INVESTMENT BEHAVIOR OF FOREIGN FIRMS IN INDIA

[A Study on Spatial Distribution of Foreign Automotive and Auto-ancillary Firms in India]

ABSTRACT

During the last half century, the attitude towards the role of Foreign Direct Investment (FDI) in the growth of nations has undergone many changes. Through the 1960s, FDI has been seen as a partner in the process of development. It is a key driver in fast growing global financial integration, called Globalization. It provides a way of creating long term, consistent and direct relationships between economies. Under the right policy setting, it can be a significant driver for the development of domestic enterprises of the host country.

This dissertation attempts to study FDI by studying the location decisions of foreign automobile and auto-ancillary firms in terms of their spatial distribution at sub-national level in India. The study focuses on the following key issues related to the spatial distribution of Indian and foreign automotive firms:

- Impact of agglomeration externalities of Foreign as well as Indian Automotive and Auto-component Manufacturing Firms in India on location decisions of new foreign automobile firms established between the years 2002 to 2012,
- Factors impacting firm agglomeration,
- The relationship between the quality of the investment climate and foreign investment inflows into Indian automobile and auto-ancillary sector,
- Establish the relative importance of factor endowments, information cost, agglomeration externalities, infrastructure related endowments, institutional practices and export potential of a region; as determinants of the location of “first-plant” of foreign automobile & auto-ancillary firms in India &
- To pin-point the investment climate which, makes most difference to foreign automobile and auto-ancillary investors in India.

The above stated objectives have been studied using both the secondary as well as the primary data. Agglomeration economies have been recognized as a major subject in FDI. It expectedly generates economies which are external to a firm but internal to a geographic area or location. These externalities may come out of i) technological spillovers; ii) availability of pool of skilled labor and iii) pool of specialized intermediate input at lower cost and in greater variety.

The Study pertains to 9 states and Union territories having foreign automobile and auto-ancillary firms. The study unveils the location determinants of “first-plants” of the foreign firms in India.
Secondary data has been compiled from the Prowess Database of CMIE, DIPP Reports on Automotive Sector and Reserve Bank of India database. Data on State-level endowments has been collected from various government sources and modified as per the requirement of the study. Dynamic Linear Programming Regression Model has been used to identify the impact of industry agglomeration as well as state-level endowments on location decisions of new foreign automobile firms.

Primary data for the study has been collected using the Questionnaire designed on the basis of 12 pillars defined in the Global Competitive Index, 2009-10 as well as the localization literature. The same had been discussed with various industry and academic experts and then finalized. All the 94 foreign companies having their “first-plants” in any of the four auto clusters namely Mumbai-Pune Cluster, NCR Cluster, Chennai- Bangalore Cluster and Sanand-Dholera Cluster have been approached for responses. Finally we have been able to collect responses from 50 foreign automobile companies. Survey data has been analyzed using Association of Attributes, Chi Square test in order to determine the factors impacting location choices of foreign automobile firms in India.

The empirical results of the secondary data suggest that the location decisions by new foreign automobile and auto-ancillary manufacturing firms in India are influenced by the plant locations of the incumbent Indian as well as foreign automotive and auto-ancillary firms. Analysis of primary data reveals that locations with better factor endowments, easy access to information about local markets and required documents for carrying business, superior infrastructure facilities, market supporting institutional practices and export potential are preferred by foreign investors. They are satisfied with the coordination between the center and the state government. Factor endowments, which are one of the important determinants of location, have been viewed as satisfactory. Foreign as well as host country agglomeration, within the same industry have been considered to be important determinants of firm location decisions. However, existence of foreign and domestic firms in industries other than automobile has not been considered to be important agglomeration attributes in plant location decisions.

With this study, we provide a better understanding of the factors impacting plant location decision of the foreign automotive firms in India. The empirical findings suggest that the government should encourage regions to exchange information and experience, as well as facilitate foreign firms by providing good investment climate and factor endowments like availability of supplier/vendor hub. Further they must work on reducing the political barriers and become more lucid and answerable to both the foreign as well as the domestic investors. States should work on improving the infrastructural facilities such as power supply, road connectivity etc. Labor laws must also be made less stringent.

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