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Outward Direct Investment from India

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Outward Direct Investment from India

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Abstract: This paper examines emerging patterns and economic implications of Indian foreign direct investment from a historical perspective against the backdrop of the evolving role of developing-country firms (emerging multinational enterprises, EMES) as an important force of economic globalisation. The novelty of the analysis lies in its specific focus on the implications of changes in trade and investment policy regimes and the overall investment climate for internationalisation of domestic companies and the nature of their global operations. The findings cast doubts on the popular perception of the recent surge in outward FDI from India as an unmixed economic blessing, given the remaining distortion in the domestic investment climate

Keywords: India, FDI, Emerging-Economy MNEs

JEL Classification: O53, F21, F23

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1. Introduction

Foreign direct investment by developing-country firms has evolved into an important force of economic globalisation over the past three decades. From the late 1960s, when sprouting of these new investors ('emerging multinational enterprises', EMNEs) was first recognised, until about the late 1980s, the bulk of their investment was in developing countries. Competitive advantage of EMNEs largely came from managerial practices and technologies that were adapted to operating in developing countries. Since about the early 1990s there has been a significant change in the pattern and nature of international investment by EMNEs, reflecting growing economic significance of their home countries, universal embrace of market-oriented economic policies and the accompanied changes in world market forces. Not only the number of EMNEs and their share in total outward FDI, but also the sophistication of their activities, have increased notably. Some of them have developed their own firm-specific assets and expanded their operations beyond the traditional domain of other developing countries to developed countries. Some EMNEs have attained sales volumes and status of brand recognition on a par with the developed-country MNEs and their presence has begun to challenge the *modus operandi* of the corporate world.

Beginning with the pioneering works of Diaz- Alejandro (1977), Wells (1977) and Lecraw (1977), a sizeable body of literature, has developed on this subject.[1] The key focus of the 'first wave' literature until about the early 1990s was the perceived 'special kind of contribution' (Wells 1983) that EMNEs can make to the development process in developing countries based on appropriate technology and other unique 'third world' characteristics of their operations. Given the emphasis on 'collective self reliance' as part of the rhetoric of the South-South policy dialogue at the time,

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[1] Lall (1984) and Wells (1983) synthesize much of the literature spread until the early 1980s. Yeung 1999 provides a comprehensive compilation of the key papers published until about 1997. For a survey of more recent literature see Cuervo-Cazurra 2008 and Goldstein 2008).

host developing countries also generally favoured EMNEs over developed-country MNEs. The transfer of technology from developing country to developing country was often highlighted in development policy circles a concrete example of South-South co-operation. These considerations have lost much of their policy relevance since the 1990 as most countries embraced global economic integration as the basic tenet of the development strategy. In a world of reduced political tensions, most host countries now make decisions on foreign investment on economic grounds rather than on nationality. In this context, the focus of the liberate literature has shifted from treating EMNEs as special actors of Third World development and solidarity to studying them as agents of economic globalisation. Consequently, there has been a renewed emphasis on examining their operations from a 'home country' country perspective in place of the old focus on examining the unique features of their affiliates in host countries.

In this context, this paper examines the role of EMNEs in growth and structural transformation of their home countries through an in-depth case study of the Indian experiences. India provides an interesting case study of this subject given the long history of involvement of Indian firms in overseas investment and significant policy shifts impacting on the process over the past two decades. In recent years overseas investment by Indian firms has attracted attention as an important aspect of increasing global economic integration of the Indian economy. The main novelty of the present study compared to the recent studies on Indian MNEs[2] lies in its specific focus on the implications of changes in domestic investment environment and policy shifts for the internationalisation of domestic companies and the nature of their global operations. It also aims to provide a historical perspective to the contemporary debate on the role of government policy in the rise of MNEs.

The paper is structured as follows: Section 2 sets out the context for the ensuing analysis. It traces the historical roots of entrepreneurial skills and surveys changes in government policy relating to outward foreign direct investment (FDI) in the context of major shifts in trade and investment policy regimes. Trends and patterns of outward FDI from India are examined in Section 3 from a comparative

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[2] These include Kumar (2007 and 2008), Kumar and Phadhan (2007), Pradhan (2008), Khanna and Palepu (2006) and Ramamurti and Singh (2008).

perspective. Section 4 deals with sources of competitive advantages of Indian MNEs, followed by a discussion of main drivers of their overseas expansion in Section 5. The implications of outward FDI for the national economy are discussed in Section 6. The final section offers some concluding remarks.

2. Historical Setting and Policy Trends

A clear understanding of the historical roots of entrepreneurial talents is needed in order to understand process of internationalisation of firms for a given country. Previous studies on the rise of Indian MNEs have generally inferred that the import-substitution era during the first four decades after independence in 1947 provided the setting for their global spread following the liberalisation reforms initiated in 1991. However, the process of industrialisation in the post-independent era began not from an industrial vacuum but against the backdrop of a distinct process of economic change and industrialisation during the colonial era (Little 1983, Tomlinson 1993). Most of the large business houses had entrepreneurial and technical capabilities built over many decades before the independence in 1947.

The British rule caused a set-back in some activities of Indian merchants and commercial capitalist, but it did not suppressed all of them for long. Even though Indian businessmen who found their industrial ambitions thwarted by the colonial rule to begin with, they were eventually able to supplant their expatriate rivals as the dominant element in the private sector. By the turn of the 19th century, Jaksetic Tata had successfully established the Empress and Swadeshi Cotton Mills and was venturing into iron and steel manufacturing. By the first decade of the 20th century the cotton textile industry, centred in Bombay and Ahmedabad was well established as the most important manufacturing industry in India. Fly-shuttle looms and rayon and other artificial fibre were integral parts of the technological base of Indian textile industry in the inter-war years. The Tata Steel Company, the premier industrial enterprise of colonial India, started production in 1913 and expanded its operations as the major supplier of steel to railway construction. It set up a successful Technical Institute in 1921 and Indian-staffed Research and Control Laboratory in 1937. During the last three decades of British rule, industrialisation process was dominated by a diffused group of Indian entrepreneurs from many different communities. These business groups expanded their activities exploiting the opportunities presented by the decline in the Calcutta colonial firms, and responding to the new patterns of demand

and supply brought about by the depression and its aftermaths. Beginning with in traditional products such as sugar, sugar and paper, they diversified into entirely new areas such as textile machinery (Birla), domestic airlines (Tata), shipping (Walchand Hirachand) and sewing machines (Shri Ram). Manufacturing industry grew at an annual rate of over 5% 1990 and 1939 (Little 1983, table 21.1). In 1945, India was the tenth largest producer of manufactured goods in the world (Tomlinson 1993, p. 92).

In the lead-up to the independence in 1947 Indian big business was optimistic that the private sector would be an equal partner in national building. The Bombay plan (January 1944), a policy blueprint prepared by leading industrialist with the support of the leaders of the independent movements, was widely acclaimed at the time as bold plan for national economic reconstruction. It had envisaged a prominent role for private enterprise in independent India.

However, these hoped were soon hashed as the new political leadership rapidly embarked on a strategy of state-led industrialisation under central planning (Panagariya 2008). A solid regulatory regime to control industry and foreign capital was provided by the Industrial Development and Control Act passed in 1951. The Act set up provisions for the licensing of all existing industrial units and new ones or substantial expansions.[3] It ushered in an era of 'expansion by stealth' for private enterprise: an era in which business success dependent crucially on the ability to find ways of dealing with the 'licence raj'. The overriding aim of the development policy of the successive Five Year development plans starting with the first plan launched in 1952 was across-the-board import substitution in the context of a foreign trade regime which relied extensively on quantitative restrictions (QRs).

The policy regime turned out to be more restrictive from the late 1960s under the Indira Gandhi administration (Patel 2002). In 1969 the government enacted the Monopolies and Restricted Trade Practices Act (MRTP) which contained strong measures to curb the economic power of the top business houses. The MRTP meant a

[3] Ghanshyam Das Birla likened the MRTP Act to 'Damocles' sword permanently hanging on you threatening that government may take change of your creation if in their opinion you are not managing your job' (Kudaisya 2003, p. 20)

more tight investment regime for the larger houses; tightening of licensing and controls over interlocking directorships. All firms above a certain asset base were restricted from entry into almost all sectors of Industry and even expanding existing plants required permission from the government on a case-by-case basis.

During this period government policy towards overseas investment was formulated on the basis of the foreign exchange earning capacity of proposed ventures. As part of the highly restrictive foreign exchange monitoring process every proposal had to be placed before an inter-ministerial committee on joint venture for approval. Overseas investment was permitted only in minority-owned joint ventures, unless the foreign government and foreign party desires otherwise. As reads the mode of financing of the proposed project, the government severely restricted cash remittances for equity participation and only encouraged the export of capital equipment from India for the purpose. When equity generated via machinery export was inadequate and the equity holding of a higher level was desired, employing other items like structural steel and construction items against equity could be considered. Equity was to be financed through provision of capital goods and technology or know-how. It was stipulated that 50% of declared dividends should be repatriated to India and the capitalization of technical fee. All project proposals were screened on a case-by-case basis, approving only those that promised quick payoffs in the form of exports.

Some liberalization of trade and investment policy regimes took place during 1975–1991, especially during the last five to seven years, including progressive loosening of import controls and increase in subsidies to exporters of manufactured goods. The approval criteria were somewhat liberalised in the 1980s, but the basic rational remained largely unaltered until 1992. According to these revisions, the requirement of minority participation was replaced by a requirement to conform to the rules and regulations of the host country. The government allowed the capitalisation of service fees, royalties etc. to meet equity participation. Indian companies were permitted to raise foreign currency loans abroad and to grant loan to their foreign joint ventures Indian parent companies to the joint ventures. In some exceptional cases direct cash remittances to joint venture too were permitted.

The liberalisation-cum-structural adjustment reforms initiated in 1991 marked a clear departure from the dirigiste past. The reforms, encompassing industrial

deregulation, trade liberalisation, and relaxing regulations governing foreign direct investment and foreign technology, subjected Indian industry to a major restructuring. The emerging competitiveness of Indian firms in the world market can be traced back, in significant part, to this process. In particular the capacity to compete with foreign firms and face import competition in the domestic market was instrumental in building confidence to compete with foreign firms in world markets (Nayyar 2008).

As part of the new policy emphasis, relaxation of restrictions on overseas investment began in 1992. The first step was to introduce an automatic route for overseas investment up to US$4 million. The authority for approval of proposals up to US$15 million was vested with the RBA, but proposals more than US$15million still had to be approved by the Minister of Finance. In 2002 the upper limit for automatic approval was raised to US$100 million per annum, of which 50% could be obtained from any authorised dealer of foreign exchange. In 2004, firms were allowed to invest up to 100% of their net worth under the automatic route. In 2005 this limit was raised to 200% of net worth and prior approval from the RBA was dispensed with and firms were permitted remitted transfer funds though any authorised foreign exchange dealer. Indian firms' access to international financial markets was also progressively liberalised and they were permitted to the use of special-purpose vehicles in international capital markets to finance acquisitions abroad (FICCI 2006).

3. FDI by Indian Firms in a Global Context

The first overseas Indian venture was a textile mill set up in Ethiopia in 1959 by the Brila group of companies, India's second largest business conglomerate at the time (Kudaisya 2003, p 384). In the following year Birla Group set up an engineering unit in Kenya. However, sustained growth in Indian overseas investment could be seen from about the late 1970s when the industrial licensing system became much more stringent as part of the government's move to controlling big business. By 1983 there were 140 projects in operation and another 88 in various stages of implementation (Lall 1986). Total number of approved projects had reached 229 by 1990 (Kumar 2007). Most of the foreign affiliates set up during this period were small or medium-scale ventures; total approved equity in approved during 1975-1990/1 amounted to only US$220 million.

The second wave of internationalisation of Indian firms began from about 1995 and gathered momentum as foreign exchange restrictions on capital transfer for overseas acquisitions liberalised at successive stages from 2000. There was a real surge in outward investment from 2005. The number of approved projects increased from 220 in 1990/1 to 395 in 1999/0 and to 1595 in 2007/8 (Kumar 2008, Figure 1). Total FDI outflow from India increased from about US$ 25 million in the early 1990s to nearly US$ 14 billion in 2007. India's share in total FDI outflows remained below 0.5% throughout the 1990s, but increased continuously from then, reaching 6% in 2007 (Table 1, Figure 1). India still remains a net FDI recipient, even though the gap between outflow and inflows has been sharply narrowing over the past few years. During the 1990, annual out flows on average amounted to 7% of inflows. This increased from about 30% to 60% between 2000-5 and 2005-7.[4]

Figure 1 about here

Data summarised in Table 1 help understand India's relative position in the world as a source country of FDI. In the early 1990s, India's share in FDI outflows from developing countries was the lowest compared to the four large emerging market economies used here as comparators (South Africa, Mexico, Brazil and China). Over the ensuing years India share has increased faster. From 2005 it has surpassed that of that of South Africa and Mexico. FDI outflows as a share of total domestic capital formation (GDCF) in India, too, has increased much faster than of the other four countries and the average for all developing countries over the fast decade.

In Figure 2 outward foreign direct investment (OFDI) from China and India are compared in terms of the percentage contribution to total developing-country OFDI and relative to gross domestic capital formation (GDCF) in each countries. During 2007-07 on average Chian accounted for 7.3% of total OFDI from developing countries compared to 3.2% of India, although the gap has been narrowing over the years. By contrast, relative to GDFC, OFDI from India on average is larger compared to that from China. The difference has widened sharply following the significant

[4] Data reported in this paper, unless otherwise stated, come from UNCTAD, *World Investment Report* database.

liberalisation of the OFDI regime in India 2004-5. During 2005-06, OFDI/GDCF share in India (4.4%) was more than two of that of China (1.7%).

Table 1 about here

Figure 2 about here

Geographical distribution

A general characteristic of EMNEs in the 1970s and 1980s was their heavy concentration in developing countries. Moreover bulk of their FDI was intra-regional, mostly in neighbouring countries. Indian subsidiaries shared the general pattern of third-world concentration, but they were unique for their wider spread within the developing world (Encarnation 1982; Lall 1986). Geographically Indian firms spaned west and East Africa, the Middle East and South and East Asia on the back of the Indian Diaspora in these countries, shared colonial heritage and familiarity with the operation within restrictive trade and investment policy regimes. By contrast operations of EMNEs from the East Asian countries and those from Latin American countries remained heavily concentrated in neighbouring countries within their own region (Wells 1983, Diaz-Alejandro 1977, Cuervo-Cazurra 2008)).

The past decade has seen a rapid spread of operational networks of Indian MNEs to encompass developed countries and also transitional economies (Table 2). The developed-country share of approved investment of Indian MNEs increased from 30% in the early 1990s to over a half by 2007. Much of this diversification has resulted from acquisitions rather than green field investment. Developed countries accounted for over 80% of the total number of Indian acquisitions during 2000-2006, a share much higher than that in total FDI. One third of these acquisitions were in the USA, while two thirds were in Europe, with the UK alone accounting for about one third. The relative importence of developed and developing country markets however varies significantly among product categories.[5] In standard manufacturing products (such as automobile, textiles, chemicals) developing countries and transitional economies are the major hosts. Developed countries are important mostly for new

[5] This observation is based on an inspection of detailed records of acquisition given in the Appendix to IFICCI (2006)

dynamic product lines such as IT support and related activities where the competitive advantage of Indian companies lie in labour and managerial cost advantages (Ramamurti and Singh 2008). Indian MNEs which go abroad in order to exploit their local technological advantages set up plants predominantly in developing countries. By contrast, firms which built on domestic labour cost advantage and managerial talents target advances countries. These firms also invest in other emerging economies, but not so much to serve these markets as to broaden the number of low-cost countries from which they can serve rich-country markets.

Table 2 about here

Sectoral Composition

During the first three decades from the late 1960s, more than 80% Indian FDI was in manufacturing (Lall 1982, Lall 1986). Within manufacturing, Indian firms were spread over a much broader spectrum of activities than those of other countries (wells 1983). The largest sector was textiles and yarn, accounting for a quarter of capital held overseas. This was followed by paper and pulp, engineering of various types, food processing and chemicals. Unlike firms from East Asian countries which used their new locations as export platforms, Indian firms were predominantly engaged in import-substitution production. These features mostly reflected the nature of the highly interventionist and inward looking nature of the Indian domestic policy regime which had spawned a highly diversified and inward-oriented domestic manufacturing base. Oil and gas and other natural-resource based industries occupy a relatively low position in Indian overseas FDI compared to that of China and Brazil (Goldstein 2008)

The past decade has seen a notable diversification of the sectoral/industry composition of overseas activities of Indian firms. Manufacturing share in total approved capital declined from 70% in the early 1990s to 30% 2005-7 (Table 3). There has been a notable increase in services-related FDI. Within manufacturing, the product mix has become increasingly diversified. Manufacturing ventures accounted for 40% of total acquisition during 2001-06, with information technology, software and business process outsourcing accounting for 30%. Within manufacturing,

pharmaceuticals, automotive, consumer goods, chemicals and fertiliser are the major areas of concentration.

Table 3 about here

Entry modes

Until about the mid-1990s green-field investment (investment in newly-established firms) was the norm for Indian forms for their overseas operations. There were no recorded cases of overseas acquisitions during this period. Given the nature of terms and conditions applicable to overseas investment, all foreign affiliates formed during the period were joint venture, usually with minority ownership. Moreover, reflecting foreign exchange restrictions on capital outflow, a disproportionately large share of equity took the form of capital goods exported by the parent companies.

Since about 2004, the expansion of Indian outward FDI has primarily taken the form of acquisition (Table 4, 5 and 6). Total number of acquisitions increased from 25 in 2000 to 277 in 2008. During 2005-8, value of total acquisitions amounted to 80% of total reported FDI outflows (Figure 3).

Tables 4 about here

Table 5 about here

Table 6 about here

Figure 3 about here

In line with this new development, the ownership structure of foreign ventures also has shifted towards majority and full ownership. According to a recent study by the Federation of Indian Commerce and Industry (FICCI) (2006), 68% of acquisitions by Indian firms during 2000-6 involved acquiring full ownership: Acquiring minority ownership took place only in less than 15% of these cases. In particular, acquiring full ownership has been the mode of entry in most of the large acquisition in developed countries. Minority ownership is largely confined to acquisition in developing countries and transitional economies.

In recent years foreign acquisitions by Indian firms have increased at much faster rate compared to the average developing country experience. In 2007-8 India ranked as the forth largest overseas business acquirer among developing and transitional economies after Singapore, United Arab Emirates and the Russian federation. India's share in total value of developing-country acquisitions (7.0%) was larger than that of China (5%) and Brazil 5.8%). It was the 17th largest business acquirer in the world surpassing a number of OECD counties (Table 7).

Table 7

Unlike in the case of outward FDI from Chian, where more than two-thirds of OFDI is by state-owned or state-controlled, Indian OFDI is predominantly a private sector activity. There were several prominent state-owned enterprises among the overseas investors until about the mid-1980s: Computer Maintenance Corporation (subsequently sold to Tata Consultancy Services); Indian Drugs and Pharmaceuticals (went bankrupt), Bharat Heavy Electrical Ltd; Heavy Engineering Corporation, Bharat Heavy Plates and Vessels; Bharat Earth Movers Lt; and Steel Authority of India. They have faded in importance in the second wave, with the sole exception of the two state-owned corporations in the oil and gas sector (ONGC and IOC).

Players

Many Indian overseas investors are parts of large business conglomerates. Until the mid-1980s the Birla Group of companies dominated the scene. They accounted for 40% of shares of equity held in Indian firms. The Tata group of companies, though larger than the Brila domestically, accounted for 11%. The Thapar group (textile and accounted for 7% (Lall 1986): These conglomerates have further expanded and consolidated their overseas operations following the liberalisation reforms. Several new players have also entered the scene in recent years. These include the pharmaceutical giant, Dr. Reddy's, information technology companies such as Infosys, Ranbaxy, Reliance, and Wipro (a wind-power company) (Table 5). However, there has been a heavy concentration of acquisition in few large firms; during the period 2000-06, 15 firms were responsible for 98 out of 306 acquisitions and they accounted for over 80% of total value of acquisitions (FICCI 2006).

4. Sources of Competitive advantage

When a firm from given country operates in another country, it incurs a set of costs (related to lack of familiarity with the home market, lack of information about other market leaders etc.) that are not faced by local firms). To offset such disadvantages ('liability of foreignness'), a successful foreign firm must usually have an assets or skills (proprietary assets) that give it a competitive edge over local firms. Proprietary assets are of two types: firm-specific advantages (FSA) and country-specific advantages (CSA) (Rugman and Doh 2008, Dunning 2000).

Firm-specific advantages are unique operational capabilities proprietary to the firm. They are intrinsically organisation and may be built on product or process technology, marketing or distribution skills, or managerial know-how. Country-specific advantages are country factors unique to the business in each home country. They can be based on natural-resource endowment, on the labour force, or on less-tangible factors include education and skills, entrepreneurial dynamism, institutional protection of intellectual property, or other factors unique to a given country. Managers of most MNEs rely on an appropriate mix of country- and firm-specific advantages CSA and FSA, so that they can be positioned in a unique strategic position in a given host country.

The proprietary advantages of developed-country MNEs rest on assets built up by research efforts and large investment in the context of large mature domestic market. Therefore the standard proprietary asset models developed to explain the global reach of these firms offer little help in understanding the competitive advantages of EMNEs which have failed to pass through a evolutionary process in their home countries. The pioneers of the literature on EMNEs therefore resorted to an eclectic approach to expanding the operation of these firms which essentially relied on an analysis of firm behaviour in the specific business environments in developing countries (Lecraw 1977, Wells 1983, Lall 1983). The consensus view was that the competitive edge lies very much in country-specific advantage; advantages moulded by the experience of their home countries. These included ability to adapt technology to suit relative factor prices in developing countries and the small size of their markets ('technological comparative advantage', *a la* Diaz-Alejandro 1977); the ability to

adapt original designs local conditions such as non-availability or prohibitive cost of raw materials, peculiarities of local consumers, and the climate and geographic conditions and their small markets, ability to complement entrepreneurial adaptation to developing-country conditions, ability to use domestic skilled labour to design and operate projects abroad at low cost, and lower cost of technical personnel and management.

In a pioneering study, Lall (1986) found that technology embodied in indigenous machinery was not an important source of competitive advantage of Indian firms in their overseas locations. Rather, the availability of a pool of Indian managers and technicians was found to be by far the main source of their competitive edge. The knowledge and experiences as embodied in Indian managerial and technical personnel placed these firms at a healthy competitive position in developing-country conditions.

In a detailed comparative study of selected firms with overseas operation across a wide rage of industries, Ramamurti and Singh (2008) conclude that the available evidence does not lead to a very clear or strong inference of monopolistic advantages possessed by these firms. Sources of competitive advantages varies greatly from case to case because even within the limits set by prevailing technology firms have the ability to undertake minor innovations to the production process or the method of marketing a particular product. In the market driven environment in the 2000s, firms seem to enjoy more degrees of freedom and more routes to internationalisation than their counterparts had in the closed-economy era. Within this complex setting the authors found that country specific advantages – in particular products and processes adapted to the particular Indian context and availability of cheap but high quality manpower - are still the major source of competitive edge of Indian firms.

In particular, Indian pharmaceutical firms seem to have built their capabilities in the decades when India had a weak intellectual property right regime, which made it easier for them to copy western drugs before they came off patent in the US or Europe. However, before expanding abroad in the 2000s, these firms had to position

themselves in the new competitive market setting by reengineering production methods, upgrading quality, developing new suppliers, and improving productivity.

Labour and managerial cost advantage has been the major source of competitive edge for Indian information technology firms in their global spread. These firms are largely engaged in a few specific stages of the value chain of functionally integrated firms that design, produce and sell, and distribute products under their own brand names; working behind-the-scene partners who help customers succeed. They focus on a few stages of the value chain in which their home country has a cost advantage. They are well placed to perform this role based on the capabilities developed in the Indian environment in managing human resources, handling government relations, or coping with unreliable suppliers and with underdeveloped hard and soft infrastructures.

Software services companies such as Infosys and Wipro are the best known examples of companies following the low-cost expansion strategy. The competitive advantage of these firms was first based on India's low-cost programming talents, but over time evolved to encompass significant firm-specific scale and scope economies and late mover advantages. Scale economies came from spreading fixed cost across a large number of employees through the expansion of their global operation network. Scope economies came from serving firms in many industries and countries: Serving a large number of industries helped smooth periodic contraction in activities in some and thus making it affordable to nurture and retain highly specialised skills within the firm. Both firms also enjoyed late-mover advantage relative to their western competitors, from the beginning they could build their staff in low-cost India, where as firms like IBM and Accenture entered the offshore operation with a backlog of a high-cost manpower in developed countries.

There are many product lines other than IT industry in which Indian firms competitive advantage mainly emanate from labour cost advantages. These include call centre business; back-office support-services, such as accounting or legal assistance, or in document preparation; medical transcription; clinical trial and pharmaceutical contract research; financial research and management consultancy research, and so on. Indian MNES in consumer goods industries (such Tata Tea and

Tata Coffee), and intermediate-input producing industries such as Bharat Forge (motor spare parts), Tata Steel, and Hindalco (an aluminium manufacturing firm) derive competitive advantage from the booming domestic demand in India. After India opened up, each of these firms consolidated strong positions in the Indian market, then, on that strength, acquired or set up new facilities in other countries to become international players.

Throughout the control era and well into the 1990s in the reform era, financing was a serious constraint for the overseas expansion of Indian firms. The ability to expand overseas therefore depended crucially on finding projects whose equity capital commitment can be met through machinery exports and the readiness of the local counterpart to raise the required finances locally. There is evidence that the tendency of Indian firms towards projects involving small fixed capital outlays emanated from liquidity shortages rather than from technological considerations. It would appear that liquidity shortages kept Indian firms away from projects for which the size of expected turnover is small relative to the fixed costs involved (Lall 1986). The policy reforms in the early 2000, implemented on the back of the strong foreign reserve position of the country, considerably removed the financial constraint. As already discussed, the reforms have ushered a new era of rapid globalisation of Indian firms.

In sum, it is an over-simplification to say that internationalisation of Indian firms is underpinned by a common set of competitive advantaged. However, it is clear that most of them (if not all) have yet to develop firm specific advantages. Their competitive advantages are fundamentally country specific: a mixture of technological adoptive capacity built over several decades and cheap brainpower, seasoned managerial class and a historically rooted entrepreneurial tradition. Following the liberalisation reforms in the early 1990s, India's large and booming economy and unprecedented access to capital have played a vital role in setting the stage for rapid global spread of Indian firms based on these country specific advantages.

5. Motives

Competitive advantage is a precondition (enabling factor), but not a sufficient condition for going global. Not every firm that develops specific advantages over its competitors undertake overseas investment, they have the option of exporting from home base or simply focus on expanding in the home country? What are then the factors that propel going abroad? The early literature has come up with litany of factors: risk diversification: uncertainty about future supplies of raw materials; buyer uncertainty resulting from lack of information to the potential buyers about their product and technologies, protect export markets, circumvent protection in developed country markets or gain preferential access to these markets and limits to growth at home, resulting either from the domestic market size or government policy (a need to circumvent the constraining effects of government policy).

There is evidence that the constraining effects of government policy on business operations played a pivotal role in the emergence of Indian MNEs during the import-substitution era. During this period many big industrial houses in India felt constrained not by the lack of profitable market opportunities at home, but by government legislation which created market imperfections and distortions affecting their ability to expand, diversify and exports. Based on interviews conducted in 1982 with 17 parent companies Lall (1986) found that the desire to escape the constraining effect of government policy was the most important motivation behind overseas investment by these firms. In particular, the firms specifically mentioned the Monopolies and Restrictive Trade Practices (MRTP) Act as the main impulse behind the decision to invest abroad (P 21). Only one-third of the firms indicated that they went abroad to open new markets and or protect existing one. Given the negative impact of trade and industry policies on export competitiveness exporting from India at the time, diversification by exporting was not an option for Indian firms. To the extent that the cost raising effects of government policies have a deleterious effect on export performance, they also indirectly provided an incentive for Indian firms to invest abroad. Thus direct investment appeared as a logical means of escape.

The available case histories of the pioneers of the Birla Group, the vanguard of overseas expansion of Indian business, provides ample support for the proposition that

the constraining effect of government policy acted as a major domestic push factors in overseas expansion (Merchant 1977, Kudaisua 2003). Birla Group made the first move to build its overseas business empire in the late 1950s in anticipation of on coming trade and exchange controls. Its rapid overseas expansion began in 1969 at a time when the Indian political leadership was bent on restricting the growth of 'monopoly houses'. In that year Aditya Brila (the late manager of Hindalco) ventured into Thailand to set up Indo-Thai Synthetic Limited, with a capacity of 12,000 spindles. He then set up a rayon manufacturing unit in Thailand with a capacity of 24 tons. He established joint ventures for textiles in the Philippines and then expanded his operations to Malaysia and Indonesia. Southeast Asian countries provided a marked contrast to India as they were opening up their trade economies to trade and investment. As the business climate in India became more restrictive, the strategy of overseas expansion gained further impetus. For instance, in 1978, when his application to expand the capacity of the viscose fibre plant of Gwalior Rayon was held up for 18 months, Aditya Birla decided to shift the proposed factory to Thailand.

In the more open economic environment over the past two decades, drivers of overseas expansion of Indian firms have become more complex and begun to look increasingly similar to those propelling overseas expansion of developed country firms. Drivers of overseas expansion are also becoming more and more firm specific rather than country or sector specific. IFICCI (2006) has identified a number of motives including access to foreign technology, sourcing raw materials, and global leadership aspirations. Market access considerations were particularly important for pharmaceuticals and automotive sectors. Many of these large takeovers in metal and metal products industries were intended to add to the global competitiveness of the investing firms rather than to exploit their existing set of advantages. The need to maintain continuous supplies to meet the booming demand in the Indian economy has also been an important consideration.

Is the desire to escape the constraining effect of government policy still a consideration in Indian firms' decision to go overseas? This is an issue worth further study because it is at the heart of any assessment of the net national gains from the overseas expansion of Indian firms; to the extent that FDI takes place for such 'negative reason', the phenomenon may regard as a disguise form of capital flight.

Policy environment for domestic operation of Indian firms have significantly improved over the past one-and-a half decade. However, what is important here is the relative attractiveness of domestic investment environment compared to the other investment locations. Despite recent reforms, India's foreign investment regime still reflects the tension between the traditional aversion to foreign investment and the current recognition of its importance to economic development. There are also many unresolved problems relating to the overall investment climate.

Tariff protection in India is still substantially higher than in most other developing countries, and this continues to block India's attractiveness as an export platform for labour-intensive manufacturing products. While, the 'License Raj' (the infamous industrial licensing policy) has been largely eliminated at the centre, it still survives at the state level, along with a pervasive 'Inspector Raj'. Private investors require a large number of permissions (eg. for electricity and water supply connections, water supply clearance etc.) from the state governments to start business and they also have to interact with the state bureaucracy in the course of day-to-day business. Notwithstanding some relaxation in recent years, the 'small scale industries' reservation policy, under which designated industries are reserved only for tiny companies that are unable to compete with the large firms, still remains a major constrain on the expansion of labour intensive manufacturing where India's comparative advantage in international production lies stringent labour laws and high corporate tax rates, restrictive labour market practices and a weak bankruptcy framework are other prominent issues. Stringent labour laws and restrictive labour market practices are among other prominent issues. These issues are reflected in India's poor ranking among the countries in the region, in particular the dynamic export-oriented economies in East Asia, in terms of various indicators of ease of doing business (World Economic Forum 2008, *Foreign Policy* 2008).

6. The Economic implications

Over the past two decades the government policy in India relating to OFDI has made a palpable transition from the cautious and restrictive approach prevailed over the first four decades of the post-independence era to one of facilitation and encouragement.

OFDI is now considered as an effective tool of economic advancement through harnessing global technological know-how, building trade support networks for enhancing international competitiveness of local firms and opening new market channels for promoting exports (Government of India 2009). The extent to which OFDI has so far contributed toward these national development goals remains an unexplored empirical issue.

In panel data analyses of the determinants of export orientation of Indian firms, (Kumar and Pradhan 2007, Pradhan 2008) have found that outward FDI has a statistically significant positive effect on the degree of export orientation across entire sample of firms (4200) and at the level of a number of key industries. In interpreting these findings it is important to take into account the fact that firms with overseas operations are largely concentrated in capital and skill intensive industries. This needs to be explicitly taken into account in further analysis; because competitive advantage underpinning the observed export success of these industries may not necessarily reflect the intrinsic comparative advantage of the country (Lall 1986, p. 75). Given the factor market conditions of the labour-abundant Indian economy, export growth per say is unlikely contribute to employment and equity objectives of national development policy.

As already noted, an issue central to any assessment of the developmental implications of outward FDI is the possible trade off between overseas investment and domestic investment. Much faster growth of overseas FDI relative to domestic investment in the reform era could possible reflects the fact that the domestic investment is still relatively less attractive to Indian firms compared to overseas investment. To the extent that relatively less attractive domestic environment act as a push factor in outward investment, some of it could take the form of pure capital flight. Of course, this does not make a case for a restrictive policy stance towards outward FDI. Rather it makes a case for further reforms to improve the domestic investment climate.

Finally, it is important to carefully study whether the recent overseas investment and acquisition boom has been entirely driven by sound economic considerations. Some suspect that some Indian corporate giants would have simply

embarked on overseas acquisitions to outdo one another (The Economist 2009). The problems faced by Tata in recently acquired Jaguar Land Rover has have raised concerns in the international business community about the ability of MNEs from emerging markets to run western brands (*Financial Times* 2009).

7. Concluding remarks

India has a history of outward FDI dating back to the late 1950s, but total outflows remained small during the ensuing four decades. Following the liberalization reforms, outflows started to increase rapidly from about the mid-1990s. In particular, there has been a real surge in outflows since about 2005 following significant dismantling of foreign exchange restrictions on capital transfers for acquisition of foreign ventures by Indian firms during 2000-04. India's share in total outward FDI of developing countries increased from below 0.5% in the early 1990s to over 6% during 2006-7. Some of the Indian firms are now among the strongest of the EMNEs.

The fact that Indian MNEs have emerged against the backdrop of a long standing import-substitution regime does not necessarily imply that a protected home market provided breeding grounds for successful global expansion of local firms; precedence does not necessarily imply causation. Industrialisation process in India had begun long before the country attained independence in 1947. There are of course some isolated cases of domestic firms developing market niches benefiting specific patent right legislation and entry barriers imposed on foreign firms. But, overall it remains a matter of speculation what would have been India's economic destiny and the role of India's big businesses if the process of economic reforms initiated in 1991 had been embraced by the political leadership much earlier or the post-independent government provided a setting for the continuation of private-sector led industrial expansion as envisage in the Bombay plan.

Notwithstanding the rapid global spread in recent years, Indian MNEs are still at the formative stage of their global operations. There competitive edge is still largely based on country specific, rather than firm specific, advantages, although there are some isolated cases of companies developing their own firm specific advantages.

Overall, they seem to be complementary to, rather than directly competing with, developed-country MNEs in their global operation.

National gains from the overseas expansion of Indian MNEs remain an important area for research. Of particular relevance in this connection is the possible trade off between overseas investment and domestic investment. Economic viability of new overseas acquisitions and the compatibility of emerging trends of MNE-related trade flows with the comparative advantage of the national economy are other issues with potentially significant returns to research.

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Table 1: Foreign direct investment outflows: India in a global context[1]

MEASURE Country/country group	1994-5	1999-0	2004-5	2006-7
(a) US$bn				
World	324.7	1159.9	900.5	1659.8
Developing economies	51.3	101.7	118.8	232.7
Developed economies	273.0	1055.4	767.4	1389.7
Southern Africa	1.9	0.9	1.1	5.2
Mexico	0.4	1.1	5.5	7.0
Brazil	0.9	2.0	6.2	17.6
China[2]	2.0	1.3	8.9	21.8
India	0.1	0.3	2.6	13.2
(b) Share in total world outflows				
Developing economies	15.8	8.8	13.2	14.0
Developed economies	84.1	91.0	85.2	83.7
Southern Africa	0.6	0.1	0.1	0.3
Mexico	0.1	0.1	0.6	0.4
Brazil	0.3	0.2	0.7	1.1
China[2]	0.6	0.1	1.0	1.3
India	0.0	0.0	0.3	0.8
(c) Share in developing country outflows				
Southern Africa	3.6	0.9	1.0	2.2
Mexico	0.8	1.1	4.6	3.0
Brazil	1.7	2.0	5.2	7.6
China[2]	3.9	1.3	7.5	9.4
India	0.2	0.3	2.2	5.7
(d) FDI outflows as % of gross domestic capital formation				
World	5.3	17.2	9.8	14.2
Developed economies	5.8	20.3	11.7	18.0
Developing economies	3.8	6.7	4.8	6.5
Southern Africa	6.7	3.6	2.7	5.4
Mexico	0.4	1.1	3.6	3.7
Brazil	0.7	1.9	5.5	3.6
China[2]	0.9	0.4	1.0	1.7
India	0.1	0.3	1.2	4.4

1 Two-year averages
2. Excluding Hong Kong, Macao and Taiwan
Source: Compiled from UNCTAD World Investment Report database.

Table 2: Geographical distribution of approved outward foreign direct investment (%)[1]

	Up to 1990	1991-95	1996-02	2002-06
Developing countries	86.1	63.8	63.3	46.2
South-East and East Asia	36.3	26.0	11.0	12.8
South Asia	9.4	8.1	2.6	0.9
Africa	17.0	8.6	11.5	13.5
West Asia	9.7	13.0	6.4	4.4
Centra Africa	10.4	1.9	0.6	1.2
Central and Eastern Europe	3.0	5.1	27.3	9.3
Latin America and the Caribbean	0.3	1.1	4.0	3.9
Developed countries	13.9	35.0	36.7	53.8
Western Europe	7.8	20.4	12.3	35.2
North America	6.1	15.1	24.2	14.1
Total	100	100	100	100
Total, US$ million	222	734	6403	11587

Note: 1. Data are on the basis of Indian financial year.
Source: Compiled from Kumar 2008, Table 3.

Table 3: Approved outward foreign direct investment by broad economic category, 1999/0 – 2007/8 (%)

	1999/0	2000/1	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7	2007/8	1999- 2008
Manufacturing	31.2	26.8	73.1	71.9	52.8	72.3	59.9	24.9	43.7	42.7
Financial services	0.2	1.2	1.6	0.1	2.4	0.3	5.9	0.2	0.2	0.7
Non-financial services	65.1	63.4	18.7	19.1	30.2	19.5	24.8	54.7	12.1	30.3
Trading	3.3	6.5	4.6	4.8	5.3	2.5	4.7	8.3	3.2	5.1
Other	0.1	2.1	2.0	4.2	9.2	5.4	4.7	12.0	40.7	21.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	1767	1406	3051	1464	1430	2781	2866	15053	22480	52299

Note: 1. Data are on the basis of Indian financial year.
Source: Compiled from Reserve Bank of India, Annual Report (various years)

Table 4: Geographical distribution of foreign acquisition by major sectors/industry, 2001-2006 (number of firms)

	Information technology	Pharmaceuticals /health care	Automotive	Chemicals	Consumer goods	Metal and mining	Oil and Gas	Other	Total	
									Total	%
Africa	0	1	0	3	1	0	6	2	13	4.2
Australia	2	0	0	1	0	8	1	2	14	4.5
Canada	0	1	0	0	0	0	0	2	3	1.0
China	1	1	2	1	0	0	1	2	8	2.6
Europe	15	30	13	2	3	3	0	15	81	26.2
UK	10	6	5	1	5	1	0	12	40	12.9
Japan	0	1	0	0	0	0	0	0	1	0.3
Latin America	2	5	0	3	0	0	1	0	11	3.6
Middle east	2	0	0	0	0	0	0	0	2	0.6
Russia	0	0	0	0	0	0	1	1	2	0.6
South Asia	0	0	0	1	1	0	2	1	5	1.6
Southeast Asia	8	0	1	2	1	3	0	4	19	6.1
USA	51	17	4	4	4	0	1	20	101	32.7
Other	1	0	2	1	2	0	1	2	9	2.9
Total	92	62	27	19	17	15	14	63	309	100.0

Source FICCI (2006)

Table 5: Sectoral composition of foreign acquisitions by Indian firms, 2001-2006

	Total number of acquisition	Acquisitions for which values are available				
		Number	%	Value, S$mn	%	Average value
Information technology	160	105	46.1	2351	24.3	22.4
Pharmaceuticals and heath care	51	23	10.1	1571	16.3	68.3
Automotive	26	13	5.7	358	3.7	27.5
Steel	9	8	3.5	1079	11.2	134.9
Metal and minerals	7	5	2.2	129	1.3	25.8
Petroleum and natural gas	13	6	2.6	1445	15.0	240.8
Chemicals	24	17	7.5	316	3.3	18.6
Telecommunication	5	5	2.2	638	6.6	127.6
Consumer goods[1]	41	25	11.0	1297	13.4	51.9
Othe2r	35	21	9.2	472	4.9	22.5
Total	371	228	100.0	9656	100.0	42.4

1. Includes textiles, electrical goods, cosmetics and toiletries, and food and beverages.
2. Include hotels, financial services and non-financial services (meadia, publishing, shipping etc.)

Source: CMIE

Table 7 : Major acquisitions by Indian companies, 2000-2009 June

	Target firm	Country	Value ($ million)	Year
Metal and metal products				
Tata steel	Corus Steel	UK	12100	2007
Tata steel	Millenium Steel	Thailand	175	2005
tata steel	NatSteel Asia	Singapore	384	2004
Hindalco (Adithya Birla)	Novelis	USA	6000	2007
Ispat Industries	Finmetal Holdings	Bulgaria	300	2005
Phamaceuticals				
Dr Reddy's	Betapharm GmbH	Germany	570	2006
Ranbaxy Laboratories	Terapia SA	Romania	324	2006
Matrix Laboratories	Docpharma NV	Belgium	235	2005
Chemicles				
Tata Chmicals	Brunner Mond	UK	177	2005
Reliance Industries	Trevira GMbH	Germany	95	2004
Automobiles				
Tata Motors	Daewoo Commercial Vehicles	South Korea	102	2004
Tata Motors	jaguar and land Rover	UK	2500	2008
Tata Motors	Hispano Carrocera	Spain	16	2005
Bharat Forge	Federal Forge	USA		2005
Bharat Forge	Carl Dan Peddinghaus	Germany	49	2003
Mahindra & Mahindra	Jiangling Tractor	China	8	2004
Mahindra & Mahindra	stokes group	UK	15	2006
Consumer goods				
Kraft Foods Ltd.	United Biscuits	UK	522	2006
Tata Tea	Tetley Group	UK	431	2000
Tata Tea	Good earth	USA	50	2005
tata Tea and tata Sons	Glaceau	USA	677	2006
Tata Coffee	Eight Oçlock Coffee	USA	220	2006
United Spirit	White & Mackay	UK	1110	2007
Power generation and electronic engineering				

Suzlon Energy	Haasen Tranmissions	Belgium	565	2006
Suzlon Energy	Repower Systems	Germany	1700	2006
Videocon International	Thomson SA	Europe/China/Mexico	289	2005
Opto Circuits India Ltd.	Eurocor GmbH	Germany	600	2005
Information and communication technology				
Wipro Ltd.	Infocrossing	USA	600	2007
I-Flex Solutions	Mantas Inc	USA	113	2006
Saskan Communication Tech Ltd	Bornia Hightech	Finland	210	2006
Tata Consultancy Services	TKS Technosoft	Switzerland	80	2006
Seagate Tech Ltd.	Evault Inc.	USA	185	2006
Citrix Software Pvt Ltd	Sequoia Software	USA	185	2001
VSNL Ltd	Teleglobe International	USA	254	2005
Telecom				
Reliance Infocomm	Flag telecom	USA	191	2003
Bharati Airtel	MTN	South Africa	13000	2009
Petroleum				
ONGC Videsh	Petrobras	Brazil	1400	2006
ONGC Videsh	Greater Nile Oil Project	Sudan	766	2002
ONGC Videsh	Sakhalin-I PSA Project	Russia	323	2000
ONGC Videsh	Greater Plutonio Priject	Angola	600	2004
Other				
Ballarpur Industries Ltd	Sabha Forest Industries (pulp/paper)	Malaysia	209	2006
Tata power	PT Bumi Resources (coal mining)	Thailand	1100	2007

Source: Kumar 2008, Table 6; FICC 2006, EPW Research Foundation, Current Economic Statistical and review (various) (www.epwrf.res.in) and media reports.

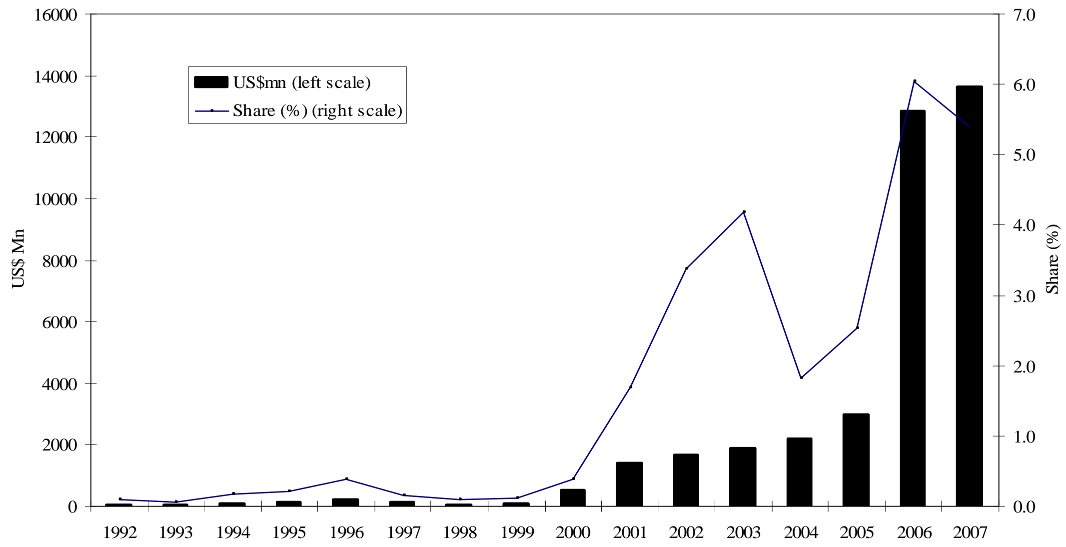
Table 8: Foreign Acquisition by developing country firms: Top 20 countries[1] in terms of total value of acquisitions, 2007-8

	US$mn	Rank	Share in developing-country acquisitions (%)	World acquisitions (%)
Singapore	26145	1	18.7	2.3
United Arab Emirates	15468	2	11.1	1.4
Russian Federation	13635	3	9.8	1.2
India	9743	4	7.0	0.9
Mexico	9430	5	6.8	0.8
Hong Kong, China	9123	6	6.5	0.8
Brazil	8026	7	5.8	0.7
Korea, Republic of	7278	8	5.2	0.6
Saudi Arabia	7110	9	5.1	0.6
China	6946	10	5.0	0.6
South Africa	5213	11	3.7	0.5
Qatar	3831	12	2.7	0.3
Argentina	3821	13	2.7	0.3
Malaysia	3533	14	2.5	0.3
Egypt	2760	15	2.0	0.2
Kazakhstan	2245	16	1.6	0.2
Turkey	1665	17	1.2	0.1
Bahrain	1609	18	1.2	0.1
Chile	1114	19	0.8	0.1
Taiwan Province of China	1047	20	0.8	0.1
Meme item				
Total world acquisitions, US$ mn	1129195			
Developing-country acquisitions, US$ mn	139 578			
Developing country share (%	12.4			
India's ranking in the world	17			

1. Excluding tax-haven countries

Source: Compiled from UNCTAD, World Investment Report database.

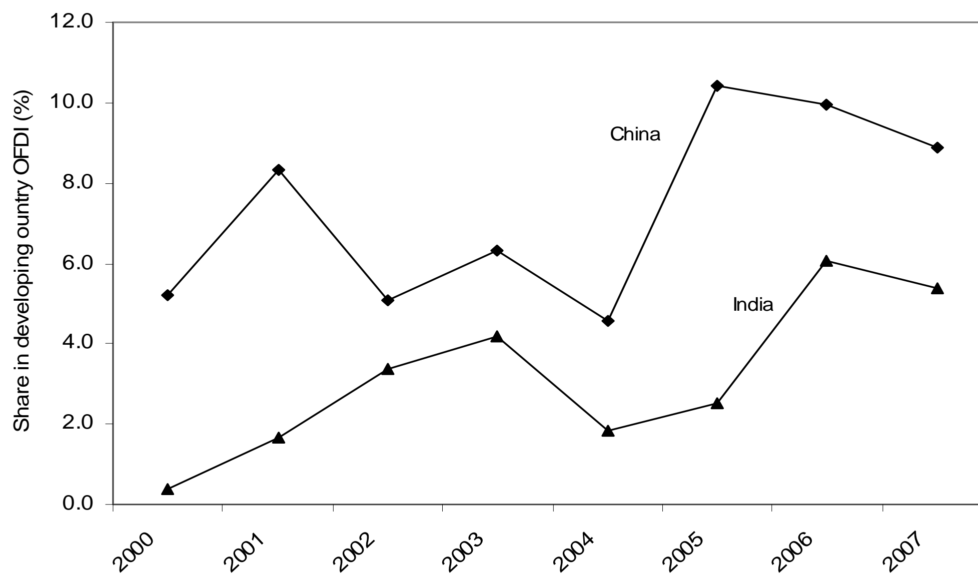
Figure 1: Indian outward foreign direct investment: value (US$bn) and share in outward flows from developing countries, 1992-2007



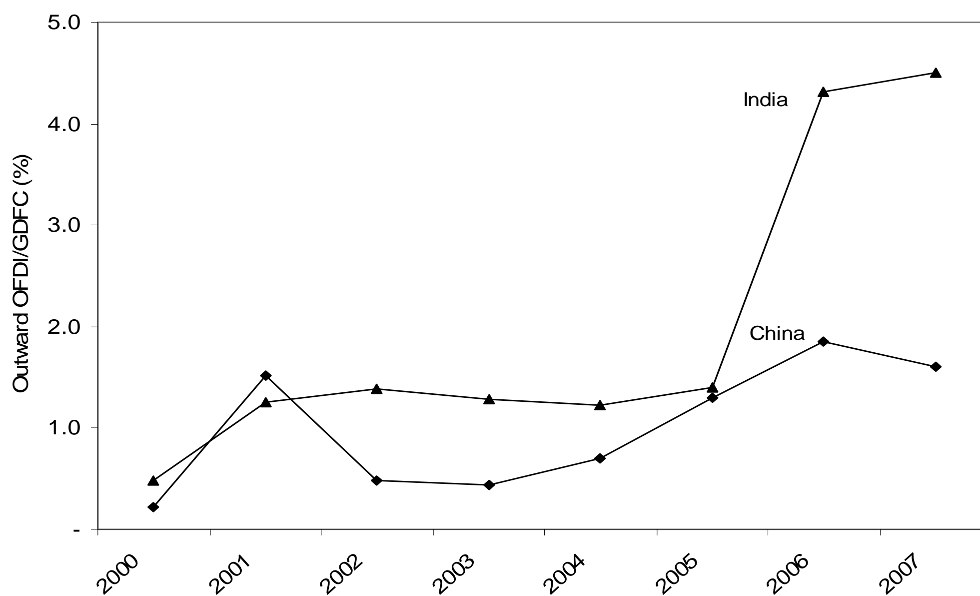
Source: Based on data from UNCTAD, World Investment Report database

Figure 2: Outward foreign direct investment (OFDI) from China and India, 2000-07

(a) As a percentage of developing-country OFDI

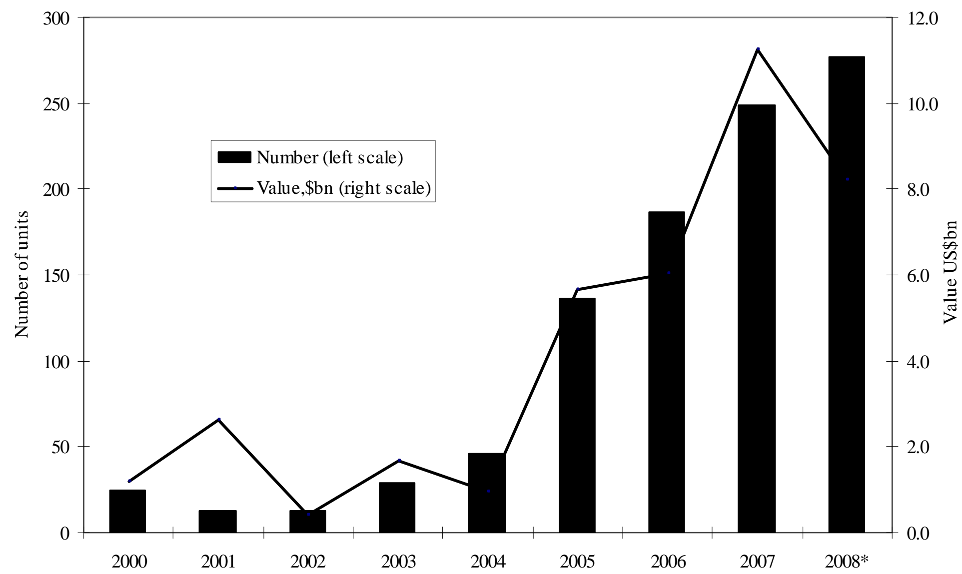


(b) As a percentage of gross domestic capital formation



Source: based on data compiled from UNCTAD, *World Investment Report* database

Figure 3: Foreign acquisitions by Indian companies, 2000-2008



* Value figures are for the first half of the year
Source: Number: FICCI 2007 and *Economist* (2009; value: UNCTAD, World Investment Report database

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