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Examining the Business Landscape in India

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Introduction

In recent years, considerable attention has been given to India. Countries have come to realise the potential that India has because of its investment climate, skilled work force and large market. The largest democracy in the world, India is home to 1.08 billion people (approximately 16.7% of the world population) and is projected to have 823 million people in the working age group by 2015.

In this paper, we highlight the key economic developments and indicators which show the huge potential of the country. The paper also talks about the Comprehensive Economic Cooperation Agreement (CECA) and its provisions. At the same time, it looks at the key considerations for doing business and investing in India. Finally, it touches on the challenges of making economic inroads into India.

Economic Development and Indicators

India is a vibrant and diverse country whose economy is rapidly integrating with the rest of the world. The business environment is considered conducive for achieving high levels of sustainable growth. The country's skilled managerial and technical work force match the best available in the world. GE Capital terms it 'unique'. PepsiCo finds it one of the fastest growing countries and Motorola is convinced that India can be a key sourcing centre.

India's GDP at market prices is nearly US$800 billion a year. In the latest four quarters for which data is available, India earned US$133 billion on the current account through earnings from merchandise and invisibles. India also achieved a GDP growth rate of 6.9% due to the strong performance of its manufacturing and services sectors. In the current 2005-06 fiscal year, the government is relying on continuous strong manufacturing and services growth, with a good summer monsoon and agriculture production, to achieve around 7% growth. In 2005-06, the direct tax-GDP ratio is expected to cross 5%.[2]

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[2] HE Mr P. Chidambaram, *The Decade Ahead for the Indian Economy*, First SICCI-ISAS Global Business Leaders Lecture, 28 March 2005.

The following are some interesting developments in India:-[3]

a) The investment rate in India rose by 3.7 percentage points of GDP in 2001-02 to 26.3% in 2003-04.

b) Overall public issues of stocks grew by roughly five times to Rs35,859 crore (approximately US$7,960 million) in 2004. The growth was concentrated in equity issues, particularly in equity initial public offerings. The benchmark Bombay Stock Exchange Index has increased at least 38% since last year.

c) Bank credit expanded by over 20% in 2004-05.

d) The incremental credit-deposit ratio, since September 2004, has been over 100%.

India's process of economic reforms has emerged from a political consensus spanning diverse political associations and ideologies. The democratic institutions, which have taken root for more than 50 years, are deeply entrenched in the country's system.

India has been a bloomer as far as Asian economies are concerned and the reasons for these are, the colonial past and the time taken for the implementation of the democratic norms and rules after independence. When India gained independence in 1947, import substitution was the key word and the focus was on attaining self-sufficiency. Economic growth was inadequate until the government reduced state control of the economy during the 1970s.

The balance of payment (BOP) crisis in 1991 led to changes in attitudes and policies in India. This deterioration in the BOP occurred despite robust growth in exports in the preceding three years. The already difficult BOP situation was accentuated in 1990-91 by a sharp rise in oil prices and the effects of the Gulf War. With the access to commercial borrowings going down and non-residents deposits showing no improvements, financing the current account deficits had become extremely difficult. Exceptional financing assistance from the International Monetary Fund, the World Bank and the Asian Development Bank had to be sought[4].

With time and a conscious effort by the Indian government, trade became freer and barriers to external trade and investment were lowered or removed. There was an emergence of a market-based reforms and India became more active in the global trading system.

Reforms and growth in the financial and IT sector have created opportunities for investments in India and there has been an increased in inward remittances. On the other hand, the growing middle class is an eager consumer and is sees the benefits of globalisation and the opening up of the Indian economy.

In 2003-04, India's gross trade flows amounted to US$225 billion, or 35% of GDP. This ratio has been rising by roughly one percentage point every year. This suggests that we might be at a trade-GDP ratio of 45% by 2015. Gross flows on the capital account went up from 15% to 20% of GDP. Summing up, India now has over 10 years of experience of total integration with the process of steady modernisation of the external sector through a mixture of a market

[3] *Ibid.*

[4] S. Narayan, *Trade Policy Making in India*, Visiting Senior Research Fellow, Institute of South Asian Studies, June 2005.

determined exchange rate and genuine two-way exchange rate flexibility. On the policy front, India has undertaken a calibrated process - the rupee is convertible on the current account and virtually convertible for all except resident Indians on the capital account.[5]

In the past few years India has been focussing on signing free trade agreements (FTAs). The South Asian Free Trade Agreement will come into effect from January 2006 and it will lead to a reduction in tariffs, and promote intra-regional trade. India has also been pursuing bilateral FTAs vigorously with various countries. As part of the Look East policy, it has already signed a FTA with Thailand and is in the process of negotiating an ASEAN-India FTA.

However, it is the Comprehensive Economic Cooperation Agreement (CECA) with Singapore that has been seen as a milestone initiative. Signed in June 2005, the CECA is more than a FTA. It is India's first comprehensive economic trade pact with bilateral economic integration agreement in services. In addition to trade in goods, it covers trade in services, intellectual property rights and double taxation avoidance agreement (DTAA), among others.

Comprehensive Economic Cooperation Agreement[6]

India and Singapore signed the CECA on 29 June 2005 and it came into effect on 1 August 2005. The CECA encompasses trade in goods and services, investments, and economic cooperation in education, science and technology, air services and intellectual property.

The CECA perhaps best illustrates India's efforts and desire to develop links with countries in the region, which, it believes would augment it efforts to develop its economy as well as open a gateway for it to Southeast Asia.

India has committed to allowing 26% foreign direct investment (FDI) in life and non-life insurance, 74% in banking (inclusive of both FDI and foreign institutional investors), 49% in telecommunications and 74% in four areas, namely, internet service provider (ISP) gateway, ISP without gateway, Infrastructure Provider (IP) -1 and IP-2. Value added services in the telecom sector will be bound at 51%.

Under the CECA, three Singapore banks - the Development Bank of Singapore Holdings, the United Overseas Bank Ltd, and the Overseas Chinese Banking Corporation Ltd - will be allowed to incorporate one insurance company, provided none of them individually or collectively holds more than 26% equity. The three banks have also been allowed to establish 15 branches in a period of four years. India will accord 'national treatment' to wholly owned subsidiaries of Singapore banks in terms of branching, places of operation and prudential requirements.

Singapore has also agreed to grant full banking privileges to three Indian banks with or without operations in Singapore. Moreover, Singapore's key investment vehicles, Temasek Holdings and any Singapore Government Investment Company (GICs) can invest up to 20% in Indian companies. India and Singapore expect this deal to have a multiplier effect. By

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5 HE Mr P. Chidambaram, *The Decade Ahead for the Indian Economy*, First SICCI-ISAS Global Business Leaders Lecture, 28 March 2005.

6 Information collated from the CECA document is downloadable from the Ministry of Trade and Industry's website at www.mti.gov.sg.

easing visa curbs, Singapore can now use qualified Indian professionals to power its own economy.

Asset managers based in India or Singapore and offering mutual funds to investors in India have been permitted to invest US$250 million in equities and instruments in the Singapore Stock Exchange over and above the existing cap of US$1 billion allowed for all mutual funds put together.

Under the DTAA, capital gains concession accorded to Mauritius has been extended to Singapore. Accordingly, capital gains from sale of shares earned by a Singapore resident will be liable to tax only in Singapore. In addition, while the import of capital goods into India is allowed at preferential tariffs in case of specified infrastructure projects, a provision has been included in the CECA to provide a case-by-case basis exemption for Singapore from customs duties.

A special carve-out has been agreed under the CECA for education, audiovisual, telecommunication and financial services. In all these sectors, there will be ownership or control by persons from both countries.

Singapore stands much to gain from the opening up of financial services markets in India. Singapore can make forays with much depth into the South Asian region as well. In addition, with the restrictions on visa and stay in Singapore removed or reduced, the expertise of the Indian skilled work force can be utilised in core sectors such as science and technology.

With favourable tax treatment, investment guarantees, and lower barriers in the goods markets, Singapore certainly stands to gain much from the CECA. With a favourable deal for businessmen on both sides facilitated by the governments, the business community will now have to take the necessary steps to realise these offers.

Special Investment Considerations

The CECA has opened a plethora of opportunities for Singapore to invest in India. On its part, India has made certain provisions at both the central and state levels to attract foreign investments into the country. The Special Economic Zones (SEZs), tax concessions and state government initiatives are some examples of the efforts in this regard.

<u>Special Economic Zones</u>[7]

The SEZs serve to provide an internationally competitive and a hassle free environment for exports. Units may be set up in the SEZs for manufacturing and the rendering of services.

Units in the SEZs have to be net foreign exchange earners but are not subject to any pre-determined value addition or minimum export performance requirements. Sales in the domestic tariff area for the SEZ units are subject to positive foreign exchange earnings, and the payment of full customs duty and the import policy in force.

[7] For more information, see Special Economic Zones in India at www.sezindia.nic.in.

The policy provides for the setting up of the SEZs in the public or private sector, joint private-public sector or by the state governments. The central government converted some of the existing Economic Processing Zones (EPZs) into SEZs as in Kandla and Surat (Gujarat), Santa Cruz (Maharashtra), and Cochin (Kerala). The EPZs in these locations became operational as SEZs in May 2004. To date, the government has approved at least 42 more locations for the setting up of the SEZs in various parts of the country.

Taxes on Corporate Income and Gains

India has a well-developed tax structure, with the authority to levy taxes divided between the central government and the state governments. In the wake of economic reforms, the taxation system has undergone tremendous changes in the past eight to ten years. The tax rates have been rationalised and compare favourably with many other countries. Further, tax laws and procedures have also been simplified to ensure better compliance. The recent adoption of a uniform value-added tax by all states in the country is a step towards simplifying the complexities of tax structure in India.

State Government Initiatives

Research at the Institute of South Asian Studies has documented the role of the federal government in promoting growth. It emphasises the role of a common governing philosophy, expectant citizenry and a cohesive and responsible administration as important attributes of growth.

In this regard, it is important to recognise the role of individual state governments in attracting investments both nationally and internationally. States such as Gujarat, Maharashtra, Tamil Nadu, Karnataka, and a few others have eased regulatory and administrative burdens considerably. These states, in the process, have also set up exclusive bodies to facilitate direct investment and to service the business community. The Industrial Extension Bureau in Gujarat is one such example. The situation is now akin to competition among states for capital and investments.

Challenges in Doing Business in India

While there are innumerable opportunities that markets in India offer, there are challenges as well. There are some usual risks involved in every country but these risks are specific to each of them. The democratic structure of the Indian government with an intense bureaucratic presence is known to have often impeded growth and process management. According to a report by Transparency International, corruption is rampant in India and India was ranked 90th out of 146 countries.

There are legal and administrative roadblocks in the smooth functioning of business in India and the foreign investor needs to be aware of these. For instance, in the recent report by the International Finance Corporation called 'Doing Business 2006', India has been ranked 116th out of 155 countries when it comes to ease of doing business. The report also points out that the time taken to start a new business in India has come down from 89 days in the last report to 71 days. However, this is still much higher than the South Asia average of 35 days.[8] Besides, 11 formalities are required to be completed in India. The report also says it takes 270

8 *Business in India is quite a task*, Business Standard, 14 September, 2005.

days to obtain a license in India, against a regional average of 195 days. India, however, fares better on the legal rights index, fetching five on a scale of 10, compared with the regional average of 3.8. Nonetheless, this figure is far below Singapore, Hong Kong and the United Kingdom, each scoring a perfect ten.

The government administrative procedures suffer from many loopholes and are often marked by red tape. The existence of three-tier governments at the centre, state and local levels have implications on policy as well. There are elections being held quite regularly in some parts of the country for various positions. This may sometimes lead to a discontinuity of policy, which could have an impact on investments and business developments.

Moreover, the supernumerary political parties that exist are of different hues and ideologies, further adding to the complexities in the country. The presence of communist leaders, for example, in the present coalition government has caused industry-wide concerns about the interests of capital. At the present moment, such fears have been quite effectively handled by the present United Progressive Alliance.

At the same time, some parts of India have been subjected to insurgencies, which inevitably affect the business and investment climates in these regions. With the absence of investment opportunities, these parts of India lag behind the rest of the country. Naturally, migration from a poorer to a richer state or region can be expected, resulting in social problems in the recipient state or region. Moreover, state-level inequality and comparisons can lead to tension between states, a concern which the central government needs to manage.

One also cannot overlook India's infrastructural deficit. The roads, the ports, the transport systems, the power and telecommunication sectors, and the banks fall far short of the requirements of a growing economy. Problems of electricity and water shortage are also persistent in many cities.

Conclusion

The initiation of economic and financial reforms in the early 1990s by the Indian government has put the country on the path of economic growth and development. The attraction of FDI and the removal of various regulations have bolstered the country's image as an increasingly liberal economy. Overall, the reform efforts have resulted in India's rapid and significant economic growth and its smooth integration into the global economy.

India today possesses a wealth of knowledge and technical work force that makes it an ideal place for sourcing for exports. India has also become a giant consumer with massive purchasing power mainly because of the burgeoning middle class. There is no denying that it is an IT superpower in the making and investors all over the world stand to reap the benefits of these phenomena. These factors have captured the attention of investors everywhere, including Singaporeans.

However even though investing in India seems like an enticing proposition and offers immense opportunities in various sectors, it is important to do the necessary groundwork and to understand the workings of the Indian federal and state governments to be able to fully capitalise on the opportunities and advantages that India has to offer.

To do business in any part of the world, a detailed understanding of the diverse markets that the country concerned have to offer is necessary before any ventures are made in the country. It is no different for India. It is important to remember that India is a large country with 28 states having their own legislation and issues. Anyone planning to do business in India should follow a policy of cautious optimism. As the famous physicist, Nobel laureate Nils Bohr said, “Prediction is very difficult, especially if it's about the future”.

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