ENOVADO

Market Opportunities in India for German Enterprises

MAKE IN INDIA

Contents

Foreword

German FDI in India continues to move from strength to strength. Currently weighing in as the 7th largest foreign investor in India[1], Germany's position highlights not only great co-operation now, but great potential for the future. These are exciting times for both nations, due to the ambitious and very real economic philosophy of Narendra Modi's "Make in India," "Skill India" and "Digital India" initiatives. It has been decades since India has enjoyed a stable majority government, giving it now the luxury of undertaking mass reforms to transform the Indian investment landscape for FDI.

Being the 2nd most populous country in the world upheld by backbone of an enviable growth rate, the belief in the India growth story has never been more potent. From a foreign investor standpoint, India is coming off not only a record quarter of FDI flows, but has also attracted the highest inflow of FDI in the world - registering a handsome US$3 billion more than China.[2] India's rank for ease of conducting business has jumped 12 spots, and the IMF has given India the prestigious distinction of being the brightest spot in the global economy.[3]

From a German perspective, collaboration on Indian soil has yielded some major success stories - in particular in areas where German knowledge in high-tech manufacturing is sought. With wages on the rise, India can no longer rely on its traditional labor cost advantage to remain globally competitive. India must protect its reputation as a major global industrial hub with high technology that drives cost savings from the factory floor to finished products. Given Germany's reputation for being a powerhouse in R&D with acute technical capabilities, the potential to collaborate is high.

Instances of high-tech manufacturing in FDI can be found across a diverse range of sectors from pharmaceuticals to ceramics. However, there are certain key sectors that we feel present greater opportunity than others in that they display large degree of technological gaps that German industry can help to address. Our report is divided to highlight specific areas of opportunity, and to provide a critical analysis of geographic locations where these advantages can be sustained. Furthermore, we will offer insight into various Indo-German success stories via case studies, that will offer potential market entry strategies for German small to medium enterprises (SMEs).

Disclaimer:

Market Opportunities in India for German Enterprises is a Enovado report. Lead author: Kunal Saigal, as part of his MBA program study at the IBUH School of Business, Berlin.

FDI India Inc. - Then

The recently elected Narendra Modi government has been anything but subtle about their ambitious plans to unlock a number of Indian commercial sectors to foreign direct investment (FDI). Set against a backdrop of decades of protectionist and cumbersome FDI policy, the global investment community has long waited for India to be truly 'open for business'.

Predominantly a socialist economy since its 1947 independence, despite the touted 'great reforms of 1991' - where the world was promised access to India's vast market - rhetoric has not matched practice. Rather, we witnessed the delicate unwrapping of the Indian market by a series of clumsy hands, courtesy of a legacy of unstable coalition governments, red tape, self-interest lobbying and creaky infrastructure.

The FDI landscape in India did not see radical transformation until recently, as it was embroiled in a battle between Indian federalism versus local suspicion, which resulted in substantial uncertainty about foreign investment policies. The federal government is theoretically in charge of establishing the legal framework for India to implement FDI reforms. However, the states of India have the ultimate say in whether and how these federal FDI guidelines are implemented within the parameters of state laws and regulations. Hypnotized by the notion that FDI brings no true economic benefit and steals local jobs, the federal government's liberalization policies were kept at arm's length by the states. At the same time, no state government wanted to challenge powerful lobbies and to agitate key vote banks such as farmers and trade unions by announcing sweeping reforms. Both instinct and interest were driven politically and not economically.

As the trickle down effects of even the meager FDI flows in the 90s grew towards the new millennium, the handful of neo-liberal FDI policies announced by the ruling governments were increasingly supported with a more transparent legal and procedural framework. Where once FDI in a majority of sectors was completely off limits for foreigners, and approval of others required a lengthy and bureaucratic approval process, the gradual liberalisation of FDI gained momentum through the turn of the century. By the early 2000s the term "FDI" had shed the negative connotation that political parties in opposition to the government had ascribed to it. With the realization that there were substantial economic gains to be made, policy measures in support of FDI were streamlined.

By 2011, many sectors which were previously either off-limits or capped with low levels of maximum permissible foreign ownership, were extensively opened up to FDI.

Such reforms have quickly borne fruit, snapping a three-year southward economic trend. Already, a 50% rise in FDI was seen in India's manufacturing sector during 2014-15 - a tribute to the success of Modi's "Make in India" manufacturing initiative. FDI into India increased by 37% to US$39.32 billion during 2015, which can be attributed to the ease in doing business stemming from recent reforms, according to the Economic Survey of India, 2015-2016.[5]

The largest beneficiary of these developments was the manufacturing sector, which increased to US$9.6 billion, and which comprised 38% of total FDI received. It is worth pointing out that it is the first time in three years that FDI in manufacturing registered a positive increase. Due to the BJP's push toward making India a global manufacturing powerhouse through a focus on high-tech, FDI growth in this sector is of supreme importance.

Even greater than manufacturing, the financial services sector soared even higher, witnessing an almost 200% rise in flows. The other major growth sector was another high-tech industry: the computer software and hardware industry, which experienced a 130% rise in FDI from US$934 million to US$2.15 billion between FY14 and FY15. Clearly, the data indicates that the Indian federal government's efforts to improve the ease of doing business and to relax FDI regulations is yielding results.[6]

COUNTRY-WISE AND SECTOR-WISE FDI FLOWS

TOP 5 CONTRIBUTORS	2012-13	2013-14	2014-15 P*	Change (%)**
COUNTRY				
Mauritius	8,059	3,695	5,878	59.1
Singapore	1,605	4,415	5,137	16.4
Netherlands	1,700	1,157	2,154	86.2
Japan	1,340	1,795	2,019	12.5
USA	478	617	1,981	221.1
United Kingdom	1,022	111	1,891	1603.6
TOTAL FDI	**18,286**	**16,054**	**24,748**	**54.2**
SECTOR				
Manufacturing	6,528	6,381	9,613	50.7
Financial services	2,760	1,026	3,075	199.7
Retail & wholesale trade	551	1,139	2,551	124.0
Computer services	247	934	2,154	130.6
Construction	1,319	1,276	1,640	28.5

**Provisional: Includes FDI through SIA/FIPB and RBI routes only. All figures in $ million unless specified, **Change in FY15 over FY14*

According to a report released by Grant Thornton India, the total value of merger and acquisition (M&A) and private equity (PE) deals in the month of August 2015 were valued at US$2.6 billion (151 deals), which is a 62% increase in volume as compared to August 2014. The report further states that with the recent "Make in India" push in 2016, coupled with "recent FDI norms and the much awaited GST will perhaps be a game changer and will further accelerate the deal activity from an inbound investment, domestic M&A and PE perspective."[7]

The Smart City Initiative

Experiencing a major demographic shift, the bulk of India's population will look to migrate from villages into cities in search of new opportunity. This new mass-migration of urban dwellers will be supported by the "Smart City" initiative, which aims to upgrade and build 100 cities stressing urban mobility, low-cost housing, and sanitation and sewerage in particular.[28] Enovado had the opportunity to conduct an exclusive interview with one of the chief economic advisors for urban development for Prime Minister Modi, Dr. Kumar V. Pratap. Dr. Pratap shed light on what implications this initiative holds for German investors, and he identified three major areas for Indo-German collaboration in high-tech functions to serve the Smart City initiative.

Construction and housing

In order to house what is projected to become the world's most populous nation, the basic building blocks of any smart city would be the creation of homes and apartments built with the utilization of environmentally friendly technologies, sustainable amenities and non-traditional building materials. The undertaking of this would open massive opportunities for construction machinery, sanitation equipment, waste and water management equipment, and other capital goods in which German manufacturers excel.

Energy and renewable energy

With the creation of smart cities, the energy upon which they run will be generated through technologically advanced methods. With high unmet current demand and an estimated future market demand of 900 GW by 2032, India's power generation, transmission and distribution systems are undergoing a massive transformation in capacity and technology absorption.[29] A "Smart Grid" is being proposed to supply the smart cities with electricity, while technology breakthroughs in thermal, hydro and nuclear power capacity are being sought. India has been doubling its capacity and investment in renewable energies every year for the last three years. Dr. Pratap additionally indicates that the Indian federal government has targeted the development of 100 GW of new solar energy and 60 GW of new wind energy capacity by 2020; a huge jump from the current levels. The immense technical knowhow, expertise and knowledge possessed by German manufacturers could play a key role in India achieving its proposed targets.

Fiscal Support

- Capital expenditure subsidy of 25% in non-SEZs and 20% within SEZs
- Reimbursement of CVD/excise for capital equipment for non-SEZ units
- Reimbursement of federal taxes and duties for 10 years in select high-tech units like FABs (semiconductor manufacturing plants)
- VAT & CST abatement
- Stamp duty exemption
- Electricity duty exemption
- Fiscal incentives of up to 100% of the fixed capital investment for Ultra and Mega projects
- 10% additional incentive on top of the above-mentioned incentive is provided by the state if the project creates double the employment required for the eligibility

Non Fiscal Support

- Skill development
- Single window clearance (SWC)
- Investor facilitation cell
- Investor aftercare cell
- Preference to domestically manufactured goods in government procurement