The Business Journal of Phoenix - July 5, 2004
http://phoenix.bizjournals.com/phoenix/stories/2004/07/05/editorial3.html

The Business Journal
PHOENIX

OPINION

From the July 2, 2004 print edition

My View

Investment in India provides opportunities for business

Richard Stern

Has the widely reported outsourcing to India created an investment opportunity? In the first quarter of 2004, the U.S. gross domestic product grew by 4.2 percent -- it would have been only 3.5 percent without the war spending.

In the same period, the Indian economy grew by 10.4 percent. That number was exaggerated by a surge in farm output of 16.9 percent as a three-year drought ended. So, even though this is not a sustainable rate, it handily exceeded our domestic growth.

The growth rate of the Indian gross domestic product from 1993 to 2000 averaged 6.7 percent, still more than double that of the United States. Technology-related services are growing at about 10 percent, but still account for only about 2 percent of the Indian GDP. The country employs about 1 million workers, a mere quarter of 1 percent of a work force exceeding 400 million.

The reasons that businesses outsource to India go beyond cheaper labor costs. Relative to countries such as China, it has superior telecommunications and a more sophisticated legal system. A major advantage is the widespread use of the English language.

But there is increasing recognition of difficulties in communicating, and educating, especially when depth of knowledge, innovation or rapid change are involved.

Lastly, the very success of outsourcing has led to wage escalation in India that is reducing its cost advantage and impacting the profitability of its providers.

On a recent visit to India, I observed and read about, not only the positive aspects described above, but also the downside: a huge proportion of the population of 1 billion mired in poverty, and a government recognized as corrupt and ineffective.

The infrastructure is terrible. The roads are not conducive to inter-city travel. Power generation is notoriously unreliable. General Electric and Bechtel were among the investors in Dabhol Power Co., which went bankrupt in May 2001 after a state electricity board stopped paying its bills.

Many of these issues were highlighted by national elections that ran from mid-April to May 10. Political parties offered different appeals to the more literate populace and to the farmers (who comprise more than two-thirds of the population) and urban poor.

The previous ruling coalition, which had promoted privatization and deregulation, was crushed by a group of political parties with more of a leftist bent. On May 14 and 17, the Indian stock market had two of its worst losses ever as investors pondered this outcome.

What are the investment possibilities in India now?

There are few direct plays on outsourcing itself. The largest call-center operators are privately owned. Infosys Technologies Ltd. and WiPro Ltd. are publicly traded Indian makers of software. Each of them just reported over a billion dollars in annual sales and significant profit growth.

Bombay-based Datamatics Ltd. purchased a Detroit financial-services processor last October. Rambaxy, a maker of generic drugs, grew its profits by 10.4 percent in the first quarter. These Indian companies' stocks are difficult for us to buy, quite thinly traded and volatile, and lack the regulatory and accounting oversights of U.S. companies.

A simpler investment strategy is to buy companies such as Citigroup or General Electric, which have solid international businesses and are growing incrementally through judicious use of outsourcing.

A local company that offers Indian call-center outsourcing and related services is eFunds Corp., in Scottsdale. As an investment, eFunds seems reasonably priced for a relatively small company with strong finances and an excellent growth record.

Richard D. Stern has been an investment counselor in Phoenix since 1978.