

Minnesota Looks at India

by Robert L. Thompson

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India is the wave of the future, is it not? It is the world's largest democracy, with English the common language of business. India's economy is growing at about 8% per year and should surpass Japan as the world's third largest (by purchasing power parity GDP) sometime in the 2020s. India's information technology and business process outsourcing sectors are booming and moving rapidly up the value chain. India has a middle class almost equal in size to the entire U.S. population, striding relentlessly toward consumer markets. India likely will be the key strategic partner of the U.S. in the 21st century geopolitics of Asia. This is the New India.

India is women in flowing saris, men in turbans, "pujas" (religious ceremonies) held in business offices on special occasions, contract signings deferred to an astrologically "auspicious" day, household servants who address their employers as "sahib" or "meh sahib," sacred cows freely roaming city streets. India is 600,000 villages, sixteen official languages. India is Hindus, Muslims, Jews, Christians, Jains, Parsees, Sikhs, Buddhists. India is a diverse, exotic, ancient civilization that still bears scars from 200 years of British domination. This is Cultural India.

India is millions of people living in slums and on city streets in conditions of indescribable privation. India is the caste system, officially discarded but still an invidious part of the social fabric, constantly encountered. India is a 60% literacy rate (48% for females). India is heartless, unspeakable, religion-based violence. India is child labor, rampant corruption and an infrastructure seemingly beyond redemption. India is stifling bureaucracy born of Nehruvian socialism. This is India's Great Challenge.

Looking at the Whole Picture

Governor Tim Pawlenty will lead a Minnesota trade delegation to India in October 2007. Many Minnesota companies are already doing business in India, and many more are looking at opportunities there. Those who recognize that opportunities in India are always balanced by challenges, and who can anticipate and creatively manage the challenges, will find the greatest success there.

The most common business impression of India today probably looks a lot like the New India described above. It is the India that is plugged into the rest of the world, the India described by Thomas L. Friedman in *The World is Flat*. In the New India entrepreneurial spirit prevails, government intervention is at a minimum, and all the world looks like one big market. It is the India of Infosys and Wipro, dozens of other world-class companies, and innovative, agile start-ups. It is here that the American business person will recognize the guideposts and feel most at home.

That is a true and accurate impression, but it is only a portion of the whole. Cultural India and India's Great Challenge are part of life in India and affect the success of business enterprises there, both domestic and foreign. In order to appreciate the entire picture, consider these aspects of India:

Curb Your Enthusiasm, Part I

No one should underestimate the challenges facing India's economy. With booming GDP growth, inflation is now running at between 6 and 7%. Interest rates have risen at a pace less than inflation. In the space of two years India has swung from a current account surplus to a deficit equal to 3% of GDP, indicating a growing gap between demand and supply. A cover story in *The Economist* in February 2007 examined the potential for overheating of India's economy and appraised the possibility of sustainable future growth, making the inevitable comparisons with China. "Perhaps the only thing really growing faster in India than China," *The Economist* observed, "is hype."

Two symptoms noted in *The Economist's* article have perhaps the greatest long-term implications for India's economy. First, a shortage of qualified employees is developing due to inadequacies of the public educational system in India. This is pushing wage rates up and eroding the cost advantage that has driven much of the economic growth in India in the past decade.

Second, the budget deficit in India is growing. India's current budget deficit is about 8% of GDP, and the ratio of public debt to GDP is 80%; both figures are the highest among the major emerging economies. This calls into question India's ability to address the woeful state of its infrastructure. Better roads, seaports, airports, power grids, and communication systems, as well as improved education and health care, are essential if India is to take its place among developed nations. But where will the money come from?

When India's finance minister announced the annual budget at the end of February it featured measures to control inflation while also substantially increasing spending for agriculture, education and health care; the rate of increase for defense spending slowed substantially. There are problems in the details and uncertainty of implementation, but the priorities are right and the direction is encouraging.

Curb Your Enthusiasm, Part II

Similarly, no one should underestimate the difficulty, on a micro level, of doing business in India. Differences in business culture between India and the United States can be masked by a superficial familiarity - persons of Indian origin are increasingly prominent in business contexts in the U.S. - and a common language. Business negotiations in India are often characterized by indirection, ambiguity and seemingly endless revisiting of settled issues, and an agreement is often merely the starting point for the next negotiation. Corruption in government and throughout the economy adds to the cost of doing business and presents legal and ethical challenges for U.S. companies. Indian courts are said to

have a backlog of 27 million cases, and it can take decades for disputes to be resolved in the courts. Patent protection is granted grudgingly and slowly. Labor laws are draconian. Many of the news media are consistently hyperbolic in expressing distrust of markets and particularly of multinational corporations. What is professed by government officials about trade liberalization and open markets is not always what is played out in the trenches of the economy. India is one tough place to do business.

Where You Play Makes a Big Difference

After the British withdrew from India in 1947, Indian Prime Minister Jawaharlal Nehru and the ruling National Congress Party determined that the state would control the “commanding heights” of a mixed socialist and market economy (combining the worst features of each, some have said). India began to edge away from central planning in the 1980s, but a balance of payments crisis in 1991 precipitated the real beginning of liberalization of the Indian economy. Because India’s journey from its post-independence socialist roots to a free market economy began relatively recently and is still underway, opportunities for Minnesota enterprises vary widely in different sectors of the economy, and industries that matured before liberalization are more likely than newer industries to be shackled by bureaucracy, reactionary labor unions and opposition to global standards of business practice.

State ownership of enterprises, once the norm, has been greatly reduced, but privatization has been slow and halting. Several basic and infrastructure industries remain in state hands, including defense industries, railways and atomic energy, as well as others in which the government is open to privatization but has not yet achieved it because of political resistance.

Once-prevalent **restrictions on foreign investment** in India have largely been lifted, but for a few industries foreign ownership is still restricted or prohibited. This is the case in banking, insurance, telecommunications, air transportation and retailing. But despite the restrictions and their roots in the pre-reform past, these industries are in some respects being quickly transformed by new technologies (e.g., wireless communications) and competition (e.g., new private-sector domestic airlines).

Some industries are officially designated “**small-scale industries**,” reserved to manufacturers with capitalization under \$250,000. These typically involve traditional cottage industries or low-cost consumer goods such as pencils and candles. While these enterprises do not achieve a scale that permits them to compete with foreign goods they remain effectively shielded from competition within India by the manufacturing restrictions and from outside by high import duties.

With the noted exceptions, U.S. companies are generally free to enter the Indian **manufacturing sector**. Manufacturing is still burdened by a legacy of government intervention and pre-reform attitudes, but increased competition in the manufacturing sector - the automobile industry is a prime example - is pulling the sector toward the New India. Individual Indian manufacturing companies, such as Reliance Industries and the

Tata enterprises, have seized the changing times and taken their places among the world's top industrial concerns.

High-tech service industries such as information technology (IT) and business process outsourcing (BPO) essentially developed under cover of darkness while the government was still focused on traditional manufacturing industries. By the time the government started paying attention success was apparent, and the new industries have been largely left alone. The services sector is the poster child of the New India economy. IT and BPO employ only about 1.3 million people from a total workforce of more than 500 million, but they have played a huge role in bringing India to a new openness in international trade. The leadership impact of this sector has been even greater than its (significant) economic effect.

Apart from the specific legal restrictions noted above, no part of the Indian economy should any longer be considered "off limits" for non-Indian firms, but some are easier to enter than others.

Opportunities for Minnesota Industries

Minnesota's leading industries fit well with the economic needs and priorities of India. Food production and processing technologies, medical devices and other health care technologies, computer technologies, wind energy and biofuels, and a variety of other strengths of Minnesota industry can find receptive markets there.

India has not had a major famine since 1943, but the challenge of feeding its poor is a long way from being met, and the problem of endemic hunger in the Indian population is among the worst in the world. Although much of the problem lies in the systems of price supports and logistics (and corruption therein), technologies that increase agricultural production are needed. India has been more accepting than many nations of genetically modified crops, although it has been somewhat inconsistent. But the story has been sufficiently encouraging for DuPont to announce, in mid-March, plans for a new \$20 million plant biotechnology research center in Hyderabad.

Health care needs in India are great, but medical facilities generally are poorly equipped, especially in rural areas. India is primarily a fee-for-service health care system, with little health insurance or government assistance available. In terms of market opportunities, apart from the sheer size of the Indian patient population, there are some state-of-the-art hospitals in major cities and a small but growing "medical tourism" industry has developed because the cost of health care in India is very low compared to Europe and the United States. India is relatively open to importation of medical devices and other health-related technologies.

One of the great geo-political dramas of the first half of the 21st century will be the quest for sufficient energy resources to accommodate the one-third of the world population that lives in the increasingly high-consumption economies of India and China. India already imports a relatively high percentage of the energy it consumes (18%, as compared to 28%

for the United States and 2% for China). The Government of India has adopted a policy encouraging production and use of bio-fuels. At present, imports are not permitted, but supplies have been inadequate and prices are high. This spring the Petroleum Ministry proposed that imports of ethanol and bio-diesel be allowed, to supplement indigenous production. There is not yet unanimity even among government ministries concerning that proposal, but it is an encouraging development.

Indian companies doing business in the United States present opportunities for Minnesota service industries. One such company, Suzlon Energy, has invested in a wind energy rotor blade factory in Pipestone, Minnesota. Essar Global Ltd., an Indian steel manufacturer, recently announced plans to invest in a steel mill on Minnesota's Iron Range. Indian pharmaceutical companies are entering and expanding in the U.S., and Indian biotech companies are likely to follow. In addition to seeking Indian markets for export of Minnesota goods, the Minnesota trade mission to India can encourage links between Indian companies that seek to do business here and Minnesota service providers and other resources that are available to them.

Much of the interest in Indian markets focuses on the large and growing middle class. However, even the poor - those 400 million Indians living on less than two dollars a day - aspire to join the market economy. University of Michigan Business School professor C.K. Prahalad demonstrated in his recent book, *The Fortune at the Bottom of the Pyramid*, that using market incentives in innovative ways to meet the needs of the poor can be profitable for multi-national companies and can be a more effective means of permanently improving the lives of the poor than traditional aid-based approaches to poverty alleviation. Prahalad's prescription requires a high degree of commitment to India, but the potential payoff is significant, both financially and in terms of a greater social good. It merits consideration by those surveying the potential of India for their businesses.

Meeting the Challenges, Moving Ahead

Despite its many challenges and uncertainties, India is and will continue to be one of the most important nations of the 21st century, both strategically and economically, and the potential for U.S. companies there is great. Moreover, it is one of the most fascinating places on the face of the earth in which to do business.

Minnesota and Minnesota companies can create a variety of successful links to India: exports, business process outsourcing, direct investment there and here, and all forms of strategic alliances. Realizing the full potential of those links requires patience and an intelligent approach, informed by cultural and historical awareness; for the New India, Cultural India and India's Great Challenge are interwoven threads in the fabric of a complicated place.

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4/23/07