Outward Foreign Direct Investment from India

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This paper examines emerging patterns and economic implications of Indian foreign direct investment against the backdrop of the evolving role of developing country firms (emerging multinational enterprises) as an important force of economic globalization. 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 internationalization of domestic companies and the nature of their global operations. The findings cast doubt on the popular perception of the recent surge in outward foreign direct investment from India as an unmixed economic blessing, given the remaining distortion in the domestic investment climate.

I. INTRODUCTION

Foreign direct investment (FDI) by developing country firms has evolved into an important force of economic globalization over the past three decades. From the late 1960s, when the sprouting of these new investors called emerging multinational enterprises (EMNEs) was first recognized, until about the late 1980s, the bulk of their investment was in developing countries. The competitive advantage of EMNEs came largely from managerial practices and technologies that were adapted to operate 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 embracing of market-oriented economic policies, and the accompanying changes in world market forces. The number of EMNEs and their share in the total outward FDI, as well as the sophistication of their activities, has increased notably. Some of them have developed their own firm-specific assets and expanded their operations beyond their traditional domain—other

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developing countries—to developed countries. Some EMNEs have attained sales volumes and status of brand recognition on par with developed country multinational enterprises (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, 3) 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 in the South–South policy dialogue at the time, host developing countries generally favored EMNEs over developed country MNEs. The transfer of technology from developing country to developing country often highlighted in development policy circles is a concrete example of South–South cooperation (Athukorala and Jayasuriya 1988). These considerations have lost much of their policy relevance since the 1990s as most countries embraced global economic integration as the basic tenet of their development strategy. In a world of reduced political tensions, most host countries now make decisions on foreign investment based on economic grounds rather than on nationality. In this context, the focus of the recent literature has shifted from treating EMNEs as special actors of third-world development and solidarity to studying them as agents of economic globalization. Consequently, there has been a renewed emphasis on examining their operations from a "home 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 the growth and structural transformation of their home countries through an in-depth case study of the Indian experiences. India provides an interesting case study given the long history of involvement of Indian firms in overseas investment and significant policy shifts affecting 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 focus on the implications of changes in domestic investment environment and policy shifts for the internationalization 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.

[1]Lall (1983) 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 (2008b).

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

The paper is structured as follows: Section II provides the context for the ensuing analysis. It traces the historical roots of entrepreneurial skills and surveys changes in government policy relating to outward FDI in the context of major shifts in trade and investment policy regimes. Section III examines the trends and patterns of outward FDI from India from a comparative perspective. Section IV deals with sources of competitive advantages of Indian MNEs. Section V then discusses the main drivers of their overseas expansion. Section VI discusses the implications of outward FDI for the national economy. The final section offers some concluding remarks.

II. HISTORICAL SETTING AND POLICY TRENDS

An understanding of the historical roots of entrepreneurial talents is needed in order to understand the process of internationalization 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 liberalization reforms initiated in 1991. However, the process of industrialization in the post-independence era began not from an industrial vacuum but against the backdrop of a distinct process of economic change and industrialization during the colonial era (Little 1982, Tomlinson 1993). Most of the large business houses had entrepreneurial and technical capabilities that were built through many decades before independence in 1947.

The British rule caused a setback in some activities of Indian merchants and commercial capitalists, but it did not suppress all of them for long. Even though Indian businessmen 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 nineteenth century, Jaksetic Tata had successfully established the Empress and Swadeshi Cotton Mills and had ventured into iron and steel manufacturing. By the first decade of the twentieth century, the cotton textile industry, centered in Bombay and Ahmedabad, was well established as the most important manufacturing industry in India. Fly-shuttle looms and rayon and other artificial fibers were integral parts of the technological base of the Indian textile industry in the interwar years. The Tata Steel Company, the premier industrial enterprise of colonial India, started production in 1913 and expanded its operations from steel (as the major supplier) to railway construction. It set up the successful Technical Institute in 1921 and the Indian-staffed Research and Control Laboratory in 1937. During the last three decades of British rule, the industrialization process was dominated by a diffuse group of Indian entrepreneurs from many different communities. These business groups expanded their activities, exploited the opportunities presented by the decline in the Calcutta colonial firms, and responded to the new patterns of demand and supply brought about by the depression and its aftermath. Beginning with traditional products such as 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). The manufacturing industry grew at an annual rate of over 5 percent during the period 1900 to 1939 (Little 1982). In 1945, India was the tenth largest producer of manufactured goods in the world (Tomlinson 1993).

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

However, these hopes were dashed when the new political leadership rapidly embarked on a strategy of state-led industrialization under central planning (Panagariya 2008). A solid regulatory regime to control industry and foreign capital was mandated by the Industrial Development and Control Act passed in 1951. The Act set up provisions for the licensing of all existing and new industrial units or substantial expansions. It ushered in an era of "expansion by stealth" for private enterprise, an era in which business success depended on the ability to find ways of dealing with the "license 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 that relied extensively on quantitative restrictions.

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 Restrictive Trade Practices (MRTP) Act, which imposed strong measures to curb the economic power of top business houses.[3] The MRTP Act meant a tighter investment regime for the larger houses, i.e., tightening of licensing and controls over interlocking directorships. All firms exceeding a certain asset base were restricted from entry into almost all sectors of industry. Even the expansion of existing plants required permission from the government on a case-by-case basis.

During this period, government policy toward 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 interministerial committee on joint venture for approval. Overseas investment was permitted only in minority-owned

[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, 20)

joint ventures, unless the foreign government and foreign party desired otherwise. As regards 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 that purpose. When equity generated via machinery export was inadequate and equity holdings of a higher level were 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. It was stipulated that all service fees and royalties, and 50 percent of declared dividends, should be remitted to the parent companies in India. All project proposals were screened on a case-by-case basis and only those that promised quick payoffs in the form of exports were approved.

Some liberalization of trade and investment policy regimes took place during the period 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 liberalized in the 1980s, but the basic rationale 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 capitalization of service fees and royalties to meet equity participation. Indian companies were permitted to raise foreign currency loans abroad and to grant loans to their foreign joint ventures with Indian parent companies. In some cases, direct cash remittances to joint ventures were also permitted.

The liberalization-cum-structural adjustment reforms initiated in 1991 marked a clear departure from the dirigiste economy. The reforms, encompassing industrial deregulation, trade liberalization, and relaxation of regulations governing FDI and foreign technology, subjected Indian industry to a major restructuring. Much of the emerging competitiveness of Indian firms in the world market can be traced back to this process. In particular, the capacity to compete with foreign firms and face import competition in the domestic market was instrumental in building Indian firms' confidence to compete with foreign firms in world markets (Gopinath 2007, 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 \$4 million. The authority for approval of proposals up to \$15 million was vested in the Reserve Bank of India, but proposals of more than \$15 million still had to be approved by the Minister of Finance. In 2002, the upper limit for automatic approval was raised to \$100 million per annum, of which 50 percent could be obtained from any authorized dealer of foreign exchange. In 2004, firms were allowed to invest up to 100 percent of their net worth under the automatic route. In 2005, this limit was raised to 200 percent of net worth, prior approval from the Reserve Bank of India was dispensed with, and firms were permitted to remit transfer funds through any authorized foreign exchange dealer. Indian firms' access to international financial markets was also progressively liberalized and they were granted permission to use special purpose vehicles in international capital markets to finance acquisitions abroad (FICCI 2006).

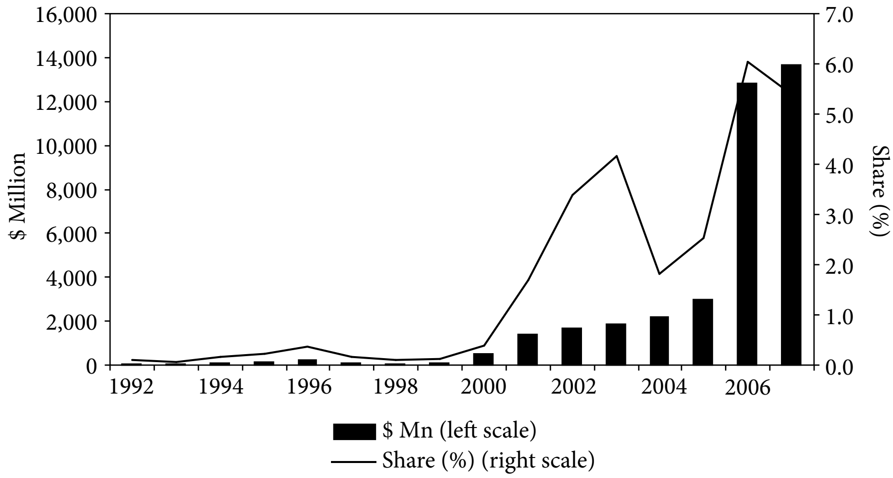
III. FDI BY INDIAN FIRMS IN A GLOBAL CONTEXT

The first overseas Indian venture was a textile mill set up in Ethiopia in 1959 by the Birla Group of companies, India's second largest business conglomerate at the time (Kudaisya 2003). The following year, the Birla Group set up an engineering unit in Kenya. Sustained growth in Indian overseas investment could be seen starting around the late 1970s when the industrial licensing system became much more stringent as part of the government's move to control big businesses. By 1983, there were 140 foreign investment projects in operation and another 88 in various stages of implementation (Lall 1986). The 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 during the period 1975–1990/1991 amounted to only $220 million.

The second wave of internationalization of Indian firms began from about 1995 and gathered momentum as foreign exchange restrictions on capital transfers for overseas acquisitions liberalized in successive stages from 2000 (Nagaraj 2006). There was a surge in outward investment from 2005. The number of approved projects increased from 220 in 1990/1991 to 395 in 1999/2000 and to 1,595 in 2007/2008 (Kumar 2008). Total FDI outflow from India increased from about $25 million in the early 1990s to nearly $14 billion in 2007. India's share in total developing economy FDI outflows remained below 0.5 percent throughout the 1990s, but increased continuously since, reaching nearly 6.0% in 2007 (see Table 1 and Figure 1). India remains a net FDI recipient, even though the gap between outflows and inflows has been sharply narrowing over the past few years. In 1990, annual outflows, on average, amounted to 7 percent of inflows. This increased from about 30 percent to 60 percent between 2000–2005 and 2005–2007.[4]

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

Figure 1. **Indian Outward FDI: Value and Share in Outward Flows from Developing Economies, 1992–2007**



FDI = foreign direct investment.
Source: Based on data from UNCTAD, *World Investment Report* database, downloaded 22 March 2009.

The data in Table 1 help in understanding 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 economies was the lowest compared to the four large emerging market economies used as comparators (Brazil, People's Republic of China [PRC], Mexico, and South Africa). Over the ensuing years, India's share has grown faster than those of the comparators. In 2004–2005, it surpassed that of South Africa and in 2006–2007, it surpassed that of Mexico. The share of FDI outflows in gross domestic capital formation (GDCF) in India has likewise increased much faster than the other four economies and the average for all developing economies during the period 1994–2007.

Figure 2 compares the outward FDI from the PRC and India in terms of the percentage contribution to total developing economy outward FDI and relative to GDCF in each economy. During 2006–2007, on average, the PRC accounted for 7.3 percent of the total outward FDI from developing countries compared to 3.2 percent for India, although the gap has been narrowing over the years. By contrast, relative to GDCF, outward FDI from India on average is larger compared to that from the PRC. The difference widened sharply following the significant liberalization of the outward FDI regime in India during 2004–2005. During 2005–2006, the contribution of outward FDI to GDCF in India (4.4 percent) was more than twice as large as that of the PRC (1.7 percent).

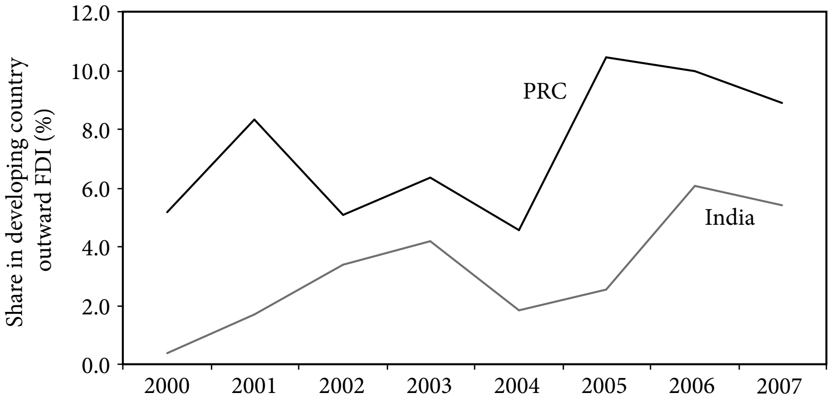
Table 1. **Foreign Direct Investment Outflows: India in a Global Context**[a]

Measure **Economy/Economy Group**	**1994–1995**	**1999–2000**	**2004–2005**	**2006–2007**
(a) $ billion				
World	324.7	1,159.9	900.5	1,659.8
Developed economies	273.0	1,055.4	767.4	1,389.7
Developing economies	51.3	101.7	118.8	232.7
South 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, People's Rep. of[b]	2.0	1.3	8.9	21.8
India	0.1	0.3	2.6	13.2
(b) Share in total world outflows (%)				
Developed economies	84.1	91.0	85.2	83.7
Developing economies	15.8	8.8	13.2	14.0
South 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, People's Rep. of[b]	0.6	0.1	1.0	1.3
India	nil[c]	nil[c]	0.3	0.8
(c) Share in developing economy outflows (%)				
South 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, People's Rep. of[b]	3.9	1.3	7.5	9.4
India	0.2	0.3	2.2	5.7
(d) Share in 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
South 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, People's Rep. of[b]	0.9	0.4	1.0	1.7
India	0.1	0.3	1.2	4.4

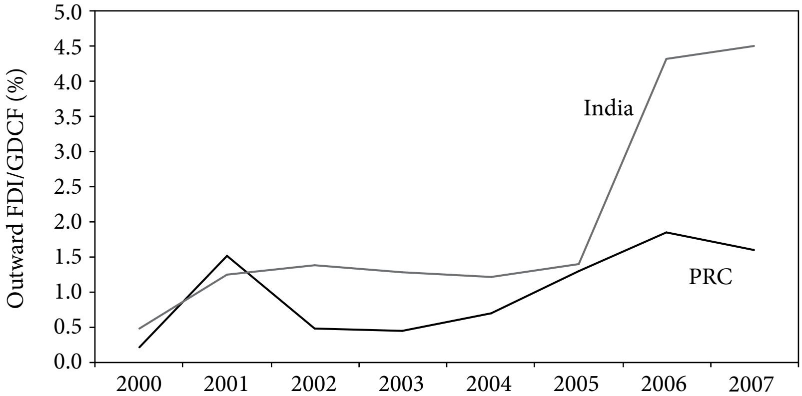
[a]Two-year averages.
[b]Excluding Hong Kong, China; Macau SAR of the People's Republic of China; and Taipei,China.
[c]Less than 0.05.
Source: Compiled from UNCTAD, *World Investment Report* database, downloaded 22 March 2009.

Figure 2. **Outward FDI from the PRC and India, 2000–2007**

(a) As a Percentage of Developing Economy Outward FDI



(b) As a Percentage of Gross Domestic Capital Formation



FDI = foreign direct investment; GDCF = gross domestic capital formation;
PRC = People's Republic of China.

Source: Based on data compiled from UNCTAD, *World Investment Report* database, downloaded 22 March 2009.

A. Geographical Distribution

A general characteristic of EMNEs in the 1970s and 1980s was their heavy concentration in developing countries. Moreover, the bulk of their FDI was intraregional, mostly in neighboring 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 spanned West and East Africa, Middle East, and South and East Asia relying on the Indian diaspora in these economies; India shared with these economies a colonial heritage and familiarity with operating within restrictive trade and investment policy regimes. In contrast, operations of EMNEs from the East Asian economies and those from Latin American economies remained heavily concentrated in neighboring economies 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 encompassing developed and transitional economies (see Table 2). The developed economy share of approved investment of Indian MNEs increased from around 35 percent in the early 1990s to more than 53 percent by 2002–2006. Much of this diversification has resulted from acquisitions rather than greenfield investment (investment in newly established firms). Developed economies accounted for over 80 percent of the total number of Indian acquisitions during the period 2000–2006, a share much higher than that in total FDI. One third of these acquisitions were in the United States (US) and two thirds were in Europe, with the United Kingdom alone accounting for about half of European acquisitions. The relative importance of developed and developing economy markets, however, varies significantly among product categories.[5] In standard manufacturing products (such as automobiles, textiles, and chemicals), developing and transitional economies are the major hosts. Developed economies are important mostly for new dynamic product lines such as information technology (IT) support and related activities, whereas the competitive advantages of Indian companies are labor and managerial cost (Ramamurti and Singh forthcoming). Indian MNEs that operate abroad in order to exploit their local technological advantages set up plants predominantly in developing economies. In contrast, firms built on domestic labor cost advantage and managerial talents target developed economies. These firms also invest in other emerging economies, not so much to serve these markets as to broaden the number of low-cost countries from which they can serve rich country markets.

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

Table 2. **Geographical Distribution of Approved Outward Foreign Direct Investment by India (%)**

	Up to 1990	1991–1995	1996–2002	2002–2006
Developing Economies	86.1	63.8	63.3	46.2
Southeast 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
Central 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 Economies	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, $ million	222	734	6,403	11,587

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

B. Sectoral Composition

During the three decades beginning in the late 1960s, more than 80 percent of Indian FDI was in manufacturing (Lall 1982b, 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 outward FDI compared to outward FDI by Brazil and the PRC (Goldstein 2008a).

The period from about 2004 to 2008 has seen a notable diversification in the sectoral/industry composition of overseas activities of Indian firms. The share of manufacturing in total approved capital declined from 72.3 percent in 2004–2005 to 43.7 percent in 2007–2008 (Table 3). There has been a notable increase in services-related FDI; disaggregated data (not reported here for brevity) show that the major areas of concentration within manufacturing are pharmaceuticals, automotive, consumer goods, chemicals, and fertilizer.

Table 3. **Approved Indian Outward Foreign Direct Investment by Broad Economic Category, 1999/2000–2007/2008 (%)**

Category	**1999/2000**	**2000/2001**	**2001/2002**	**2002/2003**	**2003/2004**	**2004/2005**	**2005/2006**	**2006/2007**	**2007/2008**	**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
	1,767	1,406	3,051	1,464	1,430	2,781	2,866	15,053	22,480	52,299

Note: Data are on the basis of Indian financial year.

Source: Compiled from Reserve Bank of India, *Annual Report* (various years).

C. Entry Modes

Until about the mid-1990s, greenfield investment was the norm for the overseas operations of Indian firms. 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 ventures, usually with minority ownership. Moreover, reflecting foreign exchange restrictions on capital outflows, 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 acquisitions (see Tables 4, 5, and 6; Figure 3). The total number of acquisitions increased from 25 in 2000 to 277 in 2008. During the period 2005–2008, the value of total acquisitions amounted to $22 billion, about 80 percent of India's total reported FDI outflows.

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

In recent years, foreign acquisitions by Indian firms have increased at a much faster rate compared to the average developing country experience. In 2007–2008, India ranked as the fourth largest overseas business acquirer among developing and transitional economies after Singapore, United Arab Emirates, and Russia. India's share in total value of developing economy acquisitions (7.0 percent) was larger than those of the PRC (5.0 percent) and Brazil (5.8 percent). It was the seventeenth largest business acquirer in the world in addition to its high rank among developing and transitional economies, surpassing a number of OECD countries (see Table 6).

Table 4. **Geographical Distribution of Foreign Acquisition by Major Sectors/Industry, 2001–2006 (number of firms)**

Economy/Region	**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, People's Rep. of	1	1	2	1	0	0	1	2	8	2.6
Europe	15	30	13	2	3	3	0	15	81	26.2
United Kingdom	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
United States	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

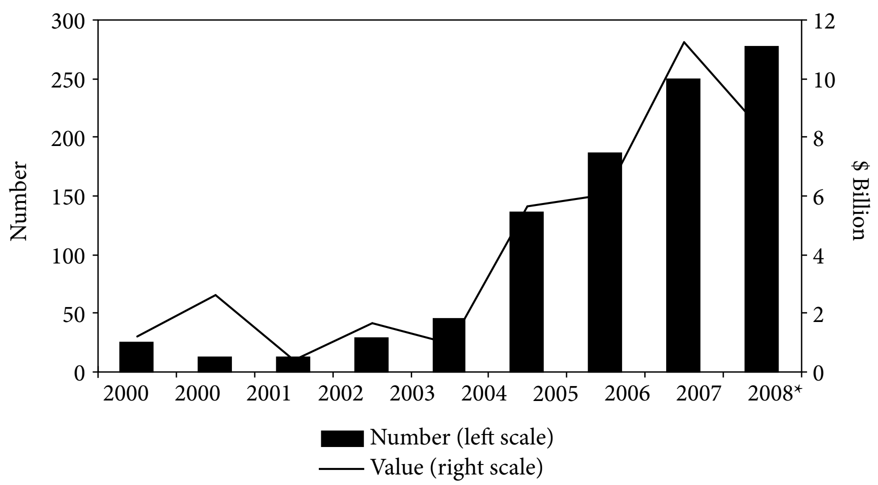
Source: FICCI (2006).

Table 5. **Sectoral Composition of Foreign Acquisitions by Indian Firms, 2001–2006**

	Total Number of Acquisitions	Acquisitions for which Values are Available				
		Number	%	Value, $ Million	%	Average Value
Information Technology	160	105	46.1	2,351	24.3	22.4
Pharmaceuticals and Health Care	51	23	10.1	1,571	16.3	68.3
Automotive	26	13	5.7	358	3.7	27.5
Steel	9	8	3.5	1,079	11.2	134.9
Metal and Minerals	7	5	2.2	129	1.3	25.8
Petroleum and Natural Gas	13	6	2.6	1,445	15.0	240.8
Chemicals	24	17	7.5	316	3.3	18.6
Telecommunications	5	5	2.2	638	6.6	127.6
Consumer Goods[a]	41	25	11.0	1,297	13.4	51.9
Other[b]	35	21	9.2	472	4.9	22.5
Total	371	228	100.0	9,656	100.0	42.4

[a]Includes textiles, electrical goods, cosmetics and toiletries, and food and beverages.
[b]Includes hotels, financial services, and non-financial services (media, publishing, shipping).
Source: CMIE (2007).

Figure 3. **Foreign Acquisitions by Indian Companies, 2000–2008**



* Value figures are for the first half of the year.
Sources: FICCI (2007), *Economist* (2009). Value: UNCTAD, *World Investment Report* database, downloaded 22 March 2009.

Table 6. **Foreign Acquisitions by Developing Economy Firms: Top 20 Economies[a] in Terms of Total Value of Acquisitions, 2007–2008**

Economy	$ Million	Rank	Share in	
			Developing Economy Acquisitions (%)	World Acquisitions (%)
Singapore	26,145	1	18.7	2.3
United Arab Emirates	15,468	2	11.1	1.4
Russia	13,635	3	9.8	1.2
India	9,743	4	7.0	0.9
Mexico	9,430	5	6.8	0.8
Hong Kong, China	9,123	6	6.5	0.8
Brazil	8,026	7	5.8	0.7
Korea, Republic of	7,278	8	5.2	0.6
Saudi Arabia	7,110	9	5.1	0.6
China, People's Rep. of	6,946	10	5.0	0.6
South Africa	5,213	11	3.7	0.5
Qatar	3,831	12	2.7	0.3
Argentina	3,821	13	2.7	0.3
Malaysia	3,533	14	2.5	0.3
Egypt	2,760	15	2.0	0.2
Kazakhstan	2,245	16	1.6	0.2
Turkey	1,665	17	1.2	0.1
Bahrain	1,609	18	1.2	0.1
Chile	1,114	19	0.8	0.1
Taipei,China	1,047	20	0.8	0.1
Item				
Total world acquisitions, $ million	1,129,195			
Developing economy acquisitions, $ million	139,578			
Developing economy share (%)	12.4			
India's ranking in the world	17			

[a]Excluding tax-haven countries.

Source: Compiled from UNCTAD, *World Investment Report* database, downloaded 22 March 2009.

Unlike the case of outward FDI from the PRC, where more than two thirds of outward FDI is state-owned or state-controlled, Indian outward FDI is predominantly a private sector activity. There were several prominent state-owned enterprises among the overseas investors until about the mid-1980s, namely, Computer Maintenance Corporation (subsequently sold to Tata Consultancy Services), Indian Drugs and Pharmaceuticals (went bankrupt), Bharat Heavy Electricals Ltd, Heavy Engineering Corporation, Bharat Heavy Plates and Vessels, Bharat Earth Movers Ltd, and Steel Authority of India. Their importance has diminished in the second wave, with the sole exception of the two state-owned corporations in the oil and gas sector (Oil and Natural Gas Corporation and Indian Oil Company).

D. Players

Many Indian overseas investors are part of large business conglomerates. Until the mid-1980s the Birla Group of companies dominated the scene. They accounted for 40 percent of shares of equity held in Indian firms. The Tata Group of companies, though larger than the Birla Group domestically, accounted for about 11 percent and Thapar Group (textile and palm oil) accounted for 7 percent (Lall 1986). These conglomerates have further expanded and consolidated their overseas operations following the liberalization reforms. Several new players have also entered the scene in recent years including the pharmaceutical giant Dr. Reddy's and IT companies such as Infosys, Ranbaxy, Reliance, and Wipro (a wind-power company) (see Table 7). However, there has been a heavy concentration of acquisition in few large firms. During the period 2000–2006, 15 firms were responsible for 98 out of 306 acquisitions and they accounted for over 80 percent of the total value of acquisitions (Goldstein 2008a, FICCI 2006).

Table 7. **Major Acquisitions by Indian Companies, 2000–June 2009**

Company	Target Firm	Country	Value ($ Million)	Year
Metal and Metal Products				
Tata Steel	Corus Steel	United Kingdom (UK)	12,100	2007
Tata Steel	Millennium Steel	Thailand	175	2005
Tata Steel	NatSteel Asia	Singapore	384	2004
Hindalco (Aditya Birla)	Novelis	United States (US)	6,000	2007
Ispat Industries	Finmetal Holdings	Bulgaria	300	2005
Pharmaceuticals				
Dr. Reddy's	Betapharm GmbH	Germany	570	2006
Ranbaxy Laboratories	Terapia SA	Romania	324	2006
Matrix Laboratories	Docpharma NV	Belgium	235	2005
Chemicals				
Tata Chemicals	Brunner Mond	UK	177	2005
Reliance Industries	Trevira GmbH	Germany	95	2004
Automobiles				
Tata Motors	Daewoo Commercial Vehicle Co	Korea, Rep. of	102	2004
Tata Motors	Jaguar and Land Rover	UK	2,500	2008
Tata Motors	Hispano Carrocera	Spain	16	2005
Bharat Forge	Federal Forge	US		2005
Bharat Forge	Carl Dan Peddinghaus	Germany	49	2003
Mahindra and Mahindra	Jiangling Tractor	China, People's Republic of (PRC)	8	2004
Mahindra and 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	US	50	2005
Tata Tea and Tata Sons	Glaceau	US	677	2006
Tata Coffee	Eight O'Clock Coffee	US	220	2006
United Spirit	White and Mackay	UK	1,110	2007

Continued

Table 7—*Continued*

Company	Target Firm	Country	Value ($ Million)	Year
Power Generation and Electronic Engineering				
Suzlon Energy	Hansen Transmissions	Belgium	565	2006
Suzlon Energy	Repower Systems	Germany	1,700	2006
Videocon International	Thomson SA	Europe/PRC/Mexico	289	2005
Opto Circuits India Ltd	Eurocor GmbH	Germany	600	2005
Information and Communications Technology				
Wipro Ltd	Infocrossing	US	600	2007
I-Flex Solutions	Mantas Inc	US	113	2006
Sasken Communication Technologies Ltd	Botnia Hightech	Finland	210	2006
Tata Consultancy Services	TKS Technosoft	Switzerland	80	2006
Seagate Technology Ltd	EVault Inc	US	185	2006
Citrix Software Pvt Ltd	Sequoia Software	US	185	2001
Videsh Sanchar Nigam Ltd	Teleglobe International	US	254	2005
Telecom				
Reliance Infocomm	Flag Telecom	US	191	2003
Bharti Airtel	MTN	South Africa	13,000	2009
Petroleum				
Oil and Natural Gas Corporation (ONGC) Videsh	Petrobras	Brazil	1,400	2006
ONGC Videsh	Greater Nile Oil Project	Sudan	766	2002
ONGC Videsh	Sakhalin-I Production Sharing Agreement Project	Russia	323	2000
ONGC Videsh	Greater Plutonio Project	Angola	600	2004
Others				
Ballarpur Industries Ltd	Sabha Forest Industries (pulp/paper)	Malaysia	209	2006
Tata Power	PT Bumi Resources (coal mining)	Thailand	1,100	2007

Sources: Kumar (2008), Table 6; FICCI (2006); Economic and Political Weekly Research Foundation reports, *Current Statistics* and *Monthly Economic Review* (various years), www.epwrf.res.in, accessed 25 July 2009; and media reports.

IV. SOURCES OF COMPETITIVE ADVANTAGE

When a firm from a 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 a set of assets or skills (proprietary assets) to give it a competitive edge over local firms. Proprietary assets are of two types: firm-specific advantages and country-specific advantages (Rugman and Doh 2008, Dunning 2000).

Firm-specific advantages are unique operational capabilities proprietary to the firm. They are intrinsic to an organization and may be built on product or process technology, marketing or distribution skills, or managerial know-how. Country-specific advantages are factors unique to the business in each home country. They can be based on natural resource endowment, on the labor force, or on less tangible factors that 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 a mix of country- and firm-specific advantages so their firms can be 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 considerable investment in the context of a large mature domestic market. Therefore, the standard proprietary asset models that were 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 an evolutionary process in their home countries. The pioneers of the literature on EMNEs therefore resorted to an eclectic approach to examining the expanding operation of these firms. This approach essentially relied on an analysis of firm behavior in the specific business environments in developing countries (Lecraw 1977, Wells 1983, Lall 1983). The consensus view was that the competitive edge lies in country-specific advantages or advantages molded by the experience of their home countries. These advantages included the ability to adapt technology to suit relative factor prices in developing countries and the small size of their markets ("technological comparative advantage," à la Diaz-Alejandro 1977); the ability to adapt original designs to local conditions such as nonavailability or prohibitive costs of raw materials, peculiarities of local consumers, the climate and geography, and small markets; the ability to complement entrepreneurial adaptation to developing country conditions; and the ability to use domestic skilled labor to design and operate projects abroad at low cost, and to lower the costs 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 of 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 range of industries, Ramamurti and Singh (forthcoming) concluded that available evidence does not lead to a very clear or strong inference of monopolistic advantages possessed by these firms. Sources of competitive advantages vary 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 greater freedom and more routes to internationalization 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 suit the particular Indian context and the availability of inexpensive but high-quality manpower—are still the major sources of competitive edge for Indian firms.

In particular, Indian pharmaceutical firms seem to have built on their capabilities through the decades when India had a weak intellectual property rights regime, which made it easier for them to copy Western drugs before their patents expired 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.

Labor and managerial cost advantage has been the major source of competitive edge for Indian IT firms in their global spread. The majority of these firms are 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; they are behind-the-scenes partners who help their customers succeed. They focus on the 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 initially 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 costs 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 contractions in activities in some of the industries, thus making it affordable to nurture and retain highly specialized skills within the firm. Infosys and Wipro also enjoyed late mover advantage relative to their Western competitors; from the beginning they could build their staff at low cost in India, whereas firms like IBM and Accenture entered offshore operations with a large share of high-cost manpower in their labor force in developed countries.

There are many product lines other than those in the IT industry in which Indian firms' competitive edge mainly emanates from their labor cost advantages. These include call center business; back-office support services, such as accounting, legal assistance, or document preparation; medical transcription; clinical trial and pharmaceutical contract research; and financial research and management consultancy research. Indian MNEs in industries including consumer goods, such as Tata Tea and Tata Coffee, and intermediate input-producing, such as Bharat Forge (motor spare parts), Tata Steel, and Hindalco (an aluminum 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, they 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 on finding projects whose equity capital commitment could be met through machinery exports and the readiness of the local counterpart to raise the required finances locally. There is evidence that the inclination of Indian firms toward projects involving small fixed capital outlays came 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 was small relative to the fixed costs involved (Lall 1986). The policy reforms in the early 2000s, implemented with the backing of the strong foreign reserve position of the country, considerably eased the financial constraint. As already discussed, the reforms have ushered in a new era of rapid globalization of Indian firms.

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

V. MOTIVES FOR OVERSEAS EXPANSION

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 undertakes overseas investment; such firms have the option of exporting from home base or simply focusing on expanding in the home country. What then are the factors that propel firms in investing abroad? The early literature provides a long list of factors: risk diversification due to uncertainty about future supplies of raw materials; buyer uncertainty resulting from lack of information to the potential buyers about firms' products and technologies; protection of export markets; circumventing protection in developed country markets or gaining preferential access to these markets; and limits to growth at home as a result of 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 that created market imperfections and distortions affecting their ability to expand, diversify, and export. Based on interviews conducted in 1982 with 17 parent companies, Lall (1986) found that the desire to escape the constraining effects of government policy was the most important motivation behind overseas investment by these firms. In particular, the firms specifically mentioned the MRTP Act as the main impetus behind their decision to invest abroad. Only one third of the firms indicated that they went abroad to open new markets and/or protect an existing one. Given the negative impact of trade and industry policies on the competitiveness of exporting from India at the time, diversification by export was not an option for Indian firms. To the extent that government policies raised costs and adversely affected 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 case history of the pioneering Birla Group, the vanguard of overseas expansion of Indian businesses, provides ample support for the proposition that the constraining effects of government policy acted as a major domestic push factor in overseas expansion (Merchant 1977, Kudaisya 2003). The Birla Group made the first move to build its overseas business empire in the late 1950s in anticipation of oncoming 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." That year, Aditya Birla (then manager of Hindalco) ventured into Thailand to set up Indo-Thai Synthetics 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 economies to trade and investment. As the business climate in India became more restrictive, the strategy of overseas expansion gained further incentive. For instance, in 1978, when Aditya Birla's application to expand the capacity of the viscose fiber plant of Gwalior Rayon was held up for 18 months, he decided to shift the proposed factory to Thailand instead.

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. FICCI (2006) has identified a number of motives including access to foreign technology, sourcing of raw materials, and aspirations for global leadership. Market access considerations were particularly important for the pharmaceutical and automotive sectors. Many of the large takeovers in the metal and metal products industries were intended to reinforce 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 increasing demand of the Indian economy has also been an important consideration.

Is the desire to escape the constraining effects of government policy still a consideration in Indian firms' decision to invest overseas? This is a question 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 a "negative reason," the phenomenon may be regarded as a disguised form of capital flight.

The policy environment for domestic operation of Indian firms has significantly improved since the early 1990s. However, what is important is the attractiveness of the domestic investment environment compared to 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 labor-intensive manufacturing products. While the "license raj" (the infamous industrial licensing policy) has been largely eliminated at the center, it still exists at the state level, along with a pervasive "inspector raj." Private investors require a large number of permissions (e.g., for electricity and water supply connections and water supply clearance) from the state governments to start business; they must also deal with 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 small companies that are unable to compete with large firms, remains a major constraint on the expansion of labor-intensive manufacturing, where India's comparative advantage in international production lies. Stringent labor laws and high corporate tax rates, restrictive labor market practices, and a weak bankruptcy framework are other prominent issues. Stringent labor laws and restrictive labor market practices are among these issues. These issues are reflected in India's poor ranking among the countries in the region—in particular among 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).

VI. ECONOMIC IMPLICATIONS

Over the past two decades, the government policy in India relating to outward FDI has made a palpable transition from the cautious and restrictive approach that prevailed over the first four decades of the post-independence era to one of facilitation and encouragement. Outward FDI is now considered an effective tool of economic advancement through harnessing global technological know-how, building trade support networks for enhancing the international competitiveness of local firms, and opening new market channels for promoting exports (Government of India 2009). The extent to which outward FDI 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), it has been found that outward FDI has a statistically significant positive effect on the degree of export orientation across an entire sample of firms (4,200) and at the level of a number of key industries. In interpreting these findings, it is important to take into account that firms with overseas operations are largely concentrated in capital- and skill-intensive industries. This will be important in further analysis because the competitive advantage underpinning the observed export success of these industries may not necessarily reflect the intrinsic comparative advantage of the country (Lall 1986). Given the market conditions of the labor-abundant Indian economy, export growth per se is unlikely to contribute to achieving the employment and equity objectives of national development policy.

As already noted, a central issue in any assessment of 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 possibly reflect the fact that domestic investment remains less attractive to Indian firms compared to overseas investment. To the extent that a relatively less attractive domestic environment acts as a push factor in outward investment, some of the investment could take the form of pure capital flight. Of course, this does not make a case for a restrictive policy stance toward outward FDI. Rather, it makes a case for further reforms to improve the domestic investment climate.

Finally, it is important to study whether the recent overseas investment and acquisition boom has been entirely driven by sound economic considerations. Some suspect that some Indian corporate giants have simply embarked on overseas acquisitions to outdo one another (*Economist* 2009). The problems faced by Tata in its recent acquisition of Jaguar and Land Rover have raised concerns in the international business community regarding the ability of MNEs from emerging markets to run Western brands (*Financial Times* 2009).

VII. 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 liberalization reforms, outflows started to increase rapidly in the mid-1990s. In particular, there has been a 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 the period 2000–2004. India's share in total outward FDI of developing countries increased from below 0.5 percent in the early 1990s to nearly 6 percent during 2006–2007. Some of the Indian firms are now among the strongest 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 is a breeding ground for successful global expansion of local firms; precedence does not necessarily imply causation. The industrialization 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 if the post-independence government had provided a conducive setting for the continuation of private sector-led industrial expansion as envisaged in the Bombay Plan.

Notwithstanding the rapid global spread in recent years, Indian MNEs are still at the formative stage of their global operations. Their 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. The 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 worth exploring for their potentially significant contributions to research.

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