Japan's Investments Reach Inflection Point

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Momentum Shift

In the field of foreign direct investments (FDI) Japan has belatedly been turning its gaze towards India. To be sure, such investments are still only a fraction of Japan's exposure to China and ASEAN, but they have been rapidly gathering momentum of late, even doubling in the course of a year from $1.6 billion in fiscal 2010 to $3 billion in 2011. From April 2000 to July 2012, $12.6 billion or 7% of India's cumulative foreign equity inflows came from Japan, compared to 9.6% from the United Kingdom and 6% from the United States, according to the latest data of India's Ministry of Commerce and Industry.

Scarcely a day passes without an announcement in the media regarding the investment plans of large and small Japanese companies across a wide range of industries and locations in India. In August 2012, for instance, the $60 billion Japanese retailing and financial services giant Aeon Co. was reported to be in deal talks with two Indian grocery retail chains. This expression of interest by Japanese retail companies is bound to translate into business opportunities as the Indian government has now permitted up to 51% FDI in multi-brand retailing and 100% FDI in single brand retailing.

Although the country's investments continue to be concentrated in transport-related industries – with 27% of FDI inflows going to the automobile sector from April 2000 to January 2011 – Japanese companies are also involved in the pharmaceutical sector and financial services sectors such as banking and insurance. A defining moment was when Daiichi Sankyo acquired India's pharmaceuticals giant Ranbaxy Laboratories in 2008. They are expected to play a huge role in the mega infrastructure projects of the future, notably the $90 billion industrial corridor between Delhi, the national and political capital, and Mumbai, the financial and commercial capital of the country.

In mid-July 2012, when the country's leading car manufacturer, Maruti Suzuki India Ltd, experienced serious labor trouble at its facility in the state of Haryana, Narendra Modi, chief minister of the state of Gujarat, visited Japan later that month. An important item on his itinerary was to take the bullet train from Tokyo to Hamamatsu to meet Osamu Suzuki. Suzuki is now making its largest investment outside of Haryana to set up a car assembly facility in Gujarat. Maruti officials in India, however, keep insisting that the shift to that state is a "stand-alone decision", unrelated to the labor trouble in Haryana.

The Japanese fascination – especially that of Mitsubishi Chemical Corporation – for West Bengal, which till recently had communist rule, is a fact that intrigues observers. Mitsubishi set up its purified terephthalic acid (PTA) facility in 1997 with an investment of $380 million, one of the largest FDI inflows from Japan. Although it explored other options, "the clinching point was the keen interest shown by the government of West Bengal," noted Srabani Roy Choudhury in her working paper "Japan's Foreign Direct Investment Experiences in India: Lessons Learnt from Firm Level Surveys" (*Indian Council for Research on International Economic Relations,* December 2009).

Currently, there are 1,422 establishments of Japanese businesses all over the country. More than 40% of these are in the southern states of Andhra Pradesh, Karnataka, Tamil Nadu and Kerala. Exemplifying the significant investments in the automobile industry, the largest number of establishments is located in Haryana and Tamil Nadu. With Suzuki building a factory in Gujarat, a lot of component suppliers will also set up shop in that state. Financial services firms tend to locate in Maharashtra. As noted earlier, Japanese businesses are also attracted by the opportunities in West Bengal.

Investments are an act of faith. Japanese investors are beginning to make huge investments despite all the problems in India – poor infrastructure, labor problems and inadequate reform – as they are more comfortable operating all over the country. Honda Motors, for instance, had a hugely successful joint venture making motorcycles with the Hero Group. After 26 years, Honda felt confident of going it alone in the Indian market and exited the joint venture. Most Japanese auto companies that established their presence initially through partnerships, such as Suzuki and Yamaha, are now on their own.

Japanese businesses are reworking their strategies as they are registering returns on their investments in a fast-growing Indian economy. Currently, 90% of multinationals (including Japanese) are making profits in the country compared to 45-50% in China. Many multinational corporations are also reporting higher profitability in India than they do globally, according to the Boston Consulting Group. The recent flare-up of anti-Japanese sentiment in China, which has affected the operations of Toyota, Honda and Nissan, is definitely bound to enhance the attractiveness of India as a destination for FDI.

Flagship Venture

Japan's flagship venture in India is the Suzuki-controlled Maruti Suzuki India Limited that sells a million cars, accounting for half the passenger car market in the country. Despite the recent incident of violence at its facility in Manesar, Haryana, the company plans to step up its investment. It is setting up a greenfield factory in Gujarat to assemble an additional 250,000 cars with an investment of $750 million (40,000 million rupees). The location of the proposed facility is strategically close to Mundra port, where it has a terminal for exporting cars internationally.

At a time when few businessmen from his country dared to venture into the Indian economy, Osamu Suzuki was the first to enter into a joint venture with the government as a minority partner in the early 1980s. It was the advent of Suzuki that triggered the automobile revolution in India with its hatchback model, the Maruti 800. This became India's Volkswagen – a people's car – that symbolized the great Indian middle class dream. As one of the lowest-priced small cars in the world, it brought car ownership within the reach of urban salaried earners, including working women.

Being a flagship Japanese venture, the vicissitudes of Suzuki's experiences – frictions with the Indian government – naturally became the barometer of the India-Japan relationship. The experience of such ventures is crucial in sending signals back home that India is or isn't a good place to invest. Japanese business had a good excuse to sit on the wall so long as the Indian government faced off with Suzuki in the late 1990s over Maruti. The negative feedback was indeed overwhelming. But once the feuding partners buried the hatchet, matters dramatically improved for Japanese business in India.

Thanks to the booming fortunes of Maruti Suzuki India Limited, more and more Japanese businesses are ramping up their capacities. Toyota, the global auto giant, is planning to establish its third greenfield plant in Hosur in Tamil Nadu. It has operated a majority-owned Indian subsidiary, Toyota Kirloskar Motor Private Limited, since1997 with two factories in Bidadi in Karnataka. Like Suzuki, Toyota, too, experienced labor troubles, in 2001, 2002 and 2006. But it has overcome them as the demand for its vehicles is growing substantially. The third facility could be Toyota's new production base in India.

Given its high comfort levels in West Bengal, Mitsubishi has also expanded its capacity to produce PTA in 2006. As Choudhury explains in her working paper, besides the support of the communist government, the company felt that the state was advantageously located close to its operations in Thailand. Proximity to textile-exporting Bangladesh was also an added consideration. As the company website adds, Mitsubishi's PTA facility on the eastern coast was also most suitable because of the excellent port facilities, abundant land and availability of skilled human resources.

TABLE 1

Japanese foreign direct investments in India

Financial year (April-March)	FDI equity inflows from Japan		FDI equity inflows from all countries*		Total FDI inflows including equity, re-invested earnings & other capital**
	Rupees in 10 million	US$ in million	Rupees in 10 million	US$ in million	(US$ in million)
2000-01	976.64	223.66	10,732.61	2,462.73	4,029.00
2001-02	808.78	177.68	18,654.21	4,064.86	6,130.00
2002-03	1,970.96	411.87	12,871.16	2,704.45	5,035.00
2003-04	360.45	78.36	10,064.10	2,187.85	4,322.00
2004-05	575.19	126.24	14,652.73	3,218.69	6,051.00
2005-06	925.07	208.29	24,584.37	5,539.72	8,961.00
2006-07	382.47	84.74	56,390.20	12,491.77	22,826.00
2007-08	3,336.41	815.20	98,642.09	24,575.43	34,835.00
2008-09	1,888.56	404.80	123,024.88	27,330.82	37,838.00
2009-10	5,670.40	1,183.40	123,119.65	25,834.41	37,763.00
2010-11 (up to January 2011)	6,179.90	1,367.33	77,901.69	17,080.09	22,058.00
Total (April 2000-January 2011)	**23,074.84**	**5,081.56**	**570,637.68**	**127,490.81**	**189,848.00**

*Note: i. *These amounts include inflows received through FIPB/SIA route, acquisition of existing shares, automatic RBI route, & RBI – NRI schemes.*
*ii. *On the basis of clarification received from RBI, the amount of stock-swaps & advances has been deleted from cumulative FDI data.*
iii. The amount of FDI equity inflows, in respect of country/sector specific data, was not provided by RBI, Mumbai, prior to April 2000.
*iv. **Country & sector specific details on 're-invested earnings' and 'other capital' are not centrally maintained by RBI.*
*v. **Data in respect of 're-invested earnings' & 'other capital' for the years 2007-08 & 2008-09 are on an estimated basis. It is estimated by RBI as an average of the previous two years.*

Source: DIPP, Ministry of Commerce and Industry, India

TABLE 2

Share of top sectors attracting Japanese investments (April 2000 to January 2011)

Rank	Sector	Amount of FDI equity inflows		% of FDI equity inflows from Japan
		Rupees in 10 million	US$ in million	
1	Automobile industry	6,257.94	1,363.43	26.83
2	Services sector	3,342.75	733.82	14.44
3	Electrical equipment	2,564.43	583.55	11.48
4	Industrial machinery	1,634.32	363.85	7.16
5	Trading	1,458.43	330.44	6.50
Total		**15,257.87**	**3,375.09**	**66.41**

Source: DIPP, Ministry of Commerce and Industry, India

Booming Investments

These developments are reflected in the ebb and flow of Japanese FDI. When India introduced economic reforms in 1991 that delicensed, decontrolled and deregulated economic activity, such investments were limited. In the 1990s, many Japanese trade missions visited India but they were largely fact-finding in nature. They observed that the investment climate in India was not good enough. Suzuki's troubles with the government also gave Japanese businesses an excuse for not taking India seriously. Investment inflows from Japan averaged around $290 million per annum during the 1990s.

Suzuki acquired control over Maruti in 2003, which definitely improved the perception of India among Japanese businesses. The downtrend in inflows to $187 million per annum from 2000 till 2006 soon gave way to a significant uptrend thereafter. In 2007, the equity inflows from Japan climbed to $815 million, rising further to a billion dollars plus since 2009, peaking at $3 billion in 2011. Clearly, this is a phase in which Japanese businesses have begun to feel more comfortable operating in India, thanks to supportive state governments like West Bengal (and Gujarat of late) and profitable business opportunities in a growing economy.

What can shift Japan's gaze even more firmly towards India in the coming years are deep-seated changes in its economy that are "hollowing out" its manufacturing activity. Unable to compete with a strong yen and with shrinking demand back home, Japanese manufacturing firms are establishing new production bases, enhancing existing facilities internationally and acquiring foreign businesses. Japan's net outward FDI flows hit a high of $116 billion last year and are expected to remain at such levels in the immediate future. If India enhances its attractiveness as a destination for FDI with more investment-friendly reforms – considering the difficulties Japan's auto giants are currently facing in China – it could immensely benefit from such outflows. The comprehensive economic partnership agreement between the two countries that was signed last year is also a force multiplier for more Japanese direct investments. JS

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