

# FORMULATING INDIA'S FDI POLICY

## Waiting for Godot<sup>#</sup>

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### Introduction

It is almost an adage that for achieving rapid economic development, developing countries require external capital to supplement their limited financial resources and access to advanced technologies.<sup>1</sup> While external capital can come in different forms like aid, loans and investments, for sometime now, due to aid weariness and debt crises, investments on account of private sector have become the preferred mode of financing development in these countries. Such investments are categorised into two main types: portfolio and direct. Portfolio investments have a short horizon. In other words, investors do not make long term commitments in their host countries. Though foreign portfolio investments are welcomed due to their non-debt creating nature and perceived contribution to the development of the capital market, they have also been a source of concern because of the volatility and asset price bubbles that they cause which, in turn, can result in the destabilization of economies. Foreign direct investment (FDI), on the other hand, provides stable long term capital for investment, besides bringing with it the much needed

There are certain simple propositions in economics that acquire the status of axiomatic truths, sometimes even the force of law. One of these, in our time, is the proposition that if a developing country (DC) seeks economic growth and welfare for its people, then the principal mechanism to do so is to try to attract foreign direct or private investment (FDI or FPI); and, furthermore, that in a globalized world, where capital is free to move where it will, the DC needs to offer competitive terms to attract FDI.

—Yash Tandon  
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South Centre, Geneva*

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<sup>#</sup> Forthcoming in *Alternative Economic Survey: 2011*.

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<sup>1</sup> However, based on the evidence that non-industrial countries that rely less on foreign capital have on an average achieved better long-run growth outcomes, it is being suggested that the real constraint to growth in many less-developed economies is investment not savings. The ineffectual financial system may not be efficiently intermediating domestic savings into investment. See: Eswar S. Prasad, "Some New Perspectives on India's Approach to Capital Account Liberalization", in Suman Bery, et. al, *India Policy Forum 2008-09*, Volume 5, Sage, 2009.

intangible assets like technology, managerial skills, international marketing network, brand names, etc.

India relaxed her foreign investment regime in 1991 as a part of the overall liberalisation of the economic policy frame. The approach was two-pronged: attract FDI in large amounts and allow foreign portfolio investors to invest through the stock market. The 2000s have also witnessed a substantial rise in India's outward investments in line with the overall growth in FDI from developing countries. While till sometime last year, this was seen as a positive development as it was being interpreted as the emergence of Indian entrepreneurs in the global arena, of late it is also being seen, alongside the fall in inward FDI, as a reflection of worsening investment climate which is characterised by not only the usual retardation in reforms especially in respect of the labour market, problems in acquisition of land and ongoing inquiries into scams of humongous magnitude. Interestingly, also for the first time after liberalisation, policy makers have brought the focus back on the manufacturing sector. The Finance Minister, in his budget speech this year has emphasised the need to increase the share of the manufacturing sector from 16% at present to 24% within the next decade. In the following sections, we shall briefly explore the two facets of India's FDI in the recent past especially the outward FDI (OFDI) about which much less is known compared to the inward FDI.

## **Inward FDI**

Even though the policy shift came in the wake of a serious external payment crisis, the expectations from foreign direct investment (FDI) were quite clear and were in line with the standard outcomes associated with FDI. The emphasis placed on the contribution of FDI to India's industrial sector is quite evident from the Statement on Industrial Policy, 1991 which was announced soon after the process of liberalisation had begun. It was stated:

Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. ... The government will therefore welcome foreign investment which is *in the interest of the country's industrial development*. (emphasis added)

... there would be greater emphasis placed on building up our ability to pay for imports through our own foreign exchange earnings.

It was also boldly stated in the first budget after the liberalisation process had begun that:

After four decades of planning for industrialisation, we have now reached a stage of development where we should welcome, rather than fear, foreign investment. Our entrepreneurs are second to none. Our industry has come of age.<sup>2</sup>

A notable feature of the new FDI policy was that even before the WTO (which imposed certain restrictions on trade related investment measures) came into being, India voluntarily withdrew major performance requirements, especially those facilitating indigenous linkages, exports and transfer technology.<sup>3</sup> Restrictions on payments for technology were also relaxed. Implied in this was the belief that restrictions on the level of foreign-held equity and payments for technology had denied India the benefits of FDI and a freer regime would attract large amount of FDI and the expected benefits would automatically follow. In the context of low level of FDI inflows in the initial years, the FDI policy was gradually relaxed further by throwing open more individual sectors, raising the hitherto existing caps on foreign holding and changing the way inflows are measured. Studies like World Bank's *Doing Business* never failed to highlight the difficult investment climate in India. Some efforts were made to address this issue as well and multiple agencies came into being at the centre: Foreign Investment Promotion Board (FIPB), Foreign Investment Implementation Authority (FIIA) and Foreign Investment Promotion Council (FIPC). Also established were the **India Brand Equity Foundation** (IBEF) in association with the Confederation of Indian Industry (CII) and **Invest India** in partnership with the Federation of Indian Chambers of Commerce & Industry (FICCI). India also signed Bilateral Investment Treaties with 80 countries since 1994. India's foreign investment regime has come to be seen as more open than many other developing

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<sup>2</sup> Budget Speech, 1991-92.

<sup>3</sup> The phased manufacturing policy was however reintroduced for the automobile sector in 1997. This policy was discontinued after India lost the dispute in the WTO brought by the EU, the US and Japan in 2001.

countries and India started figuring at ranks 2 or 3 in the global FDI Confidence Index.

For many years after opening up of the economy, inflows of FDI, however, remained modest. The initially expected volumes of about \$10 bn. per annum were indeed a far cry. Besides enhancing the sectoral caps and throwing open more areas India did manage to show higher inflows by also aligning its reporting pattern with that prescribed by international agencies by including reinvested earnings, inter-company loans and equity investments attributed to foreign branches. Relaxations to the FDI policy are still continuing.<sup>4</sup> Though a limit of 24% FDI in the equity of small scale units was placed in 1991, this was also done away with recently. Today a unit is small in scale (of investment) and not necessarily in ownership! Simultaneously, the list of items reserved for micro and small enterprises (MSMEs) has been pruned to just 20!<sup>5</sup> Of late, royalty and lump sum fee for technology and payments for use of trademark/brand name(s) have been relaxed further and placed in the automatic route. While there had been some restriction on foreign investors who were already involved in joint ventures or technology licensing arrangements to set up independent units, even this was given a go by. The restrictions like dividend balancing imposed in the initial period were done away with in due course. Practically all the manufacturing industries, the notable exception being defence industries, have been opened for full FDI participation for quite sometime now. The remaining restrictions are more with regard to services. It is a different matter that the attempt to limit FDI in certain sectors ended up as an ineffective exercise as it failed to take note of corporate control mechanisms.<sup>6</sup>

The situation started changing drastically from the mid-2000s onwards. From an average of just \$1.72 bn. during 1991-92 to 1999-00, and the slightly higher \$2.85 bn. during 2000-01 to 2004-05, the average annual *equity inflows* (excluding

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<sup>4</sup> There is pressure to further open up banking, insurance, multi-brand retail trade and the defence sectors.

<sup>5</sup> This acquires added significance in the context of the ongoing attempts to allow 51% FDI in multi-brand retail trade with the stipulation that at least 30% of the products traded are to be sourced from local small and medium enterprises.

<sup>6</sup> See K.S. Chalapati Rao and Biswajit Dhar, "Foreign Direct Investment Caps in India and Corporate Control Mechanisms", *Economic and Political Weekly*, Vol. XLVI, No. 14, pp. 66-70.

reinvested earnings, other capital, branches, etc.) surged to \$19.78 bn. during 2005-06 to 2009-10. While India has finally the satisfaction of attracting large FDI inflows after 2005-06, the reality is that more than half of the inflows during the recent past (September 2004 to December 2009) do not strictly meet the expectations from FDI.<sup>7</sup> (Table-1) The criterion for FDI having been reduced to foreign ownership of just 10% and devoid of the nature of foreign investor, the FDI has been turned into omnibus capital flow. Portfolio investors and round-tripping investments became important contributors to India's reported FDI inflows thus blurring the distinction between direct and portfolio investors on one hand and foreign and domestic investors on the other. Besides facilitating a host of foreign financial investors, it also became a conduit for dubious capital flows by speculators, corrupt politicians and even money launderers and middlemen in arms deals. These investors also exploited the tax haven route most. Moreover, the manufacturing sector, the initial focus of the FDI policy, ended up as a poor cousin accounting for only about one-fifth of the reported inflows. There has been significant underestimation of foreign acquisition of Indian businesses.

Table 1: Sector and Type of Foreign Investor-wise Distribution of Top 2,748 Inflows\*  
(September 2004 to December 2009)

Sector	Inflow		Share of Different Types of Foreign Investors (%)					
	Total (US \$ mn)	Share in Total	FDI	Other Portfolio	PE/VC/HF #	Round Tripping Only	NRI	Total (incl. unclassified)
(1)	(2)		(3)	(4)	(5)	(6)	(7)	(9)
Total	80,915	100.00	47.85	9.25	26.91	10.30	5.22	100.00
A. Manufacturing	18,015	22.26	61.57	8.82	15.48	8.05	5.47	100.00
B. Services	54,739	67.65	44.06	8.51	31.80	9.85	5.28	100.00
Construction & Real Estate	14,526	17.95	12.82	9.77	58.17	13.25	4.43	100.00
Financial	13,974	17.27	58.70	5.11	29.09	2.62	4.28	100.00
IT & ITES	8,283	10.24	61.35	2.85	19.95	1.19	14.66	100.00
Telecommunications	6,292	7.78	80.75	3.79	7.66	7.80	0.00	100.00
Other Infrastructure	4,364	5.39	14.11	29.60	13.15	38.19	4.96	100.00
Research & Development	90	0.11	56.87	0.00	43.13	0.00	0.00	100.00
Other Services	7,209	8.91	44.72	10.55	29.79	11.71	3.03	100.00
C. Energy	6,251	7.73	36.08	19.10	18.72	20.47	5.52	100.00
D. Mining & Agriculture	1,911	2.36	65.42	1.99	21.43	11.16	0.00	100.00

Source: K.S. Chalapati Rao and Biswajit Dhar, "India's FDI Inflows: Trends and Concepts", ISID Working Paper, WP1101, February 2011.

\* Each accounting for at least US \$5 mn.

# includes some investment that could be categorised as round-tripping.

<sup>7</sup> See: K.S. Chalapati Rao and Biswajit Dhar, "India's FDI Inflows: Trends and Concepts", ISID Working Paper No. 2011/01, 2011.

The fall in FDI by a substantial 28% in 2010-11, however, created anxiety among the policy makers in the context of higher level of current account deficit and dominance of volatile portfolio capital flows. If our analysis of the inflows during 2008 and 2009 is anything to go by, the fall was more because of the slowing down of the investments by foreign financial investors compared to genuine FDI investors.<sup>8</sup> FDI is now being seen as a 'stable' form of capital flow which could help bridge the gap in the current account as much reliance cannot be placed on volatile portfolio flows. Thus maximising FDI inflows has emerged as the dominant objective leaving the other objectives far behind. Also ignored is the failure of India in realising its objectives through FDI in the manufacturing sector, the primary focus of the 1991 policy. The National Manufacturing Competitiveness Council in its report to the Prime Minister highlighted India's experience in this regard in no uncertain terms and called for a relook at India's FDI policy in terms of the country's technological needs. (See Box for relevant extracts)

## Outward FDI

For quite some years now FDI from emerging markets has been much in focus.<sup>9</sup> India's experience also received considerable attention as not only does she have a long experience in investing abroad, but also because it has now come to acquire a large portfolio of foreign investments. The manner and context in which these investments have been built up need some discussion because of the twist being given to the earlier 'success' tale. It is evident that India failed to pay for her merchandise imports through own exports of goods as the 1991 policy statement had visualised. While services exports did come in handy, of late they are unable to help narrow the gap. As a result, the large reserves that have been built up are not out of India's own hard currency earnings.<sup>10</sup> On the other hand, the relatively

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<sup>8</sup> Ibid.

<sup>9</sup> Discussed at length in UNCTAD, *World Investment Report 2006, FDI from Developing and Transition Economies: Implications for Development*.

<sup>10</sup> Even the RBI Governor admitted that "Our reserves comprise essentially borrowed resources, and we are therefore more vulnerable to sudden stops and reversals, as compared with countries with current account surpluses". He added that India's foreign exchange reserves were a result of capital inflows in excess of its economy's absorptive capacity and among the components of capital flows India prefers long-term flows over short-term flows. <http://www.bis.org/review/r110131e.pdf>

substantial inflows over and above her ability to absorb them have become a problem and needed to be sterilized. In the process, a number of measures have been introduced. For instance, Indian companies have been encouraged to invest abroad by gradually freeing the limits, Indians are allowed to spend more on foreign travel and personal imports and Indian mutual funds are permitted to invest abroad. Strangely enough, foreign companies are allowed to raise capital in India through Indian Depository Receipts (IDRs)! Since the IDRs never really took off, even FII and NRI have been allowed to invest in them. On the other hand, recently, in June 2011 foreign individuals and corporate bodies, including pension funds, were allowed to invest in Indian mutual funds -- cumulatively up to \$10 billion -- in order to keep the Indian stock market buoyant.<sup>11</sup> Till then, only FIIs, sub-accounts registered with SEBI and NRIs were allowed to invest in mutual fund schemes in the country.

As noted above, even while seeking to attract larger amount of FDI inflows, India has been simultaneously encouraging Indian companies to invest abroad on an increasingly large scale. They can now invest up to four times their net worth under the automatic route. Earlier, Indian companies were allowed to invest up to 100% of their net worth under the automatic route in 2004. This limit was increased to 200% in May 2005, to 300% in June 2007 and finally to 400% of net worth in September 2007. To further facilitate the investments, Indian banks were allowed in June 2005 to extend financial assistance to Indian companies for acquisition of equity in overseas wholly-owned subsidiaries and joint ventures or in other overseas companies as strategic investment. It is pertinent to note that the RBI Committee on Fuller Capital Account Convertibility recommended the raising of the limit to 300% during 2007-08 and 2008-09 and to 400% during 2009-10 to 2010-11. Thus, most of the steps listed above form part of India's calibrated journey on the path of full capital account convertibility.<sup>12</sup>

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<sup>11</sup> One fear is that a steep fall in share prices would force FCCB holders to demand repayment instead of converting the amounts into shares thus placing a burden on Indian corporates.

<sup>12</sup> For a description of the measures see: C.P. Chandrasekhar, *Financial Liberalization and the New Dynamics of Growth in India*, TWN Global Economy Series No. 13, Third World Network, 2008.

Going by the official figures, India's outward investments have now reached \$98 bn. from only \$1.86 bn. at the end of 1999-00 (Table-2) The acceleration is evident from

Table-2 : **India's International Investment Position: Direct Investments**  
(US \$ bn.)

Year ending March	Abroad	In the Reporting Economy	FDI Abroad as a % of FDI in India
(1)	(2)	(3)	(4)
1997	0.62	10.63	5.83
1998	0.71	14.07	5.05
1999	1.71	15.43	11.08
2000	1.86	17.52	10.62
2001	2.62	20.33	12.89
2002	4.01	25.41	15.78
2003	5.83	31.22	18.67
2004	7.76	38.18	20.32
2005	10.03	44.46	22.56
2006	15.90	52.37	30.36
2007	30.95	77.04	40.17
2008	49.78	118.78	41.91
2009	67.64	127.57	53.02
2010	81.99	177.77	46.12
2011	98.21	204.18	48.10

*Source:* Based on RBI, India's International Investment Position.

2005-06 onwards (when it was \$16 bn.) and the pace seem to be in line with the increase in the investment limits and the freedom given to Indian banks. Though one is not in a position to express any opinion on the strict comparability of the two, India's foreign assets in the form of direct investment abroad have started accounting for nearly half of the inward FDI by 2008-09. The detailed data released by the RBI has indeed given rise to the interpretation that during 2010-11 India's OFDI exceeded inward FDI and that the 'capital flight' is due to worsening domestic investment climate. While there is no doubt that India's overseas investment has increased and turned substantial, the magnitudes highlighted in the media are misleading as a good part of the reported figures consist of guarantees which do not represent actual outflows. This is especially true with regard to the outward investment of \$43.9 bn. for the year 2010-11. (Table-3) If one leaves out guarantees, the actual amount comprising of equity and loans was about \$16.7 bn. Figures of the earlier years released by the Ministry of Finance do indicate their limited size of the guarantees actually invoked.



Table-3 : **India's Overseas Direct Investment Outflows**  
(2007-08 to 2011-12 up to May)

(Amount US \$ mn.)

Year	Equity	Loans	Equity & Loans	Guarantees Invoked/ Issued#	Total	Share of Guarantees Issued in Total (%)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1999-00	314	4	318	0.40	319	
2000-01	1,138	68	1,206	4.98	1,212	
2001-02	860	121	981	0.42	982	
2002-03	1,698	100	1,798	-	1,798	
2003-04	1,234	261	1,495	-	1,495	
2004-05	1,349	395	1,744	-	1,744	
2005-06	3,594	934	4,528	3.00	4,531	
2006-07	10,130	871	11,001	--	11,001	
2007-08	11,269	2,718	13,987	6,960	20,947	33.23
2008-09	10,732	3,329	14,061	3,105	17,166	18.09
2009-10	6,763	3,620	10,383	7,604	17,987	42.27
2010-11	9,352	7,347	16,699	27,231	43,929	61.99
2011-12 (Apr & May)	731	3,193	3,925	1,166	5,091	22.91
<b>Grand Total</b>	<b>38,848</b>	<b>20,207</b>	<b>59,055</b>	<b>46,065</b>	<b>1,05,121</b>	<b>43.82</b>

Source: (i) [http://business.gov.in/doing\\_business/overseas\\_trends.php](http://business.gov.in/doing_business/overseas_trends.php) and

(ii) [http://rbi.org.in/scripts/BS\\_PressReleaseDisplay.aspx?prid=24600](http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=24600)

# Figures for the period 1999-00 to 2006-07 represent the guarantees invoked and for the subsequent years they represent the guarantees issued.

This sharp rise in outward investment could be viewed in two ways. One, as a form of capital flight in the face of hostile investment climate as it is being made out now.<sup>13</sup> Another view could be that Indian companies are seeking to expand their operations overseas and in the process they may be trying to acquire technology and securing raw materials for the country – the earlier view.<sup>14</sup> In the context of Indian companies' inability to acquire technology in the freer FDI regime, this may appear to be a logical step. In the light of the experience of China, the attempt to secure energy resources is another strong argument in favour of India's OFDI. However, seen in the context of India's calibrated approach towards fuller capital account convertibility, the perceived objectives/experience may be incidental and not primary to India's approach towards OFDI.

<sup>13</sup> "Govt paralysis fuelling flight of capital: Parekh", Times of India, July 7, 2011.

<sup>14</sup> Not too long ago the Indian industry was trying to convince USA how India's investments were creating jobs in that country. (eg. CII-sponsored *Indian Roots, American Soil: A Look at Indian Companies in the US Economy* (prepared by Ernst & Young), FICCI-partnered *How America Benefits from Economic Engagement with India*, FICCI-sponsored *India Contributes to Employment, Capital Growth and Tax Revenues in the US – Direct Investments by Indian Companies in 2007-09* and *Indian Investments in the United States: Assessing the Positive Impacts -- Direct Investments by Indian Enterprises April 2008-June 2010* (both prepared by Ernst & Young).

The sectoral composition of the investments could throw some light on the motivations of the investors. RBI has, for the first time in June 2011, released company-wise actual outflows covering the period July 2007 to May 2011. The too broad classification of the investments given by the RBI is, however, not of much use partly also because of the inconsistencies.<sup>15</sup> The task became further challenging due to the non-availability of information on the activities of many investee companies. A good number of them being holding/investment companies, the purpose of investing abroad would only be known if one has information on the downstream investments. Hence we are compelled to present the results based on our own tentative classification of the investee companies. This exercise was confined to only those companies which invested a sum of at least \$20 million in the equity capital of foreign ventures during the reporting period. These numbered 214. An attempt was also made to classify the 214 companies according to their business group affiliation as also foreign equity participation/NRI involvement. The selected cases accounted for 87.68% of the equity and 78.94% of the equity and loans together during the period.

The outward investments are broadly distributed equally between natural resources, manufacturing and services. (Table-4) While Oil & Gas dominate the first group, Automobiles, Pharmaceuticals and Metals are the major recipients of the investments under the manufacturing category. Besides the top ranking IT & ITES, Construction, Finance, Communications and Entertainment are the important sectors under the services category. Among the three groups, capital flight argument may be more relevant for the manufacturing sector. A part of the investment into this sector may have been prompted by increased domestic competition and/or unfavourable policy regime and inhospitable business environment. Seen in the

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<sup>15</sup> For instance, Gammon India's JV, Campo Puma Orient SA, in Panama was classified in one entry under "Agriculture, Hunting, Forestry and Fishing" and in another under "Construction ". One could find oil exploration ventures classified under "Agriculture, Hunting, Forestry and Fishing", "Manufacturing" and "Financial, Insurance, Real Estate and Business Services". On the other hand, Tata Motors' investment in TML Holdings Pte Ltd Singapore was categorised under Manufacturing. This appears to be appropriate as the investee company is reported to have used these funds to invest in UK's Jaguar and Land Rover. A good part of the total investment is in 'holding' and 'investment' companies. Thus in the absence of the information on downstream investments, it would be difficult to classify them.

Table – 4 : Sectoral Classification of Reported ODI during July 2007 to May 2011

(Amount in US \$ mn.)

Sector/Industry	Equity	Equity & Loans	Share in Total (%)	
			Equity	Equity & Loans
(1)	(2)	(3)	(4)	(5)
<b>1. Natural Resources</b>	<b>8,757</b>	<b>11,413</b>	<b>29.69</b>	<b>27.10</b>
- Oil & Gas	6,428	9,012	21.80	21.34
<b>2. Manufacturing</b>	<b>10,625</b>	<b>15,404</b>	<b>36.03</b>	<b>36.38</b>
- Automobiles & Components	4,401	4,793	14.92	11.35
- Pharmaceuticals	1,173	1,673	3.98	3.96
- Metals	858	3,057	2.91	7.24
<b>3. Services</b>	<b>9,640</b>	<b>14,729</b>	<b>32.69</b>	<b>34.87</b>
- IT & ITES	2,959	3,560	10.03	8.43
- Construction	1,901	2,848	6.45	6.74
- Finance	1,096	2,300	3.72	5.45
- Communications	1,041	1,910	3.53	4.52
- Entertainment	799	975	2.71	2.31
<b>4. Others incl. Plantations &amp; Agriculture</b>	<b>469</b>	<b>694</b>	<b>1.59</b>	<b>1.64</b>
<b>Total Classified (1+2+3+4)</b>	<b>29,491</b>	<b>42,239</b>	<b>100.00</b>	<b>100.00</b>
Grand Total	33,634	53,511		
Share of the Classified ones in Grand Total (%)	87.68	78.94		

*Note:* Based on analysis of equity investment by companies whose total investment in equity during the period was at least \$20 mn.

*Source:* Data reported by RBI at its website <http://rbidocs.rbi.org.in>

context of a policy-induced push for outward investment and the fact that the major corruption scandals broke out mainly in 2010, it is necessary to look at individual investors for the motives and the time of their initial entry as some of the large investments could be follow up investments of the earlier decisions. For instance, Tatas, the largest outward private sector investor group, took over Corus of UK in mid-2007. The process started a year earlier. In case of Jaguar & Land Rover the effort started in mid-2007 and by early 2008 the deal was clinched.

Incidentally, Tata's equity investment in TML Holding Pte Ltd of Singapore is the single largest outward investment during the period. Out of the remaining nine of the top 10 investees six are in the energy sector, two are Vedanta group's investment holding companies (believed to be focusing on controlling mineral properties) and one ADAG's investment holding company which took over eWave World of UK, a wireless services company. These 10 ventures account for a third of the total equity investment during the period. These investments could have been prompted by increased domestic competition, availability of distressed or troubled assets abroad due to slowing down in the western world, western companies

vacating some lines of production and the desire to acquire control over natural resources.

The large OFDI investors' overseas activities are quite similar to their respective domestic market operations. (Table-5). However, as noted above, this may not be a clinching indication for capital flight. Another aspect of India's recent experience of OFDI is that besides large Indian business houses like Tatas and Ambanis, there are other important ones whose ownership and control is dual in nature. Going by the official data on FDI inflows, some of these have been inward investors too and there were also occasional references to round-tripping. The most prominent ones who are involved in both inward and outward FDI are the Vedanta and the Essar groups.

Table -5 : Major Outward Investor Groups

<i>Group Affiliation</i>	<i>Equity Investment (US \$ mn.)</i>	<i>Share in Total (%)</i>	<i>Major Sectors in which Invested</i>
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	<i>(4)</i>
Tata	4,115	13.95	Automobiles (79.8%), Metals (10.6%)
Mukesh Ambani	1,521	5.16	Oil & Gas (87.3%)
Anil Ambani	1,419	4.81	Communications (39.8%), Entertainment (25.2%), Oil & Gas (19.4%), Indeterminate (14.1%)
Vedanta*	1,262	4.28	Ores & Minerals (100.0%)
Suzlon	1,243	4.21	Manufacture (97.6%)
Shriram EPC*	794	2.69	Energy (100.0%)
Essar*	758	2.57	Oilfield Services (42.8%), Shipping (21.9%), IT & ITES (12.8%), Financial (22.5%)
Indiabulls	566	1.92	Construction (100.0%)
Mahindra & Mahindra	549	1.86	Automobiles (100.0%)
Sivasankaran*	472	1.60	Finance (87.3%), Construction (12.7%)
Renuka Sugar	366	1.24	Sugar (100%)
Wipro	363	1.23	IT & ITES (100.0%)
Bharti*	335	1.14	Communications (100%)
Dhoot	320	1.08	Oil & Gas (86.5%)
Jindal	277	0.94	Metals (91.8%)
Madhucon	243	0.82	Construction (100.0%)
United Phosphorous	240	0.81	Manufacturing (100.0%)
Malvinder Singh & Br	224	0.76	Finance (100.0%)
Reddy Labs	221	0.75	Pharma (100.0%)
Public Sector	4,211	14.28	Oil & Gas (99.0%)
Foreign	928	3.15	IT&ITES (24.3%), Pharma (15.5%) and Entertainment (14.0%)
Other NRI	921	3.12	
Others	8,143	27.61	
Total	29,491	100.00	

*Source & Note:* See Table 4.

\* These figure among inward FDI investors as well.

In fact, India may have to increasingly face this duality.<sup>16</sup> Take the case of the erstwhile promoters of Ranbaxy. From the shareholding pattern of Fortis Healthcare for the month of March 2011 it is evident that Mr. Malvinder Singh has acquired the status of an NRI.

There are others like Orient Green Power Co Ltd (OGP) an associate of Shriram EPC group. OGP is a subsidiary of Orient Green Power Pte Ltd. (OGPP), Singapore. OGPP was initially promoted as a subsidiary of Shriram EPC Singapore Pte Ltd. (SEPCS), itself is an overseas wholly owned subsidiary of Shriram EPC Ltd., Chennai. (See Diagram) Following the issue of shares two private equity investors by OGPP, the share of SEPCS in OGPP came down to 37.70%. OGP raised ₹900 crores through a premium IPO in India.<sup>17</sup> RBI's data shows that OGP's OFDI from India totalled \$792.72 mn.<sup>18</sup> whereas, according to DIPP, the FDI it received from the Singapore parent was \$42.24 mn. These figures suggest that the OFDI on account of OGP is far larger than what its parent had brought in<sup>19</sup> and in the process some domestic savings have been drawn out of the Indian economy. Such cross-flow of investments is not amenable to simple capital flight explanations.

Since the Vedanta group has become a global player and made UK its administrative base, it would be difficult to say whether the benefit of the natural resources controlled by it will accrue to India or mainly for this business group. In fact, whether Indian business groups would show 'home-bias' like their western counterparts are believed to be having is something that needs to be studied. On the other hand, there would not be any such question regarding Indian public sector companies which are major outward investors and whose investments are concentrated in the Energy Sector. There are other companies which were either taken over by foreign

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<sup>16</sup> Related foreign entities directly hold a substantial part of the promoter holding in some large Indian companies. These include: SPIC, Ballarpur Industries, Zee Entertainment, HCL, Bharti Airtel, Cipla, Dunlop, Exide, Britannia, United Breweries, etc.

<sup>17</sup> Rs. 37 as premium for a ₹10 share.

<sup>18</sup> Since the amount appeared to be very high, we have cross-checked with the RBI data and there seems to be no need for qualifying this amount.

<sup>19</sup> From the inward FDI data released by the DIPP, it is known that Orient Green Power Co Ltd received an FDI of \$42.24 mn. (Rs. 201.54 crores) from Orient Pte Ltd Singapore. The Singapore company also invested \$25.36 mn (Rs. 246.50 cr) in another Indian company Bharat Wind Farm Ltd.

companies or were promoted by them. Like the NRI groups, their OFDI could be just a reverse flow of funds brought in as inward FDI by global investors. Cairn India is a case in point which turns up as the single largest outside investment among the foreign companies covered by Prowess for the year 2009-10 with the investments at as much as \$6.9 bn. Cairn India in fact is the second largest outward investor in the database after Tata Steel whose investments were of the order of \$9 bn.

Matrix Labs which was taken over by Mylan of USA in January 2007 and the initial announcement of which came in August 2006 provides a good example of OFDI by taken over companies. Earlier in April 2004, the promoters of Matrix entered into share purchase agreement with a few foreign private equity players. While the direct benefit of inward FDI by Mylan went to the Indian promoter (and the foreign PEs), a part of Matrix's own financial resources have been subsequently diverted as investments abroad (albeit in continuation of the earlier investments), instead of being deployed for the company's expansion in India. It is also obvious that most of the dividends that accrue to Matrix from the outward investments would finally flow to USA. Such investments have direct implications for India's net inward FDI volumes. It is also interesting to note that a management which was about to enter into a sale agreement within a year went for overseas investments. In this respect one may need to look deep into the role played by the private equity investors who had held around 40% of the equity of the company. A case of double counting FDI is also involved in case foreign private equity investors sell-off to other foreign investors.

With the takeover by Mylan, the foreign investments by Matrix Labs can no longer be treated as India's OFDI nor do they fall under the capital flight category. Also, when the OFDI is by foreign companies or those already having a base abroad and which had invested in India from that base, the arguments of access to technology or marketing infrastructure or securing natural resources for India do not hold good. What now looks like India's OFDI may no longer remain the same if the investing company is taken over by a foreign company. It is relevant to note that out of the IT&ITES companies having substantial investments outside India and categorised as

foreign by Prowess, a good number are acquisition cases.<sup>20</sup> Among the top foreign investors from India there are three pharmaceutical companies all which were once again sell-offs by Indian promoters. The prime example in this regard is Ranbaxy which was once termed as Indian multinational. Outward investments thus may not remain India's especially because most Indian enterprises neither possess ownership specific advantages nor have huge financial resources to back up with unlike developed country TNCs. Their acquisitions are known to be highly leveraged.<sup>21</sup> In fact, the high risk acquisitions may land the domestic companies in trouble as has been the case with Wockhardt. This is where liberal acquisitions by foreign companies could undo India's OFDI thrust.

For the nearly one-third of OFDI which is in services, the same logic as for manufacturing would not hold true. For example, in the communications sector most of the Indian players do not have specific advantage of their own. The acquisition in Africa may thus reflect increased competition in the domestic market and the financial strength gained through exploitation of early entry in the Indian market. In most services OFDI may in fact mean losing jobs in India. For instance, IT companies setting up development centres and call centres in other developing countries could mean taking advantage of relatively cheap labour and overcoming language barriers. Some of the investors in the IT & ITES sectors have indeed a dual character and there is no guarantee that India would have a fair share of the advantages flowing from their OFDI.

It is also pertinent to note that similar to inward investors, outward investors also take advantage of the tax haven route as such countries accounted for 72.57% of the total outflows on account of equity -- Singapore (20.04%), Mauritius (19.98%), Netherlands (10.99%), Cyprus (9.37%), UAE (5.28%), British Virgin Islands (1.77%), Isle of Man (1.55%) and Cayman Islands (1.00%). (Table-6).

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<sup>20</sup> These are Mphasis, Oracle Financial, Patni Computers, Cambridge Solutions, UTV Software, Ranbaxy, Matrix Labs and Fresenius Kabi Oncology.

<sup>21</sup> See: P.L. Beena, "Economic Liberalisation and Financing Pattern of Indian Acquiring Firms Abroad", *Transnational Corporations Review*, Volume 3, Number 2, June 2011, pp. 76-86.

Table -6 : India's Outward FDI and Tax Havens

	Type of Country/Country	Investment (US \$ mn.)	Share in Total (%)
	(1)	Equity (2)	Equity (4)
1	Premier Tax Havens	13,202	39.25
	- Singapore	6,741	20.04
	- Cyprus	3,152	9.37
	- United Arab Emirates	1,777	5.28
	- British Virgin Islands	596	1.77
	- Isle of Man	520	1.55
	- Cayman Islands	335	1.00
2	Mid-Range Havens	6,954	20.68
	- Mauritius	6,719	19.98
	- Bermuda	148	0.44
	- Panama	72	0.21
	Tax Havens which are Major		
3	Financial Centres	4,213	12.52
	- Netherlands	3,697	10.99
	- Switzerland	165	0.49
	- Hong Kong	128	0.38
4	Channel Island	31	0.09
5	Notional Havens	3	0.01
6	Minor Havens	7	0.02
	Tax Havens (1+2+3+4+5+6)	24,410	72.57
7	Other Countries	9,225	27.43
	All Countries	33,635	100.00

*Note:* Country Classification is based on: Tax Justice Network, *Closing the Floodgates: Collecting Tax to Pay for Development*, commissioned by the Norwegian Ministry of Foreign Affairs, 2007. The report explains that intermediate locations having a lot of double tax treaties with other countries are chosen in order to ensure that those are not treated as a tax havens (even though they are) for having low tax rates on dividend income received, and a favourable regime for taxing interest income. The most popular locations it cites are: Ireland, the Netherlands, Luxembourg and Switzerland.

While some Indian companies have been trying to move up the technology ladder, quite a few of the outward investors have no clear strengths except for financial resources which have been accumulated both through financial investments and collecting heavy premium through new capital issues riding on the bull market often created by major stock scams. Their case has been helped further by weak corporate governance norms and lax stock market surveillance. There is a need to further analyse the OFDI data before more firm conclusions can be drawn in the absence of which the capital flight argument may be used to extract favourable policies on labour and land matters on the one hand and going soft on dealing with corporate bigwigs involved in scams and financial irregularities on the other.

### By Way of Summing Up

In the policy making circles there is renewed emphasis on the manufacturing sector. The Union finance minister in his budget speech of 2011-12 and more recently the



RBI Governor have underscored the need give fillip to this sector. The RBI governor has emphasised that the country cannot rely on services to drive the growth dynamics further. Inflows of FDI have, however, not been in tune with priorities of the government. Much of the FDI received by India is in the non-manufacturing sectors. As discussed in the earlier sections, India has been the host to foreign investors looking for quick and large gains. These investors have, therefore, not been inclined to contribute to the long term economic interests of the country by bringing in technology, managerial skills and other intangible assets. The NMCC has well brought out the problems in relying on FDI for technological advancement of the Indian manufacturing sector which has been almost completely opened to participation of FDI. Moreover, since a good part of the FDI in the manufacturing sector is by way of acquisitions, it only displaces the domestic entrepreneurs instead of augmenting existing production capacities.

India's OFDI is led by private sector, which is given a free hand, and since it is promoted as a move towards full capital account convertibility, there could have been no well-defined strategy. Indeed, not all of the OFDI can be termed as India's as some of the outward investors are either foreign or they are unlikely to have binding loyalty towards India. That there is no well-defined strategy towards OFDI is also reflected in the recent statement by RBI.

... the JV / WOS have been perceived as an effective medium of economic co-operation between India and other countries. Such overseas investments catalyze growth in our exports, transfer of technology and skill, sharing of results of R & D, access to wider global market, promotion of brand image, generation of employment and utilization of raw materials available in India and in the host country.<sup>22</sup>

In a phase when the global economic environment is turning bearish, OFDI could be accompanied by downside risk.<sup>23</sup> This stems from the fact that extension of the

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<sup>22</sup> "RBI to put the data on Overseas Direct Investment in the public domain", RBI Press Release No. 2010-2011/1855, dated June 22, 2011.

<sup>23</sup> Coupled with this, Indian companies have taken considerable liabilities on account of foreign currency convertible bonds (FCCBs). The ones falling due for conversion in 2012 are about ₹160 billion (\$35 billion). If the share prices do not hold up, the bond holders may prefer redemption instead of conversion which means that the companies would have to repay the amounts. The expansion of the scope for foreign investments in mutual funds is an attempt to shore up Indian

automatic route leaves little space for monitoring the investments especially when they go into holding companies and into tax havens.<sup>24</sup> Diverting funds abroad and leaving the domestic shareholders little control over further deployment of such funds could be an objective by itself for some of the outward investors. It is not even clear whether India's OFDI has resulted in acquiring strategic assets, including frontier technologies that can, in turn, be used to upgrade domestic industries.

With most of the domestic players not placing much emphasis on R&D activities, and many large Indian players choosing the easy route of relatively low technology intensive industries, development of an internationally competitive manufacturing sector has emerged as a major challenge. What is more, globally competitive sectors like the generic pharmaceutical industry are facing threats of take-overs. In a way, due to the desire to move towards full capital account convertibility, and ad hoc tinkering in response to low level of inflows, India's FDI policy -- both outward and inward -- lost sense and direction. Maximising FDI flows (both outflows and inflows) is a visible dominant objective. It is difficult to understand how a country needing external capital on a large scale and which does not earn its reserves could encourage outflows without any clear-cut policy objectives. The edifice built on 'invasion currency'<sup>25</sup> will remain shaky. There is a need to review both inward and outward FDI policies of India. The time has come for analyzing the empirical experience thoroughly and changing the mind set towards reforms both in policy making circles and the media. Simultaneously, a major challenge is to bring attitudinal change in Indian entrepreneurs.

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companies' share prices.

<sup>24</sup> In fact for some of the investments except for the reporting by RBI there is no trace on the internet.

<sup>25</sup> Supra note 12.

**Box**  
**FDI, Technology Transfer and the Manufacturing Sector**  
**India's Experience in the Post-liberalisation Period**

... , during the process of liberalization and globalization in this period (since 1991), the Trade and FDI policies were not adequately leveraged to strengthen manufacturing or manage substantial transfer of technology as the Countries (Korea, Taiwan, Singapore, Hong Kong, Thailand, Malaysia, Indonesia and China) had done.

...It now appears that India missed the bus not merely in terms of implementing the reforms in time, but also in terms of loss of policy space.

...The FDI policy was liberalized gradually and by the year 2000 very substantial liberalization of the FDI policy was achieved barring in very few sectors. In respect of manufacturing sector, almost all subsectors were liberalized and 100% investment by foreign companies was allowed. In fact, the concept of Joint Ventures was also given up ... The conditions of divestment to local investors, technology transfer etc., were also given up during this period.

... these technologies (acquired through FDI, purchases and M&As), quite often, are not the state of art technologies but are at least one or two generations behind what is available elsewhere in the world. Purchase of technology is increasingly becoming costly and in view of liberal FDI policies, companies from abroad are reluctant to part with technology even for purchasing.

... there has been little or no emphasis on whether technology transfer is taking place or whether the kind of technologies that are brought in were appropriate or not. In particular, many of the technologies in the fields of Defence, Aero Space, IT, Atomic Energy and other high technology areas are not available either through the liberalized FDI route or for buying them outright.

...The Multinational Companies are also permitted to open 100 percent owned subsidiaries in India. In other words, in those areas the technology would continue to remain with the Multinational Companies themselves.

...Technology transfer is considered to be one of the most important benefits of permitting FDI into a country. In India, however, in attracting the FDI the emphasis appears to be substantially on the amount of FDI flows. All announcements of successive Governments have been on the quantum of FDI received rather than on the quality of FDI. The benefits that accrued to the economy in terms of transfer of Technology, if any, is rarely highlighted possibly because no such assessments have been made.

... (technology) spillover effects do take place but not only that such spill over takes long time for the benefits to percolate, ..., it ensures that the technology gap keeps widening. The technology standing of India in the World ... clearly shows that even if some spillover benefits have been there, they have not been significant enough to take India to the upper bracket in the Technology standing index.

...Thus, there is clearly a need to have a relook at our FDI policy in terms of the technological benefits the country needs to derive.

India, National Manufacturing Competitiveness Council, *Report of the Prime Minister's Group: Measures for Ensuring Sustained Growth of the Indian Manufacturing Sector*, September 2008.

