India Calling

India-China Business Investment Opportunities

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India Calling: India-China Business Investment Opportunities
Foreword

This Knowledge Paper, prepared by KPMG, for IMC’s annual flagship event – “India Calling” – which is being held this year in Shanghai and Guangzhou from April 7-12, 2013.

India and China share many commonalities and are ranked among the key emerging market economies of the world today. It is therefore, fitting, that our strategic trade and bilateral relationships reflect our common interests and aspirations, and thus help to leverage the full potential of the multifaceted historical bonds that bind our two countries.

India-China bilateral trade is expected to touch the landmark figure of USD 100 billion by 2015. The current trade balance between the two nations stands in favour of China. There is however, still massive potential waiting to be tapped in terms of economic and commercial partnerships in a wide range of spheres between the two nations.

China is currently trying to wean its economy away from its export dependency, stimulating domestic consumption. It certainly has the potential to do so. Domestic infrastructure development is at the top of the Government’s priority list. For example, the Chinese government has plans to double its highspeed rail network (already the largest in the world at over 8,000 km) to about 16,000 km by 2020. China also holds the record for fastest passenger train in the world (486 kmph during a test run for a planned maglev link between Beijing and Shanghai). As and with the other cases, China hopes to sell its high-speed trains to the rest of the world – not just developing countries but even highly technologically advanced places such as California.

There is no doubt that despite current international economic vicissitudes, China is still in a solid growth phase. The Government of China is continually establishing quality physical and social infrastructure, thereby providing golden opportunities to Indian businesses to set-up projects there. In addition, supply of goods and services for large Chinese population that now possessed an increasingly large purchasing power, adds to opportunities for India.

This India Calling Conference is the twelfth in the row of a series of such annual events organized by the IMC. Our symposiums in China comprise a galaxy of eminent speakers and delegates from both countries. The event would help to provide an excellent interactive platform and networking opportunities for enhancing trade and business development prospects in both countries.

We are certain that this India Calling Conference to China will also meet with the same success and appreciation as its predecessor events have. There are still many areas of potential cooperation between Indian and Chinese businesses which need to be clearly identified, for building an all-round mutually beneficial business partnership between our two countries. This mega event is a key step in that direction.

IMC and KPMG are committed to promote the relationship, co-operation and business between India and China.
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Executive summary

The last two decades witnessed the entry of emerging economies on the world stage in all spheres. Growth in the world economy has shifted from developed to emerging countries with India and China being at the forefront of this change. During 1991-2010, while the world economy grew at an average growth rate of 2.7 percent only, China and India grew at an average growth rate of 10.5 percent and 6.5 percent respectively thus being the epicentres for growth of global economy despite the Global economic crisis.

China and India could stay afloat amidst global crisis due to the inherent strengths of the two countries, such as large insatiable domestic markets rising middle class population, high investments, and facilitative regulations. Further, to sustain the growth, the two nations are focusing on multi-barrel growth engines, such as infrastructure development, increasing domestic production and consumption among others. But this sheer pace of growth in both the countries presents inevitable need for inputs and thus, trade.

China realized the increasing need of inputs and thus not only invested in domestic strategy projects but also expanded the horizon to South East Asia and parts of Africa, in addition to positioning itself as a preferred trade partner with US, EU and Japan. India has robust plans for South Asia, South East Asia and significantly is pursuing opportunities in US, EU. The fact that India and China account for more than 10 percent of world exports and more than 43 percent of emerging and developing economies’ exports elucidates the plans of India and China to transform themselves into world trading power houses.

However, the bilateral trade between both the countries remains the focal point of debates and discussions. With combined global trade of ~USD 4.6 trillion (2012 estimates), the share of bilateral trade is certainly the area of improvement.

India’s global trade (USD billion*)

<table>
<thead>
<tr>
<th>Trade with China: 9.5% of total trade</th>
<th>Trade with India: -2% of total trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>795.3</td>
<td>3,866.7</td>
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</tbody>
</table>

*India the trade data is for FY 2012

Source: Ministry of Commerce and Industry, Government of India and National Bureau of Statistics, China

China’s global trade (USD billion*)

China and India in the recent years witnessed revolutions in transport, telecommunications, technology and infrastructure sectors. In addition, both the countries possess complementary strengths to facilitate mutual trade and present strong mutual business opportunities.

The Governments of both the nations realized that time has come to leverage the respective broad industrial bases and resource endowments to gain competitive advantage. Continuous economic dialogue, formation of working groups in areas such as infrastructure, energy, technology etc. and relaxation of FDI policies in some sectors are steps in that direction.
India Calling: India-China Business Investment Opportunities

Currently, China and India collaborate the most in IT-Electronics sectors. China presents itself as a good location for business for Indian IT companies, while India, presents a great opportunity for Chinese innovation and precision in electronics and consumer durables.

In addition, Infrastructure development, Farm machinery, Transport & Logistics are witnessing increased cross border investments. Recent policies in China that aim to boost West and Central regions through heavy investments in infrastructure, transport & logistics, agriculture and food processing present critical opportunities for Indian companies.

However, important areas of collaboration which are underleveraged include the financial and banking sectors. With the growth and development of tier two cities in both India and China, need for rapid urbanization amidst increasing disposable incomes present vital opportunities for two countries to collaborate and strengthen the nerve centres of economy.

The opportunities for business investments are almost self-evident and tangible, they are there primarily for the bold, the agile and the swift. The opportunities can be tapped through economic cooperation, mutual dialogue, constructive trade agreements, and increased mergers and acquisitions (M&A) among others.

Given the opportunities, and dynamics of contemporary global economy, it’s time that two countries respect each other’s competitive advantage, leverage synergies and pave the way to sustain their position as world’s leading growth economies.

Twelfth five year plan

<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>Major goals</strong></td>
<td>• Faster growth</td>
<td>• Higher quality growth</td>
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<tr>
<td></td>
<td>• Sustainable growth</td>
<td>• Long-term prosperity</td>
</tr>
<tr>
<td></td>
<td>• Inclusive growth</td>
<td>• Inclusive growth</td>
</tr>
<tr>
<td><strong>Challenges</strong></td>
<td>• Depletion of energy and water resources</td>
<td>• Resource depletion</td>
</tr>
<tr>
<td></td>
<td>• Higher energy use</td>
<td>• Intensive energy use</td>
</tr>
<tr>
<td></td>
<td>• Sustainable growth</td>
<td>• Increased pollution</td>
</tr>
<tr>
<td><strong>Areas of emphasis</strong></td>
<td>• Introduction of crucial reforms</td>
<td>• Sustainable growth</td>
</tr>
<tr>
<td></td>
<td>• Infrastructure development</td>
<td>• Transition to domestic consumption over exports</td>
</tr>
<tr>
<td></td>
<td>• Increased participation of private sector</td>
<td>• Reducing disparities</td>
</tr>
<tr>
<td></td>
<td>• Reduction in inequality and poverty</td>
<td>• Energy efficiency</td>
</tr>
<tr>
<td></td>
<td>• Conservation of energy and water resources</td>
<td>• Environmental protection</td>
</tr>
<tr>
<td></td>
<td>• Enhancing managerial and labour skills</td>
<td>• Scientific development</td>
</tr>
<tr>
<td></td>
<td>• Support farm sector growth</td>
<td>• Development of western region</td>
</tr>
<tr>
<td></td>
<td>• Increased urbanization</td>
<td>• Increased urbanisation</td>
</tr>
<tr>
<td></td>
<td>• Enabling institutions for MSMEs</td>
<td>• •</td>
</tr>
<tr>
<td><strong>Key economic targets</strong></td>
<td>• Annual GDP growth: 9.9-9.5 percent</td>
<td>• Annual GDP growth: 7 percent</td>
</tr>
<tr>
<td></td>
<td>• Annual inflation rate: 4.5-5.5 percent</td>
<td>• Annual inflation rate: 4 percent or less</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Share of services in GDP (percent): Increase to 47 percent from 43 percent</td>
</tr>
<tr>
<td><strong>Priority industries</strong></td>
<td>• Employment generation (Textiles &amp; garments; leather and footwear; gems and jewellery; handlooms and handicrafts)</td>
<td>• Biotechnology (drugs and medical devices)</td>
</tr>
<tr>
<td></td>
<td>• Technology deepening manufacturing (machine tools; IT hardware and electronics)</td>
<td>• IT (broadband network, network convergence, internet security infrastructure)</td>
</tr>
<tr>
<td></td>
<td>• Strategic security (aerospace; telecommunications; shipping; defence equipment)</td>
<td>• High-end manufacturing (aerospace and telecom equipment)</td>
</tr>
<tr>
<td></td>
<td>• Competitive advantage (automotive; pharma)</td>
<td>• New energy (nuclear, wind, solar)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Energy conservation and environmental protection</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Clean energy vehicles</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• New materials (high-end semiconductors)</td>
</tr>
<tr>
<td><strong>Social infrastructure</strong></td>
<td>• Improved literacy</td>
<td>• Increase high school enrollment ratio to 87 percent from 82.5 percent</td>
</tr>
</tbody>
</table>

Source: Government of India, Government of China (2011 documents)
India and China
World’s leading growth economies
India and China are considered as the new "world growth centers," given their high growth rates of more than 8 percent and 10 percent, respectively, in the recent past. Such high economic growth has attracted both the global investors and global institutions alike.

While India recorded a strong decadal growth of 7.6 percent during 2001-2010, China grew at an even higher rate of 10.5 percent. Though growth slowed down during the global financial crisis in 2008, both economies were quick to recover.

Post crisis, while the world economy has been pushed into a slow lane, including India and China, the two countries are still growing at higher rates and have been projected to clock average growth rates of 6.6 percent and 8.2 percent respectively during 2011-2015. These rates are closer to their previous decadal growth rates.

Despite the current slowdown, India and China continue to maintain their attractiveness supported by a host of factors such as strong services sector and domestic demand, huge investments, a large working age population base, developing infrastructure and above all policy support.
High share of services sector

In the past decade, GDP of India and China witnessed a shift in their composition in favor of services and away from agriculture. In case of India, the contribution of services increased from 51.8 percent in 2001 to 58.4 percent in 2012, whereas, the contribution of agriculture declined to 14.1 percent in 2012 from 23 percent in 2001. This shift has proved beneficial for India as the services has been growing at a much faster rate, compared to agriculture and industry that took a beating owing to poor monsoon, high interest rates and high commodity prices respectively.

Although the GDP composition of China also witnessed a similar shift in favor of services, the shift has not been very sharp owing to a strong manufacturing sector.

Higher share of the manufacturing sector places China in an advantageous position over India as the value addition and contribution to GDP is much higher. Even factors such as economies of scale, lower borrowing and labor cost further add to the benefits.

Domestic consumption in India accounts for nearly 70 percent of the GDP, underlying the lower dependence on external demand. Positively, this has insulated the Indian economy from global slowdown to some extent. On the other hand, increased domestic dependence implies lower world integration and greater negative impact of an increased tax rate, higher inflation and higher interest rates.


Source: Economist Intelligence Unit; KPMG in India Analysis
A large working age population base

Though India had the lowest percentage of working age population/labor force (15-64 years) of 65.2 percent in 2012 among the BRIC Group, it has been estimated to end 2050 with the highest percentage of 65.5 percent. Though this increase is miniscule, it is important as the working age population in other countries will fall substantially. This rise in working age population is expected ensure reaping the advantages of demographic dividend. However, this will happen only when increased education is provided, adequate employment opportunities are created and the economic growth also continues to rise. Else, the same population could adversely impact economy.

China on the other hand, had 73.5 percent of its population in the workforce in 2012. Going forward, though its workforce has been projected to decline to about 60 percent by 2050, it will still have more than half its population in the working age.

It is also estimated that the average age in India by the same time will be 29 years as against 40 years in the US, 46 years in Japan and 47 years in Europe.\(^1\)

The International Labour Organisation has predicted that India will have 116 million workers in the age group of 20 to 24 years, as compared to China's 94 million by 2020. This fact is likely to be the prime competitive advantage of India in the coming years.

On the other hand, domestic consumption in China accounts for about 50 percent of GDP, followed by investment with a share of 45 percent. This increased share of investment reduces risks from higher inflation but raises risks of higher interest rates.

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### China’s GDP break-up from expenditure perspective (%)

![China’s GDP break-up from expenditure perspective (%)](image)

Source: Economist Intelligence Unit, KPMG in India Analysis

### Working age population as % of total population

![Working age population as % of total population](image)

Source: “International Database,” United States Census Bureau, accessed in March 2013

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\(^1\) http://newindianexpress.com/education/edex/article1465055.ece
Developing infrastructure

Physical infrastructure

In case of infrastructure, both countries are focusing on development of the same. As per Global Competitiveness Report 2012-13, published by World Economic Forum, China ranks 69 out of 144 countries in the quality of infrastructure which in itself is a positive indication of the infrastructure in the country. This is the result of the Government of China’s consistent efforts to boost growth, which is also visible from its emphasis in the 12th Five Year Plan (2011-2015). For instance, it plans to invest RMB 11.1 trillion in power industry over the next 10 years and RMB 400 billion annually in rail network. It also plans to extend the country’s highway network to 83,000 km and building a new airport in Beijing. On the other hand, the Government of India plans to invest USD 1 trillion, during the XII Plan period. The opportunities for the private sector will be in projects such as power, metro-rail, roads, airports etc.

Overall, Chinese physical infrastructure is better due to increased spending on the same. The country’s infrastructure investment is 31.3 times (at USD 3,228 billion) larger than India’s infrastructure investment. Likewise, its logistics investment is also 13.5 times (at USD 1,241 billion) higher than India’s logistics investment.

Ranking on quality of infrastructure

<table>
<thead>
<tr>
<th>Indicator</th>
<th>China</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of overall infrastructure</td>
<td>69</td>
<td>87</td>
</tr>
<tr>
<td>Quality of roads</td>
<td>54</td>
<td>86</td>
</tr>
<tr>
<td>Quality of railroad infrastructure</td>
<td>22</td>
<td>27</td>
</tr>
<tr>
<td>Quality of port infrastructure</td>
<td>59</td>
<td>80</td>
</tr>
<tr>
<td>Quality of air transport infrastructure</td>
<td>70</td>
<td>68</td>
</tr>
<tr>
<td>Quality of electricity supply</td>
<td>59</td>
<td>110</td>
</tr>
</tbody>
</table>

Source: Global Competitiveness Report 2012-13, World Economic Forum
Note: Ranking out of 144 countries

Social infrastructure

Social infrastructure such as health, education and technical skills play an important role for a country in reaping demographic dividends. These parameters become even more important for countries like India and China that have the world’s most populous countries. According to the Global Competitiveness Report, 2012-2013 and 2011-2012, India has performed marginally better in higher education and technical skills in 2013, while maintaining a status-quo in health and primary education. On the other hand, China’s performance in both parameters was marginally lower in 2013 compared to 2012. Positively, China scores above the average in health and primary education.

Performance of India and China in social infrastructure

<table>
<thead>
<tr>
<th>Parameters</th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rank in 2012</td>
<td>Rank in 2013</td>
</tr>
<tr>
<td>Health and primary education</td>
<td>101</td>
<td>101</td>
</tr>
<tr>
<td>Higher education and training</td>
<td>87</td>
<td>86</td>
</tr>
</tbody>
</table>

Source: Global Competitiveness Report, 2012-13 and 2011-12
Note: Ranking out of 144 countries in 2013 and out of 142 countries in 2012

The two countries have already started working towards the end, visible through their increased financial and policy support.
Governance and policy support

Governance

Governance plays an important role in determining business activity and investment inflow, among other factors. Areas such as fair and transparent procedures for formulating policies and regulations and implementation process, along with autonomous judiciary are some important aspects of governance that shape-up the business and investor sentiment. The adverse impact of fall in the ranking of both countries in governance parameters was visible in poor business and investor sentiment.

Performance of India and China in governance

<table>
<thead>
<tr>
<th>Parameters</th>
<th>India (Rank in 2012)</th>
<th>Change in rank</th>
<th>China (Rank in 2012)</th>
<th>Change in rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transparency of government</td>
<td>58</td>
<td>▼</td>
<td>41</td>
<td>▼</td>
</tr>
<tr>
<td>policy making</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Burden of government regulation</td>
<td>96</td>
<td>▼</td>
<td>21</td>
<td>▼</td>
</tr>
<tr>
<td>Wastefulness of government</td>
<td>55</td>
<td>▼</td>
<td>30</td>
<td>▼</td>
</tr>
<tr>
<td>spending</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Irregular payments and bribes</td>
<td>95</td>
<td>▼</td>
<td>63</td>
<td>▼</td>
</tr>
</tbody>
</table>

Source: Global Competitiveness Report, 2012-13 and 2011-12

Note: Ranking out of 144 countries in 2013 and out of 142 countries in 2012

In order to improve the overall sentiment in the economy and given the increasing scrutiny from regulators, media and even investors, there is greater desire to improve corporate governance and become more transparent. This is in addition to conducive policy measures.

Policy support

Given the global slowdown, the governments and central banks of both the countries have been lending their support to boost growth.

Monetary policy: Both the Reserve Bank of India and the People’s Bank of China (PBoC) have adopted expansionary monetary policies resulting in lower interest rates, in the recent past. Though the timing of reduction in interest rates may have differed, it is expected to facilitate investment and support growth. The RBI reduced repo rate by 100 basis points to 7.5 percent. This has been brought about by 13 policy rate hikes during March 2010-March 2012.

The PBoC also slashed interest rates twice between June-November 2012 and also lowered the amount of money banks need to keep in reserves.

Fiscal policy: In the recently announced Union Budget, 2013-2014, the Government of India (GoI) announced several policy measures to aid agricultural growth, boost infrastructure, stimulate investment, fiscal consolidation etc. etc. with an aim to raise GDP growth. Besides, several measures were announced to achieve the objective of inclusive growth. These include higher allocations for education, healthcare, rural development and human development.

02. “Macroeconomic and Monetary Developments,” The Reserve Bank of India, Various issues
GoI’s measures to boost growth

<table>
<thead>
<tr>
<th>Objective</th>
<th>Measures</th>
</tr>
</thead>
</table>
| Increase agricultural production | • Continuation of interest subvention scheme for short-term crop loans  
   • An equity grant of INR1 million per registered Farmer Producer Organization (FPO) has been permitted to provide working capital. |
| Encourage savings | • Deduction of INR0.1 million to an individual taking a home loan in 2013-14  
   • Inflation protected saving instruments to be introduced. |
| Boost investment | • Investment allowance of 15 percent to companies investing INR1 billion in plant and machinery during 1 April 2013 to 31 March 2015. |
| Support infrastructure development | • Issue of tax free infrastructure bonds worth INR 500 billion in 2013-14  
   • Increase the funds pool of Rural Infrastructure Development Fund to INR200 billion  
   • Build 3,000 km of road network  
   • Two new ports to be developed with a capacity of 100 million tonnes  
   • Further, the government is incentivising coastal waterways that will bring multiple benefits for the economy (lower transportation time and cost being key among other factors). |
| Increased fuel availability | • Policy on shale gas exploration and production to be announced soon. |
| To encourage MSMEs | • Refinancing capacity of SIDBI increased to INR100 billion (The move is important as 17 percent of India’s GDP is contributed by the SMEs). |
| Foreign trade | • To announce measures to boost export of goods and services. |
| Capital market | • FIs will be permitted to participate in exchange traded currency derivatives. |
| Renewable energy | • Provision of Generation-based incentives for wind energy. |
| Aviation sector | • Concession to aircraft maintenance, repair and overhaul (MRO) division. |
| Goods and Service Tax (GST) | • Work on GST to be taken forward. |

Source: Union Budget 2013-14, Government of India

Reforms and other measures by India: The GoI along with treading the path of fiscal consolidation, announced several other measures since September 2012 to revive investor and business sentiment. Some of these measures include:

• Hike in price of petrol and diesel; cap on the number of subsidized LPG (cooking gas) cylinders and introduction of direct cash transfer scheme. The move will not only help reduce fiscal deficit but will also align product prices to the market. Further, the Direct Cash Transfer Scheme, by its very nature is believed to pass on the benefits to poor and help reduce the inequality gap in a poverty struck country.  

• Approval of disinvestment in public sector undertakings (PSUs) will help boost government finances, encourage financial investment and improve operational performance of the units.

• Relaxation in maximum investible caps for foreign investors in sectors such as aviation, broadcasting, insurance, pension and retail. This will facilitate increased foreign investment, improve access to advance technology and generate employment.

• Amendment in Forward Contracts (Regulation) Bill to permit higher institutional investment.

• Relaxation of norms for foreign non-bank finance companies (NBFCs) in specified activities in order to increase funds inflow by enabling diversification of business.

• Postponement of General Anti-Avoidance Rule (GAAR) implementation to 2016.

• Additionally, the Government has allowed real estate developers to raise external commercial borrowings for development of affordable housing.

• The central government is planning to introduce ‘Single Window Clearance’ mechanism for improving transparency and expediting foreign investment proposals.

• Additionally, the FM undertook several road-shows globally to attract foreign investment in the country.

• The performance of BIMARU states (Bihar, Madhya Pradesh, Rajasthan and Uttar Pradesh) that have been growth laggards for years together. Positively, Madhya Pradesh and Bihar have grown more than the national average, thereby imparting strength to the Indian economy.
Other measures by China: Since 1980, China has implemented an ‘open door’ policy aimed at attracting foreign investment. It further liberalized its economy in 2001 with the removal of restriction on foreign investment in the tertiary sectors, such as banking and finance, and accountancy and legal services.

Investment in certain industries requires approval from central government authorities, such as the Ministry of Commerce. However, an investment of less than USD 300 million can be approved by provincial, regional and municipal governments. Some investment projects, which are above USD 300 million but do not require overall state planning control, can also be approved at the local level.

Chinese Government has extended equal tax treatment to all enterprises, whether foreign or domestic. New concessions have been introduced in high technology industries to encourage technological development. China has introduced a framework of commercial law to encourage foreign investment. At provincial, regional and municipal levels, regulations also exist to meet this objective.

In 2011, China introduced its 12th Five Year Plan and is expected to boost domestic consumption, improving living standards, develop western and central regions and protect the environment14.

The plan identifies seven strategic industries which are expected to benefit from special incentive and funding:

- Energy conservation and environment protection
- Next Generation IT
- Biotechnology
- High-end equipment manufacturing
- New energy
- New Materials
- Clean energy vehicles

Consistent with these priorities, some sectors are likely to witness a more open investment environment, whereas others – particularly heavily polluting industries – are expected to become more restricted.

To bolster economic growth, the Government of China announced the following measures:

- It approved 60 infrastructure projects worth USD 157 billion, which is estimated to be approximately 25 percent of the size of stimulus package announced by the government during financial crisis of 200815.
- The Government is considering changing its growth model and making it more dependent on domestic demand. Thus, it has also asked companies to increase wages16.
- Some of the measures taken to increase exports (and in turn boost economic growth) include the grant of more loans to exporters, expediting tax rebates to exporters, urging banks to increase trade financing to micro and small firms raising export credit insurance for small companies and encouraging import of machinery and technology17.
- In order to support the SMEs that contribute more than 60 percent to GDP, the Government of China is considering an industrial fund to facilitate financing18.
- In order to support its photovoltaic industry that is suffering from excess capacity and obstacles in overseas expansion, the Government announced accelerating technological improvement and encouraging mergers and acquisitions to phase out obsolete technology. It is also looking at ways to encourage coordination between power generators and on-grid service providers. The Government is also looking at allowing greater market autonomy19.

These policy measures underline the commitment of both the economies to revive economic growth.

In light of the above, growth projections by various agencies reveal an optimistic picture in the near future.

### GDP growth projections (%)

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>IMF</th>
<th>World Bank</th>
<th>Gol</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>5.9</td>
<td>6.4</td>
<td>6.1</td>
</tr>
<tr>
<td>China</td>
<td>8.2</td>
<td>8.5</td>
<td>8.4</td>
</tr>
<tr>
<td>World</td>
<td>3.5</td>
<td>4.1</td>
<td>2.4</td>
</tr>
</tbody>
</table>


To conclude, the mutual trade given the complimentary production pattern will facilitate production in the two countries. The gains from mutual trade can be used for increasing their share in regional trade.

Importantly, the policy makers in both the countries need to follow an inclusive approach to growth for greater benefits to all. This would include special emphasis on social infrastructure and a fair governance mechanism.
Comparative overview

Labor productivity and capital stock

Growth of real capital stock (%)

- China fared better than India did in terms of the growth of real stock of fixed assets (machinery & equipment, buildings, etc.), mainly due to its ability to attract investments and efficiently channelize it to the real sector.

Labor productivity growth (%)

- A consistently higher growth in labor productivity in China has helped it reap the benefit of high investments, maintain its competitive edge in international markets and hence increase exports. While in India, the growth in labor productivity has been subdued and fluctuating during the past decade.

Total factor productivity growth (%)

- China witnessed a higher growth in total factor productivity, the part of economic output growth not accounted for by the growth in inputs (labor and capital), resulting in a proportionate higher increase in GDP per head.
China witnessed higher increase in per unit labor cost during the last decade as compared to that experienced by India. One of the key reasons for this could be increasing labor demand as compared to an increasing supply of labor on the back of declining demographic dividend. The working age population in the country declined by almost 3.5 million in 2012. Continuation of this trend could undermine the competitiveness of Chinese manufacturing sector.

Debt Scenario Comparison

- China fares better than India in terms of various ratios on debt. Its debt/GDP ratio of 9.5 percent is far better than India’s 18.0 percent in 2011 indicating a much less reliance on external debt. Low level of debt also puts less strain on the Chinese Government’s finances and allows more expenditure on promoting business.

Exchange Rate Comparison

- Indian currency, which follows a free float, has depreciated significantly as compared to the US dollar during the post crisis period.
- On the other hand, Chinese currency, which follows a managed float, has appreciated during the same time period helping it correct the trade imbalance that it has developed over the years. The managed float has been a mechanism for boosting exports, which has been its key growth model.
Bilateral trade and investment

China’s share in Indian trade has increased, but it has the potential to rise further

Bilateral trade has been one of the key focus areas for both the Government of India (GoI) and the Government of China. Concentrated policy efforts have resulted in higher trade and foreign investment between the two countries. The total trade between India and China has increased at a CAGR of 37.4 percent exponentially during FY01-FY12.

China’s share in India’s trade has more than trebled from 2.5 percent in FY01 to 8.9 percent in FY13 (April-December). Likewise, India’s share in Chinese trade has also more than doubled from 0.7 percent in 2001 to 2 percent in 2011.

This can be achieved through constructive agreements like the Comprehensive Economic Partnership Agreement (CEPA) or the Free Trade Agreements (FTAs) that cover both goods and services.

According to Dr Arvind Virmani’s (former Chief Economic Advisor to the Government of India) analysis in 2005, “The bilateral trade potential is very high, given the size and dynamism of the two economies and their complementary production and trading patterns. The main barriers to realising the full potential of China-India trade, including customs rules and procedures, certification and regulatory practices, non-tariff barriers, and rules of origin that need to be addressed. Thus, the two countries have to make a trade-off. While India tends to gain in services, China tends to gain in manufacturing.

Another important area is that this economic cooperation between the two countries should be embedded in Asian growth. Since the two countries are driving production and consumption at home, the same could be a source of trade with other Asian countries.

However, given the large trade pie in each country and the small trade shares accounted by India and China, highlights the potential for a much larger bilateral trade.
The bilateral trade between the two countries is skewed in favor of China that has a positive trade balance with India.

![India’s trade balance with China](image)

Source: Export-Import Data Bank, Ministry of Commerce, Government of India

India: attractive destination for foreign direct investors

India’s attractiveness as an investment destination is visible from the average net inflow that more than trebled to USD 13.6 billion during 2006-2011 from an average net inflow of USD 3.8 billion during 2001-2005. This has been enabled by higher economic growth, rising demand, lower labor cost and some government support. Going forward, the average net inflow has been projected to rise to USD 22 billion by the end of 2015.

Year-wise FDI inflow in India (USD billion)

![Year-wise FDI inflow in India](image)

Source: Economist Intelligence Unit, EIU country data accessed on 13 March 2013; KPMG in India Analysis
Services sector continues to maintain its lead over other sectors in FDI inflows

On a cumulative basis (April 2000-December 2012), the services sector surpassed all other sectors with an investment inflow in excess of USD 36 billion, followed by the construction sector with an inflow of approximately USD 22 billion. This has been facilitated due to increasing potential of the sector and has also been reflected in the sector’s contribution of GDP. The inflow in construction has been aided given the rising need to develop infrastructure and housing in the country. Hotel and Tourism, though the least attractive sector on cumulative basis, attracted the second highest inflow in 2012 (April-December).

China surpasses India in its attractiveness as a FDI destination

During 2001-2005, China attracted FDI worth 15 times the FDI attracted by India, enabled by higher economic growth and economies of scale. Thus, its average pool of inflow more than doubled during 2006-2010. However, India seems to be giving tough competition as China’s FDI inflow reduced to almost 9 times India’s FDI in the period. Going forward, China’s average FDI inflow is projected to be less than 5 times India’s average FDI inflow during 2011-2015.

In absolute terms, the gap between FDI inflow in China and India is expected to reduce to about USD 82 billion during 2011-2015 from a gap of USD 108 billion during 2006-2010.
Manufacturing sector surpasses all others

The manufacturing surpasses all other sectors with a share of 45 percent in total FDI inflow. It is followed by the real estate that has a share of 23 percent. Thus, the two sectors together account for close to 70 percent of the total foreign inflows in the country.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Actual FDI (USD million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Management and Social Organs</td>
<td>1</td>
</tr>
<tr>
<td>Culture, Sports and Entertainment</td>
<td>635</td>
</tr>
<tr>
<td>Health, Social Security and Social Welfare</td>
<td>78</td>
</tr>
<tr>
<td>Education</td>
<td>4</td>
</tr>
<tr>
<td>Services to Households and Other Services</td>
<td>1,884</td>
</tr>
<tr>
<td>Management of Water Conservancy, Environment</td>
<td>864</td>
</tr>
<tr>
<td>Scientific Research, Technical Service and</td>
<td>2,458</td>
</tr>
<tr>
<td>Leasing and Business Services</td>
<td>8,382</td>
</tr>
<tr>
<td>Real Estate</td>
<td>26,882</td>
</tr>
<tr>
<td>Financial Intermediation</td>
<td>1,910</td>
</tr>
<tr>
<td>Hotels and Catering Services</td>
<td>843</td>
</tr>
<tr>
<td>Wholesale and Retail Trades</td>
<td>8,425</td>
</tr>
<tr>
<td>Information Transmission, Computer Services and</td>
<td>2,699</td>
</tr>
<tr>
<td>Transport, Storage and Post</td>
<td>3,191</td>
</tr>
<tr>
<td>Construction</td>
<td>817</td>
</tr>
<tr>
<td>Production and Supply of Electricity, Gas and Water</td>
<td>2,118</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>52,101</td>
</tr>
<tr>
<td>Mining</td>
<td>613</td>
</tr>
<tr>
<td>Agriculture, Forestry, Animal Husbandry and Fishery</td>
<td>2,009</td>
</tr>
</tbody>
</table>

Source: National Bureau of Statistics, China

Higher FDI in China as a percentage of GDP

FDI as a percentage of GDP in India has been lower than that in China. This is visible from the lower and upper end of the percentage share of the two countries. While, FDI accounted for a small share in India varying between 0.7-3.4 percent during 2001-2012, in China it was comparatively higher varying between 2.2-4.6 percent. The increased inflow has been due to higher economic growth of China and in turn facilitated the same as well.

FDI as percentage of GDP in India and China (%)

Source: Economist Intelligence Unit, EIU country data accessed on 13 March 2013; KPMG in India Analysis
M&A/JV deal scenario between India and China

The economies of India and China share strong growth prospects which have mutually benefitted companies in both countries. Indian companies have benefitted from gaining access to Chinese markets either through acquisitions/joint ventures and access to Chinese technology. Chinese companies on the other hand have also expanded their operations in India looking to tap into the India opportunity.

For instance, power equipment manufacturing companies of China have been key beneficiaries of the planned capacity additions in the Indian power sector which has led to an increased demand for Chinese equipments. Among large players, Reliance Power has employed equipment for its Sasan Ultra Mega Power Project from Shanghai Electric Corporation. Chinese companies have been keen to enter into India through setting up their own plants or through a joint venture route to tap the opportunities in the Indian power sector. Recently, in April 2012, China-based Sinovel, one of the largest wind turbine manufacturers in the world signed an agreement with Ghodawat Group of Maharashtra to use latter’s facilities to produce turbines in India21.

Besides energy, automotive and industrial sectors have also attracted M&A and joint venture investments enabling market and technology access between both the countries.

Specifically, in December 2009, General Motors (GM) formed a 50-50 venture with Shanghai Automotive Industry Corporation of China, which is the partner of GM’s main venture in China to expand their co-operation in Asia. Subsequently, in October 2012, GM has increased stake in its Indian operations to 93 percent by buying 43 percent from its Chinese partner Shanghai Automotive Industry Corporation Group for an undisclosed sum indicating the long term potential that GM has in India22. Going forward, with India China bilateral trade touching USD 75 billion as of 2011-12, one is likely to see increased M&A/JV activity between the two countries23.

<table>
<thead>
<tr>
<th>Target company</th>
<th>Acquirer company</th>
<th>Industry</th>
<th>Year</th>
<th>Deal value (USD million)</th>
<th>Deal description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Visteon TYC Auto Lamps</td>
<td>Varroc Group</td>
<td>Automotive</td>
<td>Mar-12</td>
<td>20.0</td>
<td>Varroc Group, the India-based automotive parts manufacturer, acquired 50 percent stake in Visteon TYC Auto Lamps Co., Ltd., the China-based lighting division of Visteon Corporation which includes incandescent lamps, advanced systems for luxury models, and smart systems that integrate predictive lighting and glare elimination, from Visteon Corporation, the listed US-based automotive components manufacturer Visteon Corporation</td>
</tr>
<tr>
<td>Global Wind Power</td>
<td>China Ming Yang Wind Power Group</td>
<td>Energy</td>
<td>Jul-12</td>
<td>25.0</td>
<td>China Ming Yang Wind Power Group Limited, the listed China based wind turbine manufacturer, acquired 55 percent stake in Global Wind Power Ltd., the India based manufacturer of wind power solutions, from Reliance Capital Ltd</td>
</tr>
<tr>
<td>Acome Xintai Cables Co</td>
<td>Microqual Techno</td>
<td>Industrial</td>
<td>Feb-11</td>
<td>12.0</td>
<td>Microqual Techno, the India based company engaged in the manufacture, system integration, and service/outourcing of passive components, acquired Acome Xintai Cables Co., Ltd, the China based company engaged in carrying wiring devices.</td>
</tr>
<tr>
<td>Yancheng Tractor Company</td>
<td>Mahindra &amp; Mahindra</td>
<td>Automotive</td>
<td>Aug-08</td>
<td>28.0</td>
<td>Joint venture with China’s Yueda Group to manufacture and sell top-quality tractors in the growing Chinese market</td>
</tr>
<tr>
<td>Shandong Rongan Group</td>
<td>Binani Cement</td>
<td>Industrial</td>
<td>Aug-07</td>
<td>11.0</td>
<td>Binani Cement, the listed Indian cement manufacturer, has acquired a 49 percent stake in the cinder manufacturing plant of Shandong Rongan Group, the Chinese diversified business group engaged in mining and power generation. The acquisition is in line with Binani’s strategy to sell cement in China, West Asia and in eastern Africa.</td>
</tr>
<tr>
<td>KHD Humboldt Wedag</td>
<td>McNally Bharat Engineering Company</td>
<td>Industrial</td>
<td>Aug-09</td>
<td>16.0</td>
<td>McNally Bharat Engineering, India based company engaged in providing turnkey solutions, has agreed to acquire the engineering workshop and coal and mineral technology business of KHD Humboldt Wedag International.</td>
</tr>
</tbody>
</table>

Source: Mergermarket, Venture Intelligence, KPMG in India Analysis

22. “General Motors stake in Indian arm to 93%,” Financial Express, 16 October 2012
<table>
<thead>
<tr>
<th>Target company</th>
<th>Acquirer company</th>
<th>Industry</th>
<th>Year</th>
<th>Deal value (USD million)</th>
<th>Deal description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tamco Shanghai Switchgear</td>
<td>Larsen &amp; Toubro International PZE</td>
<td>Industrial</td>
<td>Dec-07</td>
<td>10.0</td>
<td>Larsen &amp; Toubro International PZE (LTI), the India based subsidiary of Larsen &amp; Toubro Limited (L&amp;T), has agreed to acquire Tamco Shanghai Switchgear (TSS), the China based switchgear business of Tamco Corporate Holdings Berhad.</td>
</tr>
<tr>
<td>Hubei Jing Wei Chemical Fibre</td>
<td>The Aditya Birla Group</td>
<td>Industrial</td>
<td>Sep-06</td>
<td>67.0</td>
<td>The Aditya Birla Group, acquired 70 percent stake in Hubei Jing Wei Chemical Fibre Company Limited, the China based viscose staple fibre manufacturer.</td>
</tr>
<tr>
<td>General Motors India</td>
<td>Shanghai Automotive Industry Corporation (Group)</td>
<td>Automotive</td>
<td>Dec-09</td>
<td>500.0</td>
<td>Shanghai Automotive Industry Corporation (Group), the China based company engaged in manufacturing and sales in passenger cars, commercial vehicles and components, has acquired a 50 percent stake in General Motors India.</td>
</tr>
<tr>
<td>GAIL China Gas Global Energy Holdings</td>
<td>GAIL (India) Limited; China Gas Holdings</td>
<td>Energy</td>
<td>Jul-07</td>
<td>NA</td>
<td>GAIL, the listed Indian gas transmission and marketing company and China Gas Holdings Limited, the listed Hong Kong based natural gas services operator, has established a joint venture company. GAIL and China Gas Holdings each will hold 50 percent stake each in the company. The business of the joint venture will primarily focus on natural gas sector projects in China, India and other countries.</td>
</tr>
</tbody>
</table>

Source: Mergermarket; Venture Intelligence; KPMG in India Analysis

India, China on the proposed path of economic cooperation

India and China foresee strong business opportunities within their respective economies. The Indian and the Chinese government are undertaking strategic economic dialogue to improve macro-economic policy coordination, promoting exchanges on economic issues and enhancing India-China economic cooperation. Towards this end, the first dialogue had been successfully held at Beijing in September 2011 where the two sides agreed to constitute five Working Groups on policy coordination, infrastructure, energy, environment protection and high-technology. A working level delegation from China visited New Delhi in March 2012 following which the five Working Groups met in Beijing in the months of August and September 2012.

The proposals and recommendations made by the five Working Groups were considered during the second dialogue held in November 2012 and directions given for their future activities. Specifically, the Indian and Chinese authorities agreed on the following:

- **Cooperation at the global level:** This constitutes reform of international monetary and financial systems, stabilizing the volatility in global commodity markets, working towards sustainable development and climate change goals, and ensuring food and energy security. Further, cooperation in imparting technical knowledge to reap the benefits of a skilled workforce would go a long way in future.

- **Strengthening communication on macroeconomic policies:** Both sides agreed to maintain continued economic growth while adjusting manufacturing and services, upgrading levels of technologies and skills, while developing the hard and soft infrastructure for encouraging economic growth. The authorities also decided to regularly conduct joint studies on issues of mutual interest, focusing on benefits of best practices and information exchanges.
• Deepening and expanding trade and investment: Both sides recognized the need to explore potential synergies in areas where they have mutual complementarities, improve trade and investment environments, removing market barriers, enhance cooperation in project contracting, deepen business to business exchanges, improve transportation links, encourage greater bilateral investment and work towards achieving a more balanced and sustainable bilateral trade. This will promote companies in both countries and enable them to tap/ exploit opportunities in relevant markets.

• Expanding cooperation in the financial and infrastructure sectors: Both the countries agreed to intensify the cooperation in the financial sector by encouraging financial institutions of the two countries to set up operations in either country to support enterprises of the two countries to establish/expand commercial operations. Towards this end, the Reserve Bank of India (RBI) and China Banking Regulatory Commission (CBRC) have already signed a memorandum of understanding (MoU) to increase banking and financial cooperation and agreed to grant permission to the banks of the other country to open branches and representative offices.

Besides, the main outcomes of the five working groups were as follows:

• Policy Coordination Working Group: Both sides discussed plan priorities and the ways and means of achieving plan targets recently unveiled in their 12th Five Year Plans. They exchanged views on skills development and industrial park development. The two sides also submitted assessment reports on the investment environments in each other's country based on the experiences of the enterprises of the two countries and discussed possible solutions to improve the same. The two sides have also agreed to carry out joint studies on planning cooperation and skills development for employability, and entered into related MoUs.

• Infrastructure Working Group: It focused on enhancing railway cooperation; both sides exchanged views on the broad policies and plans for railway development in each other's country. The two sides also discussed high-speed rail development programme, heavy haul and station development and entered into a MoU to exchange views and other related information in these areas. Infrastructure has also been an area where a number of Chinese companies are looking to enter into India. For instance, besides power, Chinese companies are involved in as many as six national highway projects in consortium with Indian partners. These include projects such as Srinagar-Banital, Udhampur-Ramban, Jammu-Udhampur and Piparkothi-Mothhari-Raxaul in different states of India.

• Energy Working Group: Both sides briefed each other on the development of the power sector in the two countries, the ongoing cooperation in the power equipment sector, opportunities and challenges in the wind energy sector, the possibility of Chinese power equipment manufacturers setting up service centres in India and relevant policy environment to support the ongoing cooperation. Energy has been a high area of collaboration amongst Indian and Chinese companies which have benefitted from the capacity additions in the Indian power sector.

• Environmental Protection Working Group: The two sides agreed to enhance cooperation in the implementation of energy efficiency projects through energy service companies (ESCOs), encouraging visits to industrial and manufacturing centers excelling in energy efficient initiatives, cooperate and jointly develop testing protocols and standards and have entered into a related MoU. The two sides also exchanged views on enhancing cooperation in water-saving technologies covering the areas of waste water recycling and water-efficient irrigation systems.

• Hi-Technology Working Group: The two sides agreed to enhance cooperation in the IT/ITES domain. Both sides also agreed to carry out/support joint studies to better understand the IT/ITES markets of each country and have entered into a related MoU in this area. The two sides also reached a consensus to explore the possibility of working together for developing common standards for digital TV, audio and video codec standards and mobile communication technology. Most of the leading companies from India have already tested the water in China. Promising opportunities for the IT bilateral trade development have resulted in wide presence of Indian IT Companies in all IT hubs in China. Companies like TCS, NIIT are adopting aggressive approach and participating in local business, where companies like Wipro and Infosys had made their foot hole for service of overseas client.

Chinese investments in India are growing in a number of diverse fields. Most are still in infrastructure, raw materials, and electronics. However, over the last three years, Chinese companies have started to enter India’s industries such as automotive, finance and healthcare. For instance, China’s leading car and sports utility vehicle maker Great Wall Motor Co (GWM) is planning to enter the Indian market, following the footsteps of compatriot commercial vehicles manufacturer Beiqi Foton Motor Company (BFMC). GWM is looking for an independent entry in the Indian market and not through any joint venture. On the other hand, BFMC has already signed a MoU with the Maharashtra government to set up a manufacturing plant entailing an investment of around INR 16.7 billion over a period of five years to produce commercial vehicles, including medium and heavy trucks and passenger carriers. Their comparative advantage is their ability to provide products and services that suit India’s market demands and are more cost-effective than western competitors.

The Indian and Chinese governments have set a bilateral trade target of USD 100 billion by 201525. As part of agreement to enhance trade between the two countries, eleven agreements that envisage a total investment of more than USD 5.2 billion were signed between the governments and business groups of India and China at the second strategic economic dialogue between the two nations in November 2012. Specifically, USD 3 billion financing agreement was signed between Reliance Power and China’s Guangdong Mingyang Windpower Group Company and another USD 800 million agreement between NIIT China (Shanghai) and China’s Hainan province to establish an information technology enclave in Hainan.26 Domestic companies in both countries are likely to be key beneficiaries of the enhanced cooperation and trade linkages between the two countries.

25. Project Monitor, April 2012
26. **"China’s Sino-US EV partnership is dead on arrival,"** The Economic Times, 10 December 2012
Doing Business Ranking

Even in doing business, India falls behind China with a rank of 132. This is because China has introduced improved investor friendly policies, especially in areas such as registering a property, trading across borders, enforcing contracts and resolving insolvency.

On the other hand, India fares better in areas such as providing credit and electricity and protecting investors, which could be learning areas for China. Thus, mutual learning can lead to a much improved doing business climate in the two countries, resulting in increased investments, access to improved technology, better employment and higher economic growth.

Doing Business Indicators

<table>
<thead>
<tr>
<th>Parameters</th>
<th>India</th>
<th>Change in rank</th>
<th>China</th>
<th>Change in rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall doing business</td>
<td>132</td>
<td>132</td>
<td>91</td>
<td>91</td>
</tr>
<tr>
<td>Starting a business</td>
<td>169</td>
<td>173</td>
<td>153</td>
<td>151</td>
</tr>
<tr>
<td>Dealing with construction permits</td>
<td>183</td>
<td>182</td>
<td>181</td>
<td>181</td>
</tr>
<tr>
<td>Getting electricity</td>
<td>99</td>
<td>105</td>
<td>113</td>
<td>114</td>
</tr>
<tr>
<td>Getting credit</td>
<td>23</td>
<td>23</td>
<td>67</td>
<td>70</td>
</tr>
<tr>
<td>Protecting investors</td>
<td>46</td>
<td>49</td>
<td>98</td>
<td>100</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>149</td>
<td>152</td>
<td>118</td>
<td>122</td>
</tr>
<tr>
<td>Trading across borders</td>
<td>125</td>
<td>127</td>
<td>60</td>
<td>68</td>
</tr>
<tr>
<td>Enforcing contracts</td>
<td>184</td>
<td>184</td>
<td>20</td>
<td>19</td>
</tr>
<tr>
<td>Resolving insolvency</td>
<td>109</td>
<td>116</td>
<td>78</td>
<td>82</td>
</tr>
</tbody>
</table>

Note: Ranking out of 185 countries
Agriculture & Food processing

Sector profile

<table>
<thead>
<tr>
<th>Parameter</th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market size</strong></td>
<td>• India’s Agri-GDP is estimated to be USD 138.6 billion*&lt;sup&gt;1&lt;/sup&gt;</td>
<td>• Agri-GDP was USD 730 billion&lt;sup&gt;3&lt;/sup&gt; (10 percent of the USD 7.3 trillion Chinese GDP* in 2011 (5 times that of India)</td>
</tr>
<tr>
<td>(2011-2012)</td>
<td>• India’s processed food output was valued at USD 93.1 billion during FY10 (y-o-y growth of 20 percent)&lt;sup&gt;2&lt;/sup&gt;</td>
<td>• Food industry output was USD 1.1 trillion in 2011 (almost 9 times that of India)&lt;sup&gt;4&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

*Note: INR to USD exchange rate used (2012): USD 0.018754; FY refers to Indian Financial Year i.e. April to March

<table>
<thead>
<tr>
<th>Inputs</th>
<th>Cultivation</th>
<th>Procurement storage</th>
<th>Logistics, distribution</th>
<th>Processing</th>
<th>Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seeds</td>
<td>• Tilers</td>
<td>• Soil testing equipment</td>
<td></td>
<td>• Fruit and vegetable processing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Fertilizers</td>
<td>• Tractors</td>
<td></td>
<td>• Meat processing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Plant Protection</td>
<td>• Irrigation systems</td>
<td></td>
<td>• Dairy products</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Scope of current paper</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Food processing

- The unorganized sector accounts for more than 70 percent of processed food production by volume and 50 percent of production by value<sup>6</sup>
- Food industry is dominated by players (92 percent of companies in 2011) with annual sales less than USD 740,000<sup>7</sup>

Inputs

- Missing links exist in the seed production system. There is very little focus on hybrid seed production and the market is fragmented
- Despite having the second-largest arable land acreage in the world, India’s share of the INR 1.5 trillion global crop protection market is only 2-3 percent<sup>8</sup>
- The Chinese seed industry is estimated to be USD 7.7 billion and is the second largest after the US. With 8,000 companies the market is highly fragmented<sup>9</sup>
- The Chinese market for pesticides is estimated to be ~USD 6 billion and expected to be the world’s largest market by 2016<sup>9</sup>

Exhibit: Tractors per 100 sq km of arable land (#)

Source: “Infrastructure Development in Agriculture,” KPMG in India Analysis

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*Note: INR to USD exchange rate used (2012): USD 0.018754; FY refers to Indian Financial Year i.e. April to March
Key trends

India

• The private investments in agri and allied sectors continue to rise
  It is widely acknowledged that public investment in agriculture is critical and important, in actual terms. Currently the public investment forms about 20 percent of the total investment while the 80 percent comes from the private sector.

Exhibit: Level of food processing

<table>
<thead>
<tr>
<th>Segment</th>
<th>India</th>
<th>Other countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fruits and Vegetables</td>
<td>2.2%</td>
<td>US (65 percent), Philippines (78 percent)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>China (23 percent);</td>
</tr>
<tr>
<td>Marine</td>
<td>26%</td>
<td>60-70 percent in developed countries</td>
</tr>
<tr>
<td>Poultry</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>Buffalo Meat</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>Milk</td>
<td>35%</td>
<td>60-75 percent in developed countries</td>
</tr>
</tbody>
</table>

Source: “Infrastructure Development in Agriculture,” KPMG in India Analysis

• Significant post harvest losses continue to plague the agro and food segments in India
  Significant post harvest losses (fruits and vegetables – 5.8-18.0 percent, pulses – 3.9-6.0 percent) continue on account of lack of storage and transport infrastructure, untrained labor and multiple levels in food value chain

• Agri and allied sector in India today is witnessing the rise of organic foods
  Consumer attitudes and preferences are undergoing a shift towards health consciousness which led to the emergence of organic food segment

China

• China continues to record increase in food-grain output thus ensuring the supply side in agri-food processing is intact
  China witnessed a record production of 590 million tonnes of food-grain in 2012, growing at 3.2 percent over 2011

• Chinese agri and allied sectors is amidst the increasing labor costs which might deter the ‘cost competitive advantage’ in the future
  Low labor costs had been a key competitive advantage for China. However, farm wages have been increasing on account of labor migration to cities (for example, labor costs for cotton farming increased by 20 percent during 2011)

• Currently the food manufacturers in China are increasingly targeting forward integration with an intent to move closer to customers and thwart supply chain issues
  Chinese food manufacturing companies are currently experiencing issues such as quality concerns and counterfeit products; this prompted the food manufacturers to start retailing and move closer to customers

• Emergence of new stricter safety standards to ensure food quality
  Some big Chinese players have reportedly defaulted on the quality front (ex: incidents such as food contamination in 2011) leading to a growing food safety concern amongst consumers. This has prompted the government to raise food safety standards.

10. State of Indian Agriculture 2011-12
Key drivers of growth

India

- Government initiatives tend to liberalize the sector which are likely to boost investments in the sector
  - India has undergone a calibrated liberalization of trade policy (starting with signing of ASEAN Trade Goods Agreement in 2009)
  - Increasing outlay for food processing sector under the 12th Five Year Plan is USD 2.8 billion with focus on infrastructure development. It’s more than thrice the budget allocation in the 11th plan

- Increasing consumption of high-value food items:
  Per capita consumption and spend on ‘higher order’ food items such as meat, fruits and vegetables have been growing

- Growth in organized retail (OR):
  OR is expected to grow at a CAGR of 26.4 percent during 2011-2016, and is likely to continue benefiting the sector

China

- Chinese government plans to focus on various aspects of supply chain to improve the efficiency and exports in agri and allied sectors
  - Budgetary allocation for agriculture increased to USD 190 billion* in 2012, an increase of 17.9 percent over 2011
  - Focus on farm modernization by promoting research in biotechnology, seed production and effective use of farmland. Government subsidizes inputs such as machinery, fertilizers
  - Food exports reached USD 50.5 billion and imports were valued at USD 28.8 billion, a y-o-y increase of 23 and 33 percent, respectively; the exports are further expected to increase

- The consumption of high-end food items has been increasing and expected to drive the food processing sector
  The average per capita consumption of high-end food items, such as pork and dairy products, has increased by 1.85 and 6.8 times, respectively, during 2000-10. Prepared meat and dairy sectors are amongst the fastest growing food segments in China

- Increasing number of high-end food retailing stores to bring packaged food closer to customers likely to drive the food business in India
  China witnessed an increase in the number of outlets of high-end food retailers, such as Beijing Hualian Group and Ole, that are likely to drive processed and packaged foods more closer to consumers

Exhibit: Per capita consumption of high end food

<table>
<thead>
<tr>
<th>Year</th>
<th>Pork (kg)</th>
<th>Dairy (kg)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1.68</td>
<td>3.3</td>
</tr>
<tr>
<td>2010</td>
<td>17.9</td>
<td>11.27</td>
</tr>
</tbody>
</table>

Source: [www.chinadaily.cn](http://www.chinadaily.cn)
## Sector profile

<table>
<thead>
<tr>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets under management</strong> (June 2012)</td>
<td><strong>USD 122.6 billion</strong>&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>CAGR</strong> (June 2007– June 2012)</td>
<td><strong>11.4 percent</strong>&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

### Key Market Players

**Domestic**
- UTI Asset Management
- Reliance Capital Asset
- SBI Funds Management
- ICICI Prudential Asset
- Birla Sun Life Asset

**Foreign**
- HSBC Asset Management
- ING Investment Management
- Franklin Templeton Asset
- China AMC
- E-Fund
- Southern
- Bosera
- GF
- Hua’an
- Harvest (tie-up between Deutsche Bank and China Credit Trust)
- Morgan Stanley Huaxin
- Axa Investment Managers

### Market structure
- Market is characterized by 44 asset management companies (AMCs) as of September 2012
- Liquid/money market schemes account for ~90 percent of the market.
- Highly skewed presence in major cities
- The composition of China’s asset management sector is as follows: trusts (68 percent); mutual funds (28 percent) and others (4 percent)
- Trusts, the largest players, have been slow to expand outside of their core business into asset management

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<sup>1</sup> Percentages in the parenthesis indicate approximate market share as of May 2012 for China

<sup>2</sup> Note: This is an indicative list and not an exhaustive list

---


02. China Financial sector assessment programme – IMF/World Bank initiative, KPMG Analysis
Key trends

India

- Sound regulatory environment
  Minimum entry and exit loads and a limit on expenses is a move towards more professional advice, cost-efficient processes and improved customer service.

- Highly skewed geographic distribution
  77 percent of distributors are present in top 10 cities by investment in mutual funds.

- A slew of reforms after the global financial crisis slowed the growth of the sector
  Revival in economic growth, increased disposable income and an uptrend in equity markets are expected to bring the customers back to mutual funds.

China

- International expansion
  International expansion has emerged as a key strategic priority for Chinese fund management companies (FMCs) with several European markets being the focus.
  Supported by the conducive government policies, Chinese FMCs are leveraging Hong Kong as a launch pad to seek international exposure and enhance their brand equity.

- Limited product differentiation
  Only a few FMCs have individually distinguished offerings.

- Large insurance companies have started setting up their own FMCs
  On the back of the strong growth in insurance premiums, some of the largest insurers have established their dedicated asset management subsidiaries not only to manage the funds of the parent company but also to manage those of other insurers for a fee.

- Distribution is skewed with four large commercial banks acting as major distributors
Key drivers of growth

India

- **Low penetration**
  As of December 2011, AUM/GDP ratio of approximately 5 percent as compared to 97 percent, 77 percent, 43 percent and 40 percent for Australia, the US, Canada and Brazil, respectively.\(^4\)

- **Regulatory push to expand to tier 2 to tier 6 areas**
  Easier norms to enrol new customers through a variety of distribution channels to help AMCs serve the rural markets profitably.

- **Improved performance of financial markets coupled with alternative investment options to drive the growth**
  Sound equity market and developing debt market coupled with a variety of investment options (private equity, art, derivatives, commodities, etc.) would drive the growth of the sector.

China

- **Institutional investors to drive growth**
  China’s major institutional players, with significant capital, are likely to play a major role as investors in the Chinese asset management sector.
  A large number of small players (insurers, pension funds, etc.) are expected to drive the market.

- **Increased Liberalization and improving regulatory environment**
  Government’s proposed legislation to relax restrictions on the origination and approval of new funds and allow FMCs to compete for a bigger share of China’s wealth management market, is expected to help FMCs expand their business.

- **Partnerships with domestic fund managers**
  Partnering with domestic fund managers to set up JVs offers huge opportunity to tap the Chinese market; allows maximum foreign ownership of 49 percent.

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Note: GDP/AUM is taken to be total Net Assets/GDP at current prices.

04. ICI Factbook 2012, World Economic Outlook database, IMF.
# Sector profile

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total assets</strong></td>
<td>• USD 1,601.3 billion¹</td>
<td>• USD 19,142.3 billion (close to 12 times India’s banking assets)²</td>
</tr>
<tr>
<td><strong>CAGR</strong></td>
<td>• 19.1 percent¹</td>
<td>• 20.8 percent²</td>
</tr>
</tbody>
</table>

### Key market players³

**Domestic**
- State Bank of India
- ICICI Bank
- HDFC Bank
- Bank of Baroda
- Bank of India
- Axis Bank
- Punjab National Bank

**Foreign**
- Standard Chartered Bank
- Citi Bank
- HSBC Bank
- Deutsche Bank
- Industrial and Commercial Bank of China
- China Construction Bank
- Bank of China
- Agricultural Bank of China
- Bank of Communications
- HSBC Holdings PLC
- Standard Chartered PLC
- J.P. Morgan Chase & Co
- Citigroup Inc.

### Market structure

- Market characterized by a healthy mix of public (~70 percent), private (~22 percent) and foreign (~8 percent) banks with steadily increasing market share of private and foreign banks

- CAs of December 2011, Chinese banking system is characterized by large commercial banks (~49 percent), joint stock commercial banks (~17 percent), city commercial banks (~9 percent), policy banks (~8 percent), rural credit cooperatives and financial institutions (~10 percent), rural banks (~4 percent), foreign banks (~2 percent) and rural cooperative banks (~1 percent)

*Percentages in the parenthesis indicate approximate market share of banks as of March 2012 for India and as of December 2011 for China

Note: This is an indicative list and not an exhaustive list

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01. DIPP, RBI
02. People’s Bank of China (PBC)
03. “A Profile of banks,” 2011-12, RBI

---
Key trends

India

- **High interest rate and slow economic growth have impacted the banks’ business**
  For the fortnight ending 22 February 2013, deposit and credit growth decreased to 12.7 percent and 16.3 percent, respectively.¹

- **Increase in banks’ non performing assets**
  Increase in banks’ NPA (especially in case of public sector banks)
  According to the ratings agency CARE, NPAs are estimated to have increased by 43.1 percent to INR1.79 trillion during April-December 2012⁴

- **Emphasis on alternative distribution channels**
  Banks are trying a combination of alternative channels (such as mobile banking, business correspondents, ATMs, etc.) to serve the areas with lower penetration of banks

China

- **Loans to small and medium enterprises (SMEs) has become a focus area for banks in China**
  All banks in China have begun to focus on loans to SMEs with joint-stock banks leading the pack. As of December 2011, loans to SMEs stood at RMB 10.8 trillion, 19.6 percent of total loan portfolio of RMB 54.8 trillion.³

- **Chinese banks are focusing on efforts to expand their international footprint**
  Many of the Chinese banks are gradually accelerating efforts to expand in other countries through establishing new institutions, merging and acquiring institutions and forming partnerships.

- **Commercial banks have increased their focus on private banking**
  With Bank of China and Citibank being the pioneers in private banking, 16 Chinese and foreign banks opened 150 private banking institutions in 22 cities in 2011. Total assets under private banking exceeded RMB 300 billion.⁵

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¹ DIPP, RBI
³ White Paper on Private Wealth Management in China, jointly released by Private Banking Department of Bank of China and Hurun Report, October 2011
⁴ CARE
⁵ Hurun Report
Key drivers of growth

India

- **Areas with low or no penetration of banks to drive the growth of banks’ business**
  A large proportion of the population with increasing income levels and low or no access to banks, presents huge opportunity for banks to provide various financial services. Regulatory and government initiatives such as use of business correspondents, Aadhar cards and liberal branch expansion policy in small urban and rural areas have helped banks expand their business.

- **Private banking and wealth management services to drive the growth of banks**
  Number of high net worth individuals (HNWIs) registered a strong increase of 20.8 percent in 2010 and India figured among the top 12 countries in the world in terms of HNWIs, translating into high demand for wealth management and portfolio management services.

- **Increasing immigration and NRI remittance offer growth opportunities for retail and NRI banking**
  India to top among countries with an estimated USD 58 billion of remittances in 2011 facilitated by the use of automated clearing house facilities.

China

- **Huge investment in payment infrastructure is expected to drive the growth of banking sector**
  China’s 12th Five-Year Plan has positioned payment infrastructure as one of the top three priorities for investment. As a result, there has been acceleration in activity with increased collaboration amongst industry players, significant investment in infrastructure and technology as well as government support. Consequently, mobile banking is expected to be a key growth driver for the industry while encouraging financial inclusion.

- **Rural banking to drive the growth in banks’ business**
  Total assets of rural commercial banks, which increased from 85 in 2010 to 212 in 2011, increased by 54 percent during the same period. The rural financial services market has emerged as the most rapidly expanding area within the banking sector.

- **Focus on SMEs finance to drive the growth of the banking sector**
  A combination of three factors — the changing competitive environment, robust regulatory support for SMEs lending and the rapid growth of Microcredit Companies (MCCs) and credit guarantee companies — is setting the foundation to help banks expand their balance sheets.
## Sector profile

### India

- **Market size (March 2011)**
  - USD 50 billion\(^1\)

- **Estimated CAGR (2011 – 2021)**
  - 16.0 percent\(^4\)

- **Market structure**
  - India is home to an estimated 450 million students\(^4\)
  - The market presents huge demand-supply gap. The investment required to meet expected demand is ~USD 100 billion by 2014\(^4\)
  - Largely fragmented industry with over 96 percent held by unorganized players

### China

- **Market size (2012)**
  - USD 155 billion\(^2\)

- **Estimated CAGR (2011 – 2021)**
  - 14-16 percent\(^2\)

- **Market structure**
  - Total annual educational spending in China was estimated at RMB 2.3 trillion for 2010 and was projected to increase to RMB 4.1 trillion by 2013. RMB 3.2 trillion, is expected to be spent on private education, rest on public education by 2013\(^3\)
  - Highly regulated sector

---

### Exhibit: Education system in India and China

<table>
<thead>
<tr>
<th>Education in China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formal Education</strong></td>
</tr>
<tr>
<td>K-12</td>
</tr>
<tr>
<td>Higher Education</td>
</tr>
<tr>
<td><strong>Informal Education</strong></td>
</tr>
<tr>
<td>Training Institutes</td>
</tr>
<tr>
<td>Pre-Schools</td>
</tr>
<tr>
<td>Vocational Education</td>
</tr>
</tbody>
</table>

**Source:** KPMG in India Analysis

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\(^1\) Indian Education Landscape by Anand Ramanathan, KPMG

\(^2\) http://www.jljgroup.com/page/en/18/328/China_Updates.html

\(^3\) http://www.chinadaily.com.cn/hkedition/2011-01/12/content_11830900.htm


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Key trends

India

- **Indian education system is marked by increasing PPP contracts to facilitate programme delivery**
  - These projects are funded out of schemes such as the Sarva Shiksha Abhiyan and ICT at Schools
  - Tenders are floated by state governments for a number of schools in the district and the successful companies in the bidding process are awarded 4-5 year contracts on Build-Own-Operate-Transfer (BOOT) model to provide necessary infrastructure and impart IT education
  - National Skill Development Corporation is a successful model of public-private partnership

- **Government of India has proposed vocational training and education initiatives on the lines of developed countries**
The Human Resource Development ministry proposed a National Vocational Qualification Framework (NVQF) on lines of those present in countries such as Australia, Austria, Denmark, Ireland, Switzerland and UK

- **The gross enrollment ratio in India is steadily increasing, but continues to be below the global average**
The GER which was at 15 percent in 2011 steadily climbed to 17 percent by end of 2012 but continues to be below the global average of 30 percent

China

- **The GER in China is on rise and is expected to cross all the global standards by 2015**
The GER is steadily on rise across all the education categories and expected to cross the global standards by 2015

  Exhibit: GER across education categories

<table>
<thead>
<tr>
<th>Category</th>
<th>2009</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kindergarten</td>
<td>51%</td>
<td>60%</td>
</tr>
<tr>
<td>Primary &amp; Junior Education</td>
<td>79%</td>
<td>87%</td>
</tr>
<tr>
<td>Masters</td>
<td>24%</td>
<td>36%</td>
</tr>
</tbody>
</table>

Source: KPMG in India Analysis

- **The infrastructure for education in China is on rise**
  - Total number of Universities/Institutes: 1,112/3,244
  - Total number of Secondary schools: 85,132
  - Junior Secondary schools (Regular schools, Vocational JSS and Adult JSS): 56,479
  - Primary Education: 2,90,597
  - Pre schools: 1,40,420

04. Technopark analysis
05. Chinese Ministry of Education website; KPMG Analysis
Key drivers of growth

**India**

- The increased inclination to spend on education by the growing middle class population in India presents a vast opportunity
  - Education is the second largest expenditure (8.9 percent) group for the middle class
  - The willingness to spend on education and the rise in purchasing power will allow the growing middle class to bid for an education from private institutes

**Exhibit: Expenditure among the Indian middle class**

<table>
<thead>
<tr>
<th>Category</th>
<th>Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food &amp; Grocery</td>
<td>24.50%</td>
</tr>
<tr>
<td>Education</td>
<td>8.30%</td>
</tr>
<tr>
<td>Entertainment</td>
<td>8.30%</td>
</tr>
<tr>
<td>Mobile Phones</td>
<td>7.70%</td>
</tr>
<tr>
<td>Stationery</td>
<td>4.30%</td>
</tr>
<tr>
<td>Fuel &amp; Transport</td>
<td>4.30%</td>
</tr>
<tr>
<td>Personal care</td>
<td>4.20%</td>
</tr>
<tr>
<td>Communication</td>
<td>3.70%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>3.20%</td>
</tr>
<tr>
<td>Footwear</td>
<td>3.10%</td>
</tr>
<tr>
<td>Toys &amp; Gifts</td>
<td>3.00%</td>
</tr>
<tr>
<td>Apparel</td>
<td>2.80%</td>
</tr>
<tr>
<td>Loan Repayment</td>
<td>2.33%</td>
</tr>
<tr>
<td>Household Help</td>
<td>2.23%</td>
</tr>
<tr>
<td>Cable &amp; Internet</td>
<td>2.23%</td>
</tr>
</tbody>
</table>

**Source:** McKinsey

- Increased interest from corporate fuels the activity in the education sector in India
  Off late corporate are showing interest in building education businesses and prime among them are Pre school models. For instance, Alphakids set up by Camlin group and Globe Tot’ers by Yash Birla group

- Spur in demand from Tier II and Tier III towns to act as a major driver for the sector
  Demand and affordability is increasing in small towns with the growing awareness among people about the need to send children to preschools; companies like Euro kids plans to add 1,000 pre schools in medium term with Tier II and Tier III cities as growth drivers

**China**

- A burgeoning middle class and the impact of one child policy are likely to be the drivers for education in China
  China’s middle class will represent 80 percent of the population by 2025 with considerable spending power; With China’s one child policy, it’s highly likely that Chinese parents typically invest huge amounts in their children’s education

- Blue collar vocational training is thriving by serving the vast majority of the 15-22 years old not enrolled in public education
  These vocational courses can present an access to ~73 million population in China

- The intense competition amongst graduates for white collar jobs spurs the demand in non traditional training
  White collar training (includes English, IT training, exam preparation and management training) is booming fuelled by the highly competitive market for jobs
## Sector profile

### Electronics

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market size</strong></td>
<td>USD 80 billion&lt;sup&gt;1&lt;/sup&gt;</td>
<td>USD 1,600 billion&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>y-o-y</strong></td>
<td>19.0 percent&lt;sup&gt;1&lt;/sup&gt;</td>
<td>14.0 percent&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>Demand supply scenario</strong></td>
<td>Only 38 percent of the demand is met by domestic production; the rest is met through imports&lt;sup&gt;1&lt;/sup&gt;</td>
<td>Exports of electronic and IT products increased 4.5 percent to USD 627.3 billion in 2012. Imports stood at USD 441.2 billion up 3.5 percent during the same period&lt;sup&gt;3&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

### IT

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market size</strong></td>
<td>USD 100 billion&lt;sup&gt;4&lt;/sup&gt;</td>
<td>USD 50 billion&lt;sup&gt;5&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>y-o-y</strong></td>
<td>15.0 percent&lt;sup&gt;4&lt;/sup&gt;</td>
<td>14.0 percent&lt;sup&gt;5&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>Demand supply scenario</strong></td>
<td>The Indian IT sector is primarily geared towards exports, with USD 69 billion of exports out of the total industry size of USD 100 billion in 2012&lt;sup&gt;4&lt;/sup&gt;</td>
<td>Domestic firms account for USD 36 billion of the total USD 50 billion IT market in 2012&lt;sup&gt;4&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

---


<sup>3</sup> Chinadaily, 01-01-2013; http://www.chinadaily.com.cn/ednchina/2013-01/01/content_16294216.htm

<sup>4</sup> NASSCOM Strategic Review 2012

<sup>5</sup> China IT & PO market, Deloitte
Key trends

India

- **Emergence of ESDM segment in electronic sector**
The Indian ESDM (Electronic Services, Design and Manufacturing) industry is expected to reach a size of USD 94 billion by 2015, from USD 65 billion in 2011. Imports will grow to USD 42 billion in 2015 from USD 28 billion in 2012.  

- **India is transforming as manufacturing hub in Electronics sector**
Most large foreign players have started assembling electronic products in the country; however, most of the critical components are still sourced from countries like China and Japan.

- **The IT BPO segment shaped up as a dominant sector in India**
IT-BPO industry is a significant growth catalyst for Indian economy and has grown 11x in the last decade, up from USD 8.2 billion in 2000 to USD 100 billion in 2012.

Exhibit: Indian IT-BPO Exports (USD billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Export (USD billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>50</td>
</tr>
<tr>
<td>2011</td>
<td>58</td>
</tr>
<tr>
<td>2012</td>
<td>68</td>
</tr>
<tr>
<td>2013E</td>
<td>76</td>
</tr>
</tbody>
</table>

Source: NASSCOM Strategic Review 2012

- **Exports of IT services continue to be a major source of revenue for the sector**
The Industry has primarily been export-centric with exports accounting for 67 percent of overall IT-BPO revenues.

China

- **China shapes up a as global hub for electronics**
The Chinese electronics industry has emerged as the dominant force in the sector. In 2011, the nation produced 1.13 billion cell phones, 320 million computers and 120 million television sets, accounting for nearly half the world’s total production.

- **China moves up the value chain in electronics product manufacturing**
The Chinese Electronics and IT industry has come a long way over the past two decades. From producing low-end electronic components in the early 1990’s, the nation has now emerged as the world’s largest manufacturer of high end electronics, making everything from iPhone to LED TV’s.

- **Emerging IT services market**
China is fast developing as a market for IT services. IT Services accounts for nearly 36 percent of total IT-BPO market in China with an overall size of USD 18.6 billion in FY 2012, Global players such as IBM, Fujitsu, Atos Origin, Dell and HP are expanding in China.

Exhibit: China IT Market Growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>14.5</td>
</tr>
<tr>
<td>2012E</td>
<td>13.9</td>
</tr>
<tr>
<td>2013E</td>
<td>14.9</td>
</tr>
<tr>
<td>2014E</td>
<td>10.5</td>
</tr>
<tr>
<td>2015E</td>
<td>11.9</td>
</tr>
</tbody>
</table>

Key drivers of growth

India

- Expanding customer base for Electronic products in India to drive the sector
  Financial inclusion programmes launched by the Government and rising income are generating demand for electronic products besides widening the customer base of existing ones; for instance
  - Mobile device sales in India have been projected at 251 million units in 2013, an increase of 13.5 percent over 2012 sales of 221 million units\(^{13}\)
  - The market for flat panel TVs has sold almost 4.5 million sets and has grown by 50 percent in 2011 compared to 2010\(^{11}\)

- Emerging domestic market for IT services to drive the IT sector
  India’s domestic market is now also gaining traction, partly due to slowdown in US and Europe. Domestic IT-BPO market of India is expected to reach USD 29 billion in FY 2012 from market size of USD 24 billion in FY 2011\(^{12}\)

China

- The stimulus programmes and liberalization policies initiated by the Government to boost Electronic –IT sectors in China
  - In 2009, the Government announced an investment of USD 87 billion over three years in the electronics and IT industry to promote third- generation communication services, digital TVs, and next-generation Internet; In addition, a new stimulus package worth USD 77 billion was announced in 2011, to be spent during the period 2011-16 on the sector\(^{13}\)
  - The Chinese Government has allowed electronics and IT firms to raise capital from State-owned banks at low costs, enabling them to fund their expansion and acquisition plans.

- Renewed focus on new segments to provide fillip to IT-Electronics sector
  Cutting-edge electronic components will be the main areas of investment, including embedded systems, broadband optical fibers and mobile-device components

- Tight and value oriented supply chain drives cross border investments in the sector
  Dell, Sony, Apple tied up with third-party contract manufacturers like Foxconn and Asus, and moved production to China mainly due to value proposition and integrated supply chain

Bajaj Electricals Ltd. has been doing business with China for the last 12 years. Almost 90 percent of the requirement of well known brands in Europe and US are being manufactured in China. While China has an edge over India in products of mass production, India has an edge over China in individually designed products. Thus, the two countries have immense potential for future growth through mutual learning," Shekhar Bajaj, CMD, Bajaj Electricals

Indian products enjoy a high brand equity and can easily fetch a premium of around 10 percent compared to other countries. India and China should consider working together for greater synergies. While China can bank on India’s technical and marketing skills and the advantage of English language; India can bank on China’s economies of scale, lower cost of power and investment,” Shekhar Bajaj, CMD, Bajaj Electricals.

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12. NASSCOM Strategic Review 2012
# Sector profile

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market size</strong> (2011 data)</td>
<td>• USD ~103 billion(^1)</td>
<td>• USD 3,228 billion(^3)</td>
</tr>
<tr>
<td><strong>CAGR</strong> (2006 – 2011)</td>
<td>• 17.0 percent(^4)</td>
<td>• 25.0 percent(^3)</td>
</tr>
<tr>
<td><strong>FDI inflows</strong> (2011)</td>
<td>• USD 3 billion(^2)</td>
<td>• USD 81 billion(^3)</td>
</tr>
</tbody>
</table>

**Key market players**

**Domestic**
- L&T
- Punj Lloyd Group
- GMR Infrastructure
- Jaiprakash Associates Ltd
- Hindustan Construction Company

**Foreign**
- Leighton Welspun Contractors
- Samsung Engineering India
- Tecnomont ICB
- Toyo Engineering India
- UHDE India
- China State Construction & Engineering Corporation
- China Railway Construction Corporation
- China Communication Construction
- Hochtief, First Solar
- Bombardier Inc,
- Suez Environment SA,
- Siemens AGd

\(\text{Note: This is an indicative list and not an exhaustive list}\)
Key trends

India

- **Increased participation of private players is an evident trend in the sector**
  - PPPs have become the preferred mode for construction and operation of commercially viable infrastructure projects in sectors such as highways, airports, ports, railways and urban transit systems
  - In the plan periods from 2007-2008 to 2009-2010, investment in infrastructure increased to 7.1 percent of GDP with one-third participation coming from the private sector. In future, infrastructure investment has expanded 10 percent of GDP for the Twelfth Plan and nearly half of this is envisaged through private resources

- **Administrators realized the competitive advantage of enhanced infrastructure which is marked by increased volumes and values of projects**
  Several projects are in implementation stage across ; the Government has issued contracts worth INR 18.6 billion crore relating to projects in mining, railway, infrastructure, commercial buildings

China

- **Infrastructure development, a top priority for Chinese Government for next 5 years**
  According to the 12th Five-Year Plan, there seems to be a shift in emphasis from the rapid economic growth of previous years to higher quality, sustainable growth for the future through infrastructure development

- **Significant number of projects are under development in China across diverse segments, but prime focus being the road connectivity**
  China’s expressway network has grown annually by over 16 percent, now making it the second largest in the world at over 75,000 km by 2012

- **Active domestic players**
  Chinese players are increasingly undertaking domestic and overseas projects as they have expertise in executing large construction and infrastructure projects
Key drivers of growth

India

- Committed focus of the Government of India to revitalize the infrastructure sector through planned investments and initiatives to boost the sector
  - Planned allocation of 51 percent of the expenditure on infrastructure for roads that form 60 percent of transport network in India
  - The measures include authorizing the Indian Infrastructure Finance Company Limited (IIFCL) to raise additional funds worth INR 300 billion to finance projects worth INR 750 billion
  - Liberalization of the ECBs policy, revision in the cap for home loans to INR 2 million from INR 0.5 million through inclusion in the priority sector

Exhibit: Planned out lay expenditure on infrastructure (INR billion)

<table>
<thead>
<tr>
<th>Plan</th>
<th>Expenditure (INR billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>XII Plan (2012-2017)</td>
<td>48,934.0</td>
</tr>
<tr>
<td>XI Plan (2007-2012)</td>
<td>24,540.0</td>
</tr>
<tr>
<td>X Plan (2002-2007)</td>
<td>10,052.0</td>
</tr>
</tbody>
</table>

Source: KPMG report on Indian infrastructure 2012

- Emphasis on connectivity between industrial corridors and business hubs
  Dedicated freight corridors; DMIC and the National Highway expansion plans (aim to develop 50,000 KM by 2015) will boost the Infrastructure sector

- Renewed focus on integrated infrastructure development to boost the sector
  10 Metro rail projects; One million affordable housing projects; 800 GW power capacity installations and two Industrial corridors

China

- Government policy initiatives
  The National Development and Reform Commission, announced approvals for projects that analysts estimate total more than RMB 1 trillion (USD 157 billion)

- Renewed focus on connectivity projects to boost infrastructure investments
  - China’s railway infrastructure investment will maintain rapid growth, with an estimated investment of USD 100 billion in 2013 and a total of USD 207 billion over the period 2013-2015
  - China approved plans to build 2,018 kilometres (1,254 miles) of road development projects
  - In addition to rail and roads, China announced investments in nine sewage-treatment plants, five port and warehouse projects, two waterway upgrades and subway projects in 18 cities

- Affordable housing project to boost the real estate construction
  The affordable homes project began in 2010 and aims to build 36 million units by 2015 and an estimated USD 160 billion was invested in the program last year

## Sector profile

<table>
<thead>
<tr>
<th></th>
<th><strong>India</strong></th>
<th><strong>China</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market size</strong></td>
<td>USD 29.0 billion&lt;sup&gt;1&lt;/sup&gt;</td>
<td>USD ~74.8 billion&lt;sup&gt;1,2&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>CAGR</strong></td>
<td>16.0 percent&lt;sup&gt;1&lt;/sup&gt;</td>
<td>17.0 percent&lt;sup&gt;1,2&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

### Key market players

#### Domestic
- Cipla
- Lupin
- Sun
- Ranbaxy
- Zydus
- Intas
- DRL
- Mankind

#### Foreign
- Abbott
- GSK
- Pfizer

#### Market structure
- Highly fragmented market with no clear leader
- Highly export driven market with exports contributing to 61 percent of total sector size
- India is home to the most number of USFDA approved plants outside of the US

### Note:
This is an indicative list and not an exhaustive list.

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Key trends

India

- **India strengthens its position as the hub of generics on global pharma landscape**
  - As of 2011, ~31 percent of abbreviated new drug applications (ANDAs) filed worldwide were from India\(^4\)
  - India presently exports generic medicines worth USD 11 billion globally and the penetration is estimated to increase in light of the weak R&D pipelines and the patent cliff\(^4\)

- **Indian generic companies explore new allied segments within the pharmaceutical sector**
  Indian companies continue to explore opportunities in Biosimilars and the market is estimated to be USD 338 million and has been growing at an impressive CAGR of ~30 percent since 2008\(^4\)

- **Progression from cost to value proposition through product development in niche and specialized areas**
  Indian companies have also forayed into production of drugs belonging to niche segments as opposed to vanilla generics; Segments like cardio, respiratory, neuro and oncology are gaining prominence

China

- **Generics continue to remain mainstay of the pharmaceutical sector in China**
  Generics form the backbone of the pharma industry in China and the market has more than 5000 pharma companies – about 98 percent of which produce generic drugs\(^5\)

- **China continues to be a dominant player in bulk drug manufacturing and exports**
  - Currently, more than 100 drug manufacturing sites in China are manufacturing API or drug products for U.S. NDAs (new drug applications) and ANDAs\(^5\)
  - Export value of API is USD 10 billion, with a growth rate of 31 percent, accounting for 53 percent of the exported pharmaceuticals\(^3\)

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04. IBEF Indian Pharmaceuticals report 2011; KPMG Analysis
05. IMS China market prognosis report, KPMG Analysis
Key drivers of growth

India

- Changing demographics and lifestyle patterns result in varied disease conditions thus presenting a huge potential for pharmaceuticals in India
  Lifestyle related disease conditions like Diabetes, Cardio Vascular are on rise; In addition chronic conditions like oncology, central nervous disorders and respiratory disorders are increasing; these shifts drive the domestic pharmaceutical market at an estimated 16 percent y-o-y growth for next five years

- India is fast emerging as a partner of choice in drug development and manufacturing for global pharma giants
  Diverse patient pool, favorable policies, relatively lesser costs drive CRO business; while availability of manufacturing facilities that comply with quality standards like ISO, ICH, GLP, and GCP prompt the surge in contract manufacturing business in India

- Impending patent cliff for biological presents a vital opportunity to Indian players for biosimilar business
  USD 79 billion worth of biologics are expected to go off patent globally by 2015, creating ample opportunity for companies engaged in the manufacturing of biosimilars; Indian companies like Biocon and DRL are main contenders with others estimated to follow the suit

China

- The healthcare reforms introduced by the Government in 2009 present a positive impact on healthcare landscape including pharmaceuticals
  The Government of China increased investment in the healthcare sector to serve a threefold purpose of increasing healthcare accessibility, quality and affordability; thus presenting a vibrant opportunity for pharmaceuticals

- Business policy initiatives by the Government encourage pharmaceutical exporters
  - China is actively promoting its pharmaceutical export industry by providing significant VAT (value added tax) rebates (averaging 13 percent) to pharmaceutical exporters
  - The Govt. of China has invested heavily by providing financial support to ~60 domestic manufacturers of APIs. In turn, the producers are required to produce drugs that meet international quality standards, with the aim of their further exports abroad

06. New business opportunities for Indian pharma companies - Article in Times of India accessed through Factiva dated Feb 21 2013; KPMG article on emerging opportunities for Indian pharma companies post block buster regime
**Sector profile**

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market size</strong> (2011)</td>
<td>• USD 89.0 billion&lt;sup&gt;1&lt;/sup&gt;</td>
<td>• USD 525.0 billion&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>CAGR (2006 – 2011)</strong></td>
<td>• 7.69 percent&lt;sup&gt;1&lt;/sup&gt;</td>
<td>• 25.7 (y-o-y)</td>
</tr>
</tbody>
</table>

**Key market players**

**Domestic**
- Vardhman Textiles
- Welspun India Ltd.
- Alok Industries
- Raymond Ltd
- Garden Silk Ltd.

**Market structure**
- Textile is a highly fragmented industry in India and thus lacks economies of scale
- Apparels, the largest segment of the textile market share, accounted for about 62 percent of the total Industry size in 2011

- Chinese textile industry is highly integrated and organized, as compared to other key textile producing countries in Asia
- China dominates the global textile market in terms of annual production capacity and export revenues for cotton textiles, woolen fabrics and chemical fiber garments

**Exhibit: Textile and Apparel sector**

**The value arc**

- Garmets and Apparels
- Yarn and fabric manufacturing
- Cotton, Wool, Silk and man-made fibers
- Processing
- Raw materials
- Unorganized business
- Organized business
- Finished Products

**Exhibit: Country and apparel production Efficiency percent Analysis (2011)**

- China: 57%
- India: 48%
- Pakistan: 46%
- Cambodia: 43%
- Vietnam: 40%
- Indonesia: 39%
- Bangladesh: 38%

**Note:** This is an indicative list and not an exhaustive list.

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<sup>1</sup> Textiles Compendium - 2012<sup>2</sup> Technopak analysis, June 2012
<sup>2</sup> http://www.businessvibes.com/blog/industry-insight-textile-industry-china-2011, accessed on 21 February 2013

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Textiles & Apparels

Efficiency percentage analysis, a key indicator in the apparel industry suggests the manufacturing unit’s performance. An analysis clearly suggests that China and India are the countries that produced goods at a higher rate of efficiency, and quality thus emphasizing the focus on productivity.

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Spinning (yarn manufacturing) is the organized segment within processing and presents a good scope of business opportunities both in India and China.

Finished products that include garments and apparels manufacturing relatively are highly organized in China and present good opportunity for business investments.

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Note: Efficiency is the measure of the output as compared to a particular input (factor of production), or a combination of all the factors of production. In the context of the apparel industry, it is the ratio of total work produced in minutes against the total minutes spent, as a percentage.
Key trends

India

- India is currently focusing on improving technology in textile and apparel industry in a bid to enhance productivity and thus gain competitive advantage in the sector
The level of technology in the Indian textile sector is growing with financial support from the government’s credit facilitating policies. India needs to bridge the gap in the percentage of shuttle-less looms to total looms

<table>
<thead>
<tr>
<th>Country</th>
<th>Shuttle less to total looms</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>8%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>10%</td>
</tr>
<tr>
<td>China</td>
<td>14%</td>
</tr>
<tr>
<td>Mexico</td>
<td>29%</td>
</tr>
</tbody>
</table>

Source: KPMG in India Analysis

- India continues to be self-reliant across the value chain, but currently faces a supply crunch in fabrics
The usual independent and self-reliant industry is shifting towards mechanization to improve the supply side on finished products (fabric and apparel)

<table>
<thead>
<tr>
<th>Supply Scenario</th>
<th>Fiber ('000 tons)</th>
<th>Yarn ('000 tons)</th>
<th>Fabric*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production (5 year CAGR)</td>
<td>8,655 (4%)</td>
<td>8,655 (4%)</td>
<td>8,655 (4%)</td>
</tr>
<tr>
<td>Imports (5 year CAGR)</td>
<td>337 (2%)</td>
<td>336</td>
<td>1,536 (16%)</td>
</tr>
<tr>
<td>Exports (5 year CAGR)</td>
<td>1,810 (14%)</td>
<td>1,472 (9%)</td>
<td>2,808 (10%)</td>
</tr>
</tbody>
</table>

Source: Textile Compendium-2012; Technopak analysis, June 2012

- The domestic technical textile market is emerging and is the fastest growing segment
This is one of the fastest growing segments of the textile industry. It is likely to grow to USD 31 billion by 2020, implying a CAGR of 10 percent during 2010-2020

China

- Foreign brands are fast gaining prominence in the apparel market, which traditionally was dominated by the domestic brands
Traditionally the domestic players dominated the market through extensive sales channels than their foreign counterparts. However, many foreign apparel brands such as Zara, Gap, M&S, Forever and Ted Baker forayed and have plans to strengthen their presence in China

- China continues to be a dominant exporter of textiles and apparel
Chinese textiles and garments exports reached USD 94.71 billion (grew by 22.9 percent y-o-y) and USD 153.24 billion (grew by 18.4 percent y-o-y), respectively, in 2011

- China currently is focussing on heavy investments in technological advancements to boost efficiency
According to the International Textile Manufacturers Federation (ITMF), between 2000 and 2010, over 55 percent of spinning machines and over 68 percent of weaving machines traded worldwide were imported by China

- Department stores and specialty stores continue to remain prominent distribution channels for apparel distribution
Department stores and specialty stores account for ~65 percent of apparel distribution (2010), while new formats like grocery retailers are fast gaining prominence for branded apparel

Exhibit: Major exporters in global textiles and apparel sector

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>36%</td>
</tr>
<tr>
<td>Europe</td>
<td>26%</td>
</tr>
<tr>
<td>India</td>
<td>4%</td>
</tr>
<tr>
<td>Turkey</td>
<td>4%</td>
</tr>
<tr>
<td>US</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: KPMG in India Analysis

03. “Textiles and Apparels report”; IBEF, November 2011
04. KPMG Analysis
Key drivers of growth

India

- Collaboration with domestic and international players in ramping up facilities likely to prompt robust growth for the textile industry in India
  Domestic mid-sized companies such as Vardhman Textiles and KPR Mills are exploiting the opportunities available across the textile value chain in India by diversifying through backward and forward integration and plan to leverage the integrated plan

- India is witnessing an increased retail penetration across metros and Tier-I,II,III towns, which in turn is a major boost for apparel business
  Textiles and apparel retail comprise about 40 percent of organized retailing in India.
  The share of organized retailing is expected to increase from about 5 percent currently to about 24 percent in 2020

- Favorable business and investment policies initiated by Government of India likely to yield rich dividends for textile and apparels business in India
  - Foreign direct investment (FDI) of up to 100 percent is allowed in the textiles sector through the automatic route. In November 2012, Indian government allowed 100 percent FDI in single-brand retail and 51 percent FDI in multi-brand retail in India
  - Key policy initiatives like Scheme for integrated Textile Parks (SITP), Integrated scheme and Marketing Development Program for power loom cluster development, promotional visits by ministry to the countries such as Japan, Germany, Italy and France to attract foreign investments will drive the sector

China

- The Government initiated ‘Adjustment and Revitalization plan - 2011-2020’ to boost the sector in China
  - Plans for textile industry in Twelfth Five Year Plan of China includes emphasis on domestic consumption, focus on technical innovation and brand building, eliminating obsolete capacity, reduce energy consumption and increase efficiency in the textile industry
  - Raised export tax rebate by 1 percent to 15 percent and encouraged financial institutions to provide credit guarantee and financial support to small and medium-sized units

- The increasing disposable incomes in China provide a major fillip to the garments and apparels business
  Estimates suggest that spending on apparel by high income groups (MHI USD 1,202) will increase by 30 percent a year. China witnessed steep jump in annual per capita disposable income in which grew by 8.4 percent y-o-y to USD 3,490 in Urban areas; Estimates suggest that apparel spending could reach USD 200 billion by 2014
Sector profile

<table>
<thead>
<tr>
<th>Market size (2012)</th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>• USD 92.0 billion¹</td>
<td>• USD 1,241.0 billion²</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CAGR (2008 – 2012)</th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>• 9.5 percent³</td>
<td>• 10.6 percent³</td>
<td></td>
</tr>
</tbody>
</table>

Key market players

Domestic
- Allcargo Logistics
- Transport Corporation of India
- Jet Airways
- Spic & Span
- Container Corp
- Aqua Logistics
- ABC India
- Aegis Logistics
- Gati
- DTDC

Foreign
- China Ocean Shipping (Group)
- PG Logistics
- The S.F. Express Company
- Sinotrans
- Yunnan Logistics Industry Group
- SITC
- CMHICo., Ltd

- DHL
- TNT
- Maersk
- P&O Nedlloyd

Foreign
- DHL
- FedEx
- UPS
- TNT
- APL Logistics
- K+N

Market structure

Exhibit: Share by models of transportation

- India: 60% Road, 31% Rail, 8% Water, 1% Air
- China: 30% Road, 23% Rail, 46% Water, 1% Air

Source: “Logistics Game Changers” – KPMG report 2013

Note: This is an indicative list and not an exhaustive list

3. China’s Logistics Industry Update 2012 - Li & Fung Research Centre
Key trends

India

- Transportation and logistics in India is expected to be the hub of activity
  - The sector is estimated to continue the strong growth at 1-1.3x GDP
  - EXIM in the sector is expected to grow at 15 percent

- The outsourcing and consolidation in the sector is expected to continue as the companies plan to focus on core business
  On an average, companies in India currently outsource an estimated 52 percent of their overall transportation & logistics activities
  However, many more companies are increasingly leaning towards outsourcing and Third Party Logistics (3PL) models as they seek to optimise costs and focus on their core businesses
  This rising trend is catalysing consolidation and scale development in the highly fragmented transportation & logistics industry

China

- Transportation and logistics industry in China is estimated to continue strong growth
  - Steady growth of the logistics market in China is reflected by 2 parameters: logistics demand coefficient and value-added of the logistics industry. The larger the two values, the larger is the market
  - In 2011, the logistics demand coefficient was 3.4, up from 3.2 in 2010. And the value added was RMB 3,200 billion, up by 13.9 percent y-o-y in real terms

- New segments are emerging which also present a decent profit margin for the players in T&L business
  - Road day definite freight (>30 Kg)
  - Road express (< 30 Kg)
  - Air express (< 30 Kg)

Exhibit: T&L – Level of outsourcing

<table>
<thead>
<tr>
<th>Category</th>
<th>Outsourced</th>
<th>In-house</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warehousing</td>
<td>60%</td>
<td>40%</td>
</tr>
<tr>
<td>Transport</td>
<td>90%</td>
<td>10%</td>
</tr>
<tr>
<td>T&amp;L overall industry</td>
<td>52%</td>
<td>48%</td>
</tr>
</tbody>
</table>

Source: KPMG in India Analysis

Exhibit: Logistics demand coefficient, 2007 –2011

<table>
<thead>
<tr>
<th>Year</th>
<th>Logistics demand coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2.7</td>
</tr>
<tr>
<td>2008</td>
<td>2.8</td>
</tr>
<tr>
<td>2009</td>
<td>3.0</td>
</tr>
<tr>
<td>2010</td>
<td>3.2</td>
</tr>
<tr>
<td>2011</td>
<td>3.4</td>
</tr>
</tbody>
</table>

Source: China’s Transport & Logistics market: A research report by Li & Fung Research Centre

Exhibit: China IT Market Growth

Key drivers of growth

**India**

- *Investments are on rise to enhance the road networks; the road networks are critical for the development of T&L sector in India*
  - Rising private investments, growing specialization of project & express logistics, and better quality infrastructure to boost T&L sector
  - Also the PPP projects around road infrastructure development are on rise

**China**

- *The intention to outsource transportation and logistics services by major companies presents a major fillip to the sector or*
  - Traditional functions such as transportation and distribution were the most popular services the surveyed enterprises outsourced
  - It reveals that Chinese enterprises are becoming more open to outsource more advanced logistics functions to LSPs

- *Improving transport infrastructure is key priority for China and this in turn is a major boost for domestic travel and logistics business*
  - The networks of the four modes of transport (road, railway, water and air) have been expanding fast over last 2 years
  - The total fixed assets investment in the logistics industry grew by 19.4 percent to RMB 3,070 billion in 2010
  - Investment in transportation accounted for 75.7 percent of the total fixed assets investment in the logistics industry in 2010

**Exhibit: Investment in Roads (INR billion)**

<table>
<thead>
<tr>
<th>Year</th>
<th>National Highways</th>
<th>State Roads</th>
<th>Rural Roads</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-10</td>
<td>181</td>
<td>326</td>
<td>264</td>
</tr>
<tr>
<td>2010-11</td>
<td>218</td>
<td>373</td>
<td>287</td>
</tr>
<tr>
<td>2011-12</td>
<td>264</td>
<td>388</td>
<td>341</td>
</tr>
<tr>
<td>2012-13</td>
<td>304</td>
<td>445</td>
<td>471</td>
</tr>
<tr>
<td>2013-14</td>
<td>352</td>
<td>471</td>
<td>477</td>
</tr>
</tbody>
</table>

Source: KPMG in India Analysis

**Exhibit: Investment in Roads (RMB billion)**

<table>
<thead>
<tr>
<th>Mode</th>
<th>Y-O-Y Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highway</td>
<td>46.3%</td>
</tr>
<tr>
<td>Railway</td>
<td>24.4%</td>
</tr>
<tr>
<td>Water</td>
<td>12.5%</td>
</tr>
<tr>
<td>Air</td>
<td>20.9%</td>
</tr>
</tbody>
</table>

Source: China’s Transport & Logistics Market: A research report by Li & Fung Research Centre
Business Opportunities
# China and India

Multiple business opportunities exist in sectors of mutual interest

## Business opportunities

<table>
<thead>
<tr>
<th>Sector</th>
<th>For China in India</th>
<th>For India in China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Agri &amp; Food processing</strong></td>
<td>• Farm inputs like seeds, fertilizers, plant protection present significant opportunities; though different international players exist bringing quality product at an affordable price is need of the hour. Chinese companies are known for their capabilities in processed chemicals and can leverage the expertise to tap Indian market. Only 2.2 percent of the fruits and vegetable produce is processed in India presenting a huge scope for food processing.</td>
<td></td>
</tr>
<tr>
<td><strong>Asset management</strong></td>
<td>• The penetration of certain financial services is low in India, for instance, penetration of Mutual Fund - 4 percent, PF and Pension - 6 percent, Insurance – 18 percent, ETFs are a huge emerging opportunity.</td>
<td>• The country’s asset-management market will grow by 24 percent annually for the next ten years. More than 27 foreign asset managers have entered China in the past five years, through JVs and minority stakes. Indian companies can look at significant opportunities in investment, retirement, and insurance needs.</td>
</tr>
<tr>
<td><strong>Construction &amp; Infrastructure</strong></td>
<td>• For the Twelfth Five Year Plan (2012-17), GoI is planning to invest around USD 1 trillion in infrastructure sector. Investments would span across road, oil and gas, power, ports, airports etc among others.</td>
<td>• Opportunities exist for foreign companies in China's civil and heavy engineering sectors such as power generation, transportation and water distribution. During the Twelfth Five Year Plan (2011-15), China is planning to spend around USD 370 billion in construction of railway network.</td>
</tr>
<tr>
<td><strong>Pharmaceuticals</strong></td>
<td>• The Indian pharmaceutical industry imports majority of active pharmaceutical ingredient and intermediates worth USD 3.07 billion from China. China’s increasing capability of mass manufacturing is able to meet the API needs of both developed and developing economies. There is ample opportunity for India firms to collaborate with Chinese manufacturers for API production.</td>
<td>• Indian pharmaceutical companies are know for formulations development with technical know-how on finished dosages. In addition, India brings expertise in development of New Drug Delivery systems and biosimilars. There is opportunity for Indian companies to leverage the fast growing Chinese generics market and supply affordable and authentic generics.</td>
</tr>
<tr>
<td><strong>Electronics &amp; Information technology</strong></td>
<td>• The Indian domestic demand for electronics products is expected to reach USD 125 billion by 2014. The fact that the China has successfully leveraged the domestic demand for electronic products to support the creation of global product companies from China, is well known, and leveraging the same capabilities, Chinese companies can address the potential in India. Traditionally Indian IT companies set up in China as near shore centres to serve their Japanese, S. Korean and Taiwanese clients and global multinationals based in China. Increasingly, Indian companies are looking at Chinese centres as integral part of their global delivery model to serve American, European markets in addition to IT service requirements in Chinese market.</td>
<td></td>
</tr>
</tbody>
</table>
Cross border collaborations

Chinese infrastructure companies’ collaboration with Indian counterparts to develop critical infrastructure projects in India

<table>
<thead>
<tr>
<th>Project details</th>
<th>Total investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jiangsu Provincial Transportation Engineering Group Co. Ltd (JPTEGC) implementing two road construction projects with JV partners</td>
<td>USD 200 million</td>
</tr>
<tr>
<td>— Srinagar-Banihal project (Ramkay Infrastructure)</td>
<td>USD 70 million</td>
</tr>
<tr>
<td>— Priprakothi-Mothari-Raxaul project (Tantia Construction)</td>
<td></td>
</tr>
<tr>
<td>Shanghai Electric Group Co signed a contract to supply power equipment to India’s Reliance Power Ltd</td>
<td>USD 10 billion</td>
</tr>
<tr>
<td>Power Construction Corporation of China won a bid to build a power plant in south India for India’s Infrastructure Leasing &amp; Financial Services Limited</td>
<td>USD 2.4 billion</td>
</tr>
<tr>
<td>China Railway 18th Bureau (Group) Corporation Ltd and ESSEL Infra JV has been awarded the four-laning of Ahmedabad to Godhra road project</td>
<td>USD 220 million</td>
</tr>
</tbody>
</table>

Key Indian agri and process chemicals businesses invested in China to leverage the booming farm mechanization and chemical opportunities

<table>
<thead>
<tr>
<th>Project details</th>
<th>Total investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mahindra (China) Tractor Ltd (M CTCL)</td>
<td>M CTCL (Established 2005) &lt;br&gt;JV between M&amp;M and China’s Jiangling Motor Company</td>
</tr>
<tr>
<td>Mahindra Yeuda Yancheng Tractors Company Limited (MYYTCL)</td>
<td>MYYTCL (Established 2008) &lt;br&gt;JV between M&amp;M and China’s Jiangsu Yueda Yancheng Tractor Manufacturing Co. Ltd &lt;br&gt;Tractor volumes of M&amp;M China crossed 30,000 mark for the first time in 2011-2012.</td>
</tr>
<tr>
<td>Synthite Industrial Chemicals (Kochi based chemical company)</td>
<td>Acquired a China based natural specialities and color manufacturer for INR1,590 million. The firm is based at Xinjian in the southern Jiangxi province.</td>
</tr>
</tbody>
</table>
Business opportunities exist, but only if the two countries overcome certain regulatory and trade barriers

## Doing Business Indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Market opportunity</th>
<th>Regulations *</th>
<th>Market opportunity</th>
<th>Regulations *</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td></td>
<td></td>
<td>India</td>
<td></td>
</tr>
<tr>
<td>Agri &amp; food processing</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Asset management</td>
<td></td>
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<tr>
<td>Banking</td>
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<td></td>
</tr>
<tr>
<td>Education</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Electronics &amp; IT</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Infrastructure &amp; Construction</td>
<td></td>
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</tr>
<tr>
<td>Pharmaceuticals</td>
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</tr>
<tr>
<td>Textiles</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transportation &amp; Logistics</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Regulations include permission to start new business, trade barriers created

- High Opportunity
- Good Opportunity
- Medium Opportunity

For regulations
- Least level of regulations and business friendly environment;
- Highest level regulations and trade barriers

Source: KPMG in India Analysis

Note: This is a preliminary analysis. For more opportunities and regulatory assessment, a deep dive for respective sectors is recommended.

While India and China undoubtedly present immense opportunities for respective businesses across key sectors for their mutual interest, it is evident that both have a lot more home-work to do and explore these opportunities.

The challenge lies in being able to identify how the two could get past the political and cultural differences to benefit from each other’s experience and expertise.
Towards collaboration for economic competitiveness

Cross border collaborations
It is time that China and India understand the strengths and weaknesses of each other to retool strategies and policies to boost economic competitiveness.

Leverage the advantages
China and India present various advantages for businesses; advantages that are complimentary and synergistic; and the key to success lies in leveraging the advantages.

From conflict to collaboration
Setting aside the conflicts if governments and businesses on both sides of the border have to collaborate and shape themselves as best countries to create, cultivate and innovate.
India and China are undoubtedly the leading growth centres of the world. Though their strong growth is based on varied models and has been supported by a host of factors, including policy support and favorable demographics among others, the very essence of their growth is undergoing a change. For instance, population will age over time, trade as an engine of China’s growth is already losing its steam and government policies keep altering to address the most crucial of issues. Thus, achieving sustainable high growth is a challenge.

Positively, altering government policies in sync with changing global economic environment is expected to play a crucial role in boosting growth. This is because the scope of policy support is vast and ranges from facilitating investment (both domestic and foreign), to production, to consumption, to trade (bilateral and multilateral), to currency, to sector growth etc.

Strong economic growth during the last decade and projected high growth in future have already made India and China as the economic power houses bringing in higher foreign investment and increasing business opportunities manifold. Their contribution to global trade, especially that of China’s has already made several economies depend on it.

However, bilateral trade between India and China remains limited, compared to their global trade. This underlines the potential to increase trade between the two, especially given the complimentary production pattern. While India can gain from China’s strong presence in the manufacturing sector, China can gain from India’s strong presence in the services sector.

For instance, China presents itself as a good location for business for Indian IT companies. Several Indian IT companies have invested in China to cater to their clients in Asia-Pacific region, especially in Japan and multinational companies located in China. Now with domestic market also opening up for IT services, it’s time that Indian IT companies seek more market access in this area.

Further, recent policies in China that aim to boost West and Central regions through heavy investments in infrastructure, transport & logistics, agriculture and food processing present critical opportunities for Indian companies.

Likewise, Chinese manufacturing sectors such as toys, clothing, electronics, power equipment etc. have been doing substantial business in India.

Emulating the efforts of the central government, several state governments have also worked on ensuring conducive business environment and multitude of business opportunities to foreign investors, including from China.

Currently, the trade balance between India and China is substantially in favour of China. Even though the Indian government is urging the Chinese government to grant access to certain categories of products like pharmaceutical and agro products and encourage imports from India, we could be looking at least a few more years of trade deficit for India by the time the trade in these sectors begin to impact the overall numbers.

Another important area of collaboration that is underleveraged is the financial services and banking sector. With the growth and development of tier two cities in both India and China given the need for rapid urbanization and increasing disposable incomes, present vital opportunities for the two countries to collaborate and strengthen the nerve centres of the economy.

Likewise, there are several sectors, where the bilateral potential remains untapped, such as transportation and logistics, pharmaceuticals etc. This may be so due to a host of factors such as regulation, capital considerations, trade barriers, procedures, etc. Thus, these are some sectors that must be looked into, especially transportation, where India could learn a lot from China.

The latter’s improved technology, especially in the field of high speed trains, will certainly prove beneficial for India.

Thus, the two countries can share their best technologies for increased mutual growth.

Another key learning for India on the technology front would be the economies of scale, which China has been synonymous with. Infact, this is one of the important factors for China’s competitive advantage in the global market.

The role of the SME sector has been important in the same. Though several industries in India also thrive on production by the SMEs, the share of the same in India’s GDP is small compared to China. This could be an area of consideration for India.

Further, the scope of mutual learning may be enhanced to cover government policies such as economic growth models, planning and implementation, etc.

For instance, China has appreciated India’s economic growth policy of domestic demand, and trying to follow the same; while India appreciates China’s economies of scale and is considering ways of imbibing the same. While India may also like to draw some lessons on robust planning, China could learn from Indian on how to increase consumption beyond the metros and tier-I cities.

In addition to mutual learning, some other growth reinforcing measures would be increased collaboration, bilateral talks, reduction of duties or tax rates and above all develop stronger trust. Thus, the task that lies ahead is to continuously engage with each other, build stronger relationships, both culturally and economically for a long term benefit to both countries.

Thus, the two dynamic powerful economies that are traversing the path of attaining global competitiveness, can do so through mutual learning on economic and sectoral policies and reforms to ensure high sustainable economic growth.

This needs to be supported by a holistic and integrated approach for addressing some crucial issues such as development of social infrastructure along with physical infrastructure, conservation of natural resources etc. would go a long way in sustaining growth.
Doing business in India
India follows a ‘residence’ based taxation system. Broadly, taxpayers may be classified as ‘residents’ or ‘non-residents’. A ‘resident’ individual taxpayer may also be classified as ‘not ordinarily resident’.

A ‘tax year’ means the financial year which runs from 1 April to 31 March of the following calendar year. Any income pertaining to the ‘tax year’ (known as previous year) is offered to tax in the following year (known as the assessment year).

Generally, the global income of domestic companies, partnerships and local authorities is subject to tax at flat rates, whereas individuals and other specified taxpayers are subject to progressive tax rates. Foreign Companies and non-resident individuals are also subject to tax at varying rates on specified income which is received/accrued or deemed to be received/accrued in India.

Recently, the Union Budget 2013-2014 was presented and the amendments proposed in the Finance Bill, 2013 are yet to be enacted.

Residential status

Individual

Depending upon the period of physical stay in India during a given tax year (and the preceding ten tax years), an individual may be classified as a resident, a non-resident or a ‘not ordinarily resident’ in India.

Company

A resident company is a company formed and registered under the Companies Act, 1956 or one whose control and management is situated wholly in India. An Indian Company (being a company formed and registered under the Companies Act, 1956) by definition is always a resident. A non-resident company is one whose control and management is situated wholly outside India.

Kinds of taxes

Corporate income tax – Indian Company

A resident company is taxed on its global income. Income tax @ 30 percent is levied on income earned during a tax year. Further, a Surcharge @ 5 percent shall be levied if the total income exceeds INR 10 million. The Finance Bill, 2013 proposes to introduce a surcharge @ 10 percent if the total income exceeds INR 100 million. Education cess is applicable at 3 percent on income tax (inclusive of surcharge, if any).

Alternatively, a company is required to pay Minimum Alternate Tax (MAT) at 18.5 percent on the adjusted book profits in the case that the book profits are less than the taxable income of the Company. A Surcharge @ 5 percent shall be levied if the presumptive income exceeds INR 10 million. The Finance Bill, 2013 proposes to introduce a surcharge @ 10 percent if the presumptive income exceeds INR 100 million. Education cess is applicable at 3 percent on income tax (inclusive of surcharge, if any).

Dividend Distribution Tax (DDT) at 16.995 percent (including surcharge of 10 percent and education cess) is liable to be paid on the dividend declared, distributed or paid by a domestic company.

Dividend income received by an Indian Company from Foreign Companies would be taxed at 15 percent (plus applicable surcharge and education cess) provided it holds at least 26 percent in nominal value of equity share capital of the foreign company.

Further, the Finance Bill, 2013 proposes to levy an additional income-tax at the rate of 22.66 percent (inclusive of applicable surcharge and education cess) on specified distributed income of unlisted domestic companies that buy back shares from shareholders.

Tax at specified rates/basis is levied on income arising from specified sources of business, viz. business of shipping, insurance.

Securities Transaction Tax (STT)

STT is levied on the value of taxable securities transactions on specified category of shares, derivatives and units of Mutual Funds at specified rates.

Commodity Transaction Tax (CTT)

CTT is proposed to be levied under the Finance Bill, 2013 (effective from a date to be notified) on the sale of a commodity derivative (other than agricultural commodities) entered in a recognised association.

Wealth Tax

Wealth tax is leviable on specified assets at one percent on the value of the net assets as held by a taxpayer (net of debts incurred in respect of such assets) in excess of the basic exemption of Rupees three million.01 Surcharge @ 5/10 percent shall be levied if the total income exceeds INR 10/100 million, respectively. Education cess is applicable at 3 percent on income tax (inclusive of surcharge, if any). The additional increase in surcharge whenever applicable shall only be levied for a period of one year.
Capital gains tax

The profits arising from the transfer of capital assets are liable to be taxed as capital gains. Capital assets include all kinds of property except stock-in-trade, raw materials and consumables used in businesses or professions, personal effects (except jewellery), agricultural land and notified gold bonds.

Long-term capital gains arise from assets held for 36 months or more (12 months for shares, units, etc.) and are eligible for indexation benefit. Gains arising from transfer of long-term capital assets are taxed at special rates/eligible for certain exemptions (including exemption from tax where the sale transaction is chargeable to STT). Short-term capital gains arising on transfer of assets other than certain specified assets are taxable at normal rates.

• The individual’s stay in India does not exceed 90 days
• The payment made is not deducted in computing the income of the employer.

Remuneration received by a non-resident employed on a foreign ship is exempt from tax provided his/her stay in India does not exceed 90 days.

Foreign Companies

A non-resident company is taxed at 40 percent on income which is received/accrued or deemed to accrue/arise in India. Further, a Surcharge @ 2/percent shall be levied if the total income exceeds INR 10 million. The Finance Bill, 2013 proposes to introduce a surcharge @ 5 percent if the total income exceeds INR 100 million. Education cess is applicable at 3 percent on income tax (inclusive of surcharge, if any).

Taxability of non-resident Indians

Non-resident Indians are also liable to tax in India on a gross basis depending upon the type of income received.

Foreign nationals

Foreign nationals are liable to tax in India depending upon their residential status. Indian tax law provides an exemption of income earned by employees of a foreign enterprise for services rendered in India, subject to the following conditions:

• The foreign enterprise is not conducting any trade or business in India

Tax rates

Individuals (excluding women and senior citizens) are liable to tax in India at progressive rates of tax as follows:

<table>
<thead>
<tr>
<th>Country/Region</th>
<th>Basic Tax Rates (e)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to INR 200,000 (a)(b) (USD 3,636)²</td>
<td>NIL</td>
</tr>
<tr>
<td>INR 200,001 to INR 500,000 (c) (USD 3,636 – 9,090)</td>
<td>10%</td>
</tr>
<tr>
<td>INR 500,001 to INR 1,000,000 (USD 9,090 – 18,182)</td>
<td>20%</td>
</tr>
<tr>
<td>INR 1,000,001 and above (d) (USD 18,182)</td>
<td>30%</td>
</tr>
</tbody>
</table>

**a.** In the case of a resident individual of the age of 60 years or above but below 80 years, the basic exemption limit is INR 250,000 (USD 4,545)

**b.** In the case of a resident individual of the age of 80 years or above, the basic exemption limit is INR 500,000 (USD 9,091)

**c.** The Finance Bill, 2013 proposes to introduce a rebate from tax of upto INR 2,000 available for a resident individual whose total income is below INR 500,000

**d.** The Finance Bill, 2013 proposes to introduce a 10 percent surcharge if the total income exceeds INR 10,000,000. Marginal relief is available.

**e.** Education cess is applicable @ 3 percent on income tax (inclusive of surcharge, if any)
Modes of taxation

Gross basis of taxation
Interest and Royalties/Fees for Technical Services (FTS) earned by non-residents are liable to tax on a gross basis at 20 and 25 percent (including surcharge and education cess) respectively. However, tax treaty protection may be available. Further, a Surcharge @ 2 percent shall be levied if the total income exceeds INR 10 million. The Finance Bill, 2013 proposes to introduce a surcharge @ 5 percent if the total income exceeds INR 100 million. Education cess is applicable at 3 percent on income tax (inclusive of surcharge, if any).

Presumptive basis of taxation
Foreign Companies engaged in certain specified business activities are subject to tax on a presumptive basis.

<table>
<thead>
<tr>
<th>Activity</th>
<th>Basis of taxation</th>
<th>Effective tax rate (including surcharge and education cess)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and gas services</td>
<td>Deemed profit of 10 percent of revenues</td>
<td>4.2024/4.326%</td>
</tr>
<tr>
<td>Execution of certain turnkey contracts</td>
<td>Deemed profit of 10 percent of revenues</td>
<td>4.2024/4.326%</td>
</tr>
<tr>
<td>Air transport</td>
<td>Deemed profit of 5 percent of revenues</td>
<td>2.1012/2.16%</td>
</tr>
<tr>
<td>Shipping operations</td>
<td>Deemed profit of 7.5 percent of freight revenues</td>
<td>3.1518/3.24%</td>
</tr>
</tbody>
</table>

Withholding of Taxes
Generally, incomes payable to residents or non-residents are liable to withholding tax by the payer (in most cases individuals are not obliged to withhold tax on payments made by them), except where preferential tax rates are provided for under a DTAA. Under the Act, the payments to Foreign Companies/non-residents are subject to the following withholding tax rates:

<table>
<thead>
<tr>
<th>Type of income</th>
<th>Foreign Companies#</th>
<th>Other non-residents*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest on foreign currency loan</td>
<td>20 percent</td>
<td>20 percent</td>
</tr>
<tr>
<td>Interest payable on External Commercial Borrowings borrowed between 1 July 2012 to 1 July 2015</td>
<td>5 percent</td>
<td>5 percent</td>
</tr>
<tr>
<td>Royalties and technical services fee approved by the Government or in accordance with the industrial policy</td>
<td>25 percent</td>
<td>25 percent</td>
</tr>
<tr>
<td>Long term capital gains</td>
<td>20 percent</td>
<td>20 percent</td>
</tr>
<tr>
<td>Any other income</td>
<td>20 percent</td>
<td>20 percent</td>
</tr>
</tbody>
</table>

# Surcharge of 2 percent (if the total income exceeds INR 10 million but not more than INR 100 million) plus education cess of 3 percent on income tax including surcharge is to be levied. Surcharge of 5 percent (if the total income exceeds INR 100 million) plus education cess of 3 percent on income tax including surcharge is to be levied.

* The Finance Bill, 2013 proposes to introduce a surcharge @ 10 percent if the total income exceeds INR 10,000,000. Education cess of 3 percent on income tax and surcharge is to be levied.

Carry forward of losses and unabsorbed depreciation - Subject to the fulfillment of prescribed conditions
Business loss (including that of speculation business), unabsorbed depreciation, and capital loss (long-term as well as short-term) can be carried forward and set off as per the prescribed provisions of the law. Business losses can currently be carried forward for a period of eight years.
Corporate reorganizations

Corporate re-organisations, such as mergers, demergers and slump sales, are either tax neutral or taxed at concessional rates subject to the fulfillment of the prescribed conditions.

Limited Liability Partnerships

LLPs are subject to Alternate Minimum Tax while provisions dealing with DDT do not apply to an LLP.

The conversion of a private company or unlisted public company into an LLP is exempt from tax subject to prescribed conditions.

Relief from Double Taxation

India has entered into DTAA with more than 80 countries. Generally, provisions of DTAA prevail over the domestic tax provisions. However, the domestic tax provisions may apply to the extent that they are more beneficial to the taxpayer.

India has also entered into Tax Information Exchange Agreement with some territories for eg. Bermuda, Isle of Man, Bahamas, British Virgin Islands, Cayman Islands, etc.

Authority for Advance Rulings (AAR)

A scheme of advance rulings is available to an applicant (who may be either a non-resident or a resident who has entered into a transaction with a non-resident) with respect to any question of law or fact in relation to the tax liability of the non-resident, arising out of a transaction undertaken or proposed to be undertaken.

The advance rulings are binding on the tax authorities as well as the applicant. However, they can be challenged by filing a writ petition before the High Court.

Advance rulings help non-residents and residents having transactions with a non-resident in planning their income tax affairs well in advance and bring certainty in determination of income tax liability. They also help in avoiding long drawn and expensive litigation in India.

Anti-Avoidance Measures

The provisions of General Anti-Avoidance Rules (GAAR) are proposed to be made operative from financial year 2015-2016. Under GAAR, an arrangement is to be treated as an impermissible avoidance arrangement only if the main purpose is to obtain tax benefit. Further, an arrangement is deemed to lack commercial substance if it has no significant effect on the business risks or net cash flows of any party to the arrangement other than tax benefit attached. An Approving Panel will be constituted comprising of a Retired Judge of a High Court and outside experts to issue directions on the applicability of GAAR in each case.

Venture Capital Companies (VCC)/Venture Capital Funds (VCF)

Any income of a VCC or VCF from investments in a Venture Capital Undertaking (VCU) shall be exempt from tax subject to fulfilment of certain conditions. The provisions of withholding tax and Dividend Distribution Tax are not applicable to the income paid by VCF/VCC to the investors.

Securitisation Trust

The Finance Bill, 2013 provides that income from the activity of securitisation of the Securitisation Trust regulated by Securities Exchange Board of India/Reserve Bank of India shall be tax-exempt. Income distributed bears distribution tax at 25 percent (Individual/ HUF) and 30 percent (others) and is tax-exempt for investors.

Tax Incentives

Special Economic Zones

The Special Economic Zone Scheme is administered by the Ministry of Commerce through the Board of Approvals (at Centre level) and through the concerned Development Commissioner (at SEZ level). The Scheme is operated through the Special Economic Zone Act, 2005 and Special Economic Zone Rules, 2006.

Units set up in SEZs

A unit which sets up its operations in SEZ is entitled to claim tax holiday for a period of 15 years commencing from the year in which such unit begins to manufacture or produce articles or things or provide services. The tax holiday of 15 years is as under:

- 100 percent for first five years;
- 50 percent for the next five years (without restriction with respect to creation and creation of reserves)
- 50 percent for the next five years (with restriction with respect to creation and creation of reserves)

The benefits are available against export profits.

However, MAT and DDT provisions are applicable to the SEZ units.

SEZ developer

A 100 percent tax holiday (on profits and gains derived from any business of developing an SEZ) for any ten consecutive years out of 15 years has been provided to undertakings involved in developing SEZs. However, with effect from financial year 2011-12, MAT and DDT provisions are applicable to the SEZ developers.

Offshore Banking Units (OBUs) and International Financial Services Center units (IFSCs) set up in SEZs

OBUs and IFSCs located in SEZs are entitled to tax holidays of 100 percent of income for the first five years (commencing from the year in which permission to set up OBU or IFSC is obtained) and 50 percent for next five consecutive years. However, with effect from financial year 2011-12, MAT and DDT provisions are applicable to the SEZ developers.
In-house research and development
A weighted deduction at the rate of 200 percent of the scientific research expenditure incurred (excluding expenditure on the cost of land or buildings) on an in-house research and development facility is allowed as a deduction while computing the income of a taxpayer which is engaged in the business of manufacture or production of any article or thing other than a prohibited article or thing listed in the Eleventh Schedule.

Transfer Pricing in India

**Scope and Applicability**
The price of any transaction between “associated enterprises”, either or both of whom are non-resident for Indian income tax purposes, shall be computed having regard to the arm’s length price (ALP). Two enterprises are considered to be “associated enterprises” if there is direct/indirect participation in the management or control or capital of an enterprise by another enterprise or by same persons in both the enterprises. The Act also defines specific situations wherein two enterprises shall be deemed to be associated enterprises. The definition of international transactions, along with the routine transactions of purchase and sale of goods and services, also includes guarantees, any debt arising during the course of business (e.g. credit period on outstanding receivables), business re-organizations and restructurings, intangibles (defined in detail) etc.

The applicability of the TP regulations has recently (vide Finance Act 2012) been extended to profits arising from transactions between domestic related parties under certain specified circumstances. This shall apply in cases where the aggregate amount of all such domestic transactions exceeds INR 50 million (approximately USD 1 million) in a year.

**Determination of Arm’s Length Price**
The Indian Transfer Pricing Regulations require the arm’s length price in relation to an international transaction to be determined by any one of the following methods, being the most appropriate method (MAM):

- Comparable uncontrolled price (CUP) method
- Resale price method (RPM)
- Cost plus method (CPLM)
- Profit split method (PSM)
- Transactional Net Margin Method (TNMM)
- Other Method

In a case where more than one price is determined by the MAM, the arm’s length price shall be taken to be the arithmetical mean of such prices. Up till now, the Transfer Pricing Regulations provided for an arm’s length variation of +/-5 percent to the value of the international transaction. The Finance Act 2012 introduced an amendment in this regard and an upper ceiling of 3 percent was fixed as the tolerance range for determination of the ALP. This is applicable from financial year 2012-13 onwards. Till date, no notification has been issued regarding the exact range for determination of the ALP.

**Transfer Pricing Audits**
Transfer pricing matters are dealt with by specialized Transfer Pricing Officers duly guided by Directors of International Taxation, being part of the Indian tax administration. In accordance with the internal administrative guidelines issued to the Revenue Authorities, all taxpayers reporting international transactions with associated enterprises exceeding INR 150 million are subject to a mandatory transfer pricing audit.

**Safe Harbor Rules**
The Central Board of Direct Taxes (CBDT) has been empowered to introduce Safe Harbor provisions aimed at minimizing disputes relating to transfer pricing matters. ‘Safe Harbour’ has been defined to mean ‘circumstances’ in which the Revenue Authorities shall accept the transfer prices declared by the taxpayers - i.e. such taxpayers would not be subject to transfer pricing scrutiny.

**Investment allowance**
The Finance Bill, 2013 provides for an Investment allowance at 15 percent on investments made by a manufacturing company in new Plant and Machinery acquired and installed between 1 April 2013 and 31 March 2015 if the same exceeds INR 1 billion.

**Advance Pricing Agreements**
Advance Pricing Agreements (APAs) have been introduced in India vide the Finance Act 2012 and the Rules governing the APA regime have been notified by the CBDT. The APA provisions in India provide for Unilateral/Bilateral/Multilateral APAs. The legislative framework for APAs provides that APAs can be entered into with any person undertaking an international transaction which shall include specifying the manner in which ALP shall be determined in relation to an international transaction. The manner of determination of ALP in an APA shall be any of the 6 methods prescribed in the Indian legislation or any other method, with necessary adjustments or variations. APAs shall have validity for a maximum of consecutive 5 years and shall be binding only on the tax payer signing it and the corresponding tax authorities. An APA shall not be binding if there is any change in law or facts having bearing on such APA.

**Mutual Agreement Procedure**
The taxpayers can choose a Mutual Agreement Procedure (MAP) to resolve bilateral/international tax transfer pricing issues with certain foreign jurisdictions depending on the provisions in the relevant DTAs. The Revenue Authorities have issued notifications whereby, subject to the satisfaction of certain conditions and depending on the relevant foreign jurisdiction, the taxpayers choosing the MAP process may not need to pay the tax demand until the closure of the MAP proceedings, subject to the furnishing of a bank guarantee.

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05 The date has been proposed to be extended for a period of one year upto 31 March 2014 by the Finance Bill, 2013.
**Customs Duty**

Customs duty is applicable on import of goods into India. It is payable by the importer of the goods.

Customs duty comprises of the following elements:

- **Basic Customs Duty (BCD)**
- **Additional Customs Duty (ACD)** (this is levied in lieu of CENVAT, i.e., excise duty and is applicable on goods manufactured in India)
- **Education Cess (E-cess)**
- **Secondary and Higher Education cess (SHE-cess)**
- **Special Additional Duty (SAD) (this is levied in lieu of Value Added Tax (VAT), applicable on sale of goods in India).**

The applicable customs duty rate on the import of any goods into India is based on the universally accepted Harmonised System of Nomenclature (HSN) code assigned to the said goods.

The generic BCD rate is 10 percent at present and the effective customs duty rate (i.e., the aggregate of the abovementioned components, i.e., BCD, ACD, SAD and cesses) is 28.85 percent (with BCD at 10 percent, ACD at 12 percent, SAD at 4 percent and cesses at 3 percent). The ACD paid as part of customs duty would be available as a CENVAT credit (set-off) to the manufacturers/service providers using the imported goods as inputs/capital goods in their manufacturing/for provision of services. The SAD paid as part of customs duty would be available as credit to the manufacturer. For a trader, this SAD is available as a cash refund (subject to the prescribed procedure) if State VAT has been paid on subsequent sales of the imported goods.

**CENVAT**

CENVAT, also known as excise duty, is applicable on manufacture of goods in India. It is payable by the person undertaking the manufacturing activity. It is recoverable from the buyer of the goods. The applicable CENVAT rate on the manufacture of any goods in India is based on the universally accepted HSN code assigned to the said goods. The generic CENVAT rate is 12.36 (including 2 percent E-Cess and 1 percent SHE-cess). The CENVAT paid on raw materials used in the manufacture of finished products is available as set-off against the CENVAT liability on manufacture of such finished goods, subject to satisfaction of prescribed procedures. The benefit of set-off is also available on the service tax which has been paid on services used by the manufacturer.

**Service Tax**

Service tax is applicable on provision of all services (except specified in negative list and exemption notifications) when provided in the taxable territory. The generic service tax rate is 12.36 (including 2 percent E-Cess and 1 percent SHE-cess). Generally, the service tax is payable by the service provider except in certain specified cases where the recipient is liable to pay it. Also, in cases of import of services, where the service provider is a non-resident, the service recipient in India would become liable to discharge the service tax liability on reverse charge basis. The service tax law also provides for zero rating of services which are exported outside India subject to fulfillment of prescribed conditions. The service tax paid on the services received can be used as set-off against the liability of service tax on provision of services. The benefit of set-off is also available on CENVAT which has been paid on raw materials/capital goods used by the service provider.

**Central Sales Tax (CST)**

India has both Central and State level indirect tax levies on sale or purchase of goods. Sale transactions which involve movement of goods within the same State are subject to levy of local State VAT, whereas sales which involve inter-State movement of goods are subject to CST in terms of the provisions of the Central Sales Tax Act, 1956. The rate of CST is equivalent to the VAT rate prevailing in the State from where the movement of goods has commenced. There is a concessional rate of two percent, if the buyer can issue a declaration in Form C subject to fulfillment of specified conditions. CST paid by the buyer while procuring the goods is not available as set-off for payment against any liability and hence is a cost to the business.

**VAT**

VAT is applicable on sale of goods where the movement of goods from the sale is within the same State. Each State has different laws for levy of VAT and schedules of rates on various goods. It is pertinent to note that the VAT paid to vendors for procurement of goods can be availed as input tax credit (set-off) against discharge of VAT or CST liability on sale of goods. Certain VAT/CST incentives are available to units set up in specified backward areas of the States. Such incentives would be in the nature of concessional rate of VAT/CST or of remission of VAT/CST or deferred payment of VAT/CST.

**Foreign Trade Policy (FTP)**

The FTP is outlined by the Ministry of Commerce and provides a broad policy framework for promoting exports and regulating imports into the country.
The FTP outlines various export promotion schemes for enterprises in designated areas such as Software Technology Parks and Export Oriented Units which enable them to procure the raw materials free from customs duty/ CENVAT. The FTP also outlines various export promotion schemes providing benefits such as import of goods at Nil or concessional customs duty rates if the goods manufactured/services provided are exported subject to fulfillment of prescribed export obligations.

**Entry Tax**

Entry tax is levied on the entry of specified goods into a State for use, consumption or sale therein. The entry tax rate varies from State to State and are applicable only on specified goods. Certain States provide for a set-off of entry tax paid against the VAT payable on the sale of goods in such State.

**Octroi**

Octroi is levied on the entry of specified goods into a specified municipal limit/local areas (for e.g. Mumbai) for use, consumption or sale therein. Presently, Octroi is levied only in certain areas of the State of Maharashtra.

The Octroi rate vary from Nil to seven percent across municipal areas and also depends upon the nature of the goods. No set-off of Octroi paid is available against any liability and hence is a cost to the business.

**Local Body Tax (LBT)**

Presently, LBT is levied only in certain areas of the State of Maharashtra. LBT is levied on the entry of specified goods into a specified municipal limit/local areas (for e.g. Kolhapur, Solapur, Vasai-Virar) for use, consumption or sale therein. The LBT rate vary from Nil to seven percent across municipal areas and also depends upon the nature of the goods. No set-off of LBT paid is available against any liability and hence is a cost to the business.

**Research and Development Cess (R&D Cess)**

R&D Cess is leviable at the rate of 5 percent on import of technology directly or through deputation of foreign technical personnel under a foreign collaboration.

**Other Local Taxes**

Besides the above mentioned taxes, there are certain local taxes applicable within specific areas of certain identified cities, towns, villages, etc., e.g. agricultural produce market cess and mandi tax, entertainment tax on entertainment activities, luxury tax on luxury, etc. Such taxes are generally levied on the removal of goods from the specified locations. No set-off of such taxes paid is available and hence such taxes would form part of the cost of procurement.

**Goods and Services Tax (GST)**

The Indian indirect tax system as enumerated above is complicated and multi-layered with levies both at the Central and State levels with various inefficiencies, cascading effect of taxes, multiplicity of tax rates, etc. With a view to reducing the complexities and streamlining various indirect taxes at the Central and the State levels, an Empowered Committee has been set up to look into various aspects of integrating the multiple indirect taxes into a common goods and services tax.

As per the current discussions, India is proposing to implement a dual GST structure comprising of the Central GST (CGST) to be levied by the Centre and State GST (SGST) to be levied by the States.

Integrated GST, which is combination of CGST and SGST, would be applicable on all inter-State transactions of goods and services and would be levied by the Central Government. Inter-State stock transfers would be treated at par with inter-State sales for the levy of GST.

The salient features of proposed GST are as follows:

- GST is a broad based and single unified consumption tax on supply of goods and services
- GST would be levied on the value addition at each stage of supply chain
- Full input credit of the taxes paid in the supply chain would be available. However, there would be no cross credit available between CGST and SGST
- GST proposes to subsume the following taxes:
  - Central taxes – Excise duties/ Service tax/ CVD/ SAD/ Surcharges/ Cesses
  - State taxes – VAT/ Entertainment tax (unless levied by local bodies)/ Luxury tax/ Entry tax (except in lieu of Octroi)/ Surcharges/ Cesses.

Exports would be zero rated.

The recommended tax rate structure (CGST + SGST) is as follows:

<table>
<thead>
<tr>
<th>Period</th>
<th>Goods</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Lower Rate</td>
<td>Standard Rate</td>
</tr>
<tr>
<td>Year 1</td>
<td>12%</td>
<td>20%</td>
</tr>
<tr>
<td>Year 2</td>
<td>12%</td>
<td>18%</td>
</tr>
<tr>
<td>Year 3</td>
<td>16%</td>
<td>16%</td>
</tr>
</tbody>
</table>

The levy was earlier scheduled to be introduced from 1 April 2010. This deadline has been postponed on several occasions and currently while there is no concrete clarity of the proposed date when GST would be implemented, the Finance Minister has clarified that he shall initiate all the necessary legislative measures in the next few months to ensure introduction of GST.
**Tax/Regulatory framework for investment in India**

**Governing Laws**

The objective of India’s Foreign Direct Investment (FDI) Policy issued by the Government of India (GoI) is to invite and encourage foreign investments in India. The Government issues its Consolidated FDI Policy every year with effect from 10 April.

The legal, administrative and compliance aspects of FDI in an Indian Company, including modes (e.g., Equity, fully, compulsorily and mandatorily convertible Preference Shares (CCPs) and fully, compulsorily and mandatorily Convertible Debentures (CCDs), American Depository Receipts (ADRs)/Global Depository Receipts (GDRs), etc.), are embedded in the Foreign Exchange Management Act, 1999 (FEMA) and in Regulations notified and monitored by the Reserve Bank of India (RBI).

Apart from investments in an Indian company, the FDI and Foreign Exchange Regulations are also relevant for transfer of shares in an Indian Company between Residents and Non-Residents. These are subject to detailed guidelines, valuation norms, compliances and approval requirements as stipulated.

Apart from Direct FDI, the FDI Policy also contains rules to determine Indirect FDI in an Indian Company where an Indian Company with FDI invests therein.

**Foreign Investments in India – Schematic Representation**

- **Foreign Direct Investments**
  - Automatic Route
    - Govt. Route
    - Persons Resident outside India
  - Flits
  - NREs, P10, QFIs

- **Foreign Portfolio Investments**
  - SEBI registered FVCIs
  - VCFs, IVCUs

- **Foreign Venture Capital Investments (FVCI)**
  - SEBI registered FVCIs
  - VCFs, IVCUs

- **Other Investments**
  - (G-Secs, NCDs etc)
    - Flits
    - NREs, P10, QFIs

- **Investments on non-repatriable basis**
  - NRIs, P10

**Source:** XXXXXX
Entry Tax
For the purpose of FDI in an Indian Company, the following categories assume relevance:

- Sectors in which FDI is prohibited
- Sectors in which FDI is permitted
  - Investment under Automatic Route
  - Investment under Prior Approval Route i.e. with prior approval of the Government through the Foreign Investment Promotion Board (FIPB).

Automatic Route
Under the automatic route there is no requirement of any prior regulatory approval. Only post facto filing by the Indian Company to the RBI through an Authorised Dealer (AD) is required as follows:

- Filing an intimation within 30 days of receipt of FDI;
- Issuing the equity shares/equity convertibles instruments within 180 days from the receipt of application money, failing which the entire amount shall be refunded. However, RBI may allow the allotment/ refund beyond 180 days for sufficient reasons.
- Filing the prescribed form within 30 days of issue of shares to foreign investors.
- Filing an Annual Return of Foreign Liabilities and Assets on annual basis within the time limit as prescribed.

Prior Approval Route
FDI in the following cases generally requires prior approval of the Government/FIPB:

- Proposals falling outside notified sectoral caps for the automatic route but within the ceilings permitted under the Approval route.
- Proposals for FDI in sectors/activities in which FDI is permitted only under the prior Approval Route.
- FDI in any defunct Indian Company, i.e. a Company with no operations and no downstream investments.
- FDI in any Holding Company which will undertake downstream investment in operating Companies.
- Proposals for issue of warrant/partly paid by shares.
- Import of capital goods/machinery/equipment (excluding second-hand machinery), subject to compliance with prescribed conditions.
- Pre-operative/pre-incorporation expenses (including payments of rent etc), subject to compliance with prescribed conditions.

Approval is granted by the FIPB on a case to case basis after examining the proposal for investment. Post FIPB approval, prescribed filings as applicable under the Automatic Route are also required to be carried out by the Indian Company under the Prior Approval Route.

Sectoral Guidelines
The sectoral lists for FDI falling under the Automatic Route, Prior Approval Route and prohibited list are revised on a regular basis by the Government depending upon industry needs. The FDI is also subject to other relevant sectoral laws or regulations of the relevant industry regulator.

Key Policy changes proposed under the Union Budget 2013

- A foreign investor having a stake of 10 percent or less to be treated as an FII/Financial Investor and a stake of more than 10 percent to be treated as FDI Investor.
- FII’s to be permitted to participate in the exchange-traded currency derivative segment also permitted to use their investment in corporate bonds and government securities as collateral to meet the margin requirements.

FDI in Single Brand Retail Trading
In September 2012, the Government made further changes and liberalization to the FDI policy on Single Brand Retail Trading. The liberalized policy now permits any non-resident entity having a legal tenable agreement with the brand owner to undertake single brand retail trading in India with prior Government approval. However, only one non-resident eligible entity i.e. the brand owner or the eligible franchisor/licensee/sub-licensee would be eligible for investing as FDI under this route. Further, for FDI beyond 51 percent, sourcing of 30 percent of the value of the goods purchased needs to be done from India, preferably from Micro, Small and Medium enterprises, Indian villages, cottage industries, artisans and craftsmen. This procurement requirement first needs to be met as an average of five year’s total value of the goods purchased beginning 1 April of the year during which the first tranche of FDI is received and thereafter on annual basis. Many other compliance obligations have been imposed including self-certification of procurements, etc. The policy also reaffirmed that retail trading in any form by means of e-commerce would not be permissible under this route.

FDI in Multi-Brand Retail Trading
In September 2012, the much awaited liberalization of the FDI policy enabling FDI in Multi-Brand Retail Trading was notified with the following pre-conditions:

- FDI up to 51 percent to be permitted with prior Government approval.
- Agricultural produce, fruit, vegetables, etc can be unbranded.
- Minimum amount of USD 100 million to be brought in as FDI by the foreign investor.
- At least 50 percent of the foreign investment to be invested in back-end infrastructure as stipulated within three years of induction of FDI. Expenditure on land cost and rentals is not counted for this purpose.
- At least 30 percent of the value of procurement of manufactured/processed products purchased will need to be sourced from Indian ‘small industries’ i.e. which have
total investment in plant and machinery not exceeding USD 1 million. This procurement requirement first needs to be met as an average of five year’s total value of the goods purchased beginning 1 April of the year during which the first tranche of FDI is received and thereafter on annual basis. Many other compliance obligations have been imposed including of self-certification of procurements, etc.

- Government to have first right to procurement of agricultural products
- State/ Union Territories would be free to take their own decisions for adoption/ implementation of the Policy. The relevant press note attaches the list of relevant States/ Union Territories who have conveyed agreement to implement the policy.
- Retail trading in any form by means of e-commerce would not be permissible under this route

**FDI in Civil Aviation Sector**

In September 2012, the Government announced the much awaited liberalization of the FDI policy in the Civil Aviation Sector. The liberalized policy now permits foreign airlines to acquire up to 49 percent under the Government approval route in the capital of Indian Company (except Air India Limited) operating scheduled and non-scheduled air transport services subject to the following key pre-conditions:

- The 49 percent limit will subsume FDI and Foreign Institutional Investors (FIIs) investment.
- All foreign nationals associated with the air transport services to be cleared from a security viewpoint before deployment.
- All imported technical equipments will require clearance from the relevant authority in the Ministry of Civil Aviation.

Note: A Scheduled Operator’s Permit is granted only to a Company registered and maintaining its principal place of business in India. Further, the Chairman and at least two-thirds of the Directors need to be Indian citizens and the substantial ownership and effective control is required to be vested in Indian nationals.

**FDI in Broadcasting Sector**

In September 2012, the Government reviewed the policy for FDI in Indian companies engaged in Broadcasting Sector and clarified several security related conditions/ terms associated with such FDI.

In particular, the Government amended FDI policy for Indian companies engaged in broadcasting carriage services with respect to (i) Teleports (setting up up-linking HUBs); Direct to Home (DTH); Cable Network (Multi-System-Operators operating at National or State or District level and undertaking upgradeation of networks towards digitalisation and addressability); (ii) Mobile TV. In these three Broadcasting Carriage Services sector, the revised policy permits foreign investment as under:

- Upto 49 percent under automatic route;
- Beyond 49 percent and up to 74 percent under Government approval route

The Foreign Investment in the sector to include FDI, Foreign Institutional Investors (FIIs), Foreign Currency Convertible Bonds (FCCBs), American Depository Receipts (ADR), Global Depository Receipts (GDR) and convertible preference shares held by foreign entities.

**FDI in Power Trading Exchanges**

In September 2012, the Government permitted foreign investment up to 49 percent in Power Trading Exchanges subject to several conditions. This ceiling comprises of FDI sub-limit of 28 percent under the Government approval route and FII limit of 23 percent (only secondary market purchase) under the automatic route. No non-resident investor/ entity including persons acting in concert can hold more than 5 percent equity in these companies.

**Investments by Qualified Foreign Investors (QFIs) in Indian corporate debt securities**

In July 2012, Reserve Bank of India (RBI) liberalized the QFIs regulations and permitted QFIs to purchase on repatriation basis, Indian corporate debt securities, subject to the following key conditions:

- The investment is through SEBI Registered Qualified Depository Participants (QDP)
- Eligible Indian corporate debt securities would mean listed Non-Convertible Debentures (NCDs), listed bonds of Indian companies, listed units of Mutual Fund Debt Schemes and ‘to be listed’ corporate bonds directly from the issuer/ through a registered stock broker on a recognised stock exchange in India.

**Pricing Guidelines**

Any issue or transfer of equity shares/ equity convertible instruments is subject to pricing or valuation norms. With an intention to provide better valuation based on performance, the FDI Policy permits the option of using a conversion formula for such convertible instruments subject to FEMA/ Securities and Exchange Board of India (SEBI) guidelines on pricing.

**Manufacturing Items Reserved for Micro and Small Enterprises**

Any industrial undertaking which is not a Micro or Small Enterprise (MSE), but manufactures items reserved for the MSE sector, would require prior FIPB approval where foreign investment is more than 24 percent in the equity capital. Such an undertaking would also require an Industrial License for such manufacture.

The issue of an Industrial License is subject to a few general conditions and the specific export obligation is to be achieved within a maximum period of three years from the date of commencement of commercial production.

**External Commercial Borrowing/ Foreign Currency Convertible Bonds/ Foreign Currency Exchangeable Bonds**

Overseas loans in foreign currency by Indian Companies/ Entities from Foreign Lenders are governed by the guidelines on External Commercial Borrowings (ECB) issued by the RBI under Foreign Exchange Regulations. The ECB Policy stipulates detailed guidelines for Eligible borrowers, recognized lenders, amount and maturity period, all-in-cost interest ceilings, end-use stipulations, compliances, etc.

Issue of any non-convertible, optionally convertible or partially convertible preference shares or debentures to
non-residents is considered as ECB from a foreign exchange regulation perspective and needs to comply with ECB guidelines.

An Indian Company can also raise funds by issuing FCCBs or Foreign Currency Exchangeable Bonds (FCEBs). The FCCB are convertible into ordinary shares of the issuing company in any manner, either in whole, or in part while in the case FCEBs equity shares of another Indian Company (Offered company – being a listed company, engaged in a sector eligible to receive FDI and eligible to issue or avail of FCCB or ECB) are issued on conversion. The Issuer company should be part of the promoter group of the Offered Company.

The policy for ECB is also applicable to FCCBs and FCEBs and accordingly all norms applicable for ECBs also apply to them as well.

American Depositary Receipts or Global Depositary Receipts

A company can issue ADRs or GDRs if it is eligible to issue shares to persons resident outside India under the FDI Policy subject to compliance as stipulated in this regard.

In general, Unlisted companies which have not yet accessed the ADR or GDR route for raising capital would require prior or simultaneous listing in the domestic market. Unlisted companies which have already issued ADR/GDR in the international market have to list in the domestic market on making profit or within three years of such issue, whichever is earlier.

FDI in Limited Liability Partnership (LLP)

FDI will be allowed, through the Government approval route, only in LLPs operating in sectors/activities where 100 percent FDI is allowed, through the automatic route and there are no FDI-linked performance conditions. LLPs with FDI will not be eligible to make any downstream investments. LLPs will also not be permitted to avail External Commercial Borrowings (ECBs). Conversion of a company with FDI, into an LLP, will be allowed with the prior approval of FIPB/Government.

Portfolio Investment in India

Foreign Institutional Investors (FIIs) who are eligible and apply/get register with SEBI are eligible to invest in India under the Portfolio Investment Scheme (PIS) within prescribed guidelines, ceilings and parameters.


Conceptually, an application for registration as a FII can be made in two capacities, namely as an investor or for investing on behalf of the applicant’s sub-accounts.

Sub-account means any person resident outside India, on whose behalf investments are proposed to be made in India by a FII and who is registered as a sub-account under these regulations. Entities eligible to register as sub-accounts are Broad Based Funds, Broad Based Portfolios, Proprietary Funds of the FI, University Funds, Foreign Corporates, Endowments, Universities, Charitable Trusts, Charitable Societies, Sovereign Wealth Funds and Foreign Individuals satisfying the prescribed conditions.

FIIs/sub-accounts can invest in Indian equities, debt/bonds, etc. in India and are subject to limits and conditions.

Investment by Non-resident Indians

Non-resident Indians (NRIs)/Persons of Indian Origins (PIOs) can invest in the shares or convertible debentures of an Indian Company on a repatriation basis subject to limits and conditions.

NRIs/PIOs are also eligible to invest in the shares or convertible debentures of an Indian Company (not engaged in the sectors of agricultural or plantation activities, real estate business, construction of farm houses or dealing in Transfer of Development Rights) on a non-repatriation basis subject to conditions.

Investment as Foreign Venture Capital Funds

A Foreign Venture Capital Investor (FVC) which is eligible and registered with SEBI can invest, with the specific approval from RBI, in an Indian Venture Capital Fund (IVCF) Undertaking/ Indian Venture Capital (IVC)/ in a scheme floated by such VCF subject to the condition that the domestic VCF is registered. All such investments are allowed subject to SEBI and RBI regulations and the FDI Policy.

Calculation of Total Foreign Investment

The FDI Policy also provides the methodology for calculation of Total Foreign Investment in an Indian Company for the purpose of sectoral cap and approval requirements. For this purpose all types of foreign investments, i.e. FDI; FII holdings as on 31 March; NRIs; ADRs; GDRs; FCCBs; FCEBs; and fully, compulsorily and mandatorily convertible preference shares are to be considered.
Total Foreign Investment is equal to Direct Foreign Investment plus Indirect Foreign Investment in an Indian Company.

- Direct investments are all specified types of foreign investment made directly by a non-resident entity into the Indian Company.
- Indirect foreign investments are investments in an Indian Company made through investing Indian Companies which are ‘owned or controlled’ by non-resident entities, to be calculated as per the prescribed methodology.

These provisions are far-reaching in terms of scope, coverage, and computation and go beyond the pro-rata methodology.

The entry level guidelines or conditions for FDI in an Indian Company have been expressly clarified to extend to indirect foreign investment as well, i.e., downstream investments by Indian entities owned and controlled by non-resident entities.

For foreign investments into an Indian Company engaged only in the activity of investing in the capital of other Indian Company/ies or a Company which does not have any operations and also does not have any downstream investment, prior Government approval is required.

For all cases of transfer of ownership or control of Indian Companies in specified or controlled sectors from resident Indian citizens or entities to non-resident entities, prior Government approval will be required.

For downstream investments a notification to the Government within the prescribed timeframe and parameters is required.

The investing Indian Companies cannot leverage funds from the domestic market for the purpose of downstream investment. Surplus retained by Indian entities can be utilized for undertaking downstream investments. FVCIs are also allowed to invest as non-resident entities in other companies subject to the FDI Policy.

**Investment Vehicles for Foreign Investors**

**Choice of Vehicle**

Depending upon its business needs, a Foreign Company can choose between setting up a Liaison Office (LO), a Branch Office (BO) or a Project Office (PO) or incorporating/ investing in an Indian Company under FDI Guidelines.

**Eligibility criteria for Foreign Companies wanting to set-up Liaison Office (LO)/ Branch Office (BO) in India**

A Foreign Company can establish a LO or a BO in India with prior approval from the RBI if it is engaged in a sector where 100 percent FDI is permitted under the Automatic Route as per the FDI policy. In other cases and that of Non Governmental Organisations (NGO), Not for Profit Organization, Government Bodies, Departments are considered and approved by the RBI with prior permission of the Government. The application needs to be filed with the RBI through an Authorized Dealer (Banker). The LO/ BO approval of RBI is location specific and subject to guidelines issued in this regard.

There exist eligibility criteria and procedural guidelines for establishment of LOs by foreign entities in India.

Post-set up in India, various registrations and compliance obligations entail on the LO/ BO including obtaining a Unique Identification Number from the RBI. In view of sizeable paperwork and time frame obligations, the entire process needs to be carefully planned and implemented.

**Liaison Office**

An LO can act as a channel of communication or carry out representation/ liaison between the head office or group companies and parties in India. A LO is not permitted to undertake any income generating, commercial or trading or industrial activity, directly or indirectly.

The LO is obliged to maintain itself and meet its expenditure through inward remittances from the head office. A LO is generally approved only for a specified period which is subject to renewal. In certain sectors (Financial Sector), the LO is obliged to upgrade into a Company (wholly owned Subsidiary or Joint Venture (JV)) following the initial approval period.

The LOs of foreign banks obtaining prior approval from RBI under the Banking Regulation do not need separate RBI approval under the foreign exchange regulations. Similarly foreign insurance companies are permitted to set up Los without RBI approval subject to necessary approval from the Insurance Regulatory and Development Authority of India.

**Branch Office**

A Foreign Company is permitted to establish a BO in India to undertake prescribed commercial activities and this is generally suitable for manufacturing and trading companies wanting to market/ sell their products in India or IT Enabled/ Consultancy Firms wanting to render services in India.

The activities permitted for a BO does not include manufacturing (unless set up in a Special Economic Zone (SEZ), for which setup and operation is governed under separate regulations) and domestic/ retail trading.

No prior approval is required to set up a BO in SEZ to undertake manufacturing or service activity provided 100 percent FDI under the Automatic Route is allowed in this sector and subject to other conditions.

The BOs of foreign banks obtaining prior approval from RBI under the Banking Regulation do not need separate RBI approval under the Foreign Exchange Regulations.

The Bankers/ Authorised Dealers are now authorised to deal with the closure applications of such BOs of Foreign Companies in India.

**Project Office**

Foreign Companies undertaking projects in India and satisfying prescribed requirements can set up POs for the purpose of executing the project.

The requirement of obtaining prior RBI approval for a PO that meets specified conditions has been dispensed with and only post facto filings are obligated. However, no person being citizen of China can establish in India a PO without the prior permission of the RBI. Similarly a PO can be wound up without any specific approval by relevant filings through Bankers.

A PO can only undertake activities relating to and incidental to the execution of specific projects in India and has to be wound up following the completion of the project.

A PO is permitted to open, hold and maintain one or more foreign currency accounts subject to prescribed conditions/ parameters. A PO is allowed to remit intermittent surplus to its head office.
Local Indian Subsidiary or Joint Venture Company
Subject to FDI Guidelines and Foreign Exchange Regulations discussed above, a Foreign Company can set up its own wholly owned Indian Subsidiary or Joint Venture Company with an Indian or Foreign Partner.

A Subsidiary or a Joint Venture Company can be formed either as a Private Limited Company or a Public Limited Company. A Private Limited Company is obliged to restrict the right of its members to transfer the shares, can have only 50 shareholders and is not allowed to have direct access to deposits from the public. It is also subject to fewer corporate compliance requirements as compared to a public company, which is eligible for listing on stock exchanges.

The Comparative summary of the all the above vehicle are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Liaison Office</th>
<th>Branch Office</th>
<th>Project Office</th>
<th>Subsidiary/ Joint Venture</th>
</tr>
</thead>
<tbody>
<tr>
<td>Setting up Requirements</td>
<td>Prior approval of RBI required</td>
<td>Prior approval of RBI required</td>
<td>Prior RBI approval not required if certain conditions are fulfilled</td>
<td>For activities/ sectors under the Automatic Route, only post facto filings with the RBI obligated by the investee Indian Company. Else obtain prior Government/ FIIB approval and then comply with post facto filings.</td>
</tr>
<tr>
<td>Permitted Activities</td>
<td>Only liaison, representation, and communication role is permitted. No commercial or business activities or other activities giving rise to any business income can be undertaken.</td>
<td>Only activities listed/ permitted by RBI can be undertaken. Local manufacturing and domestic/ retail trading are not permitted.</td>
<td>Permitted if the Foreign Company has a secured contract from an Indian Company to execute a project in India.</td>
<td>Subject to Sectoral policy in FDI guidelines/ framework.</td>
</tr>
<tr>
<td>Funding for Local Operations</td>
<td>Local expenses can be met only out of inward remittances received from abroad from head office through normal banking channels.</td>
<td>Local expenses can be met through inward remittances from head office or from earnings from permitted operations.</td>
<td>Local expenses can be met through inward remittances from head office or from earnings from permitted operations.</td>
<td>Funding may be through equity or other forms of permitted capital infusion, borrowing (local/overseas norms) or internal accruals.</td>
</tr>
<tr>
<td>Compliance requirement under the Companies Act</td>
<td>Requires registration and periodic filing of accounts/ other documents.</td>
<td>Requires registration and periodic filing of accounts/other documents.</td>
<td>Requires registration and periodic filing of accounts/other documents.</td>
<td>Required to comply with substantial higher statutory compliance and filing requirements</td>
</tr>
<tr>
<td>Compliance Requirement under the Foreign Exchange Management Regulations</td>
<td>Required to file Annual Activity Certificate (AAC) from the Auditors in India with the AD Bank with a copy to Income Tax Authorities and a specified report with the office of Director General of Police</td>
<td></td>
<td>Compliance certificates stipulated for various purposes</td>
<td>Required to file periodic and annual filings of receipt of capital and issue of shares to foreign investors.</td>
</tr>
<tr>
<td>Compliance requirements under Income Tax Act</td>
<td>No tax liability as generally it cannot/doe not carry out any commercial or income earning activities.</td>
<td>Obliged to pay tax on income earned and required to file return of income in India.</td>
<td>Obliged to pay tax on income earned and required to file return of income in India.</td>
<td>Liable to tax on global income on net basis.</td>
</tr>
<tr>
<td>Permanent Establishment (PE)/ taxable presence</td>
<td>LO generally does not constitute PE/ taxable presence under Double Taxation Avoidance Agreement (DTAA) due to limited scope of activities in India.</td>
<td>Generally constitutes PE and is a taxable presence under DTAA as well as domestic tax provisions</td>
<td>Generally constitutes a PE and is a taxable presence under DTAA as well as domestic income tax provisions</td>
<td>It is an independent taxable entity and does not constitute a PE of the Foreign Company per se unless deeming provisions of the DTAA are attracted.</td>
</tr>
</tbody>
</table>

#DDT is currently levied at 15 percent (plus applicable surcharge and education cess) on dividends declared/distributed/paid by the Indian Company. Limited/sub-firm dividend set-off rules apply. Pursuant to DDT, dividends are tax free for all shareholders.
Repatriation of Foreign Exchange

India does not have full capital account convertibility as yet. However, there have been significant relaxations in the recent past for withdrawal of foreign exchange for both current account and capital account transactions. The payments due in connection with foreign trade, other current business, services, etc. are regarded as current account transactions and are generally permissible. As per the Foreign Exchange Management (Current Account Transactions) Rules, 2000, the withdrawal of foreign exchange for current account transactions is regulated as follows:

<table>
<thead>
<tr>
<th>Prescribed Schedule</th>
<th>Withdrawal for</th>
<th>Approving Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schedule I</td>
<td>Transactions prohibited</td>
<td>N.A</td>
</tr>
<tr>
<td>Schedule II</td>
<td>Transactions which require prior approval of the Central Government</td>
<td>Concerned Ministry or Department of Government</td>
</tr>
<tr>
<td>Schedule III</td>
<td>Transactions which require prior approval of the RBI</td>
<td>RBI</td>
</tr>
</tbody>
</table>

In the case of certain transactions listed in Schedules II and III, prior approval is not required if the payment is made out of foreign exchange funds held in Exchange Earner’s Foreign Currency (EEFC) Account/ Resident Foreign Currency (RFC) Account of the Remitter. Remittances for all other current Account transactions can generally be made directly through the AD without any specific prior approval.

Some of the relevant Current Account payments are discussed below:

**Dividends:** Dividends declared by an Indian Company can be freely remitted overseas to foreign shareholders without any prior approval or dividend balancing requirement.

**Foreign technology collaboration:** The Government’s liberalised policy now permits payments for royalty, lump-sum fees for transfer of technology and payments for use of trademark/ brand name under the Automatic Route without any restrictions/ ceilings.

**Consultancy services:** Remittances up to USD 1 million per project (USD 10 million for specified infrastructure projects) can be made without any prior approval of the RBI.

**Import of goods:** Payments in connection with import of goods and services in the ordinary course of business are generally permissible and can be undertaken freely through direct filing of required documents with the AD, subject only to the period of settlement, rate of interest, advance that can be made, etc.

**Netting off overseas receivable and payables:** Generally, netting off of foreign exchange receivables against foreign exchange payables is not permitted. Specific relaxation exists in the regulations for some cases like units in SEZs. RBI can also give case specific approvals for netting off based on industry requirement/ practice and internal norms.
Doing business in China
Ease of doing business in China

China ranks number 79 for “ease of doing business” among 183 countries. This indicates that China is not an easy place to do business, but it is still the top ranked economy among the BRIC countries.

<table>
<thead>
<tr>
<th>Country</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singapore</td>
<td>1</td>
</tr>
<tr>
<td>US</td>
<td>6</td>
</tr>
<tr>
<td>Australia</td>
<td>10</td>
</tr>
<tr>
<td>Japan</td>
<td>18</td>
</tr>
<tr>
<td>Mexico</td>
<td>35</td>
</tr>
<tr>
<td>China</td>
<td>79</td>
</tr>
<tr>
<td>Russia</td>
<td>123</td>
</tr>
<tr>
<td>Brazil</td>
<td>127</td>
</tr>
<tr>
<td>India</td>
<td>134</td>
</tr>
</tbody>
</table>


Overall philosophy and approach

The government has adopted liberal policies to attract foreign investment. While investment in certain industries needs to be approved by central government authorities, such as the Ministry of Commerce, the authority to approve most foreign-invested enterprises, where total investment is less than USD 300 million, has been delegated to provincial, regional and municipal governments. Some investment projects, which exceed the USD 300 million threshold, but do not require overall state planning control, can also be approved at the local level.

In line with WTO commitments to create a level playing field, the PRC government has extended equal tax treatment to all enterprises, whether foreign invested or domestic. However, in order to continue encouraging technological development, new concessions have been introduced to high technology industries.

Laws and regulations

The PRC has introduced a framework of commercial law to encourage foreign investment. At provincial, regional and municipal levels, regulations also exist to meet this objective.

The PRC’s commercial laws are still evolving. KPMG China regularly issues thought leadership and alerts documenting recently introduced regulations likely to affect companies doing business in China.

Contracts and negotiations

Contracts, including foreign economic contracts, are governed by the Contract Law, which took effect in October 1999.

Foreign investors in China often encounter the mindset that contractual documentation should be kept to a minimum and that all business matters can be resolved if both parties adhere to the basic concepts of equality and mutual benefit. The assumption is that business decisions should be the subject of prior discussion and agreement by both parties and that all differences should be settled by a process of conciliation without recourse to third party arbitration or to the courts of law.

In practice there is a growing recognition among investors of the importance of including an arbitration clause when drafting a contract. Arbitration can provide a structure for investors and local partners to resolve their differences while continuing to work together, thereby avoiding more expensive litigation procedures. A popular option is to agree to refer any dispute to the China International Economic and Trade Arbitration Commission (CIETAC). This is the permanent arbitration body of the China International Chamber of Commerce.

Foreign businesses usually find that their counterparts in the PRC are knowledgeable about the potential investor or trading partner’s company, its competitive position and the worldwide situation of the industry concerned. Negotiations are likely to be long and detailed, and it is important for foreigners involved in the negotiation process to demonstrate patience, tact and politeness. Aggressive negotiation tactics are likely to fail, and exerting excessive pressure in a negotiation may result in a “false positive” outcome, where the counterparty appears to agree, but is doing so just to save face.

Many Chinese are exacting negotiators and will continue to examine all their options before signing any agreement. The key to success is to identify relatively few negotiating points on which to concentrate and to adopt a flexible attitude on minor contractual issues; the foreign party should accept from the outset that not all its normal terms and conditions will be acceptable. It should also ensure that an agreement exists, rather than merely a statement of intent.

Anti-monopoly law

China’s anti-monopoly law took effect in 2008 and contains provisions that investors need to bear in mind, especially for larger acquisitions that might be construed as “anti-competitive.”

The country’s anti-monopoly law covers three key areas:

- Prohibition of anti-competitive monopoly agreements
- Prohibition of the abuse of a dominant position
- Merger control

Source: Freshfields, China finally enacts Anti-monopoly Law, September 2007
Forms of foreign investment

The PRC offers a number of different ways to facilitate foreign investment, as detailed below. The most common form is a foreign-invested enterprise. These are established wholly or partly within China, with at least 25 percent foreign ownership. They may be Sino-foreign equity joint ventures, Sino-foreign cooperative joint ventures or wholly foreign-owned enterprises.

KPMG member firms have considerable experience assisting in the establishment of operations for overseas investors in the PRC, including all of the investment forms described below.

<table>
<thead>
<tr>
<th>Foreign direct investment categories, USD billion (2010)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whole foreign-owned enterprise</td>
</tr>
<tr>
<td>Equity joint venture</td>
</tr>
<tr>
<td>Contractual joint venture</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td><strong>USD billion</strong></td>
</tr>
</tbody>
</table>

Source: China Statistical Yearbook 2011; KPMG analysis

Processing and assembly agreements

The simplest arrangement is a processing and assembly agreement where the foreign company supplies raw materials or parts on a consignment basis to a local entity in the PRC. A fee is paid to the PRC entity for its work and the processed goods are returned to the foreign company.

In most cases, the foreign company will have to supply the necessary production technology, equipment and supervision. The foreign investor is not allowed to sell any of the goods produced on the domestic market without the approval of the PRC authorities.

Equity joint ventures

Equity joint ventures are limited liability companies with joint PRC and foreign ownership set up for a specific purpose, such as the establishment of a new manufacturing concern. In general, the foreign partner provides the capital investment, technical expertise and management skills and arranges for technology transfer. The PRC entity provides land, buildings and labour and facilitates the smooth operation of the joint venture. The two parties’ equity contributions to the joint venture determine their share of the results.

Cooperative joint ventures

Cooperative joint ventures are sometimes referred to as contractual joint ventures. They are similar to equity joint ventures but differ in that the obligations of each party are detailed in a contract. These contracts typically specify the minimum registered capital and capital contributions of each party at various levels of investment and their respective share of the results of the joint venture. A cooperative joint venture can be a legal person with limited liability, if registered as such.

Wholly foreign-owned enterprises

Wholly foreign-owned enterprises (WFOEs) are legal entities in China and are wholly owned by one or more foreign investors. The 2011 edition of the Catalogue Guiding Foreign Investments, published in December 2011, identifies the industries that are “encouraged”, “restricted”, or “prohibited” for foreign investors. It took effect on 30 January 2012, replacing the 2007 edition.

The advantage of a wholly foreign-owned enterprise is that the foreign investor has full autonomy in managing the company. In some cases, a foreign investor may prefer a wholly-owned structure as it can better protect its trade secrets and other intangible assets.

Some sectors still restrict the establishment of wholly foreign-owned enterprises, but these restrictions are gradually being relaxed. For example, in December 2004 the government lifted restrictions on foreign investment in wholesale, retail and distribution enterprises. Overseas parties are now allowed to set up wholly owned entities known as foreign-invested commercial enterprises (FICEs), which may act as a retailer, wholesaler or commission agent and engage in franchising activities.

PRC holding companies

If certain conditions are satisfied, foreign investors may establish holding companies in the PRC to hold equity interests in foreign invested enterprises. A PRC holding company may trade goods manufactured by investees and also render some shared services such as marketing, staff recruitment and consulting work.

PRC holding companies and subsidiaries are taxed as separate entities and do not file a consolidated tax return. A holding company can further apply for “Regional Headquarters” status, which allows a broader scope of services and certain tax benefits.

Representative offices

Foreign companies may set up representative offices in the PRC. Such offices are not separate legal entities and their permitted business scope is generally very limited. A representative office is prohibited from engaging in business operations.

Branches

Foreign companies in certain industries such as banking, insurance and shipping may set up branches in the PRC. These branches are not separate legal entities in China.
Construction and installation projects

With effect from April 2004, foreign contractors are no longer allowed to carry out new construction or installation projects in the PRC on a contractual basis. Instead, they need to set up foreign-invested construction companies in China, which are subject to the same licensing administration as domestic construction companies.

Subcontracted business

A foreign company may manage and operate all or part of the business of a domestic enterprise or a foreign invested enterprise as a subcontractor. Foreign companies may find opportunities to subcontract some of the operations of state-owned enterprises, subject to approval of the PRC authorities.

Intellectual property

Foreign trademarks registered in the PRC are protected by law. Since 1988, the PRC has officially adopted the international system for commodity classification and the Vienna system for design elements classification, thus internationalising the PRC’s trademark registration and administration.

The registration of trademarks is governed by the Bureau of Trademarks. Trademark applications of foreign enterprises are handled by agents approved by the Bureau of Trademarks. For example, the Trademark Registration Agency of the China Council for Promotion of International Trade in Beijing or by the China Patent Agent (HK) Limited in Hong Kong.

The PRC is facing increasing international pressure to provide greater legal protection for intellectual property rights (IPR). The PRC’s Copyright Law, which came into force in June 1991, aims to protect literary, musical, dramatic, audio and visual property.

The PRC is a signatory to the Berne Convention and the Universal Copyright Convention, the two main multilateral copyright conventions. In order to protect the rights and interests of copyright holders of foreign works, the PRC issued the Regulations on Implementation of International Copyright Treaties in September 1992.

International agreements

China is a signing party to the following international conventions which have intellectual property implications:

- Paris Convention
- Madrid Agreement Concerning the International Registration of Marks (Madrid Union)
- Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks
- Protocol Relation to the Madrid Agreement Concerning the International Registration of Marks (Madrid Protocol)
- WIPO (World Intellectual Property Organization)
- Berne Convention
- Geneva Convention for the Protection of Producers of Phonograms against Unauthorized Duplication of their Phonograms
- WTO Agreement
- Protocol Relation to the Madrid Agreement Concerning the International Registration of Marks (Madrid Protocol)

With increased outsourcing of multinational companies’ manufacturing activities and distribution of goods to China, managing the associated IPR is critical. While many cases in the PRC involve local companies infringing the IPR of international partners, domestic companies are also starting to defend their brands and IPR more vigorously.
Environmental regulations

Rapid economic growth has led to growing pressures on China’s environment, and environmental pollution has become a major concern to the Chinese government.

Since the mid 1990s the government has passed a number of environmental laws and regulations. For example, under legislation passed in 1998, construction projects are now required to conduct up to four separate environmental impact assessments. The 2002 Law on the Promotion of Clean Production extended the scope of environmental impact assessments to other manufacturing processes, to promote more efficient resource practices.

The State Environmental Protection Administration (SEPA) is the national agency monitoring environmental performance and formulating national standards. It has asked the government for greater powers, for example to shut down heavily polluting factories. It has also called on the government to create tax breaks and financial incentives, to encourage better environmental performance. The possibility exists for increased environmental regulations of businesses in coming years. For example, the new CIT Law, effective from 1 January 2008, grants preferential treatment to qualified environmental protection and energy or water conservation projects.

Transfer pricing

Transfer pricing issues have become increasingly important in recent years. CIT Law requires companies to conduct “arm’s length” transactions with related parties. Companies are required to maintain transfer pricing documentation in accordance with CIT Law; the level of documentation is based on the volume of related party transactions. If tax authorities discover that transfer pricing problems have led to unpaid taxes, they will take corrective action, which includes collecting back taxes, charging interest and imposing penalties.

Business Taxation for Enterprises

The Ministry of Finance (MOF) is responsible for formulating economic policy and developing tax legislation. The National People’s Congress enacts China’s income tax laws, while the State Council promulgates supplementary and provisional regulations. The State Administration of Taxation (SAT) interprets and applies enacted tax laws and regulations, with the publication of regular Tax Circulars.

Income tax

In March 2007, China promulgated the new Corporate Income Tax Law (CIT Law), which replaced the Foreign Enterprise Income Tax (FEIT) Law applicable to foreign invested enterprises and foreign enterprises and Enterprise Income Tax (EIT) applicable to domestic enterprises (DEs), with effect from 1 January 2008. The Implementation Rules of the CIT Law were issued by the State Council in December 2007. On 1 January 2008, the CIT rate for DEs and Foreign Invested Enterprises (FIEs) was unified to 25 percent. Companies entitled to a reduced tax rate under the FEIT law will be transitioned to a full 25 percent CIT rate over a five-year period.

In addition, the FEIT holiday of “two-year exemption and three-year half rate reduction” has been removed in the new CIT Law. Companies which are eligible for FEIT holiday will be eligible for a five-year grandfathering provision. The new CIT Law also offers some preferential income tax treatment to qualified investments, which are no longer restricted to FIEs or DEs.

Double taxation treaties

The PRC has signed agreements with over 90 countries. It also has tax arrangements with Hong Kong and Macau, offering equivalent double tax protection.

Value added tax

Value added tax (VAT) is charged on the supply of goods, and the provision of repair, replacement and processing services in the PRC as well as on the importation of goods into the PRC. VAT is charged at each stage of the production of goods and services, with each supplier receiving credit for the relevant VAT paid so that VAT is actually borne by the final consumer. VAT is normally accounted for on a monthly or quarterly basis. Where input VAT exceeds output VAT in a period, the excess should be carried forward to offset the output VAT in the following periods. Since 2009, input VAT credits have been available for VAT paid in the purchase of fixed assets. However, goods or services purchased for the production of non-taxable and exempted goods, or for employee welfare purposes, are not eligible for VAT credits.

The standard VAT rate is 17 percent but certain products are taxed at 13 percent, or are exempt. Certain small scale businesses, as defined by the authorities, may be entitled to a lower rate, but they are not eligible for VAT credits.

Exports are generally free of VAT. However the refund of VAT incurred on the purchase of goods used for exporting may be limited.
Business tax
All entities and individuals who provide services (except for processing, replacement or repair services), or who transfer intangible assets or immovable property in the PRC, are subject to business tax (BT). Taxable services for BT purposes include transportation, construction, finance and insurance, post and telecommunications, cultural activities and sports, entertainment businesses and services. The general BT rate is 5 percent. For industries such as transportation and construction, the BT rate may be reduced to 3 percent. However, entertainment services may be subject to BT of up to 20 percent. BT is a form of turnover tax, in that no credits are allowed throughout a supply chain. Moreover, BT applies if either the service provider, or the service recipient, is in China.

The government is proposing to reform the business tax in the near future, likely by merging BT with VAT to create a Goods and Service Tax that will apply to all turnovers. That process started with the commencement of a pilot scheme in Shanghai on 1 January 2012 and will progressively implement these reforms across all sectors in mainland China. The Shanghai pilot scheme applies to the transport and modern services sectors which created two new VAT rates of 11 percent and 6 percent.

Other taxation
Additional consumption tax is charged on the production, processing and importation of certain luxury goods. The tax rates vary from 3 percent to 45 percent for different categories of goods. Consumption tax is levied in addition to value-added tax.

There is a vast array of other forms of taxation applicable to various business or investment activities in China, including the Urban Maintenance & Construction Tax, Education levy, Stamp Duty, Cultural Business Levy, Deed Tax, Real Estate Tax, Land Appreciation Tax, together with various mining taxes, motor vehicle taxes and social security contributions.

In addition, foreign companies that do not have establishments in the PRC are liable for withholding tax on their PRC-sourced income including interest, dividends, rental, royalties and capital gains. Dividends received by foreign investors from foreign-invested enterprises are subject to withholding tax for profits derived after 1 January 2008.

The PRC tax laws are complex and it is recommended that professional advice is taken prior to entering into any business or financial arrangements.

Customs
The PRC General Administration of Customs administers the import and export of goods into or from the PRC. The Customs offices collect customs duty and import taxes (including value added tax and consumption tax) for goods imported into the PRC. To comply with WTO requirements, China Customs has gradually reduced the import duty rate since 2002. The average duty rate is now approximately 10 percent. Goods imported from a country that has a reciprocal preferential tariff agreement are subject to preferential rates.

Importing raw materials into the PRC to produce goods for export purposes is not subject to customs duty and import taxes, subject to approval by the Customs authorities. In addition, the PRC has 16 Bonded Zones (or Free Trade Zones) and more than 60 Export Processing Zones as of 2011 which are separate customs areas. Goods imported from overseas into these Bonded Zones and Export Processing Zones are not subject to any customs duty and import taxes.

According to current China legislation, for goods which appear on the “automatic import license goods” list, importers or their brokers must apply for an automatic import license from the Ministry of Commerce or the local Foreign Economic Relations and Trade Commission in advance. Goods imported from certain areas or countries, such as Hong Kong SAR, Korea, or the Association of Southeast Asian Nations (ASEAN) may be taxed under preferential tariffs for certain types of goods.

Export duties only apply to a few commodities, such as certain scarce minerals. Depending on the political climate, there may be considerable disparities in the imposition of import and export tariffs on trading with different countries. On 1 January 2006, China customs ceased export duty collection on textiles exports.

Accounting regulations
The accounting methods adopted by joint ventures with foreign investors are specified in the Accounting Regulations of the People’s Republic of China for Enterprises with Foreign Investment. The MOF issued these regulations in June 1992, with the intention of further safeguarding the legal rights of both the joint venture enterprise and its investors. In November 1992 the MOF also issued the Accounting Standards for Business Enterprises (ASBE) and the Financial Regulations for Business Enterprises (FRBE), both of which were designed to be applicable to all types of enterprises in the PRC, including foreign-invested enterprises.

Since the early 1990s, the MOF has continued efforts to establish standard accounting practices across different kinds of enterprises and organisations. While the PRC’s generally accepted accounting principles (GAAP) are nominally a principles-based system, in practice they are governed by many different regulations and a large existing body of interpretations. Some discrepancies still exist between regions and across sectors.

In November 2005, the PRC decided to move towards convergence with International Financial Reporting Standards (IFRS). While Chinese standards will remain separate in their legal basis, the aim is to create a materially equivalent financial reporting system. The International Accounting Standards Board has offered to work with the MOF to find common agreement in areas such as treatment of goodwill and business combinations.

As part of this transition, the MOF released new accounting standards for business enterprises in February 2006. The new standards comprise a general standard and 38 specific standards. All listed companies in China will need to prepare financial statements in accordance with the specific standards, from January 2007, while the general standard is applicable to all business enterprises.

Companies not adopting the specific standards will still need to comply with all previous standards and regulations, including ASBE and FRBE.
It is important for foreign investors to ensure that their joint venture contracts contain provisions for adequate financial control over the joint venture, including an independent external audit of the enterprise’s accounts. The annual accounts of foreign companies must be audited by certified public accountants registered in the PRC. The government has allowed international accounting firms to establish joint venture firms to perform statutory audits. In 1992, KPMG Huazhen, a KPMG member firm, was the first of the “Big Four” accounting firms to receive such approval in China.

Insolvency

Insolvency reform will be an important factor in improving investor confidence in China, particularly for minority shareholders and corporate lenders. After a decade of consultation and drafting, the Enterprise Bankruptcy Law of the People’s Republic of China was enacted in August 2006 and took effect on 1 June 2007, to bring China in line with international practice.

The Law requires the creation of an administrator, who reports to creditors and the courts. It establishes clear processes for filing claims and establishing their seniority. The Law also shows that some SOEs and banks are likely to be exempt from the full scope of the law, at least initially. The government is negotiating treaties to establish cross-border recognition of insolvency proceedings.

Land and buildings

Land

In the past, land in the PRC has been widely allocated under a system of land use arrangements. No money was payable to the government by those holding an allocation. Entities and individuals would not hold the title to the land, only the right to use it.

Land use rights are becoming more transferable, through business agreements, open bidding or auction. The PRC’s laws were amended in April 1990 to regulate the transfer and retransfer of land use rights for state-owned land in the cities. The laws also introduced provincial regulations governing the use of state-owned land for large scale development projects. Under these amendments, both domestic and foreign enterprises can obtain land use rights for fixed periods. These are 70 years for housing, 50 years for industrial use and 40 years for commercial use.

The State Land Bureau coordinates overall plans for land development and its local offices administer the process of land transfers and extensions.

Payments for land use rights vary considerably throughout the country. Costs for industrial land are comparatively low, depending on the location and facilities available, although payments have increased substantially over the last decade. Land use transactions in the PRC can be complicated by matters such as legal titles, the availability of utilities and tax on value appreciation. Foreign investors should take professional advice before entering into any land use transactions.

Buildings

The PRC’s construction industry is well developed throughout the country and is capable of operating at international standards. Most building construction for foreign invested enterprises is carried out by locally incorporated contractors. In the case of large projects and special purpose buildings, a foreign investor will commonly seek the assistance of a foreign invested construction enterprise to act as the main contractor or the project manager to ensure building quality.

Renting industrial, commercial and office space

The Special Economic Zones and certain other cities offer industrial, commercial and office space for rent under arrangements similar to industrial parks and export processing zones in other countries. In the main cities, a range of office options are available, from small office units to international “grade A” office space.

Development zones

Special Economic Zones

Since 1979, five Special Economic Zones have been established in southern China: in Shenzhen, Zhuhai, Xiamen, Shantou and Hainan. In 2010, a new Special Economic Zone was established in Kashgar, Xinjiang Province.

The authorities of the Special Economic Zones have been given a great deal of freedom to govern the activities within their zones, especially in encouraging investment through special centrally approved investment incentives. However, the reduced FEIT rate of 15 percent granted to foreign invested enterprises and foreign enterprises in these zones has been cancelled under the new CIT Law.

New and High Technology Development Zones

At present there are over 60 New and High Technology Development Zones that offer various subsidies to the enterprises located in these zones. One of the objectives of the zones is to promote the industrialisation of technologies owned by regional universities and research institutes.

Bonded Zones and Export Processing Zones

As of 2011 there were 16 Bonded Zones (sometimes referred to as Free Trade Zones) and more than 60 Export Processing Zones in the PRC. Goods imported into these zones from outside the PRC are not subject to PRC customs duty. In addition, the import license and quota system does not apply to goods imported from outside the PRC into these zones.

In addition to these customs policies, special foreign exchange and taxation policies are also available.
Hong Kong and the Closer Economic Partnership Agreement

Hong Kong companies have several decades of direct experience entering into arrangements with the PRC. Many overseas investors find it to their benefit to take advantage of this knowledge and experience. The financial services sector in Hong Kong is a catalyst in raising funds for large scale projects. In 2010, 72 mainland enterprises staged their IPOs in Hong Kong, an increase of 50 percent over that of 2009, and the funds they raised accounted for about 50 percent of the total IPO funds raised in Hong Kong. At the end of 2011, mainland enterprises accounted for nearly 56 percent of Hong Kong Stock Exchange's total market capitalisation and 66 percent of its average daily turnover value.

With effect from July 1997, the government of the PRC resumed sovereignty over Hong Kong. Prior to that time Hong Kong had been a British Dependent Territory. It has now been officially renamed the Hong Kong Special Administrative Region of the People’s Republic of China (HKSAR).

The basic policies underpinning the existence and operation of the HKSAR are set out in the Sino-British Joint Declaration, an international treaty registered at the United Nations, and in the Basic Law, the mini constitution of the HKSAR. The Joint Declaration, ratified in 1984, set out the basic rules of post-handover Hong Kong. It provided a 13-year transition period for establishing the way forward and it was during this period that the more detailed plans of the Basic Law were compiled. The key message from the Joint Declaration was the principle of “one country, two systems.” Although Hong Kong was to become an inseparable part of the PRC, the PRC’s socialist system and policies would not be adopted. Hong Kong’s capitalist system, autonomy as an international business centre and open culture would continue unchanged for 50 years.

Specifically this means:

- The HKSAR maintains its free trade policy with an open independent economy, finances and its own legal system and laws.
- The HKSAR remains a separate customs territory. It has separate membership to trade associations and is governed by the rules of international trade. Trade with the mainland is deemed to be international.
- There are free flows of capital and no foreign exchange controls. The HKSAR will continue to use the Hong Kong dollar as its official currency.

The HKSAR therefore continues to be an accessible stepping stone for foreign entities seeking investment in and trade with mainland China. The Hong Kong-PRC partnership has a good track record; the two sides have a proven, mutually beneficial relationship.

In June 2003, the PRC and Hong Kong governments signed the Closer Economic Partnership Agreement (CEPA) to accelerate the development of economic and trade relations between Hong Kong and mainland China. Under the agreement, Hong Kong firms enjoy certain trade and economic benefits when investing in China. Supplementary interpretations and revisions are made to CEPA from time to time.

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About KPMG in India

KPMG in India, a professional services firm, is the Indian member firm of KPMG International and was established in September 1993. Our professionals leverage the global network of firms, providing detailed knowledge of local laws, regulations, markets and competition. KPMG in India provide services to over 4,500 international and national clients, in India. KPMG has offices across India in Delhi, Chandigarh, Ahmedabad, Mumbai, Pune, Chennai, Bangalore, Kochi, Hyderabad and Kolkata. The Indian firm has access to more than 5,000 Indian and expatriate professionals, many of whom are internationally trained. We strive to provide rapid, performance-based, industry-focused and technology-enabled services, which reflect a shared knowledge of global and local industries and our experience of the Indian business environment.

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 156 countries and have 152,000 people working in member firms around the world.

Our Audit practice endeavors to provide robust and risk based audit services that address our firms’ clients’ strategic priorities and business processes.

KPMG’s Tax services are designed to reflect the unique needs and objectives of each client, whether we are dealing with the tax aspects of a cross-border acquisition or developing and helping to implement a global transfer pricing strategy. In practical terms that means, KPMG firms’ work with their clients to assist them in achieving effective tax compliance and managing tax risks, while helping to control costs.

KPMG Advisory professionals provide advice and assistance to enable companies, intermediaries and public sector bodies to mitigate risk, improve performance, and create value. KPMG firms provide a wide range of Risk Consulting, Management Consulting and Transactions & Restructuring services that can help clients respond to immediate needs as well as put in place the strategies for the longer term.
About IMC

Set up in 1907, the 106-year old Indian Merchants’ Chamber is a premier Chamber of trade, commerce and industry in India, an apex Chamber of trade, commerce & industry with headquarters in Mumbai. It has over 3200 direct members, comprising a cross section of the business community, including public and private limited companies and over 200 affiliated member associations through which the Chamber reaches out to over 2,50,000 business establishments in the country. IMC gets ISO 9002-2000 accreditation, the first Chamber to get this certification in the country which has since been upgraded to ISO 9001: 2008.

IMC, set up in the wake of the ‘Swadeshi Movement’ by the visionary business leaders, has done a yeoman service during the freedom struggle of India. Hence, the Father of the Nation, Mahatma Gandhi accepted the Honorary Membership of IMC, the only Chamber in the country which has this privilege. IMC has always worked towards the cause of upliftment of the Society, and has been organizing seminars, workshops, etc. for promotion of trade and investment and extending the hand of cooperation to the Society at the time of natural calamities like flood, earthquake, etc. IMC is always seized of the contemporary socio economic issues and make best efforts to find out the solution. We have been constantly fighting for “good governance” and the issues like corruption, as IMC believes that good governance is a panacea to the complex problems of India.

A Century of Service to the Nation has three distinct phases:

• A crucial role in freedom struggle in the pre-independence era (1907-1947).

• A vital and an equally important role in the promotion of trade, commerce & industry in the planned economy in the post-independence era (1947-1991).

• Promotion of business to become globally competitive in the post-liberalisation era (1991-2012).

IMC celebrated its Centenary in 2006-07. The celebration was launched by former President of India, Dr. A.P.J. Abdul Kalam. Also as recognition of the services rendered by IMC, a commemorative postal stamp was released by the Department of Post, Government of India.

The closing ceremony of the celebrations was done at the hands of Hon’ble Finance Minister, P. Chidambaram, Government of India. In its second century it continues to serve with greater zeal the cause of trade, commerce and industry, especially in terms of global trade and investment and has in place 136 Memorandums of Understanding with leading chambers of commerce in over 50 countries. Its annual India Calling programme brings investment and trade opportunities in its target countries and in India to the attention of business and political leaders. Target countries hitherto have included Singapore, UAE, the U.K., South Africa, Canada, Brussels (Belgium), Turkey, Vietnam.

With its commitment towards social upliftment at the forefront, IMC has selected ‘Inclusive Growth’ as its theme for the year 2012. Various programmes and activities undertaken by the Chamber throughout the year will be centered on this theme.