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INDIA'S FDI FLOWS: TRYING TO MAKE SENSE OF THE NUMBERS

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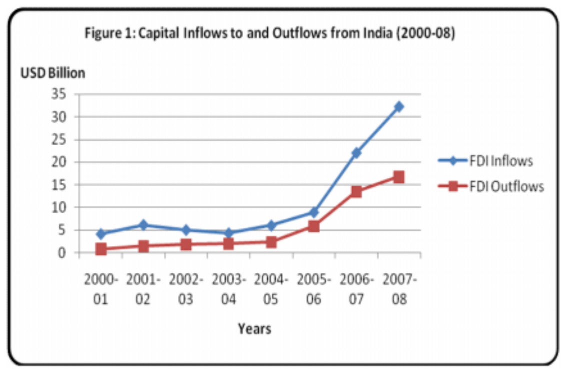
One of the noteworthy dimensions of India's increasing integration with the world economy has been the increase in both gross Foreign Direct Investment (FDI) inflows to and outflows from the country over the last decade. The simultaneous spurt in both FDI inflows and outflows has meant that FDI has not been a significant source of balance of payments financing on a *net* basis at least until 2006 (Figure 1). The rise of India as both a source and host of FDI has begun to generate a sizeable literature on the determinants and characteristics of such flows at an aggregate level. However, much less work has been devoted to the analysis of FDI inflows and outflows at the bilateral level, primarily due to the paucity of data.



Source: Based on Prasad, E., "Some New Perspectives on India's Approach to Capital Account Liberalization", Cornell University, Brookings Institution and NBER, (Revised November 2008)

Data Concerns

To be more specific, the data on bilateral FDI outflows is rather sketchy; the Ministry of Finance reports the value of aggregate FDI outflows from India and the value of approvals of FDI outflows at a bilateral level.[2] But a consistent time series of the actual value of outflows with a country-wide breakdown does not seem to be available in the public domain.[3]

While data on actual FDI inflows are reported by the Department of Industrial Policy and Promotion (DIPP) at a disaggregated country level,[4] there are serious concerns about the usefulness of the bilateral FDI inflows data that is available in the public domain.

[1] This paper builds upon initial work in R.S. Rajan, "*Outward Foreign Direct Investment from India: Trends, Determinants and Implications*", Institute of South Asian Studies (ISAS) Working Paper No.66, June 2009. Assistance with the M&A data by Rabin Hattari is gratefully acknowledged.

[2] This information is available with the IC section of the Department of Economic Affairs, Ministry of Finance, India, accessible at http://finmin.nic.in/the_ministry/dept_eco_affairs/dea.html

[3] Only since April 2008 has the Reserve Bank of India (RBI) started publishing this information (actual value of FDI outflows from India with a country-wise breakdown) in an article titled, "Indian Investment Abroad in Joint Ventures and Wholly Owned Subsidiaries" in its monthly bulletin. Accessible at http://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/83887.pdf.

[4] This information is available in the various issues of the Secretariat for Industrial Assistance (SIA) newsletters compiled by the DIPP, Ministry of Commerce & Industry, India, accessible at http://siadipp.nic.in/publicat/pub_mn.htm

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As an example, the data on FDI inflows into India almost always reveals Mauritius as the largest source of foreign investment flows into the country. But Mauritius is widely regarded as an offshore financial centre (OFC) that is used by most foreign investors as an intermediary to reach India, predominantly to capitalise on the tax rebates that the country offers so as to minimise their overall tax burden. Conversely, as Indian companies have become more globalised, many have chosen to either use their overseas locally-incorporated subsidiaries to invest overseas or have established holding companies and/or special purpose vehicles (SPVs) in OFCs or other regional financial centres like Singapore or the Netherlands to raise funds and invest in third countries.

Apart from this so-called transhipping, some parts of these inflows from Mauritius in particular, but also other OFCs, could also be round-tripping back to India to escape capital gains tax or for other reasons, not unlike the investment dynamics between China and Hong Kong, though at a much smaller scale.[5] Thus, the bilateral FDI data -- which only captures the actual flow of funds rather than ultimate ownership -- may offer a rather distorted picture of the extent of linkages between India and the rest of the world. Consequently, the usefulness of such data for research and policy analysis needs to be questioned. Any inference from this sort of data tends to give a misleading picture of reality. This is a very serious lacuna in the way direct cross-border investment flows are reported and hence there is a need to re-examine this issue using alternative datasets.

In order to understand the actual or *de facto* real linkages between India and the rest of the world, one would need to examine the data on actual ownership of the foreign investment flows going to the country. While data on individual firms that have invested in India may be available via firm-level surveys, for a more complete picture of FDI inflows into the entire economy one would need to examine an aggregation of all such firms investing in India from different parts of the world. This, needless to say, would be a prohibitively costly exercise. A more feasible alternative would be to examine the data on Mergers and Acquisitions (M&A) made by global firms in India and Indian firms globally. The M&A data, which tracks the actual ownership of the purchases and sales, are maintained by several private commercial entities like the Bloomberg, Capital IQ, Dealogic, Thomson Financial, Zephyr etc, unlike the data on FDI flows that is compiled by the national sources.

[5] For a discussion on China-Hong Kong flows within the larger context of intra-Asian FDI flows, see Hattari and Rajan (2009). "*Understanding Bilateral FDI Flows in Developing Asia*," Asian Pacific Economic Literature, 23, pp.73-93.

[6] To ensure a degree of comparability with the FDI data we have only included M&As with over 10 percent equity stake in our direct comparisons (Figures 2a,b and 4a,b).

Inward and Outward Direct Investments to and from India

Figures 2a and 2b respectively capture the data available on FDI inflows (reported by the Indian government) and the M&A purchases (reported by the private commercial entities) that have taken place in India (by source of origin) for the period of 2000-07. A comparison of the two sets of data clearly reveals the above discussed inconsistencies.[6]

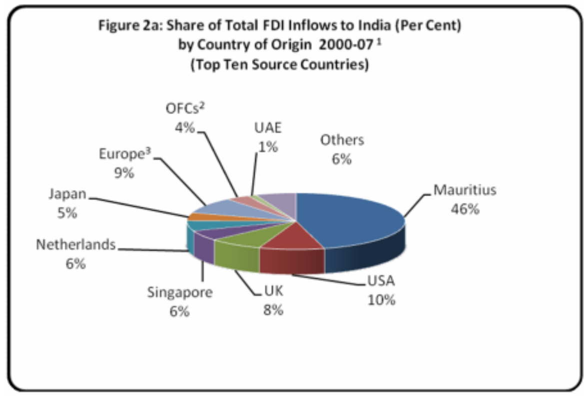

Figure 2a: Share of Total FDI Inflows to India (Per Cent) by Country of Origin 2000-07 [1] (Top Ten Source Countries)

Source for Figure 2a: Ministry of Commerce and Industry, Department of Industrial Policy and Promotion (DIPP), India, http://siadipp.nic.in/publicat/newslttr/apr2008/index.htm (Accessed on 24 July, 2009).

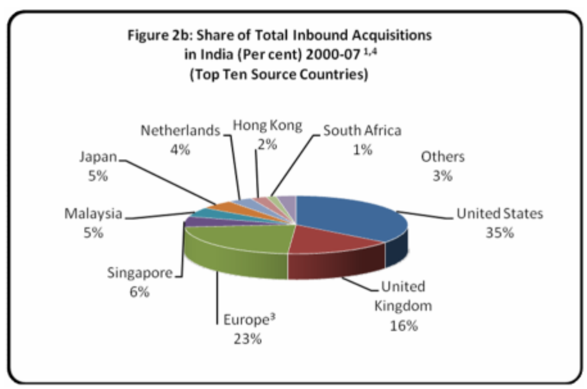

Figure 2b: Share of Total Inbound Acquisitions in India (Per cent) 2000-07 [1,4] (Top Ten Source Countries)

Source for Figure 2b: Authors' compilations from Zephyr Database.

It is interesting to note that most of the OFCs like Mauritius (mainly) but also Cyprus, the Cayman Islands and Bermuda, which comprise nearly 50 per cent share of the total FDI inflows (as reported by the government sources) do not even figure in the data on inbound M&As to India. Focussing on the FDI data, only 18 per cent of inflows to India have been by the US and the UK combined, while about 15 per cent was by the non-UK European countries (mainly the Netherlands, France and Germany) and about 10 per cent by East Asia (mainly Singapore and Japan). In contrast, the M&A data on foreign acquisitions in India tell quite a different story. The US is the single largest acquirer of Indian companies (35 percent), followed by the UK (16 percent) and the rest of Europe including the Netherlands (27 percent) and East Asia (18 percent) (distributed between Japan, Singapore, Malaysia and Hong Kong). So almost all of the inbound acquisitions to India have been by the US, Europe and Asia. This appears to offer a far more informative geographical breakdown of sources of direct investment equity flows to India compared to the FDI data noted in Figure 2a. It would appear, therefore, that a great deal of the acquisitions by the US and UK in particular have been channelled via Mauritius.

As noted, similar bilateral data on India's actual FDI outflows are not publicly available on a systematic time series basis. While approvals may not provide a fully realistic picture as not all approvals are realized, available data at least for aggregate actual outflows suggests that there is a reasonable degree of correlation between approved and the actual outward FDI flows from India.[7] Accordingly, the outward FDI approvals data ought to offer some useful insight when compared to data on India's M&A purchases overseas. It is well-known that Indian businesses have been very active in overseas investments in the last few years, particularly since 2006 (Figure 3). Anecdotal evidence and examples point to the fact that many of these investments have been in developed countries is the US, UK and rest of Europe. Notable instances would be Tata Steel's purchase of Corus and Tata Motors purchase of Jaguar and Land Rover in the UK and Hindalco's acquisition of the Canadian aluminium giant Novelis (see Table 1 in the Annex).[8]

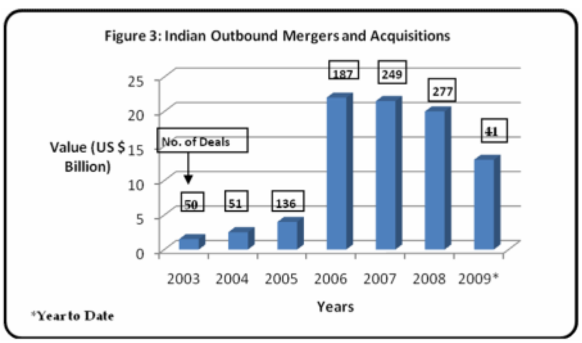

Figure 3: Indian Outbound Mergers and Acquisitions

Source: Reproduced from The Economist, May 28th, 2009 based on data from Dealogic.
http://www.economist.com/businessfinance/displaystory.cfm?story_id=13751556, (Accessed on 24 July, 2009).

Referring to Figure 4a, one notices that developed countries like the UK and the US have surprisingly small shares of India's approved outward FDI (6 percent each) for recent periods for which detailed data are available (2002-08) compared to Singapore (22 percent), the Netherlands (15 percent) and Mauritius and other OFCs in total (25 percent). So over 50 percent of India's approved FDI is towards the financial centres (regional and offshore). Examination of M&A purchases for more or less the same period (2000-7), however, reveals quite a different picture (Figure 4b).

Canada emerges as the top host country for India's outbound acquisitions with a 34 per cent share, followed by the United States with a 24 per cent share. While Indian companies have undertaken a number of varied purchases in the US, the acquisitions in Canada have been concentrated in resources, including Novelis mentioned above. Apart from these, around 16 percent of India's acquisitions have been aimed at resources rich countries (Russia, Egypt, Australia and South Africa) and the rest to the UK and Europe (17 percent).[9]

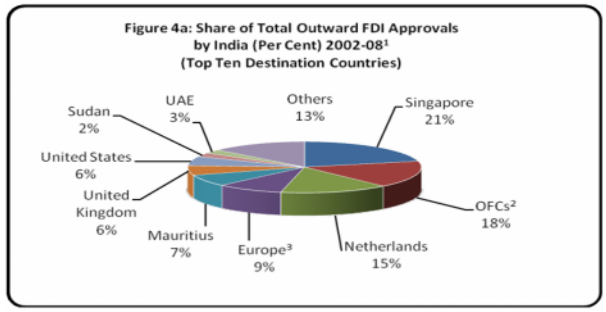

Figure 4a: Share of Total Outward FDI Approvals by India (Per Cent) 2002-08¹ (Top Ten Destination Countries)

Source: Ministry of Finance, Department of Economic Affairs
http://finmin.nic.in/the_ministry/dept_eco_affairs/dea.html
(Accessed on 24 July, 2009).

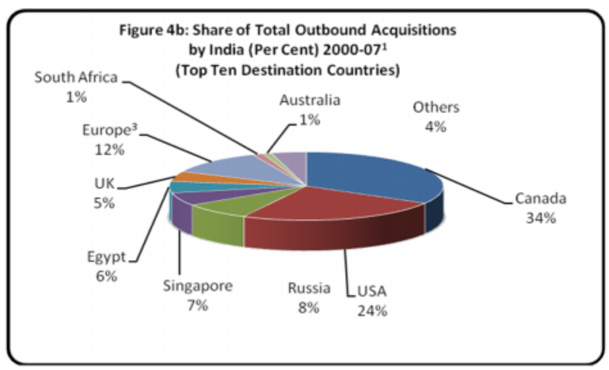

Figure 4b: Share of Total Outbound Acquisitions by India (Per Cent) 2000-07¹ (Top Ten Destination Countries)

Source: Authors' compilations from Zephyr database.
Notes: 1) FDI data are reported for the financial year; M&A data are reported for the calendar year. 2) OFCs – Aggregation of shares of Cyprus, Channel Island, the Cayman Islands and Bermuda excluding Mauritius. 3) Europe – Aggregation of shares of all of Europe except the Netherlands, United Kingdom and Russia. 4) Based on data with over 10% equity to be consistent with definition of FDI.

[7] This trend is visible when one compares Tables 6 and 7 in the chapter on "*Indian Investment Abroad in Joint Ventures and Wholly Owned Subsidiaries: 2008-09 (April-March)*", RBI Monthly bulletin (July 2009). It is also likely that this association between approval and actual is much tighter in the case of India's outflows compared to inflows.

[8] Unlike the pie charts (Figures 2a,b and 4a,b), since we are drawing on secondary sources, the other Tables and Figures are not restricted to purchase over 10 percent equity stake, but it is likely that most are.

[9] Excluding the Netherlands. It is likely that an extension of the data to 2008 would see a jump up in the UK as a source of Indian outbound M&As.

The acquisition by Tata Motors of the Jaguar and Land Rover Brands from the UK do not show up in our data as they were done in early 2008. It is likely that an extension of the data to 2008 would see a jump up in the UK as a source of Indian outbound M&As as would Europe is general, given sizeable recent purchases by India's Suzlon Energy of German wind power company RE Powers in 2009 and Indian firms (see Table 1 in the Annex). Table 2 (see Annex) summarizes the overseas acquisitions by the Tata group of companies which has been an aggressive outward investor since mid 2003-04.

Singapore's Unique Position

The data in Figures 3a and 3b suggest that Indian companies have been using Singapore, the Netherlands and OFCs as intermediaries to purchase assets overseas, primarily in the developed world and resource-rich countries. For instance, Tata Steel financed the Corus acquisition partly via a debt arranged by a consortium of banks at Tata Steel UK as well as in the form of bridge finance by its subsidiary Tata Steel Asia Singapore. As such the deal may not even have shown up in India's FDI statistics or could have shown up as being done via Singapore. While the use of OFCs as tax havens is well understood, both Singapore and the Netherlands are attractive hosts for holding companies from India and elsewhere in view of the low and simple tax rates, the large number of double tax treaties between the two countries and rest of the world, working knowledge of English, human capital, excellent logistics and air and sea connections. This explains their attraction to Indian businesses eager to internationalize their operations.

Indian businesses have been particularly aggressive in investing in Singapore since the coming into force of the Comprehensive Economic Comprehensive Agreement (CECA) in August 2005. The India-Singapore CECA, that covers agreements relating to trade in goods, services and investments, was the first bilateral arrangement that Singapore entered into with a South Asian country, and likewise India's first such agreement with a developed country. Amongst the several features of the agreement, one key provision that has assumed significance from the investment perspective is the renewed Double Taxation Avoidance Agreement (DTAA). The India-Singapore DTAA is broadly modelled along the lines of the existing Indian treaty with Mauritius, with there being exemptions for capital gains tax on profits from sale of shares. Owing to round-tripping concerns between India and Mauritius noted above, the DTAA between India and Singapore has included some key provisions to minimise this from happening.[10]

It may well be that over time there could be a greater a shift of FDI from Mauritius to Singapore by both Indian companies needing a springboard to investing globally, and vice versa for Singapore and other foreign companies looking to enter the Indian market. Already, there has been a spurt in the establishment of Indian companies in Singapore (from 1,200 in 2002 to over 3000 or so by 2008),[11] and while the FDI data clearly overstates the significance of Singapore for reasons discussed above, the city state still constitutes a substantial portion of India's overall outbound M&A (7 percent compared to 22 percent of FDI outflows from India). Apart from Natsteel's acquisition by Tata Steel in 2005, Indian educational institutions and IT companies have been prominent investors from India in Singapore, while many other Indian companies use Singapore as regional and even international headquarters (HQs). On Singapore's part, the Economic Development Board (EDB) has consciously tried to woo companies from India and elsewhere to use the city state as a base by offering attractive tax incentives or grants under the Regional Headquarters (RHQ) or International Headquarters (IHQ) Awards.

Summing Up

To conclude, one clearly has to be cautious in comparing the two sets of data (FDI versus M&A), as the M&A data excludes Greenfield investments. While M&As are growing as the preferred mode of foreign entry, the M&A data are not from national sources. As discussed, they are sourced from commercial entities and there are questions about consistency in terms of company coverage, definitions, and such. In addition, tracking transactions based on ownership is always tricky, particularly given the increasing complexity of global businesses – for instance, is Novelis considered a US or Canadian company since it is headquartered in Atlanta, Georgia, but registered as a Canadian company? All this being said, the important point is that India's FDI data at a bilateral level may offer quite a misleading indication of the extent of real linkages and should be interpreted with extreme caution, a point that researchers and analysts have failed to adequately appreciate.

[10] For more details on the key provisions of the India-Singapore CECA, see http://appstg.mti.gov.sg/data/article/116/doc/FTA_CECA_Information%20Kit.pdf (Accessed on 24 July, 2009)

[11] See http://in.rediff.com/money/2008/mar/19india.htm. (Accessed on 24 July, 2009)

Table 1: Selected Outbound M&A Transactions of over US$100 million (as of Mid 2008)

Acquirer	Foreign target	Target industry	Target country	Approximate deal value (US$)
Tata Steel Ltd.	Corus Group PLC	Steel	U.K.	14.85 billion
Hindalco Industries Ltd.	Novelis Inc.	Aluminum	Canada	6 billion
Sterlite Industries India Ltd.	Aserco Inc.	Mining	U.S.	2.6 billion
Tata Motors Ltd.	Ford Motors Co.'s Jaguar Limited and Land Rover Holdings	Automotive	U.K.	2.3 billion
Essar Steel Ltd.	Algoma Steel Inc.	Steel	Canada	1.57 billion
United Spirits Ltd	Whyte and Mackay Ltd.	Food and Beverages	U.K.	1.18 billion
Tata Power Company Ltd.	30% stake each in PT Kaltim Prima Coal and PT Artumin Indonesia	Energy	Indonesia	1.1 billion
Tata Chemicals	General Chemical Industrial Products Inc.	Chemicals	U.S.	1.0 billion
Tata Sons Ltd. Tata Tea Ltd.	30% stake in Energy Brands Inc.	Food and Beverages	U.S.	677 million
Dr. Reddy's Laboratories Ltd.	Betapharm Arzneimittel GmbH	Pharmaceuticals	Germany	571 million
Wipro Technologies Ltd.	Infocrossing Inc.	Technology	U.S	568 million
Suzlon Energy Ltd. through its subsidiary AE-Rotor Holding BV	Hansen Transmissions International NV	Industrial Machinery	Belgium	521 million
Ranbaxy Laboratories Ltd.	Terapia S.A	Pharmaceuticals	Romania	324 million
Videocon Appliances Ltd.	Thomson Multimedia cathode ray tube business	Technology	France	292 million
Jubilant Organosys Ltd.	Draxis Health Inc.	Pharmaceuticals	Canada	258 million
Tata Coffee Ltd.	The Eight O' Clock Coffee Co.	Food and Beverages	U.S.	220 million
Aditya Birla Nuvo Ltd	Minacs Worldwide Inc.	Technology	Canada	172 million
United Phosphorous Ltd.	Cerexagri S.A.	Chemicals	France	142 million
Subex Systems Ltd.	Azure Solutions Ltd.	Technology	U.K.	140 million
United Phosphorous Ltd.	Advanta Netherlands Holdings BV	Food and Beverages	The Netherlands	119 million

Source: Rajpal, D. and S. Parekh, "India Looks Outward: Cross-Border M&A by Indian Corporations – Canadian Considerations", Stikeman, October 2008. Based on data from Capital IQ.

Table 2: Global M&As by Tata companies as of Mid 2009

Year	Tata company	Acquired company	Country	Stake acquired	Value
2000					
February	Tata Tea and Tata Sons	Tetley group	UK	100 per cent (wholly-owned)	GBP271 million
2001					
November	Tata Sons (TCS)	Computer Maintenance Corporation (CMC)	India		
2002					
February	Tata Sons	Tata Communications (formerly VSNL)	India	100 per cent (wholly-owned)	GBP271 million
September	Indian Hotels	Regent Hotel (renamed Taj Lands End)	India	Effective 100 per cent stake	Rs450 crore
December	Tata Teleservices	Hughes Telecom (India)	India	50.83 per cent	Rs858.83 crore
2003					
July	Tata Communications (formerly VSNL)	Gemplex	US		
2004					
January	TCS	Airline Financial Support Services India (AFS)	India	100 per cent (wholly-owned)	GBP271 million
March	Tata Motors	Daewoo Commercial Vehicle Company	Korea	100 per cent (wholly-owned)	KRW120 billion ($102 million / Rs465 crore)
March	Tata Communications (formerly VSNL)	Dishnet DSL's ISP division	India		
March	TCS	Aviation Software Development Consultancy India (ASDC)	India		
June	Tata Chemicals	Hind Lever Chemicals	India	Amalgamation	
July	TCS	Phoenix Global Solutions	India		
November	Tata Communications (formerly VSNL)	Tyco Global Network	US		
2005					
February	Tata Steel	NatSteel Asia Pte	Singapore	100 per cent (wholly-owned)	S$468.10 million
February	Tata Motors	Hispano Carrocera	Spain	21 per cent	Euro12 million (Rs70 crore)
March	Tata Chemicals	Indo Maroc Phosphore S.A. (IMACID)	Morocco	Equal partner	$38 million (Rs166 crore)
April	Tata Motors	Tata Finance	India	Merger	

July	Indian Hotels	The Pierre	US	$9 million	Lease of the property
July	Tata Industries	Indigene Pharmaceuticals Inc	US	<30 per cent	Not disclosed
July	Tata Communications (formerly VSNL)	Teleglobe International	US		
August	Tata Tech	INCAT International	UK		
August	Trent	Landmark	India	76 per cent	$24.09 million (Rs103.60 crore)
September	TACO	Wündsch Weidinger	Germany		Euro7 million
September	Tata Communications (formerly VSNL)	Tata Power Broadband	India		
October	Tata Tea through Tata Tea (GB)	Good Earth Corporation & FMali Herb Inc	US	100 per cent (wholly-owned)	$31 million
October	TCS	Financial Network Services	Australia		
October	TCS	Pearl Group	UK	Structured deal	
November	TCS	Comicrom	Chile		
December	Indian Hotels	Starwood group (W Hotel)	Sydney	100 per cent (wholly-owned)	$29 million
December	Tata Chemicals	Brunner Mond	UK	63.5 per cent (December 2005)	Rs508 crore (December 2005)
				36.5 per cent (March 2006)	Rs290 crore (March 2006)
2006					
January	Tata Metaliks	Usha Ispat, Redi Unit	India	100 per cent (wholly-owned)	Rs115 crore
January	Tata Interactive	Tertia Edusoft Gmbh	Germany	90 per cent	Not disclosed
		Tertia Edusoft AG	Switzerland	90.38 per cent	
February	TCS	Tata Infotech	India		
April	Tata Steel	Millenium Steel	Thailand	67.11 per cent	$167 million (Baht6.5 billion)
May	Tata Tea through Tata Tea (GB)	JEMCA	Czech Republic	Assets: intangible and tangible	GBP11.60 million
June	Tata Coffee	Eight O' Clock Coffee Company	US	100 per cent (wholly-owned)	$220 million (Rs1015 crore)
September	Tata Tea through Tata Tea (GB)	Joekels Tea Packers	South Africa	33.3 per cent	GBP0.91 million
2007					
January	Tata Steel	Corus	UK	100 per cent	
March	Tata Steel	Rawmet Industries	India		Rs101 crore

April	Indian Hotels	Campton Place Hotel	US		$58 million
April	Tata Power	Acquired Coastal Gujarat Power	India		
April	Tata Tea through Tetley group	Vitax and Flosana trademarks	Poland		
April	Tata Communications (formerly VSNL) through Neotel	Transtel Telecoms (TT)	South Africa		$33 million (approximately)
June	Tata Power	PT Kaltim Prima Coal and PT Arutmin Indonesia	Indonesia	30 per cent equity stake	
October	TRF	York Transport Equipment (Asia)	Singapore	51 per cent stake	
2008					
January	Tata Chemicals	General Chemical Industrial Products	US	100 per cent stake	
January	Tata Projects	Artson Engineering	India		
March	Tata Motors	Jaguar and Land Rover brands	UK		$2.3 billion (approximately)
March	Telco Construction Equipment Company (Telcon)	Serviplem SA	Spain	79 per cent	
March	Telco Construction Equipment Company (Telcon)	Comoplesa Lebrero SA	Spain	60 per cent	
June	Tata Communications	China Enterprise Communications Limited (CEC)	China	50 per cent equity interest	

Source: As taken from http://www.tata.com/htm/Group_MnA_YearWise.htm, (Accessed on 24 July, 2009).