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MULTINATIONALS FROM DEVELOPING COUNTRIES:

THE CASE OF INDIA

by

Anita Mathur ©

A thesis
submitted to the Faculty of Graduate Studies and Research
in partial fulfilment of the requirements for the degree
of Doctor of Philosophy.

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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research, for acceptance, a thesis entitled MULTINATIONALS FROM DEVELOPING COUNTRIES: THE CASE OF INDIA submitted by ANITA MATHUR in partial fulfilment of the requirements for the degree of Doctor of Philosophy.

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To my parents

ABSTRACT

The internationalisation of economic activity has taken new and dynamic forms in recent years. Of these, perhaps the most dynamic and least expected has been the emergence of multinationals from several developing countries. However, to date, specialists in this area have made little systematic contribution to our understanding of this intriguing, and rather important aspect of the development process in some countries of the Third World. We are still without a comprehensive picture of the phenomenon of Third World multinationalism. Particularly, questions relating to the motives for direct foreign investment have neither been systematically asked nor explored. This project has been directed at doing some of that work. The study has sought to capture the essence of Third World multinationals by laying out those characteristics that appear to be common to such firms, the investment strategies pursued by them, and the character of their operations. More importantly, this study has tried to explore and understand the motives that underly these international ventures. Most of the studies in the field seem content to note the multiplicity of economic factors as the cause of direct foreign investment to the neglect of domestic political factors. We have strongly rejected such a narrow economistic stance for a broader political-economy analysis.

To help fill part of this sizeable gap in our knowledge, this study has concentrated on a single developing country - India and Indian multinationals. An international level explanation is only convincing when it can be shown that similarly situated states respond similarly to external constraints and opportunities. Since this is not true, more systematic attention has been focused on the particular characteristics of the Indian state, domestic politics, domestic market characteristics, interests and

strengths of domestic capital, the relationship between state and industry, and foreign policy of the state: in short on the political and economic structures from which the Indian multinationals originate.

The approach thus begins by identifying the system-structures relevant to this phenomenon. After going on to determine the major factors and the structures shaping this process, an attempt has been made to infer from their particular character possible explanations of the process of direct foreign investment. This study identifies three sets of factors international, national, and firm-specific. Thus, an understanding of Indian multinationals has been approached with sufficient regard for the different phases of the international economy, the international constraints and opportunities, the specificities of the home country, the macro-political and economic environment, and the contribution of specific organisational and institutional arrangements. A major hypothesis of the study is that a complementarity of interests has evolved between the Indian corporations and the Indian government as both view the foreign expansion of Indian capital as serving important national interests.

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Sep. '89 Anita Mathur

Edmonton

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CHAPTER 1

INTRODUCTION

The Problem

The familiar picture of the international system, which has dominated the perceptions of both researchers and policy-makers for decades, depicts a strict hierarchy of countries in the international division of labour organized around a dichotomy of a few highly developed countries supplying the bulk of the world's manufactured goods on the one hand, and the developing countries supplying primary products on the other. This hierarchical international division of labour between geographical regions is seen to correspond somewhat to the vertical division of labour within one of the the most impressive symbols of capitalist development - the multinational corporation.[1]

In the last two decades, cracks have begun to show in this picture. As O'Brien puts it, "Bits and pieces of evidence, of diverse kinds and from several places, suggest that the hierarchical pattern is becoming a bit blurred, with Southern entities starting to operate in economic territories hitherto regarded as the strict preserve of entities located in the North."[2] These 'Southern' entities refer to the corporations based in the Third World with an increasingly international scope of operations. Third World multinationals appear as a contradiction in terms, particularly if one examines much of the post-World War II literature in international business and trade where multinational companies are seen as part of a phenomenon originating in the West, exploiting cheap labour in poorer countries and bullying 'dependent' host governments. Heenan and

[1]Stephen Hymer, "The Multinational Corporation and the Law of Uneven Development," in J. Bhagwati (ed.), **Economics and World Order**, Macmillan Company, New York, 1972, p. 113-135.
[2]Peter O'Brien, **International Flows of Technology**, United Nations Industrial Development Organization (UNIDO), Vienna, 1979, p. 116.

Keegan, taking a somewhat diametrically opposite view with regard to Third World multinationals, comment, "The multinational corporation, long regarded by its opponents as the unique instrument of capitalist oppression against the impoverished world could prove to be the tool by which the impoverished world builds prosperity...Third World multinationalism, only yesterday an apparent contradiction in terms, is now a serious force in the development process."[3]

Based primarily in the newly industrialised countries, Third World multinationals have expanded rapidly from a few hundred in the 1960s to several thousand today.[4] Although some of these firms have established subsidiaries in industrialized countries, most of their investments have gone to the other developing countries. These firms now operate in almost every major sector of the world economy, and all available indicators suggest that they will continue to grow in the future.[5] Thus, one thing we can be certain of: "Whether viewed as a threat or an opportunity, this young phenomenon is to be reckoned with."[6]

Yet our knowledge of this recent and rapidly evolving phenomenon of Third World multinationalism is still rather anecdotal. We lack a comprehensive picture of this trend. Where do these Third World multinationals come from? What are the dimensions of this phenomenon? What are the factors responsible for it? How many of these Third World multinationals are there? How significant are they in the economies of the host countries? What are the likely consequences of this phenomenon in broader geo-political as well as more narrow economic terms? In what follows, we shall attempt

[3] In Chapter 3 we shall examine in brief the developmental implications of this phenomenon for developing countries. D. A. Heenan and W. J. Keegan, "The Rise of Third World Multinationals," **Harvard Business Review**, vol. 57(1), 1979.
[4] Tim Shorrock, "Multinationals Third World Style," **Multinational Monitor**, Jan. 1984, p. 6.
[5] K. Kumar and M. G. McLeod (eds.), **Multinationals from Developing Countries**, Lexington Press, 1981; L. T. Wells, Jr., **Third World Multinationals**, MIT Press, Cambridge, 1983.
[6] D. A. Heenan and W. J. Keegan, **op. cit.**, 1979.

to answer some of these questions.

This study will draw on the recent experience of Indian multinationals to re-examine the factors behind the emergence of MDCs. An objective study of Indian MDCs will be of significance because India has one of the largest number and the greatest variety of overseas ventures among developing countries, a fact that is rather unusual in view of its low GNP per capita, poor economic performance, and slow expansion of manufactured exports. In order to comprehend the nature of India's overseas investment activities, it will be essential to follow the structural transformation of the Indian economy, a transformation that has on the one hand resulted in a fairly large industrial sector with a high degree of depth, diversity, and self-reliance. On the other hand, it has created a highly interventionist and regulated economy which has forced Indian business to escape outward from the constraints at home. This *melange* of contradictory, stimulating and inhibiting policies explain the paradox of poor industrial and export performance of India and its impressive technology exports and overseas investments.

Economic variables cannot account for the full complexity of this phenomenon. An explanation of the rise of Indian MDCs lies not only in the structure and problems of India's economy, but also in the character of relations between business and government, the aims and conduct of its foreign policy, in the interaction between government policies and global strategies, in firm strategy and motives. In other words, an explanation needs to be constructed based on an understanding of the interaction among complex political and economic variables at international, national, and firm-specific levels. Our approach follows that of Robert Gilpin: "Although the state as the embodiment of politics and the market as the embodiment of economics are distinctive features of the modern world, they obviously cannot be totally separated...the state profoundly influences the outcome of market activities by determining the nature and distribution of property rights as well as the rules governing economic behaviour...The market itself is a source of power that influences political outcomes."[7] Further, this study will evaluate the applicability of existing theories of multinationals to the Indian case and postulate an analytical framework within which to interpret the uniqueness of Indian multinationalism.

Terminology and Definitions

The literature on direct foreign investment (DFI) and economic development is replete with confusing acronyms and abbreviations. Some conceptual definitions are needed to prevent unnecessary confusion. Our terminology consists of the following:

(i) The home country is the origin of the investment. The host country is the recipient of the investment.

(ii) DC stands for developed country. LDC denotes less developed or developing country, and refers to those so classified by the United Nations Center on Transnational Corporations (UNCTC). They are the countries with market economies in Latin America, Africa (except South Africa), Oceania (except New Zealand and Australia), and Asia (except Japan).[8]

(iii) The term MDCs or Multinationals from Developing Countries refers to those enterprises with firms in developing countries, parents of which own or control production or service facilities in one or more countries outside the country in which they are based. For an enterprise to be included in this study, its overseas operations must have some kind of ownership tie to the originating firm in the developing country.[9]

(iv) MNC and MNE are interchangeable terms. Typically, an MNC or MNE is a DC investor,

[7]Robert Gilpin, **The Political Economy of International Relations**, Princeton University Press, Princeton, 1987, p. 10.

[8]K. Kumar, **op. cit.**, p. xv.

[9]L. T. Wells, Jr., **op. cit.**, p. 7.

which according to Vernon's definition, controls subsidiaries in six or more countries.[10]

(v) A locally owned or domestic, firm is one that is at least ninety percent owned by citizens of the host country.[11]

Analytical Framework

The emergence of multinationals from developing countries (MDCs) has received somewhat mixed reaction from economists and theorists. There are some like Vernon and Knickerbocker who view this recent development as nothing new or exciting, merely an extension of a phenomenon dating back to the British East India Company. This group views the MDCs as mere newcomers which inevitably will follow the same path as their Western predecessors. Thus, it is held that explanations and theories of the emergence and growth of MNCs, notably the monopolistic theory discussed below, are sufficiently general to cover Third World multinationals as well, and that any unique features of the MDCs may be dismissed as something transitory associated with the early stages of the Third World's industrial expansion abroad. On the other hand, there are some like Wells, Lecraw, and Kojima who view the trend of Third World multinationalism as something new and intriguing which, in economic terms, is good for both the home and host countries. According to this group, the motives, methods, and strategies of multinational spread are affected by the home nationality of the enterprises involved. Thus, it cannot be ignored that the MDCs are a distinct category by themselves, differing from the Western MNCs in terms of their small-scale size, relatively mature and labour-intensive technologies, undifferentiated marketing, and low overheads. The question whether either of these two explanations can be used to understand the emergence and growth of multinationals based in one of the most industrialised economies in the developing world - India - remains to be seen.

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[10]R. Vernon, **Sovereignty at Bay**, Basic Books, New York, 1971, p. 11.
[11]V. Busjeet, **Foreign Investors from Less Developed Countries: A Strategic Profile**, MIT Press, Cambridge, 1980, p. 4.

Monopolistic Theory of Direct Foreign Investment

Taking imperfect market conditions as the starting point, conventional theories of DFI assume that a multinational firm operating in a foreign country is faced with certain additional costs that the local competitor is not. So for the international operations to prove profitable, the firm entering an overseas market must have some technological, organizational or other advantage over its local competitors. Hymer was the first to suggest that the most important motive for DFI was to maximize the returns from the firms' ownership-specific advantages under oligopolistic market structure. Further, Hymer viewed the firm's desire to undertake and control foreign operations as not merely a desire to better exploit its assets but a strategic move to eliminate competition at home and abroad. According to this view, DFI occurs in industries where technology is complex and barriers to entry due to economies of scale are significant.[12]

Kindleberger's writings examined four main areas of internationally transferable monopolistic advantages - departures from perfect competition in goods markets, including product differentiation, marketing skills, and administered pricing; departures from perfect competition in factor markets, including access to patented or proprietary knowledge, discrimination in access to capital and skill differences embodied in the firm (particularly its management); internal and external economies of scale, including those arising from vertical integration; and finally, government interventions, including wage, foreign exchange and tax regulation, and restrictions on output and entry. Such advantages compensated for the foreign firm's cost of operating at a distance.[13] Kindleberger clearly pointed out, "For direct investment to thrive, there must be some imperfections in markets for goods or factors, including among the latter technology, or

[12]Stephen Hymer, **The International Operations of National Firms**, MIT Press, Cambridge, Mass., 1979; Jorge Niosi, **Canadian Multinationals**, Garamond Press, Toronto, 1985, p. 11.
[13]Peter Buckley and Mark Casson, **The Economic Theory of the Multinational Enterprise**, Macmillan Press, London, 1985, p. 2.

some interference in competition by government...That product differentiation breeds direct investment is indicated by its prevalence in branded products such as pharmaceuticals, cosmetics, soft drinks...It does not occur in standardized goods produced by competitive industries such as textiles, clothing..."[14] A natural corollary of this dimension is the preference of the investing firm to own its foreign subsidiary outright or as nearly so as possible to fully 'appropriate' the quasi-rents resulting from its advantages.[15]

There is an emerging trend of overseas investments by large Indian firms that fits the Hymer-Kindleberger model. These ventures are located mostly in the developed countries, and most are wholly-owned subsidiaries in the non-manufacturing sector. In the manufacturing sector, this type of investment still accounts for only a small segment of India's overseas investment.

Yet a vast majority of Indian overseas ventures are manufacturing standardized, low technology products. They rarely have the advantage of product differentiation or familiar brand names. Further, these ventures are relatively small-scale operations set up by companies not very large as compared to the MNCs. How can these firms, without technological leads or scale economies, discover an internationally exploitable advantage in technologies that are relatively well-diffused and standardized? The answer seems to lie in the fact that monopolistic advantages do not fall in a clear, narrowly defined category. They tend to vary in their nature and relative significance from one country to another. Since the process of technological change in each country depends on its 'learning' environment, firms from different countries reflect somewhat different advantages. The size of the economy and its experience with industrialization, and the widely differing trade and industrial strategies, all account for the differences among the

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[14]C. P. Kindleberger, **American Business Abroad**, Yale, New Haven, Connecticut, 1969, p. 13-14.

[15]T. Ozawa, **Multinationalism, Japanese Style: The Political Economy of Outward Dependency**, Princeton Univ. Press, Princeton, 1979, p. 42.

MDCs.[16] Thus, as Lall puts it, "The answer that seems to be emerging is not that monopolistic advantages do not exist - by now it has become almost tautological to say that a foreign investor has some 'advantage' - but that all advantages are not necessarily 'monopolistic' in the original sense (i.e. of the sort that lead to entry barriers in developed countries). Firm-specific advantages may derive from mastery over particular adaptations to well-diffused technology, from access to cheaper or more appropriate management, from ethnic factors, from better knowledge of particular markets, or simply from 'being first' in a newly industrialising country."[17] It would appear that the adaptations and improvements which Indian firms have made to products and processes to better suit local factor prices, factor quality and demand conditions; the special knowledge of marketing relatively undifferentiated products; the access to relatively cheap skilled manpower in the home country; the experience and competence of the managerial staff; the simple cost advantage in production at lower volumes all have given Indian firms firm-specific advantages which can be exploited abroad.[18] Thus, it would appear that the ownership-specific advantages outlined by the Hymer-Kindleberger approach represent mainly the American type of DFI. There is a need to broaden the 'barriers to entry' concept in light of the rise of multinationals from other countries. Further, the fact that a foreign firm possesses some advantage over indigenous competitors gives the multinational its unique character but does not explain why the production process needs to be located abroad. To explain the choice of DFI over alternatives of exporting and licensing, it would be necessary to take into account other factors.

In the context of Japanese firms, some economists, led by Kojima, have argued that the small technological gap between the investing and the host country makes it

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[16]S. Lall, **The New Multinationals**, John Wiley and Sons, New York, 1983, p. 7-8.
[17]S. Lall, "The Emergence of Third World Multinationals," **World Development**, vol. 10(2), 1982, p. 127-46.
[18]Ibid.

easier to transfer operations, and thus constitutes a definite advantage for the investing firms from the relatively more advanced developing countries.[19] According to this view, the market imperfections that give advantages to a vast majority of Japan's manufacturing ventures originate in the backward industrial environment of the host countries of the Third World rather in the oligopolistic characteristics of business internal to the investing Japanese firms.[20] In other words, the advantages arise from the business experience the investing firms have gained in the more advanced market environment at home or elsewhere. P. J. Deviata, an observer of Indian DFI abroad, similarly observes, "Most of the Third World countries in which Indian enterprises are making investments...are at a stage of development at which we were five to ten years ago. Thus, Indian entrepreneurs abroad are not only able to adjust to the local environment easily but also anticipate most of the production, distribution and marketing problems that they are likely to confront."[21] Thus, it is pointed out that Indian firms have a comparative advantage in transferring the industrial knowledge of labour-intensive, small-scale manufacturing operations because of several factors associated with the overall technological level (mostly intermediate) and recent development experience of Indian industry.[22] Further, the relatively small technological advantage inclines these firms

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[19] Ian H. Giddy and Stephen Young, "Conventional Theories and Unconventional Multinationals," in A. Rugman (ed.), **New Theories of the Multinational Enterprise**, Croom Helm, London, 1982, p. 53-78.
[20] T. Ozawa, **op. cit.**, p. 44-46; K. Kojima, "A Macro-economic Approach to DFI," **Hitotsubashi Journal of Economics**, 14(1), 1973, p. 1-21.
[21] D. Thakore and P. V. Satyanarayana, "The New Multinationals," **Business India**, 20 August, 1979, p. 30-41.
[22] According to Lall, the two major reasons why firms from DCs find it difficult to introduce older technologies in developing countries are - the 'localisation' of technical change at the micro level and the 'irreversibility' of such change. Since technical change encompasses not just the innovator but a whole range of related industries (component and material suppliers, and so on), it 'moves' all the related industries with it, each enterprise innovating in the 'locality' of its known techniques. The process is irreversible. Older technologies, while they may be 'known' in some abstract sense, cannot be efficiently reproduced or transferred once the entire industrial system has moved on to new technologies. The technologies in the NICs is localised around a different set of techniques and conditions, more relevant to the conditions in other LDCs. S. Lall, **The New Multinationals**, p. 5.

favorably towards 'joint ventures', mostly with local host country enterprises, but in some cases with developed country firms as well. And even though the technological advantages of these firms might be slim and not very enduring, other factors like conglomerate ownership, experienced managerial staff, marketing skills, add up to give them a definite and enduring advantage. Interestingly, this type of investment behaviour in a non-oligopolistic industry also tends to trigger off enmasse investments by other firms in the same industry - the so-called bandwagon behaviour, considered to be typical of only oligopolistic industries and not until now associated with competitive industries.[23]

Product Life Cycle Theory

Raymond Vernon's theory of the product life cycle might be described as an application or a variant of the monopolistic theory of foreign investment, where firms react to the threat of losing markets - as the product matures - by expanding overseas and capturing the remaining rent from the product's development.[24] The theory regards technological innovations as the main determinant of the distribution of production among the countries. According to Vernon, products commonly go through a cycle of initiation, exponential growth, and decline - a sequence that corresponds to the process of introduction, maturation, and senescence. In the first stage, innovation and product development take place where demand and cost conditions permit.[25] At this stage the product is not standardised and producers serve only the market where innovation took place.

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[23]T. Ozawa, **op. cit.**, p. 63.
[24]A. L. Calvet, "A Synthesis of FDI Theories and Theories of the Multinational Firm," **Journal of International Business Studies**, Spring/Summer 1981, p. 43-59.
[25]Raymond Vernon, "International Investment and International Trade in the Product Cycle," **Quarterly Journal of Economics**, May 1966, p. 190-207. The author further developed the theory in **Sovereignty at Bay**, 1971 and **Storm Over the Multinationals**, Harvard Univ. Press, Cambridge, Mass., 1977; Jorge Niosi, **op. cit.**, p. 12.

The second stage is the maturing product stage during which both the product and the oligopoly that created it mature. The product begins to be standardised, but technology, marketing connections, scale of production and other barriers prevent other competitors from entering the industry. A market begins to emerge in other advanced countries. It is initially satisfied by exports but eventually cost factors and the threat from indigenous producers force the firm to locate in these countries.[26]

In the third stage, the product is completely standardised and sells entirely on the basis of price-competitiveness. It becomes imperative now to produce the product at the lowest possible cost. Consequently, the labour-intensive stages of production are carried out, via DFI, in developing countries where labour is cheapest.

Vernon's theory offers a good explanation of American DFI following World War II. It takes into consideration both ownership-specific and location-specific factors in explaining DFI. The location of research activities (in the centre) and the changing locational influences on production provide the dynamic for the theory.[27] According to Calvet, "The location-specific factors complement the firm-specific ones by adding the multinationality dimension - ignored by the latter. In this case, foreign involvement results from the advantage inherent in different geographical locations."[28] The theory also provides a framework within which to describe the behaviour of multinationals in responding to changing competitive conditions.

However, some recent developments appear to elude the theory - the creation by multinational corporations of products specifically intended for markets outside their countries of origin, the growing proportion of DFI that goes to produce goods already manufactured in the host country, the purchase of firms in foreign countries to acquire advantages that the multinational does not possess, and the emergence of DFI from

[26]Peter Buckley and Mark Casson, op. cit., p. 8.
[27]Ibid., p. 14.
[28]A. L. Calvet, op. cit., 1981.

developing countries.[29] At a seminar in Seoul, Vernon admitted the overall redundancy of the product cycle model in light of the changed conditions.[30] Nevertheless, Vernon held that if used judiciously some of the concepts of the model could still amount to fairly powerful tools for explaining international trade and production. "It still remains true that from time to time enterprises confronting the special conditions of their domestic economy will be stimulated to develop some special sort of capability; they may exploit that capability through exports and at some later stage consider it necessary to effect a technological transfer to a subsidiary or an affiliate in another country in order to continue to exploit their capability; and in that way they may develop a multinational structure."[31] Vernon further elaborates, "The hypothesis can also describe a situation in which, say, an Indian or Japanese firm has adapted a technology which had previously appeared in a richer country, and by means of a multinational structure maintains a lead in a poorer country with the adapted technology. The lead may be more fragile and last a shorter time, but the kind of mini-cycle described in the product cycle theory may well occur."[32] Wells has adopted a similar line of thought in his explanation of the emergence of multinationals from developing countries.

International "Pecking Order" Approach

Wells attempts to reach a theoretical understanding of the advantages of multinationals based in developing countries in the context of the overall product cycle phenomenon - the international pecking order approach. The approach views the internationalization of developing country firms simply as a stage in the product life cycle. Countries are ranked according to when they first produced a particular product. Thus, according to the approach, technology originating in the United States is often

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[29]Jorge Niosi, **op. cit.**, p. 13.
[30]Raymond Vernon, "Opportunities and Challenges for Multinational Firms from Developing Countries," **Seminar Series No. 24**, Korea International Economic Institute, Seoul, 1979.
[31]Ibid.
[32]Ibid.

picked up by European and Japanese firms, adapted to serve lower income markets and exported to NICs which modify it in turn and introduce it in less developed countries.[33] This pecking order approach is based on the availability of technology and the difference in production costs.[34] Thus, according to Wells, MDCs are imitators and followers in technologically mature industries which adapt large scale technologies from the industrialized world to a smaller scale in their home countries, and often also make the technology more labour-intensive. In general, the MDCs appear to be better adapted in terms of both technology and products they offer to the other Third World countries. Their main advantage is cost effectiveness rather than product differentiation, though some exceptions exist. The 'followers' are thus interested in transferring production to other countries where production costs are much lower.

Presuming a relatively small technological advantage for the MDCs, Wells and others suggest the importance of location-specific advantages for the MDCs to minimize the cost of foreignness and to maximize the advantages of location-specific factors within the prospective host country. The firms achieve this through:

(a) DFI involving *joint ventures* with local partners. This can be a low-cost way of building up knowledge about the market and business methods, of minimizing capital requirements, and also of avoiding ruffling political feathers in the host country.

(b) DFI in countries where *secure markets* are assured. This can be the result of previous hold on these markets as exporters, or as sub-contractors to end-user firms.

(c) DFI in host countries where *incentives*, such as tax holidays, subsidized interest rates, and even protection against competition are offered.

(d) DFI in states which have a *geographical proximity* and *linguistic or cultural affinity*

[33]L. T. Wells, Jr., "The Internationalisation of Firms from Developing Countries," in Agmon and Kindleberger, eds., **Multinationals From Small Countries**, MIT Press, Cambridge, Mass., 1977, p. 133-56; Jorge Niosi, **op. cit.**, p. 16.
[34]Yoon-Dae Euh and Sang H. Min, "Foreign Direct Investment from Developing Countries: The Case of Korean Firms," **The Developing Economies**, vol. 24(2), 1986, p. 149-168.

to the home country.

(e) DFI in countries where the strength of indigenous competition is low, which would usually mean countries which are less developed economically than the home country.[35]

The theoretical explanation offered by Wells has come to be regarded as part of the conventional knowledge on MDCs.[36] This view distinctly draws the line between the MDCs and the MNCs: MNCs are mostly large enterprises with oligopolistic positions; they employ sophisticated technologies of a large-scale and of capital-intensive nature; they compete using product quality, differentiation, brand names, and marketing skills; and they prefer fully- or majority-owned subsidiaries. On the other hand, MDCs employ labour-intensive technologies appropriate for small-scale production; produce standardised products; compete on the basis of low price; and prefer joint ventures with local parties. Wells thus asserts that, "the life cycles of many manufacturing subsidiaries of developing country firms will probably be short. With time, profits or market share are likely to be eroded by local competitors, ties with the original parent will weaken, and some subsidiaries will be sold by choice or through host government pressure."[37]

The broad industrial pattern of Indian overseas investments at first look appears to conform to this analysis. Much of the Indian investment is in sectors with relatively simple, well-diffused, labour-intensive technologies, and located mostly in the neighboring developing countries of South and East Asia. But Indian investments have also been rapidly progressing into technologies, skills, and scales formerly thought to be the sole domain of the MNCs.[38] Even some of the Indian ventures in textiles are fairly complex, capital-intensive, large scale and innovative. The product cycle perspective

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[35]I. H. Giddy and S. Young, **op. cit.**, 1982.
[36]L. T. Wells, Jr., **op. cit.**, 1983; D. J. Lecraw, "Foreign Direct Investment by Firms from Developing Countries," **Oxford Economic Papers**, vol. 29(3), 1977.
[37]L. T. Wells, Jr., **op. cit.**, p. 157.
[38]See chapter 6 for details.

thus disregards the evolving dynamic comparative advantages, and also the non-MNC and indigenous technology-based developments in developing countries like India. It also ignores the vital fact that countries pursue grossly divergent development strategies, with the inevitable result that their firms operate in a variety of ways and therefore the way in which DFI is executed also varies. Lall's observation is relevant in this context, "Clearly, the 'learning' processes which underlie the expansion of Indian firms overseas are very complex, and range well beyond initial portrayals as down-scaling of well-diffused imported technologies. This is not to argue that Indian MNCs are approaching frontiers of technological innovation or that they will soon rival the scale of operation of MNCs from the developed countries. But it does argue against too literal and uncritical an application of the product-cycle type of reasoning to this phenomenon."[39] Wenlee Ting also argues that in several instances, as the technology capacity of these firms has advanced by means of learning-by-doing to attain technological independence, they have quickly passed through the follower stage and become innovators themselves.[40] Lall's criticism of the Wells hypothesis is directed mainly at its generalisation and is accepted, at best, only as a partial theory of the advantages of the MDCs.

Another noticeable and significant departure from the product cycle model is the increasing 'upstream' investments by the MDCs. The move is motivated by the desire to defend export markets threatened by protectionist barriers, to counteract the actions of rivals, to get access to frontier technology, and to acquire knowledge, experience and reputation which could be useful in further expansion in the advanced countries.[41] The product cycle theory which addresses itself to only a particular type of DFI - the

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[39]S. Lall, **The New Multinationals**, p. 31.
[40]Wenlee Ting, **Business and Technological Dynamics in Newly Industrialising Countries**, Quorum Books, Connecticut, 1985, p. 78-80.
[41]L. T. Wells, Jr. and P. Ghemawat, "Transfer of Industrial Technology among the Developing Countries," Mimeograph for the Council on Science and Technology, Harvard Business School, 1980.

production abroad of innovations - fails to explain this short-cutting of the traditional product cycle.

Internalisation Theory

Although market imperfections still underlie much of the economic theorising on multinationals, there has been a "switch in attention from the act of foreign direct investment...to the institution making the investment."[42] Underlying this approach is the view that not only must firms possess superior resources but they must also have the desire and the willingness to internalise the advantages which result from their possession.

The explanatory power of the concept of internalisation rests on an analysis of the costs and benefits of internalising markets, particularly markets in intermediate goods. Buckley and Casson see the strongest case for internalisation in intermediate products - mostly in the form of knowledge and expertise.[43] When firms are faced with highly imperfect markets in these intermediate products, they tend to substitute for markets by creating internal markets, that is, bringing the activities which are linked by the market under common ownership and control.[44] According to Dunning, "Enterprises will engage in the type of internalisation most suited to the factor combinations, market situations and government policies with which they are faced...research intensive industries would tend to be more multinational than other industries, but that internalisation to secure foreign based raw materials would be greater for enterprises from economies which have few indigenous materials than those which are self-sufficient."[45] In essence, the internalisation theory asserts that the motivation of DFI arises not from the ownership-specific advantage *per se* but from the fact that the

[42]J. H. Dunning, **International Production and the Multinational Enterprise**, George Allen and Unwin, Boston, 1981, p. 28.
[43]Peter Buckley and Mark Casson, **op. cit.**, p. 33.
[44]O. E. Williamson, **Markets and Hierarchies**, Free Press, New York, 1975.
[45]J. H. Dunning, **op. cit.**, 1981, p. 33.

advantage can be fully exploited only through internalising the market of this advantage across national boundaries.

Yet, internalisation advantages only explain "why hierarchies rather than external markets are the vehicle by which transactional ownership advantages are transferred across national boundaries; it is the former (propreitary ownership-specific assets) which explain why these advantages are exploited by one group of MNEs rather than another, or by MNEs rather than firms indigenous to the country of production."[46] Calvet similarly states, "Firms do not expand abroad simply because they can internalise transactions within their hierarchy. Their desire to operate internationally has to stem from other reasons too. Therefore, one must combine the hierarchies versus markets paradigm with existing FDI hypotheses to arrive at a synthesis of the determinants of direct investment; thus, two facets of the foreign expansion of firms has to be explained. One is the foreign involvement - the multinational character; the other, the internalisation within a single entity."[47] This position has been unambiguously embraced by Dunning and several others in the field.

Eclectic Theory of International Production

The limitations of existing theories have led to a concerted effort to develop a more general and inclusive theory of DFI by combining various strands of approaches to the subject. One of the most comprehensive theoretical frameworks is the eclectic approach of international production by Dunning.[48] In a sense, the electic theory is no theory but a broad analytical framework with strong explanatory power.[49] It mainly

[46]J. H. Dunning, **op. cit.**, 1988.
[47]A. L. Calvet, **op. cit.**, 1981.
[48]For a detailed exposition of this approach see J. H. Dunning, "Explaining Outward Direct Investment of Developing Countries," in K. Kumar, **op. cit.**, 1981; "The Investment Development Cycle and Third World Multinationals," in K. Khan, **op. cit.**, 1986; "The Eclectic Paradigm of International Production," **Journal of International Business Studies**, vol. 19(1), 1988, p. 1-32.
[49]In his writings, Dunning uses the terms approach, paradigm, framework and theory interchangeably to refer to the eclectic theory of international production.

draws upon three strands of economic theory - the theory of industrial organization, the theory of international resource allocation, and the theory of market failure. The principal hypothesis of the theory is that the propensity of a firm to invest abroad is determined by a set of three interrelated conditions: ownership-specific advantages, internalization advantages, and location-specific advantages (OLI). The investing firm must possess or must have access to assets which its competitors do not posses, at least not in the same degree or on the same terms. The firm must find it more advantageous to use these assets itself rather than to sell or lease them to foreign firms. And lastly, it must be profitable for the firm to locate at least part of the production abroad, that is, to utilize its assets in conjunction with inputs and incentives outside its home country.[50]

According to the eclectic theory, the capability of a home country's enterprises to supply either a foreign or domestic market from a foreign base depends on their possessing certain assets not available to another country's enterprises.[51] The theory refers to three kinds of ownership-specific advantages. The first type stem from size, monopoly power, and better resource capability and usage. The second type of advantages arise to the branch plant because of the endowments of the parent company, such as, access to cheaper inputs, knowledge of markets, R&D, etc. The third type of advantages are those which arise specifically from the multinationality of a company. The larger the number and greater the differences between economic environments in which an enterprise operates, the better placed it is to take advantage of different factor environments and market situations. Although these advantages are enterprise specific, the theory asserts that they are not independent of the general economic and institutional environment of which they are part. Further, only if ownership-specific advantages are possessed, a firm will consider DFI, exporting, and licensing as equally viable options.

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[50]J. H. Dunning, **op. cit.**, 1981, p. 79.
[51]Ibid., p. 25.

The second postulate of the eclectic theory is that "it must be in the best interests of enterprises that possess ownership-specific advantages to transfer them across national boundaries *within* their own organisations rather than sell them..."[52] In other words, Dunning states, "Without the incentive to internalise the production and/or sale of technology, foreign investment in technology-based industries would give way to licensing agreements and/or to the outright sale of knowledge on a contractual basis. Without the incentive to internalise market imperfections there would be much less reason to engage in vertical or horizontal integration, and again transactions would take place between independent firms."[53] The basic proposition is that market failures and imperfections of three main kinds lead to internalisation: (i) those that arise from risk and uncertainty; (ii) those that stem from the ability of firms to exploit the economies of large-scale production, but only in an imperfect market situation; (iii) those that occur where the transaction of a particular good or service yield costs and benefits *external* to that transaction, but that are not reflected in the terms agreed to by the transacting parties.[54]

The third condition of the eclectic theory deals with the "where" of production. According to Dunning, "Enterprises will engage in foreign production whenever they perceive it is in their best interests to combine spatially transferable intermediate products produced in the home country, with at least some immobile factor endowments or other intermediate products in another country."[55] This choice of location will not be independent of the ownership and internalisation advantages of particular enterprises. Locational advantage is, as the theory suggests, a relative concept. It may involve elements of the economy of the host country sufficient in their own right to attract foreign investors, like fiscal incentives, import protection, large and

[52] J. H. Dunning, **op. cit.**, 1988.
[53] J. H. Dunning, **op. cit.**, 1981, p. 34.
[54] J. H. Dunning, **op. cit.**, 1988.
[55] Ibid.

growing domestic markets, and natural resources. Or a locational advantage of a host country may be an indirect result of disadvantage(s) in the home country of the investor, like restrictions on monopolistic practices, environmental regulations, or market saturation.[56]

The eclectic theory asserts that all forms of international production by all countries can be explained by reference to the OLI factors. This is not the same as suggesting that these advantages will be evenly spread across countries, industries, and firms. (See table 1.1) As shown in the table, the eclectic paradigm allows one to go a step further and relate the OLI parameters to a number of structural or contextual variables, namely, those which are specific to particular countries, industries, and firms. The approach stipulates that the propensity of a particular firm, of a particular nationality, in a particular industry, to engage in DFI, will vary according to the characteristics of its home country, the country in which it is proposing to make an investment, the range and type of products it is intending to produce, and its underlying management and organisational strategy.[57] For example, the presence of ownership advantages of the firm may be explained by reference to market imperfections which create barriers to competition, factor endowments, size and risk diversification strategy, and so on.

[56]J. P. Agarwal, "Intra-LDCs Foreign Direct Investment," **Developing Economies**, vol. 23, 1985, p. 236-253.
[57]J. H. Dunning, "Explaining Outward Direct Investment," 1981.

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Table 1.1. Some Illustrations of how OLI Characteristics may vary according to Structural Variables
Source: J. H. Dunning, **International Production and the Multinational Enterprise**, George Allen and Unwin, London, 1981, p. 113.

The eclectic theory recognises as one of the most crucial structural variables influencing the level and pattern of international investment, the "strategic response of decision takers within MNEs to a set of economic and other variables; and the way the idiosyncratic behaviour of firms might influence and respond to cross-border market failure."[58] Whether a firm engages in international production depends not only on its ability to do so (which inter alia will be the function of its size, product structure, existing overseas commitments) but on its perceptions of the resulting costs and benefits.[59] Clearly, individual firms have "differing capabilities for, and a need of international production; it follows that not only are they faced with a different set of strategic options, but that their evaluation of these options, and the risks attached to them, will vary. Indeed the risk diversification thesis asserts that different firms may view identical investment opportunities offered by a country differently..."[60] This makes it difficult to make any generalised explanations of firm-specific behavioural patterns, particularly when no systematic or consistent response of firms to changes in exogenous variables can be observed. Nevertheless, several recent studies have positively linked such variables as firm size, research intensity, existing overseas commitments, with the internationalisation of the firm.[61]

Similarly, the propensity of enterprises to undertake DFI will differ from industry to industry in both kind and extent, depending on such factors as industrial concentration, production economies, degree of product or process technological intensity, industry-specific tariff and non-tariff barriers, and so on. It is also essential to recognise that different types of DFI - resource-based, import substituting,

[58] J. H. Dunning, **op. cit.**, 1988.
[59] Ibid.
[60] Ibid.
[61] Y. Aharoni, **The Foreign Investment Decision Process**, Harvard Univ. Press, Cambridge, Mass., 1973; J. M. Stopford and L. T. Wells, Jr., **Managing the Multinational Enterprise**, Longman, London, 1972. These theories are unfortunately biased toward extreme rationality, and ignore or underplay DFI decisions reflecting fads, poor assessments, and/or the undue impetus of chief executives.

export-oriented, and other types - are based on different advantages and conditions.[62]

Further, the eclectic theory asserts that it would be invalid to generalise from one country's experience to another because country-specific characteristics are important in influencing the pattern and nature of foreign investment. The ability of enterprises to acquire ownership endowments is clearly not unrelated to the endowments specific to the country of origin. Otherwise, there would be no reason why the structure of foreign production of firms of different nationalities should be different.[63] Dunning correctly states that, "The fact that such assets may be the exclusive property of particular firms, and be mobile across national boundaries, does not negate the possibility that their source may be explained by the international disposition of country-specific and immobile endowments."[64] For example, the sectoral distribution of DFI from developing countries exhibits an interesting picture of the difference in the economic structures of investing countries. Whereas Korean firms have invested in construction, transport, fisheries, timber, and minerals, Hong Kong firms have mainly engaged in textiles, rubber products, plastics, and electronics. Indian investments are primarily concentrated in chemicals, heavy machinery, steel, textiles, hotel and restaurant. The competitive assets generated by firms reflect the resource endowments, market characteristics, government policies, attitudes and institutional framework of their home country.

Further, viewing DFI from the perspective of countries rather than firms, the paradigm suggests that a country's international DFI position, and changes in that position, will vary according to: (i) its stage of economic development; (ii) the structure of its factor endowments and markets; (iii) its political and economic systems; and (iv) the nature and extent of market failure in the transaction of intermediate products

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[62]J. J. Boddewyn, "Theories of Foreign Direct Investment and Divestment," **op. cit.**, Management International Review, vol. 25(1), 1985, p. 57-65.
[63]J. H. Dunning, **op. cit.**, 1981, p. 47.
[64]J. H. Dunning, **op. cit.**, 1988.

across national boundaries.[65] These differences will reflect themselves in the extent and level of OLI advantages that different countries possess and, *inter alia*, the industrial spread of their outward or inward DFI.[66]

Dunning has proposed an investment development cycle. The basic proposition of the investment development cycle is that, "The forces determining the level of inward and outward direct investment and the balance between the two are linked to a country's stage of development and that it is reasonable to think of a four-stage investment-development process or cycle, in which, after the first stage of little inward and outward investment, inward investment rises markedly, then outward investment begins to rise and/or inward investment falls but net outward investment (NOI) is still negative, and finally NOI becomes positive. The developing countries now emerging as outward investors are approaching the third stage."[67] The model is also explained in terms of the OLI configuration. For example, in stage three a country attracts DFI in those sectors in which its comparative location advantages are strongest, but the comparative ownership advantages of its enterprises are weakest; while its own enterprises invest in those sectors where their comparative ownership advantage are strongest but their comparative location advantages are weakest.[68] Any deviation from this model can be explained in terms of country-specific characteristics, particularly government policies. To sum up, the eclectic theory asserts that the precise character and pattern of "a country's international direct investment will depend on the configuration of ownership and internalisation advantages of firms and the locational advantages of countries; and these, in turn, reflect not only the nature of activities undertaken, and the countries from which and in which undertaken, but also the characteristic of the firms themselves vis-a-vis their competitors.[69]

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[65] Ibid.
[66] J. H. Dunning, "Explaining Outward Direct Investment," 1981.
[67] Ibid.
[68] J. H. Dunning, **op. cit.**, 1981, p. 118.
[69] J. H. Dunning, "The Investment Development Cycle and Third World

The eclectic theory offers a holistic framework by which it has been possible to identify and evaluate the significance of the various factors influencing both the initial act of DFI and the growth of such production, and how these vary between countries and firms. The usefulness of the theory lies in its comprehensiveness, its consideration of different economic approaches to the understanding of DFI. Further, the approach is structured in such a way that it provides room for any relevant variable and at the same time it does not assign any specific weight for individual factors or their groups.[70] The eclectic theory can readily be expanded to explicitly incorporate other elements in the consideration of ownership, internalization, and location advantages. Thus, it serves as a useful starting point for an analytical study of MDCs.

However, Dunning's analysis suffers from a serious economistic bias. It relegates the role of non-economic variables to explaining the theoretical anomalies and statistical residuals of neo-classical economics. For example, any deviations from Dunning's investment-development model are explained away in terms of specific government policies. Political agency is left out of Dunning's explanation. The approach refers to government interventions of various kinds when discussing the *sources* of ownership, location, and internalization advantages. But these sources are treated essentially as exogenous *givens* to which the firm *responds*.[71] On the contrary, "...firms and governmental institutions both rival each other and cooperate with each other in the organization of economic activity. In other words, because the pursuit of wealth interacts with the pursuit of power, government is not exogenous to the economy, while firms constantly function as both economic and political actors."[72] Public policy, relating to domestic and foreign economic affairs, is not developed in a vaccuum but by

[69](cont'd) Multinationals," in Khushi Khan, (ed.), **Multinationals of the South**, German Overseas Institute, Hamburg, 1986, p. 15-47.
[70]Jan Monkiewicz, **op. cit.**, 1985, p. 57.
[71]Jean J. Boddewyn, "Political Aspects of MNE Theory," **Journal of International Business Studies**, vol. 19(3), 1988, p. 341-63.
[72]Ibid.

individuals who are not totally immune to pressures from interested parties. The environment cannot be regarded as exogenous to firms which not only adapt to it but also attempt to restructure, control, and internalize it. Thus, it is essential to elevate an analysis of MDCs from a purely 'economic' to a more 'politico-economic' framework. As Kindleberger points out, "In economics, there is one tool: money...in political science, on the other hand, the armory of weapons is infinitely complex, with reason, argument, persuasion, diplomacy at one end and force at the other. Politics, of course, includes money as a weapon: consider bribery."[73]

We consider it important to analyze the politically induced behaviour or the political behaviour of firms, to explicitly integrate political elements into a theory of multinationals because it may provide a better understanding of why particular multinationals have succeeded where dominant economic theories could not account for their emergence and success. In this analysis, 'political behaviour' refers to particular ways of relating to *targets* located in the non-market environment of firms.[74] The political targets in the non-market environment include essentially the government, and also pressure groups and public opinion; the *means* used by firms to interact with the non-market environment constitute lobbying, monetary donations to political agents, alliances with other firms and associations, employment of former civil servants, bribery, etc.

Political behaviour of firms cannot be ignored because it is complementary to the 'traditional economic behaviour'. Thus, even if the goal of multinationals remains essentially economic, it is obvious that they use political means to that end. Theoretical explanations of multinationals must include the state "as a major purveyor of advantages (or disadvantages) to national firms seeking to initiate or pursue foreign activities."[75] But

[73]C. P. Kindleberger, **Power and Money**, Basic Books, New York, 1973, p. 14.
[74]Ibid.
[75]Phillippe Faucher and Jorge Niosi, "The State and Multinational Firms," **Etudes Internationales**, vol. 16(2), 1985, p. 239-59.

in undertaking this analysis, one must not make a simple transition from economics to politics. Rather it is essential to examine also the relationship between the specific economic objectives of the firms and the the political and economic goals of the state. We hope to accomplish this by adapting and expanding Dunning's approach to include political elements defining the political behaviour of multinationals.

With the increasing thrust towards protectionism and restrictionism in recent years, there has been a world-wide revival of neo-mercantilism, the idea of the government using its multinational companies to promote national interest.[76] In almost every market economy a partnership between government and corporations has formed, quite explicit in some and more indirect and subtle in others, to capture world markets.[77] This conjunture of interests between the government and its corporations is, however, not new. Despite occasional clashes, the American government and American MNCs have shared common goals of controlling access to raw materials, expanding exports and foreign exchange earnings, and also of augmenting American political and economic influence worldwide.[78] In Europe, this has taken the form of explicit support for 'national champions', corporations designated to do battle against foreigners at home and abroad.[79] The impressive success of 'Japan Incorporated' has led one country after another to nurture, protect and promote its corporations for reasons of promoting the parent state's place in the international system. The case of most of the NICs and particularly that of India, as we shall argue, does not depart from this overall trend.

However, in all these instances, the partnership has not been without its pulls and strains. As governments attempt to utilize their corporations to advance national

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[76] T. H. Moran, **Multinational Corporations: The Political Economy of Direct Foreign Investment**, D. C. Heath and Co., Toronto, 1985, p. 149.
[77]R. Gilpin, **op. cit.**, 1987, p. 210.
[78]Ibid., p. 241-45.
[79]T. Moran, **op. cit.**, p. 149.

objectives, corporate executives seek to maximize their freedom from all government restrictions, even as they seek to use national power for corporate advantage.[80] Vernon, pointing to this conflicting tendency, comments "...the policies of any affiliate of a MNC are bound to reflect in some degree the global interests of the multinational network as a whole, and hence can never respond single-mindedly to the requirements of any one national jurisdiction; and that the network of any multinational enterprise cannot escape serving as a conduit through which sovereign states exert an influence on the economies of other sovereign states."[81] Thus, Gilpin rejects the liberal and Marxist view of MNCs operating either independently of government policies or controlling them. Taking a neo-mercantilist perspective, he argues that, "Governments of both home and host countries try to bend the behaviour of inward and outward investors to their domestic and international purposes. Such governmental policies lead MNEs to develop a political strategy of their own - both to keep the international system relatively open and to take advantage of the quid-pro-quos obtainable from serving as an agent of home and/or host governments."[82] The emergence and growth of multinationals cannot be dissociated from a host of domestic and international political considerations and the continuously changing and evolving mutual relationship between the private capital and the state.

Relying on Boddewyn's recent work on MNCs, we have attempted to use a macro-level political behaviour analysis of multinationals and adapt it to the micro orientation of Dunning's eclectic paradigm.[83] The eclectic framework suggests that the propensity of a firm to invest abroad is determined by the ownership, location, and internalisation factors (OLI). However, the firm-specific advantages referred to in the paradigm are of the traditional 'economic' type, like size, monopoly power, propreitary

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[80]R. Gilpin, **op. cit.**, 1975, p. 146; Stephen Krasner, **Defending the National Interest**, Princeton University Press, Princeton, 1978, p. 93-96.
[81]R. Vernon, "Sovereignty at Bay Ten Years After," **International Organization**, vol. 35, 1981.
[82]Quoted in J. J. Boddewyn, **op. cit.**, 1988.
[83]J. J. Boddewyn, **op. cit.**, 1988.

technology, R&D capacity, and so on.[14] The approach fails to incorporate political advantages in the nature of: "(1) better *intelligence* about political actors and opportunities; (2) readier access to political opinion- and decision-makers, and (3) superior *influence skills* at handling the latter through various means."[15] These political assets are 'intermediate products' whose markets can be internalised and exploited abroad by the firm. We will argue that Indian big business has quite successfully translated its massive economic power into political power. Through the use of money power and interpersonal relations, by lobbying and liason, employment of former senior civil servants, political contributions to political parties, and by playing on nationalist, regional or group (south-south) sentiments, Indian firms have managed to secure subsidies, import protection and other favourable concessions from governments. Thus, by means of politically induced behaviour, firms *create* new advantages for themselves both at home and abroad.

Despite neglect of this dimension of firm-strategy by much of the literature, political behaviour constitutes an essential part of firm-strategy. We argue that market imperfections - natural and unnatural (i.e., government created) - are not to be taken as exogenous *givens* but that they can be created or enacted. In other words, we posit that firms not only adapt to their environment, but also attempt to restructure it to generate their own firm-specific advantages over time. The most obvious purpose of political behaviour is to increase the international competitiveness of the firm vis-a-vis its competitors by reducing its own production and transaction costs (through preferential treatment, subsidies, incentives, etc.) and by increasing those of others. The firm-specific advantages of political 'knowledge or expertise' act as an asset in dealing with the non-market environment to create new advantages.

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[14]Ibid.
[15]Ibid.

The second condition in Dunning's approach helps us to understand why firms prefer to internalize the ownership advantages to better political knowledge and influence than to sell them in the market. They do it partly to reduce the transaction costs of using markets and partly to ensure that they gain the maximum returns from the assets they possess.[16]

Dunning has linked internalization to the purpose of avoiding and exploiting unnatural market imperfections generated by governments, such as quotas, tariffs, price controls, and tax differences. Firms operating within an imperfect market system are assumed to take these imperfections as givens. That market imperfections may result from the interaction between the firms and their non-market environment is ignored.[17] According to Boddewyn, a market exists for 'beneficial government decisions' and since only the top managers of the parent company have the necessary credibility and clout to obtain access to political decision-makers and bargain, the political activities of the firm need to be internalized. Further, most of this political knowledge is in the nature of intangible services of the soft technology type which is highly personalized and cannot be easily codified.[18] For that matter, the recruitment of former senior government officials by the multinationals is part of this internalization process. This process of government-business bargaining results not only in exploitation of existing market imperfections, but also in the creation of new ones by exploiting, counteracting and pushing such government policies that raise the transaction costs of other competitors. For example, Indian MDCs have managed to secure monopoly or near-monopoly status and additional incentives in several developing countries which prevent or hamper other firms from competing. The advantages arising from this bilateral-monopoly situation[19]

[16]J. H. Dunning, **op. cit.**, 1986.
[17]J. J. Boddewyn, **op. cit.**, 1988.
[18]Ibid.
[19]This situation of bilateral-monopoly arises from the fact that foreign investors have control over capital, technology and skills required to undertake a project successfully; the host government has control over access before investment is made and over the conditions for operation afterward. T. Moran, **op. cit.**, p.

However, the approach minimizes the extent to which government policies, local industry positions, and even public opinion is manipulable through political actions of the firm. Such firm-specific advantages (or the lack thereof) as political intelligence and influence skills can be related to the political culture of the home country because "firms are likely to transfer abroad what they are accustomed to doing at home."[90] Thus, Indian MDCs have been able to respond and operate with greater efficiency and flexibility in the difficult conditions of developing host countries, to deal with bureaucratic inefficiency, corruption, and to allay political suspicions by entering into joint ventures. According to Wohlmuth, because of better understanding of the political and bureaucratic processes in host countries, the MDCs have an additional advantage in such areas as negotiations, public tenders and the like. The conflict minimizing and adaptive behaviour of the MDCs in host countries has also created a favorable public opinion.[91] Indian firms have found wider ideological appeal because they are perceived as less threatening politically, and less capable of the kind of elbow-twisting interference in the domestic affairs of host countries for which MNCs have acquired a reputation. As Sri Lanka's trade minister commented, "We favour investors from small countries like Hong Kong because nobody can talk about a sell-out to imperialism in the case of a country that is as small as or smaller than we are."[92]

Thus, we see that the eclectic theory can be easily adapted to accommodate political elements in its consideration of ownership-specific, internalization and location advantages. Its holistic framework also allows for the consideration of both micro and macro variables. In a sense, the eclectic theory is no theory but a broad analytical framework with strong explanatory power. It derives this power simply from the fact that it embraces all the relevant explanations of DFI. In this sense, the eclectic theory is just a framework within which specific theories can be generated. But given the fact

[90]J. J. Boddewyn, **op. cit**, 1988.
[91]K. Wohlmuth, **op. cit.**, 1986, p. 234.
[92]Kiron Kasbekar and P. V. Satyanarayana, **op. cit.**, 1979.

that the determinants of DFI are necessarily complex, the eclectic theory offers a useful tool for understanding multinational corporations.[93]

Working Hypotheses[94]

While the evidence on multinationals from developing countries, and the magnitude of their foreign economic involvement is impressive, it is not conclusive yet. In fact, much of the information that we have is still sketchy, anecdotal, and puzzlying by the extent to which the actual behaviour of these MDCs differs from one to another and also by the pace at which their nature changes. Nevertheless, we have attempted to draw out a few major propositions which shall provide the conceptual framework for an understanding of Indian MDCs in this study. The more important ones are as follows:

(i) In delineating a pattern of behaviour for the MDCs, a more in-depth analysis requires the consideration of the economic and political structures from which the firms originate. An underlying premise of this study is that *MDCs differ in their strategies and advantages due to the difference in their 'revealed comparative advantages', which are the outcome of the individual home country's political and economic structures.*

(ii) As our concern is primarily with country-specific and firm-specific determinants, this study will explore the proposition that *the propensity of a country to engage in outward DFI is partly a function of its stage of economic development and its particular characteristics (resource endowments, market size, national policy packages), and partly a function of its firms which make for a unique combination of ownership, location, and internalisation advantages.*

A handful of developing countries - the so called newly industrialising countries - account for the bulk of DFI from developing countries. Though the link between

[93]Edward K. Y. Chen, **op. cit.**, p. 35.

[94]The structure of this section has been inspired by Jorge Niosi's work on Canadian multinationals.

industrial development and DFI is not a straightforward one, nevertheless we think it is reasonably safe to assume that industrial development is positively correlated with the internationalisation of indigenous firms. It would appear that a country must reach a certain level of industrial development and technological sophistication before it can breed multinationals. Further, as different countries pursue very different development strategies, the firms of different nationalities inevitably exhibit quite varied advantages. Thus, the advantages that provide the basis of DFI do not fall into one category. Their nature and relative significance vary over time and across space.

(iii) The *process of internationalisation of firms seems a cumulative one, with experience creating a stronger base and providing greater incentives to those who have gone abroad*. For example, while the early Indian investments were somewhat cicumscribed in their 'world view', the expansion, consolidation and geographical destination of recent investments suggest that ethnic, cultural, historical, and regional ties increasingly give way to economic attractions of large markets far and near and welcoming government policies.

(iv) The *MDCs investing abroad are most often the large firms in each industry, the local technological leaders of the branches in which multinationalisation has been undertaken*, having accumulated considerable skills, technology, expertise and resources over the years and now endeavoring to appropriate the results and costs of their 'learning' in foreign markets. While a majority of these firms have a 'special asset' which is often a technological advantage, as a general rule, they also have a *'package' of assets* consisting of cheap managerial skills, marketing techniques, ethnic/government connections or any other advantage.

(v) The *international competitiveness of firms depends not only on their technological, managerial or marketing advantage but also on their capacity to extract favourable terms of operation from home and host governments*. Thus, firms do not merely respond and react to the external economic and political environment but also attempt to restructure it in order to generate firm-specific advantages. In other words, "the rules of the economic game are not simple 'givens' but are often 'takens', with significant implications for the nature of ownership advantages and the internalisation of external agents."[95]

We shall argue that Indian big business has quite effectively translated its massive economic power into political power by securing subsidies, import protection and other favourable concessions from governments through the use of their money power and interpersonal relationships, lobbying and liason, monetary donations to political agents, and employment of former senior civil servants. This has had the effect of raising the transaction costs for their competitors.

(vi) Lastly, *theoretical explanations of multinationals must include the state "as a major purveyor of advantages (or disadvantages) to national firms seeking to initiate or pursue foreign activities."*[96] In undertaking such an analysis, it becomes essential to examine the relationship between the specific economic objectives of the firms and the political and economic goals of the state. We propose that a patnership between Indian government and Indian MDCs has formed as, on the one hand, the MDCs seek to use national power for corporate advantage in the face of growing protectionism, restrictionism, and stiff international competition and on the other hand, government attempts to use the national firms to control access to raw materials, expand exports and foreign exchange earnings, and also to augment Indian political and influence world wide. Such an analysis will also allow us to assess the role of government policies in the emergence and growth of Indian multinationals.

These propositions can only be treated as working hypotheses. In the following study, we shall examine them in greater detail and on the basis of our findings, attempt to refine and if required, reformulate them.

[95]J. J. Boddewyn, **op. cit.**, 1988.

[96]Phillippe Faucher and Jorge Niosi, **op. cit.**, 1985.

Organization of the Thesis

This study has focused on the emergence of multinationals from a single developing country, India. The underlying premise of the study is that economic motivations behind DFI cannot be dissociated from international and domestic politico-economic factors. DFI reflects an interesting picture of the difference in the economic and political structures of the investing countries. Thus, an understanding of Third World multinationalism, and the motives and strategies of the investing firms, cannot be approached in general and global terms without sufficient regard for the specificities of individual countries and the contribution of specific organizational and institutional arrangements. This web of exchanges and institutions defining the political economy of Indian ventures abroad shall be the main focus of this study. The rest of the thesis is organized as follows:

Chapter two provides a perspective on the rise and success of the newly industrializing countries (NICs) which have emerged as the homes of the majority of the MDCs. In this chapter, an attempt is made to understand why such rapid industrialization was limited to a small number of developing countries, what were the common as well as distinctive conditions from which and by which the rapid growth took place. The focus is mainly on international factors. We argue that while the post-World War world economy offered opportunities for the rapid industrialisation of a few developing countries, the downturn in world economy since the mid-seventies has forced these countries and their firms to explore various options in order to maintain their rates of growth and industrialisation. It is hoped that an understanding of the continuous process, reflecting structural and cyclical factors and policy responses to them, will provide an insight into the emergence of new world suppliers of capital, technology, and skills among the ranks of developing countries. An underlying hypothesis of this chapter is that a positive correlation exists between industrial development and the internationalisation of firms.

Chapter three provides a quantitative picture of the problem, a bird's eye view of the overall trends in international DFI in the post-World War II period. It traces the changing sectoral distribution of DFI and the increasing diversification in both its origin and destinations, with particular emphasis on the increasing DFI outflows from developing countries. The chapter gives a cursory and descriptive view of the characteristics, motives, and strategies of MDCs in general, and explores the implications of this recent phenomenon for host developing countries. The second half of the chapter presents a factual description of Indian DFI in terms of ownership pattern, the size and pattern of equity participation, industrial and geographical distribution, and the shifting trends.

Chapter four shifts the focus from the general and international to the particular and national level. It examines in detail the nature of the Indian state, the structure and problems of its economy, the aims and conduct of its foreign policy, the philosophy and industrial development, and the evolving business-government relationship. The purpose of this analysis of the domestic economic and political structures is to get an insight into the 'learning environment' for the proprietary assets that Indian MDCs exploit abroad, the conditions governing their choice of exploiting these assets in the form of DFI, and finally, to understand the paradox of the poor industrial and export performance of India and its impressive technology exports and overseas ventures.

Chapter five traces the evolution of the Indian government's policy towards outward DFI, from its early grudging permissiveness to active promotion. It analyzes the role of the government in promoting Indian investments abroad, its motives and objectives in promoting these ventures, the role played by Indian business in the formulation of these policies, and the political implications of public policy for Indian DFI.

Chapter six looks at the nature and orientation of Indian multinationalism. The motives and advantages of Indian MDCs are examined within the broad framework of Dunning's eclectic paradigm. The framework integrates various strands of economic theory to explain *why* firms invest abroad (internalization), *how* they successfully compete in host country (ownership advantages), and *where* these firms locate (location advantages). The main focus of this chapter is on the dynamic interaction between the firm's strategy and its environment, the response of individual enterprises to the relevant economic and political factors.

Chapter seven completes the study by evaluating the applicability of Dunning's electic framework to the Indian case and summarising the findings of this study. Dunning's eclectic paradigm is seen as an appropriate conceptual starting point to which modifications, adaptations, and additions of new concepts can be made in light of the evidence gathered on Indian MDCs.

CHAPTER 2

NEWLY INDUSTRIALISING COUNTRIES IN THE WORLD ECONOMY

The purpose of this chapter is to trace the rise of the NICs which have emerged as the homes of the new multinationals (MDCs). These handful of countries now account for the bulk of DFI from developing countries. While the NICs are still disadvantaged vis-a-vis the developed countries, they are at an advantage vis-a-vis the more underdeveloped countries. And although some of their firms have established subsidiaries in industrialised countries, most of their investments have gone to the less industrialised of developing countries. Thus, an explanation of the emergence and growth of the MDCs cannot be analytically separated from a general analysis of the ongoing transformation of the world economy and the emerging hierarchization of the developing world.

In this chapter, we attempt an understanding of the recent economic experience of the NICs, why such rapid industrialisation was limited only to a small number of the developing nations, what were the common and yet distinctive (vis-a-vis non-NIC developing nations) conditions from which and by which the rapid growth took place. It is perhaps here, in the asking of this question, that the task of explaining the emergence of the NICs and that of the MDCs becomes clearer. For, this analysis requires an understanding of a continuous process reflecting structural and cyclical factors and policy responses to them leading to the emergence of new world suppliers of capital, technology, and skills among the ranks of the developing countries. In seeking to understand the processes and forces underlying the direct investment outflows from a few developing countries, it becomes important to consider how the firms developed the skills, the technological capabilities, the international competitiveness, to operate abroad.[97]

We shall attempt to offer an explanation of the emergence of MDCs from NICs based on two major propositions. Firstly, we shall propose that the relative level of DFI, inward and ourward, is dependent on the country's stage of development. The internationalisation of production processes is but a small, nevertheless significant, element in the overall process of industrialisation of a country. We shall develop this argument within the framework of Dunning's investment development cycle.

Secondly, we shall argue that the emergence of the MDCs from the NICs has not only stemmed from an internal dynamic but has also represented a 'response' to external, international developments. The emergence of the NICs on the world industrial scene was aided by a set of favourable conditions in the world economy in the post-World War II period. However, a downturn in the international economy since the mid-seventies has created constraints for the maintenance of rapid growth rates and exports from the NICs. A number of NIC firms resorted to DFI in order to circumvent protectionist barriers and/or to establish a presence in the market concerned.[98]

Industrialisation and Internationalisation

Viewing DFI from the perspective of countries rather than firms, Dunning has suggested that a country's international DFI position, and changes in that position, will vary according to its stage of development. The basic proposition of his investment development cycle is that, "The forces determining the level of inward and outward direct investment and the balance between the two are linked to a country's level of

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[97] John Browett, "The Newly Industrialising Countries and Radical Theories of Development," in **The Newly Industrialising Countries of Asia**, Seminar Series held by the Centre for Development Studies, Flinders University of South Australia, June-August 1983.

[98] OECD, **The Newly Industrialising Countries: Challenge and Opportunity for OECD Industries**, Paris, 1988, p. 73

development and that it is reasonable to think of a four-stage investment development process or cycle, in which, after the first stage of little inward and outward investment, inward investment rises markedly, then outward investment begins to rise and/or inward investment falls but net outward investment (NOI) is still negative, and finally NOI becomes positive. The developing countries now emerging as outward investors are approaching the third stage."[99] Dunning also explains DFI outflows in terms of the OLI configuration. For example, in stage three a country attracts DFI in those sectors in which its comparative location advantages are strongest, but the comparative ownership advantages of its enterprises are the weakest; while its own enterprises invest in those sectors where their comparative ownership advantages are strongest but their comparative location advantages are weakest.[100] Lall similarly suggests, "The internationalisation of LDC firms is growing relatively rapidly. It is linked intimately with the growth of their manufacturing capabilities and sophisticated industrial exports, since the same set of forces determine the development of technology, skills and international competitiveness in all forms...The link between the growth of technological and other skills, export and direct foreign investment is not a straightforward one, of course; nevertheless, we think that one is reasonably safe in assuming that industrial development is positively correlated with its internationalisation."[101] Placed in this rather broad historical perspective, it may not appear surprising that the more industrialised LDCs have emerged as exporters of capital (or of technology in several forms). We believe, however, that a word of caution is needed here for it would be relatively easy to associate firm advantages with the level of economic development of a country. But in principle there is no reason why countries at fairly low levels of economic development should not produce entrepreneurs with the foresight and confidence to

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[99] J. H. Dunning, "Explaining Outward Direct Investment," 1981.
[100] Ibid.
[101] Sanjaya Lall, "The Emergence of Third World Multinationals," **World Development**, vol.10(2), 1982, p. 127-46.

engage in manufacture in other countries.[102]

Several countries in the Third World "have achieved impressive aggregate growth rates, hefty hikes in exported manufactures, diversification of industrial structures, and a multiplication of trade outlets."[103] This distinct subset of Third World countries have now within their borders a sizeable diversified industrial sector, a more complex division of labour, and a growing entrepreneurial class. The most interesting feature of this industrial growth, from our perspective, is the high levels of industrialisation and development achieved by these countries in certain sectors in which they are now able to extend themselves abroad. Whether this be in the nature of licensing agreements, supply of engineering and technical services, setting up of banks abroad, sale industrial facilities, or direct foreign investments, these developing states, by extending themselves in such a fashion, are changing the very pattern of contemporary international relations.[104] The emergence of these newly industrialising countries or NICs,[105] as they are popularly known, offers a serious challenge to the prevailing notions on Third World development.

[102]I. H. Giddy and S. Young, **op. cit.**, 1982.

[103]J. K. Jacobson, "Peripheral 'Postindustrialisation': Ideology, High Technology, and Dependent Development," in J. Caporaso (ed), **A Changing International Division of Labour**, Lynne Rienner, Boulder, 1987.

[104]S. Dutt, "South-South Patterns of Exploitation", **Journal of Contemporary Asia**, vol.10,1980.

[105]There appears to be a lack of agreement between scholars and writers on the definition of NICs. The concept of NIC is used rather elastically to include anywhere from six to nearly twenty countries. Different writers use different indicators including GNP, per capita income, level of industrialisation, level and rate of growth of manufactured exports, and so on. An OECD study done in 1979 identified ten NICs based on : (a) their rapid penetration of world markets of manufactures; (b) a rising share of industrial employment; (c) an increase in GNP per capita relative to the advanced countries. The Chatham House study of NICs in 1982 focused on the Gang of Four, plus Brazil, Mexico, Argentina, and India - all of which had achieved export of manufactures in excess of $1 billion by 1976. In this study NIC refers to the ten largest exporters of manufactures in the developing world.

That it is only in the last few years that we have noticed a series of cases of economic growth and industrialization in the Third World, is due in no small part, to the appeal of the dependency theory up to the 1970s. Dependency theory, organized as it was around a dichotomy of a few highly developed countries supplying the bulk of the world's manufactured goods on one hand, and the developing countries supplying primary products on the other, saw trade as the key component in the asymmetrical relationship between the centre and the periphery.[106] The state was seen as no more than a hinge between international capital and Third World formation - a staging point in the symphoning of surplus. Working from a simple economism, dependency theory perceived Third World countries as incapable of undertaking indigenous development and improving their position in the world system. Bill Warren,[107] arguing from an orthodox Marxist stance, rendered a stinging critique of the dependency assertion that 'capitalism caused underdevelopment' in the Third World. Reversing the position of those whom he criticised, Warren pointed out the considerable capitalist development that has taken place in the Third World, the role played by the post-colonial state in this development process, and a consequent improvement in their structural position in the international economy. [108]

Comparative advantage theory refutes the 'unequal exchange' theories and views trade for the Third World in positive terms. The theory's central principle states that a country will specialise in those activities in which the opportunity cost of producing them is lower than it in other countries. It is this phenomenon of differences in opportunity cost that gives rise to profitable exchange between the most unequal of trading partners.[109] But this simple doctrine of comparitive advantage, based on

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[106]R. Higgot and R. Robison, **South-East Asia: Essays in the Political Economy of Structural Change**, Routledge and Kegan Paul, London, 1985, p.46.
[107]Bill Warren, **Imperialism: Pioneer of Capitalism**, Verso Books, London, 1980.
[108]Magnus Blomstrom and Bjorn Hettne, **Development Theory in Transition** , Zed Books, London, 1984, p.164; Richard Higgot, **Political Development Theory: The Contemporary Debate**, Croom Helm, London, 1983, p.55-6.
[109]Kimmo Kiljunen, "The international division of industrial labour and the

measures of labour productivity or relative endowments of labour and capital, has proved increasingly unsatisfactory in explaining what determines the changes in patterns and flows of international trade.[110] Its required assumptions of perfect markets, free availability of information and techonolgy, identical production functions and qualitative similarity of production factors among countries, are too hypothetical and unrealistic in the reality of the contemporary international economy.[111] "Differences between trading countries with respect to levels of development, size of domestic markets, degree of efficiency and diversification of production are ignored as are the different negotiating strengths of trading partners". [112] The theory also overlooks patterns and rigidities of a historical nature. Above all, it neglects the commonly accepted fact today that international specialisation does not take place through the market alone. Micro-macro policies of state also influence the patterns of international trade.[113] States systematically 'create comparative advantage'[114] by 'picking winners' and targeting particular industries for development and financial support, by general fiscal and monetary policies, support of education and research, import liberalisation and setting a realistic exchange rate.[115] As Zysman puts it, "Policy induced advantage can accumulate over time into real absolute advantage . . . as when abundant capital and protection allowed the investment in steel development which made Japanese producers preeminent.[116]

Over the years, several qualifications regarding the determination of comparative advantage have been made. The concept of factor endowment has been extended

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109(cont'd) core-periphery concept", **CEPAL Review**, no.30, 1986.
110OCED, **The Impact of Newly Industrialising Countries**, Paris, 1979, p.32.
111Kimmo Kiljunen, **op. cit.**, 1986
112UNCTAD, **Protection, trade relations and structural adjustment** , Belgrade, June 1983.
113G. White and R. Wade, "Developmental states in East Asia: Capitalist and Socialist", **IDS Bulletin**, vol. 15, April 1984.
114James Caporoso (ed.), **A Changing International Division of Labour**, Lynne Rienner Publishers, Inc., Boulder, 1987, p37.
115Stephen Haggard, "The newly industrialising countries in the international system", **World Politics**, vol. 38(2), 1986.
116J. Zysman, **Governments, Markets and Growth**, Cornell Univ. Press, Ethaca, NY, 1983, p.39.

beyond labour and capital to include natural resources, entrepreneurial skills, technological innovations and political will.[117] Product cycle theory emphasises technical innovation as an essential factor in a country's competitiveness. The theory proceeds from the premise that each product passes through a natural cycle, from birth through growth, maturation, and decline. New products are first introduced in technologically advanced countries and then gradually exported to others. As the product matures, technology becomes standardised and is diffused by the innovating firm, in the face of competition, to intermediate, low-cost countries. [118] There is, thus, a continuous renewal of the product cycle, with advanced countries losing the lead in some products and moving on to more sophisticated products, allowing the intermediate countries to step in. The theory helps to explain how patterns of trade and location in international production shift over time between countries at different stages of economic development, how countries move fluidly through a classic product cycle industrialisation pattern.

While the product cycle offers several advantages as an explanatory vehicle of international trade and production in manufactured goods, it stops short of shedding light on the dynamics of technology development and innovation in the NICs. This is partly because it is limited to technology embodied only in the product and thus holds the static perception of the NICs as basically recipients of hand-me-down labour-intensive technologies. It overlooks the contribution of domestic firms in terms of innovations and adaptation of imported technology to local requirements.[119]

The comparative advantage theories view the emergence of the NICs as a result of a generalised historical movement in which the advanced countries vacate the

[117] "Product cycle theory and international trade in the product cycle", **The Quarterly Journal of Economics**, vol. 80, 1966.
[118] Bruce Cummings, "The origins and development of the North East Asian political economy," **International Organisation**, vol. 38(1), 1984.
[119] Wenlee Ting, **Business and Technological Dynamics in Newly Industrialising Asia**, Quorum Books, London, 1985, p.71.

intermediate sectors in industrial production to the NICs and the NICs, in turn, vacate more basic industrial sectors in which the next tier of developing countries have a relative advantage.[120] Industrialisation is thus considered to be an identifiable uniform process of development and change whose main features are the same in all countries. As countries move up in the 'stages of development', their comparative advantage shifts towards highly capital-intensive and service sectors. [121] Contrary to this belief, several developed countries in the past, and now the NICs are not abandoning industries like textiles, apparel, and electronics assembly even as they move up the ladder of industrialisation. Indeed, the NICs are spreading from light to heavy, from unsophisticated to sophisticated industries - leaving little space for the newcomers.

A major corollary of the revival of the fortunes of the theory of comparative advantage in recent days has been the perceived success of export oriented industrialisation (EOI) strategies in a number of East Asian and Latin American countries over the last few years.[122] The proponents of the EOI strategy argue that it would lead to a form of development in the Third World which is more efficient and internationally competitive because it would promote production in lines in which these countries have an obvious comparative advantage, namely labour-intensive manufactures. Over time, these countries would progress towards more sophisticated manufacturing goods. While dependency theorists overly emphasise the static and unchanging aspects of the international system, the neo-classical view recognises such changes but downplays them by seeing them as largely relative. [123] It thus overlooks the serious obstacles to the NICs maintaining their success in export expansion, and even more so of the other

[120] Colin I. Bradford, Jr., "The rise of the NICs as exporters on a global scale," in Louis Turner and Neil McMullen (ed.), **The Newly Industrialising Countries**, Royal Institute of International Affairs, London, 1982, p.11.
[121]Bela Balassa, **The Newly Industrialising Countries in the World Economy**, Pergamon Press, Toronto, 1981, p. 164-5.
[122]Richard Higgot, "Export-oriented industrialisation, the new international division, and the corporate state in the Third World," **Australian Geographical Studies**, 22, April 1984.
[123] James Caparaso, **op. cit.**,p. 193.

developing countries emulating them.[124] Thus, the success derived, directly or indirectly, by the NICs from the adoption of EOI strategies are not easily generalisable. The benefits and costs quite widely vary with timing, the size of the country, the level of development, and other factors, national and international.

The emergence of the NICs cannot be understood just in terms of certain trade and export promotion policies. Indeed, these very developments equally emphasise the importance of the changing international context, its potential for creating opportunities and constraints for growth, and the importance of national economic strategies for the pursuit of more successful integrationist strategies.[125]

"The struggle for national development inevitably takes place in an international context, the changing circumstances of which define both constraints and opportunities for the various protagonists."[126] Ascribing such importance to the economic links between the state and the international system does not imply the dominance of the economic factors. While fully recognising the potential benefits of trade, what is really being emphasised is the importance of the domestic political task in continuously redefining the appropriate links a nation should maintain with the international system, not only in relation to particular national circumstances but also in the context of shifting international trends and developments.[127] As Katzenstein puts it, ". . . the main purpose of all strategies is to establish a basic compatabiity between domestic and international objectives."[128] The relative importance of domestic and international influences upon the

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[124] William R. Cline, "Can the East Asian Model of Development be generalised ?" **World Development**, vol. 10, 1982.
[125] Manfield Bienefeld, "Dependency in the eighties," **IDS Bulletin**, vol.12(i), 1980.
[126] M. Bienefeld, "The international context for national development strategies," in M. Bienefeld and M. Godfred (eds.), **The Struggle for Development : National Strategies in an International Context**, John Wiley and Son, Chichester, 1982, p. 25.
[127] M. Bienefeld, **op. cit.**, p. 26.
[128] Peter J. Katzenstein, "International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States," **International Organization**, vol. 30, 1976, p. 1-45.

macro-economic experience of developing countries varies from country to country. Mutual interaction and cumulative processes render it quite difficult to disentangle their separate impacts. There is, nevertheless, agreement that severe external shocks, like sharp plunge in international commodity prices, rapid increase in oil prices, protectionism, create serious difficulties of macro-economic management for all developing countries.[129] In the case of the NICs, a variety of historical circumstances, economic conditions, and physical characteristics have combined and converged to enable a dynamic process of development and export expansion. These conditions do not appear to be the same for each of these countries. Differences in market size, the role of indigenous capital, the timing of the mobilisation of labour, help to explain the divergence in their development patterns.[130] Hence it is suggested that the assertion of imprecise and abstract conceptualisations should give way to analysis which considers the specifity of the historical process in each of the NICs. A complete explanation of the NIC phenomenon requires a broader perspective taking into account specific economic and political conditions present within the NICs, as well the interdependence of these factors with the international environment.[131]

Thus, we find it difficult to share the optimism of the now strongly reasserted free trade orthodoxy, which advocates EOI and structural adjustments to market signals with the minimum of costs. We also disagree with the argument which attributes the emergence of the NICs primarily to the trade policies adopted by their governments; or which holds that this phenomenon can be extrapolated or generalised on the basis of Vernon's product cycle thesis, or some related notion of a progressive and sequential movement up a technological ladder.[132] We also oppose the view that 'large inflows of

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[129]G. K. Helleiner, "Balance of payments experience and growth prospects of developing countries : a synthesis," **World Development**, vol.14(8), 1986.
[130]Stephen Haggard, "The newly industrialising countries in the international system," **World Politics**,vol. 38(2), 1986.
[131]Agnes Gallez, "Asia's newly industrialising countries," **Vierteljahresberichte**, nr. 93, September 1983.
[132]M. Bienefeld, **op. cit.**, p. 26.

foreign capital and entrepreneurship following the logic of value' have been the most important factor in the development of the NICs.

While indebted to these approaches for theoretical and empirical insights, the argument that follows tries to adopt a somewhat broader perspective, encompassing the interaction among the political, the social, and the economic; the national and the international; the particular and the general. Bearing in mind that the NICs are a highly heterogeneous group of states with different underlying conditions and different policy responses, an attempt will be made, nevertheless, in the following pages to capture some of the important international factors in the emergence of the NICs.

The International Context

The rise of the NICs is "part of the cycle of constant change - of the ebb and flow of economies - that has characterised the world as far back as the great city-states of Rome, Carthage, and Troy."[133] The world economy must be viewed as an evolutionary system in which the locus of economic activities has continuously changed.[134] The emergence of the new industrial powers from Asia and Latin America have undoubtedly resulted in profound changes in the international realm. Contrary to the view of the dependency theorists, the recent prominence of these countries has considerably changed the relationship between the North and the South. The emergence of the NICs can be seen, to some extent, as a response to a set of international conditions in the period following the war - the rapid expansion of world trade and the relatively favourable access to the markets of the advanced countries, the accelerated diffusion of technological information, the dramatically increased access to international finance,

[133]Robert D. Hormats, "New Players in the International Economy," in T. F. Bradshaw et al., (ed.), **America's New Competitors**, Ballinger Publishing Company, Massachusetts, 1988, p. 7-10.
[134]Fernand Braudel, **The Perspective of the World - Civilisation and Capitalism, 15th-18th centuary, Vol.3**, New York: Harper and Row, 1979, p. 32.

and the increasing relocation of production to the developing countries.

The New International Division of Labour

An appropriate contextual background against which the recent economic growth of the NICs may be examined is that provided by the internationalisation of capital, which is resulting, as one manifestation, in a new international division of labour (NIDL). New approaches to the organisation of production have considerably contributed to the shift in the commodity composition of exports of some of the developing countries.[135] From being almost exclusively suppliers of agricultural and mineral raw materials, they have now emerged as important manufacturers of industrial goods. The industrialisation of the developing countries has, to some extent, been assisted by the internationalisation of production - a process which has involved the relocation of entire industries (such as textiles) as well as specific aspects of industrial production (such as component manufacture and assembly) from industrialised to developing countries.[136] According to Frobel et al., in what may be considered the most outstanding work on the subject, the new international division of labour: "(a) undermines the traditional bisection of the world into a few industrialised countries on one hand, and a great majority of developing countries integrated into the world economy solely as raw material producers on the other, and (b) compels the increasing subdivision of manufacturing processes into a number of partial operations at different industrial sites throughout the world, where the division of labour should be understood as an on-going and not as a final result."[137]

The internationalisation of production is the culmination of several factors which interact in complicated ways. One could focus on the developments in the advanced nations which led to a deterioration in conditions and opportunities for the expansion in

[135]OECD, **op. cit.**, p. 10.
[136]Richard Higgot, **op. cit.**, 1984.
[137]Folker Frobel, Jurgen Heinrichs and Otto Kreye, **The New International Division of Labour**, Cambridge Univ. Press, Cambridge, 1980, p. 45.

these countries. By the mid-sixties, two decades of unprecedented growth in the West led to a perceptible strengthening of the working class. Even the productivity increases had not been able to compensate for the relative rigidity of the wage level. This was explained either as a secular tendency of capitalist development as a result of the concentration and centralisation of the working class which accompanied the concentration and centralisation of capital, or as a result of the impact of the post war boom which largely eliminated the industrial reserve army in the advanced countries.[138] The post war inflation, the formal or informal indexing of wages to inflation, the Vietnam war, the minimum wage legislation, the social security contributions, all contributed to the rapid increase in the labour costs.[139] These increases in labour costs disproportionately affected the labour intensive industries. Thus, several of the manufacturing enterprises in the advanced countries sought production facilities in locations with abundance of cheap labour and other low costs to protect their competitve strength. The weakness of labour in developing countries and the growing wage differential between developed and developing countries made specialisation and decentralisation of production to the periphery an extremely attractive strategy for capital striving to increase productivity.

The process of 'transnational organisation of production and internationalisation of corporate-related services'[140] was greatly facilitated by a set of 'pre-conditions.' Particularly crucial were the technical advances in the production process which made possible fragmentation of complex processes and development of standard product lines in many different geographical locations.[141] The extensive and integrated systems of transport and communication gave access to practically inexhaustible world-wide

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[138]Rhys Jenkins, "Divisions Over the International Division of Labour," **Capital and Class**, vol. 22, Spring 1984, p. 18-52.
[139]James Caparaso, **op. cit.**, p. 190.
[140]J. Browett, "The newly industrialising countries and radical theories of development," **World Development**, vol.13(7), 1985.
[141]James Caparaso, "Industrialisation in the periphery : the evolving international division of labour," **International Studies Quaterly**, vol. 25(3), 1981.

reservoir of resources. And, finally, the transnational enterprise, with its knowledge of product and factor markets, tax and tariff regimes all over the world, was able to take advantage of low-cost labour, proximity to major markets, the existence of basic infrastructure, and political stability by moving capital, technology, managerial and marketing skills to favourable locations.[142] It must, however, be recognised that the coincidence of these factors in the 1960s did not by themselves result in the 'expected responses of capital to favourable and unfavourable spatial variations in the conditions for accumulation.'[143] It was the over riding pressure of capitalist competition that compelled individual capital, on pain of extinction, to search continually for lower costs and higher profits.

The new international division of labour approach is based on an oversimplification in its direct identification of industrial relocation with low labour costs. It denies any independent dynamic within the Third World and ignores the part played by specific national conditions and the role of the state in the emerging pattern of differentiation. It is clear that this process of relocation does not take place evenly throughout the peripheral world.[144] The selection of production site is determined partly by location and geo-political significance, partly by the existence of a strong internationally reliable regime and the generous incentives offered by it, and partly by the existence of cheap labour and raw materials, and institutional-technological infra-structure resulting from earlier *import substitution policies*.[145] Obviously, this search of the multinationals for favourable locations would not have been successful if there were no recipient countries possessing both the *capability* and the *need* to absorb the migrating technology and products. On the other hand, the import

[142] OECD, **op. cit.**, p. 33.
[143] J. Browett, **op. cit.**, 1985.
[144] Folker Frobel, "The current development of the world economy," in Herb Addo (ed.), **Transforming the World Economy**, United Nations University, 1984.
[145] Wenlee Ting, **Business and Technological Dynamics in Newly Industrialising Asia**, Quorum Books, London, 1985, p. 11.

substitution and later the export oriented strategies of the NICs would not have received such a boost if it had not been for the package of benefits delivered by the MNCs. One may also add that the process of industrialisation in the NICs and exports were encouraged in the 1950s and the 1960s by several governments of the industrialised countries through specific tariff regime which favoured re-exports of low value-added products to the country of origin of the inputs. The United States was the most sophisticated in implementing such regimes.[146] Thus, the degree and manner in which the developing countries became sites for world market production by foreign capital varied between countries and branches, but clearly formed part of the context for their expansion of exports.[147]

Along with the cornerstone strategy of attracting foreign investment, was a parallel effort in the NICs in promoting and encouraging the growth of indigenous enterprises by the state. Indeed, in several of these countries the end result was a triple alliance - partnership of state, local capital, and foreign capital into a 'nationalist' schema of accumulation for the development of the local economy.[148] In this sense, DFI was a policy rather than an exogenous variable in their industrial development.[149] Taking this position, Bienefeld holds that the NICs were not passive recipients of an internationally determined stimulus, but that major changes in the international economy created conditions and opportunities which a few countries which had certain geo-political, and internal economic and political charecteristics were able to utilise to produce very rapid growth and industrialisation."[150] In other cases, where such indigeneous effort was lacking, the internationalisation of capital no more than transformed the 'banana republics

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[146]OECD, **op. cit.**, 1988, p. 7.

[147]Hubert Schmitz, "Industrialisation strategies in less developed countries," **Journal of Development Studies**, vol. 21(1), 1984.

[148]Peter Evans, **Dependent Development : The Alliance of Multinational, State, and Local Capital in Brazil**, Princeton : Princeton University Press, 1979.

[149]UNIDO, **Industrial Policy in East Asia 1950-1985**, May 1986, p. 28.

[150]Manfred Bienefeld, "Development and the NICs," **Studies in Political Economy**, vol. 25, Spring 1988, p. 7-39.

into pyjama republics,' merely reinforcing the dependent integration of these societies into the world economy based on exploitation of cheap labour, industrial export production enclaves with few links with the national economy, and dominance of multinationals through their control of technology and capital.[151]

The authors of new division of labour approach, while drawing attention to the role of multinationals in the industrialisation of developing countries, have also tended to somewhat exaggerate the extent of the phenomenon. The export of capital is still predominantly between developed countries than towards cheap labour countries of the Third World. Nayyar has documented the relative unimportance of DFI in the volume of manufactured exports from developing nations vis-a-vis (1) DFI in the export of primary commodities and raw materials, (2) non-foreign owned manufacturing exports from peripheral nations.[152] Among the NICs, countries like South Korea, HongKong, Taiwan, and particularly India, have relied far less on DFI for industrialisation and export promotion than Singapore, Brazil and Mexico. Their reliance on foreign lending has been relatively higher than on DFI (see Table 2.1). The important thing is, a majority of the NICs have exercised extreme caution and selectivity in dealing with DFI. Thus, it does seem that cognisance must be taken of the ever changing forces at work not only in the world economy but also in the incipient NICs for "it is the environment which capitalism encounters on its expansion path (rather than capitalism per se) which, in large part, renders the process of expansion uneven."[153]

[151]Rhys Jenkins, **op. cit.**, 1984.
[152]Deepak Nayyar, "Transnational Corporations and Manufactured Exports from Poor Countries," **The Economic Journal**, 88(1), 1978, p. 59-84.
[153]John Browett, **op. cit.**, 1983.

Table 2.1 has been removed due to the unavailability of copyright permission.

Table 2.1. Net Direct Foreign Investment (NDFI), 1970 and 1977 (US$ millions)
Source: World Bank, **World Development Report**, 1979.

Access to Markets, Finance and Technology

Another crucial factor in the emergence of the NICs as important suppliers of manufacturers on the world markets was the favourable liberalising trend in the world trade in the 1950s and the 1960s. The NICs had the good fortune of breaking into world markets during the two decades of exceptionally rapid growth of the world economy. Manufactured exports were allowed into both Europe and North American markets without major obstacles, as these economies were still in their post war boom. Over the decade from 1963 to 1973 the volume of world exports rose at a rapid average annual rate of 8.5%.[154] In 1965, the total value of manufactured exports from the Third World came to 5.4% of the value of similar exports from developed market economy countries and 4.5% of total world manufactured exports. By 1974, Third World exports had risen to 8.4% of DC exports and 7.1% of total world exports. In terms of growth, in the ten year period 1965-74, developing countries recorded real growth rates of 16.3%, compared to 10.6% for the world as a whole and 10.8% for developed countries. [155] The main exporters for the Third World were relatively few in number. By 1976, Brazil, HongKong, Mexico, Singapore, South Korea, Taiwan, and India

[154]Robin Broad and John Cavanagh, "No More NICs," **Foreign Policy**, no. 72, Fall 1988, p. 81-103.
[155]Sanjaya Lall, **Developing Countries in the International Economy**, Macmillan Press, London, 1981, p. 73-4.

accounted for fully 70% of the developing world's manufactured exports. Under special tariff provisions, certain manufactured goods entered the national markets almost free of tariff duties when inputs were supplied by the country of importation. In the case of the US, imports from developing countries under these tariff provisions rose by 29.5 percent annually between 1966 and 1979.[156] During this period multilateral arrangements reduced tariffs and other trade barriers of the major industrialised countries.[157] In both the Kennedy Round (1963-1967) and the Tokyo Round (1973-1979) the exports of LDCs were accorded special treatment regarding trade concessions. Chapter IV, formally outlining the 'principle of non-reciprocity', was added to the original Gatt articles. It provided favourable market access for LDC exports to the industrialised countries without requiring a reciprocal commitment from the LDCs.[158] In 1970s the Generalised System of Preferences adopted by the developed countries (with exclusions), also played a modest positive role.[159] "Thus, it was this almost ideal timing between these trade liberalisation actions and the NICs' launching of their export expansion policies in the 1960s and early 1970s that in no small measure contributed to and stimulated the self sustaining and the dynamic waves of industrial expansions in these countries."[160]

Relatively easy access to finance and technology also contributed to the rise of the NICs. "A buoyant transnational banking market developed over the 1960s and 1970s, specialising in borrowing and lending currencies outside the country of issue, commonly known as the 'Eurodollar' market."[161] In the 1960s and early 1970s, the currency supply was fuelled by the overly expansionary American monetary policy,[162] and in the 1970s

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[156]Hubert Schmitz, **op. cit.**, 1984.
[157]Robert Gilpin, **The Political Economy of International Relations**, Princeton Univ. Press, Princeton, 1987, p. 191.
[158]Wenlee Ting, **op. cit.**, p. 14.
[159]OECD, **op. cit.**, p. 11.
[160]Wenlee Ting, **op. cit.**, p. 14.
[161]Hubert Schmitz, **op. cit.**, 1984.
[162]Robert Gilpin, **op. cit.**, p. 315.

by the OPEC surplus generated after the quadrupling of the energy prices in 1973. The abundance of investible funds created by the OPEC surplus, the growing recession in the advanced countries, the promise of extraordinary profits, greatly facilitated the financing of productive investment by the commercial banks in countries outside the OECD, notably the dynamic and creditworthy NICs. At the same time, producers of capital goods in the industrialised countries, faced with weak demand at home, resorted to aggressive export promotion outside these countries.[163] The high-growth, high-exporting developing countries became the largest borrowers in this period due in part to their growth prospects and their promising outlook in foreign exchange earnings through exports. Together, the eight NICs that generated three-quarters of developing-country exports of manufactures in 1976 accounted for 40% of the accumulated foreign debt of developing countries by 31 December 1979.[164] This recycling of the dollars allowed the developing countries to escape the 'conditionality' of multilateral agencies and the influence of unilateral aid-givers. It also assisted them in stepping up production drastically in several capital-intensive lines. Indeed, between 1970 and 1977 the overall growth rate in the South slipped only slightly to 5.5% per annum as compared to 3.2% of the North. The South's growth rate of manufacturing value added was maintained at 7.2% per annum, and the growth rates of imports and exports of manufactures even accelerated slightly to 11.5% and 12.1% per annum respectively.[165]

Another major factor in the growth spurt of the NICs and the international distribution of wealth and power has been the diffusion of economic technology since the 1960s from the developed countries to the developing countries.[166] Since the third session of UNCTAD at Chile in 1972, the developed countries have made a concerted

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[163]OECD, **op. cit.**, p. 35.
[164]Colin I. Bradford, "NICs in an Interdependent World," **The World Economy**, vol. 5(2), 1982, p. 171-185.
[165]UNIDO, **Industrial Development and South-South Cooperation**, March 1984, p. 3.
[166]Robert Gilpin, **War and Change in World Politics**, Cambridge University Press, Cambridge, 1981, p. 177.

effort to improve the access of developing countries to the existing world stock of technologies and thereby strengthening their national technological capability.[167] In the early stages of the development process, the NICs were basically almost passive beneficiaries of hand-me-down technologies, through foreign governments and multilateral agencies, through the dictates of the product cycle and the activities of the multinationals. However, today the NICs are not only able to acquire "off the shelf" pre-packaged technologies and manufacturing know-how instantly, but also have taken great strides in developing indigenous technology, giving them shifting dynamic comparative advantages on world markets. Enjoying the "advantages of backwardness", these developing countries are able to skip historical stages in technology development, exploit the experience of the more advanced countries, and frequently even threaten to overtake and surpass the original centers.[168] As Thorstein Veblen observed that one reason for this advantage is that "the imitators ... can adopt the most advanced and the most thoroughly proven techniques, whereas prior research-and-development costs and vested interests deter the more advanced economy from substituting the very latest techniques for obsolescent techniques. Thus, with lower costs, untapped resources, and equivalent technology, backward societies frequently can outcompete the more affluent advanced society economically and militarily."[169]

However, the process of technology transfer and diffusion from the advanced to developing countries is not even. It varies from country to country, depending on the recipient country's capacity and willingness to acquire technology. An important precondition to the adoption of advanced technology is an advanced economic and scientific base to build on.[170] Some countries, like India and Korea, have adopted deliberate policies to ensure the adaptation and diffusion of technology from abroad.

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[167]UN, **Proceedings of the UNCTAD : Vol. III**, New York, 1981, p. 246.
[168]Alexander Gerschenkron, **Economic Backwardness in Historical Perspective**, Harvard University Press, Cambridge, 1962, p. 8-9.
[169]Quoted in Robert Gilpin, **op. cit.**, 1981, p. 178-9.
[170]Ibid., p. 177.

Thus, though exposure to foreign technology has been important for technological advancement, this has not been through being a passive recipient but through active adoption and diffusion. Some of these developing countries have built up capabilities for design, technical adaptation and creation of products and processes through the gradual learning resulting from import substitution, technology development, leading finally to technology exports. In many cases, through a combination of innovation, cost cutting measures, upgrading and adapting capital equipment, and state and private sector cooperation, the 'latecomers' have developed more appropriate products and processes at more advantageous costs than similar products and technologies in developed countries.[171] In these sectors, the NICs have emerged as technology suppliers in world markets, particularly to other developing countries through licensing arrangements and DFI. An important factor in the NICs' technological advancement has been the abundant pool of relatively inexpensive engineering and technical manpower.[172]

Changing World Economy and Increasing Constraints

The path to continued and positive growth does not appear to be a smooth one for the NICs. Since 1972, a series of shocks and sharp cyclical swings affecting the world economy have considerably distorted world markets for manufactures.[173] Beginning in 1973, an economic deceleration slowed down the average annual expansion of world exports to 4% from 8.5% over the last decade from 1963 to 1973. By 1980, the increase was a marginal 1% per year, and in 1980 world exports showed no growth.[174] Both developed and developing countries were deeply affected in terms of their internal and external equilibriums by these disturbances. Some of the forces

[171]UNIDO, **High-level expert group meetings preparatory to the Fourth General Conference of UNIDO**, August 1983, p. 8-9.
[172]Louis Turner, et. al., **Living with the Newly Industrialising Countries**, Royal Institute of International Affairs, London, 1980, p. 3-5.
[173]OECD, **op. cit.**, p. 10.
[174]Robin Broad and John Cavanagh, **op. cit.**, 1988.

actively influencing the present and the future pattern of the NICs' development process are the marked increase in oil prices in 1973-74 and again in 1979; the sharp deterioration in the international economic situation, characterised by a slowing down of growth in international trade; a sharp drop in many a commodity prices; and a sharp increase in interest rates on international lending. These countries in the 1980s, thus, face a new period of adjustment in which they must aim at strengthening the balance of payments in order to maintain their rates of growth.

Oil Crisis and World Trade

The policy responses to the oil crises of 1973 varied from country to country, but many NICs succeeded in improving their current account position fairly soon.[175] They did so partly by containing domestic demand for imports, partly by shifting resources to exports, and partly by borrowing to finance their development and their international payments deficits. In fact, the easy financing conditions coinciding with the slack demand in the OECD, enabled many non-OECD countries to step up their imports, esentially of investment goods, thus providing considerable support to OECD manufactured exports in their recession of 1974-75. Through 1977 this strategy appeared to be working, but with Iran moving towards chaos in late 1978, the OPEC nations successfully pushed for a big price rise in 1979.[176] For various reasons, this round of energy price increases hit most developed and developing countries very hard.

Protectionism

The trade policies of the industrialised countries have played an important role in the changing pattern of trade in manufactures. Persistently sluggish growth, high unemployment, balance of payment deficits in the developed countries have all combined

[175]OECD, **op. cit.**, p. 10.
[176]Neil McMullen, **The Newly Industrialising Countries : Adjusting to Success**, British North American Committee, Washington, D. C., 1982, p. 70.

to slow the gowth of trade and revive economic protectionism. During the period 1970-77, in the North the overall growth rate fell by 40% to 3.2% per annum, the growth rate of manufacturing value added fell by 50% to 3.1% per annum, the growth rate of imports of manufactures fell by 45% to 6.2% per annum, and the employment in manufacturing did not grow at all.[177] It was in this context that the dynamic growth of the NIC manufactured exports were perceived as "an additional cause of the European and American economic malaise rather an attendant development which may indeed relieve these strains."[178] Thus, by the late 1970s, several broad changes began to erode the post-war system of trade liberalisation. As tariff barriers within the various rounds of multilateral trade negotiations fell, non-tariff barriers emerged in most developed countries. In addition to the growing unilateral imposition of traditional non-tariff measures, such as quotas, licensing, and surveillance schemes, greater and greater use is being made of "voluntarily" undertaken or negotiated export restraints.[179] These 'negotiated' restrictions, whether in the form of 'voluntary export restraints' or 'orderly marketing arrangements', now form an alarming pattern of new-proctectionism. In more realistic terms, these can probably be understood in terms of market-sharing arrangements in favour of aging and inefficient domestic enterprises in developed countries at the expense of competitive foreign producers. The new protectionism tends to be of a profound discriminatory and selective nature and, when aimed at the developing country suppliers, generally takes advantage of the weak bargaining power of these countries.[180]

Although developing countries account for a small but growing share of world trade in manufactures, they have been severely affected by such protectionist policies.

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[177]UNIDO, **Industrial Development and South-South Cooperation**, March 1984, p. 3.

[178]Colin I. Bradford, **op. cit.**, p. 8.

[179]Gary P. Sampson, "Contemporary Protectionism and Exports of Developing Countries," **World Development**, vol. 8(2), 1980.

[180]UNCTAD, **Implications for Developing Countries of the New Protectionism in Developed Countries**, UNCTAD V, Manila, May 1979, p. 4.

Due to their generally less diversified industrial base, the expansion of a small number of exports is often their most important catalyst for economic growth and provides a major source of finance for their vitally needed imports of manufactures and technology. The accentuation of protectionist measures in developed countries has been largely in those areas of manufactures where developing countries have a proven comparative advantage. The products affected by these measures are not only the traditional unskilled labour-intensive products such as textiles, leather and footwear, but also the highly skilled labour and capital intensive products like steel, engineering goods, electronic equipment.[111]

A majority of these barriers and restrictions have been aimed specifically against the growing NICs - clearly drawing a line between the countries of the developing world. The selective safeguard debate concerning Article XIX of Gatt, the Multi-fiber Agreement, Voluntary Export Restraints, the increasing reciprocity claims, the graduation principle, all attempt to deny the NICs the 'differential and favourable' treatment accorded to the rest of the developing countries.[112] The erosion of the GSP in its basic principles of non-discrimination and non-reciprocity has had serious implications for these exporting countries and their firms. ". . . governmental barriers against 'disruptive' imports into the North are much more likely when they emanate from firms which are truly 'foreign' than when they originate in subsidiaries of firms within the importing country."[113] Many of the competitive domestic enterprises from the NICs are seeking direct foreign investment as a means of circumventing tariff barriers set up both by the regional trading blocs and the developed countries and the developing countries pursuing import-substitution policies. "There is little doubt that to obtain and increase a share in foreign markets for industrial items, developing country enterprises who wish to keep

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[111]International Monetary Fund, **The Rise of Protectionism**, Washington, 1978.
[112]Neil McMullen, **op. cit.**, p. 80.
[113]G. K. Helleiner, **For Good or Evil : Economic Theory and North-South Negotiations**, Toronto : Univ. of Toronto Press, 1982, p. 55.

control over their growth prospects, must project themselves internationally through DFI and other forms of technology exports."[114]

Growing International Competition

Aside from protectionist pressures, a series of other developments have also stunted global demand for goods and services from developing countries. "Prominent among these developments are the commercial banks' handling of the Third World debt crisis, corporate substitution for the raw materials, and labour-saving technological innovations in the developed world."[115] Further, as more and more developing countries, including the NICs and the People's Republic of China, compete against each other to win scarce export markets, the field threatens to become more crowded and the battles more vicious. As a deputy governor to the Philippine Central Bank remarked, "We've got to always be careful now, always watching, on the lookout for other (developing) nations' next moves ... And then we've got to make sure we meet their offer and better it."[116] This applies equally to the endeavors of other developing countries, including China, to attract more DFI from both developed and developing countries for the purpose of reducing their dependence on borrowing, gaining access to advanced technology and scarce capital, import substitution and export promotion. In many cases, the multinationals from the NICs are preferred because of their political acceptability, and the suitability of their technolgy and products to the local conditions, smaller scales, simpler and more labour-intensive technologies, higher flexibility of equipment, and use of local inputs and raw materials. At the same time, firms from some of the more advanced developing countries have increasingly invested abroad to protect, expand, and capture export markets. According to one study, as many as 85% of the MDCs have

[114]Peter O'Brien, "Third World Enterprises as Exportes of Technology," **Vierteljahresberichte**, nr. 83, March 1981: 116.
[115]Robin Broad and John Cavanagh, **op. cit.**, 1988.
[116]Ibid.

invested overseas to defend their export markets.[187] The implications of this highly competitive situation for the behaviour of states and their firms are best summed by Benjamin Cohen using the theory of oligopolistic competition : In a situation of competition, interdependence, and uncertainty, the survival of any one unit is the function of the range of alternative strategies available. The oligopolistic firm with only one strategic option leads a precarious existence: if that strategy fails to result in profit, the firm will disappear. Likewise, the state with only one strategic option can never feel truly secure ... For both the firm and the state, the rational solution is to broaden its range of options ...[188]

Indebted Industrialisation

The growing external debt of developing countries further creates a serious hurdle in their growth. The total world debt shot up approximately from $ 100 billion in the early 1970s to nearly $900 billion by the mid-1980s. [189] Many developing countries, among them many NICs, borrowed heavily during this period from governments, international organisations, and commercial banks in the advanced countries to finance their economic growth (indebted industrialisation). In addition to stringent domestic regulations in creditor countries to defend the stability of their own financial institutions, the slow-down in economic growth in the advanced countries, growing protectionism, and high interest rates in the world markets have greatly contributed to a severe debt crises in international finance.[190] The political context of the debt problem makes the search for compromise solutions extremely difficult. Thus it appears, that the combined implications for developing countries of slower-than-expected OECD growth, greater than expected market politicisation and protectionism in the advanced countries, and

[187]Sumitra Chisti, **op. cit.**, 1986.
[188]Quoted in Robert Gilpin, **op. cit.**, 1981, p. 87.
[189]Robert Gilpin, **op. cit.**, p. 315.
[190]Charan D. Wadhva and M. G. Asher (eds.), **Asean-South Asia Economic Relations**, Southeast Asian Studies, Singapore, 1985, p. 1.

higher than expected interest rates poses very serious problems. Political stability in several of these countries is undermined due to growing unemployment, severe cutbacks, and slow economic growth. Rapid export growth from the developing countries is necessary not only for balancing current account deficits, to restore credit-worthiness, to meet debt servicing obligations, but also to earn precious foreign exchange required to satisfy additional import demand related with growing production and economic revival in general. And, indeed, if exports are important to growth in developing countries, manufactured exports are particularly important. In view of the collapsing commodity prices, the developing countries cannot rely on growth of raw material exports to create export expansion.[191]

The domestic economic policies of national governments and the interaction of these policies are important determinants of the volume, direction, and pattern of world trade and investment.[192] Paradoxically, growth in economic interdependence and competition has only served to increase the significance of national policies for trading relations. In the NICs, these policies have ranged anywhere from simply providing infrastructure for development, to channeling scarce resources into industrial sectors, protecting infant industries, attracting and regulating foreign investment, and providing incentives in sectors with potential comparative advantage. On a different dimension, the state acts as an entrepreneur, actively participating in business through state-owned enterprises and joint ventures, directly maintaining its control over the key sectors in the economy and assisting the private sector in achieving international competitiveness.[193]

Although all these state actions are important, in recent years the stimulation of manufactured exports and simultaneous restructuring of the economy have been the

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[191]William R. Cline, **Exports of Manufactures from Developing Countries**, Brookings Institution, Washington, D. C., 1984, p. vii and 121.
[192]Robert Gilpin, **op. cit.**, 1987, p. 209.
[193]Stephen Haggard, **op. cit.**, 1986.

centrepieces of their overall economic strategies.[194] States are increasingly resorting to 'strategic trade policies'[195] in an attempt to change the international environment to their advantage. Through protection, subsidisation, bargaining, and other measures, states endeavor to capture for their firms a large share of the markets and of the economic rents in imperfect world markets. Domestic firms, with state assistance, are increasingly venturing abroad to preserve, promote, and penetrate export markets. Thus, fundamental to the development process in the NICs has been each state's commitment to manufactured-export-oriented policies, as well as its capacity, administrative and political, to implement them or to create conditions for their success. To put it in the words of Dixit and Grossman, "As governments recognise that the international market is really one of imperfect competition rather than the ideal competition of liberal theory, they may well reason that it is far better for their own firms, rather than other countries' enterprises, to enjoy the resulting profits."[196]

The export oriented success of the NICs has often been falsely characterised as exhibiting the efficacy of a 'laissez faire' strategy. Nothing could be further from the truth for the active role of the state and import substitution industrialisation have been crucial preconditions to this process. Most NICs, today, pursue a combined strategy of export promotion in some sectors and import substitution in others.

Just as developments in the international context have been a major factor in the emergence and growth of the NICs, so they will be important determinants of their future course. Among the more important factors will be the continued access to the markets of developed countries, and to international finance and technology. Since each of these conditions is under threat, it would be foolish to extrapolate the NIC

[194] James Caparaso, op. cit., 1981.
[195] Robert Gilpin, op. cit., p. 215.
[196] Quoted in Robert Gilpin, op. cit., 1987, p. 216.

experience of the past 15 years.[197] However, specific trade policies of the advanced countries and other developing countries do not have an automatic influence in determining the export flows from the NICs. The influence of international factors will vary from state to state depending on various factors. True, no state today can insulate itself from the influence of international factors, but it is also not beyond its capacity to seek more or less positive adjustments in response. Hence it would appear that the impressive export expansion of several NICs has resulted from policies aimed both at exploiting the openings offered by trade liberalisation while overcoming or by-passing the continuing or newly created barriers. It is this interaction of domestic and international forces which results in divergent develpment strategies.

Conclusion

The diffusion of economic activities and the growth process does not take place evenly through-out the developing world. "The distribution of raw materials, the existence of entrepreneurial skills, and the networks of communication as well as the policies of the governments and other factors favour one area over another. Nations commence their development at different times and grow at different rates, and spread takes unevenly in the form of new concentrations of economic power and wealth. In time, what was an undifferentiated part of the periphery becomes a growth pole in its own right and may even become a center for the further diffusion of economic growth."[198]

We have argued in this chapter that the favourable international conditions of the 1950s and the 1960s combined with the domestic conditions in the NICs to create an environment for the rapid industrialisation of these countries. A set of international

[197] Manfred Bienefeld, op. cit., 1980.
[198] Ibid., p. 95.

contradictions, at one and the same time, produced : relatively favourable access to certain industrial-country markets; dramatically increased access to international finance and technology; and a sharp increase in multinational firm interest in relocation of production for third-country markets.[199] While these international changes and external forces created both the constraints and opportunities for national actors, they did not determine which countries would actually use (or abuse) these opportunities in pursuance of their national goals. This was partly determined by location or geo-political significance; partly by the existence of a strong, 'internationally reliable' regime; and partly by the existence of a significant technical infra-structure and skill base.[200] The interaction among these international and national factors resulted in astonishing growth in a few developing countries, particularly in some sectors of their economies in which they were able to extend themselves abroad by way of exports and DFI.

Since the late 1970s, as markets became more and more difficult to find; finance more expensive and much more difficult to get; technical change much more rapid; and prospects for terms of trade for traditional primary exports much more bleak; governments were increasingly forced, in an attempt to assist their own national firms, to intervene more and more in all aspects of domestic and international economies. "It is this real world of imperfect competition and multinational corporations that tempts governments to provide support to country's national economic champions and to develop a strategic trade policy that shifts profits to national firms."[201]

However, one should not lose sight of the important fact that promotion of industrial development and exports is only one of the many objectives of national policy. Some political and social objectives, such as self-sufficiency, power, prestige, regime

[199]Manfred Bienefeld, "International Constraints and Opportunities," Paper presented to a workshop on Facilitating Indigeneous Technological Capability, Univ. of Edinburgh, Mar. 1982.
[200]Ibid.
[201]Quoted in Robert Gilpin, **op. cit.**, 1987, p. 216.

popularity, may be in harmony with the goal of rapid economic growth or may require a compromise on the economic front to accommodate them. Thus, foreign and domestic economic strategy cannot be divorced from the realities of domestic politics, the perceptions of the political elites, the form of the state, the physical and material circumstances of the country, the international alignments, and so on. The emergence of NICs as major suppliers of technology, skills, and capital, and the complementarity of interests between the corporations and their governments, can only be understood in this wider context. In the following chapter we will examine additional empirical evidence to support our proposition that the level of investment, to and from a country, depends on the stage of development of the country. We will also take a bird's eye view of the overall trends in international DFI in the post-World War II period to assess the extent and nature of DFI outflows from developing countries.

CHAPTER 3

FOREIGN DIRECT INVESTMENT IN THE EIGHTIES

This chapter presents a brief aggregate survey of the overall trends in international direct investment in the post-World War II period. It also traces the changing geographical and industrial distribution of global DFI and the increasing diversification in both its origin and destination. In this section of the chapter, we particularly focus on the emergence of a widespread phenomenon of internationalisation of local firms from developing countries, actively engaged in direct investments abroad. We give a cursory and descriptive view of the motives, characteristics and strategies of MDCs in general, and explore the implications of this phenomenon for the host developing countries. In the latter half of the chapter we outline a quantitative and qualitative description of Indian DFI in terms of its size distribution and pattern. The purpose of this exercise is to gain a rough picture of the magnitude and direction of DFI outflows from developing countries, particularly those from India.

Recent Direct Foreign Investment Trends

The rapid growth of multinationals has been one of the landmark developments of the post-World War II period. The post-war setting provided a highly favorable atmosphere for MNCs, and although not completely new, their rapid expansion globally, their capability to integrate business across national frontiers, their enormous command over economic resources, and their enviable possession of technology and managerial skills have had significant repercussions for the world economy. At the end of 1983, the world stock of direct foreign investment (DFI) was over $600 billion as compared with $66 billion in 1960 and $213 billion in 1973.[202] Impressive as this figure is, it

[202]United Nations Center for Transnational Corporations (UNCTC), **Trends and**

Table 3.1 has been removed due to the unavailability of copyright permission.

Table 3.1. Market economies: gross inflows of DFI, 1970-1983 (percentage)
Source: UNCTC, **Trends and Issues**, 1985, p. 7.

underestimates the total impact of MNCs, for over the years non-equity forms of participation (e. g., licensing, turnkey operations, management and consultancy contracts) by multinationals in the host economies have become quite important. Further, affiliates of multinationals often finance their operations with borrowings of their own, so that a small investment by a parent company often results in a significant presence in the host country's economy.[203] The 1970s clearly witnessed a vigorous expansion in DFI which came almost to a halt in 1981, a good two years after the downturn in world economic activity, exhibiting a pro-cyclical pattern with a time lag. Between 1981 and 1983, in terms of dollars, DFI into developed countries declined by almost one quarter and into developing countries by almost a third. In most parts of the world economy the decline continued well into 1984 and 1985 also, although North America and South-East Asia began to experience a sharp increase in inflows beginning 1984. In Western Europe, the recovery was rather modest. (See Table 3.1)

Since the late 1970s, a certain diversification has taken place in both the origin and the destination of DFI. Although large domestic firms from the more industrialised developing countries have invested abroad in recent years, the bulk of DFI originates in

[202](cont'd) Issues in **Foreign Direct Investment and Related Flows**, New York, 1985, p. 3 and 15.
[203]Ibid.

the developed market economies. The Western developed economies still account for 97 percent of recorded direct investment outflows, and almost three-quarters of the flows are channeled among themselves.[204] The most dramatic development in recent years, in flows among developed countries, has been the swing in the net position of the United States from a net exporter of DFI to a net absorber.[205] Outflows from the United States declined from over 60 percent of the total outflow in the early 1970s to only 25 percent in 1985. On the other hand, inflows increased from a mere 9 percent of the world total in the early 1970s to nearly 39 percent in 1985.[206] The decline in United States' share of outflows has been compensated mainly by countries like Canada, the Federal Republic of Germany, Switzerland, and Japan. Japan's share in world outflows of DFI jumped from 6 percent in 1975 to 11 percent in 1985. In contrast, Japan absorbs an insignificant share of world total DFI inflows.[207]

The developing countries attract a relatively minor share of DFI, accounting for about one quarter of the total inflows.[208] Among the developing countries, DFI inflows are concentrated in a few more industrialised and resource rich countries in Asia and Latin America. This concentration has drastically increased in the 1980s. The twenty largest developing country recipients of DFI account for almost 90 percent of the inflows to developing countries as compared to two-thirds in the early 1970s.[209] Flows to developing countries have fallen by almost a third since their peak in 1981. In the 1980s, governments of developing countries opened their doors wider to multinationals because of the effects of world recession, the experience of the global debt crises, and the decreasing availability of other forms of capital and technology. However, the

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[204]UNCTC, **Trends and Issues**, p. 31.
[205]UNCTC, **op. cit.**, 1985, p. 17.
[206]UNCTC, **Transnational Corporations in World Development**, United Nations, New York, 1988, p. 74-5.
[207]Ibid.
[208]John Hein, **The World's Multinationals : A Global Challenge**, The Conference Board, New York, 1981, p. 4-5.
[209]UNCTC, **Trends and Issues**, p. 28.

direction of investment inflows has still not reversed in favour of developing countries.[210] The severe debt-servicing difficulties of several developing countries, the depressed domestic demand, the heightened risk of restrictive government policies and foreign exchange controls have considerably discouraged DFI inflows.

DFI Outflows From Developing Countries

Yet the most interesting and fascinating development in the nature of DFI flows, from our perspective, has been the emergence of developing countries as a source of DFI. The last two decades have witnessed an increasing tide of internationalisation of firms from these countries reflecting, among other things, the gradual maturing and upgrading of domestic technological capabilities in the more advanced nations of the Third World. What started as a tiny trickle in the 1960s, has now turned into a steady stream. In South-East Asia, it is close to a flood.[211] The major home countries appear to be Argentina, Mexico, and Brazil in Latin America, India, Hongkong, Singapore, Korea, and Taiwan in Asia; and some of the major oil-exporters and Israel in Middle East. Though the amounts of DFI originating from these countries have been relatively small, they appear to be growing rapidly. According to the UNCTC data, the DFI outflows from developing countries represent only about 3 percent of the total world stock of DFI, although this was a marked increase over the 0.3 percent recorded for 1970-72 and almost 2 percent reported for 1978-80.[212] Interestingly, DFI from developing countries during 1978-80 grew at a much faster rate (41.3 percent) than DFI on a global scale (15.6 percent).[213] The largest investing region from the developing world in 1985 was

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[210] Robert Gilpin, **op. cit.**, 1987, p. 253.
[211] Tim Shorrock, "Multinationals Third World Style," **Multinational Monitor**, Jan. 1984, p. 6.
[212] UNCTC, **Transnational Corporations in World Development**, New York, 1985, p. 22; UNCTC, **Trends and Issues**, p. 31.
[213] Nagesh Kumar, "Foreign Direct Investments and Technology Transfers Among Developing Countries," in V. R. Panchmukhi et. al., **The Third World and the World Economic System**, Radiant Publishers, New Delhi, 1986, p. 142.

Latin America (47 percent of total LDC DFI), followed by Asia (27 percent), Middle East (12 percent), and Africa (2 percent).[214] In terms of annual growth rates between 1975 and 1985, DFI from Asia increased at a faster rate (17 percent) than from Latin America (16 percent), but growth rates of both regions were surpassed by those of Middle East. By the early 1980s, Arab multinationals accounted for capital investments of at least $36 billion, thereby accounting for more capital than all the rest of Third World's multinationals put together.[215] The dramatic increase in DFI flows from Asia, in the 1980s, are to a large extent due to the surge of DFI from China.[216] The DFI from developing countries is largely being undertaken by indigenous companies which are the local technological leaders.

However, it must be emphasized that these estimates on the size and value of DFI from developing countries are, at best, approximate indicators of the trend. The significance of this phenomenon is not reflected in the statistics of these countries. There are no developing countries, except India and Korea, which regularly publish data on outward DFI stock, let alone keep comprehensive and consistent data that can be meaningfully aggregated and compared.[217] In attempting to study the MDCs, one is sometimes limited to anecdotal evidence and inadequate data. Lack of comprehensive information regarding this phenomenon tends to downplay its increasing importance in the world economy. Most MDC investment usually takes the form of joint ventures with minority participation, which also leads to their under-estimation. Some overseas investments have been made clandestinely to avoid official controls. Most developing countries have rather strict foreign exchange controls to restrict the outflow of capital. For this reason, investors from LDCs frequently use their already-established foreign subsidiaries for further investments. Several Indian firms as well as Brazil's Petrobras

[214]UNCTC Data Bank, 1988.
[215]J. B. Nugent, "Arab Multinationals: Problems, Potential and Policies," in K. Khan, **op. cit**, p. 165-83.
[216]Ibid.
[217]Marjan Svetličić and Matija Rojec, **op. cit.**, p. 31.

have adopted this practice. Thus, the reported figures presumably represent only a fraction of the real phenomenon in question. Wells, the leading authority on the subject, identified in 1980 as many as 963 parent firms from developing countries which operated through the network of around 2000 overseas subsidiaries and branches in over 125 host countries, mostly developing countries. Approximately 938 of them were engaged in manufacturing. Wells, however, estimates the actual numbers to be three to four times higher.[218] (See Table 3.2)
In 1975, only 17 MDCs, from private and public sector, featured in the Fortune International 500. By 1984 this number jumped to 42, and these MDCs accounted for 10 percent of sales, 13 percent of assets, and 9 percent of employment of the 500 companies.[219] Thus, these firms have grown not only by numbers but also by the size of their assets and sales. As much as 60 percent of the growth, between 1974-83, in DFI from developing countries has taken place in the last 4 years.[220] Monkiewicz estimated that roughly the share of DFI from developing countries accounts for over 6 percent of the total foreign investment stock of countries concerned, of which 90 to 100 percent is of regional character.[221]

Third world multinationals or the MDCs operate predominantly in other developing countries, and particularly in the developing countries in their region, although a handful of investments have also gone to the industrial countries (Korea, Brazil, and Yugoslavia appear to be the exceptions, see Table 3.3). In fact, the role of the MDCs in the economies of developing countries is much greater than is evident from their share in the world total flow of DFI. In Malaysia, their share was roughly 40 percent of the total DFI stock throughout the 1970s. They contributed 17 percent of the total gross value of output, employed 13.2 percent of the total number of industrial workers, and

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[218] L. T. Wells, Jr., **op. cit.**, p. 2.
[219] Wong Poh Kam, **Foreign Investment: Obstacles and Opportunities**, Institute of Strategic and International Studies, Malaysia, 1986, p. 11.
[220] IMF, **Balance of Payments Year Book**, various issues.
[221] Jan Monkiewicz, **op. cit.**, p. 10.

Table 3.2 has been removed due to the

unavailability of copyright permission.

Table 3.2. Investment abroad and number of foreign subsidiaries of 15 developing country firms between 1975-78.
Source: L. T. Wells, Jr., op. cit., p. 10.

owned 14.9 percent of the total value of fixed assets in manufacturing industries.[222] In Thailand and Singapore, a third of all foreign investment appears to come from 'other developing countries'.[223] In Indonesia, if petroleum and mining are excluded, MDCs account for some 31 percent of DFI and 21 percent of their value, which is more than Japanese, North American, or European investments.[224] In Nigeria, the investments of MDCs rose by 404 percent in the period 1969-77, while investments by MNCs rose by only 187 percent.[225]

In case of a few developing countries, like Korea, Brazil, and Yugoslavia, the share of developed market economies as host countries was over 60 percent (see Table

[222]Chee Peng Lim, "MNCs : A Third World Breed," **Malaysian Business**, Nov. 1979, p. 25-8.
[223]L. T. Wells, Jr., op. cit., p. 3.
[224]Ibid.
[225] Marjan Svetličić and Matija Rojec, **Investment Among Developing Countries and Transnational Corporations**, RCCDC, Ljubljana, Harare, 1987, p. 24.

3.3).

At the end of 1983, developed countries accounted for 61.9 percent of Korea's DFI outflows. This was mainly due to Korea's unfavorable natural resource endowment and its large mining, trade and service related investments in DCs.[226] The apparently high share of Brazilian DFI going to developed countries is somewhat misleading because of the policy of Petrobras to channel its entire flow of investments through United States. In 1972-76, out of Petrobras's total investments to USA, 28 percent were subsequently transferred to Iraq, 19 percent to Algeria, 11 percent to Iran, 11 percent to Columbia, and 9 percent to Libya. Since 1977, Brazilian investments to DCs have been declining and have simultaneously been increasing to Latin America.[227] The Yugoslavian investments to DCs have been explained in terms of its European geographical location.[228] But in all these three cases, the majority of manufacturing investment went to developing countries. However, the growing importance of DCs as host countries to DFI from developing countries is significant, representing a 17 percentage point increase from 1975 to 37 percent in 1985.[229]

Available data suggests that the bulk of DFI from developing countries has gone to the manufacturing sector in other developing countries having manufacturing value added (MVA) lower than that of the source country.[230] Further, it is believed that almost all of this DFI is of a horizontal[231] and import substituting nature, enhancing the domestic manufacturing base of the receiving developing countries.[232] Investment in manufacturing (55.7 percent) is followed by finance, insurance and real estate (23.7 percent), services

[226]Charles Oman, ed., **New Forms of Overseas Investment**, OECD, Paris, 1986, p. 82.
[227]Ibid., p. 135.
[228]Marjan Svetličić and Matija Rojec, **op. cit.**, p. 26.
[229]UNCTC Data Bank, 1988.
[230] Francisco Sercovich and Eduardo White, **Enterprise to Enterprise Cooperation Among Developing Countries**, UNIDO/PC.99, 1984, p.8.
[231]Horizontal here means that the DFI is basically an extension of similar types of activities that these firms undertake in their domestic markets.
[232]J. P. Agarwal, **The Pros and Cons of Third World Multinationals : Case of India**, J. C. B. Mohr, Tubingen, 1985.

Table 3.3 has been removed due to the unavailability of copyright permission.

Table 3.3. Distribution of some developing countries' DFI by host country (in percent)
Source: Marjan Svetličić and Matija Rojec, op. cit., p. 27.

and hotel (6.6 percent), whole sale and retail trading (4.6 percent), mining (3.3 percent), transportation (3.0 percent), agriculture, forestry and fishing (1.3 percent), and construction (1.3 percent).[233] However, the sectoral composition of this DFI appears to be highly differentiated by countries. Up to the early 1980s, some countries like India, Argentina and Hong Kong predominantly invested in the manufacturing sector while others like Korea, Brazil and Columbia invested more in non-manufacturing. The Arab countries have concentrated mainly in the area of finance and manufacturing.[234] For countries like India and Argentina, the share of manufacturing was as high as 88 percent in the total number of their subsidiaries abroad.[235]

[233] Marjan Svetličić and Matija Rojec, op. cit., p. 29.
[234] Ibid., p. 31.
[235] Ibid.

Characteristics of MDCs

There are interesting differences among developing countries in the nature of their DFI which can be traced to the nature of the home economy and to government policies. Nevertheless, there are also some characteristics which are common to all MDCs. At the cost of some oversimplification, we may identify some of the underlying strategies and characteristics of MDCs. Considerable similarity appears in such strategic decisions as choice of geographic locale, the organisational and ownership arrangements utilized, and the relationships - both functional and managerial - maintained between foreign affiliates and the parent company.

In choosing locations for foreign operations, the MDCs have shown a preference for investing close to home. The usual direction of MDCs' investment has been from the larger and relatively advanced country to the smaller and relatively less developed countries within the same geographic region (see Table 3.3). For example, out of 494 industrial affiliates of Southeast Asian parent enterprises, as many as 427 were located in the same region, while out of 157 Latin American foreign affiliates 118 were located in the same region.[236] Intra-regional investments exhibit a higher concentration in Asia in comparision to Latin America. Approximately 14% of the total DFI value in ten Southeast Asian countries derives from other countries of the region. From 1970 to 1978, the intra-regional investments in Southeast Asia rose from $1 billion to $2 billion.[237] The net investor countries were India, Phillipines, Hong Kong, and South Korea, and the recipient countries were Indonesia, Pakistan, Thailand, and Sri Lanka.[238] Over 60% of Indian DFI is located in Southeast Asia. Familiarity with the neighboring countries, lack of much experience in international business, inadequacy of appropriate transport-communication infrastructure among developing countries are some of the reasons responsible for

[236]L. T. Wells, Jr., **op. cit.**, p. 6.
[237]UNCTC, **Salient Features of Foreign Direct Investments**, New York, 1983, p. 42-43.
[238]Ibid.

intra-regional investments. However, inter-regional investments from developing countries appear to be growing. Some of the major factors stimulating this trend are the growing maturity of MDCs, ethnic pull, search for raw materials, and protectionist measures imposed by developing and developed countries.

Foreign affiliates of Indian firms, though most heavily concentrated in the neighboring region, are also located outside the region in reasonably large numbers. Though most of the Indian overseas investments have been undertaken in other developing countries, over a score are located in advanced countries, such as the US, UK, Canada[239], FRG, and Switzerland. These projects have been mainly in service ventures, such as hotels, restaurants, and food processing. A few manufacturing ventures have also been undertaken, such as, the units for production of rice milling machinery and oil engines in West Germany, polyethylene products in US, sal and mango oil in the Netherlands, and steel wire ropes in Yugoslavia.

With respect to organisational and ownership arrangement, the MDCs have strongly favored some form of joint venture for their investments.[240] Usually small, and typically without enough resources, these firms need local partners to add local inputs and provide knowledge of local economic and marketing environment, raw materials, and so on. Unlike the MNCs, they do not fear the loss of quality control, technical information and monopoly profits as a result of joint ventures. Joint ventures are also viewed as an effective way of dividing risks. The tendency to share ownership with local partners is also conditioned by the political sensitivities to foreign majority ventures which the investors are familiar with in their home countries. A minority equity position undoubtedly increases their acceptability to the host countries. According to a study, out of 1260 subsidiaries surveyed, 777 (62%) had minority ownership, 74 (6%)

[239]K. Balakrishnan, "Indian Joint Ventures Abroad", **Economic and Political Weekly**, 29 May 1976.
[240]D. J. Lecraw, "Internationalization of Firms from LDCs", in Kumar and McLeod (eds.), **op. cit.**, 1981.

were majority-owned, and 409 (32.5%) were 100% owned.[241] Above all, joint ventures are the result of strict exchange controls imposed by the home government. India, for example, allows its firms to export no capital, except machinery, which makes it very difficult for the investors to gain a large portion of the shares in an overseas project. The investments from developing countries usually involve partnerships between MDCs and local investors in host countries, and in some cases, between the MDCs and the MNCs.

Consistent with this willingness to share ownership in their foreign affiliates, a great deal of autonomy is granted to the subsidiaries. Each affiliate tends to produce or buy locally for most of its needs, and only rarely does a subsidiary rely on its parent for a continual flow of new technology or marketing techniques. Thus, each affiliate confines its sphere of interest to its own national and local interests. However, there is a higher degree of integration in case of exporting subsidiaries, for these enterprises have a major impact on the business of the parent.[242]

The parallelism that is manifest in the foreign investment strategies of the MDCs also shows up in the character of their foreign operations, especially in product lines, production and marketing methods, and scale of operations.

The products of MDCs can be characterized as relatively simple, standardized products. Apparently, little effort is accorded to product differentiation, and non-price competition has no important role in the marketing programs of these firms. Price differential is their major competitive weapon. Production techniques are selected with cost minimization in mind, which ordinarily dictates the choice of labor intensive, small scale production with local raw materials and indigenous equipment and technology.

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[241] Jan Monkiewicz, **op. cit.**, p. 49.

[242] L. T. Wells, Jr., "The Internationalization of Firms from Developing Countries", in Agmon and Kindelberger (eds.), **Multinationals from Small Countries**, Cambridge, MIT Press, 1979.

Further, a majority of these firms operate in the manufacturing sector.

However, some of India's investments abroad defy this common conception of Third World business competing with low technology, cheap labor intensive operations. Indian companies control Malaysia's largest integrated palm oil fractionation plant, make minicomputers and precision tools in Singapore, and run a sophisticated carbon black plant in Thailand.[243] Korea's success with its small car, 'Pony', is a further indication of the technological advancement of some of these firms. The turnkey contracts secured Indian firms under conditions of international tender suggest that the firms involved are indeed competitive. The non-manufacturing investment of Indian firms is also rising dramatically with the shift in policy to establish sales agencies, consultancies, civil construction offices, banks, and the like abroad.

In delineating a pattern of behaviour for the MDCs, a more in-depth analysis requires the consideration of the economic and political structures from which the firms originate. For instance, the historical conditioning of Indian firms may pre-dispose them to certain types of investment strategies. The economic and political dimension, therefore, provides a more idiosyncratic perspective on the MDCs from different developing countries. An underlying premise of this study is that MDCs differ in their strategies due to the difference in their 'revealed comparative advantages', which are the outcome of the individual home country's political and economic structures. In the latter half of this chapter we shall look at DFI outflows from a single developing country - India - after a brief discussion of the implications of this phenomenon for countries of the South.

[243]"Here come the multinationals of the Third World", **The Economist**, 23 July 1983.

South-South Cooperation

No discussion of Third World multinationals can be complete without consideration of the implications of this trend for the developing world as a whole. However, as it is not our purpose in this study to analyse the political, economic, and social consequences of the activity of MDCs on the host developing countries, we shall only briefly take up the issue in the following pages.

In the past thirty years a deliberate attempt to strengthen economic relations among developing countries has emerged. The rationale for cooperation is related not only to the challenges posed by the present state of the world economy to the development process but also to the possibilities of growth and development through the activation of the immense human, natural and physical capacity that remain unused in the developing world.[244] One of the strategic development instruments mentioned repeatedly in almost every document, declaration or plan of action of developing countries, in achieving a more productive development and restructuring of developing world's position in the international economic order, has been industrial joint ventures, mutual investments or enterprise-to-enterprise cooperation among developing countries.[245]

In fact, the discussions, debates and proposals regarding joint ventures among developing countries started even before the first empirical data on their existence and experience was available. As White states, "This apparent paradox is partly explained by the normative bias that characterised the first approaches. MNEs were born, in epistemological terms, as a 'normative fact'... rather than as a natural consequence of

[244]United Nations Conference on Trade and Development, **Strengthening the Weakest Link**, United Nations, New York, 1986, p. 2.
[245]Marjan Svetličić, **Investment Among Developing Countries and Transnational Corporations**, Research Centre for Cooperation with Developing Countries, Ljubljana, Yugoslavia, 1987, p. 7.

the process of growth and industrialisation in the developing countries.[246] Consequently these Third World enterprises or joint ventures were perceived solely in terms of a 'new force' which would channel productive resources within the developing world in better, more equitable terms and conditions, and which would countervail the monopolistic power of the transnationals from the North. Such great expectations formed the basis for the promotion of the MDCs. They also led to the heavy emphasis on state sponsered projects. It is no surprise that this attempt to create *de novo* enterprises has not met with much success.[247] Though this does not deny the increasing level of trade and industrial cooperation among countries of the South, the fact is, joint ventures and technology flows among these countries have occured mainly outside the framework specifically adopted for their promotion.

In the 1970s and the 1980s, far from being just a matter of prescription, intellectual speculation or political advocacy, Third World multinationals have emerged as important actors in the world economy. Affiliates established by advanced developing countries in other developing countries make up about 8% of the total number founded in these countries.[248] It appears, from a rough estimate, that over 80% of these firms are from the private sector, investing abroad with the motive of protecting and expanding export markets, reducing costs and risks, and avoiding the constraints of their domestic markets. A majority of these investors are local technological leaders, having accumulated considerable skills, technology, experience and resources over the years, and now endeavoring to appropriate the results and costs of their R&D and learning process in foreign markets. These individual firms, no differently than firms

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[246]Eduardo White, "Multinational Companies of Developing Countries: The Issue of Correct Policies," in Breda Pavlic et al., **The Challenge of South-South Cooperation**, Westview Press, Boulder, 1983.
[247]Francisco Sercovich and Eduardo White, **Enterprise to Enterprise Cooperation Among Developing Copuntries**, UNIDO/PC.99, 1984.
[248]Marjan Svetličić, "Multinational Production Joint Ventures of Developing Countries," in Khushi Khan, **Multinationals of the South**, German Overseas Institute, Hamburg, 1986, p. 67-87.

from developed countries, are inspired and motivated predominantly by the classical profit maximising strategy. According to Green, "While Southern MNCs - including a number of public sector ones - have been prominent in the last fifteen years' growth of South-South economic relations, they have acted as enterprises largely outside any more general economic integration or collective self-reliance projects and as nationally-based enterprises not joint ventures of several Southern economy partners." Green further states, "In general they are basically TNCs, secondarily national and only tertiarily Southern in nature."[249] Svetličić reiterates a similar view, "A realistic approach to this growing phenomenon is needed ... Every activity will be effective in so far as it is based on real interests and factors that promote it on the basis of short- and long-term material interests."[250] The present experience suggests that although market forces provide significant inducement, they alone are far from sufficient to assure the growth and expansion of flows among developing countries. On the other hand, political stimuli, although needed, particularly at initial stages, produce certain results only on a short-term and very limited level, unless based and built with the long-term economic rationale.[251] Thus, the achieving of macro-economic objectives (like strengthening of the bargaining power of developing countries, sharing of 'appropriate' technology) can be facilitated by appropriate policy instruments addressed to the micro-economic entities and their activities.

Enterprises from developing countries appear to face particularly complex problems which hinder their growth and development. In spite of frequent political declarations, serious attitude-based barriers exist. Its substance is demonstrated in the distrust in the quality and performance of goods, as well as material and human capital, including technology, know-how or information originating from developing countries.[252]

[249]Reginald Green, "Operational Relevance of Third World Multinationals to Collective Self Reliance," in Khushi Khan, **op. cit.**, p. 48-66.
[250]Marjan Svetlicic, **op. cit.** 1986.
[251]Ibid.
[252]Marjan Svetličić, **op. cit.**, 1987, p. 126.

These barriers are aggravated by poor economic and physical infrastructure among developing countries, poor information networks for assessing market characteristics and investment opportunities, and lack of financial resources to fund large-scale projects. Inadequate preinvestment and feasibility studies, frequently even a lack of basic information, contribute to inadequate results.

Laws and regulations in both home and host countries are also not too conducive to foreign investment. A frequently unfavourable bias at home stems from balance of payments considerations and the desire to protect scarce hard currency resources.[253] Indian law, for example, stipulates that equity participation of Indian investors should be mainly in minority shares, that the equity contribution be rather in kind than in cash, and that the machinery and equipment supplied be of Indian origin. In host countries, high legal barriers exist, historically erected against the abuse of power by multinationals from developed countries. Ironically, these barriers have proved more effective against MDCs than the MNCs. Wohlmuth thus comments, "It may be argued that the existent investment laws have indirect discriminatory effects as regards the treatment of small, unintegrated firms which lack the bargaining power of transnational corporations."[254] Increasingly, the need to create a 'margin of preference' for firms from developing countries is being emphasised.

Political barriers are not too uncommon. They may stem from either the ethnic problems MDCs pose in some countries or from some deep rooted fears of possible political domination exercised through economic domination. For example, Nepal, fearing Indian domination, prefers investors from less politically sensitive sources. Thus, in view of the existing heterogeneity among developing countries, it would be quite unrealistic to assume complete identity of interests.

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[253] Jan Monkiewicz, **op. cit.**, p. 73.

[254] Karl Wohlmuth, "Practices and Policies of Host Countries towards Third World Multinationals," in Khushi Khan, **op. cit.**, p. 211-239.

Several of the impediments to the growth of MDCs arise from the relatively low level of economic development of the developing countries. It is beyond refute that the stage of economic development seems to be an important factor which determines the relative size of investment outflow as well as the inflow.[255] Direct foreign investment, from and to developing countries, shows a high level of geographical concentration. It is the 'industrial elite' of the developing world, or the so called NICs that have emerged as the homes of the new multinationals. The host countries, most frequently comprise both the NICs as well as their recent followers such as Indonesia or Malaysia. In case of home countries, it is a question of generation of relevant ownership specific advantages, particularly technological competence whereas in case of host countries, it is a question of location specific advantages primarily associated with the size and structure of the market and the existence of proper industrial infrastructure.[256] Thus, while international organisations, like UNIDO, see MDCs as instruments for changing the asymmetrical international economic order, some critics observe that the MDCs are no more than symbols of unequal development and a means of differentiation within the Third World.[257] As a cynic puts it, "With a convenient Third World label, the projects can go as examples of 'south-south' cooperation rather than as extensions of imperialist exploitation of the Third World."[258]

There is little doubt, that in some respects, the multinationals from developing countries appear to be better suited than MNCs to the developmental needs of developing countries. They have tended to be more interested in the small but growing and complex Third World markets. They appear to have an advantage in the adaptation of technologies to Third World conditions, in the handling of labour-intensive small-scale technologies, in the greater use of local resources, and in the area of flexibility of

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[255] Ibid.
[256] Ibid., p. 104.
[257] Karl Wohlmuth, **op. cit.**, 1987.
[258] D. N., "Nature of India's Export of Capital," **Economic and Political Weekly**, 11 June 1988, p. 1201-3.

management techniques. They do increase the room for manoeuvre and the relative bargaining power of hosts by providing alternatives to MNCs. Further, a number of these MDCs are substantial in size, generate significant surpluses, and have the ability to compete with OECD based and other TNCs on fairly equal terms, at least with respect to certain markets and certain products.[259] Lall realistically observes, "To the extent that Third World firms offer technologies not provided at all by other MNCs, or provide technologies which are competitive because they are adapted to local conditions, Third World MNCs offer clear benefits to host countries. To the extent that they offer very similar technologies to developed country MNCs, their entry provides greater competition, lower prices and less 'packaged' technology, and so benefits the host country. However, these benefits are essentially circumscribed in their scope by the fact that large areas of advanced industrial technologies are still out of reach for Third World firms, and they should not be seen as a significant replacement for the traditional MNCs."[260] However, it must not be overlooked that the motives of MDCs for investing abroad are not very different from the TNCs. Thus, though DFI from developing countries appears as an attractive option to capital and technology scarce developing countries, the basic fact is that "development implications are not so much determined by the form selected for international economic cooperation, but to a considerable extent by the economic policies of host countries."[261] Only to the extent that the host developing countries employ appropriate economic policies and strategies can the new multinationals contribute to their national development.

As discussed earlier in this chapter, MDCs are generally newcomers in international markets. In contrast to MNCs, they lack the resources and the experience needed for undertaking international operations, particularly those involving long-term investment decisions. The absence of adequate information and commercial networks

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[259]Marjan Svetličić, **op. cit.**, p. 67-87.
[260]Sanjay Lall, **The New Multinationals**, p. 267.
[261]Ibid.

increases the transaction costs of firms from developing countries.[262] A number of distortions, asymmetries and shortcomings exist in the present flows among developing countries which may be corrected by appropriate policies and instruments. Greater economic cooperation among developing countries requires a set of politically and technically sound policies which may reinforce market-based processes leading in this direction. The extension of a combination of incentives and advantages, including the removal of obstacles and the granting of a 'margin of preference', would considerably mobilise individual firms to consider investment in co-developing countries. As Wohlmuth opines, "This capitalist method of integrating the South may be supported by legal and institutional moves by governments (of the home and host countries). It is argued that such a type of integration may be more cost-effective than a purely state-directed integration...such ventures are exposed too much to political considerations and are often too ambitiously planned so that ultimately the relation of economic costs and benefits is not viable."[263]

It cannot be denied that DFI is all too often a business activity based on the interests and initiative, the perception and expectation, the rationale and potential of the firm. Any developments, at the international, national or firm-specific level, which relatively decrease the uncertainties and risks involved with overseas investments and increase the economic viability and profitability of these operations, will be positively viewed by corporate strategists. Thus, Svetličić and Rojec caution against both a 'bottom-up' approach which regards DFI activities growing solely from the development needs of enterprises themselves, or a 'top-down' approach which regards these activities as being decisively stimulated by governments and specific instruments, and which would not have undertaken in the absence of such instruments.[264] The emergence and growth of multinationals must be viewed and understood in terms of a patnership

[262]UNCTAD, **Strengthening the Weakest Link**, p. 29.
[263]Karl Wohlmuth, **op. cit.**, 1987.
[264]Marjan Svetličić and Matija Rojec, **op. cit.**, p. 8.

between the firms and the home and host governments.

This study will draw upon the recent experience of Indian multinationals to reexamine the factors that give rise to MDCs. It may seem a trifle premature to discuss this phenomenon at great length. The phenomenon of international production by Indian enterprises is still relatively new. The structure of overseas activity and its economic determinants may not have 'settled down' sufficiently to enable conclusions to be drawn. It is nevertheless interesting to speculate on the reasons for DFI from these countries. An objective study of Indian MDCs is particularly of great significance - India has one of the largest number and the greatest variety of ventures abroad among developing countries, a fact which is rather unusual in view of its low GNP per capita, poor economic performance and slow expansion of manufactured exports. The experience of Indian MDCs limited and novel as it is, persuades us to question much of the received knowledge on multinationals.

Foreign Investments by Indian Firms

India has emerged as one of the most important sources of direct foreign investment (DFI) in the Third World. In fact, India not only has one of the largest but also the most diversified ventures abroad among the Third World countries. Contrary to the image of India as a society that has little to export except semi-clad gurus, bejewelled maharajas, starving children, and snake charmers, Indian managers, engineers, and skilled workmen are establishing and managing sophisticated enterprises overseas in the face of tough international competition. As in other developing countries, India's initial experience with international business operations was as a host to a variety of foreign enterprises. However, with the passage of time, financial and technological collaboration between domestic (private and public) and foreign capital resulted in the growth of a large industrial base.[265] Combining a cheap but industrious and well-educated work force with astute political leadership, labour-rich developing countries like India have evolved into complex, production-based economies.[266] Like that of Brazil and Mexico, India's route to multinationalism has probably been by initial domestic success in its own large domestic market which subsequently led to exports. However, in comparision to their Latin American counterparts, Indian entrepreneurs have moved in greater numbers and are more widely distributed geographically. India, as a home of Third World multinationals, presents an interesting case that facilitates an analysis of the emergence and trends of Third World multinationalism.

This section of the chapter presents a factual description of the phenomenon of Indian DFI in terms of value and trends. In particular, it focuses on the evidence regarding the nature of Indian DFI abroad - the scope and growth of the phenomenon, the industry structure, and the geographical distribution. It may be noted that this study has attempted to take into consideration data upto 1987. The available data run, in most cases, until late 1982 only. Since we believe that new trends have emerged in the period since 1982, we have tried to piece together information from different sources to arrive at the aggregate picture.[267] The Indian government does publish figures of Indian DFI abroad, but for various reasons, these can be suspected of grossly underestimating the phenomenon. For this reason we have also relied on data from various industry and trade associations, company reports, reports in newspapers and periodicals, and 'in the field' interviews with government and corporate officials. We also used a structured questionnaire to tap information from the firms undertaking DFI. Our efforts were not very successful in this regard. Moreover, it must be noted that this unsystematized data

[265]M. Kidron, **Foreign Investment in India**, Oxford Univ. Press, 1965, p. 185.
[266]Heenan and Keegan, **op. cit.**, 1979.
[267]The various sources include interviews with corporate managers and government officials in India, newspaper clippings from 1970-1987, Ministry of Commerce annual reports, FICCI Workshop reports on joint ventures from 1970-1986, IIC published and unpublished material.

suffers from some inconsistencies and variations, and must be taken only as a rough approximation of what has actually taken place by way of Indian DFI.

The Setting: Origin, Growth and Pattern of Indian DFI

In tracing the beginnings and development of DFI from India, it is important to take note of the fairly large scale of investments in physical assets by Indian capital during the colonial period in countries like Burma, Ceylon (now Sri Lanka), and the East African countries which were also under British rule.[268] The bulk of these activities was confined to trade, commerce, and money lending - petty operations of internal trade in which metropolitan capital was not interested. The only exception was Burma, where by 1940 the total Indian investment was around Rs. 1,889.9 million. Indians owned as many as 303 factories in 1939, most of which were nationalized by the Burmese government after independence. Some of these Indian companies in Burma were: a Birla starch factory, Adamji Haji Dawood owned watch factory, and the Nath Singh oil company.[269] Some Indian firms, such as the Tatas, also began quite early to act as intermediaries of the British for Asian trade, particularly in opium and cotton.[270] These activities of Indian merchants abroad were often accompanied by the migration of the owners themselves. But most of the Indian merchants abroad "did not see themselves as settlers, but as being temporarily resident in a foreign country in order to make money. Their ties with the mother country were strong and there was a constant exchange of men, money, and materials between the overseas and domestic operations."[271] Even though, strictly speaking, the activities of Indian merchants abroad were not DFI proper, they may be seen as the antecedents of DFI from India in the post-independence period. An important

[268]Sebastian Morris, "Trends in Foreign Direct Investment from India (1950-1982)," **Economic and Political Weekly**, 7 and 14 November 1987.
[269]Nalini Kumar Chakravarty, **Indians in Burma**, London, 1979.
[270]Srikant Dutt, **India and the Third World: Altruism or Hegemony?**, Zed Books, London, 1984, p. 136.
[271]Sebastian Morris, **op. cit.**, 1987.

part of the overseas Indian traders' role has been their transition to 'modern' economic activities, away from trade and into local industries. This movement into industry by Indian traders abroad eventually proved opportune for domestic Indian capital looking for investment opportunities abroad. The overseas Indians not only served as a reliable source of information, but also assisted Indian DFI to these places through mutual tie-ups.[272]

The first Indian industrial investment abroad in the post-independence period was in 1956 in Ethiopia by the Birlas in a cotton textile plant. The company was incorporated with an initial Birla investment of 20% of the equity, 35% was invested by the local government, and 45% raised from the public, mostly overseas Indians. Most cotton for the unit was imported from India, and subsequently the unit met 50% of Ethiopia's textile requirement.[273] By the end of 1960's there were eight manufacturing ventures and one in services in operation abroad.[274] The pace of overseas investments picked up in 1970's with a peak occurring in 1976-77. In a pioneering paper, Balakrishnan commented that, "a decade and half after the maiden unit was set up in Ethiopia...and after the successful installation of only a handful of units each year since then, in 1975 there was a perceivable spurt in activity. In a single year, 23 units were commissioned for commercial operation."[275] According to Agarwal, between 1970 and 1982 Indian joint ventures had a cumulative growth of 18% per annum; in terms of value, Indian DFI increased between 1975 and 1982 at a cumulative rate of about 23% per annum.[276] The increasing maturity of Indian firms in terms of technology, management, and finances, the restrictions on the domestic growth of large firms under the MRTP Act, the severe domestic recession of 1969 which hit the engineering and textile industries the hardest,

[272]Srikant Dutt, **op. cit.**, p. 137.
[273]Ibid., p. 94-95.
[274]Sanjaya Lall, **The New Multinationals**, p. 22.
[275]K. Balakrishnan, "Indian Joint Ventures Abroad," **Economic and Political Weekly**, May 1976, p. M35-M48.
[276]J. P. Agarwal, **op. cit.**, p. 43-44.

the oil price increases and increased development activities in its wake in the oil exporting countries, the import substitution policies of other LDCs, were some of the factors contributing to this impressive growth. The 1960s also witnessed a shift in Indian government policy from import substitutuion to export promotion. This strategic change had a profound effect on the promotion of joint ventures abroad as an export promotion strategy.

However, towards the end of the period, 1979-1982, a perceptible decline in the growth rate of Indian DFI became evident. From 1983 onwards, the decline in DFI becomes rather sharp (see Table 3.4). At the end of December 1985, the total number of ventures fell to almost the same level as in December 1980. At the end of December 1986, there were some 187 ventures abroad. Out of these, 150 were in operation and 37 were in different stages of implementation.[277] A statement made by the Minister of Commerce in Lok Sabha on 27 February 1987 shows that the number of ventures in production has further risen to 152.[278] The total equity participation of Indian parties has fallen drastically from Rs.120.51 crores in 1984 to Rs.114.20 crores in 1985 and to Rs.110.00 crores in 1986. According to a FICCI study, a combination of factors account for this decline in the number of Indian overseas ventures - the unfavorable investment climate in some host countries, failure in finding a suitable partner, lack of protective measures in host countries, financial and marketing constraints, realisation on the part of Indian investors of the risks and difficulties involved in investing abroad from practical experience, liberalisation of the domestic economy, tightening of home government approval process, and so on.[279] The decline in number of ventures may also be due to the tendency of Indian investors in recent years towards consolidation of previous investments than expansion. However, the average size of Indian equity holdings abroad (arrived at by dividing the gross stock of Indian equity held abroad by

[277] "Joint Ventures Abroad Touch 150," **Economic Times**, 8 April 1987.
[278] Ministry of Commerce, Lok Sabha, Uns. Q. 486, 27 February 1987.
[279] "Indian Joint Ventures Abroad," **Financial Express**, 11 July 1984.

	Effective Joint Venture Projects		Projects under production,		Projects under implementation	
	No. of Projects	Total Indian Equity (Rs. crores)	No. of Projects.	Total Indian Equity (Rs. crores)	No. of Projects	Total Indian Equity (Rs. crores)
Aug. 80	204	115.80	117	35.71	87	56.94
Dec. 81	207	94.67	115	35.49	92	59.18
Jul. 82	228	120.40	134	46.40	94	74.00
Dec. 83	235	112.15	154	62.55	81	59.57
Dec. 84	236	120.51	157	85.30	79	35.21
Dec. 85	210	114.20	158	94.80	52	19.40
Dec. 86	187	110.00	150	92.00	37	18.00
Mar. 87	N.A.	N.A.	152	N.A.	N.A.	N.A.

Table 3.4. Indian Overseas Ventures (1 crore=10 million)
Source: FICCI, op. cit., 1986, p. 47; GOI, **Annual Report**, 1986-87; Sanjaya Lall, **The New Multinationals**, p. 22.

the number of ventures) grew by about about 40% by 1986.[210] The returns (dividends plus other repatriations) went up from Rs.33.11 crores in 1984 to Rs.38.95 crores in 1985 and to Rs.46.36 crores in 1986.[211]

Size and Pattern of Equity Participation

A significant feature of Indian joint ventures that has had a vital bearing on their performance and operating results is the small size and scale of operation of the majority of units. However, this trend of establishing sub-optimal units is gradually being reversed. There has been a rise in the average size of equity holdings in case of ventures coming on stream during the last couple of years and also in the case of units under implementation.[212] Since the proportion of equity has not changed much over the period despite the decline in number of ventures, this indicates a jump in the size of ventures undertaken. This orientation has been greatly aided by the revision of

[210]Mano Ranjan, "Indian Joint Ventures Abroad," Unpublished paper for seminar course S-2817, Harvard University, April 1987, p. 11.
[211]"Fall in Investment, but Returns Up," **Economic Times**, 7 Jan. 1987; GOI, **Annual Report 1986-87**, p. 72.
[212]IIC, **Indian Joint Ventures Abroad: An Appraisal**, 1983, p. 6.

government guidelines for Indian DFI in 1978 which allowed for greater flexibility towards cash remittances, permitted Indian firms to raise foreign exchange loans abroad, and allowed the parent firm to grant loans to its foreign affiliate in exceptional circumstances. This trend also appears to have resulted from the increasing technological sophistication of Indian investments, the setting up of non-manufacturing ventures in trading, consultancy, and services, the increasing participation of 'giant' public sector corporations, and the tightening of government approval process to permit mainly large, economically viable projects.[213]

Indian DFI, by way of equity capital, has been effected mainly through the export of capital equipment and technology with cash remittance playing a supporting role (see Table 3.5). While the share of 'in kind' investment in the form of capital goods and capitalised know-how in 1983-84 was 61.42%, the share of 'in-cash' equity shot up dramatically from 6.0% in 1980 to 23.50% in 1983-84. Even more impressive is the increase of cash equity in ventures under implementation.[214] This trend may have resulted from more liberal Indian government policy towards cash remittances and the growth of service enterprises which are permitted to remit cash. It is important to note here that the Indian contribution in the form of capital equipment does not consist wholly of Indian equipment. In some cases, the government has permitted Indian firms to buy highly

[213]Federation of Indian Chambers of Commerce (FICCI), **Indian Joint Ventures Abroad and Project Export**, New Delhi, 1986, p. 40.

[214]The higher quantum of cash remittance which is noticeable in the case of joint ventures under implementation, has been mainly on account of 3 joint venture proposals which together have been permitted to remit about Rs.23.4 crores. These proposals are: (a) The Indo-Senegal joint venture in which the Union Government along with Indian Farmers Fertilisers Coop. Ltd., are collaborating with the Govt. of Senegal for the manufacture of phosphatic fertilisers and phosphoric acid (17 crores); (b) the proposal of State Bank to set up a joint venture merchant bank in Nigeria (Rs.2.8 crores); (c) the proposal of State Bank to set up a joint venture in Sudan (Rs.3.6 crores). It must be noted that in all these 3 large ventures, the public sector is one of the collaborators, and that these investments considerably increase the percentage share of Africa in the total value if Indian DFI. GOI, **Annual Report 1982-83**, Ministry of Commerce, New Delhi, p. 45.

Mode of participation	In operation		Under Implementation		Total	
	Actual Indian Equity	Percent of total	Appr-oved Indian equity	Percent of total	Value	Percent
Exports of capital equipment, etc.	39.74	63.5	22.28	40.8	64.02	52.43
Capitalization of know-how	4.23	6.7	6.75	11.3	10.98	8.99
Cash remittance	5.57	8.9	23.14	38.9	28.71	23.50
Bonus shares obtained	11.76	18.9	--	--	11.76	9.63
Others (loans adjustments of future profits, preliminary expenses capitalised, etc.	1.25	2.0	5.40	9.0	6.65	5.45
Total	62.55	100.0	59.57	100.0	122.12	100.0

Table 3.5. Mode of equity participation, 1983-84 (Value Rs. crores; 1crore=10m)
Source: GOI, **Annual Report**, 1983-84, Ministry of Commerce.

sophisticated equipment from third countries.[215]

Ownership Pattern

Earlier, minority participation by the Indian promoters was specifically insisted upon by Indian government but the present guidelines are resilient enough to accept majority participation. Nevertheless, according to the 1986-87 annual report of the Ministry of Commerce, in 75% of the operating ventures India's share-holding is less than 50%. The largest number of ventures (38%) fit into the 30 - 40% share holding range. Several reasons account for the minority participation of Indian firms in overseas ventures, such as host government legal constraints on foreign ownership, the Indian government insistence on minority participation, the small size and limited financial, marketing, and technological resources of these firms which affect their bargainig

[215] IIFT, **op. cit.**, p. 32.

power with the host government, the desire to reduce the risk and cost of DFI abroad by taking up partners, and the strategy to keep a low profile in host countries to avoid ruffling political feathers.

However, the extent of ownership must not be confused with the degree of control. Despite minority participation, in majority of the cases management control has been entrusted to the Indian collaborator.[286] A FICCI report states, "Notwithstanding this low capital base and small share-holding, Indian partners in most of the joint venture projects have been given the responsibility of managing the units and some of them have undoubtedly made a mark.[287] Similar views are expressed by Aditya Birla, "...10-35% equity holding in a joint venture is sufficient for the purpose of retaining control of the management of an enterprise. This is so mainly because our collaborators and people in the host countries have a tremendous amount of confidence in the abilities of our managers, most of whom have had experience in India prior to taking up assignments overseas."[288]

As far as the control of the parent firm over the affiliates was concerned, there was a great deal of autonomy.[289] The parent company exercised only periodic checks on their overseas ventures, relying on two or three managers sent from India to ensure that the operations were run smoothly. The few exceptions were with regard to export-oriented subsidiaries, firms vertically integrated to parent firm's activities, and in some cases family-owned and controlled affiliates. However, even in case of subsidiaries producing for the host country market, long term strategic decisions were taken by the parent, leaving subsidiary management to decide on operating expenses,

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[286]Indian Intitute of Foreign Trade, **India's Joint Ventures Abroad**, New Delhi, 1977, p. 31; K. V. K. Ranganathan, "Indian Joint Ventures Abroad," **Economic and Political Weekly**, May 1984, p. M69-M77.
[287]FICCI, **op. cit.**, 1982, p. 6.
[288]Kiron Kasebkar and P. V. Satyanarayana, **op. cit.**, 1979.
[289]Wells, L. T., Jr., **op. cit.**, p. 112-114.

personnel policy, sale and pricing of output.[290] This also supports the argument of Wells and Lecraw that for the kind of advantages MDCs generally exploit, the investors do not have strategic reasons to want close control.

However, the discussion so far has been in terms of the so called 'joint ventures', neglecting the *majority-owned subsidiaries* of Indian firms. According to one source, there were 221 joint ventures around 1983 and as many subsidiaries.[291] These subsidiaries are predominantly in the services - trading, banking, consultancy, hotel and restaurant, and so on. Geographically, they are almost evenly distributed among developed and developing countries. Within the LDCs, there is relatively a greater concentration in the city states of Hongkong and Singapore.[292] The subsidiaries appear as a whole to be highly profitable.[293] However, their repatriations to India have been extremely poor, suggesting that one important motivation for their fairly large investments abroad has been to get around exchange controls.[294]

The government had granted approvals to the subsidiaries with the fond hope that they would step up exports and earn foreign exchange. It has been disappointed in this regard and now views with disfavour proposals to set up subsidiaries. As one of the ministry officials stated in 1982, "In light of certain unsavoury experiences relating to subsidiaries and also the intractability of subjecting the subsidiary to discipline from India, both the Ministry of Finance and the Reserve Bank of India (RBI) have been of late, quite chary in approving the establishment of subsidiaries."[295] The government and the RBI have had little control over the subsidiaries once they are set up. For example, Tata Exports (TE) was permitted to set up a 98% owned 'joint venture' in Zambia to facilitate

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[290]Vinod Busjeet, **op. cit.**, p. 90.
[291]"Performance of Indian 'Joint Ventures' Abroad," **Economic and Political Weekly**, 21 Feb. 1987.
[292]Sebastian Morris, **op. cit.**, 1987.
[293]Ibid.
[294]Ibid.
[295]Ibid.

exports. Consequently, exports to Zambia and other countries were routed through Tata Zambia (TZ) and Tata AG in Switzerland. Tata Zambia showed book losses and on these grounds Tata Exports approached the Indian government in early 1980s to sell off the shares of TZ to a Swiss firm to draw upon credit from the Swiss export finance bank. On repeated queries it was revealed that the Swiss firm was none other than Tata AG. Revenue officials point out that while they have the authority to control the original joint ventures, their fiat does not run to ventures in subsequent generations.[296] Interestingly, the RBI also appears to have difficulties in controlling public sector undertakings as well which have shown a tendency to overdraw money from foreign banks. These firms have often bypassed the RBI or the working group by approaching their respective ministries for permission to borrow money abroad against the government's counter guarantees.[297]

Concentration of Ownership

The ownership of Indian MDCs is highly concentrated in the hands of a few Indian business houses. This validates Hymer's thesis that corporate concentration is one of the main determinants of DFI. Though only some of the very large business houses have undertaken DFI abroad (see Table 3.6), it is clearly evident, from the data given below, that Indian equity holdings abroad are highly concentrated in those large houses which decided to go multinational before the others. Also, the process of internationalisation seems a cumulative one, with experience creating a stronger base and providing greater incentives to those who have gone abroad. In 1979, Birlas alone accounted for 39% of total Indian DFI abroad. While the Birla group still leads with 15.1%, the entry and expansion of other investors has greatly reduced its dominance.[298] The Birlas are

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[296] Jayanta Sarkar, "A New Dimension for India," **Far Eastern Economic Review**, May 1980, p. 68.

[297] "Most Government Units Abroad Incurring Heavy Losses," **Indian Express**, 10 April 1982.

[298] For details on ownership patterns see: Sanjaya Lall, **The New Multinationals**, p. 32-33; J. P. Agarwal, **op. cit.**, 69-71.; Sanjaya Lall, "India," **World Development**, vol. 12(5/6), 1984; Sanjaya Lall, "The Emergence of Third World Multinationals," **World Development**, vol. 10(2), 1982, p. 127-46 .

Rank	Name of Group	Assets($ million)	Rank as Foreign Investor
1.	Tata	3528	3
2.	Birla	3407	1
3.	Reliance	1443	-
4.	J. K. Singhana	1018	4
5.	Thapar	822	2
6.	Mafatlal	754	18
7.	Modi	614	5
8.	Larsen & Toubro	592	-
9.	Chidambaram	576	-
10.	Bajaj	555	-
11.	ACC	542	-
12.	Bangur	484	-
13.	Hindustan	450	-
14.	Walchand	449	-
15.	T.V.S. Iyengar	444	-
16.	Shriram	421	-
17.	I.T.C.	394	-
18.	Kirloskar	338	12
19.	Mahindra	332	16
20.	I.C.I.	323	-

Table 3.6. India's top 20 business houses (in terms of assets)
Source: M. Chhaya, "Reliance's 'Soft Takeover' of L. & T," **India Abroad**, 28 Oct. 1988; S. Lall, **The New Multinationals**, p. 33.

followed by the Thapars who have risen from fourth to second place, and account for 13.4% of the total equity. The Tata group has slipped to the third place. Birla and Tata are almost of equal size within India but their corporate strategies, in relation to foreign outward DFI, appear to differ. Birlas have decided to pursue foreign investments much more aggressively than Tatas who have diversified over a broader range of foreign activities (turnkey projects, consultancy services, and DFI)[299] These top three investors account for 34.7% of Indian equity in ventures in operation, a decline of 21.7 percentage points from 1979. (See Appendix B for a brief sketch of these business houses). Besides the entry and expansion of other investors, this decline may also be explained as a result of the relatively high participation of state enterprises in recent Indian DFI.

[299]Charles Oman, ed., **op. cit.**, p. 34.

The state has emerged as the second largest foreign investor after the Birla group.[300] As many as 13 ventures have been undertaken by the public sector in recent years. These units are generally larger than the average size of Indian venture abroad.[301] Further, while the public enterprises lag behind the private enterprises in the internationalisation of their activities, their significance oscillates substantially by sector of activity. The Indian public corporations operate mainly in strategic areas, such as infrastructure, natural resources, and services (banking, trading, consultancy). According to an official of Engineering Projects (I) Limited, Indian public corporations undertake DFI to foster economies of scale required by certain capital-intensive projects, to overcome marketing problems in times of recession so that the enlargement of markets can compensate for recessionary effects, to complement the process of internationalisation of private firms and perhaps, to escape government controls.[302]

While a number of small and medium-size firms have occasionally ventured abroad, the field is mainly dominated by big business houses with considerable technological, managerial, financial resources and an in-depth knowledge of foreign markets. The forces making for the internationalization of large enterprises have further been strengthened by the anti-monopoly restrictions in India on these enterprises.

Geographical Distribution

Indian joint ventures, which are presently in operation, are dispersed over 35 countries. More than 80% of these units are concentrated in eleven countries: Malaysia (21), Singapore and Sri Lanka (16 each), Nigeria (12), UK and Indonesia (11 each), UAE

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[300]The data probably overstates the importance of the public sector since information on the private sector is harder to come by than that on the state sector. L. T. Wells and P. Ghemawat, "Transfer of Industrial Technology among the Developing Countries," Mimeograph for the Council on Science and Technology, Harvard Business School, 1980, p. 4.
[301]J. P. Agarwal, **op. cit.**, p. 69.
[302]Interview with the author, New Delhi, 31 July 1987.

and Thailand (9 each), USA and Nepal (7 each), and Kenya (6).[303] Thus, Indian DFI is largely concentrated in the LDCs (see Table 3.7).

Regionally, most Indian investments are located in the neighboring countries of South and South-east Asia, followed by Africa. It is noteworthy that Africa attracted the attention of Indian entrepreneurs much before South-east Asia. This happened not only because of the significant Indian population and Indian merchants and traders in the East African countries, but also because of the emergence of several politically independent states in the region in 1950s and 1960s which looked to India as a model for their economic development.[304] Consequently, there was a spurt of proposals to set up ventures in Africa. However, this wave soon ebbed due to political instability in the region, poor infrastructural facilities, lack of developed markets, and inadequacy of financial institutions.[305] The projects in the region showed a high rate of mortality with 63% of the projects abandoned by 1976. In the early 1970s, a perceptible shift to South-east Asia became evident. Of late, however, there has been a revival of interest in Africa, especially in Nigeria and Kenya.[306] The government is also increasing its involvement in African countries. Two State Bank branches are proposed to be set up in Nigeria and Sudan, and a massive fertiliser plant is under implementation in Senegal.[307] With its considerable natural resources, its growing market for manufactured goods, its large Indian population, its increasing share of the development aid from multilateral agencies, and the possibility of a Pan African Union, the region is once again attracting Indian investors.

[303]GOI, **Annual Report**, 1986-87, p. 72.
[304]K. Balakrishnan, "MNCs from LDCs," **Vikalp**, vol. 7(2), 1982, p. 132-148.
[305]"Joint Ventures," **Financial Express**, 27 November 1979.
[306]"Good Scope for Industrial Cooperation with Kenya,"**Economic Times**, 27 Dec. 1981; "India May Bid for Projects in Africa," **Times of India**, 31 July 1985.
[307]Priya V. Mutalik-Desai, "Opportunities for Joint Ventures in Africa," **Commerce**, 8 Aug. 1981.

Region	Year	In operation		Under implementation		Total	
		No. of jvs	% of Indian equity	No. of jvs	% of Indian equity	No. of jvs	% of Indian equity
S. E. Asia	1986	58	52.0	7	13.0	65	47.0
	1980	57	61.2	29	41.4	86	54.5
Africa	1986	23	36.0	7	71.0	30	41.0
	1980	24	34.1	18	25.4	42	28.8
South Asia	1986	22	2.0	4	11.0	26	4.0
	1980	4	0.7	12	15.2	16	9.6
West Asia	1986	15	3.0	3	4.0	18	3.0
	1980	17	2.1	13	7.4	13	5.4
Europe, America, and Australia	1986	21	6.0	6	1.0	27	5.0
	1980	15	1.9	15	10.4	30	7.0
TOTAL	1986	139	100.0	27	100.0	166	100.0
	1980	117	100.0	87	100.0	204	100.0

Table 3.7. Regional distribution of Indian DFI
Source: Mano Ranjan, **op. cit.**, p. 24-25.

However, the place of first preference for Indian investors in the 1970s and 1980s has been South-east Asia. Large Indian investment has poured into countries like Malaysia, Indonesia, Thailand, and Singapore, partly because of the political stability in these countries and the incentives offered by the host governments. Though investment in the region has undergone a relative decline in recent years, South-east Asia still leads as a host to Indian DFI.[308]

Despite the immense possibilities, India's impact in Middle East, in setting up investment ventures, has not been very successful. India's breakthrough has mainly been in short-term and one-shot construction and consultancy projects rather than in long term manufacturing ventures. Most of the oil-rich countries have the financial resources to import various products and have not yet felt the need to develop indigenous

[308]While investments in Singapore have shown an increase, they have gone down in Indonesia, partly due to the two successive devaluations of the Indonesian rupiah, and in Malaysia, due to the intense competitive pressures of its open market economy. "Indian Industry Pulling Out of South-east Asia," **Business Standard**, 2 Dec. 1983.

manufacturing capabilities.[309] The region has also attracted the attention of powerful MNCs and Indian firms have found the competition too intense in the region. The Indians are now seeking tie-ups with MNCs and are also shifting their attention from construction to long-term operation and management activities in an attempt to maintain their presence in this promising market.[310] This strategy has also been the result of large unpaid bills by countries like Iran, Iraq, Libya, and Algeria, in which Indian firms undertook construction and turnkey projects, and severe spending cuts in these countries in the wake of the sharp decline in oil prices and the prolonged Gulf war.[311]

Until very recently, a notable missing link in India's joint venture effort was the failure to successfully penetrate the contiguous neighboring countries of Nepal, Bangladesh, and Sri Lanka. In most cases the ambivalent attitude of the host country seemed to be the major impediment. Since the beginning of 1980s there have been overtures from Bangladesh for Indian DFI, which have not evoked much response.[312] Sri Lanka's attitude became favorable towards Indian DFI in the mid-1970's. During 1979-1982, Sri Lanka and Singapore attracted the most Indian DFI among developing countries. A UNCTC study reported a Japanese business group's observation that the stock of Indian DFI in Sri Lanka, *circa* 1978, to be as high as 31.9%, the highest for any source country at that time.[313] However, the Bank of Ceylon reported that in July and August 1983, when the ethnic disturbances began to affect large cities, over 122 industrial establishments were affected, a majority of which were Indian.[314] The continuing tensions in the country may be expected to affect future Indian investments. Indian investments in Nepal are gradually making strides. In 1986, seven Indian ventures

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[309]"Joint Ventures Make Little Headway in West Asia," **Business Standard**, 21 December 1980.
[310]"Indian Firms Shifting To Operation, Management," **Financial Express**, 8 September 1986.
[311]Ibid.
[312]K. Balakrishnan, **op. cit.**, 1982.
[313]UNCTC, **Salient Features**, 1983.
[314]Sebastian Morris, **op. cit.**, 1987.

were in operation. Nepal's primary intention is to reduce existing trade deficit and to utilize Indian and other capital, skill, and resources to acquire manufacturing capabilities, technical know-how, and generate employment.[315] For Indian entrepreneurs, Nepal offers good prospects. As a less developed country, Nepal is not faced with quota restrictions on its exports of manufactured goods like textiles in the Western markets. Indian entrepreneurs are taking advantage of this facility by locating export oriented units in Nepal.[316] Indian business has however, shown no enthusiasm in penetrating the Latin American market. Constraints such as distant location, language barriers, absence of a regular transport link, political instability, the presence of large MNCs, and most importantly, a shortage of capital due to the disinclination of the international monetary agencies to extend credits for ventures in this region, act as major deterrent to Indian DFI.[317]

The developed countries have receivèd a small but an increasing share of Indian DFI. THe largest number of ventures are located in UK and USA, and are mostly in the non-manufacturing sector. As the capital requirement of ventures in the service sector is not as high as in the manufacturing sector, an increase in the number of joint ventures in the developed countries has not been accompanied by a significant increase in the value of DFI. A few ventures have been undertaken in the manufacturing sector. Three cases are worth mentioning here. One such case is of a diesel engine assembly and rice milling machinery plant in West Germany in which 98% of the share is held by Kirloskar of India. The Kirloskars acquired in late 1960s a rice milling manufacturing unit in Hamburg and used its established market for the sale of their diesel engines and components for rice

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[315]"Investment in Nepal: Prospects for Joint Ventures," **Economic Times**, 19 September 1984.
[316]"Success story reflects a boom in India's garment exports," **Globe and Mail**, 14 October 1987.
[317]"Latin America Seeks Indian Investment," **Economic Times**, 19 September 1985; "Joint Venture Prospects in Latin America Bleak," **Business Standard**, 10 April 1984.

mill.[318] The other case is of Mahindra jeep and truck assembly plant in Greece with 55% equity share. In the course of an interview, the Managing Director expressed the motive in terms of "having a foot in the EEC markets," and "building an international reputation."[319] The most recent case in this unmistakably growing trend has been the move by Hindustan Computers Limited (HCL), India's largest public sector computer maker, to manufacture UNIX-based computers in America in collaboration with Sybase Inc. According to Yogesh Vaidya, president and chief executive of HCL America, "The company is counting on its relatively long experience with UNIX and low research and development costs in India to give it an edge."[320] Vaidya further added, "We could manufacture boards of excellent quality at lower cost in India. But we want to demonstrate our commitment to the American marketplace."[321]

In general, however, the monopolistic advantages developed by Indian enterprises find a relatively small role in advanced countries.[322] Even within the developing world, the complete absence of Indian DFI in Latin America, and the strong pull of neighboring countries, is worth noting. Indian investors have also been drawn by historic ties and institutional similarities. In the words of an Indian industrialist, "Malaysia has so much in common with India. Both were British colonies, and the British influence is lingering. The law, business language, financial instruments, bureaucracy, etc., are all similar. There is also a substantial amount of Indian population in Malaysia. Even the engineering specifications are based on the good old 'British Standard Specifications'. The Phillipines is a different wicket. It has been under American influence for a long time...To make it tough for us, their engineering specifications are based on American standards. Even the electric power used is of a different cycle and voltage; this could provide further

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[318]K. Balakrishnan, **op. cit.**, 1976.
[319]Interview with the author on 10 September 1987, Bombay.
[320]Jim Van Nostrand, "Indian Mini-Mogul to bring UNIX ashore," **Electronic Engineering Times**, 13 Feb. 1989.
[321]Ibid.
[322]S. Lall, **The New Multinationals**, p. 27.

constraints to the kind and variety of Indian equipment that can be taken from here."[323]

While the early Indian investments were somewhat circumscribed in their 'world view', the geographical destination of recent investments suggest that ethnic and historic ties are being replaced by the economic attractions of large markets and welcoming government policies. Most of the host countries are less industrialized than India, and are launching import substitution drives of the sort where Indian technology and skills have a role to play.[324]

Industrial Distribution

More than half of the Indian DFI is in the manufacturing sector (see Table 3.8). However, there has been a distinct shift towards non-manufacturing areas in the recent years. While the number of manufacturing investments in operation grew only 10% between 1980-1985, non-manufacturing investments increased by 38%.[325] In 1985 itself, among the units already in production, non-manufacturing accounted for 36% of the total whereas among units under implementation their share increased to 43%. In this sector, substantial growth has been recorded by trading and marketing, engineering contracts and construction, and consultancy.[326] The service sector is benefitting from the large, relatively cheap, reservoir of skilled labour in India. There has also been a tremendous growth of Indian hotels and restaurants abroad. At least four of them are inter-continental hotels of five star standard. Perhaps the largest hotel chain based in the developing countries is the Oberoi group from India.

Among the manufacturing industries, light engineering, chemicals and pharmaceuticals, textiles, and palm oil processing account for about three fourths of the

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[323]K. Balakrishnan, **op. cit.**, 1976.
[324]S. Lall, **The New Multinationals**, p. 28.
[325]"Shift to non-manufacturing areas in joint ventures," **Economic Times**, 1 April 1983.
[326]Mano Ranjan, **op. cit.**, 1987.

(as on 1.1.1985)	Number		
Industry	Total	In Production	Under Implementation
Light Engineering	39	30	9
Chemical and Pharmaceuticals	31	15	16
Textile and Allied Products	21	19	2
Oil seeds crushing & Palm oil refining	10	9	1
Iron & Steel Products	9	8	1
Pulp & Paper	4	3	1
Glass & its products	5	4	1
Food products	1	-	1
Commercial vehicles	3	1	2
Leather & Rubber Products	6	3	3
Cement products	2	1	1
Manufacturing & others	16	9	7
Trading & Marketing	21	17	4
Hotel & Restaurant	26	16	10
Engg. contracts & construction	11	5	6
Consultancies	10	5	5
Other non-manufacturing	22	14	8
	237	159	78

Table 3.8. Industrial distribution of Indian DFI
Source: IIC, op. cit., 1985.

value of the Indian DFI. Their share of the number of ventures was even more. The maximum growth in this sector was recorded by chemicals and pharmaceuticals, followed by light engineering. The share of textile industry in Indian DFI appears to be declining. Another feature of Indian DFI is that most affiliates are in the same product line as the parent company. This horizontal diversification of Indian firms contrasts with the natural resource, vertical orientation of many Japanese and Korean firms.

Indian investments range from activities requiring mature, simple, well-diffused, labour intensive technologies to those requiring fairly complex, capital intensive technologies. Indian firms have undertaken ventures in such well established areas as textiles, sugar, cement, leather, as well as ancillaries, steel products, electric motors, and so on.[327] Some are moving rapidly into technologies, skills, and scales formerly thought to be the exclusive preserve of MNCs. This is not to argue that Indian MDCs are approaching world frontiers of technological innovation. But it does argue against too literal and uncritical an application of the product-cycle type of reasoning.[328] The metamorphosis that India has undergone in the field of outward DFI has been enormous, and the transformation is not yet complete.

Conclusion

This overview of recent DFI tends provides the backdrop against which we can examine the emergence and growth of MDCs in general and Indian MDCs in particular. The evidence about this phenomenon is still largely impressionistic, but there is no doubt about its growing importance. Despite their shortcomings and limitations, the available statistics on DFI at least indicate that during the recent period, registered flows from developing countries grew at a high rate. In fact, in the eighties DFI from developing countries appears to have grown at a much faster rate than DFI on a global scale. This indirectly collaborates our hypothesis that the process of internationalisation of firms seems a cumulative one, with experience creating a stronger base for overseas expansion. Today, DFI outflows from developing countries constitute a relatively significant part of the global DFI stocks.

Furthermore, we find support for the proposition that the propensity of a country to engage in outward DFI is positively correlated to its process of industrialisation. The evidence indicates that a handful of developing countries, which represent the elite of the developing world, account for the bulk of DFI outflows from

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[327]K. K. Sharma, "Joint Ventures Abroad," **Financial Times**, 14 August 1978, p. 23.

[328]Sanjay Lall, **The New Multinationals**, John Wiley and Sons, New York, 1983, p. 29-30.

Third World. Thus, it would not be incorrect to suggest that the internationalisation of firms arises as a natural consequence of the process of industrialisation; as a result of a gradual accretion of skills, knowledge and capital in the home countries of these firms. As economies of these countries grew, their firms acquired greater production experience and capability, particularly in those sectors in which they had a longer production tradition. It is not surprising that as part of their 'industrial maturation' they started to export goods and technical services, a lot of times in conjunction with DFI.

India, with the lowest per capita income among the NICs but with one of the largest manufacturing sectors, has the most diversified overseas ventures both in terms of industrial and geographical distribution. Lall, thus comments, "There may be a puzzle here, and it grows more interesting when we consider the nature of India's activities abroad."[329] These widely range from activities requiring relatively simple and mature technologies to those requiring fairly complex technologies. The advantages and motivations that provide the basis and pattern of Indian DFI derive not only from the rapidly changing international economic environment. but also from domestic political and economic environment. In the following two chapters the emergence of Indian MDCs will be analysed in context of country-specific factors, such as the ideological perceptions of India's political elite, the structure of its factor endowments and market, its political and economic systems, the nature and extent of market failure in the transaction of intermediate products across national boundaries.[330]

[329]Sanjaya Lall, "The Emergence of Third World Multinationals," 1982.
[330]J. H. Dunning, op. cit., 1988.

CHAPTER 4

THE POLITICAL ECONOMY OF INDIAN INVESTMENTS ABROAD: A BRIEF BACKGROUND

It would be a grave mistake to disregard the birthplace of a multinational firm. It would indeed be a mistake because economic actors operate in real time, they emerge from economic and political conditions at home. They are the products of history, circumstance, and policy.[331] The nature of a multinational firm cannot be a phenomenon independent of the nature of its home country. The advantages and motivations underlying Indian direct foreign investment (DFI) cannot be dissociated from the domestic political, socioeconomic considerations that affect relations among capital and state at home and abroad.[332]

The purpose of this chapter is to provide an insight into the factors which give rise to the ownership advantages that Indian firms exploit abroad and the nature of these advantages that set them apart from MDCs emerging from other countries. For DFI is a reflection, however imperfect, of the technological skills and production capabilities of the exporting country. These, in turn, reflect the influence of policy and strategy on the development of these capabilities.[333] The Indian government's technology development policy has undoubtedly stimulated indigenous technological effort and assimilation which, despite its numerous and well-known inefficiences, has given the Indian firms a competitive advantage to exploit at home and in overseas markets. Paradoxically, India accounts for the most diverse and complex forms of technology exports (through project exports, consultancy, licensing, and DFI) and also has the worst record for

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[331]T. Ozawa, **Multinationalism Japanese Style : The Political Economy of Outward Dependency**, Princeton University Press, Princeton, 1979.
[332]Dennis Encarnation, "The Political Economy of Indian Joint Industrial Ventures Abroad", **International Organisation**, vol. 36(1), 1982, p. 31-59.
[333]Sanjaya Lall, "India," 1984.

manufactured exports among the NICs.[334] Thus, the question arises as to why Indian firms prefer DFI as a means of exploiting their proprietary advantages than exporting directly? Why do these firms choose to set-up production facilities abroad than produce within one of the world's most sheltered and profitable markets?

Obviously, there is no unequivocal answer to such a complex problem which involves several issues and dimensions. The answer is bound to vary from case to case given the complexity of the phenomenon. Nevertheless, in this chapter we shall start to focus our analysis by drawing different possible links between Indian DFI and domestic macro-economic conditions. At the cost of some simplification, we shall argue that Indian DFI, to some extent, has been the 'unintended' consequence or the indirect 'spillover' of a set of government policies which on the one hand, have led to diversified technological development and on the other hand, have created an over-regulated, restrictive environment with serious production problems (infrastructural bottlenecks, high cost inputs, and so on) which have encouraged dynamic Indian firms to choose between growth restrictions at home or expansion abroad.

However, even when these firms do go international, their overseas operations constitute a tiny fraction of their domestic operations. In a large number of cases, DFI has resulted when rapidly expanding Indian firms hit the ceiling imposed either by the government or by the size of their respective markets. Given the fact that domestic market continues to be the main source of attraction for a majority of these firms, it is by no means surprising that Indian DFI is more or less a duplication or an extension of the domestic operations of the firms in terms of product mix, technical skills, and machinery. Thus, an understanding of the home environment as the 'learning base' for the proprietary assets of the firms is important.[335]

[334]Ibid.

[335]Sanjaya Lall, **The New Multinationals**, p. 15.

To grasp this web of exchanges, inter-linkages, and institutions defining the political economy of Indian joint ventures we need to familiarise ourselves with the major aspects of India's economic growth, the nature of the Indian state, the ideological leanings and perceptions of its political elite, the aims and conduct of its foreign policy. This exercise is also supposed to provide us with an insight into the reasons for and the nature of ownership, location, and internalisation advantages that Indian firms exploit abroad through DFI.

Ideological Background

To understand the pattern of the state's economic behaviour and the 'substantive direction' of its policies, one must look to the economic ideologies prevailing among its political elites.[336] The present policies of the Indian state have their roots in the ideological preferences of the first generation of nationalist leaders who refused to consider the problems of economic development to the exclusion of other social goals. The policies were most strongly influenced by an unlikely blend of the religious morality preached by Mahatama Gandhi and the socialist philosophy preached by Nehru.[337]

Gandhi, who assumed the leadership of the Indian National Congress in 1920, envisioned a self-sufficient egalitarian village economy for India. While Nehru and his colleagues shared Gandhi's vision of a self-sufficient India and the relevance of small-sector industries, they did not abandon their goal of establishing a modern industrial society in India. In fact, they staunchly believed that rapid capital-intensive industrialisation and modern technology were essential to increase productivity, achieve and maintain high standards of living, eliminate poverty, and reduce India's dependence on Western powers. Nevertheless, Gandhi's critique of modern industrial society forced

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[336]Stephen Haggard, **op. cit.**, p. 345.
[337]Francine R. Frankel, **India's Political Economy, 1947-1977**, Princeton University Press, 1978, p.8.

Indian leaders to 'focus their attention on the normative aspects of industrialisation and to add moral to the material elements of economic growth'.[338]

Jawaharlal Nehru, the nationalist hero, the first Prime Minister of independent India, and the principal architect of India's development during the first fifteen years of freedom, pointed his country in the direction of 'democratic socialism'. Nehru spoke of it as "a third way which takes the best from all existing systems - the Russian, the American, and the others - and seeks to create something suited to one's own history and philosophy."[339] The Nehruvian concept of democratic socialism sought to "dissociate democratic structures from their economic bases of liberal industrialism and market rationality, and to combine them with Fabian kind of collective controls leading to regulation... of the industrial set up."[340] The task at hand was the "consolidation of democratic order, prevention of concentration of economic power, reduction of disparities in income and wealth ... and the spread of institutions, values and attitudes of a free society."[341] A product of Harrow, Cambridge and the Innner Temple, Nehru denied that the source of his attraction to socialism was academic Fabianism, but was rather the practical success of socialism in Soviet Union (before the onset of Stalinism) to which he was directly exposed during a brief visit in 1927.[342] Further, Lenin's attacks on imperialism and vigorous Soviet support for nationalist movements in Asia and Africa greatly predisposed Indian nationalists favourably towards the Soviet system.[343] For a developing country, planned economic development appeared intrinsically superior to capitalism's dependence on unpredictable market forces. According to Mehta, in these early years, the Congress Party came to represent the 'centre' of Indian politics in the sense of shared beliefs, a consensus around the values of parliamentary democracy,

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[338]Ibid., p. 13.
[339]Ibid., p. 3.
[340]V. R. Mehta, "Centre and Periphery in Indian Politics," **Government and Opposition**, vol. 17(2), 1982, p.164-79.
[341]Ibid.
[342]Jawaharlal Nehru, **An Autobiography**, London, 1936, p. 161-5.
[343]Francine R. Frankel,**op. cit.**, p. 13.

secularism and socialism. All members of the party, despite their differences, adhered to these principles.[344]

It must also be noted that the Indian leadership did not innovate state intervention in the economy. The state's active intervention in the economy had manifested itself long before under British rule. Railways, forestry, manufacture of arms and ammunition, generation and distribution of electricity were some of the major areas of state intervention. As one author correctly pointed out, "If India was not new to the institution of political democracy, she was not new to the methods of state enterprise either."[345] The Indian National Congress, determined to develop India along an independent path, was fully conscious of the economic difficulties facing the nation. The Congress leaders were especially aware that private enterprise alone, given the meagre financial and technical resources at its disposal, could not deliver the goods. They perceived that there were two options - an increasing collaboration with foreign private capital or an increasing intervention by the state in the economy. For the newly independent country and its leaders, and for a relatively weak domestic capital, the choice was not a difficult one. [346]

Centralised planning and socialism in India did not mean the suppression of private enterprise. Rather, the basic approach of the planners to economic organisation was that of a mixed economy. On one hand, the Congress Party executive endorsed socialist principles of state ownership, regulation and control over key sectors of the economy to create conditions for rapid self-development and to curb excessive economic concentration. On the other hand, successive governments pursued liberal economic policies and incentives to private sector with the purpose of creating a

[344]V. R. Mehta, **op. cit.**, 1982.
[345]Paresh Chattopadhyay, "State Capitalism in India", **Monthly Review**, Mar. 1970, p. 14-39
[346]Ibid.

favourable business environment and maximising domestic production.[347]

Political exigencies also forced Gandhi, Nehru, and other socialists in the national Congress to back down on certain socialist measures. For, by 1946 the most influential man inside the Congress organisation was neither Gandhi nor Nehru but Sardar Vallabhbhai Patel, Gandhi's chief lieutenant in building local and state party units during the freedom struggle. Patel, a staunch conservative, used his party-building experience to exclude the socialists from key positions in party organisaton. The conservative position prevailed also in decisions to establish constitutional protection for the rights and privileges of former Indian rulers, the propertied classes and the officers of the British-trained Indian Civil Service.[348] It was only after Patel's death in 1950 that Nehru reasserted his position in the party organisation and redefined the industrial and agricultural development strategies. However, through all this Nehru maintained Gandhi's 'friendly and constructive' approach towards the economic elites. Apart from the introduction of legislation to bring the private sector under more effective state regulation and control in 1951, and to eliminate the most exploitative aspects of the zamindari landlord system, Nehru avoided a frontal attack on the institution of private property. Nehru relied more on institutional change designed to speed up popular organisation and pressure from below on state governments for the implementation of social and economic reforms.[349] Ironically, the rise of powerful rural lobbies further consolidated the position of the landed proprietors and the rural money lenders. Staunchly conservative, they have acquired a preponderant influence on the working of the system largely as a result of their hold over the ballot box. So great has been, and still is, the influence of this group in the context of electoral politics that successive governments have been unable to push for the desired land reforms, increase in

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[347]Francine R. Frankel,op. cit., p. 71-7.
[348]Ibid., p. 72-87.
[349]Ibid., p. 108-9.

agricultural taxes, or decrease in agricultural prices.

The socialists in the government have had more success in expanding state control of the means of production. This was attained partly due to popular support, and partly because the state bureacracy proved to be one of their major allies.[350] Over the years, the power of bureaucracy has increased manifold, particularly since the decision in 1964 of Nehru's successor, Shastri, to constitute his own Prime Minister's secreteriat.[351] This undoubtedly placed very high ranking and high powered civil servants in the prime minister's office, not only advising the Prime Minister on important economic and political issues, but also coordinating appointments and policies in all ministries. Under the government of Mrs. Indira Gandhi (1966 - 1984), the left leaning members of the civil service elite shot to prominence as the Prime Minister moved leftward both to discredit the so called 'forces of right reaction' in the Congress and to mobilise popular support after the dismal performance of the party in 1967 elections.[352] The government moved quickly to pass the Monopolies and Restrictive Trade Practices Act (MRTP), to nationalise bank, insurance, and coal industry, and to delimit the property rights through constitutional amendment.[353] Dennon, commenting on the broad appeal of these measures, states : "The left sees it as Indian socialism, planning technicians and bureaucrats see it as a benefit to their careers, and the bigger businessmen get a protected market and high profits in return for contributions to the Congress Party."[354]

Rajiv Gandhi's ascension to power in 1984 marked a changing of the guard in Indian political leadership. The previous leadership, steeped in the experiences of

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[350]Myron Weiner, "The Political Economy of Industrial Growth in India," **World Politics**, vol. 38(4), July 1986, p. 596-610.
[351]Francine R. Frankel, **op. cit.**, p. 251.
[352]Myron Weiner, "Political Evolution - Party Bureaucracy and Institutions," in John W. Mellor, (ed.), **India : A Rising Middle Power**, Westview Press, Colorado, 1979.
[353]Myron Weiner, **op.cit.**, 1986.
[354]David H. Dennon, "AID - High Politics, Technology or Farce?" Ph. D. Dissertation, Dept. of Political Science, MIT, 1975, p. 139.

colonial domination and a prolonged freedom struggle, envisioned a self-sufficient India under a state-guided economic system. Rajiv inherited a vastly improved economy, and had a fresh perspective which envisioned India as increasingly participating in the world economy as a powerful and independent force.[355] His background as a pilot, his close association with school friends who have been managers in multinational corporations, his personal fascination with computers, and the fact that he was not brought up in the socialist intellectual milieu that shaped the youth of both his mother and grandfather have all been important factors in his liberal approach.[356] Rajiv's position was also reinforced by a group of top economic bureaucrats in the Prime Minister's secreteriat who favoured market liberalisation. With increasing foreign borrowings, the external pressures on the government for change and liberalisation also cannot be discounted. Both the International Monetary Fund (IMF) and the World Bank have extended funds to India conditional to the further liberalisation of Indian economy. The World Bank is the country's major donor organisation and is the convenor of the Aid India consortium which provides 85% of India's aid.[357]

The new policies run against vested interests spawned by the old policy: defunct economists, businessmen, bureaucrats, politicians. Rajiv's reliance on technocrats has alienated the Congress old-gaurd with the vote-getting power. Their lack of cooperation has been politically costly, as Rajiv's government realised in the 1987-88 by-elections. Clearly, it takes a great deal of political as well as economic fine-tuning to make the transition. It not only requires a new ideological orientation of the governing elite, but also requires the capacity of leadership to build a new coalition of political forces to provide support for these policies.[358] Gandhi appears to be having some difficulty in

[355]S. S. Rahman and D. Balcome, **The Asian Experience**, The Conference Board of Canada, Ottawa, 1987, p. 20.
[356]Economist Intelligence Unit, **India to 1990 : How Far Will Reform Go ?**, Special Report No. 1054, London, 1987, p. 39.
[357]Ibid., p. 38.
[358]Myron Weiner, **op.cit.**, 1986.

accomplishing the latter, and once again the result has been more concessions, more compromises, and more backsliding.

An understanding of India's economic policy would also seem to flow out an appreciation of its *foreign policy* posture, of the ruling elite's perception of the country's desired role in world affairs. Given its size, population, strategic location, and historical past, the national leadership has perceived India as a potentially powerful force in international affairs. In 1939 Nehru stated, "A free India, with her vast resources, can be of great service to the world and to humanity. India will always make a difference to the world ; fate has marked us for big things."[359] This perception of India's world role was contingent upon India's self-sufficient development, rapid industrialisation and modernisation. Thus, there has been the emphasis by successive governments on building a heavy industrial and scientific base, an independent and modern arms industry, and an impressive space and nuclear programme to bridge the gap between existing capabilities and the country's perceived role in world affairs. As Nehru underlined, "... the sooner we put India on its feet the more chance there is of our pulling our weight and surviving and having some influence in the near future."[360] The lynchpin of the foreign policy has been non-alignment and mutual cooperation among developing countries, partly reflecting the desire of Indian leaders to step out of the shadow of the super powers and take a stand on world issues as an independent force.

Non-alignment allowed India to gain a measure of autonomy in its foreign policies and also an increased assistance for its industrial projects, as well as promoted legitimacy and authoritativeness in domestic politics. By the mid-1950s, the new Indian state had not only established itself as a power independent of the two superpowers, but also as a major influence on other newly-emergent developing countries seeking a

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[359]Dorothy Norman, (ed.), **Nehru : The First Sixty Years**, vol. 2, John Day Company, New York, 1965, p. 649-50.
[360]Jawaharlal Nehru, **Independence and After**, John Day Company, New York, 1950, p. 151.

'self-reliant' development. An essential rationale of the economic component of India's non-aligned policy was to diversify Third World trade and investment, to reduce dependence on the North in money, finance, and technology by strengthening economic cooperation among developing countries.

The Indian government's committment to expand economic ties with other developing countries and to promote mutual cooperation arose, from a desire to build a new world order and to share its own development experience with other developing countries. To pursue this aim, "...some limited sacrifice of our short term economic interests may thus be necessary in the larger and long term interest of stable political relationships and overall national interests."[361] Yet, even the practitioners of this rhetoric did not deny that through economic cooperation, India was promoting its own economic and political interests and seeking an advantageous position over other states.[362] "The ideologues of the Indian state, while stressing that India's pre-eminence in the region (South Asia) must be recognised, try to portray India's role as a benevolent one, one which rescues the neighbouring countries from the machinations of imperialism and even contributes to the development of these countries."[363] Thus, economic cooperation was conceived by Indian leaders as part of India's global political role, its desire to play an influential world role as leader of a group of developing and non-aligned countries. As part of this strategy, Indian decision-makers envisaged forging stronger ties with developing countries. Nehru clearly stated that, "India's role of leadership may not be so welcome to others although it may satisfy our vanity. But it is something we cannot escape, the various responsibility that arise out of our geography and history."[364]

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[361]T. N. Kaul, "India's Economic Cooperation with Developing Countries," **Foreign Trade Review**, Jan.-Mar., 1973.
[362]H. S. Chhabra, "India's Economic Cooperation with Developing Countries," **Indo-African Trade Journal**, vol. 8(11-12), 1972.
[363]D. N., "India's Role in South Asia," 1988.
[364]Michael Brecher, **Nehru: A Political Biography**, New York, 1966.

Further, as Indian industries expanded, chronic problems of the Indian economy such as under-utilization of capacity, lack of demand, and lack of new investments emphasized the importance of expanding international economic relations and economic diplomacy. By 1970s, India's constant championing of economic cooperation was set in a new context. From being merely a recipient, India emerged as a donor of services, aid, finance, and technology. According to Dutt, "It was also during the late 1970s that the earlier Indian ruling class aspirations for world influence were revived. By this time the Indian state had developed far more tangible instruments of power with which to project its influence abroad."[365] Since the late 1960s, Indian government has viewed the MDCs or 'joint ventures' as one of the means of strengthening economic and political ties with developing countries and as a showcase of India's achievements. As a writer puts it, "Regional hegemony goes along with a regional market. The two help each other."[366] Thus, Indian overseas investments must be examined at two levels: one directed by the economic imperatives of its own internal development, the other by the mechanisms of foreign economic policy.

The Economic Performance: An Overview

Since Independence, the state in the Indian economy has taken and kept the lead in determining priorities, formulating and implementing policies, in deciding the direction and pace of change in industry, foreign trade and investment, and infrastructure development. The private sector has been an active partner in some state-determined sectors of India's so called mixed economy.[367]

India's macro-economic policies have been essentially conservative and

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[365]Srikant Dutt, **op. cit.**, p. 10.

[366]D. N., "India in South Asia," 1988.

[367]M. R. Bhagwan, "A Critique of India's Economic Policies and Strategies", **Monthly Review**, vol. 39, July-August 1987, p. 56-79.

cautious.[368] The budgetary deficits, at least up to the 1980s, have been kept very low. Climbing inflation has been quickly reduced with strict monetary measures. Foreign borrowing has been very restrained and all capital movements (inward and outward) have been strictly controlled and carefully monitored. The balance of payments has been managed largely by variations in borrowing and import controls.[369] The Indian economy thus exhibits none of the extremes of external shock and policy change, of accelerated growth or lasting major recessions, or severe debt servicing problems - problems which have afflicted the economies of the other NICs. The economy has steadfastly maintained an average annual growth rate of 4 percent in gross domestic product (GDP) - so steady and unspectacular as compared to countries like Korea and Taiwan that it has been termed as the Hindu rate of growth. [370] Modest as these rates may appear, they reflect a truly diversified, self-sufficient industrialised economy. The Indian manufacturing sector is now among the largest in the world; its contribution to GDP has grown from 16 percent in 1947 to 23 percent in 1984-85.[371] The share of the service sector in GDP has more than doubled in the same period from 21.8 percent to 45.7 percent.[372] Net domestic savings grew from 10.2 percent of GDP in 1950-51 to 23.3 percent in 1984-85 ; corresponding, figures for net capital formation are 10 percent and 24 percent.[373] However, India's export performance has been found to be less than satisfactory. Looking at India's exports in the global context, the most striking feature is the decline in its share of world exports. India's exports have not grown enough to sustain the increasing demand for imports which leaves little room for maneuver in

[368]Vijay Joshi and I. M. D. Little, "Indian Macro-Economic Policies", **Economic and Political Weekly**, vol. 22, no. 9, Feb. 28, 1987, p. 371-8.
[369]Ibid.
[370]S. S. Rahman and David Balcome, **The Asian Experience**, Conference Board of Canada, Ottawa, 1987, p. 7.
[371]Ibid.
[372]World Bank, **India : Structural Change and Development Perspectives**, April 1985.
[373]S. S. Rahman and David Balcome, **op. cit.**, p. 13.

managing the economy.[374]

The transformation and development of the Indian economy has taken place within a planned, rigidly regulated and relatively closed economic framework.[375] A succession of five-year-plans since 1950 have defined the overall contours within which planned development has been undertaken. The state has acted as the planner and the regulator to realise the planned objectives of self-sustained economic growth, equality, and a socialist pattern of society.[376] Implicit in economic planning is the existence of a large public sector and a comprehensive system of controls over private capital. It embraces prices, profits, modes of operation, investment, labour relations, foreign trade and currency, banking - everything in fact that bears on the conduct of business. Thus, the state attempts to set the parameters for business activity, and all business activity must be understood only as part of this larger and more complex set of relationships which compose the larger political system. In the following discussion we shall observe business activity in India within the narrow confines of a highly regulated economy and see how the domestic environment has contributed to the decision of Indian business to invest abroad.

External Economic Links

The transformation of the Indian economy has taken place behind high protective barriers. "Indian economy has tended to be protectionist towards the import of foreign goods, passive toward exports, and ambiguous toward the import of foreign capital".[377] A rigid policy of import-substitution has been driven by three key considerations -

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[374]Martin Wolf, **India's Exports**, Oxford University Press, New York, 1982, p. 26.
[375]S. S. Rahman and D. Balcome, **op.cit.**, p. 7.
[376]Foreword by Prime Minister Rajiv Gandhi to the Seventh Five-Year-Plan, **Seventh Five-Year-Plan, 1985-90**, vol. 1, Planning Commission, Government of India, New Delhi, October 1985.
[377]S. S. Rahman and D. Balcome, **op. cit.**, p. 11.

achieving self-sufficiency, increasing domestic competition, and conserving and increasing the supply of scarce foreign exchange.[378] It meant, until very recently, that if a capital item or a component was 'indigenously' available or produced, however inadequately, with however much delay, or at times even however theoretically, then that item was prohibited import.[379] The rationale was to build sufficient internal capacity which would serve the demands of the economy and permit the use of limited foreign exchange earnings to import 'machines to make machines'.[380] Thus, the purpose was progressively to reduce the pressure built by adverse balance of payments, and to apportion the available foreign exchange among the various users to meet their industrial input requirements through a system of import licensing.[381]

Import Regulations

The historical pattern of import controls on raw materials, components, capital goods, and the virtual ban on anything indigenously produced has meant, among other things, that protectionism, inefficiencies, and high cost domestic production at one stage adversely affected export activity at the next.[382] The import control or licensing system degenerated into an inordinately time-consuming allocational device. The licenses not only specified the commodities to be imported and their quantities but also their source, so as to absorb tied aid.[383] As even the most petty imported item required a license, all actual and potential entrepreneurs had to maintain elaborate and frequent contacts with the licensing authorities to ensure file-pushing by bribe-seeking bureaucrats at lower levels.[384] Firms attempting to expand had to wait long for the next import order to arrive

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[378]Ibid, p.43
[379]Richard Thomas, **India's Emergence as an Industrial Power**, C.Hurst and Company Ltd., London, 1982, p. 5.
[380]Deepak Lall, **New Economic Policies for India**, Fabian Research Series No. 311, Fabian Society, London, 1973, p. 10.
[381]Jagdish Bhagwati and T. N. Srinivasan, **Foreign Trade Regimes and Economic Development**, National Bureau of Economic Research, New York, 1975, p. 18.
[382]Martin Wolf, **op. cit.**, p. 68.
[383]Deepak Lall, **op.cit.**, p. 11.
[384]J. Bhagwati and T. N. Srinivasan, **op. cit.**, p. 42-3.

before they could increase output. Several firms in the Krueger study reported to being forced to turn down export orders because they could not obtain the needed raw materials or the necessary tools in time to fill the order.[315] Another serious implication of the procedural delays was that firms were forced to carry an excessive holding of inventory.[316]

However, the most serious difficulty the Indian firms appeared to have with the import licensing system, aside from the delays, was the practice of screening import requests by the 'indigenous availability' criterion. The import of goods which are locally produced , at whatever cost, is normally restricted or banned. It is obvious that the principle of indigenous availability eliminated virtually all foreign competition. A complete insulation of domestic production from competitive pressures combined with excess domestic demand for most of the products, meant that producers had little incentive to reduce costs and bring them in line with international standards. As firms are forced to buy domestic, import protection is automatically extended to these substitutes regardless of costs, efficiency and comparative advantage.[317] Exportable items produced with inferior quality and high cost domestically produced inputs and capital equipment are faced with enhanced difficulties in the highly competitive international markets. High input costs preclude international competitiveness of several Indian firms even when their own production processes are economic. [318] Further, as most industries required imported capital and intermediate goods, the detailed allocation of imports effectively determined both the pattern of investment and production in the industrial sector. Under this system, production and profitability were far more a function of obtaining licenses than it was of efficiency, cost consciousness, and quality control.

[315]Anne O. Krueger, **The Benefits and Costs of Import Substitution in India**, University of Minnesota Press, Minneapolis, 1975, p. 73.
[316]Other factors, like the inefficient transportation system, might also explain the large inventories.
[317]J. Bhagwati and T. N. Srinivasan, **op. cit.**, p. 45.
[318]Anne O. Krueger, **op. cit.**, p. 77.

Nevertheless, the import control system despite its biases, successfully diversified the industrial structure along lines it may not otherwise have followed and so has led to a greater depth of industrial capability.[389] The heavy emphasis on 'self-reliance' resulted in increasing replacement of imports by domestic sources of supply. The very act of setting up, operating and supplying inputs for an extremely diverse set of manufacturing industries has forced Indian enterprises to acquire a wide range of technical skills. A lot of technological effort had to go into making new technologies operational under the demanding import-substituting regime - using different raw materials at different operating scales to make the final product suitable for the local market.[390] Indian firms have fully exploited their experience in technology adaptation by exporting 'appropriate technology' to other developing countries.

One may infer from the following discussion that there is undoubtedly some truth behind the widespread perception that domestic prices of several consumer and intermediate goods have been artificially high, adversely affecting exportable items in highly competitive world markets. Some firms, to increase their competitiveness, have been forced to invest abroad in search of cheaper, better quality, and abundant supply of inputs. The import-substitution strategy, thus, has buttressed great many irrationalties and inefficiencies together with diversification, import substitution, and technological development. As a World Bank study of the machinery industry stated that although Indian manufacturers generally paid more for their inputs, yet the domestic prices of the outputs were internationally competitive.[391] Machinery turned out was of "competitive international quality," and the firms were "up to the standards of world equipment producers in manufacturing capacities and in efficiency of raw materials use."[392] The

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[389]Sanjaya Lall, "India," 1984.
[390]Sanjaya Lall, "Technological Development and Export Performance in LDCs", **Weltwirtschaftliches Archiv**, Band 122, 1986.
[391]World Bank, "India : Non-electrical Machinery Manufacturing - a Subsector Study", Report No. 5095-IN.
[392]Ibid.

import licensing scheme has affected different firms differently and has been just one dimension in the vast and intricate web of government restrictions and controls. In recent years there has been considerable liberalisation, recognising the fact that imports have a developmental role to play and that the attitude towards imports should not be one of indiscriminate restrictions but one of rational management.[393] However, these policy changes do not significantly depart in objectives or broad strategy from the old and remain "vulnerable to the frequently heard charges of incoherence, adhocism, vascillation, and backsliding."[394]

Export Promotion

During the first decade of economic planning, trade policies tended to emphasise import substitution to the neglect of export promotion. The government tended to be highly pessimistic regarding export possibilities, especially regarding traditional exports.[395] It is only now being accepted that exports, besides generating foreign exchange, contribute to greater efficiency in resource use, technological development, and products of better quality. It was gradually realised that if the economy was to attain its objective of self-reliance, a very large portion of the external resource required to finance economic development be met out of foreign exchange receipts derived from exports. [396] The planners of the Third Five Year Plan (1961-66) argued that, "one of the drawbacks in the past has been that the programme for exports has not been regarded as an integral part of the country's development effort under the five year plans."[397]

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[393]S. S. Rahman and D. Balcome, **op. cit.**, p. 43.
[394]Jagdish Bhagwati, "Articulating a Change," **India Today**, 15 Dec. 1986.
[395]Committee on Export Strategy, **Final Report**, Ministry of Commerce, Government of India, New Delhi, Dec. 1980, p. 185-88.
[396]Deepak Nayyar, **India's Export and Export Policies in the 1960s** , Cambridge University Press, Cambridge, 1976, p. 220.
[397]**Third Five Year Plan**, Planning Commission, Government of India, New Delhi, 1961, p. 137.

Since the 1960s, a great deal of emphasis has been placed on export promotion. Among the various heads under which subsidies are extended from the Union Budget, the single largest item next to food is the so called 'Export promotion and Market Development Scheme'.[398] However, there is widespread dissatisfaction that the subsidies and incentives for exports are excessive, they are not commensurate with the results achieved, and that they are not well designed to serve their underlying objectives efficiently.[399] One of the damaging aspects of these incentive schemes was that they were exclusively aimed at non-traditional exports of manufactures, neglecting the traditional commodities in which the country had a natural advantage. The loss of traditional exports was to some extent made up by the growth in non-traditional exports, and there is little doubt that export incentives were a major factor in this expansion. Nevertheless, the administrative complexity, the uncertainty arising from frequent policy changes, and the bureaucratic delays inherent in most of the export promotion schemes considerably reduced the potential impact of the incentives.[400]

Further, the possible advantages of export promotion policies, including the devaluation of the rupee, were off-set by the high rise in India's cost and price level and the relative profitability of selling exportables at home.[401] Protected domestic sales made it a seller's market, resulting indirectly in inadequate marketing and servicing of exports. According to Tapash Chatterjee, deputy regional manager at the Engineering Export Promotion Council's office at Chicago, "The fact is, Indian firms have little interest in exporting, given the margins they could make in the highly protected domestic setting." One indicator of the apathy towards exports among large firms, he says, is that among the 200 top firms surveyed recently by the Engineering Council, exports accounted for

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[398]Amaresh Bagchi, "Exports Incentives in India," in A. K. Bagchi and N. Banerjee (eds.), **Change and Choice in Indian Industry**, K. P. Bagchi and Co., New Delhi, 1981, p. 303.

[399]Ibid.

[400] Deepak Nayyar, **op. cit.**, p. 259.

[401]Ifzal Ali, "India's Manufacturing Exports : An Analysis of Supply Sectors," Report No. 31, Asian Development Bank, 1985.

less than one percent of output on the average.[402] The poor performance of the large firms might also be explained by the formal and informal restrictions on their expansion in the domestic market which prevent them from greater exploitation of economies of scale in production and product development.[403] The curbs on foreign collaboration and on the import of technology have further caused several of India's exportables to be uncompetitive internationally. However, despite these deficiencies and inefficiencies in India's protected industrial structure and trade performance, in almost all industries a few firms were fully competitive internationally in both prices and quality but preferred the easier option of the domestic market.[404]

In the past decade, the ratio of exports to GDP has been between 6 percent and 8 percent - an extremely low proportion which implies that *domestic demand* has been the overhelmingly deciding factor in economic activity. [405] Increasing domestic demand constrains exports of individual products where the incentive to expand production is weak or where the physical possibilities are limited. Fluctuations in domestic demand and supply have a significant effect on exports in the short to medium run, in which the structure of potential output is difficult to change. Engineering exports, between 1965-67 and again in the 1970s, greatly increased by a combination of a temporary relaxation of supply constraints and a recession in demand.[406] However, the Indian exporters were seriously hampered in their efforts by a lack of marketing outlets abroad, especially in the sale of capital goods such as machine tools. An impressive number of firms found the solution in DFI. By 1977, nearly half (46%) of all Indian

[402]T. T. Ram Mohan, "Indian Industry Pursuing US Market," **India Abroad**, Toronto, 15 April 1988, p. 11.

[403]Martin Wolf, **op. cit.**, p. 65-67.

[404]Ibid.

[405]Jayati Gosh, "Export OPtimism and Import Liberalisation," **Economic and Political Weekly**, vol.20(22), 1 June 1985.

[406]Reduction in demand was due to several factors : the wars of 1962, 1965, and 1971 which diverted public investment and created severe infrastructural bottlenecks; successive droughts of 1965/6 1966/7 and 1971/2 - 1972/3 which indirectly curtailed demand for industrial goods; and the 1973 oil crisis which led to considerable industrial dislocation.

overseas ventures in production were in engineering and textiles, both industries hit hard by the recession.[407] It also facillitated collaboration between Indian product manufacturers and Indian equipment manufacturers abroad to increase their mutual competitiveness.

Shortages and bottlenecks have long been an unfortunate feature of the Indian economy, forcing firms to carry large inventories, preventing them from expanding production and entering into long-term export contracts with buyers. To gain access to regular supplies of cheap inputs, firms have undertaken investments abroad. Further, the volatile Indian labour force has a record (by way of strikes) of roughly one day lost per year per employee in the organised sector. India's two Asian competitors, Korea and Singapore, in comparison have negligible strike records.[408] Exporters also suffer from insufficient shipping services, thus having to pay extortionate rates to foreign lines to transport their products to overseas destinations.[409] There has been dissatisfaction with export finance and credit. Even if the terms of credit were made competitive, there existed the need to simplify and streamline the procedures. Increasingly, the need has been felt for banks to provide financial management services and strengthen the infrastructural facilities for visiting Indian businessmen in the various countries. [410]

Needless to say, the domestic environment has considerably constrained exports. The Hussain Committee Report of 1984, which forms the cornerstone of the new economic regime, states, "In general the costs of production in India's export are higher than in competing countries because : (i) the costs of inputs, whether imported or domestically produced, is higher, and (ii) the productivity, which is a function of

[407]Deepak Nayyar, **op. cit.**, p. 196.
[408]Richard Thomas, **op. cit.**, p. 70-71.
[409]A study by the Indian Institute of Foreign Trade showed that freight constituted 16.5 to 38.0 percent of the value of exports of engineering industries. D. Nayyar, **op. cit.**, p. 209.
[410]P. N. Agarwal, **India's Export Strategy**, Vikas Publishing House Pvt. Ltd., New Delhi, 1978, p. 17.

technology in use and the scale of production, is lower. The pressure of domestic demand improves the relative profitability of sales in the domestic market as compared to exports and reduces the surplus available for export. Non-price factors such as quality or marketing efficiency, which in turn is a composite of several attributes, tend to reduce the ability of Indian exports to compete in world markets."[411] Even fairly large subsidies and incentives have failed to offset some of the cost disadvantages of producing in India. Few of the Indian firms have invested abroad to escape the constraints of the domestic economy.

However, it would be fallacious to rest the entire blame for poor export performance on domestic factors. The *international trading environment*, especially since the early 1970s, has been less than conducive to the growth of exports from India and other developing countries. The recovery and growth of industrial economies from the latest recession has not been matched by a proportionate increase in the level of world trade. Market access to their economies has become both difficult and uncertain with the increasing protectionism. Specific protectionist tendencies in the developed countries are particularly strong for commodities in which the newly industrialising countries have a comparative advantage. This trend has been matched by high protectionism and import-substitution in developing countries, many of whom have been forced to curtail imports drastically in order to generate trade surpluses or wipe out deficits. There is a growing competition among these countries to increase their share of world exports substantially. Much of this thrust is related to the world debt problem, which requires major debtors to generate trade surpluses for purposes of debt service.[412] Indian enginee ring goods, the fastest growing category in exports in the 60s and 70s, has suffered a setback in the past few years on account of various adverse developments including strong competition in international markets, growing

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[411]Hussain Committee, "Report of the Committe on Trade Policies," Ministry of Commerce, New Delhi, 1984, p. 34.
[412]Ibid.

protectionism, slowing down of developmental activities in several developing countries of Asia and Africa.[413] India's labour intensive exports, especially textiles and garments, are under pressure from both stiff competition and protectionist policies.[414] To circumvent the tariff barriers in developed and developing countries, a few enterprising Indian firms have set up subsidiaries abroad. As Wolf puts it, "However worrying the situation and however understandable the fears of the constraints, risks, and uncertainty generated by protectionism, opportunities for export had certainly not disappeared for those who could seize them."[415] The more difficult the environment, the harder the countries will have to compete to maintain and increase their share of the export market; and the more essential it will be to exploit every available opportunity in developed as well as developing countries. The Indian Government shares a common interest with business in exploiting the experience of India's wide industrial base, her rich pool of manpower and skills, the growing acceptabilty of her engineering goods and services through exports, export of turnkey projects, consultancy services, and direct foreign investment.

The importance of exports is not only as a source of demand for domestic producers, but also because of the need for imports. The expansion of exports allows for liberalisation of imports, with all its consequent advantages in terms of greater domestic availability of goods, increased competition, and greater efficiency in production.[416] Thus , most simply put, exports and imports are required to adjust to maintain a balance of payments. While India's exports have consistently disappointed, her imports have soared. The share of exports declined from 2.4 percent in 1949 to

[413]Government of India, Ministry of Commerce, New Delhi, Annual Report, 1986-87, p. 19.

[414]The US Government passed a bill in 1985 freezing imports of textiles, clothing and leather shoes from twelve countries incuding India. Indian exports of engineering goods and castings to the US were also disrupted under the allegation that these were unduly subsidised. S. Ananta Charlu, "A New Strategy for India's Exports," **Indian and Foreign Review**, 15 Dec. 1986.

[415]Martin Wolf, **op. cit.**, p. 144.

[416]Jayati Gosh, **op. cit.**, 1985.

0.4 percent in 1986 and the trade deficit rose to $6.771 billion.[417] Leaving aside two small surpluses in 1973 and 1977, the trade deficit has steadily widened.

Balance of Payments

India enjoyed a comfortable balance of payment position in 1947. The post-independence period was marked by a high level of public investment in building infrastructure and capital goods and intermediate goods industry to establish the base for a self-sustaining and fast growing industrial sector. The wars with China (1962) and Pakistan (1965, 1971) diverted potential public investment to unproductive defense expenditure. Foreign aid was suspended during the 1965 Indo-Pakistan war and was resumed at a lower level only after the rupee devauation of 1966. The devaluation achieved little by way of exports, partly because of the disastrous droughts of 1966 and 1967 which severely restricted the supply of raw materials and the demand for industrial goods from the agricultural sector and the consumers. [418] The result was a curious combination of recessionary situation with production and investment at reduced levels along with an accelerated price increase. The escalation in cost structures upset expectations of profit, created investment uncertainty, deccelerated private investment. Quite soon recessionary conditions hit majority of the engineering industries, as the demand for their goods was cut down due to lower production in the consumer goods sector and reduction in public sector investment outlays.[419] These conditions contributed to the fall in the prices of inputs and outputs. A survey by the Indian Engineering Association revealed that between 1965/6 and 1967 prices of various of engineering goods fell by 10 to 45 percent.[420] This contributed to the relative unattractiveness of the domestic market and improved the price competitiveness of exports. When no

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[417]Anoop Babani, "The Gulf in the Trade Gap," **South**, March 1988.
[418]Deepak Nayyar, "Industrial Development in India : Growth or Stagnation?" in A. K. Bagchi and N. Banerjee (eds.), **op. cit.**, p. 98.
[419]Deepak Nayyar, **op. cit.**, p. 195-7.
[420]For details see **Eastern Economist**, New Delhi, 22 Sept. 1967, p. 547-8.

domestic sales were possible at the margin, producers were willing to export at prices lower than average costs and also undertake DFI abroad as a safeguard against the frequent fluctuations in domestic demand. Further, in the 1960s, the bulk of the engineering manufactures were directed to other developing countries, and being rather simple and standard they were the most threatened by the import-substitution programmes in these markets. Few of the firms found it necessary to safeguard their markets through DFI. In view of the severe foreign exchange crisis of the late 1960s and the growing importance of exports and DFI abroad in India's trade strategy, in 1969 the government outlined a well defined policy for the export of capital and technology through DFI.

The economy was stabilised by the early seventies, with substantial food stocks, low inflation (5.1 percent), and above average growth of GDP (5.6 percent).[421] But the economy was then subjected to further shocks - the 1971 war with Pakistan, the influx of refugees from East Bengal, the suspension of foreign aid, the poor 1972-73 harvest, and the oil price increase of 1973. Between 1972-73 and 1974-75 the share of food, fertiliser, and oil in the import bill shot up from 23 percent to 55 percent. The current account changed from a small surplus of Rs.280 million in 1972-73 to a deficit of Rs.9.6 million in 1974-75.[422] The level of imports was so low in relation to GNP (5 percent in 1973), and reduced so completely to essentials that any significant change in the terms of trade invariably led to a severe balance of payment crisis.[423] In 1973 the government, alarmed by the price increases caused largely by the bad harvest and also rising world prices, introduced restrictive monetary and fiscal policies. Public investment fell in real terms. These measures were supported by good 1973-74 winter crop. The disinflationary policies were, apparently, not very painful as the industrial production

[421]Vijay Joshi and I. M. D. Little, "Indian Macro-Economic Policies," **Economic and Political Weekly**, vol. 22(9), 28 Feb. 1987.
[422]Martin Wolf, **op. cit.**, p. 3.
[423]Ibid.

after 1973-74 rose by 3.2 percent, 7.2 percent, and 9.6 percent in the following three years.[424] The disinflationary policies considerably restrained imports, reduced the 'pull of the home market', and encouraged exports and DFI abroad. The current balance deficit of 1973-74 was easily financed by an increase in aid and drawings on the IMF low conditionality tranches. After 1974-75 the current account turned around and was over Rs.10 million in surplus in 1976-77.[425] In 1978 the government issued a revised set of guidelines regulating Indian DFI abroad, increasing incentives and reducing bureaucratic entanglements.

Following the second oil crisis, India's balance of payment deteriorated markedly with the trade deficit reaching a peak of 4.7 percent of GDP in 1980-81.[426] As prospects for increased aid looked poor, as imports continued to far exceed the exports, and as the transfer remittances reached a plateau, the government attempted to finance the deficit through drawings from IMF Trust Fund and the Compensatory Financing Facility, and the Extended Fund Facility. India also resorted to commercial borrowings of significant amounts for the first time.[427] However, while the trade deficit inflicted a serious financial dent in the balance of payments, the deteriorating public finances posed a bigger threat. The rapidly increasing expenditure on defense, on interest payments on borrowings, on subsidies, all contributed to the 'fiscal crisis of the state'.[428] Debt service in 1983-84 and 1984-85 amounted to Rs.1.5 billion a year, or 13 1/2 percent of exports invisible receipts.[429] As a result of strong government adjustment measures, during 1980-85 exports grew at an annual rate of 12.8 percent,

[424]Vijay Joshi and I. M. D. Little, **op. cit.**, 1987.
[425]Ibid.
[426]Government of India, **Economic Survey 1986-87**, Ministry of Finance, New Delhi, p. 89.
[427]Manmohan Agarwal, "India," in John Whalley (ed.), **Dealing With The North**, Centre for the Study of International Economic Relations, Ontario, 1987, p. 332.
[428]M. R. Bhagwan, "A Critique of India's Economic Policies and Strategies," **Monthly Review**, vol.39(3), 1987.
[429]N. A. Sarma, **International Environment and India's Economic Development**, Abhinav Publications, New Delhi, 1986, p. 54.

but imports grew even faster by an average of 13 percent.[430]

One fact which has become quite clear to the planners and officials is that in the coming years India needs to have a more active management of her export promotion and payments balance. As no other source of foreign exchange than exports is likely to grow rapidly and on a large scale, a multi-pronged strategy has been evolved for the promotion of exports including the lifting of licensing restraints on export production, establishing completely export oriented units, facilitating access to imported inputs, and the founding of a Export-Import Bank.[431] Overseas investments by Indian firms and exports of projects and services have been identified as one of the thrust industries having a good export potential, and attempts have been made to provide a policy framework conducive to their growth.

Industrial Licensing

India's industrial development strategy is aimed at diversification of the industrial sector, modernisation of existing manufacturing capacities and greater self-reliance.[432] From the very beginning of independent India, or really from before Independence, there was a certain consensus within the Indian National Congress[433] itself and among the top Indian industrialists about the nature of economic policy needed to be pursued by the new Government.[434] The state was conceded a major role in the economy for the purpose of rapid industrial expansion. Since the Indian bourgeoisie was weak and in no

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[430] I. Gopalakrishnan, "1987-88 Exports Up 25 Percent, Exceeding Goal," **India Abroad**, 15 April 1988, p. 10.

[431] UNIDO, **Industrial Development Review Series : India**, UNIDO/IS.547, July 1985, p. 23.

[432] Ibid., p. 36.

[433] The Indian National Congress Party led the freedom struggle against the British rule and has formed the national government in India since independence except for a brief spell (1977-79).

[434] This refers to the famous Bombay Plan - a blueprint for the industrialisation of India - drawn up by a few top industrialists. The plan called upon the state to play an active role in the economy.

position to undertake the large initial investments required in the early stages of industrialisation, the task fell on the state not only of strengthening the indigenous capital through protection and regulation but also of directly participating in the process of industrialisation through public enterprises.[435] The post-independence strategy of state-led industrial growth classified industries into three categories : the 'commanding height' industries, which were considered to be vital for industrial growth, were to be the monopoly of the public sector; the second category consisted of industries in which the state would take the initiative in establishing new undertakings but in which private enterprise was expected to supplement the efforts of the state; the third category included all the remaining industries whose future development was left to the private sector.[436]

The development of all industry in India was to be guided by the government in accordance with the Industries Act of 1951. All private sector industries had to be licensed under the Act for the establishment of new industrial capacities, for expanding existing capacity, and for changing the product mix of existing units. This complex network of licensing procedures was designed to control the allocation of scarce industrial inputs, and the growth, composition and concentration of industrial capacity. Not surprisingly, the post-independence era came to be labeled as the 'permit-Raj'![437] From the very outset, the industrial development was not envisaged as an end in itself but rather as an instrument to take the country forward, to expand employment opportunities, to meet the basic needs, and to fulfil certain socio-economic objectives.[438]

[435]S. S. Rahman and D. Balcome, **op. cit.**, p. 10.
[436]"Industrial Development in India," **India News**, Indian High Commission, Ottawa, 16 May 1980.
[437]Deepak Lall, **op. cit.**, p.11.
[438]S. C. Bhatt, "Industrial Revolution Comes To India," **Indian and Foreign Review**, 30 Nov. 1987.

The industrial policy in the 1950s and the early 1960s was liberal, granting licenses without much inhibition. Concentration of economic power had not then become a burning issue. However, the sixties witnessed a disproportionate growth in the assets of the larger industrial houses in the corporate sector, especially in the capital intensive industries.[439] The Monopolies Inquiry Commission in 1964 stated that the bigger business houses utilised the cumbersome licensing procedure effectively to grow to the detriment of smaller rivals. These revelations regarding the growing concentration in the private sector and the accelerated growth of the share of the top few industrial houses, and the growing public discontent with government's economic and social reforms, prompted the government to explicitly define the role of the large industrial houses in the economy. Consequently, in 1969 the Monopolies and Restrictive Trade Practices (MRTP) Act was passed, subjecting an individual unit under its purview if the assets of the company by itself or along with assets of interconnected undertakings exceeded Rs.200 million.[440] A company falling under the Act would be allowed to expand or undertake new industrial activity only in a specific group of industries with prior permission of the government. The Foreign Exchange Regulations Act (FERA) 1973, restricted the industrial activity of companies having more than 40 percent foreign equity to the same group of industries as the MRTP companies.[441] The conglomerates and the multinationals were allowed, along with other applicants, to invest in the core industries of national importance, industries having direct linkages with such core industries, and industries with a long term export potential, provided the item of manufacture was not reserved for public sector or the small sector. The Industrial Policy of 1973 further opened industries requiring high technology and heavy investment for participation of large industrial houses and foreign companies.[442]

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[439]N. S. Siddharthan, "Industrial Houses, Multinationals, and Industrial Policy," **Economic and Political Weekly**, vol. 14(29), 21 July 1979, p. 1197-1203.
[440]Recently the asset threshold has been increased to Rs.1000 million.
[441]S. M. Agarwal, "Electronics in India : Past Strategies and Future Possibilities," **World Development**, vol. 13(3), 1985, p. 273-92.
[442]Indian Investment Centre, **Investment Policy for 1980s - A Focus on**

The government has over the years amended its industrial policy, without departing from the basic tenents of the old policy, on account of severe problems and resulting stagnation. The changes were aimed at rationalising and restructuring policy, simplifying procedures, delicensing a number of industries, removing bottlenecks to capacity expansion, and technology development. Restrictions on import of technology, equipment and raw materials were relaxed in the interest of accelerating the pace of industrial development.[443] Further, the government introduced enhancement in the exemption limit from licensing provisions upto an investment of Rs.50 million, reendorsement of licensed capacity on the basis of best production achieved, and automatic growth in capacity at the rate of 5 percent per annum upto a limit of 25 percent in a five year period.[444]

However, despite these policy initiatives, the new policy merely represents a slight modification than a break with the past orientation. The optimistic mood which greeted Prime Minister Rajiv Gandhi's policy initiative is glum again. Says Tarun Das, Director General of the Confederation of Engineering Industry, "The euphoria of 1985 is gone. The realities of the political situation, particularly the resistance to change in the bureaucracy, are very evident. The regulatory mechanisms have ascribed a great deal of power to the bureaucrats and led to the apportionment of significant rents to them. Its no surprise that they have resisted the liberalisation drive as a serious threat to their power. Even a large section of business has become so dependent upon government controls and protection that it has acquired a stake in the very controls it publicly denounced and used as a convenient scapegoat to blame for its incompetence. Corporate leaders have not hesitated to use their political clout to persuade government to go slow on the liberalisation drive as they fear that lowering of trade barriers and fostering of genuine competition might force the closure of their inefficient and

[442](cont'd) **Industry**, New Delhi, 1985, p. 8-9.
[443]S. C. Bhatt, **op. cit.**, 1987.
[444]Indian Investment Centre, **op. cit.**, p. 8-9.

incompetent businesses. Thus, a big gap has developed between the spirit of the original pronouncements and their implementation." [445]

This is not to deny the crippling effect of the industrial policies on the economy. Bhagwati, in his column in India Today, lashes out against the policy in no uncertain terms, "It is nonsensical to monitor and constrain diversification and capacity expansion and to rule out entry by new producers - yet this is what was practised to excess. The constraints have created a rentier rather than an entrepreneurial mentality with this regime of 'don'ts', forgetting Herbert Spencer's remark that the effect of shielding men from the consequences of their folly is to fill the world with fools."[446] There is no denying that the licensing policy has created very cumbersome and time consuming procedures. These were aggravated by the fact that industrial licensing was only the first of a number of hurdles to be crossed before setting up or extending industrial capacity. There is, in general, inadequate appreciation of the opportunity cost of time. According to Jha, "There is widespread, if unspoken, belief in the bureaucracy that such delay don't matter. The money that would have been invested in the project does not disappear, and if investment costs rise because of inflation, so as a rule do the prices of the final product."[447] The absence of clear cut criteria for acceptance or rejection of industrial licenses not only create artifical delays but also enable the officials to arbitrarily reject a project on grounds of social, as distinct from private, profitability. The desire to prevent domestic monopolies has meant that too often licensed capacity was split into a number of uneconomic units in industries where economies of scale were important resulting in high costs and non-viability. Furthermore, the restrictions on the diversification of the product mix created inflexibility in the face of changing market conditions. The over-regulated and restrictive nature of the domestic economy and the market fluctuations have forced several firms, particularly the large business houses, to

[445]"India's Reform Spirit Falters," **Time**, 6 Oct. 1986.
[446]J. N. Bhagwati, "Articulating a Change," India Today, 15 Dec. 1986.
[447]P. S. Jha, "Destined to Delay," **India Today**, 30 Nov. 1986.

invest abroad to escape the constraints of the home economy and enjoy economies of scale.

In the absence of definite criteria, the practice has been to allot licenses, within an industry, on a first-come-first-serve basis. The large business houses being better informed and better organised, could thus jump ahead of others in the queue. As there was no provision for a speedy utilisation of licenses, there was a preemption of targeted capacity by a few producers who either by design or by genuine inability did not establish the capacity, leading to an overall underutilisation of licenses and severe shortages.[448] Thus, it appears that the licensing and regulation system designed to prevent concentration of industrial ownership, paradoxically, appears to have worked in the opposite direction. As Paranjape puts it, "The MRTP Act was no more than 'a bugbear to frighten business and to impress the gullible public.'"[449] But in all fairness to the government, it must be conceded that the licensing policies did bring about a degree of diversification and decentralisation. These procedures were successful in diversifying the industrial structure from the old consumer goods industries towards the new capital and intermediate goods producing industries. Consequently, a vast and diversified industrial base has come into existence and a large measure of self-reliance achieved in basic and capital goods industries. The large business houses were encouraged to venture into new manufacturing lines and even to seek fresh pastures abroad. What has been particularly impressive, is the proliferation of medium and small scale industries. This sector accounted for more than one third of the total exports of the country in the

[448]The licensing policy erected an administrative barrier to the entry of newcomers to the field and indirectly guaranteed domestic sales at high enough prices to licensed firms make large profits even at the low levels of capacity utilisation. In addition, the ready availability of project as against maintenance aid also resulted in the creation of 'new' capacity in the face of existing excess capacity. However, underutilisation was also the result of labour strikes and lockouts, electricity breakdowns, and interruptions in transportation.

[449]H. K. Paranjape, "New Lamps For Old!" **Economic and Political Weekly**, vol. 20(36), 7 Sept. 1985.

early 1980s.[450]

Direct Foreign Investment and Technology Development

The Government of India's policy towards direct foreign investment (DFI) has progressed, since independence, from cautious encouragement to a brief spell of near 'open door' in the fifties, to a policy of rigorous selectivity in the late sixties and seventies, to an eventual policy of liberalisation in the eighties.[451] The swings in official policy have reflected both the fear and prejudice associated with foreign capital and the recognition of foreign capital as a powerful conduit for the transferance of technology, managerial skills, and capital. On one hand, various subsidies and incentives have been offered to attract DFI; on the other hand an elaborate framework of controls has been instituted to regulate the entry and operations of foreign firms in accordance with the priorities of industrialisation programmes and the objective of self-reliance.[452] In the Indian context, it is vital to remember that DFI has a marginal , highly circumscribed and non-market governed role in the economy. It would be fairly safe to take the overall foreign share of industry at just under 10 percent today.[453]

India's industrial policy governing domestic and foreign investments was first enunciated in April 1949 by Prime Minister Nehru and later incorporated in the Industrial Policy Resolution of 1956. As a rule, it was preferred that majority interest ownership and effective control of a foreign enterprise be in Indian hands.[454] As a corollary, the ceiling for foreign equity participation has been 40 percent although higher equity

[450] UNIDO, **op. cit.**, p. 30.

[451] Nagesh Kumar, "Cost of Technology Exports," **Economic and Political Weekly**, vol.20(35), Aug. 1985, p. M103-114.

[452] K. K. Subramanian and P. M. Pillai, **Multinationals and Indian Exports**, Allied Publishers Pvt. Ltd., New Delhi, 1979, p. 2.

[453] S. Lall, "India" in J. H. Dunning (ed.), **Multinational Enterprises, Economic Structure and International Competitiveness**, John Wiley and Sons, Toronto, 1985, p. 309-35.

[454] S. S. Rahman and D. Balcome, **op. cit.**, p. 51.

participation is permitted for industries using highly sophisticated technology or for export-oriented units.[455] For its part, the government promised to treat foreign enterprises equally with domestic firms and allowed them freedom to remit profits, dividends and interest and repatriate capital to outside India, subject to foreign exchange considerations. The major regulations guiding and controlling foreign investment in India have been incorporated in the Foreign Exchange Regulation Act (FERA).

The most important determinent of the foreign collaboration approval process, over the years, has been the attainment of self-reliance. As a US banker in Bombay succintly stated, "You must understand the philosophy at work. The objective is self-reliance, which means making things locally. That in turn means transfer of technology, import substitution, the promotion of exports, and the preservation of foreign exchange reserves."[456] Indigenous development of technology is one of the important aspects of self-reliance. Foreign collaboration is generally welcome only in high-tech areas where indigenous technology is not available and critical production gap exists and in export oriented areas.[457] The Hussain Committee Report stated, "An unlimited and continuous access to imports of technology would mean that tomorrow never comes for the indigenous development of technology; yet reliance on the latter alone would add to time lags and resource costs." It was hoped that a system of screening and licensing would achieve the optimum trade-off between domestic and imported technologies.

Throughout the 60s and the 70s, India had a clear preference for importing technologies via arms length licensing arrangements rather than direct investments.[458] Even the licensing arrangements were subject to stringent controls. Each agreement was

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[455]Reserve Bank of India, **Foreign Collaboration in Indian Industry, Fourth Survey Report**, Bombay, 1985, p. 5-10.
[456]S. S. Rahman and D. Balcome, **op. cit.**, p. 57.
[457]"Foreign Investment Policy," **Economic News**, Embassy of India, Washington, D. C., vol. 1(4), April 1986.
[458]S. Lall in Dunning (ed.), **op. cit.**, 1985.

closely scrutinised to ensure that indigenous technologies were not being excluded and 'excessive' prices were not being charged. Both the lump sum payments and royalty rates were regulated. Further, the Government limited the agreement in most cases to a duration of five years. This restriction was considered necessary both for foreign exchange savings and for reducing the technological dependence of Indian firms on the technology suppliers, and it was hoped that the time limitation would induce the firms to increase their efforts to absorb and adapt the imported technology.[459] Such government regulations did increase the bargaining power of the domestic firms ; they could use the regulations to support their position regarding payments.[460] However, often these restrictions on equity participation and on long-term agreements made suppliers reluctant to transfer their technologies and served to cut off Indian firms from the technological developments abroad. Further, the government faced with the need to expand exports, had discouraged agreements with export restrictions or import tying clauses and had underlined that the Indian party should be free to sub-license the technology locally. A Reserve Bank survey found regulatory clauses of one type or the other to be prevalent in 64.8 percent of the agreements.[461] More than 80 percent of restrictive clauses related to exports either barring exports to some or all countries or requiring foreign collaborator's permission to export.[462] Interestingly, the performance of public corporations in respect of the prevalence of restrictive clauses seems to have been no better than in the case of private sector companies with foreign collaborations. A number of studies suggest that in the Indian case the bulk of the exports have come from indigenous enterprises.[463] In this respect, India differs significantly from other

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[459]Ghayur Alam, "India's Technology Policy and Its Influence on Technology Imports and Technology Development," **Economic and Political Weekly**, vol. 20(45, 46, 47), Nov. 1985, p. 2073-79.
[460]K. K. Subramanian, "Technology Import : Regulation Reduces Cost," **Economic and Political Weekly**, vol. 21(32), 9 Aug. 1986, p. 1412-16.
[461]Reserve Bank of India, **op. cit.**, p. 41-9.
[462]Ibid.
[463]Mark Frankena, "Restrictions on Exports by Foreign Investors," **Journal of World Trade Law**, vol. 6(5), 1972 ; ICICI, "Export Performance of ICICI Financed Companies," Bombay, 1985 ; Ernst Utrecht (ed.), **Transnational**

developing countries. The sheltered, large market renders exporting for foreign firms a far less profitable activity than serving the domestic market.

The foreign collaborations not only serve the needs of the Indian market but also act as any other asset of the firm to facilitate subsequent operations abroad.[464] Most foreign collaborations include a phased programme of indigenisation of both components and raw materials (mainly due to government policy). The Reserve Bank survey suggests that the R&D activities of the private sector firms are mainly aimed at adapting imported technology to Indian conditions. This single item accounted for 56.2 percent of their total expenditure; 24.8 percent went towards 'developing new products and processes'; and 15.0 percent was absorbed by basic background research. In comparison, public sector firms put greater stress on 'basic background' research spending as much as 44.5 percent of their total R&D revenue expenditure on it. Among industries, chemicals and chemical products accounted for the largest proportion of R&D expenditure (37.5 percent) followed by machinery and machine tools (17.4 percent), transport equipment (16.4 percent), and electrical machinery and apparatus (15.8 percent). [465] According to an UNCTAD study, R&D as a proportion of output was two-and-a-half to three times larger for domestic firms (without collaboration), was also more purposeful in terms of development of new products than in forein controlled firms which mainly concentrated on local adaptation of imported designs.[466] Some of the firms exhibited technological dynamism after their technology

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[463](cont'd) **Corporations and Export-Oriented Industrialisation**, University of Sydney, 1985 ; Deepak Nayyar, "Transnational Corporations and Manufactured Exports from Poor Countries," **Economic Journal**, March 1978 ; Sanjaya Lall, "Exports of Manufactures by Newly Industrialising Countries : A Survey of Recent Trends," **Economic and Political Weekly**, 13 Dec. 1980.

[464]A large number of Indian firms which have invested abroad have been earlier licensees of firms from advanced nations. For details, see Dennis Encarnation, "The Political Economy of Indian Joint Ventures Abroad," **International Organisation**, vol. 36(1), 1982, p. 31-59.

[465]Reserve Bank of India, **op. cit.**, p. 174-6.

[466]UNCTAD, "Technology Issues in the Capital Goods Sector : A case Study of Leading Machinery Producers in India," UNCTAD/TT/55, 6 Sept. 1983.

import agreements had expired, some even without any imports of technology whatsoever.[467] In fact, in many cases R&D was undertaken not only in the absence of imported technology but also because technology could not be imported.

The restrictions on imports of technology led to considerable technological activity on the part of a large number of firms. The larger and more dynamic of these succeeded in assimilating, adapting, and developing fairly complex technologies, and even in exporting them to other countries. [468] The very process of import-substitution forced the pace and breadth of indigenous learning. The import substitution strategy , thus, did not eliminate the incentive to conduct research but merely imparted a bias toward conducting it in a different direction.[469] India's low reliance on foreign technologies, together with its effort to boost indigenous R&D and local enterprise through a policy of 'technological learning', has developed arguably a most diverse and 'deep' technological base. The domestic shelter against competing imports "provided an inducement to innovate within a relatively low risk environment where the costs of learning basic design and development could be absorbed."[470] India's plentiful supply of low-cost technical talent has been a spur to the growth of technological capability and its export at relatively low prices. By one estimate, India has the world's third largest pool of English speaking technical manpower.[471] Technology assimilation, adaptation, and development has given Indian firms a competitive advantage in world markets, particularly in the markets of co-developing countries.

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[467]Ashok Desai, "Indigenous and Foreign Determinants of Technological Change in Indian Industry," **Economic and Political Weekly**, vol. 20(45, 46, 47), Nov. 1985, p. 2081-94.

[468]Sanjaya Lall, **Multinationals, Technology and Exports**, St. Martin's Press, New York, 1985, p. 221-25.

[469]J. N. Bhagwati and T. N. Srinivasan, **op. cit.**, p. 212-27.

[470]Sanjaya Lall, **Developing Countries as Exporters of Technology: A First Look at the Indian Experience**, Macmillan, London, 1982.

[471]Richard Alm, "India on Cutting Edge of High Technology," **Edmonton Journal**, 25 Jan. 1988, p. A6.

Absence of internal competition invariably holds back the competitive spur to innovation and encourages firms to remain at a 'plateau of technological capability'.[472] Further, the constraints placed on the growth of large firms by the industrial licensing system has left many of them with substantially underutilised managerial and technological capacities. In industries where economies of scale are not relevant, this has, to some extent spurred healthy competition but in many other industries these firms remain too small to undertake meaningful R&D activity. The large technologically dynamic firms cannot use plant construction knowledge or industrial skills which they have build-up once they reach the limits of licensed capacity.[473] They either have to diversify into other sectors, in which case they dissipate their specialised technological advantages, or else export their technology, or expand overseas - preferring to 'cross-the-border rather than industry. And if, indeed, a firm developed new types of products or new uses of given capacity, new licensing would be required, with its attendant delays and uncertainties.[474] The growth regulations particularly restricted the technology development in process industries where repeated project implementation is crucial to technological learning.

Undoubtedly, India has come a long way in its quest for an independent and self-reliant base in production and technology. The large and diversified base, especially in the capital goods sector reflects itself in the extent of technology exports and overseas operations with high level of local embodiment in the form of Indian equipment supplied. There are individual firms which are highly efficient and competitive by international standards, which have judiciously combined technology imports with their own R&D to keep pace with latest technology developments.[475] However the same set of policies has fostered widespread areas of inefficiency and technological

[472]Sanjaya Lall, "India," **World Development**, vol. 12(5-6), 1984, p. 535-65.
[473]Ashok Desai, "Research and Development in India," **Margin**, Jan. 1975, p. 52-99.
[474]J. Bhagwati and T. N. Srinivasan, **op. cit.**, p. 225.
[475]Sanjaya Lall, **Developing Countries**, 1985, p. 211.

backwardness. It is this *melange* of contradictory stimulating and inhibiting policies and the tremendous human resource which partly explains the paradox of poor industrial and export performance of India and its impressive technology exports and overseas ventures. [476]

Capital-State Relations

Public policies, relating to domestic and foreign affairs, are not developed in a vacuum but are usually the outcome of power plays by interested parties.[477] As Gilpin has argued, "...the state profoundly influences the outcome of market activities by determining the nature and distribution of property rights as well as the rules governing economic behaviour...The market itself is a source of power that influences political outcomes."[478] In other words, government policies and regulations governing the market are fluid and manipulable through political action. In this section, we shall attempt to understand the mutual interactions between political and economic forces, the influence of economic actors on public policy. We shall examine more systematically the 'interface' between the economic and political organisation of capital, and the effectiveness of Indian capital in promoting its economic interests in the political marketplace.

Indian business, smarting under the discriminatory policies of the British Government, assumed an attitude of hard hostility against foreign capital and consistently underplayed the need for foreign resources. Economic nationalism was made the rallying point in the drive against foreign capital. A few business houses, led by the Birlas, generously supported the Indian National Congress Party in its nation-wide struggle against the British.[479] But given its weakness, the local bourgeoisie was willing to

[476]Ibid.
[477]J. J. Boddewyn, op. cit., 1988.
[478]Robert Gilpin, op. cit., 1987, p. 10.
[479]This support paid-off extremely well in the post-independence period after the

concede a large role to the future state in the economy. Clearly, Indian capital entered Independence with "a renewed, though tempered, hostility towards foreign capital; a commitment to make do with its own resources - eked out, marginally, by foreign public loans; and support for state economic inititiative as a likely vehicle for growth."[480]

This view was explicitly endorsed in the Bombay Plan authored by prominent industrialists like G. D. Birla and J. R. D. Tata just before the transfer of power - supporting a mixed capitalist economy in which a strong public sector would be complementary to a growing private sector.[481] The state was asked to play an active role in laying the groundwork for the future industrialisation of India and in accelerating economic growth. Thus, on the eve of Independence, a relatively weak and insecure private business enlisted the support of the public sector together with a firm invitation to the government for the regulation of the economy, creation of the necessary infrastructure and provision of capital for the expansion of private enterprise.

The political elite had as much to gain from a system in which the developmental resources were allocated by the state, and where business had to turn to the bureaucracy for licenses. Weiner states, "Patronage is the heart of Congress politics and controls are the heart of the patronage system."[482] However, it was the assumption, as explicitly stated in the Bombay Plan, that once the basis for indigenous capitalist development was laid the state would withdraw from the economy facilitating its total 'privatisation'. With respect to state ownership of social overheads, the Bombay Plan stated, "...if later on private finance is prepared to take over these industries, state

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[479](cont'd) Congress formed the new government.

[480]Michael Kidron, **Foreign Investments in India**, Oxford University Press, London, 1965, p. 73.

[481]Dennis J. Encarnation, **A Rationalist Theory of Collective Action and the Policy Process : The Political Economy of Capital-State Relations in India**, Unpublished Ph.D. Dissertation, Duke University, 1980.

[482]Myron Weiner, "The Political Economy of Industrial Growth in India," **World Politics**, vol. 38(4), July 1986.

ownership must be replaced by private ownership."[413] The recent attacks on state regulation, on the public sector, and on controls, all indicate the change in perception of Indian business with regard to the usefulness of state intervention in the economy.[414]

Post-colonial India chose to operate within the framework of a parliamentary democratic system. Moreover, the leadership of the national movement was committed to a self-reliant, balanced and planned development. This implied that state intervention would not only provide the where withal of industrial development but also protect the economic interests of the 'intermediate' and 'subordinate' social classes.[415] Before independence, Nehru repeatedly stated that India's immediate goal was not only to gain political independence but also the economic emancipation of her masses. Pronouncements of such nature were not very reassuring to a weak private sector.[416] The negative public image of big business in India further combined to create a considerable dependence of private capital on the political and administrative elites, and set the narrow parameters of interaction between them.

However, the relative diminution in its own resources and investment, coupled with the pressing need to increase production quickly, as well as the pressure brought to bear by interested parties at home and abroad, forced the government to beat a hasty retreat from its socialist stand only five months after independence. The essence of Indian socialism that began to take a concrete form after independence lay not in the establishment of an egalitarian society based on social ownership, but in the rapid growth of productive forces mainly, but not exclusively, through the state sector. The actual First Five Year Plan document stated, "... The large volume of resources needed

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[413]Quoted in Anupam Sen, **The State, Industrialisation and Class Formations in India**, Routledge and Kegan Paul, London, 1982, p. 92.
[414]Sanjaya Baru, "State and Industrialisation in a Post-Colonial Capitalist Economy," **Economic and Political Weekly**, 23 Jan. 1988, p. 143-150.
[415]Sanjaya Baru, **op. cit.**, 1988.
[416]Dolly Arora, "Big Business, Influence Generatiion, and Decision-Making in India," **Ecoomic and Political Weekly**, vol. 16, Feb. 1981.

for all round development of the economy can ... be secured only if the public and private sectors cooperate closely." [487] In an attempt to reassure and woo business, Nehru announced, "...The main purpose of a socialised pattern of society is to remove the fetters to production and distribution ... It becomes necessary therefore to have a private sector also and to give it full play within its field.[488] Private sector was thus confirmed as an integral part of the 'socialist pattern' to which Congress had subscribed for a long time. From thereon, "nationalisation featured as a practical issue from time to time, or as a propogandist device, but never again as a fundamental difference in principle between the government and private industry."[489] The government also backed on its pro-labour bias of early Independence. It took greater pains to define its power through specific legislation and to limit its area of discretion. Equally important were the concessions made in fiscal and monetary matters in the form of tax exemptions and long term credit extensions.[490] While the private sector welcomed these manifestations of government's 'production first' strategy, it was clearly perturbed by government's attempts to bring the economy under greater state control through nationalisation of the Imperial Bank and life insurance companies, the passage of the Industries (development and Regulation) Act of 1951 and the Companies Act of 1956, and the setting up of the State Trading Corporation in 1956 to regulate trade.

In its drive to boost production and investment, the government did not hesitate to look abroad. And since domestic capital continued to remain shy and hesitant, the government believed that a demonstration of foreign confidence would probably do more to revive domestic capital's spirits than any amount of official exhortation.[491] As early as 1948 observers could detect a shift in government's previous rigid opposition to foreign investment in India. In 1949, Nehru's Statement to the Parliament made it clear

[487] Quoted in Kidron, **op. cit.**, p. 88.
[488] Ibid.
[489] Ibid.
[490] Ibid., p. 91.
[491] Ibid., p. 136-8.

that foreign investment was considered necessary not only to supplement domestic capital 'but also because in many cases scientific, technical, and industrial knowledge and capital can best be secured along with foreign capital.' Restrictions on foreign investment were considerably relaxed. Nevertheless, the response till 1953 of foreign investors was poor. These overtures of the Government towards foreign capital were strongly resented by domestic capital which suspected the state and foreign private capital of lining up against it, mimicking the colonial model. With the exception of Tata, Birla, and a few other business houses, domestic capital ran for protectionist cover and demanded a new strict policy to restrict and regulate foreign capital.[492]

In 1956 the government, faced with two unprecedented crises - foreign exchange drain and crisis in financial resource mobilisation for the Second Five Year Plan, was once again forced to survey prospects abroad.[493] Government delegations toured Western capitals, making it clear that, 'so far as the Government are concerned, it would welcome foreign capital, but foreign capital would have to make its terms with indigenous capital and enterprise'. A private industrial mission, led by G. D. Birla, dispelled further any misgivings about the 'socialist pattern'. At this point, sharpening international competition and an expanding Indian market impelled Western business to show real interest in India. The foreign exchange crises of 1957-8 made domestic capital also review its attitude towards its foreign counterpart. As Kidron puts it, "... Domestic firms were made accutely aware of their own poverty in know-how and finance just as the Indian capital looked as if it was finally about to open out; imports became contingent on finding foreign partners or foreign intermediaries with foreign credit agencies; medium-size 'outsiders' could exploit the situation to polevault into the tight circle of Indian big business with the help of foreign collaborators; all sizes and sorts of companies found association with foreign firms an advantage in internal

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[492]Ibid., p. 98-105.
[493]Ibid., p. 156.

competition, and abroad. And on a different plane, the political advantage of a united private sector front became obvious.[494] From 1956-65 foreign collaboration became central to the investment strategy of Indian capital. Businesses found in foreign firms a new source of manufacturing technology previously unavailable to them. From an economic perspective, foreign collaboration offered the promise of higher and bigger profits. Further, the mission of industrialists which had gone abroad, convinced Indian business that domestic and foreign capital shared common interests and common fears : fear of nationalisation, doubts about the role of the private sector, too much government interference, spate of fiscal and taxation measures. This complete turn-around in domestic capital's attitude towards foreign capital carried interesting implications. As Kidron sums, "Where before the Govermnent had reassured Indian business with the continued , sence of foreign capital, now Indian business used foreign capital's nervousness as a perpetual bogeyman to keep the Government on good behaviour, and the Government's behaviour as an argument to allay foreign capital's nervousness. Yet it did not embrace foreign capital blindly. In the triangle formed by the Government and the two wings of the private sector, foreign capital could count on being isolated whenever it attempted to retain or create a monopoly position for itself to the total exclusion of Indian interests."[495] With slight modifications, this 'uneasy triangle' functions even today.

Big Business and Public Policy

Despite the socialist rhetoric of Indian politics and a large public sector, the private sector holds a predominant position in the economy.[496] In terms of total productive capital it is dominated by large 'business family houses', each of which

[494]Ibid., p. 178.
[495]Ibid., p. 181.
[496]Though the private sector includes agriculture, trade, a thriving small scale industry and handicrafts, and large scale industry, for the present purpose we shall concentrate only on large scale industry dominated by big business houses.

controls a large number of firms. These firms are often loosely linked to escape as much restrictive legislation as possible. In 1958, the four largest business houses - Tata, Birla, Dalmia-Jain, and Martin Burn - controlled over 25.5 percent of gross capital stock in the private sector; Tata and Birla alone held over 19 percent between them.[497] In an attempt to define and delimit the role of large houses in development, the Government enacted the Monopolies and Restrictive Trade Practices Act (MRTP) in 1969. The action was dictated on one hand by the exigencies of parliamentary democracy and on the other by the necessity of not alienating small and middle capital from the big capital. However, the assets of big business consistently increased over the years. In 1976 the top 20 business houses are reported to have controlled nearly two-thirds of the total private capital in the corporate sector. This concentration of economic power is likely to have increased further, as even the pretense of controlling monopoly houses was given up since the mid-seventies. It is estimated that their sales, as a proportion of net domestic product at current prices in the private sector, grew about one and one-half times over the 1970s. The Tatas and Birlas, controlling 115 companies, accounted for nearly 40 percent of 1981 sales among the top 20 houses.[498] There has been a further concentration in the power of 'top 10 houses' relative to other houses, partly because of the approval process under the MRTP Act. Till 1976, the 'top 10 houses' applied for 91.5 percent of the 'top 20' investment applied for and got exactly the same percentage, namely 91.5 percent approved.[499] Bardhan summarises the situation : "Even the ostensibly adverse Government policy of an elaborate scheme of industrial and import licenses has been allowed to be turned to the advantage of the industrial and commercial interests they were designed to control : the richer industrialists, having

[497]R. K. Hazari, **The Structure of the Private Sector : A study of Concentration, Ownership and Control**, Asia Publishing House, Bombay 1966, p. 36-7.

[498]Pranab Bardhan, **The Political Economy of Development in India**, Basil Blackwell Inc., New York, 1984, p. 42.

[499]Rakesh Khurana, **Growth of Large Business : Impact of Monopolies Legislation**, Wiley Eastern Ltd., New Delhi, 1981.

'better connections and better access', have got away with the lion's share in the bureaucratic allocations of the licenses, thus pre-empting capacity creation and sheltering oligopolistic profits."[500]

The ownership pattern of large business also reveals an interesting fact. In several cases, the majority shareholders are the public financial institutions and the nationalised commercial banks.[501] Public financial assistance has substantially contributed to the phenomenal growth and continued well-being of the 'largest business houses'. The recurrence of such names as Tata and Birla as recipients of a disproportionate share of government financial assistance, suggests that not all private capital benefits in equal measure from state participation. [502] Between 1956 and 1966, five of the largest houses recieved 13 percent of the total public financial assistance dispersed throughout the economy over the 10 year period. And between 1964 and 1974 the Industrial Development Bank of India (IDBI), the single public financial institution empowered to coordinate, regulate, integrate, and reorganise industrial financing in India, dispersed in various forms 36.2 percent of total financial assistance to large industrial houses.[503] The regulatory economy has, thus, been not too unfavourable to big business which has too often quite successfully translated its massive market power into political power.

One of the most serious handicaps undermining the force of business claims on government is the strong sense of suspicion and distrust of the private sector in India. The long standing hostility to the usurious village merchants has been transmitted to the modern business class, a transferral facilitated by the traditional merchant caste origins of the vast majority of India's large entrepreneurial families.[504] Traditional images of business are also strengthened by socialist thought which permeates the Indian political

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[500] Pranab Bardhan, **op. cit.**, p. 41.
[501] S. S. Rahman and D. Balcome, **op. cit.**, p. 34.
[502] Dennis Encarnation, **op. cit.**, p.95.
[503] Ibid., p. 96.
[504] S. Kochanek, **op. cit.**, p. 199-202.

culture.[505] Thus, there exists a widespread support for the development of a large public sector and for the government's policy of permitting the private sector to function only under a tight system of regulation and control.[506] It is therefore no surprise that no popularly elected government in India can afford to openly advocate and support the cause of business. Similarly, business has been forced to deal with "government through the old style of quiet behind the scenes lobbying and wire-pulling.[507]

It would, however, be incorrect to think of this business group as one that is united. Commenting on business dissensions, Arora states, "The regulatory nature of economy, which has empowered the ruling elite with distributive and allocative capacity, has also encouraged the big business rivalries. Individual houses are often found engaged in efforts aimed at influencing the opinions of the authorities against their business rivals in order to get the discretion exerised in their favour. They, however, get united when their interests are not diverse."[508]

In order to protect and articulate their collective interests and to press them on the political system the business has organised itself into permanent structures and associations. The federation of Indian Chambers of Commerce and Industry (FICCI) is the apex organisation representing large scale business. It hosts conferences involving government ministers, high ranking officials, and leading industrialists; undertakes independent research; and generally furnishes information to bureaucrats and politicians. FICCI also has a parliamentary liaison official who serves as a listening post and as a channel for passing information to sympathetic Members of Parliament. [509] Further, presidents of FICCI as well as functional heads of other specialised and regional apex organisations, represent the business interests on various powerful advisory and

[505]ibid.
[506]Ibid.
[507]Ibid.
[508]Dolly Arora, **op. cit.**, 1981.
[509]Dennis Encarnation, **op. cit.**, p. 172.

consultative bodies.

In the absence of its own solid bloc of representatives in the Parliament, Indian private capital has been forced to depend on the ruling Congress party to protect and promote its interests. The relationship between the two has fluctuated according to shifts in emphasis of Congress policy, from qualified support to partial alienation.[510] The strongest business support for Congress came from a group of businessmen led by G. D. Birla, who believed that the Congress was the only party capable of providing political stability and preventing a Communist takeover.[511] The other group, led by J. R. D. Tata, however, was highly critical of Congress socialism, taxation, and controls, and challenged the Congress at ideological level first through the Forum of Free Enterprise (a non-partisan organization to educate the public) and finally through the creation of the Swatantra Party. The party offered the first major challenge to the dominant economic policy consensus of the Congress and reached its pinnacle in 1967, when it assumed the leadership of the opposition in Parliament.[512] However, all business houses, including those like Tata who have challenged the Congress Party's political hegemony, have reserved roughly two-thirds of their political contributions for the ruling party for the purpose of obtaining an industrial license, a permit, or some other particularistic benefit.[513]

Thus, there exists a vast subterranean system of individual contacts with the government through the use of money power and interpersonal relations. Large business houses maintain 'industrial embassies' in New Delhi to expedite administrative actions affecting the house. They act as listening posts, collecting useful information, and passing it on to the head office. It is most common to employ former members of civil

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[510] S. Kochanek, **op. cit.**, p. 215.
[511] G. L. Nanda, S. Sinha, and G. D. Birla, **Government and Business**, Indian Chambers of Commerce, Calcutta, 1965, p. 7-8.
[512] S. Kochanek, **op. cit.**, p. 216-217.
[513] Dennis Encarnation, **op. cit**, p. 179.

services or the military for this purpose. They also provide a channel of communication with government for purposes of lobbying and liaison.[514] In order to ensure easy access, individual business houses make substantial political contributions to political parties and individual ministers, offer them financial support and luxurious hospitality, and provide jobs and patronage to relatives of ministers. Many businesses have capitalised on their pre-independence personal relationships with the members of the now ruling Congress Party.

One important aspect of this symbiotic relationship is that it operates within a political system that more than anything else sets the parameters of such interaction. As Kochanek stresses, "they are held in check by a national consensus which is committed to a socialism based on rapid economic development and a more equitable distribution of resources, by a strong and independent bureaucracy, and by the restraints of a planned, regulated, and controlled economy. The political leadership derives its goal and its support from the larger society, the political system, and its own conception of what the national interest requires."[515] The very fact that the ruling elite has to consider the larger environment limits the capacity of politics of pressure which is resorted to by special interests as a means of influencing public policy.[516] Thus, business in India has never been successful in influencing a redistributive policy. When the government is united and determined to act and when there is widespread public approval for the action, no amount of business pressure has had any impact. Business could not prevent the enactment of a variety of taxes on wealth and income or stop the nationalisation of private sector banks or general insurance. What business can, and has from time to time accomplished, is to convert a redistributive issue to a regulatory issue so as to ,"shift attention from the overall to the specific, from the visionary preamble to the technical

[514]Stanley A. Kochanek, **Business and Politics**, University of California Press, Berkeley, 1974, p. 291.
[515]Stanley A. Kochanek, **op. cit.**,p. 332.
[516]Dolly Arora, **op. cit.**, 1981.

clause, and so shift the locus of discussion from the forum to the tea table, where personal and economic power count more than mass demonstrations."[517] The MRTP Act makes an interesting case in the 'politics of power', where this spectacular policy measure directed at constraining business enabled the government to sucessfully deflect popular demands for redistrbution. Its half-hearted enforcement reflects the capacity of business to manipulate policy in its interests.

Business has been most successful in influencing developmental issues and policies. It is here that business is not regarded as a 'pariah' minority community but as a relatively powerful group responsible for a substantial amount of production. True, the private sector is profoundly influenced by state policies but it is the long term overall private sector response that determines the effectiveness and achievement of the government policies.[518] The government needs the cooperation of the private sector in the development effort, and business complaints are, thus, regarded as legitimate feedback enabling government to assess and adjust its policies.

To accomplish broad public objectives the government has granted concessions to business. In the Seventh Five Year Plan, private sector has been ascribed a key role. For the first time, private investment is to exceed public investment over the plan period. The Government has also begun to rely on private sector to upgrade technology, to increase poductivity, and to increase exports.[519] The Commerce Ministry, charged with increasing exports, has in the last few years, pulled all stops to promote exports and investments abroad. In such cases, there is almost a clientele relationship between business and government. In domestic, and more so in international market, business and government have become more interdependent than each is willing to admit.

[517]Stanley A. Kochanek, **op. cit.**, p. 329-30.
[518]Wilfred Malenbaum, "Politics and Indian Business : the Economic Setting," **Asian Survey**, 1971, p. 841-849.
[519]S. S. Rahman and D. Balcome, **op. cit.**, p. 34.

Conclusion

To sum up, like investors from other countries, Indian firms moved abroad for a variety of reasons, among which the domestic regulatory policies of the government figured prominently. As Lall puts it : India has practiced the most restrictive policies towards inflow of foreign technology - whether in the form of DFI, licenses, patents, consulting and technical services, or capital goods. It has also had the strongest government action to promote the development of local consultancy and engineering services and of local research facilities, giving it the largest local R&D infrastructure. Moreover, India has a relatively well developed technical base, with the largest absolute stock of scientists and engineers...But it has the highly regulated economy with many infrastructural constraints that stifle the effective deployment of its high technical capabilities. For example, the growth of some of the most efficient firms is constrained by controls on capacity expansion and maximum size. More generally, poor quality of local inputs, high local content requirements, difficulties in obtaining imported inputs, unreliable local delivery schedules, power shortages, and transportation bottlenecks reduce its international competitiveness in product exports.[520] Thus, many of the large, more dynamic and efficient Indian firms have undertaken DFI to escape the domestic restrictions, the sluggish growth of the national market, and the overall difficult market conditions for private business.

Yet not all business houses have invested abroad, even though most faced similar domestic regulations and policies. And neither in the decision of all investing firms have government policies figured with equal prominence as a reason for moving abroad. Clearly, the importance of domestic constraints must not be overemphasised to the exclusion of other factors.

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[520]Sanjaya Lall, "Exports of Technology by Newly-Industrialising Countries," 1984.

Further, even as corporate executives of Indian firms undertake DFI to maximise their freedom from domestic government restrictions and to realise other firm-specific objectives, they seek to use national power for corporate advantage and to take advantage of the quid-pro-quos obtainable from serving as an agent of the home government. For, as we shall argue in the following chapter, while initially Indian investment, to some extent, was the unintented consequence of government regulatory policies, it has increasingly become an important plank in the government's deliberate policy to promote exports, foreign exchange earnings, the image of India as an emerging industrial power, and above all, India's political and economic influence in host countries. This shift in government's perception of the importance of Indian MDCs undoubtedly has had significant implications for Indian firms. The following chapter will examine the nature of this evolving relationship between Indian government and Indian multinationals in light of broad national objectives.

CHAPTER 5

THE ROLE OF GOVERNMENT: POLICY AND PERFORMANCE

We have asserted that it would be incorrect to generalise from one country's experience to another because country-specific characteristics are important in influencing the pattern and nature of foreign investment. Thus, we have stressed the need to avoid easy generalisations regarding MDCs, for "different home environments produce quite different MDCs." The political and economic systems, the development strategies adopted in these countries, reflect in the nature and pattern of DFI undertaken by firms of different nationalities. Monkiewicz observes, "When assessing country-level potentials, it is crucial to take into account the type of the national industrial strategies pursued. What particularly matters are the government views and policies with regard to the internationalisation of production process.[521] In this chapter, we focus our analysis on the nature of Indian government policies towards its outward DFI, the objectives and motives underlying the policies, and the implications of these policies for Indian MDCs. The significance of this discussion lies in the fact that we view the state as a major purveyor of advantages (or disadvantages) to national firms seeking to initiate or pursue foreign activities. The international competitiveness of the firm, thus, lies not only in its technological and other advantages but also in its capacity to extract 'beneficial government decisions'.

Capital tends to expand across national boundaries and locate itself where it is most profitable. The state, on the other hand, tends to restrict, control, and channel these very economic activities to serve the perceived interests of the state. "The state can, of course, intervene to protect its domestic capital from the incursion of foreign competition, but it cannot easily defend itself from the movement of its own capital

[521] Jan Monkiewicz, **op. cit.**, p. 107.

abroad...Thus capital, which arises within the state and which exists originally only at the pleasure of the state, becomes increasingly capable of defying, or of existing 'above' the state, operating according to its own logic, with less and less regard for those of policies." [522] This observation may well apply to Indian businesses which began to go multinational as early as 1956, before the Indian government had time to reflect upon the costs and benefits of DFI by national firms in its schema of a 'self-reliant economic development'. It would however, be incorrect to say that Indian firms moved abroad in the late fifties without the knowledge, approval, or support of the Indian government. It would be equally wrong to suggest that Indian investments abroad were the 'intended' consequence of government policy.

Evolution of Policy Towards Indian DFI: 1947-68

India is one of the few developing countries which, in the wake of its industrialization during the 1950's and 1960's, not only laid down solid foundations for a self-sustained and self-reliant economy, but also developed the competence and the capacity in entrepreneurship, management and technical expertise to undertake industrial ventures abroad in collaboration with other developed and developing countries.[523]

The transformation and development of the Indian economy has taken place within a planned, rigidly regulated and relatively closed economic framework.[524] A succession of five-year-plans since 1950 have defined the overall contours within which planned development has been undertaken. The state has acted as the planner and the regulator to realise the planned objectives of self-sustained economic growth, equality, and a socialist pattern of society.[525] Implicit in economic planning is the existence of a

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[522]R. L. Heilbroner, **The Nature and Logic of Capitalism**, W. W. Norton, New York, 1985, p. 93-95.

[523]Government of India (GOI), **Annual Report 1984-85**, Ministry of Commerce, New Delhi, 1985, p. 49.

[524]S. S. Rahman and D. Balcome, **op.cit.**, p. 7.

[525]Foreword by Prime Minister Rajiv Gandhi to the Seventh Five-Year-Plan,

large public sector and a comprehensive system of controls over private capital. It embraces prices, profits, modes of operation, investment, labour relations, foreign trade and currency, banking - everything in fact that bears on the conduct of business. Thus, an understanding of the role and policies of the state become crucial in building an explaination of Indian multinationls. npThe first Indian joint venture abroad was a textile mill set up in Ethiopia by the Birlas, the second largest industrial house at that time, in colloboration with the Ethiopian government.[526] The unit began production in 1960, and subsequently met 50 percent of Ethiopia's textile requirement.[527] The success of this venture combined with other political, economic, and cultural factors to spur a spate of DFI by Indian firms. In this early phase of granting sanctions, no detailed framework for clearing proposals existed. In other words, the procedure for granting approvals for investments abroad was no more than an accretion of arrangements and decisions, lacking both in consistency and comprehensiveness. The policy evolved only gradually and mainly through ploddings, as it were, of Indian entrepreneurs.[528] The transition from an *ad hoc* state of affairs to a well defined policy for the export of capital and technology emerged only in 1969.

The 1950's and early 1960's witnessed the political independence of many Asian and African countries, inspiring calls for economic nationalism and independence from the vestiges of colonialism. Yet in this endeavor, these states experienced a shortage of resources such as capital, technology, managerial inputs, and were forced to look abroad. India, with her longer industrial experience and her strategy for a self reliant economic development, was viewed as a model for political and industrial development by these new entrants. In light of these recent developments, senior officials in the

[525](cont'd) **Seventh Five-Year-Plan, 1985-90**, vol. 1, Planning Commission, Government of India, New Delhi, October 1985.
[526]"Joint Ventures Make Little Headway in West Asia," **Business Standard**, 21 March 1980.
[527]Indian Investment Centre, **Joint Ventures Abroad**, New Delhi, 1976, p. 16.
[528]Ram Gopal Agrawal, **Joint Ventures Abroad**, GOI, New Delhi, 1984, p. 16.

Ministry of Commerce concluded that trade relations with developing countries had to be fostered in a wider perspective, with due recognition to their economic aspirations.[529] This approach reflected aspirations of Nehru and the Indian political elite to catapult India into the role of leadership of the developing world, both politically and economically. In 1963, a decision was taken by the Ministry of Commerce to form the India-Africa Development Association. One of its major objectives was, "to study, process and effectively deal with enquiries received from African countries for collaboration in industrial fields and also to process the proposals for imparting technical training in Indian factories."[530] In the following year, the Indian Technical and Economic Cooperation (ITEC) was launched to train in India technical personnel from developing countries, to assist in conducting feasibility studies and to undertake specific projects, and to contribute machinery and equipment to developmental projects.[531]

Simultaneously, a drastic change was taking place in the attitude of Indian planners towards exports and export promotion.[532] From 1947 to almost 1960, the Indian government tended to be highly pessimistic regarding export possibilities and over-emphasized import substitution to the neglect of export promotion. The architects of the Third Five Year Plan (1961-66) took an alternate stance and distinctly spelled out that if India was to attain its objective of self-seliance, a very large portion of the external resources required to finance domestic development had to be met out of export earnings.[533] This strategic change had eventually a profound effect on the promotion of joint ventures abroad as an export strategy. The immediate attempts to rationalize export policy resulted in the introduction of export subsidies and the rupee devaluation in 1966. Despite these incentives, India's total trade remained stagnant into

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[529]Ibid.
[530]FICCI, **Indian Industrial Joint Ventures Abroad**, New Delhi, 1971, p. 2.
[531]Nagesh Kumar, "India's Economic and Technical Cooperation with the Co-Developing Countries," in **South-South Economic Cooperation**, Radiant Publishers, New Delhi, 1987, p. 181-220.
[532] For details see chapter 4
[533]Deepak Nayyar, **op. cit.**, p. 220.

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Table 5.1. India's export markets, by countries and regions: 1960-1970 (in $ million)
Source: Deepak Nayyar, **op. cit.**, p. 29.

the mid-1960's. The general trend was also reflected in the trade with the countries of Asia and Africa.[534] (See Table 5.1.)

In 1967, there was a complete turnaround in the trade fortunes, instigated largely by the severe recession at home. The biggest difference occurred with India's newest trading partners - the developing countries of Asia and Africa. Exports to these countries jumped up by almost 16 percent annually during 1967-71. Meanwhile, despite the rapid growth of oil imports, imports from these countries increased at only one-half the rate for exports. Consequently, India's balance with developing countries of Asia and Africa showed an increasingly favourable balance.[535] It was being realized that India could not develop widespread and lasting trade relationships without going beyond mere exchange of goods. It was this economic compulsion which made FICCI sponsor three delegations to African countries. The Indian Industrialists' Goodwill Delegation in 1964 observed that, "in her own self interest India can no longer rely on conventional methods of trading and that newer techniques of trade demand that we must actively participate in setting up joint industrial ventures in as large a measure as possible."[536] Overseas, public and private joint ventures were repeatedly promoted as vehicles for economic development during several high level official meetings.[537] At home, the Estimates Committee of Parliament endorsed government efforts to provide, "facilities to reputable Indian firms to establish manufacturing units in underdeveloped areas...in the interests of development of economies of other countries and also to earn valuable foreign exchange."[538] The same year, at the urging of the Indo-African Development Association, a cabinet advisory committee recommended that the government evolve an

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[534] Ibid., p.16-31.
[535] Dennis Encarnation, **op. cit.**, 1980, p.125.
[536] FICCI, **op. cit.**, 1971, p. 2.
[537] These included the tripartite meeting of non-aligned powers in 1966; the official visits by Prime Minister Indira Gandhi to Africa in 1966 and South-East Asia in 1969; and the meetings of non-aligned states in Lusaka in 1970. Dennis Encarnation, **op. cit.**, 1980, p. 126.
[538] Ibid.

investment guarantee scheme to provide protection for Indian equity investment abroad.[539]

By this time, Indian industrialists were actively involved in lobbying the government. The Federation of Indian Chambers of Commerce and Industry (FICCI), the apex organization of Indian large scale private capital, began pushing the government to allow cash subsidization of joint ventures and equity capitalization of plants and machinery. Indian capital did not hesitate to utilize the political support of Indian government to promote its economic interests abroad. When large funds belonging to Ruby General Insurance Company of Calcutta and of other Indian firms were frozen under Indonesian monetary regulations, the company began to lobby the Indian government through the offices of FICCI for the release of these funds. Subsequently, the matter was included in Prime Minister Gandhi's agenda during her forthcoming visit to Indonesia in 1969. With government intervention, the release of the funds was eventually secured. [540] Interestingly, while the Indian government had become a promoter of overseas investments by Indian firms by the late 1960's, it did so with no comprehensive policy and no legislative mandate. The process for obtaining clearances from government at home was relatively easy. However, it was found that during the initial phase of enthusiasm, proposals were not scrutinized properly, and also some Indian parties, after obtaining the sanctions, were not too keen to speedily implement the proposals. The major impetus for evolving an appropriate policy towards Indian DFI and to oversee its progress came from the severe foreign exchange crisis of the late 1960's and the increasing importance of developing countries in India's export strategy.

[539]Ibid.
[540]Ibid., p.127.

The Policy Framework: Main Objectives

The promotion of venture capital, technological assets and services, and skills by the Indian government stemmed from the belief, prevalent both in business and official circles in the early 1970's, that India had already reached what is "euphemistically called the mid-stage of industrial development compared to a large part of the Third World. This is supposed to offer a basis of a new economic relationship between India and many countries of the Third World... a new and more advanced role in relation to many other developing countries."[541] Successive annual reports of the Ministry of Commerce reiterated this stance. "India's objective in encouraging and promoting joint ventures or joint enterprises abroad reflects its overall strategy to participate in the developmental efforts of other countries. India is capable of supplying a wide range of capital goods, equipment, and technical knowhow not only to the developing countries, but to some of the developed countries as well."[542]

An important by-product of this form of economic cooperation was that it enabled India to find markets for its capital goods and also gave it a base for earning foreign exchange in the years to come. The silver jubilee brochure of the Indian Investment Centre, the information storehouse for foreign investments in and outside India, underlines that while Indian investments abroad may be viewed as one of the instruments of the export expansion drive, they represent, in particular, "a strategy for promoting exports of capital goods and technical skills."[543] A severe capital goods recession during 1969-72 made it imperative for government and industry to find outlets in the machine tool industry and to earn foreign exchange. Moreover, these ventures were also expected to open an outlet for Indian technology and knowhow which were considered to be more appropriate to the development needs of the

[541] B. M., "India as a Capital Exporter," **Economic and Political Weekly**, vol. 12(51), 17 Dec. 1977, p. 2079.
[542]GOI, **Annual Report 1986-87**, New Delhi, p. 72.
[543] IIC, **Partners in Progress, 1960-85**, New Delhi, 1985.

developing countries, to open export venues for raw materials, parts, and components, intermediate materials and even finished goods, and to provide opportunities for employment of Indians abroad who were expected to earn at least part of the wages and salaries in foreign exchange making way for remittances of foreign exchange to the home country.[544] They were also to serve as an outlet for Indian enterprises to expand in world markets and in the process, expose themselves to the latest technological develoments and mangement practices abroad.

More important still, it was believed that Indian enterprises abroad would act as a catalyst for export promotion by projecting India's capacity to supply a wide spectrum of sophisticated capital goods and skills.[545] In India's case, it is of particular significance because a widespread ignorance continues to exist abroad about India's industrial capabilities. There is a need to build up the image of India and bridge the credibilty gap in this regard by providing a practical evidence on the shore of other countries.[546] In a keynote address to the FICCI workshop on Indian Joint Ventures Abroad in 1986 the Commerce Secretary, Prem Kumar, summed up Indian government's policy in the following words, "Primarily, promotion of joint ventures abroad has been considered as an export promotion strategy. In addition, joint ventures enable India to participate in the developmental process of the Third World countries of Asia and Africa. Indian enterprises abroad act as a catalyst for export promotion, by projecting India's capacity to supply a wide spectrum of capital goods and technical skill. They also serve as an outlet for Indian enterprises to internationalise and in the process expose themselves to the latest technological developments, management practices, etc. We also feel that India's experience and expertise, especially in the intermediate technology ranges could be relevant to the industrialisation programmes of many Third World countries. India,

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[544] "Hampered by Shoddy Planning," **Business Standard**, 27 July 1985; "Gaps in Policy," **Economic Times**, 3 Sep. 1985; "Joint Ventures Abroad," **Business Standard**, 26 Oct. 1976.

[545] IIC, **Indian Joint Ventures Abroad: An Appraisal**, New Delhi, 1983, p. 1.

[546] IIFT, **op. cit.**, p. 12, 13, and 19.

therefore, has emerged as an attractive partner in the developmental efforts of these countries and joint ventures have become a vehicle for fostering this cooperation."[547] Clearly, a lot was expected from Indian overseas investments, both by way of image building and building of foreign exchange reserves. In analysing government's policy towards Indian DFI, it is rather imperative to take cognizance of these objectives.

The Policy Guidelines

In December 1969, the formal guidelines governing Indian investments abroad were promulgated by the Ministry of Foreign Trade. The guidelines stipulated that:

(i) Minority participation by Indian parties should be the norm unless the foreign party and the foreign government were willing to accept majority participation;

(ii) No cash remittance was permitted except small amounts required in connection with preliminary expenses;[548]

(iii) Indian participation should be in the form of indigenous machinery, equipment, technical knowhow, etc.;

(iv) Machinery should be of Indian make and should not be second hand or reconditioned;

(v) Normal import replenishments and cash assistance would be allowed against export of equity capital;

(vi) Indian parties should, as far as possible, propose turn-key jobs and provide training facilities in India to nationals of the host country. [549] The Indian parties were directed to observe the policy and procedure of the host country.

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[547]FICCI, **Indian Joint Ventures Abroad and Project Export**, New Delhi, 1986, p. 39.

[548]The guidelines were conceived on the major premise that India, being a capital importing country, could ill-afford to allow cash-remittance for participation in joint ventures. The major consideration was to promote export of capital goods and services.

[549]Ram Gopal Agrawal, **op. cit.**, p. 18.

The Export Policy Resolution of 1970 specifically included for the first time the promotion of joint ventures abroad as one of several components in government's export promotion drive. It was realized that DFI could be an effective tool for retaining and expanding an already established market and also for opening new ones.[550] Subsequently, an Overseas Investment Cell was set up in the Ministry of Foreign Trade. The Export Credit and Guarantee Corporation expanded its coverage of the Indian capital goods exporter against certain commercial risks. Import entitlements and other export incentives were extended to cover export of machinery and other capital goods to joint ventures abroad. Despite another foreign exchange crisis, the Estimates Committee of Parliament endorsed all these measures in 1971-72 and 1973-74.[551]

Domestic Challenges to DFI Policy

In the midst of this favorable policy climate, some contrary pulls surfaced which did not favour enlargement of Indian participation in ventures abroad. A high-powered government committee warned that Indian DFI might actually result in flight of capital and leakages of foreign exchange.[552] Many saw in it the failure of Indian authorities, as much as of Indian business, to optimize locally the available resources.[553] It also defied major public objectives, namely, the government's desire to redirect MRTP firms into 'core' industries.

It appeared that different ministries, guided by different objectives, inevitably worked at cross purposes. A leading economic daily described the dispute in these words, "The Industry Minister's suggestion that MRTP companies should be kept out has

[550] Institute of Company Secretaries of India (ICSI), **Joint Ventures Abroad**, New Delhi, 1983, p. 25.
[551] Dennis Encarnation, **op. cit.**, 1980, p. 128.
[552] India (Republic), Study Team on Leakage of Foreign Exchange through Import Manipulation, **Report**, mimeographed, 1971.
[553] Jayanta Sarkar, "A New Dimension for Indian," **Far Eastern Economic Review**, 30 May 1980, p. 68.

irked the commerce ministry because it fears that any such ban would eliminate all chances of Indian companies going abroad. Joint ventures, it is argued, can be set up only by larger houses which have the necessary technology...The ban, motivated by the Industry Minister's desire to promote small scale units, may actually kill the development of the Indian joint venture in its infancy."[554] The socialists warned that earnings from ventures abroad, once repatriated, would only add to the economic resources already available to the large firms. Initially even some of the aid giving agencies, including the World Bank, expressed reservations about the transnationalization of Indian firms since it involved export of capital. UNIDO, however, was promoting such ventures with the cooperation of the regional Economic Commission in Asia and Africa and even suggested further government incentives and concessions.[555] To pacify the critics, when the government introduced foreign exchange legislation (FERA) in 1972, Parliament attached a separate clause concerning Indian investments abroad. Since the clause merely codified the existing procedures, it faced little opposition from either Indian private capital or the government, but apparently satisfied the critics.[556]

The debate over FERA was interesting in another aspect. It provided a window into the changing attitudes of Indian private capital toward foreign capital in light of its own experiences abroad. Indian ventures were seeking the same political and economic conditions abroad as sought by foreign capital in India. FICCI, in a confidential memorandum submitted to the Joint Committee of Parliament in 1972 argued: "As India is emerging as an exporter of enterprise and capital equipment which form the base for our joint ventures abroad, it is important to be circumspect as regards the treatment we mete out to foreign enterprises...in India...Not only (may) such foreign capital and technology that we would like to attract in the interest of speedy economic growth not be forthcoming, but our own industries and business interests abroad may face similar

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[554] Economic Times, 19 Feb. 1978, p. 1.
[555] FICCI, **op. cit.**, 1971, p. 15.
[556] Dennis Encarnation, **op. cit.**, 1980, p. 128.

disabilities." [557]

Policy in the Seventies and Eighties

During the seventies, as against the promising opportunities that existed for setting up ventures abroad, the progress made by Indian firms was found to be lacking. Particularly worrisome was the high failure rate among the ventures, either due to abandonment or non-implementation of the proposals. It is imperative at this point to mention that FICCI played a significant role in bringing forth the problems with investing abroad. With the support of government and business, it organised, beginning 1973, periodic workshops to undertake a review of Indian investments abroad. The workshops brought together ministry officials, managers of large enterprises, and leading industrialists. The impetus for many of the eventual changes in the government's trade and investment policies can be traced to these meetings.[558] Early recommendations emerging from this exchange to improve the performance of the joint ventures called for cash remittance facility, streamlining of the approval process, setting up of an information centre, negotiation of double taxation avoidance agreements, reduction of taxation on income accrued from foreign sources, and so on.[559]

Revised Guidelines: 1978

Regime change in March 1977 did not inhibit the process of liberalisation towards overseas ventures. In fact, the impressive trade surplus may be said to have given an added impetus. On 28 September 1978, the Government of India issued a revised set of guidelines. Indian DFI is now regulated under these new guidelines.[560] The

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[557]Ibid., p. 129.
[558]Dennis Encarnation, **op. cit.** 1982.
[559]FICCI, **op. cit.**, 1971, p.18-20; FICCI, **Workshop on Indian Industrial Joint Ventures Abroad**, New Delhi, 1973, p. 23-6.
[560]For details see, GOI, **Manual of Investment Abroad**, Ministry of Commerce, New Delhi, 1986, p. 1-3; Anil Kumar and S. K. Garg, (eds.), **Reserve Bank of**

salient features of these guidelines are:

(i)The Ministry of Commerce was to be the focal point for approving, monitoring, and evaluating all proposals of Indian entrepreneurs for investments abroad;

(ii)To avoid unnecessary delays, the approval process was simplified. An Inter-Ministerial Committee (IMC), consisting of representatives from related Ministries and Departments, was set up to give all types of clearances. The decisions of the IMC were final in all respects and had to be complied with by all concerned authorities without any reference or further scrutiny.Thus, the Committee was to serve as a 'single window clearance'. The Ministry of Commerce was to provide secretarial assistance to this Committee, arrange to place all proposals before it, and convey the decisions of the Committee to all concerned;

(iii)The revised guidelines allowed greater flexibility towards cash remittances. Normally, cash remittance was not to be allowed for meeting equity contribution, but in deserving cases cash outflow was to be allowed, particularly if substantial exports of capital goods and services was envisaged over a long time. Indian firms were permitted to raise foreign exchange loans abroad or grant a loan to the subsidiary in exceptional circumstances;

(iv)Overseas investment by individuals was not permitted. It was confined only to companies registered under the Companies Act (1956). Similarly, proposals involving individuals as foreign collaborators were not encouraged. Further, Indian promoter companies' financial soundness, its technical competence and experience in the concerned area, and also its past export performance were essential criteria for eligibility.

(v)Every proposal was to be supported by a detailed project report along with the profitability projections. The Indian promoter was also directed to furnish to the Ministry of Commerce annual performance reports in respect of the ventures abroad;

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[560](cont'd) **India's Exchange Control Manual**, Vol. - Procedure, Anupam Publishers, New Delhi, 1987, p. 207-9.

(vi)To further streamline the cumbersome process of approval and to avoid delays, the Reserve Bank of India was vested, for the first time, the necessary powers for the release of foreign exchange to meet the preliminary expenses to the setting up of overseas concerns and for the visits of technical and managerial personnel without any further reference to the Ministry of Commerce or the Department of Economic Affairs.

Further, as bureaucratic entanglements were removed, financial incentives were improved. A. K. Jain, Vice-President FICCI, nicely summed up the mood behind these changes, "The doubts which assailed the minds of some about the utility of joint ventures, is a thing of the past. The circumstances, in which some of the joint ventures came to be abandoned, are better understood and appreciated than before, alike by Government and entrepreneurs themselves. These ventures have become a significant part of development strategy of many enterprises...Government policy has, by and large, become somewhat flexible. The earlier hesitation in allowing cash remittances, whenever necessary, has been overcome with good result...Originally these ventures were looked upon as an instrument of export promotion. They are now viewed also as an important means of forging economic cooperation among developing countries as also in export of relevant technology and building an industrial image of India."[561] Import entitlements schemes and other export promotion incentives available to registered exporters were expanded to cover export of capital goods to overseas ventures.[562] Under Section 80-O and 80-N of the Income Tax Act, Indian companies are totally exempt from tax in respect of overseas income received in convertible foreign exchange by way of dividends, royalties, commission or fees in consideration of supplying technical knowhow. Clearly, foreign exchange has been a major objective in the promotion and the establishment of ventures abroad. However, dividend income from shares in consideration of export of machinery, cash investments, or management

[561]FICCI, **op. cit.**, 1982, p. xxxv-vi.
[562] FICCI, **Workshop on Indian Joint Ventures Abroad and Project Exports**, New Delhi, 1982, p. 9.

services does not qualify for the exemption.[563] Section 80-RRA confers 50% exemption in respect of the renumeration received by an individual for services abroad.[564]

As a means of protecting the tax status of Indian firms operating abroad, the government has negotiated double taxation avoidance agreements with governments of over 30 foreign nations. The Export Credit and Guarantee Corporation (ECGC) introduced an Overseas Investment Insurance Scheme from September 1978 to cover the risks relating to overseas investments.[565] The government has also stepped in to increasingly assume the role of principle financier, paralleling domestic trends. In 1982, the government set up the Export Import (EXIM) Bank to finance and promote India's foreign trade. The Bank provides term credit at a concessional interest rate of 12.5% to Indian promoters of overseas ventures for their equity investment by way of capitalization of exports of plant and machinery, technical knowhow, or even cash. The government has also tried to ensure that the EXIM Bank offers comparable services to those rendered by banks in the US, Japan, and South Korea.[566] In the last few years EXIM Bank has increasingly played the role of a monitoring agency, closely regulating the working of overseas ventures.[567] The government has also encouraged collaborations of Indian companies with MNCs to do business in third countries. This approach reflects the government's awareness that even the larger Indian firms need to collaborate to compete for international business. The Indian Investment Centre has been working to facilitate such arrangements. [568]

[563] FICCI, **op. cit.**, 1979, p. 14; Taranath Bhat, "Indian Overseas Joint Ventures," **Man and Development**, vol. 3(4), 1981, p. 170-190.
[564] For details and qualifications see ICSI, **op. cit.**, p. 49-62.
[565] It covers political risks of war, expropriation, and restriction on remittances. Commercial risks such as devaluation, and tax increases are not covered. Ibid., p. 63-70.
[566] "EXIM Bank to Fund Joint Ventures," **Business Standard**, 2 Sep. 1981.
[567] "Indian Industry Pulling Out of South East Asia," **Business Standard**, 2 Dec. 1983.
[568] Raj Aggarwal and James K. Weekly, **op. cit.**, 1982.

Policy Analysis

"As a recipient of DFI, India has a long and chequered history. That history is relevant because India is now investing in other developing countries..."[569] It is that same investment pattern which now provides the basis for India's policy towards her own DFI. It is interesting to see how India has attempted to resolve in her DFI policy the conflict between her roles as a host and a home country of multinationals. In the former capacity, she has been rather critical of the role of MNCs and assigned them a defined role in accordance with the priorities of industrialization programme and objective of self reliance.[570] Much credit has been given to this policy for India's relatively strong position vis-a-vis other developing countries and her capacity today to export venture capital, technological assets and services and skills in the international markets. But as Indian firms have matured and moved in increasing numbers to invest abroad, the government policy towards both inward and outward DFI has "moved from its early grudging permissiveness to active promotion."[571] The complex, symbiotic relations that have developed involving the Indian government, domestic private and public capital, and foreign capital have had important ramifications for India's domestic and foreign policies.[572]

The fact is, Indian DFI has never been divorced from Indian foreign policy. *Indian investments abroad are an integral part of both India's diplomacy and her economic growth strategy.* In some ways, it has been an extension of Nehru's doctrine of collective self reliance and economic cooperation among developing countries.[573] Indian DFI has been promoted in terms of India's committment to share her relatively

[569]UNIDO, **International Flows of Technology**, UNIDO/IOD.326, Vienna, Dec. 1979, p. 125.
[570]K. K. Subrahmaniam and P. M. Pillai, **Multinationals and Indian Export**, Allied Publishers, New Delhi, 1979, p. 3-5.
[571]"Indian Transnationals," **Financial Express**, 3 Aug. 1981.
[572]For an extensive examination of this relationship see previous chapter.
[573]Dennis Encarnation, **op. cit.**, 1982.

longer development experience with other developing countries. India, which has undergone numerous difficulties while obtaining foreign collaboration, would like its friendly countries to profit by its experience. Indian entrepreneurs are allowed to go as 'partners in progress' and to foster a new kind of mutually advantageous economic relationship.[574] The official guidelines governing Indian DFI normally allow only minority equity participation by Indian parties, disallow Indian investors from capitalizing the export of second hand or reconditioned machinery, and direct them to provide in-plant training to the nationals of the host country so as increasingly to allow them to participate in the venture. As can be seen, DFI when undertaken under the umbrella of 'inter developing country investments and collaborations' is not only widely accepted, politically blessed, but also relatively advantaged over investments from developed countries.

Interestingly, all Indian overseas investments have officially been referred to as 'Joint Ventures', even if the ventures are majority or in some cases wholly owned Indian firms.[575] 'Subsidiary' refers to only the near 100% Indian owned firms. There appears to be a great reluctance to even acknowledge their existence on the part of the government. Is it because the government, given its rhetoric on 'mutual cooperation' needs to underplay the activities of the subsidiaries since they can evoke the antipathy that multinationals do? Perhaps so, since the government has never tired of emphasizing the joint venture aspect of Indian DFI.[576] A statement made by the former commerce minister in 1978 typifies the government's policy, "These (joint ventures) ventures are expected to strengthen the bonds of friendship which India has forged within the developing world and should be in consonance with our sincere desire to cooperate

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[574]FICCI, **op. cit.**, 1971, p. 3.

[575]Sebastian Morris, "Trends in Foreign Direct Investment from India (1950-82)," **Economic and Poltical Weekly**, vol. 22(5), 7 Nov. 1987, p. 1909-1918.

[576]Almost 50% of Indian DFI, mostly in non-manufacturing, could be categorized as subsidiaries. "Performance of Indian Joint Ventures Abroad," **Economic and Political Weekly**, vol. 22, 21 Feb. 1987, p. 309-310.

with other developing countries to enable them to expand their industrial and infrastructural base for their own econimc development. Any proposal for such ventures which has an element of exploitation even indirectly will not therefore be approved by the government."[577] Although no proposal for equity participation abroad has been rejected on the ground that it possessed 'an element of exploitation,' one can be fully certain that "the causes that impel Indian businessmen to invest abroad are not related to the inane homilies that are a feature of domestic political pronouncements."[578]

Although Indian government pronouncements have generally contributed to creating an environment receptive to Indian DFI abroad, they have been unable to allay the negative reactions and fears to Indian DFI in her immediate neighbours where apprehension of economic domination and regional imperialism runs high. Even though South Asia has been an important market for Indian manufacturers, none of the countries in the region play host to important Indian ventures. Nepal and Bangladesh expressly discriminate against Indian DFI. Only Sri Lanka has been comparatively receptive to Indian MDCs.[579]

In addition to the laudable objective of 'sharing the experience and the expertise of Indian industrial and technological developments,' the government in its promotion of joint ventures seeks a more tangible objective - a better access to the market of the host country for Indian products and to earn foreign exchange through dividends, roylaties, and fees derived from export of managerial and technical knowhow.[580] According to Agarwal, the two underlying key elements of Indian policy towards its DFI abroad have been, "that they should not possibly lead to the same criticisms against them which have often been raised against foreign investors in India and that in terms of

[577]Dilip Thakore and P. V. Satyanarayana, "The New Multinationals," **Business India**, 20 Aug. 1979, p. 30-41.
[578]Ibid.
[579]Dennis Encarnation, **op. cit.**, 1982.
[580]M. K. Raju and C. K. Prahalad, **The Emerging Multinationals**, M. K. Raju Consultants Pvt. Ltd., Madras, 1980, p. 4.

foreign exchange their costs for India should be as low and earnings as high as possible."[581] Thus, Indian investments abroad have been directed both by the economic imperatives of its own internal development and by the mechanisms of foreign economic policy. Given the importance of expanded trade to Indian development prospects, the promotion of Indian ventures abroad as vehicles for exports constitute an important component of Indian foreign policy.

As substantial transfer of capital from India is neither feasible nor desirable at this stage of the country's economic development, the government attempts to minimize the foreign exchange costs by permitting Indian investors only minority equity participation in the form of indigenous machinery, equipment, and technical knowhow. The rules are, however, resilient enough to accommodate majority participation, if permited by the host country. The fact that a capital scarce country like India permits domestic firms to invest abroad stems from "the basic premise that foreign exchange is scarcer than capital."[582] A majority of the firms which invested abroad had excess or underutilized capacity as a result of either domestic restrictions on production expansion or due to domestic business cycles. DFI would help them utilize this idle industrial capacity and also give them greater prestige within and outside India. A greater exposure to international competition would lead to more rapid technological upgrading, better management and organization. And above all, DFI would increase foreign exchange earnings, directly and indirectly. Directly, the 'packaging' element of an investment would add to the value of the capital goods and services, which would otherwise have been sold separately or which would not altogether have found export markets. It would also create markets for additional exports like raw materials, intermediate goods, and so on. Indian ventures are expected to project an image of India as having wide ranging technical capabilities, and thus create a more receptive environment for Indian exports.

[581] J. P. Agarwal, **Pros and Cons of Third World Multinationals**, J. C. B. Mohr, Tubingen, 1985, p. 32.
[582] IIFT, **op. cit.**, p. 21.

In 1978 the government, appreciating the need for permitting cash remittances in deserving cases, revised the guidelines. This review also resulted from the country's comfortable balance of payment position in 1977. While the industry welcomed the move, it was not fully satisfied. R. P. Goenka, president of FICCI in 1986, complained that "the 'equity through equipment' policy creates an impression that Indian projects are 'tied.' The restriction on financial investment give rise to the suspicion that Indian promoters are unwilling to share the financial risk and are only interested in the export of their surplus equipment."[583] Though the government has admitted this constraint, it has refused to relent to pressures in this regard. The position has not changed since 1979 when the government made its position clear. "While seeking cash remittances for our exports overseas, we should not give the impresssion that India was a capital surplus country. This affected our receiving aid and financial assistance from international sources...Joint Venture was mainly an export promotion measure and to the extent possible our equity participation should be in the form of supply of machinery and know-how."[584] All the same, the government has vested Reserve Bank of India with necessary powers to facilitate quick release of foreign exchange. Government encourages Indian firms to avail of credit facilities in host country, or even in international markets.[585] The government is also promoting tie ups in third countries with reputed and resourceful MNCs to mitigate some of the shortcomings of Indian firms and increase their competitiveness, particularly in the field of marketing and investment finance.[586] Indian firms are being encouraged to participate in ventures funded by multilateral agencies.[587] In this regard, an exclusive section has been set up within the EXIM Bank at Bombay on Multilateral Agencies Funded Projects. Development activities

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[583]FICCI, **Indian Joint Ventures Abroad and Project Export**, New Delhi, 1986, p. 31.

[584]Statement of Mr. P. K. Kaul, then chairman of the Inter-Ministerial Committee on Joint Ventures. FICCI, **op. cit.**, 1979, p. 8.

[585]"Joint Ventures Abroad," **Financial Express**, 4 Oct. 1986.

[586]"Tie ups with foreign companies being encouraged," **Financial Express**, 13 July 1985.

[587]"India May Bid for Projects in Africa," **Times of India**, 31 July 1985.

and projects are increasingly being undertaken by Indian firms with the assistance of World Bank, IMF, and many other multilateral agencies.[588] The industry is also being urged to eliminate 'avoidable competition' among themselves, to adopt a consortia approach and to operate abroad 'in a spirit of mutual cooperation.'[589]

Big Business and DFI

The revised guidelines, by their emphasis on the technical and financial soundness of the Indian investor in the approval process, tend to favour big business houses. After disproportionate rates of failure and abandonment among projects undertaken by smaller firms, the officials in the Ministry of Commerce have come to the conclusion that the small size and scale of operations was one of the most serious drawbacks of Indian overseas ventures.[590] Large firm size and access to conglomerate financial, technical, and other resources are clearly seen as important assets in going abroad. This orientation has led to the promotion of large Indian companies with 'proven' names and track record, capable of yielding not only higher returns but also of projecting abroad a better image of Indian expertise. By October 1986, as many as 50% of the total projects sanctioned had either not been implemented or abandoned.[591] A sizable number of these failures pertain to the period 1970 and earlier when approvals were issued with less detailed scrutiny. While industry has painstakingly complained against procedural delays and red-tape, the pressure on Government has been intense to tighten its screening process and be more selective. Further, a view is gaining ground, in official

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[588]One such joint venture is the Pan African Paper Mill in Kenya, jointly sponsored by the Kenyan Government, Industrial Finance Corporation, and Orient Paper Mills of India.

[589]In one extreme case, two companies of the Birla group are competing against each other in the production of rayon in Indonesia. This peculiar situation can be explained by the growing bitter family rivalries. Charles Oman, ed., **op. cit.**, p. 34; S. N. Vasuki, "Wars of Dynastic Succession," **South**, April 1988, p. 23.

[590]B. M., "If We Can't Export Goods, Let's Export Capital," **Economic and Political Weekly**, vol. 21(48), 29 Nov. 1986, p. 2081-2082.

[591]IIC, **op. cit.**, 1983, p. 15.

and non-official circles, that penalties must be established against non-performance. A leading business daily editorial reflects these views: "In the absence of any penalty clause to curb non-performance or non-implementation by the Indian partners, they have been getting grandiose proposals cleared, drawing as much domestic mileage as possible out of it and then dropping it like a hot potato...If such a state of affairs is allowed to continue, the inevitable outcome is that other countries will be forced to reject India as an unreliable partner. This does not only mean losing out on possible foreign exchange inflows - valuable though they may be...Failure or fickleness on this front is only detracting from India's aspirations of being the trend setter for the Third World."[592]

Clearly, the industry's suggestion for further liberalization and promotional measures would be more easily acceptable to the government if the collective performance of overseas ventures had been good. The fact is that failures not only get over-publicised, but also detract attention from the successes, and there have been several of them. For instance, Indian entrepreneurs have set up the largest pulp and paper mill in Africa, the largest carbon black plant in South East Asia (outside Japan), the world's largest palm-oil fractionation plant in Malaysia, truck and jeep assembly plants in Malaysia and Greece, mini-computer manufacturing and precision tools for electronics industries in Singapore, and so on.[593]

Performance

It is not clear how well Indian MDCs have performed in terms of the objective of earning foreign exchange. According to the Commerce Ministry's annual report for 1986-87, the total quantum of Indian equity in joint ventures is placed at Rs.92 crores[594] (including bonus shares) and in ventures under implementation it is placed at Rs.18

[592] "Joint Ventures," **Business Standard**, 24 Sep. 1985.
[593] Charles Oman, **op. cit.**, p. 19.
[594] 1 crore = 10 million

crores. The returns generated were : dividends - Rs.11.57 crores; other repatriations - Rs.34.79 crores; and additional exports - Rs.161.63 crores. In addition, exports of plant and machinery for equity contribution amounted to Rs.51.56 crores. While in terms of the repatriation of dividends the performance has been dismal, it would appear that the overseas ventures have had a considerable trade creating effect.[595] It must be emphasised, particularly in the Indian context, that poor repatriations do not necessarily reflect poor performance. Given the highly restrictive exchange regime in India, it is no secret that a large part of the earnings of the joint ventures are either 'siphoned-off' to undisclosed havens beyond India's shores, or reinvested in the projects. Earnings do not appear too small if viewed against the fact that most of these ventures went into production only recently, and that the Indian share of the equity is extremely small. Thus, despite the low overall rate of earnings repatriated, these ventures apper to have benefitted India at least marginally.

Even as there have been inadequacies in the functioning of Indian joint ventures, the performance of these units has been reasonably satisfactory in attaining the objectives - to extend development cooperation in the developing countries and to create opportunities for export of capital goods, technology and knowhow.[596] Indian DFI is a testimony to the growing industrial capacity and capability of India. The opportunities are unlimited but what is required is a total commitment on the part of the Indian parent to support the overseas ventures with financial, managerial and technical resources, and for the government to support and supplement these efforts with helpful policy and back-up support measures.

[595]For details on balance of payment effect of joint ventures, see three independent studies : IIFT, **op. cit.**, p. 77-92; J. P. Agarwal, **op. cit.**, p. 75-86; Rajiv Lall, "Foreign Investment From India and the Export of Technology and Manufactures," Paper prepared for UNCTC, Oct. 1984.
[596]"Indian Joint Ventures Abroad," **Hindustan Times**, 13 Oct. 1984.

Conclusion

While initially Indian investment, to a large extent, was the unintended consequence of government regulatory policies, it has increasingly become an important plank in the government's deliberate policy to promote certain domestic and foreign policy objectives. The government has come to believe that the foreign expansion of Indian firms serves important national interests. The firms have realised the benefits of collaboration with the government in the increasingly politicised direct investment environment. And as both the Indian investor and the Indian Government attempt to enhance their positions both through individual actions and in alliance with one another, they share a common purpose in promoting their mutual international investments.

Yet this conjuncture of interests between the government and its corporations has not been without its pulls and strains because of the incompatability, at times, between the specific economic objectives of the individual firm and the broader political goals of the state. Indian MDCs constitute an integeral part of government's economic development strategy and foreign economic diplomacy. Extensive public support for MDCs has been fothcoming only when public decision-makers have felt that state interests, political and economic, were at stake. In the absence of such considerations, support has been half-hearted, non-existent, or even confrontational. For example, Morris states, "The Indian government, keeping the long-term interest of India and its capitalists, took a pro-African stand in the struggles of the indigenous Africans against the settled Indian commercial classes and publicly expressed dissatisfaction against the behaviour of the Indians 'settled' in Africa...While much of India's foreign policy in Africa during this period was not motivated by the immediate, economic considerations, the Indian government was not averse to pushing the Indian lobby within the Kenyan government to take decisions favourable to monopoly capital based in India."[597] On the

[597]Sebastian Morris, **op. cit.**, 1988.

other hand, private business has not always been cooperative when state actors have pressed them to undertake a certain venture. In other words, in the Indian context, neither the government nor the private business can said to be subservient to the other.

And finally, though government policies, both regulatory and promotional, have been important in motivating Indian firms to invest abroad they have not figured with equal prominence in the DFI decision of all investing firms. As Thakore and Satyanarayana put it, the question then is, "What makes the Indian industrial Sammy want to hop aboard for abroad?"[591]

[591]Dilip Thakore and P. V. Satyanarayana, op. cit., 1979.

CHAPTER 6

THE FIRM'S STRATEGIC PROFILE: ADVANTAGES AND MOTIVATIONS

The volume, pattern, and direction of foreign investments vary from country to country reflecting the heterogeneity of the countries from which the firms originate; the influence of different development policies and strategies. Thus, when assessing country-level potentials, it becomes crucial to take into account the nature of government views and policies with regard to the multinationalisation of domestic firms. However, although underlying economic and financial variables and government regulations play an important part in spurring and deterring DFI, the decision to invest abroad and decisions related to activities there belong to the area of strategic decision-making of the firm. The international and national market circumstances only constitute what may be termed as 'inputs' in the decision-making process of the firm. As Luostarinen states, "It is the management which through allocation of its own and other resources responds to changes in the company's environment."[599] Gray makes a similar point, "That macro-economic models should have less-than-full explanatory power is not surprising; investment decisions are made by firms and with reference to market conditions in a particular product. The fundamental act is micro-economic."[600] It is this relationship and interaction between the firm and its environment which shall be the main focus of this chapter.

[599]Reijo Luostarinen, **op. cit.**, p. 24.
[600]H. P. Gray, "Macro-economic theories of foreign direct investment: An assessment," in A. Rugman (ed.), **op. cit.**, 1982, p. 172-195.

Motives

DFI must be viewed as a spontaneous business activity based on the interests and the initiative, the structure and strategy, the rationale and potential of the firm.[601] In the words of Dunning, "As a firm's competitive position changes, as new core skills replace existing ones, as new management strategies evolve, as new markets open up and others die, and as the balance of advantages between using internal and external market shifts, so will the level and structure of its international productions."[602] Thus, individual firms will have not only differing capabilities for, but also a different need of international production which makes generalised explanations of firm-specific behavioural patterns difficult. Nevertheless, various studies have identified such variables as firm size, experience, research intensity, with the internationalisation process. Internationalization is viewed as a positive function of the maturity of the firm, the nature of its activity, and its consolidation at home. Firms initially concentrate on local and national markets. Only after accumulating enough skills, experience, and resources that they tend to move abroad.[603] But whether this will materialize, and to what extent, depends on the response of the individual firms to their external environment. Using a behavioral decision-making framework, Luostarinen states, "Even if lateral rigidity towards internationalization may be less in the later stages of the company's life cycle due to organizational learning, it usually still exists...What is usually needed to change lateral rigidity to forward elasticity...is the possibilty-oriented pull of foreign markets and/or the problem-oriented push of domestic markets."[604] Thus, DFI arises from the dynamic interaction between the firm's strategy and its environment, from the response of individual enterprises to the relevant economic and political factors. An understanding

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[601]Marjan Svetličić and Matija Rojec, op. cit., p. 82.
[602]J. H. Dunning, op. cit., 1988.
[603]Reijo Luostarinen, **Internationalization of the Firm**, Helsinki School of Economics, Helsinki, 1980, p. 10.
[604]Lateral rigidity here refers to the rigid behaviour of the firm in lateral direction, i. e., towards new alternatives. Ibid., p. 61-62.

of the DFI strategy of the firm requires an understanding of its basic purposes and motives within an explicit conceptual framework. In the following pages, the evidence of the previous chapters will be synthesised into a strategic profile which offers a composite picture of the competitive behaviour of Indian MDCs.

Most economic theories offer only a partial explanation of the behaviour of multinational corporations. In order to arrive at a more complete understanding, an eclectic framework, combining various relevant dimensions of different theories, would be appropriate. Dunning's eclectic theory of international production outlines a comprehensive framework within which the motives of a firm regarding outward DFI can be explored.[605] The framework integrates three strands of economic theory to explain *why* firms invest abroad (internalisation), *how* they successfully outcompete domestic firms in supplying their own markets (ownership advantages), and *where* these firms locate or exploit their advantage (location advantages). The principal hypothesis of such a theory is that the propensity of a firm to engage in international production depends on three conditions being satisfied:

- the firms must possess *ownership advantages* or *assets* which its competitors do not possess in the same degree or the same terms (appropriate technology, conglomerate ownership);
- it must be more beneficial to the firm possessing these advantages to exploit them itself through DFI rather than to sell them to a foreign firm (economies of interdependent activities, buyer uncertainty, transaction costs);
- it must be profitable to the firm to combine these assets with factor endowments *located* in foreign countries (raw materials, ethnic affinity).

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[605] J. H. Dunning, "Eclectic Theory of International Production," in Kumar and McLeod, ed., op. cit., 1981.
[606] See Chapter 1 for a detailed exposition of Dunning's eclectic theory of international production.

Ownership-specific Advantages

Dunning states, "...extent to which its own enterprises possess, or can gain access to, assets or rights which foreign enterprises do not possess or to which they cannot gain access, at least on such favourable terms. Such assets are called ownership-specific advantages."[607]

MDCs do not manufacture new products but generally sell those products for which technology has been standardized. They rarely have the advantages of familiar brand names and consequent consumer loyalties. The marketing and managerial skills of these firms are not very strong either.[608] It has been said that MDCs which invest abroad tend to enter those manufacturing industries which are characterized by limited initial investment, mature technology, and high labour content. With a few exceptions, this appears to be true of all MDCs. Thus, it is clear that ownership-specific factors which have been the important assets of MNCs can hardly explain the overseas expansion of MDCs. The answer that seems to be emerging is not that monopolistic advantages are absent in the case of MDCs, but that all advantages are not monopolistic in the original sense (i.e., of the sort that lead to entry barriers in developed countries). Monopolistic advantages do not fall in a clear, narrowly defined category. They tend to vary from country to country. The size of the economy and its experience with industrialisation, and the widely differing trade and development strategies, all account for the differences among the comparative advantages of MDCs. It would appear that firm-specific advantages of Indian firms may derive from mastery over particular adaptations to well-diffused technology, from access to cheaper or more appropriate management, from ethnic factors, better knowledge of particular markets, or simply from 'being first' in a developing economy. Perhaps the most important strength of

[607]J. H. Dunning, op. cit., 1981, p. 109.
[608]Krishna Kumar, "Third World Multinationals," **International Studies Quarterly**, vol. 26(3), 1982, p. 397-424.

these firms may lie in their manufacturing technologies.

Appropriate Technology

The background information reviewed in Chapter Four and in the earlier part of this chapter shows not only the relatively high level of Indian technological development, but also the relatively large domestic technological content in Indian ventures abroad.[609] A significant part of this technology is embodied in Indian capital goods and Indian personnel. This may be explained, in part, by the abundant supply of low-cost engineers and scientists in India and the emphasis placed by the Indian government on independent and self-reliant industrial development, particularly in technology development and in the capital goods sector.

Many of the Indian firms have acquired technology from abroad. However, these technologies have been adapted with respect to the distinctive characteristics of the domestic economy. Wells has suggested that these adaptations are generally of four kinds. Firms introduce innovations enabling them to use machinery on a smaller scale without sacrificing efficiency. Since markets in developing countries are usually limited, large plants are not economically viable. As Aditya Birla, the MIT-educated grandson of G. D. Birla, says of his successful batch production technique, "One advantage which we have over Japanese companies is that whereas Japanese can install a 100,000 spindle mill for the production of a variety of yarns, we can install five mills with 20,000 spindles each to manufacture five different varieties. In relatively small but choosy markets such as the Phillipines, this makes a lot of difference in terms of viability, capacity utilization, and product mix."[610] At times operating technologies are made more labour intensive without raising costs. Further, firms make modifications which permit multipurpose use of the same machinery. Since one specialized version of a product is

[609]Jan Monkiewicz, op. cit., p. 67.
[610]K. Balakrishnan, op. cit., 1982.

unlikely to have a sufficiently large market in developing countries to keep typical machines fully occupied, machines are designed for their flexibilty. Lastly, adaptations are sometimes made to enable maximum use of inputs that are locally available.[611] A study of Indian firms reported that the principal aim of R&D in Indian firms was to find ways to avoid the need to import.[612] The stimulants to technical effort have mainly been, "raw material substitution and cost reduction for process based firms, and product adaptations and new product introduction for engineering firms."[613]

The technological assets of Indian firms "lie partly in the ability simply to reproduce a given technology, partly in improved processes, partly in processes adapted to local raw materials or operating conditions, partly in product adaptations and improvement, and partly in capital goods manufacturing capability."[614] The case of Tata Engineering and Locomotive Company (TELCO) illustrates this. TELCO is the largest truck manufacturer in India and one of the largest truck producers in the world of a single model. The design, originally imported from Daimler Benz, was greatly modified by TELCO and well adapted to the rugged LDC conditions. TELCO has set up an assembly plant in Malaysia. It claims that its products are now outselling those of Daimler Benz, which also has an assembly plant in Malaysia.[615] P. J. Deviata, Managing Director of a company studying DFI abroad, believes that India's experience in developing appropriate technology relevant to LDC conditions makes Indian collaborations not only welcome but also successful. "Most of the Third World countries in which Indian entrepreneurs are making investments...are at a stage of development at which we were five to ten years ago. Thus, Indian entrepreneurs abroad are not only able to adjust to the local environment easily, but also anticipate most of the production, distribution, and

[611]L. T. Wells, **op. cit.**, p. 19-36.
[612]A. Desai, "The Origin and Direction of Industrial Research and Development in India," **Research Policy**, vol. 9, 1980.
[613]S. Lall, **The New Multinationals**, p. 56.
[614]Ibid.
[615]S. Lall, **op. cit.**, 1982.

marketing problems that are likely to confront them."[616] The investment by Hindustan Computers Limited (HCL) in Singapore exemplifies this asset. The firm manufactures minicomputers in India for companies with no user experience. Hence, it has experience with small, unsophisticated users, and feels that this gives it an edge over many international companies. HCL computers have proved reliable in tropical, underdeveloped conditions, and are designed well to withstand voltage fluctuations and power failures. All HCL computers have voltage stabilizers and a power shut-off/auto-restart feature that conserves the memory even if the power fails.[617]

The Indian evidence suggests that the adaptations which Indian firms have made to products and processes have become a *unique* asset in their DFI. Underlying this asset are twin factors of importance: The home-based technical effort and the *specificity* of that effort to the home environment which makes Indian technology so relevant to other developing countries. The similarity between Indian home market and those of other developing countries gives Indian firms an advantage over firms based in developed countries.

However, caution must be exercised in presuming that all Indian DFI abroad is small scale and uses standardized, adapted technology. Orient's paper plant in Kenya, Gwalior's carbon black plant in Thailand, Tata Oil Mills' Malaysian palm-oil fractionating plant, and TELCO's Singapore precision tools plant are all efficient size units in competitive markets. Some of them are the largest plants of their kind in host countries.[618] Similarly, quite a few Indian firms have developed new products and production processes. Amar Dye-Chem has developed dyes that are less sensitive to intense sunlight than those generally available from temperate developed countries. Amar Dye's venture in US provides consulting services for the manufacture of fibre reactive

[616]Dilip Thakore and P. V. Satyanarayana, **op. cit.**, 1979.
[617]"Indian Multinationals Spring Fresh Drive Into Asian Markets," **Business Asia**, 19 December 1980.
[618]S. Lall, **op. cit.**, p. 57.

dyes.[619]

Transnational Linkages

Technological and financial collaborations with MNCs have also figured prominently in the decision of Indian firms to invest abroad. A major portion of Indian MDCs were earlier licensees of firms from the developed countries. They appear to have gained their initial advantage when they adapted the technologies of the developed countries to meet the requirement of their domestic economy.[620] Encarnation notes, "As a potential motive for foreign investment, existing ("backward") collaboration agreements in India between Indian and foreign firms may act like any other asset of the firm to facilitate the expansion of overseas operations. In addition, Indian investors operating in other third world countries may link up with business interests based in economically developed countries. These new overseas investments, therefore, may serve as a medium for additional ("forward") collaboration in third countries ... these backward and forward transnational linkages affect both public and private enterprises based in India."[621] Encarnation observes that, with a very few exceptions, those business houses with most foreign collaborations in India had the greatest number of joint ventures abroad. He further observes that with the only exception of Birlas, the other business houses relied on earlier foreign collaborations to expand abroad.[622] However, in Lall's study, based on a sample of 17 firms, only seven firms got their initial technology from abroad. As far as subsequent technical changes were concerned, the overwhelming majority relied on their own R&D efforts to improve and innovate with their original technologies.[623]

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[619]FICCI, **op. cit.**, 1982, p. 124.
[620]L. T. Wells, Jr., "The Internationalisation of Firms From Developing Countries," in T. Agmon and C. P. Kindleberger, ed., **op. cit.**, p. 138-9.
[621]Dennis Encarnation, **op. cit.**, 1982.
[622]Ibid.
[623]S. Lall, **The New Multinationals**, p. 52-6.

However, there is little disagreement that certain firms seek DFI abroad so as to have a freer access to foreign technology. India's restrictive policies make it attractive for some firms to go abroad, to acquire technology, and to feed it back to their domestic operations. For example, TELCO's precision tools venture in Singapore enabled it to upgrade the affiliate's technology and sell it back to India.[624] 'Forward' collaborations are also sought by the firms and encouraged by the government to increase the competitiveness of the Indian firms in international markets. Increasingly, the collaborations in third countries are trilateral tie-ups involving the Indian subsidiary, the local partner, and the firm from the developed country. This trilateral arrangement not only adds to the technological and financial strength of the venture but also increases its credibility and acceptability. Tata's computer mainframe unit in Singapore, the first such venture in Asia outside Japan, is a good example of such a trilateral arrangement.[625] To bridge the technological gap between MNCs and themselves, several Indian firms have resorted to 'predatory' acquisition of technology by purchasing innovative producers in foreign countries or by setting up research facilities abroad in collaboration with technological leaders. Tata Elxsi has combined Indian capital with American technology. Elxsi was established in 1979 in Silicon Valley, California with a large stake held by India's Tata conglomerate. Much of the California company's R&D was funded by the Indian conglomerate and an agreement between Elxsi and Tata guaranteed a free exchange of technology. While until late 1983 all development work had been carried out in the United States, the Singapore arm increasingly began to take over systems software development. Set up in Singapore in 1981, 55% of the share in Tata Elxsi is held by Tata, 20% by Elxsi, and 25% by the Singapore government. THe project has been granted a ten year tax holiday, a S$8 million loan at 7.5% interest, as well as training subsidies. The venture makes liberal use of skilled and relatively low paid Indian software

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[624]Charles Oman, ed., **op. cit.**, p 45.
[625]Andrew Tanzer, "The Indian Connection," **Far Eastern Economic Review**, 18 August 1983, p. 72-73.

engineers and is aimed mainly at markets in Asia, outside Japan, and in Australia, the Middle East, and Africa.[626]

Indian firms also appear to be collaborating among themselves abroad. In most cases these firms belong to a single conglomerate group.[627] These collaborations started in the textile industry where textile machinery manufacturers joined hands with textile manufacturers to exploit opportunities abroad.[628] The government is also encouraging overseas branches of Indian banks and financial institutions to play a more supportive role in the promotion of joint ventures.[629] However, two studies show that Indian firms import non-Indian machinery for their overseas ventures in cases when supply was unavailable from India or the quality and sophistication of machinery was questionable.[630] There appears to be an important difference between private and public enterprises in this regard. Private firms import relatively more from parent firms' country while public firms rely largely on the imports from developed countries or from local sources.[631] At this stage, discussions are continuing between the Indian government and investors abroad to permit the reimport of this equipment and machinery into India on a duty free basis.[632]

Managerial Capability

A major dimension of the technological advantage that Indian MDCs exploit abroad is the experience, perspective, and competence of their managerial and technical staff.[633] India's contribution to joint ventures has mainly been in terms of equipment and management. The competitive edge in this regard arises from two aspects - special

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[626]Ibid.
[627]S. Lall, **The New Multinationals**, p. 56.
[628]K. Balakrishnan, **op. cit.**, 1982.
[629]"Promoting Project Exports," **Business Standard**, 24 March 1980.
[630]IIFT, **op. cit.**, p. 32; Vinod Busjeet, **op. cit.**, p. 63.
[631]Marjan Svetličić, **op. cit.**, p. 54.
[632]FICCI, **op. cit.**, 1986.
[633]Rajiv Lall, **Multinationals From the Third World**, Oxford University Press, Delhi, 1986, p. 26.

managerial skills which enable Indian MDCs to operate with greater efficiency and flexibility in the difficult conditions of host countries than their competitors, and the relatively low cost of management and technicians expatriated from India. According to P. J. Diviata, "Entrepreneurs in the host country who are on the lookout for collaboration opportunities often opt for Indian collaborators because not only are Indian managers and technical experts more appropriate as it were, but are also available at a far lower cost."[634] The most important contribution that management skills make to the overall functioning of the overseas ventures is practical in nature. To the extent that managerial skills are learnt on the job, the difficult Indian environment breeds a diverse range of capabilities to cope with bureaucratic and economic difficulties. In most instances the managing director, sent from India to ensure the successful initiation of the venture, is a member of the family in control of the parent firm or a senior member of the parent's executive staff with years of experience behind him. According to Aditya Birla, "...our collaborators and people in the host countries have a tremendous amount of confidence in the abilities of our managers, most of whom have had experience in India prior to taking up assignments overseas."[635] This managerial advantage may be greater for larger Indian firms because the quality and training of their managers is considered to be better, their backup resources larger, and their previous exposure to foreign markets somewhat greater than small Indian firms.[636]

In 70% of the ventures abroad, management control was in the hands of the Indian collaborator.[637] Only in 30% of the units management was in the hands of the host country partner, and even in some of these cases the Chairman of the Board of Directors has been a nominee of Indian parties.[638] In Phoenix Paper and Pulp project in Thailand, even though entrepreneurs from Austria, Belgium, and France were

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[634] Dilip Thakore and P. V. Satyanarayana, **op. cit.**, 1979.
[635] Kiron Kasebkar and P. V. Satyanarayana, **op. cit.**, 1979.
[636] Sanjaya Lall, **The New Multinationals**, p. 63.
[637] IIFT, **op. cit.**, p. 31.
[638] Ibid.

participating, the Indian collaborator was assigned the management of the unit.[639] There is also evidence to suggest that Indian management succeeded where competitors from developed countries failed. In 1976, Birla was invited by the International Finance Corporation to take over the managemenet of a loss making textile affiliate of a US firm (Spring Mills) in Indonesia. The new management lived up to the confidence exhibited in its competitiveness. Similar operations were undertaken in Phillipines with Evertex Industries, and in Kenya with Pan African Mills.[640] Thus, Indian investors tend to take advantage of not only the technology embodied in Indian machinery, but also the disembodied element of their knowhow through Indian managerial and technical expertise.[641]

However, there seems to be a lack of consensus regarding the significance of the managerial cost advantage of Indian MDCs. While there is little doubt that Indian managers are lower-paid than their counterparts from developed countries, Lall dismisses the cost advantage as too insignificant to be a major source of monopolistic advantage for Indian MDCs.[642]

Cost Differential

The wide range of technical and managerial skills of Indian personnel, when combined with small-scale, labour-intensive production techniques, provide Indian firms the capability to manufacture cost-efficiently.[643] Indian MDCs very often are serving markets that are constricted by sparse populations and meagre purchasing power.[644] They must, therefore, produce limited amounts of output while continuing to keep per unit costs low. Although Indian firms do not always possess lowest cost technology,

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[639]"An Edge Over Others," **Business Standard**, 23 August 1980.
[640]Rajiv Lal, **op. cit.**, p. 23.
[641]Ibid., p. 67-73.
[642]Sanjaya Lall, **The New Multinationals**, p. 64.
[643]Carlos Cordeiro, **op. cit.**, p. 101.
[644]R. Aggarwal and J. K. Weekly, "Foreign Operations of Third World Multinationals," **Journal of Developing Areas**, vol. 17, 1982.

they do enjoy a comparative cost advantage at lower volumes, the level of volume required in many developing countries. Production techniques are selected with cost minimization in mind, which ordinarily dictates the choice of labor intensive technology for simple, standardized products. The overhead and expatriate costs are kept low. The MDCs, unlike the MNCs, make minimum investments in posh buildings and imposing offices, though this appears to be changing. They provide moderate wages to their expatriate staff. Cost cutting gives these firms an edge in foreign markets in which the proportion of consumers sensitive to price appears to be high. Consequently, the effort is to cut prices rather than develop brand names or marketing techniques. According to Cordeiro, the production oriented industries and not market oriented ones are *a priori* better candidates for Indian DFI, because these industries can lend themselves more to price competition.[645] The home government tax rebates, concessions, and subsidies go a long way in making the products competitive in international markets. This, however, does not mean that MDCs ignore marketing techniques or brand names. India's Parle Confectionary, Asian Paints, and to some extent, TOMCO, carry with them a brand awareness which is exploited abroad.

Conglomerate Ownership

A large majority of Indian firms that have invested abroad belong to business houses or a conglomerate group. The ownership of Indian MDCs is highly concentrated in the hands of a few Indian business houses. The top five Indian overseas investors account for as much as 47.9% of total Indian DFI. This validates Hymer's thesis that corporate concentration is one of the main determinants of DFI. Though only some of the very large business houses have undertaken DFI abroad, it is evident, from the data given in Chapter 3, that Indian equity holdings abroad are highly concentrated in those large houses which decided to go multinational before the others. Also, the process of

[645] Carlos Cordeiro, The Internationalization of Indian firms, BA (Hon.) Thesis, Harvard University, 1978, p. 38.

internationalisation seems a cumulative one, with experience creating a stronger base and providing greater incentives to those who have gone abroad. The large business houses have perceived the home market to be limited, more so because scope for their expansion in India has been constrained by legislation. In most of these firms, 50% or more of the equity is held 'closely' by one family or party.[646] Collaborations among 'in-group' firms abroad has become increasingly common to increase their mutual international competitiveness.

The individual firms gain a definite advantage from their conglomerate membership. Conglomerate membership and large size, which appear to go together in most instances, not only create entry barriers at the industry level, but also acts as a powerful source of monopolistic advantage on their own by providing privileged access to capital markets, information, and government favours. As Lall observes, "This fact may be an asset in expanding overseas for several reasons: financial backing, greater ability to bear risk and initial loss, access to different technologies, access to management and other skills, better market information, possible tax avoidance devices, and various forms of political influence."[647] We have particularly argued that Indian big business, with better *intelligence* about political actors and opportunities, readier access to political opinion- and decision-makers, and superior *influence skills* at handling the latter through various means, has quite successfully translated its massive economic power into political power. Through the use of money power and interpersonal relations, by lobbying and liason, employment of former senior civil servants, political contributions to political parties, and by playing on nationalist, regional or group (south-south) sentiments, Indian firms have managed to secure subsidies, import protection and other favourable concessions from governments.

[646]Ibid., p.46.
[647]Sanjaya Lall, **The New Multinationals**, p. 65.

Third World Solidarity

The Indian MDCs have an advantage in their familiarity with the conditions in other developing states.[648] Most developing states share work orientation and work ethic, inadequate economic infrastructure, bureaucratic inefficiency, and a cultural environment which is not conducive to development. These firms can easily establish rapport with their employees, local businessmen, and the governmental authorities. All these factors greatly help them in running their operations efficiently.

India's collaborative ventures have found greater acceptability also because they are perceived as less threatening politically and economically, and less capable of the kind of elbow twisting interference in the domestic affairs of host countries for which MNCs have acquired a reputation.[649] One of the spin-offs of the acrimonious debate on the new international economic order has been the opening of new vistas for firms from Third World countries. Increasingly, several developing countries appear to prefer investment from other like countries. As Sri Lanka's trade minister commented, "We favour investors from small places like Hong Kong because nobody can talk about a sell-out to imperialism in the case of a country that is as small as or smaller than we are."[650] The 'joint venture' nature of Indian DFI, their willingness to share the experience of development with co-developing, have undoubtedly made these ventures attractive to countries anxious to reverse their adverse trade balances and march on the path of self-reliant development. The largest number of Indian ventures (38%) fit into the 30-40% share holding range. The comments made by *Kompass*, the largest circulation Indonesian daily, are characteristic of the response to Indian DFI, "Up to now Indonesia has always looked to the North when it came to importing technology, raw materials or consumer goods...there is still another source for such requirements...as regards the

[648]K. Kumar, **op. cit.**, 1982.
[649]"A Class Apart," **Business Standard**, 21 Aug 1980.
[650]Kiron Kasbekar and P. V. Satyanarayana, **op. cit.**, 1979.

use of foreign technical experts, we should prefer to choose Indians. Indonesia must learn from India how to be self reliant in various sectors."[651] The symbolism of 'benevolence' related to the joint venture nature ofIndian DFI has been quite effectively manipulated by Indian firms to promote their own advantages.

The above mentioned ownership-specific variables explain the assets of Indian MDCs that enable them to enter and compete in international markets. The technological advantage that Indian MDCs have - the experience in production and engineering, in product and process adaptations - receives an added boost from managerial skills specially developed in difficult home environment. Conglomerate ownership and collaboration with local and foreign partners provide the added technological and financial strength. It is this 'package' of assets which allows Indian MDCs to overcome the disadvantages of operating abroad. Yet, this discussion does not fully explain why Indian firms prefer to internalize these advantages through DFI than sell them (i.e. export).

Internalization Advantages

Only if ownership-specific advantages are possessed, a firm will consider DFI, exporting, and licensing as equally viable options. "It must be in the best interests of enterprises that possess ownership-specific advantages to transfer them across national boundaries *within* their own organisations rather than sell them..."[652] In other words, as Dunning states, "Without the incentive to internalise the production and/or sale of technology, foreign investment in technology-based industries would give way to licensing agreements and/or to the outright sale of knowledge on a contractual basis. Without the incentive to internalise market imperfections there would be much less reason to engage in vertical or horizontal integration, and again transactions would take

[651] Ibid.
[652] J. H. Dunning, op. cit., 1988.

place between independent firms."[653] Thus, when a firm decides to profit from its skills and assets overseas through DFI, it transfers its advantages to a subsidiary or foreign branch and thus internalizes the advantages within the firm. The choice between using the export market or internalizing the transfer seems to lie in corporate strategy. Different firms have adopted different strategies. For instance, of the two largest business houses in India, Birla's overseas activities are heavily concentrated in DFI while those of Tata's are spread over diverse forms. The public sector firms exhibit a preference for turnkey projects and consultancy exports instead of DFI. Let us consider below some of the factors which induce Indian firms to internalise their advantages.

Nature of Technology

Indian MDCs have chosen to transfer their technology internally within the firm through DFI rather than licensing their product and technology. In general, the market for technology is highly imperfect and involves the transfer of a complicated bundle of production and management skills, as well as equipment and technical services, both at the time of the initial transfer and on an ongoing basis. Knowledge of the costs, benefits, risks, and opportunities of a technology package, both at the time of the transfer and later is highly asymmetric between buyer and seller. Further, the reputation of the exporting enterprise is a crucial element in technology export activity. The newcomer, thus, faces serious difficulties in breaking into the market.

This problem is often compounded for Indian firms, since their proprietory production technology is uncodified and embodied in the managers and workers who are experienced in working with that technology. These skills often cannot be transferred to the host country by manuals or user guides.[654] The proprietary technology of firms in developing countries is often simpler than that of firms in developed countries in terms

[653]J. H. Dunning, **op. cit.**, 1981, p. 34.

[654]D. J. Lecraw, "Technological Activities of LDC Based Multinationals," **Annals**, vol. 438, 1981, p. 163-174.

of equipment, but more complex in terms of the skills and procedures required of the managers and workers who use them. If these complex managerial and production skills are not transfered along with the equipment, much of the value of the technology is lost.[655] The low cost of sending managers and workers abroad for MDCs, compared to the MNCs, has also increased the use of DFI as a means of transferring technology. Typically, subsidiaries of MDCs, at least initially, have employed a higher proportion of workers and managers from the home country, but have later engaged in more extensive training programs in order to transfer the basic operation of the plant to the local workers.

Risk Diversification

Where corporations face considerable uncertainity over political and economic policies affecting their operations, the temptation to retain market options in other countries is strong. To us, it would be a moot point whether Indian firms would view Indonesia or Nigeria as more stable politically than India. Nevertheless, in the wake of Emergency (1976) and the overthrow of Congress Government in 1977, an industrialist commented in confidence, "... many of us who have established large scale industries by using our sweat and enterprise don't want to be caught with our pants down when and if the system collapses ... we are putting our eggs in several baskets located all over the world ..."[656] In the Indian context, the volatile economic policies and the cyclical fluctuations in the domestic economy have been important motivating factors in the decision of the Indian firms to spread their future risks through DFI.[657]

[655] L. T. Wells, op. cit., p. 91-105.
[656] Dilip Thakore and P. V. Satyanarayana, op. cit., 1979.
[657] K. Balakrishnan, op.cit., 1982.

Financial and Monetary Constraints

Indian firms have also used their overseas operations as a source to create foreign exchange reserves of their own and to escape from the 'oppressive' taxation structure at home. Foreign exchange restrictions have provided Indian industrialists one of the most, if not the most, important motives to undertake DFI.[651] Indian Govermnent requires that firms which desire to import, earn their own foreign exchange. The foreign exchange earnings enable the investors to procure imported inputs and spare parts for their domestic operations with less procedural delays. Foreign subsidiaries provide an opportunity for some enterprises to earn the needed exchange. Profit remissions to the parent firm suggest the possibility of foreign exchange savings.

Internalization advantage also derives from the ability of a firm to reduce taxes by shifting revenues and costs among the units to take advantage of differences in tax rates and tax systems in various countries. Transfer pricing for exports and imports between the subsidiaries also increases the profit margins.

Thus, the potential problems inherent in export or contract negotiations can be avoided if the firm establishes its own affiliate abroad to make use of its competitive advantages. If technology is passed to a subsidiary, profits from the use of technology accrue to the parent whether the know-how is used to serve the local or export markets. Internalisation also enables the firm to circumvent certain home and host country restrictions.

[651] J. P. Agarwal, op. cit., p. 22.

Location Advantages

The ownership and internalisation advantages throw light on the firm-specific advantages which enterprises exploit overseas and the manner in which they choose to do so. They do not explain why DFI is preferred to expansion and diversification at home nor do they explain the choice of the location for the overseas operations. The location-specific advantages explain the 'push' and the 'pull' factors.

According to Dunning, "Enterprises will engage in foreign production whenever they perceive it is in their best interests to combine spatially transferable intermediate products produced in the home country, with at least some immobile factor endowments or other intermediate products in another country."[659] Locational advantage is, as the theory suggests, a relative concept. It may involve elements of the economy of the host country sufficient in their own right to attract foreign investors, like fiscal incentives, import protection, large and growing domestic markets, and natural resources. Or a locational advantage of a host country may be an indirect result of disadvantage(s) in the home country of the investor, like restrictions on monopolistic practices, environmental regulations, or market saturation.[660]

Home Country 'Push' Factors

A multitude of factors, including restrictions on expansion of large firms, high taxation, domestic demand deficiency, infrastructural bottlenecks, compell Indian industrialists to invest abroad. A factor, which has rather been overlooked in the literature, which attracts Indian businessmen to foreign shores is the high degree of respect and recognition accorded to them in host countries. As an irate Indian investor stated, "One of the most exasperating things about being successful in India is the

[659]Ibid.
[660]J. P. Agarwal, "Intra-LDCs Foreign Direct Investment," **Developing Economies**, vol. 23, 1985, p. 236-253.

general attitude towards businessmen ...virtually every politician has been shouting from roof tops that businessmen are crooks, conviniently forgetting that they have created a climate in this country in which it is impossible to survive ... Delhi bureaucrats who have made Indian industry totally dependent on licences and permits handed out by the government take sadistic delight in keeping us waiting for hours on end whenever we have to get something cleared ... I think the social respect we get abroad is a powerful incentive for investing overseas."[661] Aditya Birla's comments reflect a similar view, "Though a combination of factors is responsible for our setting up joint ventures abroad ... one of the major attractions of going overseas is that we are accorded recognition for contributing to the good of the our host societies and we are treated as professionals ... whereas in our own country our contribution to society is not only unrecognised but denounced."[662] And even though in Indian politics public denunciation of big business is compensated by the grant of the all important licenses and permits, the indicators are that the new generation of young industrialists are unhappy with this sordid arrangement.[663]

Among the more tangible factors, the domestic regulatory policies are cited as the prime factors motivating Indian DFI abroad. An IIFT study concluded, "Almost all the firms, specially those doing well, have unhesitatingly stated that they wanted to overcome the MRTP."[664] Likewise, Busjeet found that Indian firms operating in Mauritius and Phillipines had moved abroad mainly because of domestic constraints.[665] In Rajiv Lall's study, ten of the fifteen firms "pointed to domestic reasons for seeking to relocate overseas. Some specifically identified the effects of high costs of domestic and imported inputs on their competitiveness in export markets as an important reason for venturing abroad. Elsewhere, the MRTP Act and sluggish growth in domestic demand

[661] Dilip Thakore and P. V. Satyanarayana, **op. cit.**, 1979.
[662] Ibid.
[663] Ibid.
[664] IIFT, **op. cit.**, p. 67.
[665] Vinod Busjeet, **op. cit.**op. cit., p. 57-8.

were considered to be the main impulses behind the decision to invest abroad."[666]

Most of the large firms, especially from the giant conglomerate groups, went abroad due to the restrictions imposed by the MRTP Act. They preferred to move to new locations in other countries than to new industries in the home country. A study of the Indian Institute of Foreign Trade, published in 1977, concluded that nearly 60% of effective joint ventures were from the big business houses in India whose activities had been either regulated by the MRTP Act or were likely to come under the Act.[667] Encarnation showed, on the basis of data relating to manufacturing Indian joint ventures in operation in 1977, that the vast majority of Indian DFI abroad was undertaken by MRTP companies. He also observed that while their relative share had been declining, the dispropotionate rates of failure and abandonment among the ventures undertaken by smaller firms indicated that the relative hegemony of the MRTP firms will continue.[668] The recent government liberalisation of the MRTP provisions has only slightly affected this trend. In 1986, MRTP companies were resposible for 54% of the ventures as compared to 65% in 1977.[669]

The restrictions and limitations of the domestic market have also been compounded by the lack of effective demand. As an economist-turned-journalist comments, "The myth of India being a vast market is just that - a myth - and effectively I would say that the Indian market for consumer goods is ten to twenty million. And therefore, the industrial sector, if it is to achieve the economies of scale, has to find markets abroad and secure them, if necessary, by initiating joint ventures."[670] The demand deficiency has also been induced by cyclical fluctuations in the domestic economy, resulting in excess capacity in capital goods industries, particularly in textiles

[666]Rajiv Lall, op. cit., p. 21.
[667]IIFT, op. cit., p. 67.
[668]Dennis Encarnation, op. cit., 1982.
[669]Mano Ranjan, op. cit., p. 8.
[670]Dilip Thakore and P. V. Satyanarayana, op. cit., 1979.

and engineering. Balakrishnan observes, "We do not yet have an image for our capital goods, and it is hard to sell these directly, even if there is a cost advantage and the quality is more than acceptable. So these firms opted for partly owned foreign joint ventures instead of initiating direct export. The joint ventures are captive clients for our machinery."[671] Thus, most of the proposals for setting up textile units abroad came during the late 1960s, when the Indian economy faced one of the worst recessions in post-independence history. And the outflow from machine building industry during the second half of the 1970s also coincided with a sharp drop in domestic demand.[672]

The detrimental effect of the production environment in India on export competitiveness has also resulted in DFI by export oriented firms. A number of firms have the technology, marketing skill, and finance to export, but choose to move abroad because of higher costs of inputs at home, bureaucratic delays, and infrastructural impediments such as power shortages, high transport costs and labour unrest. Indian firms also face difficulty in getting continuous and prompt access to new technologies in India.[673]

While restrictive domestic policies have significantly pushed Indian firms abroad, the Indian government's efforts, in recent years, to promote joint ventures abroad in a big way cannot be altogether discounted.[674] Indian joint ventures have become an essential part of overall government policy to promote exports of capital goods and technical skills and earn foreign exchange, to project India's image as an emerging industrial power abroad, and to participate in the developmental efforts of other countries. The promotion of Indian multinationals as 'joint ventures' has given these firms greater acceptability abroad. From being merely regulatory, the policy towards

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[671]K. Balakrishnan, **op. cit.**, 1982.

[672]For further details see Chapter 4; Zhang Zuqian, "Third World Multinationals on the Rise," **Beijing Review**, no. 11, 1985, p. 16-19.

[673]Sanjay Lall, **op. cit.**, p. 70.

[674]For details on government incentives and concessions to firms investing abroad see Chapter Five.

Indian DFI has become distinctly promotional since the mid-seventies.[675] According to a senior official of Hindustan Machine Tools (HMT), a public sector undertaking, "Government incentives and concessions have served to make Indian projects more competitive in international markets."[676] There is little doubt that Indian business is continously pressing the government to take a more active and positive role in the promotion of joint ventures abroad. As FICCI president R. P. Goenka remarked, "...Industry and government should work together in evolving equally competitive terms to make our offers more attractive. In fact, better results can be achieved by business and government working closely together, reposing confidence in each other."[677] However, it appears that host government incentives have played a significantly more important role than the home government incentives in attracting Indian DFI.

Host Country 'Pull' Factors

To a great extent, the attraction of foreign shores is related to what most businessmen euphemistically refer to as the 'climate of investment'. Regionally, most Indian investments have been attracted to the neighboring countries of South and South-east Asia, followed by Africa. It is noteworthy that Africa attracted the attention of Indian entrepreneurs much before South-east Asia. This happened not only because of the significant Indian population and Indian merchants and traders in the East African countries, but also because of the emergence of several politically independent states in the region in 1950s and 1960s which looked to India as a model for their economic development.[678] Consequently, there was a spurt of proposals to set up ventures in Africa. However, this wave soon ebbed due to political instability in the region, poor infrastructural facilities, lack of developed markets, and inadequacy of financial

[675]Interview with Mr. Ravi Sawhney, Joint Secretary, Ministry of Commerce, New Delhi, July 1987.
[676]Interview with the author, Bangalore, 8 July 1987.
[677]FICCI, **op. cit.**, 1986, p. 33.
[678]K. Balakrishnan, "MNCs from LDCs," **Vikalp**, vol. 7(2), 1982, p. 132-148.

institutions.[679] In the early 1970s, a perceptible shift to South-east Asia became evident. Of late, however, there has been a revival of interest in Africa, especially in Nigeria and Kenya.[680] With its considerable natural resources, its growing market for manufactured goods, its large Indian population, its increasing share of the development aid from multilateral agencies, and the possibility of a Pan African Union, the region is once again attracting Indian investors.

However, the place of first preference for Indian investors in the 1970s and 1980s has been South-east Asia. Large Indian investment has poured into countries like Malaysia, Indonesia, Thailand, and Singapore, partly because of the political stability in these countries and the incentives offered by the host governments. Though investment in the region has undergone a relative decline in recent years, South-east Asia still leads as a host to Indian DFI.[681]

India's breakthrough in Middle East has mainly been in short-term and one-shot construction and consultancy projects rather than in long term manufacturing ventures. Most of the oil-rich countries have the financial resources to import various products and have not yet felt the need to develop indigenous manufacturing capabilities.[682] The region has also attracted the attention of powerful MNCs and Indian firms have found the competition too intense in the region.[683] Indian firms have also suffered a setback in this region due to the large unpaid bills by countries like Iran, Iraq, Libya, and Algeria, in which severe spending cuts resulted in the wake of the sharp decline in oil prices and

[679] "Joint Ventures," **Financial Express**, 27 November 1979.

[680] "Good Scope for Industrial Cooperation with Kenya," **Economic Times**, 27 Dec. 1981; "India May Bid for Projects in Africa," **Times of India**, 31 July 1985.

[681] While investments in Singapore have shown an increase, they have gone down in Indonesia, partly due to the two successive devaluations of the Indonesian rupiah, and in Malaysia, due to the intense competitive pressures of its open market economy. "Indian Industry Pulling Out of South-east Asia," **Business Standard**, 2 Dec. 1983.

[682] "Joint Ventures Make Little Headway in West Asia," **Business Standard**, 21 December 1980.

[683] **Financial Express**, 8 September 1986.

the prolonged Gulf war.[684]

In South Asia, Nepal offers good prospects for Indian entrepreneurs. As a less developed country, Nepal is not faced with quota restrictions on its exports of manufactured goods like textiles in the Western markets. Indian entrepreneurs are taking advantage of this facility by locating export oriented units in Nepal.[685] Indian business has however, shown no enthusiasm in penetrating the Latin American market. Constraints such as distant location, language barriers, absence of a regular transport link, political instability, the presence of large MNCs, and most importantly, a shortage of capital due to the disinclination of the international monetary agencies to extend credits for ventures in this region, act as major deterrent to Indian DFI.[686] The developed countries have received only a small but an increasing share of Indian DFI. The largest number of ventures are located in UK and USA, and are mostly in the non-manufacturing sector.

The main motive of Indian firms for investing in these countries has been the attraction of host markets. In an IIFT study, conducted in 1982 for a German institute, 47 (75%) out of 63 cases cited attractive growth prospects of host markets as a motive for DFI.[687] Fifteen of them specified production for export as an additional objective and only eight went abroad mainly for export. The study, therefore, indicates that exploitation of domestic markets of host countries is the most important objective of a majority of Indian firms abroad.

Though exports might be the preferred way of exploiting markets abroad, the firm often finds that the opportunities are eventually restricted. Transportation costs and tariffs may, up to a point, simply be passed on to the foreign consumer, but when

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[684]Ibid.

[685]"Success story reflects a boom in India's garment exports," **Globe and Mail**, 14 October 1987.

[686]"Latin America Seeks Indian Investment," **Economic Times**, 19 September 1985; "Joint Venture Prospects in Latin America Bleak," **Business Standard**, 10 April 1984.

[687]J. P. Agarwal, **op. cit.**, p. 16.

imitators begin to appear abroad or competitors begin to undersell, the firm's ability to pass on such costs is limited. Those firms, previously exporting to that country or hoping to establish themselves anew, are induced in the product cycle pattern to undertake DFI to protect a market threatened by actual or impending encroachments. This is especially so in industries like textiles which lend themselves easily to import substitution because of their relatively modest requirements of capital and technical skills.[688] The first Indian investments abroad were also in textiles. DFI also spurs overseas demand for capital and technology that would not otherwise have been exported. K. N. Naroaji, director of Godrej and Boyce which has set up steel furniture ventures in Malaysia, Singapore, and Indonesia, stated, "Our contact with South-east Asian countries, in which we subsequently made investments, initially developed through the export of our steel furniture made in India. The motivating factor behind our decision to set up joint ventures in these countries was related to the safeguarding of our markets in those markets. After all, a time would surely have come when these countries would have established local manufacturing capacity on their own or in collaboration with other non-residential companies in which case our market share in those countries would have been lost or reduced."[689] Century Spinning's investment in Indonesia, TELCO's in Malaysia, and Infin's in Mauritius fall in this category.[690] Eleven out of sixteen manufacturing firms in Lall's study went overseas in response to protective host government policies. Of these, six firms had the previous experience of exporting to the host country while the remaining five were set up to open a new market.[691] This conclusion is further supported by the findings of studies undertaken by Busjeet and Cordeiro.[692]

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[688]Manmohan Singh, **India's Export Trends**, Clarendon Press, Oxford, 1964, p. 83.
[689]Dilip Thakore and P. V. Satyanarayana, **op. cit.**, 1979.
[690]Sanjay Lall, **op. cit.**, p. 71-2.
[691]Ibid.
[692]Vinod Busjeet, **op. cit.**, p. 46; Carlos Cordeiro, **op. cit.**, p. 69.

Indian firms are also increasingly investing in developed countries like the United States. The most recent case in this unmistakably growing trend has been the move by Hindustan Computers Limited (HCL), India's largest public sector computer maker, to manufacture UNIX-based computers in America in collaboration with Sybase Inc. According to Yogesh Vaidya, president and chief executive of HCL America, "The company is counting on its relatively long experience with UNIX and low research and development costs in India to give it an edge."[693] Vaidya further added, "We could manufacture boards of excellent quality at lower cost in India. But we want to demonstrate our commitment to the American marketplace."[694] The move has been motivated by the desire to defend one of the largest export markets threatened by import restrictions, to counteract the actions of rivals, to get access to frontier technology, and to acquire knowledge and experience which could be useful in further expansion in United States and other advanced countries.[695]

The need to circumvent country export quotas imposed by developed countries also ranks high as a factor influencing the DFI decision of export oriented Indian firms. As quotas were imposed on the import of various products from countries like India, the firms reacted by setting up plants in other developing countries not yet subject to controls or which had large unutilised national quotas. As Cordeiro found, the export-oriented Indian ventures in Maurutius were set up to exploit the easy access to the EEC that the country's associate membership provided.[696] The jeep assembly plant of Mahindra has been set up in Greece to benefit from the country's entry into EEC. In the course of an interview, the Managing Director expressed the motive in terms of "having a foot in the EEC markets," and "building an international reputation."[697] The interest of

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[693] Jim Van Nostrand, "Indian Mini-Mogul to bring UNIX ashore," **Electronic Engineering Times**, 13 Feb. 1989.
[694] Ibid.
[695] M. Y. Yoshino, **Japan's Multinational Enterprises**, Harvard University Press, Cambridge, 1976, p. 80-3.
[696] Carlos Cordeiro, **op. cit.**, p. 30.
[697] Interview with the author on 10 September 1987, Bombay.

Indian firms in Nepal also arises from the fact that Nepal is not yet faced with quota restrictions from the West on its exports of manufactured goods.

The MDCs, in general, produce low cost, undifferentiated products. Such goods are sold mainly on the basis of their low price, and thus are highly price elastic. In order to remain competitive, export oriented firms have had to look to countries with appropriate factor costs. This motivation has been particularly strong in the case of Indian firms which face high production costs in the domestic market.

Indian firms, like those from advanced countries, have also gone abroad to establish reliable sources of raw materials. Their concern is not only the price of raw materials and the cost of importing them, but also their uninterrupted supply. Both private and public firms have undertaken ventures to secure raw materials, though public enterprises have been more active in this area of investment. Indian Oil has entered into various kinds of collaborative arrangements with the Middle East countries for oil exploration.[698] A joint venture between India and Senegal has been set up with a buy back arrangement to assure the supply of phosphoric acid. The state-owned Minerals and Metals Trading Corporation has taken up projects abroad to ensure supplies of fertilisers and diamonds.[699] TOMCO's Malaysian investment was undertaken to draw upon the abundant supplies of palm oil.[700] However, this factor has not featured too significantly in the DFI decision of Indian firms as compared to those of Korean or Japanese firms. Indian firms exhibit a bias for the horizontal pattern of investment.[701]

For a number of firms, ethnic ties have had a major influence on their decision to invest in a particular country. Numerous studies have emphasised the role of information when a firm is considering international business activity. Overseas communities often

[698]K. Kumar, **op. cit.**, p. 192.
[699]"MMTC Plans Projects Abroad with Equity," **Economic Times**, 30 March 1985.
[700]Sanjaya Lall, **op. cit.**, p. 72.
[701]IIFT, **op. cit.**, p. 70.

provide that kind of a link. In fact, in some cases, the initiative has come from the overseas Indian businessmen. Asian Paints was previously exporting to Fiji and was induced by the local Indian traders there to set up its paint plant there. Godrej received help from local partners of Indian origin in Singapore and Malaysia. Ajit India was induced to set up a plant in Dubai by an Indian businessman who was already established in business there.[702] With knowledge of the local market and access to a distribution system, they avoid negotiation costs and uncertainty by seeking out suppliers whom they know and trust. Thus, for the overseas Indians, the likely choice is the Indian firms. The role of ethnic ties is evident in yet another way - in the choice of partners selected by the Indian investors. Sometimes, the ethnic factor acts as a hindrance than an advantage. While ethnic ties can generate reliable information and potential business partners and customers, in some countries the ties of a potential foreign investor to local ethnic minorities has made acceptance of a foreign investor more difficult by the local government or by the populace.[703] In the wake of recent ethnic disturbances in Sri Lanka, Indian investments are facing similar kinds of problems.

Similarity of culture and economic systems plays a significant role in determining the pattern of investment. In the words of an Indian industrialist, "Malaysia has so much in common with India. Both were British colonies, and the British influence is lingering. The law, business language, financial instruments, bureaucracy, etc., are all similar. There is also a substantial amount of Indian population in Malaysia. Even the engineering specifications are based on the good old 'British Standard Specifications'. The Phillipines is a different wicket. It has been under American influence for a long time...To make it tough for us, their engineering specifications are based on American standards. Even the electric power used is of a different cycle and voltage; this could provide further

[702]Sanjaya Lall, **op. cit.**, p. 66.

[703]L. T. Wells, Jr., "Multinationals From Developing Asian Countries," in **Research in International Business and Finance**, vol. 4 (Part A), JAI Press Inc., 1984, p. 127-43.

constraints to the kind and variety of Indian equipment that can be taken from here."[704] Thus, mainly, the Asian countries invest in Asia, and the Latin American in Latin America. The major exceptions seem to be Indian and Hong Kong ventures in Africa. The recent investment patterns of Indian firms suggest that traditional ethnic and historical ties are increasingly being replaced by economic attractions of large markets and host government incentives.

Government policies, in host countries, with respect to inward DFI appear to rank high among corporate motives for investing abroad. It was third place among motivations of Indian firms for DFI in Mauritius and Phillipines.[705] In addition to lower rates of corporate taxes, allowance for repatriation of profits, Indian firms have been attracted by the additional incentives offered by many countries for 'pioneer firms', export oriented firms, firms setting up ventures in backward areas, and firms promoting import-substitution and indigenous manufacturing capabilities. In some cases tariffs imposed by the host government have been specifically requested by the Indian investor to curtail the import of products of competitive nature, thus granting the investor monopoly or near-monopoly status. According to Busjeet, considerable importance is by Indian firms to securing tariff protection. For example, Synchem was in the final stages of setting up a venture in Thailand when the promised 40% tariff protection offer was withdrawn. Synchem decided against undertaking the proposed venture.[706] Similarly, Hindustan Machine Tools did not invest in Kenya when the home government refused to extend protection.[707] In several cases, overseas ventures by Indian parties have been abandoned due to changes in host government DFI policies. Obviously, host government incentives and concessions are transient and changing, and the outcome of intense bargaining between the foreign investor and the host government. According to Singh's

[704]K. Balakrishnan, op. cit., 1976.
[705]Jan Monkiewicz, op. cit., p. 66.
[706]Sanjaya Lall, op. cit., p. 72.
[707]Interview with HMT official, Bangalore, July 1987.

study. Indian firms undertake systematic country surveys before choosing a particular country to invest, looking specifically for information on host government incentives and concessions.[708]

Conclusion

This discussion of the ownership, internalisation, and location-specific advantages has provided us with a strategic profile of the Indian firms investing abroad, a profile which is continuously changing in response to political and economic changes in the domestic and international marketplace. The push and the pull factors are continuously forcing new firms to take the strategic decision of investing overseas. The push-pull factors too often intermingle in such a manner that it is impossible to say which was predominant at a particular time. Moreover, DFI is also part of a secular trend whereby firms go abroad as part of overall strategic planning in which diversification and product line expansion are viewed as a method of strengthening existing business. One Indian firm, in Busjeet's study, claimed to be always on the lookout for possible investment opportunities abroad since a firm decision was made at 'the highest levels' to expand overseas; success in its initial foreign ventures also encouraged it to expand its overseas investments.[709] Thus, it is not possible to say which of the three sets of factors have been more important in explaining Indian DFI. There have been a few studies which have attempted to rate the motives of Indian firms in order of importance, but their findings have varied, by small and large margins, depending on their sample. This is so because the strategic decision to invest abroad is firm-specific and, thus, varies from case to case. The macro-economic conditions may explain not so much the existence of DFI as their timing and extent. But again, such decisions are difficult to disentangle from broader economic and political factors. Further, today's global

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[708]D. R. Singh, "Capital Budgeting and Indian Investment in Foreign Countries," **Management International Review**, vol. 17(1), 1977, p. 101-110.
[709]Vinod Busjeet, **op. cit.**, p. 58.

economy is so interdependent that Indian investments abroad can only be understood as part of this process of international competition.

Dunning's eclectic theory provides a thread which links up this wide set of factors motivating Indian firms to invest abroad. Articulated around three components or determinants of DFI - ownership advantages, internalization advantages, and location advantages - the theory allows us to consider not only the strengths and advantages possessed by Indian MDCs, but also the factors that motivate these firms to exploit these advantages through DFI rather than through exports and licensing. The theory suggests that DFI occurs in the simultaneous presence of all these three determinants of DFI. If only ownership advantages are possessed, a firm will consider DFI, exporting or licensing as equally viable alternatives. But, if such ownership advantages could be internalized, the firm will prefer DFI and exporting to licensing. Lastly, if ownership advantages could be more profitably internalized across national boundaries because of the location-specific factors, then the firm will prefer DFI to both exporting and licensing.[710] (See Table 6.1)

In the preceding pages, the ownership, internalization, and location advantages of Indian MDCs have been elucidated at length to demonstrate how the combination of these advantages leads Indian firms to invest abroad. Particular attention has been paid to country-specific factors which generate and sustain these advantages.

[710]J. H. Dunning, "Explaining Outward Direct Investment of Developing Countries," 1981.

Table 6.1 has been removed due to the unavailability of copyright permission.

Table 6.1. Conditions Determining the Forms of Foreign Involvment by Enterprises
Source: J. H. Dunning, op. cit., 1981.

CHAPTER 7

CONCLUSION

This study has been undertaken on two levels. At one level, an explanation of the internationalisation of Indian firms has been attempted in terms of the interaction between state and market. Our approach follows that of Robert Gilpin: "Although the state as the embodiment of politics and the market as the embodiment of economics are distinctive features of the modern world, they obviously cannot be totally separated...the state profoundly influences the outcome of market activities by determining the nature and distribution of property rights as well as the rules governing economic behaviour...The market itself is a source of power that influences political outcomes."[711] At another level, *the explanation has been based on an understanding of the dynamic interaction among complex economic and political variables at international, national, and firm-specific levels.* An examination of the emergence of Indian MDCs has revealed that the decision by corporate strategists to go multinational must be understood in terms of the dynamic interaction of environment and firm-specific strategy; in terms of the strategic attempts of decision-takers within these firms to fend off new threats and to capitalise on the opportunities arising in the changing domestic and international environment. In this study, these two approaches have been integrated within the broad analytical framework of Dunning's eclectic theory of production, to analyse the necessarily complex determinants (political and economic; micro and macro) of the emergence, spread and pattern of Indian DFI. Dunning's framework has been adapted and expanded to accommodate the discussion of certain political variables.

[711]Robert Gilpin, **op. cit.**, p. 10.

The evidence we have furnished, while scattered and incomplete, points to a clear trend: several developing countries like India have been attaining rapid industrial and technological development in the last two decades and have now developed the capabilty, in certain sectors, to extend themselves abroad through sale of industrial facilities, supply of engineering and technical services, or direct foreign investment (DFI). These handful of the more developed of the developing countries account for the bulk of DFI from developing countries, lending strong support to Dunning's investment-development cycle and hypothesis 2 which states that *industrial development is positively correlated with the internationalisation of firms.* "The forces determining the level of inward and outward direct investment and the balance between the two are linked to a country's stage of development and that it is reasonable to think of a four-stage investment-development process or cycle, in which, after the first stage of little inward and outward investment, inward investment rises markedly, then outward investment begins to rise and/or inward investment falls but net outward investment (NOI) is still negative, and finally NOI becomes positive. The developing countries now emerging as outward investors are approaching the third stage."[712] In other words, *DFI from relatively advanced countries like India cannot be taken as a casual or transitory phenomenon, but a natural and important aspect of their development process, as part of their 'industrial maturation' and a gradual accretion of skills, knowledge and capital by these countries.* The theory further explains the phenomenon in terms of a set of three interrelated conditions - ownership-specific advantages, location-specific advantages, and internalisation advantages (OLI configuration). For example, the theory argues that in stage 3 a country attracts DFI in those sectors in which its comparative location advantages are the strongest, but the comparative ownership advantages of its enterprises are weakest, while its own enterprises invest in those sectors where their comparative ownership advantages are

[712] J. H. Dunning, "Explaining Outward Direct Investment," 1981.

strongest but their comparative location advantages are weakest. Thus, a country's DFI is a reflection of not only the nature of activities undertaken by its firms but also the nature of the countries from which and in which undertaken, and also the characteristics of the firms themselves. This development has had important implications for policies concerning technological development and transfer in developing countries. It has also major implications for conventional theories dealing with "the role of developing countries in the international division of innovative effort and industrial skills and their subsequent long term comparative advantage in trade and production."[713]

The general direction of the outward investment flows from India and other developing countries, oriented mainly towards other Third World countries, also fits well into the eclectic theory of international production. As Svetlic'ic' and Rojec state, "This theory would suggest that ownership advantages of developing countries' enterprises are mostly of such a nature and range to direct their outward investment in large part to the other developing countries. Most developing (host) countries would be, and actually are, at a lower or at the same level of development."[714] About 90% of total Indian investments are located in other developing countries, 59% of this are concentrated in the neighbouring region of South-east Asia and South Asia.[715]

Although they account a minimal share in total world DFI flows, there is evidence, as furnished in Chapter 3, to suggest that the number of MDCs, the sophistication of their activities and their international spread is rapidly growing. Indian MDCs are now dispersed over more than 35 countries and engaged in such diverse fields as textiles, sugar, cement, light engineering, chemicals and pharmaceuticals, hotels and restaurants, and so on. It appears that the process of internationalisation of firms is a cumulative one, with experience creating a stronger base for further overseas expansion. Further,

[713]S. Lall, "Third World Technology Transfer and Third World Transnational Companies," in UNIDO, **International Flows of Technology**, 1979, p. 189-214.
[714]Marjan Svetličić and Matija Rojec, **op. cit.**, 1987, p. 28.
[715]Ibid., p. 27.

it needs to be emphasised that the reported figures on DFI outflows from developing countries presumably represent only a fraction of the real phenomenon in question. More so, the role of the MDCs in the economies of host developing countries is much greater than is evident from their share in the total world flow of DFI. Similarly, the MDCs constitute an important element in the political economy of the home developing countries. Investments to the developed countries have also shown a noticeable increase in recent years. Indian 'upstream' investments to industrialised countries constitute over 7% of its total DFI outflows, stimulated primarily by protectionist measures imposed by these countries and the desire to gain access to frontier technology.

It is important to emphasise in this context that the rapidly changing international environment has made foreign operations not only more acceptable but often the only possible way for developing country firms to survive and succeed in the competitive struggle for international markets. However, while the tendency of capital is to expand across national boundaries and locate itself where it is most profitable; the tendency of government is to regulate, to control, and to make economic acitivities serve the perceived national interest. As governments attempt to utilise their corporations to advance national objectives, corporate executives seek to maximise their freedom from all government restrictions even as they try to use national power for corporate advantages. Firms endeavour to obtain government protection, subsidisation, and other concessions to create new advantages for themselves at home and abroad, and to increase their competitiveness vis-a-vis their competitors. In this sense, *the government may be viewed as a major purveyor of advantages (or disadvantages) to national firms seeking to initiate or pursue foreign activities.* The growth in economic interdependence and international competition has only served to increase the significance of national policies.

As governments have realised the importance of their multinationals, not only as major earners of foreign exchange but also as important tools of diplomacy in their global strategy, they have significantly supported the overseas operations of domestic enterprises. Thus, in almost every market economy, a partnership between government and corporations has formed, quite explicit in some and more indirect and subtle in others, to realise their overlapping objectives.

The evidence on Indian multinationals conclusively supports our main theoretical proposition. The Indian government has, particularly since the late 1960s, sought to regulate, control and utilise the Indian MDCs both as instruments for the promotion of exports of capital goods and technical skills from India and as symbols of India's commitment to participate in the developmental process of other countries. For the Indian political elite, wishing to catapult India into the role of leadership of the developing world both politically and economically, Indian foreign investments or 'joint ventures' have become the new symbol to be used both against economic nationalism at home and in behalf of assertive challenges abroad. "The joint ventures and such other external economic activities have not merely economic but also political implications. They give some leverage to Indian political influence".[716] Thus, Indian multinationals constitite an integral part of both India's economic growth strategy and her foreign policy.

Indian multinationals have quite effectively manipulated the symbolism of Indian 'benevolence' abroad, and at the same time, have sought to maximise the advantages and concessions obtainable from serving as instruments of national policy. And as political and economic hegemony go together, the Indian investor and Indian government have found a common purpose in promoting their mutual international investments. However, the degree to which the Indian state believes that its goals are being supported by Indian MDCs determines, in turn, the level of support given to these firms at home and abroad.

[716]D. N., op. cit., 1988.

In the late sixties and early seventies, when some of the newly independent African governments nationalised Indian investments in their countries, the Indian government maintained its non-interference stance in view of its long-term political and economic interests in the region. Similarly corporate response to government incentives has depended much on the perception and expectation of resulting costs and benefits to the firms. For instance, the willingness of Indian firms to enter into 'joint ventures' or to go abroad as 'partners in progress' has resulted as much from the legal requirements of the home and host governments as from their strategy to overcome the limitations of small size and limited financial, technological, and marketing resources of these firms and to secure preferential treatment from the governments. We believe that as Indian firms gain more international experience and enter into more technologically sophisticated fields, there will be a greater tendency to undertake majority- or fully-owned ventures. Thus, Gilpin correctly observes that, "Firms and governmental institutions both rival each other and cooperate with each other in the organisation of economic activity. In other words, because the pursuit of wealth interacts with the pursuit of power, government is not exogeneous to the economy, while firms function as both economic and political actors."[717]

Undoubtedly, domestic and foreign policies of Indian government constitute an important determinant of the volume, pattern and direction of Indian DFI. They lay down the conditions underlying the unique combination of ownership, location and internalisation advantages which firms exploit abroad. To presume that corporate strategists merely respond to these policies without attempting to influence or restructure them would be incorrect. Public policies of the Indian government are not developed in a vacuum but are vulnerable to pressures from interested parties. And since a market exists for 'beneficial government decisions', corporations, both collectively and individually, resort to an armory of weapons for this purpose, ranging

[717]J. J. Boddewyn, op. cit., 1988.

from the use of money and inter personal relations to lobbying in Parliament, making substantial monetary contributions to the incumbent Congress Party and its members, employing former senior civil servants, bribery, and so on. Abroad, Indian multinationals have managed to secure favourable treatment by playing on regional and group (south-south) sentiments, by entering into joint ventures with host country parties to avoid ruffling political feathers and to gain wider ideological appeal. Thus, in addition to the traditional economic advantages like large firm size, propreitary technology, cheap managerial power, cost competitiveness, the 'package of assets' Indian firms exploit also includes political advantages in the nature of better intelligence about political actors and opportunities, readier access to political decision-makers, and superior influence skills. The large Indian business houses, with their huge financial and other resources, have been particularly successful in translating their massive economic power into political power. Political behaviour of these firms cannot be ignored because it is complementary to the traditional economic behaviour and provides a better understanding of why particular multinationals have succeeded where dominant economic theories could not account for their success.[718]

To sum up, we have shown that the behaviour of governments on economic issues will be affected by their political calculations, which in turn be determined in part by the perceptions of the political elites themselves, the political culture and structure of inherited political institutions, the physical and material conditions of the country, and the structure of world politics. The behaviour of corporations on trade and investment related issues is determined by their cost and benefit calculations, which in turn are affected by the interests and strengths of the entrepreneurs, the internal contradictions

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[718] There are problems involved in collecting information on this aspect of firm strategy. Understandably, corporate executives refrain from discussing the political strategy due to the legal, ethical and public relations dangers presented by the revelation of such behaviours. Other indicators, such as political contributions of firms, employment of former senior civil servants, amount and conditions of loans, credits and licenses sanctioned by government to major business houses, may be used to shed some light on the issue.

of the home country, and the structure of the world economy. Political steps by governments must often rest on economic capabilities and have increasingly taken economic form.[719] Economic ventures by corporations must often rest on their political skills and knowledge. Thus, our analysis of Indian MDCs clearly emphasises the need to elevate the analysis of multinationals from a purely 'economic' to a more 'political-economy' analysis. In contrast with the economic and managerial paradigms which tend to take a narrower and more autonomous view of the economic system and of the organisations functioning within it, we have depicted that an understanding of the emergence and growth of Indian MDCs cannot be dissociated from a host of domestic and international politico-economic considerations and the continuously changing and evolving relationship between the private Indian capital and the Indian state.

Concluding Remarks and Future Research

The main contribution of this study is to be found in our attempt to offer a theoretical explanation of the emergence and growth of Indian MDCs using a holistic framework. It must be emphasised that, "holisticity does not mean that the study includes all the major factors that have an impact on the internationalisation behaviour and development of the firm. It refers to the fact that the study focuses on a certain logical and systematic totality."[720] We have rejected a narrow economistic explanation of the phenomenon for a broader political-economy analysis. Our focus on the determinants of internationalisation has been at three levels - international, national, and firm-specific. From each of these three levels we selected a few key factors and observed the interaction between these variables to establish systematic relationships.

[719]Robert O. Keohane and J. S. Nye, Jr., "International Economics and International Politics: A Framework for Analysis," **International Organisation**, vol. 29(1), 1975, p. 3-36.
[720]Reijo Luostarinen, **op. cit.**, p. 199.

Many of the propositions discussed above pervade firm behaviour, government policies and political rhetoric in countries other than in India. Thus, the theoretical, interpretive framework that we have suggested, with a few amendments, could be employed to understand countries which promote outward DFI and that actively involve the state in the economy of the country. However, both the framework and its underlying logic of political economy are in need of further research and refinements that attempt to integrate the concepts of 'market behaviour' of state and politically induced behaviour of firms in a theory of the multinational enterprise.

Further,this study leaves us with the distinct impression that we have barely managed to scratch the surface of an extremely complex and dynamic phenomenon, and in the process raised more questions than we answered. Our only excuse is that we were severely constrained by the limitations of time and resources needed to explain a phenomenon of this complexity. Indian DFI is rapidly evolving and changing in its dimensions and nature. There remain fascinating and intriguing facets which need to be studied. As Lall puts it, "We can hardly be blamed for closing with the usual plea for further research."[721]

We need to know how the internationalisation pressures vary for firms in different industries. We have also been unable to examine the implications of the operations of affiliates of Indian firms in the host countries. The political and economic consequence of this phenomenon on the home country has also been a secondary concern. Consequently, serious public policy questions remain unanswered. What are the implications of having their own multinationals for the economic development of home states like India? For the other host developing states? How can Third World governments most effectively and efficiently capture the benefits from MDCs and avoid unnecessary costs? What have been the consequences of internationalisation on the

[721]Sanjaya Lall, **The New Multinationals**, p. 268.

international competitive ability of Indian firms?

Finally, one major area for further research, which lies quite unexplored, is the subject of DFI by public-enterprises, the nature of their operations abroad, the attitude of home and host governments towards them, and the implications of their internationalisation. Thus, there remain major gaps in our knowledge of this recent and rapidly evolving phenomenon of Third World multinationalism which can only be filled by extensive research on the subject.

APPENDIX A

QUESTIONNAIRE

Organization:

Address:

Filled by:

In questions where several possible answers are provided, please circle one or more correct choices. Please add any responses not provided. In questions requiring a ranking of different factors, please rank each on a scale of 1-5, with 1 indicating low relevance and 5 the highest.

1. What was the source of your information regarding investment opportunities abroad?

   (a) Govt. of India agencies abroad

   (b) Indian embassies, consulates, and offices abroad

   (c) Host government sources

   (d) International agencies

   (e) Domestic private agencies

   (f) Business and/or family connections in host country

   (g) Other (Please specify)

2. When did your firm first begin to invest abroad?

3. What is the number of your foreign subsidiaries and where are they located?

<u>Total</u>:

Subsidiary	Location
A.	
B.	
C.	
D.	

4. What were the motives for investing abroad? (Please rank the given reasons, or any other, in order of importance, for each of the subsidiaries listed in the last question.)

Motive	Subsidiary A	Subsidiary B	Subsidiary C	Subsidiary D
(a) Protection of export markets				
(b) To circumvent tariff and quotas in developed countries				
(c) Domestic (Indian) growth restrictions				
(d) Cost advantages				
(e) Host country incentives				
(f) Home country incentives				
(g) Export capital equipment				
(h) Exploit knowledge of host market				
(i) Exploit experience with similar technology requirement				
(j) Pressure to earn foreign exchange				
(k) To circumvent home technology-import restrictions (or availability of higher technology)				
(l) Other (Please specify)				

5. What were your criteria for selection of host country for each of the subsidiaries mentioned in Q.3.? (Please rank in order of importance the given, or any other, criteria.)

Criteria	Subsidiary A	B	C	D
(a) Political stability				
(b) Host government incentives				
(c) Search for raw materials				
(d) Search for lower costs				
(e) High local return				
(f) Geographic location				
(g) Business and family connections				
(h) Familiarity with host market				
(i) Protection of existing market				
(j) Access to third country markets				
(k) Other (Please specify)				

6. Was the installation of the plant in most cases the result of acquisition of a local plant or the setting up of a new unit?

7. In case of a joint venture what has been your preference for a partner?

(a) Host government

(b) Local business house

(c) Subsidiary of a developed country firm

(d) Other (Please specify)

8. What was the nature of the problems encountered in the execution of the projects?

Problem	Affiliates A	B	C	D
(a) Access to requisite information				
(b) Approval procedures of host government				
(c) Approval procedures of home government				
(d) Financing				
(e) Finding suitable local partner				
(f) Other (Please specify)				

9. What are the advantages exploited by your affiliates abroad?

Advantages	Affiliates A	B	C	D
(a) Production Technology				
(b) Unit costs				
(c) Marketing				
(d) Financing arrangements				
(e) Cultural affinity/understanding				
(f) Relations with host govt.				
(g) Other (Please specify)				

10. If technology is a major advantage enjoyed by any of your affiliates, what is the source of this technology?

(a) Formal research and development

(b) Purchase (or collaboration) from a developed country firm in home country

(c) Purchase (or collaboration) from the Indian government

(d) Purcahse (or collaboration) from another local firm

(e) Purchase (or collaboration) in the host country

(f) Production experience and project execution (learning by doing)

(g) Other (Please specify)

11. What are the R&D expenses of the parent firm as a percentage of sales?

12a. Your projects abroad are generally <u>less</u> sophisticated technologically than your projects within India:

(i) Yes (go to 12b., skip 12c.)

(ii) No (go to 12c.)

12b. Why are the projects abroad less sophisticated technologically?

(i) Because of the lower stage of industrialization of host country

(ii) Because of intense competition from developed countries at the upper end of the scale

(iii) Other

12c. Your projects abroad are generally <u>more</u> sophisticated technologically than the projects within India because of

(i) access to advanced technology

(ii) severe international competition

(iii) Other

13. In the last five years, has the average yearly rate of increase in production (output per unit of input) been higher in the parent firm or the affiliates?

(a) Parent

(b) Affiliates

14. How do you rate the performance of your subsidiaries abroad?

(a) Very good

(b) Fairly good

(c) Average

(d) Fairly bad

(e) Poor

15. If the answer in the last question is (d) or (e), what in your opinion has been the major reason for the poor performance of the units abroad?

(a) Small firm size

(b) Choice of wrong local partner

(c) Restriction on equity participation

(d) Competition from local firm or MNC[722]

(e) Other (Please specify)

16. What in the home (Indian) environment influenced the choice of exploiting assets in the form of direct foreign investment rather than exports?

(a) Slow growth of Indian economy

(b) Government restrictions on growth

(c) High taxes within India

(d) Government incentives

(e) Shortage of raw materials and inputs

(f) Other

17. Have Indian government policies towards the promotion of indigenous production

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and of local learning affected

(i) technological development?	**Yes**	**No**
(ii) technology exports?	**Yes**	**No**

18. **How do you perceive the Indian government's role in the promotion of investment abroad in your case?**

    (a) Very active

    (b) Fairly active

    (c) Very passive

    (d) Fairly passive

19. How relevant a factor was the Monopolies and Restrictive Trade Practices Act in your decision to invest abroad?

    (a) Very important

    (b) Fairly important

    (c) Slightly important

    (d) Not important

20. What policy changes in India would you suggest to encourage direct foreign investment from India?

    (a) Abolition of growth restrictions within India on firms

    (b) Lower corporate taxes

    (c) Streamlined approval procedures

    (d) Abolition of restrictions regarding equity participation in ventures abroad

    (e) Improved credit and risk guarantee facilities

(f) Other (Please specify)

21. How in your opinion will government liberalisation with respect to exports, imports, and firm expansion within India affect your decision to invest and expand abroad?

22. What are the prospects for Indian ventures (both existing and new) abroad?

23. What would be your advice to prospective entrepreneurs contemplating investment abroad?

APPENDIX B

BRIEF SKETCH OF SOME OF THE TOP TWENTY BUSINESS HOUSES IN INDIA[723]

Tata (Bombay)

The Tatas are originally from Gujarat. The founder of the house, Jamsetji Tata, started his career in industry in 1869 with the purchase of an oil mill in Bombay which he later converted into a cotton mill. After World War I, the Tatas advanced from cotton, hotels, hydro electric power, and steel into industrial banking, insurance, construction, soap, and cement. Next they moved into aviation, chemicals, and engineering. The largest two companies in the private sector in India are Tata Iron and Steel Company (TISCO) and Tata Engineering and Locomotives Company (TELCO). The business house comprised of fifty-three companies in 1972-73. Tata ranks number one in Indian private sector in terms of assets and sales, and number three as a investor abroad. As compared to DFI, Tatas are a much larger exporter of technology in the form of turnkey contracts (mostly in power generation, and sugar and cement plant), consultancy, licensing and sale of training services. In 1981, out of a grand total of 207 Indian overseas ventures, Tatas had 7, mostly concentrated in oil mills, trucks, tools and metal products. Tatas have a reputation for cautious but excellent management, technological dynamism and far sighted strategy.

Birla (Calcutta)

[723]This information has been taken from S. A. Kochanek, op. cit., p. 339-47; Vinod Singhania, **Economic Concentration Through Inter Corporate Investments**, Himalaya Publishing House, Bombay, 1980, p. 66-97; Sanjaya Lall, "The Emergence of Third World Multinationals," 1982.

The Birlas are originally from Rajasthan. The base of their business is in Calcutta. The Birlas entered the industry in 1916 with the establishment of a cotton spinning mill. By the 1930s, Birlas had gone into jute, cotton, sugar, publishing, and insurance. At present, the interests of this group are most varied - manufacturing of textile and engineering machinery, rayon, cotton, jute, paper and publishing, bicycles, automobiles, electrical goods, coffee and tea plantations, shipping, trading, investment, and other manufacturing. This business house comprises of as many as one hundred and eighty five companies. Birlas rank number two in the Indian private sector and number one as an overseas investor. In 1981, the Birlas had eighteen overseas ventures, mainly in paper, rayon, textiles and palm oil. Birlas' overseas expansion is a combination of aggressive entrepreneurship and technological capability, firmly rooted in Indian know how and equipment.

Thapar (Calcutta)

The Thapars are originally from Punjab. Their business activity is mainly concentrated in Calcutta and Bombay. The principal company, Karam Chand Thapar and Brothers, was established in 1929. Subsequent to that, the business house acquired some collieries, paper mills, sugar, cotton, engineering, construction, trade, and investment. The business group comprises of forty three companies and ranks fifth in the Indian private sector in terms of assets and sales. In recent years, DFI by the Thapars has jumped up drastically and they now rank second in terms of investments abroad. In 1981, the Thapars had nine foreign ventures, mainly in paper and trading.

Mahindra (Bombay)

The Mahindras are originally from Punjab who first set up Mahindra and Mohammad

Pvt. Ltd. in 1945. The principal was renamed Mahindra and Mahindra in 1948 after the retirement of one of the partners. The group's interests cover engineering, trade, publishing, and advertising. It comprises of fifteen companies and ranks nineteenth in the Indian private sector in terms of assets and sales. The group is renowned for its export success with jeeps and tractors. The Mahindras have set up a jeep assembly plant in Greece with 40% equity.

Kirloskar (Pune)

Laxman Kirloskar, the founder of the Kirloskar group, resigned from an academic post to sell bicycles in Bombay. In 1920 Kirloskar Brothers Ltd. was established. The group has pioneered the manufacture of agriculture machinery. It also produces machine tools, electric motors and allied equipment. Kirloskars are now one of the world's largest manufacturers of small diesel engines. They are now operating a diesel engine assembly and rice milling machinery plant in West Germany. The group comprises of 15 companies and has slipped from nineth to eighteenth rank among the Indian business houses. It is, however, emerging as a major direct foreign investor. It has eight ventures abroad, mainly in the manufacture of power pumps, diesel engines and milling machinery.

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