

Mizuho Economic Outlook & Analysis

May 13, 2008

**Japanese Companies Venturing into
the Indian Market:
India requires different marketing
strategies from ASEAN and China**

<Summary>

1. India's economy is growing nearly at double-digit percentages per year. In the *11th Five-Year Plan* (April 2007 – March 2012), India aims to continue its high economic growth by expanding at an average rate of 9% per year. By industry, the manufacturing sector is expected to play a leading role in attaining this target.
2. However, rural areas lack even in basic infrastructure. Accordingly, the goals of the *11th Five-Year Plan* include providing all rural communities with water, electricity and broadband connection. While the manufacturing industry is the driving force of the Indian economy, the government may be compelled to prioritize the needs of farming communities over the development of industrial infrastructure given its democratic system, where every farmer has a vote.
3. According to a survey conducted in 2006 by Japan Bank for International Cooperation (JBIC), India is the most promising destination for investments. According to the survey, the largest bottleneck faced by businesses entering the Indian market is the lack of infrastructure. However, the Indian government, which is well aware of this problem, has stepped up its efforts to upgrade the urban infrastructure, as is seen in the recent works to improve road conditions in Delhi and its suburbs. To overcome the shortage of electrical power supply, which underpins the industrial infrastructure, the government plans to build approximately seven large-scale electric power plants and 14 nuclear power plants. Shortage of industrial parks is also a problem. However, due to India's strict land appropriation law, the conversion of land from agricultural to other uses is a slow process.
4. On the other hand, India's steadily growing consumer market is appealing to foreign investors. The Indian government and U.S. corporations forecast around two million car sales in India in 2010 and demand for about 900 airplanes by 2020.
5. The purchasing power of India's so-called "upper-middle class" is growing, benefiting from the increase in employment by foreign companies and rising wages. Many are employed by IT companies, including software companies with international competitiveness. Furthermore, a large proportion of this group is also the young generation possessing a high propensity to consume. That, together with the increased availability of consumer loans, explains the strong buying power of this group. The government's task is to increase the entire nation's consumer spending by pulling up the low-income group through development of the manufacturing industry.
6. According to the Japanese Embassy in India, the number of Japanese companies doing business in India increased by 158 companies from 317 to 475 between January 2006 and February 2007. About 90% are concentrated in the four cities including Delhi and its suburbs, Mumbai, Chennai and Bangalore. Delhi is home to many manufacturers, especially auto makers. Many financial institutions are based in Mumbai, while many manufacturers, especially machinery companies, are based

in Chennai. Bangalore has drawn IT and auto makers. Most Japanese companies target their sales at Indian consumers. However, note that an increasing number of service companies, not limited only to manufacturers, are setting up operations in India.

Koji Sako, Senior Economist, Research Division, Research Department - Asia

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Introduction

Former Prime Minister Shinzo Abe, along with more than 200 members of an economic mission led by the Japan Business Federation, visited India in August 2007 (August 21-23). This has led to a rapid growth in interest in India in both political and economic arenas. The Research Department - Asia of Mizuho Research Institute (MHRI) conducted an economic survey in Delhi and Mumbai in late August of 2007, a week after Prime Minister Abe's visit.

In the center of Delhi, the capital of India, the streets were heavily congested with two-wheeled motor vehicles and cars. We found that in contrast to other emerging countries where economic growth is frequently accompanied by construction booms, the cityscape was dominated by old buildings. However, Gurgaon, a booming city in Haryana State, an hour's drive to the south-west of Delhi, presented a completely different landscape. The city possesses numerous large shopping malls and is undergoing a condominium-building boom. From Delhi to Gurgaon, roads and underground railway systems are now being rapidly extended or upgraded as the cities rush to complete projects in time for the Commonwealth Games (the Commonwealth version of the Olympic Games) in 2010. (Delhi and Gurgaon are scheduled to be connected by underground railway in 2010.) Suzuki, Honda and other Japanese two-wheeled motor vehicle or car companies have established business operations on the outskirts of Gurgaon. There is a shortage of industrial parks due to the rate of production expansion. The industrial park we visited appeared at first glance to be equipped with the necessary infrastructure. However, a member of the staff of a Japanese company that started operations on the developed land a year ago cited "numerous power cuts necessitating a back-up power system, the use of underground water supplies, and the lack of connections to the public sewage system."

In Delhi, we had the opportunity to exchange opinions with members from government and industry of both India and Japan. Our impression was that the atomic energy agreement between India and the United States was receiving more political attention than Prime Minister Abe's visit. We assume that that is because the introduction of

technology to build a large nuclear power plant is vital for the resolution of India's chronic power shortage, while India being a nuclear power, is showing considerable reluctance to open its nuclear facilities to third-party inspections because of national security reasons.

From Delhi, we flew into Mumbai. We were told that Delhi and Mumbai airports had been privatized and were now more convenient. There were about 60 flights a day between Delhi and Mumbai, and the planes are almost full. Delhi is located inland and is the center of politics, while Mumbai is a commercial city with a port. People working for conglomerates or financial institutions based in Mumbai, who are involved in global business, have proficient English language skills and significant financial expertise. The high skills and proficiency levels on par with their global counterparts provided us with a glimpse of the background to the global expansion of India's conglomerates such as Tata, Reliance and Birla which are accelerating cross-border M&A activities. Considering that the Reserve Bank of India (RBI) possesses its headquarters in Mumbai, India's central bank appears to place emphasis upon the maintenance of its independence. On the other hand, there are endless lines of slums in the north of the city. Such enormous income disparities are also a harsh reality of life in India.

This paper, based on our field study, explores the business possibilities of Japanese companies entering the Indian market from four different perspectives: (i) the industrial policy and foreign investment policy of the Indian government; (ii) the assistance provided by the Japanese government to the Indian government; (iii) India's attractiveness compared to ASEAN and China; and (iv) the current state of India business development by Japanese companies. In the final Chapter, this paper provides (v) the key to success in doing business in India.

We hope this paper will be of some help to Japanese companies which are or will be engaging in business in India. We would like to take this opportunity to thank all those who assisted and cooperated with our study.

(Koji Sako, Senior Economist, Research Division, Research Department - Asia)

1. Industrial and foreign investment policies of the Indian government: developing the manufacturing industry by opening the market to foreign investors

(1) Medium-term vision: “The 11th Five-Year Plan (April 2007 – March 2012)”

First, it is necessary to understand how the Indian government aims to develop the economy and industries in the mid- and long-term perspectives. Ever since 1951, the Planning Commission (a government institution) has drawn up five-year plans to serve as the nation’s mid-term plan. The fact that the Commission is currently chaired by Prime Minister Manmohan Singh, indicates the importance of the Plan. While the *11th Five-Year Plan* (April 2007 – March 2012) has yet to obtain the final approval of the government, the Indian government aims to achieve an average growth rate of 9% according to the Plan drafted by the Commission¹(Chart 1). By industry, the secondary industry is to become the main driving force of India’s economic growth. Raising the levels of both savings and investment is a prerequisite to achieve the target growth rate. Objectives of the Plan also include creating job opportunities for 70 million people, providing electricity and water to all villages, and eventually broadband connectivity. It should be noted, however, that the government has long neglected to provide even the basic infrastructure to rural areas. Even though the government aims to strengthen the secondary industry, the government may be compelled to prioritize the needs of farming communities over the building of industrial infrastructure considering that every farmer has a vote.

¹ http://planningcommission.nic.in/plans/planrel/app11_16jan.pdf

Chart 1: The 11th Five-Year Plan

		The 10th Five-Year Plan FY2001 - FY2006	The 11th Five-Year Plan FY2007 - FY2012
Item	Breakdown	Actual results (average)	Average
Real GDP		7.2%	9.0%
	Primary industry	1.7%	4.1%
	Secondary industry	8.3%	10.5%
	Tertiary industry	9.0%	9.9%
Fixed asset investment as % of GDP		27.8%	35.1%
	Public investment	6.7%	10.2%
	Private investment	21.1%	24.9%
Domestic savings as % of GDP		28.2%	32.2%
	Household	22.8%	22.0%
	Private enterprise	4.5%	6.1%
	Government enterprise	4.2%	3.0%
	Government	-3.2%	1.2%
Current account balance as % of GDP		0.2%	-2.8%

Item	Sub-item	Goal
Employment		Create 70 million new employment opportunities
Education	Literacy rate for persons aged 7 or over	75% or higher
Healthcare	Water	Provide safe drinking water by 2009
Infrastructure	Road	Ensure road connection to all villages with population of 1,000 or over
	Electricity	Provide all households with access to electricity by 2009
	Telecommunication	Provide all villages with broadband connection
Energy conservation		Improve energy efficiency by 20% by 2016-2017
Environment	Forest	Increase by 5%
	Air	Attain WHO standards of air quality
	Waste water	Treat urban waste water

Source: Prepared by Mizuho Research Institute (MHRI) based on "An Approach to the 11th Five Year Plan" (Planning Commission, Government of India; December 2006)

(2) Long-term vision: "India in 2020"

In December 2002, the Planning Commission released "India Vision 2020"² as India's long-term plan. Major numerical targets established by the Planning Commission are as set out in **Chart 2**. "India Vision 2020" indicates that India will further promote

² http://planningcommission.nic.in/reports/genrep/pl_vsn2020.pdf

industrialization and service businesses by expanding foreign trade and increasing foreign direct investment. To achieve this goal, it will be necessary to invest in health and education, and develop human resources. However, the rapid rise of energy and electric power consumption is inevitable. Even though the Indian government is already engaged in active diplomatic efforts to secure resources³, it will need to make full-scale efforts in the future for the effective use of energy and environmental protection.

Chart 2: Year 2020 envisioned by India's Planning Commission

	Year 2001	Year 2020
Breakdown of items (as % of GDP)		
Primary industry	28%	6%
Secondary industry	26%	34%
Tertiary industry	46%	60%
Foreign trade in goods as % of GDP	3.6%	35%
FDI as % of GDP	0.1%	3.5%
Education as % of GNP	3.2%	4.9%
Health as % of GNP	0.8%	3.4%
Male literacy rate	68%	96%
Female literacy rate	44%	94%
Energy consumption per capita as of GDP (kg of oil equivalent)	486kg	2,002kg
Electric power consumption per capita as of GDP	384kwh	2,460kwh

Source: Prepared by MHRI based on "India Vision 2020" (Planning Commission, Government of India, December 2002)

(3) Foreign investment policy

In this Chapter, we shall look at foreign companies sought by India. Under the current policy stance to attract investment, India fundamentally provides equal treatment to domestic companies and foreign companies. Basically, the concept of only foreign

³ India is planning to import natural gas from Russia and Iran, and is also to procure uranium from Australia in technical cooperation with the U.S. in the area of nuclear energy. There are signs that India will cooperate with China to secure resources in Central Asia, Middle East and Africa.

companies receiving preferential treatment does not exist. In this regard, India is fundamentally different from ASEAN and China (China has recently reviewed its full-scale preferential treatment for foreign companies and is moving to select companies), which have been working hard to attract investment by Japanese companies under a preferential treatment policy for foreign companies.

At present, preferential treatment for investment, including investment by domestic companies focuses on the following four areas.⁴

1. Preferential treatment for infrastructure development. Corporate tax breaks for infrastructure are applicable for 10 years (electric power, express highways, bridges, urban transportation system, water projects, airports and ports, etc.).⁵

2. Preferential treatment for targeted industries. Corporate tax breaks are applicable to petroleum refinery companies for seven years after they establish petroleum refinery facilities.

3. Preferential treatment for export-oriented companies. The Special Economic Zone (SEZ) Act, enacted in June 2005, exempts companies in the SEZs from corporate tax for five years if they export at least half of their products, followed by a 50% tax exemption for the following 5 years. According to a Japanese government-related organization, “as of the end of August 2007, there are about 20 SEZs across the nation, and some 200 SEZs are in the process of obtaining development approval from the government.” An expert on the Indian economy points out that “underlying the implementation of the SEZ Act is the Indian government’s intention to terminate various tax preferential treatments⁶ for software development companies by 2009, and to promote exports.” It is assumed that promotion of the SEZ policy is the Indian government’s attempt to shift the focus of industrial development from the software industry, which has become world-famous, to exports.

⁴ For details, check with the government of the State where you operate.

⁵ http://www.jetro.go.jp/biz/world/asia/in/invest_03/

⁶ Up until now, software companies have benefited from the substantially tax-free treatment.

4. Preferential treatment by state governments. The Republic of India consists of 28 states, the National Capital Territory of Delhi and union territories, with each state possessing very strong autonomy. Therefore, some states have their own preferential policies for investment. For example, Tamil Nadu (a south-eastern state whose capital is Chennai) announced the “Super Mega Project” in 1996 to give preferential tax treatment to companies that invest at least 15 billion rupees (approximately 45 billion yen). This - together with the fact that Chennai has a good port that has long been a hub port for Asian trade - has helped to attract foreign investment. Chennai has become the largest production base in the region and is home to many manufacturing companies. Nokia (Finland) and Hyundai (South Korea) have established plants in its suburbs. In 2007, the local government in Tamil Nadu announced a new policy referred to as the “Ultra Mega Integrated Automobile Projects Policy,” a stepped-up version of the “Super Mega Project” tailored for the automobile industry. This policy targets automobile “set manufacturers” which invest at least 40 billion rupees (approximately 120 billion yen) and produce and sell final products. This policy is expected to benefit Nissan⁷, which announced in February 2007 that it will jointly invest 40 billion rupees with Renault (France) to set up a plant in Chennai.

2. Japanese government assistance to India: Delhi-Mumbai Industrial Corridor (DMIC) Project

(1) Japan gives full support for infrastructural development in India

When Prime Minister Singh visited Japan in December 2006, he and former Japanese Prime Minister Abe executed the Japan-India Special Economic Partnership Initiative. Under the Initiative, Japan will provide assistance for infrastructural development in India and for development of human resources necessary to develop the manufacturing industry.

One part of the initiative that has drawn particular attention is a project aimed at increasing the capacity of freight railway between Delhi and Mumbai, a commercial port

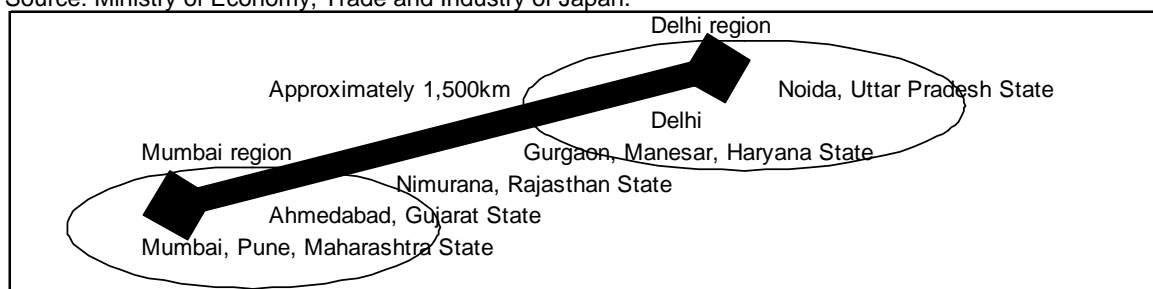
⁷ February 26, 2007 press release by Nissan Motor Co., Ltd.

city, and building an industrial corridor between Delhi and Mumbai as an industrial thoroughfare. This grand project, the first of its kind in India, is basically the Indian version of Japan's Pacific Belt Zone linking Tokyo and Osaka. This project aims to encourage the growth of local industry by developing a distribution system that covers a wide area of the country and promoting investment by Japanese companies, in line with the Indian government's policy of strengthening exports. (Chart 3)

Chart 3: The significance of the Delhi-Mumbai Industrial Corridor Project



Source: Ministry of Economy, Trade and Industry of Japan.



Source: MHRl

However, Japan and India face many necessary adjustments before the Delhi-Mumbai Industrial Corridor (DMIC) Project is actually initiated. According to the local media, the Indian government estimates that about 10 trillion yen will be needed on the project development. Japan is reported to be considering, in principle, a 400-billion-yen loan (Japanese company source) for the construction of the new freight railway between Mumbai and New Delhi, but this leaves a huge gap in the estimated amounts.

Furthermore, GE (U.S.) and other European and U.S. companies are also interested in this freight railway. Accordingly, it is uncertain whether Japanese companies may become a major player in the project, as the Japanese side expects.

Nevertheless, the route between Delhi and Mumbai is the most important corridor in India, and there is no question about the necessity⁸ for the new high-speed freight railway. India is expecting not only Japan's public funding but also investment by Japanese companies. The project involves developing a vast area, encompassing six states and could, therefore, weaken the influence of local governments in these states that have strong autonomy. This will serve as a benefit for Japanese companies. Both the Indian and Japanese governments agree on the importance of this project and its potential as a breakthrough which would trigger India's transformation from a domestic-oriented to an export-oriented economy.

(2) Yen loan aid to India

The amount of Japan's yen loan aid, which is the most common form of Official Development Assistance (ODA), provides an idea of Japan's past contribution to India's infrastructure development. Japan's assistance in the DMIC Project (the new freight railway) is an extension of these efforts.

Japan's yen loan aid to India has been increasing in recent years (Chart 4). This is a stark contrast to yen loan aid to China, which has declined after peaking in FY2000. Since FY2003, India has been the largest recipient country of yen loan aid from Japan. The Ministry of Foreign Affairs (MOFA) of Japan has designated (i) infrastructure development, (ii) poverty and environment issues, and (iii) human resources development as priority areas of Japan's ODA to India. In particular, MOFA states that Japan will provide assistance in terms of not only hardware (facilities) but also software (operation know-how) in the areas of "electric power," "transportation" and "SEZ," and presumably looks toward promoting investment by Japanese companies in India. Investment toward India has increased in recent years (over 50 billion yen in 2006,

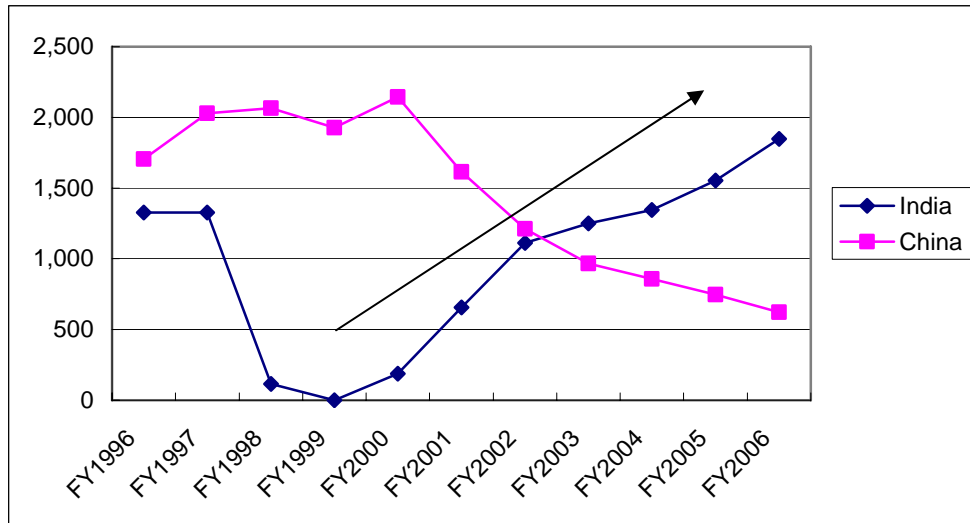
⁸ Because trains depart after cargo has accumulated at the terminal, there is no time table for trains on the existing freight railway, thereby causing considerable delay in distribution. Thus, it is necessary to construct a new high-speed freight railway.

according to Japanese statistics), while yen loan aid has quadrupled to nearly 200 billion yen.

In FY1999, Japan suspended yen loan aid because of India's nuclear test in 1998. It should be noted that India's stable political and economic relations with its neighbors are necessary prerequisites to Japan's assistance of India. Even so, relations between Japan and India have changed substantially over the last decade.

Chart 4: The actual amount of Japan's yen loan aid to India and China

(Unit: 100 million yen)



Note: Data regarding FY2005 for China refers to the loan amount concluded in June 2006.

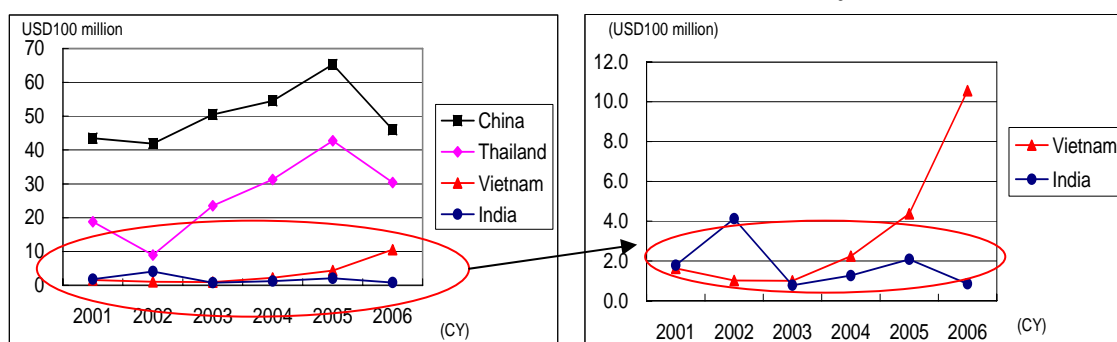
Source: Prepared from the "Japanese ODA" (the website of the Ministry of Foreign Affairs of Japan)

3. India's attractiveness compared with ASEAN and China: focus on its growing market

(1) Emerging signs that stagnant investment by Japanese companies in India is starting to pick up

India is attracting attention as a promising market, second only to China. Thus far, however, this attention has not been matched by investment. According to statistics from the Indian side, investment by Japanese companies in India has been sluggish, presenting a significant contrast to the recent rise of investment in Vietnam (Chart 5).

Chart 5: Japan's direct investment to major Asian countries
(statistical standards of each Asian country)

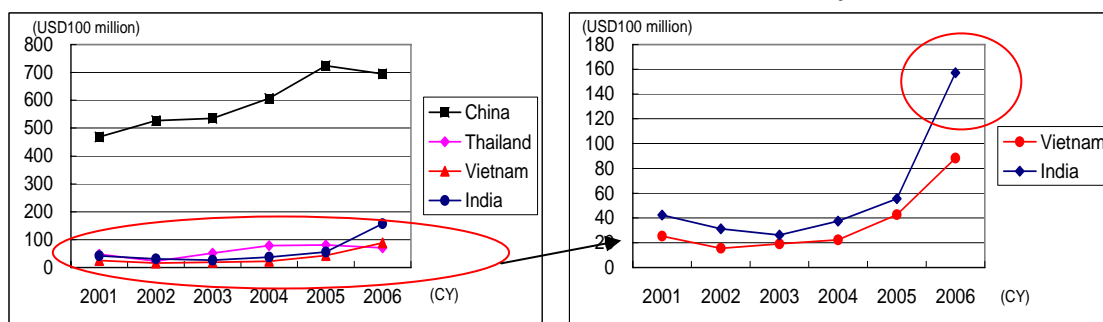


Note: China and India: actual basis; Thailand and Vietnam: approved project basis; India: data on a fiscal-year (FY) basis

Sources: Prepared by MHRI based on the data from the Chinese Ministry of Commerce, Board of Investment (BOI) of Thailand, the Ministry of Planning and Investment of Vietnam and the Indian Ministry of Commerce & Industry

Chart 6 shows the trends in foreign direct investment (FDI) in major Asian countries by other countries, mainly the U.S. and Europe. The chart reveals that the growth of investment in India exceeds than in Vietnam. While China is still the largest recipient of FDI in the Asian region in terms of monetary value, there are emerging signs that investment in China is already past its peak. On the other hand, there are strong indications that investment in India will increase rapidly, presenting a worldwide boom.

Chart 6: The world's direct investment to major Asian countries
(statistical standards of each Asian country)



Note: China and India: actual basis; Thailand and Vietnam: approved project basis; India: data on a fiscal-year basis

Sources: Prepared by MHRI based on the data from the Chinese Ministry of Commerce, BOI of Thailand, the Ministry of Planning and Investment of Vietnam and the Indian Ministry of Commerce

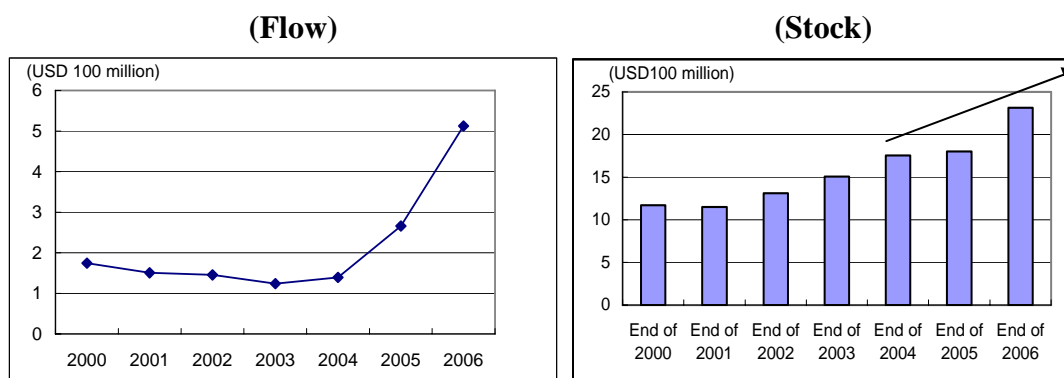
According to Indian statistics, the top 10 contributors of FDI in India as of FY2006 were Mauritius⁹ (USD6.3 billion), U.K. (USD1.9 billion), U.S. (USD0.9 billion), Netherlands

⁹ Mauritius is a tax haven where Indo-Mauritians comprise 70% of the population. It is generally assumed that a majority of investment is "roundabout" investment coming from overseas Indian, European and U.S. companies.

(USD0.6 billion), Singapore (USD0.6 billion), Germany (USD0.1 billion), France (USD0.1 billion), Japan (USD0.09 billion), South Korea (USD0.07 billion), and Switzerland (USD0.06 billion). Japan's presence is comparatively low.

However, the actual state of affairs is somewhat different. According to Japan's statistics, investment in India has been rapidly increasing (Chart 7). The gap between the Indian and Japanese statistics may be explained by the fact that "Indian statistics cover only new investments and not re-investment. Actually, existing Japanese companies, particularly auto and material makers in India, are increasingly re-investing retained earnings, and raising funds in the name of Indian corporations. Many companies are investing in India through their Singaporean subsidiaries or affiliates" (Japanese government-related organization and Japanese company sources).

Chart 7: Japan's direct investment to India (base upon Japanese statistics)



Note: Figures in yen converted to USD using the Bank of Japan interbank exchange average rate for the period

Source: Prepared by MHRI based on the balance-of-payment table (Ministry of Finance, Japan)

(2) India's under-developed infrastructure poses challenges for investment

Every year, the Japan Bank for International Cooperation (JBIC) publishes the results of questionnaire surveys on foreign direct investment (FDI)¹⁰. In 2006, 47 % of companies surveyed chose India as the most promising market, compared with 36% in 2005. On the other hand, the number of companies that said they were planning to operate in India increased by 16 over the year, while the number of companies that said

¹⁰ <http://www.jbic.go.jp/autocontents/japanese/news/2006/000169/houkokusyo.pdf>

they had no plans to operate in India also increased by 35 over the year (**Chart 8**). The survey shows that India's inadequate infrastructure is considered the largest bottleneck (**Chart 9**).

Chart 8: Promising countries and regions for business development

	India	China
Year 2006 (Reply: 484 companies)	47% (up 11% y-o-y)	77% (minus 5% y-o-y)
Plan to enter	62 companies (up 16 y-o-y)	252 companies (minus 37 y-o-y)
No plan to enter	157 companies (up 35 y-o-y)	112 companies (up 15 y-o-y)
Year 2005 (Reply: 483 companies)	36%	82%
Plan to enter	46 companies	289 companies
No plan to enter	122 companies	97 companies

Chart 9: Bottlenecks by country and region

	India	China
Year 2006	Reply:178 companies	Reply: 351 companies
Poor infrastructure	50% (up 2% y-o-y)	27% (minus 8% y-o-y)
Lack of information	27% (minus 9% y-o-y)	4% (up 1% y-o-y)
Year 2005	Reply: 127 companies	Reply: 380 companies
Poor infrastructure	48%	35%
Lack of information	36%	3%

Source: Japan Bank for International Cooperation (JBIC)

The Indian government is well aware of this problem, and plans to double the amount spent on infrastructure development during the time span of the *11th Five-Year Plan* (from about 4% of GDP to about 8% of GDP). To solve the power shortage, the

government has launched a plan to construct mega-power plants (under the Ultra Megapower Project, seven 4,000-megawatt power plants are planned, along with 14 large nuclear power plants). According to Japanese government-related organizations and Japanese companies, the Indian government has started to broach the subject of infrastructure improvement, and roads are already improving. In January 2006, India Infrastructure Finance Company Limited was set up, which is expected to help increase the volume of financing. Since the privatization of the airports in Delhi and Mumbai, service has improved and signs of improvement are starting to emerge.

However, there are structural problems regarding industrial land, such as the difficulty to convert land from farm-use to non-farm use due to strict laws regarding land appropriation. It should be noted that the business environment in India is different from that of ASEAN and China, where economic development has been prioritized, and, therefore, land has been offered to companies under the government's proactive policy of attracting businesses.

(3) India's attractiveness lies in its growing consumer market

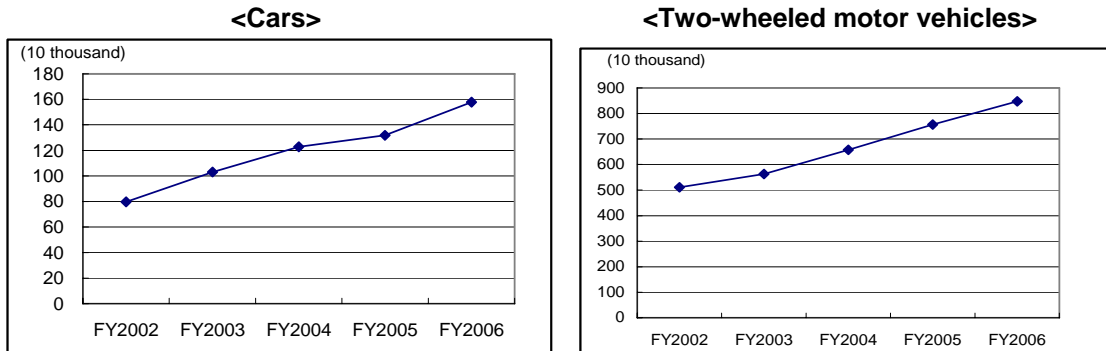
Why are international businesses attracted to the Indian market? The answer lies in its growing consumer market. For example, the Indian government and U.S. companies predict that about 2 million cars will be sold in 2010, and demand for airplanes will be around 900 units by 2020. Even when compared with China's double-digit economic growth, this projected growth is impressive (**Charts 10 and 11**). U.S. companies, in particular, highly evaluate India's growth potential.

Chart 10: The Indian market envisioned by the Indian government and European and U.S. research institutes (forecast)

2010	Air passenger traffic in India will continue to grow 25% p.a. up to 2010.	Source: Civil Aviation Minister Praful Patel Release: November 22, 2005
	With new subscribers growing by 5 million per month, half the population of India – 500 million people – will have a mobile phone by 2010	Source: Ministry of Communications & Information Technology (India): Release: January 31, 2007
	The Indian government will have completed construction of 18 nuclear power plants (total power generation capacity: 22,800MW).	Source: Nuclear Power Corporation of India Release: January 23, 2007
	Car sales will double from 1,090,000 in 2004 to 2,005,000.	Source: CSM Worldwide (U.S.) Release: August 17, 2005
	The television market will grow at a compound annual growth rate (CAGR) of 9%, reaching sales of 18,717,000 sets (worth USD3.976 billion)	Source: iSuppli Corp. (U.S.) Release: May 21, 2007
	Electric power generation will multiply 6 times in the four years from 2006. The number of middle-income group households will increase from 40 million to 65 million households.	Source: McKinsey (U.S.) Release: January 15, 2007
2020	Iron ore production will reach 862 million tons, making India the world's largest producer.	Source: National Mineral Development Corporation Release: March 17, 2006
	Due to U.S. provision of nuclear technology to India, India will benefit from special procurement of nuclear power by 2020 (40 billion dollars in total) (about 4.6 trillion yen).	Source: Estimate by the Indian government Release: June 22, 2006
	India will maintain real annual growth of 8%, quadrupling GDP by 2020.	Source: Goldman Sachs (U.S.) Release: January 27, 2007
	India will purchase 856 planes by 2020 due to economic growth and increased distribution.	Source: Boeing (U.S.) Release: August 29, 2006

Source: Prepared by MHRI based on the "Future Timeline" of Hakuodo Institute of Life and Living, Hakuodo Inc.

Chart 11: Sales of cars and two-wheeled motor vehicles in India (actual results)

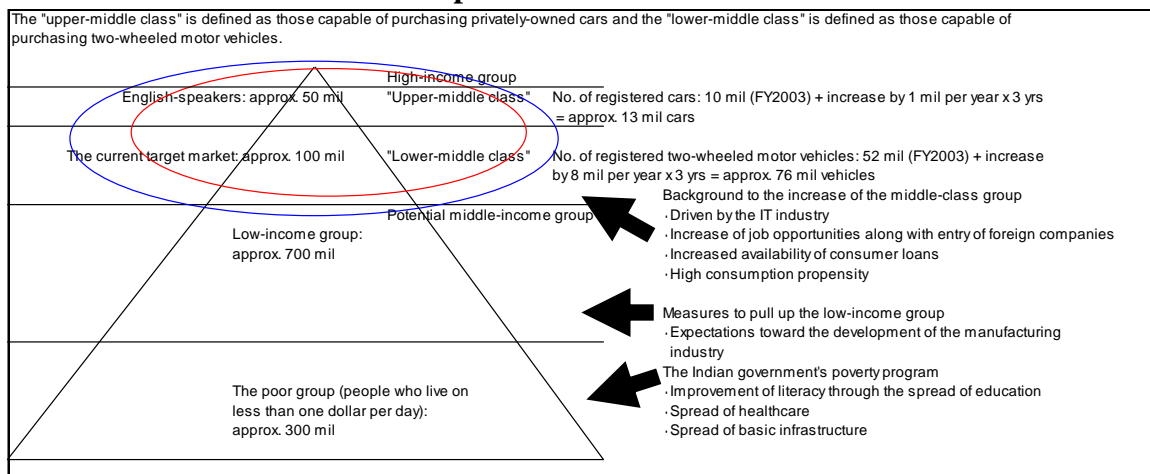


Source : CEIC Data.

However, given the gap between the rich and poor, the Indian market is not a single market. It is made up of “the high-income group,” “the upper-middle-income group,” “the lower-middle-income group,” “the low-income group” and “the poor group.” In addition to “the high-income group,” “the upper-middle-income group” (the so-called “upper-middle class” defined as those capable of purchasing privately-owned cars) and “the lower-middle-income group” (the so-called “lower-middle class” defined as those capable of purchasing two-wheeled motor vehicles) are the potential customers targeted by Japanese companies in the consumer durable goods market. At present, about 100 million people are estimated to belong to the target groups, though this is a rough estimate based on the number of privately-owned vehicles (Chart 12). According to an Indian government official, the English-speaking population of India is approximately 50 million. This group is expected to constitute the core segment of the target groups of about 100 million people. On the other hand, the low-income group is also likely to become potential customers of Japanese consumer goods. Of these groups, the purchasing power of the upper-middle class is rapidly increasing. Many people in this group are employed by IT companies, including software companies with international competitiveness, and are benefiting from the increase in employment by foreign companies and the resultant wage increases. Furthermore, the fact that this group consists of young people with a high consumption propensity, together with the increased availability of consumer loans, explains the strong consumption power of this group.

The software industry employs some 1.3 million¹¹ people as of 2006. It is estimated that 450,000¹² new jobs will be created every year in the future, which means that 4 million people will be employed by the software industry over the next five years. However, note that this constitutes less than 0.4% of the entire population. Therefore, it is difficult for the software industry alone to drive the economic growth of the entire country. On the other hand, it is estimated that more than 13 million people are currently employed by the auto industry, a figure that will double to 25 million over the next decade (Japanese company source). The Indian government's stress upon strengthening the secondary industry most likely stems from its motive to achieve sustainable economic growth by pulling up the low-income group by nurturing the manufacturing sector which will provide jobs.

Chart 12: The composition of the Indian consumer market



Source: MHRI, based upon data sources such as CEIC Data.

Furthermore, retail market reform has also contributed to the expansion of India's consumer market. In India, the bulk of retailing is conducted by mom-and-pop stores (they account for about 95% of all retailers; according to an official of a Japanese government-related organization). However, in recent years, retail chains (food supermarkets, large-scale consumer electronics stores), including those operated by conglomerates such as Tata and Reliance, are on the rise and attracting consumers. In Gurgaon, a new satellite city in the suburbs of Delhi, there are many large shopping malls

¹¹ NA SSOM (National Association of Software and Service Companies), the software industry association in India

¹² <http://www.bhetimes.com/article/613/6/>

with such chains' outlets. However, foreign companies are prohibited from directly entering the Indian retail market which will enable them to handle multiple brands. They are only allowed to enter the wholesale market via joint ventures in which they have a 51% stake. Metro of Germany has already entered the market in this way (a membership-based supermarket, but a retailer by nature), and Wal-Mart is reported to be planning to enter the market in the form of wholesaling according to local media reports.

However, in August 2007, in Uttar Pradesh, a state close to Delhi, a food supermarket operated by Reliance was temporarily shut down by the state government. The reason cited by the state authority was that, "since local small- and medium-sized retailers protested against the operation of the supermarket, it was in danger of being attacked." Some suggest that "the fundamental problem is that state governments are so strong that the central government is unable to stop their enforcement measures." (Japanese company source) In India, as in infrastructure development, it will take time to reform the retailing sector because of its structural factors. Yet, it can be assumed without doubt that India is moving in this direction.

(4) India as an export base

As described above, the Indian government has taken measures to stimulate the development of the manufacturing sector, and the sector is growing at a fast pace. However, the perception among many Japanese companies operating in India is that, India is suitable as a manufacturing base for domestic-sale products, but is inappropriate as an export base because of its high production costs. To promote exports, India needs products with international competitiveness. For example, if India focuses on limited areas in which it has gained some degree of comparative advantage and industry concentration, such as minicars, it might become a base for global exports (to Europe, in particular). Furthermore, if India is seen as a hub for exports to the countries of the Middle East, Africa and South Asia, this may lead to new export opportunities. However, since India will only have a limited range of export products for the time being, investment and improvement of the distribution system, including ports, will be indispensable.

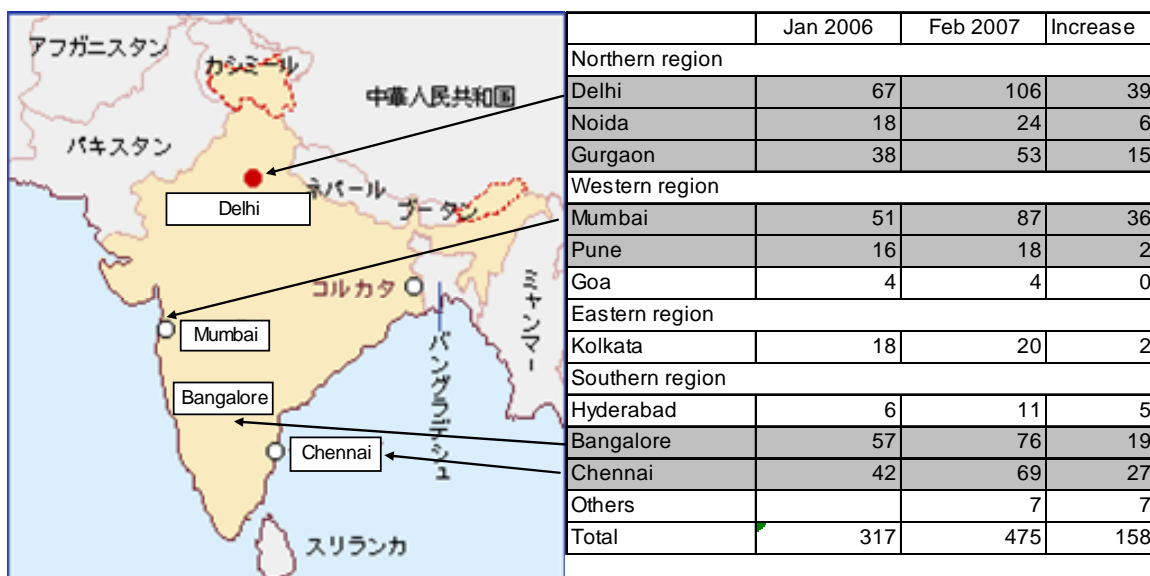
For the government, the development of SEZs is the key to India's export promotion policy. This is the Indian version of the special economic zones and development zones established in ASEAN and China to promote export. But here again, there is the problem of land appropriation. Even though there are occasional organized protests against the building of SEZs, some foreign companies are starting to take a positive stance in the utilization of this system. For example, Nokia (Finland), operates a SEZ in Chennai on its own. Furthermore, Singaporean developers and other entities, which have been involved in the development and management of industrial parks in China, are also planning to participate in SEZ projects in India. In view of the foregoing, India's investment environment is expected to improve.

4. Japanese companies venturing into the Indian market

According to the Japanese Embassy in India, the number of Japanese companies operating in India has increased from 317 to 475, up 158¹³, between January 2006 and February 2007. About 90% are concentrated in four cities– Delhi and its suburbs, Mumbai, Bangalore, and Chennai (Chart 13). Delhi and its suburbs are home to many manufacturers of two-wheeled motor vehicles and cars, while Mumbai has drawn many financial institutions. Many IT companies and auto makers are located in Bangalore, while many manufacturers, especially machinery companies, are inclined to set up plants in Chennai.

¹³ The figures include local corporations established by the existing Japanese companies in India.

**Chart 13: Trends in market entry in India by Japanese companies
(number of Japanese companies by city)**



Sources: Map (The Ministry of Foreign Affairs of Japan),
No. of Japanese companies (Japanese Embassy in India)

According to a Japanese government-related organization, inquiries by Japanese firms on entry into the Indian market have become more specific and focused in recent years. Starting from a “research and wait-and-see,” phase in 2005, progressing further to “identification of potential locations for investment” in 2006, consultations in 2007 are based upon premises on “entry into the Indian market.” The manufacturing industry is not alone. More diverse sectors, including recruitment agencies, advertising companies and financial institutions are following suit. Even though the number of Japanese companies in India is not rising dramatically, it is increasing at a steady pace (Japanese company source).

In this Chapter, we shall categorize Japanese companies’ business approaches to the Indian market into four types: (1) infrastructure, (2) domestic sales, (3) IT outsourcing, and (4) services, and provide an overview of investment trends among Japanese companies and future challenges.

(1) Infrastructure (capital goods)

According to the *11th Five-Year Plan*, investment in infrastructure is likely to accelerate.

The Indian government plans to spend about 40 trillion yen during the 11th Five-Year Plan period, broken down as follows: (i) about 15 trillion yen on improvement of the electric power system, (ii) about 8 trillion yen on improvement of the railway system, and (iii) about 5 trillion yen on improvement of roads (according to an Indian government-related organization). Against this background, infrastructure business of Japanese companies, especially heavy electric machinery and construction machinery, is showing signs of rapid expansion.

That said, there are several issues to be noted. Since India's budget deficit continues to run at a high level, in order to solve the problem of lack of funding, the BOT¹⁴ scheme has now become the mainstream of infrastructure business in India. According to a Japanese company engaging in infrastructure business, “under the BOT scheme, since a private entity is designated as an implementing agency, cost-consciousness is high. That reduces the possibility that expensive and high value-added Japanese facilities will be adopted. Facilities for electric power generation, ports and roads do not always need to be high-tech, so there will be more and more cases where relatively cheap Chinese and Korean facilities will be considered sufficient.”

(i) Thermal power generation: Toshiba awarded a contract by Tata Power Company to build a thermal power plant

Given India's chronic power shortage, the government aims to provide all households with access to electricity, and plans to increase electric power supply significantly during the 11th Five-Year Plan period. As a breakthrough measure, the above-mentioned “Ultra Mega-power Project” has been launched. Under the Project, an international bid is carried out and a private firm with the lowest bid price undertakes everything from construction to plant management. The bidding process has ended in two locations in 2006 – in Mundra, Gujarat State, Tata Power Company, an Indian conglomerate, won the bid, and in Sasan, Madhya Pradesh State, Lanco Infrac was the successful bidder. In the area of infrastructure development, foreign companies are given preferential treatment. However, given the strict bidding conditions (the required construction cost and

¹⁴A private firm Builds (B) and Operates (O) a facility for a certain number of years, and ultimately Transfers (T) it to the government.

electricity price are low), foreign companies did not show much interest in participating in the biddings. However, in August 2007, Tata Power Company awarded Toshiba a contract to build a coal thermal power plant in Mundra (five 800-MW steam turbine generators), attracting widespread attention.

The successful bid by Toshiba most likely stems from Toshiba's high reputation for its clean environmental technology. Moreover, the Japan-India Strategic Global Partnership agreement provides for the involvement of Japanese companies in Indian electricity projects. It is expected that this Tata-Toshiba power plant project will lead the two countries into more business alliances in the future. Japanese heavy electric machinery companies are gearing up efforts to increase their business in India. Mitsubishi Heavy Industries has already licensed technologies to an Indian company, and Hitachi Plant has set up a new office in Mumbai.

(ii) Nuclear power generation: conclusion of an atomic energy agreement is a prerequisite

As described above, the Indian government is planning to build nuclear power plants in approximately 14 locations. However, since India is not a signatory of the Nuclear Non-Proliferation Treaty (NPT), Japan has not concluded an atomic energy agreement (supply of nuclear technology for peaceful use, etc.) with India, and this is a hindrance to businesses expansion.

However, in July 2007, in what was considered an exceptional measure for a non-NPT signee, the Bush administration and India entered into a general agreement to sign an atomic energy agreement. GE and other U.S. heavy electric machinery companies may step up their nuclear power generation business in India. However, the smooth conclusion of the agreement remains uncertain due to concerns in some quarters that the agreement may allow the United States to interfere in Indian military matters. An economist for a major Indian conglomerate indicated that "it seems that under the agreement, the U.S. is entitled to terminate the agreement any time at its discretion. India does not want U.S. intervention in its use of nuclear power for military purposes. But Prime Minister Singh appears to be keen to conclude the agreement while President

George Bush is in office.” (This is because it is uncertain whether the next U.S. administration will treat India as an exception to the rule of the NPT.)

At present, it is difficult for Japanese companies to participate directly in nuclear business transactions in India because of the political situation. But given India’s chronic shortage of power, there is no doubt that it strongly hopes to construct large-scale nuclear power plants. Furthermore, since Japanese plant makers are promoting strategic tie-ups with U.S. and European counterparts, Japanese makers’ business development in the future is sure to attract attention.

(iii) The railway system: expectations for the Delhi-Mumbai freight railway are growing but uncertainties exist

Many Japanese companies are interested in India’s new freight railway plan, which will serve as an industrial corridor linking Delhi and Mumbai. According to a Japanese company source, the project will require total financing of about 130 billion rupees (about 400 billion yen) for electric locomotives, traffic systems and rail tracks, an amount which may be covered by a yen loan provided by Japan. If a consortium of Japanese companies wins orders for this project, it will create a major business opportunity.

However, U.S. and European companies are also showing interest. An expert on the Indian economy points out that “the Delhi-Mumbai freight railway project is a joint effort between the private and government sectors, under which the Japanese government provides ODA, and 30% of construction work is awarded to Japanese companies.” However, it is still undecided whether the freight railway should run on electricity or diesel. Japanese makers recommend the electrical method, but if the diesel method is adopted, there is a possibility that contracts will be awarded to GE (U.S.), which has proposed double-deck containers hauled by diesel locomotives.

While there is no doubt that relations between Japan and India are growing closer, Japan is not the only country that is awarded favorable treatment. According to a Japanese company, although former Prime Minister Shinzo Abe and Prime Minister Manmohan

Singh emphasized special bilateral cooperation, Japan appears to be treated equally with other countries at the ministerial level. However, since this freight railway project is the core of the Delhi-Mumbai Industrial Corridor (DMIC) Project, the choice of contractor is a matter of great interest.

(iv) Construction machinery: strong demand leading to local production

Given the growth of infrastructure development, demand for construction machinery has been rising, and an increasing number of Japanese machinery makers are beginning to operate in India to accelerate local production. According to analysis by a Japanese company, the recent rise in demand for construction machinery stems from the development of natural resources, including coal, iron ore and copper, along with the increase in thermal power generation and iron-making projects. The predicted rise of real estate development in the future is leading to expectations on the strong growth of the construction machinery market.

(2) Domestic sales (durable consumer goods and consumer products)

The most typical industry of this type is the auto industry, which is based upon a business model of local production and local sales. Japanese auto makers in India have expanded local production, targeting the rapidly growing domestic market. However, they are also increasingly looking to export.

On the other hand, Japan's household electrical appliance industry tends to focus on sales activities in India, rather than engaging in local production. Japanese household electrical appliance companies are looking to export their products to India from their production bases in ASEAN.

(i) Cars (including two-wheeled motor vehicles): lack of industrial parks despite surge of production, risks of over-production in 2010

The Indian market is characterized by a large proportion of small cars. This is mainly

because of its price competitiveness, relatively high gasoline retail prices, compared with other emerging countries (India's gasoline prices are more or less on par with Japan), and preferential tax treatment given to cars of 1,200cc or smaller. With demand basically strong, Japanese auto makers are boosting local production, and more and more auto-related companies are entering the Indian market. Suzuki and Honda are operating in the suburbs of Delhi, while Toyota is operating in Bangalore. Nissan is scheduled to set up a plant in Chennai.

At present, Japanese companies are concentrated mostly in the suburbs of Delhi. However, despite the rise of Japanese car parts manufacturers wishing to enter the Indian market or increase their existing production reflecting the announcement by Suzuki and Honda that they will increase production in India, industrial parks are in short supply in the suburbs of Delhi. The Japanese government is now working to solve this problem. JETRO and Rajasthan State Industrial Development & Investment Corporation (RICCO) have already entered into a memorandum of understanding (MOU) regarding the promotion of Japanese investments in the state of Rajasthan, and it has been decided that Japanese companies will be given priority for setting up facilities in the Neemrana Industrial Park for a period of two years starting July 2006.¹⁵ However, since the Neemrana Industrial Park is more than 100km from Delhi, and the development of the infrastructure is yet to commence, the shortage of industrial parks is likely to continue for some time.

Although demand is basically strong, the fact that many companies are starting to increase production in India presents a new concern. In addition to Suzuki (which plans to increase annual production by some 300,000 cars by around 2009) and Honda (which plans to increase annual production by some 100,000 cars by around 2009), Toyota also plans to step up output and Nissan (jointly with Renault) is scheduled to start production in India¹⁶ (annual production of about 400,000 cars for seven years after 2009). South Korean, U.S. and European companies as well as local companies such as Tata are also planning to raise output. The scheduled output expansion plans will continue until the first half of 2010. Some estimates suggest that, as a result, Indian vehicle production

¹⁵ As of July 2007, 120 Japanese companies conducted inspection tours, eight companies decided to set up facilities, and 26 companies are conducting feasibility studies.

¹⁶ February 26, 2007 press release by Nissan Motor Co., Ltd.

capacity will reach 2 million units around 2010, exceeding the projected demand of about 2 million units. Therefore, while the extent to which India's domestic demand will grow will serve as an important factor, competition among auto makers is likely to intensify for the time being.

Furthermore, plans are underway regarding exports. Amid growing worldwide concerns regarding the environment, small, energy-efficient cars are attracting attention. The Indian government aims to make India a production base for small cars. According to estimates by a Japanese company source, India will export nearly 1 million cars in the future, mainly produced by Japanese and Korean manufacturers. Some Japanese auto makers are going ahead with detailed reparations, and have already started to produce small diesel cars tailored for the European market – their anticipated export market. However, India must negotiate many obstacles to become an export base, including the improvement of the transport infrastructure linking factories with ports, and port facilities for car exports at the quays in addition to requirements to meet international quality standards. Furthermore, Thailand is currently an export base for cars in ASEAN and exports about 600,000 cars annually. Another 1 million cars from India may well serve as a source of trade friction and accelerate the ongoing appreciation of the rupee.

During our tour of an industrial park in the suburbs of Delhi, the plant at first sight appeared to be equipped with the necessary infrastructure, including power lines and road zones. However, Japanese companies operating there (two-wheeled motor vehicle companies and parts companies) cited regular power cuts and lack of water and sewage connections forcing them to resort to underground water. They also said that construction costs to build factories are higher in India than in ASEAN countries. Under these difficult circumstances, their view was that production in India was only suitable for the domestic market, and they were skeptical about the possibility of the country positioning itself as an export base.

(A large plant operated by a Japanese car company)



Photographed by the author

(The industrial park is surrounded by wasteland)



Photographed by the author

(ii) Household electrical appliances : demand for high-end goods, progress of FTA with ASEAN and shifts in the retail sector serve as tailwinds

In the Indian “white goods” market, South Korea’s two largest electronics makers, Samsung and LG have an overwhelming market share (in the color television market, their market share is 40%). Some Japanese companies believe that this stems from their heavy investment on advertising and provision of products free of charge to India’s airports and high-end hotels. Local production has also progressed. In contrast, Japanese household electrical appliance makers have got a late start, behind their South Korean competitors, in cultivating the Indian market. Although it is difficult to gain market share from South Korean makers whose brand names are familiar to Indian consumers, competition between Japanese and South Korean makers is intensifying in India.

That said, there are signs of change in the Indian household electrical appliance market, which may serve as tailwinds for Japanese makers. The first such change is the rise of demand for high-end products, such as flat-screen televisions. It is estimated that the flat-panel television market will treble from 2006 to 2007, and grow to somewhere between 400,000 to 500,000 sets (a Japanese company source). Given the rapid expansion of this market, Japanese household electrical appliance makers are increasing their presence in India. The second factor is the progress of Free Trade Agreements (FTA) between India and the ASEAN countries. In particular, under an “Early Harvest (EH)” Program, tariffs have been removed from 82 items including tube televisions and

refrigerators since 2004 in Thailand. **(Chart 14).** Many Japanese makers now use this EH program to export their products to India from production bases in Thailand, leading to the expansion of their product lineup. Note that more and more companies are starting to take this strategy. At present, in order to keep up with the growing domestic demand in India, many Japanese makers are exporting their products from production bases in Thailand on an as-needed basis.

In areas where strong demand may be expected, such as air conditioning, Japanese makers have been strengthening local production in India, and are seeking to establish an optimum production and sales system while weighing up local production and the EH program. In the event India concludes FTAs with all the countries of the ASEAN region in the future, Japanese makers will most likely export their products to India from their bases in Malaysia and Indonesia.

Chart 14: The Early Harvest Program - India and Thailand (Thai statistics)

(Unit: USD million, growth rate: %)

	Item	2004	2005	2006	2004-2006 (average growth rate)
Exports	Color TV	43	96	125	70.5
	Polycarbonate	17	112	52	77.6
	CRT for TV	5	21	32	160.1
	Air conditioner	8	16	28	90.4
	Epoxy resin	5	11	16	80.1
	Total of subject items	146	338	368	58.7
	Total export value	905	1,519	1,815	41.6
Imports	Gearbox	4	30	40	206.1
	Semifinished products of iron or unalloyed-steel	36	6	12	-41.7
	Goods classified as cocks and valves	2	4	6	84.3
	Aluminum oxide	4	6	6	16.0
	Other polyester	1	2	6	151.8
	Total of subject items	70	88	101	20.0
	Total import value	1138	1,275	1,625	19.5
Trade balance	-233	244	190	-	

Source: JETRO.

Furthermore, the household electrical appliance industry is caught in a wave of retail sector reform. As described above, mass retailing is relatively underdeveloped in India due to the political importance of mom-and-pop stores that comprise approximately 95% of the country's retail industry. Although there is still strong opposition in some quarters to mass retailing, India's conglomerates such as Tata and Reliance have changed

the situation by entering the mass retailing of household electrical appliances in 2006. They have opened branch outlets mainly in shopping malls springing up in the suburbs of large cities. However, some Japanese companies say that retail chains operated by Tata or Reliance apply very strict sales requirements (including “shelf price”). Although the environment encouraging sales has been improving, Japanese companies are expected to continue to develop their own sales channels for some time.

(A shopping mall in Gurgaon)



(Photographed by the author)

(Gurgaon connected to Delhi by metro)



(Photographed by the author)

(iii) Materials: move toward massive investment

Fuelled by the expansion of car production, materials makers, including iron & steel and chemical companies, have begun investing in production in India. Judging from the very high initial investment costs in the materials industry, at least in the tens of billions of yen, these materials makers most likely took the initiative to commence local production on the basis of their perception of India as a rewarding market in the mid-and-longer term.

(iv) Food: India's population of 1.1 billion provides new business opportunities

With the expansion of the consumer market, food makers are now beginning to explore the Indian market. Since the unit price of food is relatively low, their potential customers constitute a large segment of the Indian population. However, it should be noted that India is a unique market in a number of respects. Spice-laden curry is an

essential dish, and there are many vegetarians for religious reasons. A Japanese food maker said that their sales grew when they introduced a curry flavor into their product.

The reinforcement of their sales network is also a challenge that Japanese companies must tackle. In many cases, European and U.S. companies entered the Indian market earlier than Japanese companies. Yakult, a Japanese health drink maker, and Danone, a large French dairy products maker, have formed a global strategic alliance. In its India business also, Yakult has concluded a business tie-up with Danone.

(3) IT outsourcing

There is the strong impression that the software industry, which is centered in Bangalore, is the most representative industry in India. Two international bestsellers, “The World is Flat: A Brief History of the Twenty-first Century” by Thomas Friedman¹⁷ and “Three Billion New Capitalists: The Great Shift of Wealth and Power to the East” by Clyde Prestowitz¹⁸, describe how the U.S. now outsources not only software services but also medical care and education to India. They argue that outsourcing is expanding dynamically in many areas. Japanese IT companies are also looking to expand their bases for outsourcing, notably in Bangalore.

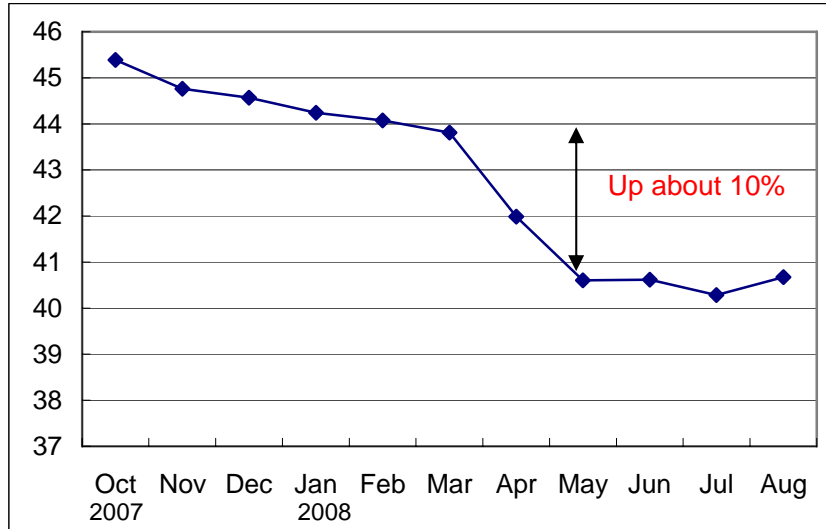
However, India’s cost advantage over developed countries is starting to erode. One of the reasons is the rapid rise of labor costs. Even India, which is purported to be an IT superpower, only has a limited number of people who are fluent in both English and IT skills. Large Indian IT outsourcing companies increasingly have difficulty in securing adequate workers. Since they are suffering from a shortage of university graduates with science degrees, they are hiring liberal art graduates instead and providing them with about nine months’ training (according to an Indian government-related organization official). In addition, the recent appreciation of the rupee (Chart 15) also works to the disadvantage for the IT outsourcing industry, which exports services. To ensure export competitiveness, they are now trying to reduce costs by extending their business to

¹⁷ American journalist and former UPI reporter

¹⁸ President of the Economic Strategy Institute and former Counselor to the Secretary of Commerce

regional cities, while upgrading their outsourcing services and adding high value to their services.

Chart 15 Rupee-Dollar Exchange Rate (October 2007 – August 2008)



Source: CEIC Data

(4) Services

(i) Distribution – expansion of the distribution network through M&A; improvement of access to ASEAN

With the expansion of the consumer market, the establishment of the global distribution network is becoming a very important issue. However, it is very difficult for Japanese companies alone to build a distribution network in India, whose area is ten times larger than that of Japan and is beset with under-developed infrastructure. The situation has led to increasing cases of Japanese companies acquiring local affiliates.

Nippon Express acquired an Indian distribution company operating in 10 major cities (17 operation bases) in India, and established a subsidiary. In the case of Mitsubishi Corporation, its existing distribution affiliate received capital contribution from an Indian distribution company, thus obtaining a strategic partner to expand the distribution business in India. There are also reliable M&A consulting firms with respectable

records. M&As are expected to increase in the future as a means to tap the Indian market.

Furthermore, given the progress of FTAs, it will be necessary to improve the distribution network between India and its neighboring countries, including ASEAN. Tokyo Senpaku Kaisha (“TSK Line”, a Nippon Yusen group company) operates a shipping service from Japan to India via Thailand. Considering that this shipping service is operated via Thailand, where many Japanese companies’ production bases are concentrated, India and ASEAN are growing closer in terms of distribution (Chart 16).

Chart 16: India and ASEAN connected by the Straits of Malacca



Source: Website of the Ministry of Foreign Affairs of Japan

(ii) Services for Japanese companies – the number of service companies is rising along with the increase in the number of Japanese companies entering the Indian market

When Japanese companies expand overseas, they need international telecommunications, human resources and advertising services. In this area, major service companies are accelerating their entry into India. Human resources companies have already started to send skilled Indian workers mainly in the area of IT to Japan. As more Japanese companies enter the Indian market, the business environment is gradually improving.

5. Key to success in doing business in India: the necessary approach

Finally, based upon the analysis in Chapters 1 through 4, we shall summarize key elements required for successful business in India.

(1) There are five markets: what to do about the low-end market

The first element is sales targets. The current Indian market is made up of “the high-income group,” “the upper-middle-income group (the so-called “upper-middle class” defined as those with privately-owned cars; this group, together with the high-income group is constituted of approximately 15 million people, and the population of this group is set to increase by somewhere between 1 to 2 million people per year);” “the lower-middle-income group,” (the so-called “lower-middle class” defined as owners of two-wheeled motor vehicles, constituted of approximately 80 million, is set to increase by 8 to 10 million people per year); “the low-income group” (approximately 700 million people) and “the poor group”(approximately 300 million people who live on less than one dollar per day).

In Japan, India is perceived as a huge market. Nevertheless, it should be noted that India’s recent robust purchasing power is driven by the upper-middle class. The Indian government aims to create employment opportunities by improving the infrastructure and strengthening industry, thereby raising the income levels of the low-income and poor groups.

It is important for Japanese companies to set clear targets. They should determine whether they will sell high-end products to the high-income group/ upper-middle class, or will sell low-end products for emerging countries to the lower-middle class/ low-income group. The Chinese market is growing also as a high-end product market. In India, however, the purchasing power of the high-end market may be limited, depending on the product. Strategies with an eye to exploration of the low-end product market are likely to be required in the mid-to-long term.

(2) Alliances with Indian companies are essential: a more practical approach than going it alone

The second element is business alliances with Indian companies. In order to supplement the under-developed infrastructure and to avoid the risks of labor disputes, Japanese companies need to utilize the business resources of local partners when doing business in India. This is different from China and ASEAN, where the infrastructure is already in place, and independent funding is preferred for smooth operations. While projects in India are expected to rise, Japanese companies will find more opportunities through business alliances with their Indian counterparts than trying to obtain infrastructure contracts only through public tenders.

(3) India differs fundamentally from ASEAN and China: need to assess India's unique characteristics

Finally, we suggest that in India, unlike ASEAN and China, requests to the Indian authorities by both the Japanese private and governmental sectors to improve the investment environment will not have immediate effect. Therefore, Japanese companies will need to adopt new market strategies by assessing the unique characteristics of the Indian market, while taking a flexible approach to the use of the know-how acquired through their business experience in ASEAN, China and other countries.

- End -

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