

The 40th Anniversary of Korea-India Amity: Evaluation and Prospects for Investment Cooperation

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1. Background

The Korea-India diplomatic relationship marked its 40th year in 2013. Regarding relations between the two countries, investment plays a particularly significant role, because trade barriers from India make investment an effective channel of cooperation compared to trade. Moreover, India has placed greater priority and emphasis on investment rather than trade, as the country is suffering from chronic trade deficits and a lack of investment sources.

Despite the importance of investment, however, in the late 2000s, other major investing countries boosted their investments significantly in India and consequently weakened Korea's standing. Since 2007, Singapore has become the second largest investor in India after Mauritius, a well-known tax haven. The fourth largest foreign investor in India is Japan, whose cumulative investment represents 7.4% of India's total investment from 2000 to 2013. Meanwhile, during the same period, Korea was ranked 13th, accounting for 0.6% of foreign investment in India.

This paper examines the achievements related to investment between Korea and India by analyzing associated trends, characteristics and determinants. Flaws and solutions are also identified, through a comparative analysis on the distinct features of FDI in India and on the investment patterns of major investors. The paper ultimately aims to propose policy challenges for the future and contribute to bringing the two countries closer together as investment partners.

2. Investment in India - Facts and Features

A. Korea's Investment in India

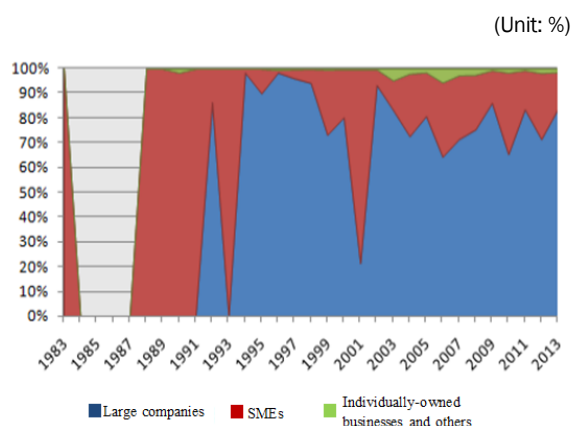
According to statistics on foreign investment released by the Export-Import Bank of Korea (Korea Eximbank), accumulated investment in India as of June 2013 stood at approximately USD 3 billion, making India Korea's 17th-largest investment destination. Investment started rising after the Bilateral Investment Promotion and Protection Agreement was signed in 1996, hitting the USD 100 million mark in 2006 for the first time ever, and peaking at USD 450 million in 2011.

There are 696 Korean companies operating in India, meaning India ranks 11th in number of companies on the list of Korea's foreign investment. But up to 206 large companies or conglomerates account for 81% of total investment, indicating a strong bias toward larger firms. In terms of actual investment volume, the percentage of large companies stands at 81% as of June 2013, compared to nearly 100% in the 1990s, but the investment scene is still dominated by big businesses as most SMEs have accompanied them into In-

dia rather than venturing out on their own. This, in turn, means that investment volumes and even business categories depend on the actions of large companies. For this very reason, investment jumped sharply until 1999 and key areas of investment were manufacturing sectors linked to the automobile or metals industries. Industries only became more diversified since the year 2000, as more SMEs started entering the Indian market and more non-manufacturing businesses got involved. Around 98% of Korean companies doing business in India have local subsidiaries, and about 60% are sole ventures. This is in contrast with Japan, which is pushing forward through M&As into more varied fields such as pharmaceuticals, life insurance, and so on.

As for type of industry, about 85% of the total investment volume is concentrated in the manufacturing sector – a typical pattern in Korea's foreign investment, which displays similar tendencies in investment to China (manufacturing accounts for about 78%). In the case of India, however, a more noticeable fact is that investment in the manufacturing industry is especially focused on two areas, with over 70% of investment accounted for by the automobile sector (45.4%) and the primary metals manufacturing sector (24.9%). Although Korea is a strong investor in electronic components, computers, video, audio and communications devices, with these areas taking up 26% of total foreign investment worldwide, they account for less than 3% of Korea's investment in India. And while investment in the non-manufacturing sector is starting to involve a wider range of industries, over 40% of non-manufacturing investment is still occupied by wholesale and retail businesses.

Figure 1. Investment by Company Size



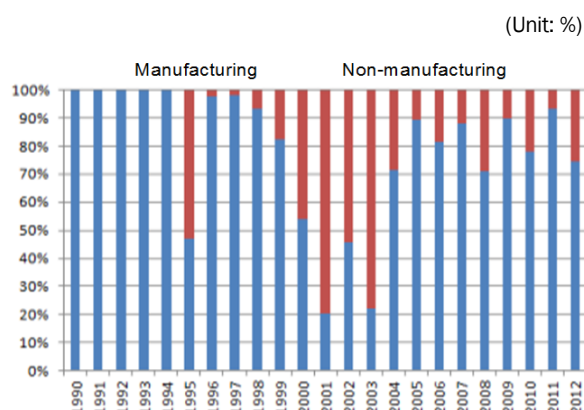
Source: Foreign Investment Statistics, Korea Eximbank.

Meanwhile, main reason that Korean companies – both manufacturing and non-manufacturing – invest in India is to gain entry into the local market. Compared to those in Korea's top investment destinations like China, the U.S. or Vietnam, local subsidiaries operating in India enjoy a much better environment in terms of business performance, financial situation, and investment effect. Ever since the Korea Eximbank began releasing statistics in 2009, the net profit of Korean companies in India has always been among the top four or five performers. Given that investment in India only amounts to 7% of that in China and 42% of that in Indonesia, this level of performance seems even more remarkable. The net-export effect from local subsidiaries has also grown, with trade balance improvements - calculated by the ratio of trade to investment volumes – surging from 176% in 2006 to 277% in 2010. ROI for India was four times the ROI for the global economy.

B. Comparing FDI with Top Investors in India

A comparative analysis was conducted on FDI inflow to India from Korea and other major investors, based on FDI statistics by country compiled in India. The top investors

Figure 2. Investment by Industry Type



Source: Foreign Investment Statistics, Korea Eximbank.

in India by accumulated amount from 2000 to 2013, in order, are: Mauritius (USD 75.7 billion), Singapore (USD 21.7 billion), the UK (USD 17.6 billion), Japan (USD 14.9 billion), and the U.S. (USD 11.6 billion). Korea ranks 13th on this list, having invested approximately USD 1.3 billion in India. This is in sharp contrast to the 1990s, when Korea ranked fifth.

After 2000, there was a major shift in the ranking of top FDI contributors in India. While Mauritius remained at the top, being a detour for investment, up until 2000 the only Asian country in the top five was Japan (ranked third). Singapore started showing up in the top of the rankings in the late 2000s, climbing to second place and staying there since 2007, and the U.S. and England were pushed out. Although China was far down the list in 31st place in terms of accumulated volume, it has closed the gap rapidly, ranking 18th (0.6%) as of the end of 2012.

Meanwhile, the composition of industries channeling FDI into India displays a completely different structure from Korea's investment into India. FDI in India has recently been concentrated in the service industry, such as finance and the construction/development sector, including infrastruc-

ture-building. Investment from Korea, however, is mostly accounted for by the manufacturing sector (84.8%), of which over 70% is taken up by automobiles and metals manufacturing. Only 1.4% of Korea's investment in India's service industry is related to construction, and a paltry 1.6% went to finance and insurance – the same industries where major investors in India are concentrating funds.

3. Analysis of Determinants for Korea's Investment in India

A. Model

A multiple linear regression model was used, being the most favored choice for conducting empirical analyses on determinants for investment. This model has the advantage of being able to include a number of investment determinants as explanatory variables. The biggest challenge here would be to secure observable variables. This paper drew plausible variables from previous studies on China, whose market characteristics are relatively similar to India. Key determinants were chosen from those variables, and determinants reflecting the characteristics of Korea's investment were added to build the following model.

$$FDI_t = f(x_t, \mu_t)$$

(x_t : observable variables, μ_t : unobservable variables, t : time)

$$\ln(FDI_t) = \alpha_1 + \beta_1 \ln(FDI_{t-1}) + \beta_2 GDP_t + \beta_3 GDPGAP_t + \beta_4 EXPORT_t + \beta_5 BIG_t + \beta_6 MANU_t + \mu_t$$

The dependent variable $\ln(FDI_t)$ in this model indicates Korea's investment volume in India, log-transformed to secure the stability of a

time series analysis, since investment in India is shown to gradually increase as time progresses. $\ln(FDI_{t-1})$, the first independent variable, is a log-transformation of investment volume from the previous year, accounting for the fact that investment, rather than being a one-time occurrence, often extends over a year or is linked to investment from associated front- and back-end businesses.¹ In this case, it is likely the coefficient estimate will be positive.

India's GDP growth, GDP_t , is a variable that stands for changes in the country's economic size. Many previous studies have revealed that the size of the economy of the investment destination works as a positive determinant for investment. Therefore, it is highly probable that the coefficient estimate for this variable will also be positive. The income gap between the two countries, $GDPGAP_t$, was used as a proxy variable to explain the difference in wages paid for labor, a key production factor. The coefficient estimate will be positive if companies seek the advantage of low wages in India. $EXPORT_t$ indicates the growth rate of exports to India, which, if positive, means investment in and exports to India are complements, and if negative, substitutes.

BIG_t and $MANU_t$ are unique attribute variables that indicate the size of companies and share of manufacturing in Korea's investment in India, respectively. They are calculated as the share of large companies and manufacturing businesses involved in new investment cases. If the coefficient estimate for BIG_t is positive, it can be inferred that Korea's in-

¹Using the lag variable of the dependent variable as an independent variable gives rise to concern about serial correlation between the residuals. The Breusch-Godfrey Serial Correlation LM Test conducted after the regression analysis – for the sake of accuracy – revealed that there was no serial correlation.

vestment in India is affected by the size of the investing company. The same applies to $MANU_t$. If the coefficient estimate is positive, this would imply that the increase in number of manufacturing businesses acts as a stimulating factor for investment in India. There was an absence of or otherwise extremely limited data available on other attributes specific to Korea's investment in India, such as adequate business performance. And for this reason, such attributes were not included in this analysis.

B. Empirical Results

The regression analysis reveals that India's economic growth rate, i.e., economic size, has a positive correlation with Korea's investment in India. This is in line with the fact that local market entry is the main rationale that drives Korean companies to invest in India. Meanwhile, negative coefficients of the income gap

between the two countries and the export volume to India imply that an increase in either one may actually reduce India-bound investment. The fact that there is a possible drop in investment particularly by export growth implies that the degree of production division between the two countries is still very low.

What stands out most in Korea's investment toward India is the concentration on large companies and the manufacturing sector, but it is unclear whether this has carried over to an expansion of investment in India. In other words, contrary to expectations, the size or type of industry did not, statistically, turn out to be a determinant for investment. The estimation results imply that any plans to increase investment in India should be accompanied by policies that support SMEs, as well as large companies, in outbound investment, and that covers not only the manufacturing but also the service sector.

Table 1. Empirical Results for Korea's Investment Determinants in India

Variable	Coefficient	Standard Deviation	t-value	p-value
C(constant)	5.693 *	2.917	1.951	0.067
$\ln(FDI_{t-1})$	0.432 **	0.190	2.264	0.036
GDP_t	0.238 *	0.125	1.902	0.072
$GDPGAP_t$	-0.041 **	0.018	-2.228	0.039
$EXPORT_t$	-0.007 **	0.003	-2.090	0.051
BIG_t	-0.005	0.011	-0.497	0.625
$MANU_t$	-0.006	0.019	-0.314	0.757
R-square	0.780			
Adjusted R-square	0.702			
F-statistics	10.051			
Prob.(F-statistics)	0.000			
D.W. statistics	2.337			
Observations	24			

Note: ***,** and * indicate 1, 5, 10 percent statistical significance, respectively.

4. Achievements and Challenges

In some ways, Korea has achieved what other

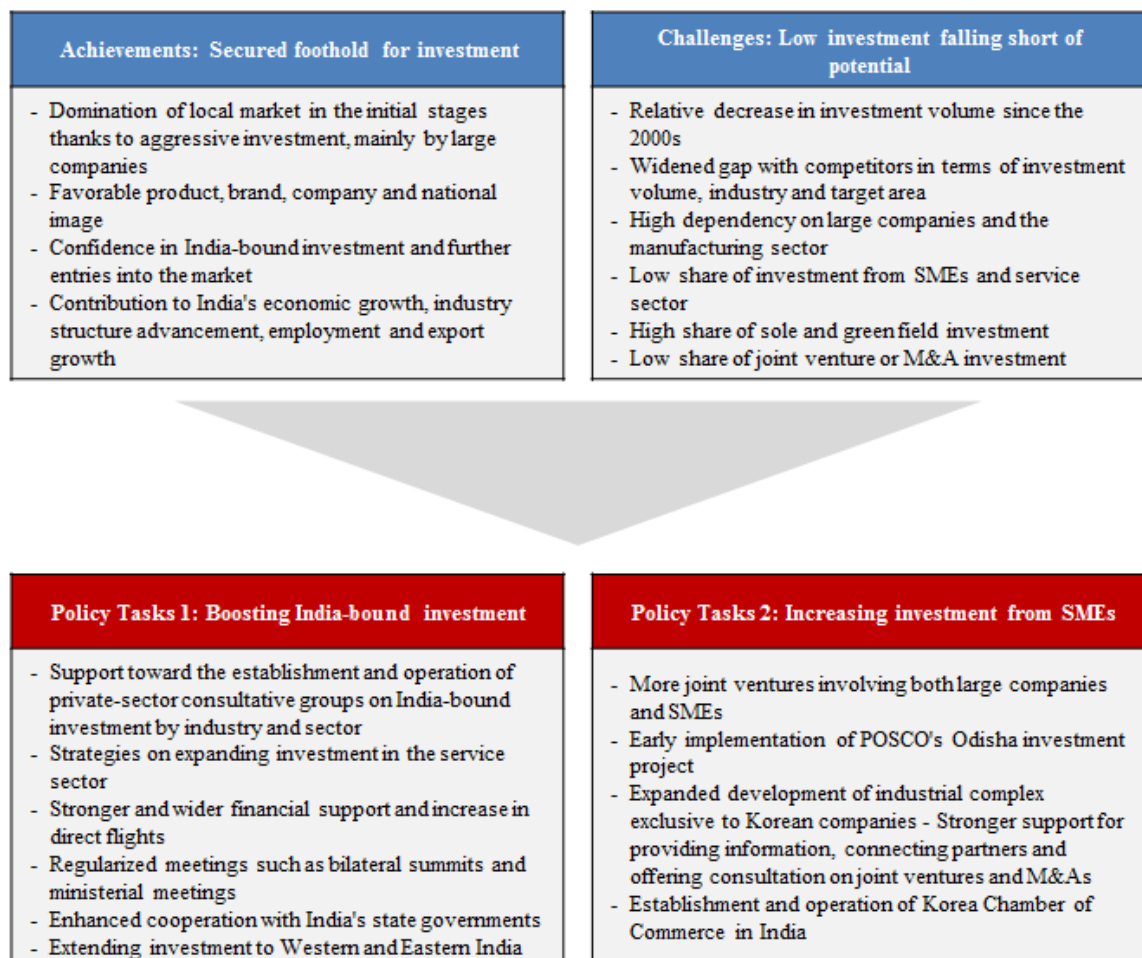
countries did not with regard to India-bound investment. Korean companies established a secure foothold by taking the lead in investment in the 1990s, and were able to quickly

become the top market players in consumer durables such as automobiles or home appliances. This helped enhance the overall image of Korea in India - its products, brands, companies and even the country itself. Since the 2000s, however, India-bound investment has been falling behind competitors like Japan, and narrowing the broadening gap by boosting investment has become the most important and pressing challenge. As mentioned earlier, once the fifth-largest investor in India in the 1990s, Korea has now plummeted to 13th place as of the end of July 2013. In terms of volume, investment does not even reach one tenth of that of Japan.

A solution to this would be to encourage the formation of private-sector consultative

groups on India-bound investment by industry and sector. Industries and companies from the private sector would take the lead, but the full support of the government and related organizations is required. Countries like Japan and Singapore should also be benchmarked, by bolstering support for investment in the services sector as well as manufacturing. Investment should also be directed to areas beyond Delhi and Chennai, to the Western and Eastern regions of India, as in the case of Japan. Likewise, financial support should be intensified. An expansion in the size and variety, of financial support is particularly important in order for Korea to take a more active role in burgeoning infrastructure development in India. Direct flights between the two countries should also be increased.

Figure 3. Korea's Investment in India – Achievements and Challenges



Early realization of these goals requires a more efficient bilateral governmental consultative mechanism. To be more specific, summits, ministerial and private committee meetings need to be held regularly and must be inter-connected. In consideration of India's political and government structure, the government of Korea should gradually establish a cooperative system with state governments as well as the central government of India. 