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India's Foreign Direct Investment Flows:
Trying to Make Sense of the Numbers[1]

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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 into 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 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.

1. 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.[3] However, a consistent time series of the actual value of outflows with a country-wise breakdown does not seem to be available in the public domain.[4] While data on actual FDI inflows is reported by the Department of Industrial Policy and Promotion (DIPP) at a disaggregated country level,[5] there are serious concerns about the usefulness of the bilateral FDI inflows data that is available in the public domain.

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[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, Working Paper No. 66, June 2009. Assistance with the merger and acquisition data by Rabin Hattari is gratefully acknowledged.

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

[4] Only since April 2008 has the Reserve Bank of India 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.

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

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 in OFCs, or other regional financial centres such as Singapore or Netherlands to raise funds and invest in third countries. Apart from this so-called transhipping, some parts of these inflows, from Mauritius in particular and also other OFCs, could also be round-tripping back to India to escape capital gains or other taxes or for other reasons, not unlike the investments dynamics between China and Hong Kong, although on a much smaller scale.[6] 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 the 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.

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. 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 purchases and sales, are maintained by several private commercial entities such as the Bloomberg, Capital IQ, Dealogic, Thomson Financial, Zephyr, etc., (unlike the data on FDI flows, which is compiled by the national sources).

2. 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 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 previously discussed inconsistencies.[7]

It is interesting to note that most of the OFCs such as Mauritius (mainly), Cyprus, Cayman Island and Bermuda, which comprise a nearly 50 percent share of the total FDI inflows (as reported by the government sources) do not even appear in the data on inbound M&A to India. Focussing on the FDI data, only 18 percent of inflows to India have been by the United States and the United Kingdom combined, while about 15 percent is by the non-United Kingdom European countries (mainly Netherlands, France and Germany) and about ten percent by East Asia (mainly Singapore and Japan). In contrast, the M&A data on foreign acquisitions in India tells quite a different story. The United States is the single largest

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6 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*, forthcoming.

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

acquirer of Indian companies (35 percent), followed by the United Kingdom (16 percent) and the rest of Europe including Netherlands (27 percent) and East Asia (18 percent) (distributed between Japan, Singapore, Malaysia and Hong Kong). Therefore, almost all of the inbound acquisitions to India have been made by the United States, 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 United States and United Kingdom 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 realised, available data at least for aggregate actual outflows suggests that there is a reasonable degree of correlation between approved and actual outward FDI flows from India.[8] Accordingly, the outward FDI approvals data should 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 such as the United States, the United Kingdom and the rest of Europe. Notable instances would be Tata Steel's purchase of Corus and Tata Motors purchase of Jaguar and Land Rover in the United Kingdom and Hindalco's acquisition of the Canadian aluminium giant Novelis (Table 1).[9]

Referring to Figure 4a, one notices that developed countries such as the United Kingdom and the United States have surprisingly small shares of India's approved outward FDI (six percent each) for recent periods for which detailed data are available (2002-08) compared to Singapore (22 percent), Netherlands (15 percent) and Mauritius and other OFCs in total (25 percent). Hence, over 50 percent of India's approved FDI appears to have been flowing towards the financial centres (regional and offshore). Examination of M&A purchases for more or less the same period (2000-07), however, reveals quite a different picture (Figure 4b).

Canada emerges as the top host country for India's outbound acquisitions with a 34 percent share, followed by the United States with a 24 percent share. While Indian companies have undertaken a number of varied purchases in the United States, the acquisitions in Canada have been concentrated in resources, including Novelis mentioned previously. Apart from these, around 16 percent of India's acquisitions have been aimed at resource-rich countries (Russia, Egypt, Australia and South Africa) and the rest to the United Kingdom and Europe (17 percent). The Tata Motors acquisition of Jaguar and Land Rover Brands from the United Kingdom do not show up in our data as they were concluded in early 2008. It is likely that an extension of the data to 2008 would see a jump up in the United Kingdom as a source of Indian outbound M&A, as would Europe in general, given recent sizeable purchases by India's Suzlon Energy of Indian firms and the German wind-power company, REpower, in 2009 (Table 1).

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[8] 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.

[9] 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 purchases over ten percent equity stake, but it is likely that most are.

3. Singapore's Unique Position

The data in Figures 3a and 3b suggests that Indian companies have been using Singapore, Netherlands and OFCs as intermediaries to purchase assets overseas, primarily in the developed world and resource-rich countries. For instance, Tata Steel is said to have financed the Corus acquisition partly via a debt arranged by a consortium of banks at Tata Steel (United Kingdom) as well as in the form of bridge finance by its subsidiary Tata Steel Asia Singapore. Therefore, the deal may not even have shown up in India's FDI statistics or could have shown up as being concluded 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 that are eager to internationalise 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, which 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 has India's first such agreement with a developed country. Amongst the several features of the agreement, one key provision which 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 exemptions for capital gains tax on profits from the sale of shares. Owing to the round-tripping concerns between India and Mauritius noted previously, the DTAA between India and Singapore has included some key provisions to minimise this problem.[10]

It may well be that over time, there may 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 Singaporean 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 as a destination for Indian investments for reasons discussed before, the city state still constitutes a substantial portion of India's overall outbound M&A (seven 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 into Singapore, while many other Indian companies use Singapore as a regional and even international headquarters. On Singapore's part, the Economic Development Board 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 Award or International Headquarters Awards.

4. Conclusion

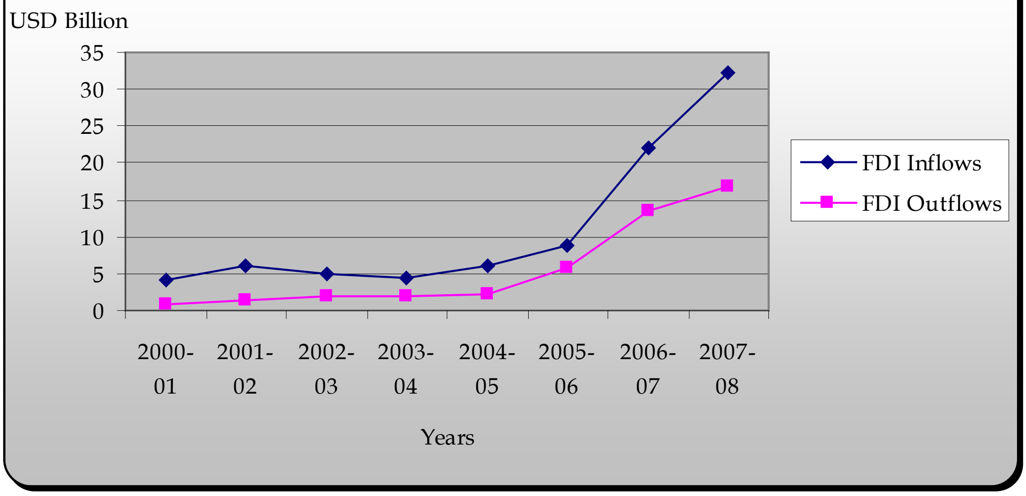
To conclude, one clearly has to be cautious when comparing the two sets of data (FDI versus M&A), as the M&A data excludes Greenfield investments. While M&A are growing as the

10 For more details on the key provisions of the India-Singapore CECA, see http://app-stg.mti.gov.sg/data/article/116/doc/FTA_CECA_Information%20Kit.pdf.

11 See http://in.rediff.com/money/2008/mar/19india.htm.

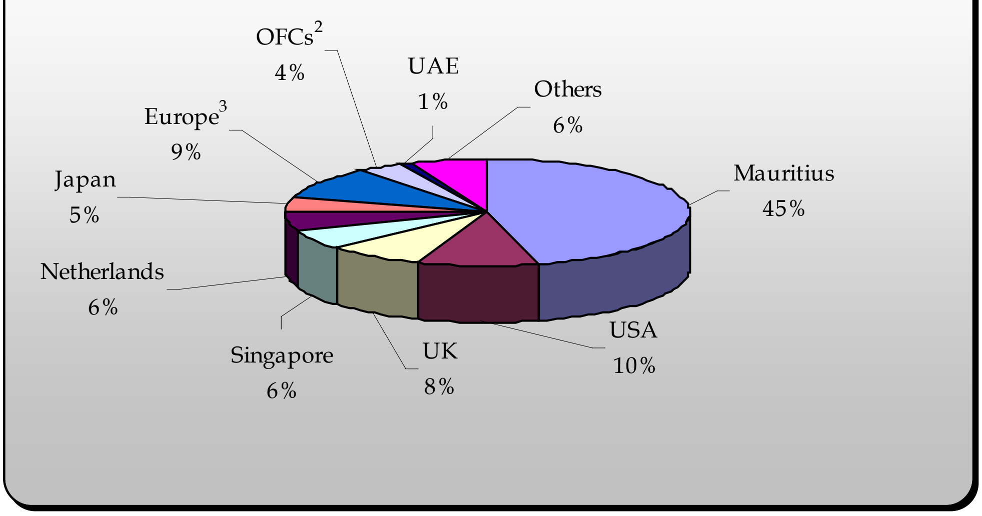
preferred mode of foreign entry, the M&A data are not from national sources. As discussed, they are sourced from commercial entities and there are questions about consistency in terms of company coverage and definitions, among other factors. In addition, tracking transactions based on ownership is always tricky, particularly given the increasing complexity of global businesses. For instance, is Novelis considered a company from the United States or Canada, since it is headquartered in Atlanta, Georgia, but registered as a Canadian corporation? This 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 appreciate adequately.

Figure 1: Capital Inflows to and Outflows from India (2000-08)



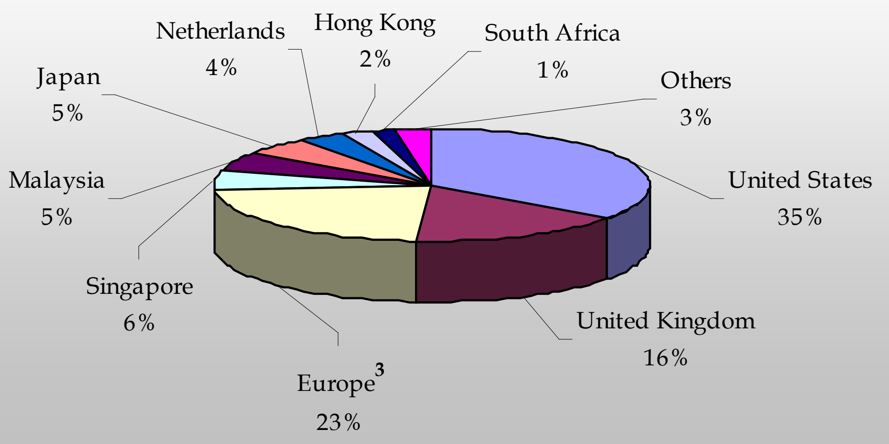
Source: Based on Reserve Bank of India Monthly Bulletin (July 10, 2009).

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



Source: Ministry of Commerce and Industry, Department of Industrial Policy and Promotion 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)



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, Cayman Island and Bermuda excluding Mauritius.

3) Europe – Aggregation of shares of all of Europe except Netherlands, the United Kingdom and Russia.

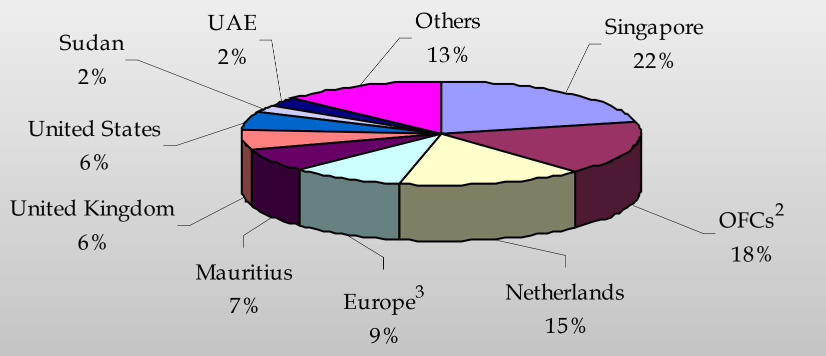
4) Based on data with over 10% equity to be consistent with definition of FDI.

Source: Authors' compilations from Zephyr Database.

Figure 3: Indian Outbound Mergers and Acquisitions

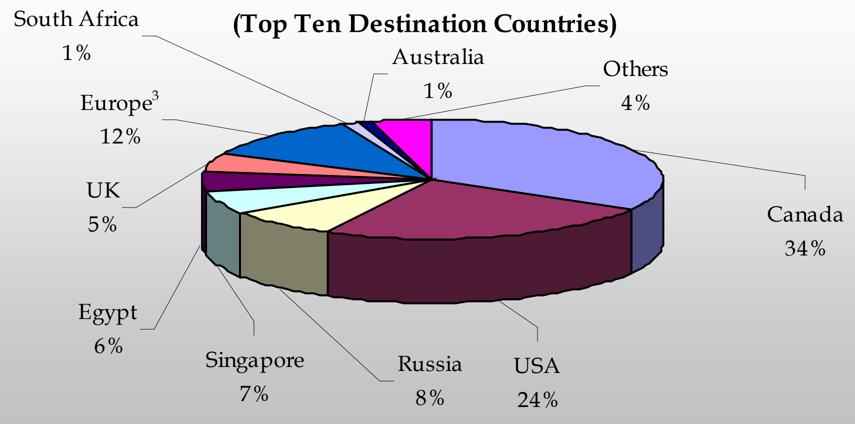
Source: Reproduced from The Economist, May 28th, 2009 based on data from Dealogic. http://www.economist.com/businessfinance/displaystory.cfm?story_id=13751556, (Accessed on 24 July, 2009).

Figure 4a: Share of Total Outward FDI Approvals by India (Per Cent) 2002-08[1] (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) 2000-07[1] (Top Ten Destination Countries)



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2) OFCs – Aggregation of shares of Cyprus, Channel Island, Cayman Island and Bermuda excluding Mauritius.

3) Europe – Aggregation of shares of all of Europe except Netherlands, United Kingdom and Russia.

4) Based on data with over 10% equity to be consistent with definition of FDI.

Source: Authors' compilations from Zephyr database.

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	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.

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