Chapter 2

Indo–Japanese Economic Relations

—Japanese Companies Seek to Catch Up

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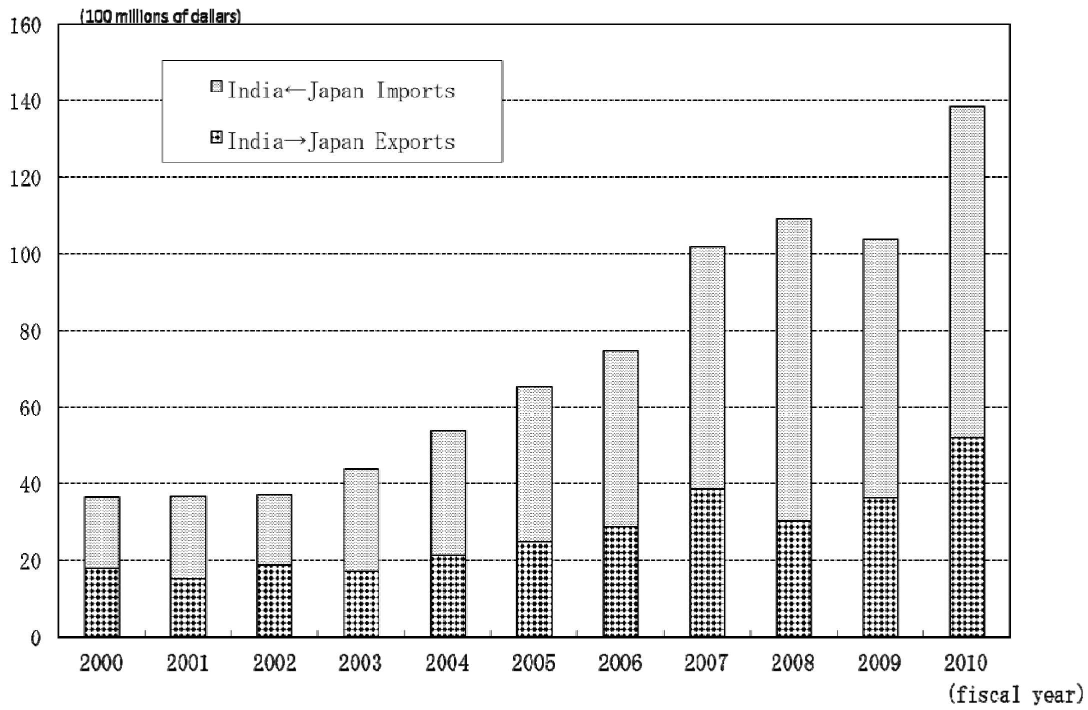
1. Expanding Indo–Japanese economic relations

1.1 Rising trade

Indo–Japanese economic relations are exhibiting a new surge. After five years of negotiations, the Japan–India Economic Partnership Agreement (EPA) entered into force on August 1, 2011, and the number of companies foraying into India has also been steadily rising. Total Japan–India trade has been trending upwards since around 2003, and in particular, exports from Japan to India have been increasing centered around steel, automobile parts, processing machinery, and the like. Although there was a decrease in 2009 due to the global downturn and currency fluctuations, a return to expansion is expected alongside the launch of the Japan–India EPA (figure 2.1).

Figure 2.1: The Trend of Japan–India Trade



Source: India’s Ministry of Commerce

In this Japan–India EPA, tariffs on goods making up 94% of the value of bilateral trade will be abolished over a period of 10 years from entry into force, and the items covered are 97% of Japanese imports from India and 90% of Indian imports from Japan.

The major items of market access improvement from India to Japan include nearly all industrial products, generic drugs, durians, sweet corn, curry, black tea, lumber, shrimp, and shrimp preparations. By contrast, the major items of market access improvement from Japan to India include, in industrial products, automobile parts such as engine-related parts and mufflers, steel products such as various types of steel plate, electric/electronic goods such as DVD players and video cameras, and industrial machinery such as tractors and bulldozers, and in agricultural, forestry, and fishery products, bonsai, Chinese yams, peaches, cherries, persimmons, and the like.

In the future, the handing of intermediary trade and rules of origin will require thorough consideration when Japanese corporations use this EPA. This is because in the rules of origin, if the 35% added value criterion and the change in HS code at the 6-digit level criterion are not simultaneously met, a certificate of origin as the exporting country cannot be obtained.

Another problem is the length of the number of years it will take to lower tariffs. Many Japanese corporations are concerned that since in the Japan–India EPA the reduction in tariffs in many items will occur in the final tenth year, there will be no reduction in tariffs for the first nine years. It has also been noted that there is a large number of items excluded from tariff reduction related to automobiles and automobile parts, for which Japanese corporations have the highest hopes. Meanwhile, from India's perspective, there is no significant effect other than an expansion in generic drug exports, and in many fields that could not be covered by the EPA, such as the movement of people including the dispatching of nurses and caregivers, negotiations currently are underway anew. Also, with negotiations towards a Japan–India Social Security Agreement being carried out separately after the entry into force of the EPA, the impression is that there is no small number of tasks that were left aside by this EPA.

However, despite these complaints, if one takes an actual look at the situation, the number of Japanese corporations acquiring certificates of origin for exporting to India as of August 2011 exceeds expectations. In the Indian market, where cost competition is already intense, for Japanese companies to compete while the yen is high, there is a large benefit to even a miniscule cost reduction. In particular, it is thought that there will be a benefit to capital-intensive industries for which international prices have been established, products with a large technological edge, and products requiring continuous research and development.

South Korea, which competes with Japanese products in India, launched an EPA with India in January 1, 2010. The India–Korea EPA has a lower level than that with Japan, but has a greater sense of speed. There are hopes for further expansion in business in India by Japanese corporations taking advantage of the Japan–India EPA.

1.2 An expansion in investment

In the Indo–Japanese economic relationship, the expansion in direct investment is greater than that of trade. Investment in India is rapidly growing from ¥59.7 billion in 2006, ¥178.2 billion in 2007, and ¥549.2 in 2008. Although this decreased in 2009 (to ¥344.3 billion), there is no mistaking that India has become one of the three largest investment destinations in Asia, alongside China and the ASEAN six majors. Japan is one of the top 5 investors from the Indian perspective as well.

In the survey “Investment Destination Countries/Regions Important to Japanese Corporations” conducted by the Japan Bank for International Cooperation (JBIC), India continues to rank in the top class alongside China. It is also often heard that the number of inquiries regarding business expansion at banks and think tanks that relate to India exceeds that for any other country.

Also, the studies of the Indian market by Japanese businesses have been changing from “setting aside the question of whether or not we will advance into India, we will just do a study,” which was the case a few years ago, to “we will investigate whether or not to advance” and then “we will do a study assuming that we will make the advance.” Thus it can be said the studies of the Indian market, at least, have become indispensable to Japanese corporations.

From these circumstances, the mindset of Japanese businesses that have already expanded to India is changing. Up to now, there has been the sense that cases where business did not go well in India was chalked up to being because of “the investment environment in India,” and conveniently set aside by saying that “it is best to wait until India becomes a bit wealthier.” However, learning from Korean corporations, many Japanese companies recently have been much more serious in furthering localization and have been introducing low-priced products. For example, Toyota and Nissan have launched strategic compact vehicles priced at under one million yen. Panasonic and Daikin have been introducing low-cost televisions and air conditioners to counter Korean corporations. Daikin has been pitching industrial air conditioners to factories, and instead of targeting Japanese companies, has been selling to local corporations, which have faster decision-making. In terms of market share for flat-screen televisions, Sony has passed the South Korean corporations to take the lead. In the field of daily commodities as well, the entry of Japanese businesses is increasing. There is the sense that, having come this far, Japanese corporations are finally catching up.

Among these businesses, the movements of Panasonic are drawing particular attention. This company, which had a late start in India, revealed a strategy emphasizing India, and is proceeding with a plan to invest ¥20 billion and double sales in India over the next three years. Also, in the planning and development of home appliances to be deployed, there are attempts to create designs suited to India by having locally stationed Japanese employees visit local Indian households themselves. In this way, personnel are increasingly local. In the future, if the expansion of sales networks, which are currently considered to be weak, and the enhancement of maintenance networks continues, there will be a good chance to catch up.

1.3 Diversification of regions and industries for investment

Japan is finally starting to catch up in the IT service industry, which had a much later start in India than manufacturing. As a result of NTT Data's acquisition of US-based Intelligroup and Fujitsu's acquisition of US-based Rapidigm, a base has been established in India. Centered on a base in Pune, Fujitsu has started offering offshore services to Japanese corporations. The use of Indian IT engineers is also on the rise. It is expected that the number of technicians that NTT Data has in India will exceed 10,000 within a year, and Fujitsu is implementing a plan to increase its number of Indian technicians to 5000 in three years. Hitachi also plans to have a 6000-person organization in a few years. The major IT companies such as Accenture and US-based IBM already have nearly 100,000 technicians in their bases in India, and despite this order-of-magnitude difference, it can be said that Japanese businesses have finally become serious about taking advantage of Indian IT.

In the service industry aside from IT as well, it is becoming clear that Japanese businesses are placing importance on India. In finance, Nomura Securities acquired the Asian branches of the fallen Lehman Brothers, and as a result, is succeeding in attracting an excellent staff in India. Mizuho Bank is also clearly setting forth with an emphasis on India. In the retail industry, aiming for the opportunities resulting from the opening up to foreign capital of the multiple-brand sector, Lawson and Daiso are proceeding with plans to expand into India.

The diversification of investment destination regions is also a prominent development. The bases for Japanese corporations had been largely collected in the Delhi national capital region, where factories for Suzuki and Honda are located, aside from which there was really only Bangalore, where Toyota had penetrated. But recently, this has been expanding to Chennai and Mumbai as well (table 2.1). Furthermore, it was recently reported that Suzuki is planning to build a new factory in the state of Gujarat. There had up to then been few examples of Japanese corporations expanding to Gujarat, but since the administrative efficiency of the provincial government is favorable and the infrastructure such as harbors and electric power is developed, it is likely advisable for other Japanese corporations to investigate investing in such states in the future.

Table 2.1: The Number of Locations of Indian Expansion by Japanese Corporations (as of October 2011)

Total: 812 companies, 1422 branches

Haryana 385 companies	(city name: companies) Gurgaon: Suzuki, Tokio Marine & Nichido Fire Insurance, Sompo Japan Insurance, Dentsu, Daikin Manesar: Suzuki, Denso Dharuhela: Honda Motorcycles Sonipat: Yakult etc.
Uttar Pradesh 51 companies	Noida: Automobile parts manufacturers such as Honda, Yamaha, and Denso
Rajasthan 29 companies	29 companies Neemrana: Daikin, TPR, Nissin Kogyo, Toyoda Gosei Tapukara: Yakult etc.
Gujarat 29 companies	
Madhya Pradesh 7 companies	Bridgestone, etc.
Maharashtra	Pune: Ebara, Sharp, Keihin, Yazaki, Bridgestone (factory planned), etc.
Karnataka 182 companies	Bangalore: Toyota, Komatsu, Fanuc, Sanyo Electric, Nissin Foods, etc.
Tamil Nadu 286 companies	Chennai: Nissan Motors, Igarashi Electric Works, Panasonic, Ajinomoto, Shimadzu, etc.
Andhra Pradesh 70 companies	Vishakapatnam: Eisai, etc.
West Bengal 67 companies	Haldia: Mitsubishi Chemical, Kubota, Hitachi Construction Machinery, etc.

(study by the Japanese Embassy in India)

1.4 Diversification of obstacles to investment

Alongside these changes, the obstacles to Indian business by Japanese corporations are also diversifying. Until a few years ago, the top three problems for Japanese corporate investment in India basically were the undeveloped infrastructure, the bureaucracy, and labor problems. In response, the Japanese government repeatedly requested improvements from the Indian government, but the reality is that there were no prominent results. More recently, the two problems of competition with local and South Korean companies as well as land expropriation are being taken seriously as new problems.

In particular, acquisition of industrial land has recently been a problem common to many Japanese corporations. Many Japanese corporations have forayed to the vicinity of Delhi and Gurgaon, but the situation is that securing the space for new industrial parks is practically impossible. When acquiring industrial land, Japanese corporations have been using the device of using local corporations as dummies to prevent a sudden jump in land prices. Also, as an example of the government supporting the private sector, there is an industrial park exclusively for Japanese corporations in Neemrana, Rajasthan through the Japanese Ministry of Economy, Trade, and

Industry (METI), the Japan External Trade Organization (JETRO), and the Rajasthan State Industrial Development & Investment Co. Ltd. (RIICO). METI and JETRO are also planning a similar enterprise in the state of Tamil Nadu. Japan's trading companies thus far had not been earnest about setting up industrial parks or Special Economic Zones (SEZs) in India, but Sojitz recently developed an industrial park for Japanese corporations outside Chennai.

2. New risks and risk dispersion in Indian business

2.1 M&A and the risks thereof

Another significant characteristic of investment in India recently has been that large-scale investments in the form of M&As have arisen. Representative examples include the ¥50 billion acquisition of electrical materials heavyweight Anchor Electricals by Matsushita Electric Works (now Panasonic Electric Works) in 2007, the ¥500 billion acquisition of the major pharmaceutical company Ranbaxy by Daiichi Sankyo and the ¥260 billion capital participation in Tata Teleservices by NTT DOCOMO in 2008, the ¥100 billion capital participation in steel heavyweight JSW Steel by JFE Steel in 2010, and the ¥60 billion capital participation in the Reliance Life Insurance Company by the Nippon Life Insurance Company and the ¥5 billion acquisition of stationary heavyweight Camlin by Kokuyo in 2011.

As a result of this increase in M&As, there has been a diversification in the nature of direct investment in India, which had been largely automobile-related. Looking at the breakdown by field of recent direct investment in India by Japan, it can be seen that Daiichi Sankyo's investment in the field of pharmaceutical products in 2008 and NTT DOCOMO's investment in the field of communications in 2009 greatly increased the total value of investment in India. To Japanese corporations, with their late start in India, acquiring strong local companies through M&As and engaging in capital participation even when in the minority have been shortcuts for catching up.

Panasonic Electric Works can be cited as successful example among the M&A cases by Japanese companies in India. Anchor Electricals, which was bought by Panasonic, engages in the manufacture and sale primarily of household electrical equipment, such as wiring instruments, circuits, electrical wire, ceiling fans, lighting lamps, and lighting fixtures. In particular, it has a nationwide sales network as the largest company for writing instruments, with a 37% market share. Panasonic Electric Works engaged in a capital participation in this company in 2007, making it a 100% subsidiary in 2009. Currently, Panasonic Electric Works is improving the production processes by sending a large number of Japanese employees to the local sites, and this is becoming a new model for success for Japanese corporations.

Aside from this, an investigation of NTT DOCOMO also stands out. This company agreed to a capital participation with Tata Teleservices, which is part of the Tata Group, in November 2008, and invested ¥250 billion in 2009 to acquire 26% of their stock as well as 12% of the stock of the related Tata Teleservices Maharashtra. NTT DOCOMO launched the brand "Tata DOCOMO" in India, started offering innovative services such as "one paisa per second" (1 rupee=100 paisas) and "one paisa per SMS character" immediately upon starting with a cellular service plan. Despite starting late in GSM, it now is holding the top spot in terms of net increase in users.

There are still many cases where the family of the founder holds much of the stock of the major corporations in India, and so it is not uncommon for there to be corporate governance problems, such as irrational transactions between family companies or the central positions being taken up by the same kinship group. Also, generally speaking, the owners of Indian businesses do not wish to let go of their stock, and so good companies tend to not go up for sale easily. To Japanese corporations, when engaging in business partnerships and starting joint ventures (JV) in India, not to mention M&As, it is necessary to perform prior studies, do due diligence, listen to the reputation of the owning family, and the like in a detailed manner in conjunction with Indian staff members and experts.

2.2 India as a global risk dispersion site

2011 was a terrible year for the Japanese economy. The giant temblor that struck in the Pacific Ocean off the Tohoku region on March 11 was the worst post-WWII earthquake. Before a year had passed, there was next the severe flooding in Thailand—an important overseas production base for Japanese companies—and many corporations incurred flooding damage. As a result of these two disasters, Japanese corporations were forced to respond to the severe consequences of the supply chain disruption.

Amidst these circumstances, business in India for Japanese companies was relatively unaffected. After the Great Eastern Japan Earthquake, Suzuki's corporation in India had three months' supply of automobile parts from Japan, and so made it through without being affected very much. Toyota, which had been planning a factory opening ceremony in Bangalore on March 15, postponed the ceremony on account of the earthquake and reviewed the production and sales plan for compact vehicles, but the recovery thereafter came earlier than in other regions. At the time of the Lehman Shock in 2008 as well, India's rural economy was in the global limelight, but, in a different manner this time, there was renewed awareness of India's significance as a "risk hedge" being brought into sharp relief.

It also seems that the Great Eastern Japan Earthquake did not significantly affect intergovernmental negotiations towards a Japan–India Civil Nuclear Cooperation Agreement, which had already been underway. Although investigations of safety with respect to location are already being conducted for existing nuclear power plants as well as new proposals in India, the Indian government is not undertaking a large review of future nuclear power plans. As there is no

Japan–India Civil Nuclear Cooperation Agreement at present, Japanese corporations cannot export the relevant materials to India, but US and French companies are hoping for Japan to export materials to India in order to build nuclear power plants there. As a result, it is likely that the response for the foreseeable future will be along the lines of gradually easing the targets of METI trade regulations. To Japan's nuclear power plant component manufacturers, facing a clearly shrinking global market, India can be said to be a likely risk hedging destination.

3. The trend of penetration by small and medium enterprises

3.1 Machinery-related small and medium enterprises

Recently, Japanese small and medium enterprises (SMEs) are turning their eyes to India. Most of the Japanese SMEs that have expanded to India are local automotive-related subcontractors for Suzuki, Honda, Toyota, and the like, and there are few Japanese SMEs that are opening up India's local or export markets. With legal problems, finance problems, the opening of the local market, and the like, India poses a high hurdle to Japanese SMEs, which despite having a high level of technology are deficient in other types of knowhow.

Even amidst these circumstances, however, Igarashi Electric Works has been an exceptionally successful Japanese SME. This company is a global enterprise that develops, produces, and sells compact DC motors. Ten years after establishing a production base in China, they opened one in Chennai. As a result of an invitation by a US trading company that is the partner in a joint venture in Hong Kong, Igarashi Electric Works has a joint venture with India-based Crompton Greaves called Igarashi Motors India. The number of employees currently exceeds 400 people, and is listed on the local stock exchange. Igarashi Motors India produces for itself as well as manufacturing parts and finished articles requested from customers. There are cases where Japanese technicians go to give guidance, but there is only one locally resident Japanese staff person. Igarashi Electric Works is being thorough in localization as part of its overseas strategy, and of its 2000 employees in China, there are only four Japanese people. The top leader of Igarashi Motors India is also concurrently a director of the Japanese parent company. Igarashi Electric Works has arranged a system for going from research all the way to prototypes by establishing a technical center in Kawasaki's headquarter premises, and is promoting global deployment resulting from creating a three-pole network with Asia and Europe centered on Japan.

3.2 SMEs related to agriculture and food products

There are also few Japanese SMEs related to agriculture and food products that have forayed to India, but there are examples of successes. Satake engages in sales and after-sales services for mechanized equipment and plant related to grain and food products such as rice, wheat, corn, and lentils in India. The products it handles are grain hullers, grain selectors, rice mills, rice polishers, and color selectors, which are especially used as processors/selectors for export rice. Based on past success, its Indian branch in Delhi was upgraded to a local corporation in 2006. As a result, Satake is aiming at its own local materials sourcing and installation construction duties in addition to enhancing its total engineering and after-sales services from conventional product sales to plant sales and establishment of business offices. Moreover, it is well known that Satake's emergency provisions (Magic Rice) were useful at the time of the major earthquake in the state of Gujarat.

3.3 Factors common to the successful SMEs

Elements common to SMEs that have been successful in India are, in many cases, having a top-down administration of the ownership system, having specialized technology that is not exposed to cost competition in the industry, and having a significant track record in countries other than India in terms of international deployment. For example, Satake has bases in China, Thailand, Myanmar, Brazil, Australia, the US, Canada, the UK, and the like aside from India, and its rice milling plant product share is quite high, at 70% among large-scale rice mill manufacturers domestically in Japan, and abroad at 70% in Asia, 50% in Central America, 60% in the Middle East and Africa, and 98% in North America.

When SMEs conduct business in India, joint ventures are particularly important. As seen in the example of Igarashi Electric Works and the like, there is no small number of corporations that have succeeded in India or have come to invest in India as a result of a joint venture.

Finally, local chambers of commerce and industry have a large role in promoting business by western SMEs. The best example is that of Germany's Indo–German Chamber of Commerce. Of course, it is clear that there are differences in disposition and budget size for chambers of commerce and industry depending on the country, but nevertheless among Japan, the US, the UK, Germany, and France, Japan is the only country that has not readied an Indian chamber of commerce and industry office. JETRO does the work in Japan that corresponds to that of chambers of commerce and industry in the West, and recently it has been evaluated highly in India as well. Still, as a public body there is an institutional limit (for example, evaluating individual companies or the like) to its fields of activity, and so efforts in the private sector are similarly needed. The need for building a base in India for a Japan–India chamber of commerce and industry has been often pointed out by Mr. Arjun Asrani, former ambassador to Japan. Of course there are the issues of cost and sponsorship, but if it is started with only Indian staff without sending any Japanese personnel, it will not require a large cost.

Finally, the support of the government and economic organizations is indispensable to promoting the expansion to India of SMEs. The German chamber of commerce is the best example of that. In Japan as well, in order to support investment by Japanese businesses in India centered on medium-sized businesses and SMEs, JETRO opened a business support center in July 2006, and is providing office services to Japanese companies centered on such enterprises as well as consulting services by means of resident advisors. Also, the Japan–India Business Co-operation Committee of the Japan Chamber of Commerce and Industry is also offering advice for SMEs, for example in Saga Prefecture, foraying to India.

4. Conclusion

Alongside a rise in interest in India, we are facing a new stage in the Indian business of Japanese enterprises. Investment in India by Japanese corporations is rapidly expanding at a level like that for China and the ASEAN six majors, and business in India by Japanese companies is diversifying in terms of investment field. The region of investment, which had been largely the capital metropolitan area, is dispersing to the vicinity of Chennai, and Suzuki's investment in Gujarat was recently reported. Also, the Japan–India Economic Partnership Agreement (EPA) entered into effect in August 2011, and further expansion of Japan–India trade is expected.

An increase in corporate acquisitions resulting from large-scale M&A is a characteristic of the entry into India by Japanese companies of late. Although it is necessary to pay thorough attention to corporate governance of partner Indian companies, as in the case of the enormous losses tallied by Daiichi Sankyo, this direction is not itself mistaken, and so it is desired that many Japanese businesses catch up using this kind of business model in the future.

The difficulty and riskiness of investing in India, such as the infrastructure and bureaucracy, have largely been emphasized so far. However, the importance of India as a global risk dispersion base has come to draw attention, since the damage that Japanese firms in India incurred was small during the Great Eastern Japan Earthquake and the massive flooding of Thailand in 2011.

Furthermore, it is predicted that investment in India by Japanese SMEs will increase in addition to that by multinational corporations such as automobile and consumer electronics manufacturers. It is hoped that Japanese SMEs that quickly carry out top-down decision-making and that can find good partners will increase in India. Indo–Japanese economic relations, which have entered a new stage, will likely exhibit new developments in the future on a variety of such levels.