Will PLIs give Japanese manufacturing a boost in India?

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Japan has a history of investment and joint ventures in India. Foreign direct investment from Japan increased to USD35 billion between 2000-2020, with USD10 billion worth of inbound mergers and acquisitions in 2015-2020 alone. Factors including geopolitical realignments in Asia, excess global liquidity and a new, incentive-based manufacturing regime in India mean that the economic relationship between India and Japan in high-value manufacturing is likely to expand further. India introduced production linked incentive schemes (PLI schemes) in 2020 and 2021 to boost domestic manufacturing and encourage investment in it by overseas companies. Under the schemes, the government offers annual direct financial incentives or cashbacks to eligible manufacturers.

Pradeep Ratnam
Senior partner
Kochhar & Co

PLI schemes are time limited. Each scheme lasts for a specified block of five financial years, (incentive block). Within that time, a manufacturing entity must meet specified targets of annual investment, production and sales. Each PLI scheme specifies the products that may be manufactured. Recent schemes include pharmaceutical products, air conditioners, LED lighting products and telecoms equipment.

In selecting successful applicants, administrators of each PLI scheme consider factors such as existing manufacturing capability, globally and in India, global revenue and net worth. Sector-specific criteria also applies, such as the number of pharmaceutical products that applicants have registered with recognised regulators such as the USFDA. These factors favour established multinational firms with good sectoral track records.

The schemes set out minimum annual and cumulative investment and sales targets, or stipulated threshold targets (STT), that a company must achieve before claiming the financial incentives. The STTs are set out in the particular scheme guidelines. Incentives are calculated by multiplying the net incremental sales of eligible products in the relevant financial year by a percentage incentive rate specified in each scheme. The relevant government department appoints a project management agency to oversee the particular PLI scheme and to verify financial claims under it.

From a legal perspective, the PLI schemes set out clearly and transparently the financial incentives available to manufacturing firms and the conditions for claiming them. From an investor viewpoint, the financial incentives are guaranteed in government budgets that annually fund individual departments. However, applicants should note some disadvantages.

The PLI schemes are compensatory. Fiscal incentives in themselves do not address the intrinsic inefficiencies in domestic manufacturing in India. Before committing to a scheme, companies should ensure the adequacy of infrastructure, supply chains, the availability of local components on which customs duties are not paid, logistics, finance, power, design capabilities, R&D and human resources. Other than being allowed a maximum grace period of two years before commencing production, companies are committed to the STTs specified under PLI schemes. Therefore, manufacturers should ensure stringent contractual and insurance arrangements to avoid manufacturing underperformance and delays. Furthermore, PLI schemes do not guarantee any other aspect of projects, such as land and other approvals, which investors should obtain in advance. Financial incentives are available only for the duration of the incentive block, and for a specific financial year. Companies may not bank, defer or catch up unclaimed financial relief.

Exclusions apply to the calculation of STTs and companies should beware of claiming expenses against items that will be disallowed. Transfers of benefits to a successor company require the approval of the relevant government authority.

PLI schemes provide opportunities for international firms with manufacturing capabilities, expertise and demonstrable track records. Success, however, depends on robust production systems and partnerships, advisory support, innovation and the ability to overcome inefficiencies and obstacles in the manufacturing ecosystem. With the advantages of a strong bilateral relationship with India, entrenched manufacturing networks and local lobbies, and business experience, Japanese companies stand to gain.