The Rise of Indian Multinationals

Edited by

Karl P. Sauvant and
Jaya Prakash Pradhan,

with

Ayesha Chatterjee and
Brian Harley

(New York: Palgrave Macmillan, 2010)
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Perspectives on Indian Outward Foreign Direct Investment

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Ayesha Chatterjee
and
Brian Harley

palgrave
macmillan
To Howard V. Perlmutter, who sparked my interest in foreign direct investment and multinational enterprises
—Karl P. Sauvant

To my dear teacher, Swami Somabeshji; to my parents, Rama Chandra Pradhan and Tapaswini Pradhan; to Sradhalaxmi Sahoo, my wife; and to my daughter: Gargi Pradhan
—Jaya Prakash Pradhan

To Kaushik and Sumita Chatterjee, for inspiring me to reach higher
—Ayesha Chatterjee

To Matthew and Pauline Harley
—Brian Harley
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Contents

List of Figures and Tables ix
List of Contributors xiii
Foreword xvii
Ravi Ramamurti
Acknowledgments xxi

1 Introduction: The Rise of Indian Multinational Enterprises: Revisiting Key Issues 1
Jaya Prakash Pradhan and Karl P. Sauvant

2 In Search of the “Indianness” of Indian Multinational Enterprises: Is There Anything Special about the Indian Path to Outward Foreign Direct Investment? 25
Michael W. Hansen

3 Political Factors Behind the Rise of Indian Multinational Enterprises: An Essay in Political Economy 57
Jørgen Dige Pedersen

Joël Ruet

5 Acquisition of Technologies and Multinational Enterprise Growth in the Automotive and the Pharmaceutical Industries: Drivers and Strategies 111
Giovanni Balcet and Silvia Bruschieri

6 Outward Investment by Indian Pharmaceutical and Software Multinational Enterprises: Are the Factors Different? 167
Vinish Kathuria

7 Indian Companies Investing in the United States: An Inquiry into Recent Patterns and Trends 187
Nandita Dasgupta
Contents

8  The Emergence of Indian Multinationals: An Empirical Study of Motives, Current Status, and Trends of Indian Investment in Germany 233
   Rajnish Tiwari and Cornelius Herstatt

9  The Surge in Indian Outbound Foreign Direct Investment to Africa: A New Form of South-South Cooperation? 255
   Parthapratim Pal

Index 277
Figures and Tables

Figures

1.1 OFDI stock of the top 15 emerging markets (2008), in US$ billions and percents 4
1.2 Indian OFDI flows (1961–2007), in US$ millions and numbers 5
2.1 The surge in Indian OFDI (1980–2008), in US$ millions 27
2.2 Closing the gap: Indian IFDI and OFDI (1980–2008), in US$ millions, logarithmic 28
2.3 Industrial composition of Indian OFDI (1975–2008), in percents 28
2.4 Host countries of Indian OFDI (1996–2005), in percents 29
2.5 Net outward investment measured as a ratio of OFDI flows to IFDI flows (1980–2008), in numbers 33
4.1 Generalized competition 99
5.2 Ratio of R&D expenses to sales: Nicholas Piramal, Sun Pharmaceutical, large Indian pharmaceutical companies, and Italian pharmaceutical companies (1994–2008) (%) 122
5.3 Ratio of marketing and advertising expenses to sales: Nicholas Piramal and Sun Pharmaceutical (1996–2008) 125
5.4 The ratio of profit after tax to sales: Nicholas Piramal, Sun Pharmaceutical, and a pool of large Indian pharmaceutical units (1994–2008), in % 127
5.5 The ratio of current assets to current liabilities: Nicholas Piramal and Sun Pharmaceutical (1994–2008), in numbers 128
5.6 The ratio of exports to sales: Nicholas Piramal and Sun Pharmaceutical (2000–2008), in % 132
5.7 Sales (standalone): Mahindra & Mahindra and Bharat Forge (1990–2008), in US$ millions 139
Figures and Tables

5.8 The ratio of R&D expenses to sales: Mahindra & Mahindra and Bharat Forge (1992–2008), in % 140
5.9 The ratio of retained profit to sales: Mahindra & Mahindra and Bharat Forge (1989–2008) (%) 142
5.10 The ratio of current assets to current liabilities: Mahindra & Mahindra and Bharat Forge (1989–2008), in numbers 143
5.11 The ratio of advertising and marketing expenses of sales: Mahindra & Mahindra and Bharat Forge (1990–2008) 144
5.12 The ratio of exports to sales: Mahindra & Mahindra and Bharat Forge (1990–2008), in % 148

8.1 Germany’s trade volume with India (2000–2009), in € millions 235
8.2 Active Indian MNEs (majority stakeholders) in Germany as of October 2008 236
8.3 Subsidiaries of Indian MNEs in Germany’s federal states as of October 2008 237
8.4 Annual turnover of survey respondents in fiscal year 2007 in Germany, in € millions 239
8.5 Business activities of Indian MNEs in Germany as of July 2008 240
8.6 Group turnover of the whole MNE in fiscal year 2007, in € millions 240
8.7 Total investment by the Indian MNE in the German-based subsidiary through July 2008, in € millions 241
8.8 Share of Indian expatriates in the workforce of German-based subsidiaries as of July 2008 245
8.9 Compound annual growth rate of the subsidiary in Germany (2005–2007), in terms of sales 247
8.10 Short-to-medium term further investments plans as of July 2008, in € millions 248

Tables

1.1 Average OFDI flows from selected emerging markets (1970–2008), in US$ millions and percents 2
1.5 Overseas acquisitions by Indian firms (2000–2009), in US$ millions and numbers 12
<table>
<thead>
<tr>
<th>Figures and Tables</th>
<th>xi</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1 Phases in Indian OFDI</td>
<td>30</td>
</tr>
<tr>
<td>2.2 Summary of argument</td>
<td>46</td>
</tr>
<tr>
<td>5.1 Nicholas Piramal’s web of linkages with incumbents and institutions</td>
<td>130</td>
</tr>
<tr>
<td>5.2 Mahindra &amp; Mahindra’s external network</td>
<td>146</td>
</tr>
<tr>
<td>5.3 Bharat Forge’s external network</td>
<td>147</td>
</tr>
<tr>
<td>6.1 Patents filed and R&amp;D expenditure by Indian pharmaceutical firms (1990–2005), in numbers and US$ millions</td>
<td>175</td>
</tr>
<tr>
<td>6.2 Outward investors and their research orientation in the pharmaceutical industry (1990–2005), in numbers and percents</td>
<td>176</td>
</tr>
<tr>
<td>6.3 Distribution of the instances of OFDI (NOFDI) by MNEs in the pharmaceutical and software industries (1991–2006), in numbers of instances and percent frequencies</td>
<td>179</td>
</tr>
<tr>
<td>6.4 Differences between pharmaceutical and software MNEs (1991–2006)</td>
<td>181</td>
</tr>
<tr>
<td>6.5 Factors influencing the number of times an MNE has invested abroad (NOFDI) (1991–2006)</td>
<td>182</td>
</tr>
<tr>
<td>7.1 Indian OFDI flows by host region and host country (1975–1990 and 1991–2001)</td>
<td>188</td>
</tr>
<tr>
<td>7.2 Indian OFDI by host region and host country (1970–2007), in US$ millions</td>
<td>189</td>
</tr>
<tr>
<td>7.3 Approved Indian OFDI in JVs and wholly-owned subsidiaries to the United Kingdom and the United States (1996–2005), in US$ millions</td>
<td>193</td>
</tr>
<tr>
<td>7.4 Actual FDI flows from India to the United States on a historical cost basis, by industry (North American Industry Classification System) (2002–2007), in US$ millions</td>
<td>193</td>
</tr>
<tr>
<td>7.5 Distribution of Indian MNEs engaged in U.S.-bound OFDI by sector and industry (2000–2008)</td>
<td>195</td>
</tr>
<tr>
<td>7.6 Number of companies, percentage and industry distribution of Indian MNEs engaged in OFDI in the United States by age group (2000–2008)</td>
<td>196</td>
</tr>
<tr>
<td>7.7 Indian OFDI to the United States by SMEs and large-sized enterprises (March 31, 2001), in US$ millions</td>
<td>198</td>
</tr>
<tr>
<td>8.1 Top investment motives for Indian MNEs in Germany (with industry breakdown)</td>
<td>242</td>
</tr>
<tr>
<td>8.2 Criteria influencing the location decision within Germany</td>
<td>243</td>
</tr>
<tr>
<td>8.3 Shift in full-time, regular jobs between India and Germany as of July 2008</td>
<td>244</td>
</tr>
<tr>
<td>8.4 Challenges encountered in the investment process and day-to-day operations in Germany (with industry breakdown)</td>
<td>246</td>
</tr>
<tr>
<td>#</td>
<td>Figure/Table Description</td>
</tr>
<tr>
<td>----</td>
<td>-----------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>9.1</td>
<td>Trends in Indian OFDI flows into Africa (1961–2007)</td>
</tr>
<tr>
<td>9.3</td>
<td>Some major Indian investments in the oil and gas industry in Africa (2002–2008)</td>
</tr>
<tr>
<td>9.4</td>
<td>Form of ownership of Indian MNE investments in Africa (1961–2007)</td>
</tr>
<tr>
<td>9.5</td>
<td>Indian acquisitions in Africa (2000–2009)</td>
</tr>
</tbody>
</table>
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Foreword

Ravi Ramamurti

The surge in outward foreign direct investment (FDI) by Indian firms in the past ten to fifteen years raises a host of interesting questions. This edited volume by Karl P. Sauvant and Jaya Prakash Pradhan takes us several steps closer to finding answers to those intriguing questions. It will be a valuable resource for all scholars interested in India’s emerging multinational enterprises.

One such question is why a poor country like India is the source of outward FDI. According to standard economic theory, poor countries are supposed to be capital short and, therefore, importers of capital. According to international business theory, outward FDI is supposed to rise only after per capita income exceeds $5,000 or $10,000, whereas India’s was only $1,000 in 2008. India is one of the few low-income countries that appear in the top-ten list of outward investors in the developing world. As Pradhan and Sauvant note in their introduction, India ranked eighth in outward FDI in 2000–2007 among Asia’s emerging economies. With the exception of China, all other outward investing countries in Asia have significantly higher per capita incomes than India: Hong Kong (Special Administrative Region of China), the Republic of Korea, Malaysia, the Philippines, Singapore, and Taiwan, Province of China. So what accounts for the premature and surprisingly high outward FDI of Indian (and Chinese) firms?

The answer to this puzzle, it would appear, is that being a large and diverse country, India has pockets—regions and industries—in which its firms are quite sophisticated, in terms of technology, operations, and management. In what they do, these firms are capable of competing with the best in the world, be it software services or engineered goods. The contrast in economic development between parts of Bihar, on the one hand, and parts of Maharashtra or Tamil Nadu, on the other hand, is striking. In other words, the level of economic development and per capita income in India’s more developed parts are comparable to those of middle-income developing countries that are major outward investors. If Mumbai or Bengaluru were city-states like Singapore, their per capita incomes would be several times India’s average. Viewed this way, the puzzle we began with is readily
resolved. The lesson one takes away is that large developing countries like India are properly viewed as collections of highly developed and highly underdeveloped parts, and it should be no surprise if the former regions spawn global firms. With this correction, India does not present a challenge to conventional theory.

But there is a deeper puzzle in the Indian case, which is why total outward FDI by India is almost as large as total inward FDI into India. It is not just that some firms are net overseas investors, but that India as a whole is close to being a net outward investor. In this regard, India is significantly different even from China, which received about $500 billion in inward FDI before its firms began to make outward investments. Even as late as 2007, China’s inward FDI was five times its outward FDI, whereas in India’s case, both inward FDI and outward FDI began to surge at about the same time—around 2005; in 2007, the two flows may have been nearly equal, if measured by deal value (official statistics define FDI inflows and outflows somewhat narrowly, but total deal value looks at the size of cross-border investments, regardless of how they are financed).

In the recent past, this has also been true of the other BRIC countries, but the puzzle in India’s case is more intriguing for two reasons. In China, state-owned enterprises have been at the forefront of outward FDI; given China’s exchange rate policy and the resulting foreign exchange reserves, it is easier to understand why the country’s state-owned firms may be on a shopping spree abroad. In the case of Russia and Brazil, a large part of the outward FDI is in the natural resource sector, consisting of either downstream integration (Russia) or upstream integration (China). Indian outward FDI is neither state-led nor predominantly in natural resource industries, but rather in knowledge-intensive industries, as Pradhan and Sauvant note in their introductory chapter. How is one to explain the volume and industry composition of Indian outward FDI?

I suspect the answer has two parts, one of which has to do with the capabilities of India’s private sector, while the other stems from weaknesses in the Indian business environment, as we have argued in an earlier work (Ramamurti and Singh 2009). On the positive side, India’s outward FDI is led by highly entrepreneurial private firms that have capabilities in design, production, branding, and distribution, and are innovative at providing products and services of “good enough” quality at ultra-low prices (Govindarajan and Ramamurti 2010). These capabilities transfer well to foreign markets, including other emerging markets. It is often noted that India’s economic reforms lagged China’s by more than a decade; but what is often overlooked is that India’s private sector is a decade or two ahead of China’s. I am inclined to agree with Yasheng Huang’s view that China’s large inward FDI flows reflect the weaknesses of its private sector, while India’s low inward FDI flows (until very recently) reflect the strengths of its private sector (2003). It is for this reason that Indian firms are showing more dynamism internationally than Chinese firms do. As for the higher
skill- or knowledge-intensity of India’s outward FDI, I think it merely reflects the high cost of doing business in India, notably the infrastructure and logistical penalty of getting goods in and out of the country. As a result, the internal efficiency of Indian firms is offset by external inefficiencies, making them unable to compete in foreign markets in businesses where cost is paramount. This not only skews Indian exports in the direction of skill-intensity (where margins are high enough to overcome the India penalties), but also makes FDI the next best alternative to exports—unlike in the Chinese case, where efficient firms can compete globally with production inside China (for more along these lines, see Ramamurti 2008).

A final puzzle in the Indian case is why so much of the outward FDI is directed at rich countries. As Pradhan and Sauvant note in their introduction, during 1961–1989, 82% of Indian outward FDI went to other developing countries; but in 1990–2007, almost 62% went to developed countries. Why is a poor country like India investing such a large proportion of its outward FDI in rich countries? Several answers have been provided for this puzzle, including the view that Indian firms are seeking Western technology and brands in areas in which they are weak. But one does not see the same concentration on rich host countries in Chinese outward FDI. I think this again reflects the greater willingness of Indian private firms to venture into advanced countries in search of ideas, technologies, and markets. Not being state-owned is a double advantage for Indian firms compared to Chinese firms, because it allows them to move more boldly and swiftly (Vernon 1979), and it raises fewer red flags among Western policy makers and the public than when state-owned firms from a Communist country are the acquirers.

I hope the above discussion illustrates the many intriguing issues raised by the Indian case for scholars interested in how and why firms internationalize. The analysis assembled so ably in this volume by Sauvant and Pradhan, and grounded so well in evidence rather than conjecture, sheds light on several such puzzling questions. It will surely provoke many more fruitful studies of Indian multinational enterprises, including comparative studies with similar firms from other major emerging markets.

Apr. 6, 2010

References


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xx     Foreword


Acknowledgments

The geography of global outward foreign direct investment is changing as firms from such emerging markets as India, China, Russia, and Brazil are increasingly venturing abroad. Indian multinational enterprises contribute to the growing importance of emerging markets’ outward foreign direct investment. Many Indian firms, which were hitherto national players, have become international players in recent years by increasingly investing abroad.

The present volume is intended to provide new perspectives on the rise of Indian multinational enterprises. The Vale Columbia Center on Sustainable International Investment and the Institute for Studies in Industrial Development, both having considerable expertise and research interests in the areas of foreign direct investment and public policy, have drawn together leading experts working on issues related to Indian foreign direct investment to shed light on this development.

All contributions by the authors have been peer-reviewed. We are grateful to the experts—Christian Milelli, Emin Akcaoglu, Glauco Arbix, Jean-François Huchet, Ling Liu, Peter Gammeltof, and Ravi Ramamurti—for providing their useful views and suggestions during the review process. The assistance of Wouter Schmit Jongbloed in editing this volume is greatly appreciated, as is the help of Lisa Sachs and Zehra Gulay Kavame in bringing this volume to fruition.

New York City and Ahmedabad, March 2010
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