Centre drops phone-makers' GST call

Mobile manufacturers are concerned that the new tax regime will remove incentives for domestic production

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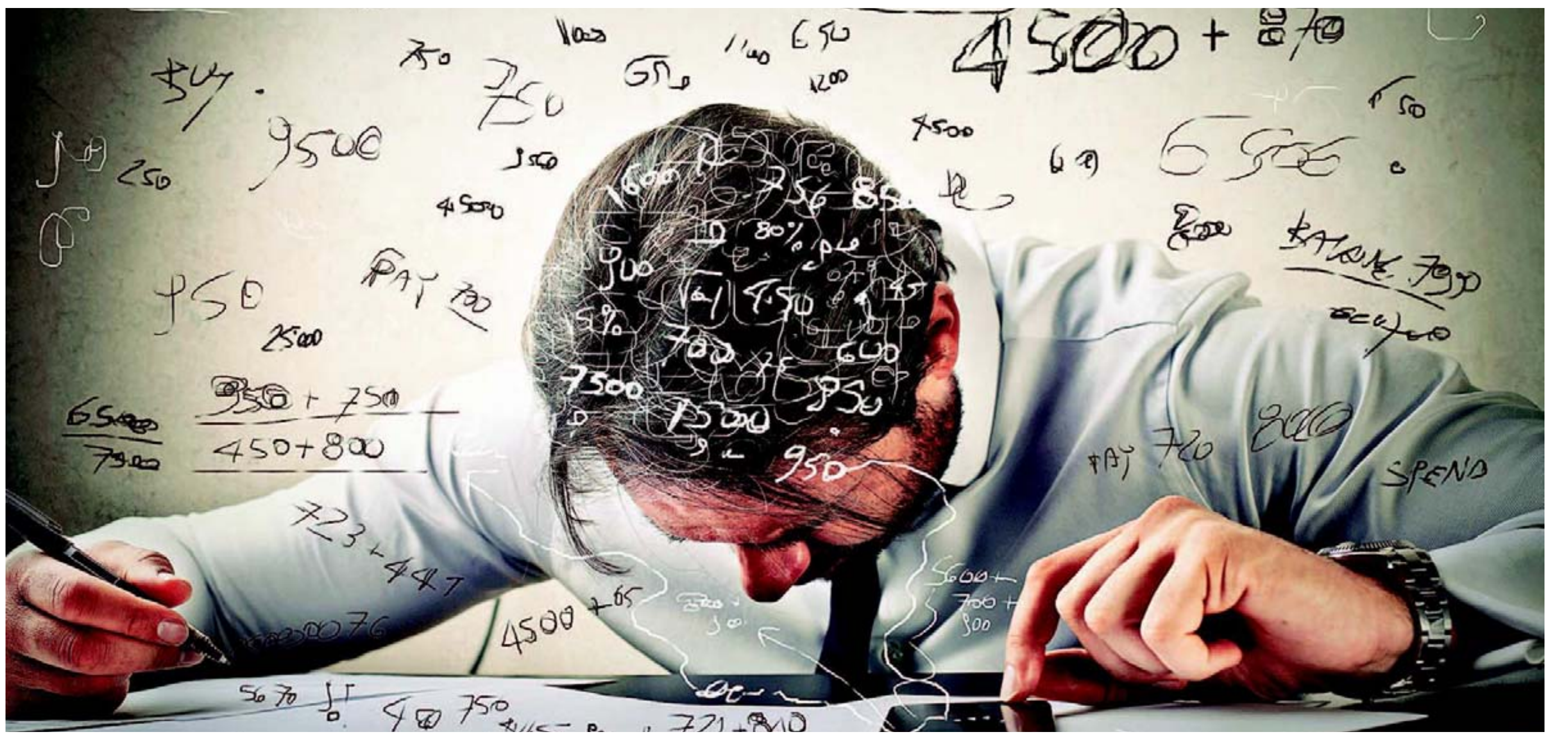
With less than a month left for the roll-out of the Goods and Services Tax (GST) regime – touted as the biggest indirect tax reform in the country's history – mobile handset manufacturers are a worried lot. Their main concern is that the duty differential, which incentivises domestic production as opposed to importing products, will no longer exist as GST will subsume all indirect Central and States taxes into a single tax rate.

The GST Council, at its meeting held in Srinagar last month, decided that 12% GST will be charged on mobile phones against 5% as sought by the industry.

"The government should ensure that the existing differential duty regime on mobile handsets and components continues once the GST regime is rolled out," said Pankaj Mohindroo, national president, Indian Cellular Association (ICA).



Numbers don't match: The GST Council, at its meeting held in Srinagar last month, decided that 12% GST would be charged on mobile phones against the 5% sought by the industry. This could, industry insiders say, hurt prospects for local manufacturing. • GETTY IMAGES/ISTOCK

Mr. Mohindroo said that in 2016, a differential duty regime was introduced on three components of handsets – chargers/ adapters, battery packs and wired headsets – whereby a tariff protection of 10.5% was provided to domestic manufacturers vis-a-vis import of same components for manufacturing.

'Significant progress'

Following this, "significant manufacturing progress has been witnessed during the past 10-12 months with over 30 new mobile component plants being set up and addition of about 30,000 direct employment," he said.

Besides, in the past two years, 40 new units that manufacture and assemble mobile handsets have also come up, due to various financial advantages given to local manufacturers.

"Enhancing tariff protection for domestic manufacturers to 11.5% vide Budget 2015 from the earlier 5% (instituted through a differential duty regime vide Budget 2014) has played a key role in this transformation," he pointed out.

A ministry official said the government and industry are in discussions to impose Basic Customs Duty on imported products to give an impetus to local manufacturing of electronics.

However, some experts feel that these worries are unnecessary as GST will bring in efficiency in the tax system, eliminating cascading of taxes. Asked if GST will discourage manufacturing of mobile phone in India, Santosh Dalvi, Partner (Indirect Tax) at KPMG in India said, "Not really... GST will support Make in India."

"While duty differential will not be there, manufacturing in India will always be better because of the cascading taxes going away under GST... It should reduce the cost of manufacturing unless you are importing from somewhere in the world where cost of manufacturing is much lower than in India," he said.

Price increase

Mr. Dalvi, however, pointed out that a 12% GST rate might lead to an increase in prices of mobile phones across almost all states.

"[For] mobile phones that are currently manufactured in India, the excise duty is 2% plus VAT 5% [excluding Maharashtra and Delhi where the rate is 12%]. So the effective rate, right now, is 7% which will go up to 12% under GST. So mobile[s] will become costlier," he said.

S.S. Gupta, senior consultant, Taxmann.com said, "As of now, basic customs duty on mobile is nil. It only attracts CVD. Therefore, import of mobiles will be beneficial. The basic customs duty shall be imposed to encourage local manufacturers. It appears that there is no duty protection to mobile manufactures."

The Hindu tried to reach various handset manufacturers to understand the impact of GST on their manufacturing plans in the country. However, none of them wanted to comment on the subject.An official of a domestic handset maker said the industry, via ICA, was engaging with the government for some kind of tariff protection.

A representative of another company said that there has been a lot of confusion in the run-up to the implementation of GST. For example, what happens to the inventory that a distributor or a retailer has, but which remains unsold post July 1, the likely date of GST implementation. The handset makers, the company representative added, may offer heavy discounts on mobile phones to consumers in a bid to exhaust existing inventory.

Mr. Gupta, however, added, "There is no confusion. The GST will be payable on all supply of mobile after July 1. The company will be entitled to credit of duty paid (CVD or SAD) on inputs as such in work-in-progress and finished goods."

As a part of the government's flagship 'Make In India' initiative, indigenous production of mobile handsets went up from 11 crore units valued at ₹54,000 crore in 2015-16 to 17.5 crore units valued at ₹90,000 crore in 2016-17, according to official data.

> **In the past 10-12 months, more than 30 component plants have been established**
> PANKAJ MOHINDROO
> National President, ICA

"As a result of increase in domestic production of mobile handsets, the share of imported mobile handsets in total domestic demand is gradually coming down," the Ministry of Electronics and IT has said, adding that the import of mobile handsets decreased from ₹56,000 crore in 2015-16 to ₹40,000 crore in 2016-17.

The government, last month, also notified the Phased Manufacturing Policy (PMP) to push the level of domestic value addition in mobile handsets made in the country. The policy, welcomed by the all handset makers intends to reduce dependency on imports by the way of tax relief and other financial incentives. However, how the policy will work once GST is rolled out is not yet clear.

Policy push

The government had said PMP is expected to generate 2 million jobs in the country by creating a $500 billion industry in the next 5-7 years.

"Presently, the contribution of domestically manufactured mobile phone components stands at 10%. The supply for the remaining parts is met by imports. Most of the components of the mobile devices are sourced from China," Sanjeev Agarwal, chief manufacturing officer, Lava International said.

The phase-wise programme covers mechanics, die cut parts, microphone and receiver, key pad and USB cable in the current financial year. It also aims to promote the indigenous manufacturing of populated printed circuit boards, camera modules and connectors in 2018-19, and display assembly, touch panels, vibrator motor and ringer in 2019-20. With the implementation of PMP, the value addition or share of indigenously procured components in manufacturing of feature phones will go up from about 15% to 37% and the same for smart phones will move up from about 10% to 26%.

The government is also in process of formulating the second phase of PMP which, it expects, will enhance value addition to 58.3% in feature phones and 39.6% in smartphones. Ashok Agarwal, general manager, manufacturing (Operations) at Intex Technologies, said the next step in PMP was critical as it needed development in areas such as Mobile Design and IDH that would primarily drive the ecosystem for Fabrication and PCB design.

"The biggest immediate challenge would be to develop design and R&D capabilities," he said.

"Forecasting the trends and their implications on consumer preferences, manufacturing costs, obsolescence and its cost would all be areas requiring specialised focus. Perhaps, special hand-holding measures will be required to ensure that India catches up with the U.S., Japan, South Korea, China and Taiwan in these areas., Mr. Agarwal added.

GUEST COLUMN

Understanding investment risk

Going against convention could help

ANAND SRINIVASAN

The business of investing is all about predicting the future. When an investor endeavours to predict the unknown and when his thoughts and actions influence the outcome of events, it involves taking risk.

Most times, retail investors flit from being risk averse to being risk-seeking individuals. Conventional wisdom is that when the indices are constantly moving up in the midst of a raging bull market, an investment in stocks is considered least risky. When the markets face correction and move downwards, everyone panics and presses the 'sell' button. Stocks are then considered risky assets.

Sadly, as most serious, value investors are aware, the converse is true. Risk is at its lowest when markets are in free fall and is at its peak when markets defy gravity. We must understand that risk is being accumulated as the markets move up and come down when markets collapse.

Dealing with risk

One has to deal with risk explicitly. For that one has to first understand his or her tolerance to risk; second, one has to make a fair assessment of risk at current levels; and third, the realisation that we have no control over the outcome of investments but that we have complete control over the consequences, is key.

Value investment teaches us that one can achieve high returns with very low risk. This happens when we buy a stock for less than what it is actually worth. This is possible even in a raging bull market as the following example illustrates.

Manappuram Finance Ltd. is a company with a long profitable track record. The business of the company is similar to that of a gold pawn shop. It finances retail consumers who are willing to pledge their gold for a loan to meet their urgent requirements.

The net interest margin, which is nothing but the difference between the borrowing rate of the company and the lending rate to the consumer, is very high.

The biggest risks in finance companies are two fold: one, the value of the pledged assets drops and the customer defaults; and two, even if the price of the asset is high there must be a ready buyer for the asset at the quoted price. Assets which have a ready market are called liquid assets.

> **When indices move up, an investment is typically considered least risky**

For some strange reason, the stock, in the midst of a raging bull market was available below its book value at ₹21.45 in September 2015. If you had bought the stock you would have gone against conventional wisdom. However, you would have been aware of two things: in rupee terms, the price of gold does not collapse and that there is a liquid market for gold.

You would have also known that most Indians do not have easy access to credit. The only way the masses can access immediate credit is to pledge their family jewellery.

Endowment effect

It is a known fact that most of us have an emotional connect with jewellery. Behavioural economists call it endowment effect. We try very hard not to default on jewellery loans. The company, in the subsequent five quarters, has declared a dividend of 50 paise per share every quarter. The stock recently traded at ₹100 on October 2016. In a recent correction, it declined to ₹61 in December and rebounded to ₹103.90 in February.

So, it was evident in 2014 that the stock was available at a discount to its intrinsic value at no risk and is today trading at close to three 3 times its intrinsic value.

(The writer is an author and consultant)

Venture capital in India surges as leaders emerge

Firms that are efficient with capital attract investments

PEERZADA ABRAR
BENGALURU

Venture capital funding in India has bounced back after a slowdown last year. Top venture capitalists said that now there is focus on leaders that are emerging in each sector and on companies that are capital efficient.

The gravy train

The Enterprise Tech sector topped the charts every year starting 2015, with 152, 155 and 60 deals respectively. The retail sector stole the show for amounts invested, with $1.95 billion, $617.4 million and $1.62 billion for the three years.*

India Tech	2015	2016	2017*
Invested ($B)	8.49	4.55	4.74
No. of deals	1,119	1,219	441
No. of companies funded	977	1,062	416
No. of companies founded	10,670	4,880	231

* 2017 figures are year to date.

SOURCE: TRACXN

Among India-headquartered tech companies, there were nine fewer instances of funding compared with Q4 '16, but total capital invested in the quarter jumped 550%, according to the 'Asia Tech Investment Report' by CB Insights, a data intelligence platform.

"You have seen consolidation in the market. Investments are going into (companies) which are seen as market leaders," said Sandeep Singhal, co-founder of Nexus Venture Partners which counts tech company Druva and online retailer Snapdeal among its portfolio companies.

Notable investments this year included Flipkart's $1.4 billion Series J, a $330 million Series H to Olacabs, and a $200 million Series A to Paytm E-Commerce, according to the CB Insights report.

'Beyond discounts'

Mr. Singhal said that there is now more focus on companies that are building businesses in a capital-efficient manner compared with the past. "We are looking for competitive differentiation beyond just discount-led models," he said.

T.C. Meenakshisundaram, founder and managing director of IDG Ventures India Advisors said that a lot of uncertainty has gone away and positive sentiment is coming back for investments. But he cautioned that there is not going to be a flood of funds like 'spray and pray' model in the past in sectors where investors have already burnt their money. "The bar is going up, clearly. We are also not going to see crazy valuations," said Mr. Meenakshisundaram whose venture capital firm counts Flipkart and cancer-treating robotics firm Perfint Healthcare in its portfolio.

Investors are also eyeing start-ups that survived the last two years in difficult industries, like food tech where scores of companies shut down. Last month, food delivery start-up Swiggy raised $80 million led by the South African Internet and media group Naspers.

Ashutosh Sharma, head of investments in India, Naspers, said that his firm was attracted to Swiggy's 'exceptional' execution in disrupting online food ordering and delivery in India, "while many players are struggling."

Swiggy promises to deliver food in about 37 minutes. Its delivery executives use smartphones and an algorithm-powered app to efficiently deliver food.

Artificial intelligence

This year, $4.74 billion has been invested till date in Indian tech start-ups compared with $4.55 billion and $8.94 billion invested in the years 2016 and 2015 respectively, according to data from start-up and venture capital tracker Tracxn.

Top sectors that attracted capital this year include enterprise tech, health tech, fintech, retail and pure technology – which include companies focused on artificial intelligence, drones, 3D Printing and Internet of Things, according to Tracxn.

"Deep tech and artificial intelligence companies are getting support from local sectors and that is heartening," said said Arun Natarajan, founder of the research firm Venture Intelligence. "Earlier they wouldn't get funded," he said.

GDP estimates: Reading the tea leaves

Only a rebound in the farm economy and government spending have helped prop up growth

AARATI KRISHNAN
CHENNAI

The CSO's provisional GDP estimates for the fourth quarter and full year FY17, released recently, had dire news to impart.

Driving the GDP

The Government is doing all the heavy lifting

Real growth rates (%)	2012-13	2013-14	2014-15	2015-16	2016-17
Private spending (PFCE)	5.5	6.2	6.2	6.1	8.7
Government spending (GFCE)	1.7	8.2	12.8	3.3	20.8
Fixed Investments (GFCF)	-0.3	3.0	4.9	6.5	2.4
GDP	5.1	6.9	7.2	8.0	7.1

PFCE: Private Final Consumption Expenditure | GFCE: Govt Final Consumption Expenditure | GFCF: Gross Fixed Capital Formation

SOURCE: PROVISIONAL ESTIMATES OF GDP FOR FY17, MOSPI

They revealed that India's real GDP growth skidded sharply to 6.1% in the January-March quarter of 2017, after averaging 7.2% in the first nine months of the fiscal year. This slump lost India the 'fastest growing economy' tag allowing China to edge ahead. But some commentators are cheering.

Why? Well, with the latest numbers demonstrating that the economy did take a size-able knock due to the note ban, sceptics now appear more convinced that the official statistics aren't dressed up.

Here are four interesting trends from the latest GDP estimates.

Q4 bore the brunt

Most sectors of the economy bore the brunt of the note ban in the fourth quarter of 2016-17 and not in the third quarter, when the thunderbolt move was announced.

When the CSO released its second advance estimates in February, many commentators expressed surprise that GDP growth held up at 7% in the critical October-December quarter. But the latest estimate says that growth gave way to 6.1% in January-March 2017. Gross Value Added (a closer measure of economic activity) slid to 5.6% in Q4 from 6.7% in Q3.

A sector-wise break-down tells us that the sectors that were expected to be hit hard by the note ban did take a knock. In Q4, the construction industry saw a 3.7% contraction compared with a 3.4% increase in Q3.

> **Government spending alone cannot ensure the long-term health of the economy**

Manufacturing growth fell to 5.3% from 8.2%, despite the new series of Index of Industrial Production (IIP) showing factory output in better light. Services such as trade, hotels and transport slowed to 6.5% growth, from 8.3%.

Why did demonetisation have a delayed impact? One explanation is that strong festival season sales in October masked the disruption to consumption in November and December in Q3. In Q4, without such one-offs, the real impact was evident.

It should be kept in mind that even the latest GDP estimates may get revised downwards in the coming months, as they do not fully reflect the performance of the informal sectors of the economy. Both the advance and provisional estimates of GDP are extrapolated based on high-frequency indicators such as the IIP, sales tax collections and the quarterly results of listed companies, which represent the organised sector. Private industry, both manufacturing and services, suffered a body blow from demonetisation. But a rebound in the farm economy and a spending spree from the government helped prop up economic growth to 7.1 per cent for the full year.

The latest estimates show all private sector components of the economy decelerating in FY17. Growth in mining GVA fell off a cliff from 10.5% in FY16 to 1.8% in FY17. Manufacturing slumped from 10.8% to 7.9% and services from 9.1% to 6.9%.

However, a good South-West monsoon boosted growth in agriculture GVA to 4.9%, from 0.7%. Pay Commission largesse saw Government expenditure expanding by 11.3% in FY17 compared with 6.7% in FY16, providing a mini-stimulus to the economy.

But over-reliance on the government is not great news for the long-term health of the economy, or the aspiration towards 'less government'. Given fiscal constraints, a government spending binge extracts a toll on taxpayers. A repeat of that agricultural growth depends on a munificent monsoon this year. Much, therefore, depends on the private sector regaining its mojo.

Investment slump

For economic growth to create jobs, demand for goods and services has to fuel investments in new factories and offices. But the investment leg of the economy remains in a moribund state.

Of the four key legs of GDP on the expenditure side, in FY17, private spending (despite the demonetisation shock) registered healthy growth of 8.7% compared with 6.1% in FY16. Government spending zoomed to 20.8% from 3.3%. But growth in new investments slumped to 2.4% from 6.5%. During the boom years from FY03 to FY08, the number averaged above 15%.

Of late, conditions have turned favourable for a restart of the investment cycle. The Government has been ironing out issues in stalled projects. Interest rates have plummeted. But the private sector is still saddled with excess capacity and only an exceptional rebound in consumer demand can revive its animal spirits.

Nominal growth returns

While economists look mainly at the real GDP (growth in the volume of economic output without inflation) to assess the state of the economy, nominal growth (economic growth in value terms) is quite important to the *aam aadmi*.

On this score, there's good news in the latest numbers. With inflation (at the whole-sale level) shooting up in recent months, GVA at current prices has staged a sharp improvement from 8.7% in the first quarter of FY17 to 11.3% in Q4. Nominal GDP growth, which had slumped from 13.8% in FY13 to 9.9% in FY16, has revived to 11% for FY17.

It is nominal GDP growth that determines increases in income for farmers, entrepreneurs and the salaried. Profit and sales growth for India Inc. are also pegged to nominal rather than real GDP growth.

Overall, if the rain gods prove benevolent and the private sector regains its animal spirits, the economy may see its sporadic green shoots sprout into foliage this fiscal.