


# ITC : BUILDING WORLD-CLASS BRANDS

# MULTIPLYING SUSTAINABLE LIVELIHOODS

Speech by Shri Y.C. Deveshwar
Chairman, ITC Limited
at the
103rd Annual General Meeting
on 30th July, 2014

Ladies and Gentlemen,

I have great pleasure in welcoming you to the 103rd Annual General Meeting of your Company.

## A NEW GOVERNMENT: NEW HOPES & ASPIRATIONS

In the best traditions of democracy, a new Government was elected with a resounding mandate. Shri Narendra Modi's clarion call for Development through Good Governance touched a special chord in the hearts and minds of people. His vision and persona has ignited new optimism among almost all sections of society. There is renewed hope that a new resurgent India will be built over time, bringing pride and dignity to all. The spirit embodied in "Sabke Saath; Sabka Vikas" indeed holds a promise of inclusive and participatory growth.

This is potentially a turning point in history and an opportunity to collectively script a new destiny for the nation. As a Company deeply rooted in India's soil, ITC is committed to realising the

Vision of a dynamic, prosperous and self-reliant India. It is your Company's avowed mission to be a world-class Indian enterprise serving national priorities. This is manifest in your Company's determination to go beyond the confines of business to create enduring value for the larger Indian society. It is with this strength of conviction in your Company's Values and Vitality that I once again pledge ITC's fullest support to the new Vision for fulfilling our shared goal of a new India of our dreams.

It is indeed heartening that, despite the constraints of time and a challenging economic environment, the Finance Minister Shri Arun Jaitley, has presented a comprehensive maiden Budget addressing key reforms with a welcome focus on physical and social infrastructure. This should lay the foundation for long-term growth whilst meeting some of the critical needs of the weakest in society.

## ITC: TRIPLE BOTTOM LINE PERFORMANCE

As in earlier years, let me first share some of the highlights of your Company's triple bottom line performance. Amidst a challenging economic context, your Company recorded yet another year of strong performance. Gross Income

registered a new high at ₹ 48,176 crores, while Net Profit increased by 18.4% to ₹ 8,785 crores. **The segment net revenue, other than cigarettes, has grown 16-fold since 1996 to ₹ 21,845 crores. As a result, almost 59% of net segment revenue of your Company is now from businesses other than cigarettes.**

*(Figures in ₹ Crores)*

| ITC Financial Highlights 1996-2014 | | |
|---|---|---|
| | **1996** | **2014** |
| Gross Income | 5,188 | 48,176 |
| Net Segment Revenue (other than Cigarettes) | 1,363 | 21,845 |
| PBIT | 536 | 12,662 |
| Profit After Tax | 261 | 8,785 |
| Total Assets Employed | 2,584 | 39,229 |
| Market Capitalisation* | 5,571 | 2,84,307 |
| **CAGR in Total Shareholder Returns in the period 1996-2014: 25.9%** | | |

**As on 25th July, 2014*

This year, the FMCG industry in India witnessed a marked slowdown. Notwithstanding such an adverse operating environment, your Company's

new FMCG businesses recorded a robust growth of 16%, crossing the ₹ 8,000 crore mark. The FMCG-Others Segment also recorded its maiden profit with a PBIT of ₹ 22 crores representing a positive swing of ₹ 103 crores. Your Company's relentless effort to build world-class Indian brands, backed by cutting-edge Research & Development and innovation, will continue to drive performance in the years ahead.

ITC's commitment to superior triple bottom line contribution is manifest in its globally acknowledged initiatives that create impactful societal value. Your Company has sustained its position as the only enterprise in the world of comparable dimensions to be carbon positive, water positive and solid-waste recycling positive for several years now. **Your Company's sustainable business models today support around 6 million livelihoods across the country.** ITC's Sustainability Report has been published for the 11th year now. The latest edition is in accordance with the new G4 guidelines of the Global Reporting Initiative. **Your Company is one of the foremost in India to report at the highest "Comprehensive" level, well ahead of the global deadline.**

## THE CHALLENGE - CREATING GROWTH WITH EMPLOYMENT AND EQUITY

We live today in challenging times. The economy continues to be in a tailspin with a second successive year of sub-5% growth. Persistent Inflation, high Fiscal, Trade and Current Account deficits have severely curbed the growth potential. The cutback in investments and piling-up of stalled projects also contributed to the dismal performance. The consequent de-growth of 0.7% in Manufacturing is therefore not surprising. Agriculture was the lone performer at 4.7%, though it continues to be at the mercy of vagaries of nature. The impending impact of the El Nino looms large with a threat to destabilise the critical agricultural sector. Though Fiscal and Current Account deficits have been reined in somewhat, it has been at the cost of productive expenditure and dependence on a weak Rupee for exports. The new Government therefore has truly an unenviable task of resurrecting the economy, whilst ensuring that growth is equitable and can spur more than commensurate employment.

Foremost among the priorities is the need to find longer-term solutions to deal with **Inflation, the Twin Deficits and Unemployment.** It is a

matter of concern that the country is yet to achieve international competitiveness in several segments crucial to its economy. This is evident in the composition of India's trade basket. **Imports are of high value-added goods and services, while exports are largely at the commodity end with relatively lower-value added products and services. Consequently, the value addition in the domestic economy is of a much lower order impacting the scale and quality of jobs.** In the interest of longer-term macro-economic stability, it is desirable that the trade account gets balanced on the strength of export competitiveness rather than on capital flows to finance the deficit. The vulnerability on the external front is further accentuated by the build-up of accumulated international debt that is far ahead of the foreign exchange reserves. As a result, the ratio of foreign exchange reserves to India's total external debt has declined from about 114% to 69% over the last 5 years.

Sizeable investments are required to take the economy to a higher growth trajectory and to build competitiveness of the Indian economy. Domestic savings alone will not be adequate to fuel high levels of economic growth.

**It is therefore crucial to attract and facilitate both domestic and foreign investment to invigorate the economy. This must be done in a manner that encourages international players to create the fullest value addition within the shores of the country enabling a multiplier effect on job creation.**

Unfortunately, the ease of doing business and setting up enterprises in India is a major constraint that deters investment. **The plethora of procedural clearances from local bodies, municipalities, district administration, state and central governments makes it virtually impossible to speedily implement projects.** I was recently saddened by media reports that high net-worth Indian nationals in a position of leadership have invested significantly large capital in real estate assets overseas. This is symptomatic of the fact that even Indian capital has to seek lucrative opportunities abroad given the difficulty of investing profitably in the domestic economy, quite apart from perhaps a serious deficit in patriotic fervour. Efforts to eliminate the extensive procedural logjam will obviously take time. In the interim, value and job creating investments will need to be supported by incentives to reward the patient and the perseverant.

Compounding the situation are lacunae in policies that have unfortunately contributed to widening the twin deficits besides restricting the job-creating potential. In my address today, based on ITC's intimate engagement with the consumer market and the rural economy, I will dwell on a few areas where a balanced policy framework can lead to larger value capture for the Indian economy and stimulate a job multiplier of a significant order.

## THE INDIAN GLOBAL MARKET: DOMINANCE OF INTERNATIONAL BRANDS

India's billion plus population represents potentially a huge consumption market. With rising disposable incomes and a growing middle as well as affluent class, there is a substantial growth momentum in the consumption of higher-end value-added products and services.

Over the years, India has progressively allowed free competition leading to the establishment of a growing Indian global market. Dating back to pre-Independence days and more so post-liberalisation, brands owned by foreign enterprises have held sway over this expanding market.

Today, almost all the well-known international players market their brands in India. **Consequently, a dominant part of the upper-end consumer spend has been captured by these brands.** These range from high-end luxury products, white goods, consumer electronics, computers and branded software to items of daily consumption, including soaps, shampoos, tea, coffee, burgers, sanitary napkins, diapers, baby food, potato chips and many more. The list is unending and includes even packaged "idli" and drinking water. **In comparison, the share of domestic brands is modest and largely confined to markets characterised by lower-income consumer groups with relatively much lower value addition.**

## JOBLESS CONSUMPTION GROWTH

Many of the international companies operating in India rely, in part or full, on their global supply chains to service the Indian market. This is primarily due to the difficulties faced in establishing competitive manufacturing units in India. Therefore, their ready access to well-developed supply chains overseas facilitated further by lowered import duties

makes international sourcing more attractive. As a result, the country's consumption basket has a large share of imports either as finished products, sub-assemblies or components. Thus, despite the presence of multi-national entities in India, a substantial part of the value created remains outside the country. **This is one major reason for the jobless consumption growth witnessed in recent times.**

For a developing country like India, with millions in poverty and a young demographic profile **that adds nearly 12 million to the job market every year,** creation of sustainable livelihoods is a crying priority. **From 2005 to 2012, only 2 million jobs were added annually, which is well below the asking rate.** It is unfortunate that commensurate employment opportunities could not be created despite the high levels of growth witnessed in the economy during this period. **The large growth in the consumption market was therefore unable to unleash an equivalent opportunity to reap India's Demographic Dividend.**

Multi-National Corporations possess the unique competitive ability to switch supply chains globally depending upon currency fluctuations as well as opportunities arising from labour

arbitrage. This does not always make for a stable employment opportunity and value addition in the domestic economy. **International enterprises must therefore be encouraged to create supply chains in India that enable larger value capture in the domestic economy.** This can be stimulated by widespread reforms that progressively create conditions for the competitiveness of enterprises operating in India supported by a combination of tariffs and incentives to make value-addition in India commercially compelling.

## LACUNAE IN ROYALTY POLICY

The problem of jobless consumption growth coupled with the widening twin deficits got further aggravated by a change in policy regime in 2009 permitting limitless repatriation of royalty payments to overseas holding companies. It has been reported that **such payouts have increased by 70% since then to reach nearly ₹ 40,000 crores. This outflow is equivalent to about 20% of India's annual Foreign Direct Investment. This transfer attracts a much lower withholding tax of around 10%, given India's bilateral agreements across the globe, thus rendering infructuous**

**the 25% tax imposed in the Budget 2013 as a remedy.**

With consumption expenditure expected to grow from the current level of USD 1 trillion to USD 3.6 trillion in 2020, such unrestrained outflows can assume even more alarming proportions. The low rates of withholding tax on royalty payments will entail a considerable loss to the Indian exchequer as this method of profit repatriation escapes the full income tax rate that Indian companies are subjected to. Consequently, the revenue deficit will have to be ultimately borne by domestic industry through higher taxes, placing them at a competitive disadvantage.

International enterprises compete with other global and domestic players for a larger pie of the attractive Indian global market. **Consequently, in their enlightened self-interest, they bring in brands, technology and know-how to continuously enhance their competitiveness, market standing and profits.** Therefore, there is really no justification whatsoever to allow royalty, let alone limitless payouts, by the Indian subsidiaries to their overseas holding companies. This policy can thus become an instrument of tax avoidance

causing considerable injury to the exchequer and the Indian economy.

**Royalty payments should therefore be permitted only between unrelated parties based on purely commercial considerations, with little or no governmental intervention. This will facilitate Indian enterprises in accessing intellectual capital to compete effectively with international players in the Indian global market.** Such a policy framework will go a long way in creating a level playing field for Indian enterprises besides ensuring that the twin deficits do not get further aggravated as India's private consumption market grows.

## THE POTENTIAL IN FOOD PROCESSING & AGRO-FORESTRY

The Government has rightly identified employment generation and control of food inflation as issues of utmost priority. In this context, I would like to highlight today the potential of two sectors relating to the rural economy, namely food processing and agro-forestry. To my mind, supportive policies in these areas can significantly contribute to job creation, enhance rural incomes,

help manage food inflation and promote sustainable agriculture.

### *Food Processing*

It is well acknowledged that the control of food inflation rests primarily on the management of supply-side constraints that fuel its growth. Even though India produces enough food, consumer prices are high due to enormous wastages that also result in lower farmer incomes. **Such wastages can be as high as 40% in the case of perishables. India processes only 2% of its agri-produce compared to 40% in countries such as Malaysia and Thailand. A big push to India's Food Processing sector will be a force multiplier in creating large-scale employment, enhancing farm incomes and combating agri-wastages.** Given that supply chains in this sector tend to be predominantly local and regional, jobs created will be largely in Small and Medium Scale Enterprises contributing to regionally balanced employment.

Unfortunately, high prices of processed food restrict demand and are a key constraint in the growth of this sector. This is primarily due to the cascading effect of taxation along the value chain. Fiscal policies have

subjected processed foods to taxes, even though food itself is generally not a taxed commodity. Consequently, there is lower demand for processed food leading to low investments in this very important sector.

**A paradigm change can take place if demand for processed food products is substantially increased by lowering prices through a zero-tax regime on this industry. This will help in paring down prices, enhancing demand thus making it attractive for investment.** A conducive policy can help create over 9 million jobs in the food processing sector, 60% of which will be in rural and semi-urban areas. Over time, growth in the processed food sector will drive investment in the agri value chain and lead to productivity enhancement and waste reduction. This will also stimulate creation of infrastructure such as cold chains, storage and modern logistics. Together with other reforms related to agriculture such as the Model APMC Act, improved access to quality inputs like seed, fertiliser, finance, irrigation and extension services, this would enhance farm incomes and unclog the supply side bottlenecks to eventually control food inflation in a sustainable manner.

Your Company's extensive engagement with Rural India that has empowered over 4 million farmers is an example of the transformational potential of the processed food sector. The ITC e-Choupal has helped in raising rural incomes and productivity by developing competitive value chains linked to ITC's Foods businesses and by promoting sustainable agriculture. This gives me the confidence to reiterate that **a concerted policy impetus to develop India's food processing sector through a zero-tax regime can bring about dimensional change by creating jobs, enhancing rural incomes and containing food inflation.**

### *Agro-Forestry*

The second area of immense potential linked to Indian Agriculture relates to Agro-Forestry that effectively addresses the traditional conflict over land-use for food, fuel, fodder, fibre and forests. By synergising tree-growing with crop production, both food and wood security can be ensured, thereby contributing to the conservation of precious natural resources. **Farmers get multiple benefits by using their scarce land resources to maximise returns through both agriculture and tree-planting,**

**considerably enhancing their incomes.** Unfortunately, the enormous potential of agro-forestry has been thwarted by a myopic policy that has prevented job creation in India whilst promoting avoidable imports.

India currently imports USD 5 billion worth of wood and wood-based products such as furniture, construction timber, pulp & paper, plywood and so on. Many of these imports attract duties as low as nil to 5%. **The tariff policy, as it stands today, makes imported wood more attractive than growing trees in India. This prevents livelihood creation in the country and "exports" jobs to countries that grow trees and sell wood-based products. At the same time, these imports contribute to enlarging the Current Account Deficit.** Conducive policies ought to be crafted to boost India's natural advantage in agro-forestry and promote employment-generating wood-based industries. **I am given to understand that agro-forestry has the potential to create over 15 billion person-days of employment.** To give a fillip to this sector, agro-forestry must be extended all the benefits available to agriculture including long term institutional credit and unrestricted movement of such

produce within India. In addition, raising import duties on wood and wood-based products to an appropriate level will encourage growing of trees, thereby enhancing employment as well as supplementing green cover. In addition, R&D must be promoted for the evolution of improved wood species that are disease and climate resistant. This could be further supplemented by suitable fiscal and financial incentives. Access to competitive sourcing of wood locally will stimulate related crafts and industries on a much larger scale. Agro-forestry is also an important source of carbon-neutral biomass energy which can significantly reduce dependence on fossil fuels. Besides, it is an ideal source for distributed energy systems which can effectively meet the needs of smaller rural communities. **By providing a crucial policy foundation, the entire wood-based value chain can substantially support the nation's quest for sustainable and inclusive means of growth.**

As you are already aware, your Company's extensive Social and Farm Forestry Programme has greened over 1,60,000 hectares, creating over 70 million person-days of employment. An innovative agro-forestry initiative has further enhanced farm incomes

supporting sustainable livelihoods and maximising productive land-use. Your Company's experience is a pointer to the tremendous opportunity that can be unleashed by conducive policy in this sector.

## BUILDING WORLD-CLASS BRANDS FOR A DEVELOPED INDIA

In my address to you last year, I had emphasised that **tomorrow's world will belong to those who create, own and nurture intellectual property.** Such assets indeed form a superior basis for sustaining competitive advantage over the long run. **Ownership of Intellectual Capital will be the springboard that will propel India from a Developing Economy to a Developed Nation.** It will transform the country from a provider of labour, commodities and relatively lower value-added goods & services to a position of leadership in innovation, thereby earning global respect.

For a country with proven intellectual prowess, creative capacity and entrepreneurial capability, it is a sad augury that the nation is bereft of globally competitive Indian brands. As a result, the country is rendered poorer by its inability to service even its own home market effectively.

**It is mission critical today to create National Champions who will build world-class Indian brands through ownership of intellectual property.** It is only then that a virtuous cycle of innovation and investment will create new opportunities for growth with the generation of higher order sustainable livelihoods.

**The Hon'ble Prime Minister has articulated the Government's resolve to revive Brand India on the strengths of 5 Ts – Tradition, Talent, Tourism, Trade and Technology. To that I humbly add another T – for Trademarks – Indian Trademarks that are manifest in world-class Brands and built on the strength of superior intellectual property.** A successful global brand is a badge of honour for the country it belongs to, and a sustained source of wealth creation. Popular brands reflect the innovative capacity of the countries of their origin. When a country's institutions build world-class brands, they enrich their economies, enabling sustainable growth and higher-income livelihood opportunities.

I have confidence that Indian enterprises truly have the mettle to create world-class brands. Not very long ago, countries like Japan and Korea had a similar dream amidst every adversity.

Today, their brands have conquered the world and earned global respect. Admittedly, building winning brands is not an easy task. Successful global brands have been steadfast in nourishing their consumer franchise through ongoing innovation and remaining well ahead on the learning curve. Therefore, the challenge of building brands in competition with such established players is no mean task. The countries that have accomplished this seemingly impossible mission have done so through close collaboration between the governments and their companies over the long haul.

Indian companies, on their part, must invest in cutting-edge R&D to build intellectual capital. **The Government can provide the right signals by refocussing the incentives to more result-oriented outcomes.** Currently, weighted tax deduction on R&D expenditure is based merely on inputs without any linkage to outcomes in the form of consumer franchise. Such incentives are best linked to revenue generated through the sale of branded products. For instance, a percentage of sales of the Indian brands could be an effective basis for crafting the incentive.

Your Company has tirelessly endeavoured to build world-class Indian brands. In a relatively

short span of 10 years, a vibrant architecture of popular brands has been crafted organically. Some of them are already clear market leaders in their segments. In aggregate, these new consumer brands currently represent an annualised consumer spend of over ₹ 10,000 crores. **Going forward, your Company's foray into the Dairy and Beverages segments will further enrich this portfolio.**

**Your Company is committed to investing in India's future. You would be happy to know that 65 projects involving a built-up area of 28 million sq. ft with an outlay of over ₹25,000 crores are currently under implementation or in advanced stages of planning. These projects are distributed across a majority of States and will create livelihood opportunities all over India. The shareholders present here today would be pleased to know that West Bengal has a high share of these projects with an outlay of over ₹ 3,500 crores, encouraged by the conducive policies of the State. Such assets will impart substantial strength to your Company's competitive capacity. Therefore, it is my belief that your Company can aim for a revenue of ₹1,00,000 crores from the**

**new FMCG businesses alone by the year 2030 and realize its vision of being the No.1 FMCG player in India.**

It is a matter of pride that your Company's brands have anchored the development of competitive value chains benefitting some of the poorest regions in the country. In conjunction with your Company's social investment programme for integrated rural development, these brands have enabled the empowerment of millions of disadvantaged in India's villages by generating sustainable livelihoods. Your Company's CSR programme includes farmer empowerment through the globally acclaimed ITC e-Choupal, large-scale Watershed Development, Social Forestry, Animal Husbandry, Women's Empowerment and Primary Education which together have transformed rural lives, winning global acclaim and recognition.

## CREATING NATIONAL CHAMPIONS

**India's challenges require a quality of growth that creates, captures and retains larger value in India.** It requires organisations to consciously strengthen value chains that extend to the country's rural areas and backward regions empowering the weakest. **Winning Nations**

**across the world, especially from among emerging economies, have supported the creation of National Champions who are prime drivers in creating sustainable wealth and livelihoods.** Global winning brands such as Sony and Samsung are the fruits of that visionary support. **It is time that India takes bold steps to create, nurture and support many a National Champion who will create enduring value for the country with passion.**

Your Company is privileged to be able to pursue a path less travelled to create multiple drivers of growth supported by winning brands and an abiding vision to put Country before Corporation. It is our collective aspiration that your Company should be one such National Champion in the service of the Nation. In this journey, I draw strength from Team ITC and from their dedication and commitment.

As I conclude, may I on behalf of the Board and the employees of your Company once again thank you, our valued shareholders, for your continued support and encouragement.

Thank you, Ladies & Gentlemen.