UNDERSTANDING THE BUSINESS ENVIRONMENT

CHAPTER FIFTEEN

SUMMARY

- Opportunities exceed difficulties in the Indian market for Australian business. But success in this market requires a clear-eyed understanding of the business environment and differences in business culture.
- This chapter outlines some of the key differences between the Australian and Indian commercial environments that business has raised throughout the consultations for this Strategy. For Australian companies seeking to do business in India, these include the challenges posed by the regulatory environment, limited state capacity, corruption and differences in business culture, in particular, the prevalence of family-owned businesses.
- Ultimately, it is also a challenge getting noticed in a crowded market. The costs of doing business weigh heavily on Australian SMEs that lack the resources to engage in a complex marketplace with a large bureaucracy.

EASE OF DOING BUSINESS

Key judgement

India is committed to improving the ease of doing business. But domestic and foreign businesses continue to struggle to navigate India's complex regulatory environment, which varies significantly across India's states.

India improved 30 places in one year to a ranking of 100 in the World Bank's 2018 global assessment on the ease of doing business. This reflected a series of business-friendly reforms and the streamlining of regulatory procedures. For example, India recently introduced a GST, which provides a common indirect tax structure and unified common market. It may appear complex to firms in the short term, with the multiple layers currently in place, but is expected to improve the ease of doing business in the long term.

Despite this progress, many Australian and other foreign companies operating in India face bureaucratic inefficiencies, inadequate infrastructure, difficult regulatory procedures, inconsistently applied and frequently shifting regulation, retrospective and seemingly arbitrary tax liabilities, as well as restrictive land acquisition and labour laws. A ranking of 100 in the World Bank's 2018 assessment means India is still in the bottom half and impediments remain widespread and ingrained. In practical terms, the most difficult areas relate to starting a business, obtaining permits and enforcing contracts.

There is wide variation in the ease of doing business across states and sectors. The individual state assessments annexed to the Strategy provide a snapshot of the performance of India's 29 states and the National Capital Region of Delhi. As the dynamic of cooperative and competitive federalism takes root, states are being exposed to more competition, driving them to progress reforms to attract investment.

Key takeaway

Australian businesses need to identify the right local sources of expert market advice, understand how legislation and regulations are practically applied, recognise the value of a targeted approach to the most competitive states or sub-national markets and tailor their business and investment decisions accordingly [*this is expanded in Chapter 14: A Collection of States, which outlines priority states*].

TRANSPARENCY AND CORRUPTION

Key judgement

While India has been making progress, the lived experience of many businesses remains one of pervasive corruption.

Combating corruption remains a high political priority of the Modi government and voter tolerance of corruption is wearing thin. In August 2017, marking the 70th anniversary of the country's independence, Prime Minister Modi said 'We are fighting corruption – for the bright future of India and the wellbeing of our people…With the help of technology, we are trying to promote honesty and transparency in the country. Our fight against black money will continue; our fight against corruption will continue'.

A range of recent policy initiatives of the Indian Government have been aimed at reducing the opportunities for corruption and crony capitalism, including: the demonetisation of 500 and 1,000 rupee notes in November 2016; the push for digital payments to formalise one of the world's most cash-intensive economies; the transition to directly transferring welfare to beneficiaries' bank accounts; the new bankruptcy code passed in 2016; and incremental political finance reforms.

The legal framework for combating both public sector and private sector corruption is making progress. The *Companies Act 2013* has introduced higher standards of corporate governance. The courts have acted to correct irregularities, as in the high-profile Supreme

Court cases quashing the irregular allocation of India's 2G telecommunications spectrum and coal mining blocks. There are also high-profile cases of India pursuing private sector firms and individuals abroad.

The indications are that high-level political corruption at the Centre has declined since Modi's election in 2014, although this is less evident at the official-level and in the states.

There are also signs that the extent of crony capitalism has declined, although it remains a concern. According to the 2016 crony capitalism index of *The Economist*, India's crony sector wealth was estimated to account for 3.4 per cent of GDP, a level similar to Australia.[xxxi] This was a significant improvement on India's performance in 2008 when crony wealth reached 18 per cent of GDP.

However, this changing sentiment is yet to affect the lived experience for most businesses. In particular, corruption is seen to pervade the police, judiciary and public service, at every level of government. The worst-affected sectors include infrastructure, real estate, mining, aerospace, defence, power and utilities. Processes with elevated corruption risk include public procurement processes, land acquisition and natural resource allocation.

India still features prominently in various indices of corruption in business. The National Council for Applied Economic Research's surveys of Indian business conducted in 2016 and 2017 find that corruption remains the number one constraint faced by business. This is echoed by the Global Competitiveness Report of 2017 which ranks corruption as the most problematic factor of doing business in India. More broadly, Transparency International finds that India has the highest bribery rate in the Asia-Pacific region, with nearly 7 in 10 Indians who had accessed public services reporting paying a bribe. In Transparency International's *Corruption Perception Index 2017*, India ranks 81 in the world (first being least corrupt).

A key driver of corruption is the opaque and discretionary power of officials and politicians. The fact that many officials are underpaid and subject to arbitrary political interference exacerbates the situation. Expectations of bribery, gifts and facilitation payments to expedite public services or applications for industrial licences are not uncommon. In general, enforcement and monitoring is weak, and impunity for public officials is perceived as widespread.

The lack of transparency in India's political finance regime adds to perceptions about an uneven playing field. Vast amounts of undisclosed donations are deployed to finance political campaigns in both state and federal elections, shielding the relationship between India's largest business groups and political parties.

Key takeaway

Australian companies need to prioritise an in-depth, forensic approach to due diligence before embarking on new business relationships in India. Australian companies can minimise the risks by being careful about their choice of local partner, by taking steps to ensure they have the appropriate market entry strategies and maintaining clear policies on corporate conduct including a strict 'no corrupt payments' policy. It is essential that Australian businesses seek their own legal advice in relation to these issues.

BUSINESS CULTURE AND STRUCTURE

Key judgement

Differences in Australian and Indian business culture present challenges for commercial relationships, especially contract negotiation, interpretation, and dispute resolution. Large, diversified company groups owned by families dominate India's corporate landscape. These firms can operate on longer time horizons and

xxxi Crony capitalism here refers to nominally free-market economic systems where businesses succeed due to close relationships between with the political class, including government officials.

with greater levels of risk compared to Australia's listed companies.

There is a deceptive familiarity between Australia and India. The similarities in federal, legal and parliamentary systems and a shared use of the English language can often assist relationships, but also catch companies unprepared for divergent business norms that sit behind these formal structures.

The business cultures of Australia and India differ with respect to the levels of comfort with uncertainty, the process and length of decision-making and the relative importance of hierarchy and seniority. Differences in business culture extend to different approaches to contract negotiation and enforcement, dispute resolution and the expected role of government in securing commercial outcomes.

Australian firms must also be aware of the dynamics of family-owned Indian businesses. They exercise significant market power and political influence; in 2016, 15 of the top 20 business groups are family-owned and over 60 per cent of Indian listed companies are majority family-owned. Many are highly diversified conglomerates, structured in complex chains of holding companies and subsidiaries, allowing outside capital to be brought in without diluting family control.

The performance of individual elements of family-owned businesses can vary significantly. Due diligence on partners should reflect not only the operations of the overall firm, the family group, and the overall management, but also the commercial performance of the specific arm being considered for partnership.

Family-owned businesses are generally more capable of developing relationships over a long term strategic timeframe, including because they have more freedom to pursue long term growth strategies and acquisitions which might incur short to medium term losses. This can bring about a mismatch of time horizons with their international commercial partners.

Succession planning within family-owned businesses can also complicate external engagement. Newer generations of family-owned businesses tend to be less wedded to the business and more likely to import the management practices of major global companies. Mooted changes to corporate governance within India, such as a proposal to separate the roles of chairperson, CEO and managing director in listed companies with over 40 per cent public shareholders, could have a significant effect on the dynamics of family-owned businesses.

In contrast to India, the Australian corporate landscape is dominated by companies listed on the ASX, driven squarely by the interests of shareholders, including a focus on short term results.

Whereas Australian companies generally determine business planning on the terms and conditions set out in tender documents and contracts, Indian governments and firms may be more likely to expect that agreements are open to reinterpretation or renegotiation, and that building strong business relationships will create flexibility in commercial terms and conditions.

The experience of Indian investors in the Australian mining sector is indicative of these differences, for example, around the inability to renegotiate water rights, and government's inability to curtail legal disputes by affected stakeholders. The experience of Australian companies involved in the New Delhi Commonwealth Games in 2010 also reflects differences in the approach to resolving conflicts, including the withholding of contract payments and the litigation of disputes.

Key takeaway

Australian companies need to inform themselves about the differences between Australian and Indian business culture and values and adopt corresponding strategies to market entry, strategic planning, contract negotiation and dispute resolution. Business planning will need to manage the different time horizons Australian shareholders and Indian partners may expect.

STATE CAPACITY

Key judgement

All levels of government in India remain stretched on resourcing but still heavy on bureaucratic processes. This puts a strain on service delivery and perpetuates regulatory uncertainty, exacerbating concerns regarding the inconsistent application of regulations, the independence and competence of regulatory agencies, and the delineation between regulators and the government.

Prime Minister Modi needs an empowered bureaucracy to support his government's broader agenda. Recent public sector reform initiatives have included technology-enabled monitoring of the attendance of public servants, e-governance to streamline public service delivery and reduce corruption, as well as tentative moves to adopt lateral recruitment at lower levels of the bureaucracy.

The paradox of the Indian public service is not that there are too many bureaucrats but that there are too few at the levels that matter. It is a top-light and bottom-heavy system. Impediments to a more empowered bureaucracy include this thin layer of decision makers, staffing shortfalls, rigid bureaucratic norms, recruitment policy, performance management systems, and a prevailing culture of deference and inertia which discourages innovation. According to a 2014 measure of government effectiveness by the World Bank, capturing the quality of the public service, independence from political pressure, and the quality of policy formulation and implementation, India ranks in the 45th percentile globally.

Given India's size, there is a paucity of Indian Administrative Service (IAS) officers who hold the key management positions in the Central and state governments and statutory bodies across the country. The current number of IAS officers is only around 5,000. This is an astonishingly low number even for Australia, let alone a country of 1.3 billion people. This is in addition to 2,600 Indian Forest Service officers and 3,900 Indian Police Service officers; which together comprise the three elite All India Services (despite the several million officers of the Central Civil Services and State Civil Services, they have only limited discretion or capability to make decisions independent of guidance from an IAS officer).

The result is significant capacity constraints at federal, state and local government levels in India, with government often failing to effectively deliver routine public services, including access to basic infrastructure, power, water and sanitation. These constraints are exacerbated by the amount of red tape officials need to navigate in doing their jobs. India cannot deliver on its potential without stronger institutions and wide ranging public sector reforms. Policy implementation and service delivery are perhaps the two largest governance challenges India faces.

Australian business should be aware of the weaknesses of Indian public institutions, which manifest in a divide between the rule of law in practice and the rule of law on paper. Many Indian public institutions struggle with managing human resources, the pressures of political interference and public accountability.

Key takeaway

Australian business needs to consider the impact of limited state capacity in India on their investments. In some cases, local advocates, agents or business partners can be powerful in helping to understand and shape regulatory processes. Limited state capacity also means that Australian companies need to be prepared to dedicate resources to India for the long haul and demonstrate commitment to the market.

GETTING NOTICED AND IMPROVING 'INDIA LITERACY'

Key judgement

Given the complexities of the Indian business environment, one of the foremost challenges for Australian firms is getting noticed. This affects commercial prospects, the ability to attract the right partners as well as the ability to gain the attention and focus of Indian Government decision-makers.

Australia is competing in an increasingly crowded marketplace. India more naturally looks to the United States, Japan and Europe as market leaders. And it is even harder for Australian companies to cut through in sectors dominated by state-owned enterprises, as in the resources sector.

Part of the solution is for Australia to target the areas in which Australia is genuinely globally competitive. The sectoral chapters of this Strategy set out where these are strongest. Complementing this effort, as part of their market strategies, individual businesses need to consider how best to explain the way their product contributes to India's own policy goals. Partnering with successful companies in India from Australia's major regional partners, including Japan and Singapore, might offer an avenue for Australian businesses to get traction.

Improving literacy of India's business environment within corporate Australia should be a first-order priority. The boards and senior leadership of Australia's biggest companies, particularly those listed on the ASX, have persistently low levels of 'Asia literacy'. This is not conducive to supporting long term strategic investments in Asian countries, especially those with relatively challenging business environments such as India. Asialink Business has found that 67 per cent of ASX 200 board members show no evidence of extensive experience operating in Asia while 55 per cent demonstrate little to no knowledge of Asian markets.[119] This is despite Australia's domestic consumer base increasingly reflecting a multicultural Asia.[xxxii]

Key takeaway

A local presence in India is important to getting noticed. Having a local office, credible local partners with established networks or high-profile champions can all play a critical role in explaining the environment and bringing products to the attention of customers or challenges to the attention of officials and politicians. Even with a greater focus on India, the Australian Government will have relatively constrained resources to deploy to facilitate outcomes as compared to some other foreign governments.

xxxii 12.2 per cent of Australians declared their Asian ancestral background from the top 30 countries in the 2016 Census.

RECOMMENDATIONS

75. Improve India literacy in Australian firms

75.1 The Australian Government and business should work together to strengthen the 'India literacy' of Australian firms.

- Australian Business Week in India should be held every two years, with a focus on sectoral streams and the priority states. Consideration should be given to how to bring together the full ecosystem that supports exporters, ranging from financiers, investors, consultants, training institutions and tech start-ups.
- The CEO Forum could play a greater role, for example, commissioning policy papers from members outlining ways to overcome constraints businesses face working in either jurisdiction.

75.2 To improve India literacy in Australian companies, the Australian Government should encourage company boards to strengthen their diversity, including expertise in Indian and other Asian markets

- the Australia-India Council board members along with Boards of other Foundations, Councils and Institutions (covering China, Japan, Korea, Indonesia and ASEAN), should meet with CEOs of large companies to champion the benefits of Asia expertise on Australian boards.

76. Expand institutional engagement with the Indian bureaucracy

Australia should increase institutional engagement to build capacity and networks within the Indian bureaucracy

- increase engagement between the Australia New Zealand School of Government (ANZSOG) and India, building on its international programs which have been delivered to Indian officials in the past
  - this would also enable us to collaboratively work on policy challenges, and build networks of influence within each other's bureaucracy
  - establish scholarships to sponsor Indian participation and look to establish a reciprocal scheme with the Indian Government
  - establish outbound ANZSOG programs to increase the India literacy of Australian state and federal public servants, including through engagement with counterparts in key Indian states
- expand existing secondments between the Australian Treasury and NITI Aayog, and establish secondments between Austrade and Invest India, Infrastructure Australia and an appropriate Indian organisation, between the ASX and Bombay Stock Exchange and between our central banks.

77. A Public Sector Dialogue

Re-initiate efforts to hold a regular public sector dialogue led by the Secretary of the Department of Prime Minister and Cabinet and Indian counterpart(s) to share Australian and Indian public policy reform experiences.