The Dynamics of Foreign Direct Investment inflow and Outflow in India

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1.1 Introduction

Foreign Direct Investment (FDI) is a critical component of a country's national financial accounts, representing the investment of foreign assets into a domestic economy's infrastructure, capital assets, and institutions. Unlike foreign investments in stock markets, FDI is more stable and typically more beneficial for a country's long-term economic health. This is because equity investments can be volatile and may exit quickly at the first sign of trouble, whereas FDI tends to be more resilient and operationally involved.

FDI refers to investments made by Multi-National Enterprises (MNEs) or foreign institutions in ventures within host countries, where the investor maintains control and aims to earn private profit. It is important to differentiate between direct and indirect foreign investments. Indirect investments include portfolio investments, acquisitions of firm reserves, and medium- to long-term debt by financial institutions and intermediaries, as well as investments in national loans, bonds, and debentures.

FDI is crucial for economic growth at all stages of a nation's development. Developing countries, in particular, benefit from significant capital accumulation and technology transfer through FDI. Today, it is widely accepted that economic growth and development depend not only on the availability of capital but also on access to technological capabilities, infrastructure, and inputs. This has coincided with the progressive economic liberalization of many developing nations. The role of multinational firms as sources of both capital and technology is a key feature of this new liberalization phase. FDI involves investments that serve the business interests of the investor in a company located in a different country from the investor's origin. The relationship between a parent business venture and its foreign affiliates forms the basis of the FDI partnership.

In India, FDI has played a significant role in the country's economic growth. It has contributed to financial stability, growth, and development, allowing India to focus on areas requiring economic attention and address various persistent challenges. India has consistently sought to attract FDI from major global investors. In 1998 and 1999, the Indian government announced numerous reforms designed to promote FDI, creating a favorable environment for investors.

FDI can be broadly classified into two types: outward FDI and inward FDI. This classification is based on the forms of restrictions imposed and the various essentials required for these investments. Outward FDI, also known as direct investments abroad, is supported by the government despite associated risks. This type of FDI is eligible for tax incentives and other forms of disincentives. Risk coverage provided to domestic enterprises and subsidies granted to local companies act as disincentives for outward FDI. Inward FDI is motivated by different economic factors, including interest loans, tax breaks, grants, subsidies, and the removal of restrictions and constraints. However, certain factors can impede the development of FDI, such as performance requirements and ownership-related restrictions. Despite the services sector contributing the largest share to India's Gross Domestic Product (GDP), it has somewhat struggled to attract significant investment.

In India, FDI is permitted through two routes: automatic approval by the Reserve Bank of India (RBI) and the Foreign Investment Promotion Board (FIPB) route for non-automatic approvals. The RBI grants automatic approval within two weeks for proposals allowing foreign equity up to specified limits (24%, 50%, 51%, 74%, and 100%), depending on the industry type and sectoral ceilings. These provisions cover most industries of interest to foreign companies, especially high-priority enterprises and trading companies engaged in exporting, which receive almost automatic approval from the RBI. For cases that do not meet the automatic approval criteria, the FIPB processes non-automatic approval cases, typically within 4 to 6 weeks. The FIPB's approach is generally favorable across all sectors and types of proposals, with few rejections. It is not necessary for foreign investors to have a local partner, even when they wish to hold less than the entire equity of the company. The portion of equity not held by the foreign investor can be offered to the public.

n conclusion, FDI is a vital mechanism for economic development, providing capital, technology, and expertise essential for growth. It supports financial stability and helps countries address specific economic needs and challenges. India's proactive approach in attracting FDI through reforms and facilitating investment approvals has significantly contributed to its economic progress.

1.2 FDI Inflows to India and Comparative Analysis with Other Emerging Market Economies

In 2010-11, India experienced substantial restraints in Foreign Direct Investment (FDI) inflows, in contrast to other emerging market economies (EMEs) in Asia and Latin America, which received significant inflows. This discrepancy

became particularly concerning due to India's increasing current account deficit, which surpassed the sustainable level of 3.0% of GDP during April-December 2010. FDI is typically regarded as the most stable component of capital flows necessary to finance the current account deficit. Additionally, FDI supplements investible resources, provides access to advanced technologies, supports production knowledge acquisition, and encourages exports.

A comparison of India’s FDI policy with other leading EMEs reveals that, although India's initial approach towards foreign investment was relatively conservative, it gradually aligned with the more liberalized policies of other developed and developing economies from the early 1990s onwards. This shift included greater access to various sectors, ease of starting businesses, repatriation of dividends and profits, and relaxed guidelines for holding equity. This trend towards increasing liberalization, coupled with significant improvements in macroeconomic fundamentals, led to a nearly fivefold increase in FDI flows to India during the first decade of the current millennium.

Examining the FDI inflows from 1998 to 2008, the data shows notable changes in the percentage shares of various countries investing in India, especially before the subprime crisis. During this period, the United States had the highest percentage share of FDI, followed by China, France, the United Kingdom, Luxembourg, Russia, and Spain. Conversely, the Netherlands saw a significant decrease in its share, from 6.3% to a negative 0.7%. Other countries like Brazil, Canada, Sweden, Ireland, and Germany also experienced declines in their percentage shares.

In contrast, India's percentage share of FDI increased from 0.5% to 3%. Japan and Italy similarly saw increases in their shares. These changes highlight a shift in global investment patterns, with certain countries increasing their investments in India while others reduced their involvement.

India's evolving FDI policy has played a crucial role in attracting more foreign investment. The country has progressively opened up various sectors to foreign investors and simplified the regulatory environment. These measures have made it easier for foreign companies to establish and operate businesses in India. Moreover, the government has introduced incentives such as tax breaks and subsidies to attract FDI.

The growing liberalization of India’s FDI policy and improvements in macroeconomic stability have contributed significantly to the rise in FDI inflows. This increased investment has not only helped finance the current account deficit but also brought advanced technologies and production expertise to India, boosting the country's overall economic growth.

In conclusion, while India faced challenges with FDI inflows in 2010-11, the country has made significant strides in liberalizing its FDI policies and improving its macroeconomic fundamentals. This has resulted in increased foreign investment, particularly from countries like the United States, China, Japan, and Italy. As India continues to enhance its investment climate, it is likely to attract even more FDI, further supporting its economic development and growth.

Globalisation - FDI and multinational enterprises - FDI flows and stocks

	1998	**PERCENTAGE SHARE**	**2008**	**PERCENTAGE SHARE**
United States	179045	30.7	319737	23.2
China	43751	7.5	147791	10.7
France	30984	5.3	96990	7.0
United Kingdom	74349	12.8	95968	7.0
Luxembourg	..	#VALUE!	80373	5.8
Russian Federation	2761	0.5	73053	5.3
Spain	11798	2.0	65412	4.7
Belgium	..	#VALUE!	59564	4.3
Australia	6003	1.0	46565	3.4
Brazil	31913	5.5	45058	3.3
Canada	22803	3.9	44689	3.2
India	2635	0.5	41169	3.0
Sweden	19843	3.4	40395	2.9
Germany	24597	4.2	24891	1.8
Japan	3193	0.5	24418	1.8
Mexico	8612	1.5	21950	1.6
Turkey	940	0.2	18171	1.3
Switzerland	8942	1.5	17407	1.3
Italy	4280	0.7	16999	1.2
Chile	4628	0.8	16787	1.2
Poland	6368	1.1	15980	1.2
Austria	4534	0.8	13525	1.0
Denmark	7726	1.3	10708	0.8
Czech Republic	3716	0.6	10704	0.8
Israel [1]	1737	0.3	10544	0.8
South Africa	550	0.1	9632	0.7

Indonesia	-241	0.0	8340	0.6
Hungary	3337	0.6	6552	0.5
Greece	72	0.0	5083	0.4
Portugal	3005	0.5	3525	0.3
Slovak Republic	707	0.1	3410	0.2
Korea	5412	0.9	2200	0.2
New Zealand	1826	0.3	1975	0.1
Estonia	581	0.1	1969	0.1
Slovenia	216	0.0	1808	0.1
Norway	3935	0.7	-95	0.0
Iceland	148	0.0	-379	0.0
Finland	12141	2.1	-4192	-0.3
Netherlands	36925	6.3	-9063	-0.7
Ireland	8856	1.5	-12278	-0.9
1	582628	100.0	1377335	100.0

Source : OECD Factbook 2010: Economic, Environmental and Social Statistics - ISBN 92-64-08356-1 - © OECD 2010

1.3 Emerging Market Economies: New Leaders in Global Outward Investment

In recent years, emerging market economies (EMEs), both developed and underdeveloped, have become significant sources of foreign investment globally. This trend reflects their increasing involvement in the international economy and their growing capabilities. Notably, a significant drive for change is coming from developing countries and transitioning economies, where both private and public sector firms are increasingly engaging in outward expansion through foreign direct investments (FDI). These companies are expanding their operations abroad to achieve both local and international reach. According to the accompanying graph, outward investment is now more frequently directed towards developing economies rather than developed ones.

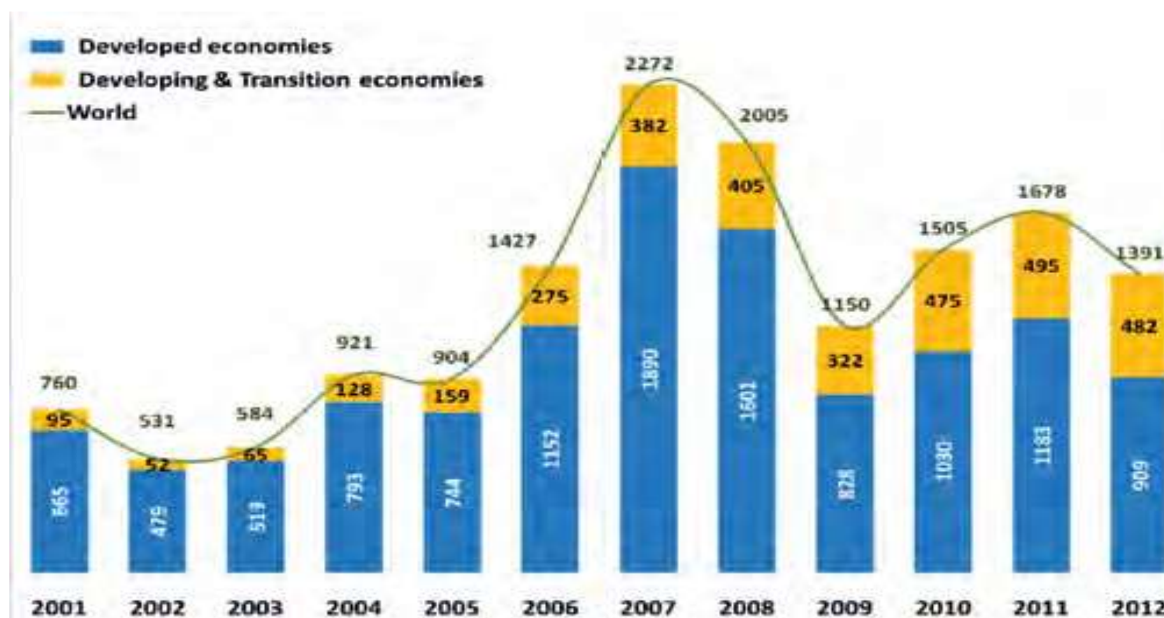

Figure1: Outward investment attracted towards developed economies then developing and transition economies

Source: Exim Research

1.4 Motivations for Outbound Investments

The motivations for foreign acquisitions by companies are multidimensional and include several key drivers:

1.4.1 Securing Resources

Securing resources is a primary motivation for outbound investments, aimed at ensuring a steady and reliable supply of essential materials to support energy-intensive development. Indian companies such as the Oil and Natural Gas Corporation (ONGC) and the Gas Authority of India Ltd (GAIL) have made significant overseas acquisitions in the oil and gas sectors to secure vital energy resources. Similarly, Suzlon Energy Ltd, the world's fifth-largest wind turbine producer, has pursued foreign acquisitions to bolster its resource base. Hindalco's acquisition of copper mines in

Australia and the Atlanta-based Novelis has made it the world's largest aluminum rolling company, highlighting the importance of resource security.

1.4.2 Acquiring Technology and R&D

Acquiring advanced technology and enhancing research and development (R&D) capabilities is a crucial motivation for outbound investments. Indian companies seek to purchase foreign firms to gain access to cutting-edge technologies, efficient processes, management expertise, and robust marketing and distribution networks. This is particularly important for the Indian pharmaceutical industry, which aims to expand its R&D base and improve its innovation capabilities through strategic acquisitions.

1.4.3 Enhancing Brand and Product Portfolio

Enhancing brand recognition and expanding product portfolios drive many Indian companies to acquire foreign firms with well-established and respected brands. For example, Tata Motors' acquisition of Jaguar Land Rover from Ford Motors demonstrates this strategy. By integrating prestigious brands into their portfolio, Indian companies can elevate their market position, diversify their product offerings, and strengthen their global presence.

1.4.4 Expanding Market Reach

Expanding market reach involves efforts by Indian companies to consolidate their presence in existing markets and explore new opportunities. Facing increasing foreign competition domestically, Indian firms are compelled to expand internationally to maintain and grow their market shares. The State Bank of India's (SBI) ventures into Mauritius, Indonesia, and Kenya illustrate this strategy, driven by the deregulation of the Indian banking sector in response to both domestic and international competition. Additionally, the pursuit of access to large developed-economy markets motivates Indian companies to invest in significant foreign acquisitions, particularly in non-tradable sectors such as hospitality (e.g., Taj Group Hotels) and education (e.g., National Institute for Information Technology (NIIT)).

1.4.5 Diversifying Risk

Risk diversification is another critical motivation. Indian software companies like Infosys and Wipro are setting up "disaster recovery" centers in countries such as China and the Philippines to safeguard against system failures. By internationalizing their businesses and revenue sources, Indian companies aim to reduce dependence on the Indian market and mitigate the risks associated with the domestic business cycle.

1.4.6 Seeking Efficiency

Efficiency-seeking investments involve industrial restructuring and the creation of regional manufacturing networks as trade barriers decline. Indian IT companies like Tata Consultancy Services (TCS) and Infosys have established significant international sourcing bases in China. Similarly, Tata Motors' acquisition of Daewoo Heavy Vehicles in Korea in 2005 has enabled a regional manufacturing network. This strategy involves producing small and medium-sized vehicles in Indian factories and selling them through Daewoo's outlets, while heavy trucks are manufactured in Daewoo's Korean plant and sold under the Tata brand in India and other countries.

Overall, these motivations highlight the strategic approaches of Indian companies as they navigate the complexities of global business and seek to strengthen their competitive position on the international stage.

1.5 Growth and Dynamics of Outward FDI from Developing Countries

According to UNCTAD's World Investment Report 2011, the stock of outward FDI from developing nations has reached US$ 3.1 trillion in 2010 (15.3 per cent of global outward FDI stock), up from US$ 857 billion (10.8 per cent of global outward FDI stock) a decade ago. On the basis of flows , outward FDI from the Third world nations has increased from US$ 122 billion in 2005 to US$ 328 billion in 2010 making for around a quarter of total FDI outflow observed at international level[1].

[1] Alhijazi, Yahya Z.D (1999): "Developing Countries and Foreign Direct Investment", digitool.library.mcgill.ca.8881/dtl_publish/7/21670.htm.

Figure 2: Drivers for Outward Direct Investments
Source: EXIM Bank Research

FDI is an outcome of the internationalization process that initiates with exports. Through this process, nations try to reach to markets or resources and slowly decrease the cost of manufacturing and transaction by enlarging overseas production operations in nations where some ownership-specific benefits can aid in competing internationally. The adoption of strategic policies has enabled countries to better compete with global rivals. A notable increase in outward Foreign Direct Investment (FDI) has been observed in India in recent years. Internationalization is a reciprocal process, evident not only in the rising scale of FDI inflows into India but also in the growing levels of Indian FDI outflows. This expansion reflects the Indian economy's deeper integration with the global market.

Indian companies investing abroad benefit from greater access to international networks and markets, along with the transfer of technology and expertise. These investments facilitate collaboration in research and development, enabling firms to share innovative ventures and outcomes. Additionally, Indian firms often seek to enhance their brand image and utilize locally available raw materials in host countries.

In the context of India, outbound investments are driven by resource-seeking, market-seeking, and technology-seeking objectives. Recently, there has been a notable rise in resource-seeking investments, particularly aimed at acquiring energy resources in Australia, Indonesia and Africa[2].
This trend highlights the strategic move by Indian firms to secure essential resources and strengthen their global presence. Overall, the increase in outward FDI from India underscores the country's growing role in the international economic landscape and its commitment to expanding its global footprint.

1.6 Trends in Foreign Direct Investment inflows to India
FDI inflows to India remained low in 2010-11, even as global FDI flows to developing economies recovered. This was despite India's strong domestic economic performance before the global recovery. The actual FDI to India during 2010-11 was less than expected, reflecting critical macroeconomic variables influenced by policy uncertainty, as measured by Kauffmann's Index.

Kauffmann's Index measures a broad range of startup activities across national, state, and metropolitan areas in the United States. It captures three dimensions: the Rate of New Entrepreneurs, which is the percentage of adults becoming entrepreneurs in a given month; the Opportunity Share of New Entrepreneurs, which is the percentage of new entrepreneurs driven primarily by opportunity; and Startup Density, which is the rate at which businesses with employees are created in the economy. These three dimensions collectively provide a comprehensive view of startup activity.

[2] Andersen P.S and Hainaut P. (2004): "Foreign Direct Investment and Employment in the Industrial Countries", http:\\www.bis\pub\work61.pdf.

In 2010-11, FDI inflows to India saw significant changes while other developing economies in Asia and Latin America received substantial inflows. This situation was concerning given India's expanding current account deficit, which exceeded the sustainable level of 3.0 percent of GDP for the period of April-December 2010. FDI is crucial as it constitutes a substantial part of the capital flows needed to fund the current account deficit. Additionally, FDI contributes to investible resources, grants access to advanced technologies, aids in acquiring manufacturing knowledge, and boosts exports.

A comparison of India's FDI policy with those of other major emerging market economies (EMEs) reveals that India's approach to foreign investment was initially conservative. However, it gradually aligned with the more liberalized policies of other developing nations from the early 1990s onwards. This shift involved greater access to various sectors of the economy, ease of initiating businesses, repatriation of dividends and profits, and relaxed regulations regarding equity ownership. This growing liberalization, along with significant improvements in macroeconomic fundamentals, led to a substantial increase in FDI flows to the country, growing nearly fivefold in the first decade of the current millennium**.**Though the liberal approach and tough/stringent economic principles [3] seem to have driven the sharp increase in FDI flows in India since one decade and maintained its momentum even in the times of global economic crisis (2008-09 and 2009-10), the latter changes in investment flows in spite of steady reformation from the crisis period seems unexplainable.

1.7 Funding pattern of outward FDI

As far as plans with respect to the financing of foreign investments are concerned, it is permitted through a number of ways. These include

(i) procurement of foreign exchange on-shore from an approved dealer in India,

(ii) funding/ financing of foreign currency proceeds to be gained/ acquired from the foreign entity through exports, fees, royalties or any other dues from the foreign establishment for supply of technical know-how, consultancy, managerial and other services,(iii) exchange of shares of Indian firm with those of foreign firm , (iv) utilization of balances held in the Exchange Earners' Foreign Currency (EEFC)[4] accounts of Indian entity retained with an authorized dealer. Exchange EEFC is an account maintained in foreign currency with an Authorised Dealer a bank dealing in foreign exchange. It is a facility provided to the foreign exchange earners, including exporters, to credit 100 per cent of their foreign exchange earnings to the account, so that the account holders do not have to convert foreign exchange into Rupees and vice versa, thereby minimizing the transaction costs. (v) foreign currency proceeds through External Commercial Borrowings (ECBs)/ Foreign Currency Convertible Bond (FCCBs). ECB is the central bank for the euro and administers monetary policy of the Eurozone, which consists of 19 EU member states and is one of the largest currency areas in the world. It is one of the world's most important central banks and is one of the seven institutions of the European Union (EU) listed in the Treaty on European Union (TEU). The capital stock of the bank is owned by the central banks of all 28 EU member states. FCCBs are a special category of bonds. FCCBs are issued in currencies different from the issuing company's domestic currency. Corporates issue FCCBs to raise money in foreign currencies. These bonds retain all features of a convertible bond, making them very attractive to both the investors and the issuers. These bonds assume great importance for multinational corporations and in the current business scenario of globalisation, where companies are constantly dealing in foreign currencies. (vi) swapping of American Depository Receipts (ADRs)/ Global Depository Receipts (GDRs) issued according to the scheme for issue of Foreign Currency Convertible Bonds. An American Depositary Share ("ADS") is a U.S. dollar denominated form of equity ownership in a non-U.S. company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares, subject to the terms specified on the ADR certificate. Global Depository Receipts (GDRs) may be defined as a global finance vehicle that allows an issuer to raise capital simultaneously in two or more markets through a global offering. GDRs may be used in public or private markets inside or outside US. GDR, a negotiable certificate usually represents company's traded equity/debt.

Here we have mentioned the funding pattern of FDI outflow from 2000-2009. As per the figure given below, we can see that outward FDI has tremendously increased since 2006. In 2007 there was a great decline then again till Dec 2007 it has increased. Again in 2008 it has decreased and in the beginning of the year it went up in 2009 and again it decline in mid June 2009.

[3] Bhagwati J.N. (1978), "Anatomy and Consequences of Exchange Control Regime", Vol 1, Studies in International economies Relations No.10, New York, ideas-repec.org/b/nbr/nberbk/bhag78-1.html.

[4] Chandan Chakraborty, Peter Nunnenkamp (2006): "Economic Reforms, FDI and its Economic Effects in India", www.iipmthinktank.com/publications/archieve.

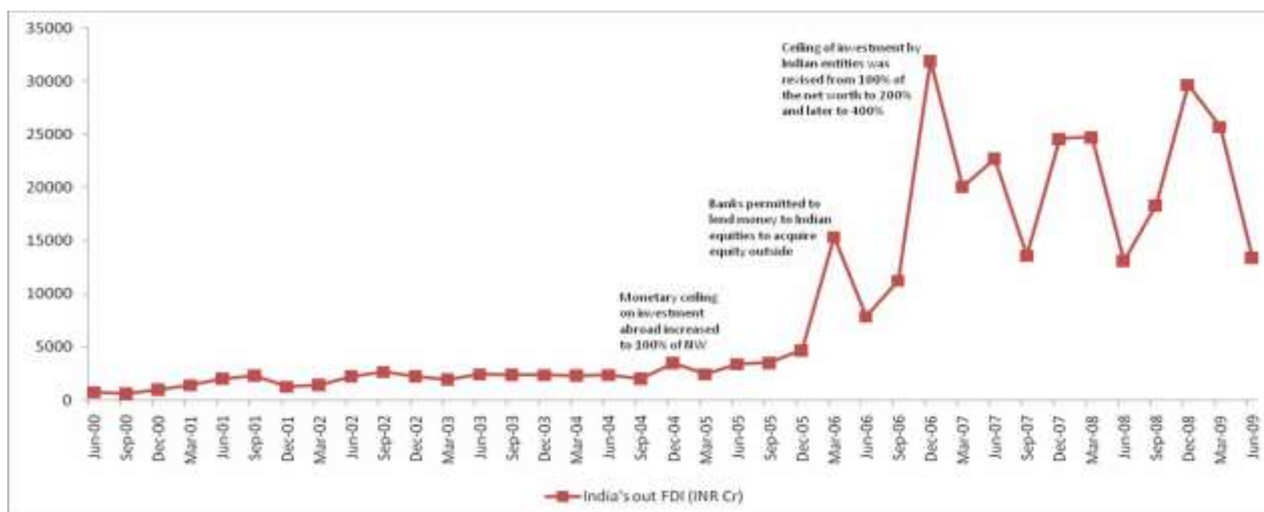

Figure 3: Trends of Outward FDI from 2000-2009

Source:
A current study by Virtus Global Partners (April 2011) based on US bound Indian investments has assured that internal accruals were the prominent financing mode used by Indian firms in 2010.[7] It also revealed that half of Indian acquisitions in the US in 2009 and 2010 were buyouts of distressed assets, whose parent firms were acutely affected by the global crisis. Grasping these chances/ contingencies in foreign markets, many acquisition/investment deals (e.g. S Kumar - Hartmax, Cadila's - Novavax, Piramal - RxElite, and 3i – NRLB, etc.) were obtained by Indian firms during 2009.

1.7.1 Role of Indian banks

Despite the fact that banks in India are not allowed to finance the equity contributions of the promoters, financial aid to Indian firms by the domestic banks for acquisition of equity in foreign joint ventures/wholly owned subsidiaries or in other foreign firms , new or existing, as strategic investment has been allowed . Such policy should embrace comprehensive ceiling on such financing, terms and conditions of suitability of borrowers, security, margin, etc. At the same time, the management of the bank may construct its own ground rules and countermeasures[5] for such borrowings, such acquisition(s) should be beneficial to the company and the nation.
In order to expedite such financial assistance of Indian business abroad, the Reserve Bank has augmented the methodical limit on credit and non-credit facilities provided by banks to Indian Joint Ventures (where the holding by the Indian firm is more than 51 per cent) / Wholly Owned Subsidiaries overseas from the current limit of 10 per cent to 20 per cent of their unimpaired capital funds[6] (Tier I and Tier II capital). Banks in India were also permitted in May 10, 2007 to expand funded or non-funded credit facilities to fully owned step-down subsidiaries of Indian firms in abroad. Banks, moreover, have to make sure situated that the JV/WOS is in a nation which has no limitation/binding on receiving such foreign currency loan or repatriation among others and they can generate legal charge on offshore securities/assets securing such exposures.

1.7.2 Role of the EXIM Bank

Exim Bank has been engaged in helping Indian direct investment overseas since its beginning and its involvement has been substantial in this regard, given its mandate. The Overseas Investment Finance (OIF) programme of Exim Bank[7] explore the entire cycle of Indian investment overseas including the financing requirements of Indian Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) with a group of financing instruments, which comprises of (a) finance for Indian company's equity participation, (b) direct finance to the overseas JVs/WOS, (c) finance for acquisition of overseas business/companies including leveraged buyouts and (d) direct equity investment. As on December 31, 2011, Exim Bank has sanctioned credit aggregating to 240.92 billion for 374 ventures set-up by over 298 companies in 69 nations.

1.7.3 Role of Export Credit Guarantee Corporation of India Limited (ECGC)

ECGC is a Government of India Enterprise which provides export credit insurance facilities to exporters and banks in India. It functions under the administrative control of Ministry of Commerce & Industry, and managed by a Board of Directors comprising representatives of the Government, Reserve Bank of India, banking , insurance and exporting

[5] Charlotta Unden (2007): "Multinational Corporations and Spillovers in VietnamAdding Corporate Social Responsibility", www.csrweltweit.de/uploads/tx/FDI_csr_vietnam12.pdf.
[6] Chen Kun- Ming, Rau Hsiu –Hua and Lin Chia – Ching (2005): "The impact of exchange rate movements on Foreign Direct Investment: Market – Oriented versus Cost – Oriented, The Developing Economies XLIV-3, pp. 269-87.
[7] See http://ec.europa.eu/trade/issues/bilateral/mgtbil en.htm and .../bilateral/index en.htm (10/29/15).

community. It evolved various export credit risk insurance products to suit the requirements of Indian exporters and commercial banks. While some of the overseas takeovers have been immensely acknowledged, some investments have been triggered a lower returns within a short period of time. There are many causes of breakdown but the most prevailing one was the incompetence to combat with conflicting changes in the operating economic and regulatory environment. This is a signal to the requisites of reductions in risk in the process of investments overseas.

ECGC popularized the Overseas Investment Insurance scheme[8] in the year of 1980 during commencement of the scheme, only 61 insurance covers with an aggregate worth of 5.73 billion have been issued. One possible interpretation given for the lower acceptance of the scheme is the notion that the rate / worth /payment of coverage is high (which is between one to 2.5 per cent per annum according to economy of nation and span of investment). After all, it is, significant to recognize the extent of the coverage, that the scheme offers by giving insurance benefits to investments counter to political risks including war, expropriation and constraints in foreign exchange payments flow. , Thus, companies in India that think to make investments in politically susceptible economies would gain from such coverage higher than those having investments in emerging nations.

1.7.4 SPV Strategy for Leveraged Buyouts

A Special Purpose Vehicle (SPV), also known as a "bankruptcy-remote entity," is designed to acquire and finance specific assets while protecting its obligations even if the parent company declares bankruptcy. SPVs, often structured as wholly-owned subsidiaries (WOSs) or joint ventures (JVs), are increasingly used in leveraged buyouts to mitigate risk on the parent company's domestic balance sheet. Significant investments have been funneled through SPVs established abroad, with financing typically arranged through overseas banks. This financing is secured by either the shares or assets of the target company and backed by guarantees from the Indian parent company.

Indian companies have predominantly relied on a combination of internal resources and external borrowings to fund their overseas acquisitions. This approach contrasts with other economies, where share swapping is a common method for cross-border mergers and acquisitions (M&As). In India, share swaps remain relatively unpopular, except in a few major transactions within the software industry.

Since India's independence, its capital market has undergone substantial liberalization, resulting in significant improvements in the market capitalization of Indian stocks. This growth has facilitated greater access to overseas capital markets, enabling Indian companies to fund their international investments more effectively. Additionally, continuous rises in corporate earnings have bolstered the profitability and strengthened the balance sheets of Indian companies, allowing them to pursue cross-border acquisitions using internal resources.

In summary, the use of SPVs for leveraged buyouts has become a strategic approach for Indian companies to manage risk and finance overseas acquisitions. This method leverages both internal and external sources of capital, reflecting a growing sophistication in India's approach to international investment.

1.7.5 Measures taken by the Reserve Bank of India

The liberalization of the outward FDI policy since the year 2003 has been considerable, given the advancements in macro fundamentals, and attitude in favor of sequential liberalization of the policy towards capital account rules In light of the avenues of foreign exchange reserves, the government took a liberal view and opened the doors for overseas direct investments up to 400 percents of the net worth as quoted earlier. So, the aggregate limit for overseas investment by mutual funds, registered with SEBI[9], was increased from US$ 4 billion to US$ 5 billion in September 2007. This was again increased to US$ 7 billion in April 2008. Besides raising the financial limits, the Reserve Bank has also automated the entire process of allocation of Unique Identification Number (UIN)[10]. The automation through a web based application has enabled efficient processing which has decreased the time taken for processing the applications and also developed the management information system.

It may thus be experiential that keeping in view the transformations in the business environment across the world, Reserve Bank has been actively playing role in regulating the policies relating to foreign exchange transactions to adapt the dynamic business environment. In June 2011, the Reserve Bank allowed Indian parties to divest their stake abroad without prior approval, where the amount repatriated on divestment is lower than the amount of the original outlay subject to certain conditions. Since July 2011, the Reserve Bank has been circulating the data in respect of outward FDI on a monthly. Table represents relaxation provided by government for overseas investment.

Exhibit 1: Major relaxations in overseas investment policy since 2004

[8] Crespo Nuno and Fontoura Paula Maria (2007): “Determinant Factors of FDI Spillovers – What Do We Rally Know?”, World Development Vol. 35, No.3, pp.277-291.

[9] Ghosh D.N. (2005): “FDI and Reform: Significance and Relevance of Chinese Experience”, Economic and political Weekly, pp.538-539.

[10] Crespo Nuno and Fontoura Paula Maria (2007): “Determinant Factors of FDI Spillovers – What Do We Rally Know?”, World Development Vol. 35, No.3, pp.277-291.

Enhancement in the monetary ceiling for overseas investment by eligible Indian entities	
January 2004	Allowed to invest upto 100 per cent of their networth in overseas JV/WOS without any separate monetary ceiling.
May 2005	Allowed to invest upto 200 per cent of their networth. The ceiling is not applicable to investments made out of balance held in EEFC accounts and proceeds of ADR/GDR.
June 2007	The limit under the Automatic route enhanced from 200 per cent to 300 per cent of the net worth.
September 2007	The limit under the Automatic route enhanced from 300 per cent to 400 per cent of the net worth.
General permission for disinvestment	
March 2006	Under the Automatic Route, Indian parties allowed to disinvest without prior approval of RBI subject to certain conditions.
Proprietorship/partnership concerns	
March 2006	To enable recognised star exporters with a proven track record and a consistently high export performance, the proprietary/unregistered partnership firms allowed to set-up JV/WOS outside India with prior approval of RBI.
Investment by Mutual Funds registered with SEBI	
July 2006 to June 2008	Aggregate ceiling for overseas investments by MFs increased from US$ 1bn to US$ 2 bn, which has gradually been increased to the present level of US$ 7 bn. A limited number of qualified Indian mutual funds allowed to invest cumulatively upto US$ 1 bn in overseas ETFs permitted by SEBI.
Overseas Investment by Indian Venture Capital Funds (VCFs) registered with SEBI	
April 2007	VCFs permitted to invest in equity and equity-linked instruments of off-shore venture capital undertakings subject to an overall limit of US$ 500 mn and SEBI regulations.
Portfolio Investments by listed Indian companies	
June 2007	The limit for portfolio investments enhanced from 25 per cent to 35 per cent of the net worth of investing company as on the date of its last audited balance sheet.
September 2007	The limit of portfolio investments enhanced from 35 per cent to 50 per cent of networth of the investing company as on the date of last audited balance sheet.
Overseas investments in energy & natural resources sectors	
June 2008	Indian companies allowed to invest in excess of 400 per cent of their net worth as on the date of last audited balance sheet in the energy and natural resources sectors.
ODI by Registered Trust/Society	
August 2008	Registered Trusts & Societies engaged in manufacturing/educational sectors allowed to invest in the same sector in JV/WOS outside India with the prior approval of RBI.
September 2008	Registered Trusts & Societies (which have set up hospitals) in India allowed to make investments in the same sector in a JV/WOS outside India with the prior approval of RBI.
Participation of Indian companies in consortium with international operators	
April 2010	Indian companies allowed to participate in a consortium with other international operators to construct and maintain submarine cable systems on co-ownership basis under the automatic route.
Performance guarantees issued by the Indian party	
May 2011	Fifty per cent of the amount of performance guarantees allowed to be reckoned for the purpose of computing financial commitment to its JV/WOS overseas.
May 2011	Indian Party allowed to extend corporate guarantee on behalf of the first generation step down operating company under the Automatic Route subject to limits.
Restructuring of the balance sheet of the overseas entity involving write-off of capital and receivables	
May 2011	Indian promoters of WOS abroad or having at least 51 per cent stake in an overseas JV, allowed to write-off capital or other receivables in respect of the JV/WOS.
Disinvestment by the Indian parties of their stake in an overseas JV/WOS involving write-off	
June 2011	Indian parties allowed to disinvest without prior approval of the RBI, where the amount repatriated on disinvestment is less than the amount of the original investment with certain conditions.

With the prior approval, certified trusts and societies involved in the manufacturing/education/hospital sectors have been approved to establish JV/WOS[11]. Besides, with the prior approval from Reserve Bank, proprietary/unregistered partnership enterprises (acknowledged star export house with proven track record) are allowed to establish JV/WOS overseas. Further, realizing the need for granting individuals the benefits from the liberalized FEMA framework as a

[11] Dunning John H. (2004): "Institutional Reform, FDI and European Transition Economies", International Business and Governments in the 21st Century, Cambridge University Press, 1-34, www.reading.ac.uk

beneficial support to India's globalization efforts as also considering the fact that economies were getting interconnected, the foreign investment policy was altered to permit individuals to possess shares under the Employ Stock Ownership Plan (ESOP) scheme by abolishing the existing monetary ceilings, allocation of shares of foreign entities on account of professional services accomplished and a general permission was also granted to posses foreign securities as qualification/rights shares.
An ESOP is a qualified, defined contribution, employee benefit (ERISA) plan designed to invest primarily in the stock of the sponsoring employer. ESOPs are "qualified" in the sense that the ESOP's sponsoring company, the selling shareholder and participants receive various tax benefits. ESOPs are often used as a corporate finance strategy and are also used to align the interests of a company's employees with those of the company's shareholders.

1.7.6 Government Measures to Promote Foreign Investment

Recognizing the critical importance of fostering foreign investments, the Government of India has implemented various strategic initiatives to support and incentivize domestic firms. The Department of Industrial Policy and Promotion (DIPP) has identified South East Asia, Eastern Europe, and Africa as key regions where Indian companies can be encouraged to acquire assets and undertake company buyouts. In 2011, the Indian government introduced a policy to facilitate the acquisition of raw material assets by select public sector undertakings (PSUs) overseas. Under this revised policy, the investment cap for 'Navratna' firms has been increased from ₹10 billion to ₹30 billion for asset buyouts, while 'Maharatna' firms are now permitted to invest up to ₹50 billion. Any investments exceeding these limits require additional government approval. This policy is applicable to PSUs in agriculture, mining, manufacturing, and electricity sectors that have demonstrated a consistent record of net profits over the past three years. The Ministry of External Affairs and Indian missions abroad collaborate from the inception of such acquisition processes. Currently, the government is evaluating proposals to assist in acquiring strategic assets, particularly in the energy sector, through special investment vehicles or cash-rich PSUs.
Foreign Direct Investment (FDI) in India is supported through two primary routes. The first is automatic approval by the Reserve Bank of India (RBI). Depending on the industry category and sectoral caps, the RBI grants automatic approval for foreign equity investments up to 24%, 50%, 51%, 74%, and 100% within two weeks of proposal submission. This system covers a wide range of industries and facilitates investments in high-priority sectors or for trading companies primarily involved in exporting. For cases not meeting the criteria for automatic approval, the Foreign Investment Promotion Board (FIPB) handles the review. The FIPB, a national agency of the Government of India, considers and recommends FDI proposals that fall outside the automatic route, providing a single-window clearance for such investments. The average processing time for these cases is 4 to 6 weeks, with few rejections due to the board's liberal approach. Foreign firms are not required to have a domestic partner even if they intend to hold less than the entire equity of a company; the unallocated equity can be offered to the public.
Several factors promote FDI inflows, including tax incentives, regulatory relaxations, low-interest loans, and specific grants. The rationale is that the long-term benefits of such financial support outweigh the short-term earnings losses incurred. However, constraints on FDI inflows include ownership restrictions and performance disparity. Outbound FDI, or "direct investment abroad," involves domestic capital being invested in foreign assets.
Recent empirical research highlights the benefits of FDI through multinational enterprises (MNEs), particularly in terms of productivity increases and horizontal spillovers within the same industry sector. However, this research often overlooks potential spillovers through buyer-supplier or backward linkages. In the post-liberalization era, the presence of foreign firms has intensified competition in domestic markets, pushing local industries to focus on export markets. Despite this, domestic industries have not significantly benefited from enhanced export performance through buyer-supplier linkages with MNEs.
A country's trade and investment relations, particularly the volume and growth of its trade, largely determine its level of economic globalization. Exports can lead to greater production efficiency through economies of scale, resulting from increased market size. Research also indicates that exports can stimulate innovative activities within firms, enabling them to remain competitive through new products and delivery methods. Success in foreign markets requires firms to acquire substantial knowledge about foreign market conditions, such as consumer preferences, regulations, distribution channels, and other market characteristics. However, gathering this information can be costly, potentially hindering market entry. "Sunk entry costs" can be substantially reduced through various overseas contacts, which provide valuable insights into foreign conditions. FDI by MNEs is a key channel for such information exchange.
The presence of MNEs in various markets allows them to access a wide range of information about foreign markets, consumers, and technology. Consequently, higher foreign equity participation by MNEs can enhance the export performance of home enterprises. This effect can occur directly through interactions with MNEs or indirectly as information about foreign markets becomes available to domestic firms, even if they do not engage in joint ventures with foreign enterprises. This phenomenon is referred to as "spillovers" from FDI.
MNEs significantly impact the productive efficiencies of domestic industries by introducing competition in product pricing and quality, which in turn enhances export performance. These "horizontal spillovers" occur when the presence of foreign firms in a sector similar to domestic industries drives improvements in the quality and pricing of local products. Additionally, if MNEs provide information about international buyers of intermediate goods, it can lead domestic producers of these goods to expand their production and benefit from economies of scale, thereby reducing

their product prices. These "backward spillovers" result from buyer-supplier linkages and contribute to the overall benefits of FDI.

To boost export competitiveness, many developing countries, including China, Malaysia, Indonesia, and Thailand, have shifted their focus towards outbound FDI. This strategy helps create strong links between the domestic economy and global markets, leveraging home country advantages such as low labor costs and abundant raw materials. Outbound FDI can foster investment by generating demand for intermediate goods, whereas locally focused FDI may crowd out domestic firms and investments. By encouraging outbound FDI, countries aim to enhance their global market presence and stimulate domestic economic growth through increased export opportunities and improved market linkages.

Economic reforms and transformations over the past 18 years have significantly boosted Foreign Direct Investment (FDI) inflows into India. Since the onset of economic liberalization, FDI inflows have increased approximately twentyfold. By 2008, net FDI flow into India reached an impressive $33.03 billion. However, a notable discrepancy exists between approved FDI and actual investment realizations. The conversion of approved FDI into actual investments has been relatively slow, potentially due to environmental factors and the nature of the investment proposals. Despite this, the surge in FDI has positively impacted both exports and imports, contributing to higher levels of foreign trade.

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