Growing Beyond

Ready for the transition

Ernst & Young's 2012 attractiveness survey

India

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Ernst & Young
Quality In Everything We Do

Ready for the transition

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India

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India: ready for the transition?

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Welcome to the second edition of the *Ernst & Young's India attractiveness survey*.

The *2012 India attractiveness survey* was carried out at a time when the dialogue among business leaders about the economic crisis was at its peak and investors were in "caution" mode. Regardless of today's crisis, a strong increase in the number of foreign direct investment (FDI) projects in India is a clear indication that global investors view the country as an attractive investment destination. More than half of our respondents remain convinced about India's long-term prospects and plan to strengthen their operations in the country, with more than two-thirds of those interested in India, planning to implement projects in the short term.

The fundamentals that make India attractive to investors remain intact. The high potential of the domestic market driven by an emerging middle class, cost competitiveness and a mammoth pool of talent continue to make India one of the most preferred destinations for our survey respondents this year as well. The country's domestic demand-driven growth model is playing a catalyst role in attracting foreign investments in the country. Although the ongoing global uncertainty stemming from recessionary concerns and sovereign debt crisis has, to some extent, prompted some discomfort among global investors to make long-term commitments, India's inherent advantages and its proven resilience to counter macroeconomic challenges far outweigh these concerns.

India is transitioning into the next phase of the growth cycle. Manufacturing will likely play a leading role in this growth trajectory. While the country leads the world ranking as a shared services destination, it is rapidly emerging as a manufacturing location for many foreign corporations. By 2020, 25% of our survey respondents see India among the world's leading three destinations for manufacturing. The new National Manufacturing Policy introduced by the government of India (GOI) is expected to further boost manufacturing activities in the country.

The overall outlook for India remains positive. However, our respondents continue to cite inadequate infrastructure and a lack of governance and transparency as major obstacles to investment. The majority of our respondents believe that improving these obstacles will have a high impact on India's attractiveness. The Government, though sensitive to the challenges, has to hasten policy-making and implementation, so that India continues to remain attractive.

We have tried to build upon our first edition of the *India attractiveness survey* by including a section on India's transition to the next phase of growth driven by the manufacturing sector. Another key element of our report is an analysis of eight priority sectors, which we believe would be the game-changers and drive the FDI momentum in the country.

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

Viewpoint

India, on the path of inclusive growth and sustainable development

Sam Pitroda, Adviser to the Prime Minister (Information, Infrastructure, and Innovation)

Realising that innovation is the engine for national and global growth, employment, competitiveness and sharing of opportunities in the 21st century, the Government of India has declared 2010–2020 as the "Decade of Innovation".

To prepare a roadmap for innovation in the country, and to formulate and implement a model of inclusive innovation, the Prime Minister constituted the National Innovation Council (NInC) in September 2010.

India has unique challenges and large unmet needs across diverse areas such as health, education, skills, agriculture, urban and rural development, energy and so on. The country also has significant challenges of exclusion and inequitable access due to multiple deprivations of class, caste and gender — all of which require disruptive approaches to find solutions. Innovation is therefore a central necessity to provide answers to many pressing challenges India is also uniquely poised to reap the advantages provided by a nation of a billion connected people, with over 800 million mobile phones, and global leadership in information and communication technology (ICT). Additionally, the ICT talent is assisting the world changing the nature of processes, business, industry, governance, education and delivery systems.

Innovations in the last two centuries have been driven by the needs of the developed world. The challenge before India is to develop an inclusive model of innovation that will move the country to progress from a knowledge-producing economy to a knowledge-sharing society, asserting its relevance to different parts of the world. India has its complex challenges which cannot be addressed through incremental approaches.

Our efforts at the National Innovation Council have been aimed at developing an inclusive innovation strategy geared towards creating "more from less for more". India needs more "frugal, distributed, affordable" innovation that produces more affordable products and services targeted for people with low levels of income without compromising their safety, efficiency, and utility. In creating this Indian model of innovation, we are looking at key drivers of sustainability, affordability, quality, global competitiveness and local needs.

We believe that:

- Innovation needs to go beyond formal R&D parameters, breaking sectoral silos and outside of a high-tech product-based approach to also include organisational, process and service mechanisms.
- Innovation eco-system must spread across domains and sectors to strengthen entrepreneurship and growth, and facilitate the germination of new ideas.
- Innovation needs to have outreach which promotes disruptive thinking, dialogue and discourse on problems of the masses.

India, as Prime Minister Manmohan Singh says, is a global experiment at promoting economic development along with political democracy for a billion plus people. National Innovation Council is working with multiple agencies of the Union and State governments, academia, professional groups, industry and communities.

Some of the key initiatives of 2010–11 have been:

a. Developing a framework to finance innovation through an India Inclusive Innovation Fund;

b. Facilitating creation of Industry Innovation clusters to drive job creation and productivity;

c. Creating a connected India through the spread of rural broadband in two years time to all 250,000 village local bodies (panchayats)

d. Intervening in Education by to promote innovation through curriculum changes, talent-spotting of innovators among students and award of Innovation fellowships; creation of a Meta University, as a global first, that rides on the National knowledge network to promote multi-disciplinary learning, and facilitating the creation of innovation ecosystems at universities through University Innovation Clusters;

e. Promoting an innovation culture through action in areas of communication and advocacy through an innovation portal and working through mass media organisations;

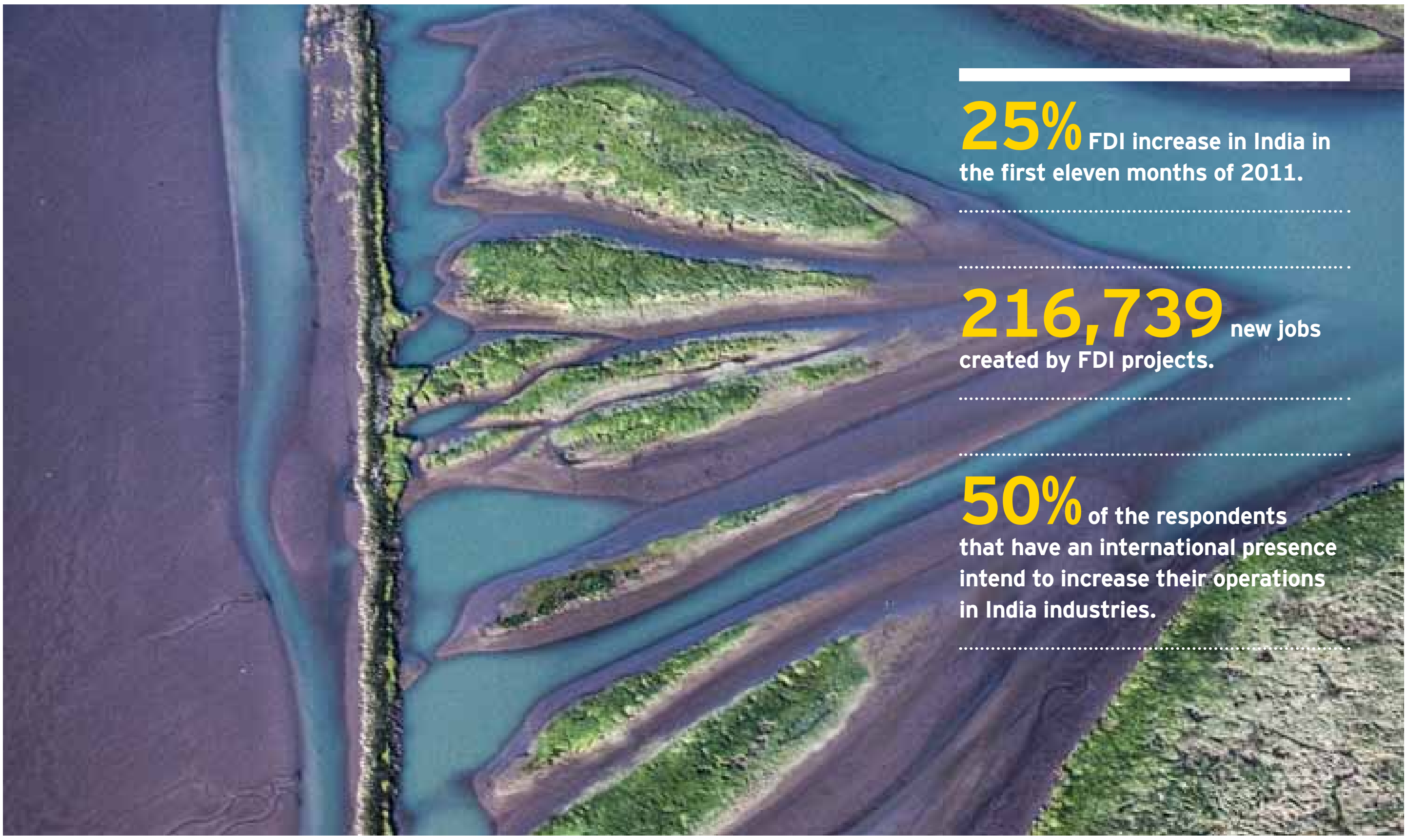
f. Creating an institutional framework for innovations in government by facilitating the setting up of State Innovation Councils in each State, and Sectoral Innovation Councils aligned to Union government ministries;

g. Promoting projects that create an innovation dividend like the setting up of a Rabindranath Tagore Knowledge city in Kolkata, setting up twenty Innovation Design Centres co-located in existing institutes;

h. Promoting co-creation and sharing of knowledge through global knowledge partnerships, beginning with a global roundtable on innovations for sharing ideas.

We feel that such an innovation movement, with the involvement and commitment of the people at all levels, would not only be critical for solving challenges of inclusion in our society, but set India on the path of inclusive growth and sustainable development.

Executive summary



Viewpoint

Our economic growth is contingent on continuing reforms

Chandrajit Banerjee, Director General, Confederation of Indian Industry (CII)

Despite challenging economic conditions, India continues to be among the fastest-growing economies in the world. The growth might have climbed down to 7% from its normal trajectory of 8.5%–9.0%; nevertheless, it continues to be impressive in the midst of anxiety all around. A large domestic market led by the emergence of a important middle class population, investor-friendly policies, rising foreign exchange reserves, availability of skills and demographic prospects are some of the strong positives that are behind the Indian growth story.

However, I believe that the propelling process of economic reforms would send positive signals to investors. The forthcoming budget should send a strong message that the government is serious about pushing the reforms process forward. There is also a need to initiate fiscal consolidation for which the government could amend the Fiscal Responsability and Budget Management Act, by drawing a road map for reduction in fiscal and revenue deficits over the next five years. Another important measure could include paving a way for US$1 trillion of investment in the infrastructure sector. The government could take the initiative to identify and fast-track 100 mega projects in infrastructure, which would serve to boost the confidence of foreign investors immensely.

India has the potential to take its rightful place as a major economic power, along with USA and China, by 2020.

Manufacturing is one of the key drivers for India's economic growth, which contributes 16% to the country's GDP, 50% to exports and employs 12% of the total workforce. Manufacturing has the potential to enhance its share of contribution to GDP and generate a greater number of additional jobs. This has also been identified as the objective of India's National Manufacturing Policy (NMP). To achieve the desired aspiration of 25% contribution to GDP and 100 million additional jobs, manufacturing GDP needs to grow between 2-4% higher than national GDP.

India has the potential to take its rightful place as a major economic power, along with the US and China, by 2020. However, our economic growth is contingent on continuing reforms, which have been impressive so far.

India 2011

An FDI hot spot in a cooling world

India remained very attractive for FDI in 2011. FDI projects increased by 25% in India in the first eleven months of 2011, attracting 864 projects, which created an estimated 216,739 jobs. This is despite a global economic growth that had not fully recovered from the financial crisis of 2008–09 and has begun to slow again, from over 5% in 2010 down to a projected 4% through 2012.[1]

Investors came to India to find growth opportunities for their business and the possibility to operate at lower cost. Fifty percent of our panel claims that India's massive and growing domestic market is their number one draw and 45% of them see India as a highly cost-competitive location.

China is India's direct competitor. Fifty-five percent of investors perceive the other rapid-growth giant as the primary competitor, which is confirmed by FDI facts: India is the fourth destination country for FDI, behind the US (first) and China (second).

India's FDI profile

Dynamic, cost competitive and specialized

India's inward FDI activity is specialized on large industrial and back-office operations. In the first eleven months of 2011, the country received 267 large-scale manufacturing projects, creating an estimated 129,709 new jobs, mostly in the automotive, industrial equipment and metals industries. India also received 220 large back-office and business process outsourcing (BPO) projects creating 26,298 new jobs, mainly in the IT services industry.

However, India is still developing its attractiveness for strategic operations, such as R&D centers and headquarters. In 2011, investors only brought 19 R&D centers to India and 11 headquarters.

Investors show strong confidence in India to maintain this performance in the long term. Only 11% of the survey respondents see India being surpassed by more dynamic countries. Twenty-nine percent believe that India will continue to experience rapid growth in the coming years. They also see India as one of the world's leading destinations for shared service centers (27%) and manufacturing (25%).

India's 2020 agenda

More open and more innovative

Investors remain committed to increasing operations in India. Fifty percent of the respondents that have an international presence intend to increase their operations in India, while 19% said they will maintain their current level of activities in the country.

Investors are also more demanding. They want to secure their investments in easily accessible (63%) and predictable business climates with FDI-friendly regulatory environments (62%).

Indian business conditions raise concerns among global leaders. Our survey respondents demand immediate upgrading of the infrastructure network (48%) and would like to see improved transparency with more open FDI regulations (45%).

In the long term, investors highlight innovation as a challenge for India. Forty-three percent of investors think that it needs to improve the quality of its labs and research institutions. More specifically, 38% of investors cite distance between research institutions and corporations as a roadblock to developing new products in the country.

1. World Economic Outlook, IMF 2011

India in 2011

An FDI hot spot in a cooling world

4th global destination for FDI.

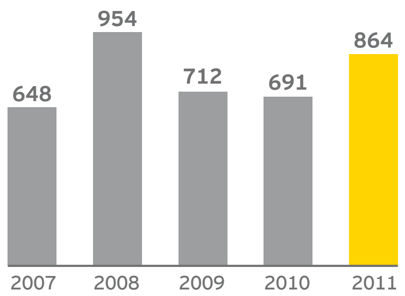
71% of business leaders surveyed are keen to invest in India in the near future.

52% of FDI projects come from US, Germany, UK and France.

Performance 2011: foreign investment decisions in India increase by 25%

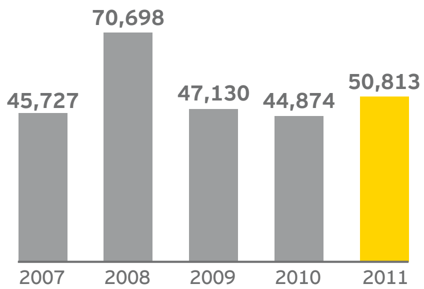
The number of FDI projects into India began to grow again in 2011, recovering from the slumps observed in 2009 and 2010.

Number of FDI projects in India



Source: fDi Intelligence; data is for eleven months (January–November 2011) for each year.

FDI by value (US$ million) in India



Source: fDi Intelligence; data is for eleven months (January–November 2011) for each year.

The number of FDI projects increased by 25% in the first eleven months of 2011 reaching 864 projects.[2] Companies have started to invest, albeit cautiously; their confidence has been supported by the consumer demand, the easy access to financing and the increased approvals by the Foreign Investment Promotion Board.[3]

Mirroring the trend seen in the number of investment projects, investments peaked in value in 2008. This number declined in 2009 and 2010, following the financial crisis, but returned in 2011. Projects have also decreased in value; in 2007, the average project was worth US$71 million and, in 2011, it was worth US$59 million.[4]

Despite the uncertain global economy and the slight majority of businesses that are putting their investment projects on hold, there was not only an increase in the number of FDI projects in India from 2010 to 2011, but the value also increased by 13% and the number of jobs by 12%. Investors perceive that India presents value and promising growth dynamics in this increasingly unstable global economy. With a rapidly expanding middle class to consume products and the presence of a large, well-trained labor force keeping costs down, India presents opportunities both to investors who want to produce and to investors who want to sell.

2. fDi Intelligence (2011 January-November).
3. Ministry of Commerce and Industry, Government of India.
4. fDi Intelligence; the averages are also based on first 11 months (January-November) for every year.

Global ranking: India remains the fourth destination for FDI

India also ranked fourth globally in terms of the number of FDI projects.

Top five recipient countries by number of projects

Rank	Top five countries	Jan-Nov 2010	Jan-Nov 2011	Change 2011 vs 2010
1	US	1,413	1,561	10%
2	China	1,236	1,306	6%
3	United Kingdom	866	936	8%
4	India	691	864	25%
5	Brazil	325	480	48%

Source: fDi Intelligence; data is for 11 months (January-November) for each year.

India recorded 864 projects, an increase of 25% over 2010, the second-highest growth rate of any country on the list.

However, India faces some real challenges in the short term. Rising inflation and unemployment are the major roadblocks. The Reserve Bank of India (RBI) is undertaking a policy to drain excess liquidity from the financial system and has raised interest rates by over 350 basis points since the beginning of January 2010 to curb rising inflation. In December 2011, Inflation fell below 9% for the first time in last 12 months.[5] Furthermore, the Government is actively confronting unemployment, increasing public and private sector employment as well as increasing vocational training for at-risk youth. These policies should bolster the confidence of investors in India and its ability to compete with even the most dynamic rapid-growth economies.

China remains India's top competitor for executives

China is the largest competitor of India in terms of attractiveness, according to 55% of the survey respondents. Like India, China's economic size, its status as a low-cost production base and easy access to international markets, make the country a magnet for investors.

Yet there are significant differences between the Indian and the Chinese appeal. The Chinese economy relies on exports, while the Indian economy is driven by its domestic consumption. This positioning gives China a greater exposure to external economic shocks, especially its manufacturing sector, which up until recently relied on demand in mature economies.[6] Compounding the potential threat from reduced demand, Chinese manufacturers face rising wages and production costs, which have slowed growth in its booming coastal cities.[7]

In your sector, which countries are the main competitors of India in terms of attractiveness for FDI?

Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 506.

5. *Ernst & Young Rapid-Growth Markets Forecast Winter Edition*, RBI.
6. *IMF China Economic Outlook report*, September 2011
7. *UNCTAD World Investment Report*, 2011.

Where from: India's FDI clients

India attracts a variety of investment from all regions of the world, but more than half (52%) from the US, Germany, the UK and France. From Asia, Japanese and UAE companies represent 15% of the 864 projects recorded in the first eleven months of 2011.

▶ FDI from the United States

The US remains the leading investor in India both in terms of projects and jobs generated, and accounted for 31% of the investment projects (1,282), with more than 316,900 jobs created between 2007 and November 2011. A number of leading American companies, such as General Electric Company, Citigroup Inc. and Honeywell International, Inc. have expanded their presence in India. Top investment sectors for US companies include ICT, primarily for design, development and testing; and business services, such as customer care centers and construction relation services.[8]

FDI inflows by source country

Rank	Country	FDI projects 2010			Change 2011 vs. 2010	Value (US$ million) 2011	Job creation 2011
		2010	2011	Share in FDI 2011			
1	US	200	260	30%	30%	11,739	64,316
2	Japan	74	107	12%	45%	6,582	38,921
3	UK	74	90	10%	22%	1,248	9,801
4	Germany	75	81	9%	8%	2,229	15,260
5	France	26	26	3%	0%	3,383	14,673
6	Sweden	7	24	3%	243%	2,319	8,899
7	Switzerland	23	23	3%	-	539	5,408
8	Spain	15	20	2%	33%	1,021	4,412
9	UAE	26	19	2%	-27%	932	5,268
10	Finland	13	17	2%	31%	843	3,907
11	Others	158	197	23%	25%	19,978	45,874
	Total	**691**	**864**	**100%**	**25%**	**50,813**	**216,739**

Source: fDi Intelligence; data is for 11 months (January–November 2011) for each year.

▶ FDI from Japan

In 2010 and 2011, Japan emerged as India's second-largest investor, in terms of the number of projects and jobs created. Leading Japanese companies, such as Toyota and Suzuki, have made substantial investments in India. The country accounted for 11% of the investment projects (440), with more than 140,000 jobs created in India between 2007 and November 2011. Japanese investment in India was hit marginally due to the March 2011 earthquake; however, it has picked up pace again. Investment in India has particularly been in the automotive manufacturing and industrial setups, with focus on heavy engineering and sales, marketing and support.[9]

▶ FDI from the United Kingdom

Strong bilateral ties, including trade and investment, climate change agreements and mutual acceptance of the global international systems reforms, have been instrumental in bringing UK investors to India. British investment accounted for 10% of the investment projects (423) with more than 99,600 jobs created in India between 2007 and November 2011. During this period, the UK ranked third in terms of the number of FDI projects. Large British companies such as Vodafone, Marks and Spencer and Cairn have made successful investments in India. British investments are mainly focused toward ICT in business services, sales, marketing and support, design, development and testing; and industrial set ups in retail and manufacturing.[10]

▶ FDI from Germany

Germany has maintained its position among the top five investors in terms of the projects created, and accounted for approximately 10% of the investment projects (409) with more than 107,200 jobs created in India between 2007 and November 2011. India has attracted large German companies such as Volkswagen, BMW and Bosch.[11]–

▶ FDI from France

Although the share of French projects has declined over the years to an average of 5% between 2007 and November 2011, France remains one of the leading sources of job creation. It tops the average jobs created per project (340) between 2007 and November 2011, ahead of the other leading countries such as the US, the UK, Germany and Japan.[12]

▶ Investors from Asian economies put their money in large projects

South Korea and China are the primary rapid-growth Asian economies that invest in India. These countries have lately lined up several big-ticket investments, particularly in the metals and mining space. South Korea's steel giant POSCO has planned an investment worth US$12 billion in a steel plant in Orissa. Once, finalized, this will be the largest ever FDI deal in India. Chinese investors also find India attractive and have invested in 62 projects, creating more than 36,200 jobs since 2007, primarily in the manufacturing and ICT sectors.

Between 2007 and November 2011, an average 401 jobs were created per project by rapid-growth Asia Pacific countries (excluding Japan), more than North American (245) and Western European countries (249). This discrepancy in job creation results from their focus on large industrial projects in India. South Korea created on average 692 jobs per project, while China created 584 jobs per project, far ahead of India's current Western clients.

8. fDi Intelligence.
9. fDi Intelligence.

10. fDi Intelligence, The Ministry of Finance, Government of India; British High Commission.
11. fDi Intelligence; Ministry of Finance, Government of India.
12. fDi Intelligence.

Where to:
India's top five FDI destinations

Top five cities in India attract 43% of the investment projects, 34% of the jobs created by FDI and 26% of the value of FDI in India.[13]

▶ Bangalore
Bangalore has become a global hub for service sector investment in IT, engineering and biotech. Bangalore's Millennium IT Policy and the Millennium Biotech Policy, which offer a variety of incentives, make it attractive for technology companies. Since 2007, the city has attracted 464 investment projects creating more than 96,400 jobs from FDI, mostly due to its educated workforce and high-quality infrastructure.[14]

▶ Mumbai
Mumbai is the commercial capital of India. It attracted 453 FDI projects between 2007 and November 2011, creating more than 34,900 jobs. Investors came to the city for opportunities in manufacturing and services. In particular, they targeted energy, transportation, software and banks / financial services institutions. To facilitate investment, the state government has policies for biotech, e-governance, infrastructure, IT, special economic zones (SEZ) and tourism.[15]

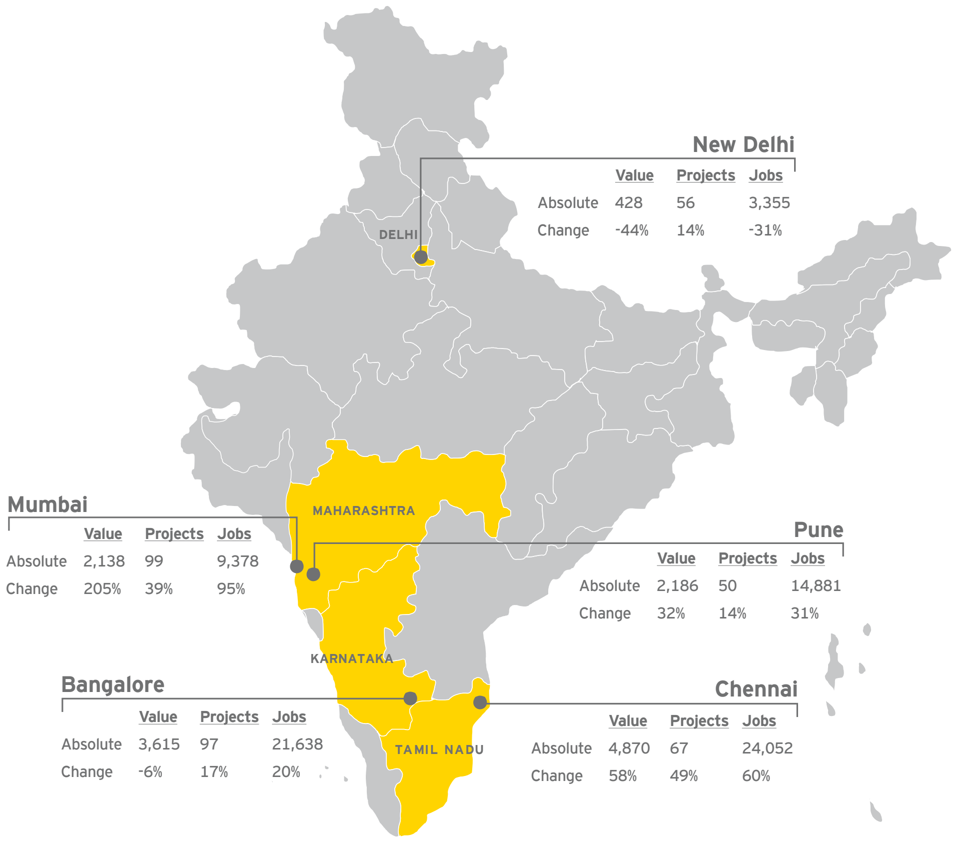
▶ Chennai
Chennai attracted 337 investment projects creating 104,002 jobs between 2007 and November 2011. It concentrates on the automotive sector, especially in automobile and railway coach manufacturing and design development and testing. State policies continue to attract these investments.

▶ New Delhi
New Delhi is an investment destination for the services industry, particularly IT and IT enabled Services (ITeS), and consulting. New Delhi has also become one of the key locations to set up branch offices for foreign companies. It attracted 301 FDI projects, creating more than 23,354 jobs, between 2007 and November 2011.

▶ Pune
Pune has a large industrial base and significant foreign investments have already been made in the manufacturing sector. In addition, the city is now becoming one of the key hubs of software and IT services. Between 2007 and November 2011, Pune attracted 243 FDI projects creating more than 64,000 jobs.[16]

Map

Top five FDI recipient cities



Note: value denotes US$ million. Source: fDi intelligence. Map depicts project and job numbers for the first eleven months (January-November) of 2011. Change represents comparison of same periods of 2011 and 2010.

13. fDi Intelligence.
14. fDi Intelligence, Government of Karnataka.
15. fDi Intelligence, Maharashtra Industrial and Economic Development Association.

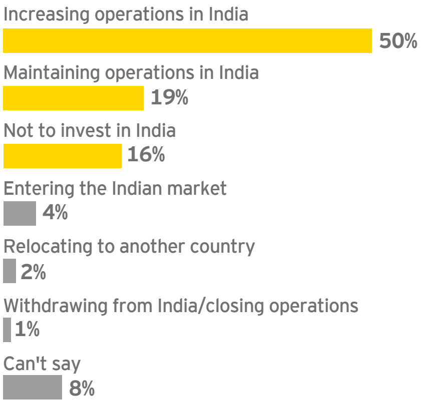
16. fDi Intelligence, Maharashtra Industrial and Economic Development Association.

Investment prospects for 2012: India's loyal FDI clients

Amid the global gloom and doom, international investors continue to show their interest in India.

Fifty percent of the respondents that have an international presence say that they intend to increase their operations in India, while 19% said they will maintain their current level of activities in the country. They see India's consumption-driven economy and large population as especially attractive.

Investors' future plans



Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 382 (companies that have international presence)

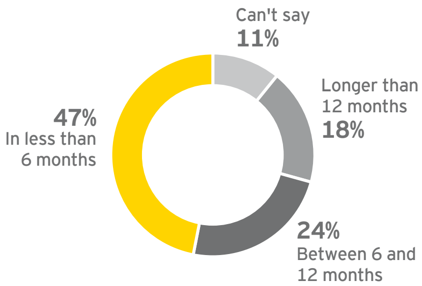
Around 16% of investors are reluctant to invest in India. Investors have put their projects on hold globally as they want to retain cash reserves.[17] The global downturn is not the only thing that concerns investors. In India, they are frustrated with the lengthy time taken to get approval for projects at the state and local government level. Recent high-profile corruption scandals and fear of "policy paralysis" driven by the retraction of the much-hyped retail FDI policy in India have also made investors nervous.[18]

Nevertheless, companies continue to be convinced by India's growth and foresee their presence in the country as a positive long-term opportunity: more than 60% of companies already present in India plan to increase their operations in the country.

▶ When will they invest?

According to Ernst & Young's 2012 India attractiveness survey, 71% of business leaders surveyed are keen to invest in the Indian market in the short term. Forty-seven percent plan to invest within less than 6 months and 24% within 6 to 12 months.

When are you planning to invest in India?

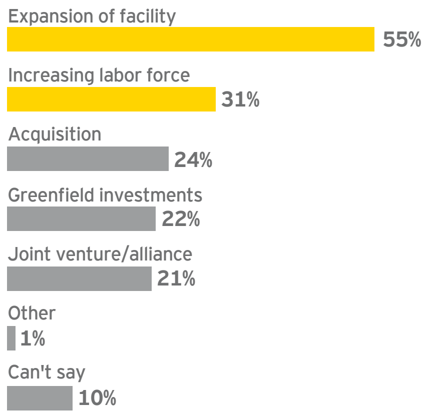


Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 220 (group considering entering the market or increasing operations in India except PE and RCP).

▶ How will they invest exactly?

Similar to our survey results of last year, organic growth is still the most preferred mode of investment in India. Fifty-five percent of companies considering entering or increasing their presence in India plan to expand their facilities, while 31% wish to increase their labor force. As these companies are familiar with the regulations and pitfalls in India, the organic growth route will likely continue as the first choice for mode of investment. In contrast, only 24% of investors plan to acquire companies, 22% plan greenfield investment and 21% plan joint ventures. This is primarily due to the lengthy approval process for investment projects.

How are you planning to invest in India?



Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 193 (group considering entering the market or increasing operations in India except PE and RCP).

17. fDi Intelligence data.
18. "GE Says India 'Frustrating' as Stalled Decisions Cost Money," *Bloomberg news*; "India's retreat is blow to global retailers," *The Wall Street Journal*, 8 December 2011, via Factiva.

India's attractiveness pillars

Manufacturing and shared services

45% of investors cite low cost labor and inexpensive manufacturing as key attraction in India.

78% of investments in India went into the industrial sector.

50% of investors believe that the high potential of the domestic market is the most attractive characteristic of the Indian market.

What investors seek in India: growth and cost competitiveness

Investors came to India to find growth opportunities for their business and the possibility to operate at lower cost.

According to half of its foreign investors, India's domestic market is the number one draw. In particular, India's rapidly rising middle class should grow from more than 160 million people in 2011 to 267 million people in 2016.[19]

Cost competitiveness remains another key characteristic of India: 45% of investors cite the availability of low cost labor and inexpensive manufacturing capabilities as a key attraction for their business. In particular, India's attractive labor costs can explain the phenomenal growth of its BPO industries and its rapidly growing manufacturing sector. Although India has witnessed some increases in its labor cost, it remains a highly attractive destination for investors who struggle to find the same mixture of low cost and high quality.[20]

Companies continue to benefit from India's young and educated workforce. India's talent pool continues to increase; there was an estimated addition of approximately four million graduates in FY2011 (April 2010 to March 2011).[21] With recent government education policies aiming to expand the number of educational institutions and "vocation"-driven education systems in India, this number will continue to rise in the coming years. According to the National Association of Software and Services Companies (NASSCOM), India ranks second (China having been ranked first) in terms of churn of total graduates every year and its ready-to-hire graduate pool is substantially more than that of other countries.[22]

Despite these positive signs, only 2% of respondents cited the ease of doing business in India as a draw to investing, which confirms the findings in the Doing Business 2012 report that India ranks 132 out of 183 countries. According to Doing Business 2012 data, starting a business in India requires 12 procedures, which takes 29 days. This is in line with other BRIC countries: starting a business in China requires 14 procedures and 38 days; in Russia it takes 9 procedures and 30 days; and in Brazil it takes 6 procedures and 34 days.[23]

What are the three most attractive characteristics of the Indian market?

Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 506; three possible responses.

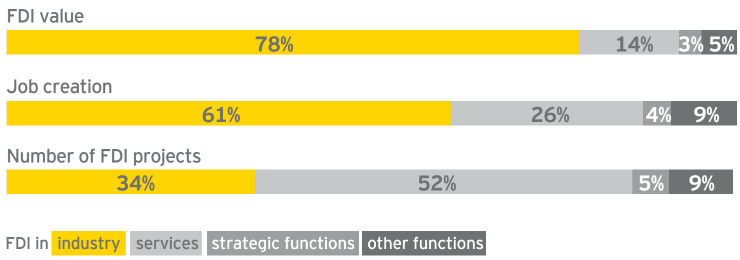
19. Asian Development Bank.
20. "Another giant leap," *The Economist*.
21. Nasscom.
22. Nasscom.
23. *Doing Business 2012*, World Bank.

What investment projects are there in India: manufacturing — the next big leap

India: an emerging manufacturing hub
During 2011 (January-November), investors committed US$50,813 million in India, 78% of which went into the industrial sector, creating 299 projects and 131,846 jobs (61% of the total jobs), and producing an average of 441 jobs per project. Since 2007 the attractiveness profile of India has evolved. Although industry was always important, it has grown from supplying one half of every FDI job in India in 2007 to almost two-thirds of every FDI job in 2011. At the same time, services jobs have fallen from creating almost one-third of every FDI job in India in 2007 to creating approximately one-quarter in 2011.

Investors increasingly see India as the destination for their new manufacturing projects (50%) drawn by the high potential of its domestic market and (45%) by its attractive cost base. When investing in industrial projects in India, investors tend to target the industrial machinery, equipment and tools (115 projects) and the automotive (76 projects) sectors. In 2011 (January-November), the automotive sector also topped the industrial projects in job creation, attracting 40,091 jobs.

Investment in India in 2011: breakdown by functions



Source: fDi Intelligence, data is for first 11 months (January-November) of 2011.
Industry includes: manufacturing, logistics, distribution and transportation, electricity.
Services includes: sales, marketing and support, business services, design, development and testing, customer contact center, technical support center, maintenance and servicing, ICT nd internet infrastructure, shared services center.
Strategic functions includes: headquarters, R&D, education and training.
Other functions includes: retail, construction, recycling, extraction.

The industrial machinery, equipment and tools sector came second in job creation, attracting 24,014 jobs.

These massive high-growth sectors attract investors with the promise of selling to the rapidly growing middle class. The automotive sector, in particular, offers the chance to reach first-time buyers and establish brand loyalty. The industrial machinery, equipment and tools sector allows investors to supply the rapidly expanding Indian industry with components.

Investment breakdown by functions (2011)

FDI type 2011	Number of FDI projects	Job creation	FDI value (US$ million)
FDI in industry	299	131,846	9,838
FDI in services	447	57,062	6,942
FDI in strategic functions	43	8,284	1,605
FDI in other functions	75	19,547	2,428
Total	**864**	**216,739**	**50,813**

Source: fDi Intelligence, data is for first 11 months (January-November) of 2011.
Industry includes: manufacturing, logistics, distribution and transportation, electricity.
Services includes: sales, marketing and support, business services, design, development and testing, customer contact center, technical support center, maintenance and servicing, ICT and internet infrastructure, shared services center.
Strategic functions includes: headquarters, R&D, education and training.
Other functions includes: retail, construction, recycling, extraction.

Support services: medium scale and sales oriented
India received 447 support services projects in 2011, accounting for 52% — the largest group of investment projects in the country. However, these projects were small to medium sized, costing investors on average US$16 million and creating on average 128 jobs. The design, development and testing sector, with 26,914 jobs in 94 projects, created the most jobs.

The sales, marketing and support function attracted 194 projects, 43% of the support services projects, dominating the sector. Despite the large number of projects, the sales, marketing and support sector only created 4,191 jobs, or 7% of the total support services jobs, and created on average 22 jobs per project. Clearly, there is an evolution in investor's perception of India and while the service sector continues to attract, it does not bring the major job creation numbers or project values to India.

Viewpoint

Manufacturing, the next big Indian story

Abhaya Agarwal, Executive Director and Leader — PPP Advisory, Government practice, Ernst & Young India

Manufacturing sector is again witnessing renewed interest after years of neglect by policy makers and the recent efforts of Indian government bode well for the economy and consequently investors. The government unveiled the National Manufacturing Policy (NMP) in October 2011. Through this policy, the government has walked the first steps to resolve the key challenges facing the manufacturing sector in India. More are likely to come soon.

NMP offers some novel solutions to resolve problems related to labour, ease of exit, skill availability, environmental laws, and infrastructure. One of the key features of NMP is the establishment of National Manufacturing & Investment Zones (NMIZ). NMIZ is proposed as a greenfield/ brownfield industrial cluster having state-of-the-art infrastructure and offering business-friendly policies or services. The infrastructure would range from logistics, power, skill development, public utilities, environment protection, which are all the essential requirements of a competitive manufacturing base. They will be supported by business-friendly approval mechanisms and operating policies. Thus NIMZ shall provide the conducive environment for industries to set up and be competitive in global economy.

Manufacturing in China has thrived in similar designated clusters or SEZs. India also aims to achieve the same success through NIMZ. In this regard, the government has already identified about key clusters under Delhi-Mumbai Industrial Corridor (DMIC) project as an NMIZ. DMIC is another initiative of the government which is generating huge investor interest. DMIC envisages development of industrial clusters along the high speed freight rail network. Govt. of Japan has already evinced interest in picking up 26% equity in the company implementing DMIC. Many international manufacturers particularly Japanese are keen to invest in DMIC manufacturing base in DMIC as an alternative to China.

Government has walked the first steps to resolve the key challenges.

The development of these NMIZs will provide attractive opportunities to investors across the board. DMIC itself envisages investment of $90 billion across logistics, power, public utilities, townships, industrial estates, among others. It will further open up more investment opportunities in manufacturing sector. Notwithstanding implementation issues, NIMZ can herald a growth of 12–14% being targeted for manufacturing sector.

These initiatives show the seriousness being attached to promoting the manufacturing sector by the policy makers. They are moving from short-term solutions to long-term efforts and the serious long-terms investors will be beneficiary of this new approach.

Interestingly, the Indian economy remains highly competitive in the services sector, which makes up 50% of its GDP.[24] However, this is not driven primarily by foreign investors; domestic players dominate the sector. Indian companies form approximately 65% in the BPO segment, while foreign companies, including their captive units, constitute the remaining 35%. Rather than compete with domestic players in their home market, foreign investors come to India to complement their service offering or gain market share.

Although some continue to create call centers and back offices, this was the exception rather than the rule in 2011.[25]

Working on strategic functions

India is still working on its attractiveness for more strategic functions. In 2011, India only received 43 projects, down 14% from 2010. This figure remains consistent with the trends in FDI over the last five years, where the number of projects in strategic functions varied from 5% to 10% of the total and from 1% to 7% of the value of investment in India.

R&D is the most attractive strategic function in India. However, in 2011, the country only gained 19 projects, or 2% of the total FDI projects. This is due to lack of sufficient training centers and vocational training courses in the country.[26] In addition, there is a need to make India's current intellectual property system more inclusive and safe,[27] and to enable inventors to access the system at low or subsidized costs.

24. CIA, The World Factbook.
25. *Strategic review of Indian IT-BPO sector 2011*, Nasscom.
26. *Strategic and implementation framework for skill development in India*, Ernst & Young, September 2011.
27. *Utility patenting: India's next move?*, Livemint.

Looking closer
FDI by sector

Infrastructure

Covering

- Building and construction materials
- Real estate
- Non-automotive transport original equipment manufacturer (OEM)
- Ceramics and glasses

73.7%

Number of FDI projects: 19 in 2010, 33 in 2011.

-11.6%

Number of jobs created by FDI in the sector: 19,385 in 2010, 17,132 in 2011.

-21.6%

Value of FDI (US$ million): 2,901.1 in 2010 and 2,274.5 in 2011.

Source: fDi intelligence; data is for 11 months (January-November) for both years.

The number of FDI projects in the Infrastructure sector grew by 74% in the first eleven months of 2011 in India. The sector contributed 4% to the total number of FDI projects and 8% to the total jobs created.[28] Development in the country's infrastructure is poised to accelerate as the Government of India (GOI) plans to double its infrastructure spending from US$500 billion to US$1 trillion during FY2012-17.[29] The GOI is aggressively focusing on minimizing India's infrastructure deficit and would like to generate investor interest in the sector.

The GOI allows investors full access to most infrastructure sectors, including: roads and highways; ports and harbors; power plans and airports. To increase infrastructure's attractiveness further, the GOI has extended tax holiday periods, and facilitated the creation of public-private partnership (PPP) projects. Drawn by the various opportunities available in the sector, a number of private players, including foreign players, have started participating in building the infrastructure sector.[30] International players, such as Toyo Engineering, Jacobs H&G, Uhde, Tecnimont and Aker Solutions, are already investing substantially in the country's infrastructure space.

However, land acquisition and environmental clearance issues, along with persistently high inflation and interest rates, hamper new investments projects, especially their timely completion. Furthermore, India's regulatory environment can periodically block the injections of foreign money into the sector.

28. fDi Intelligence.
29. Planning commission of India.
30. "FDI statistics," Department of Industrial Promotion and planning website, http://dipp.nic.in/fdi_statistics/india_fdi_index.htm, accessed 1 December 2011.

FDI case study

ITD Cementation

ITD Cementation, a subsidiary of ITD Thailand, started its operation in India in 1931. The company has been present across various infrastructure segments with a focus on civil engineering solutions. Its revenue has increased from US$41.4 million in 2001 to US$321 million in 2010.

ITD has matured from civil, mining and foundation engineering to become a part of large infrastructure projects for NHAI, the Airports Authority of India, Indian Railways, Delhi Metro, port trusts and defense organizations.

The company's commitment to India can be witnessed by its megaprojects in the country, such as the second container terminal at Chennai; the wet basin at Mazagon Dock and the Kolkata Airport modernization.

Despite the issues in the infrastructure sector, the benefits outweigh the costs for the majority of investors. In particular, power generation and transport are expected to attract the largest number of projects. India currently suffers from acute power shortages. However, privatization efforts for the sale of power are intended to attract investors to the sector. India's transportation sector also needs to be upgraded, especially its road network. The National Highway Authority of India (NHAI) has started to award PPP projects to investors who want to get a foothold on this massive transformation project.

Viewpoint

Stimulate India's infrastructure market, rather than control it

Mike Shaw, Director, Balfour Beatty India Pvt Ltd

The relative strength of the Indian economy in an extremely volatile world economic scenario has attracted global players to do business, particularly in the infrastructure sector, where the potential market is huge. However, ease of access is limited for foreign investment in India's infrastructure sector and international companies find it extremely difficult to source both debt and equity under the current legislation.

In addition, India's infrastructure market is also regarded as highly competitive with public and private partnerships (PPP) and Design, Finance, Build Operate Transfer Model (DFBOT) concession pricing of assets based on fairly bullish growth numbers in restricted tariff or revenue environments. It is difficult for many international companies to come to terms with the risk allocation expected and the potential for significantly reduced equity returns in the event the revenue growth is not achieved, and long-term debt funding options for the projects continue to be limited. With the high levels of on balance sheet gearing and current high interest rates in the local market, coupled with a high inflation market, we can possibly see some consolidation in the market.

There is also a major difference in the way local banks view transfer of risk vis-à-vis how international financial institutions view this. In the UK and Europe, PPP and DFBOT projects are not awarded until they have achieved financial close but in India this is not the case and there can be inordinate delays in the commencement of infrastructure projects particularly in the current economic environment where funding of projects is becoming more difficult.

We have had some positive discussions with the Planning Commission and suggested some changes to be made in the model concession agreement, particularly in relation to risk allocation, which will make it much easier for both foreign debt providers and equity investors to view the market more positively. In particular, it is difficult for foreign companies to get their minds around issues such as land acquisition, crop compensation and payment for scope changes required by the authorities prior to operational commencement.

International companies will have to be innovative in reducing infrastructure asset lifecycle costs.

If India is to achieve the projected infrastructure spend envisioned under the new 12th Five Year Plan, which will require US$ 500 billion in private funding, a favorable environment needs to be created for international debt instruments and bonds to be used.

There is no doubt international companies will have to be innovative in reducing infrastructure asset lifecycle costs engaged early in the process and put in place long term financial engineered solutions. This will help to compete with the experienced local infrastructure developers who are perceived to take a higher level of risk based on future revenue growth assumptions and accept lower projected equity returns.

With the current economic problems in Europe and the US, India is on the radar screen of many international infrastructure developers, investors and financial institutions but a perceived lack of commitment by the government to relax regulatory controls, and the recent U-turn in allowing reasonable levels of foreign direct investment, is creating an environment of uncertainty. International participation in the development and funding of infrastructure in India is essential if the forecast growth spend is to be achieved so the timing is right for the authorities to stimulate the market and remove the restrictive barriers of entry and regulatory controls.

Looking closer
FDI by sector

Automotive

Covering:

- Automotive original equipment manufacturer (OEM)
- Automotive components

38.2%
Number of FDI projects: 55 in 2010 and 76 in 2011.

37.9%
Number of jobs created by FDI in the sector: 29,081 in 2010 and 40,091 in 2011.

46.4%
Value of FDI (US$ million): 5,023.4 in 2010 and 7,356.6 in 2011.

Source: fDi intelligence; data is for 11 months (January-November) for both years.

The automotive sector in India attracted 76 FDI deals during 2011 (January-November), an increase of 38% in comparison to the same period in 2010. Although the sector made up 9% of total FDI projects in India, it created most jobs (18%). India is now the world's seventh-largest passenger vehicle (PV) manufacturer, and the second-largest medium and heavy commercial vehicles (MHCV) and 2-wheelers market.

The GOI created the Auto Policy 2002 to attract FDI to establish the country as a manufacturing and export base. The policy provides automatic approval of foreign equity investment of up to 100% for the manufacture of automobiles and auto components. India's automotive sector has five key manufacturing hubs – Chennai (Tamil Nadu), Pune (Maharashtra), National Capital Region (NCR), Pantnagar (Uttarakhand) and Sanand (Gujarat). These states have provided incentives to attract investment, including tax breaks, facilitated access to land and guaranteed access to energy. To further promote automotive exports, the GOI has created the Focus Market Scheme (FMS), which provides manufacturers with cash incentives of up to 5% for export of vehicles.

Investors find India an appealing destination for automotive manufacturing given its skilled technical labor force, low-cost supplier base and strong domestic demand. Furthermore, they increasingly see India as a base to manufacture and export cars, bringing in competition with Thailand, the current automotive manufacturing destination of Asia. According to our survey, investors believe that improvement in the quality of products and increased focus on R&D will enhance the position of Indian auto-component players in the global automotive supply chain.

FDI case study

Volkswagen AG

A German automobile major, Volkswagen AG (VW), has been present in India since 2001 with established brands such as Volkswagen, Audi and Skoda. India has become a key component of VW strategy aiming to become the number one automaker in the world by 2018. The company aims to capture 8–10% share of the India's car market by 2018.

VW is also known for its innovative marketing strategies in India. It created groundbreaking campaigns such as the world's first "talking newspaper." The company primarily targets the upper middle class and rich consumer segment. However, in early 2010, VW entered the mass market segment in India after launching its "Polo" model.

In 2012, VW announced its plan to invest a minimum of INR 20 billion (approximately US$380 million) on its Indian operations by 2013 to ramp up capacity, launch new models and strengthen research activities. This investment will be in addition to €580 million (INR 36 billion) that the company had announced in 2008. VW is also considering to launch its small car Up in India by the end of 2013 or early 2014.

Viewpoint

India’s middle class has fueled growth of the automobile market

Michael Boneham, President & Managing Director, Ford India

The Indian automotive sector has become significantly more attractive in the past three to four years, as evidenced by the number of investment announcements from global automotive companies. This attractiveness is partly driven by the economic imperative of what is going on globally – growth has slowed down in the US and European markets, while Asia Pacific is gaining increasingly more attention.

In contrast, automobile penetration in India is very low compared with mature markets. The four-wheel passenger vehicle market has grown impressively in recent years at the hands of the new middle class. By 2020, the overall passenger vehicle market is expected to grow to 9 million units from 3.2 million units at present. By 2020, India is also forecast to become the world's third-largest auto market. The main factors behind such growth are the increasing affluence of the average consumer, overall GDP growth, the opportunity to offer low-cost or competitive small cars, increasing capability of Indian manufacturers and the growing presence of global manufacturers, such as Ford, with products that consumers want and a large manufacturing presence to bring those products in India.

Today, India has become the export hub for several global automobile manufacturers.

In addition to its many opportunities, the Indian automotive industry presents challenges for all players. There is a need for flexibility in labor recruitment as per market requirements. A uniform rate structure is a prerequisite; this will help in avoiding diversion of trade from one state to another, checking unhealthy competition and ensuring clarity and transparency in tax structures.

Infrastructure development must keep pace with the growth of all types of vehicles on the road. As the Indian market grows and manufacturers add more capacity, component supply will be a big challenge to match the demand and keep up with a robust eco-system. The supply of components is currently stretched and will continue to be a challenge, given the growth projections.

Today, India has become the export hub for several global automobile manufacturers. Several large automotive players in India are investing substantially in capacity expansion, establishing partnerships in India and abroad, positioning India as an export center for vehicles and corporate intelligence, and setting up R&D facilities and design capabilities.

In the end, it’s a combination of great products at the right time, providing value that addresses the needs and aspirations of the discerning and well-informed customer, as well as outstanding sales and service. That’s the strategy for growth in the future.

Looking closer

FDI by sector

Retail and consumer products

Covering:

- Consumer products
- Beverages
- Consumer electronics
- Food
- Tobacco

31.7%

Number of FDI projects: 63 in 2010 and 83 in 2011.

-3.2%

Number of jobs created by FDI in the sector: 28,218 in 2010, 27,303 in 2011.

-50.9%

Value of FDI (US$ million): 4,085.6 in 2010 and 2,007.9 in 2011.

Source: fDi intelligence; data is for 11 months (January-November) for both years.

The number of projects in the RCP sector grew by 32% in the first eleven months of 2011. The sector made up 10% of total FDI projects in India and created over 27,300 jobs. Investors in RCP are interested in accessing India's rapidly growing middle class, which is increasingly able to afford consumer products. In particular, investors have observed growth in the packaged food and beverages sector.

India's large population and rapid economic growth position it to become the fifth-largest country in terms of consumption by 2025. The strong demand of the rising middle class is only part of this story; in fact, an emerging rural consumer base is also increasingly able to purchase consumer products. The specific requirements of the consumer products market in India have forced companies to innovate, adapting to the needs of Indian consumers, with diversified products portfolios.[31]

However, inflation is catching up with companies' cost structures and has resulted in rapidly rising input, packaging and fuel costs. This, in turn, has squeezed profit margins while forcing prices upward. According to our survey, RCP companies see complex regulation (40% of the RCP companies surveyed) and challenging penetration for international brands (18%) as major investment hurdles.

Looking down the road, RCP may face a difficult 2012. Investors, in 2011, were anxiously waiting for the liberalization of the Indian retail sector, allowing big box retailers to come in and set up shop. Not only did this plan portend the creation of 10 million jobs in India, but it also offered a way to alleviate supply bottlenecks and food price inflation. However, only days after introducing the plan, political squabbles forced its retraction. This has damaged the GOI's credibility as an ally of RCP investors, who may decide to look elsewhere in the coming year.[32] The decision is a big disappointment for players such as Wal-Mart Stores Inc. and Tesco plc, which were planning to make major investments in the country. The GOI, however, did not back down from allowing 100% foreign investment in single-brand retail from the current 51%. This will help some of the well-known apparel single-brand firms that are keen on entry into India, such as Hennes and Mauritz (Sweden), GAP (the US), Prada (Italy) and Arcadia Group (the UK).[33]

Consumer products are likely to witness continued demand driven by healthy disposable income growth and lower absolute spends on FMCG products. Although companies may some face margin pressure due to high raw material prices, rural markets will remain a big opportunity.

31. *Top Trends to Shape the Future of the FMCG Industry in India: The Way Ahead*, July 2011, via Datamonitor.

32. "India closes door to foreign supermarkets," *Financial Times*, 7 December, 2011.

33. *Top Trends to Shape the Future of the FMCG Industry in India: The Way Ahead*, July 2011, via Datamonitor.

Viewpoint

India, the next big market for international brands

Guillaume Geslin, Country Head, L'Occitane India Pvt Ltd

India is the next big market for international luxury brands. Buoyed by prosperity, maturing retail expertise and well-travelled, well-informed consumers with sophisticated tastes, the luxury sector is booming here. It is little wonder that, while the Indian government is keen to allow overseas retail companies to enter the country by owning up to 51% in departmental stores and similar multi-brand shops, international brands are clamouring for a foothold in India. For brands across segments, India is slowly turning from a market of great potential to one of serious business.

Brands are expanding from the traditional confines of five-star hotel lobbies to high-quality malls and even airports. A shopping mall is the perfect format for any brand to mass market luxury products. You get a lot of choice and can shop in a clean comfortable environment. Consumer traffic is also driving toward these malls as they make the shopping experience fast, easy and efficient.

Unlike Brazil or China, you can get your point across to the authorities and employees in India because everyone is conversant in English, which is a huge advantage. But India needs to modernize its distribution network. More retail brands will come here when the distribution network and retail sector wil be organized. At present. This is the case for only 5% of the retail sector. Business prospects are bright as the retail sector is quickly getting opened and modern shopping malls are being created in Tier II & III cities.

In the past, retail brands didn't come to India due to bureaucratic delays, high retail space cost and inordinate high import duties, which are one of the most important in the world. Investors look at return on investment and with high import duties, India loses its sheen as an investment destination for return on investment in the short term. High import duties need to be reduced to make the business sustainable.

International retail brands have to adapt to the culture and mentality of the people in India.

Tax structure in India needs to be harmonized. This differs from state to state and therefore generates complexity in running a pan-India business. Road infrastructure for transit of goods and consumers traveling to shopping malls needs to be upgraded. Quite often, the shopping experience is marred by the traffic chaos prevailing outside the shopping complexes.

In order to succeed here, international retail brands have to adapt to the culture and mentality of the people in India. They will have to train their local staff because most of them have never sold premium products. However, India is one of the top destinations for retail brands.

FDI case study

RCP

Nestlé India was established in 1961, with the setting up of a factory at Punjab to tap the growing Indian market. It views India as a growth engine, and has focused on portfolio "innovation and renovation," resulting in leadership positions across several categories and doubling of revenues over the past four years.

In 2010, Nestlé announced the establishment of its first R&D center in India (functional by 2012), allowing it to cater to consumers in and around the country.

Nestlé plans to invest US$275 million in India by 2015, including an R&D center at Manesar, which will serve as the base for rolling out India-specific products, along with investments in Karnataka, Haryana and Punjab.

Looking closer
FDI by sector

Technology

Covering:

- Software
- IT services
- Communications
- Semiconductors

22.7%

Number of FDI projects: 119 in 2010 and 146 in 2011.

66%

Number of jobs created by FDI in the sector: 21,928 in 2010 and 36,409 in 2011.

51%

Value of FDI (US$ million): 3,335.7 in 2010 and 5,037.2 in 2011.

Source: fDi intelligence; data is for 11 months (January-November) for both years.

The technology sector in India has a major impact on the Indian economy. The industry has grown from US$4 billion in 1998 to more than US$80 billion in 2011, employing directly and indirectly more than 10 million people. Riding on the services outsourcing wave, domestic and international companies have leveraged India's value proposition to enhance their competitiveness in the global market.

Key government initiatives, such as setting up of tax free zones, Software Technology Parks of India (STPI) and Special Economic Zones (SEZ), have given strong impetus to the export of IT services. These zones exempt companies from a variety of taxes while setting and running in the initial years of operations.

The technology sector in India received US$5,037 million through FDI in the first eleven months of 2011, showing an increase of 51% from the previous year. The investment has created 146 projects with an estimated 36,409 jobs in the industry. Five principle sectors in the IT industry, namely online businesses, IT services, IT-enabled services and software and hardware merchandise received most of the investments. Compelling cost advantage coupled with available skilled force has driven this spectacular growth.

India's domestic IT demand is growing fast and is expected to surpass US$90 billion in next decade. Technology is integrating with the conventional ways of doing business; a lot of business transactions are happening online. India's burgeoning economy needs more hardware, software and other IT services. Many Tier II and Tier III cities have the potential to support the growth expansion of the IT industry, along with providing the cost advantage compared with that in Tier I cities.

Although many low-cost delivery destinations, such as China, Philippines and Vietnam, are emerging, India's leadership position cannot be challenged. Its benefit of long-term cost competitiveness, supply of highly trained engineers and its expertise in processes and quality will continue to foster its growth.[34]

34. *Strategic review of Indian IT-BPO sector 2011*, NASSCOM; "Indian Information Technology Sector," India Law Offices.

Viewpoint

A proactive and forward looking telecom policy is needed

D. Shivakumar, Managing director, Nokia India

Indian telecom has witnessed a complete transformation in the last decade and remains one of the most attractive and fastest-growing markets. Foreign investors have a presence in the entire chain. Telecom infrastructure is virtually in the hands of Nokia Siemens Networks, Ericsson and Huawei, among others. Multinationals lead the fast-growing handsets market, though there are a few Indian brands as well. In the operator space, foreign investors hold sway by means of joint ventures with Indian companies. Barring the telecom retail and developer space, almost the entire value chain remains attractive to foreign companies.

India will be the next superpower in application development.

A major challenge faced by foreign investors is changing laws, for example, the 2G and 3G licensing system. Investors want consistency of laws. If the rules and regulations keep changing, stakeholders get a little concerned. Another challenge is with regard to the quality of handsets available in the marketplace. While there are more than 100 handset brands present, few of them adhere to any quality standards.

The current need is a proactive and forward-looking policy. That allows mergers and acquisitions, spectrum to be bought in an easy manner, and provisions to protect consumers in the handsets space. The government should label telecommunications as basic infrastructure. Once that is done, taxation will be lowered and consumers will pay lower prices for telecom services and products. Lastly, for telecom manufacturing to thrive, the local ecosystem of suppliers needs to be encouraged.

India provides immense opportunities not just for telecom manufacturing, but also innovation. I believe India will be the next superpower in application development. However, innovation has to be professional and of some value to the consumer and not amateur, as is prevalent nowadays. The idea of innovation itself needs to be different.

To succeed in India, foreign investors should be prepared to overcome the physical infrastructure bottlenecks and should consistently build a brand that consumers trust.

FDI case study

IBM

IBM is one of the earliest multinational companies to set up offices in India. It started its operations in 1992 and currently is the largest multinational employer in India, with more than 100,000 employees spread across multiple cities.

In 2001, IBM set up India Software Labs (ISL) with an investment of US$100 million. In 2006, IBM committed to investing US$6 billion as part of its long-term growth plan in the region. In 2011, it announced an increase in its current footprint in India from 22 to 47 cities by 2013, locating new offices and delivery centers in Tier II and Tier III cities.

IBM India generates a significant portion of its revenue from the Indian market. It is the biggest domestic IT player focusing on strategic outsourcing, enabling business transformation and driving technology innovation and IT-enabling businesses in the SME segment. It also leverages India both as a low-cost global delivery location and as an R&D hub to drive its innovation agenda.

Looking closer

FDI by sector

Financial services

3.1%

Number of FDI projects: 32 in 2010 and 33 in 2011.

-0.4%

Number of jobs created by FDI in the sector: 1,972 in 2010 and 1,964 in 2011.

98%

Value of FDI (US$ million): 367.0 in 2010 and 726.5 in 2011.

Source: fDi intelligence; data is for 11 months (January-November) for both years.

The first eleven months of 2011 saw the number of projects increase by only 3%, whereas the value of FDI projects increase by 98% in the Indian financial services sector. Despite a high growth potential, FDI in the industry remains low compared with other rapidly developing economies, due to capital account convertibility, capital lock-ins and numerous regulations. About 22% of the financial services companies surveyed said that capital convertibility is the main concern faced by investors and 21% believed that capital lock-ins are a key challenge in the sector. However, the demand for a wide array of financial services products, ranging from credit to insurance, is growing.

Currently, only 47% of the Indian population has access to banking facilities, while only 15% of the total insurable population have life insurance coverage. This is a tiny portion of the giant Indian market, underlining the domestic growth potential in the sector. Industry experts anticipate India will become the world's third-largest banking market by 2025 and the third-largest life insurance market by 2015.

India's vast potential in financial services, and particularly in insurance, will increasingly attract investors as the GOI relaxes restrictions on investment. According to our survey, 38% of financial services companies believe that relaxing Insurance Regulatory and Development Authority (IRDA) caps on marketing commissions will attract more foreign participation in the sector, while 26% feel that it will be made more attractive by relaxing FDI caps.[35]

FDI case study

Citigroup (Citi)

Citigroup (Citi), present in India since 1902, considers India as one of its key markets and has invested more than US$4 billion in the country to date. The bank organizes its activities under two major segments: Institutional Clients Group (ICG) and Global Consumer Group (GCG). Citi is the second-largest foreign lender in India in terms of assets, and largest in terms of capital, reserves and surpluses.* With over two million cards in force, Citi is also one of India's leading card issuers. Further, Citi moves almost 5% of India's payment flows, 17% of foreign exchange (FX) flows and 7% of trade-linked flows.

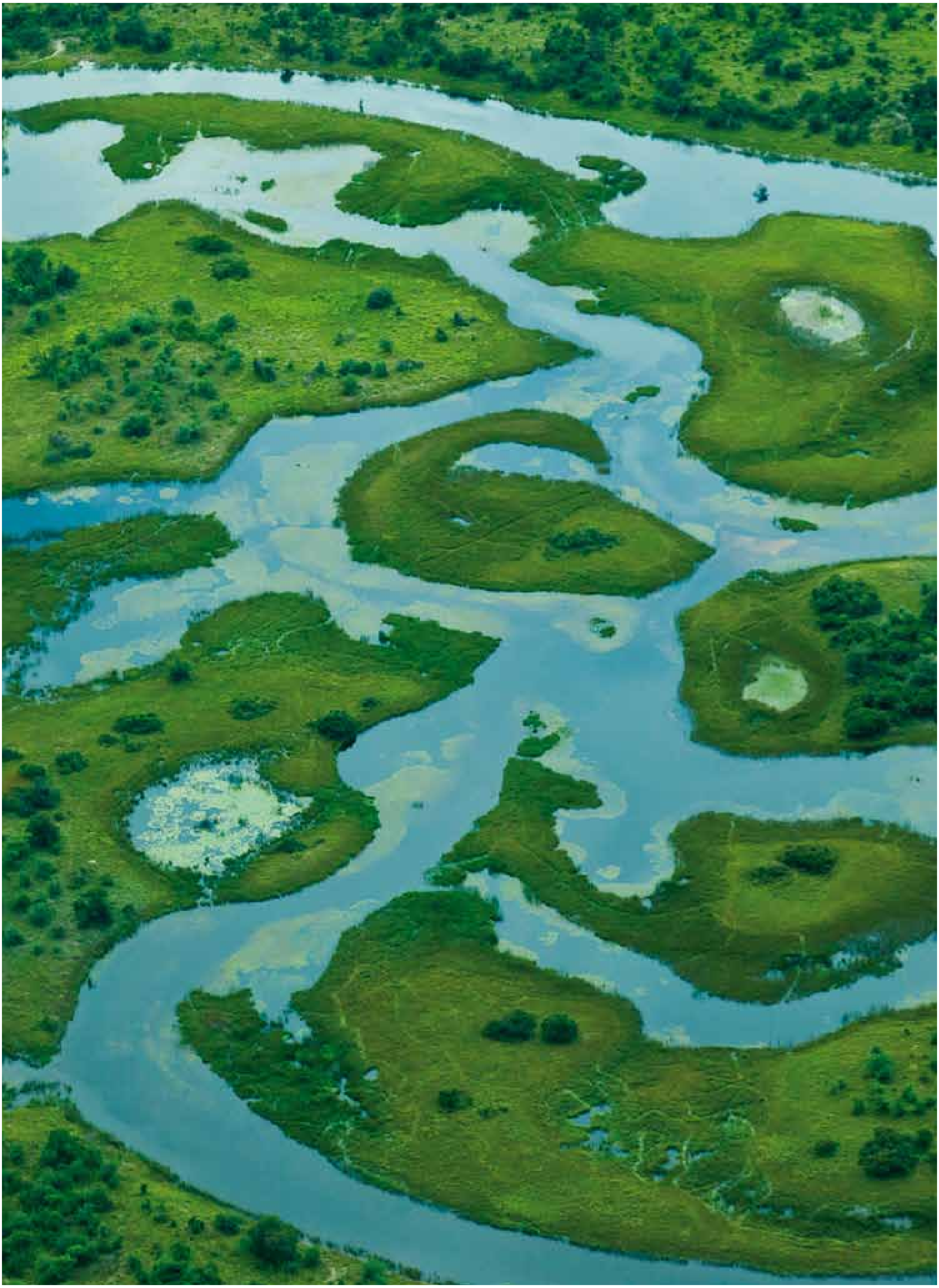
Servicing a high-growth market, emergence of Indian multinationals and low penetration of banking services in the country are the key reasons for Citi to increase its presence there. Citi helped 43 clients raise approximately US$30 billion of capital, both debt and equity, through primary and secondary market offerings in 2010 and 2011. Citi was involved in raising US$7.5 billion of the US$9 billion raised by the GOI, accounting for approximately 83% of the total proceeds of the GOI's 2010 divestment program.

In 2011, the bank continued to increase its team in India, complementing its plan to expand its business there. Citi expects to boost its loans and deposits growth in India by about 15% in each of the next two years,** while significantly enhancing its presence in the payments and digitization space.

* *The Economic Times*, October 5, 2011.

** Business Standard; Company statements.

35. Reserve Bank of India.



Looking closer
FDI by sector

Life sciences

Covering:

- Healthcare
- Pharmaceutical
- Biotechnology
- Medical devices

-26.7%

Number of FDI projects: 45 in 2010 and 33 in 2011.

-24.9%

Number of jobs created by FDI in the sector: 5,470 in 2010, 4,108 in 2011.

79.9%

Value of FDI (US$ million): 925.6 in 2010 and 1,665.5 in 2011.

Source: fDi intelligence; data is for 11 months (January-November) for both years.

Healthcare

With India aspiring to become a global economic powerhouse, there is active focus on improving the health of the nation. India has a disease burden (in terms of DALY[36]) which is around 37% higher when compared to Brazil and 86% higher when compared to China.[37] Despite higher disease burden, India has deficit of health infrastructure as highlighted by number of hospital beds per thousand population (0.9 beds per 1000 population), which is less than half of Brazil and China (2.60 and 2.20 beds per 1000 population respectively).

Even to take this bed density to 2 beds per 1000 population by year 2025, India would need 1.7 million additional hospital beds and 0.7 million clinicians, requiring an investment of around USD 86 billion.

Given this enormous opportunity, Indian health care industry is witnessing significant entrepreneurial action, including investments by large private equity firms, and this sector is likely to grow at 1.5 to 2 times the GDP growth rate over next decade. Key drivers supporting this transformation in is growing middle class (50mn in 2005 to 600 mn by 2025) and its higher spend on healthcare, changing mindsets from "sickcare" to "healthcare" and importantly emergence of healthcare as political agenda.

Government has introduced significant facilitative changes to enhance availability of clinicians and provide tax incentives to private players to establish hospitals in Tier II and Tier III cities. Government also permits 100% FDI for health and medical services under the automatic route. Furthermore, the private and public sectors across states such as Gujarat and Uttarakhand have launched various initiatives to attract PPP investments into the sector.[38] GOI also plans to cover 50% of the country's population with health insurance by 2020, improving on the current average of 15%[39] which shall significantly improve the affordability of healthcare services which currently is dominated by out of pocket expenditure. This growth in provider care is also likely to fuel investment in medical equipment and diagnostic industry. Riding on the wave of successful penetration of telecommunication technology to the masses, mHealth is likely to play an important role in taking healthcare to remote/ under-penetrated areas and present an estimated opportunity of USD500mn over next 5 years.

Pharmaceutical and biotechnology

India has one of the world's fastest-growing pharmaceutical sectors it is projected to double by 2016. To add to its attractiveness, the Indian Department of Pharmaceuticals has prepared "Pharma Vision 2020," aimed at making India one of the leading destinations for end-to-end drug discovery and innovation though a state financed venture capital fund to improve pharma infrastructure, making India an attractive destination for pharmaceutical companies looking to escape cost pressure in mature economies.[40]

According to our survey, 20% of the Life sciences companies surveyed believe insufficient budgetary allocations for R&D and high competition in the local market to be the main constraints faced by the investors in the sector. The respondents opine that improving R&D capabilities and providing inclusive access to primary healthcare will further improve the attractiveness of the sector.

36. Disease Adjusted Life Year.
37. *Fostering Quality Healthcare for All*, EY-FICCI report, 2008.

38. Overseas Indian Facilitation Centre.
39. "Indian pharma industry to be in global top 5 by 2020: Ikon Marketing Consultant," The Economic Times website, http://articles.economictimes.indiatimes.com/2011-09-13/news/30149346_1_pharma-industry-health-insurance-health-care, accessed 14 November 2011.
40. EvaluatePharma® World Preview 2016, June 2011.

Viewpoint

Chosen destination

K.G. Ananthakrishnan, Managing Director, Merck Sharp and Dohme (MSD), India

The Indian pharmaceutical market, growing around 15% per annum, is very attractive for investment. Factors like population growth, rising income levels, high disease burden, increasing healthcare spend, growing insurance penetration augurs well for investment in the industry including foreign direct investment (FDI).

However, the industry faces multiple challenges which act as deterrent to its achieving the full potential such as:

- Low government spend on healthcare (only 1 %)
- Inadequate investment in healthcare infrastructure especially in Tier II and rural areas
- Lack of proper policy framework to attract larger investments, including FDI, in healthcare sector, especially in the area of research and development
- Policy focus highly centered around controlling prices rather than improving awareness and access
- Lack of robust policies governing Intellectual Property Rights

Access to healthcare is a key challenge to all stakeholders which can be effectively addressed through a collaborative approach focusing on partnerships including private and public partnerships (PPP). Furthermore, some of the immediate steps could be increasing government spend on healthcare to around 3% of GDP with a focus on improving healthcare infrastructure in Tier I, Tier II and rural areas. In addition, capacity and capability building of healthcare professionals to address the increasing acute and chronic disease burden will also improve access in an effective manner.

In India, the issue of limited access is further accentuated by low disease and healthcare awareness. A case in point here is low treatment rate of anemia in the country. While 1/5th of the Indian population exhibit some kind of anemia, only 25–30% receive treatment, despite having low–cost treatment options available. Health awareness campaigns focused on addressing the key healthcare challenges in a systematic manner can reduce the overall disease burden in the country.

Access to healthcare is a key challenge.

India is well recognized for its capabilities in pharmaceutical manufacturing. India's strength in API manufacturing and its capabilities in formulation development are acknowledged world over. There is an immense scope for collaborations between local and global majors in the areas of Active Pharmaceutical Ingredients (API) manufacturing, formulation development and research.

Several business model innovations are happening in India to address the issue of affordability and accessibility in healthcare delivery. However, to bring in a transformational change in healthcare delivery, there is a need for effective collaboration and partnerships among multiple stakeholders including government.

FDI case study

GlaxoSmithKline

Established in 1924, GlaxoSmithKline (GSK) India is one of the oldest pharmaceutical MNCs to establish operations in the country.

GSK India has adopted a three-pronged growth strategy in India — to aggressively build a branded generics product basket, launch patented drugs from the parent company's product portfolio at India-specific Tiered pricing and enhance its rural presence. The company has signed several licensing agreements with Indian drug firms to supply generic drugs in several rapid growth markets. Simultaneously, the company plans to launch several new vaccines in the domestic market. It has also launched several rural-specific initiatives to increase brand awareness and strengthen its market presence in the country.

Rising disposable income, shift to chronic diseases, active PPPs and adequate government support are attracting investments from companies such as GSK India.

Looking closer
FDI by sector

Cleantech

260%

Number of FDI projects: 5 in 2010 and 18 in 2011.

1,325%

Number of jobs created by FDI in the sector: 124 in 2010 and 1,768 in 2011.

207.9%

Value of FDI (US$ million): 425.7 in 2010 and 1,310.7 in 2011.

Source: fDi intelligence; data is for 11 months (January-November) for both years.

India continues to be one of the preferred destinations for cleantech investments. According to the November 2011 edition of *Ernst & Young's Renewable energy country attractiveness indices*, India ranked as the fourth most attractive country (after China, the US and Germany) out of 40 countries.[41] Investors see potential in the sector, given the current Indian power generation deficit of 10.3%. The GOI has taken a number of initiatives to promote the sector. Its National Action Plan on Climate Change (NAPCC) stipulates a minimum renewable energy purchase target of 5% of total grid purchase, increasing by 1% each year for 10 years. Furthermore, the sector has been opened to foreign players, allowing investors to spend in renewable power generation on a build-own-operate basis in India.

The Indian cleantech sector looks promising to investors. The market's concern over future energy price rises is expected to boost interest in power-saving technologies. This will likely support the country's goal of 15% of green electricity by 2020.[42]

FDI case study

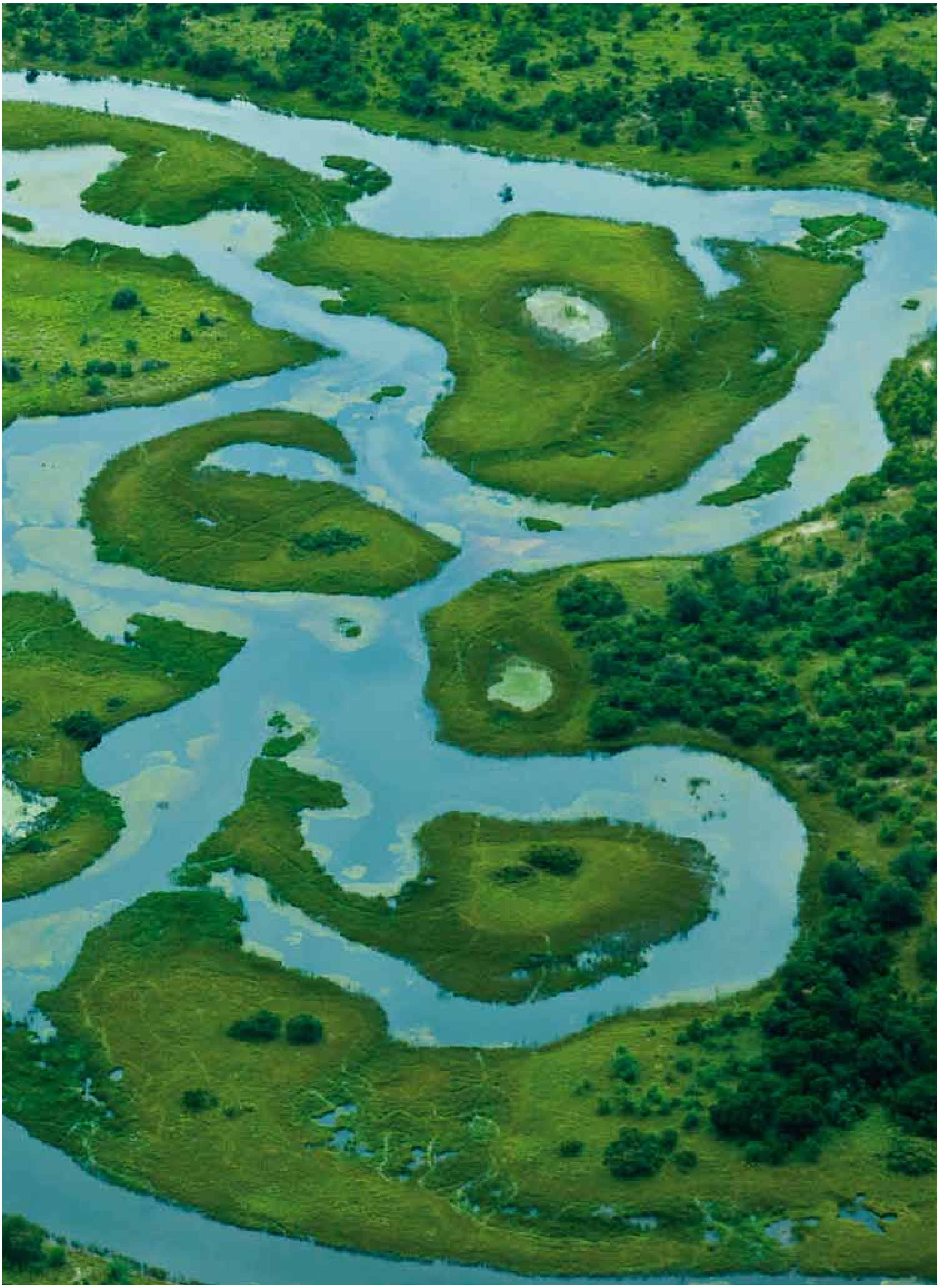
Vestas

Vestas, the world leader in wind energy, has been present in India since 1997 and employs more than 950 people. The company's activities cover the entire value chain including assessment of wind potential, project development, sales, installation and service of wind turbines. In India, it has manufacturing facilities in Chennai and Puducherry.

In India, Vestas operates its largest R&D center outside Denmark, in Chennai, employing more than 300 people. In February 2011, the company expanded the R&D center to include a test center for wind turbine components.

Since entering India, Vestas has installed more than 4,050 turbines with an estimated capacity of more than 2,400 MW of wind energy capacity.

41. *Ernst & Young's Renewable energy country attractiveness indices.*
42. *Energy Alternatives India*, Ministry of New and Renewable Energy.



Looking closer

FDI by sector

Private equity

2000

Indian companies were funded by PE the last five years.

US$50

billion was invested from 2007 to 2011.

Source: VCCEdge and Ernst & Young research.

Private equity (PE) in India has significantly evolved over the last decade. From investments of less than US$100 million annually and 20 investors at the turn of the century to a vibrant ecosystem, which has more than 300 funds and peak investment in excess of US$17 billion in 2007 and US$10 billion invested in 2011,[43] the shift has been remarkable. The funds present in India include world's renowned global PE funds and a number of Indian stalwarts and institutions. In the last five years, PE has funded close to 2,000 Indian companies and has supported these businesses in more ways than one. More importantly, the capital raised by India Inc. from PE as an investor class, far outstripped the money raised from the public capital markets, which hitherto was the main source of equity capital for them.

Leading GDP growth rate globally, driven by local consumer demand and a buoyant economy, and the need for capital building, have been the prime attractions of India for PE funds. In terms of sectors, the investments in the last few years have been largely focused on domestic consumption. Close to US$50 billion was invested from 2007 to 2011, with one-fifth of these investments going into the infrastructure sector closely followed by telecom, financial services and real estate hospitality and construction (RHC). In terms of deal activity, the technology sector has been driving the deal volumes and accounted for more than 15% of deal volumes during that time.

However, PE investors have faced challenges in terms of the fluidity in the regulatory environment and lack of free access to investment in all sectors. Further, shallowness of Indian capital markets and the inherent minority growth capital nature of Indian investing have had their own pitfalls and some of these are reflected in the exit performance of PE funds. With global slowdown and the euro crisis in the background, India-specific issues have also meant greater challenges for fund managers in raising new funds. There is far greater scrutiny by Limited Partners (LPs) and fund-raising has become more difficult by the day.

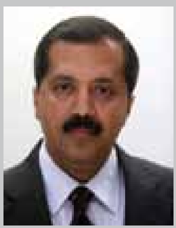
Despite the ups and downs over the past decade, PE has emerged as a very important investor class for India Inc. and with the long-term India growth story still intact, PE funds continue to look eagerly at investing in India. In the evolution of the industry, PE is possibly in a phase of consolidation, but the Reserve Bank of India remains highly optimistic about the PE and its long-term future in India.[44]

43. VCCEdge.

44. Reserve Bank of India.

Viewpoint

Be prepared for a long haul



Sanjay Nayar, Chief Executive Officer, Kohlberg Kravis Roberts (KKR)

Despite the recent gloom, India remains one of the fastest-growing economies in the world backed by high domestic consumption-driven secular growth. Further more, almost all the sectors in the country remain under invested. Both these factors have attracted us and a number of other private equity (PE) investors to India.

While India continues to offer long-term growth potential across sectors, the current environment is tough for both investments and exits. From an investment standpoint, the valuations continue to remain high and that has been a bit of a dampener especially when one compares this to China or other emerging markets globally, which offer opportunities at more attractive pricing. Another investment — related concern has been the uncertainty or inaction in policy-making and the changing regulatory framework, which is rather unsettling for the investors and corporates. Furthermore, India has not been so insulated by the global events as people earlier thought and a slowing US economy and the European crisis are starting to show some impact,as with like most of the countries globally.

Adopt a model which is local, tuned to India specific needs and has the flexibility to offer solutions to entrepreneurs.

On the exits front as well, India has not had a very good performance. Minority investing related limitations, high entry valuations and the shallowness of the capital market have been some of the main reasons for the lackluster exit performance of PE investors.

The key thing for us is to just put our head down — and by us I mean the investing community, corporates, the government and the policy-makers — and get a few things done first. Regulatory restrictions on foreign investment in some sectors need to be re-looked at. Fundamental issues such as land acquisition, financial sector and capital market regulations and governance are just few of the many areas that are in urgent need of reforms.

Very clearly, it is still not too late. There is enough resilience in this country and if we get a few things going in terms of reforms, we should see a strong rebound.

My advice to PE investors: adopt a model that is local, tuned to India's specific needs and has the flexibility to offer solutions to entrepreneurs. Given the strong fundamentals, the Indian market should offer attractive returns in the long term, but there may be some pain in the short term.

Meeting investors' 2020 agenda

Transitioning toward a more open and innovative economy

76% cite infrastructure as a barrier to investing in India.

45% see India as an innovation hub in their sector.

30% believe that India will continue to experience rapid growth.

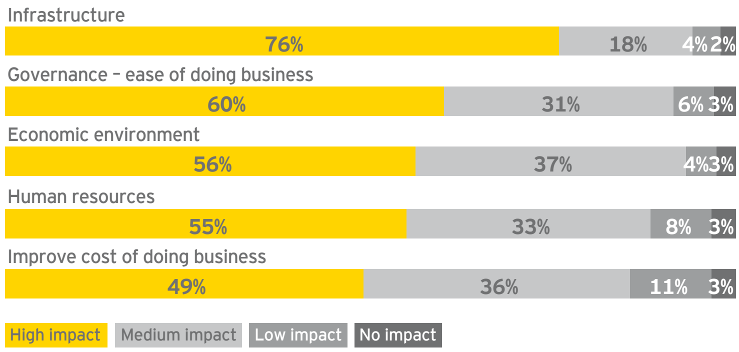
Key location factors: investors are more demanding toward future business conditions

In turbulent times, international decision-makers want their investments to be protected by the rule of law, be ready to connect with their other operations and easily accessible by clients, staff and business partners.

These criteria have changed little from year to year but the emphasis on each has grown, suggesting that, in a world of increased international mobility, reducing risks and unlocking incremental value and quality have become critical in investment decisions.

Although investors believe India has great human capital, they continue to remain concerned with the current state of infrastructure, governance and transparency in the country. Seventy-six percent of the respondents surveyed mention that improving infrastructure will have a high impact and is a prerequisite to attracting foreign investments. About 60% of the respondents believe that a better governance and transparency system will have a high impact on India's attractiveness.

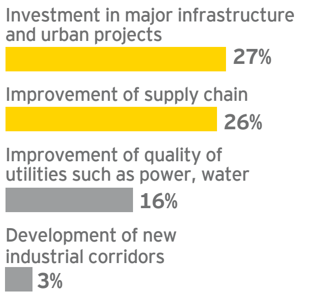
Priority measures to improve future attractiveness



Source: *Ernst & Young's 2012 India attractiveness survey.* Total respondents: 506.

▶ **Infrastructure:** Investors continue to cite infrastructure as the single biggest hindrance to doing business in the country; the World Economic Forum rates Indian infrastructure 89th among the 133 countries surveyed.[45] To nurture aspirations for global economic leadership and keep up with the growing rates of urbanization and the ensuing demand, India needs to increase infrastructure investment. The GOI recognizes this and is committed to doubling infrastructure spending to US$1 trillion over the 2012–17 period, or about 9% of GDP, and is incentivizing investors with tax holidays.

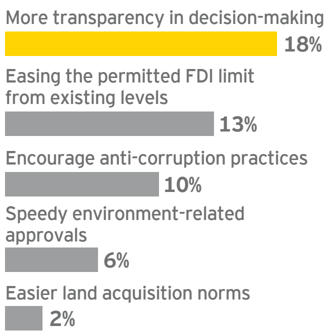
Measures to reinforce the attractiveness of infrastructure



Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 384.

▶ **Governance and transparency:** Foreign companies see big investment opportunities in India but they are reluctant to invest because of its bureaucracy. Delays due to red tape, arbitrary regulatory decisions and corruption pose a big challenge for investors. India slipped in the Transparency International's Corruption Perception Index (CPI) 2011 ranking – from 87 in 2010 to 95 – among the 183 countries. However, the GOI is taking corruption seriously and, for example, is introducing services online to reduce the instances of bribery.

Measures to reinforce the attractiveness of governance



Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 304.

45. *2011 infrastructure report: setting strategic priorities*, Ernst & Young.

India will grow on a more developed attractiveness model

China and Brazil are perceived to be India's two direct competitors in terms of attractiveness.

In the middle term, only 31% and 42% of our respondents said India's attractiveness would be better than China and Brazil respectively in the next three years.

In the longer run, only 11% of the respondents see India as being surpassed by competition from other dynamic countries. Indeed, nearly 30% of the survey respondents believe India will continue to experience rapid growth. They are confident that India's fundamental advantages – labor arbitrage and technical proficiency – will help the country maintain its position as one of the leading destinations for shared services and manufacturing activities. More than a quarter of respondents believe that India will retain its position as one of the top three destinations for such centers in 2020.

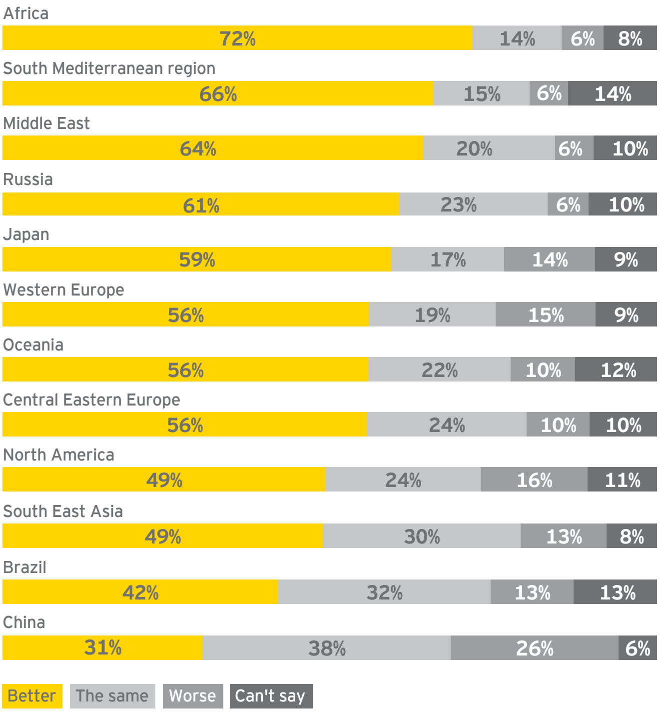
Respondents' belief that India will be one of the top three manufacturing destinations corresponds with the new manufacturing policy (released in October 2011): to increase the share of manufacturing in India's GDP to 25% and create 100 million additional jobs by 2022. A critical component of the new manufacturing policy paper is the development of the National Investment and Manufacturing Zones (NIMZs) – the greenfield townships that will be developed to ensure state-of-the-art infrastructure and availability of skilled labor.

According to our survey, investing in manufacturing activities - both for domestic and global market - appears as the investors' first choice: 35% of the companies surveyed nominated India as an attractive destination for domestic manufacturing and 21% as an attractive base for manufacturing for the global market. India's export sector is now better positioned as a result of the weakened currency and falling competitiveness of other export-oriented economies, such as China.[46]

While India's competitive position as a manufacturing destination has consistently improved because of high productivity and low costs, some of the issues such as infrastructure, high energy cost and power shortage still exist.

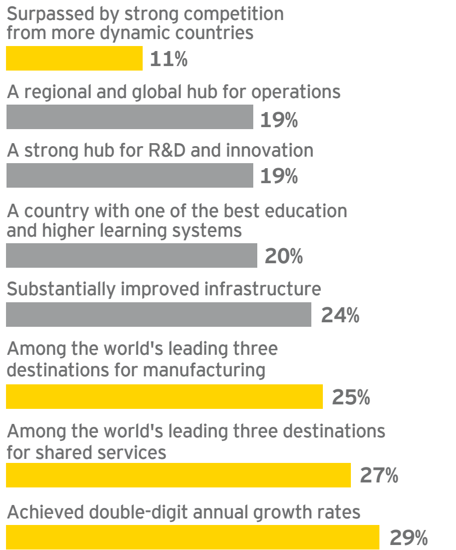
About 65% of the respondents believe that an improvement in quality of logistics and transportation will have a high impact on India's attractiveness. More than half of the respondents believe lower energy costs, improved power supply and easier regulation can impact India's attractiveness as a manufacturing destination.

In the next three years, how will India's attractiveness be when compared to other markets?



Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 506.

How do you see India in 2020?

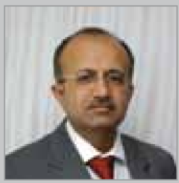


Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 506; two possible responses.

46. *Confederation of Indian Industry*, The Boston Consulting Group.

Viewpoint

The next phase of reforms



Sudhir Kapadia, Partner & National Tax Leader, Ernst & Young Pvt. Ltd. India

In their report on *Doing Business* 2012 the World Bank and IFC have ranked India at an abysmal level of 147 out of 183 countries in terms of tax administration, thus accentuating the need for India to usher in the next phase of reforms urgently.

The most recent phase of tax reforms witnessed the introduction of two significant legislations – the Direct Taxes Code (DTC) Bill 2010 to replace the existing Income tax Act and the Constitutional (Amendment) Bill to introduce the Goods and Services Tax (GST). The twin reforms have the potential to transform the Indian tax system and lead to a substantial positive impact on the economic growth of the country.

Some important aspects merit attention while bringing in the fiscal reforms. The government's proposal to replace profit-based incentives with investment-based incentives should be accompanied by a lower corporate tax rate of 25%. The GOI must also meet its commitment of grandfathering the existing incentives, without compromising them through the levy of MAT, and that too at a considerable rate of 20%.

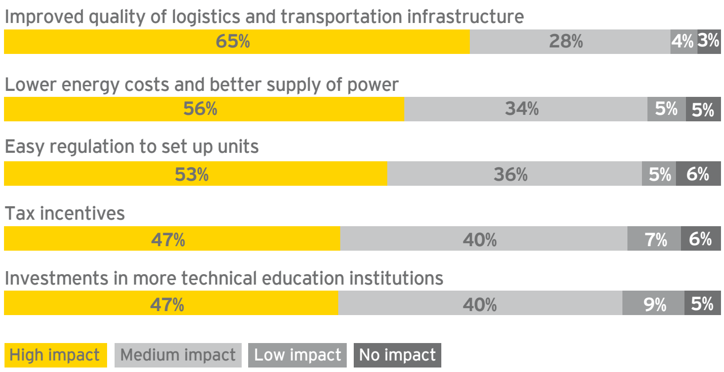
Among the administrative reforms, an important measure needed for reducing tax litigation is the strengthening of the Dispute Resolution Panels (DRPs) and enabling them to effectively perform their role by addressing the key issues of permanence, independence and accountability of the DRP officials. Besides this, adoption of standard positions on specific issues relating to transfer pricing, on which the taxpayers frequently face huge tax adjustments could help ease a lot of uncertainty and litigation for the taxpayers.

The implementation of the scheme of Advance Pricing Agreements (APAs) for international transactions introduced in the DTC will help minimize transfer pricing disputes. The industry also awaits the detailed safe harbor rules to operationalize the safe harbor provisions, first announced in Budget 2009. Simplification of tax laws accompanied by administrative circulars and guidance notes for consistent interpretation are essential to bring clarity and certainty.

What type of investment are investors looking into?

Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 193 (group considering entering the market or increasing operations in India except PE and RCP).

What changes are required to accelerate India's attractiveness as a destination for manufacturing?

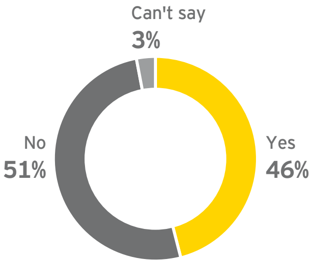


Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 506.

Innovation as a growth engine for India

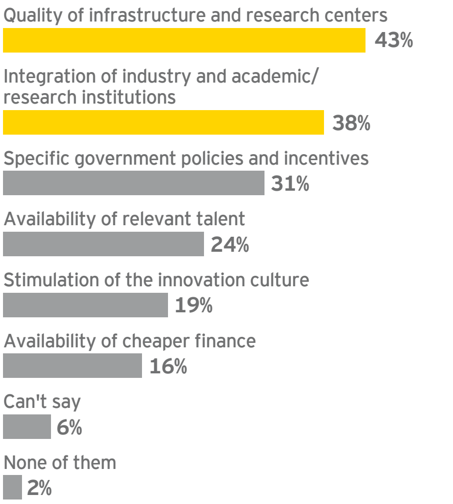
Although India is considered to be a services and industrial powerhouse, investors remain unconvinced about the country's capacity as an innovation center.

Do you identify India as a key innovation hub in your sector?



Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 506.

What are the changes required to accelerate India's attractiveness as a key innovation hub?



Source: *Ernst & Young's 2012 India attractiveness survey*. Total respondents: 506; two possible responses.

Investments in strategic functions and R&D in particular have remained stable over the past five years. Innovation is crucial to take India's industrial and services sectors to the next level in terms of taking ownership of its future development.

Mirroring the investment trends observed in fDi Intelligence, investors are divided on India's position as an innovation center. In fact, a slight majority of the respondents (51%) do not see India as an innovation hub in their sector, the remaining (46%) do see it as one. This finding confirms the results of the Global Innovation Index (GII), a 2011 study conducted by the Confederation of Indian Industry (CII) and INSEAD, France. India was ranked 62nd (out of 125 countries). This lackluster ranking is based upon inadequate-quality of research infrastructure, the difficulty in finding "relevant" skills and lack of a concrete government policy to promote innovation.[47]

However, the vision of India's innovation capacity depends upon the sector. More than 50% of the respondents from sectors such as life sciences (58%), ICT (57%) and automotive (53%), believe that India will become the innovation destination for their sectors. Fewer respondents from the Financial Services (30%) and RCP (30%) sectors see India as an innovation center.

Despite the challenges with innovation, India is increasingly becoming an innovation hub for its internal market.[48] As a result, the R&D landscape in India is expected to grow rapidly, with over 700 MNCs currently basing their R&D centers in the country.[49]

India is also on its way to becoming a frugal innovation center. The world has experienced a number of high-profile innovations that target middle- and lower-income customers in rapid-growth markets, and many of these products have been developed and tested in India. For instance, General Electric's (GE) hand-held electrocardiography (ECG) machine priced at US$1,000 was developed at GE's John H Welch Technology center (JHWTC) in Bangalore.[50] A number of other large foreign MNCs are increasingly integrating their global innovation networks with R&D operations in rapid-growth market countries such as India to pilot next-generation business models, organizational structures and to develop affordable and sustainable solutions that can be marketed on a global scale.

47. The Innovation Efficiency Index highlights those countries that achieve more from lesser conditions as well as those that lag behind in fulfilling their innovation potential.

48. Zinnov Management Consulting.
49. Zinnov Management Consulting.
50. *Economic Times*, March 11, 2011.

1 India innovation capacities

India possesses a young workforce, cost competitiveness, frugal innovation capabilities and large, untapped consumer demand. However, India must improve the quality of its infrastructure and increase collaboration between academic institutions and the corporate world before it earns recognition as an innovation destination.

2 Improve quality of infrastructure and research laboratories

India lacks the infrastructure to support innovation and become a global hub for innovative sectors. Approximately 43% of the respondents surveyed indicate that the country needs to increase the quality of its infrastructure and research laboratories. The National Innovation Council (NIC), established in 2010 to narrow down the existing challenges of quality gaps in infrastructure, announced its plan in 2011 to create a US$1 billion fund to build an ecosystem for innovation. The fund will benefit 20 local industrial clusters that the NIC identified in collaboration with industry chambers.

3 Strengthen industry-academia relationships

There is a greater need for improved industrial-academic relationships, to promote breakthrough technology and create demand for innovative products. Various investors have taken initiatives in this regard, including Yahoo! India that partnered with the Indian Institute of Information Technology (IIIT), Hyderabad, to accelerate R&D in cloud computing. Similarly, Xerox Corporation's India Innovation launched three new projects in partnership with three Indian institutes — IIT Mumbai, IIT Kharagpur and Shrishti International Labs — to explore new concepts of collaborative work through online platforms, social networking and crowd sourcing. However, such collaborations have just started in India.
In comparison, relationships between corporations and academia are very common in Western countries, such as the US and the UK.[51]

51. Nasscom.

4 Explore government incentives for innovation

To enable companies to continue to spend money on new products and innovations in the face of continued economic gloom, governments of many countries have enhanced their tax credit provisions for R&D.[52] Although, the GOI does provide some incentives, more of these will be needed to drive innovation in the country. There is also a need for the GOI to make its current intellectual property systems and copyright policy laws more secure and sound,[53] and enable inventors to use the system at minimum or subsidized costs.

52. *Exceptional India*, Ernst & Young, January-June 2011.
53. *Utility patenting: India's next move?*, Livemint.

Methodology

The Ernst & Young's 2012 India attractiveness survey is based on a three-fold methodology that reflects:

1 The attractiveness of India for foreign investors

Our evaluation of the reality of FDI in India is based on fDi Markets, UNCTAD and Indian government sources such as the RBI. The fDi Markets database tracks new greenfield and expansion FDI projects. Joint ventures are only included where they lead to a new physical (greenfield) operation. Mergers and acquisitions (M&A) and other equity investments are not tracked. There is no minimum size for a project to be included. However, every project has to create new direct jobs.

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

2 The perceptions and outlook of India and its competitors by foreign investors

We define the attractiveness of a location as a combination of image, investors' confidence and the perception of a country or area's ability to provide the most competitive benefits for FDI. The field research was conducted by CSA Institute in November 2011, via telephone interviews, based on a representative panel of 506 international decision-makers.

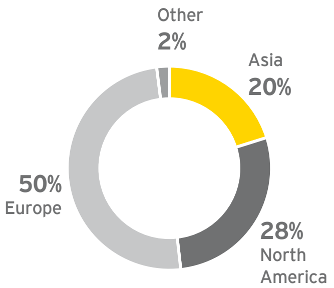
Profile of companies surveyed: sector respondents

Sector	Respondents
Energy & heavy industry	15%
RCP	14%
Financial services	13%
Private and business services	12%
Logistics , Software and IT services	10%
High-tech and telecommunication infrastructure and equipments	10%
Life science	6%
Automotive	6%
Chemicals	5%
Private Equity	5%
Infrastructure	2%
Agriculture	1%
Cleantech	1%
Total	**100%**

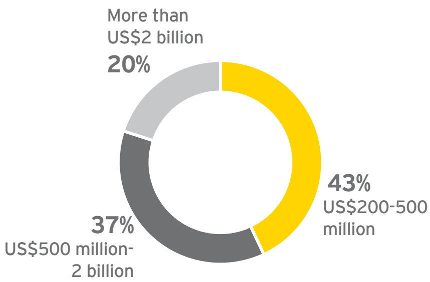
3 Companies with international development

The companies with international development were identified based on Duns & Bradstreet company tree which is one of the world's leading and longest-established business information company. Finally, this information has been verified through individual company website.

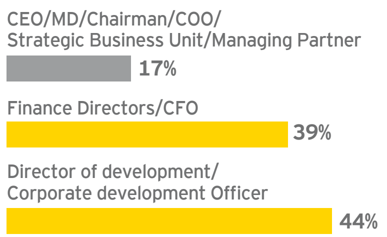
Profile of companies surveyed: geography



Profile of companies surveyed: size



Profile of companies surveyed: job title

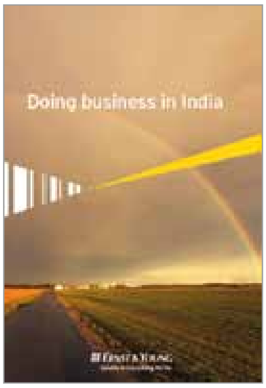


Ernst & Young in India

Ernst & Young India has offices in Ahmedabad, Bangalore, Chandigarh, Chennai, Gurgaon, Hyderabad, Kochi, Kolkata, Mumbai, New Delhi, NOIDA and Pune. Its workforce of over 10,500[54] people work towards the member firm's vision of being a trusted business advisor that contributes to the success of its clients by creating confidence and value. We help our clients achieve their potential through our technical skills and industry knowledge.

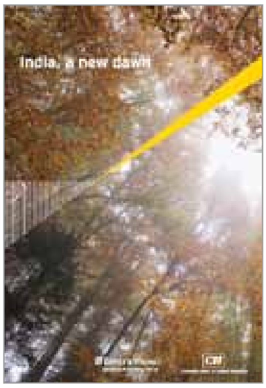
We are recognized as the leader in the professional services industry and accolades we receive encourage us to continue striving for excellence.

- Ernst & Young is the number 1 professional services brand in India (Ernst & Young Global Brand Survey 2011, conducted by TNS).
- India's Tier I tax firm for the eighth consecutive year — Euromoney ITR, World Tax Guide 2010.
- No. 1 Indian M&A Advisor on deal count for the tenth consecutive year (2002-2011) on Bloomberg League Tables.
- Financial Advisor of the Year Award — India, 2011, 2009 and 2008 — Financial Times & Mergermarket.
- Financial Advisor of the Year, 2011 — AVCJ India PE&VC Awards.
- "Most Attractive Employer" award in the Consulting sector by Randstad.
- "Excellence in Training" award in the Employer Branding Awards for 3 consecutive years.



Doing business in India

Doing business in India 2011 an annual guide for companies interested in India. It provides a quick overview of the investment climate, taxation, forms of business organizations, and business and accounting practices in India.



India, a new dawn

India, a new dawn captures the countries ongoing economic reforms, financial regulatory framework, tax policy initiatives and the opportunities and challenges in the countries demographic transition.

Transactions Quarterly

Transactions Quarterly provides regular insights on the evolving transactions environment. It analyses key inbound transactions involving foreign companies; outbound acquisitions by Indian companies; sectoral trends etc.

54. The numbers include personnel from all member firms of Ernst & Young Global in India.

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