Barriers to Business in India

Japanese companies operating in India have indicated that there are many barriers to doing business in the Indian market. The following is the list of barriers that Japanese companies in India mentioned to our Ministry.

1. Infrastructure

   Infrastructure in such areas as electric power, roads and telecommunications networks has not been developed and this is the principal barrier to the enlargement of overseas investment in India.

   Japanese companies in India are required to pay additional costs to avoid breakdown of machinery due to blackouts and voltage changes. The bad condition of roads inflicts damage on commodities during transportation. Transportation between Delhi and the South takes one week due to the lack of express highways. Economic losses are incurred because of the long transportation time and high gasoline cost caused by traffic jams in urban areas.

   International telecommunication is monopolized by VSNL and the market principle does not work. Setting up private telephone lines between a subsidiary in India and its parent company in Japan is allowed, while this is restricted between subsidiaries. Also, setting up private computer-data lines between subsidiaries is allowed, but the line capacity is restricted to 64 kilobyte per second. At least 356 kilobyte is necessary.

   Improvements in airlines, railroads, sanitation, hotels and social security would also be likely to attract more foreign visitors.

2. Inefficient, Opaque and Arbitrary Procedure of Civil Service

   Procedures concerning investment, import and taxation, and execution of laws and regulations, etc. neither quick nor consistent.

   It is strongly hoped that investment procedures are simplified and related
consultation services made more. Neither FIIA (the Foreign Investment Implementation Authority) nor FIBP (the Foreign Investment Promotion Board) offers “one-stop-window” functions. Complicated procedures are required to obtain approval of investment at each related organization.

3. Inconsistent Industrial Policy and Rules
Laws, regulations and rules are often and suddenly changed.

Foreign companies develop their business in EPZ/ESZ/STP/EHTP due to preferential treatments offered there. Since tariffs which had been exempted suddenly began to be imposed in an EPZ, one Japanese company is considering withdrawal.

4. Labor Regulations and Protections
Under the Industrial Labor Law, in the case that any company employing more than 100 employees lays off staff, it must first acquire permission from the state government. As it is extremely difficult to obtain such permission from the state government, not only does this regulation directly affect flexible business plan changes, but it also makes business closure difficult. In a market in which business exit policies are inflexible, it is difficult to attract new investment.

Harassment by a professed leader of a labor union is rampant at a Japanese company near Mumbai, which reduces the company’s incentive to invest. There are also cases in which police or politicians intervene.

5. Regulations concerning the No-Objection Certificate (NOC)
If foreign businesses with capital participation or technical partnerships in India wish to establish a new joint venture with an Indian business or a new 100% owned subsidiary, an obligatory requirement is to obtain a No-Objection Certificate (NOC) from their existing partners. Even though deregulation that allows foreign companies to have 100% foreign capital participation in most fields has been implemented, the regulation of NOC has negative effects on the deregulation. In addition, in cases where the NOC is issued, there are various obstacles to business, including the demand for a large amount of money from the existing partner company.

6. Regulations on Foreign Investment
There are upper limits placed on the ratio of foreign capital allowed in such sectors as sales, private airlines, telecommunications, real estate, banking and insurance.

As Japanese trading companies have entered the Indian market early, there is a strong desire among them for this upper limit on foreign capital to be abolished, in particular in the sales industry. This is because for local subsidiaries wholesale activities are in principle banned, and retail sales are totally banned. The introduction of foreign investment into the sales industry is linked to development of the domestic distribution system, increase of employment and expansion of export destinations for Indian products.

7. Discriminatory Rate of Corporate Tax

The corporate tax for domestic corporations is 35%, while that for foreign corporations is 40%. This difference is quite large. According to the above-mentioned regulations on foreign investment, companies including banks, trading companies and airlines are not able to have a majority share. If these companies choose the form of a branch of a foreign corporation, that results in a high rate of corporate tax being imposed in them.

8. High Tariff Ratios

India’s tariffs consist of the following: □ basic tariffs + □ countervailing tariffs + □ special additional tariffs (SAD). We welcome the gradual reduction of the basic tariffs, however, the high tariff ratio remains in place.

In August 1998, India introduced the SAD. In December 1998, in consultations on WTO dispute settlement procedures, it was pointed out by the EU that if there were products whose real tariff rates were to exceed the concessionary tariff rates of WTO as a result of imposition of the SAD, then there was a possibility of the SAD being in violation of GATT Article II. In the first Dialogue, the Indian side stated that the SAD was a temporary measure and that it would not be permanent, but the SAD remains in existence.

The high tariff ratio on parts and components is hitting Japanese corporations in India by increasing the cost of completed products. As the tariff differential between completed goods and components is small, for example, with a tariff of 25% on electronics components and 30% on completed products, this is detracting from incentives for direct investment in India.
Rules of tariff change every year along with the government’s budget compilation. Also, since the system of laws concerning tariffs is quite complicated, the tariff rate is treated differently by each member of staff of the tariff authority.

9. Foreign Exchange Control
   1) Duty to submit proof of transaction
      Although new Foreign Exchange Management ACT and new Rules have been enforced, the duty to submit detailed proof of transactions still remains.

   2) Prohibition of foreign exchange futures contract
      Foreign exchange futures contracts are banned even by new Foreign Exchange Management Rules. You cannot set up a risk-hedge for remittance from parent companies abroad.

   3) Advance permission for remittance
      It takes for one to several months to obtain permission from the RBI for remittance from abroad. It took nine months in one case. Permission is required for every remittance. Also, you are required to submit evidence including contracts.

10. Regulations concerning Transfer of Royalties
    The transfer of royalties is not liberalized and requires permission from the ministries and agencies concerned in India, including the RBI. Although it was decided in September 2000 that the transfer of a certain amount of money by 100% foreign-owned subsidiaries are automatically permitted, it is still very difficult to collect payment for technology transfers unless the cap of the amount is abolished. It is vital for India to receive technology transfers from abroad, and the above-mentioned regulation that hinders such technology transfer.

11. R&D Cess
    Based on the R&D Cess Law, fees for technology transfers from overseas are subject to a tariff of 5%. In addition, areas of application are ambiguous and arbitrary. This regulation is proving a hindrance to the transfer of foreign technology, which is essential for India to improve its domestic technology level.
12. Software Taxation of 20 %
When a company in Japan pays for software that it ordered from a company in India, a withholding tax equal to 20% of the payment is imposed, based on the India-Japan Tax Treaty. The cost is higher when a company in Japan orders software from a company in India than when it orders from a company other than in India.

13. Octroi and different taxation policies among states
Octroi increases distribution costs and prevents just-in-time distribution of parts.

Local taxes on sales are high, and taxation rules differ by local governments. They are suppressing the profits of companies.

14. Transfer-Value Tax
Transfer-value tax was introduced in FY 2001. Although the rule of enforcement was declared on August 21, the tax was applied from April 1 and companies did not have enough time to prepare. Regulations are strict, such as the requirement for a report by an accountant.

15. Regulations on Banking
1) Regulation of equity capital
   Equity capital ratio of the branches of foreign banks in India is calculated on the basis of the amount of the capital brought into India. This restricts the amount of loans they can make. It should instead be calculated on the basis of the equity capital of the banks’ headquarters, according to the international standard of BIS.

2) Limitation on amount of loans
   The equity capital of the branches of foreign banks in India used to be allowed to include capital brought into India plus offshore loans in foreign currency from their headquarters to them. But offshore loans were removed in April, 2001. This restricts the amount of loans they can make.

3) Compulsory loans to priority sectors
   A certain amount of total loans must be made to some priority sectors such as agriculture, small-scale industries and housing.
4) CRR (Currency Reserve Ratio) and SLR (Statutory Liquidity Ratio)
The high CRR and SRR imposed on commercial banks push up their capital-procurement cost, which results in high loan interest rates. Japanese companies are prevented from developing in India by such high interest rates. Since most of the profits goes to pay the loan interest, only large companies can afford to invest.

5) Limitation on borrowings from overseas headquarters
The amount of loans headquarters make to their branches in India is limited to 10 million dollars or 15% of a branch’s equity capital.

6) Limitation on foreign capital
Foreign capital for banks is limited to 49%.

16. Discrimination in International Bids
Memoranda issued by related ministries of the federal government offer systems to enable local Indian companies to win in international bids.

17. Exemption from Tariffs in Yen-Loan Projects
Tariffs are exempted in yen-loan projects in some other countries, but not in projects in India. Since tariff rates are quite high in India, tariffs should be exempted.

18. Stock Price Control
The Foreign Exchange Management Rules require foreign companies to obtain permission from the RBI when they transfer Indian companies’ stocks and bonds.

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 20 (2) and (3) impose floor prices on dealing stocks under certain conditions decided by the regulations. When you transfer the right of business administration by transferring stocks, you are prevented from setting appropriate stock prices reflecting the value of the business being transferred. The control of stock prices makes transferring stocks difficult.

19. Protection of Intellectual Property
Trademarks are infringed. At the least, trademarks that are famous worldwide should be protected.
20. Smuggling

Smuggled goods that are cheaper than products made in India are rampant. We request that the Indian government crack down on them.