FDI Confidence Audit: India

Global Business Policy Council

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A.T. KEARNEY
an EDS company

Introduction

With the market liberalizations and reforms of 1991 India appeared committed to attracting foreign direct investment. A decade later, India finds itself at a crossroads — investors are generally sanguine about the country, but reluctant to invest because of a perception that it has done less than other emerging markets to reduce fundamental obstacles to investment. As the Indian government seeks to increase the country's share of global foreign direct investment (FDI) flows, A.T. Kearney's Global Business Policy Council has undertaken a special assessment of the views of executives from the world's largest firms on India as an investment destination. The *FDI Confidence Audit: India*, is an outgrowth of A.T. Kearney's widely regarded annual *FDI Confidence Index*®, and is based on in depth interviews with senior executives from the 'Global 1000' firms.

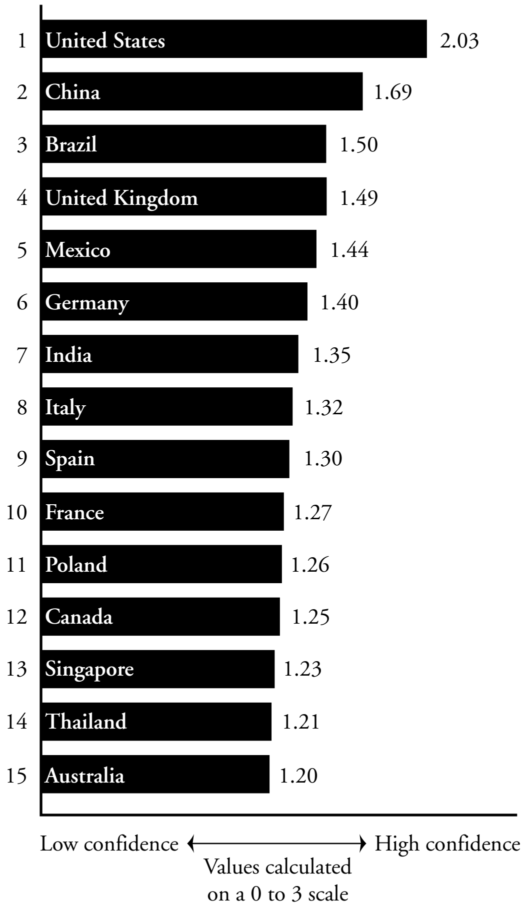
Over the last several years, the *FDI Confidence Index*® has become a prominent indicator of likely future direct investment flows. In each of these general FDI surveys, India has consistently ranked among the top eleven investment destinations of choice *(see figure 1, page 2)*. However, despite being highly regarded by investors, India has failed to record FDI levels commensurate with this high degree of interest. Drawing upon A.T. Kearney's experience in analyzing FDI trends, the *FDI Confidence Audit: India* examines corporate investors' views on the perceived strengths and weaknesses of the Indian investment environment with the intention of offering guidance as to the process of increasing India's share of global foreign direct investment flows.

Foreign Direct Investment in India

INDIA IN THE GLOBAL CONTEXT

Global foreign direct investment (FDI) rose by twenty-five percent (year on year) in 1999 to reach a record level of US$ 826 billion. UNCTAD estimates that this upward trend will continue with global FDI flows reaching one trillion dollars by the end of 2000. Cross-border mergers and acquisitions have dominated this trend, as transnational corporations take advantage of widespread liberalization and deregulation in an effort to gain market share, consolidate operations, improve efficiency, and dilute the costs associated with investing in research and development and information technology. In fact, cross-border M&A activity served as the preferred mode of entry into foreign markets in 1999, accounting for more than 96 percent of all foreign direct investments.

FIGURE 1: *FDI Confidence Index®*
(top 15, February 2001)

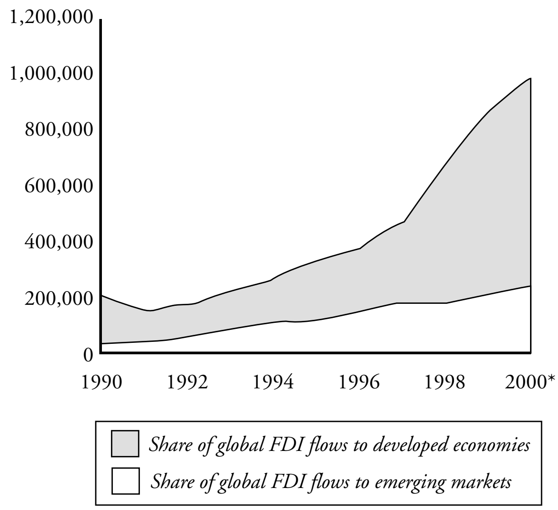


Source: A.T. Kearney

The share of global FDI flowing to developed countries increased slightly in 1999 and constitutes nearly three-quarters of total cross-border investment. While this proportion paralleled the previous year's trend, the value of FDI destined for advanced economies jumped sharply to $609 billion in tandem with overall FDI increases. The share of global FDI flows to emerging markets consequently deteriorated for the second consecutive year. Developing countries claimed only 26.5 percent of global FDI flows in 1999, down from 28 percent in the previous year and a high of 37 percent two years earlier *(see figure 2, page 3)*.

The shift in preference for investment in developed countries reflects a strong sense of investment risk aversion among corporate leaders. A.T. Kearney's January 2000 *FDI Confidence Index®* results indicate that CEOs remain much less tolerant of risk in emerging markets, even though the financial turbulence evident over the past several years has largely subsided. At the same time, corporate executives report little change in their risk perceptions toward developed countries.

FIGURE 2: Share of global FDI flows to developed and emerging markets ($US million, 1990-2000)



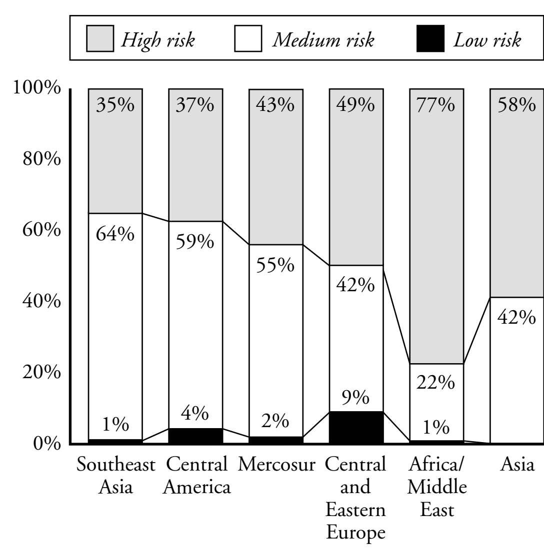
Source: UNCTAD, World Investment Report, 2000
** Estimated*

However, aversion toward emerging markets is not uniform. Large markets such as China and Brazil are perceived to offer attractive investment conditions and thus continue to earn high marks among business executives as possible investment destinations over the next one to three years. While India ranks below these popular foreign direct investment destinations, its considerable size and its continuing market potential are seen as assets that have helped India maintain substantial levels of interest among potential corporate investors.

On the negative side, India suffers from the widespread perception that Asia overall is a "high risk" investment destination *(see figure 3).* Three-fifths of the corporate executives surveyed in the *FDI Confidence Index* described Asia as a "high risk" region, positioning it in investor perception as the second most risky region after Africa. This profile offers a startling contrast to investor appraisal of Southeast Asia, which was perceived to be "high risk" by only one-third of the respondents, in spite of its high-profile economic difficulties.

To compensate for higher perceived risks, foreign investors in India evidently expect higher rates of return on their investments. Average expected returns in India are higher than in any other region, including Africa, Southeast Asia and Mercosur. This is seen foremost among consumer products firms, followed by industrial products and telecom and high technology firms. To the obvious satisfaction of those with operations in India,

FIGURE 3: CEO risk perception by region

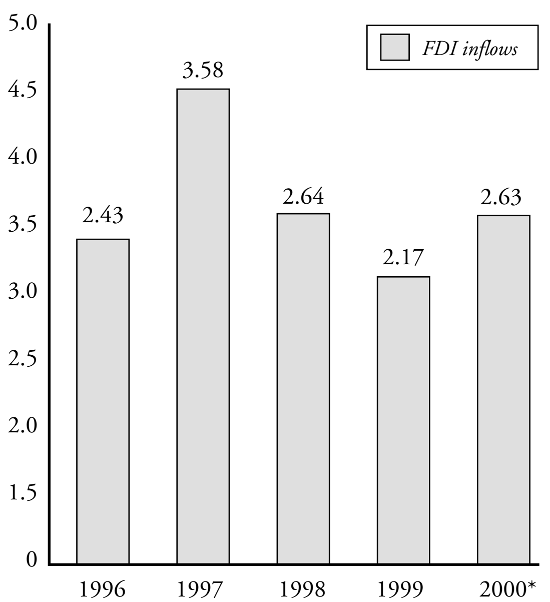


Source: A.T. Kearney, FDI Confidence Index® January 2000. Number of responses indicated as a percentage of total responses over one in every three corporate investors interviewed in the *FDI Confidence Audit: India* reported meeting their profitability targets.

FDI FLOWS TO INDIA

The nineties witnessed spectacular growth in FDI flows to India, propelled by the economic reforms set forward at the beginning of the decade. The country registered a fifteen-fold increase in foreign direct investment from 1990 to 1997, leaping from its small base of US$ 234 million a year to US$ 3.57 billion in 1997. By 1999, FDI flows were again below 1996 levels, at US$ 2.17 billion *(see figure 4)*. Latest data available from the Reserve Bank of India estimates that a slight increase will be observed in 2000, with a forecast of US$ 2.63 billion in FDI. Yet, with over one billion people, India's estimated per capita FDI inflow for 2000 comes in at a mere US$ 2.63.

FIGURE 4: FDI flows to India
($US billion, 1996-2000)



Source: UNCTAD, Reserve Bank of India
** Projected, RBI*

In a regional context, FDI flows to India represented barely over two percent of inflows to South, East and South-East Asia and one percent of inflows to all emerging markets in 1999.

Over 60 percent of India's foreign investment flows to a few sectors: engineering, electronics and electrical equipment, food and dairy products, chemical and allied products, services and computers. Close to eighty percent of these flows come from an equally select group of countries: Mauritius (a tax haven through which other countries' investment is channeled), Japan, Italy, Germany, South Korea, the United States and the Netherlands.

In part, these low levels of FDI reflect a failure to transform expressions of investor interest into actualized flows. Thus, Prime Minister Vajpayee's recent visit to the United States represented an investment promotion strategy as much as an official state visit, reinforcing the Indian government's commitment to increasing FDI flows. Upon his return, the PM's office announced that India would reach a record US$ 5 billion in project approvals by the end of 2000. Although such projects clearly reflect international interest in the Indian market, India's challenge lies in transforming these approvals into realized investment. Between 1991 and 1998, India converted less than one fourth of all approved projects into actual FDI flows.

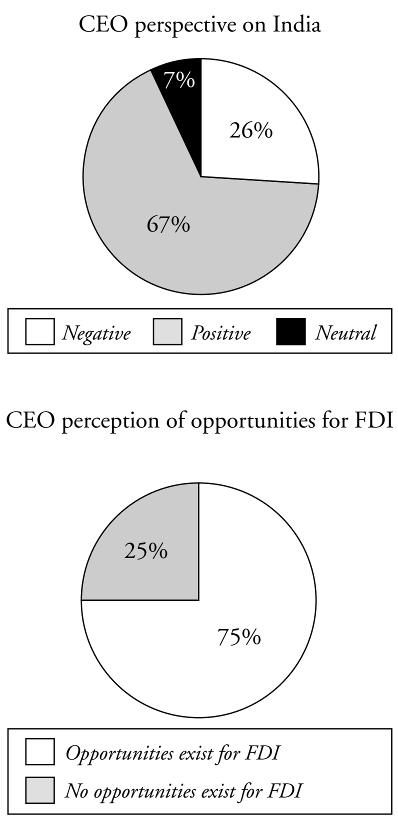
Study Findings

INVESTORS HAVE A POSITIVE OUTLOOK OF INDIA AND PERCEIVE INVESTMENT OPPORTUNITIES

Because of the size of its population and the potential of its market, India does not pass unnoticed on the radars of international investors. The *FDI Confidence Audit: India* suggests that senior executives hold strong opinions toward India. Only a small percent of those surveyed felt neutral toward the country *(see figure 5)*. In addition to the 67 percent who said that they are positive about the country's prospects, a strong majority — 75 percent of respondents — perceives opportunities for foreign direct investment in their respective industries.

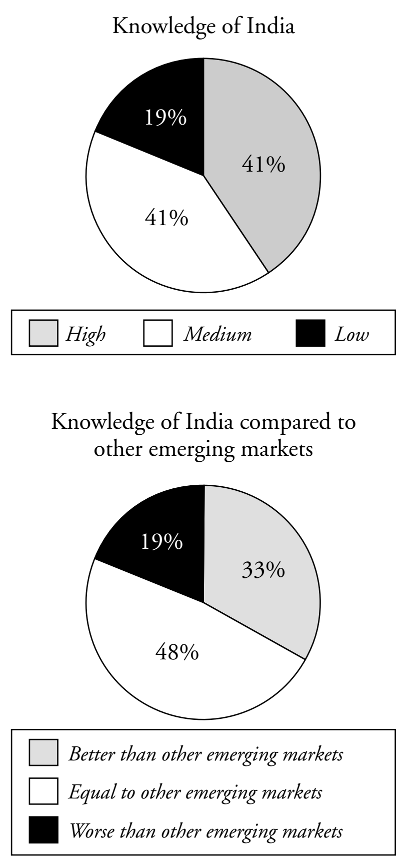
The sample represents a well-informed group of respondents — over three out of four participants had equal or better knowledge of India than of other emerging markets *(see figure 6)*. Of these, approximately half have a

FIGURE 5: Overall assessment of India as an investment destination



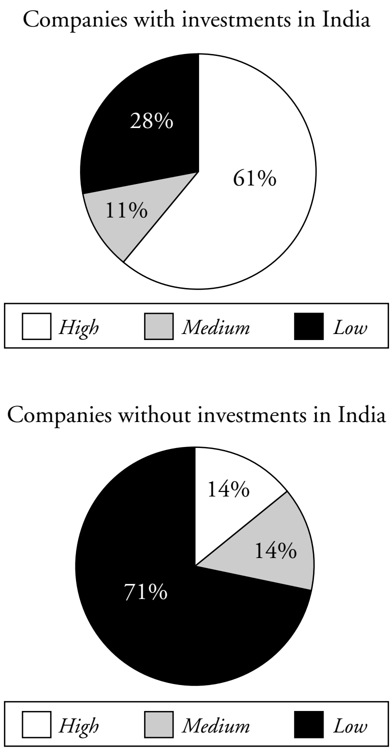
Source: A.T. Kearney, FDI Confidence Audit sample

FIGURE 6: Level of knowledge of *Audit* sample



Source: A.T. Kearney, FDI Confidence Audit sample

FIGURE 7: Likelihood of investment in India



Source: A.T. Kearney, FDI Confidence Audit sample

positive outlook on India as an investment destination.

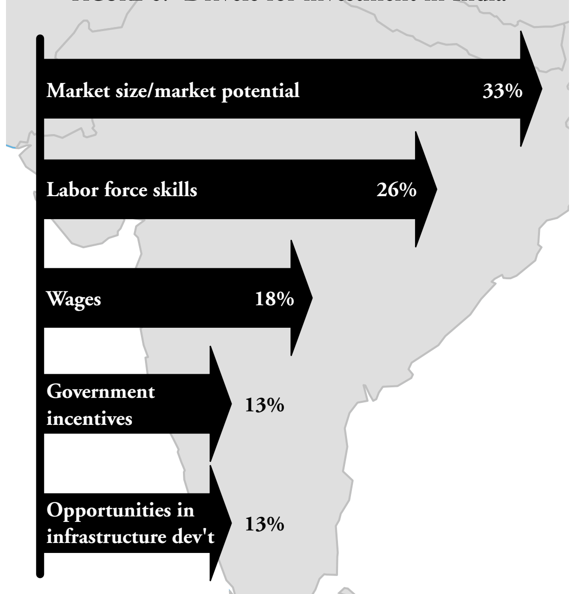
Current investors feel mostly positive about India, with over 40 percent expressing a high likelihood of investing in the country in the next one to three years. Half of these current investors have been present in the Indian market for over ten years, and more than 80 percent felt positive about the country's future prospects. Experience in the Indian market (as distinct from investor assertions of knowledge 'about' the market) provides positive perspective for investors.

To know India is to reinvest in it. Approximately two thirds of the companies with investments in India have a high likelihood of reinvesting. In contrast, only 14 percent of non-investors have a high likelihood of investment *(see figure 7)*.

MARKET SIZE AND POTENTIAL AND A SKILLED LABOR FORCE DRIVE INVESTMENT IN INDIA

The *Audit* asked executives to volunteer the most prominent drivers of investment in India. Respondents identified market size and potential, labor force skills, competitive wages, government incentives and opportunities in infrastructure development as the factors that distinguish India from other destinations for investment. These drivers reflect India's investment assets *(see figure 8)*.

FIGURE 8: Drivers for investment in India



Note: A.T. Kearney, FDI Confidence Audit sample. Number of responses indicated as a percentage of total responses

FIGURE 9: Components of India's investment appeal

Source: A.T. Kearney, FDI Confidence Audit sample

From the perspective of foreign investors, India's most attractive feature is the size and potential of its market. With a population of over one billion and growing, India offers investors a domestic market that is virtually unmatched in the world. Regardless of their level of knowledge or experience in India, three quarters of respondents perceive its domestic market as sufficiently large to meet their investment requirements *(see figure 9)*. Among the factors that could undermine the appeal of India's market are the relative weakness of consumer purchasing power (mentioned by 57 percent of respondents), slowing economic growth (47 percent), and the degree of market openness (43 percent).

The *Audit* also revealed that corporate investors perceive real "value for money" in the Indian labor force. Competitive wages and the almost unanimous perception that the Indian labor force has the skills most desirable to foreign investors represent a considerable asset to prospective investors *(see figure 9)*.

Detailed analysis provides perspective as to the particular assets that attract different types of investment to the Indian market *(see figure 10, page 8)*. Telecommunications and high-tech respondents were most enticed by what they consider a highly skilled labor force, one that is not only technically proficient, but also Anglophone. This asset was also ranked as the most important investment driver for industrial products firms and for participants in the aerospace industry. Those respondents in the construction and engineering field and in the power and utilities sector considered it as important as the size and potential of the Indian market.

This examination reveals evidence of the evolution India is undergoing in the eyes of the international investment community. Although ranked second after market size and market potential in the overall assessment of attractiveness, India's skilled labor force has the potential for claiming the spotlight as the country's most alluring characteristic for investment.

FIGURE 10: Drivers of FDI to India by sector

Driver	Market size market potential	Labor force skills	Wages	Government incentives	Opportunities in infrastructure development
Telecommunication and high-tech	★★	★★★	★		★
Power and utilities	★★★	★★★	★★	★★★	★★★
Industrial products		★★★	★★		
Consumer products	★★★	★★	★★	★★	
Construction and engineering	★★★	★★★	★★		
Financial services	★★★				★★
Aerospace		★★★			

★★★ *Most important factor* ★★ *Second most important factor* ★ *Third most important factor*

Source: A.T. Kearney, FDI Confidence Audit sample

The Indian government's investment promotion efforts have not passed unnoticed: 13 percent of respondents cited an attraction to India resulting from government incentives. However, previous A.T. Kearney FDI research has shown that government incentives generally are not among the main factors that lure investors to prospective destinations, perhaps making India an exception to the general norm, particularly in certain sectors. Power and utilities and consumer products firms were, for example, the most heavily influenced by such incentives. Almost one third of participants in these groups mentioned that government efforts to attract investment made India a more enticing market.

For corporate investors, opportunities to invest in infrastructure are as important as government incentives in determining investment interest in India. Specifically, power and utilities firms consider infrastructure sector prospects one of India's greatest attractions and cited it as frequently as they did India's market size in terms of attractiveness.

INDIA'S INVESTMENT PROFILE

In order to understand how India's investment equation differs from that of other investment destinations, the *Audit* prompted respondents to volunteer what they considered to be the major drivers of global FDI and then probed them on India's specific investment assets. The combination and comparison of these answers provides an outline of India's investment profile as seen by investors, relative to their expectations for investment globally *(see figure 11, page 9)*.

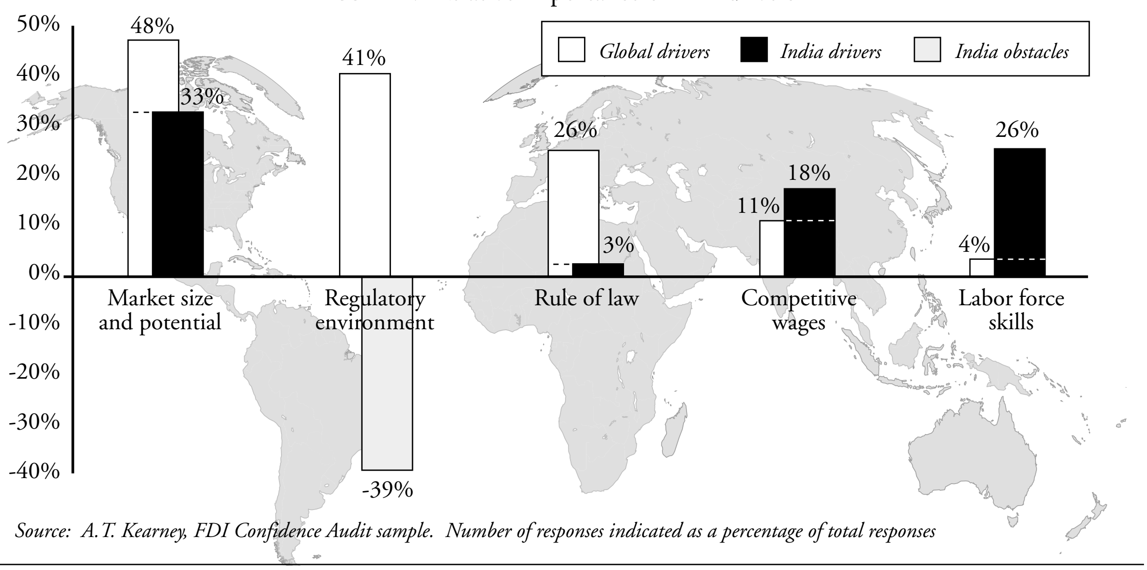
Nearly half of respondents identified market size and potential as a global driver of investment, while one third cited it as one of India's specific factors of attractiveness.

Whereas almost 40 percent of respondents identified a positive regulatory environment as a 'driver' for global investment, approximately the same number cited India's bureaucracy — an important component of the regulatory environment — as a 'deterrent' for investing in India. When considered together with other investment obstacles that have an impact on the regulatory environment — including the slowdown of the reform process (28 percent of respondents), excessive government involvement in the economy (8 percent) and corruption (6 percent) — these results suggest that India's regulatory environment is perceived to be the main obstacle for FDI in the country. It follows that what India gains in attractiveness because of its market size and potential, is diminished by negative assessments of its regulatory environment.

Overall, perceptions of India's workforce as both technically competent and competitively priced represent the heart of a powerful image of investment assets. Nonetheless, this particular productivity asset requires the support of an equally conducive regulatory environment. In the overall assessment of global drivers of FDI, investors assigned the combination of competitive wages and a skilled labor force only half of the importance that they attributed to a regulatory environment that facilitates investment. This indicates that in order to fully exploit its principal investment assets — market size and potential and the value proposition of the Indian workforce — India will likely need to address perceived deficiencies in government efficiency and perceived inadequacies of the regulatory environment.

Rule of law, an asset sought by 26 percent of respondents in all global investments, was judged important in understanding the Indian investment calculus by only 3 percent of respondents. Although India boasts a judi-

FIGURE II: Relative importance of FDI drivers



Source: A.T. Kearney, FDI Confidence Audit sample. Number of responses indicated as a percentage of total responses

> ***"Until I see the Intellectual Property Rights law signed, I will not invest in India."***
>
> — President for International Operations, consumer products firm

cial system based on the Anglo-Saxon tradition, respondents found it more often to be an obstacle rather than a driver for their investment.

Company-specific targets, such as high rates of return or the increase in shareholder value were also mentioned as important drivers for investment globally. Further probing revealed that participants have higher expected rates of return for India than for other comparable emerging investment destinations. Yet few mentioned rate of return when asked to explain their attraction to India. Thus, though investors have higher expectations regarding the return on their investments in India, the association of this factor with investment attractiveness is not one that figures in the minds of investors. This finding suggests that more efforts need to be made to focus the market on these relatively higher rates of return in order to attract the cohort of international investors for whom rate of return is a driver.

THE INDIAN INVESTMENT CLIMATE POSES CHALLENGES TO INVESTORS

Corporate investors volunteered bureaucracy and a slowing pace of reforms as the two principal deterrents to investment in India. Other direct obstacles for investment cited were corruption, poor infrastructure, cultural barriers and poverty/income disparity *(see figure 12, page 11)*. The *Audit* also probed participant concerns about the Indian investment environment, in order to better appraise the manner in which the aforementioned barriers affect investors' assessment of the market.

Corporate investors identified bureaucracy as the single largest obstacle for foreign investment in the Indian market. All of the industrial products firms cited bureaucracy as their sole investment concern, and nearly two-fifths of the respondents from the power and utilities and the telecom and high-tech sectors indicated it is a major impediment for their investments. Construction and engineering firms ranked bureaucracy and poor infrastructure as equally problematic (each factor cited by 40 percent of these respondents). However, the relative burden of India's bureaucracy is most overwhelming to the consumer products sector, with over half of respondents mentioning it as a specific deterrent.

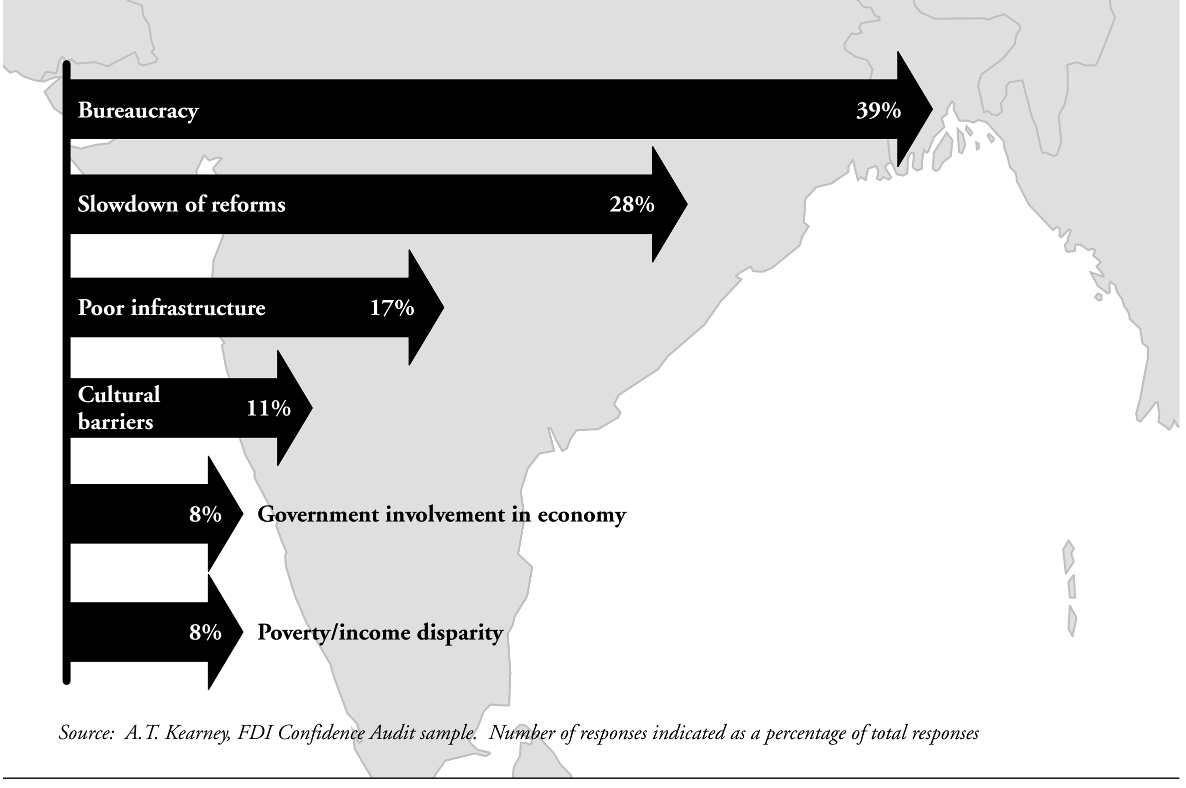
Foreign firms profess to confront India's bureaucratic hurdles at both the central and provincial government levels; however, different sectors encounter these obstacles in distinct ways. All current investors from the power and utilities and the industrial products sectors reported facing bureaucratic obstacles at both the central and provincial levels. In contrast, local bureaucratic obstacles have been more of a problem to construction and engineering and consumer products participants.

With respect to how bureaucracy inhibits FDI, respondents indicated that the stage of the investment process most affected by India's red tape is the approval of an investment project. Firms from the construction and engineering and consumer products sectors indicated that bureaucratic obstacles exclusively affect project approval. Power and utilities firms echo this concern. Three-fifths of these respondents cited project approval as a major bureaucratic obstacle, while the remainder identified project clearance as a hurdle. Respondents in other sectors felt differently. One third of telecom and high-tech firms stated that India's bureaucracy equally affected both project approval and subsequent implementation while industrial product firms stated that procurement is burdened by red tape as much as these other stages of investment.

SLOWING REFORMS AND OTHER FACTORS ALSO IMPEDE INVESTMENT

Audit participants also expressed concern regarding what they perceive are slowing eco-

FIGURE 12: Deterrents for investment in India



Source: A.T. Kearney, FDI Confidence Audit sample. Number of responses indicated as a percentage of total responses

nomic reforms, identifying them as the second most significant deterrent to investment in India. Respondents in some sectors perceived government intervention in the economy as closely related to a slowdown in the reform process that began with great promise in the early 90s. Over fifty percent of the *Audit* participants from the power and utilities and the consumer products sectors mentioned the bureaucracy/slowdown of reforms duo as a tangible barrier to further commitments in India. In addition to poor infrastructure and bureaucracy, construction and engineering firms also cited government involvement in the economy as obstructing investment. Most power and utilities sector respondents (72 percent) stated that bureaucracy and slow reforms were a hindrance, while half of the telecom and high-tech respondents volunteered corruption and slowdown of reforms as the main obstacles to investment.

Corruption, while not generally perceived to be a major factor in Indian FDI decision-making, poses significant hurdles to investors in particular sectors of the Indian economy. Although the majority of respondents (94 percent) did not list corruption as an obstacle, one-fourth of telecom and high-tech respondents perceived it as a substantial impediment. Respondents from these fields cited corruption as an obstacle in India more than they did for other emerging markets. In contrast, all other respondents ranked India in a medium-low corruption category.

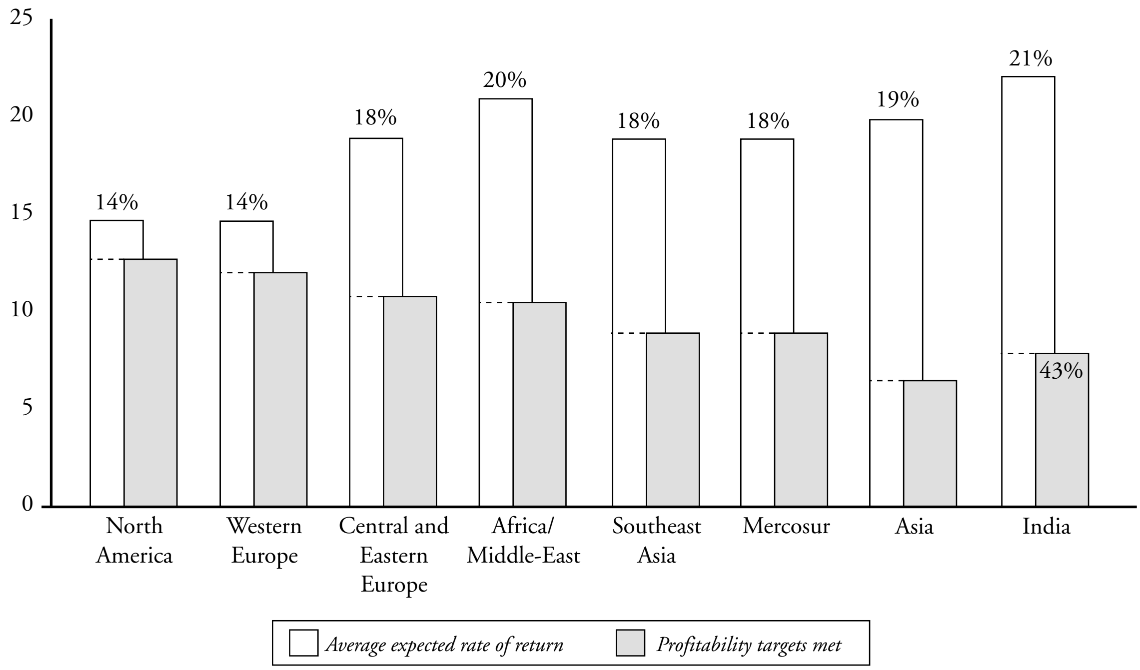
Poor infrastructure is a sector specific issue that most seriously impedes investment by affecting product distribution. Approximately one-fifth of the respondents identified poor infrastructure as an investment obstacle. Respondents in the construction and engineering sectors most clearly identified poor infrastructure as an impediment, with 40 percent mentioning it specifically. In addition, one quarter of the respondents in consumer products and power and utilities sectors acknowledged that inadequate infrastructure constitutes a significant difficulty for investment in India. Nonetheless, more than one half of the respondents (54 percent) asserted that India's structural inconveniences generally do not exceed those of other emerging market countries.

Cultural barriers and poverty/income disparity in India pose problems for investment in certain sectors, with approximately one-tenth of all respondents volunteering their conviction that these factors significantly reduce India's effective demand, and therefore its market size. (Respondents described cultural barriers as those consumer preferences

"The commitment is made, but implementation is behind."

— President, telecom and high-tech firm

FIGURE 13: Expected rates of return for India and other regions



Source: A.T. Kearney, FDI Confidence Index® January 2000 and Audit sample. Number of responses indicated as a percentage of total responses

that make global product distribution within the Indian market difficult without substantial market-specific adaptation). The consumer products sector experiences these problems most acutely, mentioning cultural barriers and income disparity as frequently as poor infrastructure as obstacles to their investment. Telecom and high-tech firms included market segmentation, along with cultural barriers and income disparity, as real investment obstacles.

NEEDED: A STRATEGY TO TACKLE INVESTOR CONCERNS

One fourth of respondents expressed concern about meeting the rates of return they expect from the market. In general, their payback period on projects is longer than in other comparable investment markets. At the same time, uncertainty persists regarding the prospect of protracted legal disputes and about indeterminate costs arising from the need to overcome unexpected infrastructure and bureaucratic hurdles. Nonetheless, the average expected rate of return on an investment in India for the *Audit* sample was higher than for other comparable emerging markets *(see figure 13)*. It would seem, therefore, that an integral part of a foreign investment strategy for India should include *promotion of India's relatively higher investment returns.*

A large number of investors are apprehensive about a perceived slowing momentum of

> ***"The negative connotation of the 'Made in India' label and poor infrastructure make India an inadequate export base."***
>
> — President, consumer products firm

India's reform process. Fully 40 percent of respondents recognize that the commitment to economic reform has been made, but feel the implementation process is lagging. Specific issues of concern to respondents include the broadening of the government disinvestments strategy (i.e. privatization), the acceleration of action on Intellectual Property Rights law, the shortening of the application/bidding/approval for FDI projects and the further reduction on caps to majority ownership. The Indian government can best respond to these concerns by *accelerating the implementation of promised reforms.* This is one of the signals that can strengthen the trust of international investors in the government's commitment to increasing FDI flows.

A further impediment to investment in India is the overall perception among investors that the Indian market alone is inadequate for major investment. A small but significant group of investors expressed caution in its consideration of India as a viable production center geared toward exports. The "Made in India" label, executives volunteered, is not perceived by the world market as synonymous to quality. At the same time, export costs are higher as a result of hurdles imposed by unsound infrastructure in roads, railroads and ports and taxes levied on the transportation of goods from state to state. Thus, while investors believe that world-class products could be manufactured in and distributed from India, the country has yet to position itself effectively as an attractive export market. *Addressing the issue of India's image as a viable export platform* is one key to unlocking India's potential for new and increased investment flows.

Executives expressed the need for the government to encourage strategic alliances between the Indian business community and foreign direct investors, with a small but significant percent of *Audit* respondents citing difficulties in finding appropriate partners for investment. While recognizing that seeking protection from foreign competitors is a natural reaction of local businesses, respondents pointed out that the benefits reaped from alliances with investors in the Indian market could help local producers offset the costs of competing with foreign exports. *FDI promotion needs to be implemented inside the Indian market as well as outside.* Successful relations with local partners are crucial to assuring re-investment, especially when foreign majority ownership is limited.

Perceptions of India's future potential depend, in great part, on the ability of domestic consumers to buy their products. Although India's record of economic growth over the decade of the nineties — averaging 6 percent increases in GDP per year — has been satisfactory for investors, respondents believe the country could be growing at faster rates and thus more rapidly realizing its potential. Paradoxically, respondents from the financial sector see the government's cautious approach to growth as fiscal discipline, an indication of long-term stability. Thus, an expression of Indian commitment to stronger economic growth balanced with fiscal discipline could serve as an effective message to *focus investors successfully on long-term market potential.*

Finally, respondents indicated that the divide between central and regional governments in the treatment of foreign investors could undermine the FDI promotion efforts of the central government. While corporate investors recognized that individual states have made great efforts to attract investment, they also expressed apprehension with regard to recurrent inconsistencies between central and regional FDI schemes. To reverse the perception that less central control over the foreign investment process leads to a decline in efficiency, *efforts to eliminate the divergence between central and regional investment policies are required.*

INDIA IS POISED TO GAIN FROM COMPETITION WITH CHINA

Respondents from all sectors identified China as India's main competitor for FDI today. Ninety percent volunteered China as a benchmark for India and confirmed that they would compare India and China in an investment analysis. Other countries that respondents compared India to were Indonesia (54 percent), Brazil (39 percent) and the Philippines (36 percent). In terms of actual flows of foreign direct investment, a comparison of India with China and Brazil reveals significant differences, in overall as well as in per capita terms. Overall, China obtained nearly 20 times more total FDI flows than India in 1999. In the same year, Brazilians received fifteen times more FDI per person than did Indians.

Although most respondents considered China to be a comparable investment destination to India, the majority felt more inclined to invest in China than in India. This is consistent with separate results from A.T. Kearney's *FDI Confidence Index®* that suggest China will retain its commanding lead over India as a preferred FDI destination over the

"The Indian science and technology capability is extraordinary and is changing the world's perception of India."

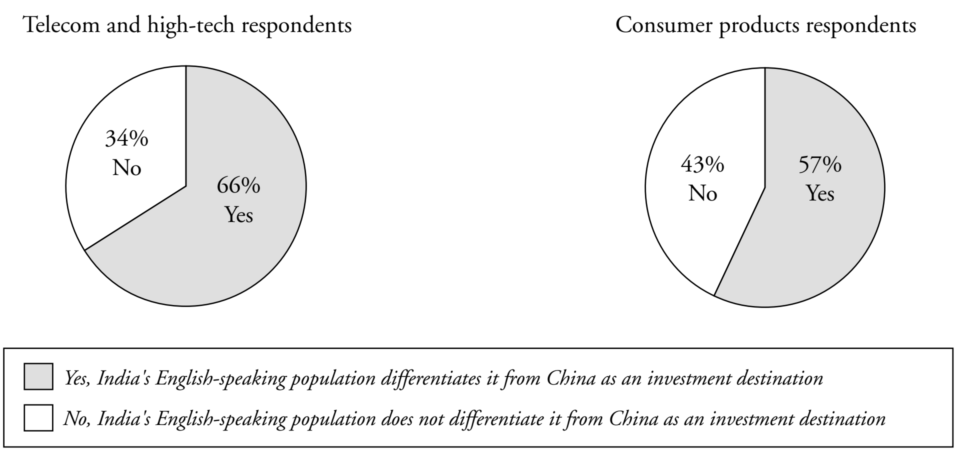
— CEO, power and utilities firm

next one to three years. In the telecom and high-tech sector, China is an especially strong competitor for FDI. The majority of telecom and high-tech participants (83 percent) feel that China and India have comparable investment climates. However, three fourths of these respondents are more inclined to invest in China than in India, with the remainder planning to invest equally in both countries.

Audit participants consider China and India most comparable in terms of market size and potential; however, the majority of respondents (84 percent) believed that the Chinese market for their products is larger than India's. According to the respondents' estimates, the relative size of these two markets varies widely. Nearly one quarter of the respondents feel that China's market for their product is twice as large as India's while another quarter feels that China's market is ten times larger. In addition to market size, *Audit* respondents noted several other comparable factors between the two countries, including demand, work force, economic development, and the state of the countries' infrastructure. When asked to describe what differentiated these two countries as investment destinations most respondents considered China to be 'more business oriented' than India, and a large percentage stated that China has better market potential. They also volunteered that FDI decision-making in China is faster and that China has more FDI-friendly policies. Corporate investors judged Chinese consumers to have higher incomes and to be more open to new products than their Indian counterparts.

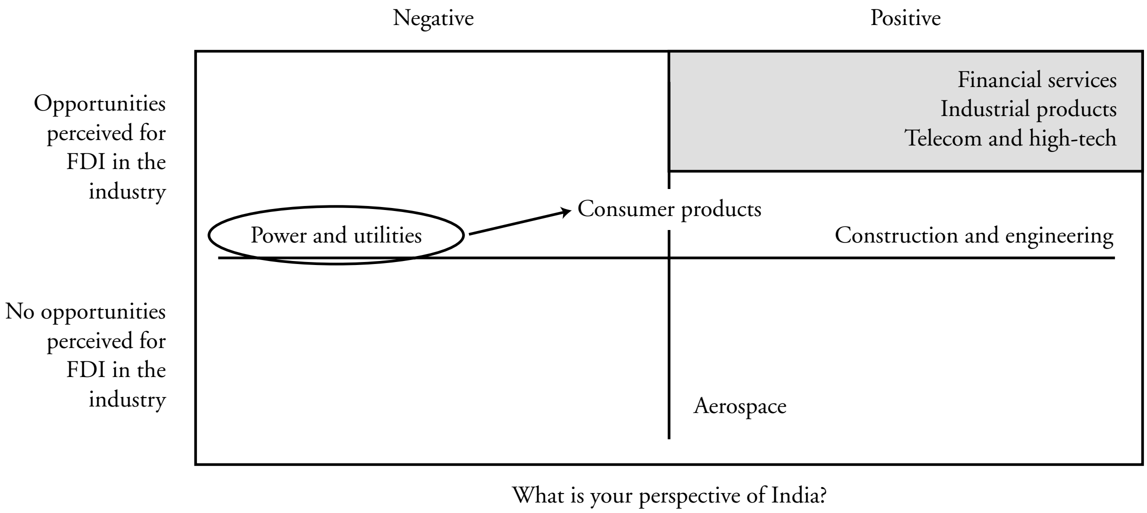
In general, it would appear that India's English-speaking population is not a factor that, on its own, differentiates India from China in the minds of investors. When asked to volunteer factors that distinguished India and China as investment destinations, no participant mentioned language. However, when

FIGURE 14: India's English-speaking population as a differentiator vis-à-vis China



Source: A.T. Kearney, FDI Confidence Audit sample. Number of responses indicated as a percentage of total responses

FIGURE 15: Investment opportunities and perspective by sector



Source: A.T. Kearney, FDI Confidence Audit sample

probed specifically about India's English-speaking population, telecom and high-tech, consumer products, and power and utilities firms considered it to be a significantly positive distinguishing characteristic. Two-thirds of the telecom and high-tech respondents noted that India's English-speaking population differentiates it from China as an investment destination *(see figure 14, page 16)*. Nonetheless, these firms indicate they remain much more likely to invest in China than in India.

INDIA OFFERS AMPLE OPPORTUNITIES FOR INVESTMENT

Three quarters of all participants indicated that opportunities for investment in their sector actually exist in India. Financial services, industrial products and telecom and high-tech firms are the most bullish towards India today *(see figure 15)*. These are the sectors in which concentrated investment promotion efforts are more likely to yield increases in FDI flows. Ironically, the Indian investment strategy traditionally has not put much emphasis on these "services" sector industries.

Attempts to create investment opportunities in oil and natural gas, trading activities, power, roads, telecom and tourism lie at the core of India's official investment promotion efforts. These industries, however, represent less than a quarter of global FDI flows, while the relatively more important services sector has not been a primary target. From 1988 to 1997 services sector FDI flows jumped from 25 percent to 43 percent of total investment in emerging markets.

India finds itself in an optimal position to capitalize on this trend. However, specific measures are needed to attract more invest-

> ***"We have evaluated India to be a 'strategic market' four months ago."***
>
> — President for Asia Pacific, telecom and high-tech firm

ment to this sector and to benefit from the strong interest among financial services, telecom and high-tech firms in India today. This need for more aggressive services sector promotion is all the more so in the light of the stiff market competition posed by China and Brazil, against whom India lags behind considerably in attracting services sector investment. In 1999, the Brazilian services sector alone captured US$ 7 billion, more than twice the total amount of FDI received by India that year. At the same time, China quadrupled India's capture of telecom services investment. Together, telecom and high-tech and financial services FDI represented slightly over 15 percent of total flows to India in 1999, leaving the market far from saturated with this type of investment. The convergence of investor interest and the existing opportunity to benefit from a global trend of increasing services sector flows provides a watershed for redirecting India's investment promotion strategy.

Opportunities also exist for better managing investment in infrastructure. After facing a challenging year in terms of investment projects in India, firms in the power and utilities sector (both current investors and non-investors) revealed a somewhat pessimistic outlook for the country, as well as diminishing opportunities for investment. However, respondents from this field also revealed that government incentives and opportunities for infrastructure development were effective drivers for their investment. Such a result suggests that government efforts to pursue further FDI in infrastructure have the potential to reverse this adverse position and entice further commitments from the power and utilities sector.

The positive reaction of international power and utilities firms and their new or strengthened commitments to the market would have two constructive results for FDI in India. First, it would increase the probability of inflows in this sector. Second, it would minimize the perception of inadequate infrastructure as a barrier for investment. Thus, a strategy directed towards recuperating lost terrain with the power and utilities sector could boost overall government FDI promotion efforts.

Conclusion

Despite its market size and potential, India has yet to convert considerable favorable investor sentiment into substantial new flows of FDI. Through interviews with executives of Global 1000 companies, the *FDI Confidence Audit: India* suggests that, overall, India remains high on corporate investor radar screens, and is widely perceived to offer ample opportunities for investment. Firms with the most experience in India represent the likeliest source of new flows, with only a small number of new investors planning to commit to the market over the next one to three years. Although optimistic about India's outlook, executives express concern about fundamental barriers to investment.

Corporate investors indicate that India possesses the most sought after asset in the global marketplace. Market size and potential give India a definite advantage over most other comparable investment destinations. Executives cite the combination of the Indian workforce's education levels and technical capabilities with competitive wages as India's other principal investment asset. The country's investment profile, however, is also conditioned by factors that inhibit foreign direct investment. Bureaucracy tops the list of investor concerns. A perceived slowdown in the process of reform generates doubts about the market's long-term potential. In the long run, excessive bureaucracy could act as the greatest barrier to increasing FDI flows by undermining India's ability to materialize investor interest.

To capitalize on its potential for FDI, it would seem that India needs to accelerate efforts to institutionalize government efficiency and advance the implementation of promised reforms. Other strategic efforts should include focusing the market on India's relatively higher rates of return on existing investments and long-term potential, addressing the issue of transforming the country into a viable export platform and encouraging strategic alliances with foreign investors.

As China emerges as India's greatest competitor for FDI flows, India must profit from its competitive advantages vis-à-vis its neighbor. Services sector executives identify India's technically trained and English-speaking workforce as the country's most specific differentiator from China. Several factors converge to indicate that India would likely reap advantage from focusing greater investment promotion effort towards the services sector. Given the sector's considerable current interest in India at this point in time, its growth as a percentage of total international investment and India's relatively underdeveloped services sector, a refocusing of India's promotion strategy would likely help yield increasing flows of FDI.

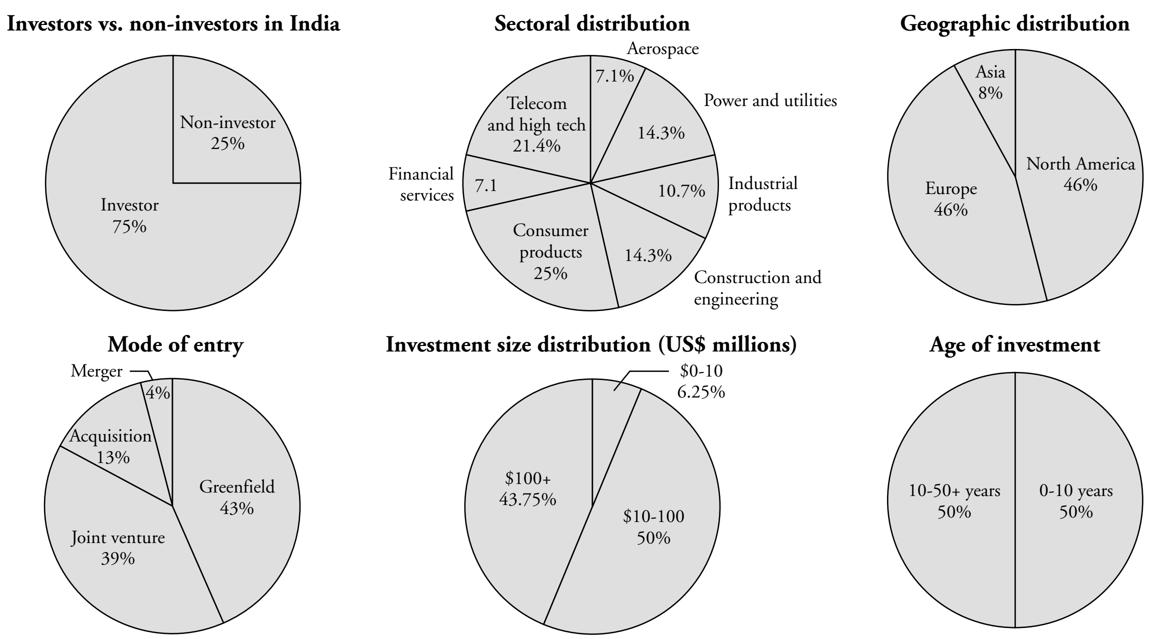
Methodology

A.T. Kearney's *FDI Confidence Audit: India* is based on in depth private interviews with senior executives from the world's largest 1,000 companies. Given the importance of India as an investment destination in Asia, many of these executives suggested the names of those officers in their organizations who have direct responsibility for operations in India and/or the Asian region. Respondents offered a diverse range of comments and opinions regardless of the degree of commitment of their firms to the country.

The *Audit* sample was selected from among January 2000 *FDI Confidence Index®* participants representing US$2.1 in annual sales and closely approximate the population of Global 1000 companies (accounting for 70 percent of FDI flows and representing US$16.1 trillion in annual sales in 1999). The participating executives include CEOs, CFOs, country managers and other genuine corporate strategists from 11 different countries and 16 specific industries. The 30 participating companies generate over US$ 600 billion in annual sales and have US$ 1.9 billion invested in India, representing over 10 percent of the country's stock of foreign direct investment in 1999.

The main secondary sources used in this analysis are the *FDI Confidence Index®* January 2000 survey, UNCTAD, the Reserve Bank of India, the Indian Ministry of Commerce and Industry's Department of Industrial Policy Promotion, and the World Bank.

Profile of participants, *FDI Confidence Audit: India*



Source: A.T. Kearney, FDI Confidence Audit sample

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