



Business Climate Survey Report 2012

India and its business potential

Swedish Chamber of Commerce India

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Preface

As a newcomer to India, I find myself struck by awe, time and again by the tremendous changes that the country has undergone over the past two decades. The economic development has been fast and the middle class is growing. It is just a matter of time before India becomes one of the largest economies in the world.

The potential is tremendous, but there are challenges to overcome, not least with the current international economic climate. To ensure a sustained path of high and inclusive growth, India needs private investments from Indians and foreigners alike, a continued improvement of the physical infrastructure, and a strong focus on solutions oriented innovations as well as entrepreneurship, quality and sustainability, and public health. Solutions need to consider that energy is a scarce resource and that environmental and social sustainability is a matter of long-term survival and well-being.

Sweden has know-how, technologies, companies and institutions well placed to contribute to India's economy and development including the manufacturing sector, solutions-oriented processes and R&D as well as skill development. There are strong complementarities, and I am convinced that the Swedish companies, many of which are operating in India since many years, others newer, but equally innovative and oriented on long-term collaborations, will play an important role in the development of the Indian economy in the 21st century.

Swedish companies however still express concern over obstacles in trade as well as uncertainties and unpredictability in the regulatory environment. They see it as imperative that these issues must be addressed to facilitate both trade and investments. An open economy and an efficient bureaucracy were key ingredients in the Swedish economic development during the 20th century. I believe that the same factors are important for growth in all economies, and India has over past decades begun a journey that can bring increasing wealth to its huge population.

This report is published by the Swedish Chamber of Commerce India. It presents how Swedish companies evaluate their situation in India, "the business climate". I recommend it for reading and as support in dialogue with the Indian government and in discussions with other organizations and institutions.

H E Mr. *Harald Sandberg*,

Swedish Ambassador to India

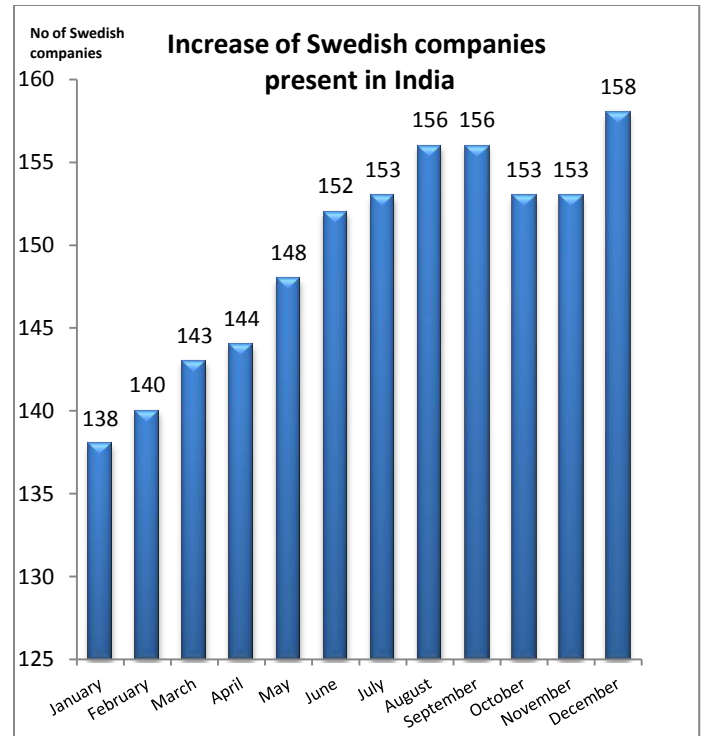
Introduction/Summary

India is a comparatively small trading partner of Sweden. The export share to India is just less than 1% and the import from India amounts to about 0.5% (if intra-European trade is excluded the figures triple). (Statistics Sweden, STC) The total export from the time period Jan-June 2012 was 5829MSEK, down about 23 % compared to the corresponding period last year. (Statistics Sweden, STC) However, the potential in India is tremendous and there is a steady increase of new Swedish companies entering the market. In December 2012 the number was 158 and the addition is about two per month.

This report intends to monitor the business confidence of all the Swedish companies in India and to gather their joint experiences and knowledge about the market to facilitate future establishments and increase investment and trade. It is based on the Business Climate Survey 2012, the 5th since the start in 2008, sent out to all Swedish companies established in India.

The survey confirms that many Swedish companies are doing well in India but there is a tendency of a recession. Most of the companies are still profitable and is going to increase their operations compared to 2011 but some have also cut down their budgets. This is especially obvious in the Telecommunication sector.

The results clearly indicate that the business climate has hardened since last year and is not as prosperous as it was some years ago. However, almost 50% of the Swedish companies have a market share above 20%, which means they still have a firm position in the Indian market. It is more problematic for new smaller companies trying to enter less explored sectors as initial investment costs are high.



78% of the analyzed companies will increase their activities in the next coming three years. In 2011 this figure was 96%.

For about 40% of the surveyed companies, the operating margins will increase slightly or substantially but for the same number the margins will decline slightly or substantially.

Average business satisfaction rate has dropped from 7 from the two previous years to 6.6

It is still the industrial manufacturing companies that show the greatest market share and are still outperforming the other sectors but their growth has stagnated. Instead, other interesting sectors such as IT and retail are showing a strong growth, and the anticipated changes within FDI will probably boost this development. Also the service sector has shown a remarkable raise.

Almost all firms were affected negatively by one or several obstacles to trade and investments during 2012. The major issues for the operation and growth of a company in India are the bureaucracy and complex taxation regulations including high tax rates. Besides, regional competitiveness, corruption, and a complex legal & regulatory system all have negative impact on the business. More than 50% of the companies were affected harmfully by non-transparent governance, “red-tape”, tariffs and taxes, complicated and costly import procedures and regulations. Infrastructure improvements would also be of major importance for the companies.

Product design and quality together with advanced technology are the main competitive advantages Swedish companies have towards the strong domestic competition. Management and brand recognition also play a major role in improving the business position within the market. On the other hand, pricing and better relations with the government and other authorities as well as access to subsidies are perceived as the biggest disadvantages.

The results are similar to those of surveys performed by, for example, the EU India Chamber of Commerce, where bureaucracy, slow decision making, slow implementation of laws and rules, customs tariffs, and administrative delay as well as corruption and infrastructure shortage are seen as main obstacles for European companies.

Retail is showing a growth from 1 to 8% while IT has evolved from 8 to 13%. The Engineering sector has dropped from 29 to 25% and unfortunately Life Science & Health & Med Tech have also demonstrated a decline from 11 to 5%.

Bureaucracy, complex taxation regulations, and high taxes hinder trade, investments, and doing business in India. Also non-transparent governance and complex import procedures as well as complying with local standards are harmful to growth.

This is also confirmed in a report “Drivers and Effects of Swedish Companies Establishment of R&D in India” recently performed by two Swedish master students from the University of Linköping.

However, the change in FDI is seen as extremely positive among Swedish companies.

Local competition benefits from lower pricing and superior government relations while Swedish companies product quality and advanced technology improves the sales process.

About the survey

The 2012 Business Climate Survey was conducted among all Swedish companies established in India before August 1, 2012. A questionnaire was sent out electronically to all involved entities and it was again sent out as an online questionnaire. Some of the questions were not completely converted to the ideal online format. This will be improved next year to facilitate and reduce the response time for the respondents in order to increase response rate. The response rate was 46% with a total of 70 eligible companies responding to the survey.

Some of the large multinational Swedish companies completed the survey as did many of the medium and small sized firms, and the distribution between sectors is rather representative. Thanks to a fairly high response rate and a comparatively even division of company sector and size, the survey gives a good presentation of Swedish business interests in India.

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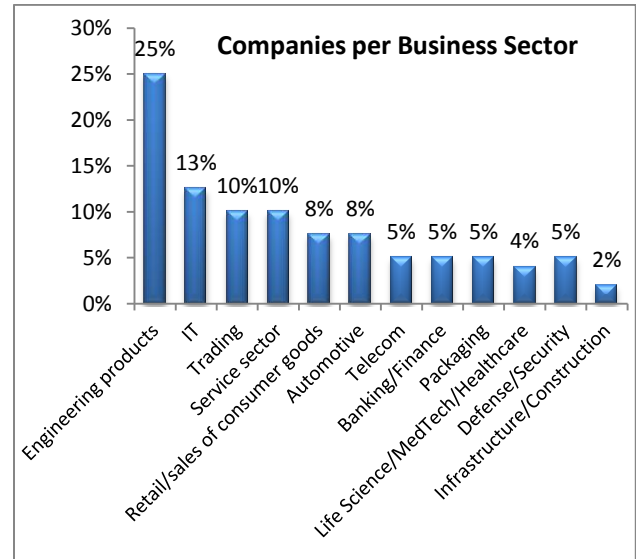
Swedish Business in India and its Current Trends

A few of the multinationals Swedish companies started their operation in India in 1960-1970, and they have a strong position in the market, while others entered the country already at the beginning of the 1900's. However, the majority is medium and small-sized entities established during the period 1990-2012 with a peak around 2005.

Even though the medium and small-sized companies dominate in numbers, they are not the main employers. Depending on calculation, Swedish companies create job opportunities to almost 800,000 people in India. There is also a steady increase of Swedish companies entering the Indian market with a pace of approximately two per months.

Engineering products still dominate but their share has decreased from 29 to 25%. Instead, the retail and IT sectors have shown significant growth. There has also been a substantial positive growth within the service sector. Health care and environmental technology have both shown negative developments.

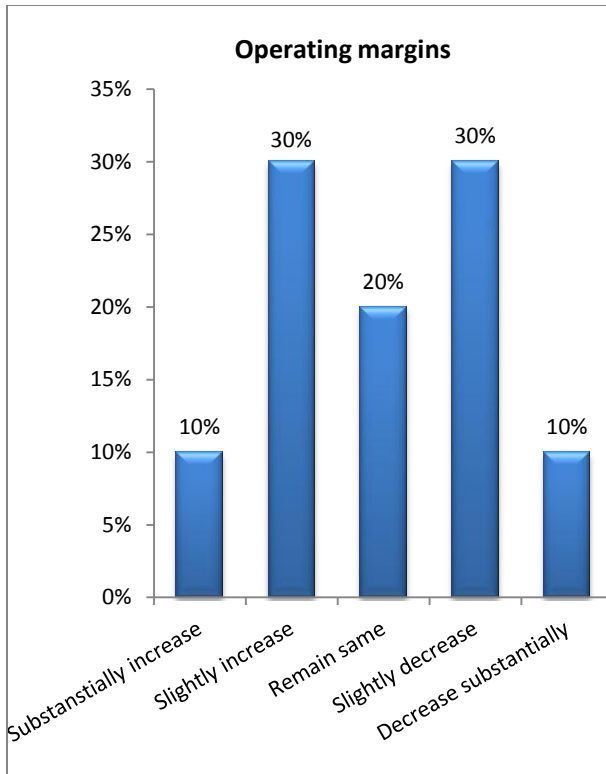
As previous years the dominating set-up is "own legal entity", which accounts for 73% of the total. New Delhi is also the city where 38% of the companies have decided to put their headquarters. However, Chennai is showing a positive growth while Mumbai is declining. However, many companies have entities in more than one city, and the multinational Swedish companies are represented almost all over India.



Own legal entity preferred type of set-up among Swedish companies as previous years.

Delhi still on top as preferred HQ city with a small increase from 2011.

Swedish companies are represented all around India.



55% of the Swedish companies have increased their market share since last year.

49% of the Swedish entities have a market share above 20%.

The business climate is perceived as less favorable since last year

Average rating has declined to 5.4 from 7.4 from the last two years

Average satisfaction rate has dropped from 7 from the two previous years to 6.6

Profitability

Even though the profitability has dropped in the last year for many of the respondents, still almost 40% of the companies show increased margins. One tenth even demonstrate a substantial increase. The service sector is a winner. However, slightly more than 40% indicate decreasing margins. The reason for this is most likely increasing costs. Rising salaries among both white collar and blue collars workers could be one factor adding to the cost increase. More than 75% of the responding companies believe that India is losing its competitive cost advantage.

More than half of the Swedish companies have increased their market share since last year and just 4% show a negative trend.

A vast majority of the Swedish companies operating in India prove once again that they are solid and healthy firms. Nearly 50% of all the respondents have a market share of 20% or above.

As expected, the larger companies having operated in India for a longer time period have a greater market share than the new comers. On the other hand, these are the ones still experiencing an increase in the market share. Some of these smaller and medium sized companies specializing in a narrow niche are very profitable with a growing market share.

The investment climate

The business climate has hardened from last year. In 2011, 54% of the Swedish companies perceived the business climate as “very favorable”. The same figure in 2012 has dropped to 8%. Last year it was only 5% finding the business environment as “not favorable”, but this year this number has reached 23%. The average has declined to 5.6 – having reached a high at 7.4 the last two years. Despite the fact that the business climate has weakened over the last year business satisfaction is still on a good level just dropping slightly from 7 to 6.6 compared to the two previous years.

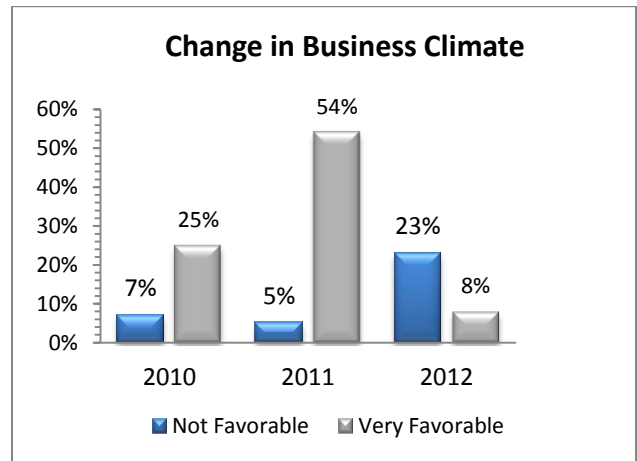
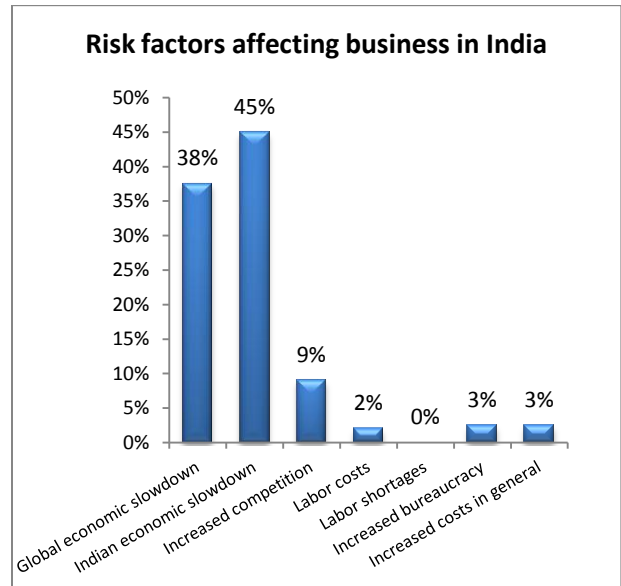
The economic slowdown, both globally and in India itself, is perceived to be the main risk factor affecting Swedish companies doing business in India. It is also quite clear that India is losing competitive cost advantages as costs are increasing. 75% of the companies confirm that the cost structure in India is increasing to some extent and 4% state it has increased to a large degree.

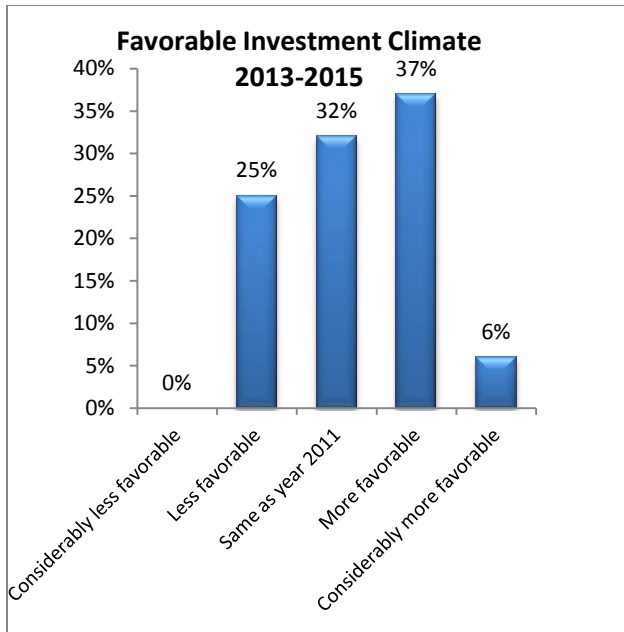
The Indian Express on Nov. 22, 2012 states, "Rating agency Moody's today said Indian economy is expected to have grown by little more than 5.5 percent in last quarter, and an initial spike in investor sentiment after recent reforms has faded and the "reality of India's deep-seated structural problems" has begun to set in.

The reforms proposed by the government may help reduce the key risks facing the economy but cannot lift the near-term outlook; Moody's said" while adding that the economy is growing well below its long-term potential."

However, they also confirm, "in a major relief to the government, which is struggling to keep the reform process on track amid stiff political opposition, rating agency Moody's on Tuesday reaffirmed India's credit rating as stable in part due to the country's high savings and investment rates." (Nov 27, 2012)

83% perceive the economic slowdown as the greatest risk factor





78% of Swedish companies will increase activities coming three years

Investments

The business climate has become tougher in India and this has natural consequences on growth.

A survey conducted by CII indicates the same tendencies. (FIRST POST ECONOMY, Sept 2, 2012).

“A majority of CEOs remain pessimistic about the outlook for the economy in the current year and expect only a moderate recovery in the forthcoming year,” CII said in its survey.

The GDP growth during 2012-13 is projected to remain below 6 percent, it confirms.

“This reflects low confidence levels in industry. The first quarter GDP numbers corroborate the fact that the slowdown is sustaining. Our best hope would be that the economy is bottoming out,” CII Director General Chandrajit Banerjee said in a statement.

Even so, the Swedish companies do believe in the future. 43% still sense the investment climate as more favorable for the coming three years compared to the past. 6% of those actually perceive it as considerably more favorable. The revenue forecast also still indicates hopes for the coming years. 45% of the Swedish companies’ revenue forecast will go up more than 20% compared to 2011 while another 25% will at least increase the forecast between 1-20%. However, there are 18% of the companies that actually will be cutting down in their prediction compared to 2011. The telecommunication sector and certain engineering companies show the biggest cuts.

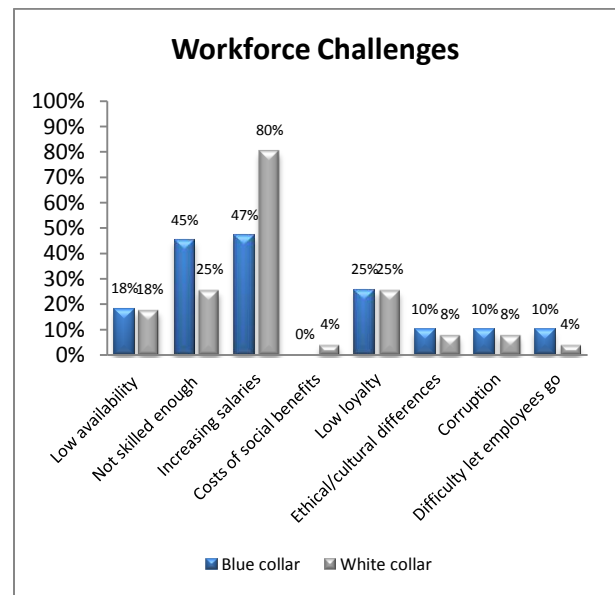
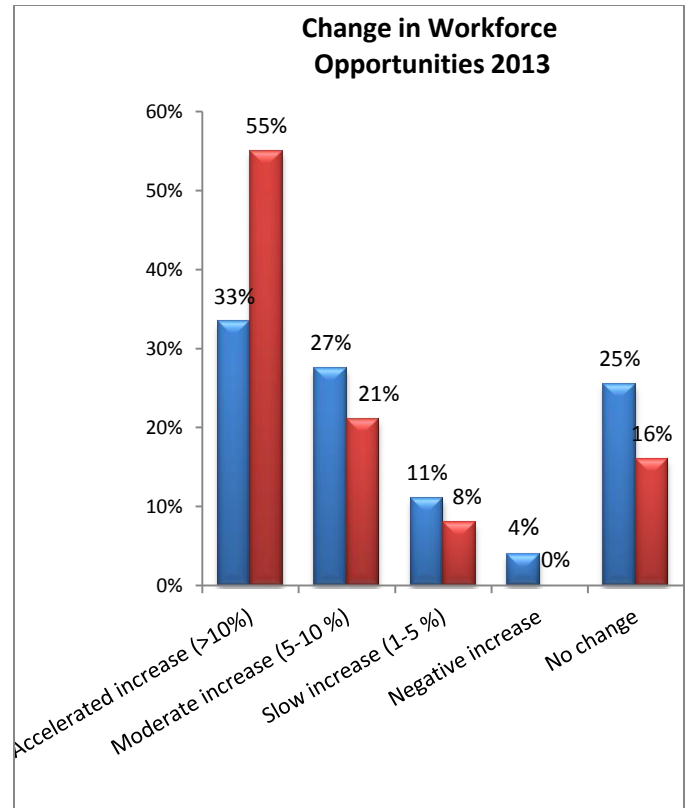
There will also be a positive change in investments compared to previous year. At least half of the companies will increase their investments with more than 10% in comparison to 2011. 16% will increase by more than 50% while a very small part of 4% will reduce their investments. For the coming three years 78% of the respondents will increase their activities in India. Even though this illustrates a slowdown compared to 2011 when corresponding number was 96%, it is still a high number. Companies that will gradually reduce their activities in India have changed from 1 to 2%.

Human Resources

Most of the companies are committed to expansion which is also expressed in the figures of the workforces. There is a positive change in workforce opportunities for 2013 but still a slowdown compared to 2011. 33% have replied they will have an accelerated increase, 27% indicate a moderate increase and 11% a slow increase. A quarter will have no change at all but will remain with the same numbers. Only 4% actually will reduce the labor force.

On the other hand, a common issue is facing most companies. The skill of the existing work-force as well as the coming generation does not fulfill the needs and expectations. According to studies, 500mn young Indians have a need for training and special education to be able to take on the required working challenges facing them in a couple of years from now. Skill development and vocational training will play a very important role for India's ability to climb up the scale and develop its economy. Swedish companies are already supporting this process as this will become an important competitive advantage.

There are also other challenges within the workforce. Increasing salaries both among the white and blue collars workers are an issue as well as cases of low loyalty. Actually, all these factors are connected to each other as a company's interest in investing in a new employee decreases if they tend to leave too soon instead of dedicating many more years to one specific company.



Competition

To understand the dynamics of the competition from domestic and other international companies, the Swedish companies were requested to share who they regard as the biggest threat in competition. They were also asked to highlight advantages and disadvantages in comparison with these competitors.

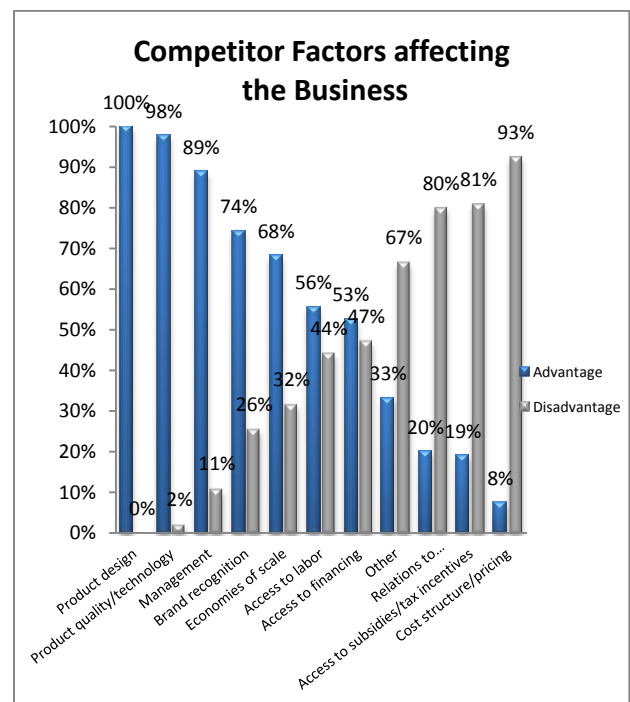
Indian small and medium-sized firms are considered as the number one competitors in the Indian market. In second place, foreign firms producing or sourcing in the domestic market are identified.

Product design, quality and superior technology stand out as the main advantages for the Swedish companies. Almost 100% of the respondents put these as the biggest advantages. Greater management is also perceived as an advantage by almost 90% of the companies, and brand recognition also plays an important part.

On the other hand, pricing and cost structure are seen as the biggest disadvantage. As pricing and quality most often reflect each other, they are also in this survey chosen by 93 and 98% respectively. This does not really come as a surprise as products with high quality normally are more costly. From this viewpoint, quality can be considered as both the biggest advantage and disadvantage.

A more important concern though is that government relations and access to subsidies and tax incentives are also rated as huge disadvantages accounting for 80 and 81% correspondingly. In a market-based economy, local and foreign-based companies should be treated equally. Government relations should, therefore, have no relevance.

Product design, product quality & technology, management, and brand recognition most powerful for Swedish companies



Obstacles to trade and investments

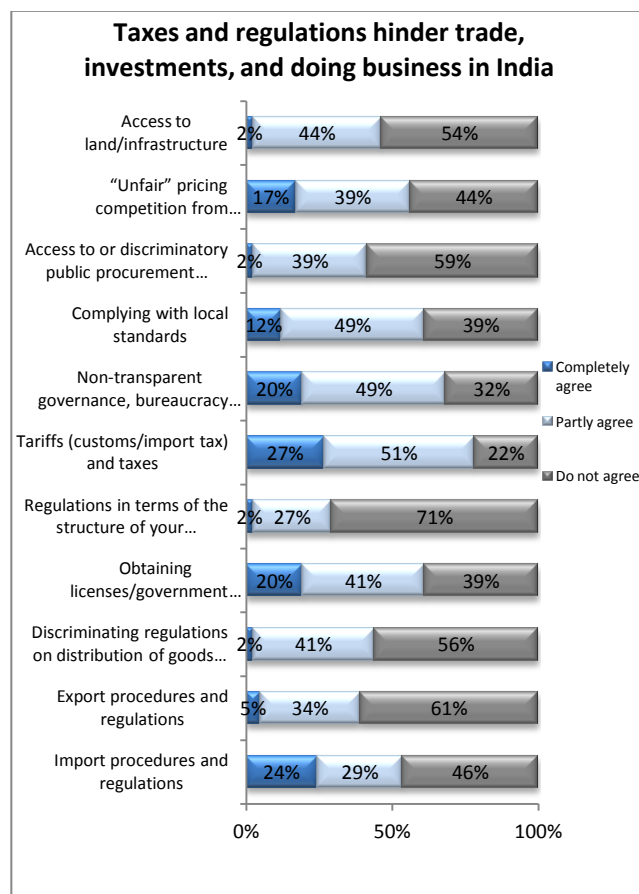
When doing business in India, foreign companies, including Swedish, face obstacles to investments and trade. These are both of an informal and formal nature and increase costs for the companies.

One example of a formal obstacle is found within the infrastructure sector. Infrastructure including roads, supply of reliable energy, and clean water as well as proper waste handling is one area that needs huge improvements. Advanced Swedish technology together with concept solutions could be of huge benefit for Indian development but limited access to India's public procurement market makes it tricky for the Swedish companies to participate. This is one reason why Swedish companies involved in these projects are unfortunately leaving India. There is a huge potential within this field but opportunities are difficult to reach. Similar constraints are found in other sectors.

There are major informal obstacles that complicate the business situation in this country. Time consuming bureaucracy, the complex and sometimes unclear regulatory system, and non-transparent governance are the main informal obstacles to trade and investments.

Both these kind of obstacles are very costly for the Swedish companies. Due to their complexity they are also overlapping, which makes the situation even harder to improve. It is easier to measure the effects of formal obstacles while approaching the informal can be hard. As these obstacles are also dependent on industry and region it is even more difficult for the companies to handle them. India's 28 states and seven union territories, all of them with very different laws and regulations, further complicate the circumstances.

In the questionnaire, the respondents were asked to evaluate how problematic certain areas are for the operation and growth of the company. The results are shown in two different graphs illustrated below. The main obstacles are discussed in more detail below with some recommendations given in italics.



Q: Have the above factors to trade, do business, and invest in India affected your company negatively in 2011-2012?

Infrastructure

Infrastructure is not the main obstacle that harms and slows down the process of doing business in India but it is a basic need. Depending on where an office or factory is located in India and in which sector the company is operating, the access to proper infrastructure varies. In some states in India the roads, ports, and airports are well developed and the supply of electricity is good. There are companies that have invested in huge generators but without any shortage in power for more than two years they have decided to dismount them. However, in other parts of India the development of the roads and easy access to important ports are lacking which hinders the development and investments in other business

sectors. In the end, most companies are dependent on effective transportation by truck, ship, or flight, which means that India needs to improve its infrastructure hugely.

The possibility of acquiring land is not a big issue, but there are other obstacles making this process slow. *There are many aspects and factors affecting the decision where to set up a factory but to choose a location with secured power supply and access to transportation would certainly improve the efficiency of the operations and be less costly in the long-term.*

Non-transparent governance & bureaucracy

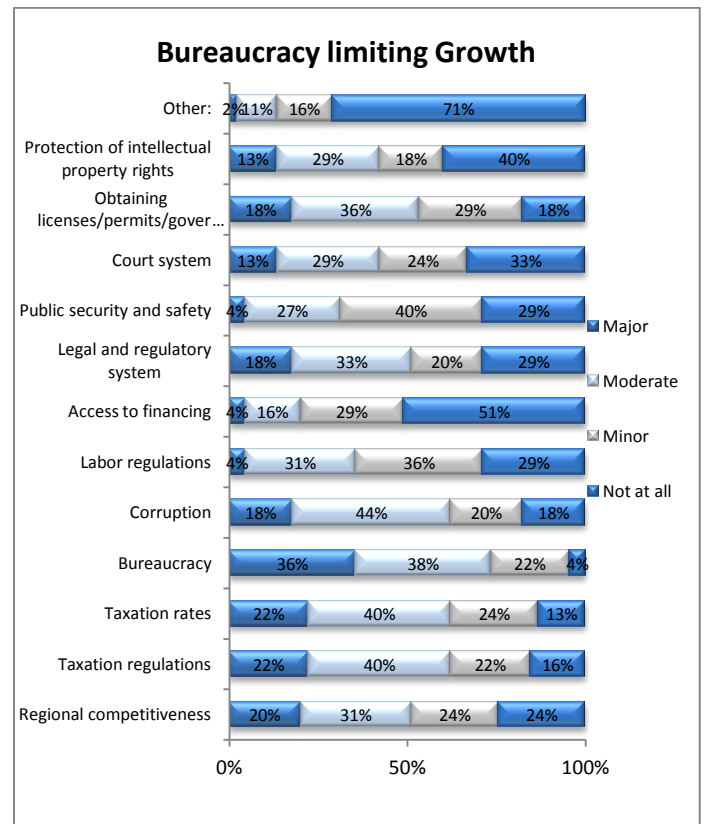
Almost 75% of the responding companies note that bureaucracy is the main reason for limiting the growth of their business.

Lack of transparency, both on national and state level, results in uncertainty, and reduced motivation to make long-term investments and thus may hinder the business development. Prolonged bureaucratic processes slow down any business, and it is considered a must to have employees that are well-connected in the government to be able to push and speed-up time-consuming processes. This creates difficulties for all companies, and is a huge barrier for newcomers. The regulatory system is also very unpredictable and in many cases implemented retroactively so the negative impact of the rules and regulations can be huge. The decision making process together with tedious administrative work delay important investments. *When deciding to enter the Indian market it is strongly advisable to have a long-term perspective together with a great amount of patience to be able to keep the focus on business plans and strategies. It is also important to have a trustworthy native person in the organization who understands the cultural aspects of these constraints.*

Import and export procedures

For some Swedish companies both import and export procedures are a main bottleneck. However, when considering also other aspects they would not be recognized as main obstacles. For the multinational companies with factories in India producing for a

global market the export procedures can be a serious problem, and due to the bureaucracy and slow handling time it takes a long while to solve such problems. Complex import procedures and regulations affect 53% of the respondents which must be recognized as a major disadvantage for investments and doing business in India.



Q: Please, judge how problematic these different areas are for the operation and growth of your company?

Taxation regulations and rates

The complex tax structure and all regulations surrounding this issue are other main inconveniences for driving investments and trade. Sweden has previously been known for its perceived high taxes. However, Swedish companies are surprised when they arrive to India and learn about the complexity and the number of different taxes as well as the high rates found in this country. If a company is not aware of the fact that a tax will be deducted from the invoice sent to the Indian customer, this can undermine the project and prevent further business. The advanced technology and superior quality might not be enough for the Swedish competitor due to the taxation. The fact that the taxation structure varies from one state to another and that there are taxes and duties when, for example, transporting products from one state to another makes the situation even more complex. *It is important to understand the complete taxation structure as well as the rates and consider these in the budget for a project. Local support and help is normally the only way to be able to handle this challenge. One solution could also be to set up a central storage outside India and from this point deliver to all different places in India.*

The jungle of tariffs including customs charges and other product taxes are considered as a major hindrance for doing business in India as it affects the margins directly. *It is of great importance to conduct research and get the best knowledge possible to be able to keep track of the extra costs associated with these tariffs.*

New reforms and changes in the old-fashioned regulatory system

Recently new reforms were decided upon within the national Indian government. Changes within FDI (foreign direct investments), have been discussed for the last decade and now it seems to be a reality. For Swedish companies in the retail sector these reforms would be of huge importance. These modifications and others to promote and facilitate foreign investments are a must for India to continue to grow, so they are seen as very favorable. It is of great significance to

accelerate this process and not slow it down by adding new rules and restrictions. It would be of great importance that all the states will finally implement them. They are indeed something that would accelerate the trade and investments from Sweden and Swedish companies. There is a huge potential in India, and these reforms would open up for new investments and growth and development of the country.

What can be done?

Swedish management is spending on an average 10% of their time to deal with governmental authorities and officials. In some companies this time is as high as 60%, a fact that should be looked at with great concern. Presently, few companies make use of the possibility of getting support from the Swedish Embassy, the Swedish Chamber of Commerce India, and Business Sweden in these matters to raise the issues to the Indian authorities. As a matter of fact, almost 70% of the time when there is an obstacle that affects trade and investments there are not an on-going process trying to decrease or eliminate the obstacle.

Concluding remarks

This survey confirms that the economy of India present Swedish companies with several opportunities for growth. A majority of the Swedish companies are profitable and have increased their market shares in the last year even though there has been a slow down in the economy. They are also planning to increase their investments for the coming three years.

There are successful multinational Swedish companies found in India as well as smaller and medium-sized highly specialized ones, many of them still having their core production and development in Sweden.

Despite a harsher business climate last year, the Swedish companies still look at the future as bright and foresee a favorable investment climate in India in the coming three years. 78% of the companies are increasing their operational plans and 71% plan to increase their workforce. A small number of companies will gradually decrease their activities and reduce the amount of employees.

However, the survey is also evidence to the fact that there are substantial obstacles and hindrances to trade and investments. Non-transparent governance, an unpredictable regulatory environment with a complex tax structure and unnecessary import and export procedures are being faced by the Swedish companies constantly.

There is a huge business potential in India, but the openness towards foreigners and their investments in this vast country needs to see change. The government has opened up and simplified rules for foreign direct investments, but there is still a long way to go, and the process is slow. It is essential for new Swedish companies entering this market that they are aware of these obstacles and plan properly. Nevertheless, the constant inflow of Swedish companies to India over the last decade clearly proves that in the long-term, India is a promising market to be in.

The Swedish Embassy is working closely with both the Swedish Chamber of Commerce India and Business Sweden to promote Swedish commercial and cultural

interests in India. A critical part of this work is to keep up the good relations with the Indian authorities. Sweden has a continuous conversation with Indian authorities, bilaterally, through EU, and multilateral organizations.

The Embassy can support companies with official communication channels and offer access to the Indian officials when issues occur. Meetings on a high-level between the two countries provide the Swedish companies possibilities to influence the business climate. For example, in October 2012, the 16th Joint Commission Meeting was held in New Delhi between the two countries. The Swedish Minister for Enterprise, Ms. Annie Lööf, met Mr. Anand Sharma, Minister of Commerce & Industry of India together with SCCI and a delegation of small to medium sized Swedish. Each company was given the opportunity to present itself and share thoughts on the Indian development and what could further enhance the possibility of attracting SMEs to do business in India.

Business Sweden offers business support for Swedish companies interested in entering the Indian market, and the Swedish Chamber of Commerce India supports in promoting Swedish commercial interests and provides its entire member companies a platform for sound networking.

There is also collaboration with the European Union, the European Business Group as well as Indian organizations and institutions such as FICCI and CII with the purpose to facilitate and improve the relations between Sweden and India.

Growth has been high in India for the last couple of years, but due to the economic slowdown globally and in India itself, it has now slowed down. New reforms such as FDI are of great importance for the progress of foreign investments. However, regulatory obstacles leading to unhealthy forms of competition still need to be changed to improve the attractiveness of the investment climate in India.

The business potential in India is huge and Swedish companies would like to be part of this growth.