How Do Japanese Companies View India's Infrastructure?

By Kondo Masanori

Obstacles Facing Japanese Companies

Many Japanese companies in India regard India's infrastructure deficiencies to be the most serious obstacle they face. A survey of Japanese companies conducted by the author with the Foundation for Advanced Studies on International Development (FASID) also suggested that the biggest problem when investing in India is poor infrastructure. (Fig. 1) Along with the advance of economic liberalization, fewer companies are reporting obstructions from India's numerous regulations compared with similar surveys in the past, but at the same time, Japanese companies' complaints relating to India's infrastructure deficiencies remain as persistent as ever. The Japan-India Business Co-operation Committee (JIBCC) and many other Japanese missions and survey groups have visited India to urge India to upgrade its infrastructure.

The prime reason India's infrastructure has not kept up with needs is because governments in the past have failed to make sufficient infrastructure investment. According to a Morgan Stanley survey, while China invested $260 billion in infrastructure in 2002, equivalent to 20% of its GDP, India spent just $31 billion, or 6% of its GDP. In India's 10th Five Year Plan, the Indian government identified the amount of infrastructure investment needed over five years as around $150 billion, but in a recent interim review, revised that figure upward by about $30 billion. Another problem is the time it takes, in democratic India, to do anything. Areas particularly neglected include power, followed by transportation. On the other hand, the area in which development has proceeded most rapidly is telecommunication. A major factor was the political ease of privatizing the telecom sector, with phones being considered luxury goods in India.

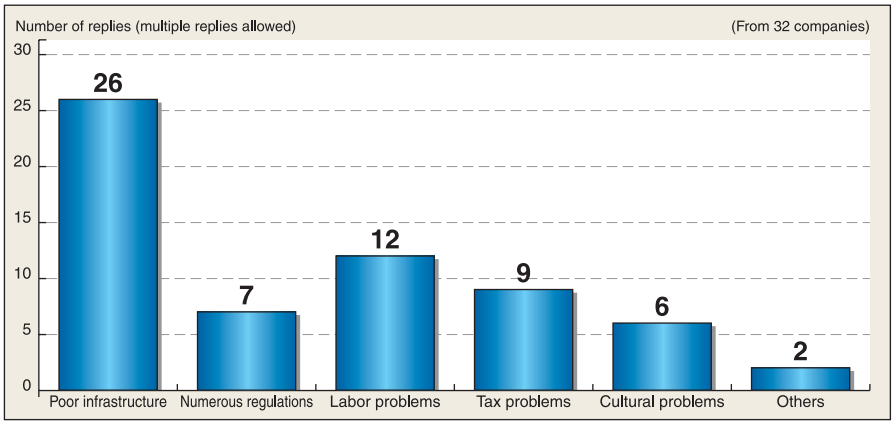
Reforms in the Power Sector

India's power supply falls short of peak demand by 9.1%, and this shortfall is increasing. While it will be necessary to almost triple current generation to 30MW by 2020, realizing this will not be easy. The quality of the power supplied is poor, and many Japanese companies in India complain that the unstable voltage shortens the life of their factory machinery. A breakdown of generating facilities shows that thermal power accounts for two-thirds in India, and most of this is from coal. However, the poor quality of India's coal is a cause of air pollution.

The most serious problem facing the power sector is power charges for farmers, which have been kept to unjustifiably low levels for political reasons. As a result, the power boards of many state governments are bankrupt, and this is causing financial difficulties for state governments. The loss of power during transmission and distribution is another serious problem. But because reforms are overdue, the World Bank and Asian Development Bank (ADB) are lukewarm about financing the poewer sector, and in particular, are not building any thermal plants at all. About half of Japan's yen loans, on the other hand, are for power projects, and about one-tenth of all the power supplied in India is thanks to Japanese financial assistance.

Since the revisions of the act in 2003, local companies like Tata and Reliance have been moving into the power sector, and the private sector now accounts for more than 11% of India's total generating facilities. Currently, privatization of the distribution business is proceeding in Mumbai and Delhi, but if this spreads to other areas of India, overseas operators are also expected to move in. While India currently does not have many foreign independent power producers (IPPs), CLP of Hong Kong succeeded with a business model of acquiring existing power stations at low prices. Looking at Japanese corporations, Marubeni is operating IPP projects in Tamil Nadu and Andra Pradesh, and the former project has been particularly successful. Several mega power generation projects were announced in 2006 in India, and business opportunities are growing.

Figure 1 Problems for Japanese Companies to Invest in India



Source : The survey the author conducted

Improving the Transportation Sector

As illustrated by a comment of former Prime Minister Atal Bihari Vajpayee, "It's not that there are holes in the road, but there are roads in the holes," the state of India's roads is seriously poor. Products and parts often get broken during transportation, and transport costs are high. According to a Morgan Stanley survey estimating the average cost of transport in relation to the value of imported goods, while the world average is 6%, and 5% in developing countries, in India transportation makes up 11% of the value of an import.

Nevertheless, the state of India's roads has recently been slowly improving. The upgrade of the highways connecting four major cities is mostly completed, and the state of India's other roads is also gradually improving. An observer from the Japanese auto industry commented several years ago: "Rather than making cars, shouldn't the focus be on making the roads first?" He recently commented with some optimism: "The roads have improved and the difference between the good quality cars we make and other ones will become clear as time goes on." Already 30 Build-Operate-Transfer (BOT) road projects have been approved, and 70% of these have been completed. While it is the local Indian companies that have the cost advantage in the labor-intensive road business, some Malaysians companies are achieving steady results.

India's distribution is shifting from the railway sector, which harbors problems of inefficiency and corruption, to the relatively well-developed road sector. Two-thirds of the income of India's railways is from freight services, and half of this is from coal transportation. The various problems of India's railway system, which employs a labor force second only in size to China's military, are difficult to deal with and not easily solvable. Moreover, the World Bank will not immediately support Indian Railways due to its poor governance, and the ADB is also reluctant. Against this background, the Ministry of Railway's recent approval for the privatization of the container sector has attracted interest. A still bigger plan is construction of mega flat corridors to link three largest cities. This Special Terms for Economic Partnership (STEP) project, amounting for ¥500 billion, was proposed when Prime Minister Koizumi Junichiro visited India in 2005, and the Japan International Cooperation Agency (JICA) is currently conducting a feasibility study.

In contrast to railway reforms, a recent success has been the Delhi Metro. The outstanding success of this official development assistance (ODA) project, financed with soft loans from Japan and already partly up and running, was because Delhi Metro Corporation's Managing Director E. Sreedharan promoted the construction separately from political interests. Following on from the success in Delhi, a similar yen loan-based metro development is being planned for Bangalore. In addition, there are also plans to build metro systems in Mumbai, Hyderabad and Kochi (Cochin), but it has been decided that these will be BOT projects rather than supported by yen loans.

Privatization is not only well advanced in metro projects, but also in airport and seaport ones. While Delhi and Mumbai airports have provided a dismal welcome to Japanese businessmen arriving in India, it seems their privatization has finally begun to take effect. The airport authorities in Germany and South Africa were successful in winning the contracts. The Indian government's stance on airport building is coalescing toward a private-sector-driven approach, and new airport construction plans for places like Bangalore and Hyderabad are being advanced.

Port projects are also looking toward the private sector. As the state of India's ports was underdeveloped, quite a few exports were first taken to ports like in Dubai or Singapore before being shipped on to the world. However, with India's recent program of deregulation, the companies operating the ports in those countries have begun investing in India. As a result, the average number of shipping days is falling all over India to around three to four days. However, this figure is worsening in some seaports, as in the Port of Haldia, near a plant operated by Mitsubishi Chemical, one of the largest Japanese corporate investors in India. Along with future economic growth, there is a possibility of ports becoming the bottleneck of India's distribution system, and Japan is urging the Indian government to develop its port infrastructure.

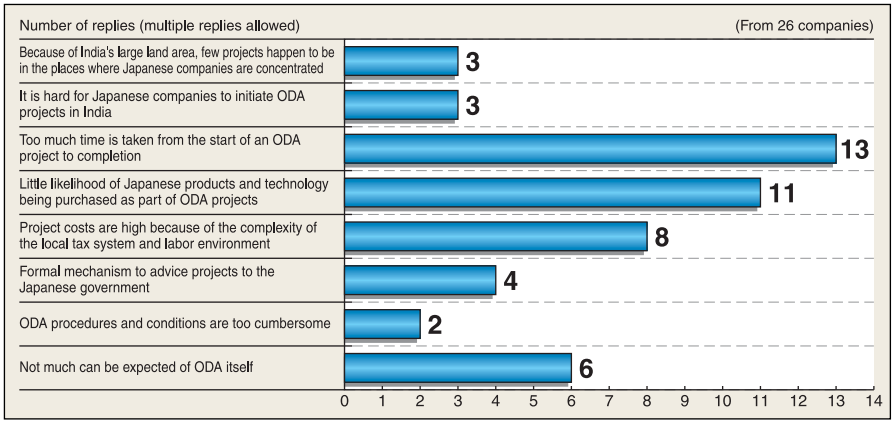
What Do Japanese Companies Want Indian ODA to Achieve?

How useful do Japanese companies consider that Japanese ODA has been for them in India? In my survey mentioned above, just under 40% of all corporate respondents indicated that ODA for India had resulted in direct profits from incoming contracts, and more than half indicated they had received indirect profits. These indirect profits were mainly from reduced costs as a result of the development of peripheral infrastructure centered on the regions they moved into. However, it cannot be ignored that some companies having great success in India indicated that ODA had played no useful part in their success.

Next, as the top reason that ODA for India was not very useful for Japanese companies investing in India, a majority of companies cited the long time taken from the identification of an ODA project to its completion. The next problems cited were the low ratio of contracts relative to the project, and the high cost of driving through the project due to the rigidity of the local tax system and the labor market. (Fig. 2)

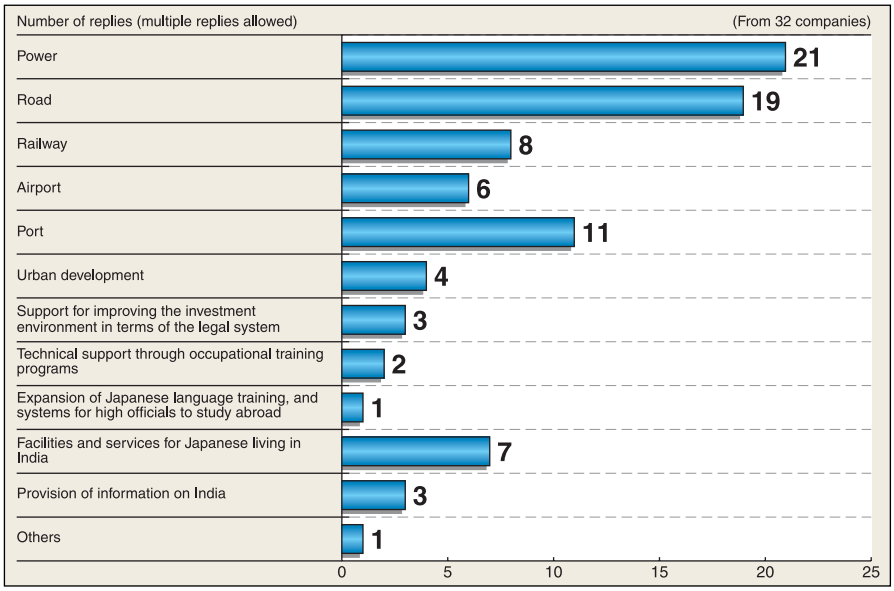
The areas in which Japanese companies want to see ODA expanded center on physical infrastructures such as power, roads and ports cited in that order. (Fig. 3) Because Japanese companies have a high possibility of obtaining contracts in the following areas, many want to see ODA projects focused on

Figure 2 Reasons ODA Is Not Sufficiently Useful for Japanese Companies



Source : The survey the author conducted

Figure 3 Areas in which Japanese Corporations Want More ODA Projects for India



Source : The survey the author conducted

them. These areas include STEP loans for projects involving the construction of new power plants as well as remodeling of existing ones, support for the construction of Special Economic Zone (SEZ) aimed mainly at Japanese companies, peripheral water treatment and waste disposal facilities, the generation and supply of power, and new urban transport systems such as subways and monorails. On the other hand, few companies called for more ODA to develop soft infrastructure, such as improving the investment climate in the areas of the legal system.

It is very interesting that after the call for more infrastructure development, the next most popular answer was: "Facilities and services for Japanese expatriates in India." Many of the Japanese residents in India complaint about their daily lives. However, the problem is the appropriateness of using ODA as a tool to achieve solutions to those issues. It would be more desirable if positive solutions could be sought by public-private cooperation outside the ODA framework.

Next, in answer to the question: "Are you considering strategically utilizing ODA for your business activities?" fewer than one in three companies replied that they were. If the five major trading houses are excluded, this percentage falls even further. One reason for this is thought to be the time needed from start to completion of an ODA project. With rigorous personnel assessments carried out every year, the overseas personnel of Japanese companies, and not only those in India are forced, quite reasonably, to take shortsighted modes of action that look only one or two years ahead. It is not difficult to imagine that this would discourage long-term strategies that take into account profits from the completion of an ODA project several years down the road.

Another issue is the divergence of interests between trading houses, which receive direct profits from ODA, and manufacturing companies, which provides indirect profits. As long as the construction of power plants and development of urban transportation facilities such as metro deliver a higher possibility of orders than road development, these projects will tend to be more attractive to trading houses. However, what is more important for Japanese manufacturers setting up in India is the development of India's road network. This difference is the reason that it is difficult for trading houses to initiate the type of projects that would deliver indirect profits to Japanese companies in India.

The most frequently cited need regarding ODA procedures and conditions was to simplify and speed up procedures. State governments requiring soft loans often fail to allocate enough of their own budget to feasibility studies for their projects, and it can take more than a year from the request for a loan to acceptance, despite the existence of such current systems as the engineering service loan system. Considering these problems, it might be worth considering establishing a yen loan to facilitate such studies could function flexibly in the short-term.

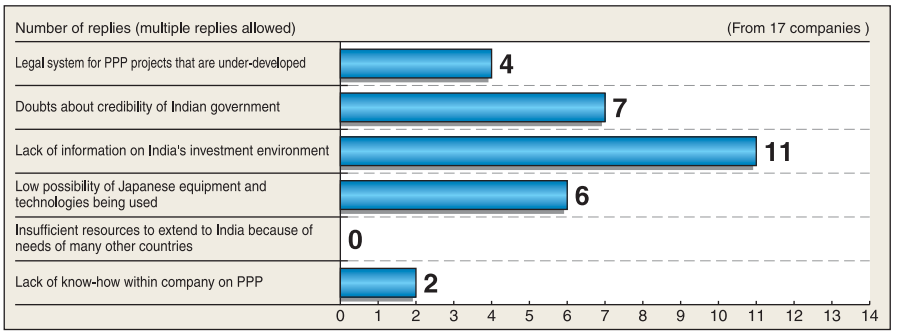
In addition to such requests to shorten the time of feasibility studies, Japanese companies that have been successful in India are requesting that JICA rules that do not reflect local conditions should not be imposed. Unless JICA completely overhauls the rules requiring an environmental assessment and JICA-style verification of the submitted studies, and shortens the time until the project can be realized, suspicions could arise among the state governments and the people, particularly in a democratic country like India, and for this reason, care needed in the future.

Apart from this, there were many requests to increase the number of projects conducive to participation by manufacturers with world-class technologies, including Japanese corporations, instead of projects where Japanese technological superiority could not be used, and projects that had to contend with severe price competition from South Korean and Chinese companies. Naturally, because the projects are ODA, it is not desirable to seek only ones that benefit Japanese companies. In contrast to ODA in Southeast Asia, there is a limit to the projects that trading houses, the advance guard, can identify on behalf of local governments in India. For this reason, it is certainly necessary to utilize the functions of JICA, the Japan External Trade Organization (JETRO), the Japan Bank for International Cooperation (JBIC) and other public institutions to make effective use of local consultants in India.

Private-Sector Investment in Infrastructure

Finally, while most of Japan's investment in India in infrastructure development projects up to now has taken the form of ODA, what the Indian government really wants of Japan is private-sector investment in infrastructure. The Indian government has set a goal of securing foreign investment in infrastructure to the value of $150 billion over the next 10 years, and naturally it has considerable expectations of Japan.

Figure 4 Issues in Infrastructure Projects for Japanese Companies



Source : The survey the author conducted

Unfortunately, however, with the exception of the earlier-mentioned Marubeni, Japanese private companies have made almost no infrastructure investments in India. On the other hand, non-Japanese private-sector companies have been participating in their respective fields of expertise.

In the above survey, I also conducted a questionnaire on private-sector investment in infrastructure in India, centered on public-private partnerships (PPPs). This questionnaire revealed that the main reason for low Japanese private-sector investment in infrastructure was lack of information on the investment climate. The provision of this information will be an issue in the future, not least to avoid missing massive opportunities for investment in the infrastructure field to the tune of $150 billion over the next several years. The government, research institutions, banks and the media all have a role to play in providing this information. After lack of information, other issues included lack of trust in the Indian government, the need to reform the PPP scheme, and the low possibility of receiving contracts. (Fig. 4) If it is possible in the future for the Japanese government to promote a certain amount of so-called take-or-pay systems, infrastructure investment by Japanese companies would surely expand from its present level.

The Indian government has a guarantee scheme called Viability Gap Funding. In addition, as new institution called the India Infrastructure Finance Company Ltd. (IIFCL), a special-purpose vehicle for funding infrastructure projects was set up very recently, along with expected financial assistance from the World Bank and ADB. Also, local private-sector financing institutions like the Infrastructure Development Finance Company Ltd. (IDFC), Infrastructure Leasing & Financial Services Ltd. (IL&FS), and the Housing Development Finance Corp. (HDFC) have set up funding for infrastructure projects and have called for institutional investors to join them. From Japan, Orix and Mizuho Corp. Bank are contributing capital. While at this current point, Japan's interest appears to be still quite low, in the future Japan should investigate new forms of infrastructure development assistance, such as the governmental assistance for infrastructure financing, or contributing capital through such organizations as the JBIC. With private-sector companies in various countries besides Japan investing in India's infrastructure, Japan's conventional approach of dispatching missions and seeking infrastructure development is now looking a little dated, at least from the Indian side, while the dissatisfactions on the Japan side remain as persistent as ever. It is now surely time for Japan and India to share new insights into the issue of infrastructure development by private capital. JS

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