India Business Service Center

Demystifying India*

Opportunities and challenges of doing business in India

Foreword

Dear Reader,

I am pleased to present "Demystifying India," a whitepaper documenting the enormous opportunities India offers, as well as the obvious and not- so-obvious challenges and risks of doing business in India.

The ascent of the Indian economy has stunned the world. Despite initial scepticism, India has managed to not only maintain growth, but to accelerate it. With growth in emerging sectors such as retail, infrastructure, healthcare services, auto and energy over the last six years, Indian industry has seen a new avatar. The Indian IT industry—which gave a new meaning to cost savings— has been a focal point of the success story. Increasingly, India's growth opportunities are capturing the attention of CEOs worldwide. Growth in India is being fuelled by increasing spending power of Indians, both at home and abroad. The mega-cities of India are exploding, fuelled by a rising middle class.

Yet India still faces big challenges. Continuing social unrest in parts of the country puts a question mark on the atmosphere of optimism. Business leaders want reassurance that change in political disposition won't affect the policy of liberalisation. Regulatory hurdles coupled with corruption and red tape make doing business a challenge. Infrastructure remains poor. Even today, doing business in India is intimidating for many.

But these hurdles must not stop multinational companies, institutional investors and entrepreneurs from exploring and investing in the world's most promising and fastest-growing economy. Several have harnessed India's expansion by successfully entering the market at an opportune moment, while others' entry plans have faltered. Recognising the reality that market entry strategies that worked well elsewhere have been less successful in India, this paper sheds light on the truths and myths about growth and cost-saving opportunities and challenges in India.

Happy reading!

Yogen Singh
Director, PricewaterhouseCoopers

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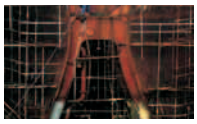

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Executive summary

Most Western multinationals have traditionally viewed India as an attractive destination for off-shoring or outsourcing business processes to reduce costs. While this has been and will continue to be a sustainable tactic, the cost arbitrage advantages are decreasing, due primarily to rapidly rising direct and indirect labour costs.

After years of rapid economic growth and favourable demographic conditions, the number of Indian households with substantive spending power has steadily increased. The major opportunity India now presents is the exponential growth in its consumer and business markets. If current economic trends continue, India is poised to become one of the world's largest consumer markets.

Our research indicates that key growth sectors include Organised Retail, Telecommunications, IT and IT Enabled Services, Energy and Utilities, Healthcare, and Infrastructure (both hard and soft). In addition to the sector-specific growth drivers indicated in our analysis, growth will be largely driven by macro-economic factors, including consumption by the growing middle class, continued liberalisation of the economy, government incentives for investment and improved infrastructure.

In pursuit of growth, Western multinationals can no longer afford to ignore the potential India presents. The knowledge about doing business in India that foreign firms have acquired by relocating their business operations to India (the cost perspective) is valuable. Multinationals must now utilise this knowledge to capitalise on India's growth opportunities.

A number of options to entering the Indian market exist. These include establishing a greenfield operation, entering a joint venture with an Indian partner, or acquiring an existing Indian business. Outside of regulatory constraints which mandate a particular mode of market entry, our analysis shows that while a joint venture can present a low-cost, low-risk market entry, it nonetheless poses significant risks. Only a few joint ventures established in India since 1993 survive. Key reasons behind the demise of the partnerships are the partners' divergence of strategic interests over time and the Indian partner's inability to invest sufficient resources to enlarge the business.

An acquisition strategy can mitigate some of these risks, but it is a much more costly option especially given the projected growth of many Indian firms today. A Greenfield operation, on the other hand, means building supplier and distribution networks, which are long-term processes in a country where relationships are key. In addition, with the red tape that still remains in the Indian regulatory environment, obtaining an operating license can be costly and time consuming.

From a cost perspective, India has emerged as the worlds' preferred location for business process outsourcing by offering the best combination of cost, quality and scalability. The abundance of young, skilled, English-speaking workers is one reason companies increasingly outsource to India. As global outsourcing has matured, however, the focus has evolved from pure cost reduction to exploiting value-added opportunities. In response, India is emerging as an offshore hub for knowledge services such as legal research, engineering R&D, content development, Pharma R&D, data analytics, equity research, and finance and accounting. Manufacturing outsourcing is another area where India's unique combination of low wages and skilled manpower is attracting success. Industries with immense potential for outsourcing manufacturing to India include automotive, chemicals and electronics.

While companies have achieved unprecedented savings by outsourcing to India, the industry faces challenges that may hamper future growth. These include significant attrition levels among the labour force, inadequate hard and soft infrastructure, and information security issues such as confidentiality breaches.

Before you embark on your journey to India, you must consider factors including the nature and size of your firm, its propensity to bear contractual and investment risk, the extent of market potential, market entry options, the most appropriate location for your operations, and legal, regulatory and tax aspects. Capitalising on the opportunity India presents while mitigating the inherent risks requires a thorough assessment of the Indian business environment.

Chapter 1
An overview of India

Introduction

The Indian economy is on a long-term bull run. Over the past decades, India has developed rapidly in terms of political stability, education and technology, and with its demographic advantages, the country is poised to become one of the major growth engines of the 21st century.

With GDP growth at 9.2% in financial year 2006-2007, India is one of the fastest growing economies in the world.

India is also home to the world's youngest population with the median age of 24 years. A growing working population with good English-speaking skills is providing consumption "fire power" as Indians buy and use more than ever before.

Vital statistics

Size	3.3 million square kilometres
Population	More than 1.1 billion people
Political set-up	Parliamentary democracy
Fundamental rights	Guaranteed by the constitution
State religion	Secular state; no state religion
Union of India	28 federal states and 7 union territories
Independent judiciary	Supreme court - highest judicial authority in India; well-established juridical system
Language	Official language is Hindi, but English is the preferred language for conducting business and is widely read and spoken

Source: PwC

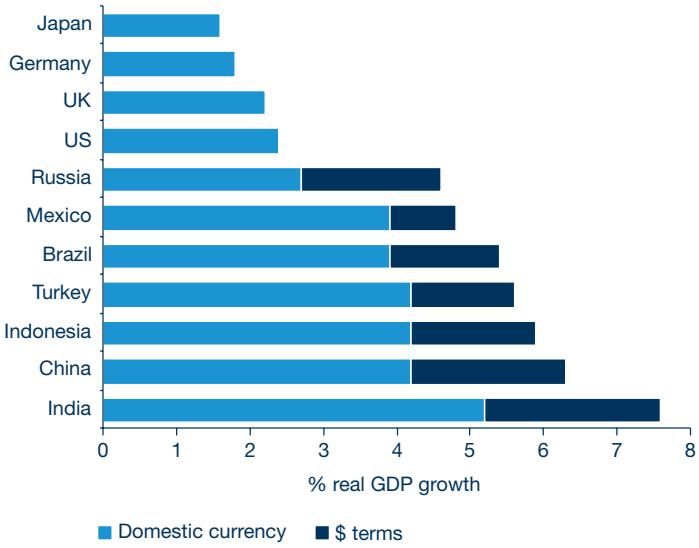
90% of CEOs from India say that they are 'very confident' about the prospects for growth in the next 12 months

PwC 11th Annual Global CEO Survey

India: A Global player

> "The question for CEOs the world over is no longer 'Should my company go to India?' but rather 'Can my company afford not to be in India?'." - Kamal Nath, Minister of Commerce & Industry, India

India is currently the fifth-largest economy (in PPP terms) in the world following the United States, (US), China, Japan and Germany.[1] By 2032, India is projected to be among the three largest economies in the world.[2] Continued economic growth is anticipated.



Projected average real GDP growth: 2005-50
Source: PwC

India has among the highest returns on foreign investment in the world,[3] and in 2005, India displaced the US as the second most favoured destination for Foreign Direct Investment (FDI) after China.

Furthermore, according to the latest survey on Global Services Locations, India is rated the best offshore location in the world. The survey analyzes locations worldwide based on cost, people skills and availability, and business environment.[4]

India is as an ideal catalyst for investors to enter the Asian market, which no global player can now afford to ignore.

The Indian culture and tradition

India has a distinctive culture which has been shaped by centuries of rich history, unique geography and the ideas of both its indigenous inhabitants and immigrants. This diversity is reflected in the great assortment of languages, cultural practices and traditions.

Indian society is generally conservative with an emphasis on family values and traditional beliefs. Strict protocols exist, and people are accustomed to hierarchies with a strong sense of "following the leader." Formal titles such as "sir" and "madam" are typically adhered to, while respect for older people regardless of their positions in the workplace is mandatory.

Capital markets

India is home to 22 stock exchanges which operate across the country. The Bombay Stock Exchange (BSE), the oldest stock exchange in Asia, is the largest exchange in India with about 4,900 listed companies.[5]

In terms of annual transactions, the BSE ranks fifth in the world, making it one of the most active global exchanges. The exchange has also experienced exponential growth with a four-fold increase in trading volume over the last 15 years. Growth has been fuelled by foreign companies that are now allowed to own majority shares in almost all industries.

Growth drivers

The strong and vibrant Indian economy is largely the result of:

Political consensus on the economy

A democratic government with a political consensus on economic reform and growth has resulted in the dizzying pace of the economy, driven by buoyant activity in the manufacturing and services sectors.

Consumption by the growing middle class

An exponential increase in the population and increases in disposable income among the quickly growing middle class also continues to drive the Indian economy. Furthermore, international demand for Indian goods and services has increased over the last few years.

1 World Bank
2 Goldman Sachs, 2003
3 US Department of Commerce
4 A.T. Kearney, 2005
5 Bombay Stock Exchange Limited, 2007

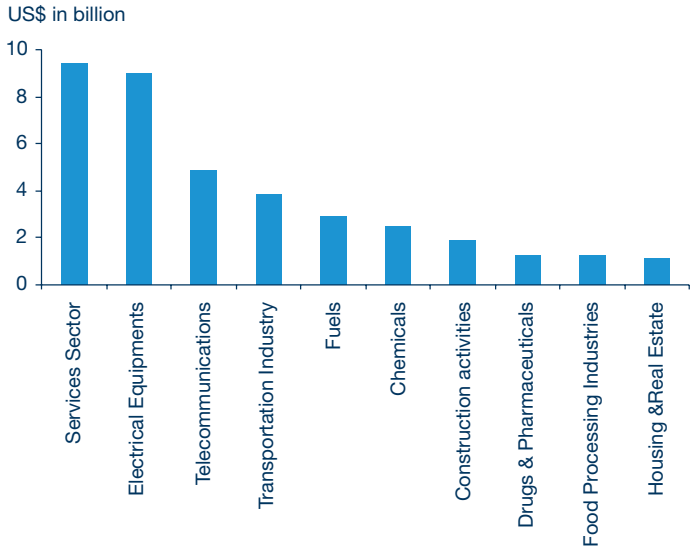
Liberalised economic regime

Through the Statement on Industrial Policy of 1991, the Indian government embarked on liberalising the Indian regulatory framework with specific reference to foreign investment. Since then, the Indian regulatory environment for foreign investment has been eased consistently to make it increasingly investor friendly.

Barriers to trade and investment are coming down. The peak customs duty rate is down to 10% in 2007 (for non-agricultural and other specified goods). Customs duty rates are now nearer the ASEAN rates of between 8-10%. India's trade has been increasing rapidly, growing at an average annual rate in real terms of around 13% over the last 10 years – twice the rate of overall world trade.

An example of the economy-wide liberalisation is that the government removed bureaucratic controls on industries. Licensing has been completely abolished except in five industries: distillation and brewing of alcoholic drinks; cigars and cigarettes of tobacco; electronic, aerospace and defence equipment; industrial explosives and hazardous chemicals.

The interest shown by global companies, in the form of FDI, suggests that these strategies are indeed working. During FY 2006-2007, India received an estimated $16 billion in FDI inflows, growing three-fold over the previous year. Recently proposed initiatives to enhance FDI flows in sectors that were previously restricted also make India a more globally competitive destination.



Sectors attracting the highest FDI equity inflows (cumulative inflows 1991–2007)
Source: Indian Ministry of Commerce and Industry

Strong Judicial system

Based on English common law, India's legal system is familiar to Western investors. The exhaustive legal framework governs all aspects of business. The government is also modelled on the British parliamentary system, with influences from the rest of Europe and the US. The Supreme Court forms the apex body of the Indian judicial system. Normal legal risks are furthermore tempered by the presence of independent courts, politicians and a free press.

Improved infrastructure

Recent years also saw robust infrastructure investment by the Indian government supported by additional investment and tax incentives for promoting infrastructure development. The Indian government plans to spend about $500 billion on infrastructure over the next five years and nearly double the rate of investment in the sector to 9% of GDP.[6]

Natural resources

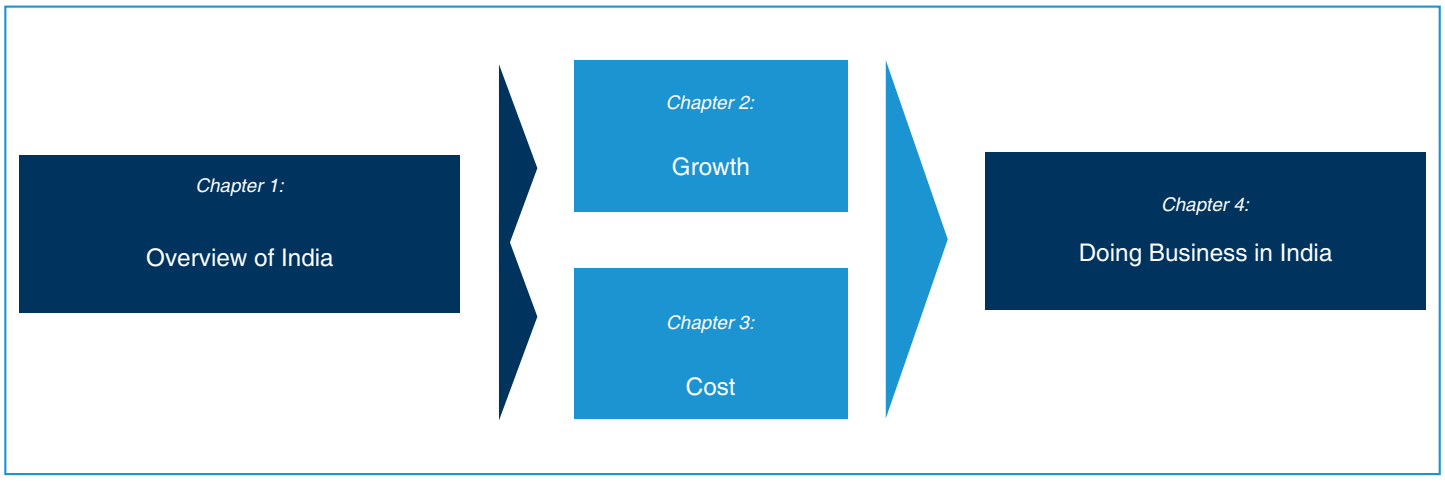
Untapped natural resources, a rich mineral base, an agricultural surplus and a huge manufacturing capability are seen as additional drivers behind the Indian growth story. Rich coalfields backed by an oil and gas reserve form the backbone of the Indian energy sector. Furthermore, India has large reserves of primary metal ores such as iron, bauxite, chromium, manganese and titanium.

Opportunities from a cost and growth perspective

Investors continuously seek to do more with less. Companies seek sales growth as well as bottom-line improvement through cost reductions. Developing a cost-reduction strategy that maximises efficiency, without compromising growth potential is a tricky proposition.

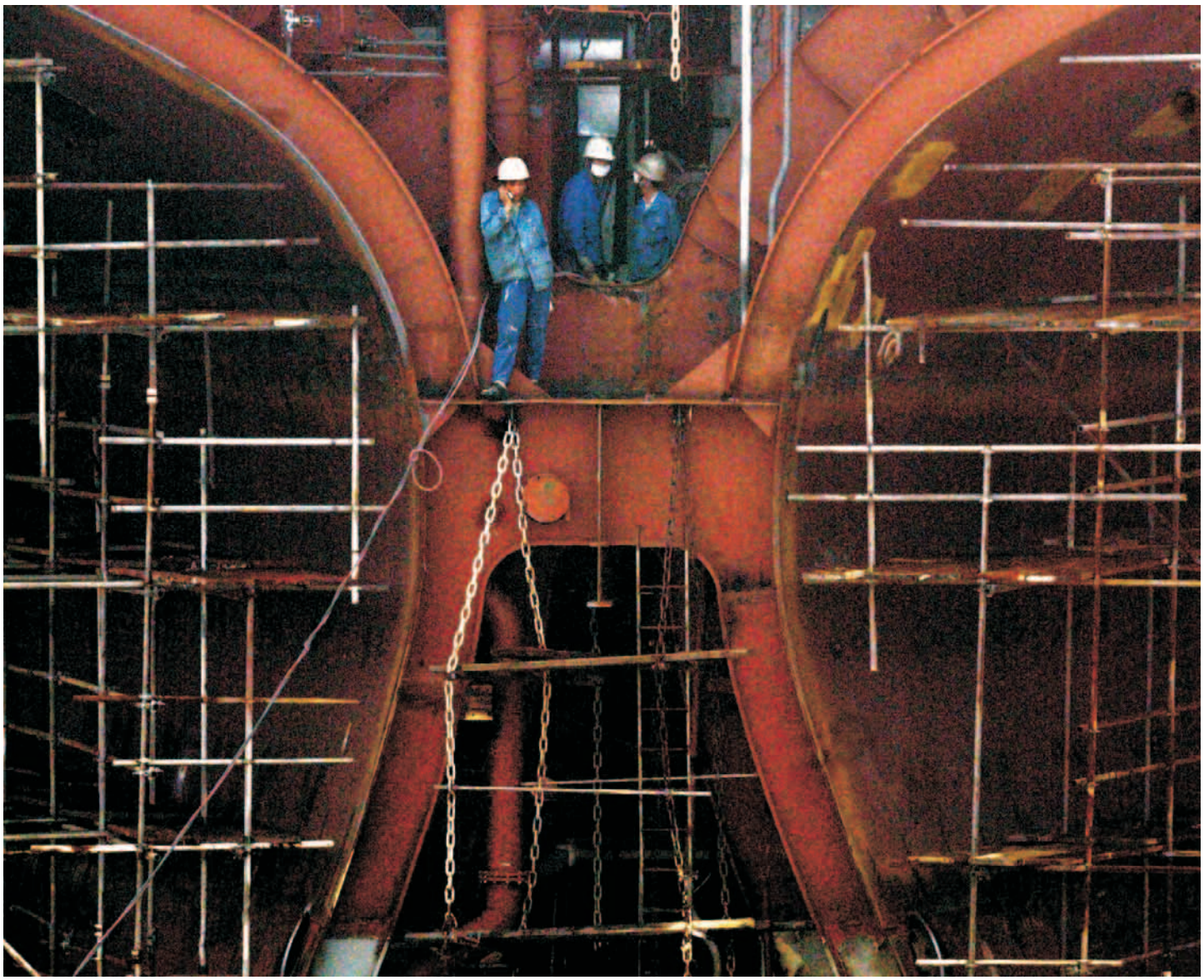
Historically, foreign firms have entered the Indian market with the single purpose of reducing operating costs. Nowadays, however, companies increasingly target the enormous growth potential India presents. This whitepaper focuses on opportunities from a growth perspective as well as a cost-savings perspective. Practical aspects such as tax incentives offered by the Indian government and regulatory aspects are also addressed.

The following figure illustrates the contents of this whitepaper:



6 Wall Street Journal Asia

Chapter 2
The truth about growth



Introduction

Slower growth in many developed economies, intense global competition and pressure on operating margins have forced organisations to look to new markets for new customers and profitable growth. In a recent PwC survey, no less than 78% of participating CEOs from developed economies stated that their companies are going global to find new customers and achieve further growth.

The size of the Indian market and its growth potential, together with the government incentives to capitalise on the growth, are the main reasons India is increasingly on the radar screens of many corporations worldwide.

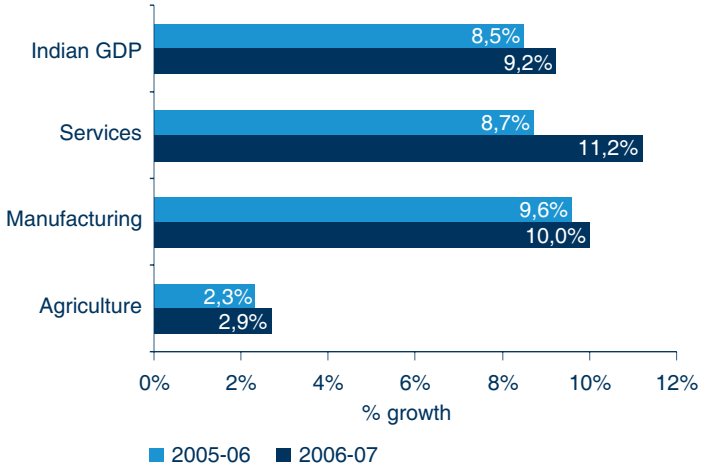
Over the last decade, Indian GDP has averaged a growth rate of around 6%, and per-capita income has risen by about the same rate. Real growth in GDP has averaged about 8.6% over the past four years. These positive growth figures since 1985 lifted about 100 million people out of desperate poverty; if current growth continues, poverty will reduce with even more impressive figures.

Thanks to the fast-growing economy, India's household spending power has roughly doubled since 1985. Such rising income has led to 300 million of India's population being classified as middle class. If India continues its current high-growth path, household income will almost triple over the next two decades, making it, according to McKinsey, the world's fifth-largest consumer market by 2025.

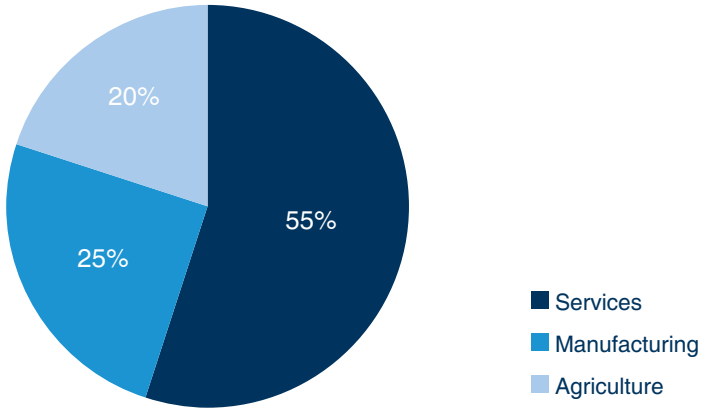
The opportunities

Modern trade in India is at a historic juncture. The rapid growth of this key element of the economy is of great interest to multiple stakeholders: consumers, manufacturers, employees, retailers and government—and to foreign investors.

India is experiencing and expecting growth in almost all sectors, some faster than others. The economy is divided into three main industries: services, manufacturing and agriculture. The strongest growing sector in the Indian economy is the broad-based service sector, which has been propelling overall growth in the Indian economy, achieving double-digit growth since 2006.



Recent economic growth in India
Source: PwC



The share of services, manufacturing, and agriculture in India's GDP
Source: The Reserve Bank of India

Services

The service industry in India today accounts for more than half of the countries' GDP. Services cover activities such as trading, banking and finance, entertainment, real estate, transportation, security, management and technical consultancy, among others.

Manufacturing

India is fast developing as a manufacturing hub for global corporations. Be it in automobiles, consumer durables or technology, a fast-growing number of multinationals have begun to see India as a viable manufacturing base. Ford, Hyundai, Suzuki, Delphi, GE, Matsushita, Colgate, Unilever, Nokia, LG, Kodak, Timex and Whirlpool all source products, components and services for their global operations from India.

Agriculture

Agriculture is currently growing at a considerably slower pace than services and manufacturing.
In the 90s, India moved from a food-scarce to a food-surplus nation. Today, it is the second-largest producer of food after China. Around 20% of the GDP comes from the food and agriculture sector today (down from about 36% of GDP in 1985). About 50% of the population is still dependent on the agricultural sector as a primary source of sustenance.

Key trends in this industry include the growth of organised retailing and supply chain improvements brought about by the technology and logistics know-how of large local and multinational companies. These changes will result in a disintermediation in the agriculture value chain and the food supply chain, as well as investments in upgrading technology and practices in the value chain, including production, packaging, grading, storage and logistics. These efforts should help reduce waste and duplication of efforts, enabling farmers to realise higher productivity and better prices.

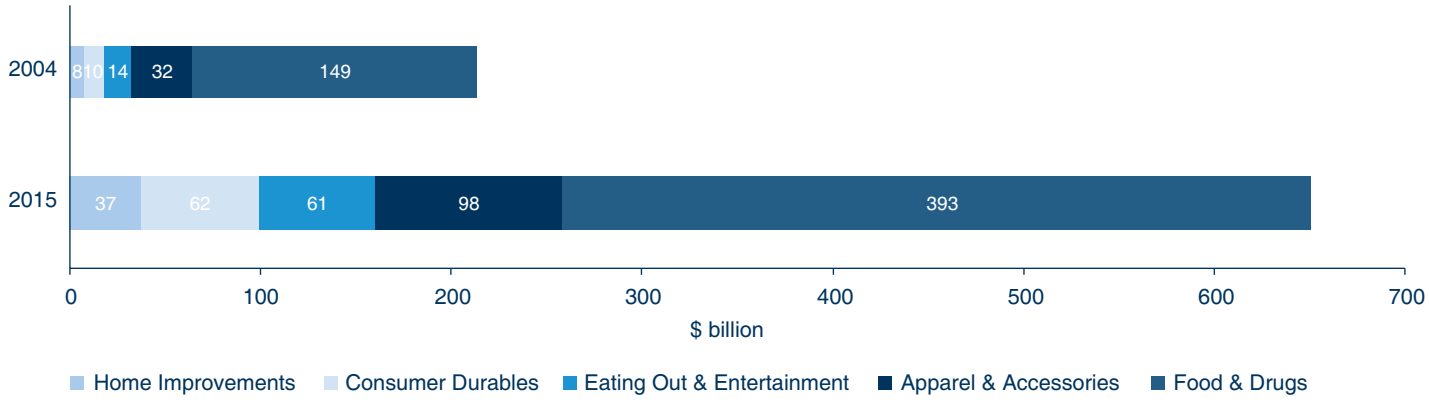
PwC analysis indicates that waste in the food supply chain can be up to 40%, mainly due to repeated handling of produce, poor packing, lack of temperature-controlled storage facilities and transportation, and poor infrastructure. Also, lack of information on end-consumer requirements and pressure from consolidators force Indian farmers to make inefficient decisions about crop selection and pricing. This results in huge waste and produce of poor quality.

During the past five years, the agriculture industry experienced spectacular advances in production and productivity of food grains, oilseeds, commercial corps, fruits, vegetables, poultry and dairy products. The output of these advances supplied the expanding manufacturing industry with raw materials for food processing. This trend is expected to keep momentum in the years to come.

While growth is expected across all sectors, the following sectors are forecast to contribute most to the economy, and provide excellent growth possibilities for foreign investors:

Retail

The retail market is expected to grow three-fold in the next 10 years, from $206 billion today to about $660 billion by 2015.[7] Contributing about 10% of the GDP, the Indian retail sector is growing at a healthy pace of 5% P.A. India is one of the most attractive destinations for retail investment. Almost every large retail chain in the world is keen to expand to India. And many large Indian corporate houses are actively planning to enter retailing. Some plan to do so in partnership with foreign retailers. Clearly retailing is poised to be the next sunrise industry.



Growing Retail Market in India
Source: Investment Commission of India

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Retail success story: Metro Cash & Carry

Metro, with a sales turnover of $55.7 billion, is the second-largest trading and retailing group in Europe and the fifth-largest in the world. It runs 2,447 stores in 30 countries covering about 12 million square metres of retail space, and it employs around 250,000 people worldwide.

Metro entered India in 2003 and operates two cash-and-carry distribution centres in Bangalore. It recently opened a new store in Hyderabad. These "junior" format distribution centres offer an array of over 18,000 food and non-food items to more than 90,000 registered business customers. Metro employs over 750 people in India. It has already invested Rs. 2 billion ($43 million) and is planning to expand into other locations soon. Over 95% of Metro's merchandise for its Indian operations is sourced locally, from both large and small-scale industries. Metro has made significant investments and efforts in upgrading productivity standards, as well as in providing vital market access to its vendors.

Metro has, however, met many challenges in India. It has faced accusations of indulging in predatory pricing to wipe out competition from political fronts, as well as accusations from local traders and industry representatives worried about the business threats from Metro.

Source: Metro Cash & Carry

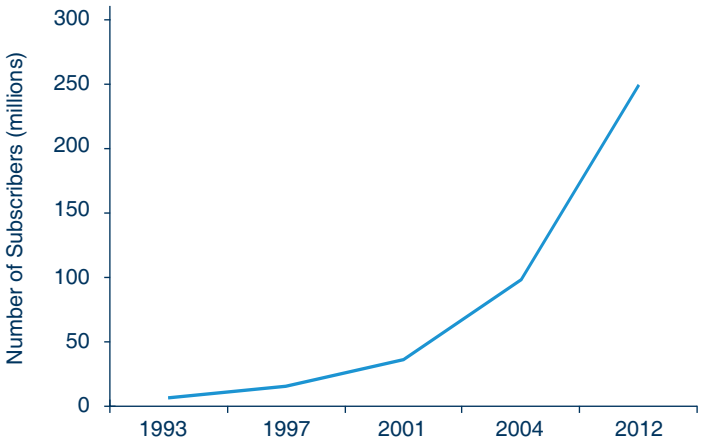
Telecommunication

Rapid growth in the telecommunication sector in India is the result of positive government policy and dynamic, entrepreneurial public and private investment. India has already crossed the 100 million mark in number of telephony access connections, thus becoming the fifth-largest network in the world after China, the US, Japan and Germany. Today, the telecom industry is one of the fastest growing sectors of the Indian economy, with the private sector having a commendable share of more than 50% of the access lines.

In the last three years alone, telecom costs have decreased by 90% with service reliability now at world-class standards. Telecom penetration in the country has increased from 3.6% in 2001 to 12.6% in 2006, and is expected to be 30% by 2009.

Despite fears of an economic downturn, CEOs continue to recognise the strategic importance of overseas expension

PwC 11th Annual Global CEO Survey



Telephone subscribers: Fixed and wireless
Source: Telecom Regulatory Authority of India

Nokia selects Chennai to manufacture mobile devices in India

Nokia opened its manufacturing facility in Chennai, India in March 2006. At this facility, Nokia produces both mobile devices and network infrastructure equipment. At the opening ceremony, CEO Jorma Ollila said "India is amongst the top five telecom markets in the world. Setting up this manufacturing facility in India reiterates our long-term commitment to the Indian market. We are proud to have taken only 23 weeks from the time we started construction, to rolling out the first products at this state-of-the-art manufacturing facility. Chennai is a great location with excellent state and central government support, availability of skilled labour, and a favourable business environment. I am confident that our manufacturing facility in Chennai will enable us to reduce our time-to-market and better respond to our customers' requirements in this market and around the region."

According to Nokia, India is set to become the world's second largest mobile device market by volume in 2010. India was therefore the natural choice for a manufacturing facility to address the needs of the Asia Pacific market.

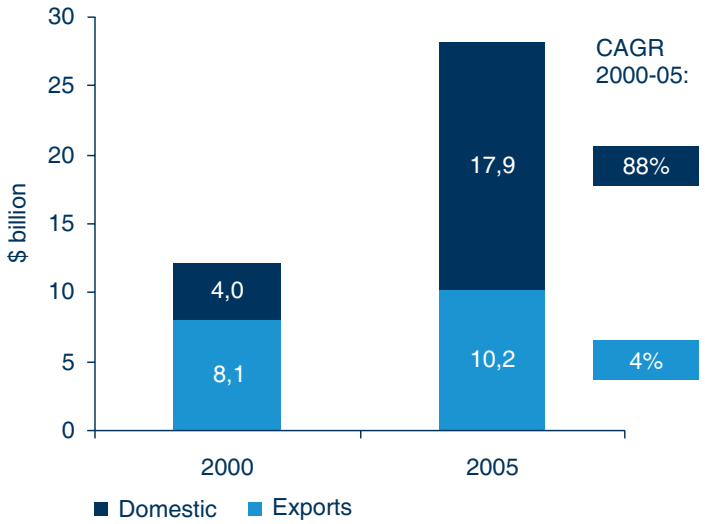
In India, Nokia is the market leader in mobile devices. Nokia maintains sales, marketing, customer care, and R&D sites in the country.

Source: Nokia

IT and IT-enabled services (ITES)

From a manufacturing as well as service perspective, IT is one of the biggest current and potential growth sectors in India. In a very short time, India has emerged as the preferred destination for outsourcing business processes and ITES. The ITES and outsourcing industry was born in the early 90s, when global corporations like American Express, British Airways and GE set up their offshore centres.

The Indian IT and ITES industry is expected to grow to $148 billion by 2012, achieving a CAGR of more than 25% per year.



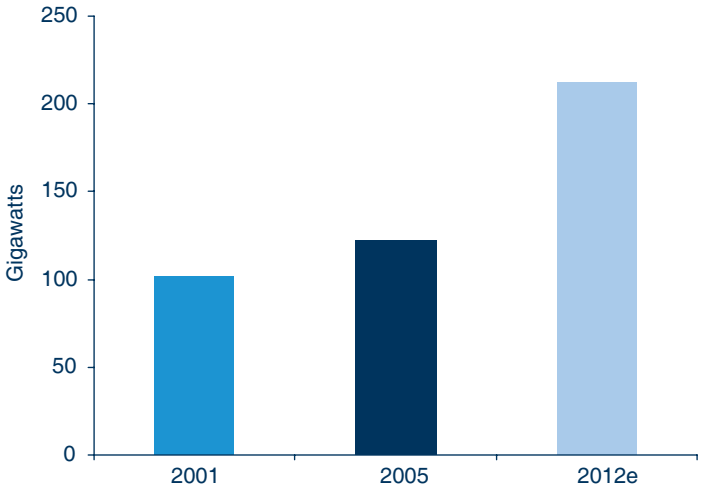
IT/ITES revenues
Source: Indian Ministry of Information Technology

Energy

India's need for energy is growing at an explosive rate. A large quantum of energy in the form of refined fuels and natural gas would be required for India to achieve current GDP growth rates. India is the sixth largest consumer of oil in the world, accounting for 3.2% of global oil consumption, and the country's oil and gas needs are projected to more than triple in the next two decades.

India imports more than 70% of its crude oil requirement, accounting for more than 30% of the country's total imports. The Indian Oil & Gas industry is estimated to be a $90 billion industry and is among the largest contributors to the GDP as well as exchequer. The sector can be divided into three distinct segments: upstream comprising exploration and production (E&P) activities; midstream comprising infrastructure such as pipelines and terminals; and downstream comprising refining and marketing activities. While the segments are still dominated by national oil companies, private and foreign players are gaining presence.

There is also a strong need for FDI in the power sector. Electricity is a key driver of economic growth and social development. At present, not only does the country suffer from an acute power shortage, but the per-capita consumption of electricity, too, is very low. Besides, around 60% of homes in rural areas still don't have electricity. With economic development, improvement in the quality of supply, and decline in population below the poverty line, per-capita electricity consumption is bound to increase.



Power generation capacity in India
Source: Indian Ministry of Power

Healthcare and pharmaceuticals

Healthcare delivery is one of the largest service sector industries in India. With estimated revenues of about $30 billion (FY 2005) it constitutes about 5% of the Indian GDP. This industry grew over 12% per year over the last four years.

The healthcare industry is one of the beneficiaries of India's economic liberalisation. Spending in the healthcare sector is projected to double over the next 10 years. Continued investment in the rapidly developing private sector infrastructure, coupled with increased healthcare funding from the government, will result in steady growth of this industry which is forecast to grow at 15% per year to about $60 billion by 2010.[8] Health insurance will contribute largely to the expected growth in this sector, with 100% growth realised in the previous two years.

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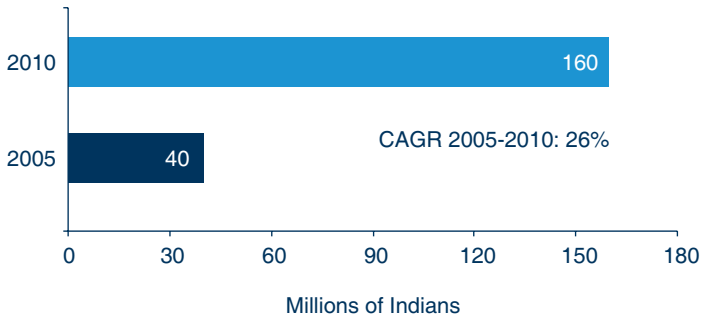
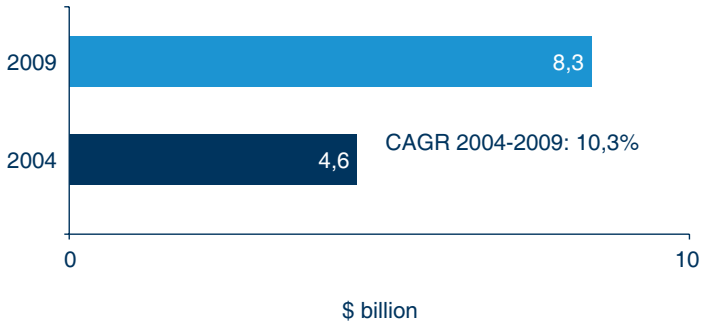


Million of Indians who have health insurance
Source: Investment Commission of India

The explosive growth in the middle class population and in their spending power has fuelled growth in the pharmaceutical industry. Manufacturing clout and a nascent research base have also made India an attractive destination for Western pharmaceutical firms. The sector has made rapid strides in the recent past and has witnessed a rush of corporate activity, including mergers and acquisitions, alliances, entry and re-entry of foreign players.



The pharmaceutical market is estimeted to increase by 80% in five years
Source: PwC

Infrastructure

India has the second largest road network in the world, which carries about 70% of the freight and 85% of passenger traffic in the country. An annual growth of 12-15% for passenger traffic and 15-18% for cargo traffic is anticipated for the next few years. Road development is essential to sustaining economic growth. The Indian government plans to increase spending on road development substantially with funding already in place. A large part of the highway development is to be accomplished through public-private partnerships.[9]

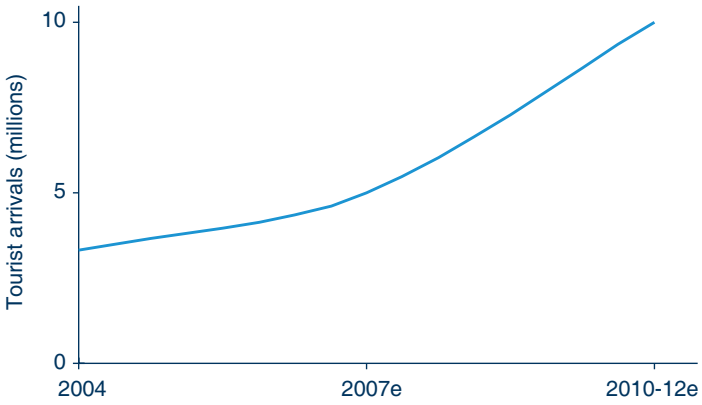
In the past, the government dominated maritime activity. Policy now aims to encouraging the private sector to take the lead in port development and operations. Cargo handling at all ports is projected to grow at 7.7% per year until 2013-2014, with minor ports growing at a faster rate—8.5%—compared to 7.4% for major ports.[10]

India has 125 airports, 11 of which are designated international airports. In 2004-2005, Indian airports handled 60 million passengers and 1.3 million tonnes of cargo. Passenger traffic grew more than 22% in 2005 over 2004, while cargo grew at 21.6% over the previous year. Passenger traffic is projected to grow at a CAGR of more than 15% and cargo traffic with 20%, within the next 5 years. Major investments are also expected for new airports while existing airports will receive major upgrades in the next few years.[11]

Hospitality, leisure and tourism

India is home to 26 world heritage sites, and is divided into 25 bio-geographic zones. The hospitality, leisure and tourism industry in India comprises the hotel sector, the travel operator sector, airlines, car rental agencies, amusement/entertainment parks, etc. The industry provides employment to roughly 11 million people and is the second largest foreign exchange earner for the country.

Due to favourable macro-economic factors and promotions by regional governments, this sector has been witnessing impressive double-digit growth rates over the last few years.



International tourist arrivals in India
Source: Investment Commission of India

9 Department of Road Transport and Highways
10 Investment Commission of India
11 Investment Commission of India

Market entry choices

Once you've selected India as a business destination, your success depends on getting things right on the ground. The biggest question for entering a new market is, How to enter? Options include:

Operating as an Indian company

Option 1: Wholly owned subsidiary
A foreign company can set up a wholly owned subsidiary in India for carrying out its activities. Such a subsidiary is treated as an Indian resident and an Indian company for all Indian regulations, despite being 100% foreign owned. At least two and seven shareholders are mandatory for private limited companies and public limited companies, respectively.

Option 2: Joint venture with Indian partner preferably with majority equity participation
Though a wholly owned subsidiary has been the most preferred option, foreign companies have also been setting up shop in India by forging strategic alliances with Indian partners. The trend is to choose a partner who is in the same field/area of activity and has sufficient experience and expertise in your line of business. Joint ventures are usually formed by two companies, with each taking up to 50% ownership.

Option 3: Acquisition of an existing business
Acquisition is another entry option for businesses looking to enter India. This involves a foreign company buying an existing Indian company. Acquisition can be the most expensive entry option, as the buyer has to carry the costs both of assets and acquisition. Buyers must furthermore deal with legal issues, barriers and risks associated with acquisition in India. In some situations, buyers must receive government approval.

Operating as a foreign company

Option 1: Liaison office
Setting up a liaison or representative office is a common practice for foreign companies seeking to enter the Indian market. The role of such offices is limited to collecting market information and providing information about the company and its products to prospective Indian customers. Such offices act as "listening and transmission posts" and facilitate a two-way information flow between the foreign company and its Indian customers. A liaison office is not allowed to undertake any business activity other than liaison activities in India and cannot, therefore, earn income in India, in terms of the approval granted by the Reserve Bank of India (RBI).

Option 2: Project office
Foreign companies planning to execute specific projects in India can set up temporary project /site offices in India for this purpose. RBI can grant general permission to a foreign entity for setting up a project office in India, subject to certain conditions. The foreign entity only has to furnish a report to the jurisdictional regional office of RBI giving the particulars of the project/contract.

Option 3: Branch Office
With prior approval from RBI, foreign companies engaged in manufacturing and trading abroad can set up branch offices in India for exporting or importing goods; rendering professional or consultancy services; carrying out research work; promoting technical or financial collaborations between Indian companies and parent or overseas group companies; rendering IT or software development services in India, etc.

In general, manufacturing activity cannot be undertaken through a branch office. However, foreign companies can establish a branch office/unit for manufacturing in a Special Economic Zone (SEZ) subject to certain conditions.

Advantages and disadvantages of the various entry options

Joint ventures

Multinationals entering new markets traditionally entered joint ventures with local partners. Recent cross-border transactions across a variety of industries indicate the following strategic factors behind entering a joint venture with a local Indian partner:

- Legal requirements in some cases restrict the level of shareholding by foreign firms in local businesses, which makes a joint venture more acceptable to regulators.
- Knowledge of local market conditions, regional variations, political and regulatory environment is better captured in a joint venture.
- Relationships with distributors, retailers, suppliers, etc., as well as brand loyalty are better with a local partner.
- Collaborating with a competitor—to compete with other local participants or as a defensive measure—is possible with a joint venture.
- Risk is reduced, either through sharing market entry risk or through mitigating the risk associated with a full acquisition.
- Joint ventures are important to gain access to privileged assets in some industries such as metals, mining, and oil and gas.

However, joint ventures also carry risks, including:

- Insufficient equity might be contributed by the Indian partner. Indian firms are unable or unwilling to put up their share of the cash when new investment opportunities come up.
- There is often a clash of objectives between the foreign firms and their Indian partners. While the foreign firms come to India with a long-term vision willing to make initial losses for long-term profits, Indian firms want immediate profits. This leads to a clash in plans, necessitating foreign firms either to set up wholly owned subsidiaries or take controlling stakes in joint ventures.
- The Indian partner is likely to be considerably smaller than the foreign multinational partner, a difference that can have consequences. Managers of foreign firms note, for example, that early, rapid expansion can require substantial capital infusions that the Indian partner may not be able to provide. It is also true that the venture may be more important to the smaller partner than to the foreign partner.
- The main contribution of the Indian partner is knowledge of Indian conditions. With time, however, the value of such contribution falls as the foreign firm gets to know local conditions.
- Each partner brings financial and other assets, and it is often not easy to determine what these assets are worth.
- Financial issues including transfer pricing, dividends and investment policies may occur.
- Changes in management or ownership of partner companies can complicate business activities.

Acquisition

Despite some clear benefits, only a handful of the major joint ventures established in India after economic reform started in 1992 still survives. The primary reason for the demise of these partnerships is that the Indian partners could not invest enough to grow the business at the pace the multinationals anticipated. Therefore, most multinationals that entered the Indian market through joint ventures exited those partnerhips and either established their own independent activities or bought out the Indian partner.

Some advantages of acquiring an existing business in India over a Greenfield operation include:

- The fact that it enables the buyer to review the target company's existing performance as reflected in financial statements, tax returns and other financial records. This can be very helpful in determining cash flow, which is not the case with Greenfield investments.
- Obtaining trained employees familiar with business operations and market conditions. Capacity in the form of manufacturing and human resources also instantly increases. Furthermore, an acquisition enables use of existing buildings, equipment and machinery.
- Obtaining or transferring existing licenses and permits as part on an acquisition often reduces the time and cost of making application and conforming to required regulations.
- An acquisition provides the option to use established supplier and distributor networks, and to inherit existing customers. Gaining established customers significantly reduces the time and marketing costs of building an adequate number of customers to support the overhead of a new operation.

Acquisitions, however, also carry risks, including:

- A high financial burden including the investment and transaction costs.
- High levels of complexity and unshared risk.
- Difficult and uncertain regulations might carry unanticipated delays and additional cost.
- Relationships with wholesalers and retailers are not guaranteed after the acquisition. Additional staff and financial resources may be required to rebuild these.

Apart from regulatory factors that dictate the choice of market entry, the nature and size of your business, your propensity to bear contractual and investment risk, the market potential (size and growth rate), and R&D costs are all important considerations.

Related challenges

India's marketplace offers many challenges, some of which are different from those in developed economies, while others are simply different in scale. The most well-known are cultural differences and unfamiliar methods or systems. Other key challenges include:

Lack of infrastructure and logistics

India is a fragmented country with 70% of its population living in rural areas. The absence of a strong infrastructure and logistics systems makes reaching customers difficult. The government is making investments to improve the situation, aiming to reduce overall transport and logistics costs.

Remaining red tape

While India has made significant strides towards reducing bureaucracy, it remains the country with the "most red tape" in the South Asian region. The country scores worst in time to register a business, difficulty of employee dismissals and delay in registering property.[12] Furthermore, India ranks second in the

12 International Finance Corporation (IFC) 2005

region for procedures and time required to enforce a contract.[13] This remaining red tape still represents one of the biggest challenges for Indian authorities as it may convince investors to consider alternative locations.

Increased bargaining power of local suppliers

Due to the fast-growing economy and increased interest in Indian business, local suppliers are demanding much more for their outputs and services, which is leading to changes in the traditional bargaining power of purchasers.

Scarcity and high cost of real estate

With most Indian cities undergoing rapid urbanisation, increasing cost of space is a growing concern for businesses considering going to India. This is equally true for rural areas where high-quality land is often occupied by the dense population. The growing demand for manufacturing space also caused increasing property prices.

Cultural and regional differences

Not only are the variations between consumer requirements vastly different between different regions, but regulations between states also vary quite dramatically. This discourages companies from operating freely across the country. This barrier applies especially to industries such as liquor and automobiles.

Scarcity of skilled labour and unrealistic salary expectations

While there should be no manpower shortfall in India given its large working population, the gap lies in finding people with the right skill sets. Proactive training is a key imperative, and some companies are partnering with management institutes to develop employee training programmes.

Indians are increasingly demanding higher salaries. Salary increase demands of more than 50% in some positions are problematic for potential investors as unanticipated salary demands might result in additional costs.

To gain competitive advantage or achieve a profitable business, companies must be confident of their strategies and take appropriate measures to mitigate risks which they may not have encountered previously.

13 World Bank

Chapter 3
The myth of cost savings

Introduction

With a global share estimated to be over 50% in 2007, India has over the last decade or so become the worlds' preferred offshore location for Business Process Outsourcing (BPO). Revenues have grown to $13.5 billion in 2006-07, with a growth rate of approximately 45%. The visibly higher preference for India is driven by its unmatched superiority when measured across a range of parameters.

Opportunities

Labour costs

British Airways was one of the first multinationals to offshore to India. In the early 1980s, it erected a captive organisation in Delhi as a base for some of its back-office operations. This remarkable adventure—unprecedented at the time—was largely driven by the cost savings potential offered by India's wage structures and cost of living. American Express, General Electric and others soon followed to capitalise on the difference in wages between India and the West.

Ever since those early days, savings has remained a key driver for companies to outsource to India. The potential for cost savings is vast. For example, it costs less than 18,000 to hire an IT project manager in India, compared to more 66,000 in the Netherlands; a senior software developer in India earns 10,000 while his or her peer in the Netherlands earns 52,000. However, today's figures are starting to leave room for doubt on the long-term benefits of outsourcing to India.

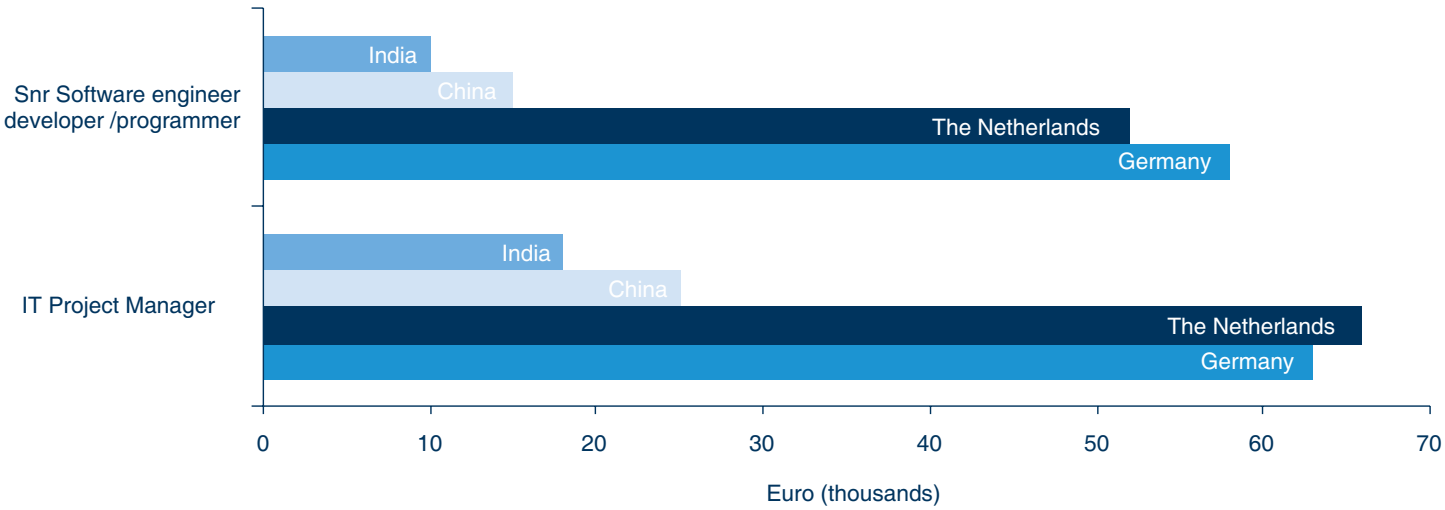
As a result of the high growth of the Indian BPO industry, salary increases of 10-15% annually are common nowadays. The pace at which rising demand is beginning to drive up pay rates in India could take away much of the cost benefits in the foreseeable future. Therefore, companies need to realise that basing offshoring decisions purely on cost reduction often does not result in the desired outcomes.

Abundance of talent

Another traditional driver for offshoring to India is the vast availability of skilled, English-speaking manpower. India's approximately 253 universities and 13,150 higher education institutions produce 2.46 million graduates each year, including 350,000 engineers and 150,000 IT professionals. Educational levels are high, and low training costs allow professionals to be continually updated on emerging technologies and practices, a critical factor in an era of shortened technology lifecycles.

A full 25% of people in the world under the age of 25 live in India, making the Indian workforce young and full of potential. A human resource base that is also fluent in English. The proportion of India's working-age population (15-60 years) is estimated to peak around the year 2020 and looks set to continue for another 15 years before registering a decline. While changing demographics are a major concern in Western countries, current demographics in India do not show a similar trend.

So, it is not only the sheer size and favourable demographic profile of India that constitutes its people competitiveness. It is also the skills that people bring, certainly when compared to other developing countries.



Median salary comparison
Source: Payscale.com (currency conversion date: November 2007)

BPO success story: ABN AMRO Bank

ABN AMRO Bank has been in India since 1919 when it opened its first Indian office in Kolkata. Its second office opened a few years later in Mumbai. For a long time, nothing happened after that. Until the early 1990s when, with the liberalisation of the Indian market, ABN AMRO began to realise that it could leverage its back office operations in India to provide services to other ABN AMRO offices worldwide.

Currently ABN AMRO Central Enterprise Services (ACES), the BPO arm of ABN AMRO, has five locations in India in three major cities: Delhi, Chennai and Mumbai, and a headcount of more than 6,000. ABN AMRO is one of the bigger outsourcers to India.

After its decision to outsource its system development and maintenance, ABN AMRO entered a deal with three major Indian IT service providers (TCS, Infosys and Patni).Over the years, ABN AMRO has found that offshoring business processes to India is paying off, not only in terms of cost reduction and quality enhancement, but also in enabling it to scale up its business across the globe.

Source: ACES

Your outsourcing choices

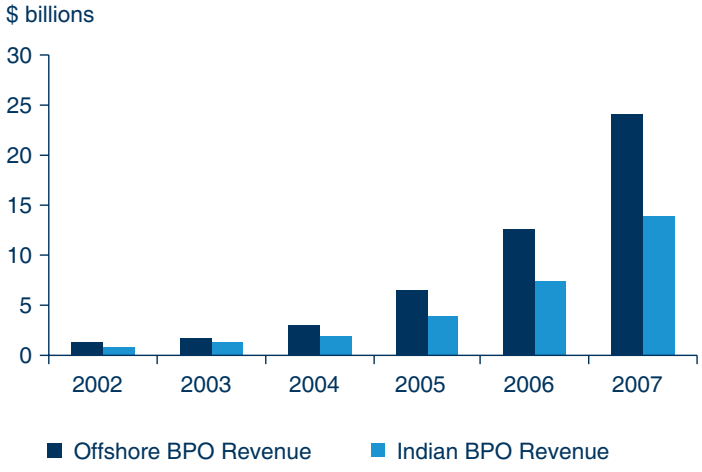
The most successful companies start offshoring low-value, non core functions. Once they understand the process and cost model required, they can make educated outsourcing/offshoring decisions for other areas.

Indian outsourcing service providers are expected to provide benefits ranging from greater expertise in the outsourced processes and lower costs, to scalability and the ability to absorb cyclicality of workloads.

The Indian BPO landscape

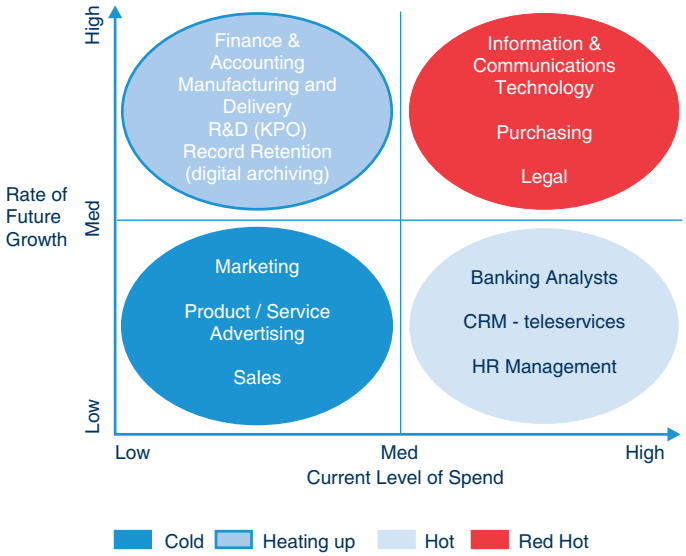
The size of the global BPO market has reached approximately $173 billion in 2007, of which $24.23 billion is outsourced to offshore contractors. India has emerged as one of the bright stars in the global BPO market and has maintained its global competitiveness by offering the best combination of cost, quality and scalability. There are more than 400 BPO companies operating in the Indian market, including captive units (of both multinational corporations and Indian companies) and third-party service providers.

India has generated around $13.8 billion in revenue from BPO in 2007 (from $1.2 billion in 2003). This includes revenues of pure-play Indian BPO service providers, captive operations of multinationals operating in India, third-party service providers and BPO subsidiaries of IT services firms.



Size of global Indian BPO market
Source: Gartner

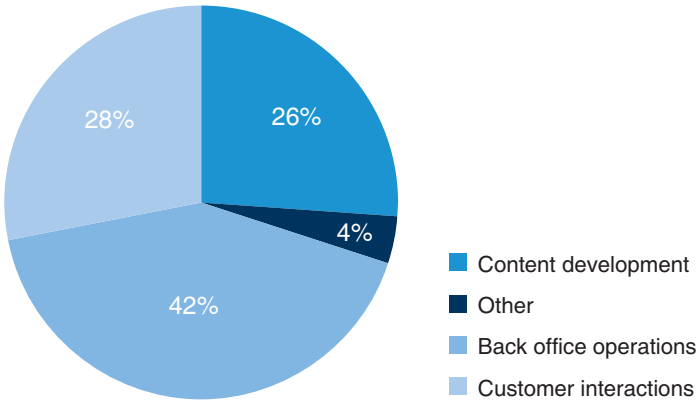
The BPO industry has many segments. The diagram below shows a number of typical BPO segments (and some that can be considered more high-end Knowledge Process Outsourcing) grouped by the level of current spend and expected future growth.



Source: PwC

A more aggregated segmentation of the BPO industry:

- Backoffice operations, including services such as revenue accounting, data entry and conversion, and HR services is the largest segment. Industries such as banking and aviation require large-scale data processing and data-based decision-making capabilities. Indian companies provide data entry (paper to digital) and rule-set processing (applying present rules and criteria for processing).
- Customer interaction is the second largest segment. Customer care centres are used for a number of customer-related functions including marketing, selling, information dispensing, advising, technical support, etc.
- Content development, including services such as animation and engineering and design is the third segment. Labour costs in India for computer animators are roughly one-tenth of those in the US.
- Other services, including medical transcription, online education and web-based training, market research analysis using statistical packages, remote network maintenance and monitoring.



Indian BPO industry by segment
Source: PwC

Knowledge process outsourcing (KPO)

The success of off shoring as a delivery model has been clearly established. As the global and Indian outsourcing sector matures, focus has evolved from pure cost reduction to exploiting value-added opportunities and generating revenue. Clearly, India is a gold mine for higher levels of skill, knowledge and experience across functions and industries. On the basis of these competitive advantages, supported by cost-arbitrage opportunities, India has gradually begun to emerge as an offshore hub for knowledge services. Knowledge process offshoring (KPO) is on its way in.

KPO is not a mere extension of BPO. Its philosophy, objective and service delivery mechanism sets it apart significantly. The core essence of KPO is not about delegating or sending away processes in order to focus on core competencies. In fact, the premise of KPO is to include into a global delivery team, the required skills that support and guide strategies for an organisation's core processes. Where BPO seeks to exclude processes (i.e. send them away), KPO seeks to include talent. The "inclusive" philosophy of KPO is driven by the global availability of skills and the simultaneous diffusion and aggregation of knowledge across geographies. Cost-reduction is an additional benefit that organisations happen to derive from including talented people from lower-cost geographies. Access to domain knowledge is undoubtedly the key driver for KPO.

There are four distinct streams of KPO supply-side participants.

- The first will be BPO companies that will move up the value chain and diversify into KPO. For example, an F&A BPO provider offering financial analytics.
- The second stream will be companies that practice a profession in the domestic market, offering services to the global market. For example, a law firm in India, offering services to its counterparts in the US.
- A third stream will be specialized groups of individuals who will offer specialized services exclusively to the global markets, for example a pharmaceutical research team.
- The fourth stream could well be individuals who choose to live in one place but provide their inputs to a process somewhere else. For example, a specialised professional may be employed by a global corporation to be a part of a global team, but the market addressed by the team could exclude the market where the individual lives.

Given the nature and diversity of knowledge processes and their participants, KPO will never be such a distinct industry as is BPO. It is a global sourcing strategy that can take many forms, rather than an industry in itself.

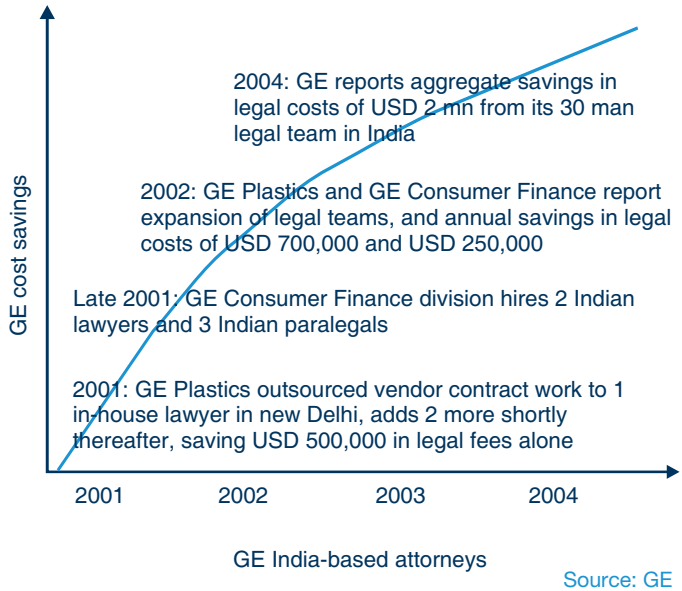
The table below includes a selection of KPO segments, the typical higher-end activities performed and some of the companies that have outsourced these to India, either via their own captive operations or by levering Indian third-party service providers, some of which have become multinational corporations themselves. A number of the KPO segments mentioned are already well established in India and play a significant role in the business fabric of global markets. Others are developing with clear potential for rapid growth in the next five to 10 years.

KPO segment	Example activities	Companies
Legal services	Legal research (including IP research), reviewing transactional and litigation documents, drafting contracts, prosecuting patents	GE, Cisco, Sun, Microsoft, Oracle, Dupont
Engineering R&D	3D modelling, 2D to 3D conversion, finite analysis, CFD analysis, technical specification for tenders, value engineering	Airbus, Boeing, Caterpillar, Intel, Apple, Nokia, Motorola, DaimlerChrysler, General Motors
Writing and content development	Editorial services, content-delivery services, data enrichment and warehousing, proof reading, text composition, E-publishing, cross-media composition	Reed Elsiever, Blackwell, Pearson, Academic Press, University Presses, Taylor and Francis, Thomson Learning, McGraw Hill, John Wiley
Pharma R&D	Drug discovery, research and development, clinical research	AstraZenenca, Novartis, GSK, Bayer AG, Roche, Eli Lilly, GlaxoSmithKline, Novo Nordisk, Aventis, Pfizer, Roche
Market and industry research	Customer and industry surveys, data analysis, report presentations	McKinsey, AT Kearney, Bain and Co., Monitor Group, Everest Group, AC Nielsen, Heidrick & Struggles, Frost & Sullivan,
Data analytics	Credit scoring, claims analysis, analysing customer behaviour patterns for detecting fraud or cross selling, optimising stock levels	American Express, Citibank, Prudential Insurance, Accenture, Honeywell, GE
Equity research	Financial modelling, company valuations, accounting standards transitioning, stock price tracking	Lehman Brothers, JP Morgan, Standard Chartered, ABN AMRO, World Bank, Goldman Sachs
Finance & Accounting	Budgeting, forecasting, treasury and risk management	ABN AMRO, Prudential, JP Morgan, P&O Nedlloyd

Source: PwC

KPO success story: General Electric

General Electric (GE) laid the foundation for the emergence of structured legal process outsourcing in 2001, when it became the first foreign conglomerate to offshore its in-house legal work to India. The GE Plastics Gurgaon unit employed lawyers to write and review contracts with vendors. The India team is estimated to have saved the GE unit $500,000 in its first year of operation. The success story was widely promoted in the organisation, resulting in other GE units adopting a similar "offshore" approach. Today, GE operates through a subsidiary in India comprising 30 lawyers, who support all critical legal services of GE's units worldwide.



Source: GE

Manufacturing outsourcing

India may be leading the market in off shored business processes, but when it comes to outsourcing manufacturing, the country lags behind many, including other Asian countries and Mexico. The primary reason is the poor hard infrastructure—electricity, water, roads and seaports—companies have to deal with when setting up manufacturing operations in India. Some multinationals including DaimlerChrysler, Toyota, ABB, Honeywell and Siemens, have nevertheless set up shop in India. A closer look at the companies and the type of work outsourced shows that most of this is skill-intensive work, requiring considerable technical expertise.

Major manufacturing companies have come to appreciate the unique combination of low costs and a skilled workforce India offers. Low costs may be found in other offshore destinations as well, but this combined with an abundance of engineers and technical talent is unique to India and a driving force behind growth in the off shoring of high-skill manufacturing processes to India. The high-skill component sets India apart from other low-cost offshore destinations.

Industries that have set foot in India include automotive, chemicals and electronics—but the potential for growth in these and other sectors is huge. Companies that set up manufacturing operations in India now may face challenges posed by the infrastructure; they will also have first-mover advantages such as strong relationships with the best vendors, access to the talent pool, and government support.

A common stumbling block company's encounter when moving manufacturing to India is not defining the end state they want to achieve. Is it disposing of the entire business and investing in a totally new plant, or simply installing existing machinery in another location? Is it continuing to manufacture the same products in a more cost-effective location, or diversifying into new products and expanding its customer base?

Location selection

Although India's position as a preferred location for off shoring is well established, the growth of the industry has been concentrated around a few key cities such as Bangalore, New Delhi, Chennai and Mumbai. However, with the continuing pressure to minimise costs to maintain margins, multinationals and service providers are increasingly looking beyond these destinations towards cities such as Hyderabad, Pune and Kolkata.

The table below shows the major hubs and their focus areas, along with some prominent companies—both multinationals who have set up captive operations—and Indian service providers, operating there.

City	Focus	Companies
Delhi (includes Gurgaon and Noida)	Call centres, transaction processing, chip design, software	GE, American Express, STMicroelectronics, Wipro Spectramind, Convergys, Daksh, ExL
Mumbai	Financial research, backoffice, software	TCS, MphasiS, i-flex, Morgan Stanley, Citigroup
Bangalore	Chip design, software, bio-informatics, call centres, IT consulting, tax processing	Infosys, Wipro, Intel, IBM, SAP, SAS, Dell, Tisco, TI, Motorola, HP, Oracle, Yaho, AOL, E & Y, Accenture
Hyderabad	Software, backoffice, product design	HSBC, Satyam, Microsoft
Chennai	Software, transaction processing, animation	Cognizant, World Bank, Standard Chartered, Polaris, EDS, Pentamedia
Kolkata	Consulting, software	PwC, IBM, ITC Infotech, TCS
Pune	Call centres, chip design, embedded software	MsourcE, C-DAC, Persistent Systems, Zensar

Source: PwC

Off shoring destination options in India can be divided into four groups of cities:

- Tier 1 - Cities that are top of mind for overall attractiveness from skills availability, infrastructure, access, lifestyle, etc. perspective. Examples: Bangalore, Mumbai.
- Tier 1-1 - Cities that have most, if not all, of the capabilities of the Tier 1s, but for various reasons, have not achieved the same level of mind-share and visibility. These cities are the most likely to take on the mantle of Tier 1 in the near future, either in addition to or by replacing the current Tier 1s. Examples: Hyderabad, Chennai, Pune.
- Tier 2 - Emerging cities that have reasonably good value propositions, coupled with strong local political will and associated activity to attract IT investments. In some cases these are being set up as "spill-over" cities to release some of the pressures on Tier 1 cities in their respective states. Examples: Kolkata, Mangalore.
- Tier 3 - Cities that have a stated vision of focusing on IT as a key growth industry, and are "on the map," but have done little else in realising that vision. Examples: Thiruvananthapuram, Ahmedabad, Jaipur, Cochin.

Tier 1, 1-1 and 2 cities can be evaluated against several criteria (see below). The outcomes show that the gap generally perceived between Tier 1 and Tier 1-1 cities is not justified. Across the board, Tier 1-1 cities score as well as Tier 1 cities, if not better. And even Tier 2 cities score very well in general with none of the criteria rated as poor (P) and hardly any as fair (F).

When a company is planning to set up operations in India, a thorough location study must be performed to be able to assess the best option. Location does matter, and it is certainly worth the effort to understand the specifics of various cities and how these match with your specific requirements. Relying on "knowledge" that is not validated and personal biases can prove to be disastrous in a realm moving as fast as the Indian BPO industry.

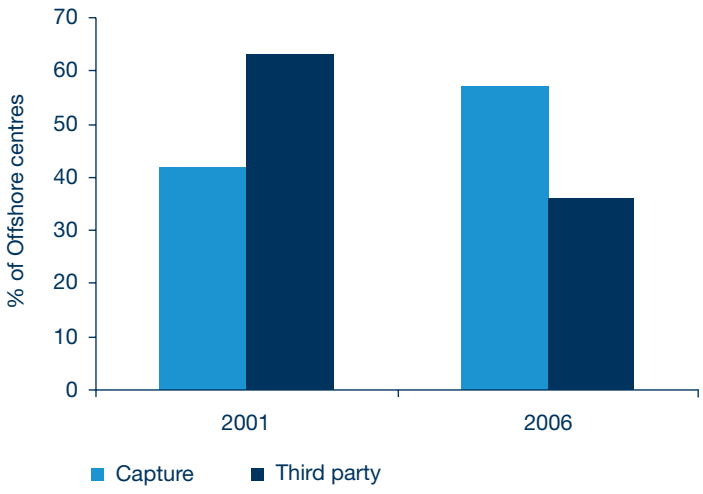
Cities	Infrastructure	Skills available	Skills retention	Access	Cost of Living	Political Support	Quality of Life
Tier 1							
Bangalore	+ ▼	+++ ▲	+ ▼	++ ▲	- ▼	+++ ▼	+++ ▼
Mumbai	++ ▶	+++ ▶	++ ▶	+++ ▶	-- ▼	++ ▶	- ▼
New Delhi	++ ▶	++ ▶	+ ▼	+++ ▶	+ ▼	++ ▶	+ ▶
Tier 1-1							
Chennai	+ ▲	+++ ▲	++ ▲	+++ ▶	++ ▲	++ ▲	++ ▲
Hyderabad	++ ▲	++ ▲	++ ▲	++ ▶	++ ▲	++ ▶	++ ▲
Pune	- ▲	+++ ▲	+++ ▲	+ ▶	++ ▲	+ ▶	++ ▲
Navi Mumbai	+ ▲	++ ▲	++ ▲	++ ▶	++ ▲	+ ▶	+ ▶
Tier 2							
Kolkata	+	+	++	+++	++	+	+
Mangalore	++	-	++	+	-	+	+
Mohali	+	+	+	-	+	++	+
Bhopal	+	+	+	+	++	+	+

Source: Gartner

Legend: -- = Poor - = Fair + = Good ++ = Very good +++ = Excellent
▼ = Worsening ▶ = No Change ▲ = Improving

Captive vs. third-party

Captives vs. third-parties has long been a favourite debate in the Indian off shoring community, but even today the jury is out on which model will emerge as the winner in the long run.



Captive vs. Third party models
Source: PwC

Looking at the numbers one could argue that captive centres have, over the last few years, proved to be the favourite model. While in the late 1990s, the third-party model was the favourite, the new century has brought a clear shift towards the captive model.

During this period, major players such as American Express, eServe, HSBC, SCOPE, and AOL have further consolidated their operations, while more than 30 companies, including Fidelity, AIG, JP Morgan, Prudential, Tesco and Reuters, have set up captive BPOs in India. However, it is still too early to call the captive model the winner. In fact, many predict another change in tide with the third-party model becoming frontrunner again when more captives are spun off like those of British Airways-WNS, SwissAir-TCS, Conseco-EXL and GECIS-Genpact.

An Infosys research team study on captives reveals some interesting insights. While the average size of a captive currently is about 1,000 people per company, the median size is 375. Less than 10 companies employ 5,000 people or more, while about 20 employ more than 1,000. Almost half the captives operate from a single location and another 20% from two cities. Only a few of the biggest players like HSBC, Dell or Axa operate in three or more cities. Bangalore is the undisputed leading location for captives, while Mumbai and Chennai each have about half the number, and Pune and Kolkata are emerging.

Advantages	Disadvantages
• Data security easier to organise • Not loosing margins to third-party service provider • Direct control/authority	• Expensive specialist skill in host countries • Compliance and legal restrictions • Unavailability of skilled manpower due to market stagnation • Management time and effort to establish and operate

Captive pros and cons
Source: PwC

Related challenges

The savings and other benefits realised by companies that have outsourced to India are unprecedented. However, the industry still faces some unique challenges that, if not given the required attention, may block future growth.

Attrition

One of the key challenges facing the Indian BPO industry is the high level of attrition. And what these attrition numbers don't show is that more than 60% of those who leave a particular company do not leave for a competitor, but leave the industry altogether. The consequences of this are considerable. There is loss of investment (e.g. training), knowledge is leaking away, building strong and solid teams becomes difficult, and the management effort spent on finding replacements cannot be spent on other priorities. At an attrition rate of 40%, the cost of attrition in the industry is estimated to be 1.5 times the annual salary.

Another major challenge for the industry, and one of the causes of the high attrition rates, is the double -digit salary increases. Increases of 10-15% are common nowadays and even increases of 40-50% are witnessed more and more today. Such increases are slowly undermining the unique selling point of India, that of cost arbitrage. This in particular holds true in the face of increasing competition from other low-cost offshore destinations such as China, the Philippines and Vietnam.

Infrastructure

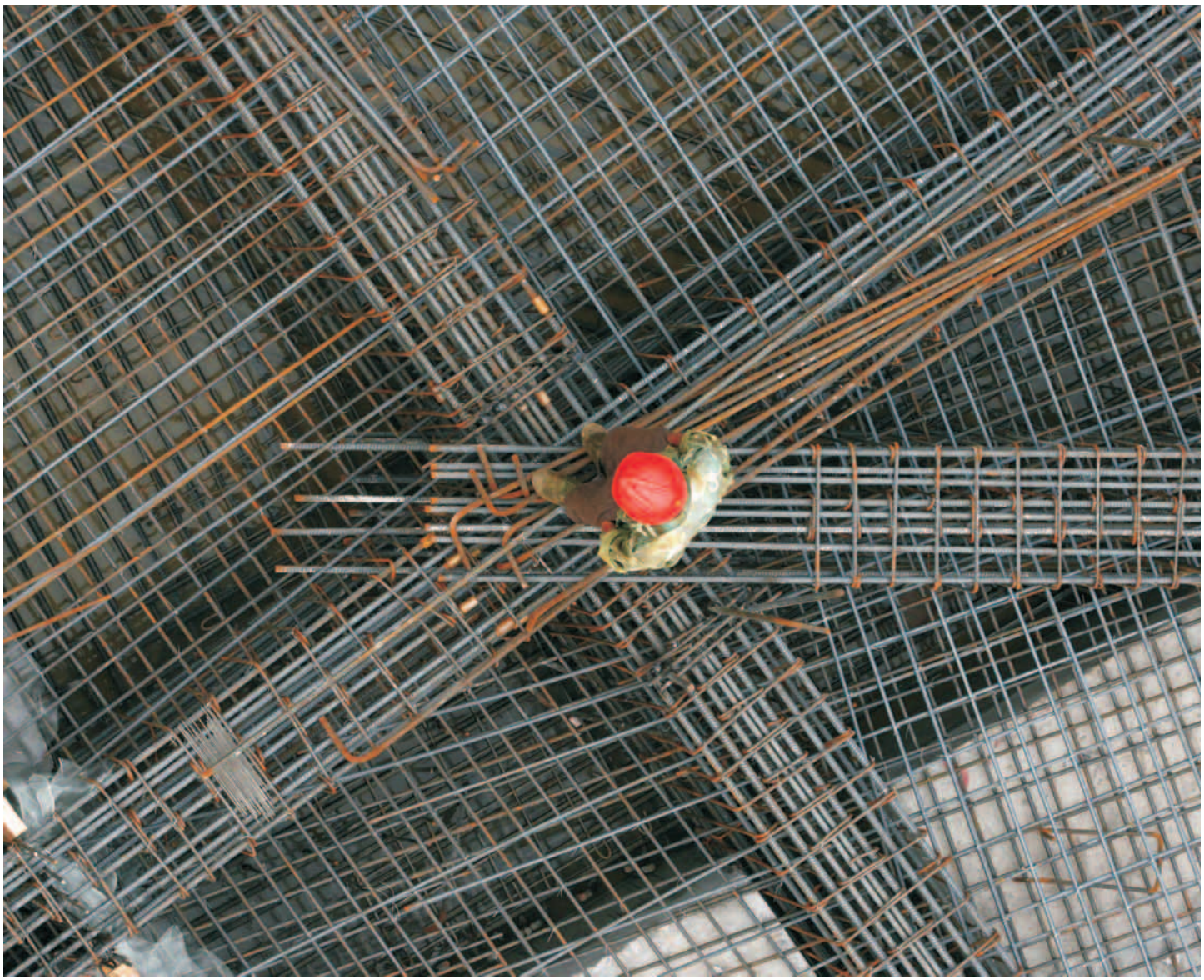
While infrastructure bottlenecks continue to hamper development, India has made considerable progress in the last decade. The achievements in the telecommunications infrastructure, for example, are remarkable. However, other key elements of a good business infrastructure, in particular the so-called hard infrastructure such as roads, water and power supply are still—on a daily basis—posing challenges to companies, more so in developing regions than in the major BPO hubs. The government gives continuing attention to improving the infrastructure, but, with increasing competition in the global off shoring market, they will have to move more quickly to not endanger India's current position in that market.

Security

The Indian BPO industry has seen a number of serious information confidentiality breaches that have attracted wide media coverage. Information security is a major concern of companies worldwide, especially when considering outsourcing.

The Indian regulatory environment is covered by laws such as the IT Act 2000, the Indian Copyright Act and the Indian Contract Act 1972, but these laws do not provide the same level of protection as similar laws in Europe and the US. As a result, companies are requiring BPOs to get certification under international standards such as BS 7799, SAS 70 and HIPAA, which are now "must haves" for serious players in the market. These moves have led to a decrease in the number of security breaches, but data security is nevertheless still a major issue in the industry. With the trend towards inclusion of Indian service providers in core value-adding business activities involving higher-risk information, this concern is likely to require ongoing management attention.

Chapter 4
Doing business in India



Today India is a strategic imperative for all corporate organisations worldwide. As a first-time investor to the Indian market, one ought to take note of the various incentives offered by the Indian government and consider other legal, regulatory and practical aspects of doing business in India. Some of these include:

FDI regulatory environment

The regulatory framework in India has been increasingly liberalised with respect to FDI. FDI is now permitted in almost all sectors with the exception of:

- Lottery businesses/gambling
- Agriculture, excluding floriculture, horticulture, seed development, animal husbandry and cultivation of vegetables
- Retail trading (other than single-brand retail)
- Other sectors, including atomic energy and agricultural plantations

The amount of FDI permitted varies per sector, with 100% FDI allowed in sectors such as advertising, mining, ports and harbours to lower amounts in sectors such as banking, defence, insurance, etc. Approval for investment in the permitted sectors can be obtained through two routes:

- Automatic route in which no prior approval is required. This is permitted for all items/activities except when the foreign investor has en existing tie-up/venture in India on 12 January 2005 or when the FDI proposal falls outside the notified sector policy or FDI caps.
- In all other cases of investment, prior approval is required from the Foreign Investment Promotion Board (FIPB). Generally, preference is given by the FIPB for projects in high-priority industries, infrastructure projects, those having export potential, large-scale employment opportunities, links with the agriculture sector, social relevance or relating to infusion of capital and induction of technology.

Tax incentives

The Indian government has introduced several incentives to encourage investment in India. These include:

Export Oriented Units

An Export Oriented Units (EOU) scheme is a 100% export-oriented scheme, focusing on promotion of exports through grant of various incentives and benefits to registered industrial units. Since its launch, the scheme has yielded far-reaching results and has re-triggered India's economic growth through increased exports and foreign direct investment.

An EOU is an industrial unit operating under customs bonding, which has undertaken to export its entire production of goods and services, except permissible sales in a Domestic Tariff Area (DTA). Such units may be engaged in the export of all kinds of goods and services (barring trading activities), including repair, remaking, testing, calibration, quality improvement, up-grading of technology and re-engineering activities, etc. for export in freely convertible foreign currency (subject to prescribed conditions).

Some advantages and tax incentives

Undertakings set up in EOUs are eligible for a deduction of 100% of export profits derived there for 10 years up to 31 March 2009. The exemption from Minimum Alternate Tax enjoyed by these units has been withdrawn effective 1 April 2007. Some EOU advantages are: no licenses required for import; up to 50% of exports' value can be sold locally with concessions on duties and taxes; 100% Foreign Direct Investment and sub-contracting are allowed.

Special Economic Zones in India

A Special Economic Zone (SEZ) is a specifically delineated, duty-free enclave, deemed to be outside the customs territory of India for the purposes of carrying out authorised activities. There are more than 30 operational SEZs in India. In addition, more than 115 SEZs have been notified and about 350 are in various stages of approval. The SEZ Act 2006 and SEZ Rules 2006, which came into force on 10 February 2006, govern development of SEZs. The act provides the umbrella legal framework, covering all important legal and regulatory aspects of SEZ development, as well as for units operating in these SEZs.

Export oriented manufacturers and service providers (including IT and ITES providers, BPOs, contract manufacturers, etc.) have huge growth potential in Indian SEZs. IT hardware and software and telecom equipment suppliers can also set up units in SEZs for supply to the domestic market.

Some advantages and tax incentives

Entities operating in a SEZ enjoy income tax, indirect tax and stamp duty incentives. Additionally, they face no minimum export obligations. SEZ developers are also entitled to 100% tax holiday (of profits and gains derived from the business of developing the SEZ) for 10 continuous years out of 15 years beginning from the year in which the SEZ is notified by the government. SEZ developers also enjoy exemption from Minimum Alternate Tax as well as Dividend Distribution Tax. Expenditure on the developing of the SEZ is also exempt from all duties of customs, excise, CST, service tax, etc.

Electronic Hardware Technology Park (EHTP) and Software Technology Park (STP) schemes

In a bid to enhance the export potential of the electronics industry and develop an efficient electronic component and information technology industry, EHTP and STP schemes have been announced. They offer a package of incentives and facilities like duty-free imports in line with the EOU scheme, deemed exports benefits and tax holidays. Export-oriented IT-enabled services like call centres, data processing, medical transcription, etc. are also eligible to be registered under the STP scheme.

Some advantages and tax incentives

Undertakings set up in a Electronic Hardware Technology Park (EHTP) or Software Technology Park (STP), are eligible for a deduction of 100% of export profits derived there for 10 years up to 31 March 2009. The exemption from Minimum Alternate Tax enjoyed by these units has been withdrawn from 1 April 2007. Furthermore, among other benefits, capital goods can be sourced on lease, 100% Foreign Direct Investment is permissible and no import duty needs to be paid.

In summary, the Indian government has increasingly liberalised its economy and opened sectors for foreign direct investments. To further encourage investments, several tax incentives such as SEZs, EOUs, EHTPs and STPs have been introduced. These factors need to be taken into consideration when embarking on your journey to India.

Key contacts

PricewaterhouseCoopers
India Business Service Center
De Entree 201
P.O. Box 22733
1101 HG Amsterdam Zuidoost

Yogen Singh
Tel: +31 (0)20 568 5638
Email: yogen.singh@nl.pwc.com

Krishna Sreerambhatla
Tel: +31 (0)20 5687481
Email: krishna.sreerambhatla@nl.pwc.com

Vikas Chaturvedi
Tel: +31 (0)20 5686891
Email: vikas.chaturvedi@nl.pwc.com

Yeroen van der Leer
Tel: +31 (0)20 5685233
Email: yeroen.van.der.leer@nl.pwc.com

Joost Petit
Tel: +31 (0)20 5685842
Email: joost.petit@nl.pwc.com

PricewaterhouseCoopers

At PwC Nederland, approximately 4,500 professionals work together from seventeen offices and three different perspectives: Advisory, Tax & HRS and Assurance.
Through our extensive network and a variety of facilities for exchanging knowledge and experience, we offer our clients solutions to complex business problems.
Advisory covers a range of corporate finance and risk management services. Tax covers all the stages in the tax consultancy and return process, and through HRS we offer solutions to HR issues. Assurance is the segment that offers accountancy services.
Our central philosophy, summarised in the motto 'Connected Thinking', helps us find innovative solutions – for large national and international enterprises, government bodies and not-for-profit organisations, well as for small and medium-sized businesses.

Knowledge of your sector

The PwC services structure covers a variety of market sectors. For each sector we operate advisory teams that are entirely up to date on the most recent developments. This means you will receive advice from professionals that are familiar with your specific sector of industry.

Worldwide network

As an independent part of a worldwide network of more than 140,000 colleagues in 149 countries, we have access to a wealth of knowledge and experience. For you this means that we can offer the right people and resources to ensure a consistent and coherent high-quality service.

Our market position reflects the strength of our worldwide network. We have the privilege of working with an impressive client base that includes some of the world's largest and most complex enterprises, as well as innovative pioneers. This enables us to share our best practices with you on a global scale, both within your sector and in different domains.

The India Business Service Center (IBSC)

The IBSC is a group within PricewaterhouseCoopers, situated in the Netherlands, with specific knowledge on doing business with India. The IBSC combines all areas of expertise within the firm and provides you with a single point of contact. We can help you:

- Assess market attractiveness and the most preferred entry option
- Carry out deal making and the associated due diligence activities
- Design the most optimal tax, legal and VAT structure
- Analyse and execute your outsourcing/offshoring operations in India

This unique combination of Indian and European local support, together with the ability to leverage on the extensive industry network that the global PwC firm possesses, will put you in a position to expand your business to India with a partner that knows you and your destination.

PricewaterhouseCoopers in India

PwC has a strong presence in India with 4200 professional staff and with offices in 8 major cities across the country. Established over 125 years ago in India, we have the local experience to supplement our global network. An industry perspective is followed and industry expertise is delivered to over 24 market sectors in three clusters namely:

- Consumer and Industrial Products & Services (CIPS),
- Financial Services (FS),
- Technology, InfoComm and Entertainment (TICE).

Abbreviations used in this paper

$	United States Dollar
ACES	ABN Amro Central Enterprise Services
BPO	Business Process Outsourcing
CAGR	Compound Annual Growth Rate
CEO	Chief Executive Officer
CII	Confederation of Indian Industry
CIPS	Consumer and Industrial Products & Services
CST	Central Sales Tax
DTA	Domestic Tariff Area
E&P	Exploration and Production
EHTP	Electronic Hardware Technology Park
EOU	Export Oriented Units
F&A	Finance and Administration
FDI	Foreign Direct Investment
FIBP	Foreign Investment Promotion Board
FS	Financial Services
FY	Financial Year
GDP	Gross Domestic Product
IBSC	The India Business Service Center
IT	Information Technology
ITES	Information Technology Enabled Services
KPO	Knowledge Process Outsourcing
P.A.	Per Annum
PPP	Purchasing Power Parity
PwC	PricewaterhouseCoopers
R&D	Research and Development
RBI	Reserve Bank of India
ROI	Return on Investment
Rs.	Indian Rupees
SEZ	Special Economic Zone
STP	Software Technology Park
TICE	Technology, InfoComm and Entertainment
US	United States of America

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