Addressing Key Challenges
U.S.-India Economic Engagement

A brief analysis of issues in select sectors
American Chamber of Commerce in India
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Executive Summary

Introduction

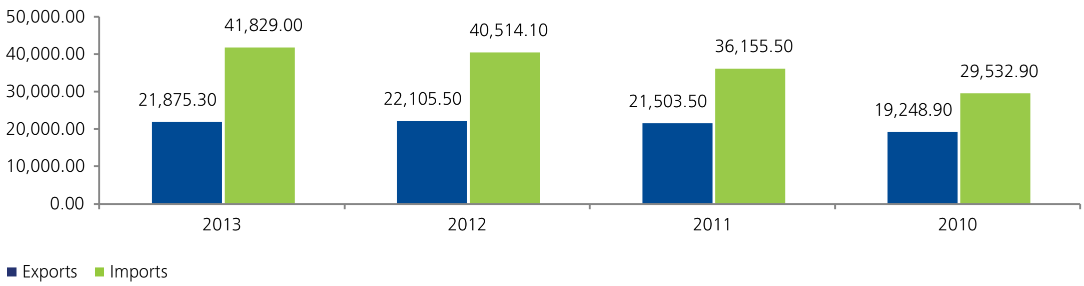
The Indian market offers lucrative and diverse opportunities for the U.S. companies/investors with the right products and services, despite a slow economic growth. As the Indian economy further globalizes and expands, the country has requirements for equipment and services for major sectors such as food processing, civil aviation, energy, healthcare, high-tech, infrastructure, transportation, defense, etc. Also, with the U.S. economy becoming more predictable, the stock markets have seen an upswing, businesses re-initiated their investments, and more jobs have been announced.

An increasing market potential also has a downside to it. There are challenges in regulation, governance, and policy, such as inadequate supply of infrastructure, an inefficient government bureaucracy, multiplicity of authorities, complex policies etc. With expected continuance of support from the government's policies, India has potential for a sustained high growth for the next couple of years; and the U.S. companies must explore the opportunities to enter the rising Indian market.

With this publication, the American Chamber of Commerce in India (Amcham - India) outlines the overview and underlying challenges in some of the important industry sectors in India including civil aviation, energy, healthcare, manufacturing, defense etc. The publication also provides some of the proposed solutions and recommendations for the government and the companies; to make the business environment more investor friendly for the U.S companies to foray into India.

Background

U.S. Trade in Goods with India (US$million)



U.S.-India Relationship

The U.S.-India relationship cuts across all sectors of economic cooperation chiefly focusing on strategic cooperation, energy and climate change, education and development, economics, trade and agriculture, science, technology, health, and innovation. It is envisaged that the upturn in the U.S. economy will not only boost exports, but positively impact economic resurgence in India. This would improve India's current account deficit (CAD). U.S. companies on their part can explore sectors in India such as infrastructure, aviation, financial services, healthcare, energy, information and communications technology (ICT), retail, defense, and homeland security for business opportunities.

The total cumulative foreign direct investment (FDI) inflows from the U.S. during April 2000-December 2013 were worth INR54, 593 crores (US$11,744 million). [2]

Country	2011-12 (April – March)	2012-13 (April – March)	2013-14 (April– December 2013)	Cumulative Inflows (April '00 – December '13)	Percentage to total Inflows (in terms of US$)
United States	5,347 (1,115)	3,033 (557)	3,670 (623)	54,593 (11,744)	6%

In this report, we have stated some of the measures that should be adopted or streamlined for overall economic growth and for improving the U.S.-India economic environment.

Role of Amcham

The American Chamber of Commerce in India (Amcham - India) is an association of American business organizations operating in India. Amcham - India, which is accredited to the Chamber of Commerce of USA (COCUSA), is also a full member of the Asia Pacific Council of American Chambers of Commerce (APCAC). Amcham's principal objectives are:

- Promote activities that would encourage and stimulate investments by U.S. companies in India
- Support ongoing business operations of its members
- Encourage bilateral trade between India and the USA

In the context of U.S.-India trade relations, Amcham has been at the forefront of identifying opportunities for improving bilateral trade and highlighting the concerns of U.S. companies operating in India.

To a large extent, these concerns relate to India's existing regulatory framework that has adversely impacted the investment climate in the country. Amcham has attempted to focus on some of these issues; and thereby draw the attention of Indian policy makers to bring about a change that will boost U.S. investors' confidence to play a more collaborative role in India's dynamic and growth-oriented market.

Recent Trends and Challenges

In the last few years, India—which has the presence of leading multinationals and investors from developed countries including the USA, Canada, the UK, and Germany—has lost much of its attractiveness as a lucrative business destination, largely due to the challenging and unpredictable business environment.

Lack of transparent and clear governance norms along with ambiguity in policies has marred the business clime. Foreign investors are unanimous in their view that the government needs to adopt a holistic perspective rather than a disparate approach if it intends to provide a stable regulatory regime in every industry sector. The various ministries of the Government of India (GoI) should work in tandem on economic issues and policy making. Delay in decision making is leading to breakdown in momentum and tardy implementation of projects.

Adoption of capital control measures is not being perceived well by businesses in India and overseas. Business leaders opine that a liberal policy of capital control will boost business in India and help win investor confidence.

Given this economic scenario, the GoI needs to take some concrete measures to revive the sagging foreign investor morale and bring the Indian economy back on track.

Regulatory environment of India

Taxation

Background

India has a well-developed tax structure with clearly demarcated authorities among the Central Government, State Governments, and local bodies. The Central Government levies taxes on income (except tax on agricultural income, which the State Governments levies), customs duties, central excise, and service tax. In the last 10-15 years, the Indian taxation system has undergone significant reforms. The tax rates have been rationalized and tax laws have been simplified resulting in better compliance, ease of tax payment, and better enforcement. In India, the process of rationalization of tax administration is an ongoing process.

Multinationals as well as investors exploring new markets look for a tax friendly environment along with political certainty, while evaluating the feasibility of doing business in that country.

Despite economic liberalization in India, foreign investors are not perceived as stakeholders in the country's growth story. In fact, little regard is given to their contribution to India's socio-economic progress. The Indian government should pay attention to the interests of foreign investors to boost investment sentiment and to ensure a continuous cycle of growth and good times. For this, a consensus of opinion needs to be factored in on vital issues such as taxation demands of foreign investors. At present, major U.S. investors and trade bodies like Amcham are not consulted on tax and finance issues to set up a predictable tax recovery environment in the country.

Direct Tax

- Retrospective amendments in tax laws create major uncertainties for companies willing to invest in India. Such amendments should be avoided for the sake of continuity of business and in the interest of prospective investors. Moreover, businesses cannot take corrective action retrospectively.
- In the absence of tax officials taking cognizance of rulings pronounced by higher authorities, companies spend a colossal amount of time and money in litigation. To avoid this distress, the authorities must issue circulars and guidance to the concerned tax departments; so that they take note of the rulings of higher authorities in tax matters.
- Rising disputes in direct taxation are a cause for concern and there is need for an effective dispute settlement mechanism to address the problem. Moreover, substantial amounts locked in litigation often are unrecoverable. The rise in litigation and disputes could be attributed to the unrealistic revenue targets set by the tax administrators; whereby tax revenue is supposed to rise even in a slowing economy.
- For the effective functioning of various alternate dispute redress mechanisms, the following suggestions may be considered:
  - The Dispute Resolution Panel (DRP) should constitute independent advisers/experts who are not Assessing Officers (AOs) and Commissioners of Income Tax. No accountability overlap should exist among DRP advisers. Introducing a mutual settlement procedure as part of the DRP process—involving waiver of interest, penalty, etc. on the taxpayer—can be considered. Further, the DRP should be empowered to settle cases; this provision will ensure timely closure of long litigated matters.
  - To make the Authority for Advance Rulings (AAR) mechanism more effective in India, speedy delivery within the statutory six-month timeline should be ensured. Also, increasing the number of AAR benches should be considered. The controversy and condition relating to non-admissibility of application in case a tax return has been filed should be addressed; so that this mechanism is available to a larger number of non-resident taxpayers.
  - Several companies have resorted to Mutual Agreement Procedure (MAP) where disputes are resolved bilaterally through inter-governmental intervention. However, this is a long drawn process and the results are not commensurate with the expectations.
    - MAP procedure should be made more transparent and the settlement mechanism should be reached within a reasonable time frame.
    - MAP procedure involves both time and money. Re-filing the MAP application for subsequent assessment years is an unnecessary waste of time and involves huge cost on the part of the assessee and competent authorities. If MAP has been achieved for a particular assessment year, the revenue authorities should not raise demands in subsequent years.
  - Recoveries of tax demand - The Indian Revenue Authorities have started seizing funds of non-resident taxpayers from their Indian bank accounts against high pitched assessments. This is despite the fact that such taxpayers have initiated MAP proceedings and provided bank guarantees as prescribed under various tax treaties. Such seizures have taken place in cases where there are stay orders by the Income Tax Appellate Tribunal (ITAT).
  - Foreign companies face high pressure for payment/recovery of demand in high pitched assessments, especially where taxpayers follow the Commissioner of Income-tax (Appeals), CIT (A) route instead of the DRP route. The revenue authorities rejects petitions for stay, ignoring the fact that AOs are not the final arbiters of disputes.
    - Indian tax authorities should be formally instructed not to collect funds in cases where the tax payer has made appropriate MAP filings and provided required bank guarantees, or where stay orders have been obtained.
    - The AOs should not act as mere tax gatherers in exercising their powers, but as quasi-judicial officials vested with the power to mitigate the hardship of the assessee.
    - Adequate provisions should be incorporated in the Income-tax Act to provide for an automatic stay of demand, so long as the matter is covered through judicial precedents by higher courts, even though it is not jurisdictional.

Transfer Pricing

- Amcham or the U.S. firms should have representation in the Finance Ministry's Transfer Pricing (TP) advisory group and International Taxation group on matters related to U.S. investments in India.
- The TP issue pertaining to issuance of shares by Indian subsidiary to foreign parent has been both

a matter of debate and concern. The issuance of shares in this context is a capital transaction and should fall outside the ambit of Indian transfer pricing domain. However, the tax officials have been treating under valuation of shares as deemed income, which is further considered as a loan to the Foreign Parent by the Indian subsidiary. The tax officials have determined interest on such deemed loan and made adjustments to the taxable income accordingly. This taxing of FDI has serious implications for capital inflows into India.

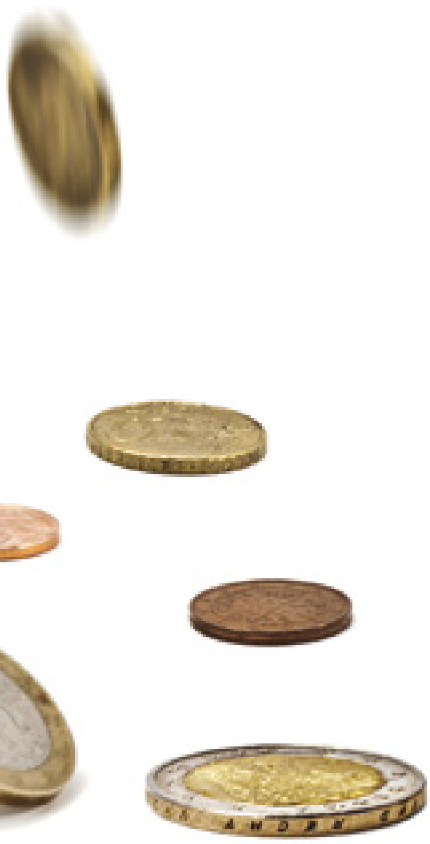
- There has been significant TP litigation on selection of comparable companies, characterization of the taxpayer, use of multiple year data, application of additional quantitative filters, and risk adjustments. TP officials often reject functionally comparable independent companies selected by the taxpayer in their TP documentation. Officials, on the other hand, cherry-pick major India IT companies, which undertake entrepreneurial activities and are not comparable with the taxpayer's companies.
- Regulations and guidelines should be in place for applying filters to select comparable companies, and the comparability analysis should regard the use of multiple year data. Further, risk adjustment benefits for low risk service providers and guidelines for undertaking risk adjustments should be provided. Time bound assessment and hearing of appeal at CIT (A), DRP and ITAT levels should be enforced.
- The Safe Harbor rules—notified on 19 September 2013—have been incorporated in the Indian TP regulations, to reduce litigation. However, the operating margins suggested in the rules are very high, so the taxpayers who have opted to be governed by these rules are very few. It is suggested that the margins prescribed in the Safe Harbor rules be rationalized and made attractive; so that a significant number of tax payers with international transactions opt for these rules.
- Competent authorities both in India and the U.S. should strive to resolve the taxability of transactions under MAP or the Advance Pricing Agreement (APA) by adopting a congenial and flexible approach, keeping in mind that several cases are pending under MAP and APA of the two countries.
- An arbitration mechanism should be in place if the competent authorities are unable to arrive at a conclusion in a reasonable time frame. In case of bilateral APAs, competent authorities on both sides (India and the U.S.) may need to use flexibility in their views and position to resolve TP issues.
- Assessment of cases under TP should be rationalized as the data for the past few years indicates that more than 50% of the cases assessed faced adjustments. The adjustments/additions made by TP officials are mostly frivolous and primarily aimed at generating bigger adjustments. A significant number of these adjustments are cancelled by the higher appellate authorities, and the whole process causes a lot of hardship on the taxpayers, by locking their money and resources in litigation. The government should ensure that TP authorities pick only those cases where there is a genuine reason to believe that tax has been evaded.

Indirect Tax

- Exporters face inordinate delays in adjudication of service tax refund claims. The filed claims are often rejected on arbitrary grounds along with citing of procedural and technical reasons as well as nexus of input services with the output services provided. Circulars/Trade notices should be issued to refund processing authorities, instructing them to process all refund claims within three months from the date of filing. To facilitate speedy adjudication of the refund claims, it would be beneficial if instructions are issued to the authorities for sanctioning 80% of the refund claims upfront on a provisional basis. Additionally, even when adjudicated, the claims have been rejected in quite a few cases and are now pending in appeal.
- The service tax audit team raises questions on the eligibility of CENVAT credit for various input services, which as per the assessee are covered under Rule 2(l) of the CENVAT credit Rules, 2004. The Excise/Service tax authorities invariably end up issuing Demand cum Show Cause Notices (SCN) in most of the cases. This uncertainty results in confusion whether to take credit or not for many input services. Each SCN generally takes at least 10 years before the case is finally decided by the Supreme Court. Similar issues are raised periodically and the disputed tax amount keeps mounting for the assessee as well as for the government.
- Under taxation rules, service tax is required to be paid before making the invoice or before receiving money from the customers.
- If the payment is not realized from the customer, resulting in bad debt, the service tax charged and paid to the government (at the time of invoicing)

cannot be adjusted/clawed-back under the current provisions resulting in additional cost to the service provider. This was not the case before April 2011 when service tax was required to be paid only on realization.

- Several restrictions are imposed on the eligibility of CENVAT credit, which is contrary to the objective of introducing credit mechanism under the service tax laws, i.e., to provide credit and to remove the cascading effect of tax. For instance CENVAT credit is not allowed in case of (a) construction of civil structure or foundation in the factory, (b) services used in setting up new factory or office for providing service, (c) Services of rent-a-cab, outdoor catering, etc. The above restrictions on CENVAT credit should be removed. The discharge of service tax liability, arising from import of services should be allowed to be adjusted.



- In tax disputes where stay of recovery is granted by the Custom Excise and Service Tax Appellate Tribunal (CESTAT), such a stay gets vacated automatically after 365 days, if the appeal is not decided. The taxpayer has no control on the disposal of the appeal due to the backlog of disputed matters before the appellate authority. The stay is granted by the tribunal only on merit after hearing both parties. Hence, the provision relating to automatic vacation of stay should be removed as it is unjustified and leads to undue financial hardship on the taxpayer.
- In the case of import transactions between related parties, the Special Valuation Branch (SVB) of Customs takes up the matter to determine whether the prices declared by the importer are influenced by the relationship or are based on the arm's length principle. Pending the order of SVB authorities, the importer is required to pay extra duty deposit (EDD) on imports. As per an SVB circular, the proceedings should be finalized within four months from the date of filing of reply to the questionnaire. If the case is not finalized within four months, the circular provides for discontinuation of EDD.
- Special Valuation Branch (SVB) assessments, however, take considerable time—up to 2 to 3 years. During this period, EDD results in extra financial burden on the importer. Besides, owing to the aforesaid delay and lack of communication between the Customs and SVB authorities, the EDD is often increased from 1% to 5% suo moto by the Custom authorities at ports.
- Clear instructions must be issued for adjudication of the SVB assessment within the prescribed four-month period. If the assessment is not completed within the stipulated time frame, instructions must be issued for acceptance of the value provided by the importer without any EDD.
- With the advent of negative list based taxation regime and the wide definition of 'Service', concerns have arisen about the service tax implications on the amount recovered by the employers from employees toward facilities like conveyance, cafeteria facility, etc. Therefore, in accordance with the general objective followed under service tax provisions, to keep the transactions pursuant to employer-employee relationship out of service tax ambit, an appropriate explanation should be issued. It should state that the recovery by employers against facilities provided to employees is not considered to be taxable.

Industry Sector Analysis

Civil Aviation

Overview

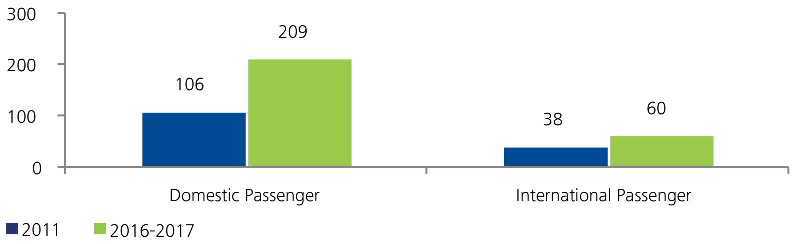
The Indian civil aviation industry comprises scheduled air transport services, non-scheduled services, and air cargo services. Currently, India is the ninth largest civil aviation market in the world with 400 aircrafts; it is expected to become the world's third largest market by 2020.[3] Thus, the aviation market becomes an important industry for future investments in India. The industry is experiencing considerable growth, albeit not without its fair share of challenges.

The cumulative FDI inflows in the air transport industry (including air freight) stood at INR2, 268.16 crores (US$489 million) during April 2000 to December 2013.[4]

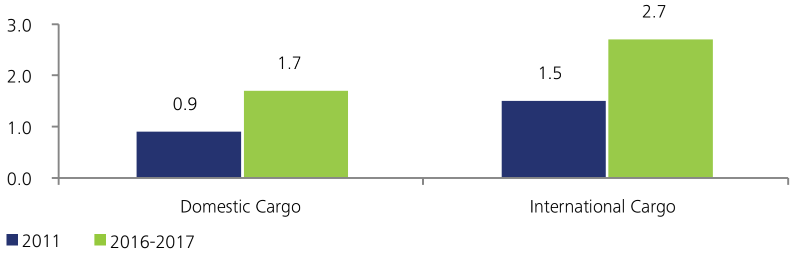
U.S.-India Relationship

Since the signing of the Open Skies Agreement between the United States and India in 2005, the bilateral civil aviation cooperation has enhanced and led to direct flights between the two countries. Further, the U.S.-India Aviation Cooperation Program, launched in 2007, is a public-private partnership enabling sharing of U.S. technology, expertise, and aviation best practices to partner with India on civil aviation development. Since, the launch of the program U.S. companies

Growth Projections for the 12th Five Year Plan Passenger (million) Forecasts



Growth Projections for the 12th Five Year Plan Cargo (MMTPA) Forecasts



India is the 9th largest civil aviation market in the world and is expected to become the world's 3rd largest market by 2020 such as Boeing, GE, Oshkosh, Honeywell, UTC, Raytheon, Hawker Beechcraft, and Gulfstream have exhibited their aircraft, helicopters, airplane engines, airport products, personnel training, aviation safety standards, and technical knowhow [5] at various civil aviation conferences including the Indian Civil Aviation Airshow—a biennial air show held in Hyderabad, India. The United States was the official partner country of India at the first international civil aviation exhibition and conference held in Hyderabad, India, in 2008. [6]

AERO 2013 (the 9th International Exhibition on Aerospace, Defence & Civil Aviation) witnessed large number of players in the civil aviation sector. The exhibition was held at Air Force Station Yelahanka, Bengaluru during 6-10 February 2013. There were notable participants in the civil aircraft manufacturers' category (out of the total 627 participants from the civilian aircraft manufacturers category, about 50 were and about 352 were from overseas).[7]

Challenges

- The Indian Government allows FDI of up to 49% for scheduled domestic passenger airlines and NRI investments of up to 100% under the automatic route, but foreign airlines are prohibited to fully own Indian carriers. In September 2012, the government liberalized the FDI policy and allowed foreign airlines to buy up to 49% stake in Indian scheduled and non-scheduled carriers, opening additional avenues of finance for Indian scheduled carriers. The limit of 49% imposed on the aggregate of FDI and Foreign Institutional Investors (FII) reduce the scope of strategic investment in Indian carriers that have FII investments.
- India restricts the possibility of any carrier to fly in or out with minimal permissions as it does not have an open skies policy. The country signs bilateral Air Services Agreements (ASA) with countries where it wants reciprocal flights to operate. India has among the highest tax rates on the Aviation Turbine Fuel (ATF), which accounts for over 40% of the total cost for airlines. The state tax levied on ATF ranges from as low as 0% in Andaman and Nicobar Islands to 28-30% in Karnataka, Bihar, Madhya Pradesh, Tamil Nadu, and Gujarat.
- Further, India levies high Maintenance, Repair and Overhaul (MRO) taxes comprising import duties on spare parts, Value Added Tax (VAT), and Service Tax. Currently, the Indian airline industry does not have any independent viable MRO facilities. As a result, most of the fleet of aircraft in India is serviced outside the country; empty aircraft and crew fly to overseas MRO hubs, accounting for approximately 13% for their total costs. Also, factors such as unfriendly taxation structure, cumbersome procedures for import of components and movement of foreign experts, and insufficient infrastructure are some of the other challenges impacting the MRO industry.
- Lack of adequate airport infrastructure is one of the major barriers for foreign companies investing in the Indian airline industry. According to the Planning Commission of India, Indian airports would require an investment of about INR 67,500 crore during the 12th Five-Year Plan (2012-17), of which, the private sector is expected to contribute around INR 40,000 crore.
- India's Route Dispersal Guideline (RDG) system requires airlines to deploy capacity to connect remote regions equivalent to 10% of the areas they operate on the most lucrative trunk routes as defined by the regulator. While the RDG did provide an initial thrust to air connectivity in remote regions, the framework is currently perceived to restrict commercial freedom by forcing airlines to fly routes that are unviable for them.
- According to the Centre for Asia Pacific Aviation (CAPA), Indian airlines incurred a combined loss of INR 9,270 crore in FY2013, down from INR 12,809 crore in FY2012. Post the Kingfisher Airlines case, the implementation of the Cape Town Convention (CTC) in India (signed in July 2008) is raising ambiguity about the applicability of the CTC in India. The CTC is a treaty designed to facilitate asset-based financing and leasing of aviation equipment, expand financing options, and reduce costs—thereby providing substantial economic benefits to the aviation industry. It reduces the creditor's risk by enhancing legal predictability in these transactions, including in the case of a debtor's insolvency or other default.

Proposed suggestions

- To address the shortage of airport infrastructure issue, U.S. companies can partner with the Airports Authority of India (AAI) to develop low cost airports to improve regional connectivity and boost air traffic. The U.S. Trade and Development Agency (USTDA) recognize immense potential and support the efforts of the U.S. private sector in aviation cooperation.
- The USTDA and U.S.-India Aviation Cooperation Program (ACP) aims at promoting growth by increasing technical capacity through training and

sharing of best practices. This can help improve high-density air traffic management operations at several Indian airports.

- Introduction of the Open Skies Agreement between the U.S. and India will lower costs and improve efficiency for the Indian outsourcing companies and the U.S. companies with offshore software development in India. Open skies agreements permit unrestricted service by the airlines of each side to, from, and beyond the other's territory; without restrictions on how often carriers fly, the kind of aircraft they use, and the prices they charge. Thus, this agreement can enable inflow of investments from the U.S. companies in the Indian airline industry.
- Reduction in ATF taxes, which amounts to as much as 40% of the total charges, can increase investment in the sector. ATF can be made a "Declared Good" that will cap the tax to 4%, thereby improving the cost structure and viability of air carriers.
- In the case of MRO taxes, rationalization of VAT and service tax could be an option. Some of the possible action plans are:
  - Apply zero rate of VAT on MROs (this will lead to development of MRO infrastructure in India)
  - Alternatively, if zero rate of VAT on MRO is not possible, aircraft parts and consumables can be brought under declared goods category
  - Provide zero rated Service Tax structure to the Indian MRO sector
  - If zero rating of service tax is not possible, the abatement should be increased to 95%

Energy

Overview

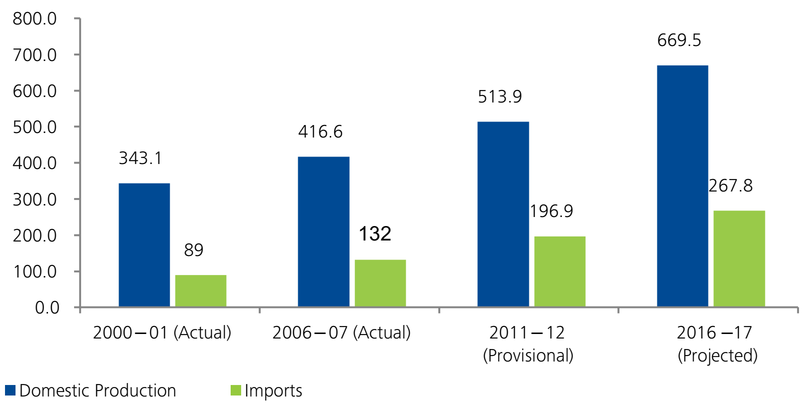
India is the fourth-largest energy consumer in the world, behind the U.S., China, and Russia. India's energy demand continued to rise despite of slowing global economy. The Power & Energy Division comprises four units - Power, Coal, Petroleum, and Energy Policy.

The 12th Five-Year Plan projects total domestic energy production of 669.6 million tons of oil equivalent (MTOE) in 2016-2017 and 844 MTOE in 2021-2022. This will meet around 71% and 69% of energy consumption respectively. The rest of the requirement will be met from imports, projected to be about 267.8 MTOE in 2016-2017 and 375.6 MTOE in 2021-2022 respectively.[8]

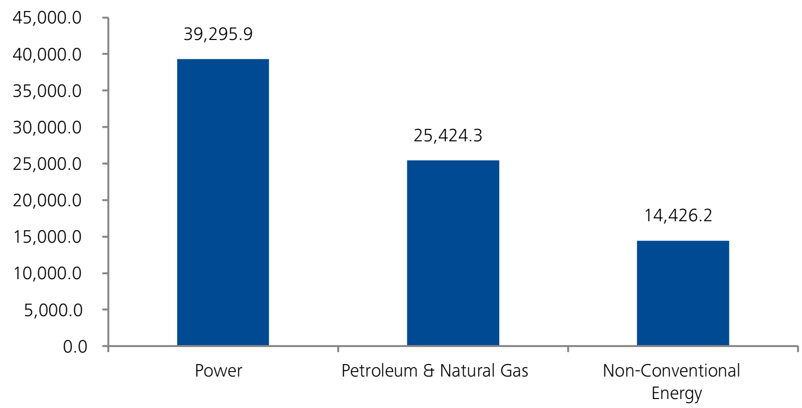
In the first nine months of 2013-14, India imported a little over 3.8 million barrels of crude oil a day, making India the third-largest oil importer in the world, behind China and the U.S.[9] Import dependence for crude oil and coal is projected to be about 78% and 22.4%, respectively by 2016-2017. By 2020, the International Energy Agency (IEA) estimates that India will become the world's largest oil importer.[10]

Coal is a dominant source of energy and accounts for over 50% share of India's energy basket. About 54% of India's total installed electricity generation capacity is coal based. Oil and natural gas account for nearly 30% and 10% share, respectively; while other renewables such as wind, geothermal, solar, and hydroelectricity represent a 2% share; and nuclear holds 1% share.

Trends in Supply of Primary Commercial Energy (MTOE)



Cumulative FDI inflows April 2000 to November 2013 (INR Crore)



IEA estimates that India will become the world's largest oil importer by 2020

U.S.-India Relationship

The U.S.-India Energy Dialogue was launched in 2005 to promote trade and investment in the energy sector. It is a key pillar of the bilateral relationship between New Delhi and Washington.

Civil nuclear cooperation between India and the U.S. is one of six major components of the energy dialogue. The two countries are still making considerations on the India's nuclear liability law as part of the Indo-U.S. nuclear deal, whether to set up nuclear reactors in India or not. American companies like Westinghouse and GE are expected to set up nuclear reactors in India, but due to the upcoming elections, the Indian government is unwilling to even contemplate any amendments.

The 2008 civil nuclear cooperation deal facilitated an exemption from the Nuclear Suppliers Group (NSG) for India that allowed several other nations like France and Russia to ink nuclear pacts with India. Others like Canada, Australia, and Japan are negotiating agreements with India.

Further, the U.S.-India Energy Cooperation Program (ECP) is a public-private partnership that aims to leverage private sector business resources in both U.S. and India. The aim is to promote commercial project development in clean energy and energy efficiency, and support the sustainable development of the energy sectors in both countries. Subsequently, U.S. companies operating in energy sectors have come together as members of the ECP. These member companies include United Technologies, GE, Honeywell, Ingersoll Rand, UL, Azure Power, American Superconductor, Quanta Power, ExxonMobil Gas India, Applied Materials, ICF Consulting, and First Solar. Moreover, Amcham India, New Delhi houses the secretariat of the ECP.

The U.S. has experienced a speedy transformation in the production of shale gas, which has more than quadrupled between 2007 and 2012.13 According to a professional from the BP, the shale gas revolution, (which has already transformed the United States and Louisiana into manufacturing powers) will vastly alter the world's energy landscape by 2035. Mark Finley, general manager, global energy markets and U.S. economics, for BP, said, Shale production will help make the United States a net exporter of natural gas in 2018, with exports growing to 10.6 billion cubic feet per day by 2035.[12]

U.S. government-owned financial entity Overseas Private Investment Corp (OPIC) announced its plans in invest up to US$820 million (about INR 3,600 crore) in the Indian renewable energy sector by the end of 2011. Of the total, OPIC will invest about US$520 million in India's renewable energy sector, including the solar segment and the remaining as private equity investments worth US$300 million, especially in small solar companies.

Meanwhile, the U.S. Trade and Development Agency (USTDA) also announced its plans in 2011 that it will invest over US$1.4 million for two projects in India's energy sector. USTDA signed pacts with Astonfield and NDPL for the proposed investments. The agency will provide US$719,985 as a feasibility study grant to Astonfield Renewables Private Limited for deploying two solar photovoltaic power projects having a total capacity of 15 MW. These funds would be utilized for setting up a 5-MW plant at Bankura, in West Bengal, and a 10-MW project at Belgaum, in Karnataka. It would also extend a US$686,447 grant to North Delhi Power Limited (NDPL) for implementation of smart grid technology. Some Grants that have been awarded by USTDA in recent times include the following:

- CESC Smart Grid Feasibility Study
- TATA Power Delhi Distribution Limited Project
- Bangalore Smart Grid Project
- Development of Shale Gas and Oil Resources
- Mumbai Demand Side Management Pilot Power Project
- Central Power Research Institute (CPRI) Smart Grid Test Bed Technical Assistance
- Rural Micro-Grid Solar Power Feasibility Study
- Bankura and Phalodi Solar PV Power Project

The Indian government has implemented various policies such as the New Exploration Licensing Policy (NELP), and Coal Bed Methane (CBD) policy to enhance investments across the industry's value chain. Further, it allows 100% FDI in upstream and private sector refining projects. The FDI limit for public sector refining projects has been raised to 49%.[13]

Challenges

- Excessive reliance on imported crude oil is making it difficult for India to achieve long-run goal of sustainable development.
- Demand for coal and petroleum resources is substantially outpacing domestic availability.
- Lack of adequate, affordable, and clean sources of energy, especially cooking fuel, as a large section of the population live in rural areas.
- India's fuel supply infrastructure, ranging from import facilities to transportation remains constrained.
- Multiplicity of regulatory organizations and stakeholders continues to stall energy suppliers from offering long term solutions. There are so many ministries focusing on energy related issues. There's petroleum and natural gas, there is power, there's renewable energy, coal, there's also the nuclear power corporation.
- Petroleum and natural gas pricing policy lacks clarity and prevents foreign investments.
- Low entry barriers and entry of non-serious players in the system significantly delays development.
- Lack of transparency and ad-hoc approach towards tendering processes keeps foreign players at bay thus discouraging them from the bidding process.

Proposed suggestions

- Reduce dependence on energy imports by achieving energy sufficiency by 2030. There should have been an attempt to empower Indian oil and gas explorers and producers. Policy should also be designed to encourage consumers to be as frugal and efficient as possible.
- Current rigid pricing setting mechanism, which is determined by the government, should be reformed. All fuels are required to be priced at market prices and add punitive taxes to ensure there isn't wasteful utilization. Currently, retail fuel prices are subsidized, that means consumers don't pay realistic prices for gas, diesel, and kerosene. This encourages inefficient use of these fuels. End-use pricing should support the government's policy for demand-side management

and facilitate a rational allocation of resources along the value-chain.

- Proposal to the Ministry of New and Renewable Energy (MNRE) to augment capacity building and training of Photovoltaic (PV) installers using in house training facilities/expertise being developed.
- State level engagement in collaboration with multiple stakeholder agencies-both Indian and U.S., being sought in progressive states of Gujarat, Tamil Nadu, Rajasthan, Andhra Pradesh etc. on energy efficiency and building code capacity augmentation.
- Collaboration sought with mega infrastructure projects such as Delhi-Mumbai Industrial Development Corporation (DMIDC) for ECP engagement.
- Energy projects must be commercially viable, with access to adequate financial resources, independent management structure, and ability to embrace the latest energy technology and improve managerial expertise.
- The current rigid pricing setting mechanism, which is determined by the government, should be reformed.
- End-use pricing should support the government's policy for demand-side management and facilitate a rational allocation of resources along the value-chain.
- Significant investments must be encouraged in the energy sector to adopt the latest technology and access for modern and clean sources of energy must be granted to all companies.
- Necessary framework conditions, including moving away from import substitution policy, must be created to attract foreign investment and compete internationally.
- Strong political support is a prerequisite to successfully cope with energy sector challenges. Consistent political messages and effective public communication are crucial to obtain the public support for the necessary energy sector reforms.
- With the new leadership in place in the Energy sector at Ministry of Power (MoP), MNRE, Central Electricity and Regulatory Commission (CERC) and Central Electricity Authority (CEA), there is an opportunity to develop consensus on new ideas which can propel development of energy sector and lead to main streaming of energy technologies. Keeping investor's interest paramount, especially in the current context of a slowing economy, there is a need to address the gaps in Central and State level policies to address their concerns and to create an investor friendly environment.

Food Processing

Overview

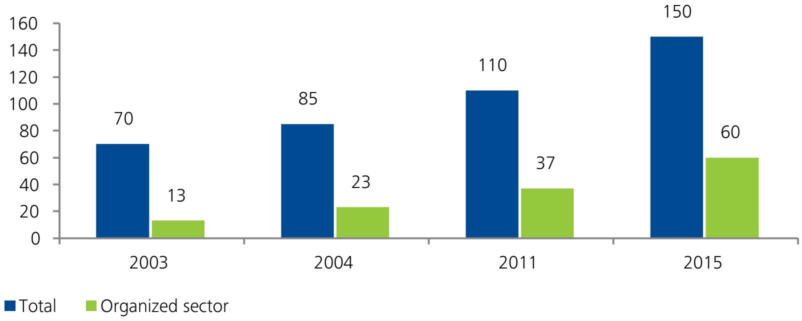
The Indian food industry mainly consists of agri-products, milk, and meat/marine products. Agri-products remain the largest consumption category.

The Indian food processing industry, which is primarily export oriented, is expected to reach around US$150 billion by 2015.[16] Food and beverages form the largest spend category of the Indian consumer budget both in urban and rural areas.

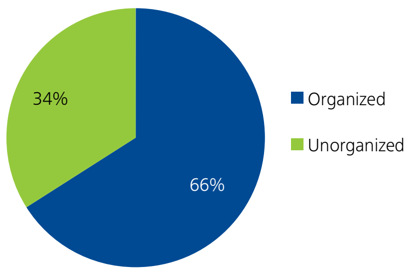
According to the Agricultural and Processed Food Products Export Development Authority (APEDA), India's agri and processed foods exports stood at Rs 116,331.68 crore (US$ 18.65 billion) during April-March 2012-13, as compared to Rs 82,480.25 crore (US$ 13.22 billion) in the corresponding period last year.[17]

Food processing in India attracted US$2.14 billion FDI during April-October 2013. The investment accounted for 17% of overall FDI in the country in those six months.[18] According to the latest data published by Department of Industrial Policy and Promotion (DIPP), the food processing and agriculture industry attracted cumulative FDI inflows of INR 30,576.46 crore (US$ 5,273.60 million) during April 2000 to December 2013[19]. Demand growth, supply advantages, and policy support are key factors attracting FDI in the food processing industry.

Food processing industry size (US$billion)



Food processing market segment



Indian food processing industry, which is primarily export oriented, is expected to reach around US$150 billion by 2015

FDI is permissible for all the processed food products under 100% automatic route (except for alcohol, beer, and items reserved for Micro, Small and Medium Enterprises (MSME), where FDI up to 24% is permissible under automatic route), subject to applicable laws/ regulations/securities and other conditions. Further, 100% tax exemption is also allowed for five years followed by 25% tax exemption for the next five years for new agro-processing industries. In addition, full excise duty exemption for goods that are used in installation of cold storage facilities.[20]

The National Mission on Food Processing (NMFP) was launched with the aim to increase food processing levels from 10% (2010) to 25% (2025). The Indian Government has provided financial assistance of INR 14,574 lakhs to 966 food processing entities in FY2012-13, to upgrade, modernize, and launch initiatives under the NMFP scheme. Further, the Ministry of Food Processing Industries has allocated General Budgetary Support (GBS) of about INR5,990 crore (US$ 959.73 million) during the 12th Five-Year Plan.

U.S.-India Relationship

US-based food and beverage giant PepsiCo Inc.'s Chief Executive Officer Indra Nooyi announced in November 2013 that the company will invest INR33,000 crore (US$5.5 billion) by 2020 to increase production capacity (by more than double) and develop infrastructure in India. PepsiCo will set up its largest beverage plant in Chittoor and Nellore districts of Andhra Pradesh. The plant will witness an investment of INR1, 230 crores and will manufacture PepsiCo's entire range of beverages, including sports drink Gatorade. It will generate around 8,000 direct and indirect jobs at full capacity. At present, PepsiCo has its largest beverage manufacturing plant at Sangareddy near Hyderabad. [20]

As per Mr. Ahmet C Bozer, International President, Coca Cola, India could emerge as a top five market for the Coca Cola Company by 2020. Meanwhile, Rasna expects revenues worth INR500 crore (US$ 80.13 million) in the next three years from the ready-to-drink beverage segment, with the launch of four variants of juices.[23]

Agro Tech Foods Limited (Agro Tech), a public limited company, is engaged in the business of marketing food and food ingredients to consumers and institutional customers. It is affiliated to ConAgra Foods Inc., a food company based in the U.S. Some of the success factors of the company's operations in India include existing range of products through development in product, process and packaging innovation, e.g., variants in Act II popcorns, 10 min meals, direct selling agreements with key accounts like Reliance Retail, Food Bazaar, Aditya Birla (More and Trinethra), Heritage, Food World, Spencers, Bharti-Walmart, Tesco, Hypercity, D-Mart among others.

Challenges

- Inadequate support infrastructure, long and fragmented supply chain, inadequate cold storage and warehousing facilities, and poor road, rail, and port infrastructure.
- Shortage of logistics infrastructure such as logistic parks, integrated cold chains, last mile connectivity, and dependence on road over rail, customized transportation, and technology adoption (barcoding, radio-frequency identification (RFIDs). These impediments lead to inefficiencies in the supply chain and logistics in India.
- Irregular enforcement of the Food Safety and Standards Act (FSSA) and multiple ministries and administering authorities at both the centre and state levels have resulted in a complex regulatory system.
- Massive capital outlay is required to set up food processing units. Further, inadequate access to credit limits investments in technology in the sector along with several food processing plants being obsolete have resulted in low processing efficiency realization and higher per unit operational cost of processing.
- The Indian Government is planning to freeze duty-free import of alcohol and food for the U.S. diplomatic staff. Duty on alcohol being imported to India currently stands at 150%, before the individual states add their tariffs. The additional duty, which is applied to all imports except for wine and spirits, is applied on top of the basic customs duty and is intended to correspond to the excise duties imposed on similar domestic products.

Proposed suggestions

- U.S. companies can share their expertise in technology, research and development (R&D), and supply chain processes. Further, policy support from the Indian Government will augment the industry. The Indian Government's Vision 2015 Plan targets at increasing growth in the food processing sector to make India a global food processing hub. The government also plans to set up 30 mega food parks in public-private partnership (PPP) mode across the country. Of the total, 10 have already been approved for the first phase.[24]
- Expansion and modification of existing infrastructure development schemes Mega Food Parks Scheme, Integrated Cold Chain Schemes, etc.
- Dedicated freight corridors in rail and concretized dual road carriageways for the state and national highways to reduce cost of goods supplied.
- Organize nation-wide skill development program for skill development of rural youths under the Swarnjayanti Gram Swarozgar Yojana of the Ministry of Rural Development.
- The National Institute of Food Technology Entrepreneurship & Management (NIFTEM) and the Central Food Technology Research Institute (CFTRI) should play a more central, proactive role to strengthen the knowledge base of the industry through greater public and private partnership in technology development.
- Develop an Innovation Fund and Venture Capital Fund for food processing industry to promote technology development in the sector.
- In January 2014, the Ministry of Food Processing signed an agreement with Invest India—(not-for-profit joint venture between the Department of Industrial Policy and Promotion (DIPP), under the Commerce Ministry, state governments, and industry body Federation of Indian Chambers of Commerce and Industry (FICCI)—to set up a help desk primarily to address online queries from domestic and foreign investors. The help desk will also support investors in locating local partners and consultants and provide hand-holding and facilitation services to investors.[23]
- Establish a network of government/private food testing labs.

Healthcare

Overview

Indian healthcare industry comprises hospitals, medical infrastructure, medical devices, clinical trials, telemedicine, health insurance, and medical equipment. Meanwhile, the Indian life sciences industry includes pharmaceutical, and biotechnology.

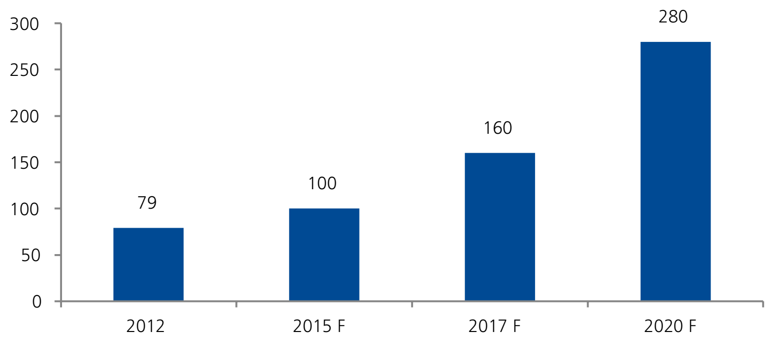
The size of the healthcare industry projected high growth rates. The key challenges such as supply deficit, lack of healthcare penetration in the market, low levels of investments by the public and private sector, limited availability of infrastructure etc. are well understood by policy makers. Unfortunately, intellectual property (IP) protection and enforcement challenges in India continue to grow, posing a serious threat to the future climate for innovation across multiple sectors and disciplines.

The pharmaceutical sector is fragmented with a stiff price competition along with government price control. Nonetheless, a number of international pharmaceutical companies are increasing their operations in India and are creating opportunities in driving the industry growth in the country.

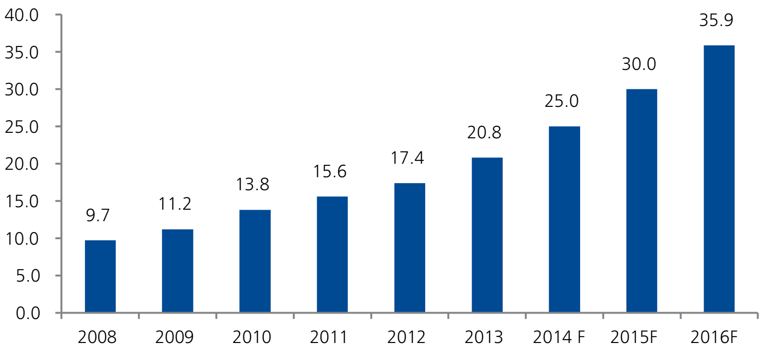
Medical devices are part of a heavily regulated global industry, and regulations touch every stage of the lifecycle of a medical device: research and development, clinical trials, pre-market approvals, manufacturing, labelling, and ultimately, marketing. There is no dispute on the importance of medical devices in healthcare and opportunities awaiting the industry. While finished goods are duty exempt, key imported raw materials and components required in manufacturing (the composition of which ranges between 30%-60% of total manufactured cost) still attract an import duty that increases the cost of manufacture.

Medical device regulation is relatively new in India, although pharmaceuticals have been regulated by the Central Drug Standard Control Organization (CDSCO) since 1940, under the Ministry of Health and Family Welfare. In February 2014, American pharma companies and their advocacy groups mentioned that the alleged restrictive India policies on clinical research are harming the companies in terms of research and development (in the efficient development of new treatments and therapies for patients, difficulty in obtaining and enforcing intellectual property rights). The companies prefer to relocate their research to more hospitable countries in Eastern Europe and China.[26]

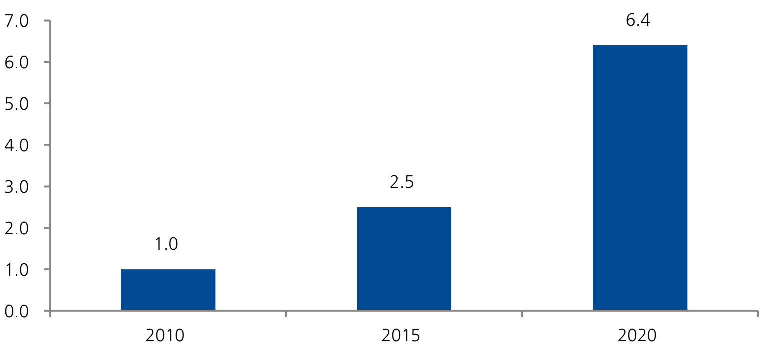
Healthcare Market in India (USD Billion)



Pharmaceutical Market in India (USD Billion)



Medical Electronics Market in India (USD Billion) - Deloitte analysis in 2011



The government announced several proposals recently to improve health care access in India:

- In March 2013, the government announced plans to increase its spending on rural health to US$4.2 billion from US$3.8 billion last year.
- In addition, in March 2013, the government exempted select cancer and AIDS therapies from excise duty and announced tax exemption on preventive health check-up spending.
- It also reduced the customs duty on imports of components to produce certain medical devices.
- Policies proposed in 2011 aimed to streamline and strengthen the public drug procurement mechanism, expand public health insurance coverage to more people, and promote generic drug use.

Authorities also proposed measures to boost the local pharmaceutical industry. In 2012, the government proposed extending R&D tax incentives from 2012 to 2017. In 2011, India had introduced policies to support R&D investment, improve access to capital for start-ups, establish drug development parks, and rationalize the tax structure. To encourage private hospital expansion, the government announced tax benefits for new hospitals opened with more than100 beds in 2010. This move could boost corporate hospital chain expansion, according to analysts.

The Government of India (GoI) has allocated INR3, 000 crore (US$ 482.32 million) in the 12th Five-Year Plan (2012–17) for the development of the medical device sector.

The GoI announced in January 2014 that it plans to retain the policy of allowing 100% foreign investment in the existing pharmaceutical firms. Under the current policy, 100% brownfield investment in the pharmaceutical sector requires prior permission of the government, whereas 100% FDI is permitted under the automatic route for greenfield investments. This ruling brings in an element of discrimination and uncertainty based on baseless fears that an acquisition of domestic pharma units by large foreign companies lead to aggressive hikes in prices for local products, diversion of these drugs to more profitable global markets and would lead to reduced availability in the local market. Moreover, 100% FDI is allowed in health and medical services under the automatic route.

U.S.-India Relationship

In the U.S., intellectual property (IP) is the engine that fuels the U.S. economy. The biopharmaceutical industry invests over US$35 billion annually in the R&D. This R&D ultimately becomes the IP that allows us to create new medicines. This property is protected through patent and related laws worldwide. Effective IP laws and predictable and transparent enforcement of these laws are therefore essential to ensure resources to invest in R&D and develop new treatments and cures for the diseases. The issuance of unwarranted compulsory licenses, unfair revocation of valid patents, and denial of patentability of inventions in India remain critical areas of concern for the pharmaceutical industry. The present IPR regime leads to disrupting the drug discovery and development cycle. Unpredictable business environment also negatively impact investments.

The impact of India's decisions in this regard is significant. The indirect and lengthy legal route that multinational companies are required to take to address their patent challenges is unacceptable. Business opportunities are lost when disputes take a lot of time to be processed.

Policy issues remain a challenge and impacts entry, expansion, and profitability of private companies across sectors

In November 2013, the healthcare division of American conglomerate General Electric (GE) announced its plans to start shipping ultra low-cost medical devices made in India to emerging markets globally. These products will be up to 40% cheaper and is expected to address 10-15% of the global healthcare equipment market.[27]

Challenges

- Regulatory hurdles (policy issues remain) can challenge entry, expansion, and profitability of private companies across sectors.
- The government limits FDI in the insurance market to 26% and does not allow FDI in the retail pharmacy segment.
- In 2011, the government announced plans to control prices for 348 "essential" drugs, which account for nearly 60% of all medicines sold in the market.
- The General Insurance Corporation of India (GIC) will not reinsure payer loss-making businesses beginning 2012, making funding harder for such companies.
- A restrictive approach by putting caps on healthcare spending has put tremendous pressure on marketing medical devices in India. Appointing a regulator for medical devices and doing away with ad-hoc approach for regulating import of devices is recommended. Several efforts are being made by Amcham and AdvaMed in this direction but much more needs to be done to bring about any perceptible improvement in this sector.
- Rather than maintain an open market, if necessary with the correct riders, the baseless fears raised by sections of the local industry will create a further disincentive to invest in India. It must be noted that 75% of the Indian market is controlled by Indian pharmaceutical companies. The treatment in FDI for the pharma sector raises serious doubts over India's commitment to free trade and foreign investors' confidence in doing business in the country.
- India has several policy restrictions in place regarding entry and expansion for foreign companies.
  - Pharmaceuticals: Beginning 2012, foreign companies acquiring Indian firms will face scrutiny by the Competition Commission of India (CCI). Similarly, foreign companies acquiring Indian drug makers will need the CCI to clear the deal, potentially delaying transactions. The government is cautious of foreign branded drug makers purchasing local companies, who are mostly generic manufacturers, as it feels acquisitions might limit patient access to low-cost medicines.

– Retail Distribution: The country has a law, which prohibits foreign companies from directly investing in retail pharmacies.
– Payers: Foreign payers can enter India only through a local joint venture and can only hold a maximum of 26% stake in a local firm.
• Companies across all health care sectors face distinct profitability issues.
– Pharmaceuticals: The Government of India is close to having 348 drugs under price control, up from an earlier 74, which is set to impact the retail price of drugs. These account for 60% of all drug sales in India. A third of these drugs will face a more than 20% price cut.
– Retail Distribution: High initial investment and infrastructure costs are reducing profits of pharmacy chains, according to industry executives.
– Payer: According to 2012 government directives, India's public reinsurer will no longer reinsure loss-making portfolios for private payers.

Proposed suggestions

- The government is offering several tax benefits encouraging private hospitals to expand operations, to meet growing health care demand in the face of constrained public providers. India allows tax exemptions for financial organizations that provide funds for hospitals with more than 100 beds.
  - The government is offering five-year tax holidays to private players building hospitals in rural areas.
  - Hospitals providing health travel facilities are also given tax incentives.
- The current body under the Drug and Cosmetics Act (DCA) does not cover the full ambit of the medical device industry and there is a need for a separate regulation. The absence of a trade promotion body (akin to the Department of Pharmaceuticals) and incentives for local manufacturers in terms of fiscal measures, capital grants, and preferential status.
- Innovation historically has been focused on cost reduction and in most cases reverse reengineering but not on customization and improvement in clinical outcomes.
- The first step towards a better regulatory regime is the approval of a medical devices regulation bill which creates a system of control, separate from that of drugs, for quality, safety, and efficacy of medical devices in India.
- Changes to the taxation structure will boost local manufacture of devices. The Indian government

proposed regulatory guidelines for medical devices in 2008, through amendments to the 1940 Drug and Cosmetics Act (DCA). New guidelines on applying drug rules to medical devices were introduced in 2012, and an updated Bill will be presented to Parliament in 2013.

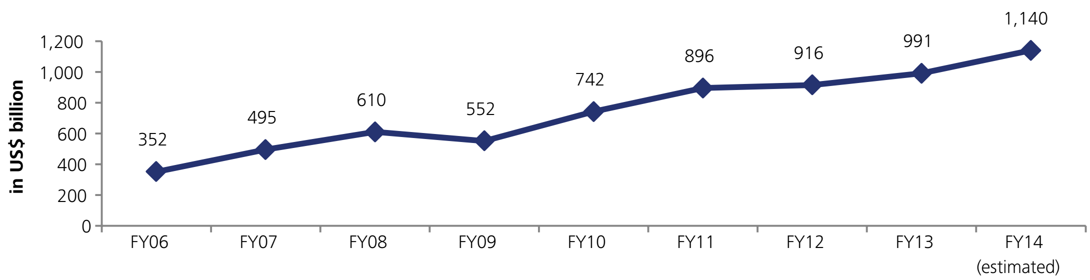
- The new Bill is expected to bring all medical devices sold in India under the purview of the government agency charged with regulating medical devices: the Central Licensing Approval Authority (CLAA) under the CDSCO. Whereas the DCA was originally meant primarily for drugs and pharmaceutical products, the new regulations attempt to regulate medical devices as a sector separate from drugs.
- Based on advise from the World Health Organisation (WHO), the FDA, the Global Harmonisation Task Force and industry experts, medical devices are classified by risk. In general, higher-risk devices are subject to stricter regulations and a more stringent pre-market conformity assessment process.
- The Food and Drug Administration (FDA) is proposing to revise medical device and biological product labelling regulations. The aim is to explicitly allow the inclusion of stand-alone graphical representations of information, or symbols, if the symbol has been established as part of a standard developed by a nationally or internationally recognized standards development organization (SDO) (referred to in this document as a ''standardized symbol''). Further, such standardized symbol is part of a standard recognized by FDA for use on the labelling of medical devices (or on a subset of medical devices), provided that such symbol is explained in a symbols glossary that contemporaneously accompanies the medical device. FDA is also proposing to revise prescription device labeling regulations to authorize the use of the symbol statement ''Rx only'' on the labeling of prescription devices.[27]

Banking and Financial Services

Background

- Indian financial market broadly comprises Banks, Capital Market Firms, Insurers, and Non-Banking Financial Companies (NBFCs).
- India's financial services sector has grown significantly over the years driven by sound macro-economic fundamentals, rising national incomes, financial sector liberalization, and the growth of a consumer-oriented credit culture.
- The financial inclusion drive from RBI has increased the market outreach to semi-urban and rural areas of the country.
- All this has led to an increasing demand for financial products, including consumer loans (especially for cars and homes), and insurance and pension products.
- India has been ranked 40th in terms of overall financial development, but is ahead of larger economies including U.S., UK, Japan and China[iii], thus offering significant growth potential.

Growth in credit off - take

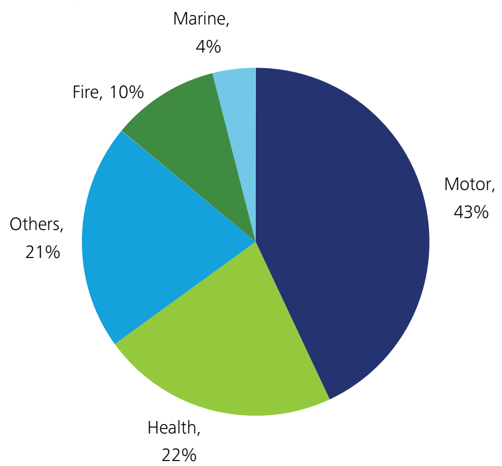


Source: IBEF

Some of the highlights of the Banking and Financial Services are:

- Credit off-take expanded at a CAGR of 22.8% and reached US$991 billion during FY06-FY13. In the same period the deposits grew at a CAGR of 21.2% and reached US$1,274.3 billion.[i]
- Total money supply increased at a CAGR of 13.9% to US$1.5 trillion during FY06-FY13.[i]
- The mutual fund industry grew at a CAGR of 16.8% in terms of AUMs (Asset Under Management), which reached US$150 billion in 2013 from US$71 billion in 2007.[ii]
- The life insurance market reached US$59.9 billion in FY12 from US$24 billion in FY06, in terms of premiums growing at a CAGR of 16.5%.[ii]
- The non-life insurance market has grown from US$5 billion in FY06 to US$12 billion in FY13 in terms of premium growing at a CAGR of 13.3%[ii]
- Motor insurance accounted for 43% of the gross direct non-life premiums in FY13 (up from 41% in 2006), with total motor premium of US$5.5 billion.[ii]

Segment - wise breakup for non - life insurance premiums (FY13)



Source: IBEF

U.S. – India Relationship

There are four major U.S. Banks with total of 49 branches operating in India (American Express Banking Corporation, Bank of America, Citibank, and JP Morgan Chase). Two of the U.S banks have presence through a representative office (Bank of New York Mellon and Wells Fargo). Citibank has the most significant presence in the Indian banking sector amongst other U.S Banks with 42 banking branches of the total 49 branches operated by U.S. banks. The total capital employed by Citigroup in banking business in India is in excess of $3 billion.[iv]

There are several U.S. Insurance firms including AIG (American International Group), MetLife, New York Life International that are present in India through joint ventures. As India emerges as an economic powerhouse, there is an ever-growing need for sophisticated insurance products that U.S. insurers can provide. Moreover, permitting higher capital participation of foreign insurers in India could benefit the U.S. insurers present in India as well as their Indian JV partners.

Challenges

- RBI has adopted a well calibrated approach in issuing banking licence. In the past 20 years, the RBI has licensed 12 banks in the private sector in two phases. Ten banks were licensed on the basis of guidelines issued in January 1993. Recently as part of issuing new licenses to private sector banks, two banking applicants have been granted in-principle to setup private sector banks in India.
- In line with other global regulators, RBI has prescribed local incorporation for foreign banks with significant presence in India that could lead to change in business and operating model. Currently, all the foreign banks operate as branches in India.
- Foreign banks also face challenges with guidelines of priority sector lending under which foreign banks are supposed to lend to the priority sector to the extent of 32% (if operating less than 20 branches) or 40% (if operating more than 20 branches). This increases operating challenges as most of the foreign banks have typically focussed on niche markets and their business model is geared towards corporate and high net worth retail customers.
- FDI in insurance is capped at 26%, which the Government is considering to increase to 49%. Recently, the Department of Industrial Policy & Promotion (DIPP) released new foreign direct investment (FDI) policy guidelines for the insurance sector, while retaining the FDI cap at 26%.
- Distribution is perhaps the biggest challenge faced by foreign firms considering entry in India's growing insurance sector. Distribution is highly decentralized and handled predominantly by agents, accounting for 79% of new individual business.
- Recently, banks have been permitted to act as insurance brokers as IRDA and RBI have come up with draft guidelines for banks to act as insurance brokers
  - The bank will now bear fiduciary responsibility and as a part of prudent governance may have to deploy part of its capital to cover for the same
  - This will enable further collaboration and alignment between banks and insurers to improve customer service and experience

Proposed Suggestions

- In current scenario, foreign banks face challenges to operate in India without subscribing to the requirement of local incorporation. Moreover, the licenses for new entrants are also based on reciprocity principle and a thorough diligence by RBI. The application evaluation process can be expedited for new entrants for faster decision making.
- Government can consider issuing differential licences to the players depending on their business models with particular player focussing on specific product, geography or market segment.
- A reorientation of the banking structure in different tiers according to the size and presence of the banks might help the existing players by addressing issues such as enhancing competition, financing higher growth, providing specialised services, and furthering financial inclusion.
- Opening up of FDI in Insurance will go a long way in restoring India as one of the key markets for attracting foreign capital.
- Wholly owned subsidiary (WoS) structure along with aligning priority sector lending mandate with differential licensing regime could be beneficial in the following way:
  - Foreign banks can expand their footprint in a growing and attractive Indian market.
  - Most of the foreign banks currently operate branches in metro and Tier-1 cities. With regulator permitting banks to expand in Tier-2-6 cities; foreign banks can migrate from "exclusive banking" model to more expansive "inclusive banking" both in retail

and corporate banking segments.
- Foreign banks can develop unique competitive proposition and further the cause of financial inclusion by increasing penetration and coverage of banking services (especially in rural areas).
- Banks can tailor the prevalent delivery models by migrating from branch to technology led branchless model.
- New products and services can be introduced in the Tier-2-3 cities by experience and expertise of banks in metros and tier -1 cities.
- Foreign banks can acquire upto 74% stake in private banks as this will help them expand their presence faster [vi]

• For insurance sector, increasing penetration of alternate distribution channels such as bancassurance (alliance between banks and insurance companies) and online aggregators can improve reach, customer service, and experience.

[i] http://www.ibef.org/download/banking-august-2013.pdf
[ii] http://www.ibef.org/download/financial-services-august-2013.pdf
[iii] https://in.deloitteresources.com/industries/fs/Documents/Financial_Service_Industry_in_India_April_2013.pdf
[iv] http://www.citibank.com/transactionservices/home/region/asia/countries/india.jsp
[v] http://www.aiadc.org/aiadotnet/docframe.aspx?docid=364312
[vi] http://www.deloitte.com/assets/Dcom-India/Local%20Assets/Documents/Financial%20Services%20industry/Roadmap%20for%20Foreign%20Banks%20in%20India.pdf

Defence

Overview

India's defence industry development and modernization has gained a lift in recent years with affordability to import major weapons systems at an accelerated pace. It has been stated time and again that India's 70% of the defence requirements are met through imports. According to SIPRI (Stockholm International Peace Research Institute), India is the world's largest importer of weaponry and accounted for 12% of global arms imports between 2008 and 2012, importing twice as much materiel as China, which was second. The emphasis of the Indian military has been on acquiring best of technology through acquisitions or upgrades of its equipment.

As per the 13th Finance Commission Report, the Defence Capital Budget is expected to grow at a CAGR of 10% per annum during 2010 - 2015 . Presuming the same rate of growth for the balance plan period, the total Defence Capital budget allocation during the 12th Plan (2012-2017) is likely to be INR4.45trillion. [3]

In the Interim Budget presented by the Finance Minister in Feb 2014, INR2.24 trillion was allocated for defence spending in 2014-15, which has been increased by 10% over 2013-14 defence budget. (INR 2.04 trillion was allocated for 2013-14).

In April 2013, the Defence Acquisition Council (DAC) approved amendments in the Defence Procurement Procedure (DPP) with focus on enhancement of indigenous content in defence products and solutions. The new policy would focus on infusing greater efficiency in the procurement process and strengthening the defence manufacturing base in the country.

U.S.-India Defence Relations – Recent Developments [6]

In September 2013, a Joint Declaration on Defence Cooperation highlighted the deepening of Indo-US relations; during Prime Minister Dr Manmohan Singh's visit to the U.S.A., India and the United States endorse the following general principles for fulfilling the vision of expanded defence cooperation:

- The United States and India share common security interests and place each other at the same level as their closest partners. This principle will apply with respect to defence technology transfer, trade, research, co-development and co-production for defence articles and services, including the most advanced and sophisticated technology. They will work to improve licensing processes and where applicable, follow expedited license approval processes to facilitate this cooperation. The United States and India are also committed to protecting each other's sensitive technology and information.
- The United States continues to fully support India's full membership in the four international export control regimes, which would further facilitate technology sharing.
- The two sides are continuing their efforts to strengthen mutual understanding of their respective procurement systems and approval processes, and to address process-related difficulties in defence trade, technology transfer, and collaboration.

Challenges:

- Amidst the growing trade relationship, the U.S. companies face certain critical issues such as unfeasible delays and extension on letters of offer and acceptance, delays in approvals for subsequent acquisitions such as for the follow-on order of (6) additional C-130Js from Lockheed Martin; lack of post-delivery risk allocation, and limitations of liability.
- India's Defence Offset Policy was introduced in 2005 towards strengthening self-reliance in Defence Preparedness and it has been simplified several times after being introduced in 2005 as part of the Defence Procurement Procedure.
- When the offset policy was considered it was predicted that there would be rapid indigenization in defence and the industry would benefit immediately. However, since its inception the policy is still evolving and the pace of indigenization through offsets is far away from expectations of the stakeholders. The major barriers in offsets procedures relate to conflicting government policies, bureaucratic procedures, inefficient managing body, and execution problems. [6]
- Another challenge that needs to be addressed during execution of offsets relates to time and cost overruns. The contract execution timelines are so long that most of the offset contracts become unviable during the final stages of implementation. Also, some issues were highlighted, when the CAG examined sixteen offset contracts signed till February 2012. These issues relate to non-adherence to DPP guidelines, waivers given by the MoD to foreign vendors, use of Direct Foreign Investment (DFI) in kind to discharge offset obligations, invalid Indian Offset Partners (IOPs), and

unfulfilled penalty charges.[7]

Proposed Suggestions:

- As per existing policies, previously agreed upon terms and conditions are being questioned by the Ministry of Defence, thus delaying commercial contracts from being signed. The new policies articulated in updated versions of the Defense Procurement Procedure (DPP) cannot be applied to preexisting offset contracts, depriving India of the added benefits of these new rules.
- The offset policies articulated in DPP 2011 and 2013 do not offer economic benefit to the OEMs but only improve the ability of OEMs to execute the offset programs, ensuring the benefits of the offset program start flowing to India sooner.
- Additionally, Indian Defence offsets can be utilized to spur India's economic and industrial progress, as per following:
  - "Dual use" items comprise components or assemblies on military platforms that also have direct utility on commercial platforms. For example, commercial airplanes that can be used for military applications have significantly higher production volumes than pure military platforms. More production volume translates into scale efficiencies for the Indian industry, which makes foreign and domestic investment in the aerospace sector an attractive proposition.
  - Tier 1 suppliers play an important part in the aerospace and defence industry, supplying from 50 to 80 percent of the cost of the final product, and owning the Intellectual Property Rights for technology in a broad array of areas. In order for India to develop indigenous capabilities, it is crucial for Indian companies, including micro, small, and medium enterprises, to have access to opportunities in these areas of specialization. By limiting the offset

discharge by Tier 1 suppliers, the offset policy does not incentivize these companies to explore sourcing opportunities from India.

- It is to be noted that with the growing importance of software in defense systems, developing new methods that provide advanced techniques for developing, deploying, and testing will become ever more important in accelerating the delivery of technical capabilities. These advances software-based systems will provide a platform for rapidly developing and deploying new capabilities.
- Additionally, any critical technology absorption and development as part of offset engagement with foreign technology providers or OEMS cannot be segregated from the pre-configures, integrated software engines. They are the powerhouse that gives intelligence and smart solutions and products for aerospace and defence.
- The Indian Software Industry is a global service provider with Industry best practices. While processes are different from the manufacturing sector, there is Quality Management System that can be audited. Processes and practices of the industry ascertain product/service quality and ensures project monitoring and tracking. In addition, outsourcing/off-shoring engineering services have compliance exposure demanding considerable effort to mitigate risks of penalties, which can include fines, forfeitures, imprisonment or even debarment from defense contracts.
- Holding offsets in abeyance for services, due to concerns related to monitoring of projects and ensuring value addition maybe addressed as per suggestions below:
- Industry practices may be customized and introduced to meet MoD requirements. The recent US DoD GAO report outlining the process for cost estimation of software projects are indeed helpful, as this is an evolving area.
- The Government may consider defining process standards like the 'maturity level-CMMi certification' of the IOP company, introduce auditing for estimation and valuation practices as a function of the offset management agency.
- Audits for compliance either in-house or by third party advisors maybe used to create a frame-work and processes for auditing IOP best practices or ensure strict compliance.
- Government should mentor companies with relatively low maturity to evolve to independent ways of working and graduate to higher maturity levels.
- Learning from within the Government Departments to strengthen the processes. For example State Trading Corporation (STC) under Ministry of Commerce and Industry audits and certifies for civil aviation related offsets for over six years now.
- The office orders holding in abeyance offsets for services impact all software projects, and have already begun to impact discussions with foreign defense suppliers. Suppliers are submitting offset proposals excluding services, and this cuts off the software Industry from these contracts. This will have a long term impact on the growth and competitiveness.
- It is therefore important that the offset held in abeyance be removed at the earliest. If prolonged, it can hamper investments and also result in sub optimal utilization of existing capacities.
- Foreign Direct Investment is capped at 26% for defense sector with case by case approval beyond that for "state-of-the-art" technology. This has limited investments of the defense sector – not only restricts valuable Foreign Exchange flow into India for an attractive sector but also deprives India of potential exports.
- There is not much logic to this cap except this principally driven by Defense PSUs to keep their interest going. It takes a huge amount of investment to bring an aviation platform to service – not possible without global customer base (else it would cost an enormous amount of money – even the French Rafale and US JSF need global base to support the programs). Business is global so this policy is anachronistic and self-defeating.
- No vendor will contribute technology without control and can't justify business case without export volume – India will see more investments from American companies once it decides to raise the FDI level in the defence sector.

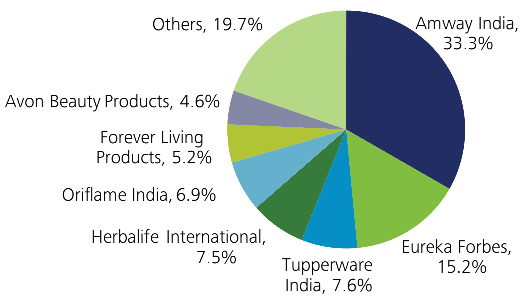
[1] SIPRI Year Book 2013
[2] http://planningcommission.gov.in/aboutus/committee/wrkgrp12/Wg_defence_equipment.pdf
[3] http://planningcommission.gov.in/aboutus/committee/wrkgrp12/Wg_defence_equipment.pdf
[4] http://in.reuters.com/article/2014/02/17/india-budget-defence-idINDEEA1G08B20140217
[5] https://www.indianembassy.org/pages.php?id=53

Direct Selling

Overview

- Direct Selling is the marketing of consumer products/ services directly to the consumers. This type of marketing is done generally in their homes or the homes of others, at their workplace and other places away from permanent retail locations, usually through explanation or demonstration of the products by a direct seller. [i]
- In India, the industry has been grouped under the Indian Direct Selling Association (IDSA). The association represents 18 direct selling companies including Amway, Oriflame, and Tupperware.
- Direct-selling companies in India, together account for 35.8 percent of non-store retail sales and 0.07 percent of gross domestic product (GDP). [ii]
- According to the Indian Direct Selling Association (IDSA), the direct selling industry grew by 12.2% to reach value of INR 7,164 crore in 2012-13, as compared with INR 6,385 crore in 2011-12. In terms of product categories, the wellness segment is the highest contributor to the sales revenue at 47% in 2012-13.[X]
- The distributor base in the direct selling industry has grown by 18.9% to reach INR 60 lakh during 2012-13. [iii]
- A report by the PHD Chambers of Commerce and Industry forecasts that the sales revenue will rise to INR 34,000 crore by the financial year 2019-20. [X]
- Direct selling is a labour-intensive industry, which results in higher employment, woman empowerment, and skill development. Factors such as entry of new firms, expansion of business to different cities and more youth joining the industry are driving the growth while global economic milieu, policy environment and declining investments are some of the challenges prevailing in the industry.

Market share by companies (2012)



Source: Euromonitor

U.S.-India Relationship

U.S. companies have strong presence in the Indian direct selling industry. U.S.-based nutrition and direct-selling company Herbalife entered India in the 90s. The company expects India to become its largest market by 2016. Herbalife is currently outsourcing the production of 80 percent of its products that are being sold in India to two companies located in Himachal Pradesh. The company had a network of 180,000 distributors across India till 2012 and the number of distributors is expected to cross 500,000 in the coming years. [iv]

In 1996, U.S.-based Tupperware Brands Corporation entered the Indian market and has steadily carved a place for itself on the shelves of the Indian Kitchen. A well-established household name today, Tupperware is strategically working towards growing their business in Asia. In India, the company plans to leverage the middle class and would focus on the under-penetrated Tier-II and Tier-III cities. [v]

Amway India Enterprises Private Limited is a wholly owned subsidiary of Amway Corporation (worth US$11.3 billion). Amway started its operations in India in 1998 and since then has captured the largest market share of the Indian direct selling industry. Amway India has invested around INR 200 crores till date in the country, and has 152 offices and 69 warehouses in India . It has recently tripled production capacities at its vendor facility at Baddi, Himachal Pradesh by commissioning four new production lines with an investment of INR 55 crores. The company announced its plans in November 2013 to set up a greenfield manufacturing facility in Tamil Nadu with an investment of INR 500 crores. The production is expected to start by mid-2015.[viii]

Challenges

- There is a lot of ambiguity when it comes to defining direct selling in India. The Department of Industrial Policy and Promotion (DIPP) classifies direct selling under the wholesale trade for the purpose of FDI inflows. According to the National Industrial Classification (NIC), 2008, direct selling is classified under retail trade (non-store format retail) but the definition of wholesale trade has gone through several changes and direct selling is not clearly defined.
- Like retail, direct selling falls under the purview of state legislation and is governed by a large number

of ministries/departments at the centre, state, and local levels. The absence of a single nodal ministry has resulted in multiple regulations governing this sector, resulting in more complexities for direct selling companies.

- Often, direct selling is presumed as Multi-Level Marketing (MLM) schemes, which involve pyramid schemes that are banned under the Prize Chits and Money Circulation Schemes (PCMCS) Act.
- Foreign companies such as Amway, Oriflame, and Tupperware are seeking clarity on the FDI policy governing direct selling operations. These companies run the risk of being clubbed with fraudulent ponzi and pyramid schemes, held guilty for violation of Foreign Exchange Management Act (FEMA) rules and other fraudulent activities, and getting penalized under the Prize Chits and Money Circulation Schemes (Banning) Act 1978.
- Apart from the FDI issue, the Foreign Investment Promotion Board (FIPB) also focuses on the quantum of sourcing from India in the case of direct selling companies, many of which are foreign players. As per the government norms, any single brand retail company with 100% FDI must mandatorily source 30% of value of products sold from the small and medium enterprises (SMEs) in India.

Proposed Suggestions

- The Forum for Direct-Selling-Companies and Consumers of India (FDCI) has urged the Central Government through a petition to create a clear legislative framework for the direct selling industry, which offers income opportunities to about 70 million Indians. A legislative framework will safeguard the interests of genuine organizations and also help distinguish them from fraudulent ponzi and pyramid schemes. [ix]
- A central law is required to define the guidelines, regulatory framework, and addressing in detail more specific issues such as the compensation plan, fair pricing, consumer rights and code of ethical marketing. One central regulatory body should be established which can have authorities and responsibilities and can govern the sector. There is a need for a nodal ministry assigned to the sector, either DIPP or Ministry of Consumer Affair, Food and Public distribution. [xii]
- The government is looking forward to a MLM and direct selling in the FDI policy. The aim is to remove ambiguities on the legal status of foreign companies

operating in the sector. Multi-layered direct selling allows the company distributors to sponsor new sellers who bring in more suppliers. Sales credits are earned on the basis of products sold by the main distributors and their sponsored vendors.

- According to the direct selling companies, direct selling should be distinguished from MLM. Further, direct selling should also be bracketed under retail, defined clearly and included in the FDI policy. The operations of direct selling companies should be 100% legalised. [x]
- Clear guidelines are also needed to check fly-by-night operators in the direct selling segment. A clear example is the multi-crore Speak Asia scam that broke in 2011. Speak Asia, the Singapore-based online company had several lakhs of Indian investors who were allegedly asked to pay INR 11,000 annually and were assured that they would get INR 52,000 a year in exchange for conducting online surveys for the website. Needless to say, they never got the promised returns. [xiii]
- There is a need to make amendments to the Prize Chits and Money Circulation Schemes (Banning) Act 1978 (PCMCS act), as it was enacted long before the direct selling industry started operating in India in 1995. Its main purpose was to control chits and other benefit or savings schemes. The act in its current form is leading to confusion among the public and the authorities between the financial pyramid schemes and the direct selling business. While the pyramid schemes are illegal and attract the provisions of PCMCS Act, the direct selling business does not. Direct selling is relatively a new business model that arrived in India decades after the 1978 Act; as such it was not anticipated by the Act.
- While designing the FDI policy, DIPP needs to follow either National Industrial Classification (NIC) classification or the United Nations Central Product Classification (UNCPC) classification, which have clearly defined different formats of retail and wholesale trade.

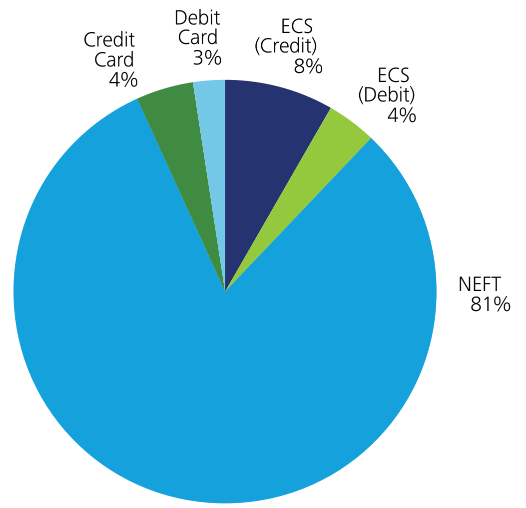
[i] http://www.idsa.co.in/WhatIsDirectSelling.html
[ii] http://www.business-standard.com/article/companies/direct-selling-companies-go-beyond-word-of-mouth-113111601309_1.html
[iii] http://timesofindia.indiatimes.com/business/india-business/Indian-direct-selling-industry-on-growth-trajectory/articleshow/27417493.cms
[iv] http://www.business-standard.com/article/companies/india-to-be-largest-market-for-herbalife-112020800072_1.html
[v] http://www.business-standard.com/article/companies/tupperware-loses-china-focus-to-train-eyes-on-india-s-bulging-middle-112120200066_1.html
[vi] http://www.business-standard.com/article/companies/amway-india-to-invest-additional-rs-150-crore-in-tn-114021100951_1.html
[vii] http://www.business-standard.com/article/companies/amway-india-to-invest-additional-rs-150-crore-in-tn-114021100951_1.html
[viii] http://www.business-standard.com/article/companies/amway-to-set-up-rs-500-cr-manufacturing-facility-in-tamil-nadu-113111300708_1.html
[ix] http://timesofindia.indiatimes.com/business/india-business/Centre-urged-to-pass-legislation-for-direct-selling-industry/articleshow/27659908.cms
[x] http://www.thehindubusinessline.com/industry-and-economy/call-for-more-clarity-on-direct-selling-in-fdi-policy/article4756784.ece
[X] http://timesofindia.indiatimes.com/business/india-business/Indian-direct-selling-industry-on-growth-trajectory/articleshow/27417493.cms
[xi] Sector Capsule – Direct Selling In India – July 2013, Euromonitor Report
[xii] http://www.icrier.org/pdf/Final_Executive_Summary.pdf
[xiii] http://www.telegraphindia.com/1130828/jsp/opinion/story_17281631.jsp

E-Payments

Background

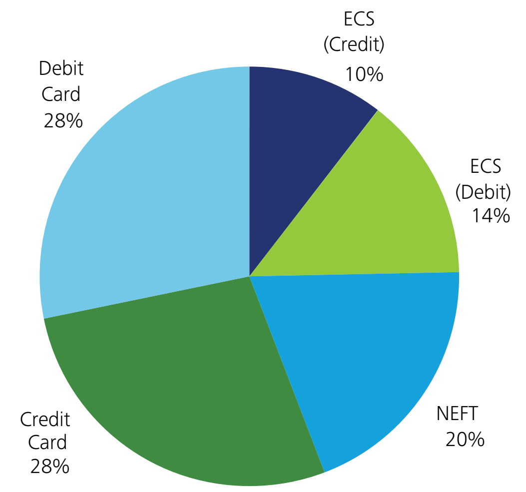
- Reserve Bank of India (RBI) took initiatives on technology-based solutions in the mid-80s and the early 90s for the improvement in the payment and settlement system infrastructure. The continued increase in the volume of cheques added pressure on the existing set-up; thus, necessitating a cost-effective alternative system.
- The payment system initiatives taken by the RBI have resulted in deeper acceptance and penetration of non-cash payment modes.
- Electronic payment acceptance in India has seen a visible growth over years when compared to the global markets. The number of people in India using electronic payments continues to grow year after year. In FY2011-12, credit card, debit card and other electronic payments grew at 26.8% to 1.21 billion transactions. This was up from 0.96 billion in FY10-11.[i]
- The size of the retail electronic payments space in India was at INR 22.1 trillion in 2011-12, the growth of 68.7% over previous year and CAGR of 60.6% during FY2004-2012.[ii]
- The number of transactions considerably increased from 167 million in 2003-04 to 1,160 million in 2011-12. [iii]
- In 2012, National Electronic Funds Transfer (NEFT) held the major share of the total retail electronic payment in value terms, with 81% share. [iv]

Retail Electronic Payment 2011 -12 (Value)



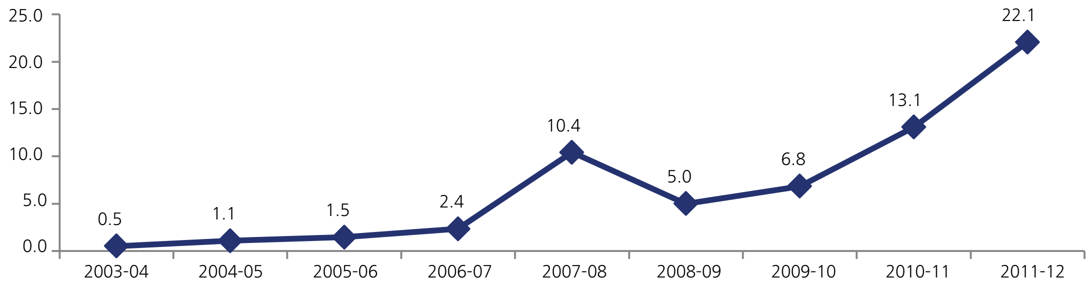
Source: RBI

Retail Electronic Payment 2011-12 (Number)



Source: RBI

Retail Electronic Payment in INR trillion



Source: RBI

U.S. – India Relationship

- U.S.-based electronic payment solutions company Calpian Inc, has invested US$1 million from Craig Hall (founder chairman of Hall Financial Group) in the home market along with supporting its Indian subsidiary My Mobile Payments Ltd (MMPL). The investment is its first tranche of a US$5 million to fund its growth plans. In India, Money-On-Mobile has served over 84.3 million unique phone number customers to date and has over 179,000 retail partners offering the service. [v]
- In August 2013, U.S.-based Boku Inc acquired Qubecell through strategic sale by buying investor share for a consideration of US$0.30 million. [vi]
- In March 2014, American Express has taken a minority stake in Bangalore-based Ezetap, barely a month after the company raised US$8 million in its latest round of financing. [vii]

Challenges

- As financial inclusion gathers momentum, there is an urgent need to enhance point of sale (POS) acceptance infrastructure in India. India has one of the lowest number of POS terminals (693 per million people) in the world, as compared to similar emerging countries such as Brazil, which has 32,995 terminals per million people and China and Russia, each of which have around 4000 terminals per million people .
- In India, there are different types of messaging solutions and formats specific to each of the payment systems. Consequently, banks/system participants are required to develop application specific Application Program Interface (APIs) to integrate with these payment systems. In the current system, however, it may be a challenge to achieve portability, i.e., a seamless switchover in the case of failure of one payment system into another.
- E-commerce and payment enablers need to be assisted in adhering to cyber law due diligence to protect the best interest of the consumers.
- Current set of technologies face significant transaction consummation challenges and thus faces credibility issues with the consumers and merchants alike.
- Challenges in payments technology also prevent the growth of segments like e-commerce.

Proposed Suggestions

- A tax structure that promotes usage of electronic modes will present an incentive for using e-payment channels. For instance, the merchant banker may be permitted to retain a small fraction of service-tax/VAT collected from its customers as an incentive/subsidy of the payment for the sales/services is received through debit card/credit card. This way, the merchants will be saving on the cost of setting up card accepting infrastructure and be further incentivised for the same. This will reduce the inconvenience of handling cash for the customers. For instance, South Korea adopted an incentive scheme as a result of which card spends of household expenditure increased from 10.7% in 1994 to 65% in 2010.
- Technology that can facilitate micro-payment transactions would substantially increase the adoption of electronic payments. Presently spends greater than INR 2 lacs are reported to the income tax department. As a result a large volume of small transactions does not enter electronic modes and consequently doesn't get reported.
- Also, the department can design multivariate filtration criteria that take into account not only spend, but demographic or geographic variables as well. Consumer payment method choices – COD, Electronic Payments, Pre-paid will lead to increased usage of commerce using the mobile phone and growth of smart phone.

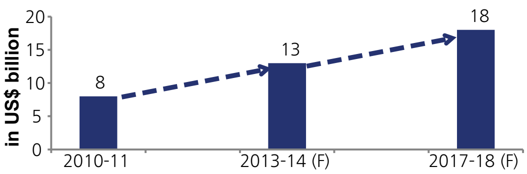
[i] http://www.indiainfoline.com/Markets/News/E-payments-rise-over-27-percent-to-1.21bn-in-FY12/5594167194
[ii] http://www.rbi.org.in/scripts/paymentsystems.aspx
[iii] http://www.rbi.org.in/scripts/paymentsystems.aspx
[iv] http://www.rbi.org.in/scripts/paymentsystems.aspx
[v] http://www.vccircle.com/news/technology/2014/03/21/money-mobile%E2%80%99s-us-parent-calpian-raising-5m-craig-hall
[vi] http://www.business-standard.com/article/companies/investors-home-in-on-mobile-payment-firms-114031201301_1.html
[vii] http://www.ft.com/cms/s/0/c3cdb920-b29d-11e3-8038-00144feabdc0.html
[viii] http://www.cxotoday.com/story/india-needs-innovative-e-payment-systems-for-financial-inclusion/
[ix] http://www.cxotoday.com/story/india-needs-innovative-e-payment-systems-for-financial-inclusion/
[x] http://www.cxotoday.com/story/india-needs-innovative-e-payment-systems-for-financial-inclusion/

Homeland Security

Background

The homeland security mostly covers threats like intrusion prevention and access denial, while solutions include surveillance, radio frequency identification etc. India's homeland security agencies primarily consist of the paramilitary forces, state and central police forces, and the intelligence agencies, all under the aegis of the Indian Ministry of Home Affairs (MHA). Apart from that, all the transportation sectors have their own security measures. The MHA has laid down six sectors for engagement and improvement in the Indian homeland security domain. After 26/11 terrorist attack in Mumbai, the Indian government has been modernizing its homeland security apparatus. The government also has taken initiatives to strengthen the security system in the country. This has led to the growth of the homeland security expenditure.

Homeland Security Market Size (approx.)



Source: Assocham India

The market size of the homeland security is expected to reach US$13 billion in 2014 and US$18 billion by 2018 from US$8 billion in 2011. Participation from private players and Original Equipment Manufacturers (OEMs) is expected to grow in the coming years.[vi]

In a scenario where homeland security has taken centre stage, annual unmanned aerial vehicle (UAV) sales in India was about US$5.2 billion in FY2013 and is expected to reach US$11.6 billion over the next decade. [vii] Technological developments and operational requirements have led to an increase on the dependency of UAVs to deliver capabilities that formerly relied on manned operations.

Many Indian companies are entering into joint ventures and transfer of technology agreements with the foreign companies. For example, Reliance Industries Limited had set up an alliance with Siemens to establish a homeland security and aerospace division in 2011. The alliance will jointly bid to install CCTV cameras across critical traffic junctions in Mumbai. [i]

Of the total India's homeland security market, about 70% is imports dominated by the U.S., UK, Germany, Taiwan, Japan, China, and Israel. The Indian government constitutes 30% of the total spend for security. [ii]

U.S. – India relationship

- India and the United States recognize the interrelationship between their homeland security concerns and have already begun laying the foundations for closer cooperation. They are exploring opportunities to improve their intelligence sharing mechanism and enhancing cooperation in new areas for strengthening homeland security.
- The two democracies initiated the U.S. - India Strategic Dialogue in 2010, to enable bilateral cooperation on mutual strategic interests and to strengthen security cooperation through expanded dialogues and exercises, as well as sharing advanced technologies.

U.S. - India Counter Terrorism Cooperation Initiative's (CCI MoU) was signed by the two nations in 2010. The MoU allows the United States to facilitate capacity building and training in India across a number of specific areas, such as:
  - Developing investigative skills
  - Promoting cooperation between forensic science laboratories
  - Establishing procedures to provide mutual investigative assistance
  - Improving capabilities to act against money laundering, counterfeit currency, and terrorist financing
  - Trading best practices on mass transit and rail security
  - Increasing interactions between Coast Guards and Navies on maritime security
  - Exchanging experience and expertise on port and border security
  - Enhancing liaison and training between specialist Counter Terrorism Units, including the National Security Guard, and their U.S. counterparts. [viii]
- In 2011, the U.S. Department of Homeland Security (DHS) and India's Ministry of Communications & Information Technology (CIT) signed a MoU on cybersecurity collaboration.
- In May 2011, the United States and India launched the inaugural U.S. - India Homeland Security Dialogue specifically focused on homeland security and counterterrorism cooperation.
- Raytheon provides proven, customized integrated Strategic Infrastructure Protection (SIP) solution to state-owned companies, the private sector and the

government of India. Raytheon provides a number of tailored solutions that can and do protect military installations and high value units (like aircraft carriers), nuclear energy facilities, natural resources and government capital regions. The company provides SIP solutions in partnership with Indian industry.
- Mahindra Defence Systems has a JV partnership with U.S.-based Telephonics Corporation to make radars and surveillance and communication systems for the Indian military. [iii]

Challenges

- Homeland security is fragmented with too many authorities involved in the decision making with no single nodal authority. Ministry of Railways leads rail transport efforts, the Ministry of Surface Transport oversees ports and maritime, and the Ministry of Home Affairs is responsible for internal security. This works as hurdle in decision making process.
- Lack of coordinated and focused approach while scoping, designing, and developing the equipment required for homeland security.
- Due to the absence of the central authority, the procurement process of the Indian government is complex and slow. The procurement process in CPMFs/MHA is governed by the DFPR (Delegation of Financial Power Rules) 1978, GFR-2005 (General Financial Rules) and the DGS&D rate contracts. DGS&D (Directorate General Supplies & Disposal) is a central purchase and quality assurance organization of government of India and falls under department of supply, Ministry of commerce. Generally, it is done through the 'rate contracts' of the DGS&D or the direct tenders by the respective forces, if it is under the financial competency of the concerned DG of the CPMF. In the current scenario, the requirement for the modern equipment is huge — ranging from the surveillance equipment for the border guarding roles, to the internal security operations in the most difficult terrains. There is requirement for the UAV for aerial surveillance operations. The procurement process for the different central police organizations are need based, and varies depending on the size of the contract. [iv]
- Regulatory framework for use of helicopters in homeland security role is non-existent and this can be addressed with support and guidance from the US FAA and Department of Homeland Security. Helicopters are recognized as effective force multipliers for law enforcement missions in many

countries around the world. Three men in a helicopter can do the work of dozens on the ground. For example, helicopters flying routine patrols over U.S. cities average two felony arrests a day, which would not have been made otherwise [v]

Proposed Suggestions

- As Indian homeland security enterprise faces a variety of challenges at the political, organizational, technological, and even societal levels, collaboration with the U.S. will help India to strengthen the homeland security system and ensure stability and security in the country. The two nations can explore opportunities in the transportation security sector, including the rail, aviation, and maritime industry.
- Formation of a central authority, which can take decisions on behalf of all different bodies involved in the homeland security.
- Encourage participation of private and foreign players. The governing body involved in homeland security must work out long-term agreements, ensuring strengthening of the relationship.
- Support greater private-public-partnerships and platforms for interactions between the Government and Corporate Institutions, creating a cohesive ecosystem.
- The procurement processes of the government needs to be simplified.
- Implementation of biometric identification systems and similar smart ID documents will provide a large opportunity.
- With the proposed opening up of nuclear sector post signing of the Civil Nuclear Cooperation Treaty with the U.S. is expected to create a large demand for Nuclear/Radiological Threat Mitigation approaches.
- The change in lifestyle of the last few years have boosted demand for private security services, with corporate offices, hotels, residential complexes as well as individuals becoming more concerned about security. Thus, the government needs to make possible amendments to the Private Security Agency Regulation (PSAR) Act.

[i] http://articles.economictimes.indiatimes.com/2011-09-02/news/30106036_1_homeland-security-security-solutions-vivek-lall
[ii] http://articles.economictimes.indiatimes.com/2012-10-09/news/34343109_1_homeland-security-market-indian-market-critical-establishments
[iii] http://articles.economictimes.indiatimes.com/2011-12-29/news/30569011_1_joint-venture-homeland-security-mumbai-cctv
[iv] http://www.forceindia.net/newsyoucanuse_How_MHA_buys_equipment_for_the_Paramilitary.aspx
[vi] http://www.aviotech.com/pdf/Aviotech_ASSOCHAM_%20Thought%20Leadership%20Series_Homeland%20Security_June%202011.pdf
[vii] http://www.indiastrategic.in/topstories3087_Homeland_Security_turns_to_UAVs_in_India.htm
[viii] https://csis.org/files/publication/130618_Nelson_US-IndiaHomeland_WEB.pdf
[v] http://www.forceindia.net/ByInvitationJuly13b.aspx

ICT - IT & Telecom

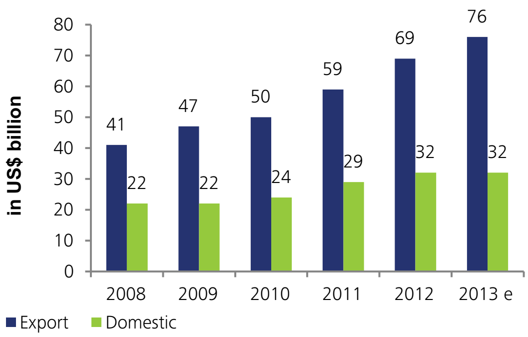
Background

- ICT sector in India has seen phenomenal growth in the last decade. IT sector has contributed almost 8% to India's GDP in 2012.
- According to Nasscom, India's technology and Business Process Management (BPM) sector (including hardware) is estimated to have generated US$108 billion in revenue during FY2013 compared to US$63 billion in FY2008.
- In telecom, India is the world's second-largest telecommunications market, with over 900 million subscribers . Wireless and wireline revenue increased at a compound annual growth rate (CAGR) of 11.9% to US$40.8 billion over FY07-12.
- In the last one year, the data consumption by 3G users has increased dramatically, which demonstrates the constant rise in mobile data consumption in the country. This indicates the need for good quality and efficient mobile broadband services with enhanced speed in order to satisfy internet users. This will help many foreign and domestic players to penetrate into the market to create their presence in the ICT sector of India.
- Indian consumers are likely to buy 225 million smartphones in 2014 , making India the second biggest market, after China.

Major growth driver of Indian ICT sector is increasing IT spend in areas like energy and utilities, digital media, process automation, etc.

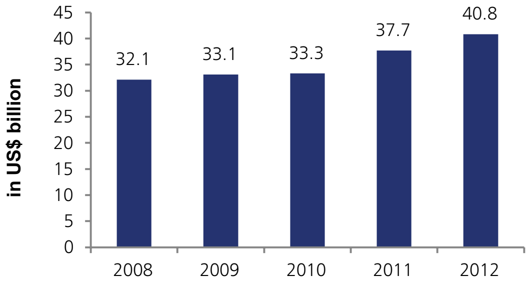
- Functional areas like business intelligence/analytics, digital media application development, mobility and cloud enablement, virtualization and infrastructure management will witness a surge of activity.

Market size of IT industry in India



Source: IBEF – Sector update 2013

Wireless and wireline revenues



Source: IBEF Sector Update 2013

U.S.-India Relationship

U.S. has traditionally been the biggest importer of Indian IT exports; over 60% of Indian IT-BPM exports were absorbed by the U.S. during FY13.[vi]

- Nearly two in five of the Fortune 500 companies[vii] outsource their technology development and process management requirements to India. Significant opportunity still exists in increasing the quantum of IT and ITES outsourcing from U.S. to India.
- The India-U.S. ICT working group (WG) broadly deals with issues relating to Information Technology, Telecommunication and Media & Broadcasting. The meeting provides a cooperative environment to discuss important market and regulatory issues as well as offer an opportunity to explore greater collaboration between India and the United States in research and collaboration. The India-U.S. ICT Dialogue has proven to be an effective and innovative mechanism to address key obstacles and challenges to greater trade, investment, and technology transfer between the two countries.
- Five India-U.S. Joint R&D projects in Ubiquitous Computing and Wireless Sensor Network have been initiated between DeitY and National Science Foundation (NSF), US. India is contributing INR 7.02 crore to its participating institutes. Likewise U.S. is contributing about $ 1.5 million[viii].
- Idea Cellular has been awarded a grant of over US$1 million [ix] from the U.S. Trade & Development Agency (USTDA), to fund a pilot involving deployment of Solar Hybrid Methanol Based Fuel Cell (SHMBFC) at telecom sites in India.
- U.S. based Dell, Inc., which has over a decade long presence in India, inaugurated new state-of-the-art Firmware Lab at its R&D centre in Bangalore in August 2013. This was an important milestone of its R&D journey in India; the lab is responsible for developing Dell's embedded systems management products

that form a part of its PowerEdge enterprise servers. In 2012, Dell launched 12G servers, the company's highest performing, manageable and innovative servers till date. At present, the Firmware R&D team in Bangalore owns 40% of the global product development in the embedded server management space. Dell Inc. has also reiterated its focus on development of small business in India. In 2012, it had acquired SonicWall, an IT network security solutions provider, in 2012.

- IBM India is the second largest private sector employer in India; it reportedly employs about 130,000 people in India. IBM's ten year deal with Bharti redefined India's telecommunication industry. In August 2013 IBM announced investment of INR25,000 crore to set up India's first chip making facility along with an international consortium with Europe based STMicroelectronics with a total outlay of INR50,000 crore. [x]

Challenges

ICT sector in India has made tremendous growth and it has potential to generate further growth through export surpluses and substantial increase in income and employment. But still there are few challenges by U.S. companies in India.

- Legal Disputes - The Indian tax slab and stringent policies are major issues that U.S. companies have with the Indian authorities. The aggressive tax positions of India's Income Tax Department are evident in such areas as the Vodafone case. Transfer Pricing (TP) issue pertaining to Issuance of Shares by Indian Subsidiary to Foreign Parent. The tax officer has treated under valuation such shares as income and imposed deemed interest income as well whole treating such undervaluation as deemed loan. This taxing of FDI has serious implications for capital inflows into India.
- Employment - Indian labour laws are designed to apply mostly to "workmen", as defined under the Industrial Disputes Act. Most labour laws are pro-workmen and provide statutory rights to workmen including the right against forced or unfair redundancies.
- While India could provide a large talent pool to address opportunities during Outsourcing 1.0, lack of appropriate high end skill-set among graduates may hinder growth in Outsourcing 2.0 phase, which requires strong R&D and business expertise.
- The Preferential Market Access (PMA) rules issued by the Indian Department of IT/Telecom are of serious concern to global players in India. PMA is inconsistent with WTO obligations.
- In relation to the PMA rules, the government, for now, has put on hold plans to apply PMA to private companies like telecom operator equipment purchases. However, this is only a stay; they remain as committed as ever to promoting local manufacturing/ IPR.

Proposed Suggestions

- The telecom department has decided to mandate the upcoming Telecom Testing & Security Certification (TTSC) centre to invite bids from organizations in the private, public, and joint sectors keen to set up telecom gear test labs in India. The government is preparing to invite bids from private operators from July 2014. Alongside, the government needs to strengthen vulnerability levels of Indian mobile networks and privacy laws on protecting the intellectual property rights (IPRs) of global network gear suppliers in order to maintain the confidentiality of IPRs owned by various system vendors. The potential is significant, as US$4 billion worth of active telecom equipment is inducted into Indian telecom networks every year.
- The government must continue the momentum of rapid stabilization on the regulatory front by expediting the spectrum trading and sharing norms. At this point in time, spectrum trading and sharing norms are likely to be released prior to the next round of auctions to be held in March 2015.
- Also, the government must come out with guidelines on equipment testing locally. While addressing genuine security concerns of India, the business must frame policies for adopting cloud computing and trans-national IT solutions. The requirement that IT/ Telecom equipment must be certified by local labs as being "security compliant" sets in a couple of months even though India does not have a fraction of the labs needed to handle the range and volume of equipment requiring certification.
- ICT R&D outfits should not to be subject to taxation on profit sharing but only on mark-up on cost with a Safe Harbor rule – Transfer Pricing cannot apply to capital infusions which actually is an FDI.
- DoT has issued guidelines for Green Telecom, which requires that in Phase-I, 50% of urban and 20% of rural towers move from gen-set backup to solar by 2015. A key concern of telecom operators is that the

solar-based solutions require high capex investments and considering the present cash-strapped situation of the industry, not many players are in the capacity to fund the projects. Since, the total cost of energy to operate a telecom site is considered to be a major cause of worry for telecom tower infrastructure providers, according to experts, the successful implementation of the directive can only be achieved through subsidy support from the government.

- The recent announcement on allowing 100% FDI in telecom will help attract new investment into the sector as early as Q4 of this fiscal year but there needs to be some additional supporting policy announcements/changes:
  - The M&A policy need to clearly indicate the spectrum of the acquired company and the payment procedures to DoT.
- Telecom Licences expiring in 2014 need clear articulation, particularly the spectrum fees that will have to be paid. More clarity is required on whether 900 MHz spectrum, will be taken back for "re-farming".

[i] http://www.smeworld.org/story/special-reports/indian-ict-industry-communic-asia.php

[ii] http://www.ibef.org/industry/telecommunications.aspx

[iii] Emerging Markets Insight – August 2013

[iv] Emerging Markets Insights – August 2013

[v] http://timesofindia.indiatimes.com/tech/tech-news/Smartphone-shipments-tripled-in-India-last-year/articleshow/31076543.cms

[vi] IBEF Sector Update - 2013

[vii] https://www.indianembassy.org/pages.php?id=49

[viii] http://deity.gov.in/content/usa

[ix] http://www.ideacellular.com/wps/wcm/connect/foryou/idea/cellular_news/Idea%20receives%20Grant%20from%20U.S.%20Trade%20Development%20Agency%20for%20Green%20Telecom%20pilot%20in%20India

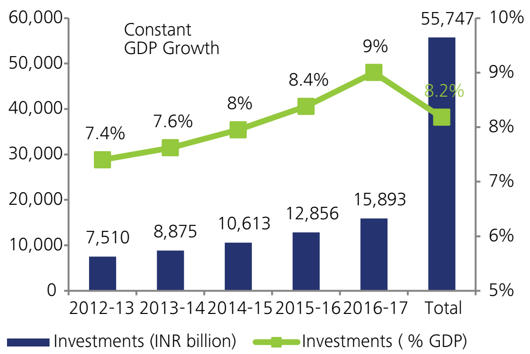
[x] http://timesofindia.indiatimes.com/business/india-business/Global-giants-look-to-invest-Rs-50000-crore-in-chip-making-in-India/articleshow/21692355.cms

Infrastructure

Background:

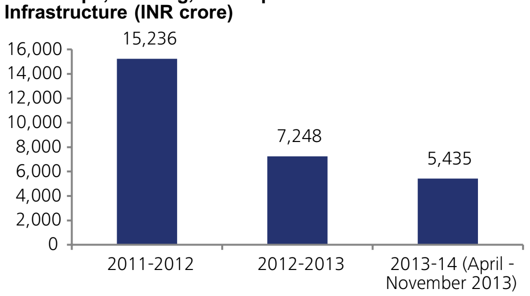
- The infrastructure sector in India primarily comprises electricity, roads, railways, telecommunications, irrigation, water supply and sanitation, ports and airports, storing facilities, and oil and gas pipelines.
- The share of infrastructure investment in India's GDP is expected to increase to more than 9% by the end of the 12th Five Year Plan. [i]
- According to the Planning Commission of India, infrastructure investments are expected to double from INR 24,243 billion during the 11th Five Year Plan to INR 55,747 billion in the 12th Five Year Plan. [i]
- Out of the total projected investments, Electricity will have the largest share (26.9%) of the total investment followed by Telecommunications (16.9%), Roads and Bridges (16.4%), Railways (9.3%), Irrigation incl. Watershed (9.0%), Renewable Energy (5.7%), Water Supply and Sanitation (4.6%), Ports (3.5%), Oil and Gas Pipeline (2.7%), MRTS (2.2%), Airports (1.6%), and Storage (1.0%).

Projected Investments in infrastructure in 12th Five - Year Plan



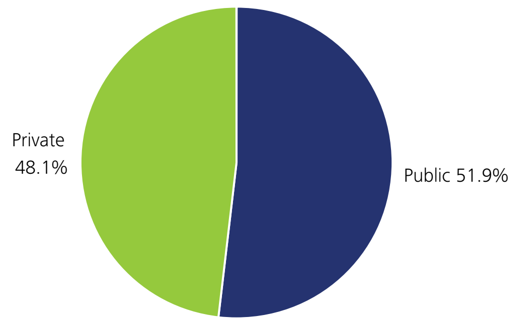
Source: Planning Commission

FDI Inflows Construction and Development: Townships, housing, built-up Infrastructure (INR crore)



Source: Planning Commission

Share of Investments in Infrastructure in 12th Five-Year Plan (%)



Source: Planning Commission

U.S.-India relationship

In 2000, U.S.-India commercial dialogue was launched. The dialogue facilitates the exchange of best practices and standards across priority sectors, which includes infrastructure as well.

India is planning to invest US$1 trillion in infrastructure development during the 12th five year plan and U.S. companies are in a unique position to offer their skills and expertise in partnership with the Indian firms. Indian economic officials have engaged with the U.S. officials and market participants in areas such as attracting private investment into infrastructure financing.

The United States Trade Development Agency (USTDA) promotes economic growth in emerging economies by facilitating the participation of the U.S. businesses in the planning and execution of priority development projects in host countries. The Agency's objectives are to help build the infrastructure for trade, match U.S. technological expertise with overseas development needs, and help create lasting business partnerships between the United States and emerging market economies.

Since 1992, the USTDA has supported over 100 priority development projects in India with public and private sector sponsors. USTDA supported a Transportation Infrastructure Exchange program to introduce Indian public officials and private sector project sponsors to U.S. infrastructure technologies and services through a series of two reverse trade missions (RTMs) to the U.S. focused on rail and ports. Such missions aim to increase awareness of U.S. technologies, services, product standards as well as best regulatory processes and operating practices that can assist India in developing its rail and ports infrastructure.

In 2013, USTDA concluded a US$692,000 grant agreement with the Central Power Research Institute (CPRI) [iv] to prepare a detailed planning and procurement document for the implementation of a Smart Grid Test Bed project in Bangalore, India. The test bed, which will consist of an integrated Interoperability Laboratory and Smart Grid Technology Demonstration Center, will allow CPRI to research and perform controlled evaluations of a variety of integrated Smart Grid technologies.

Challenges:

There is visible presence of the Indian private sector in several key infrastructure sectors – telecom, oil and gas, ports, airports, power generation, and roads. However, American companies have a very small share of this market.

- Land acquisition and resistance from local communities leading to project delays. Multiplicity of permitting agencies and complex land acquisition norms for infrastructure projects.
- Infrastructure financing also presents a number of challenges. Infrastructure projects are complex, capital intensive, and have long gestation periods that involve multiple and often unique risks to project financiers.

- As per the latest ratings by credit rating agency India Ratings (a Fitch Group Company), the outlook for infrastructure sector in the country is negative for 2014-15 due to weak credit profiles of the project companies. However, policy support from the government will lessen the impact on the sector.[i]

Conclusions:

- There is a need to change the way infrastructure development is approached in India. Clients insist on a high level of accuracy in developing cost estimates but are not willing to provide time or money required for the same. More time and clarity should be provided to the investors with their involvement from early stages.
- Speeding up Infrastructure delivery requires reforms across various stages including pre-tendering (land acquisition, statutory clearances, financial closure), execution (hiring agencies with a track record for doing quality work in a safe and timely manner, life cycle cost evaluation rather than only the lowest quoted price) and financing (raising debt and equity from Indian and International funding agencies).
- Facilitate funding for infrastructure projects. Finance is amongst the major constraints for infrastructure projects. Improved US EXIM financing for infra projects could help higher involvement of U.S. Companies in infra projects and help them fructify.
- Qualification Criteria set by public sector companies for their large Infrastructure Projects (e.g., LNG re-gasification terminals) insist on the experience of the bidding entity; and do not consider take into consideration the experience of parent entities even for 100% owned subsidiaries of American companies operating in India for qualifying with respect to tender criteria. Experience of parent or related companies should qualify and be acceptable so that American companies invested in India get a fair chance to bid.
- Contract terms for projects (including the Integrity Pact) should be equitable in character, rather than heavily loaded in favor of owners (examples are clauses pertaining to indemnities, liabilities, penalties, payment terms, termination, etc.)

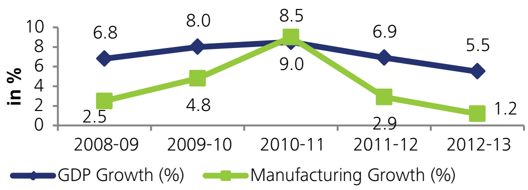
[i] http://planningcommission.nic.in/plans/planrel/fiveyr/12th/pdf/12fyp_vol1.pdf
[ii] http://dipp.nic.in/English/Publications/FDI_Statistics/2013/india_FDI_November2013.pdf
[i] http://articles.economictimes.indiatimes.com/2014-02-13/news/47305126_1_india-ratings-power-sector-stable-outlook
[iv] http://www.cpri.in/director-generals-message.html

Manufacturing

Overview

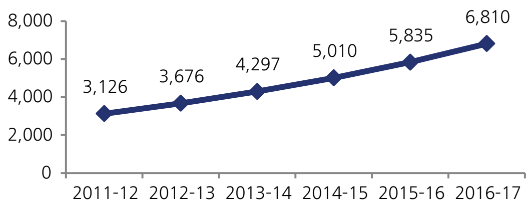
- Manufacturing sector is vital for the India's economic progress. In the recent years the government has realized the importance of this sector and has taken number of proactive steps for the growth of the industry.
- Currently, India's manufacturing sector contributes about 16% to the GDP.
- In 12th Five Year Plan, planning commission has targeted to increase manufacturing sector growth to ~2-4% more than GDP growth to make it the engine of growth for the economy and increase share to ~25% of overall GDP by 2025. The total projected market size and production at the end of XII Five Year Plan (2016-17) are INR 7,68,000 crore (16.2% CAGR) and INR 6,81,000 crore (16.8% CAGR) respectively.
- In terms of FDI, the manufacturing sectors have been able to attract significant amount of investments. Large markets, cheaper skilled labour, low cost of manufacturing, were the few of the reasons for FDI investments.
- According to Deloitte's Global Manufacturing Competitiveness Index, India ranks fourth out of as most competitive manufacturing nation. According to index, over the long term, India's workforce skills and cost advantages, improved policies and regulations, and significant investment will likely boost its competitive advantage and help maintain the country's position as a strong contender on the global manufacturing front.

GDP and Manufacturing Sector Growth



Source: RBI, IIP (Government of India – MOSPI – CSO) and Deloitte analysis

Projected Production (INR billion)



Source: Department of Heavy Industry

U.S.-India Relationship

- In 2000, to discuss intelligent transportation systems, public awareness on Intellectual Property Rights, sustainable manufacturing practices, support for small and medium enterprises, a Commercial Dialogue was launched.
- The U.S. companies have been present for a long time in India. From automotive to chemical manufacturing, U.S. companies have made their presence in the Indian market. Players like General motors, Ford, GE, Dow Chemical, Honeywell International, Agilent Technologies, Caterpillar, and Baxter are just some of the names.
- During his visit to Washington in July last year, Union Finance Minister Mr. P Chidambaram urged the leaders of the U.S. corporate sector for substantial investments in India as he emphasized the need for U.S. companies to set up local manufacturing bases in India, saying "it is in the mutual interest of both countries for India to become a large manufacturing economy.
- India's manufacturing sector needs outside help to meet the government's growth plans. U.S. equipment exporters can find a wealth of opportunity to expand sales by researching and targeting Indian manufacturers looking to increase capital expenditures for industrial equipment.

Challenges

- Currently the labour laws in manufacturing are archaic. The current labour laws regime has huge cost, exploding unorganized employment, lower organized manufacturing. These laws have been focussing on job preservation rather than job creation and hence resulted in low-productivity and sub-scale unorganized sector.
- Any competitive manufacturing industry needs excellent infrastructure facilities. Indian manufacturing is losing the competitive advantage due to poor infrastructure as it is putting an additional cost. It also affects efficient supply chain management which is one of the most critical factors in business. For example, the longer and the more complicated the transportation network is, the more difficult it is to have an efficient supply chain. Whereas the preoccupation in other geographies is with speeding up the supply chain and limiting inventory, in India the major concern is buffering inventory.
- The different regulations in different states slow down the supply chain considerably. To move goods from

the south to the north, you have to stop at every state border to be inspected, and appallingly enough it can take a week to go from north to south. The different tax structures in different states make things very complicated, and thus create significant inefficiencies for businesses. On top of a convoluted system, there is corruption to the point where it can have a significant financial impact.

- Frequent changes in the tax regime have introduced uncertainty in operational planning. Octroi, excise, customs, central sales tax, among others, have yet to be rationalized and their collection is not automated.

Proposed Suggestions

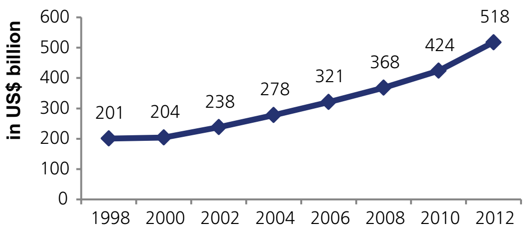
- There is a need to reform the labour laws which include a liberal hire and fire policy in the manufacturing sector.
  - Weekly, daily and quarterly working-hour restrictions could be aligned with international best practices such as 10 to 12 hours, subject to overall existing weekly caps.
  - Universal coverage of social benefits, irrespective of the size and nature of employment and a provision for employers to deposit contributions under all labour schemes (employees' provident fund, employees' state insurance, wages, disability allowance, health insurance and other payments) under different sub accounts.
  - Amending the Industrial Disputes Act, 1947, citing that the present law prohibits lay-offs.
  - Need to take steps to ensure that the trade union movement achieves its objectives of collective bargaining, while not harming the manufacturing sector.
- There is visible presence of Indian private sector in the several key infrastructure sectors – telecom, oil & gas, ports, airports, power generation and roads. However, American companies have a very small share of this market. Most infrastructure projects experience cost over-runs, delays, and exhibit poor safety and quality norms. The American companies should be encouraged to invest in infrastructure of India.
- There should be uniform excise duty across the country which can help in transmission of the goods and help in advancing supply chain.
- A representative from Finance Ministry is required who can advise American companies on the matter related to taxation.

Retail

Background

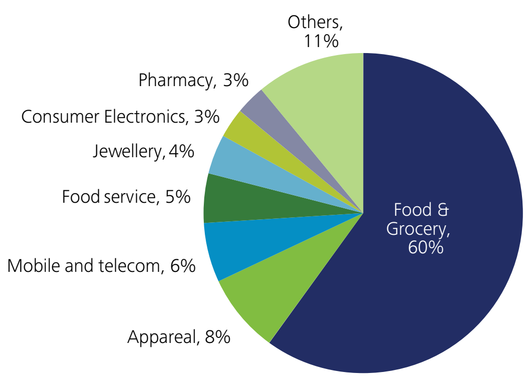
- Retail in India is one of the important businesses and has witnessed high growth in last decade. [i]
- As per AT Kearney's, The 2013 Global Retail Development Index, India is the 14th most favourable destination for international retailers. [ii]
- The industry has grown from US$201 billion in 1998 to US$518 billion in 2012 (CAGR of 7%) and is expected to grow with CAGR of 18.8% to reach value of US$869 billion by 2015 [iii]
- In 2012, the Indian government introduced the policy, which allowed FDI investments up to 51% ownership in multi-brand retail and 100% in single brand retail. [iv]
- The Organized Retail Penetration (ORP) is extremely low in India. In 2012, the ORP in India was 8%, which is very low compared to develop countries. [iii]
- The organized retail market is expected to reach US$88.3 billion in 2015 from US$40.5 billion in 2012. [iii]
- In 2012, the Food and Grocery segment accounted for 60% of the total revenue of retail sector whereas in case of Organised Retail, Apparel accounted maximum revenue with share of 33% in the total revenue. [iii]

Size of the Indian Retail sector



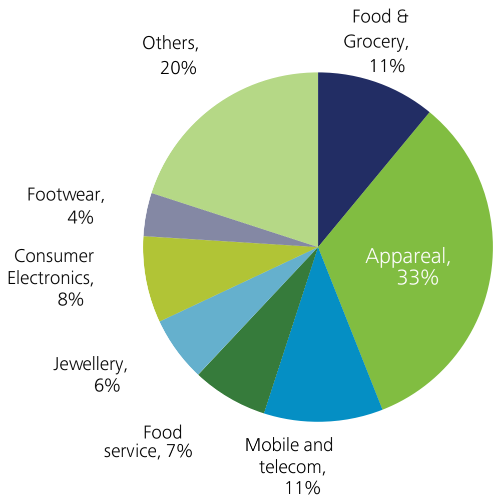
Source: IBEF

Market break - up by revenues (2012)



Source: IBEF

Organised Market break - up by revenues (2012)



Source: IBEF

U.S.-India Relationship

Many foreign players like Wal-Mart, Amazon, eBay, Groupon, JC Penny are keen to enter or to expand their presence in the Indian retail market. Some of the largest U.S/-based retailers — JC Penney, Nordstrom, Macy's, Ann Taylor through their e-commerce portals are exploring the Indian market. Wal-Mart entered India in 2007 by forming joint venture with Bharti group, called as Bharti Walmart. The JV faced issues due to the multi-brand retail FDI policy uncertainty, which required 30% of the raw materials to be sourced locally. Due to these policy restrictions, both companies called off the joint venture; and Walmart registered a new company named Wal-Mart India Private Limited to continue its operations in India. [v]

eBay started its Indian operations in 2005 has already made a mark in Indian market. In February 2014, eBay invested US$133.8 million in online market place Snapdeal. [vi]

Amazon entered Indian e-commerce market in 2013 with its Amazon.in, designed as a market place that facilitates transaction between buyers and sellers. The company has opted marketplace model, which helped overcome Indian regulatory hurdles. Amazon will sell some 7 million book titles available for purchase and nearly 13,000 movie titles and the online retailer plans to expand into other categories such as cameras and phones in the near future.

Challenges

- The Indian retail rentals have been quoted to be around 300-400 basis points higher than international rentals. Rents in prime properties in big cities have increased rapidly. According to an industry estimate, rentals comprise approximately 40% of total cost of sales in the retail sector. Also, formats like Hypermarkets require more than 60,000 square feet and departmental stores require more than 20,000 square feet of retail space. Such retail space in prime locations in the big cities is scarce and available only at high rental costs.
- One of the major challenges faced by the existing players is the availability of skilled manpower. Unfortunately, there are very few courses or trainings available, which are specific to retail sector and hence students from other streams are recruited.
- Poor roads, traditional ports, efficient supply of electricity, lack of cold chain infrastructure are some of the infrastructure challenges, which increase the operational cost of the retail chain. Compared to International level, the Indian supply chain management is less efficient due to poor infrastructure. This increases the inventory cost for the companies.
- Regulatory:
  - In India, the state government has the liberty to make its own decisions about the implementation about the FDI policies. With elections being held in 2014, the decisions of retailers to enter India could be deferred.
  - Even though the government has allowed FDI in retail, the government has laid down some requirements, which can affect the business planning for international retailers. These requirement includes; at least 30% of the of the value of procurement needs to be sourced from Indian small industries, at least 50% of FDI brought into India should be invested into backend infrastructure (distribution centres, warehousing and logistics) within three years, minimum FDI investment of US$100 million, multinational retailers can conduct their business only in cities with a population of more than one million (54 such cities as of 2011) and a requirement of a minority Indian partner. Also, the policy note does not specify whether investment in back end infrastructure needs to be a fresh investment or if foreign companies can buy stakes in already established backend infrastructure. Such conditions

create uncertainties for the foreign investors.
- Entry into a multi-brand and single-brand (if more than 49%) retail would require through approvals from the government. This will require more time to get into the actual business and also increase the cost.

- Indirect taxation structure is complex in India with varying tax rates, multiplicity of taxes, and multiple tax enforcement authorities. The tax system has a major impact on supply chains. A complex web of state, federal and city taxes adds extra cost when building an inter-state supply chain. This adds more cost to supply chain.

Proposed Suggestions

- Given the challenges on availability of quality retail space, the retailer would continue to struggle to strike a balance between the quality and economics of viable retail locations to do business. Local and regulatory authorities can have forward looking and thoughtful town planning, which can help retailers to get quality retail space with reasonable cost. Also better land facilitation services will also create better impression in the mind of investors.
- Government should have universal policies applicable over all states in India with regards to FDI. There is a need of Single Window Clearance Policy (SWCP), which can streamline license processes associated with the establishment and management of retail stores. This can also minimize the corruption involved in multiple clearance system.
- There is need to speed up the process of getting approvals. More clarity needs to be provided on work obligations and timelines defined for each agency involved throughout the process. Also, government employees should be well trained to provide information and service pertaining to procedures.
- Tax system needs to be streamlined. Existing tax policies have a significant impact on supply chain and operation designs of the retailer. The taxation structure is complex; there are certain instances of double taxation (By both the central government and state government) and irregular taxation (varying state wise taxation and incentives of the same products).
- To improve infrastructure, the government should motivate investment participation from private sector. International retailers with their rich experience and operational expertise can contribute in the infrastructural challenges and impart efficiency in the supply chain management. They will help reduce food grain wastage in the country and improve the overall economy.
- In case of FDI, the government needs to simplify the procurement guidelines. Changing the “mandatory” rule of 30% outsourcing raw material to “preferred”, would encourage more foreign retailers to enter the Indian retail sector.

[i] http://retail.economictimes.indiatimes.com/about_us.php

[ii] http://www.atkearney.com/documents/ 10192/1315829/Global+Retailers-+Cautiously+Aggressive+or+Aggressively+Cautious.pdf/b8f528f4-cb6f-411d-8ae6-7afb7fbc7b7e

[iii] http://www.ibef.org/download/retail-august-2013.pdf

[iv] http://articles.economictimes.indiatimes.com/2012-09-14/news/33844347_1_multi-brand-single-brand-fdi

[v] http://www.livemint.com/Industry/ 9n7Z8CJxviXWavLO3YU14M/WalMart -sets-up-new- company-in-India.html

[vi] http://businesstoday.intoday.in/story/india-huge-opportunity-for-ebay/1/203789.html

Conclusion

Basis the above mentioned industry overview; U.S. has been an integral part in the country's development. To enhance this fruitful relationship further; the Indian government needs to overcome a few roadblocks such as complex nature of the taxation system, number of procedures in the regulatory processes, time consuming processes for approvals, multiplicity of authorities etc. For these, some of the proposed solutions include government support for implementing investor friendly policies, a system of one-stop shops to facilitate entry into the country, adequate skillset training to employees etc.

It is envisaged that the U.S. economic upswing will bring in fresh opportunities for India and positively impact economic resurgence in the country. The Indian Government should continue to recognize industry (including U.S. investors) as stakeholders in the Indian growth story. Businesses must therefore be actively engaged in the consultative process while the Government formulates economic policies. This will take this defining partnership to the next level of growth and development.

Abbreviations

Background

- CAD – Current Account Deficit
- ICT – Information and communications technology
- FDI – Foreign Direct Investment
- APCAC – Asia Pacific Council of American Chambers of Commerce
- Amcham India – American Chamber of Commerce in India
- GoI – Government of India

Regulatory Environment

- DRP – Dispute Resolution Panel
- AO – Assessing Officers
- AAR – Authority for Advance Rulings
- MAP – Mutual Agreement Procedure
- ITAT – Income Tax Appellate Tribunal
- CIT (A) Commissioner of Income Tax (Appeals)
- TP – Transfer Pricing
- APA – Advance Pricing Agreement
- SCN – Show Cause Notices
- CESTAT – Customs Excise and Service Tax Appellate
- EDD – Extra Duty Deposit
- SVB – Special Valuation Branch

Civil Aviation

- AAI - Airports Authority of India
- ACP - Aviation Cooperation Program
- ASA - Air Services Agreements
- ATF – Aviation Turbine Fuel
- MRO - Maintenance, Repair and Overhaul
- VAT – Value Added Tax
- RDG - Route Dispersal Guideline
- CAPA - Centre for Asia Pacific Aviation
- USTDA - US Trade and Development Agency

Energy

- IEA – International Energy Agency
- MTOE – Million Tons of Oil Equivalent
- ECP – Energy Cooperation Program
- OPIC – Overseas Private Investment Corporation
- USTDA – United States Trade and Development Agency
- NDPL – North Delhi Power Limited
- NEPL – New Exploration Licensing Policy
- CBD – Coal Bed Methane
- MNRE – Ministry of New and Renewable Energy
- PV – Photovoltaic
- DMIDC – Delhi Mumbai Industrial Corridor Project
- MoP – Ministry of Power
- CERC – Central Electricity Regulatory Commission
- CEA – Central Electricity Authority

Food Processing

- NMFP - National Mission on Food Processing
- GBS - General Budgetary Support
- MSME - Micro, Small and Medium Enterprises
- FSSA - Food Safety and Standards Act
- NIFTEM - National Institute of Food Technology Entrepreneurship & Management
- CFTRI - Central Food Technology Research Institute
- DIPP - Department of Industrial Policy and Promotion

Healthcare

- IP – Intellectual Property
- CDSCO – Central Drug Standard Control Organization
- GIC – General Insurance Corporation of India
- CCI – Competition Commission of India
- DCA – Drug and Cosmetics Act
- CLAA – Central Licensing Approval Authority
- WHO – World Health Organization
- FDA – United States Food and Drug Administration

General

- FDI – Foreign Direct Investment
- WOS – Wholly Owned Subsidiary
- POS – Point of Sell
- TP – Transfer Pricing
- PMA – Preferential Market Access
- SWCP – Single Window Clearance Policy
- VAT – Value Added Tax
- GST – Goods and Service Tax
- GSDP – Gross State Domestic Product
- NIC – National Industrial Classification
- IPR – Intellectual Property Rights

Regulatory Bodies

- RBI – Reserve Bank of India
- DIPP – Department of Policy & Promotion
- IRDA – Insurance Regulatory and Development Authority
- FIPB – Foreign Investment Promotion Board

Other Bodies

- IDSA – Indian Direct Selling Association
- FDCI – Forum for Direct-Selling-Companies and Consumers of India
- USTDA – U.S. Trade & Development Agency
- CPRI – Central Power Research Institute
- CSO – Central Statistical Organization

Banking and Financial Services

- NBFC – Non-Banking Financial Company
- AUM – Asset Under Management

Direct Selling

- PCMCS – Prize Chits and Money Circulation Schemes
- FEMA – Foreign Exchange Management Act
- UNCPC – United Nations Central Product Classification

E-Payments

- MMPL – My Mobile Payments Ltd
- API – Application program Interface

ICT – IT Telecom

- BPM – Business Process Management
- SHMBFC – Solar Hybrid Methanol Based Fuel Cell
- TTSC – Telecom Testing & Security Certification

Infrastructure

- MRTS – Metro Rail Transit System

Manufacturing

- NMP – New Manufacturing Policy
- NMIZ – National Manufacturing Investment Zone

Retail

- ORP – Organized Retail Penetration

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