Outward FDI from India: Trends and Patterns

Showket Ahmad Dar
Research Scholar, A.M.U.Department of Commerce Aligarh, U.P. 202002, India

Abstract

Outward FDI from developing economies has got due importance since last two decades. The outward FDI is considered as an effective tool of economic advancement for enhancing international competitiveness of local firms and accessing new market channels for promoting exports. Despite capital scarcity in most of developing countries, there is surge in outward FDI from many developing countries. India has also witnessed the surge in the outward FDI since1990s & particularly from 2000s. The opening of the economy to external world offered new business opportunities for Indian business enterprises which resulted in the emergence of India as a source of foreign direct investment. An increasing number of Indian firms are resorting to outward investment in order to access new technologies, skills and managerial expertise etc., from developed countries. India being a capital scare country needs huge capital for domestic economy, the outward FDI could have various implications. Keeping in view the above mentioned facts, the present paper analyses the recent trends and patterns of outward FDI & examines the implications of outward FDI on home country. The paper concludes that liberalization of Indian economy and globalisation has shifted the direction and sectoral composition of Indian overseas investment from developed to developing economies and from manufacturing to service sector respectively. The paper is analytical in nature and is based on secondary data which have been collected from World Investment Reports published by UNCTAD and RBI Annual reports.

KEYWORDS: Outward FDI, Developing Countries, India

1. Introduction

In late 1980s the developing economies have witnessed enormous increase in the number of MNCs from developed economies mainly due to the liberalization of most of the developing economies especially East Asian economies, china and India. The MNCs were welcomed in developing countries and host governments formulated friendlier and encouraging policies so as to attract more FDI, as FDI is considered as an important vehicle for economic development. FDI brings various benefits such as superior technology; know how, information of new markets and capital. The presences of MNCs in host markets have created the intense competition; hence make the domestic enterprises to think to formulate policies and strategies for the survival in the market. The increased competitive pressure from... foreign firms have forced Indian business enterprises to change their business strategy despite overwhelmed by domestic market based business expansion and moved towards a strategy of global market business expansion. They realized that in an increasingly liberalizing and globalizing economy, domestic market alone cannot ensure firms survival and growth (Pradhan, 2005).

The outward FDI from India prior to liberalization was marginally low and major shift took place only after liberalization where we witnessed a remarkable increase in it. The possible reasons for such overseas investment were restrictive and discouraging policies of Indian government. As stated by (Satyanand and Raghavendam, 2010) that Indian firms began to invest in overseas in the 1960s, but India's restrictive outward FDI regime limited them to small, minority joint ventures in developing economies.

In post liberalization period, India has not only witness the surge in outward FDI but major changes were also observed in the mode of entry, geographical distribution and sectoral composition of outward FDI. Prior to liberalization the outward FDI from India were mainly concentrated towards developing countries and were also used as a tool of south-south cooperation (Ranganathan, 1988). The main motives of outward FDI before 1990s were resource seeking, as outward FDI was channelized in low and middle technology manufacturing activities like fertilizers and pesticides, leather, iron and steel etc., as such manufacturing sector accounted for more than 65 per cent of outward FDI equity (Pradhan, 2005). The sectoral composition has undergone change as most of outward FDI has gone to service sector. The geographical distribution of Indian outward FDI has also changed in the course of economic liberalisation. Pre- liberalisation Indian outward FDI was concentrated largely towards developing economies in Asia and Africa and went mainly into specific manufacturing sectors where Indian firms faced little competition. Post liberalisation and particularly 2000, outward FDI flows mainly to developed countries in the form of Mergers and Acquisitions and covers a broad spectrum of manufacturing and service sectors (Singal & Jain, 2012).

The contraction in international capital and India being a capital scarce country needs to channelize its domestic capital into its own economy. As outward FDI could have adverse impact of increased external pressure due to huge debt abroad and loss of scarce financial resources which have alternative use at home. Keeping in view the above mentioned facts, in this paper an attempt has been made to examine the recent trends and patterns of outward FDI from India since 1995 and also to review the outward FDI position at the global level.

Objectives of the study:

- To study the trends in Global outward FDI in the recent past.
- To examine trends and patterns in outward FDI from India since 1995.
- To study the implications of outward FDI for developing economies especially India.

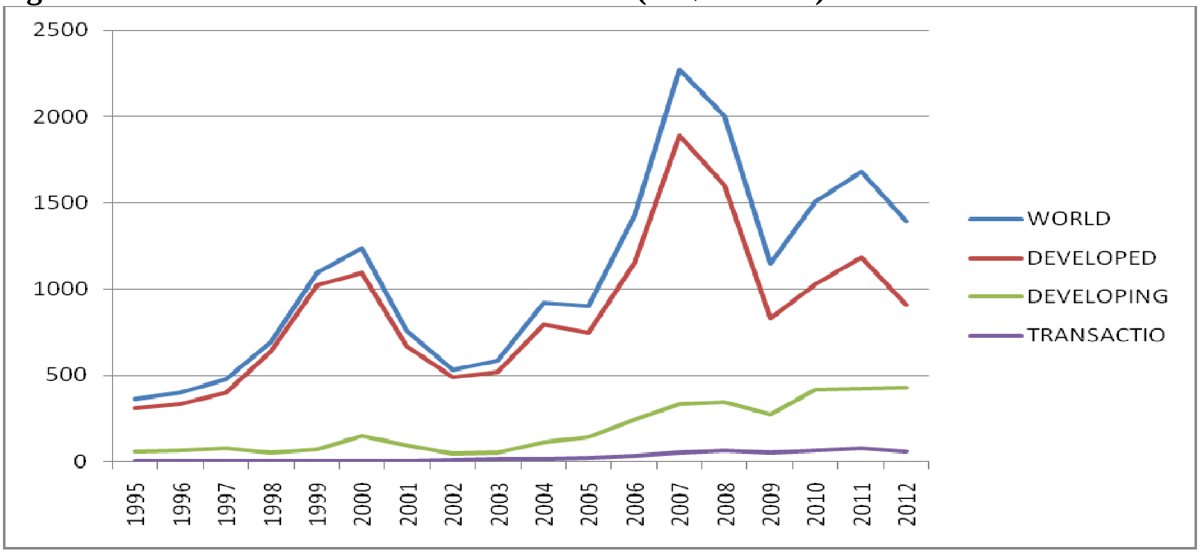
Methodology:

This study is analytical in nature and is based on secondary data source which have been mainly drawn from the published records of RBI such as RBI Bulletins, RBI Hand Book of Statistics on Indian Economy, World Investment Reports of UNCTAD. The data collected have been analysed and presented in the form of tables and pie diagrams.

2. Overview of Global Outward FDI:

The world has witnessed surge in the outward FDI since late 1980s due to the liberalization of the most of developing economies. The MNCs from developed economies took the opportunity to expand their operations and activities in the newly liberalized markets. In 1980s most of the FDI from developed countries directed towards developing counties were efficiency-seeking like, in East Asian economies & China. The global outward FDI is still dominated by the developed economies. But from 2002 onwards their share has came down due to increase in the share of developing countries. The share of developing countries has increased from 15.40 percent in 1995 to 27.40 per cent in 2010, (Figure 1)

Fig 1: Global Outward FDI from 1995-2012 (US$ Billions)



Source: UNCTAD, WIR, 2013.

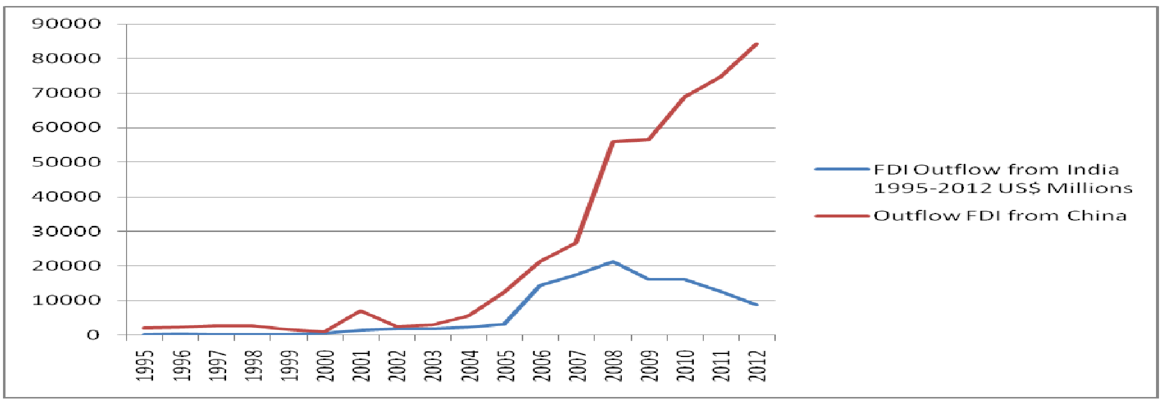
The share of developed countries had decreased from 84 per cent in 1995 to 68 per cent in 2010. The last two decades have witnessed the rise in outward FDI from transition economies as their share went up from 0.18 per cent in 1995 to 4 per cent in 2010 and have registered 22 times increase in their outward FDI. The presence of MNCs has benefited the domestic enterprises to increase their competitiveness and has also forced them to go global in order to survive which resulted in the rise of MNCs from developing countries due to both pull and push factors. The outward FDI from both developed and developing economies had been affected by the global economic ups and downs, but the outward FDI from developing economies is less affected than developed economies. After the global financial crisis there has been consistent fall in outward FDI from developed countries, but on the other hand, outward FDI from developing countries is on rise. This trend indicates the rise of new MNCs from developing counties especially from East Asia, China and India.

3.1. Outward FDI from India

India has followed the restrictive and hostile policies towards the both Outward FDI and Inward FDI for four decades after independence. The motive was to build self dependent economy, without the outside interference. As the capital is necessary for the development of economy, the Indian government discouraged the outflow of capital from the economy, due to its scarcity and necessity of capital in home economy. In early 1980s as the government started creeping liberalization, outward FDI policy were formulated by the India government which remained in place until 1992 and the outward FDI from India were motivated by two factors first, as a tool of South-South Cooperation second, maximizing economic gains at minimum possible foreign exchange costs to India. The outward FDI policy discouraged the investment flight from India, as the policy required outward FDI in the form of export of indigenous plants, machinery, and equipments required for JVs/WOSs. The basic essence of outward FDI before 1992 was inspired by the desire of using outward FDI as tool of promoting Indian exports but without offering any scope for local capital to shift transborder through cash remittances (Pradhan, 2005).

In the post liberalization period the attitude of the Indian government changed towards outward FDI, with the change in development parameters in India. In the post liberalization period as the Indian economy started to integrate in the world economy, it presented both challenges and opportunities to the domestic enterprises. On the one hand the MNCs created intense competition in the Indian market and presented challenge before the domestic enterprises for their survival as these enterprises were not in position to compete with global players, due to their lack of capital, skills and technology. On the other hand it provides opportunity to the domestic firms to learn and acquire new skills, technology and know-how. The domestic enterprises that had accumulated significant level of “created assets” were restricted from going global due to restrictive policies before liberalization; the opening up of economy provided them opportunity to materialize the benefits of these assets by going global. The first half of liberalization has not seen much rise in the outward FDI from India, as the domestic enterprises were in learning process. In 1995 India’s outward FDI was only 119 US$ million and in the wake of East Asian crisis the outward FDI from India dropped to 80 US$ million in 1999. The outward FDI from China was 8 to 18 times more than India between 1995-99, while in 2000 the gap had narrowed down to 2 times. In the first decade of 21st century outward FDI from India has seen remarkable increase, as it went up from 1397 US$ million in 2001 to 21147 US$ million in 2008 and at the same period Chinese outward FDI has went up from 6885 US$ million to 55910 US$ million and the gap between Chinese and Indian outward FDI went up again to 8 times in 2008 from 5 times in 2001 (Figure 2).

Fig 2: Outward FDI from India & China 1995-2012. (US$ Millions)



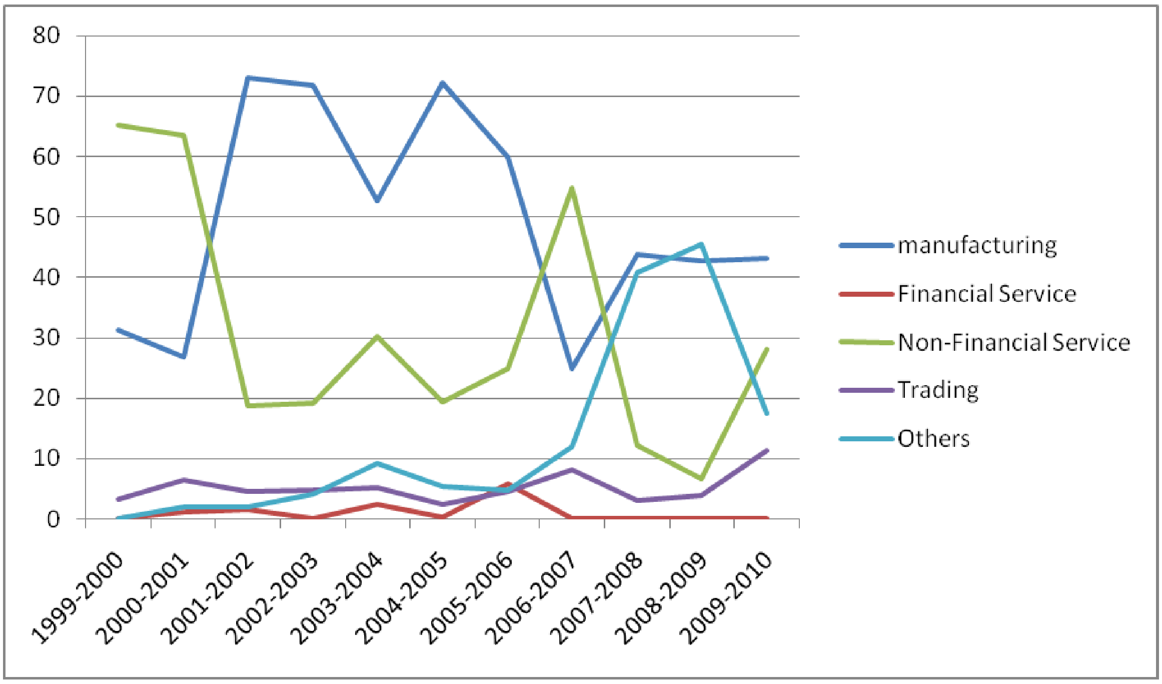
Source: UNCTAD, WIR 2012 & 2013.

The 2009 financial crisis had adversely affected the Indian outward FDI while Chinese outward FDI continued to rise. The share of outward FDI from India falls to 24 per cent in 2009 as compare to 2008 and is consistently showing a declining trend and in 2012 the outward FDI from India was only 8583 US$ million as compared to 12456 US$ millions in 2011. On the other hand Chinese outward FDI has increased to 84220 US$ millions in 2012 from 76564 US$ millions in 2011 which further increased the gap to 10 times and this gap seems to increase more in the near future.

3.2. Sectoral Distribution of Outward FDI from India

The rise of MNCs from India, in last decade has witnessed change in the motives and strategies. At the very beginning of the decade most of the Indian outward FDI was directed in non-financial services sector as it accounts for almost 65 per cent of total outward FDI while manufacturing sector accounts for 31 per cent. In 2001-02, a major shift took place in the share of non-financial service sector which dropped considerably to 19 per cent and that of share of manufacturing sector increased to 73 per cent. This trend remains throughout the last decade as the share of manufacturing shows rising trend, the non-financial services shows declining trend and vice-versa (Figure 3). The financial crisis had considerably affected the non-financial outward FDI from India as its share has dropped to 7 per cent in 2008-09 from 55 per cent in 2006-07 while the share of manufacturing has remained more or less the same at 43 per cent (Figure 4). In 2009-10 the share of non-financial services increased to 28 per cent which brought down the share of other sectors to 17 per cent from 45 per cent in 2008-09 while the share of manufacturing had shown consistency. The share of trading has remained under 10 per cent except in 2009-2010 in which it increased to 11 per cent. The rapid fluctuation in sectoral diversification reveals the changing motives and strategies of MNCs from India.

Fig 3: Sectoral Distribution of Indian outward FDI 1999-2000 to 2009-2010 (percent)

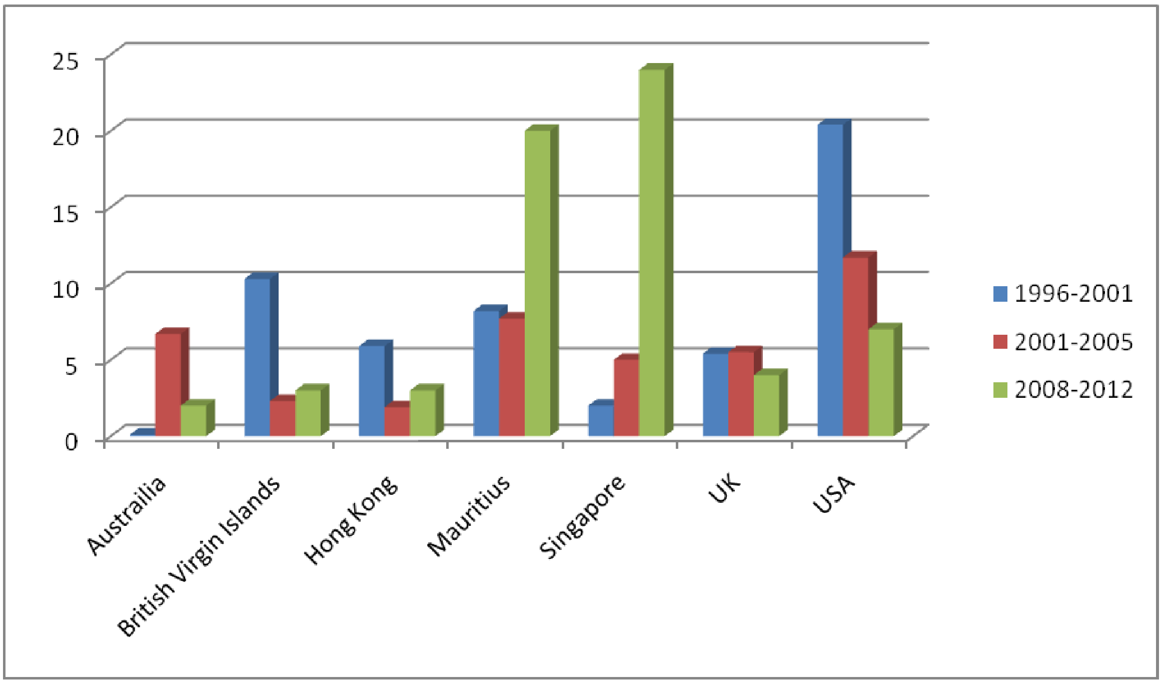


Source: UNCTAD, WIR, 2011.

3.3. Geographical Distribution of Outward FDI from India

Since the 1990s and particularly post-2000, India has been undergoing a second wave of outward FDI. While the bulk of India's outward FDI in the first wave was concentrated in developing countries in Africa and Asia, contemporary outward FDI flows from Indian firms have been directed more towards developed countries (Pradhan, 2007). As in the pre liberalization period the outward FDI from India were directed towards the developing countries, as much as 86 per cent (Kumar, 2007) while in post liberalization it were directed towards developed countries. In the first half of liberalization USA was top destination with 20.4 per cent share followed by British Virgin Islands with 10.3 per cent share in total outward FDI from India. In the second half of liberalization, Singapore and Mauritius became major destinations with 24 per cent and 20 per cent share respectively in the outward FDI during the period of 2008-2012 (Figure 5). In the last two decades the major destinations of outward FDI from India are developed economies. The changing destinations in last two decades have shown the changing motives and strategies of outward FDI from efficiency seeking to asset seeking. The above figures depicts that India is concentrating more towards developed economies in the recent past in order to access superior technology to enhance their international competitiveness.

Fig 4: Geographical Distribution of Indian Outward FDI 1996-2012 (Percent)



Source: UNCTAD & RBI Various Annual Reports.

The increasing engagement of the Indian companies in the world markets is not only an indication of the maturity reached by Indian Industry but also the extent of their participation in the overall globalization process. Generally global investments are made in two forms viz., Merger and Acquisition (M&A) and Greenfield investments. In last decade Indian MNCs have executed some big M&A deals, both in developed and developing countries. The most of M&As by Indian enterprises have taken place in developed countries, so as to acquire the superior technology, skills, and especially existing assets. As in 2007 Tata steel has acquired UK based Corus

Group, Bharti Airtel has acquired the Zain of Africa in 2010 etc., (Table 1). There has taken remarkable increase in both numbers and values of M&As from India. As the number of M&As deals increased to 141 in 2010 from 50 in 2003, the value increased from US$ 1119 million to US$ 26698 million which shows the emergence of India as a source of largest outward FDI. (Table 1 given below)

Table 1: Recent M&As by Indian MNCs

Acquiring Company	**Target Company**	**Value** ($ Million)	**Year**
Tata Steel	Corus Group (UK)	13,000	2007
Bharti Airtel	Zain (Africa)	9,000	2010
Hindalco Industries	Novelis Inc. (Canada)	5,766	2007
ONGC	Imperial Energy Plc. (UK)	2800	2009
Tata Motors	Jaguar and Land Rover (UK)	2500	2008
Suzlon Energy	Repower Systems (Germany)	1700	2006
Essar Steel Holdings	Algoma Steel Inc. (Canada)	1467	2007
ONGC	Petrobras (Brazil)	1400	2006
United Breweries	White and Mackay	1176	2007
Tata Power	PT Bumi Resources (Thailand)	1100	2007

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics).

4. **Implications of Outward FDI**

With more and more developing economies assuming importance as a source of FDI, it becomes necessary to study the implications of outward FDI on home country as well. As outward FDI can contribute both directly and indirectly to the home country and its development, the most important gain resulting from outward FDI is the increased competitiveness and performance of firms and industries involved in outward FDI. The resulted improved competitiveness in turn contributes to industrial transformation, higher national income and better employment opportunities (WIR2006, p.201). At the same time, outflow of FDI results in many negative effects such as reduced domestic investment, increased external pressure resulting from huge debt abroad, loss of jobs etc., which cannot be sidelined. However the ultimate outcome of the outward FDI depends on the motives and strategies of firms undertaking overseas investment and also on the home country characteristics.

The most frequently mentioned benefit perceived by developing country MNCs from their overseas projects was market expansion in broad including market diversification. Rising costs in the home country have been among the prime forces driving the growth of outward FDI by firms from some developing countries especially east and South East Asian economies since 1980.

FDI can be used by developing country MNCs as a means of technology sourcing and as an efficiency seeking tool. Through efficiency seeking the firms involved in outward FDI can improve their competitiveness by accessing cheaper inputs of production or achieving economies of scale through horizontal or vertical integration. The expansion of outward FDI enables firms to acquire assets such as technologies, skills, R&D facilities and brand names which help developing countries like India in the production of high value products and services to enhance their competitiveness. The resulting benefits help these MNCs to establish reputation in international markets. The outward FDI can also augment technological capabilities in the home country through the provision of training and technology spillovers from operation abroad (Globerman et al. 2000).

In terms of financial flows, outward FDI projects tends to result in net financial outflows in the BOP of home country in an initial phase, but this gradually results in net inflows once the direct investment yields returns in the form of income and other payments like royalty, fees etc., (UNCTAD, 1993). Singapore for example, has derived almost 20 per cent of its gross national income from factor incomes resulting from overseas investment income. However, financing outward FDI from domestic sources could be viewed as loss of financial capital in some developing countries that could have been used for investment at homes.

In terms of employment, the empirical evidence suggests that there is a little positive impact of outward FDI on aggregate employment, certain activities and groups of employees could be seriously hurt (WIR 1995, p. 221). However the ultimate effect depends on the kind of investment undertaken and the degree to which inputs are sourced from the home country. As has been suggested by Chen and Ku (2003) that in case of high income developing economies such as Taiwan Province of China, outward FDI to all countries was found to generate additional jobs for technical workers and managers over the period 1993-2000, while employment of unskilled labour was adversely affected to small degree by outward FDI directed to china.

It is a known fact that India needs surplus on capital account to finance its growing current account deficit and also have to keep the level of foreign exchange reserves at a comfortable level given several demands in the reserves. Therefore, expansion in capital outflows for outward FDI could have significant implication for sustainability of India's CAD and external debt profile.

Finally at the micro level of firms and the macro level for the industry, there are both positive and negative impacts resulting from large scale of outward FDI from India. At micro level negative impacts like increased costs, lower profits and higher debt are outweighed by the positive impacts such as enlarged market access for exports, upgrading technology, acquiring international brand names etc. From the macro level perspective, there are benefits like scale economies in production, sourcing inputs or raw materials etc., but negative effects like huge debt abroad and lose of scarce financial resources which have alternative use at home cannot be ignored at the same time.

5. Conclusion

The rapid liberalization since 1980s, have presented both challenges and opportunities to the developing countries. As the developing economies were now open for the international trade and investment, the world has witnessed the remarkable increase in the outward FDI, particularly from the developed economies. The developing countries have received tremendous share of outward FDI, although the developed economies still dominates the total share. The liberalization of the developing economies has not only resulted inward FDI in developing countries but outward FDI has also taken place particularly from the 2000 as the outward FDI from developing economies has increased to US$ 426 billion in 2012 from US$ 71 billion in 1999.

India has also witnessed the growth in outward FDI since liberalization in 1991, after following restrictive policies towards international finance and production for four decades. The opening up of the Indian economy had also the effect that "Indian firms have begun to go global (UNCTAD 2006: 131). The post liberalization outward FDI has shown remarkable changes in the motives and strategies of the MNCs from India. Prior to liberalization the outward FDI from India were mainly directed to developing countries as much as 86 per cent, while in post liberalization most of outward FDI from India went to developed countries which show the change in their motive from efficiency seeking to asset seeking. The outward FDI from India is meagre when compared to East Asian countries especially China. The outward FDI from China was 10 times more in 2012, and the gap is still rising. The financial crisis had considerable affect on the outward FDI from India; on the other hand there is no affect on Chinese outward FDI. In the post liberalization India has received most of FDI in service sector which has improved the competitiveness of its service sector, which resulted in the expansion of outward FDI from service sector. The rise of outward FDI from India is result of both pull and push factors, as the inward FDI increases the competition in the Indian market which leads to outward FDI from domestic enterprises to remain in competition, and on the other hand learning from inward FDI had made Indian domestic enterprises competitive so as to go global, as earlier India did not appear on ranking of major sources of FDI outside the OECD area, while in 2010 it belonged to top ten developing and transition economies. Although India has now became a major source of outward FDI, but being a capital scare developing country it could have negative implication for the home economy, as it could reduces the net external financing for domestic investment and thus for domestic GDP.

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