

DEVELOPING COUNTRIES: Globalisation through Overseas Investment



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*This article was contributed by
Export-Import Bank of India.*

Introduction

In recent years, an important indicator of the internationalisation of developing economies, besides higher exports, has been the rising trend in overseas investments by these countries. Outward direct investments can play an important role in enhancing the global competitiveness of firms from developing economies by providing access to strategic assets, technology, skills, natural resources and markets, and increasing resources. At the same time, increased investment flows between developing economies serve to enhance South-South cooperation.

Global Outward Investment Scenario

Global FDI outflows, according to UNCTAD's World Investment Report 2007, have risen significantly from US\$877 bn in 2004 to US\$1,215 bn in 2006, underlines by the rise in FDI outflows from both developed and developing economies. In the case of developing economies in particular, the rise in FDI outflows has been significant; from US\$35.6 bn in 2003 to US\$117 bn in 2004, and further to US\$174 bn in 2006. Reflecting this trend, the share of developing economies in global FDI outflows has also risen from 6.3% in 2003 to 13% in 2004, and further to 14.4% in 2006. The Asian region accounts for the bulk of the outward FDI from developing countries, with India emerging as an important overseas investor. In 2006, the Asian economies accounted for 67% (US\$117 bn) of the total FDI outflows from developing economies. The stock of outward FDI from developing economies in 2006 reached US\$1600 bn, up from US\$145.8 bn in 1990.

The rise in FDI outflows from developing economies has also been characterised by increasing range of countries. While earlier episodes of outward expansion from developing countries involved mainly the newly industrializing economies (NIEs) of Asia, and some Latin American and West Asian economies, a wide range of developing countries, such as Argentina, Chile, India, Malaysia, Nigeria, South Africa, Thailand, Turkey and Venezuela, as well as several lower income economies, are now extending their reach. The Russian Federation has also emerged as a major source of outward FDI.

Factors behind the rise of Outward FDI from Developing Economies

The rising trend of outward FDI from some developing and transition economies reflects the increasing competitiveness of many firms in these economies. The FDI surge has also partly been fuelled by soaring export revenues from manufactured products and natural resources in some countries, which have contributed to building up the financial strength needed to engage in overseas investment.

Perhaps most importantly, firms from these economies have been increasingly affected by global competition. They have come to realize the growing importance of accessing international markets and connecting to global production systems and knowledge networks

The Case of India

Overseas investment by Indian corporates is a facet of their increasing competitiveness and integration with the global economy. Total FDI outflows from India have risen from US\$2.2 bn in 2004 to US\$2.5 bn in 2005, and during 2006 surged to US\$9.7 bn. As a result, India's FDI outward stock rose sharply to US\$12.96 bn in 2006, up from a modest US\$1.86 bn in 2000.

Destinational analysis of India's FDI outflows reveals that while regional distribution of overseas investment is evenly spread out across various countries, developing and emerging countries are increasingly emerging as outward FDI destinations. In fact, emerging markets such as Russia, Mauritius, Sudan, Vietnam are among the largest destinations.

The surge in India's FDI outflows attests to the expanding base of domestic firms, which are able to compete globally, reflecting increasing quality and cost competitiveness to sustain long-term domestic and international growth. Focus on core competencies, increased R & D efforts and enhanced technological know-how have underlined this development. At the same time, access to markets, natural resources, distribution networks, foreign technologies and strategic assets like brand names have motivated Indian companies to increasingly look outward in their endeavours to internationalise their operations. Further, the shift in the pattern of financing overseas investment, from equity outflows from the host country towards re-invested earnings, is an indicator of the increasing confidence of Indian firms in internationalisation

Overseas Investment Policy in India

While globalisation of the world economy has fostered the outward orientation of Indian companies, significant policy liberalisation and renewed support in recent years have provided the impetus in this direction.

Meeting challenges on the policy front assumes importance in a global economy. The effectiveness and efficiency of firms is facilitated by the nature of policy environment under which firms operate, and whether macro-economic policies allow them to achieve the requisite economies of scale and allocative efficiency in production. It is here that the role of the Government assumes a great deal of importance as a confidence builder, a catalytic agent and a facilitating agent. The objective of liberalizing Indian investment abroad has been mainly to provide Indian industry

access to new markets and technologies with a view to increasing their competitiveness globally and help the country's export efforts.

The Indian policy framework has been very supportive of direct investment abroad. Following the recommendations of the Kalyan Banerji Committee Report on Indian Joint Ventures Abroad in December 1991, Ministry of Commerce, Government of India, approved a liberalised policy in October 1992. An automatic approval window was created and a framework of case-by-case approval put in place.

The policy was further liberalised in December 1995 with enhancement of the limit for automatic approval, removal of restrictions on equity contribution through cash remittance and designating Reserve Bank of India as the nodal agency for according all approvals. The policy has since then

been further liberalized regularly viz. Indian corporates have been allowed to investment in entities abroad up to 200% of their net worth.

The Report of Committee on Fuller Capital Account Convertibility has recommended that Limit for a company's investment in overseas JVs/subsidiaries raised to 250% of net worth in 2006-07 and gradually up to 400% of net worth in overseas subsidiaries/JVs by 2011. Further, recent Reserve Bank of India's Monetary Policy has enhanced the ceiling on overseas investment by mutual funds, has provided greater opportunity to mutual funds to invest overseas, while also taking initiatives with a view to facilitating project exporters and exporters of services from India.

These policy measures and recommendations reflect the increased importance accorded by the Government of India to create an enabling environment for Indian companies in their globalisation endeavours.

Observations

While many developing and emerging are implementing policy measures to foster and enhance outward FDI flows, according to UNCTAD, there is no one-size-fits-all policy that can be recommended to deal with outward FDI. Every home country needs to adopt and implement policies that are appropriate to its specific situation. Whether a country will benefit by moving from "passive liberalization" to "active promotion" of outward FDI depends on many factors, including the capabilities of its enterprises and the links of the investing companies with the rest of the economy.

For those countries that decide to encourage their firms to invest abroad, it is advisable to incorporate policies dealing specifically with outward FDI within a broader policy framework aimed at promoting competitiveness. For example, given the importance of generating domestic capabilities to benefit from outward investment, it is appropriate to link policies on such

investment with those relating to SME development, trade and innovation. Moreover, outward FDI is only one of several ways in which a country and its firms can connect with the global production system. Therefore, close coordination with policies aimed at attracting inward FDI, promoting imports or exports, migration and technology flows would also be advisable.

Export-Import Bank of India: Supporting Indian Overseas Investments

Export-Import Bank of India (Exim Bank) actively supports and facilitates outward investments by outward-oriented Indian companies in their quest for enhanced access to global markets. The Bank provides a comprehensive range of products and services to Indian companies in their internationalisation efforts, tailored to meet the needs of different customer groups. These include: programmes for enabling Indian companies to acquire assets to improve international competitiveness; assistance through pre-investment advisory services; finance through debt and equity; analytical information and due diligence. Such financing is available for greenfield projects, brownfield expansion, as also overseas acquisitions directly or through special purpose vehicles.

The Bank has supported more than 200 ventures in over 50 countries around the world, set up by 164 Indian companies. Exim Bank also undertakes direct equity participation in Indian ventures abroad to enhance credibility and acceptance of Indian ventures overseas, on select basis. Further, the Bank facilitates joint investment by Indian and overseas companies in third country markets.

The Bank seeks to develop commercially viable relationships with externally oriented companies by offering them comprehensive range of products and services aimed at enhancing their internationalisation efforts. The Bank has also played an important role in the setting up of the Global Network of Exim

Banks and Development Financial Institutions (G-NEXID) under the auspices of UNCTAD in Geneva in March 2006. The Forum aims to enhance sharing of experiences as also cooperation among Exim Banks and Development Financial Institutions from developing countries, which would serve to promote South-South trade and investment by providing a common platform and reducing transaction costs and making financing more readily available to new and innovative business. G-NEXID has since been given 'observer' status in UNCTAD.

Outbound investment flows from India reflect two clear discernible trends. Firstly, Indian companies are increasingly investing in developed country markets, although, until recently, most FDI flows from India took the form mainly of South-South investments, driven by comparative advantages such as local knowledge and geographic and cultural proximity. Secondly, Indian companies investing overseas are, often times, mid-sized corporates. A number of such investments are funded through means beyond just internal accruals of the companies and hence enhances the ability of mid-size firms to fund larger investments. In a bid to give further impetus to overseas investments, the Reserve Bank of India has further liberalised overseas investment norms increasing the overseas investment limit from 200 per cent of the net worth to 400 per cent of the net worth.

Risk Mitigation Measures

Indian outward investments occur in both developed and developing countries. While majority of ODI has occurred in politically and economically stable markets primarily to synergise the companies' Indian operations with their globalisation efforts. Overseas investments for acquisition of manufacturing facilities, brands, setting up warehousing, distribution of R& D facilities are some of the spheres where Indian companies have invested abroad. The companies have not faced risks relating to dividend repatriation, expropriation or other similar restrictions.

However, there is an increasing trend among large Indian manufacturing

companies in sectors like steel, paper, power, fertilizer and chemicals to acquire natural resources base abroad, primarily in developing countries in Asia, Africa, CIS and Latin America. Indian companies look for acquiring ferrous and non-ferrous mines, coal fields, forest acreage, phosphate mines, etc. to ensure regular and assured supply of raw materials at reasonable prices for their operations in India. While there may not be any political or economic risks if such investments take place in countries like Australia, Indian companies are conscious of risks in investing in developing countries.

Indian companies making large investments in other developing countries do resort to risk mitigation measure like investment protection policies available with MIGA and/or Export Credit Guarantee Corporation of India (ECGC). While MIGA essentially covers political risks, ECGC offers both political and comprehensive risk cover as well as exchange fluctuation protection policies. Cost of risk cover is also a factor that is taken into account while opting for cover. If the cost is prohibitive, companies do take risks by not taking risk cover if the entire investment is made out of company's own funds. In case of borrowings, lenders like Exim Bank do insist on risk cover as pre-condition for such loans in addition to charge on company's fixed assets overseas and/or in India.