

India's FDI Inflows

Recent Experiences

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FDI is a Bundle of Tangible & Intangible Assets

- The proprietary assets, the “ownership advantages”, can be obtained only from the firms that create them.
- They can be copied or reproduced by others, but the cost of doing that can be very high, **particularly in developing countries** and **where advanced technologies are involved**.
- Non-proprietary assets – finance, many capital goods, intermediate inputs and the like – can usually be **obtained from the market also**.

UNCTAD, *World Investment Report : Foreign Direct Investment and the Challenge of Development*, 1999.

Assets in the FDI Bundle

- The most prized proprietary asset is probably technology. Others are:
 - ❖ brand names,
 - ❖ specialized skills,
 - ❖ ability to organize and integrate production across countries,
 - ❖ to establish marketing networks, or to have privileged access to the market for non-proprietary assets (e.g. funds, equipment).
- Taken together, these advantages mean that TNCs can contribute significantly to economic development in host countries – ***if the host country can induce them to transfer their advantages in appropriate forms and has the capacity to make good use of them.***

UNCTAD, *World Investment Report : Foreign Direct Investment and the Challenge of Development*, 1999.

Definition

- *Foreign direct investment* reflects the objective of establishing a **lasting interest** by a resident enterprise in one economy in an enterprise that is resident in an economy other than that of the direct investor.
- The **lasting interest** implies the existence of a **long-term relationship** between the direct investor and the direct investment enterprise and a **significant degree of influence** on the management of the enterprise.
- The direct or indirect **ownership of 10% or more of the voting power** of an enterprise resident in one economy by an investor resident in another economy is **evidence of such a relationship**.
- Key Elements
 - ❖ Lasting interest
 - ❖ Significant influence
 - Represented by minimum 10% share in equity

OECD Benchmark Definition of FDI

Our Approach in 1991

The Statement on Industrial Policy, 1991 said:

- ❖ 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**.
- ❖ ... 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.

Measuring FDI Flows

- FDI flows comprise capital provided by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign direct investor.
- Three components of FDI:
 - ❖ **Equity capital** is the foreign direct investor's purchase of shares of an enterprise in a country other than its own.
 - ❖ **Reinvested earnings** comprise the direct investor's share of earnings not distributed as dividends - such retained profits by affiliates are reinvested.
 - ❖ **Intra-company loans** or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors and affiliate enterprises.

Substantial Increase in Inflows during 2000-01[#] and 2009-10, esp. after 2005-06

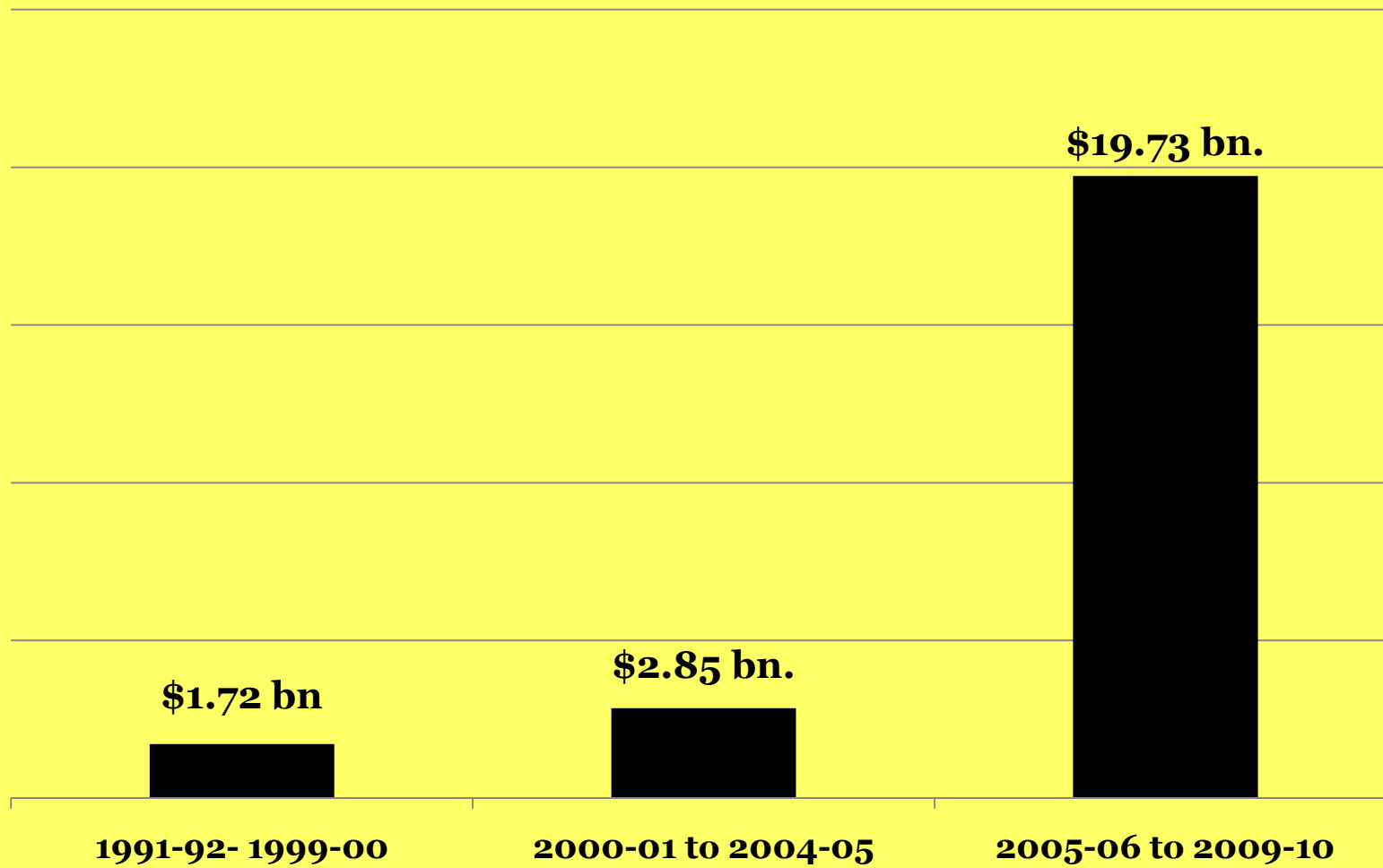
Amount in \$ mn)

Financial Year	Equity Capital (FIPB, Automatic & Acquisition Routes)	New Items	Reported Total FDI Inflows	Share of new items in total (%)	Share of Re- invested Earnings (%)
(1)	(2)	(3)	(4)	(5)	(6)
1991-92@-					
1999-00	15,483	N.A.	15,483	N.A.	N.A.
2000-01	2,339	1,690	4,029	41.95	33.51
2001-02	3,904	2,226	6,130	36.31	26.84
2002-03	2,574	2,461	5,035	48.88	36.41
2003-04	2,197	2,125	4,322	49.17	33.78
2004-05	3,250	2,801	6,051	46.29	31.47
2005-06	5,540	3,421	8,961	38.18	30.80
2006-07	15,585	7,241	22,826	31.72	25.53
2007-08	24,573	10,262	34,835	29.46	22.04
2008-09	27,329	7,851	37,838	20.75	23.86
2009-10(P)	25,609	8,558	37,763	22.66	22.96
2010-11(P)	19,430	10,950	30,380	36.04	31.02

[#] New Reporting method from 2000-01.

@ Aug 1991 to Mar 1992

India's FDI Equity Inflows



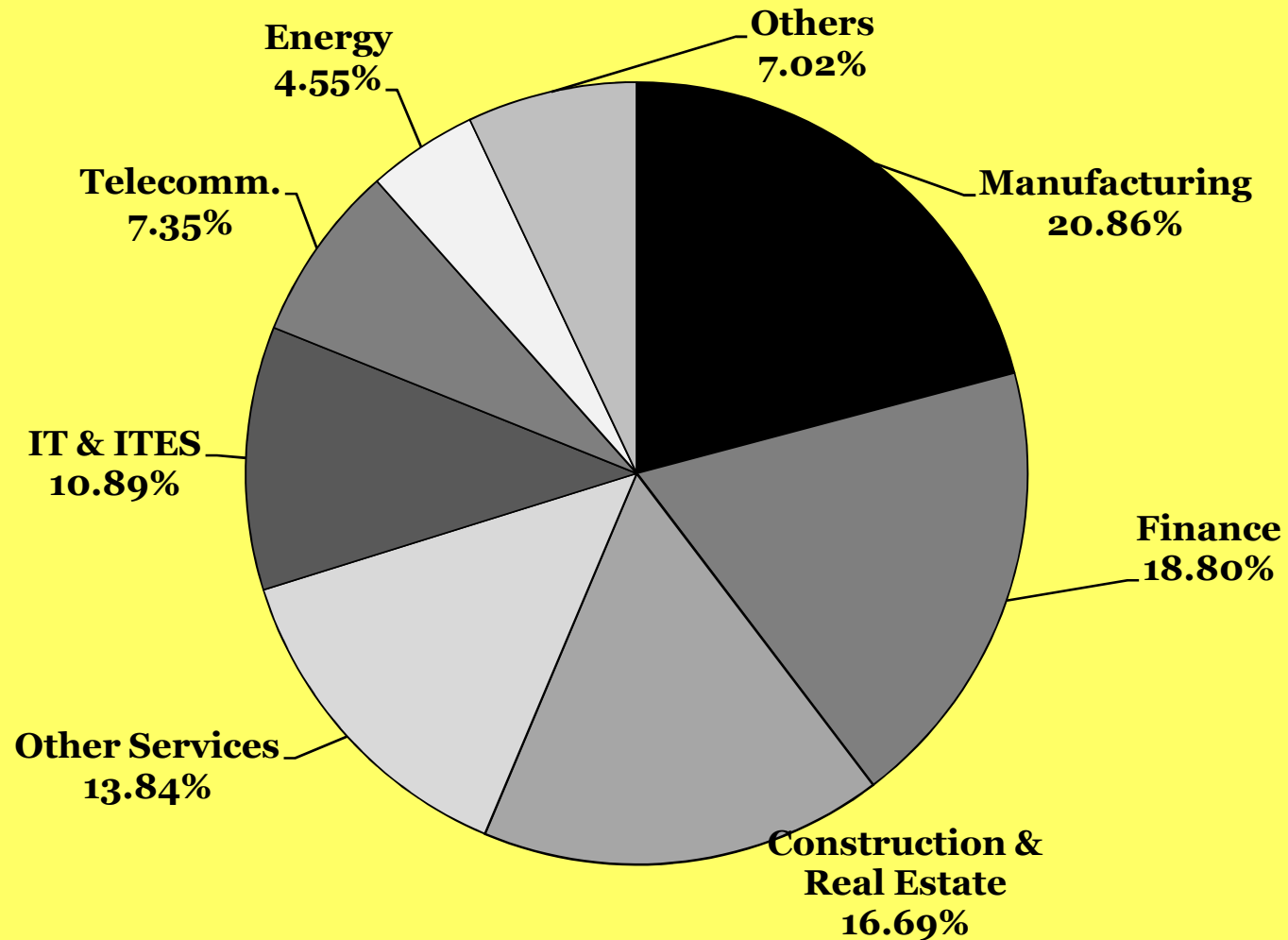
Entry Route-wise Distribution of Foreign Equity Inflows

Year	Total Amount (\$ mn.)	Share in Total (%)		
		FIPB/SIA	Automatic	Acquisition of Shares
(1)	(5)	(6)	(7)	(8)
2000-01	2,339	62.25	22.27	15.48
2001-02	3,904	56.89	20.54	22.57
2002-03	2,574	35.70	28.71	35.59
2003-04	2,197	42.24	24.31	33.45
2004-05	3,250	32.68	38.71	28.62
2005-06	5,540	20.32	40.31	39.37
2006-07	15,585	13.83	45.88	40.28
2000-08 PR	24,573	9.35	69.70	20.95
2008-09 PR	27,329	17.19	65.86	16.95
2009-10	25,609	13.55	74.16	12.29

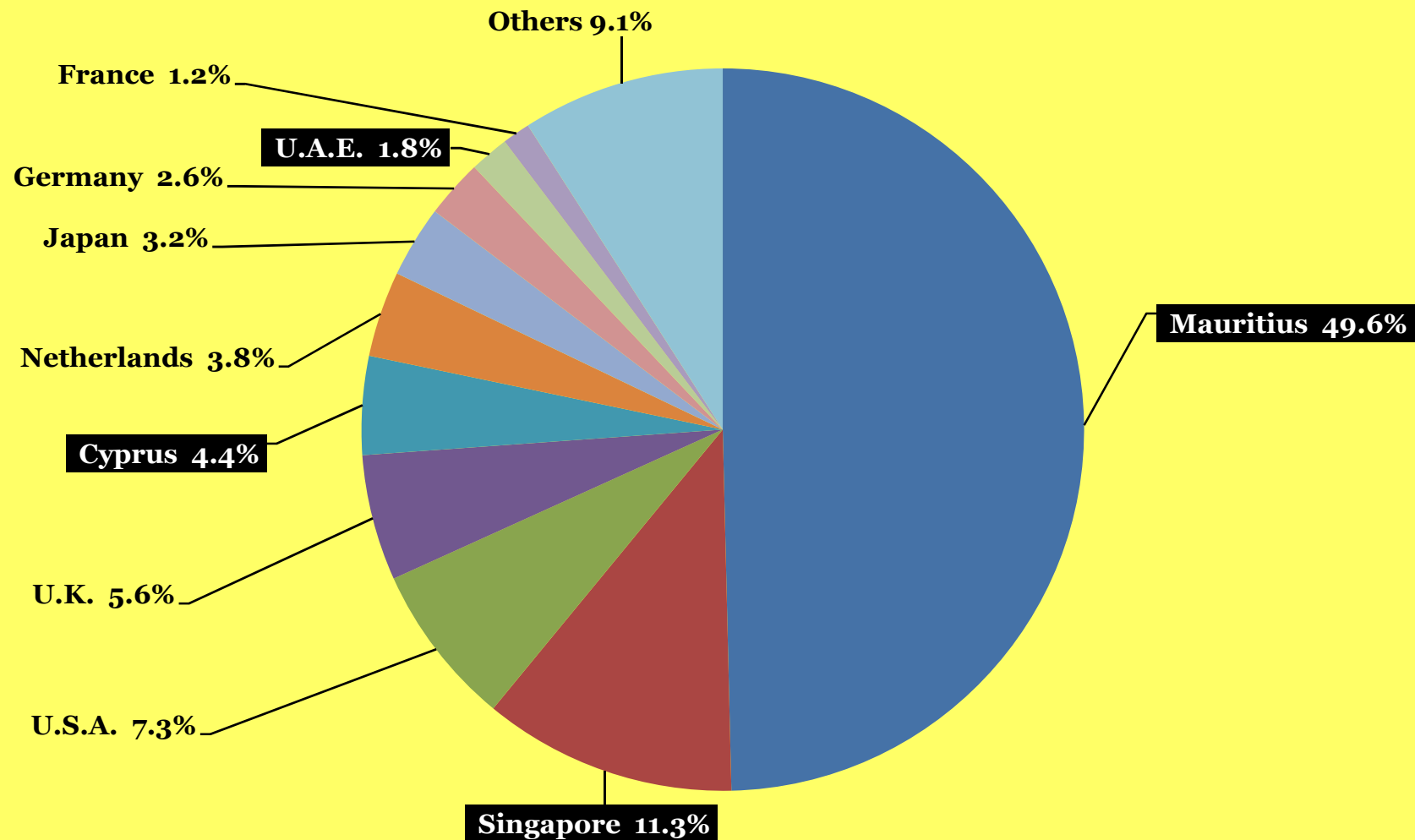
Sector-wise Distribution of Equity Inflows

Sector	Total Inflow (\$ mn.)	Share in Total Inflow for the Year (%)					2005- 2008
		2005-2008	2005	2006	2007	2008	
Manufacturing	13,436	41.41	17.44	18.67	20.35	20.86	
Finance	12,114	11.68	19.77	18.08	19.77	18.80	
Construction & Real Estate	10,754	3.12	11.50	17.41	19.88	16.69	
Other Services	8,915	11.31	20.22	10.74	13.52	13.84	
IT & ITES	7,016	21.21	17.25	15.18	5.32	10.89	
Telecomm.	4,737	3.64	8.37	6.72	7.80	7.35	
Energy	2,933	1.44	2.26	3.69	6.15	4.55	
Trading	1,367	0.65	0.76	3.62	2.05	2.12	
Mining	488	0.15	0.03	2.65	0.17	0.76	
Agriculture	136	0.21	0.01	0.75	0.02	0.21	
Unclassified	2,529	5.19	2.39	2.50	4.96	3.93	
Total	64,423	100.00	100.00	100.00	100.00	100.00	

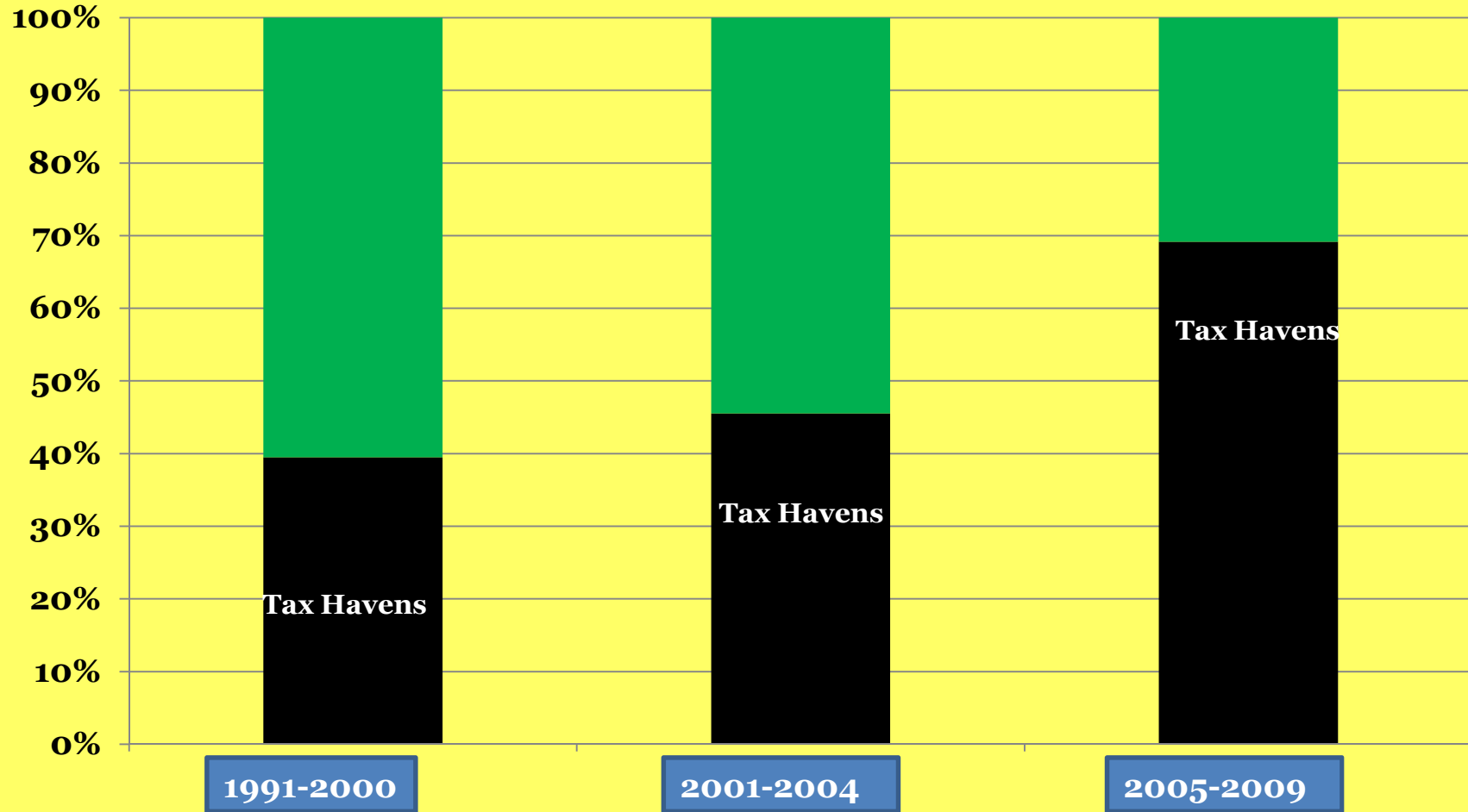
Sectoral Composition of FDI Equity Inflows (2005-2008)



Top 10 FDI Home Countries (2005-2009)

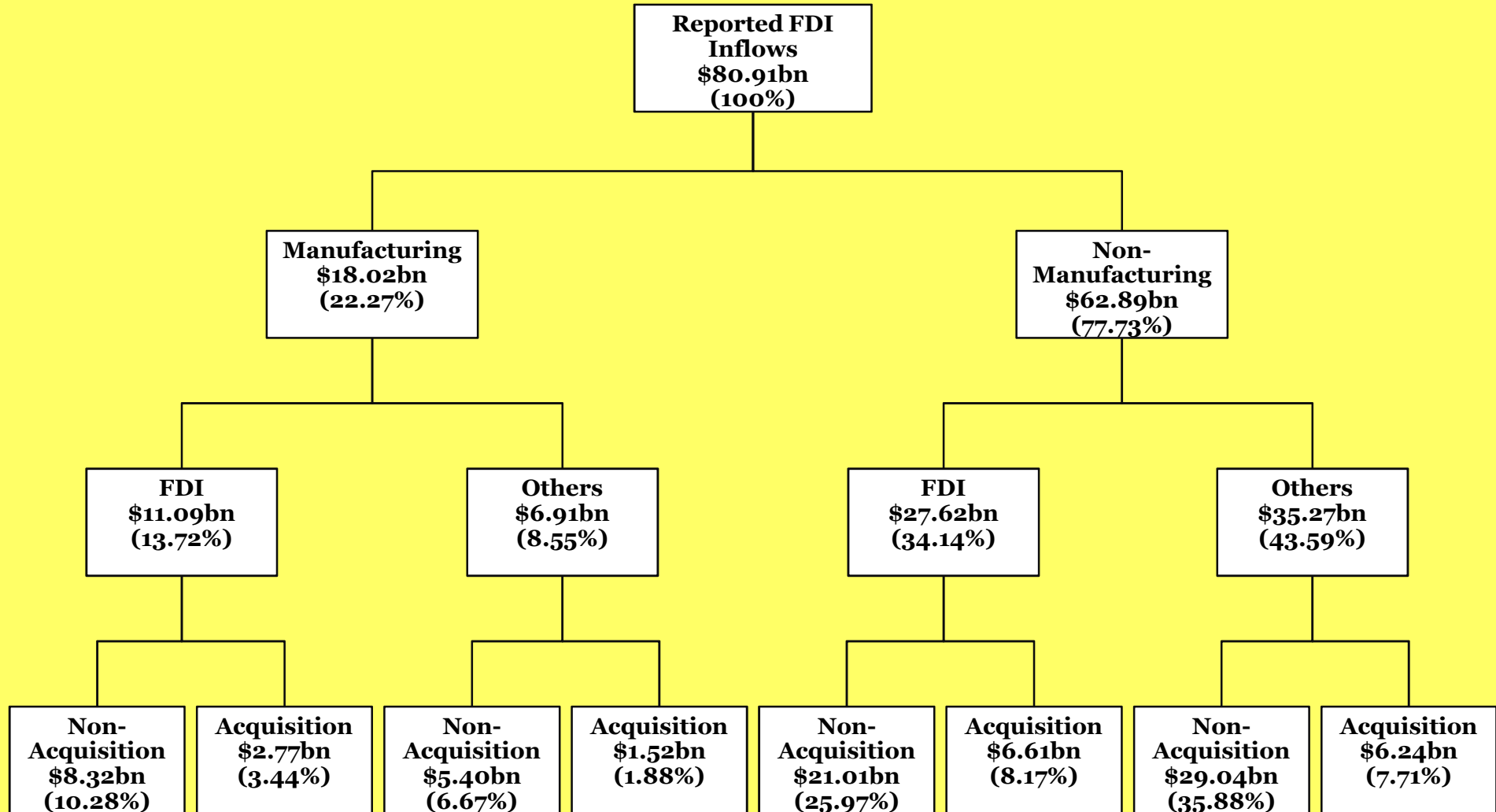


Increasing Share of Tax Havens



Analysis of Top 2,748 Individual Inflows

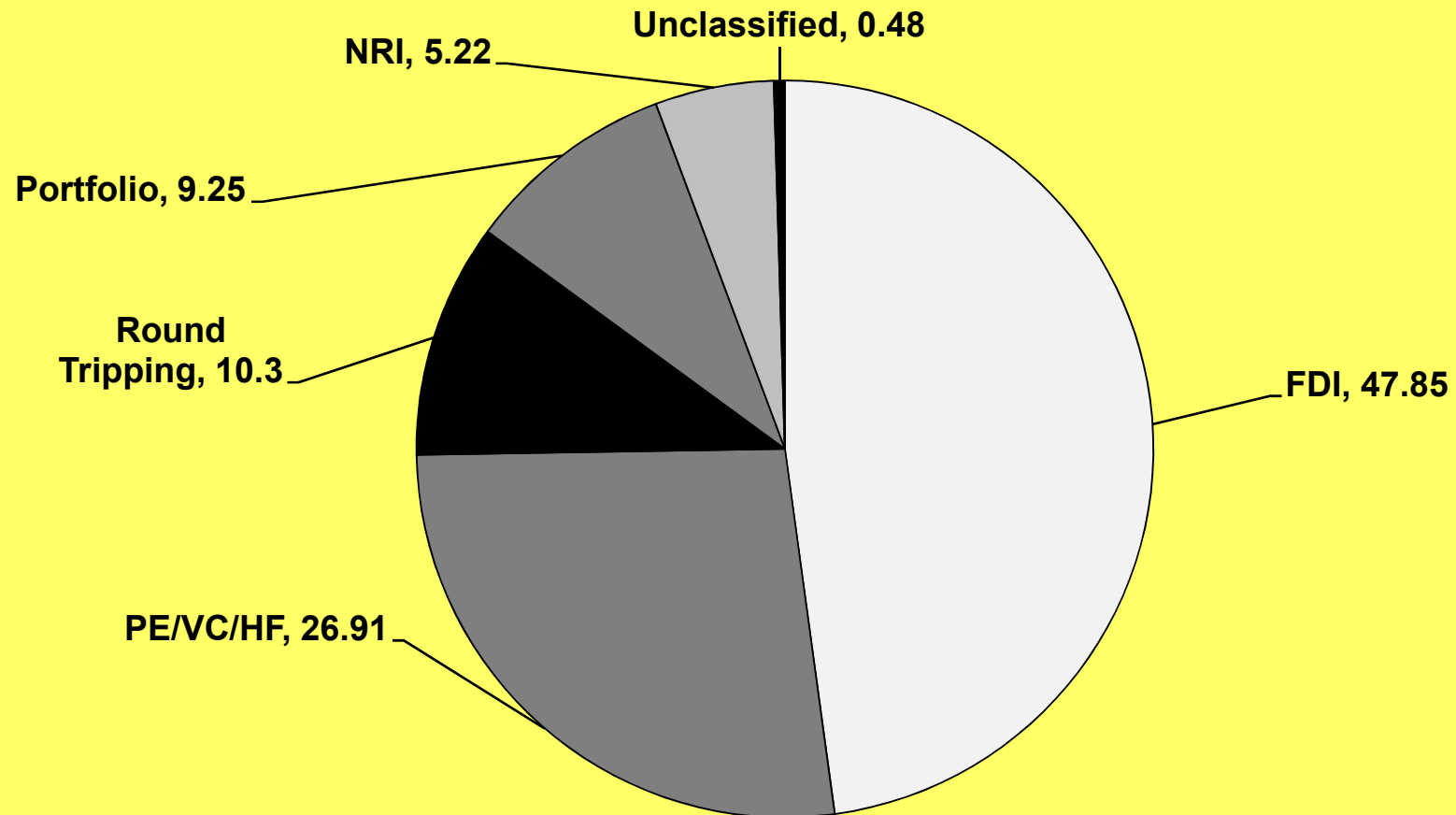
each of minimum \$ 5 mn.
accounting for 88% of the total FDI Equity Inflows
during Sep. 2004 & Dec. 2009



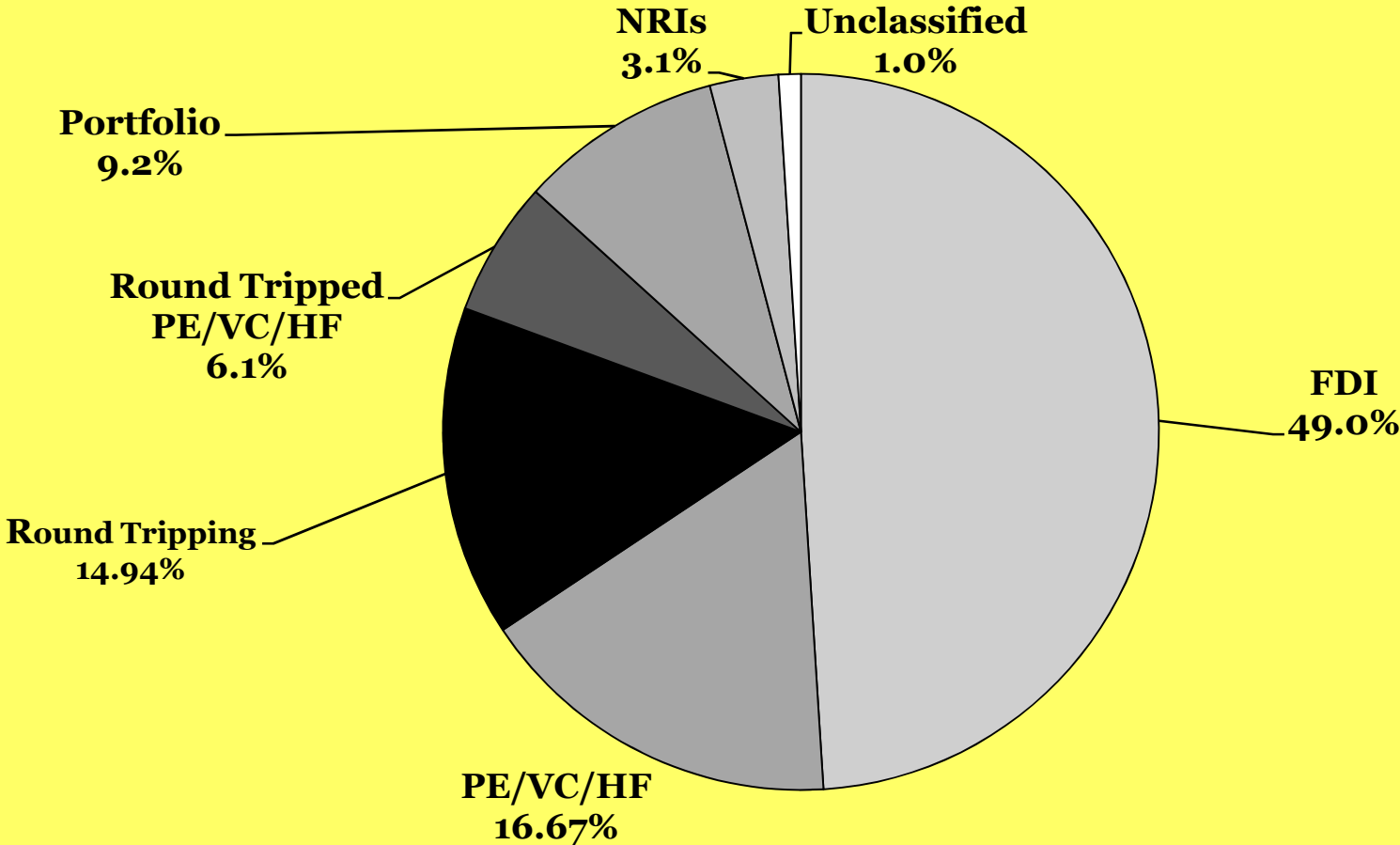
Shares of Different Types of Foreign Investors

Type of Investor/Investment	Share in Inflows (%)
FDI	47.85
PE/VC/HF #	26.90
Round Tripping Only	10.30
Other Portfolio	9.25
NRI	5.22
Unclassified	0.48

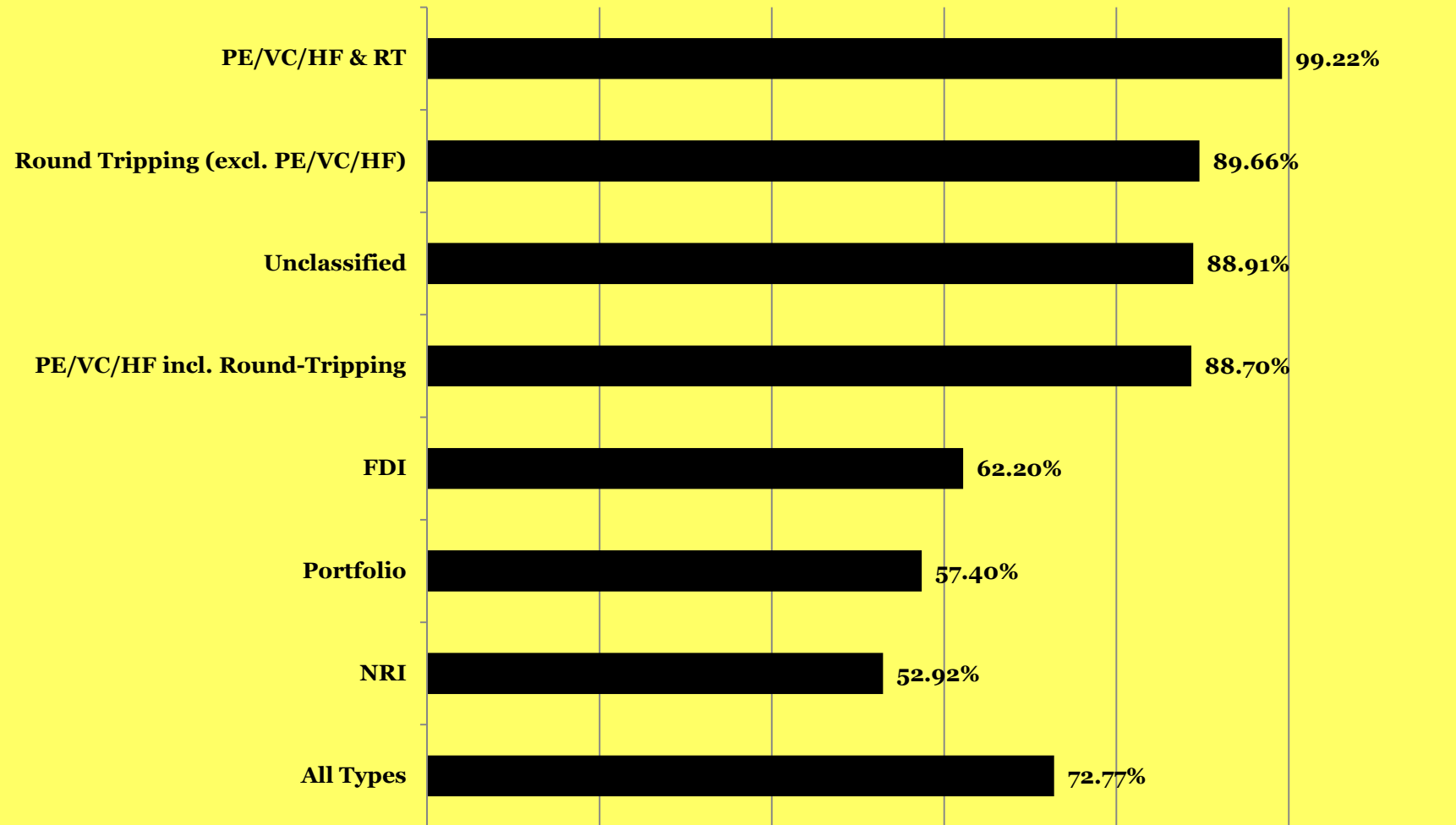
Type of Foreign Investor-wise Distribution of Top Inflows



Foreign Investors' Shares in Inflows (2009)



Share of Tax Havens in the Inflows by Different Types of Investors

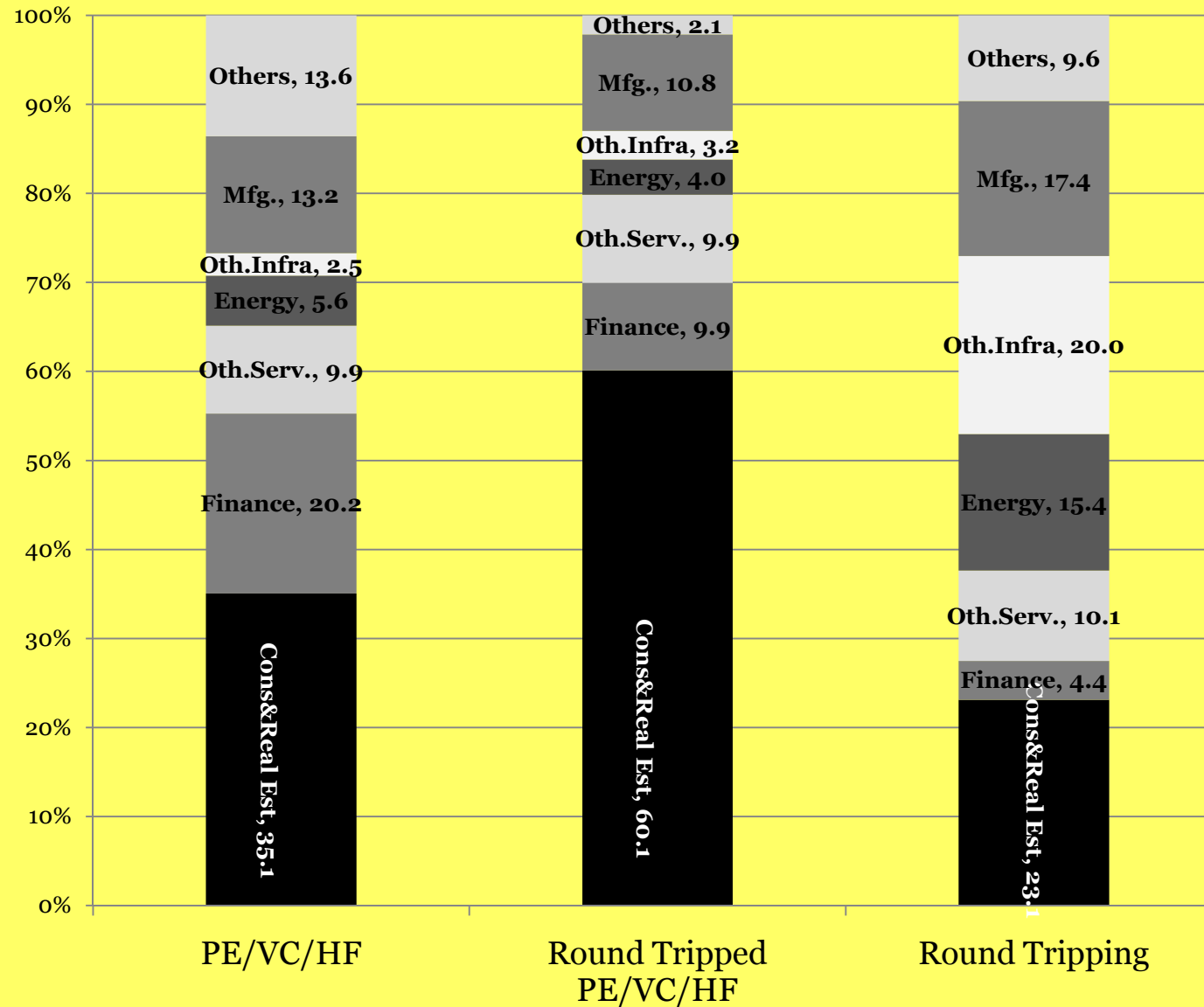


Sector and Type of Foreign Investor-wise Distribution of Top Inflows

Percentages

Sector	FDI	PE/VC/HF	Other portfolio	Round Tripping Only	NRI
Manufacturing	61.57	15.48	8.82	8.05	5.47
Construction & Real Estate	12.82	58.17	9.77	13.25	4.43
Financial	58.70	29.09	5.11	2.62	4.28
IT & ITES	61.35	19.95	2.85	1.19	14.66
Telecommunications	80.75	7.66	3.79	7.80	0.00
Other Infrastructure	14.11	13.15	29.60	38.19	4.96
Research & Development	56.87	43.13	0.00	0.00	0.00
Other Services	44.72	29.79	10.55	11.71	3.03
Energy	36.08	18.72	19.10	20.47	5.52
Mining & Agriculture	65.42	21.43	1.99	11.16	0.00

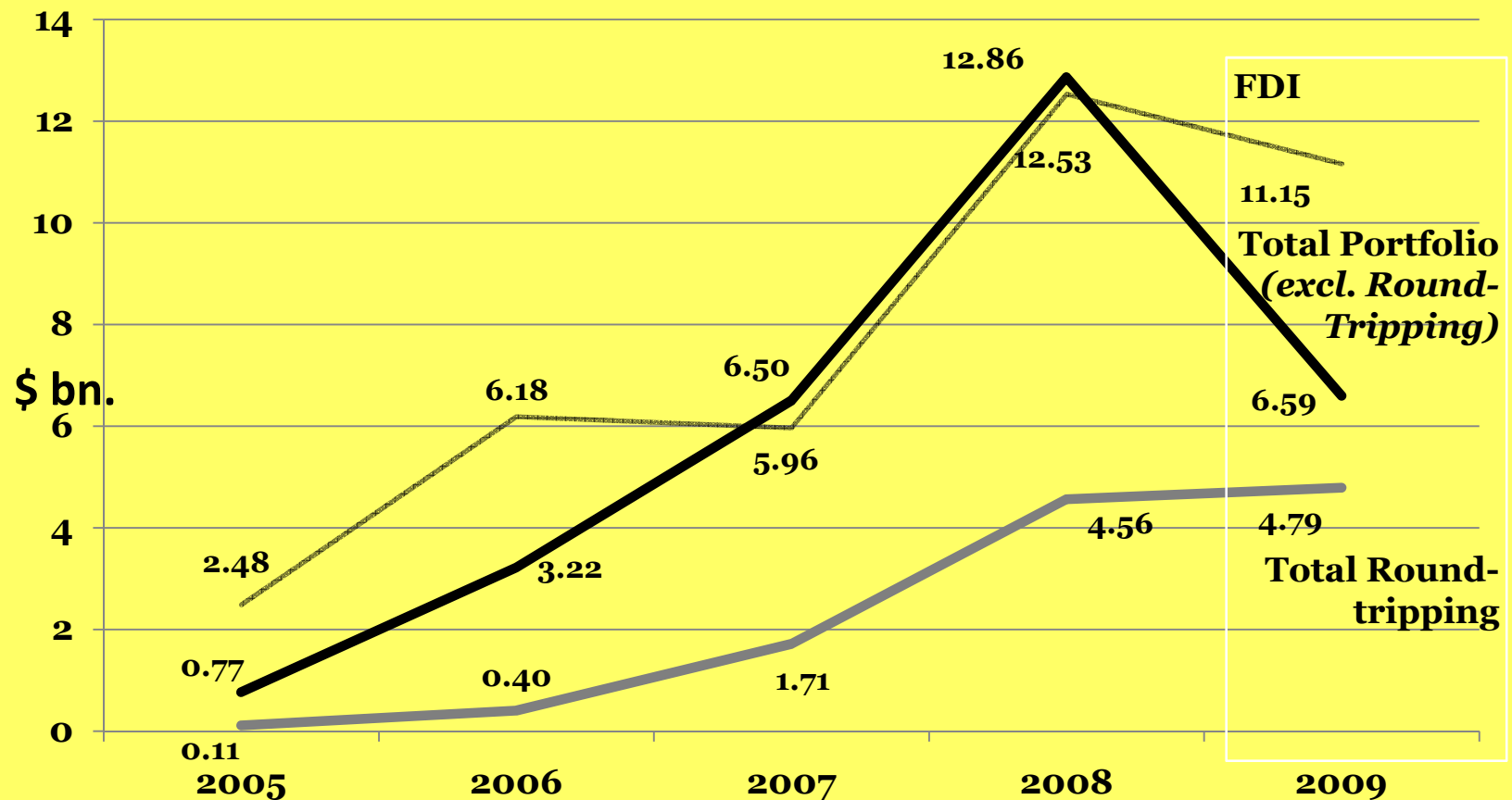
Sectoral Composition of Private Equity and Round-Tripped Investments



A Tentative Classification of the Manufacturing Realistic FDI Companies

Category	No. of Cos	FDI Inflow (US \$ mn.)	Share in Total (%)	
			No. of Cos.	Inflow
New Sole Ventures	78	1947.54	28.06	17.73
Joint Ventures	38	983.53	13.66	8.95
New Ventures by those already having mfg ops.	15	503.26	5.40	4.58
Older Companies	78	2178.69	28.06	19.83
Acquisitions	69	5374.45	24.82	48.91
Total	278	10,987.47	100.00	100.00

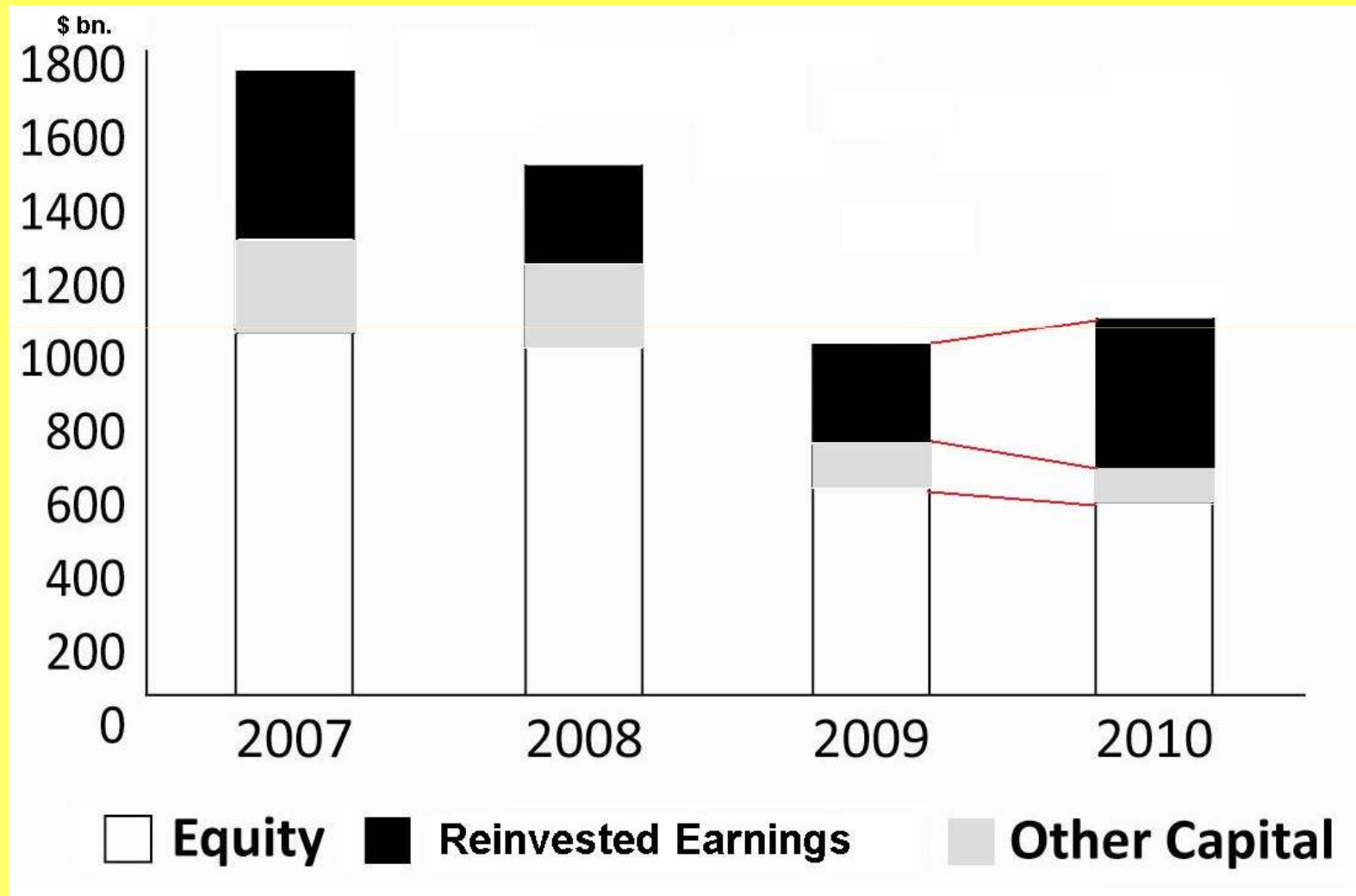
Differing Behaviour of FDI, Portfolio and Round-tripping Investments in 2009



Fall in Inflows During 2010

Sectors which experienced a fall in inflows	FDI Inflows (Rs. Cr.)		Fall in 2010		Share in Total Fall (%)
	2009	2010	Amount (Rs. Cr.)	%	
1. Housing, Real Estate & Construction	27,705	13,902	13,803	49.8	27.3
2. Services Sector	27,656	16,911	10,744	38.9	21.2
3. Agriculture Services	5,878	230	5,648	96.1	11.2
4. Telecommunications	12,444	6,918	5,526	44.4	10.9
5. Electrical Equipments	3,808	506	3,302	86.7	6.5
6. Power	7,977	5,512	2,466	30.9	4.9
7. Information & Broadcasting	3,706	1,881	1,825	49.2	3.6
8. Consultancy Services	2,023	1,163	861	42.5	1.7
9. Automobile Industry	6,587	5,747	839	12.7	1.7
10. Trading	3,242	2,532	709	21.9	1.4
11. Others	13,250	8,333	4,917	37.1	9.7
Total fall in respect of sectors experiencing decline	1,14,275	63,637	50,639	44.3	100.0
Total Inflows	1,30,980	96,015	34,965		

Global FDI Inflows by Component



Classification Problems

Three Types of Problems

- Financial Investors: neither long term interest nor the associated intangibles
- Round-Tripping
- Non-adherence to the 'international norms'

Indian Companies which could be Classified as FDI Cos by the 10 % Ownership Criterion

Name of the Indian Company	Name of the Foreign Investor holding 10% or more in Equity
Apollo Hospitals Enterprises Ltd	Apax Mauritius FDI One Ltd, a PE Company
Dewan Housing Finance Corp Ltd	Caledonia Investment Plc (FDI), a UK Invt Trust Co.
IOL Chemicals Ltd	India Star Mauritius Ltd, a PE Company
Sanitaryware & Inds. Ltd	HPC Mauritius Ltd, an investment management co.
Infotech Enterprises Ltd	GA Global Investments Ltd, invt management co.
Max India Ltd	Parkville Holdings Ltd, a Warburg Pincus co.
Shriram EPC Ltd	Venture Partners Trust
Spanco Telesystems and Solutions Ltd	Monet Ltd., s/o ChrysCapital, a PE
Varun Shipping Co Ltd	Caledonia Investments Plc
Alfa Transformers Ltd	Strategic Venture Fund

Reported FDI inflow into some Listed Cos.

Indian Company	Foreign Investor	Share in Equity Capital as on 31-12-2008 (%)
ABG Shipyard Ltd	Merlion India Fund I Ltd	8.76
Allcargo Global Logistic Ltd	New Vernon Pvt Equity Ltd	3.81
Anant Raj Industries Ltd	Master Trust Bank Of Japan Ltd., The	1.36
Anant Raj Industries Ltd	Quantum (M) Ltd	1.50
Anant Raj Industries Ltd	Lehman Brothers Asia Ltd	1.82
Bharat Hotels Ltd	Dubai Ventures Ltd	5.00
Dalmia Cement (Bharat) Ltd	Boron (I) Ltd	4.42
Development Credit Bank Ltd	GRA Finance Corpn. Ltd.	1.87
Edelweiss Capital Ltd	Lehman Brothers Netherlands Horizon BV	1.80
Edelweiss Capital Ltd	Shuaa Capital Psc	2.20
Havells (India) Ltd	Search Investement Ltd.	7.18
Hexaware Technologies Ltd	GA Global Investments Ltd	7.36
Indiabulls Financial Services Ltd	Deutsche Bank Trust Company	1.31
Jindal Poly Films Ltd	Saif li Mauritius Co Ltd	6.66
JK Paper Ltd	International Finance Corp	9.84
Jubilant Organosys Ltd	GA European Investments Ltd	7.93
KPR Mill Ltd	Ares Investments	6.78
Punj Lloyd Ltd	Merlion India Fund Iii Ltd	3.19
Sarda Energy & Minerals Ltd	LB India Holdings Mauritius li Ltd	7.73
Torrent Pharmaceuticals Ltd	GPC Mauritius	4.83
Yes Bank Ltd	Orient Global Tamrind Fund Pte Ltd	4.95

Overlapping of Domestic and Foreign VC Investors Regd. with SEBI

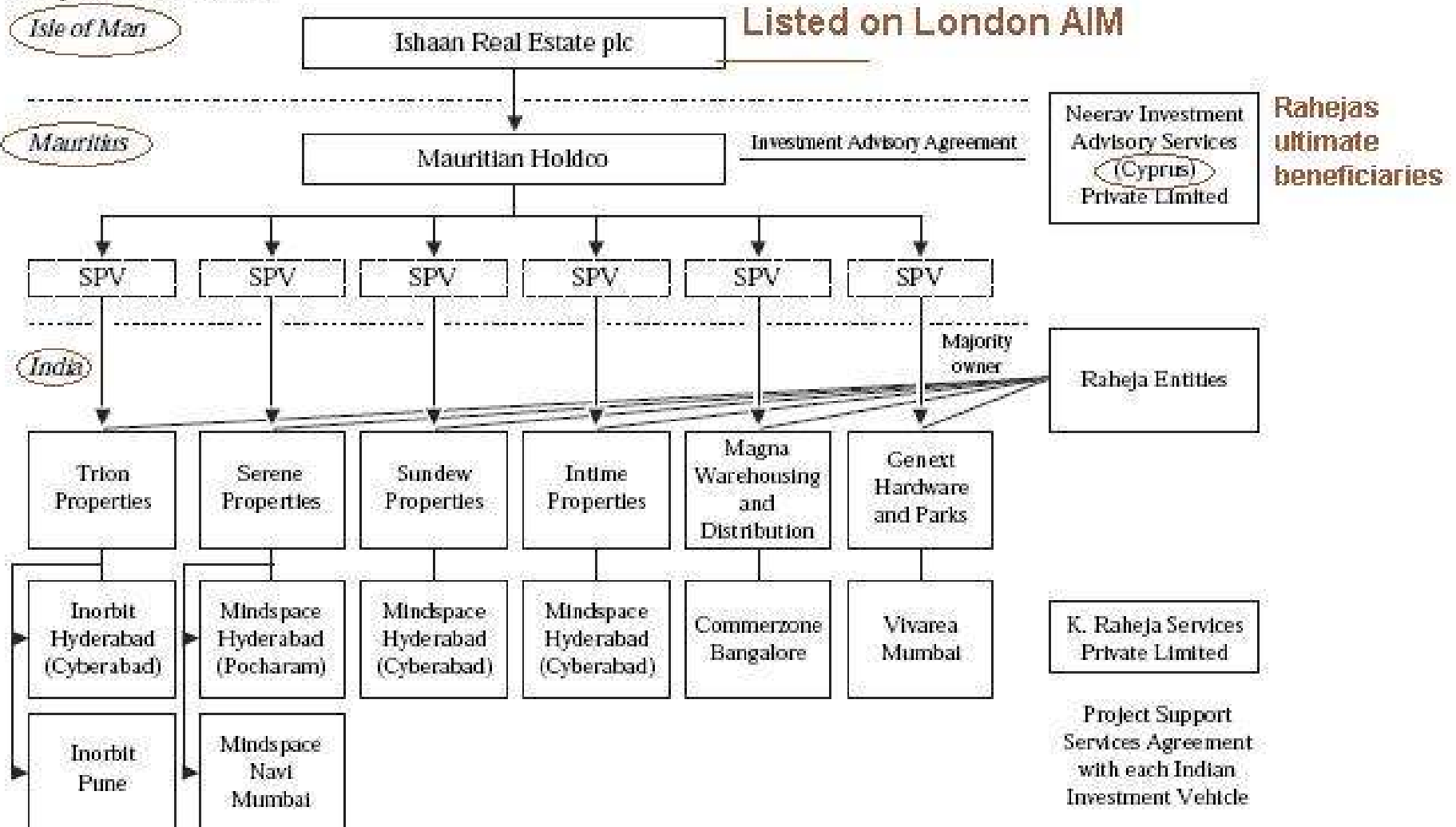
Foreign Venture Capital Investor(s)	Domestic Venture Capital Fund(s)
Aureos Offshore India Opportunities Fund Aureos South Fund LLC	Aureos Fund
Avigo Venture Investments Ltd	Avigo India Private Equity Trust
BTS India Private Equity Fund Ltd	BTS Private Equity Fund
Footprint Ventures (Mauritius), Ltd	Footprint Venture Fund
IDFC Private Equity (Mauritius) Fund II IDFC Private Equity (M) Fund III IDFC Project Equity Company IV (M) Ltd	IDFC - Infrastructure Fund - 3 IDFC Infrastructure Fund IDFC Infrastructure Fund - 2
Dynamic India Fund 1 Dynamic Fund III Dynamic Fund V Dynamic Fund IV (ICICI Real Estate Fund)	Advantage Fund 1 Advantage Fund IV ICICI Econet Fund ICICI Emerging Sector Trust
Leverage Fund LLC	IL&FS Private Equity Trust
SEAF India International Growth Fund	SEAF Investment Trust
Ventureast Biotech Fund	Ventureeast Telnet Fund
Zephyr - Peacock India I	Zephyr Peacock India II Trust

Round Tripping, Return of Flight Capital or Resource Mobilisation Abroad by Indian Cos?

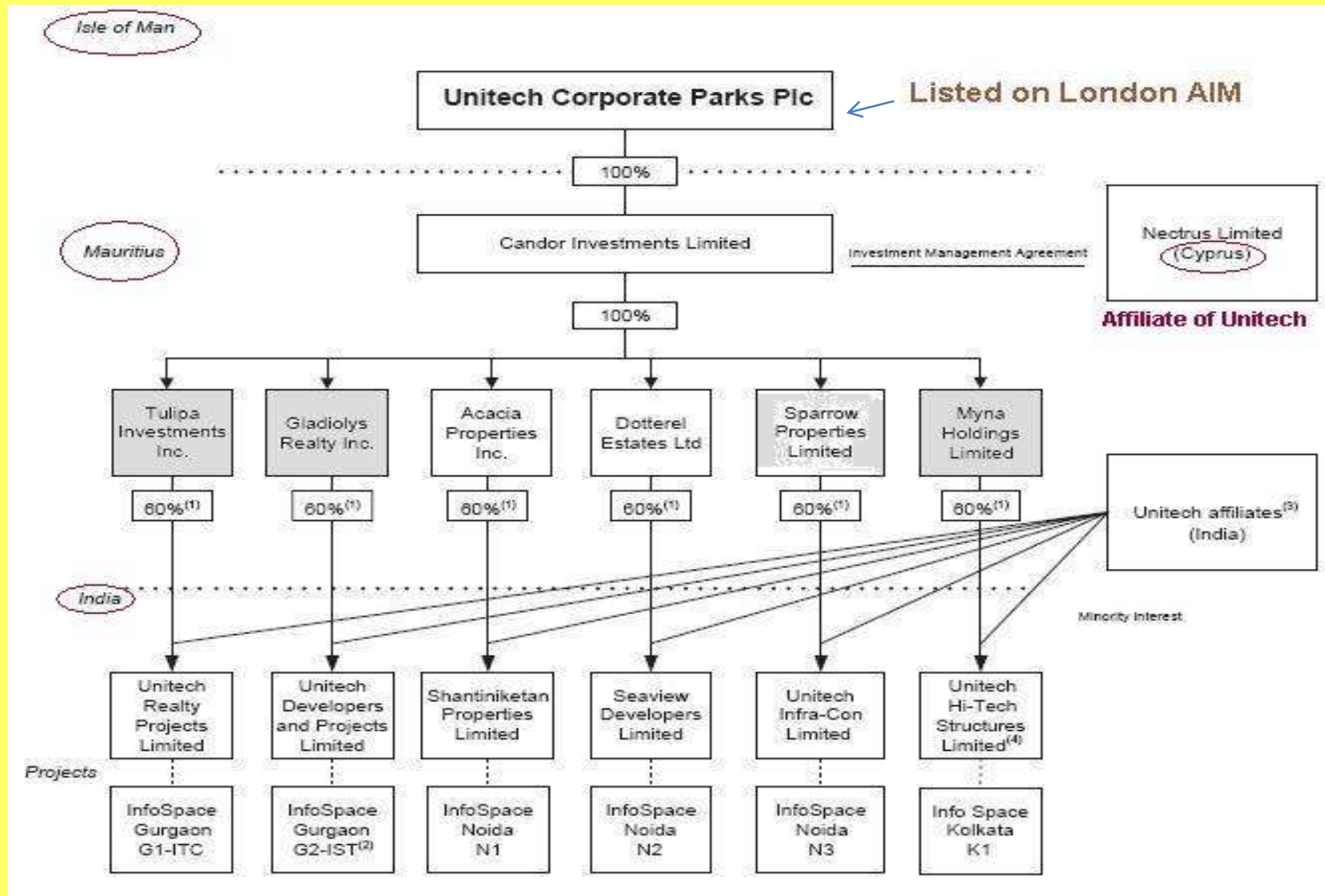
Name of the Indian Company	Foreign Investor	Country	Amount (Rs.Cr)
Bilt Graphic Paper Products Ltd	Ballarpur Paper Holding Bv	Not Indicated	638
Reliance Gas Transportation Infrastructu	Biometrix Marketing Pvt. Ltd.	Singapore	3128
Reliance Ports & Terminals Ltd	Biometrix Marketing Pvt. Ltd.	Singapore	830
Reliance Utilities Ltd	Biometrix Marketing Pvt. Ltd.	Singapore	700
Relogistics Infrastructure Pvt Ltd	Biometrix Marketing Pvt. Ltd.	Singapore	1,852
Essar Steel Ltd	Essar Logistics Holdings Ltd	U.S.A.	1,904
Vadinar Oil Terminal Ltd	Essar Shipping & Logistics Ltd.	Cyprus	90
Steel Corporation Of Gujarat Ltd	Gujarat Steel Holdings Ltd.	Mauritius	117
Trion Properties Pvt Ltd	I-2 Company (Mauritius) Ltd	Mauritius	61
Serene Properties Pvt Ltd	I-3 Company (Mauritius) Ltd	Mauritius	107
Magna Warehousing & Distribution Pvt Ltd	I-4 Company (Mauritius) Ltd	Mauritius	48
Intime Properties Pvt Ltd	I-6 Company (Mauritius) Ltd	Mauritius	63
New Found Properties & Leasing Pvt Ltd	I-7 Company (Mauritius) Ltd	Mauritius	50
Jindal Stainless Ltd	Jindal Overseas Holdings Ltd.	Cayman Island	70
Jubilant Off Shore Drilling Pvt Ltd	Jubilant Energy India Ltd	Cyprus	43
Jubilant Oil & Gas Pvt Ltd	Jubilant Oil And Gas (I) Ltd	Cyprus	71
Unitech Hitech Structures Ltd	Myna Holdings Ltd	Mauritius	323
Bilt Paper Holdings Ltd	Nqc Global (Mauritius) Ltd	Mauritius	77
Shaswat International Ltd	Orind South Asia Ltd	Mauritius	107
Solaris Biochemicals Ltd	NQC International Mauritius	Mauritius	59
Solaris Chem Tech Ltd	NQC International Mauritius	Mauritius	149
Unitech Infra Com Ltd	Sparrow Properties Ltd	Mauritius	193
Unitech Reality Projects Ltd	Tulipa Investments Inc	Mauritius	509
Kingfisher Airlines Ltd	UB Overseas Ltd	British Virginia	50

What does this Route Imply?

Corporate Structure

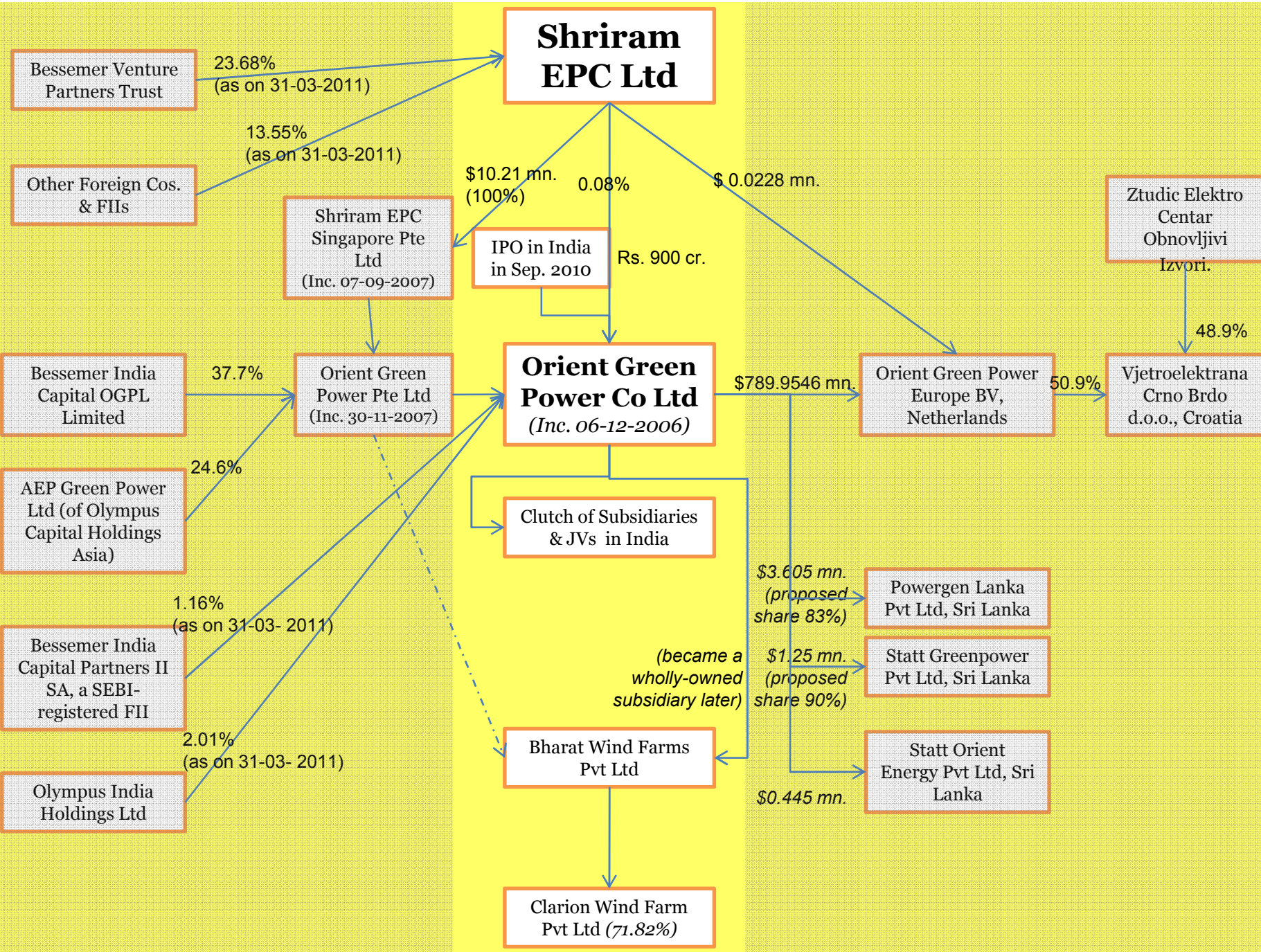


What Does ?



Can These be Called FDI Cos?

Indian Company	Foreign Promoter	Share in Equity (%)
Sterlite Industries India Ltd	Twinstar Holdings Ltd	56.93
Madras Aluminium Co. Ltd	Twinstar Holdings Ltd.	80.00
Zee Entertainment Enterprises Ltd	Delgrada Ltd	17.20
Essar Shipping Ports & Logistics Ltd	Teletech Investments India Ltd	20.56
United Breweries Holdings Ltd	Watson Ltd	21.19
Essel Propack Ltd	Lazarus Investments Ltd	10.96
Rama Phosphates Ltd	NRI Investors Inc	31.86
Exide Industries Ltd	Chloride Eastern Ltd	48.87
Zensar Technologies Ltd.	Pedriano Investments Ltd	21.55
Punj Lloyd Ltd	Cawdor Enterprises Ltd	24.94
Patni Computer Systems Ltd	iSolutions Inc	14.25
Ispat Industries Ltd	Ispat Steel Holdings Ltd	17.00
HCL Technologies Ltd	HCL Holdings Pvt Ltd	18.26



Can This be called FDI?

Indian Company	Name of the Foreign Investor	FDI (Rs. Crore)
Tata Consultancy Services Ltd	Group of Non-Resident	2,149
Sterlite Industries Ltd	Various NRIs	1,668
Kotak Mahindra Bank Ltd	Various	1,615
Reliance Communications Ltd	Various FIIs	845
Mundra Port and SEZ Ltd	Various NRIs/FIIs	711
Housing Development & Infrastructure Ltd	Various	706
Hindalco Industries Ltd	Various	667
Irb Infrastructure Developers Ltd	Various IPO	477
Arshhiya Technologies	Various FIIs	350
Mahindra Gesco Developers Ltd	Various	324
Phoenix Mills Ltd	Various FIIs	318
Welspun Gujarat Stahl Rohren Ltd	Various FIIs	302
Mahindra & Mahindra Ltd	Various FFI,FC, FFI	261
Hindustan Oil Exploration Co Ltd	Various NRIs/FIIs	220
Mercator Lines Ltd	Various FIIs	197
Tech Mahindra Ltd	Various	172
Bajaj Auto Finance Ltd	Various	158
Akruti Nirman Ltd	Various	155
Zee Telefilms Ltd	Various Investors	152
Bharat Earth Movers Ltd	42 FIIs	147
Panacea Biotec Ltd	As Per List Attached	118
Gitanjali Gems Ltd	Various NRIs/FIIs	109
Panacea Biotec Ltd	As Per List	102

How About These?

Reported FDI Inflows on account of Home Sweet Home Developers			
Name of the Foreign Investor	Rupees	Name of the Foreign Investor	Rupees
ARCHANA VADYA	10,000	SATYA KAVACHRI	10,000
ASHISH SRIVASTAVA	10,000	SATYA SIMHA PRASAD	10,000
BAIJU ANAND G NAIR	10,000	SENTHIL PALANISAMY	10,000
BRAJESH GOYAL	10,000	SHIDDALINGNAGOUDA RATI	10,000
C.SIVANANDAN	10,000	SRIKANTH PATIBANDA	10,000
DEVI PRASAD IVATURI	10,000	SRIKUMAR GOPAKUMAR	10,000
ESWAR VEMULAPALLI	10,000	SRINIVASU SUDIREDDI	10,000
JAYAKRISHNAN RADHAKRISHNAN	10,000	SRINVASA R GADDAMADUGU	10,000
KRISHNA KUMAR VAVILALA	10,000	SUKIR KUMARESAN	10,000
LAKKOJI	10,000	VENKATESHWARLU RAVIKANT	10,000
LEELA PRASAD KONERU	10,000	VIJAYA KUMAR CHRISTOPHER	10,000
NAKKAPALLI VEERA SEKHAR BABU	10,000	41 NON RESIDENT INDIANS	210,000
NIRUPAMA HENJARAPPA	10,000	SIX NRI'S ONE SHARE EACH	30,000
PRADEEP SHANTARAM BHAT	10,000	SIX NRIS 1 SHARE EACH	30,000
RAGHU BHARADVAJ	10,000	RAVI KANTH V.	10,000
RAMA MURTHY SETTY	10,000	SUMAN VIJAYAGOPAL	10,000
RAMESH BABU DODDI	10,000	1.SRIVAMSI MADHWAPTHY	
RAMESH BABU VUSIRIKALA	10,000	2.RAVI MIKKILINENI	10,000
RANGANATHA BANDE	10,000	PADMANABHA C.J.	10,000
SANGEETH OMANAMA	10,000	RAJU NUNNA	10,000
		RAMESH RACHERIA	10,000
		Total	640,000

Norms Not Followed?

- Draft Press Note of FDI Regulatory Framework (2009) while reiterating the motivation of the direct investor as:
 - ... a strategic long term relationship with the direct investment enterprise to ensure the significant degree of influence by the direct investor in the management of the direct investment enterprise.
- however, made it clear that:
 - In India the 'lasting interest' is not evinced by any minimum holding of percentage of equity capital/shares/voting rights in the investment enterprise.
- It further explained:
 - Investment in Indian companies can be made both by non-resident as well as resident Indian entities. *Any non-resident investment in an Indian company is direct foreign investment.* (emphasis added)

Draft Press Note: "Regulatory Framework of FDI", issued in December 2009.

Adoption of 10% Criterion to ensure International Comparability

- RBI was earlier following the criteria of FCRCs

Indian joint stock Companies which were subsidiaries of foreign companies, companies in which 40 per cent or more of the equity capital was held outside India in any one country and companies in which 25 per cent or more of the equity capital was held by a foreign company or its nominee were treated as Foreign-Controlled Rupee Companies (FCRCs).

- Following the IMF BoP Manual (5th edition), RBI adopted the FDI company concept and explained:

A direct investment enterprise is defined as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 per cent or more of the ordinary shares or voting power.... As such, a company in which 10 per cent or more equity capital is held by a *single non-resident investor* is defined as a Foreign Direct Investment Company.

Daimler Chrysler Investment in Tata Motors

<i>End of</i>	<i>No. of Shares</i>	<i>% Share in Total</i>
December 2001	2,55,96,476	10.00
December 2002	2,55,96,476	8.00
December 2003	2,55,96,476	7.75
December 2004	2,55,96,476	7.08
December 2005	2,55,96,476	6.80
December 2006	2,55,96,476	6.64
December 2007	2,55,96,476	6.64
December 2008	2,55,96,476	5.69
December 2009	2,55,96,476	5.34
March 2010	sold off	0.00

Appropriateness of the 10% Norm

10% mainly for Cross-Country Comparability?

DITEG's #Recommendation

The group endorsed the proposal to move to 20 per cent of voting power or ordinary shares as the threshold for the operational definition for a direct investment relationship, even though it was recognised that changing the current threshold of 10 per cent to 20 per cent would not have a significant impact on the data. *The group found that there were no strong conceptual grounds for choosing 10 or 20 per cent, and so any choice below 50 per cent would be arbitrary.* However, there are strong practical arguments for supporting the change to 20 per cent threshold, namely with regard to accounting standards.

This recommendation was, however, rejected by the OECD Workshop on International Investment Statistics and noted that :

... in the definition of direct investment, the current numerical threshold of 10 per cent (as opposed to 20 per cent recommended by DITEG) and its strict application for statistical purposes to ensure cross-country comparability.

Direct Investment Technical Expert Group was created in 2004 as a joint IMF/OECD expert group to make recommendations on the methodology of direct investment statistics.

Is the Assumption Valid (today)?

Most direct investment enterprises are either (i) branches or (ii) subsidiaries that are wholly or majority owned by nonresidents or in which a clear majority of the voting stock is held by a single direct investor or group. The borderline cases are thus likely to form a rather small proportion of the universe.

IMF BoP Manual (5th ed.)

UNCTAD on Treating Private Equity as FDI

- Investment firms, or collective investment institutions and schemes – that include, among others, private equity firms and various financial investment funds (e.g. mutual funds, hedge funds) – have recently become growing sources of FDI....
- As long as cross-border investments of private equity and hedge funds exceed the 10% equity threshold of the acquired firm, these investments are classified and should be recorded as FDI, even if a majority of such investments are short term and are closer in nature to portfolio investments.
- Investments by these funds may be the latest examples of portfolio investment turning into FDI. ...
- Further research is needed to better assess the true FDI or portfolio nature of such investments.

UNCTAD on Private Equity...

Just a little earlier it said:

Cross-border investments of private equity funds that lead to an ownership of 10% or more are in most cases recorded as FDI **even if private equity funds do not always have the motivation for a lasting interest or a long-term relationship with the acquired enterprise.** (emphasis added)

It, however, cautions that:

FDI by collective investment funds is a new form of foreign investment, which raises a number of questions that deserve further research. For instance, how does FDI financed by private equity funds differ from FDI by TNCs in its strategic motivations? Who controls such funds? And what are their impacts on host economies?

On its part OECD says:

Both aspects, investments in CII and by CII, are included in FDI statistics as far as the basic FDI criteria are met. However, **the nature and motivation of CII may differ from those of MNEs and there is a need to observe this phenomenon more closely in the coming years.**

(CII: Collective Investment Institutions)

Strict Adherence to Vague Concepts

The dominant current definition of a direct investment entity, prescribed for balance-of payments compilations by the International Monetary Fund (1993), and endorsed by the OECD (1996), avoids the notion of control by the investor in favor of a much vaguer concept. “Direct investment is the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy... The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise”

While the concept is vague, the recommended implementation is specific. “... a direct investment enterprise is defined in this *Manual* as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 % or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise) (IMF, 1993)..

Robert E. Lipsey, “Foreign Direct Investment and the Operations of Multinational Firms: Concepts, History, and Data”, National Bureau of Economic Research Working Paper no. 8665, December 2001

The Long and Short of it

Because there is control or a significant degree of influence, direct investment tends to have different motivations and to behave in different ways from other forms of investment. As well as equity (which is associated with voting power), the direct investor may also **supply other types of finance, as well as knowhow.**

Direct investment tends to involve a lasting relationship, although it may be a short-term relationship in some cases.

Another feature of direct investment is that **decisions by enterprises may be made for the group as a whole.** (emphasis added)

IMF, *Balance of Payment and International Investment Position Manual*, 2009, p. 101.

Portfolio *vs* Direct Investment

- First, FDI involves the transfer of other resources than capital (technology, management, organizational and marketing skills, etc.) and **it is the expected return on these, rather than on the capital *per se*, which prompts enterprises to become MNEs. Thus capital is simply a conduit for transfer of other resources than the *raison d'être* for direct investment.**
- Second, in the case of direct investment, resources are transferred internally within the firm rather than externally between two independent parties: *de jure* control is still retained over their usage.
- These are the essential differences between portfolio and direct investment.

John H. Dunning, "Explaining International Production", in John Dunning (ed.), *The Theory of Transnational Corporations*, UN Library on Transnational Corporations, Volume I, Routledge, 1995

Type 1 & Type 2 FDI and Portfolio Investments

- There are two main types of reasons why an investor will seek control. The first, which I shall call *direct investment*, Type 1, has to do with the prudent use of assets. The investor seeks control over the enterprise in order to ensure the safety of his investment. *This reason applies to domestic investment as well.*
- *The theory of Type 1 direct investment is very similar to the theory of portfolio investment.* The interest rate is the key factor in both. Direct investment of Type 1 will substitute for portfolio investment when the distrust of foreigners is high...
- There is another type of direct investment that does not depend on the interest rate and which I shall call direct investment of Type 2, or *international operations*. In this ..., the motivation for controlling the foreign enterprise is not the prudent use of assets but something quite different. (It)... is desired in order to remove competition between that foreign enterprise and enterprises in other countries.

Way Ahead

Chinese & US Perceptions

What China thinks:

- ❖ ... one should be clearly aware that importation of technology without emphasizing assimilation, absorption, and re-innovation is bound to weaken the nation's indigenous R&D capability, which in turn widens the gap with world advanced levels.
- ❖ Facts have proved that, in areas critical to the national economy and security, core technologies cannot be purchased. If our country wants to take the initiative in the fierce international competition, it has to enhance its indigenous innovation capability, master core technologies in some critical areas, own proprietary intellectual property rights, and build a number of internationally competitive enterprises.

What the US thinks:

- ❖ ... For many multinationals – especially tech cos -- the (Chinese) policies appear to signal that the pretence of goodwill is gone. The belief by foreign cos that large financial investments, the sharing of expertise and significant technology transfers would lead to an ever opening China market is being replaced by boardroom banter that win-win in China means China wins twice.
- ❖ ... Chinese officials believe foreign companies have been duplicitous and stingy. In their view, the bargain was market access in exchange for know-how and technology, and foreign companies held back their best to contain China's rise.

FDI, Technology Transfer & India's Mfg Sector

- ... during the process of liberalization and globalization ...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.
- ...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.
- ... 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.

FDI, Technology Transfer & Mfg Sector ...

- ... MNCs are also permitted to open 100% owned subsidiaries in India. In other words, in those areas the technology would continue to remain with the Multinational Companies themselves.
- ... 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.
- ... (technology) spillover effects do take place but not only that such spillover takes long time for the benefits to percolate, ..., it ensures that the technology gap keeps widening.
- ...there is clearly a need to have a relook at our FDI policy in terms of the technological benefits the country needs to derive.

A Few Words of Caution...

- We know that there is a lot we still do not know about FDI and MNCs, but not exactly what or how much. ... Few undisputed insights exist on which policy makers can definitely rely. *The economic effects of FDI do not allow for easy generalizations.*
- ... the effects of FDI on domestic investment are by no means always favourable and that *simplistic policies toward FDI are unlikely to be optimal.*
- ... there are good reasons to believe that an industrialized strategy based on laissez faire attitude towards TNCs may not be as successful in the long run as a more selective, strategic approach, as seen in the examples of countries like Korea and Taiwan.
- ... countries which manage their FDI are likely to benefit more than those which are managed by their FDI.

Caution...

- To ensure socially optimal allocation, it may be necessary to (selectively) restrict technology imports in internalized forms (via FDI) and promote those in externalized forms (licensing, equipment, imitation or OEM contracts). ... Over history most countries that have built strong local innovative capabilities have done it in local firms, often by restricting FDI selectively. **(Sanjaya Lall)**
- The rules of the game (globalization) have been designed for the most part by the advanced industrial countries, or more accurately, by special interests in those countries, for their own interests, and often do not serve well the interests of the developing world, and especially the poor. ... countries have to learn to live within the rules of the game, as unfair as they may be.
- But if they (developing countries like Brazil) are to do this, they must choose their own course, free of the simplistic mantras that have played such a central role in guiding economic policy in Latin America over the past decade. It will not be easy, but there is no alternative. **(Stiglitz)**

In Sum

- Much of the FDI flowing into India is closer to portfolio investment than to FDI having 'long term interest' and a 'bundle' of attributes.
- Round-tripping is another major component without the bundle of attributes,
- Worse still, some part of the inflows into India do not even qualify as FDI even going by the 10% criterion.
- In practice it appears that all equity investments which are not through the FII route, are treated as FDI irrespective of the proportion of shares held abroad and the control exercised by the foreign investor.
- The manufacturing sector to which FDI is more relevant is not attracting much investment which can be strictly classified as FDI and that adds to productive capacities, belying the initial expectations.
- There is a high degree of FDI related acquisitions which has important implications.

In Sum...

- India's liberal FDI policy today lacks direction and it focuses mainly on volume turning FDI into generic capital flow. As my colleague has put it, India's policy reminds one of Samuel Beckett's play **Waiting for Godot**.
- FDI is being seen more as 'stable' capital and BoP management tool rather than as something having the additional attributes.
- Simultaneous encouragement to outward FDI makes even the argument of supplementing domestic resources less convincing.
- While much of the FDI cannot enhance India's ability to earn foreign exchange through exports of goods and services and thus cover the current account gap on its own strength, large inflows of portfolio capital causes currency appreciation and erodes the competitiveness of domestic players.
- If FDI has to deliver, it has to be defined precisely and chosen with care instead of treating it as generic capital flow. India should strengthen its information base that will allow a proper assessment of the impact that FDI can make on its development aspirations.

In Sum ...

FDI data should ... be interpreted and used with... caveats in mind. More importantly, developing countries need to improve the quality of their FDI statistics – a major challenge for many of them.

Moreover, FDI data alone are not enough to assess the importance and impact of FDI in host economies. They should be complemented with statistical information on the activities of TNCs and their foreign affiliates (e.g. sales, employment, trade, research and development (R&D)).

UNCTAD, *World Investment Report*, 2006