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JAPANESE FOREIGN DIRECT INVESTMENT IN INDIA: A WEAK LINK IN TIES

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One of the most notable weak links in India-Japan relations is the low volume Japanese Foreign Direct Investment in India. Despite the potential of Indian markets, Japanese investors have been uncomfortable in investing in India because of the overall business milieu. Although progress has been made, it has been slow and does not seem to complement the kind of 'strategic and global partnership' both countries have envisaged. India has much to do to encourage Japanese investments.

For Japan watchers in India, one of the notable weak links in India-Japan relations has been the low volume of Japanese foreign direct investment (FDI) in India. Statistical evidence amply demonstrates that despite the much talked about attractiveness and potential of Indian markets, Japanese investments have been rather slow to pour in. A report brought out by the Confederation of Indian Industry (CII) in 2007 pointed out that between 1991 and 2006, Japanese investments were to the tune of US$2.15 billion, which amounted to just about 6 percent of total FDI flows into India for the period. The very obvious reluctance of the Japanese has stemmed from the fact that they are uncomfortable with India as a host economy due to its lack of basic infrastructural facilities, inefficiency and bureaucratic rules, corruption and overall business milieu. One of the key requirements therefore is to ensure an improvement in the investment and business environment in India.

Progress, But Not Enough

To be sure, there has been significant Japanese investment in important sectors such as the automobile industry (31%), electrical equipment (14%), telecommunication (9%), trading (8%) and the services sector (7%) along with about 879 technical collaborations since 1991. Technology transfer has been undertaken in the transportation industry, electrical equipment and chemicals sector. Amongst the big Japanese-Indian tie-ups in terms of amount of FDI are the Matsushita Electric Works Ltd-Anchor Electricals Pvt Ltd, Maruti-Suzuki and Tata Teleservices-NTT Do Co Mo. Also significant is the tie-up in the pharmaceuticals sector between Ranbaxy Laboratories Ltd and Daiichi Sankyo Co. Ltd (Japan) for $5 billion. Another milestone in recent years is the establishment of the Neemrana industrial estate about 100 kilometers from Delhi as an exclusive Japanese economic zone. Under a MoU signed between the JETRO and Rajasthan State Industrial Development and Investment Corporation in 2006 and further extended in 2008, the zone encourages Japanese investors to set up their bases in the region, even as they are being offered incentives like tax breaks and slashed sales tax rates. As of August 2009, as many as 17 companies had decided to set up their operations at the industrial park. Several Japanese companies like Nissin Brakes India Pvt. Ltd., Mitsui Prime Advanced Composites India, Toyoda Gosei Pvt. Ltd. And Daikin Airconditioning India Pvt. Ltd are setting up their facilities there. Hitachi is even planning to set up a power plant in the park to meet the supply deficit. Neemrana is locationally advantageous apart from being low-cost and well connected to National Highway-8. India would benefit from increased Japanese investments in manufacturing, retail and infrastructure sectors which would lead to creation of employment opportunities.

Bilateral cooperation on the flagship Delhi Metro Industrial Corridor (DMIC) project has also taken off with the creation of the Project Development Fund. The fund set up with equal contribution from the Indian and Japanese governments of US$ 75 million each, envisages plans to develop investment regions and industrial nodes. The two sides have also undertaken the joint creation of eco-friendly ‘smart communities’ along the corridor. Much of the infrastructure work to be accomplished along the corridor would be done by public-private partnership.

Such recent developments will hopefully be pointers towards a positive trend. In fact, the figure on Japanese investment to India in fiscal year April 2008-March 2009 touched 809 billion yen, surpassing that of the investment to China for the same period. However, experts and officials in Japan are quick to stress that these might be “wrong numbers” or perhaps inappropriate indicators to be upbeat about. According to them, this number is primarily due to the NTT Do Co Mo tie-up and Ranbaxy acquisition in this time frame. It is then amply clear that despite the visible expansion and broader interaction between both countries in terms of investment, much needs to be accomplished. South Korean companies have been gaining considerable ground and have managed to build inroads into the Indian markets when compared with their Japanese counterparts. They have essentially been able to capture the market due to the competitive pricing of their products.

There remains much to be done to bolster Japanese investment interest in India and bring it to a level which complements the kind of 'global and strategic partnership' both countries have envisaged. Not only are the Japanese investment figures relatively low and unimpressive, there are also Japanese concerns and problems which have been articulated at different times through various feedback channels like the report by the Japan Chambers of Commerce and Industry in India to the Indian government. It seems that more needs to be done to allay Japanese fears and apprehensions in order to receive increased Japanese investments. Besides an increase in volume, there is also scope to encourage investments in more sectors as well as more geographical regions in India.

Deconstructing the Japanese Reluctance

A number of interesting surveys have brought out the reasons why Japanese investors have been reluctant to test Indian waters. One is of course the fact that apart from the Maruti-Suzuki success story, other Japanese investors did not have a positive experience in the country and carried back a largely negative image of investing in India. For instance, according to a study on 'Japanese FDI experiences in India,' Toyota Kirloskar Motors tried to enter Indian markets, but faced difficulties and friction in its partnership with DCM India in building light commercial vehicles. Similar unfortunate experiences were faced by other Japanese companies like Satake and Soyo. Such Japanese companies, according to the study chose to stay away from Indian markets even after liberalization of the economy. More recently, after the taking over of Ranbaxy by Daichii Sankyo, Ranbaxy has been facing problems with the US Food and Drug Administration. Two of its products which were to hit the US markets did not get the requisite approval from authorities leading to losses and the falling of stocks. According to a prominent Japanese expert, these problems arose because inadequate homework preceded the signing of the deal.

Two, most importantly, India indubitably lacks the solid bedrock required to magnetize investment – infrastructure. Infrastructure problems are deep-rooted and widespread – be it road and railway networks, power, electricity, water supply systems or warehousing.

Thirdly, Japanese investors complain about high tariffs, tax structure, legal and regulatory set-up, procedural delays and bottlenecks. An observation made by a CII study, for instance, notes that *a typical power project requires 43 Central Government clearances and 57 State Government level (including the local administration) clearances.* Added to this is the fact that unlike other countries which might require as many clearances, there is lack of transparency on requirements, decision-making and documentation.

Besides, there are general problems associated with corruption in the public sphere, which ultimately translates into loss of time, extra financial burden and ambiguity over the fate of the investment. Such factors have proved to be deterrents to many investors who have chosen not to make forays into the Indian market.

The Changing Perception: India as an Opportunity

It is however heartening to notice that there is simultaneously an increasing awareness and acknowledgement of the criticality of the Indian option. A survey report on Overseas Business Operations by Japanese manufacturing companies brought out by the Japan Bank of International Cooperation (JBIC) carried out in November 2008 reveals that although China holds the top position amongst promising countries for investment, other countries including India are fast catching up. The number of companies that perceive India as promising is now nearly at par with China. India is thus becoming a destination for 'new' investments. For these companies, the major reasons for such a perception stem from the future growth potential of the local market, inexpensive labour and skilled human resources. India also figures at the second rank as a promising country for small and medium enterprises (SMEs) in the medium term, even as it tops the list in long-term prospects (over the next 10 years). The Japan External Trade Relations Organization (JETRO) expects more FDI in automobiles, infrastructure (US$150 billion estimated in 10 years), raw materials, and food processing and service sector.

Other prominent studies on investment options have been giving India a very high ranking as an investment destination, albeit next to China. The *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development, UNCTAD* predicts FDI growth in areas such as infrastructure and retail in both China and India. The findings of the *World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk* throw more light on India as an investment destination -

- India ranks number three among the most preferred FDI locations
- India is ranked second among top recipient countries for 'new' FDI projects
- Its business environment rank for the period 2007-11 is 54, 8 places up from 2002-06 and just one rank below China

The Goldman Sachs Outlook for 2010/11 pegs India's GDP growth rate at 9.6% and 10% respectively. It also highlights the presence of a large domestic market consisting of middle class consumers and a booming IT software and service industry.

Policy Recommendations

Despite the fact that India is now ranking high among potential areas for investment, statistics also show that the gap between China and India as the top two recipients is wide. There is the obvious geo-political angle to such a fact. For a country like Japan, which is closer to China geographically, it is natural to tilt in favor of investing in China, even as there is an 'advantage China' in terms of infrastructure facilities and business environment. India seems to be catching up, but there is a lot to be accomplished in order to be a viable and alternative attractive option for Japanese investors. Japanese investors are known to be cautious and risk averse and it is of salience to undertake some introspection in India on several aspects of the domestic economic construct.

First, it is vital to create a better business environment. As noted above, India is currently ranked only 54th in business environment ranks for the period 2007-11. This rating is a measure of quality or attractiveness of business environment. Poor infrastructural facilities have often been cited as having the most significant pull back effect on investments. Apart from the creation of such structures, care also has to be taken to ensure a controlled and proper usage of scarce resources – especially water and electricity. This can be done more effectively by sensitizing and educating citizens on ways and means of optimum and careful utilization of these resources. Problems like illegal usage and wastage of water and electricity have to be tackled firmly.

Second, labour issues have beleaguered Japanese companies like Honda and Toyota in the past and have sent negative signals to Japanese investors. Trade unions and workers form an essential part of an enterprise and need to be trained to work in an ethos which might be different from the Indian work culture. Prominent instances of labour issues involving Japanese companies were as follows - in July 2005, Honda Motor and Scooters India Ltd. workers clashed with the police over the suspension of 42 colleagues, which resulted in a loss of INR 1.25 billion to the company. In January 2006, a lockout was declared in the Toyota factory in Bangalore, which had faced a similar problem in 2001 and 2002. Stringent labour laws need to be put in place to prevent and tackle such situations.

Third, India should leverage and market its advantage as an investment destination keeping in mind the fact that it has a young, well-equipped and skilled human resource. For an optimal utilization and complete exploitation of this resource, it is of critical significance that the resource is adequately trained. There have been, for example, instances whereby Japanese companies have had problems due to inappropriate handling of cargo during custom inspection, leading to damages and at times even losses in consignments. This has been pointed out in a report brought out by the Japan Chamber of Commerce and Industry in India for the Government of India in 2009. The Japanese management system also lays a lot of stress on behavioral work culture issues like punctuality, orderliness and discipline.

Fourth, the image of Indian products is not always not synonymous with quality – a factor critically intrinsic to the Japanese construct. There is a deficit on trust that quality controls will be strictly adhered to while dealing with Indian companies. It is, therefore, critical to ensure that Indian products come with a certain measure of guarantee of good quality.

Fifth, political resistance to privatization also sends negative signals amongst investors, not just from Japan but otherwise too – examples are the violence in Nandigram (March 2007) and Singur (2006) in West Bengal. There were violent protests in Nandigram over the state government's plan to acquire land for a special economic zone to be developed by an Indonesian company. In the related violence, some villagers were shot dead, while others were injured. Similarly, the government's attempts to acquire land for a Tata Motors car manufacturing unit in Singur was met with violent resistance by the local community, joined by the opposition parties. Issues such as these have to be handled with sensitivity, control and dialogue – by the authorities and naysayers - rather than by resorting to violence.

Sixth, the Indian government needs to ensure the proper utilization of the Japan Cell in the Indian Ministry of Commerce and Industry by spreading information about its role and functions. There has to be bilingually capable human resource (in Japanese, English) available especially to understand and effectively communicate problems faced by Japanese investors to the right quarters in the Indian establishment. Success stories of Japanese companies in India who are reporting profits and plan to expand further into the market have to be proliferated to the Japanese business community through the use of electronic and print media and the internet. The language barrier has to be overcome, with more Japanese language imparting schools. It would similarly help to hold seminars in Japan like the one held recently in Singapore targeted at Japanese and Singaporean investors. The seminar not only proved to be a source of information to potential investors but also a platform for effective networking amongst such interested investors.

Seventh, a wider spectrum of sectors has to invite investment from Japan beyond the traditional forays into automobiles and electronics. For example, investment in SMEs from Japan should be encouraged. Investment in these enterprises would not only help in terms of bringing about the much needed financial boost and sharpening the technological and managerial skills in such small enterprises, but will help generate employment opportunities amongst sections of the Indian society which is unskilled and untrained. The International Division of the Japan Finance Corporation for Small and Medium Enterprises (JASME) could be tapped for the same. The JASME accepts government officials and study groups from other countries.

Eighth, it is critical also to take steps towards ensuring homeland security in India. Terrorist attacks and insecurity arising out of law and order problems are deterrents for investors. Threats range from terror attacks to the high crime rates in most parts of India. The Mumbai attacks were perhaps one of the most significant cases in point keeping in mind the fact that Mumbai is the financial capital and hub of the nation. Reports critiquing the inadequacy, tardy and uncoordinated response to the attacks were in abundance. It is vital to have a sound, well-equipped and coordinated response system to any such attacks in the future.

Ninth, it may help to move toward a single window clearance system for investments coming into India and make the system convenient and easy to handle. The present system is too complex, arduous and tedious. There is indeed much that both countries stand to gain from increased Japanese investment in India. For India, this would mean better infrastructure and creation of more employment opportunities, while for the Japanese economy, which finds itself in some trouble, India would be a promising destination and a big market. Public-private partnership is a key base to a healthier bilateral economic and strategic partnership for both Tokyo and New Delhi.

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