.24	599.7	398.66	483.04	36.38	90.79	668.79	175.64	0
Other Liabilities & Provisions +	489.74	444.49	549.63	416.45	330.24	218.02	97.67	78.51	37.61	1,648.05
Total	**7,439.52**	**7,346.13**	**9,471.97**	**7,542.10**	**5,200.33**	**3,781.49**	**2,651.53**	**2,213.53**	**959.34**	**1,657.51**
Assets										
Cash & Balances with RBI	727.03	484.27	666.14	514.1	473.73	306.26	252.96	199.29	108.29	0.16
Balances with Banks & Money at Call & Short Notice	77.81	127.61	54.13	223.74	106.64	87.36	26	102.91	49.96	646.1
Investments +	2,498.74	2,554.20	3,864.92	2,928.71	1,961.87	1,215.11	662.07	348.88	145.75	52.46
Advances +	3,276.11	3,435.18	4,099.69	3,219.02	2,118.44	1,755.85	1,462.46	1,377.32	561.8	10.77
Fixed Assets +	300.8	320.2	379.44	338.29	324.51	275.63	124.02	88.85	49.35	11.68
Other Assets +	559.03	424.67	407.65	318.24	215.14	141.28	124.02	96.28	44.19	936.34
Total	**7,439.52**	**7,346.13**	**9,471.97**	**7,542.10**	**5,200.33**	**3,781.49**	**2,651.53**	**2,213.53**	**959.34**	**1,657.51**
Contingent Liabilities +	3,578.32	2,579.16	6,067.62	7,018.20	4,632.38	3,814.30	2,460.22	1,434.41	823.84	4.05
Bills for collection	1,046.72	1,121.93	806.29	773.15	318.88	455.34	389.77	67.11	59.54	0

Source: Cyberline–Intranet version of Capitaline 2000

appendix | 2

Profit and loss statement for Global Trust Bank from inception till March 2003

Year	Mar 03	Mar 02	Mar 01	Mar 00	Mar 99	Mar 98	Mar 97	Mar 96	Mar 95	Sep 94
I. Income:										
Interest Earned +	539.6	724.22	897.5	695.51	491.36	399.08	356.83	171	36.04	4.14
Other Income +	192.58	231.73	165.64	183.97	146.58	127.04	90.14	54.17	8.11	0
Total	**732.18**	**955.95**	**1,063.14**	**879.48**	**637.94**	**526.12**	**446.97**	**225.17**	**44.15**	**4.14**
II. Expenditure:										
Interest expended +	517.41	635.85	697.17	507.19	438.46	322.79	289.76	135.95	14.18	0.08
Operating Expenses +	178.26	169.68	164.21	124.26	94.92	71.28	53.35	27.72	7.95	3.02
Provisions & Contingencies +	309.21	110.16	121.43	139.41	33.7	51.92	46.46	21.14	7.85	0.2
Total	**1,004.88**	**915.69**	**982.81**	**770.86**	**567.08**	**445.99**	**389.57**	**184.81**	**29.98**	**3.3**
III. Profit/Loss										
Net profit for the year	–272.7	40.26	80.33	108.62	70.86	80.13	57.4	40.36	14.17	0.84
Prior Year Adjustments +	–118.43	0	0	0	0	0	0	0	0	0
Profit brought forward	1.55	0.21	0.36	0.3	0.03	0.08	0.06	0.05	0.38	0
Total	**–389.58**	**40.47**	**80.69**	**108.92**	**70.89**	**80.21**	**57.46**	**40.41**	**14.55**	**0.84**
IV. Appropriations										
Transfer to Statutory Reserves	–124.5	10.06	22.09	27.15	17.71	20.03	11.48	8.07	2.83	0.17
Transfer to Other Reserves +	0	16.72	38.33	56	30	38	30.3	19.8	7	0
Proposed Dividend/Transfer to Government +	0	12.14	20.06	25.41	22.88	22.15	15.6	12.48	4.66	0.29
Balance c/f to Balance Sheet	–265.08	1.55	0.21	0.36	0.3	0.03	0.08	0.06	0.06	0.38
Total	**–389.58**	**40.47**	**80.69**	**108.92**	**70.89**	**80.21**	**57.46**	**40.41**	**14.55**	**0.84**
Equity Dividend	0	12.14	18.2	22.89	20.8	18.72	15.6	12.48	4.66	0.29
Corporate Dividend Tax	0	0	1.86	2.52	2.08	3.43	0	0	0	0
Equity Dividend (%)	0	10	15	22	20	18	15	12	20	8
Earning Per Share (Rs.)	0	3.32	6.47	8.74	6.61	7.38	5.52	3.88	2.73	1.02
Book Value	0.2	32.49	48.48	43.52	27.91	23.24	17.67	13.65	10.97	10.67
Extraordinary Items +	–0.23	19.52	–0.19	–0.26	–0.21	0	0	0	0	0

Source: Cyberline–Intranet version of Capitaline 2000

appendix | 3

Share prices and market capitalization of GTB from inception

Month	Price-High	Price-Low	Price-Close	P/E (High)	P/E (Low)	P/E (Close)	Market Cap. in Crores
200408	3.60	0.78	1.17	0.00	0.00	0.00	14.20
200407	14.05	1.50	2.48	0.00	0.00	0.00	30.10
200406	19.25	10.90	13.95	0.00	0.00	0.00	169.30
200405	23.60	15.10	17.10	0.00	0.00	0.00	207.53
200404	25.50	19.75	20.35	0.00	0.00	0.00	246.97
200403	25.45	17.85	20.75	0.00	0.00	0.00	251.82
200402	31.60	24.10	24.95	0.00	0.00	0.00	302.79
200401	35.50	26.20	26.95	0.00	0.00	0.00	327.07
200312	38.50	20.25	31.50	0.00	0.00	0.00	382.28
200311	21.80	18.00	20.55	0.00	0.00	0.00	249.39
200310	22.00	18.80	19.50	0.00	0.00	0.00	236.65
200309	26.50	19.15	19.75	0.00	0.00	0.00	239.69
200308	27.65	22.85	25.00	0.00	0.00	0.00	303.40
200307	25.50	17.50	23.70	0.00	0.00	0.00	287.62
200306	22.60	16.60	18.05	0.00	0.00	0.00	219.05
200305	21.80	13.60	19.75	0.00	0.00	0.00	239.69
200304	18.30	13.20	13.70	0.00	0.00	0.00	166.26
200302	17.40	15.15	16.70	5.24	4.56	5.03	202.67
200303	17.75	13.60	13.70	0.00	0.00	0.00	166.26
200301	19.75	15.50	16.35	5.95	4.67	5.02	202.06
200212	19.80	16.70	17.35	5.96	5.03	5.23	210.56
200211	17.30	15.05	17.15	5.21	4.53	5.17	208.13
200210	16.20	14.20	15.45	4.88	4.28	4.65	187.50
200209	19.00	14.95	15.30	5.72	4.50	4.61	185.68
200208	19.85	17.95	18.10	5.98	5.41	5.45	219.66
200207	25.60	18.50	19.20	7.71	5.57	5.78	233.01
200206	24.70	18.90	23.65	7.44	5.69	7.12	287.02
200205	25.50	17.50	19.10	7.68	5.27	5.57	231.80
200204	29.40	23.70	24.00	8.86	7.14	7.23	291.26
200203	29.90	22.90	26.35	9.01	6.90	7.94	319.78
200202	30.10	17.75	22.50	4.65	2.74	3.48	273.06
200201	22.35	17.80	17.95	3.45	2.75	2.77	217.84
200112	24.45	16.50	21.00	3.78	2.55	3.25	254.86
200111	28.50	18.00	23.45	4.40	2.78	3.62	284.59
200110	21.35	15.00	17.55	3.30	2.32	2.71	212.99
200109	19.10	14.00	16.30	2.95	2.16	2.52	197.82
200108	21.90	18.05	18.85	3.38	2.79	2.91	228.76
200107	25.70	17.70	19.15	3.97	2.74	2.96	232.40

(Continues)

Month	Price-High	Price-Low	Price-Close	P/E (High)	P/E (Low)	P/E (Close)	Market Cap. in Crores
200106	28.35	22.10	24.35	4.38	3.42	3.76	295.51
200105	30.00	25.10	28.05	4.64	3.88	4.34	340.41
200104	32.65	21.00	26.85	5.05	3.25	4.15	325.85
200103	79.20	35.45	35.45	12.24	5.48	5.48	430.22
200102	96.90	67.50	73.35	11.09	7.72	8.39	890.18
200101	108.95	73.00	86.45	12.47	8.35	9.89	1,049.16
200012	101.00	73.00	82.65	11.56	8.35	9.46	1,003.04
200011	114.70	66.75	94.35	13.12	7.64	10.80	1,145.03
200010	78.65	57.00	69.45	9.00	6.52	7.95	842.85
200009	97.00	62.00	66.85	11.10	7.09	7.65	811.29
200008	83.00	45.00	79.95	9.50	5.15	9.15	970.27
200007	64.90	49.10	52.10	7.43	5.62	5.96	632.29
200006	73.90	51.10	57.70	8.46	5.85	6.60	700.25
200005	75.00	48.00	53.50	8.58	5.49	6.12	649.28
200004	90.70	62.75	66.00	10.38	7.18	7.55	800.98
200003	96.10	61.50	79.35	11.00	7.04	9.08	962.99
200002	104.50	73.15	82.90	15.81	11.07	12.54	862.16
200001	97.10	66.50	90.75	14.69	10.06	13.73	943.80
199912	79.90	57.00	67.00	12.09	8.62	10.14	696.80
199911	52.20	34.00	52.20	7.90	5.14	7.90	542.88
199910	51.75	33.50	37.50	7.83	5.07	5.67	390.00
199909	41.60	29.00	38.45	6.29	4.39	5.82	399.88
199908	39.00	34.00	36.00	5.90	5.14	5.45	374.40
199907	42.50	33.70	37.25	6.43	5.10	5.64	387.40
199906	38.90	30.10	34.50	5.89	4.55	5.22	358.80
199905	34.55	25.00	31.70	5.23	3.78	4.80	329.68
199904	31.80	23.50	25.45	4.81	3.56	3.85	264.68
199903	41.50	29.25	32.35	6.28	4.43	4.89	336.44
199902	34.75	28.20	30.05	4.71	3.82	4.07	312.52
199901	43.70	32.50	33.15	5.92	4.40	4.49	344.76
199812	37.00	31.55	35.75	5.01	4.28	4.84	371.80
199811	40.90	34.65	35.00	5.54	4.70	4.74	364.00
199810	41.70	35.00	38.60	5.65	4.74	5.23	401.44
199809	46.95	41.15	41.70	6.36	5.58	5.65	433.68
199808	48.50	40.00	43.95	6.57	5.42	5.96	457.08
199807	49.00	41.10	43.50	6.64	5.57	5.89	452.40
199806	60.00	34.60	45.85	8.13	4.69	6.21	476.84
199805	64.00	51.00	56.85	8.67	6.91	7.70	591.24
199804	74.70	53.25	56.25	10.12	7.22	7.62	585.00
199803	66.90	57.00	59.85	9.07	7.72	8.11	622.44

(Continues)

Month	Price-High	Price-Low	Price-Close	P/E (High)	P/E (Low)	P/E (Close)	Market Cap. in Crores
199802	57.95	41.25	57.85	10.50	7.47	10.48	601.64
199801	54.00	43.25	43.75	9.78	7.84	7.93	455.00
199712	48.00	40.00	46.25	8.70	7.25	8.38	481.00
199711	50.00	40.00	43.25	9.06	7.25	7.84	449.80
199710	49.75	39.00	49.25	9.01	7.07	8.92	512.20
199709	54.25	41.50	42.25	9.83	7.52	7.65	439.40
199708	57.25	35.50	43.00	10.37	6.43	7.79	447.20
199707	38.50	32.50	35.75	6.97	5.89	6.48	371.80
199706	38.50	36.25	36.75	6.97	6.57	6.66	382.20
199705	43.00	33.75	34.00	7.79	6.11	6.16	353.60
199704	40.25	31.25	37.75	7.29	5.66	6.84	392.60
199703	43.50	31.75	32.00	7.88	5.75	5.80	332.80
199702	37.75	33.00	35.25	9.73	8.51	9.09	366.60
199701	45.00	34.00	36.25	11.60	8.76	9.34	377.00
199612	35.75	31.00	35.25	9.21	7.99	9.09	366.60
199611	37.25	32.25	33.25	9.60	8.31	8.57	345.80
199610	42.00	29.00	36.00	10.82	7.47	9.28	374.40
199609	41.00	32.00	32.00	10.57	8.25	8.25	332.80
199608	42.00	39.00	40.25	10.82	10.05	10.37	418.60
199607	48.25	39.00	39.50	12.44	10.05	10.18	410.80
199606	58.00	45.00	48.50	14.95	11.60	12.50	504.40
199605	53.00	43.00	47.00	13.66	11.08	12.11	488.80
199604	57.00	43.00	50.00	14.69	11.08	12.89	520.00
199603	46.50	42.00	43.50	11.98	10.82	11.21	452.40
199602	56.00	39.25	46.00	20.51	14.38	16.85	478.40
199601	50.00	38.00	40.00	18.32	13.92	14.65	416.00
199512	52.00	47.50	50.00	19.05	17.40	18.32	520.00
199510	66.00	55.00	57.00	24.18	20.15	20.88	592.80
199509	62.50	54.00	59.50	22.89	19.78	21.79	618.80
199511	58.00	45.50	48.25	21.25	16.67	17.67	501.80
199508	63.00	58.00	60.50	23.08	21.25	22.16	629.20
199507	66.50	58.00	61.50	24.36	21.25	22.53	639.60
199506	73.00	63.00	63.50	26.74	23.08	23.26	660.40
199505	68.00	51.50	68.00	24.91	18.86	24.91	707.20
199504	78.00	68.00	70.00	28.57	24.91	25.64	728.00
199503	77.50	71.50	73.00	28.39	26.19	26.74	759.20
199502	80.00	70.00	76.25	78.43	68.63	74.75	793.00
199501	80.00	67.50	76.25	78.43	66.18	74.75	793.00
199412	80.00	66.25	75.00	78.43	64.95	73.35	780.00
199411	95.00	60.00	77.00	93.14	58.82	75.49	800.80

Source: Cyberline–Intranet version of Capitaline 2000

appendix | 4

Ratings Given for Global Trust Bank by Agencies

Rating as on	Security Type	Amount	Rating Code	Notes
11/21/2002	Certificate of Deposit	0	WD	Rating Withdrawn
5/3/2001	Short Term Debt	0	P3	Degree of safety regarding timely payment on the instrument is adequate; however the instrument is more vulnerable to adverse effects of changing circumstances than an instrument rated in the two higher categories
6/28/1999	Commercial Paper	0	P1	Very Strong With Relatively Higher Standing
6/23/1998	Commercial Paper	0	P1	Very Strong With Relatively Higher Standing
6/4/1998	Commercial Paper	0	P1	Very Strong With Relatively Higher Standing
4/14/1998	Commercial Paper	0	P1	Very Strong With Relatively Higher Standing

Source: Cyberline–Intranet version of Capitaline 2000

appendix | 5

Emerging Scenario for Private Banks in India[7]

- Centurion Bank: Posted a Rs 105.14 crore net loss in March 2004, but is on the rebound path with Bank Muscat and Sabre Capital infusing funds and taking over the reins.
- Global Trust Bank: Made a flying start in 1993–'94, clocking Rs 100 crore of deposits on day one. Ran into bad loan problems of Rs 1,500 crore. Is now being merged with Oriental Bank of Commerce following the Centre's imposition of moratorium. Posted Rs 272.7 crore net loss in the year ended March 31, 2004.
- Time Bank merged with HDFC Bank in the first deal of its kind in the country between two new private sector banks in November. Merger effective from December 1, 1999.
- HDFC Bank has been doing well ever since its inception, clocking industry-best growth rates. Its net profit in the first quarter ended June 30, 2004, was Rs 139.97 crore, while net profit for the year ended March 31, 2003, was Rs 509.5 crore.
- ICICI Bank merged with Bank of Madura in a 2:1 swap deal in December 2000. The move made ICICI Bank among the biggest private players in the country. Its consolidation move continued, and in October 2001, it merged with its parent, financial institution ICICI, in a 1:2 swap. ICICI Bank posted a net profit of Rs 510 crore in the first quarter. Its bottom line for the financial year ended March 31, 2004, stood at Rs 1,637.1 crore.
- IndusInd Bank, another new private sector bank, has also been among the best performers. It ramped up its balance sheet in December 2003, when it merged with Ashok Leyland Finance.
- IDBI Bank, too, has been among the performers. It could be merged into parent IDBI when this financial institution converts itself into a bank.
- UTI Bank has been yet another consistent performer over the past few years. It posted a 45 percent growth in Q1, with a net profit of Rs 70.67 crore, while its full year 2004 bottomline stood at Rs 278.31 crore. The bank has also reported improvement in the quality of assets due to significant growth in non-performing assets provisioning.
- For the year ended March 31, 2004, Bank of Punjab's net profit was Rs 370.02 crore.
- Kotak Mahindra Bank, the newest bank to launch business, has had a good start, clocking a net profit of Rs 78.73 crore in 2003–'04, against Rs 44.96 crore the previous year.
- YesBank, promoted by former Rabobank chief Rana Kapoor and the last new private sector bank to get a license from the Reserve Bank of India, has just started operations in a few locations.

[7]Patel, F. 'The downside of entrepreneurship—Institution-backed private banks are more successful than their entrepreneur-led counterparts', *Indian Express*, July 29, 2004.

appendix | 6

Basic Numbers about OBC and GTB Merger[8]

Details	Oriental Bank of Commerce 2003–2004	Global Trust Bank 2002–2003
Advances	19680	3276
Deposit	35674	6920
Net worth	2677	2
Net profit/(loss)	686	–272
No. of branches	989	104
No. of ATMs	100	236
NPA (%)	0	19.77
CAR (%)	14.47	–0.7
No. of Employees	13,500	1050

appendix | 7

Shareholding of GTB before Merger with OBC

Shareholder	% of Shares
Institutional Investors	1.54
Foreign Promoters	0.25
Public	51.28
Private Corporates	20.54
NRI's/OCB's	4.94
Promoters & Associates	19.28
Others	2.17

[8] 'GTB: Was RBI remiss?', *Business India*, August 2–15, 2004.

appendix | 8

Sources & uses of funds

Global Trust Bank Ltd. Rs. Crore (Non-Annualised)	Mar 1998 12 mths	Mar 1999 12 mths	Mar 2000 12 mths	Mar 2001 12 mths	Mar 2002 12 mths	Mar 2003 12 mths
Sources of funds						
Deposits from public	1006.03	811.44	2102.04	1535.38	–1291.15	477.84
Term deposits	942.03	569.47	1465.58	1643.54	–1392.77	309
Saving bank deposits	26.64	76.23	170.6	113.15	72.32	68.86
Demand deposits	39.36	165.74	465.86	–221.31	29.3	99.98
Misc. deposits	0	0	0	0	0	0
Deposits outside India	0	0	0	0	0	0
Borrowings	–34.41	446.66	–84.38	451.18	–535.46	–12.32
Inter-bank borrowings	0	185	–110	117.35	–192.35	0
Financial institutional borrowings	–1.58	157.48	1.54	174.52	–320.78	–13.78
Government	0	0	0	0	0	0
RBI	–49.59	100	–40	–60	0	0
Foreign borrowings	16.76	4.2	64.08	–30.83	–22.33	–24.04
Debentures	0	0	0	250.14	0	25.5
Other borrowings	0	0	0	0	0	0
Deferred tax liabilities	0	0	0	0	38.62	0
Current liabilities & provisions	101.53	113.32	72.87	–79.91	–118.94	96.29
Equity capital (excl. bonus issue)	0	0	147.55	0	0	–0.75
Share premium reserves	0	0	130.19	0	0	–0.75
Reserves & surplus	85.04	86.25	130.69	106.02	–188.83	–361.44
Uses of funds						
Cash & bank	114.65	186.76	157.47	–17.57	–108.39	192.96
Other receivables	15.75	9.5	118.49	177.4	–76.32	134.36
Advances	293.4	362.58	1100.58	880.87	–664.51	–159.07
Bills receivable	–43.19	89.96	86.53	39.15	–155.55	–52.45
Short term advances	92.47	139.45	769.99	330.02	–769.66	–287.6
Long term advances	244.12	133.17	244.06	511.5	260.7	180.98
Advances to assisted cos. (FI specific)	0	0	0	0	0	0
Advances to banks/institutions	0	0	0	0	0	0
Advances/loans to other cos.	0	0	0	0	0	0
Advances in foreign currency	0	0	0	0	0	0
Advances priority sector	101.92	–42.47	190.56	91.04	272.24	–202.23
Advances public sector	10.67	–28.86	10.01	25.77	–28.46	7.68
Deferred tax assets	0	0	0	0	93.36	0
Investment	557.21	845.95	940.42	885.25	–1285.9	21.08
Government securities	197.34	250.13	667.33	551.24	–391.79	130.92
Approved securities	0	0	0	0	0	0
Assisted companies (FI specific)	0	0	0	0	0	0
Investment outside India	0	0	0	0	0	0
Associate banks/cos.	0	0	0	0	0	0
Mutual funds	13.17	–5.35	22.36	–34.02	0	0
Gross fixed assets	177.18	52.88	51.81	86.92	–54	10.29
Total sources/uses of funds	1158.19	1457.67	2368.77	2012.67	–2095.76	199.62

appendix | 9

Global Trust Bank Ltd.

Auditors' Report for the Year Ended 31st March, 2003.

1. We have audited the attached Balance Sheet of Global Trust Bank Limited as on March 31, 2003 and the relative Profit and Loss Account and Cash Flow Statement for the year ended on that date annexed thereto, which we have signed under reference to this report. These financial statements are the responsibility of the management of the Bank. Our responsibility is to express an opinion on these financial statements based on our audit.
2. We have conducted our audit in accordance with auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.
3. The Balance Sheet and Profit and Loss Account have been drawn up in accordance with the provisions of section 29 of the Banking Regulation Act, 1949 of India read with section 211 of the Companies Act, 1956, of India. Refer paragraph 5 (g) below.
4. The reports on accounts of fifteen branches of the Bank, the Corporate Office audited by us and ninety branches audited by Branch Auditors have been dealt with in preparing our report in the manner considered appropriate by us.
5. We report that:
   (a) We have obtained all the information and explanations, which to the best of our knowledge and belief, were necessary for the purpose of our audit and have found them to be satisfactory.
   (b) The transactions of the Bank, which have come to our notice have been within the powers of the Bank.
   (c) In our opinion, proper books of account as required by law have been kept by the Bank so far as appears from our examination of those books and proper returns adequate for the purposes of our audit have been received from the branches of the Bank.
   (d) The above-mentioned Balance Sheet, Profit and Loss Account and Cash Flow Statement of the Bank dealt with by this report are in agreement with the books of account and the branch returns.
   (e) On the basis of written representation received from the Directors of the Bank as on March 31, 2003, and taken on record by the Board of Directors of the Bank, none of the Directors of the Bank is disqualified as on March 31, 2003 from being appointed as a director in terms of clause (g) of subsection (1) of section 274 of the Companies Act, 1956, of India.
   (f) Attention is drawn to Note 10 of Schedule XVIII regarding preparation of accounts on a going concern basis even though the networth of the bank has been substantially eroded after considering the Loss for the year on account of substantial provision against non-performing assets, taking into account management's assessment of growth of business, infusion of capital through strategic/financial/investment/issue of further capital.

   Accordingly, these accounts to not include adjustments aforesaid in case the management's business plans do not materialize.

   (g) In our opinion, the Balance Sheet, Profit and Loss Account and Cash Flow Statement of the Bank are in compliance with the applicable accounting standards referred to in subsection (3C) of section 211 of the Companies Act, 1956, of India to the extent applicable and in so far as they are not inconsistent

with the Banking Regulation Act, 1949, of India and the method of accounting and disclosure norms prescribed/approved by the Reserve Bank of India except as stated in Note 9 of Schedule XVIII Notes on accounts regarding additional provision towards non-performing assets by utilisation of statutory reserves below the line after the net loss for the year not in conformity with the accounting principles generally accepted in India.

(h) In our opinion and to the best of our information and according to the explanations given to us, the Balance Sheet, Profit and Loss Account and the Cash Flow Statement of the Bank, together with the significant accounting policies and notes thereon and attached thereto give the information required by the Companies Act, 1956, of India in the manner so required for banking companies and also give respectively subject to paragraph 5 (i) and (j) below, the impact of which is indeterminate, a true and fair view, in conformity except as indicated in note no. 9 on Schedule XVIII with accounting principles generally accepted in India:

(i) in the case of the Balance Sheet, of the state of affairs of the Banks as at March 31, 2003,

(ii) in the case of the Profit and Loss Account, of the Loss for the year ended on that date, and

(iii) in the case of the Cash Flow statement, of the cash flows for the year ended on that date.

(i) Note 7 of Schedule XVIII regarding restructuring of certain advances subsequent to the year-end aggregating Rs 3,116,110('000) for which provision has not been considered necessary by the management, as advances are fully/substantially secured and interest has been serviced till March 31, 2003, on restructuring.

(j) Note 13 of Schedule XVIII regarding non-banking assets of the value of Rs 1,817,527 ('000) acquired in satisfaction of debts held for long term pursuant to section 9 of the Banking Regulation Act, 1949 for which, no provision is considered necessary by the management.

Signed on: September 30, 2003.

case 9

Giant Bicycles

How A Small Company in A Small Country Goes Global

ABSTRACT

International marketing and strategy scholars have been interested for quite some time in the internationalization processes, mainly of MNCs and companies from the developed world to the emerging markets. There has been substantially less interest in the reverse internationalization processes from emerging markets to the developed world. This is probably due to paucity of data due to unwillingness of companies to share information and availability of scholars interested in documenting the processes. Such studies have been mostly confined to exports management rather than the entire spectrum of internationalization, including FDI.

Giant Bicycles corporate vision is to become *The World's Best Bicycle Company*. It has also identified its corporate mission of being 'The Global Bicycle Company'.

This is a study of a small company from a small country taking big strides through a maze of complex, yet neat strategic choices and implementation.

Giant Bicycles

Giant Bicycles succeeded in establishing initial beachheads through Original Design Manufacture (ODM) route for famous global brands such as SCHWINN and TREK, and then subsequently set up its own manufacturing and service centres in several parts of the world. In 1986, Giant Europe was set up in Netherlands in order to establish European marketing networks of the company's own brand (production started in 1997). Within next two years, Giant Europe had set up fully owned subsidiaries in Germany, U.K. and France. Additionally, Giant Bicycle Inc. was promoted in 1987 for developing a marketing network of own brands in North America with the ostensible purpose of better servicing of the ODMs. Subsequently, Giant Japan, Giant Canada and Giant Australia were set up rapidly. Just like most other Taiwanese manufacturers, Giant transferred parts of production to China to take full advantage of lower labour costs and the huge potential market. Giant currently has four manufacturing bases (one in Taiwan, two in China and one in the Netherlands) and more than ten subsidiaries which focus on marketing the Giant brand worldwide. Giant, within a short period of ten years, became the third leading brand in Western Europe and second in the United States.[1]

Founded in 1972, Giant is mainly into bicycles and bicycle components production. It offers sub bikes, mountain bikes, kid bikes, sport bikes, racing bikes, electric bikes, city bikes, and folding bikes. The proportion of business activities in all-road bicycles, indoors sport bicycles, electric bicycles and bicycle parts are 74.14 percent, 1.5 percent 1.73 percent and 22.63 percent respectively.[2]

* This case was prepared by Professor Arun Kumar Jain.

HOW THE GIANT ENTERS...

Giant's Entry Strategy in the Overseas Market

In Europe...

EU is a crucial market for Taiwan's bicycle industry as 18.3 percent of the EU's imports of 'two-wheels' products (mopeds, motorcycles and bicycles) originate in Taiwan.[3] Giant's business constitutes 28 percent of Taiwan's total bicycle export in 2001.[4]

[1]Giant Annual Report, 2001
[2]Giant Annual Report, 2001
[3]Eurostat, 2000
[4]Giant Annual Report, 2001

Giant's rapid capture of market share in Europe was on account of three major factors. Firstly, Giant broke into the EU with setting up a production plant and subsidiaries. Secondly, the mid 1980s saw the fever of mountain biking expanding from the U.S. to the EU. Giant capitalised on this trend and launched its mountain bikes, thus gaining an almost immediate market share. Thirdly, in 1993, the EU imposed 30.6% anti-dumping duties on Chinese bicycles, which further spurred the growth of Giant in Europe.

However, the establishment of the Single European Market (SEM) affected Giant's business in the EU. Under the umbrella of SEM, there are many advantages for the domestic players. These advantages include closeness to the market, getting better market information, stimulating demand, raising image and local identity, removing tariff, reducing transport costs, simplifying border formalities, reducing input costs, to name a few. To reap these advantages, Giant set up a wholly owned Holding Company in the Netherlands in 1986, which was soon followed by sales subsidiaries in Germany, UK and France. These sales and marketing subsidiaries recruit local staff, familiar with the local markets and fluent in the local language. These channels offer after-sales service and help to deal with local commission agents and independent distributors. Between 1986 and 1997, Giant adopted an export strategy to enter the EU and focussed on expanding its sales to reach the mass production level and thereby reap the economies of scale.

After achieving a steady growth in sales, Giant Europe Manufacturing Co. was set up in the Netherlands as a holding company in 1995 and began manufacturing in 1997. Giant adopted a wholly owned Green-Field entry strategy into the SEM. This strategy helped Giant to source its production system from the parent company and match the fluctuations and uncertainty in the market demand. Giant Europe Mfg. currently produces more than 350,000 units annually and is based near the Rotterdam Seaport, which helps in rapid shipping of bicycle components distribution to Western European market.

In the U.S....

Constant reduction in orders by the U.S. ODM customer (SCHWINN), led Giant to speed up promotion of its own brand in the U.S. market. It broke into the U.S. market by setting up wholly owned sales subsidiaries in 1987. By 1991, Giant had gained 9.56% market share, with more than 1,400 sales channels in the country.

In China...

Giant penetrated into Chinese market in 1993 with sales subsidiaries and a wholly owned Green-Field venture in Kun Shan. To offset the risks in a planned economy, local culture, and local competition, Giant adopted a joint venture (scale-type and horizontal joint venture) with Chinese biggest bicycle manufacturer to produce low-priced bicycles. Giant leverages the knowledge of the local partner to better understand the political environment and the 'Guanxi' in doing local business thereby minimising business risks and gaining competitive advantage. This approach also offset the 'local son-of-the-soil' argument of the major local player.

On account of its high quality, GB obtained 20% of China's market in just 3 years. Giant-China, in addition to the low-priced bicycles, differentiated itself by promoting models with modern designs, western styling and high technology, thereby catering to the demand in the big cities in China.

HOW THE GIANT WORKS....

Giant Advanced Manufacturing Techniques

In 1980, Giant became Taiwan's largest original design and original brand (ODM/OBM) bicycle manufacturer. As the world's leading producer of bicycles, Giant owns and operates four manufacturing facilities in Taiwan, China, and Europe. Giant's specialization in design, development and manufacturing has made the company an original equipment manufacturer (OEM) to several international companies. It currently manufactures bicycles for many of the world's top brands, accounting for approximately thirty percent of Giant's total manufacturing capacity.

Giant's proprietary manufacturing system, known as the Giant Production System, uses state-of-the art machinery and computer-enhanced management. This produces the quality of a custom built bike with the efficiency of a large scale manufacturing facility. As a result Giant produces more bicycles than any other manufacturer in the world. To support the growing demand from Giant's manufacturing customers and consumers, Giant has made strategic investments in additional manufacturing facilities over the past few

years. Most recently, Giant has invested in a new 11,520 square meter facility in Europe to serve the growing European market.

Giant incorporates several advanced manufacturing techniques that have been developed through intensive engineering and real world testing. In the aluminum tubing production, it makes a variety of specific tubing shapes in its own factories, thereby keeping a tight control on quality and costs.

The forging process, which force-forms a solid piece of aluminum into a finished piece, creates frame components that are much stronger than machined pieces. These components are used in head tubes, suspension assemblies, and bottom bracket/main suspension pivots.

Giant has pioneered other manufacturing techniques, such as fluid forming and press forming, maximizing a material's strength while keeping weight to a minimum, integrating it into various frame designs to enhance its functionality.

Sourcing Strategy

Except for the Derailleur System, which is bought from Shimano (a Japanese company) in the open market, all the other components are purchased through internal organisation and quasi-integration. Giant owns two component-manufacturing plants in Taiwan and China that provide components unique to Giant, such as bicycle frames with Giant's patented technology. The company integrates its small suppliers to form a 'central-satellite factories' system. They cooperate closely and share information extensively by Giant's B2B portal in the electronic-marketplace. By 2000, more than 100 suppliers were linked by this system globally.[6] Essentially Giant has embarked upon 'Global Sourcing-Decentralised Strategy'. This strategy enables Giant to have lower-cost of components, higher quality inputs and lower risks; however, this strategy poses the risk of exchange rate fluctuations.

HOW THE GIANT SELLS...

Marketing Strategy

Giant is a global corporation with regional sales and marketing offices in sixty countries, making it one of the bicycle industry's most extensive enterprise networks. While Giant's regional offices work to collect, analyze and react to local consumer and market trends, Giant's worldwide headquarters oversees global considerations such as brand management, product research and development, manufacturing, finance and global marketing.

Giant began its overseas expansion in 1986 with the establishment of Giant Europe BV, in the Netherlands. The success of the Giant brand in Europe prompted the creation of additional, localized offices in England, Germany, France and Holland over the following years. North American distribution began in 1987 by Giant Bicycle, Inc. followed by the establishment of regional offices in Japan, Canada, Australia, and most recently China. Giant Europe, and these five regional sales companies make up the Giant Global Group.

The '*Global Giant, Local Touch*' approach provides Giant's regional sales companies and offices the freedom and autonomy to pursue market-specific sales and marketing. For example, Giant Europe and Giant Bicycle, Inc. (USA), each has the ability to sell a different selection of bicycles. The key is using Giant's global experience and strength while recognizing the design and marketing needs of the various regions around the world. Giant employs the talents of designers and marketers that are unique to the country they are serving. So wherever in the world, customers have the confidence of knowing that their Giant bicycle is built for the conditions they ride in.

In the marketing activity, under the pressure of cost reduction, Giant adopts high coordination approach. Sales subsidiaries cooperate with the marketing centre based in Taiwan to promote bicycles in the local markets. However, bicycles can be viewed as a sort of consumer goods. It is hard to say that the ideas generated by the central marketing department can work in every state due to the different cultures.

Brand Management

Giant's commitment to the sport of cycling is clearly demonstrated through its sponsorship of professional and amateur cycling teams, at international and regional levels. Giant currently sponsors two highly visible international race teams, the Global Giant Mountain Bike Team and the ONCE level 1 road team.

Sponsorship of such events allows Giant product developers to see their designs in real world settings, leading to product development integration in each bicycle. In 1999, the World No 1 road ranking went to ONCE rider, Laurent Jalabert. Rune Hoydahl is the

[6] Annual Report, 2001.

most successful rider in World Cup history. His win at the 2000 Napa Valley event, like his other nine wins, was while riding a Giant Bicycle. In 2000, Myles Rockwell won the World Downhill Championship in Seirra Nevada, Spain, again on a Giant Bicycle.

In addition to its international presence, Giant actively sponsors several national teams, including those of Taiwan, Japan and China. Giant also sponsors professional and amateur teams, as well as individual racers in the United States, Australia, Canada, Belgium New Zealand and South East Asia.

As a part of the 'Total Best Value' approach, Giant strives to provide consumers with the best-designed and best quality bicycles. The Giant XtC NRS-1 was an effort in this direction. As a winner of Mountain Biking magazine's 2001 'Bike of the Year', the XtC NRS-1 was acclaimed for its superior combination of quality, value and performance. By providing consumers with a combination of features that exceeded those of other competitively priced bicycles, Giant was recognized as a bicycle brand that offered superior value for money.

In the 15 years since Giant began overseas expansion, Giant ranks as the number one imported brand in Japan, Australia, Canada, South Africa, Chile, Argentina and South East Asia. Globally, the Giant brand is already one of the most widely recognized bicycle brands.

HOW THE GIANT FEEDS CONTINUOUS GROWTH....

R&D and Innovation Strategy

Just like an automobile manufacturer, Giant emphasises on R&D to develop its high quality models. In the early stages, Giant centralised the global R&D to reach economies of scale. Most of the resources were concentrated in a single centre (at Taiwan), which helped in preventing duplication of effort and leakage of ideas and in providing knowledge to foreign research departments. To cater to the rapid changes in consumer preferences and for the sake of high responsiveness, Giant has now setup local R&D support offices in a number of key locations. The allocation of production, R&D, and sourcing aids based in Taiwan, China and the Netherlands allows Giant to gain the low cost advantage by high coordination. These R&D support offices generate ideas and then transfer to the major centre (Taiwan) in charge of co-ordination. At the same time, Giant can monitor the cultural differences and local market demand condition. This R&D strategy has propelled Giant to become the most innovative Bicycle Company. The following are some of Giant's most talked about achievements:

- Giant innovated the world's first mass-produced carbon fiber composite bicycle frame in 1987 and was the first company to mass-produce bicycles using chromoly instead of steel.
- Giant's Carbon Composite Innovation team works closely with leading carbon composite bicycle designers such as Mike Burrows to develop a line of carbon composite bicycles and accessories. This collaboration has resulted in a highly successful, carbon composite MCR cycle. The award winning MCR road bicycle was presented with Business Week's Best New Product of the Year for 1998.
- The Giant TCR Compact Road frame is a combination of unique product design and an extremely lightweight aluminium construction, and at one kilo (2.2 pounds) is in fact the lightest production road frame available today. The Giant Morph/FlexX, winner of numerous industrial design awards, is the first bicycle designed to meet the requirements of kids. The Morph/FlexX's seat height and position can be adjusted to grow as kids grow. Most recently, the development of the No Resonance System (NRS) rear mountain bike suspension has redefined cross-country mountain bike suspension. The design was given top honors in Mountain Biking magazine's (USA) 2001 Bike of the Year awards.

AND LATER ....

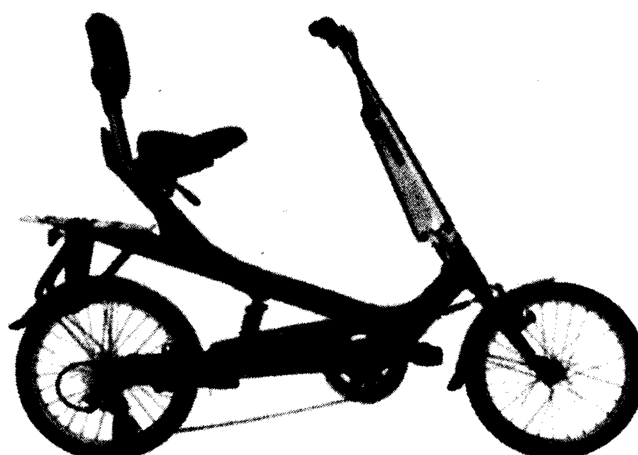
In addition to the traditional consumer bicycle market, Giant is focusing at several new segments of cycling, including meeting the needs of the commuter and recreational cyclist. Officially released in April 1999, LaFree is on the forefront of the electric-battery assisted bicycle technology. It symbolizes the future of alternative transportation and a cleaner environment. The LaFree is enjoying success in Asia, as well as in the bicycle-friendly nations across Europe.

Giant is currently developing products designed to reach people in every segment of the cycling population. This includes folding bikes, as well as the next step in versatility and style, the Prodigy Sport Utility Bike.

exhibit 1 Giant Time-Line

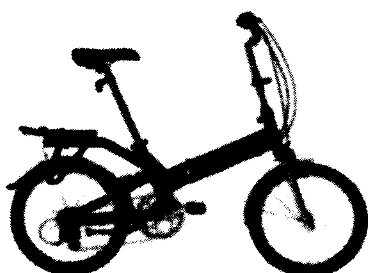
- 1972, Establishes Giant Manufacturing Co. Ltd.
- 1980, Becomes Taiwan's Largest Bicycle Manufacturer.
- 1981, Establishes Giant Sales Company, Taiwan.
- 1986, Establishes Giant Europe BV, Netherlands.
- 1987, Establishes Giant Bicycle INC., USA.
- 1989, Establishes Giant Company Ltd., Japan.
- 1991, Establishes Giant Bicycle Co., Canada, Inc.
- 1991, Establishes Giant Bicycles PTY Ltd., Australia.
- 1992, Establishes Giant (China) Co. Ltd.
- 1994, Goes Public on Taiwan Stock Exchange.
- 1996, Establishes European Factory, Netherlands.
- 1997, Establishes Chuansin Metal Products (Kunshan) Co. Ltd.
- 1998, Manufacturers 2,840,000 Bicycles in a single year.
- 1998, Acquire 30% share of HODAKA in Japan.

exhibit 2 Giant at Athens Olympics–2004



Giant Special Edition Revive for the Athens Olympics

Giant HalfWay



Giant has several Giant HalfWay bikes used by various media representatives at the Athens Olympics. The Halfway is easy to carry even in the Tram, stores in a hotel room and in the Athens traffic anytime. Handy when you are on a deadline!

It was a first for Giant bicycles to present in all cycling disciplines. More than 27 atheletes from 13 countries competed on a Giant bike. Whether a track, cross country, time trial, road race or triathlon, Giant was represented at all venues.

exhibit 3 **Some world-champions and ace cyclists from various countries riding GB in various team and individual events:**

Nationalities	Name	Teams	Disciplines
Australia	Peter Robertson		Triathlon
Brazil	Marcio May	Memorial Santos Team	Road Race
Canada	Gord Fraser	HealthNet	Road Race
Columbia	Santiago Botero	T-Mobile	Road Race
France	Frederic Belaubre		Triathlon
France	Edwige Pitel		Time Trial
Germany	Jan Ullrich	T-Mobile	Road Race, Time Trial
Germany	Andreas Kloden	T-Mobile	Road Race
Germany	Erik Zabel	T-Mobile	Road Race
Germany	Lado Fumic	T-Mobile	MTB
Germany	Manuel Fumic	T-Mobile	MTB
Germany	Carsten Bresser	Ralf Denk Racing Team	MTB
Italy	Daniele Nardello	T-Mobile	Road Race
Kazakstan	Alexander Vinokourov	T-Mobile	Road Race, Time Trial
Kazakstan	Sergei Yakovlev	T-Mobile	Road Race
Netherlands	Bart Brentjens	T-Mobile	MTB
Netherlands	Wieke Hoogzaad		Triathlon
Netherlands	Danny Stam	SDT	Track
Netherlands	Robert Slippens	SDT	Track
New Zealand	Greg Henderson	HealthNet	Track-Points race, Madison
New Zealand	Hayden Godfrey	HealthNet	Track-Individual Pursuit, Team Pursuit
Russia	Sergei Ivanov	T-Mobile	Road Race, Time Trial
United Kingdom	Marc Jenkins		Triathlon
USA	Dede Barry	T-Mobile	Time Trial
USA	Kristin Armstrong	T-Mobile	Road Race
USA	Jason McCartney		Road Race
USA	Mari Holden	T-Mobile	Track Sprint

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The *Dabbawalas*—Feeding Mumbai*

Hungry kya? What would you like: pizza from the local Domino's (30 minute delivery) or a fresh, hot meal from home? Most managers don't have a choice. It's either a packed lunch or junk food from a fast food outlet.

Unless you live in Mumbai, that is, where a small army of '*dabbawala's*' picks up 175,000 lunches from homes and delivers them to harried students, managers and workers on every working day. At your desk, 12.30 pm on the dot. Served hot, of course. And now you can order even through the Internet.

The Mumbai Tiffin Box Suppliers Association (MTBSA) is a streamlined 120 year old organization with 4,500 semi literate members providing a quality door-to-door service to a large and loyal customer base.

How has MTBSA managed to survive through these tumultuous years? The answer lies in a twin process that combines competitive collaboration between team members with a high level of technical efficiency in logistics management. It works like this.

After the customer leaves for work, her lunch is packed into tiffin provided by the *dabbawala*. A color-coded notation on the handle identifies its owner and destination. Once the *dabbawala* has picked up the tiffin, he moves fast using a combination of bicycles, trains and his two feet.

A BBC crew filming *dabbawalas* in action was amazed at their speed. "Following our *dabbawala* wasn't easy, our film crew quickly lost him in the congestion of the train station. At Victoria Terminus we found other fast moving *dabbawalas*, but not our subject... and at Mr Bhapat's ayurvedic pharmacy, the lunch had arrived long before the film crew," the documentary noted wryly. So, how do they work so efficiently?

TEAM WORK AND TIMING

The entire system depends on team work and meticulous timing. Tiffins are collected from homes between 7.00 am and 9.00 am, and taken to the nearest railway station. At various intermediary stations, they are hauled onto platforms and sorted out for area-wise distribution, so that a single tiffin could change hands three to four times in the course of its daily journey.

At Mumbai's downtown stations, the last link in the chain, a final relay of *dabbawalas* fan out to the tiffin's destined bellies. Lunch hour over, the whole process moves into reverse and the tiffins return to suburban homes by 6.00 p.m.

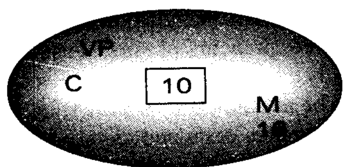
To better understand the complex sorting process, let's take an example. At Vile Parle Station, there are four groups of *dabbawalas*, each has twenty members and each member services 40 customers. That makes 3,200 tiffins in all. These 3,200 tiffins have to be collected by 9.00 am, reached the station and sorted according to their destinations by 10.00 am when the '*Dabbawala* Special' train arrives.

The railway provides sorting areas on platforms as well as special compartments on trains traveling south between 10.00 am and 11.30 am.

During the journey, these 80 *dabbawalas* regroup according to the number of tiffins to be delivered in a particular area, and not according to the groups they

Source: Case by Pradip Thakkar. Reproduced with permission from 'Hot Potatoes', *The Smart Manager*, July– Sep. 2002, Vol. 1, Issue 3.

exhibit 1



Here, the markings for the collection point are: VP for Vile Parle, C for Cooper Hospital. Destination markings are 10 (Nariman Point), 9 is the dabbawala handling the destination area, M is Mittal Tower and 16 refers to the 16th floor.

actually belong to. If 150 tiffins are to be delivered in the Grant Road Station area, then four people are assigned to that station, keeping in mind one person can carry no more than 35–40 tiffins.

During the earlier sorting process, each *dabbawala* would have concentrated on locating only those 40 tiffins under his charge, wherever they come from, and this specialization makes the entire system efficient and error-free.

Typically it takes about ten to fifteen minutes to search, assemble and arrange 40 tiffins onto a crate, and by 12.30 pm they are delivered to offices.

In a way, MTBSA's system is like the Internet. The Internet relies on a concept called packet switching. In packet switched networks, voice or data files are sliced into tiny sachets, each with its own coded address which directs its routing.

These packets are then ferried in bursts, independent of other packets and possibly taking different routes, across the country or the world, and re-assembled at their destination.

Packet switching maximizes network density, but there is a downside: your packets intermingle with other packets and if the network is overburdened, packets can collide with others, even get misdirected or lost in cyberspace, and almost certainly not arrive on time.

ELEGANT LOGISTICS

In the *dabbawalas'* elegant logistics system, using 25 kms of public transport, 10 km of footwork and involving multiple transfer points, mistakes rarely happen. According to a *Forbes* 1998 article, one mistake for every eight million deliveries is the norm. How do they achieve at virtual six sigma quality with zero documentation? For one, the system limits the routing and sorting to a few central points. Secondly, a simple color code determines not only packet routing but packet prioritizing as lunches transfer from train to bicycle to foot.

WHO ARE THE *DABBAWALAS*?

Descendants of soldiers of the legendary Maharashtrian warrior-king Shivaji, *dabbawalas* belong to the Malva caste, and arrive in Mumbai from places like Rajgurunagar, Akola, Ambegaon, Junnar and Maashi. "We believe in employing people from our own community. So whenever there is a vacancy, elders recommend a relative from their village," says Madhba, a *dabbawala*.

"Farming earns a pittance, compelling us to move to the city. And the tiffin service is a business of repute since we are not working under anyone. It's our own business, we are partners, it confers a higher status in society," says Sambhaji, another *dabbawala*. "We earn more than many *padha-likha* graduates," adds Khengle smugly.

The proud owner of a BA (Hons) degree, Raghunath Meghe, president of MTBSA, is a rare graduate. He wanted to be a chartered accountant but couldn't complete the course because of family problems. Of his three children, his daughter is a graduate working at ICICI, one son is a *dabbawala* and the younger son is still studying.

Education till standard seven is a minimum prerequisite. According to Meghe, "This system accommodates those who didn't or couldn't finish their studies. It's obvious that those who score good marks go for higher education and not to do this job, but we have people who have studied up to standard twelve

who couldn't find respectable jobs." There are only two female *dabbawalas*.

Apart from commitment and dedication, each *dabbawala*, like any businessman, has to bring some capital with him. The minimum investment is two bicycles (approximately Rs 4000), a wooden crate for the tiffins (Rs 500), at least one white cotton *kurta-pyjama* (Rs 600), and Rs 20 for the trademark Gandhi *topi*.

COMPETITIVE COLLABORATION

MTBSA is a remarkably flat organization with just three tiers: the governing council (president, vice president, general secretary, treasurer and nine directors), the *mukadams* and the *dabbawalas*. Its first office was at Grant Road. Today it has offices near most railway stations. Nobody is an employer and none are employees. Each *dabbawala* considers himself a shareholder and entrepreneur.

Surprisingly, MTBSA is a fairly recent entity: the service is believed to have started in the 1880s but officially registered itself only in 1968. Growth in membership is organic and dependent on market conditions. This decentralized organization assumed its current form in 1970, the most recent date of restructuring. *Dabbawalas* are divided into sub-groups of 15 to 25, each supervised by four *mukadams*. Experienced old-timers, the *mukadams*, are familiar with the colors and codings used in the complex logistics process. Their key responsibility is sorting tiffins but they play a critical role in resolving disputes; maintaining records of receipts and payments; acquiring new customers; and training junior *dabbawalas* on handling new customers on their first day.

Each group is financially independent but coordinates with others for deliveries: the service could not exist otherwise. The process is competitive at the customers' end and united at the delivery end. The *mukadams* are also responsible for day-to-day functioning. And, more important, there is no organizational structure, managerial layers or explicit control mechanisms. The rationale behind the business model is to push internal competitiveness, which means that the four Vile Parle groups vie with each other to acquire new customers.

BUILDING A CLIENTELE

The range of customers includes students (both college and school), entrepreneurs of small businesses, manages, especially bank staff, and mill workers. They generally tend to be middle-class citizens who, for reasons of economy, hygiene, caste and dietary restrictions or simply because they prefer wholesome food from their kitchen, rely on the *dabbawala* to deliver a home cooked mid-day meal.

New customers are generally acquired through referrals. Some are solicited by *dabbawalas* on railway platforms. Address are passed on to the *dabbawala* operating in the specific area, who then visits the customer to finalize arrangements. Today customers can also log onto the website www.webrishi.com to access the service.

Service charges vary from Rs 150 to Rs 300 per tiffin per month, depending on location and collection time. Money is collected in the first week of every month and remitted to the *mukadam* on the first Sunday.

He then divides the money equally among members of that group. It is assumed that one *dabbawala* can handle not more than 30–35 customers given that each tiffin weighs around 2 kgs. And this is the benchmark that every group tries to achieve.

Typically, a twenty member group has 675 customers and earns Rs 1,00,000 per month which is divided equally even if one *dabbawala* has 40 customers while another has 30.

Groups compete with each other, but members within a group do not. It's common sense, points out one *dabbawala*.

One *dabbawala* could collect 40 tiffins in the same time that it takes another to collect 30. From his earnings of between Rs 5,000 to Rs 6,000, every *dabbawala* contributes Rs 15 per month to the association. The amount is utilized for the community's upliftment, loans and marriage halls at concessional rates. All problems are usually resolved by association officials whose rulings are binding.

Meetings are held office on the 15th of every month at Dadar. During these meetings, particular emphasis is paid to customer service. If a tiffin is lost or stolen, a investigation is promptly instituted. Customers are allowed to deduct costs from any *dabbawala* found guilty of such a charge.

exhibit 2 **Financial profile**

	Outflows (Rs)	Inflows (Rs)
Revenues per annum		72,000
Tiffin basket luggage pass @ Rs 180 per month	2,160	
Parking charges	1,000	
Maintenance of bicycle	1,800	
Maintenance of wooden crates	150	
Fine to police and traffic police	100	
Association membership fee @ Rs 15 per month	180	
Satyanarayan puja	50	
Miscellaneous expenditure	560	
Total outflows	6,000	
Earnings per annum		66,000
Estimated net earnings per month per dabbawala		5,500

If a customer complains of poor service, the association can shift the customer's account to another *dabbawala*. No *dabbawala* is allowed to undercut another. Before looking into internal disputes, the association charges a token Rs 100 to ensure that only genuinely aggrieved members interested in a solution come to it with their problems, and the officials' time is not wasted on petty bickering.

EARNINGS

Logistics is the new mantra for building competitive advantage, the world over. Mumbai's *dabbawalas* developed their home grown version long before the term was coined.

Their attitude of competitive collaboration is equally unusual, particularly in India. The operation process is competitive at the customers' end but united at the delivery end, ensuring their survival since a century and more. Is their business model worth replicating in the digital age is the big question.

case 11

Managing Radical Change at ICICI Bank[1]: Revelations of CEO

THE PROBLEM

ICICI had a problem of atrophy, and we had to break out of it if we were to survive. In 1996–'97, we had this wonderful situation where youngsters would come and atrophy within a year. They were a small group of twenty, all from the top 10 percent of the four major b-schools. One day I asked one of these youngsters to mail merge 25 letters. Two days later, I asked what happened to those letters. He made some excuse. I went back to my room and in twenty minutes I did the mail merge, printed out the letters, signed them, and left them on his table. My colleague, Nachiket Mor, threw up his hands in frustration. His question was, "What has changed these youngsters?" They were bright and bubbly, top of the class people. Yet within six to eight months of working at ICICI, they had atrophied, lost their motivation.

The atrophy ran deep. My last job before I went to ADB (Asian Development Bank) was to put technology into ICICI. We were the first organization in the country to put Oracle into place. When I returned in 1996, I asked a senior group of forty people at a meeting, "How many of you use Oracle?" None! I accessed it, and found it was still DOS based, still had a DOS front end. I was amazed. Why hadn't the new graphics front end been put in? Why hasn't somebody asked for it? OK, the technology guy may not have put it in, I can somewhat understand that, but why hadn't somebody asked for it?

So I asked a professor how we could change this situation. He said I was too soft! I was a bit skeptical about his answer. "How do you rate people?" he asked me. "On a five point scale." "That's your problem. If everyone gets a four or five, the status quo is the easiest way to work. What's the point of working hard?" He advised me to start reading and do what other companies do, i.e. grade people. So now we grade people, and the bottom 2% to 3% have to go. We have come a long way from those days.

THE SOLUTION

I learnt how to deal with people who are stagnating—dead wood—at this point in time. It is a habit of mine to learn from everybody, and as I was reading an article in a magazine, I came across the phrase, 'parking'. It gave me the solution I was looking for. In any organizational change, you give people a golden handshake but there will still be people working in areas from which you want to push them on or out. So you park them in other spots, you remove the blockage, and get the flow going the way you want it. We parked people all over the place. A year and a half later, we offered people a second golden handshake. Many 'parked' people took it and went away. By the time the third one came, the job ended.

The important lesson for us was that the organizational chain must be free, the flow has to be free, you can't have anyone clogging it. Typically, this is some-

[1]Based on interview in Smart Manager Update 92, Reproduced with permission. Copyright Smart Manager, 2005. Not to be reproduced without written permission of the author.

thing that Indian management does not do, and it is extremely damaging. Correction of the organization has to be done all the time. Hire and fire works. I think we use 'parking' very effectively.

Once you introduce a meritocracy, people start leaving gracefully. In the last eight years we have created a whole stream of goodwill ambassadors because when people understand the process and realize that it is fair, there is greater acceptance of it. And then they find better opportunities in their own ways. We also do a lot of counseling. I meet people, talk to them, tell them we need them as ambassadors, give a big pat on the back. I want them to succeed in their new opportunities, and I think it is a win-win situation for both.

It wasn't always so. Our challenge in the first two years was how to help the bitterness which emerges when people think we are being unfair. But over the last six years, this has changed. It's an interesting side effect.

I constantly look for proxies, observing what happens elsewhere. Take a simple example. I've had some exposure to South East Asia. In the last fifteen years, with a per capita income of $500 to $600, the whole continent gained momentum. First China and later Indonesia, Philippines and Thailand created the right conditions with low interest rates and stable inflation. What happens elsewhere can happen here also. It's a question of the feasibility of applying in the domestic context and retro fitting. In a nutshell, one has to read the market early, read all the available proxies and take a decision, often with limited information.

NEW INITIATIVES

My entire team and I have a bias for action. If we see an opportunity, we don't hesitate. Take technology, unexplored technology. We believed that the Indian customer was prepared to look at technology. So we said, let's put in the ATMs, Internet banking and a call center—the key technology channels. So I think we have the ability to read what will happen a little faster than the competition. We discover opportunities in markets earlier than others. We saw a drop in interest rates and we felt that this would mean that customer lending will move fast. We stepped ahead of the competition and were able to seize market share.

Frankly this is the easy part. So many CEOs can strategize after looking at environmental factors. But after the decision making comes the execution. This is the real challenge. People try to execute in a status quo. You can never execute in a status quo. The organization is not geared to it. Is the structure right for what you want to do? If I don't think it is right, I won't allow people to do it, because it won't work. I've heard the phrase, "You cannot have a third generation strategy with a second generation organization run by first generation workers" and it's totally right.

CHANGES AND THEIR AFTERMATH

I've been here eight years and the organization has gone through five structural changes during this time. The first two changes were gut wrenching. Oddly enough, the last one, a major organizational change which should have been the most painful one, was accepted in the organization. Change by this time had become acceptable.

We had tremendous resistance in the first year. People were willing to come to blows and there were emotional breakdowns. After that we saw a clear change in attitudes and outlook, in the way people went about their work. It was a question of communicating. Every time I went to one of our offices, I would meet maybe twenty to thirty people, sit for three hours and discuss why we are doing what we are doing. We would set targets and we found they were all achieved.

The second time round, we created relationship groups. This was a complete departure from the way we used to do things around here earlier, again gut wrenching. Both in the bank and in ICICI Corporation, I invited senior managers to tell me how they plan to run their business.

Everybody came with an organization chart, and I'd just tear them up, saying, "I don't want to know that. I want you to explain the relationships you have and will have, who relates to whom, who will do what and how. I don't want boxes." After the first one or two days, people understood what we meant. First they came out with their own relationships within their line of responsibility, then the relationship between them and the rest of the organization. Slowly thereafter new business came in, meeting our targets.

Timing and how you deal with uncertainty is an important par of success. We took the right decisions and we were bold enough to take those decisions. But had the timing not been right, we could have lost out.

CHALLENGES, THREATS AND OPPORTUNITIES

In 1999 we were working in a completely blind world. Banks were faced with the Internet threat. Experts were predicting that banks would face competition from the likes of telecom companies, media companies, and any company with a large database and the ability to talk to customers on the Net. Customers would migrate, they warned. It's an interesting example of dealing with uncertainty. Most banks were not bothered but for us it was a key part of our strategy.

The challenge was what kind of partnerships do you commit to. We took some decisions which at that point of time were hasty. There to four months later we realized that the Internet was moving at a different pace. We quickly retracted from the strategy and took a different path. I would say that his was the only time in the last eight years where we took a wrong call. The important attribute here is that we could retract, we looked around, talked to people. There's no point in sitting in your seat and waiting to see what is happening around the world. We quickly discussed what we saw and took action.

On the other hand, timing was on our side in 1996. All our technology implementation took place after the mainframe era, and we could take advantage of the huge breakthroughs in computing power at the time when our customer base was exploding from 10,000 customers to 600,000 to 2.5 mn to 5 mn to 10 mn today.

You need to simplify the complex. When in a problem, everybody knows the problem, and any amount of analysis is done, but most often no decision comes out from the analysist. Ultimately the decision needs to be taken from the gut. We take decisions after a lot of analysis but it is a quick analysis. We don't allow any decision to take more than a few days. Detailed worksheets will be available later but in the beginning a lot can be deduced from back-of-the-envelope calculations. I think a lot of companies hesitate to take decisions. The status quo is not acceptable, you have to see how you can stretch the boundaries. There must be stretch, stretch and stretch again in any organization. If you achieve the target, the target must be raised again. You have to raise the bar internally and not allow people to become complacent. You can make things happen.

You need to be bold. The impact of status quo is clear to see among our competitors. We survived because of change. After eight years in this job, having seen the things I have seen, such as, creating the team, creating the structure, getting the ideas and executing them, I realize one element is critical: to be bold. In our situation, you needed to be bold and have the confidence to go along with the entire diversification play. In hindsight, it was a brave decision to diversify. We had no product knowledge, no processes and no people to run the business. But we had the 'bold' factor. We clearly had to recast portfolios and level the status quo. In this change journey, I trusted the leaders, allowing them to lead and make mistakes within the boundaries of their responsibilities. In all the new businesses, one leader had to change jobs; that too for personal reasons. Everybody else succeeded. Even he is doing well now, but in a different job.

THE SIGNIFICANCE OF TECHNOLOGY

There is a paradox which escapes many Indian managers, relating to employee productivity and technology productivity. The key today is really technology productivity not employee productivity because in India, labor is a low cost, it is not a significant contributor to P&L expenses. In our context, what is significant is technology. The cost of technology—say a system, both hardware and software, identical to Citibank's in the US—is no different in India than in the West. Suppose both have the same number of employees, it's a no brainer that India would be ahead.

The paradox in banking is that the average customer transaction and ticket size in India is one tenth of that in the West. The average deposit in the west is $15,000, but for me it is $2,500. For a government bank, it is less than $200 to $300. They still don't understand what they are doing and it is not my job to tell them what they have not understood. You can't get technology and say I'm going to do what others are doing because I can afford it. We have to run technology in a completely different way from western banks.

Take ICICI Bank. We may have $30bn in assets—but we also have 10 mn plus customers. To put that in context, our customer base is equal to the combined customer base of the three largest banks in Singapore. Yet in terms of assets, we are only one tenth their size.

Internationally, banks make money on the transaction side and on the deposits. We do not because we don't have the deposits and we do have a large number of small transactions. In the Indian context you have to squeeze employee productivity, squeeze technology efficiency. Less than 30% of customers come into the branch. Almost 70% of transactions take place through technology channels. With 500 branches, we would not have survived otherwise.

THE 90-DAY RULE

The 90-day rule is again one of my learning experiences. I was in a seminar on the use of technology in New York. It was fascinating. Someone described the '90 Day Rule' or how an entrepreneur starts off in Silicon Valley. He has to design a concept, build a product, test it and take to the market within 90 days otherwise he will be dead because 25 other people are thinking along the same lines. I started thinking, why can't we do this? When I reached London, I called Mumbai. "You are starting the '90 days rule' today", I told a team which was working on a technology project, "and the countdown began ten days ago when you started the project, not 90 days from today." It was a completely new mindset. In the next six months we took up about ten to twelve projects and they were all brought in 90 days. This concept now has a strong grip in the organization.

THE IMPORTANCE OF GRAPEVINE

I know because I many times put my ear to the grapevine. I don't have to walk around to access the grapevine. People tell me. People who are successful, the guys who will become leaders, are the people who have their ears glued to the table. They know exactly what is happening, who the good people are, and who's good at what. And I have no compunction in taking a huge stick to politics, which I make clear in public. So I don't see people politics in our organization, I see merit based jockeying.

Open postings means you can pick people from anywhere. If a leader has a really critical issue about one of his people being picked up by another, they come to me. We discuss openly about where the person is most required in an organization. Then I will call the person and say this is what I want you to do, this is where I want you to go. Probably people can't challenge me, but one avoids the challenge. Once you start compromising on this issue, I think you are dead, because the organization will not grow. You will not be able to clearly see the final objective, which is that the organization is more important than the individual. So the grapevine is a very interesting thing. And I've seen that youngsters are absolutely clued into who is what. When they get to be a manager they know exactly whom to pick if they have a choice.

BUILDING TALENT AND IDENTIFYING LEADERS

You have to mix entrepreneurship in a professional context. You have to have a strong base of entrepreneurial leadership, not just a single charismatic entrepreneur. Ideally you want everyone to have entrepreneurial ability. It is desirable if they have different make ups, that adds to the organization. Earlier, our office was opposite Hindustan Lever, and we built a lot of our building blocks looking at Hindustan Lever. It is an organization with a strong entrepreneurial drive, with a depth of management talent.

I don't know much about Hindustan's history but every five to ten years a strong entrepreneurial leader emerges. There is clearly a process of building talent. We have always admired that. So what we are trying to do in our own way is to build a parallel process of identification of leaders, to mark people as the new leadership. In our context, people enter the organization at age 24. By the time they are 32 or 33 years old, they become general managers, and by 35, they have reached the second level from the top. So we don't have much time. We need them to grow, to demonstrate personal leadership traits and that they can manage the business and people. Sometimes you think you have a leader, but when you stretch across other operations, they break. They were excellent managers at a particular level, but you throw them into the next level which is two steps into the leadership chain, they are not able to handle the challenges. We find this happening repeatedly. Our damage rate, may be, is between 25% to 30%. In ten people two won't make it. I can live with this because first, I have a pool coming in all the time,

and second, we have learnt to deal with short term damage. It is a tricky one.

In several management books, the authors try to make a case that there is something wrong about charismatic leadership. I don't agree fully with this thinking. It may appear to be a single quality but it is not a single quality. Charisma is a trait that develops in you based on several other things that you do, on how you change; as well as being the outcome of several things that happen around you. I think a bit of charisma is required because people like to follow a charismatic leader. If you don't succeed, you won't be seen as charismatic.

Good leaders are those whom followers love and respect. But to be respected is ultimately what will carry you through. If you lead through love, maybe you compromise, you give in. You have to earn respect. Finally unless your team sees leadership attributes in the same way, it is no good. At the same time, they should not be your clones, you need a culture of different skills set. We have a wide variety of leaders at the board level. I can confidently say that there are no two people who are fully alike among my top fifteen people. But there is no difference in understanding how the organization looks and the way it does things.

The challenge is to identify the leaders from the group coming in. I had joined ICICI a few years ago, and one fine day in 1974, I read an advertisement in the newspapers calling for people with a technical background such as engineers—MBAs weren't all that common then—and offering a salary for two years' experience, which was significantly higher than what we were getting after more than four years of being in the company. Some of us started calculating. We took a hard point of view. Shirish Nadkarni, who later became chairman, was very, very upset. He called a meeting of all the project officers to discuss the issue.

It was the first time we took a stand, and it had a negative impact on the organization. Later recruitment stopped. For the next twenty years ICICI did no recruit laterally! This was too much of a penalty for our organization, I can say this today. I think ICICI should have continued to recruit—may be set the pay scale right and continue to recruit right and continue to recruit. Later, we did start campus recruitment and building from the grassroots level up.

From 1986 onwards I went to campuses for three years to formally recruit people. But in 1996 when I came back, there was no lateral recruitment, we had only people that had grown from within. We started lateral recruitment from 1997. Maybe I contributed to changing a policy at that point, maybe twenty years later I contributed to completely changing the policy again. For our growth, we have to recruit laterally.

When I joined ICICI, I thought my career would be a rack within ICICI, but I got several breaks and two or three career changes. The first one was when Mr Vaghul asked me to become his executive assistant. He was chairman at the time. Working with him gave me a completely different insight into how businesses work, and how he ran the business. He is a wonderful mentor and put me on a different track. He told me to go to London and get trained. That was the first change. The second change was equally interesting. I wanted to create a strategy group. It was one of the most fun periods of my life. And I started the treasury group also. Neither departments had people, so I had to start by recruiting people in groups of about eight to ten people.

Every day at 8.30 am a new idea would come up. Mr Vaghul would come in with them and the first half hour of the day was always interesting. Seeing someone outstanding at work changed my career and let me grow. In 1988, when I got the opportunity to go to ADB, he encouraged me to go. The idea was that I would come back after a few years. This period was a time when India was in deep trouble, so I stayed on. The eight years in ADB were uneventful. I made a bit of money but it was not challenging. But I did keep my eyes open, tried to understand what was happening in places like China and South East Asia, so it was a great learning experience. When I came back, I could actually draw from my learnings. But to be very frank, in 1996 I started with a clean slate. I have tried to pick people who would lead ICICI, and find ways to reinvent the business.

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Milking the Holy Cows!

Cash rich COFC, India's most profitable public sector company, requires funds to implement its ambitious expansion plans. The Government with 96% stake in COFC asks the company to declare a special dividend to fund its fiscal deficits. A special dividend at this juncture would derail the company's growth. In whose favor should the Board of COFC take a decision?

During the last few months it has been widely conjectured that India's Finance Ministry has been looking around at a few profitable public sector companies (PSUs) to fund its fiscal deficits through special dividends over and much above the normally declared dividends.

Prominent among these PSUs are the oil and gas majors like Central Oil and Fuel Corporation (COFC) and India Energy Limited (IEL). The government had already done a similar milking strategy earlier in 2001 with its telecom monopoly Bidesh Sanchar Corporation (BSC) before it was disinvested to the private sector. BSC shelled out Rs 22.5bn as a special interim dividend just before its privatization—the argument then was that since the company was being privatized the government was only taking out the cash which rightfully belonged to it.

The case of COFC is, however, different. The government is unlikely to either divest or dilute its equity in the national oil company in the foreseeable future. But it argues that the targeting of the oil companies is legitimate since these companies had profited from subsidies on kerosene and domestic LPG over the years. It was also suggested that COFC had gained the most in the decontrolled regime by getting the globally benchmarked price for crude oil, while its cost of capital was highly subsidized. In recent times, this was as high as $28 per barrel instead of a fixed $16 earlier and COFC's kitty is swelling because of this distortion. By and large, similar reasons as in the case of BSC were preferred for taking the cash out of these companies.

* This case was prepared by Professor Arun Kumar Jain.

MILKING THE CASH COWS TO PAY FOR FAILURES ELSEWHERE?

The real reason for huge cash withdrawals from COFC, according to many financial pundits, is that the central government faces an acute revenue shortfall, compounded by its inability to meet the targets for disinvestments. The revenue gap is said to be as much as Rs 100bn out of the total disinvestment target of Rs 120bn for the year 2004–2005. Moreover, government expenditures are mounting due to administrative inefficiencies and overstaffing, poor performance in tax collections and increased non-plan expenditures.

As of now, no one seems to know the exact amount these national oil companies have been asked to pay. It has been reported that COFC alone has been asked to pay as much as Rs 60bn to Rs 100bn as a special dividend. Another report suggests that the dividend payout for all oil companies is scaled down to Rs 26bn, out of which COFC would contribute Rs 17bn.

ABOUT COFC

COFC, India's biggest oil exploration company, has an excellent track record in declaring dividends. A hefty 140% dividend was announced for the year FY03–FY04, Which was more than 30 percent of its net profits for that year and resulted in an outgo of Rs 19.96bn. In FY02–FY03, it had paid at 121 percent dividend of Rs 17.28bn. The company is still cash rich and has balance sheet reserves and surplus amounting to Rs 282.96bn for the year ending March 2004.

As a result of low production costs and receiving global market prices, COFC is India's most profitable

company. For FY03–FY04, COFC's net profit was Rs 61.98bn, about 2.5 times more than the next most profitable company Oil of India Corporation (OIC). It topped the ET500 rankings in September 2004 by displacing the more regular occupants—Bharat Levers (BLL), the Globolevers subsidiary in India, and Pepro, a homegrown infotech giant. With a market capitalization in excess of Rs 550bn, the company topped the *Business First's* BF1000 rankings in December 2004 overtaking the more famous private enterprises such as Infocomm and BLL for the amount of wealth created. COFC also outperformed the BSE Sensex during last two years (Exhibit 4).

exhibit 1 **Investment plans for COFC for next five financial years**

(Rs in bn)

	2004–'05	2005–'06	2006–'07	2007–'08	2008–'09	total
exploration	17.25	15.46	15.27	21.40	17.83	87.21
development drilling	12.06	15.04	21.45	22.56	10.35	81.46
facilities	31.54	44.21	38.89	22.36	8.60	145.60
R and D	2.14	2.32	2.69	2.88	3.20	13.23
joint venture	1.26	1.95	1.70	0.94	0.83	6.68
total domestic	64.25	78.98	80.00	70.14	40.81	334.18
overseas	19.43	22.70	34.67	31.70	27.00	135.50
total	83.68	101.68	114.67	101.84	67.81	469.68

COFC IN THE POST-AMP SCENARIO

COFC, till recently, operated in a protected market. It was required to sell its product, mainly crude oil, to public sector oil companies at a price that was much lower than the international prices of crude oil. But at the same time it had privileged access to India's best oilfields. After the removal of Administered Price Mechanism (APM), the company could sell its crude at a price determined by the international markets. This policy change, however, also exposed it to the vagaries of international oil price fluctuations. The company badley needs to expand and build new assets offshore and buy-in fresh assets in other countries to remain an internationally competitive corporate entity.

COFC plans to tackle the policy induced challenges in two major directions. First it wants to take advantage of the globalization process and expand operations globally; the second foray is in integrating itself into downstream activities like transportation, refining the marketing. Subroto Raman, chairman and managing director of COFC, feels that the business strategy of COFC should be a continued focus on its core business of exploration and production, and at the same time go for vertical integration to secure sustained growth. COFC has bared such growth intentions by acquiring the 37 percent stake of the Rising Sun Group in the loss making Mannur Refinery & Petrochemicals (MRPL). Subroto Raman also wants to build a strong downsteam presence by trying to acquire the Central Government's stake in Petroleum Corporation Limited (PCL). According to him, "We have already requested to be allowed to bid for PCL as it would help us attain vertical integration along the entire value chain of petroleum business. With the acquisition we can go into transport fuel marketing without a long gestation period as against potential competitors who pose formidable entry barriers."

COFC also plans to enter the retail business of transport fuels by opening 600 petrol filling stations around the country, making it a full vertically integrated oil company. More importantly, these synergistic forays will also diversify the company's risks. One of India's leading credit rating agencies commented on these strategic approaches, "It is like having a balanced portfolio with the risks evenly spread out. When crude prices spurt, COFC gains from upstream activity, and when they crash, its refining margins go up. It is win-win for COFC."

exhibit 2 COFC's increasing profits despite output being stagnant

year	natural gas mn cubic metre	natural gas mn cubic metre	net profit rs bn
1998–1999	29.21	22.60	20.33
1999–2000	29.22	23.70	26.77
2000–2001	27.55	23.94	27.54
2001–2002	26.18	24.56	36.29
2002–2003	26.63	25.35	52.28
2003–2004	26.30	25.00	61.97

exhibit 3 COFC's shareholding pattern (November, 2004)

shareholder	percentage of equity share held
central government	84.1
OIC	9.6
IEL	2.5
mutual funds	1.36
public	1.3
financial institutions	0.9
foreign	0.22
others	0.02
total	100.0

DOES PAYING SPECIAL DIVIDEND AFFECT COFC'S LONG TERM PROSPECTS?

Though COFC is presently the largest company in India in terms of market capitalization and net profits, it is already facing major competitive challenges. The management has realized that its high profitability was mainly due to favourable crude oil prices in the post-deregulation era. Further, despite net profits spiraling upwards, its crude oil output has remained stagnant or even declined in the last five years. A business writer wrote succinctly on this, "...the strong bottomline can be traced to a windfall of high crude oil prices, rather than any great strides in operational efficiency. Whether global oil prices will remain high beyond the near term is the great big imponderable."

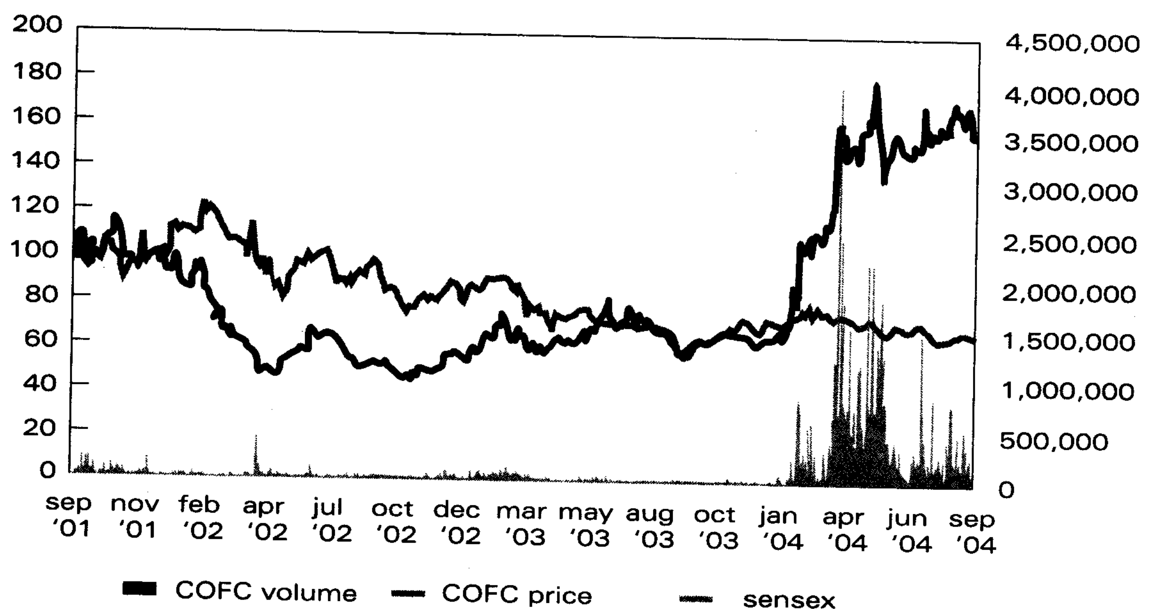
In a nutshell, it is obvious that for COFC to remain competitive and grow rapidly, it needs to show a much higher commitment and speed in

- investing in technology to upgrade its recovery and efficiency to global benchmarks, as well as investing in oilfields abroad to remain competitive in this changing scenario of global competition.
- improving reserve accretion to retain its growth of profits considering that now it does not have proprietary rights even in India for exploration of oil fields.
- integrating downstream to mitigate risks of oil price fluctuations and compete with global integrated oil companies.

In terms of implementation of above, the management has planned huge investments aggregating to Rs 480bn during the next five-year plan. The proposed dividend could also put a question mark over the funding of COFC's current projects since the company has an annual capital expenditure of more than Rs 30bn towards the redevelopment of oil wells and other investments in overseas markets during the year.

COFC requires surpluses and cash for making these massive investments. Though the reserves of COGC are currently more than Rs 280bn, it has just about Rs 60bn in cash reserves, half of which it would have to pay in the current financial year itself for acquiring a 25% stake in a Sudanese oil field. This meant that even to pay the proposed special dividend, COFC would have to encash some of its term deposits. Also, with a huge one time outgo, it may possible be required to borrow for funding its normal capital expenditures in the following year. It is noteworthy that debt is usually available to the oil exploration companies at a high interest premium due to the inherent business risks involved.

exhibit 4 **COFC's share price movement**



ROLE OF COFC'S BOARD: CAN IT STRIKE A BALANCE?

The role of a company's board in the narrow financial views is to maximize the value of shareholders equity. A broader stakeholder view entails the board to keep the reasonable and legitimate interests of the other stakeholders in mind, while taking strategic decisions such as those involving expansion, closures, mergers and acquisitions. The central government was the largest shareholder in COFC with 84 percent equity. Given the fact that Oil of India Corporation (OIC) and IEL (the other major equity holders in COFC) too were government owned, the latter effectively owned 95 percent of the company.

A high 'special' dividend might bail out the central government from its problems of huge fiscal deficit, but it may hurt the future investment plans of COFC. It could even endanger the very survival of the company. Given this, such a move may not be in the long-term interest of the majority shareholder, that is, the Government itself. In other words the Government in one strike could cripple the hen that lays golden eggs. A business editor summed up the situation rightly as, "The Government's proposal to 'get' COFC to declare a hefty special dividend could spell disaster not just for the company but the economy as a whole... To a government hungry for cash, COFC's coffers obviously present an inviting sight. But this is one coffer that the Government should only stare at and not covet, for at stake is not just a few crore rupees but the energy security of the country itself." Also in this case a legitimate claim of a majority shareholder could be detrimental to the interests of other direct and indirect stakeholders, such as, the employees and the Indian economy as a whole.

exhibit 5 Key financial figures of COFC for the period 2000–2004

(figures in rs bn unless stated otherwise)

	2000	2001	2002	2003	2004
sales	153.17	151.07	202.42	242.91	237.64
other income	6.32	9.09	8.59	9.49	12.70
total income	159.54	160.17	211.16	252.85	250.25
net profit (pat)	26.77	27.54	36.29	52.28	61.97
dividends	3.92	8.70	10.68	17.28	19.96
retained profit	22.85	18.83	25.61	35.00	42.01
paid-up-shares (in crores)	1.42	1.42	.1426	1.42	1.42
equity capital	14.25	14.25	14.25	14.25	14.25
reserves	209.38	228.22	253.84	288.85	282.96
net-worth	223.22	241.71	267.36	301.47	295.11
key ratios					
key ratios growth percent					
gross sales	0.1533	–0.0137	0.0398	0.20	–0.221
net sales	0.2166	0.0073	0.4441	0.38	–0.0399
cost of production	0.2036	–0.1035	0.1361	0.93	–0.0352
gfa	0.1045	0.0763	–0.1379	0.03	0.0388
total assets	0.0783	0.0384	0.0298	0.03	0.1292
margins percent					
pbdit/sales	0.5071	0.4999	0.6124	0.58	0.1602
pat/sales	0.1685	0.1794	0.2875	0.21	0.2564
returns ratios percent					
pat/net worth	0.1219	0.1168	0.2287	0.18	0.2041
pat/total assets	0.0749	0.0744	0.1545	0.13	0.1448
liquidity ratios					
total debt/equity	0.0042	0.0034	0.0027	0.0015	0.0012
current ratio	0.0158	0.0132	0.021	0.0134	0.0134
interest cover	0.0547	0.0525	0.1096	0.0770	0.0925
r and d as percent of sales	0.25%	0.38%	0.35%	0.34%	0.34%
dividend rate percent	27.5%	61.1%	74.9%	121.2%	140.0%
dividends as percent of pat	14.6%	31.6%	29.4%	33.1%	32.2%

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Boeing....Flying High on Values

It was scandal that had brought Harry C. Stonecipher out of retirement in late 2003 and made him chief executive of Boeing. Now a different kind of scandal broke out and sent Boeing's board scrambling to find answers. The event had its genesis in a relationship that the 68-year old CEO had with a female executive. An internal enquiry by the board of the Boeing confirmed the allegation.

Stonecipher was instrumental in setting high performance standards in the company after his reinduction into the company. In 2003, the company was struggling to come out clean over allegations in a defense deal with the Pentagon which forced Mr. Conduit—the former CEO—to resign. The US Air Force had then imposed restrictions over Boeing's participation in defense tenders. This ban was lifted in March 2005 after continuous efforts of Mr. Stonecipher to improve the image of the group on issues of business ethics and individual level morality. He introduced and designed a fresh code of conduct for all Boeing employees across the world. Under the circumstances it was difficult for the Board to either ignore or overrule the allegations against Stonecipher.

STONECIPHER RETURNS TO BOEING

Boeing was long the world's leading maker of commercial airliners but was unseated by European rival Airbus SAS in recent years. However Boeing's defense business gained strength, making up 57 percent of the company's $52.46 billion in 2004 revenue (see Appendix 2). But the defense business got mired in scandals. In 2003, former top acquisition official at Pentagon, Darleen Druyun, pleaded guilty to seeking a Boeing job while negotiating a $23 billion Pentagon deal for aerial refueling tankers. Darleen admitted that she favoured Boeing on several other multibillion-dollar deals because the company gave her daughter and son-in-law jobs.[1] The disclosure led to collapse of the deal for military refueling tankers. The Boeing Board sought the resignations of Michael Sears, the Chief Financial Officer and Darleen Druyun in November 2003, after an internal probe uncovered their job nexus.[2] In December 2003, Mr Philip M. Condit, Boeing's CEO, was asked to resign because of 'ethical' lapses, including affairs with employees, and poor business judgment.[3] Michael Sears was sentenced to four months in prison in January 2005 for 'improper' recruitment of Druyun at $250,000-a-year position.

This was the time that the 68-year old Harry C. Stonecipher, who had retired from Boeing several years ago as Chief Operating Officer, was asked to come back. "I've done this before, and that's why I'm back", Stonecipher said on his return.[4]

A son of a Tennessee coal miner, Stonecipher started working at General Motors aircraft-engine unit as a lab technician in 1955. After graduating from college in 1960, he worked for General Electric Co.'s aircraft-engine business, moving up the ranks to become head of its commercial and military transport unit in 1984. He changed jobs in the late 1980s and was instrumental in getting Sundstrand Corp back in good

* This case was prepared by Professor Arun Kumar Jain.

[1]Log P.P., "*Boeing Dismisses CEO Over Affair, The company says his relationship with an unnamed executive showed poor judgment*", Los Angeles Times, March 8, 2005. http://www.latimes.com/business/la-fi-boeing8mar081,633767.story?coll=la-headlines-business&ctrack=1&cset=true

[2]op. cit. (1) above

[3]Wayne L., "*Boeing Chief Is Ousted After Admitting Affair*", New York Times, March 8, 2005

[4]op. cit. (1) above

graces with the Pentagon after the company pleaded guilty to overchanging on defense contracts. In 1994, Stonecipher was named chief executive of struggling McDonnell Douglas. In 1997 he engineered MD's sale to Boeing, a deal which expanded Boeing's military contracting business and left the United States with just one marker of large commercial aircraft. He became CFO at Boeing before retiring in June 2002.[5]

EARLY ACTIONS

After his appointment Stonecipher told Wall Street that he was 'on a mission to convince U.S. officials that the company was not full of a bunch of crooks'. During his brief tenure, Boeing achieved a most tangible evidence of a turnaround when the US Air Force lifted a 20-month suspension in January 2005 from bidding for new government rocket-launching business imposed after Boeing won a competition using stolen documents from Lockheed. 'He did a good job of working to restore Boeing's reputation and refurbishing ethical standards at the company, and that's what Boeing needed,' said Philip Finnegan, director of corporate analysis at the Teal Group, a research firm.[6]

Stonecipher rapidly brought Boeing back on track. "The team has been committed to restoring our reputation and at the same time keeping our eye on the ball of running the business," Mr Stonecipher said in fall of 2004, as he announced earnings that exceeded Wall Street expectations. "We are relentlessly focused on execution, meeting our commitments, driving our performance to new levels and restoring our reputation with all our stakeholders."[7]

At Boeing, the tough-talking Stonecipher was not universally admired by employees, who viewed him as a relentless cost-cutter focused too narrowly on the bottom line. He was also criticized for what some employees saw as overreaching as he sought to burnish the company's image. 'He had all of us go through a recommitment-to-ethics day, but for what? There is a lot of anger here' said one employee.[8]

[5]op. cit. (1) above

[6]op. cit. (2) above

[7]Norris F., "*Boeing's Road to Redemption Paved With Affairs Great and Small*", New York Times, March 8, 2005 http://www.nytimes.com/2005/03/08/business/08place.html?dlbk=&pagewanted=print&position

[8]op. cit (1) above

After assuming charge, Stonecipher emphasized ethical conduct and adherence to the norms of corporate governance in all the dealings that Boeing executives had. The company brought out an Ethics booklet which was distributed to each employee who was expected to thoroughly go through the contents. There was an open door policy in terms of seeking clarifications whenever in doubt about the way forward. As part of this initiative, all the 159,000 employees attended half-day ethics sessions and signed a pledge to abide by a code of conduct, which declared that employees should avoid doing anything that would embarrass the company (see Appendices 1, and 7 to 10). Likely situations were highlighted and expected behaviour was explained unambiguously therein.

BOOBY-TRAPPED RELATIONSHIPS

While Boeing was climbing the market capitalization charts, there was a sudden bombshell in February 2005. Lewis E. Platt, Boeing's non-executive chairman called a conference with analysts and reporters and told them that 'an internal investigation against Stonecipher discovered some issues of poor judgment involving Stonecipher and a female executive in the same office.' He said the company's investigation found that some allegations made by an employee were untrue, such as that Stonecipher had influenced the woman's career or salary. The tip to the board included part of a 'very graphic' e-mail Stonecipher had written to the lady. Platt said that Stonecipher (who was married) acknowledged the affair and was fined. The Board concluded that the CEO's behavior violated a code which states that Boeing employees will not engage in conduct or activity that might raise questions about their (and company's) honesty, impartiality or integrity.[9] Further Platt explained that the code of conduct did not explicitly prohibit affairs between employees, but that 'when we looked into it, if certain details were disclosed, it would cause embarrassment to the company.' Platt further said that Stonecipher was fired not because 'of the fact he was having an affair. It's not a violation of our code of conduct, but as we explored the circumstances surrounding the affair, we just thought there were some issues of poor judgment that impaired his ability to lead going forward.'[10]

[9]op. cit. (8) above

[10]op. cit. (8) above

For the purpose of this investigation Boeing had brought in an outside counsel. The investigators interviewed Stonecipher and the executive, who said that they began their consensual relationship in January 2005. Stonecipher did not exercise any undue influence on the executive's compensation or her position in the company and investigators did not find that company resources were used improperly in any way, Platt said.[11] The announcement of Mr Stonecipher's departure came only days after the company's share price hit a three-year high on the news that a division was again able to compete for United States Air Force contracts. He had received generally good grades for turning the company around.[12] Responding to the question over his dismissal Mr Stonecipher said 'we set—hell, I set—a higher standard here, and I violated my own standards. I used poor judgment.'[13]

Wall Street reacted negatively to the news of removal of the CEO at Boeing. Boeing shares, which had been trading at three and a half year highs, dropped 8 cents to close at $58.30 on the New York Stock Exchange on march 8, 2005. They fell another 19 cents to $58.11 in after-hours trading.[14] On 4th March 2005, Boeing shares were traded $58.74, up 54 percent during his tenure.[15]

Interim CEO of the Group James A. Bell believed that Stonecipher's departure would not be a setback: 'I don't think we're going to backslide at all. In fact, I think it accelerates the point that no matter who you are, the rules apply'.[16] He further highlighted that 'this announcement has no impact or will have no impact on our outlook. Our financial performance in 2004 was strong, and we have projected significant growth in our businesses over the next two years,'[17] (See Appendices 2 to 6).

FINALLY, JUST DESSERTS

While removing Stonecipher, the Board recognized his hard work and announced an incentive award of $2.1 million for the growth that he gave to the company. The incentive was based on Stonecipher's ability to focus the company to achieve excellent financial results and strong stock performance for 2004. The bonus was calculated on job performance as well as the financial performance. In 2004 alone, Boeing's shares rose from around $40 a share in January to close at $51.77 by year's end.[18]

Critics attacked the move to reward the outsted CEO. 'At the beginning of the week, it looked like the Boeign board was getting tough on unethical behaviour,' said Keith Ashdown, a military analyst at Taxpayers for Common Sense, a nonprofit group in Washington. 'By the end of the week, they were giving Harry Stonecipher millions of dollars. This lush compensation package hurts any efforts of the board to make Boeing look better.'[19]

[11]op. cit (1) above
[12]op. cit. (10) above
[13]op. cit. (2) above
[14]op. cit (8) above
[15]op. cit. (10) above

[16]op. cit. (2) above
[17]Pae P., "*Wall St. Takes Boeing CEO's Ouster in Stride*", Los Angles Times, March 9, 2005. http://www.latimes.com/business/la-fi-boeing 9mar09,1,1510995,print.story?coll=la-headlines-business
[18]Wayne L., "*Ousted Chief of Boeing Gets $2.1 Million Bonus for 2004*", New York Times, March 11, 2005 http://www.nytimes.com/2005/03/11/business/11boeing/html ?dlbk=&pagewanted=print&position
[19]op. cit. (40) above