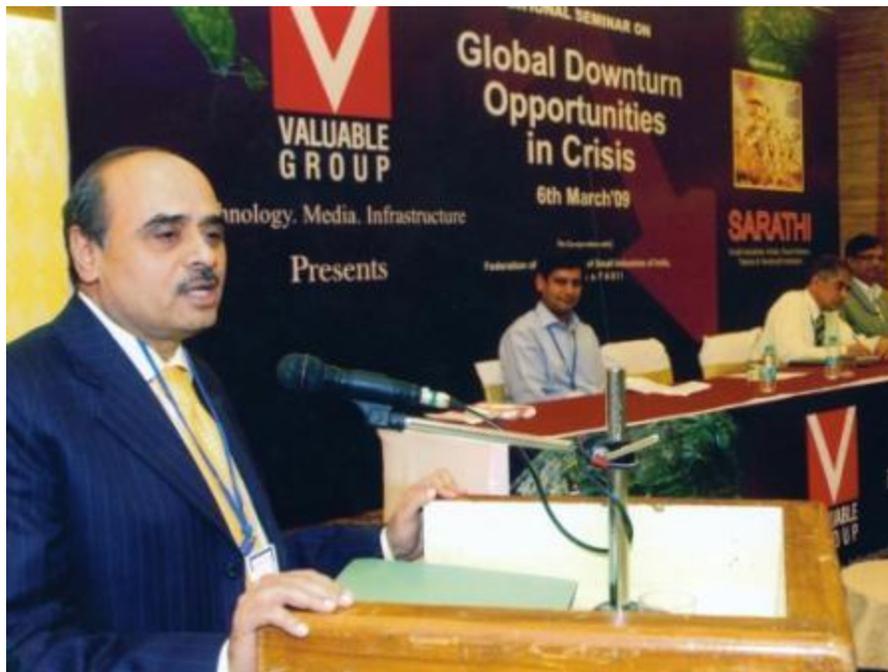


MD's Speech at Sarathi, Nagpur



Ladies & Gentlemen,

I am thankful to SARATHI for having given me an opportunity to present my views to this august gathering in Nagpur on downturn in economy & opportunities in crisis. I know that SARATHI has been active for the last 20 years in Nagpur and has done some remarkable work in the field of Arts, Sports and Social issues. I congratulate them for organizing this timely meeting on the Economic Downturn.

A lot has been written about the downturn and I am sure you all know about it. I will try to put my views in as simple a way as possible and also touch upon opportunities which could be explored by industries.

I have been thinking about the current crisis and have been wondering if downturn has already led to recession and are we now moving towards deflation? At the times of financial crisis, the corporates stop making new investments, leading to slower growth. Corporates also find difficulties in pre-financing the existing debts leading to rising defaults. Similarly, consumers find their asset price going down and also face higher interest costs. This leads to lower spending. So with lower growths and rising defaults on the one hand and lower spending on another, the recession starts setting in. The prices start falling and when the consumer starts expecting the price to fall further, they curtail the spending when the price

continues to fall, the producers start cutting down on the output and this vicious cycle moves the economy towards deflation.

I believe world economy is in grave danger of moving towards deflation, as most of the countries are facing recession. Clearly the present economic scenario is the worst crisis since the great depression of 1930's. Major financial institutions have gone bust, stock markets have fallen by more than 50% and severe liquidity and credit crunch has brought business to a halt. It is expected that there would be recession in UK, Europe, Japan and other advanced economies. Growth in China is expected to slow down to 5% and India is also experiencing sharp slow down. The US will certainly experience its worst recession in decades. A deep contraction in world economy exists till the end of 2009.

The financial crisis is being traced to what is called sub prime crisis and collapse of the US housing bubble. But the financial crisis is not caused only by the housing bubble. America's credit excesses were in residential mortgages, commercial mortgages, credit cards, auto loans and student loans. There were massive excesses in the securitised products that converted these debts into toxic financial derivatives, in borrowings, in financing leverage buyouts, in Corporate Bonds and so on. This was not confined to the US only. There were housing bubbles in many other countries fueled by excessive and cheap lending that did not reflect underlying risks. There was a commodity bubble and private equity & hedge funds bubble.

When we look back at the business sense of sub prime lending, we can't stop wondering how the financial wiz-kids can bring the world to a halt. In simple words you lend money to those whom you think will not be able to return the money, you declare them as risky loans and hence, ask for higher interest rates. Look at the contradiction. You know that this person cannot pay back the principal itself and you want to charge him higher interest rates? Interestingly, it does not stop there. People continue to mortgage the same property by declaring higher valuation. Higher valuations could be linked to any changes which are happening in and around your location. For example, a mall is being built closer to your house so you could go back to the banks saying that the valuation in this area is going up and hence, the valuation of my mortgage goes up so give me more money and banks happily give more money. Where does this money go? It went in consumers spending recklessly. For ages the financial institutions have funded the industries on the basis of credit rating. If the credit rating agency finds a company not very good, the rating was low and the banks will ask such industry to pay higher interests. So they penalize an industry which is already not doing well. Banks believe they have covered their risk because they have asked for higher interests but there are so many companies who took high interest loans and then defaulted and closed down. The US housing bubble was not the only trigger. We are told that the credit card and easy lines of credit debts are to the tune of USD 14 Trillion. Clearly, there was easy money available all around. And this easy money was coming from very respectable legitimate

channel of banks. But I think banks became greedy and did not do their work well. The entire financial crisis can be linked to one common cause and that is greed spreading all over the world.

The Indian philosophy preached to shun the greed. But in the recent past we have seen ourselves becoming very greedy. Let me give an example. I come from an industry, which looks for meritorious candidates at the entry level. We go to IITs and IIMs to pick the best. We want to be one up on the competition so we end up hiring graduates at unheard-of salaries. Management institutes take pride in announcing how the students have been picked up on the salaries which we may not have even dreamt to reach at our retirement. Obviously, having spent so heavily, we want them to perform well. We in the industry have a great way of setting the targets associated with performance and pay huge bonuses, which we call as "Variable Pay". So we set a target for the new breed of wiz kids to achieve dramatic performance. To give an example, imagine a bank where one of the key result areas is to increase lending. The guy must attend the target because a huge bonus is linked to the performance. I wonder how judicious this person can be when his immediate need is to achieve the short-term goal. There is no doubt in our mind that we are hiring people at salaries which are unsustainable but we still pay them these kind of salaries. When the bankers see their 'salary slips' they happily lend them huge money so our young population has access to easy money and when there is easy money in the system, there is no control by lenders or spenders. Industry starts compromising on efficiencies and costs as it can sell whatever they produce. Consumers and corporations start spending money on non-productive assets. An illusion of boom is created. Corporations want to grow overnight by acquisitions and the valuations go up drastically because at such times nobody wants to think prudently, lest he is painted as a negative person. All in all, greed takes over.

Indian banking industry seems to have done much better, thanks to Govt. regulations. At such times, we must take a pause and think about so called open economies and economies with some amount of regulation. I personally agree with the principal of free economy but it cannot work in vacuum as everything has to work within a framework. Everyone knows US economy is not doing well for years and their balance of trade figures are astonishing. The new President has talked about bringing down spending of the Govt. by half. I think they have failed to realize that we live in a finite world with finite resources and if we continue to recklessly consume as extravagantly as we have been doing, Mother Nature will be unable to provide us the natural resources which is required to live. Somebody has said that mother earth can feed every living being on the earth but it will fail to feed one greedy individual.

This deepening economic crisis will pose perhaps greatest threat to our stability and security. It would trigger violent extremism. Already there are violent protests reported in China where people are being pushed back from urban areas to rural areas as there are no jobs. International labour organizations announced that 50 million workers would lose their jobs this year itself. If you look at US numbers, 3.6 million have already lost their jobs. Unemployment is close to 14%, 20,000 banks have collapsed, sold

or nationalized, 62,000 companies have closed down and credit card and easy loans has led to USD 14 trillion in debts.

While it is true that it is a border less world, India could still survive from the simple reason that we have not gone overboard as far as lending was concerned and our economy does not depend heavily on exports. Our domestic market is big enough but you can see crisis all around in India. For no reason or rhyme the banks have tightened funding. I must congratulate the Government of India who through their economic stimulus program have taken some very good steps. They have brought down repo rate and reverse repo rate, re-capitalized the banks, increase the spending so the liquidity is maintained. In fact these actions have released Rs.3.8 trillion in the system. Government has taken action on taxes, got excise duties modified, changed depreciation rules. We are seeing some revival in Industry numbers from February, 2009 but it is too early to say that the stimulus packages have started showing results. I am very hopeful that Indian economy will start cranking before it is too late. I also believe that at such times lots of corrections are done, excesses are controlled and efficiency improved. This is the time when Government should act decisively in terms of improving the systems and the procedures, reduce bureaucracy, simplify tax structures, invest in Research & Development, support innovation, build infrastructure, remove hurdles of petty politics which stops industry to even acquire land. Government should also invest time and energy in agricultural sector and make India self sufficient in food. Lot of Indians operating in Western countries especially in the US and the Middle East are coming back as they are losing jobs. Government should tap these resources which could bring back a lot of knowledge and efficient processes and systems. Government must remember that two major sources of Foreign Exchange earnings namely Indians working abroad and FIIs are drying up. We must support export oriented Industry so that foreign exchange inflows are maintained.

In these difficult times what should Industries do? It must take some positive actions to survive and grow. If we could really analyze the situation and do not get distracted and see hidden significant opportunities nestled among the bad economic news, we could do well. I believe we need to have a strategy which is defensive as well as offensive at the same time. My experience tells me that at such times most of the companies go into un-mindful cost cutting. While it is true that cost cutting must be done but we cannot compromise on our future. But first thing first, we must concentrate at our current business and weed out all the inefficiency which gets build up in good times. This is the time to retrain our people and engage them to take up innovative approaches to become cost competitive. Consider several scenario of downturn and quantify the impact on the business. We need to also assess the rivals business. Look for opportunity in acquisition. These are the times when valuations do come down but interestingly we all want to talk about acquisition when the going is good and the valuation is high.

Some of the standard fundamentals which we must remind ourselves and work on them are:

1. Monitor and maximize cash
2. Aggressive working capital management
3. Financial structure optimization
4. Tighten customer credit
5. Cost reduction and increase efficiencies
6. Improve product mix
7. Work on pricing strategy
8. Judicious investments and divestments.

Indian industry has shown lot of resilience in the past and I am sure it will sail through this difficult time. I remember when trade with China opened up and very cheap Chinese products were being imported at a fraction of our manufacturing costs. The products ranged from small batteries to motorcycles. In many industry meetings we used to debate China's aggression in trade but Indian industry worked very hard in terms of cutting the costs, improving efficiency and more importantly improving the quality of product and that is why we have not heard of any major company closing down in India because of cheap Chinese imports. More recently power plants imported from China have been proved to be cheaper but of bad quality and I read in the newspapers that Govt. is banning imports of these equipments. Clearly Indian Industry is strong enough and Indians are innovative enough to overcome this crisis. I believe India has crisis of confidence which we shall soon overcome

I will end by saying "when the going gets tough, the tough gets going" and I believe India and Indian are tough and they will keep our economy moving.

Thanking you,

Sudhir Deoras

Managing Director

TRF Limited