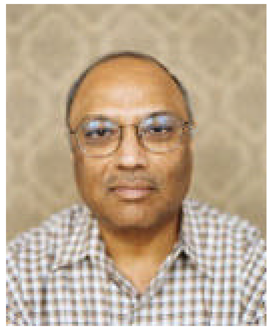

Speech delivered at Partnership Summit
by
Prof. C K Prahalad

Good morning.

Thank you for the kind words of welcome.

I will try my best to share my current thinking on what are the opportunities for India. I want to start by looking at ***global restructuring of industries***. This will take place with or without India. So there is an external trend that is taking place. I am going to spend a few minutes asking ourselves what are the ***fundamental drivers behind global restructuring***. Why do large global firms and industries morphing and transforming themselves? Then I want to switch and ask myself ***what are the needs and priorities of India, as someone from the outside sees it***. I know you have spent a lot of time over the last 4 days talking about a wide variety of wishes and if I put them all together there are probably 25 priorities in India. As all of us know when you have 25 priorities nothing gets done. So I am going to throw an external view of what may be just 2 priorities for the country. Then I would like to ask a question, ***is there a convergence between India's priorities and the global restructuring of industries and if the convergence does take place how do we, as Indian managers, capture this opportunity*** - that is the agenda.

So I will start with restructuring of global industries. India's needs and then we will talk about India's opportunities.

First, lets talk about restructuring of global industries - what might be happening? What are the key drivers? I believe ***that there are 5 fundamental key drivers that every large company and every industry is concerned abo***ut.

- First, I like to call it the ***search for new sources of revenue***. It is not selling more to the existing market but ***fundamentally creating new markets***.

- Second is a new form of ***cost reduction***. Not 5% cost take out but 50% cost reduction. Basically changing the price performance equation of every industry that we do know about.

- Third is the ***improvement in quality*** and I want to give it somewhat of different spin.

- Fourth is the ***search for scale***. Scale is not measured in the traditional terms any longer and I want to give you some idea of how big companies have to become in order to dominate their industries.

- Finally the need for speed not cycle time for product development or manufacturing cycle time but ***speed for managerial reaction***. What is the notion of cycle time for management.

I believe that ***these are five basic drivers that are creating new sources of competitive advantage*** and therefore every company is trying to get there.

I know you have spent a lot of time asking ***why China is respected more by multinationals than India is***. I am not going to go through that ground again but I just want you to look at one piece of evidence. If you are looking for new sources of revenue as a multinational company***, the size of Chinese domestic market is very attractive***. In almost every business the Chinese domestic market is larger than United States. 27 million television sets compared to 22 in the United States. Of course in United States we have large screen TV therefore in terms of dollar value it may be more, but in numbers China is larger. Certainly in refrigerators, washing machines, wireless devices – China is significantly larger. So the only attraction India holds for multinational companies is the hope that India would replicate China's growth. You know the answer. So far we haven't with some exceptions. I have to say in two wheelers, we might have done it. ***Potential for emerging markets is the attractiveness for MNCs***. We that India has the potential to replicate China.

There is a tremendous search for cost reduction and this is not coming out in the traditional way but fundamentally looking at global supply chains and I am going to just look at high volume electronics –anything that is made in very large volume at low cost. Chinese totally dominate this. About 7 years ago if you look at the picture of high volume electronics supply chain world-wide you will find the People's Republic of China building capabilities, quality, speed, cost and forcing open standards. Some people call it technology transfer, you can call it open standards so it can be replicated across. Most of the key components came still from Japan, United States and South Korea. The consumer electronics industry was dominated by Hong Kong and the computer peripheral business totally dominated by Taiwanese companies.

PRC developed links with all of them. Today what it looks like? Hong kong is a part of China. Reputation contacts and contracts still come from Hong Kong and Taiwan increasingly back into China. ***Increasingly the core component suppliers are also moving into China so with a net result there is a 70 billion $ export of computer peripherals / high volume electronics coming out of China***. If United State is very nice to China there is good reason. If by some magical thought process we stop all exports from China, there will be hardly 50% of laptops available in the world and hardly 20% or 10% of peripherals available. That is the position India must try for. ***In stead of talking we should totally dominate sectors***. That talks better than lot of rhetoric. People understand that very fast. You don't have to say we are super power. They will know you are one. That is what they have done. It also dramatically altered the cost structure because of extra ordinary levels of efficiency built into it.

Third is a search for scale. I am not particularly a great believer of scale per se is important but in every industry pharmaceutical industry - Glaxo, SmithKline Beecham together, Sandoz and Ciba Gaigee together, Dove and Union Carbide, Boeing and McDonald Douglas, Citibank and Travellers - this is not going to be stopped. The good news is ***that there is significant restructuring & consolidation***. The better news for India is nothing is secret anymore. When you put two large companies together and you have to attempt to rationalise it everything is open for challenge and that is a good news because I think it provides us new opportunities.

I do not believe that people coming to India for software or call centres or transcription services are coming here for cheap cost only. I think they are also coming here for high quality. In other words I think India might have sold itself short by focusing on cost rather than continuously talking about world class quality. In fact ***we have accomplished world class quality in all these areas but never talk as much about world class quality as we talk and emphasise cost***. I ***believe it will move on to transaction services, engineering design and product and process development***. I believe on a world wide basis there may be a 100-150 billion global outsourcing of talent at low cost.

Finally, I think search for speed. I believe fundamentally forecasting as we use to teach it, practice it, is dead. ***There is so much volatility around the world that today forecasting is not the way of providing as substitute for managerial and system reaction time***. We always use inventories, capital as a way to protect ourselves. If I did make a decision today it does not matter, it can wait for 3 weeks. 3 weeks you just piled up inventories. Today it cannot be done. The ***system reaction time*** – think about what it means. If you have a global supply chain and you want to react in 3 days time the entire system has to be finely tuned world-wide. The information technology requirements, the logistic requirements, the reaction time requirements are quite phenomenally complex. I also find in order to reduce the speed with which the managers can react, there are some natural things that people are doing, like reducing layers, increasing pressure for accountability, but I think ***increasingly business account monitoring, business activity monitoring is going to be a major issue because that is what line managers need***. If I went to a large company like General Motors and said, "tell me all the places in the world where sales was 80% less than our forecast last week". For those of you who are interested in IT, you know that problem cannot easily be solved. It looks like a simple question. But you probably have to worry about 40 different databases around the world, 18 different applications and you have to integrate all of them together to get in one page information. You can complicate your life further by saying show me all the advertising expenditure in the markets where we are not selling. It will take 10 analysts, 10 days to answer the question, by the time you have different problem.

So it is clear that there are early warning signals of restructuring already taking place. For example GE introducing GE labs here for R&D, Texas Instruments and Motorola are doing product development. Everybody talks about Foreign Direct Investment. Blind comparison of FDI between India and China is inappropriate unless we understand the underline structure of investments that are coming to India and to China. Increasingly one part of the channel management call centres is also coming to India in significant fashion. India's largest investor in call centres, in transcription services and all the services we talked about, is going to be GE. They have 40000 people in India and that is an interesting story by itself. But the supply chain is also getting fragmented on a world-wide basis. Global supplier base logistics and obviously the rest of the things you know about. So there are clear signals that these driving forces are changing the way global industries will be structured, managed and therefore where the profits will be taken. So I look at it and say the ***search for new revenues, lower cost, scale, quality and talent and speed goes beyond traditional views of outsourcing***. It is a new willingness on the part of large companies and industries to fragment the value chain. That means there is a new opportunity in this process of fragmentation and re-aggregation. There is an opportunity for us to create and shape the new industry boundaries. Therefore the large markets like China and India can have a disproportionate influence in the restructuring of large industries and large companies. That is the good news.

Now the interesting question is, ***what is India's need for the next 10 years***? I know you have spent a lot of time talking about this issue and I thought I would take somewhat of a different track. I think ***there are only two priorities for India – creation of 10-15 million jobs per year, growth of 10-15% per year***. We can talk all that we can talk about power sector, telecom sector and so on to do what. If we get the best telecom system in the world and we don't create 10-15 million jobs, we have a crisis on our hand. I am going to show you that ***if we grow at 5% we have a crisis on our hand***. You cannot create 10 million jobs and grow at 5% and if you can create 10 million jobs you will grow at 10%. So, if you can grow at 10-15% then you solve lot of the problems. I know there is a lot of debate in the country on whether we can grow at 10%. I think it's a misplaced priority. I think we should start by saying we have to grow at 10-15%. Lets figure out what to do. That is a very different approach. I am going to argue for that approach. This is India – Approximately 450 billion GDP & a billion people. At 5% we will be 730 billion at 2010. At 2020 we will be 1.2 trillion economy with about 1.3 billion people. Looks good. There is a growth here and we can always compare ourselves with countries, which are growing at 1.5%. I always hear people say does US have a problem. I say why are you worried about US. Let them have their own problems. Why are we growing at 5%? So the problem of 5% / 10% growth is not a choice for us because then I said lets take India and China – population of one billion here and 1.25 there. Per capita at US$ 450, they are US$ 1000 already. That means they are two times as large as India already. We grow 5%, they grow at 10%. In the year 2010, China will be 6 times India's size. Now let me ask the question? You want to grow at 5%? What is this debate whether we should go at 5 or 6 %. 15% is not a choice. ***We just have to put our heads together and say, how the hell do we get 15% rather than debating 5.4 and 5.5% growth rate.*** Unless we are willing to accept in this part of the world and around the wall a totally diminished Straus. If that is what we are willing to adjust for mentally, emotionally then that is fine with me. So what is our aspiration to be "recognised as super power". I put recognise within quote because given my taste, I would never use the word recognise – just be the super power. When you say I like to be recognised, you already have a doubt that no body recognises you as a super power. Choice of words is very important. If you want to be a super power, then 5% growth rate is unable to compete China, not in products, but in transforming the economy. That is the competition. Competition is not for the products. ***Competition is for the capacity to change an extra ordinary complex economy creatively. That is where we lack the energy and innovation.***

In the 20 century, large defence establishment created the super power that is the Soviet Union***.*** ***In the 21 Century, large military establishment without a large economic establishment will not create super power***. ***And that is where China is heading - largest market in the world and a huge military establishment***. And if you want to be as super power we have no choice. So the question is who is going to bridge the disconnect between our stated aspiration and the reality. I let you decide. So I ask the simple question to myself. What is the Indian dilemma of Indian opportunity. What do we give up – our aspiration or inability to grow. You cannot have both. You cannot demonstrate a continuous inability for growth, but continue to have the aspiration. We have to give one away. I like to ask you which one you personally willing to give away – your aspiration or you inability to grow. To me that is simply India's needs. 10-15 million job creation, 10-15% growth. If you can do consistently for 15 years, and China has demonstrated that you can do for 20 years consistently, then we have a chance of at least maintaining a balance of power in this region. That will only allow us a chance to play. At 5% you don't even get to play. I know it is not a pleasant news, but it takes a good friend to tell you a naked truth. So you have just accept me as a friend. All this talk about whether we invest in power or telecommunications, absolutely make not sense to me unless we start by saying we are going to make it happen, and we are going to be a super power. We do not care whether others recognise me or not, we will demonstrate that we are one. To me ***it is almost as critical as declaring "Purna Swaraj"***. When we declared "Purna Swaraj', no body knew how to get there but we did. I also believe this must become as dominant an idea as "Purna Swaraj" itself. So does India have opportunity? ***I see tremendous opportunities every where. But in order for India to influence the global industry evolution, it must do five things at a minimum.***

- ***It must become a growth market***. No body has interest in India, if you are growing at 3%. If you are growing at a blistering 30-40%, they all have interest. So in some sectors we can grow 30%, some may be 5%. But we have to grow at 15%.

- ***You cannot create 15 million jobs only based on software and pharmaceutical industry***. We have prematurely given up manufacturing as a fundamental requirement of a complex economy. Can somebody tell me that we can feed a billion people at world standard on the basis of software and no manufacturing at all. In other words, I am basically going to argue ***modern manufacturing is more knowledge intensive than many knowledge intensive businesses***. If any one has a doubt, go and look at the global supply chain management for general motors or general electric. It is extremely sophisticated in terms of IT requirements.

- We must ***deal with scale in India***. I am going to demonstrate, we just do not understand scale.

- ***Balance between domestic and export dependence for growth***.

- ***Extreme commitment to low cost high quality talent***.

These are the five things you need, if you want to play outside. They are exactly the same things you have to do to grow at 15% inside the country. In other words, I believe, ***there is a fundamental convergence between the requirements of external dominance, quality of exports and the ability to influence global markets, at the same time building domestic capabilities, domestic markets, domestic jobs***. I do not see any distinction between the two. Same five things – grow internally, focus on manufacturing and services, in addition to software, scale, balance between domestic and export growth, low cost high quality talent.

I am going to focus only on three issues. The scale of Indian firms. The size of Indian market. Domestic v/s export market. If there is any distinction at all, I want to lay to rest. ***There is no distinction between domestic success and global success***, especially with open markets. Before WTO, domestic and external had two different standards. The whole idea of WTO and opening markets is to have no differences in standards. That means if you are successful here, you should be successful outside. Or if you are successful outside, you should bring inside. So I am going to talk about a little.

First the scale of Indian firms. I thought instead of arguing in the abstract, I will take a case study. I would not name but this is a real Company in India. It is written every where as the best manufacturing company. So it is not a bad company. This is their P&L statement. 1400 crore, cost of good sold is about 1200 crore. So 85% is cost of goods sold. They are on a very lean operation. Fixed cost is 120 crores and variable cost is about 75% of 1008 crores and they make money. Variable cost as a percentage of cost of goods sold is 90%. Break even volume is 48. Good marks. What is the problem here. Suppose I want to reduce cost by 20%, can you tell me where I can reduce the cost by 20%? I cannot touch fixed cost. It is already down to nothing. I cannot take 20% as a total cost out of variable cost because all of them have been out-sourced any way. So you find your inability to cut cost. When I look at global competition, and I did not take all the fancy stuff – Sugar 8 bucks from outside India, 12 bucks from inside India. Coconut oil, fans, yogurt. We cannot even make yogurt cheaper than Spanish. They sell the yogurt here at the same price. So cost reductions at 50% is required. Then I look at the cost structure and say you tell me where to take 50% out. In other words you also have not understood that variable costs change with scale. When you manufacture 10 million two wheelers, the variable cost per scooter is different than when you manufacture 100 thousand. In other words Indian companies have build cost structure, more importantly a financial structure, that is incapable of scale. Now I like to ask the question. We want to compete & want to invest in R&D, market development, building a world class facility, etc. Lets assume these are the goals. How do we raise the money? I look at the balance sheet. When you have this balance sheet to raise 2000 crores, it is somewhat difficult. So then I said why they cannot go abroad to New York Stock Exchange, like some companies have done. Infosys showed the way, Satyam, ICICI, Dr. Reddy labs – what all of them understood was scale before everybody else did. You do not find any one of the old companies here. I like to ask a simple question. 70% of the world is Anglo-Saxon in terms of capital market. ***If you want to raise money in the capital market, why cannot we just accept American standard of accounting.*** Why cannot we mandate it for Indian companies then at least we solve one problem. Any body can go any time to raise money. I find interesting that

Germans are trying to force their companies to accept American system of accounting and we still can't. We need the money more than Germans do.

I look at GNP and FDI of India and competing countries. Forget about China. They are 2.2 times of our size, getting FDI 20 times more than India. Every body has talked about it. I am interested in why Sri Lanka is getting more FDI as a proportion than India is. How far can you fall. Vietnam gets more. Thailand gets more. So we know for sure one thing. We do not have ability to raise money here, we can't raise money in overseas market, especially New York and FDI is not going to come. So we are clearly stuck with a simple idea. If this firm is likely to limp along, squeezing a little bit more, driving a little harder, but not changing. In another words we have built paralysis into the system by design. That is question we need to come to terms with. So my friends we have a simple choice on scale. ***Play more efficiently in the traditional model. Use the crises to create global scale, global scope, new technology and innovation driven companies. But you have to fundamentally break the governance model***. It can't be done without it. It is not we would mildly change from "A" to "B". Make it a binary choice. So most Indian firms cannot grow without significant change in orientation. Therefore, they cannot compete globally or create new markets at home. So instead of dealing with this problem, we have changed the game. In other words re-phrase the question. We say rather than confront this reality, we have given up on becoming a major manufacturing centre for the world or create great opportunities at home. Giving up manufacturing is lot easier than confronting the problem.

Second, we just do not want to accept the importance of large domestic markets. How can we with a billion people, not have a big market. That is the question that has been bugging me for a long time. Billion people must represent some thing. They all eat, they all want to send their children to school, they all have to live happy lives – there must be a market out somewhere. ***Unfortunately this country represents two realities. A very optimistic, globally competitive confident reality - the Infosys, the Wipro. They do not have to be second to any body in the world. But there is also poor inefficient, disenfranchised India. We seem to co-exist simultaneously.*** We only talk about the first. We never talk about the second. 900 million people belong to the second. So the ***question is how do you conceive of a market built around the bottom of the economic pyramid***. ***There are 450 billion poor people in the world, who are like Indians. Why can't India be the export platform for the poor of the world.***

We have seen Economic Pyramid of India. Multinational companies play at the top. Most organised sector in the country plays at the top. May be some multinationals like HLL, Citibank, Godrej – some of them play in the middle. No body touches the bottom. That is where the bulk of India is. I am going to briefly argue there is lot of money to be made here.

So I am going to talk about ***poorest people in India live in the highest sub-economies***. How many of you are from Bombay? Every body knows this place. How many of you have visited Dharavi. It is the biggest slum in the world. I think it is the most interesting place in India. The interesting thing is the poorest people in Dharavi live in the highest cost of economies. Let me give you an idea. Cost of credit – 10% per day for the vegetable vendor. 500-750% is the cost of capital, if they can get it. So 40-50 times more the poor people pay. That is the reality. Municipal water per cubic meter 1.10 paise in Dharavi – 3 cents for you and me. Stomach disorder – they do not get medicine. So they get very sick and they have to go to the hospital. Per episode, 1000 Rupees for them, 100 Rupees for you. Phone call – 2 Rupees for them, 1.2 Rupees for you. Rice 14 Rupees per kg for them, 12 Rupees for you. What is the message here. All the micro landing organisations in the world charge 60% interest and we glorify them. Why? The alternative is 600%. So in other words you can charge 60% interest. People in Dharavi will think you are a great gift from heaven and you can make lot of money. I have the same date from Lima, Peru or from Sao Paulo or from Rio. There are 1300 cities in the world where slums show exactly the same data in terms of high cost economies. They have purchasing power. How many people you think have television sets in Dharavi or pressure cooker or refrigerator? I was surprised to find 85% of them have television sets, 70% of them have pressure cookers. They have money. Significant number of them are geographically concentrated. You cannot say distribution is very difficult among the poor. I am going to say they are so densely pack, you cannot miss it. How many of you know how old the Dharavi is. The first mention of the Dharavi was in 1886. It is a very vibrant community. 18000 people per hac. 27 temples, 11 mosques, 6 churches. ***Dharavi has a Rs. 3,000 crore business inside. There are at lease 1300 cities like this in the world. Extremely concentrated***. The ***rural urban divide is a myth. Politicians love this. The latest data from NCAER shows that there are as many rural rich as there are urban rich or there are as many urban poor as there are rural poor***. ***So in other words if this is the reality of the bottom of the pyramid in India and in every country of the world, why is it that no body is paying attention to the bottom of the pyramid.***

I am told that we waste more food products, especially fruit and vegetables than UK consumes per year and we are suppose to be a poor country. We waste so much - confectionery, foot wear, textile and so on. So I said may be we can start taking one or two of them not all of them. I will talk about confectionery. I have a simple idea - why can't we create a world class hard and soft centred candy- real sugar, real fruit, real chocolate at 20 paisa per candy at retail and with lots of choices for consumers. So can you create 200 million $ business? But the interesting thing is if you want to develop Rs. 1000 crores business by selling candy at 20 paisa, you must sell 4.5 billion candy per year. Do you know any company which sells 4.5 billion of any thing. If you want to sell 1 billion $ - that means 4 candy per person in India per year, if you sell 15 of them you will create world's largest brand.

Cement : More interestingly can we get world class, quick dry, easy to use cement mix. So every hut instead of having a mud floor can have cement floor. Available in small batches, delivered with no additional penalty than current retail price and choice is available- red, blue, green whatever colour the housewife wants. Can we create 200 million $ business? There is a company, which is doing it - its called Cemex in Mexico. It is a most profitable, fastest growing global cement company, scheduling on the basis of 90 minute delivery anywhere in Mexico city in small batches, It requires the most advance IT capabilities, its not about cement it is about information, it is about GPS, it is about scheduling and so on.

Water : 50% in this country suffer from water-borne diseases, primary health, hospitality. What is the real problem? Atleast Tarun Das will recognise this chart. I first showed in 1989 in CII meeting. I said there are companies, which come out of small domestic markets and some companies come out of large global markets. There are small firms and there are global firms. South Korea, Taiwan, Switzerland, Finland, Netherlands- all have small domestic markets but global firms. The reason why United States, Germany and Japan are so attractive is that there are not only large domestic markets but they also have global companies coming out of them. China, India and Brazil are all in the same - small domestic markets, local firms. The question is China and India have a opportunity because of their large domestic market and the size of their firms that they can built to become part of the big five – US, Europe, Japan and I was hoping China and India. This is 1989 chart. ***Unfortunately the reality in 2002 is China pushed like hell for exports & FDI, they pushed like hell to create a global market inside their home. So China will be part of that club. India is where it was. The question is 2010 should the picture remains the same.***

Simple idea, 800 million Indian consumers, 4.5 billion global consumers for requirements, innovative high technology solutions, new price performance levels, scale of operations and sustainable development- those are the 4 things you cannot violate if you want to open this market. So we have extensively used export driven strategy in software and pharma. Everywhere you go in the world they think you are an Indian you must be a programmer and you must know Java, C++ and I always get surprise when people think I am as smart as generally Indians are – they say are you also a programmer? I said I wish I was but it is amazing what they have done. We salute them. ***Having said that extensive use of Indian market 1 billion customers with at least 20 large businesses that is what we need. These 20 large businesses could not only create Indian market but drive export market.*** In order to do that we cannot keep talking about poverty elevation. I think poor have become a constituency in this country not a problem to be solved. The only way you can solve the problem is to treat the poor as a potential market and increasingly as a source of fundamental innovations. So my question is why can't we go from our zone of comfort to the zone of opportunity. I take this as given in India – volatility, increasing competition, high cost infrastructure, impact of WTO, demanding consumers, difficult access to capital. My sense is that in the next 2 years none of them are going to dramatically change but I can work on these. World class cost, world scale, experimentation, creating a domestic market, and thinking big. So I want to leave you with this thought :

- Is there any connection between very poor sustainable development, the internet, innovation and exciting new business opportunities? Yes, we have to do cost reduction but we have to understand structural limitations of current model. ***No distinction between domestic and global – both will demand quality cost and choices, need for scale, speed of reaction, experimentation and confidence to scale up. So the basic drivers are in place – search for revenue, cost, scale, talent and speed. India needs jobs, India needs growth. Scale is critical for us. There is a huge latent demand***. We should not make any more distinction between domestic and export market opportunities and I believe you are fundamentally imagination limited not resource limited. And focus on opportunities not on problems. ***This transformation requires most fundamentally imagination, passion, courage, humanity, some intellect. Don't put intellect first. You cannot get there because of intellect. You have to get there because of deep passion that we don't want to be recognised as super power. We must become the super power.***

I want to leave you with what Pt. Nehru said and it sounds equally important today 'the service of India means the millions who suffer, it means the ending of poverty and ignorance, disease and inequality of opportunity. The ambition of greatest man of our generation has been to wipe every tear from every eye - that may be beyond us. As long as there are tears and suffering so long our works shall not be over."

I wish you all great luck. There is tremendous opportunity and I do know that all of you will make India proud. Thank you very much.

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