Reaching towards its true potential

Ernst & Young's 2011
India attractiveness survey

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Quality In Everything We Do

Ernst & Young's 2011 *India attractiveness survey* reflects first, India's attractiveness for foreign direct investors and second, the perceptions and outlook of India and its peers for a representative panel of 505 international decision-makers.

As we present our first *India attractiveness survey*, we would like to thank all the decision-makers and Ernst & Young professionals who have taken the time to share their thoughts with us.

We would like to extend our gratitude to the selected panel of observers from the business, political and institutional communities who expressed their views on the opportunities and challenges of India: Gautam Bhandari (Managing director, Morgan Stanley India Services Pvt Ltd), Hari Bhartia (President, Confederation of Indian Industry (CII)), Olivier Blum (Managing director India, Schneider Electric India Pvt Ltd), Siraj A Chaudhry (Chairman, Cargill India Private Limited), Kamesh Goyal (Managing director and CEO, Bajaj Allianz Life Insurance and Country Manager, Allianz), Amit Mitra (Secretary General, Federation of Indian Chambers of Commerce and Industry (FICCI)), Daisuke Ochiai (Chief Financial Officer, Mitsui & Co. India Pvt Ltd), Christoph Remund (Chief Executive Officer, DHL Global Forwarding), Siddhartha Roy (Economic Advisor, TATA Group), Jyotiraditya Madhavrao Scindia (Minister of state for commerce and industry, Government of India), Abhijit Sen (CFO, Citibank, India Subcontinent), Ranjit Shahani (Country president, Novartis India), Moon Bum Shin (Former Managing director, LG Electronics India Pvt Ltd.), RP Singh (Secretary, Department of industrial policy and promotion, Ministry of commerce and industry), Vipin Sondhi (Managing director, JCB India).

The success of this survey is directly attributable to their participation and commitment.

Front picture from second Hooghly River bridge in Kolkata, India.

Ernst & Young's 2011 India attractiveness survey

Introduction

India is undergoing a transition, both in terms of investor perceptions of its market potential, and in reality. The country is moving beyond being attractive mainly as a low-cost business process outsourcing (BPO) hub. With economic growth projected to surpass 8% annually and the number of people in the Indian middle class set to treble over the next 15 years, meaning a corresponding impact on disposable income, domestic demand is expected to grow by a compound rate of 9.2% per year between 2010 and 2030[1]. This puts India in a good position to attract an increasing proportion of global foreign direct investments (FDI). Many foreign corporations have realized this, and are seeking to reinforce their positions in India in order to seize the opportunity.

An additional reason for such optimism about growing domestic demand is that India continues to benefit from a young population, whose consumption is driving the formation of the expanding middle class. India's demographic profile also helps it to provide a good price-quality ratio with an increasingly well-educated, yet relatively low-cost labor force. This is a key advantage that, in the future, will set India apart from most developed markets and indeed many of the current high-growth economies.

The growing corporate interest in India is explained not only by the country's economic growth potential, but also by perceptions about how the country will change as its GDP grows. Between November and December 2010, we interviewed more than 500 business leaders about the potential of the Indian market. A large majority believes that, as early as 2020, India will become a global leader in education, R&D, innovation and as a producer of high value-added goods and services.

To take India to the next level, in terms of both opportunities for corporations and growth in the nation's prosperity, a stronger collaboration between the Indian Government and foreign and domestic corporations will be important. Such collaboration will be critical, for example, in infrastructure, education and health care, where society's needs are huge and where the state alone cannot deliver optimal solutions.

If India is to realize this potential so quickly, the Government must take steps to attract further inflows of foreign capital and technical knowledge. Much progress has already been made and the vast majority of businesses which have entered the Indian market in the last decade are planning to increase their investments there. As business leaders start to compete again for growth opportunities globally, there is a sense of urgency among our survey participants to seize the prospects offered by the Indian market.

Specific actions that national and state governments can take to benefit all sectors include expanding and modernizing infrastructure, with an emphasis on developing infrastructure corridors that can connect major hubs to satellite cities. This will allow the latter to supply their relatively low-cost land and labor to foreign businesses that already operate in the larger metropolises. In addition, further investment to make high-quality education available to a larger share of the population will remain a crucial factor underpinning India's future transition to an R&D-led knowledge economy.

This report is the first of a series of ongoing studies into the attractiveness of the Indian subcontinent, which is designed to support both business leaders in their investment decisions, as well as Indian national and state governments in enabling the environment to accelerate growth.

Jay D. Nibbe
EMEIA Deputy Area Managing Partner,
Markets,
Ernst & Young

Farokh Balsara
National Leader,
Markets,
Ernst & Young Private Limited, India

1. Oxford Analytica Daily Brief.

View point

India offers great economic opportunities for global investors

Jyotiraditya Madhavrao Scindia
Minister of state for commerce and industry, Government of India

India is a country that presents itself as having the highest growth rate. Our decadal growth rate has been around 6.5-7% and this past quarter, we posted close to 8.9%. Hopefully, we'll close 2010 at a GDP growth rate of 8.5%. The basic economic fundamentals are strong and there is also a strong domestic market, with 1.2 billion people and a middle-class population of close to 400-500 million.

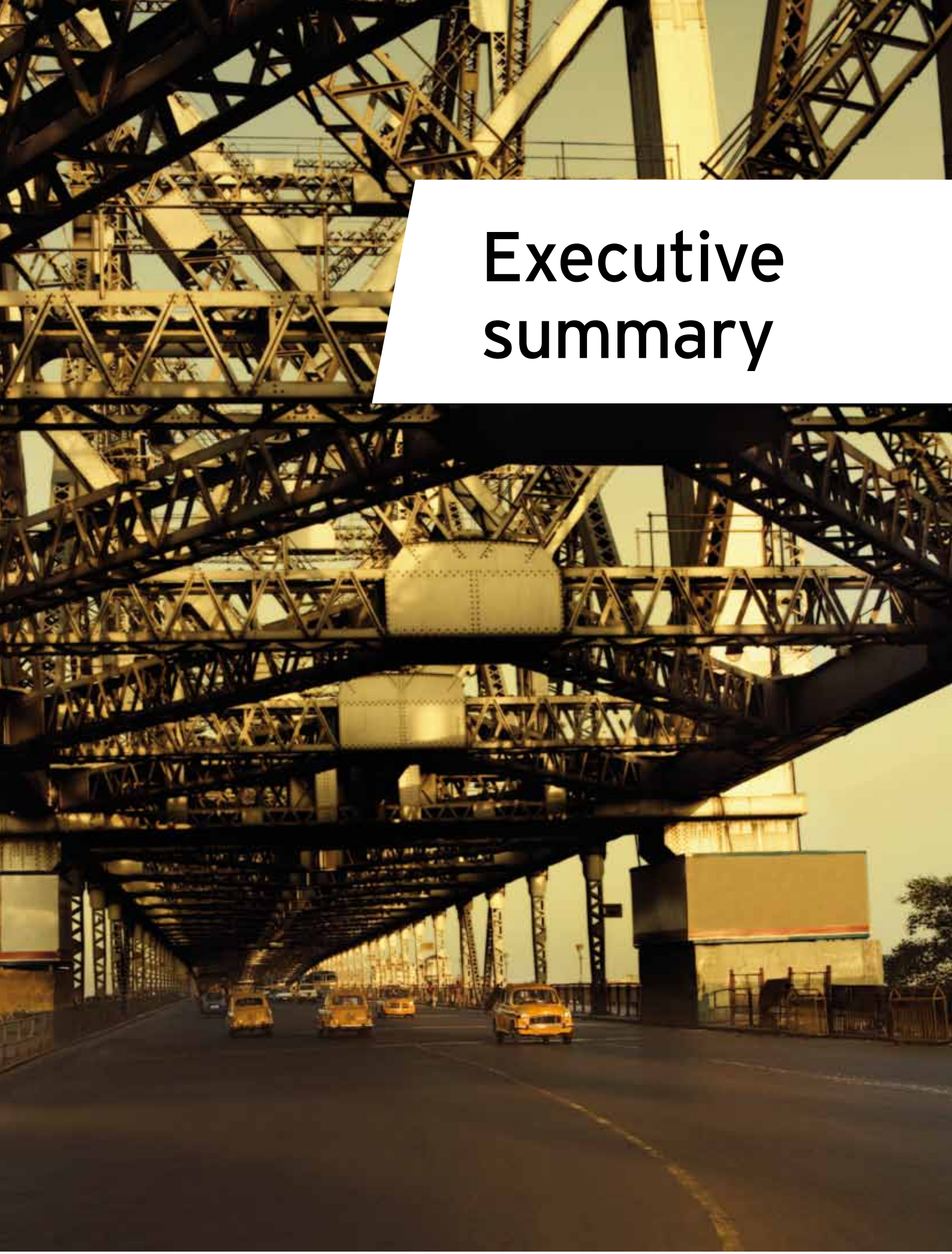
For any global investor, India represents not only an economic opportunity from the perspective of a huge domestic market, but also as a hub for manufacturing for international demand. Many multinational companies have found that to be the case in the recent past. The economic pyramid of India is becoming flatter and flatter too. In the last year, we have seen an unprecedented growth of High Net Worth Individuals, from 84,000 to about one million.

Whether it is agriculture, manufacturing or services, India presents a rare opportunity vis-à-vis the rest of the world. India is already a world leader in IT. Manufacturing is only 16% of our GDP, which clearly is below our potential and therefore we are renewing our thrust on increasing manufacturing capabilities. We are preparing a new policy to enable the country to raise itself from the present level of share of manufacturing from 16% to 25% of GDP over the next 10 years. Our democratic dividend is something we are proud of, but the demographic dividend which we will be reaped in the next decade is what will give us sustainable competitive advantage. We also have tremendous economies of scale being set up across the board, from infrastructure to fast moving consumer goods companies.

But what I think is going to be our long staying competitive advantage is our human resource base. We have a well trained manpower base but we need to redouble our efforts to appropriately train the millions of new entrants into the economy. These factors are the foundation based on which an economic enterprise is bound to flourish here, if managed properly.

With the best intentions, our economic growth can hit a roadblock without appropriate infrastructure. A significant part of the US$1 trillion for infrastructure investment over the next five year plan will come from private sources and represents a great opportunity for global investors. I also believe that the Indian agriculture sector can do much better by promoting value addition and targeted initiatives to move farmers up the value chain, which would yield rich dividends, especially in our quest for inclusive growth.

My advice for potential investors: If you're not here, you're going to miss the boat.



Executive summary

FDI to India: a story of growth

For several years, FDI flows to India have been on a rising trend. Successive waves of liberalization have reduced the involvement of the state and extended the list of industries in which FDI can be approved through streamlined procedures. On average, between 2003 and 2010, the number of FDI projects increased by 7% and the number of jobs created by FDI increased by 4% annually[2].

Organic expansion is the preferred route for FDI. A large number of investors entered India during the 2000s and are now seeking to entrench themselves to capitalize on the country's growing domestic market. A significant 75% of investors who are already operating in India are considering increasing their operations. Foreign investment is being channelled mainly toward manufacturing, business services, sales, marketing and support, and retail, which primarily serve domestic rather than international demand.

A transformation in investment mix

A transformation of FDI to India is taking place, in which the mix of both target sectors and source regions is changing. While the software and IT sector remains one of India's engines of growth, other sectors are catching up. In part, this is due to growing competition from other countries for business process outsourcing (BPO). But it is also the result of a shift in strategy by foreign corporations investing in India, which are now focusing more of their activities on servicing the rapidly growing domestic market. As a result, there has been a rapid expansion of the automotive, communications, consumer products, financial services and construction sectors.

The mix of source regions is also changing. Since 2003, the share of FDI projects implemented by North American investors has declined significantly, falling by more than one-third in six years. The decline in the share of jobs created has been even sharper. However, this has been met by a rise in the share of projects implemented by investors from Western Europe and Asia-Pacific.

Outlook and opportunities

Given the huge potential in the Indian market, it is not surprising that half of our survey respondents are increasing operations in India by expanding their facilities or headcounts. However, in order to attract more investment, a greater focus on business-friendly national and state-level policies and incentives is needed.

Our survey suggests that those Indian states that perform best in key areas of governance, notably transparency, accountability, judicial independence and predictability, and institutional stability, will stand a very good chance of attracting investors who are new to India. Similarly, states that become leading practice in terms of reducing the cost of doing business will be able to attract some of this potential new investment. Further, land concessions or tax incentives and a good price-quality ratio for labor are areas perceived as being particularly attractive by investors.

Infrastructure availability and connectivity within India, as well as internationally, are also highlighted by a majority of survey respondents as key factors common to high-performing states and cities. If implemented successfully, "infrastructure corridors" have the potential to create step changes in a state's investment attractiveness. This is because tomorrow's average foreign investor will be interested in marketing products and services to those increasingly wealthy citizens living not just in Tier I cities, but also in Tier II and Tier III cities, and beyond. As operations in Tier I cities become more costly due to higher land and labor costs, investors are more likely to relocate some of their operations to Tier II cities, where labor — although often less educated — is more abundant, and land prices are lower.

Our survey also leads us to conclude that Indian state governments should undertake targeted marketing campaigns to highlight India's positive economic fundamentals. Those states that possess an abundance of high quality, low-cost labor should take more action to publicize this among foreign investors. Further investment to make high-quality education available to a larger share of the population should also be heavily publicized abroad, as that investment will underpin India's future transition to an R&D-led knowledge economy.

2. fDi Intelligence. *Full year 2010 interim data as of 13 January, 2011.


India
States and Union territories
indicative only
N
Jammu & Kashmir
Srinagar
Himachal Pradesh
Punjab
Chandigarh
Shimla
Uttaranchal
Dehradun
Haryana
Delhi
Rajasthan
Jaipur
Uttar Pradesh
Lucknow
Bihar
Patna
Sikkim
Gangtok
Arunachal Pradesh
Itanagar
Assam
Dispur
Nagaland
Kohima
Shillong
Meghalaya
Imphal
Manipur
Tripura
Agartala
Aizawl
Mizoram
Gujarat
Gandhinagar
Madhya Pradesh
Bhopal
Jharkhand
Ranchi
West Bengal
Kolkata
Chhattisgarh
Raipur
Orissa
Bhubaneshwar
Maharashtra
Mumbai
Hyderabad
Andhra Pradesh
Arabian sea
Goa
Panaji
Andaman & Nicobar islands
Karnataka
Bangaluru
Chennai
Port Blair
Bay of Bengal
Lakshadweep
Tamil Nadu
Kerala
Thiruvananthapuram

Capital:
New Delhi

Geographically:
India consists of 29 states and six union territories.

Bordering countries: China, Nepal and Bhutan to the north, Afghanistan and Pakistan to the north-west, Myanmar and Bangladesh to the east and Sri Lanka to the south.

Figure 1: India fact file

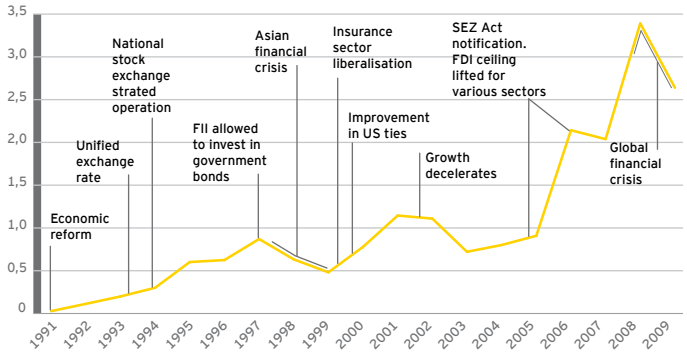
Land area	3.29 million sq km
Capital	New Delhi
Population	1.16 billion
Languages	Hindi（official language of the Union）, English（business language）
Major international airports	Ahmedabad, Amritsar, Bangalore, Chennai, Goa, Guwahati, Hyderabad, Kochi, Kolkata, Mumbai, New Delhi, Thiruvananthapuram
Major seaports	Mumbai, New Mangalore, Kolkata, Kandla, Kochi, Chennai, Ennore, Haldia, Mormugao, Paradip, Tuticorin, Vishakapatnam
Major cities	New Delhi, Mumbai, Kolkata, Chennai, Bangalore, Hyderabad, Pune, Ahmedabad, Jaipur, Chandigarh
Time zone	5 hours 30 minutes ahead of Greenwich Mean Time（GMT）
Currency unit	Indian rupee（INR）

FDI in numbers

The changing face of investment in India

Today, investors are largely attracted to India because of the size of the domestic market and its potential for growth. As shown in the figure below, since 1991, when major economic liberalization started, India's FDI has grown rapidly. FDI as a share of its GDP grew from less than 0.03% in 1991 to 3.5% in 2008, before falling in 2009 as a result of the global financial crisis. As borne out by our survey results, India has moved beyond being attractive mainly as a BPO location. India continues to benefit from a young population, which provides a relatively low-cost, yet educated labor force.

Figure 2: FDI as a share of GDP



Source: World Bank, World Development Indicators (WDI) 2010.
Note: FII=Foreign institutional investor; SEZ=Special economic zone.

Prior to India's liberalization, the country followed protectionist policies that shielded the public sector from international competition. Many sectors, such as telecommunications, banking and insurance were controlled by the government. Obtaining a business license often involved a long and costly process, which deterred private investment.

However, since 1991, successive waves of liberalization have reduced the involvement of the state and extended the list of industries in which FDI can be approved through streamlined procedures. These include up to 100% FDI ceilings that are "automatically" processed in sectors such as brewing, advertising, food processing, hotels, hospitals, management consulting, mining, oil refineries, pharmaceuticals, and power. Certain sectors such as print media (26%), insurance (26%), cable network broadcasting (49%), private sector banking (74%) and telecommunications (74%) have lower FDI ceilings. The only sectors that remain off limits to foreign investment are multi-brand retailing, atomic energy, which are considered as being of strategic importance to the state.

One of the largest single areas of focus of FDI today is telecommunications, where the adoption of mobile technology has accelerated. The number of mobile phone subscribers has increased from an estimated 8 per 100 people to 59 per 100 between 2005 and 2010[3]. Another major FDI target has been the automotive industry, where India is recovering from a shortage of private transport pre-liberalization. This industry, apart from being extremely cost-competitive, has grown in response to the booming local demand and the emergence of India as a hub for manufacturing and export of cars and automotive components. The automobile sector accounts for approximately 4% of India's GDP and is growing at a rate four times higher than that of the economy[4]. The real estate sector has also attracted significant FDI flows for similar reasons.

3. Telecom Regulatory Authority of India, World Bank, and Indian Population Clock.
4. Forbes India.

Illustrative list of sectors in which FDI up to 100% is allowed under the automatic route

- Non-banking financial companies
- Coal and lignite mining for captive consumption by power projects as well as iron and steel, cement production
- Power
- Software development
- Electronic hardware
- Film industry
- Advertising
- Hospitals
- Hotels
- Food processing
- Private oil refineries
- Manufacture of telecom products
- Airports (greenfield projects)
- Management consultancy
- Pollution control and management
- Wholesale/cash and carry trading
- Trading of exports
- Manufacture of drugs and pharmaceuticals
- Industrial parks
- Special economic zones (SEZs) and free trade warehousing zones
- Agriculture
- Alcohol distillation and brewing
- Manufacture of coffee and rubber processing and warehousing, most manufacturing activities
- Non-banking financial services
- Construction development projects including housing, commercial premises, resorts, educational institutions, recreational facilities, cities and regional-level infrastructure, townships.

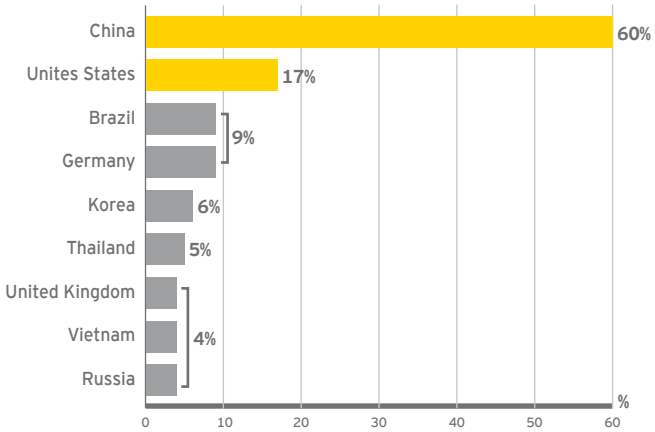
All of the above are subject to specified conditions for investment in the relevant sector/industry and are also subject to prescibed documentation requirements.

Source: Ernst & Young 2010 *Doing business in India*

India compared with its peers

Although FDI capital investment in India has increased significantly in the last two decades, it still remains low compared to China. Some 60% of the executives surveyed deem China as India's main competitor for FDI, compared to a combined share of only 35% who consider the United States, Germany and Brazil.

Figure 3: Main competitors



Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected three possible answers. Total respondents: 505.

Among the respondents who chose China, 46% cited low labor costs and better internal markets as its key advantage, while 14% noted access to highly skilled labor as the main reason for the country's attractiveness. Japan, Germany and the United States were mainly chosen because of their pools of highly skilled labor. Those who considered the United States as the main competitor were overwhelmingly in the high-tech and telecommunications sectors, while respondents from the automotive industry selected Germany and Japan.

The drop in FDI provoked by the financial crisis has affected China more severely than India. While FDI US$ inflows fell by 19% in India between 2008 and 2009, they dropped by 89% in China. This is likely to be due, in large part, to the relatively high domestic focus of India's market – a factor highlighted in our survey results. This limited India's exposure to declining global demand, compared to China's heavy dependence on exports. Investment projects in India are more geared toward servicing the domestic market than they are in China.

Amit Mitra
Secretary General,
Federation of Indian Chambers
of Commerce and Industry (FICCI)

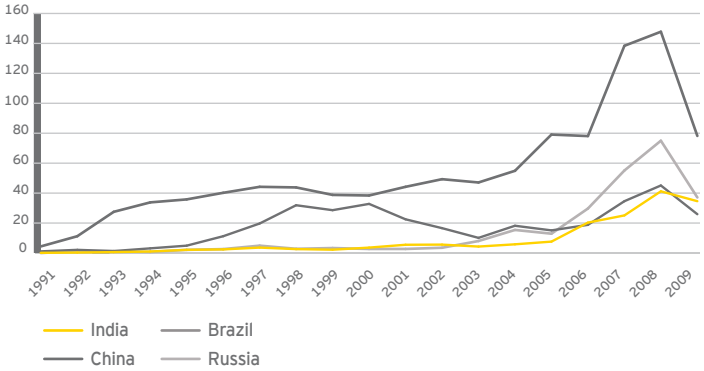
Manufacturing sector gaining more credibility in India

A popular perception is that China is the workshop of the world and India is its back office. This is wrong. China has a large services sector and India has a large manufacturing sector and is all set to further develop it.

We are committed to increasing the share of the manufacturing sector in GDP from the present 16% to about 25% over the next few years. The huge size of the domestic market, strong growth potential, availability of skilled manpower and relatively stable legal framework are the key strengths of the Indian market. As a result, the manufacturing sector is growing at a fairly robust pace and almost all segments are open to foreign investors for participation. Therefore, I would say that foreign investors should look at investing more in the entire manufacturing sector and also evaluate the

The composition of FDI to the BRICs (Brazil, Russia, India, China) in recent years also plays a role in explaining the contrasting performance of India against China (and Russia) during the recession. While FDI to China is focused mainly on the manufacturing sector, FDI to India is more diverse. In addition, the characteristics of India's banking and financial system considerably reduced the country's exposure to the financial crisis.

Figure 4: FDI inflows. Current US dollars (billion)



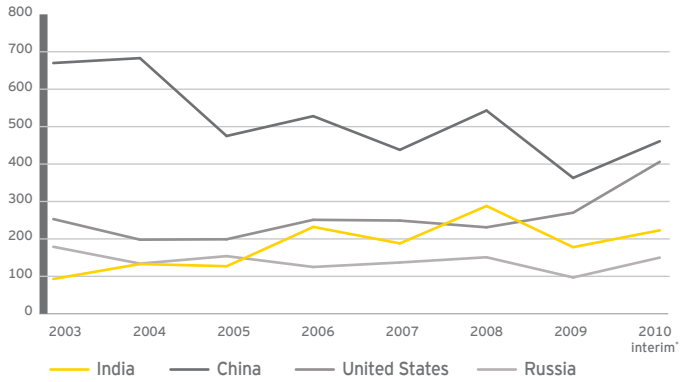
Source: World Bank, World Development Indicators (WDI) 2010.

Manufacturing

In terms of projects attracted by the sector, China is outperforming its competitors. However, the number of FDI projects attracted by China annually has trended downwards during the past seven years and is converging with the number in the United States, the second largest target for FDI. Meanwhile, between 2003 and 2010, India has managed to double the number of new FDI projects per year and overtook Russia in 2005.

During the period 2005-10, India has attracted only slightly more than one-third of the number of investment projects attracted by China. Although India has a competitive advantage in some sectors, e.g., producing better quality and cost-competitive automobiles, China outperforms India in other sectors, e.g., the production of power turbines.

Figure 5: FDI in manufacturing: number of projects



Source: fDi Intelligence. *Full year 2010 interim data as of 13 January, 2011.

View point

option of making India a global hub for manufacturing exports.

Of course, India has to compete with a number of countries for attracting investments from abroad. China and the entire block of high-growth economies are the main competitors for India when it comes to attracting investments. Besides China, many of the other high-growth economies, such as Brazil, Russia and South Africa are growing at a fairly robust pace and have their own set of advantages, which also mean there is a strong case for investing in these countries.

The two critical areas in which we feel we need to see improvements for enhancing India's attractiveness as an investment destination are infrastructure and administrative procedures at the ground level. In fact, in a recently conducted survey among foreign direct investors in India conducted by FICCI, these two issues came up as priorities for improving the investment environment in India.

Improving the overall business environment is crucial if India wants to absorb rising investment flows. Procedural reforms at the state level are also critical if India wants to emerge as the world's fastest growing economy. Broad policy reforms at the level of the central government have progressed well. What we need to see now are reforms of administrative procedures, and the role of the state governments becomes very important here.

I believe that given our recent growth performance and the near-term possibility of breaking the double-digit growth barrier, we should emerge as the third largest economy in the world by 2020. Of course, I would be delighted to see India at the top of the league table soon.

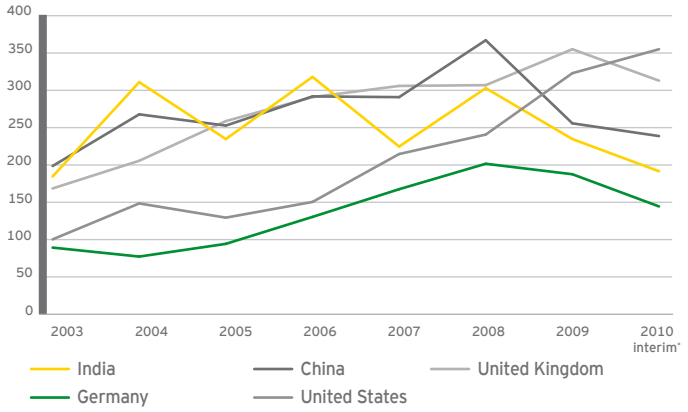
From outside, doing business in India may look like a formidable challenge. However, from within, it is manageable. Therefore, my advice to companies seeking to invest in India is: plunge in – you need to come into the Indian market to realize the profitable investment options that are on offer.

Services

The services sector exhibits a very different dynamic to the manufacturing sector. In services, India attracted fourth-most projects in both 2009 and 2010 (the latter according to interim 2010 data released in mid-January). The United States and the United Kingdom are the two clear leaders in attracting service sector FDI, with more than 300 projects each in each of 2009 and 2010. This is likely to be in part due to these two countries stable and open business environments for foreign services companies. Interestingly, for both countries the number of FDI projects attracted continued rising even during the financial crisis. This could be partly explained by acquisitions by "bargain hunters" when company valuations were low.

Third place in the ranking is taken by China, which, like India, has suffered a steep downturn in FDI to the services sector since a peak in 2008. For both countries, it is too early to suggest that this is going to be a lasting trend. It could still be related to a degree of retrenchment by US investors following the financial crisis. For both China and India, this downturn could be a temporary dip as FDI in low-valued added services begins to move elsewhere, while the anticipated rise in higher value-added services – particularly in India – has yet to gather momentum.

Figure 6: FDI in services: number of projects



Source: fDi Intelligence. *Full year 2010 interim data as of 13 January, 2011.

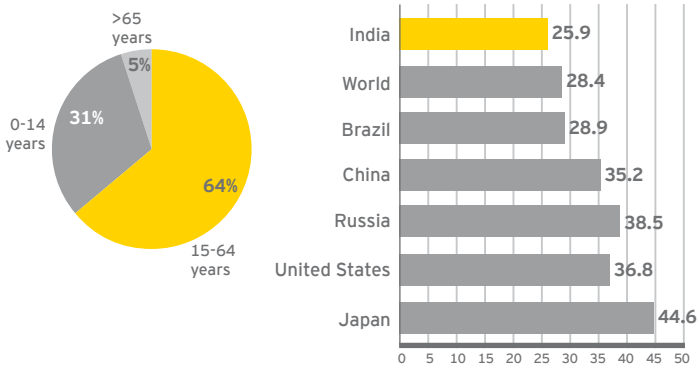
Demographic advantage

On current projections, India's population will rise from 1.03 billion in 2001 to 1.43 billion by 2031[5]. The number of people aged between 14 to 64 years will rise, resulting in a higher ratio of workers to dependants and higher savings rates. India's demographic profile will be a significant source of long-term economic strength relative to most countries.

Figure 7: India's demography

Distribution of population by age

India's median age compared to other countries (in years)



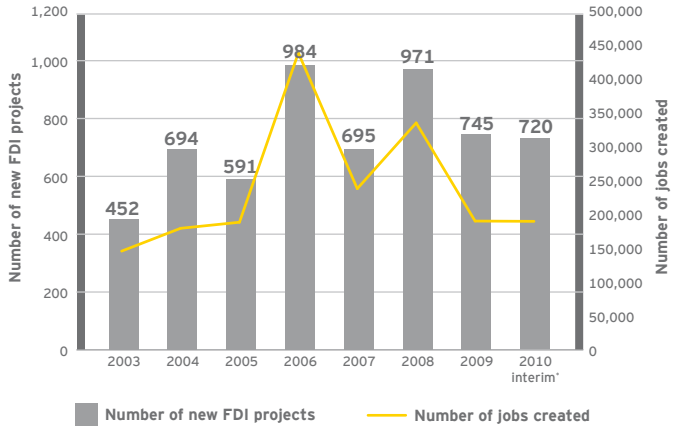
Source: CIA World Factbook, accessed 12 January 2011.

5. Oxford Analytica Daily Brief.

FDI to India: the big picture

Between 2003 and 2010, investments by foreign companies have been cyclical, with investment peaks in 2006 and 2008 and investment troughs in 2007 and 2009. In years when the rupee depreciated (2004, 2006, and 2008), the number of FDI projects in India increased as the country became relatively cheaper to invest in for foreigners. India's best performance occurred in 2006 and was almost matched in 2008. In 2009, foreign investment was subdued mostly due to the global financial crisis, as companies hoarded cash and strengthened their balance sheets. 2010 interim data confirm a slow recovery of FDI flows to India in terms of new projects and jobs created as we are not yet back to the level of 2006 or 2008.

Figure 8: Investment in India, FDI projects and jobs creation



Source: fDi Intelligence. *Full year 2010 interim data as of 13 January, 2011.

India has been experiencing clear positive trends in numbers of FDI projects and jobs created. On average, between 2003 and 2010, the number of FDI projects increased by 7% and the number of jobs created by FDI increased by 4% annually. As a result, job intensity per project has fallen over the period. This is due to a combination of gradually rising labor costs and the fall in the share of projects in the most job-intensive activities. These activities include shared service centers, customer contact centers, technical support centers, extraction and design and development. Foreign investors are focusing increasingly on business services, sales, marketing and support, and retail and manufacturing, which serve the growing domestic market rather than international demand. With the exception of manufacturing, the latter sectors require investment in less labor-intensive projects.

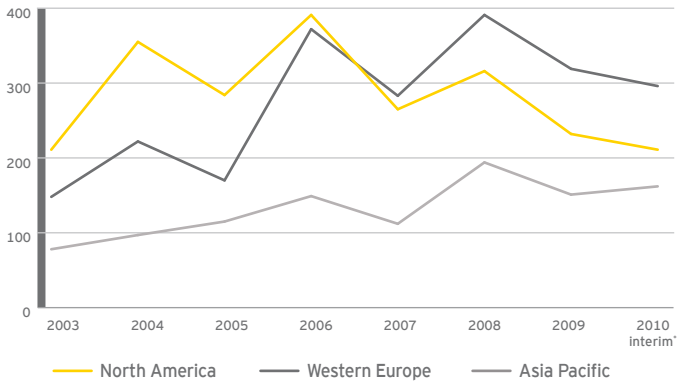
Trends among regions investing

Since 2003, the share of FDI projects implemented by North American investors has seen a large decline, falling by more than one-third in six years. The decline in the share of jobs created has been even sharper. This has been met by a rise in the share of projects implemented by investors from Western Europe and Asia Pacific.

Western Europe's ascent as a source of FDI began in 2005, and it overtook North America in 2007. Until 2005, FDI from Western Europe had been falling behind that from North America. In order to counter this trend, trade missions and high-profile visits to India were stepped up by the UK, French and German Governments, and local firms were encouraged to seize opportunities in India. The UK Government, for example, undertook a study of trade and investment links with India in 2006 and a number of initiatives have since been implemented to encourage investment by UK firms in India.

The Asia Pacific region has been steadily increasing investment in India since 2003. Its share of FDI projects in India increased from 17% in 2003 to 23% in 2009. This rise has been even stronger than that of European FDI. The Asia Pacific region has always had trade and investment links with India and has been able to build on these.

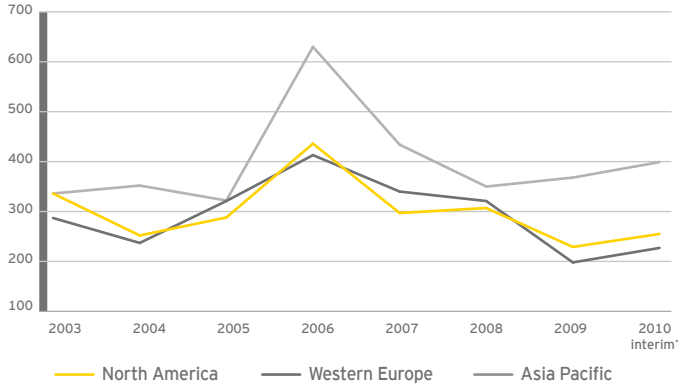
Figure 9: FDI projects by region



Source: fDi Intelligence. *Full year 2010 interim data as of 13 January, 2011.

In terms of average jobs creation per project, Asia Pacific has been the leader. From 2003 to 2010, the average project size in terms of jobs creation has been larger for Asia Pacific compared with North America and Western Europe. While job intensity spiked for all three regions in 2006 due to investment in large and labor-intensive manufacturing and construction projects, in that year projects originating from Asia were about 50% more job intensive. In the aftermath of the financial crisis, while Western European and North American investors have reduced the level of job intensity, Asian projects have become slightly more job-intensive.

Figure 10: Job intensity by region



Source: fDi Intelligence. *Full year 2010 interim data as of 13 January, 2011.

One explanation is that while the largest European projects are in software and IT and the financial sector, the largest Asian projects are in the automotive and consumer electronics sectors, which are often more labor-intensive.

View point

India has emerged as an attractive investment option

Daisuke Ochiai
Chief Financial Officer,
Mitsui & Co. India Pvt Ltd

India is a growing market and "top of the charts" at the head offices of many companies. The common impression is that India has a young generation that is rapidly growing. About 50% of the population is less than 25 years of age, thereby making a significant segment of the workforce youthful, dynamic and socially mobile. Added to this, the country's long history of democracy and its legal framework offer a stable business and political environment.

Over the last decade, India has emerged as an attractive investment option. Because of the globalization initiatives of the Indian Government and the growing purchasing power of the vast middle class segment, I am optimistic about growth in the Indian economy in future. I am also confident that the economy will avoid turmoil over the next 10 years.

However, India is not a large energy-producing country and in view of its anticipated growth, I expect the demand for energy to outstrip supply in times to come. I feel this could be a risk factor in India's growth story. Therefore, power generation capacities have to improve through the enhancement and establishment of further plants.

Without improvement in infrastructure, India cannot drive its growth. A strong impetus to improve the country's infrastructure is needed. In addition, e-governance needs to improve and become more widespread. Another uncertainty for multinational companies is transfer pricing taxation policy by Indian government in comparison with globally established practice; this too needs to be clarified and consolidated across states. Mitsui, through its long association with India, has been able to gain an in-depth understanding of the complex challenges and modalities of operating in a country where taxation and excise rules and regulations differ from one state to another. These rules need to be simplified to pave the way for future investors.

Mitsui's predecessor was the first Japanese company to open an office in India in Mumbai in March 1983. Since then, Mitsui has endeavoured to promote and maintain its trading relationship with India, tailoring its services to the changing economic conditions of the growing nation. Primarily, Mitsui's business activities in India are in commodities trading, while Mitsui has also been endeavoring to develop logistics infrastructure projects in India.

The leading investor countries

United States

The relative decline of the US as a source of FDI predates the financial crisis but was accentuated by it. Nonetheless, the US remains the largest investor in India by a considerable margin. In 2003, the US was responsible for 45% of all FDI projects in India. This figure had declined to 30% by 2009.

A closer look indicates that the fall in the share of US investment activity was caused by a large decline in design and development investment – the largest US investment activity – in Bangalore, which was not compensated for by increases in other investment activities, such as manufacturing and sales, and marketing and support. The largest US investment destinations remain Karnataka (and in particular its capital, Bangalore), Maharashtra and Andhra Pradesh.

The US decline reflects the interaction of two drivers:

1. **Geographic diversity.** Most US FDI is located in mature and developed economies, in particular in Western Europe and Canada. Asia-Pacific countries that recorded the highest increases in US FDI in 2009 included Australia, Hong Kong and South Korea – mostly in the finance and insurance sectors. India's financial sector severely restricts foreign ownership, which may explain why India did not rank higher compared with these countries.
2. **Public scepticism.** Public scepticism of BPO has been rising in the US since the mid-2000s. Given the high unemployment rate in the US at present, the pressure to maintain jobs at home remains high.

Figure 11: Top 10 leading investor countries in India in 2009, FDI projects

Source country	FDI projects in 2009	Growth compared to medium-term average[6]	Share of 2006 investment surge	Share of 2008 investment surge
United States	223	-21%	28%	14%
UK	87	16%	11%	19%
Germany	75	23%	13%	6%
Japan	69	33%	8%	15%
France	40	19%	8%	4%
Netherlands	22	54%	5%	3%
South Korea	18	4%	1%	2%
Switzerland	18	13%	3%	3%
Malaysia	17	92%	2%	1%
Italy	17	2%	3%	3%

Source: fDi Intelligence.

6. Medium-term average refers to the average value of FDI projects or jobs between 2003 and 2009.

United Kingdom

The United Kingdom is the second-largest investor in India in terms of projects and the third largest in terms of jobs creation. The UK's main investment activities are in business services, manufacturing, and sales, marketing and support, and they are concentrated in Maharashtra, Karnataka and Tamil Nadu. Although both business services and manufacturing followed cyclical trends between 2003 and 2008, investment in business services remained stable throughout the period.

Germany

Germany takes third place for FDI projects and fourth for jobs created in India. German investments in India are disproportionately in manufacturing, followed by sales, marketing and support and retail. The strong presence in manufacturing is driven by large investors such as Volkswagen, BMW and Bosch. As with the UK, Germany's top investment destinations are Maharashtra, Karnataka and Tamil Nadu.

Japan

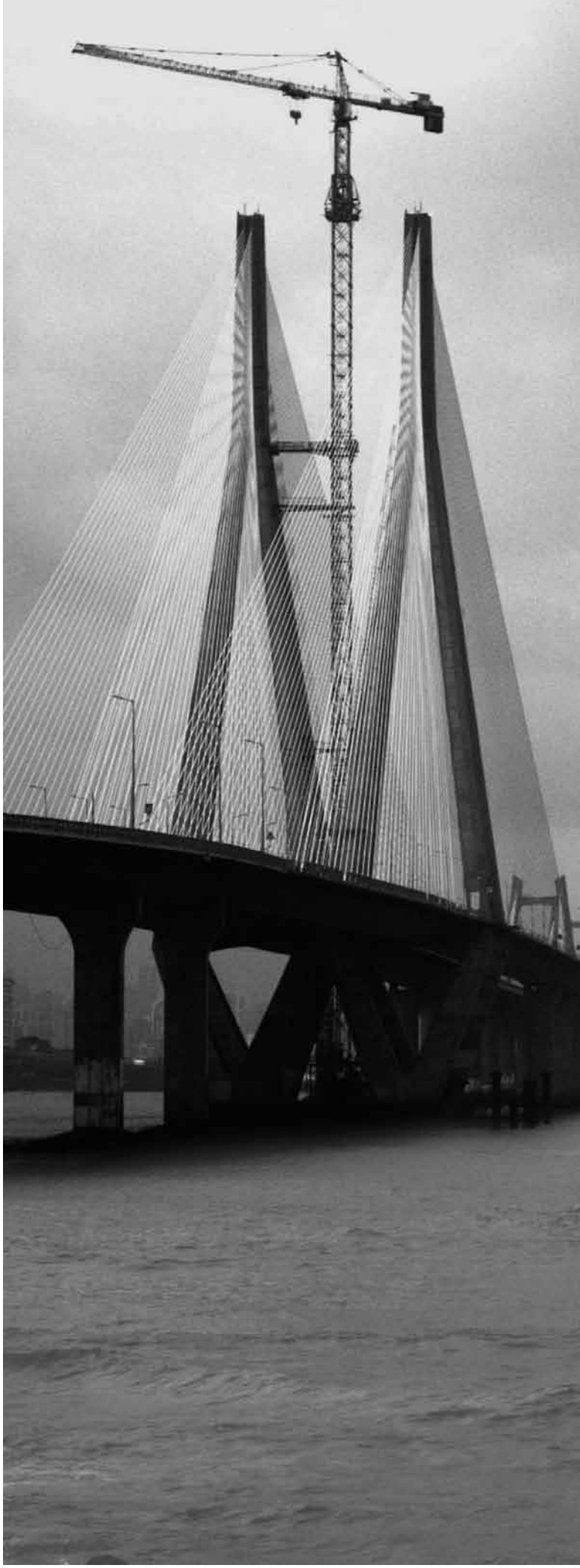
Japanese private investment to India exceeded that going to China in 2008. Almost half of all Japanese investment activity in India is in manufacturing and one quarter is in sales, marketing and support. Japanese investment used to be strong in light engineering (cars and motorcycles) but this has declined in recent years as a result of Indian partner buyouts. All major Japanese motor companies have a presence in India. However, a new strand of Japanese investment in India has emerged with emphasis on heavy engineering and project finance. This includes the Delhi Metro and the new Mumbai-Delhi corridor. The main Japanese investment destinations in 2009 have been Tamil Nadu, Karnataka Delhi and Gujarat.

France

Although France and Japan held similar shares of FDI in India in 2003, France's share of FDI projects in 2009 had fallen to almost half that of Japan. This is despite France's 19% increase in the number of FDI projects in 2009 compared with the medium-term average. As with the other major Western European investors, while the number of projects increased in 2009, the number of jobs declined. This is possibly a result of responding to rising labor costs in India, investing in less job-intensive sectors or of sending fewer jobs abroad to take into account pressure from domestic constituencies. French investment has been mainly focused on manufacturing, sales, marketing and support and business services. The states attracting the majority of this investment are Maharashtra, Karnataka and Tamil Nadu.

Interim 2010 data

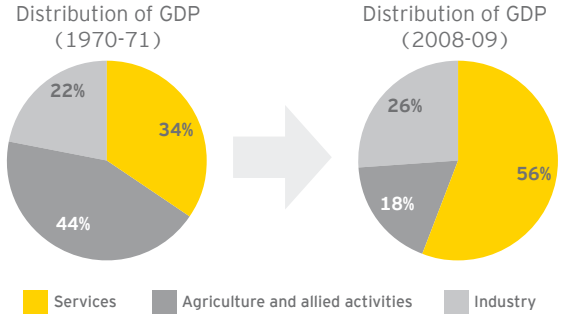
The relative decline of the United States as a source of FDI in India appears to have continued in 2010, according to interim data released in mid-January: the number of US FDI projects in 2010 (206) was the lowest since 2003 and almost half the number in 2006, which was the peak of recent years. The other top ten investor countries that experienced declines in 2010 compared to their medium-term averages (for 2003-10) were France and the UK, which declined by 21% and 3% respectively. Among the other major European investors, German and Italian investment showed a stronger performance in 2010 in terms of numbers of projects – growing, respectively, at 25% and 27% higher than their medium-term averages. This enabled Germany to overtake the UK in the ranking of leading investor countries in India, and perhaps is a reflection of Germany's stronger recovery from the global recession. However, both Germany and the UK were overtaken by Japan, whose companies started 50% more FDI projects in 2010 compared to the medium-term average. In terms of potential new long-term trends identifiable in the interim 2010 data, perhaps most significant is the rapid growth of China (and, to a lesser degree, the United Arab Emirates – despite Dubai's financial problems in 2010) as an investor in India. The 19 projects initiated by Chinese companies in 2010 was dramatically more than the seven implemented in 2009, and represented an increase of 92% compared to the medium-term average. With this, China jumped from being the 16th largest investor in India in 2009, in terms of the number of projects, to the ninth largest in 2010.



Sectoral and business activity trends

India's comparative advantage appears to be expanding from the software and IT sector to business services. Although software and IT services was still the largest sector in 2009 in terms of FDI projects and jobs, compared to the medium-term average it experienced the largest and the second-largest sectoral declines in the number of FDI projects and jobs, respectively. Sectors that have seen large rises include industrial machinery, equipment and tools, as well as business services and financial services. The automotive, consumer products and infrastructure sectors also are major motors of the economy and attract significant FDI.

Figure 12: Shift to the services sector



Source: Centre for Monitoring Indian Economy (CMIE), Ernst & Young 2010 *Doing business in India*.

View point

Vipin Sondhi
Managing director, JCB India

One must persevere to achieve business success in India

Doing business in India has become much easier and JCB's recent experience has been very positive. For instance, licensing in some of the issues related to the Ministry of Industry is no longer required. Fundamentally, the business environment is becoming increasingly friendly. Infrastructure has become an important emphasis in India in the last five to seven years and the next two to three decades will be focused on further infrastructure development. Nonetheless, certain challenges still remain and some things are not perfect, but that is the beauty of being in India.

Our operation in India benefits from three fundamental factors. First, the Indian labor force is extremely hard working and diligent. For instance, in manufacturing, the work ethic and the quality of people is on a par with or better than anywhere else in the world. Second, the supplier base has come of age, and is extremely entrepreneurial and hungry for growth. This is especially the case in the automotive sector. Finally, financing is reasonably well developed, with non-banking financial companies as well as private banks and nationalized banks providing finance to entrepreneurs.

I am optimistic that once India's full potential is unleashed, the dividends of a good demography and stable political system will boost economic growth and provide large benefits to businesses located here. It is important for businesses to persevere in India in order to build the platform necessary for doing business in the local market. Companies need to set up local operations with a long-term view of creating a strong business foundation.

Figure 13: Top 10 sectors in 2009, FDI projects

Sector	FDI projects in 2009	Growth compared to medium-term average[7]	FDI jobs created in 2009	Growth compared to the medium-term average[8]
Software and IT services	96	-36%	23,092	-39%
Business services	86	34%	14,365	-22%
Industrial machinery, equipment and tools	67	56%	9,474	22%
Financial services	52	16%	16,649	25%
Communications	37	-4%	10,399	-21%
Chemicals	31	54%	3,194	68%
Automotive (Original Equipment Manufacturers)	27	15%	21,947	11%
Transportation	24	-15%	1,820	-63%
Automotive components	24	-3%	6,606	-21%
Metals	24	14%	12,602	3%

Source: fDi Intelligence.

Despite the declining trend in IT and software projects, our executives still perceive this industry to be the most attractive by far. The automotive sector is in second place, followed by communications, consumer products, financial services and construction. These perceptions confirm the view that IT remains a significant investment target and an engine of growth. However, the demand-driven market expansion is increasing the attractiveness of other sectors, as reflected in their growth rates.

FDI flows to leading sectors

Automotive

India's automotive sector is growing fast: domestic sales of passenger automobiles rose by 33.9% year-on-year between April and August 2010[9]. This large growth is due to the expanding middle class and facilitation of borrowing. With India's well-trained labor force and strong supplier base in automotive, many global firms are also looking to increase their exports from India – potentially making it an Asian hub to compete with Thailand. Given the attractiveness of the Indian market and the presence of large domestic demand, it is not surprising that the number of FDI projects in this sector has more than doubled between 2003 and 2010.

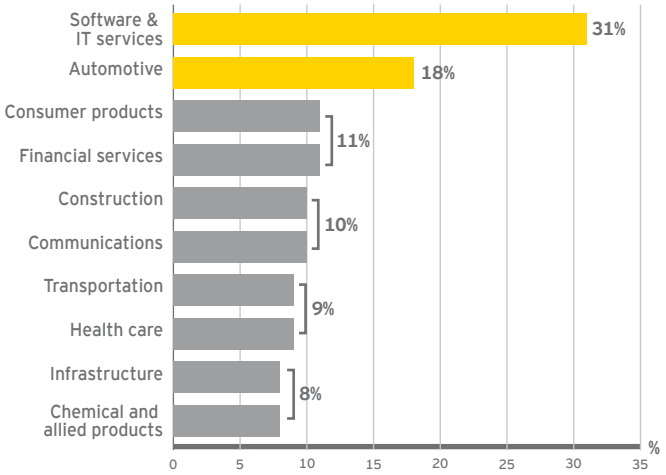
Infrastructure

India has experienced an infrastructure revolution over the last two decades. Expansion of satellite telephony and the internet in rural areas, together with investment in communications infrastructure, especially roads, by successive governments since the mid-1990s, has supported the growth of smaller cities and rural areas. Better communications have made it possible for urban-based businesses to penetrate rural markets to a greater degree. With the liberalization of FDI ceilings in telecommunications in 2005 and increasing demand for foreign investment in infrastructure, the number of FDI projects in infrastructure rose rapidly from 2003.

Consumer products

India's consumer market is forecast to become the fifth largest consumer market in the world by 2025. As more Indian households join the middle class, spending capacity will increase further and drive demand for consumer products. Consumption patterns will change from being largely necessity-based to focus more on discretionary spending, as a smaller proportion of family income is spent on basic goods. One forecast indicates that while spending on necessities is expected to rise at an annual rate of 4.5%, spending on personal goods and services will grow at 9.2% annually[10].

Figure 14: Most attractive sectors



Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected three possible answers. Total respondents: 505.

7. Medium-term average refers to the average value of FDI projects or jobs between 2003 and 2009.
8. *Ibid*.
9. The Society of Indian Automobile Manufacturers.
10. McKinsey.

Financial Services

The banking industry has grown at a CAGR 24% over the last decade; however FDI has been limited due to the various policy measures. The banking regulator has announced its intention to allow a larger participation by foreign banks. This should spur increased FDI in the banking sector.

The insurance sector has grown at a CAGR of 24% over the last decade and is worth US$66.7 billion. FDI of approximately US$1.1 billion has flowed to the industry. Further opening up of the sector and entry of global reinsurance and general insurance majors is expected to boost FDI directed towards the sector.

The asset management industry has seen the Assets Under Management (AUM) grow from US$20 billion in 2001 to US$136 billion in March 2010. Further reforms in the areas like corporate bond market and derivatives will see a larger flow of FDI to the sector.

Fast growing FDI flows

Health care

Improving national health is one of India's priorities, and foreign investors are keen to enter the Indian market. The total value of the health care market was estimated at US$35 billion in 2007 and is projected to reach US$70 billion by 2012, and US$145 billion by 2017[11]. Private health care corporates have been gaining market share and now control about 90% of this expanding market. For example, the Columbia Asia Group, a hospital chain, invested in 13 FDI projects in 2009 alone.

Renewable energy

Renewable energy generation capacity in India has grown at a healthy CAGR of about 24% over the last 5 fiscal years to reach 17 GW at present. Wind, with a share of about 70% has dominated till now, with small hydro and biomass making up the balance. In order to harness its tremendous solar potential, India has embarked on an ambitious solar mission, targeting 20 GW by 2022. Moreover, the government targets renewable energy's share in electricity generated (in kWh terms) to increase from around 4% at present to 15% by 2020. In order to facilitate investment in this sector, India is providing capital subsidies and financial incentives.

11. Oxford Analytica Daily Brief.

Ranjit Shahani
Country president, Novartis India

Education, health care and infrastructure will power India

Currently estimated to be a US$1.5 trillion economy, India is poised to catch up with Western countries, and the outlook for the next 10 years is bright.

Three things important to any economy are education, health care and infrastructure. If you have a healthy and educated society, you have a prosperous society. India is surely moving in that direction by enhancing its capabilities through policies and practices in these sectors.

Indian people are conscious that a good education is important in establishing a civil society that will help to improve governmental accountability and strengthen institutional quality. A more educated population will improve India's attractiveness as a destination

Biotechnology

The majority of leading states have issued biotechnology policies that aim to increase investment activity, sometimes with innovative incentives. The main objective of these policies is to improve the quality and quantity of R&D by assisting research centers financially. The process also involves the development of human resources and infrastructure to sustain growth in this sector.

Plastics and chemicals

India's Government announced the Petroleum, Chemicals and Petrochemicals Investment Regions policy (PCPIR) in 2007. It aims to encourage domestic and foreign investment in these sectors in India through the introduction of transparent and business-friendly policies and a highly developed infrastructure.

Figure 15: Fastest growing sectors in 2009, FDI projects

Sector	Growth compared to the medium-term average[12]
Health care	209%
Space and Defense	180%
Plastics	142%
Alternative/ Renewable Energy	105%
Medical Devices	87%

Source: fDi Intelligence.

12. Medium-term average refers to the average value of FDI projects or jobs between 2003 and 2009.

Interim 2010 data

According to interim data released in mid-January, there was a further accentuation of the decline of FDI interest in the software and IT services sector in 2010. The number of projects in this sector in 2010 fell to 80, 43% lower than the medium-term average (for 2003-10), while the fall in the number of jobs created was even sharper, at 63% below the medium-term average. Although this sector still attracts more projects than any other, the number being attracted annually is now less than half that attracted in each of the peak years for this sector, 2004-06. The industrial equipment, machinery and tools sector, which among the leading sectors for FDI grew strongest in terms of number of projects and second strongest in terms of jobs created in 2010, compared to the medium-term averages, looks set soon to overtake software and IT services as India's leading sector, in terms of FDI projects. As in 2009, the fastest growing sectors of all, in terms of numbers of FDI projects, are not among the ten largest sectors for FDI projects. In 2010, these were medical devices, and engines and turbines. Meanwhile, the financial services sector experienced a sharp decline, with the number of projects and jobs falling by 22% and 70% respectively in 2010 compared to the medium-term averages. This may still be a consequence of foreign financial institutions retrenching following the financial crisis.

View point

in terms of human resources, skills and capabilities.

There have been examples of the nation's infrastructure responding quickly once new business comes in. This has been evident across many industries since liberalization, be it telecommunications, insurance, banking, or consumer goods. The amount of progress made with regard to ports, airports and roadways — thus connecting the nation more — has been a factor catalyzing growth.

India's attractiveness will increasingly come from its ability to leverage its demographic dividend. Given that about 50% of the population is below the age of 25, India's consumer market holds a huge potential, and this is likely to be fulfilled. This will affect a multitude of sectors, e.g., health care, education and consumer goods.

Over the last few years, the growth experienced by the pharmaceuticals industry has been directly correlated with GDP growth. Given India's growth trajectory, the pharmaceuticals industry is likely to reap large dividends from this progress. The strategy of Novartis has been to focus on the domestic market, offshoring/ outsourcing, and export-oriented development, thereby making use of three different types of opportunities that the Indian market offers.

The size of the Indian population, as well as health care and lifestyle factors, present a large growth opportunity for pharmaceuticals companies in India. The presence of cost-effective and skilled labor in India gives multinational companies the opportunity to offshore and outsource R&D activities that would be too costly to undertake in developed nations. Recognizing the potential of the market, we have launched all our key new products from the global portfolio here.

Business activities

Manufacturing attracts the most FDI projects in India. This is followed by sales, marketing and support, business services, and design, development and testing. In 2009, the number of FDI projects in the electricity industry showed the highest annual rate of growth, while the number of projects in shared services centers experienced the sharpest decline. In terms of jobs created, maintenance and servicing, business services, and ICT and internet infrastructure were the fastest growing activities.

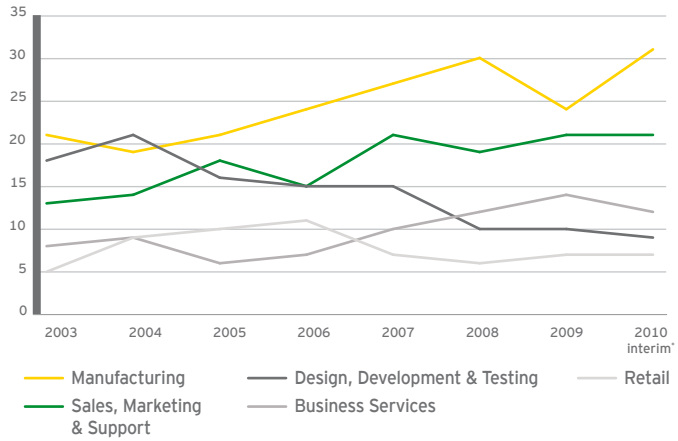
Figure 16: Top 10 business activities in India in 2009, FDI projects

Business activity	FDI projects in 2009	Growth compared to the medium-term average[13]	Share of FDI projects in 2009	FDI jobs created in 2009	Growth compared to the medium-term average[14]	Share of jobs created in 2009
Manufacturing	178	1%	24%	76,809	-28%	40%
Sales, marketing and support	156	23%	17%	18,749	34%	10%
Business services	102	45%	10%	22,120	130%	12%
Design, development and testing	71	-32%	14%	16,590	-42%	9%
Retail	53	-10%	8%	8,759	-10%	5%
Construction	30	15%	4%	11,920	-51%	6%
Logistics, distribution and transportation	28	-4%	4%	2,950	-52%	2%
Research and Development	23	-40%	5%	5,812	-41%	3%
Education and training	22	62%	3%	1,287	37%	1%
Electricity	17	94%	2%	1,555	117%	1%

Source: fDi Intelligence.

Compared to 2008, most activities saw a fall in 2009 in the number of FDI projects and jobs created. This was most notable in manufacturing and construction, where the number of jobs fell by 50% and 80%, respectively. This was the result of the financial crisis and the ensuing slowdown in global demand for manufactured goods. This lower demand also affected other activities such as retail, logistics, distribution and transportation. The only activities that experienced a substantial growth in jobs in 2009 were extraction and business services. Comparing the medium-term dynamics of the leading activities in terms of FDI projects, the top three (manufacturing; sales, marketing and support; and business services) have seen positive trends between 2003 and 2009.

Figure 17: Market share of largest activities, FDI projects



Source: fDi Intelligence. *Full year 2010 interim data as of 13 January, 2011.

Sharpest declining activities

Some activities have seen particularly sharp declines in FDI in 2009, notably shared service centers, technical support centers and customer contact centers.

Figure 18: Largest declines, FDI projects

Activity	Decline compared to the medium-term average[15]
Shared services center	-65%
Technical support center	-51%
Customer contact center	-50%
Research and development	-40%
Design, development and testing	-32%

Source: fDi Intelligence.

13. *Ibid*
14. *Ibid*
15. *Ibid*

Four major drivers help to explain these declines:

1. Many US and European companies, which are the bedrock of India's customer and technical support centers, were badly affected by the global recession. This caused a global slowdown in the IT and outsourcing market.

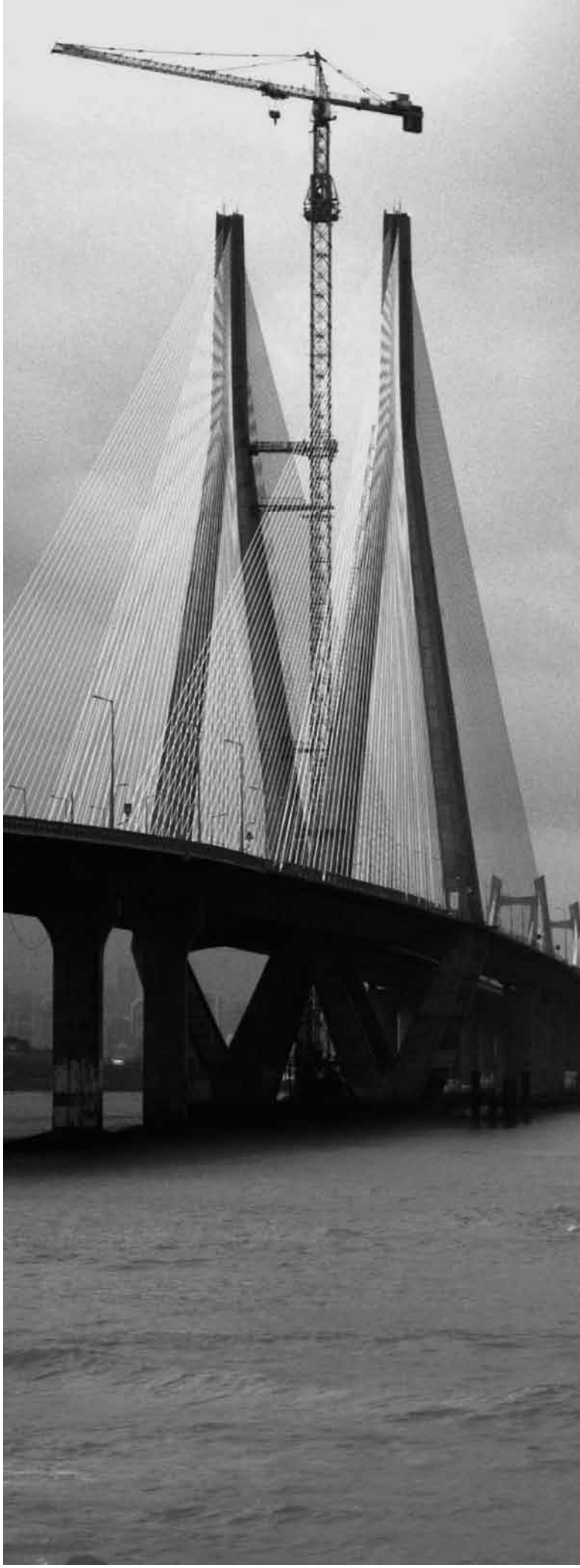
2. There has been growing pressure from the general public in the US and Europe for such jobs to be performed domestically. Companies with domestic call centers sometimes use this as a marketing point.

3. Increased competition from rival countries providing similar services has reduced demand for Indian centers. This is compounded by the fact that some Indian companies are themselves moving into these countries (e.g., Wipro in Brazil).

4. The fall in FDI in R&D is probably driven mainly by the weakening of US FDI levels in India in recent years. Many other supportive factors remain for FDI in R&D: according to current Indian Government policy, there is no equity cap for FDI in the R&D sector. Furthermore, the availability of incentives such as the income tax concession under the Income Tax Act (for earnings from R&D activities) makes foreign investment in this sector even more attractive.

Interim 2010 data

According to interim data released in mid-January, manufacturing and sales, marketing and support continued to perform solidly, attracting most and second most projects, respectively, in 2010. The share of jobs created by FDI in the manufacturing sector continues to grow, and in 2010 reached 59% of all jobs created by FDI. Business services became third in the ranking, attracting more projects than design, development and testing, which saw a decline of 32% in the number of projects compared to its medium-term average (for 2003-10). Perhaps the most striking insight from the interim 2010 data is the rapid growth in the number of FDI projects for building corporate headquarters in India. The "headquarters" activity grew by 53% in terms of number of projects, and by 29% in terms of jobs created, compared to the respective medium-term averages. This could be early evidence of India becoming a regional and sometimes global hub for multinational corporations. Further, the sectoral decline trends identified on the basis of the 2003-09 data, and explained above, are clearly borne out again in the interim 2010 data; for example, R&D attracted 60% fewer projects, and created 68% fewer jobs, compared to the respective medium-term averages.



Indian state success stories

The diversity between Indian states is so broad that it is too simplistic to look at the Indian market only at a national level. This is especially relevant given the federal character of India's governance structure. Although the central government enjoys powers of supervision over the state governments, these have autonomous powers of legislation and administration, and contribute heavily to the investment climate within the state.

The decisions of foreign businesses to invest in a state depend on many factors. These include institutional strength; governance; the economic performance of the state; and the quantity and quality of infrastructure and human resources. However, decisions to invest can also be path dependent, i.e., businesses may be attracted to locations where they have existing investments, or where other businesses are clustered. For instance, during the wave of new investments in 2006, the majority of the additional investment was absorbed by states with a large foreign investor presence and a strong economy supported by a solid infrastructural backbone.

Within the broad category of infrastructure, transport (e.g., roads, rail networks and sea ports) and specialized infrastructure (e.g., SEZ) are the most important, followed by connectivity (e.g., internet and telephony).

Businesses also find state governance important. Given that state institutions are responsible for a large set of areas that directly affect businesses (e.g., several state taxes and levies, public order and policing, trade and commerce, sanitation and public health), it is important that they have the capacity for raising revenues, display fiscal responsibility and provide an effective administrative framework. The presence of state accountability measures and an engaged civil society are also key factors affecting foreign investment.

The wide economic and investment variation between the states can be seen through the following examples[16]:

Andhra Pradesh

Geographically large and populous, Andhra Pradesh combines natural resources with sizeable agricultural, industrial and IT sectors. Export-oriented efforts to attract investment are growing, following discoveries of offshore oil and gas. Infrastructure provision is good, with three airports and one of the leading cargo handling ports. The state is also promoting a stronger road network through its "build, operate, transfer" approach. However, despite being one of the leading states in terms of power generation, power shortages remain a challenge.

Hyderabad, the capital, attracted 84% of all projects. The main sectoral investment destinations in Andhra Pradesh are agriculture, the automobile sector, IT, extraction, pharmaceuticals and tourism.

Delhi

The National Capital Territory of Delhi is a major commercial center, driven by both services and manufacturing. It attracts significant FDI and has high export levels, predominantly in IT services. Delhi's economic strength is spilling over to neighboring satellite cities. The presence of numerous higher education institutions means that Delhi has a skilled, English-speaking labor force. Infrastructure is largely good, though power shortages remain.

Delhi has introduced an IT policy that aims to make government services more transparent and efficient through e-governance. Delhi presents investment opportunities in IT, small industries and tourism, among other sectors.

16. Source for sector investment opportunities: www.business.gov.in

▶ Center-state relations

India has a federal constitution dividing powers between the central (federal) government, often termed the union government, and state governments, which have their own legislative assemblies and statutory bureaucracies. Certain subject areas are covered at central level while others belong to the states. There is also a range of concurrent areas, such as power, justice and education, which are shared between the two levels.

While the union retains exclusive control over strategic issues, the states are becoming increasingly responsible for day-to-day governance.

Union

Also referred to as List I outlines 99 subject areas over which the center (the union) enjoys exclusive control. These include:

defense and intelligence, banking, stock exchanges and futures markets, income and corporations tax, currency and coinage, insurance, national economy and debt, foreign affairs, railways and ports, post office and telecommunications, atomic energy and related mineral production, regulation of oil fields and mineral resources, interstate and foreign trade and commerce.

State

This List II covers 69 subjects over which states have exclusive legislative powers. These include:

public order and police, state taxes and duties, state economy and debt, trade and commerce within state, agriculture, sanitation, local government, gas and gas works, fisheries, public health.

Concurrent list

This list covers 52 items on which powers are shared between states and the center. These include:

economic and social planning and security, criminal law and procedure, education, welfare and labor including factories, electricity, forests, newspapers, minor ports, charities.

Source: *India Deconstructed*, Oxford Analytica

View point

Awareness about logistics as a trade enabler needs to increase

Christoph Remund
Chief Executive Officer,
DHL Global Forwarding

Healthy economic growth in India is increasingly supported by robust industrial growth. The logistics sector is one of the relatively lesser known but significant sectors that support almost all industrial activity. As a consequence, this sector has witnessed a growth rate similar to those observed in the industrial activities it supports. India has become a preferred investment destination among multinational corporations. This has resulted in demand for world-class logistics and warehousing facilities in India representing a market estimated to be around US$45 billion. By 2015, it is expected to reach almost US$122 billion — growing at a compounded annual rate of over 11%.

According to some estimates, India spends about 13% of its total gross domestic product (GDP) on logistics. This is mainly dedicated to transportation, warehousing, freight forwarding and other value-added operations including management information systems (MIS). While transportation and freight forwarding have traditionally been outsourced to external service providers, the warehousing and MIS functions have been mostly managed in-house. But the huge diversity in geographic conditions, consumer habits and infrastructure facilities across the country make it a major challenge for Indian industries to manage efficiently their supply chains to reach all parts of the country.

India and other emerging markets are a key sourcing, manufacturing and distribution base for global industries. Increasingly, they will also be key markets for consumption. This favors organizations such as ours, since our business depend on customers doing business domestically and internationally, which drives our volumes.

Deutsche Post DHL recognizes India as a key market with high growth potential and continues to invest in developing infrastructure facilities in the country.

Thus, DHL Global Forwarding is the first global logistics company to have a facility inside a Free Trade Warehousing Zone (FTWZ) in India. With an investment of US$10 million, the company is constructing a state-of-the art warehouse at the strategic location of Sriperumbudur, on the outskirts of Chennai, which offers customers the benefits of a duty free zone with high-quality infrastructure.

The impending introduction of a uniform goods and service tax (GST) in India will help the country enormously as there will be an increased demand for high-quality, reasonable-cost services in the logistics sector. There also is a need for good-quality manpower in the logistics industry. The key is to raise awareness about logistics as an industry and the significant role it plays in the economy of the country, as a trade enabler.

Gujarat

Gujarat's developed economy combines substantial industry with traditional manufacturing and agriculture. The state has a strong entrepreneurial ethos with transparent and commercially minded decision-making at the state government level. Transport infrastructure is excellent, with over 40 ports and 11 airports facilitating high export levels and transportation. A number of planned SEZs are likely to boost performance further. The power supply is also reliable, making this state attractive to investors with large electricity demands.

Since 2001, the Government of Gujarat has prioritized economic development and has actively sought investment. This has included creating a highly attractive environment for foreign and domestic investors. Between 2003 and 2009, total FDI projects more than quadrupled from 11 to 49. Among the 25 cities that received FDI investment between 2003 and 2009, 34% was invested in Ahmedabad; Vadorara attracted 16%; and Surat received 7%. Gujarat attracts investment in agriculture, chemicals, engineering, IT, minerals, pharmaceuticals, textiles and tourism. The chemicals and pharmaceuticals industries in Gujarat attract a large portion of the investment.

Special economic zones

Special economic zones (SEZs) were established in 2005 in order to stimulate investment. They offer tax and regulatory immunities. Initially, they were received with great enthusiasm. By November 2007, 400 sites had been approved and pledged investment exceeded US$40 billion. At the end of fiscal year 2007-08, 206 were actually in operation, employing 98,000 workers and attracting US$15 billion in investment, mostly concentrated in the more developed states of Maharashtra, Gujarat and Andhra Pradesh. However, since then, some of the shine has come off the SEZ idea. Problems have arisen over the acquisition of land, especially land previously used for agricultural purposes.

The central government has reduced the size of potential SEZ sites from 10,000 to 5,000 acres and both it and state governments have backed away from involvement in land purchases. Several states have passed laws limiting the overall amount of land that can be devoted to industrial undertakings, and Goa has sought retrospectively to cancel SEZs for which it had initially given its permission. Further problems have come from the Finance Ministry, which fears the shrinkage of its tax base and from trade unions and state labor bureaus, which fear a loss of their powers. Nonetheless, the development of SEZs continues and is likely to remain important for the economy.

List of operational SEZs by sector

Operational SEZs	Number
IT and related	67
Multiproduct	15
Electronics and hi-tech engineering	13
Pharmaceuticals	5
Apparel and footwear	5
Gems and jewellery	4
Other	3
Textiles	2
Food processing	2
Handicrafts	2
Energy	2
Biotechnology	2

Source: http://sezindia.nic.in/about-osi.asp

Haryana

Located in the fertile plains of north India, Haryana is a predominately agricultural state. It also has a rapidly growing industrial and services sector, aimed at both the domestic and export markets. The city of Gurgaon is the leading industrial and services center, benefiting from its proximity to Delhi, but a number of smaller urban centers also have strong manufacturing capabilities. Infrastructure and transport provision is strong, but power shortages continue. Land and labor costs are high and regulation onerous.

The state has introduced IT and labor policies to incentivise foreign investment. The labor policy's objective is to increase the productivity of the labor force while implementing health and safety measures and eliminating child labor. The state presents investment opportunities in agriculture, IT and tourism, among other sectors. More than three-quarters of foreign investment flows into Gurgaon, a satellite town near Delhi, which also forms part of the National Capital Region (NCR).

Karnataka

Karnataka accommodates 65 of the Fortune 500 companies. The state combines large-scale agriculture with a rapidly growing industrial and services sector, notably in IT, based around Bangalore. Exports, particularly technology-related, are high, though economic growth has been tempered by lower agricultural performance. Overall governance is good and Karnataka provides a comparatively stable operating environment. Good quality infrastructure is available, with electrical power extending to all villages (where two-thirds of the state population lives). The state now aims to reduce the number of power shortages affecting businesses and encourages private investment in renewable energy.

The Karnataka Government has introduced several policy measures to improve incentives for private investors. The "New Industrial Policy", introduced in 2006, aims to stimulate growth and diversification of the manufacturing base and increase the state's share of national exports and annual growth. The "Millennium Information Technology Policy" was introduced to promote the role of IT and IT-related projects in the state, with the aim of raising employment, reducing poverty, empowering women and reducing corruption through the application of e-governance.

Karnataka attracted 101 FDI projects in 2003; however, after peaking in 2006 with 150 FDI projects, the number fell to 74 in 2010. Between 2003 and 2009, 16 cities in Karnataka attracted FDI, with Bangalore securing 94% of the total. This concentration has slowed the development of Tier II cities in Karnataka. The largest investment opportunities are in agriculture, biotechnology, IT and tourism.

Kerala

India's southernmost state Kerala is economically well-developed with a large, affluent, literate and politically engaged society. Politics is competitive and volatile, and no government has ever been re-elected. However, all administrations adopt high-spending, left-wing, welfare state policies. This has ensured that education provision is excellent (Kerala has the best literacy in India) and infrastructure generally good, though utility coverage is limited. Remittances from large numbers of migrant workers in the Middle East are an important component of the economy, as are agriculture, industry and services (including a sizeable tourism industry).

Kerala is trying to attract private investment in the IT and energy sectors through several policy initiatives. IT policy is set up to attract investment by promoting a business-friendly regulatory and commercial framework. Energy policy aims to promote investment in renewable energy and "green" projects. Kochi attracts the majority of investment, while Thiruvananthapuram and Kozhikode receive most of the remaining FDI.

Maharashtra

Maharashtra is a financial, industrial and agricultural powerhouse. It is also one of the most urbanized states in India and boasts very good physical infrastructure, including roads, highways and ports and a reliable power supply. The state is growing rapidly and has become a major exporter of goods and services, which helps to explain why the number of FDI projects it has attracted increased from 56 in 2003 to 104 in 2010.

The state is aiming to achieve sustainable future growth by attracting more private foreign and domestic investment. Industrial policy measures have been introduced, which aim to incentivize investment by strengthening infrastructure, removing bottlenecks in procedures and encouraging institutional cooperation. Maharashtra has also introduced specific policies in biotechnology and IT. In the case of IT, the creation of IT parks is being promoted with guarantees of reliable power and good physical and communications infrastructure around these locations.

Between 2003 and 2009, 26 cities within Maharashtra attracted FDI projects. Mumbai, India's financial, commercial and entertainment capital, attracted the highest share of FDI projects (54%), followed by Pune (33%) and Nashik (2%). Maharashtra provides an attractive investment opportunity in many sectors, including agriculture, automotive and automotive components, biotechnology, food processing, textiles and tourism.

Orissa

Orissa has emerged as an important investment destination among Indian states. Investment inflows have mainly been in large mining and industrial projects which have higher job creation potential. A major share of these investments is in mineral extraction, manufacturing of steel and aluminium and coal-based generation of electricity.

Orissa was the first state to create a PPP Secretariat headed by a senior level officer of the rank of Secretary. Indeed PPP investments in infrastructure at various stages of maturity significantly increased in the last 5 years.

The State has enacted the Industrial Policy Resolution (IPR) 2007, reinforcing the policy framework for industrial promotion and investment facilitation put in place by IPR 2001. The Government in Department of Information Technology has also formulated an industry friendly ICT Policy in 2004 aiming at stimulating private investment through more transparent and stable rules.

Paradeep, Manesar, Bhubaneshwar, Lajigarh, Keojarh and Kujanga have attracted most of the FDI since 2003. Orissa's best investment opportunities are in agriculture, fisheries, automotive, biotechnology, handicrafts, minerals and tourism.

Rajasthan

Located along the northwestern border of India, Rajasthan is the country's largest state. It is an important economic corridor between the Northern and Western states, giving it strategic market access. Known best for tourism, it is rapidly emerging as an attractive destination for business and has witnessed, in recent years, an economic transformation with growing secondary and tertiary sectors.

The state is investing heavily in core infrastructure, through the PPP route, in specialized industrial parks and growth centers. With the commissioning of the Delhi-Mumbai Dedicated Freight Corridor (DFC) between 2012-16, important industrial development is expected as 70% of the state is within the project influence area. The pro-industry Rajasthan Industrial and Investment Policy (RIIP) 2010 has recently been announced. In addition, the new Single Window Act will effectively reduce the average time required for approvals and clearances and a single-point electronic monitoring and clearance system is being set up.

Jaipur, Neemrana and Bhiwadi are the key clusters attracting investments in the state.

Between 2003 and 2009, foreign investors have mainly focused on automotive and services sectors. With rich mineral resources, Rajasthan also attracted FDI projects in metals and oil and gas.

Tamil Nadu

Tamil Nadu is one of the fastest-growing states in India, possessing high levels of industrialization and urbanization, as well as a large, affluent and well-educated population with a large number of graduates. The political environment is stable and progressive, and government decision-making is transparent and investor-friendly. Tamil Nadu has one of the best transport and telecommunication infrastructures in India. The latter allows data intensive services to be used, a crucial factor for the IT sector. High tax and utility rates have not slowed down the rate of growth in this state.

Tamil Nadu has introduced a set of policies to attract private investment and thereby increase industrial competitiveness, employment and growth. Industrial and IT policy aims include improving infrastructure, increasing connectivity of current industrial hubs with global partners and reducing start-up costs.

The number of FDI projects attracted by Tamil Nadu doubled from 27 in 2003 to 54 in 2010. These FDI projects were spread among 17 cities in the state. Chennai, Tamil Nadu's capital city, attracted 78% of the projects between 2003 and 2009. The largest investment opportunities in the state are in agriculture, food processing, automotive and automotive components, biotechnology, chemicals, and software and electronics.

Uttar Pradesh

India's most populous state is largely rural and agricultural, though pockets of industry exist. The political environment is volatile, characterised by a large number of regional caste-based parties. The presence of a large number of universities results in skilled labor availability in some areas. Furthermore, businesses face few regulations, and land and labor (skilled and unskilled) costs are relatively low.

The state has put IT and biotechnology policies in place to attract private investment, engage domestic and international entrepreneurs and increase the competitiveness of these sectors. Apart from the agricultural sector, there are investment opportunities in the IT, sugar, mineral and tourism industries, among others.

Madhya Pradesh

Madhya Pradesh, in its present form, came into existence on 1st November, 2000 following its bifurcation to create a new state of Chhattisgarh. The undivided Madhya Pradesh was founded on 1st November, 1956 in Central India with a high concentration of population belonging to socially and economically disadvantaged groups consisting of scheduled tribes (20%) and scheduled castes (15%). The state recorded a growth rate of 9.5% in GDP between 1999-00 and 2007-08 to reach US$35.4 billion. During the same period per capita GDP increased by 1.8 times to reach US$519 in 2007-08. The growth was primarily, been due to growth in mining and quarrying and the services sectors. Electricity accounted for 56% of the total investment followed by manufacturing (22%).

The tertiary sector is the largest sector contributing to GDP with a share of 53.5%. It registered a growth of 12.9% during 1999-00 and 2007-08 to reach US$16.6 billion. It was followed by agriculture sector contributing US$10.9 billion (35.1%) and the secondary sector contributing US$3.5 billion (11.4%). The state is highly dependent of agriculture as it is a major producer of variety of crops such as soyabean which accounts for 75% of the total national output, garlic (37%), oilseeds (21.3%) and pulses (20%). It is one of the major cotton producing states (6%) with large number of textile mills clustered around Indore, Dewas, Ujjain and Malanpur. The textile exports were worth US$325 million in 2009-10.

Chhattisgarh

Constituted on 1st November, 2000, Chhattisgarh is one of the newest and fastest growing states in India — characterized by dominance of tribal and socially under-privileged population. The newly formed state has registered an impressive growth over the last five years, according to the advanced estimates in the Socio-Economic Review 2009–10, the state has recorded a year-on-year growth rate of 13.3% with estimated GDP of INR1,078 billion. The state recorded a per capita income of INR34,500 in 2008–09, which is expected to increase by 11.7% to INR38,500 in 2009–10. The investments in Chhattisgarh reached INR3,997.46 billion by the end of December 2009, an increase of 13.5% over the corresponding period of the previous fiscal.

Chhattisgarh's industry segment has emerged as the largest contributor to the state's gross domestic product, accounting for a 39.5% share in 2008–09. On a relative scale, the state's industry segment recorded the highest growth at 30.8% over 2007–08, as against 19.1% for the services sector and 8.2% for the agriculture and allied activities sector. Of the total companies operating in Chhattisgarh, 17% are engaged in exports. The major exportable products include steel, handicrafts, handlooms, blended yarn, food and agriculture products, iron, aluminum, cement, minerals and engineering products. Approximately 83% of the companies in Chhattisgarh sell their products in the domestic market. Nearly 75% of exports emanate from Bhilai and the remaining come from Urla, Bhanpuri and Sirgitti.

Indian city success stories

Projections made in 2008, prior to the global recession, anticipated the proportion of the inhabitants of the 20 largest Indian cities enjoying "middle-class" incomes to rise from 39% to 55% by 2016 – and the total urban population rising by 379 million people by 2050[17]. The extent to which the leading cities will contribute to attaining this projection will depend on the particular location of a city and on its relationship – in business, economic and political terms – to the rest of the state. In our survey, the executives identified the presence of transport links with other cities and countries, easy access to markets, customers and clients, availability of qualified staff and the presence of international companies as the most significant factors in making a city attractive.

Since the production of goods and services for the domestic market has become the single most important reason for FDI in India, the availability of adequate infrastructure to ensure access to the domestic market has become one of the most significant selling points of successful cities. A strong infrastructure expands the potential market by increasing access and enlarging the possible customer base for domestic products. It also simplifies transportation and logistics between corporations and their suppliers, reducing inventory costs and boosting corporate profits.

The presence of qualified staff is another factor that enhances the attractiveness of a target location. While FDI projects in the manufacturing sector may require the employment of cheaper and less-educated labor, many investment projects in India are in the R&D and design, development and testing sectors, which require a skilled and educated labor force capable of independent and analytical thinking. Investors are often attracted to locations that can offer a cost-effective and abundant supply of such resources.

Figure 19: Key aspects of most attractive Indian cities

Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected more than one possible answer. Total respondents: 365.

17. *India Deconstructed*, Oxford Analytica.

▸ Indian infrastructure corridors

Infrastructure corridors recognize the importance of transport and communication connectivity between economic centers, and encourage private investment in industrial regions with weak infrastructure. These investments help to enhance regional integration. The benefits of these corridors include decreased logistics costs, increased access to industrial units, lower inventory costs and better overall communications and spillovers.

Four famous corridors include:

- *The Mumbai-Pune corridor: engineering hub*
- *The Delhi-Jaipur-Agra "golden triangle": commerce and manufacturing hub*
- *The Surat-Ahmedabad industrial corridor*
- *The Golden Quadrilateral: highway network connecting Delhi, Mumbai, Chennai and Kolkata.*

Leading infrastructure corridors and satellite cities

Indian cities can be divided into clusters according to the House Rent Allowance, which was set out by the Fifth Pay Commission of India in 1997[18]. This grouping classifies cities into "Tiers". Cities that are most populous and economically advanced are rated Tier I, followed by emerging cities in Tiers II and III.

The distribution of FDI provides one indication of the distribution of GDP and growth prospects within a state. Businesses often set up operations in locations that facilitate communications with local and regional partners and suppliers. Clusters of businesses, often in Tier II or Tier III cities, connected to each other and to Tier I cities with good infrastructure, can become "infrastructure corridors". These corridors attract more and larger investment projects.

Overall, since 2003, the concentration of FDI projects in the top five cities has fallen by 40%. This demonstrates the increasing attractiveness of smaller state capitals and Tier II cities. For instance, Ahmedabad and Vadodara, located in Gujarat were performing especially well compared to their medium-term average.

Bangalore and Hyderabad are the vanguard cities in IT and BPO, although they have been losing out to the NCR recently. Major international services companies are also setting up their national headquarters in the NCR. Proximity to the Government is the key driver. Noida and Gurgaon are satellite cities to New Delhi and have attracted investment partly as a result of their proximity to the capital. These cities also have a growing manufacturing and engineering capacity. For instance, the presence of the large Maruti (India's largest car maker) factory in Gurgaon could provide an attraction for other businesses to set up in this area. Mumbai continues to be the financial services hub of India. While Kolkata is the commercial capital of eastern India, Chennai has a strong presence in the automotive and IT sectors.

Among the Tier II cities, manufacturing activities are most prevalent, followed by IT. As operations in Tier I cities become more costly due to higher land and labor costs, investors are more likely to relocate some of their operations to Tier II cities, where labor — although often less educated — is more abundant and land prices are lower.

18. Ministry of Finance, Department of Expenditure.

Kamesh Goyal
Managing Director and CEO, Bajaj Allianz Life Insurance, Country Manager, Allianz

India's opportunities and challenges

India's strength in attracting investment is primarily a result of offering a level playing field for domestic and international investors across industries. Although the financial services industry is more regulated than other sectors and foreign ownership rules are not ideal, we are hopeful that foreign ownership norms will become more liberalized and uniform.

I personally believe that the Indian economy will continue to grow. However, this growth will heavily depend on improvements in governance. For instance, judicial reforms will have to address the backlog of cases and implement procedures that allow the timely resolution of court cases. The Government has to expedite land acquisition and environment clearances related to green-field and other investment

Tier II cities

Although Tier I cities will continue to be attractive, they are especially so to first-time investors in India seeking to minimize risk. However, compared with Tier I cities, Tier II cities offer lower real estate prices and labor costs. Tier II cities include:

- **State capitals.** These enjoy relatively well-developed infrastructure, good universities and easier access to state government machinery. These cities are popular with major local and international investors, particularly those seeking large numbers of workers. Examples include Chandigarh and Lucknow.
- **Satellite cities.** The second group consists of smaller cities close to prime industry centers. Mysore near Bangalore, Gurgaon and Noida close to Delhi, and Pune, a few hours from Mumbai, belong to this group. Real estate prices are comparatively low, roads less congested and wages lower. These cities can also take advantage of infrastructure and facilities that already exist in neighboring cities, making them attractive to local and international investors. However, while labor may be available, retention may be a problem as graduates move to prime cities after gaining experience.
- **Developing options.** These are capitals in states not known for industry, or large but relatively isolated cities. They can offer greater cost reductions but, due to their relative isolation, they will probably be the preserve of larger, local firms or international firms with an appetite for risk. Examples include Jaipur in Rajasthan, Madurai in Tamil Nadu and Vishakapatnam in Andhra Pradesh. These cities are large enough to offer a sufficient quantity of workers and have adequate infrastructure.
- **Smaller cities.** The fourth group consists of smaller cities that are not on the radar of international companies. These include cities such as Udupi, Hubli and Belgaum in Karnataka, Kozhikode in Kerala, and Durgapur and Kharagpur in West Bengal. Wage rates are low and good regional colleges are able to meet modest staffing requirements.

Tier II cities

City	Sector	State
Ahmedabad	Pharamaceuticals, Chemicals	Gujarat
Chandigarh	IT, Public sector	Punjab, Haryana
Coimbatore	Textile, IT, Manufacturing, Autocomponents	Tamil Nadu
Gurgaon	Manufacturing, Real Estate	Haryana
Hubli	Machine Tools	Karnataka
Indore	Manufacturing, Retail	Mdhya Pradesh
Jaipur	Jewellery, Manufacturing	Rajastan
Kanpur	Textile, Chemicals	Uttar Pradesh
Kochi	Tourism	Kerala
Lucknow	IT, Manufacturing	Uttar Pradesh
Mysore	IT, Tourism	Karnataka
Nagpur	Textile	Maharashtra
Noida	IT, BPO	Uttar Pradesh
Pune	IT, Manufacturing	Maharashtra
Surat	Diamond, Textile, Real Estate	Gujarat
Udupi	Agriculture	Karnataka
Vadodara	Pharmaceuticals, Petrochemicals, Plastics	Gujarat
Vijayawada	Automobile parts	Andhra Pradesh
Visakhapatnam	Heavy Industry	Andhra Pradesh

Source: Oxford Analytica research.

projects in order to assist infrastructure development within the country. Government approval of investment projects will also have to accelerate in order to attract foreign and domestic investors. While most companies have started expanding beyond the top 20 cities, finding a viable cost model to expand in rural areas still remains a significant challenge to many corporations, especially in the financial services sector. Recent experience in the microfinance sector underlines the need of clarity of the regulatory framework before business takes off, otherwise financial inclusion will not be realized.

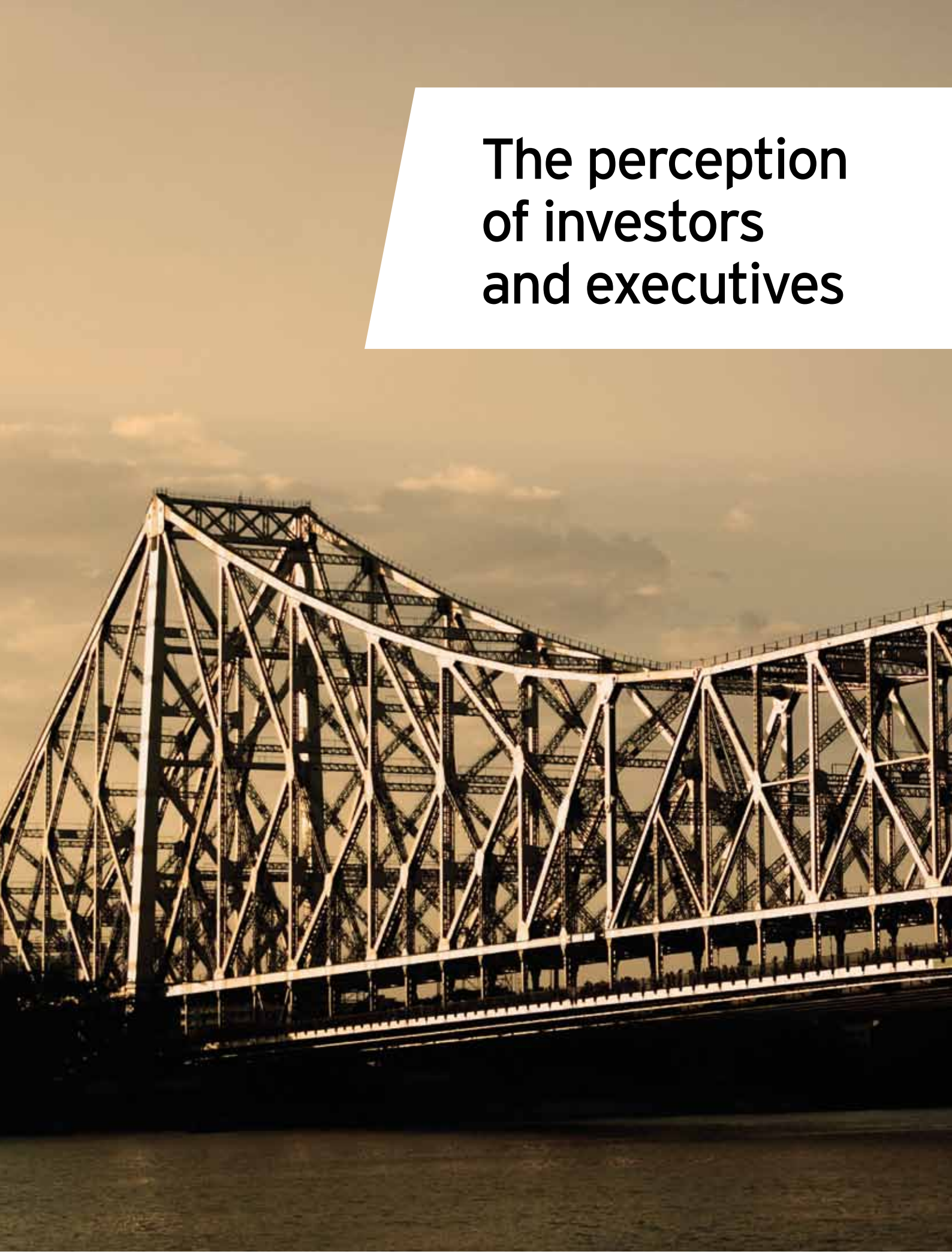
Multinationals often underestimate the level of competition in India, especially in the financial services sector where it is intense. Indian customers are open to brands as long as they provide good service at a reasonable value. However, attrition is an issue that is especially relevant for those working and setting up business in the financial services sector.

As for Bajaj Allianz, corporate growth will rise with national and per capita income and increased awareness about the insurance sector will improve market penetration. Once foreign ownership rules in the financial sector are relaxed, M&A in the insurance sector will see a surge. That could also be an opportunity for the Government to consider divestment in the PSU (Public Sector Undertaking) insurance companies. Furthermore, the Government should investigate the possibility of introducing specific taxation and capital ownership regulations to encourage companies to set up their regional headquarters in India. Availability of high-quality manpower makes India a compelling place to set up regional centers.

The views in this interview are personal and are not necessarily the views of Allianz or its associated companies. Moreover, they should be seen in the context of the time they were made.

View point

The perception of investors and executives



Introduction

Rapid growth markets such as India have managed to navigate the economic downturn well and get themselves into a strong position to compete for FDI in the future. Our survey was designed to gain a granular view on how this market is perceived by business leaders around the world. We interviewed 500 business leaders in November and December 2010 about their perceptions of the attractiveness of India.

According to earlier surveys, China appears to be the main competitor to India by far. This is not primarily due to its cost competitiveness but rather because it provides a strong internal market. Investors believe that in order for India to improve its attractiveness compared with countries such as China, infrastructure needs to be strengthened and regulation has to be reformed and simplified.

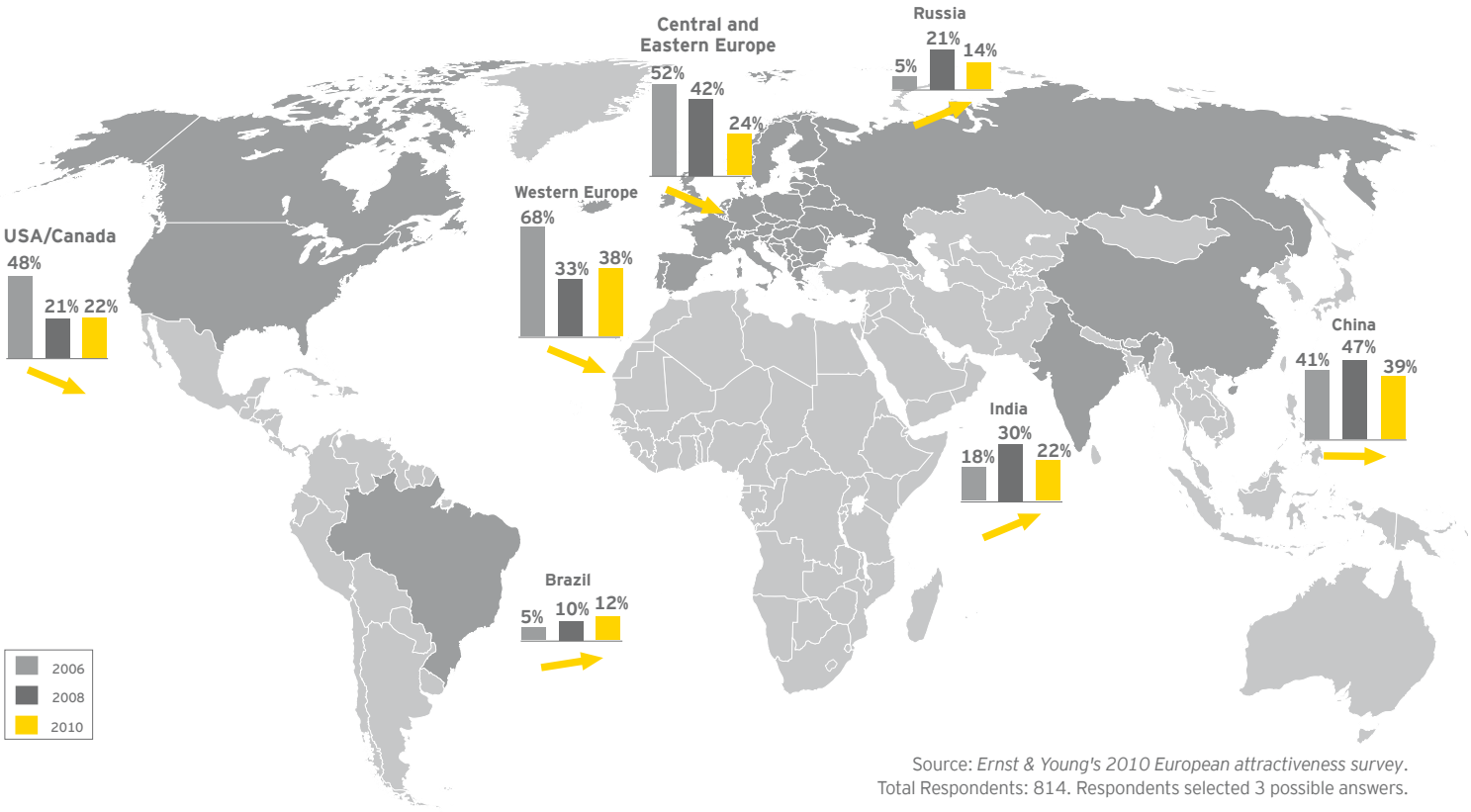
Half of our respondents could suggest ways in which India might potentially increase its attractiveness as an investment destination. A large proportion of those surveyed plan to invest in India within the next year through organic growth strategies.

Most attractive FDI regions in 2010

In Ernst & Young's 2010 *European attractiveness survey*, China (39%) edged out Western Europe (38%) as the most attractive region for FDI, reclaiming its 2008 title. These top two FDI magnets are followed by Central and Eastern Europe (24%), and only then India and North America (22% each).

In the past three years, international investors have responded to trends in the global marketplace, recognizing that their return on investment could be as stable – as well as more profitable – in high-growth markets, while their risks there could be similarly manageable to risks in low-growth markets. This partly explains why Western Europe's appeal as the most attractive destination for FDI collapsed from 68% of votes in 2006 to 38% in 2010. Enthusiasm for North America fell from 48% to 22% over the same period, while China's attractiveness ranking hovered at about 40%. India peaked in 2008 but still showed growth from 2006 to 2010.

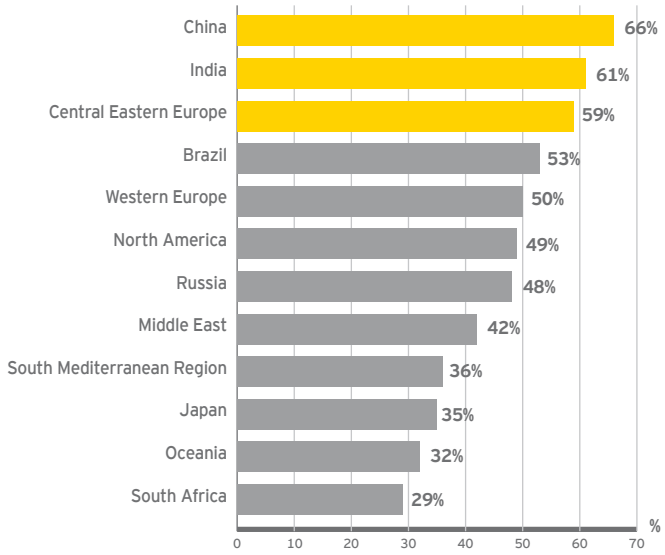
Figure 20: FDI attractiveness around the world



Source: *Ernst & Young's 2010 European attractiveness survey*.
Total Respondents: 814. Respondents selected 3 possible answers.

Over the next three years, investors clearly see the shift of the world's economic weight eastwards, as they rank China, India and Central and Eastern Europe as the most attractive regions for FDI projects.

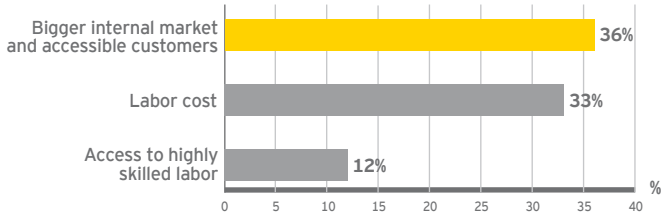
Figure 21: Most attractive regions over the next three years



Source: Ernst & Young's 2010 *European attractiveness survey*.
Total respondents: 814. Respondents selected 3 possible answer.

Executives cite the price-quality trade-off of the labor force and the larger internal market as the most important factors for China's relative attractiveness compared with India. China's demand potential will be fulfilled further when Chinese households replace the state as the main source of expenditure, increasing their shares of consumption from current levels (35%) to levels that are more conventional (60%-70%). This shift in demand will provide considerable benefits for those investors who have entered the market and established themselves with respect to competition.

Figure 22: Main advantages of India's competitors



Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected more than one possible answer. Total respondents: 430.

However, China's growth model also faces challenges. Compared with India, China's demographics are not as favorable, and ever-increasing demands placed on labor are putting pressure on wages, which will make the Chinese model less attractive in the future. In the absence of quality improvements to Chinese products and services, this increase in wages will shift the price-quality balance in favor of India.

View point

India provides stakeholders with long-term business opportunities

Abhijit Sen
CFO,
Citibank, India Subcontinent

The Indian market represents certain unique opportunities to investors who are willing to follow an adaptive strategy. Customization of products and services to suit local preferences and conditions can assure success, provided this is accompanied by some patience and perseverance. A multitude of well-established multinational corporations are willing to attest to the success of this approach.

In comparison to other destinations, India offers competitive advantage based on its population size, demographics and access to talent. In addition, India's democratic political system and its institutionalized legal system lend themselves to a high degree of stability, which is essential to provide visibility for long-term corporate planning.

However, conducive policy-making by the Government, supported by financial sector reform, will be the key to translate these advantages into drivers of growth. While the services sector has been the engine of growth so far, future growth needs to come from manufacturing. India's cost competitiveness provides a platform for making this nation a global supply source for a wide range of products.

India's banking industry must strengthen itself significantly by gearing up for forthcoming regulation such as Basel III and IFRS. Forging linkages with non-banking financial companies (NBFCs) and microfinance institutions is becoming increasingly essential for delivering funds to individuals with no access to credit.

Developing a bond market to support the needs of the infrastructure sector is another fundamental need to be addressed by the banking sector.

With an aggregate capital investment of close to US$5 billion committed to India, this is a significant franchise for Citi and spans the entire banking space. We have been instrumental in bringing retail banking into the market, as well as enabling our corporate clients to meet their global aspirations. This has been a symbiotic relationship, as the Indian market has contributed to Citi through its pool of talent which now holds various senior leadership positions across several countries.

Building on our 108 year history, we are focusing on enhancing organizational capability to stay in tune with the changing Indian market and continually innovating to develop new business models to access untapped opportunities as permitted by local regulations. We expect to grow organically in the Indian market in order to achieve sustained financial performance.

In my view, the priorities for Indian planners are to address infrastructure bottlenecks, particularly power transportation and urban development, and to pursue holistic fiscal as well as land reform. The visible measures recently undertaken to combat corruption are also very welcome. Equally, we need to work toward reducing regional imbalances that will be conducive to diffusing social tension and creating a foundation for inclusive growth.

Investors go East for larger returns

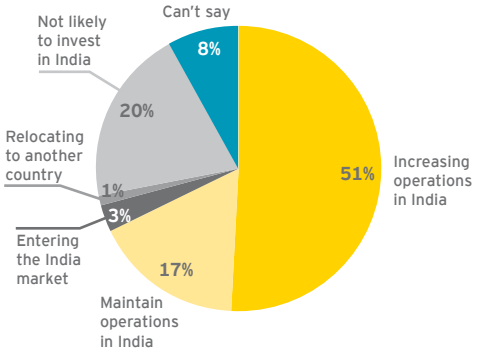
After two years of deep economic distress, North America and Western Europe are returning to fragile economic growth paths, while high-growth countries are powering ahead with pre-crisis growth rates. As business leaders again start to compete for growth opportunities, there is a sense of urgency among our survey participants to seize the prospects offered by the Indian market.

A large majority (over 60%) of the companies interviewed are considering further investments in the Indian market in the short term, with 37% intending to invest within the next 6 months and another 23% intending to invest within the next 6 to 12 months.

Our survey found that few companies had no plans for entering the Indian market. Sometimes, this is for reasons particular to those corporations, which cannot be addressed by policy measures to raise attractiveness. For example, some companies not planning to invest perceive that there is no potential in India for their sector; smaller proportions of investors simply do not regard India as a target for corporate development; while others appear to be focusing on trying to enter China first. However, there is a small number of companies that is not yet planning to invest in India, and that cites a variety of reasons that can be addressed by policy in India. These reasons include: governance issues that make it difficult to do business; the economic environment; the availability of human capital; and the "cost of doing business". These four reasons are each cited by no more than 3-4% of investors that are not planning to enter India; this is a very small number that does not allow for quantitative analysis. Nonetheless, the reasons are worth noting for Indian policymakers, as they illustrate investor opinions that could be swayed over time.

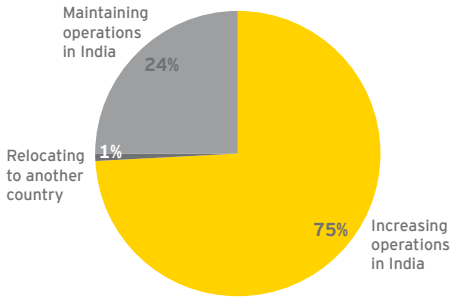
Having overcome the challenges of market entry, three out of four of the 302 investors already present are considering increasing their operations while the remainder are maintaining their current level of operation. Companies with a good understanding of the local market are investing for the long term and are convinced they will achieve good returns on additional investments. Investors see a presence in India as a long-term growth opportunity.

Figure 23: Investors' future plans



Source: Ernst & Young's 2011 *India attractiveness survey*.
Total respondents: 439. Companies having declared no internationalization projects are excluded.

Figure 24: Investment plans in India



Source: Ernst & Young's 2011 *India attractiveness survey*.
Total respondents: 302. Companies already operating in India.

Siddhartha Roy
Economic Advisor,
TATA Group

Patience bears fruits in India

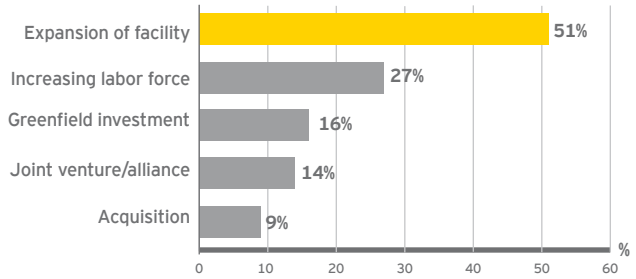
By its very diversity, India as an investment destination will be attractive to any industry that is thinking of new geographies or extending its current operations. The presence of an abundant supply of skilled and cost-competitive labor and a large domestic market provide companies in India with low input costs, which are essential for competitive exports particularly in services area. The only country that can match India's potential is China.

A large part of the FDI currently being attracted by India comes from the private equity sector. Foreign investors are especially attracted to the

Organic strategies to capture domestic growth

Organic growth is the prevalent feature of FDI in India, with 51% and 27% of investors planning to expand their facility or labor force, respectively. A large number of investors entered India during the 2000s and are now seeking to entrench themselves to capitalise on India's growing domestic market. India offers ample opportunities for capacity expansion. The organic route is likely to continue to be preferable for companies that are already established in the country and are familiar with the operations and regulations in India.

Figure 25: Means of expansion into the market



Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected more than one possible answer. Total respondents: 241.

The low share of investment through joint ventures (14%) and acquisitions (9%) can be explained largely by the following two factors:

1. The Indian market is open to FDI in all but a few sectors, minimizing the need for local joint ventures and partnerships.
2. Joint ventures and acquisitions are more cumbersome due to complexities presented by the Indian market. The importance of local knowledge is highlighted by the fact that the majority of those intending to make acquisitions are already based in India and aware of local customs and traditions.

New greenfield investment, which experienced a boom in the 2000s, is only seen as a priority by 16% of survey respondents. Potentially the acquisition of permits and authorizations for the construction of production sites, coupled with sometimes lengthy processes for setting up operations, are a deterrent.

View point

"bricks and mortar" sectors given their large market potential. Infrastructure and related industries are the best examples of such investment targets. Other attractive sectors for investment are capital goods, pharmaceuticals, engineering and design, scientific research and IT.

Despite India's demographic advantage, this nation's challenges are in the areas of education, health care and employment. Growth rates of 8.5%-10% will only be sustainable in the long term if shortcomings in the education and health sectors are addressed, poverty is reduced, and employment is increased.

India has to adopt a growth model that encourages high domestic saving and investment, together with an income effect that benefits the masses and expands markets. As the economy grows, employment has to increase and standards of living have to improve. The effects on employment can be large if processes are outsourced to small and medium-sized enterprises, which employ the majority of the labor force.

A positive aspect of India's development is that, while urbanization is taking place very rapidly, there is an impressive development in the hinterland, which takes some of the pressure away from the major cities.

India can be characterized as a large, profitable and growing market. The lessons are: it takes time to establish yourself, but once you get a foothold, you can reap the dividends.

India needs to unleash the potential in its markets

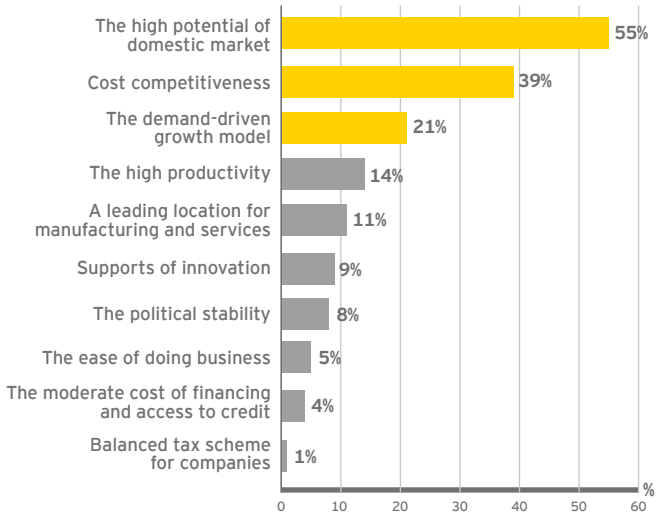
According to India's National Council for Applied Economic Research (NCAER), the size of India's middle class – households with an annual income of at least US$4,000 – increased from 13.8 million households in 2001-02 to 46.7 million households in 2009-10. The latter figure for households translates into a total of about 200 million people. With economic growth projected to expand at 8% annually and the middle class set to treble in number over the next 15 years, the most important characteristic of the Indian market, as seen by the survey respondents, is the high potential of the domestic market.

Domestic demand in India could grow at a compound rate of 9.2% a year between 2010 and 2030[19]. About 21% of respondents highlight the demand-driven growth model and 55% the high potential of the domestic market as the most important characteristics of the Indian market. This is encouraging news for India, given that one of China's main attractions to investors, according to a previous Ernst & Young survey, is the size of its market. A fulfilment of its potential can place India on the same footing as China when it comes to market size.

The second most important characteristic of the Indian market, cited by 39% of respondents, is India's cost-competitiveness. This is complemented by the high productivity of its readily available and educated labor force. This led 14% of respondents to stress the importance of productivity in their replies. Though wages for manufacturing workers rose at a rate of 19% between 2002 and 2005, they remain competitive against wages in China, which saw an increase of 28% over the same period, as well as against the developed markets[20].

19. Oxford Analytica Daily Brief.
20. Monthly Labor Review, April 2009.

Figure 26: India's competitive advantage



Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected two possible answers. Total respondents: 505.

Gautam Bhandari
Managing director,
Morgan Stanley India Services Pvt Ltd

Rich growth rewards for patient investors in India

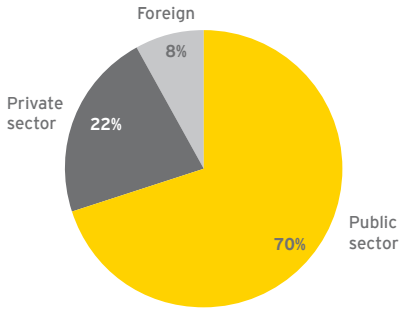
A lot of multinational and infrastructure companies are looking to invest in India because of its demographic profile and the spirit of entrepreneurship that exists today. The Government is rightly focused on infrastructure. If well executed, infrastructure development could provide a solid foundation for manufacturing growth, productivity and jobs.

Unlike China, or some other high-growth markets, India runs a current account deficit and therefore needs foreign capital for growth. The Government should continue its drive toward making it easier for domestic and international investors to invest and then making sure that they are treated fairly. It

There are also challenges that businesses face in obtaining financing and managing risk. With 80% and 70% of Indian insurance companies and banks, respectively, owned by the state and only one bank branch per 13,400 people, shortage of financial services is chronic. In an attempt to remedy financing shortfalls in the corporate sector, the Indian government raised the limit on foreign investment in five-year corporate bonds from US$15 billion to US$20 billion. However, this expansion is still not sufficient to serve corporate needs. Furthermore, in the absence of a market in credit-default swaps, investors have limited means of sharing risks. Nonetheless, the nature of the globalized economy allows investors to offset these relative disadvantages against the potentially high rewards they stand to gain by investing in India.

Further, basic corporate tax rates of 30% and other levies prevent India from being characterized as offering a competitive tax environment for companies (chosen as a competitive advantage by only 1% of respondents).

Figure 27: Market share of banks in India



Source: *The Times of India*, Ernst & Young 2010 *Doing business in India*.

View point

should also give them confidence in their return on investments by ensuring clarity of policies and regulations.

This level of confidence and trust needs to be carefully managed, such that the coming reforms do not create unexpected challenges to investors already operating in India. A number of positive reforms have been made to improve corporate laws and clarify corporate taxation. The Government is headed in the right direction but progress could be accelerated.

While we are positive about India's GDP growth, what is more important to us, as investors, is the path this growth story will undertake in the future. Morgan Stanley was one of the first multinational banks to arrive in the country. We have done very well there because we have spent a considerable amount of time studying and working in the domestic market. We have also chosen our partners carefully. Our team in India today is roughly of the same size as that of the rest of Asia, including China. This indicates the importance we place on India. But one must learn to be patient because deals there take twice as much time and effort as they take anywhere else.

What will drive our future is going to depend on the performance of the Indian companies in which we have invested. The future will also depend on the country's policies with regard to foreign investment. With respect to our global fund, we are underinvested in non-OECD countries, so we would really like to increase that exposure. We have plenty of room to grow in India.

Business activities shifting to serve local market

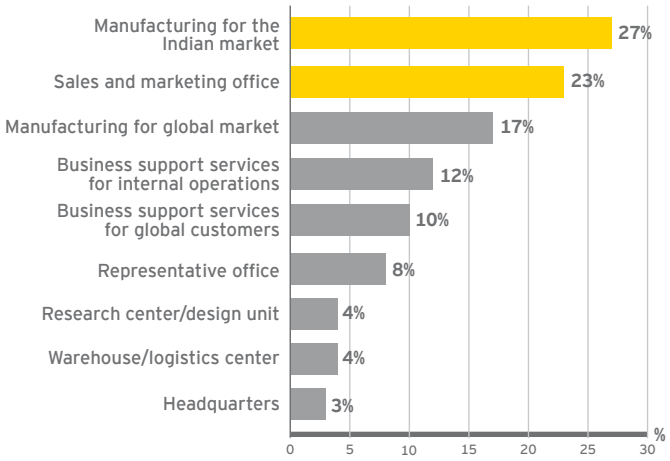
India is currently enjoying a "demographic dividend", with a median age of 25.9 years[21]. This offers favorable prospects for rapid economic growth for several decades ahead. The survey respondents clearly support the view that India's economy provides a thriving domestic market in both manufacturing and business support services.

India's economy is increasingly driven by private consumption, currently accounting for 60% of GDP (compared with only 35% in China). In 2009, the demand for typical middle-class consumer goods, such as cars, surged by 33% and for other durables by over 40%. Encouraged by recent trends, the Government is expecting annual car sales to double to three million by 2015. These trends are providing large opportunities for international companies to market to the middle-class Indian consumer. Almost a third of respondents indicate interest in sales and marketing and representative offices, which is consistent with the general desire to take advantage of the rapidly growing consumer demand.

Whereas India is known for its IT and BPO capabilities, other sectors are also gaining ground. In part, this is due to growing foreign competition in BPO. Instead, India is beginning to emerge as a manufacturing location, with 17% of respondents seeing it as an attractive base for global manufacturing and 27% nominating India as an attractive location for domestic manufacturing.

21. CIA World Factbook, accessed 12 January 2011.

Figure 28: What type of investments are investors looking into?



Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected more than one possible answer. Total respondents: 241.

View point

Doing business in India requires patience and flexibility

Olivier Blum
Managing director India,
Schneider Electric India Pvt Ltd

We see India as a democracy which gives us a stable regulatory framework and environment to do business. Government regulation is pretty open and transparent. It is also one of the largest English-speaking countries in the world, the education system is strong and there is a large talent pool available.

Schneider Electric has just completed its 2015 strategy plan and tried to identify the growth trends for itself. India is a very important market for us and we plan to grow three- to fourfold in India by 2015. We are looking to grow aggressively, both organically as well as inorganically. We firmly believe in alliances and partnerships which is possible in India. At the moment, we have an employee base of 8,500 people and plan to grow to 15,000 people by 2015. We also have a large manufacturing set-up with 17 factories. In future, our R&D intensity will increase manifold. There are 900 engineers as of today in Bangalore.

For Schneider Electric, a large middle class population is a very important factor for growth. By 2020, we see a very large and demanding middle class population asking for value for money. It has increased already in the past 5 years and it's going to be a significant factor in the next 10 years. India will become a R&D centre for value for money solutions and will influence the rest of the world, especially in developing solutions for the middle class. Services will shrink a little bit and there will be more of manufacturing and R&D happening.

However I believe that governance needs to improve and corruption has to reduce. We also hope that poverty will reduce. Schneider has accepted that there is a percentage of the market that we don't want to touch because it's inapproachable for a company which wants to comply with certain standards in terms of business ethics. We would like to see some change in that aspect. Infrastructure — roadways, railways, airports, energy — too need to improve. I am optimistic that all these changes will happen especially for a country with worldwide ambitions.

Doing business in India requires patience and flexibility, but there is a great reward at the end.

Where to focus to improve attractiveness

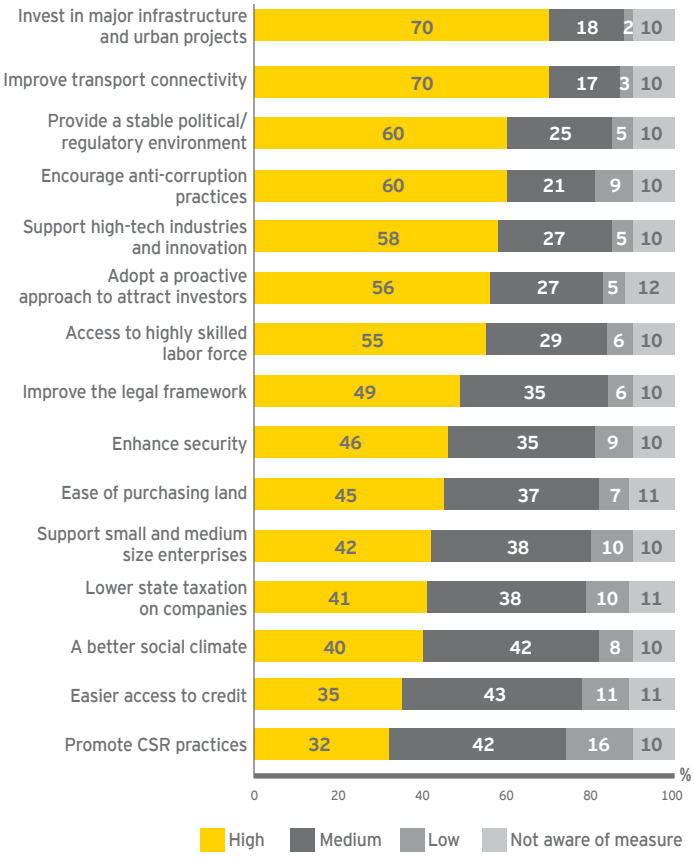
Infrastructure availability and connectivity within India, as well as internationally, are highlighted by a majority of survey respondents as the main factors common to high-performing states and cities. However, the rapid expansion of many Indian cities has left the existing infrastructure struggling, with roads, rail and air links often under extreme demand pressures.

Compared with China, India's per capita investment in urban infrastructure is low. In order to keep up with the growing urbanization rate and the ensuing demand, India needs far more investment than the current levels. The national government is attempting to remedy this problem by doubling its infrastructure spending to US$1 trillion between 2012 and 2017. With a weak domestic bond market, the majority of the funding is expected to come from foreign investors.

Corruption is often cited as one of India's main challenges. The Government has taken steps to fight corruption by offering many of its services online, thereby reducing avenues for corrupt officials to demand bribes. However, recent scandals have underlined the persistence of this problem. In part, this is the result of gaps in accountability. A failure by the central and state governments to address these weaknesses may have significant repercussions for the attractiveness of India in the future.

As mentioned, the presence of other international investors in a city is a good indicator of the level of infrastructure and connectedness to be expected from a geographic location. Often, this leads to a path-dependent dynamic, where "more attracts more". In such instances, investors assemble in hubs in order to benefit from externalities created by others in the same area. The benefits to be reaped from these synergies can be large. Another reason for this coming together would be that the presence of other investors signals a certain level of skilled labor.

Figure 29: Priority measures to improve future attractiveness



Source: Ernst & Young's 2011 *India attractiveness survey*.
Total respondents: 218.

View point

India: a land of business opportunities

Hari Bhartia
President,
Confederation of Indian Industry (CII)

Indian business leaders are optimistic about the future. They believe that India can attain and sustain a double-digit growth rate by the middle of this decade. Yet, there are some areas of concern, including the skills deficit and lagging infrastructure. Alleviating these concerns during this decade is of utmost importance and this cannot be achieved without active participation from the private sector. In that sense, these concerns actually present significant business opportunities.

It is well acknowledged that India's competitive advantage is its young population. The average age of the Indian population in 2020 is going to be about 29 years. Not surprisingly, India has embarked on a mission to provide the necessary skills for 500 million individuals by 2022. The current need is to develop innovative models by the private sector with the objective of improving the educational attainment and skill levels of individuals.

It is for this reason that as part of CII's agenda of "Business for Livelihood" for the year 2010-11, we are focusing on four key enablers for sustainable enterprises: education, employability, innovation and entrepreneurship. The themes are appropriate in the context of the discussion on inclusive growth: education and employability help create a qualified and skilled workforce, which in turn translates into higher wages. At the same time, innovation and entrepreneurship drive growth and employment generation.

On the infrastructure front, the Indian Government is making large investments in the areas of highway development, air connectivity (domestic and international), upgrading of ports and the power sector. The Eleventh Five Year Plan projections imply that only about 70% of the infrastructure needs can be met from public resources; the remaining 30% will have to come from private investment in various forms, including public-private partnerships (PPP). An investment of over US$1 trillion is required in the infrastructure sector during the Twelfth Five Year Plan in order to create world-class infrastructure in India. If these investments are to come to fruition, it becomes essential for Indian companies to collaborate with multinationals. The infrastructure sector provides opportunities for big-ticket investments by foreign companies. Other attractive sectors include food processing, pharmaceuticals, health care, retail, fast moving consumer goods (FMCG), automotive and the automotive ancillary sector.

Already, multinational companies have a significant presence in India catering to the Indian consumer. India's growth has been driven by domestic consumption. Domestic and multinational companies are taking advantage of the fact that India has one of the fastest growing middle class populations in the world. Between 2005 and 2010, the number of middle class households almost doubled and this growth will continue in the future. Indian entrepreneurs have worked out innovative low-cost models to cater to the middle class and also to those at the bottom of the pyramid.

In my interaction with foreign businesses, I have found that they have not been unduly disappointed or frustrated by business conditions in India. There are wide variations across the country, with some local governments able to provide business-friendly conditions that override constraints in national regulations. A recent World Bank report Doing Business in India 2009 compared the efficacy of government regulations across different cities in India. In 14 of the 17 locations, the report records significant business reforms at the national, state and municipal levels. These include computerizing records, putting tax registration online and setting up single-window systems for permit applications — all making it easier for businesses to comply with rules and regulations.

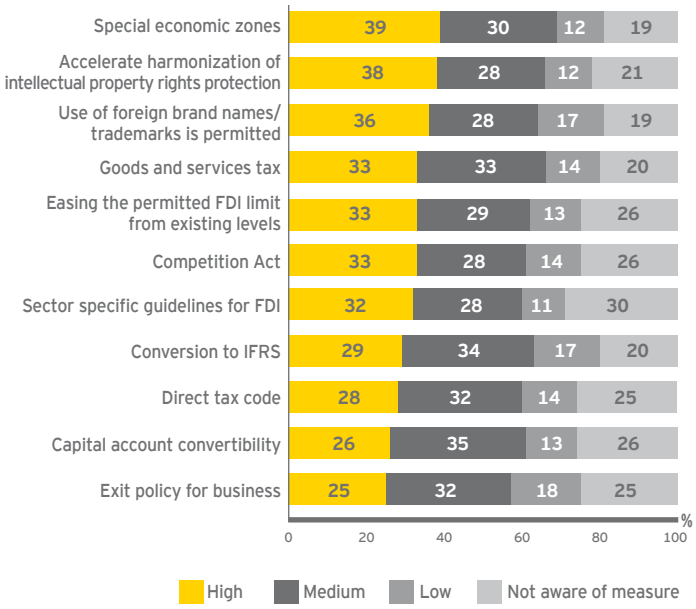
Increasingly, government policies are becoming transparent. The banking institution is strong and is becoming more active in financial inclusion. The judicial system too is in favor of investors. If you look at our stock exchanges, the regulatory mechanism for investors is quite robust and is world class.

Therefore, it is not surprising that the World Investment Report 2010 published by the UNCTAD (United Nations Conference on Trade and Development) identifies India as one of the top four countries for foreign direct investment. I am confident that the second decade of the 21st century will be India's decade, both in terms of investment opportunities it offers, and in terms of India being one of the engines of global economic growth.

Building business-friendly regulations

The majority of our respondents continues to highlight SEZs as an attraction for foreign investors as they provide an easier operating environment through tax concessions, simplified export-import procedures, more favorable regulation and better regional infrastructure – all of which reduce the cost of doing business. SEZs were considered most important by respondents in the high-tech and telecommunications sectors, which are most likely to gain from technological hubs with strong and reliable infrastructure.

Figure 30: The most important measures driven by regulation



Source: Ernst & Young's 2011 *India attractiveness survey*.
Total respondents: 505.

The strengthening of existing competition rules and intellectual property rights (IPR) would inspire greater confidence in investors who have highlighted harmonization of IPR, use of trademarks and a Competition Act as areas that would increase India's attractiveness to foreign investors. While regulations on the use of foreign trademarks and brand names are in place and a new Competition Act was enacted in 2003, the concern raised by the survey respondents indicates that better implementation of these regulations will be essential to attracting future foreign investment. Tighter IPR regulation attracts foreign investment and technology transfer via voluntary licensing contracts. It also incentivizes R&D activities, which can have large technological spillovers and enhance industry-wide productivity growth.

The tax system is not uniform and varies across different states. The creation and implementation of a consolidated tax system is on the agenda but may take a number of years to implement. In addition, the existing tax code is not particularly favorable to corporations, making the tax environment an area that may have a significant impact on improving attractiveness.

Investors will be pleased to note that one of the concerns raised in relation to conversion to International Financial Reporting Standards (IFRS) is being addressed: all companies listed outside India or with a net worth of at least 1000 crore rupees (about US$218 million) are required to report their financial statements under Ind-AS (IFRS converged standards in India) by April 2011, under the current timeline.

Srinivasa Rao
Partner & National Director
Tax & Regulatory Advisory,
Ernst & Young Private Limited, India

Charting a competitive regulatory environment

India is poised to chart its path of robust economic growth even as many leading economies struggle to regain financial and economic stability. Indeed, the world is looking at India – as one of the high-growth economies – to provide stimulus for global growth and prosperity.

Transparent and stable policies and an independent regulatory environment play a significant role in the evolution of an economy. In this context, India has witnessed steady economic growth in the last decade, firmly guided by a more globalized and progressive policy environment. Having come a long way since the beginning of the liberalization process in the early nineties, India is now taking several initiatives to provide a competitive environment for business investment.

Leading practices at state-level

The two state policies that are the most attractive for investors are tax incentives and land concessions. This comes as little surprise, as acquiring land in India is a time-consuming and complex task. Government intervention in purchasing large land areas has proven successful in securing investment. States are more likely to attract investment in major projects if they provide major incentives; often these are land-related.

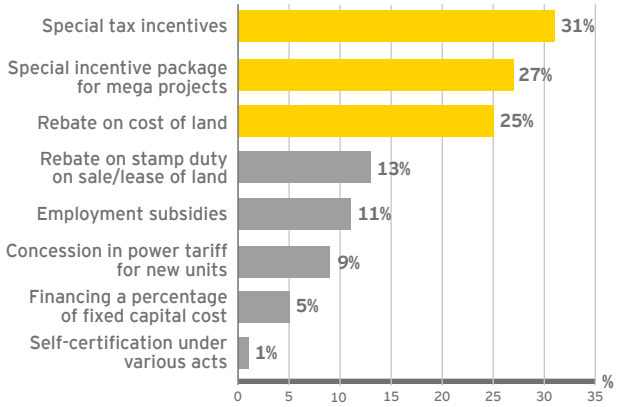
Furthermore, with both state and central government wanting to raise taxes to alleviate their own debts, states that can offer tax incentives to investors stand to gain. However, with personal income, wealth and corporate tax, customs and excise duties as well as service tax collected at the central level, the degree to which states can offer tax incentives is limited.

Employment subsidies and stamp duty rebates on land transactions have been less successful in attracting investors. They are difficult to implement and often stir up bureaucratic complexities that undermine the financial benefits from such subsidies and rebates.

Reducing the cost of investment and lowering the barriers to entry and exit can have a significant impact on attracting investors. Lessons can be learned from China, India's main competitor.

22. World Bank World Development Indicators (2010).

Figure 31: State-level incentives



Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected 2 possible answers. Total respondents: 218.

While China reduced the cost of starting up a business from 17.8% to 4.9% of GNI per capita between 2003 and 2009, the same cost increased from 53.4% to 66.1% for India in the same period[22]. Similarly, while taxes on commercial profits are about 24% in India, they are only 6% in China. Furthermore, according to the World Bank, the per capita cost of setting up a warehouse in India – which involves the acquisition of permits and licenses as well as obtaining necessary utilities connections – is slightly more than four times higher than in China. In order for India to become a more attractive destination for investors, it is essential that it reduces such costs of doing business.

View point

In keeping with the best international practices, Indian regulatory structures are being continually reformed. Convergence to the International Financial Reporting Standards (IFRS) from 2011 to 2014; introduction of significant fiscal reforms through the Direct Taxes Code (DTC) and the goods and services tax (GST); and the initiatives to introduce new, progressive legislation such as the Competition Act and the Limited Liability Partnerships Act are positive indicators of a favorable investment climate.

The DTC and the GST are two significant fiscal reforms in the pipeline which would influence India's future tax system. The DTC reflects a clear shift from a system of high tax rates coupled with incentives, to a regime with a wider base and moderate tax rates backed by a legislative framework that provides simplicity and certainty, and an effective tax administration. Measures for tackling tax evasion at domestic and international levels and an effective enforcement strategy are gaining sharper focus.

In the realm of indirect taxation, the GST is the single most important tax initiative in India since independence. It is expected significantly to enhance economic efficiency and growth, facilitate the creation of a common market across the country and make industry more competitive.

After the global economic crisis, we are entering a new era in which fiscal policy and regulations will play crucial and constructive roles in determining the attractiveness of a country, and in that country realizing its global ambitions. The United Nations Conference on Trade and Development (UNCTAD), in its World Investment Report 2010, has placed India among the top 10 destinations for foreign direct investment. And India is seriously looking to provide certainty and transparency in the regulatory and legislative environment – to spur growth and become the top investment destination.

Key lessons and actions for India

According to our survey respondents, the outlook for India is bright. The India that they portray will provide leadership on the global stage on the basis of its high levels of intellect and innovation, rather than simply through its presence as a call center location or even manufacturing hub. If these perceptions are fully realized, then future patterns of FDI in India will reflect the country's changing status, with investment increasingly flowing to higher value-added, knowledge-intensive business activities.

However, while many Indian states stand in a good position to capitalize on this opportunity, state governments need to continue focusing on how best to encourage existing investors to invest more, and to persuade new investors to come to India. Building on our analysis of FDI data and our survey of investor perceptions, we recommend that Governments focus on the following key issues.

Establish infrastructure corridors

It is well known that investing in infrastructure will be important in relieving bottlenecks in the Indian economy, and thereby make investment more attractive. Such large-scale infrastructure investment is going to require collaboration between different levels of Indian government with both domestic and foreign companies, for example through PPP. While the Indian state is planning to provide most of the infrastructure investment needed over the next several years, private sector expenditure on infrastructure will be crucial. This will provide huge opportunities for foreign investors.

If implemented successfully, infrastructure corridors (also known as investment corridors or industrial corridors) have the potential to create step changes in a state's investment attractiveness. This is because tomorrow's average foreign investor will be interested in marketing products and services to those increasingly wealthy citizens living not just in Tier I cities, but also in Tier II and Tier III cities, and beyond.

Infrastructure corridors refer to clusters of businesses, often in Tier II or Tier III cities, connected to each other and to Tier I cities with good infrastructure. Several new initiatives for infrastructure corridors are already being implemented in India. Businesses are attracted to use the corridors if they are in locations that facilitate access to several nearby major consumer markets, and that enable easy communications with local and regional partners and suppliers. Further, decisions to invest in such corridors can be path dependent, i.e., businesses may be attracted to locations where they have existing investments, or where other businesses are clustered.

To be successful, the corridors will need to learn from the pockets of leading physical and communications infrastructure that already exist in India; for example, in some SEZs. In order to avoid the type of land ownership problems that afflicted some SEZs, the new infrastructure corridors should seek engagement from all stakeholders involved, including local communities and local Non Governmental Organizations. Further, to appeal to the modern international investor, these corridors will need to minimize social and environmental impact. There are several initiatives under way to ensure that the new Delhi-Mumbai corridor conforms to such progressive requirements.

Whether the cities connected by a corridor are Tier I, II or III cities, they will need to offer an adequate pool of human capital and a vibrant local supplier and services industry. The success of an infrastructure corridor can depend on how successful the cities are that it connects. However, often the reverse is true: the corridor generates growth in Tier II and Tier III cities that are linked by it. A good example is Pune, a Tier II city that is closely connected to Mumbai.

View point

Siraj A Chaudhry
Chairman,
Cargill India Private Limited

Public and private partnership is key to success in India

The attractiveness of India is mainly due to its large demand and consumption base. India's large population and rising GDP provide an attractive market for companies across various sectors. Today, India is a US$1.5 trillion economy and with an expected growth rate of about 8% to 9% in the foreseeable future, this nation is likely to establish itself among the top countries in terms of sheer economic size. Forecasts indicate that most industry segments will experience double-digit growth. However, there may also be some laggards. Nonetheless, the future looks bright for India.

Cargill's presence in India has been growing since we began operations in 1987. Our evolution and growth in India have taken place

Infrastructure is considered to be the backbone of a country. It is a factor of production and an intermediate output which also drives the economic growth of the country. The Eleventh Five Year Plan (2007-12) envisaged investment in infrastructure of US$494 billion (at 2006-07 prices), of which 30% is expected to come from the private sector. Government (central, states, and local) current spending on infrastructure is not adequate to meet infrastructure demand and it cannot be increased substantially due to Fiscal Responsibility and Budget Management (FRBM) constraints. PPP is the preferred instrument to meet this deficit in financing due to its benefits as compared to other modes of private investments.

Among their benefits, PPP brings efficiency in asset creation, and effectiveness in service delivery, by attracting entrepreneurial energy. The private sector often encompasses better technology, management skills and dedicated resources for the project to make it efficient. PPPs also promote user charges for the facilities created and services offered, which helps in reducing corruption.

The Indian Government has set as its target that 50% of the investment in infrastructure will come from the private sector during the Twelfth Five Year Plan (2012-17), which would total about US$500 billion. This assessment is based on the premise that economic growth of 8%-9% would need gross fixed capital formation (GFCF) of 9%-10%. This magnitude of investment can be attracted only with an institutional push from the Government.

The Government has been promoting private sector participation, particularly PPPs. These include capacity building through training; model documents for various sectors; providing experts on PPPs to states; empanelling transaction advisors to help implementing agencies select the private players with lesser time and effort; and promoting FDI inflows. For most sectors and major part of the process, model documents have been prepared to support the selection of investors from the private sector.

The Government has taken many initiatives related to FDI, making India the second most favored destination. However, this volume of FDI is marginal compared to domestic investment. Further action in terms of removing FDI caps, creating a stable policy regime, developing efficient markets

parallel with the opening of the economy. Our operations include the handling and processing of a wide range of products, including refined oils, grains and oilseeds, sugar, cotton and animal feed besides manufacturing flavors and financial business. Over the years, we have learnt to navigate through the complexities of doing business in India.

Given the central nature of agricultural production in India, the agriculture and food sectors have always been sensitive areas for business operations and are subject to significant government intervention. Businesses have to realize that for a country as large and diverse as India, government decisions are often a compromise between providing a business-friendly environment and achieving social objectives. We have learnt to be mindful of these imperatives while planning for our business growth.

India has often been criticized for its weak infrastructure which can act as a bottleneck to faster growth. Poor basic infrastructure, such as roads and ports, coupled with challenging land acquisition laws and complex tax structures, pose a challenge to business growth. Given the enormity of the task ahead, public and private sectors need to act together to address these challenges. This will not only ensure a harmonious co-existence of the two but also create an opportunity to unleash the business potential of India.

and removing institutional and legal hurdles may spur further growth in FDI flows to India.

Another interesting feature of PPPs in India is the increasing focus on the social sector. Investments in India in the early 2000s have focused on water and sanitation, as well as telecommunications, transport, and energy. The social sector focus has increased further with the strengthening of local governments and initiation of PURA (provisioning of urban amenities in rural areas) using PPPs. I expect that we will observe substantial private investment in rural and social infrastructure for the urban poor in the coming decade.

While lots of initiatives have been taken, some more steps are needed in order to meet the 50% target of the Twelfth Five Year Plan. These would include creation of a healthy pipeline of PPP projects; streamlining the decision making process and timeline for each project's clearance (including implementation of a "single window" clearance wherever possible); and further capacity building at state and local levels.

Abhaya Agarwal
Executive Director, National PPP Leader,
Government and Transaction Advisory Services,
Ernst & Young Private Limited, India

Public-Private Partnership (PPP): an instrument to drive economic growth in India

Develop the skills to sustain a global R&D center

The Indian Government is determined to make India into a global center for R&D. Survey respondents are optimistic that this objective will be met: 34% see India as a leader in R&D and innovation in 2020. Respondents see India at the forefront of the global knowledge economy, with a highly educated population leading the way in providing high-value services and R&D.

Underpinning this view is India's education system, which 34% of respondents see as becoming one of the world's best, particularly at higher learning levels. Already home to leading educational institutions, there appears to be a strong belief among investors that India's increasing number of high-quality graduates will drive its ability to compete internationally for investment in cutting-edge R&D.

Figure 32: How do you see India in 2020?

Source: Ernst & Young's 2011 *India attractiveness survey*.
Respondents selected more than one possible answer. Total respondents: 505.

While it is possible that these perceptions will be realized by 2020, this can only happen if governments continue to push forward rapidly in raising the number and quality of citizens with tertiary education. At present, 12% of India's citizens enter higher education, and the Government plans to increase this to 21% by 2017.

It is generally accepted that rapid liberalization and the entry of private providers are the only way to create the massive new capacity in technical higher education that India now needs. For example, the Indian Institutes of Technology (IITs) are world class, but few in number. This year, 450,000 students applied for 7,000 places at 16 IITs. The IITs also have an unprecedented shortage of qualified faculty members. Few Indian students graduate with PhDs: just 6,000 science and engineering students did so in 2010. Vocational training is also badly neglected – India has just 5,500 industrial training institutes and 1,745 polytechnics.

Many plans for new campuses are moving ahead combining the best of IIT-style education with teaching of additional vocational and soft skills. Given the positive perceptions of India developing into a global R&D center, these educational institutions will reap huge future benefits in terms of attracting FDI into R&D. This will hold particularly true if the costs of education for individuals can be kept down, as this in turn will dampen future wage demands, helping to maintain India's key cost versus quality competitive advantage.

View point

Education will drive India's growth story

Moon Bum Shin
Former Managing director,
LG Electronics India Private Limited,
Moving to LG Electronics Head
office from February 2011

The future of India is promising and I am glad to see that the country is emerging on the global scene. India is integral to the growth strategy of numerous global companies and is seen as a priority market for many businesses. LG Electronics has started to focus more broadly on India over the last 10 years, seizing opportunities offered in the advanced digital products and applied technologies sectors. Our investment is expected to continue, and over the next three to five years, we are going to invest approximately US$300-500 million in our operations in India.

We have made investments in order to strengthen the organizational capability of LG locally. For example, we have opened a learning center to train our personnel. A research and development center and a design center have also been set up for localized products that are suitable for the domestic market.

Education is one of the key factors driving India's growth. Going forward, the Indian Government is likely to make large investments in order to improve the education system. Despite the low literacy rate, the country has been registering a growth rate of 7%-9%. Just imagine what the growth rate would be like if the literacy rate improves? Then India's future potential will be huge. If I were to look at Korea in the last 10 years, the only driver of our growth is education. We do not have abundant natural resources nor a large internal market – whereas India is the second largest English-speaking country in the world and is emerging as a central hub for companies in South Asia.

While the political leadership and the entire business environment in India is improving, there are still procedural hindrances that deter investment. The government needs to simplify its regulatory processes, which have made the approval process rather lengthy and time-consuming. The broader environment for attracting foreign direct investment (FDI) vis-à-vis China and other countries is also a critical issue to be addressed in detail.

My advice to companies: not to delay their plans for entering the Indian market. In the next 10 years, the changes in India will be much more important than ever before.

Reach out to new investors

Our survey found that few companies had no plans for entering the market. Sometimes, this is for reasons particular to those corporations, which cannot be addressed by policy measures to raise attractiveness. For example, some companies note that India is too competitive in terms of presence of international companies; others simply do not regard India as a target; while some are focusing on trying to enter China first (and, presumably, have limited capacity to pursue entry into two new large markets at the same time). However, there is a small number of companies that is not yet planning to invest in India, and that cites a variety of reasons that can be addressed by policy in India. These reasons include: governance issues that make it difficult to do business; the economic environment; the availability of human capital; and the "cost of doing business". These four reasons are each cited by no more than 3-4% of investors that are not planning to enter India; this is a very small number that does not allow for quantitative analysis. Nonetheless, the reasons are worth noting for Indian policymakers, as they illustrate investor opinions that could be swayed over time.

Herein lies an opportunity for state governments in India. Those states that perform best in key areas of governance, e.g., transparency, accountability, judicial independence and predictability, and institutional stability will stand a very good chance of attracting investors who are new to India. Similarly, states that become leading practice in terms of reducing the cost of doing business will be able to attract some of this potential new investment.

Both governance and "cost of doing business" issues can be linked to the presence of corruption. This partly explains why our survey respondents state that "encouraging anti-corruption practices" is one of the most important elements in ensuring the attractiveness of the Indian Market (figure 29). Again, this presents an opportunity for those states that implement anti-corruption safeguards in line with international good practice.

Further, those investors that are deterred by the economic environment represent a target audience to be won over by a concerted effort to publicize India's current and potential economic strength. Indian state governments should undertake targeted marketing campaigns to explain India's positive economic environment. Similarly, those Indian states that possess an abundance of high-quality, low-cost labor should take more action to publicize this among groups of investors that appear worried about human capital issues.

RP Singh
Secretary, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry

India is a place offering long-term gains

Three key strengths of the Indian economy are its growing domestic market, low unit cost of labor and the institutional set up including the independent judiciary. The Indian economy is one of the fastest growing economies in the world and is likely to sustain a growth rate in the range of 8% to 10% during the next decade. This would expand its market exponentially.

Physical and social infrastructure and overall manufacturing would continue to be the major areas for foreign investment in India. Within manufacturing, I expect significant investment in pharmaceuticals, biotechnology, automotive, machinery and food processing. The global players in defense manufacturing would be willing to make substantial investments, subject to the sector being opened for FDI.

However, our infrastructure deficit is reasonably well known. Currently, we are allocating around

8% of GDP for infrastructure purposes. This investment needs to be increased to 11% to 13% in the medium term. A major concern is the skills shortage, practically across the entire economy. The National Skill Development Corporation has identified skill gaps of 240 to 250 million persons in the next 10 years. Against this, the existing capacity of Industrial Training Institutes (ITIs) and Industrial Training Centers (ITCs) in the country is about 1.1 million persons each year. Another concern is our inability so far to reinvent the agricultural sector. Nearly 56% of the people are currently engaged in agriculture which contributes only 17% to our GDP. There is a need to shift labor to non-agriculture activities without, in any way, endangering the agriculture growth. This would require a second green revolution in agriculture, driven by infusion of resources and technology.

The Government has been quite proactive in attracting investment. The Department of Industrial Policy and Promotion has unified all FDI-related policies into a single document which was released in March 2010. Further, the e-biz initiative of the Department will provide investors with information about various services, offered all in one place, to assist entrepreneurs in setting up their businesses. In addition, amendment of the Indian Boilers Act has been made allowing for third-party inspection of boilers.

My advice to companies seeking investment in India is to be persistent and to have patience. India is a place where long-term gains are assured. Our institutional system is decidedly more transparent and unbiased. Foreign investors practically get post-establishment national treatment automatically even without bilateral agreements. It is a place for long-term involvement and durable partnerships.

View point

Methodology

The Ernst & Young's 2011 *India attractiveness survey* is based on a two-fold methodology that reflects:

The **attractiveness** of India for foreign investors. Our evaluation of the reality of FDI in India is based on FDI Markets. This unique database tracks new greenfield and expansion FDI projects. Joint ventures are only included where they lead to a new physical (greenfield) operation. Mergers and acquisitions (M&A) and other equity investments are not tracked. There is no minimum size for a project to be included. However, every project has to create new direct jobs and capital investment.

The **perceptions and outlook** of India and its competitors by foreign investors. We define the attractiveness of a location as a combination of image, investors' confidence and the perception of a country or area's ability to provide the most competitive benefits for FDI. The field research was conducted by CSA Institute from mid-November to mid-December 2010, via telephone interviews, based on a representative panel of 505 international decision-makers.

FDI in numbers

Data is widely available on FDI. An investment in a company is normally included if the foreign investor has more than 10% of its equity and a voice in its management. FDI includes equity capital, reinvested earnings and intra-company loans. But many analysts are more interested in evaluating investment in physical assets, such as plant and equipment, in a foreign country. These figures, rarely recorded by institutional sources, provide invaluable insights as to how inward investment projects are undertaken, in which activities, by whom and, of course, where. To map these real investments carried out in India, Ernst & Young used data from fDi Markets. This is the only online database tracking cross-border greenfield investments covering all sectors and countries worldwide. It provides real-time monitoring of investment projects, capital investment and jobs creation with powerful tools to track and profile companies investing overseas.

The perceptions and outlook of India and its competitors

An international panel of 505 decision-makers of all origins have been interviewed:

- 53% European businesses
- 27% North American businesses
- 20% Asian and other businesses

Globally, out of this panel, 62% have established operations in India.

Furthermore, this global panel from all business models and sectors was built to further guarantee a representative opinion on the diversity of international strategies:

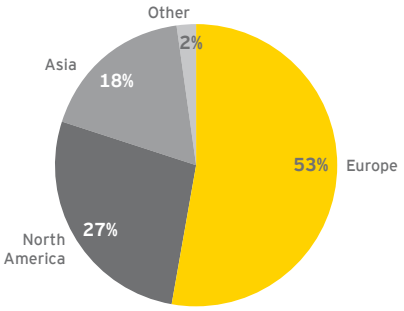
- SMEs (small and medium enterprises)
- Multinationals
- Industrial companies as well as service providers

Divided into six main sectors, the businesses surveyed are representative of the key Indian and global economic sectors:

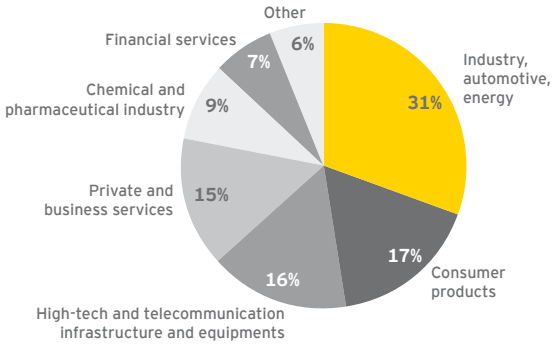
- Industry, automotive, energy
- Private and business services
- Telecoms and hi-tech
- Consumer products
- Chemical and pharmaceutical industry
- Financial services

Profile of companies surveyed

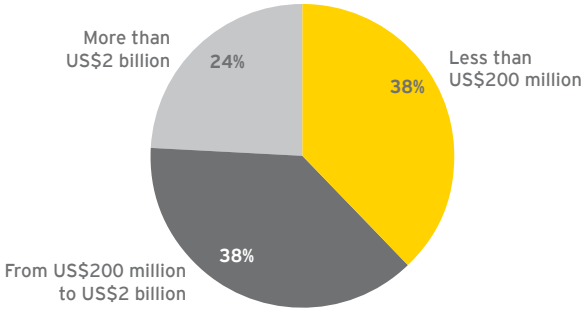
Location



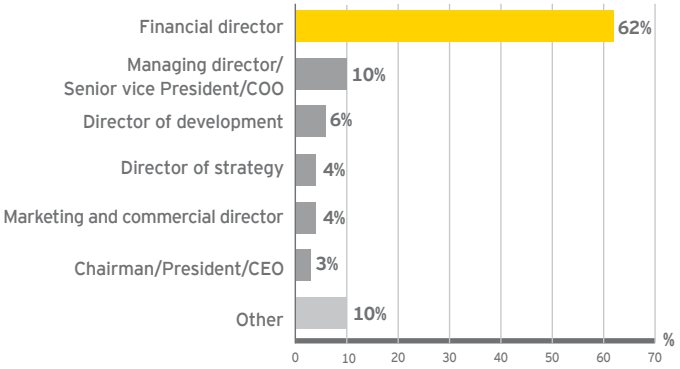
Sector



Size
(sales turnover)



Job title



Ernst & Young in India

In India, Ernst & Young has nine offices (Ahmedabad, Bangalore, Chennai, Gurgaon, Hyderabad, Kolkata, Mumbai, New Delhi and Pune). Its workforce of over 7,500* people work towards the organization's vision of being a trusted business advisor that contributes to the success of its clients by creating confidence and value. We help our clients achieve their potential through our differentiated approach, which incorporates various service dynamics, including:

- An industry-aligned delivery model that harnesses our service range. Practices focused on specific industries draw on knowledge, skills and our experiences of that industry in India and around the world. This helps us customize our approach to the needs of each client.
- Our services are broadly classified as four service lines: Assurance, Tax, Transactions and Advisory. Each service line is further streamlined into niche competencies and focused groups, which enable us to strengthen our outreach and offer a compelling portfolio of well-defined services.
- Each team is built as a multi-dimensional group of professionals from diverse backgrounds, with a range of perspectives. They understand and address our clients' concerns from a variety of standpoints while using highly evolved tools and approaches to offer inputs in a structured and compelling manner.
- Values and ethics unite us, ensuring we work cohesively towards the shared goal of making a difference. A special energy that we bring to each assignment defines the way we work and make a difference in the services we provide.

Ersnt & Young is recognized as leaders in the professional services industry and accolades we receive encourage us to continue striving for excellence.

- The most reputed Tax Firm in India – TNS Global Tax Survey Monitor, 2009
- India's tier-one tax firm for the seventh consecutive year – Euromoney ITR, World Tax Guide 2010
- Ranked #1 Financial Advisor in India for eight consecutive years for most number of deals – Bloomberg
- Asia-Pacific M&A Investment Bank of the Year and Asia-Pacific M&A Deal of the Year – 2009 Asia M&A Atlas Award
- Most Active Transaction Advisor Award, PE and M&A for 2009 – Venture Intelligence
- Financial Advisor of the Year M&A Award – India, 2008 and 2009 – Financial Times & Mergermarket
- Overall winner – consultancy rankings, in survey of risk and compliance professionals – OpRisk and Compliance magazine
- Risk & business advisory relationship with 160 of the BSE300 companies
- "Excellence in Training" award – Employer Branding Awards 2008 and 2009

* including personnel from other member firms of Ernst & Young, in India

Publications

Doing business in India
offers an overview of the investment climate, taxation, forms of business organizations and business accounting practices in this country. The complex decision-making process involved in undertaking foreign operations requires an intimate knowledge of a country's commercial climate as well as recognition of the fact that this climate is continuously evolving.

Step up to IFRS
As per the IFRS conversion road issued by the Ministry of Corporate Affairs (MCA), companies covered in phase 1 of the roadmap will start applying IFRS converged standards from 1st April, 2011.

Our guide *Step up to IFRS* purports to answer questions such as impact of IFRS on the financial statements of businesses, the conversion efforts, the challenges the companies will face and approach or strategy that should be followed in transiting to IFRS. This publication also provides key differences between IFRS and Indian GAAP.

Transactions quarterly
is the Ernst & Young's newsletter on M&A activities involving Indian companies: "Deal spotlight", "Theme of the quarter" and "Transaction analysis" by deal size, by geography, and by industry sector are the main topics addressed.

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EYG No. AU0738

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