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INDO JAPANESE COLLABORATIONS

MOVING UP THE VALUE CHAIN

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Backdrop

The roots of the Indo-Japanese relationship can be traced many centuries back to the cultural exchanges that gained momentum following the spread of Buddhism in Japan. Ever since, both countries have made rich forays through co-operation predominantly in the areas of trade, economy and technical know-how.

Among the milestone covenants of the bilateral relation is the December 2006 Memorandum of Understanding for the construction of Delhi-Mumbai Industrial Corridor, the USD 90 billion mega infra-structure project with financial and technical aid from Japan, and the Comprehensive Economic Partnership Agreement since August 2011 aimed at abolishing import duties on inter-trades, enabling Indian professionals and contractual service suppliers to set foot in Japan and liberalizing corresponding investment policies and procedures.

Now, Japan is the 4th largest foreign investor in India with foreign direct investment (**FDI**) equity inflows amounting to US$ 12,313.08 million, a figure that forms 7.23 % of the India's total FDI inflows during April 2000 to March 2012. The Japanese Bank for International Cooperation lists India as a favored destination for long-term Japanese investment. 70% of Japanese manufacturers cite India as the most attractive business destination. Since 1991, Japan has actively invested in Indian industries like automobile (31%), electrical equipment (14%), telecommunications (9%), trading (8%) and services (7%) with total trade aggregating to USD 10.4 billion. The impressive statistics is that this accounts to only about 2% of total Japanese world trade. Clearly, the scope for Indo-Japan ties is immense.

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India Calling

India has recognized the need for propagating foreign investment by liberalizing its economy and making itself an attractive business destination for the world. Since 1991, when India eased up its policies for FDI and Industrial Licensing, it has never looked back. The new FDI Policy effectively weeded out many a rigid government approval for inviting foreign investment into Indian industry across sectors.

The new-look India finds an ideal trading partner in Japan, the world's fourth largest exporter possessing the third largest GDP. Japan has achieved phenomenal industrial success in the second half of the twentieth century through its core competence in manufacturing, construction, distribution, services, and communication.

India possesses a plethora of highly skilled, educated and cost-effective workforce tailored to Japanese needs. The benefits can already be gauged in the automobile industry where cross border investments have enabled Japanese majors like Toyota, Honda and Mitsubishi to tap the Indian market and employ its colossal R&D expertise.
Japanese industries like Automobiles and Information Technology seek high end research and development (**R&D**) support. India's R&D potential is epitomized by its technology services sector. India's wealth of skilled and competent professionals is the outcome of its prestigious technical institutions. The Indian government has actively promoted this sector by enabling foreign investments without prior approval, a gesture that has already housed Japanese blue chips establishments like Hitachi, Panasonic and Sony in the Indian markets.

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A closer look

Investment Policy:

India's FDI Policy envisages investment into Indian companies through two routes namely, the automatic route calling for no prior governmental approval whatsoever and the approval route requiring prior permission of the Foreign Investment Promotion Board which is accorded on a case to case basis.
The Indian government has placed a majority of volume-driven key sectors like Manufacturing and Non-banking financial services under the automatic route, while reserving the approval route for sensitive and strategically important sectors like defense, telecommunications, and micro & small scale industrial manufacture.
Further, the Industrial Policy has abolished the erstwhile compulsory licensing requirements prescribed for a majority of Indian manufacturing industries and now exempts most industries from procuring an industrial license; 'Drugs and Pharmaceuticals' being the latest beneficiary in the exempt list. As on date, only five industries require compulsory license.

Notably, the service industry which includes financial services has been placed exclusively under the automatic route. The FDI Policy delineates 18 specific financial activities as activities permitted to be undertaken by a non-financial banking company (**NBFC**). Investment into a NBFC is permissible up to its entire share capital and can be made without prior regulatory approval.
However, such investment is required to comply with certain capitalization norms depending upon the level of investment sought. Alternatively, investment into the banking sector is capped at 74% in the private banking sector and 20% in the public banking sector.
However, a foreign bank is permitted to incorporate a wholly owned subsidiary for undertaking business in India. Further, investment in the Insurance sector is also permitted at 26%.

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Exchange Control:

As a concerted step towards achieving full capital account convertibility, India revamped its exchange control laws through the enactment of the Foreign Exchange Management Act in 1999 (**FEMA**). FEMA identifies the Reserve Bank of India (**RBI**) as the nodal agency for regulating exchange control transaction in India. Further, it provides for additional entry routes to foreign entities like establishment of branch/liaison/representative/project office. However, such routes are only available in case the entrant seeks to limit its activities solely to solicitation without undertaking any business operation.

Under FEMA, general permission is accorded for most exchange control transactions such as remittance of proceeds accrued from sale of securities held in an Indian entity, proceeds of liquidation/winding-up of Indian entity, dividends accrued on equity shares, interest payable on fully, mandatorily and compulsorily convertible preference shares / compulsorily convertible debentures (**CCPS/CCD**), etc. In addition, no prior RBI approval is required where transfer of shares or CCPS/CCD between a resident and non-resident entity is undertaken in accordance with the pricing guidelines mandated by it. Further, transfer of Indian security between two non-resident entities can be at a price mutually agreed to by the parties without prior RBI approval.

Last but not the least, FEMA governs payments in relation to current account transactions. Accordingly, royalty payments under foreign collaboration agreements or remittance for purchase or licensing of trademarks are also permitted without prior approval. This carries immense significance for foreign technical collaborations, as now any aligned consultancy or trade mark licensing agreement would not require government approval at the time of remitting consultancy or licensing fees.

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The latest cheer

India's commitment towards facilitating investment is witnessed in the recent amendments to the FDI Policy and the contemplation of a single window clearance for all foreign investments. The Consolidated FDI Policy of March 31, 2011 has announced the removal of prior approval requirements for investments into industry/activity made by existing investors with investments made from January 12, 2005. This is a key de-regulation in the spirit of the free market economy envisaged during the liberalization initiative of the early nineties.

Further, in relation to portfolio and venture capital investments, the Ministry of Finance has released a working group report proposing a single window clearance mechanism. The working group report is contemplating the abolishment of 'Foreign Institutional Investor, Foreign Venture Capital Investor and Non Resident Indian investment vehicles in favor of constituting a 'qualified foreign investor' (**QFI**) concept, to be the sole vehicle for investment across all permissible sectors in India. Keeping in line with international standards, investment below 10% would be construed as portfolio investment; whereas investment in excess of 10% would be foreign direct investment.

The impending introduction of the Direct Tax Code (**Code**) spells great news for foreign investors. The Code seeks to encourage investment by proposing among other things, a reduced corporate income tax rates, simplified permanent establishment criteria, and an imperative for adducing tax liability on a foreign assessee. This development could lead to alleviation of some major unresolved issues encountered whilst structuring a tax effective entry strategy.

On the investment front, recent entrants such as Nippon Life Insurance and NTT Docomo in the Insurance and Telecommunications sectors, respectively, reflect India's humungous potential to complement Japan's core competence in manufacturing and technological services. In the insurance sector, it has been proposed to increase the investment cap to 49% to achieve a projected industry target of 65 billion USD. In Pharma, the Japanese have made great inroads by virtue of the Daiichi Sankyo stake in India's largest drug manufacturer Ranbaxy.

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In a latest policy initiative, the government is likely to entertain prospects of opening hitherto prohibited sectors such as multi-brand retail trading to foreign investment, a lucrative proposition for Japanese majors such as Aeon and Yamada Denki. Likewise, the proposed enhancement of the FDI limit to 74% in sectors like defense will allow foreign firms a controlling stake and the confidence to transfer sensitive technology to joint ventures in India. On the legislative front, the government has promulgated the Foreign Educational Institution (Regulation of Entry and Operation) Bill, 2010. Although, awaiting legislation, the educational bill seeks to set forth a judicial mechanism to attract foreign investment into a sector which might touch 400 billion dollars of investment over the decade.

The recent Ernst & Young Attractiveness Survey released in January 2012, interviewed 506 management heads across industries about the potential of the Indian market. The report noted that majority have expressed intention to expand their operations within India during 2012 and cited ***"potential of the home market, cost competitiveness and qualified workforce as the factors driving FDI into India."*** *It also stated* ***"Investors perceive that India presents value and promising growth dynamics in this increasingly unstable global economy."***

India is among the few countries to have shown a remarkable recovery following the global economic crisis. This resilience and sustainability obviously emanates from its robust domestic market –a fact that spells great news for markets worldwide, particularly so for Japan. A symbiotic relationship between Japan and India, if nurtured with prudence and precision, will create phenomenal mutual gains. The time is ripe for the Japanese corporate cream to explore the potent possibilities on the Indian shores and reap rich rewards.

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