Why is India the best place for Japanese investments in the post Covid-19 world

Devika Chawla, Strategic Investment Research Unit, and Seerat Kohli, Japan Plus, Invest India
WHY IS INDIA THE BEST PLACE FOR JAPANESE INVESTMENTS IN THE POST-COVID-19 WORLD

-Devika Chawla, Strategic Investment Research Unit, and Seerat Kohli, Japan Plus, Invest India

INTRODUCTION

The ongoing novel coronavirus outbreak has severely disrupted economic and social life across the world. Besides an ever-increasing human toll, the economic costs of the pandemic have also been immense. This has created widespread uncertainty about China’s future global role and trade practices. It has been supplemented by growing worries about the global economy, now in its worst recession since the Great Depression of 1929. It is in this context that this paper assumes significance as it examines the recent announcements by the Japanese government offering massive incentives to their companies to move out of China and argues why Japan should look towards India as the foremost destination for diversifying its supply chains away from China. As will be seen through the course of this paper, India offers several unique returns for Japanese companies to boost their presence and investments in the country in the post-COVID world.
COVID-19 OUTBREAK DEEPENS ECONOMIC CRISIS IN JAPAN

The economic stimulus package announced by the Japanese government comes in the background of worsening economic conditions even in the overheated Japanese labour market. The COVID-19 outbreak has brought Japanese manufacturing to a near halt, thereby threatening millions of jobs and pushing numerous businesses under crippling debts. According to a recent survey by Teikoku Databank, the ongoing crisis has pushed companies like cruise ships and Japanese inns to private tutoring schools and tourism under crippling debts, even running up to 1.2 Bn Yen (USD 11 Mn) in some cases. A further 63 per cent of the companies have reported a negative impact on their businesses due to this pandemic.

Ever since the outbreak first began in Japan early January, the pandemic has wreaked havoc to the country’s manufacturing industry, leading to a deep slide and contraction in the sector, reaching at 44.8 in March as compared to an already low figure of 47.8 in February, as per data from the latest PMI survey. The sharp drop in the output was coupled with a substantial decline in new orders, making the situation much worse.

UNDERSTANDING THE JAPANESE ECONOMIC PACKAGE

The worsening economic crisis in Japan fuelled by supply shortages in Japanese factories was coupled with increasing frustration in Japan over the lack of transparency by China during the initial days of this outbreak. Consequently, a number of Japanese politicians and business elites have been critical of China’s apparent reckless approach in tackling the COVID-19 outbreak when it began and hiding the true extent of its spread.

What followed was a shutdown of factories in China, leading to a huge disruption to Japanese supply chains and a 50 per cent drop in exports to Japan in the month of February. This led to growing calls within Japan to rethink their manufacturing dependence on China. Heeding to those calls, Prime Minister Shinzo Abe while chairing the meeting of the Council on Investments for the Future on March 5 announced his willingness to bring high value-added product manufacturing bases back to Japan. Signalling the first sign of government funded relocation of domestic businesses away from China, he said, “We should try to relocate high added value items to Japan.”
Soon after, this statement was transformed into government policy with his government announcing a record budget in April to help Japan’s fight against COVID-19. The biggest highlight of this budget is the USD 2.2 Bn (240 Bn Yen) economic package created for Japanese firms currently based in China to move their production units out of China, either back to Japan or to other countries. Of this, USD 2 Bn (220 Bn Yen) have been earmarked for Japanese firms to move back to Japan while another USD 200 Mn (23.5 Bn Yen) have been provided to help relocate companies away from China to other countries.

The relief economic package, amounting to a record USD 992 Bn (108.2 Tn Yen) and is estimated to be around 20 per cent of Japan’s yearly economic output, is also a clear indication of the extent of the crisis and damage that the government is preparing for.

The implications of this package will be wide and far-reaching, both in terms of geopolitics as well as economics. Specifically, the decision to promote relocation of Japanese companies away from China, its largest trading partner indicates a growing consensus in Japan to move its supply chains back to the country, or to other preferable countries such as Vietnam, Thailand and India.

### IMPACT ON CHINA-JAPAN TRADE RELATIONS

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### REASONS DRIVING COMPANIES OUT OF CHINA

<table>
<thead>
<tr>
<th>Number of Japanese establishments</th>
<th>China</th>
<th>India</th>
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<tbody>
<tr>
<td>33,050</td>
<td></td>
<td>5,100</td>
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</table>

<table>
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<tr>
<th>Japanese FDI 2018-19 (USD Bn)</th>
<th>China</th>
<th>India</th>
</tr>
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<tr>
<td>3.8</td>
<td></td>
<td>2.9</td>
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Even though this package has been announced in the backdrop of a global COVID-19 pandemic, however it is important that this economic budget must not be analysed solely as a result of the COVID-19 crisis and needs to be put into perspective to grasp the larger picture driving the Sino-Japanese economic relations for a while now.

Enlisted below are some of the major reasons contributing to this economic fallout between the two neighbours:
As the world's second most populous country and its largest democracy, India provides the perfect combination of a large, rapidly growing market economy with open and democratic social values. Indo-Japanese cultural and economic ties have roots going back centuries, of which trade was always an important pillar. In the current times, India has been the largest recipient of Japan’s Official Development Assistance (ODA) program which has played a key role in developing India's infrastructure through affordable loans and grants. In the recent decades, India has consistently featured as one of the world's fastest growing major economies with average growth rates around 7 per cent while Japan continues to be an economic powerhouse and the third largest economy in the world.

### WHY INDIA?

**Preference for diversification to other countries:**

China has been rapidly losing its attractiveness among Japanese countries for a while now, an example of which can be seen from the fact that about 159 Japanese companies operating in China have relocated to comparable countries like Vietnam and Thailand. Such diversification and shifting of Japanese firms away from China is estimated to create a USD 730 Bn economic opportunity for developing geographies like ASEAN and India.

**Rising labour costs:**

Another reason for China losing its sheen among Japanese firms are the rising labour costs in China, estimated to have gone up by three times in the last four years, standing at USD 6.50 per labour hour currently as compared to a country like India where it is USD 5 per labour hour.

**Administrative and legal procedures:**

The export-oriented Japanese firms have been facing multiple issues around administrative and legal procedures in China- some face problems with protecting their IPR while others have to deal with a complex tax and legal system as well as other regulatory and enforcement risks.

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**U.S-China tariff war:**

Before the pandemic struck, the trade relations between the countries were already struggling. One of the foremost reasons being the heated trade war happening between the United States and China, both huge trading partners for Japan.
Indo-Japanese cooperation covers a wide spectrum of activities and has seen consistently upward growth as this strategic partnership deepens. Since the establishment of diplomatic ties between the two countries, Japan has played a key role in promoting economic and industrial development in India through affordable loans, grants, technology sharing and programs like the ODA. Over the decades, the friendly ties between the two countries have manifested in numerous successes for both, be it the Delhi Metro or the setting up of Japanese Industrial Townships (JITs) having special incentive packages for companies to operate in.

The economic relationship between India and Japan has always been on a growth spree, with a major revamp taking place since 2014, when ‘Modinomics and Abenomics’ came together to boost Japanese presence in India through greater investments and incentives. The Delhi Metro project, conceived and executed through Japan’s ODA, is a shining example of what this dynamic relationship can achieve with the right synergies in place. It did not come as a surprise, then, that in 2015, the same year that Japanese Prime Minister Shinzo Abe visited India, the country decided to bring the Japanese ‘Bullet Train’ system in India and enhance connectivity in some of India’s biggest cities and accelerate India’s economic growth.

One of the most prominent pillars of Indo-Japanese cooperation is Japan’s deep involvement in promoting connectivity and mobility in and around India. After the success of the Delhi Metro, both the countries decided to cooperate further to bring Japanese ‘Shinkansen’ trains in India. Pursuant to this, the Delhi-Mumbai Industrial Corridor project was launched after a Memorandum of Understanding (MoU) was signed between the governments of India and Japan in December 2006. According to its website, the DMICDC incorporated in 2008, is the implementing agency for the project. DMICDC has been registered as a company with 49 per cent equity of Government of India, 26 per cent equity of the Japan Bank for International Cooperation (JBIC) and the remaining held by government financial institutions. The Japanese government also announced financial support for the DMIC project to the extent of USD 4.5 billion in the first phase for the project with the Japanese sharing their cutting-edge technology required to operationalise such an efficient high-speed rail system.

The project spans across the north Indian states of Uttar Pradesh, Haryana, Rajasthan,
Madhya Pradesh, Gujarat and Maharashtra along the western Dedicated Freight Corridor (DFC) of the Indian Railways. While for the southern parts of India, the Chennai-Bengaluru Industrial Corridor (CBIC) is another major flagship project largely supported and funded by the Japanese government. Like the DMIC, the CBIC also envisions accelerated growth in the regional industries in South India to facilitate greater private investments and smooth industry access in the region.

Besides assisting and investing in nationwide infrastructure projects like the DMIC and JITs, the Japanese government is also significantly invested in a range of regional and state-specific developmental projects in India. In this regard, it is important to note that Japan has either invested or is planning to invest in a host of projects in North-East India that include a water supply project in Guwahati, enhancing the road network in Assam-Meghalaya, various forest management and agriculture projects in other North-Eastern states, which crucially also serve as a gateway to Southeast Asia. In 2017, the Japan International Cooperation Agency (JICA) signed an agreement with India to provide USD 610 Mn for the Phase I of the North-East Road Network Connectivity Improvement Project, which will focus on projects in Meghalaya and Mizoram.

BILATERAL AGREEMENTS

During Prime Minister Modi’s visit to Japan in 2018, a number of MoU(s)/bilateral agreements were signed in the following areas of cooperation:

- Healthcare and Wellness
- Postal services
- Food Processing industry
- Joint Research and Educational Hub for International Collaboration
- Japan-India Digital Partnership
- Environmental cooperation
- Food safety
- Indo-Japan Startup Hub
On December 10, 2019, Minister of Commerce and Industry, Government of India, Piyush Goyal and Minister of Economy, Trade and Industry (METI), Government of Japan, Hiroshi Kajiyama, decided to launch the India-Japan Industrial Competitiveness Partnership (IJICP).

This partnership proposes that the governments of India and Japan will jointly work toward enhancing India’s industrial competitiveness (through discussions in areas such as development and utilization of industrial zones to promote foreign direct investment), lowering cost of logistics, and facilitating smooth governmental procedures. They will also identify challenges of specific industrial sectors and the means to mitigate these challenges.

Furthermore, 57 Japanese companies also signed Letter of Intent and Acknowledgement to making greater investments in India during Prime Minister Modi’s Japan visit in 2018. These companies operate in a wide range of sectors such as automobiles and auto components, construction, textiles, food processing and energy among many others.

INDIA–JAPAN INDUSTRIAL COMPETITIVENESS PARTNERSHIP (IJICP)
This task force, co-chaired by the Secretary, Department for Promotion of Industry and Internal Trade (DPIIT), Ministry of Commerce and Industry, Government of India and the Vice Minister for International Affairs, METI, Government of Japan, will collaborate with the relevant ministries and industries to achieve the vision of a globally competitive and vibrant Indian manufacturing sector.

**SOLUTIONS FOR SMART CITIES**

- Japan International Cooperation Agency (JICA) to provide a concessional loan of ₹500 crore for smarter mobility project in Chennai to develop intelligent transport systems for an efficient traffic management system to ease the city’s congestion and promote economic growth.
- JICA has signed an agreement with the Indian government for setting up of a Chennai-based seawater de-salination plant at an ODA amounting to INR 1,800 crore.

**JAPAN IN INDIA**

**Indian subsidiaries outperforming their global parent companies**

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<tr>
<th></th>
<th>Global parents’ revenues</th>
<th>6.9%</th>
<th>↓</th>
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<tbody>
<tr>
<td>Global parents’ net profits</td>
<td>4.4%</td>
<td></td>
<td>↓</td>
</tr>
<tr>
<td>Indian subsidiaries’ revenues</td>
<td>12.6%</td>
<td></td>
<td>↑</td>
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<tr>
<td>Indian subsidiaries’ net profits</td>
<td>30.6%</td>
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Average INR of All-Asia based funds: 11.9%
Average IRR of India-focused funds: 14.4%

Source: CapitalQ As on 15th Jan’19

**TOP JAPANESE SECTORS IN INDIA**

The Japanese presence in India spans across a wide range of sectors including, but not limited to, automobile, chemicals, textiles and renewable energy. Japanese companies operating in these sectors have not only been immensely successful in India but have also reaped rich dividends on their investments made into the Indian market, reflecting the strong foundations and resilient...
nature of India’s economy. The broad success of Japanese firms in India has played an important role in maintaining and even enhancing the attractiveness of the Indian market within Japan’s business community.

A brief snapshot of the top sectors in which Japanese firms operate in India:

<table>
<thead>
<tr>
<th>Sector</th>
<th>Details</th>
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<tbody>
<tr>
<td><strong>Automobile and auto components industry:</strong></td>
<td>India is the 4th largest automotive market as well as the 5th largest auto-producing nation in the world, with Japanese auto giants such as Maruti Suzuki and Mitsubishi, constituting a large chunk of this production. With a growth rate of 18.3 per cent in 2017-18, the Indian automobile industry is only set to grow stronger.</td>
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<td><strong>Chemicals industry:</strong></td>
<td>India is currently among the top five consumers of polymers and 4th largest producer of agro-chemicals in the world and this sector contributed 9 per cent of the total FDI inflows in India in 2018. With major Japanese chemical firms such as Kansai Nerolac, Mitsui Chemicals and Sumitomo Chemicals present in India, the market is increasingly lucrative with an expected CAGR of over 10 per cent in the next five years.</td>
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<tr>
<td><strong>Food processing industry:</strong></td>
<td>India offers a huge market for Japanese food processing industries to grow and expand because of India’s vast size, offering enormous potential for Japanese firms. India is not only the largest producer of milk in world but also the second largest global producer of horticultural crops besides being the world’s largest producer, consumer and exporter of spices. With booming foreign direct investment levels, this sector has attracted a growing number of Japanese firms present in India.</td>
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<td><strong>Medical devices industry:</strong></td>
<td>One of the foremost areas of bilateral collaboration, the medical devices market in India is currently estimated to be worth USD 10 Bn in 2019 with an estimated CAGR of 15.8 per cent. Despite being the fourth largest market in Asia, India’s domestic medical devices industry is relatively nascent– with an 80 per cent import dependency. These factors provide the right environment for better utilization of Japanese technology to ramp up the production of quality, affordable medical devices in India. Furthermore, Japanese medical devices firms are also keenly looking to tap into the vast opportunities offered by India’s large size.</td>
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</table>
Electronic system design and manufacturing (ESDM) industry:
In 2017-18, India's electronics industry was sized at USD 112 Bn with its forecasted size set to become worth USD 400 Bn by 2023-2024 with a CAGR of 26.7 per cent. India's consumer electronics is one of the fastest growing segments within the electronics sector, offering much scope for the superior Japanese electronics industry to expand its presence in India. Recognizing this potential, a MoU was signed between India Electronics and Semiconductor Association (IESA) and Asia Semiconductor Trading Support Association (ASTSA) from Japan to jointly promote ESDM industry collaborations, to find synergies that can lead to the overall empowerment of the electronics ecosystem in India and Japan.

Consumer goods industry:
India's fast-growing middle class and a rising GDP have contributed in making India a rapidly growing Fast-Moving-Consumer-Goods (FMCG) market estimated to be worth USD 104 Bn by 2020 making it the world's 5th largest consumer durables market at a CAGR of 14 per cent. In India's consumer goods sector, Japanese giants such as Panasonic and Daikin have witnessed nationwide presence and burgeoning profits, in a clear indication of economic and business successes enjoyed by Japanese companies in India.

JAPANESE INDUSTRIAL TOWNSHIPS (JITS)
On April 30, 2015, India's Minister of Commerce and Industry, Nirmala Sitharaman, and Japan's Minister of Economy, Trade and Industry, Yoichi Miyazawa signed the India-Japan Investment and Trade Promotion and Asia-Pacific Economic Integration and agreed to take steps to develop 11 potential sites as Japanese Industrial Townships in India. JITs are envisaged as integrated industrial parks with readymade operational platforms, well-equipped and world-class infrastructure facilities with plug-in-play factories and investment incentives for Japanese companies. Japan is the world's only country that currently has 12 dedicated country-focused industrial townships in India.

JAPAN PLUS DESK AT INVEST INDIA (PARTNERED WITH METI)
The Japan Plus desk at Invest India is the one-stop-shop for exploring and materializing India-entry plans for Japanese companies by working closely with the union ministries, states and regulatory authorities. Comprising of officials from India as well as from the Ministry of Economy, Trade and Industry from Japan, this desk seeks to further expand bilateral engagements between both the countries. To this end, Invest India and Japan External Trade Organisation (JETRO) signed
a Memorandum of Cooperation (MoC) on May 1, 2018 with the stated intention of "strengthening their investment promotional activities to encourage further Japanese investments into India". In continuation and recognition of increased cooperation between India and Japan, a MoU was signed between Invest India and Japan Innovation Network on June 29, 2018. Such cooperation further complements the other functions of the Japan Plus desk at Invest India.

**Key functions:**

- An entire spectrum of investment promotion - research, outreach, promotion, facilitation, and aftercare
- Initiating, attracting, facilitating, fast-tracking and handholding Japanese investments across sectors
- Providing information on investment opportunities across sectors in specific projects
- Extending holistic support to the small and medium enterprises from Japan with interests in investing in India

**JAPAN-INDIA STARTUP HUB**

The Japan-India Startup Hub was launched on October 29, 2018 by the Prime Ministers of India and Japan on a visit by Indian Prime Minister, Narendra Modi, to Japan. An online platform for Japan-India Startup Hub has, since, been established, which functions as an information board on related policies, curation of events, registration and matching the startups of both countries. (https://www.startupindia.gov.in/japan)

As part of this ongoing initiative, both India and Japan consider dispatching missions, consisting of companies, startups, investors and venture capitalists, to each other's countries to ensure continuous bilateral engagements with their partners.

**Support by the Japanese side to the Indian side:**

- One-to-one support by JETRO to establish an Indian desk, which supports Indian startups in Japan
- Providing business planning support
- Free use of their temporary offices in Japan to Indian startups
- Japanese "Green Card" and "Highly Skilled Professional Visa" for highly skilled Indian professionals
- Startup visas for India's entrepreneurs
As part of the activities of the Japan-India Startup Hub, Invest India and SoftBank Group launched Tech4Future, a joint challenge to identify and support innovative startups in the fields of artificial intelligence, machine learning, face recognition, and cyber security for funding and potential incubation opportunities.

**INDIA’S ADVANTAGES AS THE DESTINATION FOR HIGHER JAPANESE INVESTMENTS**

**The labour advantage:**
Among the many synergies converging in the Indo-Japanese ties, the availability of a large pool of cheap labour in India stands out distinctly as it perfectly addresses the issue of lack of labour in Japan due to its ageing population. India, as the world's youngest large country, with an estimated average age of 29 years by 2025, is aggressively skilling its large pool of manpower to address domestic and global demands for labour.

**Investment opportunities:**
India, with its impressive and consistent growth rates, has attracted some of the highest FDI figures in the world since it liberalised its economy in 1991. In the backdrop of its growing economy, India is estimated to provide USD 4.8 Tn investment opportunities by 2025. During 2012–2017, several Indian subsidiaries of global corporates have continuously outperformed their global parent companies, demonstrating the strong growth prospects for investing in India. As of 2018–19, Japanese FDI into India stood at USD 2.96 Bn.

**Mutual trade:**
Trade between both the partners has been growing and deepening significantly reflected in the presence of 1,441 Japanese firms operating in India, in sectors ranging from automobiles to food processing and from renewable energy to textiles. In 2018–19, India’s imports from Japan stood at USD 12.7 Bn, while Indian exports to Japan have followed a similar trajectory of growth, standing at USD 4.8 Bn in 2018–19.

**Support by the Indian side to the Japanese side:**
- Free use of Indian incubation facilities and offices by Japanese startups
- Facilitation support to Japan’s entrepreneurs and startups

**Joint Challenge:**
As part of the activities of the Japan-India Startup Hub, Invest India and SoftBank Group launched Tech4Future, a joint challenge to identify and support innovative startups in the fields of artificial intelligence, machine learning, face recognition, and cyber security for funding and potential incubation opportunities.
CONCLUSION

As demonstrated in this paper, the ongoing COVID-19 crisis presents a golden opportunity for India and Japan to further boost their already successful relationship. There is little doubt in anyone’s mind that the post-COVID world will be starkly different from the one preceding it in many significant ways as the world looks towards an economic and social reset. Among other things, this pandemic has highlighted the world’s over-dependence on China, particularly in areas such as medical equipment and medical textiles, as a result of which, there has been a growing consensus between and within countries such as India and Japan about not only promoting their domestic industries but also diversifying their reliance on China for manufacturing activities.

These convergences bring Indian and Japanese interests closer and the opportunity presented by Japan’s announcement of funding its multinationals to relocate away from China, must be fully leveraged by India as the most preferable destination to secure such investments from Japan. India has a variety of factors and reasons to be the favourite destination for Japanese investments, including its global role and position as a key international player capable of replacing China, its large market size offering immense opportunities for trade, its consistently strong growth rates, its vast pool of cheap yet skilled labour and last but not the least, its open and democratic values, a major feature that differentiates India from China. A deepening of the Indo-Japanese relationship proves a win-win for both; promoting India as the prime place for Japanese companies to invest in, goes a long way in that direction.
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