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FDI into India's Manufacturing Sector via M&As: Trends and Composition

Foreign Investments Study Team

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[**Abstract**: *India's strategy towards FDI in the post-1991 period has been to attract large amount of FDI by offering it freedom of entry and operation. However, India failed to attract the desired quantum of FDI into the manufacturing sector, the prime focus of 1991 policy shift. Evidence presented in this paper suggests that even this amount may not have resulted in commensurate capacity creation. If only realistic FDI is considered, as much as 54 per cent of what went into the manufacturing sector was acquisition-related. The fact that the reported inflows had come to depend upon acquisitions to a large extent is something that has been missed probably due to the excessive emphasis on the quantum of FDI. Acquisition related inflows, unaccompanied by substantial capacity expansion, may not help India achieve the objective of increasing the share of manufacturing in GDP. Efficiency and productivity gains, which are advanced as the main benefits of M&As cannot serve India's objective of faster growth of the manufacturing sector. Instead of taking comfort from the addition to gross inflows the need is to analyse the contributing factors to the sell-offs and devise ways to strengthen Indian entrepreneurs.*]

1. Introduction

Policy debates in India consistently highlighted the contribution that foreign direct investment (FDI) can make to the country's economy, particularly by supplementing domestic savings and transfer of advanced technology. Expectedly, when India expanded the scope for foreign investment substantially in 1991, it was stated that "[f]oreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports." It was further underlined that "[t]he government will therefore welcome foreign investment which is in the interest of the country's industrial development".[1] Fostering competition was another explicitly stated objective of the Statement on Industrial Policy, 1991. The Budget Speech 1991-92 expressed the confidence that "...we have now reached a stage of development where we should welcome, rather than fear, foreign investment. Our

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1 "Statement on Industrial Policy, 1991" in Ministry of Industry, *Handbook of Industrial Policy and Statistics*, 1998, New Delhi.

entrepreneurs are second to none. Our industry has come of age". As a follow up of this and as part of the overall liberalisation thrust, a series of measures were initiated to remove/relax the impediments to new investments such as industrial licensing, public sector reservation, anti-monopoly legislation and the *Foreign Exchange Regulation Act, 1973* (FERA).

To begin with, industrial licensing was abolished for all industries except for a few on strategic, social and security considerations and the number of those requiring compulsory licensing was reduced to 18. Measures were also taken to enhance the scope for FDI and to give more freedom to the entrepreneurs to negotiate the terms for technology acquisition. Initially, FDI up to 51 per cent was allowed through the automatic route in 35 high priority and technology intensive industries.[2] This was to immediately facilitate inflow from companies which, in the earlier regime, had to reduce the foreign equity to 40 per cent under FERA and from new entrants. Importantly, there was no stipulation that the increased foreign stake in an enterprise should necessarily be accompanied by an expansion programme. It was also clarified that "Foreign equity proposals need not necessarily be accompanied by foreign technology agreements".[3] In the context of the difficult balance of payment situation dividend balancing condition[4], which had the potential to force the foreign investors to source some products from India, was introduced. However, in the very next year (1992) this condition was removed except for 22 industries in the consumer goods sector. The condition was finally done away with in 2000.[5] In 1991 the government opened all the nine manufacturing industries which were earlier reserved for the public sector, for private investment.[6] The process of reducing the protection for the small scale sector was also initiated by allowing foreign investment up to 24 per cent. The limit on the share of FDI in individual MSMEs was finally done away with and 100 per cent FDI is now allowed for small scale units.

The scope for FDI, however, got widened progressively with opening of more sectors, enhancing of the limits for foreign participation and whittling down the case-by-case approach. In the process more and more services sectors were opened to FDI. The process of opening up is continuing with multi-brand retail trade and civil aviation being the two

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2 These 35 industries were those forming the set of 'high priority' industries and were announced earlier in the *Industrial Policy Statement of 1977*.

3 *Supra* note 2.

4 The provision stipulated that cumulative outflow of foreign exchange on account of payment of dividend over a period of seven years from the date of commencement of commercial production to investors outside India shall not exceed cumulative amount of export earning of the company during those years. In case of existing companies the restriction was to apply to freshly issued shares.

5 DIPP, Press Note No. 7 (2000 Series) dated July 14, 2000.

6 Some of the important industries in this list were iron and steel, castings and forgings of steel, heavy plant and machinery required for iron and steel production, heavy electrical plants, aircraft, shipbuilding, telephones and telephones cables, telegraph and wireless apparatus.

most recent instances of service-sector liberalisation. By 2006 the entire manufacturing sector, save a few industries (on account of health, environmental and security concerns), were opened for 100 per cent foreign participation.[7] Defence industries were thrown open to the private sector in 2001. The share of FDI in these industries was limited to 26 per cent through the approval route. Subsequently, in August 2013, a new provision was introduced which allowed foreign equity beyond 26 per cent on a case-by-case basis to facilitate access to modern and state-of-the-art technology.[8]

Alongside, the terms for import of technology were also relaxed. In 1991, automatic approval was extended to foreign technology agreements in the high priority industries up to a lump sum payment of Rs. 1 crore, 5 per cent royalty for domestic sales and 8 per cent for exports, subject to total payments of 8 per cent of sales over a 10 year period from the date of agreement or seven years from commencement of production. Over the years the provisions were relaxed and at one time. In 2000, payment of royalty upto 2 per cent for exports and 1 per cent for domestic sales was allowed under automatic route on use of trademarks and brand names of foreign collaborator without technology transfer.[9] Finally in 2009 it was decided to permit payments for royalty and lump sum fee for transfer of technology and for use of brand names and trademarks through the automatic route *i.e.*, without requiring any specific government approval.[10] Other measures included restricting the application of phased manufacturing programme to the automobile sector (which too had to be withdrawn following India losing her case at the WTO). The policy shift having its genesis in the structural adjustment programme naturally focused on freer entry for FDI into the manufacturing sector while seeking to remove the conditions which could be seen as restrictive by foreign investors but which could have been justified as performance requirements. Commitments under the WTO agreements also contributed to this process. Simultaneous liberalisation of the trade regime was expected to positively influence FDI inflows.

The objective of the paper is to study FDI inflows into India's manufacturing sector at a disaggregated level with emphasis on the mode of entry as it would have implications for capital formation in the sector and market structures. Unlike most studies which use data on M&As directly which suffer from coverage and reporting issues, this study is based on classification of the actual inflows. On the other hand, it does not take into account M&As by the already existing FDI companies.

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7 DIPP, Press Note No. 4 (2006 Series) dated February 10, 2006 summarises the extant policy by giving the FDI limits in various activities.

8 DIPP, Press Note No. 6 (2013 Series) dated August 22, 2013.

9 DIPP, Press Note No. 9 (2000 Series) dated September 8, 2000.

10 DIPP, Press Note No. 8 (2009 Series) dated December 16, 2009.

2. Mode of Entry and Developmental Impact

FDI can be distinguished according to the nature of the investor, objective of investing, mode of entry, home country, sector, etc. as its developmental impact can vary significantly with those characteristics. In specific, mode of entry -- M&A and greenfield – plays an important role from the point of both capital formation and competition. While the two types of FDI (M&A and Greenfield) have differing initial impacts at least, these are not defined precisely. Even the multilateral agencies rely on data provided by private agencies. However, their concepts and coverage are open to question. UNCTAD indeed sounded a note of caution when using data from commercial agencies.[11] OECD has initiated steps to generate supplemental FDI statistics to throw light on a few relevant dimensions including M&A related FDI and others.[12] To begin with, the focus was to be only on M&As as it was felt that further research is required in case of the other modes namely, (i) greenfield investments, (ii) extension of capital and (iii) financial restructuring.[13] OECD explains the need for generating supplemental statistics on M&As in the following manner.

> Generally speaking M&As relate to existing company structures taken over fully or partially by other entities. In the context of public debate, a sharp distinction is often drawn between "greenfield" investment, providing fresh capital and additional jobs, and M&As that are perceived to include only a change of ownership in an existing corporate entity. This theoretical distinction between the types of FDI however may differ in practice *and in a number of instances the acquisition of existing enterprises can provide important additional economic benefits.* The separate treatment of M&A is part of a political reality to which investment analysts have to respond and, in light of the present debate about "strategic sectors", "national champions", etc., the need is likely to grow.[14] (emphasis added)

For many years now, M&As have been contributing significantly to global FDI flows. According to UNCTAD, the ratio of value of global cross-border M&A to the value of global FDI was as high as 80 per cent in 1999.[15] The World Bank also underlined the importance of M&As in FDI flows during the recent period.[16] The difference between the

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11 UNCTAD, *UNCTAD Training Manual on Statistics for FDI and the Operations of TNCs*, Volume 1, 2009, p. 103.

12 OECD, *Benchmark Definition of Foreign Direct Investment*, 4th Edition, 2008.

13 *Ibid*. Another categorisation of mode of entry was also attempted to group the inflows into M&A, joint venture, new plant and others. César Calderón Norman Loayza Luis Servén, "Greenfield FDI vs. Mergers and Acquisitions: Does the Distinction Matter?", *Central Bank of Chile Working Papers*, No. 173, August 2002.

14 *Ibid*, OECD, p. 31.

15 UNCTAD, *World Development Report*, 2000, p. xx. Also see: Volker Nocke and Stephen Yeaple, "Cross-border mergers and acquisitions vs. greenfield foreign direct investment: The role of firm heterogeneity ", *Journal of International Economics* Vol. 72, 2007, pp. 336–365.

16 For instance, World Bank, *International Debt Statistics 2013* notes that "[I]n common with 2010, an

contd…

initial impacts of the two modes on the host economy in terms of capacity addition and competition is obvious. It is, however, argued that in the long run there will be no difference between the two.[17] Besides experiencing productivity gains, the taken over entities could invest in greenfield projects. It is also suggested that there will be a positive effect on the overall capital formation as the selling owners will promote new ventures or invest in other businesses. On the other hand, it was noticed that there was no increase in capital formation commensurate with the FDI inflows when M&As form a major component.[18] For instance, *Global Development Finance 2001* (GDF) observed that:

> … as financial integration has progressed over time, the relationship between capital flows and investment has also declined. In particular, the association between FDI and domestic investment is seen to have been reduced in those countries where M&A have been on the rise, as they have been in East Asia and Latin America.[19]

In addition to pointing out the increased role of M&As, the GDF sought to explain the weak relationship in terms of the growing importance of offsetting transactions on the capital account, capital flight and reserve accumulation in order to safeguard against sudden capital outflows.[20] In the context of relatively large inflows on M&A account, GDF further states that much of the benefits of FDI come from "spillover effects rather than from capital accumulation effects".[21] Literature also provides evidence which suggests that the two entry modes of FDI have different implications on the host country's market competition, consumer surplus, and social welfare.[22] But, arguing against the relative preference for greenfield FDI over the M&A variety, OECD explained that

> [T]he empirical evidence suggests that the supposed advantages of greenfield investment over M&A – such as net job creation and the building of export capacities – do not figure among the main benefits of FDI. The main benefits of FDI … include productivity gains and apply generally regardless of investors' mode of entry.[23]

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important share of the 2011 investment resulted from cross-border mergers and acquisitions (M&A), which typically respond more rapidly to changes in economic conditions, but greenfield investment held steady and, importantly, two thirds of this was directed at developing countries."

17 UNCTAD, *World Investment Report, 2000: Cross-border Mergers and Acquisitions and Development.*

18 World Bank, *Global Development Finance*, 2001.

19 *Ibid*, p. 64.

20 *Ibid*.

21 *Ibid*, p. 68.

22 Larry D. Qiu and Shengzu Wang, **"**FDI Policy, Greenfield Investment and Cross-border Mergers**"**, ***Review of International Economics*,** 19(5), 836–851, 2011.

23 OECD, *International Investment Perspectives: Freedom of Investment in a Changing World*, Part I, Chapter 4, "Economic and other Impacts of Foreign Corporate Takeovers in OECD Countries", 2007.

For some time now global FDI outflows have also been characterised by a large role played by collective investment institutions and sovereign wealth funds. Further, investments by collective investment institutions and M&As have something in common as (i) investments by the former tend to get classified as acquisitions and (ii) these could be followed by actual change in the management through horizontal takeovers. Though they may be counted as FDI on the basis of the criterion of share in equity, they would lack the essential characteristics associated with FDI.[24] Also, unlike FDI which remains invested in the normal course, such investors enter the host country with a pre-set time horizon. Thus, a characterisation of the inflows on the basis of the nature of foreign investor will offer a more realistic picture of the contribution of M&A related inflows to the total inflows.

There being no unambiguous endorsement about the developmental impact of FDI, the contribution of M&A and greenfield FDI can only be discussed in relative terms.[25] The vagueness surrounding the measurement of the two types of inflows, as described in the following section, casts doubts about the validity of the observations of various studies. Only micro level studies taking into account the nature of the foreign investor, the types of owners that were replaced, mode of entry other than greenfield, possible leakages in the form of enhanced dividends resulting from increased foreign share, repatriation of capital and outward investments in general, may better explain the relative contributions of the two modes of entry. The only thing that can be said with some certainty is about the initial impact. The first step, therefore, is to identify the extent to which the inflows could have supplemented domestic investible resources.

In the following an attempt will be made to study flow of FDI into India's manufacturing sector, the prime focus of opening up in 1991 and to which technology, managerial expertise, export promotion, etc. -- the characteristics invariably associated with FDI -- are most relevant, in terms of the mode of entry and nature of the investor with a view to assess the contribution of inflows to capital formation in the sector. Given the limitations of the available data and information both at the national and global levels we can only hope to provide broad but meaningful estimates.

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[24] The widely used definition of FDI, sponsored by international agencies, which is based on a minimum share of 10 per cent in equity and devoid of reference to the nature of foreign investor tended to blur the boundaries between direct and portfolio investors on one hand and foreign and domestic investors on the other. For a discussion, see: K.S. Chalapati Rao and Biswajit Dhar, *India's FDI Inflows: Trends and Concepts*, a monograph published jointly by the Research and Information System for Developing Countries and Institute for Studies in Industrial Development, 2011.

[25] Based on a study of 16 developing countries which attracted large amount of FDI during 1980 to 1993, it was noted that, instead of complementing domestic investment efforts, FDI may well be acting as a substitute to the local efforts at promoting investment activity and it had given rise to negative net flows, in some cases of large magnitudes. See: Biswajit Dhar and Saikat Sinha Roy, "Foreign Direct Investment and Domestic Savings-Investment Behaviour -- Developing Countries Experience", *Economic and Political Weekly*, Special Number, September 14, 1996, pp. 2547-51.

3. India's FDI Inflows: The Broad Picture

With the widening of the scope for FDI, India did attract large inflows, both relative to the pre-1991 period and in absolute terms, especially since 2006. Though it remained relatively low in overall terms, the ratio of FDI inflows to gross fixed capital formation did increase over the years, and is now far higher than it was in 1990. (See *Table-1*) Some not so insignificant part of the increased inflows, can, however, be attributed to the change in the manner in which India started reporting the inflows since 2000.[26] The progressive opening up of other sectors of the economy to FDI meant diversification of objectives and the expectations from FDI. The relaxations resulted in major changes in the sectoral composition of FDI inflows; the share of manufacturing sector touched a low of about one-fifth of the inflows during 2006-2009, though data for a more recent period shows that it has climbed back to two-fifths. (See *Table-2*)

Table-1: India's FDI Inflows and their Ratios to Gross Fixed Capital Formation

Year	*FDI Inflows ($ mn.)*	*FDI inflows as a percentage of gross fixed capital formation (%)*
(1)	*(2)*	*(3)*
1990	237	0.28
1995	2,151	2.15
2000	3,588	3.27
2001	5,478	4.68
2002	5,630	4.57
2003	4,321	2.83
2004	5,778	2.69
2005	7,622	2.89
2006	20,328	6.61
2007	25,350	6.18
2008	47,139	10.83
2009	35,657	8.00
2010	21,125	3.87
2011	36,190	5.90
2012	25,543	4.27
Memorandum Items: Averages		
1991-1995	797	1.02
1996-2009	2,736	2.66
2000-2005	5,403	3.31
2006-2012	30,190	6.30

Source: Based on UNCTAD Data.

26 The additional items included reinvested earnings, equity of branches of foreign companies and other capital comprising of inter-company debt transactions. See: K.S. Chalapati Rao and Biswajit Dhar, *India's FDI Inflows: Trends and Concepts*, a monograph published jointly by the Research and Information System for Developing Countries and Institute for Studies in Industrial Development, 2011.

Table-2: Changing Shares of Manufacturing and Services in FDI Equity Inflows

(Percentages)

Sector	*2000-2005*	*2006-2009*	*2010-2012*	*2000-2012*
(1)	*(2)*	*(3)*	*(4)*	*(5)*
Services	41.92	68.36	46.18	55.95
Manufacturing	38.23	19.03	40.44	30.32
Energy	8.25	6.56	9.57	8.06
Primary (excl. Oil & Gas)	0.70	2.43	0.37	1.37
Miscellaneous	10.90	3.62	3.45	4.29
Total	100.00	100.00	100.00	100.00

Source: Based on the data provided in DIPP, *SIA Newsletter,* various issues.

While the manufacturing sector accounted for only about 30 per cent of the inflows during 2000-2012 even these were concentrated in a few industries. (*Table-3*) The top most industry in terms of FDI inflows was drugs and pharmaceuticals with $9.8 bn inflows and it accounted for as much as 17 per cent of the inflows into the manufacturing sector. Chemicals (other than fertilisers) which in fact covers a wide range of products comes next. Automobiles sector which has attracted many new entrants is the next important manufacturing industry in terms of the FDI inflows followed by metallurgical industries. Natural resource-based cement and gypsum industries also figure relatively at the top among the manufacturing industries. On the other hand, electrical equipment and industrial machinery were not only ranked very low their share in total as well as the quantum of FDI received was small.

Table-3: Major Manufacturing Industries Attracting FDI Inflows during 2000-2012

Sl. No	*Sector#*	*Amount ($ mn.)*	*Share in Inflows into Mfg. (%)*
(1)	*(2)*	*(3)*	*(4)*
1	Drugs & Pharmaceuticals	9,824.60	17.16
2	Chemicals (Other Than Fertilizers)	8,769.86	15.32
3	Automobile Industry	7,717.94	13.48
4	Metallurgical Industries	7,353.25	12.84
5	Electrical Equipment	3,095.41	5.41
6	Cement & Gypsum Products	2,632.36	4.60
7	Industrial Machinery	2,231.16	3.90
8	Miscellaneous Mechanical & Engineering Inds.	2,290.79	4.00
9	Food Processing Industries	1,694.97	2.96
10	Textiles (Including Dyed, Printed)	1,220.02	2.13
11	Electronics	1,197.52	2.09
12	Fermentation Industries	1,131.62	1.98
13	Rubber Goods	988.48	1.73
14	Paper & Pulp (Including Paper Products)	862.30	1.51
15	Prime Mover (Other than Electrical Generators)	767.94	1.34

Sl. No	Sector#	Amount ($ mn.)	Share in Inflows into Mfg. (%)
16	Machine Tools	623.85	1.09
17	Medical & Surgical Appliances	584.66	1.02
18	Soaps, Cosmetics & Toilet Preparations	511.07	0.89
19	Ceramics	506.34	0.88
20	Vegetable Oils & Vanaspati	384.01	0.67
21	Glass	371.05	0.65
22	Diamond, Gold Ornaments	381.22	0.67
23	Fertilizers	298.02	0.52
24	Printing Of Books (Incl. Litho Printing Industry)	261.11	0.46
25	Commercial, Office & Household Equipment	239.73	0.45
	Other Manufacturing (excl. Misc.)	1,049.74	1.83
	Total: Manufacturing	**57,247.91**	100.00
	Others	**1,31,357.26**	
	Grand Total	**1,88,605.17**	

This is as per the official classification. This grouping into manufacturing has been done by authors.
Source: Based on data provided in the *SIA Newsletter*, January 2013.

Often two modes of FDI entry into the host economy are referred to, *viz.*, greenfield and M&As, the former representing creation of new facilities and the latter a change in the ownership of existing facilities.[27] Officially reported M&A related inflows to India, based on the direct acquisition of existing shares by foreign investors, have generally constituted a significant part of the equity inflows. (See *Table-4*) Such inflows are, however, not being reported separately for manufacturing and non-manufacturing sectors.

It has been established in the foregoing that India's FDI inflows picked up only since 2006 following the further opening of the services sector. The manufacturing sector, the initial focus of India's FDI policy accounted for less than 1/3rd of India's FDI inflows during 2000-2012. Even these inflows were highly concentrated in a few sectors, the largest contribution coming from drugs and pharmaceuticals. While a little less than 1/4th of the equity inflows during the period were on account of acquisition of existing shares by foreign investors, their relative shares in inflows into manufacturing industries is not known. On the other hand, at the aggregate level, the ratio of inflows to gross fixed capital formation though increased progressively, the ratio remain quite low at less than 7 per cent during 2006-2012 when the inflows increased substantially. But the not so insignificant share of acquisition-related inflows, suggest that even this could be a higher estimate.

[27] The precise classification of investments as greenfield or M&As is difficult to make. Further in both cases, the extent of foreign share can vary substantially, the extreme being wholly-owned subsidiary. For a discussion on the classification-related issues one may refer to OECD, *Benchmark Definition of Foreign Direct Investment*, 4th Edition, 2008.

Table-4: Relative Importance of Acquisitions in Equity Inflows

Year	*Acquisition of Shares ($ mn.)*	*Total Equity Inflows ($ mn.)*	*Share of Acquisitions in Total (%)*
(1)	*(2)*	*(3)*	*(4)*
1995-96	11	2,144	0.51
1996-97	125	2,821	4.43
1997-98	360	3,557	10.12
1998-99	400	2,462	16.25
1999-00	490	2,155	22.74
2000-01	362	2,339	15.48
2001-02	881	3,904	22.57
2002-03	916	2,574	35.59
2003-04	735	2,197	33.45
2004-05	930	3,250	28.62
2005-06	2,181	6,276	34.75
2006-07	6,278	15,585	40.28
2007-08	5,148	24,573	20.95
2008-09	4,632	31,364	14.77
2009-10	3,148	25,606	12.29
2010-11	6,437	21,376	30.11
2011-12	11,360	34,833	32.61

Source: Based on http://rbidocs.rbi.org.in/rdocs/Publications/DOCs/155_EHS 110912F.xls and other corresponding data from RBI.

4. Classification of the Inflows

In line with the recommendations made by OECD, India, however, started reporting the inflows on account of acquisition of 'existing shares' separately since 1995-96. While these do represent the substitution of the already invested capital, they do not necessarily indicate replacement of the existing managements. This could be due to many reasons. One, the share of new investment is so small that it does not give the foreign investor sufficient voting power to replace the existing management. The new investor could be a financial investor seeking capital gains and hence may not have any interest in participating in the management.[28] Even if some of them like venture capital and private equity investors share control they will only work with the existing managements. Further, even if a few of them jettison the incumbents it will not be of a long term nature as

28 In fact, besides horizontal, vertical and conglomerate types of M&As, UNCTAD had a classification of cross-border M&As motivated by immediate financial gains and strategic reasons. Included under this category were "deals in which the acquirer is a finance company (buyout firm, venture capital company, merchant bank, commercial bank, etc.), acquiring a target firm whose main activity is non-financial".

eventually they will sell-off to others -- either another foreign or Indian entrepreneur. In the former case it will be financing the enterprise but in the end it is bound to exit, often at a very high premium resulting in large outflow and smaller net inflow.[29]

There may not be any change in control if the acquisition is by the already existing foreign shareholder to increase hold on the domestic company either by buying out the non-managerial shareholders or the joint venture partners. If the consolidation of control by the foreign shareholder is accompanied by higher dividend outgo, net addition to investible capital will not be equal to the inflows. Another important factor is the subsequent actions of the selling Indian shareholders. In case of manufacturing companies a further relevant question is whether the sellers reinvest the receipts again in manufacturing or services or invest abroad (OFDI).

An important process which the officially reported 'acquisitions' data do not capture is the inflows being used partially or fully to take over an existing Indian company through a (newly setup) holding company. The OECD *Benchmark Definition* specifically includes such acquisitions under the M&A type transaction category. It says:

> An investor (in economy A) establishes a subsidiary holding company (in economy B) to purchase existing shares issued by a target company (in economy B or C) from its shareholders.[30]

Additionally, the target company could itself have been created to takeover a business unit of an existing company. Indeed, in India some joint ventures were formed by carving out some existing businesses of local partners: contribution of the Indian partner being the business that is transferred to the joint venture without involving any cash transfers. While the case of inflows being used to acquire 'existing shares' is a straight forward one, the ones described just now are more difficult to identify particularly when existing businesses are transferred to a new company (because it will have a new year of incorporation).

The OECD *Benchmark Definition* raises some further possibilities, which make the precise classification of inflows into M&A and greenfield difficult. Thus, a simple deduction of M&A related inflows from the total inflows does not necessarily yield greenfield investments especially if one is looking for creation of new facilities. The funds could be used for capital restructuring by retiring the debt or used for working capital purposes. As

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29 The cases of acquisition of Paras Pharmaceuticals Ltd by Reckitt Benckiser and of Matrix Laboratories by Mylan illustrate this possibility. In case of Paras Pharma, against the total inflow of $157 mn on account of the participation by foreign PE investors in 2006 and $730 million by Reckitt Benckiser in 2011 to indirectly takeover Paras Pharmaceuticals Ltd, what could have remained in India after the PE investors' repatriation is $380 mn. In case of Matrix Labs, foreign PEs had a higher share than that of the Indian promoters at the time of takeover by Mylan. Obviously, much of the takeover proceeds replaced the existing foreign investors and were remitted abroad.

30 *Supra* note 13, p. 203.

noted above, the fact is that post-1991, in India, many former FERA companies increased their foreign shares either by issuing new shares or by buying out non-managerial shareholders through share buybacks.[31] A number of them even got delisted from the stock exchanges. Equity hikes in fact, formed a little more than half of the actual inflows under the automatic route till January 1995.[32]

Another persisting problem is the time factor. It is usual for the inflows to come in various tranches for the same objective. For how long after the event inflows should continue to be treated as those associated with an acquisition? A similar problem is there in case of greenfield investments. According to Direct Investment Technical Expert Group (DITEG) of IMF-OECD one view is that "an investment will cease to be classified as greenfield 4 to 5 years after the initial investment. However, there are no agreed standards on this and other related items".[33]

We have discussed a few possibilities and their implications for the mode of entry and for capital formation, in the above. The next step is to analyse India's FDI inflows keeping these possibilities in mind. We tried to classify the inflows by the type of investor, mode of entry, 'ultimate parent company' and the nature of the industry. Extensive searches were made to identify the background of the investor/investee companies especially to identify companies formed to take over existing operations, which were not reflected in the mode of inflows reported by the government or of the financial holding companies. Given the state of corporate data in India and deployment of special purpose entities (SPEs) by a number of foreign financial investors and the non-transparency of tax havens it was not always possible to accurately classify foreign investors. It has been an iterative process where each round led to some improvements. To complicate matters further, the item/activity description given by the official sources was not always helpful and at times even misleading. This could have affected the classification of inflows into manufacturing and others to some extent.

At the same time, we also believe that the supplementary information incorporated by us into the database generated from the individual inflows reported in the *SIA Newsletter*[34] would offer useful insights into the nature of FDI inflows into India's manufacturing sector during mid-2004 to the end of 2012-13. The selection of the period is solely based on the

31 One of the latest cases in this series is the buyback by Hindustan Unilever's buyback offer during July 2013.

32 See S.K Goyal, *et. al*, *Foreign Investment Approvals & Implementation Status: A Review*, a report submitted to the Ministry of Finance, Institute for Studies in Industrial Development, 1995.

33 Direct Investment Technical Expert Group, "Mergers and Acquisitions (M&As) Greenfield Investments and Extension of Capacity", Issue Papers 4, 28 and 29. IMF Committee on Balance of Payment Statistics and OECD, "Workshop on International Investment Statistics", Revised November 2004, p. 4.

34 The Newsletter is published by the Department of Industrial Policy and Promotion (DIPP) of the Ministry of Commerce and Industry. It is available at http://dipp.nic.in

availability of data on individual inflows. Incidentally, it also covers the period when India's inflows picked up substantially. (See *Table-1*) For operational convenience we have selected all those individual tranches of equity inflows which were of at least $ 5 mn. The overall number of entries was 56,104 and the amount was $174.44 bn. Those amounting to $5 mn or more (which we term as large tranches) were 5,029 covering a total inflow of $140.47 bn. Thus, the coverage of large tranches in total was about 80 per cent. Out of these, 1,594 were identified as belonging to the manufacturing sector and the corresponding inflows were $50.57 bn or about 36 per cent of the large tranches. The number of investee companies, after taking note of known name changes, is 870. It needs to be underlined that the official data only gives gross inflows and do not refer to divestments or replacement of the already existing foreign investments by other foreign investments nor there is information on foreign shares.

At this stage, it will be relevant to underline that data on India's FDI inflows suffer from a major limitation: it does not follow the international norm. UNCTAD explained this (obviously based on Indian official inputs) in the following manner.

> …, in India this [the 10% criterion] has not been strictly adhered to. Irrespective of the extent of holding in a particular company, it is considered as an FDI if the non-resident acquires shares in a company other than by way of acquisition from the stock market …[35]

Therefore, we had to make certain assumptions while classifying the inflows. Going both by the official description as also their names, we have classified the foreign investors into different categories. Whenever the foreign investor (or its parent) was found to be in the manufacturing sector we have classified it as realistic FDI (RFDI). Since information on foreign shares, representation on the board, shareholder agreements, etc. is even harder to obtain, we assumed that foreign investors belonging to the manufacturing sectors have the potential to offer the advantages expected from FDI. All such investments have been classified as RFDI into the investee manufacturing companies.[36] The remaining ones have been classified into the following categories.

(i) PE-VC (Private Equity/Venture Capital/Hedge Funds/Sovereign Wealth Funds);
 — these were further classified into those founded by Indians and others
(ii) Other Portfolio (Mutual Funds/ Banks/FIIs/etc.);
(iii) Investments controlled by Indians (ICIs)[37]; and
(iv) NRIs (individuals and OCBs)

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35 UNCTAD, *Investment Country Profiles: India*, March 2013, p. 1.

36 For an elaboration of this approach one may refer to K.S. Chalapati Rao and Biswajit Dhar, *India's FDI Inflows: Trends and Concepts*, 2011.

37 Groups like Vedanta, Essar and Hinduja fall in this category.

A few remained unclassified. Interestingly, out of the 870 investee companies, 547 received only what we have termed as RFDI. Another 302 did not receive any RFDI. Only 21 companies received varying amounts of RFDI. These companies received investment from other types of foreign investors also. (See *Table-5*) We feel that such clear polarization reflects the representative character of the classification. Out of the 21, some were listed on the Indian stock exchanges. It is understandable that non-RFDI investors could have invested in these companies following some rights offer. A few others received PE-VC investments. In their case it is possible that the PE-VC investments that had been received earlier were subsequently replaced by RFDI which means that RFDI substituted foreign PE-VC investments within this study period.[38] To that extent the net inflows would be lower than the reported inflows. In case of the 302 companies which received no RFDI, the major investors were the PE-VC category followed by Indian promoters. Other foreign portfolio investors and NRIs too had important shares. Thus, there is very little interface between RFDI and other forms of inflows. This also means that in case of as many as 302 companies there was no question of direct technology transfer. While Indian promoters and NRIs may retain their shares for the long term, about 14 per cent of the inflows cannot be treated as long-term. They may at best revolve in and out of India with part of the capital gains that were taken out of the country coming back as larger amounts. The nearly

Table-5: Distribution of Investee Manufacturing Companies According to the Type of Inflows/Investors (September 2004 to March 2013)

(Amount in $ mn.)

Investee Companies Receiving	*No. of Cos.*	*Type of Foreign Investor*					*Total (Incl. Unclassified)*
		RFDI	*PE-VC**	*Other Portfolio*	*Indian Promoters*	*NRIs*	
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
RFDI Only	547	35,773					35,773
RFDI + other Investments	21	1,974	399	151		153	2,690
No RFDI	302		4,619	2,065	3,948	1,389	12,120
All companies	870	37,747	5,018	2,216	3,948	1,542	50,573
Share in Total (%)		**74.64**	**9.92**	**4.38**	**7.81**	**3.05**	**100.00**

* Including those founded by Indians.

Source: Based on own classification of the individual tranches of inflows each amounting to at least $5mn from among the inflows reported in the *SIA Newsletter* for the period September 2004 to March 2013.

38 For instance, prior to takeover of the company by Schneider Electric of France in 2011, Luminous Power Technologies Ltd had investments from private equity investors.

10 per cent of the investments by the PE-VC category could also be the forerunner for subsequent change in management and larger outflows.

Classification of the investments according to the type of foreign investor shows that nearly three-fourths of the inflows fall into the RFDI category. (See *Table-6*) Most of the RFDI went into medium and high technology industries[39] followed by medium low and low technology industries in that order. Medium high technology category also attracted PE-VC investments and other portfolio investments the most. India related investors were more focused on medium low technology industries. NRIs also behaved somewhat

Table-6: Investor Type and Technology Level-wise Classification of Inflows into the Manufacturing Sector (September 2004 – March 2013)

Type of Investor	*Technology Classification**				
	High (HT)	*Medium High (MHT)*	*Medium Low (MLT)*	*Low (LT)*	*Total*
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
A. Amount ($ mn.)					
RFDI	12,008	13,828	7,540	4,371	37,747
PE-VC (incl. Indian promoted)	877	2,121	1,162	858	5,018
Other Portfolio	417	1,165	435	199	2,216
Indian Promoters	33	554	2,857	504	3,948
NRIs	118	344	767	313	1,542
Unclassified		6	72	25	103
Total	**13,453**	**18,018**	**12,832**	**6,270**	**50,573**
(Share of FDI in the category)	*(89.26)*	*(76.75)*	*(58.75)*	*(69.71)*	*(74.64)*
B. Shares (%)					
RFDI	31.81	36.63	19.98	11.58	100.00
PE-VC (incl. those promoted by Indians)	17.48	42.27	23.16	17.09	100.00
Other Portfolio Investments	18.82	52.57	19.63	8.98	100.00
Indian Promoters	0.84	14.03	72.37	12.76	100.00
NRIs	7.65	22.31	49.74	20.30	100.00
Unclassified		5.83	69.90	24.27	100.00
Total	**26.60**	**35.63**	**25.38**	**12.39**	**100.00**

* Technological intensity classification is based on: OECD, Directorate for Science, Technology and Industry, *Stan Indicators*, (2005 edition), 1980-2003, http://www.oecd.org/industry/ind/40230754.pdf

Figures in brackets represent the share of FDI in different technology intensity classifications.

Source: See Table-5.

[39] OECD, ISIC Rev. 3 Technology Intensity Definition, 7 July 2011. Accessed at http://www.oecd.org/sti/ind/48350231.pdf

similarly as almost half of their investment was in this group. Unclassified ones, though quite small in amount, reflected the behaviour of NRIs thereby suggesting that these could have originated from NRIs/Indian business groups and thus are not part of RFDI or other portfolio categories.

5. Acquisition-Related Inflows

Going by the official data, inflows on account of acquisition of existing shares were more prominent in the manufacturing sector. While the overall share was 22.52 per cent, for manufacturing the share was about 29 per cent and for the rest it was 19 per cent. To arrive at a more realistic picture of the acquisitions in the manufacturing sector, we have clubbed together three types of inflows into the acquisition-related category: (i) all those reported officially under the category 'acquisition of existing shares'; (ii) those that were indirectly used to acquire existing businesses[40]; and (iii) additional equity capital that was provided to the acquired companies by the foreign investors (e.g. $722 mn. invested in Ranbaxy by Daiichi).[41] Investments into new joint ventures were not included under this category. Similar is the case with strategic investments into existing companies even though they may not lead to/result in immediate capacity expansion.[42] But if the JV was formed through transfer of an existing business the inflow was treated as acquisition-related. There could still be some acquisitions which we might not have been able to identify. A similar exercise was not attempted for inflows into sectors other than manufacturing. The results are presented in *Table-7*. Following the reclassification of inflows, share of acquisitions increased substantially from 28.64 per cent to 46.65 per cent in case of manufacturing sector. In case of high technology industries, the share doubled from 40 to 80 per cent.

[40] For instance Abbott acquired Piramal Healthcare through Abbott Healthcare Pvt Ltd. Similarly, the funds deployed in the acquisition of Paras Pharma were routed through Reckitt Benckiser Investments (India) Pvt Ltd. Both these are not reported under the acquisition category by the official sources.

[41] Daiichi's takeover of Ranbaxy presents an interesting case. The *SIA Newsletter* for different months does not show substantial investments in Ranbaxy by Daiichi. The SIA Newsletter Annual Issue for the year 2011, however, has four entries corresponding to this acquisition among the Top Inflows from Japan. All were supposed to be under the automatic route. Prowess, however, shows a private placement entry for Ranbaxy with a total investment of Rs. 3,409.22 crore. In the subsequent quarterly filing of the shareholding pattern (quarter ending December 2008), the promoter family shareholdings were replaced by those of Daiichi. Our understanding is that though all the four tranches were supposed to be under the automatic route the remaining three must correspond to the acquisition of the erstwhile promoters. Hence the three were treated as inflows under the acquisition route and the remaining one as additional investment in the company by Daiichi. Similar inconsistencies in classification for instance could be found in case of Matsushita-Anchor, Hitachi-Telco Construction, Krosaki Harima-Tata Refractories.

[42] Investment of JFE Steel of Japan in JSW Steel Ltd is a case in point.

Table-7: Predominance of Acquisitions in the Manufacturing Sector

Sector	*Share of Acquisition-Related Inflows (%)*	
	Official	*Classified by us*
(1)	*(2)*	*(3)*
Manufacturing: Total	**28.64**	**46.65**
Of which,		
- High Technology (HT)	40.16	80.47
- Medium High Technology (MHT)	26.48	34.36
- Medium Low Technology (MLT)	23.62	37.94
- Low Technology (LT)	20.40	27.22
Others	**19.42**	
All Sectors	**22.52**	

Source: See Table-5.

It can be seen that at 46.65 per cent, acquisition-related investments were close to half of the total inflows into the manufacturing sector. In case of RFDI, the share of acquisitions worked out relatively higher at 53.72 per cent. Though bulk of this was classified as such by the official agencies, the amounts classified by us also formed a significant part of such inflows. Additional inflows into the acquired companies, which were not directly involved in the takeover process, were the smallest among the three categories. (*Table-8*) Thus, even if such inflows are not considered, acquisition-related inflows would still account for a very high proportion of RFDI. In case of PE-VCs and India related promoters also officially classified acquisition-related inflows did contribute substantially to their respective investments -- one-fourth and half respectively.

While it does appear that not only the acquisition-related inflows accounted for a significant part of the total inflows into the manufacturing sector, they also have influenced the year-to-year changes. The relationship is stronger in case of the inflows categorised as RFDI. This suggests that it was not a one-off phenomenon. *Table-9* shows the annual inflows categorised as RFDI and the corresponding acquisition-related inflows. In some years, the latter accounted for 60 to 70 per cent of the total. However, the relationship turns out to be even more pronounced when year-to-year changes are analysed. In all the years, the direction was the same. Except for 2007-08, acquisition-related RFDI was not at least two-thirds of the total RFDI. Fluctuations in non-acquisition-related inflows were far less pronounced than those by the acquisition-related ones. (See *Graph*)

Table-8: Distribution of Inflows into the Manufacturing Sector according to the Mode of Entry and Nature of Investor

(Amount in $ mn)

Objective of the Inflow	*Nature of the Investor*						*Total (Including others)*	*Share in Total (%)*
	RFDI		*PE-VC*	*India-Related*	*Other Portfolio*	*NRIs*		
	Amount	*Share (%)*						
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
Acquisition of Existing Shares (Official)	11,172	29.60	1,256	1,954	91	6	14,485	28.64
Acquisition-Related Inflows (classified by us)	5,971	15.82					5,971	11.81
Additional Inflows by the acquirers into the Acquired Cos.	3,134	8.30					3,134	6.20
Sub-Total	*20,277*	*53.72*	*1,256*	*1,954*	*91*	*6*	*23,590*	*46.65*
Additional Inflows into Older FDI Companies	155	0.41					155	0.31
Strategic Investments	219	0.58					219	0.43
Joint Ventures	23	0.06					23	0.05
Others	17,073	45.23	3,762	1,993	2,125	1,536	26,586	52.57
Total	**37,747**	100.00	5,018	3,948	2,216	1,542	**50,573**	100.00

Source: See Table-5.

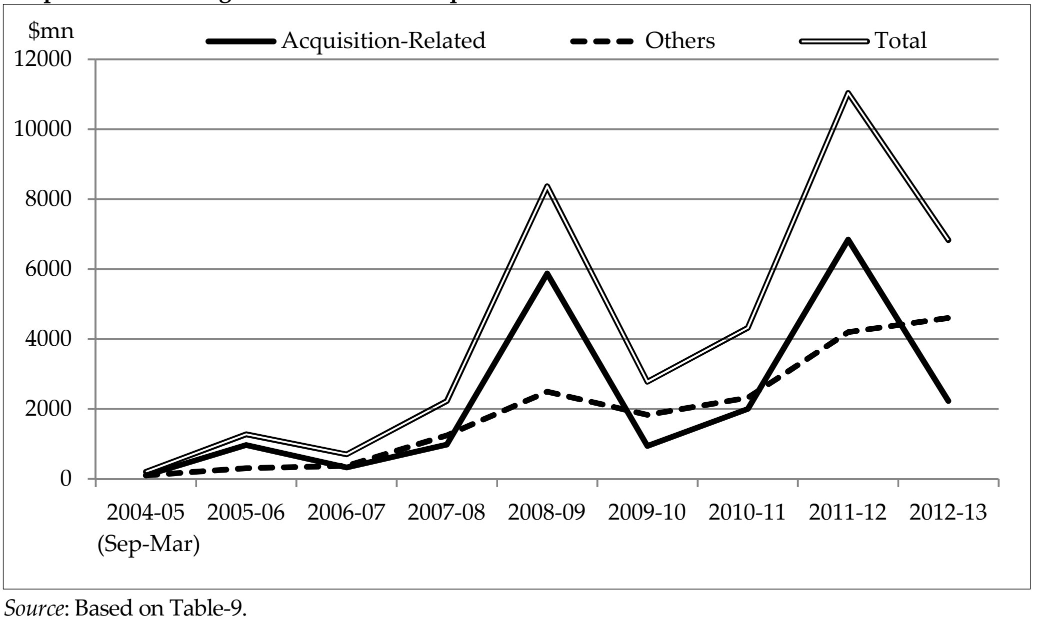
Table-9: Contribution of Acquisition-Related Inflows to Inflows Categorised as RFDI

(Amount in $ mn)

Year	*RFDI Inflows*		*Share of Acquisition-Related Inflows (%) (2)/(3) x100*	*Increase/Decrease in Acquisition-related RFDI over the Previous Year*	*Increase/Decrease in RFDI over the Previous Year*	*Ratio of Increase/ Decrease in Acquisition-related inflows to Increase/Decrease in RFDI*
	Acquisition-Related	*Total incl. Others*				
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
2004-05 (Sep-Mar)	102	202	50.21			
2005-06	971	1,276	76.15	870	1,073	0.81
2006-07	329	704	46.69	-643	-572	1.12
2007-08	984	2,228	44.18	656	1,524	0.43
2008-09	5,873	8,369	70.18	4,889	6,142	0.80
2009-10	944	2,777	34.01	-4,929	-5,593	0.88
2010-11	2,003	4,323	46.34	1,059	1,546	0.68
2011-12	6,842	11,038	61.98	4,839	6,715	0.72
2012-13	2,229	6,830	32.63	-4,613	-4,208	1.10
Total	20,277	37,747	53.72			

Source: See Table-5.

Graph: RFDI Moving in Tandem with Acquisitions



Source: Based on Table-9.

It was seen in the above (*Table-6*) that medium high (MHT) and high technology (HT) industries accounted for 62.23 per cent of the reported FDI inflows and for a slightly higher share of RFDI at 68.44 per cent. It is relevant to note that 80.47 per cent of the inflows into HT industries were on account of acquisitions. (*Table-10*) If only RFDI is considered, their share was even higher at 87.46 per cent. Further, investment in HT industries was overwhelmingly concentrated in Pharmaceuticals (82.95%) and Radio, TV and Communications equipment (12.97%). The corresponding shares of acquisition-related inflows were as high as 92 per cent and 79 per cent respectively. It is thus obvious that RFDI could not have contributed significantly to capacity creation in HT industries. Incidentally, pharmaceutical industry received the maximum amount of FDI.

Share of acquisition-related inflows was somewhat lower in other technology categories. Among the MHT industries, automobiles industry and non-electrical machinery & equipment had smaller shares of acquisition-related inflows. The case of automobiles may be understandable because India, at the time of opening up, had a limited base. However, acquisitions accounted for nearly three-fourths of the RFDI into electrical machinery & apparatus. Acquisitions played an important part in the chemical industry as well. One needs to look closely into inflows into the non-electrical machinery industry to understand the possible contribution of the inflows. Obviously, RFDI other than through the M&A route was so small that (annual average of $86 mn) it could not have made a significant difference to the overall investment in the sector.

Table-10: Share of Acquisition-Related Inflows in Different Categories of Technology Intensity

ISIC Rev. 3 Code	*Technology Category/Industry*	*Inflows ($ mn.)*			*Share in Respective Group Total (%)*	*Acquisition-Related Inflows*	*Share of Acquisition-Related Inflows (%)*	
		Total	*Of which,*				*Total**	*Only RFDI#*
			RFDI	*Indian Promoters*				
(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
I.	**High Technology (26.60%)**	**13,452**	**12,008**	**33**	**100.00**	**10,825**	**80.47**	**87.46**
2423	Pharmaceuticals	11,158	10,038	17	82.95	9,535	85.45	91.91
32	Radio, TV and communications equipment	1,745	1,488	15	12.97	1,190	68.21	78.94
33	Medical, precision and optical instruments	360	301		2.68	101	27.97	33.42
30	Office, accounting and computing machinery	171	171		1.27			
353	Aircraft and Spacecraft	18	9		0.13			
II.	**Medium High Technology (35.66%)**	**18,018**	**13,828**	**554**	**100.00**	**6,196**	**34.36**	**39.48**
34	Motor vehicles, trailers and semi-trailers	6,811	5,771	223	37.77	1,177	17.28	17.93
31	Electrical machinery and apparatus, n.e.c.	3,711	2,958	101	21.74	2,267	57.83	72.10
29	Non-Electrical Machinery & Equipment, n.e.c.	3,080	2,331	87	16.00	869	29.75	33.32
24	Chemicals excl. Pharmaceuticals	2,924	2,026	142	16.22	1,372	47.52	60.48
352+359	Railroad equipment and transport equipment, n.e.c	1,492	742		8.28	512	34.20	39.00
III.	**Medium Low Technology (25.35%)**	**12,833**	**7,540**	**2,857**	**100.00**	**4,863**	**37.94**	**42.55**
27-28	Basic metals and fabricated metal products	6,963	3,181	2,164	54.21	1,667	23.99	13.17
26	Other non-metallic mineral products	3,526	3,102	24	27.51	2,735	77.56	85.78
23	Coke, refined petroleum products and nuclear fuel	1,162	447	663	9.06	378	32.50	8.55
25	Rubber and plastics products	1,058	780	6	8.25	77	7.21	13.71
351	Building and repairing of ships and boats	124	30		0.96	8	5.78	0.00
IV.	**Low Technology (12.40%)**	**6,270**	**4,371**	**504**	**100.00**	**1,707**	**27.22**	**25.35**
15-16	Food products, beverages and tobacco	3,980	3,253	90	63.48	588	14.77	12.00
17-19	Textiles, textile products, leather and footwear	1,067	564	19	17.02	282	26.42	43.17
20-22	Wood, pulp, paper, paper products, printing & publishing	886	395	382	14.14	688	77.66	82.51
36-37	Manufacturing, n.e.c	336	160	13	5.36	149	44.24	93.17
	Total	**50,573**	**37,747**	**3,948**		**23,590**	**46.65**	**53.72**

Figures in brackets in column (2) represent the relative shares of the technology categories in the total inflows.

* Represents the share of total inflows on account of acquisitions in total inflows.

Represents share of acquisition-related RFDI in total RFDI.

Source: See Table-5.

In the MLT industries, the share of RFDI was relatively lower at 58.75 per cent. The share of acquisition-related RFDI was quite small in case of basic metals and fabricated metal products and coke, refined petroleum products and nuclear fuel at 13.17 per cent and 8.55

per cent respectively. Incidentally, these two industries received substantial investments from companies controlled by Indians. Share of acquisition-related FDI, however, again was very high in case of other non-metallic mineral products at 85.78 per cent. This is a reflection of the foreign acquisitions of a number of cement manufacturing companies. Share of the remaining industries in the MLT category was quite small and acquisitions played a minor role in their case. Within the LT industries which had the lowest share in the inflows into the manufacturing sector, food products industry received bulk of the investments (63.48%) and most of it is of the non-acquisition variety represented to a considerable extent by fresh investments by Coca-Cola. Since this investment came long after the acquisition of the soft drink business of Parle group by the company, we did not classify it as acquisition-related.

Since most of the inflows went into buying out the existing owners, they might not have added to the investible resources of the acquired companies. If the acquired shares were already held by foreign investors like private equity and venture capitalists, there would not have been net addition to capital in India either. On the other hand, the subsequent investments in greenfield projects by the acquired private sector companies may not necessarily be financed by additional inflows because the taken over companies could be holding substantial reserves.[43] Most possibly, the seller would also have utilised the same for expansion purposes had they continued to own the companies. Often, non-compete clauses prevent the exiting entrepreneurs from continuing/re-entering the same line of activity for a certain minimum period.[44] Whatever might be the reason the sale proceeds of Ranbaxy Laboratories, Matrix Labs, Piramal Healthcare and Paras Pharmaceuticals were not ploughed back into manufacturing in India, so far.

It needs to be underlined here is that not all non-M&A inflows might have resulted in new full-fledged production capacities or their continuation. The cases of Samsung India Electronics and Sony India may illustrate this. Sony India Pvt Ltd, a wholly foreign-owned company, shut down its manufacturing operations in 2004-05 and is now engaged mainly in selling imported products and software development. The closing down of its plant in Dharuhera is said to be fallout of India's FTA with Thailand.[45] Samsung India Electronics Pvt Ltd falls into a similar if not identical category. The company's annual reports suggest that the ratio of 'Own production' sales to sale of 'Traded items' was roughly 1.3:1. However, imported raw materials and components constitute about three-fourths of total consumption, thereby making it more of an assembler rather than a manufacturer. The

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43 For instance, Matrix Labs, taken over by Mylan, held reserves of nearly Rs. 2,500 crore, at the end of 2012-13. Its further greenfield expansion could as well be financed out of these funds.

44 While one does not know how long the Parle group was forced to refrain from re-entering the soft drink industry, it is only recently, after a gap of nearly two decades, the group has announced plans to re-enter the industry.

45 "Sony India's CTV Prodn in Freeze Frame", http://www.financialexpress.com/news/sony-indias-ctv-prodn-in-freeze-frame/111259.

company also engages in software development. Incidentally, Samsung pays huge amount of royalty to its parent company – the outgo on this account alone during the just two years 2010-11 and 2011-12 exceeded the company's paid-up capital of Rs. 217 crore. Imports are quite large and for 2011-12 they were about Rs.12,500 crore. Such 'greenfield' investments obviously do not yield the benefits expected from FDI.

It is also necessary to reiterate that not all the inflows can really be termed as FDI in the sense it is meant. Out of the 870 companies, which received inflows of at least $ 5mn inflows during the study period, as many as 302 did not receive *any* FDI. Some of it may be of the long-term nature. But, this alone cannot help in technology transfer, productivity gains and spillovers. While the blame mainly lies with the application of 10 per cent thumb rule for the mis-identification of FDI, it is compounded by India's practice of treating every inflow, other than that through the stock market, as FDI.

Overall, acquisition-related inflows accounted for a little less than half of the inflows, the proportion being generally higher in case of RFDI. It is thus evident that during the past decade or so when India's reported FDI inflows picked up significantly, there might not have been capacity creation in the manufacturing sector commensurate with the quantum of reported inflows especially in what are termed as high and medium high technology industries except the automobile sector. Many leading as also emerging companies with great potential were picked up by foreign investors. The process has also been facilitated by PE-VC investors. When acquisition of shares was meant to consolidate control, it is more likely that larger amounts of dividends would have been remitted thereby depleting the investible resources. On the other hand, not all the remaining could have resulted in real capacity addition.

6. By Way of Summing Up

India's strategy towards FDI in the post-1991 period has been to attract large amount of FDI by offering it freedom of entry and operation. Relaxation of the trade regime was expected to act as a further incentive for foreign investors. However, India failed to attract the desired quantum of FDI into the manufacturing sector, the prime focus of 1991 policy shift. Evidence presented in this paper suggests that even this amount may not have resulted in commensurate capacity creation. Consolidation of hold by foreign companies by reversing the effect of FERA was an important facet of the inflows in the initial years. Since there was no requirement for this process to be accompanied by any expansion programme, while not contributing to capacity creation, the investments could have been subsequently ploughed back through a variety of payments including larger share in dividends or were utilised in the restructuring of group entities and takeover of unrelated ones within India.

For the period since the latter half of 2004-05, going by the official criterion, acquisitions accounted for 29 per cent of large tranche inflows into the manufacturing sector compared to 19 per cent for services and others. If only what one can call realistic FDI, as much as 54 per cent of what went into the manufacturing sector was acquisition-related. It seems that leading companies in high and medium technology industries as also newly emerged ones which had already made their mark and established consumer goods companies are also on their radar.[46] The fact that the inflows had come to depend upon acquisitions to a large extent is something that has been missed probably due to the excessive emphasis on the quantum of FDI.

The prevalence of acquisitions in pharmaceuticals shows that they could be sector-specific and thus may be indicative of the uncertain future foreseen by the Indian entrepreneurs in the changed policy environment. The progressive loss of control has raised many concerns relating to access, affordability, appropriate research, etc. But then what factors explain sell-off of low-technology, long established consumer brands to foreign enterprises?[47] Some of them may be finding it difficult to break into the next stage or to face competition due to lack of access to finances of the required magnitude or the offer was too tempting. On the other hand, even if they could secure finances from PE-VC investors, the terms were so stiff that the recipient had no option but to sell-off more often than not. Access to long term finance from domestic financial institutions could have probably averted this situation.

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[46] For instance, Biosync Scientific, a designer and developer of innovative interventional cardiology products, including cardiovascular stents was acquired by MIV Therapeutics, USA in 2007. The acquiring company's release said:
"Biosync Scientific not only *contributes a highly competitive CE Mark stent platform* that complements our revolutionary polymer-free drug-eluting coatings, but also the leadership, expertise and experience of Mr. Vaishnav, one of India's most respected and well known stent authorities … We welcome Mr. Vaishnav and his team to the MIVT family, and we look forward to *continuing to build our brand* in one of the world's fastest-growing markets." (emphasis added)
http://www.drugs.com/news/miv-therapeutics-completes-acquisition-biosync-scientific-expand-operations-accelerate-5346.html
Mr. Vaishnav, founder of the company and who was responsible for developing many of the leading bare-metal and drug-eluting stents, turned himself into the Chief Executive Officer of Biosync Scientific.
Schneider Electric, France of made a series of acquisitions which included some leading local businesses. These were: Luminous Power Technologies Ltd, a leader in the inverter and secured power market; Digilink Business, leading structured cabling systems provider (including manufacturing) of Smartlink Network Systems; APW President Systems Ltd; Building Solutions and Special Projects business of Zicom Electronic Security Systems; Uniflair India Pvt Ltd; Areva T&D India; Meher Capacitors Pvt Ltd (leader in Power Factor Correction); Conzerv Systems Pvt Ltd (leader in Metering & Energy audit); S&S Switchgear; and Low tension control gear division of Crompton Greaves (CGLV).

[47] For instance, MTR Foods Pvt Ltd. was taken over by Orkla, a Norwegian company. Orkla further acquired Rasoi Magic Foods (India) Pvt Ltd through MTR Foods Pvt Ltd. McCormick of USA got into Eastern Condiments Ltd (Spices), AVT group (spices) and Kohinoor Foods (basmati rice and food products). The acquisition of Parle's brands by Coca-Cola was the earliest prominent case of established Indian companies making way for large foreign companies.

Privatisation not being the main vehicle for M&A related inflows in India, it reflects quite adversely on the state of the India's private sector. Instead of focusing on FDI, the policy makers need to address the problems faced by the domestic enterprises.[48]

Acquisition-based inflows, which during the past decade constituted a significant proportion of the total inflows, unaccompanied by substantial capacity expansion, may not help India achieve the objective of increasing the share of manufacturing in GDP. This implies that the expected benefits from FDI inflows have remained limited as this form of capital would not have contributed to the expansion of India's manufacturing base. Efficiency and productivity gains, which are advanced as the main benefits of M&A alone cannot serve India's objective of faster growth of the manufacturing sector. Instead of taking comfort from additions to gross inflows the need is to analyse the contributing factors for the sell-offs and devise ways to strengthen Indian entrepreneurs. Surpluses from domestic enterprises could have a larger effect on investment and growth as they are more likely to remain within the economy. The extensive support in favour of developing domestic enterprises including on the grounds of absorptive capacity for spill overs provides further justification to such an approach.

When India's need is to expand the manufacturing base, the freedom of entry and operation to foreign investors without accompanying performance requirements led to inflows that did not add substantially to its capacities. The cases of pharmaceuticals, electronics and automobiles underline the fact that the FDI policy, instead of following a hands-off approach, need to dovetail other policies, especially the trade policy, to deliver the desired outcomes. On the other hand, the expected efficiency gains were not translated into large net trade balances. Indian subsidiaries of foreign companies in most manufacturing activities run a huge negative trade balance.[49] To this if other forms of

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48 Even Williamson, the author of Washington Consensus, noted that the revised proposals were meant to indicate the direction the policy should go "without trying to tell countries exactly which reforms are needed, or most urgent, or how they should be done". He then added: [t]hose are tasks for national policy-makers, whom we aim to assist, *but not absolve from thinking*, with our new agenda." (emphasis added) See: John Williamson, "The Strange History of the Washington Consensus", *Journal of Post Keynesian Economics*, Winter 2004–05, Vol. 27, No. 2 195, p. 205. Earlier he mockingly said: "[t]he main motivation for restricting FDI is economic nationalism, which Washington disapproves of, at least when practiced by countries other than the United States. See: John Williamson, "What Washington Means by Policy Reform", http://www.iie.com/publications/papers/paper.cfm?researchid=486#3.

49 The foreign subsidiaries operating in the manufacturing sector, even after exclusion of coke and petroleum products, are net losers on trade account in 2012-13. Their contribution to manufacturing trade deficit in 2012-13 was about Rs. 1,10,000 crore. Besides the obvious 'coke and refined petroleum products', the biggest losers are 'computer, electronic and optical products', 'basic metals' and 'electrical equipment'. This observation is based on: Reserve Bank of India, "Annual Census on Foreign Liabilities and Assets of Indian Companies: 2012-13", *RBI Bulletin*, February 2014, pp. 107-112. An earlier study also noted that the balance of payments effect of foreign subsidiaries was

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foreign exchange outgo like dividends, royalty payments etc., and which have acquired prominence over the recent past are added, foreign companies would be net losers of foreign exchange of a large magnitude. The acquisitions can only accelerate that burden.

Unlike most studies which approach the issue from the broad data on acquisitions, the present study based on actual inflows sought to throw light on the possible contribution of FDI to the growth of the Indian manufacturing sector. It made some attempts at overcoming the weaknesses of the official data by identifying the inflows meant for acquisitions rather than mere acquisition of existing shares, which approach was also advocated by the OECD. The next stage would be to look more closely at the individual cases to understand the possible motives of the sellers, their subsequent actions and subsequent behaviour of taken over companies to help evolve appropriate policy prescriptions.

negative. See: S.K. Goyal, "Impact of Foreign Subsidiaries on India's Balance of Payments", a study prepared for the UNCTC-ESCAP, Bangkok, Indian Institute of Public Administration, 1979.

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