New Zealand Businesses in India: Opportunities and Challenges

Swati Nagar

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Primary Supervisor: Professor Peter Enderwick

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Attestation of Authorship

I hereby declare that this submission is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person (except where explicitly defined in the acknowledgements), nor material which to a substantial extent has been submitted for the award of any other degree or diploma of a university or other institution of higher learning.

Swati Nagar.

Abstract

As a resource based economy international engagement plays a critical role for the growth and development of New Zealand. One of the most notable trends over the past 15 years has been the rise of some of the largest markets around the world, that have led to a rapid and substantial increase in international trade and investment flows. The liberalisation and consequently the rise of emerging markets has today changed the economic geography for the business world, with companies entering these markets with the hope of getting superior returns arising from rapid economic growth and related market opportunities. Amongst other emerging markets, the economic resurgence of the Indian market in the recent years has been widely noticed and in many senses has influenced and changed the structure and operations of businesses around the world.

The prospects offered by India have allowed firms to substantially expand their activities beyond their domestic borders and access new growth opportunities generating significant productive growth. The benefits that markets like India today generate are likely to be particularly significance for New Zealand, given the small size of the domestic market. Indeed, increasing New Zealand's exporting and international investing activity is vital to raising New Zealand's growth rate. The rapid rise and deregulation of the Indian market has seen a rise in the number of New Zealand businesses keen to tap into the vast prospects across different sectors over the recent years. Nevertheless, New Zealand businesses have not been participating to nearly the same extent as most businesses from other small developed countries currently operating in the Indian market.

Reasons for this limited interaction are unclear and not well documented in the current literature that examines the economic activities amongst the two markets.

Given the importance of international engagement New Zealand businesses cannot afford to isolate themselves from the opportunities provided by the Indian market. Considering this, the main aim of this research is to focus on the opportunities that India provides and the benefits that New Zealand businesses stand to gain from those. On identifying, this may help devise actions that might lead to substantially increased levels of international investments by New Zealand firms, given the challenges of entering the Indian base from a small remote country. Drawing on insights gained from existing literature and case studies of companies operating in India, the research will identify appropriate strategies and policies that might help New Zealand businesses to succeed and better direct operations in India.

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Chapter 1: Introduction

Economic liberalisation has led to the opening of some of the largest markets in the world, which have come to offer tremendous opportunities for businesses around the world, including New Zealand. In the recent years amongst other emerging markets, India has become one of the fastest growing economies in the world; with a growth rate that over shadows most Asian markets. These developments have seen a rapid increase in the level of international interaction between countries and their businesses with the hope of cashing in from the opportunities that all the emerging markets, more recently India in particular, stand to offer. However, despite these developments the international interaction as well as the performance of the New Zealand economy and its businesses has not been that significant, when compared to other economies of similar size.

Given the size engaging and increasing its interaction with other markets is vital for New Zealand's growth and survival. In order to achieve sustainable growth the New Zealand economy and its businesses in particular need to recognise some of palpable prospects markets like India, can today provide. This is the main aim of this study.

1.1 Nature of the Topic:

The opening of the Indian economy has seen New Zealand businesses enter the Indian market, with India increasingly becoming an important trade partner for New Zealand. However, despite promising opportunities New Zealand businesses still struggle to gain stability and growth in the Indian market. In addition, the level of involvement of New Zealand businesses within India is quite limited. The reasons for failures and limited interaction are unknown and key mistakes are not well documented. Moreover, the data available from the existing literature on New Zealand companies currently operating in India presents few insights about the two markets in terms of trade patterns and activities, which makes this research imperative.

Most of the studies, which have explored the internationalisation of India as an emerging market, have mostly concentrated on North American and European businesses. The findings of most of these studies conducted provide a more generic perspective covering areas such as economic and political environment and overall outlook of the business and investment climate in India. {Calcich 2002} {Campbell-hunt 2003} These findings, also, offer little guidance to smaller firms, particularly from resource-based economies like New Zealand. Hence the findings of such studies may not provide useful insights for New Zealand companies. {Deng 1995} {Coviello 1995}

The existing literature also does not suggest in detail the possible motives for New Zealand businesses to internationalise their operations into markets like India. It also fails to provide insights on the potential problems and challenges these businesses stand to face when operating in the Indian market. Although New Zealand companies like Fisher & Paykal, Beca Engineering, Fonterra and Solid Energy to name a few have been successful in carrying out joint ventures in the Indian market, research on India and New Zealand businesses is important to conduct as many small or medium sized New Zealand may lack the knowledge necessary for operating in India. {Asia Foundation 2006}

The literature also does not present substantial information on the entry modes that have been opted by New Zealand businesses to establish a presence in the Indian economy, as well as the advantages and disadvantages of particular modes is not well documented. The above mentioned points suggest that research in this area is quite limited and that research on this topic is of importance as insights gained from this study could be insightful for businesses seeking to conduct operations in India.

1.2 Research Questions to be addressed:

To overcome the limitations of existing literature, this study will draw on four distinct sources of literature:

1. The limited evidence on New Zealand firms doing business with India;

2. Literature on New Zealand businesses in other markets;

3. Work on the experience of other countries doing business with India;

4. The expansive general literature on the internationalisation of small and medium sized firms.

Drawing on the eclectic literature sets hence, the research aims to explore the following research questions:

- ***Why do New Zealand businesses internationalise? (Possible reasons: Small domestic market, lack of opportunities in the local market, diseconomies of scale, which may compel the businesses to internationalise)***
- ***What interests New Zealand businesses to venture into India and the possible advantages linked to that?***
- ***What are the possible areas/opportunities for conducting operations in India, which might interest New Zealand businesses?***
- ***What are the benefits of entering those areas?***
- ***What are the possible challenges that New Zealand businesses may face in India and how can they possibly overcome those?***

- ***What are the possible strategies/policies that can be implemented for New Zealand companies that might consider entering the Indian market?***

In answering these questions the study has five specific objectives:

1. To examine the business opportunities that exist in the recently liberalised Indian economy;

2. To analyse the competitive strengths that New Zealand businesses could deploy in the Indian market;

3. To identify the key constraints that New Zealand businesses face in international business operations with a market such as India;

4. To identify the major market and management challenges that arise in doing business with India;

5. To derive appropriate managerial and public policy implications from the foregoing analysis.

1.3 Methodology:

The methodology used for this research would primarily be based on qualitative methods and would focus on content analysis, providing a review and integration of the literature identified as well as use of case examples where necessary. A case study method is one seeks to examine the facts or theory in existence which can lead to answers for particular research questions. The case study approach seeks a range of different kinds of evidence, which can be collated to get best possible answers the research questions. As no one kind or source of evidence is likely to be sufficient on its own, the use of multiple sources of evidence, each with its own strengths and weakness, is a key characteristic of a case based research method.

The case study is one but several ways of conducting research. The case study approach is best used when "how", "why" and "what" are being posed and also when the investigator has little control over the events that are under question. Hence to meet the aims of this research the author intends to use content analysis and case based examples, to provide an integration of existing literature and a number of case examples on the topic to seek relevant solutions to the questions raised above and to provide a significant contribution to an area of significant importance to New Zealand. This research is particularly opportune as 2007 was New Zealand's Export Year.

1.4 Structure of the Study:

The proposed structure of the research, which would help explore the aspects discussed so far, is as follows:

The ***First Chapter*** has aimed to establish the importance of this topic and the insights this research could help gain. It has also outlined the questions that this study intends to answer. Considering this, to establish the need for internationalisation and increase the level of international interaction, the study begins with introducing the background of the New Zealand and its patterns of trade over the decades in the ***Second Chapter***. This chapter presents a brief analysis of the New Zealand economy and highlights the changes that the market has gone through over the recent years. Having presented a summary the study then moves on to present the third chapter.

The ***Third Chapter*** aims to analyse the main reasons for New Zealand businesses to internationalise their operations. The key points discussed in the light of this are the small size of the local market and hence lack of opportunities, inability to achieve economies of scale and stifled growth due to the size of the consumer base in the immediate market. Having presented these points, the chapter then moves onto to discuss the state of the New Zealand economy in the pre-reform period. Here the section analyses the trade patterns and trading partners of the New Zealand economy prior to 1984. The section also aims to examine the form of trade that was conducted by New Zealand businesses in the

international market in the pre-reform period and based on this, the section study's the position and the performance of New Zealand in the world economy in comparison to similar size economies. It also presents an analysis of the drawbacks of the government policies that then governed the functioning of the New Zealand economy and presents the implications that the restrictive polices had on the New Zealand economy as a whole.

Following this discussion, the study, then moves on present the economic reforms introduced by the government in 1984 and analyses the impact those had on the New Zealand market in ***Chapter Four***. This is done by the way of presenting the performance of the New Zealand economy in the world economy part 1984, with a particular focus on Exports and Foreign Direct Investment flows from the economy. As a way of conclusion the ***Chapter Five***, presents the emergence of some of the world's largest markets with a focus on India in particular and the potential that India holds for New Zealand businesses.

Thus keeping in mind the importance of international engagement for New Zealand businesses with a particular focus on India, the ***Chapter Six*** presents a background of the Indian economy prior to the economic reforms of 1990. The chapter presents an analysis of the Indian market and the regulations that were active in the market until 1990. Having presented an analysis of the Indian market, it then analyses the main reasons that led to a balance of payment crisis within the Indian economy in the early 1990's, that subsequently piloted the new government to embark on a reform programme, that has helped India change its economic dynamics as a market. As a sequel, the ***Chapter Seven***

concludes by the way of presenting a brief analysis of the reforms that were introduced within the Indian economy as a consequence of the crisis in the 1990's, with a focus on some of the key sectors like Industrial Development, Infrastructure, Finance, and Public Enterprises.

Encompassing the Seventh chapter, ***Chapter Eight*** then presents the development the Indian economy has seen in the post-reform period. The analysis of the level of development is done by focusing on key areas such as Manufacturing, Services and Trade (Inward Foreign Direct Investment). Having presented this analysis, ***Chapter Nine***, presents the potential that the Indian market holds for New Zealand. To being with the chapter first analyses the economic and trade relations that the two markets share and the presents a detailed sectoral analysis that might present substantial prospects for New Zealand businesses in India. This is achieved by focusing on key sectors such as Information Technology, Biotechnology, Food Processing and Infrastructure that seem to present key opportunities for growth in India. The opportunities in these sectors are analysed by identifying the potential gaps these sectors currently experience in the Indian market and relates it to the capabilities that New Zealand businesses possess to bridge these fissures.

Considering the sectors and the opportunities those present for New Zealand businesses ***Chapter Ten*** moves on to discuss the importance of entry options for a market like India and presents an analysis of the modes that may be suited for New Zealand businesses

wanting to conduct operations in the Indian market. This is done by analysing the characteristics of both the Indian market and New Zealand firms. Comprising the points in this chapter, ***Chapter Eleven*** presents the key challenges/barriers that New Zealand firms could stand to face in the Indian market and the potential impact those may have on the business operations of those companies. Amongst other barriers, the analysis particularly focuses on challenges like Size of New Zealand businesses when compared to the Indian market, the risk of Liability of Foreignness, Market Failure, and Bureaucracy/Tax System.

Finally as a way of conclusion the study aims to present possible implications that could act as a framework or a guideline for New Zealand businesses in ***Chapter Twelve***. The chapter presents three possible implications which emphasise on the importance of market research for a diverse market base like India, local networks and contacts and the benefits that the businesses would stand to gain due to good local networking. It also presents the role of the New Zealand government and the New Zealand Trade Enterprise in pushing trade relations between the two economies. ***Chapter Thirteen***, concludes the study, by presenting a brief summary of the entire research and emphasises on the fact that the New Zealand businesses must increase the level of international engagement in order to further boost productivity and growth in the economy as a whole and this could be achieved by engaging with markets like India, that today offer tremendous opportunities that would help New Zealand businesses improve their performance not only at a domestic but also at an international level. Hence, to being with the following section presents a brief background of the New Zealand economy.

Chapter 2: Background: New Zealand Economy

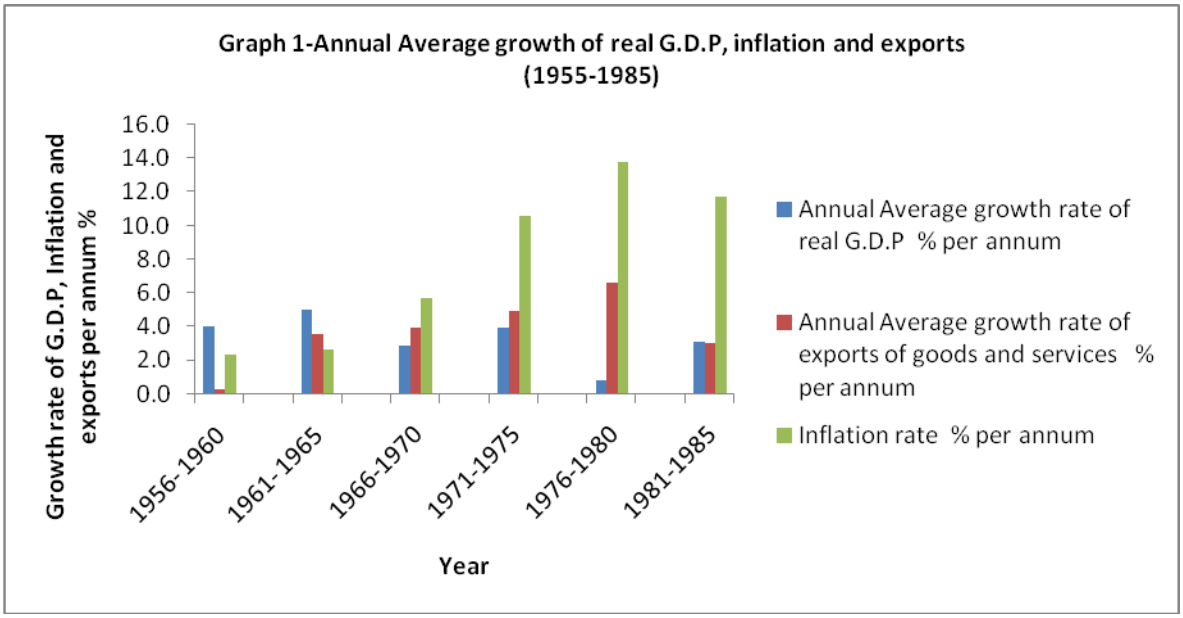
New Zealand emerged from World War II with an expanding and successful agriculture-based economy. In the 1950s and 1960s, a period of sustained full employment, GDP grew at an average annual rate of 4 percent. Agricultural prices remained high, due in part to a boom in the wool industry during the Korean War. However, even during this period there were signs of weakness. In 1962, the Economic and Monetary Council advised the government that between 1949 and 1960 New Zealand's productivity growth had been one of the lowest amongst the world's highest earning economies. {www.treasury.govt.nz}

In the 1950's New Zealand's trade relations still resembled those of most of the earlier 20th century. New Zealand mainly sold rural products such as wool; lamb and dairy produce largely to the UK. In return for this the UK supplied New Zealand with resources mainly in the form of capital equipment and intermediate goods used to produce finished products. Apart from that, the UK was also the key foreign investor into the New Zealand market at this time. {www.treasury.govt.nz} However the situation changed dramatically over the next twenty years. After 1955, as the UK increased its attention towards the EC, concern became apparent within New Zealand. The UK's desire to enter the EC had been signalled quite early on to New Zealand and the long-term viability of the British market was a concern to New Zealand businesses throughout the 1960's. {Abbott 2007}

In the late 1960s, faced with growing balance of payments problems, successive governments sought to maintain New Zealand's high standard of living through increased levels of overseas borrowing and increasingly protective economic policies, mechanisms that failed to work, resulting into an unsteady economic growth. Also at the time, all major trading countries had fixed exchange rates. This was known as the Bretton woods system. Under this system, the values of most currencies were fixed for long periods of time against the US dollar. The dollar in turn was set at a fixed price in relation to gold. {Abbott 2007} Maintaining this fixed exchange rate, while promoting growth proved to be difficult for New Zealand during this period. Often the government was forced to tighten up the allocation of foreign exchange to those seeking to import goods or even to restrict imports.

Apart from the exchange and the import controls, tariffs were levied on many imported goods. This meant that many domestic producers of manufactured goods were protected from foreign competition. {Abbott 2007} The foreign exchange, import and tariff controls were used to protect and develop local manufacturing as a part of the national development policy at the time. This was done with the intention to protect the much-required foreign reserves. The government could have borrowed to fill in the gap between the foreign exchange earnings and spending. However the government was not in favour of doing so, as it did not want to plunge the economy into further monetary and economic problems. As a result of this, manufacturers found it difficult to keep the prices of the goods low thereby losing competitive advantage amongst their key markets and trade saw a relative decline as compared to the other markets. {Abbott 2007}

During the decades of 1950's and 1960's the annual average growth rate of the New Zealand economy was solid by later and pervious standards, averaging 4 percent in the late 1950's and 5 percent in early 1960's. However these figures were low in comparison with most other western countries at the time, many of whom were experiencing very high rates of growth. New Zealand exports growth suffered a decline, which was unusual at a time when international trade was growing strongly throughout the western world. For instance, between 1953-1963, the world output growth was on average 4.3 percent per annum compared to 6.1 percent in world trade. Between 1963-1973 growth in real trade was even higher at 8.9 percent per annum, compared to 5.1 percent for world output (Bhagwati 1988) {Abbott 2007} ***Figure 2.1***

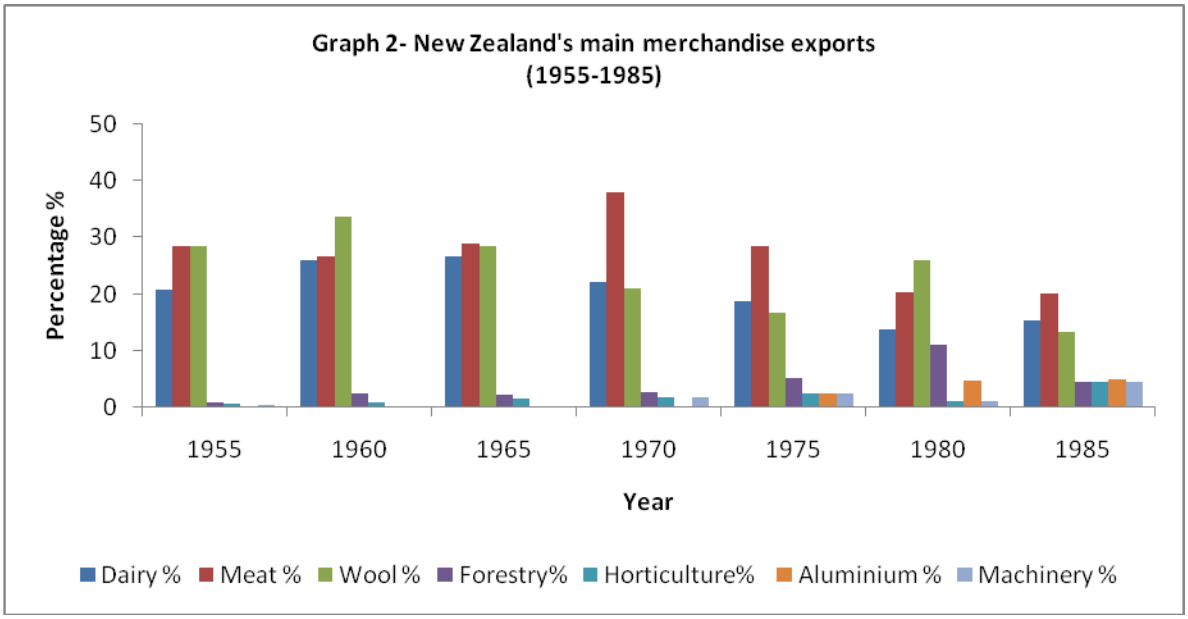


(Source: International Monetary Fund) {Abbott 2007}

As is seen in the graph above the annual average growth within New Zealand in terms of exports of goods and services per annum was only 0.2 percent in 1956-1960 rising steadily to only 3.9 percent between 1963-1973. There were two main reasons behind this. First, New Zealand's most important trading partner the UK experienced a slow growth in the 1950's and 1960's that had an adverse effect on New Zealand trade, the second was that the greatest growth in the world trade was in manufacturing rather than agricultural goods. Although international negotiations reduced the barriers to allow free movement of manufactured goods, agriculture was not included in these negotiations. Apart from that the European, American and the Japanese markets erected additional barriers towards trade of agricultural produce. (Bhagwati 1988) {Abbott 2007}

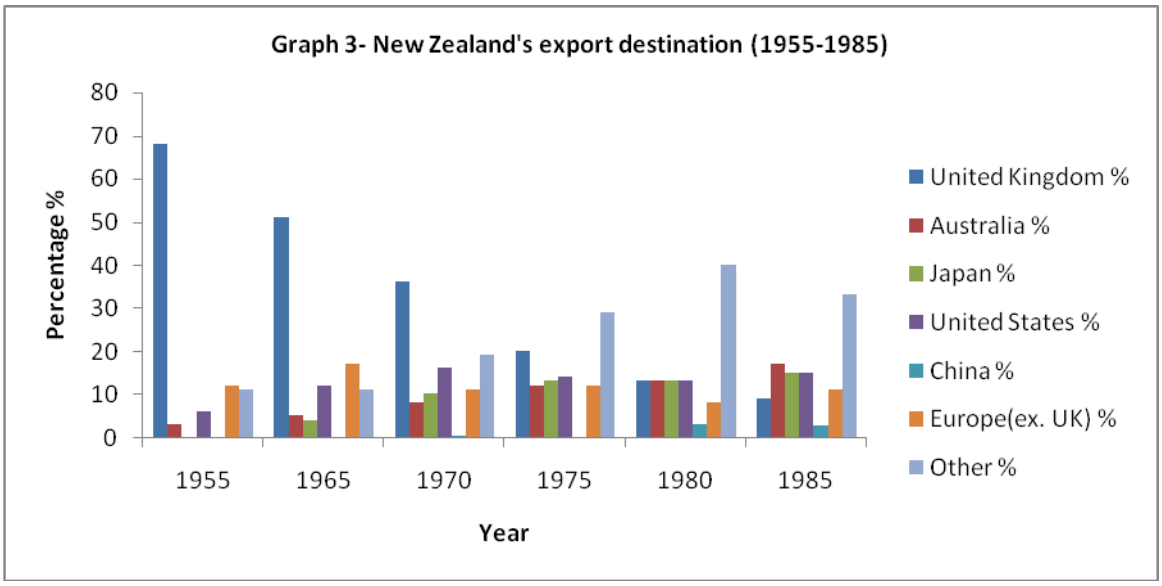
Although the agricultural sector showed steady growth during this period through development of greater mechanization (e.g. tractors, processing equipment, tanker trucks, aerial top-dressing) and improvements in animal husbandry new fertilizers and other techniques, however, the growth of the New Zealand economy as a whole still lagged behind its western counter parts. {Abbott 2007} Periodic declines in prices in many overseas markets made it difficult for New Zealand farmers to take full advantage of the improvements in the agricultural sector. The graph below shows that the major exports came from the agricultural sector, with main exports from dairy, meat and wool while other manufacturing areas like aluminium and machinery showed little growth until 1980's. This aspect made it difficult for New Zealand economy to solely survive on one key sector for income, thereby limiting the growth to a very large extent.

Figure 2.2



Problems mounted further within the economy in the 1970s, as by this time New Zealand was one of the most regulated economies in the OECD. Access to key world markets especially the UK and EC, for agricultural commodities became increasingly difficult. Until the 1973, the UK served as the major market for NZ products. However, the sharp rises in international oil prices in 1973 and 1974 coincided with falls in prices received for exports damaging the economy even further more. As in many OECD countries, policies in New Zealand were principally aimed at maintaining a high level of economic activity and employment in the short term. {Abbott 2007} {www.treasury.govt.nz} High levels of protection of domestic industry had greatly undermined competitiveness and the economy's ability to adapt to the changing world environment. The combination of expansionary macro policies and industrial assistance led to macroeconomic imbalances, structural adjustment problems and a rapid rise in government indebtedness.

Figure 2.3



As seen in the graph above New Zealand's main markets until the 1970's were the UK and Australia. However, as exporting to these markets became difficult, businesses started looking for new markets in order to survive. However, the growth was not as expected. As the world growth slowed and the import prices of oil and commodities soared in 1979 and 1980, New Zealand's economic relations with the rest of world became more precarious. {Abbott 2007}{www.treasury.govt.nz}

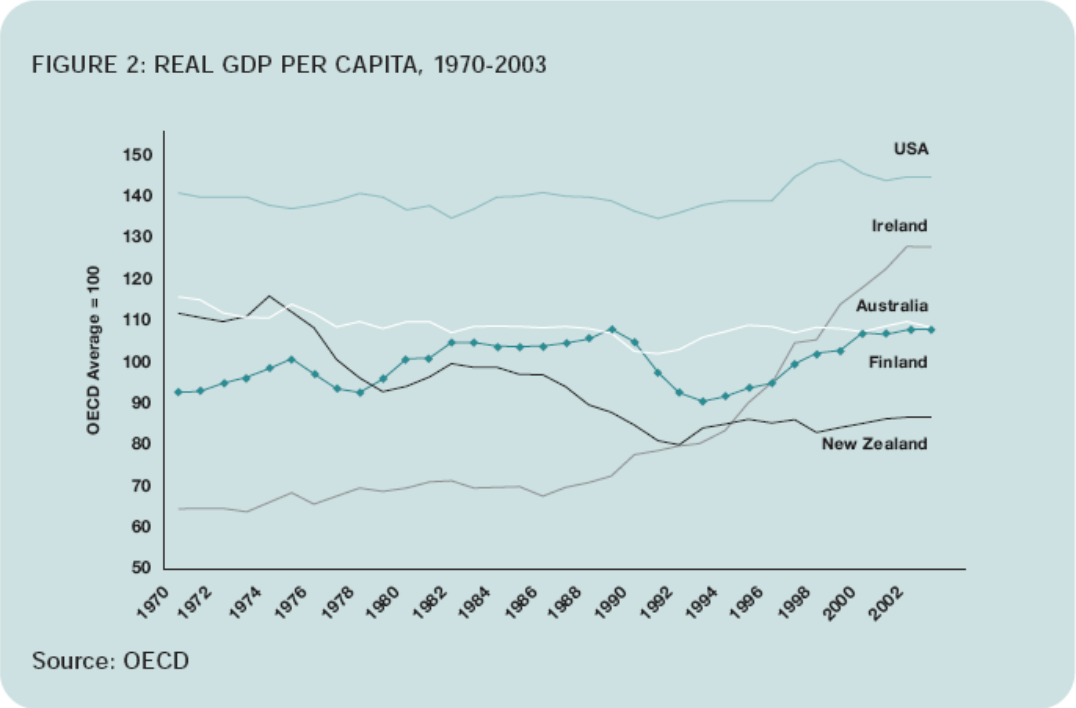


Figure 2.4

As figure 2.4 shows, New Zealand's real G.D.P per capita declined against the OECD average from 1970 (and indeed, from the 1950s). {Skilling 2005} Until the 1980's New Zealand had extensive restrictions on the importing of manufactured goods, which had important implications for the country's trade composition and competitiveness. However between 1974 and 1984, the policy turned direction and has focused on sustaining and increasing overseas earnings became an important objective of economic policy. {Akoorie 1992} {www.treasury.govt.nz} The changes in the policies applied by the government led to a steady growth moving the economy during that period. The direction of economic policy in the country turned away from intervention toward the elimination of many forms of government assistance. The government brought about a change by introducing reforms at both macro and micro economic levels. On the

macroeconomic level, policies were aimed at achieving low inflation and a sound fiscal position while microeconomic reforms were introduced to open the economy to competitive pressures and world prices. {www.treasury.govt.nz}

The reforms included the floating of the exchange rate, abolition of controls on capital movements, the ending of industry assistance, the removal of price controls, deregulation across a number of sectors of the economy, corporatisation and privatisation of state-owned assets, and labour market legislation aimed at facilitating more flexible patterns of wage bargaining. {www.treasury.govt.nz} The economic liberalization, which occurred after 1985, accelerated the integration of New Zealand within the world economy. After a period of weak growth during the late 1980s, New Zealand's economic performance improved significantly during the 1990s. From mid-1991, the economy grew strongly with particularly strong output from 1993 to 1996, with annual average growth in real GDP peaking at 6.8 percent in June 1994. {www.treasury.govt.nz}

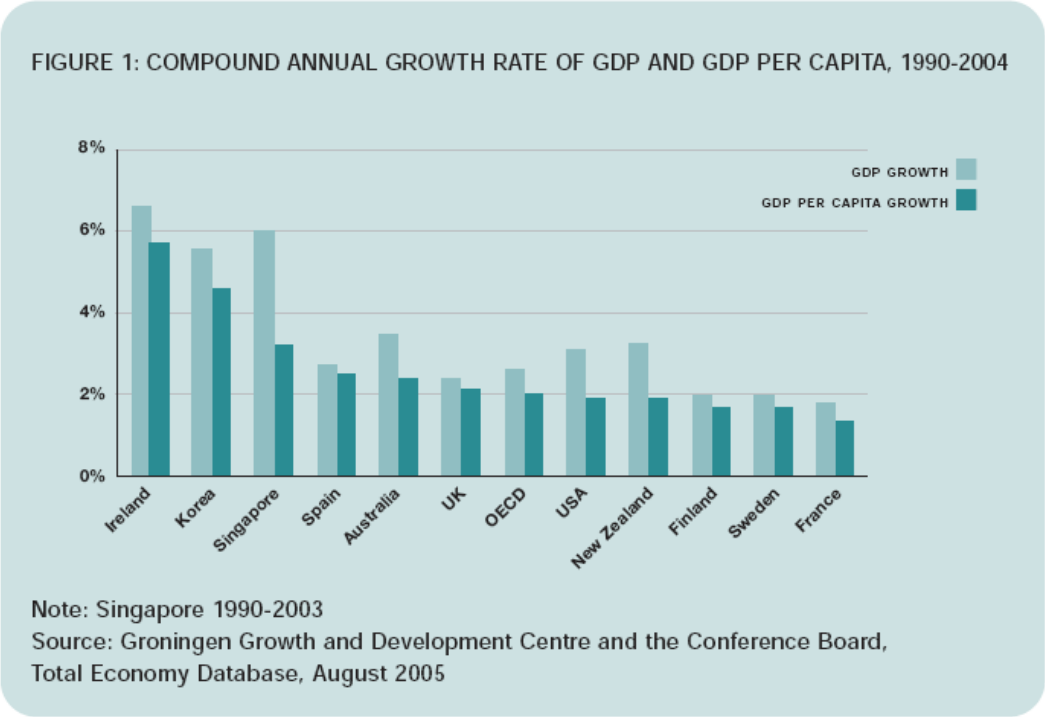
Until the early 1990s, although New Zealand's relative income decline had been halted, New Zealand has not begun to catch up to other OECD countries in a meaningful way. This is because many other OECD countries have generated strong growth since 1990, as compared to New Zealand. New Zealand's per capita income was 87 percent of the OECD average in 2003. This contrasts with Australia at 109% of the OECD average, which is more than 25 percent higher than New Zealand's income level and Ireland's per

capita income now stands at 128 percent, a substantial improvement on its 1990 position when its per capita income was just 78 percent of the OECD average. {Skilling 2005}

After this period, the economy performed strongly with the exception of a short weaker period during 2001 when growth slowed to around 2 percent, much lower than the 5.7 percent peak reached in the year to June 2000. However, the economy regained momentum, with a combination of two good agricultural seasons, relatively high world prices for New Zealand's export commodities, a low exchange rate and a robust labour market contributing to strong income flows throughout the economy. Over 2002 to 2004, growth in GDP was generally in the 3.5 percent to 4.5 percent range, peaking at 4.6 percent annual average growth in December 2002. {Skilling 2005} {www.treasury.govt.nz} New Zealand's recent economic growth performance benchmarks well against most other OECD countries, as shown in figure 2.5. New Zealand's economic growth rate of 3.2 percent per year between 1990 and 2004 ranked 7th among the 30 OECD countries, and was higher than the OECD average of 2.6 percent.

This represents a shift from the bottom quartile of OECD country growth rates over the 1970-1990 period to the top quartile between 1990 and 2004. {Skilling 2005} New Zealand's per capita income growth performance of 1.9 percent annually over the 1990-2004 period ranked 12th in the OECD, behind Australia whose per capita growth over this period was 2.4 percent annually and slightly less than the OECD average of 2.0

percent. This represents a shift from the bottom of the OECD to the top half of the OECD in terms of growth rates, which means that New Zealand is moving closer to the top half of the OECD, albeit very slowly (OECD (2005)). {Skilling 2005}

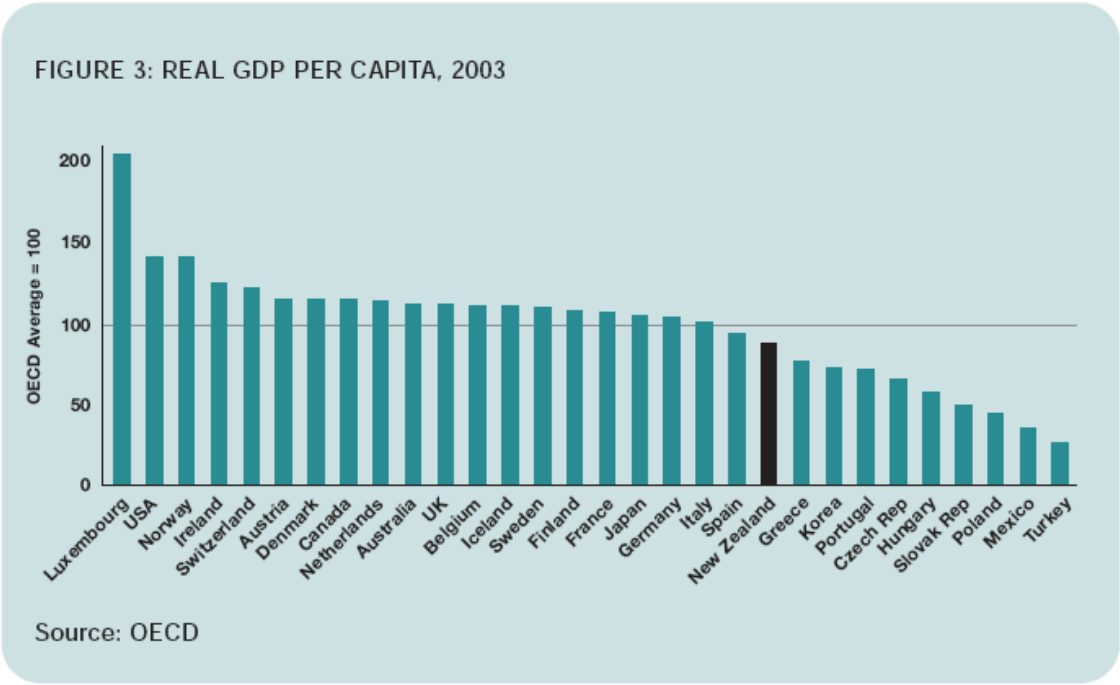


{Skilling 2005} ***Figure 2.5***

More recently, growth has eased as a result of high oil prices and interest rate increases, with the economy flat in the second half of 2005. There was a slight recovery during the first half of 2006 with quarterly growth of 0.8 percent and 0.4 percent in the March and June quarters respectively. Growth of 0.3 percent was recorded in the September quarter of 2006, giving annual average growth of 1.4 percent for the year to September, down from the recent peak of 4.4 percent in the year to 30 September 2004. Growth is forecast to remain relatively subdued in the short-term. Annual average real GDP growth of 1.8 percent and 2.3 percent is predicted for the 2007 and 2008 March years as households go

through a period of consolidation before an expected export-led recovery leads to growth increasing to trend levels of around 3 percent in 2009 and 2010. {www.treasury.govt.nz}

However, despite the encouraging developments, New Zealand's growth performance does not come close to matching some of the standout performers over the past 15 years, such as Ireland that generated per capita income growth of 5.7 percent per year between 1990 and 2004 and Finland whose per capita income grew at 3.4 percent annually after 1994. For instance the Irish economy grew by 8 percent annually between 1995 and 2005. (Lynch 2005) {Sautet 2006} ***Figure 2.6***



This sterling performance surprise many commentators, including some policy makers, who participated in the Irish reform process. According to economist Colin Lynch, no magic recipe explains the economic success of Ireland. Rather it springs from a series of

reforms which taken together changed the business environment in a very favourable way. As Benjamin Powell (2003) suggests, the massive increase in economic freedom in the past 20 years is the best overall explanation of the Irish phenomenon.

Despite of having developed key reforms to help change the economic environment New Zealand has not been able to achieve the desired growth and development. The possible reasoning for this could be one area in which New Zealand does differ substantially from other OECD countries is in terms of its combination of a small domestic market and remoteness from other major markets. The evidence suggests strongly that the small effective size of the New Zealand market has a powerful effect on New Zealand's economic performance, and can be linked growth directly.

2.1 Chapter Summary

This chapter has presented an analysis of the New Zealand economy with a comparison of other similar economies. The points presented above suggested that despite of developing key reforms with the aim to boost productivity and development within the market, the New Zealand economy has not been able to achieve the desired levels of outcome over the years. Also, it was observed that New Zealand's level of international engagement is relatively restricted especially when compared to other economies that share similar size and resource characteristics.

Thus, having summarized the background of the New Zealand economy the next chapter introduces the importance of international trade for the economy of New Zealand. It starts with analysing the importance and the need for internationalisation of New Zealand businesses. Keeping this in mind it further presents an analysis of the state of the New Zealand economy pre & post reforms and presents the outcomes of the reforms for the New Zealand economy and its businesses. Finally the section then discusses the importance of emerging markets (with India as a particular focus) in today's world economy and the importance these markets hold for New Zealand businesses and consequently the economy as a whole.

Chapter 3: New Zealand in the World Economy

Chapter Two outlined the background of the New Zealand economy. This suggests that international trade has been a very important facet, which has supported and facilitated the growth of the economy. However, it is seen that international trade has been largely restricted to certain geographical markets alone. As briefly highlighted in the previous section, prior to the reforms the economy was heavily regulated and international business activities were conducted mainly in the form of trade i.e. import and export. Lower levels of outward investment meant that the level of international engagement of New Zealand businesses was restricted, thereby limiting the avenues in the international market. However after 1984, the reforms brought about a change in the entrepreneurial climate and gave a starting point that has greatly enhanced the economic environment in New Zealand. Hence this section seeks to analyse the purpose and the extent of internationalisation of New Zealand businesses. It also discusses the importance of international activities to the economy and the role that New Zealand businesses play in the world economy.

The chapter starts by introducing the reasons for internationalisation and then discusses the extent of internationalisation pre and post reforms and the impact of the reforms on the New Zealand economy. It also seeks to analyse the methods of international operation chosen by most New Zealand businesses, which have concentrated on exporting and outward foreign direct investment. It finally concludes by presenting the role of New

Zealand businesses in today's globalised economy, focusing largely on the emerging markets, India, in particular, and the importance of the Indian market for New Zealand enterprises.

3.1 Need for Internationalisation:

As a resource based economy the New Zealand market has always been largely dependent on international trade and support activities. Sustaining and increasing overseas earnings has been an important objective of the economic policy over the recent years. One of the main reasons for engaging in and being largely dependent on international trade is the size of the domestic market. New Zealand has a history of being a trading nation, engaged economically with other countries and there has long been an understanding in New Zealand of the importance of international engagement to secure New Zealand's economic future.

However, the extent of the internationalisation was hampered due to protectionist government policies until 1984. The economic liberalisation, which occurred after 1985, has accelerated the integration of New Zealand within the world economy. The liberalisation led to the opening of the market, which saw a rise in the number of firms in the domestic market. With increased competition in the domestic market came the recognition of the need for indigenous firms to internationalise operations in order to survive. Although New Zealand is not new to international trade, however, the main reasons behind the need for internationalisation within the New Zealand market have become more prominent after 1984.

There are three potential reasons that have been identified which seem to drive New Zealand firms to further integrate in the world economy today are as follows:

- Small Domestic Market.
- Lack of Economies of Scale (high costs while operating in the domestic market and therefore low profits)
- Increased Competition due to limited avenues for growth.

Hence, this section starts with discussing the impact of these three factors on the growth of New Zealand businesses.

3.1.1 Small Domestic Market:

The importance of international trade for any economy becomes high owing to the size of the domestic market. If the size of the domestic market is large, businesses in that market may not be forced to consider internationalisation as the local market would tend to suffice the growth and revenue potential of the businesses in the early stages of their operations in those markets. For example, for large economies like the United States, the dependence on international trading it not that high as the size of the economies/markets and the number of consumers is very high as compared to New Zealand. {Abbott 2007} Hence businesses operating in these markets tend be large in size and engage in diverse production activities at a local level.

In contrast to this small economies like New Zealand have a tendency to specialize in certain sectors in order to achieve economies of scale by producing in bulk for the domestic market due to availability of limited resources. Small size of the domestic market not only affects the levels of earnings but also affects the size of the businesses. For example, the average size of New Zealand firms operating internationally is small in world terms and has few large domestic firms. {Deng 1995} Also businesses operating in a small market like New Zealand face limited growth opportunities and hence the need for internationalisation is realised more early on. In general, it can be said, that the larger the domestic economy, the less is the reliance of that economy on international engagement. {Akoorie 1992} {Abbott 2007}

Therefore the pursuit for long-term growth and sustainability are possibly the major factors that drive New Zealand firms to internationalise. Also the other factor that is quite prominent is the ownership of unique products/technology that may offer better returns in the international markets as against the domestic front. {Akoorie 1992} Even though New Zealand has a limited access to resources (which is true in all economies) other than natural wealth, businesses today specialize in sectors other than agricultural or other resource based industries, which has given them a competitive advantage in the international market and symbolizes a diversification from the reliance on resource-based industries as a major source of income. {Akoorie 1992}

For example, a large number of New Zealand businesses are in industries such as manufactured plastics, electrical machinery, and business services which have allowed them to create a niche for themselves in international markets. {Akoorie 1992} An example of this is seen in the plastics industry within New Zealand. Plastic companies in New Zealand are very strong in packaging solutions, with a focus on the needs of the agricultural sector. With a strong international focus, New Zealand plastics processing companies have invested strongly in new plant and technology in the past decade. This has created a highly competitive industry.

New Zealand's plastics industry is unlike similar industries overseas because it is a processing industry. {Enterprise 2007} There is comparatively more packaging manufacturing in the industry, compared to other developed nations. New Zealand's

plastics manufacturers are recognised for high quality of craftsmanship and the ability to engineer small production runs at short notice. Toolmakers are in demand for their innovative designs and accurate workmanship. {Enterprise 2007} As an example, the total value of direct exports is in excess of NZ$500 million per year. The same amount again is being exported "indirectly" as packaging or components for other export industries.

Processed plastic products exports have increased significantly over recent years and a significant proportion of direct exports have a market in Australia. {Enterprise 2007} However, apart from having successful industrial development, New Zealand businesses find it difficult to achieve economies of scale in the long run if they focus on the domestic market alone. As a relatively small economy, New Zealand firms need to access global markets in order to achieve economies of scale. A 4 million person domestic economy is not alone sufficient to deliver strong economic growth and development for New Zealand businesses. {Skilling 2007} Hence apart from a small domestic market, the other major reason for internationalisation of New Zealand firms is the desire to achieve economies of scale.

3.1.2 Economies of Scale:

Owing to the size of the market, achieving economies of scale can be difficult for New Zealand firms. Apart from that high cost of production in the domestic market, limits the profitability of New Zealand businesses. With limited finances and managerial resources New Zealand businesses find it difficult to compete in the domestic market and hence see internationalisation as a pathway to long-term growth and constant returns to scale. The small size of the New Zealand economy principally motivates businesses to constantly hunt for new markets to achieve their pursuit of operating efficiency and lower production costs. (Driver, 1991, Vautier, 1984) {Akoorie 1992} For example successful New Zealand businesses believe in market development, which is suitable for their products, involve one or more international markets, with appropriate distribution channels. {Jaeger 2007}

They target these international markets according to their personal preferences and what they think is right for their products. Furthermore, markets and available production should match in quantity and quality. This is crucial for small firms with little means to control international demand. {Jaeger 2007} For example, a recent paper at the Oxford Business and Economics conference presented the role of New Zealand businesses in the global economy. According to the survey conducted by the authors it was shown that experienced exporters for example, know where they can sell their products and where they should not even try {Jaeger 2007}. Markets which lack purchasing power for high priced / high value products, and markets that are too small with insufficient demand for

unsuitable products prove to be costly exercises. {Jaeger 2007} As the size of businesses and availability of resources is small, most New Zealand businesses venturing into the international markets analyse the requirements appropriately in order to achieve the desired levels of revenue. Thus inability to achieve economies of scale most if not all New Zealand businesses engage in international trade with an aspiration to secure long-term development. Also the other reason that limits the ability of New Zealand businesses to rely on the domestic market alone is the large number of producers in the local market. Owing to the small size of the market, large number of producers (both local and foreign) poses to be a problem for businesses in the New Zealand, as it gives rise to intense competition.

3.1.3 Increased Competition:

Competition in the New Zealand market is quite intense as the numbers of producers are far more as compared to the size of the market. Due to this fact, most businesses tend to compete on the basis of price to attract a larger market share in the domestic market. However, competing on the basis of price may not be cost effective for all local businesses therefore most domestic businesses see internationalisation as a conduit to get away from the competition in the local market, and secure their earnings by moving away from the domestic market. {Abbott 2007} As a result the need for internationalisation for New Zealand businesses is more pressing.

With foreign companies entering the New Zealand market, and growing number of local firms, domestic producers find it difficult to compete with price related strategies. The reason for this is that most New Zealand businesses (due to size) proffer small product offerings that do not allow them to contend against the competition, (foreign and local) both in terms of product offerings and costs. Therefore the pursuit of long-term growth and profitability emerges as the strongest motive in terms of both the initial decision-making and current reasons for internationalisation of domestic businesses. These aspects become more prominent keeping in mind the extent of competition in a small domestic market. {Enderwick 1998}

Hence, the importance of international trade is quite high in the New Zealand market, as the New Zealand firms today appreciate the benefits they stand to gain with increased international involvement that may not be possible to achieve only by operating at a domestic level. Considering the factors mentioned above it becomes necessary to analyse the role of the government and the policies laid down which facilitate international involvement of New Zealand businesses. It also becomes imperative to analyse the bearing of those policies on the performance of the economy at an international level.

Therefore, the next section discusses the performance of New Zealand in the world economy. The section starts by presenting the policies of the government prior to the economic reforms, and discusses the impacts of those on New Zealand businesses at the time. The section then discusses the reforms introduced by the New Zealand government in 1984 and analyses the outcomes of those for the businesses and relates that to the performance of the economy at an international level thereafter. Lastly, the section presents the importance of emerging markets for the New Zealand businesses and the economy in turn.

3.2 Performance of New Zealand in World Economy:

As discussed in an earlier section the need for internationalisation is an important factor for New Zealand businesses and consequently the economy. However, the notion of international trade is not new for the New Zealand economy. As a resource based economy, it has been engaged in the international trading, although the extent of its participation was restricted until 1984. Prior to 1984 the economy was highly regulated and was dependent on UK as a major market for most of its exports. The economy had many impediments that stopped local businesses from carrying out effective international operations. Hence in order to understand the standing of New Zealand in world economy it becomes vital to first consider the policies laid down by the government before and after 1984 and discuss the impact of these reforms (both pre and post 1984) on the performance of New Zealand businesses at a domestic and international level.

3.2.1 The New Zealand Economy: A stop-go approach (1950-1980)

3.2.1.1 Policies for the period of 1950-1960:

New Zealand entered the 1950s as a relatively insular economy, highly dependent on the production of primary commodities. Trade relations during this period were fairly one-dimensional with the UK being the largest market for most of the produce from the economy. In a comparison of a group of 20 OECD countries, New Zealand's exports were the second least diversified in terms of composition and the third-least diversified in terms of destination. (Easton, 1997) (This is seen in figure 3.2 below) {Conway 2000} After the experience of the great depression of the 1930's successive New Zealand governments assumed that control over an increasingly large proportion of economic activity through state ownership of industry and resources would help bring about steady development within the economy. {Conway 2000} As in many OECD countries, policies during this period, in New Zealand were principally aimed at maintaining a high level of economic activity and employment in the short term.

These policies were designed to reduce the dependency of the economy on the external environment and facilitate growth and industrial development in the local market. {www.treasury.govt.nz} These controls were meant to bring about economic development in the domestic market, by allowing businesses to develop themselves and protect them from foreign competition. Hence in order to support this thought the New Zealand government initiated the use of policies such as import substitution to help development in the domestic economy.

Although import substitution (licensing) and exchange controls were first introduced in 1938 in the face of exchange crisis, the intensity with which these were subsequently used fluctuated during the 1950's and 1960's. {Abbott 2007}{Akoorie 1995} Throughout the period of import licensing, the justification for its use was that it would foster the development of New Zealand industries. Import licensing and exchange controls were used more frequently to restrict imports of certain type of goods into the economy. Although politicians and economists at the time expressed the view that tariffs were preferable to direct imposing licensing the latter largely superseded the use of tariffs during the 1960's. {Enderwick 1998} As a system, import licensing itemized a complete range of goods imported and then set broad limits on the value and quantity of different goods according to priorities at the time. {Abbott 2007}{Ralph 2004}

Licenses were sold for a nominal charge and allowed the holder to import a certain value of goods of a particular type over a set period. The types of goods subject to licensing varied over time and a large percentage of imports (in particular raw materials) were exempt. {Ralph 2004} Import licensing and exchange controls thus became important for sheltering industrial profits and jobs although this was not the government's original intention. The policies once introduced as a crisis measure soon became presented as a desirable policy. (Hawke 1981) {Enderwick 1998} This represented a decision supported by a popular sentiment that the direction of the economy should be determined less by events overseas and more by choice of New Zealanders (Sutch 1966) {Enderwick, 1998 #15} However, these policies did not bring about the desired development to the businesses and the domestic economy as a whole.

3.2.1.2 The turbulent years of the late 1960s and 1970s:

As the world price of wool fell 20 percent in 1966 and another 20 percent in 1967, it presented a major setback for the New Zealand economy. Given that wool accounted for about one-third of New Zealand's export receipts at the time, this price fall had a pronounced impact on the economy, pushing it into recession. {Abbott 2007} In retrospect, this price fall signalled the beginning of a tumultuous period in New Zealand's economic history. During the 1970s, the terms of trade fluctuated considerably. {Ralph, 2004} From 1971 to 1974, increased global demand for commodities helped push the terms of trade up by almost 50 percent.

However, a year later, oil supply restrictions imposed by the OPEC cartel led to a three-fold increase in the price of imported oil, and more than reversed all of the previous gains in New Zealand's terms of trade. {Conway 2000} In addition, as a consequence of the first oil shock, the world economy went into recession, and demand for New Zealand's exports contracted. The combined effect of a heavy dependence on imported fuels and contracting exports saw a rapid increase in the current account deficit, which reached 14 percent of GDP (figure 3.1). {Conway 2000}

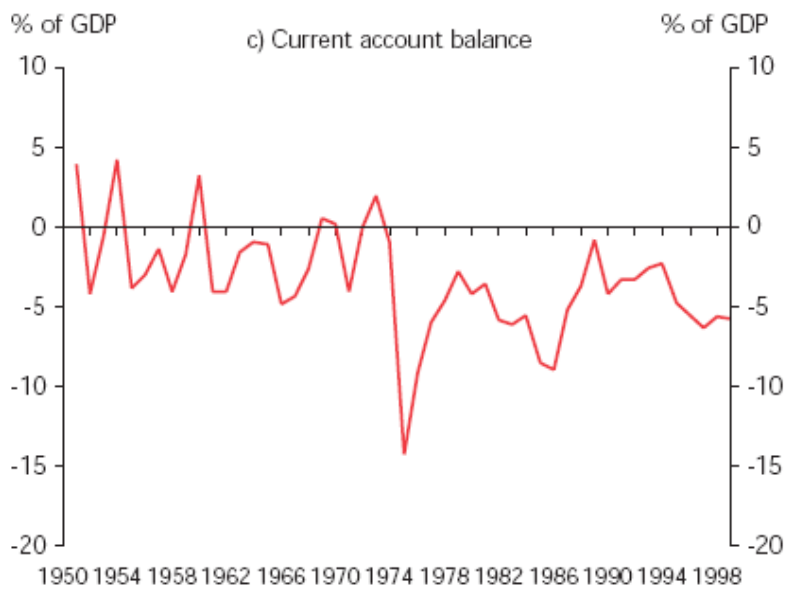


Figure 3.1

To add to these difficulties, access to the key export market was increasingly restricted upon Britain's entry to the EEC in 1972. In addition, many commodity producers in other countries (Europe in particular) increased their effective rates of protection for agricultural products, and thereby impeded the ability of New Zealand primary producers to reap the benefits of their comparative advantage. {Abbott 2007} Owing to these changing circumstances, there came stagnation in the economic growth and development within the New Zealand economy. The initial reaction of the government was to intensify government protection in the economy in order to develop strategic, export-oriented industries.

This was done in an attempt to stimulate demand and protect domestic living standards. This interventionist response involved the government retaining more controls on imports and foreign exchange while borrowing overseas to cover its increasing deficit. {Abbott

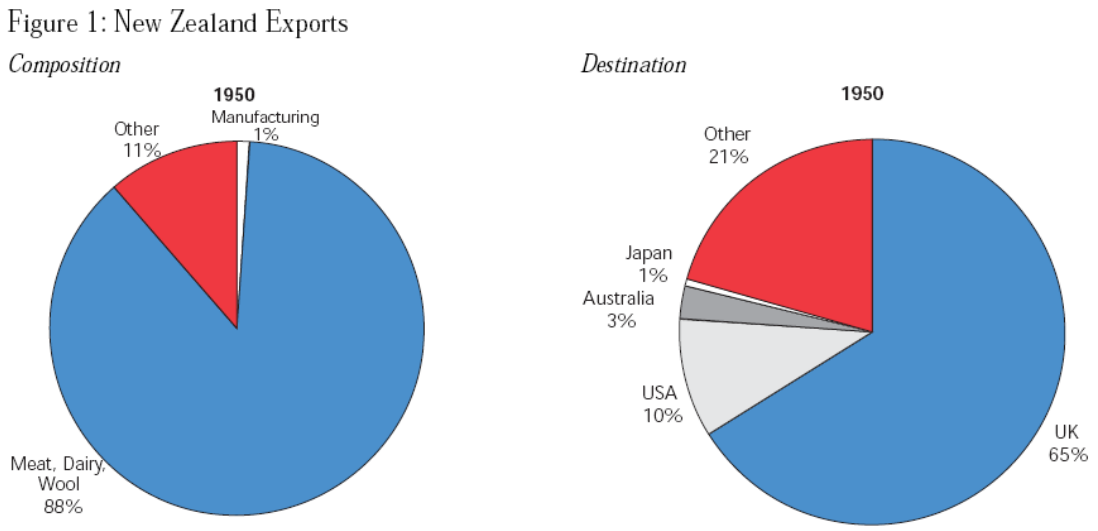
2007} In order to encourage export growth the government granted further subsidies and tax concessions to exporters. In the late 1970's the government started to invest in large-scale industrial projects designed to generate much needed export income and reduce imports. Although the projects did create income for the economy, they proved to be much less successful than originally hoped for, which made it more difficult to sustain growth. Overlooking the above discussion it can be seen that the unsustainable policies over the 1970s contributed to a general worsening in New Zealand's macroeconomic situation. Hence it becomes essential to consider the impact of the government policies on trade, manufacturing and foreign direct investment, discussed in the section below.

3.2.2 Impact on Trade, Manufacturing and Foreign Direct Investment: (Pre-reforms)

3.2.2.1 Trade:

In the mid 1950's the measures negotiated at the British Imperial Conference at Ottawa in 1932 were still largely in force. These involved reciprocal agreements between the UK and New Zealand to provide preferential treatment on trade. New Zealand's heavy reliance on primary products and close trading relationship with Britain were reflected in the composition and destination of exports, as can be seen in the two charts below (figure 3.2) {Conway 2000}

Figure 3.2



New Zealand goods entering the UK at the time had tariffs lower than those levied on agricultural produce from non-commonwealth countries such as the US and Europe. {Conway 2000}

In return for this New Zealand extended a similar treatment to British imports of manufactured products. These preferential agreements are important to consider as these shaped specific sectoral development within the New Zealand economy. {Conway 2000} These agreements not only encouraged traditional trade between New Zealand and UK but also reduced the ability of New Zealand to negotiate agreements with other countries if those came at the expense of British exporters to New Zealand. {Abbott 2007}

In addition to this, the government controlled a large proportion of economic activity through state ownership and regulation to facilitate trade terms with the UK. As shown in figure 3.3a (below), the terms of trade in terms of primary produce like meat, dairy and wool were relatively favourable over the 1950s and most of the 1960s. With favourable prices for commodity exports in the international market, New Zealand's income grew at a robust rate, broadly comparable to that of the OECD over this period (figure 3.3b) {Conway 2000}

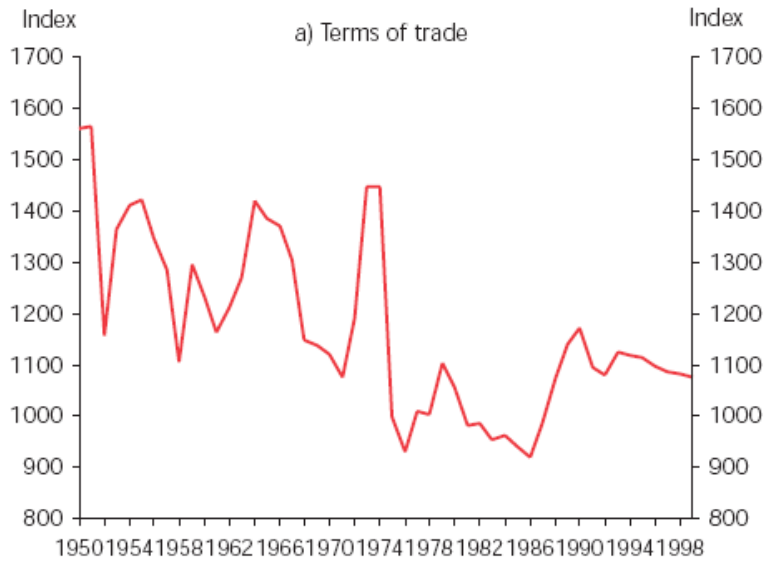


Figure 3.3 (a)

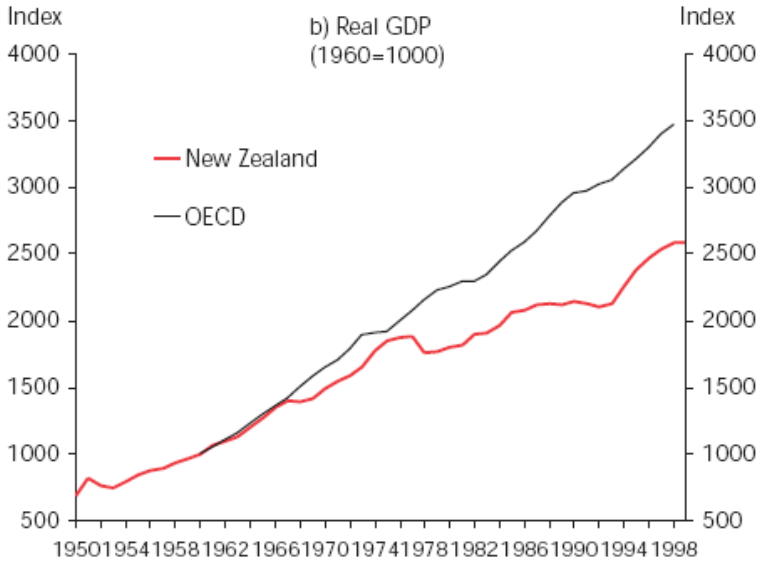


Figure 3.3 (b)

However this growth was short lived. At the end of 1954, the British market opened up to competition, whereby New Zealand agricultural exports faced increasing competition from countries such as Denmark, Netherlands, and France. Products offered by these markets, aggressively competed against New Zealand exports in the British market, which came at a cost for New Zealand exporters. {Abbott 2007} The European products could effectively compete, as governments in Western Europe subsidized farmers that helped them gain sales in British markets at the expense of New Zealand exporters. {Abbott 2007}

As a small country producing for overseas markets, New Zealand producers of agricultural products, had little control over the prices and had to accept what the market offered making them price takers in the international market. This meant New Zealand exporters in particular had to be very efficient in production, processing and transportation into the international market. Changes in demand and supply caused prices to fluctuate and in turn alter the prices levels substantially. As the government adopted a fixed exchange control system, it was difficult for New Zealand businesses to adjust to fluctuating price levels in the international market. Over a period of time this proved to be costly for New Zealand exporters to compete effectively against other producers in the UK market, making it difficult for New Zealand businesses to sustain solely on the basis of the UK market. {Abbott 2007} {Akoorie 1995}

3.2.2.2 Manufacturing

On the manufacturing front, prior to the reforms the principle objective of the government was to encourage domestic production of a wide range of goods, regardless of whether New Zealand had a comparative advantage in producing those goods. {Ralph 2004} Hence in order to promote domestic manufacturing the government opted for high levels of protection of the domestic industries through the import-substitution and exchange control policies. As these controls were in place, they deterred imports and helped expand an industrial base geared towards the domestic market. {Ralph 2004}

There were three main arguments in support of the protection of domestic manufacturing at the time:

- **Infant industry Argument:** In its early stages of development a new industry might not be able to compete with established producers abroad. Therefore the government normally would provide some assistance in order for the businesses to survive through the early stages of growth. Keeping this concept in mind the government at the time, provided assistance through the policies of import-substitution and other forms of regulations with the intention to help foster and develop local production as it would have been difficult for New Zealand businesses to achieve economies of scale had the market been open to foreign competition. {Abbott 2007}

- **Terms of Trade Argument:** The second argument in order to support the policies was the terms of trade. As a small economy, New Zealand businesses were heavily dependent on the international markets for selling their produce. Apart from this most of the goods that were sold by New Zealand producers at the time were primary agriculture based products such as dairy, wool and meat products that were not distinct to New Zealand alone. Hence as small economy New Zealand businesses did not have any power over the prices in the international markets and had to adjust to the market requirements as and when required. Given the size of the economy, the government therefore thought it would be best to opt for licensing and other control measures to help develop an efficient export-oriented industry that could reap sufficient economies of scale. {Abbott 2007}

- **Strategic Trade Argument:** If increasing returns and product differentiation are common, then a government can assist local firms to gain a strategically dominant position in the international markets and it might be able to extract substantial returns in due course of time from those markets. However, this was not true for New Zealand businesses. New Zealand businesses had limited avenues for growth in terms of the product offerings as most of its production was agriculturally based giving no room for diversification. Hence, in order to foster local production activities, the government adapted heavy protection measures that would protect local firms from foreign competition. {Abbott 2007}

Owing to the these arguments the common thought at the time was that the economy could not alone survive on the basis of agricultural products and that it needed to develop its industrial base by fostering growth in the manufacturing sector. {Ralph 2004} Although the agricultural sector was the major source of income for the economy at the time, it did not stand to receive the same leverage as the other industries in manufacturing. {Ralph 2004} There was a feeling that national development required the expansion of manufacturing. It was thought that a modern, developed economy should have a manufacturing sector, which would embody innovation and develop new technologies that the agriculture sector could not. {Abbott 2007}

It was therefore thought that productive growth required the development of a modern manufacturing sector. As well, support for tariff and license protection was driven by a growing pessimism about the future of agricultural products, fostered by the fact that the two most important exports-butter and wool- faced increasing competition in the international markets. {Abbott 2007} Through the use of these policies, the intention of the government was to bring about development in the local economy. However, these policies failed to realise the intentions of the government and the drawbacks of these policies soon became evident. The import substitution policy for instance, meant that imported goods were generally prohibited or substantially reduced in amount if they competed with any domestic manufacturer. This reduced the ability of consumers and companies to import goods manufactured overseas. {Abbott 2007}

Import substitution and small - size encouraged the formation of high-cost units of sub-optimal size. The overall effect of import licenses was to build a small manufacturing base that was domestically oriented. Therefore the manufacturing base was relatively uncompetitive in the international markets. New Zealand businesses involved in manufacturing prior the 1980's mainly concentrated on intermediate goods rather than consumer goods, which raised the cost structure of New Zealand industries in general. As domestic goods were dearer in comparison with imported ones, consumer demand for local production declined making it difficult for businesses to compete on the basis of price, as they were unable to cover their basic costs.

Also import licensing favoured capital equipment and material for local processing over consumer goods. Due to this there was very little variety in the market for most goods (Evans 1996). {Shaw 2004}{Enderwick 1998} Many goods produced or assembled in New Zealand would have been manufactured elsewhere had free trade been possible. Entrepreneurs were limited in their capacity to differentiate their goods; trade restrictions stifled their comparative advantage. This in turn fuelled the demand for imported consumer goods in the domestic market. {Shaw 2004} Continued protectionism created lack of flexibility in terms of what could and could not be produced in the market. The policies were designed to compensate businesses and finance for the development of new export sectors other than agriculture. However, the traditional export sector (agriculture) was also to be compensated for the cost of protection because of increased costs of the inputs.

For example the government provided income support to offset the decline in the farm income due to increase in agricultural protectionism in developed markets and the cyclical effects of the changes it brought about in commodity prices. {Enderwick 1998} However this did not help boost the trade of agricultural products in the international markets, as most western markets further pushed up their trade barriers for agricultural produce at the time. (Bhagwati 1998) {Abbott 2007} Hence although the intention was to reduce dependence on imports while maintaining the export base in pastoral exports, this failed to happen. Imports barriers and the small – size of the economy encouraged the development of inefficient business units dependent on imported inputs or high cost domestic substitutes which stalled them from being able to export effectively. {Enderwick 1998}

As a result there was a continuing demand for imports within a wide range of categories as the production within the economy was restricted towards only a given number of sectors. {Enderwick 1998} One of the main argument to support the continuation of protectionism of the local manufacturing was that for a small economy like New Zealand cultivating firms of sufficient size and resources to compete internationally was difficult without these firms enjoying a dominant position on the domestic front. However this does not hold to be true. Policies designed to assist businesses should be based on their ability to compete in a given industry internationally rather than applying a blanket of policies which are designed to cover all industries irrespective whether they were focused towards the domestic or international markets. {Enderwick 1998} Heavy protection therefore greatly undermined competitiveness and the economy's ability to adapt to the

changing world environment. Thus a combination of expansionary macro policies and industrial assistance led to macroeconomic imbalances, structural adjustment problems and a rapid rise in government indebtedness.

3.2.2.3 Foreign Direct Investment

Prior to 1964, there were no statutory regulations governing overseas investment in New Zealand. However successive governments in the post-war era adopted an essentially passive attitude towards foreign investment. Foreign investment during the import substitution phase encouraged an inward orientation towards growth. The intention was to reduce dependence on imports while maintaining the export base in pastoral exports. Although the government did not encourage outward foreign investment, foreign subsidiaries, which the government thought would benefit local businesses with their knowledge and technical capabilities, were allowed to make inward investments within the economy. Government departmental reports favoured inflows of foreign capital if it was accompanied by technical knowledge (Deane 1967). {Enderwick 1998}

For example, The Overseas Takeover Regulation Act (1964) established the threshold for approvals at 25 percent of ownership. The general requirements established a more selective approach to overseas investment that emphasized access to technology not available locally. This was done to reduce the effects of monopolistic practices present in the New Zealand market and also to help the development of export markets. {Enderwick

1998} However, this development came at a cost. The foreign investors at the time exploited existing ownership specific advantages in the domestic market. Their main advantages over the local firms were availability of technical assistance, internationalising capabilities through sourcing components and the ability to access both foreign and domestic sources of capital. {Enderwick 1998}The other advantages were evident in the operation, organisation and marketing of their outputs.

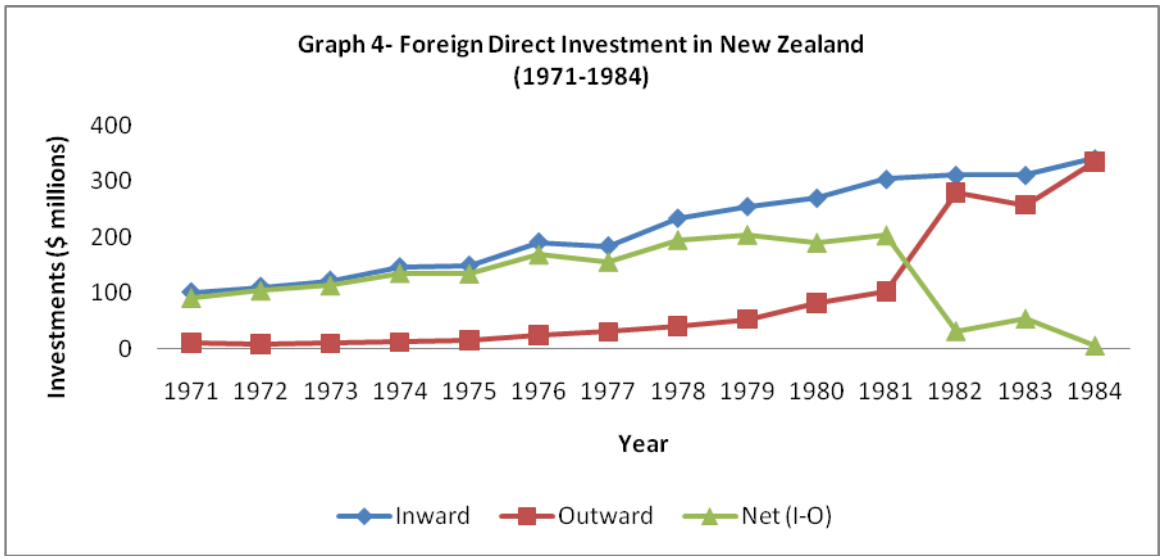
Also the government offered the same incentives to the foreign national companies as it did to the domestic firms in manufacturing, making them all the more competitive in the New Zealand market. {Enderwick 1998} Local firms for example like Fletchers, Cable Price, Downer and Wilkins and Davies found it difficult to expand as finance for expansion was limited by the capacity of the small local market. Growth was achieved by mergers but upgrading of existing plant and operations suffered through lack of funding. {Akoorie 1995} Lack of investment in new plant and equipment meant that firms operated at a cost disadvantage relative to overseas competitors, from which, import licensing protected them. As the import substitution policy was applied at various levels severity throughout their period it limited the contribution that foreign companies could make towards transforming the economic structure. {Akoorie 1995}

One of the major effects of import substituting activities by foreign firms was they had established monopolistic or oligopolistic positions in a number of industries. Deane (1967) established that foreign-owned or partially foreign-owned firms had a monopoly

in industries such as oil-refining, telecommunications cable, window glass, aluminium fabricating to mention a few. Other industries such as wallpapers, electrical and small household appliances, tobacco, coffee and tea, to name a few, also were dominated by two or three manufactures. {Akoorie 1995} Presence of imports barriers and the small – size of the economy encouraged the development of inefficient business units dependent on imported inputs or high cost domestic substitutes which stalled local firms from being able to manufacture for the local market and as well stopped them from exporting effectively.

As an example, import substitution favoured the exchange of high-cost (small-scale) local production for (low-cost) more efficiently produced imports. This resulted into losses for local businesses that did not have sufficient funds to produce in bulk and sell at lower prices in the domestic market. {Enderwick 1998} While other countries were becoming more integrated through expansion in international trade, the reverse was true in New Zealand. Foreign investments (both inward and outward) were negligible from 1950's until late 1960's. However the period of 1971-1984 saw a shift in the economic structure, which saw an increase in both inward and outward investment.

Figure 3.4



The graph (3.4) above shows the changing ratios of inward to outward investment, which suggest that underlying shifts were occurring in the economic structure, between 1971-1984. This period saw changes in terms of supporting the economic structure. The government policies tried to introduce New Zealand businesses into the external economic environment. {Enderwick 1998}The increasing amount of inward investment can be first explained by increasing demand in the New Zealand market for more technically complex consumer durables. Secondly, there was an increase in the importation of advanced overseas technology in a series of a large scale projects such as the public sector energy projects, synthetic fuels, fertilizers production, oil refining, electricity generation, aluminium and steel production. {Enderwick 1998}{Akoorie, 1995}

During this time, Australia increasingly became an important source of direct investment for New Zealand equalling investment flows from Britain. Government policy in the development of regional trade arrangements with Australia and export incentives encouraged outward investment by New Zealand firms particularly in the manufacturing sector. Policy changes laid the foundation for a more outward orientated economy, with first tentative steps being taken towards free-trade arrangements with Australia in 1966. Although there were attempts made to implement some change to the basic economic structure these were only partially successful. {Abbott 2007}{Akoorie 1995} The government was hampered in its progress by focusing more on short-term palliative measures against longer-term change. Thus in order to achieve success consensus politics required commitment for change from affected interested groups. {Akoorie 1995}

Since it was likely that interest groups would be unevenly affected by structural changes, the compromises, as a result attempted to compensate each section of the manufacturing sector, while subsidies were introduced to compensate the agricultural sector for declining incomes. {Enderwick 1998} Growth in manufactured exports was encouraged through subsidization compensating the inefficiencies created through import protectionism. Although restrictions on outward and inward investment remained, the influence of foreign investment structure (evident from the increasing amount of investment) mirrored the underlying changes in the pattern of economic activity. {Akoorie 1995} For some firms in New Zealand such as those in the engineering and construction sectors, outward foreign investment through joint ventures was a precursor to their own growth in foreign outward investment in the following stages.

Inward foreign investment and internal demand created by the government funded infrastructural development enabled these firms to develop their ownership specific advantages, which they were able to exploit in subsequent periods. {Enderwick 1998} However despite of these developments government intervention was largely present within the economy, which did not bring about the kind of growth the government, had hoped for. Reasons for this were structural. As discussed in the preceding sections it is evident that varying levels of protection had supported industrial developments within the economy. Government intervention to compensate for market imperfection effectively prevented the firms from making structural changes to accommodate changing external circumstances. {Akoorie 1995}

Research suggests that foreign investments (both inward and outward) tend bring about a flow of capital and other resources vital to the growth and development of that economy which may be absent within the local market. Also foreign aid can bring about significant help to the economy only when the policies laid down in the domestic market do not intervene with the dealings of the businesses in that environment. This was to be true in case of New Zealand. However policy changes were not favoured at large. {Akoorie 1995} Although the official policy was to encourage FDI, but there were concerns about the effects of foreign control on the New Zealand economy. The level of outward foreign direct investment saw a steady decline after 1981 and was negligible by 1984. (This is seen in graph 3.4 mentioned above.)

Critics of overseas investment were also those who favoured protectionist policies. Despite of knowing the negative effects on the balance of payments caused by constant outflows of capital (Deane 1967), government policies largely favoured a nationalist viewpoint, with the encouragement of developing a local manufacturing base with indigenous technology and innovation. {Akoorie 1995} Alternative solutions to foster growth within the economy included aspects like providing fixed term loans and technical assistance over equity capital. (Symposium of Foreign Investment 1966). However these short-term solutions failed to attract investors. Fears of the effects of foreign control were fuelled by emotive arguments using derogatory terms such "Take Over New Zealand" (Sutch 1972) and the anti-government thoughts expressed in the economy at the time. {Akoorie 1995}{Enderwick 1998}

Policy responses to resolve the situation moved in two different directions. While there was a slow but undeniable trend towards trade liberalisation and a greater reliance on market forces, there was at the same time increased government intervention in the economy to compensate interest groups who were negatively affected by the changing economic circumstances. {Akoorie 1995} For example the preferential trade agreement with Australia had shown that there was a commitment to an opening up of an economy. However, the agreement only covered a limited number of products. The inherent difficulty of negotiating access in industries where protectionist policies were paramount meant that only limited progress was made in trade expansion. {Enderwick 1998}

The remedies applied by the government to rectify the problems faced by the businesses at the time, (since 1960's) were largely analgesic. This deteriorated the condition of the businesses and consequently the economy, as the interaction at an international level became largely absent. {Enderwick 1998} As a result the potential for FDI to contribute to the process of structural change in New Zealand was limited by government policies. It could not be expected that in such a climate of negativity that the benefits from FDI in terms of the effects through the linkages and transfer of technology and management skills could even be recognised. Owing to the factors discussed above it can be seen that the state of the New Zealand economy deteriorated steadily particularly between 1970's-1984. The title of the Treasury documents, Economic Management, as an example, indicated the main thrust of the argument that New Zealand's performance- described, as one of the most lackluster in the developed world- was a result of very poor economic management by government policy markers. {Ralph 2004}

The Treasury listed five specific reasons for poor economic management. The first and the most important reason was the failure to adjust the structure of the New Zealand economy to changing external conditions. The government had increased its overseas debt in an unsuccessful attempt to cushion the domestic economy from the impact of falling terms of trade during the 1970's. Second the Treasury argued that the government had failed to deliver consistent economic policies but had instead tended to concentrate on improving one objective at time to the detriment of other. {Ralph 2004}

Thirdly, it was also claimed that the government had relied on market regulations to suppress the symptoms of New Zealand's economic malaise rather than using more general instruments of economic management to address the underlying causes. Widespread restrictions on competition in both private and public sectors had prevented an efficient use of the country's resources. Fourthly the treasury argued that the domestic industry had been too insulated from the international economy by import substitution, exchange controls, export subsidies and the willingness of the government to borrow overseas to support an overvalued exchange rate. The implication was that New Zealand had failed to concentrate its economic activity in the areas where domestic producers had a comparative advantage in the international market. {Ralph 2004}

Finally it can be observed that the government policies had introduced further instability into the economy by expanding and contracting the budget deficit time and again, which increased the instability within the economy. Owing to these analyses the new government (labour) at the time hosted the Economic Summit Conference in September 1984. Representatives of the government, trade unions, employer groups, and business and primary sectors attended this three-day conference. {Ralph 2004} Although there were differences in the emphasis among the various speakers the communiqué accepted that New Zealand's poor economic performance over the previous thirty years, owed much to the way the domestic economy had been managed. It was agreed that there were three basic aspects that would be required to be addressed in order to bring about development in the local economy.

The three aspects were as follows:

- The policies needed to focus on sustainable economic growth, employment, price stability, monitoring of external factors that were critical to the economy and equal distribution of income.

- It urged that the government pursued these objectives in a balanced manner within a consistent policy framework that encompassed all the inter-related elements of the economy.

- Finally and most importantly given the character of the reforms that were actually to be put in practice, the communiqué accepted that New Zealand could no longer isolate itself from the international market place as this was the key to growth and development for the economy.

3.3 Chapter Summary

The points discussed in the chapter helped highlight the major issues that the New Zealand economy faced prior to reforms of 1984. As seen in the analysis presented the government polices prior to 1984 aimed to protect the New Zealand economy and its businesses by introducing a range of restrictions that protected New Zealand businesses from foreign competition. Apart from this, as a part of preferential agreements, New Zealand was quite reliant on the UK as a major destination for most of its trading activities. In addition, the government sought to bring about growth and development within the economy by banking on mostly on the agricultural sector. Restricted international engagement and a closed door policy lead the New Zealand economy to perform well-below its capability.

As a result, the economy deteriorated steadily particularly between 1970's-1984. The exchange crisis that hit the economy in 1984 saw the Treasury highlight the key reasons for the deterioration and suggested three main aspects with the aim to de-regulate and stabilise the economy. The communiqué was of the view that the policies and the market structure needed to be flexible to adhere to the changing external environment and that New Zealand could not afford to isolate itself from the international environment as engagement with the international market place was thought to be the key for future development. Owing to the issues discussed above, the following chapter now discusses the policy changes introduced in 1984, and analyses the impact they had on the New Zealand economy with major focus on Trade and Foreign Investment.

Chapter 4: Economic Reforms

The new economic policy introduced by the labour government in 1984, included regulatory reforms and economic liberalisation (Bollard 1987). After the exchange crisis had settled the government embarked on a programme of reform, which among other things opened up the country to intensified trade. Internally, these reforms involved deregulation in the finance sector, the removal of entry licensing in manufacturing and services, abolition of price controls and the easing of controls over trade practices and foreign investment. {Abbott 2007} Subsidies and tax concessions to agricultural and other exporters were phased out and import quotas gradually converted to tariffs.

These tariffs were gradually reduced throughout the 1980's and 1990's and the fixed exchange rate regime came to an end when the New Zealand dollar was floated in March 1985. Many of the assistance programmes and incentives the government had previously extended to businesses (exporters, in particular) were all abolished at this time. The supplementary minimum price for instance, was phased out as were the subsidies to inputs such as fertilizers, water supply, pesticides, and extension services as well as subsidies and tax concessions provided to manufacturers were abolished. Combined, the reforms changed the direction of New Zealand moving it towards a more market-orientated economy away from a regulated one. {Ralph 2004}

The basic rationale for the changes was that, by relying on regulation and suppressing competition, the government had prevented an efficient use of the country's resources. By insulating New Zealand from the international economy through import and exchange controls, subsidies and borrowing overseas to support an over-valued exchange rate, the government had promoted a misallocation of resources. {Abbott 2007} In economic terms this was a loss of efficiency both allocative and technical, which was not achieved prior to 1984. The closed nature of the economy amounted to drawing away resources from industries where New Zealand had a comparative advantage towards where New Zealand had a comparative disadvantage. Only by opening up New Zealand to the rigours of competition, both internationally and domestically could the misallocation be rectified. {Abbott 2007}

In terms of technical efficiency, a lack of competition in domestic markets meant that companies were not compelled to achieve the lowest possible costs. This could be most clearly seen in manufacturing where many firms were protected from foreign competition by licenses, and consequently achieved levels of technical efficiency well below that of world's best practice. The link between the degree of competition in markets and the achievement of efficiency was an important one. {Abbott 2007} Prior to 1985, the main tendency was to try to reduce the degree of competition faced by most firms in most markets. Hence the main aim of the reforms was to intensify competition, which would pressurise the firms to be more efficient. If the domestic markets could be made more competitive, the firms that operate in them would be more efficient, improving their international competitiveness. {Ralph 2004}

Together these measures changed New Zealand from being one of the most closed Western economies to one of the most open (Evans, Lewis, Grimes, Wilkinson and Teece 1996) with the intention of bringing about growth and development within the domestic economy, by opening it to the international environment. {Ralph 2004}{Abbott 2007} Having presented a brief background of the reforms, the next subsection presents an analysis of the changes in the New Zealand market post reforms with a particular focus on changes within trade and foreign investment.

4.1 Impact on Trade, and Foreign Direct Investment: (Post-reforms)

4.1.1 Trade (Exports)

Trade liberalization reforms dramatically changed the trading climate for New Zealand businesses both domestically as well as at an international level. As seen in the previous sections prior to the deregulation the country had maintained trade relations with relatively few countries mainly concentrating on the U.K as a base market. However, as the reforms initiated industrial development in the local economy the result led to a sudden growth of businesses within the domestic environment to serve local market needs. With the competition that emerged with trade liberalization, many firms – both exporters and non-exporters started to consider the option of international markets options rather than continuing in the intensely competitive domestic market (Tradenz, 1993/1994; Chetty, 1999). {Shaw 2004}. As this growth led to increased competition in the domestic market, it brought recognition of the need for indigenous firms to internationalize operations. {Shaw 2004}

The pace and scope of this deregulation was assessed to be among the most far-reaching of any in the Organisation of Economic Co-operation and Development (OECD, 1990), embracing financial, product and labour markets as well as border protection, and all in a very short period. Although the reforms were aimed to bring about improved openness within the business environment, the outcome was not as desired. The reforms did stop the economy from deteriorating further and changed the entrepreneurial climate

dramatically however it failed to prove as a growth dynamo for New Zealand. As a small country, international engagement seemed to be vitally important to New Zealand's future economic prosperity; however the level of engagement was not at level that could yield the desired results. {Shaw 2004} Hence this section to begin with, now considers New Zealand's exporting performance. In particular, it examines the level of exporting, both in terms of how it has changed over time and how it benchmarks against other countries. The composition of the goods and services exported from New Zealand is also considered, and compared to the export structures of other developed countries.

4.1.1.1 Level of Exporting:

The standard measure of a country's exporting performance is the share of exports of goods and services in the overall economy. New Zealand's export to GDP ratio has trended upwards over the past few decades, from 22 percent in 1971 to 29 percent in 2005, as shown in figure 4.1(as seen below). This rise in exports to GDP over the past few decades means that, on average, exports have grown slightly more rapidly than the overall economy and are making an increased contribution to New Zealand's national income.

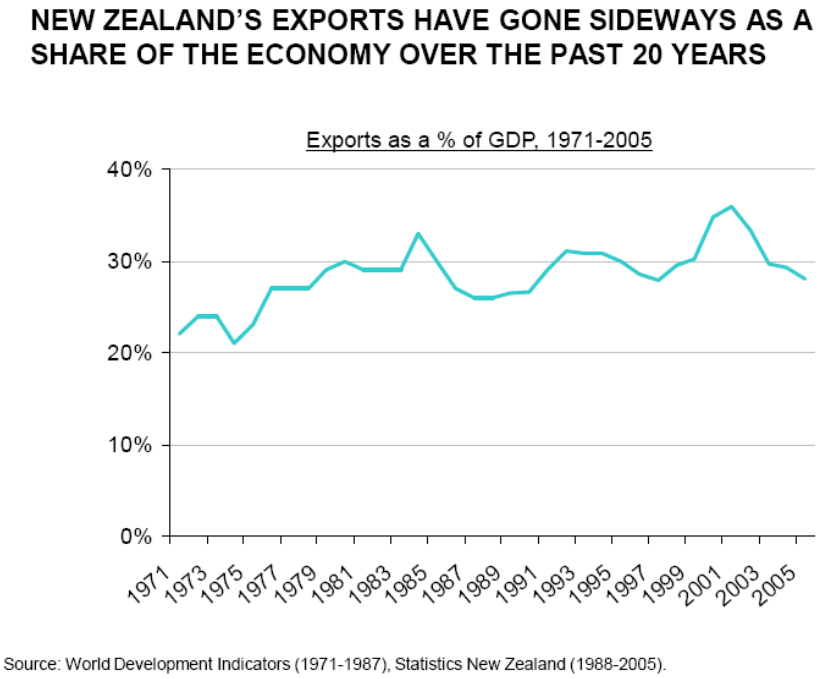


Figure 4.1

New Zealand's exports grew as a share of GDP most rapidly from the early 1970s until the mid-1980s. Interestingly, aside from an immediate dip around 1973, there was no indication that the loss of preferential access to the UK market on the UK's entry into the European Community did lasting damage to New Zealand's export income. Rather it seemed that New Zealand successfully found alternative markets for its primary exports. However, New Zealand's exporting level has been static since the mid-1980s. {Skilling 2007} Despite several pronounced peaks and troughs in the export series, there has been no trend of increased exporting activity over the past 20 years. The share of exports in New Zealand's national income has gone plateaued. In fact, the level of exports in 2005 was the same as in 1983 at 29 percent of GDP.

This suggests that increased exporting activity has not been an important driver of New Zealand's economic growth over the past 20 years. New Zealand's growth has been driven to a much greater extent by domestic activity, as opposed to international activity. This reliance on the domestic New Zealand economy to generate economic growth has been particularly evident over the past several years. New Zealand's exports have fallen from a high of 36 percent of GDP in 2001 to 29 percent of GDP in 2005. {Skilling 2007} To place New Zealand's exporting performance in context, this experience needs to be compared to the level and growth of exports in other developed countries. There has been a worldwide trend towards aggressive international engagement, with most developed economies substantially more integrated into the global economy than was the case 20 years ago.

A common feature in the growth experience of the past few decades has been countries rapidly expanding their international economic presence. This is reflected in the strong export growth observed across the world over the past few decades. Overall world trade grew by 9.5 percent a year between 1970 and 2002, substantially in excess of world income growth. The World Trade Organisation (2004) reports that world merchandise exports grew by 6.4 percent annually between 1990 and 2000, considerably faster that the world merchandise production at 2.5 percent per year. (World Trade Organisation 2005) These global export growth rates significantly exceed New Zealand's export growth over the past few decades, as can be seen in figure 4.2.

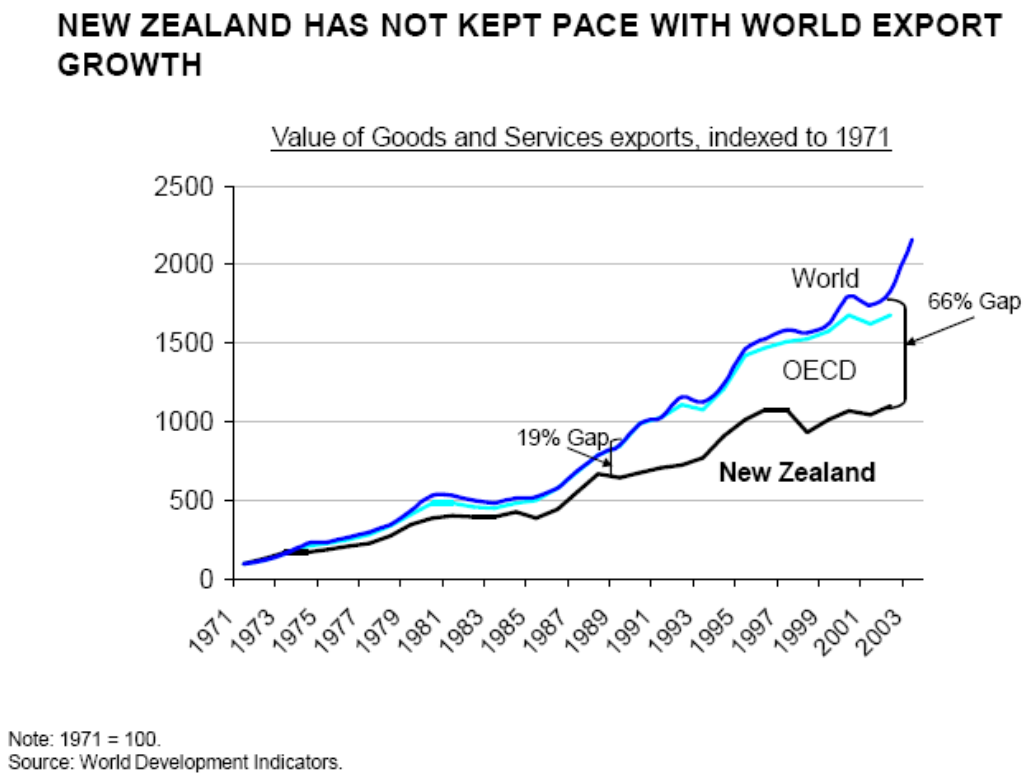


Figure 4.2

New Zealand's exports grew at 7.8 percent per year between 1971 and 2002, slower than the world growth rate of 9.5 percent per year. Indeed, of the 24 OECD member countries in 1971, New Zealand's export growth rate ranked 23rd over the three decades from 1971-2002. Only Switzerland generated slower export growth than New Zealand over this period. {Skilling 2007} So although New Zealand's level of exporting as a share of national income has increased slightly over the past few decades, this has been more than matched by other countries. This is reflected in a decline in New Zealand's share of world trade from 0.28 percent in 1980 to 0.22 percent in 2004, a reduction of 19 percent over a 24-year period.

Over time New Zealand's slower rates of export growth have accumulated into a very large gap in the level of exports. Had New Zealand's exports grown at the world average rate since 1971, they would be 66 percent higher than they currently are, as shown in Figure 4.2. This gap is continuing to widen as world export growth continues to exceed New Zealand's export growth. New Zealand's relatively slow export growth has been a consistent feature of the past three decades. However, slow export growth has been particularly apparent in New Zealand over the past several years with exports declining as a share of GDP.

This contrasts sharply with the strong world export growth in recent years. {www.unctad.org} {Skilling 2007} The World Trade Organisation (2005) estimates that real exports of goods grew by 9 percent across the world in 2004, almost double the world's rate of real income growth. Real trade growth is projected to grow by 6.5% during 2005. (World Trade Organisation 2005) Similar estimates have been made with respect to the growth of exports of commercial services. As a consequence of New Zealand's consistently slow export growth, New Zealand's level of exports to GDP is now lower than in most other developed countries. This is clear from figure 4.3.

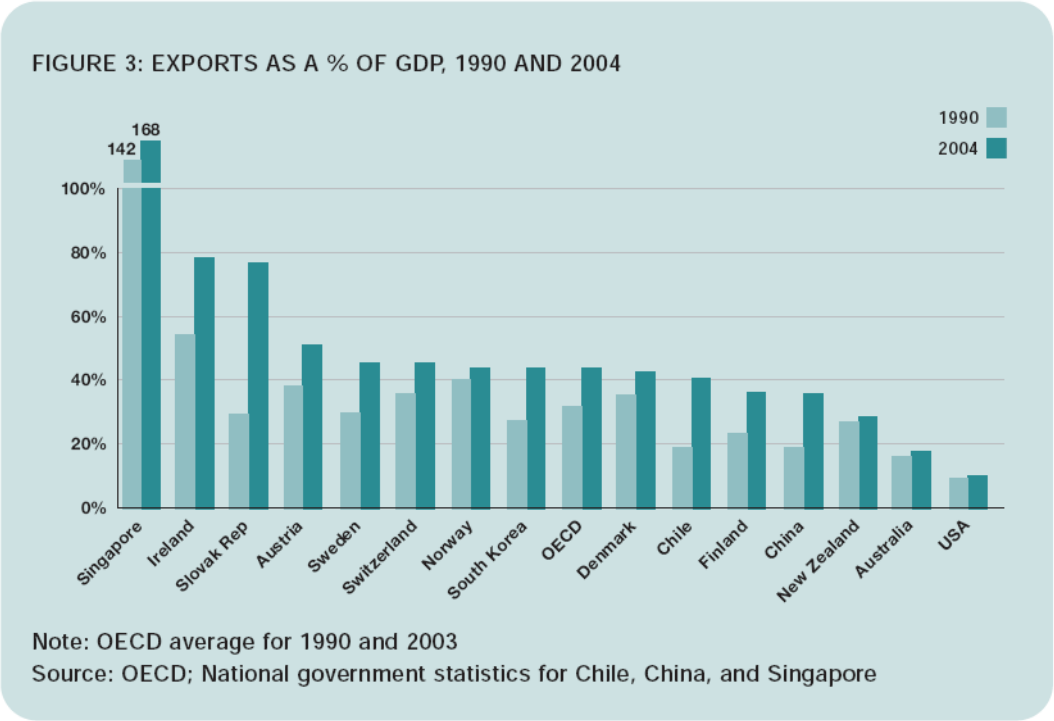


Figure 4.3

At 29 percent of GDP, New Zealand's level of exports is in the bottom third of the OECD, ranking 21st out of 30 OECD countries. New Zealand's relatively low level of exporting activity is particularly apparent relative to other small-developed countries. Small countries tend to have a greater reliance on exporting than do larger economies like the US and Japan, who have larger domestic markets to leverage. This is an important reason why Australia's level of exports to GDP is lower than that of New Zealand. {Skilling 2007} Hence larger countries, such as the US, Japan, and Australia, tend to have significantly lower ratios of exporting than do smaller countries.

This suggests that New Zealand's level of exports ought to be compared to that of other small developed countries. It turns out that New Zealand's level of exporting is at the bottom of the group of small developed countries. The average level of exporting for the 15 OECD countries with populations of 10 million or less is 53 percent of GDP; almost double the level in New Zealand. {Skilling 2007} There is no developed country with a similar population size that exports less than New Zealand. The countries ranking below New Zealand are considerably larger in terms of population, including the US, Japan, and Australia. The perception of New Zealand as a small successful trader is unfortunately well out of date.

It is also apparent from figure 4.3 that many countries substantially increased their exports between 1990 and 2004. Across the OECD, exports have been growing more rapidly than the overall economy leading to higher levels of exports to GDP. The median increase in the level of exports to GDP across all OECD countries between 1990 and 2004 was 12 percent of GDP, which compares to an increase of 2 percent for New Zealand. {Skilling 2007} {www.oecd.org} Significant increases in the share of exports in the economy have been widespread over the past decade: the ratio of world exports to GDP rose from 20 percent in 1990 to 30 percent in 2003 (World Trade Organisation (2004)). {Skilling 2007}

By international comparison, then, New Zealand's export growth over recent decades has been substantially slower than in most other developed countries. New Zealand has not

kept pace with the substantial progress made by many other developed countries in terms of expanding their exporting activity. In addition to its relatively low level and growth of exporting, New Zealand's exporting performance is also distinctive in terms of its composition. This is the case for the composition of New Zealand's exports of both goods and services. New Zealand's exports of goods are dominated by primary goods, like wood and pulp, meat, dairy, and other food, with about two thirds of goods exports currently coming from the primary sector (NZTE (2005)). Manufactured exports comprise just one quarter of New Zealand's exports. Scanning the list of New Zealand's top 20 exports in Table 4.4 shows the reliance on exports of primary goods. {Skilling 2007}

Table 4.4

TABLE 1: NEW ZEALAND'S TOP TWENTY EXPORT CATEGORIES

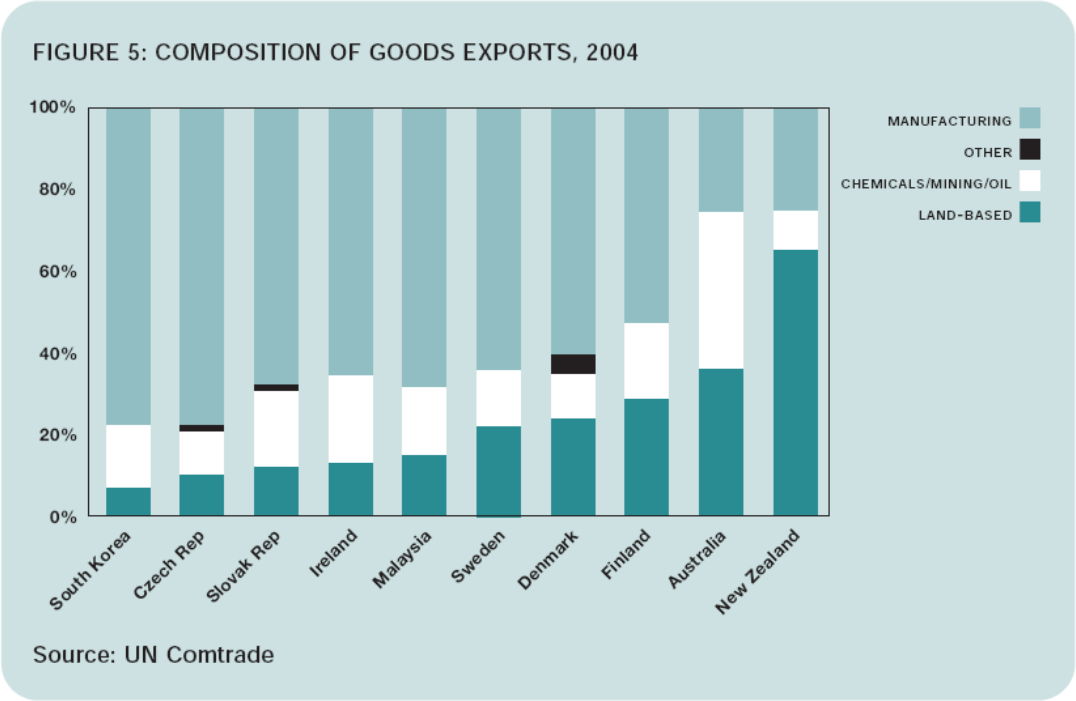
2004 Rank	Commodity Description	1980 Rank
1	Meat and edible meat offal: fresh, chilled, or frozen	1
2	Milk and cream	4
3	Fruit and nuts: fresh and dried	13
4	Cheese and curd	10
5	Butter	3
6	Wood: simply worked, and railway sleepers of wood	15
7	Aluminium	5
8	Starches, insulin, and wheat gluten; Albuminoidal substances; Glues	6
9	Wool and other animal hair (excluding tops)	2
10	Fish: fresh, chilled, or frozen	12
11	Edible products and preparations, not elsewhere specifed	79
12	Pulp and waste paper	9
13	Paper and paperboard	7
14	Other wood: in the rough or roughly squared	16
15	Crustaceans and molluscs: fresh, chilled, frozen	14
16	Alcoholic beverages	52
17	Vegetables: fresh, simply preserved; Tubers, not elsewhere specified	20
18	Household-type equipment, not elsewhere specified	29
19	Crude petroleum and oils from bituminous minerals	New
20	Veneers: plywood, "improved" wood and other, not elsewhere specified	23

Source: UN Comtrade 3 digit annual trade data

Much of New Zealand's export activity is still land-based and involves New Zealand extracting value from its natural resource endowment, particularly its land and climate. New Zealand's export composition is highly distinctive in comparison with other OECD countries. New Zealand has the highest share of land-based exports in the developed world, and this share is not reducing significantly over time. This runs counter to the clear trend in other developed countries, in which the primary export share is declining as manufacturing and services exports increase. {Skilling 2007}

Figure 4.5 describes the export structure for several countries. Most developed countries rely to a much greater extent on the export of manufactured goods.

Figure 4.5



The World Trade Organisation (2004), for example, estimates that 75 percent of total world trade is manufacturing trade. Australia and Norway are probably the two most similar countries to New Zealand in terms of having a heavy reliance on commodity products like agriculture, minerals, and oil, but this is unusual in the context of OECD countries. {Skilling 2007} The other notable feature of New Zealand's export composition is the absence of substantial change over the past few decades. Although there has been some change in the overall composition, this has been mainly due to a couple of large changes such as the decline in the export share of wool from 18 percent of goods exported in 1973 to 2 percent in 2004.

The most rapid change in the composition of New Zealand's exports occurred between 1970 and 1980. Since then, the pace of change has progressively declined. The composition of New Zealand's goods exports has not changed in a material way since 1990 relative to the changes observed in preceding decades. One indication of this can be seen in Table 4.4 (above). Most of the top 20 export categories in 1980 were also major exports in 2004. Indeed, the top 20 categories in 1984 accounted for 80 percent of New Zealand's goods exports in 1980 and these same categories accounted for 60 percent of export value in 2004, suggesting only modest change over the past quarter of a century. {Skilling 2007}This absence of change is also evident when more disaggregated analysis is conducted, examining the changes in more detailed export shares.

Although there has been some change in the composition of New Zealand's exports over the past decade or two, this is better described as incremental change rather than transformational. The majority of what New Zealand firms export today is recognizable from 25 years ago. {Abbott 2007} There are rapidly growing sectors in New Zealand, such as the wine industry, information and communications technology (ICT), and biotech, but these sectors tend to be growing from a low base and do not yet comprise a significant share of New Zealand's exports. Exports of goods from these sectors are small compared to New Zealand's total exports, and the emergence of these sectors has not been sufficient to lead to a transformation in the composition of New Zealand's exports.

For example, Comalco generates over $1 billion annually in exports of aluminium, which is over twice the $435 million exported by the entire New Zealand wine industry in the 12 months to June 2005. Indeed, wine exports comprise just 1 percent of New Zealand's total exports despite the rapid export growth of the wine industry. So although the emergence of successful new industries is commendable, however the extent of this success to date is not at a level desired. New Zealand's record contrasts sharply with the experiences of other small countries in terms of the pace and scale of change in the composition of exports. Small countries like Ireland and the Scandinavian nations have generated some rapid changes in their export structures over the past 15 years. {Abbott 2007}

This experience shows that major changes can be made in short periods of time, rather than taking several decades to accomplish. For example, 25 years ago Finland's exports were dominated by forestry exports, with wood, pulp, and paper products making up 45 percent of their exports. By 2000, these categories accounted for just 27 percent of Finnish exports, with the export share of high-technology manufacturing having increased substantially. Routti (2001) reports that exports of electronics rose from 4% of Finland's exports in 1980 to 11 percent in 1990 and to 31 percent in 2000. This is a transformational change in Finland's export structure. One argument sometimes made is that New Zealand's exports are changing in terms of the degree of value-adding processing rather than in terms of the export categories: for example, to the extent that New Zealand is exporting processed wood products rather than unprocessed logs. There has been a steady decline in the share of primary exports that leave New Zealand in an unprocessed way, from 27 percent in 1988 to 15 percent in 2001.

The share of elaborately transformed manufactures increased from 11 percent to 16 percent over this same period (Black et al. (2003)). But although this suggests some increase in the extent of processing, the extent of change has not been rapid or substantial. Another measure of the composition of New Zealand's exports is in terms of the technological intensity of manufactured exports. New Zealand is at the bottom of the OECD in terms of the technological intensity of manufactured exports, ranking 29th out of 30 OECD countries in terms of the share of manufactured exports that are either high tech or medium-high tech (OECD (2005b)).

At 67 percent, the OECD average share of high tech and medium-high tech manufactured exports is over three and a half times higher than New Zealand's 19 percent share. The share in Australia is 31 percent, substantially higher than in New Zealand. However, New Zealand has the largest share of low-tech manufactured exports in the OECD. At 70 percent, this share is over three and a half times bigger than the OECD average. {Skilling 2007} This reflects the low technological intensity of the food and beverage sector, which is New Zealand's main type of manufactured export. The OECD also reports that New Zealand generated relatively low growth in high tech and medium-high tech manufactured exports between 1994 and 2003, despite its low starting point. {Abbott 2007} Greece, the country immediately above New Zealand in terms of the technological intensity of its manufactured exports, grew its high and medium-high tech exports at twice the rate of New Zealand over the 1994-2003 decade.

This has occurred despite Greece having no obvious comparative advantage in this type of activity relative to New Zealand. Taken together, this evidence suggests that, although improvements have been made, there has not been a substantial increase in the value added component of New Zealand's exports. Across a range of independent measures, the extent of change in New Zealand's exports has been neither rapid nor substantial. This is particularly evident when the scale and pace of change in New Zealand is compared to that observed in other developed countries. {Skilling 2007} A key test of whether New Zealand is adding more value to its exports is whether overall export value is increasing. From the earlier discussion, it is apparent that this is not happening in a

material way. This absence of change in New Zealand is perhaps surprising given the extensive economic reforms that occurred from the mid-1980s.

Among other things, these reforms removed distorted price signals and impediments to efficient resource reallocation enabling changes to be made in New Zealand's export structure where there was an incentive to do so. However, there is little evidence of substantial change in the type of goods that are exported. In essence, New Zealand is still a land-based economy that relies on generating export income from its natural resource endowment. This is likely to continue given the low levels of research and development spending in the New Zealand economy and the small size of New Zealand's non land-based export sectors.

A major reason that New Zealand's export growth has been less than that of overall world trade growth is that world demand for the goods that New Zealand exports has grown less rapidly than overall world exports. For example The World Trade Organisation (2004) reports, that agricultural trade growth in the 1990s was lower than for manufacturing exports and other types of services. The OECD (2003b) observes "technology intensive exports accounted for much of the growth in trade over the past decade". High technology industries account for about 25 percent of total OECD trade, and generated the highest rates of export growth. {Abbott 2007}

New Zealand's export composition means that it does not have a substantial presence in these high growth markets. In contrast, it has a large presence in slower growing markets such as those based on the primary sector. For example over the past few decades, New Zealand businesses have ventured across markets, though the main barrier in terms of international expansion has been the limited number of markets that have been targeted over these years. New Zealand businesses normally tend to conduct their overseas activities in known markets such as Australia, with 65.1 percent of exporters targeting this country. {Skilling 2007} The next markets most likely to be served are the Pacific Islands (32.4 percent), the USA (32.4 percent) and the UK (26.0 percent). These results are consistent with the markets targeted by the population of New Zealand businesses (Shaw and Hassan, 2002; Statistics New Zealand, 2003). {Shaw and Darroch 2004}

The main focus on markets either physically close to, or culturally similar to, New Zealand (e.g., Chetty and Hamilton, 1996) suggests that entrepreneurs are focusing on less risky markets rather than pursuing markets which are distinctly different to New Zealand such as the Asian markets. {Shaw and Darroch 2004} Entrepreneurs are traditionally seen as being risk-takers; perhaps in the case of New Zealand businesses the risk-taking is more on the product/technical side than on the market side. {Shaw and Darroch 2004} Also, New Zealand has a substantial presence in the (low technology) food, drink, and tobacco sector, which generated the slowest growth rates of all the categories in manufactured exports at about half of the overall average growth rate. Intra-industry and intra-firm trade has also grown very rapidly over the past few decades.

This has occurred as technology has made it possible to undertake various steps in the production process in different countries. This type of trading pattern has been a major driver of overall world trade growth. But again New Zealand has not been significantly involved in these types of trading activities. As a result, New Zealand's exports have not grown as rapidly as have many other developed countries that are far more engaged in this type of trade. Indeed, 81 percent of New Zealand merchandise exports by value were in categories that grew at a slower rate than average world export growth between 1990 and 2003. These categories included New Zealand's major exports like dairy, wood, and meat. Only 19 percent of New Zealand's exports were in high growth categories.

This suggests that the commodity composition effect provides a powerful explanation for New Zealand's low export growth. This has a substantial impact on the level of New Zealand's exports. If New Zealand's goods exports had grown at the world average growth rate between 1990 and 2003, they would be 28 percent higher than they currently are. The effect of participating in slow growth markets may be offset by the competitiveness effect if New Zealand exporters are growing market share in these products. However, New Zealand lost market share in categories that comprise 57 percent of its exports by value between 1990 and 2003, with gains in market share occurring in categories that accounted for 43 percent of New Zealand's export value. This acts to compound the composition effect. Indeed, 42 percent of New Zealand's exports by value are in slow growing categories in which New Zealand is losing market share. This combination is not a recipe for exporting success.

Increasing New Zealand's exports will require an increased presence in high growth markets as well as at least maintaining market share in those goods and services that New Zealand firms currently export. However, the evidence outlined above shows that New Zealand is not moving rapidly into new markets in which demand is growing more rapidly. So this pattern of relatively slow export growth is likely to continue. There have been some positive developments in terms of New Zealand's exporting performance over the past decade, such as a slight rise in the level of exports to GDP and the ongoing development of new strengths. Overall, however, New Zealand's exporting performance does not compare well to other developed economies. Although New Zealand's exports have tended to increase as a share of GDP, this improvement in performance has not been nearly as significant as that generated by many other countries over this period. New Zealand's export composition has occurred on the margin, rather than being material changes that have a significant impact on aggregate export outcomes. {Skilling 2007}

Having discussed the outcomes of the exports for the New Zealand market, the following section presents the development in foreign direct investment flows within and outside the market.

4.1.2 Foreign Direct Investment:

Another mechanism for international engagement by New Zealand firms is in the form of foreign direct investment both inward and outward, which allows New Zealand to earn income from overseas business activity. Although inward foreign direct investment in an economy is as critical as outward foreign direct investment, for purpose of this study, the section presents an analysis of outward foreign direct. Outward foreign direct investment (FDI) occurs when an investment is made in an overseas firm or where a New Zealand firm makes a new investment offshore such as the creation of manufacturing facilities or a distribution network or the establishment of a retail presence. As presented in the previous sections, foreign direct investment was highly regulated which had hampered the progress of the businesses and thereby the local economy. However, the introduction of the reforms changed the investment scenario in the New Zealand market, as relaxation of controls over foreign direct investment (both inward and outward) were a key part of the deregulation of the economy. {Skilling 2007}

The relaxation of controls on investment flows led to a significant increase in both inflows and outflows of capital. {Enderwick 1998} For example when the New Zealand dollar was floated in 1985 a number of capital market restrictions were abolished which changed the scale and scope of foreign capital flows in and out of New Zealand. Regulations restricting the ability of New Zealand businesses to borrow overseas were abolished, as were the restrictions on overseas companies borrowing from New Zealand's capital markets. Both the amount of inward and outward foreign investment increased

substantially (relative to earlier periods) reflecting the policy of investment liberalisation on inward foreign investment and the relaxation of controls on capital movement for outward foreign investment. As an example, the timetable for completion of the CER free-trade agreement with Australia was accelerated and in 1987 an agreement was reached on the progressive elimination of restrictions on investment in services (Enderwick and Akoorie 1996, Enderwick 1994, Bollard 1987). {Enderwick 1998}

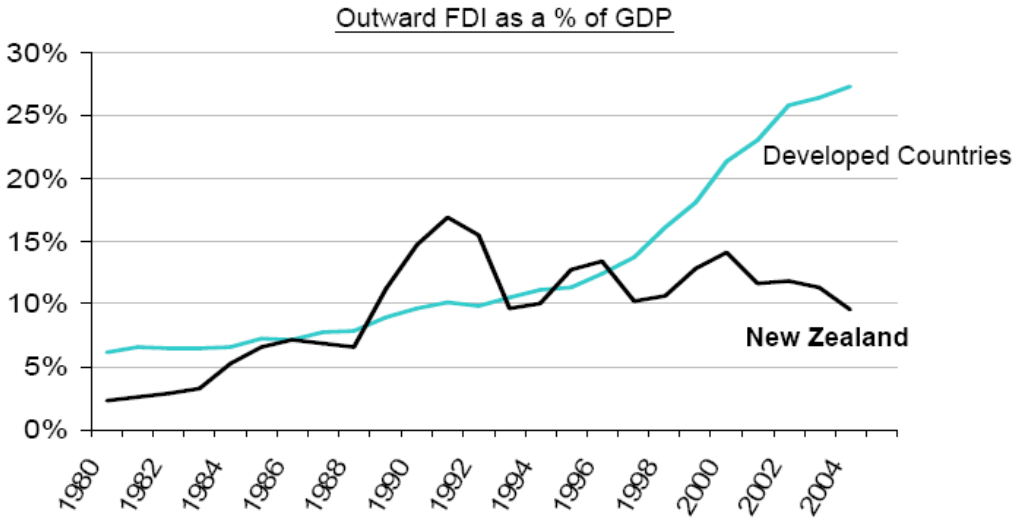
The changing ratio of outward to inward investment reflected the increasing competitive capacities of New Zealand businesses as they undertook outward investment, particularly in resource-based investments (principally to exploit existing ownership assets developed in the domestic base) in other locations. The average annual investment between 1982 and 1991 was just under $1 billion. This investment activity generated a significant increase in New Zealand's level of outward FDI, with the stock rising from 2.3 percent of GDP in 1980 to 14.7 percent of GDP in 1990 (UNCTAD, 2005). {Skilling 2007} The year 1991 was the high water mark for the level of outward FDI. However this growth was short lived. Although New Zealand participated in the process of intense FDI activity in terms of receiving substantial amounts of inward FDI, particularly in the early 1990s, it was not true in terms of substantial FDI outflows.

Due to this there has been a steady decline in New Zealand's FDI outflows in the last 15 years from 1990. {Enderwick 1998} As described above, New Zealand's FDI outflows have been lower in the period since 1990 than they were in the 1980s. As with New

Zealand's relative exporting performance, New Zealand's performance with respect to outward FDI has diverged from other OECD countries during the 1990s. This divergence can be seen clearly in the figure 4.6 below.

Figure 4.6

NEW ZEALAND'S OUTWARD FDI REDUCED THROUGH THE 1990s, PARTICULARLY RELATIVE TO OTHER DEVELOPED COUNTRIES

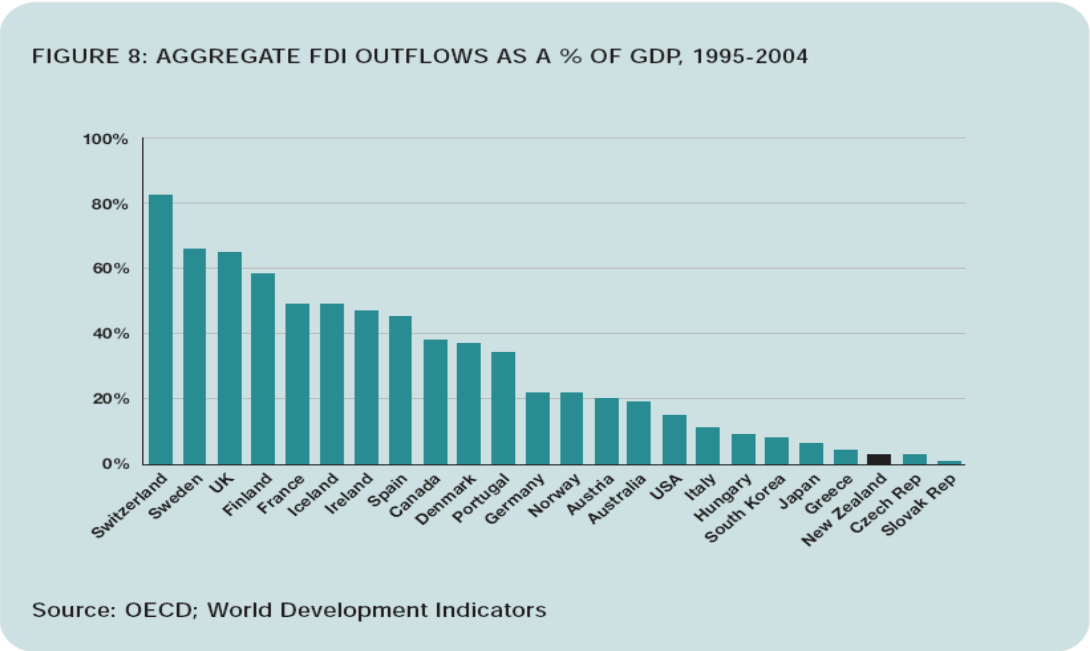


Source: UNCTAD.

Although New Zealand's stock of outward FDI was above the OECD average in 1990, it has declined steadily since. This has occurred while the developed country average for the stock of outward FDI has grown strongly from about 10 percent of GDP in 1990 to 27 percent of GDP in 2004. This means that the stock of outward FDI as a proportion of GDP has increased by a factor of three while New Zealand's stock has reduced significantly. New Zealand's stock of outward FDI as a share of GDP now ranks 21st out of 30 OECD countries. {Skilling 2007}

A significant reason for the reduction in the stock of outward FDI has been the low outflows of FDI by New Zealand firms over this period. While significant FDI outflows were being observed across the OECD countries, New Zealand's outflows were not keeping pace as is evident from figure 4.7 below.

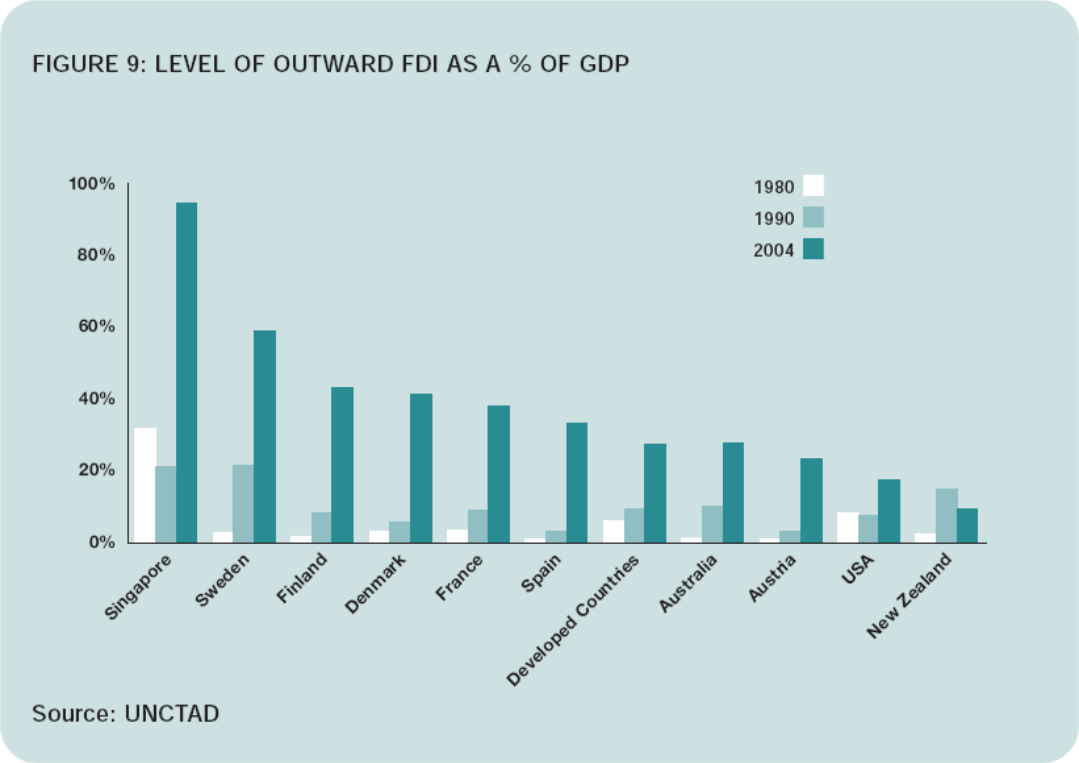
Figure 4.7



New Zealand's total FDI outflows over the 1995-2004 decade were considerably lower than for other OECD countries, at just 3 percent of GDP. This compares with total outflows of 19 percent of GDP for Australia, 45 percent for Spain, and 58 percent for Finland. Indeed, New Zealand's FDI outflows as a share of GDP between 1995 and 2004 were 25th out of 30 OECD countries. Only five OECD countries had lower FDI outflows than New Zealand over this period: Poland, the Czech Republic, the Slovak Republic, Turkey, and Mexico.

Moreover figure 4.8 below shows that New Zealand's low level of outward investing persists. {Skilling 2007}

Figure 4.8



The OECD (2005a) reports that New Zealand's FDI outflows between 2001 and 2004 were the second lowest in the OECD in absolute terms. This pattern of FDI outflows is reflected in a low level of outward FDI as a share of GDP compared to other developed countries. Figure 4 compares the level of New Zealand's outward FDI to that in a range of other developed countries in 2004. The latest available internationally comparable observation for New Zealand has the FDI stock at 9.5 percent of GDP. This compares with 27 percent for Australia, 65 percent for the UK, and an average of 27 percent for the developed world in 2003 (UNCTAD (2005)).

In addition, several non-OECD countries have substantial levels of outward FDI, such as Singapore (95 percent of GDP) and Hong Kong (247 percent of GDP). {Skilling 2007} Although the relationship between country size and direct investment is weaker than for exporting – because larger companies make larger international investments, and there are more large companies in larger countries many of the small developed countries also have substantial amounts of overseas direct investment. Small countries like Finland, Switzerland, and Ireland, have substantial amounts of outward FDI through companies like Nokia, Novartis, and CRH. In fact, New Zealand has very few multinationals compared to other countries of similar size. To illustrate this point, New Zealand has just one company on the Forbes Global 2000, whereas Ireland has 8, Finland 15, Singapore 13 – and Australia has 38. {Skilling 2007}

Moreover, the reduction of New Zealand's outward FDI stock is a unique experience in the developed world. New Zealand's outward FDI stock as a share of GDP was well above the developed country average in 1990. Although since then, New Zealand's outward FDI has reduced, which is in sharp contrast with the general tendency for FDI to increase and often by substantial amounts. Australia's stock of FDI, for example, rose from 10 percent to 27 percent of GDP between 1990 and 2004. One of the most notable features of figure 4.8 is the large and rapid increase in the level of outward FDI across many developed countries between 1990 and 2004. Many of the European countries, like Finland, Denmark, France, and Spain, increased outward FDI from under 10 percent of GDP to levels well in excess of 30 percent of GDP over this period. {Skilling 2007}

The flows of direct investment from New Zealand have been low by international standards, and have declined over the past decade. This is despite of the past decade being a period in which direct investment flows have grown strongly worldwide, as firms have increasingly sought to establish an international presence. Unfortunately New Zealand has gone backwards since 1990 relative to other developed countries and also in an absolute sense. Furthermore the returns generated from the investments that have been made by New Zealand firms have often not been strong. New Zealand is not keeping pace with most other developed countries in terms of outward FDI. This divergence is becoming increasingly apparent, with a widening gap between New Zealand and other countries in terms of the level of outward direct investment. This is troubling because international investment provides a relatively clean measure of the international competitiveness of an economy.

Whereas a country can generate high levels of exporting through the local activities of foreign firms, outward direct investment is due to the qualities of domestic firms. The ability of a country's firms to compete successfully abroad provides a good indication as to how competitive the economy is. In this sense, New Zealand's relatively poor performance in terms of outward FDI does not provide a positive message about the competitive position of the New Zealand economy. For a small country like New Zealand, raising the level of international economic activity is vital to achieving and sustaining higher rates of productivity growth. New Zealand's ability to generate economic prosperity will depend to a large extent on the ability of New Zealand's firms to compete successfully in international markets.

These aspects take on an added significance, in an era in which international trade and investment openness are the guiding principles of government and business thinking and in which the capacity of enterprises to take advantage of openness is an increasingly pressing concern. The concern is all the more greater in small, open economies such as New Zealand's where, in many cases, the only way for businesses to grow is by exploiting international opportunities. As evidenced by the increasing focus on the importance of international activities, the development of markets outside New Zealand offers the largest growth opportunities to New Zealand businesses. {Skilling 2007}

4.2 Chapter Summary

The points presented in this chapter analysed the key reforms that were introduced to foster stability and growth of the New Zealand economy. It also analysed the performance of the New Zealand economy post reforms. The above discussion highlighted that although the government deregulated the economy with an intention to promote development through increased international engagement, the economy has not been able to achieve the desired outcomes. This aspect is evident when the international performance of the economy is compared with other countries that share a similar market size and resource characteristics. As discussed above, the exporting as well as Outward Foreign Direct Investment has not seen significant improvements over the last two decades. The analysis suggests that the New Zealand economy in many ways has been unable to create a competitive position for itself in the world economy.

The discussion above makes it clear that given the size of the domestic market, New Zealand businesses should encompass to embrace the opportunities provided by the international markets in order to prosper into today's highly competitive environment. In order to bring about progress and expansion New Zealand cannot afford to isolate itself from the changing dynamics of world trade. The international markets, in particular the emerging markets, today present some of the most palpable opportunities for growth for most businesses around the world, and are no different for New Zealand businesses. Thus, Chapter Five presents the role of New Zealand businesses in the emerging markets

and discusses the importance of these markets to New Zealand businesses and the economy as a whole.

Chapter 5: Changing World Economy

The past several decades have seen a wave of significant global economic integration, with substantially higher levels of international economic activity. International flows of goods and services, investment capital, companies, and people have increased considerably, and particularly over the past decade or two. The pace of change and the intensity of competition are likely to increase further as the markets around the world continue to integrate into the global economy over the coming decades. This process provides a substantial opportunity for New Zealand to increase its activities in the international environment. Given the importance of meaningful international engagement for improved productivity growth in New Zealand, these outcomes are of real concern.

Although there are some positive developments in terms of New Zealand companies competing successfully in international markets, the materiality of this activity needs to be significantly increased. Going forward, the pace of change and the intensity of competition are likely to increase further as markets like China and India continue to integrate into the global economy and as companies become increasingly global in reach. These developments will increasingly impact on New Zealand's exporting and investing performance. These markets provide a substantial opportunity for New Zealand, but it is simultaneously a major challenge. {Skilling 2007}

5.1 Emerging Markets: Asia: China and India

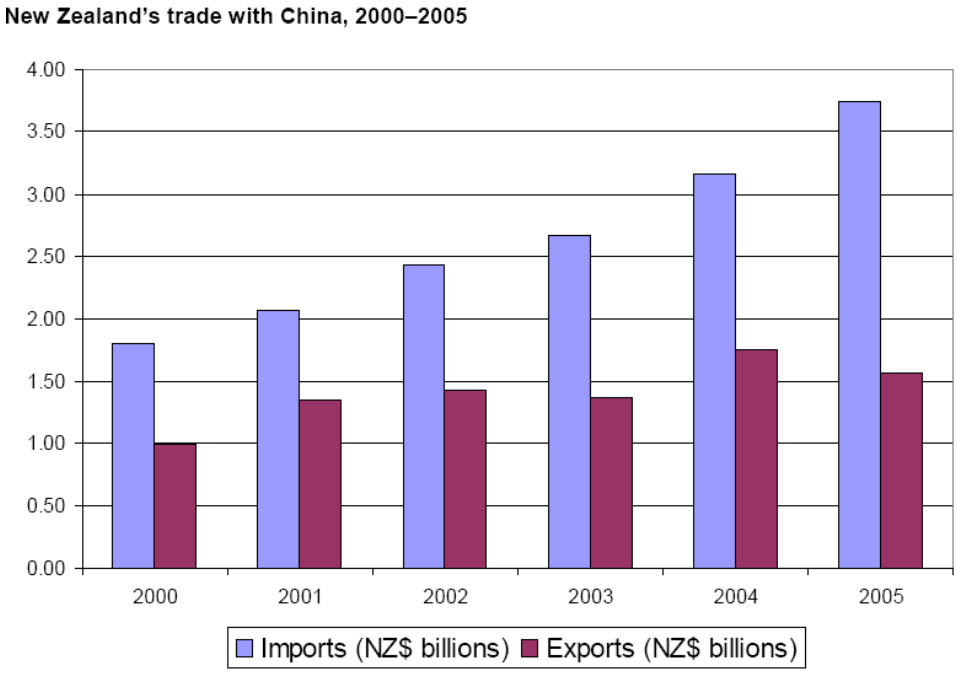
Emerging markets today have become major combat zones for companies large and small in which they compete in the hope for superior returns arising from rapid economic growth and market related opportunities. Among the pantheon of emerging markets, India and China stand out as offering the greatest and most far-reaching changes in distribution and growth of business activity in the contemporary world. With the emergence of the China and India, economic engagement with these markets has become increasingly vital for businesses around the world, New Zealand being no exception to that. With markets around the world being more dependent on emerging markets, New Zealand would find it difficult to achieve and sustain high rates of productivity growth without making much greater use of larger markets through international activity.

5.1.1 China: Role of New Zealand

Over the past two decades, China has been one of the world's fastest growing large economies and as grown at an annual rate of 9.4 percent. No other country in the world, besides the United States, receives more FDI. Fuelled by ''twin surpluses'' of trade balance and capital flow, China's foreign reserves rose 20 fold in the last decade from less than US$10 billion to over US$200 billion by 2001. This made China's foreign reserves the second largest next only to Japan's during that period. As of Oct 1st 2006 China's foreign reserves stood at $987bn - and they are growing by $18billion each month. {BBC 2007}

Currently China's economy continues to be powered by a huge appetite for investment, and a boom in exports that generated a trade surplus of $177.47 billion last year. {Schifferes 2006}

Figure 5.1



New Zealand exports to China, for example, have increased substantially in recent years, and represented 5.08 percent of New Zealand's total exports in the year ended December 2005. Imports from China have also increased substantially, growing to NZ$3.75 billion in the year ended December 2005. This represented 10.68 percent of New Zealand's total imports for the period, as is seen in the table above. {Enterprise 2006} Exports have traditionally been primary sector products such as wool, dairy, meat, seafood and wood products. This is unlikely to change in the near future, though respective proportions may alter as is seen in figure 5.2 below.

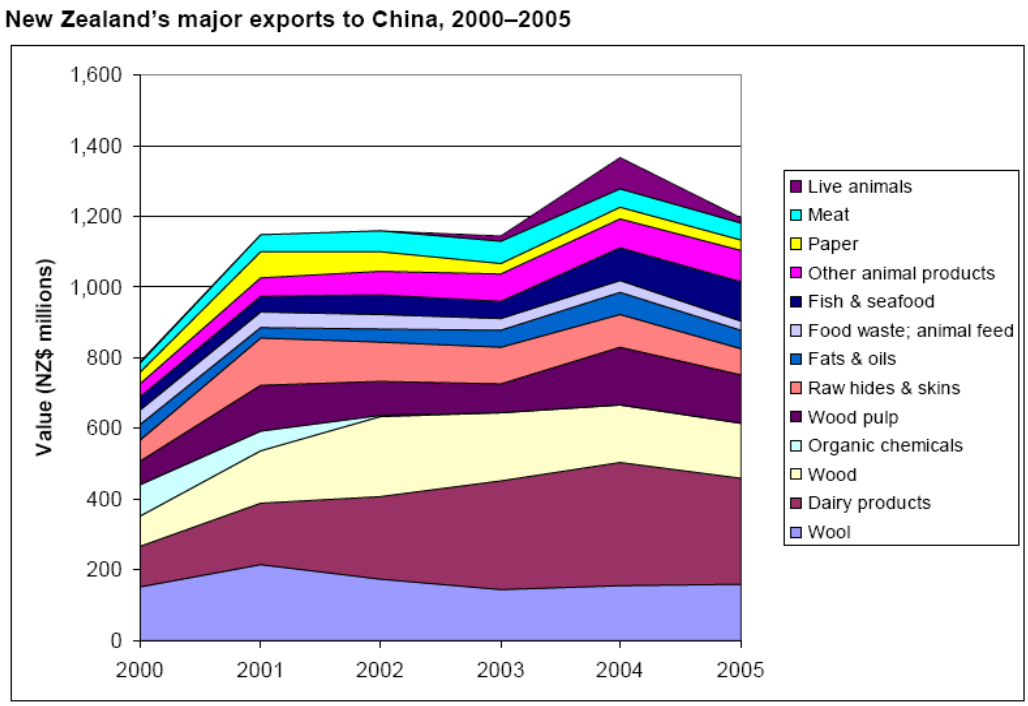


Figure 5.2

However, this has seen a slow and steady change. With the increase in demand for particularly for high-tech and wood processing sectors, a new trend has emerged whereby New Zealand high-tech products are starting to enter the Chinese market, often via third markets. For example, China is now the biggest construction site in the world with 2.9 billion m2 currently under construction. Beijing has overtaken Shanghai as the city with the most land area under construction. There is an increasing demand for interior fit out products and niche opportunities for energy saving, energy efficient, environmentally friendly building products. This is driven by the need for China to adopt more modern building techniques, as well as a shortage in resources. There is also demand in the new hotel and hotel refurbishment sector for a wide range of building products.

China has now approved a building code that will allow timber framed houses to be built, and as radiata pine is included as an approved species which potentially opens up the market for New Zealand housing solutions and structural grade timber. {Enterprise 2006} China's growing middle class has been a major driver in the increased demand for housing, building products and furniture. These are all key sectors that consume wood, panel products, laminated flooring and so on, and as incomes continue to rise, the demand for apartments, houses, furniture, kitchens and so on will increase, driving an increased demand for wood products. {Enterprise 2006} These activities in the building sector and other sectors alike in this market have seen an increasing recognition and demand for New Zealand expertise.

Apart from that, the recent years have also seen India as the next emerging market after China. With the opening of the Indian market, businesses are tapping into this market, driven by the hope of cashing into the abundant opportunities this country stands to provide. Likewise the economic liberalisation in 1991 has seen the rise of India as an emerging market that holds abundant prospects for businesses both domestic and international. Since the mid 1990's a broad commitment to liberalisation demonstrated by three successive governments has sparked an unprecedented growth and opportunity for both local and foreign companies, which has allowed the economy to grow, more than double in real terms since 1991. {Sinha 2005} The G.D.P compound growth rate was 5.5 percent in 1997-2003, increased to an estimated 7.1 percent in 2004 and is projected to continue till 2009. {Sinha 2005}

5.1.2 The Indian Market

The Indian economy ranks tenth in terms of G.D.P in the world and predictions hold that the preceding growth will rank it among the top five by 2025. {Sinha 2005}The foreign trade has seen a steady increase and was at $235 billion in 2004 and increasing by another 8 percent in 2006 in real terms, making a contribution of 34 percent from 16 percent in 1995, towards the compound G.D.P. {Sinha 2005}India today represents 4 percent trade within the Asian economy and 1 percent of global trade. {Sinha 2005}Compositions of trade in 2003 were $28 billion in service and $57 billion in manufacturing sectors within exports and were $28 billion and $71 billion in imports. {Sinha 2005}

The Investment climate over the past decade has seen an improvement. Since 1991, the economy has attracted $30 billion in foreign capital and inflows have doubled since 1995. {Sinha 2005} Liberalisation has made India a hot bed for private equity and portfolio investment, which has increased to an annualised rate of more than $10 billion. {Sinha 2005} Labour productivity within the market has increased by 50 percent since 1990, but India still trails China and South Korea in its rate of productivity growth. {Sinha 2005}The compound annual growth rate of India as compared to other countries shows the steady progress the economy has made in the recent years:

- China- 7.3%
- South Korea- 4.1%

- India- 3.3%
- U.S- 1.7%
- Japan- 1.3% {Sinha 2005}

Increasingly global executives are recognizing India's potential as one of largest the consumer market after China. Demand there may be at an inflexion point as a burgeoning middle class (40 million) begins to enjoy the rewards of economic reform. {Sinha 2005}In order to further facilitate development the government has recently broaden protection for patent holders. The government has also implemented a value added tax (VAT) within the key sectors like Apparel, Timber, Food processing, Aluminium, Pharmaceuticals, Engineering, IT and Outsourcing which is encouraging however sectors such as retailing, banking and energy lack. {Sinha 2005}

India's actual growth reforms have undergone tremendous change in bringing about a steady rise in the G.D.P from 5.8 percent in 1997-2003 to 7.1 percent in 2004 and the country intends this to be the projected growth until 2009. {Sinha 2005}India has since introduced reforms, which have removed product and market barriers and this has lead to the reduction in the government ownership within various sectors encouraging a growth of privatisation.{Sinha 2005} Introduction of reforms has also seen a steady improvement in the labour infrastructure.

5.1.2.1 New Zealand and India

With the opening up of the Indian economy, New Zealand businesses are rapidly increasing their trade activities in the Indian market. {NZTE 2006} India is increasingly becoming an important market for New Zealand especially with regards to the IT software, defence, security and telecommunication equipments. {NZTE 2006} Other potential areas of mutual interest between the two markets include biotechnology, wood processing, ICT, Infrastructure developments, where New Zealand companies expertise is considered by the Indian government. {NZTE 2006} There are major road, aviation, energy, and rail projects underway in many cities. The aviation sector for example has four large international airports either under construction or in planning at Delhi, Mumbai, Bangalore & Hyderabad.

This offers particularly promising opportunities for New Zealand, as expertise of New Zealand companies is well considered and appropriate for such & other Indian projects. {NZTE 2006} New Zealand's trade with India has grown from a very low base of NZ$1.3million in 1970 to NZ$232 million in 2005. {Asia Foundation 2006} However, despite promising opportunities, New Zealand companies still struggle to gain stability and growth in the Indian market. {Asia Foundation 2006} Reasons for failures while conducting operations in the Indian market are unclear and key mistakes made are not clearly defined. Moreover the data within the existing literature presents little information about the trade activities/patterns, which exist, between the two markets, which makes research in this area imperative.

5.2 Chapter Summary

Economic liberalisation over the last two decades has seen the rise of some of the largets markets in the world. The points briefly discussed above suggest that amongst other markets, the liberalisation of China and more recently India has changed the economic geography of the contemporary world. The opening of these markets has seen the rise of significant opportunities and businesses around the world have come to realise the importance of these markets, with New Zealand being no exception. Although the level of interaction between China and New Zealand is considerable, New Zealand businesses have been slow in recognising the prospects that the Indian market stands to provide. While some New Zealand businesses are already active in India, the level of interface between the businesses across the two economies is quite dormant.

Considering this, in order to establish the importance of the Indian market, the next chapter aims to present a detailed analysis of the Indian market prior to the 1990 reforms. It will present an analysis of background of the Indian economy which will help understand the state of the Indian economy prior to the reforms.

Chapter 6: Background: Indian Economy

In the last decade, significant structural reforms have helped India become one of the world's fastest growing economies. India is a large, diverse market, with a current growth outlook that overshadows most Asian markets. India's economic development has brought tremendous success for the country with a better global image. An 8 percent growth rate of India's national income for three consecutive years (2004-2007) is a strong indication of its growth potential. An early 1990's balance of payments crisis promoted the Indian Government to undertake significant reforms.

These reforms opened the economy to the world with the aim of attracting and offering trade and investment opportunities. The reforms abolished industrial licensing, floated the exchange rate, and increased domestic and foreign participation in financial markets. Over the 1990's the reforms provided a considerable boost to both productivity and economic development. It is useful to consider how the reforms have brought about unprecedented growth in the Indian economy. Thus following section presents an analysis on the reforms and subsequent development. It first briefly discusses the backdrop of the Indian economy and state of the market prior to the reforms. It then discusses the reforms introduced in 1991, which changed the development scenario within the Indian economy. Finally it discusses the impact the reforms have had on certain critical sectors within the economy.

6.1 Regulated Market

A Brief History 1950-1990

6.1.1 Regulated Phase of 1950-1973

During the period of 1950-1973, the Indian leadership embarked on a development strategy based on economic self-reliance and a regulatory framework (policy regime) that became increasingly more restrictive towards international engagement. As championed by China and the then USSR, India too, opted for central planning and state control, making the economy a strong proponent of socialism. Hence, the government at the time had a vision of a state-guided closed economy and viewed international trade and a market economy as a whirlpool of economic imperialism (Nehru, 1946, pg 546) rather than positive instruments for achieving economic growth. {Srinivasan 2003} They also perceived that free trade and a liberalised capital market would be major causes of India's economic under-development in the future.

As a result, the development strategy implemented between 1950 and 1973 had two main goals. The first was to gain state control over the economy through a progressive expansion of public ownership of the means of production. As the development of basic and heavy industrial sectors was thought to be the key to bring about development and prosperity within the economy these industries were exclusively reserved for the public sector (chemicals, pharmaceuticals, aviation, and infrastructure). A further element was the use of fiscal and monetary instruments to deploy and mobilise private financial savings for public investment. In order to achieve this, financial organisations and

commercial banks were nationalised in 1955 and 1969 respectively. The nationalisation of these institutions gave the government complete control over financial flows within the economy. The second goal was to get the private sector to conform to plan priorities through quantitative restrictions on private investment, capital issues, and foreign collaborations as well as imports of technology, capital goods, and intermediate inputs. In order to achieve this goal, licensing was introduced in the market, with an aim to restrict the activities carried out by the private sector at the time. Industrial licensing, for example, introduced in 1951 on a comprehensive scale, was considered essential to conserve scare capital and to align domestic production capacity with developmental priorities, which were predetermined by the government. {Srinivasan 2003}

The main intention of the government in introducing licensing, particularly within the private sector, was to avoid 'unnecessary duplication of investment and production'. Thus, in order to avoid duplication of production and investment activities the government, awarded licenses to only a select group of private investors. In addition, the government used licensing as a tool to monitor and control the level of production undertaken by private companies at the time, thereby largely limiting the production capacity of the private sector. Doing so precluded the competition in the domestic market for products and saw the emergence a few large-scale domestic producers that dominated the local market. Consequently, by the 1960s and 1970s, all activity in the formal manufacturing sector was subject to licensing and rigid capacity controls.

As a result, a highly regulated market structure emerged, which initiated patterns of heavy industrial concentration across different sectors within the domestic economy. Procter & Gamble's Indian arm, for instance, could not produce a large amount of Vicks Vapo Rub during a flu epidemic in the country, as the company was worried that it might break the anti-monopoly rules, which were in place that monitored and restricted the amount of output produced by individual firms in the market. Another example of this was seen in the case of Bajaj, a local scooter producer, which could not manufacture more scooters than it was licensed to produce, as it would violate the regulations, which had been designed to foster the creation of small companies as a way of encouraging self-sufficiency {Robyn 2007}.

Apart from licensing, the government also introduced import substitution to foster development within the industries in the local economy, as it was believed that import substitution would serve as an instrument to protect domestic businesses from foreign competition. Hence, in order to discourage imports and foster development within local businesses, graded import tariffs were placed on various goods and services according to the level of their importance for the development of the local market. For example, tariffs were highest on "least essential" consumer goods, (e.g. clothing, automobiles, food items) and lower on industrial intermediate inputs (e.g. raw materials, components, parts) as well as capital goods deemed "essential" for production (e.g. machinery, equipment, technology) for the development of the local businesses. {Srinivasan 2003}

These tariffs not only largely prohibited imports of finished consumer goods but also chiefly restricted the imports of necessary capital and intermediate goods within the market. As a result of this, producers found it difficult to upgrade their production techniques with the necessary technology, which further lowered the standard and the competitive advantage of the local Indian businesses, making it difficult for them to compete in the market. Apart from imposing graded tariffs on imports, as seen below in the table (6.1), the government also used other measures, further regulating the domestic economy (examples of which are discussed below).

Table 1(a). India's industrial policy regime, 1950–84

Industries (Development and Regulation) Act, 1951	Imposed licensing requirements for firms above certain size in a specified list (Schedule I) of industries.
Industrial policy resolution, 1956	Reserved some industries for state enterprises (Schedule A) and restricted private-sector growth in others (Schedule B).
Monopolies and Restrictive Trade Practices Act (MRTPA), 1969	Applications for production licenses from big business houses and subsidiaries of foreign companies were referred to the MRTP Commission.
Industrial Policy Statements, 1973	Made licensing mandatory for all firms above certain size. Some industries reserved for small-scale firms. Large business houses and foreign firms confined to a specified list of 'core' industries.
Foreign Exchange Regulation Act, 1973	Foreign-owned firms required to reduce equity stake to below 40 per cent, with some exceptions.
Industrial policy resolution, 1977	Expanded the list of industries that were reserved for small-scale firms, to include over 800 products.

{Kapur 2006} ***Table 6.1***

As well as regulating the domestic economy, restrictive trade policies meant that the economy had little interaction with other markets internationally. India aimed to maintain minimum international interaction, and did so successfully by establishing bilateral

external assistance with Eastern Europe between 1955- 1980 and barter trade agreements with the Soviet Union between 1965 and 1990. Owing to the rigid nature of the market and the absence of international trade, the domestic economy constantly struggled with low capital reserves. As a result of this regulated approach the economy suffered with a balance of payment crises in the late 1950's, followed by another major deficit in the 1960's. Although in the wake of the crisis the government encouraged inward foreign investments within the economy (both in the 1950's and in 1960's), these did not help boost development.

In order to foster growth amongst local Indian businesses, the government aimed to encourage collaboration between foreign subsidiaries and domestic companies. However, this policy did not yield the desired results. For example, as a policy requirement, foreign subsidiaries entering the local market were given a certain amount of time to complete the 'Indianisation' process, which was to form collaboration with a local Indian business and develop operations that focused solely on functioning within the Indian market. Moreover, the government made it mandatory for foreign investors to give a 40 percent equity stake to their Indian counterparts. This was done with the intention of retaining control of such operations in Indian hands. This equity stake was further increased to 60 percent in the mid 1970's. {Johnson 1996}{Srinivasan 2003} Additionally, the government was of the view that earnings generated through such alliances be retained in India alone.

Hence, in order to achieve this objective the government for example, introduced the Foreign Exchange Regulation Act, (FERA) which allowed maximum retention of earnings and reduced outflows of capital reserves from the domestic market. (Athreye and Kapur 2001) {Kapur 2006} {Kelly 1996} In addition to this, distortionary policies, such as the Monopolies and Restrictive Trade Practices Act (MRTP) of 1969, for example, scrutinized the proposal by large domestic firms for capacity expansion as well as any foreign collaboration that these firms sought to use to expand their operations in the market. Furthermore, approval of such collaborations was often tied to export commitments and technology transfers, which discouraged the entry of foreign firms into the Indian market.

Due to these restrictive policies the market saw a downward trend of FDI inflows particularly in the late 1960's and 1970s. The average annual inflow of FDI for example, during this decade was only $3 million. Due to the lag effect of the FERA, during the mid and later 1970s, the total stock of FDI shrunk to $1.9 billion in 1979 from $2.2 billion in 1976, as foreign firms withdrew capital from their Indian investments. {Kelly 1996} In addition, in sectors where domestically owned firms were unable to compete with foreign-owned firms, restrictions were put in place to prevent the entry of foreign firms. Nevertheless, this did not help the domestic firms to efficiently use resources and become competitive in the domestic market. The restrictions only worsened the situation, as the protection served further to shield incumbent local firms in the Indian market, thereby preserving concentrated market structures and encouraging the emergence of a 'dualistic

structure': a few large firms and a fringe of small producers, with little movement between the two categories.

Although wide-scale tariff and other quantitative restrictions, (as discussed above) were initially imposed to help contain the balance of payment deficits these regulations continued in varying intensities until early 2001. As a result, these restrictions heavily protected domestic firms from price competition, allowed inefficient firms to survive, and supported a more fragmented structure within the Indian economy relative to what stronger price and product competition would have created. The pattern of development of the Indian economy, during the regulated phase was a product of government design rather than market forces. Hence, with the chosen path of development government aimed to bring about an equal (but slow) growth amongst all sectors within the economy, which came to be termed as the "Hindu Growth Rate".

6.1.2 Piecemeal Deregulation: 1971-1990

The mid 1970's saw a change in the attitude of the government in terms of relaxing the policy regime in order to boost the development of the Indian economy. During the mid 1970's a succession of favourable agricultural harvests in combination with an agricultural price policy that offered attractive prices to producers, resulted in an accumulation of public stocks of food grains that provided a boost for the growth of the economy. Moreover, a sharp increase in the international oil prices saw a favourable boost of foreign reserves into the Indian economy. For example, increase in the oil prices led to massive cash flows from the Gulf countries into India in two ways. Firstly, the newly affluent oil-producing nations proved to be ideal markets for India's exports of agricultural products because of locational advantage. Secondly, the development efforts by Organisation of Petroleum Exporting Countries (OPEC) generated a great demand for middle-level skills that was readily met by the migration of Indian workers, bringing in much needed foreign reserves within the Indian economy.

Furthermore, in order to attract foreign investments into the country, the government relaxed the restrictions that were initially in place to protect local businesses. For example, foreign investors, particularly from OPEC, were allowed an equity participation of up to 40 percent without the requirement of technology transfer and/ or/ export commitments, in core sector industries such as fertilisers, cement, petro-chemicals, export-oriented industries and hotel and hospital projects. This action was taken on the

recommendations of three official committees that looked into the possibilities for the simplification, rationalisation and liberalisation of the policy regime. {Srinivasan 2003} These committees focused on import and export policies, the possible shift from physical to financial controls, and a third on industrial policies, and recommended a cautious and selective deregulation and rationalisation of the economy.

Following the recommendations of these commitments the economy witnessed a relaxation of restrictions such as licensing and graded tariffs. For example, the official committees recommended three steps to relax the existing framework of Industrial licensing. Firstly, licensees were permitted to diversify into interrelated industries or investments, without seeking a fresh license as well as a minimum efficient scale of capacity was announced for several industries. Secondly, automatic expansion of already licensed capacity and production in excess of the existing licensed capacity was allowed, without penalty under stipulated conditions. Thirdly, as a part of industrial liberalisation, the committees also established a system of 100 percent export-oriented units along the lines of free trade zones. Moreover, to further boost foreign inflows the government also actively promoted investment by non-resident Indians (NRI) (during 1982-83) by allowing them to invest in certain schemes without the insistence on the transfer of technology.

These investments were also given tax and interest rate concessions, which further made India lucrative for foreign investments {Johnson 1996}. In addition to this, the trade and investment policy was set for a 3-year term, (instead of a 5 year term) in order to reduce the uncertainties of year-to-year policy changes and promise a stable environment for foreign investments. As the market became more deregulated, the economy saw a slow and steady rise in much-needed inward FDI at the time. The annual value of actual FDI investment (in particular, within the export oriented industries such as fertilizers and cement) for example, rose from $1.19 billion in 1980 to $1.43 billion in 1988, as the average annual inflow of FDI during the decade climbed to over $100 million. In addition to this, Indian exports (in dollar terms) doubled from $ 8.9 billion in 1985-86 to $18.1 billion in 1990-91. {Srinivasan 2003} However, this growth was short lived. Although the restrictions were relaxed, the approach towards deregulating the economy was very selective in nature and the policy regime did not change its basic character.

Hence, even though the government did deregulate the market to some extent, the existing controls were not completely eliminated rather it was more a case of simply substituting one form of control for another. This increased the complexity of understanding regulatory requirements and made it difficult for businesses to function successfully in the market. Although quantitative restrictions (on imports and exports) were loosened, the economy did not stand to gain. As discussed earlier, the licensing system which divided imports into three categories, in an ascending order of

“essentiality”: consumer goods, intermediate goods (e.g. raw materials, components, and parts) and capital goods (e.g. equipments, heavy machinery) remained in place.

Moreover, imports of non-essential consumer goods such as clothing, food products, and automobiles were banned whereas those seen to be essential such as edible oil, sugar, and certain drugs and pharmaceuticals were exclusively imported through state-agencies, which resulted into a regulated system of supply. {Srinivasan 2003} Under the deregulation, businesses still found it more profitable to sell their products in the local market as opposed to the international markets. In addition to this, despite the fact that Indian exports had seen an increase over the period of piecemeal reforms, it was more due to real exchange rate depreciation (mostly because of exogenous forces) rather than an explicit policy reform aimed at reducing trade barriers.

Even though the period of piecemeal deregulation aimed to contribute towards the development of the economy by relaxing the barriers it did not prove to be effective in improving the economic situation. The performance of the Indian economy, while distinctly better in the 1980’s, as compared to the earlier periods, was supported on the demand side by unsustainable fiscal policies and it ended with an economic crisis in 1991. In sum, the policy regime remained distorted and restrictive in character, despite some piecemeal deregulation, until 1991. The restrictive attitude of the Indian policy makers and sudden external trade shocks plunged the Indian economy into a balance of

payments crisis in 1991. Hence, the next section discusses the three main reasons that triggered the crisis and the reforms that followed to resolve the crisis.

6.1.3 The Crisis of 1991

Like most developing countries, India's reforms were preceded by an economic crisis. Although the BOP crisis hit in 1990-91, the signs of an economic failure had loomed over India for at least a half a decade. The discussion below highlights the three major reasons for the BOP crisis in 1990-91. Firstly, as discussed earlier, the economy experienced a short-lived growth period from the mid 1980's to early 1990's. However, this growth was accelerated by borrowing the required capital reserves, and not by drastic restructuring and opening of the economy. The piecemeal deregulation within the economy did not provide much incentive to attract a substantial amount of foreign investments.

To maintain growth, much of the capital needed by the economy was borrowed from commercial sources (both domestic and international). Therefore, despite the earnings generated within the economy at the time (mid 1980-1990), these proved to be insufficient to outweigh the combination of rising interest payments on external debt and the rapid growth of imports induced by fiscal deterioration. The growth achieved by the economy in the eighties (relative to the seventies) was accompanied by higher fiscal deficits, rising current account deficits and larger external debt. The external debt rose from 12 percent of GDP in 1980-81 to 23 percent in 1990-91. {Virmani 2001}

Consequently, the rising deficits started to crowd out the private investments and inflationary pressures became evident. As investors pulled out of the market the government faced a daunting task to replace the reserves to repay the amounts borrowed. As a result, foreign exchange reserves hit an all time low, and were barely enough to finance the economy for two and half months. Owing to this, as the rate of inflation soared, exceeding 10 percent in the early period of 1990, and expectations of an imminent devaluation of the rupee led to the withdrawal of deposits by foreign investors and non-resident Indians. A spectre of financial debts, as a result of extensive external public borrowing and a downturn in the market loomed for the Indian economy.

Although the external payments crisis provided the immediate impetus for change, there were other political and international factors that had been pushing India towards radical policy reforms. First, the country's cautious and limited deregulation of the 1980's had delivered a period of rapid development. Although this growth turned out unsustainable, it made further liberalization of the policy regime politically acceptable {Srinivasan 2003}. Second, the Iraq-Kuwait War had an adverse effect on the Indian market. The Gulf crisis began with the invasion of Kuwait by Iraq at the beginning of August 1990. Unlike in the case of earlier oil shocks, this one was over as rapidly as it began. However, what was for most countries a temporary shock was much more lasting for India, because of its dependence on Kuwaiti & Iraqi crude supplies including long-term supply contracts with the latter.

The effect of the oil price increase was therefore multiplied for India by a more permanent disruption of oil supplies from Iraq imposing a heavy price on the Indian economy {Virmani 2001}. Due to the substantial presence of Indian migrants in these two countries the government banked on the inflow of foreign capital brought through workers' remittances. As a consequence of the war, the Indian economy suffered a temporary, but a substantial, decline in the inflow of the workers' remittances from these markets, thereby affecting the foreign reserves of the economy. Thirdly, and perhaps the most important reason, was the collapse of the Soviet Union. India and the Soviet Union shared close economic ties. The Indian economy was heavily dependent on the USSR for foreign capital inflows and Rupee (IRS) trade with the Soviet bloc was an important element of India's total trade in the eighties. Exports to Eastern Europe for example, constituted 22.1 percent of total exports in 1980 and 19.3 percent in 1989. Apart from that, a significant proportion of trade comprising imports of capital goods and defence equipment was financed by long-term trade credits {Virmani 2001}.

With the breakup of the Soviet Union, several mutual arrangements that the two countries shared, were terminated in 1990-91 giving rise to concerns (within India) about the future difficulty of trading with these markets. The breakdown of traditional arrangements also meant an interruption to the prearranged credit arrangements and a consequent increase in the net repayment on the debt account for India. More importantly, the collapse of the world's leading centrally planned economy undermined India's faith in central planning. For example, several perceptive observers-some in government (Jha 1980 and Dhar 1990), others independent academics (Bhagwati and Desai 1970, Bhagwati and

Srinivasan 1975) – had drawn attention to the fact that state controls on economic activity and inward orientation had cost India dearly in slow growth {Srinivasan 2003}. However, despite these concerns, the government had long ignored the importance of a market economy as well as the benefits of international trade and would have continued to do so had it not been for the collapse of India's major trading partner, the USSR. Equally important was China's spectacular growth after the 1978 reforms that had opened its planned economy to the rest of the world and allowed a greater role for markets. The rise of China was a clear example of the benefits that a market economy could bring and could not be ignored by India.

Hence, the fear of "being left behind" by China led Indian policymakers to realise that this crisis, unlike earlier ones, could not be handled without bringing about radical changes in the existing policy regime. Apart from the external turmoil, India also faced severe problems with its own political system as well. Frequent changes in the central government towards the end of 1980's – early 1990's, created political uncertainty and eroded confidence in the government's ability to manage the economy and maintain stable economic policies. Thus, a combination of domestic and external factors triggered a balance of payments crisis in 1990-91.

6.2 Chapter Summary

The points discussed above presented a brief analysis of the state of the Indian economy prior to 1990. As seen the basic aim of the governments prior to 1990 was to encourage self-sufficiency and bring about an overall development within the economy. In order to achieve this the government, following the footsteps of China and former USSR, established policies that restricted foreign businesses from entering the market, giving rise to inefficiency and stifling the growth of local businesses. Although there was deregulation within the economy particularly in the late 1970's and early 1980's, it was piece-meal in nature. Thus the regulated structure of the market saw the economic performance deteriorate over four decades (1950-1990) and later plunged the economy into a balance of payment crisis in 1990-91.

The crisis of 1990-91, and the spectacular rise of China, saw the newly elected government embark upon a reform programme that set India on the path of growth and development. The areas addressed through the reforms saw the deregulation and privatisation of key sectors deemed to be critical for the prosperity of the Indian economy. Thus, the following chapter presents a brief analysis of the reforms that brought unprecedented growth to the Indian economy and highlights the impact that the reforms have had on the economy.

Chapter 7: Economic Reforms

The new government that took office in June 1991 (Congress) realised that the situation in India was in need of drastic restructuring. The severe economic crisis gave the government an opportunity to undertake major policy reforms, which would eliminate the long-standing restrictive domestic investment and international trade policies. Prior to 1991, the government and the policy makers had been quite resistant to change and intended to maintain the status quo. However, the crisis was suggestive of the fact that the policies had failed to generate the desired economic growth and hence; the new government committed itself to a programme of structural reforms that would set India on the path of growth and development.

To being with the government aimed to reduce inflation and the fiscal deficit with the primary intention to stabilise the economy. Following this, the authorities then took a systematic approach to liberalise the economy and introduced a reform programme to revive and develop the economy. Under the reforms, India gradually abandoned the use of quantitative controls in economic management in favour of market-based instruments. There was a decisive move away from inward orientation and toward greater integration with the global economy. To achieve this, the government dismantled the quantitative restrictions and licenses that had previously governed the functioning of businesses in India. For example, India's industrial environment prior to the reforms was characterised by persuasive government controls on private investment, which had prevented entrepreneurs from responding quickly and flexibly to market signals, thereby reducing their efficiency. {Sachs 1999}

Reducing these controls was essential to create a more competitive industrial environment and this part of the reform enjoyed wide political and business support. As a result, of this liberalisation, domestic and foreign private investment flowed into the economy and businesses started to focus on the development of areas such as steel, telecommunication services and equipment, electricity generation, petroleum exploration development and refining, coal and mining, and air transport, sectors that had been controlled by the government prior to reforms. Moreover, the government also aimed to boost trade by lowering the import duties that had controlled the flow of goods into the country. Prior to 1991, the import duties levied on various categories of goods were amongst the highest in the world with duty rates in excess of 200 percent being common, making it difficult for domestic businesses to function efficiently.

In order to allow flow of goods and services into the market, the government aimed reduce these duties. To achieve this import tariffs on all goods (intermediate, capital and consumer goods) were progressively reduced to 35.5 percent (simple average) and 29.8 cent (import-weighted basis) by 1999. {OECD 2007} Furthermore, in order to stabilise currency fluctuations in the market the government introduced a dual exchange rate system in March 1992. This system was unified shortly after in March 1993 and the rupee was floated in the market. {Montek 2002} This move helped Indian industries compete more effectively with the imports that entered the domestic market due to trade liberalisation. The flexible exchange rate regime also worked reasonably well, as it responded well to fluctuations in market conditions rather than government intervention,

making it easier for capital flows. Other than dismantling trade restrictions, the other main aim of the government at the time was to attract foreign investments into India. Thus, the reforms involved a drastic re-orientation of foreign investment policy. The government actively sought to attract foreign investment into India as these investments were not only seen as a preferred means of financing the balance of payments deficits (compared to external borrowing), but also because they would provide an access for Indian businesses to closely held technology through global linkages.

Foreign investment was now perceived as a source of scarce capital, technology and managerial skills, aspects that were considered necessary in an open, competitive, world economy. The process of approving (inward) FDI for instance, was expedited by providing a window of automatic approval (more commonly known as the "automatic route") of FDI inflows of up to 51 percent in a defined list of forty-eight industries and up to 74 percent for nine high priority industries. {Montek 2002} To facilitate foreign investments, the government established an inter-ministerial body called the Foreign Investment Promotion Board (FIPB). The board helped negotiate terms between Indian business houses and potential foreign investors, to form collaborations between the two companies. These collaborations helped the domestic businesses attain access to capital, technology as well as access to international markets.

Apart from liberalising the market for foreign investments, the government also made efforts to streamline the local finance and capital markets. Prudential norms and standards relating to providing adequate capital to businesses were set up that supported the businesses in borrowing funds within the domestic market. For example, the deposit and lending rates were deregulated and were allowed to be determined by market conditions rather than by government officials. This deregulation made it easy to gain financial assistance to fund operations for both local and potential foreign investors within the market. {Sachs 1999}

Thus, the reforms introduced more transparency in the process of accessing capital and financial dealings within the market, making it easier for all businesses to function within India. Additionally, the government also opened investment opportunities for private businesses within the public sector and infrastructure. This was done with the aim to turn loss making government subsidiaries/sectors over to private investors with the hope of generating large revenues, and consequently develop these subsidiaries/sectors. Although the reforms in these two sectors have a long way to go, post-reform governments, have come to realise the importance of privatisation and the role that businesses play in the development of the economy.

7.1 Chapter Summary

As discussed above the main intention of these reforms was to deregulate India and develop it into an economy that was guided by market forces rather than government intervention. By excessively regulating the economy, the government had stifled competition, which in turn had reduced allocative as well as technical efficiency of local firms within the market. Quantitative restrictions meant that the firms were not forced to achieve economies of scale and maintain efficiency in their operations. As discussed above an example of this could be seen in manufacturing where licenses and import tariffs were used to protect local firms from competition, leading to misallocation of resources and allowing firms to function well below international standards.

The main aim of the reforms was to open the market to foreign investment thereby intensifying competition, which would in turn pressurise local firms to be more efficient and bring in much-needed foreign capital reserves. Hence, having presented the reforms the next chapter highlights the impact these reforms have had on the Indian economy, and discusses the developments that have occurred in the Indian market with a focus on Manufacturing, Inward FDI and Services sectors in particular.

Chapter 8: Significance of India: An Emerging Market

The reforms initiated by the government in 1991 liberalised India with the aim of integrating the Indian market with the world economy. India's economy has doubled in real terms since reforms began in 1991, and shows little sign of slowing down. For example, according to the World Trade Organisation (WTO), India has grown at the rate of 8-to-9 percent annually during 2003-04 to 2006-07. {India 2008} This contrasts to annual growth of GDP per capita of just 1¼ percent in the three decades from 1950 to 1980. The broad commitment to the reforms by various governments (both Bharatiya Janta Party [BJP] and Congress) over the years has brought India unprecedented growth. The momentum behind the reforms is irreversible for it is driven by a collective belief that India must have a strong economy to improve its standard of living, to be taken seriously by the world, and, not least, to keep pace with neighbouring China.

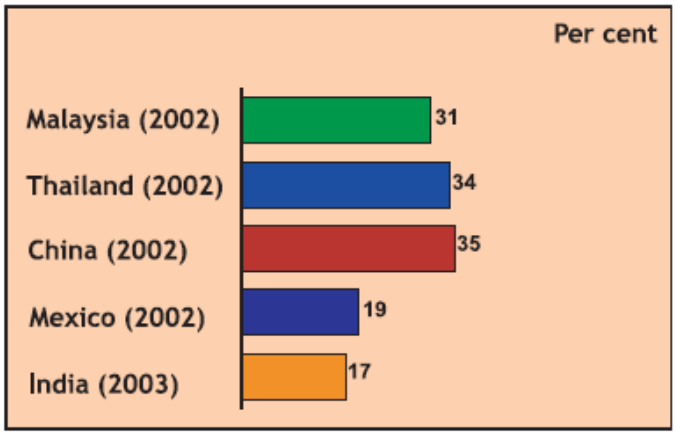
Interest in emerging economies (in this case India) is not driven by the geographic size of these economies but by the growth rates and potential, they hold. One of the most influential sources for example, regarding the growth and significance of India has been the Goldman Sachs Report (Wilson and Purushotam 2003) that examines the future growth trends of four major emerging economies, Brazil, Russia, India, and China (the BRICs) {Enderwick 2007}. According to the report, if current momentum of growth continues India's economy would be larger than that of Japan by 2032, and China would overtake the US by 2041. This means that the three largest economies by 2050 would

China, the US and India. The report also states that India stands to command a bigger share in the world economy in the coming years. For example, it states that India has the potential to show the fastest growth over the next 50 years. To sustain current trends the Indian market has to grow by more than 5 percent over the next 30 years and close to 6 percent as late as 2050. Owing to this, it is anticipated that the economy will grow to become a US $26 trillion market; the third largest economy in the world, fifty times bigger than it currently is. Hence, the potential impact that India has, and will likely have on investors and the world economy, is significant. {Sachs 2007}

In addition, due to change in the economic structure, India's growing consumer market, already in the top ten, could reach $400 billion by 2010-making it one of the five largest markets in the world. Also is the fact, that during the next few decades, as India (likely) surpasses China as the world's most populous country, companies seeking faster growth must begin to focus on the subcontinent. As consumer incomes rise this will translate into a growth in demand for various commodities, consequently companies offering diverse products and services will see a very strong hike in the coming years. Due to this the main product categories that have seen a steady growth in demand consist of FMGC products, consumer durables, and packaged goods. {Zainulbhai 2005}

Apart from this, an indicator of the growth that has occurred is the performance of individual sectors that support the view that changes in government policies has boosted

growth. Hence, an analysis of the key areas also helps understand the significance of these sectors and their contribution towards India's overall development over the years. The growth and development as discussed above has been fuelled by two key sectors: **Manufacturing and Services.** Although the growth within manufacturing sector is not as significant when compared to the services sector, it is an area critical for India's growth. Owing to vast untapped potential, various governments have placed emphasis on the growth of industry. However, the share of manufacturing has been stagnating at a low level for over two decades. One of the major reasons for the reduced contribution by manufacturing has been the inability of the country to build and maintain competitiveness needed to meet the global challenges as well as to develop a larger domestic market through low cost production. This becomes evident when a structural comparison of the Indian manufacturing sector's contribution towards GDP is contrasted with other countries. For example, as seen in the figure (8.1) below, when compared to Asian and the Mexican economies the share of manufacturing (towards GDP) is the lowest at 17 percent (this share stands at 20 percent as of 2006-07).



Source: 2004 World Development Indicators

Figure -2: Share of manufacturing in GDP

{Source: NMCC 2006} ***Figure 8.1***

Although there have been periods of growth within this sector, they have been short-lived. For example, the sector was able to achieve a creditable growth rate of around 9-to-10 percent, between 1988-91, 1993-97 and again in 2003-2005. {Source: NMCC 2006} As seen in the example, over the last two decades, the manufacturing sector has been able to achieve little stability in its growth as a sector. This suggests that the negative impact of protection given to Indian industry through the aegis of licensing until 1991 still prevails.

As discussed in the earlier section, **(Background of Indian Economy)** India had followed an inward orientated, heavy industrialisation strategy with the aim of self-reliance. However, this strategy stifled the growth of the sector rather that enabling it. Due to of lack of competition and restriction on imports, any growth was accompanied by widespread technological lags and inefficiencies. The sector also suffered from a number of policy-induced constraints. Thus, the trade and industrial regime followed by India unfortunately has resulted in a situation where the Indian manufacturing sector lost its position as the leading exporter of manufactured goods in the developing world, despite the reforms. India (particularly in the manufacturing sector) has been largely bypassed by the development that has taken place in other emerging markets in particular, China. For example, the manufacturing sector in India has annually grown only at an average of 7 percent as against over 12 percent in China. {NMCC 2006}

The level of FDI inflows attracted by the sector is also low. FDI brings better technology and management, access to marketing networks and offers competition, the latter helping Indian companies improve. However, the FDI inflow figures stood at $8 billion in 2005, as against China's $53.51 billion. {NMCC 2006} India has under-performed and there is a need to attract FDI within manufacturing as it is a catalysing factor for the sector's growth. In addition, although the government has introduced Special Economic Zones (SEZ) with the aim to foster development within manufacturing the approach has been selective, and until recently has been slow. The slow development of existing SEZs led the government to introduce a new policy at the beginning of 2006. The previous policy, while giving considerable tax advantages, has not overcome the administrative barriers faced by businesses nor did it overcome the infrastructure barriers, notably for road and electricity. The new policy now relies on private developers to create the zone and provide infrastructure facilities with the objective of generating additional economic activity.

Even though the manufacturing sector has not achieved the outcomes as desired by the government the fact the sector was able to grow at 9-to- 10 percent in three spells of three to four years in the past two decades indicates its growth potential. Hence, with appropriate policies and renewed efforts at attracting FDI it may be possible for the manufacturing sector to achieve higher growth rates in the coming years. Unlike manufacturing, the services sector within India has shown tremendous growth in the post reform period and the contribution of the services sector to GDP is the largest in the

Indian economy today. Technological advancements taking place in the field of information and communication technology (ICT) have played a major role in transforming and accelerating the growth of the services sector. As seen, in the table (8.2) the share of the services sector stood at 41.9 percent (1991-92) and 51.1 percent (2003-04) respectively as against the Industry and Agriculture sector. This share has moved up to 60 percent in 2007. {NMCC 2006}

Sector	Industry	Agriculture	Services
1991-92	26.7%	31.3%	41.9%
2003-04	26.8%	22.1%	51.1%

Table 8.2

This can be seen in the figure below (8.3) which shows the share of the services sector towards the GDP in the economy.

Figure 8.3

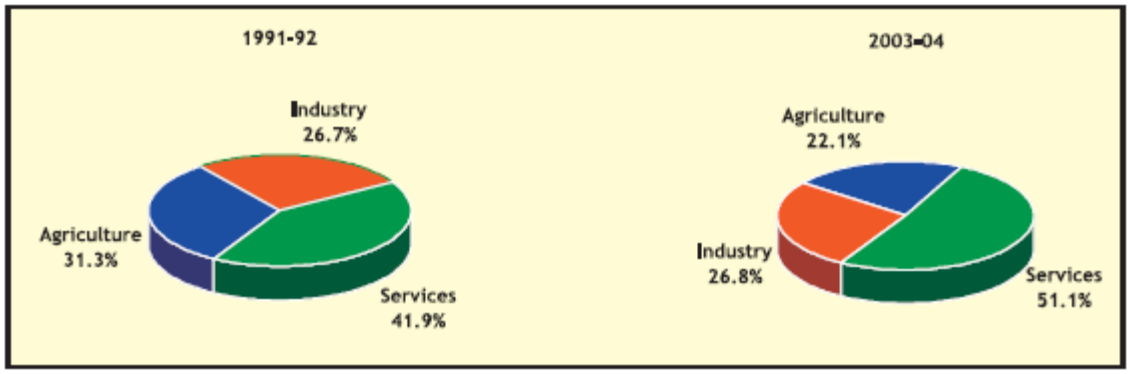


Figure -1: Share of Agriculture, Industry and Services in GDP

In general, development of the services sector occurs after developments in agriculture and manufacturing. In India's case, the reverse has occurred. The fact that the industry has continually lost ground to services – is because unlike China, due to constraints of regulation and poor infrastructure, India has followed on a services based model for its

growth and development. This is a marked difference to the more traditional manufacturing led path pursued by China. The two main reasons for India's choice of development path are:

- The services sector is less constrained by India's weaknesses- a low level of savings, bureaucratic regulation, limited amount of inward FDI (in relation to the size of its economy) and inefficient infrastructure.
- India's strengths in education, particularly tertiary-level, technical skills, widespread usage of English, and IT competency all facilitate the development of internationally traded services {Enderwick 2007}.

Technical developments and the opening of once protected services industries, means that this model may offer an increasingly feasible base for national development. It is not only low-skilled service tasks like call centres, remote data entry and data processing that are internationally tradeable, but also increasingly professional services, business processes, most recently, research, and development work is being relocated to India. (UNCTAD 2005) {Enderwick 2007} In addition, services tend to be less dependent on large-scale investments, and so are less subject to investment related regulatory hurdles. Also, transport and logistics shortcomings (a major concern in India) do not hinder the operations of this sector; as a result this sector has enjoyed striking growth over the last decade and half.

Strong growth in foreign demand, deregulation, liberalisation of foreign investment and greater private sector participation since 1991 has increased industry outsourcing as well as the demand for a range of services, have been among the key factors driving high growth in India's services sector (Gordon and Gupta 2004) {Walters 2007}. Furthermore, the fast growing Indian services market offers considerable potential for foreign investors as a reflection international demand for services, FDI in India's services has grown strongly over the recent years. Business and computer services have been the main sectors that have attracted substantial FDI investments. This is not surprising as these sectors have not been subjected to significant regulation and have been deregulated to face competition since 1991.

Besides this, with the liberalisation the services sector has experienced a prominent development in the trade of services. For example, India's services trade has grown at a phenomenal rate in recent times reflecting strong growth in foreign demand, particularly for IT–ITES. Exports over the last ten years have grown at an annual growth rate of 20 percent and total services were valued at US$60.6 billion, (2005-06) up over 40 percent on their 2004–05 value. (RBI 2006a) {Walters 2007} Around 85 percent of the growth in services exports is attributable to growth in commercial services excluding transportation and travel. Services imports also have demonstrated a similar pattern of strong growth, reflecting the two-way nature of trade opportunities generated by growth in the commercial services sector. For example, between 2003–04 and 2005–06, total services imports doubled to US$38.3 billion. Imports of commercial services excluding

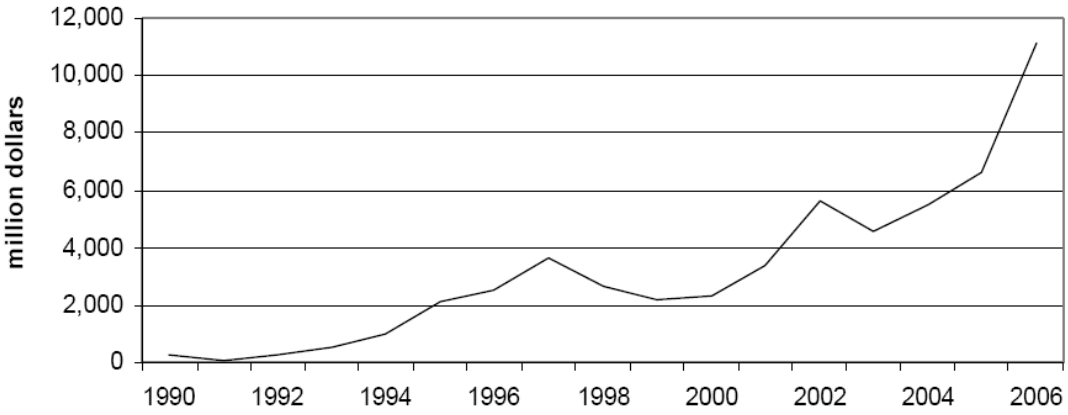
transportation and travel accounted for some 60 percent of the total growth in services imports in 2005–06 (RBI 2006a). {Walters 2007} Technological developments have been the key enabler of the rapid development in commercial services trade.

Specifically, investment and rapid technological advancements in telecommunications and information technology are driving reductions to the cost of digitising, transmitting and processing information, thereby enabling an ever-increasing number of services to be undertaken remotely by specialist providers. Additionally, India, with its large cohort of engineering graduates and widespread English language skills, has been a particular beneficiary of this services tradability revolution. In addition, in order to further boost the development within this sector the government has established Software Technology Parks, which provide incentives as well as a support framework to the companies that operate in this sector (details of this will be discussed in the opportunities section). The brief analysis presented above suggests that the liberalisation of the economy has brought about substantial development within the services sector (ITS and ITC in particular).

Although the growth amongst various areas within services is not uniform and critical services like transportation, retail and logistics to name a few, need to be developed, the development experienced by India due to this sector in particular is worth noting. In addition to these developments, the Indian market has also seen a substantial flow of inward FDI post 1991. India's liberalisation of its foreign investment regulations for

instance, has generated strong interest by foreign investors, turning India into one of the fastest growing destinations for global foreign direct investment (FDI) inflows. As seen the figure below (8.4) inward FDI in India, for example, was valued at $4.7 billion in the 2005–06, and have more than tripled, to $15.7 billion, in the 2006–07.

Figure 2-1 FDI inflows to India, 1990–2006



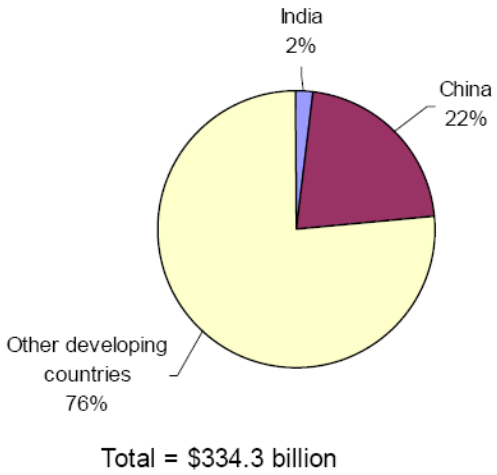
Source: UNCTAD, Country Fact Sheet, UNCTAD online database and Government of India, Ministry of Commerce & Industry, Department of Industrial Policy and Promotion, *FDI Statistics* 2006.

Source :{ Bloodgood 2007}

Figure 8.4

Although the value of inward FDI flows to India relative to all developing countries remains small, (as seen in the figure 8.5 below), however, due to the sudden surge of investments experienced in the last two years, in particular, FDI inflows to India surpassed inflows to South Korea in 2006. This has made India the fourth largest destination for FDI in Asia, behind China, Hong Kong, and Singapore.

Figure 2-2 FDI inflows to developing countries, 2005

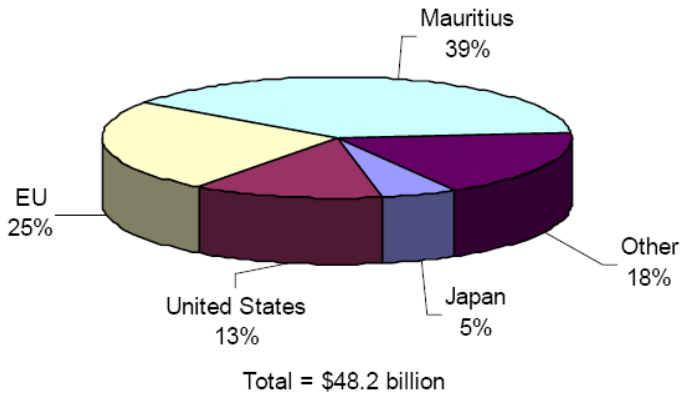


Source: UNCTAD, Country Fact Sheet.

Source :{ Bloodgood 2007} ***Figure 8.5***

The major source of FDI flowing into the country comes predominantly from four countries: Mauritius (39 percent), EU (25 percent), [with UK being the primary investor from this region] US (13 percent) and Japan (5 percent) as seen below in figure 8.6. As seen the in figure below major flow of FDI investment is by Mauritius at 39 percent. It is unlikely, given the small size of the Mauritian economy that much of the capital destined for India originates in Mauritius. The possible reason behind this is that many companies based outside of India utilise Mauritian holding companies to take advantage of the India-Mauritius Double Taxation Avoidance Agreement (DTAA). The DTAA allows foreign firms to bypass Indian capital gains taxes, and may allow some India-based firms to avoid paying certain taxes through a process known as “round tripping.” {NMCC 2006} Other countries that have shown significant interest in India over the last few years have been Switzerland, France, Netherlands, South Korea, and Singapore. {Bloodgood 2007}

Figure 2-7 Share of top investing countries, cumulative FDI equity inflows, August 1991–December 2006

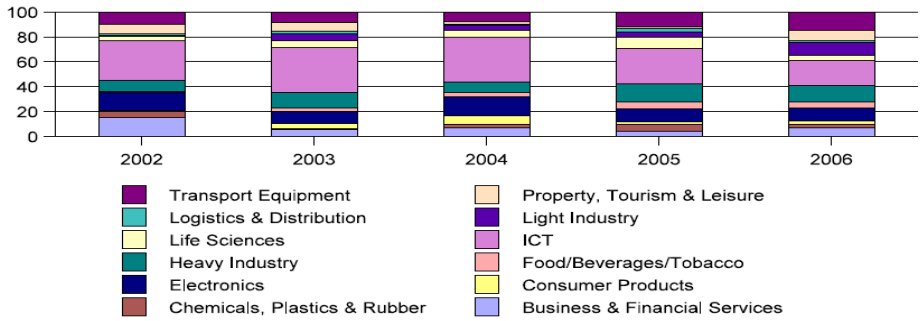


Source: Compiled from Department of Industrial Policy and Promotion, Fact Sheet on Foreign Direct Investment.

Source :{ Bloodgood 2007} ***Figure 8.6***

The investments made by these countries as seen in the graph below, stream chiefly into services such as computer software, telecommunications, financial services, and tourism, and manufactured goods including, chemicals, pharmaceuticals, and food processing to mention a few. Apart from these sectors as exhibited in the figure 8.7 transportation equipment, heavy and light industries have also seen a rise in the level of investments.

Figure 2-13 Cluster shares of total projects, annually, 2002–06



Source: OCO Consulting Ltd., *LocoMonitor FDI database*.

Source :{ Bloodgood 2007} ***Figure 8.7***

Owing to these developments, businesses around the world have come to note the favourable conditions in the Indian economy and the importance of India to their global operations. Nokia, for example, a leading Finnish producer of mobile technology, in an announcement concerning its choice of Chennai, (India) as a new global network solutions centre site, noted the robust nature of the Indian market and stated that establishing operations in India was an imperative step to help further develop the firm's global network. Caterpillar Inc (a U.S.-based organisation) a global producer of construction and mining equipment, diesel and natural gas engines, and industrial gas turbines, is another example of a company seeking to expand its operations in India. The company has recently increased its investment in India to serve growing Indian demand for its products and services, particularly in the areas of infrastructure and earthmoving equipments, working effectively in India through Public Private Partnership (PPP) to aid the development of key support frameworks within the infrastructure sector. {India 2006}

In addition, to further attract FDI, the government also offers various incentives to businesses that seek to operate in India, mainly through greenfield projects. For example, in order to promote and facilitate the development of manufacturing apart from establishing SEZ's the government also provides investment incentives to businesses who seek to conduct operations outside the SEZ's. These are generally designed to channel FDI to specific industries, and promote development of critical sectors. This is

particularly true for companies wanting to invest in the development of infrastructure facilities.

For instance, in addition to liberalising ownership equity caps, there are a number of tax incentives for foreign firms to invest in infrastructure, including 10-year tax holidays and allowance of 50 percent profit retention generated during operations in the country. (Details of this will be discussed in the section outlining the opportunities within India). Furthermore, the FDI approval process has also been shortened and simplified through the implementation of the automatic route for approval in a range of industries. Thus the measures taken by the government, along with the continued liberalization of caps on foreign firms' ownership equity in most industries, have contributed to the recent steep increases of FDI in India.

8.1 Chapter Summary

Considering the points stated in this chapter, it could be suggested that the trade liberalisation initiated through the reforms, has opened the Indian market with a promise of vast opportunities to businesses around the world. Hence, most businesses that were slow in recognising China's potential upon opening are flocking to India out of the fear of missing one of the last great growth stories. The significance of India as a market is imperative, particularly for New Zealand businesses, as India becomes more integrated into the world economy it is critical that New Zealand businesses recognise the prospect and the potential that this market holds. The developments discussed above are bound to have a significant impact on the level of growth and competition of businesses in the international market and hence may increasingly influence New Zealand's exporting and investing performance.

Given the importance of meaningful international engagement, New Zealand firms cannot afford to ignore the opportunities presented by India today. In view of this the next section thus presents possible avenues that New Zealand businesses could consider to enter the Indian market. The section first discusses the trade relations that New Zealand and India share. It then moves on to discuss the opportunities that could be of potential interest to New Zealand businesses while considering operations in India. Amongst others, this section particularly analyses Information Technology, Biotechnology, Food Processing and Infrastructure sectors and the competitive advantage that New Zealand businesses have within these areas.

Chapter 9: Opportunities in India

In recent years the view of India, as an economic partner has undergone a change in New Zealand. This change, as discussed earlier has been driven largely by the dramatic rise of India, its rapid growth and growing influence both regionally as well as internationally. Increasingly New Zealand sees economic relations with India as a priority. This can be seen in the trade flows between the two countries. New Zealand's trade with India has grown from a very low base of NZ$1.3million in 1970 to NZ$232 million in 2005. However in contrast, trade flows between Australia and India are significantly high. For instance, in 2005 Australian exports to India were AUD$7.0 billion, making India, Australia's sixth largest market. For New Zealand, India was the 24th most important market in 2005, with this position having remained fairly static over recent years. {Asia Foundation 2006}

In addition, tables (9.1 and 9.2) below summarise the trade relations between the Indian and New Zealand economies in the last few years.

Table 9.1

Table 12A: New Zealand's Exports & Imports: Total and to India (NZ $ million)

Year	Exports to India	Total	Share (%)	Imports from India	Total	Share (%)
2000	175	29257	**0.597**		30,736	
2001	165	32670	**0.505**		31,682	
2002	192	31034	**0.619**	192	32,337	**0.5937**
2003	157	28397	**0.553**	181	31,782	**0.5695**
2004	196	30712	**0.638**	203	34,905	**0.5816**

Table 12B: India's Exports and Imports: Total and to and from New Zealand (US $ million)						
Year	Exports to New Zealand	Total	**Share (%)**	Imports from New Zealand	Total	**Share (%)**
1999/2000	64.35	36,822	**0.17**	96.5	49,738	**0.19**
2000/1	63.28	44,560	**0.14**	79.3	50,536	**0.16**
2001/2	62.21	43,827	**0.14**	82.2	51,413	**0.16**
2002/3	67.7	52,719	**0.13**	76.4	61,412	**0.12**
2003/4	85.97	63,843	**0.13**	78.9	78,150	**0.10**
Source: DGCIS(2005)						

Table 9.2

Trade relations between the two economies have not been very significant in recent times, as the outlined in the tables above. India's share of New Zealand's exports or New Zealand's share of Indian exports and imports has been less than 1 percent in the last few years {Ashra 2006}.

India

June 2007 bilateral trade with New Zealand

New Zealand exports to India: June years (NZ$000 FOB)

Code	Description	2005	2006	2007(P)	% Change
5101	Wool	57,413	57,962	57,003	-2
4403	Logs	24,148	43,318	49,048	13
0405	Butter	0	5,186	16,112	211
7602	Aluminium; waste and scrap	2,773	4,284	15,406	260
4105	Sheep skin leather	8,374	8,317	10,336	24
7204	Ferrous waste and scrap	604	3,524	6,578	87
1702	Sugars	1,189	1,312	5,428	314
8474	Machinery for sorting, etc	1,501	3,594	5,350	49
4707	Waste and scrap of paper and paperboard	1,989	3,499	5,311	52
4407	Timber	17	36	4,614	12,764
4411	Fibreboard	1,213	3,474	3,703	7
8412	Engines and motors	10	624	3,613	479
0808	Apples	2,063	2,867	3,606	26
8414	Air or vacuum pumps	776	2,103	3,460	65
4102	Raw skins, sheep	1,355	1,404	3,061	118
8462	Machine-tools; for bending etc	0	1,381	2,664	93
4101	Raw hides and skins	3,953	4,206	2,472	-41
1502	Fats of animals	1,246	1,587	2,228	40
4705	Wood pulp	0	1,538	2,140	39
8473	Machinery; parts	105	735	1,850	152
	Top 20 subtotal	**108,729**	**150,951**	**203,983**	**35**
	NZ's total exports to India	197,606	311,578	362,122	16
	Top 20 as % of total exports to India	55	48	56	

Table 5.28b

{Statistics 2007} ***Table9.3***

India's trade seems to be more diversified than New Zealand – which is more specialised. For example, the top 5 commodities account for more than 50% of New Zealand exports to India whereas the top 5 of India's exports to New Zealand account for only around 20% of India's total exports to New Zealand. To some extent, this is akin to what standard trade theory would suggest considering the size of the two economies. For instance, as seen in table 9.3 above New Zealand exports to India are mainly agricultural and forestry based. More than 40 percent of the exports from New Zealand to India have been wood and wool products in the last decade and a half.

Wood has emerged as an important category of exports after 1996, whereas wool products have been an important part of New Zealand exports to India since the early 1990's. However, the share of wool exports has seen a steady decline in the recent years. The other import export categories are machinery and electrical equipment {Ashra 2006}. Although trade activities between the two countries are relatively stagnant, New Zealand businesses have come to recognise the potential that India holds as a market, more so, after 2004-05. For example, in terms of dollar value overall exports from New Zealand grew from under $200 million in 2004 to $337 million in the 2006 calendar year making India the second fastest growing market for New Zealand – though this is from a low base. India is increasingly becoming an important market for New Zealand especially with regard to IT software, defence, security and telecommunication equipment. India has developed world-class status in the information technology industries.

In areas relating to information technology, the scope for outsourcing R&D (research and development) holds great potential for New Zealand investors {NZTE, 2006 #82}{Asia Foundation, 2006 #81}. Besides IT, India is also investing substantially in the creation of excellent capability in the areas of biotechnology and biomedicine, an area of potential interest for New Zealand businesses. The opportunity for New Zealand companies has to be considered in the light of these sectors that stand to offer long-term opportunity, where price points are acceptable, and where high-value solutions, rather than low-value components, are sought. Equally, India is also becoming increasingly important in the global value chains of major industries. There are few industries that are not represented at some level of the value chain in India. New Zealand companies appear to have considerable potential to tap into parts of these global value chains, positioning themselves as innovative suppliers at critical steps in the value-adding process.

There is also increasing opportunity for New Zealand companies to draw on the Indian market for subcontract manufacturing to support their global business, as local skills develop to the same world-class level as those already seen in software and computer programming. {NZTE, 2006 #82} The other major area that is of interest between the two markets is infrastructure development, where the Indian government values New Zealand companies' expertise. There are major road, aviation, energy, and rail projects underway in many cities. The aviation sector for example has four large international airports either under construction or in planning at Delhi, Mumbai, Bangalore & Hyderabad. This offers particularly promising opportunities for New Zealand, as expertise of New Zealand companies is well known and appropriate for these and other

Indian projects. Apart from this, other substantial areas of interest include apparel, timber, food processing, engineering, pharmaceuticals, and a range of technology services.

In many of these areas, skill levels in India are relatively less developed, but are likely to escalate with the inflow of foreign technology and expertise. Many argue that now is a good time for firms to be preparing for business in India, taking advantage of the country's receptiveness to foreign knowledge, technologies and services. The major opportunity for New Zealand companies in India thus appears to be in high-value niche areas across a range of product and service sectors. Hence, as India invests heavily in infrastructure, new manufacturing capacity and development of services, New Zealand companies have come to appreciate India as an increasingly attractive marketplace and it can be concluded that there is enormous potential for expanded trade and economic ties between the two countries. Considering this, the next section presents a detailed analysis of prospective sectors that could offer promising growth and returns for New Zealand businesses in the Indian market. The analysis presents the potential of Information Technology, Biotechnology, Food Processing and Infrastructure sectors.

9.1 Potential Prospects for New Zealand Businesses

As discussed earlier, the Indian market today presents various openings for businesses around the world (including New Zealand firms) in a range of sectors. However, the key sectors that have attracted significant interest from international investors are Information and Technology, Biotechnology, Food Processing and Infrastructure. The possible reason behind the interest within these sectors, in particular is due to the fact that although domestic firms in India have access to skills and capital, they at times lack the necessary know-how and innovation abilities critical for the successful development and growth of these sectors. Hence, although India has benefits of low cost production and size (as a market), the inability to innovate at world-class standards has motivated foreign investors to collaborate with Indian counterparts to fill potential gaps present in these sectors, to the benefit of both sides.

Thus, the section presents a brief analysis of the potential prospects of the key sectors as well analysis the skills and knowledge that New Zealand firms could bring to further enhance the development of these sectors in the Indian market.

Potential Sectors	Highlights	Companies India + New Zealand	New Zealand Competitive Advantage	Indian Advantage	Synergy	Mode of Entry
Information & Technology	One of the fastest growing sectors	CMC+QLB	Innovative performance measurement software product.	Access to a significant sales force and large customer base in India.	+	Collaboration
	Major growth propelled by exports		Distinctive capabilities to enhance the ability of firms to measure their performance.	The firm aims to provide consulting and back-up support to QLB.com for conducting operations in India.		
	Indian IT is seen as a preferred global partner		Ability to provide creative solutions tailored to CMC's requirements through world-class technology	Access to capital to help finance operations conducted by QLB.com both New Zealand and India.		
	Due to rapid developments the sector is attracting increasing attention from foreign investors		Software enables firms like CMC to capture data, analysis, reporting, and improve planning can be rapidly collated, shared, and implemented across entire communities of operators.	Immediate opportunities to promote the software with the TATA Group, an organisation that has 93 operating companies with a market capitalisation of US$ 47 billion.		
			Collaborations with QLB.com have allowed CMC to greatly enhance its capability and its methods of measuring the firm's performance.	Partnership with CMC has enabled QLB.com to leverage off the excellent reputation that CMC enjoys both in India and internationally.		
		CMC + Massey	The e-centre at Massey has specialist skills in evaluating technology companies and helping those companies develop their products for global markets, including India.	Initiative with CMC has allowed New Zealand IT firms (like Sonar 6 and SMX) to enter the Indian market. CMC acts as a channel to promote New Zealand's innovation in the field across different countries with India being their first market.	+	Collaboration
			Collaborating with Massey has allowed CMC to achieve a direct access into the New Zealand IT industry.	This relationship confirms the competitive solutions are being developed in New Zealand and opens third market opportunities through CMC.		

Table 9.1.1

Table 9.1.1

Potential Sectors	Highlights	Companies India + New Zealand	New Zealand Competitive Advantage	Indian Advantage	Synergy	Mode of Entry
Biotechnology	Biotech is one of the fastest developing sectors in India.					
	The Indian biotech industry today comprises of over 280 companies with six of those generating revenues of over US$ 22.7 million. The industry is set to touch US$45 billion in revenues by 2010. {IBEF, 2006#85}	Dr. Reddy + Auckland University	Collaboration between Auckland University and Dr. Reddy to test a Super-Drug called the "polypill". The project was led under the guidance of Professor Anthony Rodgers at University of Auckland, an institution that enjoys the reputation of being a world-leader in clinical trials.	Indian firms today aim at reducing cycle times in development and innovation of products, by accelerating clinical research and reducing bottlenecks associated with clinical data management and trials.	+	Collaboration
	Rising prominence of this field is making India a coveted partner for bilateral technical co-operation.		One notable aspect from New Zealand point of view is the clinical development expertise and global creditability that Professor Rodgers and his team have brought to this project.	On the other hand Dr. Reddy has helped in financing successful trials and the development of the drug.		
	The Indian biotech industry has an increasingly outward focus with the intention to fill in the gaps through transfer of knowledge/ skills and technology with the help of global partners.		The calibre of New Zealand investigators and clinicians in the field is high and New Zealand firms and research institutions offer expertise both in terms of ethics and regulatory standards, an aspect that Indian companies are keen to incorporate with their operations.	In order to support this venture the Health Research Council of New Zealand invested NZD$ 350,000 and Dr. Reddy aims to invest NZD$ 7.5 million to fund the clinical trials. {INZ, 2007#135]		
	New Zealand has signed a Memorandum of Understanding with India which will allow the two to share technical skills and knowledge to expand ties within this sector.		Indian firms like Dr. Reddy and Biocon, a leading Indian biotech firm realise that access to innovation within India is frugal, hence look for partners that can support their ventures.	Collaborating with Indian firms will create opportunities for New Zealand firms and research institutions to use low-cost services to develop and test products along the value chain.		

Table9.1.1

Potential Sectors	Highlights	Companies India + New Zealand	New Zealand Competitive Advantage	Indian Advantage	Synergy	Mode of Entry
Food Processing	Due to India's diverse agro-climatic conditions, India has a large base of raw-material base suitable for food-processing industries.					
	With the liberalisation, the sector has seen slow but a steady growth. Rapid urbanisation and rising per capita income have all caused a rapid growth and changes in demand patterns leading to tremendous growth of new opportunities for exploiting the large latent market.	Britannia+Fonterra	One of the fastest growing sectors amongst others in the food processing sector is the traditional dairy segment, an area where New Zealand firms have an advantage.	India's total dairy market at NZ$50 billion is one of the world's biggest and steady growth have opened up attractive opportunities for investment in the country's dairy industry.	+/-	Joint Venture
	The market is seeing a rapid rise in the number of domestic and international players entering the sector, with the hope of getting high returns.		Recognising the potential of the Indian dairy market, the New Zealand Milk consumer division of Fonterra entered the market by establishing a joint venture with Britannia Industries, a company that owns one of the strongest brands in India in 2001-02.	Alliance with Britannia has given Fonterra a strategic point of entry into a market that has huge potential and since then has helped Fonterra access a robust base of existing dairy business and local market knowledge.		
	Amongst other International firms, a few New Zealand firms have realised the potential this sector presents and have moved into the market.		Fonterra provides advanced technical knowledge and assistance, learning from other international markets & access to its R&D strengths to upgrade product quality reduce costs.	The combined strengths of the two today constitute a formidable force in meeting consumer needs and further developing a presence in the Indian dairy segment.		

		United Breweries + Index Distribution	Index Distribution, a Nelson based organisation has recognised the potential for New Zealand wines in the Indian market.	The number of New Zealand brands currently sold in the Indian market is limited making it easier for the company to introduce new brands to the Indian consumers.	+/-	Local Distributor
			The number of New Zealand brands currently sold in the Indian market is limited making it easier for the company to introduce new brands to the Indian consumers.	Although consumer awareness of wines is limited, consumers today are willing to try new products, making it the right place and time to introduce New Zealand wines.		Both the alliances mentioned here may have a positive spill-over effect. However, these alliances could face problems and competition if the Government of India goes ahead with the privatisation of the retail sector in India.
			Opportunities for investments in other sectors lie in various stages like packaging preservation of food with suitable refrigeration and thermo processing, quality control, canning, dairy plants, specialty processing, cold chain management system and research and development, areas where the Indian food processing industry is quite inefficient.	New Zealand firms specialising in the development of food processing equipments, machinery and technology could benefit by entering the Indian market as the government supports foreign investments by permitting full repatriation of profits and capital invested during the operations. Apart from this, businesses are also permitted to import or transfer technology without import duties.		

Table 9.1.1

Potential Sectors	Highlights	Companies India + New Zealand	New Zealand Competitive Advantage	Indian Advantage	Synergy	Mode of Entry
Infrastructure	The state of infrastructure in India has been of a major concern for both local and foreign businesses seeking to operate in the market.					
	According to the Government of India, investments of around US$320 billion are expected as a part of the 10th five year plan. {KPMG, 2006#102}	Beca Group	Beca Group supports road and highway developments by rendering consultancy services to their Indian counterparts & government authorities.		+	Collaboration with Indian businesses & government authorities.
	The creation of world class infrastructure would require large investments in addressing the deficits in both quantity and quantity. Emphasis on Public Private Partnership (PPP) to foster development in the area. Major emphasis on the development of roads & highways and airports.		New Zealand expertise in engineering consultancy and construction is highly regarded by Indian firms and government alike. New Zealand firms that seek to enter this sector could offer services ranging from project feasibility, quality control, & architectural expertise such as master planning, design, project implementation & management, services that are inefficient in India.	In order to support foreign investments in the area, the government has developed a streamlined regulatory framework. This move has made it easy for businesses to establish & conduct operations as well as increased the transparency of procedures. Special regulatory frameworks are been created to help address issues such as land acquisition & protection in case of default. These actions have been positively received by investors both foreign & local.		
	In order to improve existing road infrastructure the government plans to spend US$ 50 billion by 2011. {India, 2007#94}		Opportunities for technology transfer & supply of innovative materials, building & consultancy services offer possibilities to New Zealand firms.			

	In order to develop and modernise airports, the government has plans to privatise development activists within this sector. Due to rapid growth the airline services and related infrastructure is considerably strained.	Aviation NZ, Glidepath, Airways International	Aviation New Zealand, the apex industry body in the aviation sector in New Zealand, recently announced the commencement of its operations in India. {PRwire, 2008 #95} Aviation New Zealand aims to partner with Indian firms & authorities to leverage New Zealand's unparalleled expertise in the Indian aviation sector.	Policies are been developed which aim to standardise and simply the PPP transactions for airports & related amenities giving the needed transparency to the companies that seek to operate within this sector.	+	Possible alliances with Indian firms.
	With Greenfield projects (built from scratch on new undeveloped sites) underway amid most cities in India, the government expects this sector to receive a total investment of US$ 9 billion over the next 5 years.		Glidepath and Airways International have been early movers into the Indian market. Glidepath for instance offers services like baggage handling systems with the aim to further enhance the existing airport facilities in India. Similarly Airways International plans to offer commercial, operational and technical experience in Air Navigation Services (ANS).	In order to harness the enhancement of the existing airports the government permits FDI inflows of up to 100 percent. This is done with the intention to contract out activities to private investors to the advantage of firms like Glidepath & Airways International that specialise in rendering services to enhance the facilities within existing and new airports in India.		Possible alliances with local Indian businesses & authorities may help firms like Airways International achieve local market knowledge.
	To meet the development needs to of this sector, the government has undertaken major policy initiatives with the aim to attract foreign investments into the area. Considering the developments in this sector, New Zealand firms have realised the prospects these areas could provide.		Likewise New Zealand firms could offer expertise in other areas like designing, planning & implementing of air navigation systems, areas that have significant gaps in India.			

9.2 Analysis:

Table 9.1.1 presents a summary analysis of the potential prospects that the Indian market offers. The growth experienced by the sectors (as highlighted above) have seen a rapid rise in the number of foreign investors, including New Zealand businesses keen to tap in to the opportunities presented by these sectors in the Indian market. The possible reason for the rising New Zealand presence in the Indian market could be because New Zealand firms have a competitive advantage and can help bridge the potential gaps present in these sectors. As the size of most New Zealand firms is small, it is only natural that firms here tend to focus on innovation and creativity to create a niche for themselves. As discussed in the examples in the table, this aspect is recognised by Indian firms that are keen to incorporate the innovative abilities that New Zealand firms possess.

Indian firms today are keen to create global partnerships not only with the intention to expand their operations internationally, but also with the prospect of filling in gaps through transfer of knowledge/skills and technology across different areas. Considering this, New Zealand firms could capture potential opportunities that may benefit businesses on both sides. Although Indian firms can look to develop the requisite capabilities themselves, but it often makes sense for them to adapt to offerings from overseas markets like New Zealand. The innovative, market-focused product development services are typical of New Zealand capability to create a cost effective solutions that enable Indian companies to identify and create relationships with complimentary New Zealand companies.

Thus, drawing on the insights gained it can be suggested that there are two main commonalities observed in most cases outlined above:

- New Zealand Perspective: New Zealand firms have the skills/know-how and access to technology, however they may lack the market knowledge and necessary capital to fund operations in India.
- Indian Perspective: Indian businesses possess the local market knowledge as well as sufficient capital to fund operations however they may lack the necessary technical ability.

The examples discussed in the table suggest that collaborative arrangements can help develop win-win relationships between Indian and New Zealand companies so that each can leverage the others competitive advantage. Examples such as CMC and QLB.com/ Fonterra and Britannia suggest that in many respects opportunities for New Zealand businesses will come in the form of co-operation and collaboration, enabling each partner to specialise in its strengths and augment its capabilities in other areas. Apart from this, such collaborations could give New Zealand firms direct access to other third markets across the world, which may not be possible without Indian support. In addition, as succeeding in the Indian market requires long-term engagement, alliances with local firms could help New Zealand firms establish and maintain their presence in the market.

The examples discussed in this section suggest that a few New Zealand firms have been early in recognising the significance of the Indian market and have moved into the market with the hope to benefit from the prospects offered. However, these companies may not be typical of all New Zealand firms. The companies analysed here may be larger than average for all New Zealand based firms, hence may have access to the necessary knowledge as well as the capital required to fund operations in India. Hence, it can be suggested that most New Zealand businesses considering operations in India may not have the required knowledge as well as may lack the necessary finance to venture into the Indian market. In making progress to answer this issue further analysis in the area would be necessary to gain helpful insights into the nature of operations of New Zealand firms and their ability to venture into a market like India.

9.3 Chapter Summary

The points discussed in this section suggest that the Indian market today presents substantial opportunities across a range of sectors, and New Zealand businesses do have a comparative as well as a competitive advantage in these areas, which makes them perfectly positioned to tap into these prospects. As analysed in this chapter, apart from the other sectors, the sectors that could be of potential interest to New Zealand businesses considering operations in India, are IT, Biotechnology, Food Processing and Infrastructure development. The key reason for this is the fact that New Zealand expertise in these areas is well regarded and considered by Indian businesses. Also as discussed in the examples in the chapter, it is evident that there are a few New Zealand businesses that have already recognised the potential that the Indian market holds and are actively pursuing operations with the help of Indian partners.

This suggests that New Zealand businesses could enter the fast growing sub-continent, not only in the sectors outlined in this chapter, but also in other areas that may present significant opportunities to enter the Indian market. Hence, having considered the potential prospects that may be of interest to New Zealand businesses in the Indian market, the following section discusses the possible entry modes that New Zealand businesses could regard while seeking to conduct operations in India.

Chapter 10: Investing in India: Entry Modes

The mode of entry is a fundamental decision that a firm makes when it enters a new market because the choice of entry automatically influences the marketing and production strategy of the firm. The mode of entry also affects how a firm faces the challenges of entering a new country and deploying new skills to successfully market its product/services. (Gillespie, Jeannet and Hennessy 2007) {Johnson 2007} Entry mode selection is also contingent on several-firm specific traits. First, a firm's resource possession in internationalisation will influence its ability to explore market potential and help the firm gain a competitive advantage in that market. A firm without distinctive resources (technological, operational and financial) but willing to share these risks may consider a joint operation method.

In the case of New Zealand firms, although New Zealand businesses do possess distinctive technological and operational resources, they may lack the ability to finance their operations and hence may not be able to scale up their operations to meet the demand in a market like India. Second, the risk of leakage of technologies may affect the entry mode that a business chooses. If the risk associated is high a wholly owned subsidiary or exporting mode of operation increases the firm's ability to use and protect these technologies. Third, a firm's strategic goals for international expansion are one of the foremost determinants underlying entry mode selection.

When a business attempts to pursue market expansion entry modes like a partnership, alliance or umbrella companies may be better. The reason a company may pursue either of the modes mentioned above, is because these modes enable a firm to have a deeper understanding of the local market requirements and its practises. However, if a business aims to exploit factor endowment advantages, low commitment entry modes such as sub-contracting, trade, co-production, cooperative arrangements may be better, than other options because risks and costs are low. Nevertheless, the strategy may not be market focused.

Finally, international or host country experience is also crucial in determining the choice of mode. Businesses with little or no experience in the international environment and/or/ the host country, may prefer low control and resource commitment entry modes such as export, sub contracting, leasing, franchising or countertrade. In contrast businesses with significant international experience normally prefer intermediate control and resource commitment entry modes such as alliances and collaborations to enter the market. However, this aspect does not hold to be true for all businesses in particular small businesses. For example, although most New Zealand businesses move to serve offshore markets they however, do not always enter those markets with alliances but more so by simply exporting their products to overseas markets. Also the interaction of most New Zealand businesses is limited to certain international markets mainly markets that are geographically and/or culturally similar.

Thus, New Zealand businesses do interact at an international level, their exposure is limited as the costs and risks associated with doing business internationally are high and most often if not most businesses lack the capital needed to operate in distant markets. Whilst, the points presented above hold to be true for any foreign market that a business considers, the choice of entry becomes particularly important for emerging markets like India as these markets are quite diverse and volatile at times making it necessary for businesses to evaluate the mode of entry in accordance with their business needs. Considering the points discussed above the next sub-section analyses three possible entry modes that New Zealand businesses could consider while seeking to conduct operations in the Indian market and relates those to the characteristics of New Zealand businesses.

10.1 Investment Vehicles for New Zealand Investors

10.1.1 Alliances/Collaboration:

An alliance is an agreement of collaboration between a firm in the home market (New Zealand) with a firm located in a host nation (India) to share activities in the host nation. This entry mode would best suit the requirements of New Zealand businesses seeking to conduct operations in the Indian market. As discussed in the previous chapter **(Opportunities for New Zealand businesses)** examples of alliances and collaborations between New Zealand and Indian businesses were found in the areas of Information Technology, Biotechnology, as well as Food Processing. One of the major reasons for the use of this entry mode is perhaps due to the fact that most New Zealand businesses discussed in the examples (excluding Fonterra and Beca Group) are small when compared to other competitors existing in those sectors within the Indian market.

Moreover, most New Zealand businesses seeking to conduct operations in India may have little or no experience about the market and the industry trends. Also the knowledge about the regulatory systems and the business environment/practises may not be that well defined and hence the foreign investor may face obstacles if the businesses enter the market without any local support. An alliance/collaboration may allow the firms to have a deeper involvement with the indigenous market bringing more opportunities to accumulate the necessary knowledge for successfully operating in the Indian market.

This aspect holds true as the companies discussed in the examples stated that collaborations and alliances with Indian partners were critical to their success as they not only supported them with the necessary knowledge about the market but also provided them with an easy market access, which without the partnership would be difficult to achieve. Apart from this, an alliance/collaboration could also give access to the established distribution/ marketing setup as well as the necessary contacts which could help smoothen the process of setting up of operations and give a deeper insight into functionality of the local market and its business system.

As examined earlier the benefit of an alliance and collaboration model is driven by the need for a two-way flow of benefits for both New Zealand and Indian businesses. By entering the market with an alliance/collaboration New Zealand firms can provide essential technical know-how to help research and manufacture new innovative products and services, - knowledge that Indian firms may lack as well as provide Indian businesses with erudition of other international markets and the practises observed. On the other hand Indian firms can provide New Zealand businesses not only with market access but also provide financial assistance for conducting operations in India or New Zealand and/or any third market that has affiliations with that Indian company.

Considering these points an alliance/collaboration would suit New Zealand businesses that seek to enter the Indian market, (particularly in areas of Information and Technology,

Biotech and Food Processing) as cooperation and collaboration within these sectors will enable each partner to specialise in its strengths, augment its capabilities and share knowledge much to the benefit of both New Zealand businesses and their Indian counterparts, helping to ensure long term success for both businesses within the market. Considering the possible reasons such as market entry, expansion or cost savings it can be suggested the alliance/collaboration mode of entry may be helpful in learning the market practises. Apart from alliances/collaborations, the other mode of entry that New Zealand businesses could consider is a Project office, which is discussed below. Apart from alliances/collaborations, the other mode of entry that New Zealand businesses could consider is a Project office, which is discussed below.

10.1.2 Project Office:

A project office would best suit New Zealand businesses seeking to operate in the areas of infrastructure where the companies could set up temporary project/site offices till the completion of the work undertaken. This mode of entry would help New Zealand businesses rendering services in the areas of construction, building and development where the main intention is to Build-Operate-Transfer (BOT). BOT is a 'turnkey' investment mode, where a foreign investor (in this case a New Zealand business) assumes the responsibility for the design, construction and development of an entire operation and upon completion of the project, turns the project over to the purchaser and hands over its total management to the local personnel in that market.

In return for completing the project, the investor receives periodic payments which are normally pre-determined before the project is undertaken. BOT is especially useful for very large-scale, long term infrastructure projects such as power generation, airports, dams and road networks to mention a few. Due to in part difficulties working out financing and equity arrangements, the BOT approach is often used in combination with an alliance with a local or a foreign investor. Doing so helps the business generate sufficient capital to finance the project as well as reducing the risk of incurring losses and costs during the process. Due to their ability to provide foreign investors with returns in excess of their proportional contributions to the venture's total registered capital, companies normally opt for contractual alliances for such BOT infrastructure projects.

Given the characteristics (such as small size, limited access to finance) this mode of entry would suit New Zealand businesses as the risk involved is considerably less. The springboard project for the Beca Group into India for example, was the major road construction programme funded by organisations such as the World Bank and the Asian Development Bank, with which Beca secured a number of initial projects in India. During the early years of its operation the company maintained project offices in India as it realised that successful operations in the Indian market would require the development of local alliances and an intensive phase of learning about the institutional environments in India. In this case the company did not use a one-step action process rather an evolutionary process involving a series of incremental decisions during which the firm increased their commitment towards the Indian market. {Asia Foundation 2006}

The Government of India also provides support to ensure that the investments made by foreign investors through this mode are assured with the security of returns upon the completion of the project. For example, the Reserve Bank of India allows companies involved to remit the profits generated from the project back into their countries, eliminating the risk element to a great extent much to the benefit of New Zealand companies that are first time entrants in the Indian market. {SIA 2007} Furthermore, setting up a project office would allow New Zealand businesses to accumulate the necessary knowledge of functioning in the market and also prove to be helpful in identifying potential partners that would ease the market expansion process in later stages.

In addition to this, a project office is also helpful in analysing the market trends in the Indian base and reporting those to the parent company to help adapt operations to local requirements. Doing so would give New Zealand businesses a good understanding of the dynamics and the challenges that the market would likely present while conducting operations. Thus, given the advantages of establishing a project office, New Zealand businesses seeking to operate in the infrastructure sector, in particular, may benefit by this mode as it helps businesses safeguard their investments and eliminates risk of operating in the Indian market to a great extent.

10.1.3 Agents/Distributors

The third mode of entry that New Zealand firms could consider is establishing operations in the Indian market with the help of either agents and/or distributors. This would best suit companies that approach the Indian market with the aim to sell products without manufacturing those in India or seek to render services. This mode of entry for example, was used by Fisher & Paykal Healthcare (FPH) to conduct operations in the Indian market. Essentially the company sells to hospitals and to dealers in healthcare equipment. It has three broad sales channels:

- Through its own sales organisations in its major markets;
- Through distributors in different markets and;
- Sales to original equipment manufacturers.

The company had a similar approach within India as well. Although, the company first entered the Indian market about 20 years ago, it was mainly through the third channel as mentioned above. It sold its products to the manufacturers of ventilators who would then incorporate FPH respiratory equipment (always with their branding) into that product. However, the market only developed slowly utilising this approach.Subsequently FPH moved to appointing distributors in India, with a New Zealand based manager making many trips to the market. This led to improved sales, but still lacked significant momentum. About five years ago, the company accepted that as India would inevitably be a large potential market for them in the future, and they therefore had to commit more resource to it. They showed this commitment by appointing their own representative in the Indian market. {Asia Foundation 2006}

Having such a representative has since, intensified their knowledge of the market, helped them deal with regulatory issues, the bureaucracy, and indicated to key players in India that the company had extended its resources with an intention to stay and further build its business in the market. Apart from Fisher & Paykal Healthcare, Cadmus is another company that entered the Indian market with the help of a local representative. {Asia Foundation 2006} The company suggested that having a local representative was vital for their operations in India, recognising the need to merge their technology with local knowledge of the market. Doing so has enabled Cadmus to better understand the market practises and tailor their offerings and practises accordingly.

Similarly, Solid Energy credits its success in the market to their local Indian agent. The company suggests that having an agent in the market was helpful to establish operations, particularly in the initial stages as the agent helped the company understand the marketplace as well as helped in maintaining strong linkages with customers and with potential support agencies, which would have been difficult to establish, without local support. The examples discussed suggest that New Zealand businesses with current operations in India have found the use of an agent or a representative in the local market very helpful. Also, given the nature and size of the Indian market, many New Zealand firms may not be able to make significant investments in the earlier stages of operations, as most businesses may not be able to finance their operations at such a large scale.

Hence, a local support would help the businesses not only understand the local market practices but also help businesses attain access to key distribution channels, regulatory requirements, as well as potential customers. This mode of entry is suitable for New Zealand businesses as the risk and the level of investment required in this mode is less and can be managed by businesses that seek to operate in the Indian market, with the intention to test the market first and then expand operations at a gradual level.

10.2 Chapter Summary

Thus, considering the points discussed in this chapter, New Zealand businesses could opt for any one of the three modes as outlined above. Although New Zealand businesses can choose any of the three modes, having a local presence may suit the requirements of New Zealand businesses as this would not only help secure market access but local networks could also prove to be helpful in providing the necessary finances, required to function in the market. As seen in the examples discussed in this chapter, New Zealand businesses with current operations in India have achieved local support either through an alliance/collaboration, or with the help of a local agent. In addition, local alliances may also act a support for third market access, adding to the benefit of both New Zealand and Indian businesses.

Hence, having discussed the possible entry modes, the next chapter presents an analysis of the probable barriers that New Zealand businesses may encounter while conducting operations in India and discusses the possible impact those barriers could have on their activities in the market.

Chapter 11: Barriers/Challenges

The aspects discussed in the study so far have presented the importance of the India as a possible market for New Zealand businesses. The analysis thus far suggests that the integration of the world economy has given rise to some of the largest emerging markets that present palpable prospects for businesses around the world, including New Zealand. The research also has examined that high levels of international economic engagement are vitally important for a small economy like New Zealand as the economic future of New Zealand and hence its businesses today rests on their ability to compete successfully in international markets.

However, competing successfully in international markets, in particular within large markets like India, presents considerable challenges for New Zealand businesses. Thus, the focus of this chapter is to identify the challenges that could pose possible difficulties for New Zealand intending to operate in the Indian market. The section aims to identify the main barriers that New Zealand firms are likely to face while internationalising and the possible impacts these barriers may have on their operations in India. International expansion either through exporting or through outward forward direct investment can be a daunting challenge for firms from any county.

The added difficulty, cost and risk of going into an overseas market is perhaps the major reason as to why businesses without sufficient resources and knowledge are sceptical for

conducting operations in the international markets. The costs involved while conducting operations in a vast market like India, may be due to added logistics costs, as well as those costs that are associated with setting up a presence in that market. Foreign firms also need to invest in understanding new markets, set up distribution channels, develop a reputation and tailor product offerings to the requirements of that particular market. Establishing such a presence can be time consuming and expensive for any firm, but particularly for small firms. These costs mean that only small firms with sufficient capital may be able to move into international markets. Apart from this, firms that decide to operate in the international environment, (in this case emerging markets) need to be more profitable in order to generate sufficient revenues, so that the firms can absorb the additional costs incurred in operations and remain competitive with other firms in both their home market as well as in that particular international market. This is possibly a key reason that the firms that are engaged internationally in terms of either exporting or outward foreign direct investment tend to be significantly more productive and more capital intensive as compared to domestically oriented firms (Skilling & Boven 2005 a)

Considering the above-mentioned aspects, conducting international operations in emerging markets like India, can be quite difficult for New Zealand firms in particular. Hence, the section now presents possible barriers that New Zealand firms may face while carrying out operations in the Indian market. While the number and the type of barriers present in India are quite considerable it would be difficult to encompass them all hence, the following section discusses the major issues/challenges that New Zealand businesses could face in India.

11.1 Small Size and Physical Remoteness

Large emerging markets like India, present substantial barriers/challenges for any foreign business that seeks to operate in that market. One of the main reasons identified to hamper the operations of foreign firms is the scale and size of these markets (in this case India) that makes it challenging. The substantial attractions of such large markets are normally balanced against considerable challenges of doing business in these economies. The number and the type of difficulties encountered in an emerging market such as India are likely to be higher and quite different from the barriers that are experienced by foreign firms in other developed markets.

This is because of the fact that these markets are distinctive in terms of the way the local market and businesses operate and the dynamics of the market as a whole is quite distinct when compared to other developed markets. {Enderwick, 2007 #24} While this aspect may hold to be true for any foreign business that seeks to conduct operations in the Indian market, it becomes particularly relevant for New Zealand businesses. New Zealand firms may tend to face discrete barriers in the Indian market due to two key reasons: *A)* ***Predominance of small firms in the New Zealand market, B) Physical distance between New Zealand and India.***

A) Predominance of small firms in the New Zealand market: The issue of size of the business/level of operations is perhaps the most significant barrier that New Zealand

firms may possibly face while operating in the Indian market. As most New Zealand firms tend to be small by international standards at the point they seek to enter international markets, New Zealand businesses may find it difficult to develop an efficiency advantage in the Indian market. The businesses (both local and foreign) operating in the Indian market would be large and usually engage in diverse production activities at a local level. In contrast to this, small economies like New Zealand have a tendency to specialise in certain sectors in order to achieve economies of scale and aim to produce in large masses for the domestic market due to availability of limited resources.

Due to this, most New Zealand firms that would seek to conduct operations in India would need to scale up their operations to meet the local demand, which can be risky given the size of the business. The risk associated with making investments to scale up the operations would also escalate if there were any uncertainty around subsequent business in that market. (Simmons 2002) Therefore, New Zealand firms will tend to be smaller and less capital intensive when compared with other firms that will compete within a market like India, which may act adversely as the number and the size of businesses operating across different sectors, will be large. These difficulties are compounded by the fact that large markets like India, in particular, are distant from New Zealand, which is likely to make it more costly to enter and develop a substantial presence in the market, as compared to other businesses that originate from countries, having proximate markets to expand their operations.

B) Physical distance between New Zealand and India: Distance is also an important aspect that New Zealand businesses consider before going international. The geographical characteristics impose an obvious disadvantage on companies seeking to go international from a New Zealand base, as the distance from major markets is quite significant. For example, it is easier for a Belgian or a Danish firm to expand beyond their domestic borders because of their proximity to large markets than it is for a New Zealand firm. This basic intuition is strongly supported by international evidence that suggests that physical distance from key markets, has a substantial negative impact on the size of the country's international economic relationships. Indeed physical distance, can explain considerable amount of variation in the trading, FDI (outward+inward) and financial capital flows. This relationship is perhaps the most robust and well tested in the economics literature. For example, the Boston Consulting Group (2001) notes evidence that the distance and size of the businesses are major drivers for overseas investments made by businesses from a given country.

For New Zealand, the absence of large proximate markets means that interaction and investments within other international markets is relatively lower as compared to other European countries of a similar size, which have an access to large markets. In support this facet, research suggests that due to small size and geographical distance most New Zealand firms tend to operate in markets that are close to New Zealand in terms of either culture or geography. For example, the most popular market served by New Zealand firms is Australia with 65.1 percent of businesses targeting this country as their major overseas market. This is not surprising considering Australia's close geographic and

physic distance. The other potential markets that are served by New Zealand companies include the Pacific Islands (32.4 percent), the USA (32.4 percent), and the UK (26.0 percent) (Chetty and Hamilton 1996).

This suggests that New Zealand businesses most often tend to focus on markets that are less risky or markets that they are familiar with, rather than pursuing markets like India, for example, that are distinctly different from New Zealand. Although in the recent years New Zealand business have managed to attain some success in indentifying other alternative markets in the Middle East and Asia, it has proved to be relatively difficult to expand into these markets. This is due to the fact that, functioning in these markets often requires significant investments and deeper understanding of the local requirements.

Hence, due to limited international exposure, New Zealand firms may lack the necessary knowledge of market-based barriers that increases the difficulty of pursuing operations in a distant market like India. In addition, a barrier related to the physical distance is the liability of foreignness that a business can experience due the distance between two markets. Liability of foreignness is a factor that could possibly act as a hurdle for New Zealand businesses in the Indian market, given the physical and cultural distance the two markets share. Hence, the next point discusses the disadvantage of foreignness that perhaps could act as a barrier for New Zealand businesses.

11.2 Liability of Foreignness:

Any business that seeks to operate in an international environment, particularly, in the emerging markets, faces the barrier of "foreignness" in that market. The liability of foreignness concerns extra costs incurred by a company once it enters a foreign market, which a local firm in that market would not incur. These costs may incur on account of investing, operating, and managing in the foreign country's task and institutional environment. These outlays mainly occur due to lack of familiarity with local business environment, (e.g. supplier, buyer, competitor and distributor) cultural differences, (e.g., adaptation costs) geographical distances (e.g., transport and communication costs) and institutional environment (e.g., legal, regulatory, political, sociocultural and economic).

Although it has been recognised that International businesses have strong-firm specific advantages that can be used to offset these costs, as a direct consequence, such additional costs can sometimes result into a competitive disadvantage for a foreign firm, as these markets tend to unique in nature. {Enderwick 2007} The uniqueness about emerging markets, (in this case India), is the transitional nature of their industrial and institutional environments. The transition, for example, that the Indian market has made in the recent years has brought in tremendous opportunities to investors whilst creating a number of challenges and uncertainties for foreign business operations in particular.

Liabilities of foreignness in the Indian market are high as uncertainties in the industrial environment are largely structural, and the challenges in the institutional environment are normally unpredictable, making it difficult for firms to control external disturbances. While this is true for most foreign businesses in the Indian market, this aspect becomes very critical for New Zealand businesses in particular while conducting their operations in India as most New Zealand businesses may have little or no practical knowledge of the industrial and institutional environments in that market. This is partly due to the fact that, there are not many New Zealand businesses that have well established operations in India, hence the familiarity with the market and local practises is quite restrained.

One of the reasons for limited New Zealand operations in India is perhaps, due to the physical distance between two countries. A firm would perceive its liability of foreignness to be relatively little in similar neighbouring countries and great in distant and cultural dissimilar countries. In other words, a firm would expect to perform better in foreign countries associated with little 'psychic distance.' Hence, due to small size and consequently limited resources, particularly finance, most New Zealand businesses prefer to operate in markets that are similar to New Zealand in terms of culture and/or physically close, instead of distant markets like India. Moreover, research suggests that in the case where internationalisation is preferred through foreign direct investment, learning about the local business environment would not start until after the establishment.

Evidently, with no or little experience obtained in the foreign market, (in this case India) the liability of foreignness would initially be quite high. Additionally, as given a firm seeks to enter a market that has greater physic distance, normally would take its other foreign operations as a 'stepping stone' to new markets. Together, the stepwise expansion in terms of geography and resource commitment would tend to reduce foreign market unfamiliarity substantially prior to the establishment of operations. However, this is not true for most New Zealand businesses as they tend to have limited international experience and most may have not functioned in a market like India.

This aspect is evident in the study conducted by Petersen and Pedersen (2002). The study analysed the liabilities of foreignness perceived by businesses in Denmark, Sweden and New Zealand. All the three countries compared are relatively small in terms of their population and market size. Due to limited home markets, most firms in these countries are forced to engage in international operations at an early stage of their development. The profiles of the firms analysed from Denmark (201) and Sweden (176) for instance, were very similar in terms of size and level of internationalisation. However, the firms differed in their levels of international experience. For instance, both Swedish firms (30.3 years) and the Danish firms (20.9 years) typically had longer export experience as against New Zealand firms. {Pedersen 2002}

According to the study, the firms from New Zealand (117) had less international experience (16.1 years) and operated in fewer countries. Moreover, the study also

suggests that the ability to adapt to the local norms and rules is expected to be highly correlated with the international experience of firms. The more the firms have been exposed to foreign markets, the greater the international experience hence, the greater the ability to adapt to new local markets. As most New Zealand firms have limited experience operating internationally particularly in emerging markets like India, the ability to understand and adapt to local requirements in the Indian market would be limited. {Pedersen 2002}

Furthermore, the differences in the industrial and institutional environments between the two markets are quite high, which would make it complex for New Zealand businesses to enter the market without a proper understanding of the local market requirements. Hence, owing to this New Zealand businesses may face elevated liabilities of foreignness chiefly, in the early stages of their operations in the Indian market. Apart liabilities of foreignness, the other major barrier that could hamper New Zealand businesses operations is Market failure. Thus, the next point discusses the types of market failures that New Zealand businesses could face while operating in India.

11.3 Market Failures:

A characteristic of almost every emerging market is the underdevelopment of local markets and absence of supporting institutions that are critical for carrying out operations in that market. The absence of this critical support can at times, lead to complications for carrying out smooth operations particularly if the business is not familiar with the trends of the local market. Under ideal conditions, a market entails normal trade activities amongst businesses without the interference of extra-market mechanisms such as regulations or other factors that could introduce friction in carrying out smooth business operations.

However, such conditions seldom prevail across a broad spectrum of industries, especially in emerging economies like India (Khanna et al 2005, Stiglitz 1989, Wright, Filatotchev, Hoskisson and Peng 2005). {Li, 2006}In fact, market failure is more the norm than the exception in such markets. Market failures do commonly occur in Product/Service markets, Labour markets, Financial and Intellectual markets in India. Such market failures are widespread across the market and although in most cases these are not overwhelming but do, likely present considerable challenges to businesses that may be unfamiliar with the local business and market practises. Thus, the points discussed below analyse the Product/Service markets, Labour markets, Financial and Intellectual markets and the possible effects on the New Zealand business operations in India.

11.3.1 Product/Service Market Failure

In most emerging markets and likewise in India, the market structure in terms of Product/Service markets is largely volatile and often businesses operate with the help of local networks. In addition, the businesses have to adhere to the national as well as state regulations and policies while operating in the market. In terms of product/service markets for example, restrictions may exist because of government ownership or protection of businesses in a certain sector/ industry, which may cause significant delays in understanding the local requirements and customising the products/services accordingly.

An example of the complexity that exists in terms of government rules and regulations can be seen in the agricultural biotechnology sector. In order to protect local Indian businesses the Indian government in 2006, announced regulations that would further monitor the products imported within the Indian market. The regulations introduced by the government at the time made it compulsory for businesses to adhere to mandatory labelling for biotechnology food products, and documentation requirements for foods produced through biotechnology or foods that contain ingredients or additives from such foods. Considering these regulations, foreign businesses supplying agricultural products at the time, found it difficult to export food products to India as neither the products covered nor the import requirements necessary to implement these regulations were clear. This made it difficult for businesses to adhere to the requirements and hindered trading activities with the Indian market. {Debes 2006}

Apart from this, New Zealand firms may also face barriers in terms of leveraging their brand equity across multiple products/services in any given industry in the early stages of their operations. As consumers and key stakeholders in the market, may not be familiar with the company and its product/service offerings, it may be difficult for the business to establish itself in the Indian market. Apart from that, lack of local market knowledge may also make it difficult to address distribution bottlenecks, increasing transaction costs and thereby reducing the economies of scale while conducting the operations in the market.

Hence, in order to avoid these difficulties businesses need to have local market knowledge to help create and organise a stable supply chains that support their activities in the market. These aspect becomes all the more critical for New Zealand businesses as given the size of most New Zealand firms and limited access to capital, New Zealand firms would face a significant challenge in overcoming this barrier without any local business and/or/ network support.

11.3.2 Labour Market Failure

Labour market failure arises when businesses face shortages of and/or/ are unable to recruit efficiently skilled labour within the local market of operations and is an important barrier that New Zealand business should consider before or while entering India. Typically, such failures are prevalent in settings that have less number of vocational training schools and institutions of learning that are capable of offering hands-on skills to a sizeable segment of the employable population in any given industry in that market. Consequently, this facet constrains the free availability of skilled labour in that local environment. According to the research presented by Mckinsey Quarterly (2005) Multinationals currently operating in India, for example, suggest that although India has a vast reserve of workers, finding the right ones can be difficult. The companies were also of the view that the cost and availability of talent can have a significant impact on the business operations in that market.

This aspect is also true for some New Zealand businesses currently operating in the Indian market. For instance Glidepath Ltd, when first launched its operations in the Indian market, suggested that difficulties had arisen from over-estimating the quality and efficiency of the Indian labour market. This in turn created difficulties for the company in meeting their customers' requirements of quality and on time delivery. In some cases, high level of technical expertise is required and at times, it may be difficult to access local people with requisite skills, hampering the operations.

As recruiting expatriates from New Zealand may prove to be very expensive, New Zealand firms may want to look for local talent in the Indian market. However, this too may prove to act as a barrier as the firms may incur significant costs in training and developing necessary skills amongst the required local force. In addition, labour regulations in the Indian market relating to hiring, firing and benefits administration for employees are different and may pose difficulty for companies to recruit the right set of people successfully. As an example, the research conducted by McKinsey Quarterly states that labour laws in India, prevent a business with more than 100 employees from firing any of them with the state government's approval- a road block for any business that might consider building medium to large scale operations to take advantage of India's low labour costs.

Although most New Zealand firms may not consider this factor in the early stages of their operations, it is an important aspect to consider for long term operations in the market. Hence having considered the possible barriers within the labour market, the next point analyses the other significant issue of capital market failure and the affect it can have on the operations of a foreign business in a market like India.

11.3.3 Capital Market Failure

The ability of a business to attract capital for Investment successfully is crucial in operating in an international environment. (Gertner, Scharfstein and Stein 1994, Stiglitz 1989) In developed countries, capital markets are sufficiently well developed and deep for potential organisations to venture into for obtaining the necessary capital to fund operations in the market. However, in emerging economies like India, the capital markets may not be that strong and at times are shallow in terms of attracting foreign investments that may significantly limit any firm's potential to obtain capital to fuel expansion and growth (Khanna and Palepu 1997, Khanna et al 2005, Stiglitz 1989). {Li 2006}

Although research suggests that as compared to China, India's ability to attract foreign investments and the ratio of domestic savings is less, the economy still enjoys an average growth rate two-thirds of China. In addition, India's banking system is more efficient and foreign and private owned banks have a market share of around 25 percent. However, despite this fact, often if not, the access to debt capital is largely controlled and most banks act in consent with the government to support political initiatives and priorities in the industrial sector (Ramaswamy, Li, Pecherot, Petitt 2004, Whitley 1999). Furthermore, there many legislative hurdles that preclude the firms operating in India from looking overseas to attract capital. Apart from that, the relatively weak governance norms at times may make it difficult to seek funding in the local market. {Enderwick 2007}

Given the paucity of funds in the Indian market, large business groups therefore enjoy privileged access to capital resources that small stand-alone firms might lack in such settings (Khanna and Palepu, 1997, 1999 b). The availability of a pool of capital has proven to be a strong mitigation mechanism that has helped businesses remedy capital market failure. The genesis of the leading business groups in India reflects this advantage (Shiba and Shimotani, 1997). The capital access allows these groups to sense and respond to opportunities in the market place, in essence internationalising the role of the unaffiliated investor in a vibrant capital market. This barrier is particularly important for New Zealand businesses to consider as limited access to necessary capital and limited financial resources may hinder the operations of the businesses wanting to function in India.

For example, according to research, only 11.8 percent of New Zealand firms have external equity partners. This may be a reflection of the difficulty to attract capital investment in small firms (Ali and Camp 1993, Buckley 1989, Coviello and McAulley 1999, Fillis 2001, Karagozoghu and Lindell 1998, Kirpalani et al 1987). Hence, New Zealand businesses may find it difficult to sustain their operations in India without local support to fund their operations in the market. Taking this into account, New Zealand businesses seeking to operate in India can overcome barrier by relying on local connections and relationships to overcome financial obstacles and complement such inflows through the creation of an internal capital market to fund and support the activities in the local market.

Apart from difficulties faced in accessing the necessary capital from the local market the other issue that could act as a challenge for New Zealand businesses in the Indian market is the protection of Intellectual property. Thus, the next point highlights the prominent issues with the protection of Intellectual property that the businesses could face while operating in India.

11.3.4 Intellectual Property

The protection of Intellectual property is one of the major concerns for any business seeking to operate in emerging markets such as India. This is because of the fact that the threat of piracy and the lack of protection of intellectual property in such markets are well known. The major issues that the companies face lie with copyrights, patents, trademarks and technology transfer. In spite of this, intellectual property protection remains an afterthought for many companies wanting to tap into markets such as India for production or research and development purposes.

Although in general intellectual property concerns in India are not that difficult to deal with, nevertheless it is important that New Zealand businesses have a proper understanding of the intellectual property rights upon entry in the market. This is because the government regulations and patent/copyright protection laws are not that stringent and in most cases loosely defined which makes the implementation of these policies difficult to protect critical information and property of the company operating in that market. As a result, there is a significant risk of breach of intellectual property that should be kept in mind. {Enderwick 2007}

The government has initiated various steps towards the protection of intellectual property rights, by introducing enforcement agencies that work towards monitoring intellectual property amongst various industries in the market. However, reliance on the litigation is

unlikely to be sufficient where enforcement is weak and New Zealand companies operating in the market should opt for effective strategies to tackle likely problems. An example of this is seen in the case of Novartis, a global leader in innovative pharmaceuticals, generics, vaccines' and health care products, that has well-established operations in India. The case revolves around a patent application filed by Novartis for its anti-cancer drug Glivec. On application for a patent for the drug, Glivec, (2005) the company was refused the patent by the Indian patent office in January 2006, as the Indian office felt that the drug was not inventive enough to merit a patent under the 2005 Indian law. In response to this Novartis approached the Madras High Court in Chennai (India) in May 2006, challenging two distinct elements of the decision. First, the company challenged the grounds on which the Indian patent office, led by the Patent Controller, had rejected the patent. Second, the company also challenged the reliability of the patent system in India as the decision not only contravened with Trade-Related Aspects of Intellectual Property Rights (TRIPS) as governed by the WTO, but also the Indian Constitution, (article 14, within the patent protection law) which ensures equality before the law.

The company pursued legal action against the government in India subsequent to its decision to decline the patent for Glivec in January 2007. Novartis stated that they had pursued the action to challenge the establishment of additional hurdles to patentability in India that discourages both breakthrough and incremental innovation. Novartis, which has patented Glivec in 36 countries worldwide, stated that it wanted clarification on the

Indian law; as the company wanted to ensure that it gets adequate patent protection for any drugs it plans to offer in India in the future. Novartis also suggested that the company was not challenging any provisions of the Indian patent law that are currently in place but was concerned with safeguarding its Intellectual property. However, the company is still awaiting a decision on the patent from the Indian Government. {Novartis 2007}

As seen in the example of Novartis, it can be observed that although the Indian government does have laws to protect the intellectual property of a company, these are not practised at all times. Moreover, the gaps in the provisions and the system make it difficult for companies to protect their intellectual property. The protection of the Intellectual property is important for any organisation as companies make significant investments in order to maintain a competitive advantage in that industry and market. As innovation, research and development is the core to any business model, New Zealand businesses would find operating in such markets challenging.

Apart from Patent and Copyright protection, the New Zealand businesses could also face difficulties in data protection and security of critical information. As compared to developed countries, India lacks many of the data protection and security laws which make it difficult to protect confidential information and stop data theft. In India, data protection is achieved through the enforcement of privacy laws and property rights. The Indian Penal Code for instance, prohibits the dishonest misappropriation of data or

criminal conspiracy and India's Information Technology Act of 2000 (the "IT Act") prescribes penalties for cyber crimes such as hacking, source code tampering, and breach of confidentiality and privacy. {Steinberg 2007} However, the practical implementation of these and other laws are severely limited.

For example, the local law enforcement does at times lack adequate tools and training to handle cyber and data theft crimes. Elite state or Central Government agencies often lack necessary resources to investigate cases other than high profile breaches. Finally, the severe backlog of cases in the Indian civil system make civil suits an inadequate source of relief other than for injunctions requested by companies to protect their intellectual property. In order to safe guard their intellectual property while operating in India, New Zealand firms are best to integrate their product/service to be an integral component of the company system making it difficult to duplicate the systems, processes, services or products of the company. The businesses need to analyse the risk appropriately and ensure that the customers and local businesses or partners that they deal with are not a "front for another manufacturer". intellectual property issues can also be avoided or largely reduced by retaining their intellectual property in New Zealand while collaborating with other local businesses for manufacturing, assembling products or carrying out research and development activities in India.

In addition to this while collaborating with local Indian businesses, the risk could be reduced by evaluating the company's work entity towards copyright and patent protection. Furthermore, while New Zealand businesses could copyright or patent their Intellectual property in New Zealand, it is vital that the firms consider the validity of such a protection in India. Thus, intellectual property protection is a very critical element that should be part of the business model of any New Zealand business seeking to operate in India, as the Intellectual property protection laws and other mechanisms used are not implemented carefully. Hence, understanding the country's intellectual property rights and following the best practises according to local requirements can drastically reduce the risk of losing the firm's intellectual property. Further, commitment to protect the intellectual property of a company should be developed and nurtured amongst local employees and partners to avoid this risk.

11.4 Bureaucracy and Tax System

Bureaucracy and Corruption are common aspects of the Indian business environment and New Zealand businesses seeking to conduct operations in India should be aware of these factors. Bureaucracy and red tape are quite distinctive within the business system of India, which is reported to be due to burdensome government requirements and formalities, non-transparent governance, and overly complex decision-making processes. This becomes more difficult to deal with when bureaucratic procedures are coupled with corruption. Following complex regulatory requirements both at Central and State level can be challenging of any foreign business operating in India. However, this can be particularly taxing for New Zealand businesses, as most New Zealand businesses wanting to conduct operations in India, may not be very familiar with the business and regulatory environment.

These barriers may be easy to deal with if the information to help resolve these issues is readily available. Conversely, as the business system in India is more dependent on personal relations, gathering the necessary knowledge to help deal with these barriers can be a bit daunting for New Zealand businesses. As a country, India is known to have extensive "rep tape." Red tape is the requirement of extensive paper work and rigid conformity to formal rules, which hinders action and aids slow decision-making. {Zainulbhai 2005} Thus, New Zealand businesses, while functioning in India may often find difficulties in dealing with government officials and a trail of paper work necessary while conducting day-to-day business activities.

The main reason why New Zealand businesses may find it difficult to overcome these issues is perhaps due to lack of experience of functioning in a market like India. Keeping this in mind, local market knowledge, and networking becomes all the more imperative for New Zealand businesses. Most foreign businesses, hence, when operating in India find it essential to develop relations with key stakeholders and have representatives in the market. Businesses often have representation in the market through agents, distributors or partners who possess the required information for dealing adequately with bureaucracy and regulatory issues. This aspect is vital for a market like India as most states in the country have varied requirements and regulations that businesses need to adhere to while functioning in those states.

With little or no knowledge, gathering information about these requirements as a foreign business can be a time and money-consuming task, especially for first time entrants. Moreover, as stated earlier, as the business system is relationship and network based; businesses may also find it difficult to access key decision makers which could further impede operations in India. This aspect is deemed critical by some New Zealand businesses that are currently operating in India. For example, Vista Entertainment Solutions Ltd, a New Zealand based business, with current operations in India, suggests that the business had local help from an Indian company (acting as an agent for Vista Entertainment Solutions) for successfully conducting operations in the Indian market.

The company stated that the Indian company was able to assist them tailor their technology to the requirements of different states in India – an undertaking that would be very difficult without local knowledge and influence. {Asia NZ Foundation 2006} New Zealand businesses may also observe (particularly in the public sector, like Infrastructure developments) that public procurement procedures at times are biased towards locals. Moreover, these procedures and the legalities of the dealings may be non-transparent, and often may exclude foreign companies. {Kumar 2007} Although today there are quite a few government portals and offices that ensure that these procedures and procurements are conceded without any bias or corruption, it is an important aspect that New Zealand businesses should keep in mind. Apart from this, tariffs and duties are generally thought to be high, but most companies do not regard them as a barrier to doing business in India.

The other aspect that could particularly important is that many Indian businesses may not be willing to collaborate with New Zealand businesses. This is due to a perception held by some large Indian companies that New Zealand businesses may not have the ability to build trusting relationships due to asymmetries of size and so may be reluctant to do business with New Zealand firms. New Zealand businesses need to understand this barrier and develop a sense of trust with their Indian stakeholders, as without local support functioning in the Indian market can be very challenging.

The other significant issue that could obstruct operations is the tax system. Due to the size of the country and differences in states regulations, businesses are imposed with different tax requirements within the country. This makes operating in the market a bit difficult at times for foreign businesses. Although different states and central requirements have largely been streamlined with the establishment of Special Economic Zones, and high priority sectors like Infrastructure development, Research and Development, and Food processing to mention a few, that offer exemptions from taxes for up to 10 years, it is vital to have a basic understanding of the tax framework.

Some of the major taxes that New Zealand businesses should be aware of are: Sales Tax, Wealth Tax, Octroi Duty (Duty levied on goods when they across states), R&D Cess (Cess of 5 percent is levied on all payments made for import of 'technology'), Service Tax (a tax of 10 percent is levied on all tradeable services), Value added Tax (VAT, is similar to GST and is payable on goods purchased from within a state). All the taxes and the duties mentioned above may vary from state to state unless specified by the Central or State government. Hence it is advisable that New Zealand businesses seeking to operate in the Indian market are aware of the tax system and accordingly tailor their activities.

Thus, as outlined above bureaucracy is an integral part of the business environment in India and having local input to overcome these issues is very critical for any New Zealand business seeking to conduct operations in the market. Hence, New Zealand firms

when operating or before entering the market should focus on building relationships with the appropriate stakeholders in the market, backed with the commitment to stay in the market for a long term. Doing this will help New Zealand businesses establish a presence and gain local confidence in the market, much to the benefit of the business.

11.5 Extent of Competition

As discussed in the study earlier, Indian businesses were protected through licensing and import substitution for nearly four decades. This protective nature of the government and the business environment, has resulted to the development of a number of large diversified family conglomerates like the Tata Group and Reliance Industries to name a couple. These companies not only operate in traditional manufacturing facilities and but also are fast growing players in the new emerging industries like information technology and telecommunications. Owing to this, these companies can prove to be a tough competitor for New Zealand businesses seeking operate in both segments of the market. {Enderwick 2007}

Apart from this, as compared to most New Zealand businesses, the average size and number of both Indian and foreign businesses operating in India is large. This aspect may act as barrier for New Zealand businesses as the size of most New Zealand businesses is small and the extent of competition faced by these businesses in New Zealand is fairly limited. In addition, although New Zealand businesses have operated in international markets, their ventures have been mainly limited to certain markets. Hence, operating in a market like India (in terms of size and number of businesses in the domestic market) may be a bit strenuous. Moreover, as businesses are more reliant on networking, critical information about the market may not be readily available to New Zealand businesses, making find it difficult to take decisions under serve constraints and pressure of local competition.

Since networking is a prominent way of collecting information in the Indian market, New Zealand businesses may find it hard to gather vital information about suppliers, costs, distribution channels and most importantly dominant players in the area of interest. This factor is particularly important as most businesses in India rely on subjective rather than objective information, while dealing with competition in the Indian market. {Enderwick 2007} In addition, New Zealand businesses also have to consider, that owing to the nature of the market and the number of opportunities offered, businesses (both local and foreign) are moving assertively to expand their operations across various sectors and hence developing effective strategies to establish a strong hold in the market is essential for survival in that market. This is particularly true for fasting growing sectors, such as IT and Biotechnology, areas that may be of keen interest to New Zealand businesses.

Thus, in order to deal with competition in the market, New Zealand businesses have to bank on local networks to help gather information which is detailed and tailored to meet their business requirements. Furthermore, although the level of competition in the market is quite significant, with proper analysis of the market and area of interest New Zealand businesses can devise strategies, which may help in efficiently handling competition. Thus, even though the size of and the growth within the Indian market are very attractive, New Zealand businesses must understand the opportunities in the perspective of a liable competition that exists within that market.

11.6 Chapter Summary

The points presented in the chapter discussed the possible barriers that New Zealand firms could face upon entry or while operating in the Indian market. As examined, the barriers outlined above are faced by any foreign business seeking to operate in India, but hold particular importance for New Zealand businesses as most New Zealand businesses seeking to venture into India may have very little information about the dynamics of the market and the possible barriers it presents. Amongst other barriers, the major challenges discussed in this chapter suggest that New Zealand businesses need to understand the local market practises, level of competition and the business system in India. Businesses also need to be cautious of the factors that could lead to a possible market failure as well as understand the impact the failure could have on the operations. The aspects outlined in this chapter may hamper New Zealand businesses if the barriers and the possible solutions to deal with those are not clearly understood. Considering this, thus, the final chapter of this study discusses possible recommendations and implications that could act as a framework for most New Zealand businesses while seeking to operate in the Indian economy.

Chapter 12: Recommendations: Possible Implications

As discussed in the previous chapter, New Zealand businesses face some obvious barriers in the Indian market. Amongst other factors, aspects like small size and physical remoteness of the New Zealand economy makes international expansion more challenging and this in many ways explains New Zealand's relatively low level of international economic activities despite promising opportunities in the international markets like India. However, simply being able to explain the barriers and linking them to the underperformance of New Zealand firms does not remove the problem. Although difficult, it remains the case that, international economic engagement with markets such as India is of fundamental importance to New Zealand firms' growth and economic prospects going forward. Hence, it becomes imperative to consider possible solutions that can act as a framework for New Zealand firms thinking of conducting operations in India. Thus, this chapter aims to present possible strategies that may help New Zealand firms overcome these barriers and may ease the process of operating in the Indian market.

12.1 Diversity of the Indian Market

India is very diverse and its market promising but volatile in nature. Perhaps the most important aspect in India is that, people rather than institutional and business frameworks play a significant role in shaping and guiding commercial activities in the local environment. For this reason, like other emerging markets, India too has a unique set of commercial practises and business culture, one that is more people oriented and socially-embedded. As such, interpersonal networking is important for any foreign market but becomes particularly is vital for markets like India, as the business system is quite reliant on personal relationships and networks. Also, as discussed in the earlier section **(Barriers)** due to the informal nature of the business environment, critical information about the suppliers, customers, regulatory requirements and competition can be difficult to gather without local support. Hence, networking is often necessary for nourishing business activities.

Other than this, factor markets and institutional support needed for economic development and business growth are weak. Factor markets, such as capital markets, labour markets, information markets and production markets are generally underdeveloped and thus still are subjected to high levels of intervention by governmental institutions and departments. Moreover, institutional support such as services provided by central and commercial banks, transparency of government policies and services offered by commercial and industrial administrative agencies are generally incomplete.

These institutional inefficiencies often affect the operations of both local and international businesses in the Indian market. In addition, emerging markets like India tend to experience faster economic growth as compared to other economies around the world however this growth is often accompanied with uncertainties and volatilities. Risks may arise from government policy changes, underdeveloped factor or market economy institutions and volatile product markets and /or industry structural changes. Furthermore, markets like India are often characterised with strong market demand, especially from a vast emerging middle-class consumer base. However, consumption behaviours are not necessarily the same as those in advanced markets, nor necessarily similar to cross-regional consumers within the Indian market and so market opportunities often may be trapped by this heterogeneity.

Product and service markets are highly segmented and differentiated along consumption behaviours, income levels social norms and cultural traits. {Luo 2002} The key challenge of these market segments is the need to develop offerings and new business models that suit the market requirements. In quintessence, as a market, India can provide learning opportunities for New Zealand businesses that they will need to master if they are to compete successfully with local firms and tackle the vast sub-markets within India. Considering this, local product/service adaptation is very critical to sustain operations in the domestic market.

Apart from this New Zealand businesses currently operating in the Indian market suggest that given the size of the market, businesses seeking to operate in India, should best approach the market by dividing it into segments that are approachable and manageable, rather than approaching the market as a whole, as it can be tasking to serve the entire or a significant share of the market. In addition, as discussed earlier, India also faces challenges with its labour market. In spite of huge labour reserves, companies operating in the market suggest that finding the right skills and knowledge can be a bit challenging and investments for training the labour base according to requirements may be necessary, adding significantly to the costs of doing business in the market.

Apart from market size and low costs of production, one of the core reasons for investing in the Indian market is to gain access to specialist resources and opportunities for learning. India as a market possesses pockets of highly skilled specialist labour particularly in the areas of Information and Technology and Manufacturing to mention a few and recognising this fact businesses approach the Indian market with an attempt to cut costs, improve quality and increase their production levels. However, accessing these specialist resources comes at a price. In order to successfully operate in that market, like other firms, New Zealand businesses too need to understand the importance of making investments to develop key suppliers, create a dialogue with the authorities and other key stakeholders, to help build good will and provide input on regulatory issues and develop local management talent. (Luthra et al 2005) {Enderwick 2007}

Although, the synopsis of the diversity of the Indian market above may hold true for any foreign firm entering the Indian market, however, it becomes even more critical for New Zealand businesses as most businesses tend to conduct international operations through exporting, which to some extent may limit their ability to better understand the requirements/practises of the local market. Apart from this the level of international engagement observed by New Zealand firms is limited only to certain international markets. This aspect in particular can make expanding into the Indian market a very daunting task as due to limited international exposure New Zealand firms may not be aware of the local environment and business practises, making it all the more difficult for these businesses to operate in the Indian market. Keeping this in mind, thus the next section presents possible implications/solutions that New Zealand businesses could implement while considering operations in the Indian market.

12.2 Possible Solutions/Implications

The study so far has outlined the ways in which New Zealand's small scale and remoteness from markets impacts on decision-making by New Zealand firms around international expansion as well as the structural impact that these features have on the economic activity that takes place in New Zealand. This analysis provides the basis for identifying the specific business and government actions that are necessary to improve the international economic activity of New Zealand businesses in particular with markets like India. The solution areas will try to address firm-level constraints around international expansion by focusing on improving the financial incentives that firms can generate in going international. The solutions will also identify the focus of corporate strategies and the effect this focus can have on successful operations in the Indian market. The section also aims to present the importance of getting real market access as well as emphasizes on the importance of local networks and physical presence in India.

12.2.1 Implication 1: Improved Corporate Strategy around International Expansion

The behaviour and performance of New Zealand firms is critically important to achieving increased levels of international economic activity. The success or failure of international operations and investments can generally be traced back to what happens within companies. While it is important that New Zealand's policy settings are supportive of international expansion, such actions will have a limited effect without a pipeline of New Zealand firms with the capacity and aspiration to go global. Exporting and outward FDI cannot be raised by government decree alone. Research conducted by the New Zealand Institute, for example, suggests that as most New Zealand firms are small in terms of their business activities, these businesses find it much easier to function only within their domestic boundaries, rather than looking at international markets. {Skilling 2006}Also is the fact that a business involved in any activity seeks to make profits while functioning in any market.

The aspect of profitability, however may not be steady at all times, particularly in international markets, which makes New Zealand businesses sceptical of considering international operations in markets that are volatile in nature or those markets that the firms are not familiar with. Although it is true that New Zealand firms face particular challenges in terms of going global from New Zealand, however, conducting operations either in the domestic or limited international markets is not feasible in the long term. Considering this, as discussed, New Zealand firms need to be more active in markets like India that offer immense opportunities and they need to adopt strategies that are

appropriate to this context. Understanding the factors that make international success, more likely will be an important part of raising New Zealand's overall level of international engagement. Hence, the question is what do New Zealand firms need to focus on in order to generate a substantial improvement in their international success, in particular within the Indian market.

To make progress in answering this question, the New Zealand Institute for example, undertook a joint project with McKinsey & Company. {Skilling 2006} This project drew on a major international research project that McKinsey had undertaken on the success criteria associated with 'global champion' companies. The research was particularly interested in those global champion companies that had grown from small domestic markets, such as Ireland and Finland and compare those to New Zealand. It was observed (as discussed earlier in this study as well) that both Ireland and Finland were more active at an international level, as compared to New Zealand.

Due to the distinctive challenge of going global from New Zealand, the study supplemented this international research with a series of interviews with New Zealand business leaders who have experience in international expansion. {Boven 2006} The study conducted by the New Zealand Institute has helped in identifying four key factors that New Zealand companies need to focus on in order to enhance the prospects of international success, which can be applied to businesses thinking of operating in the Indian market. These are outlined as below:

- ***The importance of the company having a long-term commitment towards the international market of interest:***

Commitment towards the foreign market (in this case, India) in which the firm seeks to operate is an important aspect that can possibly ensure success in that market. New Zealand firms currently operating in the Indian market suggest that success in India requires a long-term commitment. This aspect holds to be true as experienced by Beca Group. The company today has established operations in the Indian market and suggests that a key success factor for the business has been making long-term commitment in the early stages of entering the market. The company suggested that having a long-term commitment for the market was vital because of the importance of building relationships and personal networks in the local environment.

As part of this commitment, Beca today offers internships for undergraduate Indian engineers to build capability, with a long term goal of employing these graduates to supplement resources available in New Zealand. {Asia Foundation 2006} This has helped the company to further enhance its reputation in the local market, adding to the success of the firm in India. The company implies that businesses need to develop a local essence in their operations and need to develop an image, where the company is perceived to be a part of the local environment rather than being perceived as a foreign business. This aspect is critical as this can

help build trust with key stakeholders that would help ensure long term stability and success in the Indian market.

- ***Investing in developing the company's products/services that caters to the domestic level:***

Like most foreign markets, while thinking to conduct operations in the Indian market, it is important that New Zealand businesses understand the need to invest in developing products/services and/or technology that caters to the local market needs. As the market is diverse in its requirements, it is critical for businesses to adapt their product/services offering to the local tastes, in order to ensure success within the Indian market. An example of this was seen in the case of Vista Entertainment Solutions. Based in Auckland the company develops and supplies specialised software to the entertainment industry, especially to cinemas, both multiplexes and single cinemas. The company first entered the Indian market in 2000. {Asia Foundation 2006}

The first sale came about through connections of Village Sky City Cinemas, but parallel to that, a new Indian company approached Vista through the company's website. Although the company's actual entry into the Indian market was to some extent opportunistic, Vista had already identified it as a huge potential market. A major success factor for Vista in India, as the company suggests, has been their willingness to adapt their products to suit the requirements of individual customers, including the various State regulators. The company is of the view that being able to succeed in the Indian market requires the ability to constantly listen to the end-users and endeavour to be as flexible as possible.

The company, for instance, developed their software to work with the automatic ticket vending machines now appearing in some cinemas in India. In addition, the company lowered the prices of its products and service offering in order to cater to the needs of the price sensitive market. The company suggests that the pricing strategy was put in place to encourage sales in a market that they believe has huge potential. While all their main research and development has been carried out in New Zealand, Vista has had one of its software modules further enhanced in India which aims to cater to the local cinema/multiplex requirements and the company is prepared to consider more of that in the future as the market develops.

Hence, considering the example discussed, it can be suggested that in order to retain success in the Indian market New Zealand firms need to understand the local tastes/preferences and accordingly design products/services that will meet the requirements of not only the customers but also the state regulations prevalent in the local market. Apart from product/service offerings, New Zealand businesses may also need to understand and consider revising price point and marketing strategy. Moreover, businesses also need to understand the dynamics of the distribution system and develop networks to help access these channels in the local market. Thus, structuring their product lines, services, marketing and distribution strategies for the local consumer requires that businesses judge their product development process and investments required to adjust to local requirements prior to entering the Indian market.

- ***Expanding in steps, learning along the way, rather than in a 'big bang' way:***

The other important factor that New Zealand businesses need to consider is the way to approach the Indian market. As the market is quite large and diverse, the companies are best to approach it on a piece-meal basis rather than a 'big-bang' approach. As discussed earlier, the Indian market presents significant barriers and risks and New Zealand businesses should be well aware of these barriers and the possible impact of these risks upon entry. In order to safeguard the interests of the business and be successful in the local market, companies should tap into the domestic market, with an intention to first learn and understand the local business and market environment and then further invest to expand within the market. As outlined earlier Fisher & Paykal, successfully exhibit this approach.

Although the company has been in the Indian market for over 20 years, the firm initially approached India through third channels such as manufacturers, willing to sell their products in the local market, gradually moving up to appoint distributors in the local market and finally having their own representatives and staff in the Indian market. {Asia Foundation 2006} The company suggests that having this measured entry mode, has helped it understand the details of the functioning within the Indian market without the risk normally involved in operating in such large markets. The company is also of the view a systematic approach can help businesses entering the Indian market not only understand the practices of the local market but also is helpful in calculating the level of risk that

a business can take in order to cater the domestic market, without having to lose any opportunities and investments made in turn.

The extreme volatility and unconventional business methods in emerging markets require different management skills than are needed in the more mature, Western markets. For businesses that are unaccustomed to such an environment, operating in this environment can be very challenging and expensive. Keeping this aspect in mind, as most New Zealand businesses have limited international exposure and capital flows it is important that the firms approach the Indian market in a methodical manner and develop a reasonable understanding of the local environment before planning significant investments in the market.

- ***Developing real on-the-ground understanding of the foreign market by accessing local networks.***

The study has emphasised the fact that like any market, successful operations in India also require a detailed understanding of the local environment. Unlike developed markets, critical information about the Indian market most often is not readily available and institutional and governance frameworks are loosely defined. This aspect makes it challenging for businesses to collect the information necessary for operating in that market. In addition, as discussed in the earlier section, as the business system is complex and information sharing is dependent on personal contacts and relationships, networking at a local level becomes critical for surviving in this environment. Also as 'red-tape' and corruption are distinctive, functioning in the market may be difficult. Furthermore, the country has different state and central regulations and the information about these may be hard to access and understand without any local input.

New Zealand companies with current operations in India, suggest that developing relations at a local level are vital for functioning in the domestic setting and recommend other businesses seeking to tap into India to develop good connections at a domestic level, prior to or upon entry into the market. Contacts and relations with key stakeholders do matter, as these can help businesses acquire the necessary information and provide them with the guidance essential for operating in the Indian market. (Details of this are further discussed in the

section: Local Networks, in this section below) Thus, considering this, it is important that New Zealand businesses develop local contacts and emphasise developing networks in the industry that they seek to operate in the Indian market.

In addition to these firm-specific issues as outlined above, there are some broader issues that will strengthen the capacity of New Zealand businesses around international expansion. In particular, improving the quality of business education in New Zealand with respect to international expansion within the Indian market, in particular, is likely to make a substantial contribution to strengthening the capacity of New Zealand firms in dealing with the challenges of operating in the market. Furthermore finding ways to enhance knowledge sharing between New Zealand firms who are active in India will ensure that best practice is rapidly spread throughout the business community, easing the process of entering and functioning in the Indian market.

12.2.2 Implication 2: Achieving Real Market Access

New Zealand's major policy focus in terms of assisting New Zealand firms to achieve international market access over the past few decades has been through trade liberalisation negotiations. This has occurred mainly in the context of World Trade Organisation (WTO) and increasingly in terms of bilateral free trade agreements (FTAs). The government, for example, recently noted that it will continue to "give top priority to our trade policy agenda of opening up markets for New Zealand" through the WTO and FTAs. Over the years, New Zealand has signed FTAs with Australia (CER), Brunei, Chile, and Singapore, and recently with China. In addition, the government now has talks underway with India for a similar arrangement between the two economies. The objective of this policy approach is to expand market access for New Zealand's exports of goods and services by reducing tariff and other barriers, with a particular focus on primary sector exports and trading within the Indian market.

In addition, New Zealand has undertaken export promotion activities through New Zealand Trade & Enterprise (NZTE) and has also invested in national branding at a commercial level. Nevertheless these activities have been viewed as of secondary importance relative to trade negotiations. However, New Zealand's low level of international economic activity raises serious questions about whether this policy approach is working. It has not positioned New Zealand well to participate in the strong international trade and investment growth over the past 15 years. In particular, the primary focus on trade negotiations is increasingly insufficient to assist New Zealand

firms to overcome the challenges involved in going global from a small, remote economy.

The emphasis on trade liberalisation may have been appropriate when New Zealand was predominantly interested in finding markets for its primary exports. Conversely in a world where the priority is also to assist firms to break into markets like India, with other types of goods and services, much more is needed. In any case, the benefits to New Zealand from trade liberalisation will not make a major contribution to achieving the specified export target. The gains generated through FTA's are obviously worth having, and New Zealand should continue to pursue trade liberalisation through FTAs where they make strategic sense, but such negotiations should not be relied upon to generate a substantial increase in New Zealand's international economic activity.

The real challenge around market access is not getting goods across the markets without tariffs or quotas but is increasingly about helping New Zealand firms access the market that is willing to pay for their good, service, or idea. This involves accessing supply chains, obtaining access to local networks, and developing an understanding of market preferences. New Zealand needs to update the way in which it tries to improve market access for New Zealand firms. New Zealand already undertakes some of these activities in the Indian market, but significant change is required in order for improved outcomes to be generated.

The aim should be to provide services to help enhance market access within India that augment the growth profile of the firms seeking to operate in that market. The challenge is to identify the range of services that will assist these firms as they seek to expand substantially from a New Zealand base into India. New Zealand firms are best assisted by having people and programmes in place in the offshore market (in this case, India). The most important service is providing New Zealand firms with access to people who have deep market understanding and know how business is done locally, who understand the channels to market, which can identify market opportunities, and can open doors for New Zealand firms in the Indian market. There is no substitute for having great people in offshore posts, who are senior, who understand business, and who know the market well.

In order to understand the dynamics of the market well, it is desirable to contract with professional services firms located in India, (like large accountancy and law firms, banks and consultants) to provide some of these services in-market to New Zealand firms while conducting operations in India. This may require NZTE further building relationships with these professional-services firms so that New Zealand firms can access and leverage market research. By partnering with the local offices of these professional-services firms, it will be possible to access specific market research and advice that individual firms may not be able to access readily. NZTE may have a role here in acting as the front for New Zealand firms through which the firms access the private sector services.

A physical in-market presence of the NZTE is important, as an in-market support would enable New Zealand firms to share costs, pool risks with the local networks as well as gain access to services that they would not otherwise be able to afford. This physical presence will provide the ability for networking and collaboration between New Zealand firms, which may provide a powerful form of learning about the Indian environment. NZTE's beachheads programme is an example of the type of initiative that has real potential and has received a lot of positive feedback from New Zealand businesses. The beachheads programme has given important insights about the Indian market as many Indian consultants and businesses have participated in the programme, thereby enabling New Zealand businesses to gain reasonable knowledge about the market prior to entry.

The programme further should aim to make the provision of physical infrastructure that will help achieve an access to the local market networks. Such initiatives will help reinforce commercially-oriented activities more directly between the two markets. This proposed level of service, which is dependent on deep market understanding, cannot be provided in all markets or at least, not with the current or expected level of resourcing. Rather, New Zealand will need to be much more strategic about where it can deploy its resources in the offshore markets and make much more substantial investments in markets like India that hold immense potential and are vital for New Zealand's international economic engagement. The focus here should be to develop a few key relationships with the Indian government, and key corporate sectors that offer substantial opportunities for New Zealand firms.

The real value comes from deep market awareness, and this can only be developed on the basis of sustained investments in the market. However, New Zealand's offshore representation is currently thinly spread across the Indian market. NZTE for example, has just two offices in India, (Delhi and Mumbai) and the consequence is that only a basic service can be provided within the market, which is often insufficient to add real value to New Zealand firms seeking to increase their market access in India. The standard objection to a narrower geographic focus is that having a broad New Zealand presence gives New Zealand greater visibility on emerging growth opportunities. However, the absence of deep investments in the Indian market is likely to mean that New Zealand is not well positioned to take advantage of opportunities when they do emerge. Indeed, New Zealand's lack of participation in India is suggestive that the current approach is not working well. Instead New Zealand needs to focus its efforts so that it can achieve real cut-through within India, in particular.

This approach would involve a strategic focus on country engagement, in which the key economic relationships are identified and resources are invested appropriately in key sub-markets and sectors of interest in India. This focus will allow businesses seeking to invest in India to make a judgement on the key sectors that hold potential and the level of investment required within those, given financial and human resource constraints faced by the firms. Hence, New Zealand needs to be much more strategic about its offshore representation in India in order to achieve better outcomes. Specific exporting and outward FDI targets should be set for markets like India, to help develop key economic

relationships between the two economies and resources should be deployed to achieve these targets with clear accountabilities within the Indian market.

Obtaining increased local market access for New Zealand firms is much more about providing in-market services rather than, negotiating trade liberalisation agreements with India. Although New Zealand should continue to pursue trade agreements, both through the WTO and with individual countries (in this case India), the policy and resource share of mind should be shifted towards helping potential firms obtain market access, through providing access to detailed in-market knowledge and networks and strengthening New Zealand's offshore presence within India.

12.2.3 Implication 3: Integrating into Local Networks and Developing New Models

One predicted consequence of the decline in communication costs was that economic activity should become more widely dispersed, and that it should matter less where economic activity takes place. There are many examples of this happening. Many services have been outsourced to emerging markets on the back of electronic communication however much economic activity remains heavily local. This is because much knowledge is reliant on face-to-face communication and is difficult to communicate electronically. Conversely, international trading relationships are positively related to a shared language, common history and culture, because these factors ease communication across distance. Although New Zealand and India have some common aspects to share, (language amongst other things), the two markets differ significantly in their business systems, regulatory requirements, and market practises.

This suggests that deliberate efforts should be made to integrate New Zealand firms into local networks that would assist in establishing economic relationships in the Indian market. Considering this, it becomes important to understand the practises that New Zealand firms can use to establish their presence in India. Due to the size and diversity of the market the priority should be to invest in people-to-people networks and businesses need to take aggressive action to develop connections with the Indian market. In particular, New Zealand businesses need to better understand the strategic importance of local communications, and person-to-person links, and consider them as an integral part of their operations strategy.

Most New Zealand businesses with current operations in the Indian market (such as Beca Group, Vista, Glidepath, Cadmus to mention a few) have established networks and relations with key stakeholders with the help of local agents and/or representatives and are of the view that having local connection eases the process of operating in India. {Asia Foundation 2006} Establishing a presence in the local market with the help of agents and/or representatives would allow New Zealand businesses to gain access to the local networks, and, over time, build relationships to become a part of the network involved in the industry of interest. The networks include a range of stakeholders, but of primary importance are the decision-makers (often policy officials) and customers. Advantages of developing such connections in India would include access to knowledge about the local market, and links to key decision-makers, allowing New Zealand firms to tap into local knowledge and practises.

In addition, companies entering the local market with the aim to sell their products/ services without manufacturing in India could obtain widespread distribution across India, through the use of a master distributor, whose primary role would be to generate business, and then on-sell to sub-distributors in the relevant local sub-markets (as seen in the case of Index partnering with United Breweries (UB) Group in India). Doing so will enable a high level of interaction and relationship-building as there would be only one main agent/distributor that the business needs to monitor and maintain relations. Hence, getting the right agent/distributor is critical to success. A key attribute of successful agents or distributors is their connectedness with political representatives and officials, as

well as with potential customers and decision-makers. Apart from this, if any company wants to establish production facilities without a joint venture or partnership, use of agents' could also be instrumental in sourcing the right skilled labour and over time could invest in distribution, warehousing and sales and marketing in India.

Strengthening links with agents is best done gradually. For example, some companies develop agency relationships with key clients or customers once they gain confidence in their ability, reputation and integrity. Moreover, regardless of the level of direct involvement in India, regular face-to-face contact between New Zealand businesses and their agents is very important. This enables greater control over the agent's activities in the Indian marketplace, coordination with activities in New Zealand, and, most importantly, acquisition and transfer of knowledge relating to the business. For example, competitor activities can be monitored, face-to-face interaction with customers can take place, meetings with key decision-makers, including policy officials can occur, and insights from the agent can be gained. Regular visits by New Zealand personnel's also signal the commitment and support of the New Zealand business to its agent and customers.

Agents normally perform best when they are working as 'partners', rather than merely as traders and it is important that they are involved in planning and building the company's business in India. Doing so motivates the agents to guide the business appropriately and

the business too gains substantial knowledge of the local requirements. New Zealand businesses can apply a range of approaches to achieve this, including: ensuring that the company's products form a significant part of the agent's business; training agents in New Zealand; taking a minority equity stake in the agent's business; aiming to be the agent's best supplier, in terms of support and commitment; building a shared vision between the New Zealand business and its agent/s; as well as leveraging from their credibility with other domestic companies or customers in India.

While some New Zealand companies prefer to work with agents of similar size, it is also helpful if the partners or agents are large organisations in India. Apart from providing a large customer base, linkages with large Indian corporations sometimes provide substantial opportunities for New Zealand companies (for instance the tie up between Fonterra and Britannia). These arise from a range of factors: the reputation of the company, the opportunity to tap into their business networks, including customers, and access to markets. Moreover, having a strong network with the local business community (suppliers, buyers, distributors and banks) and government authorities such as political governments, industrial administrative departments, foreign exchange departments, foreign trade and economic commissions can help New Zealand businesses gain a competitive advantage in the local market.

In many cases, large corporations may also have an influence at government level, and are able to lobby for industry-based regulatory changes, access critical information, or negotiate with key decision-makers, much to the benefit of New Zealand businesses that may not have the necessary resources (capital and human)to gather the required knowledge for operating in that context. In addition, as markets are built around a complex business and social web, the costs of establishing distribution channels or business networks by New Zealand investors are likely to outweigh the potential benefits of a local network. Moreover, establishing such a network can be a long process and the businesses may not be able to seize the opportunities or align with changes in a timely fashion. In a new environment, a local partner's competencies are fundamentally important for New Zealand businesses seeking market position and power. Whilst the government has an important role to play in developing new strengths, a major part of the responsibility lies with business in terms of developing new business models.

This requires innovation and creativity in terms of developing new modes of approaching international markets. New Zealand firms will need a much greater reliance on outward FDI and so need to develop new ways of operating in markets like India, rather than just the traditional model of exporting goods from New Zealand. There is enormous potential for New Zealand firms to create value from a New Zealand base by adopting new business models that play to New Zealand's strengths. Companies like Fonterra, QLB.com, and R&D Solutionz as discussed in the earlier chapters give a sense of what is possible. These examples suggest that New Zealand based start-up companies with great ideas can be instantly recognised for their ideas and potential by Indian firms. This in

many senses suggests that, it has never been more possible to create value in a short period of time through international interaction.

Thus, achieving a substantial improvement in New Zealand's economic engagement with India is unlikely to be achieved through simple exporting and trading activities. New business models and new types of economic activity will be required to generate a substantial and sustained improvement in the performance of New Zealand firms within markets like India. Achieving this will involve understanding which parts of the value chain New Zealand firms can be profitably engaged in, in the Indian market, and can only be accomplished by establishing close connections and presence in India.

12.3 Chapter Summary

Seeking to conduct operations in India from the end of the world can be challenging. New Zealand's small scale and physical remoteness make international expansion difficult for New Zealand firms than for firms from many other small, developed countries. But simply because international expansion is challenging does not make it any less important to New Zealand's economic future. Economic success, at both firm and national level, is about how decision-makers respond to challenges and opportunities. New Zealand may need to work harder given the additional challenges that it faces, but the lesson from the international experience is that these challenges are not fatal. Every country faces its own set of advantages and disadvantages, and tailors its public policy and business actions accordingly.

However, New Zealand has not responded with sufficient force or intensity to these challenges. In order benefit from the opportunities presented by markets like India, New Zealand and businesses need to update their strategies and approaches to compete effectively in a changing world. New Zealand's meagre exporting and outward FDI performance could be attributed primarily to the consistent lack of a global economic strategy rather than to New Zealand's disadvantaged geographic position. There are a range of actions (some of which are outlined as above) that can be taken by government and by businesses that may have the potential to lead to significant improvements in New Zealand's international performance through increased participation in markets like India, that have enormous prospects to offer.

Chapter 13: Conclusion

This study has sought to draw attention towards the emergence of markets such as India and the importance they hold for New Zealand economy and businesses in particular. New Zealand economy and its businesses have particularly lagged in terms of making their mark on the international front over years. Given the size of the economy and its businesses the study discussed the importance of international engagement for New Zealand. Over the years despite of growth of economic and trade interaction within the world economy, the New Zealand economy has failed to engage with the world economy at a level that bring about sustainable development for New Zealand businesses and the economy as a whole.

New Zealand's level of international economic activity does not compare well to that of other developed countries. In terms of exporting and outward direct investment, New Zealand firms have not been participating in the powerful growth seen across much of the world. Indeed, despite much talk about the bereavement of distance and the emergence of the flat world, the New Zealand economy has become less engaged with the global economy over the past decade or so. This is of real concern given the small size of the New Zealand economy. New Zealand cannot sustain significantly higher rates of productivity and income growth without a substantial contribution from international economic activity. Hence in order to achieve this, the economy would need to generate a meaningful improvement in performance will require significant changes from both

business and government at an international level. This has been the main focus of this study.

To being with the study discussed a brief background of the New Zealand economy in ***Chapter Two***. The background has helped understand the trade patterns of New Zealand, which made it evident that the economy had little interaction with international markets, and focused to a certain key destinations for most of its trade. The chapter also highlighted the changes that the New Zealand economy has gone through over the years in terms of trading activities and established the importance of international trade for the economy of New Zealand.

Keeping this aspect in mind, ***Chapter Three*** discussed the performance of New Zealand in the world economy both pre and post economic reforms. It was evident from the chapter that as an economy New Zealand has heavily relied on the UK market as its major trading partner and also that the main exports were heavily reliant on agriculture and dairy based products. The closure of the UK market in the late 1960's hit the New Zealand economy and its businesses hard, as there was little or no interaction with other markets that New Zealand had focused on for the purpose of carrying trade. Also as the government policies prior to 1984 were quite restrictive towards international engagement, the economy lagged behind, having an adverse effect on the growth of the economy. ***Chapter Four*** presented an analysis of the reforms introduced by the new government that came into power in 1984 with the aim to open New Zealand to the world

market thereby improving the performance of the economy as whole. Although the reforms introduced by the government at the time were significant and stabilised the economy, they failed to prove as a growth mechanism for the economy, particularly at an international level. Owing to this it was concluded that the development of the economy and its businesses had lagged due to lack of international interaction, which has become predominantly important with the rise of the emerging markets that have changed the economic geography of the world. As a way of conclusion ***Chapter Five*** discussed the importance of emerging markets with a particular focus on India as a key destination and emphasised on the importance that this market holds for New Zealand businesses.

Hence in order to fully understand the dynamics of the Indian market, ***Chapter Six*** introduced the background of the Indian economy prior to its economic reforms of 1990. From the points discussed in the section, it became evident that India too as a market was highly regulated and closed to world trade by focusing on former USSR as a key-trading partner. Heavy restrictions and internal barriers introduced by the governments until 1990 deteriorated the condition of the Indian economy at a domestic and international level. Regulations within the market stopped industrial and business development to a large extent within the economy and most of the control as retained in the hands of the government. Owing to the lack of interaction at an international level, the economy was hit with a balance of payments crisis in the wake of the Gulf war and the collapse of the Soviet Union, in 1990. Following the crisis the government of India embarked on a reform programme that aimed to deregulate the economy and its sectors and open the market at an international front. Considering this development as a way of conclusion

Chapter Seven discussed the major reforms introduced by the then Indian government and the effects that those had on the economy. As a sequel ***Chapter Eight*** concluded that the economy had performed favourably post reforms and has today become of the fastest growing economies in the world that stands to offer tremendous opportunities to businesses around the world, New Zealand being no different.

Having understood the developments in the Indian economy over the recent years, ***Chapter Nine*** introduced some of the key areas/sector opportunities that would be of interest to New Zealand businesses in particular. The key areas discussed were the IT, Biotechnology, Food processing and Infrastructure, each of them holding significant investment opportunities as New Zealand skills and know-how are well developed in these sectors and regarded by the Indian market. The section presented sector opportunities for New Zealand and highlighted the growth that these sectors have experienced in the recent areas as well as presented the potential they hold for New Zealand businesses in particular. It was concluded that although a few New Zealand businesses have moved in to serve the Indian market, these firms may not be typical of all New Zealand firms, and analysing this would require further investigation in the area. Following this, ***Chapter Ten*** discussed the possible entry modes that New Zealand businesses could consider in order to tap into these sectors. It presented the possibilities of alliances/collaboration or partnerships as well as presented an analysis of setting up project offices and establishing operations with the help of local agents.

Hence having presented the opportunities ***Chapter Eleven*** discussed the key challenges and risks that New Zealand businesses could face when operating in the Indian market. It emphasised on the aspects of market failures, level of competition, and disadvantages of being a foreign company as well as discussed the level of bureaucracy and the tax framework in the market, and how can these aspects challenge a business operating in the market. Considering the challenges that the businesses are likely to face ***Chapter Twelve*** then presented possible recommendations that may help businesses better understand the Indian market and manage operations much more effectively while operating in the market. It accentuated on key concepts like understanding the local market prior to entering the market as well as the importance of local connections and networks, and the critical role they play in a complex market like India. It also analysed the role that the New Zealand Trade Enterprise (NZTE) could play in facilitating New Zealand businesses that seek to operate in India.

13.1 Suggestions for Future Research:

The research has analysed the potential that the Indian market holds with a particular focus on New Zealand businesses. The points discussed in this study have outlined cases of a few New Zealand businesses that have current operations in India across four different sectors. However, the analysis is preliminary in nature as the data analysed is secondary and considers the operations of these businesses only in their early stages of entry. In order to better understand the dynamics of the Indian market it is important that the next step examines the key challenges and possible success factors of operating in a market like India with a particular focus on New Zealand businesses and their unique characteristics. As a start to this a follow-up of successful New Zealand firms with current operations in India would be useful. The analysis would help better relate the key strategies selected by these firms to the challenges faced while operating in the market and the occurrence of any post-entry strategic changes.

In addition to this it would also insightful to carry out a detailed analysis of a particular sector that has prominence in both New Zealand and India (possible sectors could be food processing, biotechnology and infrastructure to mention a few). The study could examine a matched sample of New Zealand firms some with active operations in the Indian market and those that have not entered the Indian market. The analysis could be helpful in identifying key differences and perceptions between these two sets of firms and also

would be useful in identifying the key challenges perceived by New Zealand firms that are apprehensive about the Indian market.

As discussed in this study most New Zealand firms are quite small when compared to other businesses that may conduct operations in the Indian market and hence, may find it difficult to deal with some of the challenges that are distinctive to India. Amongst the issues outlined in this study, one of the most common problems (as discussed earlier in the section of **Barriers**) that most businesses face in the Indian market is the shortage of skills. As highlighted earlier (in the section of **Diversity of the Indian Market**) multinational firms operating in the Indian market suggest that finding the right skills and knowledge can be challenging. Hence, in order to bridge this gap most businesses tend to opt for a more traditional approach by making significant investments in building on-shore capability.

While this approach may be helpful, most New Zealand firms currently operating or wanting to operate in the Indian market may not be able to make the required investments (at least in the early stages of their operations) to help develop the necessary capabilities. In some cases, high levels of technical expertise may be required, and a few New Zealand companies have experienced difficulty in accessing local people with the requisite skills as seen in the case of Glidepath (as discussed earlier in the section of **Barriers**) . To deal with this issue New Zealand firms could use a more measured approach by identifying and bringing local Indian talent to New Zealand for training or short term employment

purposes. This not only would allow companies to build requisite skills but also help firms gain trained labour that are well versed with the dynamics of the Indian market. Doing so would allow businesses to retain their standard of work at a much lower cost and also benefit from gaining the required local market knowledge.

Apart from this, the other aspect that could be further researched is the use of collaborative arrangements amongst New Zealand firms when considering international operations in markets such as India. As discussed in this thesis, India has its own risks and is quite volatile when compared with the more mature Western markets. New Zealand firms may find operating in the Indian market quite challenging as most firms (due to small size and hence lack of resources) may not have operated in such exigent market conditions. Considering this, further work analysing collaborative strategic responses such as consortia, working projects and collaborative partnerships for example, could help analyse the benefits of collaborative or collectivist arrangements while considering operations in large markets like India. These approaches could be valuable where New Zealand firms may lack the necessary resources and finances needed to undertake successful operations in such markets. However, a combined effort amongst a group of firms could shield the businesses from the risks encountered to some extent and allow them to efficiently share resources and build required capabilities.

The other area that would worth further research is analysis of the success factors that have been identified in other large markets, for example China. Both India and China are

large markets, however when compared, China has attracted far greater attention than India. The key strategies (in terms of products/services offered, methods used to deal with market challenges such as competition, political, economic and legal disparities, labour issues, corruption, and networking to mention a few) used by New Zealand firms in China could offer insights about the dynamics of emerging markets. Lessons learnt from such an analysis may aid understanding of the similarities and differences between the two markets and whether successful business strategies could be transplanted from one to the other.

Lastly, as discussed in the section of **Possible Solutions/Implications**, the importance of suitable policies that would help New Zealand firms integrate further into the global economy were highlighted. Markets like India are and will continue to be important for businesses around the world, including New Zealand firms. Considering this, appropriate policies that would help New Zealand firms in such markets are critical and require further examination. Further research to analyse the types of policies that are appropriate for a firm depending on aspects such as level of international experience, type and size of business, importance of the firm's skills in the foreign market, for example, would be worthwhile. Analysis on more pervasive policies such as tax benefits and help towards market research and development would also further understanding of the factors that determine successful international engagement for the New Zealand economy. It would be helpful to examine the efforts being made by the New Zealand government towards opening up the most promising markets like India through such initiatives as closer trade relations and a possible bilateral trade agreement.

The research issues outlined in the above paragraphs suggest that further work could provide solutions for bridging the gaps in the existing literature. It can be concluded that raising New Zealand's productivity growth in a substantial and sustained way will necessarily involve higher levels of international economic activity. No matter how efficient and flexible the New Zealand economy is the small size of the domestic market means that sustaining high rates of economic growth will require active participation in global markets. Indeed, a characteristic of a high-performance economy is that its firms are able to compete successfully in international markets against the world's best, which can be achieved by considering direct investments in markets like India as a way for New Zealand firms to exploit their competitive advantage at a global level and gain access to a larger customer base for further growth and enhanced economic performance.

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