

**The Rise of Indian Multinationals**

**Edited by**

**Karl P. Sauvant and  
Jaya Prakash Pradhan,**

**with**

**Ayesha Chatterjee and  
Brian Harley**

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# The Rise of Indian Multinationals



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## Perspectives on Indian Outward Foreign Direct Investment

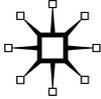
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To Howard V. Perlmutter, who sparked my interest in foreign direct  
investment and multinational enterprises

—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

**Vale Columbia Center on Sustainable International Investment**—The Vale Columbia Center on Sustainable International Investment (VCC) seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy, paying special attention to the sustainability dimension of this investment. It focuses on the analysis and teaching of the implications of FDI for public policy and international investment law. Its objectives are to analyze important topical policy-oriented issues related to FDI, develop and disseminate practical approaches and solutions, and provide students with a challenging learning environment. For more information, please see <http://www.vcc.columbia.edu>.

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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

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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.

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