

CHAPTER TWO

THE RISE OF INDIA: INDIA AND THE WEST—INSTITUTIONAL CONTRASTS

India is now emerging as a major player in the world economy that is increasingly dominated by the ascendance of knowledge-based activities. It is the second fastest growing economy in the world, with an expected GDP growth of 8 percent during 2005–2006. The rapid growth of the information technology sector along with globalization, and deregulation, created new opportunities as well as new challenges for firms in an environment that is ever changing at an accelerating rate.

In the changed scenario, India is becoming an active participant in the global economy, while at the same time drawing increasing interest among foreign investors as well as national governments in Europe, North America, and Asia. A number of factors indicate the growing integration of India in the world economy and is reflected by a number of different indicators. To begin with, there has been a significant increase in the flow of foreign direct investment to India. It is estimated that foreign direct investment increased by 66 percent in 2001.¹ More broadly during the decade 1990–1991 to 2001–2002 foreign direct investment inflows increased from US\$103 million in 1990–1991 to US\$5.9 billion in 2001–2002.² During the period 1991–2002 India is estimated to have received a total amount of US\$24 billion in foreign direct investment. This figure, of course, does not include that of Foreign institutional investment that is considerably larger.

There are other indications that an economic transformation may well be underway in India. A study by Goldman Sachs suggests that India is expected to be the world's third largest economy in 2035, after United States and Japan.³ A ranking by Forbes of the world's best corporations included nine Indian companies such as Indian Oil, HLL, Infosys, Reliance, and WIPRO.⁴ By 1999, India had become the third largest car market in Asia.⁵

The intense competition in the Indian market due to the entrance of foreign competitors, has led domestic firms to upgrade the quality of their products, and these firms often give the multinationals a run for their money. India has become a haven for foreign companies seeking to outsource their business operations. General Electric is reported to have garnered cost savings of US\$350 million a year by outsourcing to India.⁶ The decision by IBM to buy Daksh (see chapter three), India's third largest back office services firm, in an acquisition that is valued between

US\$150–200 million is a good example of India's increasing attractiveness as an investment destination.⁷ Overall, it is estimated that there are several hundred call centers in India with a turnover of US\$2 billion and employing about 150,000 people in India for companies such as Citibank, Deutsche Bank, HSBC, Dell Computer, SAS, and Compaq.⁸

India's resurgence as a major economic player is not without historical precedence. It is estimated that in the early nineteenth century, India accounted for about 16 percent of the world's GDP.⁹ As noted in chapter one of this book, as early as the second century BC, India was a major trading nation and it was perhaps the reputation earned as a commercially oriented country that led Alexander the Great to invade India in 327 BC,¹⁰ Indians exported products to the Roman Empire, and after its fall had developed ties with their successors both in that part of the world as well as South Asia. The active involvement of the Indians in trading suggests a strong entrepreneurial spirit among Indians, a spirit that was curtailed (although not eliminated) initially by overseas invasions, as well as the advent of colonial rule, and post independence, by a regulatory regime that created impediments to innovative ideas.

That this entrepreneurial spirit still exists can be seen not simply by the rapid growth of the information technology industry in India (see chapter three), but also by the fact that the Indians who have migrated overseas, have utilized their entrepreneurial spirit for considerable gain for themselves as well as the larger community. It has been suggested, for example, that a third of the engineers in the Silicon Valley are of Indian origin while 7 percent of the high tech firms are led by Indian CEOs.¹¹ Similarly about one third of Microsoft employees, a quarter of IBM, and a sixth of the scientists of Intel are said to be of Indian origin. There are other examples as well. Consider the case of the Jain community, who have carved out a dominant position in the lucrative international diamond trade. It is estimated that they control about 50 percent of the market for gem quality diamonds.¹² The Tatas and the Birlas, two of the leading business groups in India developed under British occupation and fortified their position in the post-1947 regulatory regime. The global Indian diaspora is estimated to be about 25 million people and their importance seems to be on the rise.

What are the implications of the potential emergence of India as an economic superpower for foreign investors seeking to do business in this country? This is the central theme that we attempt to address here. Although the resurgence of India as an economic power is a view that is now widely held by scholars and business people, India is still a country in the process of economic transition. It is our belief that while the Indian market does offer huge opportunities, the opportunities have to be utilized in the right way.

A prerequisite for such an endeavor and a deep understanding of the Indian business environment. This calls for a keen knowledge of the Indian political, cultural, and economic realities that govern economic transactions in this country. Although each business opportunity is unique, tailoring that opportunity for creating a win-win solution for all, requires a sophisticated understanding of environmental realities.

We begin this chapter by providing a broad overview of the differences that exist in the institutional environment between India and the North American and European

environments and the implications that they may have for the practice of business in these countries. A more detailed analysis of the political and the cultural environments follows in the subsequent chapters of this book. The institutional environment comprises the economic dimension, the political dimension, and the sociocultural dimension. These dimensions are not entirely independent of each other but for expositional purposes we will be dealing with them as separate entities. We also recognize that not all European countries are the same, and are equally cognizant of the fact that the European business environment is different from the North American one. Therefore, the institutional gap is likely to be far greater between India and the Western world than is the case between Western European countries and North America.

The Institutional Contrast between India and the Western World

“The nineteenth century belonged to Europe, the twentieth went to America, and many believe that the twenty-first century is likely to be Asia’s.”¹³ This comment highlights the great optimism that is felt by some experts about developments taking place in this region. Some experts are even suggesting that within Asia, it is India that may have the edge over China, given the strong tradition of entrepreneurship in the country.¹⁴ Indeed, the Global Entrepreneurship Monitor of the London Business School has rated India second in entrepreneurship globally.¹⁵ It is evident that there is considerable potential in this country, and indeed, one of the implications suggests that the institutional gap between India and the West may diminish over time, and that there is a possibility of a two-way knowledge flow, as opposed to a one-way flow, that traditionally existed between the West and India.

(a) *Political Dimension*

“India is a modern state, but an ancient civilization,” writes Stephen Cohen in his 2001 book *Emerging Power: India*.¹⁶ As a modern state, India came into existence in 1947 when it attained independence from the British. As an ancient civilization, contemporary India had its origins in the Indus Valley civilization. This civilization was at its peak around the third millennium BC. This was an extraordinarily sophisticated civilization in which commerce played an important role. The geographical extent of this civilization was huge, spreading as it did from the eastern border of Iran till eastern India. The decline of the Indus Valley civilization was followed by the rise of the Indo-Aryan civilization, which provided the spiritual foundation of India as a civilized entity. It was during this period that some of the most sacred Indian texts (e.g., Vedas) were written.

A unique feature of the early Indian political order was its chronic instability. The idea of a state as an agency that could exert power to change society was notably lacking in this period.¹⁷ The stability of a society rested less on the political order than on the social order that was shaped by the cultural ideology of *Brahmanism*. The *Brahmins* exchanged political power for social power by creating a set of cultural rules that everyone in the society had to follow. A notable example of this is the caste

system, which drew a distinction among different segments of the society, and provided a hierarchical ordering of the society. The Hindu ruler was constrained by caste obligations and his duty was to preserve the integrity of the Hindu social system.¹⁸

It is the disjunction between political power and social power that was the hallmark of the earlier Indian civilization. The greater emphasis laid by Brahmanism on social conduct rather than on issues of governance was also to have a number of significant implications. This was in contrast to the developments in Europe where the onset of reformation and the birth of renaissance during the period 1450–1670 created a situation where the political rulers started to extend their control over territories, carving out their own spheres of influence. The impetus for this was both economic as well as political.¹⁹ This was the immediate precursor for the emergence of the nation-state in Europe in the mid-nineteenth century.

British colonialism undoubtedly left a deep imprint on the Indian society and commentators still remain sharply divided as to its impact on Indian development. Whatever be the merits or the demerits of the different arguments in this domain, it was the British who introduced India to the notion of a state as a sovereign entity with definable territorial boundaries.²⁰ However, a vast cultural gap between the British and the Indians, with the British relying on the local Indian elite to maintain control remained. Although pragmatically expedient, this policy continued to maintain the cultural gap between the parties, and generated its own counterreaction in the form of a nationalist reaction. This manifested itself in the formation of the Indian National Congress, a political party that was founded in 1885, and was the precursor of the post-independence Congress party.

The impact of colonialism on the Indian mind-set should not be underestimated. It has shaped India's attitude toward foreign investment, played a role in stressing the importance of self-reliance and autonomy in the country's developmental strategy, and more broadly, it has traditionally made the country more cautious when engaging with the outside world. After the liberalization of 1991, this mind-set has begun to change, and there is less now less suspicion of foreign capital than at any other time in India's history, but remnants of this fear probably still exist, and it may take a little more time before the ghosts are finally laid to rest. This is only understandable given that nationalist feelings are not entirely absent even in the industrialized world. Consider the case of Norway where foreign investors such as Danske Bank, of Denmark, Fortum of Finland, Elf Aquitaine of France, and Telia of Sweden have been thwarted by nationalistic pressures in acquiring local companies.

With India gaining independence in 1947, Jawaharlal Nehru became India's first prime minister. A charismatic politician who was deeply involved in India's struggle for independence, Nehru embarked on a process of rapid modernization of the country. Although the economic policies pursued by his government, proved to be counter-productive in the end, the early years of his government were crucial in both extending and enhancing state capability as well as firmly embedding the principles of democracy in India. Indeed, one of the most remarkable things about India is that democracy has taken firm root, even though some of the preconditions for the establishment of a democratic state in Western Europe and the United States such as the preexistence of a nation-state, high literacy rate, a vibrant middle class, high levels of industrialization were absent in 1950.²¹ Perhaps it is also worth mentioning that

while in the West democracy arose as a result of a contest between aristocrats and commoners, in India democracy was the by-product of the Indian fight against colonialism. A further point of contrast is, while in the West the growth of democracy limited state authority, in India, it led to an increase in the power of the state.

India is now the world's largest democracy with a voter turn out that is often higher than in many industrialized countries. The most recently concluded election in the summer of 2004, in which the voters decided to vote against the Bharatiya Janata Party (BJP) led coalition, against all expectations, is clearly indicative of a thriving democratic culture.

During the first 50 years of independence, India was primarily governed by the Congress Party, with a brief interlude, during which, a coalition the comprising of the Janata Party, the BJP, and other opposition parties, was in power in the late 1970s. If there was opposition, it existed within the party, rather than from other competing parties. All of this began to change in the late 1980s with the rise of BJP, a party that focused its appeal on reviving Hindu nationalism or "Hindutva." This ideology had many dimensions to it. One was rediscovering and/or recreating, the greatness of India, which had been crushed during the era of colonialism. The other point was that the state should seek to favor the interests of the Hindus as they constitute the majority of the population.

The nuclear tests conducted by the BJP in 1998 were a dramatic illustration of recreating India's past glory and making its mark as a major power. The BJP was quick to capitalize on the weaknesses of the previous governments, and in conjunction with a moribund economy, extended its electoral base from the trading community to the middle and the upper middle class. In 1996 the BJP emerged as the single largest party although it was not able to retain power for any significant period of time.

Although BJP has undoubtedly, of late, been a major player in the Indian politics, its ability to fully realize its nationalistic aspirations are constrained by its necessity to rely on coalition partners who do not necessarily subscribe to its "Hindutva" plank. The BJP's first extended run of power came in 1999, when it formed a coalition government. When it called for elections six months before its term in 2004, it was expected it would return to power in conjunction with its coalition partners. This did not happen and it has surprised both the ordinary public as well as political commentators.

The emergence of coalition politics in recent years is another theme that is gaining prominence in the Indian political context. The new Congress-led government is also a coalition government. Some have voiced concern that because the government is dependent on communist support it may not be able to vigorously pursue reforms to the extent desired, as the communists are not keen on liberalization. The current prime minister of India, Dr. Manmohan Singh dismisses these concerns and suggests that his government will have no difficulty in implementing the reform measures.²² Although the ultimate proof lies in the actions taken by the government it needs to be noted that even the communists have been promoting reform and liberalization in the state of West Bengal where they are in power.

In recent years there has been an increase in the number of regional political parties, and they are now likely, in the foreseeable future, to decisively shape the pattern of Indian political development. The increase in the number of regional parties, and

in particular, the growing mobilization of the lower castes in the electoral process, has imparted a new dynamic to Indian political development. The new groups are trying to maximize the benefits more for their own particular group. At the same time they are opposed to the narrow nationalistic vision inspired by BJP, which is primarily an upper caste based, predominantly Hindu party.

The emergence of coalition politics does impart a certain degree of unpredictability to the political dynamics, but this unpredictability is not unique to India. Many European countries such as Denmark, Italy, or Germany have had coalitions. The fact that coalition governments may not necessarily be detrimental to sustaining growth is also illustrated by the fact that in the 1990s the Indian GDP grew at an annual rate of 6.3 percent, but this was also the period characterized by political instability.

As stated earlier, a core constituency in support of economic reform has now emerged in India with the resulting implication that while the pace of economic reform may not consistently accelerate, it is at the same time, unlikely to be reversed altogether.

(b) Economic Dimension

Without question, there is still a vast gap between the GNP per capita in India and that in Europe and North America. World Bank 2002 statistics suggest that GNP/capita in India is US\$480, US\$35,060 in United States, US\$26,220 in France, US\$26,180 in Germany, and US\$25,870 in UK.²³ Nearly a third of the country's population is below the poverty line. In the IMD's annual ranking of world competitiveness in 2004, India was ranked 34 whereas in 2003 the country had been ranked 50. Although this represents a considerable improvement over previous years, the study also suggests that Indian growth and development is constrained by the poor quality of infrastructure and ineffective management of public finances.

There are numerous infrastructure bottlenecks in power, transportation, ports, and telecommunications sectors. An infrastructure survey by the World Economic Forum in 1999, ranked India 55 out of 59 in terms of the adequacy of the infrastructure. Inadequate infrastructure has without question hampered the growth of the Indian economy, with some estimates suggesting the cost is about 3 percent of the annual GDP.²⁴ One gets additional perspective on the nature of the problem by looking at more micro level data. For example, it is pointed out that the cost of industrial power in India is 8 cents per Kwh, which compares unfavorably with other countries where the cost is estimated to be only between 4–6 cents per Kwh.²⁵ It has also been pointed out that given the unreliability of the power supply more than 70 percent of the Indian firms possess their own generating sets.

The Indians were cognizant of the problem and in 1991 opened the doors to foreign investors in power generation, but the results have been disappointing. The Indian government expected to add new generating capacity of 10,000 MW during the period 1991–2000 but in actual fact the net increase was only 2000 MW.²⁶ A number of foreign firms decided to pull out of potential projects that they were seeking to develop. Although there are a number of reasons for their exit, the common problem centered was the lack of certainty of payment by the State Electricity

Boards, who were to buy the power generated by these projects. It is widely acknowledged that the State Electricity Boards are in poor financial health either due to excessive subsidization of electricity and/or due to theft. The first example of privatization of distribution of electricity took place in Delhi in 2002. In Delhi theft of power accounted for a staggering 50 percent of transmission and distribution losses.

The inland transportation costs are also said to be high thus adversely affecting the competitiveness of Indian industry. For example, the freight costs from Gujarat to Chennai are said to be around US\$40 per MT whereas the comparable costs from China to Chennai are around US\$20 per MT. The Indian ports are also not noted for their efficiency. It is estimated that in 1999 in India it took about 4.7 days to turn-around a ship whereas in Singapore it was 6–8 hours.²⁷ This adversely affects the competitiveness of Indian exports and has a cascading effect on inefficiency throughout the system. Although a new policy designed to encourage private investment in ports has been announced, the conditions surrounding the investment have not made such an investment a very attractive one for the foreign investor, at least not yet.

The reforms in the telecommunications sector have progressed more smoothly vis-à-vis the power sector. Although much has been accomplished compared with the situation in the early 1990s the pace of movement needs further acceleration. It is estimated, for example that in 1997 India had 18.6 telephone lines per 1,000 people compared with 444 in Korea, 107 in Brazil, and 96 in Mexico. Ten years ago the information technology structure in India was on par with China. However, in 2000, the “teledensity” in China was 112 telephone main lines per 1,000, whereas in India the figure was 32. Likewise China had 15.9 personal computers per 1,000 Chinese whereas India had 4.5 per 1,000.²⁸ However, it may be noted that at the time of writing, the mobile phone user base in India was already nearing the 45 million mark, crossing the number of fixed line subscribers, usually seen, particularly from the experience of China, as a critical inflexion point in the growth and modernization of a country.

Although there is clearly much that remains to be done, India has made considerable progress in recent years and there is an underlying dynamism that is now increasingly being exhibited by the Indian economy. It would also be fair to say that India is now at a stage where the logic of the economic reforms has gained widespread consensus within the country. This means, there is no going backward, the only choice is to move forward.

To understand the full magnitude of the transformation that has occurred and is happening in India, one must examine the current pattern of Indian industrial growth and development in the context of the period after independence in 1947. In 1950, the Indian per capita income was estimated to be around US\$95.²⁹ The country was primarily agricultural with over 70 percent of the population being engaged in agriculture and with just less than 50 percent of the GDP from agriculture.³⁰ Scholars remain divided as to the impact of the colonial rule on the Indian economy. While the British created the institutional foundations for a functioning market economy, India still remained largely non-industrialized at the onset of independence (see chapter one).

As seen in chapter one, the then prime minister, Jawaharlal Nehru decided to embark on a policy of import substitution led industrialization. This policy had acquired ideological respectability at that time in history and many countries sought

to follow this model. The underlying rationale to pursue this policy in the Indian case was a deep sense of pessimism about increasing the country's exports, a desire to industrialize rapidly, and a romantic attachment to the fundamental tenets of Fabian Socialism, so deeply ingrained into some of the new India's ruling class under the influence of, amongst others, The London School of Economics.

In practical terms this policy meant that some industrial sectors were to be the sole monopoly of the state, others could be jointly developed between state and the industry, while the other sectors were reserved for the private sector, and all this in a regime of licenses and exchange controls. In practice, this "well-intentioned" policy, led to a cumbersome system of controls in which the bureaucrats and the politicians reigned supreme. Many commentators described this period as "license raj," during which business firms were subject to extreme forms of micro management by the bureaucracy. Naturally many of them, sought to evade these controls, and in doing so, furthered the practice of corruption (see chapter five, "Understanding India").

Internal constraints on entrepreneurial activity were also reflected in India's declining share of world trade. In the period 1947–1990, India's share of world trade declined from 2.4 percent in 1947 to 0.4 percent in 1990.³¹ What is interesting is that in 1948 India's share of world merchandising exports was 2.2 percent, a figure that exceeded China's 0.9 percent, and Japan's 0.4 percent.³² The consequences of this introspection were profound. During the period 1950–1980, India's GDP growth rate was around 3.75 percent per year, a rate that often came to be pejoratively called the "Hindu rate of growth."

By the late 1970s or the early 1980s it had become reasonably clear that the existing growth strategy was producing suboptimal outcomes. Analysts classified India as a "low income, slow growing economy."³³ When Rajiv Gandhi came to power in the early 1980s, the first attempts to liberalize the economy were made but the reform agenda was never implemented wholeheartedly for a variety of reasons including the debilitating effects of a weapons purchase scandal involving Bofors of Sweden.

It took the balance of payments crisis in 1991 to refocus the government's attention on removing the shackles on the Indian economy. While the economic imperatives for reforming the economy were clear, it was the collapse of the Soviet Union, and the emergence of China as a major actor on the world stage, that impelled the Indian government to initiate bold and decisive action. The reform process of 1991, was spearheaded by Dr. Manmohan Singh, the then Finance Minister and the current Prime Minister. He initiated a series of first generation reforms, that is, reforms covering industrial policy, trade and exchange rate policy, and financial markets. The government for all practical purposes abolished industrial licensing, allowed automatic approval for foreign investors to gain 51 percent equity in their ventures in India, and lowered tariffs and quantitative restrictions on imports. Prior to the liberalization the average tariff rate in India was 125 percent.³⁴

The impact of the first generation reforms has been, without question, positive. Analysts estimate that the poverty levels in both the rural and the urban areas have declined by a third.³⁵ It has also been pointed out that in absolute terms, the number of poor people has declined by 60 million with the poverty rate declining from 55 percent in 1973/1974 to 26 percent in 1999.³⁶ This has also been accompanied by an increase in the literacy rate, which rose from 52 percent in 1991 to 65 percent in 2001.³⁷

This is in large part a consequence of the higher growth rates experienced by the economy in the post-reform period. The reforms have also helped to alter the sectoral shares of agriculture, industry, and manufacturing, in the GDP. The share of agriculture as a percentage of GDP has declined from 40 percent in the 1971–1980 period, to 28.3 percent in the 1991–2000 period. At the same time the share of the services sector in the GDP has increased from 34.4 percent in 1971–1980 to 44.4 percent in 1991–2000.³⁸ Furthermore, the opening up of the Indian economy has also helped to create new opportunities for the Indian exporters.

Finally, the growing opening up and integration of India in the world economy has also strengthened the impression among foreign investors that India may be a good place to do business. This intangible benefit is of vital importance because investor sentiments are crucial in attracting foreign direct investment. In India's case this is doubly important as prior to 1991, the Indian trade and investment regime was very restrictive.

Although much has been accomplished, there is clearly more to be done. Policy makers need to focus their attention on second generation reforms like reforming labor laws, which would make it easier to lay off workers. However the focus on privatizing inefficient public sector enterprises that are a drain on the national treasury remains a controversial issue, and the newly elected coalition government may have to fight some battles in moving this process along. They have already disbanded the Ministry of Privatization, but that by itself may not necessarily be a negative omen.

Mr. P.C. Chidambaram's appointment as the Minister of Finance is an encouraging sign as he is considered to be an ardent supporter of reform. There is an urgent need to deal with the overall government deficit (central and state combined), which is estimated at about 10 percent of GDP. This deficit is a consequence of excessive subsidies given by the central and the state governments, as well as a low tax yield, stemming from the fact that only few people pay taxes. The free distribution of power to farmers, as well as transmission and distribution losses due to theft, are additional contributing factors. As we have pointed out earlier, an emphasis on the improvement of infrastructure is an absolute must if higher rates of growth are to be sustained. An improvement in government finances will provide an opportunity for the government to undertake substantial investments in this area.

In our view, there is now an increasing recognition in European countries as well as in the United States that India is fundamentally committed to the process of economic reform, although there is a clear understanding that in a democratic framework, the reform process may not necessarily proceed smoothly. But this greater interest in India that is now being demonstrated by the United States and the European countries is likely to further strengthen the Indian enthusiasm for engaging with the outside world. The visit of the then U.S. President Bill Clinton to India in 2000 generated a very positive response. This openness means that the reform process is unlikely to alter its fundamental direction, even though its pace may accelerate or decrease, depending on circumstances.

What are the implications of this economic contrast for the European and the North American investors who seek to do business with India? The first point to be noted is that there is a new spirit of openness in India with the Indian populace recognizing that integration with the world economy can produce significant benefits. This spirit of openness has been reinforced by the dramatic growth of the information

technology industry in India (see chapter three). This industry has become one of India's major exports and also a major advertiser of India's strengths. Consider the fact that India's software exports increased from US\$128 million in 1990–1991 to US\$8.3 billion in 2001.³⁹ The industry has been experiencing 50 percent annual growth since 1991 and constitutes about 8 percent of total Indian exports. Most Western companies now consider India as their first option in outsourcing software development.⁴⁰ This is particularly true of American companies.

In the year 1997–1998 total software exports from India totaled US\$1.8 billion, and of this figure 58 percent went to the United States, 21 percent to Europe, and 8 percent to South East Asia. The industry has gradually moved up the value chain with Indian companies now engaged in high value-added work. A study by McKinsey and Company suggests that the output of the Indian software and services industry is expected to increase to US\$87 billion by 2008, of which US\$50 billion may be exported. NASSCOM, the industry association, predicts a turnover of over US\$20 billion for the current fiscal year with US\$16 billion to be exported.

In addition to the success of the Indian software firms in the global market, foreign firms are also taking advantage of the local talent that is available here. Intel has reportedly invested about US\$25 million in software development in Bangalore, India. This investment appears to be paying off handsomely. In 2003, the Indian subsidiary of the U.S.-based company Intel filed 63 patents. Intel is not alone in reaping the benefits of operating in India. More than 100 multinational firms have established research and development centers in India including companies like General Electric, Bell Labs, Du Pont, Caterpillar, Microsoft and IBM. One of the largest R&D centers has been established by GE in Bangalore. This is a US\$100 million center that was set up in 2000 and has already applied for 17 patents. Texas Instruments, which was one of the first companies to set up operations in Bangalore has realized 225 patents while Cisco systems has 120.

There are many other companies that have attained comparable level of success. The development of this industry has undoubtedly been greatly aided by the presence of a large and skilled manpower that is fluent in English. India annually produces about 75,000–80,000 software professionals, and perhaps more interestingly, there are about 140,000 professionals who work in Bangalore, a number that is 20,000 more than in Silicon Valley. Analysts predict that foreign firms are likely to use India as a base for R&D even in industries such as biotechnology and pharmaceuticals.

The demographic profile of the Indian population is also becoming younger and this has implications for the marketing strategy of firms as well as for a country's rate of growth and development. Estimates suggest that more than 500 million Indians are below the age of 21 and the median age of the Indian population is 24.⁴¹ This is in sharp contrast to the median age of 36 in the United States and 30 in China.

The implications of this demographic transition are many. A more youthful population that has grown up in the Internet age and in era of globalization may have higher levels of aspiration, and may also seek to realize their higher aspiration levels in different ways. It is now widely believed that well over 600 shopping malls in the American style, may now be created in India. Malls have already been established in Gurgaon, a town on the outskirts of Delhi. These malls contain outlets of the likes of international brands such as Nike, Benetton, and Pizza Hut, among others.

The growing number of young consumers is also forcing multinational firms to tailor their marketing strategy to a new market segment. Motorola has developed cheap phones primarily for the younger consumer market segment. Citibank has observed that the average age of a mortgage holder has declined in India from 41 to 28. The company is developing new programs to attract an increasingly younger crowd. The youth are part of an emerging middle class in India. Estimates of the middle class vary but a study by the U.S. Department of Commerce suggests that India has 20 million people with annual incomes in excess of US\$13,000, 80 million people with annual incomes in excess of US\$3,500, and 100 million people with incomes in excess of US\$2,800.⁴²

A shift in the age distribution of the population also has implications for the rate of growth that a country can hope to realize and sustain. Scholars note that when the percentage of people who are working in a given country increases, the saving rate increases correspondingly. Increased savings, in turn, will enhance the growth rate.

The heightened interdependence between India and European and North America also implies that there are many more foreign investors active in India and likewise there are Indian companies that are increasing the scale and scope of their international operations. Foreign companies are operating in India in a wide range of industries such as the automotive, consumer electronics, food processing, telecommunications, financial services, infrastructure, engineering, information technology, biotechnology, entertainment, retail, and healthcare sectors. Ford has made an investment of more than US\$350 million in India. The company currently exports cars from India. At the other end of the spectrum, Marks & Spencer, a well-known U.K.-based retail chain has set up franchisee outlets in Delhi and Mumbai.

In the era of control it would have been unthinkable for Indian companies to operate overseas. As Indian firms venture overseas, they are likely to absorb the capitalist ethos to a heightened degree, and may seek to reshape their corporate culture to conform to the demands of the international environment. This can only but strengthen the Indian integration in the global capitalistic environment. There are several indications to suggest that this process is already underway. India has already become the eighth largest investor in the United Kingdom. At the same time Indian companies are reported to have acquired about 120 foreign firms during the period 2001–2003 with a combined value of US\$1.6 billion.⁴³ Indian pharmaceutical companies, for example, have sought to acquire overseas firms. Dr. Reddy's laboratories acquired Trigenesis, a U.S.-based company, for US\$11 million to enter the speciality drugs market. Ranbaxy acquired the French generic drugs maker, RPG Aventis for about US\$70 million. Hindalco has acquired an Australian company, Straits (Nifty) Pty., for a value of AD\$79.80 million. Seven Indian companies are reportedly listed in the New York Stock Exchange while three are listed on NASDAQ.

India is a country comprising 29 states and 6 union territories. There is considerable interstate variation in economic performance. In 1998/1999 the Gross State Domestic Product per capita was highest in the state of Maharashtra (US\$657) and lowest in the state of Orissa (US\$238).⁴⁴ Since the start of reforms, highest growth has been recorded in the states of Karnataka, Maharashtra, Tamil Nadu, and Gujarat, and lowest in the states of Uttar Pradesh and Bihar. Andhra Pradesh, Karnataka, Maharashtra, Tamil Nadu, and Gujarat have also been the most pro-reform

states, whereas Bihar and Uttar Pradesh, with very large populations, can at best be described as reluctant reformers. The implications of this state of affairs are fairly clear.

The five pro-reform states have accounted for two-thirds of private investment inflows, even as these states constitute only a third of the country's population. To put it in more concrete terms, Tamil Nadu has become a major hub for companies in the automotive sectors with firms such as Mitsubishi, Ford, and Hyundai having a presence in the state. Karnataka and Andhra Pradesh have staked out their claim in the information technology sector by attracting companies such as Microsoft and Sun Microsystems while Maharashtra has been a home to Mercedes Benz and Siemens amongst others.

Differences in the regional performance of states has a number of different implications. First, it clearly suggests that some states are much more attractive destinations for foreign investors than others. The differential economic performance of the states may be attributable to the differences in the quality of governance and that of the infrastructure, as well as differences in their motivation and ability to create an investment climate that is attractive to foreign investors. The area around Delhi, the southern states in India and the western region of the country are by far much more attractive destinations for foreign investors than states such as Uttar Pradesh, Bihar, or Orissa.

As foreign investment gets localized in the more promising states, the differences between the high growth and the low growth states are likely to widen. Regional inequality is likely to increase and this may create some interstate tensions as the less well-performing states demand greater allocation of resources from the center. Although these tensions may cause some hiccups they are highly unlikely to fundamentally threaten the integrity of India as a nation-state.

We are also seeing the emergence of regional centers of excellence within India. Thus the southern states, and in particular, the city of Bangalore in Karnataka, has become the hub of the Indian information technology and biotechnology industries. These centers, if we can call them as such, are often much more integrated with the global economy and the operating routines within these segments conform to global norms. Finally, the clustering of foreign investment within certain regions may also have the additional potential of creating synergies among the foreign investors.

(c) Cultural Dimension

Many scholars have often debated as to whether India belongs to the East or to the West, but a consensus seems to be emerging that the Indians are closer to Europeans/Americans than they are to the Asians. A renowned German scholar of India, Max Mueller, once noted "India for the future belongs to Europe, it has its place in the Indo European world, it has its place in our own history, and in what is the very life of history, the history of the human mind."⁴⁵ A good example of this observation is the close linkage that exists between *Sanskrit*, the language of the Aryans of India, and *Greek*, *Latin*, and *Anglo-Saxon*. Scholars have shown that all of these languages have a high degree of commonality about them with this commonality being indicative of a shared Aryan culture. The Aryans who are supposed to have migrated to India around 1500 BC spoke Sanskrit and this provides the foundation for languages currently spoken in India.

Even if we move from the realm of shared knowledge to the realm of action there are similarities. The Indian, for example, is aggressive, argumentative, emotional, and analytical. These are traits that set the Indian far apart from the model of the “Confucian gentleman” that is so revered in Asia. A Japanese anthropologist, Chie Nakane, described the Indians as being very logical and noted that their thinking was much more similar to the Westerners than it was to the East Asians.⁴⁶ An ABB manager who has done business in India for more than 20 years once indicated to one of the author/s that it was extremely difficult to win an argument with the Indians.

Similarities aside, there are without question, some differences between the Indian and the European/American cultural realities. Cultural differences are rooted in ideas/practices that originated in ancient times, but it needs to be noted that all societies evolve and adapt continuously. Culture is, therefore, both stable as well as malleable, and for this reason its potential impact cannot be overlooked. At this point we would like to draw attention to some aspects of the Indian culture that have exerted a significant impact on practices from ancient times till the present. The aspects that we will focus on are the caste system and the family.

(i) *Caste System*. No aspect of the Indian social system has probably attracted greater attention than the caste system. Although both Indian and foreign observers have been, and continue, to be critical of it, it is still very much a part of contemporary life in modern India. The caste system represents a hierarchical ordering of the society and stands in opposition to the norm of social equality, so characteristic of Western societies in general and of Scandinavia in particular. Although hierarchy is a universal feature of all societies, the hierarchical ordering implied by the caste system had extreme rigidity, and it was this rigidity, that has most fundamentally attracted the opprobrium of many commentators past and present.

The term *caste* is derived from the Portuguese word “*casta*,” which refers to family strain, breed, or race and was first employed by Portuguese traders in their interactions with the Indians in the sixteenth century. The Sanskrit word for *caste* is “*jati*.” The *jati* was broken down into four varnas, which in a hierarchical order were *Brahmins* (priests), *Ksatriyas* (warriors), *Vaishyas* (merchants), and *Shudras* (workers). Each group in this hierarchical order had an important role to play in promoting the well-being of the society. The *Brahmins* at the apex of this order were the intellectual guardians of the society; the *Ksatriyas* defended the society from external or internal threats; *Vaishyas* provided the commercial lubricant for the society, while *Shudras* performed the menial tasks in the society.

Each *caste* has its own *dharma* or a set of behavioral norms defining what is acceptable and unacceptable behavior. The *Brahmins* are expected to be vegetarians, teetotalers, and spiritual; the *Ksatriyas* must be strong and brave and it is acceptable for them to drink alcohol and be nonvegetarian; *Vaishyas* are your conventional businessman; while the *Shudras* were considered to be seen as behaving in a less than desirable manner.

The caste system in India originated more than 3,000 years ago when the Indo-Aryans migrated to India. Deepak Lal has made the interesting argument that the caste system developed in India as a response to problems of political stability that was endemic in the early Aryan civilization.⁴⁷ There was an urgent need to ensure a

stable supply of labor for the labor-intensive agriculture that was practiced by the Aryans in the Indo-Gangetic plain. Given the lack of an effective centralized state, which could maintain control over labor through coercive means, only a decentralized control mechanism could ensure this option. Within the rubrics of the caste system, it was not possible for any individual or group to flee, because they would lack the complementary skills necessary to function autonomously.

Although the origins of the caste system may have been benign, and while the caste system may not have been very rigid in the early Vedic period, it is a system which continues to exist, notwithstanding governmental laws and regulations which explicitly forbid caste discrimination. It is believed that there are around 2,000–3,000 subcastes today as a consequence of the subdivision of the original fourcastes.

It is also worth noting that there is some, although not a perfect correlation between status and income, implying people of higher status are overall more prosperous. It is interesting to note that the Indian information technology industry, in which India excels, has been primarily dominated by *Brahmins*. One commentator made the observation that “There have never in Indian history been so many entrepreneurial *Brahmins* as seen in the software industry now.”⁴⁸ This is a remarkable development, but in some ways not surprising because the *Brahmanical* emphasis on knowledge goes well with the development of the information technology industry, in that the latter is also knowledge intensive. The political elite has also, for the most part been dominated by people, who belong to the upper castes and the unstated goal of the now-ousted BJP was to strengthen the position of the upper caste groups.

What is the role of caste in modern India, and especially in the business sphere? Undoubtedly, caste has less relevance in the urban domain than it has in the rural domain. In the urban domain, business transactions are anonymous and professional identities may be more salient. However, it is worth noting that while caste barriers may not negatively shape interaction, caste similarity may certainly induce the actors to be more motivated to cooperate with each other. In this context caste is not intrinsically important, but it is important only because it helps to draw a distinction as to whether a person is a member of an in-group or a member of the out-group. Most often members of in-group are trusted more than those of the out-groups making it easier to enter into transactions with the former than the latter.

(ii) *Family*. The family represents the fundamental building block of the Indian social system. It has been the “*joint family*,” that is, a family in which two, three, or four generations all live together, that has been the normative ideal in India. The Indian system, by and large, is a patriarchal one, which brings together many generations under one common roof. Although the *joint family* may be undergoing some changes, and especially so in the urban areas, it would be fair to say that the family is revered by most Indians, even today. The basis for this strong identification lies in the strong mother–son relationship as well as a deeply internalized set of obligations that are inculcated in early childhood. Parents are willing to make sacrifices for their children and vice versa, a norm far different from that of contemporary Western industrialized societies. The family structure is hierarchical with key decisions being made by the head of the family. Such hierarchy is usually accepted by the younger members of the family, as it is accompanied by benevolent paternalism.

The strong sense of interdependence that exists among the members of a family does not imply that there are no conflicts. Often, there is an attempt to paper over or avoid these conflicts, but should either of these prove unsuccessful, conflicts can certainly escalate in an unrestrained manner. Most importantly, it is hard to overestimate the impact that family has on social life and on business practices in India. In other words, without a sufficient grasp of the role played by the family in an Indian's life and world, it is often difficult to explain the Indian employee's commitment to the organization, or to the strategic decisions made by Indian organizations.

For an Indian, the primary loyalty and commitment lies with the family rather than to the work or organization. Scholars have maintained that it has been the narrow loyalty to the family or to the caste grouping that has historically prevented the development of a broader loyalty toward the nation. This does not imply that Indians cannot transfer their loyalty to the larger organization; only that such a transference requires a communal corporate culture and a nurturing leadership style.⁴⁹

The strategic significance of family in a business context can best be gauged by recognizing that much of Indian business is still family owned. It has been estimated that 71 percent of India's market capitalization can be attributed to the Indian family business. The Indian family businesses are said to employ 75 percent of Indian citizens.⁵⁰ In the post-independence period the Indian business firm grew in a protected and a closed environment. The key to success was good relationships with the bureaucrats and the politicians. Analysts have noted that Indian family business has often suffered from a lack of clear focus, short-term thinking, weak marketing skills, and often an inability to separate the interest of the family from that of business.⁵¹ It has also been pointed out that very few (3 percent) of Indian family businesses are able to survive in their present form beyond the third generation. One of India's largest family owned businesses, the Reliance Group, witnessed a major power play between two brothers who inherited the business after the demise of their father.

Post-1991, the Indian family business firm is facing new challenges as a number of multinationals have entered the Indian markets and tariffs/quantitative restrictions have been eased, thus permitting foreign firms to export directly to India, after a long time. How are the Indian family businesses doing in the changed scenario? By all accounts, it has not been an easy ride for them and there is often still a reluctance to thoroughly professionalize management by bringing in "non family" members in positions of control.

A recent study on family businesses conducted by Grant Thornton found that 46 percent of Indian business people felt that their successor should come from their family whereas only 24 percent of Europeans and 22 percent of North Americans subscribed to this view.⁵² Indeed, even in the Indian pharmaceutical company as dynamic as Ranbaxy, it appears there are pressures to re-exert managerial control from within the company. The sudden departure of their professional CEO raised concerns within the larger financial community in India.

There are Indian family business firms that have made a mark in the Indian business environment. The three largest owned family businesses in India are Reliance Industries with an estimated value of US\$9.63 billion; the Tata Group with an estimated value of US\$7.9 billion; and the Aditya Birla Group Industries that has

an estimated value of US\$6 billion. These are companies that have been bold and innovative in coping with the changing environment, although as we have noted above, the Reliance Group is now confronted by sibling disputes.

We began this section by making the argument that culturally speaking India is closer to Europe and North America than it is to Confucian Asia. Although in subsequent paragraphs we have identified some key differences between the Indians and the European/Americans, these differences have to be viewed within the context of an overriding similarity. The Indians and the European/Americans have an analytical bent of mind and an abiding desire to know more about the world, although there may well be differences in how they have made, and make use their knowledge about the world.

Commonality in language (English), the annual exodus of many Indians to study in the United States and Europe, and external events, most notably the end of the Cold War, and more recently the terrorist attacks of September 11, 2001 have only heightened this natural affinity. This shared sense of unity is, of course, also accompanied by differences, and it is this bridge that Western expatriates will have to build to succeed in the Indian environment. As pointed out in the earlier part of this chapter, the Indian environment is now becoming an increasingly attractive one for Western firms. The next few chapters will discuss the best methods to operate in such a challenging environment.