Indian Budget & Investment Hotspots

Introduction

Apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of a young, well-educated, English speaking workforce, relatively lower wages, special investment privileges such as tax exemptions, relaxation of FDI policy across various sectors, improvements in bankruptcy act, significant relaxation to repatriation of dividends and revenue by foreign owners. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment.

We expect to see major activity and interest by foreign investors in Indian businesses, which are serving the Indian consumer through technological advancements. There has been successful tech investments across e-commerce, logistics, fintech, healthtech, online marketplaces, and internet of things in the last few years. Major global VC and PE investors have made sizeable investments into the Indian consumption story.

We expect to see further meaningful investments in Indian fintech, healthcare and smart cities. We also believe some of India's successful start ups, who received investments through VC investors will be planning their second rounds of funding through private equity, or family offices. Successful Indian startups like Paytm, Flipkart, Just Buy Live, Oyo rooms, Snapdeal, Ola Cabs, OLX Shopclues, Freshdesk are shining examples of foreign direct investments into Indian companies.

The Annual Conference (TatXpo) to explore trade & investment opportunities hosted by Tat Capital in India have given Tat Capital's clients in Australia & New Zealand access to many such great companies last year. We expect this year's event slated to be in June 2017 in Mumbai will do the same.

On Feb 1, 2017, the Government of India also presented its union budget for 2017-2018. First major initiative for the calendar year from the Indian Government post demonetization. Indians at large, across the country, were expecting to see a budget which can make an impact in a meaningful way. Mainly because of significant disheartenment and distortion created by the banning of high denomination currency notes, which was executed with an objective to tackle the black money, access to cash by terrorists, curb tax evasion, and encourage cashless transactions by the Government in November 2016. To that effect, there seems to be general consensus from various industry leaders that this union budget presented by Mr. Arun Jaitley gave some thing for the most of India. (Highlights on the Indian budget are available later in this report for one's reading.)

Commenting on the Budget, Mr. Jaitley said "India stands out as a bright spot in the world economic landscape. My approach in preparing the budget is to spend more on rural areas, infrastructure, and poverty alleviation with fiscal prudence. Signs of retreat from globalisation have potential to affect exports from many emerging economies, including India. One of the thrust areas of my tax proposals is to stimulate growth, give relief to the middle class, (promote) affordable housing, curb black money, bring transparency in political funding and simplify tax administration."

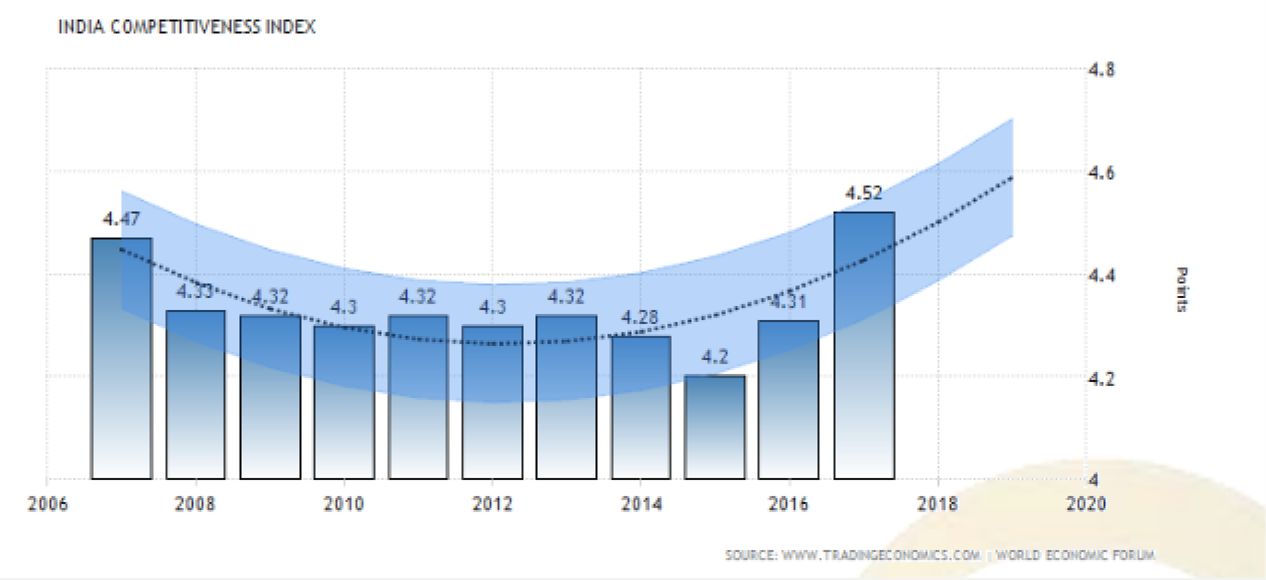
Key takeaways from the budget 2017-2018 are

1. Transparency across all payments over ~A$6,000 will now be possible as Indian Government limits any cash payment to a maximum of ~A$6,000 (Huge boost to Fintech & Digital businesses)
2. Huge Infrastructure, Railways, Roads & Rural budget to revive both rural & urban India, and allied industries serving rural India (Huge Boost to Agribusiness, Infrastructure, Telecom, Energy, Tourism & Food processing related sectors)
3. Low income earners get a significant tax relief, which might see an improvement in lower middle class population. (Big boost to FMCG, Electronics)
4. All donations to political parties are now capped at a maximum cash donation of ~A$40, and any donation bigger than A$40 can be done by declaring identity, and such transaction is conducted using cheque or online mechanisms. This brings up much needed transparency and accountability in the political system.
5. Significant budgets allocated for Skill India, giving access to low cost credit to farmers, women empowerment, boost to rural housing construction sectors.

6. Micro to Small to Medium enterprises with turnover less than Rs 50 crore (A$9.8m) will now pay a corporate tax of 25% vs. 30% previously.

According the global competitiveness index published by World Economic Forum, "India climbs for the second year in a row, to 39th. Its 16-place improvement is the largest this year. India's competitiveness has improved across the board, particularly in goods market efficiency, business sophistication, and innovation. Thanks to improved monetary and fiscal policies, as well as lower oil prices, the Indian economy has stabilised, and now boasts the highest growth among G20 countries. Recent reform efforts have concentrated on improving public institutions (up 16), opening the economy to foreign investors and international trade (up 4), and increasing transparency in the financial system (up 15)."

The chart below from Trading Economics shows a trendline of improvement of India's competitiveness in the coming years.



Structural reforms in the last two years

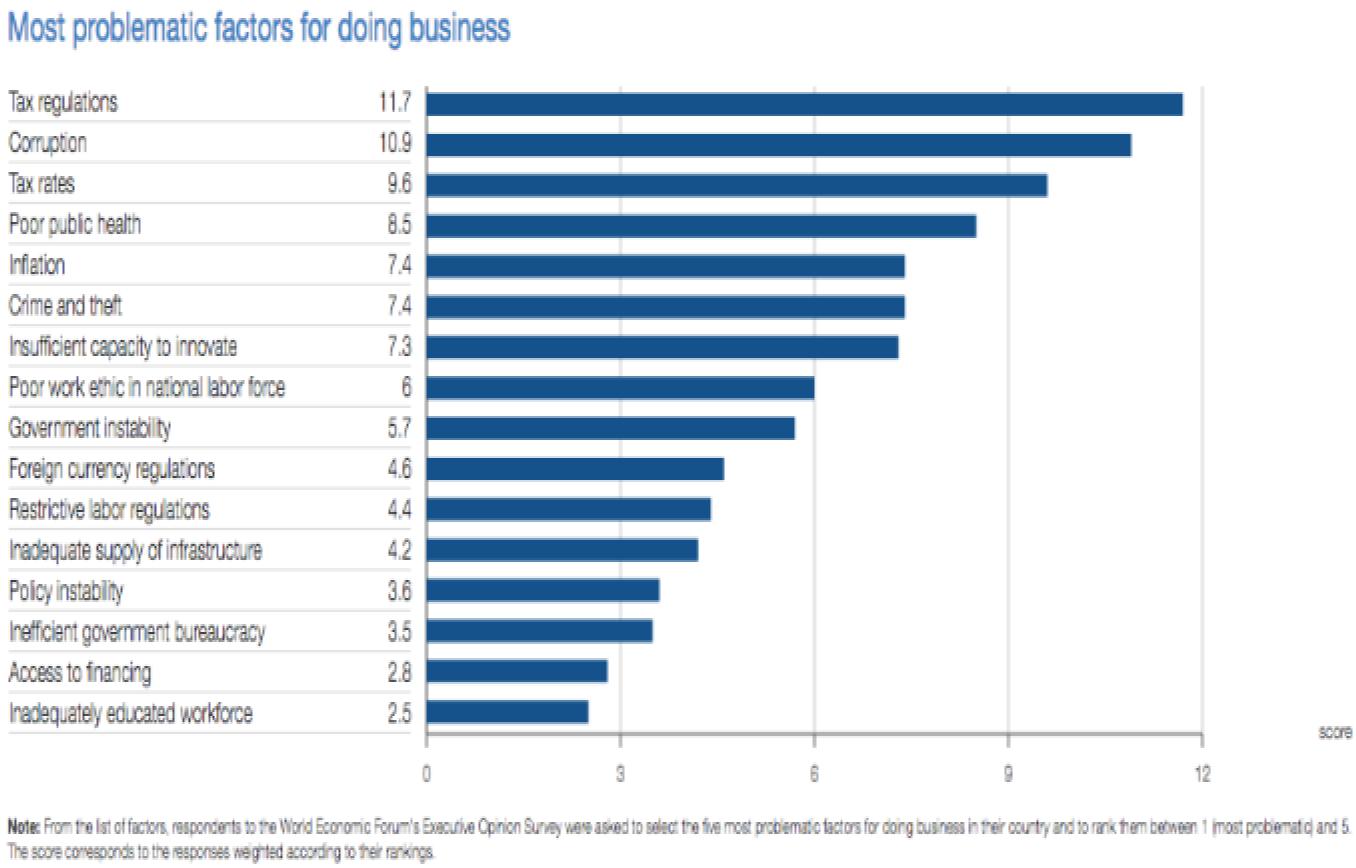
Bharatiya Janata Party (BJP), since forming the government with clear majority in the lower house, have announced many important fiscal reforms, and are currently busy implementing some of these policies. Some of the notable policies which will help in building Brand India and ease of doing business in India are as follows:

1. The reforms that Goods and Services Tax (GST) is going to bring in, like the ease of starting a business, elimination of dual taxation, simpler process, reduction in logistics cost, etc. The rollout of GST will be a very positive development from an equity market perspective.

2. The insolvency laws in a country lay out the frameworks / processes by which companies in financial distress can be resolved / recovered, and the dues to creditors paid up. Laws for resolution of insolvency in India have been in existence since long, but they have followed a piecemeal approach at every point of evolution, addressing a single / few market participants – Indian business houses as dominant debtors; or banks and public financial institutions as dominant creditors, etc. These biases are also reflected in the development of credit market in India, which has been dominated by secured lending and reputation based lending, by banks with miniscule participation, and by alternative capital providers. A policy should be holistic and be developed in such a way as to protect the interests of all parties. This is what the most recent Insolvency and Bankruptcy Code, 2016 ("Insolvency Code") aims to address. Insolvency Code will help open up the credit market in India, which is currently predominantly dominated by the secured credit provided by banks and financial institutions to alternative sources of credit.
3. Recent efforts by Indian government in Nov 2016 around the ban of higher denomination currency notes have forced Indian citizens to develop aptitude and interest in transacting and making payments online. If Indian citizens take a cue from such an event and turn more towards online payment, it may help the Indian fintech companies to attract higher investments into this sector.

Major factors impacting business in India

Some of the key factors that have been identified by the World Economic Forum (WEF) that may impact India's competitiveness are discussed below:



If GST is implemented successfully, we expect to see significant comfort gained by foreign investors in dealing with Indian tax system, as GST aims to centralise taxes through a single source, and help overseas businesses to understand Indian tax system a lot better than now.

As far as the corruption in India goes, there has been an improvement in Indian corruption rank over the last five years, and we believe that this will further improve by enabling Indian citizens to interact with government via digital channel. Thereby reducing human interference across value chain of dealings with various stakeholders across public and private enterprises in India.

The below snapshot from Transparency International and Trading Economics explains the Indian Corruption index:

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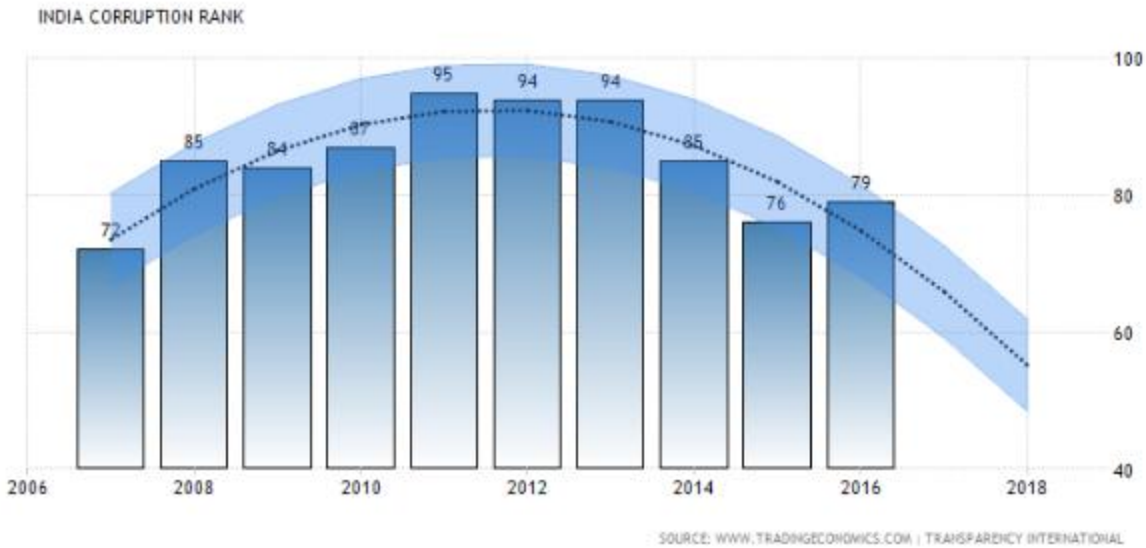
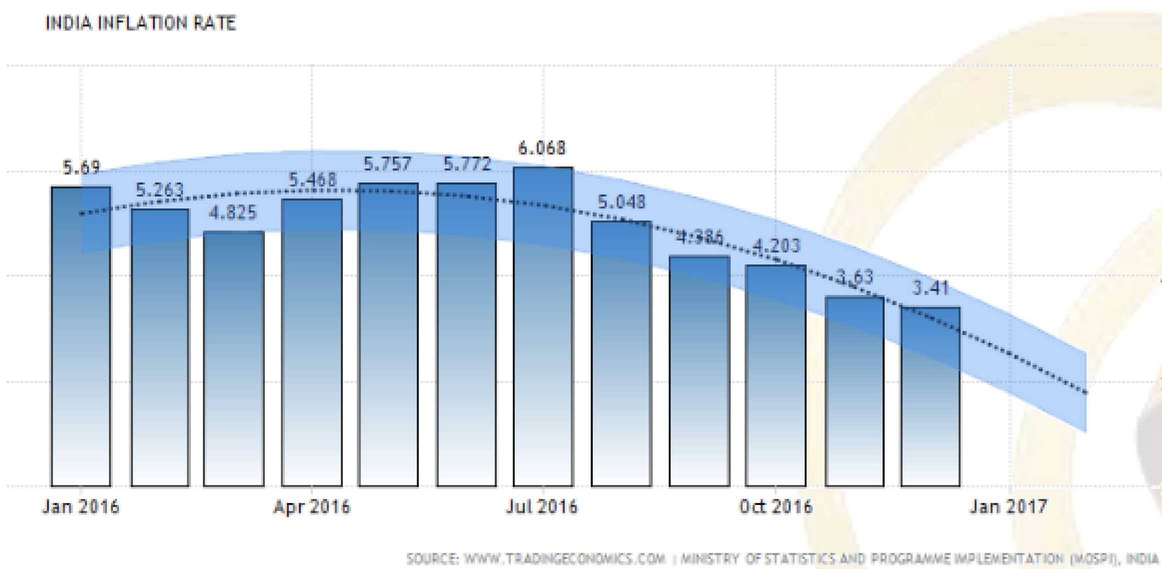


Inflation in India, which has been identified as a problem by the WEF, has also been addressed by the current Monetary Policy Committee headed by the RBI governor. A monetary policy designed around targeting a 4% inflation rate has been one of the main achievements passed on by the previous RBI Governor M. Raghuram Rajan to the current Governor Mr. Urjit Patel.

The below chart explains the inflation in India with its forecast to be in the band of 3-6% target for 2017.



Impact of Trump on India

1. Whilst there are no immediate impacts on India's strong growth trajectory, there remains significant political uncertainty surrounding US President Trump's policies, particularly regarding trade agreements with the rest of the world.
2. Furthermore, unlike China and many other Asian countries, India's GDP is heavily driven by private consumption. In fact, household consumption is 59% of GDP, compared to China's 36% compounded by favourable demographics and urban migration. Therefore, the sensitivity of India's GDP to global growth is relatively low, providing some insulation from economic uncertainty. President Trump said in the past that India-US ties will have a "phenomenal future".
3. Most visible sector which may start feeling the hit will be Indian IT outsourcing sector, which is a U$150bn export market for the country. Close to 60% (approximately U$90bn) of the total IT exports outsourcing are to the US. There is a bill which is now placed in the US parliament to increase the minimum wage of a H1-B Visa holder to U$130,000. This may have a wider impact on Indian tech companies' abilities to bring the talent from India.
4. Some of the broader commentary from President Trump at the U.S. CEO meeting, centered around manufacturing in America, may resonate with some of the CEOs: the Trump administration is contemplating to keep manufacturing facilities in USA to avoid a massive border tax.

Which sectors will see more FDI

The Indian government's favourable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country. The government has taken many initiatives in recent years like relaxing FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

"Prime Minister Modi wants companies to make products in the country as part of his "Make in India" policy, aimed at reaping the benefits that come from manufacturing facilities and jobs. His administration doesn't want technology companies to sell products and take advantage of its vast consumer base without making their own capital investments."

According to Department of Industrial Policy and Promotion (DIPP), the total FDI investments India received during April - September 2016 rose 30 per cent year-on-year to US$ 21.6 billion, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results.

Data for April - September 2016 indicates that the services sector attracted the highest FDI equity inflow of US$ 5.29 billion, followed by telecommunications – US$ 2.79 billion, and trading – US$ 1.48 billion. Most recently, the total FDI equity inflows for the month of September 2016 touched US$ 5.15 billion.

During April - September 2016, India received the maximum FDI equity inflows from Mauritius (US$ 5.85 billion), followed by Singapore (US$ 4.68 billion), Japan (US$ 2.79 billion), (US$ 1.62 billion), and USA (US$ 1.44 billion).

Impact investments in India is expected to grow at a compound annual growth rate (CAGR) of 20-24 per cent to touch US$ 6-8 billion by 2025, from US$ 1 billion in 2015.

The Commerce and Industry Ministry is planning to release the next edition of its consolidated FDI policy document soon, incorporating all the changes made over the past year.

"The next edition of the consolidated FDI policy circular of 2017 is due to be issued this year, which would incorporate all the changes effected in FDI policy...," the Department of Industrial Policy and Promotion (DIPP) said.

1. India will require around US$ 1 trillion in the 12th Five-Year Plan (2012–17), to fund infrastructure growth covering sectors such as highways, ports and airways. This would require support from FDI flows. India's growth rate, along with competitive location in terms of wages and policies like Stand Up India, is expected to boost FDI in the coming future.
2. According to the data from DIPP, inflows of FDI (in equity) into India rose 29% in 2015-16 from a year earlier to $40 billion. Such inflows rose 30% in the first half of this fiscal from the previous year. In the trading space, FDI inflows rose almost 41% in the last fiscal from a year earlier.

B. DIPP'S – FINANCIAL YEAR-WISE FDI EQUITY INFLOWS:
(As per DIPP's FDI data base – equity capital components only):

S. Nos	*Financial Year (April – March)*	*Amount of FDI Inflows*		*%age growth over previous year (in terms of US $)*
FINANCIAL YEARS 2000-01 to 2016-17		*In Rs Crores*	*In US$ Million*	
1.	2000-01	10,733	2,463	-
2.	2001-02	18,654	4,065	(+) 65 %
3.	2002-03	12,871	2,705	(-) 33 %
4.	2003-04	10,064	2,188	(-) 19 %
5.	2004-05	14,653	3,219	(+) 47 %
6.	2005-06	24,584	5,540	(+) 72 %
7.	2006-07	56,390	12,492	(+)125 %
8.	2007-08	98,642	24,575	(+) 97 %
9.	2008-09	142,829	31,396	(+) 28 %
10.	2009-10	123,120	25,834	(-) 18 %
11.	2010-11	97,320	21,383	(-) 17 %
12.	2011-12 ^	165,146	35,121	(+) 64 %
13.	2012-13	121,907	22,423	(-) 36 %
14.	2013-14	147,518	24,299	(+) 8%
15.	2014-15 #	189,107	30,931	(+) 27%
16.	2015-16 #	262,322	40,001	(+) 29%
17.	2016-17#	144,674	21,624	
<u>CUMULATIVE TOTAL</u> (from April, 2000 to September, 2016)		1,640,533	310,258	-

<u>Note:</u> *(i) Including amount remitted through RBI's-NRI Schemes (2000-2002).*
(ii) FEDAI (Foreign Exchange Dealers Association of India) conversion rate from rupees to US dollar applied, on the basis of monthly average rate provided by RBI (DEPR), Mumbai.
 # Figures for the years 2014-15 to 2016-17 are provisional subject to reconciliation with RBI.
^ Inflows for the month of March, 2012 are as reported by RBI, consequent to the adjustment made in the figures of March, '11, August, '11 and October, '11.

3. Also based on DIPP Data, the top ten sectors where India had much success in attracting FDI are as follows:

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F. **SECTORS ATTRACTING HIGHEST FDI EQUITY INFLOWS:**

Amount in Rs. Crores (US$ in Million)

Ranks	Sector	2014-15 (April-March)	2015-16 (April – March)	2016-17 (April,16 – September, 16)	Cumulative Inflows (April '00 - September '16)	% age to total Inflows (In terms of US$)
1.	SERVICES SECTOR **	27,369 (4,443)	45,415 (6,889)	35,368 (5,288)	293,722 (56,080)	18 %
2.	CONSTRUCTION DEVELOPMENT: TOWNSHIPS, HOUSING, BUILT-UP INFRASTRUCTURE	4,652 (769)	727 (113)	414 (62)	114,350 (24,250)	8 %
3.	COMPUTER SOFTWARE & HARDWARE	14,162 (2,296)	38,351 (5,904)	6,903 (1,032)	119,087 (22,050)	7 %
4.	TELECOMMUNICATIONS (radio paging, cellular mobile, basic telephone services)	17,372 (2,895)	8,637 (1,324)	18,659 (2,787)	111,388 (21,169)	7 %
5.	AUTOMOBILE INDUSTRY	16,760 (2,726)	16,437 (2,527)	4,865 (729)	86,259 (15,793)	5 %
6.	DRUGS & PHARMACEUTICALS	9,052 (1,498)	4,975 (754)	4,270 (641)	74,367 (14,490)	5 %
7.	TRADING	16,755 (2,728)	25,244 (3,845)	9,936 (1,482)	78,772 (13,354)	4 %
8.	CHEMICALS (OTHER THAN FERTILIZERS)	4,658 (763)	9,664 (1,470)	3,561 (532)	63,116 (12,433)	4 %
9.	POWER	4,296 (707)	5,662 (869)	3,744 (559)	56,357 (11,035)	4 %
10	HOTEL & TOURISM	4,740 (777)	8,761 (1,333)	3,497 (523)	53,207 (9,750)	3 %

Note: *(i)** Services sector includes Financial, Banking, Insurance, Non-Financial / Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis*
(ii) Cumulative Sector- wise FDI equity inflows (from April, 2000 to September, 2016) are at - Annex-'B'.
(iii) FDI Sectoral data has been revalidated / reconciled in line with the RBI, which reflects minor changes in the FDI figures (increase/decrease) as compared to the earlier published sectoral data.

Highlights from Union Budget 2017-2018

Following are the highlights of Union budget delivered by Finance minister of India Mr. Arun Jaitley for the 2017/18 fiscal year that begins on April 1. (Source: The Hindu)

Demonetisation

- Demonetisation is expected to have a transient impact on the economy.
- It will have a great impact on the economy and lives of people .
- Demonetisation is a bold and decisive measure that will lead to higher GDP growth.
- The effects of demonetisation will not spillover to the next fiscal.

Agriculture sector

- Sowing farmers should feel secure against natural calamities.
- A sum of Rs. 10 lakh crore (A$196bn) is allocated as credit to farmers, with 60 days interest waiver.
- NABARD fund will be increased to Rs. 40,000 crore (A$7.8bn). A dedicated micro irrigation fund will be set up for NABARD with Rs 5,000 crore (A$0.98bn) initial corpus.
- Irrigation corpus increased from Rs 20,000 crore (A$3.92bn) to Rs 40,000 crore (A$7.8bn).

- Dairy processing infrastructure fund will be initially created with a corpus of Rs. 2000 crore (A$0.39bn).

Rural population

- Government targets to bring 1 crore (10 Mn) households out of poverty by 2019.
- During 2017-18, 5 lakh farm ponds will be be taken up under the MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act)
- Allocating Rs. 19,000 cr (A$3.73bn) for Pradhan Mantri Gram Sadak Yojana (PM Village road Scheme) in 2017-18
- We are well on our way of achieving 100% rural electrification by March 2018.
- Swachh Bharat (Clean India) mission has made tremendous progress, sanitation coverage has gone up from 42% in Oct 13 to 60% now.
- Sanitation coverage in rural areas gone up from 42% in Oct 2014 to 60% now.

For youth

- Introduction of a system of measuring annual learning outcomes, innovation fund for secondary education.
- There will be a focus on 3,479 educationally-backward blocks
- Colleges will be identified based on accreditation
- Skill India mission was launched to maximise potential. 100 India International centres across country. Courses on foreign languages to be introduced.
- Skill India Mission was launched in 2015 to maximise the potential of our youth. 100 India International Skill centres will be established across the country.
- Steps to create 5000 PG seats per annum

For the poor / health care

- Mahila Shakthi Kendras (Women Empowerment Centres) - Rs. 500 cr allocated.
- Nationwide scheme for pregnant women - Rs. 6000 each will be transferred.
- For women and Kids - Rs. 1,84,632 cr. allocation investment
- Elimination of tuberculosis by 2025 targeted.
- 1.5 lakh health sub centres to be transformed into health wellness centre.
- Two new AIIMS in Jharkhand and Gujarat.
- Structural transformation of regulator framework for medical education in India
- Allocation for Scheduled Caste - Rs. 52,393 crore
- Aadhaar-based smart cards for senior citizens to monitor health.

Infrastructure / railways

- Total allocation for Railways — Rs. 1,31,000 crore (A$25.6 bn)
- Rs. 64,000 crore (A$12.5bn) allocation for highways.
- Allocation of high speed Internet 1,50,000 gram panchayats

- New Metro rail policy to be announced with new modes of financing

Energy sector

- A strategic policy for crude reserves will be set up
- Rs. 1.26,000 cr (A$24.71bn) for energy production-based investments received

Financial sector

- FDI policy reforms - more than 90% of FDI inflows are now automated.
- Shares of Railway PSE like IRCTC would be listed on stock exchanges.
- Bill on resolution of financial firms to be introduced in this session of parliament.
- Decided to abolish FIPB in 2017-18. Foreign Investment Promotion Board to be abolished.
- Pradhan Mantri Mudra Yojana lending target at Rs 2.44 lakh crore (A$47.84bn) for 2017-18
- Digital India - Bhim app will unleash mobile phone revolution - two new schemes to promote the app.

On funding of political parties

- Maximum amount of cash donation for political parties will be Rs 2,000 (~A$40) from any one source from Rs 20,000 (~A$400)
- Political parties will be entitled to receive donations by cheque or digital mode from donors.
- Amendment is being proposed to RBI Act to enable issuance of electoral bonds that government will scheme. Donor can purchase these bonds from banks or post office via cheque or digital transactions. They can be redeemed only by registered political parties.

Tax proposals

- India's tax to GDP ratio is not favourable.
- Out of 13.14 lakh (1.3M) registered companies, only 5.97 lakh (597,000) companies have filed returns for 2016-17. Proportion of direct tax to indirect tax is not optimal.
- Between Nov 8 to Dec 30 (The Demonetization period): Deposits between Rs 2 lakh (~A$4,000) and Rs 80 lakh (~A$160,000) was made in 1.09 crore (10.1M) accounts.
- Corporate tax: In order to make MSME companies more viable, propose to reduce tax for small companies of turnover of up to Rs 50 crore to 25%. About 67 lakh companies fall in this category. 96% of companies to get this benefit.
- Income Tax Act to be amended. No transaction above Rs 3 lakh (~A$6K) to be permitted in cash.
- Limit of cash donation by charitable trust reduced to Rs 2,000 (~A$40) from Rs 10,000 (~A$200).

Personal Income Tax

- Existing rate of tax for individuals between Rs. 2.5 lakh (~A$5,000) - Rs. 5 lakh (~A$9,800) reduced to 5% from 10%
- All other categories of tax payers in subsequent brackets will get benefit of Rs. 12,500.
- Simple one page return for people with annual income of Rs. 5 lakh (~A$9,800) other than business income. People filing I-T returns for the first time will not come under govt. scrutiny.
- 10% surcharge on individual income above Rs. 50 lakh (~A$100,000) and up to Rs 1 crore (~A$200,000) to make up for Rs 15,000 crore loss due to cut in personal I-T rate. 15% surcharge on individual income above Rs. 1 crore to remain.

(A$1 = 51.31 rupees as on 1st February, 2017)