Outward FDI and Cross-Border M&As by Indian Firms: A Host Country-Level Analysis (Dr Beena P L, Associate Professor, CDS, Trivandrum)

Abstract

This study engages an econometric analysis of the determinants of outward FDI by Indian firms through CBM&As during the period, 2004 to 2014 by using data from host countries. This has been done by testing the relevance of motivations developed by the theory on determinants of FDI, namely, market-seeking, resource seeking and strategic asset seeking. The study did not find any empirical evidence to validate the hypothesis developed by the theories on MNEs related to market seeking motivations. Natural resources and assets such as technologies were found to be the major determinants of outward FDI through CBM&As by Indian firms. Indian currency depreciation against dollar would have given enough incentives for Indian firms to engage continuous outward investment in those host countries. The study further argues that Indian firms have invested abroad through CBM&As in order to support their export activities. The study further argues that outward investment through CBM&As by Indian firms was initiated to maximise profit by minimising taxation. To speak of control variables in the home country i.e., India, ownership-specific advantages developed by the firms in India through inward FDI and strong financial liquidity market of India played a significant role to facilitate such deals. Strong political stability which is measured in terms of rule of law of the host countries could have facilitated such deals in spite of having weak institutional set up.

Key Words: India; FDI; Internationalisation; CBM&As; trade-FDI nexus; WTO.

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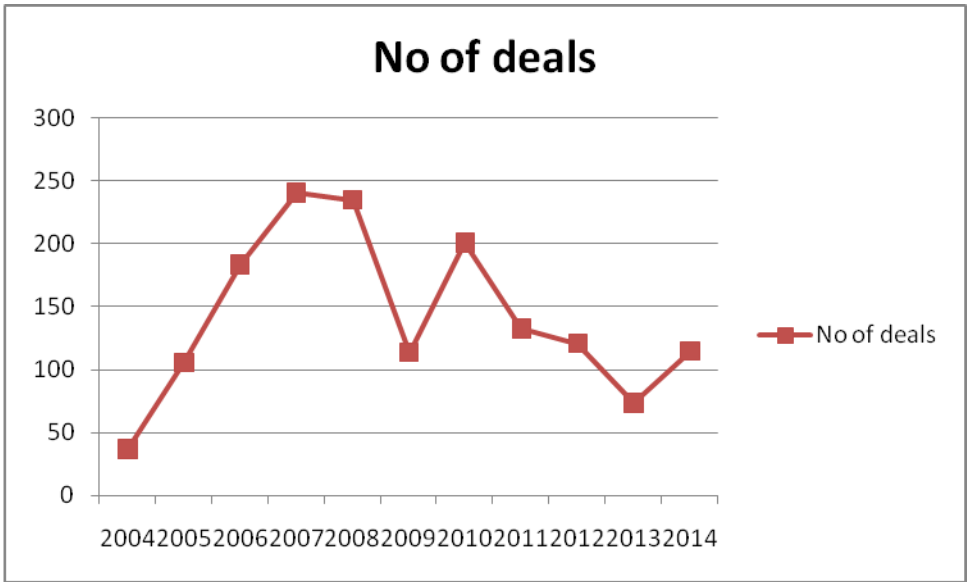
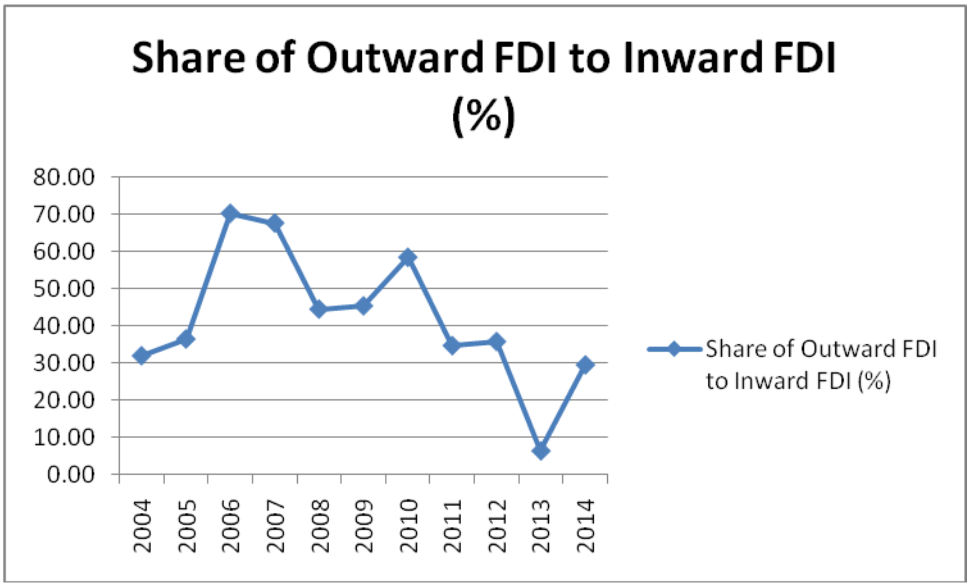
Introduction

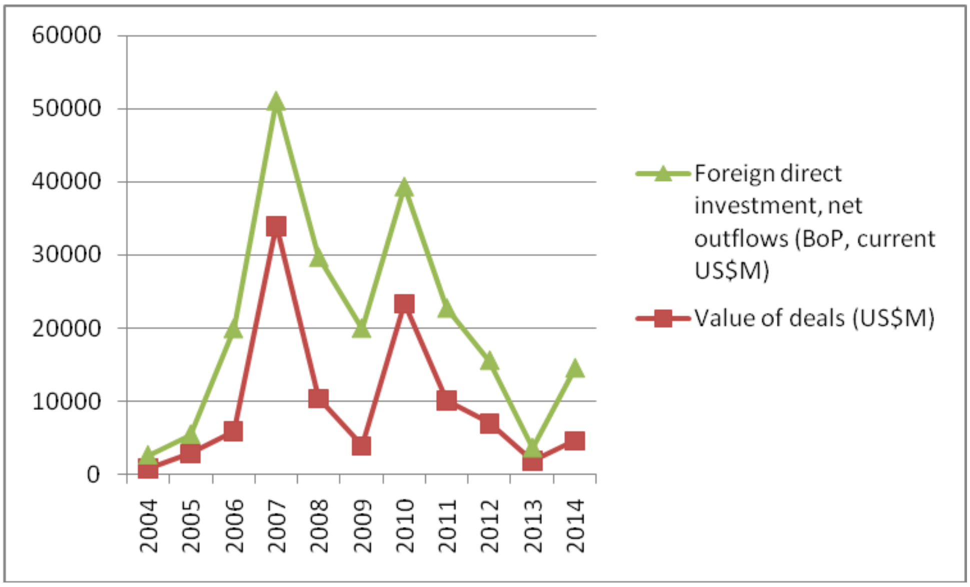
India's integration with the world economy has accelerated with India's accession to the World Trade Organisation in 1995. Although India was successful in attracting foreign investment since 1990s, it has also experienced an outflow of investment through CBM&As especially after 2000. There are various studies exists in the literature related to the determinants of outward FDI and OFDI through CBM&As (Lall S,1983;Lall RB,1986, Morris,1991; Nayyar 2008;Pradhan 2008; Beena 2011;Beena 2014). This study try to analyse the factors determining foreign expansion of Indian FDI through CBM&As engaged in different countries by applying eclectic theory. The empirical study is based on a panel data of CBM&As by Indian firms across nineteen countries over the period 2004 to 2014. Data on CBM&As by Indian firms for the period 2004 to 2014 has been compiled from the Venture Intelligence Capital data base. We have compiled data on various independent variables by extracting data from the world development indicators, Global Governance Report and Global Competitiveness Report. The paper is organised as follows. Section 2 analyses the recent trends and patterns of CBM&As by Indian firms dating from January 2004 to December 2014. Various hypotheses have been developed in section 3 based on the framework of eclectic theory. An empirical and theoretical literature review has also been done in this section. Data, methodology, results and interpretations of the model are given in Section 4. The Section 5 concludes the main findings of the study.

Section 2: Trends and Patterns of CBM&As by Indian Firms

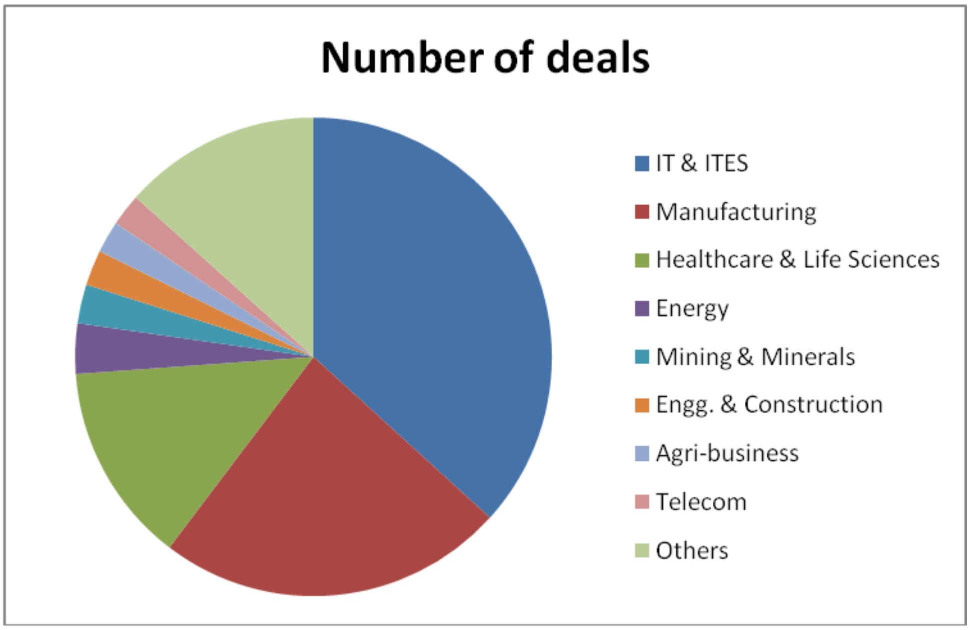
According to the Venture Intelligence Capital data base, there were 1704 CBM&As deals completed during 2004 to 2015 within 46 countries. 66 out of 1704 deals are incomplete with missing deal value of CBM&A by Indian firms. The total number of deals during 2004 was only 37 which have increased to the level of 106 within a year in 2005. This number has further jumped into the level of 241 during 2007. This trend was reversed since 2009 and declined to the level of 127 during 2015.

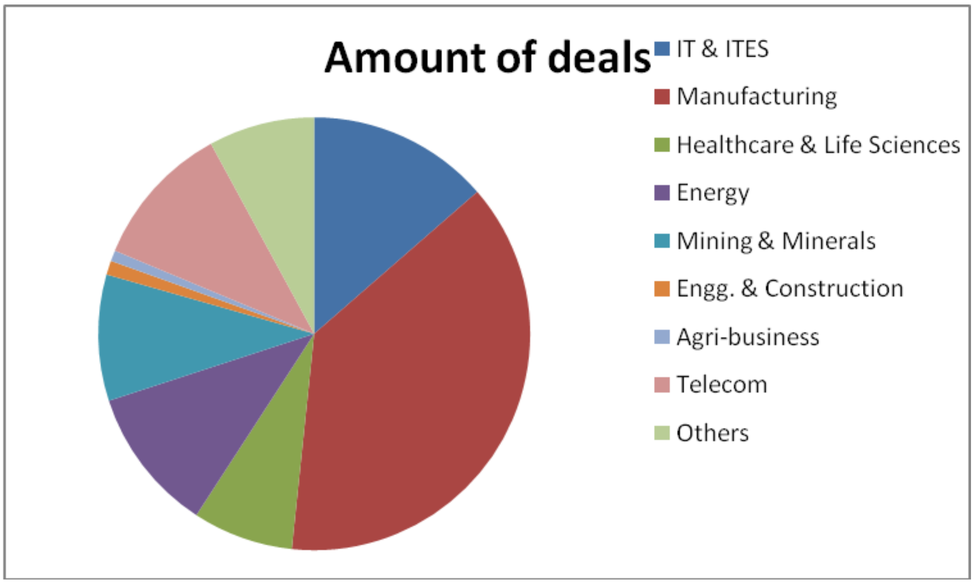

No of deals
300
250
200
150
100
50
0
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
No of deals


Share of Outward FDI to Inward FDI (%)
80.00
70.00
60.00
50.00
40.00
30.00
20.00
10.00
0.00
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Share of Outward FDI to Inward FDI (%)



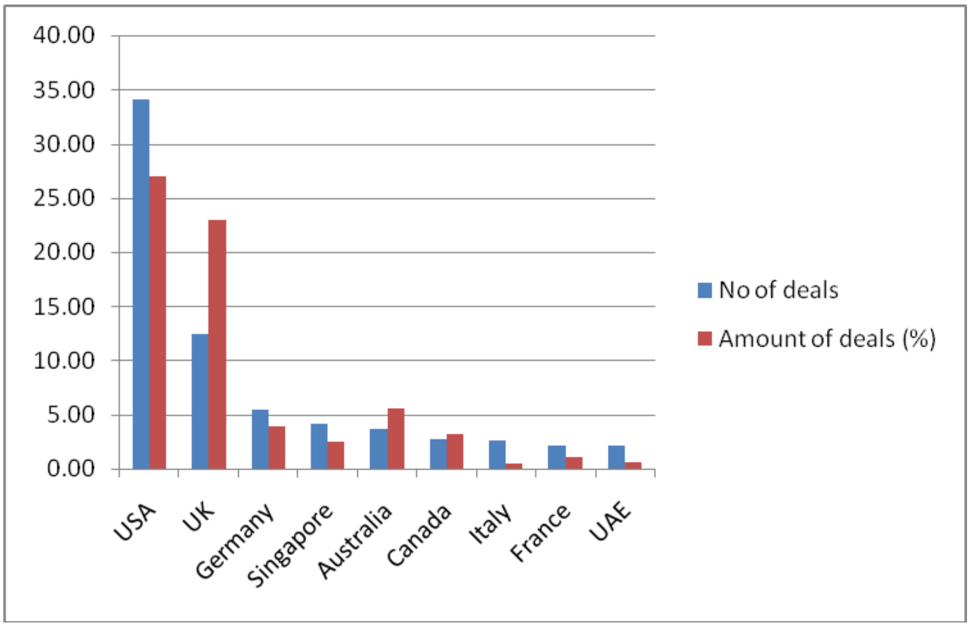
The similar pattern is observed in terms of value of deals as well. Almost 48 per cent of such deals are engaged in the manufacturing sector while 47 per cent of them are with the service oriented sectors. The rest of them are with the resource intensive sectors.





The single most attractive sector is IT sector which accounts almost 24 per cent of the total deals. The other three major sectors are Pharma, Business services and auto components which accounts 9 per cent, 8 per cent and 5 per cent of the total deals. The other significant sectors are Coal, Oil, Natural gas; Metal extraction; Telecom; Chemicals; Food products and Garments which accounts almost 2 per cent of the total 1704 CBM&A deals by Indian firms. BFSI, Media and entertainment, Hotels, IT products, FMCG, Steel, Industrial machinery and Building & construction accounted only 1 to 1.8 per cent shares. US and UK attracted most of such deals by Indian firms.

Country-wise Distribution of Number and Value of CBM&As during 2004-2014



Section 3: Theoretical and Analytical Framework

According to the most popular theory on FDI, i.e; eclectic theory or OLI theory developed by Dunning (1976), a firm would engage in foreign expansion if it has ownership and internationalisation advantages. Moreover host country must have locational advantages as compared to the firm's home country. It should be keep in mind that this OLI theory was developed (Dunning 1977;,1979 and 1988) by integrating three approaches to FDI: 1) the Industrial Organization theory (Hymer 1976), which focus on structural imperfections, argues that a foreign firm which establishes a subsidiary in another country must have some firm-specific advantages(e.g.brand name, patent-protected superior technology, marketing and managerial skills, etc) with respect to the domestic firm in the host country; 2) the internationalisation theory, assumes the market imperfection is transaction –cost imperfection, explains that FDI is the result of firms replacing external market transactions with internal transactions, as a way of avoiding imperfections in the markets for intermediate inputs (Buckley and Casson, 1976). Internationalisation theory asserts that MNEs internalise transactions as long as the benefits outweigh the costs (Buckley et a.,2009); 3) the Location theory. However it was postulated that the three advantages are not likely to be uniformly spread among countries, industries, and firms and likely to change over time. It is further argued that the eclectic theory could be used as a framework for analysing the determinants of international production or sale of a firm rather than considering this theory for predicting the activities of MNE (Dunning 2001).

It is further argued in the literature that CBM&As are facilitated by strategic asset seeking rationale (Wang and Boateng,2007; Deng 2007 and 2009;Hopkins,2008) and are largely influenced by institutional and political constraints, organisational capabilities and entrepreneurship (Nolan and Yeung,2001;Hong and Sun,2006). Thus factors determining outward FDI or foreign acquisitions include market size, endowments of natural resource, and knowledge based-asset/strategic asset, political risk, corporate tax, and exchange rate, openness of the host countries, FDI inflows and the capital market of the home country. Apart from these factors, institutional factors were also thought to be related to the CBM&As.

Location and Internationalisation Advantages

If an MNE locates its value adding activities in a specific host country only if such activities in the host country function better there than in the home country. Location advantage consists input-side (abundant natural resources, appropriate and superior technologies) and output-side (large market size)(Pedersen 2003). Similarly internationalization advantage of a firm means that a firm could transform the transaction cost from an external disadvantage into internal advantage by acquiring a foreign firm. It is further argued that the rationale of outward FDI through CBM&As are to get access to natural sources and new technologies to diversify markets and risks, to facilitate faster entry into foreign market and synergies (Wang and Boateng, 2007), seeking strategic–assets investments especially R&D and Know-how (Deng 2009), for the saturation in the home market and promoting exports to circumventing trade barriers by foreign countries (Wong and Chan,2003). The market size of the host country is a conventional determinant of FDI flows and CBM&As. GDP and or GDP per capita of the host country are generally considered as relevant proxies for market size and/or potential sales. (Lizondo,1991). Similarly, firms from emerging countries are interested in the superior technologies and skills which are available in an advanced host countries (Makino et al., 2002). Innovation in the host country could be the proxy for strategic asset seeking CBM&As. A positive association between the number or value of deals with the endowment of natural resources of the host country is expected as internationalisation theory asserts the importance of equity-based control in the exploitation of scarce natural resources (Buckley and Casson 1991). Large and unexpected modifications of the legal and fiscal frameworks might adversely affect the economic outcome of a given investment (Lizondo, 1991). Therefore one can assume a positive correlation between the number and value of CBM&A deals by Indian firms with the political stability of the host country. Further it is argued that an MNE prefers to locate its business activities in countries with a low corporate tax rate (Grubert and Slemrod, 1998).

Theoretically speaking, depreciation of Indian currency can expand exports and hinder foreign direct investment or CBM&As by Indian firms. At the same time, the external transaction cost which is denominated by the Indian currency would go up when rupee depreciates. Thus the increased external transaction cost provides incentives for MNEs to locate their production in other countries. The depreciation of home currency could probably increase the pace of CBM&As by Indian MNEs. Thus one can expect positive or negative association between exchange rate of Indian currency with the number and value of CBM&A deals.

The investment development path theory suggests that inward FDI boosts economic growth and its own location advantage which in turn increases outward FDI by domestic firms.

(Buckley et al., 2009). The strengthened location advantage helps the indigenous firms to upgrade their own competitive advantages by acquiring firms in the advanced countries. Competition from MNEs can drive Indian firms to invest abroad as a survival strategy. Moreover, the investments by indigenous firms would affect both supply and demand for the products supplied by foreign firms and their desire to internalise their markets for the competitive advantages (Dunning 2001). Thus there could be a positive association between the number and value of foreign acquisitions with the FDI inflows in India.

The liquidity of a stock market is expected to rise if foreign investors invest through purchasing existing equity which would in turn increases the value traded. Therefore it is argued that FDI is positively correlated with stock market capitalisation and value trading (Classens et al,2001). Another study by Giovanni (2005) based on a large panel data set of CBM&As for the period of 1990-1999 found a strong positive association between the size of the stock market (ratio of stock market capitalisation over GDP) and Outward FDI. Many studies on international business have shown that countries with high institutional quality can attract FDI inflows as well as could shape the form of outward investment (Dunning and Lunden,2008). It is argued that developing and undeveloped countries would prefer to invest in developed countries where the institutional framework is well developed. It is also argued in the literature that Institutional factor can either act as a barrier or a facilitator for FDI and or CBM&As. Government subsidies or certain policy initiatives such as simplifying norms of raising funds can promote outward investment by offsetting ownership and locational disadvantages abroad (Aggarwal and Agmon,1990). Therefore the present study would consider institutional factors of host countries as well as India as a control variable in the model. Institutional framework could be characterised by (Global Competitiveness Report,2005-06) the respect for rule of law, an efficiently working judicial system, high levels of transparency and accountability within public institutions.

Section 4: Data, Methodology and Results

The study has formulated two models by the panel data which consists of number or value of CBM&A initiated by Indian MNEs in 19 countries over the period 2004 to 2014. The definitions and sources of all the variables considered in the present study are given in the following table.

Table 1.

	Name of Variables	Proxies	Expected sign	Theoretical Justifications	Data Sources
Dependent Variables	Number of CBM&As by Indian MNEs				Venture Intelligence Data set
	Value of CBM&As by Indian MNEs				World bank
Independent Variables	Market size of Host country	GDP per capita	+	Location advantage	World bank
	Natural resources Endowments of Host country	Ratio of ore and metal exports and fuel exports to merchandise exports	+		World bank
	Political stability of host country	Rule of law rating	+		
	Corporate tax of host	Corporate Tax rate	-	Internationalisation advantage	World bank

	country				
	Exchange rate of India against US$	Nominal exchange rate of India against US$	+/-		World Bank
	Openness of host country	Average ratio of export and import over GDP	+	Location advantage	World bank
	Inward FDI of home country	Inward FDI in India	+	Ownership advantage	World bank
	Domestic capital market	Share of total value of stock traded to GDP	+		World bank
	Institutional quality of host country	Institutional rating	+	Institutions	Global Competitiveness report
	Endowments of strategic assets of Host country	Innovation rating/Trade mark registration	+	Location advantage	Competitiveness report

Control Variables	Institutional Quality of Home country	Institution Rating		Institutions	Competitiveness report

The study used negative binomial regression for analysing the factors determining the Indian acquisitions abroad across selected countries where the dependent variable is a count data (i.e; number of CBM&A deals by Indian firms). The study has made use of simple OLSRE Model where the value of deals has been considered as a dependent variable. We have tested the null hypothesis that the coefficient estimated by the random effects estimator are the same as the ones estimated by the fixed effects. The results of the Hausman test in NBRModel 1 shows that “Prob>chi-sq= .998 is positive though not significant while the same test in Model 2 shows a negative value. Thus it is observed that differences of coefficients are not systematic in the two regressions which imply that Random Effect (RE) model is more preferable than the Fixed Effect (FE) model. The study has therefore reported only the result of random-effect in the case of Model 1 and RE&FE in the case of Model 2.

Table 2: Random Effect negative binomial regression: Dependent Variable-Number of foreign acquisition deals

	Independent Variables	RE NBR Model 1	t-value
Market size of Host country	Lngdp	.1207	0.86
Trade	Imports	-.1507	-0.57
	Exports	2.13	7.76***
Natural resources Endowments of Host country	Ores metal export share to world	.0398	4.09***

(Iron ore)			
Natural resources Endowments of Host country (Fuels)	Fuel export share to world	.0140	2.41***
Endowments of strategic assets of Host country	Innovation score	.5419	2.87**
	R&D expenditure to GDP		
Political stability of host country	Rule of Law	.629	2.67***
Corporate tax of host country	Cortex	-.0214	-1.81**
Exchange rate of India against US$	REER (Cpi36currency)	.0536	2.23**
Openness of host country	(Imports+exports) /GDP	-.0035	-1.9**
Inward FDI of home country	FDI inflows	1.54	3.85***
Domestic capital market	Market capitalisation to GDP	.0033	0.98
Institutional quality of host country		-.1588	-0.73

Institutional Quality of Home country		2.936	5.89***
Wald			761.03
Prob>chi-sq			.0000
Haussman test: chi-sq			2.34
Prob>chi-sq			.998
N			209

Table 3: Dependent Variable-Value of foreign acquisition deals

	Independent Variables	RE Model 1	t-value	FE Model 1	t-value
Market size of Host country	Lngdp	-.0511	-.49	-.1009	-0.96
Trade	Imports	-.1791	-.76	-.1379	-0.58
	Exports	.778	2.78***	.8699	3.09***
Natural resources Endowments of Host country (Iron ore)	Ores metal share	.0085	.87	.0089	0.91
Natural resources Endowments of	Fuelshare	.005	1.04	.0061	1.27

Host country (Fuels)					
Endowments of strategic assets of Host country	Innovation score	.4168	1.85*	.4708	2.08**
	R&D expenditure to GDP				
Political stability of host country	Rule of Law	.3188	1.41	.402	1.76*
Corporate tax of host country	Cortex	-.0048	-.42	-.008	-.70
Exchange rate of India against US$	REER (Cpi36currency)	.041	1.78*		
Openness of host country	(Imports+exports) /GDP	-.002	-1.28	-.002	-1.59
Inward FDI of home country	FDI inflows	.2136	.58		
Domestic capital market	Market capitalisation to GDP	.0063	1.88*		
Institutional quality of host country		-.521	-2.25**	-.633	-2.7***
Institutional Quality of Home country		.721	1.52	-2.4	-1.10
Wald			50.24		

Prob>chi-sq			.0000		
Haussman test: chi-sq			-7.5		
Prob>chi-sq			NA		
N			209		209

Although, the study could not find any association of GDP either with number of deals or value of deals, a strong statistically significant correlation was observed between the number of foreign acquisitions by Indian firms with India's export share to the respective host countries. The similar result is observed when the dependent variable is changed as value of deals instead of number of deals (see NBRModel in Table 2 and Model 2 in Table 3). This indicates that market seeking was not a key motives for CBM&As by Indian firms. Resource endowments such as fuel and iron ore & metals in the host countries as well as strategic-asset endowment which are measured in terms of Innovation score are found to be statistically significant with the expected sign in Model 1 in Table 2. The study could not find similar association between values of deals with the natural endowments. But a strong positive association is observed between strategic assets such as innovation score and value of CBM&As (Model 2 in Table 3). Therefore we could very well argue that Indian firms would have preferred to invest abroad through CBM&As in order to access market, natural resources and technologies.

Corporate tax is found to be significantly correlated with an expected negative sign with the value and number of CBM&As by Indian firms. And this indicates that the motives of Indian firms investing abroad through CBM&As were to maximise profit by minimising taxations. Real effective exchange rate is positively correlated with the number/value of CBM&As by Indian firms. From this, one could infer that the increasing external transaction cost due to rupee depreciation would have given enough incentives for Indian firms to invest abroad through CBM&As. The study does find significant correlation between India's capital markets with the value of CBM&As. However India's inward FDI is found to be significant only with the number of CBM&As. Therefore one could argue that ownership-specific advantages or Domestic capital market of host country could play an important role for facilitating CBM&A by Indian firms. However the study could not observe any significant correlation between host countries' openness index with the value of CBM&As although an association with expected sign is observed between the number of CBM&As and openness index. Political stability of the host country which is measured in terms of rule of law found to be statistically significant with the number and value of CBM&As (NBR Model 1; FE Model 2) with an expected sign. Institutional quality of the host country is found to be inversely related to the value of CBM&As of Indian firms while institutional quality of India is found to be positively associated with the number of CBM&As. From this, one could infer that high level of political stability of the host countries could attract India's investment through CBM&As inspite of scoring low level of institutional quality across host countries. Institutional set up/quality of India did act as a complementary role in facilitating such deals.

Conclusion

The study tried to analyse the trends, patterns and determinants of outward FDI through CBM&As by Indian firms based on the theoretical framework developed on MNEs. As suggested by OLI theory, the study observed that resource and strategic asset seeking motivations are important factors determining CBM&As by Indian firms. The study did not find any empirical evidence to validate the hypothesis developed by the theories on MNEs related to market seeking motivations. Indian currency depreciation against dollar would have given incentives for Indian firms to engage continuous investments through CBM&As. The study further argues that Indian firms have invested abroad through CBM&As in order to support their export activities. It is also clear that such investment through CBM&As by Indian firms was initiated to maximise profit by minimising taxation. The study could further argue that ownership specific advantages developed by the firms in India through inward FDI and strong financial liquidity market of India have played an important role for facilitating such deals. Strong political stability of the host countries could have facilitated such deals inspite of having weak institutional set up in those respective countries.

Sectoral Distribution of Number and Value of CBM&As by Indian firms

Resources			Services			Manufacturing		
	No	Share to Total		No	Share to Total		No	Share to Total
Metal Extraction	38	2.23	BFSI	32	1.88	FMCG	24	1.41
Coal,Oil,Natural gas	47	2.76	Renewable energy	10	0.59	Pharma	147	8.63
Minerals	4	0.23	Telecom	37	2.17	Auto components	68	3.99
	89	5.22	Business service	144	8.45	Automobiles	16	0.94
			Hotels	31	1.82	Forgings	4	0.23
			IT services	401	23.53	Steel	23	1.35
			Other services	37	2.17	Chemicals	35	2.05
			Media&Entertainment	31	1.82	Hospitals	9	0.53
			IT Products	28	1.64	Building&Construction	21	1.23
			Mobile Services	10	0.59	Ceramics&Glass	6	0.35
			Mobile VAS	25	1.47	Food products	34	2.00
			Engineering Services	7	0.41	Industrial Machinery	18	1.06
				793	46.54	Garments	37	2.17
						Medical devices	11	0.65
						Tyres	3	0.18
						Cables	3	0.18
						Biotech	8	0.47
						Electricals	5	0.29
						Electronics	5	0.29
						Engineering Products	6	0.35
						Others	339	19.89
						Total MFG	822	48.24

Calculated by the Author.

Countrywise Distribution of Number and Value of CBM&As by Indian firms

Total	Number of deals		Amount (US$M)	
USA	582	34.11	29818.79	27.04
UK	212	12.43	25264	22.91

Germany	92	5.39	4327.74	3.92
Singapore	71	4.16	2686.1	2.44
Australia	62	3.63	6183.14	5.61
Italy	44	2.58	575.73	0.52
Canada	46	2.70	3530.3	3.20
France	37	2.17	1111.26	1.01
UAE	36	2.11	633.29	0.57
South Africa	36	2.11	946.95	0.86
Netherland	26	1.52	1848.15	1.68
China	20	1.17	635.2	0.58
Belgium	18	1.06	2355.8	2.14
SriLanka	14	0.82	13.8	0.01
Brazil	21	1.23	3393.6	3.08
Indonesia	17	1.00	1211	1.10
Malaysia	14	0.82	926.4	0.84
Mauritius	8	0.47	15.19	0.01
Isreal	8	0.47	266	0.24
Japan	10	0.59	150.9	0.14
Russia	6	0.35	1372	1.24
Switzerland	17	1.00	974.98	0.88
Vietnam	9	0.53	136.66	0.12
spain	20	1.17	671.49	0.61
Bengladesh	4	0.23	375	0.34
Kenya	8	0.47	10805	9.80
Sweden	14	0.82	653	0.59
Others	254	14.89	9409.3	8.53
Total	1706	100	110290.8	100

Calculated by the Author.

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