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FDI in India: Prospects for Japan

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Abstract

India has already marked its presence as one of the fastest growing economies of the world. It has been ranked among the top 3 attractive destinations for inbound investments. Since 1991, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly. After formation of new government in May 2014 at Centre, Indian prime minister visited Japan to boost business and political ties. Japanese companies' investments have flowed into manufacturing sector of India and are expected to rise. The Government of India (GOI) recently launched a major new national program "Make in India" designed to facilitate investment, foster innovation, enhance skill development, protect intellectual property and build best-in-class manufacturing infrastructure. The cumulative Foreign Direct Investment (FDI) inflows (including equity, re-invested earnings & other capital) in India from Japan from April 2000 to February 2014 are US$ 321.81 billion which ranked Japan 4th largest investor in India. Further, it is found that sectors attracted maximum FDI equity inflows from Japan from April 2000 to February 2014 are drugs & pharmaceutical, automobile industry, services sector, metallurgical industries and electrical equipment. This study aims to highlight Japan-specific investment opportunities in India against the backdrop of Japanese investors' concerns regarding FDI in India.

Keywords: FDI, Investment, Infrastructure, Export Performance, Investors.

Introduction

Foreign direct investment (FDI) is a significant source of capital for financing development and infrastructure in countries especially India. It contributes to productivity benefits by providing fresh investment, better technology, managerial skills and export markets (Borenszetin, De Gregorio and Lee, 1998; Harrison, 1994; Sahoo, 2006). Blonigen and Wang (2005) found that FDI flows to developing countries, as opposed to developed countries, have a particularly strong effect on growth by crowding-in- domestic investment. Kee (2011) showed that direct and indirect spillovers can be quite strong, as demonstrated by the case of Bangladesh, where FDI inflows impact both domestic intermediate input suppliers that provide raw material to FDI firms, through increase in demand for high-quality intermediates and domestic final good producers who are users of those high-quality intermediates as a result of shared supplier spillover.

It is a relationship which has historical significance and has only evolved stronger into a political and economic alliance in the 21st century. Historically, the ties between both countries was linked because of Buddhism and has only grown and evolved through centuries with visits by travelling monks from Japan to India from the 8th century onwards.

The relationship between Japan and India has only grown stronger over the years and both countries are set for stronger ties in the future years. This became evident with Prime Minister Narendra Modi’s first choice of visit being Japan after being elected. After the meeting, the two Prime Ministers signed a Joint Statement entitled, ‘Tokyo Declaration for Japan-India Special Strategic and Global Partnership’.

India on its part has been driving home its three great advantages that the Japanese economy can leverage on; democracy in the form of single-window clearances and speedy decision-making; demography cast in the burgeoning youth segment of India’s population more than half of which is currently under the age of 25; and demand, huge capacity of private consumption. Either way it is a win-win scenario for industry in India on both sides.

The good news is that work has already begun on chalking out these synergies with both India and Japan taking steps to unlock the business and economic potential that they offer to each other. The Indian Government has set up Japan Plus, a special management team, to facilitate Japanese investors. The team is actively interacting with Japanese companies and hand-holding them through various approval processes for diversified projects including Japanese Integrated Industrial Parks.

Japan was the second-largest investor in India both in terms of FDI projects and jobs created during the period 2007–12. Japanese investment in India is split between services (40.6%) and manufacturing (45.2%). Most Japanese investors chose New Delhi and Mumbai for their services projects, and Bengaluru and Chennai for their manufacturing plants. Specifically, Japanese companies are interested in India’s industrial and automotive sectors. During the six years up to 2012, Japan established 225 projects in these sectors, creating a total of 98,708 jobs. Honda, Toyota Motors and Sony are just some of the companies that have made long-term investments in the country (The Washington Post 2013). Japan is also keen to invest in the development of India’s infrastructure — the DMIC is a prime example. The relationship between the two nations holds considerable potential but, to progress further, improvements in the tax system and regulatory reforms are required.

Constraints on Japan's Investment in India

According to a report submitted to the Department of Industry Policy and Promotion, the Japan Chamber of Commerce and Industry in India characterizes the Indian business environment as "tough". The document titled "suggestions for Government of India by JCCII" contains detailed suggestions related to the issues of land acquisition, tax system, infrastructure, logistics distribution, relaxation of FDI regulations, visa application procedure, inefficiency and lack of administrative transparency, social security agreement and Intellectual property rights.

Japan's Investment in India

With growing economic strength, India has adapted its foreign policy to increase its global influence. Consequently, Indo-Japanese relations have undergone a paradigm shift and there is now an ongoing effort to build a strategic and global partnership between the two countries. There has been a steady and sure progress in bilateral economic partnership. FDI inflow from Japan has jumped, amounting to $618 million during June-September, 2014, against $273 million for the corresponding period in 2013. The number of Japanese companies in India has reached 1209 (as of October 2014) which is 13 per cent higher over the same period last year. This is a huge increase form 276 companies which were present in 2004.

JETRO has been conducting an annual survey since 1987 called the 'Survey of Japanese-Affiliated Companies in Asia and Oceania' and its findings in India state that over 78 per cent of the firms have plans for expansion over the next year or so. This survey covers 20 countries in the region. Among all the Asian countries that were a part of the survey India has the largest figure. The survey conducted by Japan Bank for International Cooperation (JBIC) also confirmed the same trend. Both the surveys confirmed the overall intention between India and Japan. A simple diagnosis of Japanese firms in India will show that there are an almost equal number of manufacturing and non-manufacturing firms. This reflects that sales activities are very aggressive in India but the main objective is to increase the percentage of Japanese manufacturing firms in India.

India has been ranked the top destination for future investment by 1,000 manufacturing companies of Japan, according to the Japan Bank for International Cooperation and the expanding frontiers of cooperation are rapidly straddling new shores of technology, infrastructure, renewable energy and defence. Japanese firms have started paying attention to India because of strong ties that Prime Minister Narendra Modi created and cemented during his stint as Chief Minister. Investment in India saw a boon especially with the introduction of BRICs by Goldman Sachs in 2003. Since then there has been steady increase of Japanese companies in India. An analysis of the FDI equity inflows, received in India since 2000 shows that the FDI inflows have risen substantially. Table 1 shows that the cumulative FDI equity inflows received during April 2000-February 2014 were US$ 214170 million. Out of this, FDI equity inflows from Japan (which ranks 4th) are US$ 15968 million, which represents 7.46 per cent of the cumulative inflows received. Total FDI inflows during the period April 2000 to February 2014 (including equity, re-invested earnings & other capital) are US$ 321809 million.

On perusal of the sector-wise distribution of FDI equity inflows received from Japan, during April 2000-February 2014, it is seen that the highest FDI equity inflows have been in the Drugs &

Pharmaceuticals, which accounts for about 28 per cent of FDI inflows from Japan. Automobile industry with about 16 per cent is in second place, services sector with over 15 per cent is in the third place. Metallurgical industries and electrical equipment accounts for about 9 per cent and 4 per cent respectively occupying fourth and fifth place. Overall these five sectors accounts for about 72 per cent of FDI inflows from Japan as showed by Table 2.

The factors that have contributed to the changing Japanese perception of the Indian economy include economic growth despite the global economic downturn; domestic demand; projections of expansion of India's working population aged 15-64 over the long term; strengthening ties with other East Asian economies particularly South Korea; and geographically strategic position of India to develop as a production and export base for the growing market in the Middle East and Africa.

Future Prospects

- India and Japan need to be linked by more robust bridges of economic cooperation that factors in the imperatives and future drivers of growth in both countries and mutual desire for greater contribution to the entire Indo-Pacific region.

- Japan-India Investment Promotion Partnership which was agreed at the summit meeting between Prime Minister Narendra Modi and Japanese Prime Minister Shinzo Abe in September 2014 "seeks synergies between Abenomics and Modinomics".

- Japan will contribute to the Indian Government's "Make in India" initiative to "support India in becoming a base of economic growth for the Indo-Pacific region and the world". This will tremendously boost India's prospects as a manufacturing destination which "Make in India" aims to do by offering incentives in the form of simplification and rationalization of existing rules and regulation and expeditious clearances. There are 25 potential sectors open for Japanese investments in manufacturing facilities and increased exports.

- In infrastructure, India and Japan are also discussing possible projects that Japan could help develop in India's north-east that would improve India's connectivity with its South Asian and South-east Asian neighbours. With the feasibility study for the country's first high-speed railway in its final stages, Japan also expects India to choose a 360-degree project rather than a piecemeal one, involving the utilisation of Japanese technology, wisdom, experience and human resources.

- India and Japan also see opportunities in India's booming e-commerce sector which is growing 40-50 per cent every year. The Japanese e-commerce market looks saturated and companies are looking to expand their presence overseas. Opening up the space to foreign investment would allow companies like Rakuten, one of Japan's big online retail companies, to enter the Indian market and become a global player. Uniqlo, a clothing retailer with a strong global presence both online and offline is also looking to expand in India.

- India is keen on its 'Look West' policy and is aiming at forging and developing ties with the Middle East and Africa which earlier governments might not have had the same rigor. JETRO would like to appeal to potential investors from Japan to come and invest in India. Free Trade

Areas (FTAs) like ASEAN-India Free Trade Agreement, Comprehensive Economic Partnership Agreement (CEPA) are there to leverage and invite FDI in manufacturing. To promote export-oriented investment into India, the FTAs should be utilized more efficiently.

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Table 1: FDI Inflows in India from Japan (US$ million)

Year	Total FDI Equity Inflows from Japan	Total FDI Equity Inflows in India	Share of Japan in total FDI Equity Inflows	Total FDI Inflows (including equity, re-invested earnings & other capital)
2000-01	224	2463	9.09	4029
2001-02	178	4065	4.38	6130
2002-03	412	2705	15.23	5035
2003-04	78	2188	3.56	4322
2004-05	126	3219	3.91	6051
2005-06	208	5540	3.75	8961
2006-07	85	12492	0.68	22826
2007-08	815	24575	3.32	34843
2008-09	4470	31396	14.24	41873
2009-10	1183	25834	4.58	37745
2010-11	1562	21383	7.30	34847
2011-12	2972	35121	8.46	46556
2012-13	2237	22423	9.98	36860
2013- (Feb.14	1418	20766	6.83	31731
Cumulative Total (April 2000-Feb. 2014)	**15968**	**214170**	**7.46**	**321809**

Source: DIPP, FDI fact sheet, various issues

Table 2: Share of Top Sectors attracting FDI Equity Inflows from Japan

Rank	Sector	Amount of FDI Equity inflows (US$ million)	% age of FDI Equity inflows from Japan
1	Drugs & Pharmaceuticals	4401	27.56
2	Automobile Industry	2526	15.82
3	Services Sector*	2447	15.33
4	Metallurgical Industries	1397	8.75
5	Electrical Equipment	687	4.30
Total of Above		**11458**	**71.76**

*services sector includes financial, banking, insurance, non-financial/business, outsourcing, R&D, courier, technology, testing and analysis.
Source: DIPP, FDI fact sheet, various issues