Chapter-2

REVIEW OF LITERATURE

2.1 Introduction

The present chapter provides the overview of few earlier studies from the vast literature available on outward FDI in the Indian as well as Global context. We have reviewed the literature by classifying into three categories; the first dimension is on India’s OFDI policies, trends and pattern of India’s outward FDI. The second and third part is on the determinants and impact of OFDI in the Indian and Global context. Accordingly, the study reviewed the literature in the following headings;

- Review of Literature on India’s OFDI Policies, Trends and Pattern
- Review of Literature on Determinants of Outward FDI
- Review of Literature on Impact of Outward FDI on Home country

2.2 Review of Literature on Policies, Trends and Pattern

Pradhan and Abraham (2004) examined the Patterns and motivations behind the overseas M&A’s by Indian enterprises. This paper provided useful insights into the nature and character of M&A’s done by developing country enterprises. The study found that the large majority of overseas M&A’s which are originated within services sector led by software industry and in some difficult cases were
directed towards developed countries of the World Economy. U.S.A and U.K are the two major hosts regarding Indian overseas M&A’s. Finally, this study suggests that Indian firm’s overseas acquisitions have been motivated by wide reasons from the access to international market, to firm-specific intangibles like technology and human skills, to benefit from operational synergies.

**Pradhan (2005)** explained in his study the overview of the changing patterns of OFDI from India over 1975-2001. This study analyses the growth of Indian Transnational Corporations (TNCs) since 1960 to 2005. The rise in the propensity of Indian firms to undertake international production is being driven by several internal as well as external factors. He shows that the increasing number of Indian MNCs during the nineties have been accompanied by a number of changes in the character of such investments which include the tendency of Indian Outward investors to have full or majority ownership, expansion, into new industries and service sectors. The overall study seems that the motives of Indian-TNCs for investing abroad is not only of market seeking but also expand the strategic assets and skills overseas through establishing trade-supporting infrastructure.

**Anwar et.al (2006)** analyzed the trend and position of the Outward FDI since 1950 to 1990 and after liberalization. This study dealt the location determinants of Indian OFDI (pull factors) such as Market size, growth rate, inflation, physical distance, taxes and investment treaties of the host country. The empirical results analyzed the
location determinants of Indian OFDI during 1970-1990 and it showed that real GDP, real GDP per capita income, geographic distance and real GDP deflator of the host country are the significant determinants in the case of Indian Outward FDI. This study suggests that developing countries governments should provide investment friendly incentives in order to attract FDI. The overall study concluded that real GDP, real GDP growth, and real GDP deflator of the host country are the influencing factors on the flow of Indian multinationals’ OFDI in the country of destination.

Nagaraj (2006) opined that India is not only experiencing a boom in Outward flow, but also it is true for developing countries as a whole. According to him recent Indian acquisitions have been, one, mainly in the advanced economies and two, the acquisitions are now concentrated in manufacturing (software being the exception). The software is the single largest industry of acquisition, followed by pharmaceuticals and the automotive industry. Although the Indian IT firms lead the number of acquisitions from India, the bulk of these firms quantitatively small in value. There are domestic reasons and international factors which are propelling Indian Outward flows and industry specific factors have also contributed to the trend. He suggested that there is a need for strategic initiatives to boost public and private sector firms to seek scarce natural resources. There is an necessity to refocus on India’s long-term investments in exploration and development of mineral and energy resources. Therefore, it may
be desirable to be open to forming joint ventures with firms in developed economies to acquire technology and design capabilities.

**Hansen (2007)** explained the theoretical synthesis which forms an appropriate analytical framework for explaining Indian Outward FDI and also explained the trends of Outward FDI from India. To inject dynamism Outward FDI from developing countries, the Investment Development Path (IDP) is useful. The IDP seeks to explain the link between the net Outward FDI flows and the level of development of a given country. This study explains about the three phases i.e. the initial phase (1975-1990), the Startup phase (1991-2000) and the Take-off phase (2001 onwards). Overall this study provides explanations for the unique Indian outward investment path and explained the idiosyncratic nature of Indian industrialization.

**Kumar (2007)** analyzed the trends, patterns and determinants of Outward FDI by Indian enterprises. This study quantitatively analyses the patterns and determinants of Outward FDI activity of Indian enterprises by using exclusive panel dataset and the data covering 4,271 Indian enterprises in manufacturing from the period 1989/90 to 2000/01. After economic reforms, Outward FDI notably has been increased and thereafter Outward FDI has been accompanied by a shift in the geographical and sectoral focus as well. Indian firms have also started to acquire technology, natural resources and strategic assets in developed countries. The author developed a framework for explaining the probability of Indian enterprises investing abroad.
Finally, the study says that liberalization policy of the 1990s has encouraged Indian enterprises to venture Abroad.

**Shyamala (2007)** shared her views in an International conference that exports were the main door towards the globalization but now the scenario has changed. Acquiring overseas assets, including intangibles like brands and goodwill also influencing in World market. In this paper, she focused on trends and evolution of overseas investment policies. The author classified into two distinct phases i.e. pre 2003 phase and the post-2003 phase and also tried to trace out the policies implemented by the Govt. since 1968 till now.

**Nayyar (2008)** analyzed that rapid expansion in Outflows of Foreign Direct Investment from India and the spurt in foreign acquisitions by Indian firms during the past decade. He explained the trends and patterns before 1990 and also analyzed the trend after liberalization up to 2006. The expansion of foreign direct investment from India has been led by mergers and acquisitions abroad. There was a phenomenal expansion in OFDI from India during the 1990s, in both absolute and relative terms. The period 2005 was probably a turning point because the boom in acquisitions abroad by Indian firms more significant during this period. This study shows that acquisitions in abroad by sector-wise during the period 2000-06 i.e. more than 40% of the acquisitions were in manufacturing sectors, while another 30% were in the information technology sector and almost 80% of the acquisitions were in the industrialized countries. Consequently, this
study endeavored on the trend up to 2006 and analyzed the sectoral distribution of OFDI and also highlighted some economic implications which are revealed positive and negative implications.

**Pedersen (2008)** made an assessment of the recent international expansion of Indian companies in the second wave of investments abroad. The study elaborated the policies towards Outward FDI since 1969 and continued upto liberalization and thereafter as well. The Indian companies are targeting the markets in Europe and the U.S.A. through acquisitions of local companies. Consequently, Indian companies have been continued investment in developed and developing countries to expand their market and brand name at the global level.

**Athukorala (2009)** observed that the new investors who called as Emerging Multinational Enterprises (EMEs) were first recognized in late 1960 and the bulk of their investment was in developing countries. Since about the early 1990s, there has been a significant change in the pattern and nature of international investment by EMEs and thereafter the number of MNEs and their share in the total Outward FDI has increased notably. Indian MNEs have generally inferred that the import-substitution during the era of first four decades after independence 1947. During the period 1969, the Govt. policies toward overseas investment were formulated on the basis of the foreign exchange earning capacity of proposed ventures. However, there was a surge in Outward investment from 2005. Consequently,
the Author identified that the possible trade-off between overseas investment and domestic investment.

**Saikia (2009)** enlighten on the trend before liberalization and after liberalization. He said that the first foreign direct investment took place in 1955 and Indian companies have been invested since the 1970s, but OFDI activities quite low during this time. Later 1991, Indian companies were started to invest in host countries and rapidly increased in investment activities. Consequently, he distinguished the trends before and after liberalization and explained the factors which are motives towards outward FDI.

**Singh and Varinder Jain (2009)** explained the review of theory and practice of emerging multinationals from developing countries and also examined the India’s Outward Foreign Direct Investment in an evolutionary perspective. The study traced out the emerging pattern of India’s OFDI hints at the facilitating role of state policy to encourage the outflow of foreign direct investment. The study endeavored on trend in the restrictive period and after the liberalization. Consequently, this study is useful because it gives in depth information on what are the policies towards OFDI and how the trend has been changed since 1990.

**Hattari and Rajan (2010)** analyzed the trends and composition of Outward FDI of India which has been varying since pre-liberalization to post liberalization. The study finds that the Government has taken a more positive attitude towards internalized trend and liberalized
foreign exchange policies, access to international capital markets and other rules and regulations during the post liberalization period. While analyzing the determinants of Outward FDI, the study selected market size and distance as variables. This study identified the empirical findings which suggest Outward FDI from India is not entirely different from that of other countries in that it is motivated by broadly similar factors. In this study sample is based on a balanced panel of annual data on 57 source countries and 57 host countries between 2000 and 2005, and data set contains over 19000 observations. Ultimately the study finds that India’s Outward FDI has certainly boosted India’s image abroad as offering dynamic, highly educated, Scientists and Engineers. Overall this study concluded that the Indian company’s overseas investment may help generate positive linkages with the rest of the economy by using Indian factors of production (management, construction, IT, etc.) while also bringing back to India new technologies, brand names, export markets, and so forth.

**Baskaran and Chaarlas (2012)** opined that the Government should support for Indian firms in the overseas expansion because such kind of expansions will increase home country exports and provide raw materials to parent firms. The MNCs generate spillover effect and this helps to domestic enterprises to increase their ownership advantages. This study explains the trends and pattern of OFDI, motives for OFDI and conducted the survey on the major global acquisition by Indian corporate and their destinations. The study obtained data from RBI bulletins and World Investment Reports of UNCTAD. The study finds
that Indian MNCs after liberalization and globalization have shifted the direction and location of investment by investing more in the developed economies as compared to developing ones.

**Kasturi (2012)** explained the trends which have been changing since 2007. He opined that as India’s investment, which flows to abroad overwhelmingly, be in the form of direct investment, has been growing rapidly. The major concern of this paper is on official investment data and this paper looks for clues in RBI’s regulations and accounting practices to reconcile the different data sets as well. The study says that since last six years, the export of capital by Indian companies has risen dramatically. Consequently, India’s business conglomerates export capital is that the policy certainly works in their interest.

### 2.3 Review of Literature on Determinants of Outward FDI

**Grubaugh (1987)** tested three theories which have been advanced to explain that why some firms invest directly in foreign countries and other firms do not. The study used the data which is based on a random sample of 300 U.S. firms. The model used is similar to that reported by Horst (1972). Two functional forms were estimated, one is the Linear Probability Model, which can be estimated using ordinary least squares, the second functional form used is the cumulative logistic probability function (logit). Consequently, the results of this study consistent with Hymer hypotheses. The study also brings the statistical studies of a firm’s choice directly abroad with results obtained from case studies that have generally found support for the intangible assets model.
**Kyrkilis and Pantelidis (2003)** tested the hypothesis that determines outward FDI by choosing the variables such as real income, home country interest rate, home country exchange rate index, technology, export and import and human capital. The model used the time series data and developed to identify the main determinants of outward FDI from five European Union members and four non-European Union countries. At the end, the model provided that the real gross national product is proved the most important determinant of outward FDI and also suggested that Developed European countries specialize in human capital intensive FDI, whereas non-European union countries in technology intensive.

**Pradhan (2004)** in his study analyzed that the determinants of the overseas direct investment activity of Indian manufacturing enterprises depend on the firm-specific characteristics such as technology, Product differentiation, Marginal skill, Size and Firm age. According to the industrial organization theory, these are essential for firm's foreign investment. He has been observed that the impact of age and size on OFDI is to be non-linear. In certain industries, the product differentiation activities and the productivity of firms are other useful factors in the expansion of production. Consequently, his study sought on the emergence of firm age in the determinant of overseas production activities and product differentiation in certain industries does confer some competitive advantage on outward-investing firms.
CrespoNuno and Fontoura Paul a Maria (2007) analyzed the factors determining various dimensions of FDI spillovers. They identified that FDI spillover depends on such factors like absorptive capacities of domestic firms and regions, the technological gap, or the export capacity.

Pradhan (2007) analyzed the determinants of the overseas direct investment activity of Indian manufacturing enterprises. The study postulated that the OFDI propensity (OFDINT) of Indian enterprises depends on firm specific characteristics such as technology, product differentiation, managerial skill, size, productivity and age. The study used the Tobit model for the analysis. The study has been estimated for a sample of 3951 Indian manufacturing firms with 26346 observations during the period from 1990-91 to 2000-01. Consequently, the study revealed that the performance of the chosen firm-specific variables is subject to the sectoral dynamics.

Holtbrugge and Kreppel (2009) explained the Outward FDI particularly the determinants of OFDI from BRIC countries. The study conducted eight companies case studies (two companies from each country) to understand OFDI of the BRICS countries. The authors enlighten on the industry-level and firm-level determinants of FDI. Availability of secondary data is helped to know deeper insight of determinants of OFDI from BRICS country firms. Consequently, the major contribution of this study is the identification of several determinants of OFDI that are not adequately reflected in conventional internationalization theories.
Kayam (2009) examined the home country factors that determine the outward foreign investments from 65 developing and transition countries in the period 2000-2006. The main hypothesis tested in this study is that the small market size, trade conditions, costs of production and local business conditions are the main drivers of Outward FDI. The study selected the variables such as GDP-level and per capita- inflation, exports and imports, employment-population ratio, infrastructure. The findings of this study assert that the size of the economic activity, development level, infrastructure and labor market conditions determine Outward FDI from developing and transition countries. At the end, this study concluded that the economic performance is not the sole determinant of Outward FDI but stability in political and business environment is important as well.

Kathuria (2010) contributed to the literature by carrying out on the choice between Joint Venture (JV) and Wholly-owned subsidiary (WOS) for firms from the developing country and also this study tried to carry out whether the factors are different than the one for the developed country foreign firms. This study used a sample of 250 entries made by 142 Indian manufacturing firms during 1992 to 1999 for investigating the entry choice decision. About 35% of this entry (i.e.88 entries) consisted of WOS and remaining 162 entries were JVs. Ultimately, the result of this study indicated that the younger Indian MNCs, which were relatively big in size, having sufficient foreign experience and belonging to low-technology sector preferred going for WOS.
Subramanian et.al (2010) analyzed the trends of India’s OFDI and also attempted to identify the driving factors of OFDI. The study analyzed by chosen 287 instances of foreign investment from India by top Indian companies across 17 sectors and has drawn “eclectic” paradigm to study the impact of ownership, location and internalization variables on India’s foreign investment. At an aggregate level, the study has been found that acquisitions have been the predominant mode of entry for Indian firms investing abroad and seeking new markets the primary intent of investment. At the end, the study also found that high distribution expenses and the need for resources had a very positive influence on foreign investment.

Nunnenkamp et.al (2012) empirically assessed the determinants of India’s OFDI across a large sample of host countries during the period from 1996-2009. The study used the Poisson pseudo maximum likelihood (PPML) estimators based on the gravity model specifications. The major finding of the study is that the India’s OFDI is hardly affected by motives to access raw materials or superior technologies. Finally, the study found out the Indian direct investors are relatively resilient to weak institutions and economic instability in the host countries. The study identifies GDP of the host economy, Per capita GDP of the host economy, Corruption index of the host economy, R&D spending in host economy influence on country’s OFDI.

Das K. (2013) examined the home country determinants of outward FDI from developing economies by doing an empirical study. The
study was based on panel data and covered the period from 1996-2010. The study was using the variables such as GDP per capita, exports and imports as a percentage of GDP, political risk index, R&D and Real effective exchange rate. The overall study indicates that the home country’s level of economic development, globalization, political risk and technological efforts are significantly contributed to outward FDI from developing countries.

Garcia-Herrero and Deorukhkar (2014) analyzed the empirically what are the factors behind the geographical destination of India’s OFDI. The study estimated the gravity model by using weighted EGLS into a panel data of 74 ODI destinations from India during the period from 2008 to 2012. The result suggested that India’s direct investors are attracted towards richer countries and not so much proximity with India. Furthermore, the bilateral and/or multilateral free trade agreements with host countries are found to strengthen outward FDI from India. At the end, the study suggested that an efficient governance system in host countries is found to attract higher OFDI from India.

Sarma (2015) explained the decision behind India’s outward investments to its top destination countries. The study used panel data by choosing the period from 2008-2013 and selected ten countries and six determinants of FDI flow. The evidence shows that India’s overseas investment decisions are not homogenous and differ on the characteristics of the host country. At the end, the study shows that trade and exchange rate is determining factors for India’s OFDI flow to other countries.
2.4 Review of Literature on Impact of Outward FDI on Home country

Kim (2000) examined the effects of Outward FDI on home country performance with reference to Korea. He tackled two main questions in this study i.e. what role did Korean OFDI play in its economic performance? And, what are the characteristics of Korean OFDI? Korean firms have weak capabilities, so called small bases of ownership advantage. Outward FDI by Korean conglomerates intended more to establish market share in host countries. The study comes to know that Korean OFDI has been most concentrated in the manufacturing sector, followed by wholesale trade. Kim assessed the effect in terms of domestic investment and Exports. He opined that the effect of OFDI on domestic investment is mixed. He used the variables such as GDP, GDP per capita and OFDI, to assess the effect of OFDI on Korean country. Finally, this study concluded with the hints that the effect of OFDI is likely to be positive.

Dasgupta (2005) examined the long run effect of Indian exports, imports and FDI inflows on the outward FDI. The study covered the period over 1970 through 2005 and used the Granger causality and vector autoregression (VAR) model. The result shows that strong evidence of unidirectional causality from the variables such as export and import to outward FDI. But the inward FDI indicates that the effect of FDI inflows on the determination of outward FDI is still limited in India.
Desai, Foley and James (2005) in their study tried to evaluate the evidence of the impact of Outbound FDI on the domestic investment rates. They observed that the OECD countries in the eighties had high rates of Outbound FDI and in nineties exhibited lower domestic investment than other countries, which suggests that FDI and domestic investment are substituted for each other. However, when US MNCs had greater foreign capital expenditures, with greater domestic capital spending by the same firms, suggesting that foreign and domestic capital are complements in production by the MNCs.

Konings and Murphy (2006) analyzed the employment behavior of home multinational enterprises in Europe. The study used the panel data set of more than 1000 European multinational parent enterprises and their European affiliates. The study found that the labor cost elasticity of parent employment in the manufacturing sector regarding North EU affiliates labor cost is positive and statistically significant. This shows that employment substitution between parents and their North EU based affiliates takes place in response to wage cost differentials between the parent and its North EU based affiliates. At the end, the study says there is no evidence to show the substitution effects between parent employment and its affiliates that are located in low-wage regions in the EU and in the Central and Eastern Europe.

Castellani, Mariotti and Piscitello (2008) investigated the impact of Outward FDI by Italian multinationals on their total employment and skill composition. The study distinguishes investments towards i)
advanced countries, ii) Central and Eastern Europe (CEE) countries, and iii) other developing countries. The study attempted empirical analysis by using data on 108 Italian manufacturing firms which set-up their first production affiliate in the period 1998-2004. The data obtained from, The Reprint database, which has been compiled at the politecnico di Milano (it is sponsored by the Italian Institute for International Trade (ICE), The Outlook on Balance sheets of Italian incorporated companies and The Excelsior database, which provides data on Italian firms employment from 1998 to 2004. The study concluded that the impact of Outward FDI on the skill composition of the parent company is positive and significant only when foreign initiatives are undertaken in Central and Eastern Countries, supporting the hypothesis that the transfer of labour intensive production activities which require lower skilled employees, leads to an increase in skilled workers at the parent company level.

**Bhaumik et.al (2010)** examined the impact of Ownership structures of emerging-market firms which are shaped by local institutions, on the decision of these firms to undertake Outward FDI. The result of this study suggested that family firms and firms with concentrated ownerships are less likely to invest overseas and that strategic equity which is held by foreign investors facilitates Outward FDI. The analysis of this study is based on firm-level data from the Indian pharmaceutical and automotive sectors. The data covered from 2000 to 2006, resulting in 5410 firm-year observations.
Goh and Wong (2011) have done an empirical study on Malaysia’s OFDI by considering the impact of foreign market size and home international reserves by using multivariate cointegration and error correction modeling techniques. The empirical result shows that there is a positive long-run relationship between Malaysia’s OFDI and its key determinants such as foreign market size, real effective exchange rate, international reserves and trade openness. The study suggests that apart from the market seeking incentive and the adoption of outward-oriented policies, the Malaysian government could also encouraged OFDI by implementing liberal policy on capital outflows. On the basis of the findings, the study has drawn some policy implications for the country’s economic development.

Goh and Wong (2012) tried to explore the impact of Outward and Inward Foreign Direct Investment on domestic investment in Malaysia. He used a model which is developed by Feldstein and Horioka (1980) or called as F-H model to explore the impact of OFDI on domestic investment. Gross Domestic Investment (GDI), Gross National Savings (GNS), IFDI and OFDI are the variables which are used in this study. The data has obtained from Bank Negara Malaysia’s (BNM) Monthly Statistical Bulletin. The sample period of the study was from 1999Q1 to 2010Q3. The study used “bounds” testing approach developed by Pesaran (2001) which is based on the OLS estimation of an ARDL equation to analyze the long run effect of OFDI on GDI. This model (ARDL) showed that there is a long-run equilibrium relationship involving the four variables i.e. between domestic investment and its determinants viz. FDI Outflows, FDI Inflows and domestic savings.
Ali (2013) in his working paper empirically examined that effect of Outward FDI on domestic investment in developing countries. Developed countries have concern about the impact of Outward FDI on domestic investment when raising the levels of Outward FDI, whereas developing countries haven’t concern on such kind of effect on domestic investment. In order to find out the impact of FDI outflows on domestic investment, this study applied an econometric model based on a modified version of the flexible accelerator model and employs panel data for 121 developing countries over the period 1990-2010. The empirical study shows that Outward FDI reduces the domestic investment in the home country. Obviously, the empirical result shows that FDI outflows negatively impact on the rate of domestic investment.

Sermcheep (2013) addressed the two questions in this study viz. what are the pattern and trend of Thailand’s FDI, transition from inward to outward FDI, and what are the implications of this transition on Thailand’s economic growth?. The study examined the pattern and the implication of FDI on Thailand economy during the period 1978-2011. In this study, the result shows that the major destination of Thailand’s outward is ASEAN and inward FDI contributes to Thailand’s economic growth and industry development. The study also found when Thailand becomes the exporter of direct investment; this may not discourage domestic investment and export.
2.5 Research Gaps

The above studies highlighted on Indian as well as international context regarding trends, pattern, determinants and impact of Outward Foreign Direct Investment. In the Indian context, after the liberalization, we found that there are changing trends and patterns in India’s OFDI. However, there are few studies focused on India’s OFDI. From the literature, it is found that there is a lack of in-depth study with focus on assessing the impact of India’s liberal OFDI policy on trend and pattern, identifying the determinants, how these determinants are influencing on India’s OFDI and finally what is the impact of OFDI on Indian economy. In this context, it clearly shows that there is a need of an in depth study with focus on assessing the policies, trends, patterns, determinants and its impact. Therefore, the present study, with identifying such research gaps in the literature relating to India’s OFDI, tries to provide comprehensive picture on policies, trends, determinants and its impact of the India’s Outward FDI.