Chapter 2

LITERATURE REVIEW

The growing importance of FDI has led to the development of numerous theories and models seeking to explain the motivations behind FDI and MNCs’ choice of particular entry modes and localisations. Researchers unanimously agree that the phenomena of FDI cannot be explained singularly by a single theory, and requires a variety of different theoretical assumptions, approaches, and models (Faeth, 2009) which are not mutually exclusive. Early definition of the nature of FDI was descriptive in nature and more recently has included empirical analysis with econometrics (Vasyechko, 2012). This chapter provides a comprehensive evaluation of the existing literature on multinational enterprises (MNEs) and foreign direct investment (FDI) through a chronological description of the main strands since the earliest perfect competition studies from the 1960s till the more recent contributions such as the Knowledge-capital model and other works on internalisation issues. It covers both theoretical and empirical studies. The literature review has been presented in a thematic manner under the following sections (Table-2.1).

Table 2.1: Chapter Scheme

<table>
<thead>
<tr>
<th>Section 2.1</th>
<th>Theoretical models of FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section 2.2</td>
<td>Empirical literature on the locational determinants of Indian OFDI</td>
</tr>
<tr>
<td>Section 2.3</td>
<td>Literature on the trends, patterns and determinants of Indian OFDI.</td>
</tr>
<tr>
<td>Section 2.4</td>
<td>Literature regarding the evolution, growth and the internationalisation strategies adopted by the firms in the Indian Pharmaceutical industry.</td>
</tr>
<tr>
<td>Section 2.5</td>
<td>Literature on the evolution, growth and pattern of OFDI flows from other emerging and developing economies.</td>
</tr>
</tbody>
</table>
2.1 Theoretical Models of FDI

This section covers the main nine theoretical models which are as follows.

(1) Early studies of determinants of FDI
(2) Determinants of FDI according to the neoclassical trade theory
(3) Ownership advantages as determinants of FDI
(4) Aggregate variables as determinants of FDI
(5) Determinants of FDI in the ownership, location and internalisation advantage (OLI) framework
(6) Determinants of horizontal and vertical FDI
(7) Determinants of FDI according to the knowledge-capital model
(8) Determinants of FDI according to diversified FDI and risk diversification models, and
(9) Policy variables as determinants of FDI.

2.1.1 Early Studies on Determinants of FDI

Early empirical works typically regarded FDI to be determined by a host of factors such as marketing factors, trade barriers, costs factors and investment climate. The marketing factors included market size, market share and growth. The cost factors, involved labour availability and raw materials, besides lower production costs. The other notable determinants were financial inducements by the government, political stability (Basi, 1963) along with foreign exchange stability. Some of the major contributors analysing FDI in general were Robinson (1961), Behrman (1962), Basi (1966), Kolde (1968), Wilkins (1970) and Forsyth (1972), while FDI in Australia was explored by Brash (1966), FDI in New Zealand by Deane (1970), FDI in Scotland by Forsyth (1972) and FDI in Ireland by Andrews (1972).
2.1.2 Determinants of FDI According to the Neoclassical Trade Theory

The first theoretical explanation of FDI as part of international capital trade was based on the Heckscher–Ohlin Model of the neoclassical trade theory. The Heckscher–Ohlin model provided a $2 \times 2 \times 2$ general equilibrium framework which involved two countries (domestic and foreign), two factors of production (usually capital and labour) and two goods with the assumption of perfect competition in the goods and factor markets. The Model also assumed identical constant returns to scale production functions with zero transport costs and excluded specialisation from factor endowments. The Model acknowledged differences in factor endowments and commodities between countries, given their varied factor intensities. These differences gave rise to international factor price differentials which often resulted in a relatively capital abundant country exporting the capital-intensive good or moving capital to foreign in the absence of commodity trade where the expected returns on capital involved is higher and returns on labour lower until factor price equalization is achieved. However, countries could influence the magnitude of capital returns and capital flows through the imposition of taxes to increase their welfare. The neoclassical approach has been criticized by many researchers for its lack of realism and inability to explain FDI (Hymer, 1976; Kindleberger, 1969). Both the authors were of the view that FDI took place in the presence of structural market imperfections. However, the neoclassical assumption that capital moves from economically developed countries towards the capital-scarce countries was very important for understanding FDI incentives in transition economies (McDougall, 1960; Kemp, 1964).

Aliber (1970) was of the view that capital movement was due to differences in capital returns owing to differences in capital endowments and currency risks. Firms from countries with less fluctuation in value could borrow money in countries with ‘softer’ currencies at a lower interest rate than host country firms due to their lower risk structure incentivising them to invest in the host country.
2.1.3 Ownership Advantages as Determinants of FDI

Coase (1937) introduced the concept of transaction costs to explain the international activities of the firm and their spatial distribution of assets. In line with Coase, Hymer (1960) offered a micro economic analysis of MNCs based on the industrial organization theory. Hymer (1976) and Kindleberger (1969) criticized the assumption of perfect competition in the neoclassical theory and opined that for FDI was based on market imperfections. They therefore focused on the concept of ‘monopolistic advantage’ to explain firm’s international activities. According to Hymer the neo-classical theory of portfolio flows fails on three counts in explaining firms cross border activities. Firstly, the behavior and performance of firms and their strategy in foreign markets is significantly influenced by the presence of market imperfections such as risks and uncertainty, volatile exchange rates and costs of acquiring information.

Secondly, Hymer pointed out that FDI is not merely a flow of financial capital, but a foreign firms possession of a ‘monopolistic advantage’ in the form of ownership advantages such as product differentiation, managerial expertise, new technology or patents, to overcome the disadvantages of entering a foreign market such as higher risk, less information, more uncertainty, physical distance and differences in culture and the legal system and other regulations in order to successfully compete with local firms.

Thirdly, Hymer distinguished between foreign direct investment (FDI), which involves no change of ownership of the transferred sources or rights and portfolio investment where in a change of ownership takes place. He stated that both the forms of investment differed both in the organisational modality as well as in the value added by both of them.

Caves (1971) stated that MNEs would prefer FDI over exporting or licensing if the focus was on product differentiation rather than in managerial skills. He focused therefore on product differentiation as a monopolistic advantage and believed that the presence of imperfect competition in international markets induces firms to differentiate their products and undertake horizontal FDI. A
successful firm, producing a differentiated product, can not only service the domestic market but also the foreign markets at little or no cost.

Knickerbocker’s (1973) theory characterized FDI as an oligopolistic reaction to a competitor’s investment. He opined that the optimal strategy for a firm was to match its rivals ‘actions move for move even though there was no immediate advantage for the followers. The intention was to simply spoil the market for the leader. He analysed the behaviour of 187 US firms that had invested in 23 countries and found evidence for ‘follow-the-leader’ FDI. Graham (1978) offered a similar theory in which oligopolists imitate each other by establishing subsidiaries in each other’s market. He found proof when analyzing the reaction of European MNEs to US FDI in Europe.

The oligopolistic reaction theories of FDI were criticized for failing to explain the objective of a firm while undertaking overseas investments such as, profit maximisation, managerial risk aversion, growth maximization, etc. (Buckley and casson, 1976). These theories also do not clearly explain why firms have to follow the leader irrespective of the profitability of the leader’s strategy. There was also no clarity on which firm would emerge as a leader and whether the leader can change over time. The motivations of the leader in investing overseas were also not explicitly stated. But rivalry between firms also affects their decisions to cut production costs to become more competitive, which led Vernon (1966) to explore the theory of product life cycle and Aharoni’s (1966) behavioral theory which sought to explain why companies opt for FDI through competition factors, such as the fear of loss of competitiveness, the need to follow rivals into foreign markets and increased competition in the domestic market. Vernon related investment theory to trade theory, arguing that the investment decision was a decision between exporting and investing, as products move through a life cycle divided into three stages (new, mature and standardized products), giving a cost-based rationale for the switch from exporting to foreign based production.

At the new product stage, the innovating firm initially enjoys a monopoly position requiring highly skilled labour for the development and improvement
of the product. Initially, the firm extends exports to countries similar in market conditions to the innovating country. As the product moves to maturity, huge capital outlays are undertaken for mass production and for marketing of the products and the investor begins to undertake overseas investment with FDI displacing exports. At this stage the direction of the investments is targeted largely towards the developed countries. Finally, at the standardized product stage, the product begins to enjoy growing consumer acceptance leading to mass production. The technology stabilises requiring raw materials, capital and unskilled labour. At this juncture the direction of the investments shifts from the developed to the developing countries abundant in unskilled and cheap labour with competition based solely on price.

Buckley and Casson (1976) formalized the various streams of thought into a theory of the MNE which was an extension of Coase’s (1937) internalisation concept. By comparing the efficiency of various forms of transactions between firms, Coase stated that it may be efficient for a firm to “internalise” market transactions than incur the costs involved using an external market because of transaction costs and market. According to Buckley and Casson the same was true for MNEs. The internalisation (transaction) theory holds that “firms choose the least cost location for each activity they perform, and grow by internalising markets up to the point where the benefits of further internalisation are outweighed by the costs” (Buckley, 1988).

Four factors were found to be critical to the internalisation decision. They were industry specific factors such as the nature of the product and the structure of the external market, secondly region specific factors such the geographical and social characteristics of the region linked by the market, thirdly nation specific factors relating to the political and fiscal relations between the nations concerned, and lastly firm specific factors which reflect the ability of the management to organise an internal market". (Buckley and Casson, 1976). Casson observed that MNEs that were active in research and development (R&D) intensive industries had a higher degree of internalisation.
Later on researchers considered "transaction costs" or "natural market imperfections" to be critical for the decision to internalise markets (Teece, 1981, 1985; Rugman, 1982; 1986; Hennart, 1982, 1991; Casson, 1982) as they covered all the costs in organising an economic activity. The logic was that if firms incur lower costs or higher revenues, then they will internalise markets across national boundaries.

Hennart (1982, 1991), theory was largely based on McManus’s (1972) theory of property rights and Williamson’s (1975) ‘market and hierarchies’. He argued that expertise and good will lead to internalisation advantages resulting in horizontal integration, while lack of competence in other markets may result in vertical integration. In both cases, MNE hierarchy could replace the price system of the market thereby eliminating transaction costs and be more efficient. Hennart saw FDI more as a response to natural market imperfections (such as imperfect information) rather than to structural market imperfections (such as market power). Contrary to Hennart (1981), Teece (1985) described vertical FDI as the response to market failure, while horizontal FDI was the response to both market power and market failure. He further added that incentives to internalize markets could be the "circumventing or minimizing taxes and controls" and monopoly power. Casson (1987) argued that any market imperfections distorting market prices such as government regulations, tariffs and taxes, controls and asymmetric information between buyers and sellers also provided an incentive to internalise production.

### 2.1.4 Aggregate variables as determinants of FDI

Scaperlanda and Mauer (1969) tested aggregate variables to explain MNCs’ incentives to invest. They found evidence of an impact of GNP size on FDI in Europe. Other researchers also proved through their empirical works the role played by important FDI determinants such as market size, market growth, distance between the investor and host countries, cultural and language similarities, and diverse trade barriers (Goldberg, 1972; Davidson, 1980; Lunn, 1980). These variables were used largely in modeling, especially in the gravity model.
2.1.5 Determinants of FDI in the OLI Framework

Dunning (1979, 1980, 1988) combined the internalisation theory and traditional trade economics to develop an eclectic paradigm also known as the “OLI (Ownership, Location, Internalisation) paradigm which explained the pattern and the choice of mode of entry of international activities undertaken by firms. The three set of advantages he put were ownership (firm specific), internalisation and location advantages.

The OLI Paradigm stated that multinational firms must possess some ownership advantages to overcome the various risks and costs associated with overseas production. The risks arise due to legal, linguistic, cultural and political differences between the home and host countries, besides the increased costs of transportation and communication. The OLI Paradigm stated that the ownership advantages could be in the form of process patents, technical knowledge, management skills and brands along with better organisational capabilities or "any kind of income-generating assets which make it possible for firms to engage in foreign production" (Dunning, 1991).

The significance of locational (L) advantages is derived from traditional Hekscher-Ohlin –Samuelson (H-O-S) trade theory. Location advantages refer to specific (pull factors) of the host country as a site of investment as well as to the uniqueness (push factors) of the home country. These advantages include access to protected markets, favourable tax treatments regimes, lower production and transport costs, lower risk and favourable structure of competition. Regarding the locational advantages, Dunning pointed out that firms will be "involved in foreign production whenever they perceive it is in their best interests to combine spatially transferable intermediate products produced in the home country, with at least some immobile factor endowments or other intermediate products in another country" (Dunning, 1988).

The internalisation advantage refers to the advantages of controlling and coordinating ownership and location specific advantages within the MNEs rather than selling the rights to domestic firms in the host country.
The eclectic paradigm, therefore, provides a general framework which explains international production with respect to the Ownership-Location-Internalisation advantages. The OLI advantages also depended on countries level of development, their size, technological intensity, innovation capacity, nature of competition and the size and age of the firm (Dunning, 1988).

Dunning (1993) categorised the motivations of outward FDI into four categories:

i) Market-seeking investments aimed at penetrating into third markets.

ii) Efficiency-seeking investments based on efficient specialisation of firms involving both product or process specialisation and aimed at exploiting economies of scale and scope across or along value chains.

iii) Resources-seeking investments aimed at searching for unique resources such as natural resources available in specific foreign locations.

iv) Strategic asset-seeking investments aimed at augmenting the set of proprietary resources of firms to advance a company’s position globally in search of assets such as technology, brands, distribution and marketing networks (Dunning, 1993).

The central concepts of the OLI paradigm have also been introduced in a framework known as the Investment Development Path (IDP). According to the IDP theory, the outward and inward FDI position of a country is dependent on a country’s level of economic development which in turn determines the nature of ownership advantages that firms possess in that country as well as changes in the advantages of the home economy vis-à-vis potential host economies. The IDP theory suggests that countries tend to go through five stages as they evolve from being a net recipient to ultimately becoming a net source of FDI (Dunning 1981, 1986, 2005, Dunning and Narula 1996, Dunning et al 1998).
In the first stage, there is likely to be very little inward and outward FDI as the location-specific advantages such as a large market or clusters of development are very few. Domestic firms do not possess many firm-specific advantages that might allow them to invest overseas given their inadequate technology accumulation and created assets. The existence of created assets is also predominantly confined to the labour-intensive manufacturing and the primary sector. The role of the Government is limited to providing basic infrastructure and upgradation of human capital through training and education and the formulation of economic and social policies such as import protection, domestic prices and export subsidies (Dunning and Narula, 1996). During this phase of limited created assets, foreign firms will prefer to undertake exports and imports rather than invest directly in such markets.

In the second stage, inward FDI begins to rise as domestic markets grow both in terms of size and purchasing power. The outward investment on the other hand remains low or non-existent. The attractiveness of the host countries depends on their ability to possess desirable locational factors like necessary infrastructure such as transportation, communications facilities and supplies of skilled and unskilled labour (Dunning and Narula, 1996). Subsequent to progressive government policies and successful training and education investments, the O advantages of domestic firms develop and the production now moves towards semi-skilled and moderately knowledge intensive consumer goods. The nature of the Outward direct investment is mostly either market seeking or trade-related in nearby economies or is directed to developed countries which are lower along the Investment Development Path than the home country in search of strategic assets (Dunning and Narula, 1996).

In stage three, outward direct investment increases with domestic firms developing their own ownership advantages and they will be able to manage the spatial distribution of their dispersed assets with less dependence on the government. Inward direct investment will focus now on efficiency seeking production and gradually move away from import substituting production. Strategic asset acquiring inward direct investment may arise in industries
where local firms have a competitive advantage and Government expenditure on education, vocational training and innovatory activities will significantly contribute to the creation of assets (Dunning and Narula, 1996).

In stage four, the net outward investment position becomes positive and exceeds or becomes equal with the inward direct investment stock. The growth rate of outward FDI also rises faster than the rate of inward FDI. At this stage location specific advantages will be based almost solely on created assets and local firms will attempt to internalise the market for their ownership advantages through foreign direct investment rather than exporting (Dunning & Narula, 1996). Improvements in the domestic capabilities of firms enable them to compete not only with other foreign firms but are also able to enter into foreign markets. While inward direct investment tends to be from other stage four countries, Outward investment will be into economies lower along the development path in order to sustain their competitive advantage (Dunning and Narula, 1996).

In the fifth and final stage, inward investment grows more swiftly than outward foreign direct investment leading to a decrease in the economy’s net outward investment position (NOI) and eventually it fluctuates around the zero level. Firms in this stage globalise with firm-specific assets independent of the economic, political and cultural conditions of their home country.

The inward direct investment is both market and knowledge seeking investments from countries at lower stages of development. Government policy plays a key role in the setting of macro-organisational strategies influenced by what other economies are emphasising in the formation of their organisational strategies (Dunning and Narula, 1996).

2.1.6 Determinants of Horizontal FDI and Vertical FDI

Within the theory of traditional multinational activity, three approaches were proposed which came to be known as the vertical FDI model (Markusen, 1984), the horizontal FDI model (Helpman, 1984), and the knowledge-capital model (Markusen et al., 1996). Key elements of the industrial organisation
literature, such as imperfect economies of scale and product differentiation began to be included in trade theories beginning from Krugman (1979, 1980) and Helpman (1981) providing a framework in which MNEs could integrate better into the trade theory. This alternate framework combined ownership and location advantages with technology and country characteristics while analysing FDI and MNE activity. While the ownership advantages captured technological aspects of the firm such as, economies of scale, R&D efforts and transport costs, locational advantages included host country characteristics such as factor prices, factor endowments, and distance measured in terms of transport costs. While some studies focus on the analysis of horizontal MNEs or FDI, other studies have been confined to the study of vertical FDI.

Vertical MNEs break up the production process into various stages geographically based on relative cost advantages. They therefore are in typically look out for low cost inputs to supply their output to other subsidiaries of the MNE through intra–firm exports accounting for a bulk of international trade (Hanson et al., 2003). In contrast, horizontal MNEs produce more or less the same product in different locations to gain easier access to the host market.

Prominent among the studies on vertical MNEs, is the pioneering model of Helpman (1984) who developed a general equilibrium framework which included monopolistic competition and differentiated products to explain as to why firms break the production process across borders rather than keep all stages in the home country. According to him, Vertical MNEs divide the production processes to the cheapest locations to take advantage from factor endowment differences across countries. In the case of vertical MNEs, FDI and trade were complements. Large differences in factor endowments led to greater volume of trade. So while vertical MNEs deliver unfinished goods to their affiliates for further processing, final goods were also traded within the group (parent and affiliate) to be sold in different markets (ibid).

Zhang and Markusen (1999) offered a (2×2×2) model of vertical MNEs in a Cournot oligopoly framework, which included transport costs and was missing
in the monopolistic competition approach of Helpman (1984). The model establishes a positive relationship between host country size and the number of vertical multinationals with a minimum threshold size below which no FDI takes place owing to transport costs and economies of scale. The firms incur transport costs as its entire output cannot be sold in the host country market and will have to be shipped back to the home country. The Model also suggests the need for a minimum threshold of skilled labour in the host country and below that minimum FDI should be discouraged. Finally, MNE activity leads to a more skilled labour-intensive production in both countries resulting in a rise in the real wage of skilled labour.

In case of horizontal approach of MNE activity, researchers have attempted to explain why firms prefer serving foreign markets through FDI rather than simply exporting. Markesan’s (1984) general equilibrium trade model based on imperfect competition explains the simultaneous activities of horizontally integrated firms across several countries. Given their strong knowledge base, foreign MNEs have an advantage over domestic firms, as they increase technical efficiency resulting in economies of multi-plant operation.

Ethier (1986) used a general equilibrium model, which was a two-country, two-good, two-factor model with land as a fixed factor and labour as a mobile factor. Manufactures produced were labour intensive and their production involved three stages: research, upstream and downstream production. FDI was larger when endowments were similar and when the uncertainty faced by agents was more.

By taking forward the approaches taken by Helpman and Markusen (1984), and by focussing on horizontal MNEs Horstmann and Markusen (1987a) argued that MNE activity should be derived endogenously in a general equilibrium trade model. The presence of firm-specific costs, tariff and transport costs encouraged firms to undertake both foreign and domestic production. The presence of plant-scale economies incentivised firms to have only domestic production and to export to the foreign market. MNEs were in
industries with large firm-specific costs and high tariff and transport costs, but with relatively small plant scale economies.

Krugman (1983) developed the proximity–concentration hypothesis, based on a trade-off between maximising proximity to customers and concentrating production to achieve scale economies. The firm’s knowledge capital of producing different products depended on the cost factor and this knowledge could be traded directly or indirectly by trading commodities. Firms preferred to invest in foreign markets when overseas production was cheaper than trade and therefore FDI and exports did not occur simultaneously. The proximity–concentration hypothesis was further elaborated by Horstmann and Markusen (1992) for homogeneous goods and by Brainard (1993) for differentiated products and both concluded that country size positively affected MNEs.

Horstmann and Markusen (1992) based the investment decision of the firm as a Cournot output game where firm’s decision of how many plants to establish in two countries was based on firm- and plant-level scale economies and trade costs. Firm-level scale economies determined the number of firms, while plant-level scale economies and trade costs determined the number of plants. Larger the size of the host market, firms were more likely to establish additional plants.

In the same direction as Markusen (1984), the works of Brainard (1993, 1997) suggest that horizontal FDI is preferred to exporting when the gains from avoiding trade costs outweigh the costs of maintaining capacity in multiple markets. Technically, horizontal MNEs are more likely to arise when firm-level scale economies are high and plant-level scale economies are low while trade costs are high.

Supporting Brainard’s model, Markusen (1998) and Venables (2000), used a general equilibrium framework to investigate the importance of host country characteristics in determining MNE activity and their trade model. The relevant host country characteristics included the relative factor endowments, market size and the presence of plant level scale economies and trade costs. Their studies noted that MNEs had an edge over domestic firms when markets
were of similar size with similar labour costs, when transport costs were high and when firm-level scale economies were large relative to plant level scale economies.

Helpman et al (2004) constructed a model of intra-industry firm heterogeneity type of MNEs and the main contribution of this model was that FDI sales was more relative to exports in sectors that had more firm heterogeneity.

New trade models were empirically tested by Brainard (1993, 1997), Eaton and Tamura (1994) and Ekholm (1998) who found strong support for the horizontal FDI model. They found variables such as market size, transport costs and trade barriers to have a positive impact on FDI, while factor endowments were only relevant in some cases. The results substantiated the idea that MNEs were firms with ownership advantages.

Brainard (1993) examined a cross-section of industry–country pairs to test whether factors such as freight factors, average foreign import tariff, per capita income, exchange rate appreciation, average effective corporate income tax rate, openness to trade and FDI and plant-level scale economies were determinants of total affiliate sales between the USA and other countries and trade.

Brainard (1997) extended the analysis of the proximity–concentration trade-off to additional factors such as corporate scale economies, host market GDP, industry R&D, occurrence of a political coup, same language as investing country and their effects on the outward and inward share of affiliates’ sales over total sales and on import and export shares and the proximity–concentration hypothesis was found to be robust.

2.1.7 Determinants of FDI According to the Horizontal FDI, Vertical FDI and Knowledge-Capital Model

Markusen et al. (1996) and Markusen (1997, 2002) brought together two streams of literature that explained vertical firms and horizontal firms independently in a so-called knowledge-capital model that involved building
multiple plants and separating headquarters services and production as special cases. They set up a 2×2×2 model with one good with constant returns to scale and a second good with plant- and firm-level scale economies, factoring in differences in relative endowments, country size, high and low transport cost and optional FDI ban. Their study found that countries where trade costs were high, FDI was banned.

The presence of horizontal MNEs was predominant when FDI was allowed, while liberalisation of trade and FDI led to the existence of vertical MNEs especially when factor endowments were different. When countries had similar factor endowments, no MNEs existed as factor prices were equalised. Markusen argued that horizontal MNEs were more common than vertical MNEs, which only existed for some host economies in some industries.

In his knowledge-capital model, Markusen (1997) combined ‘horizontal’ motivations for FDI (i.e. the desire to place production close to customers and avoid trade costs) with ‘vertical’ motivations (i.e. the desire to carry out unskilled labour-intensive production activities in locations with relatively abundant unskilled labour). Similarities in market size, factor endowments and transport costs were determinants of horizontal FDI, while differences in relative factor endowments determined vertical FDI.

2.1.8 Determinants of FDI according to the Diversified FDI and Risk Diversification Models

Many empirical studies have attempted to explain the role of risk factors in analyzing FDI patterns and MNCs incentives to invest abroad. (Rugman, 1975, 1976; Caves, 1996). According to Rugman, MNEs undertake overseas investments to enjoy product and factor market diversification and to enjoy growth in their profits. Diversification enabled firms to produce not only for the domestic markets, but also for foreign markets resulting in ‘double diversification’ –a diversification in product and location. Rugman’s ‘diversification hypothesis’ has found wide empirical support. Kopits (1979)
was the first to examine the rise of conglomerates in response to high-risk business environments.

Baniak et al (2002) found MNCs’ appetite for risk-aversion varying from one another and the decision to undertake investment activities abroad was found to be inversely related to the degree of risk aversion of the potential investor. Their study revealed that the value of the expected utility from future profits could be too small for long-term investors characterised by high risk aversion, but it could be satisfactory for less risk averse or risk-loving firms, focused more on speculative transactions. While the presence of uncertainty in the host market impeded the flow of FDI, it was noted that uncertainty in the investor’s home market was the main push factor motivating FDI. Hence one of the main drivers for capital outflow was to escape the unfavourable home environment for business and this trend has been observed in many transition economies (Kimino, Saal, and Driffield, 2007; Kayam, 2009).

Based on monthly return data for 32 domestic and 50 multinational corporations in the USA to analyse whether the MNEs’ variability in returns was less than, equal to or greater than that of otherwise similar domestic firms, Hughes et al. (1975), Michel and Shaked (1986), Miller and Pras (1980) and Thompson (1985) found empirical support for the hypothesis that firms resorted to geographical diversion to reduce risk. They found that not only did the MNEs enjoy higher average returns, but also lower systematic and unsystematic risk than domestic firms thereby benefitting from establishing affiliates overseas.

Enders and Sandler (1996) found terrorism to be another risk factor that affected FDI. They found that terrorism in Spain and Greece led to a persistent and significant negative influence on FDI stocks and flows. Tcha (1998) analysed the effect of labour disputes on FDI from Korea. Labour disputes reduced FDI to North America, but was not significant for FDI to Asia. Other determinants included exchange rate volatility, current account balance and per capita GNP. Looking at asset returns for 125 US MNEs over a 5-year period and comparing groups of MNEs with similar risk–return performance
profiles, Kim et al. (1993) found geographically diversified MNEs to have a better risk–return performance than other MNEs. Based on the panel data for 15 countries, Caves (1989) analysed the link between exchange rate movements and FDI in the USA. He found that exchange rate depreciation reduced FDI in the USA. Other variables tested for included US GNP, the lagged stock of foreign-controlled capital, the profit rate, the share-price differential and the trade balance (differential).

Froot and Stein (1991) showed that foreign assets and FDI were significantly affected by the mean real value of the US dollar and a time trend, and FDI was decreasing in the value of the US dollar when analysing quarterly and annual US inward FDI data.

### 2.1.9 Policy Variables as Determinants of FDI

The factors influencing a firm’s investment decisions are varied and often complex. The firm’s choice between domestic production, licensing or FDI is often influenced by a host of government’s policies and incentives. The firm’s location choice and mode of investment are also influenced by government policies. Therefore MNEs are often found bargaining with the host countries over issues such as taxes, subsidies, financing arrangements, training, local employment, local input, export conditions and capital repatriation. This bargaining process between MNEs and the government is in turn influenced by information asymmetries, competitive structure of the economy, market size and projected market growth, political stability, the level of infrastructure and the endowment of natural resources, besides the competition from other host governments (Faeth, 2009).

Root and Ahmed (1978) conducted one of the first empirical studies to analyse policy variables in detail and tested 44 economic, social, political and policy variables for significance using data on FDI inflows of 41 developing countries and classified the countries in three categories (unattractive, moderately attractive and highly attractive). They observed that the corporate
tax level discouraged and regular executive transfers encouraged FDI, while tax incentives laws and liberal policy regimes were not significant.

Subsequently various other empirical works (e.g., Bond and Samuelson (1986); Black and Hoyt (1989); Haaparanta (1996); Haufler and Wooton (1999); Mudambi (1999); Grubert and Mutti (1991); Loree and Guisinger (1995); Devereux and Griffith (1998),) highlight that policy variables such as corporate tax rates, tax concessions, tariffs and other fiscal and financial investment incentives had a significant effect on FDI in a number of studies and should thus be considered as potentially important determinants of FDI. In general, the effect that tax policy had on FDI was small compared with that of other factors (including market size and growth, basic infrastructure, political stability, cost and availability of factors of production).

Bond and Samuelson (1986) highlighted the fact that countries could attract FDI by offering investment incentives such as offering tax holidays, signaling to the firms that local factors were high quality when there was asymmetric information between MNEs and countries.

Haaparanta (1996) showed that low-wage countries always attracted more FDI than high-wage countries when there were no subsidies and high-wage countries on the other hand could attract FDI when they offered higher subsidies than low-wage countries.

Haufler and Wooton (1999) found that market size was an important determinant. They found that despite levying lower taxes, smaller countries found it difficult to attract FDI.

Haaland and Wooton (2001b) examined the role of labour market flexibility and the employment level in attracting FDI in particular industries. They found that countries with the attractive local economic conditions, such as a flexible labour market and high unemployment (low opportunity costs of employment) attracted investment. Low risk firms were attracted to countries with inflexible labour markets and high unemployment, while high risk firms were drawn to countries with flexible labour markets and low unemployment.
A cross-sectional study of the US FDI stock in 33 countries conducted by Grubert and Mutti (1991) revealed that stock of plant and equipment and the US exports to affiliates and to countries in general were increasing in the inverse of the tax rate, the tariff rate, GDP and GDP per capita.

Loree and Guisinger (1995) studied the location variables of US FDI outflows using data on 48 countries. They found that the important non-policy variables were political stability, cultural distance, GDP per capita, telecommunications and transportation infrastructure.

Using a panel data of annual inward bilateral flows from a number of European countries, Japan and the USA, Bénassy-Quéré et al. (2001) found that a high rate of taxation of corporate profits reduced FDI. They found that the effective rate of taxation, exchange rate volatility, and GDP differential, distance and transport costs reduced FDI, while bilateral openness, market size and potential had a positive effect. Tax policy had very little impact on FDI when compared to that of other factors (including market size and growth, basic infrastructure, political stability, cost and availability of factors of production).
<table>
<thead>
<tr>
<th>Theory &amp; Theoretical Approach</th>
<th>Determinants</th>
<th>Author(s) (year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hecksher-Ohlin Model /</td>
<td>Higher return on investment, lower labour cost, exchange risk</td>
<td>Hecksher &amp; Ohlin (1933), Hobson (1914), Jasay (1960), MacDougall (1960), Kemp (1964), Aliber (1970)</td>
</tr>
<tr>
<td>MacDougall-Kemp Model</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market Imperfections</td>
<td>Ownership benefits (product differentiation), economies of scale, government incentives</td>
<td>Hymer (1976), Kindleberger (1969)</td>
</tr>
<tr>
<td>Product differentiation</td>
<td>Imperfect Competition</td>
<td>Caves (1971)</td>
</tr>
<tr>
<td>Oligopoly Markets</td>
<td>Following the rival, responding to competition in domestic market</td>
<td>Knickerbocker (1973)</td>
</tr>
<tr>
<td>Product life cycle</td>
<td>Production function characteristics</td>
<td>Vernon (1966)</td>
</tr>
<tr>
<td>Behaviour Theory</td>
<td>Fear of loss of competitive edge, Following rivals and increased competition at home</td>
<td>Aharoni (1966)</td>
</tr>
<tr>
<td>Internalisation</td>
<td>Market failures/ insufficiencies</td>
<td>Buckley and Casson (1976)</td>
</tr>
<tr>
<td>Eclectic paradigm (OLI – ownership, location, internalization)</td>
<td>Benefits of owning productive processes, patents, technology, management skills</td>
<td>Dunning (1979)</td>
</tr>
<tr>
<td></td>
<td>Advantage of locating in protected market, favorable tax system, low production &amp; transport costs, lower risk</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Advantage of internalisation cutting transaction cost, lowering risk of copying technology, quality control.</td>
<td></td>
</tr>
</tbody>
</table>
### Table 2.2 (Contd.)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Barriers to entry</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Factor Endowments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tariffs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax Rate</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Assuncao et al (2011)
2.2 Empirical Literature on the Locational Determinants of Indian OFDI

Pradhan and Singh (2010) examine the role of host country determinants of Indian OFDI in influencing the spatial distribution of overseas acquisitions of standalone and Business Groups (BG) affiliated Indian firms during the period 2000–2008. The findings of the study highlight the differences in the regional geography of overseas acquisitions done by BG affiliated and non-affiliated Indian firms. The study finds a large majority of the BG affiliated firms concentrated in the EU region, while the standalone firms are largely attracted to North America. By using a censored Poisson estimation, the empirical analysis reveals that both the stand alone and BG affiliated firms are attracted to the market size of the host countries and the prevalence of preferential tax regime with India. But Indian OFDI is discouraged by weak currency of the host country. BG affiliated firms also appear to be positively sensitive to host countries growth rate, endowments of fuel resources and the existence of bilateral investment treaties with India. Standalone firms, on the other hand are strongly inclined to acquire business units in host locations that import more from India, possess good sources of iron ores & steel and enjoy cultural proximity with the home country. The article concludes by indicating that BG-affiliated firms are more mature in taking decisions regarding their OFDI location and are guided by a wider and broader set of considerations in comparison to standalone firms who seek safety in terms of the ‘avoidance of double taxation, foreign currency strength and cultural proximity factors.

Using a panel dataset on foreign acquisitions by Indian MNEs in 82 countries over the period 2000-2007, Buckley (2007) attempts to model the determinants of Indian OFDI through mergers and acquisitions and examines the extent to which these determinants can be explained in the background of the eclectic paradigm. The article tests a number of hypotheses and concludes that Indian OFDI through cross-border acquisitions have revealed both conventional and idiosyncratic trends. The role of exchange rate fluctuations and that of cultural and language factors were found to be important determinants of these acquisitions. Indian acquisitions were found to be
primarily motivated by market-seeking purposes, with no evidence of resource and strategic asset-seeking FDI. The article also highlights the idiosyncratic patterns of Indian OFDI whose growth trajectory has followed a “leapfrog” development model by transforming from a basically agrarian economy into a services-based one, primarily by bypassing manufacturing. The article maintains that this deviation cannot be explained by the conventional Investment Development Path.

De Beule (2010), in his cross country study of Chinese and Indian cross-border acquisitions, has confirmed the existence of peculiarities unique to both the countries. His empirical work reveals that Indian companies appear to have used the inorganic route more frequently than their Chinese counterparts. The study also highlights that most of the outward investors from China are state-owned, while most of the prominent investors from India are private firms. In the study, the variable GDP per capita which proxies for market size, does not turn up significant indicating that Chinese and Indian companies focus not merely on the rich markets, but also target other lower income economies. Host country trade openness is shown to be significantly important to both the countries. Natural resources have also turned out to be significantly attractive to both Chinese and Indian firms indicating that both these countries have carried out more and more acquisitions in natural resource rich countries. Strategic asset seeking investments appear to be more important to Chinese than to Indian multinationals as these multinationals seem to increasingly acquire firms in technologically advanced countries. Institutional quality proxied by the variable Rule of Law appears to have a positive effect on Chinese and Indian multinationals as they are increasingly interested in protecting their investments. However the institutional variable, political stability turns out to be insignificant as these multinationals have invested more in countries with higher political risk. Corruption also appears to be of no major concern for these multinationals as they are accustomed to similar corrupt environment in their home country. The variable exchange rate does not have a large impact on the investment decisions of Chinese multinationals as they prefer countries that have appreciating currencies. Distance has a negative impact on Chinese
and Indian acquirers, suggesting that investors prefer to invest in countries within the same geographic region.

Anwar et al (2008) highlight the increasing trend of multinationals from Third World-growing and emerging economies to undertake outward investment mostly in the developed countries. In the Indian context, the study reveals that most of the Indian OFDI has been through mergers and acquisitions (M&As) in host countries spread across diverse sectors ranging from primary sector to the services and the manufacturing sector. The study examines the critical role played by host country related factors (pull factors) in determining OFDI from the Third World multinationals such as the market size, real GDP growth, real exchange rate, GDP deflator, and distance from the host country, political stability, natural resource, market openness, investment treaties and tax incentives provided by the host country. The empirical analysis indicates that the choice of investment destinations of the Indian multinationals is influenced by a number of host country characteristics such as real GDP, real GDP growth, and real GDP deflator of the host country.

Pradhan (2010) analyses the overseas acquisition activities of emerging Indian pharmaceutical multinationals based on the general framework of technological change and a locational choice model. The empirical results from the locational analysis based on the censored Poisson regression have highlighted the prominent role of strategic resource-seeking motivations behind Indian pharmaceutical acquisitions. The foreign acquisitions of Indian pharmaceutical firms has been found to be more attracted to host countries that offer a large domestic market, strong patenting activities and skilled human resource base. The results appear to imply that Indian pharmaceutical industry are using acquisitions as a mixed strategy for accessing both markets as well as strategic assets. The study also traces the evolution and growth of the Indian pharmaceutical industry from a phase of adaptive R&D based on imported technologies in the past to the accumulation of indigenous innovative capabilities in the 1980s. The industry’s growth has centered more on process developments than expanding product development capabilities. The study elaborates that strategic government policies such as public sector drug
production, adoption of short duration process patent regime and strong monitoring of activities of foreign companies have resulted in cost-effective process development and the rise of domestic productive capacity to meet both domestic demand as well as exports to overseas markets. The study also highlights a number of potential market and operational risks involved in foreign acquisitions such as substantial investment requirements and inadequate technological skill set. The other challenges include decisions regarding target markets, identifying target companies and the determination of the transaction value, besides gaining information related to host country legal and environment clearances.

Shahmoradi and Baghbanyan (2011) explores the determining factors of foreign direct investment (FDI) inflows over the period of 1990-2007 using a sample panel data of 25 developing countries. In the model, dependent variable is FDI inflows. Independent variables are FDI outflows, GDP, population, openness of the economy, the presence of mobile and internet technology, and labour. According to the econometric results, openness of the economy, market size, availability of labour force, the presence of mobile and internet technology appear to have positive effects on FDI inflows in developing countries. Openness of the economy has a positive relation with FDI inflows in developing countries as open economies facilitate both exports as well as imports. The study highlights that the presence of big markets have a positive impact on FDI inflows. Infrastructure in developing countries also plays a critical role in enhancing the productivity potential of investments in a country and therefore stimulates FDI inflows towards the country.

2.3 Literature on the Trends, Patterns and Determinants of Indian OFDI

Pradhan (2003a) reviews the recent trends and patterns of the rise of Indian service sector outward (OFDI) activities and tries to identify the key determinants behind such investments. The study reveals that during the seventies firms from hotels & restaurants, finance and marketing segments led overseas investments and were directed at developing regions with most of them being minority owned. In contrast, during the nineties, the service sector
has been predominantly led by the software segment owned largely by majority-owned ventures and directed mostly towards the developed countries. This internationalization of Indian services sector may be attributed to the labour cost advantages, significant improvement in service infrastructure like finance, transport and communication and the availability of human resources ranging from the general education to technical professionals has also given Indian service firms a global competitive advantage. The article highlights the innovativeness of Indian firms in the computer segment of Indian service sector. The high level of sophistication and competencies in the areas of cognitive engineering, artificial intelligence, virtual reality, genetic algorithms, knowledge solutions, and training and education market etc has been instrumental in attracting the attention of global players like Microsoft, IBM, Oracle, etc.

Pradhan (2005) provides an overview of the changing patterns of OFDI from India for the period 1975 to 2005. The study of Indian OFDI has been conducted across two phases or two waves- The ‘First Wave’ covers the period 1975-90 while the ‘Second Wave’ covers the period from 1991 onwards. During the First Wave OFDI flows were dominated by a few manufacturing sectors and confined to developing countries. The second wave on the other hand saw Indian firms beginning to invest abroad on a much larger scale than before, and spread across almost all sectors of the economy. The study reveals that the service sector dominated all other sectors led by the software industry. The country orientation of the service sector firms were mostly towards the developed countries and were majority-owned projects. The study highlights that the main motivation of the Indian multinationals for investing abroad has been not merely to seek markets but also to access strategic assets and skills overseas.

Pradhan (2006a) has developed an empirical framework for inclusion of quality dimensions in exploring FDI related spillovers on host country productivity and has proposed a percentile criterion to distinguish between low and high quality FDI firms in his empirical analysis. Since there are several dimensions of FDI quality, the study suggest that researchers can utilize the
principal component analysis (PCA) to build a composite quality index to define low and high quality FDI firms. The construction of FDI quality index and related spill over variables for the Indian manufacturing sector shows that there exist considerable differences between the spillovers variables associated with high and low quality FDI firms. This difference is more pronounced at individual industries level. Unless the differences that are present across foreign firms in terms of quality are brought into the spillover analysis, the obtained results are likely to give misleading conclusions. The study highlights that most of the existing literature on knowledge spillovers from FDI and host country productivity growth tends to treat all foreign firms as homogeneous and that they all are equally important for knowledge spillovers from FDI to transpire. However, this assumption contradicts reality as all foreign firms are different from one another in their developmental quality for the recipient countries. Their differences are in terms of their appetite for exports, their capacity to undertake local R&D activities, and their ability to create a demand for local raw materials and entry modes. This study has conceptualized the quality of FDI in terms of five dimensions and identified suitable indicators.

Pradhan (2007a) has examined the evolution and growth of Indian multinationals and their relative impact on the development of both host countries and home country. The study reveals that the OFDI behaviour of Indian firms in the earlier periods of 1970s and 1980s was confined to a small group of large-sized family-owned business houses investing mostly in a select group of developing countries with the restrictive government policies becoming the main push factor for Indian OFDI. The ownership pattern of Indian OFDI projects was also predominantly minority-owned and joint venture in nature given their intermediate technologies, which were more suitable in fellow developing countries. The restrictive Indian OFDI policy with cumbersome approval procedures also contributed significantly. The OFDI policy mandated that Indian party’s involvement in the overseas ventures was to be only in the form of exports of Indian made machinery, equipment and know-how. However, since the 1990s, Indian OFDI has undergone significant changes with Indian investors strongly orienting
themselves to the developed parts of the world economy. The article attributes
the significant changes undergone during this period to a number of factors
such as policy liberalization with the establishment of automatic approval
route and removal of ceiling on annual investment, etc. The substantial
improvements in locational advantages of Indian economy like rising foreign
exchange reserve, infrastructure, skill, and institutions have also contributed to
the growing sophistication of the ownership advantages of Indian firms in the
1990s.

Kumar (2007) analyses the trends, patterns and determinants of outward
foreign direct investment (OFDI) by Indian enterprises, since the onset of
reforms by undertaking an empirical analysis with an exclusive panel dataset
covering over 4,270 manufacturing companies for the 1989-2001 period. The
empirical findings suggest that Indian enterprises already engaged in exporting
are more likely to be outward investors and they draw ownership advantages
from accumulated production experience, cost effectiveness of their
production processes and adaptations to imported technologies through
technological effort, and product differentiation. The article emphasizes the
importance of firm size in international markets and therefore recommends a
consolidation of fragmented capacity in some industries and suggests that
Indian firms should build global brands and position themselves as providers
of world class products or services. Finally, the article recommends a
progressive liberalised macroeconomic environment which will foster an
increased external orientation of Indian enterprises.

Pradhan (2007b) has investigated the nature of relationship between OFDI by
Indian multinational firms and their exports in the Indian context. The
empirical analysis proceeded with the Tobit specification of export behaviour
of Indian firms comprising of a set of firm specific factors, sectoral effects,
and a dichotomous variable representing the policy shift. By evaluating the
nature of OFDI projects undertaken by Indian multinationals and from
drawing upon the past empirical literature, he posits that OFDI by Indian
multinationals has played a major role in significantly improving exports at
the firm level. The study suggests that Indian firms are using outward FDI to
establish distribution and marketing centers in other countries and are enhancing their ability to provide sales and after-sales services to global buyers. Foreign affiliates of Indian enterprises are being helped by sourcing raw materials, capital goods and intermediate inputs by their Indian counterparts. These positive impacts on exports appear to outweigh any negative impact caused by the foreign affiliates’ products displacing export of final products from India. Apart from OFDI, export competitiveness is observed to be positively determined by firm’s in-house R&D activities, foreign affiliations, and liberalization of policy regime.

The policy lesson from the above analysis for India is that it needs to pursue a proactive strategy towards OFDI and policy makers should strive to reduce the barriers faced by Indian firms while undertaking OFDI and provide assistance in the form of making available information on overseas investment opportunities and government regulations in foreign countries. Indian government should also increase the number of bilateral investment and double tax avoidance treaties.

Pradhan (2008a) has explored the growth of developed region bound Indian FDI since 1960s. Developed countries have emerged as largest hosts to Indian investment in 2000–07 indicative of the growing confidence, maturity and capability of Indian firms to emerge as global players. The article reveals that a total of 1866 Indian companies have been operating in 30 developed countries and their green field investment stock amounted to US $17 billion by 2007. Initially Indian FDI was led by the services sector, but from early 2000s, manufacturing firms have overtaken them in the developed region. The study highlights that for both the service and manufacturing sectors, European Union continues to be the largest host sub-region within developed region, with North America also becoming an attractive destination for Indian FDI. The two major hosts for Indian FDI in the developed region are UK followed by USA. The preferred mode of entry has increasingly been through acquisitions, besides Greenfield investments. The study found that a total of 306 Indian firms undertook 596 acquisition deals amounting to US $47 billion targeted at 28 developed countries.
Pradhan (2008b) has analyzed the overall regional trends in Indian direct investment flows into developing region since 1960s and the various development impacts they have on host developing countries. Cheap imports and entry of foreign firms and the desire of technologically efficient Indian firms to expand into overseas market accompanied by the liberalisation of domestic policies with regard to outward FDI, industry and technology are factors responsible for the Indian firm’s outward orientation.

The article highlights that regionally Indian FDI covers a total of 92 developing countries with considerable amount of investment going into intra-regional host countries (i.e. Asian countries), followed by Africa, South-East Europe & CIS and Latin America. Indian investment is widely spread across sectors, from manufacturing to services. Since 1990s, the main motive behind Indian FDI has been resource seeking covering oil, gas and minerals led by public-owned companies owing to the growing energy needs of the Indian economy. Developing country FDI projects are more suitable to host developing countries which are mostly joint venture in form and possess intermediate technologies. However since 1990s, in-house innovation and technological activities of Indian parent firms and large scale acquisition of foreign technologies, is making Indian investing firms increasingly going for wholly owned FDI projects in developing countries, resulting in no direct spillover of transferred technologies to local parties. The study notes that since Indian multinationals presence is not confined to only the primary sector and labour-intensive industries, but also is spread across knowledge-based sectors.

Hansen (2008), while tracing the evolution and growth of Indian OFDI, notes that the Indian OFDI path significantly deviates from the received literature on OFDI from developing countries and emphasises the need to revisit the existing theory of OFDI from developing countries. His paper offers a number of explanations for the unique Indian outward investment path. Some of the deviations mentioned in the study are listed below. Typically OFDI from developing countries has followed large inflows of FDI, but this has not been the case with India. While OFDI from developing countries traditionally has taken place in other developing countries, Indian OFDI is directed towards
advanced economies. Typically, the sectoral profile of OFDI from developing countries has been in manufacturing and resource extraction, while Indian outward FDI is driven by services. The ownership (o) advantages of developing country MNCs traditionally have been in mature technologies and industries, while many Indian MNCs have their advantages in technologically cutting-edge industries such as IT and pharmaceuticals. The main motivation of developing country FDI has been for market and resource seeking, while the prominent motivating factor behind current Indian outward investments has been to seek strategic assets. The study further observes that India has succeeded in speeding up the Investment Development Path (IDP) sequence as Indian firms have been able to build strong Ownership-advantages, partly by linking up to, and learning from foreign firms through arms-length collaborations. Thus, the Indian experience suggests that inward FDI need not be a precursor for outward FDI. India’s strong position in sectors such as services and other knowledge based services has enabled the growth of Indian OFDI path enabling it to exploit the opportunities provided by globalization.

Singh and Jain (2009) examines India’s outward foreign direct investment in an evolutionary perspective and credits the supporting role played by state policy as an important factor encouraging the outflow of foreign direct investment. He notes that in the pre 1990s era, most of the Indian firms operated largely in the developing countries possessing similar or lower technological capabilities in comparison to India. The Indian OFDI activities were also mostly concentrated in the manufacturing sector. A discernable trend was witnessed post 1990s, when more than 70 per cent of Indian OFDI went to industrially advanced countries through acquisitions in the developed countries. The article concludes by highlighting the positive role played by state policy. The liberalisation phase encouraged Indian firms to undertake overseas investments due to increasing domestic competition and the scaling up of domestic capabilities in the form of technology and management. The national innovation system developed during the last five and a half decades has also enabled Indian firms to compete globally.
Dasgupta (2008) examines the effects of international trade and investment related macro economic variables, namely, exports, imports and FDI inflows on the outflows of FDI from India from 1970 to 2005 by using time series data analysis. The empirical findings suggest that lagged imports and exports are a driving force of current FDI outflows and that India’s capability of undertaking outbound FDI will be related to the country’s performance in its trade front. Indian firms undertake horizontal OFDI projects to exploit firm specific products by the parent firms while vertical OFDI projects are undertaken by the Indian firms seeking to acquire sources of raw materials and inputs from abroad directly resulting in higher imports into the home country. The study also shows that the imports to India have a positive relation with the FDI outflows.

Gupta and Bera (2009) while examining the inward and outward FDI, both from the south and North observed that although FDI sourced from the South is increasing alongside FDI inflows from the North, the dominance of the US is declining both in inward and outward FDI activities in relation to India. Indian investors are finding more willing allies in Singapore, the Netherlands and other countries. The study, based on the econometric analysis found that FDI from both the South and the North are in export-oriented sectors. The study also notes that there is not much difference between FDI from the North and from the South, as both concentrate in sectors with larger markets, higher export orientation and lower import intensity. Generally, it was found that excessive government bureaucracy, corruption and competition policy are detrimental to inward FDI.

Athukorala (2009) examines the emerging patterns and economic implications of Indian foreign direct investment as an important aftermath of economic globalization. The article lays special emphasis on the facilitating role played by the liberalisation of trade and investment policy regimes and the overall investment climate on the internationalisation strategies of domestic companies. The author opines that despite the rapid strides made by the Indian MNES in the global arena, they are still in the nascent stage of development and their competitive edge is largely country-specific, rather than firm-
specific. The study notes, that Indian firms appear to complement rather than compete directly with developed country MNEs in their global operations.

Kathuria (2010) carried out an analysis on a sample of 250 entries (88 wholly owned subsidiaries (WOS) and 162 joint ventures (JVs) made by 142 Indian manufacturing firms during 1992 to 1999 to study outward FDI from India. His study focuses on the factors that determine the choice between joint venture (JV) and wholly-owned subsidiary (WOS) for firms from developing country; and whether these factors vary for firms from the developed countries. The analysis indicates that Indian firms’ outward investment depends upon a number of transaction specific variables. Size, age and experience influenced entry choice in more developed countries, whereas building of both upstream and downward capabilities is found crucial for firms investing in relatively underdeveloped countries. Based on the results, the study argues that if other developing countries especially in South Asian and African region wish to increase the south-south FDI inflow, they need to focus on improving the institutional environment of their home countries which in turn would improve the ranking of their country index. The article further highlights the importance of both transaction cost and non-transaction cost factors in influencing entry choice of Indian firms. The transaction costs can be lessened by choosing culturally and geographically closer regions and by investing in low technology sectors. Adequate foreign experience and the quality of the host country’s institutional environment also determine the transaction costs. The non-transaction cost variables such as the size of the firm and its age also influence entry choice. The empirical results suggest that older firms prefer JVs to WOS as they tend to be more conservative while on the other hand the younger Indian MNCs prefer WOS as their entry mode, given their foreign exposure and relatively large size. The policy implications emerging from this study suggest that investments in R&D and the building of a strong brand are essential requisites if firms intend to invest in WOS in less developed countries. The study also suggests that the first step in setting up is to invest in the neighbouring region so as to gain some experience.
Hattari and Rajan (2010) observe that while India is an increasingly attractive destination for inward FDI, the country is also becoming a significant source of outflows with many Indian enterprises viewing outward foreign direct investment (OFDI) as an important aspect of their corporate strategies. This paper discusses the rationale for and empirical determinants of overseas acquisitions by Indian companies. The study observes that most of the Indian OFDI is more market- and resource-seeking than OFDI from most other countries. The paper concludes by highlighting the impact of the global rise of Indian companies on the Indian economy.

Pradhan and Singh (2011) have examined the issue of globalness of Emerging Multinationals (EMs) based on the analysis of outward investing Indian firms. Based on the spatial distribution of aggregate outward investments from India, the article highlights the fact that Indian firms are diversifying across both the developed and developing regions. Interestingly, the study found that more than eighty percent of the total sales of Indian multinationals were from non-home regions than their home region indicative of the truly global nature of emerging Indian multinationals.

2.4 Literature Regarding the Evolution, Growth and the Internationalisation Strategies Adopted by the Firms in the Indian Pharmaceutical Industry

Pradhan (2003b) has empirically verified the impact of economic liberalization on the R&D behaviour of Indian pharmaceutical firms by conducting Tobit analysis for a sample of firms during the period from 1990 to 2001. The study observes that liberalization has not only made Indian pharmaceutical firms competitive, but has also driven them to pursue R&D activity. Factors such as firm age, size, profitability, intangible assets, export orientation and outward foreign direct investment have greatly influenced the innovative activities of the industry. The study highlights several policy measures such as providing special scheme for small size firms, intensifying collaborative research efforts between private sectors and government research institution and utilizing flexibilities in the TRIMs agreements to persuade
foreign firms to relocate their R&D units into the country which have helped in the removal of obstacles inhibiting the outward orientation of firms.

The study also observes that the size of the firm has had strong non-linear impact on the R&D performance and the impact of liberalization has been confined to large and medium firms, given the lack of resources for small size firms. The study points out that government initiatives like the establishment of a Drug Development Promotion Foundation (DDPF) and a Pharmaceutical Research and Development Support Fund (PRDSF) to promote R&D activity need to be targeted towards small size firms given their critical role in keeping drugs prices within the reach of the poor. The study notes that profit margins and firm age are two important determinants of R&D behaviour of Indian pharmaceutical firms. The outward orientation of an enterprise also determines the R&D activities of a firm. Therefore government policies that encourage Indian firms to exports and to undertake outward direct investment play a critical role in the development of indigenous technologies. The study also observes that the R&D behaviour of Indian pharmaceutical firms crucially depends on their brand valuation as these intangibles are critical to appropriate rents from their innovative activity.

Beena (2006) observes that contemporaneous with the global trends, the Indian pharmaceutical industry experienced greater consolidation through mergers, acquisitions, alliances as well as sale of assets. The study observes that the dilution of various policy regulations has led to a market expansion strategy and majority of the firms are using merger as a means to expand their product profile to remain risk free. Though firms undertaking such mergers constitute less than ten percent of all firms in this industry, their overall performance has been better than the others and their own pre-merger period performance. The study recommends that the gains accruing to the industry through such mergers in the form of their improved performance should translate to the consumers in the form of lower prices and better quality of drugs.
Pradhan and Alakshendra (2006) has studied the two important modes of internationalisation of the Indian pharmaceutical enterprises namely overseas acquisition strategy and outward green field foreign investment and has examined their relative strengths and weaknesses so as to determine which among the two are a more effective internationalization strategy. This analysis has been conducted in three stages. First, the evolution of the internationalization process of the Indian pharmaceutical industry across four stages and the different modes of internationalisation like inward foreign investment, imports, exports, outward green field investment, overseas acquisition and contract manufacturing including inter-firm strategic alliances has been elaborated. Second, the study examines the different ways in which Greenfield investment and overseas acquisition can maximize the revenue productivity of pharmaceutical firms. Third, case study of Ranbaxy Laboratories has been undertaken to empirically assess its experience with overseas acquisitions. The analysis acknowledges that strategic government policies have paved the way for the growth and internationalisation of Indian pharmaceutical enterprises. The study concludes that acquisition is a more effective internationalization strategy than Greenfield investment since it not only provides all the benefits that the latter gives, but also offers other competitive advantages such as access to brand names, marketing and distribution channels which are important for the firms performance and survival in the world market.

Pradhan (2006b) studies the trends in the Indian Pharmaceutical industry in a comparative perspective with its global peers in areas of pharmaceutical value-added, productivity, research and development and trade performance besides the new strategies adopted by the Indian pharmaceutical companies to become global players. The article attributes the rapid transformation of the Indian pharmaceutical industry from a mere importer and distributor of drugs to an innovation-driven cost-effective producer of quality drugs to the home country’s strategic government policies. The study also underlines the limitations in the existing government policies such as low productivity and R&D intensity and comments that competitive strategies like green field direct investment, overseas acquisitions, strategic alliances and contract
manufacturing have emerged as favourites to Indian pharmaceutical companies.

Kale (2007) explores patterns and motives for internationalisation by Indian pharmaceutical firms into foreign markets. The evidence presented in this paper shows that Indian pharmaceutical firms are internationalising their operations through the inorganic route as well as by setting up their subsidiaries, in order to access resources, move up value chain and enter new markets. Firms also have employed internationalisation of R&D, production and distribution strategy to develop new competencies.

Pradhan (2008c) examines the overseas acquisition strategy of the Indian Pharmaceutical firms and attributes the transformation and growth of the pharmaceutical industry to the strategic government policies such as public sector drug production, adoption of short duration process patent regime and the monitoring of activities of foreign companies. All these factors have enabled the pharmaceutical industry to scale up its domestic production and become an efficient producer of generic drugs cost efficiently thereby giving a boost to exports. It is only in the post-liberalization period and with a product regime, that Indian pharmaceutical firms have pursued an innovation based strategy directed towards product oriented R&D. The study notes that the industry has used the route of overseas acquisitions to overcome their inadequate product development capabilities, and to acquire new products, new markets and strategic skills and technologies. The study examines brief case studies of five acquirers from Indian pharmaceutical sector validating this trend. The study also highlights the challenges that arise while undertaking acquisitions in new markets starting from the huge investment requirements to the technological capabilities, along with the market and operational risks involved. Adequate information about the right markets and companies that fit Indian requirements besides host country laws and institutional environment are also a challenge. The study concludes by stating that as long as Indian acquiring firms are aware of the potential risks involved in acquisition and well prepared to face them, overseas acquisitions can bring about scaling up of
the technological capabilities and wider geographical and economic diversification.

Athreye and Godley (2009) examine the strategies adopted by US pharmaceutical firms in the 1930s, with those of the Indian pharmaceutical firms in a comparative perspective. The similarities between the two groups lie in their leapfrogging strategies to gain technological superiority and to further their firm-specific advantages. The study emphasizes the preferred route of international acquisitions chosen by the Indian firms for scaling up their technological deficiencies. Their study also suggests that the internationalisation strategies adopted by the groups are specific to the sectors involved as well as the economic environment of the two countries. While US firms have preferred to rely on international alliances as their preferred mode of entry, Indian firms have depended on joint ventures and acquisitions. The study further observes that in the case of the steel sector, India and China have used acquisitions to gain market shares, despite having different motivations. In contrast, in the software sector, Indian and Chinese firms deviate from one another in both their motivations as well as strategy.

Fei and YingMing (2011) explore the growth and drivers of the pharmaceutical industry in India and china in an evolutionary perspective with special focus on the role of strategic government policy and globalisation. The authors suggest that China can learn a lot of valuable lessons from India’s experience in internationalisation. Indian companies through their strategic alliances, joint ventures, or asset acquisitions in the industry have increased its knowledge about host country regulations and have also successfully moved up the value chain. The authors recommend that Chinese pharmaceutical industry can gain by examining closely India’s experiences and lessons carefully before it transforms itself into a leading player in the global pharmaceutical industry.

Dixit (2008) identifies and analyses the motivations, capability handicaps and responses of a sample of Indian pharmaceutical firms in the early phase of internationalization. The author highlights various challenges and managerial
shortcomings faced by the Indian firms as they attempt to internationalise. The motivations for internationalisation were identified as opportunities for higher profit margins, market diversification, and surviving global competition. But Indian firms in the early stages of internationalisation are known to face capability handicaps such as regulatory compliance, gaining customer acceptance and attaining quality assurance and control. The other challenges include the decisions related to goals of internationalisation and the kind of market diversification to be pursued. The study observes that firms overcome these handicaps by acquiring the needed capabilities from outside and developing them through trial and error. The top management’s commitment and motivation to their employees to internationalise also plays a critical role in the development of these capabilities. The study integrates the insights from in-depth studies of internationalisation experience of six pharmaceutical companies.

Broche (2011) in his explorative case study suggest attempts to explain the trajectories and dynamics of emerging multinationals’ international catch-up processes. The author distinguishes between ‘fortress industries’ and ‘leapfrogging industries as the two extreme points of a scale in high-tech industries. Fortress industries would be industries dominated by conventional MNEs with typical industry barriers like accumulated knowledge, reputational or intellectual assets, or complex global entry barriers as in the case of in the global pharmaceutical, auto, packaged software, or certain branded consumer goods industries. While, the chances for leapfrogging by EMNCs may be higher in the emergent stages of an industry life cycle like for instance in the wind, photovoltaic or IT outsourcing services industries, or in mature and commoditized industries such as (standard) PCs or base steel. The study concludes by pressing the need for further exploratory case studies on emerging market MNCs in selected industries to discern the role of structural industry characteristics from other influences like vocational or company-specific antecedents or Government support.

Greene (2007) presents an overview of India’s pharmaceutical industry from an evolutionary perspective to its current status of becoming the world’s
leading supplier of generic drugs. While chronicling the important policy reforms, the study attributes the growth of Indian pharmaceutical industry to India’s meeting of its WTO TRIPs obligations and amendment of its patent laws and implementation of the Patents (Amendments) Act 2005. With the re-institution of “product” patents, it effectively ended 36 years of protection for Indian companies and terminated legal reverse engineering or copying of patented foreign pharmaceuticals drugs. The study highlights the use of acquisitions and exports by many Indian companies to internationalise. Notably, among India’s export market is the United States where Indian generic drugs have greater acceptance. However, the study notes that Indian companies have been facing severe price competition in the U.S. for their generic drug market due to domestic competition from U.S. generic manufactures as well as from suppliers belonging to other low-cost countries.

Bhaumik and Driffield (2011) using a large firm level data base explore the determinants of the direction of outward investment of Indian pharmaceutical companies to the developed vs. developing country destinations. The results presented in the study validate the firm-specific capabilities of Indian firms which explain the phenomenon of Indian outward FDI. The most significant result reported in this paper is that family firms in emerging markets like India are likely to invest more in other developing countries given the similarity in their developmental standards as well as in their institutional environment. The study observes that since bulk of the cash rich firms in emerging markets are family owned, it is likely that south-south cooperation is mostly driven by private sector FDI. The study therefore suggests that developed countries desirous of attracting large investments from emerging markets, should engage with these firms notably either through equity ownership or in any other way.

Chaturvedi and Chataway (2006), employing firm-level case studies, examine the contemporary strategic approaches employed by Indian firms for integrating new knowledge and capabilities for developing innovation competencies. Using empirical evidence from firm-level investigations, this study reflects on the transformation of the Indian pharmaceutical firms from early days of reverse engineering to being one of the technologically advanced
and sophisticated organizations. The case studies in this study suggest that technology and innovation is not something which firms acquire from outside. On the contrary, it is rooted in a specific set of resources owned by the firms along with the firms absorptive and innovative capabilities. Each firm under investigation in this research has designed for itself a strategy based on the mix of resources it possesses.

Malhotra and Lofgren (2004) provide a descriptive analysis on of the development and structure of the Indian pharmaceutical industry, and explore the challenges arising from its integration into global markets. The study notes that the Indian pharmaceutical industry has been able to transform itself into a world producer of high quality cheap generic drugs owing to measures such as absence of product patents, low costs and a strong engineering tradition and the implementation of the WTO patent regime in 2005. The study envisages competition with the foreign MNCs and is critical of the fact that while the scale of R&D has been significantly higher than that off the last decade, it would be far-fetched to suggest that the recent growth and developments in India’s pharmaceutical industry, alongside the IT sector, signal the beginning of a high-tech take-off that could lift the whole of the Indian economy.

Yeoh (2011) studies the internationalization strategies and locational choices of two firms in the Indian pharmaceutical industry namely Ranbaxy and Wockhardt, and provides useful insights with respect to firm’s geographic segmentation and selection strategies. Ranbaxy as an early internationaliser, had the first-mover advantage in terms of drug development for generic markets as well as new drug development efforts with the company pioneering the exploration of and entry into the generics market well before liberalization and the announcement of WTO accession. The study highlights the role of top management leadership as an important differentiator between early and late internationalisers, as it is not uncommon to find decisions concentrated in the hands of a few individuals in emerging companies.
2.5 Literature on the Evolution, Growth and Pattern of OFDI Flows from other Emerging and Developing Economies

Mathews (2002) considered the OLI framework to be a static paradigm and proposed an improvised alternative theoretical framework entirely based on a group of dynamic firms originating in the Asia-Pacific region, named “Dragon Multinationals”. Using the resource based analysis in a number of his works during 2006, he observed that most of the emerging market MNEs lack in ownership advantages that they can exploit abroad like other conventional MNEs. Their internationalisation strategies are mainly based on resource seeking motives and therefore enter into partnerships and joint ventures in order to reduce their level of risk in international markets.

Taking forward this aspect, Mathews put forth the Linkage, Leverage and Learning (LLL) framework. According to him emerging market MNEs enter the global value chains with foreign companies through Linkages, such as joint ventures to access new resources that they lack internally. Once linked, these ‘latecomer’ firms use their global linkages to leverage their resources and particularly their cost advantages and learn about new sources of competitive advantage and how to operate internationally. In the LLL framework too, in the initial phase of MNE formation, the main motive for international expansion is most likely to be asset-exploring rather than with asset-exploiting as suggested by the OLI framework. Mathews has pointed out that being a latecomer in the international markets may advantageous for firms in the internationalisation processes if they happen to have access to advanced technologies and innovations through imitation and, thus, catch-up as fast as possible (Mathews, 2006d ; 2007).

Luo, Y., et al (2009) examine the motives and processes adopted by the Chinese governments to promote OFDI in the emerging market context. They maintain that, emerging market governments pursue OFDI promotion policies to offset competitive disadvantages of emerging market enterprises in global competition. Given that China is the world’s leading emerging economy, in terms of market size and growth rate, it is an ideal country to illustrate why
and how governments in emerging economies promote OFDI policies. This study presents the governmental institutions that impact Chinese OFDI, discusses evolutionary changes of OFDI policies, and describes current policies and measures that stimulate Chinese companies to expand into the global market.

Hattari (2008) uses bilateral FDI flows data to investigate trends and patterns of intra-Asian FDI flows over the period 1990 to 2005 by employing an augmented gravity model framework. The study observes that developing countries have rapidly emerged as new and important sources of foreign direct investment (FDI) to other developing countries with a large share of outward investments from Asia being recycled intra regionally. The study examines a host of drivers of FDI flows including transactional and informational distance (proxied by distance), real sector variables, financial variables and institutional quality. The data in the study indicates that around 35 percent of FDI flows to developing Asia between 1990 and 2005 have originated intra regionally with over 90 percent of the flows originating from Hong Kong SAR, Mainland China, Singapore, and Taiwan. But some of these flows could be overstated owing to recycling or round-tripping of funds especially between Mainland China and Hong Kong. Empirical evidence provided by the study suggests that the Intra-regional FDI activity between emerging Asian economies are driven by economic factors of the host country such as market size, export intensity, real exchange rate changes and measures of financial depth. The other important host country characteristics are institutional factors such as political risk and legal origin, the presence of operational Free Trade Agreements (FTA), and level of financial openness of the host country. The variable distance also stands out as an important determinant of bilateral FDI flows, suggesting that high transport costs and informational asymmetries may hinder FDI flows.

Banga (2004) analyses the aggregate FDI inflows to fifteen developing countries of South, East and South East Asia for the period 1980-81 to 1999-2000. She examines the impact of fiscal incentives offered, removal of restrictions and signing of bilateral and regional investment agreements with
developed and developing countries on FDI inflows after controlling for the
effect of economic fundamentals of the host countries. The study concludes
that economic fundamentals such as, large market size; low labour cost (in
terms of real wages); availability of high skill levels (proxied by secondary
enrolment ratio and productivity of labour); lower external debt; and extent of
electricity consumed in the economy are significant determinants of aggregate
FDI. FDI policies too are found to be important determinants of FDI inflows
with lower tariff rates attracting FDI inflows. However, fiscal incentives
offered by the host governments are found to be less significant in attracting
FDI inflows. The study highlights the important role played by Bilateral
investment treaties (BITs) in attracting FDI inflows and point out that their
impact on developed and developing countries are different. Results show that
BITs with developed countries have a stronger and more significant impact on
FDI inflows as compared to BITs with developing countries. The impact of
economic fundamentals on FDI also varies between developed and developing
countries. FDI from developed countries are attracted to large market size,
higher education levels, higher productivity of labour, better transport and
communication and lower domestic lending rates, while cost factors play a
more significant role in attracting FDI from developing countries with
determinants such as large market size, potential market size, lower labour
cost, devaluation of exchange rate, better transport and communication, lower
lending rates and lower budget deficit being significant. The above results of
the study highlight the importance of government policies in attracting FDI
inflows into developing countries. They show that apart from the economic
fundamentals of the economy, FDI policies of the host governments and
investment agreements also play an important role.

Amighini et al., (2009) reviews the recent literature on OFDI from developing
countries, with a critical focus on the theory and evidence of FDI as a channel
for technological catch-up. OFDI has become such an important route for
technological catch-up and for sourcing strategic assets, given the modularity
of production in an increasing number of sectors, combined with weak
national innovation systems (NIS) in many developing countries. The
literature includes a number of case studies validating this channel for catch
up. The study observes that the determinants of the different internationalization strategies pursued by developing country MNEs vary depending on the type of industry and country characteristics. The technological regime prevalent in the industries determines the degree of modularity of production, and the nature of the innovative activities of firms trying to catch up. Moreover, modularity of production makes it possible for latecomer firms to catch-up in sectors with higher technology content and where innovation is less predictable. The article also highlights that countries with more developed Innovation system are likely to being less motivated to enter foreign involvement than countries with weaker or less efficient NIS.

Fortanier and van Tulder (2008) examine the level, pace, variability, and temporal concentration of internationalization activity of 256 large firms over the period 1990 to 2004 and compares the pattern of international expansion of large firms from China and India with those from developed countries. They find that Chinese and Indian firms have internationalised more rapidly having a more volatile trajectory of internationalisation relative to developed country firms. The study reveals that sectoral distribution of internationalisation activity for the developed country firms Vs firms from China and India are very different. Sectors such as food & beverages and retail distribution are dominated by developed country multinationals while internationalisation activity by Chinese and Indian firms are concentrated in sectors such as steel, materials, shipping and construction. Both developed and developing country multinationals are active in sectors such as chemicals and pharmaceuticals, oil and petroleum, and telecommunications.

Kumar and Chadha (2008) examine the recent evolution of steel industry in China and India where demand for steel is high. Early industrialization accompanied by a more liberal OFDI regime has resulted in large scale investment in steel manufacturing in both countries. As a result, both Chinese and Indian firms have ventured overseas, undertaking both green field investments and acquisitions. The study highlights the differences in the underlying motivation across the two countries FDI. Chinese outward FDI has been mainly driven by state-owned enterprises aiming to secure access to raw
materials for expanding domestic steel production. In contrast, Indian private sector steel firms have ventured abroad to seek markets and strategic assets, both to exploit economies of scale and economies of scope across steel–dependent manufacturing sectors such as automobiles.

Niosi and Tschang (2008) examine the trajectories adopted by Chinese and Indian firms in the software industry and conclude that both the internationalisation process and the sub sectors in which they have chosen to operate have differed for Chinese and Indian MNEs. The focus of the Chinese software firms have been on their domestic market by working with foreign MNCs and operating on regional markets in Japan Taiwan and Korea. The Indian firms on the other hand have continued to expand overseas using a services model influenced by the US market. The study notes that while the dominant mode of entry for both the countries has been green field investments, Indian firms have been preferring acquisitions in recent years. Both Chinese and Indian firms have internationalised rapidly in markets where competition from US and European firms have not been severe. In markets where competition has been cut throat as in the case of software products for the finance sector, the success of Indian and Chinese firms has been less protected.

Duysters et al., (2008) look at two of the large internationalising conglomerates, the Haier group from China and the Tata group from India. While the Tata group has had a long history, the Chinese groups are relatively young and their rapid growth in recent years can be credited to active state support. They point out that Haier has used a ‘walking on two legs strategy’ – on one hand replicating in overseas markets the innovations developed to cater for the needs of large domestic market and at the same time acquiring related technological expertise internationally in order to grow from a single-product to a multi-product company. On the other hand the Tata group has used internationalisation to become more specialised in their operations and to increase value from a few chosen lines of business. Although the industry sectors that comprise the group firms are different, the paper shows that in
Govindarajan and Rammurthi (2011) emphasise that fast growth rates of emerging economies accompanied by globalisation has promoted innovation in poor countries and their presence is being seen in both poor as well as rich countries. These innovations have been customised according to the local context and have brought about a lowering of costs accompanied by easy portability. These innovations have leapfrogged to frontier technologies and are noticeable in new businesses, such as wireless communication or mobile banking. Some of these innovations have even challenged the developed country MNEs to resort to reverse innovation themselves. Having studied this trend, the article lays out a research agenda to revisit the main stream models, develop arguments and theories more carefully, and test the resulting hypotheses empirically.

Rammurthi (2009) explores the theoretical value of studying Indian multinationals and states that the rise of these new multinationals provides an opportunity to revisit and carefully construct theories of how firms internationalise. His study highlights the differences between Indian firms and their western counterparts. By virtue of being ‘infant MNEs’, the Indian firms differ from Western firms that are “mature MNEs” in both their internationalisation strategies and in their competitive advantages. The study therefore implores for more research to be conducted on early-stage internationalisation to broaden research perspectives. Rammurthi questions the adequacy of the Ownership-Location-Internalisation (OLI) paradigm, as a guide for developing internationalisation strategies. He observes that while the OLI paradigm answers the ‘why’, ‘where’, and ‘how’ questions of multinationalisation in vertical compartments, taking them one at a time, it does not connect the answers horizontally to propose internally-consistent why-where-and-how strategies for internationalisation. Research on Indian MNEs, and emerging-market MNEs, provides the opportunity to make such horizontal connections in the area of international business as well as develop new concepts.
Madhok (2010) investigates the phenomenon of rapid internationalisation undertaken through acquisitions by emerging market multinationals in advanced economies. The study views acquisitions as an act and form of entrepreneurship, aimed to overcome the ‘liability of emergingness’ and undertaken by firms for competitive catch-up in order to seek opportunities and transform capabilities. The study focuses on the unique asymmetries of emerging multinationals given their historical and institutional differences with advanced economy multinationals.

Baskaran et al (2011) has examined the factors driving outward FDI from the emerging transition economies by selecting six cases of TNCs, such as CNPC and ZTE from China; Tata Steel and Hindalco Industries from India; MTN Group Limited and Sasol Limited from South Africa. Amongst the cases studied, CNPC’s outward investment mostly adopted the mode of joint exploitation and sharing the output with the host countries in the initial phase and later shifted to buying shares besides merger and acquisition. The main motivating factor for OFDI by CNPC is to secure long term supply of oil for its operations in China.

The main motivating factors of ZTE’s outward investment are to secure regional and global markets and increase their competitiveness through accessing international skills and capital. The main factors behind Tata Steel’s foreign investments have been to emerge as a global competitor by increasing productive capacity, market and technological capabilities, and to ensure raw material security. Through foreign investment Tata Steel has been able to increase productive capacity, market and technological capabilities. Hindalco’s OFDI is aimed to transform the company into one of the global leaders in the industry, to ensure long term supply of copper concentrate to its plant in India, and to move upstream (with value-added products). OFDI has helped Hindalco to attain global competitiveness, particularly through its investments in Australia and Canada. Similarly, the OFDI by MTN was mainly driven by the intent of spreading its revenue and expand subscriber base and enjoy economies of scale in infrastructure. Sasol aimed to increase its global competitiveness through OFDI by following a twin approach of making
new investment or consolidating its existing investments in the developed economies where it aims to increase its performance by strategic positioning in the end user markets; and making new investments in developing economies in Africa and Asia to secure oil, gas, and coal supplies for its global operations. The case studies from China, India and South Africa show that the main motivating factors behind OFDI is to gain new markets in developing countries besides accessing the R&D and other technological capabilities of the developed countries in order to improve their competitiveness and emerge as a global player.

2.6 The Gaps in Literature

Despite India’s growing economic importance on the global stage and with considerable increase in the expansion of cross-border investments by Indian companies, it has been observed that a lot of attention both in academic literature and media has been limited mostly to FDI inflows to emerging markets including India. Research on India’s strength as potential outward investor has been fairly under explored so far and is just gaining momentum in academia.

Similarly, existing literature has revealed that much of the research focus has been on foreign direct investment (FDI) from advanced economies and many researchers have expressed reservations on the applicability of those findings to the determinants of FDI from emerging markets (Ramamurthi, 2009). Very little is known about the motives and strategies of these firms from developing economies as compared to Multinational enterprises (MNEs) from developed economies. Indian pharmaceutical industry has been a leader in outward expansion along with the IT and auto ancillary sectors and has led the OFDI since 2000, making it ideal for a study of internationalisation strategies in the emerging economy context.

Most of the recent studies on Indian pharmaceutical industry have been limited to cover mostly the push factors responsible for driving out Indian firms to invest abroad and in studying the impact of economic liberalisation
and the changes in the intellectual property rights (IPR) regime on industry’s performance besides the development of indigenous R&D and the growing focus on patenting, rising exports, lowering of drugs prices and public health (e.g., Watal, 1996; Lanjouw, 1998; Pradhan, 2002a, b, 2006; Kumar and Pradhan, 2003; among others). However, the rising global competitiveness of the Pharmaceutical industry through mergers and acquisitions and the importance of locational pull factors of potential host countries such as market size, business policies and the economic and political environment among others which have attracted Indian MNEs to invest abroad have been largely ignored. Having identified these gaps, the current study attempts to address these gaps.

Conclusion

The major theoretical approaches relating to FDI flows were reviewed in order to explain why enterprises invest in foreign countries and what factors influence their location decisions. The various gaps in literature have also been highlighted and the current study attempts to address these gaps by trying to develop a comprehensive list of predictors that encourage FDI.