CHAPTER - 1
INTRODUCTORY
BACKGROUND, STATEMENT
OF THE PROBLEM AND
OBJECTIVES OF THE STUDY
1. **INTRODUCTION**

Foreign Direct Investment (FDI) has played an important role in the process of globalization during the past two decades. The rapid expansion in FDI by multinational enterprises since the mid-eighties may be attributed to significant changes in technologies, greater liberalisation of trade and investment regimes and deregulation and privatisation of marks in many countries including developing countries like India. Fresh Investments as well as Mergers & Acquisitions play an important role in the cross country movement of FDI. However, various qualitative differences have been identified between Greenfield FDI and Mergers & Acquisitions.

Capital formation is an important determinant of economic growth. While domestic investments add to the capital stock in an economy, FDI plays a complementary role in overall capital formation and in filling the gap between domestic savings and investment. At the macro level FDI is a non-debt creating source of additional external finances. At the micro level FDI is expected to Boost Output, Technology, Skill Levels, Employments and linkages with other sectors and regions of the host economy. There are fears that foreign firms might display domestic monopolies and replace these with foreign Monopolies which may in fact create worst conditions for consumers. Thus it is important to have an efficient competition policy along with sector regulators in place.

Realizing the important contribution that FDI can make to economic development, India has introduced many policy reforms to attract them. Restrictive investment regimes have been liberalized. In addition, various types of incentives are being offered to attract foreign direct investment. Greater attention is also being paid to making the macro-economic environment more conducive to foreign investors. Provision of infrastructure and other support services is being targeted, financial sector reforms are being undertaken to facilitate financial flows in various forms.

Changes in policy frameworks in India dealing with foreign direct investment inflows are studied in four phases, namely,

(a) 'Cautious welcome policy' from independence to the emergence of crisis in the late sixties (1948-66),

(b) 'Selective and restrictive policy' from 1967 till the second oil crisis in 1997,
(c) 'Partial liberalization policy' from 1980 to 1990 with progressive attention towards regulations, and
(d) 'Liberalization and open door policy' since 1991 onwards, signifying liberal investment regime.

The sweeping changes introduced since 1991 mark a radical departure from the past and reflect a positive approach towards foreign capital. The changes provide freedom to foreign investors to enter into Indian industry. Under the ongoing policy phase the thrust is on providing access to capital, technology and market in order to induce greater industrial efficiency and integration of the domestic economy with the global economy. The enlarged spheres for FDI entry now include mining, oil exploration, refining and marketing, power generation and telecommunication, which were earlier reserved for the state sector. Under the new policy, foreign direct investments are also permitted in tourist and hotel industries and trading companies engaged in exports in the service sector. Clearly the sectors opened to FDI now are much larger as compared to the earlier policy.

Most countries have an approval requirement for the entry of foreign direct investment. In India, one of the irritants in the earlier policy phases has been the cumbersome procedures involved in the implementation of the regulatory policies. Apart from the delays, the bureaucratic discretion is inbuilt into the procedure of granting approval on a case-by-case basis. As compared to the earlier policy phases a distinctive feature of the liberalization policy phase is the simplification of procedures.

In India, all cases other than those coming under the parameters of automatic approval require prior scrutiny and clearance of the Government. Foreign Investment Promotion Board (FIPB) or the Secretariat for Industrial Assistance (SIA) clears such proposals for Industrial Approval. It must be appreciated that the approval requirement in China is higher and more rigid than in India.

Indian policy on transfer of technology has also been made liberal since 1991. Like FDI, there is the provision of automatic approval for technology agreements related to high priority industries within specified parameters. Similar facilities are available for other industries as well if such agreements do not require the expenditure of foreign exchange. Other liberalization measures include the freedom to use foreign trade names in the domestic market, which was not allowed earlier. Now, the hiring of foreign technicians and foreign testing of indigenously developed technologies do not
require prior clearance. In short as against the earlier practice of getting government's prior approval involving delays and uncertainty, the firms are at present free to negotiate terms of technology transfer with their foreign counterparts according to their own commercial judgments. Besides, there exist liberal external commercial borrowings and debt servicing norms. No ceiling has been placed on raising Global Depository Receipts (GDRs)/ American Depository Receipts (ADRs)/ Foreign Currency Convertible Bonds (FCCBs). Overseas business acquisitions have also been permitted through the ADR/GDR route. Indian companies in IT sector have been permitted to issue ADR/GDR linked stock options to permanent employees of its subsidiary companies incorporated in India or abroad. Allowing Foreign Institutional Investors (FIIs) to invest in the capital of the companies is a welcome change for Indian companies.

In a nutshell, the sweeping changes introduced since 1991 marks a radical change from the past and reflect a positive approach towards future foreign collaboration. The changes provide freedom to foreign investors to enter into Indian industry. In terms of openness to FDI entry, we may say that the prevailing Indian policy is not unfavorably placed in terms of competitiveness with other major FDI-receiving countries in Asia.

1.1 STATEMENT OF THE PROBLEM

It is well recognised that the role of Foreign Investment (FI) in India’s Industrialisation vis-à-vis economic development has a historical inheritance. So far as its nature is concerned it is found that the inflow of FI in India has taken the form of Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII). Interestingly, the flow of FII in India has recently occupied a conspicuous place due to free cross-country mobility of capital as an outcome of the widespread deregulation in Trade, Investment and Finance due to globalization. In fact a majority of this FII has been found to be invested for short term speculative gain. So far as FDI is concerned one can easily find a sharp distinction between the nature of FDI during the pre-reform period and post-reform period. In the pre-reform period it was mainly in collaborative form which consisted of pure collaboration and technical collaboration such that technical collaboration has been found to be to the order of 60% of all FI. Surprisingly, in the post-reform period the flow of FDI in India was in the nature of Merger & Acquisitions (M&A) and Greenfield Investments (GI). Of these two forms,
the former that is flow of FDI through M&A by multinational corporations has been of very recent origin and is gradually gaining larger importance since 1995. At present about two-fifth of the total flow of FDI in India has been found to be in the form of M&A such that the horizontal M&A occupies a dominant place relative to vertical M&A with a strategy of non-price modes of rivalry involving a contrived entry barrier. Now, since the M&A result into cross border buying and selling of assets (i.e., transfer of assets), one has to investigate whether M&A has led to a net addition to the industrial capital assets of our country.

On the other hand, flow of FDI in the form of GI has still been found to enjoy a dominant position in the total flow of FDI and the liberalisation has boosted this process of inflow such that there has been a radical change in its nature, pattern and composition particularly after the liberalisation. The data on the magnitude of FDI clearly reveal so such that there is a tremendous fall in share of FDI in manufacturing sector from (84.9% to 37.18%) which accompanied by a sharp increase in the flow of FDI in infrastructural sector such as energy and power from (0.1% to 28.91%) and telecommunication services (20.21%) over the period between 1990-1997. Now since we know that the Greenfield Investment actually implies the creation of assets or industrial capital it is necessary to explore the impact of such investment on the industrial growth vis-à-vis the overall economic development of our economy. The data on FI along with its breakup however do not reveal a uniform trend and pattern of change. It seems that there has been break in trend particularly since inception of the process of globalization. In fact, the non-linear dynamics of the FI in India has been found to be linked with policies which have been pursued by the Government of India from time to time. So far the evolution of Government policies towards FI is concerned one can safely distinguish it into four phase’s viz.: (a) Phase I (1951 to mid 1960s); (b) Phase II (mid 1960s to 1980); (c) Phase III (1980s); (d) Phase IV (1990s).

Phase I was characterized by a soft attitude of the Government of India (GOI) towards FI because of the persuasion of the policy of import substitution as well as heavy industrialisation. The implicit reason behind this was that at that time India was constrained by capital, technology and infrastructure. As an outcome there was large outflow of resources from India towards the payment of royalty, dividend and fees of technological expertise resulting into severe Balance of Payment (BOP) crisis. So Government was compelled to pursue restrictive attitude towards FI in Phase II particularly to those which were unaccompanied by technology transfer and which
demanded more than 40% foreign ownership. Further Indian economy has been found to experience a prolonged industrial stagnation during mid 60s to 1978 which also produced a dampening impact on the inflow of FDI. As a complementary to this, Foreign Exchange Regulation Act (FERA) was also introduced in 1970s. However, as fallout of these Indian industries continued to suffer from technological backwardness. So for bringing about modernization in Indian industries, once again the GOI continued to follow a liberal policy toward FI in the 3rd phase i.e., during 1980s. Finally with the adoption of the policy of economic reforms since 1991 which entail the objective of Liberalisation, Privatisation and Globalisation (LPG) thereby resulting into a gradual switchover from bureaucratic control over trade, investment and finance to the transcendental marketism. As its fall out there has been a widespread deregulation in trade, investment and finance. Now if one compares the behaviour of FI then it can easily be found that there is a spurt in the inflow of FI in the 1st phase which has been followed by a modest decline in the 2nd phase and finally by an increasing trend since the 3rd phase.

However, rapid transformation in the nature, trend and industry wise as well as region wise composition of FDI is not only influenced by the Government policies but also by its other determinants namely, variations in market size, quality of infrastructure, cross state differentials in real rate of return on investment, growth rate of Gross Domestic Product (GDP)/State Domestic Product (SDP), industrial growth rate, domestic investments, extent of urbanisation etc. So one has to explore the most crucial and proximate correlates of FDI and also the exact form of relationship between FDI and its correlates. All these facts motivate us to undertake such a study in this area.

1.2 REVIEW OF AVAILABLE LITERATURE

This section represents an exhaustive review of literature in our area of study. In fact, there is a plethora of literature in this area which concentrates on the various aspects of FDI in India. We have classified the literature into two groups (i) the cross-country studies relating to our area of research and (ii) the studies pertaining to the role of FDI on Indian economy.

Cross-country studies are reviewed first. An important cross-country study done Singer (1950) focused on the role of FDI on economic development across the developing countries. He argues that the FDI has a detrimental effect on developing
countries and leads to uneven global development. This is based on the premise that FDI going to developing countries is mainly in the primary sector. Further, in his study done in 1975 Singer modified his views by focusing on differences between countries rather than commodities.

On the other hand, Rodan (1961), Chenery and Strout (1966) in the early 1960s argued that foreign capital inflows have a favorable effect on the economic efficiency and growth towards the developing countries. It has been explained that FDI could have a favorable short-term effect on growth as it expands the economic activity. However, in the long run it reduces the growth rate due to dependency, particularly due to “decapitalization” (Bomschier, 1980).

Chenery and Strout (1966) stated that external finances could enhance growth prospects of recipient countries by augmenting domestic availability of investable surpluses. In the present frame work, external financial inflows are presumed to result in a virtuous circle of growth. Domestic savings in recipient countries could be negative, if capital inflows became large enough, implying thereby that external finance did not necessarily supplement, but might actually replace domestic savings. FDI is also an important source of human capital augmentation and provides specific productivity increasing labour training and skill acquisition through knowledge transfers.

However, Vernon (1966) argues that oligopolistic structure of markets, international integration, imports and the level of foreign direct investment are complementary.

Griffin (1970) also support the view that FDI from developed to developing countries does not have beneficial effects.

The dependency theorists believe that FDI can have a favourable short term effect on growth. In the long-run, however, as FDI accumulates, it can have a negative effect on the rest of economy due to the intervening mechanisms of dependency, in particular, “decapitalization” and “disarticulation” (Stoneman, 1975).

The idea of trade-related international knowledge spillovers developed by Grossman and Helpman (1991) extended by Walz (1997) show that FDI is accompanied by interregional spillovers of knowledge from more to less advanced countries. Policies leading to an inflow of FDI therefore speed up the growth process and anything from investment controls for TNCs to specific taxes on their repatriation
of profit hurts the international growth process and thereby the consumers in the developing country. Thus, theoretically speaking, the main avenues by which FDI can effect growth are productivity spillovers, human capital augmentation and technological change, though it becomes very difficult to incorporate these in empirical studies as these are not easy to measure.

FDI by one firm in an oligopolistic environment might trigger similar activities by other firms. Showing the importance of export-oriented FDI, Sach and Warner (1995) indicated that export-oriented FDI links the local economy to the international economy. Openness to both imports and exports has been shown as powerful force for growth and growth has so far been the only credible means of alleviating absolute poverty.

De Mello and Sinclair (1995) show that FDI can promote knowledge transfers even without significant capital accumulation as in the case of licensing and startup arrangements, management contracts and joint ventures in general.

The study by Chen, Chang and Zhang (1995), using time series data for the period of 1979-93, estimated the regression between GNP, domestic saving in one period lag, and FDI in one period lag (all in logarithmic value). The results of the study show that there is a positive relationship between FDI and GNP and it is significant at 5 per cent level for the Chinese economy. It also supported by other study by Sahoo et al (2002).

Balasubramanyam et al. (1996) find the effect of FDI on average growth rate for the period 1970-85 for the cross-section of 46 countries as well as the sub-sample of countries that are deemed to pursue export-oriented strategy to be positive and significant but not significant and sometimes negative for the sub-set of countries pursuing inward-oriented strategy.

A study by Kasibhatla and Sawhney (1996) in the U.S. supports a unidirectional causality from GDP to FDI and not the reverse causation. This may be due to the fact that for a developed country, FDI follows GDP, as GDP is an indicator for market size.
Ana Mar (1997) reviews the evidence on the scale of FDI to low-income countries over the period 1970-96 and major factors determining foreign companies’ decision to invest in a particular country. The study concludes that large market size, low labor costs and high return in natural resources are amongst the major determinants in decision to invest in low income countries.

Hu and Khan (1997) attribute the spectacular growth rate of Chinese economy during 1952 to 1994 to the productivity gains largely due to market oriented reforms, especially the expansion of the non-state sector, as well as China’s “open-door” policy, which brought about a dramatic expansion in foreign trade and FDI.

Aitken, et al. (1997) showed the external effect of FDI on export with example of Bangladesh, where the entry of a single Korean Multinational in garment exports led to the establishment of a number of domestic export firms, creating the country’s largest export industry.

Mello (1999) considered that FDI affects growth through the accumulation of capital as well as by the transfer of knowledge. These hypotheses were tested with time series and panel data. The time series results were not conclusive. The panel data showed that FDI has a positive effect upon growth as result of the transfer of knowledge in OECD counties, but not in the rest. The effect upon the accumulation of capital was only manifested in the non-OECD countries. This indicates that the end result depends on the complementary or substitution of foreign and domestic investment.

Alam (2000) in his comparative study of FDI and economic growth for Indian and Bangladesh economy stressed that though the impact of FDI on growth is more in case of Indian economy yet it is not satisfactory. He used a multiple regression technique to evaluate the role of FDI on the export performance in the Indian economy. The study concluded that FDI does not have a statistically significant role in the export promotion in Indian Economy. This result is also confirmed by the study of Pailwar (2001) and the study also argues that the foreign firms are more interested in the large Indian market rather than aiming for the global market.
**Bailliu (2000)** analyzed the impact of private capital flows, financial development and economic growth in 40 developing countries during 1975-95 and found that capital inflows faster higher economic growth, above and beyond any effects on the investment rate, but only for economies where the banking sector has reached a certain level of the development.

**Agarwal (2000)** analyzed economic impact of FDI in South Asian Countries: India, Pakistan, Bangladesh, Sri Lanka and Nepal and found that FDI inflows in South Asia were associated with a manifold increase in the investment by national investors, suggesting that there exists complementarily and linkage effects between foreign and national investment. The impact of FDI inflows on growth rate of GDP is found to be negative prior to 1980, mildly positive for early eighties and strongly positive over the late eighties and early nineties. Hence, FDI is more likely to be beneficial in the more open economies.

A causality test between FDI and product growth was proposed by **Nair-Reichert and Weinhold (2001)**, based on panel data for 24 developing countries between the years of 1971 and 1985. The main conclusion here was that the relation between investments, whether foreign or domestic, and product growth was strongly heterogeneous, and that FDI efficiency was positively influenced by a country’s degree of trade openness.

**Want (2001)** examined the impact of FDI inflows on 12 Asian economies: Bangladesh, China, Hong Kong, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Singapore, Thailand and Taiwan during the period 1987-97 and found that FDI in manufacturing sector has a significant and positive impact on economic growth in the host economies.

**Buckley et.al (2002)** used panel data for several regions in China for the 1989-98 period. In the first place, the author points out that if the rate of growth of FDI has positive effect upon GDP growth, the reverse does not hold true. Secondly, no evidence was found to support the hypothesis according to which the efficiency of FDI depends on a minimum level of human capital. Contrastingly, human capital is
more significant in less developed provinces, while FDI stimulates growth notably in the more developed provinces.

Salisu A. A. fees (2002) examined the determinants and impact of FDI on economic growth in developing countries using Nigeria as a case study. The study observed that inflation, debt burden, and exchange rate significantly influence FDI inflows into Nigeria. The contribution of FDI to economic growth in Nigeria was very low even though it was perceived to be a significant factor influencing the level of economic growth in Nigeria.

According to World Investment Report (2003), foreign investors regard both China and India as a hub for relocation of labour intensive activities. In India, the relocation has been confined to the services, particularly information and communication technology. In China, about $2/3^{rd}$ of FDI flows into a diverse range of manufacturing industries.

Pradhan J. Prakash (2003) while empirically verifying the role of FDI in the growth process of developing countries found that the growth effects of domestic investment is relatively more sensitive than FDI to the level of human development. For developing countries with higher human development, the impact of domestic investment on growth is not only positive but also statistically significant, whereas, it has no significant impact in the case of developing countries with lower human development. The study found that the international linkages have a major role in the growth process, if the country has a lower human development than a country with a higher human development.

The research paper of Shalini Sharma and Ruchi Sharma (2003) developed two alternative econometric models to examine the degree of relationship between FDI inflows and GDP. The study used the data of 29 countries and provided an empirical base to the hypothesis that FDI is related directly to the development, as measured by income, in order to provide a scientific base to the often-repeated commonsense speculation about the role of FDI in development. But no evidence was found to support the thesis that the rates of growth of GDP and FDI are related.
In their study, Greenway et al. (2004) suggest that Multinational Corporations (MNCs), especially export-oriented ones, appear to generate positive export spillovers and significantly increase the probability of exporting for domestically-owned firms operating in the same industry. Conversely, Barrios et al. (2003) studied the case of Spain and found no evidence of export spillovers to local firms from the existence of MNCs.

Ruane and Sutherland’s (2004) findings through using the case of Ireland agrees with Barrios et al. (2003) findings that there appears to be no evidence of export spillovers from MNCs to local firms in Ireland.

Burak Camurdan and Ismail Cevis (2009) developed an empirical framework to estimate the economic determinants of FDI inflows by employing a panel data set of 17 developing countries and transition economies for the period of 1989-2006. Seven independent variables were taken for this research namely, the previous period FDI, GDP growth rate, wage, trade rate, inflation rate and economic investment. The empirical results conclude that the previous period FDI is important as an economic determinant. Besides, it is also understood that the main determinants of FDI inflows are inflation rate, the interest rate and trade (openness) rate.

Now, we carry on with the review of studies relating to Indian economy.

The Work of Rao and Rao (1987) is one of the earlier attempts to analyse mergers in India from a sample of 94 mergers orders passed during 1970-86 by the MRTP Act 1969. This study, besides examining nature and motives of concerned parties, also takes into account effectiveness of MRTP act by highlighting reasons given by the Government for approving or rejecting the merger proposal. He observed that these companies prefer expansion through horizontal and conglomerate mergers rather than through vertical integration. Out of the 94 mergers studied, 38 found to be of horizontal type and 34 of conglomerate type.

Bajpai and Sachs (1997) in their study concluded that in the existing global scenario; it is possible for India to achieve very dynamic growth based on labour-intensive manufacturing that combines the vast supply of Indian labour including
skilled managerial and engineering labour, with foreign capital technology and markets. However, from the long term development point of view, they are of the view that export-led growth involves a broad range of sectors, both traditional and new (Bajpai and Sachs, 1998). The most interesting by far of the new sectors is software and information technology.

The study by Dua and Rashid (1998) for the Indian economy does not support the unidirectional causality from FDI to Index of Industrial Production (IIP), where IIP is taken as the proxy for GDP. In fact, this study used the monthly data for IIP and GDP, which may include seasonal component in its variation and hence it is required to de-seasonalise the data.

Study by Beena (1998) attempts to analyse mergers in the post 1991 regime. Though the study covers on the trends of mergers in India over 1974-1975 to 1994-1995, a deeper analysis is done with respect to mergers in the private corporate manufacturing sector during 1990-94 for a sample of 45 mergers. This analysis tries to identify the characteristics and causes of mergers and their impact on financial performance. In her sample vertical and conglomerate mergers were equally distributed. Based on the trends in the merger activity from 1974-75 to 1994-95, she finds acceleration in the merger activity in the liberalized regime of 1990s. It is argued that a number of factors have triggered off the merger and acquisition wave during the 1990s. With relaxation and removal of many legal restrictions as noted above, many Indian firms are substituting their green field growth plans with takeover strategies. This is because the benefit of takeover companies is lucrative enough to make this strategy preferable to organic growth. For the post reform period, she argues that the merger wave in the early 1990s was a mere means of internal restructuring rather than an instrument to further product market or asset share. It is observed that the internal restructuring, which formed an important part of the spate of mergers during the 1990s, was aimed at possibly increasing size; deriving marketing and financial benefits and exploring scale economies. Moreover, there are signs of mergers aimed at the synergies associated with vertical mergers at linking more closely the production plans of related firms; and at increasing the size. She also finds no significant difference in the rate of return and profit margin between the
periods before and after the mergers. Overall the results point to the possibility of merger driven by managerial self-interest motive of growth maximization.

Roy (1999) analyses M&A activity based on CMIE data bank from September 1995 to August 1997. The study characterizes mergers in terms of their nature, and attempts to identify the likely causes behind this form of restructuring, apart from following case study approach. She in her analysis for 1995-97 observes that in most cases, the company taken over is horizontally related to the company taking it over. However she observes that the conglomerate type mergers are negligible.

Nagesh Kumar (2000) has made an exploratory attempt to examine the patterns of MNC related mergers and acquisitions in India in the nineties with the help of an exclusive data base. He finds that the liberalization of policy framework since the early nineties has led the MNCs to increasingly use the Merger and Acquisition route to enter and strengthen their presence in the country. In the recent years, two fifths of all FDI inflows took the form of M&As compared to virtually all of FDI inflows coming from Greenfield ventures earlier. The deals relating to MNCs are predominantly horizontal rather than vertical in nature. In terms of development implications he finds that FDI inflows in the form of M&As are of an inferior quality compared to Greenfield investments. These findings, therefore, emphasize the need for adopting a comprehensive competition policy framework in India.

Basant (2000) has analysed mergers over 1991-97 to find out nature, causes and distribution of mergers by broad industry group. The study was conducted by taking a sample of 397 mergers. The study finds that 60 percent cases of mergers and acquisitions of horizontal nature during the 1990s. The sample highlight 11 percent cases of vertical and a significant share (28 per cent) of mergers of conglomerate type. The study also observes that economic reforms have significantly reduced microeconomic rigidities and enhanced competitive pressure. Corporate restructuring in the form of mergers and acquisitions is a response to this opportunity provided by the liberalized policy framework in order to meet the emerging competitive challenges.
The study by Das (2000) examines the extent of concentration on the manufacturing sector in India in 15 product groups over the six years from 1993-98. It finds high concentration ratios for most of the different product groups studied and also observes that as a consequence of dominance of horizontal mergers, the concentration ratio in the product group level has gone up. He observes that 65 percent of the merger cases in the sample were of the horizontal type. The study finds 16 percent cases of vertical and nearly 19 percent of conglomerate types. According to the study, in the new industrial climate following economic liberalization, both domestic firms and foreign companies in India derived their own sets of incentives to increase participation in industrial production. Mergers were chosen to be a convenient route for their distinct economic advantage over starting a new plant or firm. In terms of available evidence, the study compares pre merger and post merger size for a sample of 18 acquiring companies. Overall increase in size seems to be significantly driven by merger. However, no study exists to find out the realization of motives relating to efficiency gains and market power. The study also compares the pre merger and post merger operating profit margin for a sample of 14 acquiring firms and finds a decline in profitability in 8 of these companies after merger. When pre merger profitability (an index of efficiency of a company) of acquirer and target companies is compared, the study finds the acquiring companies had higher pre merger profitability in 18 of the 25 merger cases considered. This reveals that, in general, acquiring firms were more efficient than the corresponding targets in terms of profitability. The study also compares the pre- merger average net sales (an index of firm size) for the acquirer and target firms and finds that in 86 percent of the cases, acquiring companies had higher pre- merger sales. In general, acquiring firms were larger in size than the corresponding targets. For finding the pre merger debt burden of a company, the average gearing ratio has been computed; the study finds that in 68 percent cases, this ratio was higher for target companies as compared to the acquiring companies.

Another study by Kumar (2000) deals exclusively with multinational enterprises and mergers in India from a period of 1993-2000 to identify motivating factors behind mergers by MNC and industrial composition of such activity.
**Saple (2000)**, analyses a sample of 36 firms involved in mergers over the period 1992-95 to identify the characteristics of acquirer and acquired firm with respect to other firms in the industry. The study also made a comprehensive analysis of pre-merger and post merger analysis of operating performance of the acquiring firms. The study finds 14 cases of horizontal mergers. It observes that mergers did not lead to an improvement in performance as measured by profitability (return over net assets) adjusted for the industry average. Comparing the pre merger profitability of the firms involved with the industry average, the study finds that the target firms were better than industry averages while the acquiring firms had lower than industry average profitability. Overall, acquirers were high growth firms which had improved the performance over the years prior to the merger and had a higher liquidity. The target firms, on the other hand, were firms with higher than industry profitability, which had deteriorated over the period just prior to merger.

**Chakraborty and Basu (2002)** explore the co-integration relationship between net inflows of FDI, real GDP, unit cost of labor and the proportion of import duties in tax revenue for India with the method developed by Johansen (1990). They find two long-run equilibrium relationships. The first relationship is between net inflow of FDI, real GDP and the proportion of import duties in tax revenue and the second is between real GDP and unit cost of labor. They find unidirectional Granger Causality from real GDP to net inflow of FDI.

By using a vector error correction model (VECM), **Chakraborty and Basu (2002)** tried to find the short run dynamics of FDI and growth. The study reveals that GDP in India is not Granger caused by FDI; the causality runs more from GDP to FDI and the trade liberalization policy of the Indian government had some positive short run impact on the FDI flow.

**Naga Raj (2003)** discusses the trends in FDI in India in the 1990s and compares them with china. The study raises some issues on the effects of the recent investments on the domestic economy. Based on the analytical discussion and comparative experience, the study concludes by suggesting a realistic foreign investment policy.
There are some studies who have concentrated on finding out the true level of FDI flows to India. However, Srivastava (2003) has found that there are major differences in the definition of FDI and the interpretation of FDI data. But no comparative analysis of the different methods of measurement of FDI inflows to India with those prescribed by International Monetary Fund (IMF) has been undertaken.

Chandana Chakraborty, Peter Nunnenkamp (2004) in their study "Economic Reforms, FDI and its Economic Effects in India" assess the growth implications of FDI in India by subjecting industry - specific FDI and output data to Granger causality tests within a panel co-integration framework. It turns out that the growth effects of FDI vary widely across sectors. FDI stocks and output are mutually reinforcing in the manufacturing sector. In sharp contrast, any causal relationship is absent in the primary sector. Most strikingly, the study finds only transitory effects of FDI on output in the service sector, which attracted the bulk of FDI in the post-reform era. These differences in the FDI-Growth relationship suggest that FDI is unlikely to work wonders in India if only remaining regulations were relaxed and still more industries opened up FDI.

Nayak D.N (2004) in his paper "Canadian Foreign Direct Investment in India: Some Observations", analyse the patterns and trends of Canadian FDI in India. He finds out that India does not figure very much in the investment plans of Canadian firms. The reasons for the same is the indifferent attitude of Canadians towards India and lack of information of investment opportunities in India are the important contributing factor for such an unhealthy trends in economic relation between India and Canada. He suggested some measures such as publishing of regular documents like newsletter that would highlight opportunities in India and a detailed focus on India's area of strength so that Canadian firms could come forward and discuss their areas of expertise which would help in enhancing Canadian FDI in India.

Commenting on FDI in India, P.L Beena et. al. (2004) agree to the fact that India has come a long way since 1991 as regards the quantum of FDI inflows is concerned, though there is a view that the MNCs are discouraged from investing in India by bureaucratic hurdles and uncertainty of the economic reforms. However, they feel that very little discussion has taken on the experience of the MNCs and the
relationship between their performance and experience with the operating environment and the extent of spillovers in the form of technology transfers. The importance of the former is that the satisfaction of the expectations of the MNCs that are already operational within India is an important precondition for growth in FDI inflow. Transfer of technology and knowhow on the other hand is at least likely to have an impact on India’s future growth and the quantum of FDI inflow. They argue that to the extent that India’s future growth will depend on the global competitiveness of its firms, the importance of such spillovers can be paramount.

Kulwinder Singh (2005) analyzed the developments (economic and political) in India relating to the trends in two sectors:- Industry and Infrastructure. The study concludes that the impact of the reforms in India on the policy environment for FDI presents a mixed picture. The industrial reforms have gone far, though they need to be supplemented by more infrastructure reforms, which are a critical missing link.

Baig, Mirza Sarvar (2006) focused mainly on comparison of FDI before liberalisation and after liberalisation. It was discussed that reformation policies of the Government were not very effective and could not attract foreign investors. Hence, foreign investment could not contribute much in the economic growth as it was expected at the time when reformation process was started. So in pre-reformation and post post-reformation period, FDI has not played very significant role.

Bajpai and Jeffrey (2006) attempted a paper on “Foreign Direct Investment in India: Issues and Problems”, to identify the issues and problems associated with India’s current FDI regimes, and also the other associated factors responsible for India’s unattractiveness as an investment location. Despite India offering a large domestic market, rule of law, low labour costs, and a well working democracy, her performance in attracting FDI flows have been far from satisfactory. The conclusion of the study is that a restricted FDI regime, high import tariffs, exit barriers for firms, stringent labour laws, poor quality infrastructure, centralized decision making processes, and a very limited scale of export processing zones make India an unattractive investment location.
Dahiya, Vikas (2007) has analyzed that ceiling cap on FDI in various sectors imposed by the Government has been a big obstacle for regular foreign direct investment. Regular changes in Government policies have also affected foreign investment. On the other hand, due to investment in the form of FDI, the manufacturing sector has increased productivity and profitability.

V.N Balasubramanyam and David Spasford (2007) compare the inflow of FDI in China and India and find that India may not require increased FDI given India's factor endowments and the structure and composition of her economy. There are a variety of explanations for the low volumes of FDI in India relative to that in China. This paper suggests that there may be yet another explanation - i.e., the structure and composition of the manufacturing and services sector in India and her endowments of human capital. India's manufacturing sector consists of a substantial proportion of science based and capital intensive industries. The requirements of managerial and organizational skills of these industries are much lower than that of the labour intensive industries such as those in China. Also, India has a large pool of well-trained engineers and scientists capable of adapting and restructuring imported knowhow to suit local factor and product market conditions. All these factors promote effective spillovers of technology and knowhow from foreign to locally owned firms. The optimum level of FDI which generates substantial spillover enhances learning on the job and contributes to the growth of productivity, is likely to be much lower in India than in other developing countries including China.

Basu P., Nayak N.C, Vani Archana (2007) in their paper "Foreign Direct Investment in India: Emerging Horizon", intends to study the qualitative shift in the FDI inflows in India in-depth in the last fourteen odd years as the bold new policy on economic front makes the country progress in both quantity and the way country attracted FDI. It reveals that the country is not only cost-effective but also a hot destination for R&D activities. The study also finds out that R&D as a significant determining factor for FDI inflows for most of the industries in India. The software industry is showing intensive R&D activity, which has to be channelized in the form of export promotion for penetration in the new markets. The study also reveals strong negative influence of corporate tax on FDI inflows. To sum up, it can be said that large domestic market, cheap labour, human capital, are the main determinants of FDI.
inflows to India, however, its stringent labour laws, poor quality infrastructure, centralize decision making processes, and a very limited numbers of SEZs make India an unattractive investment location.

**Agrawal, Ruchi (2007)** discussed that before liberalisation trend and quantum of FDI in India was very low but after liberalisation, trend was kept on increasing and Government has made changes in the FDI policies as required time to time by the circumstances. After liberalisation, in the initial years, trend and pattern of FDI was traditional like investment in equities and stock market but during last few years trend and pattern has changed from traditional to modernized way like investment through joint venture.

**Singh (2009)** stated in his study that foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conductive policies has therefore become a key battleground in the emerging markets. The paper highlighted the trend of FDI in India after the economic reforms, sector-wise and country-wise share of FDI, the manner in which FDI has affected the growth of Indian states.

**Kumar and Karthika (2010)** found out in their study on “Sectoral Performance through Inflows of Foreign Direct Investment (FDI)”, that Foreign Direct Investment has a major role to play in the economic development of the host country. Most of the countries have been making use of foreign investment and foreign technology to accelerate the place of their economic growth. FDI ensures a huge amount of domestic capital, production level and employment opportunities in the developing countries, which is a major step towards the economic growth of the country.

**Sapna Hooda (2011)** analyzed the impact of FDI on economic growth of Indian economy for the period 1991-92 to 2008-09. She used OLS method for this purpose. The empirical results found that foreign Direct Investment (FDI) is a vital and significant factor influencing the level of growth in Indian economy. She also estimated the determinants of FDI inflows and found that trade GDP, Research and
Development GDP, Financial position, exchange rate, Reserves GDP are the important macroeconomic determinants of FDI inflows in India.

**K.S. Chalapati Rao and Biswajit Dhar (2011)** made an attempt on the ambiguities surrounding the definition and the non-adherence of international norms in measuring the FDI inflows. The study found that portfolio investors and round tripping investments have been important contributors to India’s reported FDI inflows thus blurring the distinction between direct and portfolio investors on one hand and foreign and domestic investors on the other. These investors were also the ones which have exploited the tax haven route most.

**Rajalakshmi and Ramachandran (2011),** in their paper “Impact of FDI in India’s automobile sector with reference to passenger car segment.” studied the foreign investment flows through the automobile sector with special reference to passenger cars. The research methodology used for analysis includes the use of ARIMA, coefficient, linear and compound model. The period of study is from 1991 to 2011. This paper is an empirical study of FDI flows after post liberalisation period. They have also examined the trend and composition of FDI flow and the effect of FDI on economic growth.

**Shalini Aggarwal, Ankush Singla and Ritu Aggarwal (2012),** studied on the need of FDI in India, to exhibit the sector-wise & year-wise analysis of FDI in India and to rank the sectors based upon highest FDI inflows. The results show that Mauritius is the country that has invested highly in India followed by Singapore, Japan, and USA. It has also showed that there has been a tremendous increase in FDI inflow in India during the year 2000 to 2011.

**Parul Mittal and Sandeep Aggarwal (2012)** made a general analysis of the inflows and outflows of FDI since the post liberalization era. The purpose of this paper was to provide an examination of foreign direct investment in various sectors. At the end of this examination, figures showed the trend of FDI inflows and geographical distribution of FDI.
According to Patil Usha .N (2012), there were varied viewpoints on the impact of FDI in the retail sector in India. According to one viewpoint, the US evidence is empirical proof to the fact that FDI in the retail sector does not lead to any collapse in the existing employment opportunities. The unorganized retail sector contributes about 14% to the GDP and absorbs about 7% of our labour force. Hence the issue of displacement of labour consequent to FDI is of primal importance.

Devajit (2012) conducted the study to find out the impact of foreign direct investments on Indian economy and concluded that Foreign Direct Investment (FDI) as a strategic component of investment is needed by India for its sustained economic growth and development through creation of jobs, expansion of existing manufacturing industries, short and long term project in the field of healthcare, education, research and development.

From the foregoing detailed review of literature, it has been observed that although a plethora of literature on different facts, dimensions and aspects of FDI in India is available, still there is dearth of literature especially dealing with the inflow of FDI in all its forms. Though there is a common consensus among all the studies in the Indian context that FDI is not growth stimulant rather it is growth resultant, very few of the studies have tried to examine the role of FDI at the sectoral level in the Indian economy. Further, only few studies have concentrated on the post reform scenario of FDI in India. This has motivated us to undertake a separate study on the role of FDI in the economic development of India since the period of reform. However, in our study we have tried to compare the role of FDI in India’s economic development during the pre and post reform period.

Thus the motivation of our study descends actually from existing observations which evolve out of the available data and literature in this area.

1.3 MAIN OBJECTIVES OF THE STUDY
Since India has chosen the path of export-led growth like the other East Asian Countries, it needed a huge capital outlay for the resurgence of its economic, infrastructure and industrial sector and the domestic savings were insufficient to
finance for it, so India has sought to increase inflows of foreign direct investments. The main objectives of our study are as follows:

- To examine the policy framework of India in relation to foreign direct investments.
- To examine and assess the various aspects pertaining to the performance of FDI in India across sectors, region and time during the pre and post reform period.
- To analyse the trends and patterns of foreign direct investments in India and to assess the present position of FDI.
- To understand the nature, extent and structure of cross-border deals in India.
- To analyse the impact of FDI on Indian economy with the help of some selected indicators.

The major research questions which emanate out of the survey of literature and information available from various sources can be outlined as follows:

1) Whether FDI climate in India has improved in the post liberalization era or not?
2) What has been the behavioural pattern of FDI (industry specific and region specific) during the pre-reform and post-reform period in India?
3) What are the proximate explanatory factors behind the cross-time and cross-state variations in the inflow of FDI?
4) Is there any relation between flow of FDI in the form of Greenfield Investment and Merger & Acquisition? Is the relative importance of the flow of FDI through M&A larger than that in terms of GI?

The tentative hypotheses of the study which can be formulated on the basis of research questions stated above are as follows:

1) There has been a tremendous change in the pattern and composition of the flow of FDI in India since Independence particularly during the post liberalisation period.
2) There exists significant relationship between economic growth and FDI inflows in India.
3) That economic reform made significant positive impact on FDI attractiveness in India.
4) The flow of FDI through M&A has helped boosting the rate of growth of industrial output in India since 1995.

1.4 DATA & METHODOLOGY USED IN THE STUDY

The study is basically empirical in nature. It is based on the secondary data which are mainly available from various reports of government and semi-government organizations in this field, namely, Annual Survey of Industries, Indian Statistical Abstract, National Account Statistics (CSO Publications); Annual Report, Bulletin, Report on Currency & Finance, Handbook of Statistics on the Indian Economy (RBI Publications); Newsletter, Ministry of Industry, Economic Survey, Ministry of Commerce and Industry, Economic Review of Individual State (GOI Publications); Foreign Trade & Balance of Payment, National Income Statistics (CMIE Publications), research publications and the renowned books in this particular topic and also relevant websites on the Internet. The data collected from such various sources have been classified, tabulated and analysed by using some conventional statistical tools. The present study deals with the empirical analysis on the impact of FDI on Indian economy. The data series has been taken from 1980-81 to 2013-14 for the purpose of our study. The choice of the periods of study is dictated purely by the availability of a complete data series with respect to all variables. For the sake of maintaining consistency, data on most of the variables have been taken as Rs crores and in few cases as $ million. Appropriate splicing technique and Deflator has been used to make the data comparable.

We have applied both descriptive statistics as well as contemporary econometric tools like time series analysis and panel data regression analysis for the purpose of our study. For the purpose of conducting econometric analysis EVIEWS and SPSS software has been used.

1.5 PLANS FOR THE STUDY

The study has been arranged into six following chapters:

Chapter-1 highlights the introductory background and statement of the problem to be investigated and deals with the objectives of the study, research methodology, and sources of data and general layout of the study.
**Chapter-2** explains the policy framework of GOI, trends and patterns with regard to foreign direct investments in India and also examines the extent of relationship between inflow of FDI and Industrial Output with the help of time series econometric analysis during the pre-reform period.

**Chapter-3** explains the trends and patterns with regard to foreign direct investments in India and investigates the extent of relationship between inflow of FDI and Industrial Output with the help of time series econometric analysis during the post-reform period.

**Chapter-4** analyses the impact of foreign direct investment on some selected macroeconomic variables and tries to find out the explanatory factors behind cross-state variations in the inflow of FDI in India with the help of panel data regression analysis.

**Chapter-5** analyses the nature, extent, structure and implications of Cross-border deals in India.

**Chapter-6** presents a summary of the study along with findings, which also lays down the implications of the study for future policy formulation. It also highlights the scope for further research in this area and specifically mentions the limitations of the study.