

Issue: Doing Business in India

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Can a new government lead to lasting change?

Executive Summary

India, with 1.25 billion people and a growing middle class, offers a vast market for global companies. The government of Prime Minister Narendra Modi, elected in mid-2014, has promised to improve the climate for all types of businesses and has reached out to foreign investors. Indeed, there are signs the economy is picking up throughout the vast, multicultural land. But the obstacles are great. Corruption and red tape remain entrenched. Businesses continue to be concerned about the workforce and whether it can meet the needs of the nation's modernizing economy. Infrastructure problems make day-to-day transportation and operation a challenge. Even though the government has promised to spend billions of rupees to improve the situation, it's unclear when progress will become visible.

Overview



Screen displays news coverage of now-Prime Minister Narendra Modi during the Indian general election of May 16, 2014, as well as stock trading statistics that day. Indian stocks rose to all-time highs then on news of the victory of Modi's alliance. (Vivek Prakesh/Bloomberg via Getty Images)

Anuradha Acharya moved her growing start-up company—and her family—from Chicago to Hyderabad, India, in 2000, to be closer to her extended family and to enjoy a better quality of life.

India at that time was ripe with business opportunities. The country's economic liberalization process, started a decade earlier, was beginning to show results, and there was a lot of exuberance about the future.¹ Acharya was aware of the challenges of doing business in India, a country infamous for red tape and corruption. But, she says, she was ready.

"If I wanted to work for someone and lead a nice life, I would have stayed" in Chicago, says Acharya, who founded and moved Ocimum Biosolutions, a life science informatics firm. "I didn't become an entrepreneur for that."

The transition wasn't smooth. Even though Acharya is Indian-born and knowledgeable about the nation's government and the quirks of its bureaucracy, getting Ocimum running was a struggle. Permits and regulations were complicated; approvals were mired in a long, drawn-out process. What would have taken only days to accomplish in the United States took more than a month in India.

"There are so many regulations and so much paperwork that you need at least two people to work full time to get a business started," she says. "We moved our entire life to this country, and the process was so complicated that each day seemed painfully long."

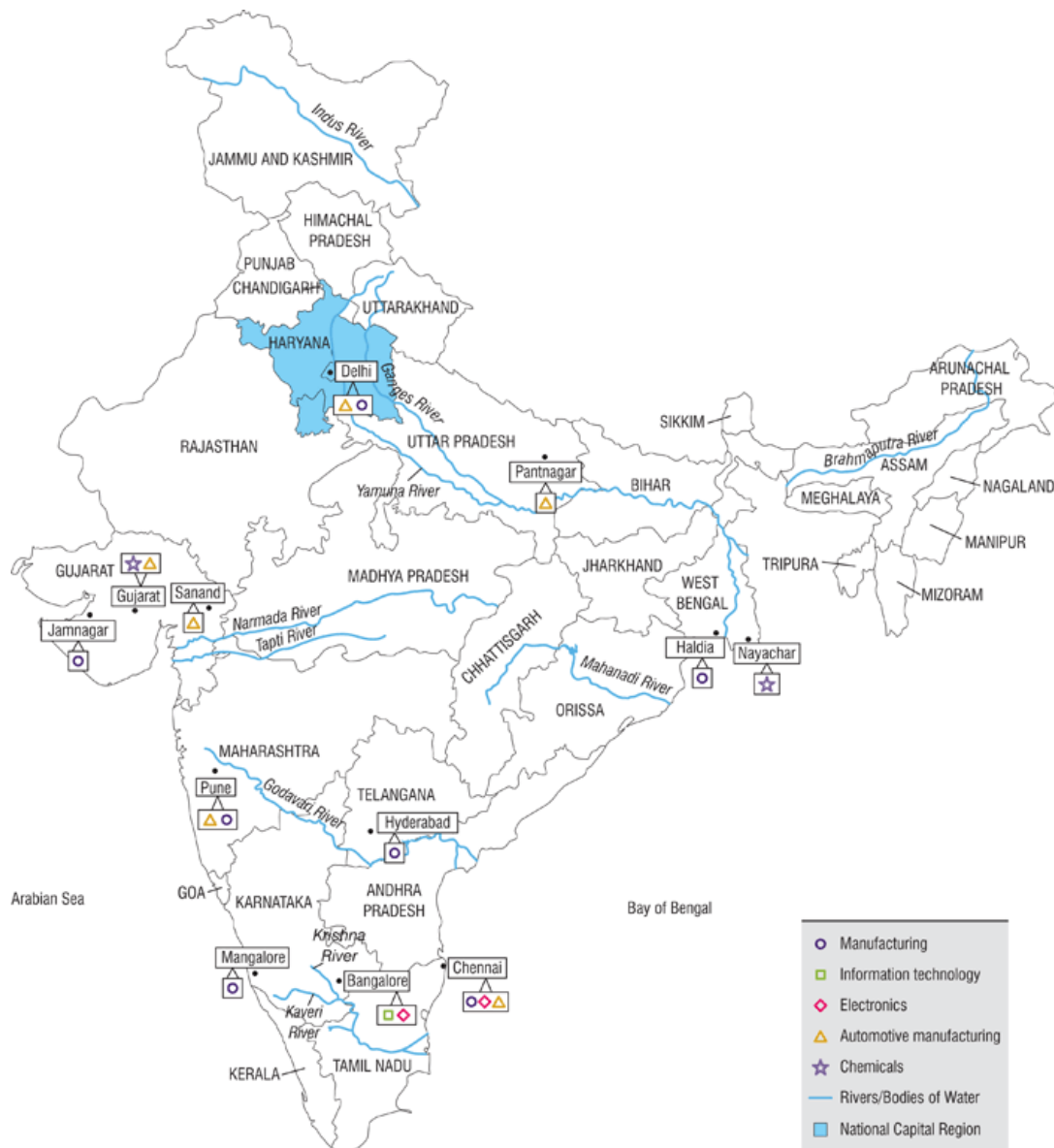
But, Acharya says, "the opportunities were worth the hassle." Acharya, who remains on the board of Ocimum, has since founded another Indian biotechnology firm, Hyderabad-based Map My Genome, where she is the CEO.



Anuradha Acharya (Map My Genome)

With its sheer size—1.25 billion people, the world's second-largest population after China—and swelling middle class, India offers a vast market for global companies.² The relatively cheap, educated workforce and a burgeoning young population are added bonuses. Yet a challenging supply chain, infrastructure problems, cultural barriers, complicated investment regulations, confusing bankruptcy laws, security problems and an excruciatingly slow legal system can deter investors. Additionally, India has a reputation as a corrupt country tangled in red tape and complicated tax laws. But the government formed in 2014 by the Bharatiya Janata Party (BJP), perceived as business friendly, promises a new economic era. Within just a few months, Prime Minister Narendra Modi met with leaders of China, Japan, Russia, France, Great Britain and the United States to boost foreign investment and trade, and announced a "Make in India" pro-manufacturing policy. He has promised to replace the red tape with a red carpet for businesses.

India's Cities Drive Major Industries



Sources: "Manufacturing Sector in India," India Brand Equity Foundation, updated September 2014, <http://tinyurl.com/ka58yth>; N. Madhavan, "More spaces to park," Business Today, Oct. 16, 2011, <http://tinyurl.com/o6lqzvs>; "The Potential of Specialty Chemicals Industry in Gujarat," Federation of Indian Chambers of Commerce and Industry, September 2013, <http://tinyurl.com/lj26fxr>

A number of major cities, including the capital of Delhi and the coastal port city of Chennai, serve as hubs for India's information technology and manufacturing industries.

But not everyone is as optimistic. Skeptics say one man cannot change an entire system. Modi's economic initiatives might be bold, but he needs the cooperation of various government departments to sustain his programs, they say.³ In addition, increasing foreign direct investment remains a politically divisive topic, drawing opposition from those who see foreign firms as competitors.⁴

Businesses face other hurdles as well. "Indian tax laws are so complex that it's hard to not break one or another unknowingly," says Siddharth S. Singh, associate professor of marketing at the Indian School of Business in Hyderabad and Mohali. "Compliance is a huge issue because laws are not clear and some bureaucrats can harass businesses, sending them notices and making them run from pillar to post."

India ranks 142 among 189 nations in ease of doing business, according to the World Bank. It trails most of Europe, the Americas and Asia, including China, as well as its neighbor Pakistan.⁵ The ranking is based largely on a nation's regulatory environment for starting and sustaining a local firm.

India is "one of the most challenging places in the world in which to do business," according to Ravi Venkatesan, former chairman of

Microsoft India and author of "[Conquering the Chaos: Win in India, Win Everywhere](#)." "This is partly due to the arbitrary interpretation of tax laws by venal revenue authorities."⁶

Venkatesan cited a retroactive change in 2012 to a law that forced telecom giant Vodafone to pay a \$2 billion tax bill. Other international companies that have struggled with the tax laws and ended up with "surprise" tax bills include Nokia Corp., Mondelez International Inc., HSBC Holdings PLC, General Electric Co. and AT&T Inc. Royal Dutch Shell was embroiled in a tax dispute with the government and won a ruling in its favor in November 2014.⁷

In all, India had \$78 billion in disputed tax claims against companies and individuals as of March 2012, according to a 2013 government audit.⁸ The country, along with mainland China, is the worst in the Asia-Pacific region in terms of predictable tax laws, according to a Deloitte survey.⁹

Nonetheless, investors and business leaders remain enthusiastic about India. Since 1991, the nation's growth rate has been among the top 10 percent in the world, according to the World Bank.¹⁰

Given its huge population and \$1.9 trillion economy, "it is a market that cannot be ignored by any investor," says Fethi Kirdar, chief financial officer with the Moby Group, a Dubai-based media and entertainment company.

Moby is preparing to launch an online entertainment platform in India that targets urban 18- to 30-year-olds. India's diversity has been an attraction for the company. Despite sharing a rich and ancient culture, the country's 29 states have multiethnic identities with diverse culinary habits, languages and religious practices. Hindus constitute 80.5 percent of the population, and yet even within Hinduism, rituals and religious ceremonies differ.¹¹

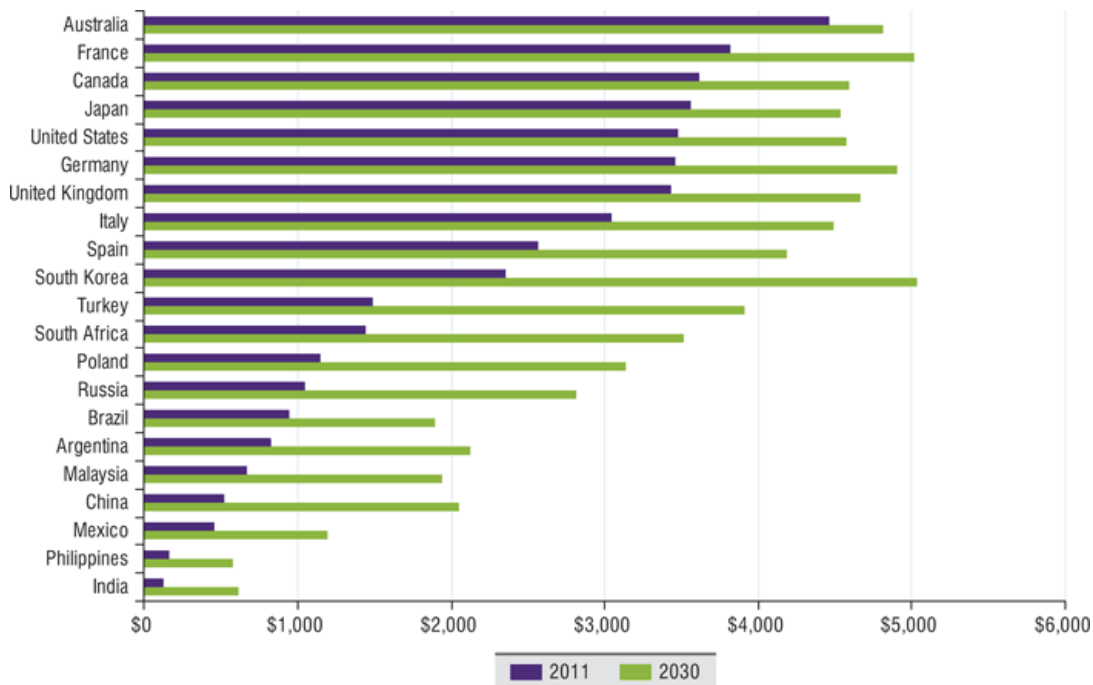
Kirdar says India's diverse cultural landscape helps foreign companies channel products and services to a particular group rather than the entire population, while still reaching a large enough market to make it worth the investment.

The demographics also are appealing. More than half of India's population is younger than 25. By 2020, India's average age will be 29, compared with 37 in China and the United States and 45 in Western Europe.¹²

According to the U.S. Bureau of Labor Statistics, among all the economies it studies, India had among the lowest hourly compensation for workers in manufacturing (3.1 percent of the U.S. level)—attractive for businesses trying to cut costs.¹³

Indian Wages to Remain Low

Average monthly wage, 2011 vs. 2030 (in 2011 \$U.S.)



Note: Projections in 2011 U.S. dollars, adjusted for projected exchange rates.

Source: "Global wage projections to 2030," PricewaterhouseCoopers, September 2013, pp. 5–6, <http://tinyurl.com/kpmau96>

India is projected to be the second-cheapest country for wages out of 21 countries in 2030, up from the

cheapest, with an average monthly wage of \$616 per worker. China, by comparison, is projected to pass Malaysia and Brazil and achieve an average monthly wage of \$2,057, while monthly wages in the United States are predicted to increase from \$3,482 to \$4,574.

Many Indians remain poor, but it's widely agreed that the middle class is growing. The National Council for Applied Economic Research, an Indian think tank, estimated in 2011 that by 2015, the middle class would grow from about 13 percent of the population to about 20 percent, or 267 million people, using a definition roughly equivalent to what was then household income of \$5,500 to \$27,200 per year.¹⁴

And yet, only three decades ago, India didn't register on the global investment community's radar. After it gained independence from the British Empire in 1947, India embraced a mixed-socialist economy that looked inward and relied heavily on central government intervention.

"The country was just emerging from 200 years of slavery [to the British], and state investment and engagement were very important," says Chandan Kumar Sharma, a sociology professor at Tezpur University, in the northeastern state of Assam. "The government realized that there were very few people with access to capital and resources, and [a] majority of the people were poor and uneducated."

However, inefficiencies and corruption led to an economic crisis toward the end of 1990. To secure loans from the International Monetary Fund (IMF) and the World Bank, India airlifted its gold reserves to the United Kingdom and Switzerland.¹⁵ As a result of the crisis, the government under Prime Minister Narasimha Rao and Finance Minister Manmohan Singh began liberalizing the country's economy, moving toward an open market and allowing international trade and investment.¹⁶

Liberalization jump-started the economy and accelerated growth in the decades that followed. India tapped into its large, educated English-speaking workforce to become a hub of information technology (IT) and business outsourcing services. Between 2003 and 2012—despite the 2008 global financial crisis—India's economic growth averaged 7.8 percent annually, according to World Bank data. Contrast that with the United States, where annual growth since the 2008 crisis has hovered around 2 percent, or Europe, where growth has been even weaker.¹⁷

India Maintains High GDP Growth Rate

Annual GDP growth rate, 2003–13



Source: GDP growth rate calculated from national accounts data from the World Bank and the Organisation for Economic Co-operation and Development; "World Databank," World Bank, accessed Nov. 8, 2014, <http://tinyurl.com/cq9guf3>

India's gross domestic product (GDP) grew by around 8 percent or more annually during most of the last decade, although that rate shrunk to about 5 percent in 2012 and 2013. During the 2008 global recession, India's GDP grew by 3.9 percent, then bounced back up to 8.5 percent in 2009—a stronger performance than

the economies of the United States and United Kingdom, both of which experienced negative growth for two years, followed by more-modest growth since 2010.

However, in 2011 India's growth rate had begun to slow, and by 2013, the value of the rupee plummeted against other currencies, job creation dwindled and inflation jumped to almost 11 percent as investors shifted capital out of the country.¹⁸ Reasons for the slowdown included government and economic institutions that were unable to handle the strains brought on by years of growth, as well as depressed demand from abroad, according to Raghuram Rajan, an economist who that year became head of the Reserve Bank of India, the nation's central bank.¹⁹

In the May 2014 election, amid discontent over government corruption and the lingering economic problems, BJP resoundingly defeated the governing National Congress Party. Modi promised to encourage foreign investment, job creation and infrastructure growth.

Many see a new era of economic hope. "India's growth rate is up for the first time in two years. India's stock market has reached historic highs. There is a sense that history may well look back and say, 'This was the time India began to undergo a rebirth,'" Ajay Banga, CEO of MasterCard and chairman of the Washington-based U.S.-India Business Council, said in October 2014.²⁰

Venkatesan and others say that India has challenges, but nothing that cannot be overcome with the right attitude.

"India is a difficult place," Venkatesan says, speaking in a telephone interview. "To succeed and thrive here, you have to have love for the country. You've got to love the people, the colors, the noise and energy. That makes the things that don't work much more tolerable. Otherwise it's quite intolerable."

The challenges of doing business in India are similar to those in any emerging market, he says. If investors conquer those problems in India, they can tackle them elsewhere.

"You can't say you want growth and won't deal with challenges," he says. "The reason it's an emerging economy is because it has challenges, so companies should get used to that and just deal with it."

As companies weigh the challenges and opportunities of doing business in India, these are some of the key questions under debate:

Weighing the Issues

Can India overcome corruption and red tape?

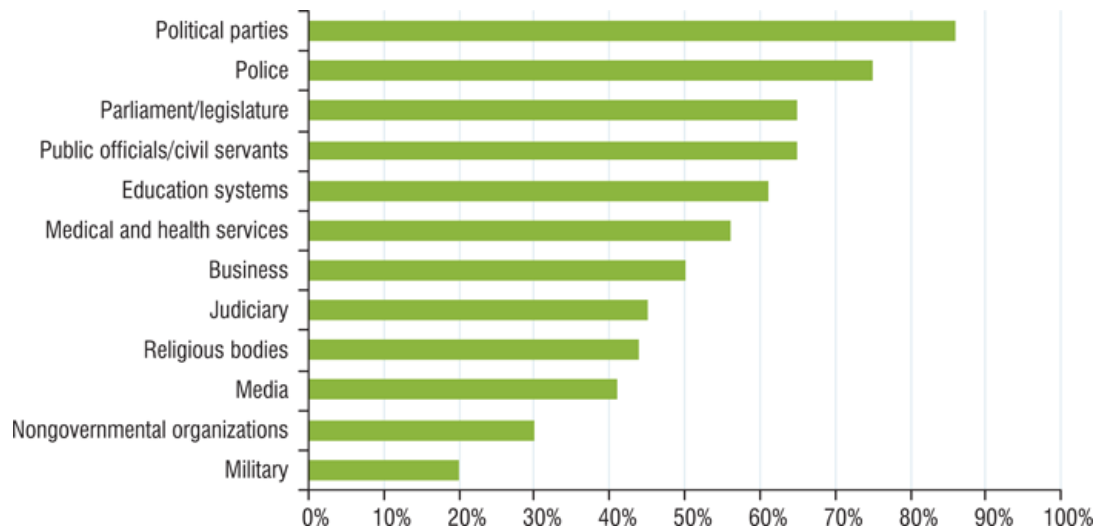
Like many other emerging markets, India has a reputation as a country that is difficult to navigate because of red tape and government inefficiency and corruption. Investors face two unpalatable options: Either succumb to pressures and bribe officials to get things accomplished while facing the risk of prosecution under the U.S. Foreign Corrupt Practices Act and other statutes, or follow international standards and risk losing business to less-ethical competitors.

"Bribery is still very rampant," says Singh of the Indian School of Business. "And there's also this uncertainty that if you pay someone, things may still not get done. Bureaucracy is the biggest problem coming in the way of growth in India."

India ranks a dismal 85th among 175 countries on the Corruption Perceptions Index, compiled by nonprofit global organization Transparency International.²¹ The problem has cost the country and its economy dearly. The World Bank estimates that 0.5 percent of India's \$1.9 trillion gross domestic product (GDP) is lost to corruption every year.²²

Indians Say Parties, Police Most Corrupt Institutions

Percentage who say institutions are corrupt/extremely corrupt



Source: "Global Corruption Barometer: India," Transparency International, 2013, <http://tinyurl.com/jvnr3ns>

Eighty-six percent of Indians say political parties are either "corrupt" or "extremely corrupt," according to a survey by Transparency International, a nongovernmental organization that monitors corruption globally. The country's police force (75 percent) had the second-highest rate, followed by Parliament and public officials (both 65 percent).

Corruption, mainly in government and its bureaucracy, is "forcing investors to rethink their India entry strategy and ... it is distorting the function of the free market and creating unfair competition in it," according to a report by fraud investigators at accounting firm Ernst & Young. A survey of executives in India, conducted for that report, found five top factors contributing to rampant corruption and bribery in India: weak law enforcement; numerous government "touch points"; complicated taxes and licensing system; reluctance to obtain licenses and approvals "the right way"; and gaining an unfair advantage in business.²³

Businesses, too, share the blame for fostering corruption. At the most basic level, the Indian government institutes rules and regulations and the businesses pay government officers to circumvent those rules. At the higher level, the government sells public assets, or makes business deals with private companies for kickbacks.

Corruption is deeply entrenched and is rooted in the political system, says Michael Kugelman, senior program associate for South and Southeast Asia at the Woodrow Wilson Center, a research group in Washington.

The epidemic spares no one, from the average Indian to big corporations and global organizations, and is often fed by a nexus of politicians, bureaucrats and business houses. In 2011, the country was rocked by the infamous 2G scam, which involved then-telecommunications minister Andimuthu Raja, who was accused of underpricing communications bandwidth to mobile phone companies in return for bribes. According to estimates, the scam cost the government nearly \$7 billion, making it the biggest graft episode in India. Time magazine ranked it among the top 10 abuses of power by business and government leaders globally over the years.²⁴ As of early 2015, a trial was still continuing.²⁵

"There's this whole system of patronage," Kugelman says. "Political parties think by doing favors to people they can ensure their support."

Forty-seven percent of Indians 18 to 21 years old say they have paid a bribe, according to a 2012 Hindustan Times survey.²⁶ In the 2014 version of that survey, youths ranked corruption as the biggest challenge facing the country.²⁷

Corruption can be traced to the country's colonial past, analysts say.²⁸ India inherited a cumbersome bureaucracy from the British when it became independent in 1947. The first government, under the leadership of Jawaharlal Nehru, implemented economic regulations to boost domestic markets. Those included the 1951 Industries Act, which required all new operations to obtain licenses from the central government.²⁹ Such government interventionist policies strangled foreign investment, harmed competition and encouraged bribery as part of doing business.

"Historically, the roots of India's corruption came from the proliferation of licenses," said Jagdish Bhagwati, a professor of law and economics at Columbia University. "The idea was to ensure economical use of resources, so you would not waste foreign exchanges. To this day, this is what Indians have been very aware of: that the institution of licenses and permits was responsible for creating corruption on a massive scale."³⁰

According to a white paper by Milwaukee-based law firm Foley & Lardner, the “complex administrative and bureaucratic environment” feeds perceptions that India is a corrupt place.³¹

Powerful bureaucrats, combined with weak law enforcement and judicial systems, have diluted the effectiveness of laws such as the Prevention of Corruption Act, which makes bribery an offense carrying fines and up to five years in prison. Businesses are wary of dealing with India's courts, and blame corruption on the inefficiency and “terrific powers” of the Indian bureaucracy, according to a report from an international consulting company.³²

Yet recent public uprisings against graft, the voting out of the Congress Party in 2014, and the passage of such measures as the 2013 Lokpal (Citizens'Ombudsman) bill, which creates an ombudsman aimed at curbing corruption and bribery in all levels of government, provide hope to many.³³ The Modi government is backing the universal use of the Aadhaar program for distribution of identification numbers. Inspired by the U.S. Social Security system, the Aadhaar program issues a unique number to individual residents, linked to fingerprints and retina scans. It aims to help the government track subsidies, including pensions, scholarships and social welfare programs. It's also used to track worker attendance in government offices. Experts believe that wider use of Aadhaar will help weed out corruption in government subsidies.³⁴

“Corruption can be overcome, and it's not as bad in India as it is made out to be,” says Pranjal Bora, partner at Luthra & Luthra, a leading Indian law firm. (Bora's views are his own and don't reflect company policies.)

According to the law firm Foley & Lardner, businesses can overcome corruption hurdles by tailoring solid risk management tools to the Indian market. That includes training employees and third-party partners on illegal conduct and how to avoid paying bribes. It also involves dedicating personnel and resources for a strong anti-corruption compliance program, including an effective system for reporting possible violations and for following up on problems.³⁵

“Companies such as Google, Amazon and Microsoft have been doing business here for a while now and have survived,” says Bora, largely by refusing to pay bribes. “There are issues that companies encounter, but you just have to put your foot down and say no to pay even a single penny.”

Such refusals might delay projects for a few days, Bora says, but, ultimately, work does get done.

Does the Indian labor pool meet the needs of modern business?

A cheap but educated workforce has been one of the biggest selling points for emerging India, which is home to the world's second-largest population after China's.

For instance, the country trains 1.5 million engineers of all kinds annually, according to estimates from the National Association of Software and Services Companies, an Indian trade association.³⁶ “There are phenomenally technically qualified engineers, who are articulate, speak English, [are] quick learners and very eager to please their managers,” says Ranjini Manian, founder and CEO of Global Adjustments, a relocation company, and author of “Doing Business in India for Dummies.”

It's not just engineers. In terms of availability of part-time or contract workers, India is ranked among the top six countries in a list of 75, according to a study by staffing company Manpower Group. It's also the most cost-efficient. “India's average monthly wages for contingent labor are significantly lower than many competing countries (\$121.37 per month),” Manpower reported. That's 68 cents per hour for contingent manufacturing labor.³⁷ The median annual per capita income in India in 2013 was \$616, compared with \$15,480 in the United States, placing India 99th among 131 countries.³⁸

“With such a rich and diverse pool of people, there are many talented individuals in many sectors—services, IT, manufacturing, health care,” says Kirdar of Moby Group.

Some industry experts say, however, that India's labor force doesn't meet the demands of modern businesses. The years spent in academia acquiring an engineering and technical background and a long trail of degrees don't always translate into great workplace skills.

“One of the greatest uncertainties in India is the depth and flexibility of its workforce,” said Eugene M. Makar in his 2008 book, “An American's Guide to Doing Business in India.”³⁹

A Wall Street Journal headline summed up the problem: “India Graduates Millions, but Too Few Are Fit to Hire.” According to assessment tests administered regularly by the National Association of Software and Services Companies, that article reported, India's high-growth global industries, including information technology and call centers, could not employ 75 percent of technical graduates and more than 85 percent of general graduates.⁴⁰

“The quality of education is highly suspect,” says Venkatesan, the former chairman of Microsoft India. “Many people with degrees are not necessarily fit to be out on jobs.”

Singh at the Indian School of Business says many of India's technical and higher-education institutions are run or owned by the government, politicians or businesses, which is problematic. They have captive customers in their students; teachers may not be well qualified.



"Professors have lecture notes that are 20 years old, with no pressure to improve," Singh says. "There's no incentive to bring competition, and students are left with no choice."

Each year, only a small number of graduates come out ready to move into the professional world, he says. "What you see in numbers is different from what the ground realities are," Singh says. "Yes, we have inexpensive labor, but companies have to mold them the way they want them to be."

The problem is worse among semiskilled workers, says Sharma of Tezpur University. "Unlike other countries, there are no strong vocational institutions here," he says.

Many companies, including Tata, the giant Indian manufacturing conglomerate, and Wipro, a Bangalore-based IT services firm, have opened their own intensive in-house training programs for recruits.⁴¹

Students attend a first-year economics honors class at the Indian School of Business and Finance in New Delhi, which is affiliated with the University of London and the London School of Economics and Political Science. (Melanie Stetson Freeman/The Christian Science Monitor via Getty Images)

India also has the lowest productivity of all leading countries in the Asia-Pacific region because of the number of total days of leave permitted, according to Manpower.⁴² In a country that celebrates diversity and democracy, there's seemingly a holiday for every occasion, and "bandhs," or shutdowns for political protests, are frequent. For instance, in 2014, central government offices observed 17 mandated holidays. In addition, there are state and local observances, religious holidays and political shutdowns of roads and cities. In comparison, U.S. federal government offices observe 10 annual holidays.⁴³

Employee retention can be a nightmare. A 2013 study by the Hay Group predicted that one in four employees would switch jobs that year. That was the highest attrition rate in the world at that time.⁴⁴ Venkatesan and others cite two reasons—the competitive market for good employees, and companies' failure to focus on retention.

"You have to make a massive investment when you are hiring young people," says Venkatesan, who like other business leaders says commitment to employees can help keep them. "When companies don't invest in their employees, they end up with revolving doors and a lot of attrition."

Is India's infrastructure developing quickly enough?

Prime Minister Modi has promised to lead an infrastructure boom, the kind that has been happening in neighboring China. In mid-2014, Modi announced plans to spend \$700 million to establish a 1,006 mile freight route on the nearly 1,560-mile Ganges River. He also proposed spending billions of dollars to build roadways and urban infrastructure.⁴⁵

Infrastructure problems have been the biggest barriers to the country's economic growth, experts say. Broken bridges, unreliable communications and nonexistent roads have deterred entrepreneurs and investors. Successive governments have promised to invest in huge projects, but results have been difficult to see. For its infrastructure, India ranked 71 out of 148 countries in the World Economic Forum's most recent "Global Competitiveness Report."⁴⁶

Projects often miss deadlines and get snared in bureaucratic webs. The ones that do make it through approvals and construction, such as the Golden Quadrilateral, India's largest highway project, are not maintained properly.

The lack of adequate infrastructure has plagued India for years, said Makar in his book “An American's Guide to Doing Business in India”—“especially in terms of how it holds back economic growth and condemns hundreds of millions of people to a third-world existence,” he wrote.⁴⁷

Others agree.

“It remains the biggest concern,” says Saibal Sen, senior assistant editor at the Times of India in Kolkata. “The Golden Quadrilateral project was initiated by the Atal Bihari Vajpayee government in 2001, and now a decade and a half later, the states and the center are yet to decide on a mechanism on who repairs and maintains the national highways.”

Commuters can sit for hours in traffic getting to and from the office. In Bangalore in southern India, Western firms have threatened to pull out of projects and joint ventures (and some have withdrawn) due to fears that it is impossible to get around with any kind of efficiency.⁴⁸

In a country as diverse as India, developing uniform transportation and supply systems overnight is impossible. In many rural areas, camels, elephants and country boats still provide transportation, and electricity and clean drinking water are luxuries. In larger cities such as Delhi and Kolkata, rail lines, trams and fancy cars ferry people between home and work.

History explains the huge divide.

“Post-independence, the government led a state-centric approach to infrastructure development by building, owning, and managing projects,” according to a report from the Council on Foreign Relations, a think tank with offices in Washington and New York City. “The system created a host of inefficiencies.”⁴⁹

In the early 1990s, as part of economic liberalization, the government finally opened the sector to private investment. But much of the private investment went to city centers, further widening the gap between urban and rural India.

“Urbanization has been so rapid and aggressive in certain parts of India that it leaves behind other areas,” says Kugelman at the Wilson Center.

Buying land and securing environmental clearances remain difficult. “Acquiring land is one of the biggest hurdles in India,” says Aniruddha Bagchi, associate professor of economics, finance and quantitative analysis at the Kennesaw State University Coles College of Business in Kennesaw, Ga. “The previous government passed some bad laws, [creating] unrealistic hurdles.”

Among other requirements, the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act of 2013 mandates that the government obtain the consent of at least 80 percent of affected families when it is acquiring land for the use of private companies.

Former India Microsoft Chairman Venkatesan wrote in 2013 that the most recent overhaul of the Mumbai airport alone resulted in 220 property, labor and environmental disputes. Antiquated laws have resulted in overflowing drains, pothole-laden roads, congested airways and ports and a weak railway system, he said. Red tape, corruption and inefficient governance have also blocked projects.⁵⁰

One of the worst threats to India's growth, according to its government and business community, is the chronic electricity shortage. According to a Council on Foreign Relations report, while GDP growth zoomed at around 8 percent annually until 2010, electricity generation increased only 4.9 percent per year.⁵¹

Power generation faces new complications, Bagchi says. “The Supreme Court canceled the licenses of [hundreds of] coal mines, so there is a lot of coal sitting in the country and no one to mine,” he says. “Thus power plants are not running on full capacity.”

In August 2014, the court said almost all coal mining licenses awarded to companies by the government since 1993 were granted illegally, without competitive bidding. Auditors had found that the government lost \$33 billion by selling the licenses too cheaply through secretive, corrupt processes.⁵² Although the government has controlled the coal industry since 1973—the state-owned Coal India Limited is the largest producer and only seller of coal—some companies were allowed to open mines for their own private use.⁵³ The government has since moved to allow foreign investment in coal and has sold shares in Coal India.⁵⁴

Infrastructure development is essential to attract manufacturing and foreign investment, and the Modi government is pushing ahead with its development agenda. For instance, the government awarded contracts to build about 1,156 miles of highways in the first five months of 2014. Between April and August 2014, power generation capacity increased by 8,400 megawatts, nearly 47 percent of what was achieved in all of the previous year, according to The Economic Times.⁵⁵

“Corporate investment is recovering swiftly as business confidence has been boosted by the decline in political uncertainty and the commitment by the government to reduce red tape,” according to the Organisation for Economic Co-operation and Development (OECD), the Paris-based multigovernment economic development group. “Efforts to put large stalled infrastructure projects back on track are also beginning to pay off.”⁵⁶

"I think the situation is improving," says Acharya, the Map My Genome CEO. "It will take time, but I am not very worried; there's enough going on that will contribute toward overall infrastructural development."

"In a few years, I don't think infrastructure will be an issue," says Singh of the Indian School of Business. "The new government under Prime Minister Modi is very serious, and they are moving aggressively to relieve the infrastructure bottlenecks. Unlike previously, projects are getting cleared in a time-bound manner."

Kugelman says the Modi government should concentrate on finishing the projects that the earlier National Congress government started.

"I think if he starts with the low-hanging fruit, the country would see a fair amount of progress relatively quick," Kugelman says. "Otherwise, it would be basically like destroying a sand castle and building from scratch."

Background

An Ancient Civilization

Trade between India, the Middle East, Africa and Western Europe dates as far back as 3500 B.C., according to historians. The ancient Indus Valley's economy depended on trade, supported by a well-developed transportation system.

"No golden tombs, no fancy ziggurats. Four thousand years ago city builders in the Indus Valley made deals, not war, and created a stable, peaceful, and prosperous culture," wrote science journalist Shanti Menon.⁵⁷

They used ships to transport goods, mostly metals, to Mesopotamia in the Middle East, where the land was known as Meluhha.⁵⁸

Later, political unification and enhanced military power under the Mauryan Empire circa 320 B.C. helped lead to a unified economic system and a common currency in most of the Indian subcontinent, giving a huge boost to trade. When the Mauryan Empire collapsed in 185 B.C., India was left with small, isolated kingdoms until the founding of the Gupta Empire in 320 A.D.

Called the Golden Age, the Gupta Empire was one of the most important in Indian history because of the kingdom's major advances in science, mathematics, medicine, architecture and the arts. Among other achievements, Gupta scientists invented the number zero and developed the 365-day calendar.⁵⁹

Medieval Period

The next great empire to emerge was the Mughal in the 16th century. Mughal emperors such as Akbar (who ruled from 1556 to 1605) linked various parts of the country through an efficient road system and abolished many inland tolls and duties.⁶⁰ They also had been pioneers of trade in their Central Asian homeland and brought that spirit to India. Quickening economic activity in India occurred during the great age of exploration, when new sea routes were being discovered and foreign trade was growing.

Mughals laid out the red carpet to the foreign trader, gave them protection and security for transactions, and levied a very low custom duty (usually no more than 2.5 percent ad valorem).⁶¹ Indian exports consisted mainly of manufactured articles, such as cotton cloth and saltpeter. India exported cotton to almost half the world. The principal imports were bullion, horses and luxury goods, such as raw silk, precious stones and European wines. Under the Mughals, India's economy was the biggest in the world. In 1700 it commanded nearly 25 percent of the world GDP, more than China or the nations of Western Europe combined, according to Maddison.⁶²

Colonial India

Beginning in the late 1400s, traders from Portugal, France, Holland and England established trade centers along India's coasts. They slowly gained political power and turned these trade centers into colonies.

The East India Company, a trading firm founded by a group of English merchants in 1600, was the most successful of the foreign business entities: Through plunder, military force and diplomacy, the company gained power and wealth in the 18th century. But its very success led to massive military expenditures, and the East India Company's financial troubles brought greater British government involvement in Indian affairs.

Slowly but steadily, Britain extended its rule over India. After the British crushed the native rebellion of 1857–58, the East India Company was dissolved and India became a Crown colony, governed by the British Parliament.⁶³

Colonization set India's economy back, as the British government created tariff and trade policies with British businesses in mind. "The British were not averse to Indian economic development if it increased their markets, but refused to help in areas where they felt there was conflict with their own economic interests or political security," British economist Maddison said.⁶⁴

"Undoubtedly, this was a period of remarkable stagnation that cannot be explained as a result of normal business cycles," wrote Bagchi at Kennesaw State University.⁶⁵



The Taj Mahal in Agra, a renowned symbol of India's culture, is considered the most spectacular example of Mughal dynasty architecture and one of the most beautiful buildings in the world. The white marble mausoleum was built between 1631 and 1648. (Keating Holland)

Besides boosting British interests, the English erected huge barriers of entry for Indian entrepreneurs. During the British Raj, India went from being an exporter of finished products to an importer of raw materials. According to Maddison, India's share of the world income fell from 24 percent in 1700 to 4 percent in 1950.⁶⁶

Post-Independence

In 1947, India became independent. Besides setting Soviet-style development plans, the government controlled the airlines, railroads and local transportation and communication services, while small and medium-sized companies dominated the private sector. Most transportation and communication services, such as airlines, postal, telephone and telegraph, and radio and television broadcasting, were under the government's control, as were education and health care.

In an attempt to improve infrastructure, agricultural production, health care and education, India adopted five-year development plans after the Soviet model, but progress was slow because of a lack of capital formation, Cold War politics, rising defense expenditures and an inadequate infrastructure unable to keep pace with a growing population. Because of government restrictions on trade and international investment, India failed to benefit from trade.

India nationalized its banking systems in the late 1960s and early 1970s. The country began producing industrial goods that formerly were imported. Unlike other developing countries at the time, India maintained macroeconomic policy discipline and didn't suffer hyperinflation.⁶⁷

Growth improved in the 1980s. During the decade, the economy grew at an average annual rate of 5.7 percent.⁶⁸ Social services, agriculture, transportation and mining were the focus of public-sector funding. Prime Minister Rajiv Gandhi advocated for the development of technology.⁶⁹ Private savings drove most of the investment, but, in the mid-1980s, private savings slipped and India had to rely on foreign borrowing. Excessive borrowing led to a balance-of-payments crisis leading up to 1991. India's foreign reserve plummeted to \$1 billion, bringing India close to defaulting on its payments.⁷⁰ To get loans from the IMF and the World Bank, India airlifted its gold reserves to the United Kingdom and Switzerland. In 1991, the government introduced its first steps toward liberalization.

Liberalized Economy

Much of India's economy today is shaped by what happened in the 1990s, when the government expanded the role of private and foreign investment and adopted market-oriented policies. The reforms gradually freed the domestic economy from state control. The nation's leaders identified business as the engine of growth and began to see the private sector as the primary means of increasing efficiency in the marketplace, according to Montek S. Ahluwalia, an economist who was a member of the Indian planning commission at the time.⁷¹

Reform moves included relaxing licensing procedures; increasing foreign stakes in Indian firms to 51 percent in some sectors and to 100 percent in other areas, including infrastructure, power, oil exploration and telecommunications; allowing private banks to set lending rates; relaxing regulations on foreign capital financial flow; reducing the average tariff rate from 150 percent to 50 percent; devaluing the rupee; and drastically reducing government investment in social programs.⁷²

Although the changes seem many and drastic, the process was slow and gradual. "The more impatient of my friends often argued that it was more like glacialism, because you could barely see the movements taking place," Ahluwalia said.⁷³

Here are some of the major changes:

- **Industrial policy:** The biggest shift was perhaps in India's industrial policy, where the central government loosened controls and



Microsoft CEO Steve Ballmer, left, and then-Microsoft Chairman Ravi Venkatesan address a press conference in New Delhi in 2010. The two discussed jobs that could be created by Microsoft's expansion into cloud services. (Raveendran/AFP/Getty Images)

introduced deregulation to increase competition and efficiency. Except for a few industries deemed hazardous or environmentally sensitive, central-government licensing was abolished. Industries on the public-sector list were reduced from 18 to the three of the most sensitive ones: defense aircraft and warships, atomic energy generation and railway transport.⁷⁴

Trade policy: For decades, the government banned the import of manufactured consumer goods, and high tariffs and pervasive import restrictions underlaid India's trade policy. To ferry goods into the country, an importer needed a license, and the process for acquiring one was opaque and encouraged corruption. The economic reforms reduced import duties and sought to phase out licensing. "One of the most important steps undertaken

in 1992 was to shift the basis of regulating imports from a positive list of freely importable items to a limited negative list in 1992," according to a 2012 report for the U.N. Conference on Trade and Development. "Now, except the products listed in the negative list, all other products could be freely imported."⁷⁵ Among other things, the changes allowed the import of foreign technology.

- **Financial sector:** Reform opened the banking industry, largely made up of nationalized banks, to foreign and privately owned institutions. It also removed controls on interest rates and relaxed bank reserve and liquidity requirements.⁷⁶ Even now, though, state-controlled banks dominate the formal financial sector, although informal financial operations such as moneylenders maintain a major role, especially in poor rural areas.⁷⁷

After the economy opened up, India attracted much more investment, especially in the IT sector. Globalization and liberalization have turned the country into a huge consumer market. With the help of its skilled workers, the country has developed a robust service sector and became known as "the back office to the world."⁷⁸

In January 2015, during his second visit to India, U.S. President Obama lauded the nation's progress and drew parallels between it and his own country. "As societies that celebrate knowledge and innovation, we transformed ourselves into high-tech hubs of the global economy. Together, we unlock new discoveries—from the particles of creation to outer space—two nations to have gone to both the moon and to Mars. And here in India, this dynamism has resulted in a stunning achievement. You've lifted countless millions from poverty and built one of the world's largest middle classes."⁷⁹

Current Situation

Lower Energy Prices Boost Consumer Spending

India is a big importer of fuel, so falling oil and gas prices worldwide mean business costs have dropped and consumers have more money to spend.⁸⁰

"One of the main bottlenecks holding back the Indian economy was the energy sector," Bill Adams, senior economist with the U.S.-based PNC Financial Services Group, told The Wall Street Journal. "That seems to have now eased." According to Adams, India's electricity output jumped to a record high, as the country is able to buy more oil and gas to fuel its power stations.⁸¹

The increase in power generation is a welcome sign for manufacturers and investors, who are often anxious about dealing with blackouts in plants and factories. In October, according to a government report, output in eight core infrastructure industries grew 6.3 percent compared with the previous month; greater coal production and electricity generation drove the increases.⁸²

Labor Reforms



Indian Prime Minister Narendra Modi, seated left, and U.S. President Barack Obama chat during a parade celebrating Republic Day in New Delhi in January 2015. The holiday commemorates the date India's constitution took effect. (Pete Souza/White House)

India's labor laws date back to the colonial era. The government has proposed revamping those archaic labor laws to boost job creation, especially in the manufacturing sector. Announcing his labor reform proposal, Modi said, "For the success of 'Make in India,' ease of doing business should be given priority."⁸³

Not everyone is happy about the proposed changes, which aim to streamline rules about how to treat workers. Labor unions are among the leading opponents, including Bharatiya Mazdoor Sangh (BMS), also known as the Indian Workers Union, the nation's largest alliance of unions. BMS has denounced the labor law amendments and is also skeptical about the government's proposal to increase foreign direct investment in railways, insurance and defense. A number of central trade unions have joined together to fight what they call the government's "anti-worker policies."⁸⁴

As part of the reforms, the Labor Ministry is beginning a skill development program to cater to the manufacturing sector, whereby

the department will finance a two-year apprenticeship program for workers. The government also announced a revamped system so workers can change jobs more easily and move across state lines while still receiving the benefits of payroll-financed pension savings.⁸⁵

Modi's proposed changes included greater accountability in business inspections to cut down on harassment by unscrupulous inspectors. Additionally, companies would be able to file a single compliance report online pertaining to 16 labor laws.

Business interests in India applauded the labor reform announcements. "This is something industry would welcome very strongly and has been awaiting for a long time," said Bidisha Ganguly, chief economist at the Confederation of Indian Industry.⁸⁶

Infrastructure Ambitions

India is gearing up for changes to its roads, villages and urban centers. As a start, on Oct. 2, 2014, the government launched a clean India campaign, where bureaucrats, politicians (including the prime minister) and regular citizens took to the roads, broom in hand, to clean neighborhoods and street corners.⁸⁷

Modi also has announced plans to build 100 high-tech "smart cities," as well as bullet trains, highways, waterways, power plants and high-speed networks.⁸⁸

While those plans were praised by many, skepticism is setting in, given India's record building infrastructure. Nearly half of India's major infrastructure projects are delayed, according to government estimates.⁸⁹ The Modi government is wooing international investors to fund the projects it envisions.⁹⁰

The government also is attempting to change the nation's financial infrastructure. In August 2014, Modi announced a push to provide bank accounts to every Indian household. Nearly 40 percent of Indian families, especially in remote rural areas, do not have bank accounts.⁹¹

At a loftier level, Modi has said he wants to expand the nation's space program, which is small compared with others but is still one of the world's most successful. In September 2014, India put a spacecraft into orbit around Mars. Only the United States, Russia and the

European Space Agency have reached Mars. ⁹²

Privatization

In response to chronic coal shortages, the Modi government has announced plans to open the closely controlled coal industry to outsiders for the first time in four decades. Foreign companies, which are registered locally, will have access to mining and will be allowed to sell coal when commercial mining is permitted. Until now, only the state-owned coal firm could sell coal. The opening up of the coal industry is expected to send private coal production soaring, to about 441 million short tons by 2019. In 2013, private companies produced less than 50 million tons. ⁹³

Although the government budget announced in July 2014 disappointed investors and analysts because it lacked details and early progress on fixing structural economic problems, the reform proposals have somewhat reinforced trust in the new government. ⁹⁴ The economy is improving and inflation is abating. Indian shares, bonds and rupee have performed well in response to the new economic policies.

But, Modi still has far to go.

“A generation of aspirational, educated youths all below 35 years of age form nearly 60 percent of the population. They are restive and want results,” says Sen at the Times of India.

He says Modi has no option but to deliver: “There is no middle path, for he has raised expectations.”

Looking Ahead

In its October 2014 World Economic Outlook, the IMF projected that Indian economic growth would accelerate from 5.6 percent in 2014 to 6.4 percent in 2015. The IMF forecast that India would become a \$2 trillion economy in 2014, which would make it the 10th biggest in the world. By 2019, it's expected to top \$3 trillion. ⁹⁵

In late 2014 and early 2015, fuel and food prices dropped (as did the overall inflation rate), encouraging consumers to spend more.

For a sustained turnaround, though, the government has to boost infrastructure projects, beef up the manufacturing sector, rid the country of archaic laws and reduce red tape and corruption, analysts say.

“As long as the Modi government can make the manufacturing revolution happen, we will again be on the 8 to 10 percent GDP growth rate within the next few years,” says Bagchi of Kennesaw State University.

Bagchi says India needs faster job growth and targeted social and infrastructure development to rid the country of poverty and uneven growth. In certain parts of India, where growth never happened, Maoists and secessionists are gaining ground and disrupting peace. If that continues, it will hurt India's ability to attract investment and sustain economic growth, he says.

Despite the early enthusiasm over Modi and his economic policies, there are doubts about what one man can achieve. India's growth rate slid in the third quarter of 2014. Manufacturing remained stagnant, growing just 0.1 percent, dampening the promises of the new government to turn India into a manufacturing giant. ⁹⁶

Singh at the Indian School of Business says that even though those hurdles are real, he is optimistic. “I am way more hopeful about the economy today than I was right before the elections,” he says. “These guys [BJP] are not like typical politicians; they are a bridge between politics and businesses and they can get things done.”

Kugelman at the Wilson Center urges caution. India is a huge, complicated place with no guarantees the new government can achieve success, he says. Structural hurdles such as corruption, vested interest and bureaucracy will make it difficult for it to move very quickly, he says. “I am quite skeptical.”

Chronology

1600–1885	India becomes a British colony.
1600	East India Company receives English royal charter to trade in India.
1757	East India Company wins Battle of Plassey over the Nawab of Bengal and begins consolidating its rule.
1858	Mutiny against the East India Company fails; India comes under the direct rule of the British Crown.

1885	Indian National Congress is founded, an outcome of rising nationalism.
1900–1950s	India gains independence and creates a centralized economy.
1920	Mahatma Gandhi launches civil disobedience movement against the British. Boycotts of British goods follow.
1939–43	India's government gives limited powers to provincial governments to provide necessities of life. Famine strikes in eastern and southern India. ... War and other crises disrupt international trade.
1947	India gains independence from the British Empire. ... The first prime minister, Jawaharlal Nehru, crafts inward-looking, centralized economy, with the goal of achieving rapid industrialization. ... "License Raj"—a complex system of licensing and controls—is established.
1948	Industrial-policy resolution of 1948 lays out vision for state-controlled industrial development.
1951	Inspired by the Soviet Union, India embarks on its first five-year plan; its focus is on agriculture, irrigation and power projects.
1956	The second five-year plan turns to industrialization and also sets social goals. Industrial production increases at an average of 6 percent per year over the next decade.
1960s–1970s	The nation's economy struggles.
1961	The third five-year plan seeks to raise national and per capita income levels and expand the industrial base. ... Corruption sets in; excessive state controls, expanding red tape and growing inefficiencies also plague the economy. Private investment dwindles.
1967	India launches its Green Revolution, emphasizing irrigation and hybrid seed development.
1973	Rising oil prices hurt India, a large importer, throughout the decade.
1980s–1990s	<u>India undertakes economic reform.</u>
1981	Public-sector spending increases on social services, agriculture, transportation. ... India gets \$5.68 billion loan from International Monetary Fund.
1985	India begins limited economic liberalization under Rajiv Gandhi, especially in the technology sector.
1991	India airlifts gold to secure loans to meet balance-of-payments crisis. ... "Structural adjustment policies" dictated by international development organizations begin. ... The government sells off more shares in its companies and welcomes foreign investment.
1995	Gross domestic product grows by 7.6 percent, inflation falls, information technology sector booms as economic reforms pay off and India becomes a major exporter of software.
2000s–Present	Deregulation and decentralization continue.
2000	India launches States Fiscal Reforms Facility to help states reform fiscal policies, set up economic zones and establish high-tech industry, such as software parks.
2005	The Telecom Regulatory Authority of India cuts tariff for international communication.
2012	India's economic growth slows some after years of strong increases, leading to sharp increases in inflation and drops in the exchange value of the rupee in 2013; national discontent rises.
2014	The Bharatiya Janata Party comes to power and Prime Minister Narendra Modi promises a new India that welcomes business investment. He also launches labor reforms and proposes infrastructure projects.
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Organizations

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Industry-led and -managed organization that plays an active role in India's development process.

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<http://dipp.nic.in/English/default.aspx>

Indian government agency charged with facilitating flow of investment and technology and monitoring industrial development.

Embassy of India

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Official Indian government presence in the United States that provides advice to American companies on Indian products and export/import rules and regulations; also assists Indian businesses in dealing with U.S. trade policies.

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Nongovernmental, not-for-profit organization that serves as voice of India's business and industry.

Franchising Association of India

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Nonprofit group of franchising-related interests in India.

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Government-run group whose primary aim is to accelerate the pace of foreign direct investment in India.

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Indian government commission that assesses resources in the country and prepares plans for effective and balanced use of resources for economic growth.

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