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Guest Editorial

Foreign Direct Investment and Development in India

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Abstract: This editorial introduction provides an overview of different issues and topics analyzed in the present TNCR special issue. Topics surrounding the rise of India as a host to FDI and a home for emerging Indian TNCs are discussed. The special issue make a significant contribution to the current debate on internationalization of emerging economies like India.

Keywords: Emerging economies, India, FDI, TNCs
JEL: O50, F23

1. Introduction

The rise of relatively large emerging economies is leading to significant structural transformation of global industries, international institutions and global power arrangements (Pradhan and Lazaroiu, 2011). Accelerated internationalization involving foreign direct investment (FDI) is turning out to be an important medium of these economies' expanding global influence. Being the sources of higher growth, they are the most sought after destination for global firms from developed countries looking for growth, opportunities and stability of performance. These emerging economies' share in global FDI inflows has gone up sharply in the past decade with developing and transition economies receiving more than half of global FDI inflows in 2010 (UNCTAD, 2011). Besides, the growth of global firms based in emerging economies is making market competition ever more challenging across sectors and geographies. Outward FDI undertaken by emerging transnational corporations (TNCs) is growing faster as they are on a buying spree of assets and companies abroad. The share of developing and transition economies in global FDI outflows increased to 19 per cent in 2008 and further to 25 per cent in 2009 (UNCTAD, 2010). This changing importance of emerging economies as a host to and source of global FDI flows therefore raises important issues regarding the activities and role of established and emerging TNCs.

Among relatively large emerging economies, India represents an interesting case of rapid growth and internationalization witnessed during the past two decades. It achieved the second highest real GDP growth (8.4 per cent) after China (10.1 per cent) during 2006−2010[1] and became the top ninth host to global FDI inflows in 2009 (UNCTAD, 2010). Although, India lagged behind China in terms of the scale of FDI inflows received (e.g. China received US$95 billion in 2009 as compared to US$34.6 billion of

[1] This is among top 15 populated economies and based on the average growth rate obtained from the data on 'Real Historical Gross Domestic Product (GDP) and Growth Rates of GDP for Baseline Countries/Regions (in billions of 2005 dollars) 1969-2010' available from www.ers.usda.gov.

India), the former outpaced the latter if the intensity of such investment is considered in relation to the gross fixed capital formation of the host country during 2005−2009 (this ratio is 5.9 per cent for China while it is 6.8 per cent for India). Clearly, India turns out to be an attractive emerging economy host for global TNCs seeking new sources of growth, efficiency and low-cost innovation. As the gravity of global growth shifts from developed to emerging markets, it appears that securing a successful presence in a growing emerging economy like India is a crucial strategy of TNCs to ensure their future growth. A stronger domestic demand, pursuance of a liberal policy regime for FDI and opening up of new domestic sectors to foreign operations in India since 1990s seem to have supported this intensifying involvement of global TNCs in India.

The internationalization of Indian economy has also assumed even stronger sense with the transformation of a large number of Indian firms into TNCs. The outflows of FDI from India grew by a whopping 119 per cent on annual average during 2000−09 far exceeding that of China at 97 per cent. Similar to the case of inward FDI flows, India falls behind China substantially in terms of the scale of OFDI but outperform by OFDI intensity. In 2009 Chinese OFDI flows stood at US$48 billion as compared to US$15 billion of outflows from India. However, as a per cent of gross fixed capital formation such flows from China averaged 1.8 per cent during 2005−2008 which is nearly half of that relates to India (3.6 per cent). The emergence of Indian multinationals and their expanding profile in global markets through large sized acquisitions and green-field projects abroad may possess implications for a host country's market structure, capital formation, productivity, technology, employment and trade performance.

In the above context, understanding the role of global TNCs in India and Indian TNCs in global markets are clearly crucial issues worthy of analysis and learning. While there are voluminous studies about the Chinese experience, it is only fitting that the study of India should complement the literature on internationalization of emerging economies. The present special issue of the *Transnational Corporations Review* (TNCR) was imagined precisely to deals with the recent FDI experience of the emerging economy of India. The contributions in the special issue can be broadly grouped under three main headings: 'FDI in India', 'FDI from India' and 'Issues in FDI and Internationalization' each presenting state of the art knowledge, thoughts, assessments and research findings about the operation of TNCs in India and that of Indian TNCs.

2. FDI in India

The first part of the special issue reviews some of the emerging subjects related to the operation of foreign firms in India. Special attention is given to the role of non-equity operation of TNCs, locational distribution of their investments, and challenges emanating for operationalizing natural resource-based FDI projects in India.

TNC involvements in India is not just limited to equity modes like establishing joint ventures and wholly-owned subsidiaries recently but the same is assuming new forms of non-equity modes like outsourcing, strategic alliances and licensing. Pradhan's essay is primarily concerned with the outsourcing as an important form of TNC operation in India. While India is well known as an attractiveness destination for outsourcing by global services TNCs, such outsourcing activities of global firms to India in manufacturing is less recognized. In addition to their captive sourcing of raw materials and inputs locally in India, a growing number of MNCs can be observed to have resorted to contract manufacturing from independent suppliers in pharmaceuticals and automotive sectors. These emerging non-equity modes of TNC operations can have significant development implications for the host country.

Rao and Murthy revisit the analysis of the location of FDI in India. They argue that existing studies on state-wise distribution of FDI in India are mostly based on aggregate flows data and could offer inadequate perspectives into the location choice of foreign firms. However, as the location of FDI is being deeply related to the specific characters of FDI projects such as modes of entry (greenfield vs. acquisitions; joint ventures vs. wholly-owned subsidiaries), nature of the foreign investor, sector of investment, etc. Incorporating these characteristics would yields more illuminating views of regional dimension of FDI distribution in India. Analysis of India shows that FDI inflows have been largely dominated by services and infrastructure projects, equity hikes by existing foreign firms, and takeover of existing companies/units and therefore, relating aggregate FDI flows with state level characteristics such as level of industrialisation, infrastructure development, growth trend, reform-orientation, corruption and quality of governance, is less appropriate.

The paper by Park explores host country issues associated with the entry of natural resource-based FDI into India. His analysis of the experience of India's biggest foreign direct investment (FDI) project, namely the proposed Posco integrated steel plant in Orissa, reveals a complex set of issues from regulatory clearances especially forest and environmental clearances and the socially and politically sensitive issue of land acquisition and displacement. This natural resource-based project has faced long drawn protests by local people against land acquisition and got entangled in environmental concerns and livelihood issues. The delay in the beginning of the project is a clear reflection on the failure of state and local administration in building local consensus about the benefits of it and in addressing effectively the compensation and livelihood issues of the local people being displaced. This would suggests that massive FDI in natural resource sector is required to be facilitated in an holistic environment of consensus building and assurance of new employment in the relocation zone for the displaced population.

3. FDI from India

The second part of the special issue raises and discusses issues concerning the rise of Indian TNCs and their outward FDI (OFDI) activities. The study by Nazareth Satyanand provides preliminary account of Indian OFDI in the agriculture and food sector. India provides an interesting example of a rapidly internationalizing economy with a broad-based sectoral OFDI profile (Pradhan, 2011). However, when it comes to agriculture, the emergence of Indian TNCs is of more recent origin. With the consistently growing food prices and relaxation on restrictions on corporate involvement in agriculture during the last decade, a number of Indian firms turn translational. An upsurge of overseas acquisitions by Indian firms can be seen in beverages, tea, crop protection and floriculture. These acquisitions are driven by a multiplicity of firm-specific objectives like access to new technology, products, networks, raw materials, etc.

Bhat and Narayanan focuses on the OFDI behaviour of Indian TNCs from chemicals and information technology (IT) sectors. Specifically they examined Indian TNCs investment in their existing affiliates abroad. Their analysis shows that Indian firms from both these sectors are more likely to undertake investment in their foreign affiliates if parent entities are engaged in in-house R&D. In the chemical industry, imports of capital goods and disembodied technologies also play a positive role. This would verify that acquisition of technology internally by firms or through external purchase may encourage their OFDI involvements. Firm's spending on labour is found to be positively related to the OFDI probability and OFDI level of IT and chemical firms respectively.

The United States has emerged as the third largest host to Indian OFDI flows during the period April 2000 to March 2009 (Pradhan, 2010). It attracted about US$6.2 billion of FDI accounting for 8.6 per cent of total FDI flows from India. In this context, Jain's paper is a rich empirical account of the operation of Indian firms in the U.S. through greenfield investments and mergers and acquisitions (M&As). It presents a number of interesting characteristics of Indian FDI in the U.S. that are worth exploring further. Between greenfield investments and M&As, Indian TNCs are observed to prefer the latter while entering the U.S. market and even in M&As they tend to target high-technology, knowledge-intensive manufacturing industries and services, such as pharmaceuticals, automotive and IT. It appears that U.S. bound Indian FDI projects are motivated by the desire to acquire technology and brands and facilitated by the liberal U.S. business environment and opportunities to acquire valuable assets at low valuations.

Are Indian acquisitions abroad simply a result of cash-rich Indian firms? Beena's paper introduces the debate on whether recent foreign shopping of Indian firms is due to their internal resource base. The data presented in the paper pertaining to the period 1991–2009 shows that internal finances constitute about 40 per cent of total resource mobilization by Indian acquiring firms for their business operation. In comparison, the share of external finances reached 60 per cent. Borrowings and resources raised from capital markets played a key role in the financing patterns of these companies. The case studies of selected acquiring Indian TNCs further confirm that these firms have resorted to foreign borrowings and issues of Foreign Currency Convertible Bonds and Foreign Currency Exchangeable Bonds in order to acquire large sized foreign entities.

4. Issues in FDI and internationalization

The third part of the special issue contains the remaining set of five papers each offering thoughtful analysis of emerging topics related to India's experience with internationalization. The essay by Rasiah explores the contribution of joint ventures to the firm-level technological capability building in the rapidly evolving Indian automotive sector. This knowledge-based sector has been significantly liberalized since 1990s and restriction on foreign ownership has been removed. It is to be expected that enterprises with foreign ownership would go for higher local R&D activities given the large size of the host market, stiff competition, stringent quality and regulatory conditions and adequate supply of human capital. The findings on technological performance of a sample of firms from the greater Delhi region do seem to bode well for local innovation. Firm's overall technological capabilities through human resource practices, process technology and R&D are found to be higher for joint-venture firms with over 10% foreign equity as compared to fully domestic owned firms. The superior performance of firms with foreign equity also hold true at the disaggregated level for human resources and process technology.

The contribution by Hansen, Petersen and Wad analyzed the interesting issue of how subsidiary mandates changes with the shifting characteristics of a host emerging economy like India. Unlike the previous period, India has adopted a progressively outward-looking trade and investment regimes since 1990s and considerably liberalized its business environment. Rapid growth of Indian market, access to skilled labour, cost effective production, quality changes in local industry and growing capability of local suppliers have positively affected the mandates of Danish subsidiaries in India. These subsidiaries have evolved being small assisting operations with relatively low standing in the global strategy of their parents in 2001, to be assigned with larger and more significant operations in 2008. The impression gathered in the survey suggests that Danish subsidiaries are preparing for increased activities related to after-sales services, R&D expansion and export mandate for regional markets.

In his paper Abraham dealt with the changes in the competitive structure and composition of the Indian IT industry among three types of firms distinguished based on the perspective of internationalization. They are the Indian owned IT firms having overseas subsidiaries (Indian TNCs), those Indian firms without such affiliates (Indian domestic firms) and subsidiaries of foreign firms operating in the Indian IT sector (foreign TNCs). Statistics presented in the paper suggests that Indian TNCs, on an average, are larger than foreign TNCs and both these TNCs in turn are larger than domestic Indian IT firms. In addition, there is a secular decline in the share of both foreign TNCs and domestic firms in the industry sales since 2004. Domestic firms constituted about three-fourth of the total number of IT firms but were small in size, least export-oriented and claimed marginal market share. On the contrary, Indian TNCs represented only a small share in the total number of firms (20 per cent) but are export oriented and large sized entities that dominated the Indian IT industry. From this the author argues that there exists a dual industrial structure in the IT sector between Indian TNCs and domestic firms.

To understand the internationalization of Indian firms, it is also important to explore the role of business networks that help firms to access critical resources and deal with environmental uncertainty. Varma devoted her attention to the theoretical underpinnings of networks affecting the rise of born global firms from India. Though her main hypotheses remained untested empirically, findings from another study tend to suggest that business ties are important for firm's internationalization pattern. While dealing with the locational patterns of Indian overaseas M&As, business group (BG) affiliated Indian TNCs are found to be guided by a broader set of considerations than standalone Indian TNCs mainly due to BG's derived resources and access to parental networks (Pradhan and Sing, 2011).

Finally, the article by Das delves into the characteristics of M&A transactions involving Indian and Chinese companies in the technology sector comprising of computer and electronic manufacturing, IT, telecommunication, media, and professional, scientific and technical services. Empirical results suggest that while outbound M&A deals from India and China are not significantly different, domestic and inbound deal types in these two countries are significantly different. It is found that in most cases Indian and Chinese TNCs opted for similar acquisition strategy, namely acquisition of controlling stake.

5. Concluding remarks

In closing, it is our hope that this special issue of TNCR offers reader with new insights and perspectives for understanding the current and emerging trends in India's FDI experience. The variety of issues discussed and analyzed for India may also be useful and relevant for other emerging economies.

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