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The Chaotic History of Foreign Companies in India

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Introduction

In a recent *Global Finance* article[1], India has been recognized as an important contributor to global corporate earnings. The British company Vodafone managed to cut losses due to its strong performance in India, and Swiss Holcim, the world's second largest cement-maker, spent more than 2 billion Swiss Francs on acquisition in India to counter the weakening housing market in the United States of America (USA). These strategies reflect the contribution from one of the fastest-growing economies in the world (9.3% growth for the first quarter of the fiscal year 2007/2008). This growing interest in India from the biggest multinational corporations (MNCs) but also from Small and Medium Size Enterprises (SMEs) in the last ten years is partly linked to the its attractiveness as a low-cost production site but also to the huge potential of the local market. Furthermore, the new waves of mergers and acquisitions in western countries of the last five years have benefited from significant media coverage, for example Tata Chorus or Mittal-Arcelor (the authors acknowledge that Mittal is not an Indian company), and this has given India the image of a new global player on the world stage. However, the promotion of this "India Shining" must not hide the difficulties met when trying to enter such a huge market.

India is globally ranked only 111th in terms of preference for siting a business and 165th in terms of fiscal concerns (World Bank 2007). Yet, once settled, 70% of foreign companies declare profit earnings, and 84% plan to expand their business, according to Federation of Indian Chambers of Commerce and Industry's (FICCI) annual survey[2]. Starting a business in India, as in any emerging country, is a complex process which requires a clear comprehension of all its administrative as well as cultural and industrial aspects. This article proposes to illustrate clearly the various situations a foreign company will have to face if it wishes to set up operations in India. However, it should also be noted that some of this complexity is not due to the country itself, but to internal problems or barriers within companies. Setting up international business operations is not a straightforward process. The stereotypes that an individual develops

[1] Chaze A., "India's contribution to Multinational Corporations' global earnings goes mainstream", *Global Finance*, Dec. 2007, p. 12.
[2] Federation of Indian Chambers of Commerce and Industry, *ExpressIndia.com*, "Majority of MNC's in India making profits: FICCI", Aug. 2005, <www.expressindia.com/fullstory.php?newsid=52723>.

and carries into an intercultural situation can trigger many misunderstandings and may even result in a breakdown of negotiations or, worse still, firms completely abandoning the idea of overseas set-up. This article is divided into three parts. The first lays out a brief history of foreign investment in India, which was reluctant to open its market to foreign companies until the 1990s. Then, having established a clearer understanding of Indian strategy with regard to direct foreign investments, the second part will focus on early-stage difficulties in entering India, showing that it is often reluctance on the part of the firm that prevents implementation of a comprehensive and appropriate strategy. Finally, we will conclude our discussion with a description of the specificities of SME set-up on Indian soil and common pitfalls that can be avoided.

Economic policy since 1947

From Independence to the 1980s: the import substitution way

The presence of foreign companies in India is not a recent phenomenon and many have experienced a 'bumpy ride'. As a legacy of British colonization, many companies already operated in the country and some stayed on after the country gained independence in 1947. The various governments, from that of Jawaharlal Nehru to Rajiv Gandhi's administration, saw the launch of famous MNCs, and some resounding 'packed up and lefts' as well (i.e. Coca-Cola, IBM or Bio Merieux) with a growing anti-MNC public feeling. Driven by Nehru's desire for a planned economy within a socialist climate (since 1951), rigorous regulations were implemented until 1991 in order to achieve self-reliance, eradicate poverty, promote the development of indigenous technology, and protect the local private sector and small firms.

In this post-colonial context, the development model of import substitution consisted of four main measures (Basu, 1998; Jaffrelot, 2004): a large public sector, centralized planning in which industry and agriculture were favored (through the implementation of five-year plans), high custom barriers, and a restrictive system of administrative authorization. Through its bureaucracy, the State regulated the capacities as well as the diversification of public and private companies (the *Licence Raj*). Little by little the public sector took a more dominant place on the Indian stage (Boillot, 2006) and by the end of the 1980s, it represented 20-25% of GDP and was a significant employer. In 1960, 7 million people worked for the public sector. This figure then reached 21 million in 1970. This situation was one of the factors that led to the marginalization of the private sector in India.

With regard to centralized planning, two-thirds of the India's total investment in 1980-85 were mandated by the plan, as well as three-quarters of the state budget spending (including the interest on the national debt). The *Licence Raj* was implemented in order to overcome a severe crisis of resources just after Independence. British colonization weakened the Indian economy (Singh, 2005, quoting Maddison) and India's share of the world income fell from 22.6% in

1700 – as opposed to Europe's share of 23.3% – to a low of 3.8% in 1952. This feature could be said to be responsible for the introduction of industrial licenses, as part of the first Industrial Policy Resolution (IPR) of 1948. Beyond asserting the principle of nationalization, this policy classified Indian industry into four categories (Josiam et al., 1999). Two of them were under strict control of the state (including atomic energy, railways, iron and steel, coal, telephone and telegraph). The third consisted of industries considered important for the economic development of the country (such as railways and insurance), which were heavily regulated by the state. The last category was left to the private sector (and mainly concerned consumer goods).

In 1956, more categories were opened up to the private sector but reserved sectors were also introduced in order to develop Small Scale Industries (SSIs). The second Industrial Policy Resolution in 1956, by way of the import substitution policy, came about as a result of two pieces of legislation, and had a major impact on MNCs present in the country. With the Monopolies and Restrictive Trade Practices Act (1969), approvals were often tied to export commitment.

In 1970, the Indian Patent Act specified that there should be no product patents for pharmaceuticals, food and chemical-based products. Process patents covered these industrial sectors only in order to avoid the population paying high prices for western-patented drugs. The intellectual property right was thereby redefined: if India recognized the process of patenting, it would not recognize the product patent itself (it was only in 1994 that Indian government revised its law, strongly encouraged to do so by the World Trade Organization). The third Industrial Policy statement (in 1973) identified high-priority industries where investment from large industrial houses and foreign companies should be permitted. The same year, the Foreign Exchange Regulation Act (FERA) obliged foreign companies to sell the majority equity to Indian shareholders (a measure which led to the withdrawal of Coca Cola and IBM). Thus, up to 1993, both MNCs and big Indian Companies were heavily controlled by the Central Bank and the Ministry of Finance. However, as Josiam et al. (1999) explain, the consequence of this act was not purely a negative one for the foreign firms affected. The companies that decided to stay chose to expand their equity base rather than sell their equity stake – selling these additional shares to other Indian companies or shareholders. This dispersion allowed them to retain control, as the largest single major shareholders, and still finance their growth using Indian funds and capital. This situation led to the Indianization of companies' names, such as the “Imperial Tobacco Company” which became the “Indian Tobacco Company”.

This approach continued virtually unchanged until the beginning of the 1980s. Almost forty years after its implementation, the consequences of this policy are mixed. India achieved self-sufficiency in grain production and greatly improved its industrial production. However, the country's growth rate (renamed the “hindu rate of growth” which stagnated around 3.5%), was not sufficient to curb the population growth rate. Besides, the import substitution policy led the country to be inward-looking, protected from international competition, and saddled with a large civil-servant class. The poor level of competitiveness in the private sector, which was not exposed to international competition (and thus to international standards), meant that it was not able to invest accordingly.

The foreign exchange crisis of 1980 – a consequence of the second oil shock – obliged Indira Gandhi’s government to seek a loan from the International Monetary Fund. Some of these loan conditions called for certain local reforms. De facto changes were announced, such as the extension of the number of delicensed categories in the industrial area and the encouragement of joint ventures (such as Maruti Suzuki for instance, in 1984). After Indira Gandhi’s assassination, her son Rajiv Gandhi implemented new deregulation measures. More export and import licenses were liberalized, credit facilities were encouraged and the tax policy streamlined. The first results of these reforms were positive: between 1980 and 1991, the average GDP growth reached 5.6% with 3.4% for the Primary sector, 7% for the Secondary and 6.7% for the Tertiary (Nagaraj, 2000). However, the improvement of the economic situation and the decline of poverty and self-sufficiency that were reached – thanks to the effect of the Green Revolution – only served to mask the limits of Indian growth and of its model of development. As a result of the isolationist policy, the trade deficit, which was below 1% of GDP in the 1960s, swiftly increased and led to a current account deficit of 9% in 1986-87[3] (Sheel, 2001). Furthermore, the inflation rate reached 13.9% in 1991. In 1988, India became the biggest debtor in all Asia, with a total debt of nearly US$ 60 billon. Thus, the budgetary drift could not be curbed by economic growth, and the impact of the new measures was not sufficient to correct these imbalances mainly because of low FDI levels, among other reasons.

Liberalization and the turning-point of 1991

Ahluwalia et al. (1998, pp. 3-4) explain the origin of the 1991 crisis as "stagnation created by severe macro-economics imbalances and cumulative problems resulting from the poor productivity performance in the economy; rising inflation and dwindling of foreign exchange reserves to a level barely enough to meet India's normal import needs for ten days". The trade deficit in 1990 reached US$9.44 billion and the current account deficit was US$9.7 billion[4]. With below US$1 billion of foreign exchange reserves, the first measures of change

[3] In order to compare, Maastricht’s norms accept 3%.
[4] Source available on <oldfraser.lexi.net/publications/books/econ_free/countries/india.html> (consulted 13/02/2008).

implemented in the 1980s became the credo of the new elected government of Narasimha Rao. Led by his Finance Minister, Manmohan Singh (Prime Minister since 2004), they agreed new policies (already discussed during the 1980s but not acted on).

The first significant measure was the dismantling of the *Licence Raj* with the exception of only six industries (tobacco, alcoholic beverages, industrial explosives, chemicals, drugs and pharmaceuticals, electronic, space and defense equipment). Additionally, the number of reserved items for the Small Scale Industries (SSI) was reduced. The second measure linked to the Balance of Payment crisis was to improve the trade balance by a revision of the exchange-rate policy. In 1991, the country still had a fixed exchange-rate system where the rupee (*Rp.*) was linked to a basket of its major trading partners' currencies. Consequently, the rupee was devalued by 20% (Bhalla et al., 2000). The last major set of measures concerned the custom tariffs. Tariffs were lowered from 150% before 1991 on average, to 30% in 1997 (Chaturvedi, 2007). This new international orientation also allowed a move from an import substitution policy to export promotion, and gave foreign trading firms the opportunity to invest up to 49 or even 51% (and even more depending on the sectors) in a joint venture. At the same time, the approval process became much simpler and more systematic.

These economic reforms were not slow to show results: the annual growth rate of the GNP reached 6.8% between 1992-1997. The years 1997-2003 saw a slowdown of this growth (5.6% 1997-2002, then 4.2% between 2003-04) because of the Asian crisis and the political instability due to two years of a coalition government without a real majority (from 1996-98). This period did not favor radical economic policy decisions. However, driven by strong growth in the industry and services sectors, the growth rate climbed to 8.5% in 2003-04 (Basu, 2007). India also improved its exports from US$18.143 billion in 1991 to US$126.4 billion in 2006-07 (with an average growth of more than 20% since 2004). However, the balance of payment still remains in deficit (US$59.4 billion in 2006-07)[5]. This current account deficit is partly due to the oil imports that represent 34% of the country's imports.

In 2001, India lifted its quantitative import restrictions. Custom tariffs were once again lowered to 12.5% in 2006 (average not consolidated). However India still remains a very protectionist country: tariffs still persist on specific items, especially in the agricultural sector, in order to protect local industries worried by the opening-up of the market (wine 140%-250%, alcoholic spirits 200%-520%, automotive 100%). Moreover, an additional tax on non-agricultural products equivalent to the excise duty is applied to similar

[5] Source available on <www.indiaonestop.com/economy/balanceofpayments/economy-macro-balance%20of%20payments.htm> (consulted 13/02/2008).

products produced locally (the rate was fixed at 16% by default). An additional tax of 2% is also applied. Thus, for numerous products, the customs tariffs average about 33% (Mission économique de Bombay, 2005). In parallel, India has also developed and reinforced non-tariff barriers to trade, such as new regulations concerning the sanctioning of imported products, which must be in keeping with the Indian norms. A large number of companies therefore found themselves no longer competitive in the Indian market, and began to struggle with their pricing. Even if their products were of better quality than the local products, price differences became so great that it was no longer worth importing them for Indian companies or consumers. It's for this reason that a number of companies have decided to go for their own industrial or commercial set-up.

Realities of FDI in India

Although there was a slow-down in the pace of reform overall during the second half of the 1990s, FDI inflows continued to rise. From August 1991 to November 2007, the cumulative amount of FDI inflow reached US$ 65.8 billion. In 2007, India received more FDI than ever: US$17.6 billion (26.75% of the cumulative amount, and +94% compared to 2006[6]). This growth is partly due to investments made by Wal-Mart, which has started to enter the market, but also to investments by General Motors, IBM, Toyota, Nissan and Renault, which are expanding their presence in the country. One of the biggest investments this year was the acquisition by Kohlberg Kravis Roberts & Co. (United States) of 85% of Flextronics Software Systems Ltd, with an investment of US$900 million (World Bank, 2007). However, compared to the global FDI flow in 2007 (US$1.3 billion), India represents only 1.3% of the total amount (China represent 5% with US$69.5 billion). As shown in the graph, Mauritius is India's most important source of FDI. But it must be pointed out that India and Mauritius have close political links and bilateral strategic agreements such as low tax rates and a double taxation avoidance regime. Consequently, many MNCs prefer to set up companies in Mauritius before entering India. The second largest investor remains the United States.

[6] Source: Ministry of Commerce and Industry, available on <dipp.nic.in/ fdi_statistics/india_fdi_Nov2007.pdf> (consulted 19/02/2008).

Table 1. First ten investors in India 2000-07
(US$ million)

Rank	**Country**	**Cumulative Inflows** (from April 2000 to November 2007)	**Percentage**
1	Maurtius	85.178	39.3
2	USA	18.04	8.3
3	UK	15.363	7.1
4	Netherlands	11.177	5.2
5	Singapore	9.742	4.5
6	Japan	8.578	4.0
7	Germany	5.813	2.7
8	France	3.108	1.4
9	Switzerland	2.788	1.3
10	Cyprus	2.748	1.3
Total		216.534	

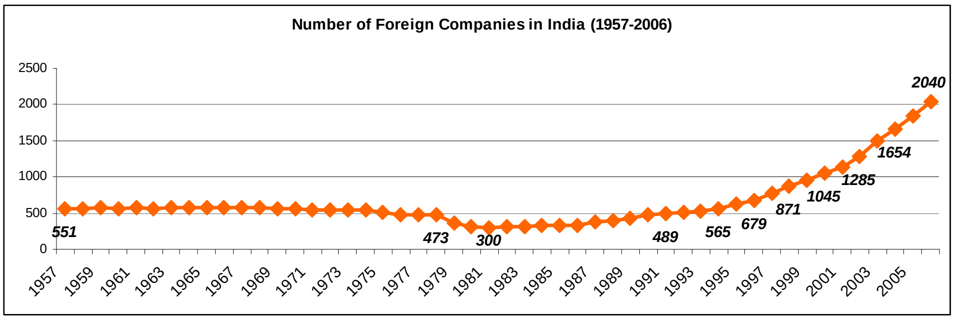
Source: Ministry of Commerce and Industry

FDI are still not allowed in some strategic sectors: retail trading, nuclear energy, residential property estate, some agricultural and biotech activities; while in others access is allowed but remains restricted: insurance (26%), defense equipment (26%), the banking sector (less than 50%, but 74% in 2009: Mission économique, New Delhi, 2007).

Since liberalization, the number of foreign companies in India has drastically increased (see chart below). This evaluation of the number of foreign companies in India is defined by Section 591 of the Companies Act (1956)[7]. Until 1973-74, the number of foreign companies remained almost constant. However, due to the FERA, in 1973, and the restrictive measures for investing in India, this figure declined until 1981 when only 300 branches of foreign companies remained. It was only after 1991 and concomitant economic reforms that this number increased to a significant extent. In the decade 1996-2006, the number of foreign firms tripled to reach 2.040 registered entities. But foreign companies barely represented 0.27% of the total of the Indian companies in 2005 (Ministry of Corporate Affairs, 2006).

[7] A foreign company is a company which is incorporated in a country outside India under the law of that other country and has a place of business in India. The Act says that provisions of these sections shall apply also to companies incorporated outside India and having an established place of business in India in which 50% or more paid-up share capital is held by Indians. Available on <ezinearticles.com/?Foreign-Companies:-Procedures-for-Opening-Branches-in-India-under-Companies-Act-and-FEMA.&id=697216> (consulted 19/02/08).

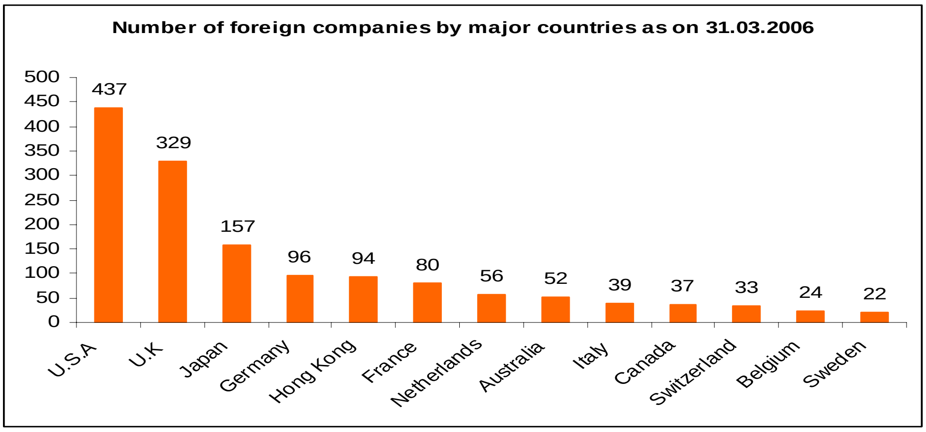
Figure 1. Number of Foreign Companies in India, 1957-2006



Source: Ministry of Corporate Affairs, Annual Report 2006

American companies represent a fifth of the total foreign companies in India, way ahead of British companies, which were mostly set up in the country long ago. Between 2005 and 2006, France saw the number of its companies in India increase by 11% (the highest growth as compared to 9.7% for UK and 5.4% for the USA). These figures may seem very limited for a country like India, but as shown above, the number of companies included is restricted to companies registered through the Companies Act of 1956, which does not take into account liaison offices which are still very numerous, nor firms created in India by foreign citizens (thus regulated by Indian law). The French Trade Commission declared the presence of 546 French firms in India at the end of 2006, exhibiting a growth of 110% in two years (in 2004, 250 firms were present in the country).

Figure 2. Number of Foreign Companies by major countries



Source: Ministry of Corporate Affairs, Annual Report 2006

In 2004, 90% of the foreign companies' head offices were concentrated in five states: 44% in New Delhi, 27% in Maharashtra (Mumbai), 7.7% in Karnataka (Bangalore), 5.8% in West Bengal (Calcutta) and 5.7% in Tamil Nadu (Chennai)[8]. With regard to the

[8] Source: Lok Sabha, "Unstarred Question", No.2935, Dec. 2004, available on <www.indiastat.com>.

French firms, the data given by the French Trade Commission in India for 2006 show that 32% are located in New Delhi, 25% in Mumbai, 15% in Bangalore and 10% in Chennai. A large majority of the territory remains therefore unexploited and represents a strategic opportunity for further foreign set-ups.

Although for many years India was reluctant to open its market, and remains a rather protective country in specific strategic areas (such as agriculture or small-scale industries), for the past 15 years the country has shown its willingness to give foreign companies more opportunities. Understanding India's complex historical relationship with the external world is a first requirement to set up any kind of business in the country. The second step, more complex again, is to fight the inner resistance or stereotypes that individuals within a firm can have upon entering the Indian market. Identifying the most suitable people to guide and give pertinent information about fieldwork in India is another important step.

First step difficulties: use India's strengths and install an efficient strategy

In order to set up a firm in India, we must first lay groundwork in the home country. For strategic and economic reasons – as well as its recent emergence as a fashionable investment opportunity –, India, these days, seems to be something of an inevitable business destination. Two kinds of problems need to be overcome for a successful business set-up in India. First, internal reluctance caused by embedded perceptions of the country as broadcast by the media. Second, finding reliable people who are knowledgeable about India and who can help form a clear overview of the Indian market in order to set up a proper implantation strategy?

Internal difficulties

The first difficulty attending a project in India is usually the struggle against stereotypes and prejudices. For the last ten years, the common image of India has shifted from "The city of joy"[9] to the image of "India shining"[10]. The India long perceived as a poor country (still with 77% of its population living below the poverty line[11]) has given way to another kind of stereotype: "India is as China was in the 1990s, the next emerging power". The companies' internal decision process can be seriously affected by these views, which are widely purveyed by the media.

The impact of popular Indian imagery

India has always fascinated the West for a variety of reasons. The spices, the jewelry and the fabrics were well known in European high society long before the 17th century. As a resource-rich, fertile country, India was also the stage for colonial imperialism between the

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[9] D. Lapierre, *The City of Joy* (Boston [MA], G K Hall & Co, 1985), has contributed to the creation of an imagery associating India with poverty, with more than 8.5 million copies sold.
[10] Largely broadcast during the last BJP (Hindu nationalist party) campaign in 2004.
[11] Source: NSSO Survey, in *The Times of India*, 10/08/2007

British and French empires. After Independence, the main figures of the fight for freedom, such as Gandhi and Nehru, became political models and the most visible representatives of this brand new state, for the West. But the images coming from India were mostly images of poverty, hunger and starvation (although hippies made the country fashionable in the 1970s). Even though there has been no real famine since 1984, most westerners remember these images and still believe that all Indians remain poor.

However, there is a growing section of the population who live in a true consumerist society. In 2005, 13.3 million households, about 50 million people, were recorded as belonging to the middle class (earning between *Rs*.0.2 million to *Rs*.1 million, per year, that is, between €3,390 and €16,950). 1.2 million people are considered very rich (with incomes exceeding *Rs*.1 million). Within 10 years, this ratio should exceed 60.6 million households (300 million people), and 3.3 million households for the very rich (McKinsey&Co, 2007).

In recent years, China has increasingly been presented in the media as the new 21st century power. India, with its booming economy and its more than one billion inhabitants, has now appeared as a possible alternative and, potentially, as a counterbalance; to the Chinese giant. With a growth-rate reaching almost 9% in 2006-07, India has also tried to change its image by participating in international forums in order to bring more foreign investment into the country. For example, in 2006, India conducted a large campaign at the World Economic Forum in Davos, where it was the guest of honour. At the same time, Indian companies placed orders around 300 planes at the Le Bourget Air Show in 2005. But one of the most striking actions of the new Indian emerging power has been the takeover of Arcelor, one of the long-standing symbols of French industry, by Mittal Steel[12].

This sudden awareness of India's existence as a key international player prompted western editorial boards to send their journalists in search of images of this new "Eldorado"[13] Foreign journalists arrived *en masse* between 2004 and 2007. In 2003, there were three permanent French journalists representing most of the French daily newspapers and radio channels (at that time, no French channel had an official correspondent in India). In 2008, the French journalist community in India numbers more 20, and almost every French newspaper, magazine and TV channel now has a local representative.

This increasing media presence has created a strong impression and had a deep impact on western social representations of India. On discussing this issue with numerous foreign companies'

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[12] Although Mittal Steel is a Dutch multinational, the Indian nationality of its CEO, Lakshmi Mittal, has dominated perceptions.

[13] P. Prakash, *Libération*, "La ruée vers l'Inde", November 10th 2006, available on <www.liberation.fr> and P. Prakash, "La nouvelle cité de la joie", *L'express*, 8 August, 18th 2006, available on <www.lexpress.fr>.

representatives during our fieldwork, we have noticed that these prejudices could have an impact on both the writing and conclusions of market research as well as on firms' strategy building. A few years ago, it was not uncommon to read that India was a 1.2 billion consumer-rich country, whereas it has currently barely 55 million people who could be described as 'consumer classes'. Besides, for others, as we see in the automobile sector, some business developers were bringing in fairly good prospective figures, but their decision-makers would still hark back to the "city of joy" stereotype. An executive from a famous French company coming back from India to visit his boss after a successful trade mission confided in us: *"my boss doesn't understand why we have to go to India".* Thus, there is a confusion in the decision-makers' minds which could be potentially harmful to both India and its investors.

In today's increasingly globalized environment, the need to find new markets for MNCs and other international companies – coupled with increased media coverage – has created a growing interest in India. This keen interest in the economic potential of India has attracted more and more business-people, business developers and export managers. The impact has been observed through the number of business visas issued by the Indian embassies. Additionally, the number of foreigners in Indian exhibitions and passing through the Delhi and Bombay airports has increased drastically. The number of international flights to Bombay, Delhi and others main cities has also risen within the last three years. USA, Italy, Germany, France, China, United Kingdom (UK), have all come with business delegations of between 100 and 200 members, usually in organized partnership with the FICCI or the Confederation of Indian Industries (CII). Meanwhile, Indian businessmen travel much more and participate in numerous international exhibitions. However, as we have noticed, deceptive images of India have an impact on the strategies formulated by business executives within their country of origin. Fighting against these stereotypes through accurate information and travel in India itself are an essential first step in all projects to set up in India. But internal reluctance on the part of foreign firms must also be overcome.

Fear of relocation

Another common cliché is that of job-loss in the process of foreign set-up. The number of job transfers in the industry in low-cost countries (and especially China) has weakened the belief of western employees in the security of their positions. If this quest for profitability was understandable for low-skilled jobs, in many highly qualified employees' minds, it is difficult to imagine that India, which was not long ago considered a third-world country, could start competing for skilled service jobs. Since India became a major Business Process Outsourcing (BPO) country, in the late 1990s and early 2000s, and later a Knowledge Process Outsourcing (KPO) center, western white-collar workers have felt increasingly insecure and have staunchly opposed outsourcing. The USA and UK were particularly concerned, as here language was not considered a barrier. While the job-loss process caused by outsourcing is difficult to evaluate, this fear is tangible, and has affected westerners' views of foreign set-up.

Between "the city of joy" and "India shining", these stereotypes and mediatized images of India have really impacted on entire organizations, not only on managers' perceptions, but also those of their employees. The decision process to set up in India is influenced by the views of the whole chain of participants and can be considered the first real difficulty to surmount. One of the solutions consists of finding adequate and pertinent information as well as intermediaries through relevant channels, dedicated websites or professionals. However, this task is not as simple as it sounds.

Finding reliable people

In order to initiate their project, foreign firms have two main possibilities. Either they examine their internal resources to find employees of Indian origin likely to help them, or they have to find external partners and advisors. The search for reliable people is tricky and time-consuming, but worth this attention.

Among the companies

The Indian diaspora is estimated to constitute between 20 and 25 million people. 1,679 000 Indians are officially resident in the USA (2001 figures Cadene, 2008), 850,000 in Canada, 1.2 million in the UK, and 60,000 in France (coming mainly from the former French trading posts in South India). The strengths and the weaknesses of these Non Resident Indians (NRIs) come from their knowledge of India, since they too have their own prejudices about their country, or their parents' country. Most of them left India before or during the 1990s. At that time, India was far from being a booming economy and many of them have only known times of paucity, when there was still a six-month waiting list to obtain a landline phone. Furthermore, India being a strongly regionalized country, most of them only know a small part of India which cannot be representative of the whole country. The idea of "unity through diversity" (the national motto) and the complexity of the country make India difficult to tackle: it has more than 16 official languages, hundreds of dialects, and strong regional cultures and identities. Even within the Indian population, people do not understand each other fully (it can even be easier for a north Indian to sell his products in Dubai rather than in South India). However, in some cases, this strategy has been very successful, as in Bangalore for example, where most of the first IT companies were started by NRIs who had previously worked in Silicon Valley in the USA (Cadene and Holmstrom, 1998).

However, for smaller companies, finding qualified employees with a good knowledge of India is difficult. In this case, employees with international experience are usually sent abroad to find local partners or intermediaries.

Outside the companies

Over the past five years, Indian companies have started to get more international exposure through fairs and websites. In China, *Alibaba.com* (which includes Chinese suppliers) has played an important role in making Chinese companies more accessible. In India, websites like *Tradeindia.com* and *Indiamart.com*, for instance, are also trying to induce the local Indian industries to get a good Google ranking. Thus, slowly, foreign companies and managers outside India have increasing opportunity to make direct contact with Indian companies.

Business developers look first for reliable importers; although in India reliable importers are very few. Most of them are grey-market specialists, despite marketing themselves as real importers. For instance, in the food import business, the traditional import markets (Crawford market in Bombay, and Sadar Baazar or INA market in Delhi) are run by old importer families or castes. In India, part of the business system is led by trade communities which are used to handling all the customs and international transportation routes and methods which existed long before Independence. In Bombay, the Muslim community leads the field with the *vaishyas* (the trade caste) and in most of the Indian states, the "Marwari" communities lead the international business links. From our fieldwork, with a list of 100 official importers and having held meetings with 50 of the larger importers, we have determined that 15 to 20 of the food importers have capacities that match that of western exporters (because they have been dealing in this field for years, they have sometime been educated or trained in the USA or UK, and they have a broad awareness of what foreign export managers want).

Once in the country, export managers face another challenge: finding trustworthy vendors and cross-checking information. In industry, it is always possible to visit the factory or the warehouse. But it is almost impossible within a short period of time to check the whole network; this demands time and local contacts who can organise the checking.

Furthermore, industrial and commercial set-up requires reliable lawyers, chartered accountants and, of course, employees. A common strategy among foreign MNCs is to hire one of the big four audit firms as accountants, and then to go with well-known local lawyers. Smaller companies are more willing to work with local professionals, who can be very helpful through their local implantation and influence. Finding a good lawyer and chartered accountant whether in western countries or in India is always a challenge and recommendations are heavily relied upon.

Trade commissions and bilateral chambers of commerce can therefore be very helpful for a first approach – thanks to their fieldwork knowledge and contacts (even if they do not cover the whole of India). Moreover, with economic growth, local and international consultants have flourished and some of them can have a real impact on potential partners' decisions and identification (we should note that their longevity in India is a good indicator of their degree of integration and network connectedness).

Misunderstandings in written and spoken English

Finding reliable people for a team also means finding human resources who speak sufficiently good English. Indeed, a lot of foreign companies don't have enough employees who speak fluent English, even in their executive teams. This is especially true for non-English speaking countries such as France, Italy, Spain, Japan and Germany. A lot of difficulties are created by misunderstandings due to poor language or use of jargon. As far as the technical side is concerned, there are fewer problems. But with regard to commercial agreements (distribution, etc.), joint ventures or any other legal agreements, every word is essential and all too often companies do not spend enough time making sure all parties are in perfect understanding. Thus, during an oral negotiation, certain elements may be mentioned and skipped over quickly, even though they are essential.

The apparent complexity of this essential fieldwork is not exclusive to India, however. Finding accurate information through trustworthy intermediaries allows firms to conquer the 'first base' of local strategy, which has to be carefully thought-out, with special focus on the size and diversity of the Indian market.

The need for a clear overview of the Indian Market

The segmentation of the Indian market can be difficult to understand because of Indian diversity in terms of communities, geography, and consumer classes. This situation can make strategy difficult to formulate, if it is not given full consideration. As each strategy is specific, it is not possible to give an exhaustive list of all the markets in India. However, a brief overview of the situation can be offered.

The charts below show a graphic representation of the Indian consumer population. According to the McKinsey&Co report (2007), Indian consumers can be divided into five categories.

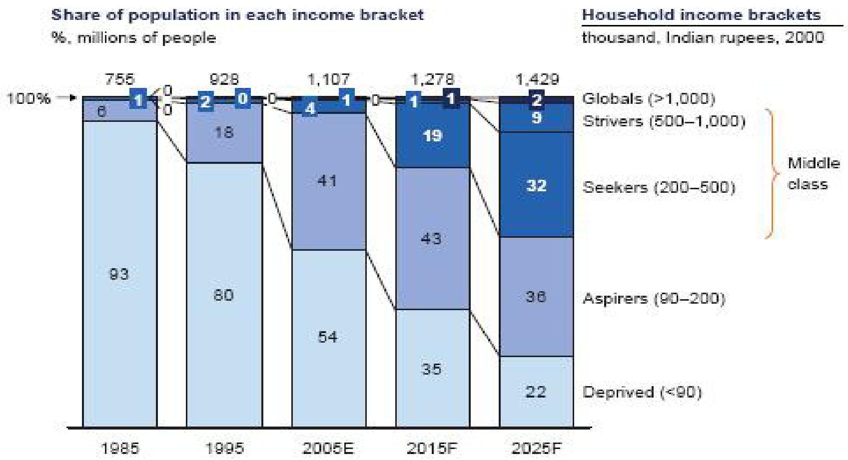
Table 2. An analysis of the consuming population of India

	Household income in 2000 (US$)		**Population** (%)	**Number of inhabitants** (million)
Global		21,882	0.1	1
Strivers	10,841	21,882	1	11
Seekers	4,376	10,941	4	44
Aspirers	1,976	4,376	41	454
Deprived	Less than 1969		53.9	598
			100	1108

As already mentioned, the majority of the Indian population is deprived. They usually live in rural India or on the urban fringe. But according to the charts below, the situation will evolve with every category aspiring to shift upwards to its superior consumer category.

Global consumers are probably under-valued, as these figures come from official tax collection. Indeed, the number of luxury cars in circulation is superior to the number of "global consumers" according to this study. This shows that any such study cannot take the black-market economy into account. Today, all the FDI money injected into the Indian economy is waiting for the 'aspirers' and 'seekers' categories to become full consumers. Most of them are earning enough money from the current global and strivers category, but they are usually holding out for a market break-through.

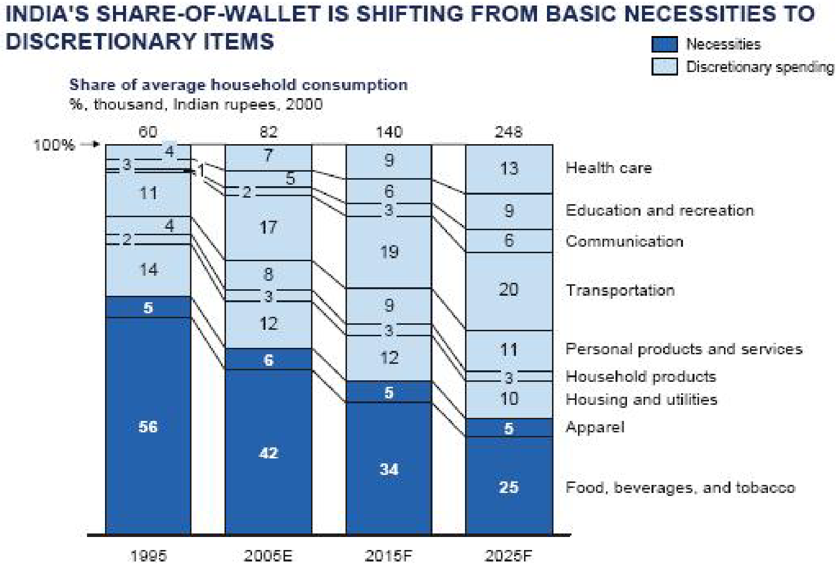
Figure 3. Household income distribution



Note: Figures are rounded to the nearest integer and may not add up to 100%.
Source: Mckinsey Global Institute

As we can see in the chart below, the share of essential commodities and basic necessities is slowly diminishing for the typical Indian household. The chart also shows expected development for a developing country. India's peculiarity means that, because of a very low redistribution system, the Global and Strivers categories are already in a Western consumer profile, while the Seekers, Aspirers and Deprived categories remain at the level of a developing-country consumer profile – with the majority of their income allocated to food, lodging and basic necessities.

Figure 4. India's share of wallet is shifting from basic necessities to discretionary items

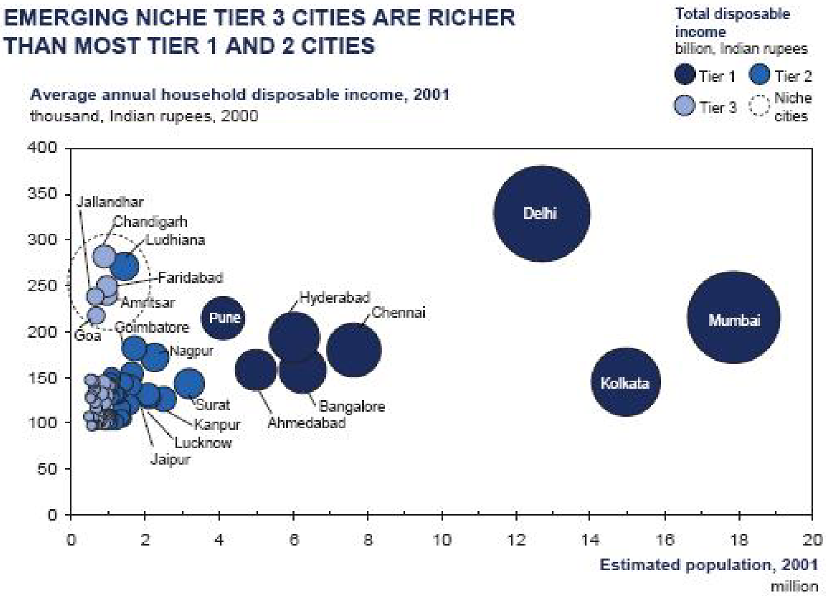


Note: Figures are rounded to the nearest integer and may not add up to 100%.
Source: Mckinsey Global Institute

Another distinction has to be made between urban and rural India. 30% of the population is urban (McKinsey&Co, 2007) and the growth in urban consumption contributes to 68% of aggregated annual consumption. Furthermore, urban consumers mainly belong to the Strivers and Global consumers groups and have bigger purchasing power. It should be pointed out that Tier 2 and Tier 3 cities[14] are often underestimated by foreign companies. Their purchasing power is nevertheless significant because their living costs are lower and because they have an important local industrial or local economic elite.

[14] Tier 1 cities: above 4 million inhabitants, Tier 2: between 1 and 4 million inhabitants; Tier 3: less than a million inhabitants.

Figure 5. Emerging niche tier 3 cities are richer than most tier 1 and 2 cities



Source: *The Great Indian Middle Class*, NCAER; MGI India Consumer Demand Model, v1.0; MGI analysis

Additionally, the rural consumer population appears to be underestimated in most strategies. Companies like LG have tried three different strategies to reach Indian rural consumers, and can now finally be classified as successful since India now represents more than 25% of their global turnover.

Getting from the strategy to the field: facing the reality

Once strategy has been determined and local supports identified, the local set-up stage can begin. In this last part of the article, we will differentiate industrial set-up strategy and commercial set-up, because the networks are different and the difficulties can vary too. We will present the major steps in the creation of a local company, as well as the main difficulties in this set-up process.

The creation of a private limited company

When the possibility of developing a bigger business rather than exporting occurs, a local company is required. This solution allows companies to function as would any Indian company. As a first step, some companies prefer to open a liaison office, but the administrative formalities are about as complicated as setting up a private limited company and the liaison office statute does not allow billing. In order to create a private limited company, a good lawyer or chartered accountant is required. There are two possibilities at this stage depending on the nationality of the promoter. For Indians, the creation of the company is very quick and easy, as soon as all the administrative formalities have been completed and the required documents rendered (such as proof of identity, due payment of taxes, and proof of address). On receipt of these official documents, a Director Identification Number (DIN) is created.

For foreigners, obtaining a DIN can be something of a hassle. Indeed, the documents need to be certified in their country of origin by a court or a notary, depending on the country. Following this, the Indian Embassy must grant its approval, and only then can the document be sent to India to begin the next step. This formality can take between two weeks and two months. This first step is also a way to observe which companies are serious and sincerely intend to invest in India, knowing that about 10% of investments stall at this stage (source: fieldwork).

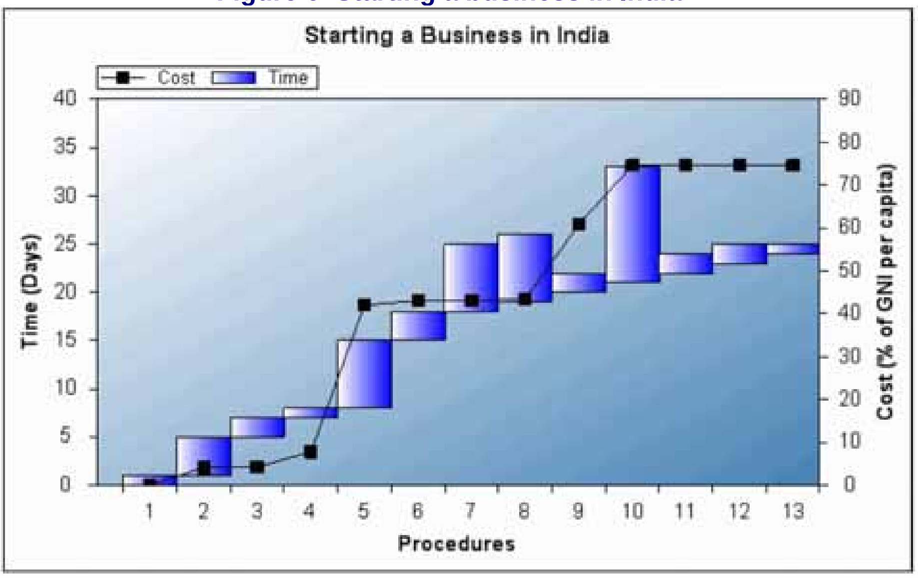
The formation of a company requires two directors. Every director will be issued with a DIN. Once the minimum two DINs have been approved, the lawyer or chartered accountant sends off ‘form

1A' in order to seek company name approval. A list of five or six name options must be submitted. At this stage, many international companies discover that they cannot use their original name, as somebody in India has already registered a similar one.

Once the name is approved, the chartered accountant or the lawyer writes the Memorandum of Articles (MOA) and the Memorandum of Understanding (MOU). The MOA and MOU contain the company's life principles and an outline of its structural make-up. The shareholders must sign these and submit them to the Register of Companies. The Register of Companies (ROC), under the Ministry of Corporate Affairs, maintains all the records of new companies, their life cycles, evolution and death. They also give information to tax offices in order to facilitate monitoring. If all the documents are correct and the rules respected, the Register of Companies sends a ROC certificate, which allows the company to proceed to tax registration and the opening of a bank account. This MOU/MOA approval can take between 15 and 30 days depending on the relationship between the lawyer or chartered accountant and the ROC, and also depends on the workload of the ROC at the time.

A bank account can now be opened. The process can be more or less complicated, depending on the bank chosen. If the banker knows about the required account in advance, the process can be accelerated. For a first bank account opening, all the documents must be filled in perfectly. If the promoters are Indian, the money can be deposited in cash or by cheque. If the promoters are not Indian citizens, the money must come through foreign remittance.

Figure 6. Starting a business in India



Notes: In India, the Gross National Income (GNI) (former GNP: Gross National Product), was $820 in 2006. 1. Obtain DIN 2. Obtain electronic signature 3. Reserve company name 4. Stamp and sign the memorandum and Articles of association 5. File registration in the ROC (register of companies) 6. Make a seal 7. Obtain PAN (tax number) 8. Obtain TAN (VAT registration) 9. Register a shop 10. File sales tax

11. Register for profession tax 12. File EPF (Employee and Provision Fund) 13. File for ESIC (Employee State Insurance Corporation)

Source: Doing business in India 2007 and fieldwork.

Recently, the company creation process has been centralized and harmonized on the internet by the Ministry of Corporate Affairs, and part of the process has been outsourced to certain private parties, such as Tata Consultancy Services (TCS). The uploaded forms are checked by these private companies before being transmitted to the official ROC offices. This new decision has "formalized" the process all over India, making it more rigid but also more efficient.

If the company promoters are Indian and are familiar with the process, the entire registration procedure can thus be completed in three weeks. However if the promoters are foreigners – without a strong network or local connections – the process can take from 2 to 6 months. This also depends on how well the company has researched the field before deciding to forge ahead.

Once the company is created and all the documents are in order, the physical set-up process can start. Usually both steps are launched at the same time, but the one may delay the other.

Common problems for foreign set-ups in India

There are four main questions regarding new venture set-ups in India. The first is related to the form of the set-up, the second to its location, the third concerns the company's financing once settled, and last but not least come problems of corruption.

Which legal form to choose?

100% FDI Investment: the process and its advantages

As seen previously, company creation is a relatively easy task if completed with the assistance of trustworthy local individuals. Power remains in the shareholders' hands, which simplifies the decision-making process. Most sectors have now been opened up to foreign investors and there are fewer failures with 100% FDI than with joint ventures.

Installing a branch or liaison office is not particularly recommended since the paperwork for this is just as complicated as for the formation of a private limited company (plc). If the company is serious about its investment in India, FDI remains the easiest way. FDI has been quite successful so far, with companies like Pepsi Cola India, Coca-Cola and L'Oréal recording good results. A number of automobile suppliers in the industry have implemented 100% FDI too with a relatively high degree of success. The main advantage is that the company is easier to manage, and that there are fewer decision-making problems, but this path requires more human resources at the beginning and good advice from consultants or from the initial team chosen.

But this doesn't mean that all FDIs will be successful. A company like Apple has never been able to settle its R&D services in India. They have managed to create good distribution and sales net-works, but their investment in production has not yielded satisfactory results and they have all but closed their R&D investment in India these days.

Company take-over

At first, it can seem simpler to take over a company already within your target field or in a parent field. But outside appearances can be misleading, and this operation is much more difficult than it may seem. First of all, the right company has to be found. When companies are leaders in their sector, they are easy to identify but are rarely for sale. Besides, compared to the late 1990s, there are far fewer companies for sale because industry is thriving.

Once the company is identified, the two main difficulties a buyer can face are finding information regarding the companies' market value and dealing with the Indian company's structure. Wherever a company is sold, estimating the market price is always difficult. Internationally, a company is valued according to its assets and its turnover or margin.

In India, the main problem comes from the fact that the assets are often overvalued, usually because of high land prices and factory prices or shop rates. The seller tends to over-estimate the growth potential of his company, be it its turnover, usually estimated at 15% per year, its future capital value or the price of its shares The company is therefore overpriced when compared to the return on investment. The second problem is company structure.

Indeed, most of the companies are family-owned and family-run. In a typical company, the father may work as Managing Director, and the children or nephews as financial managers and/or marketing managers. Family hierarchy is often very important, the elder son's word carrying more weight than that of the younger, with the father keeping his right to the final decision. This is what is called the "karta" system of management: it is found mainly in small and medium-sized companies – *karta* meaning "the head of the family" (Lachaier *in* Dorin, 2003). Opinions may differ significantly between generations – and their objectives likewise – making the agreement on a single opinion often quite difficult. From our fieldwork, based on questioning almost thirty European companies that have taken over companies in India, it seems that only 25% of the takeover deals have been successful.

Entering into a joint venture

In India, arranged marriage is a common practice, whereas in the West, love marriages are preferred. But in a joint venture both should be present in an ideal "arranged love marriage". Arranged, because reason must prevail and because common interests must be present; and love, because without a good relationship, the partnership will not be successful, and the company's day-to-day running will be difficult.

There are a few successful joint ventures in India between foreign firms and local ones, such as Maruti-Suzuki, which is one of the oldest (1982), or more recently Toyota-Kirloskar (1997). France has known some resounding failures such as the Peugeot-PAL Premier joint venture. This joint venture was a complete failure for both parties, and adversely affected the willingness of French companies to invest in India for several years.

The reasons for the failure are several. Firstly, the choice of the car itself was a reflection of poor market research, which came across almost as insulting for Indian consumers. As the press commented: "Peugeot took a colonial approach", according to Horamazd Sorabjee, Editor of *Auto India Magazine* in the *International Herald Tribune* (25 September 1997). The 309 model was chosen despite being a 12-year-old model in Europe – perhaps in view of the fact that in 1995 India was still perceived as a developing country. The board of directors (mostly French at that time) could have been influenced by the "City of Joy syndrome", thinking that this car was good enough for a "Third World country". The 309 model and motor were suitable for Indian roads; it was a solid car, able to resist years on the local roadways. But, the consumers' purchase aims were underestimated. Indeed, if an Indian consumer buys a car, he does not want to have an old-fashioned model from Europe, even if this one is new in India. Besides, the car had a 1980s style which didn't match with the Indian consumer's aspirations. The second problem identified was to do with supply chain management. Spare parts were not sufficiently supplied from France and Europe, therefore they were not always available in the mechanics' workshops. The third problem was the partnership itself; the partners' targets and sizes were probably not well-matched. PAL Premier was a small actor on the Indian market and the management team was not big enough for such a project. Besides their financial capacities were insufficient. Finally, by taking only 30% of the company shares, Peugeot didn't have full control. And when they wanted to take it, Premier refused. Then a strike in their Bombay factory brought more trouble. Moreover, at this time, Peugeot was having difficulties in many other countries, and the Indian investment, around US$75 million, was not sufficient to be successful, where General Motors or Fiat were injecting one billion each over the same period. As the market was not that competitive in the mid-1990s, efforts had to be constant. Last but not least, Peugeot's strategy as well as its decisions were unclear from the beginning. Moreover, the joint venture structure (40% for PAL, 40% for Peugeot and 20% for financial institutions) was a handicap for the decision-making process and the share of responsibility. Finally Peugeot retreated from the project, and the joint venture ended.

Financing a company

Another difficulty foreign companies face involves bringing sufficient cash flow into their subsidiary current accounts. The first amount available is of course the shares capital, but it's usually not enough. Obtaining money for the daily life of the subsidiary until it is fully financially independent is a problem because only the investment in assets can easily be covered by a loan, an External Credit Borrowing (ECB) to the parent company authorized by the Reserve Bank of India. As a manufacturing hub, advance on orders can always be used, but when a commercial subsidiary is loss-making, the equation is more difficult to solve. These companies try quickly to make their company independent, and endeavor to reduce their overheads.

Location and land availability

The first obstacle to overcome is choosing a location for the business. The strategy will depend on whether it is a commercial or an industrial set-up.

For commercial reasons, most foreign brands choose to start their business in metropolises (usually Bombay or Delhi at first). Then regional offices are required, depending upon the company's activity. For retail, location is paramount. Finding a place for a commercial activity is as hard as finding a plot for an industry. It requires good brokers and patience. The laws determining which space can be used for commercial business are not always clear. And the situation is different in every city. For instance in Mumbai, Malabar Hill and South Bombay are still the richest areas in town, as are Defence Colony and Khan Market in Delhi. However, new areas which did not have this reputation are now becoming attractive middle class areas (Bandra, Andheri and Navi Mumbai in Mumbai, or Lajpat Nagar in Delhi, or Gurgaon near Delhi). Concerning industrial localization, if the industrial company exports, it will choose Tamil Nadu, Gujarat, or Karnataka, or perhaps Andhra Pradesh or the NCR region (National Capital Region: Delhi with the inclusion of Noida, Gurgaon, Ghaziabad, etc.). Even if the firm doesn't export, it will usually aim to be situated near a well-positioned international airport.

Once the location is chosen, companies have to find a plot of land. These days, this is one of the worst difficulties of industrial set-up. Indeed, the price of land has shot up and they can be even more costly than in Europe. For example, in Chennai's suburbs or in Gurgaon, near Delhi, plots can easily go up to 2 crores rupees (a crore = 10 million) per acre (4,046 m²), that is to say more than €300,000. Town centres can be even more expensive.

There are different kinds of plots. Their common characteristic from the purchaser's point of view is that buying a plot requires due diligence on the part of a good lawyer, in order to be sure that the company is not being cheated. Each category has its own advantages and disadvantages depending on the strategy.

Agricultural land

These lands are owned and used by farmers. They are not supposed to be used for any other purpose, but when they are close to a city or to an industrial plot, they can be converted for industrial purposes. However, the time required for this kind of operation is long and can be very costly. Usually, the size of these plots is not sufficient and they have to be aggregated. This category is cheaper but the change of the land's legal denomination can often prove difficult.

Dry land

Dry land usually consists of an agricultural plot which is not very profitable because of lack of water or for other reasons. It is easier to get the right to use this kind of land for industrial purposes and it tends to be cheaper. But of course the situation varies from district to district.

Private industrial plot

Usually an old agricultural or dry-land plot converted by the owner with local government approval, the difficulty is often how to bring electricity and water to the plot. Prices vary across different regions.

Government industrial plots

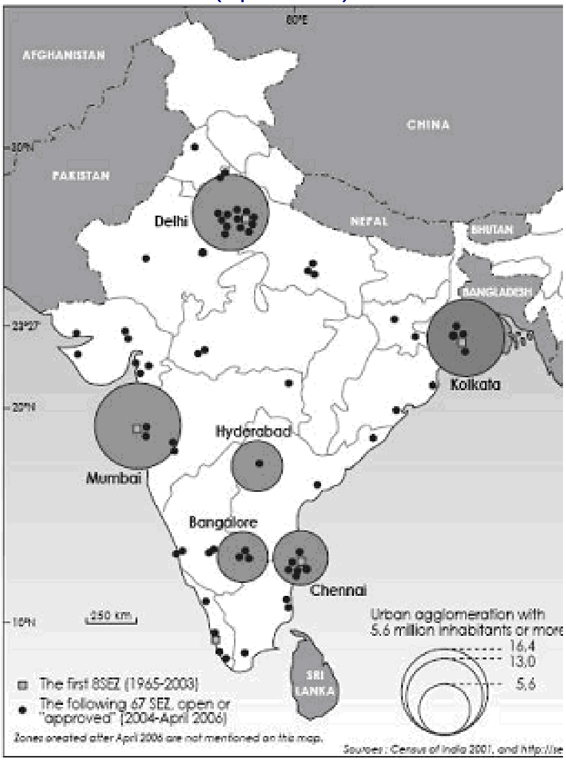
These plots are usually promoted by the regional government and are declared public land. The state governments acquire them from the owners – at a statutory fixed price – and convert them into industrial lands. The governments usually provide electricity and water, plus basic roads and other elements of infrastructure. The state industrial agencies are in charge of the development and sale of these plots. Some of them have been enormously successful, such as Sriperumbudur in the Tamil Nadu Industrial Development Corporation, where Saint-Gobain, Hyundai and Nokia are settled. These plots reduce the number of difficulties in building a factory, as the seven signatures needed to get building approval are easier to obtain if the land is supplied by the government. The central and federal governments may also put plots up for rent.

Many foreign companies do not understand the local difficulties of securing a plot of land in the first place. They usually find these plots too expensive, with inflated prices caused by land scarcity and high population density. Famous scandals have been few, but stories such as that of Volkswagen in Andhra Pradesh should prevent companies from taking hasty decisions and trusting the first man who looks honest. Volkswagen had acquired land near Hyderabad, but the man who was involved in the sale was not the real owner. He posed as a government representative, which also turned out to be untrue. But Volkswagen has not run away from India after this misfortune, and the company is currently planning to go into Maharashtra.

SEZ

Special Economic Zones (SEZ), earlier known as Export Processing Zones, have been created in India very early on, in 1964 in Kandla (Gujarat). Eight more were established during the 1970s and 1980s in Madras (Chennai), Noida, Santacruz (Bombay), Falta (near Calcutta), Cochin, and Vizag.

Map 1. The New map of SEZ
(April 2006)



In 2001, the law was reinforced and now provides many more advantages: low rent, 10-year income tax holidays, good facilities for industries (easy connection to main road hubs, electricity, water, etc.). They also offer tax incentives in the form of free trade zones: lower local tax, no import duty, tax-free for five years, with a five-year extension option, automatic routes for investment with the FDI, the option of Small Scale Industries investment, etc. In 2005, the SEZ Act was modified in order to involve more private players. Since then, more than 400 SEZs have been approved by the ministry of commerce. (Grasset & Landy, 2007). Their advantage is that they provide a real platform hub for exporters and are usually well maintained.

A number of BPO and KPO companies have applied to open in the SEZs, but as yet many of them are still under the Export Oriented Unit (EOU) status[15]. Older units have remained outside the SEZs. However, in 2005, 90% of the SEZ investors were nevertheless Indian, and only 10% were foreigners[16] (the MEPZ in Chennai is the SEZ which has experienced the highest level of foreign investment: 30%).

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[15] The EOU is a status which offers facilities in customs clearance and some reduction in excise tax.
[16] Source: Ministry of Finance, 2006, available on: <www.sez.gov.in> and <www.eepc.com> or <sezindia.nic.in/>.

Myths and truths about corruption

Transparency International, a well-known Non-Governmental Organisation, defines corruption as the misuse of entrusted power for private gain. Their annual report further differentiates between corruption "according to rule" (when a bribe is paid to receive preferential treatment for something that the bribe receiver is required to do by law), and corruption "against the rule" (when a bribe is paid to obtain services the bribe receiver is prohibited from providing). According to this study, petty corruption alone represents *Rs*.210 billion in India, around US$5 billion, which makes India one of the most corrupt countries in the world (ranked 72 out of 179 in 2006).

In Western countries, corruption occurs mostly at the highest level of governmental institutions or in private companies, and remains very discreet. In India, the State and the federal states have always had a strong influence on the economy, especially until liberalization in 1991. The Licence Raj systems, for instance, lead to numerous arrangements and abuses of the industry in order to bypass the quotas. Thus, many daily activities, such as getting a phone line, were also managed by the State following five-year plans, where the objectives where not aligned with population needs. Furthermore, civil servants at every level were and are still very low-paid[17]. This has encouraged officials to engage in bribes. As Sondhi (2000) points out, another contributing factor is the complexity of administrative procedures requiring specific knowledge and connections in order to fulfill all the correct steps necessary to obtain a service. Moreover, the lack of severe punishment for this kind of practice does not contribute to the reduction of the phenomenon. The judiciary system is expensive, slow-moving and also subject to some corruption. Many perpetrators are let off with minor penalties (although the press quite often denounces high-level scandals, the quotidian acts of bribery are rarely taken to court). Unfortunately, liberalization of the economy did not succeed in solving the situation completely, these practices being deeply rooted.

Transparency International (2005) has used the chart below in order to create a composite, used as a basis for the following study.

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[17] On March 24th, India's Finance Ministry was advised to raise wages for some 4 million civil servants by about 40% on average. If approved, minimum wages will rise to *Rs*.6,600 per month for central government workers, while pay for high-level ministry secretaries would jump to *Rs.*80,000 ($2,000, €1,300, £1,000). Source: *Financial Times*, 24/03/08, available on <us.ft.com/ftgateway/superpage.ft?news_id=fto032420082013345300>.

Factors	Indicator	Weights	
Experience of paying bribe	Proportion of Hh paying bribe	0.40	Experience weight=0.6
Using Influence	Proportion of Hh using influence	0.15	
Quality of Services	Proportion of Hh not satisfied with services of Dept	0.05	
Perception of Dept.	Proportion of Hh who perceive the Dept to the corrupt	0.25	Perception weight = 0.4
Increase/ Decrease in corruption	Proportion of Hh who perceive that corruption has increased in the Dept in last one year	0.10	
Commitment to reduce corruption	Proportion of Hh who think the Dept. is not committed to reduce corruption	0.05	

Hh: Household

The Experience item represents 60% of the index and Perception item represents 40%. Concerning the Experience item, the number of household using influence and paying bribes has been included. For perception, the three retained criteria are the proportion of households perceive the department as corrupt (0,25 of the total index), the number of people who think that corruption has increased in the previous year, and the proportion of households who think that the department is committed to reducing corruption.

The situation varies among the states, but at least 25% of the people we questioned have paid bribes at least once to gain a public service concession.

Table 3. Classification of Indian states according to their degree of corruption
(from the least to the most corrupt)

State	Composite Index	Rank
Kerala	240	1
Himachal Pradesh	301	2
Gujarat	417	3
Andhra Pradesh	421	4
Maharashtra	433	5
Chattisgarh	445	6
Punjab	459	7
West Bengal	461	8
Orissa	475	9
Uttar Pradesh	491	10
Delhi	496	11
Tamil Nadu	509	12
Haryana	516	13
Jharkhand	520	14
Assam	542	15
Rajasthan	543	16
Karnataka	576	17
MP	584	18
J&K	655	19
Bihar	695	20

Source: TII-CMS 2005 study.

Unsurprisingly, the most corrupt states are among India's poorest (such as Bihar or Jammu and Kashmir, where the political tensions are also among the highest in the country). But it is interesting to note that the States where most FDI is realized (Delhi, Maharastra, Karnataka and Tamil Nadu) are not among the least corrupt areas.

However, of the 11 public services considered for the study and detailed in this second chart, disparities can be observed in each sates. For instance in Gujarat, ranked as one of the less corrupt states, Education, Land Administration and Judiciary are ranked more corrupt in comparison to the other states. This also applies for Maharastra where Municipal Services are ranked among the top five corrupt services in the country. Conversely, in Rajasthan, the judiciary system is ranked among the less corrupt.

The chart below shows the main public utilities' concerns regarding bribery. Land, water and electricity are sectors where industry and business can potentially be affected.

Table 4. Main areas of corruption according to the answers of service-users

(% of the respondants)

Department	Direct experience of bribing	Quality of service is poor	Using influence/ middlemen	Perception that department is corrupt	Commitment to reduce corruption	Perception increased	**Composite index value**
NEED BASED							
RFI*	19	23	14	25	31	29	**22**
Income tax (Individual Assesses)	20	30	23	62	38	38	**35**
Municipalities	23	60	32	75	60	57	**47**
Judiciary	47	62	31	81	58	63	**59**
Land administration	48	58	37	79	63	62	**59**
Police	80	74	12	88	64	77	**77**
BASIC							
Schools (upto 12th)	18	20	9	45	27	31	**26**
Water supply	9	33	13	56	37	38	**29**
PDS (Ration card / supplies)	16	43	27	62	48	46	**37**
Electricity (Consumers)	20	41	12	67	50	49	**39**
Govt. Hospitals	27	44	18	67	48	50	**42**

Note: RFI: Rural financial institution.

Source: TII-CMS 2005 study.

Needs-based services (except Rural Financial Institutions, RFIs) are more affected by corruption because there are no alternatives to them, which is not the case for basic services which can be sourced from alternative, private providers. But this chart shows that no sector of daily life is spared. Bribes are more prevalent in the police service. Interestingly, the experience of bribing is close to the perception of bribes that people have. However, common opinion on municipalities seems to be worse than reality. Land deals also have a bad rating, and our fieldwork has confirmed this. So far, the schooling system is not affected so much. But worryingly, most of the households have the feeling that corruption is everywhere. Thus the trust in the public organisation is low and it brings more incivilities and less respect to public institutions.

Another interesting fact is the use of middleman. Indeed in India, only a few people have direct experience of bribing, and somebody is usually employed for it (and as we can read on the chart, especially in land deals).

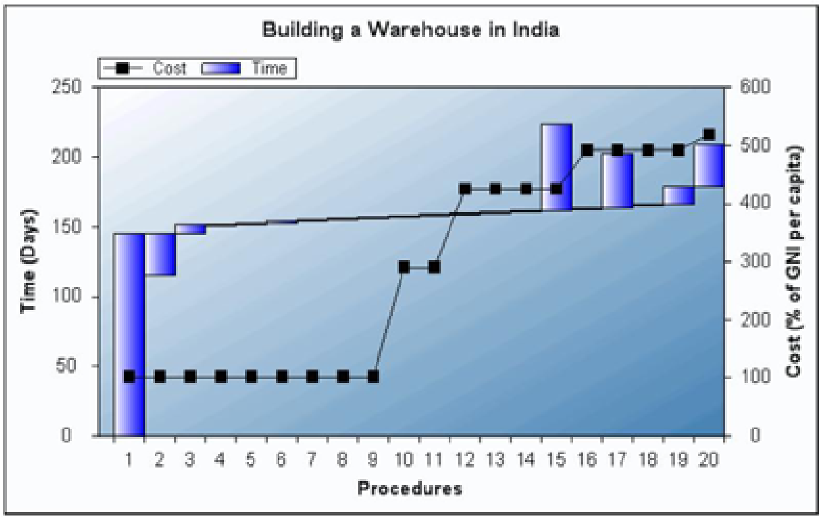
However, from a business development point of view, corruption will not be a major issue at each and every step. Using a range of consultants will make the process easier to handle and ensure correct accounting. Corruption is thus not an entirely inevitable problem when starting up a company, if correct procedures have been strictly followed.

The adventure of the construction

Once the land had been bought and the land documents and titles are in the company's name, the building period is the next concern. As we have seen in the previous section, finding a good project manager is really important. The impact of human resources is so important in this project that the wrong project manager, or the wrong architect or builder can transform a simple six- to eight-month process into a two-year project.

Common sense and regular checks are more than ever essential here. Negotiations should emphasize the importance of reputation and quality over price. A public tender can help to obtain reasonable quotes. In each city there are five to ten well-known architects able to manage a large project. Builders are probably available in roughly the same numbers, with large public limited companies now bidding for very large projects. But smaller companies will have to choose a smaller firm.

Figure 7. Building a warehouse in India



Notes: 1. Obtain construction drawing plan approval. 2. Obtain approval of construction from the Area Development Authorities. 3. Notify the Municipal Corporation of the construction foundation. 4. Receive an on-site inspection by the chief engineer of the municipal corporation. 5. Receive an on-site inspection, midway, through construction by the assigned sub-engineer of the Municipal Corporation. 7. Receive an inspection of the construction by the Fire Department. 8. Apply for an occupancy permit at the Municipal Corporation. 10. Apply for approval of completed construction by the Fire Department. 11. Receive an inspection of the completed construction by the Fire department. 12. Apply for permanent water and sewage confection. 13. Receive an on-site inspection by the inspector of factories. 14. Receive an on-site inspection and water connection by the utility provider. 15. Obtain a permanent sewage confection. 16. Apply for permanent power confection. 17. Receive an on-site inspection and electricity connection by the utility provider. 18. Apply for Internet and telephone connection. 19 Receive an on-site inspection and telephone connection by the utility provider. 20. Obtain an occupancy permit.

Source: Doing business in India 2007

From the chart above, we can see that it takes about 200 days, including the construction period, to open a warehouse or small factory, if all goes well. The construction period will vary according to the size of the factory or the warehouse. The whole process officially costs around $4,000 to $5,000 in terms of approval from the different government bodies. From our fieldwork, the amount may unofficially be equivalent or higher.

The steps set out here are the common steps for every project, but they can require more time if the administrative files are not filed properly, or if the project is a little more complicated. Getting approval is relatively easy if the rules are respected. As in Europe and the USA, drawings have to be submitted to various authorities which will check if the building conforms to the regulations. If not, a facilitator will be required, or new projects will need to be re-submitted. Taking ino account the damage that occurred during the Gujarat earthquake in 2004, and considering the condition of many buildings, it is clear that many rules are ignored by builders. As real estate is a highly lucrative sector, some powerful local figures are usually involved in such practice.

Conclusion

Investing in India is becoming increasingly important for MNCs and SMEs as India is indisputably developing into a key new international player. Facts and figures demonstrate this global interest in India as an investment destination, although some companies remain timid when it comes to the country's potential and their local investments. A significant number of companies have been successful in their start-up attempts, and usually take the lead over the local market after a couple of years, but the time taken to get a return on investment, partly due to the protectionist business environment and local administrative complexities, still frightens off many SMEs which do not have the financial reserves to wait for so long. However, the difficulties facing these companies come not only from features peculiar to the Indian environment but also from deep-rooted stereotypes, as well as from lack of knowledge and adaptation capacities either within the board of directors or in executives on the ground. The need for well-briefed and trusted local intermediaries is not specific to India but the intrinsic diversity of the country and its large size renders a coherent strategy difficult to set up and to implement.

If the administrative difficulties and local requirements for set-up in India can be surmounted, the main challenge for foreign firms becomes how to stay in India, successfully, for the long term. Indeed, the local employment market for key executives and English-speaking staff (necessary to supply intermediaries for the parent company) is very volatile because of a scarcity of skilled and experienced managers. Working mentalities in India have changed and now a high attrition rate among the emerging middle class applies considerable pressure on Indian and foreign companies, pushing them to implement new human resources strategies in order to maintain a durable workforce in the firm. Set-up is therefore only the first step towards establishing a lasting strategy in India.

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