Opportunities and Issues on Business in India for Japanese and Korean Companies

Tetsuji UEMURA, HaJin BAE, Naoki IKEZAWA,
Makoto OKUDA, Koji ADACHI

Nomura Research Institute
Opportunities and Issues on Business in India for Japanese and Korean Companies

Tetsuji UEMURA, HaJin BAE, Naoki IKEZAWA, Makoto OKUDA, Koji ADACHI

Since the release of the BRICs Report in 2003, increases in foreign direct investment (FDI) into India by European, US and Korean companies, who had steadily prepared for entry into the Indian market, have led to a rise in real estate prices and wages by 2006. In some regions where a number of foreign companies have enthusiastically established their offices, the purchasing power of the middle class has grown to be quite strong.

Until 2005, Japanese and Korean companies have conducted business activities from the long-term perspective with the aim of tapping India’s domestic market. In 2006, some pioneering Japanese and Korean companies such as LG, Samsung and Suzuki have shifted their focus to new business development such as exports to retain their advantage in the Indian market. Latecomers have tried to establish sales bases to enter and spread their business in sales in the Indian market.

Among the issues that Japanese and Korean companies face in the process of developing business in India, the lack of infrastructure and connection to labor unions, which have been pointed out for a long time, are being recognized as matters that can be addressed. The largest remaining issues are related to employee management such as a high job change rate, high rate of wage increases and developing employees’ loyalty to the company.

With the remarkable growth of the Indian middle class, the focus of players in the Indian markets should shift to brand strategies and segment strategies in India from long term positioning strategies in the world. For the leading companies, it will be significant to establish middle term branding for securing their advantage in the market. Conversely, latecomer companies should consider differentiating strategies such as segment specialization and dominant strategies for securing or tapping their position in the market.
I Changes of Doing Business in India

Recently, in Japan, interests on doing business in India are gradually rising as well as those in other BRIC countries like Russia and Brazil. Many books about India have been published, and magazines frequently feature India. Most of these publications have focused on the perspectives given below.

(1) Noting that the agricultural population, which accounts for about 70 percent of all population, has remained poor.

(2) Highlighting the Western lifestyle of younger people working for IT (information technology) companies as the new middle class.

(3) Discussing the growth potential of India based on macroscopic economic indicators.

(4) Comparing India with other BRICs countries.

Before this paper was written, Nomura Research Institute (NRI) had analyzed the Indian economy, industry and market in Chiteki shisan sozo (Knowledge Integration and Creation) and 2010 nen no Asia – Jisedai no seisokushu (Asia in 2010: The Next-Generation Growth Scenario, Toyo Keizai Inc., 2006). We had concluded in these publications that while India was very appealing to Japanese companies, any strategies about India should be considered after working on post-China policies in ASEAN (Association of South East Asian Nations) countries such as Vietnam. In case some Japanese companies would like to enter the Indian market, we also suggested that they should do so as early as possible in order to accumulate experience there.

On the other hand, looking at the political world, as the phrase “sei-netsu-kei-rei (heated political moves vs. cool economic activities)” represents, the political world has shown more interest in India in recent years than have economic circles. Starting in early 2007, many Japanese government ministers visited India to strengthen cooperative ties between Japan and India. They included Yoshihide Suga, Minister for Internal Affairs and Communications (January); Katsuhito Asano, Vice Minister for Foreign Affairs (March); Akira Amari, Minister for Economy, Trade and Industry (April); Toshikatsu Matsuoka, Minister for Agriculture, Forestry and Fisheries (April); Taro Aso, Minister for Foreign Affairs (April) and Tetsuzo Fuyushiba, Minister for Land, Infrastructure and Transport (May).

In view of these moves, in May 2007, NRI conducted interviews with Japanese and Korean companies operating in India to find out the economic, industrial and market trends in India.

India is geographically located far from Japan, and it brings about a huge gulf between what the headquarters of Japanese companies think and what really happens in India. In fact, according to interviews with 18 overseas affiliated companies in India (mostly Japanese), we can see an obvious change in business conditions in India.

For instance, in our interviews until around 2005, most employees of Japanese-affiliated companies in India stressed the negative aspects of Indian business such as “although India is a very attractive market from the future perspective, there are many difficulties in doing business in the current environment.” In contrast, in our interviews in 2007, the emphasis of their comments had changed 180 degrees and most of them expressed positive answers, such as “while it is very difficult to conduct business in India, the Indian market is very promising from the future perspective.”

Reflecting these changes in the Indian market, this paper focuses on changes in doing business in India by Japanese and Korean companies during the year 2006. We analyzed not only Japanese companies, but also Korean companies with the cooperation of the Tokyo office and the Seoul branch of NRI. This is because Korean companies, especially those in the electronics industry, that have entered the Indian market ahead of Japanese companies are also reaching a new stage in response to the middle class that has come to display very strong purchasing power.

In the subsequent chapters of this report, we observe the hypothetical structural changes in 2006, and analyze the appeal of and the issues facing Indian business from the perspectives of Japanese and Korean companies. We also discuss business opportunities and recommended approaches for doing business in India in the coming few years.

II Structural Changes in 2006

The notable changes of business in India during 2006 are listed below.

(1) Rapid and greater increase in foreign direct investment (FDI)

(2) Rapid increase in the number of Japanese affiliated companies in India

(3) Skyrocketing real estate prices

(4) Sharp rise in labor costs

These phenomena will be discussed in the following sections.

1 Changes in Direct Investment (FDI) in India

First, Figure 1 illustrates the changes in foreign direct investment (FDI) in India.

Since the economic liberalization in 1991, from the long-term perspective, FDI has been constantly increasing. As is clear in Figure 1, there were several ups and
downs before 2006. However, the quarterly level of FDI up until fiscal 2005 never exceeded $1.5 billion. In contrast, the growth during fiscal 2006 was spectacular.

Second, Figure 2 shows the growth in FDI by industry. The service sector (finance and non-finance) registered the most significant growth during the period from fiscal 2005 to fiscal 2006. Investments in the service sectors include not only investments for the financial sectors but also investments to expand business process outsourcing (BPO). The service sector is followed by the electrical machinery and software sectors. Investments in these sectors include not only those in hardware such as factories but also those to develop human resources for software development.

Thus, these data suggest that the rapid increase in FDI, especially in the service sector, has served as the driving force behind the growth of the Indian economy in 2006.

2 Trends of Japanese Companies Entering into the Indian Market

Since 1998, the number of Japanese-affiliated local companies has been continually increasing (Figure 3).

After 2003, when Goldman Sachs, a major US investment bank, released the paper “Dreaming with BRICs: The Path to 2050” (a report on the future potential of Brazil, Russia, India and China; commonly called the BRICs report), there was a remarkable increase in the number of Japanese affiliated companies in 2006. During this year, the number of Japanese companies entering the Indian market increased from 155 to 166, up 7 percent over the preceding year, and the number of companies affiliated with Japanese increased from 198 to 216, up 9 percent over the preceding year. On the other hand, the peak of investment by Korean companies, which did business in India between two waves from Japan, was recorded for three years, from 1996 to 1998 (Figure 4). These investments were conducted by three major global Korean companies, namely, Samsung Electronics, LG Electronics and Hyundai Motor Company because they began their operations in India during these three years. As for the Korean companies, no significant investments were conducted. However, after publication of the BRICs Report, the trend of both the number and amount of investments has gradually increased and, in 2006, the number of investment reached the maximum since they entered the Indian market.
market. The investment of 1996-1998 is regarded as for launching new businesses and that of 2005-2006 is considered to be additional investments for maintaining an advantage over competitors in the Indian market.

3 Skyrocketing Real Estate Prices

Real estate prices seem to be reflected in the trends of foreign direct investments. Increasing demand for offices sharply pushed up land prices in major cities. Figure 5 indicates the quarterly data of traded land prices in Connaught Place, New Delhi. As is clear from this figure, land prices more than doubled in the single year of 2006. It is considered that the background factor behind such a sharp rise is the limited supply of new properties. This is because, sometimes, the government of India temporally stops developing new industrial parks like special economic zones (SEZs) due to protests by residents. Unanimous agreement by landlords is necessary to develop new properties or renew contracts to rent a room or an office. Furthermore, some Indian capitalists have been speculating on real estate, spurring a rise in land prices.

From this perspective, it is reasonable to assume that a sort of a real estate bubble has been occurring in the major cities of India. Nevertheless, as long as FDI continues and the restrictions in the supply of real estate remain, we forecast that, even if the current phenomenon can be regarded as a bubble, it will not burst easily.

4 Sharp Rise in Labor Costs

A sharp rise can also be seen in wages. At present, no official statistical data on wages have been released because there is a lag in the official statistics, which are generally published after a few years. However, according to interview surveys conducted by NRI in May 2007, it appears that the rate of changing marketing and sales jobs has increased from 20 percent to 40 percent in 2006 due to personnel recruiting by companies newly entering the Indian market. To discourage resignations, companies have generally increased wages. The average rate of wage increase is thought to exceed 15 percent.

5 Shift to Manufacturing

The above-mentioned moves are especially pronounced in the manufacturing industry. Figure 6 shows the quarterly data on the growth rate of India’s GDP (gross domestic product). While India’s real GDP growth rate
has stood at a level of 6 ~ 12 percent since 2003, the growth rate of the construction industry, a leading indicator, has never been below 8 percent since 2003. In addition, after 2006, the growth rate of the manufacturing industry sharply increased from a level of 8 ~ 10 percent to a level exceeding 12 percent. As such, economic indicators in production activities suggest that manufacturing, in particular, gained momentum in 2006.

As described above, since the release of the BRICs report in 2003, foreign companies have started to enter the Indian market and have gradually expanded their operations in India. We assume that in 2006, the inflow of the vast amount of FDI served as a trigger to accelerate these activities all at once and, by following the path of increased real estate prices and increased wages, a bubble-like growth has occurred. We also assume that these moves are occurring especially in the fields related to the manufacturing industry.

As mentioned above, we can consider that India has passed a major turning point, i.e., a shift from an agriculture-based economy.

III Positioning of Business in India by Japanese and Korean Companies

We now turn our eyes to what Japanese and Korean companies anticipate in entering the Indian market.

Figure 7 indicates what Korean companies expected in entering the Indian market based on a survey by the Korea Institute for International Economic Policy (KIEP). The largest number of respondents selected “to meet domestic demand.” Because multiple answers were allowed for the top five items, “low wages and workforce” relative to production was included, and “requests by trading partners” was also selected because not only assembly manufacturers but also related companies have entered the Indian market. Nevertheless, it is fair to assume that the major purpose overall is “to meet domestic demand.”

As described in Chapter II, entry into the Indian market by Korean companies reached a peak around 1998, which corresponds to the period when Japanese companies temporarily withdrew from India as a reaction to the nuclear test conducted by India.

At that time, Korean companies had been growing in the same business fields as those of Japanese companies. Because Japanese companies were successful in the markets of advanced countries, Korean companies entered the Indian market as part of their efforts to tap new markets. The concentrated investments at that time eventually represented a factor of the current success of Korean companies in the Indian market.

On the other hand, because most Japanese electrical machinery manufacturers had already established production bases in ASEAN countries, it was not worthwhile for them to take the trouble to establish additional production bases in India. Accordingly, the basic strategies adopted by Japanese companies chiefly in the electrical machinery industry were to gradually expand their sales in India by importing products from Japan by keeping pace with the decline in customs duties and the growth of the domestic market.

Nevertheless, the situation differs from company to company. In the case of the automotive industry, as shown in Figure 8, exports are also increasing due to the recent expansion of production. Among such automotive manufacturers, Maruti Suzuki India and Hyundai Motor Company are noted for their focus on opportunities and issues on business in India for Japanese and Korean Companies.
exports. In addition, some component manufacturers also have their export achievements. Furthermore, moves are also seen among some foreign automotive component manufacturers to make India a development base. As such, companies are positioning their business in India as a base for purposes beyond simple manufacturing and sales.

Generally, most Japanese and Korean companies have pursued meeting India’s domestic demand. However, because India is geopolitically located in the center of Asia, the Middle East, Africa and Europe, there is ample possibility that India can serve as a base for export purposes.

In addition, as is well known from the past, India has also been developing as a BPO (business process outsourcing) base for the US and Europe. Actually, some Japanese companies have been providing e-mail support service to the US in India and/or have assigned the role of serving as call centers for Asia including the Middle East, while their major purposes in entering the Indian market are to meet domestic demand.

While most companies have principally been attracted by the vast size of India’s domestic demand, they are actually acting in a variety of ways as part of their current global strategies, such as entering the markets of neighboring countries.

In this chapter, in order to discuss the current issues for Japanese and Korean companies in doing business in India, we outline how Japanese and Korean companies are addressing such issues according to the flow of business. Table 1 shows a summary of the results of our interview survey conducted in May 2007.

### IV Issues for Japanese and Korean Companies in Doing Business in India

#### 1 Procurement-Related Issues

The issues of procurement depend on industry characteristics. Manufacturers like the automobile industry, of which logistics costs are unavoidably huge, must choose to manufacture locally. On the other hand, manufacturers in, for example, the electronics industry can choose whether they import final products or manufacture them.

Table 1. Overview of Business Conducted by Japanese and Korean Companies in India

<table>
<thead>
<tr>
<th>Product development</th>
<th>Procurement</th>
<th>Manufacture</th>
<th>Physical distribution</th>
<th>Marketing</th>
<th>Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Products are developed in Japan by incorporating the opinions of Indian people.</td>
<td>• No problems are encountered in procuring basic components because most industries ranging from light to heavy industries exist in India.</td>
<td>• White most products are manufactured to meet domestic demand, some products are manufactured for export.</td>
<td>• Basically, this is not a major problem. Although the infrastructure has been developed to some extent, the reason why the number of days required for transportation has not been shortened is that the infrastructure within urban areas remains poor.</td>
<td>• Korean companies are spending a lot of money for a vast amount of advertising. Such efforts contribute to increased brand recognition, which distinguishes them from other companies.</td>
<td>• Major problems include income gaps and geographical gaps.</td>
</tr>
<tr>
<td>• Some European and US companies have established bases for development.</td>
<td>• However, India is still weak in terms of safety devices such as air bags and ABS, devices requiring highly sophisticated processing and electronic components.</td>
<td>• Because ASEAN countries such as Thailand have high production capabilities, there is no reason for Japanese companies to establish production bases in India.</td>
<td>• In any case, there is a need for having a larger intermediate stock than in other countries.</td>
<td>• Because Japanese companies have limited market data sources available to them, they are unable to conduct sufficient market research locally.</td>
<td>• It appears that it will take three to five more years for the middle class to grow to a sufficient size.</td>
</tr>
</tbody>
</table>

| Personnel management | | | | | |
| • While India has a large population, the number of eligible workers is limited. Although individual people are competent, only a few intend to work hard for the sake of their companies. | • The entry of foreign companies in the Indian market and the prosperity of IT companies increased the current turnover rate to 20 ~ 30%. The rate of wage increase also increased to 13 ~ 14%. In addition, to discourage job-hopping, companies are providing other incentives such as supplying cars and mobile phones. | • While the caste system presents no special problems, academic careers constitute a major problem. | • Establishing a company in a suburb can reduce the turnover rate to some extent. | | |

| Others | | | | | |
| • Spaces in industrial parks are mostly sold out. | • Japanese companies are too slow to make decisions on purchasing land. European, US and Korean companies make decisions promptly on such purchases. | • If the rate of investment in a local company is minor, the consistent management of all affiliated companies will be hindered. | | |
| • Japanese companies are spending a lot of money for a vast amount of advertising. Such efforts contribute to increased brand recognition, which distinguishes them from other companies. | • Because the utility infrastructure (water supply and sewerage) is poor, the quality of life is less than ideal. | • Industries subject to regulations face similar problems in all countries. | • Because the utility infrastructure (water supply and sewerage) is poor, the quality of life is less than ideal. | | |

Notes: ABS = antilock brake system, ASEAN = Association of South East Asian Nations, IT = information technology.
Source: Compiled based on an interview survey conducted by Nomura Research Institute in May 2007.
locally according to Free Trade Agreement (FTA) negotiations between India and ASEAN or Thailand. In fact, as represented by the Early Harvest Program (EHP) of the FTA, various tariffs have gradually been reduced to a level at which importing high value-added products from ASEAN, etc. in the electronics industry is profitable even now. Nevertheless, complicated Indian taxation regulations and frequent tax rate revisions increase the amount of back-office operations for exports/imports and domestic transportation.

2 Issue of Insufficient Infrastructure

From the perspective of logistics, insufficient infrastructure, which is frequently pointed out in doing business in India, has been considered a problem for a long time. Nonetheless, recently, companies have been dealing with this problem by increasing their intermediate stock. While a company’s global efforts are being made to reduce distribution inventory as part of global supply chain management (SCM), some companies have loosened these conditions in light of the current situation in India.

However, when we look at the average transportation distance per day, while it is around 800 km (the one-day delivery zone is within 800 km) in Japan, it is around 600 km in India because logistics can only depend on trunk road networks. Accordingly, there are no significant differences between Japan and India in terms of domestic logistics. While almost all companies have experienced their products damaged by traffic accidents during physical distribution, such accidents usually occur only several times a year.

In consideration of the fact that some companies are procuring components that must be transported 2,500 km from Chennai to Delhi, the physical distribution infrastructure is not worthy of special mention as India’s vulnerability. Rather, in recent years, Japanese trading companies and logistics companies have started to provide physical distribution network services including warehousing in India. Accordingly, the lack of adequate physical distribution infrastructure can be regarded as a problem that can be dealt with.

Rather than such long-distance distribution infrastructure, traffic congestion and poorly paved roads in cities constitute the remaining bottleneck. Even if high-quality highways are developed between cities, we cannot expect a major change in the current situation until the roads within the cities are improved.

With respect to insufficient infrastructure in cities, Korean companies that have been operating on a full scale in India for about ten years face a similar situation. Figure 9 outlines major obstacles pointed out by Korean companies in conducting business in India. In the same way as with Japanese companies, many Korean companies, chiefly manufacturers, cite the issue of infrastructure as a problem. They are mostly plagued with the issue of an inadequate supply of electrical power, rather than physical distribution. Similarly, many Japanese companies also cite the shortage of electrical power and an unstable power supply as a problem in their manufacturing operations (Figure 10). Such a shortage of electrical power supply is a major contributor to poor infrastructure, largely affecting the quality of life of employees stationed in India. When employees are stationed in India with their families, the lack of a stable power supply and poor water and sewerage service constitute major problems.

While some say that improvements have been made in large cities such as Delhi, a private power generation system remains indispensable in constructing factories, large-scale buildings and houses.

As described above, the issue of the lack of adequate infrastructure that is frequently talked about in India mostly refers to an unstable power supply and poor water and sewerage service, rather than referring to deficiencies in terms of high-quality highways, airports and ports that are related to domestic physical distribution.

The Indian government is well aware of these problems, and is making efforts to develop adequate infrastructure by effectively utilizing the public-private partnership (PPP) scheme. Despite these efforts, progress is very slow. Nevertheless, employees stationed in India and who know what India was like ten years ago say that the situation is steadily and surely improving.

Figure 9. Major Obstacles Faced by Korean Companies in Conducting Business in India

![Figure 9](image_url)

Note: Top five items; multiple answers
3 Issues in Manufacturing Activities

Figure 10 indicates the problems perceived by Japanese companies operating in India in their manufacturing there. Overall, many responding companies pointed out recent increases in prices of commodities and that local companies are unable to meet the required level. In particular, the number of responding companies that selected “increase in procurement cost” as a problem increased remarkably in the 2006 survey. “Difficulties in quality control” also suggests difficulties in personnel management. The number of responding companies that selected “difficulties in locally procuring raw materials and components” was somewhat reduced. This implies that Indian companies have continuously been making efforts by keeping pace with the entry of Japanese and Korean companies into the market and that the production quality of local companies has been improving, albeit gradually.

4 Issues in Marketing and Sales Activities

Figure 11 indicates the matters that Japanese companies consider as problems in their marketing and sales activities in India, Vietnam and Thailand.

The reason why “request for price reduction by major trading partners” ranks first is that responding companies include those operating the business-to-consumer (B2C) type of business and the business-to-business (B2B) type of business. This answer strongly reflects the opinions of the B2B companies.

Figure 10. Problems Perceived by Japanese Companies in Manufacturing Activities in India

Figure 11. Problems in Sales and Marketing Activities (Fiscal 2006)
In comparison with Thailand, which is the core country of ASEAN, and Vietnam, which has recently been rising rapidly as “China plus one,” the survey results suggest that companies are having relatively few difficulties in expanding the Indian market although competition is intense. In addition, the problem of “sluggishness of the major sales markets” as perceived in Thailand and Vietnam is not cited for India.

To conclude the description above, spurred on by intense competition, the Indian market has been continually expanding. Accordingly, it is fair to assume that companies now operating in India have been enjoying the benefits of market expansion. Actually, in our interview survey conducted in May, an interviewee said that “there are no employees stationed in India who deny the severity of the competition, but there are also no employees stationed in India who sustained a loss in the past two to three years.”

Nevertheless, when we look at individual fields, Japanese companies have been having a tough time competing against Korean companies in the electric home appliance field. This is considered partly attributable to the lower amount of advertising by Japanese companies than by Korean companies.

For example, LG Electronics and Samsung Electronics appear to be spending about ¥3 billion annually in advertising. In contrast, the amount of advertising expenses spent by even such a large company as Sony among Japanese companies is limited to about ¥500 million. The background factor behind such a discrepancy is said to be differences in the approaches of the national tax authorities of Japan and Korea with respect to the payment of the advertising expenses by the head office for its local subsidiary.

As a result, the marketing activities of Korean companies are relatively successful, while those of Japanese latecomer companies are experiencing difficulties.

Other problems assumed in the sales aspect include the “difficulties in the collection of payments.” As indicated in Figure 9, this issue was cited as a hindrance in doing business in India although the rate of respondents who selected this issue was limited to 7.7 percent. However, because almost all companies changed their method of settlement to cash transactions, this issue has not become a major problem.

5 Issues in Personnel Management

In concluding this chapter, we would like to examine the issues related to personnel management.

Figure 12 compares the problems perceived by Japanese companies in employment and labor in 2005 and in 2006. As of 2006, the labor issues and labor laws in India that are often covered by the mass media and much talked about by people in general were no longer regarded as problems. The reasons for their not being regarded as problems are discussed below.

While it is possible for a factory having a certain number of employees or more to establish a labor union, such a labor union will not be established unless requested by the employees. In many cases, most Japanese companies that have recently entered the Indian market have established sales offices rather than factories. Accordingly, to begin with, there is no prospect of forming a labor union. Furthermore, when Japanese companies already operating in India intend to construct a second and/or third factory, they hire employees in full consideration of the measures applicable to labor unions based on the lessons learned at the first factory.

For example, in the case of one Japanese company, when it established its first factory, it recruited employees from nearby areas thereby facilitating the creation of a situation where forming a labor union was easy. Based on this experience, when it established its second factory, the company recruited employees from all over the country. In addition, the company made special efforts to establish close daily communication between management and employees. These efforts contributed to avoiding the formation of a labor union.
With respect to employment and labor issues, as of 2006, companies consider “difficulties in recruiting personnel” and “increases in employee wages” as major problems, rather than the issue of labor unions. These two items were followed by “poor retention rate of employees.” A problem newly perceived from 2006 is the “cost of Japanese directors (employees) dispatched to and stationed in India.”

These survey results suggest that Japanese companies operating in India have shifted from their start-up phase to the phase of full-scale activities and started to pursue the improvement of management efficiency so that local companies can maintain their competitiveness in India where cost competition is intense.

However, as we repeatedly note, excessive movement of employees in charge of marketing and sales is assumed to have an adverse effect on the planning and implementation of long-term marketing and sales strategies. If Japanese companies take no measures, any efforts to strengthen their sales abilities that are weak now will be hindered. In the future, Japanese companies must consider mechanisms that can guarantee continuity even if personnel are changed as part of their marketing and sales strategies in India.

In our interview survey conducted in May 2007, interviewed companies pointed out the “need to develop ideas for communication” in addition to the problems of job-hopping and increased wages.

For example, it is said that Indian people have a strong tendency to respond superficially to instructions made by persons who have a higher academic rank, are older or are higher in position. “Discordance between one’s words and actions” is frequently talked about as a characteristic of Indian people. However, this does not mean they are lazy but is because their values with reference to labor tend to avoid confrontation with superiors. Accordingly, solutions to this communication problem adopted by interviewed companies include discussing the matter until Indian employees are convinced of the need to act in a certain way and/or asking Indian employees to submit their own proposals.

What we discussed above is the business situation in India during the year 2006. Thus far, the issues facing business in India are reported in many books, reports and papers. However, most of these issues refer to the situation as of 2005. Since 2006, when middle class purchasing power reached full strength, the problems perceived by companies have largely changed.

Companies will always face problems as long as they operate businesses. However, changes in such problems can serve as indicators of the current development stage of the relevant country. From the perspective of problems in operating business as well, the year 2006 was the turning point for business in India to move on to the next stage.

V Outlook on Business in India

While sharp increases in wages, as explained in the last chapter, had an adverse effect on corporate activities through higher costs in terms of production and marketing/sales, such increases also have had a positive effect of rapidly growing the purchasing power of the middle class. Accordingly, in this chapter, consideration is given to the market trends in India for the coming two to three years in view of these factors.

Figure 13 outlines the correlation of some events that are assumed to have occurred in 2006. We consider that basically, in addition to increased FDI and increased demand that resulted from the entry of a greater number of foreign companies, such as Japanese, Korean, European and US companies, “supply restrictions” unique to India have contributed to the rapid economic expansion observed in 2006.

Specifically, one of the supply restrictions in India means that India is the world’s largest democratic nation, and the other is an insufficient number of skilled workers.

One example of democracy contributing to supply restrictions is that when land ownerships are divided into parcels, development projects cannot be started until the consent of all the owners can be obtained. To rent an office building in Delhi, for example, contracts must be signed with more than ten property owners. As is well known with the case of the construction of a steel plant in Orissa by POSCO, the largest steel manufacturer in Korea, the state government cannot take any action unless the consent of the residents is secured even if the central government agrees to the construction.
Because 60 to 70 percent of India’s population resides in agricultural areas, there is a strong tendency among politicians of the state government to give full consideration to the opinions of local residents so that they do not lose an election. Because of this, even a development project that is strongly needed from a socioeconomic perspective cannot progress as required. This is the point demonstrating that India largely differs from China and ASEAN countries that have achieved economic progress through autocratic development.

The other restriction is an insufficient number of skilled workers. This problem is not related to the caste system. As indicated in Table 1, almost no companies consider this system to be a problem. Because the government has adopted the policy of providing priority admissions to higher educational institutions to lower caste people, from a macroscopic viewpoint, the caste system would have only a limited influence on the supply of human resources. Rather, a mismatch in the supply of human resources constitutes a greater problem.

Table 2 indicates the number of students enrolled in institutions of higher learning in India. In terms of the number of students, India has about four times that of Japan. Annually, about 100,000 students graduate with a master’s degree in science, and about 550,000 students graduate with a bachelor’s degree. Around 2.25 million graduates who have a master’s degree and a bachelor’s degree in science or liberal arts enter society as new members of the workforce every year. However, when we look at the demand side, for example, we see that the net increase in the number of persons recruited by the IT industry was 300,000 in 2006. This means that one-seventh of all graduates was absorbed by the IT industry alone. Accordingly, human resources who have received a higher education are in short supply in business fields overall.

In addition, facilities and educational content provided by educational institutions other than those of higher learning generally fall short of the level required by Japanese companies. This requires a substantial cost for education after employment to develop such graduates into capable employees.

Recently, Toyota Motor announced the opening of the Toyota Technical Training Institute for middle-school graduates. This move is indicative of a specific solution to the stable supply of human resources in the future. It is also true that such a move was possible only because Toyota is large enough to open an institute. We assume that general small-scale local companies will not be able to follow suit and will be plagued with the matter of securing capable personnel for the time being.

From the short-term perspective, there is no expectation that these supply restrictions will be eliminated. Actually, in urban areas, these supply restrictions support a sort of asset bubble. In terms of wages as well, as long as the expectation of foreign companies in the Indian market remains, FDI will continue to be made and it is unlikely that such a bubble would collapse. Conversely, in rural areas, these supply restrictions will hamper development. As far as the coming two to three years are concerned, as shown in Figure 14, while rapid economic development can be expected in major cities, in particular, in areas where foreign companies establish their offices, rural areas would be left behind in such growth, increasingly expanding the gaps between urban and rural areas.

### Table 2. Enrolled and Estimated Graduates from Institutes of Higher Learning in India

<table>
<thead>
<tr>
<th>Institutes of Higher Education</th>
<th>Polytechnic Institutes</th>
<th>Technical, Industrial, Arts &amp; Crafts Schools</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Enrollment as of 2004</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>11,777,296</td>
<td>388,627</td>
</tr>
<tr>
<td>Ph.D. candidates</td>
<td>55,352</td>
<td>742,330</td>
</tr>
<tr>
<td>Master’s candidates</td>
<td>790,267</td>
<td></td>
</tr>
<tr>
<td>(Science departments)</td>
<td>(196,719)</td>
<td></td>
</tr>
<tr>
<td>Bachelor’s candidates</td>
<td>7,424,638</td>
<td></td>
</tr>
<tr>
<td>(Science departments)</td>
<td>(2,167,384)</td>
<td></td>
</tr>
<tr>
<td>Medical and pharmaceutical departments, etc.</td>
<td>3,557,039</td>
<td></td>
</tr>
</tbody>
</table>

Reference: Universities in Japan have a total enrollment of about 2.6 million students as of fiscal 2006.

<table>
<thead>
<tr>
<th>Estimated Number of Graduates per Year</th>
<th>Polytechnic Institutes</th>
<th>Technical, Industrial, Arts &amp; Crafts Schools</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>2,894,000</td>
<td>389,000</td>
</tr>
<tr>
<td>Ph.D. candidates</td>
<td>56,000</td>
<td></td>
</tr>
<tr>
<td>Master’s candidates</td>
<td>396,000</td>
<td></td>
</tr>
<tr>
<td>(Science departments)</td>
<td>(100,000)</td>
<td></td>
</tr>
<tr>
<td>Bachelor’s candidates</td>
<td>1,857,000</td>
<td></td>
</tr>
<tr>
<td>(Science departments)</td>
<td>(547,000)</td>
<td></td>
</tr>
<tr>
<td>Medical and pharmaceutical departments, etc.</td>
<td>585,000</td>
<td></td>
</tr>
</tbody>
</table>


Opportunities and Issues on Business in India for Japanese and Korean Companies
When we look at FDI by specific cities, the amount of money invested largely differs, as shown in Figure 15. Among major four cities in India, that is, Mumbai, Delhi, Chennai and Kolkata, the top three ranks are occupied by Mumbai, Delhi (New Delhi) and Chennai. Kolkata ranks 8th and the investment there is only about one-twentieth of that in Delhi. As such, it is highly likely that gaps between even existing major cities in economic growth will expand in the near future.

In view of these moves, while it is important for both Japanese and Korean companies to develop business in rural areas, latecomer Japanese companies in particular must formulate and implement sales and marketing strategies as quickly as possible in the environs of areas where more and more foreign companies are establishing their offices, such as Delhi, Mumbai and Chennai. Conversely, it would not be too late for a company to make a decision to establish an office in any of the major cities where foreign companies have not yet established offices, such as Kolkata, that is mentioned above, after identifying the policy of the state for inviting foreign companies to its market.

As represented by the phrase “United States of India,” the state governments have strong authority for the policy of permitting the entry of foreign companies into their states. As such, if we cross a state border by even one step, we are likely to see a completely different business environment. Accordingly, we are approaching the time when we must consider the production and sales/marketing strategies in units of each state and/or each major city, rather than simply applying a line of demarcation based on “north, south, east and west.”

### VI Stronger Approaches Are Needed for Doing Business in India

As we have explained so far, 2006 was the year that moved India’s business environment towards the next stage. The economic growth in India can be characterized as domestic-demand-led and democracy-driven economic development. In comparison with the export-led, autocratic economic development in China and Vietnam, the pace of economic growth is quite different. Nevertheless, the slow but steady economic development achieved by the world’s largest democratic nation allows foreign companies intending to conduct business in India sufficient time to set up strategies to develop business. Actually, most activities conducted by companies until 2005 were generally based on the long-term perspective. In contrast, in 2006 and thereafter, competition intensified for a rapidly expanding market, particularly around major cities.

As Figure 16 shows, more than 80 percent of Japanese companies still intend to expand their business operations in India. Because Korean companies that had moved ahead of Japanese companies in entering the Indian market have been actively investing to maintain their dominance such as the construction of their second plants, Japanese companies must speed up the promotion of their business activities. Otherwise, the gaps between Japanese and Korean companies in business operations in India may further widen.

For example, the issue for pioneering companies is to what extent they can maintain their dominance in the premium market and the middle-class market that are expected to grow in the coming three to five years. For these pioneering companies, branding strategies from the mid- and long-term perspectives will become increasingly important.

On the other hand, latecomer companies (in particular, Japanese companies that organized sales networks in and after 2006) must establish strategies to differentiate themselves from pioneering companies in the next one to two years. Specifically, they must establish strategies focusing on a certain segment, such as those focusing on a certain area (developing strategic dominance for that area).

For short-term strategies, the head office should assume the principal role. However, in actuality, personnel at the...
head office must also engage in business activities in other countries such as Russia, Central/Eastern Europe, China, etc., and those who are capable of handling such activities might be limited.

Although the Indian market has expanded rapidly, except for some companies such as Maruti Suzuki India and LG Electronics, the size of the Indian market targeted by most companies, even overall, is somewhat less than the entire size of the market in Korea. If this market size is compared to that in Japan, it is about the size of the Tokyo metropolitan area consisting of 40 million people. In particular, if a company limits its coverage, the market size becomes smaller, which will not require so many human resources and funds to formulate and implement strategies. Companies should allow a local company in India a high degree of flexibility in management matters, and should establish a structure that enables the local company to flexibly implement strategies that are suitable for the actual situation on site.

The purchasing power of the middle class that reached full strength in 2006 is driving Japanese and Korean companies to redesign their schedules of business activities in India and to formulate and implement more specific strategies. To be successful, Japanese and Korean companies are required to become more deeply involved in the Indian market.

**Notes**

(1) This was explained in a talk given by Kazumasa Kuboki of JETRO Bangalore at the India-Japan Chamber of Commerce & Industry in Chennai.

(2) Actually, according to a survey on real estate in India’s seven major cities conducted by India’s *Businessworld* jointly with DTZ, a global property adviser in the UK, while the trend of excess supply is seen to some extent, a decline in land prices is only seen in one district of Bangalore. This is considered partly attributable to the fact that the areas for development provided by the supply side do not correspond to the areas needed by the demand side. (Source: *Indo Watcher*, June 2007; original source: DTZ Research, *Businessworld*, May 14, 2007)

(3) According to a survey conducted by the *Financial Express*, an Indian economic magazine, among 500 companies with sales of 3 billion rupees or more, 91 percent of such companies experienced average increases in personnel expenses of 27 percent. In addition, the Business Standard reported that the rate of India’s wage increase in fiscal 2006 was 14.5 percent, with the rate in Indian local companies exceeding 14.9 percent and that of foreign companies being more than 14.3 percent.

(4) Nissei ASB Machine Co., Ltd. (PET bottles) and Igarashi Electric Works, Ltd. (small motors) are noted as 100 percent export-type Japanese companies (based on material released by JETRO).

(5) In the case of Korean companies, the Korean tax authority (National Tax Service) does not impose taxes on a company’s head office that pays advertising expenses for its overseas affiliated companies because the tax authority regards such expenses as general administrative costs. Instead, an overseas affiliated company pays taxes on the amount remitted in accordance with the tax law in the relevant country (National Tax General Consulting Center in Korea). On the other hand, if the head office of a Japanese company remits advertising expenses to its overseas affiliated company, the tax authority imposes a 50-percent tax by regarding such remittance as a contribution from the head office to the overseas affiliated company. However, if the company pays advertising expenses as part of its activities to strengthen the capital base of an overseas affiliate company, no taxes are imposed because such activities are regarded as capital transactions.

(6) From a different perspective, this characteristic of India can minimize the destruction of the environment caused by rapid economic development. India is actively engaged in developing renewable energy sources such as wind power. In addition, the fuel of buses and other public transportation systems in Delhi has been switched to compressed natural gas (CNG) as part of measures to reduce air pollution. In some aspects, India is a more advanced country than Japan in terms of environmental integrity.

(7) This information is based on a survey by the National Association of Software and Service Companies (NASSCOM).

(8) In *Toyota Motor*’s press release dated March 23, 2007, Toyota Kirloskar Motor Private Limited (TKM), Toyota’s affiliated company in India, announced that it would open the Toyota Technical Training Institute (TTTI) to offer the opportunity to acquire the special skills of *Monozukuri* (skilled manufacturing) in August 2007. The purpose of this technical training institute is to offer an opportunity to acquire the special skills of *Monozukuri* (skilled manufacturing) to those students who have the talent but cannot afford higher education. TTTI will provide a three-year residential course. Students will study engineering subjects and take one of four specialized courses in automobile painting, automobile welding, automobile assembly and mechatronics (a combination of mechanical and industrial electronics). The courses also involve practical training at the TKM plant. TTTI will charge students no fees for admission or tuition. In early April, it started accepting applications from middle-school graduates residing in Karnataka State. For a quota of 60 students in 2007, it received 4,000 applications. TKM will encourage potential graduates of TTTI to join the company, anticipating that they will play an important role as core employees in manufacturing operations at TKM.

This paper presents some of the results of the R&D project that is now ongoing in the Consulting Division. The R&D project members include:

**Naoki Ikezawa**, Consulting Division  
**Makoto Okuda**, Project Planning Office, Consulting Division  
**Koji Adachi**, Project Planning Office, Consulting Division  
**Masashi Takano**, Asia and China Business Consulting Department

Opportunities and Issues on Business in India for Japanese and Korean Companies
We appreciate the assistance and cooperation of Trans-wel and Neeru Dhall for our research activities in India.

Tetsuji UEMURA is chief researcher at NRI’s Social Industry Consulting Department (currently a Ph.D. student at Imperial College London). His specialties include environmental policy/forest accounting, social infrastructure management, water service/sewerage policy, Indian regional studies, etc.

HaJin BAE is a consultant at NRI’s Seoul Branch. His specialties include information communications, business strategies, research on overseas areas, etc.

Naoki IKEZAWA is chief researcher at NRI’s Consulting Division. His specialties include research and development management.

Makoto OKUDA is senior consultant at NRI’s Consulting Division and Representative Manager of the Nagoya Office. His specialties include management reforms based on the strengthening of marketing/sales ability and sales operations innovations, channel strategies and marketing strategies.

Koji ADACHI is senior consultant at NRI’s Consulting Division and Representative Manager of the Osaka Office. His specialties include international economy, corporate management, governance, privatization strategies, etc.
As a leading think tank and system integrator in Japan, Nomura Research Institute is opening new perspectives for the social paradigm by creating intellectual property for the benefit of all industries. NRI’s services cover both public and private sectors around the world through knowledge creation and integration in the three creative spheres: “Research and Consulting,” “Knowledge Solutions” and “Systems Solutions.”

The world economy is facing thorough structural changes led by the dramatic growth of IT industries and the rapid expansion of worldwide Internet usage—the challenges of which require new concepts and improvement of current systems. NRI devotes all its efforts to equipping its clients with business strategies for success by providing the best in knowledge resources and solutions.

*NRI Papers* present selected works of NRI’s 3,000 professionals through its worldwide research network. The mission of *NRI Papers* is to contribute new ideas and insights into business management and future policy planning, which are indispensable for overcoming obstacles to the structural changes in our society.

All copyrights to *NRI Papers* are reserved by NRI. No part of this publication may be reproduced in any form without the prior written consent of NRI.

Inquiries to: Corporate Communications Department
Nomura Research Institute, Ltd.
E-mail: nri-papers@nri.co.jp
FAX: +81-3-6660-8370