

The Elephant Re-Awakens! A Fresh Start To India's Economic Emergence

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Rejuvenated and re-invigorated with the newly instated government led by Prime Minister Narendra Modi, India's business climate has undergone an instant facelift in terms of investor, market and public confidence. Governments and investors from developed and developing economies are racing to meet with Modi to better understand new market opportunities and the reforms he intends to bring in. Adding thrust to this new wave of optimism is the fact that the landslide majority victory of Modi's Bharatiya Janata Party (BJP) has paved the path for an end to coalition politics – the *raison d'être* for non-existent governance, utterly slow policy creation/reforms and the negative spiral in terms of foreign direct investment over the

past decade. Tractus believes that this major impediment to attracting high impact investors will be lifted under the auspices of Modi and his cabinet of ministers. A feel good factor has definitely started to bubble again.

Before being sworn in as Prime Minister, Modi was known to have spearheaded the development and rise of his home state of Gujarat (where he was Chief Minister) by aggressively pursuing inward investment across key sectors and eliminating red-tape. To propel Gujarat as an attractive destination for foreign investments he had

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proactively reached out to foreign investors and trimmed the fat out of Gujarat's governance machinations. This focus on wooing international investments into his state revealed his inclination to upgrade industrial infrastructure and help local businesses learn from and compete with multinationals that are coming to tap the Indian market in terms. His intention now, which is to customize this model for India as a whole, has been highlighted in the initial few steps his team has taken by shaking up the bureaucratic malaise in the halls of power in Delhi, choosing a leaner cabinet of ministers and through the initiatives in the 2014 Union Budget. These details are

critical for India to push itself into becoming a stronger economic power.

Decades of being predominantly an agrarian economy coupled with several advancements in the tertiary sector (services industry) has seen India miss out on the second step of natural economic progression – developing a strong manufacturing/industrialization base. Modi and his team have identified the importance of having a robust manufacturing platform as crucial to India's future identity as a true economic powerhouse (as of now the manufacturing sector only contributed 16% to India's GDP). However, India's investment climate has taken a battering after 2008. The economic downturn coupled with over half a decade of politicking eroded investor confidence to large extent. A major thorn in the confidence and plans of foreign investors has been the laxity on pro-investment policies from the previous government and regressive tactics such as retrospective taxation (as Vodafone and Nokia could testify), uncertainty in the reforms of key sectors and the age old issue in India of acquiring licenses. Such complications sour the mood for investors. Since 2011, over US\$ 10 billion worth of investments were pulled out by international companies and institutional investors from India. POSCO and ArcelorMittal both pulled out their mega projects in the mining sector due to slow land acquisition and licensing approvals. Other high profile investors such as Walmart, Berkshire Hathaway and Carrefour started re-considering their India plans. Stemming this outflow of investor funds and confidence seems to be on top of Modi's agenda given his upcoming schedule of visits to and from nations such as Japan, the UK, China, and the USA – economies whose companies are already some of the biggest investors in India. This July, American e-commerce giant Amazon.com pledged US\$ 2 billion for further investment into its India operations. By 2015, Honda

and Suzuki (with its Indian JV Maruti), global auto majors, are to invest over US\$ 400 million in a greenfield facility and US\$ 660 million in capacity expansion projects respectively. Since the beginning of 2014 and the anticipation of seeing Modi's government become the new political power, overseas institutional investors have already poured in over US\$ 25 billion from January 2014 till July 2014 into the Indian financial markets – a clear indicator of confidence and optimism. We augur that these positive FDI developments will continue and increase as more reforms are put in place.



Understanding that one of the major gripes of incoming investors is the sheer amount of time taken to approve any application/licenses, the newly instated Minister of State for Commerce has already begun working on improving this by proposing a 90 day timeline to process the applications of foreign investors. During an interview to the Indo-Asian News Service (IANS) in May, Modi clearly stated that, "We have to clear projects in a fast track mode. If there are environment related concerns, they need to be suitably addressed, but all decisions must be taken in a time frame. We cannot permit the present state of policy paralysis and indecisiveness to continue for long".

The latest Union Budget, Tractus believes, is of a very progressive nature as it looks to introduce a host of pro-business initiatives addressing basic necessities which business need in order to flourish:

- Pushing roads and highway development by allotting US\$6.2 billion for over 5,280 miles of national/state roads and along with major railway upgrades. Airports in all Tier I and II cities have been highlighted as high priority projects (this will help connect several industrial parks and zones)
- Adding 3370 MW of renewable energy generation capacity for increasing overall power supply and reducing rates.
- Introducing the concept of centralized GST (Goods and Services Tax) to reduce the multiple levies that corporations incur when business is done across India's states.
- Dispelling foreign investors' fears about retrospective taxes by outlining that "such powers have to be used in a very cautious way so as to maintain a positive image of India's investment climate internationally".
- Boosting manufacturing via a special investment allowance rate of 15% to companies that invest more than US\$ 4 million on new machinery and plants between now and 2017.
- Introducing a 10 year tax holiday for those projects that are generating, distributing and transmitting power by 2017.
- Promoting manufacturing and consumption by reducing customs and excise duties for certain products, especially intermediate goods used in the making of a final product, across several sectors (such as home appliances, renewable energy/clean-tech, metals and minerals, etc.).

- Building 'smart cities and industrial corridors' across various regions that will house manufacturing clusters in order to push development across various regions in the country.

In the budget, we notice an emphasis on the basic pillars of infrastructure, power, and technology. These are paramount for laying strong manufacturing foundations for any economy and India has been lacking drive in strengthening these areas - which ultimately are the main complaints of foreign investors who have been here for some time or are looking to enter.

Tractus' experience and projects in the industrial site selection and FDI space has seen our teams conduct detailed due diligence across industrial and special economic zones in India for several sectors. Visiting various sites firsthand has helped Tractus better understand India's business environment for international investors and keep an eye on the practicalities faced on a daily basis by firms here. Our reports have a pattern in terms of linkages between zones/sites to quality roads and highways, industrial grade power supply, access to airports and seaports as well as labour and internet connectivity. As each state in India largely operates in its own capacity, the levels of ease of doing business differs by each state. Tractus is of the opinion that the new government's idea of pushing through the pro-investment reforms will help provide a national level benchmark for states to adhere to in terms of providing an attractive business climate to foreign investors. However, though reforms are spelt out by incumbent governments when they start, execution takes place over a longer timeframe. In India, given the sheer number of stakeholders that are involved in any kind of business or government projects, implementation is naturally time consuming.

Though Tractus shares the optimism surrounding the new government in place and the first steps they have taken, we temper it with caution. Modi's government has laid out its plan for reforms and the key areas it intends to prop up so that FDI, particularly in the manufacturing sector, is given a clear welcome. However, we believe that application of all these new reforms and their impact on the ground will not be instantaneous but be realized gradually over a short term time frame of 6 months – 2 years as the government looks to fix what it has inherited. India is at the cusp of becoming a truly lucrative market for global investors yet managing expectations is still advised.



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