

Doing Business in India: Opportunities and Challenges

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The paper describes the challenges as well as the emerging opportunities of doing business in India. It finds high correlation between compound annual growth rates of India's major States in 1999-2006 period and poverty decline rates in these States during the four decades, 1960-2000. The analysis suggests that poverty decline is a robust explanatory factor of India's economic growth in recent years. The paper argues that India's poverty decline trend is sustainable as it is founded upon the enfranchisement of the poor in democratic India and the pro-poor vote winning strategy cutting across all major political parties. In view of the consequent increase in the size of the BOP market, targeting BOP market is a winning business strategy in India.

INTRODUCTION

Doing business in India is indeed challenging. Yet, today's India with its growing domestic market, burgeoning pool of human capital and increasingly robust democratic polity has begun to offer attractive longer term investment opportunities.

What makes the 'Rise of India' story particularly interesting is that unlike the East Asian story Indian governments have not fashioned any export led growth strategy and stimulated growth by allocating resources in key private sectors; nor is India's growth propped up by the bubbles of expectation generated in the financial/capital market or in the property/asset market as seen in USA and many other western countries. India's growth, on the other hand, is fueled by its growing domestic market and by productivity gains in manufacturing and service sectors. Most importantly, it is shaped and nurtured by India's democratic political processes the role of which in scripting India's growth story will be discussed in this paper.

The paper is divided into five sections. The next section gives an overview of the challenges of doing business in India, which is followed by the section that enumerates facts about the growth of Indian economy. In the penultimate section, an analysis of the factors driving India's recent growth is presented. Section 5 concludes the discussion.

Business Environment: Challenges

The challenges of doing business in India are many. It has inadequate infrastructure, rigid labor laws, complicated tax systems, labyrinthine judicial system and inefficient public delivery system afflicted by corruption. The economic and social backwardness of the average Indian is reflected in the human development profile briefly described in the next paragraph. Also described in the subsequent sub-sections are the procedural complexities in running a business enterprise in India, labor market rigidities,

infrastructure bottlenecks and the elaborate tax structure and compliance requirements. They speak volumes of India's challenging business environment.

Human Development Profile

India is the largest democracy in the world with its 1.17 billion people growing currently at an average annual rate of 1.4%. Its democratic polity is enshrined in a written Constitution that confers major legislative power to the Union Parliament. About 60% of its population is engaged in lowly productive agricultural activities which have contributed only 14.6% of GDP at factor cost in 2009-10 (Economic Survey 2009-10, Government of India). Its human development rank in 2009 was 134 (out of 182 countries) making it at best a medium human development country (World Development Report, 2010). The state wise figures in Table 1 below capture the diversity across major states². India's rather unimpressive human development profile is easily understood by the fact that largely populated Indian states such as Uttar Pradesh, Madhya Pradesh, Bihar and Rajasthan constituting 42% of India's population have remained laggards for many decades.

**TABLE 1
SELECTED STATE-WISE INDICATORS**

State	Life Expectancy		Literacy rate		Head CountPoverty Index		Mean HDI Rank (1981-2001)	Rank in Poverty Decline	Rank in Growth rate between (2000-2007)	Rank in per capita SDP
	female	male	female	male	Rural	Urban				
Andhra Pradesh	63.5	61.2	51	71	29.2	17.8	9	3	2	7
Maharashtra	66.6	64.1	68	86	42.9	18.2	3	10	8	2
Gujarat	62.9	60.9	59	81	32.5	14.7	6	4	1	3
Tamil Nadu	65.1	63.2	65	82	38.5	20.9	4	6	6	5
Punjab & Haryana	66.7	65.2	60	77.5	11.6	9.2	2	2	5	1
Kerala	75.9	70.4	88	94	19.5	13.9	1	1	3	4
Karnataka	64.9	61.6	57	76	37.9	21.4	7	8	7	6
West Bengal	63.6	62.2	60	78	25.1	15.5	8	5	9	8
Orissa	57	57.1	51	76	43.5	15.2	10	7	4	10
Rajasthan	60.1	59.1	44	76	23	18.3	11	9	12	9
Assam	57.1	56.6	56	72	35.4	13	12	14	11	11
Bihar	58.4	60.4	35	62	48.6	26.7	15	13	10	14
Madhya Pradesh	55.2	55.6	51	77	36.6	18.5	13	12	14	12
Uttar Pradesh	56.9	58.1	44	71	28.7	21.7	14	11	13	13
ALL INDIA	61.8	60.4	54	76	32.9	18.1				

Sources: Economic Survey 2009-10; Dreze and Sen(2002); and Datt and Ravallion(2002)

Governance and Regulatory Framework

In the World Bank's *Doing Business Survey 2010*, India ranks 133 among 183 economies. The Survey gives India a poor rank, 169 in starting a business, still poorer ranks, 183 and 175 in enforcing contracts and getting construction permits respectively. From Confederation of India(CII)'s document(CII,2009a) and the World Bank's survey(World Bank, 2010), it is found that before setting up business

establishments in India as many as twenty-four clearances are required from central government and state/local governments. Clearances/approvals from central government include the following:

1. Obtaining director identification number (DIN) on-line
2. Obtaining digital signature certificate on-line
3. Reserving the company name with the Registrar of companies on line
4. Presenting the company documents duly stamped by Superintendent of Stamps or the authorized bank along with the registration fee to the Registrar of Companies to get the certificate of incorporation
5. Obtaining a Permanent Account Number (PAN) from National Securities Depository Services Limited (NSDL) or Unit Trust of India (UTI) Investor services Limited or their authorized agent.
6. Obtaining a Tax Account Number (TAN) for tax deduction at source (TDS) from Income Tax department
7. Obtaining Environmental Clearance under environment impact assessment(EIA) notifications of 2006
8. Clearance for diversion of forest land
9. Coastal Zone regulation (CRZ) under CRZ Notification
10. Wildlife clearance under Wildlife (Protection) Act,1972
11. Stack height clearance under Aircraft Act, 1934
12. Clearances required from Ministry of Defense
13. Clearances under Electricity Act,2003
14. Clearance from chief controller of explosives (CCE) to use explosives under Explosives Act, 1884 and Explosive Rules, 1973
15. Clearance to use groundwater in exploited blocks
16. Security clearance
17. Obtaining importer-exporter code

At the state/local government level, following clearances and approvals are required:

1. Approval of building plans by Municipal authorities and factory inspectorate
2. Licenses required from Chief Inspector of Factories under the Factories Act,1948
3. Permission to use water and power allocation
4. Consent to establish and operate and grant of emission and discharge from Pollution Control Board (PCB).
5. Registrations under labor laws such as Provident fund (PF) and Employees State Insurance (ESI).
6. Registration with VAT and professional tax authorities
7. Registration under Shops and Establishment Act.

Labour Market

Industrial Disputes Act, 1947 makes it difficult for the formal sector that employs more than 100 workers to retrench or lay off workers. Such lay off/retrenchment requires prior permission from the competent government authority (as per Section 25N of the Act), and it is difficult for any government in India to give the permission as trade unions vehemently oppose such moves. Section 25 G of the Act lays down the procedure of retrenchment. It provides that in the absence of any agreement between the employer and the workman in this behalf, the employer shall ordinarily retrench the workman who was the last person to be employed in the category of workman in which he was employed. To be sure, Indian companies have been downsizing its work force, mostly through voluntary retirement scheme. Many public sector banks downsized their workforce by offering attractive voluntary retirement schemes. Jet

Airways retrenched hundreds of its staff in 2007-08 when the airline industry was suffering huge loss due to demand shortfall.

Infrastructure

According to a McKinsey & Company report, “Building India: Accelerating Infrastructure Projects” (2009), projects awarded in national highways, power and port sectors fell short by 30% than the planned targets in the first two years of the current 11th plan. Ray (2010) argues that one major problem is that due to access constraints global infrastructure construction companies have not yet been effectively responding to the global bids in India’s PPP projects. Moreover, domestic players who can develop good quality infrastructure within time and cost constraints are too few in number. As a result of India’s chronic infrastructure deficit, logistics costs are as high as 13-14% of GDP, considerably higher than 8% in United States (Chandra and Jain, 2008).

In a recent study CII estimated average transaction cost in Indian ports which account for 95% of foreign trade by volume and 75% by value. It worked out to be Rs.7,437 (US\$170) per TEU, 44.6% of which was ‘unnecessary’ cost incurred due to high dwell time in yard, pre-birthing detention and non-working time at berths. The average turnaround time in Indian Port is 3.6 days compared with just 1.5 days average in Southeast Asian ports. Consequently, an identical shipment of textiles to the United States from India costs 20% more than from Thailand and 35% more than from China. (CII, 2009b)

Indian Railways, a 150-year old network covering 40,000 mile, moves seven billion passengers and 830 millions of cargo a year. But its modernization has not kept pace with the growth of Indian economy; its tracks have remained too lightweight and locomotives too underpowered to haul more than 5,000 tons of cargo, compared with 20,000-ton capacities of trains in the United States, China and Russia. According to a recent New York Times report, containers take more than two weeks time to travel 870 miles by rail from Mumbai to New Delhi from Mumbai. This time lag will, however, be drastically reduced after the proposed Delhi-Mumbai dedicated freight corridor comes into being.

It is necessary to mention here that Indian government has recently been giving top priority to reduce infrastructure deficit. A planned investment of US \$514 in the ongoing eleventh five year plan is expected to raise the share of infrastructure to 9% of GDP by 2011-12 from about 6% five years back. India’s Planning Commission has already announced planned investment of US\$ 1 trillion on infrastructure development in the ensuing twelfth five year plan.

Corruption

Wade (1982) showed how the system of delivering irrigation water to farmers in southern India was structured to facilitate bribe collection by bureaucrats in the public works department. Things have not improved much even after four decades since the aforesaid classic study. India now ranks 85 among 180 countries in the Corruption perception index of Transparency International. Transparency International India (TII)’s “India Corruption Study 2008” has estimated that below poverty line (BPL) households spent over 883 crore paying bribe of which Rs.223 crore were paid by the poorest to avail 11 basic public services such as hospital, education and water that they are entitled to. Nearly two-thirds of BPL household could not avail of PDS, school education and electricity because they could not pay bribe or use contact or influence to avail of service (Press Information Bureau, 2008). According to TII’s estimate, nearly Rs.80,000 (US \$1800) are paid annually by a single truck as bribes at toll plazas, check points, state borders while en-route.

Tax Structure and Compliance Requirements

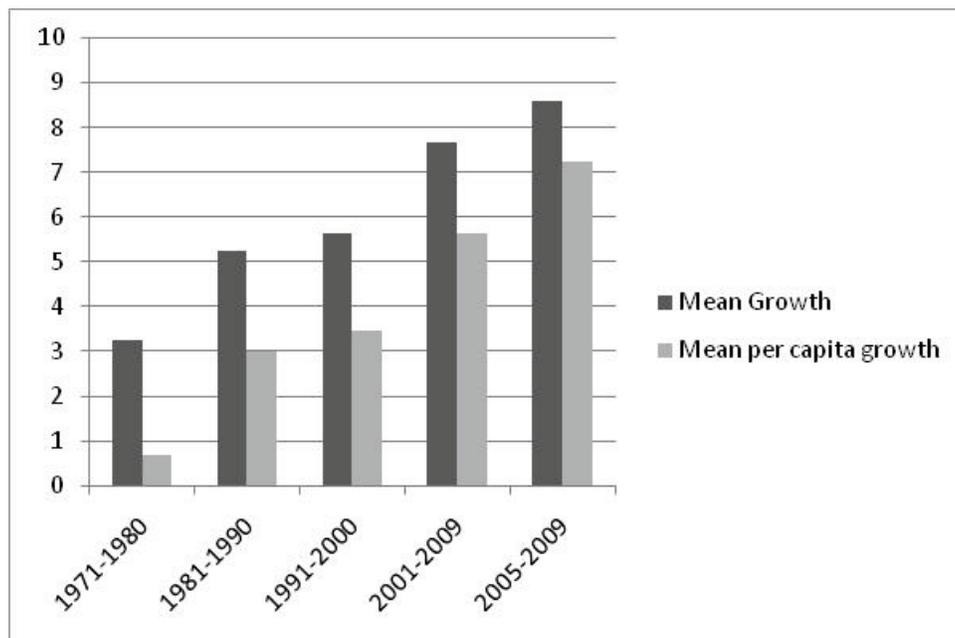
Domestic tax structure in India is fairly complicated with multiple taxes levied at the central and state government levels. The cumulative incidence of indirect taxes on goods is estimated to be 28% of the sale price without taxes in February 2010 (CII, 2009). Table 3 at Appendix 1 gives a summary of India’s present tax structure and compliance requirements. It may be mentioned that the proposed goods and services tax (GST), scheduled to come from next year, will simplify and rationalise indirect tax system as it subsumes all major consumption taxes levied by the central as well as state governments³.

The Rise of India: A Profile

Despite poor governance and huge infrastructure deficit, India's growth story is impressive as the following facts and figures suggest:

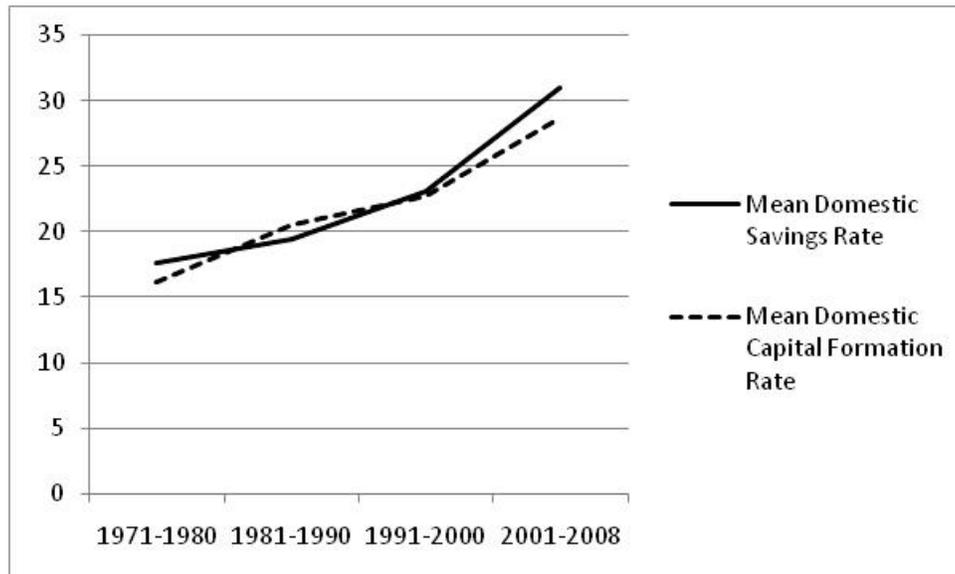
- i. In the past two decades India's GDP has increased in real terms by four fold. In the current decade the average annual growth in real terms has been 7.65% on the back of 5.62% average annual growth in 1990s decade. In the past five years, average annual growth was 8.58% . Fig.1 shows how mean annual growth and per capita growth have increased successively in the last four decades while Table 4 at Appendix 2 shows the trend of India's stable and sustainable growth over the last four decades.

**FIGURE 1
MEAN GNP GROWTH BY DECADE**



- ii. Domestic saving increased over the last four decades from the mean annual saving rate of 17.5% of GDP in 1970s decade to 31% in this decade; gross fixed capital formation also increased during the same period from 16.13% to 28.62%. The sector-wise share in savings in 2008-09 is dominated by household sector with 70% share followed by private corporate sector's share of 26%. In domestic capital formation private corporate sector contributed 36%, household sector 34%, and public sector, 26% (Economic Survey 2009-10; table 1.6 at page A10 and figs.1.2 and 1.3 at page 10)

FIGURE 2
GROWTH IN MEAN DOMESTIC SAVING AND CAPITAL FORMATION IN FOUR DECADES



- iii. Domestic private consumption share being 59% dominates the demand side composition of GDP over the last five years. The share of government consumption was only 11%, while investment's share was 35% with net exports being always in the negative (Economic Survey 2009-10, table 1.4, page 6).
- iv. The primary sector grew at an annual average rate of 3.2% only while manufacturing sector grew at 9.6%. Major service sectors grew at still higher rates: for example, trade, hotels, transport and communication sectors grew at 10.6%; and financing, insurance, real estate and business services grew at 12% (Economic Survey 2009-10 at page A7).
- v. Net sales growth of corporate manufacturing sectors increased from 14.5% in 2003-2004 to 26.6% in 2008-09, while the growth in services sector (other than financial services) has been more than 20% throughout the period (CII, 2010).
- vi. Average annual productivity (total factor productivity) growth in industry has increased from -1.2% in the period 1997-2001 to 1.9% in 2002-2004; the average productivity growth in services during the same period increased from 2.8% to 3.0%. Since 2003 about 50% of the jump in growth, from 5%-6% to nearly 8%, is attributable to productivity growth (Goldman Sachs, 2007, pp3- 6).
- vii. India's consuming class whose annual income in 2005-2006 prices is in the range of US \$ 15,000- US 30,000 had grown from 13.8 million households in 2005 to 24.9 million households (average household size is 5.38) in 2010. In the next five years this population is estimated to grow to 39.8 million households. India's middle class and lower middle class are expected to drive 200% growth in telecom subscribers, 100% in power generation, 100% in healthcare services, 80% in processed foods, and 75% in colour TV sales. (Source:CII,2010).
- viii. According to World Economic Forum's Global Competitiveness Report 2010, India holds strategic competitive advantages in market size and financial market sophistication. According to the Report, its overall rank of 49 among 134 countries shall increase

- considerably once it implements its planned investments in infrastructure and improve its fiscal deficit and inflation parameters.
- ix. The Global Competitiveness Report, 2009 shows that India's rank in availability of scientists and engineers was 3 compared with China's 52, Russia's 34, Brazil's 57; its rank in domestic market size is 4, in foreign market size 5, in intensity of local competition 11, and in extent of markets dominance 19; in quality of Math and Science education, 17 (CII, 2010).
 - x. With median age of 25.3 years compared with China's 34.1, USA's 36, and Japan's 44; 78% of its population are below age 40; and average labour costs are lower than other emerging economies including China (Global Demographics and CII, 2010).
 - xi. India has a sound financial system with capital adequacy ratio of 13% in 2008, well above Basel II norm of 8% (CII, 2010).
 - xii. According to the Nielson Global Consumer Confidence Study, 2009 India tops consumer confidence globally; and for the fourth time in five years, India is the most attractive country for retail investment according to A T Kearney Global Retail Development Index, 2009(CII, 2010). According to IMD's Global Competitiveness Report, business efficiency indices in India have been better than those in China during the last five years.

Factors Driving India's Growth Momentum

What explains India's growth at increasing rates over the decades? In order to better understand what factors may be at play, it is necessary to look at the disaggregated state level data in Table 2 below.

Growth Divergence among Major States

As Table 2 shows, per-capita nominal state domestic product (SDP) grew in this decade at the slowest pace in the poor states of Madhya Pradesh and Uttar Pradesh, while highest growth is witnessed in the rich states of Gujarat and Andhra Pradesh whose ranks in poverty reduction and overall HDI are also relatively high. Five states with the lowest ranks in per capita income, decline in poverty incidence and HDI ranks had lowest ranks in growth rate while five rich states with highest ranks in poverty decline, namely, Kerala, Punjab and Haryana, Gujarat, Andhra Pradesh and Tamil Nadu had highest growth ranks.

Maharashtra, however, did poorly in terms of both poverty decline and growth rate in post 2000 period. Though it is the most industrialised, third largest and the second richest state in terms of per capita SDP (Punjab& Haryana with an aggregate population less than half of Maharashtra's is richest in per capita SDP), it grew at a paltry 12.7% as against Gujarat's 15.9%, Andhra Pradesh's 15.1%, and Kerala's 14.2%,. Its poverty decline rate in four decades prior to 2000 also stood at a low 1.31% as against Kerala's 3.26%, Andhra Pradesh's 2.38% and Gujarat's 2.02%.

The states which were among the poorest grew at lowest rates in 1990s also. Studying major Indian states, Datt and Ravallion (2002) found that poorest states in 1980s grew at the slowest pace in 1990s. An interesting finding of this paper is that growth in India has been higher in states that exhibit lower growth elasticity of poverty decline which explains why economic growth has not significantly reduced poverty incidence in India. In other words, this study suggests that poverty decline in India did not follow from economic growth.

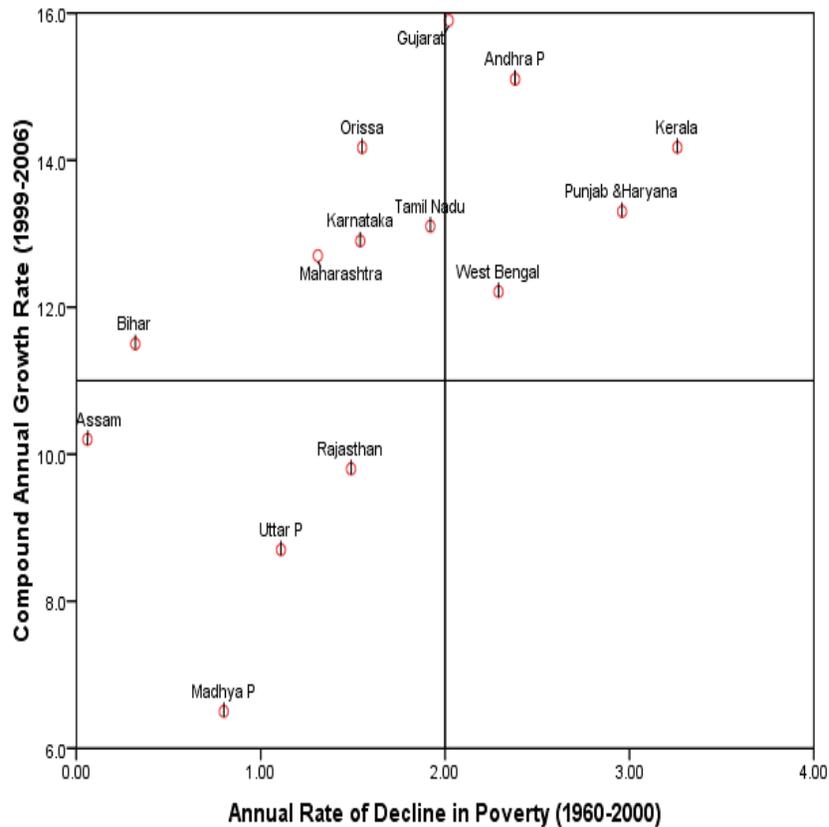
TABLE 2
POVERTY DECLINE AND GROWTH

State	Population	SDP per capita (Rs.)	Poverty Decline 1960-2000(%)	Annual Compounded nominal growth in current prices from 1999-2000 to 2006-07 (%)	Growth Rank (2000-2007)	Poverty Decline (1960-2000)
Andhra Pradesh	76	35,864	2.38	15.1	2	3
Maharashtra	97	47,051	1.31	12.7	8	10
Gujarat	51	45,773	2.02	15.9	1	4
Tamil Nadu	62	40,757	1.92	13.1	6	6
Punjab & Haryana	45	51,712	2.96	13.2	5	2
Kerala	32	43,104	3.26	14.171	3	1
Karnataka	53	36,266	1.54	12.9	7	8
West Bengal	80	31,722	2.29	12.21	9	5
Orissa	37	23,403	1.55	14.17	4	7
Rajasthan	56	23,933	1.49	9.8	12	9
Assam	27	21,991	0.06	10.2	11	14
Bihar	110	11,135	0.32	11.5	10	13
Madhya Pradesh	81	18,051	0.8	6.5	14	12
Uttar Pradesh	175	16,060	1.11	8.7	13	11
ALL INDIA	1,027	33,283		12.73	33,283	

Sources: Economic Survey 2009-10; and Datt and Ravallion(2002)

The scatter diagram, Fig. 3, clearly brings out the correlation between poverty decline during 1960-2000 and the compounded annual growth rate (CAGR) in state domestic product (SDP) per capita between 1999-2000 and 2006-07. States with higher rates of poverty decline and growth have clustered in the north eastern quadrant while states with lower growth and poverty decline rates have clustered in the south western quadrants of the diagram. Among the poorer states, Bihar and Orissa grew at relatively higher rates mainly because these mineral rich metal producing states benefitted from high international price of commodities following surge in demand from China and India. Maharashtra, the second richest state in per capita output that has been drawing the highest foreign direct investment with more than one-third of total cumulative FDI in India, has been laggard in poverty eradication.

FIGURE 3
CORRELATION BETWEEN POVERTY DECLINE AND GROWTH IN MAJOR STATES



The rank correlation co-efficient between post 2000 growth and pre 2000 poverty decline is 0.81, while rank correlation coefficients between growth and its other explanatory variables, namely, per capita state domestic product, literacy rate, foreign direct investment and capital formation are much lower at 0.50,0.43,0.58 and 0.65 respectively. Subtracting the growth and poverty decline rates of different states from those rates of Karnataka, which is the median state in the achievement of both rates, one finds the differential growth rate and differential poverty decline rates of different states vis-à-vis Karnataka. The correlation coefficient between these two differential rates of growth and poverty decline is also quite high, 0.61. Even after controlling for median-state specific effects on both growth and poverty decline that may simultaneously influence this correlation, the poverty decline-growth correlation is quite high, 0.61. This shows that poverty decline during 1960-2000 is a robust explanatory factor of the growth achieved in India during 1999-2000.

Poverty Reduction and Growth: Explanation of the Link

Ray *et al.*(2001) models three factors of production that determine the growth dynamics of the real economy: private capital such as physical capital and knowledge capital; social capital that is commonly accessible; and individual accessibility to such commonly accessible social capital that determines the per capita social capital that the average individual in a particular socio-economic space can use productively. An economy with low levels of per capita social capital exhibits neoclassical growth- it attains steady state and cannot grow in the long run. In contrast, economies with higher levels of per-capita social capital grow at rates proportional to the growth in access to such social capital.

India's growth story broadly follows this dichotomous dynamics in its richer and poorer states. Comparatively richer states where poverty declined the most provided higher access to public capital

goods (a proxy for commonly accessible social capital). These states grew relatively faster than poorer states which exhibited neoclassical growth dynamics with diminishing returns to capital. Maharashtra is an exception though. In spite of being the second richest state in India that drew 35.46% of total foreign direct investment (FDI) flow, its ranks in growth rate and poverty decline were 8 and 10 respectively out of 14 major States. A possible interpretation of this outcome is that lower poverty decline was the cause of lower access to commonly accessible social capital which in turn caused lower growth rate in Maharashtra.

Ray (2006) shows that in a milieu where per capita access to commonly accessible social capital grows, investments in new knowledge-capital drive the growth of the aggregate economy. The paper shows that where the accessibility does not grow, the economy is trapped in a steady state in the long run. One result of this analysis is that growth dynamics of an economy is sustained in the long run if access to such common capital is widened to include the marginal groups in the mainstream economy.

The demand side link of growth with poverty reduction is that an increase in the income of poor generates incremental demand for goods and services. "According to National Sample Survey (NSS) data, per capita consumption in rural India has a whole increased by 12% in the 12 months between 2004-05 and 2005-2006 against a 15% increase in five years between 1999 and 2004. This acceleration was primarily the result of an explosive increase in the consumption of the lowest one-third of the rural population; from a mere 7% in the five years 1999 to 2004 to 15% percent in a single year." (Ranade, 2011)

Due to increase in income and access to public goods, the demand of the rural poor has increased for fast moving consumer goods, consumer durables, education, healthcare, transportation, and telephonic and other communication services. Some of these sectors such as education, healthcare, and telecommunication services are characterized by positive external effects in production. Demand side externalities are also typically associated with network services. The growth of these sectors can therefore have multiplier effects on the growth of the economy. Sustained growth in private consumption of goods and services in rural India lends credence to such a growth story.

Political-Economic Dynamics of Poverty Decline

Decline in poverty incidence can be attributed to three important political milestones in democratic India. The first milestone is the bank nationalisation program in 1969 as part of the *garibi hatao* (removal of poverty) program of the newly formed Indira Gandhi led Congress (Indira) party. A special component of this program had provided for targeted welfare programs and widened opportunities for access to education and employment opportunities for the socially disadvantaged groups such as the Scheduled castes, Scheduled tribes, women and minorities. The party won the 1971 general election on the pledge of *garibi hatao*.

Bargess and Pande (2005) found that bank nationalisation led to expansion of rural branches of the nationalised banks. This was followed by rural expansion of other large private banks. Priority sector lending also increased as a result of expansion of rural branches of large banks. The study found that bank nationalisation was associated with poverty reduction, which supports the thesis that poverty decline in India was caused by India's democratic political dynamics and not by the trickle-down effect of aggregate growth of the macro-economy. The link between higher domestic savings and bank nationalisation attributed in Basu and Maertins(2007) also suggests that the causal link flows from pro-poor political dynamics through poverty decline to growth.

The second major political event is socially backward population's increasing access to political power. The movement started with the Constitutional provisions for proportional reservation of seats in legislatures, civil services, and academic institutions for the scheduled castes, scheduled tribe and other socially backward caste population. It got momentum in the second half of 1980s as the newly established Janata Party led government of India headed by V.P. Singh decided to implement recommendations of Mandal Commission for backward castes. Clearly the new party wanted to increase its sphere of political influence among these large social groups.

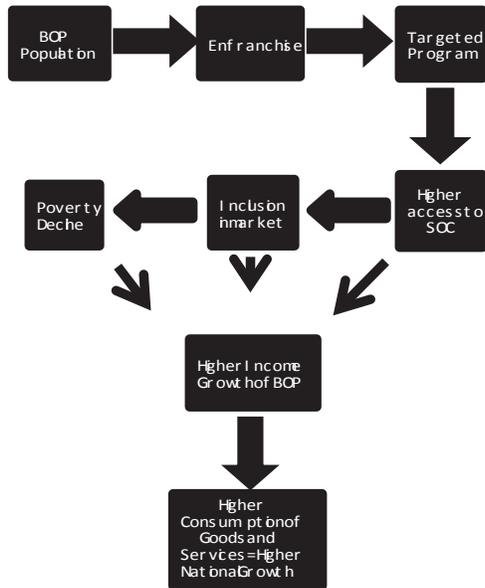
Banerjee and Somanathan (2007) studied investments in rural infrastructure (for example, primary schools, piped water, and electricity connections) over 1970s and 1980s and their access to different categories of population using data on public goods and social structure from parliamentary constituencies in rural India. They found evidence of considerable equalisation of access in accordance with national policies and political agendas of ruling parties. Primary schools were available in 75% of all villages in 1991 as against 53% in 1971; electricity connections increased from 18% to 70%, and there was nine fold increase in access to piped water over these two decades. The scheduled caste population who were better organised politically got higher access than the scheduled tribes who were not so well organised politically.

Since backward caste population are now better organized politically as parties representing these groups have been in power for the last two decades in the two largest states, Uttar Pradesh and Bihar, it is reasonable to think that the access to public goods are now more equitably distributed than ever before. The formation of new states of Chhattisgarh, Jharkhand and Uttarakhand with predominant tribal population is expected to increase access of tribal population to public goods and services.

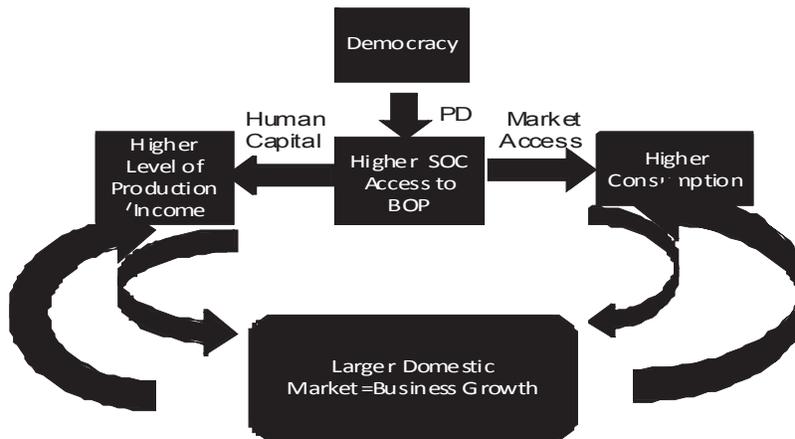
The third major political milestone was National Rural Employment Guarantee Act, 2005(NREGA), which was followed by two other important legislations, Right to Education Act, 2009(REA) and the Women Reservation Bill, 2010 (WRB). These legislations seek to lay the foundation for India's rapid socio-economic transformation in coming years. NREGA guarantees at least 100 days wage employment in every financial year to every household in rural areas whose adults volunteer to do unskilled manual work. REA makes free and compulsory education a fundamental right for all children between the ages of 6 and 14 providing for 20% quota in private schools for the disadvantaged groups. WRB provides for reservation of 33% seats for women in Union and states legislature.

These pro-poor political dispensations cutting across all major political parties have proved to be effective in winning over political constituencies. India's democratic polity has thus been steadily transforming its socio-economic environment. At the heart of these transformation process lies the growing access of India's poor and marginalised population to education, healthcare and other important public services. This has opened up windows of growth opportunities that were closed to the teeming millions for hundreds of years. As they accumulate human capital and thereby acquire greater access to the growing pool of productive knowledge-capital and social capital, India's growth momentum will be higher and more sustainable in the long run. The inclusive growth dynamics witnessed in India due to enfranchisement of the population at the bottom of the pyramid (BOP) population are shown in Fig. 4 while Fig.5 captures the virtuous cycle associated with such growth mechanics.

**FIGURE 4
HIGHER ACCESS TO SOCIAL CAPITAL (SOC)
AND GROWTH OF BOP MARKET**



**FIGURE 5
THE VIRTUOUS CYCLE**



CONCLUDING REMARKS

India's democratic political dynamics-the vote winning pro-poor political strategies cutting across all political parties- have been steering India to a stable, inclusive and consumption-led growth path. The prospect of India's growth is brighter in years ahead with the growing reservoir of educated workforce, planned investment of about US \$500 billion in infrastructure during the current plan period, improved business climate following the ongoing economic reforms program, and most importantly the changing power equations from the upper caste groups to socially backward groups particularly in largely populated Indian states such as Bihar and Uttar Pradesh.

Two recent examples of India's efforts at improving business climate and governance machinery are the e-BIZ project and the Unique Identification Number Program (UNIP). The first mentioned initiative is on course to take India to a new height in e-governance of G2B services through an integrated on line portal for clearance, approval, and compliance related services of central state and local governments. UNIP will improve governance, accountability and transparency as it will help in effectively monitoring public funded programs including those targeted for the poor and vulnerable.

With its growing lower middle class population India holds an awesome potential for stable growth in sectors such as FMCG, consumer durables, automobiles, petrochemicals, generic pharmaceuticals, food processing, retail trading, power generation and distribution sectors, highways, ports, airports, civil aviation, logistics, hospitality services, telecommunication, and banking and insurance services. India's growth engine is cruising steadily. Alfaro and Chari (2009) have shown in their firm level study the growing returns of both private and public sector investments in India. India's stock markets also reflect positive expectations of Indian economy as evident from the fact that BSE Sensex index, quickly recovering from the aftershocks of the financial crisis, doubled from around 9,000 in March 2009 to about 18,000 in the course of the year. It is still in that level in the first half of May 2011. Favorable investment prospect and overall business climate is also reflected in the survey of Japanese firms in India by Japan External Trade Organization (JETRO). This survey revealed that: i) revenue and profits of these firms came entirely from domestic market; ii) they were in expansion mode; iii) none of them required to retrench their workforce; and iv) none was considering shifting their business to other countries. (JETRO,2009)

The pro-poor democratic political processes lend legitimacy, stability and sustainability to India's growth mechanics. Due to enfranchisement of the poor and steady empowerment of socially marginal groups, political parties are vying with one another to win over this growing constituency. Though India has a long way to go in poverty alleviation, its democratic polity with a vigorous civil society and an active press and electronic media has begun to script the emerging model of India's sustainable 'inclusive' growth. Private capital will therefore gain more by understanding this political dynamics and devising business strategy targeted at BOP market as Prahlada (2004) had envisioned. Innovative people centric business strategies create brand value and goodwill that are crucial for business growth in India over longer run period.

NOTES

1. An earlier version of this paper was presented in the inaugural Asian Business Management Conference held in Osaka in October 2010. I am grateful to Prof. Kiyoshi Kobayashi, Dean, Graduate School Of Management, Kyoto University for his support in this research.
2. India, a Union of 29 States and 6 Union Territories, has 15 major States where 98% of its population live. For the purpose of this paper, Punjab and Haryana, the two neighboring States-the latter carved out of the former in 1966, are shown as one State in order to take the advantage of the poverty decline rates between 1960 and 2000 available in Datt and Ravallion(2002) study for 14 major states including the combined Punjab & Haryana
3. For a detailed account of the proposed GST, see the First Discussion Paper on Goods and Services available in the Finance ministry, Government of India website <http://finmin.nic.in/GST/>.

For analysis of the implications on foreign companies see Ray (2009b). Also see Ray (2009a) for GST's implications on interstate trade.

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APPENDIX 1

TABLE 3
TAX STRUCTURE AND COMPLIANCE REQUIREMENTS

Sl. No	Nature of Tax	Authority	Tax Rate	Compliance	Remark
1.	Personal Income Tax	Central government under IT Act,1961	i)NIL up to annual income of Rs. 160,000 for men, Rs. 190,000 for women, and Rs.240,000 for senior citizens; ii)10% for Rs.160001- Rs.500,000; iii)20% forRs.50,001- Rs.800,000; iv) 30% for above Rs.800000 Plus Education cess of 3% has to be paid on the net tax payable	Get Permanent Account number from UTI services, and file annual return by July 31 of the following year	Electronic filing of return allowed; Double Taxation Treaty Agreement (DTAA) between India and respective foreign countries.
2.	Corporate Income Tax	Central Government under IT Act,1961	Domestic company: 30% Foreign Company: 40% Plus Education cess of 3% has to be paid on the net tax payable	Permanent account number; Advance tax at quarterly intervals; annual return by September 30 of the following year	Electronic filing of return allowed; Double Taxation Treaty Agreement (DTAA) between India and respective foreign countries
3.	Withholding Tax	Central Government under IT Act,1961	10% in general; 2% for contract	Get Tax Deduction Account Number;Deduction/ deposit on monthly basis by 7 th of next month; Issue TDS certificates annually and salary TDS certificate quarterly	Electronic filing of return allowed
4.	Wealth Tax	Central Government under Wealth Tax Act,1961	1% of the amount exceeding Rs.30 lakhs	Annual payment and filing of return by September 30 of the following year	
5.	Dividend Distribution Tax	Central Government under IT Act,1961	15% of the amount declared, distributed or paid	Payment within 14 days from the earliest date of declarationwq	

6.	Central VAT on goods	Central Government under Central Excise Act, 1944	Basic rate: 10% Plus Education cess of 3% of the tax payable	Payment from CENVAT credit account and Personal Ledger Account; Monthly return by 20 th of next month; small scale units can file quarterly return	CENVAT paid on input goods and services can be used for payment of CENVAT on final goods.
7.	State VAT on goods	Respective State Governments under their State VAT Acts.	Ranges from 4% to 20%	Monthly/quarterly payment depending on turnover value; submission of return by 25 th of next month/quarter	Credit of state VAT on input goods can be taken for payment of duty on the transaction price of value added goods
8.	Service Tax on specified services	Central Government under Chapter V of Finance Act, 1994	10% Plus Education cess of 3% of the tax payable	Monthly payment by the 5 th of next month; half yearly return by 25 th of the month following the particular half year.	Credit of CENVAT paid on input goods and service tax paid on input services are allowed.
9.	Central Sales Tax on inter-state sale of goods	Central Government under Central sales Tax Act, 1956	2%	Monthly/quarterly payment depending on turnover value; submission of return by 25 th of next month/quarter	No credit allowable.
10	Customs duty	Central government under Customs Act, 1962	Peak import duty rate is 10%(basic duty); CVD equivalent to applicable CENVAT rate; Plus Education cess of 3% on the total tax payable	Bill of entry to be filed (on line or through service centers) in the prescribed. proforma Duty can be paid on line with designated banks	Dwell time in assessment and customs clearance to a few hours.
11.	Professional Tax; Taxes on Lottery, betting and gambling; Octroi; Entertainment tax; Luxury tax; property tax	Respective State governments under respective Acts; property tax levied by respective municipalities	Different from state to state. Some states do not have many of these taxes	Professional tax is deducted at source by employer and paid to state government account monthly	To be subsumed under the GST

Source: Respective Tax Manuals

APPENDIX 2

TABLE 4
GROWTH AND STANDARD DEVIATION SINCE 1971-72

Year	GNP growth(1999-2000 prices)	Per capita growth		
1971-72	1	-1.8		
1972-73	-0.3	-3.1		
1973-74	4.7	2.2		
1974-75	1.3	-1.3		
1975-76	9.1	6.9		
1976-77	1.3	-1.2		
1977-78	7.6	5.3		
1978-79	5.5	3.2		
1979-80	-5	-8.2		
1980-81	7.2	5		
Mean 1970s	3.24	Standard deviation 4.33646	0.7	4.405678
1981-82	5.5	3.5		
1982-83	2.6	-0.1		
1983-84	7.8	5.8		
1984-85	3.8	1.3		
1985-86	4.2	1.8		
1986-87	4.3	2		
1987-88	3.3	0.8		
1988-89	9.8	7.9		
1989-90	6.1	3.9		
1990-91	5	3.1		
Mean 1980s	5.24	Standard Deviation: 2.185406	3	2.419826
1991-92	1.4	-1.1		
1992-93	5.4	3.4		
1993-94	5.9	3.5		
1994-95	6.5	4.4		
1995-96	7.3	5.2		
1996-97	8.1	6.2		
1997-98	4.5	2.3		
1998-99	6.7	4.6		
1999-2000	6.4	4.3		
2000-01	4	1.8		
Mean 1990s	5.62	Std.Deviation: 1.924578	3.46	2.063546
2001-02	6	3.7		
2002-03	4	2		

2003-04	8.5		7
2004-05	7.5		5.6
2005-06	9.5		7.8
2006-07	9.7		8.1
2007-08	9.6		8
2008-09	6.7		5
2009-10	7.4		5.7(estimated)
Mean(2001-02 to 2009-2010)	7.655556	(Std. Dev: 1. 912281)	5.628889 (2.236707
Mean(2005-06 to 2009-2010)	8.58		7.225
[Source: Economic Survey,2009-10]			