Chapter 1

INTRODUCTION

The growth and rising prominence of emerging economies such as Brazil, Russia, India, China and South Africa (BRICS) has been a salient feature of the world economy in the last decade. These economies have not only been major recipients of foreign direct investment (FDI) but have also transformed themselves as important outward investors. While surges in a country’s inward FDI highlight a country’s attractiveness as a destination for foreign investors, outward FDI (OFDI) is indicative of an economy’s ability and competitiveness to venture beyond its domestic boundaries. This palpable trend of developing economies contributing significantly to World FDI flows has resulted in bringing about a paradigm shift to international business. They have not only redefined the competitive structure and nature of global industries but have also become a new source for business opportunities.

Traditionally advanced economies have been the investors in the developing and under developed economies. These economies have not only liberalised their OFDI policies completely but also put in place a number of policy tools to assist their firms in investing abroad. Some of the OFDI promotion programmes include the dissemination of information and technical assistance, equity and loan financing, and investment insurance. Developed countries have also led the process of concluding bilateral investment treaties (BITs) and double taxation treaties (DTTs) with other countries (UNCTAD, 1995).

Inspired by their Northern Partners, emerging market economies (EMEs) have also initiated various liberal and promotional measures in a phased manner to encourage OFDI for strengthening organic and inorganic growth of their firms, thereby providing impetus to the industry and the economy at large.
1.1 Outward Foreign Direct Investments: Global Trends and Perspectives

Over the last decade, global outward direct investment (ODI) flows have risen significantly from US$ 760 billion in 2001 to a peak of US$ 2,272 billion in 2007; with both the developed and developing economies contributing to this trend. While the global financial crisis, which surfaced in 2008, brought about a slowdown in global ODI flows, they once again bounced back in 2010 and recovered by 30.8 per cent to touch US$ 1505 billion. This recovery trend continued well into 2011, with FDI outflows registering 11.4 per cent increase to aggregate to US 1678 billion. Nonetheless, in 2012 ODI flows again witnessed a decline to touch US$ 1391 billion (World Investment Report (WIR), 2013).

A palpable trend in the world FDI outflows has been the growing prominence of developing economies as key contributors to these flows. The share of developing economies (including transition economies) in world ODI flows increased by close to three times from 12.5 per cent in 2001 to 34.6 per cent in 2012. This surge in developing country FDI outflows over the last few years has largely been due to the dynamism exhibited by the countries of the Asian region. The share of developing Asia in developing country ODI flows (including for Transition Economies) increased from 58.9 per cent to 64.0 per cent, while the share of transition economies increased from 9.7 per cent to 11.5 per cent, during the same period. Within Asia, China has led the pack, with its share increasing from 8.4 per cent to 17.5 per cent. India, on the other hand, witnessed a marginal decline in share from 2.0 per cent to 1.8 per cent during this period. The other key players accounting for ODI flows from Asia include South Korea followed by Hong Kong, Taiwan and Singapore.

Bulk of the ODI stock within developing economies was from the Asia region which grew from 68.6 per cent in 2005 to 70.8 percent in 2012. The ODI stock share of China and India in overall developing economies’ ODI stock increased from 3.9 per cent to 11.4 percent and from 0.6 percent to 2.6 per
cent, respectively during the period 2005-2012. The outward FDI policy of both the countries has been different reflecting the differences in their political systems and overall development strategies. While China’s overseas investment thrust has been more top-down, India’s approach has been more decentralised and a large part of its outward FDI has been undertaken by private companies unlike China, where a large part of outward FDI is contributed by state owned enterprises (WIR, 2013).

In 2013, global FDI flows witnessed an upswing and rose by 9 per cent to $1.45 trillion in 2013. This trend was witnessed across all major economic groupings – developed, developing, and transition economies. The rise has been majorly driven by the economic recovery which began in most of the developed economies. Some emerging markets continued to be vulnerable owing to risks related to policy uncertainty and regional conflict derailing the expected upturn in FDI flows (WIR, 2014).

Developing Asia continued to be the region with the highest FDI inflows, significantly above the EU, traditionally the region with the highest share of global FDI. FDI inflows were up also in the other major developing regions, Africa (up 4 per cent) and Latin America and the Caribbean (up 6 per cent, excluding offshore financial centers) in the year 2013-14. Although FDI to developed economies resumed its recovery after the sharp fall in 2012, it remained at a historically low share of total global FDI flows and 57 per cent below its peak in 2007. Thus, developing countries maintained their lead over developed countries by a margin of more than $200 billion for the year 2013-14. Developing countries and transition economies now also constitute half of the top 20 economies ranked by FDI inflows (WIR, 2014).

1.2 Regional Trends in FDI

Developing Asia remained the number-one investment destination with total FDI inflows of $426 billion in 2013 and accounted for nearly 30 per cent of the global total and remained the world's number one recipient region. FDI inflows to East Asia rose by 2 per cent to $221 billion. The stable performance
of the sub-region was driven by rising FDI inflows to China as well as to the Republic of Korea and Taiwan Province of China. With inflows at $124 billion in 2013, China again ranked second in the world. In the meantime, FDI outflows from China swelled by 15 per cent, to $101 billion, driven by a number of megadeals in developed countries. The country’s outflows are expected to surpass its inflows within two to three years. Inflows to South Asia rose by 10 per cent to $36 billion in 2013. The largest recipient of FDI in the sub region was India which experienced a 17 per cent increase in FDI inflows to $28 billion. Corridors linking South Asia and East and South-East Asia are being established such as the Bangladesh-China-India-Myanmar Economic Corridor and the China-Pakistan Economic Corridor which is expected to enhance connectivity between Asian sub regions and provide opportunities for regional economic cooperation. These initiatives are likely to give a boost to infrastructure investment and improve the overall business climate in South Asia (WIR, 2014).

1.3 Outward Foreign Direct Investments: Indian Perspective

Contemporaneous with the global trend, India too has followed the OFDI path. The efforts to encourage OFDI by the developing economies face an inherent macro- micro conflict. The macro aspect is related to balance-of-payments (BOP) considerations in terms of outflows through OFDI. The micro aspect encompasses the international competitiveness of firms as it enables firms to access not only markets but also a wide gamut of resources required for production. Notwithstanding this dilemma, countries like India with a strong growth trajectory have gone for OFDI. In the Indian context, encouraging OFDI has been a logical outcome of its growing globalisation, liberalisation and privatisation process.

The increasing liberalisation measures initiated in external trade and investment regimes backed by internal economic reforms have resulted in Indian firms expanding their business operations into overseas market. Prior to 1990s, the early initiators of Indian overseas investment activities were a small group of family – owned large business conglomerates largely focusing
on neighbouring developing countries (Pradhan 2005). But since 1990s Indian firms have resorted to outward investment as an important internationalisation strategy (Pradhan and Sahoo, 2005) both for survival as well as to capitalise the opportunities offered by a global market. Between 1991 and 2003 the number of outward investing Indian companies have grown at a rate of 809 percent from 187 to 1700, much higher than countries like China (805 percent), Republic of Korea (611 percent) Brazil (116 percent) and Hong Kong (90 percent) over comparable periods (WIR, 2006).

Increasingly, outward investments have come to be regarded as a tool for achieving global competitiveness for the Indian firms besides enabling them to acquire new knowledge, technology, competent business practices and other firm specific intangibles leading to higher exports from the home country. In industries such as pharmaceuticals, software, IT, telecommunications, and transport, Indian MNCs have based their investments on advanced technologies, high knowledge intensity and on cutting edge strategies and organizational modes (Huang and Khanna, 2003).

Indian OFDI has provided its domestic corporate sector better access to global networks and markets, transfer of technology and skills which has enabled them to share research and development efforts and outcomes. OFDI has also been seen as a corporate strategy to promote the brand image and utilisation of raw materials available in the host country. Indian overseas investments have been primarily driven by either resource seeking or market seeking or technology seeking motives. Of late, there has been a surge in resource seeking overseas investments by Indian companies, especially to acquire energy resources in Australia, Indonesia and Africa. Even within the traditionally highly protected Indian manufacturing industry, there are a range of Indian manufacturing firms becoming global leaders in their industry. For example: Ranbaxy Laboratories, Reliance Industries, Hindalco metals, Welspun, Jubilant Organosys, Tata Motors, Bajaj Auto, Moser Baer, etc. (India Brand Equity Foundation, 2007). Therefore, it appears that India is in the middle of an OFDI take-off.
The Indian outward investments were also meant to contribute to the South-South Cooperation where Indian multinationals were visualized to play a constructive role in the development of host Southern region in a non exploitative and mutually beneficial ways unlike the developed country multinationals. India’s journey on the OFDI path is a salient aspect of globalisation. Firms from developing countries like India have become new champions of the forces of globalisation, competing very often on par with MNCs from developed countries rather than become victims of their own restrictive domestic regimes.

1.3.1 Trends in India’s Investment: Inflows & Outflows

During the beginning of the last decade, trends in direct investments both inward and outward were rather meagre and gained momentum steadily only during the latter half of the same decade. FDI inflows increased from US$ 3.9 billion in 2001-02 to US$ 46.6 billion in 2011-12, registering a CAGR of 28.2 per cent. FDI Outflows on the other hand on the other hand registered a higher growth, increasing at a compounded annual rate of annual rate of 40.9 per cent – from US$ 1.0 billion to US$ 30.9 billion during the same period. While the gap between FDI and ODI flows, were quite substantial during the first half of the decade, it narrowed down significantly in subsequent years. In 2001- 02, annual outflows, on average, amounted to 26 per cent of inflows which increased to 33 per cent in 2004-05. However, in the year 2005-06, FDI outflows shot up significantly and were 87 per cent of the inflows in that year, before tapering to 47 per cent in 2010-11, but again moved northwards to touch 66 per cent in 2011-12. The sudden spurt of the ratio of ODI to FDI in 2011-12 was largely on account of substantial increase in FDI outflows by 88 per cent from US$ 16.4 billion in 2010-11 to US$ 30.9 billion in 2011-12 (RBI Bulletins). However, past two years witnessed a decline in these investments which fell to $ 11,097 million in FY12 and further to $ 7,134 million in FY13. Total FDI investment made by India between April–January FY14 stood at $ 29,294 million. Out of the total investment, $ 19,079 million were guarantee issued, which accounted for 65.1%. Investment in equity and
loans stood at $7,007 million and $3,208 million with a share of 23.9% and 11% respectively (RBI Bulletins).

1.4 Significance of the Study

The current study attempts to capture the contemporaneous trends of emerging economies by focusing only on the under explored aspect of FDI flows namely the Outward Foreign Direct Investments from India. The theme is having considerable policy relevance in the context of an underlying dilemma of micro level competitive requirements of firms and enhancement of industrial growth and macro level BoP considerations through outflows by OFDI. The study is relevant as it addresses the misconception that OFDI would be a development constraint for the home country as OFDI is perceived as flight of capital. Lastly, studying outward FDI flows helps to assess the extent to which the Indian economy has globalised. The empirical analysis attempted in the current study aims to contribute to the limited research on the motives, and internationalisation strategies of developing country MNEs by focusing on those host country specific advantages (CSA) which have attracted Indian MNEs to invest abroad.

1.5 Scope of the Study

The current study analyses both the macro and micro aspects of Indian OFDI over the last five decades. At the macro level the study examines the evolution of India’s policy regime with respect to OFDI, the sectoral and regional distribution of these investments, ownership choice, and government policy. The measurement of foreign direct investment in the Indian context is also enumerated besides exploring the developmental impact of such flows both on the home country and the respective host countries.

In the last decade a host of new multinational enterprises have risen from developing countries such as India and China also known as latecomer multinationals which have challenged the existing paradigms and mainstream theories of the developed countries. In this context the study focuses on the
motivations and drivers of the India multinationals and looks at the factors behind their recent growth which has remained a fairly neglected topic. The study takes into its fold the case of the Indian Pharmaceutical industry due to its global competitiveness and examines the internationalisation strategies of these firms.

Using a Panel data set on foreign acquisitions by Indian Pharmaceutical MNEs over the period 2000 to 2012, the study seeks to examine the locational determinants of Indian OFDI. It focuses on the country-specific advantages (CSA) like market size, macroeconomic indicators of the host country, business policies and environment which have attracted India MNEs to invest abroad (Pull factors).

1.6 Objectives of the Study

The study of O-FDI at a macro level involves the following as objectives:

1. To examine relevant theoretical and empirical literature summarising mainstream and alternative explanations for the theories of FDI and the theory of internationalisation of firms with particular emphasis on studies of firms from developing countries.

2. To observe the trends and patterns of FDI outflows.

3. To enumerate the major policy initiatives taken to boost FDI Out flows.

4. To analyse the magnitude of OFDI flows.

5. To track sectoral composition of OFDI flows from India.

6. To map the geographical distribution of Indian overseas investments flows across the developing and developed region.

7. To identify Top ten destinations of Indian overseas investments.

8. To explore the deviations in the Indian OFDI Path from mainstream theories.

9. To gain some insights regarding levers that would help in encouraging FDI Outflows and make policy recommendations.
The Study of O-FDI at a micro level has the following as objectives:

10. To examine the case of the Indian Pharmaceutical industry as a prominent outward investor and assessing factors responsible for its rapid growth.
11. To understand internationalisation strategies adopted by the Indian Pharmaceutical Multinationals.
12. To track spatial distribution of Indian pharmaceutical overseas investments.
13. To carry out testing of the locational determinants of Indian Pharmaceutical acquisitions.

1.7 Hypotheses

In accordance with the objectives of the study, the current study attempts to test the following hypothesis.

$H_1$ : The market size of the host country has a positive impact on the number of Indian Pharmaceutical acquisition deals.

$H_2$ : The host country endowment of Strategic assets has a positive impact on the number of Indian pharmaceutical acquisition deals.

$H_3$ : Sound economic environment of the host country has an impact on the number of Indian pharmaceutical acquisition deals.

$H_4$ : The institutional environment of the host country has an impact on the number of Indian Pharmaceutical acquisition deals.

$H_5$ : The geographical distance between India and the host country has an impact on the number of Indian pharmaceutical acquisition deals.

$H_6$ : The host countries speaking English language have a positive impact on the number of Indian Pharmaceutical acquisition deals.
$H_7$: The openness of the host country has a positive impact on the number of Indian Pharmaceutical acquisition deals.

1.8 Limitations of the Study

The locational choice model in the current study has been confined only to the Indian pharmaceutical industry. In the empirical model, the deal value of pharmaceutical acquisitions could not be considered as a dependent variable, as most of the times the deal value is not disclosed by companies. Also due to unavailability of data of some of the independent variables, some acquisition deals could not be considered for analysis. Another important limitation of the study is that the study focuses on only the country-specific advantages in attracting FDI while firm-specific advantages are not within the scope of the study.